ANNEX I

ANSWERS OF PARTIES TO THE PANEL'S QUESTIONS AND OTHER COMMENTS AND DOCUMENTS RECEIVED FROM PARTIES

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ANNEX I-1

ANSWERS OF BRAZIL TO QUESTIONS POSED BY THE PANEL FOLLOWING THE FIRST SUBSTANTIVE MEETING OF THE PANEL

11 August 2003

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TABLE OF CASES CITED

Short Title	Full Case and Citation
Brazil - Aircraft	Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, adopted 20 August 1999
Brazil – Aircraft (21.5)	Panel Report, *Brazil – Export Financing Programme for Aircraft. Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW, , adopted 4 August 2000

LIST OF EXHIBITS

Agricultural Assistance Act of 2003, in P.L. 108-7	Exhibit Bra-135
P.L. 106-113	Exhibit Bra-136
P.L. 106-224	Exhibit Bra-137
P.L. 107-25	Exhibit Bra-138
68 Federal Register 20331, 20331-20332	Exhibit Bra-139
Pindyck, Robert S. and Rubinfeld, Daniel L., Microeconomics, 5 Edition (2002), Prentice hall, New Jersey.	Exhibit Bra-140
7 U.S.C. 5622	Exhibit Bra-141
Agricultural Outlook, USDA, May 2002	Exhibit Bra-142
Agricultural Statistics 2003, USDA	Exhibit Bra-143
G/AG/R/31	Exhibit Bra-144
US and State Farm Income Data, (United States and States 1997-2001), USDA	Exhibit Bra-145
Acreage, NASS, 28 June 2002	Exhibit Bra-146
Estimate of Support Granted by Commodity via Counter-Cyclical Payments. Agricultural Prices	Exhibit Bra-147
Statement of Administrative Action	Exhibit Bra-148
Agricultural Outlook, USDA, August 2002	Exhibit Bra-149
G/AG/N/USA/10	Exhibit Bra-150
"US Export Credit Guarantee Programs: What Every Importer Should Know About the GSM-102 and GSM-103 Programs", USDA, November 1996.	Exhibit Bra-151
GAO, Statement of Allan I. Mendelowitz, Director, Trade, Energy and Finance Issues, National security and International Affairs Division, before the Task Force on Urgent Fiscal Issues of the Committee on Budget of the US House of Representatives, "Status Report on GAO's Reviews of the Targeted Export Assistance Program, the Export Enhancement Program, and the GSM 102/103 Export Credit Guarantee Programs," GAO/T-NSIAD-90-53, 28 June 1990.	Exhibit Bra-152

US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report N° 06401-14-FM, June 2001	Exhibit Bra-153
US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report N° 06401-4	

US Department of Agriculture, Foreign Agricultural Service, "Revised FY 2000 and FY 2001 Annual Performance Plan".	Exhibit Bra-165
US Department of Agriculture Foreign Agricultural Service, News Releases regarding extension of GSM 102 and GSM 103 guarantees to Dominican Republic, Morocco, Ghana, South Korea, Vietnam and Algeria	Exhibit Bra-166
12 Steps to Participating in the USDA Supplier Credit Guarantee Program, Step 5.	Exhibit Bra-167
US Department of Agriculture Foreign Agricultural Service, News Releases regarding extension of SCGP guarantees to Tunisia, Azerbaijan, Vietnam, South Korea, Japan and Nigeria	Exhibit Bra-168

A. UPLAND COTTON

1. Please confirm that all information and data that you have provided to the Panel relating to "cotton" in fact relates to upland cotton only. BRA, USA

Brazil's answer:

1. Brazil can confirm that, except as explicitly stated otherwise, all the data and references made by Brazil to "cotton" relate and will relate to "upland cotton" only.

B. PRELIMINARY ISSUES

Note to parties: As indicated in the cover note, the Panel has expressed its views in respect of the three United States requests for preliminary rulings. The Panel's questions reflected in this compilation relating to the requested preliminary rulings on which the Panel has expressed its views are those that were posed in the course of the first session of the first Panel meeting. This is to give an opportunity for the parties to transpose into writing their oral responses.

1. Product scope of Panel's terms of reference relating to Brazil's export credit guarantee claims

2. Is Brazil's claim in relation to export credit guarantees against the measures said to constitute the GSM-102, GSM-103 and SCGP programmes in their entire application, or against the measures said to constitute the GSM-102, GSM-103 and SCGP programmes [illegible] in their neao

2. Expired measures

14. Please submit evidence regarding the programmes under the 1996 FAIR Act, in particular, production flexibility contract payments and market loss assistance payments, to the extent that they would be relevant to the Panel's determination under Article 13 of the Agreement on Agriculture in your answers to questions and rebuttal submission. USA

15. Do the parties agree that it is beyond a Panel's power to recommend a remedy for an expired measure? Could the Panel could be required to examine "expired measures" in order to conduct its assessment of the matter before it? How, if at all, is Article 7.8 of the SCM Agreement relevant to these matters? BRA, USA

Brazil's answer:

6. The Panel must examine any continuing effects of subsidies provided by expired measures, and it can recommend a remedy for any such continuing effects. Brazil has set forth its arguments in that respect in paragraphs 4-7 of its Closing Statement at the First Substantive Meeting of the Panel with the Parties, as well as in paragraphs 141-144 of its Oral Statement at the same meeting. Subsidies provided under expired subsidy measures can be the source of present adverse effects. Preventing a panel from examining expired measures in its assessment of the matter before it would render the adverse effects provisions of the SCM Agreement a nullity, as a Member would be freed

17. (a) What is the relationship of the Agricultural Assistance Act of 2003 to other legislation in the request for establishment of the Panel? BRA, USA

(b) Do the legal instruments follow directly one after another, or are there temporal gaps? Are payments authorized under a broad legislative authority or are they specific to each legal instrument? BRA, USA

(c) Please provide any implementing regulations. Do these implementing regulations resemble those relating to previous programmes or payments? Are payments made retrospectively? How if at all is this relevant? BRA, USA

existing (but unfunded) Cottonseed Payment Program, which formed part of the request for consultations and which has been consulted upon. The MY 2002 cottonseed payments are therefore within the terms of reference of this Panel and Brazil is entitled to challenge the adverse effects caused by these payments.

12. Finally, the Agricultural Assistance Act of 2003 appropriated $50 million in cottonseed payments expressly for the MY 2002 crop. Payments will be made after the United States has received all applications and has calculated the payment rate.[12] Since, payments are made after the 2002 crop has been harvested, payments can be considered to be made retrospectively. Yet, irrespectively of when the payments are made and irrespective of the Panel's decision whether they form part of the Panel's terms of reference, they are made in respect of MY 2002[13] and, therefore, these payments should be included in the calculation of the MY 2002 support to upland cotton for purposes of the test under Article 13(b)(ii) of the Agreement on Agriculture.

18. If the Panel is correct in understanding that cottonseed payments are divided between processors and producers, how is this reflected in Brazil's calculations? BRA

Brazil's answer:

13. Brazil has included the full amount of cottonseed payments in its peace clause calculations for MY 1999, 2000 and 2002 because cottonseed payments constitute support to upland cotton. This approach is consistent with the United States' notifications of these payments as product-specific support to upland cotton in its notification of domestic support for MY 1999.[14]

14. Brazil furthermore notes that the full amount of cottonseed payments is available to stimulate production and distort trade. Including the full amount of cottonseed payments is also consistent with basic principles of microeconomics that the incidence of a tax or subsidy does not depend on where in the processing chain the tax or subsidy is applied. The production or consumption effects of a tax or subsidy depends on supply and demand elasticities and market conditions, but these market impacts do not depend on whether government checks are written in the name of farmers or initial processors.[15]

C. MEASURES AT ISSUE

19. The Panel notes that Brazil's panel request refers, inter alia, to alleged "subsidies" and "domestic support" "provided" in various contexts. Please specify the measures, in particular, the legislative and regulatory provisions, by number and letter, in respect of which Brazil seeks relief and indicate where each is referred to in the panel request. BRA

Brazil's answer:

15. Brazil's Request for Establishment of a Panel ("Panel Request") challenges two types of domestic support "measures" provided to upland cotton and various different types of export subsidy measures. The first type of domestic support "measure" is the payment of subsidies for the production and use of upland cotton. These payments were and continue to be made between MY 1999 to the present (and will be made through MY 2007) through the various statutory and regulatory instruments listed on pages 2-3 of Brazil's Panel Request. Brazil referred to these payments at pages 2-

Code (IRC) by inserting into it a new Section 114, as well as a new Subpart E, which is in turn composed of new IRC Sections 941, 942 and 943.[19]

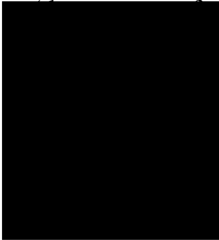
19. With respect to Brazil's export credit guarantee claims, the measures challenged by Brazil are the GSM 102, GSM 103 and SCGP programs as established and maintained by 7 U.S.C. 5622[20] and 7 CFR 1493.[21] Brazil challenges 7 U.S.C. 5622(a)(1) and (b),[22] which provide for the extension of export credit guarantees on terms better than those available on the marketplace. Furthermore, Brazil challenges the maintenance of the GSM 102, GSM 103 and SCGP programs at premium rates that are inadequate to cover the long-term operating costs and losses of the programs. Additionally, Brazil challenges the failure of 7 U.S.C. 5622 and 7 CFR 1493 to prevent circumvention (or the threat of circumvention) of the US export subsidy commitments under the Agreement on Agriculture. Brazil also challenges as a "measure" GSM 102, GSM 103 and SCGP export credit guarantees facilitating the production and export of US upland cotton as actionable subsidies and thereby causing adverse effects to the interests of Brazil.

D. ARTICLE 13(B): DOMESTIC SUPPORT MEASURES 19.7Tj 105.75 0 116tments u1ntees 0 "exempt fromductions" .2914 0.2

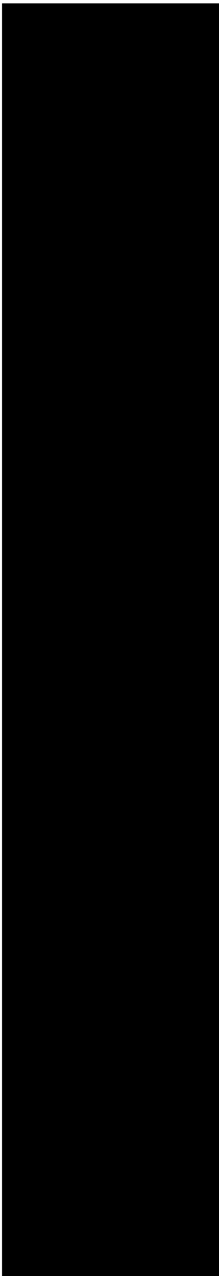
Brazil's answer:

20. The meaning of the term "defined" in relation to "base period" is the period of time used to define the parameters ("indicate the extent"[23]) of the base period. The word "period" is defined as "a

25. For an upland cotton producer with upland cotton base in MY 2001 and MY 2002, the direct payments available in MY 2002 were based on the following four elements: (1) yield (the average of the farm for MY 1981-85), (2) base acreage for the farm (resulting from either MY 1993-95 or MY 1998-2001 production), (3) only 85 percent of base acres could receive payment, and (4) the payment rate of $0.0677 cents per pound (applied to base acreage x yield x .85). The production flexibility contract payment for that same upland cotton farmer in MY 2001 would have been based on (1) yield



r MY 1981-85), (2) base acreage resulting from MY 1993-95 production, (3) only ase acres could receive payment, and (4) 5.99 cents per pound.[45] Thus, with the per pound payment rate – which increased



34.

production. Further, the updating of the base acreage for the direct payment programme (which one third of all eligible US farms took advantage of to increase their base acres eligible to receive direct payments), created further production enhancing effects today (as well as in the future) as detailed by Professor Sumner in paragraphs 20-29 of his Statement at the First Meeting of the Panel on 22 July 2003.[55]

40. Brazil finally notes that if follows from the first sentence of Annex 2, paragraph 1 that any domestic support measures not complying with one of the basic or policy-specific criteria in Annex 2 is to be presumed to violate the fundamental requirement that it have no, or at most minimal, trade-distorting effects or effects on production. This conclusion holds regardless of the finding of the Panel on the character of the first sentence of Annex 2, paragraph 1 as a stand-alone obligation.[56]

28. Please explain the meaning of the word "criteria" in Articles 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the Agreement on Agriculture have on the meaning of the preceding sentence? BRA

Brazil's Answer:

41. Articles 6.1 and 7.1 reference "criteria" in general, without a specific mention of "basic criteria", or "policy-specific" criteria. To give meaning to the "fundamental requirement" of Annex 2, paragraph 1, the use of the word "criteria" must encompass all the rules, standards, or requirements established by Annex 2 as conditions for determining whether a domestic support measure can be exempted from reduction commitments. There is no basis, therefore, on which to exclude the fundamental requirement in Annex 2, paragraph 1 from the criteria that a domestic support measure must be exempted from the reduction commitments.

Brazil's Answer:

47. Yes. A failure of a Member's measures to meet in any given year the conditions of the peace clause lifts the entitlement to peace clause protection for the whole implementation period for all measures found to fail meeting the conditions of the peace clause. This conclusion applies to domestic support measures as well as export subsidies.

48. At the outset, Brazil would like to recall that the peace clause provides Members only limited protection from actionable and prohibited subsidy claims under the SCM Agreement and GATT Article XVI. Domestic support measures are only exempt from action under Articles 5 and 6 of the SCM Agreement and under GATT Article XVI:1, if the domestic support measures do not violate the Total AMS reduction commitments of a Member and if they do not grant support to a specific commodity in excess of that decided during the 1992 marketing year. Export subsidies are only exempt from actions under Articles 3, 5 and 6 of the SCM Agreement and GATT Article XVI, if they conform fully to the provisions of Part V of the Agreement on Agriculture.

49. The peace clause does not impose any positive obligations and can, thus, not be violated. It constitutes a right and defence of a Member that this Member may or may invoke. The *US – FSC* and *US – FSC (21.5)* dispute are examples of disputes, in which a Member has chosen not to invoke the peace clause defence. Brazil has demonstrated before, that the peace clause is in the nature of an affirmative defence.[61] Accordingly, a complaining party does not bear the burden of proof that the measures at issue do not meet the conditions of the peace clause.

50. Nothing in the text of Article 13 suggests that a Member, which foregoes its peace clause exemption for particular measures in one year during the implementations period, shall be entitled to claim peace clause exemption for those measures for other – earlier or later – years. Article 13 offers peace clause exemption for measures that "fully conform" to Article 6 and that do not "grant support" "in excess of" that decided during the 1992 marketing year, as well as for measures that "fully conform" to Part V of the Agreement on Agriculture. If measures fail to meet one of the relevant conditions in any year – be it the current year or an earlier year during the implementation period – those measures can no longer be considered to "fully conform" or to not "grant support" "in excess of". Consequently, those measures are not exempt from action.

51. Finally, Brazil notes that the Panel need not decide this issue due to the circumstances of the present case. Brazil has demonstrated that the United States' domestic support measures at issue in this dispute do not meet the conditions of the peace clause in any marketing year from MY 1999 to the present and that the US export subsidies also do not conform fully to Part V of the Agreement on Agriculture. Thus, none of the subsidies at issue in this dispute is entitled to exemption from actions pursuant to the peace clause.

36. Does a failure by a Member to comply with Article 13(b) in respect of a specific commodity impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? BRA, USA

Brazil's Answer:co75 1ws5 bp2s Answer:measu bw TD 0.008i1n36.25Xcl -12 TD /F0 11.25 Tf 0.085 Tc53.2

37. In the United States' view, why did the drafters not use the exact term "product-specific" in Article 13(b)(ii)? USA

38. Given the fact that subsidies available for more than one product could have various effects on production, how does the United States demarcate between product-specific support and non-product specific support ? USA

39. If "such measures" in Article 13(b)(ii) refers to all those in the chapeau of Article 13(b), why are they not all included in the potential comparisons with 1992? In what circumstances can measures which grant non-product specific support lose exemption from action under Articles 5 and 6 of the SCM Agreement and Article XVI of GATT 1994? USA

40. In relation to which other provisions in the Agreement on Agriculture is it relevant to disaggregate non-product specific support in terms of specific commodities? BRA

Brazil's Answer:

53. The Panel's question uses the phrase "non-product specific support", which is not defined explicitly in the Agreement on Agriculture. Therefore, before responding to this question, Brazil will set forth its understanding of what this term means and which measures at issue in this dispute fall within that definition.

54. "Aggregate Measurement of Support" and "AMS" are defined in Article 1(a) as the "annual level of support, expressed in monetary terms" (a) "in favour of the producers of the basic agricultural product" or (b) "non-product-specific support provided in favour of agricultural producers in general . . ." (emphasis added). Brazil notes that the ordinary meaning of the word "general" is "including, involving, or affecting all or nearly all the parts of a (specified or implied) whole."[62] The "whole" in the case of Article 1(a) of the Agriculture Agreement refers to agricultural producers of all or nearly all basic agricultural products covered by the Agreement on Agriculture. Because the universe of domestic support measures includes either "product-specific" or "non-product-specific" domestic support measures, it follows that any domestic support that is not provided "in favour of agricultural producers in general" is deemed to be "in favour of the producers of the basic agricultural product". Accordingly, the test for determining whether a domestic support measure is "non-product specific" for the purpose of calculating AMS is whether, as a factual matter, the measure provides support to "agricultural producers in general".

55. The United States has argued that Article 1(a) is useful context for interpreting the meaning of "support to a specific commodity".[63] However, the United States latches on to only the first part of Article 1(a), and ignores the "in general" qualification in the second part, which provides the essential meaning as to the scope of what is and is not "product-specific". Brazil notes that none of the measures it used to calculate the levels of support for purposes of Article 13(b)(ii) for MY 1992 or MY 1999-2002 could properly be deemed to be "non-product-specific" support as defined in Article 1(a) of the Agreement on Agriculture. And, as Brazil has previously argued, all of these measures are "support to" upland cotton within the meaning of Article 13(b)(ii).

56. With that introduction, the answer to the Panel's question is that Brazil is not aware of any provision of the Agreement on Agriculture requiring the dis-aggregation of support that is "provided in favour of agricultural producers in general", as discussed above. However, Brazil notes that Article 13(b)(ii) is a sui generis provision of the Agreement on Agriculture that does not use the phrases "AMS", "non-product specific" or "product-specific" support. Contrary to all of the other

[62] The New Shorter Oxford English Dictionary, 1993 edition, p. 1073.

[63] First Submission of the United States, para. 78; *See* also Closing Statement of the United States, para. 18 (ignoring "in general" language).

60.

1993-1995. USDA reported in 2001 that the 1997 census showed there were 31,500 upland cotton farms. Assuming no increase in the number of US upland cotton farms since 1997, this represents 1.46 percent of all farms in the United States.[69]

- Upland cotton cash receipts as a percentage of total cash receipts from all agricultural commodities was 2.5 percent in MY 1999, 2.35 percent in MY 2000, and 3.05 percent in MY 2001.[70]

- The 10 "programme" crops in the CCP (and direct payment) programme represented only 23.49 per cent of total farm cash receipts from all agricultural commodities on average between MY 1997-2001.[71]

- The base acreage of the 10 "programme" crops in the CCP (and direct payment) programme represented only 30 percent of total US farm acreage in MY 2001.[72]

- In MY 2002, CCP payments to holders of upland cotton base acreage represented approximately 80 percent – or $1.143 billion – of total CCP payments ($1.420 billion) for the ten eligible programme crops.[73]

- In MY 2002, no CCP payments were made to holders of 8 of the 10 eligible crops. In particular, holders of base acreage for barley, corn, grain sorghum, oats, soybeans, other oilseeds, and wheat received no CCP payments.[74]

- CCP base acreage receiving CCP payments in MY 2002 (upland cotton and rice base acreage) represented only 2.2 percent of total US farmland.[75]

- 90 percent of US acreage eligible to receive upland cotton CCP payments for upland cotton is located in only 10 out of 50 US states, with the top 5 US States accounting for 66 percent of US upland cotton production.[76] Thus, upland cotton CCP payments are focused on farms in a limited number of US States (i.e., the "cotton belt").

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[69] Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9-9). There were 2.155 million farms in the United States in 2001. USDA reported that in 1997, there were 31,500 farms that grew cotton. Exhibit Bra-46 ("Cotton: Background and Issues for Farm Legislation," USDA, July 2001, p. 2).

[70] Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, p. 59). The calculations cited above were derived from comparing upland cotton cash receipts compared to total commodity cash receipts net of government payments.

[71] Exhibit Bra-145 (US and State Farm Income Data (United States and States 1997-2001), USDA, Table 5).

[72] Brazil does not have access to actual CCP base acreage figures. Therefore, Brazil has used MY 2001 figures as a proxy and relies on MY 2001 PFC base acreage for the 7 crops covered by PFC payments (Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, p. 50) and has added MY 2001 soybean, peanut and other oilseed acreage (Exhibit Bra-146 (Acreage, NASS, 28 June 2002, p. 14, 15 and 17) (286.8 million acres). Total US farmland in 2001 was 959,163,331 million acres (Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9.6).

[73] Exhibit Bra-147 ("Estimate of Support Granted by Commodity via Counter-Cyclical Payments").

[74] Exhibit Bra-147 ("Estimate of Support Granted by Commodity via Counter-Cyclical Payments").

[75] Upland cotton and rice PFC base acreage represented 16.2 and 4.1 million acres (Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, p. 50)). Brazil does not have any information on the effects of the base acreage update and, therefore, uses the PFC base acreage as a proxy for CCP base acreage. Total US farmland in 2001 was 959,163,331 million acres (Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9.6).

[76] Exhibit Bra-107 ("US and State Farm Income Data, Farm Cash Receipts," ERS, USDA, June 2003).

63. This evidence demonstrates that CCP (and direct payments) are provided to only a fraction of the producers of agric

SCM Agreement. Given the textual similarities between "subsidized product" and "support to a specific commodity", assessment of whether "support to a specific product" exists could be examined with at least some reference to the specificity criteria of Article 2 of the SCM Agreement. Article 2 of the SCM Agreement provides, in relevant part:

> 2.1 In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as "certain enterprises") within the jurisdiction of the granting authority, the following principles shall apply:
>
> (a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.. . .
>
> (c) If, notwithstanding any appearances of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of the subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionally large amounts of subsidy to certain enterprises . . .
>
> 2.2 A subsidy which is limited to certain enterprises within a designated geographical region within the jurisdiction of the granting authority shall be specific.

67. The US Statement of Administrative Action ("SAA") describes in some detail how the United States intends to administer the specificity provisions, suggesting that the US Department of Commerce applies a low threshold for finding both "de jure" and "de facto" specificity:

> The Administration intends to apply the specificity test in light of its original purpose, which is to function as an initial screening mechanism to winnow out only those foreign subsidies which truly are broadly available and widely used throughout an economy.[81]

Brazil agrees with this statement that the "original purpose" of the specificity criterion is to make subsidies non-specific only y rnacripcificity Arna.e-0.07a467 Tw (subsidy shall be specific.0.00.) Tj 310.5 0 TD 0 T
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> availability and use of a subsidy, the benefit of the subsidy is spread throughout an economy. Conversely, the specificity test was not intended to function as a loophole through which narrowly focused subsidies provided to or used by discrete segments of an economy could escape the purview of the CVD law.[83]

70. Therefore, the ordinary meaning, context and object and purpose of Article 2.1(a) of the SCM Agreement confirm that subsidies that are available to discrete segments of an economy or to only particular industries are specific. Under these standards, each of the subsidies challenged by Brazil in this dispute (and listed as support for the purposes of the peace clause analysis) are provided to "discrete segments" of the US economy. Indeed, they are provided to discrete segments of the sub-section of the US economy known as "agriculture". Thus, if the Panel were to apply the specificity standard set out in Article 2 of the SCM Agreement to Article 13(b)(ii) of the Agreement on Agriculture, the identified domestic support subsidies would be considered "specific".

71. Brazil notes that further support for the use of specificity concepts from the SCM Agreement in interpreting Article 13(b)(ii) of the Agriculture Agreement is found in the definition of "AMS" in Article 1(a) of the Agriculture Agreement. The definition of "non-product specific" support ("support provided in favour of agricultural producers in general") illustrates that the concept of specificity in the context of the SCM Agreement and of AMS in the Agreement on Agriculture are similar. Both would require a finding of specificity unless support is provided to an economy generally, in the case of the SCM Agreement, or to "producers" of agricultural commodities "in general," in the case of AMS under the Agriculture Agreement.

72. In contrast, the United States seeks to apply an extremely restricted concept of specificity to the peace clause that begins and ends with the question whether production of a specific commodity is required to receive the payment. This is one of the "policy-specific" criteria of a "green box" test in Annex 2, paragraph 6, but not the test of "support to a specific commodity" required by Article 13(b)(ii). Further, as demonstrated above, this narrow US interpretation finds no support in the provisions of the SCM Agreement and the Agreement on Agriculture that speak to specificity.

4. "in excess of that decided during the 1992 marketing year"

47. Where does Article 13(b)(ii) require a year-on-year comparison? BRA, USA

Brazil's Answer:

73. The text of Article 13(b)(ii) sets up a comparison between the "support" "grant[ed]" during the implementation period with support "decided" during the 1992 marketing year. Brazil cannot conceive of a methodology in which all support granted during the entire implementation period could be compared with the support decided during marketing year 1992. In order to generate an "apples to apples" ("support to support") comparison, it is necessary to compare the support granted in any marketing year during the implementation period with the support decided during marketing year 1992. No other reading of Article 13(b)(ii) would permit the required comparison.

74. Additionally, Brazil notes that the second condition for domestic support measures to be exempted from actions under the SCM Agreement is that a Member's domestic support measures conform fully to Article 6, and, thus, grant support within the limits of that Member's Total AMS reduction commitments. These Total AMS reduction commitments are made on a yearly basis. The nature of the reduction commitment and the manner, in which compliance with Article 6 is determined, demonstrates that Article 13(b)(ii) – read in accordance with its chapeau and the reference to Article 6 therein – requires a year-by-year comparison. The context of the chapeau provides support for Brazil's argument made above that the relevant comparison for Article 13(b)(ii)

[83] Exhibit Bra-148 (Statement of Administrative Action, p. 930).

involves a comparison of support granted in any of the marketing years during the implementation period with support decided in MY 1992.

75. Similarly, Article 13(c) provides further context to support the conclusion that Article 13(b)(ii) requires a year-by-year comparison. Brazil notes in its answer to Question 7, that export subsidy reduction commitments under the Agreement on Agriculture are made on a commodity-specific basis. Brazil has also pointed out in its answer to Question 79 that a violation of Part V of the Agreement on Agriculture, and the resulting loss of peace clause exemption, must also be assessed on a yearly basis.

48. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made? BRA, USA

Brazil's Answer:

76. The answer to the first question is yes, the text of Article 13(b)(ii) requires a comparison between the "support granted" for marketing years between 1995-2003 with the "support decided" in marketing year 1992. Brazil has explained in detail in its First Oral Statement the basis for this legal conclusion.[84]

77. The second question asks how the comparison must be made. Brazil is of the view that a harmonious interpretation of "support decided" with "support granted" requires an examination of the expenditures incurred for all of the support related to the 1992 marketing year and each of the marketing years during the implementation period ending 1 January 2004. This expenditure approach permits an objective, easily verifiable approach to compare the support for each of the two time permitgg asa ybywo tiUnisa yent t poilows Tj -211.5 -775 TD -0.1309 Tc 0.33373 Tw0(per) saj Tive, easiach of e

Brazil's Answer:

79. Brazil set forth its interpretation of the terms "grant" and "decided" in its First Oral Statement.[86] Brazil concluded that the text, context, and object and purpose of Article 13(b)(ii) meant that the MY 1992 "decision" must be related to "support granted" in order to make possible the comparison between MY 1992 and marketing years during the implementation period. Yet, Brazil does not believe that the "decision" in marketing year 1992 means that all of the support had to be "granted" (i.e., paid) during the 12-month period of that single marketing year. Rather, the decision had to authorize payment in respect of a specific marketing year, including MY 1992.[87] However, a Member could have decided during the 1992 marketing year to budget a certain amount of support to specific commodities for the next several marketing years, including MY 1995 et seq. In that case, the relevant peace clause comparison would involve comparing the support granted to a specific commodity in any marketing year during the implementation period to what was decided during the 1992 marketing year to be provided for that later marketing year.

80. Brazil has cited the negotiating history of Article 13(b)(ii), which indicates that the EC insisted on the use of the word "decided" to obtain a safe harbour for the total quantity of its domestic support subsidies that it had already budgeted in marketing year 1992 for marketing year 1995 and thereafter.[88] Brazil will comment further, as required, on the intentions of the "drafters" following receipt of the answers of the European Communities and the United States.

50. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) and, in particular, why both words "grant" and "decided" were used. USA

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shortcomings of other approaches, on which Brazil will comment below. In particular only an expenditure incurred approach allows for an effective comparison in the following situation: Assume, a Member introduces a payment that is made at a fixed rate per pound and is paid for each pound of actual upland cotton production. In this situation, it would be difficult to compare this domestic support measure, which is completely unrelated to market prices to a domestic support measure decided by a Member in MY 1992 and which sets a target price and provides price support.

83. With this qualification in mind, Brazil's understanding of this question is that the assumed single "decision" was the establishment of a target price of 72.9 cents per pound for eligible US upland cotton production during MY 1992. The assumed single "decision" on a target price of 72.9 cents per pound comprised of many other sub-decisions on the mandatory acreage reduction programme, on the operation of the 50/92-programme option, and on optional flex acres, among others.[89] Professor Sumner has analyzed in detail the process through which such a target price of support could be compared to the support provided in MY 1999-2002.[90] For MY 1992, he found that the estimated per unit support rates for all programs was 60.41 cents per pound. For MY 2001, he found the per unit support rates for all programmes was 66.51 cents per pound. Brazil refers to Professor Sumner's detailed description of the methodology he used to make these calculations.[91]

84. The irrationality of the simplistic "72.9 is greater than 51.92" approach by the United States is revealed by comparing it with the results of Professor Sumner taking into account in the calculation of the "rate of support" eligibility criteria and the costs imposed by participation in the US upland cotton support programs. It is also demonstrated by comparing the expenditures in MY 1992 ($1.9 billion) with the expenditures in MY 2001 ($4 billion).

54. Please identify all United States legal and regulatory and administrative instruments decided during the marketing year 1992, with the respective dates of decision, that decided support for upland cotton. BRA, USA

Brazil's Answer:

85. Brazil will comment further upon receipt of the answer provided by the United States to this question. The United States obviously has access to records related to all the decisions taken by the United States concerning its support programs for MY 1992. However, Brazil notes that given its understanding of the operation of the US support programmes, the United States took a number of decisions with respect to the upland cotton support programmes for MY 1992.

86. Many of the US support programmes for MY 1992 were decided by Title V of the Food, Agriculture, Conservation and Trade (FACT) Act of 1990 (P.L. 101-624), which established US farm policy for the 5 crop years 1991/92-1995/96, and by the Omnibus Budget Reconciliation Act (OBRA) of 1990 (P.L. 101-508), which established several programme provisions in order to reduce programme costs. Brazil considers that among the decisions taken by the United States in relation to MY 1992 upland cotton support programmes were the following:

- Continuation of the upland cotton target price under the deficiency payment programme at the 1990 level of 72.9 cents per pound set by the 1990 FACT Act. The OBRA limited the maximum payment acreage at 85 percent of the crop acreage minus the acreage reduction programme requirement, which was set annually. Therefore, the United States had to take a decision with respect to the MY 1992 percentage of deficiency programme

[89] For a more thorough discussion of the decisions Brazil understands the United States has taken with respect to MY 1992, *see* Brazil's answer to Question 54.

[90] *See* Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel).

[91] Annex 2 to Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel).

base acreage that would be required to be set aside under the acreage reduction programme.

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- In connection with the former, the United States also took a decision allowing producers to plant up to 25 percent of upland cotton acreage base, the so-called "flex acreage," to any commodity except fruits and vegetables and mung beans.

- Furthermore, the United States had to decide on how to implement the 50/92-programme option under the deficiency payment program.

- The United States also needed to determine the upland cotton acreage base for purposes of the deficiency payment programme, which for MY 1992 represents the previous three-year average of planted and considered planted upland cotton acreage.

- Concerning the deficiency payment program, the United States finally had to decide on the payment rate for upland cotton.

- Concerning the marketing loan programme, the United States had to take a decision setting the marketing loan rate for upland cotton.

- Furthermore, the United States had to establish a weekly "adjusted world price" and, thus, the repayment rate for marketing loans determining the rate of marketing loan gains or loan deficiency payments.

- Furthermore, the United States took a weekly decision in MY 1992 with respect to the Step 2 payment rate applicable for that week.

- Regarding crop insurance, the Federal Crop Insurance Act of 1980 was the authorizing legislation, but it was necessary to adopt decisions concerning individual insurance

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world price for the eligible share of production.[95] The higher the market price, the higher the resulting budgetary outlays.

93. Additionally, there is one further important reason why the notion of support in Article 13(b)(ii) should include the market price. Without reference to the market price, it is impossible to say what the rate of support means to farmers. It may be that the support is completely irrelevant, because market prices are much higher than the loan rate or the target prices set by the US Government. For instance, the loan rate was irrelevant for US upland cotton producers in MY 1994-1996,[96] because market prices were so high that no payments occurred. However, under essentially the same program, market loan benefits amounted to 26.6 cents per pound in MY 2001.[97] Thus, without taking market prices into account, it is impossible to translate a "rate of support" into actual support provided and to give meaning to the term "support."

60. Can you provide information on support decided in 1992 and the years with which you believe it should be compared, on a per support programme / per unit of production / per annum basis? If possible, please specify how, if at all, budget outlays may be transposed into units of production, and which units of production are best to use. BRA, USA

Brazil's Answer:

94. Brazil maintains that the appropriate measure of support decided during MY 1992 is total actual expenditures resulting from any decisions regarding support to upland cotton. This must then be compared to total actual expenditures for support to upland cotton for MY 1999, 2000, 2001 and 2002. Presenting expenditures as a "rate of support" per pound of upland cotton disguises the fact that US expenditures for upland cotton have increased considerably since MY 1992. This is due to the fact that the increased US expenditures are now spread over an also increased US production. Therefore, a "rate of support" based on budgetary outlays or expenditure understates the real increase in US support to upland cotton. However, even disregarding the underestimation of the amount spent for upland cotton by presenting the budgetary outlays in the form of support per pound of actual upland cotton production, the data presented below show that also this measurement demonstrates that the US support in MY 1999-2002 is higher in each year than it was in MY 1992.

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seeking to remain in business must calculate whether the amount of government support plus market revenue compensates for the cost of production incurred by producing a pound of upland cotton.

97. Brazil arrives at the figures presented in the following table by dividing the total annual amount of budgetary outlays to upland cotton from a US support programme by the total amount of production of upland cotton in the relevant marketing year.

Support Per Pound Of Upland Cotton By Year And Support Programme

Year	1992	1999	2000	2001	2002
Programme	----- cents/pound -----				
Deficiency Payments[1]	13.49	none	none	none	none
PFC Payments[2]	none	7.00	6.71	4.81	none
Market Loss Assistance Payments[3]	none	6.97	7.15	6.65	none
Direct Payments[4]	none	none	none	none	6.04
Counter-cyclical Payments[5]	none	none	none	none	12.43
Marketing loan (Loan gains and LDP)[6]					

[4] Direct payments per pound actually produced = total direct payment expenditure for upland cotton base * (actual upland cotton acreage/direct payment upland cotton base acreage) / (total production [bales] * 480 [pounds/per bale]). Total direct payments for MY 2002 have been re-estimated from the figure presented by Brazil in its First Submission, para. 59. The new figure is based on the statutory payment rate of 6.67 cents per pound of upland cotton base multiplied by the direct payment upland cotton base acreage of 16.3 million acres (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)) multiplied by the direct payment yield of 604 pounds per acre (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). Payments are made on 85 percent of base acres. This translates into a total of $558.17 million. This amount has been adjusted by the ratio of upland cotton acres actually planted Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4) to upland cotton base acres in the direct payment program. Because the latter figure is higher than the former, this leads to a reduction in the direct payment rate. This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton. Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

[5] Counter-cyclical payments per pound actually produced = total counter-cyclical payment expenditure for upland cotton base * (actual upland cotton acreage / counter-cyclical payment upland cotton base acreage) / (total production [bales] * 480 [pounds/per bale]). Total counter-cyclical payments for MY 2002 have been re-estimated from the figure presented by Brazil in its First Submission, para. 69. The new figure is based on the MY 2002 payment rate of 13.73 cents per pound of upland cotton base multiplied by the counter-cyclical payment upland cotton base acreage of 16.3 million acres (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)) multiplied by the counter-cyclical payment yield of 604 pounds per acre (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50) Brazil notes that this underestimates the payments, as it disregards the yield update for purposes of the counter-cyclical payments). Payments are made on 85 percent of base acres. This translates into a total of $1,148.98 million. This amount has been adjusted by the ratio of upland cotton acres actually planted Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4) to upland cotton base acres in the counter-cyclical payment programme. Because the latter figure is higher than the former, this leads to a reduction in the direct payment rate. This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton. Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

[6] Marketing loan benefit per pound of actual production = total marketing loan expenditures / (total production [bales] * 480 [pounds/per bale]). Total marketing loan payments (marketing loan gains plus loan deficiency payments) are taken para. 144, 148-149 of the First Submission of Brazil. Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

[7] Step 2 payments per pound of actual production = total Step 2 expenditures/(total production [bales] * 480 [pounds/per bale]). Total Step 2 payments are contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). Brazil has estimated the MY 2002 amount at note 335 in its First Submission to be $317 million. The amount of production has been taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4). Brazil notes that the difference between 3.95 cents per pound resulting from this calculation and 4 cents per pound – which was the basis for Brazil to calculate the total Step 2 payment for MY 2002 – is due to rounding effects.

[8] Crop insurance payments per pound of actual production = total crop insurance expenditures / (total production [bales] * 480 [pounds/per bale]). Total crop insurance payments are taken from Exhibit Bra-57 ("Crop Year Statistics", Federal Crop Insurance Corporation). Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[9] Cottonseed payment per pound of actual upland cotton production = total cottonseed expenditures/(total production [bales] * 480 [pounds/per bale]). Total cottonseed payments are listed in Brazil's answer to question 17 (see para. 9). Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

98. Brazil notes that also under this approach, the total US support to upland cotton in MY 1999-2002 surpasses the support decided by the United States in MY 1992. Brazil furthermore notes that even considering the support programs (and their respective replacements)[99] individually, nearly all of them provide higher support in MY 1999-2002 than they (or their predecessors) did in MY 1992 (with the exception of Step 2 and PFC.75lTc 1 Tw ( ) Tj 22.5Td0 TBsal llist Tot Tj -1 th1D /F0 1131c 0 Tw (-) Tj -354.7

total budget outlay, according to Brazil, increased more than that. What, in Brazil's view, is the reason for this difference in the rate of increase? BRA

Brazil's Answer:

99. US budgetary outlays for upland cotton are a function of the level of price, income and other support provided by the US support programmes. Everything being equal, an increase in the "rate of support" as interpreted by the United States would translate one-to-one into an increase of expenditure. However, the "rate of support" is not the only determinant of budgetary outlays, as two important qualifications apply. First, the most important US subsidy programmes for upland cotton are price-based.[100] For instance the marketing loan payment in MY 2002 guarantees a return of 52 cents per pound. With lower market prices, the gap between the adjusted world price and the loan rate, i.e., the basis for the calculation of the marketing loan benefit, widens and payments per pound increase. During the period MY 1992-2001, prices for upland cotton fell drastically.[101] For example, average upland cotton prices received by farmers in the United States were 53.7 cents per pound in MY 1992 and dropped to a low of 29.8 cents per pound in MY 2001.[102] Therefore, even for an identical set of programs providing an identical "rate of support," budgetary outlays would have vastly increased due to the drop in prices.

100. Second, the United States increased the production of upland cotton between MY 1992 and MY 1999-2002 from 15.7 million bales in MY 1992 to 16.3 million bales in MY 1999, 16.8 million bales in MY 2000, 19.6 million bales in MY 2001 and 16.7 million bales in MY 2002.[103] Thus, the increased "rate of support" was applicable to an increased production of upland cotton.

101. In sum, budgetary outlays for upland cotton increased between MY 1992 and MY 2002 for three main reasons: first, the United States increased its "rate of support", second, lower upland cotton prices led to higher budgetary outlays per pound of upland cotton produced; and third, at times of falling market prices, the United States expanded its upland cotton production so that more upland cotton was eligible to receive the increased rate of support. All of this resulted in an increase of budgetary outlays for upland cotton that is relatively bigger than the increase in the US "rate of support".

102. Lastly, Brazil notes that none of the figures presented by Professor Sumner[104] represent actual payments or actual rates of support. Rather, those figures represent average or expected rates of support in any given marketing year. They are not based on actual production or prices,[105] but solely on expected production and prices. Therefore, they cannot easily be compared to actual payments made by the United States in support of upland cotton. Professor Sumner chose the expected support approach in order to match the approach suggested by the United States as closely as possible, while correcting for its simplistic reliance on the target price that disregarded the eligibility criteria and other features of the programmes.

63. In relation to Prof. Sumner's presentation at the first session of the first substantive meeting, please elaborate on the reasons behind the increase in the figures (from 1992 to 2002) concerning Loan Support and Step 2 payments. BRA

Brazil's Answer:

103. The support rate from the marketing loan programme calculated by Professor Sumner represents the expected support rate from the marketing loan programme. Concerning the marketing loan programme, Brazil notes that the statutory loan rate, indeed, fell from 52.35 cents per pound in MY 1992 to 51.92 cents per pound in MY 1999-2001[106] before being slightly increased in MY 2002 to 52 cents per pound.[107] However, the somewhat higher loan rate in MY 1992 was accompanied by strict eligibility criteria.[108] In MY 1992, only production on farmland that participated in the upland cotton deficiency payment programme was eligible for marketing loan benefits, which restricted eligibility to 84.7 percent of production.[109] In MY 1999-2001, only upland cotton produced on farmland that participated in the PFC programme was eligible. Professor Sumner has conservatively used 97 percent of upland cotton production in MY 1999-2001 as the participation rate of upland cotton.[110] Finally, in MY 2002, all US production of upland cotton was eligible to receive marketing loan benefits.[111] Thus, taking into account the eligibility criteria for benefiting from the marketing loan programme, the slightly higher loan rate in MY 1992 provided less support to total expected US upland cotton production than the slightly lower loan rates in later years.

104. Concerning the difference between the expected Step 2 rate of support in MY 1992-2001 and MY 2002, this difference stems from the fact that the United States eliminated the 1.25 cents per pound threshold for Step 2 payments in the 2002 FSRI Act. Before MY 2002, Step 2 payments were made in the amount of the difference between the A-Index and the lowest priced US quote for upland cotton minus a 1.25 cents per pound threshold. Section 1207(a)(4)23.25 -1r has 012 Tc 0.3769 eTc 0.3769 eTc 0.3

106. For some of the US support programs, the support indicated can be considered – within certain limits – as support available per pound. However, there is not a complete identity between the "expected rate of support" and the "support available to a pound of actual upland cotton production," because – as noted above – expected and actual production will vary from each other.

107. For marketing loan benefits, the loan rate can be considered the maximum support available to eligible production in case the market price would fall to zero. Similarly, for deficiency and counter-cyclical payments, the difference between the loan rate and the target pric e can be considered the maximum support available, albeit again only for the eligible production. The expected support differs from that, as it takes into account that not all of the expected production will benefit from those subsidies. The actual support differs again, as expected and actual production may not be identical. Finally, actual US Government payments depend on market prices.

108. For PFC, market loss assistance, direct and cottonseed payments and crop insurance subsidies, the "expected rates of support" represent expected expenditures per unit of expected production. This has been calculated by using average budget expenditures over an appropriate period as expected support, and by using average production as the expected production. Thus, these payments are not maximum available "rates of support". For example, under the crop insurance programme the US Government pays premium subsidies. Higher per unit support would have been available had all farms5 -1ts deies,a79 1212.5 -1c 0.322id Tj 16.5 0 756D 0.008798

period as e normly,der the crop inpremium so5 Tw (4) Tj -116.25 -12.75 544 -0.140 T82c 1.02increiondain oMY T

<u>Brazil's Answer:</u>

113. Brazil does not believe that an adjustment for inflation is relevant in the context of the comparison under Article 13(b)(ii). First, there is nothing in the text of Article 13(b)(ii) that provides for such an adjustment. Second, the only provision of the Agreement on Agriculture addressing inflation is Article 18.4, which provides: "In the review process Members should give due consideration to the influence of excessive rates of inflation on the ability of any Member to abide by its domestic support commitments." The "review process" is the review by the Committee on Agriculture of the progress of implementation of commitments as set out in Article 18 of the Agreement on Agriculture. The fact that negotiators explicitly opened the possibility of "giving due consideration to the influence of excessive rates of inflation" in the review process, but not for purposes of Article 13(b)(ii), is evidence that this omission was intentional.

114. Furthermore, at no time during the review process has the United States ever stated or made any notifications that "excessive rates of inflation" in the US economy have negatively impacted "the ability of [the United States] to abide by its domestic support commitments". Even, if it had, Article 18.4 has no relevance for the purposes of the comparison required by Article 13(b)(ii), as it refers to the review process only, and not to the peace clause. Accordingly, there is no basis for the Panel to apply any adjustment to the US level of support to upland cotton in marketing year 1992.

115. Nevertheless, if the Panel should decide to use such an adjustment, Brazil submits that the appropriate index to be used is the applicable US agricultural price index. Three alternative indexes could be used. The first and most direct is the index of prices received for cotton. Other indexes that may be considered are the index of prices received for crops and the index of prices received for all farm products.

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Brazil's Answer:

117. Brazil has presented figures for budgetary outlays by unit of actual production in its answer to Question 60. However, Brazil would like to add some further considerations on the shortcomings of this approach.

118. A significant issue in using these per unit figures to represent support rather than total budgetary outlays is that a per-unit approach discounts the fact that some of the change in production is itself caused by changes in the rate of support or subsidy. If support is calculated by dividing budgetary outlays by total production, the result neglects this effect. As support rises in the numerator, production rises in the denominator and the ratio or per unit of an increased support rate rises by less than total support (and may even decline).

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restrictions and costs of participation. Brazil refers the Panel to Annex 2 to Exhibit Bra-105 for the details of Professor Sumner's methodology.

125. In addition to eligibility, the Panel's question refers specifically to payment limits. Payment limits are applied on the basis of persons, including corporations, partnerships, producers and other persons actively engaged in agriculture.[115] Typically, for larger farms, there is more than one person

possible approach to account for the increase in production – would increase the "expected rate of support" for later marketing years, as the amount of US production of upland cotton increased.[126] The result of the comparison of MY 1992 and MY 1999-2002 support will, however, be the same: The United States' support to upland cotton in MY 1999-2002 exceeded the support to upland cotton decided in MY 1992 and the US domestic support measures fail to meet the condition in Article 13(b)(ii) for exemption from actions under Articles 5 and 6 of the SCM Agreement and GATT Article XVI:1.

(d) Per unit rate of support for upland cotton (Prof. Sumner's approach at the first session of the first substantive meeting). USA

(67) The Panel requests the parties to calculate and submit estimates of the AMS for upland cotton for marketing years 1992, 1999, 2000, 2001 and 2002. For this purpose the parties are each requested to submit AMS calculations for upland cotton (using the budgetary-outlay/non-price gap methodology employed by the United States in respect of cotton in its DS Notifications (e.g., G/AG/N/USA/43) and using the formats and supporting tables in document G/AG/2) on the same basis as would be the case in calculating a product specific AMS for the purposes of the calculation of the "Total Current AMS" in any year in accordance with the relevant provisions, including as appropriate Article 1(a), (b) and (h), Article 6 and Annex 3 to the Agreement. BRA, USA

Brazil's Answer:

129. Brazil sets forth the following table that summarizes the AMS calculation for upland cotton for marketing years 1992 and 1999-2002. Using the definition of non-product specific support detailed in Brazil's answer to the Panel's Question 40, all of the programmes listed constitute non-exempt direct payments, within the meaning of G/AG/2, providing product-specific support to upland cotton. The table includes all support programs that should have been included in "Supporting Table DS:6", within the meaning of G/AG/2. To the best of Brazil's knowledge, no other "product-specific" support to upland cotton has been provided by the US Government.

130. Brazil notes that the United States has notified the deficiency payments using the price gap

AMS For Upland Cotton By Year And Support Programme

Year	1992	1999	2000	2001	2002
Programme	----- $ million -----				
Deficiency Payments[1]	812.1	none	none	none	none
PFC Payments[2]	none	547.8	541.3	453	none
Market Loss Assistance Payments[3]	none	545.1	576.2	625.7	none
Direct Payments[4]	none	none	none	none	485.1
Counter-cyclical Payments[5]	none	none	none	none	998.6
Marketing loan (Loan gains and LDP)[6]	743.8	1,545	542	2,506	952
Step 2 Payment[7]	206.7	421.6	236.1	196.3	317
Crop Insurance[8]	26.6	169.6	161.7	262.9	194.1
Cottonseed Payment[9]	none	79	184.7	none	50
Total	**1,789.2**	**3,308.1**	**2,242.0**	**4,043.9**	**2,996.8**

Notes

[1] This calculation is based on the price gap formula set forth in para. 10 and 11 of AoA Annex 3. In its notification of marketing year 1995 support (Exhibit Bra-150 (G/AG/N/USA/10, p. 18), the United States that the applied administered price for upland cotton under the deficiency payment programme is $1,607.169 per ton. The applied administered price (or target price) has been the same in MY 1992 and MY 1995 (Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 5). Therefore, Brazil uses that figure. The external reference price has been notified by the United States to be $1,275.741 per ton. Paragraph 11 of AoA Annex 3 specifies that the external reference price is based on 1986-1988 averages that have not changed between MY 1992 and MY 1995. Thus, Brazil bases the price-related direct payments from the deficiency payment programme in MY 1992 on the difference between $1,607.169 per ton and $1,275.741 per ton ($331.428 per ton) multiplied by the eligible production, which results from multiplying the eligible upland cotton base acreage and the payment yield. Professor Sumner has calculated the eligible upland cotton base acreage for MY 1992 to be 10.17 million acres, while the payment yield is 531 pounds per acres (Exhibit Bra-105 (Annex 2 to Statement of Professor Daniel Sumner at the First Meeting of the Panel, p. 5-6). Thus, the eligible production is 5,400,270,000 pounds or 2,450,213 metric tons (2204 pounds equal one metric ton). Thus, the amount of deficiency payments in that enters the calculation of total AMS for MY 1992 is 2,450,213 metric tons * $331.428 per ton = $812.069 million.

[2] PFC payment expenditure for upland cotton = total PFC payment expenditure for upland cotton base * (actual upland cotton acreage / PFC upland cotton base acreage). Total PFC payment expenditure for upland cotton is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). This amount has been adjusted by the ratio of upland cotton acres actually planted (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4)) to upland cotton base acres in the PFC programme (Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). This adjustment is necessary because only the portion of upland cotton PFC payments that actually benefits acres planted to upland cotton can be considered support to upland cotton.

[3] Market loss assistance expenditure for upland cotton = total market loss assistance expenditure for upland cotton base * (actual upland cotton acreage / market loss assistance (i.e., PFC) upland cotton base acreage). Total market loss assistance expenditures for upland cotton is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). This amount has been adjusted by the ratio of upland cotton acres actually planted (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4)) to upland cotton base acres in the market loss assistance (i.e., PFC) programme (Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton.

[4] Direct payments = total direct payment expenditure for upland cotton base * (actual upland cotton acreage / direct payment upland cotton base acreage). Total direct payments for MY 2002 have been re-estimated from the figure presented by Brazil in its First Submission, para. 59. The new figure is based on the statutory payment rate of 6.67 cents per pound of upland

cotton base multiplied by the direct payment upland cotton base acreage of 16.3 million acres (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-

negotiations who are third parties in this dispute and who in fact use export credits – Canada, the European Communities and New Zealand – agree with Brazil.

71. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement? Why or why not? Does it confer a benefit within the meaning of Article 1.1(b)? Why or why not? If so, to whom? USA

Brazil's Comment:

139. In paragraphs 287-289 of its First Submission, and again at paragraph 116 of its Statement at the First Panel Meeting, Brazil demonstrated that CCC export credit guarantees are expressly included as "financial contributions" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. Although export credit guarantees do not automatically confer benefits, CCC export credit guarantees confer "benefits" within the meaning of Article 1.1(b) because they are extended at premium rates and on repayment terms that are not available and in fact do not exist on the market. In its comments and answers to Questions 75 and 82 below, Brazil discusses passages from the GSM 102, GSM 103 and SCGP regulations and materials from USDA's Foreign Agricultural Service (FAS) concerning the programmes, which demonstrate that GSM 102, GSM 103 and SCGP confer "benefits".

140. Brazil notes that a number of agents benefit from the subsidy provided by the guarantees. The US financial institutions and the foreign bank enter into lucrative contracts they would not otherwise have, the importer also gets financing that would not otherwise have be available in the market, but the US Government ultimately designed the programs to provide a benefit to US farmers and exporters. On the FAS website "What Every Exporter Should Know About The GSM-102 and GSM-

142. Articles 1.1(a)(1)(i) and 1.1(b) of the SCM Agreement are relevant for a number of reasons, including for the purposes of Article 10.3 of the Agreement on Agriculture. As demonstrated in paragraphs 263-268 of Brazil's First Submission, the United States has surpassed its export quantity commitment levels for commodities eligible for GSM 102, GSM 103 and SCGP support. Under Article 10.3, the burden now lies with the United States to prove that its exports in excess of these commitments did not benefit from export subsidies, including export credit guarantees. United States will, inter alia, have to prove that those programs do not grant "benefits" within the meaning of Article 1.1(b) of the SCM Agreement.[133]

72. Could Brazil expand on why, as indicated in paragraph 118 of its oral statement, it does "not agree" with the United States arguments relating to the viability of an a contrario

[35] ". . . provided, however, that prior-stage cumulative indirect taxes may be exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products sold for domestic consumption, if the prior stage cumulative indirect taxes are levied on inputs that are consumed in the production of the exported product . . . ." (emphasis added).
[36] ". . . provided, however, that in particular cases a firm may use a quantity of home market inputs equal to, and having the same quality and characteristics as, the imported inputs as a substitute for them . . . ."
[37] In any event, such measures may well fall within the scope of footnote 1, and thus not represent

148. In contrast, the evidence required to meet the elements of item (j) are completely unrelated to the evidence necessary to establish that a guarantee programme confers a benefit "to the recipient" of a loan guarantee. Whether the premia collected under an export credit guarantee programme meet the long-term operating costs and losses of the programme is completely irrelevant to the question whether a benefit "to the recipient" of the export credit guarantee is conferred. Consequently, allowing an a contrario reading of item (j) that provides, as the United States argues, "a dispositive legal standard"[143] for determining whether guarantees are prohibited, would suggest that the "to the recipient" market benchmark standard does not apply to guarantees. This cannot be true, since guarantees are expressly included in Article 1.1 (and Article 14(c)) as "financial contributions" that can confer "benefits" to a recipient relative to a market benchmark.

149. The conclusion that item (j) does not admit of an a contrario defense is relevant for a number of reasons, including for the purposes of Article 10.3 of the Agreement on Agriculture. As demonstrated in paragraphs 263-268 of Brazil's First Submission, the United States has surpassed its export quantity commitment levels for commodities eligible for GSM 102, GSM 103 and SCGP support. Under Article 10.3, the burden now lies with the United States to prove that its exports in excess of these commitments did not benefit from export subsidies, including export credit guarantees. Even if the United States is able to demonstrate that premia for the GSM 102, GSM 103 and SCGP programs meet long-term operating costs and losses, it will also have to prove that those programs do not grant "benefits" within the meaning of Article 1.1(b) of the SCM Agreement. Since item (j) does not admit of an a contrario interpretation, disproving the elements of item (j) will not be sufficient to remove the programs from the definition of "export subsidy."

73. The Panel could arguably take the view that Articles 1 and 3 of the SCM Agreement were relevant in assessing the WTO-consistency of United States export credit guarantees. The United States has yet to submit any evidence or argumentation on this point, either as potential context for interpretation of the terms in Article 10 of the Agreement on Agriculture or in relation to Brazil's claims under the SCM Agreement. The Panel would therefore appreciate United States views in respect of this situation, and invites the United States to submit relevant argumentation and evidence. USA

74. If the Panel decides to refer to provisions of the SCM Agreement for contextual guidance in the interpretation of the terms in Article 10 of the Agreement on Agriculture, should the Panel refer to item (j) or Articles 1 and 3 of the SCM Agreement or both? BRA, USA

Brazil's Answer:

150. In determining what constitutes an export subsidy within the meaning of Article 10.1 of the Agreement on Agriculture, Brazil considers that the Panel should refer to contextual guidance included in Articles 1 and 3 of the SCM Agreement, and in item (j) of the Illustrative List of Export Subsidies annexed to the SCM Agreement. As discussed in paragraphs 258-261 of Brazil's First Submission, this is consistent with the Appellate Body's decisions in US – FSC[144] and Canada – Dairy.[145] As a factual matter, Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes constitute export subsidies under Articles 1.1 and 3.1(a) of the SCM Agreement, and under item (j) of the Illustrative List (as well as under Articles 1(e) and 10.1 of the Agreement on Agriculture.

75. The Panel's attention has been drawn to Article 14(c) of the SCM Agreement (see e.g. written third party submission of Canada) and to the panel report in DS 222 Canada- Export

Agreement, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would be the appropriate market benchmark to use for any comparison? Please cite any other relevant material. BRA, USA

Brazil's Answer:

151. As one way of demonstrating that the GSM 102, GSM 103 and SCGP programs constitute export subsidies within the meaning of Article 10.1 of the Agreement on Agriculture, Brazil has demonstrated that those programmes constitute financial contributions that confer benefits and that are contingent on export, within the meaning of Articles 1.1 and 3.1(a) of the SCM Agreement. Brazil recalls that as discussed above in response to Question 72, Article 10.3 of the Agreement on Agriculture in fact places the burden on the United States to prove that export quantities in excess of its export commitments have not benefited from export subsidies.

152. In any event, Brazil has demonstrated that the CCC guarantee programs confer "benefits" within the meaning of Article 1.1(b) because they are extended at premium rates and on repayment terms that are not available on the market. In fact, the CCC programmes are unique financing vehicles for agricultural commodity transactions that are not available on the commercial market.

153. Brazil notes that the United States has argued in Canada – Aircraft II that where there is no comparable financial product on the market, a programme confers benefits per se. It stated:

> 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 in the market. A government entity "operating on commercial principles" is still a government entity. It is not the commercial market.[146]

154. Brazil agrees with the United States. This interpretation is, in fact, consistent with the benchmark established by Article 14(c) of the SCM Agreement. In relevant part, Article 14 provides as follows:

> For the purposes of Part V, any method used by the investigating authority to calculate the benefit to the recipient … shall be transparent and adequately explained. Furthermore, any such method shall be consistent with the following guidelines:
>
> …
>
> > (c) 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.

155. Brazil first draws the Panel's attention to the fact that Article 14 was specifically conceived for the purposes of Part V of the SCM Agreement only. It should be referred to exclusively as context to determine whether a benefit exists when a particular transaction is backed by a government export credit guarantee. Secondly, Brazil observes that subparagraph (c) of Article 14 is simply a

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[146] Panel Report, *Canada – Aircraft II*, WT/DS222/R, Annex C-2 (para. 7).

item (j). The Panel will recall that Brazil's initial formula, which was included in paragraph 281 and Figure 20 of its First Submission, can be stated as follows:

Premiums collected – (Administrative expenses + Default claims + Interest expenses)

159. Where this formula yields a negative number over a period constituting the "long term", Brazil argued that loan guarantees are provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the programme", within the meaning of item (j).[152] Applying this formula to data for the period 1994-2003, Brazil demonstrated that premiums collected for the CCC guarantee programmes were indeed inadequate to cover operating costs and losses for the programmes.

160. To correct for alleged errors in Brazil's initial constructed formula, which was included in paragraph 281 and Figure 20 of its First Submission, the United States adopted its own alternative formula, in paragraph 173 of its First Submission, which can be stated as follows:

(Fees + Claims recovered + Claims rescheduled) – Claims paid

161. Where this formula yields a positive number over a period constituting the "long term," the United States asserts that loan guarantees are provided at premium rates that are adequate to cover the long-term operating costs and losses of the program, within the meaning of item (j).

162. Brazil made several criticisms of the US formula. In paragraph 123 of its Statement at the First Panel Meeting, Brazil demonstrated that the failure to account for interest paid by the CCC to the Treasury Department leads to artificially low accounting of operating costs. In paragraph 122, Brazil additionally demonstrated that it is incorrect to treat rescheduled debt as a recovery of a default claim. Brazil notes that rescheduling can in fact have the effect of increasing the costs incurred by the government, rather than reducing those costs. In its budget documents, the US Government treats Paris Club rescheduling of imminent defaults as "work-outs."[153] According to the US Office of Management and Budget ("OMB"), work-outs can either have a negative or a positive effect on cash flow.[154] The U. General Accounting Office ("GAO") has in fact stated that historically, the majority of GSM support that is rescheduled is "in arrears."[155] If any -0. -0, 0 TD1o,Eragr.rectgsis Clubp+2s.03d.unegi09 0 T

163. The United States' formula did correct for one shortcoming of Brazil's initial constructed formula, however. The United States is correct that Brazil's formula did not include recoveries.[156] Brazil therefore introduces a revised constructed formula that accounts for recoveries and interest on those recoveries, as recorded in the "Principal collections" and "Interest collections" rows[157] of the US budget. It also accounts for the interest accruing to the CCC on balances maintained in its so-called "financing account" for the purposes of potential claims,[158] as recorded in the "Interest on uninvested funds" row of the US budget documents.[159] Brazil's revised constructed formula can be stated as follows (including references to the specific budget lines involved):

(Premiums collected + Recovered principal and interest (Line 88.40) + Interest revenue (Line 88.25)) – (Administrative expenses (Line 00.09) + Default claims (Line 00.01) + Interest expense (Line 00.02))

164. Brazil emphasizes that it does <u>not</u> intend for this revised constructed formula to <u>replace</u> the formula used by the US government itself to track the costs of the CCC guarantee programs, pursuant to the US Federal Credit Reform Act ("FCRA"). In paragraphs 124-133 of its Statement at the First Panel Meeting, Brazil discussed the FCRA cost formula in considerable detail. The chart included at paragraph 132 of Brazil's Statement demonstrates that under the FCRA cost formula, CCC's export credit guarantee programs are offered at premium rates that are inadequate to cover their long-term operating costs and losses. Brazil believes that the FCRA cost formula is one very useful way to determine the performance of the CCC guarantee programs relative to the elements of item (j). However, if the Panel would like to confirm the results of the FCRA cost formula, or refer to an alternative formula, Brazil offers its revised constructed formula for these purposes.

165. Where Brazil's revised constructed formula indicates a net cost over a period constituting the "long term", export credit guarantees are provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the programme", within the meaning of item (j). The following chart demonstrates that during the ten-year period FY 1993-2002, premiums for GSM 102, GSM 103 and SCGP export credit guarantees have been inadequate to cover long-term operating costs and losses. Net costs for the programmes during this period total more than $1 billion as set forth below:

Fiscal year	Premiums collected (88.40) + Recovered principal and interest (88.40) + Interest revenue (88.25)	Admin. expenses (00.09) + Default claims (00.01) + Interest expense (00.02)

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1995	$18,000,000 + $62,000,000 + $0[168] = $80,000,000	$3,000,000 + $551,000,000 + $10,000,000[169] = $564,000,000
1996	$20,000,000 + $68,000,000 + $26,000,000[170] = $114,000,000	$3,000,000[171] + $202,000,000[172] + $61,000,000[173] = $266,000,000
1997	$14,000,000 + $104,000,000 + $26,000,000[174] = $144,000,000	$4,000,000[175] + $11,000,000[176] + $62,000,000[177] = $77,000,000
1998	$17,000,000 + $81,000,000 + $54,000,000[178] = $152,000,000	$4,000,000[179] + $72,000,000[180] + $62,000,000[181] = $138,000,000
1999	$14,000,000 + $58,000,000 + $0[182] = $72,000,000	$4,000,000[183] + $244,000,000 + $62,000,000[184] = $310,000,000
2000	$16,000,000 + $100,000,000 + $99,000,000[185] = $215,000,000	$4,000,000[186] + $208,000,000[187] + $62,000,000[188] = $274,000,000
2001	$18,000,000 + $149,000,000 + $125,000,000[189] = $292,000,000	$4,000,000[190] + $52,000,000[191] + $104,000,000[192] = $160,000,000
2002	$21,000,000 + $155,000,000 + $61,000,000[193] = $237,000,000	$4,000,000[194] + $40,000,000[195] + $93,000,000[196] = $137,000,000
Total	$1,841,920,000	$2,925,064,000
Long-term Net Cost	**$1,083,144,000**	

166. To arrive at this result, Brazil notes that it did not rely on "estimates" of the programmes' costs.[197] The annual US budget documents upon which Brazil relied track CCC data for three consecutive years – the prior year, the current year and the budget year. The 2004 budget, for example, which is completed in 2003, includes data for 2002, 2003 and 2004. Budget year data is

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[167] Exhibit Bra-95 (US budget for FY 1996, p. 162).
[168] Exhibit Bra-94 (US budget for FY 1997, p. 176).
[169] Exhibit Bra-94 (US budget for FY 1997, p. 175).
[170] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[171] Exhibit Bra-93 (US budget for FY 1998, p. 174).
[172] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[173] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[174] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[175] Exhibit Bra-92 (US budget for FY 1999, p. 105).
[176] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[177] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[178] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[179] Exhibit Bra-91 (US budget for FY 2000, p. 111).
[180] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[181] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[182] Exhibit Bra-90 (US budget for FY 2001, p. 112).
[183] Exhibit Bra-90 (US budget for FY 2001, p. 110).
[184] Exhibit Bra-90 (US budget for FY 2001, p. 111).
[185] Exhibit Bra-89 (US budget for FY 2002, p. 118).
[186] Exhibit Bra-89 (US budget for FY 2002, p. 116).

indeed

premium rate to all guarantees – is $358.54 million.[203] The total amount of received applications for GSM 102 export credit guarantees for the period 1999-2002 was $11.77 billion, resulting in a theoretical additional maximum premium of $78.08 million for that period.[204] Thus, the highest amount of premiums the United States could have generated under this programme from its inception through 2002 would amount to $436.62 million.[205] This does not come close to covering the programme's losses from the Iraqi and Polish defaults alone.

- Third, CCC financial statements for fiscal year 2002 report that uncollectible amounts on post-1991 CCC guarantees total $770 million.[206] As noted in the chart above at paragraph 165, CCC collected premiums of $222.641 million for GSM 102, GSM 103 and SCGP during the period 1992-2002.[207] Thus, even without accounting for other operating costs, or for receivables that CCC hopes to collect but may not, losses for the CCC export credit guarantee programmes outpace premiums during the period 1992-2002 by nearly $550 million.

- Fourth, CCC's 2002 financials also report uncollectible amounts on pre-1992 CCC guarantees of $2.567 billion.[208] While actual data concerning premiums during the period 1981-1991 (from the first year GSM 102 was available until the last year before credit reform was introduced with the Federal Credit Reform Act) is not publicly available, Brazil has applied a proxy based on the average annual fees collected during the period 1992-2002 ($20.24 million). Multiplying $20.24 million by the 11 years included in the 1981-1991 period results in total fees of $222.64 million. Thus, even without accounting for other operating costs, or for receivables that CCC hopes to collect but does not, losses for the CCC export credit guarantee programs outpace premiums during the period 1981-1991 by more than $2.3 billion.

- Finally, the US General Accounting Office ("GAO") estimated in 1992 that if GSM 102 and GSM 103 continued until 2007, costs for the programs would reach $7.6 billion.[209] Premium fees

[203] *See* Exhibit Bra-73 ("Summary of Export Credit Guarantee Programme Activity", USDA, covering GSM 102, GSM 103 and SCGP for US fiscal years 1999-2003) for the total amounts of allocations. These have been multiplied by 0.663 percent to obtain the theoretical maximum premium.

[204] Exhibit Bra-73 ("Summary of Export Credit Guarantee Programme Activity", USDA, covering GSM 102, GSM 103 and SCGP for US fiscal years 1999-2003).

[205] This amount is a substantial overstatement, as premiums for periods of coverage shorter than 3 years will yield substantially lower premiums of as low as 15.3 cents per $100 as compared to 66.3 cents for a 3-year coverage. Exhibit Bra-98 ("Guarantee Fee Rate Schedule Under GSM 102 and GSM 103").

[206] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 14). This figure theoretically includes not only uncollectible amounts for the GSM 102, GSM 103 and SCGP programs, but also uncollectible amounts for CCC's Facility Guarantee Programme ("FGP"). Brazil has not challenged the FGP in this dispute. Brazil notes, however, that in fiscal years 1999-2003 (for which programme activity data is available on CCC's website, at http://www.fas.usda.gov/excredits/Monthly/ecg.html), exporter applications were only received for a total of $4.8 million in coverage under the FGP. Thus, defaults on FGP guarantees, if any, would contribute only negligibly to the $770 million figure discussed above.

[207] The chart in paragraph 165 does not include premiums for 1992. Those premiums totalled $36.14 million. *See* Exhibit Bra-125 (US budget for FY 1994, p. 383). According to US budget documents, premiums for the FGP are included in the budget line item for fees on the GSM and SCGP programs.

[208] Exhibit Bra - that in f 0 TD /F0 9.75 Tf -0.07ine item for fees on the GSM and SCGP programs.

[208] Exhibit Bra

for the period 1992-2007 (assuming current rates) would only reach $323.84,[210] demonstrating that fees for the programme do not meet costs.

In sum, CCC financials state that during the period 1981-2002, costs and losses for CCC export credit guarantee programmes exceeded premiums collected.

78. Can the United States provide supporting documentation for data used relating to "costs and losses" in paragraph 173? Could the United States confirm that the figures cited in paragraph 173 of its first written submission relate to the SCGP? Why did the United States cite these figures after stating th

171. For scheduled agricultural products, the Panel needs to determine whether the export subsidies for a particular scheduled agricultural product are in excess of the export subsidy reduction commitment levels for that agricultural product in the year in question, or whether the application of the export subsidies threatens to lead to circumvention of the export subsidy reduction commitments. More specifically, in this dispute, the Panel needs to assess whether the CCC export credit guarantee programmes threaten to circumvent the export subsidy reduction commitments of the United States for scheduled agricultural products.

80. In Brazil's view, why did the drafters of the Agreement on Agriculture not include export credit guarantees in Article 9.1? BRA

Brazil's Answer:

172. The negotiating history of the Agreement on Agriculture does not reveal why the drafters did not include export credits guarantees in Article 9.1, just as it does not reveal why the drafters did not include well-known and widely-used export subsidies like the United States' FSC regime in Article 9.1. Yet, the Appellate Body concluded that the FSC regime constitutes an export subsidy and is subject to the general export subsidy disciplines in the Agreement on Agriculture, including Article 10.1 thereto. As Brazil has previously noted, Article 1(e) defines export subsidies as "including" those listed in Article 9.1 of the Agreement on Agriculture, and Article 10.1 refers to a universe of export subsidies "not listed in" Article 9.1. As the Appellate Body's report in US – FSC illustrates, if a measure meets the definition of "export subsidy", it is subject to Article 10.1, even though it is not included in Article 9.1.

173. Under the Vienna Convention rules, Articles 9.1 and 10.1, as well as Article 10.2 of the Agreement on Agriculture, are to be interpreted according to their ordinary meaning, in their context, and according to the object and purpose of the Agreement on Agriculture. Brazil has demonstrated that the CCC export credit guarantee programs fulfill the definition of "export subsidy" in the Agreement on Agriculture and the SCM Agreement, and that export credit guarantees are not, under a

<u>Brazil's Comment on Question 81(g):</u>

174. Brazil may wish to comment in its rebuttal submission on the response the United States ultimately provides to this and the other sub-parts of question 81. In the meantime, however, Brazil would like to comment on the distinction between actual and estimated costs and losses.

175. As noted above in comments on Question 77, Brazil has used data from the prior year column of the US budget. This column is titled "actual," since it reflects reconciled data for a full fiscal year. Data reported in the prior year column of the "guaranteed loan subsidy" row of the US budget is "actual" in this sense. Brazil explained in paragraph 127 of its Statement at the First Panel Meeting that the FCRA calls for the CCC to make annual "reestimates" to the cost calculation and thus to the "guaranteed loan

financial statement, makes adjustments for defaults, fees and reestimates undertaken in fiscal year 2002 with respect to all post-1991 guarantees, and results in a new subsidy figure of $411 million for those post-1991 guarantees.[220] This positive net present value means that CCC has "los[t] money" during the period 1992-2002.[221]

178. While Brazil has demonstrated that the reestimation process applied to the FCRA formula does in fact track actual data and does in fact account for actual performance of CCC export credit guarantees, Brazil notes that a certain degree of estimated data would be perfectly acceptable in an analysis of the costs and losses of guarantee programs under item (j). The purpose of the FCRA and its cost formula was, after all, "to measure more accurately the costs of Federal credit programmes," including contingent liabilities like export credit guarantees.[222] As the United States evidently agrees, accounting for the costs of contingent liabilities like guarantees on a cash basis is not appropriate, since it masks the real costs of those guarantees. Even if the FCRA cost formula does entail the use of some estimated data, the US Congress and the President consider that that formula is the most accurate way of tracking costs.

179. Brazil notes, finally, that it is not entirely accurate to call the data used to arrive at initial estimates of the "guaranteed loan subsidy" figure "estimated" data. The US Federal Accounting Standards Advisory Board, the Government-Wide Audited Financial Statements Task Force on Credit Reform, the Office of Management and Budget and the Department of Agriculture itself have emphasized that "[m]ethods of estimating future cash flows for existing credit programs need to take account of past experience,"[223] that "[a]ctual historical experience of the performance of a risk category is a primary factor upon which an estimation of default cost is based",[224] and that the technical assumptions underlying subsidy calculations reflect "historical cash reports and loan performance".[225] This demonstrates that "estimates" of the subsidy cost of CCC guarantees are informed by actual historical experience with borrowers.

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82. Please explain each of the following statements and any possible significance it may have in respect of Brazil's claims about GSM-102 and GSM-103 (7 CFR 1493.10(a)(2), Exhibit BRA-38): BRA, USA

<u>Brazil’s Answer:</u>

181. As discussed below, these passages corroborate evidence provided by Brazil to demonstrate that the CCC guarantee programmes constitute export subsidies within the meaning of Articles 1.1 and 3.1(a) of the SCM Agriculture, and thus within the meaning of Articles 1(e), 10.1 and 8 of the Agreement on Agriculture.

> **(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

<u>Brazil’s Answer:</u>

182. The passage cited by the Panel provides corroborating evidence that CCC guarantees provide “benefits”, within the meaning of Article 1.1(b) of the SCM Agreement. Specifically, the passage states that the CCC programmes “operate in cases . . . where US financial institutions would be unwilling to provide financing without CCC’s guarantee”. This demonstrates at least two things. First, it establishes that the CCC guarantee programs are used in situations where, without a CCC guarantee, a borrower could not secure financing at all – not just financing on less attractive terms [illegible]

changed the fee for a 12-month guarantee with semi-annual repayment intervals from $0.209 per $100 of coverage to $0.229 per $100 of coverage. Second, it decided to offer borrowers the additional option of 30- and 60-day guarantees, at the same fee charged for 90-day and 4-, 6- and 7-month guarantees.

85. Is the Panel correct in understanding that, under the SCGP, the exporter pays a fee for the guarantee calculated on the guaranteed portion of the value of the export sales? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? Please explain any "risk" assessment involved in the programme. USA

Brazil's Comment:

194. The Panel is correct in stating that fees for SCGP guarantees vary only according to the dollar value of the transaction and the length of the guarantee. SCGP fees do not otherwise vary and are charged according to a fee schedule that does not account for the country risk involved or the credit rating of the borrower. For SCGP guarantees of up to 90 days, the fee is $0.45 per $100 of coverage, and for SCGP guarantees from 90-180 days, the fee is $0.90 per $100 of coverage.[237] Brazil attaches news releases from the US Department of Agriculture's Foreign Agricultural Service announcing SCGP guarantees to Tunisia, Azerbaijan, Vietnam, South Korea, Japan and Nigeria.[238] The Panel will

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194.85. Is the Panel46ll

The "international undertaking on official export credits" cited in this provision is the Organization for Economic Co-operation and Development's Arrangement on Guidelines for Officially Supported Export Credits ("OECD Arrangement").[242]

201. To determine whether a particular Canadian measure could benefit from the safe haven in the

Brazil's Comment:

202. Brazil includes a new version of the current "Upland Cotton Domestic User/Exporter Agreement" (Revision 7, in effect as of 1 August 2003 and issued on 17 June 2003), which replaces Revision 6 that Brazil has included as Exhibit Bra-65 to its First Submission.

93. Please elaborate why the United States deems that Step 2 payments upon submission of proof of export are not subsidies contingent upon export. Is it the US contention that, in order to be contingent on export, exportation must be the exclusive condition for receipt of the payment? USA

94. Is the Panel correct in understanding that Brazil alleges an inconsistency with Article 3.1(b) of the SCM Agreement only with respect to Step 2 domestic payments? BRA

Brazil's Answer:

203. Yes.

95. Do the criteria in 7 CFR 1427.103(c)(2) (Exhibit BRA-37) that Step 2 "eligible upland cotton" must be "not imported cotton" apply to both domestic and export payments? USA

96. Is a domestic sale a "use" for the purposes of Step 2 payments? Is a sale for export, or export, considered a "use"? USA

97. How does the United States respond to Brazil's assertion, at paragraph 70 of Brazil's oral statement at the first session of the first substantive meeting, that "It is obvious that a single bale of cotton cannot be both exported and used domestically." Is this a relevant consideration? USA

98. How many Step 2 payments are received if a bale of upland cotton is exported, and then opened by a domestic user in the United States, or vice versa? USA

99. How does the United States respond to Brazil's arguments in paragraphs 71-75 of Brazil's oral statement at the first session of the first Panel meeting concerning the relevance of the Appellate Body Report in US-FSC (21.5). USA

100. How does Brazil respond to the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale,

Brazil's Answer:

204. The applicable regulations (7 CFR 1427.104)[246] define eligible domestic users and exporters of upland cotton.[247] To receive a Step 2 export payment, a person (including a cotton producer or a cooperative) must be "regularly engaged in selling eligible [US] upland cotton for export".[248] To receive a domestic payment, a person must be "regularly engaged in the business of opening bales of eligible [US] upland cotton to manufacture US upland cotton into cotton products in the United States".[249] The only actor who can be indifferent whether they export or use cotton domestically is a hypothetical domestic US cotton product manufacturer regularly engaged in opening US bales for domestic US manufacture that also regularly engages in exporting US cotton. In that situation, if a bale of cotton is opened by mistake instead of being exported, the exporter who is also the US cotton product manufacturer will receive a Step 2 domestic payment for that bale if the company has already entered into a contract with CCC for Step 2 payments, and subject to proof that bale is in fact used for manufacturing cotton products in the United States. But even if that hypothetical situation were to occur, then the payment would be contingent upon the domestic use of only US upland cotton (prohibited by Article 3.1(b) of the SCM Agreement). And if the bale were exported, the US exporter would receive the Step 2 payments subject to proof of export of US (not foreign) upland cotton (prohibited by Article 3.1(a) of the SCM Agreement).

205. It follows that the "two distinct factual situations" resulting in the payment of Step 2 subsidies are (1) the domestic "use" of eligible US upland cotton by a manufacturer of cotton products regularly engaged in opening bales; and (2) the "export" of eligible US cotton by exporters regularly engaged in selling US upland cotton. The United States argues that this case is distinguishable from US – FSC (21.5) because in that case one situation involved property produced within the United States and held

207. Concerning other relevant dispute settlement reports, Brazil believes that the *Canada – Aircraft* decisio

other relevant measures or provisions which you consider should guide the Panel in respect of this issue. USA

110. Section 1207(a) of the 2002 FSRI Act provides that during the period beginning on the

Annex 3, paragraph 7, because there are two types of domestic subsidies – those that comply with Article 3.1(b) of the SCM Agreement and those that do not." Paragraph 85 of Brazil's First Oral

commodity violates Article 3.1(b) of the SCM Agreement. That is simply not correct. Yet, without this assumption, there is no inherent conflict between the SCM Agreement and the Agreement on Agriculture. The absence of any conflict coupled with the absence of any explicit exemption for local content subsidies in Article 13(b) or anywhere else in the Agreement on Agriculture supports the conclusion that local content subsidies related to agricultural goods violate Article 3.1(b) of the SCM Agreement.

117. What is the relationship between Step 2 payments to exporters and the marketing loan payments, both of which appear to compensate for the price differences relative to the Liverpool A-Index? For example, is there double compensation? Or is one of the explanations that these export-related price compensatory payments are paid to different operators (namely, the producer, on the one hand under the marketing loan arrangements, and the processor/users (Step 2 programme) arrangements on the other? USA

118. Can the United States confirm that it does not rely on Article III:8 of GATT 1994? USA

G. ETI ACT

119. How does the United States respond to Brazil's reference to the panel report in India - Patents (EC) (at paragraph 138 of its oral statement at the first session of the first substantive meeting)?[262] How, if at all, should the Panel take this report into account in considering the issues raised by Brazil's claims relating to the ETI Act? USA

120. Concerning its claims on the ETI Act, Brazil relies on the US – FSC case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the United States appear to invoke Article 6 of the Agreement on Agriculture. If the Panel's understanding is correct, how, if at all, are these differences relevant here? Could you direct the Panel to any relevant findings or conclusions by the panel or Appellate Body in that case? BRA

with Part V of the Agreement on Agriculture. Therefore, the United States does not enjoy peace clause exemption under Article 13(c) of the Agreement on Agriculture.

121. How do you respond to the reference in paragraph 43 of EC third party oral statement with respect to the relevance of Article 17.14 of the DSU, and, in particular, the phrase "a final resolution to that dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the DSU, and please cite any other provisions you consider relevant. USA, BRA

Brazil's Answer:

219. Brazil is of the view that DSU Article 17.14 requires that following the adoption of an Appellate Body report, the parties to the dispute, i.e., the defending and complaining Member, are unconditionally bound by the results of that report. This interpretation is consistent with the Appellate Body decisions in US – Shrimps (21.5)[263] and EC – Bed Linen (21.5),[264] both confirming that panel and Appellate Body reports adopted by the Dispute Settlement Body must be considered final resolutions to a dispute between the parties to that dispute. There is no precedent in the WTO or GATT that would require the Panel to find that the United States alone is bound in this case. It is difficult to imagine, however, how the United States could take a different position in defending against Brazil's ETI claims in this case, in light of the adoption by the DSB of the Appellate Body and panel reports in US – FSC (21.5), and the recommendation by the DSB that the United States bring the ETI Act into conformity with the Agreement on Agriculture and the SCM Agreement.

220. In this case, Brazil challenges exactly the same measure as that found by the panel and the Appellate Body in US – FSC (21.5) to violate the Agreement on Agriculture and the SCM Agreement. There have been no changes to the ETI Act since the adoption of the panel and Appellate Body reports by the WTO Dispute Settlement Body.[265] Brazil challenges the ETI Act with exactly the same rationale as the EC. Thus, there is a complete identity between the "measure" and the "claims" in this case and the US – FSC (21.5) dispute (noting that upland cotton is a sub-set of all the products covered by the ETI Act). Under these circumstances, it is appropriate for the Panel to make similar findings of fact, conclusions of law, and recommendations as the panel and Appellate Body in US – FSC (21.5).[266]

221. Brazil does not consider any of the other provisions cited by the Panel to be relevant to this particular question. Should the Panel wish Brazil to elaborate on any of provisions more specifically, Brazil will be pleased to do so.

[263] Appellate Body Report, *US – Shrimps (21.5)*, para. 97.

[264] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 90-96.

[265] The United States has indicated in its First Submission (para. 189) that both branches of Congress are considering legislative proposals that would repeal the ETI Act. However, Brazil notes that it has been over 18 months since 29 January 2002, the date on which the panel and Appellate Body reports on the ETI Act were adopted by the DSB.

[266] First Oral Statement of Brazil, paras. 138-39.

ANNEX I-2

ANSWERS OF THE UNITED STATES TO THE QUESTIONS FROM THE PANEL TO THE PARTIES FOLLOWING THE FIRST SESSION OF THE FIRST SUBSTANTIVE PANEL MEETING

(11 August 2003)

UPLAND COTTON

1. Please confirm that all information and data that you have provided to the Panel relating to "cotton" in fact relates to upland cotton only. BRA, USA

1. The United States can confirm that, with the exception of export credit guarantees, all of the information and data we have provided to-date relates to upland cotton only. With respect to export credit guarantees, the Commodity Credit Corporation does not maintain data to distinguish transactions involving different types of cotton (for example, upland cotton versus extra-long staple (ELS) cotton). However, the United States has no reason to believe that types of cotton other than upland cotton constitute a material percentage of such transactions.

PRELIMINARY ISSUES

Product scope of Panel's terms of reference relating to Brazil's export credit guarantee claims

3. If the request for consultations in this dispute omitted certain products in relation to export credit guarantees, on what basis is it argued that it failed to identify the measures at issue in accordance with Article 4.4 of the DSU? USA

2. The only export credit guarantee measures identified in the Brazilian consultation request were those in respect of upland cotton. The request for consultations did not identify export credit guarantee measures for any other agricultural commodities.

3. The request for consultations identified the measures subject to consultations in a single sentence:[1]

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

Another sentence followed this one, setting out (in a page and a half) a listing of measures that were included within the identification in the first sentence.

4. Apart from the footnote, the first two lines of the sentence quoted in the previous paragraph address "subsidies provided to US producers, users and/or exporters of upland cotton"; thus, apart

[1] WT/DS267/1, at 1.

from the footnote, it is clear that subsidies provided to US producers of, say, soybeans are not included within the scope of the request. Equally, apart from the footnote, it is clear that subsidies provided to, say, banks that finance US cotton exports (but do not produce, use or export cotton) are not included within the scope of the request. To give an example from another part of the request, Brazil's consultation request identified "[e]xport subsidies provided to exporters of US upland cotton under the FSC Repeal and Extraterritorial Income Exclusion Act of 2000" as a challenged measure. Having identified that measure at issue for purposes of DSU Article 4.4 as subsidies provided to upland cotton exporters under that legislation, Brazil could not then have included in its panel request such subsidies provided to exporters of all agricultural commodities or all industrial goods.

5. Brazil, however, contends that "[t]he footnote clarifies that Brazil's request with respect to export credit guarantees is *not* limited to upland cotton."[2] Brazil's contention is incorrect. The footnote does nothing more than direct the reader of the consultation request to look "below" for an explanation. The footnote by itself does not contain any "identification of [a] measure at issue" as required by DSU Article 4.4, and therefore cannot itself bring any additional measures within the scope of the consultation request. Any such additional measures would have to be found -- if anywhere – in an explanation "below."

6. However, as described in the first US submission, no such explanation or identification of additional measures ever appears. In fact, though Brazil devoted several paragraphs to this issue in its oral statement, it has never pointed to any explanation of any kind -- or any other identification of additional measures – "below."

7. In addition, the statement of evidence attached to Brazil's consultation request did not include any evidence related to measures other than those for upland cotton. For Brazil to now argue that its consultation request was broader than its statement of evidence is for Brazil to admit that its consultation request was in breach of Article 7.2 of the Subsidies Agreement. Brazil cannot have it both ways.[3]

8. In summary, while Brazil's consultation request did identify measures at issue for purposes of DSU Article 4.4, the measures it actually identified did not include export credit guarantees for agricultural commodities other than cotton. Thus, the latter measures were not within the scope of consultations, were not consulted upon, and could not have been included in Brazil's panel request.

4. Is it argued that the export credit guarantee programmes concerning upland cotton are each a separate or independent measure, in that they operate independently? USA

9. The CCC export credit guarantee programme (GSM-102), the CCC intermediate export credit guarantee programme (GSM-103), and the Supplier Credit Guarantee Programme (SCGP) each constitute separate programmes. The distinct operation of the programmes themselves is manifested in both the terms of the particular programmes as well as in the nature of the obligation guaranteed. The GSM-102 and GSM-103 programmes guarantee obligations of banks. SCGP extends exclusively to obligations of importers. Obligations guaranteed under the GSM-102 programme may not extend beyond three years. SCGP guarantees a far lower percentage of principal (65 per cent).

10. Within each programme, allocations are made by country, by commodity, and by amount.[4] Thus, discrete programming decisions are made in connection with each such country, commodity,

[2] Brazil's Opening Oral Statement, para. 90.

[3] In light of the Panel's intended finding on the scope of Brazil's consultation request with respect to export credit guarantees, the United States will be making a request for a preliminary ruling on this point.

[4] *See* 7 C.F.R. §§ 1493.4, 1493.5 (setting forth allocation criteria). These criteria also apply to SCGP. 7 C.F.R. § 1493.400.

programme, and amounts (in terms of a guarantee value).[5] As a result, for the last 10 fiscal years, for example, as described in the First Written Submission of the United States, no cotton transactions occurred under the GSM-103 programme.

11. Furthermore, each export credit guarantee issued is a separate measure. Under DSU Article 4.4, it is incumbent upon Brazil to identify in its consultation request "the measures at issue." Here, Brazil identified the measure as "export credit guarantees . . . to facilitate the export of US upland cotton," and the United States may, and did, rely on that consultation request (including the attached statement of evidence) for notice.

5. Is there a specification in any legislation or regulation (or any other official government document) which limit or restrict the export credit guarantee programmes at issue exclusively to upland cotton? USA

12. Programme a

specific basis confirms that alleged export subsidy measures can be defined on a product-specific basis – and that is exactly what Brazil did here.

16. In contrast, for those specific commodities for which such Member does not have a reduction commitment, then such Member may not provide export subsidies at all in connection with such specific commodities. As a result, the same programme that, as applied, may be entirely in conformity with that Member's reduction commitment vis-à-vis one commodity may be a prohibited subsidy with respect to another commodity.

8.

States is also commodity specific. Conformity with WTO obligations and the application of Article 13(c)(ii) to export credit guarantees with respect to those twelve commodities could only be evaluated by an examination of *each* commodity subject to reduction commitments.

Expired measures

14. Please submit evidence regarding the programmes under the 1996 FAIR Act, in particular, production flexibility contract payments and market loss assistance payments, to the extent that they would be relevant to the Panel's determination under Article 13 of the Agreement on Agriculture in your answers to questions and rebuttal submission. USA

31. The United States will present evidence and arguments regarding payments under the 1996 Act as may be relevant to the Panel's Peace Clause analysis with respect to those measures.

15. Do the parties agree that it is beyond a Panel's power to recommend a remedy for an expired measure? Could the Panel could be required to examine "expired measures" in order to conduct its assessment of the matter before it? How, if at all, is Article 7.8 of the SCM Agreement relevant to these matters? BRA, USA

32. The United States agrees that it is beyond a panel's power to recommend that a Member bring into conformity a measure that no longer exists.[10] However, more fundamentally, the issue is whether the expired measures in this dispute could have been measures affecting the operation of any covered agreement within the meaning of DSU Article 4.2 or "measures at issue" within the meaning of DSU Article 6.2. Because the production flexibility contract payments and market loss assistance payments were completed, the programmes terminated, and the statutory instruments providing them superseded before Brazil's consultation and/or panel requests were filed, they could not have been "measures at issue," and they could not properly have been consulted upon or brought within the terms of reference of the Panel. This is a broader concern than whether the Panel may recommend a remedy since findings cannot be made with respect to such expired measures.

33. To determine whether past subsidies may currently be challenged, it is useful to distinguish between recurring and non-recurring subsidies. A non-recurring subsidy is a measure that continues in existence for the duration of the allocation of the subsidy to production.[11] For example, a subsidy to acquire capital stock to be used in future production would be non-recurring and allocated over the useful life of the stock. Where a subsidy is non-recurring and is allocated to future production[12], the

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superseded, there would no longer be any measure in existence to challenge. Accordingly, a Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures suggested that recurring subsidies – such as grants for purposes other than the purchase of fixed assets and price support payments – should be expensed, or attributed to a single year, rather than allocated over some multi-year period.[13]

35. In the case of production flexibility contract payments and market loss assistance payments, these measures were subsidies allocated to a particular crop or fiscal year by the respective authorizing legislation. Pursuant to the 1996 Act, the last production flexibility contract payment was made for fiscal year 2002 (1 October 2001 – 30 September 2002) "not later than" 30 September 2002.[14] Pursuant to legislation enacted on 13 August 2001, the last market loss assistance payment was for the 2001 marketing year (1 August 2001 – 31 July 2002), that is, for market conditions prevailing in that year.[15] Once the relevant fiscal year and marketing year, respectively, had been completed, these measures would no longer exist. Thus, by the time of Brazil's consultation and/or panel requests, there were no measures to consult upon nor to be at issue under the DSU; production flexibility contracts and market loss assistance payments therefore do not fall within the Panel's terms of reference.

Agricultural Assistance Act of 2003

16. What, if any, prejudice in terms of the presentation of its case does the United States allege, should the Panel proceed to consider the measures constituting the cottonseed payments under the Agricultural Assistance Act of 2003? USA

36. It has been a fundamental characteristic of both the GATT 1947 and the WTO dispute settlement systems that proposed measures may not be the subject of dispute settlement. This has meant that dispute settlement proceedings, including consultations, could not begin until the measure at issue actually came into existence. In seeking to bring into the scope of this dispute the Agricultural Assistance Act of 2003, Brazil is seeking to fundamentally expand and change the nature of WTO dispute settlement. This issue goes well beyond the question of whether a particular responding party is prejudiced in a particular dispute and cannot be resolved on the basis of whether such prejudice has occurred. The reasons that the United States would be prejudiced if the Panel considered any measure under the Agricultural Assistance Act of 2003, including a cottonseed payment under that Act, are the reasons that the dispute settlement system has been organized to only allow proceedings on actual, not proposed, measures. First, the responding party would have lost the benefit of consultations on these measures. Consultations serve a number of important functions, including helping the parties to understand each others' concerns and aiding in efforts to resolve the dispute. The DSU affirms the importance of consultations and *requires* that a Member cannot proceed to a panel unless the Member has consulted on that measure. Likewise, the DSU requires that the "measures at issue" be identified in the panel request, and non-existent measures quite simply are not measures at all.

37. Apart from reflecting the importance Members have placed on consultations, the DSU's requirement that a measure exist before it can be the subject of dispute settlement proceedings avoids a waste of resources since anticipated measures may never come into effect, or may, when enacted, be in substantially changed form. Further, allowing challenges to measures not yet in existence would

[13] G/SCM/W/415, paras. 1-12; *id.*, Recommendation 1, at 26-27.

[14] Federal Agriculture Improvement and Reform Act of 1996, § 112(d)(1), Public Law No. 104-127 (4 April 1996); 7 US Code § 7212(d)(1).

[15] Public Law No. 107-25, § 1(a) (23 Aug. 2001) ("The Secretary of Agriculture ... shall, to the maximum extent practicable, use $4,622,240,000 of funds of the Commodity Credit Corporation to make a market loss assistance payment to owners and producers on a farm that are eligible for a final payment for fiscal year 2001 under a production flexibility contract for the farm under the Agriculture Market Transition Act.").

effectively authorize panels to issue advisory opinions. Should Members desire to expand the scope of the dispute settlement system in this manner, they may do so – indeed could only do so – through amendment of the DSU. The DSU now requires the existence of a measure before consultations may be requested or a panel established.

38. Finally, were the issue of the specific prejudice to the United States relevant in deciding whether a panel's terms of reference could include a measure not in existence at the time of consultations or the panel request, the United States notes that this dispute is already complex, with multiple measures at issue involving multiple claims. To require the United States to address Brazil's allegations on the Agricultural Assistance Act of 2003 would detract from the time and resources available to respond to questions and make arguments relating to those measures that *are* properly within the terms of reference.

17. (a) What is the relationship of the Agricultural Assistance Act of 2003 to other legislation in the request for establishment of the Panel? BRA, USA

(b) Do the legal instruments follow directly one after another, or are there temporal gaps? Are payments authorized under a broad legislative authority or are they specific to each legal instrument? BRA, USA

(c) Please provide any implementing regulations. Do these implementing regulations resemble those relating to previous programmes or payments? Are payments made retrospectively? How if at all is this relevant? BRA, USA

breaches a tariff binding, another Member will need to resort to dispute settlement in order to resolve the issue. This does not mean that it is not possible to fully obligate the Member to observe its tariff bindings. The similar situation arises with respect to procedural obligations as well.

45. When responding Members have been confronted by situations in which they considered that complaining parties did not meet requirements for invoking dispute settlement procedures, those responding Members can voice their objections at consultations and the DSB meetings at which panel establishment has been considered, but then must accept that the issue will ultimately be decided by the panel. For example, notwithstanding that the DSU requires consultations on a measure before a panel may be established, there is no mechanism available to address a complaining party's failure to consult absent resolution by a panel.

46. Responding Members have allowed jurisdictional issues to go to the panel for resolution as a practical way forward that offers sufficient protection for their interests while also protecting the integrity of the dispute settlement system. This does not mean that responding Members in any way lost their rights, for example, to consult on the measures at issue before being subject to panel proceedings; it has simply been practical to allow the issue to be decided by panels.

47. Likewise, in this dispute, the fact that Brazil has attempted improperly to invoke dispute settlement procedures notwithstanding the Peace Clause – and the fact that the United States has accepted that the issue should be resolved by the Panel – does not and cannot diminish the right of the United States to be exempt from Brazil's action. The fact that Members may disregard their obligations, or act based on a misunderstanding of the facts or obligations, does not affect those obligations. In this case, Brazil considers that the Peace Clause is inapplicable. As our argumentation to date indicates, we disagree and consider that, based on a correct reading of the law and facts, the Peace Clause is applicable, and Brazil was obliged not to bring this dispute. Upon making a finding on this issue in our favour, the Panel would effectively be concluding that Brazil's invocation of dispute settlement was improper – even if undertaken in good faith – just as panels have in the past concluded that complaining parties have improperly included measures that were not consulted upon in their panel requests or claims that were not within the panel's terms of reference in their argumentation.

21. In US - FSC and US -71ttlement 8n.

precisely."[21] "Fixed" means "stationary or unchanging in relative position."[22] Thus, as used in paragraph 6(a), a "defined and fixed base period" means a base period that is "set out precisely" and "stationary or unchanging in relative position." That is, the "definite" base period must not be "changing in relative position"; for example, the "base period" for purposes of determining "base acres" for the deficiency payments under the 1990 Act was a farm's average acreage over the three most recent years[23], and so, was not a "fixed" base period but a moving one. On the other hand, US direct payments satisfy this criterion because eligibility is determined by historical production of any of a number of crops (including upland cotton) in a base period that is "definite" (set out in the 2002 Act) and "stationary or unchanging in a relative position" (does not change in relative position for the duration of the 2002 Act).

23. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. BRA, USA

50. Paragraph 6(a) establishes that eligibility for payments under a decoupled income support measure shall be determined by clearly-defined criteria in "*a* defined and fixed base period." That is, paragraph 6(a) does not mandate that any particular base period be used for a decoupled income support measure and does not mandate that the same base period be used for all decoupled income support measures. This contrasts with the use of the phrase "*the* base period" in paragraph 9 of Annex 3, which is defined in that same paragraph as "the years 1986 to 1988."[24]

51. Paragraphs 6(b), (c), and (d) use the term "*the* base period." As these subparagraphs all follow paragraph 6(a), in which eligibility is set in "a" defined and fixed base period, the later references to "the base period" should be read to refer to the base period used for eligibility under paragraph 6(a). Again, because paragraph 6(a) does not mandate that any particular base period be used (as opposed to paragraph 9 of Annex 3), "the base period" for paragraphs 6(b), (c), and (d) will be the "defined and fixed base period" used for purposes of eligibility under the decoupled income support measure. The definite article "the" is commonly used to refer back to a member of a indefinite set identified by the indefinite article "a." For example, it would be common grammatically to say: "A Member may take action if the Member makes the appropriate notification to the WTO."

24. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the Agreement on Agriculture? BRA, USA

52. Paragraph 6 establishes policy-specific criteria applying to a decoupled income support measure. Under paragraph 6(a), eligibility for payments under such a measure shall be determined by criteria "in a defined and fixed base period." Other policy-specific criteria under paragraph 6 establish that the amount of payments under a decoupled income support measure shall not be related to or based on the type or volume of production, the prices, or the factors of production employed in any year after the base period used for purposes of determining eligibility under paragraph 6(a).

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[21] *The New Shorter Oxford English Dictionary*, vol. 1, at 618 (1993 ed.).

[22] *The New Shorter Oxford English Dictionary*, vol. 1, at 962 (1993 ed.).

[23] *See* US First Written Submission, para. 101 n. 92.

[24] Agriculture Agreement, Annex 3, paragraph 9 ("The fixed external reference price *shall be based on the years 1986 to 1988* and shall generally be the average f.o.b. unit value for the basic agricultural product concerned in a net exporting country and the average c.i.f. unit value for the basic agricultural product concerned in a net importing country *in the base period*.") (emphasis added). *See also id.*, Annex 3, paragraph 5 ("The AMS calculated as outlined below for *the* base period shall constitute the base level for the implementation of the reduction commitment on domestic support.") (emphasis added). Appellate Body Report, *Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef* , WT/DS161/AB/R - WT/DS169/AB/R, adopted 10 January 2001, paras. 115-16.

Thus, with respect to a decoupled income support measure, the base period used must be "defined and fixed."

53. There is no requirement in paragraph 6 that a *particular* base period be used for a decoupled income support measure nor that the *same* base period be used for purposes of every decoupled income support measure. Thus, so long as the base period for a particular measure is "defined and fixed," this element of the policy-specific criteria in paragraph 6 will be met.

54. For purposes of this dispute, the base period for US direct payments under the 2002 Act is defined by the 2002 Act and fixed for the duration of the 2002 Act – that is, for marketing years 2002-2007. Thus, one "defined and fixed base period" applies for payments under the US direct payment programme for the six-year period to which the 2002 Act applies.

25. Does the United States consider that there is any ambiguity in the term "type of

because there is *no requirement* that a recipient produce upland cotton or any other crop in order to receive these payments. Direct payments are made with respect to farm acreage that was devoted to agricultural production in the past. In its rebuttal submission, the United States will describe production flexibility contr

66. As set out in the US answer to Question 29 from the Panel, the United States does not view the first sentence of paragraph 1 as merely setting out a general principle; according to its term, it establishes a "fundamental requirement" for green box measures under Annex 2. However, Annex 2 also indicates that measures that conform to the basic criteria of the second sentence plus the applicable policy-specific criteria of paragraphs 6 through 13 comply with that fundamental requirement. Thus, the first sentence of paragraph 1 provides important context for the interpretation of other provisions of Annex 2.

67. US direct payments satisfy the criteria set out in Annex 2 and therefore comply with the fundamental requirement of the first sentence of paragraph 1. As explained in the US answer to Question 30, US direct payments satisfy the two basic criteria under the second sentence of paragraph 1. In addition, as set out in the US first written submission,[33] direct payments satisfy the five policy-specific criteria set out in paragraph 6 of Annex 2 for decoupled income support.

68.

matter whether the measure were enacted annually. If there were a finding of a breach of the Peace Clause, then the complainin

examination of the support those measures were granting as of the time such measures were in existence. Were the Peace Clause breached in any particular year, a Member could bring an action against such measure (subsidy), but only for the year of the breach. For example, where subsidies were provided on a yearly basis, a Member could breach the Peace Clause in one year in which the support such measures grant is in excess of that decided during the 1992 marketing year but could be in conformity in the following year if support were again within the 1992 marketing year level. Only the subsidies for the year in which the Peace Clause were breached would not be exempt from actions.

76. Finally, we note that payments under the 2002 Act are recurring subsidies, expensed in the crop year to which they apply and superseded by new payments in the following crop year.[40] (So too were past payments under the expired 1996 Act.) Thus, whether such measures conform fully to Article 6 and do not grant support in excess of that decided during the 1992 marketing year – that is, whether such measures are exempt from action under Article 13(b) – must be judged on a year-by-year basis. A breach of the Peace Clause in any particular year would allow a Member to bring an action against such measures, but only for the year of the breach.

36. Does a failure by a Member to comply with Article 13(b) in respect of a specific commodity impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? BRA, USA

77. No. For example, were the Panel to find a breach of the Peace Clause because the product-specific support US measures grant for upland cotton is in excess of that decided during the 1992 marketing year, this would not remove Peace Clause protection for support for soybeans (or any other commodity). In any subsequent action, a complaining Member would have to demonstrate that the challenged measures breach the Peace Clause with respect to that commodity and support.

37. In the United States' view, why did the drafters not use the exact term "product-specific" in Article 13(b)(ii)? USA

78. It is not possible to determine exactly why the drafters of Article 13(b)(ii) did not use the term "product-specific support" in place of "support to a specific commodity." Nonetheless, the phrase "support to a specific commodity" must be interpreted according to its ordinary meaning, in context, and in light of the object and purpose of the Agreement. As the United States has explained, this phrase means "product-specific support."[41] We note that while it is no doubt a good *drafting* rule to use one and only one term for any given concept in an agreement, the drafters' failure to follow that rule does not alter a treaty *interpreter's* obligation to interpret under the customary rules of public international law the words that actually are in the treaty.

79. Further, it is not surprising that this exact phrase is not used in the Peace Clause. The phrase "product-specific support" is not a defined term to be found in Agriculture Agreement Article 1. Not surprisingly, then, in different provisions the Agriculture Agreement uses different words to describe the concept of product

"support."[43] The use of the phrase "support to a specific commodity" in the Peace Clause to refer to "product-specific support" is not remarkable in light of these multiple examples of different words in the Agreement that describe the same concept.[44]

38. Given the fact that subsidies available for more than one product could have various effects on production, how does the United States demarcate between product-specific support and non-product specific support ? USA

80. The phrase "support to a specific commodity" in the Peace Clause proviso, read according to its ordinary meaning, in context, and in light of the object and purpose of the Agreement, means "product-specific support." The United States finds the demarcation between product-specific and non-product-specific support in the Agriculture Agreement. Specifically, Article 1(a) defines the universe of support making up the Aggregate Measurement of Support as follows:

> "Aggregate Measurement of Support" and "AMS" mean the annual level of *support,* expressed in monetary terms, *provided for an agricultural product in favour of the producers of the basic agricultural product or non-product-specific support provided in favour of agricultural producers in general,* other than support provided under programmes that qualify as exempt from reduction under Annex 2 to this Agreement . . . (italics added).

Article 1(h), which defines the "Total Aggregate Measurement of Support,"[45] and paragraph 1 of Annex 3, explaining the calculation of the Aggregate Measurement of Support[46], also distinguish between product-specific and non-product-specific support, without providing additional detail to that found in Article 1(a).

81. Article 1(a), therefore, provides the basic demarcation between product-specific and non-product-specific support; as mentioned at the first panel meeting, Brazil has not contested this point. Product-specific support, then, is "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product." This definition contains two elements. First, the support must be provided "*for an agricultural product*," which suggests that the subsidy is given "in favour of"[47] a product and not in respect of criteria not related to the product or in respect of multiple products. Second, such support is "in favour of the *producers of the basic agricultural product*,"

[43] Again, the use of the term "commodity" in place of "product" may result from the unique negotiating history of the Peace Clause. While the term "product" is used exclusively elsewhere in the Agreement, in the course of the Uruguay Round agriculture negotiations, the term "commodity" had been commonly used. *See, e.g.*, Framework Agreement on Agriculture Reform Programme, Draft Text by the Chairman, MTN.GNG/NG5/W/170, paras. 3, 5, 6, Annex I (11 July 1990). Despite the fact that the Peace Clause uses "commodity" in place of "product," Brazil has not suggested that "commodity" should be interpreted as anything other than agricultural "products" subject to the Agreement.

[44] The United States also notes that under paragraph 1 of Annex 3, non-product-specific support is to be aggregated into one separate AMS, which supports the notion that non-product-specific support is *not* to be allocated to specific products, contrary to what Brazil urges the Panel to do here.

[45] Agriculture Agreement, Article 1(h) ("'Total Aggregate Measurement of Support' and 'Total AMS' mean the sum of all domestic support provided in favour of agricultural producers, calculated as the sum of all aggregate measurements of *support for basic agricultural products*, all *non-product-specific aggregate measurements of support* and all equivalent measurements of support for agricultural products . . . .").

[46] Agriculture Agreement, Annex 3, paragraph 1 ("Subject to the provisions of Article 6, an Aggregate Measurement of Support (AMS) shall be calculated *on a product-specific basis for each basic agricultural product* receiving market price support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment ('other non-exempt policies'). *Support which is non-product specific shall be totalled into one non-product-specific AMS* in total monetary terms." (emphasis added)).

[47] *The New Shorter Oxford English Dictionary*, vol. 1, at 996 (1993 ed.) (definition of "for": "in favour of"; "[w]ith the purpose or result of benefitting").

specific or non-product-specific. This analysis has no foundation in the Agriculture Agreement. In fact, Brazil has not followed its own approach through to its logical conclusion: as alluded to by Question 41 from the Panel, presumably Brazil could have taken *all* non-product-specific support provided by the United States and allocated some portion of that support to upland cotton producers.

93. If the Panel were to conclude that the Step 2 programme and payments made thereunder could be separated in to domestic and export components, and the export component were deemed to be an export subsidy, logically, that component would no longer constitute domestic support. Therefore, that measure would not form part of an analysis under Article 13(b), but rather would fall under Article 13(c). For data relating to Step 2 payment by fiscal year and use, please see the US answer to Question 104 from the Panel.

46. What is the relevance, if any, of the concept of "specificity" in Article 2 of the SCM Agreement and references to "a product" or "subsidized product" in certain provisions of the SCM Agreement to the meaning of "support to a specific commodity" in Article 13(b)(ii) Agreement on Agriculture? BRA, USA

94. The concept of specificity in Article 2 of the Subsidies Agreement is entirely unrelated to the meaning of "support to a specific commodity" in Article 13(b)(ii) of the Agreement on Agriculture. Generally, under Article 2 of the Subsidies Agreement, a subsidy is specific if it is limited, in law or in fact, to "an enterprise or industry or group of enterprises or industries." The relevant context for "support to a specific commodity" is found in Articles 1(a), 1(h), 6.4, and Annex 3 of the Agriculture Agreement.

"in excess of that decided during the 1992 marketing year"

47. Where does Article 13(b)(ii) require a year-on-year comparison? BRA, USA

95. Please see the US answer to Question 35 from the Panel for a reply to this question.

48. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made? BRA, USA

96. The proviso to Article 13(b)(ii) requires a comparison of the product-specific support that challenged measures grant (in this case, for upland cotton) to the product-specific support decided during the 1992 marketing year. The United States agrees with Brazil that the Peace Clause proviso requires an apples-to-apples comparison. However, while Brazil's proposed comparison (the budgetary outlays that may be allocated to a commodity, whether product-specific or non-product-specific) has no grounding in the text or context of the Peace Clause, the United States believes the basis for this comparison is established by the use of the word "decided."

97. The term "decided" is not explicitly defined in the Agreement and is not used elsewhere in the Agriculture Agreement nor in the Subsidies Agreement to refer to support or subsidies. Members' unique choice of words must be given meaning. "Decide" means to "[d]etermine on as a settlement, pronounce in judgement" and "[c]ome to a determination or resolution *that, to do, whether*."[54] Thus, the basis for the comparison under the Peace Clause proviso is the product-specific support that was "determined" or "pronounced" during the 1992 marketing year. US measures "decided" product-specific support for upland cotton in terms of a rate of 72.9 cents per pound through the combination of marketing loans and defi[illegible]

year could be made through more than one decision, however. In addition, the Communities suggests that this decision is one "in which support for a specific product is decided and allocated for future years." While it may be that a Member decided support for a future year during the 1992 marketing year, forming the benchmark for the comparison under the Peace Clause proviso, it would also appear likely that a Member decided on a level of support for the marketing year during that marketing year. Thus, the support decided during the 1992 marketing year would not appear to be necessarily limited to support for future years.

52. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". BRA, USA

103. The ordinary meaning of the words "decided during" would be "determined or pronounced during" or "having come to a determination or resolution that or to do during." The United States understands that the term "

107. Finally, we note that in anticipation of the 1993 crop year the Department of Agriculture also initially pronounced the level of support for the 1993 crop year during the 1992 marketing year. On 24 March 1993, regulations were published at 58 Federal Register 15755 setting the marketing loan rate at 52.35 cents per pound and leaving undisturbed the effective price for deficiency payments at 72.9 cents per pound.[63] Thus, the support decided for the 1993 crop was the same as that decided for the 1992 crop: to ensure producer support of 72.9 cents per pound of upland cotton.[64]

55. Please provide a copy of the instrument in which the rate of support for upland cotton during the marketing year 1992 was decided, indicating the date of the decision. USA

108. As indicated in the US answer to Question 54 from the Panel, the United States has provided copies of multiple legal, regulatory, and administrative instruments and publications reflecting the rate of support decided during marketing year 1992. These multiple decisions stem from the fact that an effective price and marketing loan rate were first published in advance of the 1992 marketing year in order to allow producers to become familiar with the programmes; subsequently, the Secretary of Agriculture decided not to change either the effective price (72.9 cents per pound) or the marketing loan rate (52.35 cents per pound), despite having the authority to do so.

56. Could the United States please explain how support granted under legislation that dates back to 1990 can have been support "decided during the marketing year 1992"? USA

109. Payments during the 1992 marketing year were made pursuant to the 1990 Act, which directed the Secretary of Agriculture to make marketing loan payments and deficiency payments (as well as Step 2 payments). The 1990 Act, however, was only the first decision on the level of support. The Act provided that the marketing loan rate could "not be reduced below 50 cents per pound".[65] The 1990 Act also stated that the "established price for upland cotton shall not be less than $0.729 per pound".[66] Thus, the Secretary had discretion to alter those rates of support.

110. The Secretary decided to set the marketing loan rate at 52.35 cents per pound in April 1992 but also decided not to change the implementing regulations establishing the effective price for deficiency payments. Similarly, during the 1992 marketing year, the Secretary had the discretion *to raise* the deficiency payment target price above 72.9 cents per pound and *to raise* the marketing loan rate above 52.35 cents per pound but decided not to. Documents published during 1992 evidence this decision: the 1992 supplement to the United States Code published in January 1993 reflects the decision not to alter the statutory provisions relating to upland cotton rates. The 1993 Code of Federal Regulations was published in January 1993 and also reflects the decision not to alter the regulatory rate provisions. Finally, when the upland cotton fact sheet was published in September 1992, the effective price and marketing loan rate were left unchanged, reflecting the Secretary's decision not to change the level of support.

111. In this case, the support determined or pronounced by US measures during the 1992 marketing year was also the support determined or pronounced for the 1992 marketing year. This result is entirely consistent with the Peace Clause text; in fact, it provides certainty to both Members seeking to provide support within Peace Clause limits and Members seeking to understand whether the Peace Clause has been breached.

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[63] A proposed rule for the 1993 crop was published on 29 September 1992. The 1993 rates were announced on 2 November 1992, and published in the 24 March Notice.

[64] We note that one distinction made by the 24 March 2003 regulations between the 1993 crop and the 1992 crop was that the acreage reduction program percentage was lowered from 10 per cent in 1992 to 7.5 per cent in 1993.

[65] 7 U.S.C. 1444-2(a)(1), (2)(A) (1992 Supp.) (Jan. 4, 1993) (Exhibit US-5).

[66] 7 U.S.C. 1444-2(c)(1)(B)(ii) (1992 Supp.) (Jan. 4, 1993) (Exhibit US-5).

112. Thus, the 1990 Act initially established a level of support applicable to the 1991-95 crops. The US Congress could have changed the 72.9 cents per pound level at any time during MY 1992, but it decided not to. The Secretary of Agriculture also had discretion to alter the level of support (that is, to raise it) but also decided not to. Thus, 72.9 cents per pound was decided and remained decided as the level of support for each day of the 1992 marketing year.

57. If the United States decided on a rate of support for MY1992, does that not mean that it decided on whatever budgetary outlay was required to meet that rate of support, even if the exact amount was not known at that time ? USA

113. The Peace Clause proviso establishes the benchmark for comparison: the support "decided" during the 1992 marketing year. To say that the United States "determined" or "pronounced" an indefinite amount of budgetary outlays would not fit those meanings of the term. The United States could also not have come to a "determination or resolution" to make any budgetary outlay since that outlay would be determined by market prices during the year, *not* by the US Government. To read support "decided" as encompassing not only the explicit rate of support set out in US measures but also "whatever budgetary outlay was required to meet that rate of support, even if the exact amount was not known at the time," would also appear to make the Peace Clause comparison impossible. That is, because both during the 1992 marketing year and under the 2002 Act the support decided would be "whatever budgetary outlay was required to meet that rate of support," both budgetary outlay "decisions" by the United States would appear to be unlimited, and one could not be in excess of the other. Alternatively, one could reason that a decision to provide whatever budgetary outlays would be necessary implies that the 1992 decided level would be higher because, even if prices fell to zero, the higher nominal level in 1992 would mean higher budgetary outlays.

114. The only support "decided" by the United States was the 72.9 cents per pound level of support. In effect, the United States provided a revenue floor for producers by guaranteeing a rate of income for plantings. The United States has never exceeded that level of incentive "for the commodity." Brazil's approach, which would ascribe to the United States a decision to make budgetary outlays resulting from differences between market prices and the level of support, is an effort to impose something akin to an AMS limit on US support for upland cotton. (We note, however, that Brazil cannot simply argue for calculating an AMS for upland cotton because that would exclude non-product-specific support, which Brazil wishes to include in the Peace Clause comparison, and would not require that support be measured through budgetary outlays.) Members considered and rejected any product-specific AMS limits in the Uruguay Round, however, and such a concept may not be overlaid onto the Article 13 language. The United States has introduced payments decoupled from production precisely to lower the incentive to produce the marginal pound of cotton and avoid exceeding the product-specific level of support of 72.9 cents per pound.

59. Should the rate of support as indicated in Article 13(b)(ii) include the market price? If so, why is Tcs1-0.1196 a.81-0.06 Tw (59Tc 0.26vel i8(b)(ii) include t58dnw (payments decou64 fRA,1 F

annum basis? If possible, please specify how, if at all, budget outlays may be transposed into units of production, and which units of production are best to use. BRA, USA

116. The United States has explained that the product-specific support decided during the 1992 marketing year for upland cotton was 72.9 cents per pound through the combined effect of the target price for deficiency payments and the loan rate for marketing loans. This rate was the only support "decided" by the United States as evidenced by the relevant legislation, regulations, and programme

of upland cotton approach thus would not only be based on a faulty premise, but to calculate outlays per unit might also necessitate an *ex post* or retrospective analysis. Again, this cannot reflect the support "decided" by the United States.

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(d)

Product-Specific Support in Sumner's per Unit Subsidy Rates (Cents per Pound) by Programme and Year					
	MY1992	MY1999	MY2000	MY2001	MY2001
Marketing Loan	44.34	50.36	50.36	50.36	52.00
Deficiency	13.25	na	na	na	na

US Upland Cotton Aggregate Measurement of Support	
2002[70]	970

129. For marketing year 1992, the United States has used official data on budgetary outlays[71] to calculate the upland cotton Aggregate Measurement of Support, except for other product-specific support in the form of storage payments and interest subsidies. The latter payment amounts are based on estimates by the US Department of Agriculture. The calculations, in millions of US dollars, are as follows:

Crop year 1992 (estimate)	Payments	Source
Deficiency payments	1,017	US Department of Agriculture (USDA), Upland Cotton Fact Sheet (Ex. Bra-4)
Marketing loan gains / Certificate exchange gains	476	USDA budget data (Ex. Bra-6)
Loan deficiency payments	268	USDA budget data (Ex. Bra-76)
User marketing certificates	207	USDA, Upland Cotton Fact Sheet (Ex. Bra-4)
Commodity loan forfeit	(5)	USDA estimate
Other payments	122	USDA estimate of storage payments & interest subsidy
	2,085	

130. To calculate the upland cotton Aggregate Measurement of Support for marketing year 1999, the United States has used official budgetary outlays data for loan deficiency payments, marketing loan gains, certificate exchange gains, user marketing certificates, and the 1999 crop year cottonseed payment. For storage payments and interest subsidies, we have used estimates by the US Department of Agriculture as notified to the WTO. The calculations, in millions of US dollars, are as follows:

70

Crop year 1999	Payments	Source
Marketing loan gains/ Certificate exchange gains	860	USDA budget data (Ex. Bra-55)
Loan deficiency payments	685	USDA, Upland Cotton Fact Sheet (Ex. Bra-4)

Crop year 2001 (estimate)	Payments	Source
Marketing loan gains	47	USDA budget data (www.fsa.usda.gov/dam/

(b) How, if at all, would these elements be relevant to the claims of Brazil, and the United States response thereto? BRA, USA

137. (a) For the reasons stated in its first written submission[76] and in response to Question 71(b), the United States does not believe that the appropriate analysis of the US export credit guarantee programme should begin with the Subsidies Agreement, much less Article 1of that Agreement. The text of Article 10.2 defers WTO obligations for export credit guarantees until disciplines are internationally agreed, such as within the OECD

141. As the United States has argued, the first point of analysis is Article 10.2 of the Agreement on Agriculture, in which Members agreed that they would only provide export credit guarantees in conformity with internationally agreed disciplines, which they undertook to develop. That is, Article 10.2 indicates that no "internationally agreed disciplines" currently exist. The obligation with respect to export credit guarantees is, in effect, a work programme to establish a future discipline. Brazil has not contested that challenged US export credit guarantee programmes are within the scope of Article 10.2. Therefore, neither item (j) nor Articles 1 and 3 of the Subsidies Agreement are relevant to the Panel's analysis of Article 10.2. We do note, however, that item (j) of the Illustrative List of Export Subsidies was agreed in the Uruguay Round, and, in fact, had previously formed part of the Illustrative List under the Tokyo Round Subsidies Code. Thus, the fact that Members had agreed on item (j) and yet, in Article 10.2, agreed to "undertake to work toward *the development* of internationally agreed disciplines to govern the provision of export credits, export credit guarantees" and, once agreed, only to provide export credit guarantee programmes "in conformity with" such developed and agreed disciplines, suggests that item (j) does *not* impose disciplines on export credit guarantees for agricultural goods.

142. Context for Article 10 is found in Article 9.1 of the Agreement on Agriculture, which describes specific practices that constitute export subsidies for purposes of the Agreement on Agriculture [illegible]

79. In respect of what time periods does Article 13(c) require an assessment of conformity with Part V of the Agreement on Agriculture? How does this affect, if at all, your interpretation of Article 13(b)? BRA, USA

151. Article 13(c) applies to "export subsidies that conform fully to the provisions of Part V of th[e Agriculture] Agreement, as reflected in each Member's Schedule." Part V of the Agreement, and in particular Article 8, establishes that "Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule." Those export subsidy reduction commitments, which are expressed in both export quantity and budgetary outlay terms, apply on a yearly basis.[80] Accordingly, a Member may be in conformity one year and not in conformity in another with regard to any particular commodity subject to reduction commitments.

152. If a Member has provided export subsidies to a particular commodity in any one year in

(c) paragraphs 125 ff. (guaranteed loan subsidy)[81]

156. The Credit Reform Act of 1990 establishes the procedures and parameters for US credit and credit guarantee programmes. In accordance with the provisions of that Act, the budgeting and accounting for US credit programmes, including the CCC export credit guarantee programmes, are based on the estimated lifetime costs to the Federal Government of making the credit available. In the case of credit guarantees, those costs are based on estimated payments by the Government to cover defaults and delinquencies, interest subsidies, and other requirements, and payments to the Government, including origination and other fees, penalties, and recoveries.

157. In presenting the annual budget, the subsidy costs of the programme reflect an *estimate* of the long-term costs to the Government. This estimate reflects various assumptions regarding credit risk, interest costs, and other factors that will apply over the lifetime period of the credit. At the time the budget is prepared, these costs are presented as estimates as of the date the budget is prepared – that is, they are a snapshot of the estimated costs. In fact, Brazil acknowledges in paragraph 125 of m.09431s, aea 0 -12 T
157. teI57.cas609ey are a484e progre -

163. With the exception of 2002, all cohorts for annual export credit programming since the inception of credit reform accounting in 1992, have a cumulative downward re-estimate. The net total for all cohorts for guarantees issued since 1992 currently stands at a downward re-estimate of $1.9 billion. This experience with re-estimates indicates that performance under the programme has been better than originally projected and that the original cost estimates for those programming years as presented in the annual US budget were too high. This experience also demonstrates that the assertion by Brazil at paragraph 129 of its oral statement that the original estimate of "guaranteed loan subsidy" line in the budget is an "ideal basis" for determining the costs of the programme is in error. Those estimates will be re-estimated on an annual basis until each cohort is closed and, as demonstrated above, to date the re-estimates for each cohort on a net basis have been almost exclusively downward.

(b) paragraph 123 (interest on debt to Treasury)

164. Under the guidelines for credit reform budgeting as established in the Credit Reform Act of 1990, there are two kinds of interest calculations that affect the CCC export guarantee programmes. These calculations are "snapshots" in time and will change annually for a cohort until the cohort has closed. Therefore, any one number shown in the budget for a given year is an estimate. The actual cost of the programme can be determined only when all financial activity for the cohort is completed.

165. An interest rate re-estimate is a component of the annual re-estimates of a cohort, which are made for as long as the guarantees are outstanding. The interest rate re-estimate calculates the difference between the estimated interest at the time the guarantee programme was budgeted and the actual interest at the time the guarantee is disbursed. If the actual interest is higher, the additional cost is shown in the programme account as a re-estimate. It should be noted that this cost would change

re-estimates thus far have resulted in a net reduction in the estimated costs of these programmes of over $1.9 billion since the inception of credit reform budgeting in fiscal year 1992.

174. Further, as discussed in response to Question 81(c), the combined net costs of the cohorts associated with the 1994 and 1995 guarantee programmes, which are expected to close this year, are a receipt of $29 million to the Federal Government. Based on those results, the Brazilian claim in paragraph 24 that "operating costs and losses for GSM 102, GSM 103, and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992" is not supportable.

82. Please explain each of the following statements and any possible significance it may have in respect of Brazil's claims about GSM-102 and GSM-103 (7 CFR 1493.10(a)(2), Exhibit BRA-38): BRA, USA

(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions -

> **development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

178. Although the goal of the export credit guarantee programmes is to expand market opportunities, such goal alone has no bearing on the proper characterization of the programmes, the

on export credit guarantees; second, "after agreement on such disciplines," they must provide export credit guarantees "only in conformity therewith". Thus, Members agreed that those internationally agreed disciplines would constrain the provision of export credit guarantees, which in turn would contribute to the goal of Article 10, to prevent the circumvention of export subsidy commitments.

191. Although the language quoted from paragraph 21 of the United States' closing oral statement was intended to address concerns involving domestic support for upland cotton,[85] it also applies in the case of export subsidies. The United States also cannot provide export subsidies without limit. It has a schedule of export subsidy reduction commitments for 12 commodities. For these commodities, export subsidies can only be provided in accordance with such schedule. For the remainder of agricultural commodities, the United States cannot provide export subsidies at all.

192.

credit guarantees, and insurance programmes until internationally agreed disciplines are reached, and in that sense the export subsidy disciplines of the Agreement do not apply to the export credit guarantee programmes at issue in this dispute.

195. The SCGP began in 1996, and no transactions occurred under this programme in connection with cotton until fiscal year 1998, which began in September 1997. Although the negotiators obviously could not have considered the application of this specific programme, it is substantially similar in its operation to other US export credit guarantee programmes. Again, Brazil has not contested that SCGP provides export credit guarantees within the meaning of Article 10.2. Thus, the deferral of disciplines under Article 10.2 similarly applies.

STEP 2 PAYMENTS

89. Does the United States confirm Brazil's statement in paragraph 331 of its first

exports and submitted to the USDA FAS. Is Exhibit BRA-66 - Form CCC 1045-2 - also a valid example? If not, please identify any differences or distinctions. USA

200. The Brazilian exhibits appear to be accurate versions of old Step 2 programme documents. Some of the documents in the exhibit are for domestic handlers and involved programme payment assignments. We also note that, in making an export claim, other documentation like bills of lading may be needed.

201. The official documents for the upland cotton step 2 programme can be found at the Farm Services Agency website (www.fsa.usda.gov/daco, click on "cotton" and on "upland cotton user marketing certificate programme".) There is a common contract that exists for both domestic users and exports under the Step 2 programme, CCC Form CCC-1045UP. Because of the different nature of uses and therefore applications, there are separate reporting forms: CCC-1045UP-1 for domestic users and CCC-1045UP-2 for Exporter Users. Recently updated documents used for this programme are attached as Exhibit US-21.

93. Please elaborate why the United States deems that Step 2 payments upon submission of proof of export are not subsidies contingent upon export. Is it the US contention that, in order to be contingent on export, exportation must be the exclusive condition for receipt of the payment? USA

202. As the United States has indicated, all upland cotton produced in the United States is eligible for the benefit of the Step 2 cotton subsidy. If the statutory price condition applies, all US upland cotton used during the applicable period of time will received the subsidy. “Use” in domestic manufacture or export constitutes the universe of potential use of US upland cotton. The United States submits that when the entirety of production of a good in a country is eligible to receive a subsidy, no contingency on export exists. The Step 2 subsidy is entirely distinct in this regard from a hypothetical situation in which a subsidy is theoretically available for domestic use, but in reality is exclusively or nearly exclusively available in connection with exports.

95. Do the criteria in 7 CFR 1427.103(c)(2) (Exhibit BRA-37) that Step 2 "eligible upland cotton" must be "not imported cotton" apply to both domestic and export payments? USA

203. Only domestic cotton is eligible for Step 2 payment, which is made if the statutory price conditions are met and requisite proof of use is submitted.

96. Is a domestic sale a "use" for the purposes of Step 2 payments? Is a sale for export, or export, considered a "use"? USA

204. A sale is not a use for purposes of the Step 2 subsidy. For domestic manufacture, opening the cotton bale constitutes use. For exports, similarly, the sale alone does not itself constitute use; the exporter must demonstrate actual exportation.[86]

97. How does the United States respond to Brazil's assertion, at paragraph 70 of Brazil's oral statement at the first session of the first substantive meeting, that "It is obvious that a single bale of cotton cannot be both exported and used domestically." Is this a relevant consideration? USA

205. It is unclear what Brazil’s assertion is intended to demonstrate. The Step 2 programme makes payments to documented users of US upland cotton. If a bale cannot be both opened domestically and exported (although it is not clear why that would be so), that amounts to arguing that a single bale

[86] 7 Code of Federal Regulations 1427.103(a).

cannot be "used" twice. The fact remains that *either* opening the bale domestically *or* exporting it – that is, the universe of activities resulting in use of US upland cotton – is entitled (given certain market conditions) to a Step 2 payment.

206. The United States notes, moreover, that it may actually be possible (economic realities aside) that the same bale could be exported and then brought back into the country and opened for domestic use. (Please see the US answer to Question 98 for more detail.) The US Department of Agriculture's position would be that the payment should be made on the bale once only. The purpose of the programme is to provide support to upland cotton farmers. Once the bale has been purchased by an upland cotton user, there would be no additional support for upland cotton farmers from providing Step 2 payments on additional "uses" of the same bale.

98. How many Step 2 payments are received if a bale of upland cotton is exported, and then opened by a domestic user in the United States, or vice versa? USA

207. If a bale were exported and then imported and opened up (or vice versa) it would be the US position that only one payment would be made. It does not appear that this situation has ever arisen in fact, but we note that the Step 2 regulations specifically provide that "imported" cotton is not eligible for payment. Such cotton may include any cotton that was imported, even if it had been produced in the United States.

99. How does the United States respond to Brazil's arguments in paragraphs 71-75 of Brazil's oral statement at the first session of the first Panel meeting concerning the relevance of the Appellate Body Report in US-FSC (21.5). USA

208. In contrast to the factt7-0.0186 Tc 14the8rt Panel meeting concerningAppellate Body Report in US

99. If a ba64j -390 -108action has58 balespo97rt would bynts" T* c yes d, eo "usthrTj 0 -267.5 TD /F1 1

contract was made. As the Panel is aware, Step 2 payments can be made only when there is a difference between world and US prices for cotton for a certain time period. In the case of fiscal year 1996, these prices did not satisfy the Step 2 conditions, but there were some payments that were made during that fiscal year because they had accrued by an export contract made in the previous fiscal year. That rule is now changed[88] so that the rate that applies for export use is the rate that is in effect when the export is made not when the contract for export was made.

105. Why is the Step 2 programme separated into "domestic users" and "exporters"? Apart from differentiating between exporters and domestic users, with consequential differentiation as to the forms that must be filled out and certain other conditions that must be fulfilled, are the eligibility criteria for Step 2 payments identical? Are the form and rate of payment, as well as the actual payment made, identical? USA

213. US law does not separate the Step 2 programme into domestic users and exporters. There is but one Step 2 statute – codified at 7 US Code 7937 – and but one Step 2 rule for all users – found at 7 Code of Federal Regulations 1427.100-.108. The statute and rule do identify "domestic users" and "exporters" as the universe of *bona fide* users of upland cotton and thus potential recipients for Step 2 payments. Therefore, the only distinction drawn between these recipients is the proof of use: domestic handlers are paid when they open a bale, and exporters are paid when they export. The form and rate of payment are identical.

106. With respect to paragraph 139 of the United States' first written submission, are Step 2 export payments included in the annual reduction commitments of the United States? If so, why? USA

214. The United States does not distinguish between the uses of US upland cotton for purposes of reporting the subsidy because the subsidy is not contingent on export performance. *All* Step 2 payments are reported as product-specific domestic support for upland cotton and are included within the Total Aggregate Measurement of Support calculation for purposes of *domestic support* reduction commitments.

107. Please comment on any relevance, to Brazil's de jure claims of inconsistency with the provisions of the Agreement on Agriculture, of Exhibit BRA-69, which shows Step 2 payments made to (i) domestic users and (ii) exporters. This Exhibit shows that, from FY 91/92 through 02, the Step 2 payments for exporters exceeded those for domestic users in FY 94; FY 95; FY 96 (in fact there were no domestic payments in FY 96); and FY 02. In the other years, the domestic payments are greater than export payments. BRA, USA

215. Without commenting on the accuracy of the specific numbers set forth in Exhibit BRA-69, it is entirely possible that in certain years one type of user happened to receive a larger share of payments than another type of user. This would entirely be a function of market conditions and relative demand for manufacture or for export. That is, differences in amounts paid to exporters and domestic users during any time period are happenstance based on actual use of US upland cotton.

216. The United States notes that payments to exporters were previously made based on when exporters finalized the sale contract, not on when the cotton was actually exported. In the specific case of fiscal year 1996, it appears that payments for exported upland cotton *accrued* during a period when Step 2 payments were allowed by the statute, but that the payments were actually made at a time when market conditions no longer met the statutory criteria for payment. The rule has been changed,[89] and that situation can no longer recur.

[88] *See* 61 Federal Register 37544, 37548 (18 July 1996).
[89] *See* 61 Federal Register 37544, 37548 (July 18, 1996).

108. At paragraph 135 of its first written submission, the United States states : "[T]he subsidy is not contingent upon export performance..." (emphasis added). Again, in the course of the first Panel meeting, the United States admitted that the Step 2 payments

(b) Why would a domestic user or an exporter select to receive a marketing certificate over a cash payment? What is the proportion of cash payments vs. marketing certificates granted under the programme? USA

220. A user of upland cotton that elects to receive payment in the form of a marketing certificate is entitled to redeem that certificate for an equivalent amount of upland cotton held by the Commodity Credit Corporation (CCC). Although authorized by statute, no Step 2 payments have been made in recent times in the form of certificates. Marketing certificates in lieu of cash payments for Step 2 were last used heavily in the early to mid-1990s. The CCC does not currently maintain high upland cotton inventories from which such certificates if issued could be redeemed.

111. Does the United States maintain its argument that actions based on Article 3.1(b) of the SCM Agreement are conditionally "exempt from actions" due to the operation of Article 13 of the Agreement on Agriculture? USA

221. Article 13(c) provides that "export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be . . . exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement." Article 13(b), which applies to domestic support measures, does not reference Subsidies Agreement Article 3. Brazil has advanced claims under Article 3.1(b) of the Subsidies Agreement only with respect to Step 2 payments, which are domestic support measures and not export subsidies. Thus, on the US view the Peace Clause would not appear to be applicable; however, to the extent Brazil asserts that Step 2 payments (or some part thereof) are export subsidies, Article 13(c) would be relevant.

222. We also note that paragraph 7 of Annex 3 requires that support in favour of domestic agricultural producers that is provided through payment to processors shall be included in the AMS of the Member. If payments are made in connection with both domestic and foreign product then such payments are not support in favour of domestic agricultural producers. Consequently, the Agriculture Agreement necessarily contemplates that support paid to processors may be paid solely with respect to domestic production. Under Article 6.3 of the Agriculture Agreement, if a Member is providing support within its domestic support reduction commitments, then such support may not be challenged under Article 3.1(b) because that Article applies "[e]xcept as provided in the Agreement on Agriculture". If a Member exceeds its domestic support reduction commitments, on the other hand, then such support paid to processors would be actionable under Article 3.1(b).

112. In the event that the Panel finds that Article 6.3 of the Agreement on Agriculture does not preclude an examination of Brazil's claims under Article 3.1 of the SCM Agreement and Article III:4 of GATT 1994, how does the United States respond to the merits of Brazil's claims relating to Step 2 payments under those provisions? USA

223. As indicated in the US answer to Question 111 from the Panel, and as the European Communities has noted in its third party submission, inasmuch as paragraph 7 of Annex 3 of the Agreement on Agriculture requires support in favour of agricultural producers that is paid to processors to be included in the Member's Aggregate Measurement of Support, then the Agreement on Agriculture necessarily contemplates that such payments to processors may apply solely with respect to domestic product. Otherwise, as in the case of Step 2 payments, domestic cotton producers would not receive the relative price benefit conferred by the payment. Consequently, such discrimination in favour of domestic production is permitted under the Agreement on Agriculture and, under Article 21.1 of that Agreement, the provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement are expressly "subject to the provisions of [the Agriculture] Agreement." For that reason, neither Article 3.1(b) of the Subsidies Agreement nor GATT 1994 Article III:4 precludes such payments to users of US upland cotton, unless the United States exceeds its domestic support reduction commitments.

113. Is it necessary for measures directed at agricultural processors included in AMS to discriminate on the basis of the origin of goods? USA

224. The United States does not express an opinion whether it is necessary in all circumstances for all Members with respect to all commodities. However, paragraph 7 of Annex 3 of the Agreement on Agriculture certainly contemplates that support in favour of domestic producers provided by payments to processors is included in the Aggregate Measurement of Support. In the case of Step 2 payments on upland cotton, if payments were provided in favour of all upland cotton, whether domestic or foreign, used by domestics mills or exporters, the price benefit for US producers would not be achieved. Without such a benefit to US producers, these payments would not need to be included in the Aggregate Measurement of Support. The Agreement on Agriculture does not preclude payments that solely benefit domestic producers; indeed, paragraph 7 contemplates such discriminatory subsidy payments. Accordingly, the United States reports all Step 2 payments as domestic support in favour of US producers of upland cotton.

115. What is the meaning and relevance (if any) to Brazil's claims under Article 3 of the

different forms of support, the latter (Step 2) being a form of support that can facilitate higher market.75 0 sp3.a/m2.

ANNEX I-3

COMMENTS OF BRAZIL TO ANSWERS TO QUESTIONS POSED BY THE PANEL FOLLOWING THE FIRST SUBSTANTIVE MEETING OF THE PANEL

22 August 2003

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Brazil - Aircraft	Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, adopted 20 August 1999
Guatemala – Cement (I)	Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, adopted 25 November 1998
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Market Revenue and US Government Payments to US Upland Cotton Producers — *Exhibit Bra- 169*

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Rice Outlook, USDA, 13 August 2003, Table 1 — *Exhibit Bra- 172*

Revised Estimate of Support Granted by Commodity via Countercyclical
Payments7aad8 303.75 0 TD 0 Tc 0.1875 Tw ( ) 840 11312 12.75 TD /F2 11.25 Tf -0.1376 Tc 0.3251 Tw (Exhibit B

I. PRELIMINARY ISSUES

(3) If the request for consultations in this dispute omitted certain products in relation to export credit guarantees, on what basis is it argued that it failed to identify the measures at issue in accordance with Article 4.4 of the DSU?

Brazil's Comment on US Answer:

1. In paragraphs 5-6 of its 11 August Answer to Question 3, the United States argues that footnote 1 to Brazil's request for consultations does not expand the scope of the request, with regard to the US export credit guarantee programmes, beyond upland cotton. This is inaccurate. The footnote number falls *immediately after the words "upland cotton"* in the first sentence of the first paragraph of the request. With reference to "upland cotton", the footnote reads, "[e]xcept with respect to export credit guarantee programmes as explained below".[1] Although the United States claims that there is no explanation "below", there is indeed such an explanation. In particular, Brazil described its potential claim as follows, on page 4 of the request:

Regarding export credit guarantees, export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and other measures such as GSM-102, GSM-103,

violation of Article 7.2.[3] As demonstrated above, Brazil's request, and the accompanying statement of available evidence, do not support the United States' assertion. Both the request and the statement of available evidence address the US export credit guarantee programmes without limitation to any particular commodity or commodities.

5. Moreover, even if the United States were to make this request for a preliminary ruling and the Panel were to grant it, it would not affect Brazil's claims. Brazil's compliance with Article 7.2 of the SCM Agreement can have no effect on its claims under the Agreement on Agriculture, or on its prohibited subsidy claims under the SCM Agreement, or on its actionable subsidy claims with respect to upland cotton.

6. Finally, according to the Panel's Working Procedures, requests for preliminary rulings by a party were to have been made "not later than its first submission to the Panel".[4] Thus, the US request would not be timely. Brazil submits this information at this stage in the hope of avoiding another lengthy procedural objection by the United States.

(4) Is it argued that the export credit guarantee programmes concerning upland cotton are [illegible]

commodity or commodities. If it did, responding Members would have every incentive to refuse to answer any questions during consultations, thereby halting dispute settlement proceedings altogether.

(10) What actual prejudice, if any, has the United States suffered as a result of the alleged omission of products other than upland cotton from the request for consultations?

Brazil's Comment on US Answer:

10. Brazil agrees that "a Member cannot proceed to a panel unless the Member has consulted on that measure", as the United States argues in paragraph 19 of its response. Brazil's request for consultations included the CCC export guarantee programmes in connection with all commodities, however, and the United States concedes, in paragraph 17 of its answer to Question 8, that it consulted with Brazil via the list of questions included in Exhibit Bra-101.

11. Brazil does not agree with the United States' assertion, at paragraph 20 of its 11 August Answer, that the consultation request is of a "jurisdictional nature". While the Appellate Body has concluded that a complaining Member's request for *establishment* is jurisdictional in nature, and strictly delimits a panel's terms of reference[6], it has not made this statement with respect to a request for *consultations.* In fact, in *Brazil – Aircraft*, the Appellate Body concluded that there is no requirement for a *"precise and exact identity"* between a request for consultations and a request for establishment, which suggests that a request for consultations is *not* jurisdictional in nature.[7]

12. In paragraph 23 of its 11 August Answer, the United States argues, without any proof, that it "has suffered an inability to prepare, respond, and consult with respect to allegations on measures never presented to the United States in accordance with the DSU". As noted above, Brazil's request for consultations specifically addressed potential claims against the US export credit guarantee programs in connection with all commodities, and not just upland cotton. Moreover, the United States acknowledges that Brazil posed questions to it regarding those programmes in connection with all commodities. The questions were provided to the United States in writing on 22 November, in advance of the consultations session.[8] In paragraph 92 of its Oral Statement at the First Meeting of the Panel, Brazil offered extracts from those questions, which clarify that consultations regarding the US export credit guarantee programs were not limited to upland cotton.

13. The United States, therefore, was aware, both from Brazil's request for consultations and from Brazil's extensive list of questions, that the consultations included US export credit guarantee programs with respect to all commodities, and not just upland cotton. That the United States refused to respond to Brazil's questions does not mean that it had an "*inability*" to prepare, respond, and consult with Brazil – it means that the United States made a strategic decision not to do so. The United States had more than seven months from receipt of Brazil's questions until it filed its First Submission to "prepare and respond" to Brazil's claims. This demonstrates that no due process rights were violated nor any prejudice caused. The United States alone bears responsibility for any alleged "prejudice" it has suffered as a result of its own strategic decision.

14. In paragraph 24 of its 11 August Answer, the United States argues that it "has not had [sic] proper opportunity to consult" with Brazil on the US export credit guarantee programs with respect to

consultations request and its extensive list of questions, however, Brazil fulfilled the requirement to consult with the United States on the full scope of the programmes.

(11) Does the United States agree that Brazil's request for establishment of the Panel can be understood to indicate that Brazil's export credit guarantee claims relates to products other than upland cotton? How, if at all, is this relevant?

Brazil's Comment on US Answer:

15. At paragraphs 96-97 of its Statement at the First Panel Meeting, Brazil noted that in other disputes, the US position has been that "'a Member should be permitted to refer a claim to a panel if it was actually raised during consultations, even though it may not have been included in the written request for consultations.'"[9] In its 11 August Answer to Question 11, the United States now suggests that its position is different with respect to measures than it is with respect to claims. According to the United States, while a Member can add *claims* not present in its consultations request to its panel request, it cannot add *measures*.[10]

16. Brazil repeats that its request for consultations does in fact address the US measures (the GSM 102, GSM 103 and SCGP programs) in connection with all commodities. Every measure included in its request for establishment was similarly included in its request for consultations. The US argument is therefore irrelevant.

17. In any event, the US reliance on the Appellate Body's decision in *Guatemala – Cement (I)* is misplaced.[11] In that case, the Appellate Body explained that the text of Article 6 of the DSU and Article 17.4 of the Anti-Dumping Agreement required a distinction between measures and claims. The United States has, however, failed to explain the textual reason why the distinction between measures and claims is relevant *for the purpose of comparing a request for consultations with a request for establishment.* In fact, the Appellate Body has specifically held that Articles 4 and 6 of the DSU do not "require a *precise and exact identity* between the specific measures that were the subject of consultations and the specific measures identified in the request for the establishment of a panel".[12] Nor has the United States offered any logical reason why a Member should be allowed to add claims not covered by its consultations request to its request for establishment, but not measures. If anything, a defending Member would seem to suffer greater prejudice by the addition of claims than by the addition of measures, since the Member is likely more familiar with its *own* measures than it would be with *another Member's* claims.

(16) What, if any, prejudice in terms of presentation of its case does the United States allege, should the Panel proceed to consider the measures constituting the cottonseed payments under the Agriculture Assistance Act of 2003?

Brazil's Comment on US Answer:

18. There have been many disputes in which Panel found that measures, which were replacement measures to measures originally consulted on, were included in the panel's terms of reference, *Korea – Beef*[13] *and Chile- Agricultural Products (Price Band)*[14], to name a few. The Agricultural Assistance Act of 2003 is in the nature of a revised measure, as Brazil has argued in paragraphs 145-150 of its

[9] Panel Report, *US – DRAMS*, WT/DS99/R, para. 6.8.
[10] US 11 August Answer to Question 11, para. 25.
[11] US 11 August Answer to Question 11, para. 26 note 9
[12] Appellate Body Report, *Brazil – Aircraft*, WT/DS46/AB/R, para. 132.
[13] Panel Report, *Korea – Beef*, WT/DS161/R and WT/DS169/R, para. 563-564.
[14] Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, para. 143-144.

II. ARTICLE 13(B): DOMESTIC SUPPORT MEASURES

A. "EXEMPT FROM ACTIONS"

(20) In paragraph 8 of its initial brief (dated 5 June, 2003), the United States argued that the word "actions" as used in the phrase "exempt from actions" in Article 13 of the Agreement on Agriculture includes the "bringing of a case" and consultations. In paragraph 36 of its first written submission (dated 11 July, 2003), the United States stated as follows:

"[P]rior to this point in the process, the DSU rules did not afford the United States any opportunity to prevent the dispute from proceeding through consultations and panel establishment automatically, regardless of the US insistence that its measures conform to the Peace Clause."
Is it the United States' understanding that the drafters used the phrase "exempt from actions" knowing that under the DSU it would not be possible fully to exempt "actions", as the United States interprets that term?

(21) In US - FSC and US - FSC (21.5) the Appellate Body made findings under the SCM Agreement relating to export subsidies in respect of agricultural products without making a finding in respect of Article 13 of the Agreement on Agriculture. How is this relevant to the United States' interpretation of the phrase "exempt from actions" as used in Article 13? USA

Brazil's Comment on US Answers:

23. The United States and the European Communities maintain that the complaining party has the burden of proof under Article 13 of the Agreement on Agriculture. More specifically, they claim that Article 13 is not in the nature of an affirmative defence. Brazil's comment will again show that their position is untenable.

24. In its 11 August Answer to Question 20 of the Panel, the United States asserts, under the "exempt from action" argument, that "Brazil has attempted to improperly invoke dispute settlement procedures notwithstanding the Peace Clause."[19] According to the United States, a dispute settlement procedure could only be initiated after a determination of non-compliance with Article 13 has been made. In its 11 August Answer to Question 21, the United States then dismisses the findings in *US – FSC* by simply stating that they do not address the peace clause and that the issue was not raised by either party in that case.[20] Therefore, those rulings and recommendations "provide no guidance for purposes of this dispute".

25. The EC maintains that "Article 13 is more akin to a threshold permitting further action if the threshold is not complied with."[21] The EC affirms that Article 13 "is an integral part of the *Agreement on Agriculture*".[22] In that sense it would be comparable to Article 6 of the ATC, Article 3.3 of the SPS Agreement, and Article 2.4 of the TBT Agreement, which were found not to be affirmative defences by the Appellate Body.[23] According to the EC, those provisions, like Article 13 of the Agreement on Agriculture, "provide certain rights to WTO Members, but cannot be seen as exceptions".[24]

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[19] US 11 August Answer to Question 20, para. 47.
[20] US 11 August Answer to Question 21, para. 48.
[21] Third Party Submission of the EC, para. 11.
[22] Third Party Submission of the EC, para. 12.
[23] Third Party Submission of the EC, para. 12.
[24] Third Party Submission of the EC, para. 12.

31. Article 13 of the Agreement on Agriculture is entirely different. The peace clause imposes no obligations on WTO Members. As the EC rightfully stated in paragraph 6 of its Initial Submission of 10 June 2003:

> a Member is not under an obligation to act consistently with Article 13 of the *Agreement on Agriculture* – failing to respect Article 13 implies that a Member no longer enjoys protection thereof. Consequently ... Article 13 of the *Agreement on Agriculture* can only be seen as a defence against a claim brought under other aspects of the WTO Agreements which regulate the provision of subsidies. It would seem bizarre if before Brazil could bring a claim with respect to subsidies which it considered did not respect the US's obligations, Brazil had first to establish that potential defences did not apply. (italics in original) (underlining added)[28]

32. Brazil entirely agrees with the characterization of Article 13 as a potential defence against claims brought before the WTO. In fact, as the Panel is well aware, in Brazil's request for the establishment of the Panel, Brazil does not claim that the United States violated Article 13. Such violation is indeed impossible, since Article 13 of the Agreement on Agriculture imposes no obligations whatsoever on WTO Members. Article 13 simply provides shelter to Members that invoke its exemption from actions based on certain other provisions of the WTO Agreements. Again, as the Appellate Body stressed every single time it addressed the issue, "the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence."[29]

33. Second, Brazil's interpretation is entirely compatible with the findings of the panel and the Appellate Body in *US – FSC*. Brazil, unlike the United States, considers these finding to be very relevant to this dispute. In *US – FSC*, the United States decided not to invoke Article 13 of the Agreement on Agriculture as a possible defence against the challenges brought by the EC. The panel and the Appellate Body did not need to address Article 13 simply because it was not used as a defence by the respondent. This situation is not necessarily unusual. For example, a respondent that knows, in advance, that it is not complying with the requirements of Article 13, may well choose to directly rebut the prima facie case of the complainant by providing rebuttal arguments and evidence without attempting to use the Article 13 shelter.

34. Indeed, interpreting Article 13 of the Agreement on Agriculture as a "threshold"[30] provision is at odds with the Appellate Body's findings in *US – FSC*, *US– FSC* (21.5), *Mexico – HFCS* (21.5) and *US – Byrd Amendment.* In Mexico – HFCS (21.5), the Appellate Body held that

> We believe that a panel comes under a duty to address issues in at least two instances. First, as a matter of due process, and the proper exercise of the judicial function, panels are required to address issues that are put before them by the parties to a dispute. Second, *panels have to address and dispose of certain issues of a fundamental nature, even if the parties to the dispute remain silent on those issues.* In this regard, we have previously observed that '[t]he vesting of jurisdiction in a panel is a fundamental prerequisite for the lawful panel proceeding.' For this reason, panels cannot simply ignore issues which go to the root of their jurisdiction – that is, to their authority to deal with and dispose of matters. Rather, *panels must deal with such issues – if necessary, on their own motion – in order to satisfy themselves that they have authority to proceed*. (emphasis added) (footnote omitted)[31]

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[28] Initial Third Party Submission of the EC, para. 6.
[29] Appellate Body Report, *US – Shirts and Blouses*, p. 14.
[30] Third Party Submission of the EC, para. 11.
[31] Appellate Body Report, *Mexico – HFCS (21.5)*, WT/DS132/AB/RW, para. 36.

B. “SUCH MEASURES” AND ANNEX 2 OF THE AGREEMENT ON AGRICULTURE

(22) Please explain the difference, if any, between the meaning of “defined” and the meaning of “fixed” in the phrase “a defined and fixed base period” in paragraph 6(a) of Annex 2 of the Agreement on Agriculture.

Brazil’s Comment on US Answer:

40. The United States 11 August Answer to Question 22 renders the meaning of the word “fixed” meaningless by isolating the phrase “relative position” from the full dictionary definition.[36] The complete definition includes the phrase “definite, permanent, and lasting”.[37] There is nothing “permanent” about the US interpretation of the meaning of “fixed base period” for the PFC and direct payment programmes. For further comments on the issue, Brazil refers the Panel to paragraphs 10-12 of its Rebuttal Submission.

(24) How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the Agreement on Agriculture?

Brazil’s Comment on US Answer:

41. Brazil agrees with the United States’ statement that there is “no requirement in paragraph 6 that a particular base period be used for a decoupled income support measure nor that the same base period be used for purposes of every decoupled income support measure.”[38] But this misses the point. The legal and factual question is whether a measure for which a new base period is ‘*fixed*’ has the same structure, design, and eligibility criteria as an older replaced measure which had a *different* base difign, and eligibility criteria a Tj 13.52.25 TD /F0 6.75 Tf 0.375 Tc 0 Tw (38)9Tj 7.5 -5.25 TD /F0 11.25 Tf -0 T

(32) If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2.

Brazil's Comment on US Answer:

43. Contrary to the US argument at paragraph 68 of its 11 August Answers, there is no conflict between the Brazil's position regarding the fruits, vegetables and wild rice prohibition and Annex 2, paragraph 1 'fundamental requirement"-0.73c frdamisputed fas thsw this pais afohibition anonhe

Brazil Comment to US Answer:

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52. The United States 11 August Answer does not address the second of the Panel's questions directly. But based on the argument in the "answer," the direct answer to the question would have been "*there are no circumstances in which measures which grant non-product specific support lose exemption from action under Articles 5 and 6 of the SCM Agreement and Article XVI of GATT 1994*." The arguments presented by the United States in its answer confirms that its interpretation creates a broad new category of "exempt" non-green box support – those presumptively trade and production-distorting measures it labels "non-product specific". The US constructs this new exempt category by improperly interpreting the phrase "product-specific" to include only non-green box support legally requiring the production of upland cotton. This incorrect definition is inconsistent with the fact that in analogous situations involving calculation of AMS, paragraphs 12-13 of Annex 3 of the Agreement on Agriculture require all types of non-green box support providing support to the producers of an agricultural commodity be included in the amount tabulated. These points are further discussed in paragraphs 13-67 of Brazil's Rebuttal Submission.

53. The US 11 August Answer to the first question in paragraph 84 indicates that it interprets the phrase "such measures" as only including "product-specific" support. Even apart from the incorrect US definition, such an interpretation renders a nullity the reference to most of the "measures" referred to in the "such measures" phrase of Article 13(b)(ii). If the drafters had intended to limit the universe of non-green box support in the manner suggested by the United States, they would have used the phrase "product-specific" instead of "such measures". The better interpretation that does not render the *chapeau* a nullity is that suggested by Brazil: any type of support listed in the chapeau which provides "support to a specific commodity" must be included within the support to be counted for the purpose of the required 13(b)(ii) comparison.

D. "IN EXCESS OF THAT DECIDED DURING THE 1992 MARKETING YEAR"

General Comment by Brazil on the US Answers to Questions 47-69

54. Brazil notes that the United States has not fully answered many of the questions posed by the Panel. The United States further announced in variTD -pts posludsed0.18Bs viewh me /F0 11.25 Tf ( ) Tj 210.75
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56. Any methodology that cannot account for *all* of the support "decided" and "granted" in MY 1992 and during the implementation period cannot be legitimate. A methodology that would sanction the cover-up of hundreds of millions – if not billions – of dollars of expenditures cannot be justified by the object and purpose of Agreement on Agriculture or by any reasonable reading of the text of Article 13(b)(ii).

57. With these general points in mind, Brazil comments on the answers provided by the United States.

(43) What are the precise differences between deficiency payments and counter-cyclical payments that lead you to classify the former as product-specific and the latter as non-product specific? How do you classify market loss assistance payments?

Brazil's Comment on US Answer:

58. The US 11 August Answer at paragraph 87-90 reveals its erroneous interpretation of the phrase "product-specific" in Article 1(a) of the Agreement on Agriculture. The United States ignores the phrase "in general" and assumes that "non-product specific" support is a huge residual category of support that includes everything *except* support which *requires* production of a specific product. Further, the United States' answer ignores the fact that all types of support in favour of domestic producers of a basic commodity are included in the analogous AMS calculation of Annex 3 – including "product-specific" support where the recipient is *not* required to produce a specific commodity. Brazil outlines the erroneous US interpretation in paragraphs 13-23 of its Rebuttal Submission.

59. The improper narrow US interpretation of "product-specific" is highlighted in its discussion of counter-cyclical payments where the only relevant fact is that a producer receiving CCP payments need not plant any crop at all. Brazil addresses in detail the evidence demonstrating that CCP payments are "support to" upland cotton in paragraphs 48-52 of its Rebuttal Submission.

60. With respect to market loss assistance payments, Brazil notes that it provides a detailed analysis of how such payments are "support to upland cotton" in paragraphs 29-35 of its Rebuttal Submission, as well as in paragraphs 50-54 of its Oral Statement. Contrary to the US statement in paragraph 92 of its 11 August Answers, Brazil has al

(48) Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made?

Brazil's Comment on US Answer:

62. Brazil comments on the US 11 August Answer to Question 48 in the context of its Rebuttal Submission at paragraphs 68-96.

(54) Please identify all United States legal and regulatory and administrative instruments decided during the marketing year 1992, with the respective dates of decision, that decided support for upland cotton.

Brazil's Comment on US Answer:

63. As Brazil has noted in its general comment at paragraphs 54-57 above, the United States focuses solely on the alleged target price decision of 72.9 cents per pound. This simplistic approach does not accurately reflect the actual operation of the US support programmes to upland cotton. As detailed by Professor Sumner in his Statement at the First Meeting, the United States took a number of decisions concerning support for the 1992 marketing year.[46]

64. Professor Sumner – who actually participated in the decision making process concerning the MY 1992 acreage reduction programme decision – explained during the First Meeting of the Panel that the decision on the percentage of upland cotton base that farmers participating in the deficie ncy98g3176.25 -12

United States considers storage payments and interest subsidies[50] as product-specific support to upland cotton. Consequently, under the US approach, these product-specific domestic support measures need to be taken into account for purposes of the Article 13(b)(ii) decision. Yet, the United States fails to account for these programmes in its list of decisions taken concerning support to upland cotton, just as it failed to account for various decisions relating to the deficiency payment, marketing loan and Step 2 programmes.

67. Brazil also notes that the United States failed to answer Question 54 that asked the United States to identify "all" instruments that decided support for upland cotton. This would also cover instruments other than product-specific instruments. However, the United States has only followed its simplistic view of what kind of decision it took and has not provided information on other decisions. This appears to be an attempt to avoid the conclusion under all other approaches: that the United States provided support in MY 1999-2002 in excess of that decided during the 1992 marketing year.

(55) Please provide a copy of the instruments in which the rate of support for upland cotton during the marketing year 1992 was decided, indicating the date of the decision.

Brazil's Comment on US Answer:

68. Page I8 Tj -378 Tw (Brazi TD 0.00 payments 33oma1o0.4639 Tw (marketing 75 -1 /F0 11date 1875 Tw2

71.

United States asserts. Professor Sumner[58] established that the US support programmes in MY 1992 did *not* provide a rate of support of 72.9 cents per pound to each pound of upland cotton produced in the United States. Numerous restrictions on the availability of the support by the deficiency payment programme and the marketing loan programme existed. In addition, participation in both programmes was costly to farmers, as farmers were mandated to set aside a certain percentage of acreage every year. USDA Chief Economist Keith J. Collins and USDA Deputy Chief Economist Joseph W. Glauber explain that

> [s]everal programme changes beginning with the 1985 Farm Act reduced the ability of deficiency payments to stabilize incomes by fixing programme payment yields, reducing the amount of acreage eligible for payments, and tightening payment limits. In addition, many producers elected not to participate in farm programs, making a large portion of production not covered by payments and a large portion of producers ineligible for them by the early 1990s.[59]

76. I h a d 0 1 r y Tf 0.4575 Tc 0 Tw Tw6

(66) Cou4/R/Adp0 uc 0.1875 Tw 11.2g Twomme

84. Total expenditures for MY 1992 and total expenditures for marketing years during the implementation period are the only legitimate bases for the comparison required by Article 13(b)(ii) of the Agreement on Agriculture. All other calculation methods are either not supported by a *Vienna Convention* analysis of Article 13(b)(ii) (US rate of support approach; US rate of support approach as modified by Professor Sumner), or have major shortcomings that should lead them to be used them with extreme caution (budgetary outlays per unit). Brazil notes that its expenditure approach and the analogous AMS calculation yield identical results, if one were to account for deficiency payments in terms of expenditures rather than by using the formula approach offered by Annex 3, paragraph 10-11 of the Agreement on Agriculture.[69]

(d) Per unit rate of support for upland cotton (Prof. Sumner's approach at the first session of the first substantive meeting).

Brazil's Preliminary Comment on US Answer:

85. Brazil will further comment on any answer pursuant to the US promise to provide "a detailed critique of Mr. Sumner's analysis."[70] As for the 11 August US comments, Brazil has earlier in its 22 August Comments to Questions 66(a) and (b) argued that Professor Sumner properly accounted for all US decisions.[71] Concerning the inclusion of crop insurance subsidies, PFC and market loss assistance payments, as well as direct and counter-cyclical payments, Brazil has demonstrated in its Rebuttal Submission[72] and in comments to Questions 38 and 43 that these domestic support measures constitute support to upland cotton as well as product-specific support. Thus, there is no basis to exclude these payments from any US calculation of upland cotton AMS.

(67) The Panel requests the parties to calculate and submit estimates of the AMS for upland cotton for marketing years 1992, 1999, 2000, 2001 and 2002. For this purpose the parties are each requested to submit AMS calculations for upland cotton (using the budgetary-outlay/non-price gap methodology employed by the United States in respect of cotton in its DS Notifications (e.g., G/AG/N/USA/43) and using the formats and supporting tables in document G/AG/2) on the same basis as would be the case in calculating a product specific AMS for the purposes of the calculation of the "Total Current AMS" in any year in accordance with the relevant provisions, including as appropriate Article 1(a), (b) and (h), Article 6 and Annex 3 to the Agreement.

Brazil's Comment on US Answers:

86. The United States' calculation of upland cotton AMS is incomplete because it does not account for the product-specific support provided to upland cotton from PFC and market loss assistance payment, direct and counter-cyclical payments and crop insurance subsidies. Brazil has discussed the nature of these programs as product-specific (and as constituting "support to upland cotton") and the incorrect US interpretation of "product-specific" elsewhere.[73] Brazil further notes that the United States has included in its calculation of upland cotton AMS storage payments and interest subsidies – product-specific support measures that the United States has not mentioned so far during this dispute.[74] Based on this and other new data supplied by the United States, Brazil provides an update of its AMS calculation and of its analysis of total budgetary outlays.[75]

[69] Brazil's 11 August Answer to Question 60, para. 97, and to Question 67, para. 130.

[70] US 11 August Answer to Question 66, para. 121.

[71] *See* para. 81-85 *supra*.

[72] Rebuttal Submission of Brazil, paras. 24-67.

[73] Rebuttal Submission of Brazil, para. 13-67.

[74] Brazil notes that it has asked the United States in consultations for information on any other domestic support measures the provides support to upland cotton and that the United States did not mention these

III. EXPORT CREDIT GUARANTEES

71 (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement? Why or why not? Does it confer a benefit within the meaning of Article 1.1(b)? Why or why not? If so, to whom?

(b) How, if at all, would these elements be relevant to the claims of Brazil, and the United States response thereto?

87. In responding to this Question, the United States relies solely on Article 10.2 of the Agreement on Agriculture and – alternatively – restricts the use of context from the SCM Agreement to item (j) only.[76] Brazil addresses the United States' arguments regarding Article 10.2 of the Agreement on Agriculture at paragraphs 99-100 of its Rebuttal Submission. In determining what constitutes an export subsidy within the meaning of Article 10.1 of the Agreement on Agriculture, Brazil considers that the Panel should refer to Articles 1(e) and 10.1 of the Agreement on Agriculture itself, as well as to contextual guidance included in Articles 1 and 3 of the SCM Agreement, and in item (j) of the Illustrative List of Export Subsidies annexed to the SCM Agreement. This is consistent with the Appellate Body's decisions in *US – FSC*[77] and *Canada – Dairy*.[78]

(73) The Panel could arguably take the view that Articles 1 and 3 of the SCM Agreement were relevant in assessing the WTO-consistency of United States export credit guarantees. The United States has yet to submit any evidence or argumentation on this point, either as potential context for interpretation of the terms in Article 10 of the Agreement on Agriculture or in cov0 TD c 1.4t *US*

such situations. Article 1.1 defines the existence of a subsidy for the purposes of the SCM Agreement and provides relevant context for the interpretation of the term "export subsidy" under the Agreement on Agriculture. Article 1.1(b) requires a comparison between what the recipient of a financial contribution received from the government and what the recipient could have received on the marketplace.[84] The Appellate Body clarified that the standard under Article 1.1(b) is not the cost incurred by the government (as under item (j)).[85] The relevant standard is the "benefit to the recipient" standard.

92. This definition of a subsidy cannot simply be read out of the SCM Agreement in a situation where there is no comparable commercial financing available. Nothing suggests that Article 1.1(b) is inapplicable in such a situation. The United States and the European Communities would certainly agree that a direct transfer of funds without consideration is not commercially available. In these

Brazil's Comment on US Answer:

94. In paragraph 145 of its response, the United States suggests that claims and defaults must exceed "revenue from whatever source it may be derived" to meet the elements of item (j), despite the fact that item (j) limits the revenue to be used to offset operating costs and losses to "premium rates". On the other hand, the United States maintains that it is only legitimate to account for claims and

reduction commitments. In any event, under the current regime governing the provision of export credit guarantees, they are subject to the anti-circumvention disciplines in Article 10.1 of the Agreement on Agriculture and count towards a Member's export subsidy reduction commitments, if they constitute export subsidies within the meaning of the Agreement on Agriculture (and, by context, the SCM Agreement).

(81) How does the United States respond to the following in Brazil's oral statement

(a) paragraph 122 (rescheduled guarantees)

Brazil's Comment on US Answer:

99. Although "rescheduled amounts are counted as *receivables*, not losses," that does not mean that rescheduled amounts are actually collected, or even expected to be collected. CCC's 2002 financial statements demonstrate that many of CCC receivables are classified as "uncollectible" – in fact, $3.34 billion of total receivables of $6.93 billion are classified as "uncollectible."[93] Moreover, as

102. Brazil notes that the United States has offered no documentation and data to support the figures included in paragraph 160 of its 11 August Answer. The Panel should not accept these unsupported assertions by the United States.

103. At paragraphs 122-123 of its 11 August Answer to Question 81(c), the United States asserts that "[a] cohort consists of all transactions associated with each type of guarantee issued during a particular year", and that "[n]ot until the cohort is closed can one make an assessment as to whether or not that particular cohort represents a cost to the Federal Government". Brazil notes that a "cohort" is not necessarily composed of *all* guarantees issued in a particular year. As the US Office of Management and Budget notes, cohorts may also be divided according to risk categories, with annual reestimates calculated according to those risk category-based cohorts.[96] The United States in fact acknowledges at paragraph 148 of its 11 August Answer to Question 86 that "[a]ll countries eligible for any of the CCC export credit guarantee programmes are categorized according to risk".

(d) paragraphs 127-129 (re-estimates, etc.)

Brazil's Comment on US Answer:

104. In paragraph 163 of its 11 August Answer, the United States asserts that the "net total for all cohorts for guarantees issued since 1992 currently stands at a downward re-estimate of $1.9 billion", suggesting that by the time a cohort is closed and final data becomes available, the cohort becomes profitable. Although the United States offers no citation, the $1.9 billion lifetime reestimate figure appears to be taken from the Federal Credit Supplement attached to the 2004 US budget. As discussed further in paragraphs 115-117 of Brazil's Rebuttal Submission, however, the United States fails to note that when these total lifetime reestimates for all cohorts of guarantees disbursed since 1992 are netted against the total *original* subsidy estimates adopted each budget year during the period 1992-2002, *the*

(e) Exhibits BRA-125-127

Brazil's Comment on US Answer:

106. The United States' 11 August Answer is incorrect. Reestimates are recorded in the "programme account" segment of the CCC guarantee programme budget, in line item 00.07 (interest on reestimates is recorded in line 00.08).[98] Furthermore, Brazil has consistently also included the financing account in its exhibits, including – contrary to the US allegation[99] – in Exhibit Bra-127.

(f) the chart on page 53 of Brazil's oral statement at the first session of the first Panel meeting relating to "Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM-102 GSM 103 and SCGP"?

Brazil's Comment on US Answer:

107. Brazil refers the Panel to paragraphs 111-119 of Brazil's Rebuttal Submission for discussion of the US arguments concerning "estimated" versus "actual" data.

(g) In respect of (a)-(f) above, how and to what extent do the information and data presented for the export guarantee programmes concerning "programme" and "financing", "summary of loan levels", "subsidy budget authority", "outlay levels", etc., in particular in Exhibits BRA-125-127, reflect "actual costs and losses" of the GSM-102, GSM-102 and SCGP export credit guarantee programmes(see e.g. Brazil's closing oral statement at the first session of the first substantive meeting, paragraph 24)?

Brazil's Comment on US Answer:

108. Brazil refers the Panel to paragraphs 111-119 of Brazil's Rebuttal Submission for discussion of the US arguments concerning "estimated" versus "actual" data.

(84) Is the Panel correct in understanding that, under the GSM-102 and GSM-103 programmes, the exporter pays a fee calculated on the dollar amount guaranteed, based on a schedule of rates applicable to different credit periods? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates?

Brazil's Comment on US Answer:

109. As noted in Brazil's 11 August Comment on Question 84 (at paragraphs 192-194), GSM 102 and GSM 103 fees are charged according to a fee schedule that does not account for the country risk involved or the credit rating of the borrower. The US Department of Agriculture's Office of the Inspector General noted in June 2001 that "the fees CCC charges for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed in 7 years and may not be reflecting current costs".[100] It repeated this statement in February 2002.[101]

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[98] *See* Exhibits Bra-88 to Bra-95 (US budgets for the years 1996-2003); Exhibits Bra-125 to Bra-127 (US budgets for the years 1994, 1995 and 2004). *See also* Exhibit Bra-184 (US budget for fiscal year 1993); Exhibit Bra-183 (US budget for fiscal year 1992).

[99] US 11 August Answer to Question 81(e), para. 168.

[100] Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-FM (June 2001), p. 31).

110. Moreover, the US General Accounting Office ("GAO") analyzed CCC's failure to charge guarantee fees that take account of country risk or the creditworthiness of individual borrowers. Brazil quotes at length from the GAO study, since it provides further corroborating evidence that beneficiaries of CCC guarantees receive terms better than available on the market, and that CCC guarantee fees do not cover the costs of the CCC guarantee programmes:

> Although GSM-102 recipient countries vary significantly from one another in terms of their risk of defaulting on GSM-102 loans, CCC does not adjust the fee that it charges for credit guarantees to take account of country risk. CCC fees are based upon the length of the credit period and the number of principal payments to be made. For example, for a 3-year GSM-102 loan with semiannual principal payments, CCC charges a fee of 55.6 cents per $100, or 0.56 per cent of the covered amount. For 3-year loans with annual principal payments, the fee is 66.3 cents per $100.[ ] CCC fees that included a risk-based component might not cover all of the country risk, but they could help to offset the cost of loan defaults.
>
> USDA officials told us that including a fee for country risk could reduce the competitiveness of GSM-

111. Brazil notes that CCC fees for GSM 102 have not changed materially since the GAO published its report in 1995.[104] Moreover, the United States confirmed in its 11 August Answer to Question 84 (at paragraph 180) that US law prohibi

Brazil's Comment on US Answer:

115. The United States incorrectly argues, in paragraph 187 of its 11 August Answer, that "[i]f export credit guarantee programmes were already subject to export subsidy disciplines, then Article 10.2 would be unnecessary." The negotiators may have considered it useful to neg

"conform fully to the provisions of Part V" of the Agreement on Agriculture within the meaning of Article 13 (how can you assess "conformity" or non-conformity when there are allegedly no disciplines against which such an assessment could occur)?

Brazil's Comment on US Answer:

120. The United States argues that since export credit guarantees are not subject to export subsidy disciplines in the Agreement on Agriculture, they "cannot be out of compliance with Part V" of the that agreement. The pertinent question is whether export credit guarantees can, under the terms of Article 13(c), "conform fully to the provisions of Part V" of the Agreement on Agriculture. In this regard, the United States ignores the conclusions of the panel in *Canada – Aircraft (21.5)*.[108] As noted in Brazil's 11 August Comment on Question 88(c) (paragraphs 200-202), if the United States is correct that CCC export credit guarantees are not subject to the disciplines in Part V of the Agreement on Agriculture, then CCC guarantees cannot logically "conform fully to the provisions of Part V" and trigger the exemption from action provided for in Article 13(c).

121. Alternatively, the United States suggests that Article 13(c) does not apply to export credit guarantees because "export credit guarantees are not export subsidies within the meaning of either Article 9.1 or 10.1" of the Agreement on Agriculture. This assertion is not supported by the United States with any reference to the tools of interpretation included in the *Vienna Convention*, and is fundamentally incorrect. Brazil has demonstrated that the GSM 102, GSM 103 and SCGP export credit guarantee programs administered by the CCC constitute export subsidies within the meaning of Articles 10.1, 1(e) and 8 of the Agriculture Agreement, Article 3.1(a) of the SCM Agreement, and item (j) of the Illustrative List of Export Subsidies attached as Annex I to the SCM Agreement.[109]

(d) Is the United States advocating the view that its own export credit guarantee programmes, which pre-dated the Uruguay Round, are effectively "grandfathered" so as to benefit from some sort of exemption from the export subsidy disciplines of the Agreement on Agriculture? How, if at all, is it relevant that the SCGP did not, according to the United States, become relevant for upland cotton until the late 1990's (i.e. after the entry into force of the WTO u p l T c 2 .

Brazil's Comments to the US Answers:

123. Brazil notes that the Step 2 regulations make a clear distinction between "domestic *users*" and "exporters".[110] "Domestic *users*" may only receive payment upon "proof of purchase and *consumption of eligible cotton by the domestic user. . .*".[111] The agreement for domestic users provides that a domestic user is a person regularly engaged in manufacturing eligible upland cotton into cotton products in the United States and that "in the event that the cotton is not used for that purpose, the payment received shall be returned immediately and with interest".[112] There is no requirement that "exporters" prove, prior to receiving payment, that exported US upland cotton be "used" for anything upon export. Rather, the payment is a function of "proof of export of eligible cotton by the exporter".[113] Thus, the structure of the Step 2 programme clearly differentiates between "export" and "use". Article 3.1(b) applies the phrase "contingent upon *use*." Article 3.1(a) uses the phrase "contingent . . . upon export performance".

124. In relation to Exhibit US-21, Brazil agrees with the United States that the two different forms that have to be annexed to the User/Exporter Agreement have different objectives depending on the final destination of upland cotton. That is, if the upland cotton is *used* domestically, then the CCC-1045UP-1 form has to be completed and annexed to the User/Exporter Agreement. If the cotton is exported, then the CCC-1045UP-2 form has to be used. However, contrary to the US statement at paragraph 201 of its 11 August Answer to Question 92, the latter makes no reference whatsoever to an "Exporter User." Indeed, the term "exporter user" is not contained either in the Step 2 regulations nor in the form that has to be annexed to the User/Exporter Agreement if the upland cotton will be exported. This is consistent with the fact that an exporter is not a "user" under the Step 2 programme and the act of exporting is unlikely a final "use" of upland cotton. In sum, Step 2 export payments are not made contingent upon "use," but contingent upon "*export*".

(93) Please elaborate why the United States deems that Step 2 payments upon submission of proof of export are not subsidies contingent upon export. Is it the US contention that, in order to be contingent on export, exportation must be the exclusive condition for receipt of the payment?

(99) How does the United States respond to Brazil's arguments in paragraphs 71-75 of Brazil's Oral Statement at the first session of the first panel meeting concerning the relevance of the Appellate body Report in US- FSC(21.5)

Brazil's Comment on US Answers:

125. The United States in its 11 August Answer to Question 93 states at paragraph 202 that "all upland cotton produced in the United States is eligible for the benefit of the Step 2 cotton subsidy".[114] Furthermore, it submits that "when the entirety of production of a good in a country is eligible to receive a subsidy, no contingency on export exists".[115]

126. Brazil provides a detailed comment to these assertions in its Rebuttal Submission.[116] In fact, Step 2 payments are not made to every pound of upland cotton that is "used". Rather, Step 2 payments are made on every pound of upland cotton that is *exported by eligible-*

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used by __eligible__ domestic __users__. No Step 2 payment is made for upland cotton exported or used by ineligible persons, or for upland cotton that is neither used domestically nor exported, but that is for instance stored, stolen or incidentally destroyed by for example fire.

127. Furthermore, the criterion whether Step 2 payments are available to all upland cotton produced in the United States is entirely irrelevant for Brazil's claims under Article 3 of the SCM Agreement. That provision prohibits the payment of subsidies that are contingent upon export or contingent upon the use of domestic over imported goods. It follows that a subsidy is prohibited if its payment is conditional on the existence of one of the two situations: export or use of local content.

(107) At paragraph 135 of its first written submission, the United States states: "The subsidy is not contingent upon export performance…"(emphasis added). Again, in the course of the first Panel meeting,

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ANNEX I-4

Please refer to Section V. of Annex D-4.

ANNEX I-5

ANSWERS OF BRAZIL TO QUESTIONS POSED BY THE PANEL FOLLOWING THE RESUMED FIRST SUBSTANTIVE MEETING OF THE PANEL

27 October 2003

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Short Title	**Full Case and Citation**
EC – Sugar Exports II (Brazil)	GATT Panel Report, *European Communities – Refunds on Exports of Sugar Complaint by Brazil,* L/5011 – 27S/69, adopted 10 November, 1980.
EEC – Wheat Flour	GATT Panel Report, *European Economic Community – Subsidies on Export of Wheat Flour*

List of Exhibits

"Production and Trade Policies Affecting the Cotton Industry," ICAC, September 2003	Exhibit Bra- 284
"Agriculture Fact Book 2001-2002," Chapter 3 – American Farms.	Exhibit Bra- 285
Direct and Counter-Cyclical Programme Contract, Form CCC-509, USDA, Commodity Credit Corporation	Exhibit Bra- 286
Market Revenue and US Government Payments to US Upland Cotton Producers.	Exhibit Bra- 287
"NASS to Update Acreage If Necessary," National Agricultural Statistics Service, USDA, 29 September 2003.	Exhibit Bra- 288
7 CFR 1412.606; 7 CFR 79	

John C. Beghin and Holger Matthey. "Modelling World Peanut Product Markets: A Tool for Agricultural Trade Policy Analysis". Center for Agricultural and Rural Development (CARD), May 2003.	Exhibit Bra- 303
John C. Beghin, Barbara El Osta, Jay R. Cherlow, and Samarendu Mohanty. "The Cost of the US Sugar Programme Revisited", Centre for Agricultural and Rural Development (CARD), March 2001.	Exhibit Bra- 304
Larry Salathe, J. Michael Price and David Banker. "An Analysis of the Farmer Owned Reserve Programme 1977-82. American Journal of Agricultural Economics, February 1984.	Exhibit Bra- 305
"Supply Response under the 1996 Farm Act and Implications for the US Field Crops Sector," Lin et al., USDA, July 2000.	Exhibit Bra- 306
Change in US and World Exports in Per cent.	Exhibit Bra- 307
"Decoupled Payments: Household Income Transfers in Contemporary US Agriculture," ERS, Agriculture Economic Report N° 822.	Exhibit Bra- 308
Barnard C., Nehring, R., Ryan, J., Collender, R. "Higher Cropland Values from Farm Programme Payments: Who Gains?" Economic Research Service. USDA, Agricultural Outlook November 2001.	Exhibit Bra- 309
"The Incidence of Government Payments on Agricultural Land Rents: The Challenges of Identification," Roberts, Kirwan and Hopkins, August 2003, American Journal of Agricultural Economics.	Exhibit Bra- 310
Side by Side Chart of the Weekly US Adjusted World Price, the A-Index, the nearby New York Futures Price, the Average US Spot Market Price and Prices Received by US Producers from January 1996 to the present.	Exhibit Bra- 311
Cotton Outlook Reports dated 7 June 2002, 27 September 2002 and 4 October 2002.	Exhibit Bra- 312

A. REQUEST FOR PRELIMINARY RULINGS

5. Brazil emphasizes that it is not challenging the underlying statutes authorizing the payment of cottonseed payments in MY 1999, 2000 and 2002, *i.e.*, Brazil does not challenge those payments *per se*. Brazil challenges as "measures" the payments of those subsidies as causing adverse effects to its interests. The United States and Brazil have consulted about those payments.[8] Brazil properly included reference to all "payments" for upland cotton in its request for the establishment of the Panel.[9] This is sufficient to properly identify cottonseed payments as measures for the purposes of Brazil's request for the establishment of the Panel.

B. EXEMPTION FROM ACTIONS

6. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture*? BRA, US

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6. No. Brazil's claims relate to prohibited and actionable subsidies provided during MY 1999-2002 whenA c c o r d i e n t o f 1

Brazil's Answer

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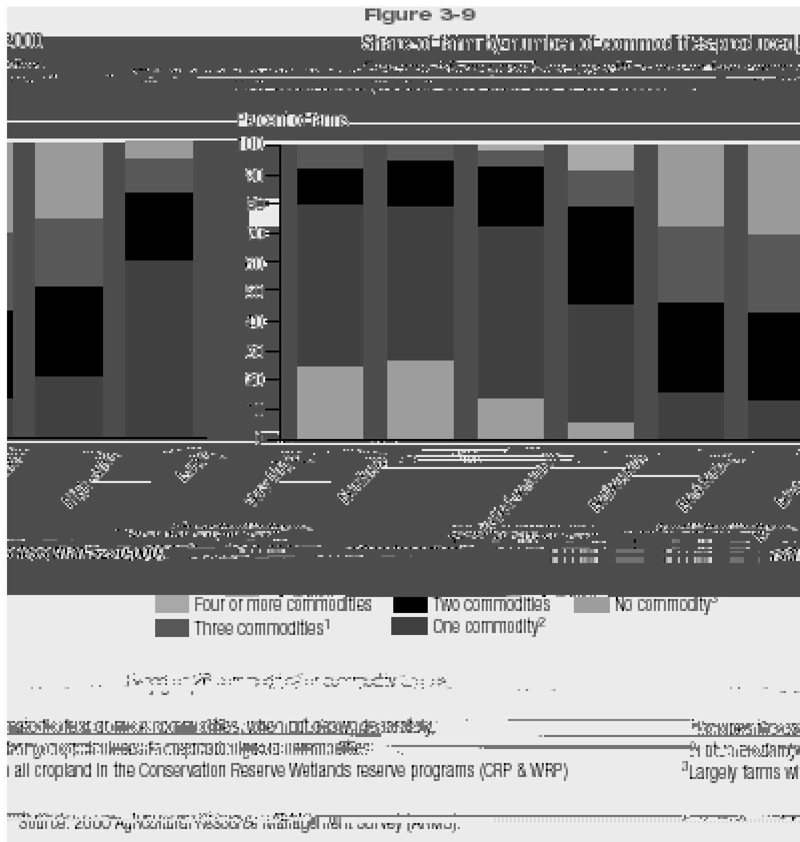
8. This evidence shows that farms with 500 or more acres of upland cotton are heavily specialized in the production of cotton. While these farms represented 33 per cent of US farms producing upland cotton, they produced 75 per cent of total US upland cotton in MY 1997.[11] Thus, the great majority of US production of upland cotton takes place on farms that largely specialize in the production of upland cotton.

9. Other data regarding specialization is found in a 1998 USDA report indicating that most smaller farms – defined as farms with income below $250,000 and which account for 92 per cent of all US farms – tend to produce only one or at most two crops.[12] This is illustrated in the chart below:

[10] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms", USDA, October 2001, p. 9).

[11] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms". USDA, October 2001, p. 7).

[12] Exhibit Bra-



10. Approximately 55 per cent of upland cotton is produced on such smaller farms.[13] Thus, even for those smaller farms producing upland cotton, the evidence suggests that over 50 per cent produce mainly upland cotton and the rest produce at most one additional crop. This evidence is consistent with Brazil's argument concerning cotton specialization.

11. With respect to the Panel's question, the 38 per cent figure cited by the United States refers to "planted cotton acreage" as a percentage of "total acreage operated".[14] The United States provides no information on what "total acreage *operated*" means. Nor does the United States provide the Panel with the amount of "planted cotton acreage" as a percentage of "total PFC/DP base acreage". It may be that the cotton acreage accounts for most of a farm's "base acreage". Thus, the "total acreage operated" is not the appropriate basis to calculate a percentage of base acreage for farms producing upland cotton. The best evidence of specialization is the actual payments made to upland cotton producers discussed in Brazil's Answer to Question 125 (5). The next best evidence is the USDA data on specialization of cotton farms cited above.

12. Moreover, Brazil's arguments are not dependent on proof that the majority of cotton farms produce *only* upland cotton. The evidence suggests that larger farms tend to grow at least some other crops and, therefore, may have more than one type of PFC/market loss assistance or direct and counter-cyclical payment "base acreage".[15] As Christopher Ward testified, farmers rotate the production of several different crops, planting one crop on a certain portion of the farmland, and then

[13] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms," USDA, October 2001, Table 7) tabulating farms with value of production less than $250,000.

[14] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms," USDA, October 2001, Table 3).

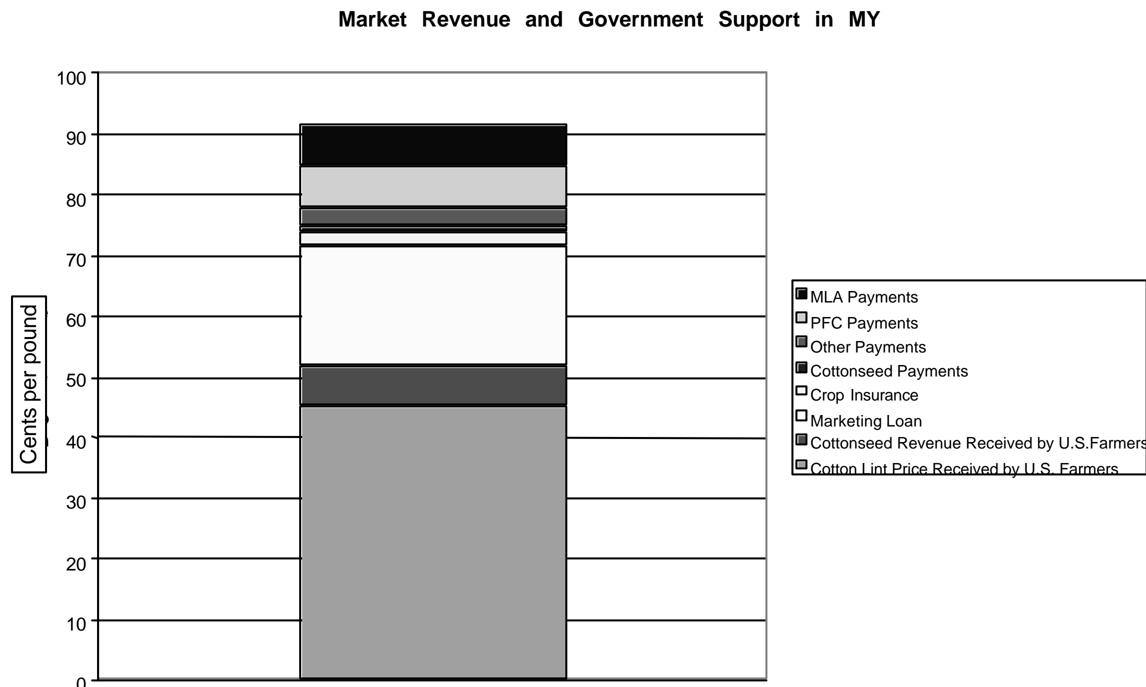
[15] This is also demonstrated by Exhibit Bra-286 (Direct and Counter-cyclical Program Contract, Form CCC-509, USDA, Commodity Credit Corporation), which provides for the possibility to establish base acres for different crops.

moving the production of that same crop to another portion of the farmland.[16] But the fact that crops are rotated or that some farmers have multiple types of "base acres" and produce more than one crop on their farm does not mean that farmers do not continue to plant upland cotton and use cotton-specific machinery and ginning facilities. This is confirmed by the fact that between MY 1999-2002, there were no wide swings in planted upland cotton acreage.[17]

13. Finally, while the United States is correct in stating that upland cotton is produced in 17 states, 66 per cent of upland cotton is produced in only 5 states, and 90 per cent is produced in only 10 out of the 50 US states.[18] In addition, even within each of these 10 sta

Dr. Glauber's comment that Step 2 payments are not received by US upland cotton producers but rather by exporters and domestic users.[20] Brazil generally agrees with this statement. Therefore, Brazil has excluded Step 2 payments from the pool of revenue received by US upland cotton producers.[21] It presents data on the total amount of market revenue for upland cotton lint and seed, marketing loan benefits, crop insurance payments, cottonseed payments, so-called "other payments"[22] and PFC, market loss assistance, direct and counter-cyclical payments.

15. The following chart shows revenues of upland cotton producers in MY 1999:[23]



16. The chart shows that US upland cotton producers received total revenue of 91.54 cents per pound of upland cotton produced. At the same time, the average cost of production was 82.03 cents per pound in MY 1999[24] and prices received by producers were 45 cents per pound.[25] It follows that US producers could not produce upland cotton without the financial assistance of the US Government in the form of large amounts of subsidies. US producers needed 4.46 cents per pound from the total combined upland cotton PFC and market loss assistance payment of 13.97 cents per pound to recover their costs.[26]

[20] Exhibit US-24, p. 3 fifth and sixth paragraph.

[21] This does not affect Brazil's view that Step 2 payments are properly included in the peace clause analysis under Article 13(b)(ii) of the Agreement on Agriculture as "support to upland cotton". While Step 2 payments may not directly benefit domestic producers of upland cotton, they do so indirectly. As they increase demand for US upland cotton, they increase prices received by US producers and are, therefore, properly described as "support to upland cotton".

[22] Interest subsidies and storage payments.

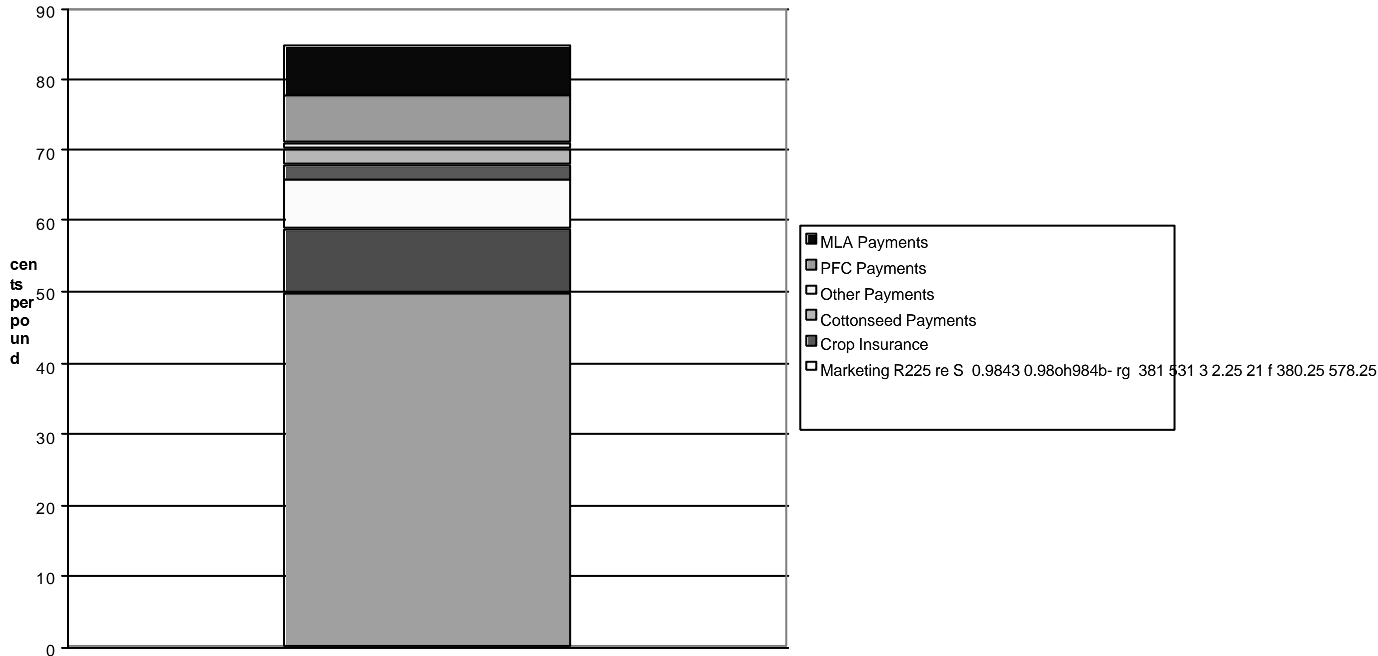
[23] *See* Exhibit Bra-287 (Market Revenue and US Government Payment to US Upland Cotton Producers).

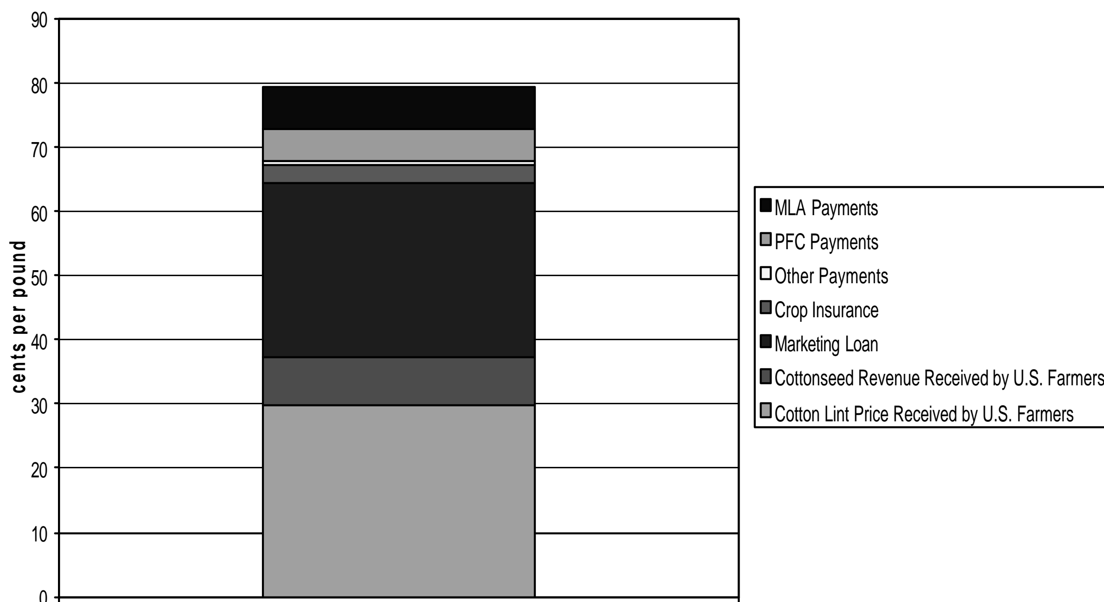
[24] Exhibit Bra-205 (Costs and Revenues of US Upland Cotton Producers).

[25] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 5).

[26] Thus, they could have produced upland cotton on wheat, corn, grain sorghum, cotton and rice base acreage without suffering a loss.

17. In MY 2000, the financial situation of US upland cotton producers worsened. While the price they received for upland cotton lint increased to 49.8 cents per pound[27], their total revenue fell to 84.74 cents per pound[28], only slightly above their average cost of production of 82.69 cents per pound.





20. US producers received a total revenue of 79.41 cents per pound,[30] only 29.8 cents per pound of which was market revenue for upland cotton lint. At the same time, they faced an average cost of production of 76.44 cents per pound.[31] Thus, the average US producer of upland cotton needed an upland cotton or rice PFC and market loss assistance payment to break even, while upland cotton production on corn or any other crop base acreage would have generated a loss.

21. For MY 2002, average US producers even suffered a loss from upland cotton production on upland cotton base acres[32], let alone corn or other crop base acres, except for rice and peanuts.[33] The average US upland cotton producer received total revenues of 82.96 cents per pound[34], while their average total cost for MY 2002 was 83.59 cents per pound.[35]

[30] *See* Exhibit Bra-287 (Market Revenue and US Government Payment to US Upland Cotton Producers).

[31] Exhibit Bra-205 (Costs and Revenues of US Upland Cotton Producers).

[32] Brazil notes that it is not in a position to quantify the effect of the yield update for purposes of the counter-cyclical payments and, thus, likely underestimated the amount of those payments (*See* Brazil's Answer to Questions 125 (8)). With slightly higher counter-cyclical payments than assumed by Brazil, US producers of upland cotton might have made a small profit in MY 2002.

[33] Brazil notes that while evidently some former corn producers had shifted to upland cotton production, the fact that they were allowed to update their base acres to upland cotton base acres meant that they could now receive upland cotton payments (*See* Brazil's Answer to Question 125 (7)).

[34] *See* Exhibit Bra-287 (Market Revenue and US Government Payment to US Upland Cotton Producers).

[35] Exhibit Bra-205 (Costs and Revenues of US Upland Cotton Producers).

on FSA's certified acreage information. As Exhibit Bra-288 makes clear, NASS reported the 2003 revisions using FSA information in the October Crop Production report, rather than waiting until December.[43]

(5) Do the acreage reports under section 1105(c) of the FSRI Act of 2002 indicate or assist in determining the number or proportion of acres of upland cotton planted on upland cotton base acres? Was there an acreage reporting requirement for upland cotton during MY1996 through 2002? BRA, US

Brazil's Answer:

30. The short answer to both of the Panel's questions is "yes". Regrettably, the United States has refused to provide Brazil or the Panel with the number or proportion of acres of upland cotton planted on upland cotton base acres for MY 1999-2002, despite Brazil's repeated efforts to obtain this information over the past year and despite the Panel's Question 67bis, in which the United States claimed incorrectly that it did not have access to this information.[44]

31. As implemented, Section 1105(c) of the 2002 FSRI Act requires any recipient of direct and counter-cyclical payments to submit, as a condition of eligibility of receiving the payments, "annual acreage reports with respect to all cropland on the farm".[45] This means that the precise acreage for each crop grown on the farm must be tabulated and identified in an annual report. Depending on the state and the county, these acreage reports are generally due by the middle of each calendar year.[46]

32. In addition to the annual acreage reports, the 2002 FSRI Act required all farms eligible for direct and counter-cyclical payments to file application forms establishing and proving their historic production of the 10 programme crops.[47] The required information includes the types, amount, and yields of all direct and counter-cyclical payment base acreages during the period 1998-2001 or reference to the earlier PFC base acreage. All of these applications were due no later than 1 June each year.[48] USDA reported in July 2003 that 99.6 per cent of eligible farms had completed the required applications and signed up for the direct and counter-cyclical programme.[49] Farms submitting both

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appear that the United States has collected precise acreage and payment information on (1) farms with PFC cotton base acreage, and (2) farms that produced upland cotton and received PFC and marketing loan payments. Combined with the specific farm identification number, this information would clearly permit the matching of information on a farm's crop base acreage and current planting and, thus, the collection of the amount and type of PFC (and market loss assistance) payments made to producers of upland cotton between MY 1999-2001.

34. In sum, the United States has exclusive control of the information that would provide the *amount* and *type* of PFC, market loss assistance, direct and counter-cyclical payments made by the US Government to US cotton producers during MY 1999-2002. The United States also has not provided information regarding the amount of updated upland cotton direct and counter-cyclical payment base acreage, the average yields applying to that (updated) base acreage, or the total amount of direct and counter-cyclical payment funds paid to holders of upland base acreage for MY 2002. All of this information is exclusively in the control of the United States and was first requested by Brazil over a year ago.[51] The Panel first requested this information in August 2003.[52] If the United States continues to refuse to provide this information, then Brazil submits that the Panel must either (1) draw adverse inferences that the information retained by the United States reflects greater payments than those estimated by Brazil,[53] or alternatively, (2) rely on Brazil's estimate that the payments equal total upland cotton base acreage payments times the ratio of upland cotton planted acreage to upland cotton base acreage.

(6) Please prepare a chart showing upland cotton base acreage, planted acreage and harvested acreage for MY1996 through 2002. Does the planted acreage fluctuate within a broad band? If not, does this indicate any stability in decisions to plant the same acres to upland [illegible]

38. The answer to the second question is yes. As indicated in Brazil's Answer to Question 125(2)(c), upland cotton producers would lose money in MY 2000-2001 (even with the subsidies) if they grew upland cotton on anything other than upland cotton or rice base acreage. The record indicates that PFC per acre payments were $30.84 for upland cotton and $23.48 per acre for corn in MY 2001.[58] There were no PFC or market loss payments for peanut base under the 1996 FAIR Act.[59] Testimony from NCC representatives indicated that a number of producers in the south-eastern part of the United States grew upland cotton on corn base acreage during MY 1999-2001.[60] NCC representatives argued that it would only be "fair" for producers with corn base acreage that had switched into upland cotton production to be able to update their base acreage to receive *upland cotton* direct and counter-cyclical payments.[61] NCC's efforts were successful, as reflected in the fact that under the 2002 FSRI Act, maximum total direct and counter-cyclical per acre payments for upland cotton base acreage is $109.50, while for corn it is $54.10 per acre. This large increase in per acre payment for cotton relative to corn in the 2002 FSRI Act reflects the much higher cost of producing upland cotton – and the expectation that historic cotton producers receiving such high payments will continue to grow high-cost upland cotton.

39. Given the much higher per acre payments in MY 2002 for upland cotton base acreage, any producer who could gain more upland cotton base acreage would certainly take advantage of the chance to update. Thus, any increases in the updated upland cotton base in MY 2002 reflect the economic incentive to obtain significantly greater additional revenue by switching to upland cotton acreage than in staying with historical corn, wheat, oats, barley sorghum and barley acreage. Finally, the higher per acre payments for upland cotton also reflect the squeeze in profits for those cotton producers that grew upland cotton in MY 1999-2001 on corn base acreage, as testified to by NCC representatives, discussed above.

(8) How could one take account of upland cotton producers who receive PFC, MLA, direct and counter-cyclical payments for other covered commodity base acreage? BRA, US

Brazil's Answer:

40. The best information to use would be the actual data collected by the United States concerning the amount of PFC, MLA, DP, and CCP payments to US upland cotton producers. In the absence of this information, Brazil's methodology assumes that US producers of upland cotton grew upland cotton on upland cotton base acreage. This is a reasonable proxy, because there will be some upland cotton that is grown on rice (and peanut) base receiving higher payments, and some upland cotton that is grown on, *e.g.*, corn base receiving somewhat lower payments. On average, Brazil's approach would roughly cancel out the *over*-counting of rice and peanut payments and the *under*-counting of corn and any other lower-paying programme crop payments.

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[58] Brazil's 9 October Closing Statement, Annex 1, para. 31, *citing* Brazil's 22 August Rebuttal Submission, paras 32-34.

[59] Brazil's 24 June First Submission, para. 45; Brazil's 22 August Rebuttal Submission, para. 24

[60] *See* NCC testimony quoted in Brazil's 24 June 2003 First Submission, para. 53 *citing* Exhibit Bra-41 (Congressional Hearing, "The Future of Federal Farm Commodity Programs (Cotton)," House of Representatives, 15 February 2001, p.32).

[61] "[W]hat has happened is, under Freedom to Farm . . . in the Southeast we moved from corn, like I have done, to cotton. *So the last few years we have increased our cotton acreage in Georgia, for instance, to about a million and a half acres; we are getting [PFC] payments on about 900,000 acres*. [W]e have a tremendous production in the Southeast that is not getting a [Market Loss] payment or a regular [PFC] payment. So we are recommending . . . to this committee that a farmer have a choice with remaining with his existing acreage and yield, *or he has an option to move to a modified acreage and yield on his farm or acreage on his farm, and this would make this, we think, fair*. . . And this happened . . . outside the Southeast, but it is been more pronounced in the Southeast than any other section of the Country." (emphasis added) Exhibit Bra-41 ("The Future of Federal Farm Commodity Programs (Cotton)," Hearing before the House of Representatives Committee on Agriculture, 15 February 2001, p. 32). Brazil's 24 June First Submission, para. 53.

F. PROHIBITED SUBSIDIES

128. Could the US respond to Brazil's assertions relating to the meaning and effect of the introductory phrase of Article 3 ("Except as provided in the *Agreement on Agriculture....*")? Would the meaning/effect change if Article 13 of the *Agreement on Agriculture* did not exist? BRA, US

<u>Brazil's Answer</u>:

41. In commenting on the first question directed to the United States, Brazil notes that the United States argues that the phrase "except as provided in the Agreement on Agriculture" necessarily means that negotiators intended to carve out both domestic local content and export subsidies for agricultural products from the disciplines of Article 3 of SCM Agreement.[62] But the United States' argument twists the meaning of the phrase "*except* as provided". The word "except" does not imply 62

rightly cautioned against interpretations that would exempt disciplines from entire sections of WTO agreements in the absence of a clear and unambiguous carve-out of rights and obligations.[64]

45. Furthermore, the United States' interpretation, which would (permanently) carve out all agricultural products from the prohibition of Article 3.1(b), is contrary to the object and purpose of Article 3 of the SCM Agreement. Negotiators expressed their intent that local content subsidies are a special class of trade-distorting subsidies. Because of their particularly trade-distortive nature, negotiators dispensed with the requirement of showing any adverse effects and made them prohibited subsidies. Given the special prohibited nature of such subsidies – coupled with the ability of negotiators to carve such subsidies out explicitly from the operation of the SCM Agreement – it would be expected that any exception from the disciplines would be clear and unambiguous.

46. The answer to the second question is "no". As Brazil's earlier submissions have articulated, Article 13(b) is not the only basis for Brazil's argument that the Agreement on Agriculture does not carve out agricultural local content subsidies from the Article 3.1(b) prohibition of local content subsidies.[65] As Brazil has argued, there is no inherent conflict between requiring the notification and scheduling of payments to processors of agricultural goods benefiting domestic producers under Annex 3, paragraph 7 of the Agreement on Agriculture and the prohibition on payments to processors of agricultural goods that are contingent upon the use of domestic over imported goods.[66] Nevertheless, the absence of any reference to Article 3 of the SCM Agreement in Article 13(b) of the Agreement on Agriculture (while a similar reference exists for export subsidies) is consistent with Brazil's other arguments that local content subsidies for agricultural goods are prohibited subsidies.

47. The US interpretation eliminating any prohibitions on agricultural local content subsidies creates a sharp distinction in the way that the other group of normally prohibited subsidies – subsidies contingent upon export – are treated under the Agreement on Agriculture. The Agreement on Agriculture provides many instances in which export subsidies for an individual agricultural product may be challenged as prohibited subsidies under the Agreement on Agriculture. These include prohibitions on export subsidies for unscheduled products, prohibitions on subsidies given to products where support is beyond the scheduled reduction commitments, and prohibitions on subsidies that lead to circumvention of export subsidy reduction commitments. By contrast, under the US interpretation of local content subsidies, there will never be an instance in which local content subsidies for an individual agricultural product would ever be prohibited.

48. It would be expected that such radically different treatment of local content subsidies would be spelled out clearly in the Agreement on Agriculture. Yet, the only link the United States can find to justify its total exclusion of local content prohibited subsidies is the provision in Annex 3, paragraph 7 to include local content subsidies – along with the multitude of other types of domestic subsidies that are *not* prohibited subsidies – in the support to be counted for total AMS. All that Annex 3, paragraph 7 stipulates is that AMS calculations shall include measures that "benefit the producers of the basic agricultural products". Such language contains nothing that conflicts with the obligation established in Article 3.1(b) of the SCM Agreement. Brazil notes that measures that "benefit the producers of the basic agricultural products" may or may not be "contingent upon the use of domestic over imported good". In both situations these subsidies must be included in AMS calculations. However, when challenged under the DSU, those subsidies that require local content

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[64] Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128; Appellate Body Report, *EC – Bananas*, WT/DS27/AB/R, paras. 157-158; Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, paras. 201, 208; Panel Report, *India – Quantitative Restrictions*, WT/DS90/R, para. 5.103.

[65] Brazil's 22 July Oral Statement, paras. 84-86; Brazil's 11 August Answers to Questions, paras. 215-217; Brazil's 22 August Rebuttal Submission, paras. 131-144.

[66] Brazil's 22 August Rebuttal Submission, paras. 137-140 (setting out examples where no such conflict would exist).

will be found to violate Article 3.1(b) of the SCM Agreement, and the subsidizing Member will be urged to withdraw such measures.

G. SPECIFICITY/CROP INSURANCE

129. In the event that the Panel does not consider that the alleged prohibited subsidies fall within the provisions of Article 3 and are therefore, pursuant to Article 2.3, "deemed to be specific", are there any other grounds on which Brazil would rely in order to support the view that such measures are "specific" within the meaning of Article 2 of the *SCM Agreement* (see, for example, fn 16 of Brazil's further submission)? BRA

Brazil's Answer:

policies that exceed the amount of premiums collected, thus providing free *reinsurance for private insurance companies* offering crop insurance.[72]

53. Brazil has demonstrated that crop insurance policies that are eligible for subsidy payments – both premium and reinsurance subsidies – are not available in respect of all agricultural products. The United States claims that crop insurance subsidies are and will in the future be available to livestock and dairy producers.[73] This assertion is incorrect. First, it is entirely irrelevant if crop insurance will be available to livestock and dairy producers in the future. The question that faces the Panel is whether the US crop insurance subsidies in MY 1999-2002 are specific, not whether they may at some point in the future become less specific. Brazil demonstrated that except for a very narrow pilot programme that began in MY 2002, there were no livestock "crop" insurance policies during MY 1999-2002.

54. Second, Brazil has demonstrated that crop insurance is currently – in MY 2003 – only available to livestock producers in a limited number of US states and counties.[74] The Adjusted Gross Revenue policy cited by the United States[75] covers only "incidental amounts of income from animals and animal products and aquaculture reared in a controlled environment," which must not exceed "35 per cent of expected allowable income".[76] In addition, this policy is only available for producers in a limited number of counties in 18 US states.[77] Even making the entirely unrealistic assumption that *all* US livestock in those pilot counties would be eligible for adjusted gross revenue coverage, that production[78] would only represent 7.58 per cent of the value of total US livestock production.[79] In addition, Brazil has demonstrated that the total value of US livestock and dairy production represents 52 per cent of the value of total US agriculture.[80] Thus, even taking into account the pilot counties for the adjusted gross revenue coverage, at least 48 per cent of the value of US agriculture is excluded from crop insurance subsidy benefits.

55. Third, the 2000 ARP Act itself explicitly limits its application to, *inter alia*, US crops, and does not cover insurance for the production of dairy, beef, poultry, pork and other livestock.[81]

56. In sum, the US crop insurance subsidies are not available to all US agricultural production.

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[72] Exhibit Bra-30 (Section 508(k) of the Federal Crop Insurance Act). For the reinsurance agreement standards *see* Exhibit Bra-39 (7 CFR 400.161 et seq.).

[73] US 30 September Further Submission, para. 15.

[74] Brazil's 7 October Oral Statement, para. 7.

[75] Brazil notes that this policy is the only one that is cited by the United States in support of its allegation that crop insurance would be available to all US agricultural products. Brazil is not aware of any other policy that would enable and in particular enabled US dairy or livestock producers during MY 1999-2002 to benefit from crop insurance subsidies.

[76] Exhibit Bra-272 ("Fact Sheet: Adjusted Gross Revenue," Risk Management Agency, USDA, February 2003, p. 1).

[77] Exhibit Bra-272 ("Fact Sheet: Adjusted Gross Revenue," Risk Management Agency, USDA, February 2003, p. 1,3).

[78] The record shows that most farms are small, and that many small farms specialize in beef production. *See* Bra-285 ("Agriculture Fact Book 2001-2002, Chapter 3 – American Farms, Figures 3.1 and 3.8). Therefore, these farms could not be eligible under the pilot programme because more than 35 per cent of their revenue is generated from the production of livestock. This suggests that even the figure of 7.58 per cent of total US livestock production is a significant overestimate.

[79] Exhibit Bra-271 (Analysis of the Market Value of Livestock in Adjusted Gross Revenue Insurance Pilot States and Counties).

[80] Brazil's 22 August Rebuttal Submission, para. 59 and Exhibit Bra-177 ("ERS Briefing Room: Farm Income and Costs: Farm Income Forecasts").

[81] Exhibit Bra-30 (Section 518 of the Federal Crop Insurance Act) contains a list of the "agricultural

131. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" -- in Article 2 of the *SCM Agreement* apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the *SCM Agreement*: BRA, US

(a) is a subsidy in respect of all agricultural, but not other, products specific?

(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?

(c) is a subsidy in respect of certain identified agricultural products specific?

(d) is a subsidy in respect of upland cotton, but not other products, specific?

(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?

(f) is a subsidy in respect of a certain proportion of total US farmland specific?

Brazil's Answer:

57. The short answer to Questions 131(a) – (f) is "yes."

58. Brazil's Further Submission sets forth a detailed analysis of the legal requirements for *de facto* and *de jure* specificity (paras. 34-40), demonstrating the broad agreement between the official US interpretation of Article 2 of the SCM Agreement in the Statement of Administrative Action ("SAA") and the position of Brazil. Brazil also provided a detailed application of those requirements for each of the relevant subsidies (paras. 41-70). Brazil offers the following additional comments below:

59. With respect to Question 131(a), a US subsidy that is made available to all enterprises in the industry producing agricultural commodities is specific. As Brazil and the United States agree, the purpose of the specificity requirements is to "function as an initial screening mechanism to winnow out only those foreign *subsidies which truly are broadly available and widely used throughout an economy*".[82] The United States' SAA notes that "all governments, including the United States, intervene in their economies to one extent or another, and to regard all such interventions as countervailable would produce absurd results". Among such "absurd results" would be countervailing "public highways and bridges, as well as a tax credit for expenditures on capital investment even if available to all industries and sectors".[83] After providing these examples, the SAA states that "the specificity test was not intended to function as a loophole through which narrowly focused subsidies provided to or used by discrete segments of an economy could escape the purview of the CVD law".[84]

60. The US subsidies at issue in this case – including crop insurance – are *de jure* limited under Article 2.1(a) because they "explicitly limit access to a subsidy to certain enterprises", *i.e.*, those producing, using, or exporting either crops, certain crops, or one crop.[85] The US subsidies are also *de facto* specific under Article 2.1(c) because they are used by a limited number of enterprises in relation to all enterprises and industries making up the US economy. Only the group of enterprises

[82] Exhibit Bra-148 ("Statement of Administrative Action," p. 929).

producing agricultural crops is entitled to receive or actually use these subsidies. All other enterprises and all other industries are excluded from the right to receive and, in fact, do not use such subsidies.

61. The broad diversification of the US economy is a relevant fact for the Panel to consider for *de facto* specificity under Article 2.1(c) ("account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority".). The US SAA indicates that the US Department of Commerce should take "account of the number of industries in the economy in question" in "determining whether the number of industries using a subsidy is small or large".[86] The US industry growing and producing agricultural products, or even the sub-industry of US producers who grow crops, are in the words of the US SAA, "a discrete segment" of the US economy. The value of all US agricultural production of all commodities is only 0.8 per cent of total US GDP.[87] Article 2.1(c) requires a Panel to undertake a "case by case" approach to diversification, and Brazil believes the approach presented here and endorsed by the US SAA is an appropriate application of the provision. In the case of the United States, there is a multitude of US industries that do not use the US subsidies at issue in this case. By contrast, in the case of Benin, the agricultural industry represents 38 per cent of its GDP.[88] For a country like Benin, subsidies to the entire agriculture sector would most likely not be considered to be specific because they are widely available to a large portion of the producers within the economy. No such facts exist for the cotton subsidies at issue in this dispute.

62. Brazil sees no basis in the text of Article 2 of the SCM Agreement for a different specificity test to be applied to subsidies for the purpose of Part V (countervailing measures) and Part III (actionable subsidies) of the SCM Agreement. Nor does Brazil see any basis to apply a different test of specificity for agricultural and other types of goods and industries – no such distinction exists in Article 2 of the SCM Agert I Tw (of aeninexample,-12.75 r large ase odthe totalture suctiutomojurTD -0.1643052 T

64. In deciding the question, the Panel should also take into account the significant implications of accepting the US arguments that any subsidy provided to all agricultural producers of all agricultural commodities would be non-specific. This interpretation would create a new class of trade-distorting agricultural subsidies that are non-actionable. The United States has always notified its crop insurance subsidies as amber box subsidies, *i.e.,* presumptively trade distorting. And USDA economists have found that even lower subsidies provided by the pre-2000 ARP Act increased US upland cotton acreage by 1.2 per cent and US upland cotton exports by 2 per cent.[92] Professor Sumner found that the higher subsidies provided by the 2002 ARP Act increased US upland cotton acreage by 3.3 per cent, US exports by 3.8 per cent, and decreased world A-Index prices by 1.3 per cent on average for each year between MY 2000-2002.[93]

65. The US specificity interpretation would permit, for example, a Member to provide a revenue guarantee to every enterprise producing any agricultural commodity to pay for the total cost of production plus a reasonable profit margin of 10 per cent. The US interpretation would permit Members to make direct payments to every farming enterprise that are tied to a constructed average price index for all agricultural products (not individual prices such as the CCP) and a farmer's current total production. A Member could also provide free inputs for the production of all agricultural commodities to every enterprise producing any agricultural product without that subsidy being actionable under Articles 5 and 6 of the SCM Agreement. In short, if the criteria is, as the United States argues, that the subsidy only need be provided to all farming enterprises, then *any* type of trade distorting non-green box domestic subsidy meeting that universal application criteria would escape discipline under the SCM Agreement.

66. The USinterpretation would create a gaping hole in the disciplines of the Agreement on Agriculture and the SCM Agreement. Such an interpretation is clearly inconsistent with the object and purpose of the Agreement on Agriculture, which is to "correct[] and prevent[] restrictions and distortions in world agricultural markets". It is inconsistent with the SCM Agreement's object and purpose of disciplining trade-distorting actionable subsidies. And it is completely inconsistent with the interpretation including in the United States' SAA.

67. With respricti

69. Finally, with respect to Question 131(f), another tool for evaluating the specificity of a subsidy is the amount of total US farmland that receives the subsidy. The use of "farmland" is a rough proxy for the number of enterprises producing agricultural products within the meaning of Article 2.1. For example, only 38 per cent of US farmland is used for the growing of crops (including hay) that are eligible for the payment of crop insurance.[95] By rough

positive subsidy figure of $411 million for the period 1992-2002.[99] The Panel will recall that under the Federal Credit Reform Act, when "payments from" the government exceed "payments to" the government on a net present value basis, a positive subsidy results, meaning that CCC is "los[ing] money".[100]

73. Brazil has explained that the FCRA cost formula is one way to determine the performance of

guarantee programme to exports of US upland cotton between MY 1999-2002. Brazil has no data – nor has the United States provided any – that would enable it to calculate the benefit involved in the GSM 102 transactions.[105]

83. However, the National Cotton Council, which represents the industry benefiting from the GSM 102 programme, has provided what appears to be a reasonable estimate of the benefits to US upland cotton producers, users and exporters. These benefits are significant enough to generate an additional 500,000 bales of US upland cotton exports per year and to raise domestic US prices by 3 cents per pound.[106]

84. Having proven the export subsidy character of the GSM 102 programme, as well as having proven the production and export-enhancing as well as A-Index-suppressing effects of the programme[107], Brazil has met its burden of proof under Articles 5 and 6.3 of the SCM Agreement and GATT Article XVI to establish that the GSM 102 programme causes serious prejudice to the interests of Brazil.

141. The Panel notes the US argument, *inter alia* in its further submission, that the export credit guarantee programmes are "self-sustaining". Recalling that item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* refers to "premium rates", could the US expand upon how it takes into account the premium rates for the export credit guarantee programmes in its analysis. US

Brazil's Comment:

85. As Brazil has argued elsewhere, the United States cannot make a showing that the CCC guarantee programmes do not constitute export subsidies by appealing to an *a contrario* interpretation of item (j), since item (j) does not admit of an *a contrario* defense.[108]

86. Even if item (j) does admit of an *a contrario* defense, proving that the CCC programmes are "self-sustaining" is not enough. Were an *a contrario* defense possible, it would require the United States to demonstrate that over a period constituting the long term, "premium rates" are adequate to cover operating costs and losses, which include but are not limited to "claims or defaults". In contrast, the United States has argued that it is sufficient to show that "claims or defaults" do not exceed "revenue from whatever source it may be derived".[109] "Revenue from whatever source it may be derived" gives credit to the United States for revenue that is not recognized as relevant for the purposes of item (j), and "claims or defaults" ignores "operating costs and losses" that are relevant for the purposes of item (j).[110]

87. As a factual matter, Brazil quite evidently does not agree that the premium rates for the CCC programmes meet their long-term operating costs and losses. Brazil has presented voluminous quantitative data demonstrating that long-term operating costs and losses incurred by the CCC programmes outpace premiums collected. Brazil has also provided statements from the USDA Inspector General[111] and the US General Accounting Office[112] establishing that CCC's failure to

[105] However, Brazil has established that GSM 102 guarantees confer benefits *per se*, since there is no comparable commercial instrument available in the marketplace.

[106] *See* also Brazil's Answer to Question 143.

[107] Brazil's 9 September Further Submission, paras. 184-192.

[108] Brazil's 11 August Answers to Panel Questions, paras. 143-149.

[109] US 11 August Answers to Panel Questions, para. 145.

[110] *See* Brazil's 11 August Answers to Panel Questions, para. 162; Brazil's 22 July Oral Statement, paras. 122-123.

[111] Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-

account for country risk or the credit rating of the borrower in setting guarantee fees means that CCC is charging "premium rates" that do not allow it to cover its operating costs and losses over the long-term.

142. The US has pointed out that there are many limitations on granting export credit guarantees and that there is no requirement to issue any particular guarantee (US further submission, paras 153-156). Can the Commodity Credit Corporation decline to grant an export credit guarantee even in cases where the programme conditions are met? US

Brazil's Comment:

88. No, the CCC cannot decline to grant an export credit guarantee even in cases where the programme conditions are met. The CCC cannot "stem[], or otherwise control[], the flow of" CCC export credit guarantees.[113] The CCC export credit guarantee programmes therefore threaten to lead to (and in fact have led to) circumvention of the United States' export subsidy reduction commitments, within the meaning of Article 10.1 of the Agreement on Agriculture.

89. Under the Budget Enforcement Act of 1990, the US Office of Management and Budget classifies the CCC export credit guarantee programmes as "mandatory".[114] Mandatory programmes like the CCC export credit guarantee programmes are exempt from the requirement in US law that a programme receive new Congressional budget authority before it undertakes new loan guarantee commitments.[115] As the Congressional Budget Office has noted, support *via* mandatory programmes like the CCC export credit guarantee programmes "must be available to all eligible borrowers", without regard to appropriations limits.[116] The Congressional Research Service has similarly stated that "[e]ligibility for mandatory programmes is written into law, and *any individual or entity that meets the eligibility requirements is entitled to a payment as authorized by the law*".[117]

90. The fact that the CCC can deny guarantees to individuals who do not meet the eligibility criteria does not, of course, affect the conclusion that CCC cannot "stem[], or otherwise control[], the flow of" CCC export credit guarantees.[118] The United States' FSC measure had eligibility criteria, but

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export credit guarantee programmes have not been changed in 7 years and may not be reflecting current costs".). Exhibit Bra-154 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC (February 2002), p. 49 ("[T]he fees CCC charged for its GSM-

the Appellate Body still concluded that nothing in the measure "stem[ed], or otherwise control[led], the flow of" FSC benefits, leading to a threat of circumvention of the United States' export subsidy reduction commitments.[119]

91. The entitlement that qualified applicants have to CCC guarantees is not curtailed by the requirement in US law that CCC not make available guarantees to countries that cannot adequately service debt.[120] That CCC has the authority to deny guarantees on this basis is not relevant, for at least three reasons.

92. First, under the United States' FSC measure, US authorities were permitted to undertake a factual enquiry into whether the foreign-source income of the foreign corporation was "effectively connected with the conduct of a trade or business within the United States".[121] This authority, and the possibility that the factual enquiry could limit the amount of income that would qualify for the FSC exemption, did not prevent the Appellate Body from concluding that nothing in the FSC measure "stem[ed], or otherwise control[led], the flow of" FSC benefits, leading to a threat of circumvention of the United States' export subsidy reduction commitments.[122] Similarly, the authority that CCC has to undertake an enquiry into whether particular countries are creditworthy, and the possibility that this enquiry could end up reducing the amount of CCC guarantees, does not prevent a conclusion that nothing "stem[s], or otherwise control[s], the flow of" CCC guarantees. (Brazil notes that, in any event, a conclusion by CCC that a particular country is not creditworthy would not necessarily reduce the threat of circumvention, since nothing prevents CCC from simply reassigning the country's allocation to a country that is creditworthy.)

93. Second, as Brazil has previously noted, the US General Accounting Office ("GAO") concluded that the requirement that CCC not make available guarantees to countries that cannot adequately service debt does not remotely curtail CCC's extension of its guarantees. According to the GAO, "the statute does not place any limit on the amount of guarantees that can be provided each year to high-risk countries in aggregate or individually".[123] Thus, the theoretical possibility to halt support to non-creditworthy countries does not "stem[], or otherwise control[]," the flow of CCC guarantees.[124]

94. Third, CCC is not concerned enough about creditworthiness to vary its fees based on the country risk involved.[125] Nor does US law require the CCC to take account of the creditworthiness of *individual guarantee recipients* in the fee charged. In fact, CCC fees expressly do not take account of the credit rating of an individual borrower.[126] Thus, even if CCC finds a country to be creditworthy, it is not compensated for particularly poor individual credit risks.

95. Nor is the entitlement that qualified applicants have to CCC guarantees curtailed by CCC's ability to adopt product- and country-specific allocations for its export credit guarantee programmes. Although CCC adopts initial allocations at the outset of a fiscal year, it generously increases those allocations as needed. In its announcement of initial allocations for fiscal year 2004, for example, which extends $2.8 billion in allocatio-

more than $6 billion.[127] Browsing the archived list of USDA press releases announcing supplemental allocations extended throughout fiscal year 2003,[128] for example, demonstrates that this is exactly what CCC does –

report are product-specific.[136] The press release announcing initial allocations for 2004 contains no product-specific allocations. These allocations do not "stem[], or otherwise control[], the flow of" CCC export credit guarantees in a way that would curb the threat that they will be used to surpass the United States' export subsidy reduction commitments for scheduled products.[137]

100. Second, the allocations are made on a *monetary* basis, which provides virtually no assurance that the United States will not surpass its *quantitative* export subsidy reduction commitments. This might not happen for all scheduled products in all years, but the threat that it will happen is tangible. Rice provides a good example. Based on the monetary amounts of exporter applications received for the CCC programmes, US export data, and average world prices, CCC guarantees to support US rice exports caused the United States to surpass its quantity export subsidy reduction commitments in fiscal years 2001, 2002 and 2003.[138] (Even if monetary allocations were relevant, nothing limits the amount of funds that can be allocated. The CCC programmes operate without the constraints of the appropriations process, and Congress requires that CCC make available a *minimum* of $5.5 billion in export credit guarantees.)

101. Third, the United States' schedule demonstrates that the CCC export credit guarantees are not the only subsidies available to support exports of scheduled commodities. Combining CCC guarantees with these other export subsidies augments the threat that the United States will exceed its export subsidy reduction commitments.

102. In summary, the CCC cannot "stem[], or otherwise control[], the flow of" CCC export credit guarantees.[139] None of the factors mentioned by the United States stem the flow of those guarantees, which CCC cannot decline to grant in cases where the programme conditions are met. The CCC export credit guarantee programmes therefore threaten to lead to (and in fact have led to) circumvention of the United States' export subsidy commitments, within the meaning of Article 10.1 of the Agriculture Agreement.

103. With respect to its claims under the SCM Agreement, Brazil notes that even if the CCC had the discretion not to grant export credit guarantees in cases where the programme conditions are met, it would not affect Brazil's claim that the guarantees confer benefits *per se*. As Brazil has discussed elsewhere, since CCC export credit guarantees from the GSM 102, GSM 103 and SCGP programmes are unique financial instruments for agricultural commodity transactions that are not available on the commercial market (certainly not for terms longer than the marketing cycles of the eligible commodities), each time they are granted, they confer benefits within the meaning of Article 1.1(b) of the SCM Agreement.

143. Brazil agrees with National Cotton Council estimates of the effects of the GSM 102 programmes (Brazil's further submission, para. 190) but it also cites a different conclusion by Prof. Sumner (paragraph 192). Brazil cites other estimates by Prof. Sumner throughout its further submission. Does Brazil adopt Prof. Sumner's conclusions and estimates as part of its submission? BRA

104. Brazil considers both the National Cotton Council's and Professor Sumner's estimates as independent parts of the record that demonstrate the serious prejudice caused by the GSM 102 programme to the interests of Brazil. The NCC has a staff of expert economists (including the former

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[136] Exhibit Bra-299 ("Summary of FY 2003 Export Credit Guarantee Programme Activity", USDA, covering GSM 102, GSM 103 and SCGP (Total GSM 102, GSM 103 and SCGP allocations for fiscal year 2003 are listed as $6.025 billion, with product-specific allocations as follows: $370 million of GSM 102 guarantees to Korea; $85 million of GSM 102 guarantees to Pakistan; and, $10 million of GSM 102 guarantees to Tunisia).

[137]

director of the FAPRI cotton model) and has testified to Congress that the effects of the GSM 102 programme increase annual US cotton exports by 500,000 bales and have a 3-cent per pound price effect.[140] Brazil has no reason to doubt the accuracy and reliability of the sworn NCC testimony to the US Congress.

105. Professor Sumner has based his analysis of the effects of the GSM 102 export credit guarantee programme on the earlier work by the National Cotton Council. Professor Sumner has modelled the impact of the GSM 102 export credit guarantee programme as a shift out of the demand curve for US upland cotton by 500,000 bales.[141] Brazil believes that the resulting lower estimates of the effects of the GSM 102 programme offered by Professor Sumner are yet another illustration of the conservative (and reasonable) nature of his model.

106. In response to the Panel's Question, Professor Sumner has rerun the model analyzing the results of a fixed 500,000 bales export effect rather than a shift out of the demand curve by that amount. His original results showed an average annual 305,000 bales export-increasing effect for MY 1999-2002.[142] But the assumption of a fixed 500,000 bale export-increasing effect from the GSM 102 programme results in an average world price effect between MY 1999-2002 of 0.928 cents per pound (or 1.80 per cent) compared to 0.57 cents per pound (or 1.12 per cent) estimated under the previous assumption.[143] For the period MY 2003-2007 the average world price effect would be 1.07 cents per pound or 1.93 per cent compared to the 0.53 cents per pound or the 0.96 per cent estimated previously.[144]

107. Brazil has submitted the analysis of Professor Sumner along with results from other economists and other evidence throughout its submissions. The Panel should consider the complete record in analysing the collective effects of the US subsidies. *Both* the NCC's as well as Professor Sumner's studies are positive evidence of the export-enhancing and price-suppressing effects of the GSM 102 export credit guarantee programme. Both the NCC's testimony as well as Professor Sumner's original as well as revised analysis establishes that GSM 102 causes serious prejudice to the

Brazil's Answer

and the individual and collective effects of all of the actionable subsidies.[145] If the Panel chooses to examine the individual instead of the collective effects of some of the US subsidies, it can do so based on the evidence produced by Brazil.[146] This evidence establishes causation whether the subsidies are examined individually or collectively. With respect to the interactive effects of the various US subsidies, please see Brazil's Answer to Questions 146.

146. Brazil acknowledges that there are some interaction effects that may increase or decrease the overall effects of the subsidies (Brazil's further submission, para. 225). How would your analysis under Articles 5(c) and 6.3 of the *SCM Agreement* and Article XVI of *GATT 1994* differ if it excluded, for example, crop insurance subsidies, PFC and/or direct payments? BRA

Brazil's Answer:

114. The evidence in the record is more than sufficient to establish present and threat of significant price suppression, increasing world market share, and inequitable share of world export trade even if PFC/direct payments and crop insurance subsidies were not deemed to be actionable subsidies.

115. In response to the Panel's question, Brazil asked Professor Sumner to use his model described in Annex I to Brazil's 9 September Further Submission to eliminate the effects of *all subsidies except the PFC/direct payment and crop insurance subsidies*. Professor Sumner's analysis examined the effects of the remaining US subsidies with respect to a number of factors such as planted acreage, production, US price, adjusted world price etc. The complete set of results is set forth in Exhibit Bra-301.[147] Brazil describes the interactive effects of all US subsidies *except* crop insurance and PFC/direct payments on US export and world A-Index prices below.

116. Analyzing the results for the MY 1999-2002 period from Exhibit Bra-301 shows that *but for* the payments from all US subsidy programmes (except the PFC and crop insurance), US exports would have fallen by 36.81 per cent and the world A-Index prices would have increased on average by 11.00 per cent (or 5.73 cents per pound). When crop insurance and PFC/direct payments are included in the original analysis, US exports fall by 41.17 per cent and Aor 5.73 c -0. pound). When cr75 0 14TD

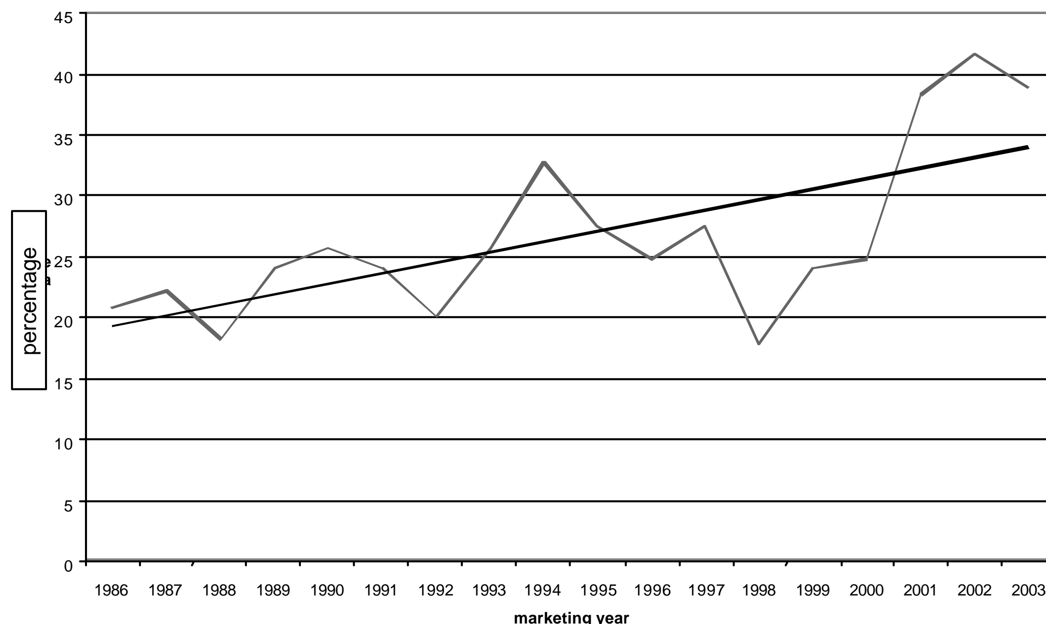
118. Brazil notes that most of its evidence does not involve proof regarding PFC/direct payments or crop insurance and would, therefore, not be impacted by the assumption in the Panel's question. In addition, many of the econometric analysis cited by Brazil focus on only some of the subsidies challenged by Brazil. The results of these studies are consistent with the findings of Professor Sumner's analysis set out in Annex I to Brazil's 9 September Further Submission and Exhibit Bra-301. In sum, even ignoring the effects of the crop insurance and PFC / direct payment programmes, the US subsidies cause serious prejudice to the interests of Brazil, within the meaning of Articles 5(c), 6.3(c) and (d) and GATT Articles XVI:1 and 3.

148. How should the significance of price suppression or depression be assessed under Article 6.3(c) of the *SCM Agreement*? In terms of a meaningful effect? Or another concept? BRA, US

Brazil's Answer:

119. The significance of pri

approximately 83,500 Benin upland cotton farmers below the poverty line.



126. The trend line beginning in MY 1986 in the graph above shows an overall consistent increase of US export market share over an 18-year period. This steady long-term increase coincides with the introduction of the marketing loan programme in MY 1986. Another highly trade distortive subsidy, the Step 2 payments, was introduced in MY 1990. The combination of these two subsidies, along with the other trade-distortive subsidies, played an important role in the progressive increase in US world market share over the long-term period covered by the MY 1986-2003 graph above. Thus, looking at all the trends collectively provides corroborating evidence that the large increases in the US world market share from MY 1998 to the present are caused, in significant part, by the US subsidies, in violation of Articles 5(c) and 6.3(d) of the SCM Agreement.

127. Brazil notes that MY 1998 was an unusual year with a relatively low US world market share as a direct result of a 20-per cent abandonment of upland crop acreage due to weather-related issues.[166] *But for* those weather-related problems, the US world market share would have been higher in MY 1998.

128. Finally, Brazil wishes to correct a typographical error in its calculation of the US world market share for MY 1997. The correct market share (as reflected in Figure 26 of Brazil's 9 September Further Submission) is 27.6 per cent, rather than 19.8 per cent,[167] as was incorrectly noted in Exhibit Bra-206. Brazil notes that this typographical error did not affect the calculations of the increase in the US world market share.[168] Correcting for this error, Brazil resubmits the corrected figures:

[166] *See* US 30 September Further Submission, para. 19.

[167] The error results from a typographical error in the line of the "total world exports", which were 26.7 million bales in MY 1997 and not 36.7 million bales, as erroneously included in the calculation.

[168] Brazil notes that Figure 26 of Brazil's 9 September Further Submission is unaffected by this data error and shows a very similar trend in the US world market share in cotton.

Figure 25 (para. 270)[169]

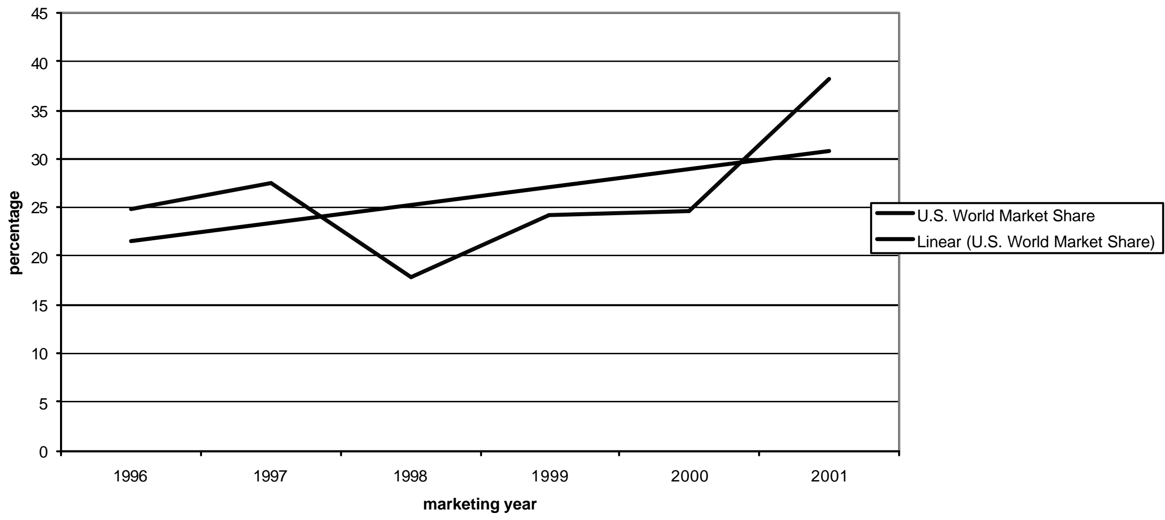


Figure 37 (para. 402)[170]

Brazil's Answer:

131. Brazil has established in paragraphs 117-123 of its 9 September Further Submission that between MY 1997-2002, US upland cotton producers on average were not able to cover their total cost of production,

producers would have to cut upland cotton production, and much upland cotton acreage would no longer be planted to upland cotton. This result is intuitively clear and is confirmed by evidence of significant production cut-backs by Mato Grosso producers (34 per cent) who are sensitive to changes in prices, as described in Christopher Ward's statement of 7 October.[182] It is also confirmed by the results of many economists examining the effects of eliminating US subsidies. They found that eliminating the US subsidies that cover the US producer cost-revenue gap would result in lower US production, leading to lower US exports and higher US and world prices.[183]

136. The Panel has also asked for US cost data on variable and fixed costs. Brazil provides below the most recent USDA data covering the period MY 1997-2002.[184] These data demonstrate that the "gross value of the US production" did not permit US upland cotton producers to cover their total costs of production. In MY 2001, the gross value of the production did not even permit them to cover their variable costs of production. In MY 2002, their revenue only covered slightly more than their variable costs. Not reflected in the chart below is the fact that US subsidies made up all (or almost all) the difference between the "gross value of the US production" and the "total costs listed" between MY 1997-2002.

US cotton production costs and returns per planted acre, excluding direct Government payments,
US cott208ed in thew (all) the differene3 Tw (2 1/) T69.5 0 TD 0 Tc 0.1875 Tw ( ) T -485-12.75 D -0.7u0) Tj

Allocated overhead:						
Hired labour	33.72	33.92	35.48	36.98	37.89	38.16
Opportunity cost of unpaid labour	28.03	28.76	29.27	29.90	30.28	32.73
Capital recovery of machinery and equipment	94.21	93.16	96.80	97.97	101.49	100.39
Opportunity cost of land	58.33	46.04	51.84	51.68	43.83	46.76
Taxes and insurance	14.97	14.20	15.07	15.93	16.68	17.01
General farm overhead	15.55	14.21	15.35	15.82	16.11	15.97
Total, allocated overhead	244.81	230.29	243.81	248.28	246.28	251.02
Total costs listed	516.27	461.16	488.07	517.66	530.52	529.02
Value of production less total costs listed	**29.28**	**-105.06**	**-173.27**	**-142.48**	**-259.12**	**-221.19**
Value of production less operating costs	**274.09**	**125.23**	**70.54**	**105.80**	**-12.84**	**29.83**

1/ Estimates based on 1997 survey.

2/ Method used to determine the opportunity cost of land.

J. CAUSATION

165. Please comment (and submit substantiating evidence) on the US assertion that the FAPRI model has been designed and developed for prospective analysis, and is not suitable for retrospective counterfactual analysis. What is the reliability of past FAPRI-produced analyses when compared with actual data for the period covered by them? Is there any other instrument that can be used to try to identify the effect of subsidies already granted, or of their removal? BRA, US

Brazil's Answer:

137. Concerning the first question, there is nothing inherently different in using a calibrated simulation model (the category of models into which the FAPRI and many other models fall) to investigate (i) questions of the future effects on prices and quantities of a potential change in policy
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produced analyses

139. As with other calibrated simulation models, the FAPRI model itself is also used routinely for both projections *and* retrospective counterfactual analysis. One recent publication that applied retrospective counterfactual analysis concerned world peanut (groundnut) policy. That study adapted the basic FAPRI framework, much as it was adapted to apply to the current case for upland cotton, to consider international peanut policy questions. The model is calibrated to three recent years – 1999/2000, 2000/2001 and 2001/2002 – and examines a peanut trade liberalization scenario.[185]

140. A second recent retrospective counterfactual application was to the US sugar programme in a project conducted for the US General Accounting Office. In that analysis, a version of the FAPRI domestic sugar model was combined with the CARD international sugar model (much as Professor Sumner has done for upland cotton, as reported in Annex I to Brazil's 9 September Further Submission). The model was calibrated to 1999 data, and results considered the effects of policy reform relative to the 1999 crop year actual outcomes.[186]

141. In addition, Brazil notes that USDA has frequently used calibrated simulation models to perform retrospective, counterfactual analysis. For example, USDA economists calibrated the USDA "SWOPSIM" model, which was used extensively to analyze trade policy options in the 1980s and 1990s, to 1989 data and solved it for commodity prices and quantities that would have obtained in that year under alternative trade liberalization scenarios.[187]

142. and examinpr ,HrfactuilOa30.2c 12rquequiteuentil2231 Tc 0.1052 Tc 0,w (Fample, USDA ions in420.1875 - Exhibit 338model48 Tw c O77 2467 TD /F0 6.75 T

baseline used for the analysis was the USDA 2000 baseline, which did not anticipate the sharp decline in cotton price for 2001 crop year."[190]

. . .

"The Commission requested that the above study be updated to take into account the sharp decline in cotton prices for the 2001 crop (Westcott). The updated analysis indicated that elimination of marketing loan benefits for the 2001 crop would have lowered cotton acreage by 2.5 to 3.0 million acres or 15-20 per cent and reduced rice acreage by 300,000 acres or 10 per cent."[191]

145. Finally, there are literally hundreds of other academic and government studies using a variety of models calibrated on retrospective data that analyze policy questions. All computable general equilibrium models use this approach, and most academic partial equilibrium simulation models do so as well.

146. Concerning the second question, it is difficult to determine the reliability of the analysis of *potential* (*i.e.,* future) policy outcomes because – by definition – the baseline approach will not mirror exactly the actual conditions. This is why baseline projections use long-term data to even out inevitable fluctuations in commodity market developments. Similarly, the *but for* analysis of a retrospective study attempts to simulate what would have (but did not actually) occur with different policy assumptions. However, the retrospective analysis has the benefit of using actual market data and not projected benchmarks. It is, of course, possible to critique selected portions of the FAPRI baseline projections if they are treated as forecasts of the future values for prices and quantities. Against this benchmark, the FAPRI projections – like all others – will sometimes miss future movements in commodity markets.

147. One measure of the reliability of the FAPRI baseline is that the FAPRI model continues to be relied upon regularly by a variety of US government and US industry organizations to guide decisions on important policy questions. USDA even provided the FAPRI economists with their highest award based on the 2002 baseline analysis.[192] In addition, FAPRI economists over the years have performed checks to ensure that the FAPRI model is as reliable as possible. For example, observed (actual) planted acreage has generally responded in the directions the model projects when the loan rates and other driving factors are relatively constant. In addition, FAPRI constantly examines the internal consistency of the model and its economic logic when compared to actual market events and conditions and makes appropriate adjustments, as necessary.

148. Concerning the third question, there are a number of other potential simulation modelling frameworks that can be used as instruments to respond to retrospective counterfactual policy questions. The USDA FAPSIM model is one such framework. It was used, for example, in the Westcott/Price analysis of the effect of removing all marketing loan payments for MY 2000 and MY 2001.[193] However, the FAPSIM model does not have a full international cotton model as used in the

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[190] Exhibit Bra-276 (Report of the Commission on the Application of Payment Limitations for Agriculture, August 2003, p. 124).

[191] Exhibit Bra-276 (Report of the Commission on the Application of Payment Limitations for Agriculture, August 2003, p. 125). *See* further: Westcott, Paul C. "Marketing Loans and Payment Limitations." Presentation to the Commission on the Application of Payment Limitations for Agriculture, May 2003 as cited in the Payment Limitations Report; Exhibit Bra-222 (Westcott, Paul C., and J. Michael Price. Analysis of the US Commodity Loan Program with Marketing Loan Provisions. USDA, ERS Agricultural Economic Report 801, April 2001); Westcott, Paul and Mike Price. Estimates done at the request of the Commission on the Application of Payment Limitations for Agriculture utilizing the Economic Research Service's FAPSIM model, 2003 as cited in the Payment Limitations Report.

[192] Brazil's 9 September Further Submission, Annex I, para. 4 (last sentence).

[193] *See* Brazil's 7 October Oral Statement, paras 32-33.

FAPRI/CARD framework, and thus would be less appropriate for dealing with the world price aspects of this case. In general, for specific questions about how quantities and prices of upland cotton

made. All of the dark area below the 52 cents line represents marketing loan subsidies paid to US upland cotton producers. This illustrates US producers' indifference to market prices. To paraphrase the United States, the line of 52 cents per pound illustrates a "disconnect," but it is not one between the A-Index price and US subsidies. Rather, this graph illustrates the disconnect between the AWP (and more importantly, the US price received by upland cotton producers) and the acreage and production response of US producers: even when prices go to record lows, US producers' revenue is insulated from the decline. This revenue not only kept them in production, but it allowed them to *increase* production during MY 1999-2001. And more remarkably, it kept many of the producers planting 14.2 million acres of cotton when the AWP was near record lows in the period from February-June 2002. These low prices during the crucial planting decision period are clearly reflected in the figure above.[197] It was this period that USDA economists Westcott and Price examined and found that but for the marketing loan payments in MY 2001, US upland cotton production would be 2.5-3 million bales less than it actually was.

152. Thus, this graph helps explain why there is such a limited response from high-cost US upland cotton producers to changes in upland cotton prices. Of course, the graph above does not represent the full amount of revenue supplied by all US subsidies. Other programme features and other programmes provide additional subsidies that cause the effective per unit revenue guarantee to be much higher than the loan rate.

153. If the purpose of Exhibit US-44 was to demonstrate the absence of a link between US upland cotton production (and price suppression) and US marketing loan payments, then it flies in the face of the findings of USDA's own economists. Brazil has referenced the testimony of USDA's chief economist, among many other USDA economists, who have candidly acknowledged the enormous production and price effects that US marketing loan subsidies have on stimulating and maintaining large amounts of US upland cotton production.[198]

170. Brazil quotes a report that states that a 10 per cent increase in soybean prices reduces upland cotton acreage by only 0.25 per cent (Brazil's 7 October oral statement, para. 27). Could Brazil indicate if this analysis is done on a short-run basis or a long-run basis? BRA

Brazil's Answer:

154. The authors of the USDA study cited by Brazil mlss than53 Tc 23 0 16 Tc 08n basis thio5 0 TD7cW

155. Lin et al. present their results in Table 21 of their study.[202] It appears that the resulting estimates of the acreage price elasticities are short or medium-term elasticities (acreage reaction one to three years in the future), and that the adaptations by Westcott and Meyer are also short to medium-term elasticities.[203]

172. Please estimate the price effect, in cents per pound, of the growth in the US retail market which it is said has directly contributed to strengthening world cotton prices. US

Brazil's Comment:

156. Brazil emphasizes that its claims under Article 6.3(c) of the SCM Agreement revolv T US.

Figure 14

2001-02 meant that Chadian production fell because producers could not afford inputs such as fertilizer.[211]

160. For US producers at the time of planting for the MY 2002 crop – between January-April 2002 – the AWP and US price received by US producers were near record lows.[212] Faced with an annual 39 cents per pound differential between total costs and such prices in MY 2001, US cotton producers still planted 14.2 million acres of upland cotton for MY 2002.[213] The resulting US production in MY 2002 was 16.73 million bales (or 3.64 million metric tons). This is an extraordinary amount of acreage and production given the huge gap between US producers' costs and expected *market* revenue. It is estimated that without US subsidies, US production in MY 2002 would have been approximately 1.92 million metric tons, or 1.72 million metric tons less than what US upland cotton farmers actually produced.[214] The effects of this additional 1.72 million metric tons of subsidy-generated production can be judged from the effects of an *actual* decline in world supply of 2.365 million metric tons[215], which contributed to an *increase* in A-Index prices of 33 per cent between MY 2001 and MY 2002.[216] If an *additional* 1.72 million metric tons of US production were taken out of world supply, prices would have been even higher. Professor Sumner has indicated that A-Index prices in MY 2002 would have increased by 17.70 per cent absent the US subsidies.[217] Thus, the effect of the US subsidies in MY 2002 – even as prices increased – was to suppress prices.

178. The Panel notes Exhibit US-63. Could the US please provide a conceptually analogous graph concerning US export sales during the same period? US

Brazil's Comment:

161. Brazil offers a conceptually analogous figure to Exhibit US-63 concerning US and rest-of-the-world export sales. The figure below shows the relative changes in US and non-US exports as compared to the previous year for the period MY 1997-2002, based on data covering the period MY 1996-2002.[218]

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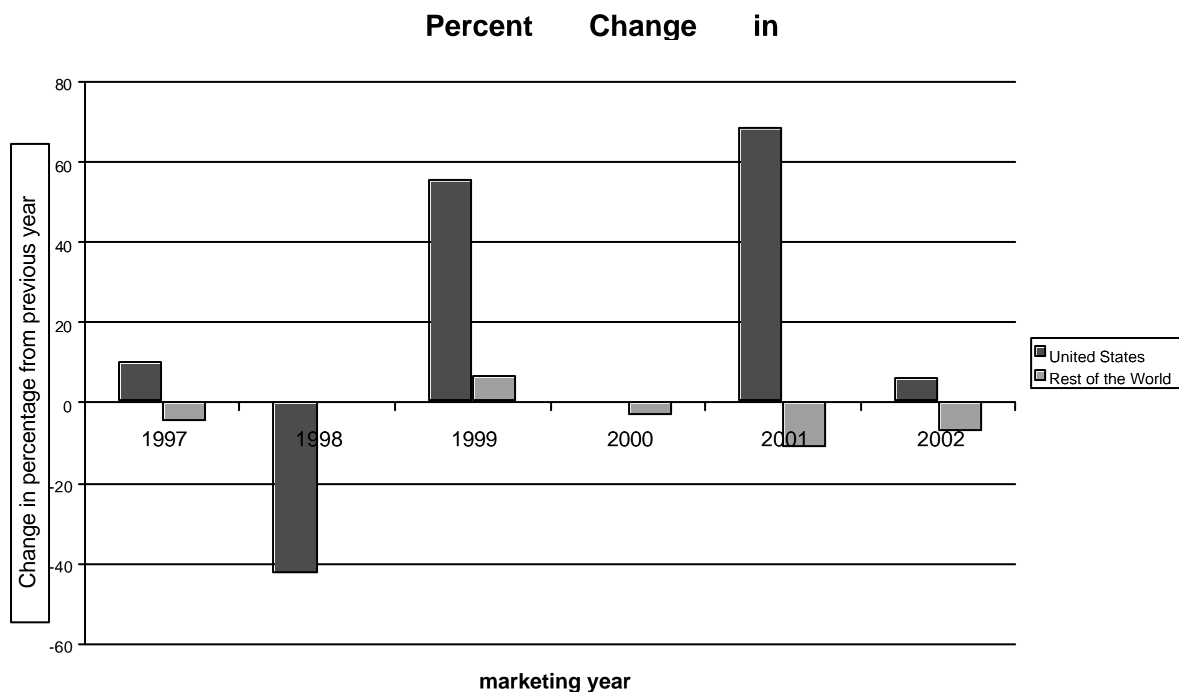
[211] Chad's 8 October Oral Statement (Statement of Ibrahim Malloum, para. 7).
[212] *See* Brazil's Answer to Question 167.
[213] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).
[214] Brazil's 9 September Further Submission, Annex I, Table I.5a applying the percentage change.
[215] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 4).
[216] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 106).
[217] Brazil's 9 September Further Submission, Annex I, Table I.5a.
[218] Exhibit Bra-307 (Change in US and World Exports in Percent). The exhibit also contains the underlying data for the figure with the sources being described in more detail in Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).



162. The figure demonstrates that US exports increased in every year except for MY 1998, during which the United States claims it suffered a major crop failure. In addition, US exports increased in all years, except for MY 1998, more than exports from non-US producers, which since MY 2000 even *decreased* continuously. The figure demonstrates that the United States gains world market share, with its own exports increasing since MY 1999, at the expense of non-US exports, which have fallen since MY 2000.

163. In sum, this figure supports Brazil's claim of serious prejudice under Articles 5(c) and 6.3(d) of the SCM Agreement. It also supports Brazil's claim of serious prejudice under Articles XVI:1 and 3 of GATT 1994 because the USshare of world export trade increased, in significant part, by the US subsidies at the expense of other lower-cost producers.

179 Could Brazil comment on the argument that decoupled payments and other subsidies to upland cotton are largely being capitalized into land values and that removing these subsidies would reduce the cost of production of upland cotton producers (US 7 October oral statement, para. 48). What would be the net effect of these adjustments? BRA

Brazil's Answer:

164. A February 2003 study by ERS economists estimated that "decoupled" payments lead to an increase of about 8 per cent in US farmland values.[219] A more comprehensive ERS 2001 report estimating the regional effects of all subsidies (not just decoupled subsidies) on land values found that land values increased by 16 per cent in the regions where upland cotton is grown. This is shown in the following chart:[220]

[219] Exhibit Bra-308 ("Decoupled Payments: Household Income Transfers in Contemporary US Agriculture," ERS Agricultural Economic Report No. 822).

[220] Exhibit Bra-309 (Barnard C., Nehring, R., Ryan, J., Collender, R. "Higher Cropland Value from Farm Programme Payments: Who Gains?" Economic Research Service. USDA Agricultural Outlook November 2001, p. 29).

ERS/USDA Estimated Cropland Value Attributable to Commodity Programme Payments

Region	Total Value of Land Harvested in 8 Programme Crops	Estimated Value Attributable to Commodity Programme Payments	Per cent of Value Attributable to Commodity Programme Payments
Prairie Gateway	41.70	9.40	23.00
Mississippi Portal	17.30	2.70	16.00
Fruitful Rim	21.60	2.20	10.00
Southern Seaboard	18.20	1.80	10.00
Eastern Uplands	4.60	0.50	10.00
Total	**103.40**	**16.60**	**16.05**

165. Brazil notes that neither of these studies provides an estimate of the percentage of each dollar of "decoupled" or total subsidy payments that are capitalized into land *values.* However, an August 2003 study by ERS economists indicates that PFC payments in MY 1997 resulted in an increase of land rents by 34-41 cents of per PFC dollar.[221] Thus, contrary to the premise of the

Brazil's Answer:

168. Brazil looks forward to receiving a detailed description of the complicated calculation of the adjusted world price from the United States in reply to this question. Brazil has set forth a brief description of the calculation of the adjusted world price in paragraph 73 of its 24 June First Submission, and will elaborate to the best of its understanding.

169. The details of the complicated calculation method for the adjusted world price are laid down in 7 CFR 1427.25.[226] The weekly

international and third country markets. The parallelism in the price movements establishes the link between price suppression in the US and international markets and other third country markets.

182. Please explain why the US can be taken to be price *leaders*, or price *setters*, (and not just takers) when US producers receive large subsidy payment to support the difference between *world prices* and their own costs? BRA

Brazil's Answer:

177. The Panel's question focuses first on "US producers" who receive large subsidies. One of the premises of this question is that US producers receive subsidies that account for the difference

181. For example, the large size of the US production, which represents approximately 20 per cent of total world supply annually, is a key factor in driving and influencing world prices.[236] Shifts in US production caused by good or bad US weather influence total world supply and create an impact on world prices.[237] In much the same way as US weather plays a role in the discovery of world prices (by reducing US and, thus, world stocks), continued high levels of US production generated by US subsidies suppressed world prices throughout the period of investigation by increasing world supplies.

182. Further, the dominant (over 40 per cent) export market share of the United States coupled with the Step 2 and GSM 102 export subsidies creates a further suppressing effect on world prices.[238] These export subsidies allow US exporters to price their upland cotton below the prices of most other world producers because Step 2 gives them (not US producers) the difference between the lowest US price and the A-Index price (the average five lowest prices in the world market).[239] These subsidies, along with the domestic production and direct payment subsidies, have permitted exporters of high-cost US upland cotton to increase US world market share even as prices plunged throughout MY 1999-2001. Thus, while individual US exporters may not have "set" or "led" prices, the US subsidies allowed these exporters to continue marketing high-cost US cotton at *whatever* market price was determined by global supply and demand conditions.

K. ARTICLE XVI OF GATT 1994

183. Why does Brazil believe that the appropriate "previous representative period" is the term of the previous Farm Bill, MY1996-2002? (Brazil's further submission, para. 282) BRA

<u>Brazil's Answer</u>:

183. The Panel's question has stimulated a re-evaluation by Brazil of the appropriate "previous representative period" in relation to Article XVI:3. Brazil agrees with the US arguments made in the *EEC – Wheat Flour* GATT dispute that the appropriate "previous representative period" in Article XVI:3 should be one in which trade patterns have not been distorted by subsidies. In that dispute, the United States correctly argued:

> …that the three most recent calendar years could not be used as the representative period in the case since, given the distortion of trade patterns resulting from the heavy

acreage was abandoned and US harvested acreage fell by 2.8 million acres compared to MY 1997.[246] US production fell by 4.77 million bales and US exports fell by 3 million bales. As a result, US world market share declined from 27.6 per cent in MY 1997 to 17.9 per cent in MY 1998.[247] This considerable decrease in the US share of world export trade provides an approximation for the Panel to assess what the equitable US share would be *but for* the US subsidies in MY 2001-2003. Thus, MY 1998 is a useful representative period for the Panel to examine (in conjunction with Professor Sumner's and USDA economists Westcott/Price's analysis).

187. An alternative representative period that the Panel could use for assessing the *inequitable* nature of the US share of world export trade in upland cotton is the period MY 1994-96, during which the average level of US subsidies fell to "only" $495 million per year.[248] The developmaunlr3g2o9Yu053tb0t9Yuw6P

184. Why does Brazil believe that an "equitable share" is one which factors out all subsidies? To the extent that domestic support and export subsidies are permitted by the *Agreement on Agriculture*, why should they not be accepted as being normal conditions in analyzing an equitable market share? (See Brazil's further submission, paras 288-289) BRA

Brazil’s Answer:

189. Brazil believes, for the reasons articulated by the United States in the *EEC - Wheat Flour* dispute quoted in Brazil’s Answer to Question 183, that the appropriate representative period for evaluating the *inequitable* share of share of world export trade is one in which no (or at most very

provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in *US-FSC*, para. 117[260] here?

Brazil's Answer:

202. Brazil agrees that Article 6.3(d) reflects one of the situations that would also fall under GATT Article XVI:3. An increase in the world market share compared to the previous three-year average through the effects of subsidies would be consistent with a finding of an inequitable share of world trade under GATT Article XVI:3. However, an increase over the previous three-year average is not a necessary prerequisite for a finding of a violation of GATT Article XVI:3. For example, a Member's share of world export trade may be inequitable even if that share has not increased over the average of the past three years. Similarly, a Member's increase in exports may be inequitable even if an increase in exports has not followed a consistent trend, as required under Article 6.3(d).

203. GATT Article XVI:3 is concerned with whether a particular level of a Members' share of world export trade is equitable, whereas Article 6.3(d) of the SCM Agreement only addresses an *increase* in the share. Article 6.3(d) creates a presumption that an increase in a Member's world market share over its previous three-year average that follows a consistent trend over a period when subsidies have been granted nullifies and impairs other Member's rights. No such presumption exists for Article XVI:3 – the nullification and impairment must be demonstrated by showing that the share

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[260] WT/DS108/AB/R, para 117:

> "… the provisions of the *SCM Agreement* do not provide explicit assistance as to the relationship between the export subsidy provisions of the *SCM Agreement* and Article XVI:4 of the GATT 1994. In the absence of any such specific textual guidance, we must determine the relationship between Articles 1.1(a)(1) and 3.1(a) of the *SCM Agreement* and Article XVI:4 of the GATT 1994 on the basis of the texts of the relevant provisions as a whole. It is clear from even a cursory examination of Article XVI:4 of the GATT 1994 that it differs very substantially from the subsidy provisions of the *SCM Agreement*, and, in particular, from the export subsidy provisions of both the *SCM Agreement* and the *Agreement on Agriculture*. First of all, the *SCM Agreement* contains an express definition of the term "subsidy" which is not contained in Article XVI:4. In fact, as we have observed previously, the *SCM Agreement* contains a broad package of new export subsidy disciplines that "go well beyond merely applying and interpreting Articles VI, XVI and XXIII of the GATT 1947". Next, Article XVI:4 prohibits export subsidies only when they result in the export sale of a product at a price lower than the "comparable price charged for the like product to buyers in the domestic market." In contrast, the *SCM Agreement* establishes a much broader prohibition against *any* subsidy which is "contingent upon export performance". To say the least, the rule contained in Article 3.1(a) of the *SCM Agreement* that all subsidies which are "contingent upon export performance" are prohibited is significantly different from a rule that prohibits only those subsidies which result in a lower price for the exported product than the comparable price for that product when sold in the domestic market. Thus, whether or not a measure is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the *SCM Agreement*. Also, and significantly, Article XVI:4 of the GATT 1994 does not apply to "primary products", which include agricultural products. Unquestionably, the explicit export subsidy disciplines, relating to agricultural products, contained in Articles 3, 8, 9 and 10 of the *Agreement on Against T.2570.490.187569.1875 Twing 0 Tw 8reement*

of world export trade is *inequitable*. While a particular situation may – as in this dispute – fall under both provisions, the focus and proof required for both provisions can be different.

204. Thus, Article 6.3(d) of the SCM Agreement subjects a specific subset of the situations covered by GATT Article XVI:3 to the remedy provided in Article 7.8 of the SCM Agreement. But it does not cover *all* of the situations covered by GATT Article XVI:3. This marks the crucial distinction between the provisions on export subsidies in the SCM Agreement that "take precedence" over those in GATT[261] and the provisions on actionable subsidies in both agreements that are complementary.

205. With respect to the Appellate Body's holding in paragraph 117 of *US – FSC*, the provisions on export subsidies in Articles 3 and 4 of the SCM Agreement represent the results of years of negotiations that have pushed the level of obligation in this area well beyond Article XVI:4. The conclusion that the Appellate Body drew in that instance was that "whether or not a measure is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the SCM Agreement." Brazil agrees that the provisions of Article XVI:2-4 that deal with subsidies contingent upon export performance are superceded by the respective export subsidy provision contained in the Agreement on Agriculture and in the SCM Agreement.

206. However, as Brazil has argued in response to Question 185(a), the second sentence of GATT Article XVI:3 is not a provision limited to subsidies contingent upon export performance. Rather, its disciplines apply to *any* form of subsidy that operates to increase the exports of a Member. Thus, it is not superceded by the export subsidy provisions of the Agreement on Agriculture and the SCM Agreement. Rather, it provides rights and obligations concerning any form of a subsidy independent of the right and obligations set forth in Article 3 of the SCM Agreement.[262]

(c)

ANNEX I-6

ANSWERS OF THE UNITED STATES TO QUESTIONS FROM THE PANEL TO THE PARTIES FOLLOWING THE SECOND SESSION OF THE FIRST SUBSTANTIVE PANEL MEETING

27 October 2003

A. REQUEST FOR PRELIMINARY RULINGS

122. Does Brazil allege that cottonseed payments, interest subsidies and storage payments are included in the subsidies that cause serious prejudice? Do they appear in the economic calculations? BRA

123. Does Brazil's request for the establishment of the Panel name the statute authorizing cottonseed payments for the 1999 crop? BRA

B. EXEMPTION FROM ACTIONS

124. According to its revised timetable, the Pan

the last several years, producers have reduced plantings of upland cotton and increased plantings to alternatives. A list of the full range of alternative crops that are viable in these areas would be extensive. Below we present a regional breakdown of some principal alternative crops to upland cotton as well as historical plantings since 1996 of these crops compared with upland cotton.

6. Upland cotton producers in the Southeast region (Alabama, Florida, Georgia, North Carolina, South Carolina, and Virginia) have corn and soybeans as principal alternative crops. Peanuts are also an alternative, though mainly in Georgia. Between 1996 and 2003, area planted to upland cotton, corn, and soybeans in the Southeast averaged about 8.6 million acres, ranging from 8.2 to 9.1 million acres. During this same period, upland cotton area ranged from 3.0 to 3.6 million acres. Since 2001, upland cotton has been reduced in favour of corn and soybeans in this region.

7. Upland producers in the Delta region (Arkansas, Louisiana, Mississippi, Missouri, and Tennessee) also have corn and soybeans as an alternative and, to a lesser extent, rice in some areas. Between 1996 and 2003, area planted to these 4 crops averaged 22.9 million acres, ranging from 22.2

11. In the short run, investment costs may slow acreage adjustments to market prices. This does not mean, however, that cotton producers do not respond to changes in market prices. Research by Lin et al. suggest that cotton producers may, in fact, be more responsive to own price changes (that is, the response of cotton acreage to changes in cotton prices as opposed to changes in prices of competing crops) **than other competing crops** are.[9] In the long run, fixed assets like cotton pickers are less of a constraint to entry, and thus one would expect the acreage response to changes in price to be larger.

Acreage own-price elasticity for major field crops

Crop	National acreage price elasticity
Wheat	0.34
Corn	0.293
Sorghum	0.55
Barley	0.282
Oats	0.442
Soybeans	0.269
Cotton	0.466

Source: Lin *et al.*, Appendix table 21 (Exhibit US-64).

(3) In calculating the amount of PFC, MLA, direct and counter-cyclical payments that went on upland cotton, Brazil made an adjustment for the ratio of current acreage to base acreage (see its answer to question 67, footnotes 2, 3, 4 and 5). Ba61 (Exhibio,0038 Tcppropriea70.187.5 0.75 h0 TD -m

1996 Farm Bill. Dividing harvested acreage by base acreage could potentially overstate the difference if there is significant acreage abandonment after producers reported their payment acres to the Farm Service Agency. Also, there remains a problem with the comparison since harvested acres are survey-based while base acres are reported numbers.

15. In the June *Acreage* report, the National Agricultural Statistics Service reports reliability estimates for selected crops. The **reliability of acreage estimates is computed by expressing the deviations between the planted acreage estimates and the final estimates as a per cent of the final estimates and averaging the squared percentage deviations for the 1983-2002 twenty-year**

19. The following chart shows upland cotton base acreage, planted acreage and harvested acreage for marketing years 1996 through 2002:

US upland cotton area (thousand acres)

Crop year	Base acreage 1/	Planted acreage 2/	Harvested acreage 2/
1996	16128	14395	12632
1997	16213	13648	13157
1998	16412	13064	10449
1999	16377	14584	13138
2000	16268	15347	12884
2001	16239	15499	13560
2002	16217 (est.)	13714	12184

1/ US Department of Agriculture, Farm Service Agency
2/ US Department of Agriculture, National Agricultural Statistics Service, selected Acreage reports

20. Over the period 1996-2002, US upland cotton planted acres ranged considerably, from 13,064,000 acres to 15,499,000 acres. Year-over-year, planted and harvested acreage can rise or fall significantly. For example, from marketing year 2001 to marketing year 2002, planted acreage fell by 1.785 million acres or 11.5 per cent; harvested acreage fell by 1.376 million acres or 10.1 per cent. As was pointed out in the US closing statement at the second session of the first substantive meeting of the Panel and in Exhibit US-63, year-over-year changes in US harvested cotton acreage have been similar to year-over-year changes for harvested cotton acreage outside of the United States. These data do not provide any information on whether the same or different acres are planted to upland cotton.

21. As noted above in the US answer to Question 125(5), based on a preliminary review of a sampling of marketing year 2002 acreage reports, it would appear that nearly half of farms receiving direct and counter-cyclical payments in 2002 for upland cotton base acreage planted no upland cotton at all. That so many farms that produced upland cotton during the historical base period of 1993-1995 or 1998-2001 no longer plant even a single acre of upland cotton suggests that there has been a large exit of past cotton producers and a large entry of new producers or a large expansion by other historical cotton producers.

(7) Brazil states that one third of all US farms with eligible acreage decided to update their base acreage under the direct payments and counter-cyclical payments programmes using their MY1998-2001 acreage. What is the proportion of the current base acreage for upland cotton resulting from such updating? Is the observed updating of base acreage consistent with Brazil's argument that it is only profitable to grow upland cotton on base acreage (and peanut and rice base acreage)? BRA

(8) How could one take account of upland cotton producers who receive PFC, MLA, direct and counter-cyclical payments for other covered commodity base acreage? BRA, US

22. Under Brazil's approach, one would need to take account of upland cotton producers receiving decoupled payments only for base acreage for other covered commodities. This follows from Brazil's explanation that "only the portion of upland cotton [decoupled] payments that actually benefits acres planted to upland cotton can be considered support to upland cotton".[11] Thus, under Brazil's approach, one would need to deduct any production (or acreage) attributable to such producers from the acreage figures Brazil has used to adjust the amount of decoupled payments on upland cotton base acreage.

[11] Brazil's Answer to Question 67 from the Panel, fn. 2-5.

(9) Assuming that Brazil's payment figures were to amount to a prima facie case, please answer the following questions: US

(a) How would the United States calculate or estimate the proportion of upland cotton producers who receive subsidy payments for upland cotton base acreage?

(b) Should any adjustment estimates be made for any factors besides those listed by Brazil?

(c) What adjustment estimate would it be appropriate to make?

(d) How could one take account of upland cotton producers who receive decoupled payments for other programme crop base acreage?

(e) Could the US specifically indicate what, in its view, are the flaws in the approach summarized in paras. 6-7 of Brazil's closing oral statement on 9 October (i.e. the use of the ration of 0.87 to adjust the amount of total upland cotton direct and CCPs for the MY to obtain the amount of subsidies received by upland cotton producers)? Can the US suggest an alternative approach that would yield reliable results in its view?

23. Putting Peace Clause and green box issues to one side, the United States believes that the issue of what payments may be attributed to upland cotton production is fundamentally part of Brazil's burden to present evidence substantiating the amount of the subsidy that it is challenging. However, the United States would note that this issue is not a matter of "the proportion of upland cotton producers who receive subsidy payments for upland cotton base acreage." Rather, the issue is, first, what is the quantity of decoupled payments received by upland cotton producers; second, how are those payments allocated across the total value of each farm's agricultural production; and third, how much and in what amount are US cotton exports subsidized by these payments.

24. Brazil has conceded that decoupled payments made with respect to upland cotton base acreage are not "tied to the production or sale" of upland cotton, by adjusting such payments by 0.87.[12] That is, Brazil recognizes that, even on its theory, at least 0.13 of these payments "can[not] be considered support to upland cotton" because at least that fraction of upland cotton base acres were not planted to upland cotton in marketing year 2002. Because these payments are not "tied to the production or sale" of upland cotton, as suggested by Annex IV of the Subsidies Agreement, they must be allocated across the total value of production of each recipient. Brazil has not denied the applicability of the allocation methodology set out in Annex IV, but neither has Brazil provided any evidence relating to the total value of production of decoupled payment recipients.[13]

25. Brazil claims that its "suggested methodology is based on the conclusion that all upland cotton producers received these payments".[14] In fact, Brazil's methodology is based on the further assumptions that (1) every acre of upland cotton in marketing year 2002 was planted by a holder of upland cotton base acreage and (2) no such base acreage holder planted more upland cotton than his or her base acres.[15] Brazil has provided no evidence to support these assumptions, which is no

[12] In addition to issues relating to the "adjustment," the United States disagrees with the total amount of decoupled payments paid with respect to upland cotton base acreage that Brazil calculates and uses as the base for its adjusted payment amounts. *See* US Answer to Additional Question 67*bis* from the Panel, para. 28, fn. 37, 38.

[13] As noted in the Panel's Question 125(2)(a), average cotton area is approximately 38 per cent of a cotton farm's acres. Thus, a substantial portion of the average cotton farm's agricultural production will be derived from production of other crops.

[14] Brazil's Closing Statement at the Second Session of the First Panel Meeting, para. 8.

[15] Using figures for marketing year 2002 planted acreage and base acreage, Brazil claims, "Out of the 16.2 million upland cotton base acres, 2.1 million were not planted to upland cotton in MY2002." Brazil's Closing Statement at the Second Session of the First Panel Meeting, para. 6. However, given the planting and

surprise since the evidence is to the contrary. For example, the fluctuations in upland cotton planted and harvested area in recent years and the fact that one-third of all US farms with eligible acreage decided to update their base acreage using their MY1998-2001 acreage, imply substantial new entrants or new acreage that were not included in the base period figures under the 1996 Act. In fact, as noted above in the US answer to Question 125(5), based on a preliminary review of marketing year 2002 acreage reports, the United States estimates that nearly half of all farms receiving direct and counter-cyclical payments in 2002 for upland cotton base acreage planted no upland cotton at all.

26. We also note that there are substantial requirements with which a payment recipient must

agricultural products for which policies are offered by private companies. Therefore, pursuant to Article 1.2, this "subsidy" is not subject to the provisions of Part III of the Subsidies Agreement.

30. With respect to cottonseed payments, we recall that these payments are not within the terms of reference of the Panel.[16] With respect to "other payments" for upland cotton notified by the United States to the WTO – that is, storage payments and interest subsidy – the United States also recalls that these payments are not within the Panel's terms of reference.[17] Without prejudice to the US request for preliminary rulings on these three types of payments, the United States considers that these product-specific amber box payments are subsidies within the meaning of Article 1.

31. With respect to green box production flexibility contract payments under the 1996 Act and direct payments under the 2002 Act, the United States does not consider that Brazil has demonstrated what is the amount of the subsidy attributable to upland cotton producers pursuant to Article 1. Article 1 requires that a financial contribution by a government or public body or income or price support confers a benefit. The subsidies Brazil challenges are subsidies to producers, users, and/or exporters of upland cotton. However, Brazil has not identified the portion of the production flexibility contract payments that is properly attributable to upland cotton producers as opposed to other recipients of this subsidy. In fact, Brazil concedes that the entire amount of these payments does not confer a benefit on upland cotton producers by reducing the amount of production flexibility contract payments and direct payments on upland cotton base acres by the proportion 14/16. However, Brazil has provided no evidence of the amount of these decoupled payments received by producers that currently produce cotton. Nor has Brazil demonstrated how much or to what extent US cotton exports are subsidized.

32. With respect to *ad hoc* market loss assistance and counter-cyclical payments under the 2002 Act, the United States also does not consider that Brazil has demonstrated what is the amount of the subsidy attributable to upland cotton producers pursuant to Article 1. Specifically, as with production flexibility contract payments and direct payments, Brazil has not identified the portion of the subsidy that is properly attributable to producers of upland cotton as opposed to other recipients of this subsidy. Brazil has not identified the benefit to upland cotton producers conferred by these payments. Rather, Brazil merely assumes that for every upland cotton harvested acre, upland cotton producers had a corresponding upland cotton base acre. However, Brazil has provided no evidence of the amount of these decoupled payments received by producers that currently produce cotton.

F. PROHIBITED SUBSIDIES

128. Could the US respond to Brazil's assertions relating to the meaning and effect of the introductory phrase of Article 3 ("Except as provided in the Agreement on Agriculture....")? Would the meaning/effect change if Article 13 of the Agreement on Agriculture did not exist? BRA, US

33. It is not entirely clear to the United States to which assertions of Brazil the Panel refers in its question. Moreover, the United States does not believe Brazil has purported to ascribe a specific meaning to that particular phrase. Indeed, with respect to Article 3.1(b), Brazil's arguments would effectively delete the introductory phrase in its entirety.[18]

G. SPECIFICITY / CROP INSURANCE

129. In the event that the Panel does not consider that the alleged prohibited subsidies fall within the provisions of Article 3 and are therefore, pursuant to Article 2.3, "deemed to be

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[16] *See, e.g.*, US Further Submission, para. 8.
[17] *See* US Further Submission, paras. 6-7.
[18] See Answer of the United States to Panel Question 144, *infra*.

agreed have no or at most minimal trade

submission, paras 153-156). Can the Commodity Credit Corporation decline to grant an export credit guarantee even in cases where the programme conditions are met? US

56. A proper response to this question requires one to define by what is meant by "programme conditions". The arguments of Brazil would appear to create a tautological circularity: if one assumes that none of the various discretionary programmatic and budgetary bases that would permit the Commodity Credit Corporation not to issue a particular export credit guarantee are in effect, then can the CCC decline to grant that particular guarantee? Under those circumstances the question itself dictates that the answer must be "no". The United States submits, however, that assuming away all of the real-world bases that would permit CCC to decline issuance of a guarantee is not a proper basis for analysis.

57. The fact remains, as the United States has pointed out, that numerous bases exist for denial of a guarantee.[25] Brazil has argued, however, that "CCC does not enjoy the discretion to refuse to issue a guarantee to an eligible individual".[26] This is simply not true. Perhaps a practical example would further illustrate the point. As the United States mentioned during the first substantive meeting of the Panel, CCC internally maintains limits on the amount of its exposure to obligations of particular foreign banks.[27] Although a qualified applicant might apply for an export credit guarantee for an eligible good to an eligible destination (each of those elements themselves constituting potential bases for denying an application), notwithstanding the eligibility of the applicant, good, and destination, if the foreign-bank obligor envisioned in the transaction would exceed the applicable *internally established* exposure limit if it consummated the transaction, CCC could and would deny the application for the guarantee. Thus, while it is true that the CCC does not engage in any *arbitrary* or standard-less denials, the point is that no exporter seeking to engage in a particular export transaction can be certain of obtaining a credit because of CCC decisions relating to the conditions for issuance of export credit guarantees.

143. Brazil agrees with National Cotton Council estimates of the effects of the GSM 102 programmes (Brazil's further submission, para. 190) but it also cites a different conclusion by Prof. Sumner (paragraph 192). Brazil cites other estimates by Prof. Sumner throughout its further submission. Does Brazil adopt Prof. Sumner's conclusions and estimates as part of its submission? BRA

I. STEP 2 PAYMENTS

144. Is the Panel correct in understanding that the US does not dispute that Step 2 (domestic) payments are contingent upon import substitution, and that it argues that such measures are permitted due to the operation of the provisions of the Agreement on Agriculture? How is that relevant to a claim under Articles 5 and 6 of the SCM Agreement? US

58. The United States acknowledges that to receive a payment under the Step 2 programme a domestic user must open a bale of domestically produced baled upland cotton. As the United States noted in its Further Submission of 30 September 2003[28], the introductory clause of Article 3.1 of the Subsidies Agreement, "Except as provided in the Agreement on Agriculture", applies to both Articles 3.1(a) and 3.1(b). Brazil's arguments would delete the application of the introductory clause to Article 3.1(b). As the exception's applicability to Article 3.1(b) must be given meaning, the United States has noted that the Agreement on Agriculture does permit domestic content subsidies in favour

[25] See, e.g., US Further Submission (30 September), paras. 153-156
[26] Second Oral Statement of Brazil (7 October), para. 67.
[27] See http://www.fsa.usda.gov/ccc/banks_foreign_rqts.htm.
[28] Paras. 165-176.

of agricultural producers, albeit paid to processors, if such subsidies are provided consistently with the Member's domestic support reduction commitments.[29] The European Communities concur.[30]

59. As the United States has previously indicated to the Panel[31], the United States reports all Step 2 payments as product-specific domestic support to cotton. As the United States is entitled to the protection of the Peace Clause under Article 13(b)(ii) of the Agreement on Agriculture, the United States is exempt from action under Articles 5 and 6 of the Subsidies Agreement. By their express terms, Articles 5 and 6 do "not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture".

60. The question of "import substitution" is otherwise irrelevant to Brazil's claims under Articles 5(c) and 6, which focus on the effect of the particular subsidy without regard to the origin requirements of the subsidy. In contrast, Article 3.1(b) focuses on whether a subsidy is contingent upon use of domestic over imported goods to determine whether a particular subsidy is a prohibited subsidy irrespective of its effect.

J. ACTIONABLE SUBSIDIES

145. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Articles 4.7 and 7.8 of the SCM Agreement. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the SCM Agreement to withdraw the subsidy without delay, can the Panel:

(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel? BRA, US

(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the SCM Agreement? BRA, US

61. As a practical matter, there may be limited value in a particular dispute from making a finding that a particular subsidy is both a prohibited subsidy and causes adverse effects. If a subsidy is prohibited, then the remedy required to be recommended under Article 4.7 is to withdraw the subsidy without delay. A finding at the same time that a subsidy causes serious prejudice, if done cumulatively with an analysis of other subsidies, would mean that it would leave unclear the question of whether the other, non-prohibited subsidies cause adverse effects. That may diminish the value (in terms of resolving the dispute) of any finding concerning those other subsidies.

62. On the other hand, if the Panel were to make a separate "adverse effects" analysis for each of the non-prohibited subsidies, there would be no reason to so analyze any prohibited subsidy. First, an adverse effects analysis of a prohibited subsidy could not affect a panel's findings with respect to each non-prohibited subsidy. Second, since under Article 4 the panel would have recommended withdrawal of the prohibited subsidy, compliance with Article 4 would also comply with a recommendation under Article 7. Therefore, having made a recommendation under Article 4 with respect to a subsidy, there would be no utility to also making a recommendation under Article 7.

146. Brazil acknowledges that there are some interaction effects that may increase or decrease the overall effects of the subsidies (Brazil's further submission, para. 225). How would your analysis under Articles 5(c) and 6.3 of the SCM Agreement and Article XVI of GATT 1994 differ if it excluded, for example, crop insurance subsidies, PFC and/or direct payments? BRA

147. Does the US agree that subsidies provided under the marketing loan programme, counter-cyclical payments and market loss assistance are or were more than minimally trade-

increase follows a consistent trend over a period when subsidies have been granted. Where the evidence offered by a complaining party relies in large part on abnormal production and trade data evidently caused by factors unrelated to the challenged subsidy (in the case of the United States in 1998, severe drought and record abandonment of planted acres), use of that data cannot satisfy the complaining party's burden of demonstrating causation – that is, the "effect of the subsidy".

78. Article 6.3(d) sets out a fairly mechanical two-part test: first, there must be an increase in world market share as compared to the average over the preceding period of three years. Thus, assuming *arguendo* that Brazil could challenge expired marketing year 2001 support measures, this

82. The year-by-year analysis under the Peace Clause does not affect how the Panel would undertake a serious prejudice analysis; it affects only the Panel's analysis of which of the US measures that Brazil has challenged may be the subject of the serious prejudice analysis. In the event, Brazil has only claimed that the effect of US subsidies in marketing year 2001 was inconsistent with Article 6.3(d). Therefore, the Panel's task is first to analyze whether US domestic support measures in marketing year 2001 breached the Peace Clause. If so, then the Panel would be able to undertake a serious prejudice analysis – and that second analysis is distinct from the first one. The United States has demonstrated that US measures in marketing year 2001 do not grant product-specific support to upland cotton in excess of that decided during the 1992 marketing year, whether measured according to the level of support granted by those measures or a price-gap AMS calculation.

83. With respect to the two-part test of the three-year average and consistent trend over a period when subsidies have been granted, the Peace Clause would have no impact on these tests. That is, assuming *arguendo* that marketing year 2001 measures were not exempt from action, the fact that the Peace Clause exempts from action measures for other marketing years would not preclude the Panel from examining data and evidence from those years as part of its serious prejudice analysis of the 2001 measures. The payments made in those other marketing years (that is, the marketing year 1999 measures and the marketing year 2000 measures) would be exempt from action; evidence relating to those years would not be sheltered from examination by the Panel in its serious prejudice analysis of the 2001 measures.

153. Would the conditions in Article 6.3(d) of the SCM Agreement be satisfied in respect of time periods othe r than the one specified? What relevance, if any, would this have for Brazil's claims? BRA

154. Does the US agree that upland cotton is a "primary product or commodity" within the meaning of Article 6.3(d) of the SCM Agreement? (ref. Brazil's further submission, para. 262) and within the meaning of Article XVI:3 of the GATT 1994? US

84. Yes.

155. Please respond to Brazil's identification of the seven-year period beginning with MY1996 (following the passage of the FAIR Act of 1996) as the "most representative period" for the purposes of Article 6.3(d)? (ref. Brazil further submission, para. 269) US

85. Brazil has challenged only those US subsidies that allegedly had the effect of increasing US world market share in marketing year 2001 – that is, marketing year 2001 payments. The second part of the test under Article 6.3(d) is that any increase in world market share that is the effect of the challenged subsidy over the average of the preceding three-year period "follows a consistent trend over a period when subsidies have been granted". The marketing year 2001 payments were granted
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the "effect of the subsidy" is "significant price suppression [or] depression" of the price of a non-subsidized product in the same market. For the reasons set forth in the US further submission, the United States considers that such an interpretation would render the "in the same market" language inutile because the subsidized and non-subsidized products could never be found in the same geographic market and still be considered to be in the same "world market". Furthermore, under the EC's approach, a Member could be selling at a price well above another Member's price in the same country, and yet be found to be depressing prices on the "world market" due to a comparison between sales prices of the Member in one country compared to sales prices of the other Member in a different country.

92. However, the EC itself concedes that a "world market" could only be deemed to exist if there were not significant barriers to trade in the product at issue, such as customs duties, technical barriers to trade, etc. The EC's own explanation suggests that such a "world market" is unlikely to exist because of significant barriers to trade somewhere in the world. Thus, even under the EC's approach, it is not the case that there is a "world market" for upland cotton.

160. Without prejudice to the meaning of "world market share" as used in Article 6.3(d) of the SCM Agreement, can you confirm the world export share statistics provided in Exhibit BRA-206? US

93.

161. Would a finding of serious prejudice under Article 5(c) of the SCM Agreement be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the SCM Agreement in this context? BRA, US

94. Article 5(c) establishes that one of the adverse effects that a subsidizing Member should not cause to the interests of other Members is "serious prejudice", and footnote 13 to that Article states that the term "'serious prejudice to the interests of another Member' is used in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994". Therefore, "serious prejudice" under Subsidies Agreement Article 5(c) and GATT 1994 Article XVI:1 must be read to have the same meaning. As Article 5(c), and Article 6 which explains it, are the more detailed provisions on "serious prejudice" and contain a more effective remedy than the consultation envisioned under GATT 1994 Article XVI:1, the Panel's analysis should begin with the Subsidies Agreement provisions. Were the Panel to agree that Brazil has not established that the effect of the challenged subsidy is "serious prejudice" within the meaning of the Subsidies Agreement, it would be difficult to see how the Panel could then determine that "serious prejudice" exists within the meaning of GATT 1994 Article XVI:1 since the term is used "in the same sense" in these provisions.

162. Can the US confirm that marketing loan/LDP, step 2 and counter-cyclical payments are mandatory if the price conditions are fulfilled? US

95. The statutory authority for marketing loan payments, step 2 payments, and counter-cyclical payments does not provide the Secretary with the authority to arbitrarily decline to make these payments to qualified recipients. However, certain conditions must be met before these payments will be made: price conditions must be met, the producer must meet all conditions for payment, including compliance with "sodbuster" and "swampbuster" provisions and any planting restrictions, the Commodity Credit Corporation (CCC) must not have exhausted its statutory borrowing authority, and Congress must not have cut back on the programme, by an appropriations bill or otherwise.

96. As the question notes, different price conditions apply to each of these payments. For example, in the case of marketing loan payments, the adjusted world price (as calculated by the Department of Agriculture) must be below 52 cents per pound. Recently, the adjusted world price has been above 52 cents per pound and thus no marketing loan payments have been made to qualified recipients.

97. There is no preset limit on the total amount of payments that can be made under each of these programmes although for counter-cyclical payments a maximum total outlay can be calculated using the base acres, base yields, and maximum payment rate for each commodity produced during the historical base period. In addition, for certain recipients, per-person payment limits may apply. We also note that under Section 1601(e) of the 2002 Act, the Secretary has the authority (so-called "circuit breaker" authority) to make adjustments to farm programmes because of WTO domestic support reduction commitments. Presumably, this authority could result in refusals to make certain payments.

98. Conditions for receiving counter-cyclical and marketing loan payments are numerous. The programme contract for counter-cyclical payments is required by section 1105 of the 2002 Act. That section provides explicitly that the producers must agree: (A) to comply with the requirements dealing with the highly erodible cropland conservation found at 16 USC 3811 *et seq*.; (B) comply with the wetland conservation requirements found at 16 USC 3821 *et seq*.; (C) comply with the planting flexibility requirement of Section 1106 of the 2002 Act; (D) use the land representing the base acres for an agricultural or conserving use but not for a non-agricultural, commercial, or industrial use, as determined by the Secretary; and (E) control noxious weeds and otherwise maintain the land in accordance with sound agricultural practices as determined by the Secretary of Agriculture, if the agricultural or conserving use involves the noncultivation of any portion of the land as permitted under the specification just set out in (D). For marketing loans, the loan agreement and loan

regulations, contained in 7 CFR part 1421, specify various conditions that must be met and followed by the producer. Under 16 USC 3811 *et seq.*, the wetland and conservation provisions cited above are made applicable to all commodity benefits, including loans.

163. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims ? US, BRA

99. The United States notes that even using cost data that reflects 1997 cost structures[44], US producers appear to have been able to cover variable costs through the sale of cotton at harvest time in every year but marketing years 2001 and (more narrowly) 2002. In this, US producers were no different than Brazil's farmer witness, Christopher Ward, who stated: "But even with these high yields and the excellent quality of our land, we were not able to fully recover all of our variable costs of production during the 2000/01 and 2001/02 seasons[,]" a position evidently shared by most producers in Mato Grosso, Brazil's leading cotton-producing state.[45]

100. Furthermore, even in years in which US producers may not have been able to cover fixed and variable costs, it does not follow that it is subsidies that covered these costs. Again, Mr. Ward explained that in marketing years 2000 and 2001, "Nor were we able to meet our total costs which include the additional fixed costs." Therefore, producers can cover costs from revenue sources other than subsidies. That harvest prices at times fall below costs does not necessarily mean that subsidies have had the effect of maintaining production.

US upland cotton operating costs compared to harvest cotton price

Year	Cotton price at harvest ($/lb)	Average operating cost ($/lb)
1998	0.64	0.481
1999	0.47	0.418
2000	0.57	0.473
2001	0.35	0.447
2002	0.42	0.453

Source: USDA, Economic Research Service, Agricultural Resources Management Survey (www.ers.usda.gov/data/ costsandreturns/testpick.htm)

K. CAUSATION

assumptions in the model, particularly in regards to how decoupled payments were modelled and the choice of baselines used by Dr. Sumner, which have led to results that have exaggerated the impact of US subsidies on world cotton markets.

165. Please comment (and submit substantiating evidence) on the US assertion that the FAPRI model has been designed and developed for prospective analysis, and is not suitable for retrospective counterfactual analysis. What is the reliability of past FAPRI-produced analyses when compared with actual data for the period covered by them? Is there any other instrument that can be used to try to identify the effect of subsidies already granted, or of their removal? BRA, US

102. FAPRI uses its models for prospective analyses; that is, they analyze the future effects of proposed programme changes against a baseline that assumes current programmes are in place. Recent examples of FAPRI analyses include the effects of stricter payment limitations on US farmers[46], an analysis of the European Union's 2003 CAP Reform Agreement[47], and the effects on the US dairy industry of removing current Federal regulations.[48] These analyses are forward-looking examinations of the effects of policy changes.[49]

103. Econometric modelling systems similar to the ones maintained by FAPRI and USDA are designed for prospective analyses of alternative policy assumptions. The foundation for forward-looking analyses is the baseline projections, which are conditioned on specific assumptions for exogenous variables, i.e., those that are independent of the modelling system. The baseline model is also conditioned to incorporate the current structure of specific commodity markets through equation specifications, elasticity estimates, and structural shift and dummy variables. As a result, the baseline models will not be appropriately structured to analyze changes over a historical period. For example, models calibrated for the current structure of the US textile industry may not be appropriate to assess the structure present in the late 1990's due to the tremendous changes that have occurred. Another difficulty of using the system over a historical period is the degree of external shocks that impact the model. In prospective analysis, assessing the impacts of alternative policies occurs absent of extreme shocks from independent variables.

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[46] FAPRI. *FAPRI Analysis of Stricter Payment Limitations* FAPRI-UMC Report #05-03 17 June 2003. 15 pp. Available at: http://www.fapri.missouri.edu/FAPRI_Publications.htm.

[47] FAPRI. *Analysis of the 2003 CAP Reform Agreement.* FAPRI Staff Report #2-03, 9 September 2003. 16 pp. Available at: http://www.fapri.missouri.edu/FAPRI_Publications.htm

[48] FAPRI. *The Effects on the United States Dairy Industry of Removing Current Federal Regulations.*

104. As mentioned by Dr. Sumner in Annex I to Brazil's submission of 30 September, baseline models such as the one utilized by FAPRI or USDA are not forecasting models. They are used to analyse proposed policy changes.[50] The attached table shows the forecast accuracy for year ahead price forecasts by FAPRI.

FAPRI farm price projections for upland cotton compared to actual prices, MY1999-2003 ($/lb)

FAPRI published baseline	Marketing year	FAPRI projected price	Actual price 1/	Difference 2/
January 1998	1999/00	0.689	0.45	-0.239
January 1999	2000/01	0.531	0.498	-0.033
January 2000	2001/02	0.479	0.298	-0.181
January 2001	2002/03	0.554	0.43	-0.124
January 2002	2003/04	0.385	0.463 3/	0.078

Source: FAPRI, USDA World Agricultural Supply and Demand Estimates
1/ Marketing year average farm price reported by USDA.
2/ Actual farm price minus forecast price
3/ Average cotton farm price for August 2003. USDA is prohibited from publishing cotton price forecasts.

105. One potential approach to using a baseline model to estimate the effects of subsidies during a historical period would be to use an *ex post* prospective analysis. Under an *ex post* analysis, instead of using the current baseline for measurement, one would use a past baseline to make year-ahead projections of the effects of subsidies on the cotton market. For example, to analyze the effects of subsidies on the 1998/99 marketing year, one could use the January 1998 FAPRI baseline model to project the effects of removing subsidies and compare them to baseline levels for the 1998/99 marketing year. To analyze the 1999/00 marketing year, one would update the baseline to the January 1999 baseline and so on, until the current baseline. This would provide baseline comparisons that would reflect the estimated effects of the programmes at the time of planting in each year.

166. The US states that "futures prices demonstrate that market participants predict increasing upland prices over the course of the marketing year" (US 7 October oral statement, para. 62). Please elaborate on this argument including citing specific futures prices. US

106. Exhibit US-68 shows average daily closing prices for the December 2003 cotton futures contract. Daily futures prices for December 2003 and May 2004 delivery have increased by as much as 35 per cent from January 2003 levels.

107. Futures prices reflect a price that a buyer is willing to pay to secure a supply at a given price and protect against the possibility of prices rising even higher. Thus, where futures contract prices are higher than current market prices, the futures prices suggest that cotton buyers are concerned about

[50] For example, the US Department of Agriculture explains:

The projections are a conditional scenario with no shocks and are based on specific assumptions regarding the macroeconomy, agricultural policy, the weather, and international developments. In particular, the baseline incorporates provisions of the Farm Security and Rural Investment Act of 2002 (2002 Farm Act) and assumes that current farm legislation remains in effect through the projections period. The projections are not intended to be a Departmental forecast of what the future will be, but instead a description of what would be expected to happen under a continuation of the 2002 Farm Act, with very specific external circumstances. Thus, the baseline provides a point of departure for discussion of alternative farm sector outcomes that could result under different domestic or international assumptions."

USDA Agricultural Baseline Projections to 2012. Office of the Chief Economist, US Department of Agriculture.

the possibility of cotton prices rising still higher and are willing to lock in a purchase price that carries a premium over current prices.

108. In fact, current futures prices reveal that market participants anticipate upland cotton prices rising over the current 2003 marketing year.

New York Cotton Exchange, Closing Futures Prices MY03 Friday, 24 October 2003[51]	
December 2003 contract	82.11 cents per pound
March 2004 contract	84.34 cents per pound
May 2004 contract	84.50 cents per pound
July 2004 contract	84.64 cents per pound

That is, a producer may sell cotton futures for December delivery at 82.11 cents per pound, but for deliver later in marketing year 2003 the price rises to greater than 84 cents per pound. To update the information provided by the United States to the Panel in its further submission[52], these futures prices indicate that the market expects cotton prices to remain well above their 20-year average of 67.86 cents per pound (1983-2002) within the current 2003 marketing year and well above what Brazil calculates as the 1980-98 A-index average (74 cents per pound) – that is, the average for the period *before* Brazil alleges serious prejudice through significant price suppression or depression.[53] Thus, given expected cotton prices reflected in futures contracts, Brazil has not demonstrated any clearly foreseen and imminent likelihood of serious prejudice. Quite the contrary: in marketing year 2003, upland cotton producers expect high and increasing prices.

167. How does Brazil react to Exhibit US-44? BRA

168. Please confirm that the production figures cited in Exhibit US-47 are for upland cotton only and do not include textiles. US

109. Yes, the production figures cited in Exhibit US-47 are for upland cotton production only. They do not include the raw cotton equivalent of textile production.

169. Can the US confirm the accuracy of the facts and figures cited in the four bullet points in paragraph 12 of Brazil's 7 October oral statement? US

110. From paragraph 12 of Brazil’s 7 October oral statement:

Between MY 1999-

production leading to an increase of US exports by 78.7 per cent and to an increase in the US world market share from 24.1 per cent to 41.6 per cent. . . . .

Fact check:

171. In paragraphs 22 and 23 of its further submission, we understand that the US is, in short, claiming that increased total supply (i.e. including polyester) drove prices down. On the other hand, we note that, according to the figures in the chart in paragraph 22 of the same submission, the world production of cotton during this period has basically been steady. Do all polyester fibres as represented by these figures compete directly with cotton? That is to say, do these figures for polyester fibres include, for example, those that are used for textiles that technically cannot be substituted by cotton? US

111. The figures in the chart in paragraph 22 represent world polyester textile production. Polyester competes with cotton either directly in the fibre market or indirectly through apparel and other intermediate products.

172. Please estimate the price effect, in cents per pound, of the growth in the US retail market which it is said has directly contributed to strengthening world cotton prices. US

112. As was presented in the table in paragraph 27 of the Further Submission of the United States of 30 September 2003, US retail purchases of raw cotton fibre increased from 12.3 million bales in 1990 to 20.9 million bales in 2002, an increase of 8.6 million bales. This increase accounted for the entire increase in world retail purchases of raw cotton fibre

115. US cotton is grown to be used to make cotton textiles and apparel. The point of the US submission is to explain how the location of where US cotton is manufactured into products has shifted. US and world consumers continue to purchase cotton products. But increasingly US consumers purchase those cotton products, made from exported US cotton, from overseas manufacturers as US manufacturers are less able to compete. That is the structural transformation that paras. 33-34 and the accompanying table seeks to present and explains at least in part some of the changes in US exports.

174. How, if at all, did the Asian financial crisis affect the United States' world market share? Did it disproportionately affect the US as compared to other exporters? US

116. The Asian financial crisis disrupted cotton consumption (spinning) in the major consuming countries of Thailand, Indonesia, and the Republic of Korea in 1997/98, reducing their mill use 9 per cent from the preceding year. In addition, the decline in world economic growth induced by the crisis reduced total world cotton consumption 3.4 per cent in 1998/99 from the pre-crisis level in 1996/97. Subsequently, however, the depreciation of currencies in these three countries boosted their cotton consumption due to expanding textile exports. World cotton consumption rose 11 per cent between 1996/97 and 2002/03, while consumption in Thailand, Indonesia, and Korea collectively rose 16 per cent. During this same period, US spinners lost market share to textile imports, due in large part to currency effects, and US domestic mill use fell 35 per cent.

117. US export share in these markets is influenced by total supply availability, qualities produced, and price. For example, US export share of the three countries' consumption fell by more than half in 1998/99, due to the drought-devastated US crop. Export share has since returned to the pre-crisis level of about 30 per cent and, with higher consumption, this added about 400,000 bales to US exports between 1996/97 and 2002/03. Since the combined total consumption increase for Thailand, Indonesia, and Korea was about 800,000 bales, this indicates that other exporters also increased exports by about 400,000 bales. As US mill use of cotton declined while exports increased, US world market share was left relatively unchanged (with a slight downward bent) by the Asian financial crisis.

175. With reference to paragraphs 57-58 and the related table on page 21 of the US further submission, could you please clarify the arguments regarding the ratio of the soybean futures to the cotton futures prices since in the table the inverse ratio is used? US

118. Attached is a corrected version of the table. The ratio of cotton futures price to soybean futures prices is positively correlated with movement in planted cotton area.

Expected cotton and soybean prices and planted cotton acreage

Year December cotton futures (cents/lb)xports Sp22 consuij -3345 Tw (n Tc 0 T9i342.25 0 Thhs6Nely bge 21 of t13ratio o

179. Could Brazil comment on the argument that decoupled payments and other subsidies to upland cotton are largely being capitalized into land values and that removing these subsidies would reduce the cost of production of upland cotton producers (US 7 October oral statement, para. 48). What would be the net effect of these adjustments? BRA

180. Please describe the precise formula as to how USDA determines the "adjusted world price" using the Liverpool A-Index, the NY futures price and any other relevant price indicators. Please submit subs tantiating evidence. BRA, US

122. The Adjusted World Price (AWP) is equal to the Northern Europe (NE) price (the 5-day average of the 5 lowest-priced growths for Middling 1-3/32 inch cotton, cost, insurance and freight [CIF] northern Europe), adjusted to US base quality and average location. The AWP for individual qualities is determined using the schedule of loan premiums and discounts and location differentials. A "coarse count adjustment" (CCA) may be applicable for cotton with a staple length of 1-1/32 inches or shorter and for certain lower grades with a staple length of 1-1/16 inches and longer. The AWP and CCA are announced each Thursday.[59]

123. A Step 1 adjustment to the AWP may be made when the 5-day average of the lowest US growth quote for Middling 1-3/32 inch cotton, CIF United States-northern Europe (USNE) price, exceeds the NE price and the AWP is less than 115 per cent of the loan level. The Secretary of Agriculture may lower the AWP up to the difference between the USNE price and the NE

-/32 in . charhe loan lb

Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?

128. The United States notes the Appellate Body's discussion of relevant differences between the provisions of the Subsidies Agreement and those of GATT 1994 in *United States – FSC*.

186. Could the United States please expand upon its statement that "[t]hese are the types of considerations that led to the negotiation of the Subsidies Agreement...." (US further submission, para. 109)? Is there any relevant material, including, for example, drafting history that might support this statement? US

129. Dissatisfaction with the difficulties in applying the "more than equitable share" standard of GATT 1994 Article XVI:3 was an important motivation for the negotiation of stronger and more operational disciplines in the WTO Subsidies Agreement. In two separate challenges in 1979 and 1980 to the sugar export subsidy programme of the European Communities by Australia and Brazil, panels were unable to find that the export refunds provided by the Communities resulted in a "more than equitable share" of world export trade.[62] Similarly, in the 1983 US challenge to export subsidies

the Wheat Flour panel) "in light of . . . , most importantly, the difficulties inherent in the concept of 'more than equitable share'".

131. Thus, there was a recognition in the Uruguay Round subsidies negotiations that the effort in the 1979 Subsidies Code to make GATT 1994 Article XVI:3 more operationally effective had not succeeded. For example, a reference paper on GATT subsidies rules and the existing status of discussion of these rules prepared by the GATT Secretariat for the Negotiating Group on Subsidies and Countervailing Measures states:

> The most pronounced difficulties have occurred in connection with the concept of "more than an equitable share" embodied in Article XVI:3 of the GATT. The Agreement on Subsidies and Countervailing Measures (Article 10) attempted to bring precision to Article XVI:3 but it has not always been found to give clear guidance on its interpretation. Consequently a number of disputes involving the concept of "more than an equitable share" have not found a satisfactory solution and in some cases have provoked retaliatory subsidization. The case-by-case application of this concept has revealed its imprecisions and the fact that it largely refers to notions which escape objective criteria. There is, for example, sufficient imprecision in this concept to allow countries using export subsidies to argue that these subsidies do not result in obtaining more than equitable share. On the other hand it is not always possible to provide causality between the subsidy and the increase share. Furthermore, it is impossible to derive a general line of case law from the decisions of panels, some of which have given divergent interpretations.[64]

132. A checklist of issues for the negotiations based on Contracting Parties' written submissions and oral statements prepared by the Secretariat demonstrates that Contracting Parties were well aware of these difficulties and the need to move away from the "more than an equitable share" concept:

> There is a need for review, with a view to improving GATT disciplines, of the provisions of Article XVI:2 and 3. Notably there is a need to build on the recognition embodied in Article XVI:2 and the exhortation in the first sentence of XVI:3 in the direction of improving the conditions of competition on world markets for primary products currently covered by the equitable share criterion in the second sentence of Article XVI:3.
>
> The review should examine the application of the "more than an equitable share" rule for primary products. Thi.0998nh20.0ry There i subsrv

> There are serious deficiencies in Article XVI:3 of the GATT and in Article 10 of the Code, notably the fundamental problems connected with the 'more than equitable share' concept. However, these problems arise from the basic fact that current disciplines for primary products are significantly weaker than those which apply to manufactured goods. They cannot be resolved merely by making minor adjustments to rules which are intrinsically defective. The only genuine, long-term solution is an effective prohibition on all export subsidies. Accordingly at this stage of the negotiating process, there is little value in trying to improve the "more than equitable share" rule, which is only relevant so long as there is no general prohibition on export subsidies.[65]

133. Reflecting the desire of Members to move away from the "more than an equitable share" concept which had repeatedly been found by panels to be incapable of application, the WTO Subsidies Agreement does not provide any further definition or interpretation of GATT 1994 Article XVI:3. Instead, it contains the general prohibition on export subsidies in Article 3 and rules on adverse effects, including serious prejudice.

M. THREAT CLAIMS

187. Please provide USDA's projections of marketing loan/LDP payments, direct payments and counter-cyclical payments to be made during MY2003 through 2007 based on the most recent USDA baseline projection. US

134. The following table shows projections for cotton marketing loan/LDP payments, direct payment and counter-cyclical payments for crop years 2003 through 2008, as published in the FY2004 Mid-Session Review on 15 July 2003. We note that projected outlays for marketing year 2003 are likely to be significantly overstated given the increase in prices and futures prices over the course of this marketing year. For example, no marketing loan payments are currently being made because the adjusted world price is above the marketing loan rate.

Projected outlays (million dollars)

Item	2003	2004	2005	2006	2007	2008
Direct payments	587	587	587	587	587	587
Counter-cyclical payments	929	602	521	521	521	521
Loan deficiency payments	420	298	193	137	137	82
Marketing loan gains	22	13	8	6	6	3
Certificate gains 1/	196	114	75	55	52	29

1/ Includes value of non-cash marketing loan transactions.

188. Can the United States comment on the FAPRI projections for cotton provided in Exhibit BRA-202? US

135. The FAPRI projections presented by Brazil in Exhibit BRA-203 reflect the January 2003 FAPRI projections. These projections were published by Iowa State University in January 2003.[66] The same projections were published by FAPRI at the University of Missouri in March 2003 and were referenced by the United States in Exhibit US-52.

[65] *Checklist of Issues for Negotiations: Note by the Secretariat*, MTN.GNG/NG10/W/9/Rev.4, at 26-28 (12 December 1988).

[66] Food and Agricultural Policy Research Institute. *FAPRI 2003: US and World Agricultural Outlook*. Iowa State University Staff Report 1-03. January 2003.

136. Of significance is the difference between the January 2003 baseline and the preliminary baseline of November 2002 utilized by Dr. Sumner in his analysis. Under the January 2003 baseline, the Adjusted World Price (AWP) forecasts for 2002/03 to 2007/08 are considerably higher than the forecasts made in the preliminary November 2002 baseline. Because loan deficiency payments and marketing loan gains are calculated based on the difference between the loan rate and the AWP, this means that expected marketing loan subsidies under the November 2002 baseline are far higher than expected marketing loan subsidies under the January 2003 baseline. Thus, the effects of eliminating marketing loans would tend to be biased upwards using the preliminary November 2002 baseline.

Differences in the Adjusted World Price forecast between the November 2002 and January 2003 FAPRI baseline ($/lb)

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
November 2002 baseline 1/	0.3597	0.3722	0.3983	0.4194	0.436	0.4548
January 2003 baseline 2/	0.448	0.454	0.46	0.46	0.467	0.48
Difference	0.0883	0.0818	0.0617	0.0406	0.031	0.0252

1/ As presented by Dr. Sumner in Annex I and oral statement of 7 October 2003.
2/ As reported in Exhibit BRA-203 and Exhibit US-52

N. CLARIFICATIONS

189. Please indicate whether the correct figure in paragraph 37 of Brazil's 7 October oral statement is 38.1% or 38.3%? BRA

190. Please confirm that the figure "17.5" in paragraph 43 of Brazil's 7 October oral statement, is "percentage point". BRA

191. Could Brazil clarify its statement in para. 12 of its 9 September further submission: "Alternatively crop insurance is not specific because the 2000 ARP Act denies benefits to commodities representing more than half of the value of US agriculture. Further US crops represent only 0.8 per cent of total US GDP." (emphasis added) BRA