ANNEX I-7

ANSWERS OF BRAZIL TO QUESTIONS POSED BY THE PANEL FOLLOWI

Table of Cases

Short Title	Full Case and Citation
Korea – Beef	GATT Panel Report, *Republic of Korea – Restrictions on Imports of Beef – Complaint by the United States*, BISD 36S/268, adopted on 7 November 1989.
Japan – Alcoholic Beverages	Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, adopted 1 November 1996.
EC – Hormones	Appellate Body Report, *European Communities - Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, adopted 13 February 1998.
Brazil – Aircraft	Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/R, adopted 20 August 1999.
Indonesia – Automobiles	Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, adopted 23 July 1998.
Argentina – Textiles and Apparel	Appellate Body Report, *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/AB/R, adopted 22 April 1998.

List of Exhibits

upland cotton for the period 1 August 2002 through 31 July 2003. The panel request further covers 2002 FSRI Act and 2000 ARP Act payments *to be made* during marketing years MY 2003-2007. In addition, the identified measures guarantee the right of eligible US producers, users and exporters to receive future payments.[4] Given the comprehensive scope and timing coverage of the request for the establishment of a Panel and the mandatory nature of the payments,[5] the Panel's terms of reference

upland cotton in MY 2002. Therefore, Brazil looks forward to the United States answering this question in full on 22 December.

7. Unfortunately, Brazil cannot calculate direct payment and counter-cyclical payment figures because the United States refused to produce on 18 December the information requested by Brazil and the Panel. In particular, the United States refused to provide farm-specific identifying numbers, thus rendering any matching of farm-level information on contract payments with information on farm-specific plantings impossible. Only this unique farm number (or a substitute number protecting the alleged confidentiality of farmers) would allow any matching of planting and payment data critical for the calculation of the amount of contract payments that constitute support to upland cotton.[9] The United States asserts newfound "confidentiality" concerns even though it provided identical information on rice to a private US citizen making a simple FOIA request. But even these confidentiality concerns could not possibly apply to aggregate matched figures that the United States could easily calculate with the data the United States admits it has collected. On 12 January 2004, Brazil will provide a more detailed analysis of the US failure to cooperate in this proceeding by continuing to refuse to provide Brazil and the Panel with the requested information.

8. In view of the US failure to produce the requested information that would allow Brazil and the Panel to calculate easily the amount of direct and counter-cyclical payments (as well as PFC and market loss assistance payments for MY 1999-2001), Brazil must present below revised figures using its so-called "14/16th" methodology.[10] The figures represent the best information available and are corroborated by circumstantial evidence. Moreover, in view of the US refusal to produce the actual information regarding direct payment and counter-cyclical payments, the Panel could reasonably infer that the *actual* amounts are greater than those estimated by Brazil.

[9] Brazil pointed this out more than a month ago when it stated in its 18 November Further Rebuttal Submission, that "CCC-509 *does* indicate the quantity of base acreage fir each programme crop on the farm. Since both CCC-509 and FSA-578 require identification of the *identical* 'farm' by a unique farm serial number, the base acreage from CCC-509 can be matched with the planted acreage in FSA-578. What the United States has failed to do is 'connect the dots,' *i.e.*, match the information in the two forms." (Brazil's 18 November Further Rebuttal Submission, para. 44, emphasis in original, footnotes omitted).

[10] In view of the new information provided by the United States in Exhibit US-95, Brazil has adjusted the total amount of contract payments by a ratio of 13.714 million acres of actual upland cotton plantings in MY 2002 to 18.858 million acres of total upland cotton base.

PROGRAMME	PREVIOUS AMOUNT OF PAYMENTS[11]	NEW AMOUNT OF PAYMENTS
MARKETING LOAN GAINS AND LDPS	**$918 MILLION**	**$832.8 MILLION[12]**
CROP INSURANCE	**$194.1 MILLION**	**$194.1 MILLION*** **(+ $104.2 MILLION[13]) ($298.3 MILLION)**
STEP 2	**$217 MILLION**	**$217 MILLION***
DIRECT PAYMENTS	**$485.1 MILLION**	**$454.5 MILLION[14]**
COUNTER-CYCLICAL PAYMENTS	**$998.6 MILLION**	**$935.6 MILLION[15]**
COTTONSEED PAYMENTS	**$50 MILLION**	**$50 MILLION***
OTHER PAYMENTS	**$65 MILLION**	**$65 MILLION***
TOTAL PAYMENTS	$2,927.8 MILLION	$2,749 MILLION ($2,853.2 MILLION)

* Brazil has no new information on the amount of these payments

9. Concerning the export credit guarantee programmes, Brazil estimates the amount of payments using the "guaranteed loan subsidy" estimate FY 2003 (which largely overlaps with MY 2002) results in a subsidy amount of $17 million.[16] In sum, the latest data available to Brazil continues to demonstrate that US support to upland cotton in MY 2002 far exceeds the support decided in MY 1992.

197. Please provide actual data for 2002/2003 for US exports, US consumption and per cent of world consumption to replace the projected data in Exhibit US-47. If available, please provide projected data for 2003/2004 to replace the forecast data. USA

9.

Brazil's Answer:

10. Brazil has no reason to disagree with the US calculations which appear based on information exclusively within the control of the United States.

199. What is the composition of the A-Index? We do note footnote 19 and, for example, Exhibit BRA-11, but please explain more in detail how this index is calculated. BRA

Brazil's Answer:

11. Brazil refers the Panel to the statement made by Andrew Macdonald in Annex II of Brazil's 9 September Further Submission that provides considerable detail about the calculation and formation of the A-Index.[17] Further information is set forth in Exhibit Bra-375.[18] The A-Index, along with the B-Index, are two important indices that summarize the price developments of the physical market in various countries around the world. Both indices are published by Cotlook, Inc., a private company, and reflect an average price.[19] As an index, it is not a trading or negotiable price, but a composite of

planting decisions.[24] Because the United States' 18 November Further Rebuttal Submission focused on the December Futures price in February as the relevant contract month to gauge producer's revenue expectations, Brazil presented a similar chart in its 2 December Oral Statement based on average December futures prices in January-March planting period.[25] Using December futures prices (like the nearby futures chart) confirms USDA's economists – al2prirfnIorld222s eleadng Dcottn

little." As Andrew Macdonald has indicated, the purpose of the futures market is not for the buying or selling of physical cotton.[30] Rather, it is used for hedging position for growers and the upland cotton industry while the speculators in the market provide the day-to-day liquidity.[31] Physical delivery is theoretically possible in order to give reality to the market, *i.e.*, it is always possible to take or give delivery of cotton at the expiration of the contract. This ensures that the futures truly reflect the market and vice versa. However, the volume normally delivered is very small compared to the total volume traded during the life of a contract. This is because traders with long (or buy) futures contracts and traders with short (or sell) futures contracts "close out" or "settle" the contracts by offsetting trades at the end of the contract period and, thus, no physical cotton is delivered.[32]

19. With respect to the final question of whether a "futures sale impacts the producer's entitlement to marketing loan programme payments," the answer is "no." A producer is entitled to receive a marketing loan payment independent from any futures price or selling price that the producer may receive. A producer receives a marketing loan benefit if – after having taken out a marketing loan – he sells the upland cotton, [illegible]

205. Does the United States accept or agree with the EWG data submitted by Brazil? If not, please explain your reasons. USA

206. Please explain how the graph in paragraph 40 of the US further rebuttal submission was derived. In so doing, please clarify whether the figures are on a cents per pound basis or some other basis. What averaging method was used? Can you prepare individual charts showing average US and Brazilian cotton prices for each of those third country markets? USA

207. Please indicate whether any of the measures challenged in this dispute *obliges* cotton farmers to harvest their crop in order to receive the benefit of the programme (subsidy). USA

208. Please provide data for the marketing years 1992 and 1999-2002 of the "quantity of production to receive the applied administered price" (*Agreement on Agriculture,* Annex 3, paragraph 8) for purposes of a price-gap calculation of support through the marketing loan programme. USA

209. It is understood that the data in the graph in paragraph 5 of the US oral statement are as at harvest time, while the data in the graph in paragraph 39 of Brazil's oral statement are as at planting time. Please explain why the trend of US acreage increase/decrease differs between these two graphs. BRA, USA

Brazil's Answer:

29. The trend between those two graphs differs because they provide a different measure for US upland cotton acreage. The graph at paragraph 5 of the US 2 December Oral Statement shows *harvested* acreage, while the graph at paragraph 39 of Brazil's Oral Statement shows *planted* acreage. The figures differ because not all planted US upland cotton is harvested. The rate of abandonment that describes the difference between planted acres and harvested acres is significant in the United States. During MY 1996-2002 it varied between 3.6 per cent in MY 1997 and 20 per cent in MY 1998. The average for the period was 12.2 per cent.[48]

30. Brazil notes that US upland cotton farmers naturally reflect their planting decisions in planted – not harvested – acreage. To analyze whether the planting decisions of upland cotton farmers in the United Sates are "congruent" to farmers in other parts of the world, it would be best to compare planted acreage figures. Harvested acreage figures are a function of weather effects that may cause the abandonment of a significant portion of planted acreage. This is relatively common in the arid cotton producing areas of the US Southwest and less common in the irrigated regions of the US West or in the high rainfall regions of the South. Brazil also refers the Panel to its response to Question 210.

210. Are worldwide planted acreage figures available? BRA, USA

Brazil's Answer:

31. To the best of Brazil's knowledge, there are no planted acreage figures available on a worldwide basis. However, the fact that these figures do not or may not exist does not render the US harvested acreage graph valid for the purpose of evaluating the responsiveness of the US farmer to world prices.

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

34. The United States relies on its "harvested acreage" chart to argue that "US producers have increased and decreased acreage commensurately with producers in the rest of the world" relying on data for MY 1996-2002.[52] But even using this inappropriate harvested acreage chart, the same disconnect between US producers and other world producers can be seen. Only in two out of seven years is there a similar movement in the harvested acreage of the US and the rest of the world. In the other five years, the movement either goes in the opposite direction or the magnitude of the acreage movement is much smaller or greater respectively.

35. These distinctly different reactions by US and non-US farmers are consistent with the fact that non-US farmers must actually deal with market signals. The significant production declines by Mato Grosso producers in MY 2000 and 2001 in the face of record low prices (even though they are among the world's highest yield and lowest cost producers) illustrate this point well.[53] In addition, the fact that US farmers' planted acreage did not significantly decline in MY 1999-2002 is totally inconsistent with the considerable exchange rate increases of the US dollar during the same period.

36. Finally, even in MY 2002 when US acreage movements were relatively consistent with the rest of the world, the effect of the US subsidies significantly dampened the decrease in US acreage. As Professor has demonstrated, the US planted acreage in MY 2002 would have been 7.5 million acres *without* US subsidies not the 13.7 million acres actually planted.[54] Thus, the effect of the US subsidies is better estimated by examining the amount (or level) of US planted acres, rather than percentage changes in which the graph moves. Were it not for the US subsidies, the US downward trend in MY 2002 would have been much sharper, as a large number of inefficient cotton producers would have chosen not to plant or would have switched crops.

211. Brazil presents a graph in paragraph 59 of its further rebuttal submission indicating the increasing cumulative loss incurred by cotton producers. Please comment on the argument that US cotton producers could not continue operating without subsidies. In particular:

(a) to what extent does the use of 1997 survey technological coefficients with annually updated values affect the results?

(b) to what extent do producers base planting decisions on their ability to cover operating costs but not whole farm costs? USA

212. Brazil states in paragraph 37 of its oral statement that studies of Westcott and Price found that the effect of the programme on cotton is to add an additional 1 to 1.5 million acres during marketing years 1999-2001 and to suppress US prices by 5 cents per pound. Does the US reject these findings? Why or why not? USA

213. What differences, if any, can be observed in the results of econometric models in the literature which use lagged prices and those which use futures prices to analyse the effect of prices on planting decisions? BRA, USA

[52] US 2 December Oral Statement, para. 5. This data is different from the one contained in the above

Brazil's Answer:[55]

37. Econometric simulation models of the sort used by Professor Sumner, USDA and other independent economic analysts have not used futures markets in their projections or counterfactual analysis. Instead, analysts have used either lagged prices and revenues or some variant of lagged or actual realized prices or revenues as the representation of grower expectations. Thus, there are no comparisons that one could make in this regard.

38. As previously noted, "it is impossible to know what precisely individual farmers expect"[56] because price expectations of farmers are "fundamentally unobservable."[57] It is important to note that USDA economists Westcott and Price, like Professor Sumner, have used and relied on the same retrospective analysis of the effects of marketing loans using so-called "lagged prices" – not futures prices. The United States notes that the use of a futures price analysis for MY 2002 is not possible for "multi-commodity modeling frameworks for extended time projection."[58] The United States accepts that FAPRI, USDA and the US Congressional Budget Office use lagged prices rather than futures prices as proxies for price expectations.[59] And Dr. Glauber indicated during the second Panel meeting on 3 December that the United States accepts the FAPRI modeling system as a valid means to analyze the questions faced by this Panel.

39. The statistical estimation literature in agricultural economics has used a variety of proxies for anticipated prices and revenue for the upcoming season. These include rational expectations in which many sources of information available to decision makers are combined and the expectations are consistent with the conditional forecasts of the model. Such models have strong theoretical grounding but have been impractical in most estimation situations.

40. No systematic survey has been undertaken of the very large statistical literature estimating supply functions to study how estimates differ based on assumed models of the formation of expectations.[60] In a recent study for rice, McDonald and Sumner[61] found that most published articles for rice (another US programme crop with complex government programmes) used a variant of lagged information is notw67t

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conservative. This is, because, as a matter of statistical theory, the more precise the proxy for expected price or revenue, the larger the coefficient of supply response. For example, in regression estimations, when an explanatory variable is measured with error, the regression coefficient tends to be biased toward zero, thus undercounting the significance of the variable. When there is less error in measurement (*i.e.*, the imperfectly measured proxy variable becomes more accurate) the regression coefficient tends to be larger.[62] In the present context, this means that if futures market prices were better proxies for farmers' expectations, the estimated coefficient of the price or revenue effect on acreage (the acreage response elasticity) would be larger. It follows that the estimated acreage response elasticity would be too low in the FAPRI model. US acreage would respond stronger to changes in relative cotton revenue than estimated in the FAPRI models. In the context of the Professor Sumner's simulation analysis, that would mean larger US supply response to expected price and revenue changes, and thus higher supply and export response to government programme benefits. In sum, Professor Sumner's results, which are based on FAPRI elasticity estimates, would not be wrong, but would underestimate the amount of additional acreage, production and exports from US policy incentives.

III. Domestic Support

214. Please provide a copy of regulations regarding the marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993. What does this regulation indicate about the target price? USA

215. Please expand or comment on the statement at paragraph 91 of the US further rebuttal submission that the counter-cyclical target price ceases to be paid when the farm price rises above 65.73 cents per pound. In this scenario, should the Panel disregard Direct Payments? BRA, USA

Brazil's Answer:

43. It is correct that the CCP payments cease when average US farm prices for the marketing year received by US farmers rise above 65.73 cents per pound. But this has only happened four times since the 1930s and the last time was seven years ago in MY 1996. In MY 2002, the average price received by US farmers was 40.50 cents per pound.[63] Through November 2003, MY 2003 average price received by US farmers was 58.5 cents per pound.[64] Indeed, the first CCP payment has been made for MY 2003.[65]

44. The impact of the direct payments has been analyzed and quantified by Professor Sumner who found, using the FAPRI November 2002 baseline, that in MY 2002 direct payments added 120,000 acres to US upland cotton production.[66]

45. Even in the highly unlikely event that expected US farm prices were to exceed the CCP target price of 72.4 cents per pound for MY 2004[67] (prices that have occurred only twice in the past 75 years), direct payments would still be made and US producers would still require direct payments

[62] *See e.g.* William H. Green, Econometric Analysis, 5th edition, 2002, Prentice Hall or any standard textbook on regression analysis.

[63] Exhibit Bra-202 (Agricultural Outlook Tables, USDA, August 2003, p. 5).

[64] Exhibit Bra-382 (Cotton and Wool Outlook, USDA, 12 December 2003, Table 6) for September to November 2003 and Exhibit Bra-328 (Cotton and Wool Outlook, USDA, 14 October 2003, Table 6) for August 2003.

[65] Exhibit Bra-340 ("USDA Announces First Partial 2003-Crop Counter-Cyclical Payments," USDA Press Release, 17 October 2003).

[66] Brazil's 9 September Further Submission, Annex I, Table I.5a.

[67] US farm prices have exceeded 72.4 cents per pound only twice in 75 years – in MY 1995 and in MY 1980. Exhibit Bra-4 ("Fact Sheet Upland Cotton," USDA, January 2003, p. 5).

to cover the total cost of current production. These payments, like the other payments in the package of cotton subsidies, are essential to maintain past, current, and future high levels of US upland cotton production.[68] Thus, they must be taken into account in assessing the production-distorting effects they caused in MY 2002 as well as today in MY 2003.

46. Brazil recalls that even if futures price were to indicate that US

including wheat, feed grains, and rice pressured Congress to include updating of acreage and yield bases in the 2002 Farm Bill.[71]

49. The 2002 FSRI Act provided for the opportunity for all farmers to update their base acreage for purposes of the direct payment programme and to update their base acreage and base yields for purposes of the counter-cyclical payment programme. They could do this without having to

subsidies listed in Article 9.1. What significance, if any, does this contextual aspect have for how Article 10.2 might be interpreted having regard, *inter alia*, to:

(a) the fact that export performance-related tax incentives, which like subsidised export credit facilities were considered as a possible candidate for listing as an Article 9.1 export subsidy in the pre-December 1991 Draft Final Act negotiations, have been held (for example, in *United States – Tax Treatment for Foreign Sales Corporations*, WT/DS108) to be subject to the anti-circumvention provisions of Article 10.1; and

(b) the treatment of international food aid and non-commercial transactions under Article 10? USA

220. What will be the relevance of Articles 9 and 10.1 of the *Agreement of Agriculture* to export credit guarantees when disciplines are internationally agreed? BRA

Brazil's Answer:

51. The relevance of Articles 9 and 10.1 of the Agreement on Agriculture following the conclusion of the negotiations called for by Article 10.2 of the Agreement necessarily depends on the commitments that are negotiated. Brazil does not know what the outcome of the negotiations will be, or what commitments, if any, parties will undertake. Nor does Brazil know in what way those commitments would be brought into the WTO – automatically, *via* the cross-reference in Article 10.2, or instead *via* amendments to the Agreement on Agriculture or the SCM Agreement, or yet some other means. The nature of the disciplines negotiated and the way in which those disciplines are transposed into the WTO will dictate the effect they will have on Articles 9 and 10.1. With these important reservations about the purely hypothetical nature of this exercise, Brazil will explore a number of possible outcomes and the impact those outcomes would have on Articles 9 and 10.1.

52. One possible outcome is that negotiators will reach agreement on other types of export credits, but that export credit guarantees will not be included. In Brazil's view, this would mean that export credit guarantees would continue not to be among those *per se* export subsidies listed in Article 9.1, and would continue to be subject to Article 10.1, to the extent that they constitute export subsidies and circumvent (or threaten to circumvent) a Member's export subsidy commitments.

53. or tinformal 0 Tc [illegible]

(a)

(d) Please identify what is considered an "administrative expense" for this purpose.

(e) The Panel notes the US statement in paragraph 160 of its answers to Panel questions following the first meeting that all cohorts are still open although the 1994 and 1995 cohorts will close this year. Is this still an accurate statement? If not, please indicate whether any cohorts have since "closed" for the period 1992-2002.

(f) The Panel notes the current "high" figures for 1997 and 1998 indicated in the original US chart. Pending their confirmation and/or updating by the US, why does the US assert that a cohort will *necessarily*

224. Please indicate how the CCC's cost of borrowing was treated in the 2002 financial statement of the CCC, in Exhibit BRA 158. USA

225. Please indicate whether there was any instance where the CCC "wrote off" debt and, if so, please indicate the accounting regulation or principle used. If a "written off" debt is subsequently recovered, do the CCC's accounts reflect both the interest cost and interest received in relation to the debt during the time it was "written off"? USA

226. If a debt was "written off" more than ten years ago, does it still create a cost to the programme? If so, how is this reflected in the 2002 financial statement of the CCC, in Exhibit BRA 158 (or any other material)? USA

227. The United States has indicated that Brazil continues to "mischaracterize" the amount of $411 million in the 2002 financial statement of the CCC, in Exhibit BRA 158, pp. 18 & 19. Can the United States please indicate how it believes this amount – referred to on p. 19 of the Exhibit as "Credit Guarantee Liability-End of Fiscal Year" - should be properly characterized? How, if at all, does it represent CCC operating costs or losses? USA

Brazil's Comment:

67. On page 4 of the notes to the CCC 2002 financial statements, CCC defines the term "Credit Guarantee Liability" as follows:

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

the Panel to arrive at a determination of the precise amount by which operating costs and losses incurred by the CCC guarantee programmes outpace premiums collected.

69. For these reasons, Brazil has offered a number of different methodologies and sets of evidence that the Panel can use to determine whether premium rates are adequate to meet the long-term operating costs and losses of the CCC guarantee programmes. Each of those methodologies or sets of evidence demonstrates that premium rates are inadequate to meet the long-term operating costs and losses of the CCC guarantee programmes.

70. One methodology is the present value accounting endorsed by the US Congress and the President in the Federal Credit Reform Act ("FCRA"). The FCRA has been translated into accounting standards for US government loan guarantees by the Federal Accounting Standards Advisory Board ("FASAB"). Consistent with the FCRA, the FASAB accounting standards state that "[f]or guaranteed loans outstanding, the present value of estimated net cash outflows of the loan guarantees is recognized as a liability."[93] The FASAB standards (and the FCRA) state that "[t]he amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows, discounted at the interest rate of marketable Treasury securities with a similar maturity term applicable to the period during which the loans are disbursed."[94]

71. As one way to determine whether the long-term operating costs and losses of the programmes outpace premiums collected, Brazil has used the net subsidy expense (including reestimates) calculated using the FCRA and FASAB standards over the period 1992-2002.[95] The CCC has itself adopted this methodology in its 2002 financial statements, when it lists a net subsidy expense of $411 million for all post-1991 CCC guarantees.[96] Using present value accounting, CCC's 2002 financial statements also track enormous uncollectible amounts on pre-1992 and post-1991 guarantees that far outpace premiums collected for the programmes – by $2.3 billion on pre-1992 guarantees, and

72. The Panel asks whether, if US government regulations require costs to be treated differently than they would be under generally accepted accounting principles, the Panel must conduct its analysis in accordance with that treatment. As Brazil has already noted, nothing in item (j) would require the Panel to do so. However, Brazil notes that in its 2002 financial statements, the CCC, which relies on present value accounting, states that "[t]he accounting principles and standards applied in preparing the financial statements and described in this note are in accordance with Generally Accepted Accounting Principles (GAAP) for Federal entities."[98]

73. In this dispute, the United States objects to the use of present value accounting to determine the costs of the CCC guarantee programmes, because present value accounting entails the use of "estimates."[99] Apart from the fact that the FCRA does not in fact rely on "estimates" to the extent suggested by the United States,[100] Brazil also notes that in other contexts, the US government is comfortable with this inherent aspect of present value accounting for loan guarantees. Present value accounting has been endorsed by the US Congress and the President in the FCRA, as well as by the FASAB, the Office of Management and Budget,[101] and the General Accounting Office,[102] to name a few. Finally, Brazil notes that the United States is comfortable with the Panel relying on present value accounting and *some* estimated data, as long as the Panel limits itself to data suggesting that CCC guarantees issued in some, carefully-selected years did not lose money.[103] This is not an appropriate means of determining the performance of the "programmes," as is required by item (j).

74. Other methodologies and means of accounting for CCC's long-term operating costs and losses confirm the result reached using present value accounting. First, Brazil has constructed a methodology using actual data on income, costs and losses, which shows net losses for the CCC guarantee programmes of $1.1 billion.[104] Second, defaults of more than $4 billion on CCC guarantees for exports to Iraq and Poland alone similarly demonstrate costs and losses far in excess of total CCC premiums collected.[105] Third, a methodology adopted by the US General Accounting Office concluded that if GSM 102 and GSM 103 continued until 2007, costs would reach $7.6 billion, which exceeds maximum premiums collected by nearly $7.3 billion.[106]

75. In conclusion, item (j) does not require that the Panel use any particular accounting principles in assessing long-term operating costs and losses. Brazil has offered the Panel a number of different methodologies based on a variety of accounting principles. Each methodology confirms that premium rates are inadequate to meet the long-term operating costs and losses of the CCC guarantee programmes.

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[98] 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. 1).

[99] US 11 August Answers to Questions, paras. 157-161, 162-163, 169-172, 173; US 22 August Rebuttal Submission, para. 162; US 18 November Further Rebuttal Submission, para. 196.

[100] Brazil's 22 August Rebuttal Submission, para. 113; Brazil's 11 August Answers to Questions, paras. 180-181.

[101] Exhibit Bra-116 (OMB Circular A-11) and Exhibit Bra-163 (Office of Management and Budget Annual Training, Introduction to Federal Credit Budgeting, 24 June 2002).

[102] Exhibit Bra-120 (GAO, Report to the Director, Office of Management and Budget, "Credit Reform: Review of OMB's Credit Subsidy Model," GAO/AIMD-97-145, August 1997, p. 3-5).

[103] US 18 November Further Rebuttal Submission, paras. 196-198.

[104] Brazil's 11 August Answers to Questions, paras. 158-166 (including chart at para. 165). Brazil's all-inclusive formula can be stated as follows: (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)).

[105] *See* Brazil's 11 August Answers to Questions, para. 167 (second bullet point and note 226); Brazil's 18 November Further Rebuttal Submission, para. 251.

[106] *See* calculation included at Brazil's 11 August Answers to Questions, para. 167.

Article 6.7 of the SCM Agreement creates exemptions from serious prejudice findings even if the requirements of Article 6.3 would be fulfilled. These situations include export prohibitions by the complaining Member, *force majeure*, arrangements that limit exports, or the failure to conform to standards and regulatory requirements. Article 6.9 of the SCM Agreement covers another situation in which the "may" language would be applicable. It exempts serious prejudice that exists even where the requirements of Article 6.3 are fulfilled because the subsidies are exempt from action by virtue of the peace clause of Article 13 of the Agreement on Agriculture.

230. Please comment on Brazil's views on Article 6.3 of the *SCM Agreement* as stated in paragraphs 92-94 of its further submission. USA

231. Do you believe that the now-expired Article 6.1 and/or Annex IV of the *SCM Agreement* are relevant context for the Panel's interpretation of Article 6.3? USA

232. How, if at all, should the Panel take into account the effects of other factors in its analysis of the effects of US subsidies under Article 6.3? If the Panel should compare the effects of other factors to establish the relative significance of one compared to others, how would this be done? What would be relevant "factors" for this purpose? BRA

Brazil's Answer:

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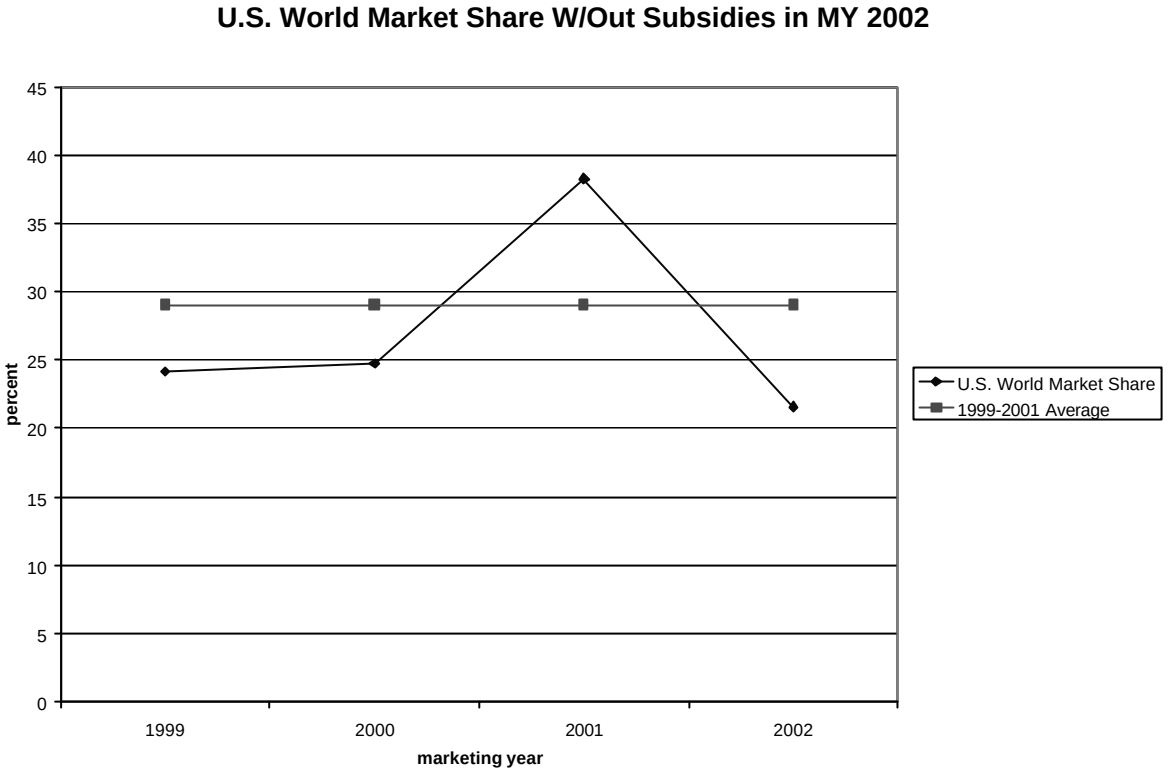
> conditions, and technical changes in cotton production that reduce costs, such as boll weevil eradication and release of genetically modified cotton varieties. Remember, my model is calibrated to reproduce actual cotton market data for the historical period. *Hence, my model incorporates all these historical factors into the baseline from which I analyze the impact of removing cotton subsidies.*[110]

84. The econometric evidence presented by Brazil – including the studies by USDA economists Westcott and Price, Professor Sumner, and Professor Ray of the University of Tennessee, among others – separate out the effects of the US subsidies from the effects of all other supply and demand factors that impact on the upland cotton market. In effect, these studies are designed precisely to answer the question posed by the Panel. The results of these studies sift through the "other factors" to isolate for the effects of the US subsidies. Professor Sumner has conservatively estimated that A-Index prices would on average be 12.6 per cent or 6.5 cents per pound higher without the US subsidizing upland cotton production, use and exports. The other econometric simulation models find that cotton prices are suppressed to a significant degree regardless of whether other factors push upland cotton prices up or down.

85. It bears repeating that Brazil has not claimed in this dispute that the entire decline in upland cotton prices during MY 1999-2002 was due to the effects of US subsidies. Brazil's argument has been all along that *but for* the US subsidies upland cotton prices would be higher.



89. This graph shows that in MY 2002, US exports would have fallen and remained below their previous three-year average *without* the US subsidies for that year. In other words, *but for* the 2002 US subsidies, there would have been a reduction in US world market share, not an *increase*.[115] This analysis also demonstrates that while there may have been other factors at work stimulating US exports (such as reduced domestic US demand for upland cotton), these factors were not enough to cause an increase in US world market share over the previous 3 year period as required by Article 6.3(d).

233. In Brazil's view, what is or are the "same market(s)" for the purposes of Article 6.3(c)? Does Brazil's view of "world market" imply that regardless of which domestic (or other) "market" is examined, price suppression will be identifiable? BRA

Brazil's Answer:

90. The "same market(s)" for the purposes of Brazil's price suppression claims under Article 6.3(c) are (1) the world market for upland cotton, (2) the Brazilian market, (3) the US market, and (4) 40 third country markets[116] where Brazil exports its cotton. US and Brazilian "like" upland cotton is found in each of these markets.

115

91. The record establishes that there is a "world market" for upland cotton and that the prices for that market are reflected in the New York futures prices and in the A-Index prices.[117] Brazil established that there is a global price discovery mechanism that reflects the "world market price," which is heavily influenced by world market supply and demand factors, including the US subsidies.[118] These "world market prices," in turn, are transmitted to the US market, the Brazilian market, and to the 40 other markets where both Brazilian and US subsidized cottons are marketed as typical commodities.[119]

92. In response to the Panel's question whether the world market prices that Brazil claims are suppressed are also "identifiable" in the "domestic (or other) 'market,'" the answer is "yes." The evidence of the transmission of the global effects to these other markets includes (1) USDA's own data for the US prices received by US producers,[120] (2) USDA volume and value data for US exports to third countries,[121] (3) Brazilian Government volume and value data for Brazilian exports to 40 countries,[122] (4) Brazilian ESALQ Index data regarding internal Brazilian prices,[123] (5) data from various third countries reflecting upland cotton import prices,[124] and (6) data from several third countries reflecting their domestic prices for upland cotton.[125] In addition, Brazil has presented the evidence of Andrew Macdonald and Christopher Ward who testified concerning the importance of the A-Index. Brazil further includes the views of Gerald Estur, the ICAC's chief statistician, as set out below.[126]

93. A-Index world prices are a useful benchmark by which to judge whether prices for upland cotton traded internationally or even within domestic markets are influenced by global world market forces.[127] While the New York futures prices play a major role in influencing markets, the short term volatility of the futures market makes comparison with monthly or annual export prices more difficult. Andrew Macdonald indicated that "the price oscillations of the A and B-Index are much less pronounced than the futures market, but in the longer term they accompany the signs and trends coming from the futures market."[128] Moreover, the US

export prices to 40 different countries, based on official published US and Brazilian Government sources. It then provides (based on availability) information concerning the import prices of all imports from certain of the 40 countries where both Brazil and US upland cotton was exported during MY 1999-2002. Finally, Brazil presents information of internal domestic prices in the United States, Brazil, and China.

Brazilian and US Export Prices

95. In response to the Panel's question, Brazil first presents evidence of US and Brazilian export prices to 40 different markets where both Brazilian and US upland cotton was exported at some point during MY 1999-2002. The information and evidence below is based on a compilation from two sources. First, all information on US upland cotton export prices is based on the "US Trade Internet System," a web application run by USDA's Foreign Agricultural Service (FAS).[130] Second, information on Brazilian upland cotton export prices is taken from information published and maintained the Brazilian Ministry of Agriculture on its public web-site.[131] The export "prices" represent the declared contract value of the upland cotton at the US and Brazilian port of export – known as "Free Alongside Ship (FAS)" values.[132]

96. The first way to examine the available data is to view it collectively similar to what the United States did in Exhibit US-75. The first graph below examines the cumulative Brazilian and US export prices in MY 1999-2002 covering exports to the 40 markets where Brazil exports its upland cotton as well as US exports to Brazil.[133]

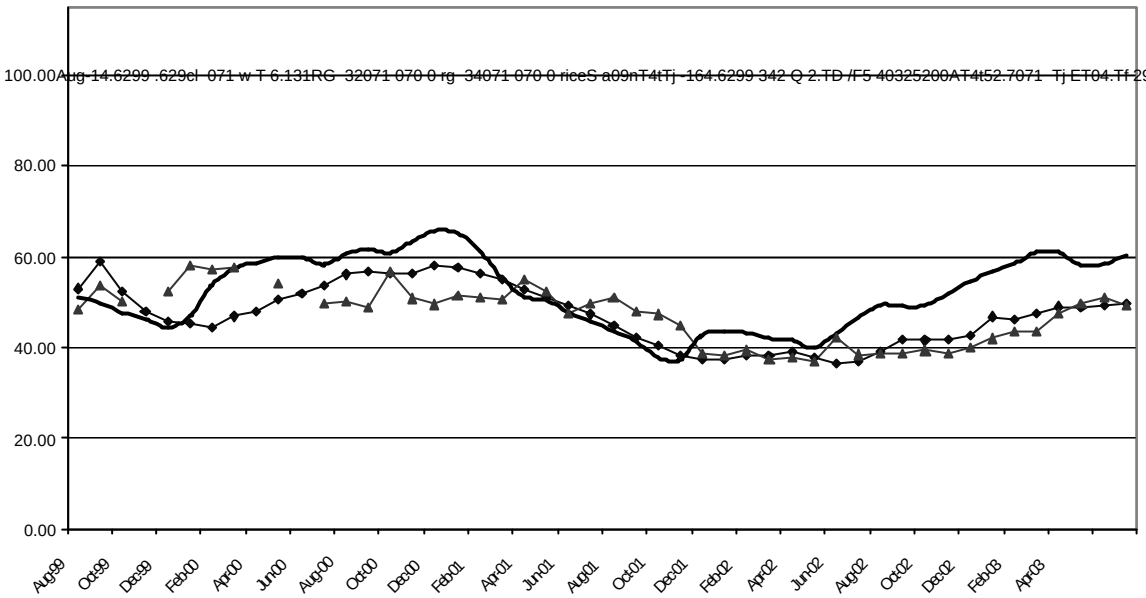
[130] *See* http://www.fas.usda.gov/ustrade/. The four upland cotton HS-10 codes used are 5201001010, 5201001020, 5201001025 and 5201001090. All data originally in tons and dollars, was converted into pounds and cents.

[131] *See* http://alicewebl.desenvolvimento.gov.br; www.mdic.gov.br/indicadores/balanca/balanca.html. See also Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country). All Brazilian data originally provided in kilograms and dollars was converted into pounds and cents.

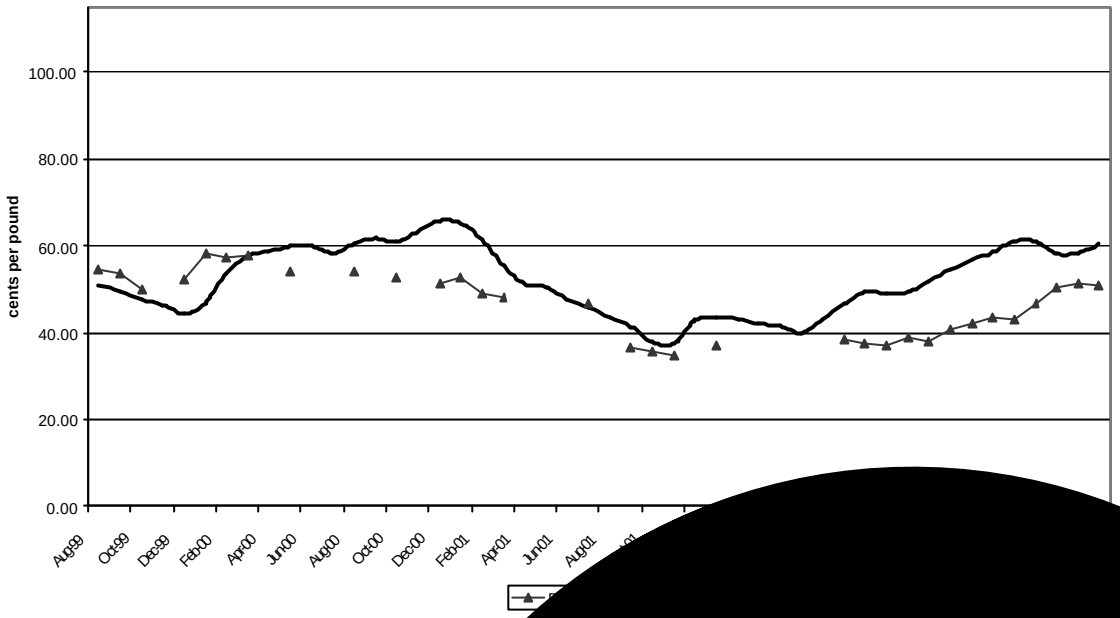
[132] The FAS value includes all inland freight, insurance and other charges incurred in placing the merchandise alongside the carrier at shipping or insurance costs.

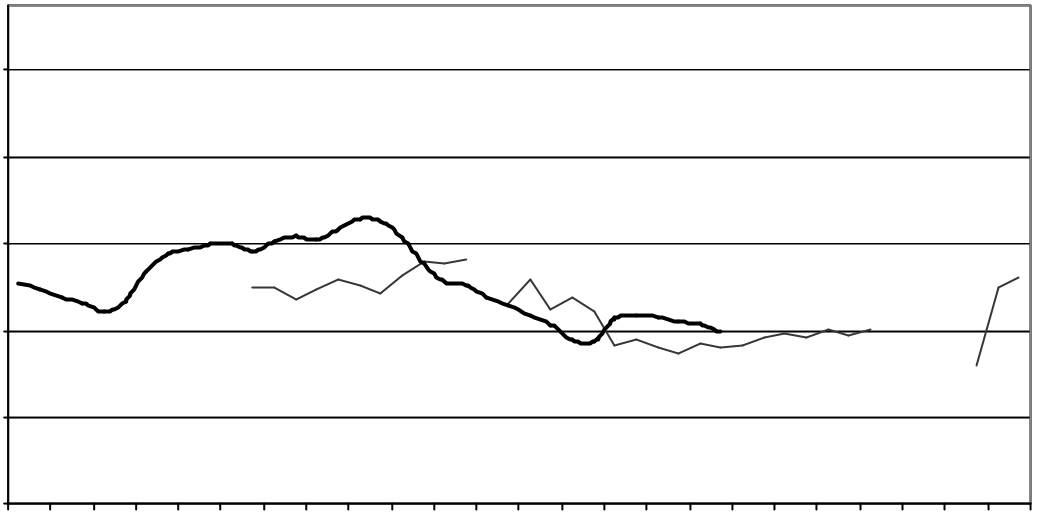
[133] Exhibit Bra-386 (Brazil and US Export Prices by Country). The data for all of the graphs in this subsection of Brazil's answer is contained in Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).

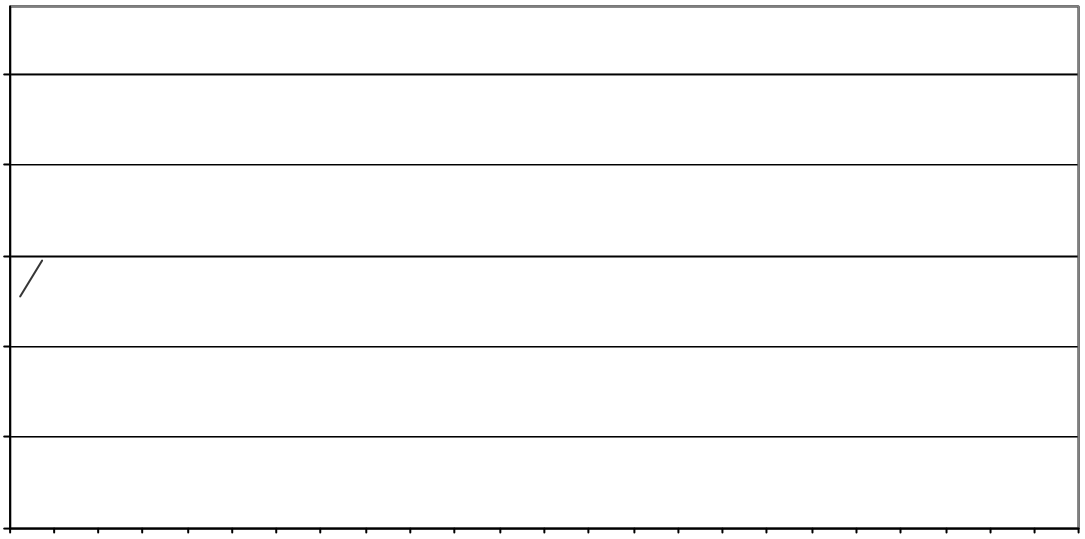
Export Prices Total

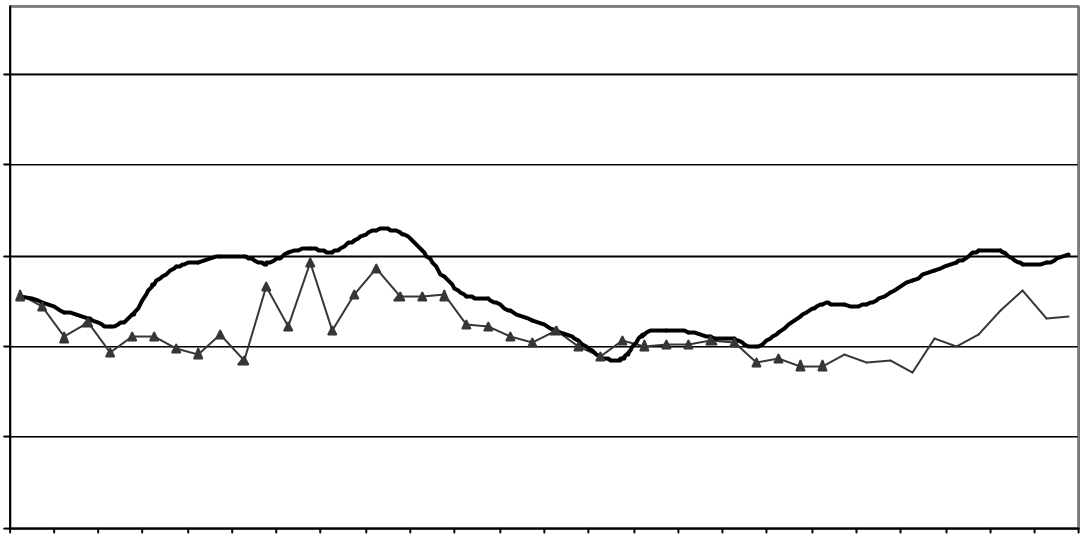


Brazilian Export Prices to Argentina







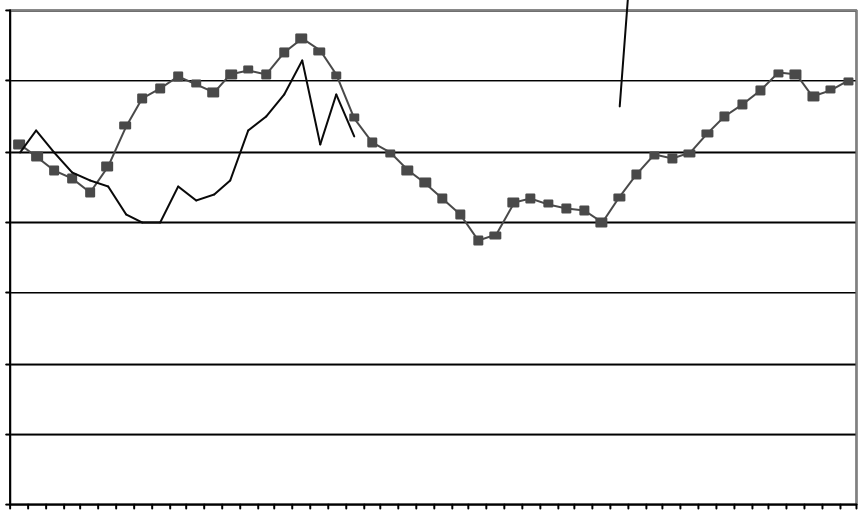


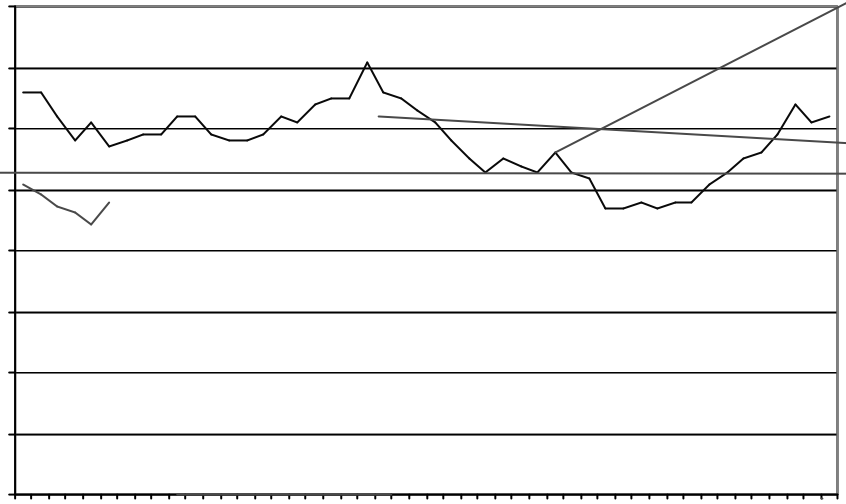
used in production of finer cotton fabric.[143] During certain period between MY 1999-2002, both Brazil and the United States exported cotton with a high staple length or a particularly good quality to a third country market, resulting in higher prices. This no doubt accounts for much higher US prices compared to Brazilian cotton in some markets such as France, Germany, and Portugal.

103. Second, smaller monthly export sales to a third country market with relatively few imports may result in much higher prices than large volume sales to large importers. Larger consuming countries (with larger consumers) can demand volume price premiums and sellers can export at higher volumes and lower prices based on economies of scale. The country data of the world's largest importers such as China, Hong Kong, Taiwan, and Indonesia, for example, closely match A-Index price trends.[144] But even larger importing countries data reflects an occasional month where prices diverge from the overall trend. This may be due to the fact that smaller shipments were purchased quickly on a spot basis at higher prices.

104. Third, some exports or forward contracts for export sales are fixed-price contracts, which may be executed months before export takes place.[145] For example, a yarn spinner or textile producer in Brazil may contract to purchase 100 tons of US cotton on 1 January 2002 at an import price fixed at 40 cents per pound at that date, but when the cotton is actually exported on 1 June 2002 the A-Index price may be 50 cents. This type of contract with terms fixed at execution rather than on delivery may explain a number of country market graphs where there is a delayed reaction of the country price to declines or increases in the A-Index prices. However, even where there is a delay in response, the longer-term trends in most markets thereafter track the downward or upward climb of A-Index prices.

105. But even with the limitations in the monthly data for individual country markets, the data on the whole strongly supports the conclusion that world prices do influence local export market prices. Any anomalies in smaller importing country markets are notably eliminated by using the weighted average analysis of monthly data from all 40 markets where Brazil and US cotton exports are found. With the vast bulk of US – and most of Brazilian cotton – being exported to large volume markets, the combined analysis shows the close relationship between A-Index prices and both Brazilian and US prices. Indeed, the Chief StatisticiancomC-3in ts. This tee035.25 2.04784 Tng A

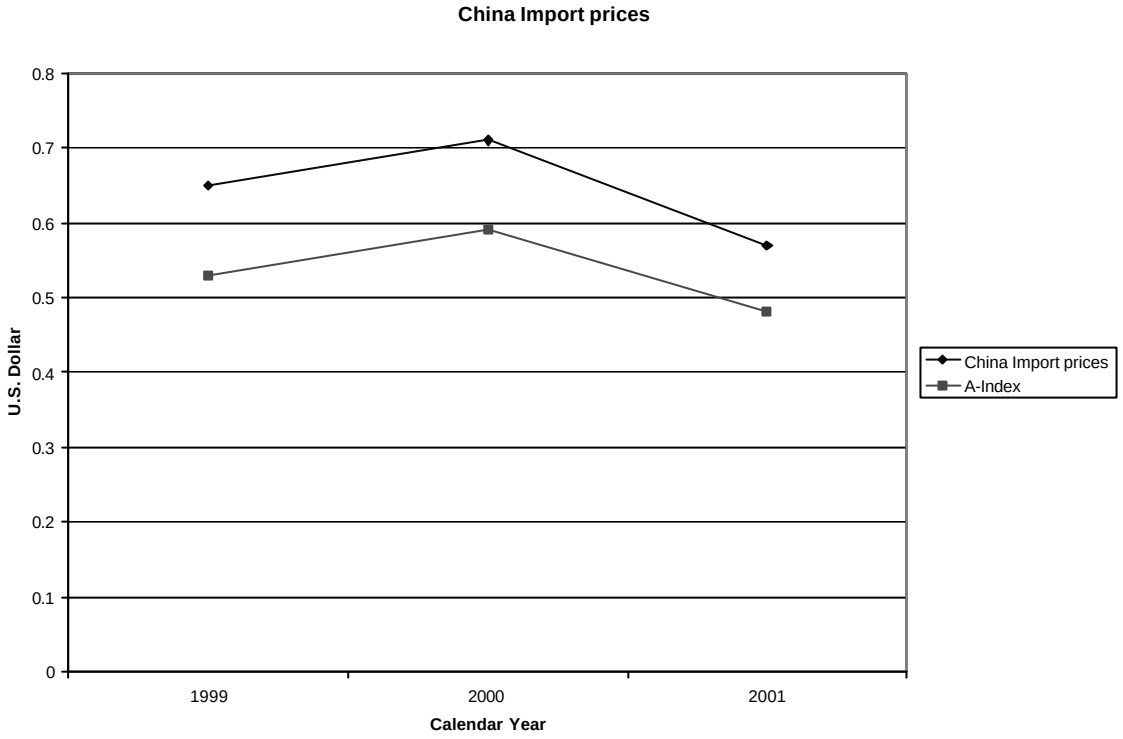




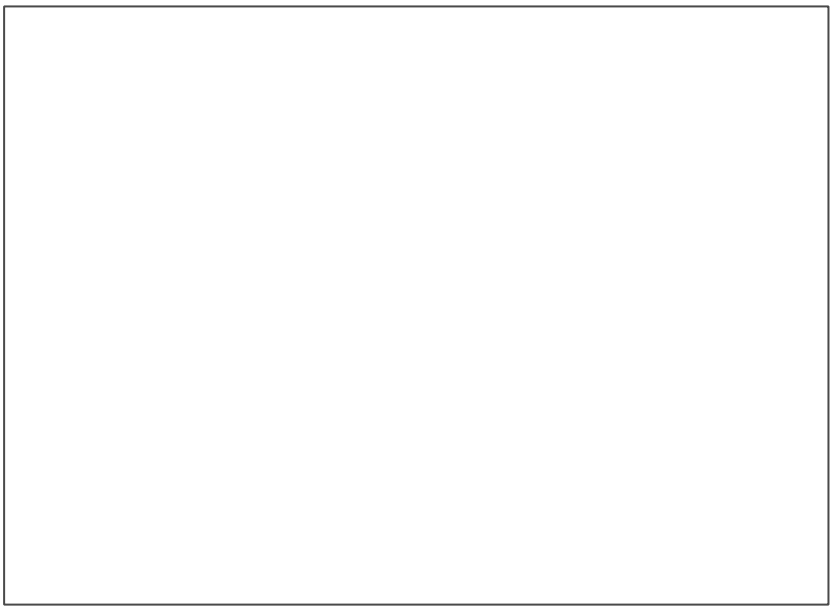
8

7

108. There is also *annual* import data available from a few countries. While annual data does not provide as detailed information concerning price movements within a year, it also supports a link between the A-Index and import prices. These import prices, in turn, serve as a proxy for prices in the third country market generally. For example, the available import data from China, Chile, and the United Kingdom is set forth below:[147]



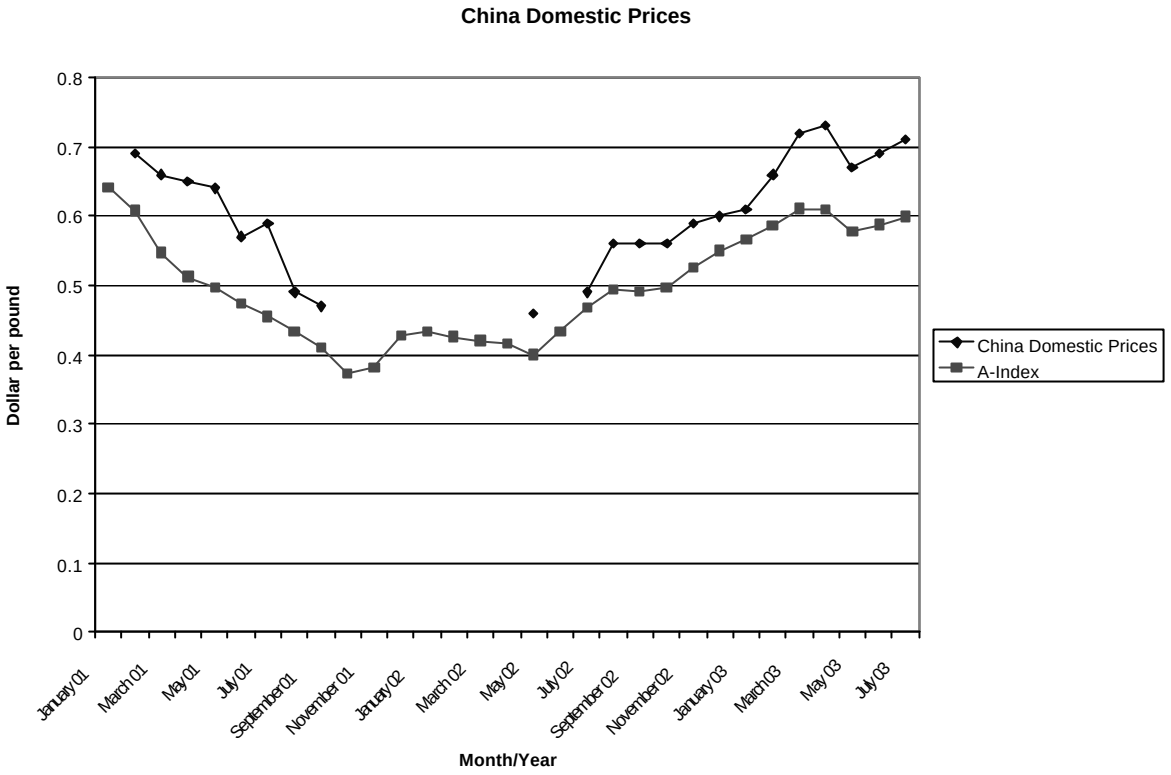
[147] Exhibit Bra-384 (Import Prices from Various Countries).



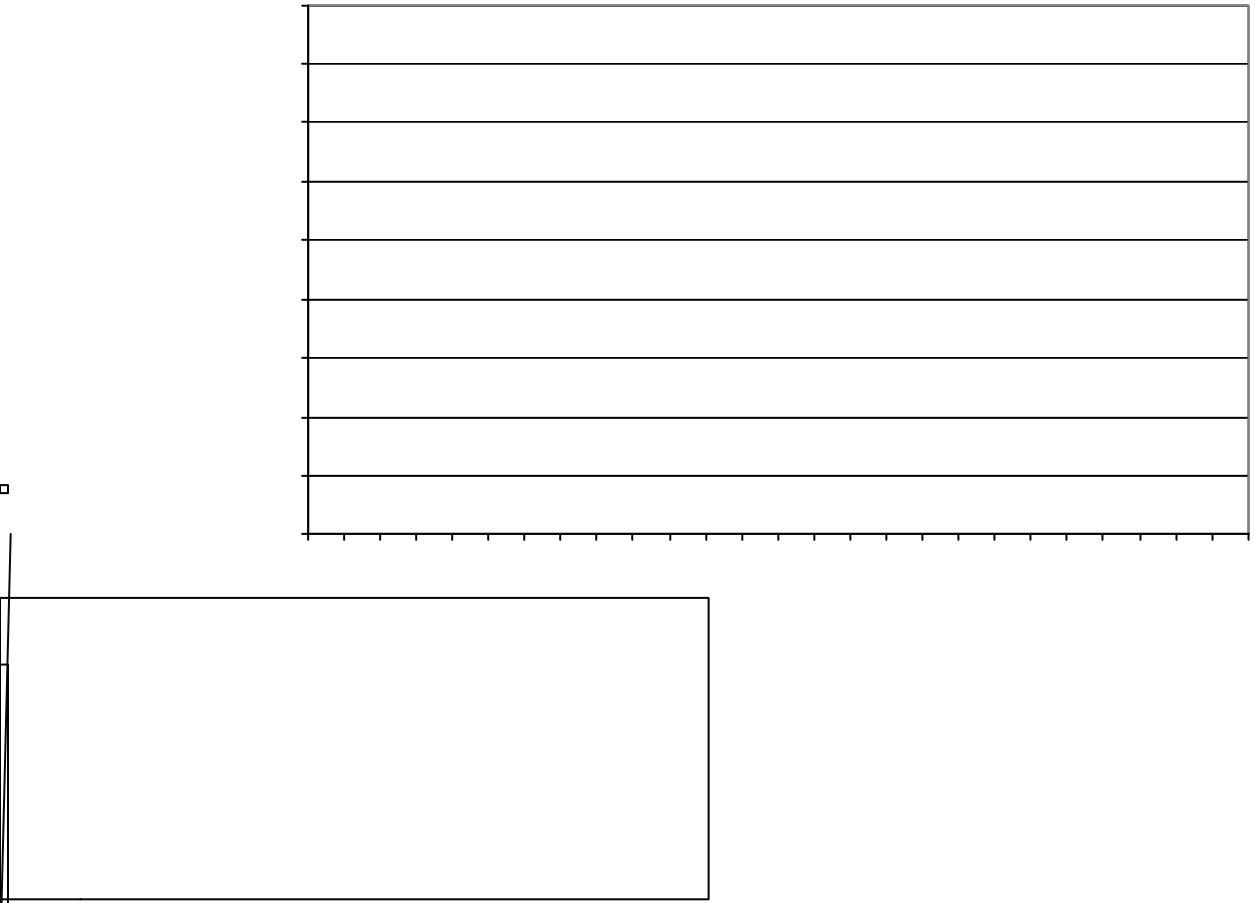
Individual Country Domestic Prices

109. Finally, Brazil presents a series of graphs showing domestic prices in those countries for which domestic prices were available. Andrew Macdonald has indicated that most countries do not collect or maintain accessible data on domestic upland cotton prices. This was confirmed by the requests for such data by Brazilian embassies around the world. Therefore, Brazil can only offer information on domestic prices from a limited number of countries. These countries, however, constitute key markets, including the United States, China, Brazil and Pakistan.

110. The record shows that domestic prices within several key producing countries including the United States, Brazil, China and Pakistan also reflect and generally move with the overall trends of A-Index prices. This is shown in the graphs below:[148]



A similar pattern also evolves for domestic prices in another major producers and user of upland cotton: Pakistan.[151]



been used for further investment in high-yielding lower cost production.[154] By any measure, this evidence establishes both "significance" of the price suppression and "serious prejudice" to the interests of Brazil.

235. Please comment on paragraphs 8, 9 and 10 of the US 2 December oral statement, in particular, why the average Brazilian price is shown as lower than the average US price. BRA

Brazil's Answer:

116. Brazil previously has set forth its reasoning why evidence of lower Brazilian prices in some markets is irrelevant to the issue of whether or not all the prices in those markets were suppressed by the global effects of US subsidies.[155] This global price transferral mechanism is and remains the relevant analysis of Brazil's Article 6.3(c) price suppression claim as Brazil has outlined in its Answer to Question 233. Brazil sets forth its comments and rebuttal to paragraphs 8, 9 and 10 of the US 2 December Oral Statement and Exhibit US-75 below.

Cumulative Analysis of 8 Country Export Prices

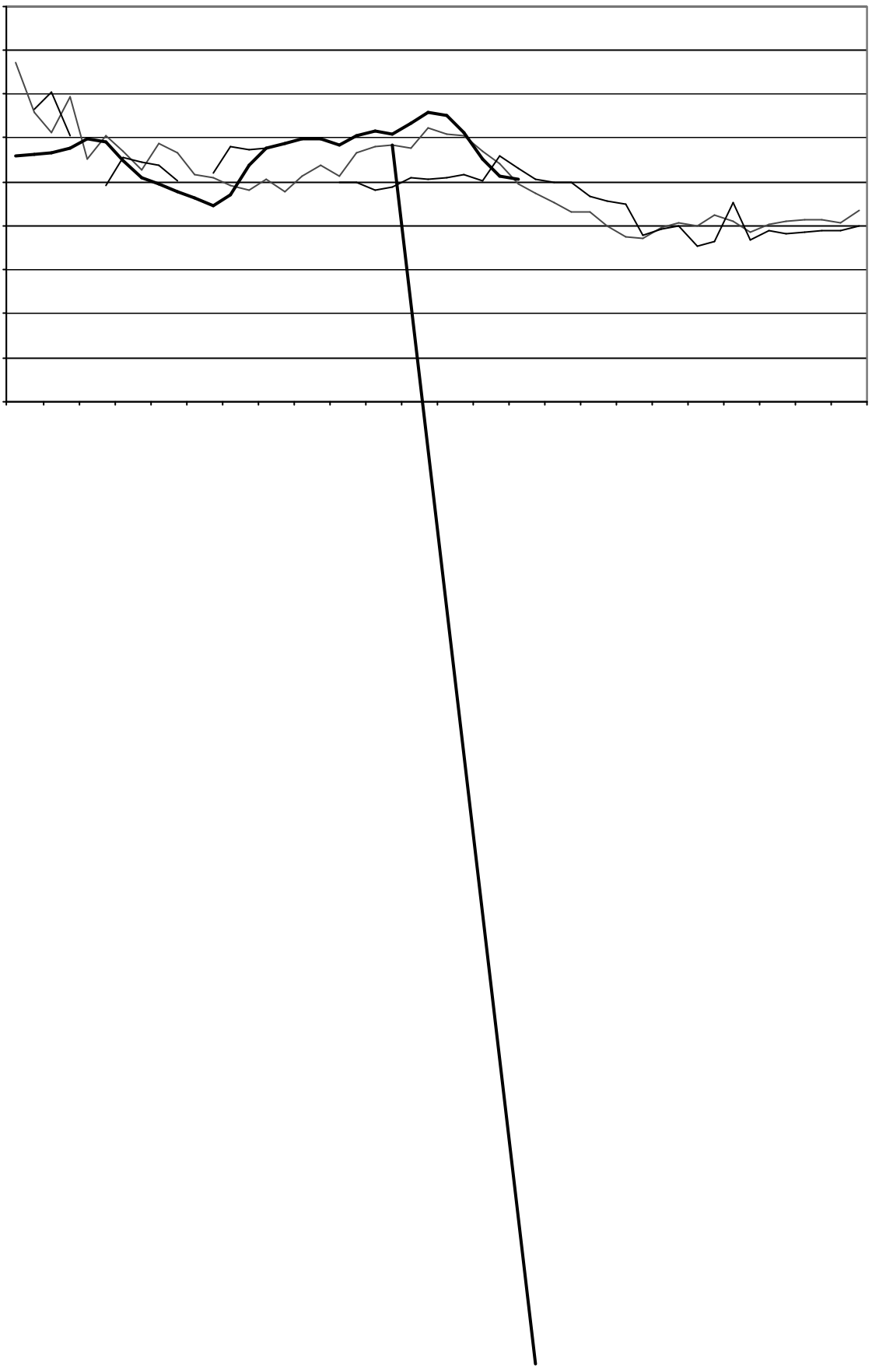
117. With respect to the US "price undercutting" argument, and in particular the US chart set out in Exhibit US-75, the factual assertion that cumulative US prices in the 8 countries examined are consistently much higher than Brazilian prices is simply wrong. One fundamental error with Exhibit US-75 is that the United States did not "weight-average" the data regarding export prices for Argentina, Bolivia, Italy, Philippines, Portugal, Indonesia, Paraguay and India. Rather, Exhibit US-75 is based on a simple average, not taking into account whether Brazilian shipments on a monthly basis were 2 tons or US shipments the same month were 100,000 tons. In addition, the US chart (and accompanying data) in Exhibit US-75 provides no volumes on monthly shipments, provides no published backup material, uses a non-public source of information, and inexplicably does not use official USDA Foreign Agricultural Service (FAS) published data on export prices.

118. Using the proper monthly weighted average methodology and FAS's own official export pricing data together with the Brazilian Government's official export pricing data,[156] the collective situation in the eight countries examined in Exhibit US-75 looks completely different than the US chart in that exhibit:

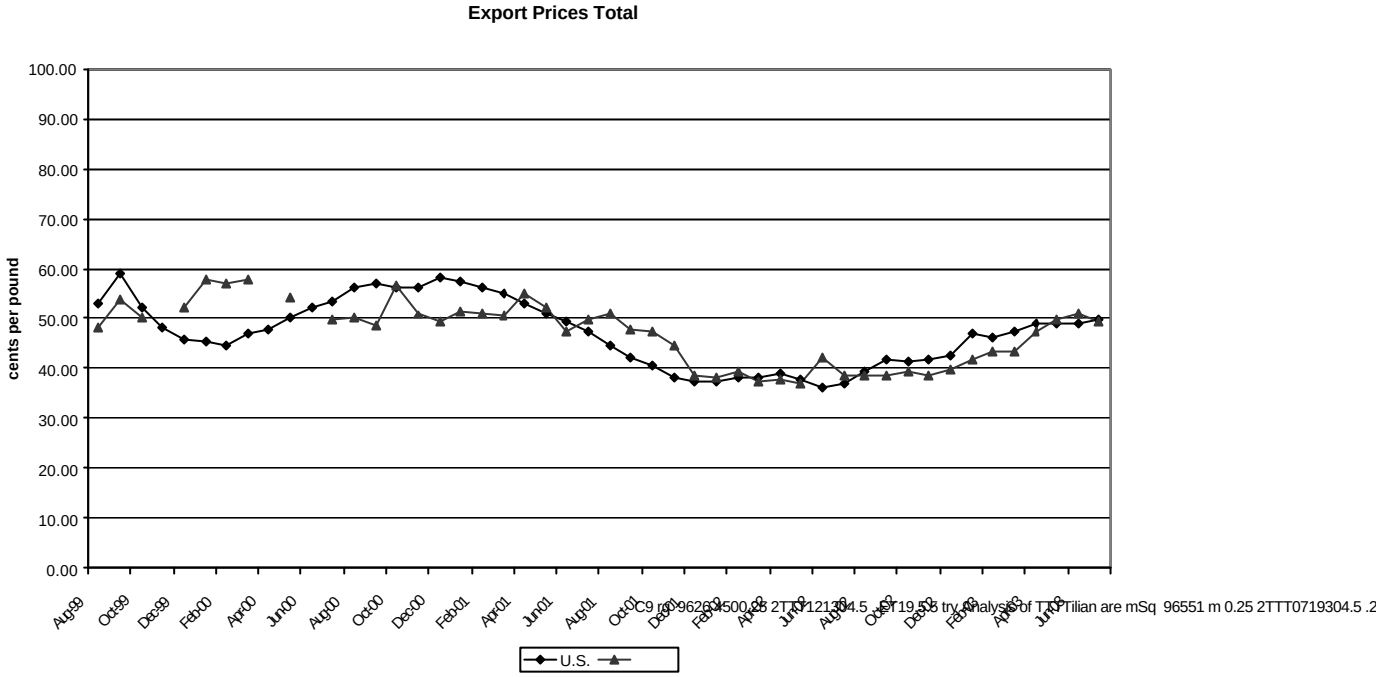
[154] Brazil's 9 September Further Submission, Section 6 and Annex III. *See* also Exhibit Bra-283 (Statement by Christopher Ward – 7 October 2003).

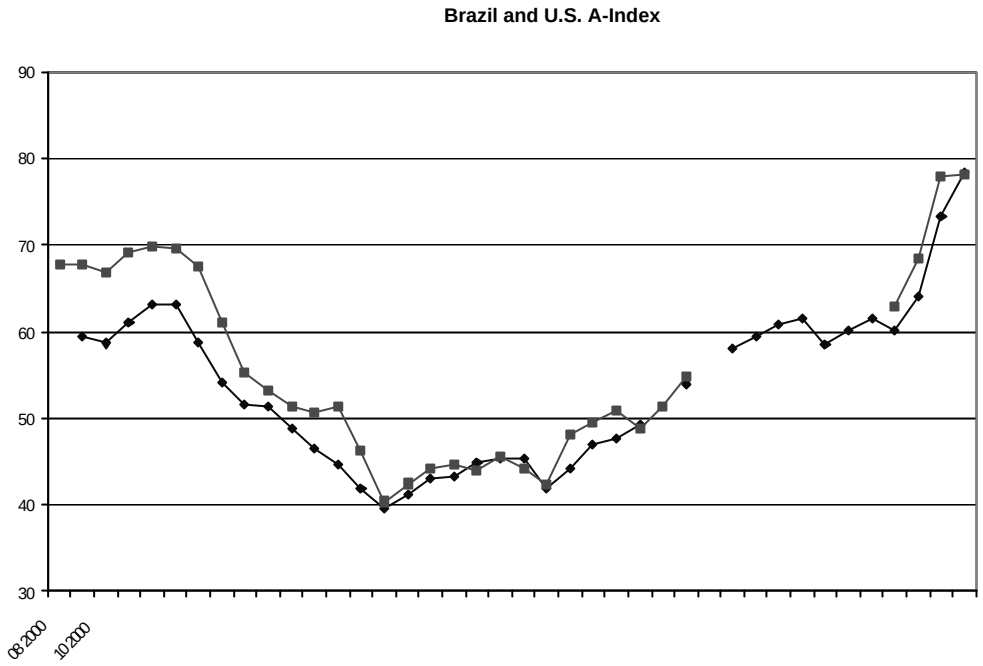
[155] Brazil's 2 December Oral Statement, paras. 14-19 (providing evidence and references to other evidence supporting Brazil's clams); Brazil's 9 September Further Submission, Section 3.3.4.9.

[156] This data was discussed in some detail in Brazil's Answer to Question 233 and is contained in Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).



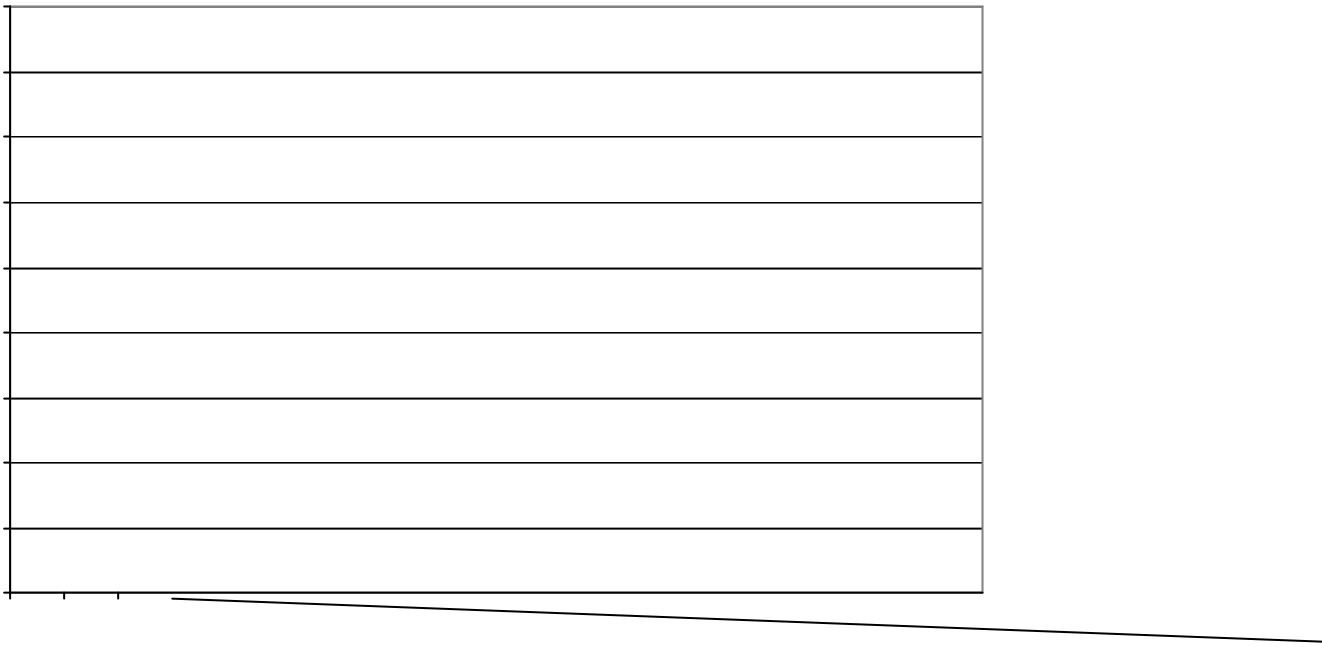
121. These very close relationships – as well as movements – of Brazilian and US cumulative prices in the 41 countries are reflected in cumulative weighted average monthly prices in the graph below:[161]

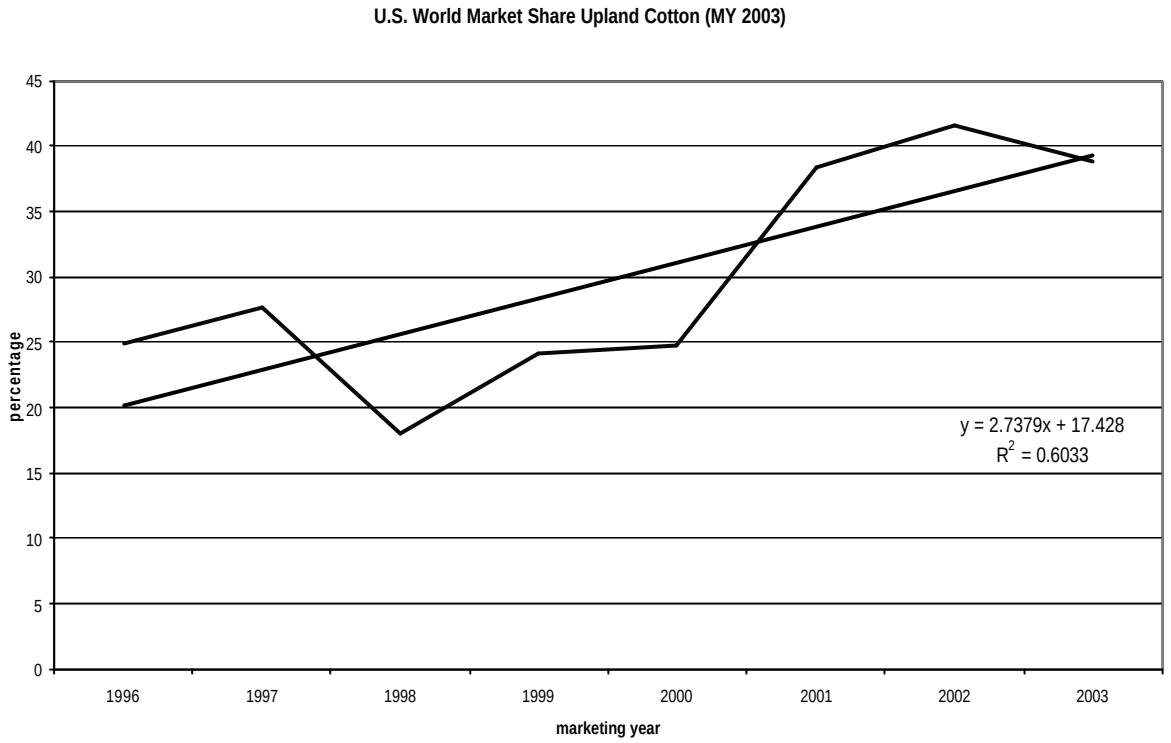


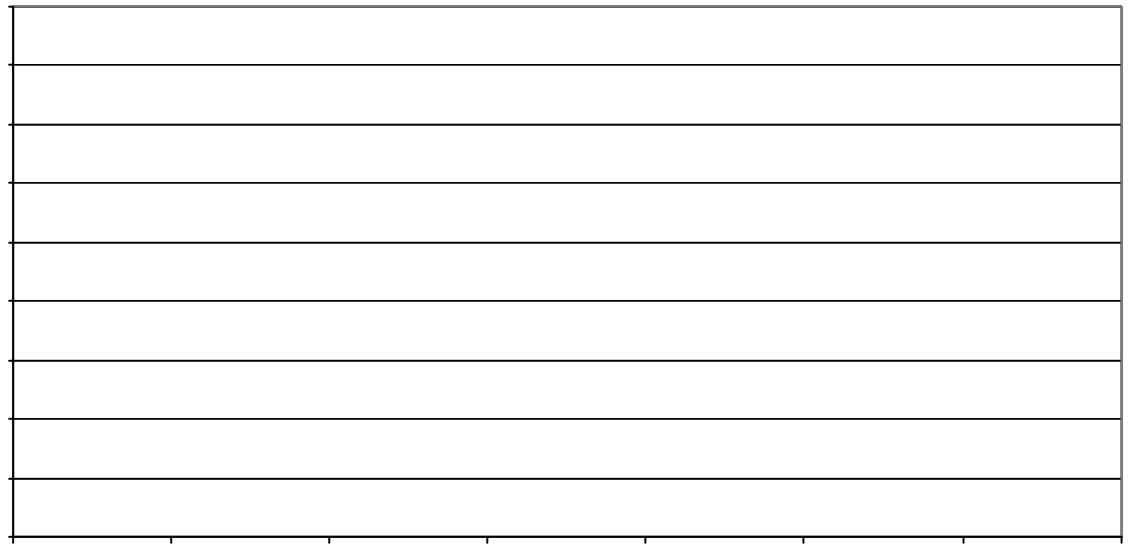

Brazil and U.S. A-Index
90
80
70
60
50
40
30
08/2000
10/2000

prices.[184] This evidence confirms the testimony of Andrew Macdonald that Brazilian textile purchases of cotton may, *inter alia*, US imports – or the threat of US imports – to negotiate lower Brazilian domestic prices during MY 1999-2002.[185] It may also be an effect of US GSM 102 export

139. However, Brazil has also run a regression analysis for the trends over the period MY 1986-2003, MY 1996-2003 and MY 1996-2002, with the results being reproduced in the graphs below.[193]




U.S. World Market Share Upland Cotton (MY 2003)
45
40
35
30
25
20
15
10
5
0
percentage
y = 2.7379x + 17.428
R2 = 0.6033
1996
1997
1998
1999
2000
2001
2002
2003
marketing year



238. According to the US interpretation of the term "world market share":

(a) should the domestic consumption of closed markets be added into the denominator?

(b) if US production and consumption increased by the same percentage, whilst the rest of the world's production and consumption remained steady, would this imply an increase in the US "world market share" by a different percentage?

(c) does Saudi Arabia have a small world market share for oil? USA

239. How does the US respond to Brazil's assertions that, under the US interpretation of the term "world market share":

(a) there would be no WTO disciplines on production-enhancing subsidies that increase a Member's world market share of exports? (see paragraph 64 of Brazil's 2 December oral statement);

(b) a Member's exports would have to be disregarded in calculating their "world market share" in terms of "world consumption"? (see e.g. paragraph 65 of Brazil's 2 December oral statement) USA

240. Does Article XVI:3 of GATT 1994 provide context in interpreting Article 6.3(d) of the *SCM Agreement*? Do these provisions apply separately? If not, could it indicate that "world market share" is intended to mean the same as "share of world export trade"? USA

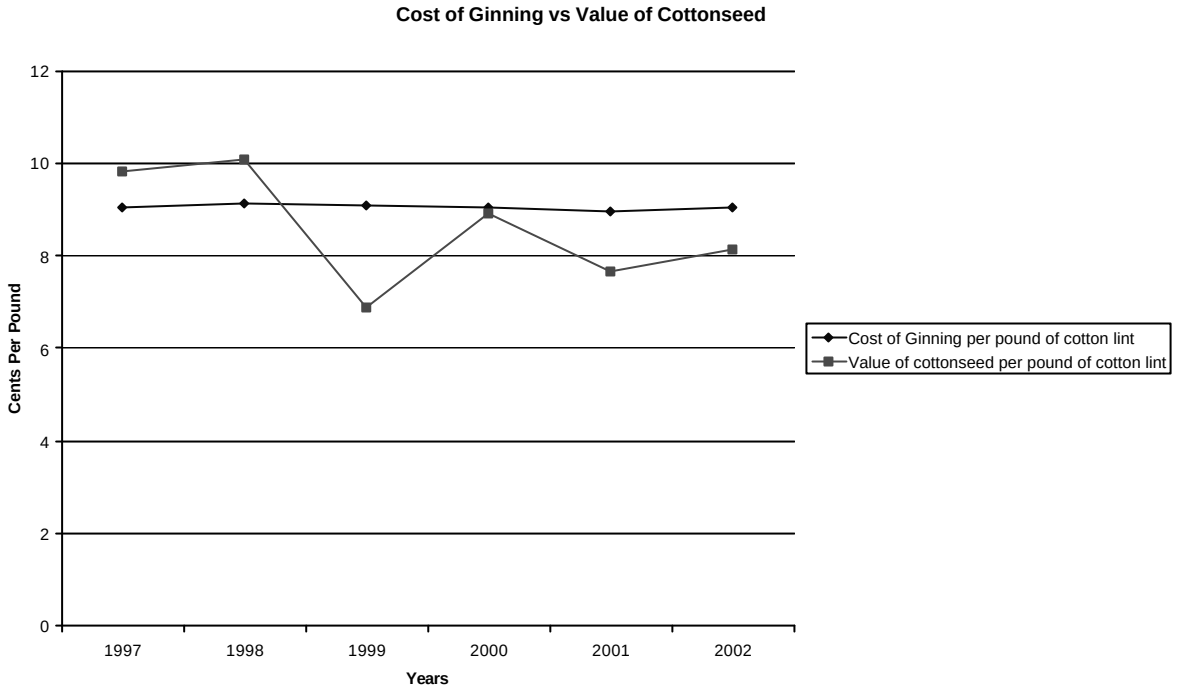
241. How does the US reconcile its data on consumption for 2002 in US Exhibit 40, Table 1 with the "consumption" data it refers to in its 30 September submission, paragraph 34, Exhibit US- o3904 Tesfinterpreting Art78.75 0 TD in its cons 2.9218 Tw (enhancing s) Tj 72 0 e US "(a)rog246i8

cottonseed prices. This was made clear by the official USDA announcement of the USDA Secretary Glickman in announcing the MY 2000 cottonseed payments:

> Agriculture Secretary Dan Glickman announced today that USDA will propose to pay cotton farmers and ginners about $74 million to help offset losses from low 1999-crop cottonseed prices.
>
> Because of those low prices, many gins were unable to meet operating expenses normally covered by cottonseed revenues and some cotton farmers had to pay higher ginning costs," Glickman said. "This discretionary programme will help farmers make up this lost income."
>
> The proposed payments would be made to cotton gins based on seed tonnage produced from the 1999 crops of upland and Extra Long Staple cotton. USDA plans to propose that *gins share cottonseed programme payments with cotton farmers commensurate with any increased 1999-crop ginning charges as a condition of accepting programme payments.*[194]

142. This analysis makes it clear that upland cotton producers in MY 1999-2000 were required to pay more for ginning when cottonseed prices fell because ginning companies accept as part of the payment for ginning the cottonseed produced from the ginning process of raw cotton. The benefits of the cottonseed programme to producers explains why the NCC strongly supported the "the establishment of a permanent programme for cottonseed" during the debate for the 2002 FSRI Act.[195]

endobj 42 0 obj 3731 22.5 -12.75 TD 67-0.1895 Tc 1.427 Tw (pa4.8nt for gi-12.totalevalue-12.j 10825 TD 0427 Tc 3.9



144. This graph shows that producers were the primary beneficiaries of the cottonseed programme. When cottonseed prices declined in MY 1999, ginning costs exceeded cottonseed prices by 2.18 cents per pound of cotton lint.[198] This gap between ginning costs and cottonseed prices totalled $170.5 million.[199] Congress authorized $185 million in cottonseed payments in MY 2000[200], which covered much of the MY 1999 losses. As noted, it was upland cotton *producers* – not ginners – who were required to pay the $170.5 million difference in MY 1999 between the costs of ginning and the value of the cottonseed. When cottonseed prices again plunged in MY 2001 and MY 2002, Congress provided relief to producers with the 2002 cottonseed payments. For example, the $50 million in cottonseed payments in MY 2002 covered part of a gap of $73 million between the ginning cost and the value of the cottonseed.[201] Thus, this evidence suggests not only that cottonseed payments were support to upland cotton within the meaning of Article 13(b)(ii) of the Agreement on Agriculture, but that these payments, while relatively small in comparison to the billions of dollars paid to US producers, nevertheless, provided yet further subsidies supporting large quantities of US upland cotton production.

245. Can a panel take Green Box subsidies into account in considering the effects of non-Green Box subsidies in an action based on Articles 5 and 6 of the *SCM Agreement*? BRA, USA

[198] Exhibit Bra-391 (Cost of Ginning and Value of Cottonseed per Pound of Cotton Lint).

[199] This figure has been calculated based on the price gap of 2.18 cents per pound multiplied by the MY 1999 production of 16.294 million 480-pound bales (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[200] Brazil'sExhis00213 ffects of non

cotton subsidies and whether these mandated and unlimited subsidies constitute a permanent source of uncertainty in the upland cotton market.[204]

149. The Panel's question raises both legal and factual issues. First, as a legal matter, Brazil has previously argued that it is appropriate for the Panel to consider pricing, export, production, acreage and other evidence occurring after the date of establishment of the Panel.[205] The Panel's terms of reference in this case involve both *present* and *threat* of serious prejudice claims (*i.e.*, matters) with

> It's interesting that we project nearly an 8 per cent increase in world production [in MY 2003], but US production is forecast to rise only slightly. *This tells me the world is certainly more price sensitive and responsive than the US cotton producer*. I think the nature of our farm programme definitely creates this situation. *Cotton futures prices need to rise to nearly 70 cents a pound to make cash prices better than the farm programme protection.*[218]

In addition, Mr. Dunavant emphasized that US producers "must have" the GSM-102 programme "if we are to export the quantities needed to support our level of cotton production in 1. Tw (In additi3sn in 1.aSy [/F0

only five quotes making up the given A-Index. During MY 2002, there were zero Step 2 payments during five weeks: 20 September, 27 September, 4 October, 11 October and 18 October 2002.[222]

160. By contrast, during MY 2001, Step 2 payments were zero during 15 weeks: 14 December, 21 December, 28 December, 4 January, 11 January, 18 January, 25 January, 1 February, 8 February, 15 February, 22 February, 1 March, 8 March, 15 March, and 22 March.[223]

161. The elimination of the 1.25 cent per pound threshold under the 2002 FSRI Act has reduced the likelihood of zero payments under the Step 2 programme because the lowest US quote must now be even lower relative to the A-Index for Step 2 payments to expire. It also means that the US government will pay the entire difference between the cheapest US price quote for the A-Index and the A-Index itself.

249. The Panel notes that the definition of eligible "exporter" in 7 CFR 1427.104(a)(2) includes "a producer":

(a) How does this reconcile with Brazil's argument that Step 2 "export payments" do not directly benefit the producer?[224] How, if at all, would this be relevant for an analysis of the issue of export contingency under the *Agreement on Agriculture* or the *SCM Agreement*? BRA

Brazil's Answer:

162. As set out in Brazil's Answer to Question 125, Step 2 payments generally are not received by US producers but rather by eligible exporters and domestic users.[225] Of course, it is theoretically possible for a producer to receive directly Step 2 payments when the producer meets the definition of an exporter "regularly engaged in selling eligible upland cotton for *exportation* from the United States."[226] However, the fact that most US producers do not *directly* receive Step 2 payments does not mean that they do not benefit *indirectly* from Step 2 payments. Quite the contrary. Step 2 payments support significant quantities of planted upland cotton acreage, production and exports by stimulating the demand for high-cost and high-priced US cotton.[227] Brazil has provided considerable evidence of these effects in its earlier submissions that has never been rebutted by the United States.[228]

163. The answer to the second question is "not at all." Exporters are only eligible to receive Step 2 export payments if they produce evidence to CCC that they have exported an amount of US upland cotton. Thus, payments are conditional upon proof of export. Exporters will not receive any Step 2 export payments if they have not produced evidence of the export of US

serious prejudice."[235] Indeed, no provision in US law is designed to forestall serious prejudice to US trading partners caused by US agricultural subsidies *specifically in support of upland cotton.*

169. The current US "total AMS" is $19.1 billion. As long as the United States stays below this

ANNEX I-8

ANSWERS OF THE UNITED STATES TO QUESTIONS POSED BY THE PANEL FOLLOWING THE SECOND SUBSTANTIVE MEETING OF THE PANEL

(22 December 2003)

A. TERMS OF REFERENCE

192. Regarding the interest subsidies and storage payments listed by the United States in its response to the Panel's Question No. 67:

(a) Please provide a copy of the regulations under which they are currently and

9. We note that Brazil has not made any adjustment in the outlay figures it has presented to the Panel for purposes of both Peace Clause and its actionable subsidy claims to reflect the fact that the EWG percentages are substantially lower than the 87 per cent revision made by Brazil to correct its initial Peace Clause analysis. The adjustment resulting from the EWG data in the total decoupled payments for upland cotton base acres made to upland cotton "producers" is also substantial. Since Brazil presents the EWG percentages as Brazil's own data, Brazil has effectively conceded that its own figures should be corrected at least as follows:

Decoupled payments for upland cotton base acres to upland cotton "producers" ($ millions)			
	Brazil initial amount[13]	Brazil corrected amount[14]	EWG amount[15]
1999 PFC	616	547.8	no data presented
1999 MLA	613	545.1	no data presented
2000 PFC	575	541.3	373.4
2000 MLA	612	576.2	436.7
2001 PFC	474	453	364.3
2001 MLA	654	625.7	402.8

payments on rented acres will be captured by landowners and capitalized into land values.[18] Thus, to reflect the benefit to upland cotton producers, the EWG data should be adjusted *downwards by 65 per cent* to reflect the fact that "[n]ot all operators [producers] can therefore be considered as true beneficiaries of the [PFC] programme, since competitive cropland rental markets work to pass through payments from PFC recipients who are tenants to the owners of base acres."[19] Only those upland cotton producers who are owners of upland cotton base acres will receive the benefit of those decoupled payments.

11. Finally, to answer the Panel's question on the total payments for upland cotton base acres that benefit upland cotton producers would require information relating to the total value of each recipient's production. The EWG figures, adjusted to account for the capture of 65 per cent of those payments by owners of base acreage who are not cotton producers, would need to be allocated across the total value of production in order to calculate the subsidy benefit to upland cotton. Brazil has not brought forward information to permit that allocation; in fact, as discussed in more detail in the US answer to question 256 from the Panel, Brazil has not even claimed that such an allocation is necessary. Accordingly, it does not appear possible to calculate the total payments to upland cotton producers that benefit upland cotton nor any per pound measurement.

196. Please provide the latest data for the 2002 marketing year on payments under the marketing loan, direct payments, counter-cyclical payments, user marketing certificate (step 2) programmes and export credit guarantee programmes. BRA, USA

12. Data for marketing loan and user marketing certificate programmes are for upland cotton only and are current as of 12 December 2003.[20]

- Marketing loan programme (includes loan deficiency payments, marketing loan gains, and certificate gains): $832,836,963
- Step 2 payments (data are on a October 2002 - September 2003 fiscal year basis): $415,379,000

13. Data for direct payments and counter-cyclical payments are presented for upland cotton base acres only and are current as of 12 December 2003.[21]

- Direct payments: $181,811,374 million. (Because the 2002 marketing year was a transition year between the 1996 and 2002 farm bills, $436,805,000 in Production Flexibility Contract payments were made in 2002.)
- Counter-cyclical payments: $1,309,471,167

14. Data for export credit guarantee programmes are only available on a fiscal year basis (October 2002 - September 2003) and apply to all cotton. No breakout is available for upland cotton. The value of registration guarantees is $234,423,344. This figure represents the coverage applied for by exporters, not actual exports. An exporter may apply for a guarantee but not actually ship the goods.[22] Outstanding claims are $280,898, less than one-tenth of one per cent of the value of

[18] *See* US Further Rebuttal Submission, paras. 75-77.

[19] Burfisher, M. and J. Hopkins. "Farm Payments: Decoupled Payments Increase Households' Well-Being, Not Production." *Amber Waves,* Vol. 1, Issue 1, (February 2003): 38-45, at 44 (Exhibit US-78)

[20] Source: Official data base of the Commodity Credit Corporation, maintained by the Farm Service Agency, USDA; latest data are unpublished and may differ from published FSA data.

[21] Source: Official data base of the Commodity Credit Corporation, maintained by the Farm Service Agency, USDA; latest data are unpublished and may differ from published FSA data.

[22] Published data on guarantee values can be found in *Export Assistance, Food Aid, and Market Development Programmes, FY 2003 Summary* at http://www.fas.usda.gov/excredits/quarterly/archive.html. Data for FY 2003 found in this report are current as of 9/30/03 and differ slightly from these figures, which reflect exporter activity through mid-December, including cancellations and reserve activity. Data for FY 2003

incorrectly estimates programme yields to be 531 pounds per acre. This underestimates deficiency payments for MY 1992.

18. The US calculation uses the methodology set out in paragraphs 10 and 11 of Annex 3. Consistent with the 1995 US

24. As was reported in the US Answer to Panel Question 125(5) and the US oral statement of 2 December, a preliminary review of data from the Farm Service Agency shows that approximately 47 per cent of upland cotton farms eligible for decoupled income support payments planted no cotton in marketing year 2002. This number is consistent with the Environmental Working Group data presented by Brazil in its further rebuttal submission that showed the per cent of farms receiving only contract payments in 2000, 2001, and 2002 (46, 45, and 45 per cent, respectively).[34] Thus, the EWG data support the US position that decoupled income support is, in fact, decoupled from production decisions since nearly half of historic upland cotton farms no longer plant even a single acre of cotton.[35]

25. The EWG data also show that Brazil's 14/16 adjustment to decoupled payments, even on Brazil's faulty allocation theory, is too small an adjustment. Brazil has asserted that 87 per cent of decoupled payments for upland cotton base acres are received by upland cotton producers and support to upland cotton. However, the EWG data suggest that in marketing years 2000, 2001, and 2002 only 71, 77, and 74 per cent, respectively of upland cotton base acreage payments went to farms that planted upland cotton. Thus, the EWG data support the US position that Brazil has overestimated and failed to properly calculate the subsidy benefit to upland cotton provided by these payments. For further detail, please see the US answer to question 195.

26. We also note a serious misuse of the EWG data when Brazil claims that, because approximately 92 per cent of total marketing loan payments received in MY 2002 by farms planting upland cotton were upland cotton payments, therefore such farms must predominantly produce cotton. In fact, marketing loan payments crucially depend on whether prices are above or below the loan rate for the crop at issue. Soybeans and corn saw high prices in MY 2002, meaning few marketing loan payments were made in MY2002.[36] Furthermore, the data collected by the United States in response to Brazil's request for certain information demonstrate that for MY 2002 upland cotton planted acres

> **Free Along Ship Export Value (F.A.S.) –** The value of exports at the seaport, airport, or border, port of export, based on the transaction price, including inland freight, insurance, and other charges incurred in placing the merchandise alongside the carrier at the port of exportation. The value, as defined, excludes the cost of loading the merchandise aboard the exporting carrier and also excludes freight, insurance, and any charges or transportation costs beyond the port of exportation**.**
>
> **Free On Board (F.O.B.)** – A standard reference to the price of merchandise on the border or at a national port. In F.O.B. contracts, the seller is obliged to have the goods packaged and ready for shipment at the place agreed upon, and purchaser agrees to cover all ground transport costs and to assure all risks in the exporting country, together with subsequent transport costs and expenses incurred in loading the goods onto the chosen means of transport.

FOB is greater than FAS except when the vessel is not changed at the port of export, in which case the values are equal.

29. The World Trade Atlas publishes an average unit price for exports. The average unit price is calculated by dividing the value of the exports by the quantity for selected HS codes. Average unit prices are expressed in dollars per kilogram. This value was converted to dollars per pound for the graphs.

30. The graph in paragraph 40 of the US further rebuttal submission is a comparison of simple average unit prices of cotton exports from the United States and Brazil to Argentina, Bolivia, Italy, Philippines, Portugal, Indonesia, Paraguay, and India. The data for each third country market is provided in the following table.

Unit Export Values to Selected Countries

US

Country	3Q/99	4Q/99	1Q/00	2Q/00	3Q/00	4Q/00	1Q/01	2Q/01	3Q/01	4Q/01	1Q/02	2Q/02
Argentina	0.71	0.71	0.42	0.49	na	na	na	na	na	na	na	na
Bolivia	na	1.15	1.15	na	na	na	na	0.76	na	na	na	na
India	0.96	0.46	0.51	0.55	0.64	1.04	0.74	0.50	0.43	0.36	0.38	0.42
Indonesia	0.61	0.59	0.56	0.57	0.59	0.65	0.65	0.57	0.49	0.50	0.50	0.45
Italy	0.90	0.81	0.80	0.98	0.73	0.93	0.90	0.92	0.92	0.67	0.76	0.70
Paraguay	na	na	na	na	na	na	na	na	na	na	na	na
Philippines	0.50	0.42	0.41	0.41	0.53	0.54	0.52	0.44	0.42	0.41	0.41	0.38

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207. Please indicate whether any of the measures challenged in this dispute obliges cotton farmers to harvest their crop in order to receive the benefit of the programme (subsidy)

on the years 1986 to 1988 and shall generally be the actual price used for determining payment rates."3m

Crop year

the industry is not reflected in cost of production data. In addition, Brazil treats the only sources of farm income as cotton market prices and government payments, ignoring crop diversification and off-farm sources of income. By ignoring alternative revenue sources, Brazil invalidates its claim that *only* government payments could serve to cover any alleged cost-revenue gap.

42. But most importantly, Brazil has no legal basis for its argument. Brazil argues that the Appellate Body in *Canada - Dairy (21.5)* has stated that total costs are the relevant measure, but that reasoning is inapt here. The only question in that dispute was whether a practice involved an export subsidy within the meaning of Article 9.1(c) of the Agriculture Agreement. Solely because the question was to determine whether certain milk provided to processors constituted a payment for purposes of Article 9.1(c) did the Appellate Body opt to use the average cost of production.[41] However, the Appellate Body explicitly recognized that "a producer may well decide to sell goods or services if the sales price covers its marginal costs." The Appellate Body also noted that cost of production can be measured "in at least two ways": (1) per unit average total cost of production and (2) marginal cost of production.[42] Here, the issue for which Brazil seeks to use total costs is not whether a subsidy exists but to evaluate the effect of the subsidy, an altogether different analysis. Thus, *Canada - Dairy (21.5)* provides no support Brazil's average total cost argument.

(a) to what extent does the use of 1997 survey technological coefficients with annually updated values affect the results?

43. As described in detail in previous US submissions[43], the combination of, among other things, the boll weevil eradication programme and the extraordinary adoption rates of biotech cotton have combined to lower producers' costs and enhance net revenues. Despite the difficulty in providing precise figures on the extent of cost savings and net revenue increases for the cotton sector that have occurred since the 1997 USDA ARMS cost and returns survey, the rapid adoption of biotech cotton (over 90 per cent of area in key producing States) suggests farmers are reaping significant benefits in terms of net returns. These cost savings have been analyzed and documented in a wide range of studies.

44. In June 2002, the National Center for Food and Agricultural Policy (NCFAP) compiled 40 case studies of 27 crops to document the benefits of biotechnology.[44] These case studies were done by various universities. Among other findings, one study found that adoption of insect resistant biotech cotton in states in the Southeast and Southwest experiencing high infestations of budworm resulted in a $20 per acre increase in net income. Another study that examined the use of herbicide-resistant cotton in several Mid-South states estimated producers saved $133 million annually in weed control costs.

45. The post-1997 updates of the cost of production data assume the same technological coefficients as the 1997 survey – for example, pounds of seed per acre, the number of pesticide applications per acre, etc. Brazil correctly notes that the ERS/USDA updated COP data from 1997 show increased seed costs, which reflects the use of higher-cost biotech seed.[45] To the extent those inputs become more costly (for example, as biotech seed replaces conventional), cost increases are captured by the updating process through input price indexes. What is not captured is the *cost savings* from technological changes that alter the mix of production activities and inputs. New survey data

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[41] The specific issue addressed was limited to whether the supply of certain milk to processors constituted a "payment" on the export of milk "financed by virtue of governmental action."

[42] *Canada-Dairy: First Recourse to 21.5*, AB-2001-6, para. 94.

[43] US Further Submission, paras. 46-54; US Further Rebuttal Submission, paras. 123 -132.

[44] *Plant Biotechnology: Current and Potential Impact For Improving Pest Management in US Agriculture: An Analysis of 40 Case Studies.* Leonard P. Gianessi, Cressida S. Silvers, Sujatha Sankula and Janet Carpenter. NCFAP, June 2002. The full report can be found at http://www.ncfap.org/40CaseStudies.htm.

[45] Further Rebuttal Submission of Brazil, 18 November, para. 72.

will incorporate new technological coefficients as well as changes in such practices as direct pesticide costs, changes in tillage, application and cultivation trips, and handweeding. Many of the cost-saving aspects of biotechnology or other new practices (no-till farming) cannot be accurately captured by simply updating old cost data by price indices. Thus, relying on such updated cost data that reflects an outdated technological mix is in error.

(b) to what extent do producers base planting decisions on their ability to cover operating costs but not whole farm costs? USA

46. As explained in some detail in the US Further Rebuttal Submission of 18 November, the agricultural economics profession is clear that short-run production decisions are made based on the ability of a producer to cover his variable or operating costs.[46] All economic models that attempt to capture supply response (producer planting behaviour) use variable costs in the equations, not total costs. Examples include the FAPRI baseline projections model (a variation of which was used by Dr. Sumner), the ERS baseline projections model, and the Economic Research Service's FAPSIM model, the results of which are cited by Brazil.[47] No economic model of which we are aware looks to total costs as the relevant costs for producer planting decisions.

47. One can do the same exercise as done by Brazil in paragraph 59 of its further rebuttal submission, but using the economically correct variable costs instead of total costs.[48] Even using the technologically- and structurally-dated cost-of-production data based off the 1997 ARMS survey, in all years except the extraordinary year of 2001, average market returns more than covered variable costs, allowing producers to earn a sufficient margin to pay off other fixed costs, a conventional agricultural business practice, as noted by Christopher Ward.[49] Instead of a cumulative loss of $332.79 per acre over the 6-year period as claimed by Brazil, producers had a cumulative net margin of $592.65 per acre. Clearly, if all years were like 2001, US cotton farmers would go out of business.[50] But because most US

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212. Brazil states in paragraph 37 of its oral statement that studies of Westcott and Price found that the effect of the programme on cotton is to add an additional 1 to 1.5 million acres during marketing years 1999-2001 and to suppress US prices by 5 cents per pound. Does the US reject these findings? Why or why not?

48. While an interesting "academic" analysis of the impacts of the US marketing loan programme, the Westcott and Price study *Analysis of the US Commodity Loan Programme With Loan Provisions* (Exhibit BRA-222) is not relevant for the Panel's assessment of the matter before it. In this study acreage decisions are based on an expected net returns which includes as the expected price term as the higher of the lagged market price or the loan rate plus additional marketing loan facilitated revenue. Since the period of analysis for the study is 1998 through 2005, rather than actual data, the authors used USDA's 2000 baseline. This baseline incorporates actual data for years prior to marketing year 1998 and partial marketing year 1999 to make projections about prices and other factors for marketing year 1999 forward. Thus the study is based on projections except for MY1998.[51]

49. A panel, however, cannot base its findings on hypothetical market conditions instead of actual conditions. That is, Brazil must show that US domestic support has actually caused serious prejudice in a given year based on actual market conditions and not that under some assumed conditions US domestic support programme (Exhib8-0.1022 510(oin a nexpected inpr 1in po 68hUhe 5 0 TD -0.115 Tw ((Ex

62. For example, during marketing years 2000, 2001, 2002, and 2003, lagged prices significantly understate the harvest season prices expected by producers as seen in the futures prices at the time of planting. The use of lagged prices thereby inflate the effect of the marketing loan rate. In fact, those lagged prices would have to be increased by 8-25 per cent, depending on the year, to equal the harvest season price actually expected by producers as indicated by the futures price.[57] For the period MY 1999-2003, only MY 2002 exhibits expected prices below the marketing loan rate when using futures prices. However, over that same period, when lagged prices are used as expected prices, the loan rate is higher than the expected price *in every year over this period* except MY1999. Thus, it is a significant error for Brazil and Dr. Sumner to use lagged prices instead of the futures prices Brazil's own expert explained to be the more accurate gauge of farmers' price expectations.

Harvest Futures Prices at Planting Time Compared to "Lagged Prices"(cents per pound)					
	MY1999	MY2000	MY2001	MY2002	MY2003
Futures Price 1/	60.27	61.31	58.63	42.18	

pared (4.93 0 Tc 0.1875 Tw ( ) Ti 48 0

C. DOMESTIC SUPPORT

214. Please provide a copy of regulations regarding the marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993. What does this regulation indicate about the target price? USA

65. Please see US Exhibits 117 and 118. In these document, the Department of Agriculture set the level of support for the 1993 marketing year. For example, the Department announced a marketing loan rate of 52.35 cents per pound. In addition, the Secretary did not exercise his discretion to alter the effective price, which by statute was to be "not less than" 72.9 cents per pound.[59] We also note that the March 24 notice lowered the acreage reduction percentage (the share of base acreage on which deficiency payments could not be obtained) from 10 to 7.5 per cent.

215. Please expand or comment on the statement at paragraph 91 of the US further rebuttal submission that the counter-cyclical target price ceases to be paid when the farm price rises above 65.73 cents per pound. In this scenario, should the Panel disregard Direct Payments? BRA, USA

66. Direct payments are made to producers regardless of the price level; no production of upland cotton or any other crop is required to receive payment, and the recipient may additionally leave the land in conserving use. In contrast, the counter-cyclical payment is contingent on farm prices falling below the target price of 72.4 cents per pound less the direct payment rate of 6.67 cents per pound. Thus, at farm prices near to or over the 65.73 cents threshold, the counter-cyclical paDirec1875 Tm575at farm p0 -

would likely be an associated budgetary cost. Given the current US fiscal situation, increases in the agricultural budget are seen as unlikely.

217. What is the reason for reducing payments under the PFC and direct payments programmes for planting and harvesting fruit, vegetables and wild rice on certain base acreage? Please comment on the statements by the European Communities that "the reduction in payment for fruit and vegetables, if the EC understands correctly, is in fact designed to avoid unfair competition within the subsidising Member." (EC oral statement at first session, first substantive meeting, paragraph 29) and "To find otherwise would not permit a WTO Member wishing to introduce decoupled payments to take account of important elements of internal competition (…)" (EC response to Panel third party Question No. 5).

71. The limitation only applies to base amounts of acreage, and to that end it is worthy of note that the US December 18-19 filings indicate that cotton farms plant less than one-third of their total cropland to cotton. Of note, too, is that fruit and vegetable prohibition came into play before 1996 in connection with the "flex acre" concept of the 1990 farm bill as reflected in the provisions of 7 USC 1464 (1988 ed. Supp. III) as enacted at that time. It continues to be the case under the 1996 and 2002 Farm Bill, as with the 1990 Bill, that the restrictions on plantings is only limited to the base acres amount of the farmer's cropland.

72.

73. Paragraph 6 prohibits basing payments on production requirements, not basing payments on not producing. As the United States earlier pointed out, consider a situation in which a recipient of direct payments produces fruits and vegetables and sees the direct payment reduced. How could that recipient receive the entire payment to which he or she is entitled? The marginal amount of decoupled payment is not "related to, or based on, the type or volume of production" undertaken by the producer since the recipient need not produce anything at all. Rather, to receive the marginal payment, the recipient need merely refrain from producing fruit, vegetables, or wild rice. Thus, the extra amount of payment is not "related to, or based on" production; if anything, it is "related to, or based on" non-production (of certain crops).

218. Please comment on the testimony of USDA Chief Economist Keith Collins cited in paragraph 36 of Brazil's oral statement regarding the trade-distorting and production-distorting nature of the marketing loan payments.

74. We agree with the statement of Dr. Collins that marketing loan payments are potentially production- and trade-distorting. The United States has consistently notified upland cotton marketing

government payment for the difference between the loan rate and the adjusted world price. For this reason, we believe that the marketing loan programme was more distorting in 2002 when expected cash prices were below loan rates at planting than in 2001, when expected cash prices were higher than loan rates at the time of planting. However, as explained previously, the observed decline in upland cotton planted acreage in marketing year 2002 was commensurate with the decline in futures prices over the year before.

D. EXPORT CREDIT GUARANTEES

219. Under the *Agreement on Agriculture* the general position is that the use of export subsidies, both those listed in Article 9.1 as well as those within the scope of Article 1(e) which are not so listed, may only be used within the limits of the product specific reduction commitments specified in Part IV of Members' Schedules. One might therefore have expected that Article 3.3 of the *Agreement on Agriculture* would have prohibited the use of both listed and non-listed export subsidies in excess of reduction commitment levels in the case of scheduled products and, in the case of non-scheduled products, would have simply prohibited the use of any export subsidy. Instead, the Article 3.3 prohibition is limited in both cases to export subsidies listed in Article 9.1. What significance, if any, does this contextual aspect have for how Article 10.2 might be interpreted having regard, *inter alia*, to:

(a) the fact that export performance-related tax incentives, which like subsidised export credit facilities were considered as a possible candidate for listing as an Article 9.1 export subsidy in the pre-December 1991 Draft Final Act negotiations, have been held (for example, in *United States - Tax Treatment for Foreign Sales Corporations*, WT/DS108) to be subject to the anti-circumvention provisions of Article 10.1; and

(b) the treatment of international food aid and non-commercial transactions under Article 10? USA

76. The United States has previously noted the unremarkable fact that Article 9.1 of the Agreement on Agriculture sets forth a list of six very specific practices known to the drafters and deemed to constitute export subsidies under that Agreement.[60] The specific identification and description of these export subsidy practices, well-known and notorious in the agricultural trade sector, served at least three purposes in the text. First, under Article 3.3, these particular practices were unambiguously subject to the export subsidy reduction commitments of each member.

77. However, certain limited exceptions to this rule constitute the second and third purposes of the specific list of export subsidies in Article 9.1: Article 3.3 is by its terms "subject to the provisions of paragraphs 2(b) and 4 of Article 9." Article 9.2(b) has since lapsed, but while in effect permitted a Member to provide export subsidies listed in Article 9.1 in a given year in excess of the corresponding annual commitment levels in the Member's schedule, subject to the cumulation limits of Articles 9.2(b)(i)-(iv). Under Article 9.4, during the implementation period, developing country Members were not required to undertake export subsidy commitments with respect to export subsidies listed in Articles 9.1(d) and 9.1(e), except not to apply them in a manner that would circumvent their reduction commitments.

78. Unlike export performance-related tax incentives, which are not expressly mentioned in the Agreement on Agriculture, export credit guarantees were subject to an altogether separate treatment and commitment: exclusion from the export subsidy disciplines altogether until agreement on

[60] US First Written Submission (11 July 2003), para. 161.

internationally agreed disciplines. Under Article 10.2, Members were (and continue to be) obligated to work toward the development of such disciplines, and once agreed, adhere to them.

79. Question 219 suggests one might have expected Article 3.3 to have prohibited the use of both listed and non-listed export subsidies in excess of reduction commitment levels in the case of scheduled products and, in the case of non-scheduled products, to have simply prohibited the use of any export subsidy. Article 8, however, serves this specific role. It imposes the obligation not to provide export subsidies otherwise than in conformity with the Agreement on Agriculture and with the commitments specified in the respective Members' schedules.

80. The anti-circumvention provisions of Article 10.1 further highlight the separate treatment of export credit guarantees. That article explicitly recognizes that "non-commercial transactions" shall not be used to circumvent export subsidy commitments. This phraseology is distinctly similar to that of item (h) in Addendum 10, entitled "Export Competition: Export Subsidies to be subject to the terms of the Final Agreement," dated August 2, 1991, among the series of addenda to the Note on Options

GSM 102/GSM-103/SCGP Subsidy Estimates and Reestimates By Cohort							
Original Subsidy Cohort	**Cohort Reestimates by Fiscal Year Estimate**	**FY93-00**	**FY01**	**FY02**	**FY 03**	**Total Reestimates**	**Subsidy Estimate Net of Reestimate**
1992	267,426,000	166,136,256	-599,604,000	27,030,201	14,823,708	-391,613,835	-124,187,835
1993	171,786,000	-10,556,906	-257,206,000	23,017,631	16,571,778	-228,173,497	-56,387,497
1994	122,921,000	-82,345,960	-77,135,000	2,228,985	41,521,000	-115,730,975	7,190,025
1995	113,000,000	-40,555,149	-105,216,000	2,823,516	-6,351,460	-149,299,093	-36,299,093
1996	328,000,000	896,907	-386,916,000	7,611,330	44,934,327	-333,473,436	-5,473,436
1997	289,000,000	0	-237,316,000	19,845,279	50,733,713	-166,737,008	122,262,992
1998	301,000,000	0	-237,271,000	14,661,079	- 15,693,431	-238,303,352	62,696,648
1999	158,000,000	0	-68,758,000	51,146,455	-144,434,351	-162,045,896	-4,045,896
2000	195,000,000	0		-91987247	-61,534,936	-153,522,183	41,477,817
2001	103,000,000			-33497152	16,381,864	-17,115,288	85,884,712
2002	97,000,000				40008586	40,008,586	137,008,586
Total for all Cohorts	**2,146,133,000**	**33,575,148**	**-1,969,422,000**	**22,880,077**	**-3,039,202**	**-1916005977**	**230127023**

Source: FSA Budget Division Reestimate Documentation and Apportionment Documents.
There were no reestimates apportioned during FY 1998 through FY 2000.

(b) Please clarify whether and how the Panel should treat the figures in Exhibit BRA-182 for the net lifetime re-estimates for each respective cohort.

83. The United States has no objection to use of the figures in the column entitled "Net lifetime

Cohort	Estimate	Re-estimates (Bra-182)	Net of Re-estimates
1992	267426000	-370963000	-103537000
1993	171786000	-239160000	-67374000
1994	122921000	-133746000	-10825000
1995	113000000	-159564000	-46564000
1996	328000000	-333407000	-5407000
1997	289000000	-166737000	122263000
1998	301000000	-238304000	62696000
1999	158000000	-162046000	-4046000
2000	195000000	-153522000	41478000

> transferred to and merged with the appropriation for "Foreign Agricultural Services, Salaries and Expenses", and of which $834,000 may be transferred to and merged with the appropriation for "Farm Service Agency, Salaries and Expenses."

Also, paragraph 38 of Statement of Federal Financial Accounting Standard No. 2[67], originally issued 23 August 1993[68], provides:

> Costs for administering credit activities, such as salaries, legal fees, and office costs, that are incurred for credit policy evaluation, loan and loan guarantee origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes, are recognized as administrative expense. Administrative expenses are not included in calculating the subsidy costs of direct loans and loan guarantees.

(e) The Panel notes the US statement in paragraph 160 of its answers to Panel questions following the first meeting that all cohorts are still open although the 1994 and 1995 cohorts will close this year. Is this still an accurate statement? If not, please indicate whether any cohorts have since "closed" for the period 1992-2002.

90. Although the United States has not completed the formal administrative steps to close cohorts 1994 and 1995, all financial transactions necessary to do so are complete. Consistent with figures reflected in the 2004 Budget Federal Credit Supplement Table 8 (Exhibit Bra-182), the net of reestimate figure for each of cohorts 1994 and 1995 will be negative, indicating profitability.

(f) The Panel notes the current "high" figures for 1997 and 1998 indicated in the original US chart. Pending their confirmation and/or updating by the US, why does the US assert that a cohort will *necessarily* reach a "profitable" result (for example, the 1994 cohort, which has almost closed still indicates an outstanding amount)? Do "re-estimates" reflect also expectations about a cohort's future performance?

91. Until a "closing reestimate" occurs with respect to a particular cohort, which is made "once all the loans in the cohort have been repaid or written off,"[69] each reestimate does necessarily reflect certain expectations about a cohort's future performance. "Reestimates mean revisions of the subsidy cost estimate of a cohort (or risk category) based on information about the actual performance and/or estimated changes in future cash flows of the cohort."[70] Generally, reestimates must be made immediately after end of each fiscal year.

92. With the passage of time, of course, each reestimate necessarily more closely reflects actual results. In the case of the GSM-102 export credit guarantee programme, for example, after three fiscal years have elapsed both the actual amount of guarantees and the actual amount of defaults are known.

93. With respect to the 1994 cohort alone, as noted in the response to Panel Question 221(b) above, the numbers from Table 8 of the Federal Credit Supplement (Exhibit Bra-182), indicate profitability. As noted in the immediately preceding response, although the United States has not

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subsidy estimate / re-estimate process will incorporate information relating to actual operating experience, the original subsidy estimate figures in the budget do not reflect any operating experience for the respective cohort. Thus, those subsidy estimates cannot properly be used as part of an analysis of whether the export credit guarantee programmes conform to Item (j) of the Illustrative List (i.e, the sufficiency of premia to cover long-term *operating* costs or losses (if any)).

(h) Why should the Panel "eliminate", in addition, the 2000 cohort, as also suggested in paragraph 198 of the US further rebuttal submission for which information is presumably more "complete"?

100. The Panel is of course correct to note that the data for the 2000 cohort is necessarily more complete than with respect to the subsequent cohorts. And, as the United States would have anticipated, the large negative reestimates have commenced for the 2000 cohort. As we are now in the third month of fiscal year 2004, all outstanding GSM-102 and SCGP guarantees will have expired, and the next budget cycle reestimate process will necessarily reflect that fact.

101. The same points made in the immediately preceding response to question 221(g) apply to the 2000 cohort. Of particular note with respect to this cohort, however, is the very large difference between the original projected level of use reflected in the 2000 budget ($4,506 million) and the actual level of sales registrations reflected in the 2002 budget for that cohort ($3,082 million). This difference, approaching $1.5 billion of initially overestimated utilization, has a profound effect on the budgetary depiction of programme performance and required estimates (although the tables set forth above eliminate this distortion in the US budget by starting from the estimate figure corresponding to actual sales registrations).

(i) Under the US approach, at what point in time could a Panel ever make an assessment of the programme, if it had to wait for each cohort to be completed before it could be "properly" assessed? Why is it inappropriate for the Panel to include these "most recent years" in its evaluation, as the US suggests in paragraph 199 of its 18 November further rebuttal submission? USA

102. Fortunately, neither the Panel nor the United States has to answer this question entirely in the abstract. First, Brazil and the United States agree that an examination beyond 10 years is inappropriate.[73] Indeed, as the United States has noted, to subject the programme to the analytical yoke of the unique circumstances of the Polish and Iraqi defaults over 10 years ago would effectively require elimination of the programme altogether.[74] Item(j) analysis requires a certain retrospection to make the requisite comparison between premia and net operating results of the programme. The question therefore becomes at what point does the financial data yield a sufficiently accurate picture to render this judgment.

103. The United States has noted that the budgetary figures inherently tend to exaggerate negative performance of the programme. This is more pronounced in the "most recent years" for the reasons noted above. As noted in the immediately preceding sub-question(h), in the case of fiscal year 2001 and 2002 cohorts, the original budgetary subsidy estimates do not reflect any operating results of those cohorts. In contrast, cohorts 1992-1999, taken as a whole, currently reflect a net negative reestimate (i.e., profitable performance). Although it is theoretically conceivable that status could change, every indication in the trends related to the programme, including most specifically the uniform performance of reschedulings, indicate that the negative reestimates will grow, not diminish, in time.

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[73] The most recent manifestation is Brazil's statement in paragraph 81 of its 2 December 2003, Oral Statement: "Item(j) requires the Panel to determine whether the 'programmes,' . . . charge premium rates that meet operating costs and losses over a period that the United States and Brazil agree should be 10 years."

[74] US Rebuttal Submission (August 22, 2003), paras. 172-174

104. Consequently, the United States believes the Panel has sufficient data to determine that premium rates are adequate to cover long-term operating costs and losses of the programmes.

> **222. For GSM 102, 103 and SCGP, please provide year-by-year amounts from 1992 to 2003 with respect to: (i) cumulative outstanding guarantees; (ii) claims paid; (iii) recoveries made; (iv) revenue from premiums; (v) other current revenue, including interest earned; (vi) interest charges paid; and (vii) administrative costs of running the programmes. Please indicate any allocation methodologies used to calculate administrative costs. USA**

105. The chart constituting Exhibit US-128 sets forth the information requested. This data is current through November 30, 2003. As the Panel will note, claims outstanding plus interest and administrative expenses are now well below premia plus interest otherwise collected or earned. This current data clearly reflects that premia are adequate to cover long-term operating costs and losses.

106. For each of cohorts 1992-1996, $3 million of administrative costs are allocated. For each subsequent cohort, $4 million of such costs are allocated. These are the figures reflected in the table accompanying paragraph 132 of Brazil's Oral Statement of July 22, 2003, and the corresponding references to the US budget cited therein. As Exhibit US-128 breaks out activity for each of GSM-102, GSM-103, and SCGP, these respective administrative costs have then been allocated based on the relative registration values of these programmes. Interest costs and revenue (see response to question 224 and table therein) have similarly been allocated based on registration value.

> **223. Are the premium rates applicable to GSM 102, 103 and SCGP subject to regular review as to their adequacy in enabling the operating costs and losses associated with these programmes? If so, what criteria or benchmarks are taken into consideration for this purpose? Secondly, how do the premium rates applied compare with the implicit**

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the account party under the letter of credit. Consequently, the importer may have to pay its bank in full upon disbursement under the documentary letter of credit. The existence of an export credit guarantee transaction also has no necessary effect on the pricing of financing or letter of credit fees that the importer's bank may charge. In this respect, the export credit guarantee transaction is less favourable to the importer than a forfaiting transaction.[78] As the United States has previously observed, forfaiting and export credit guarantee transactions compete as a method for trade financing over comparable tenors in similar markets, but it is difficult to make direct comparisons of implicit rates even among forfaiting transactions themselves.[79]

224. Please indicate how the CCC's cost of borrowing was treated in the 2002 financial statement of the CCC, in Exhibit BRA 158.

110. In the 2002 financial statements of the CCC, the cost of borrowing is treated as interest expense. It is included as part of the Net Cost of Operations set forth in Exhibit US-129, entitled "Commodity Credit Corporation Consolidated Statement of Net Cost (Note 13) for the Fiscal Year Ended 30 September 2002)." A separate column is presented for Foreign Programmes, of which the Export Credit Guarantee programmes are a part. Borrowing costs are subsumed within "Intragovernmental Gross Costs". CCC also earns interest on monies held by Treasury. These interest collections become a component of "intragovernmental earned revenue." The net result is the difference between these two figures in a given year.

111. With respect to the export credit guarantee programmes specifically, this "interest on debt to Treasury" and "interest on uninvested funds" are reflected in the financing account portion of each budget. As interest expense and revenue are necessarily homogenized numbers, they are not readily allocated to cohorts. Actual interest expense and revenue figures for a particular fiscal year are set forth in line 00.02 and 88.25 of the financing account provisions of each budget. The following table sets out these figures, which are also reflected in the table responding to question 222 above.

[78] See, generally, US Further Submission (30 September 2003), paras. 157-162
[79] US Rebuttal Submission (22 August 2003), para. 189-191

CCC Export Credit Guarantee Programme – Financing Account
Payments of Interest on Borrowings from Treasury (00.02) and
Interest Earned on Uninvested Funds (88.25)

2.75

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Annual President's Budgets											
Programme Year	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
2001 Actuals											
Interest on Borrowings										$104	
Interest Earned										(125)	

225. Please indicate whether there was any instance where the CCC "wrote off" debt and, if so, please indicate the accounting regulation or principle used. If a "written off" debt is subsequently recovered, do the CCC's accounts reflect both the interest cost and interest received in relation to the debt during the time it was "written off"? USA

112. A complete response to this question requires a vocabulary distinction between "write off" for purposes of CCC accounting and debt forgiveness. A "write off" conventionally is used to describe debt that CCC itself independently determines to be uncollectible. This determination is made by the Controller of CCC.

113. Debt forgiveness, on the other hand, refers to multilaterally agreed debt forgiveness, usually through the Paris Club, that is subsequently implemented by the United States and CCC through legislation or other internal mechanisms to eliminate the outstanding debt. As a result, in the more common parlance, that debt too is written off.

114. Historically, debt forgiveness is far larger than independent "write off." CCC has independently written off as uncollectible only approximately $190,000 of private sector debt with respect to the export credit guarantee programmes as follows:

Cohort	Fiscal Year of Write Off	Country	Amount
Pre-1992	1995	Nigeria	$129,000
Pre-1992	1999	Argentina	48,000
1992	1999	Russia and Former Soviet Union	13,000

Debt forgiveness:

Cohort	Fiscal Year of forgiveness	Country	Amount
Pre-1992	1991, 1994	Poland	$1,406,000,000[80]
Pre-1992	1997	Yemen	1,686,000
Pre-1992	1999	Honduras	5,951,000
Pre-1992	2002	Former Yugoslavia	3,343,000
Pre-1992	2002	Tanzania	8,806,000

None of the foregoing debt in either table has been recovered.

226. If a debt was "written off" more than ten years ago, does it still create a cost to the programme? If so, how is this reflected in the 2002 financial statement of the CCC, in Exhibit BRA 158 (or any other material)?

115. The provisions of the Federal Credit Reform Act first took effect with fiscal year 1992, which commenced on 1 October 1991. Write-offs before 1 October 1991 would have no continuing effect in the current financial statements of CCC, as such write-offs would have been reflected as part of the operating loss of the corporation, which in turn was replenished through the annual appropriations process in the year following such write-off.

[80] This amount is approximate as it requires allocation of write off related to debt arising from various programmes.

116. Write-offs after 1 October 1991 also would not independently create an expense. Upon payment of a claim on an export credit guarantee, CCC receives a fully subrogated position to collect from the defaulting obligor. As a result, this debt is then reflected as a loan receivable for both budgetary and financial statement purposes. In accordance with paragraph 61 of Statement of Federal Financial Accounting Standard No. 2,[81]:

> When post-1991 direct loans are written off, the unpaid principal of the loans is removed from the gross amount of loans receivable. Concurrently, the same amount is charged to the allowance for subsidy costs. Prior to the write-off, the uncollectible amounts should have been fully provided for in the subsidy cost allowance through the subsidy cost estimate or reestimates. Therefore, the write-off would have no effect on expenses.

227. The United States has indicated that Brazil continues to "mischaracterize" the amount of $411 million in the 2002 financial statement of the CCC, in Exhibit BRA 158, pp. 18 & 19. Can the United States please indicate how it believes this amount - referred to on p. 19 of the Exhibit as "Credit Guarantee Liability-End of Fiscal Year" - should be properly characterized? How, if at all, does it represent CCC operating costs or losses? USA

117. Brazil wrongly describes this amount as "record losses . . . for its guarantee programmes over the period 1992-2002."[82] This figure does *not* represent a loss. It is a *prospective* estimate at a particular moment in time of anticipated experience under the programme. It is, like the budget figures, an estimate.

118. The $411 million figure is simply another manifestation of the estimate and re-estimate process required under the Credit Reform Act of 1990 and reflected in the budget figures of the United States. As a result, it is another depiction, albeit in a different format, of the results of the estimate and re-estimate process.

119. Just as the estimate figures in the budget proceed in a downward direction (i.e., good performance), one would expect this corresponding estimate figure in the CCC Financial Statements to do the same. And it does. On the corresponding page of the Notes to Financial Statements 30 September 2003 and 2002[83], the $411 million figure has declined to $22 million.

120. As reflected on page 19[84] of Exhibit Bra-158 and on its 2003 analog, the $411 million figure and the more recent $22 million figure are the result net of "interest rate reestimate" and "technical/default reestimate". The figure, net of such total subsidy reestimates, is then brought forward to the subsequent year (as is manifest on page 19 from 2001 to 2002 and in turn from 2002 to 2003). Prior years' figures similarly brought forward are also figures net of "total subsidy reestimates".

121. Furthermore, Appendix E of the Statements of Federal Financial Accounting Concepts and Standards of the Financial Accounting Standards Advisory Board is a consolidated glossary of terms

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[81] Exhibit US-127.

[82] The most recent example of this repeated assertion is in paragraph 84 of the 2December 2003, Statement of Brazil.

[83] Audit Report, Commodity Credit Corporation, Financial Statements for Fiscal Years 2003 and 2002, Note 5, page 19. (Exhibit US-129).

[84] The information and format of this page are required by Statement of Federal Financial Accounting Standards No. 18: Amendments To Accounting Standards for Direct Loans and Loan Guarantees In Statement of FedStan8uarants69).FurthermorB: Sc03 analog, the $411 miAtdB0.465Tj 3 0 TD 0.0698 Tc 0.5677 -itlAcc"8 Tc 0.5In SRe

applicable to GAAP for federal entities. That glossary defines "liability" as: "For Federal accounting purposes, a probable future outflow or other sacrifice of resources as a result of past transactions or events." Loss, on the other hand, is: "Any expense or irrecoverable cost, often referred to as a form of nonrecurring charge, an expenditure from which no present or future benefit may be expected."[85] The $411 million figure in the 2002 Financial Statements and the $22 million figure in the 2003 Financial Statements describe "credit guarantee liability," not loss.

228. What accounting principles should the Panel use in assessing the long-term operating costs and losses of these three programmes? For example, if internal US Government regulations require costs to be treated differently to generally accepted accounting principles, is it incumbent on the Panel to conduct its analysis in accordance with that treatment? BRA, USA

122. Financial statements of the Commodity Credit Corporation are prepared in accordance with generally accepted accounting principles (GAAP), based on accounting standards promulgated by the Federal Accounting Standards Advisory Board (FASAB).[86] In October, 1999, this board was designated by the American Institute of Certified Public Accountants (AICPA) as the standards-setting body for financial statements of federal government entities, with respect to the establishment of generally accepted accounting principles. On October 19, 1999, AICPA adopted an amendment to its Code of Professional Ethics to recognize accounting standards published by the FASAB as GAAP for federal financial reporting entities. The amendment recognized FASAB as the source of GAAP for federal entities. Consequently, no incompatibility of accounting principles exists.

E. SERIOUS PREJUDICE

230. Please comment on Brazil's views on Article 6.3 of the SCM Agreement as stated in paragraphs 92-94 of its further submission. USA

123. Brazil's arguments fail to convince. First, Brazil complains that "[t]here is no valid basis for the US interpretation that the word "may" in the chapeau of Article 6.3 of the SCM Agreement [to] mean[] that a complainant - in addition to demonstrating the existence of one of the effects listed in the subparagraphs, e.g., significant price suppression - must also make a separate showing of 'serious' prejudice."[87] Brazil may choose to believe there is no "valid" basis, but there is a clear textual basis for the US interpretation: the ordinary meaning of the word "may."

124. The ordinary meaning of "may" is "have ability or power to; can."[88] Therefore, the chapeau of Article 6.3 permits but does not require a finding that serious prejudice exists when one of the situations in Article 6.3 is demonstrated.

125. Second, Brazil argues that the use of "may" in Article 6.3 is merely intended to reflect that there are "situations in which the four enumerated types of serious prejudice exist but are not actionable." For example, Brazil points to Article 6.7, which delineates certain circumstances in which displacement or impeding of exports shall not arise, and Article 6.9, which states that Article 6 does not apply to measures that conform to the Peace Clause. Brazil's argument is badly flawed. The ordinary meaning of the chapeau to Article 6.3 does not suggest that serious prejudice must arise if one of the situations in Article 6.3 exists. If the drafters had intended merely to suggest that exceptions to Article 6.3 exist, they succeeded instead in creating a provision that does not compel

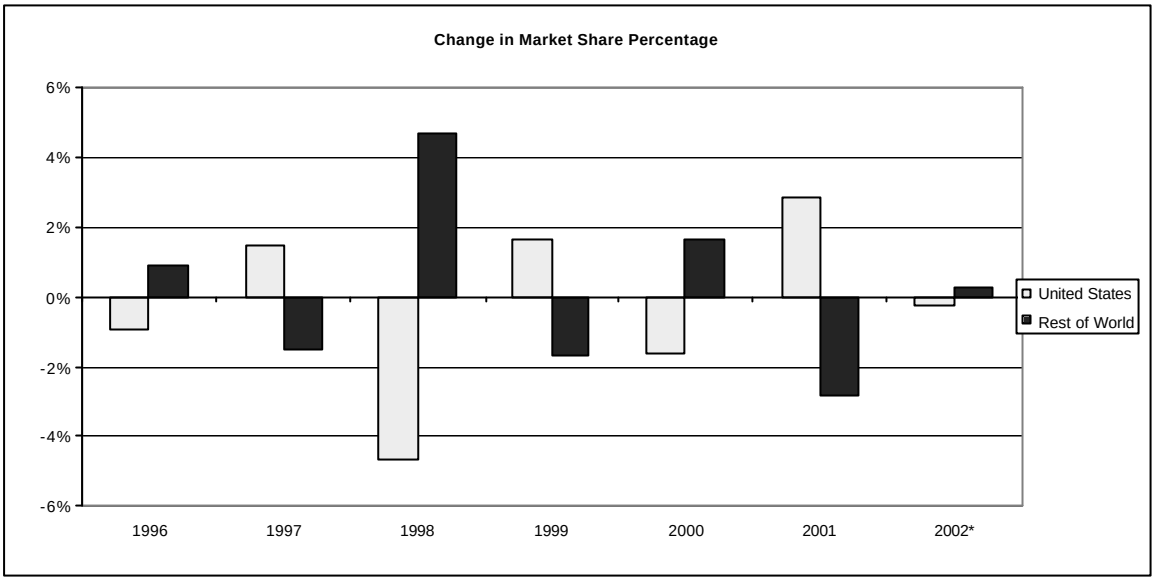
[85] Statement of Federal Financial Accounting Concepts and Standards (May 2002), Appendix E, pages 1140-1141 (Exhibit US-130).
[86] The website for the FASAB is www.fasab.gov.
[87] Brazil's Further Rebuttal Submission, para. 92.
[88] *New Shorter Oxford English Dictionary*, vol.1, at 1721.

any finding of serious prejudice in a circumstance in which one of the criteria under Article 6.3 is met, even when the circumstances in Articles 6.7 and 6.9 are met.

126. Indeed, the text of Article 6 does reflect Members' decision to create in Articles 6.1 and 6.2 exactly the sort of mandatory presumption / exception structure that Brazil attempts to read into Article 6.3. Article 6.1 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 *shall be deemed to exist* in [certain] case[s]" (emphasis added). Article 6.2 states that, "*[n]otwithstanding* the provisions of paragraph 1, serious prejudice *shall not be found* if the subsidizing Member demonstrates that the subsidy in question has not resulted in any of the effects enumerated in paragraph 3" (emphasis added). By way of contrast, Articles 6.3 and 6.7 do *not* use mandatory language (for example, "shall be deemed to exist" / "shall not be found") to establish a presumption / exception relationship. Rather, the language of Article 6.3 is permissive, and Article 6.7 is not expressed as an exception to a mandatory finding under Article 6.3.

127. Brazil's reference to Article 6.9 is inapt. We note that Article 6.9 does not limit its application to situations under Article 6.3. Rather, it states: "This *Article* does not apply to s6.3Aeits

231. Do you believe that the now-expired Article 6.1 and/or Annex IV of the SCM



237. Could a phenomenon that remains at approximately the same level over a given period of time be considered a "consistent trend" within the meaning of Article 6.3(d)? Do parties have any suggestions as to how to determine a "consistent trend", statistically or otherwise? BRA, USA

139. It would not appear that a phenomenon (world market share) that remains at approximately the same level over a given period of time could be considered a "consistent trend" within the meaning of Article 6.3(d). This follows from the text of Article 6.3(d) itself because the "effect of the subsidy" must be an *increase* in world market share (as compared to the preceding three-year period), and "this increase [must] follow[] a consistent trend over a period when subsidies have been granted." Thus, if world market share remains at approximately the same level over a given period of time, the trend would not be an "increase" in world market share; hence, the trend would not be a "consistent trend" within the meaning of Article 6.3(d). And, in fact, the data do not demonstrate that US world market share has increased following a consistent trend over a period when subsidies have been granted.[93]

238. According to the US interpretation of the term "world market share":

(a) should the domestic consumption of closed markets be added into the denominator?

140. It is not clear from the Panel's question what is meant by "closed markets," but the US reading of Article 6.3(d) is that "world market share . . . in a particular subsidized primary product or commodity" means just that: a Member's share of the world market in, for example, upland cotton. There is nothing in the text of Article 6.3(d) that supports excluding any portion of the "world" from the analysis. For this reason, Brazil's reading of this provision as solely relating to world export trade necessarily excludes any portions of the "world market" for upland cotton that do not import, no

[93] *See, e.g.*, US Opening Statement at the Second Panel Meeting, paras. 12-13 ("That is, the facts demonstrate that since marketing year 1996, US world market share has increased and then decreased in altemating years, and US world market share in marketing year 2002 (19.6 per cent) is lower than in marketing years 1996 and 1997 (20.4 and 21.6 per cent, respectively).").

(b) a Member's exports would have to be disregarded in calculating their "world

151. The United States does not see any basis to say that "world market share" was intended to mean the same as the "share of world export trade". The key difference is the use of the term "market" instead of "export". The term "market" can, of course, mean a domestic market; its meaning is not limited to markets in international trade. "Export" refers to cross-border transactions; therefore, a more limited set of transactions would be of interest. As a result, the term "world market share"

159. If the United States has understood the Panel's question, the answer would appear to be no. To explain this answer, we distinguish between three types of subsidies: (1) a subsidy tied to production of upland cotton, (2) a subsidy tied to production of another commodity, and (3) a subsidy not tied to the production of any commodity. In the first case, a subsidy tied to production of upland cotton (for example, marketing loan payments) would be support to upland cotton exclusively, even if the upland cotton producer also produces other commodities. In the language of Annex IV, a subsidy that "is tied to the production or sale of a given product" is deemed to subsidize "the recipient firm's sales of that product."[99] Similarly, in the second case, a subsidy tied to the production of another

commodities." And yet, allocating a non-tied payment across the total value of the recipient's production necessarily means that the payment is support *not* to a specific commodity but rather to multiple commodities (in fact, any commodities the recipient happens to produce).

164. Thus, it is important to distinguish Agreement on Agriculture concepts for purposes of Peace Clause from Subsidies Agreement concepts for purposes of identifying the amount of subsidy benefit and subsidized products. While decoupled payments – properly allocated – may provide support to upland cotton within the meaning of the Subsidies Agreement, they do not provide support to a specific commodity within the meaning of the Peace Clause. In fact, such decoupled payments provide support to any commodities the recipient happens to produce.[101]

245. Can a panel take Green Box subsidies into account in considering the effects of non-Green Box subsidies in an action based on Articles 5 and 6 of the SCM Agreement? BRA, USA

165. A subsidy that is green box – that is, conforms fully to the provisions of Annex 2 to the Agreement on Agriculture – is "exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement" pursuant to Article 13(a)(ii) of the Agreement on Agriculture. Therefore, green box subsidies may not be taken into account when considering whether a Member has caused serious prejudice to the interests of another Member through the use of any other subsidy for purposes of Article 5 nor when considering the "effect of" any other subsidy for purposes of Article 6.

246. Can a panel take prohibited subsidies into account in considering the effects of subsidies in an action based on Articles 5 and 6 of the SCM Agreement? BRA, USA

166. The United States has previously indicated that it takes no position on whether prohibited subsidies may be taken into account in considering "the effect of the subsidy" under Article 6 or whether the use of any subsidy has caused adverse effects. We note, however, that there may be limited utility in making a finding that a subsidy is prohibited and then finding that that subsidy contributes to "adverse effects" or "serious prejudice." Once the DSB adopts findings that a subsidy is prohibited, the responding Member is required to withdraw the subsidy without delay under Article 4. If the same measure were to form part of findings that a Member had caused adverse effects in the form of serious prejudice, for example, the responding Member would presumably be free to argue that the withdrawal of the prohibited subsidy was sufficient to remove the adverse effects. Thus, as the Panel is charged with making findings to promote a prompt settlement of disputes, the Panel should not include any subsidy it deems to be prohibited as part off its actionable subsidy analysis.

247. Can the Panel take into account trends and volatility in market and futures prices of upland cotton after the date of establishment of the Panel? If so, how do they affect the analysis of Brazil's claim of a threat of serious prejudice? BRA, USA

167. Under its terms of reference, the Panel is called upon "[t]o examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/7, the matter referred to the DSB by Brazil in that document."[102] Past panels have concluded that it is appropriate to look at the measures at issue in a dispute as of panel establishment. By that time, it was already

[101] As the United States has noted, finding that non-tied payments, once allocated, could be "support to a specific commodity" would rob Members of the ability to design their measures to be consistent with the Peace Clause. For example, if every recipient of decoupled income support, or any other non-tied payment, decided to produce upland cotton, a Member could be deemed to have granted support in excess of that decided during the 1992 marketing year, solely as a function of producer choices, not that of the Member.

[102] WT/DSB/M/145, para. 35.

evident that the challenged US measures would not pose a threat of serious prejudice. For example, the 2003 harvest season futures price at planting time – 59.60 cents per pound, or a 54.60 expected cash price – suggested that the marketing loan rate (52.00 cents per pound) would have no or minimal effect on planting decisions.[103] The evidence already indicated that US acreage movements corresponded to acreage changes in the (largely unsubsidized) rest of the world.[104] The evidence already indicated that direct and counter-cyclical payments have no more than minimal impacts on production and trade. Thus, by the time of panel establishment the evidence did not support a clearly demonstrated and imminent likelihood of future serious prejudice.

168. The Panel is not precluded from examining evidence subsequent to panel establishment. In fact, both Brazil and the United States have presented such evidence (of course, which cannot alter the Panel's terms of reference). For example, actual market prices and future prices for the 2003 marketing year confirm that producers are receiving higher prices for their 2003 crop and expect to continue doing so for the remainder of the marketing year. Thus, that evidence arising after panel establishment serves to confirm what prior evidence suggested: the evidence does not support a clearly demonstrated and imminent likelihood of future serious prejudice.

F. STEP 2

248. In respect of the level of Step 2 payments in certain time periods, the Panel notes, inter alia, footnote 129 in the US first written submission; footnote 33 in the US

(b)

What is clear is that the Congress thought that the problems with total dollar commitments, the AMS, were the only problem likely to arise given that Congress did discipline itself to stay within the support levels of the Peace Clause. The continuation of decoupled payment programmes was anticipated to protect producer income without causing distortions that could increase the level of US world share or could result in price suppression or depression in particular markets. To the contrary, because the Congress anticipated that US prices would still be higher than those elsewhere, the 2002 Act reauthorizes Step 2

provision, which presumably would allow the Congress to intervene in the event that the Secretary felt it necessary to implement the authority contained in 1601.

(d) How would the Secretary exercise her authority to prevent serious prejudice to the interests of another Member? How would she exercise her authority to prevent a threat of serious prejudice to the interests of another Member? At what time and on the basis of what type of information would she exercise her authority?

180. To the extent mandated by the statute, the Secretary would, subject to the foregoing concerns about the breadth of the statute, adjust the programme provisions to provide for reduced expenditures. But, as indicated, the statute does not appear to contemplate any such finding of serious prejudice, but rather is seemingly focussed more particularly on the overall level of expenditures as that was the only restriction agreed to in this instance by the United States and the United States believes its programme designs to be in compliance with its WTO commitments. The United States continues to maintain its compliance with the AMS levels as agreed to and with all other aspect of its obligations under the agreement, as we have shown. As noted, Congress understood and believed that it was acting within traditional levels and with the allowed levels of the agreement.

(e) What does "to the maximum extent practicable" mean? In what circumstances would it not be practicable for the Secretary to exercise her adjustment authority? USA

181. We believe that this provision of the 2002 Act is directed, in the first instance at least, more at domestic complainants in the event that the correction by the Secretary, because of the difficulties of predicting how much an effect a change could have, could prove more than needed. If so, this could lead, to potential legal claims by US farmers that they had been unduly denied benefits that there were entitled to receive. However, this provision could also contemplate that in some cases the results of an adjustment might well be unknown or that certain programmes or procedures would be too far along in a crop year to allow corrections to be made in any real or fair way, leading to results that otherwise might be objectionable.

254. Would payments made after the date of panel establishment be mandatory under the marketing loan, direct payments, counter-cyclical payments and user marketing certificate (step 2) programmes, but for the circuit-breaker provision? USA

182. Not in the sense at least that there are many conditions that a person must meet in order to qualify for payments, and in the sense that the payments are of course dependent upon the availability of funds from the Commodity Credit Corporation (CCC). The CCC has a large, however limited,

sufficient evidence and arguments to carry its burden of establishing a *prima facie* case. Thus, although a panel may be able to draw reasonable inferences from evidence on the record as part of its objective assessment of the facts of the case, such inferences cannot take the place of evidence necessary for a complaining party to establish its *prima facie* case.

184. The difficulty in this dispute arises because Brazil has chosen to challenge decoupled income support measures – namely, direct payments and counter-cyclical payments – that are not tied to production or sale of upland cotton. For payments that *are* tied to production of upland cotton – for example, marketing loan payments – there is no difficulty because the subsidy is solely attributed to upland cotton.[107] As set out in previous US submissions and oral statements, however, decoupled payments must be allocated across the value of each recipient's production in order to determine what is the benefit to upland cotton within the meaning of Article 1 of the Subsidies Agreement. A failure to allocate the decoupled payment either would result in arbitrarily assignin g subsidy benefits to one

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prerogative. The Panel must judge whether those arguments and evidence amount to a *prima facie* case. Where Brazil has refused to adopt the proper approach to allocation of decoupled payments and has identified no evidence to allow a proper allocation, the Panel may not step into the breach and make any "reasonable assumptions" to support Brazil's claims.

ANNEX I-9

COMMENTS OF THE UNITED STATES CONCERNING BRAZIL'S ECONOMETRIC MODEL

22 December 2003

I. THE SUMNER MODEL PRESENTED BY BRAZIL DOES NOT PROVIDE ACCEPTABLE ECONOMIC SUPPORT FOR BRAZIL'S CLAIM OF SERIOUS PREJUDICE

A. INTRODUCTION

1. Our review of Brazil's economic model analysis as submitted by Brazil and independently by Dr. Bruce Babcock of Iowa State University shows a clear and consistent manipulation of well-known econometric tools and mischaracterization of the US cotton programme in order to exaggerate acreage and ultimate price impacts. In particular:

- The Sumner approach forces changes onto the FAPRI system, and misleadingly claims the result as a FAPRI-type analysis;
- Using flawed and often unsubstantiated economic assumptions, Brazil transformed the FAPRI model for its own purposes;
- Every economic result ascribed to a FAPRI-type analysis by Brazil contains the same flawed assumptions originally introduced by Dr. Sumner;
- Brazil did not use the correct models or assumptions according to FAPRI/CARD analysts and appears to have even changed the underlying FAPRI baseline in order to exaggerate acreage and price impacts of programme removal.

2. This critique is directed primarily at Dr. Sumner's model, the results of which were first presented to the Panel in Annex I.[1] Brazil continues to cite Annex I as a part of its fundamental economic findings. The United States notes that Brazil has introduced different analytical tools since the United States and the Panel requested to see the model used to produce the Annex I results.[2] In no instance has Brazil appeared to retreat from its impacts cited in Annex I.

3. Dr. Sumner's supply-side adaptations or modifications 11 T/F5 11.Tw (ac80875 Tw ( ) Tj -324.75 -12.7)

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forward into all subsequent econometric demonstrations using subsequent FAPRI baselines. In many respects, Brazil's Annex I (and subsequent) results are caused directly by introduced changes to the FAPRI model.

4. Brazil offers Dr. Sumner's model results as evidence that but for the US cotton programme, US cotton acreage would have declined and world prices would have increased. While the US has in its submissions and oral statements demonstrated the fatal flaws in Brazil's arguments on subsidy identification, causation, and its actionable subsidies claims, it is clear to the United States that but for the significant manipulation and adaptation of the FAPRI model carried out by Brazil and Dr. Sumner, acreage impacts attributed to the US cotton programme by that economic model would be far less than reported in Annex I. As a result, Dr. Sumner's economic analysis cannot serve as a basis for any findings on the effect of challenged US subsidies.

II. BRAZIL MODEL IS NOT FAPRI/CARD ANALYSIS

5. The adaptations and modifications made to the FAPRI model by Brazil have so changed the model that Brazil cannot rely on FAPRI's reputation to confirm the results.

- Dr. Babcock, Dr. Sumner's "collaborator" on the project, states that a FAPRI analysis would have used different models and applied different assumptions;

-

international cotton model used in Dan's analysis was a stand-alone cotton model developed to better understand the role that China plays in i

19. Although the US does not agree that decoupled payments impact planting decisions, it is useful to compare FAPRI's view of the impacts with that of Dr. Sumner.

20. Looking further into the FAPRI model, one finds that the decoupled payments are not included on a crop-specific basis as done by Dr. Sumner in his adaptations. Instead, FAPRI allocates total decoupled payments across all crops in a region. First, the total money is put on a per-acre basis by dividing the payments by acres planted to the major crops. Second, FAPRI then determines a total acreage impact for the region based on the responsiveness of the total land to the infusion of money. Third, the total acreage impact is allocated to the individual crops in each region based on the crop's share of recent plantings.

- Dr. Sumner discarded this FAPRI approach to decoupled payments and inserted his own "coupling" factor.

- Cotton acreage impacts for US decoupled programmes as would likely be presented by FAPRI are about 0.3%, consistent with the estimates in the economic literature previously presented by the United States (e.g., Westcott et al.).[12]

- Dr. Sumner's cotton acreage impacts, by contrast, are as high as 15.9% - that is, more than 50 times larger than what the FAPRI model would indicate.

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worthwhile to note that Dr. Sumner's net impacts are still 25 times larger than the gross impacts derived from the FAPRI model. Simply put, FAPRI's model would not show the kind of acreage impacts assumed by Dr. Sumner.

Acreage Impacts of Decoupled Payments (Million Acres)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	99-02 Avg	03-07 Avg
FAPRI Model Gross Total Area Impact of all Decoupled Pymts Across All Crops (1)	1.379	1.838	1.912	2.091	1.534	2.180	2.566	2.379	2.101	1.805	2.152
% of Plantings of All Crops	0.5%	0.7%	0.8%	0.8%	0.6%	0.9%	1.0%	0.9%	0.8%	0.8%	0.8%
FAPRI Model Gross Impact of All Decoupled Pymts on Cotton Acreage (2)	0.069	0.090	0.092	0.101	0.075	0.105	0.123	0.115	0.101	0.088	0.104
% of Upland Cotton Area	0.5%	0.6%	0.6%	0.7%	0.5%	0.7%	0.8%	0.8%	0.7%	0.6%	0.7%
FAPRI Model Gross Impact of Cotton Decoupled Pymts on Cotton Acreage (3)	0.023	0.030	0.031	0.029	0.037	0.042	0.045	0.043	0.040	0.028	0.041
% of Upland Cotton Area	0.2%	0.2%	0.2%	0.2%	0.3%	0.3%	0.3%	0.3%	0.3%	0.2%	0.3%
Sumner's Gross Impact of Cotton Decoupled Pymts on Cotton Acreage (4)	0.352	0.437	0.670	0.538	2.185	2.114	2.200	2.038	2.029	0.500	2.113
% of Upland Cotton Area	2.4%	2.8%	4.3%	3.8%	15.9%	14.2%	14.9%	13.9%	14.2%	3.4%	14.6%
Sumner's Net Impact of Cotton Decoupled Payments on Cotton Acreage (5)	0.350	0.320	0.510	0.300	1.710	1.190	0.790	0.860	0.850	0.370	1.080
% of Upland Cotton Area	2.4%	2.1%	3.3%	2.1%	12.4%	8.0%	5.3%	5.9%	6.0%	2.5%	7.5%
FAPRI Model Gross Impact of Cotton AMTA/DP Pymts on Cotton Acreage (6)	0.018	0.017	0.013	0.014	0.014	0.014	0.014	0.013	0.013	0.016	0.014
% of Upland Cotton Area	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Sumner's Gross Impact of Cotton AMTA/DP Payments on Cotton Acreage (7)	0.191	0.164	0.240	0.202	0.575	0.567	0.593	0.544	0.544	0.199	0.565
% of Upland Cotton Area	1.3%	1.1%	1.5%	1.4%	4.2%	3.8%	4.0%	3.7%	3.8%	1.3%	3.9%
Sumner's Net Impact of Cotton AMTA/DP Payments on Cotton Acreage (8)	0.190	0.100	0.170	0.120	0.420	0.310	0.200	0.220	0.220	0.145	0.274
% of Upland Cotton Area	1.3%	0.7%	1.1%	0.9%	3.0%	2.1%	1.4%	1.5%	1.5%	1.0%	1.9%
FAPRI Model Gross Impact of Cotton MLA/CCP Pymts on Cotton Acreage (9)	0.005	0.014	0.017	0.015	0.023	0.028	0.031	0.029	0.027	0.013	0.028
% of Upland Cotton Area	0.0%	0.1%	0.1%	0.1%	0.2%	0.2%	0.2%	0.2%	0.2%	0.1%	0.2%
Sumner's Gross Impact of Cotton MLA/CCP Payments on Cotton Acreage (10)	0.161	0.273	0.431	0.336	1.610	1.546	1.607	1.494	1.484	0.300	1.548
% of Upland Cotton Area	1.1%	1.8%	2.8%	2.4%	11.7%	10.4%	10.9%	10.2%	10.4%	2.0%	10.7%
Sumner's Net Impact of Cotton MLA/CCP Payments on Cotton Acreage (11)	0.160	0.220	0.340	0.180	1.290	0.880	0.590	0.640	0.630	0.225	0.806
% of Upland Cotton Area	1.1%	1.4%	2.2%	1.3%	9.4%	5.9%	4.0%	4.4%	4.4%	1.5%	5.6%

(1) Source: File US CROPS MODEL 2002.xls, Model sheet, Row 4484.
(2) Source: File US CROPS MODEL 2002.xls, Model sheet, Row 4475.
(3) Source: Calculated in file *US CROPS MODEL 2002 NO Decoupled.xls* by setting cotton decoupled payments to zero.
(4) Source: File FINAL US2003CropsModel WORKOUT.xls, Equations sheet, sum of Rows 728 and 740.
(5) Source: Sum of Sumner's Net Impacts of AMTA/DP Payments and MLA/CCP Payments.
(6) Source: Calculated by subtracting acreage impacts of NO MLA/CCP from acreage impacts of NO Decoupled payments.
(7) Source: File FINAL US2003CropsModel WORKOUT.xls, Equations sheet, Row 728.
(8) Source: Table I.5b of Annex I.
(9) Source: Calculated in file *US CROPS MODEL 2002 NO MLA CCP.xls* by setting cotton MLA/CCP payments to zero.
(10) Source: File FINAL US2003CropsModel WORKOUT.xls, Equations sheet, sum of Row 740.
(11) Source: Table I.5c of Annex I.

2. Dr. Sumner Assigns Production Effects to Crop Insurance that FAPRI Does Not

25. Dr. Sumner's arbitrary introduction of crop insurance into his acreage system is a direct departure from the FAPRI model. Dr. Sumner provides no statistical basis to support his incorporation of crop insurance. He simply derives a per-acre value, forces those impacts into the acreage system, and treats the results as valid analysis. There is absolutely no empirical validation associated with his results.

26. FAPRI does not explicitly attribute any acreage response to the availability of crop insurance. Dr. Sumner's gross impacts range as high as 1.05 million acres, and net impacts reach 590 thousand acres.

27. The exclusion of crop insurance from the FAPRI model is warranted. As the United States has previously suggested[13], if one were to consider the coverage levels obtained by cotton farmers, over 90 per cent of insured cotton area would be subject to coverage levels agreed by Members to have no or minimal trade-distorting effects.

28. The United States has also demonstrated that the economic literature examining acreage effects of crop insurance is clearly mixed, but have never gone so far as to attribute production impacts as great as those asserted by Brazil.[14] The literature in general reflects that by its very nature the impact of crop insurance on production may be significantly different than its impact on acreage.

29. It seems intuitive to the United States that a dollar provided in the way of an insurance premium subsidy (provided to reduce the cost of an insurance product that pays when the crop is not produced) would have different impacts on producer decisions than a dollar provided to the producer when the value of a harvested crop falls short of some defined level (such as a marketing loan payment). Dr. Sumner's analysis treats them the same. FAPRI does not.

30. Thus, it is significant that the FAPRI model does not attribute acreage response to the availability of crop insurance. Dr. Sumner deviates from that model without any empirical foundation in the economic literature.

Acreage Impacts of Crop Insurance (Million Acres)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	99-02 Avg	03-07 Avg
FAPRI Model Impact of Cotton p2020											

3. Dr. Sumner Assigns a Production Effect to Export Credits that FAPRI Does Not

31. In a further departure from the modelling approach used by FAPRI, Dr. Sumner introduces a 500 thousand-bale impact for export credit programmes. US exports are reduced by introducing this shift in the US export equation.[15] The resulting effect is to lower the US price while increasing the world price. However, as with Dr. Sumner's other modifications, there is no statistical basis for these changes.

32. Brazil provides no statistical or other economic foundation for this level of impact from the export credit guarantee programme. Dr. Sumner's stated source for the 500,000 bale impact is testimony delivered by the National Cotton Council of America in 2001, a US trade association that operates on behalf of the US cotton industry.[16] Brazil presents no evidence of how that estimate was calculated and presents no analysis of its own.[17]

33. With respect to any actual effects on world prices caused by the application of the US export credit guarantee programme to US cotton exports, Brazil has cited no subsidy component estimates and demonstrated no economic analysis.

34. Dr. Sumner's model passes off his 500,000-bale export shift as economic analysis and forces it upon the FAPRI model. Does the Sumner model show acreage impacts from the removal of the export credit guarantee programme? Of course it does since Dr. Sumner forced it to show those impacts. Brazil, cannot, however, base its estimates on FAPRI or on any demonstrated analytical approach.

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[15] Exhibit Bra-313, page 5, "For the export credit, as explained in the Annex I, I base the estimated shift in export demand conservatively on the information provided by the US Cotton Council. The FAPRI baseline, which assumes continuation of the export credit programme, implicitly includes 500,000 bales of cotton attributable to the export credit programme. So eliminating the programme is implemented by simply subtracting 500,000 bales from the intercept of equation 7 in each year."

[16] See Exhibit Bra-41. The National Cotton Council is a trade association that lobbies the US government on behalf of the US cotton industry.

[17] In the 9 September Brazil Submission before the Second Session of the First Panel Meeting, paras

Export Shifts due to Export Credits (Million Bales)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	99-02 Avg	03-07 Avg
FAPRI Model Impact of Export Credits on Cotton Exports (1)	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Sumner's Gross Impact of Export Credits on Cotton Exports (2)	0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.500
Sumner's Net Impact of Export Credits on Cotton Exports (3)	0.300	0.290	0.330	0.300	0.300	0.300	0.300	0.310	0.310	0.305	0.304

(1) Source: No impact included in file US CROPS MODEL 2002.xls.
(2) Source: Paragraph 59 of Annex I.
(3) Source: Table I.5g of Annex I.

III. ANNEX I RESULTS USED VARIABLES LOWER THAN CITED NOVEMBER 2002 FAPRI BASELINE

35. The United States has previously indicated to the Panel its concern that acreage impacts in Annex I were based off of the FAPRI preliminary November '02 baseline instead of the more recent and readily available final January 2003 FAPRI baseline. The United States believes this choice of baseline biased the results shown in Annex I.[18] A closer review of the Annex I results, however, show they were not exactly based off the November 2002 baseline either.

A. USE OF VARIABLES LOWER THAN NOVEMBER 2002 BASELINE INCREASED ACREAGE IMPACTS

- By using prices and other variables that were even lower than the FAPRI November '02 baseline, Brazil managed to further increase acreage impacts it attributed to the US cotton programme.

36. Contrary to the assertions contained in Annex I, it appears that the baseline that is presented there is not the FAPRI November 2002 baseline. The following table provides a comparison of the "A" Index from the baseline presented in Annex I with the FAPRI November 2002 baseline as provided by Dr. Babcock on 26 November.

[18] US Opening Statement at the Second Session of the First Panel Meeting, 7 Oct. 2003, para. 36.

Comparison of Annex I Baseline with FAPRI November '02 Baseline

	2003	2004	2005	2006	2007
"A" Index (Cents/Lb)					
Annex I	50.69	53.44	55.75	57.56	59.60
FAPRI Nov '02 Baseline	52.35	54.74	56.77	58.69	60.52
Change from FAPRI	-1.66	-1.30	-1.02	-1.13	-0.92
Upland Cotton Farm Price (Cents/Lb)					
Annex I	44.96	47.74	50.30	51.20	53.89
FAPRI Nov '02 Baseline	45.66	48.83	51.18	52.04	54.67
Change from FAPRI	-0.70	-1.09	-0.88	-0.84	-0.78
Upland Cotton Planted Area (Million Acres)					
Annex I	13.780	14.880	14.770	14.650	14.270
FAPRI Nov '02 Baseline	13.782	14.720	14.772	14.658	14.252
Change from FAPRI	-0.002	0.160	-0.002	-0.008	0.018
Upland Cotton Production (Million Bales)					
Annex I	16.050	17.420	17.400	17.370	17.010
FAPRI Nov '02 Baseline	16.052	17.215	17.397	17.377	16.982
Change from FAPRI	-0.002	0.205	0.003	-0.007	0.028

Source: FAPRI Nov '02 Baseline numbers from file *US CROPS MODEL 2002.xls*

37. The baseline used by the Annex I model appears to contain slightly lower cotton planted acreage, different upland cotton production, lower upland cotton farm prices and lower "A" index cotton prices than were shown in the FAPRI preliminary November 2002 baseline.[19]

B. BASELINE USED IN ANNEX I EXAGGERATED PROGRAMME EFFECTS BEYOND THAT PREVIOUSLY ASSUMED BY UNITED STATES

38. me

38. The baseline used in Annex I exaggerated programme effects even more than previously assumed by the United States. The baseline used in Annex I contained lower cotton prices than those included in the FAPRI November 2002 baseline. It also contains several other variables that are different from the November 2002 baseline. There is no basis for this discrepancy, if Dr. Sumner

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49. In fact, the explanatory power and reliability of Dr. Sumner's acreage model is far less than one explanation of recent movements in cotton acreage provided by the United States, the ratio of cotton to soybeans expected harvest season futures prices at time of planting. Because soybeans is a major competing crop of cotton in many cotton-producing regions, this ratio expresses the relative attractiveness of planting cotton from expected market returns.[23] Simply put, the ratio of expected futures prices does a much better job of explaining the movement in US cotton acreage than what is found in Dr. Sumner's arbitrary formulation.

Correlation of Selected Explanatory Variables with Upland Cotton Planted Area, 1996-2002 Period (1)

	Corn Belt	Central Plains	Delta States	Far West	Southeast	Southern Plains	**US**
Sumner's Cotton Expected Net Returns (Nominal $)	-0.27	0.11	-0.29	0.29	-0.53	-0.09	**-0.28**
Sumner's Cotton Expected Net Returns (Real $)	-0.29	-0.08	-0.32	0.38	-0.58	-0.14	**-0.30**
Sumner's Weighted Expected Net Returns for all Crops (Real $)	-0.21	0.40	-0.25	0.17	-0.35	0.16	**-0.14**
Ratio of Cotton and Soybean Futures Prices	0.55	-0.37	0.66	0.23	0.33	0.63	**0.69**
Ratio of Lagged Cotton and Soybean Farm Prices	0.14	-0.64	0.37	0.40	-0.06	0.46	**0.40**

(1) Source: File FINAL US2003CropsModel Correl 1.xls

50. The statistics are very clear. Dr. Sumner's methodology of modelling producer expectations and planting decisions has no explanatory power, and analysis based on these equations is not reliable. His proposed formulation of net returns is not consistent with producers' expectations and acreage decisions. The equations are not reliable for assessing the removal of US programmes, and this applies to not only decoupled payments and crop insurance, but also marketing loans.

51. Recent historical data clearly indicate that producers are making their decisions on their expectations of market prices for cotton and primary competing crops.[24] Furthermore, those price expectations are not captured by the naïve approach of simply using last year's price to determine this year's acreage decision. As Brazil's expert, Mr. MacDonald explained at the second session of the first panel meeting, futures markets embody the best available information about expected prices. The data indicate that cotton farmers' planting decisions are made accordingly.

[23] Paragraphs 5-9 of Answers of the United States of America to the Questions from the Panel to the Parties following the Second Session of the First Substantive Panel Meeting, 27 October 2003.

PFCi = 0.85 * (PFC Payment Rate) * (Programme Yield)i,
MLAi = 0.85 * (MLA Payment Rate) * (Programme Yield)i,
DPi = 0.85 * (Direct Payment Rate) * (Programme Yield)i,
CCPi = 0.85 * max(0, Target Price – max)(Loan Rate, Farm Price)) (Programme Yield)I,

The variables for decoupled payments and crop insurance have been calculated for each crop and

52. The formulations discussed in Annex I do not reflect the expectations of producers and do not explain the movement in US cotton acreage. This is particularly troublesome as those formulations are a critical link in Brazil's attempt to ascribe significant acreage impacts to the US cotton programme. There is no credible statistical evidence that supports this linkage, and the Annex I formulations that form a part of this analytical linkage fail to accurately explain movement in acreage.

V. DR. SUMNER'S METHODOLOGY DEVIATES FROM FAPRI'S LINEAR ACREAGE SYSTEM

53. FAPRI's linear acreage system would tend to ensure that impacts from a static change in returns should be the same across several years. However, contrary to the normal FAPRI system, the Sumner analysis shows impacts that grow substantially over several years.

54. According to the US crops model (Excel file US CROPS MODEL 2002.xls) sent by Dr. Babcock on 26 November, upland cotton acreage in each region is determined by the following equation:

$CTPLT_i = a_o + a_o$*$CTENR_i/PD + A$*(Vector of Competing Crop Returns$_i$)/PD
+ Decoupled Payment Impacts$_i$ + CRP Impacts$_i$ + ?$_i$

where

CTPLT = upland cotton planted acreage in region i
CTENR = expected cotton net returns from the market and the marketing loan in region i
PD = general price deflator
A = vector of parameter estimates for competing crops.

Expected net returns for each crop are defined as
(Lagged Farm Price + max(0, Loan Rate – Lagged Loan Repayment Price)) * Expected Yield – Variable Costs.

55. As documented in equation (1) of Annex I, Dr. Sumner modifies expected net returns to include his calculations of decoupled payments and crop insurance benefits. The new equations for expected net returns are transformed as follows:

(Lagged Farm Price + max(0, Loan Rate – Lagged Loan Repayment Price)) * Expected Yield – Variable Costs + b_{pfc} * PFC + b_{dp} * DP + b_{mla} * MLA + b_{ccp} * CCP + CIS,

where

PFC = per-acre PFC payments
DP = per-acre direct payments
MLA = per-acre MLA payments
CCP = per-acre counter-cyclical payments
CIS = crop insurance variable
b_{pfc} , b_{dp} , b_{mla} , b_{ccp} = scaling factors.

56. An important aspect of the linear acreage equations as modified by Dr. Sumner concerns the response to changes in net returns. If net returns for cotton change by a given amount, then the impact or shift in cotton acreage is determined as a_i*(Change in returns)/PD. If the change in returns is the same across years, then the only difference in terms of the acreage impact is due to the value of the price deflator PD.

A. ACREAGE IMPACTS FOR 2003-07 APPEAR INCONSISTENT WITH 1999-2002 PERIOD

57. Dr. Sumner's acreage impacts attributed to decoupled payments and crop insurance show tremendous variations over the 1999-2007 period. 57.

the relative programme values assumed by Dr. Sumner. In the case of decoupled payments, incorporating Dr. Sumner's "coupling" factors does not fully explain the differences in impacts.

58. The following table provides a comparison of the average acreage impacts reported in rows 720-771 of the file FINAL US2003CropsModel WORKOUT.xls. The averages reflect the two periods of the analysis covered by the different farm bills. The US cannot verify Dr. Sumner's calculations due to insufficient information. However, some basic calculations cast serious doubt on the validity of Dr. Sumner's analysis.

59. The acreage impacts reported for DP payments over the 2003-07 period are much larger than those indicated for PFC payments during 1999-2002 even though direct payment rates under the current farm bill are actually smaller than PFC payment rates under the FAIR Act. Surprisingly, this difference cannot be adequately explained by Dr. Sumner's decision to provide much stronger acreage impacts for Direct Payments than he attributed to PFC payments. Even when the United States attempted to incorporate Dr. Sumner's "coupling" factor, the acreage impacts appear much larger than the increased (1.5 times) "coupling" factor would seem to indicate.

60. The same concern holds true for MLA and CCP payments. The acreage impact associated with CCP increases by a factor of five while the effective payment under the 2002 Act is 3.4 times larger than the MLA payment. In the Central Plains, the impact is more than 147 times larger over the 03-07 period than over 99-02. The Southeast shows an acreage impact due to CCP that is almost 8 times the size of that implied for MLA by Dr. Sumner under the 1996 Act.

B. CROP INSURANCE IMPACTS OVER 2003-2007 PERIOD VARY FROM IMPACTS OVER 1999-2002

61. In paragraphs 52 through 56 of Annex I, Dr. Sumner addresses his contrived methodology for incorporating crop insurance. He states that the per-acre crop insurance effect on net revenue is the same in all years of the analysis, and at the national level, it equals $19 per acre. He does not indicate if the value changes for each region in his acreage systematic, notwithstanding, we do know that the impact on net revenue is the same in all years o

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Comparison of Calculated Payment Rates with Acreage Shifts Reported in FINAL US2003CropsModel WORKOUT.xls

	99-02 Average	03-07 Average	Ratio
AMTA/DP Effective Average Payment Rate (Cents/Lb) *	1.10 (= 7.34 * 0.15)	1.67 (= 6.67 * 0.25)	1.52
AMTA/DP Acreage Impacts (Mil Acres)			
Corn Belt	0.0015	0.0047	3.03
Central Plains	0.0025	0.0053	2.11
Delta States	0.0390	0.1425	3.65
Far West	0.0004	0.0012	2.84
Southeast	0.0764	0.2734	3.58
Southern Plains	0.0794	0.1380	1.74
Total U.S.	0.1993	0.5650	2.84
MLA/CCP Effective Average Payment Rate (Cents/Lb) *	1.61 (= 6.42 * 0.25)	5.49 (= 13.73 * 0.40)	3.41
MLA/CCP Acreage Impacts (Mil Acres)			
Corn Belt	0.0023	0.0137	5.96
Central Plains	0.0001	0.0151	147.22
Delta States	0.0872	0.3867	4.43
Far West	0.0022	0.0037	1.67
Southeast	0.0927	0.7307	7.88
Southern Plains	0.1157	0.3983	3.44
Total U.S.	0.3002	1.5482	5.16
Crop Insurance Average Benefit (Dollars/Ac)	$19	$19	1.00
Crop Insurance Acreage Impacts (Mil Acres)			
Corn Belt	-0.0002	-0.0003	1.52
Central Plains	0.0120	0.0219	1.83
Delta States	0.0596	0.1018	1.71
Far West	0.0012	0.0013	1.06
Southeast	0.2372	0.4609	1.94
Southern Plains	0.3728	0.4279	1.15
Total U.S.	0.6826	1.0135	1.48

* Effective Rates Calculated by Multiplying Average Rates by Dr. Sumner's "Coupling" Factor.

C. SUMNER MODEL ADOPTS NON-LINEAR RESPONSES CONTRARY TO FAPRI

63. In Exhibit Bra-313, Dr. Sumner provides further documentation regarding the analysis of decoupled payments and crop insurance. The new documentation suggests an entirely different methodology than presented in Annex I.

64. The documentation provided in Annex I suggests that cotton area is determined by the equation:

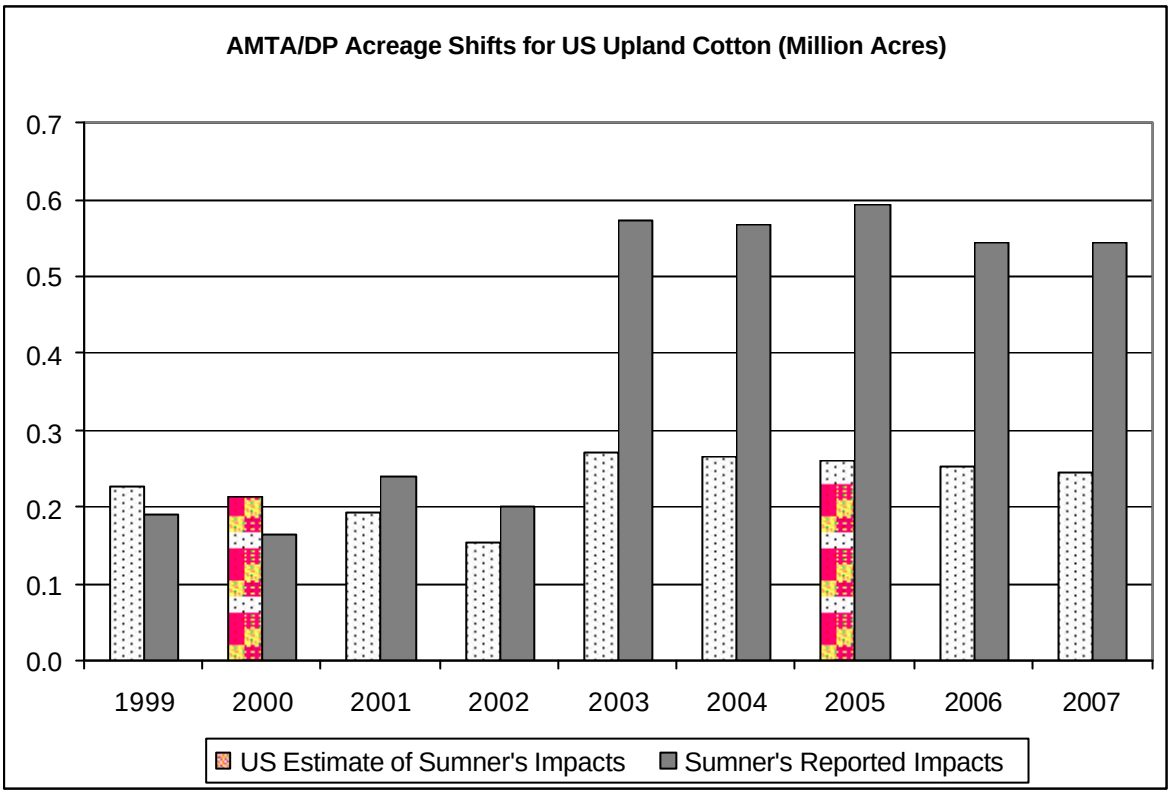
$CTPLT_i = a_o + a_o$*$CTENR_i/PD + A$*(Vector of Competing Crop $Returns_i$)/PD
+ ?i

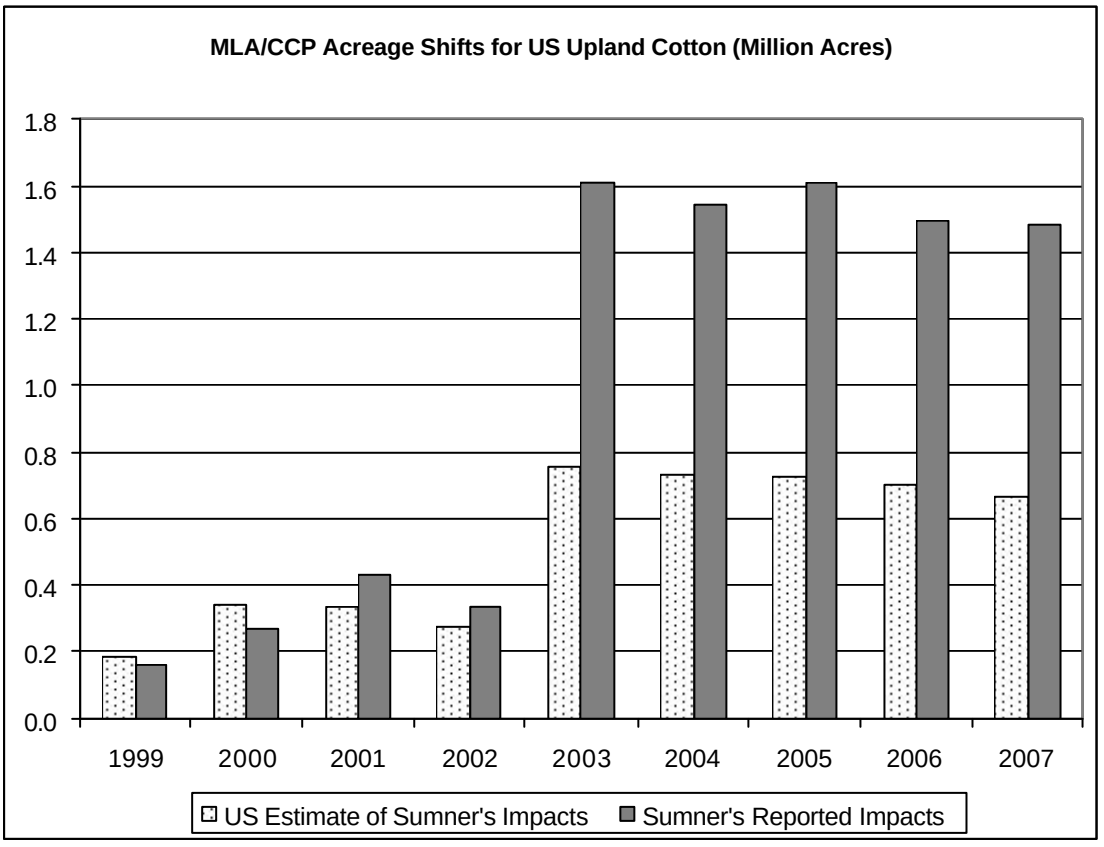
where cotton expected net returns CTENR are determined as
(Lagged Farm Price + max(0, Loan Rate – Lagged Loan Repayment Price)) * Expected Yield – Variable Costs + b_{pfc} * PFC + b_{dp} * DP + b_{mla} * MLA + b_{ccp} * CCP + CIS.

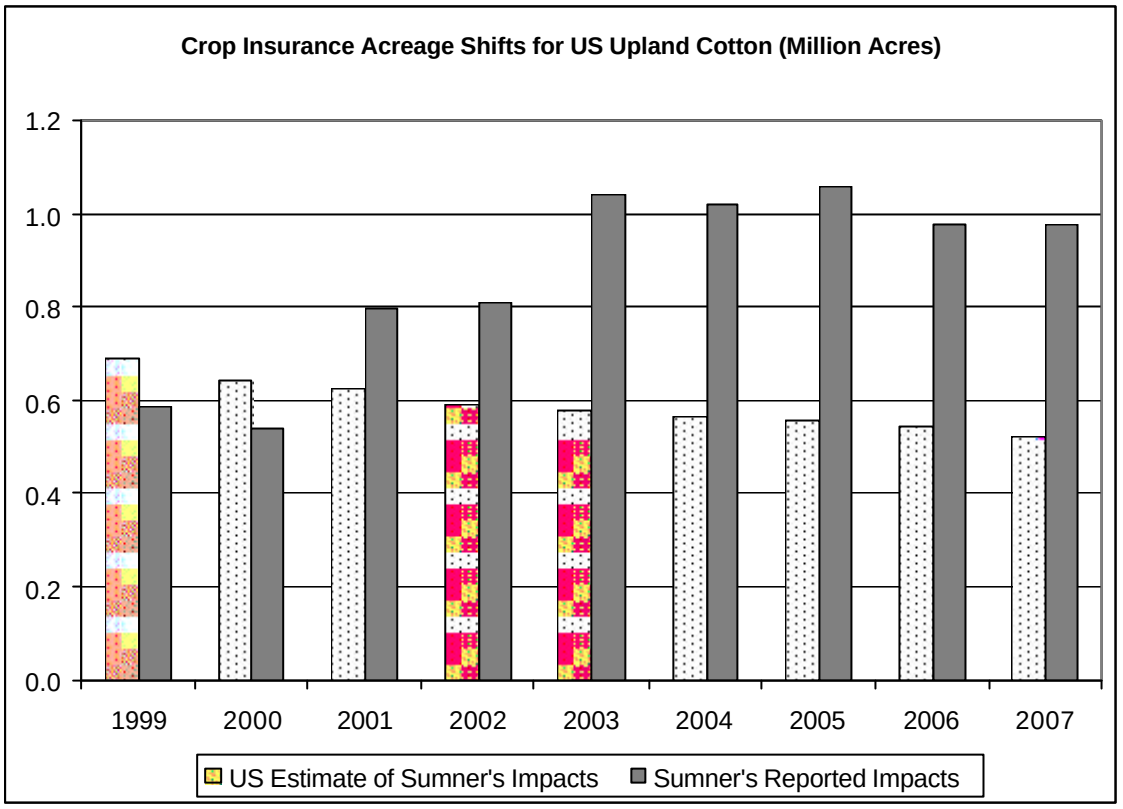
65. Based on this documentation, -65.

impact due to decoupled payments and crop insurance of 3.1 million acres over the 2003-07 period. Estimates by the US using Dr. Sumner's formulas find an impact of only 1.2 million acres. The inability to even remotely replicate Dr. Sumner's estimates casts serious doubts about the validity of his results. Dr. Sumner's calculations appear to be as arbitrary as his economic logic.

AMTA/DP MLA/CCP


AMTA/DP Acreage Shifts for US Upland Cotton (Million Acres)
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0.0
1999
2000
2001
2002
2003
2004
2005
2006
2007
US Estimate of Sumner's Impacts
Sumner's Reported Impacts


MLA/CCP Acreage Shifts for US Upland Cotton (Million Acres)
1.8
1.6
1.4
1.2
1.0
0.8
0.6
0.4
0.2
0.0
1999
2000
2001
2002
2003
2004
2005
2006
2007
US Estimate of Sumner's Impacts
Sumner's Reported Impacts



VI. SUMNER MODIFICATIONS TO FAPRI MODEL DESCRIBED IN BRA-313 CONTAIN ERRORS

73. In Exhibit Bra-313, equation (2) on page 2 states that real net revenue for crop i in year (t-1) is a function of the price in (t-1) and the loan rate in (t-1), and other variables. It is this specification for real net revenue that determines acreage in year t, as described in equation (1). The combination of these two equations indicates that the loan rate in t-1 helps determine acreage in period t. In other words, Dr. Sumner's equation seems to assert it is last year's loan rate, and not the one in effect for this year's crop, that determines this year's plantings. Not only is this completely illogical, but it is in direct conflict with acreage equations previously developed by both FAPRI and USDA. The United States cannot determine if this equation reflects a lack of knowledge of the model, a broader deficiency in economics, or some previously unknown modification of the FAPRI or CARD models.

74. Dr. Sumner's documentation presented in equation (2) is inconsistent with equations contained in the files US CROPS MODEL 2002.xls (provided by Dr. Bruce Babcock on 26 November) and FINAL US2003CropsModel WORKOUT.xls (provided by Brazil on 18 November). Equation (2) defines real net revenue for crop i by taking the higher of the lagged farm price and the lagged loan rate, then multiplying by trend yield and subtracting variable costs. He further explains that this formulation applies to all crops except cotton and rice, where the marketing loan benefit depends on the difference between the loan rate and the AWP. However, in the two electronic versions of the crops model, which have been provided by Dr. Sumner and Dr. Babcock[26], the formulation of expected net revenue is not consistent with Dr. Sumner's documentation. According to the electronic versions, all crops incorporate the marketing loan benefit by taking the difference between the loan rate and the loan repayment price. The United States and the Panel are left to wonder why there is a discrepancy between Dr. Sumner's documentation and the models that have been provided.

[26] File US CROPS MODEL 2002.xls (provided by Dr. Bruce Babcock on 26 November) (Exhibit US-116) and FINAL US2003CropsModel WORKOUT.xls (provided by Brazil on 18 November) (Exhibit US-115).

75. Exhibit Bra-313 and Annex I provide different and conflicting methodologies for incorporating the impacts of crop insurance and decoupled payments. According to equation (1) of Annex I, the formula for determining expected net revenue has been modified to include per-acre decoupled payments and crop insurance benefits. These net returns then determine cotton planted acreage. However, in equation (1a) of Bra-313, Dr. Sumner indicates that net revenue only considers returns from the market and the marketing loan. He then incorporates the impacts of decoupled payments and crop insurance by adding some arbitrary acreage impacts into the equation. As explained earlier[27], the approach presented in Exhibit Bra-313 only serves to exaggerate his acreage impacts.

76. In equation (7), Dr. Sumner documents the equation specification for US cotton exports. His documentation indicates that exports in year t are a function of production in t-1, and other variables. Dr. Sumner's model suggests that last year's production directly determines this year's exports. This is both illogical and a departure from the specification included in the FAPRI framework.

w (asti46375233.2

VII. OVERALL PRICE RESPONSIVENESS OF THE ANNEX I MODEL

77. The overall price impacts generated by a model are determined by the underlying supply and demand elasticities within the system.

domestic demand less the elasticity of their domestic supply. In the case of the Meyer model, the elasticity of excess demand is -0.37 –

- Many of Dr. Sumner's adaptations contain errors.

83. In the final analysis, Brazil does not rely on the FAPRI model to prove its case, it relies on its manipulation of that model to ensure it obtains the desired results.

ANNEX I-10

BRAZIL'S ANSWERS TO ADDITIONAL QUESTIONS FROM THE PANEL

20 January 2004

TABLE OF CASES

EC – Sugar Exports I (Australia)	GATT Panel Report, *European Communities – Refunds on Exports of Sugar (Complaint by Australia)*, L4833 - 26S/290, adopted 6 November 1979
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.
US – FSC	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R, adopted 20 March 2000.
US – 1916 Act	Appellate Body Report, *United States – Anti-Dumping Act of 1916*, WT/DS136/AB/R, adopted 26 September 2000.

257.

3. The Appellate Body held that "[w]hen a measure is challenged 'as such,' the starting point for an analysis must be the measure on its face. If the meaning and content of the measure are clear on its face, then the consistency of the measure as such can be assessed on that basis alone".[2] The Appellate Body in *US – Corrosion-Resistant Steel* found that the "as such" challenge "hinges upon whether [the Sunset Policy Bulletin] instruct[s] USDOC to treat dumping margins and/or import volumes as determinative or conclusive, on the one hand, or merely indicative or probative, on the other hand, of the likelihood of future dumping".[3] Finding ambiguity in the text of the Bulletin (the use of the word "normally" and "good cause"), the Appellate Body held that the panel should have examined the history of the application of the Bulletin and individual decisions thereunder.[4] Since the panel had failed to make the necessary factual findings, the Appellate Body was unable to complete the analysis and to rule on Japan's claim.[5]

4. Nevertheless, the Appellate Body's decision appears to stand for the proposition that "*per se*"

United States admits that "the CCC has a large" borrowing authority and "*rarely has CCC run out of funds* but it has happened for brief periods of time".[14] Indeed, while the 1996 FAIR Act imposed a $701 million budgetary limit on the Step 2 programme during MY 1996-2001, this limit was reached by 1999. At the urging of the NCC, Congress eliminated the spending cap in 2000.[15] Unlimited funding has existed ever since, including $415 million in expenditures in MY 2002 alone.[16]

9. The Secretary of the USDA must make payments pursuant to the plain text of Section 1207(a)(1), (2), and (4) of the 2002 FSRI Act (as set out in paragraph 245 of Brazil's 24 June First Submission). Consistent with the *US – Corrosion-Resistant Steel* decision, the evidence of mandatory payments demonstrates the absence of any flexibility for US officials to apply the programme in a WTO-consistent manner. Even if US authorities, acting in the best of faith, recognize that Step 2 payments are inconsistent with the US export subsidy obligations as well as with the prohibition on local content subsidies, *Congress has not given them the discretion to stop the payments*. Indeed, Congress has created a legal right for eligible recipients to demand and receive payments.

- **export credit guarantee programmes: GSM-102, GSM-103 and SCGP (see, e.g., para. 90 Brazil's oral statement at second Panel meeting).**

Brazil's Answer

10. The Appellate Body Report in *US – Corrosion-Resistant Steel* does not affect the legal standard and elements set out by Brazil to establish its claims against the GSM 102, GSM 103 and SCGP programmes under Articles 10.1 and 8 of the Agreement on Agriculture, and under Article 3.1(a) of the SCM Agreement. In fact, the mandatory/discretionary distinction is not relevant to Brazil's claims against the CCC export credit guarantee programmes under Article 10.1 of the Agreement on Agriculture.

11. Article 10.1 prohibits circumvention, and the threat of circumvention, of export subsidy reduction commitments. Brazil has demonstrated actual circumvention, by establishing that with respect to both unscheduled products[17] and at least one scheduled product[18], the United States has in fact circumvented its export subsidy reduction commitments. This is somewhat akin to an "as applied" daim, and it is therefore not relevant to this claim whether the CCC programmes are mandatory or discretionary.

12. Brazil has also demonstrated threat of circumvention. With respect to unscheduled products, the Appellate Body has held that it constitutes threat of circumvention to provide *any* export subsidies for unscheduled products.[19] Having proven that CCC guarantees are export subsidies (under Articles 1.1 and 3.1(a) of the SCM Agreement, as well as item (j)), and having proven that those guarantees are available for unscheduled products[20], Brazil demonstrated threat of circumvention, and a violation of Article 10.1. This is the standard set out by the Appellate Body in *US – FSC*; it does not appear to be relevant to this claim whether the CCC programmes are mandatory or discretionary.

13. With respect to scheduled products, the test under Article 10.1 is not whether the CCC programmes are "mandatory" 2r5 Tw ( ) Tj -ore n-12drodu24 2 0 Tc 0.18759e

subsidy reduction commitments, Brazil has noted that the test set out by the Appellate Body in *US – FSC* is whether the CCC can "stem[], or otherwise control[], the flow of" CCC export credit guarantees. Brazil has demonstrated that CCC cannot do so.[21] One fact Brazil has noted is that the CCC programmes are "mandatory," as that term is defined in US law.[22] (In Brazil's view, the CCC programmes are also "mandatory," within the meaning of WTO/GATT law).

14. Brazil also claims that the CCC export credit guarantee programmes constitute prohibited export subsidies under Articles 1.1 and 3.1(a) of the SCM Agreement. Brazil has demonstrated that the CCC programmes confer "benefits" per se, within the meaning of Article 1.1(b) of the SCM Agreement (as well as that they are financial contributions and are *de jure* contingent on export). Brazil has relied on three types of evidence and argument to make this *per se* showing, as summarized in paragraphs 231-241 of its 18 November 2003 Further Rebuttal Submission. These three types of evidence and argument demonstrate that every time a CCC guarantee is issued, a benefit is conferred *per se*. This is effectively the equivalent of saying that the CCC programmes "mandate" a violation.

15. Finally, Brazil also claims that the CCC export credit guarantee programmes constitute prohibited export subsidies under item (j) of the Illustrative List of Export Subsidies included as Annex I to the SCM Agreement. Brazil does not consider that, to the extent the traditional mandatory/discretionary principle was modified by the Appellate Body in *US Corrosion-Resistant Steel*, those modifications have any impact on Brazil's claim.

16. Moreover, Brazil does not consider that it is particularly useful to determine whether Brazil's claim is "as applied" or "as such", thus necessitating a determination whether the CCC programmes are "mandatory" or "discretionary". Indeed, the Appellate Body in *US Corrosion-Resistant Steel* stressed that the "import of the 'mandatory/discretionary distinction' may vary from case to case", cautioning "against the application of this distinction in a mechanistic fashion".[23] Item (j) imposes a *sui generis* standard – it calls for an evaluation whether the CCC programmes are offered at premium rates that are inadequate to cover the long-term operating costs and losses of the programmes. Brazil has established these elements in two ways. First, using a number of methodologies, Brazil has looked at historical data concerning premiums collected and costs and losses incurred, to establish that costs and losses incurred exceeded premiums collected over a 10-year period.[24] Second, Brazil used statements by USDA's Office of the Inspector General and the US General Accounting Office to establish that premium rates for the CCC programmes, and not just premiums collected, do not and .

Brazil's Answer

17. The *US – Corrosion-Resistant Steel* decision does not significantly change Brazil's analysis of its serious prejudice or threat of serious prejudice claims. There has never been an issue whether the statutes and regulations providing for the five US subsidies referred to in the Panel's question are "mandatory" – this has been clear from the face of the statutory and regulatory provisions, as set out in Brazil's earlier submissions and even acknowledged by the United States.27 The record establishes that marketing loan, crop insurance, direct and counter-cyclical payments, and Step 2 payments are "mandatory" provisions – payments and expenditures are required to be made by US Government officials to eligible producers, users or exporters.[28]

18. The mandatory nature of the US subsidies is relevant to (a) Brazil's "per se" claims as well as (b) Brazil's threat of serious prejudice claims that do not involve claims regarding the "*per se*" validity of the statutes. The evidence of mandatory (or "normative") measures is a required element for Brazil's "*per se*" claims. And a threat of serious prejudice under Article 6.3 and 5(c) will be more likely to exist if the subsidies are mandatory, i.e., that the subsidies must be paid to eligible producers, exporters, and users. The record demonstrates that there are no provisions in US law limiting the payments, and, thus, limiting the threat of serious prejudice (i.e., significant price suppression, increased world market share for US exports, or inequitable share of world trade). The so-called "circuit-breaker" in the 2002 FSRI Act is not applicable to individual commodities, but instead only to total US AMS.[29] The United States has admitted that there is no provision in US law that stops subsidy payments when serious prejudice is caused to other WTO Members.[30] In particular, there was no flexibility provided to US government officials to limit upland cotton payments at any time during MY 1999-2002. When prices plunged to record lows in MY 2001 and MY 2002, USDA poured funds into sustaining high levels of US upland cotton production and exports. The participants in the world market know this will happen again when prices fall. And world producers, such as those from Brazil, as well as traders discovering prices in the New York futures markets, know that this means that US production and exports will remain high for the remainder of the 2002 FSRI Act.[31]

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[27] *See* Brazil's 9 September 2003 Further Submission, Sections 4.2.1-4.2.5 (summarized in paragraph 423); US 27 October 2003 Answer to Question 162, para 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."); para. 97 ("there is no present 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".).

[28] *See* also Brazil's Answer to Question 257(b) below.

[29] US 2 December 2003 Oral Statement para 82. US 22 December 2003 Answer to Question 253, para. 180.

[30] US 22 December 2003 Answer to Question 253, para. 180 (the circuit-breaker provision "does not appear to contemplate any such finding of serious prejudice, but rather is seemingly focused more particularly on the overall level of expenditures as that was the only restriction agreed to in this instance by the United States … ".).

[31] The absence of any "circuit breaker" for upland cotton is significant given the fact that producers of upland cotton received far more per unit and *ad valorem* subsidies than any other US commodity during MY 1999-2002 (Brazil's 9 September 2003 Further Submission, para. 4). No other US crop has a "competitiveness" subsidy such as Step 2, which paid $415 million to US users and exporters of upland cotton in MY 2002. No other US crop had counter-cyclical payments of over $1 billion in MY 2002. No other US crop had such large per unit marketing loan payments during MY 1999-2002. These huge guaranteed payments, along with the *unlimited* amount of upland cotton that can receive benefits from marketing loan, Step 2, and crop insurance subsidies, together with the very high per-acre direct and counter-cyclical payments (compared to other programme crops), together constitutes strong evidence that these measures have not, are not, and will not be applied in the future in a WTO-consistent manner.

19. This permanent threat of serious prejudice is similar to "threat of circumvention" of export subsidy reduction commitments, under Article 10.1 of the Agreement on Agriculture. In US – FSC, the Appellate Body held that the absence of any legal mechanism that can "stem[], or otherwise control[], the flow of"[32] subsidies creates a *threat* of circumvention. Again, as in this dispute, in *US – FSC Tw2m*

provides government officials with the discretion to implement the measure in a WTO-consistent manner.[44] But the terms of the statutes/regulations provide no discretion or flexibility to any US Government official when low prices trigger the required marketing loan and counter-cyclical payments or when high prices lead payments to phase out temporarily. Rather, price levels are an eligibility condition for payment, similar to conditioning eligibility of a producer for contract payments on his not growing fruits and vegetables.

28. Objective conditions, such as market price movements, or objective eligibility criteria are not appropriately considered in determining whether a measure gives an implementing official "discretion" to act in a WTO-consistent fashion. For example, the FSC measure payments were only available where the income concerned was of foreign origin. Despite the fact that non-foreign sourced income would thus be excluded from FSC benefits, the measure was still found to threaten the circumvention of export subsidy requirements. Similarly, Step 2 payments are only available if an exporter is regularly engaged in the business of exporting upland cotton. The fact that a USDA official cannot legally make a Step 2 payment to a non-eligible exporter does not make the Step 2 programme "discretionary". And the fact that no marketing loan payments are available for upland cotton when the adjusted world price exceeds 52 cents per pound does not mean that the billions of dollars of payments made during MY 1999-2002, when prices were below that level, were "discretionary".

29. The United States argues that measures are "discretionary" if there are any conditions attached to payments – regardless of whether the executive official is permitted to exercise any discretion in refusing to make the payment. Such an interpretation would read out any meaning to the "mandatory/discretionary" distinction. Of course, at some level of abstraction, it is possible to create scenarios under which subsidies might not be paid. For example, the US Congress could decide to impose actual limits on CCC funding or change the 2002 FSRI Act to include a cotton "circuit-breaker" provision to limit cotton payments. But these theoretical possibilities do not make the existing mandatory text of the 2002 FSRI and 2000 ARP Act discretionary.

30. However, even if these existing texts were not mandatory on their face (which they are), the *US – Corrosion-Resistant Steel* decision teaches that the Panel must give weight to the long-term application of the measure to determine its normative character. The fact that billions of dollars in marketing loan, Step 2, counter-cyclical and direct payment were paid to US upland cotton producers, users and exporters of upland cotton over the past four years is highly relevant evidence for that determination. So is the fact that billions more will be paid before the 2002 FSRI ends in MY 2007. The provisions of these programmes have never been applied in a "discretionary" manner. Not a single eligible upland cotton farmer, user or exporter has been denied payment under these programmes by USDA officials. This is because there is simply no discretion vested in any US official to decide, independent of any objective market conditions or eligibility criteria, not to make these payments. Therefore, they are mandatory within the meaning WTO/GATT precedent, including the *US – Corrosion-Resistant Steel* decision.

(c) Does Brazil challenge as "mandatory" the "subsidies" themselves, the subsidy programmes or the legal/regulatory provisions for the grant or maintenance of those subsidies, or something else? BRA

Brazil's Answer

31. With respect to the Panel's question, Brazil does not believe that there is any difference between the "subsidy programmes" and the "legal/regulatory provisions" for the grant or maintenance of the subsidies.

[44] Appellate Body Report, *US – 1916 Act*, WT/DS132/AB/R, para. 100.

32. With respect to Brazil's "*per se*" claim, it challenges as "mandatory" the legal/regulatory provisions for the grant or maintenance of the subsidies.[45]

33. Brazil's "threat of serious prejudice" claim also challenges as "mandatory" the legal/regulatory provisions for the grant or maintenance of the subsidies. However, in this claim Brazil is not challenging the text of these provisions in the traditional "*per se*" sense, but rather under the rationale of the *EC – Sugar Exports* precedent. Under this claim, the mandatory nature of the atu implemr txt o provise tr)allekey eY 20 subdem trtof tt oan ongott ,2.75 TD -0.4375 Tc 00701 Tw (p972the)

unscheduled products. Under *US – FSC*, it does not appear to be relevant to this claim whether the CCC

the farm. These additionally allocated contract payments stem from contract payments made for other crops and not allocated to these other crops.

48. However, as with upland cotton contract payments, any contract payments for other crop base would be primarily assigned as support to the production of those crops. As with upland cotton contract payments, any other programme crop base payments are treated as support to those crops up to the amount of base acreage that is actually planted to the respective programme crop. Payments on any further base acreage for those programme crops are allocated to the crops for which planted acres exceed base acres. The following table illustrates this for Sample Farm 4:

Sample Farm 4

counting.[58] It also ensures that each contract payment dollar is allocated to a programme crop, as exemplified by the calculations for Sample Farms 5 and 6 below.

51. The first table shows the allocation of contract payments on Sample Farm 5, a farm with fewer planted (370 acres) than base acres (400 acres).

Sample Farm 5				
Crop	Cotton	Corn	Wheat	Rice
Crop Base	100 acres	100 acres	100 acres	100 acres
Crop Plantings	140 acres	120 acres	40 acres	70 acres
Crop Base Allocated as Support for the Crop in Question	100 acres	100 acres	40 acres	70 acres
Remaining Crop Base Available for Allocation	0 acres	0 acres	60 acres	30 acres
Crop Plantings To Which Additional Payments Will Be Allocated	40 acres	20 acres	0 acres	0 acres
Pooled Available Crop Base	60 Wheat Base Acres and 30 Rice Base Acres			
Allocated Share of Payments on Pooled Crop Base	40/60th or 2/3			

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PooTD -0.09 -5 5.25 TD /R11 5.25 f D 0 Tc 0.1875 Tw ( ) T2 24.701w ( ) Tj 12 2

Sample Farm 6				
Crop	Cotton	Corn	Wheat	Rice
Crop Base	100 acres	100 acres	100 acres	100 acres
Crop Plantingq	125 acres	125 acres	80 acres	80 acres
Crop Base Allocated as Support for the Crop in Question	100 acres	100 acres	80 acres	80 acres
Remaining Crop Base Available for Allocation	0 acres	0 acres	20 acres	20 acres
Crop Plantings To Which Additional Payments Will Be Allocated	25 acres	25 acres	0 acres	0 acres
Pooled Available Crop Base	20 Wheat Base Acres and 20 Rice Base Acres			
Allocation	100 Cotton Base Acres and 1/2 of 20 Wheat and 20 Rice Base Acres (10 and 10)	100 Corn Base Acres and 1/2 of 20 Wheat and 20 Rice Base Acres (10 and 10)	80 Wheat Base Acres	30 Rice Base Acres

53. In both cases, the contract payments on wheat and rice base acres that are not allocated to production of these crops (as current plantings are below the base acreage) are pooled. The resulting amount of contract payments is distributed as support to upland cotton and corn with the share of both crops corresponding to the ratio of plantings to which additional payments are allocated.[59]

54. This same principle would be applied for farms that have *no upland cotton base acreage*. For these farms, contract payments would be allocated to upland cotton solely from the pool of payments made on crop base not planted to the respective programme crop. This is illustrated in the table below (Sample Farm 7).

Sample Farm 7			
Crop	Cotton	Rice	Corn
Crop Base	0 acres	100 acres	100 acres
Crop Plantings	100 acres	50 acres	50 acres
Crop Base Allocated as Support for the Crop in Question	0 acres	50 acres	50 acres
Remaining Crop Base Available for Allocation	0 acres	50 acres	50 acres
Pooled Available Crop Base	50 Rice Base Acres and 50 Corn Base Acres		
Crop Plantings To Which Additional Payments Will Be Allocated	50 Rice Base Acres and 50 Corn Base Acre	0 acres	0 acres

[59] Additional payments will only be allocated to planted crop acres exceeding the amount of base acreage.

55. For Sample Farm 7 with no upland cotton base but 100 acres of upland cotton plantings, contract payments would be allocated from the rice and corn base not allocated to these crops. In this case payments on 50 rice and 50 corn base acres are allocated to upland cotton. On average, the per-acre payment from those crop base acres is similar to the amount of upland cotton base acre payments.

ANNEX I-11

ANSWERS OF THE UNITED STATES TO FURTHER QUESTIONS
FROM THE PANEL TO THE PARTIES FOLLOWING

controlled by annual appropriations acts and the outlays that result from that budget authority. "Direct" spending (commonly referred to as "mandatory" spending)[9] means budget authority and outlays resulting from permanent laws as well as "entitlement authority".[10] That is, whether spending is "mandatory" for purposes of the BEA is an accounting classification issue and does not control whether a measure is "mandatory" for a mandatory / discretionary analysis for WTO purposes.

7. The Office of Management and Budget classifies the export credit guarantee programmes as "mandatory" because the "budget authority is provided by law other than appropriation Acts".[11] As a result, although the export credit guarantee programmes are exempt from the ordinary requirement that budget authority be provided in advance through annual appropriations acts, they remain subject to the continuing availability of budget authority in law other than annual appropriations legislation. Of note, the Office of Management and Budget has also recognized: "While mandatory and discretionary classifications are used for measuring compliance with the BEA, *they do not determine whether a programme provides legal entitlement to a payment or benefit*"[12] (italics added). Thus, the classification of these programmes as "mandatory" for purposes of the BEA merely means that the budget authority is not "discretionary", that is, "provided in appropriation Acts".[13] This accounting classification does not alter CCC's considerable discretion in operating the programmes, as explained in more detail in the US answer to Question 257(d), and does not make the programmes "mandatory" for purposes of a mandatory/discretionary analysis.

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[9] See OMB Circular A-11 (2003), Section 20: Terms and Concepts (available at: http://www.whitehouse.gov/omb/circulars/a11/current_year/s20.pdf).

[10] This distinction between discretionary spending, mandatory direct spending and mandatory entitlement spending is reflected in the applicable statutory definitions. 2 U.S.C. Section 900(7) and 900(8) provide:

"(7) The term 'discretionary appropriations' means budgetary resources (except to fund direct-spending programmes) provided in appropriation Acts.

"(8) The term 'direct spending' means—
(A) budget authority provided by law other than appropriation Acts;
(B) entitlement authority; and
(C) the food stamp programme

[11] 2 U.S.C. 900(8).

[12] OMB Circular A-11 (2003), Section 20.9 (emphasis added).

[13] 2 U.S.C. 900(7).

ANNEX I-12

BRAZIL'S COMMENTS ON THE 22 DECEMBER US COMMENTS CONCERNING BRAZIL'S ECONOMETRIC MODEL

20 January 2004

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"Farm Groups Shocked at UC Economist's Testimony in WTO Dispute," Western Farm Press, 2 September 2003.	Exhibit Bra- 396
"Report of the Commission on the Application of Payment Limitations for Agriculture," August 2003.	Exhibit Bra- 397
Western Farm Press, 7 January 2003	Exhibit Bra- 398
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List of Publications of Professors Babcock and Beghin	Exhibit Bra- 400

I. BRAZIL'S INTRODUCTORY COMMENTS

1. Brazil's response to the US 22 December 2003 Comments Concerning Brazil's Econometric Model ("US Critique") is divided into two parts. First, Brazil provides some introductory comments setting the US Critique into perspective. And, second, Brazil offers Professor Sumner's detailed response to the US critique.

2. The United States Critique initially focuses on proving a point that has never been contested by Brazil, i.e., that the Sumner model is not exactly like the FAPRI model. As Professor Sumner points out, he never claimed that his model was identical to the FAPRI model. The United States points to no contradictions between what Professor Babcock has stated and what Professor Sumner stated in Annex I or his other statements concerning the links between his model and the FAPRI model. Nevertheless, while there are differences between the Sumner model and the FAPRI model, the record is undisputed that the core elements of the FAPRI model – the hundreds of demand and supply equations – are identical. The differences in Professor Sumner's model are primarily the result of his use of the CARD international cotton model and additions to the FAPRI model made by Professor Sumner. The additions were necessary to enable the FAPRI/CARD modelling framework to respond to the questions before this Panel.

3.

(presumptively trade- and production-distorting) subsidies paid to current producers of upland cotton and allocated as support to upland cotton had no effect on upland cotton production has been, and remains today, incredible. The United States has never explained why upland cotton base acreage payments are so much higher than other programme crops (except rice). The obvious reason is that Congress and the NCC expected the bulk of acreage historically planted to upland cotton to continue to be planted to upland cotton, a high-cost crop. Nor has the United States been able to explain how there could be no production effects when US upland cotton producers would have lost $332.79 per acre over a six-year period if they had received no contract payments.[11] NCC representatives stated that these payments were "critically needed"[12] to "make ends meet"[13], i.e., to cover their cost of production.

5. In fact, Professor Sumner has been, in the view of Brazil, probably overly conservative in his estimation of the effects of these contract payments on US upland cotton production. Brazil notes that the nature of Professor Sumner's modelling does not permit an assessment of the cumulative losses such as the $332.79 per acre over a six-year period. Even Professor Sumner acknowledges that his use of only $0.25 of each direct payment dollar as having production effects is probably low in light of the obvious impact of this subsidy in supporting the continued survival of many US producers.[14] Similarly, Professor Sumner's use of only $0.40 of each counter-cyclical payment dollar as having production effects[15] is also low in light of the fact that $1 billion in payments in MY 2002 were crucial to the economic survival of many upland cotton producers. In light of the evidence produced by Brazil, the US Critique that Professor Sumner's analysis is fundamentally wrong for not concluding that these huge subsidies, filling almost half of the cost-revenue gap, have no effects is completely unjustified.

6. The United States Critique also expresses amazement that Professor Sumner could attempt to model the effects of export credit guarantees. The fact that FAPRI has not yet modelled this subsidy is completely irrelevant. Nor is Professor Sumner blazing new economic ground by modelling export credit guarantees. The NCC has a team of economists working with the United States on this dispute, headed by Gary Adams, a former FAPRI economist who worked on the FAPRI upland cotton model.[16] NCC economists concluded in 2001 that major changes to the GSM 102 programme would result in 500,000 fewer bales being exported from the United States and result in a 3 cent per pound increase in prices.[17] It is curious that the United States, assisted by NCC economists, now seeks to contradict the conclusions of the beneficiaries of this GSM 102 programme by asserting that there were no production, export or price effects from this subsidy. The NCC's 2001 findings, which Professor Sumner used conservatively to estimate the production, export and price effects of the export credit guarantee programmes, was supported by the fact that $1.6 billion in US upland cotton exports between MY 1998-2002 were covered by GSM 102 export credit guarantees.[18] Further support for the NCC's 2001 estimate comes from the US Congressional Research Service that concluded that guarantees have "mainly benefited exports of wheat, wheat flour, oilseeds, feed grains

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[10] This figure is based on Brazil's estimates at paragraph 8 of its 9 September 2003 Further Submission as updated by the table at paragraph 8 of its 22 December 2003 Answers to Questions.

[11] Brazil's 2 December 2003 Oral Statement, para. 27.

[12] Brazil's 22 July 2003 Oral Statement, paras. 52-54 and 58-60 and exhibits cited therein.

[13] Exhibit Bra-324 (NCC Chairman's Report by Kenneth Hood, 24 July 2002, p. 2).

[14] Brazil's 9 September 2003 Further Submission, Annex I (paras 48-51 setting out high and low estimates of production effects for the four contract payments).

[15] Brazil's 9 September 2003 Further Submission, Annex I (paras 48-51 setting out high and low estimates of production effects for the four contract payments).

[16] *See* Exhibit Bra-395 ("Trade Issues Facing the US Cotton Industry," Speech by Dr. Mark Lange, President and CEO, National Cotton Council, San Antonio, 6 January 2004), Lange noted that Gary Adams had spent "countless hours" working with USTR on the Brazil upland cotton dispute.

[17] Exhibit Bra-41 ("The Future of Federal Farm Commodity Programmes (Cotton)," Hearings before the House of Representatives Committee on Agriculture, 15 February 2001, p. 12).

[18] Brazil's 9 September 2003 Further Submission, para. 188.

and cotton".[19] Andrew Macdonald has also testified to the export-enhancing effects of the US GSM 102 programme.[20] In its evaluation of the US Critique's claim that Professor Sumner – and the 2001 NCC economists – incorrectly estimated the effects of removing the GSM 102 subsidies, the Panel must consider this uncontested evidence.

7. The United States Critique also challenges Professor Sumner's modelling of the effects of removing crop insurance subsidies. The US Critique focuses primarily on the fact that FAPRI has not yet modelled these subsidies.[21] But this is irrelevant. What is relevant are the facts which show that $788 million in crop insurance subsidies were provided to upland cotton producers between MY 1999-2002.[22] And it is relevant that USDA's own economists found that lower pre-2000 ARP Act crop insurance subsidies had significant production and price effects for upland cotton (as opposed to other programme crops).[23] Current higher crop insurance benefits under the 2000 ARP Act would certainly have higher effects. Professor Sumner's crop insurance modelling is also consistent with USDA's own economists' conclusion that the "availability of subsidized crop insurance affects farmers' current crop production decisions by creating a direct incentive to expand production".[24] It is uncontested that the amount of crop insurance subsidies received by upland cotton producers is directly related to the amount of upland cotton they plant.[25] Given this evidence, it was reasonable for Professor Sumner to conclude that each dollar of crop insurance subsidies had direct effects on US production.

8. With respect to Professor Sumner's modelling of marketing loan payments, the US Critique is essentially silent.[26] This silence is no doubt due to the fact that Professor Sumner's model uses exactly the same elasticities and estimates of effects as the FAPRI model, for which the United States has indicated it has no objection.[27] Further, Professor Sumner's findings regarding the effects of marketing loan payments between MY 1999-2002 are very much consistent with those of Westcott/Price who found that in MY 2001 that marketing loan payments caused 3 million additional

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the attention of US producers who depend on marketing loan payments – the adjusted world price (AWP).[31]

9. Nor does the US Critique find any fault with Professor Sumner's analysis of the Step 2 subsidies.[32] Brazil notes that Professor Sumner models the effects of Step 2 domestic and export subsidies in exactly the same manner as FAPRI. Professor Sumner's Step 2 analysis is also completely consistent with the overwhelming evidence that Step 2 export and domestic subsidies have significant production, export, and world price effects. As with the GSM 102 subsidies, the NCC has been quite vocal in praising the production and export effects of the Step 2 subsidies.[33] There would simply be no basis for the United States to contradict these testimonies from the users and beneficiaries of the Step 2 programme.

10. The Panel must also assess the validity of the US critique in view of the overwhelming non-econometric evidence that the US subsidies had significant production, export and price effects.[34] For example, the Panel must ask whether it is reasonable to conclude, as the United States argues, that $12.9 billion dollars in amber box, presumed trade-distorting subsidies had no effect on US production, US exports, and world prices. It is further uncontested that USDA's own data shows that the average US upland cotton farm would have lost $872 per acre during MY 1997-2002 – but had a "profit" of $106 per acre when subsidies are included in their revenue.

11. Further, the Panel must also examine the US Critique of Professor Sumner's analysis in light of the evidence of other econometric studies examining the effects of removing US upland cotton subsidies. The United States has argued that all these studies – including USDA's studies – were wrong in finding significant production, export, and price effects. Would the United States also argue that all of these other economists analyzed the US upland cotton subsidies and their effects on the (world) upland cotton market "for the express purpose of achieving pre-conceived results"?[35] Brazil submits that a common sense analysis of these other studies, including USDA's own studies, shows that Professor Sumner's results are both valid as well as conservative. They are certainly within the ranges of the other econometric studies in the record and consistent with what would be expected given the non-econometric evidence in the record.

12. Finally, Brazil notes US suggestions that Professor Sumner made modelling choices "for the express purpose of achieving pre-conceived results"[36] and "in order to exaggerate acreage and ultimately price impacts".[37] These are offensive and inappropriate charges directed at one of the world's leading agricultural economists. Members of the NCC admitted that "Dr. Sumner is a brilliant economist" who is "well-respected" and a "widely recognized UC [University of California] economist" who is a "confidant to the administration on trade and other issues".[38] Personal attacks by the United States against Professor Sumner's integrity are ironic given the fact that only seven months ago he was one of only two private US economists to be asked by the Chairman of the US

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[31] *See* Brazil's 2 December 2003 Oral Statement, paras. 42-55.

[32] The United States points out a typo (US 22 December 2003 Comments on Brazil's Econometric Model, paras. 76) that did not affect the actual analysis undertaken by Professor Sumner (*see* below, Comments on Section VI).

[33] For an example of the extensive evidence supporting this fact, *see* Brazil's Further Submission, paras. 141, 178-180.

[34] *See inter alia* Brazil's 9 September 2003 Further Submission, Sections 3.3.4.1-3.3.4.6; Brazil's 7 October 2003 Oral Statement, Section 2; Brazil's 18 November 2003 Further Rebuttal Submission, Sections 3.1-3.4, 3.7; Brazil's 2 December 2003 Oral Statement, Section 5.

[35] US 22 December 2003 Comments on Brazil's Econometric Model, para. 9.

[36] US 22 December 2003 Comments on Brazil's Econometric Model, para. 9.

[37] US 22 December 2003 Comments on Brazil's Econometric Model, para. 1. *See* also para. 38.

[38] Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute," Western Farm Press, September 2, 2003)(quoting Earl Williams, President of California Cotton Ginners and Growers Association).

Commission on the Application of Payment Limitations for Agriculture, Chief USDA Economist Keith Collins, to testify before that Commission. In evaluating the effects of additional payment limitations, the Report of the Commission relies, inter alia, on the testimony and advice provided by Professor Sumner.

his work in this dispute.[45] To their credit, these U.C. Davis officials have refused to bend to the pressure.

15. As Dr. Lange's statements quoted above indicates, the NCC now has focused on Professor Babcock for his very limited role in working with Professor Sumner in the application of parts of the

II. PROFESSOR SUMNER'S COMMENTS CONCERNING THE US CRITIQUE OF HIS MODEL

Response to "Comments from the United States of America
Concerning Brazil's Econometric Model" dated December 22, 2003

Daniel A. Sumner

20 January 2004

18. This response to the US critique of the modelling work on US cotton subsidies conducted by myself and my colleagues addresses each of the US comments in the order in which they appear in the US critique submitted on 22 December 2003. However, let me start with some general comments I feel are in order.

19. Much of the US critique repeats the description of my adaptations to the FAPRI model, as provided in Annex I and subsequent documents.[47] The model I developed was based on the core domestic crops model of FAPRI with several additions and modifications to fit the questions before this Panel. I stated in detail where my model made those additions and modifications.[48] Thus, these US comments add nothing by reasserting that my model was not identical to the FAPRI model. Since I never claimed that my model was the FAPRI model, I frankly do not understand the point of these repeated assertions that are written as though they were exposing some revelation.

20. Second, the United States at least three times asserts claims about my motivations for modelling choices. Twice in the very first paragraph the United States asserts that my modelling choices were made "in order to exaggerate" acreage and price impacts. Then in paragraph 9, the United States asserts that my modelling choices were made, "for the express purpose of achieving pre-conceived results". I am puzzled how the United States would claim to have any evidence about my motivation. But more important, these statements suggest seriously immoral and unprofessional behaviour on my part. This is a very serious charge that I do not take lightly. I submit that besides being simply wrong, such attacks have no place in these proceedings.[49] 67 180.75 7 0 TD - TcCl thougS677 T

21. Most of the substantive issues raised in the US critique are simply re-

Section II

22. Paragraphs 5 to 11 of the US critique are devoted to reasserting what I stressed in Annex I that was submitted many months ago, namely that I made adaptations to the FAPRI modelling framework. As I have explained, the FAPRI framework alone was not appropriate for the analysis of the questions before this Panel and therefore I modified and supplemented the framework. However, let us put these modifications and additions in perspective. Of the hundreds of equations used to compute the results, almost all are directly taken from the FAPRI domestic crops model. The basic behavioural supply and demand equations are taken directly from the FAPRI model as are the elasticities used to quantify those equations. In Annex I, and in subsequent documentation[51], I tried to avoid taking credit for work that was not mine. At the same time, I tried to be clear about the distinctions between my work and that of FAPRI and CARD.

23. Professor Bruce Babcock from CARD – with whom I worked together in his private capacity – provided a letter to Congressional staff economists[52]

Section II. A.

26. The heading of this section is oddly contradicted by its content. The heading says the "Brazil Model Not Comparable to the FAPRI System", yet the next three paragraphs proceed to compare these two models. Several incorrect assertions are included here, but these are repeated in more detail in later sections and so are dealt with bebw. However, one clarification is important to make both here and below. Whereas the FAPRI system does not include separate explicit provisions for crop insurance and export credit guarantee programmes, this does not imply that the FAPRI system assumes that there are zero supply impacts of these programmes. Rather, effects of these programmes are imbedded in the baseline of the FAPRI framework.

27. If the FAPRI system had been posed questions about the impacts of crop insurance or export credit guarantee programmes, the natural approach would be to proceed as described in Annex I and in subsequent submissions: to ask how a new scenario with these programmes removed would differ from the baseline that includes these programmes. This procedure was precisely what FAPRI analysts did when they analyzed payment limit rules for the Commission on Payment Limitation in analysis presented in June 2003.[56] The FAPRI framework also does not contain any explicit provisions on payment limitations. These were added to the system for the analysis of the effect of payment limitations, much as I added equations on crop insurance and export credit guarantees for purposes of my Annex I analysis.

28. It is simply wrong to assert that, because a programme is not identified separately in the FAPRI framework, its effects must be assumed to be zero. Furthermore, as discussed further below, in some cases the best evidence on the impact of a programme is from the users of that programme. This was my judgment about the impacts of the export credit guarantee programmes. It certainly makes no sense whatsoever to assume that a programme has zero effect, simply because its impacts, which are known to be positive, are difficult to quantify precisely.

Section II.B.1

29. I explained in great detail the basis for my approach to PFC, DP, MLA and CCP payment programmes.[57] Clearly I disagree with the assertion made in paragraph 16 and 17. There is no new content here and there is no reason to repeat my argument and evidence. I note, however, that no "official" FAPRI analysis of these payment programmes has asked the question how acreage would respond if cotton programmes were removed while the payments for the other programme crops remained in place. The FAPRI analysis is concerned with the very different question of what would be the impact for all crops if the payment programmes were removed for all crops simultaneously. Therefore, I had to make some adjustments to the treatment of these programmes, as the question that faces this Panel could not be answered by the traditional FAPRI framework. In addition, as footnote

[56] *See* for example, FAPRI analysis FAPRI-UMC Report #05-03 and #06-03 to be found at http://www.fapri.missouri.edu/FAPRI_Publications.htm and partly reproduced in Exhibit Bra-228.

[57] Annex I, paras. 37-51; and my oral statements on 22 July (Exhibit Bra-105, paras 20-33), 2 December (Exhibit Bra-342, paras 31-37) and my closing statement on 9 October (Part 4); Exhibit1; and 2.8248 s67 Tc 0 T

57 highlights, my judgment is that the programmes all have some commodity-specific acreage impact for cotton.

30. The table referred to in paragraphs 21 through 24 simply shows that when the planting impact of these payment programmes for cotton are assumed to have no specific impact on cotton acreage, but only a broad and diffuse effect on all programme crops, then the resulting acreage impact will indeed be nearly zero.

Section II.B.2

31. Annex I as well as subsequent submissions and oral discussions with the Panel have explained in detail my approach to the production impacts of crop insurance and why my approach, for example by leaving out risk reduction impacts, is conservative.[58] The approach is straightforward. The crop insurance subsidy lowers costs to cotton growers and the acreage impact of lower costs in percentage terms may be calculated by multiplying the lower per acre costs by the elasticity of supply. The FAPRI framework has not been used to assess the production impacts of crop insurance. But the impacts of crop insurance subsidies are implicit in the FAPRI baseline.[59] My approach made the impacts explicit so that I could assess the acreage effects of removing the subsidy. This is discussed in somewhat more detail below.

32. Paragraphs 25 through 30 and the table referred to there simply repeat the US claim that hundreds of millions of dollars of crop insurance subsidies for cotton producers has had zero effect on farmers' choices to grow cotton. I disagree and my model has quantified these impacts using FAPRI elasticities and other features of the FAPRI US crops model.

33. Not withstanding the "intuition" of the United States, the analysis that underlies paragraph 29 of the US critique is evidence of faulty economic reasoning. Furthermore, the US claim about how the FAPRI model treats crop insurance subsidies is misleading at best.[60]

Cotton Councils estimates, as explained in detail in response to questions from the Panel[61], and as the US acknowledges in footnote 17 to paragraph 32 of its critique. The National Cotton Council testified that the impact on export was 500,000 bales and the impact that I estimate is considerably smaller. I use my model, based significantly on FAPRI elasticities and other parameters to calculate the price, acreage and other impacts of the initial shift of 500,000 bales. This resulted in much lower net impacts on price and export quantities than estimated by the National Cotton Council. [62]

Section III

35. In paragraphs 35 through 38 of the US critique, the United States points out that the baseline prices reported in Annex I are not the same as baseline prices provided to the United States by Professor Babcock on November 26 as part of the model documentation.[63] The United States implies that I have manipulated the baseline to generate higher effects.[64] This allegation has no basis whatsoever.

36. The documentation delivered by Professor Babcock[65] was the FAPRI US crops model that was calibrated with the system of FAPRI international crops models to reproduce the FAPRI November 2002 preliminary baseline projections. The Annex I analysis began with these FAPRI November 2002 preliminary baseline projections. However, the Annex I results were developed by linking the FAPRI US crops model with the CARD international cotton model that was developed by researchers at Iowa State University. Unfortunately, the description of the baseline in Annex I and subsequent submissions was imprecise by not making this distinction explicit. Instead, I labelled the baseline as an (unpublished) FAPRI November 2002 preliminary baseline rather than a slight modification thereof. This slight modification was required for internal consistency reasons, as explained below.

37. The table below provides a full comparison of the differences in the baseline reported in Annex I and the FAPRI November of 2002 preliminary baseline. As can be seen, they are different but those differences are very small overall.

38. There are two reasons for the small differences between the baseline projections used in the Annex I analysis and reported in Annex I and the November 2002 FAPRI preliminary baseline projections. The first was caused by the need to calibrate the CARD cotton model rather than the FAPRI international model with the US crops model. Consistency with the CARD international cotton model implied very small changes in the baseline. The second source of difference was that new macroeconomic projections became available in late November, 2002. These new macroeconomic projections were incorporated into the CARD international cotton model. I stress that the equations of the FAPRI US crops model were not changed in any way. Again, the slight changes between the baseline projections are solely a result of the calibration of the model, once with the FAPRI international crops models (FAPRI preliminary November 2002 baseline) and once with the CARD international cotton model (Annex I model), as well as the updated macroeconomic data used.

39. To put this baseline issue in perspective, Brazil has provided the Panel with several sets of results from similar models on several alternative baselines, including the official FAPRI 2003

[61] Brazil' Brazil"

baseline.[66] The bottom line is that these results are extremely robust to those alternative baselines and slight modifications to modelling specifics.

40. The same robustness applies to [illegible]

Comparison between baseline projections

	2003	2004	2005	2006	2008
	Planted Area (million acres)				
Annex I baseline	13.7802	14.8798	14.7722	14.6525	14.2744
FAPRI baseline	13.7820	14.7205	14.7716	14.6584	14.2519
	Harvested Area (million acres)				
Annex I baseline	12.0444	13.0666	12.9761	12.8739	12.5282
FAPRI baseline	12.0462	12.9164	12.9751	12.8791	12.5068
	Yield (bales per acre)				
Annex I baseline	1.3325	1.3328	1.3410	1.3494	1.3579
FAPRI baseline	1.3325	1.3328	1.3408	1.3492	1.3578
	Production (million bales)				
Annex I baseline	16.0497	17.4157	17.4010	17.3715	17.0121
FAPRI baseline	16.0519	17.2152	17.3974	17.3769	16.9818
	Free Stocks (million bales)				
Annex I baseline	4.9155	4.6527	4.3863	4.3458	4.0330
FAPRI baseline	4.8188	4.4349	4.2145	4.1920	3.8837
	Imports (millions bales)				
Annex I baseline	0.0050	0.0050	0.0050	0.0050	0.0050
FAPRI baseline	0.0050	0.0050	0.0050	0.0050	0.0050
	Mill Use (million bales)				
Annex I baseline	7.7825	7.7018	7.6339	7.5896	7.5245
FAPRI baseline	7.7429	7.6547	7.5968	7.5532	7.4927
	Exports (Million bales)				
Annex I baseline	9.7667	9.9817	10.0384	9.8275	9.8054
FAPRI baseline	9.9042	9.9495	10.0260	9.8513	9.8024
	Season Average Price ($/lb)				
Annex I baseline	0.450	0.477	0.503	0.512	0.539
FAPRI baseline	0.457	0.488	0.512	0.520	0.547
	A Index Price ($/lb)				
Annex I baseline	0.507	0.534	0.558	0.576	0.596
FAPRI baseline	0.524	0.547	0.568	0.587	0.605
	Adjusted World Price ($/lb)				
Annex I baseline	0.372	0.398	0.419	0.436	0.455
FAPRI baseline	0.387	0.410	0.428	0.446	0.463
	Step 2 Payments ($/lb)				
Annex I baseline	0.057	0.060	0.063	0.047	0.052
FAPRI baseline	0.054	0.060	0.063	0.047	0.052

Section IV

43. In section IV of the US critique, the United States claims that my model does not forecast future or explain historical outcomes of cotton plantings and that variables, such as the ratio of soybean to cotton futures prices, are more highly correlated to acreage variations in the seven years from 1996 to 2002.[74] The United States claims that this has some relevance for the validity of my model and its simulation results. These claims are seriously flawed.

44. Section IV of the US critique demonstrates a complete lack of understanding of the role of policy simulation models. A policy simulation model is not designed to and does not have the capability of forecasting. Policy simulation models are designed to ask "but for" counterfactual questions not to attempt to replicate a specific history or forecast the future. Specific statistical tools

[74] *See inter alia* paragraphs 39-42 of the US critique. This is the entire theme of section IV.

apply to forecasting economic time series – generally based on some variant of regression analysis – to forecast/predict future or explain historic outcomes of, for instance, cotton plantings. Contrary to the assertion of paragraph 39 of the US critique, no professional economist would ever propose a simulation model designed to consider the impacts of policy alternatives as the appropriate tool for forecasting the future or for explaining historical data for an industry. I certainly would never propose the use of a policy simulation model for forecasting purposes.[75]

45. I begin my response to the US critique in section IV by noting that – as I understand it – the questions before the Panel relate to the analysis of the effects of the US cotton subsidies, not to predict cotton plantings for future marketing years.[76] The simulation model that I have presented in Annex I and in later submissions to the Panel addresses exactly that first question before the Panel. Given the baseline that covers historical data for marketing years 1999-2001 and projections for marketing years 2002-2007, my simulation model asks what would have been or what would be the effects of removing the US subsidies on US acreage, use and exports of cotton as well as on cotton prices and other variables.

46. The United States is wrong when it implicitly claims that the ability of a policy simulation model to forecast or account for variations in a time series provides any useful guide to its reliability in terms of the simulation results that it generates – for example in assessing what may happen if

50. A simple illustration may clarify the point that statistical regression models and policy simulation models serve different purposes. Consider a period in which a large direct production subsidy was in force, but the parameters of the programme did not change. Given changes in climate, agronomic factors or other economic incentives, planted acreage would change over the period, but none of the changes in acreage would be due to changes in the subsidy, because there were none. The result of any time-series regression analysis of a limited number of data points is incapable of isolating the effects of variables, such as subsidy programmes, that do not change considerably during the period under analysis. Other variables would explain the variation in acreage over the period and would be better predictors of future acreage shifts so long as the large subsidy programme remained unchanged.

51. But does this mean that the large direct production subsidy is irrelevant to planted acreage? No, of course not. Does this mean that a model to consider the amount of acreage that would be planted, but for the subsidy, should assume the subsidy was irrelevant? No, of course not. Therefore, a statistical regression (or correlation) model applied to analyze the effects of such "constant variables" would fail to capture their importance. In sum, only a policy simulation model, of the general sort that I have provided in Annex I w T5explain tequTj lrele thees

positive or negative, large or small, they have no statistical significance and provide no meaningful information.

55. In sum, the US statement at paragraph 50 of its critique has no basis whatsoever. As with all policy simulation models, including the FAPRI and USDA simulation models, any single factors or set of variables in my model are not necessarily expected to "explain" the time series data. The model was not designed to explain historic events or predict future outcomes. Instead my model is designed to simulate what would be expected to happen if US subsidies were removed. A test of the model would be to observe responses if subsidies were removed and other factors were held constant. Presenting a set of simple correlation coefficients on seven years of historical data over which subsidies remained in place provides no evidence of any relevance.

56. Finally, I refer the Panel to the many instances in which I have addressed the question of lagged prices used to model farmers' price expectations at planting time.[83] I will not repeat these arguments here to respond to the US criticism that I should have used futures market prices.[84] I would note that Brazil's submissions have thoroughly addressed the US arguments that US farmers planting decisions are made in accordance with futures market prices.[85]

Section V

57. This section of the US critique repeats again that my model differs from the FAPRI US crops model. It also asserts that the United States had difficulties in replicating results of my analysis from the electronic files. This section also reveals that the United States made several mistaken "assumptions" about how certain variables entered the model. As indicated before, given the complexities of working with these models, both Professor Babcock and I have repeatedly offered to work with the United States to replicate my results.[86] US government or other economists working on the US critique of my model could have contacted either Professor Babcock or myself requesting any needed information or assistance with any problems they have had. If they would have done so, we could have clarified any ambiguities and the United States could have avoided the evident errors made in applying my model. However, they did not contact either of us. As a result they made inappropriate assumptions and have failed to apply the model correctly.

58. Let me begin by addressing the US statements about the differences between the Annex I model and the FAPRI model.[87] The essence of those differences was explained in Annex I while the operational details were specified more precisely in Exhibit Bra-313. Annex I attempted to provide a relatively simple heuristic discussion of the modelling approach. Exhibit Bra-313 provided the model8

then apply this constant elasticity to the percentage effects of the subsidy on net revenue. This constant elasticity modelling is well established in the literature.[89] Paragraphs 53-56 of the US critique misstate the operational model I used and ignore the information in Exhibit Bra-313 that explains how the heuristic explanation in Annex I was operationalized.

Sections V.A to V.C

59. In sections V.A and V.B, the Unites States fails to acknowledge that, because the level of net returns vary from year to year, the constant elasticity specification explained in Exhibit Bra-313 means that the impacts of the PFC, MLA, DP, CCP and crop insurance programmes will vary as well. When one recognizes this commonly applied feature of my specification, there is no inconsistency whatsoever between the acreage impacts in the periods 1999 through 2002 and 2003 through 2007.

60. In fact, the United States acknowledges its understanding of the operational specifications explained in Exhibit Bra-313 in paragraphs 63 through 66 of section V.C. And they acknowledge that with constant percentage effect, the number of acres shifted will depend on the percentage impacts of the subsidies on net revenue, not the absolute dollar impacts. The US observations about the programme effects in section V.A (paragraphs 57-60), section V.B (paragraphs 61-62) and in the table that follows paragraph 62 of the US critique are explained by my explicit description of the operational specifications of the Annex I model in equations (4) through (6) in Exhibit Bra-313. It is therefore puzzling why the United States included Section V.A and V.B in the document at all, since they provide no new information. The United States first simply mischaracterizes my approach as linear, and then states that the results are not in line with that linear characterization. As I explained in Exhibit Bra-313 (equations (4) through (6)) and as repeated by the United States in section V.C, my model uses a constant elasticity, constant percentage effect for these impacts.[90]

61. Let me clarify this a little further. The FAPRI US crops model applies a constant linear response to any added revenue. My Annex I model takes the same approach for all variables that are included from the standard FAPRI US crops model. This refers to all variables for which no modifications are reported in Exhibit Bra-313. The FAPRI linear system means that a $100 increase in subsidy has the same effect on acreage whether the base revenue is $200 or $1,000. My alternative approach is used for PFC, MLA, DP and CCP payments as well as crop insurance. It implies that a subsidy that is a constant 10 percent of net revenue has a constant percentage effect on acreage. Hence, a $100 increase in subsidy has a bigger percentage effect on acreage if base revenue were $200 (a 50 per cent increase) than if base revenue were $1,000 (a 10 per cent increase). Constant percentage impacts and constant elasticity models are far more common in the economics literature than are strictly linear models. Constant percentage effects do not imply larger impacts in general. In effect, a constant percentage effect says that subsidies have a bigger acreage effect when they are a bigger share of net revenue than when they are a smaller share of net revenue.

62. Section V.B on crop insurance contains some additional US mistakes in applying my model. The United States seems to apply a constant per-acre crop insurance benefit for all regions. This is inconsistent with my approach and with reality. As explained in paragraphs 54 and 55 of Annex I, crop insurance subsidy rates differ substantially by region and my model incorporates those differences. When the constant percentage effects are incorporated and when one applies the different regional subsidy rates, there is absolutely no inconsistency between the results in the period from 1999 through 2002 and the period 2003 through 2007.[91]

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[89] *See*

Section V.D.

63. The point of paragraphs 67 and 68 and the table to which they refer, which follows paragraph 70 ("Example of Southern Plains Acreage Impact"), are not at all clear. Most importantly, the United States is simply incorrect that I used only market revenue plus marketing loan gains as the basis for the percentage calculation.[92] The full net revenue including all programme payments are included in the model specification. It is not clear why the United States made this mistaken assumption.

64. In addition, the labelling of the table itself is not clear. For example, neither Annex I nor my other submissions include regional acreage effects of subsidy programmes. This is because the focus of this case is on national and international impacts. It appears that it was the United States which calculated the figures reported in the table following paragraph 70 ("Example of Southern Plains Acreage Impact"). I note that the marketing year 2005 planting effect of crop insurance in the Southern Plains that the United States labels "Sumner Impact" exceeds the effect I report in Annex I for the entire United States.[93] This reason for this seems to be that the United States presents first round effects, i.e., effects before any feedback effects (second-round effects) from both the US crops model itself as well as before any feedback from the CARD international cotton model. To be clear, these US figures are not the equilibrium figures that I reported in Annex I. They are also not the first-round effects that were intermediate for the results reported in Annex I because of mistaken US assumptions, as discussed below.

65. Further, the column (2) of the US table at paragraph 70 ("Example of Southern Plains Acreage Impact") is labelled "Programme Revenue," yet includes crop insurance. I assume this refers to the total subsidy per acre, not programme revenue. Also, the "programme revenue" only includes revenue from DP and CCP payments as well as crop insurance. No revenue from the marketing loan programme (10.06 cents per pound in MY 2005 pursuant to an AWP of 41.94 cents per pound reported in the baseline)[94] is included in the calculations. By not including marketing loan payments in its calculations, the United States does not follow its own proposition of what the right approach is.[95] Rather, it has excluded marketing loan revenue entirely from its calculations in the table at paragraph 70 of its critique ("Example of Southern Plains Acreage Impact"), leading to distorted elasticity calculations.

66. There are a number of further problems in the examples the United States provides in the tables at paragraph 70 of the US critique ("Example of Southern Plains Acreage Impact") that seem to account for the differences they have created by misapplying my model. Let us use the crop insurance calculations as an example. I calculate that the Southern Plains crop insurance subsidy is $26.14 per acre, not $24.67 per acre[96], as the United States enters into its table in the "programme revenue" column. Furthermore the acreage elasticity that I use is not 0.28, but rather 0.362. These

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the accompanying table). This is, however, not true. Net crop insurance subsidies in the Corn Belt were negative over time, with indemnity payments being below premium payments. Therefore, the program provided farmers with a net negative return causing negative acreage impacts. This is an entirely plausible result. *See* below the discussion on the amount of crop insurance subsidy payments (at paragraph 66, note 96 below). I also note that cotton is not an important crop in the Corn Belt and that crop insurance benefits in the more important regions in the Southern Plains and in the Southeast are much higher.

[92] *See* paragraph 68 of the US Critique.

[93] *Compare* the 0.446 million acres reported by the United States without offering any source with the results I have reported in Annex I, Table I.5d, which is 0.420 million acres.

[94] *See* Annex I, Table I.5a.

[95] *See* paragraph 68 of the US Critique.

[96] The regional crop insurance subsidy rates that I use are as follows: Corn Belt: -$0.70; Central Plains: $28.24; Delta: $7.37; Far West: $13.62; Southeast: 15.71; Southern Plains: 26.14.

two further obvious errors in the US application of my model account for the bulk of the differences that the United States seems to imply (incorrectly) were errors on my part.

67. Besides this, the table following paragraph 70 of the US critique ("Example of Southern Plains Acreage Impact") not only contain numbers that are not my reported impacts, they also make the serious conceptual error of simply adding the impact of each programme across the columns to get a "total" effect. This is an error because the effects of the programmes are not independent. In order to estimate the impacts of removing these three sets of programmes together, one must simulate that scenario explicitly. The resulting impacts will be smaller than the sum of the impacts of removing each programme one at a time. For example, if one removed the crop insurance programme for cotton, supply would fall and the market price of cotton in the United States would rise. This would imply that the CCP programme would have a smaller subsidy element and its effect would be smaller. The fact that the United States reported the simple sum of impacts across programmes and represented that as the impact due to the three sets of programmes together seems to demonstrate either an inadvertent error or a basic lack of understanding of how the programme and the model operates.

Section V.E

68. There are several problems and inconsistencies in the discussion and tables included in this section. Thesas2rj 3.75 ns3 spply to the caldPed in rogwsdp1

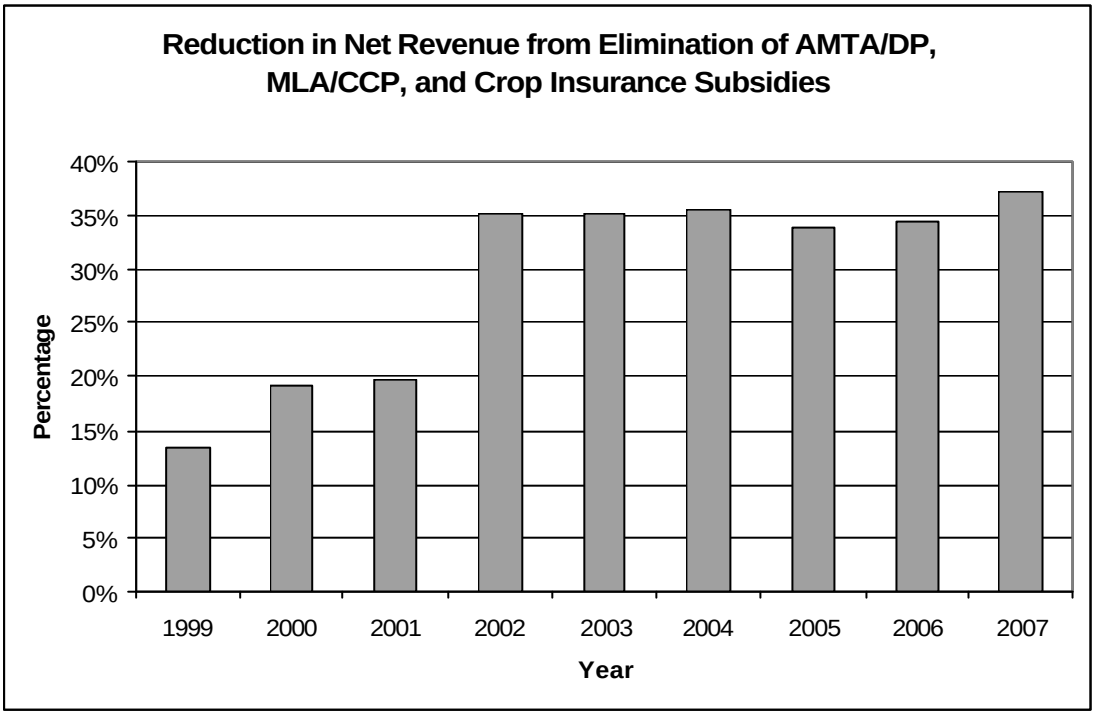
of these listed programmes are, however, based on a constant elasticity structure. As I will show, the US implementation of the United States' method using time-varying, linear elasticities is deeply flawed and leads to a dramatic underestimation of the effects. To clarify this step by step, I take as a starting point the US implementation of my Annex I methodology.[101]

72. The United States calculates time-varying, linear elasticities by multiplying the slope coefficient in the FAPRI US crops model by real net revenue (net revenue divided by a GNP deflator) and dividing the result by base acreage.[102] Net revenue used in this calculation is expected market revenue plus marketing loan gains. Contrary to the US approach and as discussed above, I use a set of 4uoir6i7f0.4fno by ba 0 Tc 0.1875 nj

75. I note that the effects reported in chart 1 are quite similar to the pattern of effects presented by the United States, as reported in the charts following paragraph 72 of the US critique.[105] I have included the aggregate effects from these three programmes, controlling for interaction effects between them, which accounts for the differences between my figures and the sum of the figures presented by the United States.

76. I also note that, in chart 2, the pattern of acreage effects estimated by my use of a constant elasticity model specification[106] is consistent with the pattern of the importance of these subsidies, i.e., the share of the total net revenue presented by these subsidies.

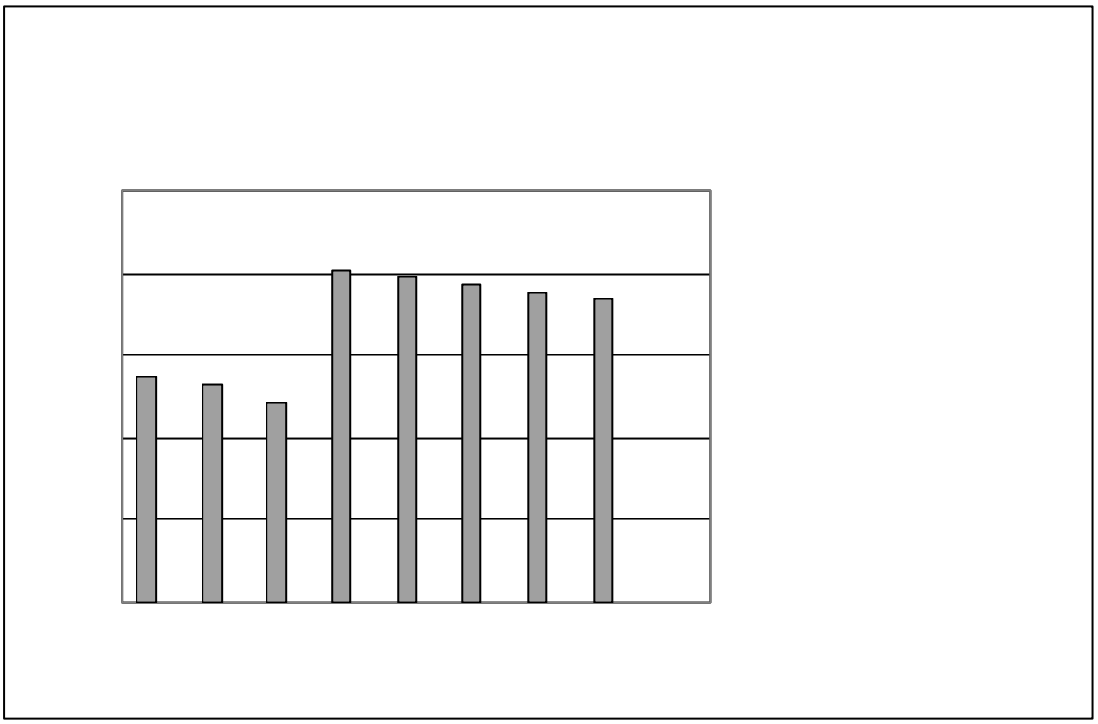
Chart 2



77. The results in chart 1 would suggest that most of the discrepancy between the first-round effects that lead to my Annex I results and those first-round effects calculated by the United States is due to different assumptions regarding elasticities.

78. However, it is not true that the difference in the assumptions regarding the elasticities does primarily account for the difference. First, there is much less difference between the results from the two assumptions regarding the elasticities once an error in the United States' method for calculating its time-varying, linear elasticities is correcte

Chart 4



84. It turns out that, contrary to what the United States implies in paragraph 74 of its critique, this typo introduced no ambiguity at all and would not have affected the results in any significant way. The fact is that the loan rate for cotton is essentially constant over the full period of analysis and, thus, the loan rate in period 't' is equal to the loan rate in period 't-1'.[114] Despite the tone of the paragraph, the model was clear, and the subscript 't' or 't-1' make no difference at all in this case. Yet, I stress again that this typo only occurred in the transcript of equation (2) in Exhibit Bra-313, and not in the electronic versions of the Annex I model itself.

85. In paragraph 74 the United States makes a major issue of what amounts to their own semantic confusion. The model that I use for the marketing loan benefits for cotton is as specified in equation (2) (noting the typo discussed above). As noted by the United States, the electronic versions of the models show that the marketing loan effect is based on the difference between the loan rate and what is labeled as the loan repayment rate. For crops other than rice and cotton the loan repayment rate is the US market price of the crop (a local market price). For cotton and rice the loan repayment rate is an international price and, for cotton specifically, it is the adjusted world price (AWP). Thus, there is no discrepancy between Exhibit Bra-313 and the electronic documentation provided. The formulation that I use for the marketing loan impacts is the same as the FAPRI US crops model.

86. Paragraph 75 of the US critique simply repeats their discussion from the section V.C., which I have addressed above.

87. Finally, in paragraph 76 of its critique, the United States alleges that I have taken an "illogical" approach on specifying the export effect of Step 2 payments that constitutes "a departure from the specifications in the FAPRI framework." Similar to my response to the US critique at paragraph 73, I regret that I made another typo in the subscript in Exhibit Bra-313 that was not included in the electronic version of the model and, therefore, does not affect my results. Of course exports in period 't' market the crop produced in that period. The US marketing years are calibrated so that this is generally true. The United States is correct that, with the typo, equation (7) obviously makes no sense. The subscript should have referred to production in period 't' rather than 't-1', which, of course, is the equation contained in my model as well as in the FAPRI US crops model. Despite the US tone in paragraph 76, I expect the United States is aware that the specification of equations (7) and (8) follow the FAPRI model, as provided in the electronic verification of both the FAPRI US crops model as well as my cotton-focused model. Removal of the export step-2 and domestic step-2 subsidies increase effective demand for US cotton by lowering the effective net price paid by buyers.

Section VII

88. In paragraphs 77 through 80 of the US critique, the United States notes that the CARD international cotton model used different supply and demand elasticities than found in a paper by FAPRI-Missouri economist Seth D. Meyer. In fact there are several sets of such elasticities in the literature.

89. I relied on the CARD model and the CARD elasticities for four simple reasons. First, the authors of the published studies that underlie the CARD international cotton model include Professors Babcock and Beghin, who are two of the most widely-published and respected agricultural economists in the field. The scholarly credibility of their work and that of their CARD colleagues has been reinforced by scores of professionally-refereed academic articles to their credit as well as awards and other accolades.[115] In terms of quality objective research in agricultural commodity market economics and related areas, the CARD team has a long distinguished track record and a top notch

[114] I note that the loan rate was 51.92 cents per pound in marketing years 1999-2001 and 52 cents per pound in all later marketing years, so there is a tiny difference between 2001 and 2002.

[115] Exhibit Bra-400 (List of Publications of Professors Babcock and Beghin).

professional reputation. By contrast, I do not know the professional work of Seth D. Meyer, and have not been able to locate any of his work in professionally-refereed publications.

90. Second, the CARD international cotton model was the model that had been used by CARD in its respected work on other international commodity analysis. I would note that the various CARD international commodity models developed by Professors Babcock and Beghin and their colleagues

modelling steps and offered my assistance to the Panel and the United States to facilitate the understanding of this complicated econometric model and its results.

95. The United States has criticized my choice of baseline and I have provided analysis under various other baselines, demonstrating the robustness of my results. The United States has also criticized my modelling choices for PFC, MLA, DP and CCP payments, crop insurance and export credit guarantees. I have provided evidence that these choices were reasonable and, in fact, conservative. Concerning the largest US subsidy, the marketing loan programme, I note that the United States has not criticized its modelling. I have explained that the use of lagged prices for a large-scale policy simulation analysis is standard and does not generate biased or exaggerated results – in fact, no futures prices could or have been used in such models.

96. In sum, I stand by my conclusions in Annex I "that very large subsidies provided to US producers and users of upland cotton have had and will continue to have large impacts on quantities of US cotton produced, used and traded and on both US and world prices of cotton".

ANNEX I-13

COMMENTS ON US ANSWERS TO QUESTIONS POSED BY THE PANEL FOLLOWING THE SECOND SUBSTANTIVE MEETING OF THE PANEL

28 January 2004

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Table of Cases

Short Title	Full Case and Citation
EC – Sugar Exports I (Australia)	GATT Panel Report, *European Communities – Refunds on Exports of Sugar Complaint by Australia*, L/4833 – 26S/290, adopted 6 November, 1979.
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.
US – Gasoline	Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996.
EC – Hormones	Appellate Body Report, *European Communities - Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, adopted 13 February 1998.
Australia – Salmon	Panel Report, *Australia – Measures Affecting Importation of Salmon*, WT/DS18/R, adopted 6 November 1998.
EC – Bananas	Panel Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, WT/DS27/ARB, adopted 9 April 1999.
Brazil – Aircraft	Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/RW, adopted 28 August 2000.
Indonesia – Automobiles	Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, adopted 23 July 1998.-
Argentina – Textiles and Apparel	Panel Report, *Argentina – Measures affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/R, adopted 22 April 1998.
Canada – Aircraft	Panel Report, *Canada – Measures affecting the Exports of Civilian Aircraft*, WT/DS70/R, adopted 20 August 1999.
Canada – Aircraft	Appellate Body Report, *Canada – Measures affecting the Exports of Civilian Aircraft*, WT/DS70/R, adopted 20 August 1999.
Japan – Agricultural Products	Appellate Body Report, *Japan – Measures Affecting Agricultural Products*, WT/DS76/AB/R, adopted 19 March 1999.
Korea – Dairy Safeguards	Appellate Body Report, *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R, adopted 12 January 2000.
Canada – Dairy	Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, adopted 27 October 1999.
Canada – Dairy (21.5) (II)	Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/RW, adopted 17 January 2003.
US – FSC	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000. DaBT 72.75 243 TD /F2 1

US – Wheat Gluten	Panel Report, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/R, adopted 19 January 2001.
US – Wheat Gluten	Panel Report, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/R, adopted 19 January 2001.
Chile – Agricultural Products (Price Band)	Appellate Body Report, *Chile- Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted 23 October 2002.
US – CVD's on EC Products	Appellate Body Report, *United States – Countervailing Duties on EC Products*, WT/DS212/AB/R, adopted 8 January 2003.
Canada – Aircraft II	Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS222/R, adopted 19 February 2002.
EC – Sardines	Appellate Body Report, *European Communities – Trade Description of Sardines*, WT/DS231/AB/R, adopted 23 October 2002.
EC – Sardines	Panel Report, *European Communities – Trade Description of Sardines*, WT/DS231/R, adopted 23 October 2002.
Japan – Apples	Appellate Body Report, *Japan*

List of Exhibits

Second Declaration of Andrew Macdonald, 27 January 2004.	Exhibit Bra- 401
"Genetically Engineered Cotton Suffering from Production Problems", Organic Consumers Organization, 11 January 2002.	Exhibit Bra- 402
"NCC will Intensify Emphasis for Quality, Yield Answers", Western Farm Press, 3 March 2001.	Exhibit Bra- 403
"Benefits - BT Cotton", Monsanto Imagine.	Exhibit Bra- 404
"Sample Costs to Produce Cotton Transgenic Herbicide- Resistant Acala Variety", San Joaquin Valley, University of California Cooperative Extension, 2003.	Exhibit Bra- 405
"Cotton Cost-Return Budget in Southwest Kansas", Kansas State University Agricultural Experiment Station and Cooperative Extensive Service, October 2003.	Exhibit Bra- 406
Documents on Cost of Production Insurance Plan for Cotton.	Exhibit Bra- 407
Export – Import Bank of the United States, Standard Repayment Terms.	Exhibit Bra- 408
Ex-Im Bank Fee Schedule.	Exhibit Bra- 409
Export Insurance Services.	Exhibit Bra- 410
"The Federal Scoop: US Government Financing for Service Exports", Export America, May 2003.	Exhibit Bra- 411
Cotton and Wool Situation Outlook and Outlook Yearbook, USDA, November 2003, Table 16.	Exhibit Bra- 412
"Agricultural Cash Rents", USDA, NASS, July 1999.	Exhibit Bra- 413
"Agricultural Land Values and Cash Rents," USDA, NASS, August 2003.	Exhibit Bra- 414
"Agricultural Land Values", USDA, NASS, April 1999.	Exhibit Bra- 415
"What is a Farm Bill?", Congressional Research Service, Report for Congress, 5 May 2001.	Exhibit B TD 875 TD w4.1mepg3D 875

Agricultural Outlook Tables, November 2003, Table 17.	Exhibit Bra- 420
ERS Briefing Room: Farm Income and Costs: US Farm Sector Cash Receipts from Sales of Agricultural Commodities, USDA.	Exhibit Bra- 421
Fruits and Tree Nuts Yearbook, USDA, October 2003, Table A-2.	Exhibit Bra- 422
Vegetables and Melons Yearbook, USDA, July 2003, Table 3.	Exhibit Bra- 423
Allocation Calculations Based on US Methodology and US Summary Data.	Exhibit Bra- 424

Questions from the Panel to the parties –
second substantive Panel meeting

I. TERMS OF REFERENCE

192. Regarding the interest subsidies and storage payments listed by the United States in its response to the Panel's Question No. 67:

(a) Please provide a copy of the regulations under which they are currently provided and under which they were provided during the marketing years 1996-2002;

(b) Please indicate whether there are any such payments which are not provided to implement the repayment rate for upland cotton within the marketing loan programme. USA

Brazil's Comment:

1. The United States finally confirms that the "other payments" (*i.e.*, interest and storage payments) are not separate subsidies but rather a component of the marketing loan programme.[1] The US acknowledgement eliminates any question whether such payments are within the Panel's terms of reference.[2] Brazil's request for the establishment of a panel clearly includes "subsidies and domestic support … relating to marketing loans … providing direct or indirect support to the US upland cotton industry".[3] Based on the US answer, Brazil amends the table at paragraph 8 of its 22 December 2003 Answers to Question 196 to add $65 million "other payments" to the $832.8 million for marketing loans, for a grand total of $887.8 million in marketing loans for MY 2002. Brazil also makes similar changes for MY 1999-2001 that combine "other payments" and marketing loan payments in Table 1 of Brazil's 9 September 2003 Further Rebuttal Submission.

193. Are interest subsidies and storage payments already included in the amounts shown in your submissions to date for payments under the marketing loan programme? Has there been any double-counting? BRA

194. Does the United States maintain its position stated in response to the Panel's Question No. 67 that "it would not be appropriate for the Panel to examine payments made after the date of panel establishment"? If so, please explain why. Can Brazil comment on this statement? BRA, USA

Brazil's Comment:

2. Brazil's 22 December 2003 response to this question, particularly its reference to the request for the establishment of the panel and existing jurisprudence, provides a comprehensive response to the points raised by the United States.[4] Brazil would offer the following additional comments to the US Answer.

3. Contrary to the suggestion at paragraphs 3-4 of the US 22 December 2003 response, Brazil's 11 August 2003 response to Question 19 did not change in any way the scope of Brazil's request for the establishment of a panel ("Panel Request"). Question 19 asked Brazil to clarify the measures in respect of which Brazil sought relief. Brazil's answer referred to one set of measures relating to

[1] US 22 December 2003 Answers to Questions, para. 2.
[2] US 30 September 2003 Further Submission, paras. 6-7; US 7 October 2003 Oral Statement, para. 2.
[3] WT/DS267/7, p. 2 (paragraphs relating to both the 2002 FSRI and the 1996 FAIR Act).
[4] Brazil's 22 December 2003 Answers to Questions, paras. 3-5.

Brazil's serious prejudice claims as those involving domestic support and export subsidy payments that had been made and were required to be made by the terms of the various statutory instruments identified in the Panel Request from MY 1999 through MY 2007. Some of these payments are relevant to Brazil's present serious prejudice claims for the period MY 1999-2002, and some of the payments are relevant to Brazil's threat of serious prejudice claims for the period MY 2002-2007. But as Brazil indicated in its 22 December 2003 Answer to Question 195, the text of the Panel Request (as well as Brazil's 11 August 2003 Answer to Question 19) in no way limits the type or scope of the payments made under those statutory and regulatory instruments up to 18 March 2003.

4. It is curious that the United States in its 22 December 2003 response takes an opposite position in this dispute than the one it took as the complaining party in the only other WTO serious prejudice dispute.[5]

DSU Article 11 based on all the relevant facts. These decisions are also grounded in the need for the "prompt settlement" of disputes under DSU Article 3.4 – and are structures to avoid the endless filing of precision-timed annual disputes and the litigation gaming strategy envisioned by the US argument.

II. ECONOMIC DATA

195. Does the United States wish to revise its response to the Panel's Question No. 67*bis*, in particular, its statement that "the United States ... does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers"? Did the United States make enquiries of the FSA in the course of preparing its original answer? USA

Brazil's Comment:

6. Brazil notes that the US answer is largely unresponsive to the Panel's question.

7. The Panel's question whether the United States "maintains information" is straight-forward. A correct answer would have been "yes". The ordinary meaning of the word "maintain" is "practice habitually", "observe", "cause to continue (a state of affairs, a condition, an activity)".[12] The United States consistently misled Brazil and the Panel by stating that USDA never collected, organized and maintained information regarding the amount of contract payments paid to current producers of upland cotton.[13] There is no doubt that these statements were false and misleading. It is significant that the United States has made no attempt to refute the evidence produced by Brazil in its 18 November 2003 Further Rebuttal Submission regarding the FSA forms completed by practically every US farm receiving contract or marketing loan payments.[14] Nor can the United States dispute that all of the information collected from the contract and acreage forms is (and was) maintained in a centralized database in USDA's Kansas City facility. The rapid response of USDA's Kansas City office to the rice FOIA request provides compelling evidence of the habitual practice of the US government in "maintaining" both contract and planted acreage information.[15] Indeed, the strongest proof of the United States' misleading conduct is the fact that USDA produced within three weeks the rice data in response to a FOIA request, and that the United States effectively admitted in its 18 and 19 December 2003 and 20 January 2004 Letters to the Panel that it maintains this information.

8. In fact, the United States continues to mislead the Panel in its 22 December 2003 Answer to Question 195. It states that "because those payments are decoupled from current production, expenditures under such programmes are not tracked by whether the recipient produces upland cotton".[16] Neither Brazil nor the Panel ever asked the United States how the programmes are "tracked". Rather, the Panel asked whether the United States "maintains information" that would permit the calculation of the amount of such payments. As Brazil has demonstrated in using the rice FOIA request[17], in discussing its proposed methodology, and in using the incomplete summary data provided by the United States on 18/19 December 2003, this is a simple exercise.[18]

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[12] New Shorter Oxford Dictionary, 1993 edition, p. 1669.

[13] US 27 August 2003 Comments on Brazil's Rebuttal Submission and Answers to Additional Question, paras. 20, 21, 27; US 11 August 2003 Answer to Question 60; The United States made similar statements during the consultations held between November 2002 and January 2003.

[14] Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.2.

[15] Exhibit Bra-368 (Second Statement of Christopher Campbell – Environmental Working Group, 1 December 2003).

[16] US 22 December 2003 Answers to Questions, para. 6.

[17] Exhibit Bra-368 (Second Statement of Christopher Campbell – Environmental Working Group, 1 December 2003).

[18] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55; Brazil's 28 January Comments and Requests Regarding US Data, Section 9.

9. The United States also asserts that "Brazil has also not asserted that the United States

years, the US world market share, *i.e.*, the US share of world exports, is or will be even above its previous three-year average, strengthening the consistent trend of increasing world market shares since MY 1996 (as well as since MY 1986).[26]

198. Please comment on the respective merits of the price-gap calculations of MY1992 deficiency payments in US comments of 27 August, footnote 14 ($867 million), and Brazil's response to the Panel's Question No. 67 ($812 million). BRA, USA

Brazil's Comment:

13. As indicated in Brazil's 22 Decembers Answers to Questions, Brazil agrees with the US methodology of calculating MY 1992 deficiency payments[27] for purposes of an AMS approach, as developed by the United States in its 27 August 2003 Comments on Brazil's 22 August 2003 Rebuttal Submission.[28]

14. However, Brazil strongly disagrees with the US proposition that the US AMS calculation of deficiency payments is "conservative".[29] The US calculation is the only appropriate one under paragraphs 10 and 11 of Annex 3 of the Agreement on Agriculture. The United States suggests that it should have used "eligible" acreage rather than "actual" acreage for the calculation.[30] However, paragraph 10 of Annex 3 does not refer to eligible acreage; it refers to "the quantity of *production* eligible to receive the applied administered price".[31] Production eligible to receive the applied administered price under the deficiency payment programme is calculated based on the eligible, participating acreage and the applicable programme yield (not the actual yield). Any production exceeding the programme yields and any production on acreage that did not participate in the deficiency payment programme necessarily was not eligible production. Thus, the fact that theoretically more acreage could have participated in the upland cotton deficiency payment programme (*i.e.*, those farms opted to not participate) cannot artificially inflate the upland cotton AMS figure resulting from this programme. Thus, any production that takes place on a farm not participating in the deficiency payment programme is not, in fact, eligible to receive the applied administered price and, therefore, cannot be part of the AMS calculation under paragraphs 10 and 11 of Annex 3.

199. What is the composition of the A-Index? We do note footnote 19 and, for example, Exhibit BRA-11, but please explain more in detail how this index is calculated. BRA

200. Concerning the chart on page 37 of Brazil's further rebuttal submission, why did Brazil use a futures price at planting time? Is this a relevant measure for assessing acreage response? BRA

201. Is data available to show the proportion of US upland cotton production sold under futures contracts, and the prices under those contracts, at different times during the marketing year? If so, please provide summarized versions to the Panel. How does a futures sale impact the producer's entitlement to marketing loan programme payments? BRA, USA

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[26] *See* Brazil's 27 October 2003 Answers to Questions, paras. 123-129. *See* also Brazil's 22 December 2003 Answers to Questions, paras. 133-139, concerning Brazil's arguments regarding a "consistent trend."

[27] Brazil emphasizes that it does not agree with to applying any price-gap calculation method for the calculation of marketing loan payments for AMS purposes. *See inter alia* Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 10-16.

[28] Brazil's 22 December 2003 Answers to Questions, para. 10.

[29] US 22 December 2003 Answers to Questions, para. 19.

[30] US 22 December 2003 Answers to Questions, para. 19.

[31] Emphasis added.

Brazil's Comment:

15. Brazil notes that the study cited by the United States[32] on upland cotton farmers' use of hedging instruments is relatively dated (from 1996) and analyzes a time period during which prices were high. Therefore, it may not reflect farmers' use of hedging instruments during the period of investigation.

16. In addition, Brazil notes that the futures market is not only used as a hedging instrument by US farmers, but also by farmers in other parts of the world, including Brazilian farmers.[33] It is also used by speculators.[34] It follows that the number of open contracts does not bear any relationship to the amount of the US upland cotton crop hedged by futures contracts at the New York futures market.[35]

202. Concerning paragraph 7 of the US oral statement, are the expected cash prices shown for February only? Can the US provide the prices for January and March of each year as well? USA

Brazil's Comment:

17. Brazil notes that the expected cash price is not the relevant price for purposes of analyzing the effects of the marketing loan programme. Since any marketing loan benefits are calculated as the difference between the loan rate and the adjusted world price, it would be necessary to look at the expected adjusted world price to draw any conclusions.[36] This point is admitted by the United States in paragraph 75 of its 22 December 2003 Answers to Questions: "… because farmers will receive a government payment for the difference between the loan rate and the adjusted world price".[37]

18. Brazil also notes that the figures presented by the United States differ to a minor degree from the ones presented by Brazil.[38] Brazil does not know the reason for these minor differences and does not consider them to be material.

203. Please provide information concerning the organization, mandate, credentials and standing of FAPRI. BRA

204. Which support to upland cotton is not captured in the EWG data referred to in Brazil's 18 November further rebuttal submission? BRA

205. Does the United States accept or agree with the EWG data submitted by Brazil? If not, please explain your reasons. USA

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[32] US 22 December 2003 Answers to Questions, para. 20.

[33] Exhibit Bra-281 (Statement of Andrew Macdonald – 7 October 2003, para. 13).

[34] Exhibit Bra-281 (Statement of Andrew Macdonald – 7 October 2003, para. 13).

[35] The United States appears to suggest this relationship in paragraph 21 of its 22 December 2003 Answers to Questions.

[36] *See* Brazil's 2 December 2003 Oral Statement, Section 5.2 for further details on this point.

[37] Brazil addresses this point in greater detail in its comment on Question 212 and 213 below.

[38] *Compare* US figures at paragraph 22 of the US 22 December 2003 Answers to Questions with Brazil's figures as reported in Exhibit Bra-356 (January – March Quotes of the December Futures Contract, Expected and Actual AWP and Cash Price) and at paragraph 44 of Brazil's 2 December 2003 Oral Statement.

Brazil's Comment:

19. As a preliminary comment, the United States answer does not rebut evidence from EWG's

received by upland cotton producers were *upland cotton* payments.[55] This supports USDA's own

the use or export of upland cotton to trigger payments.[62] Brazil notes that the crop insurance programme requires farmers to *plant* upland cotton to receive premium subsidies. No harvest is required from farmers to receive indemnity payments, which in turn may trigger additional reinsurance payments to the private insurance companies running the crop insurance programme.[63]

208. Please provide data for the marketing years 1992 and 1999-2002 of the "quantity of production to receive the applied administered price" (*Agreement on Agriculture,* Annex 3, paragraph 8) for purposes of aprice-gap calculation of support through the marketing loan programme. USA

Brazil's Comment:

29. Brazil notes that this question directly implicates earlier evidence and arguments demonstrating that the United States has never used a "price-gap" methodology for calculating its marketing loan portion of AMS, *inter alia*, for upland cotton.[64] Rather, the United States has always used and notified a *budgetary* methodology in accounting for marketing loan payments (marketing loans, loan deficiency, certificate payments, and interest & storage payments).[65] In particular, when it agreed with other WTO Members on what the US "base level" would be for purposes of Total AMS, the United States chose to calculate marketing loan payments using a budgetary approach.

30. This is easily seen by first examining Exhibit Bra-191[66], which is a document in which the United States notified "supporting material related to commitments on agricultural products contained in Schedule XX - United States". Marketing loan payments for upland cotton are listed on page 20 of the document. The document lists the US loan deficiency payments for upland cotton for MY 1986 as $126.860 million, for MY 1987 as $0.364 million, and for MY 1998 as $42.038 million. Comparing these figures with the actual budgetary outlays for loan deficiency payments in MY 1986-88, as set out in Exhibit Bra-4, show the same figures (rounded out). Similar *budgetary* outlays are used for marketing loan gains and interest and storage payments that are also related to "marketing loan payments". In addition, Exhibit Bra-191[67] contains an Annex which is the "Supporting Table for Cotton: Deficiency Payment Calculation for GATT AMS." This table is there because the United States used the "price-gap" formula of Annex 3, paragraph 10 of the Agreement on Agriculture to calculate the AMS for deficiency payments. But no such supporting table exists for marketing loan payments, because a *budgetary* approach was used. In short, there is no doubt that the United States Total AMS Commitments were based, *inter alia*, on the US decision to use *budgetary* outlays for calculating its marketing loan payments for upland cotton.

31. The US decision under Annex 3, paragraph 10 to use budgetary outlays instead of the price-gap formula in calculating upland cotton AMS for marketing loan payments is legally binding on the United States. Annex 3, paragraph 5 states that "[t]he AMS calculated as outlined *below* [*i.e.*, paragraphs 6-13 of Annex 3] shall constitute the *base level* for the implementation of the reduction commitments on domestic support." The marketing loan budgetary decision reflected in G/AG/AGST/USA was incorporated into the US schedules and set the US "base level" of total AMS. The title of the G/AG/AGST/USA suggests its legally binding character – "Supporting Tables Relating to Commitments on Agricultural Products in Part IV of the Schedules." These "supporting

[62] US 22 December 2003 Answers to Questions, para. 31.
[63] Brazil's 24 June 2003 First Submission, paras. 80-83.
[64] *See* Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 10-16.
[65] *See, e.g.*, Exhibit Bra-191 (G/AG/AGST/USA, p. 20); Exhibit Bra-47 (G/AG/N/USA/43, p. 20); Exhibit Bra-150 (G/AG/N/USA/10, p. 18).
[66] G/AG/AGST/USA, p. 20.
[67] G/AG/AGST/USA, p. 21-22.

tables" were the basis upon which the "final bound commitment level specified in Part IV" of the US schedule was determined.

32. Annex 3, paragraph 5 of the Agreement on Agriculture indicates that the United States is bound by its initial decision to calculate AMS using a budgetary approach (as permitted in Annex 3, paragraph 10 of the Agreement on Agriculture). This conclusion follows from the text of Article 6.3 of the Agreement on Agriculture:

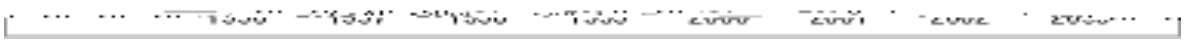
> A Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS *does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule.*

33. Further, Article 3.2 provides that "[s]ubject to the provisions of Article 6, a Member shall not provide support in favour of domestic producers in excess of commitment levels specified in Section I of Part IV of its Schedule". The United States' "final bound commitment level specified in Section I of Part IV" of the US Schedule is currently $19.1 billion. Nothing in Article 6 or any other provision of the Agreement on Agriculture permits a Member such as the United States to change its Annex 3, paragraph 10 choice of budgetary or price gap calculations for the purposes of calculating *current* AMS.

34. Brazil has previously detailed the reasons why permitting Members to reverse the Annex 3, paragraph 10 choice to calculate *current* AMS for a product would make the disciplines of Article 3.2 and 6.3 of the Agreement on Agriculture inutile.[68] The United States never denied it has always notified marketing loan payments using a budgetary approach, and has never rebutted Brazil's

updated the cost of production data to show increased upland cotton seed costs.[93]

next step was to determine that between 1997-2002 an average of 58 per cent of cotton acreage was planted to BT-cotton between MY 1998-2002. This is reflected in the graph below:[99]



45. With 58 per cent of US acreage between 1998-2002 was planted to BT-cotton, this meant that the average per acre national cotton cost savings was $12 between 1997-2002 (0.58 x $20). But recall that the United States answer claims that the USDA 1998-2002 cost data reflects the cost increases for BT-cotton seed, but not the cost savings from use of fewer chemicals. Therefore, to reflect the *net* cost savings, Brazil further deducted the difference in between increased cotton-seed in 1997 and between 1998-2002 ($12.8 per acre).[100] Thus, in the best-case US scenario, the total amount of average cost savings allegedly *not* reflected in published USDA data was $24.8 per acre.

46. Brazil recalls that the total six-year *deficit* between total costs and total revenue from USDA's 2003 revenue and costs estimates (*i.e.*, the updated 1997 ARMS Study) is $872 per acre.[101] Brazil then assumed (1) the accuracy of the $12 per acre net cost reduction from using BT-cotton, (2) that the $12 per acre net cost savings existed for the entire 1998-2002 period, and (3) that USDA cost experts updating the 1997 ARMS Study in 1998-2002 were not aware of such cost reductions or improperly failed to include them in the latest USDA update of cotton revenue and costs, then the 1997-2002 deficit between USDA's total reported costs and total market revenue would still be $748 per acre.[102]

47. In sum, while Brazil believes that at least some of the assumptions listed above are highly questionable, the "best case" that the United States could have put forward (but did not) shows continued huge long-term deficits of $748 per acre between US producers' total costs and their market revenue. In short, the United States has not met its burden of proving that its own USDA data was hopelessly flawed. Brazil and the Panel can properly rely on the 2003 cotton cost and revenue data showing either $872 or $748 average per acre deficits between costs and market revenue during MY 1997-2002. Both figures reflect huge gaps between market revenue and total costs of production. As Brazil has argued, this evidence strongly supports the significant impact of the US subsidies on US production, exports and on world prices.

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[99] http://www.whybiotech.com/index.asp?id= visited 28 January 2004.
[100] This was done by subtracting the amount of increased seed costs in Exhibit Bra

(ii) Comment on US Argument concerning Canada Dairy

48. Finally, Brazil notes the US attempt to distinguish the Appellate Body's decision in *Canada – Dairy* in paragraph 42 of the US 22 December 2003 Answer to Question 211. In assessing the

> that producers must recoup if they are to remain in business over time. … The costs incurred by the farmer that must be recouped to avoid going out of business do not stop at the 'farm gate'.[105]

Brazil agrees with the United States that all of the costs identified above (which the Appellate Body accepted in its decision) are "real costs" that a producer must recoup "in order to stay in business over time". This is precisely Brazil's point in this case.

51. The United States argues that *Canada – Dairy* is inapposite because "the issue for which Brazil seeks to use total costs is not whether a subsidy exists but to evaluate the effect of the subsidy, an altogether different analysis".[106] First, this is incorrect as a factual matter. One use of the total cost of production data by Brazil has been as circumstantial evidence to demonstrate that contract payments are support to upland cotton and that such payments provide a benefit to US upland cotton producers.[107] This is directly analogous to the issue of whether the subsidy existed in Article 9.1(c) of the Agreement on Agriculture in *Canada – Dairy*.

52. Second, the evidence of the total cost of production was used in both cases to demonstrate that both dairy and cotton producers were selling their products into a market well below their total costs of production. In *Canada – Dairy*, Canadian producers were selling C-milk into the export market well below their total cost of production. In cotton, the US producers were selling into all identifiable markets at well below their total costs of production.[108] And in both cases, the subsidies provided by the Canadian and US governments permitted these producers to continue to produce without regard for the gap between market revenue and total costs of production. In sum, without both the *Canada – Dairy* panel and this Panel examining *total* costs of production, it would be difficult to determine whether all the alleged subsidies existed, and second, to determine the role that subsidies played in maintaining production.

(a) to what extent do producers base planting decisions on their ability to cover operating costs but not whole farm costs? USA

Brazil's Comment:

53. Brazil generally agrees that covering operating costs are important to producers who are making planting decisions "in the short term – that is, the market price for one year".[109] And it is true that during a one-year "short term" period, a producer may be able to afford to receive revenue that only meets its operating costs and at least some of the fixed costs.[110] But the US 22 December 2003 Answer to Question 211(b) appears to suggest[111] that even over a long-term period of time – between 5-10 years – producers can continue to plant upland cotton oblivious to whether they meet their total costs of production. This is, of course, economic nonsense for agriculture or any other economic sector.

54. Basic economics holds that no business can continue to operate unless its total costs of production are met over the long term. The United States recognizes this when it states, in its 18 November 2003 Further Rebuttal Submission, that "in the long run, producers will have to cover these asset and overhead (i.e., economic) costs".[112] USDA's ERS suggests that the long term is a period between 5-10 years[113], and Christopher Ward testified that the normal recovery period for

costs such as leasing land, employing workers, and annual financing costs for replacement equipment.

59. The Westcott/Price study is an approved USDA paper published by USDA's Economic Research Service.[126] It is only during this dispute that the United States' government began to characterize this study as an "interesting 'academic' exercise"[127], whereas, outside this dispute, its results represent USDA's official view on the effects of the marketing loan programme.

60. Brazil recalls that the US Payment Limitations Commission, chaired by USDA's Chief Economist, requested Westcott and Price to update their study and analyze the effects of the marketing loan programme in MY 2001.[128] This official US Commission never criticized the approach chosen by Westcott and Price; rather, the Payment Limitations Commission relied on it. It is not clear to Brazil why the United States considers this study to be appropriate for analyzing effects of current agricultural policies and for considering policy reform proposals such as more effective payment limitations in a domestic political context, but, when US upland cotton subsidy programmes undergo multilateral scrutiny in a WTO context, the United States considers the very same study to be fatally flawed and unreliable.

61. Indeed, the United States goes so far as to characterize the Westcott/Price study as irrelevant for the analysis of this Panel.[129] The United States claims that using baseline projections for the period MY 1999-2001 will not suffice for the Panel's analysis, as the Panel needs to assess "actual conditions".[130] Brazil notes that the 2000 USDA baseline actually projected much higher prices than occurred during the period MY 1999-2001, thus the 5-cent per pound price suppression found by Westcott and Price understate the effects of "actual conditions".[131] This is confirmed by the fact that, when Westcott and Price used actual data to update their study for the Payment Limitations Commission, their results showed much stronger effects of the marketing loan programme.[132] Brazil notes that Professor Sumner has analyzed the effects of the marketing loan program

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[131] Priceispu Unievconncd Cole.[130]

upcoming prices and represents a third approach to modeling price expectations – the others being of course lagged prices and futures market prices.

64. In the context of its critique of the Westcott/Price study, the United States repeats its contention that futures market prices are the appropriate indicator for upland cotton farmers' price expectations, and that the effect of the marketing loan programme can be judged by looking at farmers' expectations about the US seasonal average cash price in the upcoming marketing year.[139] *This approach is simply factually wrong. There is no question that marketing loan payments are based off the adjusted world price – not a cash price.* Both Brazil and Professor Sumner explained this fact in detail on 2 and 3 December 2003.[140] Indeed, the United States acknowledges this fact elsewhere in its 22 December 2003 Answers to Questions.[141] Thus, the effects of the marketing loan programme would depend on upland cotton farmers' expectations about the adjusted world price. All of the repeated US arguments that there are no effects of the marketing loan programme for upland cotton in MY 1999-2001 because the expected US cash price was above the loan rate are simply meaningless.[142]

65. The US argument that the marketing loan programme has no effects if the expected US cash price is above the loan rate is, however, also wrong on its merits. (The same would be true had the United States relied on the correct price – the adjusted world price.) Brazil demonstrated that the spread between the January to March quotes of the December futures contract and the adjusted world price is (i) 18.5 cents[143] (if measured against the average AWP for the following marketing year) or (ii) 12.22 cents[144] (if measured against the December AWPs).[145] Subtracting this spread from the average of the January to March quotes of the December futures contract provides the expected adjusted world price (i) for the upcoming marketing year and (ii) for the upcoming December. As Professor Sumner has explained, it is also not at all clear which futures prices to use for any such calculations.[146] Taking the quotes of just one month for a single futures contract, as the United States does, is an overly simplistic approach.[147] But whether one assumes that farmers look at the average AWP for the upcoming marking year or at some particular AWP for a specific month such as

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[139] US 22 December 2003 Answers to Questions, para. 51. *See* also US 18 November 2003 Further Rebuttal Submission, Section IV.G (for earlier US arguments using this fatally flawed approach).

[140] *See* Brazil's 2 December 2003 Oral Statement, Section 5.2 and Exhibits Bra-370 – Bra-371. *See* also Brazil's 22 December 2003 Answers to Questions, para. 155; Brazil's 20 January 2004 Answers to Additional Questions, para. 21.

[141] US 22 December 2003 Answers to Questions, para. 75. Also Exhibit US-126 calculates the marketing loan benefit correctly as the difference between the loan rate and the adjusted world price, rather than – as implied by the United States in its other arguments – as the difference between the loan rate and the cash price.

[142] US 22 December 2003 Answers to Questions, para. 51. Brazil is puzzled to learn that the United States continues to ignore these basic facts about the operation of the marketing loan program for upland cotton and continues to rely on this seriously flawed argument. Brazil recalls again that the United States is fully aware of its error, as demonstrated by its statements in paragraph 75 of its 22 December 2003 Answers to Questions and by Exhibit US-126, both of which rely on the adjusted world price as the basis for calculating marketing loan benefits.

[143] Exhibit Bra-356 (January – March Quotes of the December Futures Contract, Expected and Actual AWP and Cash Price).

[144] Exhibit Bra-370 (The Difference Between the Adjusted World Price and the December Futures Contract), presented by Professor Sumner on 3 December 2003.

[145] Concerning the problems inherent in the choice of the exact spread, *see* Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 13).

[146] Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, paras. 11-12).

[147] Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 12).

December, the fact is that the expected world price has always been well below the loan rate during MY 1999-2002.[148]

66. Moreover, even if the expected adjusted world price would not have been below the loan rate, that does not mean that there are no effects from the marketing loan programme. As Professor Sumner explained on 3 December 2003, this is because farmers have a probability distribution for the expected adjusted world price. That means they will expect with th5 -4.5 TD /F0 11.25 Tf 2n rate,

except rice) increases the revenue guarantee beyond the official loan rate, as shown by the data in Exhibit US-126. This data, however, understates the real effect for two basic reasons. First, it calculates the additional revenue based on an average national cash price that may be quite different from the price an actual upland cotton farmer receives for its crop. Second, and more importantly, it omits the second source of "marketing loan facilitated revenue" – the timing decisions of farmers in marketing their crop and taking out marketing loan benefits.

70. The existence of additional marketing loan programme facilitates revenue further highlights the importance of the upland cotton marketing loan programme in assisting upland cotton producers to close the gap between costs and market returns. It also invalidates further the US argument during the peace clause phase of this dispute that a rate of support should be used for purposes of the "peace clause" analysis, as the rate of support is the only measure that the United States controls.[156] The United States now admits that it does not control the rate of support either, as the rate of support may be above (or even below) 52 cents, depending on market conditions[157], and farmers' timing decisions for the marketing of their crop. Nor does the United States control the flow of marketing loan payments, as there is no mechanism in the upland cotton marketing loan programme to stem or control the flow of upland cotton marketing loan payments. This is precisely one of the reasons that Brazil has challenged this mandatory programme as causing a threat of serious prejudice.

213. What differences, if any, can be observed in the results of econometric models in the literature which use lagged prices and those which use futures prices to analyse the effect of prices on planting decisions? BRA, USA

Brazil's Comment:

71. The United States focuses its response entirely on Professor Sumner's model. In fact, it does not provide an answer to the question posed by the Panel. Brazil recalls that this question asks for differences in results that can be observed from models *in the literature* that use lagged prices and futures prices. In its 22 December 2003 response to this question, Brazil detailed that there are no comparable models that use futures prices, but that all models discussed in the context of this proceeding – as well as all other large-scale multi-commodity models – use some variant of lagged prices.[158]

72. At the outset, Brazil notes that the United States *has presented no econometric model* in this dispute. The United States has not taken advantage of the economic and econometric expertise of USDA's Economic Research Service to substantiate econometrically its argument that $12.9 billion in upland cotton subsidies have had no effect on production and exports of US upland cotton and have had no effects on US or world prices.

73. Instead, the United States has criticized various aspects of Professor Sumner's model.[159] In particular, it has focused its critique on Professor Sumner's approach to modeling farmers' price expectations. However, Professor Sumner and Brazil have effectively rebutted all of these criticisms.[160]

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[156] *See inter alia* US 11 July 2003 First Submission, para. 94; US 22 July 2003 Oral Statement, paras. 12-13.

[157] These market conditions are in particular reflected in the spread between the adjusted world price and the cash price received by US upland cotton producers.

[158] Brazil's 22 December 2003 Answers to Questions, paras. 37-42.

[159] US 7 October 2003 Oral Statement, paras. 26-50; US 22 December 2003 Comments on Brazil's Econometric Model.

[160] *See* Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effects of US Cotton Subsidies – Professor Daniel Sumner, 2 December 2003, paras. 6-14, with further references).

74. The United States cites Andrew Macdonald in support of its propositions that futures prices are the better price indicators.[161] However, once again, the United States takes a quote out of context. What Mr. Macdonald actually said in the cited paragraph is that New York futures prices are an indicator of the direction in which prices will move in the future, *i.e.*, price trends, not an indicator of actual price in the future.[162]

75. The United States further cites a US government study that allegedly demonstrates that a certain percentage of US upland cotton producers rely on the New York futures market to *price* their crop for actual sales.[163] While Brazil cautions against the use of the specific results of the study (as it is somewhat dated)[164], Brazil agrees that at least some farmers *price* their crop with reference to the New York futures price. However, what this study *does not demonstrate* is that US upland cotton producers rely on the futures market in *making their planting decisions* many months before marketing.

76. The basic question that arises from the US criticism is the following: is Professor Sumner's approach to model farmers' price expectations biased towards generating stronger effects? The United States correctly notes that "[t]he lagged prices used by Brazil and [Professor Sumner] can[,] at

80. The approach favoured by the United States is not itself free of problems.[171] So far, futures market prices have only been used in statistical estimation using aggregate time-series data and not in econometric policy simulations.[172] Using it for modeling purposes raises further questions about the choice of futures contracts, the time period over which quotations are used, and calculations of appropriate spreads, among others.[173]

81. In sum, there are good reasons that FAPRI, USDA and the CBO use lagged prices in their policy simulation models. The Panel will recall that the FAPRI model (using lagged prices) was influential in the policy-making process leading to the 2002 FSRI Act, and that FAPRI, USDA and CBO models (all of which are based on lagged prices) are used regularly in US policy evaluation and formulation. Professor Sumner's approach uses a simple and commonly used proxy for the fundamentally unobservable price expectations of farmers.[174] Brazil is puzzled that the United States now views the very approach that every credible econometric policy simulation model takes as a significant error once this approach is used by Brazil in this dispute.

82. The United States further argues that in years with strong exogenous shocks lagged price models are poor proxies for price expectations.[175] The United States criticizes Professor Sumner's MY 2002 results as grossly overstated.[176] Brazil notes that it is has never relied on Professor Sumner's results of individual years. Instead, Brazil has used averages of the effects of the US programmes in MY 1999-2002 and MY 2003-2007. Using these averages mitigates any problems that may have existed from the use of lagged prices in any individual year.

83. Finally, Brazil notes that the United States relies on elasticities supplied by Professor Sumner in Annex I to calculate acreage responses from the expected lower cash prices in MY 2002.[177] However, these US calculations the United States are meaningless for several reasons. First, the futures prices used by the United States are problematic. Using only a single month's quotes for a single contract does not appropriately model the complexities of farmers' planting and marketing timings.[178] Second, it is unclear from the US response whether the United States used an appropriate spread for the calculation of price expectations held by farmers.[179] Third, it is therefore unclear whether the United States has calculated the appropriate change in price expectations between MY 2001 and 2002. Finally, even assuming that all of these problems did not exist, the results calculated by the United States using Professor Sumner's elasticities fail to provide meaningful results. These elasticities were applied in Professor Sumner's model to obtain direct effects, *i.e.*, effects before any feedback from the FAPRI US crops model and the CARD international cotton model.[180] Thus, the results are nowhere near the results that one would have obtained using Professor Sumner's full Annex I model. For all these reasons, Brazil strongly disagrees with the conclusion that the marketing loan programme did not have any effect in MY 2002. Brazil also recalls its arguments

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[171] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, paras. 9-14).

[172] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 9).

[173] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, paras. 11-13).

[174] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 14).

[175] US 22 December 2003 Answers to Questions, para. 61.

[176] US 22 December 2003 Answers to Questions, para. 63.

[177] US 22 December 2003 Answers to Questions, para. 63.

[178] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 12).

[179] Brazil's 2 December 2003 Oral Statement, para. 44; Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 13).

[180] *See* Brazil's 20 January 2004 Comments on US Model Critique, paras. 64, 70.

and evidence regarding the serious flaws in the US application of its futures price methodology using expected cash prices rather than expected adjusted world prices.[181]

III. DOMESTIC SUPPORT

214. Please provide a copy of regulations regarding the marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993. What does this regulation indicate about the target price? USA

215. Please expand or comment on the statement at paragraph 91 of the US further rebuttal submission that the counter-cyclical target price ceases to be paid when the farm price rises above 65.73 cents per pound. In this scenario, should the Panel disregard Direct Payments? BRA, USA

216. How many times have upland cotton producers been able to update their base acres since 1984? How do upland cotton producers come to note the possibility of future updating? Please provide examples of relevant material. BRA, USA

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Brazil's Comment:

86. The United States does not answer the Panel's first question as to "what is the reason" that PFC and direct payments are reduced for planting and harvesting fruits, vegetables, and wild rice. No reason is provided in the US 22 December 2003 response.

87. Nor does the United States take advantage of the Panel's second question to comment on the statement made by the European Communities that "the reduction in payment for fruit and vegetables, is in fact designed to avoid unfair competition within the subsidizing Member".[189] No US comment is provided. The EC argument involves considerable speculation about the "design" of the US measures. With the United States deciding not to provide any such reasons, the Panel is left without a factual basis to know whether the US reduction of payment based on growing fruits and vegetables is intended to "minimize any distortion which may be caused by any decoupled payments in markets which were historically undistorted by subsidies".[190]

88. The EC argument appears to attempt to impose a "trade distortion" test to the criteria of Annex 2, paragraph 6. However, Brazil notes that the EC argued that a decoupled domestic support measure need *not* be tested with regard to the "fundamental requirement" in Annex 2, paragraph 1 to determine whether it has "trade distorting effects".[191] Nor do any of the specific criteria in paragraph 6(b) of Annex 2 refer to "trade distorting effects".[192] Annex 2, paragraph 5 requires the specific criteria of Annex 2, paragraph 6 to be met for a direct payment measure to be included within the green box.

89. But even if Annex 2, paragraph 6(b) included a "trade distorting effects" test, the EC is simply wrong that the elimination or reduction of PFC and direct payments when fruits and vegetables and wild rice are grown does not "distort" trade. The EC argument ignores the distortion in trade in the products on which payments are focused, *i.e.*, upland cotton and the other programme crops rather than fruits, vegetables, and wild rice. Limiting or prohibiting payments for types of products representing 60 per cent of the value of production in a region such as California, Florida, or Arizona

unambiguously trade-distorting and production-distorting".[200] This is quite a different statement than the one the United States appears to "agree" to. Coming from the Chief Economist of the USDA, who is one of the most-widely respected agricultural economists, it is positive evidence that marketing loan payments are not only "potentially" production- and trade-distorting, but that these payments have, in fact, "unambiguously" distorted US production and exports of upland cotton. But Dr. Collin's statement also confirms what other evidence in the record already demonstrates: the effect of the marketing loan programme is to sustain economically unviable US production of upland cotton, that in turn increases US exports and suppresses world prices.[201]

96. In a further response to this question, the United States itself provides the reason why its arguments about the expected cash price as a meaningful measure of the effects of the marketing loan programme are seriously flawed. The United States confirms that marketing loan benefits are not paid off the cash price (so that any expectations about future cash prices would matter), but that "farmers will receive a government payment for the difference between the loan rate and *the adjusted world price*".[202] Thus, what potentially matters in evaluating the effects of the marketing loan programme is the expected adjusted world price, and not the expected cash price.[203] Looking at the expected adjusted world price, it is below the loan rate in all marketing years during the period of investigation and, therefore, the marketing loan programme is expected to have a significant effect on US farmers' upland cotton planting decisions.[204] This fact confirms all the other evidence presented by Brazil to demonstrate the trade- and production-distorting effects of the marketing loan programme.[205]

IV. EXPORT CREDIT GUARANTEES

219. Under the *Agreement on Agriculture* the general position is that the use of export subsidies, both those listed in Article 9.1 as well as those within the scope of Article 1(e) which are not so listed, may only be used within the limits of the product specific reduction commitments specified in Part IV of Members' Schedules. One might therefore have expected that Article 3.3 of the *Agreement on Agriculture* would have prohibited the use of both listed and non-listed export subsidies in excess of reduction commitment levels in the case of scheduled products and, in the case of non-scheduled products, would have simply prohibited the use of any export subsidy. Instead, the Article 3.3 prohibition is limited in both cases to export subsidies listed in Article 9.1. What significance, if any, does this contextual aspect have for how Article 10.2 might be interpreted having regard, *inter alia*, to:

(a) the fact that export performance-related tax incentives, which like subsidized export credit facilities were considered as a possible candidate for listing as an Article 9.1 export subsidy in the pre-December 1991 Draft Final Act negotiations, have been held

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[200] Brazil's 2 December 2003 Oral Statement, para. 36 and Exhibit Bra-211 ("The Current State of the Farm Economy and the Economic Impact of Federal Policy," Hearings before the Committee on Agriculture, US House of Representatives, p. 43)(emphasis added).

[201] Brazil's 9 September 2003 Further Submission, Section 3.3.4.7.1; Brazil 7 October 2003 Oral Statement, paras. 31-33; Brazil's 18 November 2003 Further Rebuttal Submission, Sections 3.1, 3.2, 3.4 and 3.7.1; Brazil's 2 December 2003 Oral Statement, Section 5.2.

[202] US 22 December 2003 Answers to Questions, para. 75 (emphasis added).

[203] Brazil's 2 December 2003 Oral Statement, Section 5.2. Brazil notes that the United States, in Exhibit US-126, appears to acknowledge this fact, as it calculates the marketing loan benefit as the difference between the loan rate and the adjusted world price, rather than the cash price, as the United States implies in its other arguments.

[204] Brazil's 2 December 2003 Oral Statement, Section 5.2, in particular paras. 44-50 (including Exhibits Bra-356-359) and Professor Sumner's oral explanations on 3 December 2003 (including Exhibit Bra-370-371).

[205] Brazil's 9 September 2003 Further Submission, Section 3.3.4.7.1; Brazil 7 October 2003 Oral Statement, paras. 31-33; Brazil's 18 November 2003 Further Rebuttal Submission, Sections 3.1, 3.2, 3.4 and 3.7.1; Brazil's 2 December 2003 Oral Statement, Section 5.2.

view, Article 10.4 could be considered an example of the situation envisioned in paragraph 56 of Brazil's 22 December 2003 Answers to Questions.[213] Article 10.4 sets out a benchmark against which to determine whether particular international food aid measures constitute "export subsidies", within the meaning of Article 10.1. Thus far, the Appellate Body's decisions (in *US – FSC*[214] and *Canada – Dairy*[215]) have directed panels to contextual guidance included in the SCM Agreement for this determination. In a case against international food aid measures, however, a panel could look to the alternative benchmarks set out in Article 10.4 as context for its determination whether those measures constitute "export subsidies" for the purposes of Article 10.1. (A panel could also look to a Member's notifications to the Committee on Agriculture. The United States, for example, notifies international food aid – or some portion of the international food aid provided by it – as export subsidies to be counted towards its reduction commitments.[216])

220. What will be the relevance of Articles 9 and 10.1 of the *Agreement of Agriculture* to export credit guarantees when disciplines are internationally agreed? BRA

221. In respect of the table in paragraph 161 of the US August 22 rebuttal submission (concerning the cohort specific treatment of export credit guarantees), the Panel notes the subsequent US agreement (footnotes 82 and 96 in US further submission of 30 September 2003; footnote 160 in US 18

108. Brazil emphasizes, however, that showing gains or losses for particular *cohorts* is not relevant for the purposes of item (j), which calls for the assessment of a *"programme"* across its entire portfolio.

(f) The Panel notes the current "high" figures for 1997 and 1998 indicated in the original US chart. Pending their confirmation and/or updating by the US, why does the US assert that a cohort will *necessarily* reach a "profitable" result (for example, the 1994 cohort, which has almost closed still indicates an outstanding amount)? Do "re-estimates" reflect also expectations about a cohort's future performance?

Brazil's Comment:

109. Once again, the United States' response is inaccurate. The United States asserts that data for the 1994 cohort indicate profitability.[223] Using the Tj 41zzil's69(the 1994 yailr5 0 .) Tj 17u(Commg5o91180 Tw (c

million in the chart accompanying its response to Question 221(a), and Brazil tracks losses of $211 million in Exhibit Bra-193.

113. The second point the United States makes is that the data it has presented in its response to question 221(a) includes no "operating experience" with the 2001 and 2002 cohorts.[228] This is wholly inaccurate. Estimates of costs and losses are based, first and foremost, on historical experience with borrowers.[229] Moreover, the chart included in the US response to question 221(a) shows that reestimates – which are in part made to reflect operating results – have already been made for both the 2001 and 2002 cohorts.

118. For these reasons, the US suggestion that the 2000 cohort should be disregarded by the Panel in its item (j) analysis should be rejected.

(i) Under the US approach, at what point in time could a Panel ever make an assessment of the programme, if it had to wait for each cohort to be completed before it could be "properly" assessed? Why is it inappropriate for the Panel to include these "most recent years" in its evaluation, as the US suggests in parag

inappropriate "to subject the [CCC programmes] to the analytical yoke of the unique circumstances of the Polish and Iraqi defaults over 10 years ago . . ".[236]

123. The United States had previously made this assertion, albeit only with respect to Iraq.[237] The United States has offered no support whatsoever for this assertion[238], which is inaccurate in at least two respects. As Brazil has noted, these defaults were not "over 10 years ago". The US General Accounting Office reports that the losses in Iraq occurred over the period 1990-1997.[239] Nor are these defaults "unique," as the United States argues. As discussed below in Brazil's comments on the US response to question 225, the evidence regarding write-offs by the CCC (not even mentioning defaults that are not written off) demonstrates that the Iraqi and Polish defaults are not at all "unique".

124. Setting factual inaccuracies aside, if the United States wants to put post-1991 defaults on pre-1992 guarantees behind it, it should *embrace*, rather than *reject*, the net present value accounting methodology adopted in the FCRA. Using net present value accounting and the FCRA formula to make an assessment of the CCC programmes under item (j), the United States is not held accountable (in these proceedings, at least) for post-1991 defaults on pre-1992 cohorts. Post-1991 activity on pre-1992 CCC guarantees is treated separately[240], and is not in any way included in the data provided by the United States in its response to question 221(a), or by Brazil in Exhibit Bra-193. Even without the effect of the Iraqi and Polish defaults, both the United States and Brazil conclude that the CCC programmes have lost money over the period 1992-2002 (the United States puts those losses at over $230 million; Brazil at $211 million). (For a complete assessment under item (j), administrative expenses in the amount of approximately $39 million should be added.[241])

125. Rejecting the use of net present value accounting to assess the CCC programmes under item (j) does not keep the United States from cherry picking the results of the FCRA formula to make its case. According to the United States, using data for *some* cohorts that have not yet closed is acceptable, but using data for other cohorts that have not yet closed is not acceptable. Several points are clear regarding the United States' approach.

126. First, it is factually inaccurate for the United States to assert, in paragraph 103 of its response, that "trends" suggest that annual downward reestimates on older cohorts will continue and will grow. The chart included with the US response to question 221(a) indicates *upward* reestimates in 2002 *for every cohort* during the period 1992-1999. Similarly, that same chart shows *upward* reestimates in 2003 for the 1992, 1993, 1994, 1996, 1997 and 2001 cohorts. Moreover, that same chart shows "trends" of positive net subsidy estimates after adjusting for cumulative reestimates, even for cohorts that the United States considers are close to closing – 1994, 1997 and 1998. In other words, *these aging cohorts are losing money*. Thus, it is not at all factually accurate to conclude that reestimates are generally downward as a cohort ages and approaches closure, or that as a cohort approaches closure, the data suggests that it will have made money.

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[236] US 22 December 2003 Answers to Questions, para. 102.

[237] US 22 August 2003 Rebuttal Submission, para. 172.

[238] As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

127. Second, even if one accepts the US argument that the 2001 and 2002 cohorts should be left out of the calculation because there are not yet any "operating results" for those years (a point that is itself factually inaccurate, as addressed by Brazil above)[242], this does not explain the United States' decision to eliminate the 2000 cohort – for which it acknowledges there are "operating results" – when it concludes that "cohorts 1992-1999, taken as a whole, currently reflect a net negative reestimate (i.e., profitable performance)".[243] When the 2000 cohort is included, the data provided by the United States in the chart accompanying its response to question 221(a) show losses. This is a gross example of the cherry-picking exercise in which the United States would have the Panel engage to gerrymander a result in the United States' favour. Consistent with the Panel's duty to make an objective assessment of the facts, it should not accept this approach.

128. Third, the US approach does not tell the Panel anything about how the CCC *programmes* fare when assessed under item (j). Item (j) calls for an assessment of the entire portfolios of the *programmes* themselves.[244] In contrast, the US approach only offers some indication of how particular, carefully-selected *cohorts* are performing (and as discussed in the previous two paragraphs, the results do not even reflect profitability for those cohorts). The data provided by the United States itself demonstrates that using the net present value methodology imposed by the FCRA, premiums for the CCC guarantee *programmes* over the period 1992-2002 were inadequate to cover the operating costs and losses of the programmes, in the amount of $230 million.[245] For a complete assessment under item (j), administrative expenses in the amount of approximately $39 million should be added.[246]

129. If the Panel does not consider that net present value accounting is an appropriate way of assessing the CCC programmes under item (j), Brazil has also demonstrated that the long-term operating costs and losses of the programmes outpace premiums collected, using a *cash-basis accounting* methodology. The chart included at paragraph 165 of Brazil's 11 August 2003 Answers, reproduced below, tracks this result:

[242] US 22 December 2003 Answers

2002	$21,000,000 + $155,000,000 + $61,000,000[280] = $237,000,000	$4,000,000[281] + $40,000,000[282] + $93,000,000[283] = $137,000,000
Total	$1,841,920,000	$2,925,064,000
Long-term Net Cost	**$1,083,144,000**	

130. In Exhibit US-128, the United States has also provided data to be used for an assessment of the CCC programmes under item (j) using cash-basis accounting. As discussed further in Brazil's comment to the US response to question 222, the data offered by the United States in Exhibit US-128 leads to the same conclusion, when adjusted to account properly for the impact of rescheduling on defaults.[284]

131. Finally, an even more fundamental approach demonstrates the incredibility of the United States' assertion that "trends" suggest that the CCC programmes are making and will continue to make profits. Congressional testimony by USDA officials and reports by the US General Accounting Office demonstrate that 1990-1997 defaults on Iraqi and Polish CCC guarantees amounted to approximately $4 billion.[285] The US General Accounting Office also noted in 1995 that defaults on Russian and Former Soviet Union GSM 102 guarantees similarly reached $2 billion by the end of 1993, and that despite repeated rescheduling agreements, those debts were not being repaid.[286] These defaults were not, therefore, all "over 10 years ago", as the United States suggests at paragraph 102 of its 22 December 2003 response. Nor are they "unique", as the United States also suggests at paragraph 102. In addition to this $6 billion in defaults, the United States' response to question 225 cites to further "written-off" or "forgiven" defaults of $20 million. This does not, of course, account for other defaults that have not yet been written-off or forgiven.

132. *Even if premiums collected over the entire lifetime of the CCC guarantee programmes are considered, these defaults, in the amount of over $6 billion, would mean net losses in the amount of*

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[277] Exhibit Bra-88 (US budget for FY 2003, p. 118).
[278] Exhibit Bra-88 (US budget for FY 2003, p. 119).
[279] Exhibit Bra-88 (US budget for FY 2003, p. 120).
[280] Exhibit Bra-127 (US budget for FY 2004, p. 109).
[281] Exhibit Bra-127 (US budget for FY 2004, p. 107).
[282] Exhibit Bra-127 (US budget for FY 2004, p. 108).
[283] Exhibit Bra-127 (US budget for FY 2004, p. 108).
[284] At paragraph 103 of its 22 December 2003 response, the United States refers to "the uniform performance of reschedulings". The United States has offered no proof that its reschedulings are performing. Yet as the party asserting this fact, the United States bears the burden of proving it. *See, e.g.*, 284

over $5.5 billion.[287] Brazil emphasizes that this is just taking account of the defaults about which

been rescheduled as 100 per cent recovered on the day the terms of the rescheduling are agreed.[292] Brazil, on the other hand, has treated rescheduled claims as receivables, until they have been actually recovered.[293] Only once CCC actually collects incremental amounts on a rescheduled claim is the corresponding incremental amount of the default considered "recovered" and no longer a loss to CCC.[294] Under Brazil's approach, whatever portion of rescheduled claims is collected in a particular year is treated as a recovery, whereas under the United States' approach, the *entirety* of the rescheduled claims is treated as a recovery at the moment the terms of the rescheduling are agreed.

136. Brazil's approach is the more actuarially appropriate of the two, and is consistent with the cash-basis accounting preferred by the United States in this dispute. Under cash-basis accounting, when financial commitments are rescheduled, they would normally be re-amortized on a new, longer payment schedule that reduces the amount of each periodic payment due from the borrower. Rescheduling does not mean that a creditor *collects* on an outstanding claim – it just means that the creditor *hopes* to do so in the future by reducing the amount the borrower has to pay each month.[295] CCC, in fact, acknowledges that all it possesses following a rescheduling is a receivable, and that not all receivables are collectable.[296] (And in fact, CCC rescheduling has historically been in arrears.[297]

137. Brazil maintains its position that it is not appropriate to treat as "recovered" those losses (resulting from defaults) that were actually incurred by the CCC export credit guarantee programmes and that are rescheduled, until such a point in time when the money *actually has been recovered*. Therefore, Brazil maintains that its cash-basis formula is the appropriate one. It follows that the CCC export credit guarantee programmes suffered losses of $1.1 billion between fiscal years 1993-2002, resulting in a finding that the CCC programmes operate at premium rates inadequate to cover the long-term operating costs and losses of the programmes, within the meaning of item (j).

223. Are the premium rates applicable to GSM 102, 103 and SCGP subject to regular review as to their adequacy in enabling the operating costs and losses associated with these programmes? If so, what criteria or benchmarks are taken into consideration for this purpose? Secondly, how do the premium rates applied compare with the implicit cost of forfaiting transactions and with premiums for export credit insurance? USA

Brazil's Comment:

138. Although the United States asserts that premium rates for the GSM-102, GSM-103 and SCGP programmes are "reviewed annually"[299], it offers no evidence to support this assertion.[300] As Brazil has already noted, both USDA's Inspector General and the US General Accounting Office have noted the CCC's failure to change its premium rates or to reflect credit risk in those rates – and its inability to do so given the one-per cent fee cap included in US law – as evidence of a failure to cover costs and losses.[301]

139. The CCC guarantee programmes are unique financing instruments that are not available on the market.[302] Brazil has demonstrated that forfaits and CCC export credit guarantees are not similar financial instruments, and therefore that the terms for forfaits cannot serve as benchmarks against which to determine whether CCC export credit guarantees confer "benefits".[303] The United States has offered no evidence that the two instruments "compete as a method for trade financing over comparable tenors in similar markets …."[304] Further, the regulations for the CCC programmes belie the United States' assertion that "an importer does not necessarily realize any benefit from a CCC export credit guarantee".[305] The regulations state that the programmes operate in cases where banks "would be unwilling to provide financing without CCC's guarantee".[306] To summarize the differences between the two instruments, the essential function of a CCC guarantee is to make possible an export sale that would otherwise be impossible. A forfait, by contrast, does not make an impossible sale possible, but instead merely allows an exporter to collect its receivable without waiting for that receivable to come due.[307] This opportunity, offered by the forfait, only arises if the CCC guarantee has made the sale happen in the first place.

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[299] US 22 December 2003 Answers to Questions, para. 107.

[300] As the party asserting this fact, the United States bears the burden of proving it. *See* Appellate Body Report, *Japan – Apples*, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[301] Brazil's 22 December 2003 Answers to Questionsc 0 301 to Questio0Uise roof thereof. TD -0.0038 Tc

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140. Even if the two instruments were similar, the United States has not met its burden to establish (under either Article 10.3 of the Agreement of Agriculture, or as the party asserting the fact) that CCC guarantees are provided on terms no better than those offered for forfaiting instruments on the market. Although the United States curiously repeats its argument that it "does not have access to specific implicit rates available in the marketplace"[308], Brazil presented evidence regarding forfaiting fees five months ago, with its 27 August 2003 submission. That evidence demonstrates that forfaiting fees are well above fees for CCC export credit guarantees.[309] It also demonstrates that unlike CCC guarantee fees, which vary on the basis of only one factor – the length of the underlying credit – forfaiting fees additionally vary according to the risks involved in the transaction[310], as one would expect of any market-based financial instrument.

141. Similarly, export credit insurance and CCC export credit guarantees are not similar financial instruments, and therefore the terms for export credit insurance cannot serve as benchmarks against which to determine whether CCC export credit guarantees confer "benefits". The United States has acknowledged the differences between CCC guarantees and export credit insurance.[311] One critical difference, noted by the WTO Secretariat in the WTO document quoted by the United States in paragraph 108 of its 22 December 2003 response, is that premia for insurance vary according to the credit rating or risk status of both the importer and the importing country.[312] In contrast, neither importer risk nor country risk have *any* impact on the premiums payable for GSM 102, GSM 103 or SCGP guarantees.[313] Moreover, Brazil notes that while export credit insurance is indeed available for agricultural commodities, export credit insurance for agricultural commodities is limited to 360 days, or the expected/useful life of the commodity in question.[314] In contrast, CCC guarantees are available for terms of up to 10 years.[315]

142. Even if the two instruments were similar, the United States has not met its burden to establish (under either Article 10.3 of the Agreement of Agriculture, or as the party asserting the fact) that CCC guarantees are provided on terms no better than those offered for export credit insurance obtained on the market. The United States argues that "[p]rivate commercial quotes for export credit insurance are simply not available to the United States".[316] Brazil attaches two premium fee schedules: first, a fee schedule published by Export Insurance Services, Inc., a private broker for export credit insurance for small businesses offered by the US Export-Import Bank ("Ex-Im Bank") (Exhibit Bra-410); and second, a fee schedule published by Ex-Im Bank itself for export credit insurance for small businesses (Exhibit Bra-409).

143. The Panel will note that the rates in Ex-Im Bank's own fee schedule, which do not even include administrative fees that would be added by a private broker such as Export Insurance Services, exceed those offered for CCC guarantees by considerable margins.[317] When administrative

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[308] US 22 December 2003 Answers to Questions, para. 109.

[309] Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 76-77 and Exhibit Bra-199 (Trade and Forfaiting Review, Volume 6, Issue 9 July/August 2003).

[310] Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 75-76.

[311] US 11 August 2003 Answers to Questions, para. 179. The United States has correctly observed that "[i]f 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 . . ." Panel Report, *Canada – Aircraft II*, WT/DS222/R, Annex C-2 (para. 7) (emphasis added).

[312] G/AG/NG/S/13, para. 9.

[313] *See* US 11 August 2003 Answers to Questions, para. 184; Brazil's 11 August 2003 Answers to Questions, paras. 192, 195.

[314] Exhibit Bra-408 (Export-Import Bank, Standard Repayment Terms), p. 3 (Chart II, no. 2), 4 (second bullet point). Brazil made a similar point with respect to forfaits. *See* Brazil's 27 August 2003 Comments, para. 78.

[315] Brazil's 24 June 2003 First Submission, para. 101.

[316] US 22 December 2003 Answers to Questions, para. 109.

[317] *Compare* Ex-Im Bank schedule in Exhibit Bra-409 *with* CCC fee schedule in Exhibit Bra-155.

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considers that a 10-year period is *adequate* in this case to get a picture of the performance of the CCC programmes' portfolio. If the Panel wishes to look beyond that 10-year period, Brazil does not believe that doing so would be "inappropriate". Brazil has noted that should the Panel wish to corroborate evidence showing that over the period 1992-2002, the long-term operating costs and losses for the CCC programmes outpace premiums collected, it could look to CCC's 2003 financial statements, which state that uncollectible amounts on pre-1992 CCC guarantees outpace premiums collected during the period 1981-1991 by nearly $2 billion.[329]

227. The United States has indicated that Brazil continues to "mischaracterize" the amount of $411 million in the 2002 financial statement of the CCC, in Exhibit BRA 158, pp. 18 & 19. Can the United States please indicate how it believes this amount –

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will have lost $1.16 billion (as opposed to the $770 million it reported in its 2002 financial statements).[333]

228. What accounting principles should the Panel use in assessing the long-term operating costs and losses of these three programmes? For example, if internal US Government regulations require costs to be treated differently to generally accepted accounting principles, is it incumbent on the Panel to conduct its analysis in accordance with that treatment? BRA, USA

V. SERIOUS PREJUDICE

229. What is the meaning of the words "may arise in any case where *one or several* of the following apply" (emphasis added) in Article 6.3 of the *SCM Agreement*? Please comment on the possibility that these words indicate that one of the Article 6 subparagraphs may not be sufficient to establish serious prejudice and that serious prejudice should be considered an additional or overriding criterion to the factors specified in the subparagraphs. BRA

230. Please comment on Brazil's views on Article 6.3 of the *SCM Agreement* as stated in paragraphs 92-94 of its further submission. USA

231. Do you believe that the now-expired Article 6.1 and/or Annex IV of the *SCM Agreement* are relevant context for the Panel's interpretation of Article 6.3? USA

Brazil's Comment:

155. For the reasons Brazil has previously articulated, Brazil disagrees that Article 6.1 and Annex IV of the SCM Agreement are relevant context for interpreting the present text of Part III of the SCM Agreement.[334]

156. The US 22 December 2003 response to Question 243 confirms the fundamental role that Annex IV plays in its analysis of actionable subsidies in Part III of the SCM Agreement. The United States treats Annex IV as if the title of the Annex were "Calculation of the Total Ad Valorem Subsidization for Subsidies Subject to Part III of the Agreement". But all participants know and agree that Annex IV is dead. If it were not, then Brazil's submissions would certainly have been far more concise, as the total *ad valorem* subsidization for the US subsidies is 95 per cent over the four-year period of investigation.

157. The US reference in paragraph 131 of its 22 December 2003 Answer to Question 231 to the Appellate Body report in *US – CVD's on EC Products* is inapposite. That case involved countervailing duty measures, not actionable subsidy measures and claims under Part III of the SCM Agreement. The Appellate Body's citation to Annex IV was in the context of citing to a long list of SCM provisions that refer to the "recipient" of a "benefit" in the SCM Agreement. The Appellate Body did not, as the United States seeks to do in this case, use Article IV as the sole legal basis for the wholesale inclusion of countervailing duty methodologies into Part III of the SCM Agreement.

158. In paragraph 132 of its 22 December 2003 Answer, the United States continues to make the assumption that contract payments are "not tied to the production of upland cotton". As a factual

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matter, Brazil has demonstrated that contract payments *are* tied to the production of upland cotton.[335] The evidence of much higher upland cotton per-acre payments, among many other facts, demonstrates that the *de jure* "flexibility" is, in practice, not exercised by upland cotton producers[336], and that the bulk of the upland cotton contract payments are paid to current upland cotton producers.[337]

159. More importantly, while the United States repeats its calls for Brazil to implement various allocation methodologies in paragraph 132 of its 22 December 2003 Answers to Questions, it refuses to provide the information that would allow Brazil or the Panel to even perform a calculation using the flawed US methodology based on Annex IV. And the United States is just plain wrong to suggest in paragraph 132 of its 22 December 2003 response that Brazil has "refus[ed] to countenance any allocation of the decoupled payments it has challenged … ". Brazil's 20 January 2004 Answer to Question 258 explained in greater detail in Brazil's methodology for allocating the payments.[338] Brazil even demonstrated that applying the US allocation methodology with the flawed and incomplete US 18/19 December 2003 data resulted in levels of support to upland cotton that were consistent with Brazil's 14/16th Methodology.[339]

232. How, if at all, should the Panel take into account the effects of other factors in its analysis of the effects of US subsidies under Article 6.3? If the Panel should compare the effects of other factors to establish the relative significance of one compared to others, how would this be done? What would be relevant "factors" for this purpose? BRA

233. In Brazil's view, what is or are the "same market(s)" for the purposes of Article 6.3(c)? Does Brazil's view of "world market" imply that regardless of which domestic (or other) "market" is examined, price suppression will be identifiable? BRA

234. Does "significant" price suppression under Article 6.3(c) necessarily amount to "serious" prejudice within the meaning of Article 5(c)? Could the level of "significance" of any price suppression under Article 6.3(c) determine whether any prejudice under Article 5(c) rises to the level of "serious prejudice"? USA, BRA

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[335] *See* Brazil's 22 August 2003 Rebuttal Submission, Section 2.2 and references included therein. *See* also Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.7.5.

[336] *See* Brazil's 22 August 2003 Rebuttal Submission, Section 2.2 and references included therein. *See* also Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.7.5.

[337] Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.1; Brazil's 28 January 2004 Comments and Request Regarding US Data, Section 9. *See* also Brazil's comment on Question 205, above.

[338] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[339] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 10.

Brazil's Comment:

160. The US 22 December 2003 response again ignores the determination of the panel in *Indonesia – Automobiles*, which found that the term "significant" in Article 6.3(c) required examination of a link between the size of the margins of undercutting and whether those margins could "meaningfully affect suppliers of the imported product".[340] Under this "meaningfully affect" standard, the focus, at least for the purposes of Article 6.3(c)[341], is on producers of the non-subsidized like product. Have their revenue, investments, or crop choices been "meaningfully affected" by the level of price suppression experienced? These are the types of questions that provide guidance as to whether a particular level of price suppression is significant or not. The notion of "meaningfully affect" and "serious prejudice" are, in essence, equivalent for the purpose of Article 6.3(c).

161. The US 22 December 2003 response to Question 234, at paragraph 136, states that "[t]he use of the term 'significant' however, would seem to be intended to prevent insignificant price effects from rising to the level of serious prejudice." But this statement presumes some sort of an objective standard exists by which to judge what are "insignificant price effects". The United States provides no suggestions how this Panel or future panels are to make such an abstract determination. The United States' position implies that the "Panel will know them when they see them". But the Article 6.3(c) test, at least, requires the Panel to make an assessment of the relationship between the price effects and serious prejudice. And this link is to be judged by whether the price effects are "significant".

162. The Panel should firmly reject the two-step process suggested by the US interpretation. The first step would require a finding, using some unknown, non-textual standard, of whether a particular price level of suppression is "significant". Evidence that Brazilian producers would have lost $71.5 million during MY 1999-2002 from only one cent per pound of price suppression[342] would be totally irrelevant for the first step.[343] Only if a panel makes this "significant" finding, divorced from any impact on producers, would it move to the second step, *i.e.*, whether that level of now-significant price effects caused serious prejudice. But such an interpretation, like many proposed by the United States in this dispute, would leave Members who lost millions of dollars due to the effects of subsidies without a remedy. There is no textual basis for such a result, which would be contrary to the object and purpose of the SCM Agreement. In sum, the Panel should adopt the *Indonesia – Automobiles* standard of judging significance in light of whether the particular level of price suppression "meaningfully affects" non-subsidized suppliers of the like product.[344]

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[340] "Although the term "significant" is not defined, the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that *margins of undercutting so small that they could not meaningfully affect suppliers of the imported product* whose price was being undercut are not considered to give rise to serious prejudice…" (emphasis added). Panel Report, *Indonesia – Automobiles*, WT/DS54/R, para. 14.254.

[341] Brazil notes that Articles 6.3(a), (b) and (d) do not contain similar qualitative or quantitative qualifiers.

[342] Brazil's 9 September 2003 Further Submission, para. 258 (citing a $143 million loss from a 2 cents per pound level of price suppression).

[343] A good example of evidence that would be irrelevant under the first part of the US test is found in the testimony of Christopher Ward. He indicated that a 10 percent increase in prices for Mato Grosso producers in MY 2000 and MY 2001 would have permitted them to cover their variable costs for MY 2001 and come close to covering variable costs in MY 2000. However, because of the losses they suffered without such revenue increases, many Mato Grosso producers reduced production or were forced out of cotton production. Mato Grosso production fell by 34 per cent between MY 2000 -2001. Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, paras. 8-10 and accompanying graph).

[344] The US example of a per-unit payment of 0.0001 cents per pound in paragraph 136 is irrelevant, because under its hypothetical, this particular level of price suppression could never "meaningfully affect" any suppliers of the like product.

163. But even if the Panel decides to adopt some sort of numerical standard not reflected in the text of Article 6.3(c), Brazil has also set forth evidence showing that the levels of price suppression found by a number of different economists are "significant".[345] In assessing whether the various levels of price suppression found by USDA and other economists are "significant," the Panel should take into account the fact that upland cotton is a primary commodity traded in huge volumes and produced and consumed in a large number of countries. Under these circumstances, any measurable and identifiable effect on the *world* price from the subsidies provided by a single Member is important. In this case, the Panel is faced with particularly compelling facts – during MY 1999-2002 (and even during MY 1997-1998) the record shows that the absolute numerical levels of price suppression caused by some or all of the US subsidies were significant, ranging from 4 to 26.3 per cent of the world price, and 10 to 33.6 per cent of the US price.[346]

164. Finally, the United States argues in paragraph 136 that the effect of Brazil's interpretation is that any production subsidy would run afoul of Part III of the SCM Agreement, thus turning it into a prohibited subsidies provision. There is no basis for this argument. First, it is difficult to see how extremely low levels of production subsidies (0.0001 cents per pound price effects in the US example) could "materially affect" any competing producers of the none0also set forth evides09argum23.5 2is fm6TD 0

defined by the United States[350], far exceeds 100 per cent. To clarify this point, Brazil presents the

	US upland cotton exports	Non-US upland cotton exports	World upland cotton exports	US Share	Non-US Share	Total Share
		million bales			per cent	
1995	7.375	19.394	26.769	27.55	72.45	100.00
1996	6.399	19.384	25.783	24.82	75.18	100.00
1997	7.060	18.534	25.594	27.58	72.42	100.00
1998	4.056	18.559	22.615	17.94	82.06	100.00
1999	6.303	19.805	26.108	24.14	75.86	100.00
2000	6.303	19.170	25.473	24.74	75.26	100.00
2001	10.603	17.072	27.675	38.31	61.69	100.00
2002	11.266	15.796	27.062	41.63	58.37	100.00
2003	11.225	17.690	28.915	38.82	61.18	100.00

169. Brazil will address the US arguments that the world market share means share of world consumption in detail in its comments on the following questions.

237. Could a phenomenon that remains at approximately the same level over a given period of time be considered a "consistent trend" within the meaning of Article 6.3(d)? Do parties have any suggestions as to how to determine a "consistent trend", statistically or otherwise? BRA, USA

Brazil's Comment:

170. As noted in its 22 December 2003 response to this question, Brazil agrees that a phenomenon that remains at approximately the same level over a given period cannot be considered a consistent trend.[355] However, as detailed in that answer, this is not the situation facing this Panel. The data

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does not mean “world consumption share”, but world market share of exports, as detailed by Brazil many times, including in these comments.

in offering up an Article XVI:1 remedy (which is inexorably linked to Article XVI:3, second sentence) in paragraph 147, while arguing elsewhere that this provision is no longer applicable and has been replaced by Article 6.3.

Brazil's Comment:

184. Regarding the first question, Brazil has previously detailed the basis for its arguments that Article XVI:3, second sentence of GATT 1994 provides very important context for interpreting Article 6.3(d).[374] In response to the Panel's second question, Brazil has demonstrated that these provisions do apply separately, for the reasons Brazil has earlier stated.[375] With respect to the third question, the phrase "world market share" in the text of Article 6.3(d) is intended to mean the same thing as "share of world export trade".[376]

185. The United States points out several differences between Article XVI:3 and Article 6.3(d), one of which is its faulty interpretation that Article XVI:3, second sentence only deals with "export" subsidies. Brazil has earlier demonstrated that the pool of subsidies that could cause serious prejudice is the same for Article 6.3(d) and Article XVI:3, second sentence.[377]

186. The United States further argues that Brazil agreed in the Tokyo Round Subsidies Code that GATT 1994 Article XVI:3 is limited to export subsidies.[378] This is not correct, as demonstrated by the text of the Tokyo Round Code.[379] It uses the language "shall include" and "export subsidy" in connection with the notion of a more than equitable share of world trade.[380] Thus, an inequitable share of world trade may result from export subsidies, but it is not limited to that source. Moreover, whatever the interpretation of these terms may have been in the now extinct plurilateral Tokyo Round Subsidies Code, the only text that continues to exist is the ordinary meaning of the words used in Article XVI:3, second sentence, which must be interpreted according to its ordinary meaning in its context, and in light of the object and purpose of the GATT. Yet, the United States argues that even that provision is "incapable of definition or application".[381]

187. The United States argues in paragraph 151 that the use of the term "market" provides the

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242. How much of the benefits of PFC, MLA, CCP and Direct Payments go to land owners? If not all of the benefits go to land owners, what proportion goes to producers? USA

Brazil's Comment:

192. The Panel's question is set out in a section entitled "Serious Prejudice" and uses the word "benefit" relating to contract payments. Brazil will address its comments to the US 22 December 2003 response in two senses of the word "benefit". First, Brazil will address its

evidence is supported by Professor Sumner's conclusions because significant amounts of the PFC payments (approximately two thirds) were available to generate production effects.[398] Finally, Brazil also demonstrated that the total USDA-estimated increase in land values from PFC payments translated into less than one per cent of an upland cotton producers' total costs.[399]

200. The United States 22 December 2003 response now claims for the first time that only 35 per cent of the value of decoupled payments benefited upland cotton production during the period of investigation.[400] Having asserted this fact, the United States bears the burden of proving it.

-in6o that the.c2 also demonstrate
investigation.

203. It is also possible to test the US "35 per cent" assumption by examining non-cotton-specific cash rent and land value data. If the US assumption were correct, then cash land rents for cropland in states where upland cotton is produced should have increased significantly since the guaranteed PFC payments started in MY 1996. Further, it would be presumed, if the United States is correct, that 65 per cent of all the PFC upland cotton-related payments (as well as the other three contract payments) were captured by increased cash rents for cropland during MY 1996-2002. But this is simply not the case, as demonstrated below.

204. USDA carefully tracks cropland cash rents in all US states. In almost all of the 16 states where cotton is produced, land rents for cropland increased only slightly between MY 1996 and MY 2003.[408] This is in contrast to the value of cropland which increased to a far greater extent.[409] The United States seeks to have the Panel assume that both cropland values and cash rents increased significantly by stating, in paragraph 156 of its 22 December 2003 response, that "land rent data … follows the same trend" as land values. This is a misleading statement because, while cash rents increased, they did so at a much lower rate. For example, in Texas, cash rents for land increased 13.5 per cent ($18.50 to $21.00 per acre) during 1996-2003 while the value of an acre of cropland increased 28 per cent, from $674 in 1997 to $937 in 2003.[410] The increase in cash rents in Texas is less than the inflation rate (17 per cent) for the seven-year period.[411]

205. Cash rents in other US states producing upland cotton increased by similar amounts:[412]

US State[413]	Cash Rent 1996	Cash Rent 2002	Difference	Percentage Change
Texas	$18.50	$21.00	$2.50	13.5 per cent
Oklahoma	$25.60	$27.00	$1.40	5.5 per cent
Arkansas	$48.80	$53.00	$4.20	8.6 per cent
Louisiana	$53.00	$57.00	$4.00	7.5 per cent
Mississippi	$45.00			

206. As the figures demonstrate, the increase in cash rents is below the inflation rate of 17 per cent in most of the states. The highest numerical increase between 1996 and 2002 is $9 in Mississippi. Being extremely conservative, Brazil has assumed that this Mississippi increase represents the increase in cash rents for all US upland cotton cropland. It follows that for MY 2002 (with 13.8 million acres planted to upland cotton) and with about 25 per cent of upland cotton land cash-rented, these $9 mean that $31 million of the total of $454.5 million[414] in direct payments found their way into increased cash rents for upland cotton land.[415] Thus, USDA's own data shows that only 6.8 per cent of the MY 2002 direct payments could have been attributable to increased cash rents – not 65 per cent as the United States asserts.

207. It should be noted that none of this analysis includes CCP payments. If CCP payments were included with direct payments, the percentage share would be even lower. Generally, the United States agrees that cash rents also reflect long-term expectations about crop prices and programme benefits. While direct payments are paid regardless of prices, CCP payments vary with prices. Therefore, one can expect that the payments will be discounted by a margin reflecting the uncertainty about the availability of CCP payments in future years for which cash rents are fixed.

208. The United States claims that cash rents are "sticky" and do not respond quickly to the increased net revenue from the use of the land.[416] The United States further suggests that the estimated 34-41 per cent of PFC payments captured for MY 1997 as set out in an August 2003 ERS study will be higher for later years.[417] But the evidence outlined above suggests that cash rents for cropland did not increase significantly between MY 1996-2002, and thus do appear to reflect to any considerable extent the effects of PFC or other contract acreage payments. The US assertion amounts to speculation, as the authors of the August 2003 study properly acknowledge.[418] Cash rents may be just as easily, if not more, affected by expected low prices for upland cotton, as suggested by the NCC President[419], or other factors such as interest rates. The absence of evidence of significant cash rent increases more than seven years after enactment of the 1996 FAIR Act suggests that whatever production effects from direct payments and CCP payments exist presently will continue to exist in the future – supporting Brazil's threat of serious prejudice claims.

209. The above discussion has focused on PFC payments, since that is the only type of contract payment for which the United States presented evidence. However, the United States "35 per cent" assumption also was made regarding CCP payments and market loss assistance payments.[420] The Panel will look in vain for any evidence produced by the United States that only 35 per cent of MY 2002 CCP payments benefited upland cotton producers who cash rent upland cotton cropland. Because CCP payments are triggered on a year-by-year basis depending on low prices for upland cotton, a non-producing landlord cannot know in what amount CCP payments will be made. Further, as Brazil has demonstrated repeatedly, given the high non-land-related production costs involved in producing cotton, most US producers simply could not profitably produce cotton without CCP

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[414] Brazil's 22 December 2003 Answer to Question 196, para. 8.

[415] 13.8 million acres times 0.25 times $9 equals $31,050,000.

[416] US 22 December 2003 Answer to Question 242, para. 157.

[417] US 22 December 2003 Answer to Question 242, para. 157.

[418] Exhibit Bra-310 ("The Incidence of Government Program Payments on Agricultural land Rents: The Challenges of Identification," Roberts, Kirwan, Hopkins, p. 769) ("It could be … [and] [m]ore research is needed to verify these incidence estimates to ascertain the time it takes for rents to reflect changes in associated government payments and to measure how incidence is ultimately capitalized into land values.").

[419] Exhibit Bra-41 (Testimony of Roberto McLendon, p. 7)("I think people that are professional farm managers have been concerned for the last 2 or 3 years that we are going to have a decrease in land values because they saw it in the 1980's. We had low prices and a bad situation. Again, in my opinion, we have had such a strong economy outside of agriculture it has supported land values, but that support won't last forever … .")

[420] US 22 December 2003Answer to Question 242, para. 158.

218. The US 22 December 2003 response highlights the differences between the parties on how to allocate the "benefit" for payments made under the four types of contract payments. Further, the US response reflects the parties' differences over whether the quantification exercise is relevant for the peace clause "support to cotton," or whether it is instead

220. The US 22 December 2003 response reiterates, in paragraphs 161-163, the US peace clause arguments that the absence of any *requirement* to produce upland cotton in the statutory provisions of the 1996 and 2002 Farm Acts for direct and counter-cyclical payments (as well as PFC and market loss assistance payments) completely insulates these subsidies from any actionable subsidy challenge during the implementation period. Brazil demonstrated how this extremely narrow US "production requirement" test is contrary to the *chapeau* of Article 13(b)(ii), contrary to the context of Annex 2, paragraph 6(e), contrary to the context of Annex 3, paragraphs 10, 12, and 13, and contrary to the context of the AMS definition in Article 1(a) (referring to "in general").[444] Brazil also demonstrated that the US "production requirement" test is contrary to the object and purpose of the Agreement on Agriculture, because it carves out huge amounts of amber box subsides from any discipline of the SCM Agreement during the implementation period.[445]

221. The United States argues, at paragraph 163 of its 22 December 2003 response, that Brazil's allocation methodology "eliminates the concept of non-product specific support for purposes of the peace clause since a non-tied payment may always be allocated according to the recipient's production". Brazil notes again its fundamental disagreement with the US assumption that $935.6 million in CCP payments and $454.5 million in direct payments paid in MY 2002 to current producers of upland cotton are "untied" subsidies.[446] The overwhelming evidence in the record shows they are *de facto* "tied" to upland cotton production.[447] Further, the United States incorrectly assumes that "non-product specific support" is the language set out in Article 13(b)(ii). The actual text is "sup

largely legally and factually wrong, is an astounding display of hubris in light of the US refusal to produce the very evidence that would permit the application of the methodology it advocates.

244. What proportion of the 2000 cottonseed payments benefited *producers of upland cotton*, given that payments were made to *first handlers*, who were only obliged to share them with the producer to the extent that the revenue from sale of the cottonseed was shared with the producer? (see 7 CFR §1427.1104(c) in Exhibit US-15). BRA

245.

of serious prejudice to the interests of another Member? At what time and on the basis of what type of information would she exercise her authority?

(e) What does "to the maximum extent practicable" mean? In what circumstances would it not be practicable for the Secretary to exercise her adjustment authority? USA

Brazil's Comment:

227. In its arguments at paragraphs 176, 178 and 180 of its 22 December 2003 response, the United States speculates about the "thoughts," "anticipations," "contemplations," "understandings", and "belief" of the US Congress. Yet it provides no citation to the extensive C

the legal entitlement nature of these programmes means that payments must be made – if necessary after CCC funds have been replenished.

231. Finally, Brazil recalls that the United States argued in the peace clause portion of this dispute that is has no control over the flow of the upland cotton subsidies.[462] In fact, there is no legal mechanism to stem, or otherwise control, the flow of these upland cotton subsidies, which cause a permanent source of uncertainty in the world upland cotton market.[463] Thus, the US subsidies cause a threat of serious prejudice, in violation of Articles 5(c), 6.3(c) and 6.3(d) as well as footnote 13 of the SCM Agreement, and GATT Articles XVI:1 and 3.

255. How does Brazil respond to US assertions concerning the circuit-breaker provision? (see US 2 December oral statement, paragraph 82). Does this mean that US subsidies cannot be "mandatory" for the purposes of WTO dispute settlement? BRA

256. The United States submits that the Panel cannot make rulings without allocating precise amounts of payments to upland cotton production. However, to the extent that such precise data is not on the Panel record, to what extent can the Panel rely on less precise data, and on reasonable assumptions, in fulfilling its duty under Article 11 of the *DSU* in this case? USA

Brazil's Comment:

232. Because the United States has refused to cooperate in producing the most precise data concerning the amounts of contract payments to upland cotton producers, the Panel should (1) first draw adverse inferences from the US refusal to cooperate, and (2) use the best information available in making its determination.[464] Brazil presents the factual and legal basis permitting the Panel to make findings based on reasonable assumptions in its separate 28 January Comments and Requests Regarding US Data. These separate comments address most of the points raised in the extensive – and largely unresponsive – US answer to Question 256.[465] Additional points are set out below.

233. First, there is relevant WTO jurisprudence that provides a legal basis for the Panel to draw –

United States appealed this decision, the Appellate Body affirmed the panel, stating that "where a party refuses to provide information requested by a panel, that refusal will be one of the relevant facts of record, and indeed, an important fact, to be taken into account in determining the appropriate inference to be drawn".[470] The Appellate Body further indicated that it "deplored the conduct of the United States" in refusing to cooperate and provide information that was within its exclusive control.[471]

234. Another example of a panel using the best information available when a Member refused to provide documents within its exclusive control is the *Argentina – Textiles and Apparel* case. In that case, the United States requested Argentina to produce complete original customs documents of all footwear imports to demonstrate that Argentina was imposing and requiring payment of specific duties in excess of its bound duty rates of 35 per cent *ad valorem*.[472] Argentina refused to provide the complete (or any) documents.[473] The United States then provided examples of customs documents, which Argentina contested on a variety of authenticity and relevance grounds.[474] The panel rejected these Argentine arguments and found that "the United States has provided *sufficient evidence*".[475] In so holding, the panel noted that "[i]n situations where direct evidence is not available, relying on

236. Turning to its claims of serious prejudice and threat thereof, Brazil remains of the firm view that neither Part III of the SCM Agreement nor GATT Article XVI requires an exact determination of the amount of subsidies involved.[483] Rather, Brazil must demonstrate their *effects*.[484] Nevertheless, and as an alternative legal argument, Brazil presented extensive evidence concerning the *amounts as well as the effects* of each challenged subsidy. This is the same evidence Brazil used to demonstrate the amount of support to upland cotton.

237. The United States asserts that Brazil has to allocate all contract payments received by an upland cotton producing farm over the total value of that farm's sales.[485] However, even though the United States alone is in exclusive control of the information that would permit such an allocation, it has refused to produce that information.

IX. ADDITIONAL QUESTIONS POSED ON 23 DECEMBER 2003 AND 12 JANUARY 2004

257. The Panel takes note of the Appellate Body Report in *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan* (DS244), which was circulated to WTO Members on 15 December 2003. The Panel is aware that this report has yet to be adopted by the Dispute Settlement Body. Nevertheless, the Panel asks the parties to respond to the following related questions.

(a) In tht report, the Appellate Body cautioned against the "mechanistic" application of the so-called "mandatory/discretionary distinction" and stated that the import of this distinction may vary from case to case (para. 93). For the Appellate Body, the question of whether a measure is mandatory or not is relevant "if at all" only as part of the assessment of whether the measure is, as such, inconsistent with particular obligations. How, if at all, are these statements and the related findings concerning the mandatory/discretionary distinction in that Appellate Body Report relevant to:

(i) the legal standard and elements Brazil sets out to establish its export and prohibited subsidy claims under the provisions of the *Agreement on Agriculture* and Articles 3.1(a) and (b) of the *SCM Agreement*, concerning: BRA

- **Step 2 payments (see, *e.g.* paras. 244-245 & 250 Brazil's first written submission; Panel Question 109 and parties' responses/comments thereon); and**

- **export credit guarantee programmes: GSM-102, GSM-103 and SCGP (see, *e.g.*, para. 90 Brazil's oral statement at second Panel meeting).**

(ii) the legal standard and elements Brazil sets out to establish its serious prejudice and "threat of serious prejudice" claims, and in particular, its designation of marketing loan; crop insurance; counter-cyclical payments; direct payments and Step 2 as "mandatory"? BRA

(iii) the legal standard and elements Brazil sets out to establish its "*per se*" "serious prejudice" claims (*e.g.* Brazil's 9 September further submission, para. 417 *ff*; US oral statement at second Panel meeting, para. 86 *ff*.)? BRA

(b) How and to what extent are the legal and regulatory provisions cited in paras. 415 and 423 of Brazil's 9 September further submission "normative" in nature and treated as binding within the US legal system (see, *e.g.*, para. 99 of the Appellate Body Report)? Does your response differ depending on whether the payments are dependent upon market price conditions? BRA

(c) Does Brazil challenge as "mandatory" the "subsidies" themselves, the subsidy programmes or the legal/regulatory provisions for the grant or maintenance of those subsidies, or something else? BRA

(d) Does the "requirement" upon the CCC to make available "not less than" $5.5 billion annually in guarantees have a normative character and operation? (see, e.g. Brazil's response to Panel Question 142; Exhibit BRA-297, 7 USC 5641(b)(1); 7 USC 5622(a) & (b); paragraph 201 of US 18 November further rebuttal submissions). Is this requirement "mandatory"? If so, how does the CCC have "discretion" not to make this amount of guarantees available in a given year? USA

It is required to do so by law.[497] It is, moreover, altogether exempt from any ceiling on the amount of guarantees it extends, and from the normal requirement that it receive new budget authority before undertaking new guarantee commitments (the programmes' "mandatory" status under US law "does not effectively constrain credit activity").[498] The CCC uses that exemption liberally, increasing allocations throughout the fiscal year to meet the needs of US exporters.[499]

245. Even if the CCC does not reach its goal of issuing over $6 billion in guarantees by year end, the fact that US law tells it that it must make available at least this amount, the fact that it sets its sights on and actually announces this amount, and the fact that nothing in US law sets any upward bound on the amount of guarantees it can issue, communicates a threat that it will circumvent its export subsidy commitments. Even if the CCC does not reach its goal of issuing $6 billion in export credit guarantees, foreign competitors of US farmers see that it has announced its intent to do so, that it has the authority to do that and an unlimited amount more, and that there is no "mechanism in the measure" for CCC to "stem[], or otherwise control[], the flow of" CCC export credit guarantees.[500]

246. Moreover, foreign competitors of US farmers have seen how, as an historical matter, the United States has applied the CCC guarantee programmes to surpass its quantitative export subsidy reduction commitments – even when falling short of its announced intent to issue $6 billion in guarantees. Brazil has demonstrated how this threat materialized for one product – rice – in fiscal years 2001, 2002 and 2003 (despite the fact that the CCC did not reach its announced intent of handing out $6 billion in guarantees in any of those years).[501] Foreign producers' fears that the threat will materialize in other years for other products are legitimate, and the threat is therefore tangible (regardless whether or not the CCC meets its goal of handing out $6 billion in guarantees in any given year).

247. Merely having what the United States claims is the unwritten, administrative discretion to "tamp down the actual issuance of guarantees" would not be enough under this test.[502] The reason the Appellate Body in *US – FSC* looked for an affirmative "mechanism in the measure" subject to an Article 10.1 claim that would stem or control the flow of subsidies, rather than merely accepting as sufficient the unwritten administrative discretion to do so, is that only when such a mechanism exists, will .

circumvention is not real. The purpose of the mechanism, in other words, is to diminish the threat. (Had this not been the Appellate Body's intent, it would simply have stuck to the traditional mandatory/discretionary formula it has used elsewhere and that the United States asserts applies in the analysis of an Article 10.1 claim.)

248. In any event, the "discretionary elements" that the United States asserts[503] abate the threat

its *quantitative* export subsidy reduction commitments.[518] Brazil has demonstrated how this threat materialized for one product (rice)[519]; the threat that it might happen in some years for other products is therefore tangible.

254. Everything about the CCC programmes aggravates and legitimizes the fear foreign competitors of US farmers have that the programmes will be used to circumvent the United States' export subsidy commitments. Brazil has demonstrated that under Articles 1.1 and 3.1(a) of the SCM Agreement, and item (j), guarantees under the programmes constitute *per se* export subsidies. The CCC issues these export subsidies free from the normal budgetary constraints placed on federal spending. The only constraint placed on the programmes is one that in fact encourages fear of circumvention – the obligation the US Congress has placed on the CCC to make available *a minimum* of $6.5 billion of CCC guarantees every year.[527] While the United States considers CCC's failure to actually grant $6.5 billion in guarantees in a given year as significant to its defense, it misunderstands the obligation included in Article 10.1. Article 10.1 prohibits the threat of circumvention. Foreign competitors of US farmers see and fear the unchecked authority US farmers and the CCC have to circumvent US export subsidy commitments. Their fear is legitimate, since that unchecked authority has been used in the past to circumvent those commitments.[528]

255. There is no affirmative "mechanism in the measure" that will stem or control the flow of CCC guarantees in a way that will abate the threat of circumvention of the US export subsidy commitments with respect to scheduled products. To abate the fear that makes the threat real, foreign competitors need to see a mechanism in place that will keep the United States from using the CCC programmes to provide export subsidies that surpass the US reduction commitments. The nature of the obligation in Article 10.1 – the prohibition of a threat – is such that it cannot be met with a showing that there is mere discretion to avoid surpassing those commitments. That the Appellate Body failed to apply the traditional mandatory/discretionary distinction in interpreting the standard required by Article 10.1 demonstrates its understanding that to prevent a measure from posing a threat of circumvention, there needs to be some affirmative mechanism in place to reduce the legitimate fear of circumvention.

258. Please submit a detailed explanation of the method by which one could calculate total expenditures to producers of upland cotton under the four relevant programmes on the basis of the data which it seeks. BRA

[527] For citations, *see* Brazil's 2 December 2003 Oral Statement, para. 91.
[528] Exhibit Bra-300 (Calculation on US Rice Exports Benefiting from GSM 102, GSM 103 and SCGP).