ANNEX D-14

BRAZIL'S COMMENTS ON THE RESPONSES OF THE UNITED STATES TO THE PANEL'S SECOND SET OF QUESTIONS

(24 April 2007)

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LIST OF ABBREVIATIONS

Arrangement	OECD Arrangement on Officially Supported Export Credits
AWP	Adjusted World Price
BSC	Bond Street Capital
CCC	U.S. Commodity Credit Corporation
CCPs	Counter-Cyclical Payments
DSB	Dispute Settlement Body
DSU	Understanding on Rules and Procedures Governing the Settlement of Disputes
ECG	Export Credit Guarantee
ERS	USDA's Economic Research Service
FAPRI	Food and Agricultural Policy Research Institute
FAS	USDA's Foreign Agriculture Service
FCRA	Federal Credit Reform Act
FSRI Act	Farm Security and Rural Investment Act of 2002
FY	Fiscal Year
GATT	General Agreement on Tariffs and Trade
GAO	Government Accountability Office
GSM 102	General Sales Manager 102
GSM 103	General Sales Manager 103
LCI	ExIm Banks Letter of Credit Insurance
MBS	Mortgage-backed securities
MPRs	Minimum Premium Rates
MTI	ExIm Bank's Medium-Term Export Credit Insurance
MY	Marketing Year
NCC	National Cotton Council of America
NPV	Net Present Value
OECD	Organization for Economic Co-operation and Development
SCGP	Supplier Credit Guarantee Program
SCM Agreement	*Agreement on Subsidies and Countervailing Measures*
SPS Agreement	*Agreement on Sanitary and Phytosanitary Measures*
TBT Agreement	*Agreement on Technical Barriers to Trade*
U.S.	United States
USDA	U.S. Department of Agriculture
WTO	World Trade Organization

TABLE OF CASES

Short Title	Full Case Title and Citation
Australia – Salmon (21.5)	Panel Report, *Australia – Measures Affecting Importation of Salmon*, WT/DS18/R and Corr.1, adopted 6 November 1998, modified by Appellate Body Report, WT/DS18/AB/R, DSR 1998:VIII, 3407
Canada – Aircraft	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377
Canada – Aircraft (21.5)	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, adopted 4 August 2000, DSR 2000:IX, 4299
Canada – Aircraft Credits and Guarantees	Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R and Corr.1, adopted 19 February 2002, DSR 2002:III, 849
Canada – Dairy (21.5 II)	Appellate Body Report, *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*, WT/DS103/AB/RW2, WT/DS113/AB/RW2, adopted 17 January 2003, DSR 2003:I, 213
Chile – Alcoholic Beverages	Award of the Arbitrator, *Chile – Taxes on Alcoholic Beverages – Arbitration under Article 21.3(c) of the DSU*, WT/DS87/15, WT/DS110/14, 23 May 2000, DSR 2000:V, 2583
EC – Bed Linen (21.5)	Panel Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, WT/DS141/RW, adopted 24 April 2003, modified by Appellate Body Report, WT/DS141/AB/RW, DSR 2003:IV, 1269
EC – CVDs on DRAMs	Panel Report, *European Communities – Countervailing Measures on Dynamic Random Access Memory Chips from Korea*, WT/DS299/R, adopted 3 August 2005
EC – Sugar	Appellate Body Report, *European Communities – Export Subsidies on Sugar*, WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R, adopted 19 May 2005
Guatemala – Cement I	Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, adopted 25 November 1998, DSR 1998:IX, 3767
Mexico – Corn Syrup (21.5)	Appellate Body Report, *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States*, WT/DS132/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6675
U.S. – 1916 Act	Award of the Arbitrator, *United States – Anti-Dumping Act of 1916 – Arbitration under Article 21.3(c) of the DSU*, WT/DS136/11, WT/DS162/14, 28 February 2001, DSR 2001:V, 2017
U.S. – Byrd Amendment	Award of the Arbitrator, *United States – Continued Dumping and Subsidy Offset Act of 2000 – Arbitration under Article 21.3(c) of the DSU*, WT/DS217/14, WT/DS234/22, 13 June 2003, DSR 2003:III, 1163
U.S. – Export Restraints	Panel Report, *United States – Measures Treating Exports Restraints as Subsidies*, WT/DS194/R and Corr.2, adopted 23 August 2001, DSR 2001:XI, 5767

Short Title	Full Case Title and Citation
U.S. – FSC (21.5 II)	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Second Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW2, adopted 14 March 2006
U.S. – Gambling (21.5)	Panel Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/R, adopted 20 April 2005, modified by Appellate Body Report, WT/DS285/AB/R
U.S. – OCTG from Argentina (21.5)	Appellate Body Report, *United States – Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods from Argentina - Recourse to Article 21.5 of the DSU by Argentina*, WT/DS268/AB/RW, adopted 12 April 2007
U.S. – OCTG Sunset Reviews	Appellate Body Report, *United States – Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods from Argentina*, WT/DS268/AB/R, adopted 17 December 2004, DSR 2004:VII, 3257
U.S. – Softwood Lumber IV	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, adopted 17 February 2004, DSR 2004:II, 571
U.S. – Softwood Lumber IV (21.5)	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada – Recourse by Canada to Article 21.5 of the DSU*, WT/DS257/AB/RW, adopted 20 December 2005
U.S. – Softwood Lumber V	Appellate Body Report, *United States – Final Dumping Determination on Softwood Lumber from Canada*, WT/DS264/AB/R, adopted 31 August 2004, DSR 2004:V, 1875
U.S. – Softwood Lumber VI (21.5)	Appellate Body Report, *United States – Investigation of the International Trade Commission in Softwood Lumber from Canada – Recourse to Article 21.5 of the DSU by Canada*, WT/DS277/AB/RW, adopted 9 May 2006
U.S. – Upland Cotton	Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, adopted 21 March 2005
U.S. – Upland Cotton	Panel Report, *United States – Subsidies on Upland Cotton*, WT/DS267/R, and Corr.1, adopted 21 March 2005, modified by Appellate Body Report, WT/DS/267/AB/R

TABLE OF EXHIBITS

A. SCOPE OF THIS PROCEEDING

Questions to both parties

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

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

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

1. The United States' response addresses whether Brazil's claims regarding the amended GSM 102 pig meat and poultry meat are properly within the scope of these Article 21.5 proceedings.

2. The first issue for the compliance Panel in assessing the scope of these proceedings is to identify the measure(s) taken to comply with respect to the DSB's recommendations on the application of the GSM 102 program.[1]

3. By way of implementation, the United States modified the guarantee fee schedule of the GSM 102 program. This is intended to eliminate the "subsidy" component of the original program. There is no dispute between the Parties that the amended GSM 102 program, in particular the revised guarantee fee schedule, is a "measure taken to comply". The amended GSM 102 program remains the United States' declared "measure taken to comply" whether or not, as the United States suggests, the original panel's findings related to specific guarantees issued under the original GSM 102 program for specific products.[2]

4. Under Article 21.5, this Panel is required to examine the declared compliance measure – the amended GSM 102 program – "*in its totality*" for "consistency" with the United States' obligations under the *Agreement on Agriculture*, because it is a measure taken to comply that is included in Brazil's panel request.[3] In *U.S. – OCTG from Argentina (21.5)*, the Appellate Body emphasized that there are important reasons of principle for requiring compliance panels to examine "fully" the WTO-consistency of compliance measures. These include promoting the prompt settlement of disputes by avoiding the delay resulting from new proceedings, and "making efficient use of the original panelists and their relevant experience".[4] The fact that the United States objected to two members of the original panel hearing this dispute cannot alter the importance of this last factor in interpreting Article 21.5 generally.

5. The United States relies on the rulings in *EC – Bed Linen (21.5)* to suggest that its voluntary decision to amend the GSM 102 program with respect to pig meat and poultry meat is beyond the scope of Article 21.5 proceedings. However, this dispute is very different from *EC – Bed*

[1] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 142.
[2] U.S. 2 April response to question 44, para. 8.
[3] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 146 (emphasis in original).
[4] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 151.

Linen (21.5). In that dispute, the EC took a single measure to comply with its WTO obligations (Regulation 1644/2001). Thereafter, it adopted two formally separate and unrelated measures (Regulations 160/2002 and 696/2002) that, while addressing substantive issues similar to those raised in the original proceedings in *EC – Bed Linen*, related to imports from other countries that were not part of the WTO proceedings. The panel found that these two *separate measures* (Regulations 160/2002 and 696/2002) were not measures taken to comply, because they dealt with imports unconnected to the original WTO dispute.

6. In contrast, in this dispute, with respect to export credit guarantees, Brazil challenges the application of a *single measure* – the amended GSM 102 program – which the Parties agree is a measure taken to comply. The United States did not take a measure to comply that relates solely to GSM 102 ECGs for unscheduled products and rice, and separately adopt an unrelated measure relating solely to GSM 102 ECGs for pig meat, poultry meat and other scheduled products other than rice. Rather, the United States adopted a single measure taken to comply – the amended GSM 102 program – which has a single set of provisions that apply in exactly the same way to all eligible products.

7. The United States appears to argue that the Panel should parse the single compliance measure into components that relate to pig meat and poultry meat, and other components. The components relating to pig meat and poultry meat would, under the United States' approach, be excluded from these proceedings.

8. In *U.S. – OCTG from Argentina (21.5)*, the Appellate Body held that, where the challenged components of a compliance measure are not "separable", but "integral parts" of that measure, the measure must be examined "in its totality".[5] In this dispute, there are no "separable" provisions of the amended GSM 102 program that apply to pig meat and poultry meat, but not to other products. Instead, the provisions of the program, in particular the revised fee schedule on the basis of which "benefits" are conferred, constitute an integrated package that applies to all eligible products in exactly the same way. There is, therefore, no basis for dividing the measure taken to comply into different components.

9. Where the challenged components of a compliance measure are integral parts of the measure, the Appellate Body also found it "difficult to conceive" how two different panels (the first composed under Article 21.5, and the second in entirely new proceedings) could review inseparable elements of a single measure.[6] As a result, the Appellate Body held that the compliance panel must examine the integrated compliance measure "in its totality". In this dispute, Brazil challenges the revised GSM 102 fee schedule, which is an integrated schedule that does not distinguish between products. In Brazil's view, institutional efficiency and considerations of legal certainty require that a single panel assess this schedule "in its totality".

10. The United States also argues that, in revising the guarantee fee schedule, it was not taking action with respect to DSB recommendations regarding pig meat and poultry meat.[7] The panel in *U.S. – Gambling (21.5)* also recently ruled that measures cannot be excluded from the scope of compliance proceedings "due to the *purpose* for which they have been taken".[8] In *U.S. – Softwood Lumber IV (21.5)*, the Appellate Body also found the "first assessment review" to be a "measure taken to comply" even though the United States Department of Commerce did *not* adopt it "with the intention of complying with the DSB's recommendations and rulings."[9] It is, therefore, irrelevant whether the United States intended to implement the DSB's recommendations with respect to pig meat and poultry

[5] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, paras. 146 and 148.
[6] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, paras. 151.
[7] U.S. 2 April response to question 44, para. 18.
[8] Panel Report, *U.S. – Gambling (21.5)*, para. 6.24 (emphasis in original).
[9] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, paras. 15, 67 and 92.

meat when it adopted the amended GSM 102 program. The issue is whether the amended program "in its totality" is "fully" consistent with the covered agreements, including with respect to the United States' export subsidy commitments for pig meat and poultry meat.

11. The United States also contends that this dispute may relate to specific guarantees issued for specific products[10], and professes confusion whether Brazil is "challenging" the "GSM 102 program as such", or "particular guarantees under the GSM 102 program".[11]

12. The United States' assertion that the measure at issue is only specific guarantees for specific products, and its feigned confusion concerning Brazil's "challenge", is disingenuous. As the United States is aware, Brazil's claims under Articles 10.1 of the *Agreement on Agriculture* involve a number of elements. One such element is a showing that the United States is providing "export subsidies".

13. The original panel found that the *original GSM 102 program*, without reference to specific guarantees or specific products, constituted an export subsidy under item (j) of the Illustrative List in Annex I of the *SCM Agreement*.[12] In these Article 21.5 proceedings, Brazil similarly establishes, in a number of ways, that the *amended GSM 102 program* is an export subsidy.

14. First, Brazil has demonstrated that the amended GSM 102 program constitutes an export subsidy under item (j). Nothing about this showing is product-specific.

15. Second, Brazil has demonstrated that according to official, normative statements by the U.S. government in the GSM 102 regulations, FAS publications and FAS' self-assessment of the program, the program always offers export-contingent financial contributions that confer "benefits" on recipients. Nothing about this showing is product-specific.

16. Third, Brazil has demonstrated that under the amended GSM 102 fee schedule, GSM 102 ECGs will necessarily constitute export-contingent financial contributions that confer "benefits" on recipients. With its ExIm Bank comparison exercise, Brazil has provided exhaustive proof of this, demonstrating methodically that on a country-by-country, tenor-by-tenor basis, GSM 102 ECGs issued under the amended GSM 102 fee schedule are export subsidies.[13] As a practical matter, this amounts to a showing that the amended GSM 102 program is an export subsidy itself. Nothing about this showing is product-specific.

17. Turning to another element of Brazil's claims, Brazil has demonstrated, as in the original proceedings, that the United States has "applied" the export subsidy in a manner that results in circumvention of U.S. export subsidy commitments, within the meaning of Article 10.1 of the *Agreement on Agriculture*. The "application" of the GSM 102 program that results in circumvention is, as it must be, established with respect to specific scheduled products (as well as with respect to the category of unscheduled products). In assessing whether the program is "applied" in a manner that circumvents export subsidy commitments, the original panel considered evidence relating to the cumulative level of the guarantees issued for the specific products that were the subject of claims. However, the individual guarantees issued under the program did not thereby become the export subsidies at issue; nor do they become the export subsidies at issue in these proceedings.

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[10] U.S. 2 April response to questions 44 and 46, paras. 12 and 52.

[11] U.S. 2 April response to question 97, paras. 224-225.

[12] Panel Report, *U.S. – Upland Cotton*, para. 7.869.

[13] In comments on Question 98, Brazil shows that the amended GSM 102 program is an export subsidy by comparison with ExIm Bank products, even taking account of the differing interest rate coverage of the products. In its 2 April response to question 100, Brazil has also demonstrated that this same evidence proves that GSM 102 ECGs lower the "total cost of funds" in GSM 102-supported transactions.

18. In any event, even if the individual GSM 102 guarantees issued for specific products are the export subsidies at issue in these compliance proceedings, all of those guarantees – for rice, pig meat and poultry meat, and all unscheduled products – have a sufficient nexus to the amended GSM 102 program, the declared compliance measure, that they are part of the compliance measures for purposes of whether the program is "applied" consistently with Article 10.1.

19. In this regard, Brazil notes that it is the United States that has suggested that the individual guarantees are the challenged "measures taken to comply". [14] It appears to accept that these new individual guarantees could, in theory, be "measures taken to comply" with DSB recommendations. Yet, when it comes to marketing loan and counter-cyclical *payments*, the United States vehemently objects that new payments cannot be "measures taken to comply" with DSB recommendations concerning earlier payments under the same programs. Brazil argues below that the correct approach is to recognize – as the United States does for individual guarantees – that the new payments are sufficiently closely connected to the DSB's recommendations regarding the old payments to be "measures taken to comply".[15]

20. Having identified the amended GSM 102 program as a declared "measure taken to comply", a second question arises for the compliance Panel with respect to the scope of the claims that can be made regarding that measure. Brazil's claims concern the application of the program to three scheduled agricultural products (rice, pig meat and poultry meat) and unscheduled agricultural products.

21. The United States' argument is that the DSB's recommendations did not impose any implementation obligations with respect to pig meat and poultry meat. As a result, it says, even though its compliance measure applies to these products, no claims can be made regarding them. This position incorrectly assumes that Article 21.5 proceedings are limited to examining whether the implementing Member has eliminated the WTO-inconsistencies identified in the DSB's recommendations.

22. According to the text of Article 21.5, a compliance panel is the appropriate forum for resolving any "*disagreement*" relating to the *general* "*consistency with a covered agreement*" of a "measure taken to comply". Thus, in *Canada – Aircraft (21.5)*, the Appellate Body expressly "disagreed" with the panel's view that Article 21.5 proceedings are confined to examining whether the implementing Member "*has implemented the DSB recommendation*".[16] In *U.S. – OCTG from Argentina (21.5)*, citing *Canada – Aircraft (21.5)*, the Appellate Body reiterated that a compliance panel must "examine ***fully*** the '*consistency with a covered agreement* of the measures taken to comply', as required by [Article 21.5]".[17] As noted, it also affirmed that a compliance panel must examine the compliance measure "*in its totality*".[18]

23. As a result, the precise scope of the DSB's recommendations does *not* determine the scope of Article 21.5 proceedings. Moreover, Article 21.5 proceedings can, therefore, involve claims and arguments regarding the WTO-"consistency" of a measure taken to comply, even though these claims were not the subject of DSB's recommendations.[19]

24. In effect, the United States asks the Panel, in essence, to reverse the Appellate Body's interpretation because it asserts that this Panel can – indeed, must – examine *exclusively* whether the measure taken to comply has eliminated the WTO-inconsistencies established in *the DSB's*

[14] U.S. 2 April response to question 97, paras. 224-225.
[15] *See* Brazil's comments on U.S. responses to questions 45, 47 and 48, below.
[16] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 40.
[17] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, paras. 151.
[18] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, paras. 146.
[19] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 41.

recommendations. The Panel should reject this argument, and follow the wording of Article 21.5. The Panel may, therefore, examine whether the application of the amended GSM 102 program is "consistent" with the United States' obligations under Article 10.1 of the *Agreement on Agriculture*.

25. There remain, of course, limitations on the claims that can be made regarding a measure taken to comply. In particular, certain panels have ruled that *no new claims* can be made with respect to *unchanged elements* of the original measure; equally, the *same claim* cannot be made with respect to *unchanged elements* of the measure *if that claim was rejected* in the original proceedings. As Brazil has previously explained, neither of these limitations apply.[20] Brazil's claims regarding pig meat and poultry meat concern a *new element of the measure taken to comply*, namely the revised guarantee fee schedule in the amended GSM 102 program. There are no limits on the claims (much less the arguments) that can be made with respect to a new element of the compliance measure.

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

26. The United States' response to question 45 clouds the issue it raised in its preliminary objection. Brazil's request for the establishment of a panel identifies two measures that it claims cause adverse effects under Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*. These measures are: (1) the marketing loan and counter-cyclical payment programs and (2) payments made under these programs.[21] The key issue is whether these two categories of measures are properly within the scope of compliance proceedings. Brazil addresses these measures in turn below.

(i) Subsidy Programs

27. In *U.S. – OCTG from Argentina (21.5)*, the Appellate Body recalled that determining the scope of "measures taken to comply", or the absence thereof, involves an examination of the recommendations and rulings contained in the original panel report, which is adopted by the Dispute Settlement Body ("DSB").[22]

28. With respect to the subsidy programs, the issue that divides the Parties is whether the original panel's findings of "present" serious prejudice included findings regarding the programs themselves. Brazil has presented a straightforward reading of the original panel report that logically ties together: (1) the panel's identification of the measures at issue in the "present" serious prejudice section; (2) its reasoning regarding the "effect" of those measures, which included a lengthy exposition of the "effects" of the programs; (3) its reasoning for declining to examine Brazil's claims of threatened of serious prejudice; (4) its reasoning for declining to examine Brazil's claims of "as such" violations; and (5) its description of the implementation action that the United States was obliged to take.

29. Brazil has addressed these factors in detail in earlier submissions, and will not repeat its arguments.[23] All of these factors point in one direction: the original panel's findings of "present" serious prejudice included the subsidy programs, as well as the payments mandated by these programs. In these circumstances, the EC's arguments on the nexus between the programs and the payments, and the United States' criticism of those arguments, are moot because they are premised on the assumption that the original panel made no findings regarding the programs.

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[20] Brazil's 26 February response to question 6, paras. 32-60.

[21] WT/DS267/30, paras. 13 and 17.

[22] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 142, circulated 12 April 2007, not yet adopted.

[23] *See, in particular*, Brazil's 26 February response to question 11 and its 2 April response to question 45.

30. In rebutting Brazil's reading of the original panel report, the United States relies heavily on fragments of Brazil's arguments in the original proceedings in an attempt to demonstrate that the original panel's findings did not include the programs. However, as the Appellate Body held in *U.S. – OCTG from Argentina (21.5)*, the DSB's recommendations and rulings are framed in terms of the findings made by the original panel and the Appellate Body, and not by the complainant's arguments.[24] The compliance Panel must, therefore, focus on the original panel's findings, and the reasoning explaining those findings.

31. The United States accuses Brazil of "grasp[ing] at isolated statements in the original panel report".[25] However, it is the United States that relies on isolated phrases, and misreads the original panel report. The United States attaches considerable importance to the alleged temporal limitation on the scope of the measures. Yet, it asserts no basis in the original panel report for its conclusion that the original panel's findings were limited to payments made in MY 1999-MY 2002.

32. The original panel's general description of the measures at issue included the statement that "[t]he *programmes and legislation* identified [in Brazil's request for establishment of a panel] *include payments* made before the date of establishment of the Panel, *and those made subsequently*."[26] This statement reveals that the panel saw a necessary link between the programs and payments because it stated expressly that the programs "*include payments*". Further, the relevant "payments" were found to be both those made before and those to be made after the date of establishment.

33. The United States also contends that a footnote in the Peace Clause section of the report decisively addresses the scope of the measures addressed in the separate "present" serious prejudice section.[27] This is absurd, because the original panel included a separate statement of the measures at issue in each section of the report. The footnote in the Peace Clause section, by its own terms, does not address the other sections of the report. It cannot, therefore, alter the scope of the measures examined in the "present" serious prejudice section.

34. Instead, in that section, in paragraph 7.1107 of the report, the original panel stated that serious prejudice measures included the "*legislative and regulatory provisions*", in addition to the payments.[28] The United States' explanation of this statement is that the reference to the "*legislative and regulatory provisions*" merely captures the "*application*" of those provisions.[29] This is a distortion of the panel's words. As Brazil has noted, the original panel refers to the "provisions" as measures, without any qualification or other hint that the "provisions" are not, in fact, measures – as the United States now argues.[30] Further, it would have been utterly redundant for the original panel to identify the "application" of the "provisions" separately from the listed payments, because the payments *are* the "application" of the provisions.

35. The United States also suggests that it is not "surprising" that the original panel considered the operation of the subsidy programs in examining the effects of payments.[31] However, the United States overlooks that, in examining the effects of the three programs, the panel referred to them as the "*three measures*" and the "*subsidies in question*".[32]

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[24] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 142, circulated 12 April 2007, not yet adopted.
[25] U.S. 16 March comments, para. 65.
[26] Panel Report, *U.S. – Upland Cotton*, para. 7.187.
[27] U.S. 16 March comments, para. 63.
[28] Panel Report, *U.S. – Upland Cotton*, paras, 7.1107.
[29] U.S. 16 March comments, para. 68.
[30] Brazil's 2 April response to question 44, para. 13.
[31] U.S. 16 March comments, para. 68.
[32] Brazil's 2 April response to question 44, paras. 14 to 16.

36. Thus, once again, the original panel stated that the programs themselves were the "measures"; and it examined "their effects" in a particular reference period, finding that these effects included "present" serious prejudice to the interests of Brazil. It concluded that the United States was "***obliged*** to take action concerning its *present statutory and regulatory framework* as a result of our 'present' serious prejudice finding."[33]

37. In its 2 April responses, the United States also suggests that, if the original panel's findings included the programs, this would erode the distinction between "as such" and "as applied" findings.[34] This is incorrect. The original panel found that an examination of the "*effects*" of the subsidies (programs and payments) "*cannot be conducted in the abstract*".[35] The original panel, therefore, examined the effects of the subsidies (programs and payments), in the marketplace, *in a defined reference period* developed by the panel. Accordingly, the original panel did not find that the programs "*as such*" cause adverse effects at all times. Brazil has demonstrated, in these proceedings, that subsequent to the implementation period, the unchanged programs and new mandatory payments continue to cause adverse effects, as shown by the analysis of their effects in a different reference period.

38. Finally, the United States has failed to offer any explanation whatsoever why the original panel would have decided not to rule upon Brazil's threat claims, and its "as such" claims, if the "present" serious prejudice claims were limited to payments last made in MY 2002 – more than a year before the original panel issued its ruling. If the United States were correct, the original panel *chose* to rule exclusively on past payments that it *knew* might no longer produce "effects" in the marketplace because, by the time of its ruling, these payments had been superseded by payments made in MY 2003 and MY 2004; and it simultaneously *chose not* to rule on subsidy programs and future payments that it knew would still be producing "effects" during the implementation period.

39. It is simply not credible to believe that the original panel would have decided not to rule on the threat and "as such" claims in these circumstances. Nothing suggests that the original panel decided to undermine the utility of its own work in this way. To the contrary, the original panel was highly sensitive to the importance of implementation of its rulings, and decided not to rule on the threat and "as such" claims because "the United States is ***obliged*** to take action concerning its *present statutory and regulatory framework* as a result of our 'present' serious prejudice finding."[36]

40. In sum, the marketing loan and counter-cyclical subsidy *programs*, including payments mandated under these programs, are properly within the compliance Panel's terms of reference because the original panel's "present" serious prejudice findings included these programs.

(ii) Payments in MY 2005 and Thereafter

41. The second category of measures that Brazil challenges in these proceedings covers payments made under the marketing loan and counter-cyclical programs. Brazil's arguments have focused on the adverse effects caused by these measures in MY 2005 and thereafter. Although the United States disputes that the original panel made findings on the subsidy *programs*, it accepts that, at a minimum, the panel made findings regarding payments made in MY 1999 to 2002. Even on the assumption that the United States is correct (*quod non*), Brazil demonstrates in this section, as it did in its 26 February responses[37], that the marketing loan and counter-cyclical payments made in MY 2005 and thereafter must be regarded as (WTO-inconsistent) "measures taken to comply" because of their extremely close connection to the payments found to be causing serious prejudice in the original proceedings. These

[33] Panel Report, *U.S. – Upland Cotton*, para. 7.1501.
[34] U.S. 2 April response to question 45, paras. 27 ff.
[35] Panel Report, *U.S. – Upland Cotton*, para. 7.1198.
[36] Panel Report, *U.S. – Upland Cotton*, para. 7.1501.
[37] Brazil's 26 February response to question 15, paras. 145-150.

arguments are, obviously, made without prejudice to Brazil's principal argument that the original panel found that the subsidy programs, including the payments mandated by the programs, were found to be WTO-inconsistent.

42. In *U.S. – OCTG from Argentina (21.5)*, the Appellate Body last week reiterated that it is for a compliance panel to determine whether the measures listed in a panel request are "measures taken to comply".[38] As noted above, citing the Appellate Body ruling in *U.S. – Softwood Lumber IV (21.5)*, the panel in *U.S. – Gambling (21.5)* also recently ruled that measures cannot be excluded from the scope of compliance proceedings "due to the *purpose* for which they have been taken".[39] It is, therefore, irrelevant whether the United States granted the new marketing loan and counter-cyclical payments for the specific purpose of complying with the DSB's recommendations.

43. Rather, as the United States accepts, the determination whether the new payments are "measures taken to comply" depends on the closeness of their relationship ("interrelatedness") to the DSB's recommendations.[40] Because the DSB's recommendations are "directed" at the measures originally found to be WTO-inconsistent, the compliance Panel must assess the relationship between the alleged measures taken to comply and the original measures.[41]

44. In *U.S. – Softwood Lumber IV (21.5)*, the Appellate Body also held that a compliance panel must examine the alleged measures taken to comply "in their *full context*, including *how such measures are introduced* into, and *how they function* within, the particular system of the implementing Member."[42] Further, in its 2 April responses, the United States acknowledges that, in *U.S. – Softwood Lumber IV (21.5)*, *Australia – Leather (21.5)* and *EC – Bed Linen (21.5)*, measures that "*undid*" or "*undermined*" the implementing Member's compliance efforts were found to have a sufficiently close connection to the DSB's recommendations to be "measures taken to comply".[43]

45. In view of these considerations, the new payments are (WTO-inconsistent) "measures taken to comply" with the DSB's recommendations regarding the original payments. These payments and the new payments collectively constitute an unbroken stream of identical subsidies. As Brazil has noted, the payments subject to the DSB's recommendations and the payments subject to these proceedings are mandated by the very same subsidy programs under the FSRI Act of 2002; they are made to the same recipients; they support the same crop; and they are granted on the same terms and conditions.[44] Thus, under U.S. domestic law, the original and the new payments are all "*introduced*", and "*function*", in precisely the same way.[45]

46. Significantly, the new payments "undermine" – indeed, eviscerate – the United States' compliance efforts. Assuming that the original panel confined its findings to payments (*quod non*), the United States came under an obligation, on 21 March 2005, to take steps to remove the adverse effects of, at a minimum, the marketing loan and counter-cyclical payments made in MY 1999 to MY 2002, or to withdraw these payments.

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[38] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 140.

[39] Panel Report, *U.S. – Gambling (21.5)*, para. 6.24 (emphasis in original). Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, paras. 15, 67 and 92. The Appellate Body found the "first assessment review" to be a "measure taken to comply" even though the United States Department of Commerce did not adopt it "with the intention of complying with the DSB's recommendations and rulings."

[40] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 142 and Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 68. *See* United States 2 April response to question 44, paras. 8 and 9.

[41] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 68.

[42] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 67 (emphasis added).

[43] U.S. 2 April response to question 44, footnotes 5 and 22, and para. 17.

[44] Brazil's 26 February response to question 15, para. 147.

[45] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 67 (emphasis added).

47. Yet, instead of taking any action of that nature, the United States simply continued to provide the very same marketing loan and counter-cyclical payments throughout MY 2005, and thereafter. Thus, rather than taking appropriate implementation action, the United States simply substituted the WTO-inconsistent payments with new payments that, given the annual nature of both the payments and the crops, superseded the adverse effects of the original payments. Thus, the effects of the original payments have simply been replaced by adverse effects caused by the new payments. The United States thereby makes effective implementation under Article 7.8 impossible. As the Appellate Body held in *U.S. – FSC (21.5 II)*, a Member fails to implement when it "replaces" one WTO-inconsistent subsidy with another.[46]

48. The United States' *sole* defense to this line of argument is that Brazil attempts to "add" to the original measures found to be WTO-inconsistent by challenging the new payments, which were not found to be WTO-inconsistent.[47] Brazil is *not* seeking to "add" anything to the original ruling. Brazil accepts that the new payments were not part of the DSB's recommendations because the original panel exercised judicial economy with respect to the threat claims that would have included the new payments when they were still possible future payments. In *U.S. – OCTG from Argentina (21.5)*, the Appellate Body held that complaining Members are not prevented from making claims in Article 21.5 proceedings that were the subject of judicial economy in the original proceedings.[48] In short, complaining Members are not prejudiced in compliance proceedings by the original panel's decision to exercise judicial economy.

49. Thus, in the circumstances of this dispute, where *possible future* payments were challenged in an original *threat* claim that was subject to judicial economy, nothing in the DSU prevents those payments from being "measures taken to comply" after they are *actually made*, provided that they have a sufficiently close connection to the DSB's recommendations.

50. Finally, the United States incorrectly rejects the view that WTO dispute settlement becomes a "moving target", and is reduced to a "Groundhog Day", if the U.S. approach is accepted.[49] The United States observes that the Parties are "bound" by the "outcome" of the original dispute.[50] Yet, the United States believes that it can evade the "outcome" of the original panel's "present" serious prejudice findings regarding payments simply by making more payments. After every round of payments, it says that the complaining Member could contest the new payments *solely* in new proceedings. However, on this view, the complaining Member could never take retaliatory action under Article 22 of the DSU for an endless stream of identical recurring payments because there would never be any compliance measures. As a result, the WTO disciplines regarding the "present" effects of the most obvious form of subsidies – cash payments – would be reduced to inutility.

(iii) Conclusion

51. In conclusion, Brazil argues that the marketing loan and counter-cyclical subsidy *programs* are properly within the panel's terms of reference because the original panel's rulings, and the DSB's recommendations, regarding "present" serious prejudice include these programs.

52. In addition, Brazil argues that subsidy payments made in MY 2005, and thereafter, are "measures taken to comply" with the DSB's recommendations regarding payments made in MY 1999 to MY 2002 because of the extremely close connection between these new payments and the DSB's recommendations. The new payments cause "present" serious prejudice.

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[46] Appellate Body Report, *U.S. – FSC (21.5 II)*, para. 84.
[47] U.S. 16 March comments, para. 100; and U.S. 2 April response to question 47, para. 53.
[48] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 148.
[49] U.S. 2 April response to question 48, para. 54.
[50] U.S. 16 March comments, para. 101; U.S. 2 April response to question 48, paras. 54 ff.

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

53. Brazil's comments on the United States' answer to Question 44 also address relevant aspects of the United States' answer to this question. Brazil also notes that the United States acknowledges that the "group of agricultural products" eligible to receive ECGs has not been altered since the original proceedings.[51]

54. The United States professes "difficult[y]" in seeing why a Member would comply with the DSB's recommendations relating to subsidies provided to one product by providing subsidies in respect of other products.[52] There are very straightforward reasons why a Member may wish to adopt precisely this course of action. Subsidies are, generally, provided to benefit *producers, not products*. A Member may very well attempt to maintain the level of prior support afforded to a particular group of producers by altering the group of products eligible to receive subsidies. In that event, a "disagreement" may arise as to whether the subsidies granted to different products under the compliance measure are consistent with the WTO covered agreements. The implementing Member could argue that the DSB's recommendations did not require it to take action with respect to the newly eligible products and, in consequence, this element of the measure is not a measure taken to comply. Yet, this is a good example of why the Appellate Body confirmed in *U.S. – OCTG from Argentina (21.5)* that Article 21.5 disputes extend to assessing "fully" the "consistency with a covered agreement" of a measure taken to comply "*in its totality*", and are not limited by the terms of the DSB's recommendations.[53]

Questions to the United States

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

55. Brazil refers the compliance Panel to its comments on the U.S. response to question 45, above.

48. How does the United States address the argument of Brazil that "[i]f the United States were to prevail on its view that subsequent mandatory and price-contingent marketing loan and CCP payments are not properly before this Panel, the grant of annual recurring subsidies becomes 'a moving target that escape from [the WTO subsidy] disciplines' "? (Closing Statement of Brazil, para. 4)

56. Brazil refers the compliance Panel to its comments on the U.S. response to question 45, above.

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[51] U.S. 2 April response to question 46, para. 52.

[52] U.S. 2 April response to question 46, para. 51.

[53] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, paras. 146 and 151 (emphasis in original).

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

57. Brazil makes claims regarding the non-existence of compliance measures between 21 September 2005, the end of the implementation period under Article 7.9 of the *SCM Agreement*, and 1 August 2006, when the United States adopted certain compliance measures with respect to the Step 2 program. The United States response is that "Brazil has not identified any textual basis that requires the Panel to make findings regarding compliance as of the end of the six-month period set out in Article 7.9 of the *SCM Agreement* rather than as of the date of panel establishment pursuant to Article 21.5 of the DSU."[54]

58. This argument is absurd. Article 7.9 of the *SCM Agreement* provides a clear textual basis for Brazil's claim. The provision states:

> *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.

59. The provision sets forth that the DSB "shall", by negative consensus, authorize "countermeasures" when ("in the event") the implementing Member fails to implement "within six months" of the date of adoption. Thus, according to the treaty text, a right to "countermeasures" arises on that date, subject only to negative consensus. By pursuing its claim regarding the non-existence of measures on 21 September 2005, Brazil seeks a multilateral basis for the DSB to authorize countermeasures against the United States for its failure to take any implementation measures by the date required in Article 7.9 of the *SCM Agreement*.

60. Brazil also notes that additional textual support for its position is found in the DSU. Although Articles 7.8 and 7.9 are "special or additional rules and procedures" under Article 1.2 of the DSU, they do not supplant the DSU. Instead, the DSU continues to apply to the extent that the rules in the DSU do not conflict with the special or additional rules.[55]

61. Articles 3.7 and 21.3 of the DSU indicate that "prompt compliance" with the DSB's recommendation, in principle, implies "immediate" compliance.[56] If "immediate" compliance is not "practicable", Article 21.3 envisages, as an exceptional matter, a grace period for implementation. Accordingly, under these provisions, the implementing Member must have complied with the DSB's recommendations, at the latest, by the end of the implementation period. None of these rules in the DSU conflicts with Article 7.9 of the *SCM Agreement*.

62. Under Article XVI:4 of the *WTO Agreement*, the United States was bound to comply with its WTO obligations in the *SCM Agreement* and the DSU by the end of the six month implementation period. Under Article 21.5 of the DSU, as part of the "*continuum of events*"[57] from the original

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[54] U.S. 2 April response to question 49, para. 59.

[55] Appellate Body Report, *Guatemala – Cement I*, para. 65.

[56] *See* Award of the Arbitrator, *Chile. – Alcoholic Beverages*, para. 38; Award of the Arbitrator, *U.S. – Byrd Amendment*, para. 40; Award of the Arbitrator, *U.S. – 1916 Act*, para. 30.

[57] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 103 (emphasis added) citing Appellate Body Report, *Mexico – Corn Syrup (21.5)*, para. 121. *See* Brazil's First Written Submission, para. 28.

proceedings, a complaining Member is entitled to obtain a ruling, for purposes of its compensation rights in the dispute, that the implementing Member failed to implement by the required date.

63. Besides being supported by the text of the covered agreements, Brazil's position is fully supported by the ruling of the compliance panel in *Australia – Salmon (21.5)*, which ruled that Australia had failed to take appropriate compliance measures with effect from the end of the implementation period.[58] It stated that "Australia was under an obligation to comply with DSB recommendations and rulings by the end of the reasonable period of time. If it did not do so, Australia could face suspension of concessions or other obligations under Article 22.6 of the DSU."[59]

64. Brazil's argument does not preclude a Member from coming into compliance with its WTO obligations after the end of the implementation period. Nor does it exclude measures from the scope of compliance proceedings simply because they were not adopted during the implementation period. However, if the implementing Member *chooses* to implement later than required by the *SCM Agreement* and the DSU, the complaining Member is entitled to a finding by a compliance panel to that effect, and to seek "countermeasures" for the delay.

65. The United States relies on two panel reports in which the panel ruled that the appropriate date for declaring the non-existence of compliance measures is the date of the compliance panel's establishment. However, these panels failed to consider the significance of this date for the implementing Member's compensation rights. The United States also refers to the fact that the parties in those disputes entered into sequencing agreements, like the agreement in this dispute, which address procedures under Articles 21 and 22 of the DSU. However, these agreements do not diminish the *substance* of complaining Member's rights under the covered agreements. In particular, the sequencing agreement in this dispute does not, in any way, diminish Brazil's right to seek authorization for countermeasures under Article 7.9 of the *SCM Agreement* for the United States' failure to implement by 21 September 2005.[60]

B. CLAIMS OF BRAZIL REGARDING PRESENT SERIOUS PREJUDICE

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

Questions to both parties

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

66. At the outset, Brazil notes that, in response to a strictly legal question, the United States embarks on a lengthy summary of its various factual arguments regarding alleged "expectations" of U.S. farmers and the alleged absence of *anything* more than *minimal* effects from the billions of dollars of marketing loans and counter-cyclical subsidies provided to U.S. upland cotton producers. These U.S. arguments would certainly come as a surprise to the National Cotton Council, one of whose primary functions is to lobby the U.S. Congress for huge marketing loan and counter-cyclical subsidies in order to maintain the commercial viability of U.S. upland cotton production.[61] These

[58] Brazil's 26 February response to question 21, paras. 154 ff.

[59] Panel Report, *Australia – Salmon (21.5)*, para. 7.30. *See, also*, para. 8.1(i) of the panel's findings and conclusions (underlining added).

[60] WT/DS267/29.

[61] Panel Report, *U.S. – Upland Cotton*, footnote 1471 referring to Exhibit Bra-109 (Testimony (Full) of Robert McLendon, Chairman, NCC Executive Committee, Before the House Agricultural Committee. National

arguments would also surprise the typical U.S. cotton farmer, embodied by Mr. Stephen Houston, Sr. who was recently quoted as stating that "[market] prices don't have anything to do with what we're doing … [w]e're just looking at the government payments."[62] And these arguments certainly would have surprised the original panel which, when confronted with the *same* U.S. arguments, found that there was "no doubt that marketing loan payments stimulate production and exports and result in lower world market prices."[63] Finally, these arguments would surprise the 58 U.S. Senators that recently wrote to President Bush expressing concerns about reductions in U.S. agricultural subsidies. The Senators states that a deal in the Doha Development Agenda would "reduce[] net farm income through steep cuts in farm programs," indicating their belief that government subsidies play a fundamental role in allowing U.S. farmers, including U.S. upland cotton farmers, to generate sufficient profits from growing crops.[64]

67. Brazil has responded to these arguments in numerous previous submissions.[65] Therefore, Brazil will not repeat the overwhelming evidence demonstrating that U.S. upland cotton farmers have received, do receive, and expect to receive huge marketing loan and counter-cyclical subsidies supporting the production of upland cotton. Brazil's arguments and evidence demonstrating that, but for marketing loan and counter-cyclical subsidies, U.S. upland cotton acreage, production, exports and stocks would be much lower and world market prices for upland cotton would be much higher are summarized in Brazil's answer to question 69[66] and found throughout Brazil's many submissions.

68. Brazil explained that the most basic facts concerning the U.S. subsidies at issue and the conditions of competition in the world market for upland cotton suffice to establish a causal link between the subsidies and significant price suppression in the world market.[67] These facts are as follows: It is undisputed that U.S. upland cotton is "like" Brazilian upland cotton as well as the upland cotton produced by many other countries.[68] It is undisputed that there is a closely integrated world market for upland cotton and that heavily subsidized U.S. upland cotton competes directly in that world market with upland cotton from Brazilian and other third country producers.[69] It is undisputed that the price of U.S. upland cotton, like that of other upland cotton producers, is reflected in a world market price, the A-Index.[70] Finally, it is undisputed that the United States maintains a 40 percent world export market share and accounts for 20 percent of total world production resulting in a substantial proportionate influence on the world market price of upland cotton.[71]

69. These undisputed facts, combined with the fact that massive price-contingent U.S. marketing loan and counter-cyclical subsidies represent a 40 percent *ad valorem* subsidization rate over the

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Cotton Council (NCC)). *See also* Exhibit Bra-324 (NCC Chairman's Report by Kenneth Hood, 24 July 2002, p. 2).

[62] Exhibit Bra-563 ("Cotton bailout: How your tax dollars prop up big growers and squeeze the little guy," Atlanta Journal-Constitution, 1 October 2006, p. 2, accessed December 2006 at http://www.ajc.com/search/content/metro/stories/cotton1.html).

[63] Panel Report, *U.S. – Upland Cotton*, para. 7.1291.

[64] A letter to the President dated 12 April and signed by 58 U.S. Senators states "We cannot support a deal that directly reduces net farm income through steep cuts in farm programs in return for minimal market access gains whose effects on farm gate receipts is speculative at best," available at http://conrad.senate.gov/issues/statements/agriculture/070412_WTO_Ag_Letter.pdf.

[65] Brazil's First Written Submission, paras 126-150; Brazil's Rebuttal Submission, paras. 101-113, 180-194, 209-231; Brazil's Oral Statement, paras. 63-78.

[66] *See* Brazil's 2 April response to question 69, paras. 90-106.

[67] Brazil's 2 April response to question 69, paras. 92-96.

[68] Brazil's First Written Submission, Section 7.4.

[69] Brazil's First Written Submission, Section 7.4.

[70] Brazil's First Written Submission, Section 7.4; Brazil's Oral Statement, para. 148 and Declaration by Andrew Macdonald, Brazil's First Written Submission, Annex II, para. 18.

[71] Exhibit Bra-559 ("Potential Challenges to U.S. Farm Subsidies in the WTO: A Brief Overview," Congressional Research Service Report for Congress, 25 October 2006, p. 5).

lifetime of the FSRI Act of 2002, *alone* are sufficient for the compliance Panel to find that these subsidies cause significant price suppression in the world market for upland cotton. This is all the more true in light of the consistent inability of the average U.S. upland cotton producer to cover its costs of production without these two subsidies.

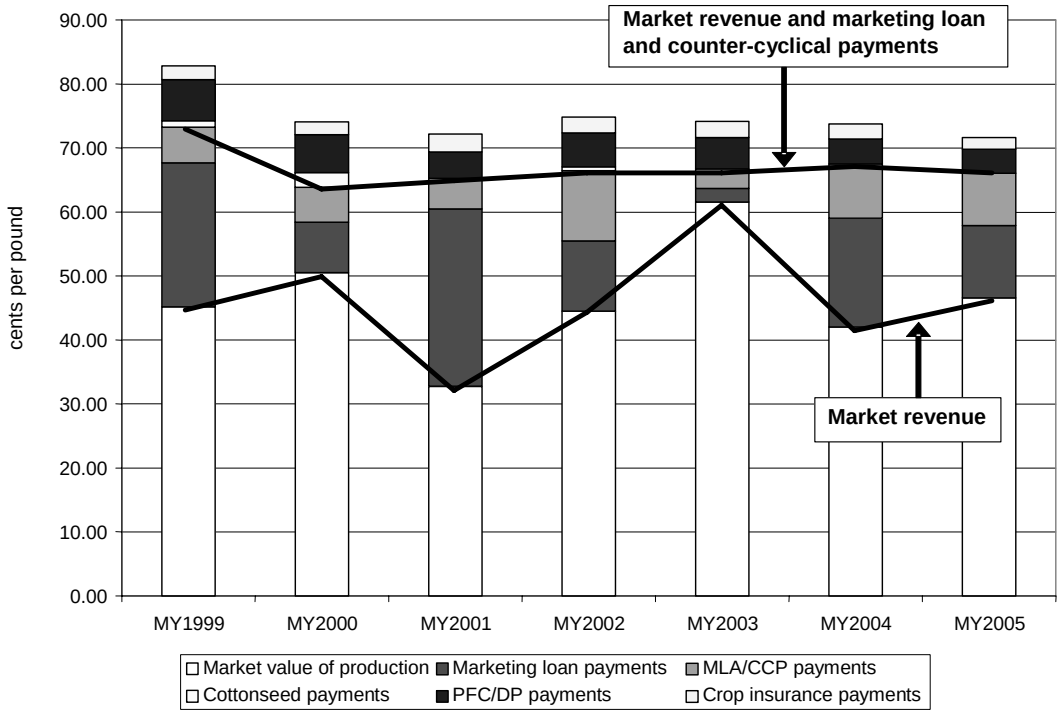
70. In these comments, Brazil focuses on the general theme of the U.S. response, *i.e.*, "expectations" allegedly held by U.S. upland cotton farmers at the time of planting. Brazil agrees that an analysis of U.S. upland cotton producers' expectations, at the time of planting, about market prices and subsidy revenue is a useful supplement to the basic facts identified above. Indeed, Brazil conducted just such analyses in its First Written Submission[72], Rebuttal Submission[73] and Oral Statement.[74] However Brazil considers that an assessment of the basic facts noted above is sufficient for the compliance Panel to find that the U.S. marketing loan and counter-cyclical subsidies cause significant price suppression in the world market for upland cotton, in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*.

71. The United States emphasizes that it is "important to look at the way that the marketing loan and counter-cyclical payment programs *actually* operate and interact with production decisions."[75] Brazil agrees with this general proposition. U.S. upland cotton farmers, like any other businesses, function to generate revenue and make a profit. One of the questions before this compliance Panel is from what source typical U.S. upland cotton farmers expect to receive revenue sufficient to cover production costs and generate profits from their business. Do market returns alone provide sufficient revenue, or are U.S. marketing loan and counter-cyclical subsidies necessary to achieve the current levels of U.S. upland cotton supply? Both an assessment of actual costs and returns and expected costs and returns are relevant in considering these questions.

72. Expectations of U.S. upland cotton farmers, almost all of whom grow on upland cotton base acres benefiting from upland cotton counter-cyclical payments, are usefully summed up by Figure 8 of Brazil's First Written Submission, showing a consistent high stream of total revenue.[76]

[72] Brazil's First Written Submission, paras. 126-150.
[73] Brazil's Rebuttal Submission, paras. 101-113, 180-194, 209-231.
[74] Brazil's Opening Statement, paras. 63-78.
[75] U.S. 2 April response to question 51, para. 69 (emphasis in original).
[76] Brazil's First Written Submission, Table 8 at para. 133.

Figure 1 – Support to Upland Cotton[77]



73. This figure demonstrates the critical impact of marketing loans and counter-cyclical subsidies. U.S. upland cotton farmers can expect high total revenue even if prices turn out to be low, for instance due to a collapse of Chinese demand or expanded Indian exports. Indeed total revenue will be high regardless of whether prices plunge for demand- or supply-related reasons. Every U.S. upland cotton farmer knows that, year-in and year-out, no matter what happens, he or she *will* receive a guaranteed revenue for the upland cotton he or she produces. During the lifetime of the FSRI Act of 2002, marketing loan and counter-cyclical subsidies accounted for an average of 40 percent of the market value of upland cotton.

74. The United States now claims that it is "not remarkable" that marketing loans and counter-cyclical payments have this revenue-stabilizing effect.[78] Yet, labelling these payments as "income support" and suggesting that this is a normal and expected effect of price-contingent subsidies disregards the critical role of these subsidies for U.S. upland cotton production. Indeed, the U.S. arguments boil down to the following: the planting decisions of the typical U.S. upland cotton farmer have no, or at most minimal connection, to the two price-contingent subsidies that provide revenue worth an average of 40 percent of the market revenue of the crop produced. That argument is totally inconsistent with, to quote the United States, "the way that the marketing loan and counter-cyclical payment programs *actually* operate and interact with production decisions."[79]

75. Contrary to the U.S. arguments, which attempt to minimize the revenue-stabilizing effect of these subsidies[80], Brazil's "expectation" arguments have always heavily relied on the fact that U.S. upland cotton farmers know, at the time of planting, that they will receive guaranteed and profit-

[77] Brazil's First Written Submission, Table 8 at para. 133.
[78] U.S. 2 April response to question 53(c), para. 94.
[79] U.S. 2 April response to question 51, para. 69.
[80] U.S. 2 April response to question 51, para. 71.

making revenue by virtue of the price-contingent subsidies, no matter how market prices develop in the months ahead. The Appellate Body recognized this when finding that "*although farmers had expected higher prices in making their planting decisions, they were also aware that if actual prices were ultimately lower, they would be 'insulated' by … marketing loan program payments [and]also counter-cyclical payments, which were based on a target upland cotton price of 72.4 cents per pound*."[81]

76. Brazil, of course, does not assert that marketing loan and counter-cyclical subsidies are the *only* consideration for U.S. upland cotton farmers. Certain other factors, such as the current record high corn prices, will influence the planting decisions of upland cotton farmers. This is because even the generous U.S. marketing loan and counter-cyclical subsidies for upland cotton are no match for the returns that a farmer can expect from growing corn in MY 2007.[82] Against this background, the remarkable fact is not, as the United States asserts[83], that U.S. upland cotton acreage for MY 2007 is down. The remarkable fact is that despite vastly most attractive corn prices, the significant majority of U.S. upland cotton acreage stays in the production of upland cotton.

77. The original panel and Appellate Body found that marketing loan and counter-cyclical subsidies *numb* U.S. farmer's reactions to market forces – not totally *deaden* them.[84] The considerable weight of the evidence shows that, over the life-time of the FSRI Act of 2002, for *many* farmers, these government subsidies made the difference between earning a long-term profit and having to leave the business of growing upland cotton.[85] This is the background to the planting decisions made by thousands of U.S. upland cotton farmers like Mr. Houston. The result of these guaranteed and price-contingent subsidies is a U.S. upland cotton supply that is much larger than it would otherwise be. This is what USDA economists[86] and the original panel found[87], what the Appellate Body affirmed[88], and what the evidence on record before this compliance Panel demonstrates.

78. In its response to the compliance Panel's narrow legal question, the United States also repeats a number of arguments, at paragraph 72, that Brazil previously responded to in detail. Brazil briefly recalls those responses and cross-references to its own argumentation refuting these points.

79. First, the United States claims that Brazil improperly focuses on actual prices and payments received by U.S. farmers at the time of harvest.[89] Of course, actual prices in an isolated marketing year cannot be relevant to planting decisions taken before their realization. However, the collective knowledge of historic actual prices – and large subsidies resulting therefrom – constitute highly relevant evidence showing that, year-in and year-out, U.S. upland cotton farmers know that their revenue will be supported no matter what happens to prices. A typical U.S. farmer planting upland cotton in the spring of 2006, knew that when prices collapsed in MY 2004 against expectations, he received price-contingent subsidies accounting for 60 percent of market revenue.[90] This experience is highly relevant to the farmer's planting decision in MY 2006. In any event, Brazil has also provided

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[81] Appellate Body Report, *U.S. – Upland Cotton*, para. 445.

[82] Brazil's Oral Statement, paras. 70-71.

[83] U.S. 2 April introduction to responses to questions, paras. 1-4.

[84] Panel Report, *U.S. – Upland Cotton*, para. 7.1294. Appellate Body Report, *U.S. – Upland Cotton*, para. 445.

[85] Brazil's Oral Statement, paras. 54-91.

[86] Panel Report, *U.S. – Upland Cotton*, para. 7.1295.

[87] Panel Report, *U.S. – Upland Cotton*, para. 8.1(g)(i).

[88] Appellate Body Report, *U.S. – Upland Cotton*, para. 763.

[89] U.S. 2 April response to question 51, para. 72, first bullet point.

[90] Brazil's First Written Submission, Table 6 at para. 111, as amended by updated marketing loan subsidy amounts (*see* Brazil's 16 March Comments on U.S. Answer to Question 4, para. 14) and an updated counter-cyclical subsidy amount in MY 2005 (*see* Brazil's Oral Statement, paras. 40, 107-119).

detailed evidence showing that the typical U.S. upland cotton farmer expected to receive marketing loan and counter-cyclical subsidies every year under the FSRI Act of 2002.[91]

80. Brazil also notes Professor Sumner's explanation that farmers' price expectations are fundamentally unobservable and that "it is impossible to know precisely what individual growers expect."[92] However, given past experience with the price volatility of upland cotton and the price-contingent U.S. subsidies at issue in this dispute, it is appropriate to assume that farmers learn from their experience. Thus, an examination of historical payments is important. The United States asserts that "farmers cannot rewind time."[93] But farmers certainly can – and no doubt do – learn from previous time periods. In trying to predict the future, farmers will rely on their past receipt of large marketing loan and counter-cyclical subsidies.

81. Moreover, Brazil demonstrated, relying on the Appellate Body's findings[94] and much other evidence[95], that farmers' expectations take account of their experience of past very high counter-cyclical and marketing loan subsidies, and the knowledge that, whatever happens to prices, their revenue will be protected by U.S. subsidies at profitable levels.[96] The United States has not and cannot explain how such subsidies today suddenly no longer affect planting decisions and how they no longer have significant supply-enhancing and world market price-suppressing effect.

82. Second, the United States claims that Brazil has ignored net revenue and other conditions regarding competing crops vis-à-vis upland cotton.[97] This is simply false. Among other evidence, Brazil demonstrated in figures 1-12 of its Oral Statement[98] and its Comments on the U.S. Oral Statements[99] that it was *upland cotton* marketing loan and counter-cyclical subsidies that allowed U.S. upland cotton farmers to expect higher profits from planting upland cotton than from switching to substitute crops, such as soybeans or corn.[100]

83. Third, the United States claims that Brazil has focused on total production, as opposed to plantings, and ignored other factors affecting production that are outside of a farmer's control.[101] That is also false. Brazil has recognized that factors such as weather and yields do impact total production and total exports.[102] Yet, Brazil has demonstrated that, in MY 2005, but for the two challenged subsidies, U.S. production and exports would actually have been 18 and 25 percent lower, respectively.[103] The subsidy-induced extra acreage benefits from good weather or increased yields and significantly contributes to higher U.S. production and higher U.S. exports.[104] Brazil also noted that the original panel conducted its analysis at a time when a significant percentage of U.S. upland

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[91] Brazil's First Written Submission, paras. 126-150; Brazil's Rebuttal Submission, paras. 101-113; 180-194, 209-231; and Brazil's Opening Statement, paras. 63-78.

[92] *See* Quantitative Simulation Analysis by Professor Daniel Sumner, Annex I to Brazil's Further Submission before the original panel, 9 September 2003, para. 18, available at http://www.mre.gov.br/portugues/ministerio/sitios_secretaria/cgc/analisequantitativa.pdf.

[93] U.S. 2 April response to question 51, para. 71.

[94] Appellate Body Report, *U.S. – Upland Cotton*, para. 445.

[95] *See, e.g.*, Brazil's Rebuttal Submission, Sections 7.7, 7.8, 7.9, 7.11, 7.12.

[96] Brazil notes that even using the futures price analysis for the December contract, U.S. upland cotton farmers expected to receive significant marketing loan and counter-cyclical payments in every year under the FSRI Act of 2002.

[97] U.S. 2 April response to question 51, para. 72, second bullet point.

[98] Brazil's Opening Statement, paras. 63-77

[99] Brazil's Comments on U.S. Oral Statements, paras. 13-34.

[100] *See* also Brazil's comments on the U.S. responses to questions 53 and 59, below.

[101] U.S. 2 April response to question 51, para 72, third and fourth bullet points.

[102] Brazil's Rebuttal Submission, paras. 201-202.

[103] "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Brazil's First Written Submission, Annex I, Table

[104] Brazil's Rebuttal Submission, paras. 226-231.

cotton was already grown from biotech varieties[105], and that also during the reference period assessed by the original panel yields had increased.[106]

84. Fourth, the United States claims that Brazil improperly focuses on total costs and not variable costs. In fact, Brazil's evidence addresses both types of costs. Brazil refers the compliance Panel to its comments on the U.S. response to question 59, below. Indeed, it is the United States that improperly downplays the crucial importance of covering total costs in light of the enormous long-term deficit of $12.4 billion in losses that U.S. upland cotton farmers would have accumulated over the past seven marketing years based only on market revenue.[107]

85. Fifth, the United States claims that Brazil fails to take into account demand from China in the world market for upland cotton.[108] Brazil acknowledged that China plays an important role in the discovery of the A-Index world market prices, primarily from the demand side.[109] But Brazil also emphasized that the United States – with a commanding 40 percent world market share of exports – plays a crucial role on the *supply* side of that price discovery process.[110] Indeed, Brazil demonstrated that while Chinese demand skyrocketed in MY 2004 and MY 2005, prices actually fell due, in significant part, to record high U.S. production and exports.[111] Thus, Brazil demonstrated that the impact of Chinese demand on the world market prices does not break the genuine and substantial relationship of cause and effect between the challenged subsidies and significant price suppression in the world market.

86. Finally, the United States' response to question 51 summarizes a number of arguments that it elaborates on in more detail in response to other questions. Brazil refers the compliance Panel to its comments on the U.S. response to question 53 with respect to additional planting decision and expectations related arguments[112], questions 56/57 with respect to studies on the effects of counter-cyclical payments[113], and question 59, with respect to the U.S. cost of production.[114] Brazil also notes that the United States again repeats its criticism of Professor Sumner's simulation model that it advanced in its First Written Submissions[115], but that the United States has not even attempted to rebut any of the arguments, explanations and rebuttals submitted by Brazil and Professor Sumner in their many submissions since.

52. In its Third Party Submission New Zealand observes:

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

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

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[105] Brazil's Comments on the U.S. Oral Statement, para. 31.

[106] *See* Exhibit Bra-562 (Cotton and Wool Situation Outlook and Yearbook, USDA, November 2006, Table 2, accessed November 2007 at http://usda.mannlib.cornell.edu/usda/current/CWS-yearbook/CWS-yearbook-11-21-2006.pdf.

[107] *See, e.g.*, Brazil's comments on the U.S. response to question 59, below.

[108] U.S. 2 April response to question 51, para. 72, fifth bullet point.

[109] Brazil's Rebuttal Submission, paras. 335-336.

[110] Brazil's Rebuttal Submission, paras. 324-345.

[111] Brazil's Rebuttal Submission, paras. 337-339.

[112] U.S. 2 April response to question 51, paras. 75-76.

[113] U.S. 2 April response to question 51, para. 77.

[114] U.S. 2 April response to question 51, para. 78.

[115] U.S. 2 April response to question 51, para. 73.

87. Brazil refers the compliance Panel to its own response to this question.

Questions to the United States

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

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

88. Brazil agrees with the United States that there is no legally relevant distinction between "actual" and "indirect" production effects recognized in Articles 5 and 6 of the *SCM Agreement*.[116] That should have been the extent of the U.S. answer. Unfortunately, the United States went on to provide an extensive and unresponsive recap of its *factual* arguments. Brazil briefly responds to these unresponsive assertions and cross-references to Brazil's earlier submissions where these arguments have been addressed.

89. Brazil's comments on the U.S. response to question 51 summarize a number of Brazil's arguments concerning "expectations" of farmers and how the marketing loan and counter-cyclical subsidies "numb" those farmers response to market forces.[117] In an attempt to counter this core finding by the original panel, the United States now argues that "it is unrealistic to suggest that there should be a one-to-one link between upland cotton planting, production, and export and upland cotton prices."[118] Yet, Brazil's claims never required such a "one-to-one" link and the original panel never based its findings on such a precise link. Nor does Brazil claim that U.S. producers are incapable of *any* response to market price signals.[119] Rather, Brazil's claim is that the updated evidence continues to demonstrate the correctness of the original panel's finding concerning the "*numbness*" of U.S. producers to market prices. That is, U.S. upland cotton producers do not react to market price signals and/or do not react to the extent that would be expected absent the price-contingent U.S. subsidies at issue in this dispute.

90. Brazil demonstrated that, as in the earlier MY 1999-2002 reference period, Brazilian and other non-subsidized low-cost producers continued during MY 2002-2006 to react to lower expected world market prices by lowering their acreage and decreasing production.[120] In fact, in every year between MY 2002-2006, total foreign harvested acreage moved in the same direction as futures

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[116] U.S. 2 April response to question 53(a), para. 83.

[117] These Comments respond to many of the expectation-related arguments in the U.S. 2 April response to question 53(a).

[118] U.S. 2 April response to question 53(a), para. 85.

[119] *See, e.g.*, Brazil's Rebuttal Submission, para 188 (Brazil agrees that there are some factors that may influence planting decisions for some upland cotton producers in addition to expected prices and expected subsidy revenue . . . However, these exogenous factors do not reduce the importance or U.S. upland cotton producers of the key economic factor based on what farmers decide to produce upland cotton: expected revenue from selling upland cotton as topped up by massive U.S. marketing loan and counter-cyclical payments.").

[120] Brazil's Rebuttal Submission, para 221-222 discussing Figure 8 – Futures Prices and Planted Acreage; *see also* U.S. Rebuttal Submission, Figure in para. 306 (showing that since 2002, foreign harvested acreage has increased when prices were predicted to be higher, and decreased when prices were predicted to be lower; by contrast, the U.S. harvested acreage did not show any correlation to price movements in MY 2003, MY 2005, and MY 2006).

prices.[121] By contrast, the planting decisions of subsidized, high-cost U.S. upland cotton producers, in general, did not correlate with changes in cotton market prices.[122] For example, between MY 2002-2006, U.S. harvested acreage moved in opposite directions to those expected based on price movements in three out of five years – MY 2003, MY 2005, and MY 2006. The United States attempts to explain this by claiming that, in MY 2003 and MY 2006, this is because "U.S. harvested acreage reacts more *conservatively* than foreign acreage to increasing futures prices …."[123] Yet, it is the *lack* of a correlation to prices that illustrates how U.S. producers are "numbed" from reacting to market forces.

91. More importantly, the degree and magnitude to which U.S. producers respond to market signals is also muted compared to their non-U.S. counterparts. In the past 5 years (MY 2002-2006), the change in U.S. harvested acreage from the previous year averaged 7 percent. Annual changes in Brazil, by contrast were 36 percent.[124] These facts constitute evidence sustaining Brazil's point and that of Mr. Houston[125] – that expected upland cotton market prices do not play an important role in the planting decisions of many U.S. upland cotton farmers.[126]

92. The United States repeats several times the unsupported assertion that "[s]ince the [FSRI Act of 2002] came into effect, U.S. export behavior has been entirely consistent with that of foreign counterparts."[127] This is incorrect. A recent USDA analysis of the cotton market found that "[o]n the export side of the world trade equation, *the United States has accounted for the lion's share of global gains*, with 11 million bales of increased exports since 1999/2000."[128] Brazil recalls that record U.S. export volumes were achieved in MY 2001, 2002, 2003, 2004 and 2005. The 40 percent U.S. share of world exports is more than three times higher than the share of Uzbekistan, the second largest exporter.[129]

93. The dramatic 55 percent increase in absolute U.S. export volumes between MY 2002 and 2005[130] inevitably came at the expense of producers in non-subsidizing countries. Australia's average export market share of 12 percent between MY 1999-2001 was cut in half to 6 percent by

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[121] U.S. Rebuttal Submission, Figure in para. 306 (showing that since 2002, foreign harvested acreage has increased when prices were predicted to be higher, and decreased when prices were predicted to be lower; by contrast, the U.S. harvested acreage did not show any correlation to price movements in MY 2003, MY 2005, and MY 2006).

[122] Brazil's Rebuttal Submission, para. 224 discussing Figure 9 – Changes in Acreage and Percentage Changes in Futures Prices; Brazil's First Written Submission, paras 141-143 discussing Figure 9 – Futures Prices and Planted Acreage; Brazil's Oral Statement, para. 61-62.

[123] U.S. 2 April response to question, para. 89.

[124] Exhibit Bra-629 (Brazilian Harvested Acreage, Producer, Supply & Distribution Database, FAS, USDA, accessed February 2007 at http://www.fas.usda.gov/psdonline/psdquery.aspx). *See also* Exhibit Bra-570 (Producer, Supply & Distribution Database, FAS, USDA, accessed January 2007 at http://www.fas.usda.gov/psdonline/psdquery.aspx).

[125] Citations by Stephen Houston Sr., a cotton farmer from Georgia, can be found in Exhibit Bra-563 ("Cotton bailout: How your tax dollars prop up big growers and squeeze the little guy," Atlanta Journal-Constitution, 1 October 2006, p. 2, accessed December 2006 at http://www.ajc.com/search/content/metro/stories/cotton1.html).

[126] *See* also Professor Sumner's analysis regarding the magnitude of the reaction of U.S. upland cotton producers to an elimination of marketing loan and counter-cyclical subsidies, Brazil's First Written Submission, Annex I.

[127] U.S. 2 April response to question 53, paras. 88 and 90 ("the data show … that U.S. production and exports shift consistently with production and exports elsewhere in the world.").

[128] *See* "Cotton Backgrounder," USDA, March 2007, accessed April 2007 at http://www.ers.usda.gov/Publications/CWS/2007/03Mar/CWS07B01/).

[129] Producer, Supply and Distribution Database, Foreign Agriculture Service, USDA, accessed April 2007 at http://www.fas.usda.gov/psdonline/psdQuery.aspx.

[130] Exhibit Bra-447 (Upland Cotton Supply and Use).

MY 2005.[131] Similarly, West and Central Africa's share of the world market declined to a ten-year low in MY 2005. The UN Food and Agricultural Organization recently summed up what has been occurring:

> Subsidies maintain cotton production at otherwise unprofitable levels in industrialized countries, reducing the opportunities for developing countries to export to subsidizing country markets and displacing their exports to third countries.[132]

94. Of course, exports of upland cotton are the consequence of planting decisions and other factors, including subsidies, yields, domestic demand, etc. The relevant question is, therefore, what would U.S. exports be but for marketing loan and counter-cyclical subsidies. As discussed above, U.S. upland cotton planting are higher than they would be but for the U.S. subsidies at issue. Brazil has demonstrated that *but for* the two U.S. subsidies at issue, U.S. exports would have been 25 percent lower in MY 2005.[133]

95. But even accepting, *arguendo*, the U.S. argument that U.S. and foreign exports *did* react in roughly the same manner as non-subsidized foreign exports, the United States ignores the reason *why* this may have occurred. Many of these non-subsidized foreign producers have far lower costs of production than U.S. producers.[134] Brazil recalls ICAC's finding that it costs U.S. upland cotton producers $0.67 to grow a pound of upland cotton, while it costs producers in West and Central Africa $0.45 and producers in Brazil just $0.38.[135] Such lower costs are essential to the survival of Brazilian and African producers, because they do not have the benefit of 40 percent *ad valorem* subsidies for the same basic commodity product as U.S. producers. These lower costs allow them to withstand certain levels of lower prices and still cover their total costs. U.S. producers are only able to compete with foreign producers in MY 2005 because marketing loan and counter-cyclical subsidies allowed them to sustain high levels of planted acreage. Brazil has demonstrated that *but for* these two subsidies, U.S. producers would have reacted to lower expected prices in MY 2005 (combined with higher costs) by reducing acreage, reducing production, and reducing exports.[136] And with lower U.S. exports available to meet world demand, world market prices would be higher.

96. Finally, against this backdrop, the United States claims that the elimination of Step 2 payments caused a major shift in U.S. exports.[137] While complete data for MY 2006 is, of course, not available, USDA projects that U.S. exports in MY 2006 will be at their second highest level in history. USDA further projects that the U.S. world market share of exports will be 36 percent in MY 2006. While this does constitute a decline in the U.S. world market share of exports, the United States still holds a commanding market share. As Brazil explained at the Panel meeting, the decline in the U.S. share of world exports in MY 2006 is largely due to the rise of Indian exports to China and the surge of U.S. exports just prior to the termination of the Step 2 program at the end of MY 2005.[138] Further, with over 9 million bales of U.S. upland cotton sitting in U.S. warehouses, USDA and FAPRI project that the United States will increase its exports in MY 2007. In fact, FAPRI's 2007 baseline

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[131] Producer, Supply and Distribution Database, Foreign Agriculture Service, USDA, accessed April 2007 at http://www.fas.usda.gov/psdonline/psdQuery.aspx.

[132] Exhibit Bra-579 ("Cotton: Impact of Support Policies on Developing Countries – Why Do the Numbers Vary?" FAO Trade Policy Brief, p. 1, accessed December 2006 at ftp://ftp.fao.org/docrep/fao/007/y5533e/y5533e00.pdf).

[133] "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Brazil's First Written Submission, Annex I, Tables 2.A.1-2.A.3.

[134] *See* Brazil's First Written Submission, para. 162. *See also* Exhibit Bra-480 (Survey of the Cost of Production of Raw Cotton, ICAC, November 2004, p. 13).

[135] *See* Brazil's First Written Submission, para. 162. *See also* Exhibit Bra-480 (Survey of the Cost of Production of Raw Cotton, ICAC, November 2004, p. 13).

[136] *See* Brazil's First Written Submission, paras. 167-180.

[137] U.S. 16 March comments on Brazil's answer to question 28(a), para. 121.

[138] *See* Brazil's Closing Statement, para. 11.

projects the U.S. share of the world export market to rise to 43 percent in MY 2007 and remain above 40 percent through MY 2011.[139]

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

97. The United States asserts that the "mere" fact that income support programs support the income of agricultural producers "does not, however, mean that the payments have 'major' effects on planting or cause any of the adverse effects listed in Articles 5 and 6 of the *SCM Agreement*."[140] Brazil agrees that different forms of income support may have different effects on production and that Articles 5 and 6 do not contain a presumption of adverse effects from income support. As the complaining Member, Brazil must demonstrate that the particular price-contingent subsidies at issue in this dispute cause serious prejudice to its interests. Contrary to the U.S. assertion, all of the evidence submitted by Brazil in this proceeding is sufficient to more than discharge this burden.

98. In commenting on the U.S. response, Brazil recalls its 2 April response to question 69, its comments on the U.S. response to questions 51 and 53(a), above, and 53(c), below, and the many arguments and evidence provided in its earlier submissions.

99. Brazil does not consider it "mere" or unimportant facts that, during the lifetime of the FSRI Act of 2002, marketing loan and counter-cyclical subsidies represented an *average* 40 percent *ad valorem* subsidization rate, covered an average 29 percent of total costs of production[141], and were received by 96 percent of U.S. upland cotton producers holding upland cotton base acres.[142] Nor is it "mere" fact that, *but for* these subsidies, U.S. production would be 15 to 16 percent lower[143] and U.S. exports 21 to 22 percent lower.[144] Nor is it "mere" fact that the original panel found that the subsidy payments are mandatory, *i.e.*, they must be made by the U.S. Secretary of Agriculture without exceptions, and that they are contingent upon world and U.S. prices, *i.e.*, they function to guarantee U.S. producers revenue regardless of how low prices fall. As both the Appellate Body and the original panel found[145], the knowledge of U.S. upland cotton producers that these subsidies will be received at times of low prices is an important factor affecting their planting decisions and, consequently, affecting U.S. supply of upland cotton to the world market.

100. While it is possible that some forms and low levels of income support may not cause serious prejudice under particular conditions of competition, this is certainly not the case with respect to the two subsidies at issue: U.S. marketing loan and counter-cyclical subsidies for upland cotton. These particular mandatory, price-contingent subsidies cause serious prejudice in view of their nature and

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[139] *See* "World Cotton," 2007 FAPRI Baseline, accessed April 2007 at http://www.fapri.iastate.edu/brfbk07/CottonTables2007.xls.

[140] U.S. 2 April response to question 53, para. 92.

[141] Exhibit Bra-477 (Upland Cotton Costs and Returns).

[142] Brazil's Rebuttal Submission, Table 3 at para. 157. Results are from U.S. First Written Submission, table at para. 224.

[143] Average effects from MY 2002-2005, *see* "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Brazil's First Written Submission, Annex I, Tables 2.A.1-2.A.3.

[144] Average effects from MY 2002-2005, *see* "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Brazil's First Written Submission, Annex I, Tables 2.A.1-2.A.3.

[145] Appellate Body Report, *U.S.–Upland Cotton*¸ para. 445; Panel Report, *U.S. – Upland Cotton*, paras. 7.1290-7.1303.

magnitude, and in view of the product they support and the particular conditions of competition in which that product is traded in international markets.[146]

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

> "...we have demonstrated that these subsidies stabilized cotton producers' revenue despite wildly fluctuating market prices, thereby insulating and numbing acreage response to market price signals. These subsidies also cover the huge long-term gaps between market returns and total costs of production. Both effects are closely interrelated." (para.55)
>
> *Is the United States only arguing that Brazil has not empirically substantiated that these two "effects" have actually occurred or is it also the position of the United States that these effects are in any event legally irrelevant to an analysis of whether a subsidy causes significant price suppression within the meaning of Article 6.3 (c) of the SCM Agreement?*

101. The passage cited by the compliance Panel ties together two important themes in Brazil's causation arguments and two important effects of the U.S. marketing loan and counter-cyclical subsidies. The planting decisions analysis presented in the paragraphs that follow this portion of Brazil's Oral Statement shows how marketing loan and counter-cyclical subsidies (i) numb farmers' planting decisions and (ii) cover their total costs of production, resulting in higher levels of planting and supply than would exist but for the subsidies.

102. In its response, the United States accepts that marketing loan and counter-cyclical subsidies stabilize upland cotton producers' revenue, *i.e.*, constitute price-contingent subsidies, but submits that Brazil's demonstration to that effect is not "remarkable".[147] Yet, the conciseness of this fact and the simplicity of its demonstration does not make it any less important. It is crucial that every U.S. producer growing upland cotton on upland cotton base knows that he or she will receive a profitable return regardless of market prices at the time of harvest. This knowledge is *the* key aspect of revenue "expectations" at the time of planting.[148]

103. While the United States presents a number of arguments concerning the alleged absence of any effects on production of marketing loan subsidies (responses to which are largely set out in Brazil's comments to U.S. response to question 51), the United States fails to demonstrate *any* fundamental change in the conditions of competition in the U.S. or world upland cotton market between the reference year of MY 2002 and the reference year of MY 2005 (or MY 2006). The *same* basic facts continue to exist. Therefore, and because the U.S. arguments raised are without merit, there is no basis for the compliance Panel to deviate from the findings of the original panel, as upheld by the Appellate Body. The FSRI Act of 2002 mandates the payment of marketing loan subsidies for every pound of upland cotton grown in the United States, *without limitation*, if the adjusted world price falls below $0.52 per pound.[149] Farmers know that the more upland cotton they produce, the more they will receive in marketing loan subsidies. Perversely, the operation of this subsidy means that when U.S. supply surges and world prices fall as a result, *more* marketing loan subsidies are made, perpetuating the cycle of high levels of production.[150] In view of this fact, there is little wonder that the original panel found that "[w]e have *no doubt* that the payments stimulate production and

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[146] *See*, *e.g.*, Brazil's 2 April response to question 69.

[147] U.S. 2 April response to question 53(c), paras. 94-95 citing Brazil's Oral Statement, para. 55.

[148] Brazil's comments on the U.S. response to question 51, above, address the arguments in paragraphs 95-96 in the Answer to Question 53(c).

[149] For more details on the functioning of the marketing loan program, *see* Section 7.3.1 of Brazil's First Written Submission or *see* 7 U.S.C. §7931(a) in Exhibit Bra-442 (7 U.S.C. §§ 7901-7939, Legal Information Institute, Cornell Law School, accessed July 2006 at http://www.law.cornell.edu/uscode/).

[150] Panel Report, *U.S. – Upland Cotton*, paras. 7.1294-7.1295.

exports and result in lower world market prices than would prevail in their absence."[151] Moreover, the original panel found that "the text of the measure indicates that the payments are mandatory, where certain market conditions prevail."[152] Brazil notes that marketing loan subsidies in MY 2005 were 41 percent larger than in MY 2002.[153]

104. The United States repeats its argument that the actual payment of marketing loan and counter-cyclical subsidies is irrelevant and that only expectations matter.[154] As Brazil has repeatedly demonstrated[155], actual payments of these subsidies provide U.S. producers with payments worth 40 percent of the market value of a highly price-sensitive commodity.[156] The experience of U.S. upland cotton farmers, who received very large subsidies over the years due to actual prices below the trigger prices, is a crucial fact that forms part of the background against which U.S. farmers' build their expectations about future revenue from the market and the subsidy programs.[157] This remains unchanged from the facts before and the findings of the original panel and the Appellate Body.[158] The U.S. expectation analysis narrowly and incorrectly assumes that farmers expect to receive subsidies only on the basis of a firmly expected price and disregard the possibility (i) that actual prices might deviate from this projection and (ii) that U.S. price-contingent subsidies provide a revenue guarantee against such changes in volatile upland cotton prices.[159]

105. With respect to the U.S. arguments regarding the absence of effects from counter-cyclical subsidies[160], Brazil refers the compliance Panel to its rebuttal of similar arguments made in response to questions 56/57 below.

106. Next, the United States raises several new arguments (or new variations on older arguments) and presents new evidence in its response to question 53(c). In particular, it argues that "in every single marketing year since the FSRI Act came into effect, it would have been economically rational for upland cotton farmers to plant upland cotton rather than allowing their land to sit idle because the farmers expected that, even without any payment from the government, market revenue for upland cotton was more than sufficient to cover variable costs."[161]

107. This assertion is fundamentally flawed for a number of reasons. First, Brazil has never suggested that all or even most upland cotton acreage would be left idle without marketing loan and counter-cyclical subsidies. The counter-factual before this compliance Panel concerns the question whether, in the absence of marketing loan and counter-cyclical subsidies, upland cotton acreage would decline. Whether that land would be left idle or would be switched to the production of alternative crops that continue to benefit from U.S. subsidies, such as corn, soybeans, wheat, and rice, is not relevant for this assessment.

108. Further, contrary to the U.S. assertion, it is not economically rational to plant upland cotton year after year unless producers are able to cover their *total* costs, not merely *variable* costs. The

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[151] Panel Report, *U.S. – Upland Cotton*, para. 7.1291.

[152] Panel Report, *U.S. – Upland Cotton*, para. 7.1291.

[153] Brazil's First Written Submission, Table 6 at para. 111, as amended by updated marketing loan subsidy amounts (*see* Brazil's 16 March Comments on U.S. Answer to Question 4, para. 14) and an updated counter-cyclical subsidy amount in MY 2005 (*see* Brazil's Oral Statement, para. 40). *See also* Brazil's 2 April Answer to question 69, para. 99.

[154] *See* also Brazil's comment on the U.S. response to question 51, above.

[155] *See* also Brazil's comment on the U.S. response to question 51, above.

[156] Brazil's First Written Submission, paras. 111-113 and Table 6.

[157] *See* Brazil's comment on the U.S. response to question 51, above.

[158] Appellate Body Report, *U.S. – Upland Cotton*, para. 445; Panel Report, *U.S. – Upland Cotton*, paras. 7.1290-7.1303.

[159] *See* Brazil's comment on the U.S. response to question 51, above.

[160] U.S. 2 April response to question 53, para. 97.

[161] U.S. 2 April response to question 53, para. 98.

original panel recognized this fact when it found that "[w]e believe that the existence of this gap between upland 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."[162] Brazil refers the compliance Panel to its 2 April response to question 71 for a discussion of why total costs, in addition to variable costs, are highly relevant to planting decisions.[163]

109. Moreover, a significant portion of upland cotton farmers are *not* able to cover their *variable* production costs with market revenue alone, nor do many upland cotton farmers expect to be able to do so at the time of planting.[164] The portion of upland cotton farmers that are not able to cover their variable costs of production depend on which costs are considered variable.[165] As explained in Brazil's Oral Statement, whether or not a cost is variable depends on the time period being considered.[166]

110. However, in addition to the time period under consideration, the categorization of cost items depends on the nature of the counterfactual examination. In this dispute, the compliance Panel is tasked to examine the effect of permanently removing a major source of upland cotton producers' income.[167] This question is fundamentally different from examining the effects of annual fluctuations in market price levels. The counterfactual involving a permanent removal of the subsidies calls for the inclusion of costs in a planting decisions analysis that might not always be included when assessing planting decisions based solely on limited annual price fluctuations. For instance, if a drop in prices is expected to be isolated (*i.e.*, only lasting a single year), a farmer would be more willing to continue producing even if he or she is unable to cover fully the opportunity cost of labor and land and special machineries. However, if the farmer knows that, due to the termination of a government program, a source of revenue representing an average 40 percent *ad valorem* subsidization rate will permanently be lost, no rational farmer would continue planting upland cotton unless he or she can cover operating, land and labor costs. Instead, the farmer would shift production to other crops or potentially lease his or her land to other farm operators. In other words, a producer's supply response would be greater if the reduction in subsidies was fully anticipated and permanent.[168]

111. Next, the United States claims that "in each of the years under FSRI Act, shifts in U.S. planted acreage were consistent with what one would expect if there were no marketing loan payments or counter-cyclical payments and U.S. farmers were basing their planting decisions solely on market prices signals and other considerations relevant to planting and production."[169] This assertion is based on a flawed U.S. analysis of upland cotton planting decisions. The new U.S. analysis appears to have been engineered to make upland cotton appear more attractive relative to corn and soybeans than it actually was.[170]

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[162] Panel Report, *U.S. – Upland Cotton*, para. 7.1354.

[163] *See* also Brazil's comments on the U.S. response to question 59, below.

[164] Brazil's Rebuttal Submission, paras. 254-283.

[165] The United States does not consider unpaid labor, land or capital recovery costs to be variable, *see* U.S. Rebuttal Submission, paras. 324-332. Brazil considers these costs to be fully, or in part, variable, *see* Brazil's Rebuttal Submission, para. 254-283.

[166] Brazil's Oral Statement, paras. 87-88

[167] *See* Brazil's 2 April response to question 73; Brazil's First Written Submission, Annex I.

[168] *See* Brazil's Rebuttal Submission, Annex I, para. 11. Brazil also notes that it addresses the other U.S. cost of production related arguments in its comments on the U.S. response to question 59, below.

[169] U.S. 2 April response to question 53(c), para. 99.

[170] Brazil notes that it is impossible to verify much of the new information presented by the United States. Exhibit U.S.-139, which contains the U.S. analysis, was not provided electronically and much of the information does not appear to be publicly available. Brazil's analysis, by contrast, was based on publicly available information and provided to the Panel and the United States in electronic format.

112. The first major flaw in the United States analysis is the manner in which the United States calculates expected market prices (*i.e.*, the farm price). It derives that price by applying a "basis" (or discount) to the January-March average closing price of the harvest period *futures* contract. For example, the United States discounts the futures price for soybeans and corn by $0.14 and futures prices for upland cotton by $0.05 a pound.[171] The United States cites a USDA website in support of its "basis" for corn, soybeans and upland cotton.[172] However, the website applies only to soybeans, corn and wheat, but not upland cotton.[173] Thus, the United States provides no explanation or any data to justify why its basis of $0.05 per pound is appropriate.

113. While trumpeting FAPRI's analysis in its repeated critique of Professor Sumner's model, the United States rejects Brazil's use of projected prices published in FAPRI's baseline projections. However, the United States does not explain why FAPRI's projected prices should not be used. Nor does the United States explain why the compliance Panel should find that prices calculated by the United States for purposes of this litigation – and not supported by the source cited by the United States – should be adopted by the compliance Panel as superior to FAPRI's published price projections. (Brazil notes that USDA is prohibited by U.S. law from publishing its own price projections for upland cotton.)

114. As noted, Brazil's alternative crop expectations exercise relies on prices projected by FAPRI and published in its baseline during the planting period.[174] The differences between these FAPRI-projected prices and the prices constructed by the United States are very significant for most marketing years, and especially for those crucial to the compliance Panel's assessment. The table below shows the expected prices for upland cotton under the two approaches:

Table 2 – Expected Upland Cotton Prices[175]

	2002	**2003**	**2004**	**2005**	**2006**	**2007**
New U.S. Expected Prices	0.38	0.54	0.62	0.48	0.54	0.54
FAPRI Expected Prices	0.39	0.47	0.57	0.44	0.48	0.53

115. The bias of the new U.S. analysis becomes apparent when applying these two sets of prices. When the FAPRI-projected prices are inputted into the U.S. planting decisions analysis, upland cotton is no longer the most attractive crop to plant in any year other than MY 2004.[176] In other words, correcting solely for this single flaw in the U.S. analysis leads to the collapse of the U.S. assertion that "shifts in U.S. planted acreage were consistent with what one would expect."[177] Given the absence of *any* evidence supporting the U.S. "basis" for upland cotton of $0.05 per pound, there is no basis for the compliance Panel to accept its use.

116. Another significant flaw in the U.S. planting decisions analysis concerns the manner in which the United States derives expected yields. The first error in the U.S. yield analysis is that the

[171] U.S. Comments on Brazil's Oral Presentation, Annex I, Section 1 "Expected Market Prices."

[172] U.S. Comments on Brazil's Oral Presentation, Annex I, Section 1 "Expected Market Prices."

[173] *See* http://www.ers.usda.gov/Data/PriceForecast/, accessed April 2007.

[174] Brazil used CBO's projection of MY 2007 prices because the corresponding FAPRI projection was not yet available. *See* Exhibit Bra-634 (Analysis of Planting Decisions Based on Expected Returns).

[175] *See* expected prices for upland cotton in Exhibit Bra-634 (Analysis of Planting Decisions Based on Expected Returns) and Exhibit US-139 (Data Supporting Expected Market Returns Above Variable Costs Chart)

[176] Compare expected net outlays in Exhibit US-139 (Data Supporting Expected Market Returns Above Variable Costs Chart, p. 1).

[177] U.S. 2 April response to question 53(c), para. 99.

United States erroneously overstates expected yields by relying on yields per *harvested* acres[178], whereas the planting decision analysis should be based on expected yields by *planted* acre.[179] Correcting this error would reduce expected yields (and expected market returns) by an average 12 percent each year.[180]

117. The United States also improperly constructs yield projections based on a linear regression analysis of actual yields per harvested acre for MY 1995-2006.[181] In other words, the United States derives projected yields for, *e.g.*, MY 2003 taking into account information of actual yields in MY 2004-2005 and assuming that farmers fully anticipated the record high yields achieved in the MY 2004 and MY 2005.[182] An examination of the annual USDA baselines released prior to the planting periods from MY 2002 through MY 2007 confirms that USDA did not project yields to increase to the extent that they did. Much less could U.S. upland cotton producers have made that projection.

Table 3 – USDA Yield Projections[183]

	2002	2003	2004	2005	2006	2007
	Yield per planted acre					
2002 USDA Baseline Projection	**572**	577	578	579	579	581
2003 USDA Baseline Projection		**574**	579	581	581	582
2004 USDA Baseline Projection			**587**	589	590	591
2005 USDA Baseline Projection				**612**	612	616
2006 USDA Baseline Projection					**699**	706
2007 USDA Baseline Projection						**725**
Actual Yield	**579**	**643**	**806**	**799**	**668**	**NA**
Percent greater than USDA projection	1%	12%	37%	31%	-4%	NA
Yield used by U.S. in their analysis	**723**	**745**	**766**	**788**	**809**	**831**
Percent greater than USDA projection	26%	30%	31%	29%	16%	15%

118. Table 3 shows that USDA *projections* of upland cotton yields in the upcoming marketing year were significantly less than *actual* yields achieved every year. Of course, it is impossible for farmers

[178] *See* US-139 (Data Supporting Expected Market Returns Above Variable Costs Chart, p. 20). For convenience, Brazil's replicates and provides citations to the United States yield calculations in Exhibit Bra-688 (Expected Upland Cotton Yields).

[179] USDA cost of production of data clearly specifies that yields are in terms of planted acres, not harvested acres. *See*, e.g. Exhibit Bra-475 (U.S. Cotton Producers Costs and Returns Per Planted Acre, Excluding Government Payments, Economic Research Service, USDA, accessed October 2006 at http://www.ers.usda.gov/data/costsandreturns/testpick.htm).

[180] The United States provided very little documentation as to how it constructed its "linear trend equation" of expected yields in US-139 (*see* U.S. Comments on Brazil's Oral Statement, Annex I). Brazil has reconstructed the U.S. calculation for the panel's convenience, using both yields per harvested acre and yields per planted acre in Exhibit Bra-688 (Expected Upland Cotton Yields).

[181] *See* US-139 (Data Supporting Expected Market Returns Above Variable Costs Chart, p. 20). For convenience, Brazil's replicates and provides citations to the United States yield calculations in Exhibit Bra-688 (Expected Upland Cotton Yields).

[182] By contrast, Brazil used a three year rolling average of yields per planted acre actually achieved on farms in USDA's cost survey. *See* Exhibit Bra-634 (Analysis of Planting Decisions Based on Expected Returns).

[183] USDA baseline projections are from Exhibit Bra-635 (2002-2007 USDA Agricultural Baseline Projections). Actual yields are from Exhibit Bra-562 (Cotton and Wool Situation Outlook and Yearbook, USDA, November 2006, Table 2, available at http://usda.mannlib.cornell.edu/usda/current/CWS-yearbook/CWS-yearbook-11-21-2006.pdf). Yields used by the U.S. in their planting decisions analysis is from Exhibit US-139.

to predict both the weather and their yields. And it is unreasonable for the United States to now suppose that U.S. farmers, but not USDA, anticipated the dramatic increases in yield in MY 2004 and MY 2005. Table 3 also shows that the yields used by the United States in their planting decisions analysis significantly overstated the expectations of upland cotton farmers. The yields used by the United States in its analysis are, on average, 24 percent greater than USDA baseline projections. Correcting this flaw in the U.S. analysis, once again, invalidates the U.S. conclusions that "shifts in U.S. planted acreage were consistent with what one would expect."[184]

119. In sum, the new U.S. planting decision analysis is based on unsupported assertions that result in a biased and result-orientated conclusion to attempt to argue that mandatory and price-contingent subsidies constituting 40 percent of the market value of a basic commodity product have no effect on production. This analysis should be rejected by the compliance Panel.

120. As Brazil demonstrated in its own analysis, a proper assessment of U.S. upland cotton producers' plantings decisions demonstrates that, but for marketing loan and counter-cyclical subsidies, it would have been economically rational for them to switch to the production of alternative crops nearly every year.[185]

121. Finally, even assuming, *arguendo*, that the flawed U.S. analysis demonstrates that upland cotton farmers planting decisions move generally in the <u>same direction</u> as might be expected from market signals, the U.S. analysis fails to refute the original panel's basic finding that these subsidies "numb" U.S. producers reactions. The United States analysis does *not* demonstrate that the <u>extent</u> to which U.S. producers have changed upland cotton plantings is consistent with the extent to which U.S. upland cotton producers would have changed their plantings *but for* the subsidies.

122. The original panel found, and Brazil demonstrates with updated evidence, that upland cotton producers are numbed from market signals, not completely deadened. The elimination of subsidies that account for an average of 40 percent of the market value of upland cotton and cover an average of 29 percent of total costs over the life-time of the FSRI Act of 2002 would cause a significant shift of acreage to alternative uses now providing higher net returns. Brazil again recalls that the issue before the compliance Panel is not whether the general *direction* of U.S. planted acreage correlates with expected revenue from upland cotton and other crops. The issue before the compliance Panel is whether U.S. upland cotton acreage would be lower and world market price higher but for marketing loan and counter-cyclical subsidies. One relevant piece of evidence of the effects of these subsidies is the fact that their revenue-stabilizing effect numbs U.S. upland cotton producers' reactions to market price signals.

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

123. In its response, the United States asks the compliance Panel to revisit the original panel's findings regarding marketing loan and counter-cyclical subsidies. These adopted findings should be followed by the compliance Panel. Prior adopted panel and Appellate Body reports create "legitimate expectations" among WTO Members, and should be taken into account by panels when they are relevant to the resolution of a dispute.[186]

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[184] U.S. 2 April response to question 53(c), para. 99.

[185] *See* Brazil's Oral Statement, paras. 63-78 and Brazil's Comments on the U.S Oral Statements, paras. 13-27. As Brazil explained in its Comments on the U.S. Oral Statements, using total costs or variable costs does not change the relative attractiveness of producing upland cotton versus corn or soybeans.

[186] Appellate Body Report, *U.S. – Softwood Lumber V*, para. 111.

124. This is particularly the case where particular issues and questions of fact before a panel are the same as those previously examined by the Appellate Body. In such a situation, it is "not only appropriate," but to "be expected," that the panel would follow the Appellate Body's earlier conclusions.[187] With respect to compliance proceedings, in particular, the Appellate Body has stated that "Article 21.5 proceedings do not occur in isolation but are part of a '*continuum of events*.'"[188] The Appellate Body observed that "doubts could arise about the *objective nature* of an Article 21.5 panel's assessment if, on a specific issue, that panel were to *deviate* from the reasoning in the original panel report in the absence of any change in the underlying evidence."[189] The compliance panel in *U.S. – Gambling (21.5)* noted that "[a] re-assessment in a compliance proceeding of an issue that had already been ruled upon in an original proceeding in an adopted report, even with better arguments by the respondent but without a change relevant to the underlying facts in the intervening period, would run counter to the prompt settlement of disputes."[190] The United States is not entitled to re-litigate an issue that has been definitively resolved for purposes of this dispute.

125. As a factual matter, Brazil recalls that the evidence regarding the nature of marketing loan and counter-cyclical payments remains unchanged, that their magnitude in MY 2005 is even larger than the magnitude assessed by the original panel for MY 2002 and that the conditions of competition in the world market for upland cotton have not changed in any fundamental way since the original panel's assessment. Therefore, there is no basis of the United States to argue that the compliance Panel should disregard and/or overturn the findings of the original panel, as upheld by the Appellate Body. Brazil addresses the specific U.S. arguments raised in response to this question in the context of its comments on other U.S. responses. Specifically:

- With respect to the U.S. arguments concerning the production effects of marketing loan subsidies[191], Brazil refers to the compliance Panel to its comments on the U.S. response to question 53, above.

- With respect to the issue of production effects from counter-cyclical payments supporting the production of upland cotton, Brazil refers the compliance Panel to its comments on the U.S. response to questions 53, above, and 56/57, below.[192]

- With respect to the cost of production related issues raised by the United States in response to this question[193], Brazil refers the compliance Panel to its comments on the U.S. response to question 59, below.

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

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

a) Is it not more accurate to characterize the Lin and Dismukes study as a simulation of the possible effect of countercyclical payments on production rather than a study on

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[187] Appellate Body Report, *U.S. – OCTG Sunset Reviews*, para. 188.

[188] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 103 (emphasis added) citing Appellate Body Report, *Mexico – Corn Syrup (21.5)*, para. 121. *See* Brazil's First Written Submission, para. 28.

[189] Appellate Body Report, *U.S. – Softwood Lumber VI (21.5)*, para. 103 (emphasis added).

[190] Panel Report, *United States – Gambling (Article 21.5)*, para. 6.53.

[191] U.S. 2 April response to question 54, paras. 108-110.

[192] U.S. 2 April response to question 54, paras. 111-115.

[193] U.S. 2 April response to question 54, paras. 117-120.

the actual impact of the payments since it does not statistically estimate the effect of the actual payments (which began only in 2002) on crop production? (Please refer to pages 9-12 of the paper which describe the data, covering the period 1991-2001, used for the study).

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

126. Brazil provides below consolidated comments on the U.S. responses to questions 56 and 57.

127. The United States argues that since the original proceeding there "have been a number of studies conducted regarding the effects of the [counter-cyclical] program."[194] This statement is not correct with respect to counter-cyclical payments for upland cotton. No empirical study has specifically examined the effect of counter-cyclical payments on upland cotton production and the United States has cited one empirical study on the effect of counter-cyclical payments generally.[195] As noted by the compliance Panel in question 57(a), this study, by Lin and Dismukes, is a simulation of the possible effect of counter-cyclical payments on production, rather than a study on the actual impact of the subsidies. The dearth of studies, as implied by the compliance Panel's question, is due to the fact that the program is relatively new. However, the absence of specific studies does not constitute a basis for the United States to argue that Brazil has not met its burden of demonstrating that there remains a the strong positive link, found by the original panel, between counter-cyclical payments and the production of U.S. upland cotton.

128. The original panel found that counter-cyclical contributed to serious prejudice based on an examination of the structure, design and operation of the program.[196] As Brazil explained, the few studies that have been conducted since then support the finding that counter-cyclical subsidies contribute to serious prejudice.[197]

129. As explained by Professor Sumner, there are at least five major mechanisms through which counter-cyclical payments have the potential to affect production.[198] The study by Lin and Dismukes examined only two of these mechanisms.[199] Beyond that, the study solely examined counter-cyclical subsidies for corn, wheat and soybeans in the Midwest. In its 2 April response to questions 64 and 65, Brazil provided a number of reasons why counter-cyclical subsidies for upland cotton would be expected to have significantly greater effects on production that counter-cyclical subsidies for these field crops in the Midwest. [200] For convenience, Brazil lists these factors in the following chart, comparing counter-cyclical subsidies for upland cotton to counter-cyclical subsidies for the commonly studied field crops in the Midwest.

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[194] U.S. 2 April response to question 56, para. 123.

[195] Brazil also cited one study by McIntosh, Shrogren and Dohlman on the effect of counter-cyclical payments that found significant production impacts from counter-cyclical subsidies. *See* Brazil's 2 April response to question 64.

[196] Panel Report, *U.S. – Upland Cotton*, paras. 7.1301-7.1302.

[197] Brazil's First Written Submission, paras. 167-185; Brazil's Rebuttal Submission, paras. 69-70, 119-123 or Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments), paras 42-47.

[198] These include reducing risk associated with price variability, increasing investment through wealth effects, reducing risk aversion through wealth effects, constraining production choices because of planting restrictions, and increasing incentives to plant because of base acre updating. *See* "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Brazil's First Written Submission, Annex I, paras. 59-64.

[199] These include reducing risk associated with price variability and reducing risk through wealth effects. *See* Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, para.)

[200] Brazil's 2 April response to questions 64 and 65.

Table 4 – Comparison of CCPs for Cotton and CCPs for Soybeans, Corn and Wheat in the Midwest

	Upland Cotton	Soybeans, Corn and Wheat in the Midwest
Frequency of CCP Subsidies[201]	• Every year under the FSRI Act • Maximum CCPs in three out of four years	• No CCPs for wheat • No CCPs for soybeans • CCPs for corn in two out of four years; subsidies below their maximum in both years
Maximum Size of Payments[202]	• CCP of $75 per acre (19 percent of target price)	• Corn CCP of $39 per acre (15 percent of target price) • Wheat CCP of $20 per acre (17 percent of target price) • Soybean CCP of $10 per acre (6 percent of target price)
Maximum CCPs and Production Costs[203]	• 14 percent of production costs	• Corn: 10 percent of cost of production • Wheat: 10 percent of production costs • Soybean: 4 percent of production costs
Substitute Crops	• Peanuts, rice, corn, soybeans, hay, sorghum, fruits, vegetables, melons and wild rice	• Very few substitute crops • Many regions plant corn and soybeans exclusively
Supply Elasticities	• High supply elasticities	• Low supply elasticities

130. As demonstrated in Table 4, upland cotton counter-cyclical subsidies are larger and paid out far more frequently than counter-cyclical subsidies for major field crops in the Midwest. In addition, counter-cyclical subsidies cover a greater portion of upland cotton producers' costs of production then they do for soybeans, corn and wheat. It follows from these basic differences that the effect of counter-cyclical subsidies for upland cotton is greater than that for major field crops in the Midwest. The availability of substitute crops is another significant reason why counter-cyclical payments for upland cotton have a larger effect on acreage and production that they do for corn, wheat and soybeans. Upland cotton acreage can more readily switch to the production of other crops and, thus, has a higher elasticity of supply than soybeans, corn and wheat. The collective effect of these differences is to dramatically increase the ability of upland cotton counter-cyclical payments to reduce risks associated with price variability and ultimately, increase supply as compared with counter-cyclical payments for soybeans, corn and wheat.

131. For all these reasons, upland cotton counter-cyclical subsidies greatly reduce the risk of producing upland cotton. They do so, however, only when upland cotton is grown on upland cotton base, as only under this scenario is there the revenue stabilizing effect resulting from the combination of *upland cotton* market revenue and *upland cotton* price-contingent counter-cyclical subsidies. This is the reason that the vast majority of U.S. upland cotton is grown on upland cotton base.

132. The studies cited by the United States do not and can not address this crucial issue because the data on upland cotton base and upland cotton plantings is not available in the public domain.[204] Yet, this information was available to the original panel, and the same data is available to the

[201] Exhibit Bra-675 (Updated Program Crop Comparison, March 2007).
[202] Exhibit Bra-675 (Updated Program Crop Comparison, March 2007).
[203] Compare Exhibit Bra-675 (Updated Program Crop Comparison, March 2007) to U.S. 2 response to question 53, para. 101.
[204] *See, e.g.*, Brazil's attempt to obtain this data through a Freedom of Information Act request was rejected. *See* Exhibit Bra-689 (Freedom of Information Act Rejection Letter).

compliance Panel. Based on the data available to the original panel, it correctly rejected the United States attempt to argue that counter-cyclical payments were "decoupled" from production.[205] Instead, it found a "strongly positive relationship"[206] between historic upland cotton producers receiving upland cotton counter-cyclical subsidies and *current* upland cotton producers. It also found that these subsidies allowed U.S. producers to remain farming upland cotton because they were an important contributor to the total cost of production.[207] None of the studies of counter-cyclical subsidies discuss such crucial data.

133. In response to this finding, the United States now claims that the fact that 96 percent of U.S. upland cotton is produced on farms with upland cotton base acres[208] should not be surprising because upland cotton was grown historically, and continues to be grown today, on land particularly suited for upland cotton.[209] Yet, this is precisely the basis for the original panel's finding that the high per-acre upland cotton counter-cyclical payments were connected with the *current* production of upland cotton.[210] By this admission, the United States confirms that when Congress set very high per-acre payments for upland cotton base acres, it did so intending that the payments would be used to allow producers of upland cotton to cover their high costs of production. That is exactly what the National Cotton Council asked for prior to the FSRI Act of 2002.[211] Congress would not provide counter-cyclical subsidies to historic cotton producers that are *seven* times higher per-acre than those for historic soybean producers if it thought that the upland cotton producers would grow soybeans.[212]

134. Thus, the structure, design and operation of the counter-cyclical subsidies is to specifically enable farmers that historically had planted high-cost upland cotton to continue to plant upland cotton. This is exactly what has happened. Almost all (96 percent) of U.S. upland cotton continues to be grown on farms with upland cotton base acres.[213] These farmers know that the counter-cyclical subsidy will be paid if the price received by the U.S. producer falls below the target price of $0.724 per pound. And the average U.S. upland cotton farmer covered 10 percent of its total cost of production with counter-cyclical payments over the life-time of the FSRI Act of 2002.[214] This evidence, not studies of counter-cyclical subsidies for other crops, demonstrates the linkage between U.S. counter-cyclical subsidies, upland cotton plantings, supply and world market prices.

58. The Unites States stated that the key consideration in assessing a farmer's decision to grow upland cotton is whether the farmer has been covering his variable costs of production. In this connection, it presented upland cotton costs and returns estimates for marketing years 1999-2005 (Exhibit US-47). Brazil has disputed the absence of certain items – land, labour and capital recovery costs - in the US calculations of variable costs. In response, the United States has referred to the Commodity Costs and Returns Estimation Handbook (Exhibit US-88) prepared by a Task Force of the American Agricultural Economics Association as the basis for leaving out these items in its

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[205] Panel Report, *U.S. – Upland Cotton*, paras. 7.634-7.647.

[206] *See*, *e.g.*, Panel Report, *U.S. – Upland Cotton*, paras. 7.6377.1362.

[207] The original panel stated 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 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." Panel Report, *U.S. – Upland Cotton*, para. 7.1353.

[208] Brazil's Rebuttal Submission, Table 3 at para.157. Results are from U.S. First Written Submission, table at para. 224.

[209] U.S. 2 April response to question 54, para. 115.

[210] Panel Report, *U.S. – Upland Cotton*, para. 7.1362.

[211] Exhibit Bra-109 (Testimony (Full) of Robert McLendon, Chairman, NCC Executive Committee, Before the House Agricultural Committee. National Cotton Council (NCC)).

[212] Exhibit Bra-675 (Updated Program Crop Comparison, March 2007).

[213] Brazil's Rebuttal Submission, Table 3 at para.157. Results are from U.S. First Written Submission, table at para. 224.

[214] *See* Exhibit Bra-477 (U.S. Upland Cotton Costs and Returns).

calculations. However, the Task Force which authored the Handbook does not use the categories "fixed" or "variable" costs and in fact recommends that the microeconomic concepts of fixed and variable costs not be used in preparing and reporting cost and return estimates. Page 2-67 of the Handbook states:

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

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

135. Brazil welcomes the United States' acknowledgement that operating costs are distinct from variable costs.[215] However, having done so, the United States continues to blur the distinction between the two. For example, the United States claims that "Brazil has attempted to include as 'variable' or 'operating' costs, costs that are not in fact 'expendable in a single defined period' including land, unpaid labor, and capital recovery costs."[216]

136. This statement is not consistent with the earlier U.S. acknowledgment[217] that "operating costs" and "variable costs" are distinct economic concepts. Nor is it correct. To clarify, Brazil does not consider land, unpaid labor and capital recovery costs to be "operating costs". Brazil does, however, consider these costs to be wholly, or in part, "variable costs".[218] Brazil's approach is entirely consistent with the approach detailed in the American Agricultural Economics Association ("AAEA") Handbook.

137. Brazil also welcomes the United States acknowledgment that "allocated overhead" differs from "fixed costs".[219] The United States then criticizes Brazil's inclusion of fixed costs and/or imputed (or non-cash) cost as part total costs in its cost of production and planting decision analyses.[220] Brazil responds to these arguments in its comments on the U.S. response to question 59, below, in which Brazil address comprehensively issues related cost of production and plantings decisions that the United States raised in its 2 April responses to questions.

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

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[215] U.S. 2 April response to question 58, para. 132.
[216] U.S. 2 April response to question 58, para. 134 (emphasis added).
[217] U.S. 2 April response to question 58, para. 133.
[218] Brazil's Rebuttal Submission, paras. 254-283.
[219] U.S. 2 April response to question 58, para. 136.
[220] U.S. 2 April response to question 58, paras. 135-136.

138. In response to a limited question by the compliance Panel concerning income from other crops and off-farm income, the United States launches into a lengthy discussion of farm bankruptcy.[221] The United States response misses the point of the compliance Panel's question.

139. Contrary to the U.S. response, Brazil does not assert that the major issue before this compliance Panel is whether upland cotton farmers would exit farming altogether *but for* marketing loan and counter-cyclical subsidies. Rather, the relevant question, as stated in question 59, is whether farmers would exit "cotton farming," that is, would they discontinue planting upland cotton. The evidence presented by Brazil demonstrates that a significant percentage of U.S. upland cotton farmers would exit the production of upland cotton. [222]

140. Throughout this proceeding, the United States, understandably, has sidestepped the $12.4 billion gap between upland cotton producers' total costs of production and market returns over the past seven years. U.S. arguments have shifted from highlighting the importance of whole-farm costs[223], to relying on cost and return data in the high price year of MY 2003[224], and finally, to attacking USDA's own cost of production data itself.[225] Yet, none of these arguments individually or collectively explains how an industry that would have lost $12.4 billion without subsidies over the past seven years[226] is economically viable.

(a) Whole Farm Costs Are Irrelevant

141. The U.S. argument that whole-farm costs are relevant to upland cotton production decisions[227] is simply not logical. Why would a farmer cross-subsidize the production of upland cotton – in effect subsidizing foreign purchasers of low-priced/high-cost U.S. upland cotton – with income from other crops or from off-farm income? The United States does not answer that question. Instead, it highlights studies which find that farmers increasingly supplement their income with off-farm work.[228] Brazil does not dispute these studies or this trend. Yet, the fact that U.S. upland cotton farms earn income from growing other crops or in other sectors of the economy is not relevant to these proceedings. As the original panel found, "[w]e are considering costs and market revenues in respect of upland cotton. Our examination is one of the upland cotton industry … 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."[229] Moreover, as the studies submitted by the United States point out, the issue of off-farm income is of particular importance for small farms.[230] And as these studies also point out, most U.S. upland cotton production occurs on

[221] U.S. 2 April response to question 59, paras. 137-142.

[222] *See* Brazil's First Written Submission, Section 7.11; Brazil's Rebuttal Submission, Section 2.3.6; Brazil's Opening Statement, Section 2.4; and Brazil's Comments on U.S. Oral Statements, Section 4.

[223] U.S. First Written Submission, paras. 293-297; U.S. Rebuttal Submission, paras. 344-348; and U.S. 2 April response to question 59, paras. 155-157.

[224] U.S. Rebuttal Submission, para. 337; U.S. Opening Statement, paras. 11-13; and U.S. 2 April response to question 59, paras. 144-145.

[225] U.S. 2 April response to question 59, paras. 147-154.

[226] Brazil's Oral Statement, para. 57.

[227] U.S. 2 April response to question 59, paras. 155-157.

[228] The United States repeatedly quotes a portion of one of these studies which finds that "[o[ff-farm work could hypothetically effect exits in two ways" (U.S. Answers to Second Set of Questions, para. 156). As explained above, the question before this compliance Panel is not whether farmers would go bankrupt. It is whether a farmer would stop producing upland cotton. Furthermore, the "hypothetical" effects of off-farm income on farm-exits is no more than a theory. *See* Exhibit US-46 (Hoppe, Robert A. and Korb, Penni. "Understanding U.S. Farm Exits." Economic Research Service Report 21. June 2006, p. 20).

[229] Panel Report, *U.S. – Upland Cotton*, para. 1354, footnote 1470.

[230] U.S. 6 March response to question 31, para. 30.

farms that have very big commercial operations.[231] The U.S. argument is, therefore, not even relevant to the vast majority U.S. upland cotton production.

(b) MY 2003 Cost Data Is Atypical

142. Much of the distorted U.S. analysis of "costs" rests on its reliance on an unusual year – MY 2003.[232] This year was unusual because it was the first – and only time – in the history of the FSRI Act of 2002 (and the first time in eight years) that U.S. farmers actually earned a profit ($65 per acre) based solely on market revenue. The United States understandably focuses its arguments on MY 2003 cost of production data in its Rebuttal Submission and subsequent submissions.[233] In doing so, however, it fails to acknowledge several important points.[234]

143. First, the U.S. MY 2003 cost data is not materially different from what Brazil has used during this entire proceeding. The only difference is that it is broken down into three arbitrary cost groups – low, medium and high.[235] When all cost groups are aggregated, the average acre planted to upland cotton made a profit of $65. Brazil's assertions regarding the seven-year $837 loss on each acre planted to upland cotton is based exclusively on USDA cost data and *includes* the average profit of $65 per acre achieved in MY 2003.[236] Therefore, the United States assertion that "Brazil ask[ed] the Panel to simply ignore this data"[237] is incorrect. Far from ignoring the data, Brazil used *the same USDA data* in its First Written Submission, Rebuttal Submission and Oral Statement.[238]

144. Second, the United States failed to acknowledge that MY 2003 is the only year in the past eight in which the U.S. producers covered their total costs of production only with market revenue. In its response to this question, the United States has finally acknowledged that "prices in MY 2003 were high."[239] However, the United States now argues that that most producers nevertheless would have covered their total costs in MY 2004 and 2005 because of, *inter alia*, increasing yields.[240] USDA data squarely contradicts this statement: the data clearly show that the average acre planted to upland cotton lost $18 in MY 2004 and $88 dollars in MY 2005.[241]

145. Third, U.S. producers' costs are increasing significantly in MY 2006. National average yields are estimated to be 668 pounds per planted acre in MY 2006, far lower than yields of 806 pounds per

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[231] U.S. 6 March response to question 31, para. 30.

[232] U.S. 2 April response to question 59, paras. 144-146.

[233] U.S. Rebuttal Submission, para. 337; U.S. Opening Statement, paras. 11-13; and U.S. 2 April response to question 59, paras. 144-145.

[234] U.S. Opening Statement, paras. 11-12; U.S. 6 March Response to Question 29, para. 20; and U.S. 2 April response to question 59, paras. 144-146.

[235] Brazil notes that the U.S. also adjusts the data to exclude costs and returns associated with cottonseed.

[236] *See* Exhibit Bra-477 (U.S. Upland Cotton Costs and Returns); *see also* Exhibit Bra-475 (U.S. Cotton Producers Costs and Returns Per Planted Acre, Excluding Government Payments, Economic Research Service, USDA, accessed October 2006 at http://www.ers.usda.gov/data/costsandreturns/testpick.htm).

[237] U.S. 2 April response to question 59, para. 145.

[238] *See*, *e.g.*, Brazil's First Written Submission, paras. 156-164.

[239] U.S. 2 April response to question 59, para. 145.

[240] U.S. 2 April response to question 59, para. 145.

[241] Exhibit Bra-477 (U.S. Upland Cotton Costs and Returns); *see also* Exhibit Bra-475 (U.S. Cotton Producers Costs and Returns Per Planted Acre, Excluding Government Payments, Economic Research Service, USDA, accessed October 2006 at http://www.ers.usda.gov/data/costsandreturns/testpick.htm). Brazil notes that USDA's use of harvest period prices underestimates losses in MY 2004. The harvest period (Oct-Nov) farm price of upland cotton was 51 cents per pound (Exhibit Bra-477), while the marketing year average farm price was just 42 cents per pound (Exhibit Bra-448 (Cotton and Wool Situation Outlook and Yearbook, USDA, November 2005, p. 38, accessed October 2006 at http://usda.mannlib.cornell.edu/usda/current/CWS-yearbook/CWS-yearbook-11-25-2005.pdf)).

planted acre in MY 2004 and 799 pounds per acre in MY 2005.[242] Further, U.S. producers are faced with significantly higher seed, fertilizer, and fuel costs in MY 2006 than in MY 2003-2005.[243] Total costs in MY 2006 are forecasted to be 10 percent higher than their MY 2003-2005 average.[244] With market prices remaining low throughout the first eight months of MY 2006[245], the loss based on market revenue is expected to significantly widen in MY 2006 compared to MY 2003-2005.[246]

146. Fourth, the United States makes the remarkable assertion that "there is no basis to assume that the [MY 2003] results would have been substantially different in later years"[247] However, unlike MY 2003, when the average U.S. farm price was $0.62 per pound[248], the average farm price was $0.416 per pound in MY 2004 and $0.477 per pound in MY 2005.[249] The current average farm price for MY 2006, as of April 2007, is $0.472 per pound.[250] Thus, there is no way that the average "mid-cost" producer, with total costs of $0.57 per pound, covered his or her total costs of production in those years. Nor will those costs be covered in MY 2007.[251]

147. In any event, breaking upland cotton farms into arbitrary cost groups is neither necessary nor particularly relevant. It is far more appropriate for this compliance Panel, like the original panel, to examine national average cost of production data to get a complete picture of the U.S. upland cotton industry. Indeed, the Appellate Body in *Canada Dairy (21.5 II)* found that

> [i]t, therefore, seems to us that the benchmark should be a single, industry-wide cost of production figure, rather than an indefinite number of cost of production figures for each individual producer. The industry-wide figure enables cost of production data for producers, as a whole, to be aggregated into a single, national standard that can be used to assess Canada's compliance with its international obligations.[252]

148. Using national average data certainly does not "obscure" cost of production data as the United States suggests.[253] Brazil, the United States and the compliance Panel are all aware that upland cotton farmers have different cost structures. In any given year, about half of the acres planted to upland cotton have costs that are higher than the national average, while the other half has costs that are less than the national average. This is nothing more than basic statistics. It follows, therefore, that in years when the average acre planted to upland cotton lost money (six of the past seven years) more than half of the acreage planted to upland cotton suffered a loss. In this context, it is import to recall that Professor Sumner's analysis suggests that 17-19 percent of U.S. production of upland

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[242] For yields in MY 2004 and 2005, *see* Exhibit Bra-562 (Cotton and Wool Situation Outlook and Yearbook, USDA, November 2006, Table 2, available at http://usda.mannlib.cornell.edu/usda/current/CWS-yearbook/CWS-yearbook-11-21-2006.pdf). For yields in MY 2006, *see* Table 1 from the April 2007 Cotton and Wool Outlook, accessed April 2007 at http://www.ers.usda.gov/Briefing/Cotton/Data/COTTONTABLE1.xls.

[243] *Compare* seed, fertilizer and fuel costs in Exhibit Bra-475 (U.S. Cotton Producers Costs and Returns Per Planted Acre, Excluding Government Payments, Economic Research Service, USDA, accessed October 2006 at http://www.ers.usda.gov/data/costsandreturns/testpick.htm) and Exhibit Bra-575 ("Cost-of-production forecasts for U.S. major field crops, 2006-2008F," Economic Research Service, USDA, accessed January 2007 at http://www.ers.usda.gov/data/costsandreturns/data/Forecast/cop_forecast.xls).

[244] Exhibit Bra-634 (Analysis of Planting Decisions Based on Expected Returns).

[245] *See* Brazil's Comments to Question 82 below.

[246] Based on partial year USDA and FAPRI data, the loss is expected to be $116 per acre, *see* Exhibit Bra-648 (Actual Costs and Returns Analysis).

[247] U.S. 2 April response to question 59, para. 145.

[248] U.S. 2 April response to question 59, para. 145.

[249] Exhibit Bra-562 (Cotton and Wool Situation Outlook and Yearbook, USDA, November 2006, p. 36, available at http://usda.mannlib.cornell.edu/usda/current/CWS-yearbook/CWS-yearbook-11-21-2006.pdf)

[250] *See* Table 1 from the April 2007 Cotton and Wool Outlook, accessed at http://www.ers.usda.gov/Briefing/Cotton/Data/COTTONTABLE1.xls.

[251] *See* Brazil's comments on the U.S. response to question 82, below.

[252] Appellate Body Report, *Canada – Dairy (21.5 II)*, para. 96.

[253] U.S. 2 April response to question 59, para. 144.

cotton would cease without marketing loan and counter-cyclical subsidies.[254] This is consistent with the notion that only higher-cost U.S. producers would exit upland cotton production without these subsidies.

149. Thus, the various U.S. cost-related arguments based on MY 2003 data are entirely misplaced. The reference period of MY 2005 demonstrates significant losses by the average acre of upland cotton of $88 per acre. These losses are set to increase to an estimated $116 per acre in MY 2006.[255] These are significant losses and above the average $65 per acre loss per year over the lifetime of the FSRI Act of 2002.[256]

(c) USDA's Total Cost of Production Data is Relevant and Appropriate

150. For the first time in *this* proceeding, the United States attacks the total cost of production data itself, arguing that it "provides a stylized, abstract view"[257] and is used by Brazil in a way in which "it was never intended."[258] These criticisms echo similar arguments made by the United States in the original proceeding.[259] These old U.S. arguments attacking its own USDA cost data were properly rejected by the original panel.[260] The renewed arguments should again be rejected by this compliance Panel.

151. The United States criticism of USDA's own total cost data is two-fold.[261] First, the U.S. criticizes the method by which USDA values non-cash costs, such as imputed farm labor and land ownership costs.[262] Second, the United States argues that USDA's total cost data is not an appropriate indicator of the financial viability of upland cotton farming because it includes non-cash costs.[263] Both criticisms of USDA's cost data are without merit.

152. The United States challenge to USDA's analysis of non-cash costs squarely contradict basic economic and accounting principles. Non-cash costs, such as ownership costs and opportunity costs, are real, not imaginary, costs, as the U.S. suggests. Indeed, USDA explains that:

> [c]ommodity costs and returns include estimates of both cash expenditures and noncash costs. Cash expenditures are incurred when factors of production are purchased or rented. Noncash costs occur when factors are owned. For example, if a farmer fully owns the land used to produce corn, he/she would have no expenditure for land rental or for loans to pay for the purchase of land. *Yet, an economic cost arises. By owning the land and using it to grow corn, the farmer foregoes income from other uses of the land, such as renting it to another producer. These costs come about because production resources are limited and have alternative uses.* If a farmer uses savings to pay for operating inputs, such as seed, fertilizer, chemicals, and fuel, and thus pays no interest on operating loans, the farmer still incurs an economic cost because the savings could have earned a return in another use. Likewise, the farmer has an opportunity cost of his/her labor used in the production of

[254] Brazil's First Written Submission, para. 167.
[255] Market returns minus total costs was reduced by the product of 5 percent and total costs, *see* Exhibit Bra-648 (Actual Costs and Returns Analysis).
[256] Exhibit Bra-477 (U.S Upland Cotton Costs and Returns).
[257] U.S. 2 April response to question 59, para. 147.
[258] U.S. 2 April response to question 59, para. 143.
[259] *See e.g.*, Section F of U.S. Further Rebuttal Submission from the original proceeding, 18 November 2003.
[260] Panel Report, U.S. – Upland Cotton, paras. 7.1353-7.1354.
[261] U.S. 2 April answer to question 54, para. 119.
[262] U.S. 2 April answer to question 54 and 59, paras. 119, 147-151.
[263] U.S. 2 April answer to question 54 and 59, paras. 119, 152-154.

> the commodity because it could have been used on another farm or in off-farm employment.[264]

153. The need to cover total costs of production, including both cash and non-cash costs, is an economic reality facing all farmers. No farmer would or could repeatedly plant his fields with a chronically loss-making crop. There is no basis for the U.S. assumption that farmers do not take into account non-cash "opportunity" costs when making production decisions. This assumption is directly contradicted by USDA economists who include both cash and non-cash costs in their cost and returns estimates.

154. The need for producers to cover total costs of production was recently highlighted by the Appellate Body in *EC – Sugar*. The Appellate Body found that

> in the ordinary course of business, an economic operator makes a decision to produce and sell a product expecting to recover the total cost of production and to make profits. Clearly, sales below total cost of production cannot be sustained in the long term, unless they are financed from *some other sources*.[265]

155. The "some other sources" in this case that cover total costs of production are marketing loan and counter-cyclical subsidies. Without such subsidies, average seven-year losses totalled $837 per acre. With these two subsidies, the average acre showed a seven-year profit of $104 per acre.[266]

156. As noted by the Appellate Body, not only is an economic operator expected to cover his or her total costs of production, but he or she is also expected to make a profit. Brazil notes that USDA also recognizes the need for farmers to make a profit. USDA defines "residual return to management and risk" as follows:

> *[r]esidual returns to management and risk* is the difference between the gross value of production and total economic costs. The return to management and risk indicates the extent to which longrun production costs are covered by production valued at average harvest-month prices.[267]

157. The Appellate Body's findings in *EC – Sugar* and USDA's definition of residual returns to management and risk demonstrate the importance of not only covering costs, but also of generating profits from farming. The ability of upland cotton farmers to cover their variable costs, let alone total costs, is not sufficient to show that marketing loan and counter-cyclical subsidies do not impact production.

158. Brazil's cost of production analysis has not previously factored in the obvious need to make profits on the farmers' investments. This is because the huge losses based only on market revenue readily demonstrate the decisive role played by marketing loans and counter-cyclical subsidies in sustaining revenue and large amounts of upland cotton production. But if the compliance Panel were to consider the need for farmers to generate some reasonable profit, the gap between market returns and such a profit margin obviously would be even greater. For example, assuming even a fairly low profit margin of only 5 percent, the *average* gap between market revenue and the five percent profit would increase to $1,017 per acre in the seven year period of MY 1999-2005. For MY 2005 alone,

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[264] *See* Commodity Costs and Returns: Methods, Economic Research Service, USDA, accessed April 2007 available at http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm (emphasis added).

[265] Appellate Body Report, *EC – Sugar*, para. 266 (emphasis added).

[266] Exhibit Bra-477 (Upland Cotton Costs and Returns).

[267] *See* Definition of Residual Returns to Management and Risk, Economic Research Service, USDA, accessed April 2007 available at http://www.ers.usda.gov/data/CostsAndReturns/Glossary/def_resr.htm).

the gap would be $115 per acre – not the $88 per acre based on a break-even methodology.[268] The projected gap in MY 2006 would be $144 per acre, based on a five percent profit margin.[269]

159. Next, the new U.S. criticism of USDA's valuation methodologies ignores the fact that they were conceived by the American Agricultural Economics Association and implemented by USDA.[270] The data are based off of surveys that are generated in the ordinary course of USDA business.[271] The methods and data used to generate cost of production data are objective and appropriate. USDA explains that four approaches are used to estimate commodity costs, including (1) direct costing, (2) valuing input quantities, (3) indirect costing and (4) allocating whole-farm expenses.[272] The United States singles out only the fourth element for its criticism – not the other three.

160. Brazil notes that "allocating whole-farm expenses"[273] is only used by USDA to determine "general farm overhead" and "taxes and insurance."[274] These costs account for about 5 percent of upland cotton producers' total costs of production.[275] The other valuation methodologies used by the USDA cost survey are also properly used to address the question before this compliance Panel. USDA explains that "[u]npaid labor hours are valued using an estimate of the wages earned off-farm by farm operators"[276] and that "[l]and is valued according to the average cash rental rate for land producing the commodity in the particular area." [277] These relatively straightforward methodologies in no way distort or undermine an assessment of the financially viability of upland cotton farming using total costs of production.

161. Finally, the United States criticizes Brazil's use of USDA total costs of production data by highlighting the fact that the total cost of production was greater than market returns for nearly all U.S. field crops in MY 2005. Based on this fact, the U.S. argues that Brazil's planting decision analysis is "absurd"[278] and "fundamentally erroneous."[279] Neither Brazil nor the U.S. Congressional Research Service ("CRS"), an agency of the U.S. Government, would agree with this latest U.S. assertion. In fact, CRS confirms that "it is only with the aid of subsidies that a substantial portion of

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[268] Annual market returns minus total costs were reduced by the product of 5 percent and total costs, *see* Exhibit Bra-477 (Upland Cotton Costs and Returns).

[269] Market returns minus total costs was reduced by the product of 5 percent and total costs, *see* Exhibit Bra-648 (Actual Costs and Returns Analysis).

[270] *See* Commodity Costs and Returns: Methods, Economic Research Service, USDA, accessed April 2007, available at http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm.

[271] The data are collected in Agricultural Resource Management Surveys, s*ee* Commodity Costs and Returns: Methods, Economic Research Service, USDA, accessed April 2007 available at http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm.

[272] *See* Commodity Costs and Returns: Methods, Economic Research Service, USDA, accessed April 2007, available at http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm.

[273] U.S. 2 April answer to question 59, paras. 148-150.

[274] *See* Commodity Costs and Returns: Methods, Economic Research Service, USDA, accessed April 2007, available at http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm.

[275] Exhibit Bra-475 (U.S. Cotton Producers Costs and Returns Per Planted Acre, Excluding Government Payments, Economic Research Service, USDA, accessed October 2006 at http://www.ers.usda.gov/data/costsandreturns/testpick.htm). In any event, it is appropriate to allocate costs to different crops based on their contribution to a farm's operating margin. It is the most reliable method of allocating costs that must be accounted for.

[276] *See* Commodity Costs and Returns: Methods, Economic Research Service, USDA, accessed April 2007, available at http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm.

[277] *See* Commodity Costs and Returns: Methods, Economic Research Service, USDA, accessed April 2007, available at http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm.

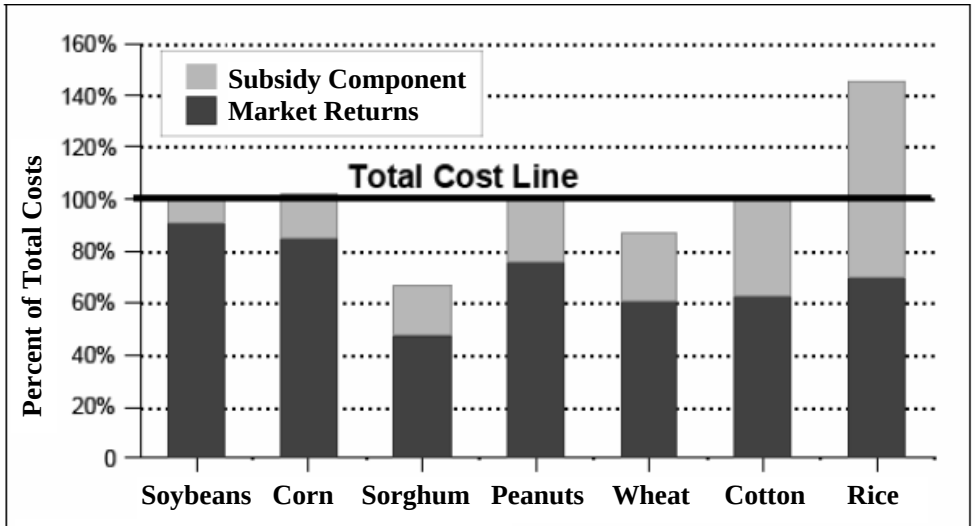
[278] U.S. 2 April response to question 59, para. 143.

[279] U.S. 2 April response to question 53(c), para. 102.

U.S. production [of all crops] is made economically viable."[280] CRS's analysis relied upon a graph of total costs versus market returns in selected periods[281] with and without subsidies as set out below:

Figure 5 – Excerpt from CRS Report to Congress[282]

Figure 1. U.S. Revenue Components as Share of Total Costs, Selected Program Commodities



Source: Calculated by CRS from USDA data.

162. Based on this chart calculated from USDA data, CRS concluded that "the substantial contribution of subsidies toward covering otherwise unmet production costs implies a high chance for adverse rulings for any of the major covered commodities."[283]

163. Indeed, data on farm income from USDA's Economic Research Service ("ERS") shows that, in MY 2005 as well as in previous years, the U.S. farm sector as a whole, *i.e.*, including crop and livestock production, has been viable based on an assessment of costs, farm-related revenues and government subsidies.[284] As the ERS Agricultural Income and Finance Outlook of November 2006

[280] Exhibit Bra-577 (Schnepf, Randy, Potential Challenges to U.S. Farm Subsidies in the WTO, Congressional Research Service Report for Congress, 25 October 2006, p. 23).

[281] The periods vary across commodities based on the consistency of program operations and the availability of data. Corn and sorghum are for the period 1996-2004, soybeans and cotton are for the period 1997-2004, wheat is for the period 1998-2004, rice is for the period 2000-2004, and peanuts are for the period 2002-2004. *See* Exhibit Bra-577 (Schnepf, Randy, Potential Challenges to U.S. Farm Subsidies in the WTO, Congressional Research Service Report for Congress, 25 October 2006, p. 25).

[282] Exhibit Bra-577 (Schnepf, Randy, Potential Challenges to U.S. Farm Subsidies in the WTO, Congressional Research Service Report for Congress, 25 October 2006, p. 23).

[283] Exhibit Bra-577 (Schnepf, Randy, Potential Challenges to U.S. Farm Subsidies in the WTO, Congressional Research Service Report for Congress, 25 October 2006, p. 23). Brazil notes that consistent with the analysis conducted by CRS, both sorghum and wheat acreage has declined. Sorghum planted acreage declined by about 50 percent from MY 1996 to MY 2005. *See* USDA's Feedgrains database, available at www.ers.usda.gov/data/feedgrains.

[284] For detailed income data for 2003-2007, see www.ers.usda.gov/briefing/farmincome/data/nf_t2.htm, accessed April 2007.

points out, this is the case primarily due to record subsidy payments of $24.3 billion in MY 2005, with a significant portion of these payments received from "ad hoc and emergency programs".[285]

164. USDA data shows a profit of $222 million in MY 2005 from the production of soybeans, corn, sorghum, peanuts, wheat, upland cotton and rice – taking into account total costs, market returns and revenue from the marketing loan, counter-cyclical and direct payment program as well as crop insurance subsidies.[286] Production of certain crops in MY 2005, including upland cotton, resulted in losses based on market revenue alone.[287] Citing low prices in MY 2005, the United States government provided additional very high emergency payments amounting to $3.2 billion.[288] These additional subsidies are not accounted for in the above assessment of the overall financial viability of these seven crops.

165. Thus, the United States is incorrect when asserting that "U.S. farmers would have lost money *across the board* from producing *any* of these crops".[289]

166. To allow a more comprehensive assessment of the role of U.S. subsidies in ensuring the financial viability of U.S. program crop production, Brazil also provides the compliance Panel with data for the other years under the FSRI Act of 2002. Between MY 2002 and 2005, the gap between total costs and market returns for soybeans, corn, sorghum, peanuts, wheat, upland cotton and rice was $43 billion.[290] Marketing loan, counter-cyclical, direct and crop insurance subsidies to the same crops amounted to $53 billion, providing a $10 billion offset to shortfalls in revenue.[291] In addition, U.S. farmers received large emergency and disaster payments in totaled $8.5 billion over the MY 2002-2005 period.[292] This evidence demonstrates that large portions of U.S. program crop production, including upland cotton, are profitable *only* due to large U.S. subsidies.

167. In sum, in view of tens of billions in various forms of subsidies provided to program crops under the FSRI Act of 2002, CRS's and Brazil's conclusion reached based on USDA's cost and returns data are neither absurd nor unexpected. The United States' claim that Brazil's and CRS's methodology of assessing USDA's cost and return data would lead to the conclusion that all of U.S. agriculture is not viable even with subsidies is simply wrong. The USDA data discussed above shows that certain sectors of U.S. agriculture are not viable <u>but for</u> U.S. government subsidies. It also confirms Brazil's analysis[293] and the findings of the original panel[294] with respect to the profitability of growing upland cotton in the United States.

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

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[285] *See* ERS Agricultural Income and Finance Outlook of November 2006, p. 4-5 accessible at http://usda.mannlib.cornell.edu/usda/current/AIS/AIS-11-30-2006.pdf, accessed April 2007.

[286] Exhibit Bra-690 (Crop Losses and Profits 2002-2005).

[287] *See* Exhibit Bra-690 (Crop Losses and Profits 2002-2005).

[288] *See* ERS Data on Direct Government Payments 2002-2007 at www.ers.usda.gov/Briefing/FarmIncome/Data/Government%20payments0207.xls, accessed April 2007.

[289] U.S. 2 April response to question 53, para. 101.

[290] *See* Exhibit Bra-690 (Crop Losses and Profits 2002-2005).

[291] *See* Exhibit Bra-690 (Crop Losses and Profits 2002-2005).

[292] *See* ERS Data on Direct Government Payments 2002-2007 at www.ers.usda.gov/Briefing/FarmIncome/Data/Government%20payments0207.xls, accessed April 2007.

[293] *See* Brazil's First Written Submission, Section 7.11; Brazil's Rebuttal Submission, Section 2.3.6; Brazil's Opening Statement, Section 2.4; and Brazil's Comments on U.S. Oral Statements, Section 4.

[294] Panel Report, *U.S. – Upland Cotton*, para. 7.1353.

prejudice? If not, what modifications does the United States think should have been made to the model?

168. Brazil also notes that, in response to this question, the United States once again repeats its summary and general criticism of Professor Sumner's simulation model. However, the United States does not even attempt to rebut any of the specific arguments, explanations and rebuttals submitted by Brazil and Professor Sumner in the many submissions since the beginning of this proceeding.[295]

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

Questions to the United States

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

169. The U.S. response provides no clear guidance with respect to the textual basis for its argument regarding the first element of Article 6.3(d), *i.e.*, whether there has been an increase in the world market share for the year in question compared to the previous three-year average. Nor does the United States elaborate, either in this response or in any of its other submissions, on what it believes to be the required proof with respect to the first element of Article 6.3(d). Rather, the United States vaguely asserts that "what is at issue is movement, not something static like the absolute level of market share in a particular year."[296] The United States then concludes that "the upward movement [] itself [must be] proven to be 'the effect' of a challenged subsidy."[297]

170. It is difficult to respond to such vague arguments. Yet, using the terminology in the U.S. response, Brazil has demonstrated that the "movement" (*i.e.*, the increase in MY 2005 compared to the previous three year average of MY 2002-MY 2004) was the effect of marketing loan and counter-cyclical subsidies. Brazil proved this by showing that *but for* the marketing loan and counter-cyclical subsidies, the U.S. world market share in MY 2005 would not have increased, but would have *decreased* compared to the MY 2002-MY 2004 three-year average.[298] This is not a "static" analysis, as asserted by the United States.[299] Rather, this assessment constitutes a dynamic comparison between two time periods demonstrating that it was the effect of the two challenged subsidies that led to the increase in the U.S. world market share in MY 2005 compared to its previous three-year average.[300]

171. Finally, Brazil refers the compliance Panel to its response to question 76, in which it addresses in detail the absence of any textual basis for the U.S. argument regarding the *second* element of Article 6.3(d) – the consistent trend. The U.S. response to question 75 provides no additional textual basis or argument to support its new and erroneous interpretation of the "consistent trend."

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[295] *See*, *e.g.*, Brazil's Comments on U.S. Oral Statements, paras. 35-56.
[296] U.S. 2 April response to question 75, para. 175.
[297] U.S. 2 April response to question 75, para. 175.
[298] Brazil's Rebuttal Submission, paras 348-349; Brazil's First Written Submission, paras. 214-226; 230-236.
[299] U.S. 2 April response to question 75, para. 175.
[300] Brazil's Rebuttal Submission, paras 348-349; Brazil's First Written Submission, paras. 214-226; 230-236.

C. CLAIM OF BRAZIL REGARDING THREAT OF SERIOUS PREJUDICE

Questions to both parties

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

172. As set out in Brazil's answer to this question, Brazil is not asserting that the existence of the marketing loan and counter-cyclical subsidy programs, in and of themselves, causes a threat of serious prejudice.

173. Brazil notes the U.S. assertion in its response that a challenge to the very "existence" of such programs would be "extraordinary" and "remarkable." In effect, what the United States asserts is that "per se" challenges – *i.e.*, challenges to the very existence – of subsidy programs under Articles 5 and 6.3 of the *SCM Agreement* are, as a practical matter, simply not viable. Yet, the United States' preliminary ruling arguments in this case seek to require the categorization of Article 6.3 claims in strict "per se" and "as applied" terms. According to the United States, "as applied" claims could only be asserted against the *application* of subsidies, *i.e.*, the payment of subsidies for a specified period of time.[301] And the only implementation obligation regarding such subsidies that cause adverse effects, according to the United States for such subsidies, is to remove the effects of such historical subsidy *payments* (*i.e.*, the "application").[302] On the United States view, a Member can take no action when recurring payments are found to cause adverse effects because the "effects" of past payments are wiped away by new payments that, it contends, cannot be regarded as "measures taken to comply", even though they have an extremely close connection to the DSB's recommendations and rulings regarding past payments. Brazil addresses this issue further in its comments on the United States' response to question 45, above.

174. In its response to question 78, the United States has now confirmed its views of the practical impossibility ("extraordinary" and "remarkable") of establishing a "per se" violation of Articles 5 and 6.3 of the *SCM Agreement*. Yet, in doing so, the United States has also confirmed that its arguments reduce the obligation in Article 7.8 of the *SCM Agreement* to inutility where a Member grants annual recurring payments to support the production of an annual crop. Under its strict segmentation of serious prejudice claims into "per se" and "as applied" categories, this remedy becomes meaningless. Indeed, acceptance of such a strict categorization would prevent Members suffering serious prejudice from securing any prospective relief for the future application/payment of recurring subsidies under such programs. This is because, as the United States has argued, only "per se" challenges can result in any obligation to change the statutory or regulatory provisions mandating subsidies.[303] Members seeking relief by challenging, "as applied", the application of those statutory and regulatory provisions would, in the case of recurring annual payments, have to continually institute new WTO proceedings, but would never have any right to take "countermeasures" because there would never be any compliance measures.[304] As Brazil has demonstrated, such an interpretation is neither justified nor mandated by the text, context, and object and purpose of Articles 5 and 6 of the *SCM Agreement*.[305]

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[301] U.S. Rebuttal Submission, paras. 20-28.

[302] *See* U.S. 2 April response to questions 47 and 48, paras. 53-57; U.S. 27 February response to question 17(b), para. 32.

[303] *See e.g.*, U.S. Rebuttal Submission, paras. 20-28.

[304] *See* Brazil's comments on the U.S. 2 April answer to question 45, above.

[305] Brazil's 27 February response to questions 11 and 12, para. 83-116; Brazil's comments on U.S. 27 February response to question 17, paras. 27-31.

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

175. The United States' response reaffirms its attempt to import the "imminent and clearly foreseen" standard of threat in Article 15.7 into Part III of the *SCM Agreement*.[306] Brazil has explained in its response to this question and in its First Written Submission why this is contrary to the text, context, and object and purpose of Articles 5 and 6 of the *SCM Agreement*. In this comment, Brazil addresses briefly a number of points raised by the U.S. response.

176. The United States is incorrect in asserting that footnote 5/Article 6 and Article 15.7 of the *SCM Agreement*, together with Article 4.1 of the *Safeguards Agreement* "serve a similar function."[307] Brazil explained in detail in its response to this question[308] that the "imminent and clearly foreseen" threat standards in Article 15.7 and Article 4.1 serve a distinct function, *i.e.*, regulating unilateral action by investigating authorities of imminent surges of *imports*.[309] By contrast, Part III of the *SCM Agreement* deals with the far broader object of protecting against the *effects of subsidies* in a *multilateral* dispute settlement context. Such effects may or may not involve the imminent shipment of goods. Thus, as Brazil has argued, a threat standard such as "significant likelihood" is consistent with both the slower pace of WTO dispute settlement procedures and its the associated remedies, as well as the time it takes for the effects of certain types of subsidies to materialize.

177. The United States' response distinguishes between a *temporal* ("imminent") and a *probability of occurrence* ("clearly foreseen") component of threat under Article 15.7. The United States asserts that Canada's (and Brazil's) approach ignores the temporal element altogether.[310] This is not correct. Rather, Brazil asserts that the notion of "imminent" is appropriate given the ability of investigating authorities (under Article 17 of the *SCM Agreement*) to take rapid action against subsidized imports. Yet, such a standard is not appropriate in a multilateral proceeding. In effect, the United States is requesting the compliance Panel to adopt a "temporal" standard that will force WTO Members to wait just until subsidies are about to cause serious prejudice before asserting their multilateral rights. Brazil has explained why application of the particular "temporal" element ("imminent") of Part V into Part III of the *SCM Agreement* is inconsistent with rules of treaty interpretation.

178. However, Brazil emphasizes again that it does not suggest that there be *no* temporal element to a threat standard in Part III of the *SCM Agreement*. Rather, Brazil's "significant likelihood" standard incorporates the notion that the threat must be real, not be based on allegation, conjecture or *remote* possibility. In sum, the temporal element should be tailored to the particular object and purpose and remedies and procedures applicable to multilateral disputes settlement proceedings applicable to Part III of the *SCM Agreement*, not blindly imported from the different context in Part V of the *SCM Agreement*.

Questions to the United States

80. How does the United States address the argument of Japan that in view of the different purposes of Parts III and V of the SCM Agreement the standard for determining threat of material

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[306] *See* U.S. Rebuttal Submission, para. 410 ("There is no reason why the *elaboration* of the term "threat" in Article 15.7 of he *SCM Agreement* and Article 4.1(b) should not be used as contextual guidance in interpreting the same term in footnote 13 of the *SCM Agreement*."). The "elaboration" advanced by the United States is the "imminent and clearly foreseen" standard.

[307] U.S. 2 April response to question 79, para. 184.

[308] Brazil's 2 April response to question 86, paras. 172-177.

[309] *See* Article 15.7 ("No one of these factors by itself can necessarily give decisive guidance but the totality of the factors considered must lead to the conclusion that *further subsidized exports are imminent* and that, unless protective action is taken, material injury would occur. ").

[310] U.S. 2 April response to question 79, para. 181.

injury in Article 15.7 of the SCM Agreement is an inappropriate standard for determining the existence of a threat of serious prejudice under Part III of the SCM Agreement? (Third Party Submission of Japan, paras. 8-12.) '

179. Brazil believes that Japan has correctly identified significant differences between Parts III and V of the *SCM Agreement* that demonstrate the inappropriateness of importing the "imminent and clearly foreseen" standard of Article 15.7 into Part III of the *SCM Agreement*. Brazil therefore disagrees with the primary point made by the United States in this response, *i.e*., that there is no difference between the function, object, and purpose of Article 15.7 and Part III of the *SCM Agreement*.

180. The United States suggests that "there is no basis for understanding the same terms in [Article 5/footnote 13 and Article 15.7] to have different meanings based on the an assumption that national authorities are necessarily prone to 'misusing' their discretion whereas WTO panels are not."[311] This is a false argument. Neither Brazil nor Japan "assumes" that investigating authorities will misuse their discretion. Instead, Brazil emphasizes that there are considerably different "temporal" considerations for such authorities compared to a WTO panel.

181. While the United States champions the "temporal" element of "imminent", the U.S. argument ignores the vastly different *temporal* periods involved in a rapid unilateral provisional remedy based on Part V and years of WTO dispute settlement proceeding under Part III of the *SCM Agreement*.

182. It is entirely appropriate that investigating authorities armed with rapid provisional remedies to control imports be compelled to make a finding that such imports are "imminent." The purpose of the rapid provisional remedies under Articles 17 and 15.7 of the *SCM Agreement* ensure that the domestic industry need not suffer material injury while waiting for remedies to take effect. Those rapid remedies available in the unilateral trade remedy context explain why the drafters used an "imminent" temporal standard of threat.

183. But the situation in a challenge under Part III of the *SCM Agreement* is totally different. Part III is not focused on controlling subsidized *imports* but rather on the adverse effects of any subsidy. Even the expedited dispute settlement procedures potentially available (but seldom used) under Article 7 of the *SCM Agreement* require at least 18 months of litigation time before a ruling and implementation can take place. No provisional "self-help" remedies are available under these rules. If "imminent" threat were the standard, then a WTO panel could be confronted with facts demonstrating that the threat was "clearly foreseen" but was not "imminent" because the effect of the subsidies would not take place for another year or two.[312] (By contrast, a domestic industry could petition investigating authorities only months before major shipments of subsidized goods were scheduled to be shipped and obtain relief under procedures sanctioned by Articles 15.7 and 17 of the *SCM Agreement*.) The complaining WTO Member would, in effect, be left without a remedy for future serious prejudice that was real, but not "imminent."

184. The United States asserts that both Article 15.7 and footnote 13/Article 5 strike a balance between disciplining and permitting subsidization.[313] Yet, if the real balance between disciplining subsidies and permitting their use is to be maintained, the concept of threat must be flexible enough to allow the disciplining of the effects of subsides – in practical terms – *well before* subsidized products are about to hit the market. *Avoiding* real and foreseen future adverse effects in the form of material

[311] U.S. 2 April response to question 80, para. 192.

[312] By contrast, a domestic industry could petition investigating authorities only months before major shipments of subsidized goods were scheduled to be shipped and obtain relief under procedures sanctioned by Articles 15.7 and 17 of the *SCM Agreement*.

[313] U.S. 2 April response to question 81, para 192 (claiming that both Article 15.7 and Part III function to establish a balance between the right to subsidized and the right to discipline subsidies).

injury and serious prejudice is the object of both Article 15.7 and Part III of the *SCM Agreement*. However, the entirely different temporal aspects of these two different remedies and procedures compel the use of different threat standards to maintain that balance. Otherwise, the U.S. interpretation creates far greater an opportunity for subsidizing Members to cause serious prejudice without any effective multilateral relief. This appears to be the main objective of the Japanese arguments and is one that Brazil supports.

81. How does the United States respond to the argument of Australia that "it is beside the point for the United States to argue that the programmes under consideration are due to expire in late 2007"? (Third Participant Oral Statement of Australia, para. 13)

185. The United States' response repeats its erroneous assertions that there is no threat of serious prejudice because the FSRI Act of 2002 will allegedly expire by the end of marketing year 2007, *i.e.*, 31 July 2008.[314]

186. Brazil disagrees that the alleged expiration of the FSRI Act of 2002 in the end of July 2008 is a relevant fact before the compliance Panel.[315] The "matter" before the compliance Panel with respect to Brazil's threat of serious prejudice claim is whether marketing loan and counter-cyclical subsidies for MY 2006 and MY 2007 cause a threat of serious prejudice. MY 2006 is the relevant year to consider whether threat of serious prejudice presently exists. It will not end until 31 July 2007, *i.e.*, after the compliance Panel issues its determination. MY 2007 will not end for another 16 months, *i.e.*, on 31 July 2008. The FSRI Act of 2002 remains in effect until the end of MY 2007.[316] Brazil's threat of serious prejudice claims in this proceeding involve the determination of whether there is a threat of serious prejudice today, not at the end of MY 2007 or beyond.

187. Yet, having asserted (incorrectly) that the expiration of the FSRI Act of 2002 is a relevant fact by suggesting that marketing loans and counter-cyclical subsidies may also completely expire, the United States is in no position to then assert that it is entirely *irrelevant* for the compliance Panel to consider whether the marketing loan and counter-cyclical subsidies will continue, in some form or another, in the *next* U.S. Farm Bill.[317] It is undisputed that there will be *some* new Farm Bill that will be enacted at some time in the future after these proceedings have finished.[318] The marketing loan program for upland cotton has been in existence since 1986 and, since, has been a key component of U.S. farm legislation. The current USDA proposal calls for a continuation of both the marketing loan and the counter-cyclical payment programs with certain changes.[319] Thus, Australia is certainly correct when it states that "there is no guarantee that [the marketing loan and counter-cyclical programs] will not be rolled over or maintained in another form with adverse effect."[320] The compliance Panel cannot, of course, determine the exact scope of the marketing loan and counter-cyclical provisions that will exist in the next U.S. farm bill.

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[314] U.S. 2 April response to question 81, para. 195.

[315] U.S. Rebuttal Submission, para. 415.

[316] For counter-cyclical payment provisions, *see* Section 1108 of the 2002 FSRI Act ("This subtitle shall be effective beginning with the 2002 crop year of each covered commodity through the 2007 crop year."). Exhibit Bra-29 (2002 Farm Security and Rural Investment Act). For marketing loan provisions, *see* Section 1207(a)(1) of the 2002 FSRI Act ("During the period beginning on the date of the enactement of this Act through July 31, 2008, the Secretary shall issue marketing certificates or cash payments …"). Exhibit Bra-29 (2002 Farm Security and Rural Investment Act).

[317] U.S. 2 April response to question 81, para. 197.

[318] *See*, *e.g.*, CRS Report for Congress, "Farm Bill Proposals and Legislative Action in the 110th Congress," available at http://www.nationalaglawcenter.org/assets/crs/RL33934.pdf, accessed April 2007.

[319] USDA's Farm Bill proposal is available at http://www.usda.gov/documents/07finalfbp.pdf, accessed April 2007.

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

188. Finally, whether the provisions of any new Farm Bill fully remove the serious prejudice caused by the FSRI Act of 2002, or the ongoing threat thereof, cannot be determined at this time. However, the United States is incorrect to suggest that the mere expiration of the FSRI Act of 2002 in the future would represent a "withdrawal" of the subsidy.[321] If the marketing loan program and the counter-cyclical payment programs remain in some form in the new Farm Bill – or are replaced by programs with similar effects – then these subsidies will *not* have been withdrawn, within the meaning of Article 7.8 of the *SCM Agreement*.[322]

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

189. In its answer to this question, the United States focuses on projections of *prices*[323] to derive projected subsidies and downplays projections of *subsidy outlays* itself (what it terms "aggregate figures"[324]), arguing that it is "difficult to fit these projections"[325] with the projections of prices. This is highly misleading and contrary to basic accounting principals used and espoused by USDA.[326] Projections of prices and subsidy outlays are, in fact, entirely consistent, as explained below.

190. Consider the following simplified example, as articulated by Professor Sumner in Exhibit Bra-659.

> But, let us take the case of a farmer with the following view of the future AWP. He considers that there is a 40% chance of an AWP of 42 cents, a 20% chance of an AWP of 52 cents and a 40% chance of an AWP of 62 cents. The expected value is exactly 52 cents. He expects no marketing loan payout, but the value of the program is 4 cents per pound to him. That is 0.4(52-42) = 4 cents. Only if the farmer was absolutely sure the AWP could not be below the loan rate would the program be of no value.[327]

191. Even if the Adjusted World Price ("AWP") is expected to be $0.52 per pound, or higher, it does not mean that the marketing loan program provides no benefit. As noted by the Appellate Body, even if U.S. upland cotton farmers expected prices to be above the adjusted world price at the time of planting, they "were also aware that if actual prices were ultimately lower, they would be 'insulated' by government support, including not only marketing loan program payments but also counter-cyclical payments, which were based on a target price of $0.724 per pound."[328]

192. The distinction between the prices farmers expect and the marketing loan subsidies they expect is akin to the difference between deterministic and stochastic projections of marketing loan subsidy outlays.[329] Like farmers, USDA also ascribes value to the marketing loan program even when prices are expected to be at or above the loan rate. For example, USDA's *deterministic* projection of

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[321] U.S. 2 April response to question 81, para. 196.

[322] *See* Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para 77.

[323] U.S. 2 April response to question 82, para. 202.

[324] U.S. 2 April response to question 82, para. 202.

[325] U.S. 2 April response to question 82, para. 202.

[326] *See* Brazil's 2 April response to question 89, para. 189 ("deterministic projections, by their nature, tend to underestimate outlays").

[327] Exhibit Bra-569 (Statement of Professor Sumner Concerning Various U.S. Argument, para. 55).

[328] Appellate Body Report, *U.S.-Upland Cotton*¸ para. 445 (addressing similar arguments raised by the United States in paras 226-235 of its First Written Submission).

[329] For a detailed explanation of the difference between deterministic and stochastic estimates, *see* Brazil's Opening Statement, para. 82 and Brazil's 2 April answer to question 89, paras. 189-190.

marketing loan subsidies, which is based on price projections, is $0 in MY 2009, while its *stochastic* projection is $468 million.[330]

193. USDA's deterministic projection of marketing loan subsidies in MY 2007 is $238 million, indicating that USDA expects the AWP to be below the loan rate.[331] However, based on the probably that prices will be even lower, USDA's stochastic projection of marketing loan subsidies is $798 million. USDA's latest projection that upland cotton production will be 20.7 million bales in MY 2007[332] suggest per-unit expected marketing loan subsidies of 8 cents per pound[333], not 2 cents per pound, as put forward by the United States.[334]

194. In sum, by relying on expected prices, instead of expected subsidies, the United States is repeating a mistake it has made throughout this proceeding. Only stochastic estimations of marketing loan subsidies capture the likelihood that prices will be lower and payments higher. Relying on the difference between the expected AWP and the loan rate does not capture this effect. As explained by USDA, "deterministic projections, by their nature, tend to underestimate outlays."[335]

195. Brazil notes that the United States does cite to FAPRI's July 2006 stochastic projections of marketing loan subsidies. However, this projection of marketing loan payments of 1.9 cents per pound[336] is significantly below USDA's own projections of 8 cents per pound. There is a very good reason why USDA estimates are more reliable than the July 2006 FAPRI projections – they are more recent. USDA estimates are found in USDA's Commodity Estimates Book for the FY 2008 President's Budget, which was released in February 2007 – eight months later than the FAPRI baseline that the United States relies on.[337]

196. Furthermore, while the complete 2007 FAPRI baseline has not been released[338], the parts that have been released confirm that FAPRI's projections of upland cotton prices in July 2006 were too high. For example, FAPRI now projects the MY 2007 U.S. farm price for upland cotton to be $0.518 per pound.[339] Last July, it predicted the same price to be $0.534 per pound.[340]

197. Current futures prices also indicate that large marketing loan and counter-cyclical payments can be expected due to expected low prices in MY 2007. The following chart details daily closing prices of the December 2007 contract for upland cotton.

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[330] Brazil's 2 April response to question 89, Table 4 at para. 189.

[331] *See* U.S. 2 April response to question 82, para. 203.

[332] Exhibit Bra-635 (2002-2007 USDA Agricultural Baseline Projections).

[333] $798 million / (20.7 million bales * 480 pounds per bale) = $0.0803 per pound.

[334] *See* U.S. 2 April response to question 82, para. 203.

[335] Exhibit Bra-460 (Explanatory Notes for Stochastic Budget Outlay Estimates, Farm Service Agency, accessed October 2006 at http://www.fsa.usda.gov/Internet/FSA_File/msrexplain.doc).

[336] Exhibit Bra-479 (2006 Baseline Update for U.S. Agricultural Markets, FAPRI-UMC Report 12-06, July 2006, p. 6, accessed October 2006 at http://www.fapri.missouri.edu/outreach/publications/2006/FAPRI_UMC_Report_12_06.pdf).

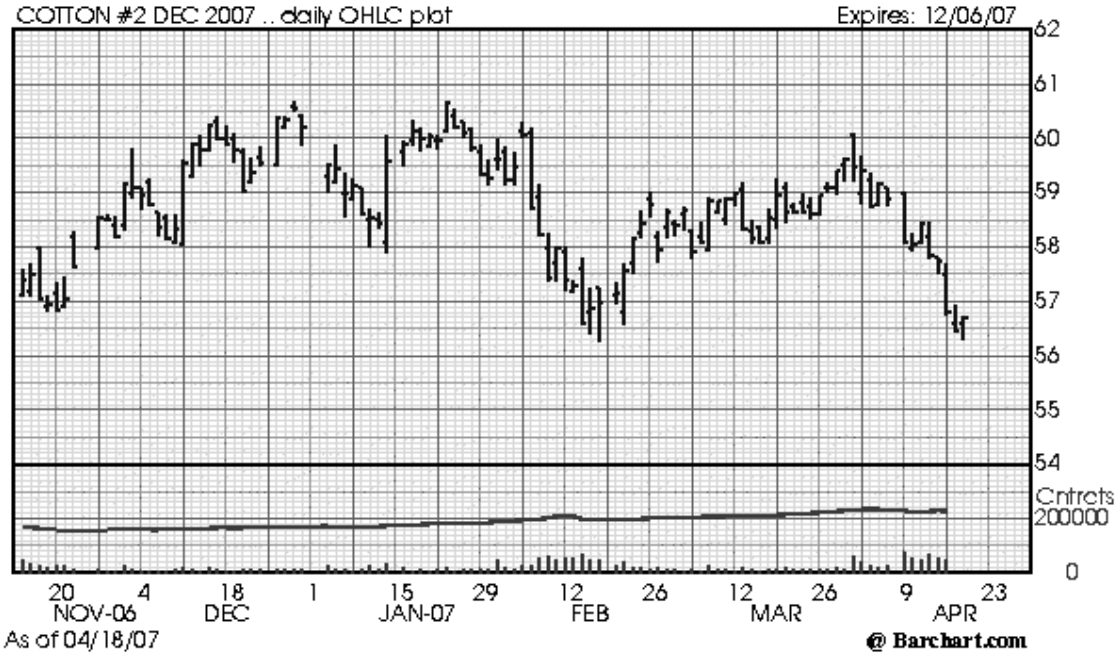
[337] Exhibit Bra-639 (Commodity Estimates Book for FY 2008 President's Budget)

[338] Unfortunately, relevant portions of the latest 2007 FAPRI Agricultural Outlook" has not yet been released, but the FAPRI "World Agricultural Briefing Book" has been released, *see* http://www.fapri.iastate.edu/brfbk07/.

[339] FAPRI World Agricultural Outlook Briefing Book, World Cotton, available at http://www.fapri.iastate.edu/brfbk07/CottonTables2007.pdf.

[340] Exhibit Bra-479 (2006 Baseline Update for U.S. Agricultural Markets, FAPRI-UMC Report 12-06, July 2006, p. 6, accessed October 2006 at http://www.fapri.missouri.edu/outreach/publications/2006/FAPRI_UMC_Report_12_06.pdf).

Figure 6 – Prices for the December 2007 Upland Cotton Futures Contract[341]



198. The average January to March closing price of the December 2007 futures contract was $0.588 per pound.[342] The price of the December 2007 futures contract has since fallen to less than $0.57 per pound. Brazil recalls that marketing loan subsidies are based off of the adjusted world price, which is, on average, 17.3 cents below the average January to March futures price.[343] A simple linear regression of futures prices and actual marketing loan payments indicates that, based on the current futures price of $0.588 per pound for MY 2007, farmers can expect a marketing loan subsidy of 12.3 cents per pound[344], or about $1.2 billion.[345] This would represent 17 percent of the total projected cost of producing a pound of cotton in MY 2007.[346]

199. In the end, it is impossible to know how large marketing loan subsidies will be in MY 2007. Brazil notes that the average futures price of $0.588 per pound during the planting period of MY 2007 is similar to futures prices in the planting period of MY 2001, 2003 and 2006.[347] Actual marketing loan subsidies in these years varied widely, ranging from $2.6 billion in MY 2001, to $757 million (projected) in MY 2006 and to just $184 million in MY 2003.[348] The inability of futures prices to

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[341] *See* http://www2.barchart.com/dfutpage.asp?sym=CT&code=BSTK.

[342] This figures includes complete data through the end of March (*See* Exhibit Bra-691 (Average January to March Price of the December 2007 futures contract)). Despite being asked to provide complete data by the Panel, the United States only provides data through 9 March in Exhibit US-147.

[343] Brazil's Rebuttal Submission, para. 105.

[344] *See* Exhibit Bra-621 (Upland Cotton Expected Marketing Loan Program Payments Based on Futures Prices).

[345] USDA's 2007 baseline projects 20.7 million bales of production in MY 2007. *See* Exhibit Bra-635 (2002-2007 USDA Agricultural Baseline Projections).

[346] Marketing loan payments (12.3 cents per pound) * expected yield per planted acre (806 pounds per acre) / Total costs per acre (593.5 dollars per acre) = 16.7 percent. *See* Exhibit Bra-634 (Analysis of Planting Decisions Based on Expected Returns).

[347] The average January to March closing price of the December contract was 58.07 cents per pound in MY 2001, 59.12 cents per pound in MY 2003 and 59.28 cents per pound in MY 2006. *See* Exhibit Bra-621 (Upland Cotton Expected Marketing Loan Payments Based on Futures Prices.

[348] *See* Brazil's First Written Submission, Table 6 at para. 111. For MY 2006, *see* Brazil's 2 April response to question 89, Table 4 at para. 189.

predict actual subsidies was even more apparent in MY 2004 and 2005. The average futures price in MY 2004 was $0.674 per pound, while in MY 2005 it was $0.529 per pound. Yet, in MY 2004, marketing loan subsidies amounted to $1.8 billion and were 50 percent greater than marketing loan subsidies of $1.2 billion in MY 2005.[349] The following chart shows the progression of nearby futures prices over the past four years:

Figure 7 – Nearby Futures Prices[350]

200. In sum, every farmer knows that expectations based on futures prices, just like USDA and FAPRI projections are just that – projections – and that *actual* prices and *actual* subsidies vary widely. Despite the U.S. focus on "expectations," the underlying reality throughout the life-time of the FSRI Act of 2002 has been self-sustaining low upland cotton prices and enormous price-contingent marketing loan and counter-cyclical subsidies. The evidence in the record fully supports the conclusion that such subsidies and their price suppressing effects will continue throughout the lifetime of the FSRI Act of 2002.

D. EXPORT CREDIT GUARANTEES

1. Outstanding export credit guarantees

Questions to the United States

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

[349] *See* Brazil's First Written Submission, Table 6 at para. 111, as amended by updated marketing loan subsidy amounts (*see* Brazil's 16 March Comments on U.S. Answer to Question 4, para. 14) and an updated counter-cyclical subsidy amount in MY 2005 (*see* Brazil's Oral Statement, para. 40). *See also* Exhibit Bra-621 (Upland Cotton Expected Marketing Loan Payments Based on Futures Prices.

[350] *See* http://www.agweb.com/, accessed April 2007.

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

201. Although the United States asserts that it does not maintain data concerning outstanding ECGs on a commodity-specific basis, FAS' monthly summaries of GSM 102 program activity is recorded on a commodity-specific basis (at least with respect to select commodities, such as rice).[351]

202. However, if the United States does not maintain data regarding ECGs issued and outstanding on a commodity-specific basis, this fact is telling, and confirms that there is no factual basis for the United States to characterize the measure subject to Brazil's claims of inconsistency with Articles 10.1 and 8 of the *Agreement on Agriculture* as "the pig meat and poultry meat GSM 102 guarantees".[352] Neither the amended GSM 102 program in its totality, nor the individual amendments, set out terms or conditions that differ as between different eligible products.[353] In its response to the compliance Panel's question, the United States insists that it *does not even maintain data* on GSM 102 ECGs issued and outstanding on a product-specific basis.

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

Questions to both parties

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

203. Contrary to the United States' assertion in its response, Brazil does not ask the compliance Panel to "ignore" Article 14(c) of the *SCM Agreement* in its assessment of the "benefit" flowing from GSM 102 ECGs under the amended GSM 102 fee schedule.[354]

204. Based on Appellate Body jurisprudence, Brazil has noted the Appellate Body's ruling that Article 14 must not be applied "rigidly", even in disputes under Part V of the *SCM Agreement*, to which the provision explicitly applies.[355] The Appellate Body has held that even in disputes under Part V of the Agreement, the provision must be applied flexibly, to account for the "factual circumstances" at hand.[356]

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[351] *See* http://www.fas.usda.gov/excredits/Monthly/ecg.html. This is unfortunately not so for some other commodities, which are grouped into categories (*e.g.*, feed grains) that do not match the commodity categories included in the U.S. Schedule of reduction commitments, making an assessment of circumvention under Article 10.1 of the *SCM Agreement* impossible in some instances. It is for this reason that Brazil asked the Panel to pose question 7 of the list of questions to the United States. Question 7 asks the United States for a correspondence table tying the categories of commodities included in FAS' monthly summaries to the categories of commodities included in the U.S. Schedule.

[352] U.S. Rebuttal Submission, para. 10.

[353] *See* Brazil's 26 February answers to questions, para. 29.

[354] U.S. 2 April answer to question 95, para. 211.

[355] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.

[356] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.

205. Preserving this flexibility is even more important in disputes under Part II of the *SCM Agreement*. In a dispute under Part II, only the existence of *some* "benefit" under Article 1.1(b) must be established, and not the quantity of that benefit. In a passage cited by the United States in these proceedings, the original panel considered that imposing the "quantitative focus and more detailed methodological obligations of Part V" of the *SCM Agreement* on disputes preceding under Part III of the *Agreement* was not appropriate, even where assessing the "magnitude" of the subsidy was required.[357] For a dispute under Part II of the Agreement, where *no* assessment of the "magnitude" of the subsidy is required, much less the calculation of a countervailing duty rate, there is no basis whatsoever to impose the "quantitative focus and more detailed methodological obligations of Part V …. "[358]

206. In its 2 April response to question 100, Brazil demonstrated the proper role for Article 14(c) in these proceedings. The "factual circumstances"[359] in these proceedings under Part II of the *SCM Agreement* are such that a "particularized showing"[360], utilizing data concerning "individual loan costs and fees" or "comparable commercial loans and their terms"[361], is not necessary. Proof of some "benefit" can be established without the type of evidence on which the United States insists.

207. Indeed, in proceedings involving claims against government guarantees under Parts II and V of the *SCM Agreement*, panels have already twice ruled that evidence of the type insisted on by the United States is not necessary to show that a benefit exists.[362] Rather, evidence far short of that produced by Brazil in these proceedings (described in Brazil's 2 April response to question 100[363]) was accepted by these two panels as sufficient to satisfy Article 1.1(b) of the *SCM Agreement*, as informed by Article 14(c). Each of these two panels effectively accepted that, in principle, below-market fees for government guarantees translate into lower costs for commercial credit, and thus a lower total cost of funds – a conclusion rooted in the basic principles of financial economics addressed by Brazil in its 2 April response to question 100.[364]

208. This does not amount to "ignoring" Article 14(c), as the United States asserts.[365] Rather, it amounts to putting Article 14(c), and the evidence required to satisfy it, into the particular context of these proceedings.

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

209. The United States' position is that two-year bullet loans and three-year amortizing loans are equivalent, as long as one averages out the lives of the two loans.

210. Brazil's position is that two-year bullet loans and three-year non-amortizing loans are not equivalent, and that averaging out the lives of the two loans does not make them so, in light of the varying risks of default.

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[357] U.S. 16 March comments, para. 70. Panel Report, *U.S. – Upland Cotton*, para. 7.1177. *See also Id*., para. 7.1167.

[358] Panel Report, *U.S. – Upland Cotton*, para. 1177. *See also Id*., para. 1167.

[359] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.

[360] U.S. 6 March Response to Question 41, para. 80.

[361] U.S. Rebuttal Submission, para. 137.

[362] Panel Report, *EC – CVDs on DRAMs*, para. 7.189; Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.345.

[363] Brazil's 2 April answer to question 100, paras. 232-262.

[364] Brazil's 2 April answer to question 100, paras. 245-253.

[365] U.S. 2 April answer to question 95, para. 211.

211. In its response to question 96, Brazil provided support for its position. Instead of providing support for the U.S. position, the United States instead ascribes to Brazil positions that Brazil has not taken, and argues against those imaginary positions. The United States' response is nothing more than an effort to mislead the compliance Panel, and to deflect attention from the evidence Brazil has offered to prove that bullet and amortizing loans do not have equivalent spreads even if they have the same average lives.

212. With reference to a simplified example addressed at paragraphs 220-222 of Brazil's Oral Statement, the United States argues that Brazil's position requires the compliance Panel to assume that risk "increases over time", such that there is "much higher risk in year 3 of the GSM 102 transaction." The United States admonishes Brazil for providing no basis for this "assumption", which it argues is "not even sound as a theoretical matter."[366]

213. This characterization of Brazil's position is so misleading as to be absurd. Brazil has not asked the compliance Panel to assume this scenario as a matter of fact, but merely to consider it as one hypothetical example. Other examples, involving alternative patterns of default risk, are also considered in paragraphs 31-32 of a statement by Professor Sundaram included as Exhibit Bra-686 to Brazil's 2 April responses. Each of these paragraphs includes two examples; in one example in each paragraph, default risk <u>increases</u> over time, while in the other example in each paragraph, default risk <u>decreases</u> over time. As the examples show, the spread on amortizing loans could be greater or lesser than the spread on bullet loans, depending on the pattern of default risk. That is Brazil's position, and it is mathematically proven by Professor Sundaram in Exhibit Bra-686.

214. In paragraphs 221-222 of its 2 April response, the United States provides a reference that in fact supports Brazil's position. The United States cites a paper finding that for seven-year loans, the likelihood of default "in general" increases over time, rather than decreases.[367] This substantiates Brazil's argument that since default risk is not constant from year to year, bullet and amortizing loans will, in general, have different spreads.[368]

215. Brazil also addresses three other issues raised in the United States' response to question 96: (i) the use of the average life concept in the context of mortgage-backed securities; (ii) the use of the average life concept in pricing swaps in terms of U.S. Treasuries with the same average lives; and, (iii) the use of the average life concept in pricing for an amortizing loan obtained by adding a fixed spread to an index.

<u>Average life in the context of mortgage-backed securities</u>

216. In paragraph 219, the United States suggests that "the concept of average life is commonly used for price comparability of investments and debt-instruments of various terms." The first example in paragraph 219 refers to mortgage-backed securities ("MBS"). Brazil makes two observations about this example.

217. First, and most importantly, the reference does not address, much less establish, the comparability of bullet and amortizing loans with the same average lives, which is the question raised by the Panel. Indeed, in discussing the relevance of the average life concept to MBS, the United States makes no reference at all to pricing. The United States does not, for example, suggest that the price of an MBS is the price of a similar bullet security with the same average life.

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[366] *See* U.S. 2 April answer to question 96, paras. 218, 221, 222.

[367] Exhibit US-152 (Dennis Glennon and Peter Nigro, "Measuring the Default Risk of Small Business Loans: A Survival Analysis Approach," *Journal of Money, Credit, and Banking*, Vol. 37, No. 5 (October 2005), p. 935, 945).

[368] Brazil's 2 April answer to question 96, para. 223. *See also* Exhibit Bra-686 (Statement of Professor Sundaram).

218. Second, the reference to MBS relies on an incorrect understanding of why average life is used for MBS. The biggest risk faced by the holder of an MBS is *pre-payment risk*, or in other words, the risk that some of the individual mortgages underlying the MBS will be pre-paid by the borrowers.[369] Thus, the maturity of the MBS is not, in itself, adequate to describe the instrument. Two MBS may have the same maturity, but if one has higher pre-payment risk than the other (say, because the mortgage coupons underlying it are higher), then the cash flows will last for a shorter period of time. To restore some kind of comparability between different MBS, investors use models that attempt to predict the volume of pre-payments, and calculate an average life accordingly.[370] Such an average life calculation is unnecessary if there is no prepayment risk.

Average life in pricing swaps

219. In paragraph 219 of its response, the United States quotes an article stating that swap dealers "'routinely price the fixed rate side of an interest rate swap as a spread over United States Treasuries of a similar average life.'"[371] This statement does not provide support for (or even address) the United States' assertion that two-year bullet loans and three-year amortizing loans with the same credit quality have identical credit risk whenever they have the same "average lives".

220. The article cited by the United States describes a situation in which an institution holding fixed-rate amortizing mortgage debt funded with the issue of floating rate short-term debt seeks to hedge interest rate risk by using a "swap". A swap is an exchange of cash flows computed at a floating rate of interest, for cash flows computed at a fixed rate of interest. The institution in question looks to receive the floating-rate payment from the swap seller and make the fixed-rate payment to the swap seller so that, taken together with the mortgage that it holds and the floating-rate debt issued to fund that mortgage, the institution's interest-rate exposure is only fixed rate.

221. To identify the fixed rate in a swap, dealers generally add a spread to the Treasury yield on a bond with the same maturity as the swap. However, where the notional principal is amortizing, as in the example offered in the article quoted by the United States, a problem arises – while the notional principal on the mortgage is amortizing, Treasury bonds are bullet bonds. Some adjustment is required to equate the differing maturities of amortizing and non-amortizing debt. This adjustment is addressed in endnote 4 to the article: "[a]verage life is used by swap dealers to equate the maturities of nonamortizing Treasury debt and amortizing mortgage debt."[372]

222. The compliance Panel, however, has asked for support in the literature for the U.S. assertion that non-amortizing and amortizing debt with the same credit quality have identical credit risk whenever they have the same "average lives". This proposition is not even addressed by the example offered in the article quoted by the United States, because the mortgage debt and the Treasury bond in the example have different credit qualities, despite the fact that they have the same "average life".

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[369] *See* http://www.riskglossary.com/link/mortgage_backed_security.htm ("Prepayments introduce uncertainty into the cash flows of a mortgage pass-through. The rate at which fixed-rate mortgagors prepay is influenced by many factors. A significant factor is the level of interest rates. Mortgagors tend to prepay mortgages so they can refinance when mortgage rates drop. By acting in their own best interest, mortgagors act to the detriment of the investors holding the mortgage pass-through. They tend to return principal to investors when reinvestment rates are unattractive, and they tend to not do so when reinvestment rates are attractive"). *See also* http://personal.fidelity.com/products/fixedincome/pombs.shtml. In any event, the vast majority of MBS in the United States have no default risk, since they are guaranteed by federally-sponsored institutions such as Freddie Mac, Fannie Mae, and Ginnie Mae. *See* http://www.sec.gov/answers/mortgagesecurities.htm. *See also* http://www.riskglossary.com/link/mortgage_backed_security.htm.

[370] *See* http://www.riskglossary.com/link/mortgage_backed_security.htm. *See also* http://personal.fidelity.com/products/fixedincome/pombs.shtml.

[371] U.S. 2 April answer to question 96, para. 219, *quoting* Exhibit US-150.

[372] Exhibit US-150, p. 21 (note 4) (emphasis added).

The article cited by the United States does not, as a result, provide support for the U.S. assertion that two-year bullet loans and three-year amortizing loans with the same credit quality have identical credit risk whenever they have the same "average lives".

Average life in pricing an amortizing loan
obtained by adding a fixed spread to an index

223. In paragraph 220 of its response, the United States offers another example of the "average life" concept, in this instance suggesting pricing for an amortizing loan obtained by adding a fixed spread to the appropriate index.

224. The example cited by the United States in paragraph 220 and the website cited at Exhibit US-151 do not, as requested by the Panel, offer support for the U.S. position that two-year bullet loans and three-year amortizing loans are equivalent, as long as one averages out the lives of the two loans. Indeed, Exhibit US-151 and the example included in paragraph 220 of the U.S. response do not address the correctness of the U.S. position at all.

225. The U.S. example demonstrates how a single firm in the industry, Bond Street Capital ("BSC"), approaches the pricing of its amortized loans. The example does not involve the use of "average lives" to put bullet loans of a particular maturity and amortizing loans of a different maturity on equivalent footing, therefore enabling a comparison of the prices for the two instruments. The example shows that BSC indexes its loans to average lives of U.S. Treasuries or swaps. It does not suggest that BSC considers an amortizing loan with an average life of *m* years to be equivalent in spread to a bullet loan with a life of *m* years. Indeed, the example does not even mention how BSC would price a bullet loan. Neither the example, nor the material included in Exhibit US-151, exclude that BSC would add different spreads to the index for bullet and amortizing loans.

226. Brazil also notes that the "average lives" of the loans included in the example do not comport to the common understanding of that concept. In paragraph 220 of the U.S. response and Exhibit US-151, BSC asserts that a "15/15" loan has an average life of 9 years. That is simply not accurate. A "15/15" loan has an average life of 8 years. One-fifteenth of the capital is repaid in each of the fifteen years, so the average life is (1/15) * (1+2+ . . . +15), or 8 years. Similarly, BSC asserts that the average life of a "20/20" loan is 12 years, but it is actually 10.5 years ((1/20) * (1+2+ . . . +20) = 10.5). Even if the example served to support the position for which it is offered, it is not reliable, as the average life computation is incorrect.

Questions to the United States

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

227. In its comment on the U.S. response to question 44, Brazil has addressed the United States' professed confusion over whether Brazil is "challenging" the GSM 102 program "as such", or instead "particular guarantees" under the GSM 102 program.[373] As noted in that comment, Brazil has shown that the amended GSM 102 program is an export subsidy. Separately, Brazil has also shown that the GSM 102 program is "applied", *via* individual GSM 102 ECGs for particular products, in a manner that results in circumvention of U.S. export subsidy commitments.

[373] U.S. 2 April answer to question 97, paras. 224-225.

228. In any event, it is not necessary in WTO dispute settlement to prove that a measure violates WTO law in "all" instances. As the panel in *U.S. – Export Restraints* held, it suffices that a measure violates WTO laws in some instances.[374]

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

229. In its First Written Submission, Brazil demonstrated that GSM 102 fees are below the fees charged by the United States' Export-Import Bank ("ExIm Bank") for financial instruments that are in key respects similar to GSM 102 ECGs – ExIm Bank's Letter of Credit Insurance ("LCI") (which serves as a reference point for GSM 102 ECGs issued for tenors of *up to 360 days*), and ExIm Bank's Medium-Term Export Credit Insurance ("MTI") (which serves as a reference point for GSM 102 ECGs issued for tenors *exceeding 360 days*).[375] The results of this comparison between GSM 102 and ExIm Bank fees are tracked in Exhibits Bra-536 (for transactions involving annual repayment of principal) and Bra-537 (for transactions involving semi-annual repayment of principal).

230. The United States argues that GSM 102 ECGs are not similar to ExIm Bank LCI and MTI products, and are therefore not suitable for comparison, for five reasons.

231. Before addressing each of these five reasons, Brazil notes the irony of this situation. Brazil has demonstrated that there is no credit protection product available in the marketplace that is comparable to a GSM 102 ECG.[376] Nonetheless, in addition to that showing, Brazil undertook a comparison between GSM 102 fees and fees for comparable non-market products offered by ExIm Bank. In rebuttal, the United States has not offered a single example of a credit protection product available in the marketplace. Brazil's fundamental position – that GSM 102 ECGs confer "benefits" *per se* because they have no parallel at market – remains unrebutted by the United States with anything that resembles evidence, and indeed echoes the position the United States has taken in other disputes.[377]

232. With that important qualification, Brazil addresses each of the five reasons offered by the United States in support of its argument that ExIm Bank LCI and MTI products are not suitable for comparison with GSM 102 ECGs.

First U.S. criticism:
No ExIm Bank MTI cover for agricultural product transactions

233. **First**, the United States observes that ExIm Bank's MTI is not available for agricultural products, and that it is not therefore comparable to GSM 102.[378]

234. Brazil has already alerted the Panel to this distinction. As Brazil noted in its First Written Submission[379], ExIm Bank cover is indeed not, in normal circumstances, available for agricultural

[374] Panel Report, *U.S. – Export Restraints*, para. 8.78.

[375] Brazil's First Written Submission, paras. 381-406 and Annex IV (Methodology for Comparison of GSM 102 Fees with Fees for ExIm Bank Products).

[376] Brazil's First Written Submission, paras. 377-378. *See also Id.*, Annex III (Statement of Professor Rangarajan Sundaram), paras. 8-9.

[377] Panel Report, *Canada – Aircraft Credits and Guarantees*, Annex C-2 (para. 7) ("If the commercial market does not offer a particular borrower the exact terms offered by a government, then the government is providing a benefit to the recipient whenever those terms are more favorable than the terms that are available at market. A government entity 'operating on commercial principles' is still a government entity. It is not the commercial market.").

[378] U.S. 2 April answer to question 98, para. 227.

[379] Brazil's First Written Submission, paras. 389-393.

export transactions with tenors exceeding 180 days or, exceptionally, 360 days.[380] The *minimum* tenor for a transaction to qualify for MTI cover is 360 days. Thus, MTI cover is not available for agricultural products.

235. Brazil fails to see how this criticism aids the United States' defense. All the U.S. observation establishes is that it is not even possible to identify a *non*-market instrument *distorted by government intervention* to serve as a benchmark for GSM 102 ECGs issued for tenors exceeding, at most, 360 days, let alone a *market* instrument. The compliance Panel will recall that in Congressional testimony, the Chairman of CoBank stated that GSM 102's three-year tenor "is critical to the program's success," and that the program "provides for tenors that are typically unavailable in the market and this is a crucial strength of the program."[381]

236. In any event, as Brazil has already explained and the United States has ignored, the fact that a financial instrument does not apply to agricultural products does not undermine the comparability of its fees to GSM 102 fees, and in fact reveals that the ExIm Bank comparison is overly generous to the United States.[382]

237. There is no reason why guarantees for agricultural products should be less risky than credit protection for transactions involving capital goods and products. If anything, making agricultural products subject to ExIm Bank's MTI cover would *increase* MTI fees. In an agricultural export transaction, the value of the product sold holds little value for the guarantor as a security against default by the foreign obligor. Shortly after sale, an agricultural commodity is likely to be (and short of preservation may indeed have to be) consumed; the value of any security interest in the commodity will be short-lived, and usually far less than 360 days. In contrast, an industrial product is generally more durable and lasting, and as such is more susceptible to use as security for performance by the foreign obligor, should the guarantor wish to do so. The availability of this option may lower the risk associated with default faced by the guarantor and, as a consequence, lower the fees necessary to offset that risk. Where this option is not viable, the loss in the event of default is greater, as will be the fees necessary to offset the corresponding risk.

Second U.S. criticism:
No ExIm Bank MTI cover for repayment terms between 360 days and 2 years

238. **Second**, the United States appears to suggest that unlike GSM 102, which applies for repayment terms of up to three years and in "hundreds of … transactions" for less than two years, ExIm Bank's MTI is only available for repayment terms of *more than* two years.[383] While not expressed clearly, the U.S. allegation appears to be that Brazil has not offered a valid comparison for GSM 102 fees for transactions involving repayment terms of between 360 days and two years.

239. To isolate with precision the U.S. criticism, Brazil notes that the criticism does not affect the comparability of GSM 102 fees and ExIm LCI fees for transactions involving repayment terms of 360 days or less. Nor does it affect the comparability of GSM 102 fees and ExIm MTI fees for transactions involving repayment terms of between two and three years.

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[380] *See* Exhibit Bra-532 (ExIm Bank, "Standard Repayment Terms," Chart II, accessed October 2006 at www.exim.gov/tools/exposure/ebd-m-26.html). *See also* Exhibit Bra-533 (ExIm Bank export credit insurance product description, accessed October 2006 at http://www.exim.gov/products/insurance/index.cfm).

[381] *See* Exhibit Bra-528 ("GSM Programs Benefit U.S. Agriculture and the Rural Economy", Testimony of Otis Molz, Chairman of the Board of CoBank, to the U.S. Senate Committee on Agriculture, Nutrition and Forestry, 18 July 2000, accessed November 2006 at http://agriculture.senate.gov/Hearings/Hearings_2000/Untitled/00718mol.htm).

[382] Brazil's First Written Submission, para. 443.

[383] U.S. 2 April answer to question 98, para. 227.

240. The United States assertion that MTI cover is not available for repayment terms of between 360 days and two years is, to put it bluntly, untruthful. ExIm Bank documents expressly state that MTI coverage is available for repayment terms of 1-5 years.[384] The ExIm Bank calculator with which Brazil generated the MTI fees tracked in Exhibits Bra-536 and Bra-537 also specifically permits the user to control for repayment periods of between 360 days and two years (and beyond).[385]

241. In any event, the vast majority of GSM 102 ECGs are indeed issued for transactions involving repayment terms in excess of two years – to which the United States acknowledges ExIm Bank's MTI policies apply. The United States notes that "hundreds of GSM-102 transactions, totalling hundreds of millions of dollars are in fact for terms of less than 2 years."[386] When the figures offered by the United States are compared to total GSM 102 ECGs issued in FY 2003-2006 (as well as part-year totals for FY 2007), however, the compliance Panel will note that they compose approximately 8 percent of the nearly $10 billion in GSM 102 ECGs issued in that period.[387] Thus, the vast majority of GSM 102 ECGs – 92 percent – are issued for repayment terms of over two years, which even the United States acknowledges matches the repayment terms for ExIm Bank MTI cover.

242. The United States deliberately withheld its comments on Brazil's ExIm Bank comparison until this late stage of the proceedings, having foregone the opportunity to do so in the 7 submissions it made prior to its 2 April answers and subsequent to Brazil's proffer of the comparison in Brazil's First Written Submission. When it finally offers comment, it misleads the compliance Panel with inaccurate factual statements contradicted by the very U.S. government documents and data on which the United States relies. As well as being tardy, the United States' criticisms of Brazil's ExIm Bank comparison are not credible.

Third U.S. criticism:
Differing interest coverage as between GSM 102 and ExIm Bank products

243. **Third**, the United States argues that Brazil's comparison fails to account for differing levels of interest coverage by GSM 102, on the one hand, and ExIm Bank's LCI and MTI policies, on the other.[388]

244. Once again, had the United States taken the opportunity to raise this concern in the 7 submissions it made prior to its 2 April answers, it could have been resolved in a timely manner. Nonetheless, to answer the United States' concern, Brazil has re-run its ExIm Bank comparison to account for differing levels of interest coverage under GSM 102 and ExIm Bank's LCI and MTI policies. The results show that given the massive gap between GSM 102 fees and ExIm Bank fees, differing interest cover has no material impact on the results of the ExIm Bank comparison tracked in Exhibits Bra-536 and Bra-537.

245. The benchmarking exercise tracked in Exhibits Bra-536 and Bra-537 yields a total of 1071 comparison points between GSM 102 and ExIm Bank fees; in 97.76 percent of those comparisons (1047 of 1071 comparison points), GSM 102 fees fall below ExIm Bank fees.[389] Taking account of the differing interest cover noted by the United States means that GSM 102 fees fall below ExIm

[384] *See* Exhibit Bra-534 ("ExIm Bank Repetitive Sales Bank-to-Bank Export Credit Insurance Policy", Form EIB 99-10, p. 1, accessed November 2006 at http://www.exim.gov/pub/ins/pdf/eib99-10.pdf) ("The policy covers credit sales in which payment terms range between one and five years (exceptionally 7 years).").

[385] *See* http://www.exim.gov/tools/fee_calc.html.

[386] U.S. 2 April answer to question 98, para. 227 (and note 236).

[387] *Compare* figures provided in footnote 236 of U.S. 2 April answer to question 98 *with* GSM 102 totals recorded in end-of-fiscal-year Monthly Summaries of Export Credit Guarantee Program Activity for FY 2003-FY 2006, provided, respectively, in Exhibits Bra-518, Bra-510, Bra-511 and Bra-523. The March 2007 monthly summary is available at http://www.fas.usda.gov/excredits/Monthly/ecg.html.

[388] U.S. 2 April answer to question 98, paras. 229-235.

[389] Brazil's First Written Submission, para. 395.

Bank fees in 97.2 percent of the 1071 comparison points (or 1041 of 1071 comparison points).[390] In other words, what the United States characterizes as "[t]he most significant" difference between GSM 102 ECG cover and ExIm Bank LCI and MTI cover that "Brazil has failed to address" changes the result of Brazil's comparison for a grand total of ***six*** out of 1071 comparison points.[391]

246. Brazil now describes how it has factored the differing interest coverage into the comparison, and explains why even the meagre impact just described is likely exaggerated in the United States' favour.

247. As noted by the United States, in the event of default, GSM 102, on the one hand, and ExIm Bank LCI or MTI coverage, on the other, foresee payment of a share of principal, and a share of interest.

248. As far as principal is concerned, under both GSM 102 and ExIm Bank LCI cover, default results in the guarantor having to pay out 98% of the principal amount that is still outstanding; the ExIm Bank fee calculator allows the user to calculate the applicable MTI fee for 98 percent cover.[392]

249. With respect to interest, there are two questions to assess:

- What is the upper limit for interest coverage under GSM 102, on the one hand, and for ExIm Bank LCI and MTI, on the other?

- Where do the actual interest rates on loans secured with GSM 102 or ExIm Bank LCI/MTI cover fall relative to these caps?

250. These questions are important in determining what level of interest coverage must be taken into account in comparing the GSM 102 and ExIm Bank products. In sum, for the reasons explained below, Brazil has relied on the maximum possible difference in interest rate coverage between GSM 102 and ExIm Bank LCI, to assess the significance of differential interest rate coverage.

251. Concerning the first question, the United States asserts, with supporting data, that GSM 102 interest coverage is capped at approximately 2.8%[393], meaning that in the event of default by a foreign obligor, the CCC will pay the U.S. bank no more than 2.8% for unpaid interest, even if the interest rate on the loan to the foreign obligor exceeds 2.8%.

252. ExIm Bank LCI interest coverage is capped at the prime rate (the interest rate charged by major banks to their most creditworthy customers) minus 50 basis points ("bps"). Data provided by the United States shows that the prime rate less 50 bps is, today, equal to approximately 7.8%.[394] Again, this means that in the event of default, ExIm Bank will pay no more than 7.8% interest cover in case of default, even if the interest rate on the loan subject to LCI cover exceeds 7.8%. ExIm Bank MTI interest coverage is not subject to a cap.[395]

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[390] The few instances in which GSM 102 fees exceed ExIm Bank LCI or MTI fees does not mean that GSM 102 fees do not confer "benefits" relative to the market. *See* Brazil's First Written Submission, paras. 403-406, and Annex III (Statement of Professor Rangarajan Sundaram), paras. 17-24.

[391] U.S. 2 April answer to question 98, paras. 230, 229, 235.

[392] For GSM 102, *see* Exhibit Bra-520 ("Export Credit Guarantee Program," USDA FAS Fact Sheet, March 2006). For ExIm Bank LCI, *see* Exhibit Bra-531 (ExIm Bank Letter of Credit Insurance for Banks, ExIm Bank online). For ExIm Bank MTI, the fee calculator is available at http://www.exim.gov/tools/fee_calc.html.

[393] U.S. 2 April answer to question 98, paras. 231, 233 (and note 243) and Exhibit US-156.

[394] U.S. 2 April answer to question 98, paras. 230, 232 (and note 242) and Exhibit US-154.

[395] U.S. 2 April answer to question 98, para. 230.

253. As noted by the United States, maximum interest coverage is, therefore, higher for the ExIm Bank products than for GSM 102 ECGs. To answer the United States' concern with Brazil's ExIm Bank comparison, Brazil re-ran that comparison to account for differing levels of interest coverage under GSM 102 and ExIm Bank's LCI and MTI policies. In so doing, Brazil applied the maximum interest coverage available under the ExIm Bank LCI cap, and applied the ExIm Bank LCI cap for the purposes of MTI cover – or in other words 7.8%. On the other side of the equation, Brazil similarly applied the maximum interest coverage under the GSM 102 cap – or in other words 2.8%. The details of this comparison, including interest coverage, are explained below.

254. The answer to the second question explains why application of the LCI cap, like Brazil's ExIm Bank comparison overall[396], is extremely conservative and favourable to the United States. In short, under both current and historical economic conditions, actual interest rates by borrowers benefiting from LCI or MTI cover fall significantly below the LCI cap.

255. The United States has provided data in these proceedings concerning the interest rates secured by foreign obligors on GSM 102-guaranteed loans. The highest interest rate tracked by the U.S. data is [[ ]][397], which at current levels corresponds to approximately [[ ]].[398] A USDA FAS publication confirms the U.S. data: "Typically interest rates between U.S. banks and the importer's banks are negotiated at Libor, the London Interbank Offered Rate, plus a fraction of a percent."[399] GSM 102, ExIm Bank LCI and ExIm Bank MTI products all contribute the same U.S. government credit rating to a transaction. Therefore, the rates offered on loans secured with ExIm Bank LCI/MTI cover will be the same as the rates offered on loans secured with GSM 102 cover – LIBOR plus a fraction of a percent or, today, approximately [[ ]].[400]

256. This evidence demonstrates that the rates secured with ExIm Bank LCI or ExIm Bank MTI cover do not reach the ExIm Bank LCI cap of 7.8%. Interest rates on loans subject to ExIm Bank LCI/MTI coverage are considerably lower than the LCI cap. While the United States argues that the absence of an interest cap for ExIm Bank MTI cover means that "one can only infer the disparity between CCC interest cover and [MTI cover] is even greater" than the disparity between CCC interest cover and LCI cover[401], this is not a logical or reasonable inference at all, in light of the fact that actual interest rates fall well below even the LCI cap.

257. Nor have rates secured with ExIm Bank LCI or ExIm Bank MTI cover reached the ExIm Bank LCI cap as an historical matter.

258. Over the 10-year period of 1997-present, the prime rate has ranged between a low of 4.0% from July 2003-June 2004, to a high of 9.5% from June 2000-January 2001.[402] The compliance Panel will recall that according to the United States, the LCI cap is set at the prime rate minus 50 bps.[403]

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[396] Brazil's First Written Submission, Annex IV (Methodology for Comparison of GSM 102 Fees with Fees for ExIm Bank Products), para. 6.

[397] U.S. First Written Submission, paras. 122, 125, 129. *See also* Exhibit US-22 (Letter from [[ ]]).

[398] *See* LIBOR USD rates for the first week of April 2007, available at http://www.bba.org.uk/content/1/c4/86/12/Apr07.xls. Averaging the data for the first week of April across maturities yields approximately 5.3%. This data is posted on the website of the British Bankers' Association ("BBA"), which itself determines the LIBOR rate every day by polling international banks. *See* http://www.bba.org.uk/bba/jsp/polopoly.jsp?d=225&a=1416.

[399] Exhibit Bra-589 (Foreign Agriculture Service Online, *Keys to Successful Trade*, p. 5) (emphasis added).

[400] *See* Brazil's 2 April answer to question 100, para. 251.

[401] U.S. 2 April answer to question 98, para. 234.

[402] *See* http://www.moneycafe.com/library/prime.htm, reproduced in Exhibit Bra-692 (LIBOR and Prime rates, 1997 to the present).

259. As discussed above, actual interest rates secured with LCI or MTI cover are pegged to LIBOR, with the addition of "a fraction of a percent,"[404] or as the United States has shown, around [[ ]] bps.[405] Over the 10-year period of 1997-present, LIBOR has ranged between a low of 1.09% in March 2004 and a high of 6.83% in November 2000.[406]

260. As both current economic conditions and historical conditions demonstrate, whether rates are high or low, LIBOR and the prime rate move roughly in tandem.[407] At no point has the LCI cap of prime minus 50 bps come any where close to falling below LIBOR plus [[ ]], or even LIBOR plus 1 percent (100 bps). The gap between the lower interest rates accessible by borrowers benefiting from LCI or MTI cover, on the one hand, and the higher LCI interest coverage cap, on the other, always exists.

261. Even though actual interest rates accessible by borrowers benefiting from LCI or MTI cover have never reached the LCI interest coverage cap and at present economic conditions fall below the cap by [[ ]] bps (7.8% less [[ ]])[408], Brazil has applied the LCI cap as the amount of interest cover available with LCI and MTI cover. Thus, Brazil's assessment of the impact of interest coverage is extremely conservative and favourable to the United States.

262. Thus, in its revised ExIm Bank comparison, Brazil assumes GSM 102 interest coverage at the cap of 2.8%, and ExIm Bank LCI and MTI interest coverage at the LCI cap of 7.8%.[409]

263. Under these conditions, if default occurs on a GSM 102-guaranteed loan, the CCC will pay 100.8% of the remaining principal – 98% towards principal, and 2.8% towards interest. If default occurs on a loan secured with LCI or MTI cover, ExIm Bank will pay 105.8% of the remaining principal – 98% towards principal, and 7.8% towards interest.

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[403] U.S. 2 April answer to question 98, para. 230.

[404] Exhibit Bra-589 (Foreign Agriculture Service Online, *Keys to Successful Trade*, p. 5).

[405] U.S. First Written Submission, paras. 122, 125, 129. *See also* Exhibit US-22 (Letter from [[ ]]).

[406] *See* http://www.moneycafe.com/library/1mlibor.htm, reproduced in Exhibit Bra-692 (LIBOR and Prime rates, 1997 to the present).

[407] *Compare* the 1997-present chart tracking evolution of the LIBOR rate, at http://www.moneycafe.com/library/1mlibor.htm, *with* the 1997-present chart tracking evolution of the prime rate, at http://www.moneycafe.com/library/prime.htm. These charts are reproduced in Exhibit Bra-692 (LIBOR and Prime rates, 1997 to the present).

[408] Over the 10-year period of 1997-present, actual interest rates on ExIm Bank LCI/MTI cover have fallen below the LCI interest coverage cap by between 113 bps (the low, in November 1999) and 326 bps (the high, in January 2001). *Compare* the 1997-present chart tracking evolution of the LIBOR rate, at http://www.moneycafe.com/library/1mlibor.htm (plus the [[ ]] bps noted by the United States as the spread for loans backed by U.S. government credit protection instruments, *with* the 1997-present chart tracking evolution of the prime rate, at http://www.moneycafe.com/library/prime.htm (less the 50 bps noted by the United States to generate the LCI cap). These charts are reproduced in Exhibit Bra-692 (LIBOR and Prime rates, 1997 to the present). The third and final chart in Exhibit Bra-692 represents the difference, in each month, between the LIBOR and prime rates in force.

[409] This is conservative and favorable to the United States for at least two additional reasons. First, the 5% gap between the 2.8% GSM 102 cap used by Brazil and the 7.8% LCI cap used by Brazil is greater than the 4.91% figure cited by the United States as the average size of the gap between GSM 102 and ExIm Bank LCI interest coverage for the period 2005-2007. U.S. 2 April answer to question 98, para. 233. Second, Brazil assumes that interest payments by the borrower on the loan are due annually. How much interest is owed by the CCC or ExIm Bank at the time of default depends on the contractual frequency of interest payments. If interest is paid annually, then at the time of default, the CCC or ExIm Bank are liable for a fully year's interest. If interest is paid quarterly and default occurs after, for example, the close of the second quarter, then at the time of default, the CCC or ExIm Bank are liable for interest on the third and fourth quarters only. Because a longer interval between interest payments increases the dollar magnitude of the differences in interest coverage highlighted by the United States, Brazil's analysis assumes that interest payments are due annually.

264. Let p_{gsm} be the premium charged per dollar of principal for GSM 102 cover, and let p_{exim} be the premium charged per dollar of principal for ExIm Bank LCI or MTI cover. As noted above, a GSM 102 premium pays 100.8% of the remaining principal in the event of default, while an LCI or MTI premium pays 105.8% of the remaining principal in the event of default. This means that per dollar of coverage, CCC charges $p_{gsm}/100.8$, while ExIm Bank charges $p_{exim}/105.8$.

265. If $p_{gsm} < [p_{exim} \times (100.8/105.8)]$, then GSM 102 fees are cheaper than LCI or MTI fees even after accounting for the differentials in interest coverage. Since (100.8/105.8) is approximately 95.3%, wherever GSM 102 fees are less than 95.3% of LCI or MTI fees, GSM 102 fees are below LCI or MTI fees, even accounting for differing interest coverage.

266. On the basis of the GSM 102 and ExIm Bank LCI and MTI fees listed in Exhibits Bra-536 and Bra-537[410], Exhibits Bra-693 (for GSM 102 transactions involving annual repayment of principal) and Bra-694 (for GSM 102 transactions involving semi-annual repayment of principal) list GSM 102 fees as a percentage of ExIm LCI and MTI fees. In every instance in which GSM 102 fees are less than 95.3% of LCI or MTI fees, GSM 102 fees are below ExIm Bank fees, even accounting for differences in interest cover. As Exhibits Bra-693 and Bra-694 show, <u>this is the case in 97.2 percent of the 1071 comparison points</u> (or 1041 of 1071 comparison points).[411]

267. In conclusion, differing interest cover between GSM 102 and ExIm Bank products does not undermine the validity of Brazil's comparison; nor does adjusting for those differences materially influence the results of that comparison.

Fourth U.S. criticism:
<u>Differing principal coverage as between GSM 102 and ExIm Bank MTI cover</u>

268. **Fourth**, the United States notes that while GSM 102 offers coverage for 98% of principal, ExIm Bank's MTI is available for coverage of up to 100% of principal.[412] In paragraph 390 of its First Written Submission, however, Brazil noted that the fee calculator available at ExIm Bank's website allows a user to reduce the amount of coverage, and to calculate the applicable MTI fee for 98 percent principal cover, or in other words, equivalent principal cover to GSM 102. Brazil did so for the purposes of calculating the ExIm Bank MTI fees tracked in Exhibits Bra-536 and Bra-537. Brazil has fully controlled for the possible difference in principal coverage noted by the United States. Not only has the United States waited nearly 5 months to comment on Brazil's ExIm Bank comparison until this late stage of the proceedings, having foregone the opportunity to do so in the 7 submissions it made prior to its 2 April answers, but it misleads the compliance Panel by raising an element that was controlled for by Brazil, *expressly*, in that comparison.

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[410] The Panel will recall that wherever a choice was presented with respect to variables in the ExIm Bank calculator used to generate MTI fees, Brazil adopted the most conservative option available, or in other words the option that would result in a lower ExIm Bank fee. *See* Brazil's First Written Submission, Annex IV (Methodology for Comparison of GSM 102 Fees with Fees for ExIm Bank Products), paras. 7-12.

[411] Instead of in 97.76 percent of those comparisons (1047 of 1071 comparison points), without accounting for differences in interest cover, as was the case in Exhibits Bra-536 and Bra-537. *See* Brazil's First Written Submission, para. 395. The few instances in which GSM 102 fees exceed ExIm Bank LCI or MTI fees does not mean that GSM 102 fees do not confer "benefits" relative to the market. *See* Brazil's First Written Submission, paras. 403-406, and Annex III (Statement of Professor Rangarajan Sundaram), paras. 17-24.

[412] U.S. 2 April answer to question 98, para. 236.

Fifth U.S. criticism:
Differing principal coverage as between GSM 102 and ExIm Bank LCI cover

269. **Fifth**, although not disputing that ExIm Bank's LCI product, like GSM 102, covers 98% of principal for transactions involving agricultural products[413], the United States appears to assert that another feature of the LCI product effectively raises principal coverage to 100%. Specifically, the United States alleges that under an ExIm Bank LCI policy, "'the insured may arrange recourse or 'pass back' to a third party of all or any part of any uninsured amount.'"[414] The United States asserts that "[t]his is not permitted under GSM 102," and that therefore, unlike in the case of a holder of an LCI policy, a GSM 102 holder is, under the GSM 102 regulations, not able to insulate itself from exposure to default on the 2% of principal, and any percentage of interest, not covered by the GSM 102 ECG.[415]

270. The United States' characterization of the GSM 102 regulations is misleading and incorrect. The regulations do not support the U.S. contention that the holder of a GSM 102 ECG "is not permitted" to insure the remaining 2% of principal not covered by the GSM 102 ECG. In fact, the regulations establish exactly the opposite – that a holder of a GSM 102 ECG can insulate itself from exposure to default on the 2% of principal, and any percentage of interest, not covered by the GSM 102 ECG.

271. The United States asserts that under Section 1493.110(b)(4) of the GSM 102 regulations, included as Exhibit US-142, "[u]pon default the claimant must subrogate to CCC the claim to the entire amount in default, not just the guaranteed portion."[416] As noted by the United States, Section 1493.110(b)(4)(iv) states that the holder of a GSM 102 ECG must sign an agreement "subrogating to CCC the respective rights of the exporter and the exporter's assignee, if applicable, to the amount of payment in default under the applicable export sale."[417] The United States further asserts that under Section 1493.130(a) of the GSM 102 regulations, "CCC then has the right to recover from the obligor all moneys in default."[418]

272. In other words, the United States implies that although a GSM 102 ECG only covers 98% of principal, in the event of default and payment by CCC to the holder of the ECG of 98% of principal, the CCC enjoys a claim on 100% of any monies recovered from the foreign obligor.

273. The United States has not been fully forthcoming with the compliance Panel. As the United States is surely aware, Sections 1493.110(b)(4)(iv) and 1493.130(a) are not the end of the story. Indeed, Section 1493.130(c) directly contradicts the United States' argument, and show that a GSM 102 ECG holder, as in the case of an ExIm Bank LCI policyholder, is indeed able to insulate itself from exposure to default on the 2% of principal not covered by the GSM 102 ECG.

274. Section 1493.130(c) provides as follows:

> Recoveries made by CCC from the importer or the foreign bank, and recoveries received by CCC from the exporter, the exporter's assignee, or any other source whatsoever, will be allocated by CCC to the exporter or the exporter's assignee and to CCC on a pro rata basis determined by their respective interests in such recoveries. The respective interest of each party will be determined on a pro rata basis, based on the combined amount of principal and interest in default. <u>Once CCC has paid out a</u>

[413] *See* Exhibit Bra-531 ("ExIm Bank Letter of Credit Insurance for Banks," accessed October 2006 at http://www.exim.gov/products/insurance/loc.html).
[414] U.S. 2 April answer to question 98, para. 236.
[415] U.S. 2 April answer to question 98, para. 236.
[416] U.S. 2 April answer to question 98, para. 236.
[417] 7 CFR Section 1493.110(b)(4)(iv). *See* Exhibit US-142.
[418] U.S. 2 April answer to question 98, para. 236.

> particular claim under a GSM-102 or GSM-103 payment guarantee, CCC prorates any collections it receives and shares these collections proportionately with the holder of the guarantee until both CCC and the holder of the guarantee have been reimbursed in full.[419]

275. The underscored sentence is particularly significant. Following default by a foreign obligor on a GSM 102-guaranteed loan from a U.S. bank, the U.S. bank files a claim with the CCC. Upon receipt of the claim, the CCC pays the U.S. bank 98% of principal and any interest up to the GSM 102 cap. Subsequently – "[o]nce CCC has paid out a particular claim"[420] – CCC seeks to collect from anyone it can. If the CCC succeeds in securing collections, the regulations state that it "shares these collections proportionately with the holder of the guarantee until both CCC and the holder of the guarantee have been reimbursed in full."[421]

276. If the United States were correct that the CCC is entitled to 100% of any recoveries it secures from the foreign obligor, why would the U.S. exporter, or more likely the U.S. bank, as the exporter's assignee and the holder of the guarantee, be entitled to a prorated, proportionate share of any collections secured by the CCC? If the United States were correct, once the U.S. bank, as the holder of the guarantee, was paid its claim – 98% of principal and any interest up to the GSM 102 cap – it would be entitled to nothing more. The U.S. bank would at that point "have been reimbursed in full", and any subsequent monies secured by the CCC as part of its collection efforts would be for the CCC to retain.

277. But the United States is not correct. Section 1493.130(c) clarifies that if the CCC's collection efforts are successful, the holder of the guarantee is indeed entitled to more than its claim to 98% of principal and any interest up to the GSM 102 cap. Out of any collections secured by the CCC subsequent to payment of the U.S. bank's claim, the U.S. bank is entitled to its "proportionate[]" share – presumably, up to the remaining 2% of principal, and the portion of interest, not covered by the GSM 102 ECG. The U.S. bank need not wait until CCC has been made whole; rather, CCC's claim on recoveries is ranked *pari passu* with the U.S. bank's claim on recoveries.

278. In other words, the United States has mischaracterized the GSM 102 regulations, asserting a difference between GSM 102 and ExIm Bank's LCI cover that does not exist. As with ExIm Bank's LCI policy, GSM 102 cover allows the holder of a GSM 102 guarantee to recover amounts in excess of 98% of principal and any interest up to the cap.

279. In fact, GSM 102 may well be <u>superior</u> to ExIm Bank's LCI cover in this regard. Section 1493.130(c) of the GSM 102 regulations, quoted at length above, provides that after CCC has paid a claim, it shares recoveries on a pro rata basis with the U.S. bank. This means that CCC's claim on recoveries is ranked *pari passu* with the U.S. bank's claim, rather than senior to the U.S. bank's claim.

280. In contrast, under ExIm Bank's LCI, were the exporter or the U.S. bank to arrange cover with a third party for 2% of the principal and any portion of interest not covered by the ExIm Bank LCI policy, that third party's claim may well rank <u>junior</u> to ExIm Bank's claim. In that case, Section 1493.130(c) of the GSM 102 regulations would mean that GSM 102 provides a <u>superior</u> product from the exporter or the U.S. bank's standpoint. With a GSM 102 ECG, the exporter or the U.S. bank does not stand in line behind the CCC to recover the 2% of principal and any portion of interest not covered by the GSM 102 ECG; rather, out of the first and last dollar of recoveries secured by the CCC, the exporter or the U.S. bank gets its pro rata share. If anything, this means that

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[419] 7 CFR Section 1493.130(c) (emphasis added). *See* Exhibit US-142.
[420] 7 CFR Section 1493.130(c). *See* Exhibit US-142.
[421] 7 CFR Section 1493.130(c). *See* Exhibit US-142.

GSM 102 fees should be even higher than ExIm Bank LCI fees, rather than the reverse, as the United States asserts.

281. Even if this is not the case, however, as Brazil has explained above, Section 1493.130(c) of the GSM 102 regulations means, at the very least, that the difference between GSM 102 and ExIm Bank's LCI cover alleged by the United States does not exist. Having foregone the opportunity to comment on Brazil's ExIm Bank comparison in the 7 submissions it made prior to its 2 April answers and subsequent to Brazil's profer of the comparison, the United States' misleading and inaccurate characterization of its own regulations at this late stage of the proceedings is disappointing and not credible.

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

282. The United States argues that there is "no basis in the text" of the *SCM Agreement* for Brazil's assertion that GSM 102 fees are insufficiently scaled to account for risk.[422] The United States notes that it "is not aware of any provision of the *SCM Agreement* that establishes what constitutes 'sufficient' scaling."[423]

283. The United States may be unaware of Article 1.1(b) of the *SCM Agreement*, which has been interpreted by the Appellate Body to require a comparison between the terms offered a recipient for a government financial contribution, and the terms available to the recipient for a comparable instrument secured at market.[424] Brazil has demonstrated that there is no credit protection product available in the marketplace that is comparable to a GSM 102 ECG.[425] Nonetheless, Brazil has additionally undertaken a comparison between GSM 102 fees and fees for comparable non-market products offered by ExIm Bank.

284. That comparison exercise, undertaken methodically on a country-by-country, tenor-by-tenor basis, demonstrates that GSM 102 fees are consistently below ExIm Bank fees. At paragraph 400 of its First Written Submission, Brazil also demonstrated graphically that ExIm Bank fees rise much more sharply than GSM 102 fees in response to increased transaction risks, even if ExIm Bank fees do not represent the market. Consistent with fundamental tenets of corporate finance, as maturity and, in particular, country risk, increases, the *rate* at which ExIm Bank fees rise increases significantly. The same cannot be said of GSM 102 fees, which are barely responsive to increased risks arising from longer maturities and/or increased country risk.

285. In other words, by comparison to other similar instruments, GSM 102 fees are insufficiently scaled to account for transaction risks that even non-market entities take into account. The comparison exercise undertaken by Brazil enjoys a basis in the relevant provisions of the *SCM Agreement* – specifically, Article 1.1(b) of the *Agreement*, as interpreted by the Appellate Body.

4. Item (j) of the Illustrative List

Questions to both parties

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

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[422] U.S. 2 April answer to question 99, paras. 237, 238.
[423] U.S. 2 April answer to question 99, para. 237.
[424] Appellate Body Report, *Canada – Aircraft*, para. 157.
[425] Brazil's First Written Submission, paras. 377-378. *See also Id.*, Annex III (Statement of Professor Rangarajan Sundaram), paras. 8-9.

Exhibit Bra-613 (other than the United States' criticism that Brazil has not taken recoveries corresponding to pre-1992 guarantees into account in its "cash basis" accounting calculations, of which the Panel is already aware)?

286. The United States suggests that Brazil is backing away from net present value accounting as a reliable way to measure the long-term costs of the GSM 102 program.[426] If it is not already abundantly clear to the United States[427], Brazil agrees that net present value accounting is a reliable way to account for the costs of contingent liabilities.

287. Using a net present value methodology, the CCC has, in every year since the inception of credit reform in 1992 (including in budgets for FY 2006, 2007 and 2008[428], under the amended GSM 102 fee schedule), projected that costs and losses for the "cohort" of ECGs issued in the coming fiscal year would, at closing, exceed projected fees, penalties and recoveries. Using the same net present value methodology, CCC's 2006 audited financial statements state that the CCC does not anticipate covering the costs and losses of the ECG programs across all outstanding cohorts of ECGs issued since 1992.[429]

288. As noted in Brazil's 2 April response to question 105 (at paragraphs 283-307), it is the United States that is backing away from the net present value methodology, while trying to give the impression that it embraces that methodology.

289. First, in these proceedings, the United States consistently derides the net present value methodology required by U.S. law as "unreliable", because it allegedly does not reflect the CCC's particular experience[430] – a proposition with which USDA and FAS disagree, outside the context of WTO litigation.[431]

290. Second, although the projections of long-term losses included in the 2006 CCC financials, and in the U.S. budgets for GSM 102 ECGs issued in fiscal years 2006, 2007 and 2008, are calculated using the net present value methodology mandated by U.S. law, the United States derides these projections as not reflective of "actual" results.[432] The United States' objection that this evidence does not reflect "actual" results most clearly demonstrates its abandonment of the net present value approach. By definition, net present value calculations are projections of future results, discounted back to present value terms. The only way the United States will accept a net present value

[426] U.S. 2 April answer to question 102, paras. 240-242.

[427] Brazil's First Written Submission, paras. 433-437; Brazil's Rebuttal Submission, paras. 483-484, 501-511; Brazil's Oral Statement, paras. 252-254, 257-260.

[428] Exhibit US-71.

[429] Exhibit Bra-585 (Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2005 and 2006, Report No. 06401-21-FM, November 2006, p. 11, 26 of Notes to the Financial Statements) (identifying a USD 220 million "credit guarantee liability", defined as representing "the estimated net cash outflows (loss) of the guarantees on a net present value basis.").

[430] U.S. Rebuttal Submission, paras. 111-125.

[431] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, Section 3.CR2, accessed January 2007 at http://www.whitehouse.gov/OMB/expectmore/detail.10002020.2005.html) (the "credit models used to calculate the subsidy for the guaranteed credits were revised in FY2001 and FY2003 and currently provides reliable estimates", and identifies the model applied specifically as "[t]he USDA model") (emphasis added); Exhibit Bra-616 (U.S. Department of Agriculture, Office of the Chief Financial Officer, Credit, Travel, and Accounting Division, *Agriculture Financial Standards Manual* (May 2004), p. 121, accessed December 2006 at http://www.ocfo.usda.gov/reports/index.htm) ("In estimating default costs, the following risk factors are considered: (1) loan performance experience ….").

[432] *See* U.S. Rebuttal Submission, para. 88; U.S. 2 April answer to question 108, paras. 276-277.

methodology is if it is converted into a retrospective, cash-basis accounting methodology, by taking account of re-estimates.[433] This amounts to a rejection of the net present value approach.

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

291. The United States argues that there is "no basis in the text for the obligation" to taken into account foreign obligor risk in setting an ECG fee.[434]

292. The United States may be unaware of item (j) of the Illustrative List, which requires an assessment of "premium rates" for an ECG program, and "long-term operating costs and losses" of the program. As noted by the original panel, item (j), "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."[435] The United States may also be unaware that Article 1.1(b) of the *SCM Agreement* defines a subsidy as a government financial contribution provided on terms that are better-than-market. Market-based institutions do not provide credit protection instruments without taking account of foreign obligor risk.

293. Brazil has submitted evidence demonstrating that to be "fully reflective of the risks of a particular transaction"[436], ECG fees must be set to take account of foreign obligor risk.[437] The United States has offered no evidence to rebut Brazil's showing that market-based financial institutions (let alone other U.S. government entities providing credit protection instruments similar to GSM 102 ECGs[438]) do not rely on exposure limits alone to adequately manage risk.

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

294. In paragraph 266 of its 2 April response, the United States addresses CCC's recent, massive write-offs of uncollectible amounts attributed to pre-1992 ECGs, as recorded in the United States' "liquidating account". In Brazil's view, these write-offs offer an additional reason why the liquidating account does not turn a cash-basis assessment of program losses into program profits, as the United States has asserted.[439] Writing off billions of dollars worth of losses does not make a program profitable.[440]

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[433] *See*, *e.g.*, U.S. First Written Submission, para. 87; U.S. 2 April answer to question 102, para. 244.
[434] U.S. 2 April answer to question 104, para. 251.
[435] Panel Report, *U.S. – Upland Cotton*, para. 7.805.
[436] Panel Report, *U.S. – Upland Cotton*, para. 7.805.
[437] *See* Brazil's Rebuttal Submission, para. 498 and Exhibit Bra-615.
[438] *See* "transaction risk increment" field in the U.S. Export-Import Bank fee calculator, defined at http://www.exim.gov/tools/calchelp.cfm.
[439] U.S. Rebuttal Submission, paras. 97-99.
[440] *See* Brazil's Oral Statement, paras. 261-263.

Questions to the United States

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

295. Please see Brazil's comment on the U.S. response to question 108.

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

296. The United States misrepresents the significance of the "credit guarantee liability" figure in the 2006 CCC financial statements.

297. The United States' response ignores altogether the definition of "credit guarantee liability" included in the financial statements itself. The definition reads as follows:

> Credit guarantee liabilities represent the estimated **net** cash outflows (loss) of the guarantees on a net present value basis. To this effect, CCC records a liability and an expense to the extent, in management's estimate, CCC will be unable to recover claim payments under the Credit Reform Export Credit Guarantee programs.[441]

298. The bold, underlined word "net" belies the U.S. assertion that the credit guarantee liability figure in the CCC financial statements includes only a "liability for which there is an offsetting balance sheet entry of an asset."[442] By the express terms of this definition, the credit guarantee liability figure in CCC's financials represents "net" cash outflows or losses – meaning that having netted expected cash inflows against expected cash outflows on a net present value basis, the CCC expects that the latter will exceed the former, and that it will therefore experience a "loss" (another term expressly used in the definition).

299. As acknowledged by the United States, the original panel, in its adopted findings, agreed. The United States notes the original panel's finding that "the credit guarantee liability represented a prospective estimate of anticipated experience under the program".[443] This is somewhat of an understatement. Citing the credit guarantee liability figures from the 2002 and 2003 CCC financial statements, the original panel stated as follows:

> [W]e 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. "Liability" is defined as "...a probable future

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[441] *See* Exhibit Bra-585 (Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2006 and 2005, Report No. 06401-21-FM, November 2006, p. 11, 26 of Notes to the Financial Statements) (emphasis added). This is virtually identical to the net present value formula called for by the U.S. Federal Credit Reform Act. Exhibit Bra-656 (2 U.S.C. 661a(5)(C)) ("The cost of a loan guarantee shall be the net present value, at the time when the guaranteed loan is disbursed, of the following estimated cash flows: (i) 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 . . .").

[442] U.S. 2 April answer to question 108, para. 268.

[443] U.S. 2 April answer to question 108, para. 277, *citing* Panel Report, *U.S. – Upland Cotton*, para. 7.855.

> outflow or other sacrifice of resources as a result of past transactions or events." 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.[444]

300. In its response, the United States not only asks the compliance Panel to revisit the original panel's adopted findings regarding what the credit guarantee liability figure represents, but further challenges the reliability of the credit guarantee liability figure as a basis on which to make an item (j) assessment of long-term costs and losses, because it is a future-oriented assessment of long-term losses on a net present value basis rather than an "actual" or "retrospective" loss.[445] The United States made the same arguments during the original proceedings.[446] The original panel and the Appellate Body rejected the U.S. arguments, and accepted a forward-looking approach to the assessment of the ECG programs under item (j).[447]

301. These adopted findings should be followed by the compliance Panel. Prior adopted panel and Appellate Body reports create "legitimate expectations" among WTO Members, and should be taken into account by panels when they are relevant to the resolution of a dispute.[448] Further, where the issues before a panel are the same as those previously examined by the Appellate Body, it is "not only appropriate," but to "be expected," that the panel would follow the Appellate Body's earlier conclusions.[449]

302. With respect to compliance proceedings, in particular, the Appellate Body has stated that "Article 21.5 proceedings do not occur in isolation but are part of a '*continuum of events*.'"[450] The Appellate Body observed that "doubts could arise about the *objective nature* of an Article 21.5 panel's assessment if, on a specific issue, that panel were to *deviate* from the reasoning in the original panel report in the absence of any change in the underlying evidence."[451]

303. Nothing about the way in which the credit guarantee liability figure is defined in the CCC financial statements, or calculated, has changed from the original proceedings.[452] To find now that the

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[444] Panel Report, *U.S. – Upland Cotton*, para. 7.855 (footnotes omitted).

[445] U.S. 2 April answer to question 108, paras. 275-276.

[446] The United States appealed this specific element of the original panel's analysis. U.S. Appellant's Submission in *U.S. – Upland Cotton*, paras. 407 and 410-413 (and note 419), *available at* http://www.ustr.gov/assets/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/WTO/Dispute_Settlement_Listings/asset_upload_file938_5598.pdf. For U.S. arguments before the original panel, *see* U.S. 11 July 2003 First Written Submission, paras. 176-178; U.S. 11 August 2003 Answers to Panel Questions, paras. 157, 159, 170 and 173; U.S. 22 August 2003 Rebuttal Submission, paras. 161-162, 167, 171; U.S. 30 September 2003 Further Submission, para. 151; U.S. 18 November 2003 Further Rebuttal Submission, paras. 196-199; U.S. 22 December 2003 Answers to Panel Questions, paras. 86, 90, 91-95, 96-99, 100-101, 103, 117-121 and U.S. 11 February 2004 Answers to Further Panel Questions, para. 21.

[447] Appellate Body Report, *U.S. – Upland Cotton*, paras. 763-764 and Panel Report, *U.S. – Upland Cotton*, paras. 7.842-7.843. *See also Id*., para. 7.835 ("[T]he item (j) analysis need not be a purely retrospective one ….").

[448] Appellate Body Report, *U.S. – Softwood Lumber V*, para. 111.

[449] Appellate Body Report, *U.S. – OCTG Sunset Reviews*, para. 188.

[450] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 103 (emphasis added) citing Appellate Body Report, *Mexico – Corn Syrup (21.5)*, para. 121. *See* Brazil's First Written Submission, para. 28.

[451] Appellate Body Report, *U.S. – Softwood Lumber VI (21.5)*, para. 103 (emphasis added).

[452] The United States' argument that the credit guarantee liability figure in the CCC financial statements includes only a "liability for which there is an offsetting balance sheet entry of an asset" does *not* represent a *change to the definition or calculation of the credit guarantee liability figure* since the original proceedings.

figure is unreliable would involve a significant departure from the findings in the original proceedings, with no valid basis for that change. It would also involve a violation of the principle of *res judicata*, because the reliability of the estimates has been definitively resolved for purposes of this dispute. As noted by the panel in *U.S. – Gambling (21.5)*, "[a] re-assessment in a compliance proceeding of an issue that had already been ruled upon in an original proceeding in an adopted report, even with better arguments by the respondent but without a change relevant to the underlying facts in the intervening period, would run counter to the prompt settlement of disputes."[453] The United States is not entitled to re-litigate an issue that has been definitively resolved for purposes of this dispute.

Rather, it is simply a new argument by the United States, and one that, as addressed above, is belied by the very definition of "credit guarantee liability" included in CCC's financial statements and relied on by the original panel.

[453] Panel Report, *U.S. – Gambling (21.5)*, para. 6.53.

ANNEX D-15

UNITED STATES' COMMENTS ON THE RESPONSES OF BRAZIL TO THE PANEL'S SECOND SET OF QUESTIONS

(24 April 2007)

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TABLE OF EXHIBITS

Exhibit US-	Title
165	"China: Cotton import quotas of 1.5mn tons to be issued," available at www.fibre2fashion.com (April 24, 2007).
166	U.S. Export Sales for Week Ending 4.12.2007, available at www.fas.usda.gov/export-sales/cottfax.htm
167	U.S. Export Sales Weekly Export Performance Indicator for Week Ending 4.12.2007, available at http://www.fas.usda.gov/esrquery/esrpi.aspx.
168	NASS March 2007 Cotton Ginnings Report
169	N.Y. Futures After Issuance of Planting Intentions Report

1. In its answers to the second set of questions from the Panel, Brazil has reasserted many of the same unfounded arguments presented in its earlier submissions, which the United States has already addressed and rebutted. Many of Brazil's answers to questions also repeat the same information. The United States does not intend to resubmit all of these U.S. arguments in response. Rather, for the convenience of the Panel, the United States first offers one general comment regarding Brazil's answers to each major section of the Panel's questions. The United States then proceeds to address those aspects of Brazil's answers that are either new or call for further comment. Where possible, the United States refers the Panel to its prior submissions where Brazil's arguments have been addressed.

2. To the extent the United States does not address a particular answer or a particular aspect of an answer, this is not intended as – and should not be understood to be – agreement with Brazil's position.

I. GENERAL COMMENTS REGARDING BRAZIL'S ANSWERS

A. BRAZIL HAS NO BASIS TO CHALLENGE MEASURES THAT WERE NEITHER ORIGINAL MEASURES SUBJECT TO ANY FINDING OF WTO-INCONSISTENCY OR DSB RECOMMENDATIONS AND RULINGS NOR MEASURES TAKEN TO COMPLY WITH ANY RECOMMENDATIONS AND RULINGS[1]

3. Brazil repeats in its answers to Questions 44 to 46 the incorrect argument that it is entitled to renew in this "compliance" proceeding under Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") claims against measures (a) that were never found to be WTO-inconsistent and were never subject to any DSB recommendations and rulings; and (b) that are not measures taken to comply with any recommendations and rulings.[2] These measures include the GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat. They also include the marketing loan and counter-cyclical payment programs and payments made under the program in years beyond MY 1999-2002. Brazil's arguments continue to be unavailing.

1. Neither GSM 102 guarantees in respect of exports of pig meat and poultry meat nor Brazil's claims with respect to them are within the scope of this proceeding

4. Brazil's assertion of an "entitlement" to make a claim against GSM 102 guarantees in respect of exports of pig meat and poultry meat rests on two untenable grounds. First, Brazil asserts erroneously that *any* changed measure may be challenged in a compliance proceeding regardless of whether it was "taken to comply" with any recommendations and rulings of the DSB.[3] And, second, Brazil asserts that a complaining party may renew in a compliance proceeding any claims that were not "definitively resolved" in the original proceeding.[4] Neither proposition finds support in the DSU.

5. Contrary to Brazil's assertions, the test of whether a measure is properly within the scope of an Article 21.5 compliance proceeding is not simply whether it has changed since the original proceeding. That would effectively write out of Article 21.5 the requirement that the measure be "taken to comply" with the DSB's recommendations and rulings. Rather, under the express terms of Article 21.5, the touchstone of what is and is not a "measure taken to comply with the

[1] The United States does not submit comments regarding Brazil's claims in respect of compliance in past periods as none of Brazil's answers to the second set of questions relate to that issue. For the U.S. arguments in respect of those claims, the United States respectfully refers the Panel to the U.S. First Written Submission, paras. 49-56, U.S. Rebuttal Submission, paras. 64-71, U.S. Answers to Parts A-C of First Set of Panel Questions, paras. 45-46, U.S. Comments on Brazil's Answers to First Set of Panel Questions, paras. 104-111, and U.S. Answers to Second Set of Panel Questions, paras. 54-61.

[2] *See* Brazil Answers to Second Set of Questions, paras. 1-35.

[3] *See e.g.*, Brazil Answers to Second Set of Questions, para. 6, 34.

[4] *See e.g.*, Brazil Answers to Second Set of Questions, para. 7.

recommendations and rulings" of the DSB is – necessarily – the DSB's recommendations and rulings. Where the DSB's recommendations and rulings distinguish between different components of a measure or different measures, that distinction is determinative for purposes of the compliance proceeding as well.

6. Here, the DSB's recommendations and rulings clearly distinguish "export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes . . . *in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes, and in respect of one scheduled product (rice)*"[5] from other export credit guarantees under those programs. As Brazil's response to Question 44 confirms, this distinction goes to which *measures* were found to be WTO-inconsistent (*i.e.*, which measures the United States was obligated to bring into compliance with its obligations under Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*). The question for this compliance Panel, then, is whether Brazil has demonstrated either that the United States has (a) not brought those measures (export credit guarantees in respect of rice and unscheduled products) into conformity with the DSB's recommendations and rulings or (b) that those measures – as modified – are inconsistent with the provisions of the WTO Agreement cited by Brazil.[6]

7. Brazil has attempted to obscure this distinction by insisting variously that (a) the original panel's findings were made with respect to the GSM program as a whole[7] and that guarantees thereunder are not even "measures" for purposes of WTO dispute settlement[8], (b) that it is Brazil's *claims* and not the measures challenged that are "product specific;"[9] (c) that the United States has made changes across the entire GSM 102 program including with respect to export credit guarantees in respect of exports of pig meat and poultry meat[10], and (d) and that the GSM 102 program applies in

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[5] *Upland Cotton (Panel)*, para. 8.1(d) (emphasis added). This is because the original panel found that Brazil had only made its case under Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement* with respect to export credit guarantees provided in respect of exports of rice and unscheduled products.

[6] There can be no presumption that the U.S. measures taken to comply are inconsistent with its WTO obligations; the burden is on Brazil to prove inconsistency.

[7] As the United States has explained, this argument is inconsistent with Brazil's prior arguments and the original panel's resolution of Brazil's claims. *See* U.S. Comments on Brazil's Answers to First Set of Panel Questions, paras. 12-15. This even contradicts Brazil's own clarification in its rebuttal submission that "*Brazil does not assert that the GSM 102 program itself circumvents the United States' export subsidy commitments, within the meaning of Article 10.1 of the Agreement on Agriculture*." Brazil Rebuttal Submission, para. 378 (emphasis added).

[8] *See, e.g.*, Brazil Responses to Panel Section A-C Questions, para. 29. This argument is at odds with Brazil's arguments elsewhere that an *a contrario* reading of item (j) would prevent a Member from challenging specific export credit guarantees (*i.e.*, as opposed to the export credit guarantee *programs* generally). *See* U.S. Comments on Brazil's Answers to First Set of Panel Questions, paras. 10-11. If specific guarantees cannot even constitute "measures," as Brazil now asserts, Brazil's complaints about being able to make claims against specific guarantees would be entirely moot. Brazil's argument is also inconsistent with the clarification by the Appellate Body that a "measure" for purposes of WTO dispute settlement may encompass "[i]n principle, any act or omission attributable to a WTO Member. . . ." *United States – Corrosion-Resistant Steel (AB)*, para. 81.

[9] Calling Brazil's claims "product-specific" does not change the fact that only particular guarantees – those provided in respect to the particular "product" at issue – are the subject of the claims. Where those guarantees were not the subject of any DSB recommendations and rulings and are not measures taken to comply with any DSB recommendations and rulings – as in the case of the GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat – there is no basis for a claim to be considered with respect to them in a DSU Article 21.5 proceeding. See U.S. Comments on Brazil's Answers to First Set of Panel Questions, paras. 16.

[10] *See e.g.*, Brazil Answers to Second Set of Panel Questions, para. 6. As the panel in *EC – Bed Linen (21.5)* recognized the mere fact that improvements have been made to more than just the original measures subject to findings of WTO-inconsistency and DSB recommendations and rulings does not render all changed measures "measures taken to comply." *See* U.S. U.S. Answers to Second Set of Panel Questions, paras. 1-16 (discussing *EC – Bed Linen (21.5) (Panel)*, paras. 6.9-6.22)).

the same way regardless of what products are involved.[11] As the United States has explained[12], however, not only are certain of these assertions wrong, they do not alter the conclusion that GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat are not within the scope of this proceeding.

2. **The marketing loan and counter-cyclical payment programs, payments made thereunder after MY 2002, and Brazil's claims in respect of those measures are outside the scope of this proceeding**

8. In its response to Question 45, Brazil continues to press the Panel impermissibly to expand the scope of this compliance proceeding to include claims against the marketing loan and counter-cyclical payment programs and payments made thereunder in periods after MY 2002. Brazil's arguments turn on its own pronouncements that the original panel did in fact find the Step 2, marketing loan, and counter-cyclical payment programs to be causing "present" serious prejudice and that it similarly found payments allegedly "mandated" to be made thereunder in MY 2003-2007 to be causing "present" serious prejudice (though, of course, such payments had not even been made as of the time the matter was referred to the original panel). These pronouncements are flatly contradicted by the facts and the express language of the original panel report.

9. Brazil's approach in Question 45 – as it has been throughout this proceeding – consists of cherry-picking individual sentences of the panel report and imposing upon them a strained reading that is neither supported by the context nor consistent with the most basic principles of WTO dispute settlement (e.g., that a panel cannot make the claim for a complaining party, let alone make claims never presented by a complaining party). As the United States has explained, there is no merit to these arguments.[13]

10. In fact, it is remarkable that, in its response to Question 45 from the Panel, Brazil accuses the United States of "mischaracteriz[ing] the original panel's findings from beginning to end."[14] Not only is this untrue, but the irony of the accusation is that Brazil has never even attempted to reconcile its arguments with the "original panel's findings from beginning to end." So, for example, Brazil has never explained what legal basis this Panel has for ignoring the original panel's *actual* conclusion on present serious prejudice:

> 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.[15]

This conclusion *on its face* contradicts Brazil's assertion that "the United States . . . wrongly assumes that 'U.S. subsidies' does not include the legislative and regulatory provisions – the subsidy

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[11] *See e.g.*, Brazil Answers to Second Set of Panel Questions, para. 4. Contrary to Brazil's assertions, the U.S. argument is not premised on the assumption "that different ECG measures apply to different products." Brazil Answers to Second Set of Panel Questions, para. 4. As the United States has explained, this is irrelevant to the U.S. arguments.

[12] U.S. First Written Submission, paras.24-30, U.S. Rebuttal Submission, paras. 10-15, U.S. Answers to Parts A-C of First Set of Panel Questions, paras. 17-26, U.S. Comments on Brazil's Answers to First Set of Panel Questions, paras. 8-44, and U.S. Answers to Second Set of Panel Questions, paras. 1-16 and 42-48.

[13] U.S. First Written Submission, paras. 31-48, U.S. Rebuttal Submission, paras. 16-63, U.S. Answers to Parts A-C of First Set of Panel Questions, paras. 27-44, U.S. Comments on Brazil's Answers to First Set of Panel Questions, paras. 45-103, and U.S. Answers to Second Set of Panel Questions, paras. 17-41.

[14] Brazil Answers to Second Set of Panel Questions, para. 12.

[15] *Upland Cotton (Panel)*, para. 7.1416.

programs – mandating the subsidy payments."[16] The language confirms that the United States has not *assumed* – let alone *wrongly* assumed – what the "U.S. subsidies" are, as Brazil charges.

11. To the contrary, as the original panel clearly states, the "United States subsidies at issue" . . . [are] marketing loan programme *payments*, user marketing (Step 2) *payments*, MLA *payments*, and. . . CCP *payments*." There is no other way to understand the language in between the dashes in the conclusion or the fact that the original panel uses the introductory phrase "that is" – a phrase used for clarification of what a term means – to explain that the "subsidies at issue" are marketing loan programme *payments*, user marketing (Step 2) *payments*, MLA *payments*, and counter-cyclical *payments*. Brazil has never reconciled its theory – that the "subsidies at issue" include the programs providing for these payments – with this language or with the scores of other clear indications by the original panel that the subsidies subject to its "present" serious prejudice examination were payments made in MY 1999-2002 under, *inter alia*, the Step 2, marketing loan, and counter-cyclical payment program.

12. Nor has Brazil offered any credible explanation for:

- How the original panel could have made a finding of *present* serious prejudice against either the Step 2, marketing loan, and counter-cyclical payment programs or payments allegedly "mandated" to be made thereunder in MY 2003-2007 when it did not recognize Brazil as even presenting a *claim* of "present" serious prejudice with respect to either group of measures.[17]

- Why the original panel identified only "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*"[18] as the "challenged measures" that were alleged to be the "subsidies" for purposes of Brazil's "present" serious prejudice claim. The panel only found that those measures constituted subsidies within the meaning of Articles 1 and 2 of the *SCM Agreement*.[19] The panel did not conduct *any* assessment as to whether the statutory/regulatory provisions authorizing these payments were also "subsidies."

- How the original panel could have made findings of WTO-inconsistency with respect to the Step 2, marketing loan, and counter-cyclical payment programs or future payments allegedly "mandated" to be made under the programs without addressing the extensive arguments that the parties made, and without making any of the factual

[16] Brazil Answers to Second Set of Panel Questions, para. 13.

[17] The United States recalls that the panel set out the claims presented by Brazil as follows: (a) claims of "present" serious prejudice with respect to "U.S. subsidies provided during MY 1999-2002"; (b) claims of threat of serious prejudice with respect to "U.S. subsidies mandated to be provided in MY 2003-2007;" and (c) *per se* claims of threat of serious prejudice against "selected provisions of the FSRI Act of 2002 and the ARP Act of 2000" providing for these subsidies, to the extent relevant to upland cotton, and their implementing regulations. *Upland Cotton (Panel)*, para. 3.1(vi) – 3.1(viii). The original panel did *not* identify a "present" serious prejudice claim under Article 5(c) and 6.3(c) of the *SCM Agreement* as one of the claims "concerning selected provisions of the FSRI Act of 2002 and the ARP Act of 2000." Nor did the original panel identify "selected provisions of the FSRI Act of 2002 and the ARP Act of 2000" as part of the measures subject to Brazil's claims of "present" serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*.

[18] *Upland Cotton (Panel)*, para. 7.1120. The original panel ultimately found that these constituted "subsidies" within the meaning of Article 1 of the *SCM Agreement* because they were "financial contributions" (mostly in the form of "grants") conferring a "benefit." *Upland Cotton (Panel)*, paras. 7.1112-7.1120.

[19] *Upland Cotton (Panel)*, para. 7.1112-7.1120.

findings that *Brazil* conceded would be necessary to support an affirmative finding of WTO-inconsistency in respect of those measures.[20]

13. And Brazil has not addressed the other clear textual signals that – consistent with the claims presented to it – the original panel's findings of "present" serious prejudice were made with respect to payments made in MY 1999-2002. This includes:

- The fact that the original panel's prohibited subsidy-related conclusions and recommendations regarding the Step 2 program, *as such*, expressly refer to "section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters of upland cotton"[21] and "section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users of upland cotton."[22] If the conclusions regarding "present" serious prejudice in paragraphs 8.3(d) and 8.1(g)(i) of the original panel report also pertained to the Step 2 program, *as such*, together with the marketing loan program and counter-cyclical payment program, the panel would certainly have included the same specific kind of reference, rather than a reference to "user marketing (Step 2) *payments*.."

- The fact that in Section VII:D of the Panel Report, dealing with the evaluation of domestic support measures under Article 13 of the *Agreement on Agriculture*, the original panel expressly stated that, "[i]n this Section of our report, the Panel will consider the current programmes 'as applied' and 'as such' together. Therefore, references to marketing loan programme, user marketing (step 2), direct, counter-cyclical and crop insurance 'payments' include the legislative and regulatory provisions authorizing those payments unless otherwise indicated."[23] No similar statement can be found in Section VII:G, which is the section including the original panel's analysis of the effects of the subsidies alleged to be causing serious prejudice. In fact, the original panel in Section VII:G clearly distinguishes payments from provisions providing for those payments. Nor is there any similar statement made in connection with the recommendation in paragraph 8.3(d) of the panel report (or paragraph 8.1(g)(i), which contains the conclusion on actionable subsidies to which the recommendation relates).

- The panel's clarification that it was not precluded from considering whether production flexibility contract and market loss assistance *payments* were causing "present" serious prejudice even though the legislative and regulatory provisions authorizing those payments had expired even before Brazil made its request for

[20] For example, Brazil conceded in the original proceeding that "[i]t is established under WTO law that a Member can only challenge measures of another Member *per se* if such measures mandate a violation of the WTO Agreement." Brazil First Submission in Original Panel Proceeding, para. 244 (citing *US – 1916 Act (AB)*, para. 88). Thus, in the case of its claims against the challenged programs, *per se*, Brazil asked the Panel "to find that the mandatory provisions of the 2002 FSRI Act and the 2000 ARP Act together with their implementing regulations, as listed above, *cannot be applied in a WTO consistent manner*." Brazil's 9 September 2003 Further Submission, para. 435-436. Explaining what this would mean in the context of this dispute, Brazil argued "[f]irst, the Panel needs to evaluate whether the U.S. subsidies will *necessarily threaten* to cause serious prejudice at price levels below the trigger prices of the U.S. subsidies. Second, the Panel needs to consider whether the U.S. subsidies threaten to cause serious prejudice *even at price levels at which only crop insurance subsidies and direct payments are made*." Brazil's September 9, 2003 Further Submission, para. 426 (emphasis added). The Panel neither conducted the requested evaluations, nor made any findings along the lines requested by Brazil.

[21] *See Upland Cotton (Panel)*, paras. 8.3(b) and 8.1(e).

[22] *See Upland Cotton (Panel)*, paras. 8.3(c) and 8.1(f).

[23] *Upland Cotton (Panel)*, para. 7.337(ix), n. 466.

> consultations.[24] If the original panel's findings with respect to "payments" – and the DSB's recommendations and rulings on the basis thereof – were to be understood to automatically refer also to the programs authorizing those payments, as Brazil urges, the recommendation with respect to "MLA payments" in the panel's "present" serious prejudice conclusion would necessarily be a recommendation also with respect to the "MLA program" as such (an expired measure). This would be inconsistent with the original panel's express clarification that it was not making any findings of WTO-inconsistency or any recommendations and rulings with respect to expired programs, as such[25] as well as with the Appellate Body's subsequent clarification that "there [is] an obvious inconsistency" between a finding that a measure has expired and a "subsequent recommendation that the . . . DSB request the United States to bring the [expired measure] into conformity with its WTO obligations."[26]

14. In short, Brazil has not – and cannot – reconcile its own arguments to the "the original panel's findings from beginning to end."[27] Brazil's does not offer any coherent interpretation of the original panel report that addresses and takes into account all of the facts discussed above and in the prior U.S. submissions. Simply ignoring the facts or making accusations that the United States is "mischaracteriz[ing] them" does not allow Brazil to overcome that fatal deficiency. It remains, therefore, that Brazil's claims against the marketing loan and counter-cyclical payment programs and any payments made under the programs post-MY 2002 are outside the scope of this proceeding.

B. MARKETING LOAN AND COUNTER-CYCLICAL PAYMENT PROGRAMS ARE NOT CAUSING ANY PRESENT "SIGNIFICANT" PRICE SUPPRESSION WITHIN THE MEANING OF ARTICLES 5(C) AND 6.3(C) OF THE *SCM AGREEMENT*

15. For the reasons set out above and in the prior U.S. submissions, Brazil's claims of "present" serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement* against the marketing loan and counter-cyclical payment programs and/or any present payments thereunder are not within the scope of this proceeding. Were they to have been within the scope, they would nonetheless fail because they are bereft of a basis in the facts.

16. Indeed, a substantial part of Brazil's responses to the Panel's Questions 51 and 62-74 are devoted to attempts to explain away this failing. Brazil complains, on the one hand, that it should not be required to provide "direct evidence of what would actually happen to U.S. acreage, production, exports, and world prices"[28] without marketing loan and counter-cyclical payments and it complains, on the other, that the United States has "ignore[d] the hundreds of exhibits and circumstantial evidence presented by Brazil."[29] Both assertions are baseless.

17. Brazil – as the complaining party – bears the burden of proving its claims with evidence and arguments that actually *support the claim for which they are offered*. It has not done so. Further, in observing this, the United States has not "ignored" any argument or exhibit submitted by Brazil. To the contrary, the United States has painstakingly examined and addressed – over the course of two written submission, the presentation before the Panel, three set of responses to questions from the

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[24] *Upland Cotton (Panel)*, para. 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*. 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.") (italics added).

[25] *Upland Cotton (Panel)*, para. 7.111.

[26] *Upland Cotton (AB)*, para. 272 (citing *U.S. – Certain EC Products* (AB), paras. 81-82).

[27] Brazil Answers to Second Set of Panel Questions, para. 12.

[28] Brazil Answers to Second Set of Panel Questions, para. 91.

[29] Brazil Answers to Second Set of Panel Questions, para. 90.

Panel, comments on Brazil's "oral" presentation to the Panel, and now two sets of comments on answers – every argument made by Brazil and demonstrated that these do not, individually or collectively, support Brazil's claims of "significant" price suppression.[30]

18. ***Brazil's assertions about the removal of the Step 2 program are unsubstantiated, internally contradictory, and inconsistent with arguments made by Brazil in the original proceeding:*** Brazil's claims are premised on the assertion that removal of the Step 2 program has not removed the adverse effects of the package of payments found by the original panel to be causing "present" serious prejudice. However, Brazil's assertions about the effects of removing the Step 2 program are unsubstantiated, internally contradictory, inconsistent with arguments made by Brazil in the original proceeding, and contradicted by the empirical evidence.[31]

19. Thus, for example, having proclaimed to the original panel that "it is difficult to imagine how a subsidy could be *more* of an export subsidy than the Step 2 export provisions" and that "[the program] plays an important role in stimulating and maintaining the present record high U.S. upland cotton world export market share,"[32] Brazil has no basis now to allege that "removal of the Step 2 program does [not] result in any significant or long-term reduction of U.S. exports."[33] The United States notes the irony in Brazil's assertion here that a "long-term" assessment of the effects of the removal of the Step 2 program is appropriate while in its analysis of the marketing loan and counter-cyclical payment program it insists that "the assessment is necessarily of a short-term, not a long-term nature."[34] This is yet further evidence that Brazil's positions on such fundamental questions as the appropriate analysis under the *SCM Agreement* shift simply depending on its preferred outcome. Moreover, the United States notes that Brazil's asserted bases for this assertion do not withstand scrutiny.

20. Indeed, while Brazil attempts to assert as evidence a statement by a National Cotton Council ("NCC") representative that in MY 2007, "NCC sees U.S. exports recovering to 16.22 million bales as foreign mill use increases," Brazil fails to quote for the Panel the statement immediately prior to this one in which the same representative notes that:

> the 2006 marketing year is the first of the post-Step 2 era, and the impact on exports has been evident. Through mid-January, export commitments of upland cotton totaled roughly 6 million bales. This time a year ago, total commitments had surpassed 10 million bales.[35]

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[30] In fact, if the United States were in fact "ignor[ing]" Brazil's arguments, one can only wonder why Brazil has repeatedly attempted over the course of this proceeding to attempt to cut U.S. opportunities for response: for example, arguing at the start of the proceeding that the United States should be given no more than two weeks to respond to Brazil's nearly 200-page first written submission and; arguing that the United States should not be permitted to address Brazil's contingent "threat" claim in its rebuttal submission; arguing that the United States should be given no opportunity to respond to Brazil's unsolicited third written submission submitted under the guise of an "exhibit" to Brazil's "oral" presentation; and in its latest attempt to obtain an unfair procedural advantage, arguing against the grant of any additional time for submission of these comments.

[31] The full U.S. arguments in this respect are set out at U.S. First Written Submission, paras. 149-195, U.S. Rebuttal Submission, paras. 175-214, and U.S. Oral Statement, paras. 54-59.

[32] Brazil's Rebuttal Submission to the Panel Regarding the "Peace Clause" and Non-Peace Clause Related Claims," para. 128 (22 August 2003) (emphasis in original).

[33] Brazil Answers to Second Set of Panel Questions, para. 90.

[34] Brazil Answers to Second Set of Panel Questions, para. 131.

[35] "US Cotton Industry To Face Challenges In Global Market," 2006 AgWeb.com (Exhibit BRA-679).

The United States recalls Brazil's assertion that in assessing the effects of payments "the views of their recipients constitute particularly relevant evidence."[36] Brazil would presumably attach similar importance to the NCC statement it neglected to cite.

21. In any event, the possibility of an increase in the export volume in MY 2007 in *absolute* terms does not change the analysis regarding the effects of removing the Step 2 program. As the United States explained in its rebuttal submission[37], such factors as China's import needs may have contributed in part to the decline in the level of U.S. exports as of August, 2006. And as there are changes in those factors, there may well be effects in the level of U.S. exports. However, those factors do not account for the entire decline. Thus, for example, primarily in connection with the pending release of import quota by China[38], there have been recent purchases of some 795,800 running bales of U.S. cotton.[39] This represents a marketing-year high. Yet, even with these purchases, total export commitments, both sales and shipments, are 31% and 15% below last year's total and the 5-year average, respectively.[40] The fact that U.S. export volume may recover somewhat in the future, thus, does not suggest that export levels would not have been even higher had the Step 2 program been in effect.

22. In the face of such empirical data at odds with its assertions (for purposes of this proceeding) about the alleged effects of eliminating the Step 2 program, Brazil urges the Panel, in its response to Question 74, to consider MY 2005 – *a year in which Step 2 payments were still in effect* – as the relevant period for purposes of its analysis of the effects of removal of the Step 2 program. Presumably, the Panel would then have to accept Brazil's assertions (for purposes of this proceeding) about what the effects of that program would or would not have been in that year rather than relying on the actual evidence thereof. Neither this suggestion by Brazil nor its unsubstantiated assertions about the effects of removing the Step 2 program may be credited.

23. ***Brazil does not show that marketing loan and counter-cyclical payments cause "present" serious prejudice:*** Citing the original panel, Brazil argues that "an examination of the 'effects'" of the challenged measures "cannot be conducted in the abstract."[41] Yet, in support of its claims, Brazil repeatedly suggests that, even without considering the existing market conditions (or conducting any assessment of what these were likely to be) the original panel somehow found marketing loan and counter-cyclical payments to be causing significant suppression of world market prices today.[42] Similarly, it makes generic assertions about impacts on wealth and risk aversion that – if credited – would effectively preclude *any* payment to farmers no matter what their form and no matter how minimal their impact on planting, production, exports, and prices.[43]

24. Brazil's claim cannot properly rest on these bases. For one, the original panel did not find that marketing loan and counter-cyclical payment *programs* caused significant price suppression in MY 1999-2002. Therefore, Brazil is incorrect to assert – in response to Question 69, for example – that it could prove significant price suppression in this proceeding merely by asserting[44] that payments were made under those programs over the course of the FSRI Act and that "[t]he world market for

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[36] Brazil Answers to Second Set of Panel Questions, para. 48.

[37] U.S. Rebuttal Submission, paras. 206-213.

[38] "China: Cotton import quotas of 1.5mn tons to be issued," available at www.fibre2fashion.com (April 24, 2007) (Exhibit US-165).

[39] U.S. Export Sales for Week Ending 4.12.2007, available at www.fas.usda.gov/export-sales/cottfax.htm (Exhibit US-166).

[40] U.S. Export Sales Weekly Export Performance Indicator for Week Ending 4.12.2007, available at http://www.fas.usda.gov/esrquery/esrpi.aspx (Exhibit US-167).

[41] Brazil Answers to Second Set of Panel Questions, para. 10 (citing *Upland Cotton (Panel)*, para. 10).

[42] *See e.g.*, Brazil Answers to Second Set of Panel Questions, paras. 45, 53-55, 94, 99.

[43] *See e.g.*, Brazil Answers to Second Set of Panel Questions, paras. 49, 55, 94.

[44] These are assertions by Brazil, not "undisputed facts," as it has stated. Brazil Answers to Second Set of Panel Questions, para. 95.

upland cotton identified by the original panel still functions on the same basis as found by the original panel."[45] The original panel's finding of "present" serious prejudice related to the effects of an entirely different set of measures (*payments* not only under the marketing loan and counter-cyclical payment programs but also under the Step 2 program) made in a different time period (MY 1999-2002) and under substantially different market conditions. There have been many changes since that time. These include not only the removal of the Step 2 program but many other factors, for example production-related technological changes that have had dramatic effects on the cost structure of U.S. upland cotton farming (as well as farmers in other countries, such as India) and shifts in patterns of world trade in upland cotton – shifts that are so significant that even the basis for Brazil's asserted "world market price" (the A-Index) has had to be changed (from a Northern Europe basket of quotes to a Far Eastern basket of quotes).

25. The original panel did not – and could not – have taken these factors into account in assessing the "present" effects of the different package of measures at issue in the original proceeding. And, in fact, it is precisely because the original panel could *not* predict what these changes might be (for example, if the United States were to modify the statutory and regulatory provisions providing for Step 2, marketing loan, or counter-cyclical payments in order to implement the Panel's findings), or foresee what effect the challenged measures might have under such changed factual circumstances, that it declined to make any "threat" finding against either future payments or the marketing loan and counter-cyclical payment programs as such.

26. In addition, as explained in the U.S. comments regarding Question 62, Brazil's attempts to indict support to agricultural producers simply on the basis it contributes to the "wealth" of producers and may render them less "risk averse" in their production decisions cannot be credited. If Members had agreed that no domestic support could be provided to agricultural producers, the *Agreement on Agriculture* could have been a great deal shorter. The drafters could simply either have inserted one provision either in that agreement or the *SCM Agreement* stating that "no Member shall provide payments to any producer of any commodity" as this, *inevitably*, contributes to the "wealth" of the producer and, as such, may also render him less risk averse. No such provision exists in either agreement because Members have not agreed to such a prohibition.[46]

27. What the United States finds instead is clear recognition in the *Agreement on Agriculture* and *SCM Agreement* that domestic support to producers of a commodity may have effects that lie anywhere in a range from "no or at most minimal, trade-distorting effects" to more substantial effects that may implicate the reduction commitment obligations in the *Agreement on Agriculture* but are not of the type to render the domestic support an "actionable subsidy" under the *SCM Agreement*, to the kinds of serious effects on trade identified under Articles 5 and 6 of the *SCM Agreement*. It is only the latter – "adverse effects" to the interests of another Member – that are disciplined under the *SCM Agreement.* Whether or not a Member may *challenge* a measure under the *SCM Agreement* has no bearing on whether it can establish a breach of Articles 5(c) and 6.3(c). It can only do the latter where it proves that "the effect" of a measure found to be a "subsidy" is "*significant* price suppression" within the meaning of Article 5(c) and 6.3(c) of the *SCM Agreement*.

28. As the United States has demonstrated[47], none of the allegedly "abundant and diverse evidence" that Brazil asserts in its answers to questions or any of its prior submissions proves that this

[45] Brazil Answers to Second Set of Panel Questions, para. 94.

[46] To the contrary, there is one agriculture-specific actionable subsidy provision in the *SCM Agreement* – Article 6.3(d) of the *SCM Agreement* – and that falls far short of a blanket prohibition on any subsidy that increases producer wealth and renders them less risk averse.

[47] U.S. First Written Submission, paras. 203-331 and Annex I; U.S. Rebuttal Submission, paras. 215-404 and Annex I; U.S. Answers to Parts A-C of First Set of Panel Questions, paras. 27-44; U.S. Oral Statement, paras. 50-85 and Statement of Dr. Joseph W. Glauber; U.S. Answers to Parts D-E of First Set of Panel Questions, paras. 14-42; U.S. Comments on Brazil's "Oral" Presentation, paras. 34-91 and Annex I, and U.S. Answers to Second Set of Panel Questions, paras. 1-4, and 62-170.

is "the effect" of the marketing loan and counter-cyclical payments. What the substantial evidence shows, instead, is that any effects of marketing loan and counter-cyclical payments on U.S. planting, production, exports or world market prices of upland cotton are minimal and not subject to discipline under Articles 5 and 6 of the *SCM Agreement*.

C. THE EFFECT OF THE MARKETING LOAN AND COUNTER-CYCLICAL PAYMENT PROGRAMS IS NOT ANY "PRESENT" INCREASE IN THE U.S. SHARE OF THE WORLD MARKET FOR UPLAND COTTON WITHIN THE MEANING OF ARTICLES 5(C) AND 6.3(D) OF THE *SCM AGREEMENT*

29. Even though Brazil has admitted that "U.S. *share* of world production . . . stayed relatively stable" over the entire period that the FSRI Act has been in effect (*i.e.*, MY 2002-2005), Brazil has attempted in this proceeding to assert a breach of Articles 5(c) and 6.3(d) of the *SCM Agreement* on the basis of a slight (0.46 percent) up-tick in the U.S. share of the world market in MY 2005 over the average for MY 2002-2004.[48] The evidence on the record shows clearly that this increase in MY 2005 is part of the ordinary fluctuations in U.S. share of world supply[49] and is directly attributable to such factors as a sudden shift in acreage from soybeans in certain regions of the United States due to concerns about an outbreak of Asian soybean rust at the end of MY 2004.[50] Thus, Brazil's claim fails – at the outset – because Brazil cannot establish any causal connection between the challenged measures and the slight increase in U.S. world market share in MY 2005 (*i.e.*, it cannot prove the first of the two elements under Article 6.3(d), that "the effect" of the U.S. marketing loan and counter-cyclical payment programs "is an increase in the world market share" of the United States "as compared to the average share it had during the previous period of three years.")

30. But Brazil's claim also fails on a second basis – namely, Brazil's failure to establish that "this increase" – *i.e.*, the "increase in the world market share of the subsidizing Member . . . as compared to the average share it had during the previous period of three years" – "follows a consistent trend over a period when subsidies have been granted." This safeguard precludes complaining parties from establishing a breach under precisely the kind of factual circumstances before this Panel – where an increase in one year is clearly part of the normal fluctuation of world market share and attributable to any number of factors other than subsidies. As the United States showed in its first written submission and again in its rebuttal submission[51], the slight increase in U.S. market share above the previous three-year average has *not* followed a "consistent trend over a period when subsidies have been granted." To the contrary, over the entire period that the FSRI Act of 2002 has been in effect there were only *one* year in which this happened – MY 2005.[52]

31. To try to escape this key flaw in its claim, Brazil urges the Panel to adopt an end-point to end-point comparison using, as the starting point, MY 1998, a year before the entry into force of the

[48] Brazil First Written Submission, paras. 222 and 224. This is the figure if one looks at U.S. share of world production plus beginning stocks. If one looks at U.S. share of world production, there was a similarly small increase (of 1.53 percent) over the average for MY 2002-2004.

[49] *See* U.S. First Written Submission, paras 332-343.

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

[51] The United States notes in this regard that Brazil devotes much effort in its answers to Questions 76-77 to attempting to characterize the U.S. interpretation of Article 6.3(d) as a "new" interpretation not previously presented. This is inexplicable given that in the U.S. first written submission, the United States clearly examined whether the U.S. world market share was higher than the average share of the previous 3-year period for each year in the periods MY 1996-2006, MY 1980-2006, and 1960-1996. This is the exact same examination conducted by the United States in its rebuttal submission. Indeed, Brazil appears to be confusing two separate issues – (a) the question of normal fluctuations in market share, which relates to the question of causation and whether in any particular year it is the challenged measures that are "causing" an increase over the previous three-year average and (b) the question of a "consistent trend" under the second element of Article 6.3(d).

[52] This is true if one looks at world production. If one looks at world production plus beginning stocks, U.S. share of world supply would have been higher than the previous three-year average also in MY 2002.

FSRI Act of 2002 and one in which counter-cyclical payments were not even in existence. The reasons for Brazil approach are patently obvious – MY 1998 was a disastrous year for U.S. production, in which, as a result of severe drought U.S. abandonment rates skyrocketed and harvested area fell more than 2,000,000 acres compared to the previous year. U.S. production that marketing year was the lowest in almost a decade, by more than 1,500,000 bales, and lower than any marketing year *since* by more than 3,000,000 bales. By contrast, growers in the rest of the world, unaffected by the drought, increased harvested area about 100,000 acres. As a result, U.S. share of the world market was at an extremely low point in MY 1998. By selecting this year as the starting point of its "representative period,"[53] and drawing a line from this to the U.S. share of production in MY 2005 – one which would *inevitably* slant upwards – Brazil asserts that it has met its burden of showing that "this increase follows a consistent trend over a period when subsidies have been granted" under Article 6.3(d) of the *SCM Agreement*. Brazil is wrong. As the United States explains in its comments regarding Question 76, Brazil's argument is premised on a fundamentally flawed interpretation of Article 6.3(d) of the *SCM Agreement*. That interpretation would – if adopted – effectively write out of Article 6.3(d) of the *SCM Agreement* both the reference to "this" increase and to a "consistent" trend. As Brazil fails to establish either of the two elements required under Article 6.3(d), it fails to make any *prima facie* of breach of that provision.

D. NEITHER THE MARKETING LOAN AND COUNTER-CYCLICAL PAYMENT PROGRAMS – NOR ANY PAYMENTS THEREUNDER – ARE CAUSING A "THREAT" SIGNIFICANT PRICE SUPPRESSION UNDER ARTICLES 5(C) AND 6.3(C) OF THE *SCM AGREEMENT*

32. There are two fundamental flaws in Brazil's claims of "threat of" significant price suppression under Articles 5(c) and 6.3(c) of the *SCM Agreement*. The first is that Brazil's claim is premised upon a legally incorrect interpretation of "threat of" significant price suppression. The second is that Brazil has not established as a factual matter that there is a "threat of" significant price suppression as a result of either the marketing loan and counter-cyclical payments programs or any payments under the programs. Brazil's answers to the Panel's questions regarding "threat" focus mostly on the first issue.

33. In its response to Questions 86-88, Brazil urges the Panel to replace the term "threat" in footnote 13 of the *SCM Agreement* with "significant likelihood," a standard that Brazil admits is "not found in the *SCM Agreement* or any other WTO Agreement."[54] Indeed, the only basis that Brazil has ever asserted for grafting a "significant likelihood" standard that drafters did *not* agree upon into footnote 13 is that "the precedent interpreting the terms 'threat' and 'threaten' suggests that the appropriate standard of threat in Part III [of the *SCM Agreement*] is one in which there is a significant likelihood, based on the nature of subsidies and particular conditions of competition, that serious prejudice will occur in the future."[55] As the United States pointed out in its rebuttal submission, however, even leaving aside that there is no basis to attempt to interpret a treaty in accordance with "precedent" rather than "in accordance with customary rules of interpretation of public international law,"[56] Brazil cannot even identify any "precedent" that "suggests" that the appropriate standard for "threat" of serious prejudice is "a significant likelihood."[57]

34. Brazil's proposed "significant likelihood" standard injects an entirely new term into the text that (a) is not used by the drafters either in Article 5(c) of the *SCM Agreement* or elsewhere to define "threat," (b) ignores entirely a critical aspect of the ordinary meaning of the "threat," (proximity in time) and (c) itself requires interpretation (e.g., what is a "significant" likelihood of serious prejudice). Brazil has provided no basis whatsoever for writing "significant likelihood" into footnote 13 of the *SCM Agreement*. And, indeed, to do so would contravene the express provisions of Article 3.2 of the

[53] Brazil First Written Submission, para. 227.
[54] Brazil Answers to Second Set of Panel Questions, para. 182.
[55] Brazil First Submission, para. 253.
[56] DSU Article 3.2.
[57] U.S. Rebuttal Submission, para. 413.

DSU, which provides that "[the dispute settlement system of the WTO] serves . . . to clarify the *existing provisions of those agreements in accordance with customary rules of interpretation of public international law*."

35. Brazil has also failed to establish an empirical basis for a finding of "threat" of serious prejudice. To the contrary, Brazil is asking the Panel to find that there is such a "threat" even though the evidence shows:

- an expected decline in U.S. planted acreage of more than 20 percent in MY 2007[58];
- an expected decline of 11 percent in U.S. production[59] in MY 2006 from year-before levels that is expected to continue on into MY 2007[60]
- an expected decline in U.S. *share* of world production in MY 2007[61];
- a 31 percent decline in U.S. exports going into the end of MY 2006 (compared to MY 2005 levels)[62];
- that U.S. producers are likely to cover their variable, or operating, costs as well as a large share of their total costs in MY 2007 (even looking at the inflated "total costs" that Brazil has attempted to use repeatedly in this proceeding).[63]
- that marketing loan payments are likely to be small (at most 2 cents/lb) in MY 2007 and counter-cyclical payments – which are paid regardless of what is planted – are likely to remain at effectively "fixed" levels[64]; and
- the FSRI Act of 2002 is scheduled to expire in October of 2007 meaning that there will be no further payments thereunder as of MY 2008.

There is no basis for a finding of "threat" of serious prejudice under these circumstances.

E. THE UNITED STATES IS PROVIDING GSM 102 GUARANTEES IN RESPECT OF EXPORTS OF RICE AND UNSCHEDULED PRODUCTS CONSISTENTLY WITH ARTICLES 10.1 AND 8 OF THE *AGREEMENT ON AGRICULTURE* AND 3.1 AND 3.2 OF THE *SCM AGREEMENT*

36. In its responses to the Panel's questions – including Questions 92, 95, 100 – Brazil continues to urge the Panel to ignore the provisions of the *SCM Agreement* expressly setting out the conditions under which export credit guarantees may be found to be export subsidies and to make a finding that the provision of GSM 102 guarantees is prohibited simply because the fees under that program are allegedly lower than those charged by Ex-Im Bank for it Letter of Credit Insurance for Banks ("LCI")

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[58] *See* U.S. Answers to Second Set of Panel Questions, paras. 1-4 (discussing NASS Prospective Plantings Report (March 30, 2007) (Exhibit US-140)).

[59] Indeed, just last month, USDA lowered expected production levels for MY 2007 even further. According to NASS, the MY 2007 U.S. upland cotton crop is now forecast at 20.8 million bales – down from the 21.3 million bales forecast in December 2006 – and approximately 11 percent below MY 2005 levels. NASS March 2007 Cotton Ginnings Report (Exhibit US-168).

[60] U.S. Export Sales Weekly Export Performance Indicator for Week Ending 4.12.2007, available at http://www.fas.usda.gov/esrquery/esrpi.aspx (Exhibit US-167).

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

[62] U.S. Export Sales Weekly Export Performance Indicator for Week Ending 4.12.2007, available at http://www.fas.usda.gov/esrquery/esrpi.aspx (Exhibit US-167).

[63] U.S. Rebuttal Submission, paras. 422-425.

[64] *See* U.S. Answers to Second Set of Panel Questions, paras. 196-199 (showing that both FAPRI and CBO project at most a 2 cents/lb marketing loan payment for MY 2007.

and Medium-Term Export Credit Insurance ("MTI") products. There is no support in the text or in logic for such a conclusion.

37. As the United States has explained, the drafters expressly set out in item (j) of the Illustrative List the conditions under which export credit guarantees may be found to be export subsidies. Brazil has not shown – and cannot show – that GSM 102 guarantees are provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the" program. The data show that – to the contrary – for cohorts 1992-2002, examined by the original panel, the negative subsidy net of reestimates (*i.e.*, profit) is now $926,331,216. For all cohorts 1992-2006, the negative subsidy net of reestimates (*i.e.*, profit) is $403,714,701.[65] These are the figures under the U.S. government's credit reform accounting, which Brazil championed in the original proceeding as:

> an ideal basis on which to determine whether the CCC's export credit loan guarantee programs are offered at premium rates that are inadequate to cover the long-term operating costs and losses of the programs, within the meaning of item (j) of the Illustrative List of Export Subsidies. It functions as a more sophisticated alternative to constructed cost formulas, and thoroughly accounts for all of the premium and operating cost and loss elements required by item (j). Moreover, it has the virtue of serving as the actual, real-world calculation used by the U.S. Congress, the President of the United States, and federal agencies like the CCC to "measure more accurately the costs of Federal credit programs."[66]

38. Brazil has no basis for its arguments now – including in response to Question 114 – that the Panel should disregard this actual data and should use instead, Brazil constructed cost formula. The "the actual, real-world calculation used by the U.S. Congress, the President of the United States, and federal agencies like the CCC to 'measure more accurately the costs of Federal credit programs'"[67] confirms that export credit guarantees under the GSM 102 program are being provided at premiums that are *well* above those that would be required simply to "cover" long-term operating costs and losses. Under the text of the *SCM Agreement*, the analysis begins and ends there. There is no "separate" standard under Articles 1.1 and 3.1(a) for when export credit guarantees constitute an "export subsidy."

39. But even if item (j) did not exist, asserting that Ex-Im Bank charges higher fees for export credit guarantees than CCC does under the GSM 102 program would not establish any breach of Articles 1.1 and 3.1(a) of the *SCM Agreement*. As Article 14(c) of the *SCM Agreement* makes clear[68], a loan guarantee provides a "benefit" recognized under Article 1.1 of the *SCM Agreement* only where it affects the underlying transaction – *i.e.*, where it results in there being a "difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee." This makes perfect sense. Export credit guarantees have no value in and of themselves; they simply modify and relate to the underlying loan transaction. It is only when they cause the underlying loan to be more attractive than loans otherwise available on the market that there is a possibility of trade distortion (*i.e.*, making a particular purchase of U.S. goods more attractive than it would have been absent the guarantee). The fee charged for a guarantee is passed through by the U.S. exporter to the foreign purchaser and becomes part of the overall cost of the financing. And it is only through the comparison of the total cost of loans guaranteed by GSM 102 guarantees and comparable commercial

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[65] *See* U.S. Answers to Second Set of Panel Questions, paras. 277-278.

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

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

[68] Because it interprets and applies the definition of "benefit" set out in Article 1.1, Article 14 has been relied upon by the Appellate Body as important contextual guidance in interpreting "benefit." *Canada – Aircraft (AB)*, para. 155.

loans not guaranteed by GSM 102 guarantees that one can assess whether the GSM 102 guarantee actually rendered particular transactions more attractive than they otherwise would have been.

40. Brazil has not even attempted to make the kind of particularized showing contemplated under Article 14(c) of the *SCM Agreement*; it has not shown that the overall cost, including fees, of each of the loans guaranteed by the government is less than overall cost of a comparable commercial loan that could be obtained without a government guarantee. Instead, Brazil relies on sweeping and erroneous assertions that obligors on loans guaranteed under the GSM-102 program can *never* obtain any other financing of any kind and that the United States could *never* provide an export credit guarantee without also providing an export subsidy. These arguments simply do not square with the evidence submitted by the United States showing that such obligors are in fact able to obtain financing even without GSM 102 guarantees and on terms better than those available *with* GSM 102 guarantees. The declining level of use of the GSM 102 program in recent years is even further evidence of this.

41. Brazil's attempts to declare GSM 102 guarantees export subsidies merely on a comparison to fees charged by Ex-Im Bank are contrary to the text and logic of Articles 1.1(a), 14(c), and item (j) of the *SCM Agreement*. As the United States has explained, Brazil has not established that the LCI and MTI products are even comparable to the GSM 102 guarantees provided by CCC.[69] But, regardless of this, the reasoning underlying Brazil's comparison of these products is unavailing.

42. Brazil is effectively asking the Panel to assume that the LCI and MTI products are themselves provided at "below market" rates even though Brazil has conducted no actual comparison vis-a-vis any other comparable product available on the market. Following from this assumption, Brazil would have the Panel accept that, if the CCC charges lower fees than Ex-Im Bank, the fees for the GSM 102 guarantees must also be "below market." Brazil's approach is based on unfounded factual assumptions and on logic that is not found anywhere in the *SCM Agreement*. Member did *not* agree that export credit guarantees could be found to be export subsidies simply if one government entity charges fees that are different or lower than another government entity. Brazil's efforts to establish a breach of Articles 1.1(a) and 3.1(a) of the *SCM Agreement* on that basis are unavailing.

II. SPECIFIC COMMENTS REGARDING BRAZIL'S ANSWERS

A. SCOPE OF THIS PROCEEDING

Questions to both parties

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

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

[69] Brazil First Written Submission, para. 381.

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

43. The United States respectfully refers the Panel to its general comments above regarding Brazil's claims in respect of exports of pig meat and poultry meat as well as to its own response to this question.[70]

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

44. The United States respectfully refers the Panel to its general comments above regarding Brazil's claims in respect of the marketing loan and counter-cyclical payment programs as well as to its own response to this question.[71] The United States also submits one additional brief observation regarding Brazil's answer to this question.

45. The United States disagrees with Brazil's assertion that a claim about a measure "as such" is "typically understood to involve an examination of a general rule or norm in the abstract."[72] An "as such" claim relates to whether the application of a measure in *all* present and future circumstances results in a breach of a covered agreement. This is not an inquiry "in the abstract" but the exact opposite, an inquiry across *all* of the possible factual circumstances that have and are expected to arise. Indeed, the Appellate Body underscored exactly this aspect of "as such" claims in *United States – Sunset Reviews on OCTG from Argentina*, where it explained that:

> *By definition*, an "as such" claim challenges laws, regulations, or other instruments of a Member that have general and prospective application, asserting that a Member's conduct – *not only in a particular instance that has occurred, but in future situations as well* – will necessarily be inconsistent with that Member's WTO obligations.[73]

The Appellate Body explained that "as such" claims were to be considered to be "serious challenges" because "[i]n essence, complaining parties bringing 'as such' challenges seek to prevent Members *ex ante* from engaging in certain conduct."[74]

46. Despite this clarification from the Appellate Body about the caution to be exercised with "as such" challenges – and Brazil's own acknowledgment, in response to this question, that a finding regarding the *effects* of a subsidy under Articles 5 and 6 of the *SCM Agreement requires* an examination of market conditions and the operation of the alleged subsidy within those conditions – Brazil would have the Panel believe that the original panel made a serious prejudice finding against the statutory and regulatory provisions authorizing Step 2, marketing loan, and counter-cyclical payment *programs* without so much as addressing the market conditions likely to prevail in the future. Rather, Brazil urges the Panel to ignore Brazil's own express explanation to the original panel that the MY 1999-2002 period was "*both the period of time covering the measures challenged by Brazil* as well as the period of investigation to examine present serious prejudice caused by the U.S. subsidies under Articles 5(c) and 6.3 of the SCM Agreement" and its arguments in this proceeding that the MY 1999-2002 period presented an unusually "dynamic" situation for world market prices and U.S.

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[70] *See* U.S. Answers to Second Set of Panel Questions, paras. 1-16.
[71] *See* U.S. Answers to Second Set of Panel Questions, paras. 17-41.
[72] Brazil Answers to Second Set of Questions, para. 10.
[73] *United States – Argentina OCTG Sunset Reviews (AB)*, paras. 172.
[74] *United States – Argentina OCTG Sunset Reviews (AB)*, paras. 172.

exports.[75] Instead, Brazil would now have the Panel believe that the original panel simply used MY 1999-2002 as a reference period for the entire period of effectiveness of the FSRI Act of 2002. The facts simply do not support Brazil's argument.

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

47. The United States respectfully refers the Panel to its general comments above regarding Brazil's claims in respect of exports of pig meat and poultry meat, its comments regarding Brazil's answer to Question 44 above, as well as to its own response to this question.[76]

Questions to the United States

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

48. How does the United States address the argument of Brazil that "[i]f the United States were to prevail on its view that subsequent mandatory and price-contingent marketing loan and CCP payments are not properly before this Panel, the grant of annual recurring subsidies becomes 'a moving target that escape from [the WTO subsidy] disciplines'"? (Closing Statement of Brazil, para. 4)

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

Question to Brazil

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

48. In its response, Brazil appears to acknowledge that lyocell, lysine, and wood products fall outside the scope of the *Agreement on Agriculture*. By definition, therefore, the provision of GSM 102 export credit guarantees in respect of lyocell, lysine, and wood products cannot circumvent U.S. agricultural export subsidy commitments under that agreement.[77] In its request for establishment of a

[75] Brazil Rebuttal Submission, para. 236.
[76] *See* U.S. Answers to Second Set of Panel Questions, paras. 1-16.
[77] U.S. Rebuttal Submission, paras. 81-83

panel, Brazil presented claims under Articles 3.1 and 3.2 of the *SCM Agreement* "as a result and to the extent of [the alleged] violation of Article 10.1 (and, as a consequence, Article 8) of the *Agreement on Agriculture*."[78] As there can be no "violation of Article 10.1 (and, as a consequence, Article 8) of the *Agreement on Agriculture*,"[79] there can be no claim under the *SCM Agreement* with respect to the GSM 102 export credit guarantees in respect of lyocell, lysine, and wood products under the express terms of Brazil's request for panel establishment. Where a claim is not set out in the request for panel establishment – as here – it is not part of the matter referred to the panel and falls outside the scope of a panel proceeding.

B. CLAIMS OF BRAZIL REGARDING PRESENT SERIOUS PREJUDICE

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

Questions to both parties

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

49. The United States notes that, although the Panel's question asks each party to "explain how its approach to the analysis of the impact of [marketing loan and counter-cyclical] payments on production of upland cotton is supported by the provisions of Articles 5 and 6 of the *SCM Agreement* and by any other relevant WTO provisions," Brazil does not appear to actually answer this question. Rather, Brazil devotes almost all of its response to explaining why even green box measures can be subject to challenge under the *SCM Agreement*. This is inexplicable because Brazil then asserts that (a) the marketing loan and counter-cyclical payment programs are properly viewed as so-called "amber box" measures and (b) in the very next question, concedes that the fact that measures are classified in the "amber box" does not mean that they cause adverse effects within the meaning of Articles 5 and 6 of the *SCM Agreement*. It is difficult to understand, therefore, what – if anything – Brazil's answer has to do with explaining whether Brazil's approach is consistent with Articles 5 and 6 of the *SCM Agreement*.

50. Instead, Brazil's discussion seems to be aimed at suggesting that U.S. marketing loan and counter-cyclical payments should be found in breach of Articles 5 and 6 of the *SCM Agreement* no matter how minimal the effects thereof. Any such suggestion would be flatly wrong under the terms of those provisions. Only "subsidies" the effect of which is "significant" price suppression are subject to discipline by virtue of Articles 5(c) and 6.3(c) of the *SCM Agreement*. Whether any measures – whether green, blue, amber, or something else – may be *challenged* does not change the fact that the complaining party bears the burden of *proving* through evidence and argument that the challenged measures are causing adverse effects within the meaning of Articles 5 and 6 of the *SCM Agreement* (in the present case, "significant" price suppression under Article 6.3(c)). Where – as here – a complaining party fails to do so, its claim cannot succeed.

52. In its Third Party Submission New Zealand observes:

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

[78] Brazil Request for Panel Establishment, para. 28.
[79] Brazil Request for Panel Establishment, para. 28.

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

51. The United States respectfully refers the Panel to the U.S. comments regarding Brazil's response to Question 51 above.

Questions to the United States

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

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

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

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

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

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

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

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

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

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

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

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

58. ***The Unites States stated that the key consideration in assessing a farmer's decision to grow upland cotton is whether the farmer has been covering his variable costs of production. In this connection, it presented upland cotton costs and returns estimates for marketing years 1999-2005 (Exhibit US-47). Brazil has disputed the absence of certain items – land, labour and capital recovery costs - in the US calculations of variable costs. In response, the United States has referred to the Commodity Costs and Returns Estimation Handbook (Exhibit US-88) prepared by a Task Force of the American Agricultural Economics Association as the basis for leaving out these items in its calculations. However, the Task Force which authored the Handbook does not use the categories "fixed" or "variable" costs and in fact recommends that the microeconomic concepts of fixed and variable costs not be used in preparing and reporting cost and return estimates. Page 2-67 of the Handbook states:***

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

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

59. ***In discussing the impact of long-term costs of production (and hence long-term profitability) of upland cotton production on farmers' decisions to exit cotton***

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

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

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

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

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

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

<u>Questions to Brazil</u>

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

52. Brazil's response to the first part of this question highlights that fact that Brazil is attempting to have the Panel find income support to agricultural producers to effectively be a prohibited measure under the *SCM Agreement*.

53. Indeed, Brazil asserts as "one of the fundamental facts supporting Brazil's adverse effects claims"[80] the mere *fact* that marketing loan and counter-cyclical payment programs provide income support to U.S. producers at times of low prices. Similarly, Brazil argues that it is evidence of price suppression under Articles 5(c) and 6.3(c) of the *SCM Agreement* that U.S. farmers "know" that if prices fall below certain levels, they may receive payments under the marketing loan and counter-cyclical payment programs. As the United States explained in its response to Question 53(b), however, *any* eligible recipient of income support "knows" that he or she will receive some income protection due to those payments. That is the very nature and intent of income support programs – to ensure that producers receive some income that they would not otherwise get on the market.

54. In fact, U.S. farmers are even more secure in their "knowledge" that they will receive such payments where payments are fixed, as in the case of direct payments (*i.e.*, as compared to payments under the marketing loan and counter-cyclical payment program, which depend on U.S. and world market prices that are not within the control of individual farmers and cannot even be known until many months after the decision is made whether or not to plant cotton). Yet, as the original panel recognized in the case of direct payments[81], the fact that farmers have such "knowledge" does not necessarily result in any "adverse effects" within the meaning of Articles 5 and 6 of the *SCM Agreement*.

55. As the United States has noted before, most economists agree that direct payments, like marketing loan payments, counter-cyclical payments, payments supporting elderly or low-income recipients or, for that matter, *any* type of payment to a producer of agricultural products will have some effect on risk and wealth and that this may, in turn, have some effect on production. The question under Articles 5(c) and 6.3(c) is whether Brazil has shown that – taking into account the particular structure and design of the programs and the way they operate under the market conditions prevailing at present – payments under the programs are having actual effects on production that are so substantial that they are resulting in "present" *significant* price suppression. It is significant price suppression that is precluded under the SCM Agreement, not any *possible* effect on production or any *actual* effect on production that does not ultimately result in significant price suppression in the market identified by the complaining party.

56. Brazil's response to the second part of the Panel's question – asking Brazil to respond the U.S. observation about the lack of an empirical basis for Brazil's claims of "present" serious prejudice – confirms that Brazil has not established such actual "present" effects. Thus, for example, Brazil cites as "evidence" findings made by the original panel and the Appellate body about the collective effects of a different set of measures (Step 2, marketing loan and market loss assistance or counter-cyclical payments) in a different period of time (MY 1999-2002) and under different market conditions.[82] These findings are not directly relevant here. Moreover, as the United States explained in its response

[80] Brazil Answers to Second Set of Questions, para. 44.

[81] Brazil's assertions about the alleged "key role" that direct payments allegedly play in "allowing many upland cotton farmers to achieve a healthy 'profit' from growing upland cotton" – even though direct payments are not at issue in the present proceeding – is further evidence of Brazil's efforts to render income support a prohibited measure under the *SCM Agreement*. Brazil Answers to Second Set of Questions, para. 56. According to Brazil, "such profits play an important role in maintaining upland cotton production over the longer term by increasing the 'wealth' of producers." Brazil Answers to Second Set of Questions, para. 56. What Brazil asserts is true of any payment to any agricultural producer; any such payment would "increas[e] the 'wealth' of producers." This does not mean that all payments to producers are causing "significant" price suppression.

[82] As Brazil confirmed in the first (resumed) meeting with the original Panel, "[t]he four-year period in which these subsidies [the "subsidies provided for the production, export and use of U.S. upland cotton during the period MY 1999-2002"] were provided is both the period of time covering the measures challenged by Brazil as well as the period of investigation to examine present serious prejudice caused by the U.S. subsidies under Articles 5(c) and 6.3 of the SCM Agreement." Brazil's 7 October 2003 Second Statement at First Panel Meeting, para. 3 (emphasis added)

to Question 54[83], the factual observations that the original panel made regarding marketing loan and counter-cyclical payments in reaching its conclusion about the collective effects of the Step 2, marketing loan and counter-cyclical payments made in MY 1999-2002 do not support a finding that marketing loan and counter-cyclical payments are causing "significant" price suppression at present under the existing market conditions.

57. Brazil then asserts that a "strong link" "has been recognized" by various entities between the programs and payments challenged by Brazil in this proceeding and upland cotton acreage, production, exports, and prices.[84] However, *not a single one of the sources* Brazil cites actually looks to the collective effects of the marketing loan and counter-cyclical payments on world market prices, let alone looks at whether these effects amount to significant price suppression under the market conditions existing in the "present" (*i.e.*, MY 2006). Indeed, Brazil even goes as far as to cite as "evidence" a U.N. Food and Agricultural Organization ("FAO") report that observes that "all of the recent studies unambiguously demonstrate that *the removal of domestic subsidies in industrialized countries* reduces cotton production in and exports from these countries."[85] There is no basis whatsoever to find that U.S. marketing loan and counter-cyclical payments are causing "present" significant price suppression within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement* simply on the basis that they are "domestic subsidies in [an] industrialized countr[y]."

58. Moreover, contrary to Brazil's assertions, the FAO report does *not* suggest that there is a "strong link" between the marketing loan and counter-cyclical payments and upland cotton acreage, production, exports or prices.[86] The FAO report simply reviews a number of different studies examining the removal of various domestic support measures and/or tariffs from the cotton sector in a number of countries (some even looking at removal of such measures world-wide). As Brazil has acknowledged, the original panel reviewed similar studies during the course of its analysis and "recognized that many of the parameters including magnitude, and time period of the subsidies, elasticities, measures, and selection of baselines did not address exactly the time period or legal issues before the original panel."[87] Accordingly, the *only* conclusion that the original panel considered appropriate to draw from these widely divergent, inapposite studies – according to Brazil – was that "subsidies bestowed by Member governments have the *potential* to distort production and trade."[88] This does not equate to the recognition of any "strong link."

59. Brazil also points to statements by a U.S. trade association made before enactment of the 2002 farm bill purporting to show that U.S. farmers would be "bankrupt" without marketing loan and counter-cyclical payments. Again, not one of these statements pertain to marketing loan or counter-cyclical payments. Rather, they were made about emergency relief provided under the FAIR Act of 1996 in the period MY 1999-2001. These statements – quoted out of context – about an entirely different set of measures (including disaster payments), offers no insight regarding the role of marketing loan and counter-cyclical payments in production decisions or about U.S. farmers' costs and revenues today. Certainly it does nothing to detract from the actual data regarding "present" costs and revenue, which, as discussed in the prior U.S. submissions, flatly contradict Brazil's claims that

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[83] U.S. Answers to Second Set of Panel Questions, paras. 101-106.

[84] Brazil Answers to Second Set of Questions, para. 45.

[85] Brazil Answers to Second Set of Questions, para. 45.

[86] Brazil Answers to Second Set of Questions, para. 45.

[87] Brazil Rebuttal Submission, para. 309.

[88] Brazil Rebuttal Submission, para. 309. Indeed, the FAO itself concludes that any potential distortion may be minimal. The FAO estimates price effects of *only* 3.1 to 5 percent and it does so for "*complete elimination of domestic subsidies as notified to the WTO* <u>*and*</u> *tariffs*;" in other words, *every domestic support* and *every tariff* for *every* country in the world that notifies either to the WTO. Poonyth, Daneswar, *et al.*, "The Impact of Domestic and Trade Policies on the World Cotton Market," FAO Commodity and Trade Policy Research Working Paper No. 8, April 2004, p. *i* (Exhibit US-55). Any possible effect of *U.S.* domestic supports – let payments under only *two* of the U.S. programs – would necessarily be substantially less. This is hardly evidence of a "strong link."

U.S. upland cotton farmers would be bankrupt without the marketing loan and counter-cyclical payment programs.

60. What is conspicuous in its almost complete absence from Brazil's listing of the evidentiary basis for its claims is evidence of any present production-inducing effects of the marketing loan and counter-cyclical payments under the market conditions prevailing at present and without the Step 2 program in place. Indeed, the *only* argument that Brazil makes about the effects of marketing loan and counter-cyclical payments under the current market conditions is that, according to a U.S. "market expert," current U.S. stocks will allegedly "keep a heavy lid on the market" and, in term of prospective plantings, that "any total acreage number below 12.5 million acres will be bullish. The lower the intended plantings, the higher the price rally."[89]

61. Brazil's assertion that this is "evidence" of significant price suppression is misleading. The question under Articles 5(c) and 6.3(c) is whether U.S. marketing loan and counter-cyclical payments significantly suppress world market prices for upland cotton. Whether or not increased U.S. stocks may have some effects on prices does not answer that question. Any effects on prices could only be attributed to U.S. marketing loan and counter-cyclical payments to the extent that Brazil proves that it was marketing loan and counter-cyclical payments that *cause*d all of the production that is placed in inventory. Brazil clearly has not done so.[90]

62. Absent specific evidence regarding the effects that marketing loan and counter-cyclical payments are having at present under the prevailing market conditions, Brazil has no basis for its claims of "present" serious prejudice under Articles 5(c) and 6.3(c).

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

63. The United States notes that the bulk of Brazil's answer to this question addresses arguments that have never been made by the United States. The United States has never suggested that "Article 6.3 of the *SCM Agreement* . . . compel[s] a complaining Member to produce evidence that the challenged subsidies result in a steady *increase* in production or acreage."[91] Therefore, it is inexplicable why Brazil devotes nearly four pages of argument in an attempt to rebut such an assertion.

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[89] Brazil Answers to Second Set of Questions, para. 51.

[90] The market analysis submitted by Brazil actually *confirms* that – contrary to Brazil's assertions – U.S. production and exports/stocks are not primarily responsible for the upland cotton market trends that are currently being observed. Specifically, the actual planting intentions figures for MY 2007 were far lower than those predicted by the "market expert" cited by Brazil – the report forecasted U.S. upland plantings to be only 11.86 million acres. NASS Prospective Plantings Report (March 30, 2007) (Exhibit US-140). This is 20.7 percent lower than MY2006 acreage and over 600,000 acres below the point at which the "market expert" predicted there would be a "bullish" impact on prices. Yet, both the May and December futures contracts for upland cotton, as quoted by the New York Board of Trade, *declined*, on average, since the report was issued. N.Y. Futures After Issuance of Planting Intentions Report (Exhibit US-169). This is hardly the "bullish" response predicted and confirms that other factors – such as China's upland cotton trade balance – are very much responsible for the world market price phenomenon that experts are trying to understand. As discussed in response to Question 74 below, Brazil has never properly accounted for these other factors in its assessment of "present" serious prejudice.

[91] Brazil Answers to Second Set of Questions, para. 59.

64. Rather, as the Panel's question itself reflects in its reference to footnote 72 of the Comments of the United States on Brazil's "Oral" Presentation in the meeting with the Panel, the United States has taken issue with Brazil's inexplicable arguments in its unsolicited third written submission – BRA-659 – that the Panel should disregard a number of the studies submitted by the United States because they do "not examine whether CCPs are decoupled from production. Rather, [they] examine whether CCPs increase acreage."[92]

65. The United States appreciates Brazil's acknowledgment now, in response to this question, that its focus on "coupling" in the language cited by the United States was misplaced: "the notion of "coupled" and "decoupled" support in the Agreement on Agriculture . . . is not relevant for the assessment of the effects of subsidies under Articles 5 and 6 of the SCM Agreement."[93] Rather, as Brazil now concedes the salient question is whether marketing loan and counter-cyclical payments cause such substantial shifts in planted acreage that oversupply, export, and ultimately "significant" price suppression within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement* result.[94] As discussed in the prior U.S. submissions[95] and above in the general comments of the United States regarding Brazil's claims under Articles 5(c) and 6.3(d) of the *SCM Agreement*, the evidence before the Panel does *not* support Brazil's arguments that the marketing loan and counter-cyclical payments are causing any such significantly suppressed world market prices.

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

66. Brazil fails to establish why the McIntosh, Shogren & Dohlam study – a study that does not address upland cotton specifically and that is premised on highly restrictive assumptions about the operation of the counter-cyclical program – is "more applicable to the assessment that the compliance Panel is tasked with"[96] than the many studies submitted by the United States.

67. Indeed, it is important to note that – because the McIntosh, Shogren & Dohlman study is not limited to upland cotton production – its results are presumably supposed to be valid even for predicting effects on wheat, corn, and soybean acreage. However, it comes to *directly* inconsistent conclusions about the effects of counter-cyclical payments on wheat, corn, and soybean acreage than the studies submitted by the United States (for example, the Lin & Dismukes study finding that "[t]he effect of CCPs on producers' planting decisions . . . appears to be *very negligible* – an increase in the acreage of major field crops of less than 1% . . . .")[97] Although Brazil has argued that the Panel should ignore those other studies because they are not specific to upland cotton, Brazil has never explained

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[92] Supplementary Statement of Daniel Sumner, para. 21.

[93] Brazil Answers to Second Set of Questions, para. 65. Brazil's attempts to attribute the focus on "coupling" to the United States in its response is, however, patently unfounded, as the U.S. discussion in footnote 72 (reflected above) clearly shows.

[94] Brazil Answers to Second Set of Questions, para. 66.

[95] U.S. First Written Submission, paras. 203-331 and Annex I; U.S. Rebuttal Submission, paras. 215-404 and Annex I; U.S. Answers to Parts A-C of First Set of Panel Questions, paras. 27-44; U.S. Oral Statement, paras. 50-85 and Statement of Dr. Joseph W. Glauber; U.S. Answers to Parts D-E of First Set of Panel Questions, paras. 14-42; U.S. Comments on Brazil's "Oral" Presentation, paras. 34-91 and Annex I, and U.S. Answers to Second Set of Panel Questions, paras. 1-4, and 62-170.

[96] Brazil Answers to Second Set of Questions, para. 67.

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

why the McIntosh, Shogren & Dohlman study should be viewed as reliable when it comes to such different conclusions about the effects of counter-cyclical payments even with respect to the other crops. Indeed, the divergence in the results for wheat, corn, and soybean acreage simply confirm what the United States has argued and the authors of the McIntosh, Shogren & Dohlman study themselves acknowledge[98] – that this study overstates any effects of counter-cyclical payments on acreage.

68. The authors themselves identify some of the reasons why that particular study overstates any effects of counter-cyclical payments on acreage. Namely:

> Our design did not address two features of the 2002 Act which could affect the interpretation of our results. First, there are no adjustments made in our bonuses for the fact that direct and counter-cyclical payments are made only on a percentage (85 percent) of base acres. If these adjustments were incorporated, the lump sum bonuses would have been lower, implying our results could overstate the effects of CCPs. Second, we excluded the marketing loan program to focus on the basic CCP structure—target price, market price, and direct rate. Adding the marketing loan program into our design would temper the basic effects of CCPs by providing an additional price support mechanism.[99]

69. There are other reasons as well that have to do with the kind of laboratory experiments upon which the McIntosh, Shogren & Dohlman study is premised. The use of a laboratory experiment may allow the researchers to focus on a particular set of problems or issues but necessarily abstracts away from other highly relevant factors that also affect a producer's planting decision. Thus, for example, Brazil cites the authors of the McIntosh, Shogren & Dohlman study as noting that "farmers have other risk management tools at their disposal; large and less risk-averse farms tend to dominate production of program crops; and other programs such as marketing loan provisions already offer price protection."[100] The McIntosh, Shogren & Dohlman study excludes these factors in assessing the effects of counter-cyclical payments. Yet, as Paul Westcott *et. al.* explained[101], it is precisely these kinds of factors that mitigate and temper any *actual* effects of counter-cyclical payments.[102] To

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

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

[100] *See* Brazil Answers to Second Set of Questions, para. 68, n. 63 (citing McIntosh, Christopher R., Jason F. Shogren and Erik Dohlman, "Supply Response to Counter-Cyclical Payments and Base Acre Updating under Uncertainty: An Experimental Study," Forthcoming paper in the American Journal of Agricultural Economics, November 2006, p. 16-17 (See Exhibit BRA-565)).

[101] The original panel found an earlier version of Westcott's analysis to be persuasive as to the effects of counter-cyclical payments.

[102] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 203-205 (Exhibit US-35). Westcott notes in this regard that: (a) where prices are expected to be above maximum threshold – counter-cyclical payments behave just like the fixed direct payments; (b) "cross-commodity effect[s] suggest[] that CCPs may provide a general reduction in revenue risks rather than a crop-specific effect. Net returns among alternative crops would remain the primary consideration underlying production choices;" (c) "while a number of studies indicate that farmers are risk averse (Chavas and Holt, 1990, 1996, for example), other risk reduction instruments already exist to manage risks. Thus, with revenue risk reduction now provided by CCPs as part of farm programs, farmers may adjust their use of these other farm and nonfarm risk management strategies;" and (d) "a large portion of output in the U.S. agricultural

ignore these factors is to improperly attribute to counter-cyclical payments effects that they do not *actually* have in the real world but only have in some artificial vacuum created for purposes of a laboratory experiment. It says little about whether counter-cyclical payments are *actually* having the kind of production effects alleged by Brazil and whether those effects are *actually* lead to the kind of price suppressive effects with which Article 6.3(c) is concerned.

70. What Brazil presents – in short – is a highly abstract study with limited conclusions.[103] The laboratory experiment upon which the study is based does not reflect the economic conditions of actual upland cotton producers.[104] Rather, the experiment "mimicked" certain stylized scenarios to attempt to isolate and measure the impact risk aversion and uncertainty might have on production decisions.[105] In doing so, however, the authors removed from consideration some of the most critical factors that affect the degree to which farmers are, in fact, risk averse, such as the size of the enterprise and the availability of other price hedging mechanisms. Moreover, they exclude important factors other than risk that affect a farmer's planting decisions. When *all* factors are taken into account – as reflected in the empirical data used by some of the other studies submitted by the United States – a much more realistic picture emerges of the effects of counter-cyclical payments.

71. Brazil also claims that the McIntosh, Shogren & Dohlman study is more relevant because it is not confined to the geographic regions of other studies.[106] That is a curious argument given that Brazil at once asserts that geographical factors may have some effect on the effects of counter-cyclical payments and asserts that a study that takes *none* of these factors into account is somehow the most reliable measure of the effects of counter-cyclical payments. In any event, Brazil's criticism that the Lin & Dismukes and Goodwin & Mishra studies on corn, soybeans, and wheat are less relevant to upland cotton because supply elasticities for these crops are much smaller than for upland cotton is only valid if one ascribes to the inflated supply elasticity used by Brazil in its Sumner II (CATO) model. For the reasons explained in the prior U.S. submissions, it is not appropriate to do so.[107]

72. Finally, the United States notes that Brazil misstates the U.S. arguments. The United States has not criticized the field of behavioral or experimental economics, nor has the United States

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sector is produced by a small share of large producers. . . . Evidence that risk aversion decreases as income rises (Chavas and Holt, 1990, 1996) suggests that risk aversion may also tend to decline as the size of farms increases. Thus, with larger farms that account for most production being less averse to facing risk, this lowers potential production effects of CCPs due to risk reduction. And while smaller farms may be more risk averse in their farm enterprise, off-farm income may reduce the overall level of household income risk." Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 203-205 (Exhibit US-35). On the basis of these and other factors, Westcott concludes that "there are several mitigating factors which suggest that overall production effects of CCPs through revenue risk reduction are likely to be limited." Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 205 (Exhibit US-35). The other studies submitted by the United States examining the empirical evidence of production effects – for example, including the Lin & Dismukes study finding that "[t]he effect of CCPs on producers' planting decisions . . . appears to be *very negligible* – an increase in the acreage of major field crops of less than 1% . . . ." – confirm that the effects of the counter-cyclical payments are, in fact, very limited. Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter- cyclical Payments' Production Impacts," *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 83 (Exhibit US-85) (emphasis added).

[103] Brazil Answers to Second Set of Questions, para. 68.

[104] Brazil Answers to Second Set of Questions, para. 69.

[105] McIntosh, Christopher R., Jason F. Shogren and Erik Dohlman, "Supply Response to Counter-Cyclical Payments and Base Acre Updating under Uncertainty: An Experimental Study," Forthcoming paper in the *American Journal of Agricultural Economics*, November 2006, p. 5) (Exhibit Bra-565).

[106] Brazil Answers to Second Set of Questions, para. 69.

[107] *See e.g.*, U.S. First Written Submission, paras. 319-328 and Annex I; U.S. Rebuttal Submission, paras. 349-386 and Annex I; U.S. Oral Statement, paras. 76-81 and Statement of Dr. Joseph W. Glauber; U.S. Comments on Answers to Parts D-E of First Set of Panel Questions, paras. 30-42; and U.S. Comments on Brazil's "Oral" Presentation, paras. 79-91.

suggested that the McIntosh, Shogren & Dohlman is invalid merely because it is based on controlled experiments, as Brazil claims.[108] Rather, the United States has identified the numerous factors that limit the utility of the McIntosh, Shogren & Dohlman study in assessing the question at hand, including those expressly acknowledged by its authors. Moreover, the United States has noted the irony in Brazil's criticisms leveled at the studies submitted by the United States (*i.e.*, that they are not unique to upland cotton production), when Brazil itself submits studies that do not even examine the behavior of actual farmers but, rather, the responses of University of Wisconsin economics students to some highly stylized scenarios. To claim that this highly abstract experimental study "analyzes more closely the effects of counter-cyclical payments on the production decisions of U.S. upland cotton farmers than results of empirical studies"[109] – as Brazil does – is simply not supported by a review of the study and its conclusions.

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

73. Brazil's answer to this question fundamentally contradicts its answer to Panel question 64. Brazil asserts that the studies submitted by the United States are not probative "due to their failure to address the specific effect of upland cotton counter-cyclical subsidies on upland cotton production."[110] Yet, as Brazil admits in Question 64 there are no studies that "address the specific effect of upland cotton counter-cyclical subsidies on upland cotton production."[111] and in fact that studies upon which it relies itself – including the McIntosh, Shogren & Dohlman study – do not even do so. Brazil's complaint on this basis is, thus, patently absurd.

74. Equally unavailing are the four bases that Brazil asserts for why the effects of counter-cyclical payments made to a holder of upland cotton base acreage that produces upland cotton should be understood to be fundamentally different from those observed by Lin & Dismukes for counter-cyclical payments made in respect of corn, wheat, and soybeans and Goodwin & Mishra for marketing loss assistance payments in respect of the same crops. For example, Brazil does not explain what its assertions about "maximum per-acre counter-cyclical payments" have to do with effects on production. In fact, if it were true – as Brazil alleges – that the costs of production for upland cotton are higher than for other crops, one would expect rational farmers to produce other crops while still collecting the allegedly very high maximum upland cotton counter-cyclical payment. Thus, Brazil's reasoning actually supports exactly the opposite conclusion than the one it asserts.

75. Brazil's assertions about the "frequency of payment" similarly lack merit. Differences in what Brazil calls the "fill rate" did not preclude Brazil's preferred study – the McIntosh, Shogren & Dohlam study – from presenting one single assessment across all counter-cyclical payments. This supports the conclusion that any alleged differences in the "frequency of payment" do not preclude the Lin & Dismukes and Goodwin & Mishra from being highly probative of the likely effects of counter-cyclical payments made in respect of upland cotton base acres.

76. Brazil's third asserted basis – its allegation that "one would expect low supply elasticities in these regions for these crops"[112] – is similarly without merit. As noted in response to Question 64, this appears to be premised on Brazil's own assertions of grossly inflated supply elasticities for upland cotton.

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[108] Brazil Answers to Second Set of Questions, para. 71.
[109] Brazil Answers to Second Set of Questions, para. 73.
[110] Brazil Answers to Second Set of Questions, 75.
[111] Brazil Answers to Second Set of Questions, 75.
[112] Brazil Answers to Second Set of Questions, para. 80.

77. Finally, as noted above, there is no basis for Brazil's attempts to invoke certain statements by the NCC carefully selected to give the impression that U.S. upland cotton farmers would simply be "bankrupt" without counter-cyclical payments. As Brazil admits, these statements were not even made with respect to counter-cyclical payments under the FSRI Act of 2002 but rather were made in February 2001 – before the FSRI Act of 2002 even came into effect – about certain emergency relief that had been provided under the FAIR Act of 1996 including production flexibility contract payments, marketing loss assistance payments, and disaster payments. These statements offer no insight regarding the role of counter-cyclical payments in production decisions or about U.S. farmers' costs and revenues today. And they certainly do nothing to detract from the actual data regarding "present" costs and revenue, which flatly contradict Brazil's claims that U.S. upland cotton farmers would be bankrupt without counter-cyclical payments.

78. In sum, Brazil has offered no valid reason why the Panel should not consider the studies submitted by the United States to be highly probative on the question of the effects of the counter-cyclical payments on acreage and production decisions. The United States submits that these studies continue to provide important insight into the effects of those payments and confirm the U.S. arguments that these effects are not the "significant" production and price effects that Brazil has alleged.

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

67. Please confirm whether or not the Panel's understanding is correct:
"Table 6" in Brazil's First Written Submission was produced using the so-called "Brazil's method" using USDA data.
"Table 5" in Brazil's Rebuttal Submission was produced using the so-called "cotton-to-cotton" methodology using USDA data.
The figures cited in para. 40 of Brazil's opening statement (i.e. "$868 million and $838 million) are produced with the "Brazil's method" as well as the "cotton-to-cotton" methodology, using the data provided by the United States in exhibit US-64.

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

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

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

79. In the cited portion of the U.S. oral presentation, the United States observed that:

> regarding the *degree* of any possible effects on world market prices, the United States notes that the *only* evidence that Brazil has submitted purporting to examine the price

> effects of marketing loan and counter-cyclical payments specifically are the results of the modeling exercise that it has conducted for purposes of this proceeding.[113]

80. Brazil accuses the United States of "ignor[ing] the hundreds of exhibit and the circumstantial evidence presented by Brazil in the original proceeding and in this compliance proceeding,"[114] and then expounds for 10 pages about the "abundant and diverse evidence" it has allegedly presented.[115] However, not a single piece of the allegedly "abundant and diverse evidence" does what the United States noted – examines the degree of any possible effects on world market prices of the marketing loan and counter-cyclical payment programs. The United States therefore understands Brazil's response to confirm the U.S. observation.

81. As to Brazil's assertion that its allegedly "abundant and diverse evidence" nonetheless supports a finding that "the effect" of marketing loan and counter-cyclical payments is "present" significant price suppression, Brazil is wrong. The United States has addressed each of Brazil's arguments in its prior submissions[116], in the general U.S. comment above regarding Brazil's claims under Articles 5(c) and 6.3(c), and in the U.S. comments regarding Brazil's responses to Questions 62-65 and 70. As shown therein, none of the "evidence" asserted by Brazil withstands scrutiny.

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

82. The United States notes that Brazil chooses not to respond to the Panel's question. The Panel asks Brazil to "respond to the United States' rebuttal that Brazil has not even established a temporal correlation between payment of subsidies and *significantly suppressed prices during the life of the FSRI, that is from marketing year 2002 to 2005*." Instead of responding, however, Brazil attempts to sidestep the issue by attributing to the United States – inexplicably – the "assertion" that "there were not 'coincidences' between (a) *increased U.S. production and exports* and (b) large U.S. marketing loan and counter-cyclical subsidies" and then proceeding to attempt to rebut that alleged "assertion."[117] The United States has never suggested that this is the appropriate analysis, let alone made the kind of "assertions" that Brazil attempts to attribute to the United States. Nor did the original panel conclude that an increase in absolute levels of production and exports would equate to a "temporal coincidence" between allegedly *significantly suppressed world market* <u>*prices*</u> and payments under the marketing loan and counter-cyclical payment program.

83. Rather, the original panel considered a number of factors *every single one* of which the United States examined in its first written submission and its rebuttal submission.[118] As the United States showed therein, none of the factors considered by the panel in the original proceeding in reaching its conclusion of a "discernible temporal coincidence" between U.S. subsidies and significant

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[113] U.S. Oral Statement, para. 76.

[114] Brazil Answers to Second Set of Questions, para. 90.

[115] Brazil Answers to Second Set of Questions, para. 101.

[116] U.S. First Written Submission, paras. 203-331 and Annex I; U.S. Rebuttal Submission, paras. 215-404 and Annex I; U.S. Answers to Parts A-C of First Set of Panel Questions, paras. 27-44; U.S. Oral Statement, paras. 50-85 and Statement of Dr. Joseph W. Glauber; U.S. Answers to Parts D-E of First Set of Panel Questions, paras. 14-42; U.S. Comments on Brazil's "Oral" Presentation, paras. 34-91 and Annex I, and U.S. Answers to Second Set of Panel Questions, paras. 1-4, and 62-170.

[117] Brazil Answers to Second Set of Questions, para. 108.

[118] U.S. First Written Submission, paras. 277-291; U.S. Rebuttal Submission. paras. 314-320.

price suppression support such a finding with respect to the marketing loan and counter-cyclical payments now. Brazil has never rebutted the U.S. arguments in this regard; and does not do so now even despite the direct request by the Panel to do so. This confirms that Brazil has not – and cannot – prove any "discernible temporal coincidence" between significantly suppressed world market prices and marketing loan and counter-cyclical payments. Indeed, as discussed below, Brazil has not even proven the factual predicates therefor, including significantly suppressed prices.

84. Rather than offering any proof of "discernible temporal coincidence" between significantly suppressed world market prices and marketing loan and counter-cyclical payments, Brazil relies on reasoning that is entirely untenable. Consider, for example, Brazil assertion that the increase in the absolute level of U.S. production and exports alone over the life of the FSRI Act of 2002 should be understood "in isolation" to "suggest a relationship" between the marketing loan and counter-cyclical subsidies and allegedly suppressed world market prices.[119] As evidenced by the fact that U.S. share of world production and exports has remained relatively stable over the course of the entire FSRI Act, however, it is a fact that there is *precisely* the same "temporal coincidence" between increased foreign production and exports and the U.S. marketing loan and counter-cyclical payments. Does this – "in isolation" – support the same conclusion in respect of *foreign* production and exports? Should the U.S. marketing loan and counter-cyclical payments be understood to have *caused* the increase in the absolute level of *foreign* production and exports? Surely not. Surely any rational analysis would look more closely at how the marketing loan and counter-cyclical payments interact with the production decisions (*i.e.*, the decision on what to plant).

85. When one looks at planted acreage, one finds that the *increase* of absolute levels of U.S. production is solely attributable to an increase in yields. In fact, in MY 2005, U.S. producers actually planted *fewer* acres than in either MY 2001 or MY 1999 (13.9 compared to 15.4 and 14.5 million acres, respectively), the years that Brazil has urged the Panel to look at as comparison years before the FSRI Act came into effect. Moreover, had the yields in MY 2005 been what they were in those earlier years, U.S. production in MY 2005 would have been far lower.[120] Thus, contrary to Brazil's assertions, the increased production in these years is not evidence of any causal link between the marketing loan and counter-cyclical payments and production. It is evidence of dramatic improvements in yields.

86. In an apparent effort to avoid this flaw in its argument, Brazil then argues that "but for" the U.S. marketing loan and counter-cyclical payments, U.S. planted acreage would have been lower over the life of the FSRI Act.[121] As the United States has shown – examining the planting decisions made by U.S. farmers in MY 2006, MY 2005 and, in fact, every year under the FSRI Act of 2002 – the facts do not support Brazil's assertion.[122] Thus, Brazil's answer only confirms that, notwithstanding its assertions, Brazil does not – and, in fact, cannot – "reinforce the original panel's finding, at paragraph 7.1351 of its report, of a discernable temporal coincidence of suppressed world market prices and the price-contingent U.S. subsidies."[123]

87. Nor does Brazil respond fully to the second of the Panel's questions. As the Panel's question reflects, the United States identified a key flaw in Brazil theory at the very start of this proceeding.[124]

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[119] Brazil Answers to Second Set of Questions, para. 109.

[120] If yields were at the levels that prevailed in MY 2001, U.S. production would have been almost 30 percent lower in MY 2005. If yields were at MY 1999 levels, U.S. production would have been almost 40 percent lower. *See* U.S. First Written Submission, paras. 279-282.

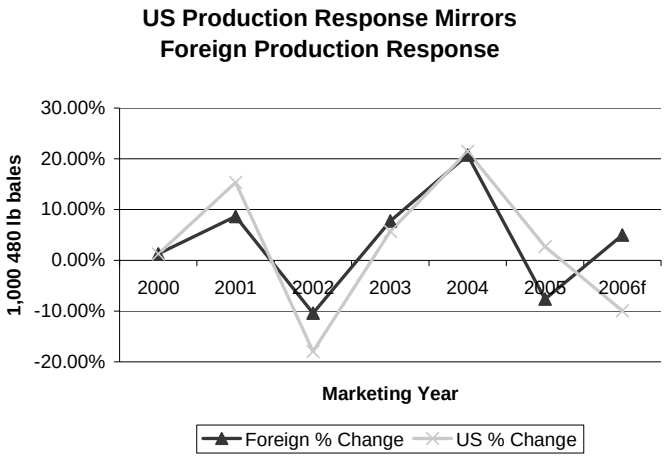
[121] Brazil Answers to Second Set of Questions, para. 108.

[122] *See e.g.*, U.S. Comments on Brazil's "Oral" Presentation, paras. 58-78.

[123] Brazil First Written Submission, para. 152. The United States notes that, while Brazil asserts in its first written submission that it will isolate the effects of the marketing loan and counter-cyclical payment programs, it does not do in its assessment of "temporal coincidence."

[124] U.S. First Written Submission, paras. 243-252.

Namely, if, as Brazil alleges, U.S. producers were cut off from market signals, why does U.S. production response mirror foreign production response (see chart below)? Why does one not find U.S. share of world production and exports increasing over the life of the FSRI Act as U.S. producers allegedly ignore the same market signals received by their foreign counterparts?



88. Brazil has never been able to rebut this evidence; its only response has been to assert that the stable share of world production and exports is somehow itself evidence that U.S. producers are insulated from market signals. However, as the United States explained in its first written submission, in making this assertion, Brazil is improperly assuming its own conclusion – *i.e.*, "stable U.S. share of world production and export proves that U.S. support payments cause price suppression because without the price suppression caused by U.S. support payments U.S. share of world production and exports would not be stable."[125] Brazil's circular reasoning is not improved by its reassertion in Brazil's response to this question.

89. In its response, Brazil also argues at length about the alleged "United States [*sic*] claims that the stability of U.S. acreage demonstrates the lack of any 'temporal coincidence' (and hence causation)."[126] Brazil's arguments in this regard are baffling because the United States has not "claimed" any such thing. What the United States has noted is (a) the original panel's analysis that "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;"[127] and (b) *Brazil's* arguments that in its discussion of production and "temporal coincidence" in the panel report, "[t]he [original] Panel simply referred to "production" as shorthand for planting decisions by producers, which even in agricultural economics literature is not uncommon."[128] According to Brazil's argument, then, the original panel found an "overall increase" in the U.S. upland cotton planted acreage in MY 1999-2002 and considered this as one factor in its finding of a "discernible temporal coincidence". The United States has shown that there is no similar "overall increase" in the U.S. upland cotton planted acreage over the life of the FSRI Act. To the contrary, planted acreage declined from MY 2002 levels in MY 2003 and MY 2004, picked up

[125] U.S. First Written Submission, para. 251.
[126] Brazil Answers to Second Set of Panel Questions, paras. 112-115.
[127] *Upland Cotton (Panel)*, para. 7.1351.
[128] Brazil Appellee Submission, para. 686. Brazil argued that "ultimate production" is not an appropriate basis for assessing production *decisions* as "producers do not decide on production, but on plantings. Ultimate production is affected by weather and other factors affecting yields." Brazil Appellee Submission, para. 706, n. 995. As a result, Brazil asserted that the original panel's discussion of an "overall increase in production" was actually a discussion regarding planting, not actually production.

slightly in MY 2005 and more so in MY 2006 but is projected to fall dramatically in MY 2007 to levels lower than they have been in almost a decade.[129]

90. There is similarly no merit to the other arguments made by Brazil regarding U.S. planted acreage.[130] Brazil continues to make arguments on the fundamentally flawed assumption that U.S. planted acreage should change year-to-year based on changes in the futures price for upland cotton alone. Thus, for example, Brazil even claims as "one of the most important 'temporal coincidences' in the record" – the fact that U.S. planted acreage increased slightly in MY 2005 even though futures prices for cotton in that year were lower than the year before.[131] But Brazil's own assertions about the proper analysis of planted acreage in another year – MY 2007 – demonstrate the fallacy in Brazil's arguments about planted acreage shifts in MY 2005. If U.S. planted acreage must move in synch solely with upland cotton prices, why does Brazil argue that U.S. upland cotton acreage should be *decline* dramatically in MY 2007[132] even though the expected harvest time price for upland cotton in this year (*i.e.*, the average January-March 2007 New York futures price for the December contract) is 59 cents/lb, more than 6 cents/lb *higher* than for MY 2005 and almost the same level as in MY 2006. The reason why Brazil argues that there should be a decline is because the prices for *corn* – a competing crop – make that a more attractive option in MY 2007.[133] The same kind of considerations of competing crops, weather, pests and other such factors – not some narrow assessment of changes in the futures price for upland cotton price alone – explain the acreage shifts also in MY 2005 (and indeed in each of the other years that the FSRI Act has been in effect).[134]

91. Finally, the United States notes that although the Panel asks Brazil specifically to respond to the U.S. arguments regarding world market prices, Brazil does not do so. Rather, Brazil simply asserts that prices over the life of the FSRI Act are below those that prevailed in MY 1980-1998.[135] As the United States explained in its first written submission, however, Brazil's claim in this proceeding is of significant price *suppression*, not price *depression*. A *decline* in prices does not demonstrate price *suppression*.[136] The question is whether prices are being prevented from *rising* by

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[129] *See* U.S. First Written Submission, para. 280 and U.S. Answers to Second Set of Panel Questions, paras. 1-4.

[130] As the United States explained in its rebuttal submission, Brazil's attempts to compare changes in U.S. *planted acreage*, changes in foreign *harvested* acreage, and *changes* in the futures prices is fundamentally flawed both because of its apples-to-oranges comparison and also because it seeks to explain changes in U.S. upland cotton acreage *solely* by reference to upland *cotton* futures, in disregard of the basic fact that acreage decisions are made in consideration of prices and other factors not only for cotton but for competing crops. U.S. Rebuttal Submission, paras. 305-306. In fact, what Brazil's flawed analysis shows – when conducted on the same harvested-acreage basis for both the United States and the rest of the world – is that *neither* U.S. nor foreign harvested acreage moves closely in line with futures prices of cotton alone. U.S. Rebuttal Submission, para. 305-307. Nonetheless, even if the comparison were valid (and it is not), it would show that, where changes in U.S. and foreign area diverge, U.S. harvested acreage tends to react more *conservatively* than foreign acreage to increasing prices (as in MY 2003 and 2006). U.S. Rebuttal Submission, paras. 305-307. This would undermine – rather than support – Brazil's assertions of alleged "subsidy-fueled overproduction."

[131] *See* U.S. Comments on Brazil's "Oral" Presentation, para. 70.

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

[133] *See* Brazil Oral Statement of Brazil, para. 73 (arguing that "[i]f marketing loan and CCP subsidies did not exist, and if U.S. cotton farmers would have to react to market price signals, far more than 14 percent of cotton acreage predicted by the NCC [for MY 2007] would switch to substitute crops."); *see also* U.S. Comments on Brazil's "Oral" Presentation, paras. 1-4 (rebutting Brazil's argument).

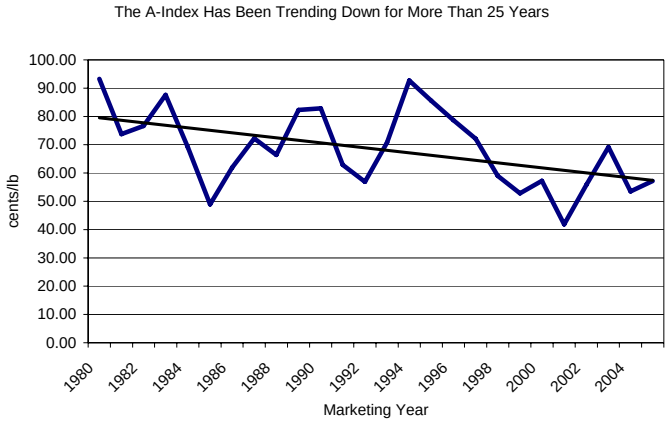
[134] *See* U.S. Comments on Brazil's "Oral" Presentation, para. 70. For example, the data show a perfect correlation between a shift away from soybean acreage in MY 2005 due to concerns about an outbreak of Asian soybean rust in the Delta and Southeast regions of the United States and an increase in the competing crop – cotton – in the exact same areas.

[135] Brazil Answers to Second Set of Questions, para. 113.

[136] Interpreting "suppression" in accordance with its ordinary meaning of "[p]revent or inhibit (an action or phenomenon)," the panel in the original proceeding defined "price suppression" as "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

something (in this case, the marketing loan and counter-cyclical payment programs). Brazil provides no empirical evidence showing such "suppression" as a result of marketing loan and counter-cyclical payments.

92. Rather, the fact that the A-Index has trended downwards for more than 25 years now – well before the FSRI Act came into effect – and the fact that the A-Index has gone *up* from the levels that prevailed *before* the FSRI Act came into effect as of MY 2002 would tend to suggest that, to the extent there is any price *suppression*, it is not "the effect" of the marketing loan and counter-cyclical payment programs.



Source: USDA, Agriculture Marketing Service Reports[137]

93. Brazil has never rebutted this evidence nor established that there is a "discernible temporal coincidence" of U.S. marketing loan and counter-cyclical payments and allegedly suppressed world market prices.

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

94. The United States offers a number of observations regarding Brazil's answer to this question. First, Brazil asserts that there have been no fundamental changes in the conditions of competition or any other relevant factors that would compel the compliance Panel to reject the findings of the original panel's causation analysis relating to "total cost of production."[138] Brazil is incorrect.

– 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." *Upland Cotton (Panel)*, paras. 7.1276-7.1277. The Appellate Body agreed that this was an appropriate interpretation of "price suppression." *Upland Cotton (AB)*, para. 424.

[137] Compiled Statistics – Prices (Exhibit US-25).

[138] Brazil Answers to Second Set of Questions, paras. 117 and 118.

95. As the United States explained as early as September 2003, the 1997 ERS/USDA survey data on cost of production used by both Brazil and the United States in the original panel proceeding likely overstated certain costs because of technological and other changes.[139] The U.S. arguments were borne out when ERS released new cost of production data based on a 2003 survey. As a result of changes in technology – widespread adoption of biotech cottonseed, and other improvements in production practices, such as boll weevil eradication programs – upland cotton yields have exhibited a structural increase and per unit input costs have fallen.[140] This dramatic shift in the cost and yield structure for upland cotton certainly represents a fundamental shift in the conditions of competition, contrary to Brazil's assertions. As the United States explained in earlier submissions, the data show clearly that upland cotton producers covered not only their operating (variable) costs but also a substantial portion of their total costs between 2002-2005.[141]

96. Second, Brazil continues to assert that total costs of production, including non-cash or economic costs, are determinative of a producer's planting decision, without offering any basis in the economic literature or even in fact to support that assertion. The United States has reviewed this issue thoroughly in its prior submissions and, rather than repeating this here, refers to the Panel to the earlier discussion.[142] For the reasons explained by the United States, if the Panel were to examine effects on planting/production in a single year – MY 2005 – the relevant consideration is operating costs, not "total" costs.[143]

97. Third, while Brazil is correct in its observation that a farmer has two different cost concerns – one a year-to-year planting decision and another long-term decisions about the economic viability of his farm – Brazil analysis of these decisions is flawed. As the United States has explained the "total costs" that Brazil uses is not an appropriate consideration with respect to either decision.[144] To the extent a producer has planting options for various crops, based on agronomic conditions, the first decision is an assessment of net returns per crop; that is, what is relative market revenue minus operating costs (net revenue per crop).[145] In addition, over time, a producer must also cover all cash costs, including such items as mortgage costs and equipment. The United States agrees with Brazil that "without generating sufficient funds to meet this second set of costs, there would be no facilities or equipment to grow upland cotton in the first place."[146] However, as the United States has shown, U.S. farmers assess the economic viability of a farm *based on the total costs and revenue for the farm*.[147] It is on the basis of those considerations – not some artificially segmented crop-by-crop "total cost" analysis – that the farmer makes decisions such as whether to declare bankruptcy.

98. It is a significant flaw in Brazil's analysis, therefore, that Brazil disregards off-farm income and income from other crops, both of which are an important part of the total revenue of a farm. It is similarly incorrect for Brazil to attempt to include in its "total cost" analysis such factors as imputed opportunity costs that have been calculated by USDA to attribute some value to unpaid labor and owned land but that are not necessarily costs that must be paid off in order for farmers to avoid having to "close down [their] business[es]."[148] As a result of these flaws, the picture that emerges of the

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[139] U.S. Further Submission in the original panel proceeding, paras. 46-54 (September 30, 2003). U.S. Further Rebuttal Submission in the original panel proceeding, para. 123-133 (November 18, 2003).

[140] U.S. First Written Submission, December 15, 2006, para. 302.

[141] U.S. First Written Submission, December 15, 2006, para. 300.

[142] For the most recent review, see U.S. Comments on Brazil's "Oral" Presentation, paras. 62-65.

[143] Any such analysis would also have to look at the other factors besides expected operating costs affect the planting decision – MY 2005 being a good example of other confounding factors. In that year, a major unanticipated factor was the emergence of soybean rust in key cotton producing states, which encouraged producers to switch from soybeans to cotton. U.S. Comments on Brazil's "Oral" Presentation, para. 70.

[144] *See* U.S. Answers to Second Set of Panel Questions, paras. 96-100, 113-116, 133-154.

[145] *See e.g.*, U.S. Comments on Brazil's "Oral" Presentation, paras. 66-67.

[146] Brazil Answers to Second Set of Questions, para. , para. 121.

[147] *See e.g.*, U.S. Answers to Second Set of Panel Questions, paras. 133-154.

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

financial viability of U.S. farmers is completely and thoroughly distorted. It results in the attribution to marketing loan and counter-cyclical payment "effects" that they are not in fact having.

99. When one considers instead, the total cash costs that most farmers do in fact have to meet over the long term, the data show that U.S. farmers have in fact generated sufficient funds to cover their total cash costs over the long term. The cost data for the period 2000-2005 show that, instead of the cumulative $663 *deficit* per acre erroneously asserted by Brazil, the cumulative returns over the same period were a *positive* return of $161 per acre. Moreover, for MY 2000-2006, instead of the $837 *deficit* per acre alleged by Brazil, the cumulative net returns were a positive $133 per acre.[149]

100. The FAPRI baseline projections from July 2006, which Brazil used in an earlier submission, confirm the same facts. Comparing gross market revenue for upland cotton per acre to variable expenses per acre shows that upland cotton revenue would more than cover variable expenses and would cover a large share of other cash expenses. For the period 2004/05-2010/11, cumulative net returns per acre were projected to be $620.34.[150]

101. It is important to remember that these results look *only* to total costs and revenue for upland cotton production. When whole-farm costs and revenue from all sources is taken into consideration an even more robust picture of economic viability would likely emerge.

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

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

102. In its response to this question, Brazil continues to suggest incorrectly that stock responses are incorporated into the demand elasticities used in Brazil's new model. This is simply untrue.

103. Brazil also attempts to minimize the importance of stock adjustments to overall market price movements. However, stock-holding activity is an important component of any storable commodity market. Market participants hold stocks for a variety of reasons to accommodate a number of possible factors. The adjustment of stocks is an important determinant in overall price movement. The United States has shown that by ignoring the importance of stocks in a short-run analysis, Brazil's analysis overstates the price impacts.[151]

104. The United States agrees that stock adjustments are not necessary to an analysis of long-term demand and price adjustments. However, in a long-term analysis, the elasticities that are used must fully reflect long-term adjustments in supply and demand. Based on such elasticities documented by FAO, the United States demonstrated that – even using Brazil's own econometric model, which suffers from certain fundamental structural flaws that tend to overstate the results – any price impacts due to the removal of U.S. programs are only in the range of 1 to 1.5 percent, not the grossly exaggerated results that Brazil attempts to show.

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[149] U.S. Comments on Brazil's "Oral" Presentation, paras. 76-77.
[150] Brazil's First Written Submission, para. 286. *See also* Exhibit Bra-479, page 6.
[151] *See e.g.,* U.S. Comments on Brazil's "Oral" Presentation, para. 86.

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

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

More specifically:

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

105. The United States offers two observations in respect of Brazil's answer. First, Brazil's response to this question appears to make little sense. Brazil asserts that it has not modeled reductions of the U.S. marketing loan and counter-cyclical payment programs because the United States has not made changes to reduce payments under those programs. However, the United States has also not *eliminated* the marketing loan and counter-cyclical payments. Under its own reasoning, Brazil would have no basis for purporting to model the total elimination of those payments either.

106. Second, the United States notes that Brazil reasserts its arguments about the appropriateness of assessing the "short-run" response of "shocking" the system with elimination of marketing loan and counter-cyclical payments. As the United States has explained, Brazil confuses the question under Articles 5(c) and 6.3(c) of the *SCM Agreement*. The question under those provisions is what the present effects of the challenged measures are (and whether these effects comprise "significant" price suppression). The question is not what the effects are of *eliminating* anything. To the extent a counterfactual analysis is conducted to attempt to tease this out, the question is simply where the equilibrium would have been *today* had the challenged measures not been in existence. The question is not what *will* happen in the *short run* if a Member were to eliminate the challenged measures today. Brazil's citation of *Korea – Ships* confirms this precisely:

> price suppression is the situation where prices have been restrained by something, and price depression is the situation where prices have been pushed down by something. So the question to be answered is whether the "something" is subsidization. Looking at a counterfactual situation, *i.e.*, trying to determine *what prices would have been in the absence of the subsidy*, seems to us the most logical and straightforward way to answer this question.[152]

107. Indeed, in other disputes, Brazil has confirmed that in assessing trade effects using a counterfactual analysis, "elasticity values should be taken from long-run estimates and not short run estimates."[153] Brazil has provided no valid reason for why the analysis is different here.

(b) If simulations of such scenarios are performed, would the current values of the elasticities chosen (particularly the supply elasticities) to simulate the elimination of marketing loan and counter-cyclical programmes continue

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[152] *Korea – Ships (Panel)*, para. 7.612.
[153] *U.S. – Continued Dumping and Subsidy Offset Act (22.6)*, para 3.101.

to be appropriate? Please kindly provide an explanation for the chosen answer.

108. The United States is surprised by Brazil's assertion now that its inflated U.S. supply elasticity is actually appropriate even for assessing a partial reduction of payments under U.S. programs. Brazil itself has argued that different elasticities are necessary for reduction of payments versus "permanent" removal of payments and has attempted to have the Panel dismiss the FAPRI parameters on the basis that they are not applied to "permanent" removal of payments.[154] Now – however – the Panel is to believe that the inflated Sumner elasticities are nonetheless appropriate for use in every context. Brazil's assertions about the these elasticities simply lack credibility. The United States has shown that the modeling parameters and assumptions that Brazil uses are grossly exaggerated.[155] This is true regardless of whether they put to an analysis of partial or full reduction of payments.

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

109. The United States offers three observations about Brazil's answer to this question. First, Brazil's response to this question provides an interesting contrast to its response to Question 69 above. In that response, Brazil attempts to excuse its failure to provide empirical evidence regarding the effects of the marketing loan and counter-cyclical payment programs on the basis that "Brazil cannot unilaterally remove the U.S. subsidies to present direct evidence of what would actually happen to U.S. acreage, production, exports, and world prices without those subsidies. Only the United States can do so."[156] In its response to this question, however, Brazil argues that where the United States *has* removed a domestic support program, the Panel should *not* rely primarily on the "direct evidence of what would actually happen to U.S. acreage, production, exports, and world prices without" payments under that program but rather on Brazil's own "counterfactual" assertions about the effects of the removal of the Step 2 program (which are, in any event, heavily contradicted by the arguments presented by Brazil itself in the original panel proceeding and undermined by the empirical evidence).[157] In effect, Brazil suggests that – regardless of what the facts actually are and regardless of whether payments are being made under the challenged programs or not – the Panel must rely on whatever Brazil alleges about the effects of the payments. There is no basis for such a suggestion.

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[154] Brazil's assertions about the FAPRI parameters are patently untrue. FAPRI has used their modeling system to analyze the removal of domestic subsidies under trade liberalization scenarios and the reduction of farm subsidies under various farm bill scenarios, including the "permanent" removal of payments. Indeed, in attempting to argue that elimination of the Step 2 program has had no effects on exports or prices, Brazil itself submitted and repeatedly cites to a FAPRI assessment of the effects of eliminating that program. *See* Brazil First Written Submission, para. 203 (addressing FAPRI, "Impacts of Commodity and Conservation Reserve Program Provisions in House and Senate Reconciliation Bills," FAPRI-UMC Report #15-05, December 2005(Exhibit Bra-484).)

[155] *See e.g.*, U.S. First Written Submission, paras. 319-328 and Annex I; U.S. Rebuttal Submission, paras. 349-386 and Annex I; U.S. Oral Statement, paras. 76-81 and Statement of Dr. Joseph W. Glauber; U.S. Comments on Answers to Parts D-E of First Set of Panel Questions, paras. 30-42; and U.S. Comments on Brazil's "Oral" Presentation, paras. 79-91.

[156] Brazil Answers to Second Set of Questions, para. 91.

[157] *See* U.S. First Written Submission, paras. 149-195; U.S. Rebuttal Submission, paras. 175-214; U.S. Oral Statement, paras. 54-59.

110. Second, the facts relating to the period after the removal of the Step 2 program – which Brazil attempts to have the Panel ignore – show U.S. plantings declining and U.S. exports declining dramatically even as the cost structure of U.S. upland cotton farms improves due to such factors as the use of genetically modified cottonseed. Brazil has not established that, despite these facts, U.S. marketing loan and counter-cyclical payments are somehow "significantly" suppressing world market prices. The decline in exports and the decline in predicted plantings are occurring even though both the marketing loan program and the counter-cyclical payment program remain in place and even though – according to Brazil – these programs are allegedly "designed" to provide consistently high payments to U.S. farmers. These facts are not consistent with the theories that Brazil has put forward purporting to establish the alleged "numbing" of U.S. production response and alleged substantial levels of overproduction and export of U.S. upland cotton.

111. Third, Brazil asserts that the removal of the Step 2 program should be assessed as part of a "non-attribution" analysis and suggests that the original panel's analysis somehow supports this approach. Brazil is wrong. The original panel never assessed the effects of Step 2 payments as part of any "non-attribution" analysis; Step 2 payments were, instead, part of the package of payments whose effects were *directly* at issue in the "present" serious prejudice analysis under Articles 5(c) and 6.3(c) of the *SCM Agreement*.

112. Nor does it make sense that *removal* of the Step 2 program would be part of a "non-attribution" analysis. As the Appellate Body has explained, a "non-attribution" analysis focuses on "ensur[ing] that the effects of other factors on prices are not improperly attributed to the challenged subsidies."[158] This requires separating out the effects of other factors suppressing world market prices and ensuring that they are not attributed to marketing loan and counter-cyclical payments. As removal of the Step 2 program is not suppressing any prices, it is not logical to speak of including that factor in any "non-attribution" analysis.

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

Questions to the United States

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

Questions to Brazil

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

[158] *Upland Cotton (AB)*, para. 437. As the United States has noted in its prior submissions, Brazil has not made any meaningful attempt to "ensure that the effects of other factors on prices are not improperly attributed to the challenged subsidies." *Upland Cotton (AB)*, para. 437. Brazil's "analysis" consists of unsupported assertions that nothing "attenuates" the link that it asserts between the marketing loan and counter-cyclical payments and allegedly significantly suppressed world market prices. This is entirely insufficient to meet Brazil's burden, especially in light of substantial evidence submitted by the United States (and even, unwittingly, by Brazil itself) showing the key importance of other factors (such as China's trade in upland cotton) affecting world market prices. *See e.g.*, U.S. First Written Submission, paras. 308-318; U.S. Rebuttal Submission, paras. 387-396.

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

113. The United States respectfully refers the Panel to its general comments above regarding Brazil's claims under Articles 5(c) and 6.3(d) of the *SCM Agreement* as well to the U.S. arguments on this issue in its prior submissions.[159]

114. In its response to this question Brazil asserts that the second element of Article 6.3(d) – "this increase follows a consistent trend over a period when subsidies have been granted" – can be met simply by showing an increase in U.S. world market share from MY 1998 to MY 2005. Brazil's approach – if adopted – effectively write out of Article 6.3(d) both the reference to "this" increase and to a "consistent" trend.

115. As the United States explained in its answer to Question 75, Article 6.3(d) of the *SCM Agreement* is concerned with *increase* in world market share.[160] An *increase* is – by definition – "the action, process, or fact of making or becoming greater."[161] Thus, what is at issue in Article 6.3(d) is movement ("becoming greater"), not something static. The key question, then, is *what movement is relevant for purposes of that provision* The text provides the answer. The movement that is relevant is that in getting from point A – "the average share [the allegedly subsidizing Member] had during the previous period of three years," – to point B, the level in the year that is the subject of the claim. If upward movement – *i.e.*, "increase" or "growth" – is involved in getting from the former to the latter, and the upward movement is shown to be "the effect" of a challenged subsidy – the first element of Article 6.3(d) is satisfied.

116. An "increase" is also at issue in the second element of Article 6.3(d) – the requirement that "this increase" be shown to "follow[] a consistent trend over a period when subsidies have been granted." Again, the text makes clear which particular increase is at issue – it is "this increase" - *i.e.*, the *same* increase that was relevant for purposes of the first element. Thus, under the second element, the complaining party must show that "this increase" – the "increase in the world market share it had during the previous period of three years" – "follows a consistent trend over a period when subsidies have been granted."

117. Brazil's argues that "the United States attempts to read the separate element of a three-year average into the element of a 'consistent trend,'" but ignores the fact that Article 6.3(d) specifically refers to "this" increase, relating back to the reference to the increase over the previous three-year average. Brazil offers no reason why the drafters would have referred back to "this increase" if they had intended that a completely different increase – one defined by the complaining party – was to be the relevant increase for purposes of the second element of Article 6.3(d).

118. Instead, Brazil confuses two entirely separate questions. One question – just discussed – is what the relevant comparison is in assessing whether there has been an "increase" (*i.e.*, whether the proper points of comparison are the share of world production in a particular year versus the average share over the previous three-year period, as the text suggests, or rather two years selected by the complaining party, as Brazil urges). A second, and separate, question is whether an increase must be shown in *every* year in order to show that "this increase follows a *consistent trend* over a period when subsidies have been granted" (emphasis added). These are distinct issues. Contrary to Brazil's assertions, the United States has never suggested that for a "consistent trend" to be shown there must be an increase in every single year that subsidies have been granted. Nor is this a necessary implication of the U.S. interpretation of Article 6.3(d).

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[159] *See e.g.*, U.S. First Written Submission, paras. 323-343; U.S. Rebuttal Submission, paras. 399-404; U.S. Answers to Second Set of Panel Questions, paras. 171-172.

[160] U.S. Answers to Second Set of Panel Questions, paras. 171-172.

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

119. While there may not be a need to show an increase in *every* year, where – as here – a complaining party can only point to one[162] isolated year in which there has been an increase over the previous three-year average (and even that slight increase is shown to be both part of the ordinary fluctuation of world market share and caused by factors other than the challenged measures) there is clearly no basis whatsoever for an assertion of a "consistent trend."

120. Indeed, it is Brazil's interpretation that is inconsistent with the "consistent trend" language in Article 6.3(d). Brazil has argued that a complaining party should be able to satisfy the second element of Article 6.3(d) by simply selecting two end-points in the period that subsidies have been granted and drawing an upward-slanting line between the two points. However, this would simply show an increase. It would not necessarily show a "trend," and it would most certainly not show a "consistent" trend. To the contrary, it would render the term "consistent" entirely meaningless because – under Brazil's theory – there would only ever be two end-points and one line connecting them. This line could never be "consistent" with anything else because there would simply never be anything else with which to be "consistent." Brazil would – in effect – simply write "consistent" out of Article 6.3(d) altogether. This is not an permissible interpretation of Article 6.3(d).

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

121. The United States respectfully refers the Panel to its general comments above regarding Brazil's claims under Articles 5(c) and 6.3(d) of the *SCM Agreement*, to the U.S. comments regarding Brazil's answer to Question 76, as well to the U.S. arguments on this issue in its prior submissions.[163]

C. CLAIM OF BRAZIL REGARDING THREAT OF SERIOUS PREJUDICE

Questions to both parties

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

122. The United States respectfully refers the Panel to its general comments above regarding Brazil's "threat of" serious prejudice claims under Articles 5(c) and 6.3(c) of the *SCM Agreement* as well to the U.S. arguments on this issue in its prior submissions.[164]

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

123. The United States respectfully refers the Panel to its general comments above regarding Brazil's "threat of" serious prejudice claims under Articles 5(c) and 6.3(c) of the *SCM Agreement* as well to the U.S. arguments on this issue in its prior submissions.[165]

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[162] Or, at most two, if one considers world production plus beginning stocks.

[163] *See e.g.*, U.S. First Written Submission, paras. 323-343; U.S. Rebuttal Submission, paras. 399-404; U.S. Answers to Second Set of Panel Questions, paras. 171-172.

[164] *See e.g.*, U.S. Rebuttal Submission, paras. 405-425; U.S. Answers to Second Set of Panel Questions, paras. 173-199.

Questions to the United States

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

81. ***How does the United States respond to the argument of Australia that "it is beside the point for the United States to argue that the programmes under consideration are due to expire in late 2007"? (Third Participant Oral Statement of Australia, para. 13)***

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

Questions to Brazil

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

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

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

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

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[165] *See e.g.*, U.S. Rebuttal Submission, paras. 405-425; U.S. Answers to Second Set of Panel Questions, paras. 173-199.

124. The United States respectfully refers the Panel to its general comments above regarding Brazil's "threat of" serious prejudice claims under Articles 5(c) and 6.3(c) of the *SCM Agreement* as well to the U.S. arguments on this issue in its prior submissions.[166] In addition, the United States submits the following observations regarding Brazil's answer to this question.

125. Article 3.2 of the DSU provides that "the dispute settlement system of the WTO . . . serves to . . . clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law." One of these "customary rules" is that treaty terms are to be interpreted "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."[167] In its response to this question and Question 88, Brazil urges the Panel to ignore the U.S. application of this rule in interpreting the term "threat" in footnote 13. Brazil provides no basis for why Article 3.2 of the DSU should not be applied here.

126. As United States has explained, the ordinary meaning of the term "threat" includes *both* concepts of probability of occurrence and close proximity in time.[168] This is reflected in Articles 15.7 of the *SCM Agreement*, Article 3.7 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade ("*AD Agreement*"), and Article 4.1(b) of the *Agreement on Safeguards* in describing the meaning of the term "threat." By application of customary rules of treaty interpretation under Article 3.2 of the DSU, the ordinary meaning of "threat" of certain injurious effects as reflected in these other provisions provides important contextual guidance in interpreting "threat" of serious prejudice in Article 5(c)/footnote 13 of the *SCM Agreement*.

127. There is no merit to Brazil's arguments that the Panel should artificially strip out the concept of close proximity in time from the ordinary meaning of "threat" in footnote 13 and should disregard the important contextual confirmation provided in the definition of "threat" in Articles 15.7 of the *SCM Agreement*, Article 3.7 of the *AD Agreement*, and Article 4.1(b) of the *Agreement on Safeguards*.

128. Brazil alleges, for example, that "Article 4.1(b) and 2 of the *Agreement on Safeguards* as well as Article 15.7 of the *SCM Agreement* deal primarily with the threat posed by a potential surge of imports" but that "[b]y contrast, Articles 5(c) and 6.3as well as footnote 13 of the *SCM Agreement* deal with the likelihood of adverse effects – not subsidized imports – occurring sometime in future."[169] Brazil suggests that this is one reason why the concept of close proximity in time should be artificially stripped out of the ordinary meaning of "threat" for purposes of footnote 13. This argument is flawed.

129. First, it is wrong in its characterization of Article 15.7 of the *SCM Agreement*. Neither that provision – nor, for that matter its counterpart in Article 3.7 of the *AD Agreement* – "deal primarily with the threat posed by a potential surge of imports," as Brazil suggests. To the contrary, Article 15.7 expressly states that it is concerned with the "threat of *material injury*," not a "surge in imports." A "surge in imports" is not even required for a showing of material injury. To the contrary, Article 15.7 identifies as only *one* of five factors that administering authorities "should" consider ("*inter alia*") in making a "threat of material injury" determination whether there has been "a

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[166] *See e.g.*, U.S. Rebuttal Submission, paras. 405-425; U.S. Answers to Second Set of Panel Questions, paras. 173-199.

[167] See *United States – Gasoline (AB)*, p. 17 (noting that "[this] general rule of interpretation [codified in Article 31 of the Vienna Convention on the Law of Treaties] has attained the status of a rule of customary or general international law. As such, it forms part of the 'customary rules of interpretation of public international law' which the Appellate Body has been directed, by Article 3(2) of the DSU, to apply in seeking to clarify the provisions of the General Agreement and the other 'covered agreements' of the Marrakesh Agreement Establishing the World Trade Organization. . . .)

[168] *See* U.S. Rebuttal Submission, para. 409.

[169] Brazil Answers to Second Set of Panel Questions, para. 172.

significant rate of increase of subsidized imports into the domestic market indicating the likelihood of substantially increased importation." The chausette to Article 15.7 even makes clear that "no one of [the five] factors by itself can necessarily give decisive guidance." In other words, Article 15.7 of the *SCM Agreement* could hardly be more clear that it does *not* "deal primarily with the threat posed by a potential surge of imports." Brazil's arguments premised on that assertion are, thus, irrelevant.

130. Second, Brazil ignores the fact that "injury" is itself classified as an "adverse effect" under Article 5 of the *SCM Agreement*. Indeed, Article 5 of the *SCM Agreement* makes clear in footnote 11 that "injury to the domestic industry" therein is "used here in the same sense as it is used in Part V." Thus, it is illogical for Brazil to assert that the focus in Article 5 on adverse *effects* somehow places a "threat of serious prejudice" inquiry into a fundamentally different category than a "threat of material injury" inquiry; one that precludes the Panel from consulting the ordinary meaning of "threat" in the latter context as important contextual guidance in interpreting the same word in footnote 13.

131. An inquiry into whether subsidized imports into the domestic market of a Member threaten to cause material injury is no less an inquiry into *effects* than an inquiry as to whether subsidies threaten to cause serious prejudice to the interests of another Member. The fact that one looks to the effects of subsidized imports while the other looks to the effects of subsidies is not material; the United States has never suggested that footnote 13 and Article 15.7 are identical provisions. And there is certainly no requirement that two provisions be identical in order for one to provide contextual guidance as to another.

132. Brazil also alleges that the Panel should read the concept of close proximity in time or "imminence" out of the ordinary meaning of the term "threat" in footnote 13 because the multilateral remedy available under Article 5 is somehow a "slow" remedy while the remedy available under Part V of the *SCM Agreement* is a "quick" remedy. Once again, the factual predicate of Brazil's argument is flawed. A remedy in WTO dispute settlement is not necessarily any more "slow" or "fast" than the process of applying duties under the *SCM Agreement*, *AD Agreement*, or *Safeguards Agreement*. Indeed, the pace of a particular WTO, CVD, AD, or safeguard proceeding necessarily depends on the particular circumstances of each proceeding.

133. Investigations by different Members' authorities require differing periods of time. And different Members may have different appeal mechanisms that affect the amount of time to obtain a remedy. In short, any number of factors could affect whether or not the domestic remedy available under the *SCM Agreement*, *AD Agreement*, and *Safeguards Agreements* is a slow or fast remedy. The same is true for the multilateral remedy available through WTO dispute settlement (e.g., the amount of time required for a remedy could depend on the complexity of the dispute brought by the complaining party, whether any appeals are made, the reasonable period of time for implementation of any adverse findings and other such factors). Brazil's generic assertions about the "slowness" or "quickness" of the different remedies is, thus, speculative at best.

134. In any event, Brazil neglects one simple fact – the drafters *chose* to use the same term ("threat") in all four contexts. If the remedies available thereunder were *so* different that same word could not even have the same ordinary meaning in the four contexts, the drafters could very well have chosen to use different words. They could very easily have inserted, for example, Brazil's preferred "significant likelihood" standard in footnote 13 to differentiate it from "threat" in Articles 15.7 of the *SCM Agreement*, Article 3.7 of the *AD Agreement*, and Article 4.1(b) of the *Agreement on Safeguards*. But they did not do so. They chose to use "threat" in all four contexts and – for clarity – even expressly reflected the ordinary meaning of that term in certain of the provisions. Brazil has no basis unilaterally to change the text now.

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

135. The United States respectfully refers the Panel to its general comments above regarding Brazil's "threat of" serious prejudice claims under Articles 5(c) and 6.3(c) of the *SCM Agreement* as well to the U.S. arguments on this issue in its prior submissions.[170]

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

136. The United States respectfully refers the Panel to its general comments above regarding Brazil's "threat of" serious prejudice claims under Articles 5(c) and 6.3(c) of the *SCM Agreement*, to the U.S. comments regarding Brazil's answer to Question 86, as well to the U.S. arguments on this issue in its prior submissions.[171]

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

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

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

137. The United States respectfully refers the Panel to its general comments above regarding Brazil's "threat of" serious prejudice claims under Articles 5(c) and 6.3(c) of the *SCM Agreement* as well to the U.S. arguments on this issue in its prior submissions.[172]

138. In addition, the United States notes that, in its response to this question, Brazil attempts to explain away the evidence – submitted by Brazil itself – undermining its assertions that marketing loan payments are "designed 'in such a manner that payments would be made in consistently large amounts.'" Table 27 submitted by Brazil in its own first written shows the AWP *increasing* over the period MY 2006-2010 and projected marketing loan payments *declining* over the same period. Brazil's response is, however, inexplicable.

139. Brazil delves into a discussion of "deterministic" versus "stochastic" projections of government outlays in its response to the Panel's question. However, according to Brazil's own notations, Table 27 presents, *inter alia*, the AWP and payments under the marketing loan and counter-

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[170] *See e.g.*, U.S. Rebuttal Submission, paras. 405-425; U.S. Answers to Second Set of Panel Questions, paras. 173-199.

[171] *See e.g.*, U.S. Rebuttal Submission, paras. 405-425; U.S. Answers to Second Set of Panel Questions, paras. 173-199.

[172] *See e.g.*, U.S. Rebuttal Submission, paras. 405-425; U.S. Answers to Second Set of Panel Questions, paras. 173-199.

cyclical payments projected by FAPRI. The total amount of government outlays shown in Table 27 were *not* projected by FAPRI; to the contrary, the government outlays were *estimated by Brazil*.[173] In any event, as USDA points out in the very document Brazil cites for the proposition that "deterministic projections, by their nature, tend to underestimate outlays":

> The Congressional Budget Office (CBO) and the *Food and Agricultural Policy Research Institute (FAPRI) have used a stochastic approach to estimate outlays and cost legislative proposals for some time*. CBO adopted a stochastic approach for crop sector analysis in September 1995 while working on the 1995/96 budget reconciliation/farm bill debate. *FAPRI adopted a stochastic approach just prior to the 2002 farm bill debate*.[174]

140. Indeed, the July 2006 FAPRI baseline from which the data in Table 27 is taken is simply an update of the "full" 2006 baseline published earlier. The earlier baseline clarifies that "[i]n recent years, we have reported average values from the stochastic analysis for government costs and farm income and traditional point estimates for all other variables."[175] Thus, the simple answer that Brazil fails to provide is that – at the time FAPRI issued its July 2006 baseline update FAPRI projected that in MY 2007 the marketing loan payment would be *less than one-half of a cent and thereafter would amount to nothing at all*. The very fact that the projection was made – projections that were considered sufficiently reliable for Brazil to include in its written submission and use in its modeling exercise – confirm that marketing loan program was not set up pursuant to some master "design" to result in large payments.

141. What the marketing loan program under the FSRI Act of 2002 *was* designed to do, moreover, was expire after MY 2007. Thus, regardless of whether projections are "deterministic" or "stochastic," whether they are of $1 or $1 billion, the fact is *none of them take into account the fact that, as currently scheduled, no marketing loan payments will be made under the FSRI Act of 2002 in MY 2008*. That fact alone renders Brazil's claims moot to the extent that they extend to any hypothetical measures in that year.

D. EXPORT CREDIT GUARANTEES

1. Outstanding export credit guarantees

Questions to the United States

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

> ***... nothing in the SCM Agreement provides that "withdrawing" a "subsidy" allegedly "taking the form of a program" "includes an obligation to abstain from performing on commitments outstanding under that program as of the deadline for implementation." That argument improperly equates "performing on commitments under the program" with the "subsidy" itself. Such an equation was appropriate in Brazil – Aircraft (21.5), where Brazil continued to issue new WTO-inconsistent bonds even after the period of implementation on the basis that it had pre-existing contractual obligations to do so. However, it is not accurate here, where the guarantees are not themselves prohibited subsidies.***

[173] *See* Brazil First Written Submission, Table 17, n. 454.

[174] Explanatory Notes for Stochastic Budget Outlays, (Exhibit BRA-460)

[175] FAPRI 2006 U.S. Baseline Briefing Book, p. 1 (available at http://www.fapri.missouri.edu/outreach/publications/2006/FAPRI_UMC_Report_01_06.pdf).

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

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

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

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

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

Questions to Brazil

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

142. Contrary to Brazil's assertions, the situation in the present proceeding with respect to export credit guarantees issued prior to July 1, 2005 is not analogous to Brazil's continued provision of WTO-inconsistent bonds in *Brazil – Aircraft (21.5)*. Brazil's bonds continued to be prohibited export subsidies both before and after the date of implementation. By contrast, since July 1, 2005 (and, indeed, even before that time), U.S. export credit guarantees ceased being part of any program that is being operated at a "net cost to the government."[176] Thus, unlike Brazil, the United States has not attempted to continue providing prohibited export subsidies past the date of implementation.

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

2. Legal Bases for Brazil's export subsidies claims

Question to the United States

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

[176] *Upland Cotton (Panel)*, para. 7.804.

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

Questions to both parties

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

143. The United States respectfully refers the Panel to the U.S. response to this question.[177] In addition, the United States offers the following observation regarding Brazil's response.

144. Brazil's response assumes that the United States "argues that Brazil must prove that [an export credit] guarantee also resulted in a benefit to a foreign bank by lowering the 'total cost of funds' involved in the transaction."[178] This is a mischaracterization of the U.S. position. The United States has made no argument concerning the necessity to prove a benefit to any particular participant in a transaction or group of participants. Instead, consistent with Article 14(c) of the *SCM Agreement*, the United States has argued that the proper focus is on the guaranteed loan transaction itself, and whether the there is a "difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee."

145. The express focus under the text is on a comparison of two *transactions* to determine whether a benefit exists at all, not on whether a particular entity does or does not receive a benefit. Brazil has made no attempt to provide such specific information on individual loan costs and fees or to identify comparable commercial loans and their terms.

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

146. Brazil's response to this question appears to be irrelevant to the question posed by the Panel. Brazil offers an exhibit (BRA-686) in which the consultant retained by Brazil for purposes of this dispute expounds on "why at any point in time, the principal exposures between the two-year bullet loan and the three-year amortizing loan can be different."[179] However, the United States has never argued that a loan with principal payable over 3 years has the same principal exposure as a loan with principal payable over 2 years. To the contrary, the United States has simply demonstrated that the prosaic arithmetic concept of average life provides a common and straightforward basis for comparing the costs and fees derived for loans of differing principal repayment terms.[180]

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[177] U.S. Answers to Second Set of Panel Questions, paras. 206-211.

[178] Brazil Answers to Second Set of Questions, para. 203.

[179] Brazil Answers to Second Set of Questions, para. 225.

[180] U.S. First Written Submission, paras. 123-124; U.S. Rebuttal Submission, para. 153; U.S. Answers to Second Set of Panel Questions, paras. 212-218.

147. Brazil has previously argued that such a difference *necessarily* renders the two types of loans not comparable because "the patterns of credit risk to which the lender is exposed are very different in these two cases."[181] Brazil now appears to retreat from this unequivocal argument, when it states that the difference in principal repayment terms "pose *potentially* differing risks of default."[182]

148. Brazil's consultant states "the likelihood of default in the two periods *may* be different."[183] Presumably, therefore, they may also *not* be different. As the United States has previously observed, Brazil's analysis simply *assumes*, without a factual basis, "that the borrowing bank's credit outlook is sufficiently positive in the short term that there is a very low default likelihood perceived in the first two years . . . and a greater likelihood of default in the third year."[184]

149. Brazil's consultant expressly acknowledges that if the chance of default in each of the years is the same then there is no difference in spread between the two-year bullet loan and the three-year amortized loan.[185] However, he argues that if one assumes the risk of default is higher after the first year then "the amortizing loan commands a higher spread."[186] And, conversely, if one assumes higher risk of default in the first year, "the amortizing loan now has a lower spread."[187] While this may be true, in the absence of any factual basis in the examples before the Panel for an assumption that the risk is greater in the out years, then Brazil's theoretical disquisition is of no significance. Far from there being any such factual basis, however, the United States has actually submitted evidence that in a study of medium-term U.S. government-guaranteed loans, the authors found that "as the medium-maturity loans season the likelihood of default increases initially, peaks in the second year after origination, and declines thereafter."[188]

150. In any event, in the absence of any specific basis for assigning, in particular transactions, differing default risks in particular years, Brazil's analysis simply *confirms* the basic utility of average life for comparing pricing of loans of different principal repayment terms.

Questions to the United States

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

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

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

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

[182] Brazil Answers to Second Set of Questions, para. 225.

[183] Brazil Answers to Second Set of Questions, Exhibit Bra-686, para. 11.

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

[185] Brazil Answers to Second Set of Questions, Exhibit Bra-686, para. 30.

[186] Brazil Answers to Second Set of Questions, Exhibit Bra-686, para. 31.

[187] Brazil Answers to Second Set of Questions, Exhibit Bra-686, para. 31.

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

Questions to Brazil

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

151. Effectively conceding that it has not provided the requisite specific information on loan costs and fees or identified comparable commercial loans and their terms, Brazil protests that it is "not in the position of an investigating authority" and therefore cannot be expected to produce "this type of data."[189] This does not excuse Brazil from making a *prima facie* case of breach. If it does not have evidence that the United States is breaching its WTO obligations – as the United States has argued is in fact the case – Brazil has no basis to make claims to that effect before a WTO panel. Brazil finds itself in no different position than domestic industries, who must submit sufficient evidence of subsidization (including financial contribution, benefit, and specificity within the meaning of Articles 1 and 2 of the *SCM Agreement*) and injury in order to warrant an investigation under Part V of the *SCM Agreement*.

152. Brazil next implies that the commercial bank that has provided specific transactional information submitted by the United States may be motivated to falsify such information because of a specific interest in maintaining the GSM 102 program.[190] These assertions are completely baseless and do not merit a response.

153. Brazil also mischaracterizes the arguments of the United States. Brazil asserts that "the United States argues, in essence, that the interest that the lender charges on a loan guaranteed by the U.S. government could be higher than the interest it charges on a loan guaranteed by a commercial enterprise."[191] Consistent with Article 14(c) of the *SCM Agreement*, however, the arguments of the United States have not been restricted to comparisons of interest alone, nor to a comparison of two transactions in which a guarantee is necessarily involved. Rather, the United States has noted that private sector commercial products comparable to the GSM-102 program are available in the marketplace and commercial lenders have provided unsecured financing to foreign banks who are CCC-approved obligors on terms the annualized cost of which was less than that available under the GSM-102 program.[192] This contradicts Brazil's sweeping assertions that GSM 102 guarantees are only provided where credit would not otherwise not have been available to foreign obligors.

154. Finally, Brazil asserts that "as a factual matter, [] Article 14(c) is not directly applicable to GSM 102."[193] The United States has never asserted that Article 14(c) is directly applicable. Rather, the United States – like the Appellate Body – has noted that Article 14 provides key contextual guidance in assessing "benefit." In the case of loan guarantees, it is Article 14(c) that is relevant.

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[189] Brazil Answer to Question 100, para. 226. Brazil later asserts that it has discharged its burden by virtue its "ExIm Bank fee comparison." *Id*., para. 244. This comparison of fees is not an appropriate analysis. Moreover, the United States has demonstrated, however, the elements of the Ex-Im Bank products render them not comparable to the GSM-102 guarantee. U.S. Answer to Question 98 (2 April 2007).

[190] Brazil Answers to Second Set of Questions, para. 226 and fn. 297.

[191] Brazil Answers to Second Set of Questions, para. 246.

[192] *See, e.g.*, U.S. First Written Submission, paras. 111-131

[193] Brazil Answers to Second Set of Questions, para. 234.

155. Article 14(c) recognizes that a loan guarantee is made for the sole purpose of supporting a loan transaction; the guarantee becomes an integral part of that transaction and has no value beyond it. The particular fee assessed for a guarantee is affected by the terms of the underlying loan transaction, who the parties are to the underlying loan transaction, the nature of the goods being purchased and sold, and any number of other factors. In turn, the terms of the underlying loan transaction and the costs and fees associated with that financing may be affected by the fees assessed.

156. Therefore, the drafters expressly provided that "a loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees." In other words, they expressly recognized that an assessment of the total costs of the transaction is necessary to assess whether a "benefit" is *actually* conferred by the guarantee. Brazil has provided no basis to depart from this logic.

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

4. Item (j) of the Illustrative List

<u>Questions to both parties</u>

> ***102. What, in your view, explains the different results achieved by the two methods advocated, on the one side, by the United States in paragraphs 87-89 of its First Written Submission and by Brazil in Exhibit Bra-613 (other than the United States' criticism that Brazil has not taken recoveries corresponding to pre-1992 guarantees into account in its "cash basis" accounting calculations, of which the Panel is already aware)?***

157. The United States appreciates the observation by Brazil that under the Federal credit reform accounting methodology, "application of re-estimates effectively converts the process to a retrospective, cash-basis accounting methodology."[194] It is precisely because of such re-estimates that the profitability of the export credit guarantee programs is evident.[195] As Brazil elsewhere notes in its answers to the Panel's questions, the required accounting methodology under the Credit Reform Act of 1990, "'measure[s] more accurately the costs of Federal credit programs' than does cash-basis accounting."[196]

158. In addition to this observation, the United States respectfully refers the Panel to its extensive arguments regarding the profitability of the export credit guarantee programs in its prior submissions.[197]

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[194] Brazil Answers to Second Set of Questions, para. 266.
[195] *See, e.g.*, U.S. First Written Submission, paras. 81-99.
[196] Brazil Answers to Second Set of Questions, paras. 273, 285.
[197] *See e.g.*, U.S. First Written Submission, paras. 73-104; U.S. Rebuttal Submission, paras. 84-100.

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

159. The United States has already addressed all of Brazil's arguments in response to this question in its prior submissions. Brazil is simply incorrect to assert that CCC "predicts" that "'cohorts' of GSM 102 ECGs issued in FY 2006 and FY 2007 (and thus under the amended GSM 102 fee schedule) will suffer losses over the long term."[198] In this respect, the United States respectfully refers the Panel to the U.S. comments on Brazil's answer to Question 105 below as well as the U.S. Rebuttal Submission at paragraphs 108-126. With respect to the "cash results" that Brazil advances[199], the United States respectfully refers the Panel to the U.S. comments herein in response to Brazil's answers to Question 102 and 106.

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

160. The United States respectfully refers the Panel to its own response to Question 104[200] and simply notes again that it establishes internal bank limits to govern exposure to potential defaults by foreign obligor banks in individual transactions.[201] Brazil does not dispute the fact of such limits but indicates that the United States has offered "no evidence" of the way in which it establishes such limits. In particular, Brazil suggests that "CCC does not account for differing ratings between individual non-sovereign foreign obligors in a country, [but] rather, it applies a single rating . . . for all non-sovereign foreign obligors within that country."[202] Brazil is incorrect.

161. As the United States has explained, CCC conducts an independent analysis of *each* foreign bank to establish the risk rating for such bank and the resulting bank limit.[203] The Office of Management and Budget ("OMB") establishes 11 sovereign and 9 non-sovereign risk categories for use by government agencies and programs subject to the Federal Credit Reform Act of 1990.[204] CCC uses the same risk category methodology to classify foreign banks it approves for the GSM-102 program. Generally, if a bank is itself considered to be sovereign, then it will not be rated better than the sovereign country rating. Similarly, if a bank is considered non-sovereign, then it generally will not be rated better than the OMB non-sovereign rating for its country. CCC's independent analysis of each bank applies a standard CAMEL approach, evaluating capital adequacy, asset quality, management, earnings, and liquidity of the foreign bank.[205]

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

(a) The original Panel found that original subsidy estimates, while not reflecting 'actual' figures, nevertheless provide a reliable measure of the United States government's own assessment of the profitability of the

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[198] Brazil Answers to Second Set of Questions, para. 272.
[199] Brazil Answers to Second Set of Questions, paras. 276-278.
[200] U.S. Answers to Second Set of Panel Questions, paras. 246-248.
[201] U.S. First Written Submission, para. 78.
[202] Brazil Answers to Second Set of Questions, para. 281.
[203] U.S. First Written Submission, para. 78.
[204] U.S. First Written Submission, para. 78, fn. 120; U.S. Rebuttal Submission, para.118; "Informal consultation questions to the United States," question 19 (Exhibit BRA-517).
[205] U.S. First Written Submission, para. 78, fn. 120; U.S. Answers to Second Set of Panel Questions, para. 248, fn. 266 and 279-283.

export credit guarantee programmes. Is the United States asking the Panel to revisit that conclusion (see paras 108 ff. of the United States' First Written Submission).

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

162. First, Brazil is incorrect to assert that "the CCC predicts that costs and losses for the 'cohorts' of GSM 102 ECGs newly issued in FY 2006, FY 2007 and FY 2008 will, over the long term, exceed fees, penalties and recoveries."[206] As the United States has explained, initial subsidy estimates in the U.S. budget are not derived from the specific experience of the CCC programs, nor do they in any way constitute a prediction of loss.[207]

163. Furthermore, the United States does not "ask the compliance Panel to ignore the original panel and the Appellate Body's findings" nor abandon "the original panel and Appellate Body's adoption of a forward-looking, future-oriented assessment under 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,' in favor of a purely retrospective assessment of program performance."[208] To the contrary, the United States has expounded at length on the prospective viability of the program[209] and – unlike Brazil – on its profitability under the credit reform methodology "used and relied upon by the United States government."[210]

164. One additional factual assertion in Brazil's answer to Question 105 merits response. Brazil ascribes erroneous significance to "the USDA model" to which it refers in paragraph 302 of its answers and in Exhibit Bra-588. This is not a reference to a model specific to USDA of "expected loss rates or estimated default costs" particular to the CCC export credit guarantee programs, as Brazil asserts. Instead, it refers only to a cash flow model required of all U.S. government agencies providing international credit, which cash flow model is only an initial step in the budgetary process and which must, in any event, use risk ratings and assumed loss rates required by the OMB for all such agencies, irrespective of the particular program experience.[211] The OMB then also requires such agencies to use "a credit subsidy calculator . . . that agencies use to convert agency-estimated cash

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[206] Brazil Answers to Second Set of Questions, para. 284.

[207] U.S. Rebuttal Submission, paras. 108-126.

[208] Brazil Answers to Second Set of Questions, para. 292.

[209] *See, e.g.,* U.S. First Written Submission, paras. 73-80; U.S. Rebuttal Submission, paras. 101-107, 127-128.

[210] *See, e.g.,* U.S. First Written Submission, paras.81-99;U.S. Rebuttal Submission, paras. 84-100.

[211] United States Government Accountability Office Report to Congressional Committees (GAO-04-531) September 2004: Export Import Bank - OMB's Method for Estimating Bank's Loss Rates Involves Challenges and Lacks Transparency, p. 7 (Exhibit US-73) ("To estimate their subsidy costs, credit agencies estimate the future performance of direct and guaranteed loans. Agency management is responsible for accumulating relevant, sufficient, and reliable data on which to base these estimates. To estimate future loan performance, agencies generally have cash flow models, or computer-based spreadsheets, that include assumptions about defaults, prepayments, recoveries, and the timing of these events and are based on the nature of their own credit program. Agencies that provide credit to domestic borrowers generally develop these cash flow assumptions, which OMB reviews, based on their historical experience. *For U.S. international credits, OMB provides the expected loss rates, which are composed of default and recovery assumptions, that agencies should use to estimate their subsidy costs.*") (Emphasis added)

flows into present values."[212] These figures can in no way be characterized to reflect that "CCC anticipates losses."[213]

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

165. The United States respectfully refers the Panel to its own response to this question[214] as well as to the comments of the United States below in response to Brazil's answer to Question 114.

Questions to the United States

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

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

109. Please indicate to the Panel whether there have been occurrences of reschedulings prior to the occurrence of defaults and the payment of claims by the CCC.

110. Is it possible to calculate the "subsidy estimate net of reestimates" for GSM 102 alone (similar to what the US has done for all three programmes in para. 87)? If so, please provide a table recording the results of this exercise.

111. In paragraph 7.853, the original Panel stated that it "disagree(d) with the United States that we should 'eliminate' the data for certain, more recent, cohorts in our analysis." Is the United States asking that this Panel eliminate such data for the most recent cohorts (the table at para. 87 of the United States' First Written Submission includes data up to 2005 only). Why should this Panel do what the original refused to do? What would be the result of the United States "re-estimates" exercise if the original subsidy estimate for the 2006 and 2007 cohorts were included?

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[212] United States Government Accountability Office Report to Congressional Committees (GAO-04-531) September 2004: Export Import Bank - OMB's Method for Estimating Bank's Loss Rates Involves Challenges and Lacks Transparency, p. 10 (Exhibit US-73).

[213] Brazil Answers to Second Set of Questions, para. 302.

[214] The United States notes a typographical error in its response, however. In paragraph 261, the fourth sentence should read: "Therefore, it is inexplicable - and entirely disingenuous - that Brazil criticizes the United States for including recoveries received before 1992 (indeed as far back as *1980*)." The United States inadvertently included "not" before "including" in its response.

112. Please explain whether and how the CCC limits risks or control costs of the GSM 102 programme as regards foreign banks' individual credit ratings.

113. Please explain whether and how CCC country risk categories correspond to ICRAS ratings.

Question to Brazil

114. Brazil argues that "(t)hat the United States has, on one view of the data, beaten the odds and met its costs and losses over a series of years does not mean that ECG programs are structured and designed to do so" (para. 503, Brazil's Rebuttal). Is Brazil arguing that evidence regarding the actual operation and "profitability" of the programme (i.e. retrospective evidence) is irrelevant to the Panel's analysis under item (j)?

166. The United States notes that Brazil now appears to be advocating exclusively for "cash results" in respect of an analysis under item (j).[215] This appears to be a *wholesale abandonment of Brazil's position in the original panel proceeding* regarding the credit reform accounting methodology, a shift that can only be explained by the fact that the methodology now confirms the robust profitability of the programs, directly undermining Brazil's theory in the present proceeding. The United States recalls that Brazil had previously stated that "it does *not* intend for this revised constructed formula to *replace* the formula used by the U.S. government itself to track the costs of the CCC guarantee programs pursuant to the U.S. Federal Credit Reform Act."[216] Brazil's response to the compliance panel's Question 114 reflects a complete reversal of that position.

167. While Brazil's positions on the issue may shift to accommodate the results Brazil prefers, the overwhelming evidence confirms the profitability of the export credit guarantee programs. This evidence directly contradicts Brazil's claims that premiums charged under these programs are insufficient to cover the long-term costs and losses of the programs.

[215] Brazil Answers to Second Set of Questions, para. 314.

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