

ANNEX I-7

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

(22 December 2003)

TABLE OF CONTENTS

	<u>Page</u>
I. Terms of Reference.....	278
II. Economic Data	279
III. Domestic Support	291
IV. Export Credit Guarantees	293
V. Serious Prejudice	303
VI. Step 2.....	339
VII. Remedies	341
VIII. Miscellaneous	342

Table of Cases

Short Title	Full Case and Citation
<i>Korea – Beef</i>	GATT Panel Report, <i>Republic of Korea – Restrictions on Imports of Beef – Complaint by the United States</i> , BISD 36S/268, adopted on 7 November 1989.
<i>Japan – Alcoholic Beverages</i>	Appellate Body Report, <i>Japan – Taxes on Alcoholic Beverages</i> , WT/DS8/AB/R, adopted 1 November 1996.
<i>EC – Hormones</i>	Appellate Body Report, <i>European Communities – Measures Concerning Meat and Meat Products (Hormones)</i> , WT/DS26/AB/R, adopted 13 February 1998.
<i>Brazil – Aircraft</i>	Panel Report, <i>Brazil – Export Financing Programme for Aircraft</i> , WT/DS46/R, adopted 20 August 1999.
<i>Indonesia – Automobiles</i>	Panel Report, <i>Indonesia – Certain Measures Affecting the Automobile Industry</i> , WT/DS54/R, adopted 23 July 1998.
<i>Argentina – Textiles and Apparel</i>	Appellate Body Report, <i>Argentina – Measures affecting Imports of Footwear, Textiles, Apparel and Other Items</i> , WT/DS56/AB/R, adopted 22 April 1998.
<i>Guatemala – Cement (I)</i>	Appellate Body Report, <i>Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico</i> , WT/DS69/AB/R, adopted 25 November 1998.
<i>Japan – Agricultural Products</i>	Panel Report, <i>Japan – Measures Affecting Agricultural Products</i> , WT/DS76/R, adopted 19 March 1999.
<i>India – Quantitative Restrictions</i>	Panel Report, <i>India – Quantitative Restrictions on Imports of Agricultural, Textiles and Industrial Products</i> , WT/DS90/R, adopted 22 September 1999.
<i>Canada – Dairy</i>	Appellate Body Report, <i>Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products</i> , WT/DS103/AB/R, adopted 27 October 1999.
<i>US – FSC</i>	Appellate Body Report, <i>United States – Tax Treatment for “Foreign Sales Corporation”</i> , WT/DS108/AB/R, adopted 20 March 2000.
<i>Argentina – Footwear</i>	Appellate Body Report, <i>Argentina – Safeguard Measures on Imports of Footwear</i> , WT/DS121/AB/R, adopted 12 January 2000.
<i>Australia – Leather</i>	Panel Report, <i>Australia – Subsidies Provided to Producers and Exporters of Automotive Leather</i> , WT/DS126/R, adopted 16 June 1999.
<i>US – Certain EC Products</i>	Appellate Body Report, <i>United States – Import Measures on Certain Products from the European Communities</i> , WT/DS165/AB/R, adopted 10 January 2001.
<i>US – Export Restraints</i>	Panel Report, <i>United States – Measures Treating Export Restraints as Subsidies</i> , WT/DS194/R, adopted 23 August 2001.
<i>Chile – Agricultural Products (Price Band)</i>	Appellate Body Report, <i>Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products</i> , WT/DS207/AB/R, adopted 23 October 2002.
<i>Canada – Aircraft II</i>	Panel Report, <i>Canada – Measures Affecting the Export of Civilian Aircraft</i> , WT/DS222/R, adopted 19 February 2002.
<i>Argentina – Peach Safeguard</i>	Panel Report, <i>Argentina – Definitive Safeguard Measure on Imports of Preserved Peaches</i> , WT/DS238/R, adopted 15 April 2003.
<i>Japan – Apples</i>	Panel Report, <i>Japan – Measures affecting the Importation of Apples</i> , WT/DS245/R, adopted 10 December 2003.
<i>US – Steel Safeguards</i>	Appellate Body Report, <i>United States – Definitive Safeguard Measures on Imports of Certain Steel Products</i> , WT/DS248/AB/R, adopted 10 December 2003.

List of Exhibits

Loan Deficiency Payment and Price Support Activity as of 12/3/2003	Exhibit Bra- 373
“Crop Year Statistics MY 2002” – Federal Crop Insurance Corporation	Exhibit Bra- 374
Information Provided by Gerald Estur, ICAC.	Exhibit Bra- 375
“About FAPRI,” Center for Agricultural and Rural Development, Iowa State University	Exhibit Bra- 376
“About FAPRI,” Food and Agricultural Policy Research Institute at the University of Missouri.	Exhibit Bra- 377
“About FAPRI,” Food and Agricultural Policy Research Institute.	Exhibit Bra- 378
CARD Report, 40 Anniversary Commemorative Issue	Exhibit Bra- 379
“Food and Agriculture Policy Research Institute Receives USDA’s Highest Honor,” CARD Press Release, 9 July 2002.	Exhibit Bra- 380
Jeffrey D. McDonald and Daniel A. Sumner. “The Influence of Commodity Programmes on Acreage Responses to Market Price: With and Illustration concerning Rice Policy in the United States.” American Journal of Agricultural Economics, (85) 4 November 2003.	Exhibit Bra- 381
Cotton and Wool Outlook, USDA, 12 December 2003.	Exhibit Bra- 382
Brazil and US Export Data on Export Quantities and Values by Country	Exhibit Bra- 383
Import Prices from Various Countries	Exhibit Bra- 384
Domestic Prices from Various Countries	Exhibit Bra- 385
Brazil and US Export Prices by Country	Exhibit Bra- 386
Brazil Export Prices v A-Index Prices by Country	Exhibit Bra- 387
US Export Prices v A-Index Prices by Country	Exhibit Bra- 388
Brazilian Domestic Price Data	Exhibit Bra- 389
“Glickman Proposes Cottonseed Payment Programme,” USDA News Release, 29 February 2000.	Exhibit Bra- 390
Cost of Ginning and Value of Cottonseed per pound of Cotton Lint	Exhibit Bra- 391
“William Duvanant Says: Overproduction Thwarts Cotton price Upturn,” Western Farm Press.	Exhibit Bra- 392
Futures Prices as of 19 December 2003	Exhibit Bra- 393

UNITED STATES – SUBSIDIES ON UPLAND COTTON

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**

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

Brazil's Answer:

1. The answer to both questions is “no.” Brazil reported interest subsidies and storage payments separately and thus did not double count them.¹ To the extent that the United States confirms that both of these payments are connected in some way to the storage of bales of cotton involved in the marketing loan programme, then they would appropriately be included within the overall marketing loan numbers. In that case, the Panel should increase the amount of payments attributable to marketing loan payments by including interest and storage payments related to bales of cotton in the marketing loan programme.

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 Answer:

2. Brazil reserves its right to further comment on the US answer provides some initial thoughts.

3. Brazil reiterates its arguments that the Panel must examine data relating to payments made after the date of establishment.² In addition, the Panel is not prevented from examining payment data that originates after the date of the Panel's establishment because these payments are identified in Brazil's panel request and, therefore, are within the Panel's terms of reference.

4. The measures covered by Brazil's request for the establishment of the Panel are very broad and encompass, *inter alia*, any type of payment made under the 2002 FSRI Act and the 2000 ARP Act.³ In addition, the panel request covers, *inter alia*, a time period of a “marketing year” for 2002 for

¹ See e.g. Brazil's 9 September Further Submission, Table 1.

² Brazil's 22 August Rebuttal Submission, paras. 88-96; Brazil's 22 July Oral Statement, paras. 40-44.

³ WT/DS267/7, p. 2.

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 encompass all payments made under the 2002 FSRI Act for the period marketing year 2002.

5. As has been firmly established in WTO jurisprudence, any "measure" identified in the panel request pursuant to DSU Article 6.2, is within terms of reference of the panel.⁶ As noted above, Brazil identified all relevant "measures" in its request for the establishment in the Panel. Further, in the *Chile – Agricultural Products (Price Band)* case, the Appellate Body held that a panel request which includes reference to "amendments" is sufficient to bring later enacted significant changes to legislation within the Panel's terms of reference.⁷ While Brazil's panel request also included "amendments," this case does not even raise the *Chile – Agricultural Products (Price Band)* issues because Brazil's panel request identified the measures that have not changed or been amended since 18 March 2003. Further, to the extent that "payments" made since 18 March 2003 are evidence, the Appellate Body and panels have repeatedly found that evidence generated after the establishment of the panel can be used by panel's in their objective assessment of the facts under DSU Article 11.⁸

II. Economic Data

195. Does the United States wish to revise its response to the Panel's Question No. 67bis, 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

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 (step2) programmes and export credit guarantee programmes. BRA, USA

Brazil's Answer:

6. With its letter of 18 December 2003, the United States has finally confirmed – after asserting the contrary repeatedly to Brazil and then to the Panel – that it has collected complete planted acreage, contract base acreage, contract yields, and even payment data that would allow it to calculate with relative precision the amount of direct and counter-cyclical payments made to current producers of

⁴ Brazil's 9 September Further Submission, para. 423.

⁵ US 27 October Answers to Questions, paras. 95-97.

⁶ Panel Report, *Japan – Agricultural Products*, WT/DS76/R, para. 8.4; Panel Report, *Indonesia – Automobiles*, WT/DS54/R, paras. 14.3-14.4.

⁷ Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, para. 135.

⁸ Panel Report, *India – Quantitative Restrictions*, WT/DS90/R, para. 5.161-5.163 ("In this case the parties and the IMF have supplied information concerning the evolution of India's balance of payments and reserve situation until June 1998. To the extent that such information is relevant to our determination of the consistency of India's balance of payments measures with GATT rules as of the date of establishment of the Panel [18 November 1997], we take it into account."); Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, paras. 133-4 ("The deliberate disregard of, or refusal to consider, the evidence submitted to a panel is incompatible with the panel's duty to make an objective assessment of the facts. ... A claim that a panel disregarded or distorted the evidence submitted to it is, in effect, a claim that the panel, to a greater or lesser degree, denied the party submitting the evidence fundamental fairness, or what in many jurisdictions is known as due process of law or natural justice."); Panel Report, *Japan – Apples*, WT/DS245/R, para. 8.49; GATT Panel Report, *Korea – Beef*, BISD 36S/268, paras. 122-123.

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 for 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 DIRECT PAYMENTS	\$217 MILLION	\$217 MILLION*
COUNTER-CYCLICAL PAYMENTS	\$485.1 MILLION	\$454.5 MILLION ¹⁴
COTTONSEED PAYMENTS	\$998.6 MILLION	\$935.6 MILLION ¹⁵
OTHER PAYMENTS	\$50 MILLION	\$50 MILLION*
TOTAL PAYMENTS	\$65 MILLION	\$65 MILLION*
	\$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

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

¹¹ Taken from Table 1 of Brazil's 9 September Further Rebuttal Submission.

¹² Exhibit Bra-373 (Loan Deficiency Payment and Price Support Activity as of 12/3/2003).

¹³ Brazil notes that the United States also paid \$104.2 million in fulfilment of its reinsurance obligations towards the insurance companies providing the insurance policies to upland cotton producers. These payments also constitute support to upland cotton, but Brazil had so far not included them in its calculation of the total support to upland cotton. This amount results from a MY 2002 loss ratio of 1.26, *i.e.*, the 26 per cent of the \$400,666,618 in indemnity payments were not covered by the Federal Crop Insurance Corporation or producer premium payments. These \$104.2 million were paid by the Federal Crop Insurance Corporation (*See* Exhibit Bra-374 (“Crop Year Statistics MY 2002” – Federal Crop Insurance Corporation).

¹⁴ This calculation is based on total direct payments for upland cotton base of \$625 million (US 27 August Comments, Table at para. 28 reporting PFC payments for MY 2002 of \$452 million and additional direct payments of \$173 million). This figure has been adjusted by the ratio of MY 2002 plantings (13.714 million acres) and MY 2002 direct payment base acreage (18.858 million acres) (*See* Exhibit US-95).

¹⁵ Brazil has used the direct payment of \$454.5 million and adjusted it by the ratio of the direct payment rate of 6.67 cent per pound basis and the CCP payment rate for MY 2002 of 13.76 cents per pound.

¹⁶ Brazil refers the Panel to Exhibits Bra-333 (Cotton: World Markets and Trade, USDA, October 2003, Table 3) for the amount of cotton exports that were covered by export credit guarantees during the fiscal years that overlap with MY 2002 (FY 2002 and FY 2003). Since the overlap is largely with fiscal year 2003, Brazil has used the share of cotton export credit guarantees (\$349.63 million) of the total guarantees made available (\$5,953 million) under GSM 102 and GSM 103 in that year to calculate the amount of payments as estimated by the FCRA formula. The original subsidy estimate for FY 2003 (taken from the 2004 budget) is \$294 million. The share attributable to cotton export credit guarantees would be \$17 million.

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 quotations from the major producing origins around the world, much like a poll.

12. The A-Index is published weekly by the Cotton Outlook and calculated daily based on daily cotton price quotes converted on the basis of delivery to Northern European ports. The A-Index is generated based on Cotlook receiving daily information as regards quotations for upland cotton referring to 16 different origins. The quotes are for an upland cotton described as quality Middling Grade with a 1 3/32" staple length. The 16 quoted prices that are eligible for inclusion in the A-Index include prices for Brazilian Middling 1 3/32" upland cotton as well as prices for US Memphis and California/Arizona Middling 1 3/32" upland cotton.²⁰ The A-Index value of the day represents the average of the five cheapest quotes out of the 16 quotes that are considered for the index calculation. The price quotes are derived from a variety of physical markets, merchants and trade information, which is gathered telephonically and analyzed for consistency and logic.²¹

13. Andrew Macdonald testified that growers, consumers and traders perceive the A- (and B-Index), along with the New York futures prices as reflecting the "world" market price for cotton.²²

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

Brazil's Answer:

14. Brazil presented the nearby futures chart in its 18 November Further Rebuttal Submission²³ to rebut US arguments that US producers allegedly respond to market price signals in making their

¹⁷ Brazil's 9 September Further Submission, Annex II, paras. 22-25.

¹⁸ Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).

¹⁹ Brazil's 9 September Further Submission, Annex II, paras. 22-25.

²⁰ The other quotes being Mexican Middling 1 3/32", Paraguayan Middling 1 3/32", Izmir/Ant St White 1 3/32", Syrian Middling 1 3/32", Greek Middling 1 3/32", Spanish Middling 1 3/32", Uzbekistan Middling 1 3/32", Pakistan Punjab SG 1503 1 3/32", Indian H-4/Meach-1 1 3/32", Chinese Type 329, Tanzanian AR Type 2, African "Franc Zone" Middling 1 3/32" and Australian Middling 1 3/32".

²¹ Brazil's 9 September Further Submission, Annex II, para. 22.

²² Brazil's 9 September Further Submission, Annex II, para. 22.

²³ Brazil's 18 November Further Rebuttal Submission, paras. 81-82.

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 – and the world's leading cotton trader's²⁶ – conclusions that US subsidies make cotton producers largely unresponsive to market price signals.²⁷

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

Brazil's Answer:

15. Brazil has reviewed the questions very carefully and regrets that it does not have a clear understanding of the meanings of the terms used. Therefore, Brazil provides alternative answers depending on the possible intent of the questions/terms used. Brazil regrets if it has misinterpreted the terms in the questions and would welcome the opportunity to provide additional comments if the Panel should so desire.

16. The first question focuses on data relating to “cotton production sold under *futures contracts*.” The term “futures contracts” could have several meanings in the context of this dispute. First, if the phrase “production sold under futures contracts” means the amount of US production sold on a forward delivery basis, the answer is that Brazil has no access to any such data. However, Brazil notes that all US upland cotton that is exported is for “future delivery” because it takes time to actually ship cotton from the United States, and some contracts are more “future” than other contracts. Theoretically, it would be possible to take the volume of US upland cotton exported each week and assume that it was sold at the average A-Index price that week. However, this would only be an estimate and would not necessarily reflect the price received by the US producers, or the prices received by the exporter. Prices received by US producers are tabulated by USDA and are before the Panel.²⁸ Average A-Index prices are also evidence before the Panel and are found in Exhibit Bra-311. If this is the information sought by the Panel, Brazil would be pleased to provide an estimate.

17. If the phrase “production sold under futures contracts” means contracts for future delivery where the contract for sale contains a pricing clause pegged to the New York futures price at the time of delivery, then the answer to the first question is “no,” *i.e.*, there is no data that would provide the amount of production sold through such contracts. The record contains evidence that Brazilian and Chad producers and purchasers of upland cotton use such clauses in their contracts.²⁹ Brazil has no access to information concerning the amount of US upland cotton sold through such contracts.

18. Finally, if the phrase “cotton production sold under futures contracts” means the amount of US upland cotton that is sold through the New York cotton futures exchange, the answer is “very

²⁴ Brazil's 7 October Oral Statement, paras. 13-15. Brazil's 27 October Answers to Questions, paras. 35-36.

²⁵ See *e.g.* Brazil's 2 December Oral Statement, para. 44.

²⁶ See Brazil's Answer to Question 247 *infra*.

²⁷ Brazil's 2 December Oral Statement, paras. 39-40.

²⁸ See *e.g.* Exhibit Bra-4 (“Fact Sheet: Upland Cotton,” USDA, January 2003, p. 5) and various issues of USDA's Cotton and Wool Outlook, Table 6.

²⁹ Brazil's 9 September Further Submission, Annex II, para. 16; Chad's 8 October Oral Statement, para. 9 (Statement by Ibrahim Malloum).

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, *i.e.*, loses the beneficial interest to the upland cotton, or foregoes the right to a marketing loan in favour of a LDP payment, which is paid upon ginning of the raw cotton.³³ The process of marketing and selling the upland cotton in the United States or for export through forward contracts to supply upland cotton in the future, or contracts which set the price based on future New York futures market prices does not impact in any way the amount the US producer receives in marketing loan payments. The amount of marketing loan payment solely depends on the difference between the loan rate and the adjusted world price. Whether the actual selling price is below or above the loan rate, or below or above the adjusted world price, has no impact on the amount of the marketing loan benefit. The fact that producers may sell at prices above the adjusted world price means that they generate a combined revenue from the market and the marketing loan programme that exceeds 52 cents per pound.

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

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

Brazil's Answer:

20. The Food and Agricultural Policy Research Institute (FAPRI) was established in 1984 by a grant of Congress and continues to be financed largely by the US Congress. FAPRI is a unique dual-university programme by the Center for Agricultural and Rural Development (CARD) at Iowa State University³⁴ and the Center for National Food and Agricultural Policy at the University of Missouri (Columbia),³⁵ with researchers at the University of Missouri focusing mainly on the domestic / US side of agriculture and researchers at Iowa State University focusing mainly on international agricultural issues. FAPRI uses comprehensive data and computer modeling systems to analyze the

³⁰ Brazil's 9 September Further Submission, Annex II, para. 17.

³¹ Brazil's 9 September Further Submission, Annex II, paras. 14-15.

³² The information in this paragraph was provided by Andrew Macdonald to counsel for Brazil during the week of 12 December.

³³ Exhibit Bra-4 (“Fact Sheet: Upland Cotton,” USDA, January 2003, p. 1-2).

³⁴ Exhibit Bra-376 (“About FAPRI,” Center for Agricultural and Rural Development, Iowa State University).

³⁵ Exhibit Bra-377 (“About FAPRI,” Food and Agricultural Policy Research Institute at the University of Missouri).

complex economic interrelationships of the food and agriculture industry.³⁶ FAPRI's mission is to provide objective qualitative and quantitative analyses of alternative US and international agricultural policies.

21. FAPRI is considered the leading US agricultural policy research institute and ever since the 1985 farm bill³⁷ has conducted analyses of alternative policies that have helped shape US farm legislation. In July 2002, FAPRI received the USDA Secretary's Honor Award, the highest award bestowed by the US Department of Agriculture, for its analysis of various farm bill proposals that led to the 2002 FSRI Act.³⁸ Professor Bruce Babcock described the award as follows:

This award recognizes the outstanding research effort by FAPRI at [Iowa State University] and [the University of] Missouri in analyzing policy proposals during the 2002 farm bill debate. This group has dedicated itself to being the world's best at conducting agricultural policy analysis.³⁹

...

World economic integration makes it increasingly vital that we understand the impacts of US policy decisions on US and world markets, producers and consumers. Increasing numbers of policy proposals and their complexity requires that we continually update our analytical capabilities and our market intelligence.⁴⁰

22. FARPI is the leading research institution that fulfills this task in the United States. FAPRI prepares baseline projections each year for the US agricultural sector and international commodity markets. The multi-year projections are published as FAPRI Outlooks,⁴¹ which provide a starting point for evaluating and comparing scenarios involving macroeconomic, policy, weather, and technology variables.⁴² These projections are intended for use by farmers, government agencies and officials, agribusinesses, and others who do medium-range and long-term planning.⁴³

23. FAPRI describes its objectives as follows:

- To prepare baseline projections for the US agricultural sector and international commodity markets. These multi-year projections are available in print and on the Web.
- To examine the major commodity markets and analyze alternative policies and external factors for implications on production, utilization, farm and retail prices, farm income, trade, and government costs.
- To help determine effective risk management tools for crop and livestock producers, and to analyze how government policy affects risk management strategies.

³⁶ Exhibit Bra-378 ("About FAPRI," Food and Agricultural Policy Research Institute).

³⁷ Exhibit Bra-379 (CARD Report, 40th Anniversary Commemorative Issue, Part 2, p. 1-2.)

³⁸ Exhibit Bra-380 ("Food and Agriculture Policy Research Institute Receives USDA's Highest Honor," CARD Press Release, 9 July 2002).

³⁹ Exhibit Bra-380 ("Food and Agriculture Policy Research Institute Receives USDA's Highest Honor," CARD Press Release, 9 July 2002).

⁴⁰ Exhibit Bra-380 ("Food and Agriculture Policy Research Institute Receives USDA's Highest Honor," CARD Press Release, 9 July 2002).

⁴¹ See <http://www.fapri.iastate.edu/outlook2003>.

⁴² See <http://www.fapri.iastate.edu/publications> for all of FAPRI's publications.

⁴³ Exhibit Bra-378 ("About FAPRI," Food and Agricultural Policy Research Institute).

- To brief staff members of the US Senate and House Agriculture Committees on projections for US and world agricultural markets.
- To disseminate research results through printed reports, staff presentations, and on the Web.⁴⁴

24. In sum, FAPRI is the most influential organization in the United States analyzing farm policy and its effects on US and world commodity markets, *i.e.*, that has the highest reputation and experience in answering the kind of “but for” questions faced by this Panel. This is a fact implicitly recognized by Dr. Glauber who indicated on 2 December in responding to the Panel’s oral questions that the United States was not contesting FAPRI’s work or analysis but rather took issue with Professor’s Sumner’s modifications to and use of the FAPRI baseline.

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

Brazil’s Answer:

25. While Brazil believes that the EWG data is a useful indicator of the amount of support provided to producers of upland cotton, the EWG data undercounts the amount of support in several basic ways. First, the database *undercounts* the amount of marketing loan payments reflected in FSA’s “LDP / Loan / Market Gain Activity” Summary Report by \$572 million for MY 2000 through MY 2002.⁴⁵ The EWG database also undercounts the amount of contract payments by \$61 million in MY 2000 and MY 2001.⁴⁶ This means that there are very likely additional farms and recipients of upland cotton contract payments that also received marketing loan payments, but that are not tracked by EWG data.

26. Second, as described more fully in Christopher Campbell’s statement in Exhibit Bra-316, the database also undercounts the percentage of contract payments to farms growing upland cotton, because marketing loan certificates are often purchased by partnerships, with the partnership receiving the payment from USDA.⁴⁷ There can be multiple partners in these partnerships that eventually get a portion of the marketing loan certificate payment. These partners are not recorded in the EWG data as receiving marketing loan payment – thus as upland cotton producers – but they *are*, in fact, producers of upland cotton that will most likely receive contract payments.

27. Third, current producers of upland cotton also received contract payments from base acreage other than upland cotton. The EWG database does not readily permit the allocation of these payments without the application of a complex methodology requiring a number of assumptions. Only farm-specific data exclusively controlled by the United States, which it continues to refuse to provide to Brazil and the Panel, would permit such a calculation.

28. The EWG data, however, provides corroborating evidence that Brazil’s “14th/16th” methodology is a reasonable approximation of the amount of contract payments that are support to upland cotton. In view of the continued refusal of the United States to provide the requested information on contract payments and acreage matched by farm, the Panel should infer that Brazil’s methodology of calculating these payments undercounts the actual amount of contract payments that constitute support to upland cotton.

⁴⁴ Exhibit Bra-378 (“About FAPRI,” Food and Agricultural Policy Research Institute).

⁴⁵ See Brazil 9 September Further Submission, Table 1 p. 4 and Exhibit Bra-316 (Statement of Christopher Campbell – Environmental Working Group).

⁴⁶ Compare Exhibit Bra-4 (“Fact Sheet: Upland Cotton,” USDA, January 2003, p. 6) with Exhibit Bra-317 (EWG Database: Tables of Results, Table 2).

⁴⁷ Exhibit Bra-316 (Statement of Christopher Campbell, para. 13).

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 *oblige* 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 States 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

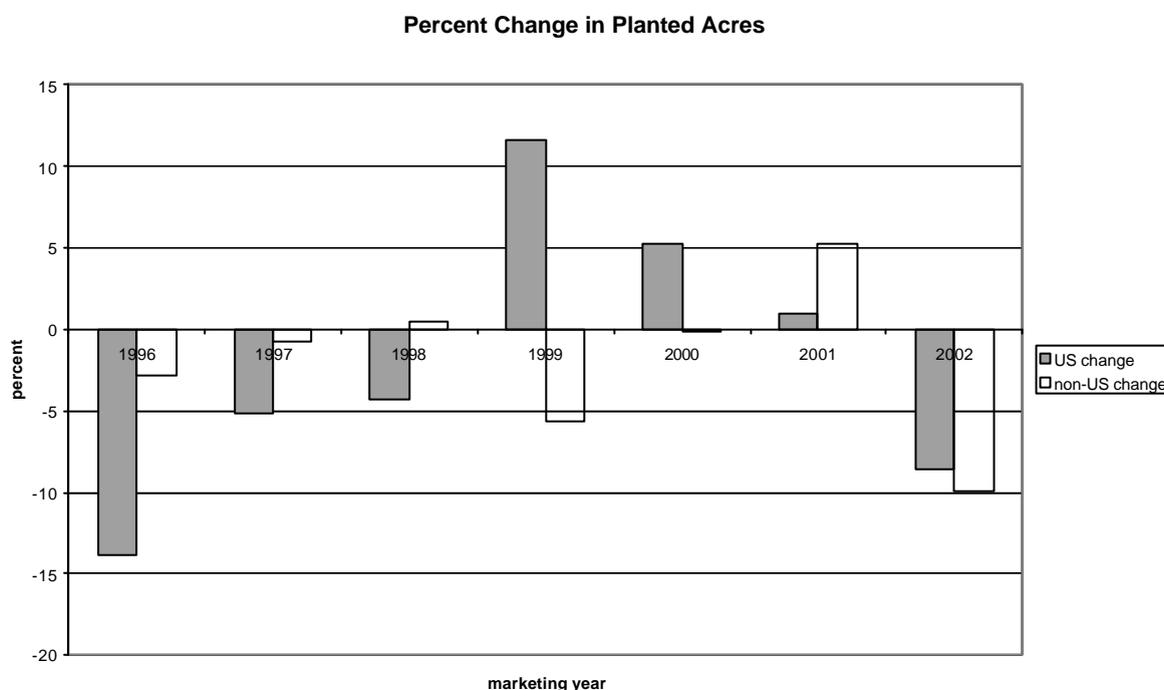
Brazil's Answer:

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).

32. Nonetheless, variations in harvested acreage could be a reasonable proxy for variations in planted acreage for the world outside the United States. The reason is that the relationship between planted acreage and harvested acreage on a worldwide basis can be assumed to be relatively stable, *i.e.*, weather-related problems likely lead to the abandonment of about the same percentage of planted acreage at the aggregate level each year. Upland cotton is grown in many regions and worse than normal weather conditions in one region will be offset by better than normal weather in other regions. But this is not the case when only an individual country such as the United States is analyzed because individual countries have more variable weather. This is particularly true for the United States with the considerable variance in abandonment in the Southwest. Thus, for the United States, planted acreage is the appropriate measure of production decisions. By contrast, on the worldwide level, high abandonment in one region would be compensated or balanced out by low abandonment in other regions. On average, these differing trends would cancel each other out and worldwide harvested acreage would remain relatively stable over from year to year.

33. The following graph shows percentage changes in US planted acreage and percentage changes in non-US (harvested) acreage.⁴⁹



As expected, the graph demonstrates that the decision-making process of US producers is quite different than that of non-US producers. US planted acreage moved in *opposite* directions to world harvested acreage between MY 1998-2000. In MY 1996, 1997 and 2001, US planted acreage changes to a far greater extent than non-US planted acreage.⁵⁰ Given those significant differences, for any valid statistical analysis, this graph could not possibly be used to support a claim that planting decisions in the US were analogous to those made worldwide. In fact, taken together with the other evidence that US producers are not sensitive to market signals,⁵¹ this graph confirms that US producers are insulated from market forces and act independently of competitors' behavior.

⁴⁹ The US planted acreage is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4) and Non-US acreage is taken from Exhibit US-63.

⁵⁰ The non-US planted acreage is approximated by using non-US harvested acreage. As discussed above, with a stable rate of abandonment, changes in harvested acreage equal changes in planted acreage.

⁵¹ Brazil's 18 November Further Rebuttal Submission, Section 3.4 with further references.

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 graph, as it is based on US harvested acreage data rather than planted acreage.

⁵³ See Exhibit Bra-283 (Statement by Christopher Ward – 7 October 2003).

⁵⁴ Brazil has applied the percentage change as estimated by Professor Sumner in Brazil’s 9 September Further Submission, Annex I, Table I.5a.

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 Sumner⁶¹ found that most published articles for rice (another US programme crop with complex government programmes) used a variant of lagged information to project prices and future revenue per acre. None of the rice estimates used futures markets.

41. Across a wide variety of commodities, no systematic differences are noticeable in estimated supply or acreage response depending on how expectations of prices and other revenue terms are represented in the model. That is, there is no evidence that the estimated acre response elasticity are systematically lower or higher using futures markets to represent the price that then enters the projected relative net revenue function used for estimation.

42. Finally, if the United States were right (which it is not) that futures prices are a better indicator of farmers' price expectations, then Professor Sumner's results are *not wrong*, but

⁵⁵ The information and analysis in this answer was provided by Professor Sumner.

⁵⁶ Brazil's 9 September Further Submission, Annex I, para. 18.

⁵⁷ Exhibit Bra-279 (Statement of Professor Sumner – 7 October 2003, para. 9). *See also* Exhibit Bra-361 (Cotton Pricing Guide, July 2001) containing guidance for farmers to take planting and marketing decisions.

⁵⁸ US 7 October Oral Statement, para. 34.

⁵⁹ US 7 October Oral Statement, para. 34.

⁶⁰ Exhibit Bra-306 (Lin, William, Paul C. Westcott, Robert Skinner, Scott Sanford, and Daniel G. De La Torre Ugarte. *Supply Response Under the 1996 Farm Act and Implications for the US Field Crops Sector*, TB-1888, US Department of Agriculture, Economic Research Service, July 2000) provides a survey of the literature and cites mostly studies that use a variant of lagged prices. Lin et al. use both lagged prices and futures markets to represent expectations.

⁶¹ Exhibit Bra-381 (Jeffrey D. McDonald and Daniel A. Sumner. "The Influence of Commodity Programmes on Acreage Response to Market Price: With an Illustration concerning Rice Policy in the United States." *American Journal of Agricultural Economics*, (85) 4 (November 2003): 857-871).

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 2004⁶⁷ (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 farm prices will be at or somewhat above the target price, the programme has a significant impact on planting decisions. At planting time, the producer still is unsure on whether or not the target price will be met during the following marketing year. Given the considerable price fluctuations and the low prices in the MY 1997-2002 period, there is a significant risk that actual prices will be lower than the futures market predicts. The direct and counter-cyclical payments remove the risks of lower prices. The evidence of a long-term lack of any significant US acreage response to higher or lower prices since MY 1996 demonstrates that US producers have and will continue to plant upland cotton because they face no downside revenue risk. Professor Sumner outlined this effect when he responded to a similar question by the Panel at the second meeting with the parties.⁶⁹ This reinforces the argument that the Panel cannot disregard these payments in the scenario described in the question.

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

Brazil's Answer:

47. Under the deficiency payment programme as provided by the 1985 and 1990 Farm Acts, farmers were offered the option to update the amount of acreage participating in the programme each year. To do this, they were required to opt *out* of the programme and receive no payments during the period in which they increased the amount of acreage planted to the programme crop. Relatively few upland cotton farmers took advantage of this programme feature because the costs of forgoing payments in the current year generally outweighed the present value of benefits of higher base acres and base yield in the future.

48. In the 1996 FAIR Act, farmers established their production flexibility base acreage by carrying over the would-be deficiency payment base acreage. For example, any producers of upland cotton during the period MY 1991-1995 were entitled to place such acreage into the PFC programme along with any acreage that had been in the conservation programme and was released from that programme in MY 1996.⁷⁰ Unlike the 1985 and 1990 Farm Acts, the 1996 FAIR Act did not authorize any acreage or yield updates by individual farmers during later years. In the 1996 FAIR Act, Congress essentially told farmers they should take advantage of planting flexibility and that planting alternative crops would not affect the amount of their payments. However, several years after 1996, as commodity prices began to decline, momentum for an update in the next farm act began to build. Many upland cotton farmers and others argued that their historical acreage and yields no longer reflected the reality of their current production and that they needed additional payments on their increased programme crop acreage. These upland cotton and other programme crop growers

⁶⁸ Brazil's 18 November Further Rebuttal Submission, para. 26 citing, *inter alia*, the National Cotton Council.

⁶⁹ Exhibit Bra-371 (Simple Example of the Calculations of Marketing Lon Benefits (Probability Distribution)).

⁷⁰ Any such former deficiency payment base being released from the conservation programme could be added to the PFC base once the land left the conservation programme.

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

50. The pressure for updates will come especially from farmers who were not in a position to take advantage of the 2002 update having switched away from higher per-acre payment crops like upland cotton or rice. For example, farmers who had planted less than their full upland cotton base to upland cotton in the MY 1998 to 2001 period would likely have found the acreage update unattractive. But, since the yield update was only available to farmers who updated acreage, these farmers also missed the opportunities to update yields. These farmers expressed deep disappointment in 2002 that they had used planting flexibility, only to find that they were penalized by not being allowed to update payment yields. These farmers saw the update of 2002 by farmers who had stayed in upland cotton production during MY 1998-2001 as unfair and look to have this redressed in the next revision of the programmes. Many of those (non-updating) farmers are now planting their full upland cotton base (or more) and are maintaining high and expanding inputs to expand their yields in order to be in a position to take advantage of an anticipated base update at the next opportunity. These farmers will add to the political pressure to update base in 2007, if not before.

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). USA

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. USA

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

⁷¹ See e.g. Exhibit Bra-41 (Congressional Hearing, "The Future of Federal Farm Commodity Programmes (Cotton)," House of Representatives, 15 February 2001, p. 4, and 24).

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. Another possible outcome is an amendment to Article 9.1 that would add export credit guarantees (or possibly those export credit guarantees issued or programmes maintained on particular terms or conditions) to the list of *per se* export subsidies. Article 10.1 would no longer be applicable, since export credit guarantees would no longer be “[e]xport subsidies not listed in paragraph 1 of Article 9”

54. Yet another possible outcome is agreement to subject export credit guarantees to the same type of notification, consultation and information exchange disciplines agreed in the OECD Arrangement on Officially Supported Export Credits for industrial products (“OECD Arrangement”).⁷² For example, the OECD Arrangement includes provisions regarding: prior notification of derogations, permitted exceptions, matching of derogations, permitted exceptions, non-conforming non-notified terms, and terms granted by countries that are not parties to the OECD Arrangement. The United States now characterizes such disciplines as “pedestrian.”⁷³ In *Canada – Aircraft II*, however, the United States characterized these provisions and the disciplines they

⁷² See OECD Arrangement on Guidelines for Officially Supported Export Credits, Chapter IV (Sections 1-5) available at <http://www.oecd.org/dataoecd/52/3/2763846.pdf>.

⁷³ US 3 December Closing Statement, para. 3.

provided as central to the “entire logic” of the OECD Arrangement, and as a critical way to prevent “a subsidy ‘race to the bottom.’”⁷⁴

55. Under this outcome, 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. Under WTO jurisprudence, the provisions regarding notification, consultation and information exchange would be read cumulatively with Article 10.1, since the obligations imposed would not be mutually exclusive or mutually inconsistent.⁷⁵

56. Another possible outcome would be agreement on alternative benchmarks against which to determine whether export credit guarantees and export credit guarantee programmes would constitute export subsidies. In determining what constitutes an “export subsidy” within the meaning of Article 10.1, the Appellate Body’s decisions in *US – FSC*⁷⁶ and *Canada – Dairy*⁷⁷ currently direct the Panel to refer to contextual guidance included in Articles 1 and 3 of the SCM Agreement and in item (j).⁷⁸ Were agreement one day reached on alternative benchmarks following negotiations pursuant to Article 10.2, that agreement might provide relevant context for a panel to determine what constitutes an “export subsidy” for the purposes of Article 10.1. Alternatively, it might serve as “subsequent practice,” pursuant to Article 31(3)(b) of the Vienna Convention on the Law of Treaties, indicating the interpretation of the term “export subsidy” that the Members intend for the purposes of Article 10.1.⁷⁹

57. Under this outcome, export credit guarantees would continue not to be among those *per se* export subsidies listed in Article 9.1. Moreover, they would continue to be subject to Article 10.1, to the extent that they constitute export subsidies, and to the extent that they circumvent (or threaten to circumvent) a Member’s export subsidy commitments. The difference would be that the interpretation of the term “export subsidy” might be based, among other things, on the context or evidence of “subsequent practice” offered by the newly-negotiated alternative benchmark.

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 November further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August 2003 comments on US rebuttal submission) that the total figure net of re-estimates should be \$230,127,023 instead of the figure which originally appeared (\$381,345,059).

⁷⁴ Panel Report, *Canada – Aircraft II*, WT/DS222/R, Annex C-2, paras. 12-13 (Third Party Submission of the United States, 22 June 2001).

⁷⁵ See e.g. Appellate Body Report, *Guatemala – Cement*, WT/DS60/AB/R, paras. 66, 73-74; Panel Report, *Indonesia – Automobiles*, WT/DS54, para. 14.28.

⁷⁶ Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 136-140.

⁷⁷ Appellate Body Report, *Canada – Dairy*, WT/DS103/AB/R and WT/DS113/AB/R, para. 87-90.

⁷⁸ See Brazil’s 24 June First Submission, paras. 258-261.

⁷⁹ The extent to which alternative benchmarks agreed pursuant to negotiations under Article 10.2 qualify as relevant context for or as “subsequent practice” regarding the interpretation of the term “export subsidy” in Article 10.1 will depend, in part, on the form the agreement takes. If agreement is reached among only the 10 WTO Members that participated in OECD discussions on agricultural export credit disciplines, it will be difficult to argue that the agreement serves as relevant context for interpretation of Article 10.1, which is applicable to 146 Members. Nor would such an agreement constitute evidence of “subsequent practice.” See Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, para. 213 (defining “subsequent practice” as “a ‘concordant, common and consistent’ sequence of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties [to a treaty] regarding its interpretation.”). See also Appellate Body Report, *Japan – Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, p. 12-17.

- (a) Please submit a corrected table reflecting all of the necessary information to produce this result, to the extent this is possible for the reasons indicated in footnote 96 in US further submission of 30 September 2003.
- (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.
- (c) The Panel notes that the CCC 2002 financial statement in Exhibit BRA-158 refers to annual "administrative" expenses of \$4 million, and that the US has also referred to this figure in its submissions (e.g. US first written submission, paragraph 175). Please confirm whether the figures in the table in paragraph 161 of the US August 22 rebuttal submission (or a corrected version thereof) includes "administrative expenses", of approximately \$4 million per year over the period 1992-2002, and explain why (or why not) this affects the substantive result.

Brazil's Comment:

58. With respect to the \$4 million of administrative expenses for the CCC guarantee programmes, Brazil draws the Panel's attention to Congressional testimony by the administrator of the programmes, General Sales Manager Christopher Goldthwait. This testimony is included on pages 20-21 of Exhibit Bra-87. Mr. Goldthwait's testimony clarifies that premiums charged by the CCC are sufficient to cover these administrative expenses, but not other costs and losses of the programmes.

59. A member of Congress posed the following question to Mr. Goldthwait and August Schumacher, USDA's Under Secretary for Farm and Foreign Agricultural Services:

Is [the GSM] programme operated at essentially no net costs to the US Government? By that what I mean putting to one side the Iraq and the Poland experiences which you outlined earlier in your response to questions, do we charge fees that reflect the cost of administering the programme *and the risk that is involved, the default, things such as that*, or is this a programme which is subsidized at a fairly significant level by the Federal Government? (emphasis added)

Mr. Goldthwait's response was as follows:

Yes. The programme is *from the administrative standpoint* at least pretty much self-financing. We do collect fees. The fee structure is relatively modest. We keep the fees low because the legislation has limited us to no more than 1 per cent. But, nonetheless, we collect several million dollars a year in fees, *and that enables us to say that effectively the administrative cost of running the programme are more than covered*. Now, that money does not come directly to us at the USDA, it goes to the general Treasury account, but the amount of the money is more than *enough to cover the administrative costs of the programme*. (emphasis added)

60. Thus, although the question asked whether fees covered "the cost of administering the programme *and the risk that is involved, the default, things such as that*," Mr. Goldthwait, the administrator of the CCC guarantee programmes, responded that fees "at least pretty much" covered only "the administrative cost of running the programme." Mr. Goldthwait could not state that the fees collected also cover "the risk that is involved, the default, things such as that," since, as Brazil has established, fees for the CCC guarantee programmes are not set to (see comment to question 223) and in fact do not cover those risks and defaults.

- (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* 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:

61. Brazil reserves the right to comment on the US response, but would like to provide a preliminary comment on the last part of the Panel's question. To a certain extent, reestimates do reflect expectations about a cohort's future performance. Agencies are to undertake two types of reestimates – interest rate and technical reestimates. The Office of Management and Budget ("OMB") defines these two types of reestimates in the following way:

Two different types of reestimates are made:

- Interest rate reestimates, for differences between interest rate assumptions at the time of formulation (the same assumption is used at the time of obligation or commitment) and the actual interest rate(s) for the year(s) of disbursement; and
- Technical reestimates, for changes in technical assumptions.⁸⁰

62. One purpose of technical reestimates is "to adjust the subsidy estimate for . . . new forecasts about future economic conditions, and other events and improvements in the methods used to estimate future cash flows."⁸¹ The OMB also states that one purpose of technical reestimates is to record "changes in assumptions about future cash flows."⁸²

- (g) Why should the Panel "eliminate" the 2001 and 2002 cohorts from its examination, as suggested in paragraph 198 of the US further rebuttal submission?
- (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"?
- (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

⁸⁰ Exhibit Bra-116 (OMB Circular A-11, p. 185-15).

⁸¹ Exhibit Bra-116 (OMB Circular A-11, p. 185-16).

⁸² Exhibit Bra-163 ("Introduction to Federal Credit Budgeting," OMB Annual Training, 24 June 2002, White House Conference Center, p. 32).

include these "most recent years" in its evaluation, as the US suggests in paragraph 199 of its 18 November further rebuttal submission? USA

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

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 forfeiting transactions and with premiums for export credit insurance? USA

Brazil's Comment:

63. Brazil reserves the right to comment on the US response, but would like to provide a preliminary comment on the first part of the Panel's question. First, Brazil notes that premium rates for the three CCC guarantee programmes are not subject to regular review. In audit reports of the CCC's fiscal year 2000 and 2001 financial statements, USDA's Office of the Inspector General confirmed that "the fees CCC charges for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed in 7 years and may not be reflecting current costs."⁸³ Two changes have been made, in the fee schedule for GSM 102, since November 1994: (i) for a 12-month guarantee with semi-annual repayment intervals, the fee was changed from \$0.209 per \$100 of coverage to \$0.229 per \$100 of coverage; and (ii) borrowers are now offered the additional option of 30- and 60-day guarantees, at the same fee charged for 90-day and 4-, 6- and 7-month guarantees.⁸⁴

64. Moreover, the US General Accounting Office ("GAO") analyzed CCC's failure to charge guarantee fees that take account of country risk or the creditworthiness of individual borrowers. The GAO emphasized that CCC's failure to do so means that it lacks the flexibility to cover the costs and losses of the programmes:

Although GSM-102 recipient countries vary significantly from one another in terms of their risk of defaulting on GSM-102 loans, CCC does not adjust the fee that it charges for credit guarantees to take account of country risk. CCC fees are based upon the length of the credit period and the number of principal payments to be made. For example, for a 3-year GSM-102 loan with semiannual principal payments, CCC charges a fee of 55.6 cents per \$100, or 0.56 per cent of the covered amount. For 3-year loans with annual principal payments, the fee is 66.3 cents per \$100.¹¹ CCC fees that included a risk-based component might not cover all of the country risk, but they could help to offset the cost of loan defaults.⁸⁵

⁸³ Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-FM (June 2001), p. 31). *See also* Exhibit Bra-154 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC (February 2002), p. 49 ("[T]he fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed for many years and may not be reflecting current costs.").

⁸⁴ Brazil's 11 August Answers to Questions, para. 167 (first bullet point).

⁸⁵ Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 135-136).

As noted above, CCC fees for GSM 102 have not changed materially since the GAO published its report in 1995.⁸⁶ Moreover, the United States confirmed in its 11 August Answer to Question 84 (at paragraph 180) that US law prohibits CCC from charging fees in excess of one per cent of the guaranteed dollar value of the transaction.

65. With respect to the second part of the Panel's question, Brazil has demonstrated that forfaits and export credit insurance are not similar financial instruments to CCC export credit guarantees, and therefore that the terms for forfaits and export credit insurance cannot serve as benchmarks against which to determine whether CCC export credit guarantees confer "benefits."⁸⁷ Moreover, Brazil has demonstrated that in any event, fees for forfaiting instruments are well above fees for CCC export credit guarantees.⁸⁸

66. Although government support from the US Export-Import Bank does not constitute a market benchmark for the purposes of determining "benefit," Brazil has offered evidence that premiums for CCC guarantees are considerably lower than fees for Ex-Im Bank guarantees.⁸⁹ This demonstrates that the terms for CCC guarantees do not even meet *non-market* benchmarks. As noted by the GAO:

The US Export-Import Bank, which provides credit guarantees to promote a variety of US exports, uses risk-based fees to defray the cost of defaults on its portfolio. Under its system, each borrower/guarantor is rated in one of eight country risk categories. Exposure fees vary based on both the level of assessed risk and the length of time provided for repayment. For example, in the case of repayment over 3 years, a country rated in the lowest risk category is charged a fee of 75 cents per \$100, whereas a country in the highest risk category is charged a fee of \$5.70 per \$100 of coverage. Thus, the bank's fee structure includes a substantial added charge for high country risk. According to the bank, its system is designed to remain as competitive as possible with fees charged by official export credit agencies of other countries.

Under section 211(b)(1)(b) of the 1990 Farm Bill, CCC is currently restricted from charging an origination fee for any GSM-102 credit guarantee in excess of an amount equal to 1 per cent of the amount of credit extended under the transaction.^[90] This restriction was initially enacted in 1985 following proposed administration legislation to charge a 5-per cent user fee for exports backed with credit guarantees. Some Members of Congress were concerned that such a fee would adversely affect the competitiveness of GSM-102 exports. Under the 1-per cent restriction, CCC would be considerably limited in the size of the fee that it could charge to take account of country risk should it decide to do so. For example, as previously noted, CCC charges 0.56 per cent for a loan payable in 3 years and with principal payments due annually. The most it could increase the fee would be 0.44 per cent. In contrast, the Export-Import Bank currently charges fees as high as 5.7 per cent for 3-year loans.⁹¹

⁸⁶ Brazil's 11 August Answer to Question 77 and 84, para. 167, 193-194.

⁸⁷ Brazil's 22 August Rebuttal Submission, paras. 103-105; Brazil's 27 August Comments on US Rebuttal Submission, paras. 68-70; Brazil's 7 October Oral Statement, para. 72; Brazil's 18 November Further Rebuttal Submission, paras. 233-241; Brazil's 2 December Oral Statement, para. 79.

⁸⁸ Brazil's 27 August Comments on US Rebuttal Submission, paras. 76-77 and Exhibit Bra-199 (Trade and Forfaiting Review, "Argentina Trade Finance to the Rescue," Volume 6, Issue 9 July/August 2003).

⁸⁹ Brazil's 27 August Comments on US Answers, para. 110.

⁹⁰ The United States confirmed in paragraphs 179-180 of its 11 August Answer that this remains the case.

⁹¹ Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 135-136).

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 programmes.⁹²

Thus, Brazil stands by its characterization of the \$411 million figure as a cumulative running tally of the losses for the programmes during the period 1992-2002, and as one way of demonstrating that the CCC guarantee programmes meet the elements of item (j).

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

Brazil's Answer:

68. Item (j), interpreted according to its ordinary meaning, in its context and according to the object and purpose of the SCM and Agriculture Agreements, does not require that the Panel use any particular accounting principles to assess long-term operating costs and losses. Similarly, under item (j), it is not *incumbent* on the Panel to conduct its analysis in accordance with US government accounting principles, whether or not those principles adhere to GAAP. (A Panel may, however, consider it particularly persuasive that the US government's own accounting principles lead to a conclusion that premium rates are inadequate to meet the long-term operating costs and losses of the CCC guarantee programmes.) Nor is it necessary, at this stage of dispute settlement proceedings, for

⁹² 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. 4)).

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 by \$550 million on post-1991 guarantees.⁹⁷

⁹³ Exhibit Bra-118 (Federal Accounting Standards Advisory Board, “Statement of Federal Financial Accounting Standards No. 19, Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees” in STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 2, March 2001, p. 13 (para. 23)).

⁹⁴ Exhibit Bra-118 (Federal Accounting Standards Advisory Board, “Statement of Federal Financial Accounting Standards No. 19, Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees” in STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 2, March 2001, pgs. 13-14 (para. 24)).

⁹⁵ Exhibit Bra-193.

⁹⁶ 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. 19).

⁹⁷ See Brazil’s 11 August Answers to Questions, para. 167 (third and fourth bullet points); Brazil’s 18 November Further Rebuttal Submission, para. 250; Notes to Financial Statements contained in 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), pg. 14). Contrary to the United States’ assertion at paragraph 170 of its 22 August Rebuttal Submission, for post-1991 CCC guarantees, the amounts in the “subsidy allowance” column are actually the amounts of receivables associated with post-1991 CCC guarantees that CCC considers uncollectible. Under the FCRA – and as confirmed above in the quote from page 4 of the CCC 2002 financial statements – the subsidy allowance is recorded on a net present value basis, which means that it represents the cost CCC considers it will incur on a guarantee cohort at the time that cohort is closed. The amount listed in the “subsidy allowance” column in the receivables table of CCC’s 2002 financial statements for post-1991 guarantees is therefore as uncollectible as the amount listed in the “uncollectible” column of the pre-1992 CCC guarantee receivables table.

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.

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.

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

Brazil's Answer:

76. The phrase "*one or several*" must be interpreted in its ordinary meaning. This phrase means that the conditional clause "may arise" is satisfied when *one* of the following applies or when *more than one* of the following apply. The phrase "*one or several*" is equivalent to: "*at least one*." Such a trigger is not conditioned on any other clause. In fact, this is stressed by the words "in any case" just before the phrase *where one or several*. Therefore, serious prejudice may be shown *in any case* where *at least one* of the subparagraphs of Article 6.3 applies.

77. Brazil disagrees with the possibility that the words *one or several* indicate that one of the Article 6.3 subparagraphs may not be sufficient to establish serious prejudice. Had negotiators felt that this should be the case, they certainly would have found a way to say so. This was the case, for example, in Articles 3.2 and 3.4 of the Anti-Dumping Agreement, where after the enumeration of relevant factors, the text states that no "... one or several of these factors" can "give decisive guidance." Identical language is found in the SCM Agreement itself. Article 15.4 *in fine* reads "... nor can one or several of these factors necessarily give decisive guidance." In SCM Article 15.7 negotiators were even more explicit, affirming that "[n]o one of these factors by itself can necessarily give decisive guidance but the totality of the factors considered must lead to the conclusion that"

78. The provisions of the Anti-Dumping and SCM Agreement cited above relate to situations where a number of factors could lead to a determination of injury. Article 6.3 of the SCM Agreement is meant to address a similar situation: a list of factors could lead to a determination of serious injury. However, in stark contrast with Articles 3.2 and 3.4 of the Anti-Dumping Agreement and Articles 15.4 and 15.7 of the SCM Agreement, negotiators chose not to include reference to the possibility that, in Article 6.3, "the words *one or several* indicate that one of the Article 6 subparagraphs may not be sufficient to establish serious prejudice." To find so, the Panel would need to read into Article 6.3 the words found in Articles 3.2 and 3.4 of the Anti-Dumping Agreement and Articles 15.4 and 15.7 of the SCM Agreement. The Appellate Body has made clear that panels must not read into a text words that are not there.

79. The phrase "may arise in any case where one or several of the following apply" recognizes that effects of subsidies constituting serious prejudice under one of the identified paragraphs of Article 6.3 may *also* constitute serious prejudice under another of the identified paragraphs of Article 6.3. This case is a good example. US cotton subsidies have both increased the US world market share under Article 6.3(d) as well as suppressed world market prices and prices in third country markets under Article 6.3(c). But the existence of "serious prejudice" in this or other cases does not depend upon whether the effects of the subsidies cause one or four different types of serious prejudice.

80. In its context within Article 6, the phrase "may arise in any case where one or several of the following apply" is necessary because while the facts may demonstrate that the effects of the subsidies *may* create the one, two, three or four enumerated types of serious prejudice, these effects may not be *actionable*. For example, under Article 6.3(d), there may be an increase in the world market share for a commodity product. But it "may" not be actionable because there are specific multilaterally agreed rules for that commodity, within the meaning of footnote 17. Further,

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:

81. Brazil divides its response to this question into two parts. First, Brazil will discuss Article 6.3(c), and, second, Brazil will discuss Article 6.3(d).

82. Concerning Article 6.3(c), the Panel can and should, to the extent it is relevant to do so, take into account the effects of non-subsidy related factors in its analysis of the price-suppressing effects of US subsidies. The only “other factors” identified by the United States include demand-related factors the United States claims contributed to lower cotton prices in MY 1999-2002 including weak cotton demand, flat retail consumption, falling world incomes, increasing US textile imports, and China's releasing of stocks.¹⁰⁷ The United States further claimed that US production-related factors accounted for increased US production including boll weevil eradication, higher yielding GMO cotton, and lower prices of alternative crops.¹⁰⁸

83. Brazil addressed all of these “other” factors in earlier submissions and demonstrated that while some of the so-called other factors no doubt influenced prices, many of them either were factually incorrect (*i.e.*, not “other factors”) or could not have had the effect claimed by the United States.¹⁰⁹ Brazil further demonstrated that Professor Sumner's analysis took account of all the “other” factors identified by the United States. Professor Sumner stated:

The baseline is calibrated to reproduce the acreage, production, exports, prices and other variables that actually applied between the marketing years 1999-2001, the period over which data was available at the time the baseline was developed. *By calibrating the baseline to actual data for the recent past, the model incorporates all the factors that have determined the situation of the cotton market during this period.*

The United States has highlighted some of these factors. In their Further Submission they discuss developments in the synthetic fiber market, such as prices of polyester; Chinese stock releases, exchange rate movements, global and US macroeconomic

¹⁰⁷ US 30 September Further Submission, paras. 22-44.

¹⁰⁸ US 30 September Further Submission, paras. 45-70.

¹⁰⁹ Brazil's 7 October Oral Statement, paras. 18-28; Exhibit Bra-279 (Statement of Professor Sumner – 7 October 2003, paras. 13-14); Brazil's 27 October Answers to Question 176, paras. 157-160.

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 by a significant degree, whether prices rise or fall. Thus, for example, the fact that Chinese release of stocks may have lowered world prices in MY 2000-2001 to a certain extent is entirely consistent with Brazil’s evidence and its proof. Brazil demonstrated that actual market prices in MY 1999-2002 would have been higher to a significant degree but for the US subsidies.

86. Thus, the Panel can and should take “other factors” into account. But the record shows that there is no legitimate basis to conclude that “other” supply and demand factors collectively (a) accounted for *all* of the declines in prices during the period of investigation or (b) meant that prices went as high as they would have even if no US subsidies had been provided.

87. Brazil’s claim under Article 6.3(d) concerns the development of actual world market share data. This world market share is the result of several key factors including US subsidies, weather effects in many countries, and exchange rate effects. However, Brazil has demonstrated that the US subsidies were a major contributing factor behind the increase in the US world market share, which occurred even when prices were falling and the US dollar increased in value. Professor Sumner has conservatively estimated that without the US subsidies, US exports would be on average 41.2 per cent lower during MY 1999-2002.¹¹¹ The US upland cotton farmers’ long-term cost of production gap between market revenue and total costs of \$872 per acre for over 14.38 million acres during MY 1997-2002 (or \$12.5 billion) fully supports Professor Sumner’s analysis.¹¹²

88. It follows that the US world market share would be much lower absent the US subsidies. As an example, based on Exhibit Bra-302, Brazil has calculated out the effects of a 41.2 per cent decline in US exports as estimated by Professor Sumner for MY 2002.¹¹³ In this example, US world market shares for MY 1999-2001 remain unchanged.¹¹⁴ The results are as follows:

¹¹⁰ Exhibit Bra -279 (Statement of Professor Sumner – 7 October 2003, paras. 13-14).

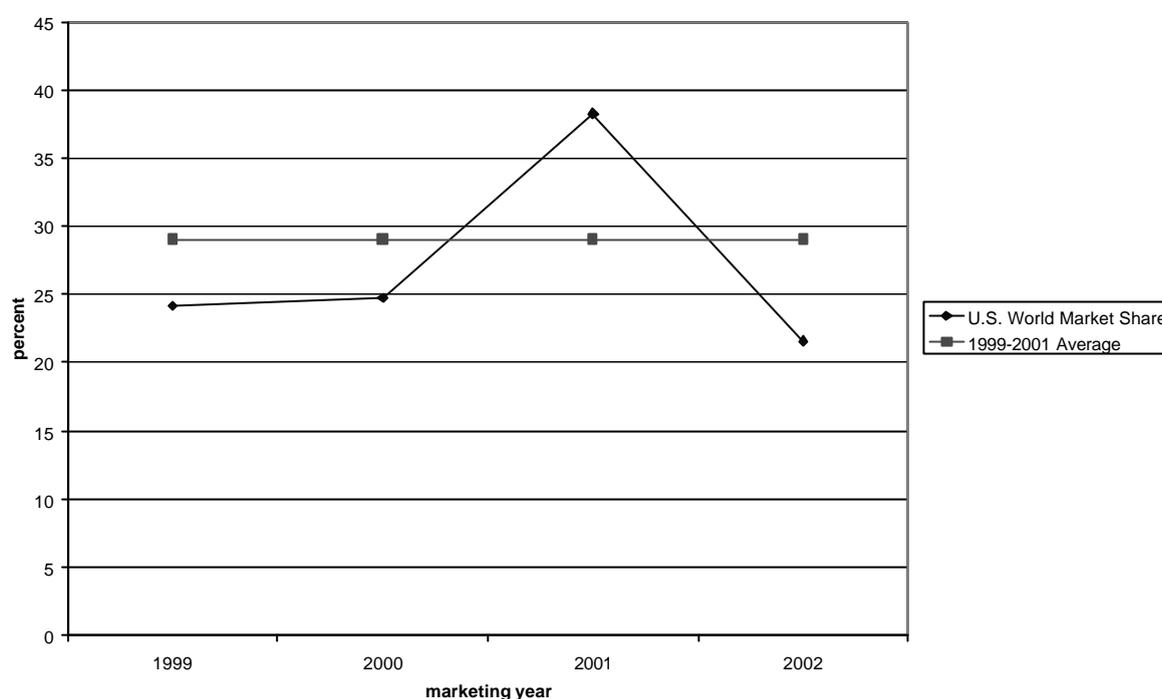
¹¹¹ Brazil’s 9 September Further Submission, Annex I, Table I.5a.

¹¹² Brazil’s 3 December Closing Statement, para. 13.

¹¹³ This calculation assumes that total world trade would not be affected if US subsidies were not provided.

¹¹⁴ Brazil emphasizes that also for these years there are strong export-enhancing effects of the US subsidies, but has assumed for this exercise that they had no effects on US world market share.

U.S. World Market Share W/Out Subsidies in MY 2002



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 markets¹¹⁶ where Brazil exports its cotton. US and Brazilian "like" upland cotton is found in each of these markets.

¹¹⁵ Brazil's 9 September Further Submission, Annex I, Table I.5a.

¹¹⁶ Argentina, Belgium, Bangladesh, Bolivia, Cambodia, China, Chile, Colombia, Cuba, Ecuador, France, Germany, Greece, Hong Kong, Indonesia, India, Israel, Italy, Japan, South Korea, Malaysia, Morocco, Netherlands, Pakistan, Peru, Poland, Portugal, Philippines, Singapore, South Africa, Spain, Switzerland, Thailand, Tunisia, Turkey, Taiwan, United Kingdom, Ukraine, Venezuela, Vietnam.

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 Government uses the A-Index as a key basis for Step 2 and marketing loan payments. Professor Sumner’s model adapted from the FAPRI model used actual A-Index prices for the period MY 1999-2001 and the “world price” simulation effects are estimated “A-Index” prices.¹²⁹

94. Organized below is the evidence on pricing data supporting the link between A-Index prices that reflect the global supply and demand influences (including effects of the US subsidies) and prices in “other markets” as posed in the Panel’s question. Brazil first presents evidence of US and Brazilian

¹¹⁷ Brazil’s 2 December Oral Statement, paras. 14-16 (*citing* evidence set out in the record from earlier submissions to the Panel).

¹¹⁸ Brazil’s 2 December Oral Statement, paras. 14-16 (*citing* evidence set out in the record from earlier submissions to the Panel).

¹¹⁹ Brazil’s 2 December Oral Statement, paras. 14-16 (*citing* evidence set out in the record from earlier submissions to the Panel).

¹²⁰ Brazil’s 9 September Further Submission, para. 113 (*citing* Exhibit Bra-4 and Exhibit Bra-202).

¹²¹ Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

¹²² Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

¹²³ Exhibit Bra-207 (Cotton lint: International Prices & Brazilian Prices); Brazil’s 9 September Further Submission, para. 115 note 156.

¹²⁴ Exhibit Bra-384 (Import Prices from Various Countries).

¹²⁵ Exhibit Bra-385 (Domestic Prices from Various Countries).

¹²⁶ Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).

¹²⁷ Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC)(“The A-Index is a good proxy for prices of cotton traded internationally.”).

¹²⁸ Brazil’s 9 September Further Submission, Annex II (Statement of Andrew Macdonald, para. 23.).

¹²⁹ Brazil’s 9 September Further Submission, Annex I (Sumner Analysis, para. 70 (“the model uses the Cotlook A-Index price to represent the world price . . . [and] the actual A-Index prices were used for the database for the model for marketing years 1999-2001.”)).

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

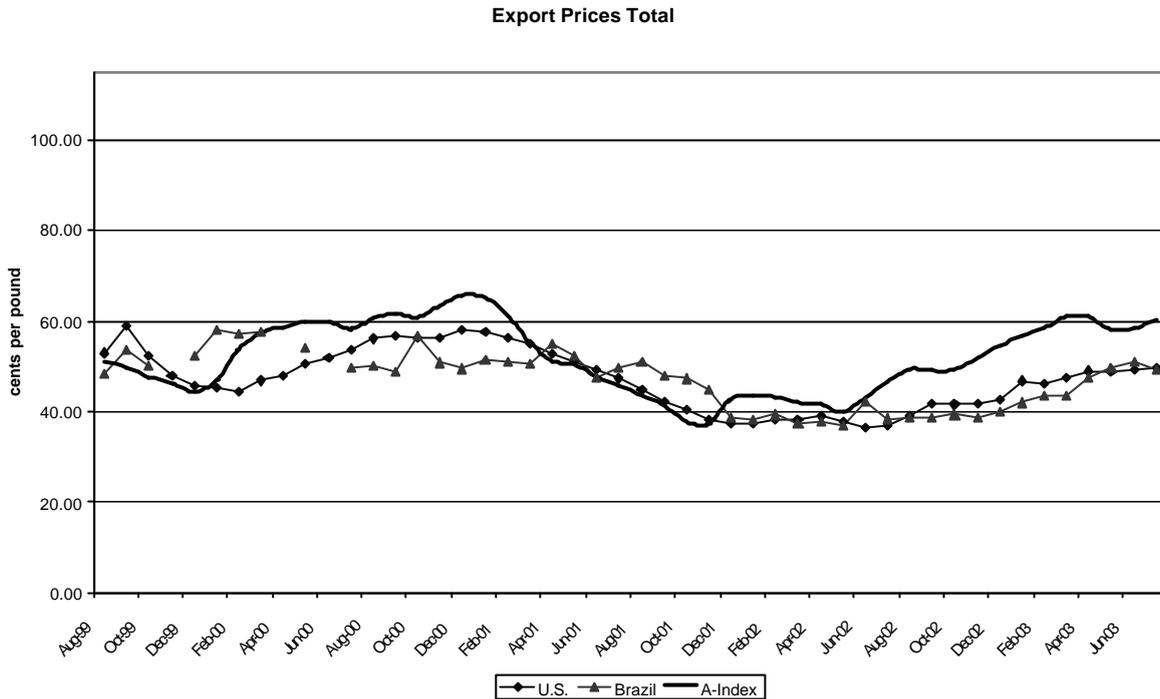
96. The first way to examine the available data is to view it collectively similar to what the United States did in Exhibit US-75. The first graph below examines the cumulative Brazilian and US export prices in MY 1999-2002 covering exports to the 40 markets where Brazil exports its upland cotton as 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://aliceweb1.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).

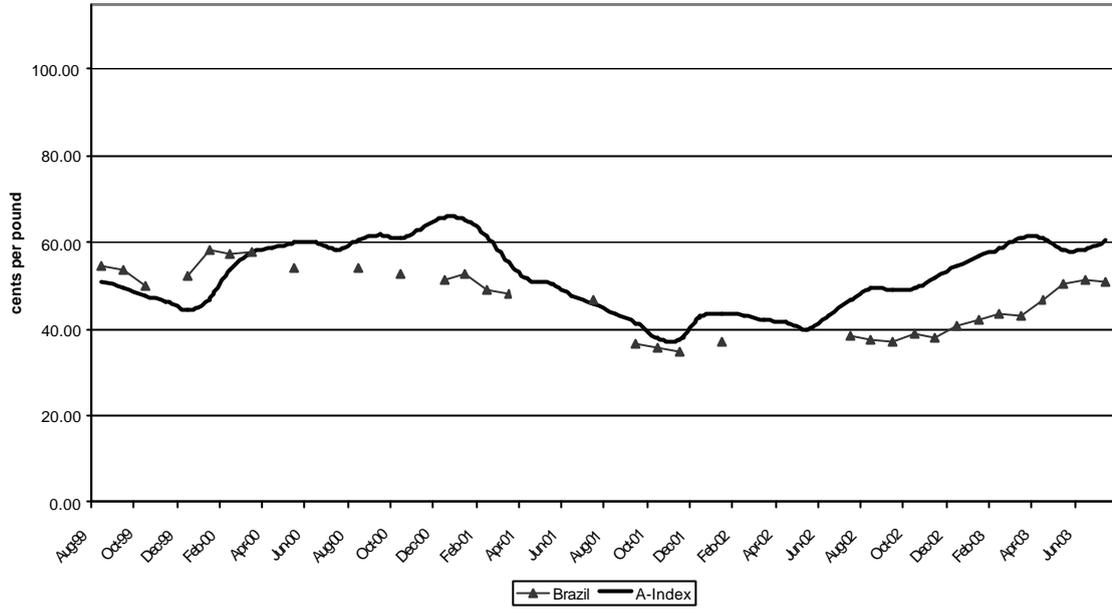


97. The A-Index on the graph is the solid black line. The Panel can see that over the four year period, US and Brazilian export prices closely follow the movements in the A-Index. In addition, as discussed in greater detail in the answer to Question 235, Brazilian prices are at times equal to, slightly greater than US prices or slightly lower than US prices.

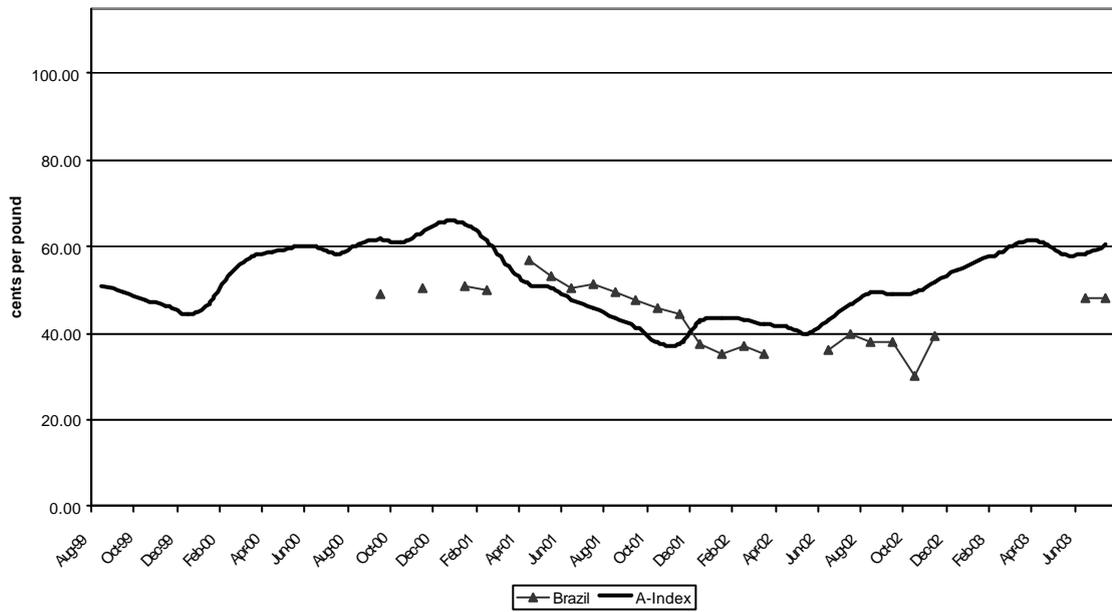
98. The Brazilian export data can be used as a proxy for third country market prices in a handful of countries where there were extensive Brazilian exports. This is illustrated in the cases of three of the larger markets for Brazilian exports – Argentina, India, and Portugal as set out in the graph below.¹³⁴

¹³⁴ The Panel will find a complete list of graphs showing A-Index prices plotted against Brazilian export prices to all countries to which Brazil exports in Exhibit Bra-387 (Brazil Export Prices v A-Index Prices by Country).

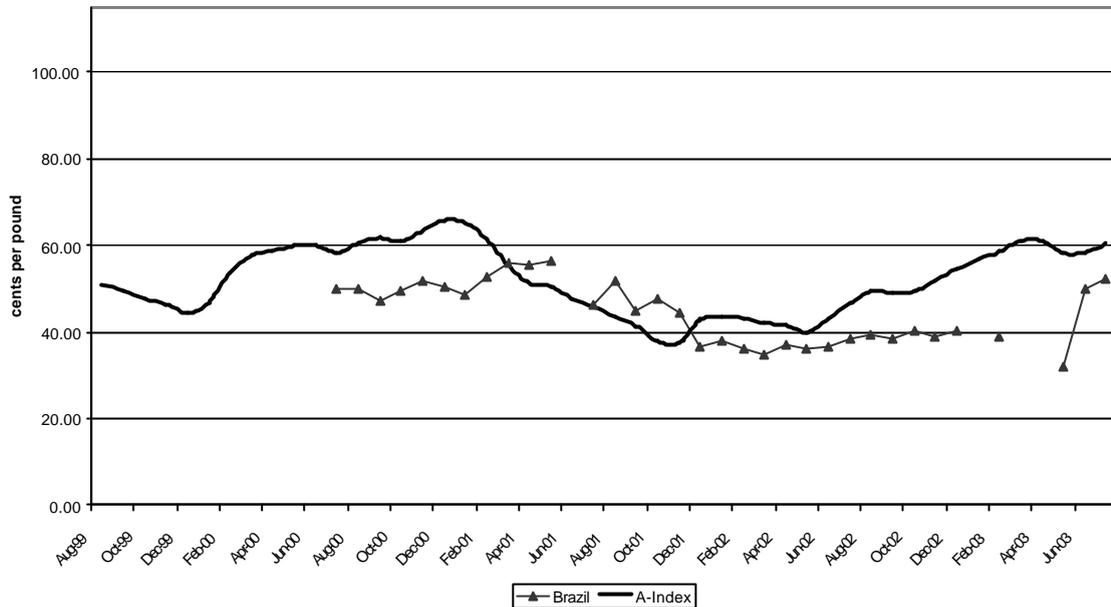
Brazilian Export Prices to Argentina



Brazilian Export Prices to India

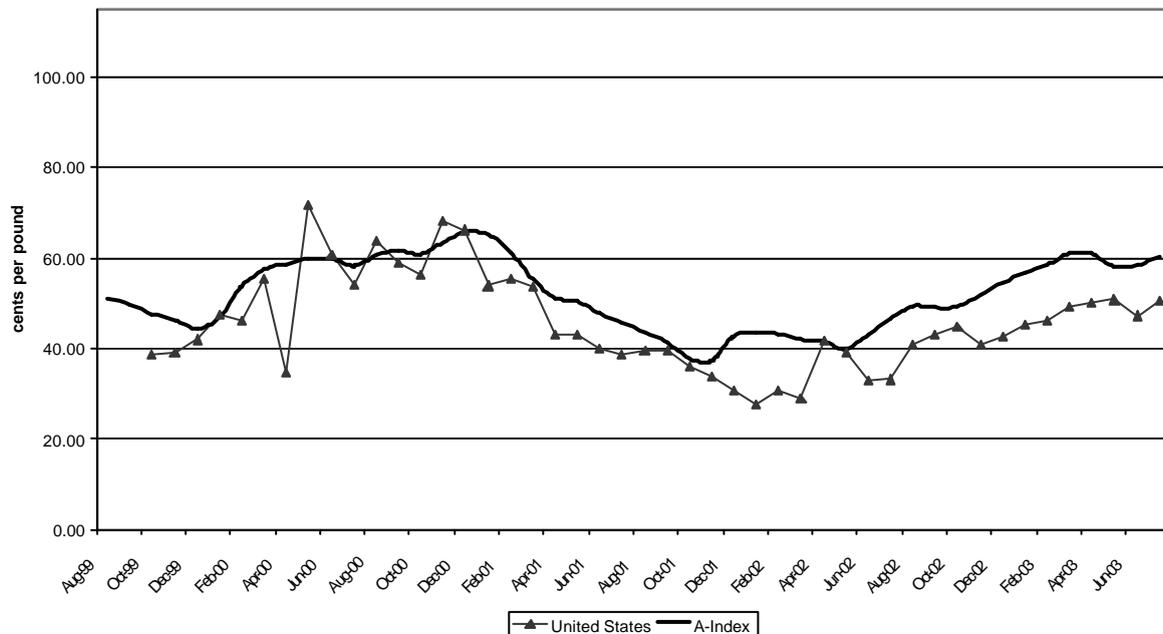


Brazilian Export Prices to Portugal



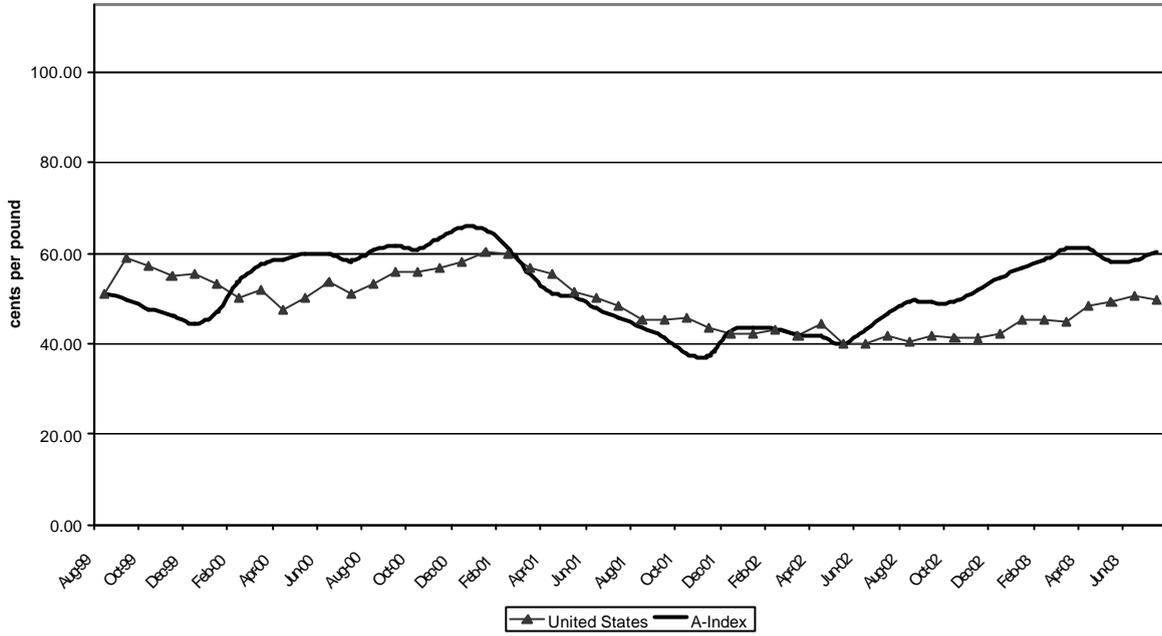
99. Because US exports were so much greater than Brazilian exports, a better way to examine the relationship between A-Index prices and prices in the 40 countries is to examine US export prices, particularly where there were large volumes of US exports. This is illustrated in the graphs below for China, Indonesia, South Korea and the Philippines (as well as other graphs in Exhibit Bra-388):¹³⁵

US Export Prices to China

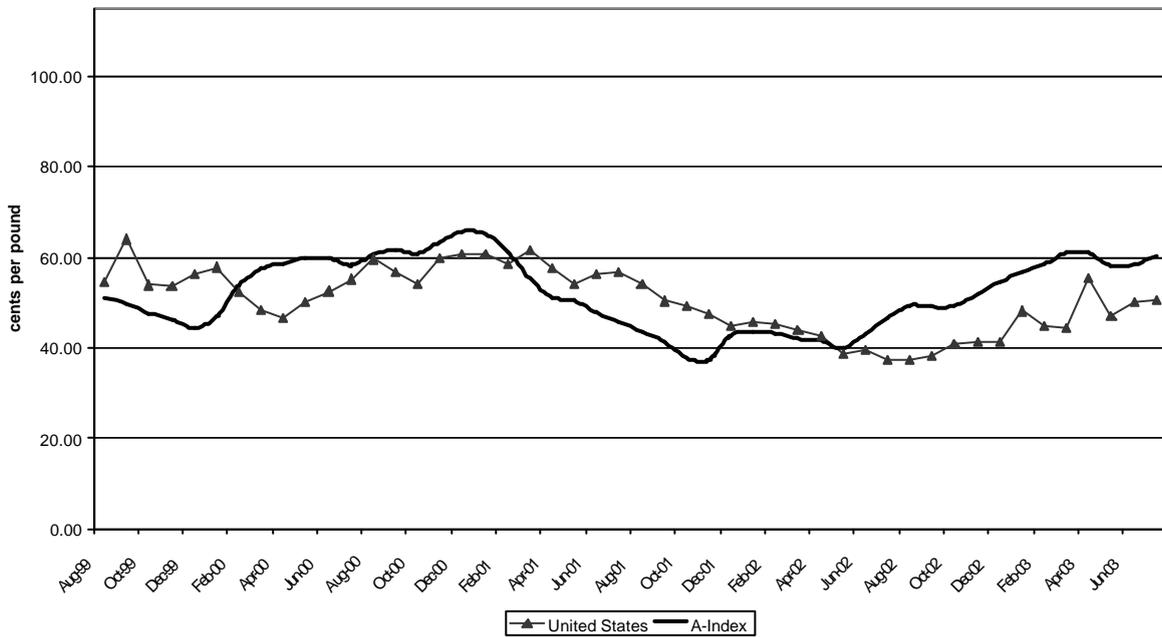


¹³⁵ The Panel will find a complete list of graphs showing A-Index prices plotted against US export prices to all countries to which Brazil exports in Exhibit Bra-388 (US Export Prices v A-Index Prices by Country).

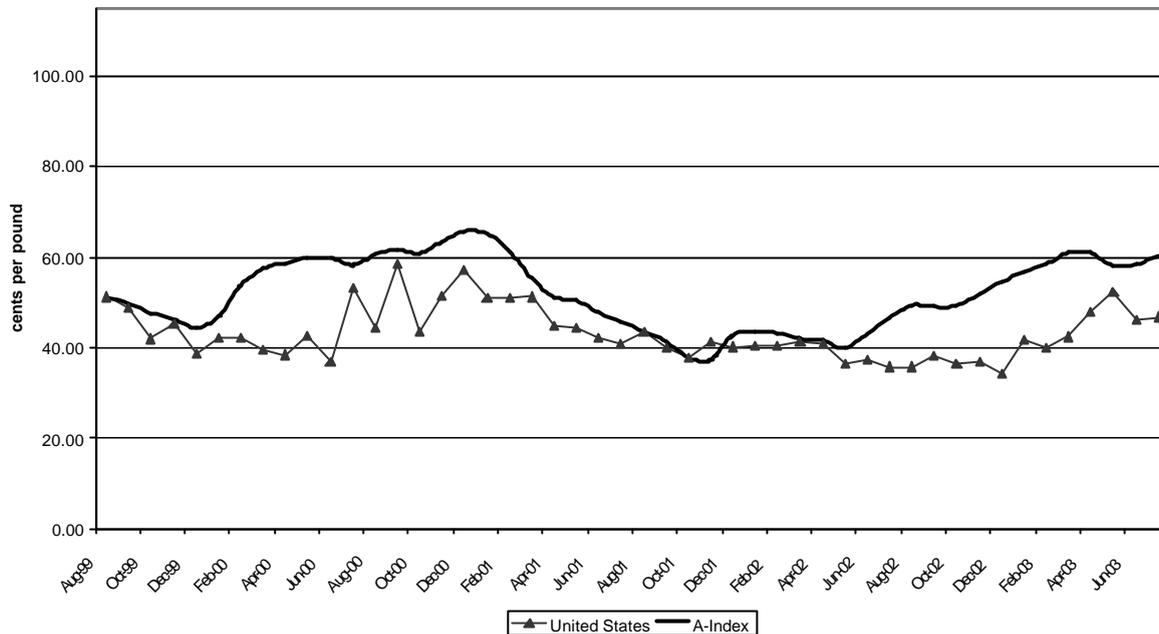
US Export Prices to Indonesia



Export Prices to South Korea



Export Prices to Philippines



100. Brazil presents in Exhibit Bra-383 the underlying data on all 40 of the markets where Brazil and the United States export their upland cotton. This underlying data is presented in a variety of different graphs; one set compares Brazilian exports to the A-Index;¹³⁶ another compares US exports to the A-Index,¹³⁷ and a third combines Brazilian and US export prices.¹³⁸

101. Many of the 40 markets show only very limited amounts of Brazilian exports. Compared to the volume of US exports, Brazilian exports during MY 1999-2002 were relatively small (representing approximately 1 per cent of total world market share).¹³⁹ Thus, when the monthly export data is examined on a country-by-country basis, there are very few third country markets where Brazil exported in each of the 48 months in MY 1999-2002, *i.e.*, where there is a complete set of 48 data points. Nevertheless, even the limited data points for each of the 40 countries shows that Brazilian export prices generally tracked A-Index prices.

102. Many of the graphs also reflect fairly widely ranging data point prices, particularly where the import volumes are not very great.¹⁴⁰ By contrast, country markets with very high volumes of imports¹⁴¹ tend to have much more stable import prices that closely follow the A-Index. This is why the US high-volume import data graphs provide reliable evidence of pricing trends in some of the 40 country markets examined. There are various reasons that explain the widely ranging pricing data points. First, while US and Brazilian cottons may have the same staple length, their quality may differ significantly which, in turn, impacts their respective price.¹⁴² For example, California A-Index cotton is consistently sold at a premium in world markets because its superior quality allows it to be

¹³⁶ Exhibit Bra-387 (Brazil Export Prices v A-Index by Country).

¹³⁷ Exhibit Bra-388 (US Export Prices v A-Index by Country).

¹³⁸ Exhibit Bra-386 (Brazil and US Export Prices by Country).

¹³⁹ Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 4 and 76).

¹⁴⁰ See Exhibit Bra-387 (Brazil Export Prices v A-Index by Country). Examples are Belgium, Pakistan, South Africa.

¹⁴¹ See Exhibit Bra-387 (Brazil Export Prices v A-Index by Country). Examples are Argentina, China, India, Italy, Portugal, Philippines, Thailand.

¹⁴² Brazil's 9 September Further Submission, Annex II (Statement of Andrew Macdonald, paras 9-10).

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 Statistician of the ICAC, who has extensive experience with individual country and world market pricing data, came to the following conclusions:

For all importing non-producing countries, domestic prices follow the Cotlook A Index, taking into account appropriate location and quality differentials and the quality differential for the particular type of cotton needed by the spinning industry.

Prices of imported cotton in producing countries also follow the Cotlook A Index, with appropriate location and quality differentials. The international market for raw cotton is relatively open, with rather low imports taxes (averaging less than 5 per cent. The US having one of the highest).

¹⁴³ Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC)(California/Arizona cottons “is usually about 2 cents more expensive than Memphis”). See also Brazil's 9 September Further Submission, para. 241, figure 17 (showing California A-Index quotes at higher prices than Brazil A-Index cotton which is comparable to Memphis).

¹⁴⁴ See Exhibit Bra-387 (Brazil Export Prices v A-Index by Country), Exhibit Bra-388 (US Export Prices v A-Index by Country) and Exhibit Bra-384 (Import Prices from Various Countries).

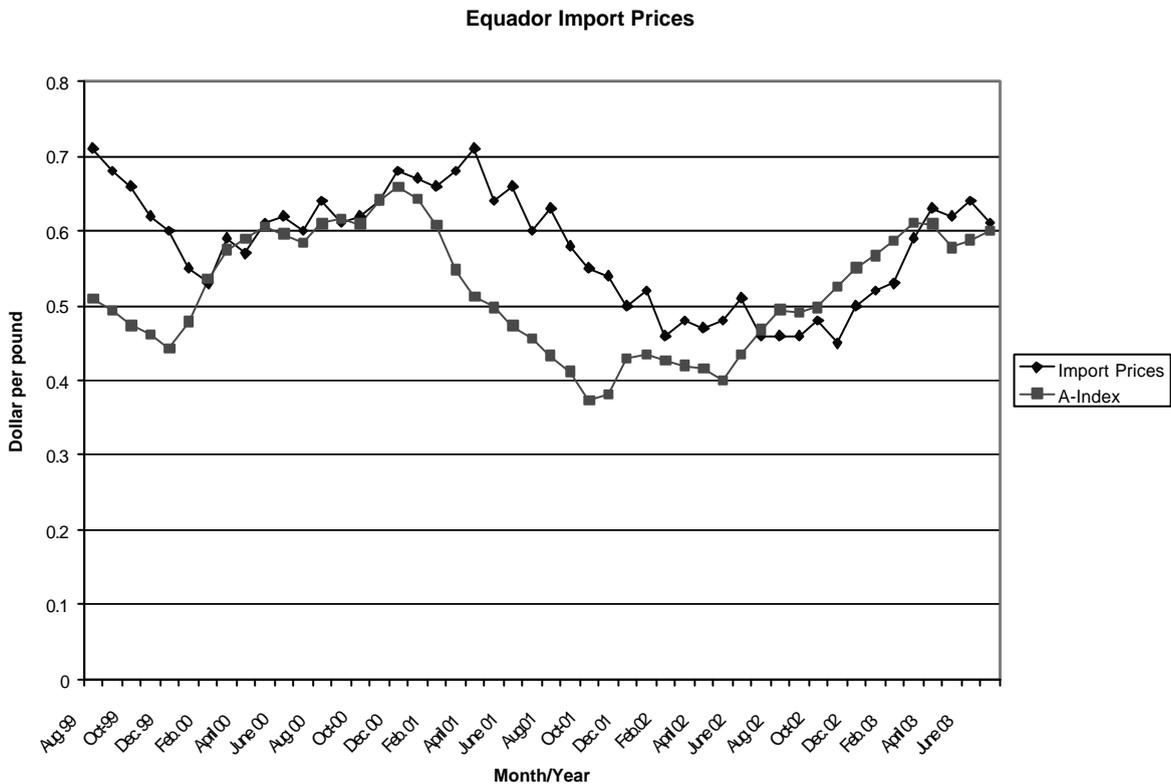
¹⁴⁵ Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC)(“Actual prices of imported cotton, in non-producing as well as in producing countries, are based on the A Index or on New York Futures . . . on the day of the contract (concluded prior to shipment, and cotton can be sold more than one year forward). As a result, the average price of imports (value divided by quantity) for a specific period is not directly related to prevailing market prices.”).

Domestic prices of cotton produced and consumed locally are influenced by the supply and demand situation in the country but are not disconnected from international prices.¹⁴⁶

Individual Country Market Import Price Data

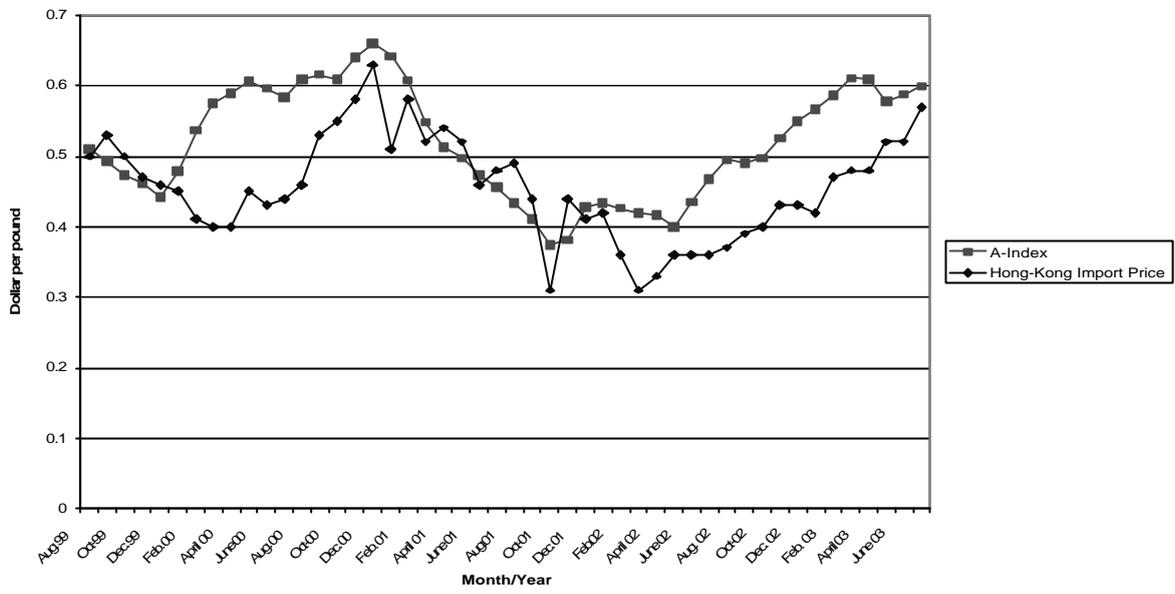
106. Additional evidence responsive to the Panel’s question is found in various third country market *import* pricing data that was collected since 9 December 2003 by Brazilian embassies around the world. The data and the graphs are set out in Exhibit Bra-384. This data is available in two forms: (1) *monthly* import data from all sources, and (2) *annual* import data from all sources. While this information is not available to Brazil for many of the 40 export market countries, the available evidence confirms the other third country market data discussed above.

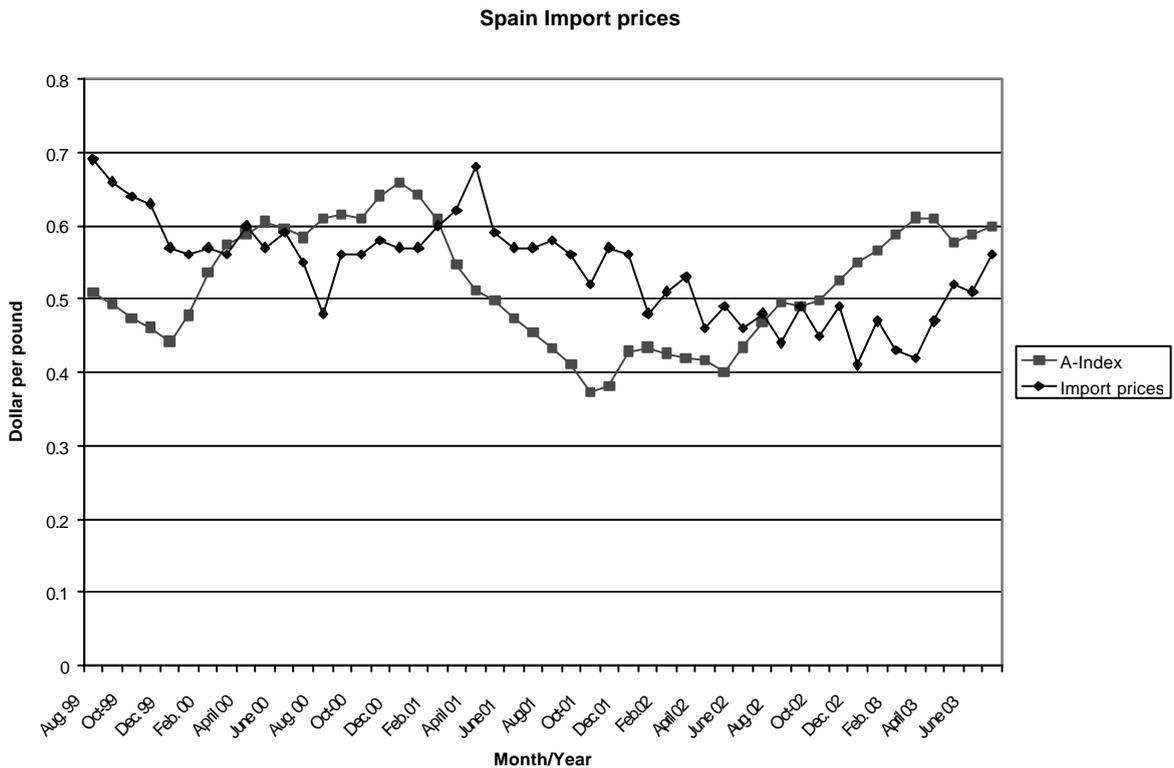
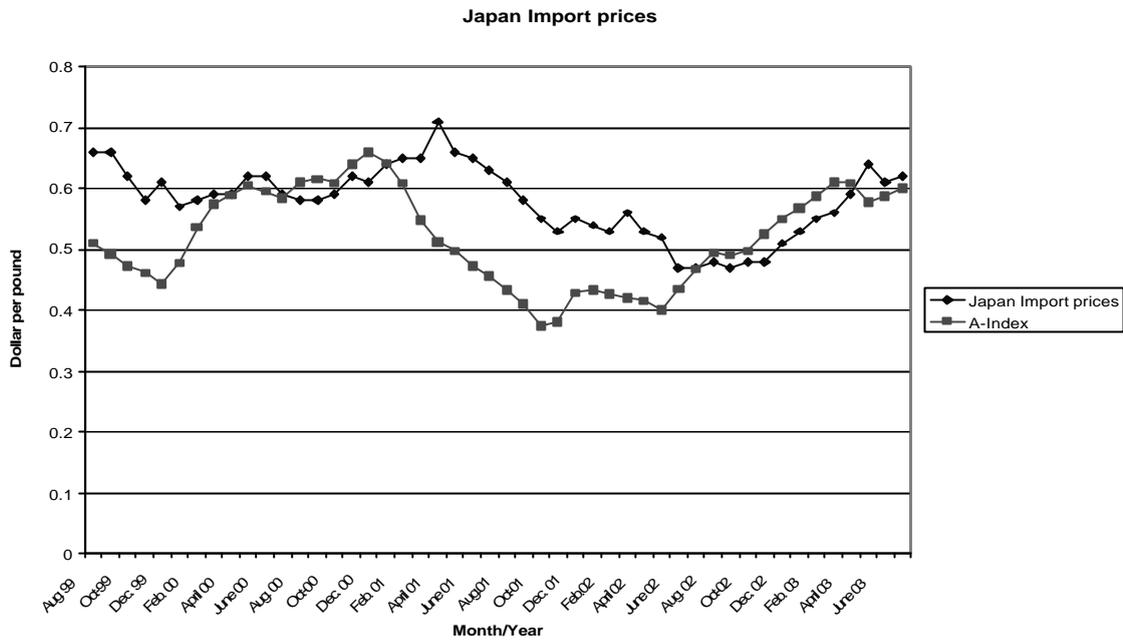
107. Monthly import data is available from Argentina, Ecuador, Hong Kong, Japan, Spain, Thailand, and the Ukraine. The data generally shows a close relationship between the movement of import prices and the movement of the A-Index. For example, set out below are graphs representing the data from Ecuador, Hong Kong, Japan and Spain:



¹⁴⁶ Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).

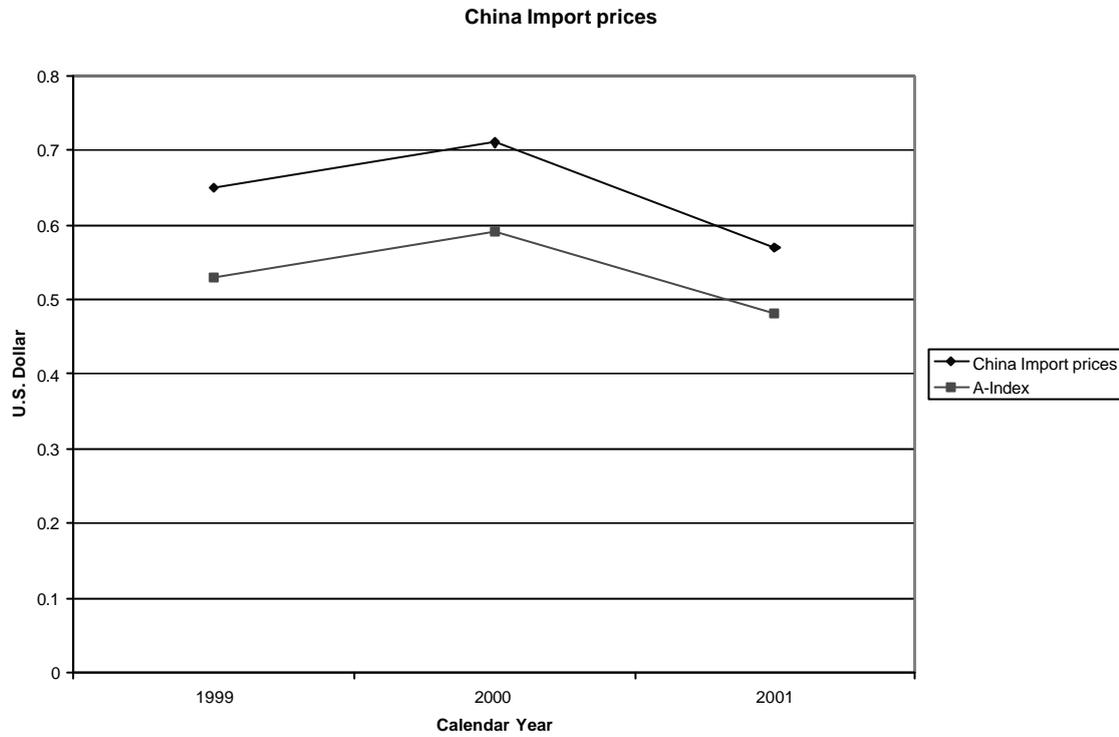
Import Prices in Hong-Kong





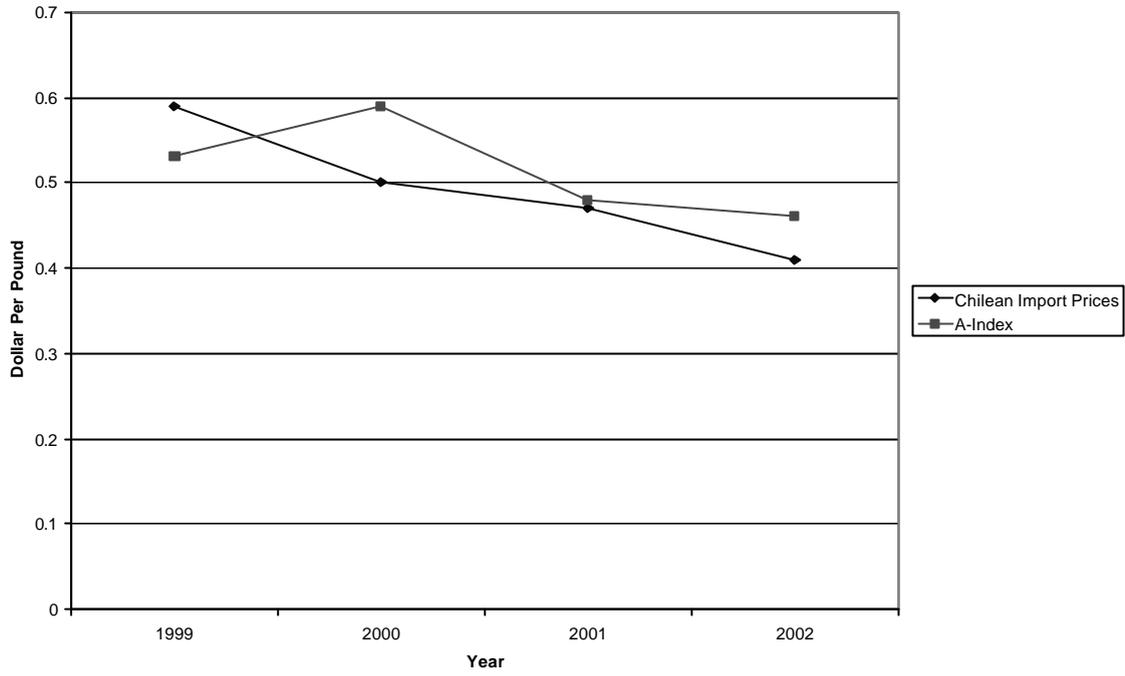
The monthly data for these countries reflects fairly high-volume imports from all worldwide sources. The higher volumes guarantee a more accurate reflection of the bulk of prices within these countries. The link between A-Index and import prices is also confirmed by the data for Argentina, Thailand and the Ukraine in Exhibit Bra-384.

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

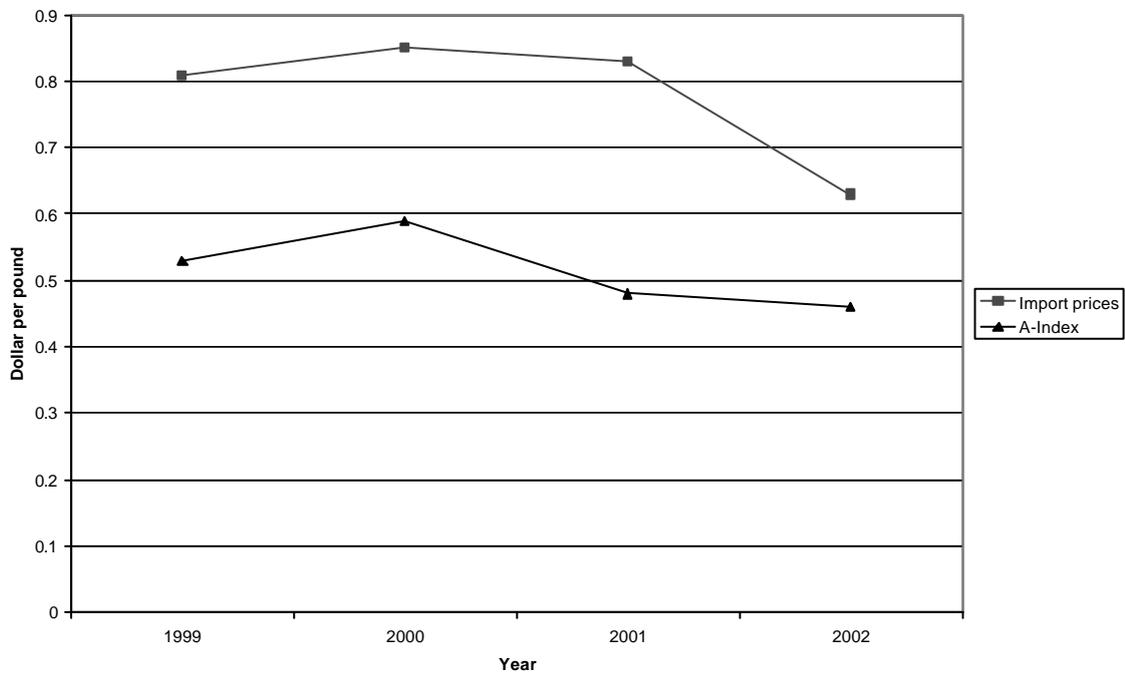


¹⁴⁷ Exhibit Bra -384 (Import Prices from Various Countries).

Chilean Import prices



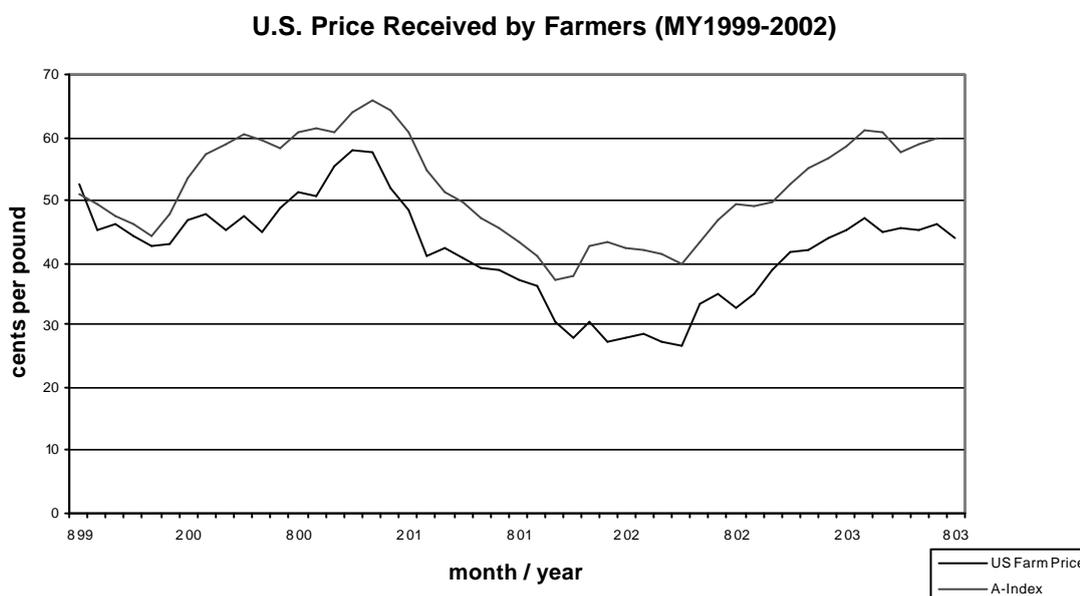
United Kingdom Import prices



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

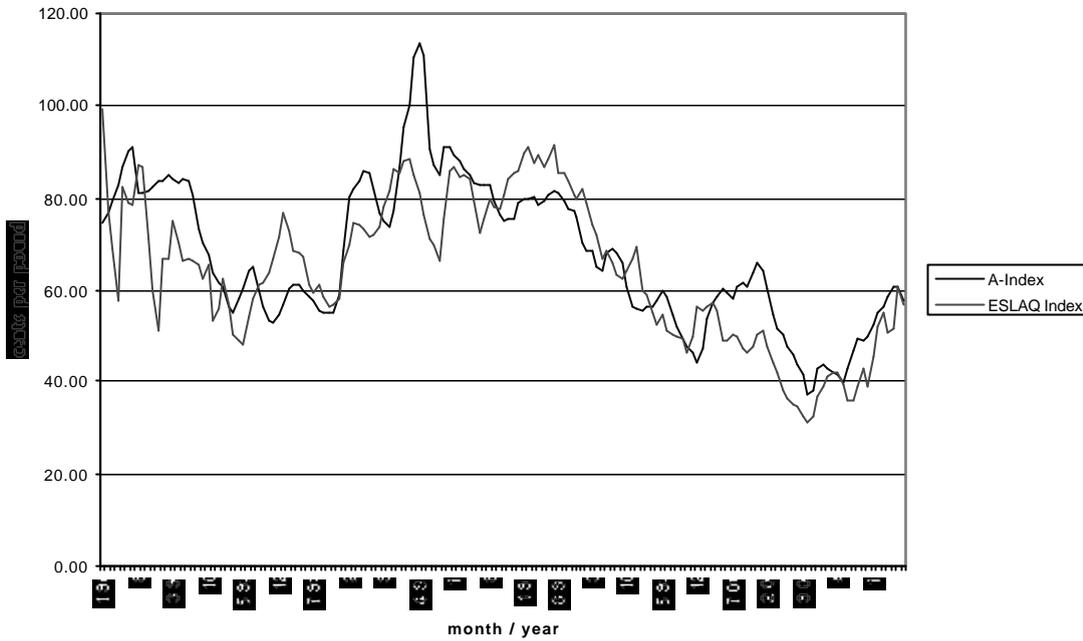


111. This data provides further confirmation of the close link between US domestic prices and the A-Index prices. As set forth below, this close link also exists for the domestic Brazilian market where most of Brazilian production is marketed:¹⁴⁹

¹⁴⁸ This graph is reproduced from Figure 5 of Brazil's 9 September Further Submission.

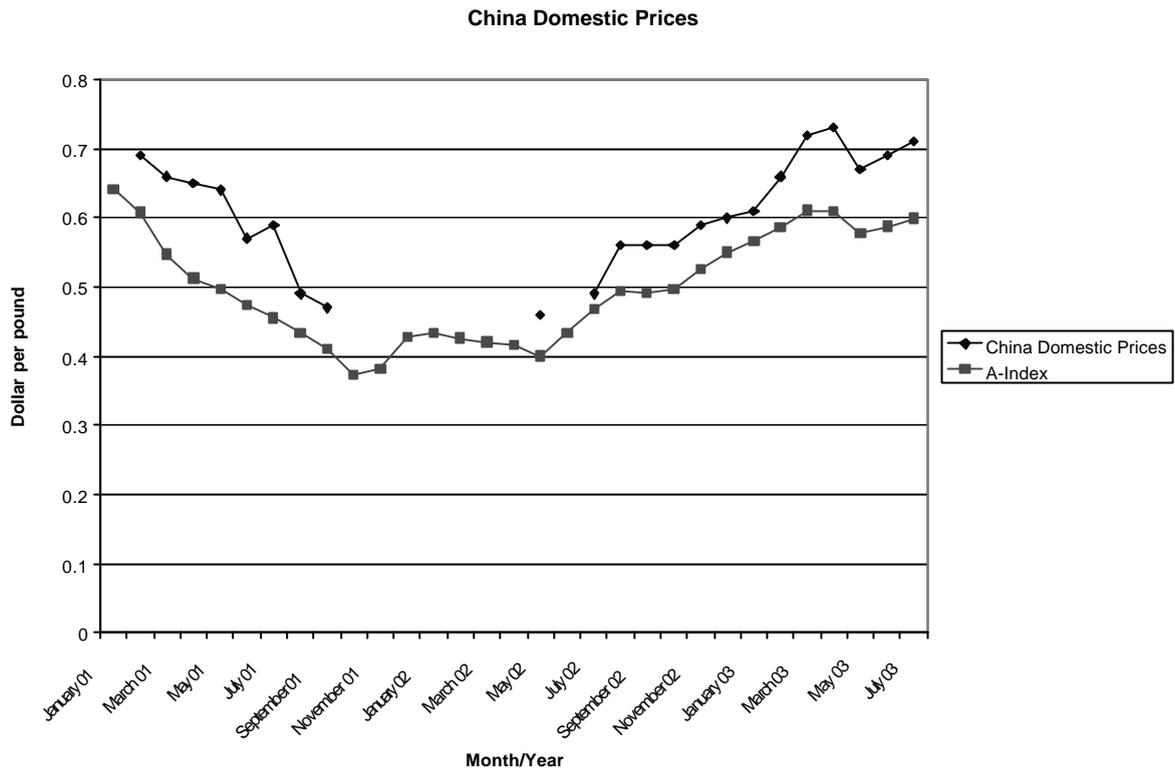
¹⁴⁹ This graph is reproduced from Figure 7 of Brazil's 9 September Further Submission.

A-Index v Brazilian Prices (long-term)

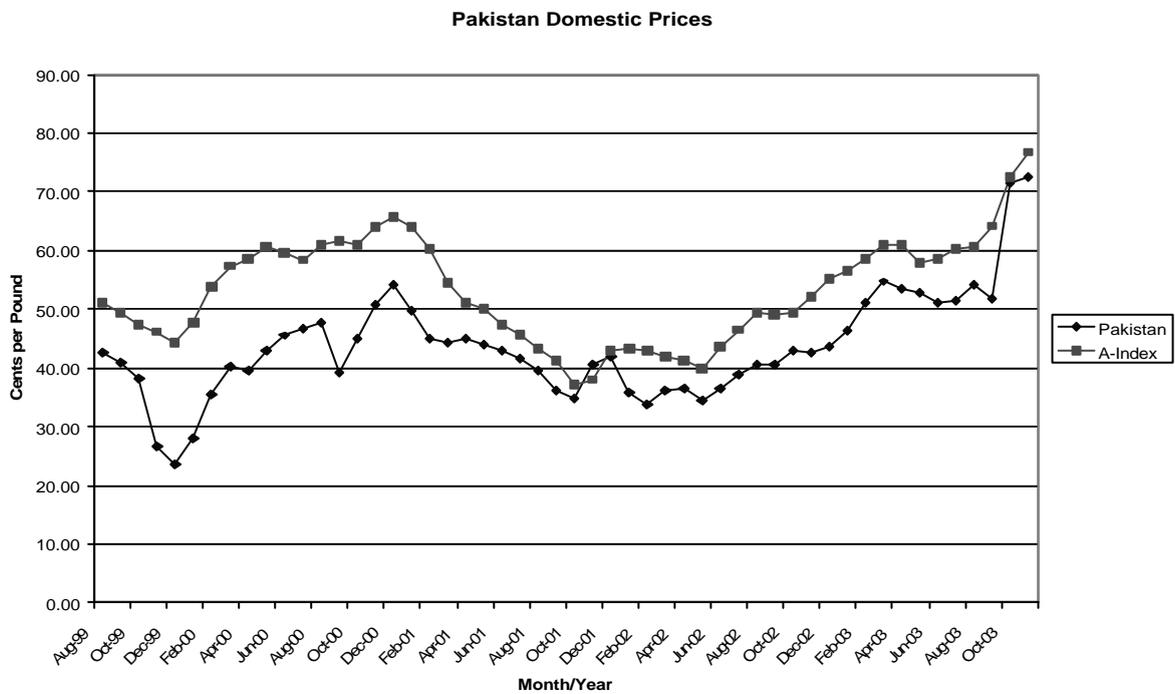


112. Finally, the domestic prices of the world's largest producer and consumer of upland cotton is the Chinese market. Because China is one of the world's largest importers of upland cotton, it is not surprising that its domestic market prices also track the A-Index prices as seen in the graph below:¹⁵⁰

¹⁵⁰ Exhibit Bra -385 (Domestic Prices from Various Countries).



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



¹⁵¹ Exhibit Bra -385 (Domestic Prices from Various Countries).

Conclusion

113. The evidence outlined above and in Brazil's earlier submissions shows that world market prices were transmitted to other markets during MY 1999-2002, and that this continues today. Whether the data is viewed collectively or individually, the data generally shows that Brazilian, US and other exporters' prices to these 42 countries are consistent with movements and trends in the A-Index price. While there are some (particularly low volume) graphs that show monthly differences from A-Index trends or movements, Brazil has set forth the quality, contract, and timing factors accounting for such anomalies. The collective statistical evidence supports the conclusion of the ICAC's chief statistician that "[a]ctual prices of imported cotton, in non-producing as well as in producing countries, are based on the Cotlook A Index or on the New York futures" and "the prices of the major types of cotton ... are affected by the supply and demand situation facing the market as a whole."¹⁵² All of this evidence is consistent with the conclusion that these third country market prices are heavily influenced by A-Index and New York futures prices. Professor Sumner analysis and the studies by USDA economists undeniably show that the US subsidies have suppressed A-Index and New York futures prices. Since these indices are the benchmarks for prices in those "same markets" where US and Brazilian upland cotton were exported, it is indisputable that the US subsidies have suppressed the prices in each of the "markets" cited in the introductory paragraph of Brazil's answer to this question.

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

Brazil's Answer:

114. In response to both questions, Brazil, New Zealand, and Argentina have argued previously that whether price suppression is "significant" cannot be judged solely by reference to a non-textually based "objective" amount of price suppression.¹⁵³ Rather, the "significance" of price suppression must be assessed with reference to the quality of the impacts of *whatever* level of price suppression exists on the producers of the like product. For example, a panel could find that even large amounts of price suppression are not "significant" where the complaining party producers had *de minimis* production, or no exports, and/or that the total value of lost revenue from suppressed prices was minimal. On the other hand, very large producers of a commodity product like upland cotton would suffer serious prejudice from even smaller "objective" levels of price suppression in terms of the amount of lost revenue.

115. The Panel's question really comes down to whether Article 6.3 of the SCM Agreement requires a two step process – first, an objective finding of an amount of price suppression that is "significant," and second, whether the complaining party Member suffers serious prejudice from such "significant" levels of price suppression. Brazil does not believe the text requires such a two-step process for the reasons outlined above and in previous submissions. However, the facts of this case show that even if such a test were required, the amount of price suppression caused by the US subsidies is significant and far from *de minimis*. Brazil has also submitted undisputed evidence that its producers have suffered considerable losses in revenue from suppressed prices that could have

¹⁵² Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).

¹⁵³ Brazil's 9 September Further Submission, paras. 251-259; Brazil's 7 October Oral Statement, para. 30; Brazil's 27 October Answers to Questions, paras. 119-122. New Zealand's 3 October Further Submission, paras. 2.21-2.27; New Zealand's 8 October Oral Statement, para. 8; Argentina's 3 October Oral Statement, para. 36; Argentina's 8 October Oral Statement, para. 38.

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.

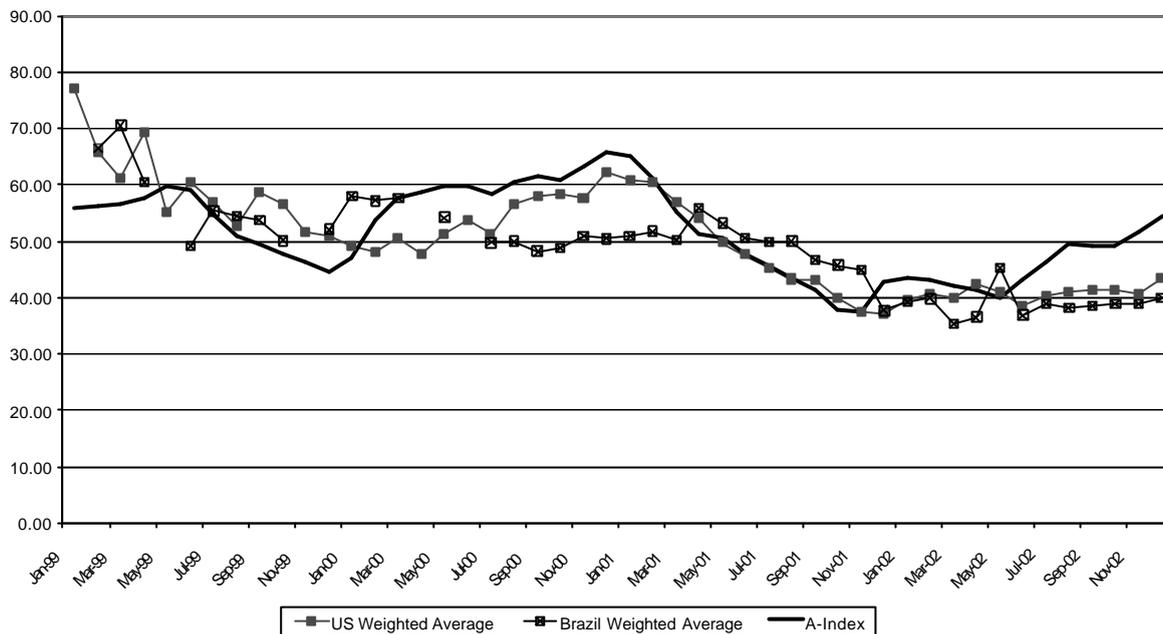
118. Using the proper monthly weighted average methodology and FAS’s own official export pricing data together with the Brazilian Government’s official export pricing data,¹⁵⁶ the collective situation in the eight countries examined in Exhibit US-75 looks completely different than the US chart in that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

Weighted Average U.S. and Brazil Export Prices to Argentina, Bolivia, Italy, Philippines, Portugal, Indonesia and India



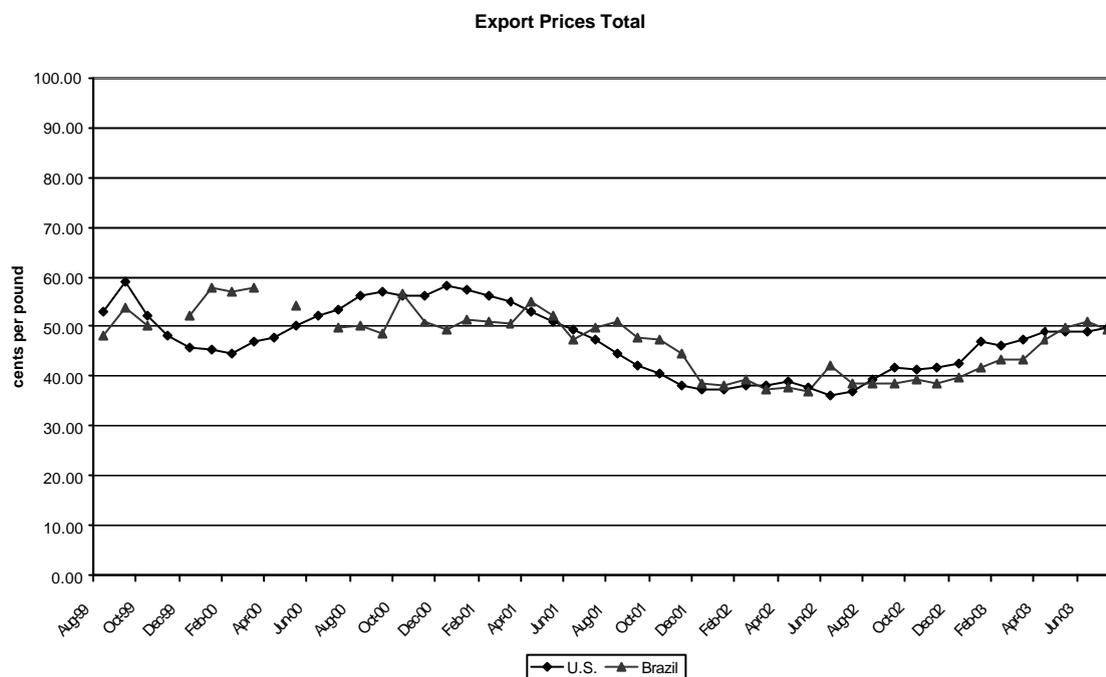
119. The graph shows that US and Brazilian prices fluctuate with Brazilian prices at times higher than US prices and US prices higher than Brazilian prices at other times. The chart shows that beginning in November 2000, US prices plunged along with the A-Index prices and that Brazilian prices quickly followed, with both US and Brazilian prices remaining at record lows until near the end of 2002 when both started rising again. Finally, the chart shows that US prices generally followed the movements or trends in A-Index prices (the solid line in the graph). As discussed in Brazil’s Answer to Question 233, this is what is relevant for a price suppression claim under Article 6.3(c) as opposed to any alleged “undercutting” by Brazilian cotton in individual markets as the US claims.

Cumulative Analysis of US and Brazilian Prices in 40 Third-Country Markets

120. Moving beyond the 8 countries in Exhibit US-75 to all 41 countries (including Brazil) where Brazil and the US both sold at least some upland cotton between MY 1999-2002 further demonstrates the absence of so-called “price undercutting” by Brazilian products as alleged by the United States. For the period MY 1999-2002, the weighted average price covering a total of 10.5 billion pounds of US upland cotton exported to these same 41 countries (including Brazil) is 45.33 cents per pound.¹⁵⁷ By contrast, the average weighted price of 709 million pounds of exported Brazilian upland cotton to 40 export markets is 44.65 cents per pound.¹⁵⁸ This is a difference of 0.68 cents per pound. For marketing year 2001 – the year when prices plunged to record lows – the weighted average price of US upland cotton in all markets where Brazilian cotton was also exported was 38.83 cents per pound while Brazilian weighted average prices to the same markets was significantly higher at 44.05 cents per pound.¹⁵⁹ Brazilian prices were lower than US prices during MY 2000 and 2002, but were higher than US prices in MY 1999.¹⁶⁰ This is hardly evidence of “price undercutting” by Brazilian upland cotton.

¹⁵⁷ Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).
¹⁵⁸ Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).
¹⁵⁹ Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).
¹⁶⁰ 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



122. This graph illustrates the absolute closeness of prices between Brazilian and US prices, particularly after mid-2001. But it also shows very similar *movements* in prices between Brazilian and US exports. And, as discussed in Brazil’s Answer to Question 233, these similar movements are further evidence of the influence of the global pricing mechanisms on prices received by US and Brazilian exporters in third country markets.

Individual Third-Country Analysis of Brazilian and US Export Prices

123. When US and Brazilian prices in the 40 individual markets are examined, the evidence does not support the United States’ broad assertion that Brazilian prices are consistently lower than US prices. In some of the key textile producing countries where US exporters ship large quantities of US upland cotton – Hong Kong, Taiwan, India, Pakistan, and Vietnam – US prices during MY 1999-2002 were *lower* than Brazilian prices.¹⁶²

124. In other large consuming (textile producing) countries, while US prices were somewhat higher than Brazilian prices, the volume of US exports vastly exceeded the volume of Brazilian exports, including China (120 times greater), Bangladesh (26 times greater), Colombia (9 times greater), Indonesia (17 times greater), Japan (35 times greater), Korea (3384 times greater), and Peru (631 times greater).¹⁶³ Huge volumes of US exports in these 7 markets compared to the volumes of Brazilian exports suggest that US exports, not Brazilian exports, play a dominating role in the conditions of competition in those markets.

¹⁶¹ Exhibit Bra-386 (Brazil and US Export Price by Country).

¹⁶² A complete set of graphs for each of the 40 countries country markets and the underlying data are set forth in Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country) and Exhibit Bra-386 (Brazil and US Export Prices by Country).

¹⁶³ Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

125. Indeed, overall, the cumulative volume of US exports to the 40 countries where Brazilian exports were shipped was *15 times* greater than the volume of Brazilian exports.¹⁶⁴ For Brazilian exports to secure any sales, let alone increase market share in competition with heavily subsidized US exports in these markets, it would not be surprising that textile consumers of upland cotton would expect Brazilian exporters to discount their prices. Andrew Macdonald confirmed that such discount pricing was necessary for non-Brazilian cottons to compete with US cotton.¹⁶⁵ This is particularly true in Argentina, Bolivia, Chile, Colombia, Ecuador, Indonesia, Peru, South Korea, Turkey and Venezuela where US exporters received the benefit of US export credit guarantees.¹⁶⁶ No exporter of non-US cotton could hope to compete with those export credits without discounting its upland cotton prices.¹⁶⁷

126. But even where the volume of Brazilian exports was greater than US exports, the evidence does not suggest the absence of overall price suppression from the effects of US subsidies.¹⁶⁸ Brazilian exports were greater than US exports in only 10 of the 40 countries (Argentina, Bolivia, Cuba, Poland, France, Germany, Greece, Portugal, South Africa, and Spain) over the MY 1999-2002 period. These 10 countries represented a tiny fraction – 0.49 per cent – of total US exports during MY 1999-2002 to the 41 countries, and only 37.5 per cent of Brazilian exports.¹⁶⁹ Yet, even without significant US exports to these countries, the domestic prices of these countries still largely followed A-Index prices, as discussed in Brazil's Answer to Question 233.

127. Further, in the 10 countries where the volume of Brazilian exports was larger than the United States, Brazilian prices were higher than US prices in 3 of the 10 countries – Poland, Greece, and South Africa.¹⁷⁰ Further, US prices in 4 of the 10 countries – France, Germany, Spain, and Portugal – were much higher than Brazilian prices.¹⁷¹ The very low volume of US exports to these same four countries suggests that far higher quality US cotton was sold in these countries which produce low-volume specialized cotton textile products.¹⁷² Finally, US and Brazilian prices were very close in remaining 3 countries – Argentina, Bolivia, and Cuba.¹⁷³ Thus, contrary to the US arguments, this evidence does not suggest that Brazilian prices are suppressing US prices, even in those markets where there are larger volumes of Brazilian imports.

128. Similarly, the unqualified US assertion that “the Brazilian A-Index quote is consistently *below* the US A-Index quote”¹⁷⁴ is both untrue as well as irrelevant to the question of whether US production subsidies caused suppression of world and third country market prices. Comparing US Memphis A-Index prices with Brazil A-Index prices shows the following graph.¹⁷⁵

¹⁶⁴ Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

¹⁶⁵ Brazil's 9 September Further Submission, Annex II, para. 50.

¹⁶⁶ Exhibit Bra-73 (Summary of Export Credit Guarantee Programmes, FY 1999-2003) and Exhibit Bra-299 (“Summary of FY 2003 Export Credit Guarantee Activity,” USDA, Covering GSM 102, GSM 103 and SCGP).

¹⁶⁷ Brazil's 9 September Further Submission, Annex II, paras. 49-53.

¹⁶⁸ Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).

¹⁶⁹ Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).

¹⁷⁰ Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).

¹⁷¹ Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).

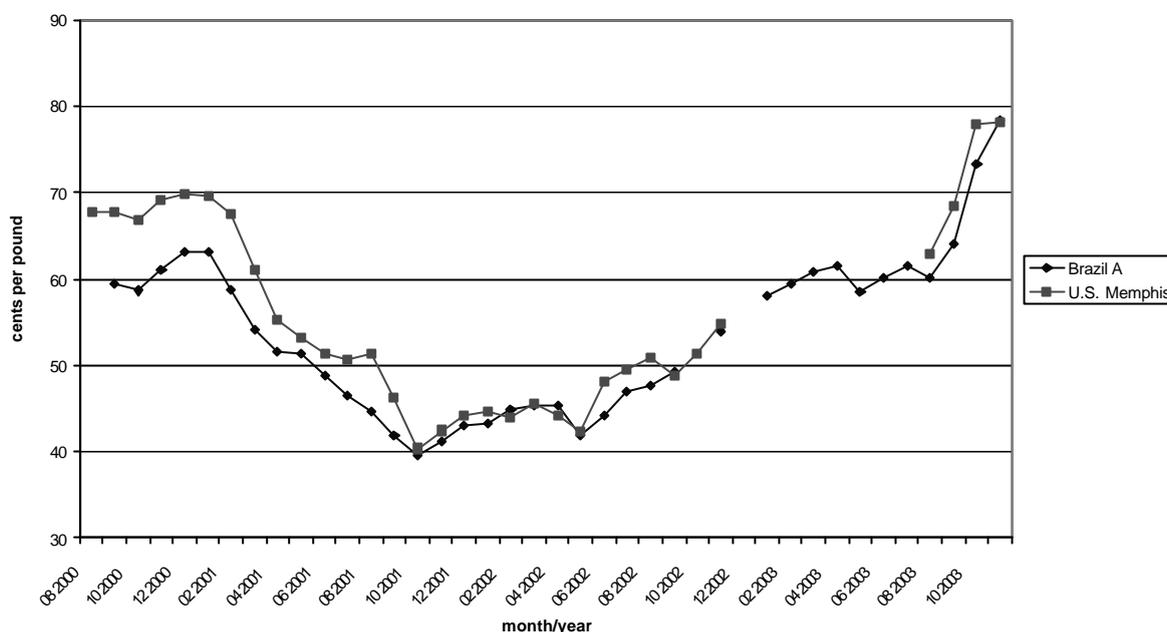
¹⁷² Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).

¹⁷³ Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).

¹⁷⁴ US 2 December Oral Statement, para. 10.

¹⁷⁵ Based on Exhibit Bra-242 (A and B-Index Quotes from Major Producers), extended to November 2003 using Cotton Outlook quotes.

Brazil and U.S. A-Index



129. As the Panel can see from the graph, since October of 2001, the US Memphis A-Index price has been slightly higher or slightly lower than the Brazilian A-Index price.¹⁷⁶ But throughout the entire period, the *movements* of both US Memphis and Brazilian A-Index prices track each other very closely.¹⁷⁷ This is the key fact illustrating the transmission of global price-suppressing effects as discussed in Answer to Question 233 *supra*.

Domestic Prices for Brazil, US and China

130. Nor does the record support the US claim that Brazilian prices undercut US export prices to the Brazilian market. Indeed, the evidence suggests the opposite. More than 90 per cent of Brazilian production of upland cotton was sold in Brazil during MY 1999-2002.¹⁷⁸ Imports represented approximately 20 per cent of Brazilian consumption during MY 1999-2002.¹⁷⁹ US exports to Brazil represented 21 per cent of Brazilian imports with a total of 306 million pounds of US upland cotton exported to Brazil¹⁸⁰ in MY 1999-2002.¹⁸¹ US annual weighted average export prices to Brazil were lower in every year except MY 2000 when US exports volumes fell to very low levels.¹⁸² Significantly, in MY 1999, when US export volumes to Brazil represented 17.6 per cent of very large Brazilian imports of upland cotton, the US weighted average prices were 10.27 cents *below* Brazilian domestic prices.¹⁸³ Similarly, in MY 2002, when US exports represented 50 per cent of total Brazilian imports, US export prices were 4.57 cents per pound *lower* than Brazilian domestic

¹⁷⁶ The US comparison between the Brazilian quote and the California/Arizona quote is misleading given the much higher quality of the latter cotton, as discussed above.

¹⁷⁷ The absence of data in MY 2002 for Memphis cotton was due to weather-related quality problems according to Gerald Estur of the ICAC. See Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).

¹⁷⁸ Exhibit Bra-208 (“Cotton: World Statistics,” ICAC, September 2003, p. 76).

¹⁷⁹ Exhibit Bra-208 (“Cotton: World Statistics,” ICAC, September 2003, p. 76).

¹⁸⁰ Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

¹⁸¹ Exhibit Bra-208 (“Cotton: World Statistics,” ICAC, September 2003, p. 76).

¹⁸² Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

¹⁸³ Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

prices.¹⁸⁴ This evidence confirms the testimony of Andrew Macdonald that Brazilian textile purchases of cotton used, *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 credit guarantees. And this evidence further confirms the price suppressing effects of US subsidies in the Brazilian market.

Conclusion

131. The evidence set out above refutes the inappropriate non-weighted average analysis in Exhibit US-75, and confirms the effects of the US subsidies in each market where Brazil and the US upland cotton were found in MY 1999-2002. Any “competition” between US and Brazilian cottons took place against the background of subsidy-distorted marketplaces. In the final analysis, the fact that selected US prices are higher¹⁸⁶ or lower in the A-Index or in individual third country markets is largely irrelevant to the question whether US subsidies are causing significant price suppression “in the same market” where US and Brazilian cotton is marketed. Rather, as Brazil has established, it is the impact of the US subsidies on the global supply and demand factors that suppresses prices in the world market as well as in the third countries where upland cotton is marketed. This means that the prices in each of those 40 third country markets – as well as the Brazilian and US markets – were already suppressed before any cotton was shipped by US or Brazilian exporters.

132. Finally, the generalized price-suppression effect manifests itself in all 42 individual country markets¹⁸⁷ in which Brazilian upland cotton is consumed. Professor Sumner estimates that over 40 per cent of US upland cotton exports during MY 1999-2002 would not have been made *but for* the US subsidies.¹⁸⁸ Forty per cent fewer US exports necessarily means lower, or even non-existent, US exports in many of the 40 markets where Brazil exported its upland cotton. Had significant volumes of US upland cotton not received Step 2 export payments, US exports and, thus, the amount of US upland cotton competing with Brazilian cottons would have been lower. Similarly, far fewer bids of US upland cotton financed by the GSM 102 programme may well have meant higher prices for Brazilian exporters and/or an expanded market share in each of these markets.

236. The Panel notes Exhibit US-47 (and the chart in paragraph 13 of the US 2 December oral statement). Please provide a conceptually analogous chart to Exhibit US-63 with respect to data relating to the US interpretation of "world market share". USA

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

¹⁸⁴ Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country); Exhibit Bra-389 (Brazilian Domestic Price Data) *updating* Exhibit Bra-240 (International, US and Brazilian Prices).

¹⁸⁵ Brazil's 9 September Further Submission, Annex II, para. 47 (“local purchasers of Brazilian cotton will frequently threaten to import foreign cotton if they consider the price of local cotton to be too high.”).

¹⁸⁶ *See* Brazil's 9 September Further Submission, Figure 17 (US California A-Index prices were higher than Brazilian prices).

¹⁸⁷ 40 export markets plus the United States and Brazil.

¹⁸⁸ Brazil's 9 September Further Submission, Annex I, Table 5a. This conclusion is conservative in view of the huge \$12.5 billion loss that would have been suffered by US producers with no US subsidies between MY 1997-2002.

Brazil's Answer:

133. In responding to this question, Brazil starts from the ordinary meaning of the term “consistent trend.” A “trend” means “a general course, tendency or drift.”¹⁸⁹ “Consistent” means “congruous, compatible with, not contradictory, marked by uniformity or regularity.”¹⁹⁰ A consistent trend within the meaning of Article 6.3(d) therefore means a non-contradictory tendency marked by regularity.

134. Generally, a phenomenon that remains at approximately the same level could be considered a consistent trend. However, read in the context of Article 6.3(d), which speaks of an “increase that follows a consistent trend over a period when subsidies have been granted,” the consistent trend must reflect the increase in the world market share of a Member over its previous three-year average. Thus, for a given period of time, the world market share of a Member could remain at approximately the same level and be compatible with a finding of a consistent trend. Yet, there will not be a consistent trend, within the meaning of Article 6.3(d), if during the final year there is no increase of a Member’s world market share over its previous three-year average. It follows that over the period when subsidies have been granted there must be a regular tendency of an increase in the world market share of a Member – although no increase in each and every year is required for the conditions of Article 6.3(d) to be fulfilled.

135. This interpretation is confirmed by the scope of Article 6.3(d), which applies to primary products or commodities. The parties agree that this includes agricultural products that necessarily will be affected by favourable or adverse weather conditions. The United States, for example, repeatedly asserts that the weather-related problems of MY 1998 mean that data for that year should be disregarded. These weather-related effects alone could cause in particular years the world market share of a Member to increase or decrease. This may well be the reasoning behind requiring examination of a longer trend in Article 6.3(d). But to require a constant increase in the world market share during each year “when subsidies have been granted” would render the disciplines of Article 6.3(d) largely inutile for agricultural products faced with weather-related production fluctuations.

136. Brazil has offered data on the US world market share over the period since MY 1996 as well as since MY 1986.¹⁹¹ The data shows that the trendline for the US world market share increases whether based on MY 1996 or MY 1986 as the starting point. The Panel’s question asks for guidance on the conditions for a finding whether this trend is consistent.

137. Brazil cautions that statistical methods may not be helpful in analyzing the consistency of a trend within the meaning of Article 6.3(d) for two reasons: first, Article 6.3(d) is concerned with yearly data over a relatively short period. That means that only very few data points will be available, which will affect the statistical significance of any results. Second, as discussed above, it is the nature of world market shares in agricultural products to fluctuate due to weather-related effects. This phenomenon tends to further weaken any statistical significance of methods analyzing the consistency of a trend.

138. With these considerations in mind, Brazil suggests that the Panel analyze the trendlines offered by Brazil¹⁹² and decide whether on their face they demonstrate – as Brazil has argued – a trend consistent with a finding that the effect of the subsidies is an increase in the US world market share for upland cotton. Brazil believes they do, particularly if the severe MY 1998 decline is disregarded.

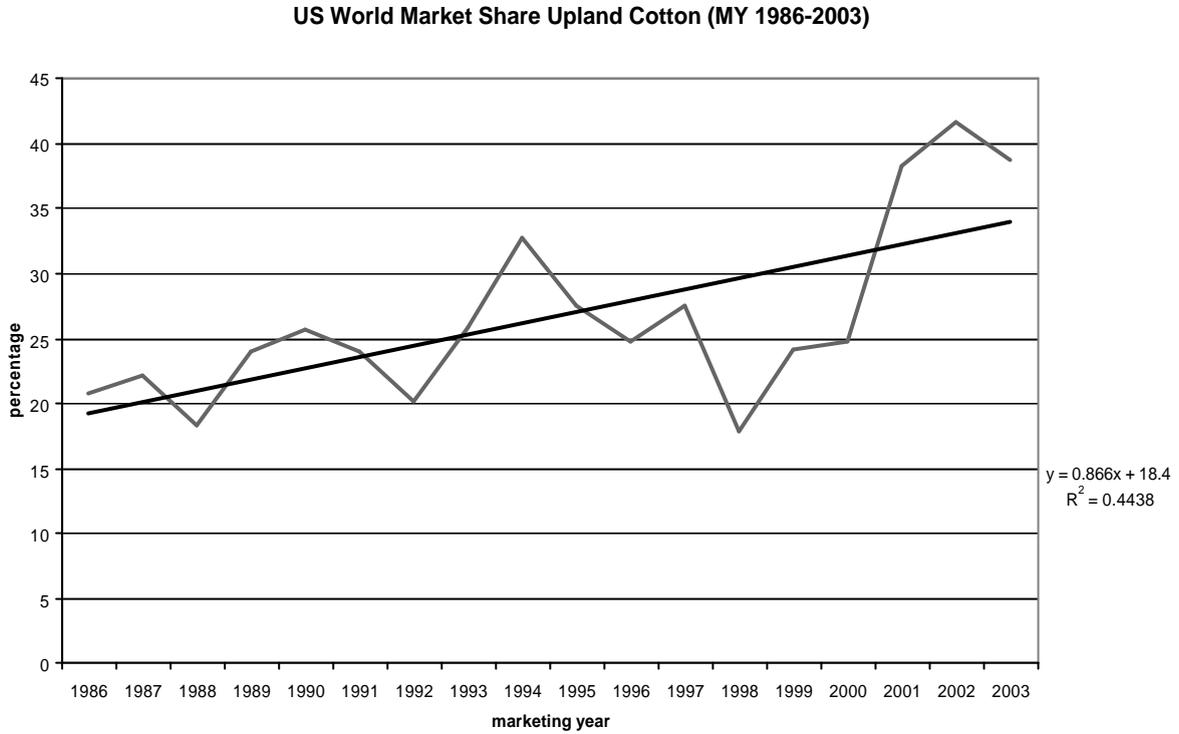
¹⁸⁹ The New Short Oxford English Dictionary 1993 edition, p. 3384.

¹⁹⁰ The New Shorter Oxford English Dictionary, 1993 edition, p. 486.

¹⁹¹ Brazil’s 27 October Answers to Questions, paras. 123-129 and Brazil’s 9 September Further Submission, Sections 3.4 and 4.12.2.

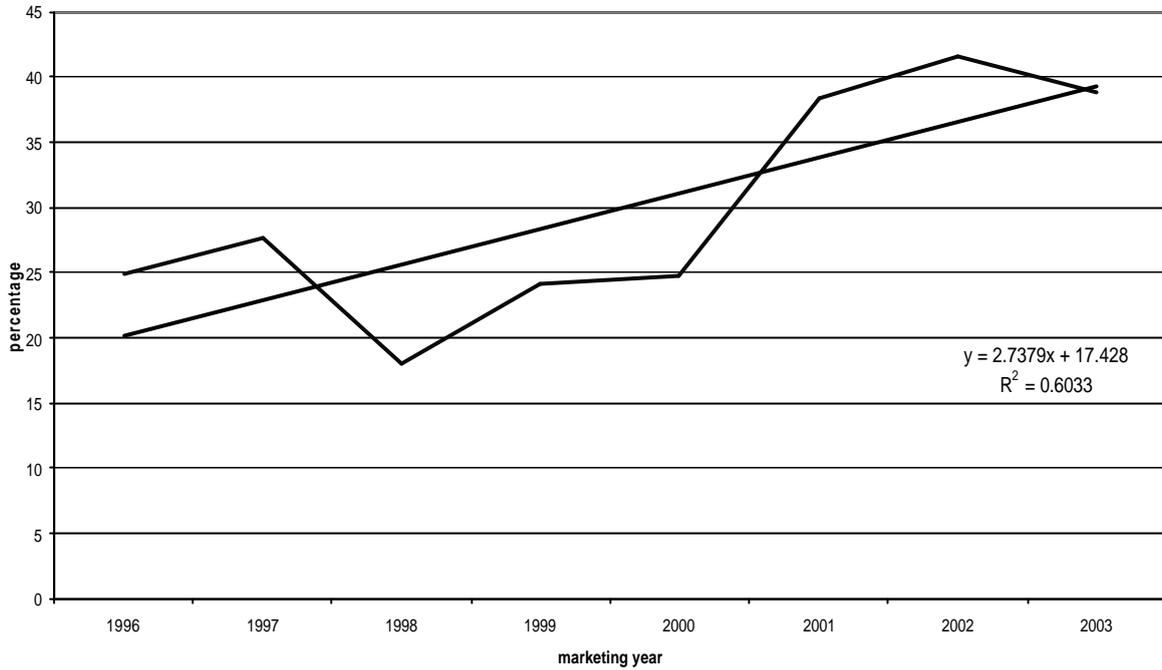
¹⁹² Brazil’s 27 October Answers to Questions, paras. 123-129 and Brazil’s 9 September Further Submission, Sections 3.4 and 4.12.2.

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

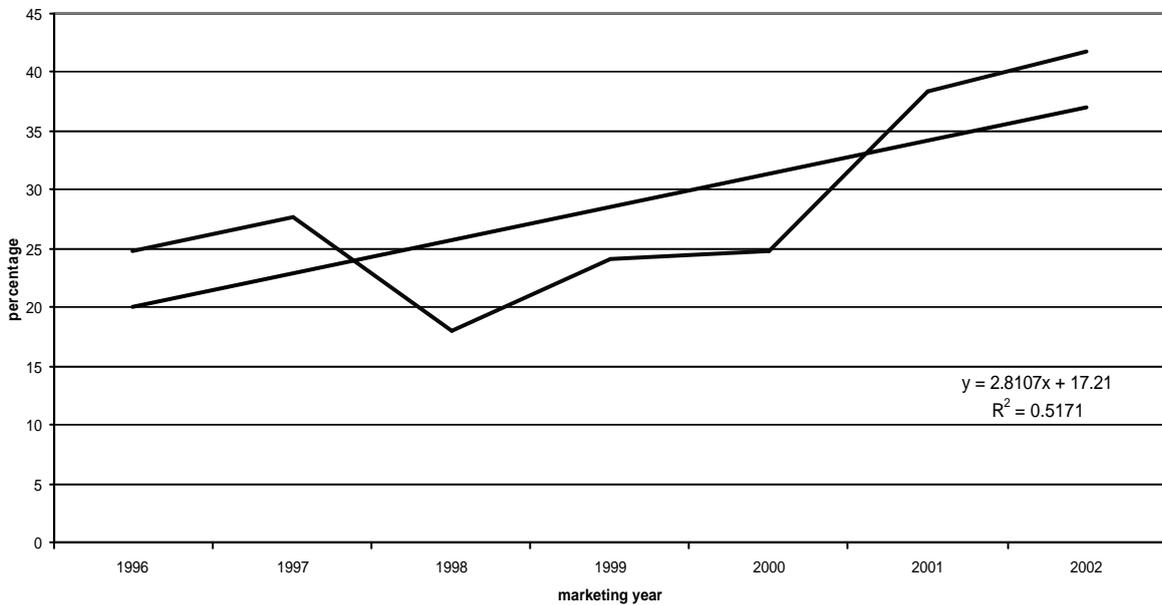


¹⁹³ The results are based on data as reported in Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) Claim).

U.S. World Market Share Upland Cotton (MY 2003)



U.S. World Market Share Upland Cotton (MY 2002)



The R^2 – the measure for the fit of a regression analysis – varies between 0.44 for MY 1986-2003 and 0.60 for MY 1996-2003. The R^2 demonstrate that there is a positive relationship between the US world market share and its increase over time. In view of the limited number of observations and the nature of the commodity market in question, this is a very high number.

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-47 or US-71? USA
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
243. Can the Panel assume that any support at all, even marketing loan programme payments, benefits upland cotton if an upland cotton producer has other agricultural production besides upland cotton? USA
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

Brazil's Answer:

140. Brazil does not know "what proportion of the 2000 cottonseed payments" were paid *directly* to producers of upland cotton by first handlers. Any such information would be within the exclusive control of USDA. Therefore, Brazil looks forward to the United States providing this information in its 19 January comments.

141. However, there is evidence that the MY 2000 cottonseed payments – together with the MY 1999 and MY 2002 payments – benefited upland cotton producers either directly or indirectly. First, producers who ginned their own cotton received payments directly as "first handlers." But even producers who did not gin their own cotton received indirect benefits because the purpose and effect of the subsidy was to prevent producers from having to pay *more* for ginning because of low

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 ginner 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 In testimony before Congress, the Chairman of the NCC stated as follows:

*Cottonseed is a critical component of total farm revenue generated from cotton production. From 1994-1998, cottonseed accounted for approximately 13 per cent of the total value of cotton production, averaging \$58 per acre. Unfortunately cottonseed prices weakened significantly in 1999 as a result of weak crushing demand and as well as low oilseed prices. Cottonseed values remain well below those of previous years. The special cottonseed payment authorized by Congress for the 1999 and 2000 marketing years were vitaly important on boosting producer income and helping to maintain the industry's ginning infrastructure.*¹⁹⁶

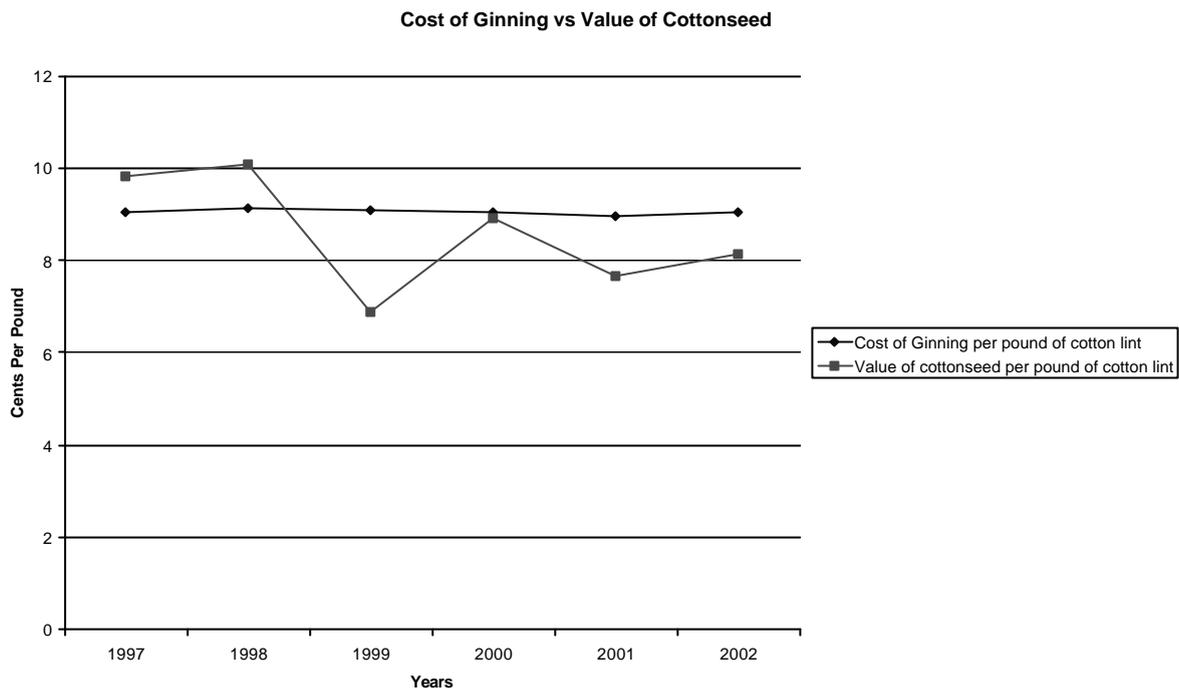
143. Finally, the importance of cottonseed payments to producers is further demonstrated by comparing the costs of ginning to the value of cottonseed. This is illustrated in the graph below:¹⁹⁷

¹⁹⁴ Exhibit Bra-390 ("Glickman Proposes Cottonseed Payment Programme," USDA News Release, 29 February 2000) (emphasis and underlining added).

¹⁹⁵ Exhibit Bra-41 (Congressional Hearing, "The Future of Federal Farm Commodity Programmes (Cotton)," House of Representatives, 15 February 2001, p. 5).

¹⁹⁶ Exhibit Bra-188 (Testimony of James Echols, Chairman of the National Cotton Council before the Committee of Agriculture, Nutrition and Forestry of the US Senate, 17 July 2001, p. 9).

¹⁹⁷ This graph is based on per pound figures for the value of cottonseed and the cost of ginning per pound of cotton lint produced as calculated from Exhibit Bra-323 (Costs and Returns of US Upland Cotton Farmers, MY 1997-2002). They calculated figures are reproduced in Exhibit Bra-391 (Cost of Ginning and Value of Cottonseed per Pound of Cotton Lint).



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 2000²⁰⁰, 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’s 9 September Further Submission, Table 1.

²⁰¹ This figure has been calculated based on the price gap of 0.92 cents per pound multiplied by the MY 2002 production of 16.531 million 480-pound bales (Exhibit Bra-391 (Cotton and Wool Outlook, USDA, 12 December 2003, Table 1).

Brazil's Answer:

145. The Panel is well aware of Brazil's view that all of the US subsidies are non-green box. But if the Panel were to find that certain of the subsidies are green-box subsidies, then under the specific circumstances of this dispute, Article 13(a)(ii) of the Agreement on Agriculture prohibits – during the implementation period – the effects of these subsidies being included along with other effects of non-green box subsidies in assessing Brazil's actionable subsidy claims. Professor Sumner's analysis in Annex I of Brazil's 9 September Further Submission permits the Panel to examine both the individual as well as collective effects of the various US subsidies. In response to Question 146, Professor Sumner analyzed the production, export and price effects of all of the subsidies except PFC subsidies.²⁰² This analysis would also permit the Panel to ensure that effects caused by, for example, PFC payments, were not attributed to the effects caused by the other non-green box subsidies.

146. After the 9-year implementation period of the Agreement on Agriculture, there is nothing in that Agreement that exempts the effects of green box subsidies from being considered by panels in actions based on Articles 5 and 6 of the SCM Agreement. Subsidies that conform to Annex 2 of the Agreement on Agriculture are exempt from the reduction commitments established under Article 6, but there is nothing in Articles 5 or 6 of the SCM Agreement that provides for any type of exemption, beginning in 2004. On the contrary, Article 5 of the SCM Agreement clearly states the Members should not cause, "... through the use of *any* subsidy ... adverse effects to the interests of other Members." The only exception provided therein refers to the temporary exception of Article 13 of the Agreement on Agriculture.

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

Brazil's Answer:

147. Yes, the Panel is required to take into account *all* non-green box subsidies, including prohibited subsidies in assessing Brazil's Article 5 and 6 claims under the SCM Agreement.²⁰³ Even if the Panel were to conclude that the effects of prohibited subsidies, such as Step 2 and export credit guarantees, should not be assessed for the purposes of Brazil's Article 5 and 6 claims, Professor Sumner's analysis permits the Panel to analyze such claims for those non-green box and non-prohibited subsidies (marketing loan payments, crop insurance subsidies and contract payments).

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

Brazil's Answer:

148. Yes. Nothing prevents the Panel from considering – in assessing Brazil's threat of serious prejudice claims – the volatility of the upland cotton market and current and likely futures price developments after the date of establishment of the Panel. Brazil has proposed that the Panel follow the guidance of the GATT *EC – Sugar Exports* panels and the Appellate Body in *US – FSC* and analyze whether there is any mechanism that stems, or otherwise controls, the flow of US upland

²⁰² Brazil's 27 October Answers to Questions, paras. 114-118 and Exhibit Bra-301 (Additional Results from Professor Sumner's Model, Table "Impact of removal of all domestic support except PFC/direct payments and crop insurance).

²⁰³ See Brazil's 27 October Answer to Question 145(b).

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 each of these types of claims overlapping during the period of MY 2002. Thus, the "matter" before the Panel has not changed (and cannot) since the establishment of the Panel.

150. In "making an objective assessment of the matter," the Panel must make "an objective assessment of the facts of the case" pursuant to DSU Article 11. Nothing in the text of DSU Article 11 suggests that this objective assessment of "facts" cannot include collecting and analyzing facts occurring after the establishment of a Panel. Indeed, there are a number of precedents in which panel's have considered evidence that came into existence *after* the date of the establishment of a panel.²⁰⁶ As with investigating authorities in trade remedy investigations, a "period of investigation" for a WTO Panel in an Article 5 and 6 claim is useful for assessing whether present or threatened effects presently exist. There is nothing in the text of Part III of the SCM Agreement or the DSU that suggests that the time period for the collection of evidence or data to investigate must stop with the establishment of the Panel.

151. The second question raised by the Panel's question is a factual one, *i.e.*, what weight should the Panel give to the most recent evidence of volatility in the cotton futures and spot markets? It is fact that upland cotton prices have risen – and fallen – significantly since the Panel was established in March 2003. For example, futures prices for the nearby March 2004 contract rose from 55.80 cents on 6 March 2003 to a high of 86 cents on 30 October before falling to 72.32 cents on 19 December 2003.²⁰⁷ But the record shows that such volatile futures price increases – and decreases – also occurred between MY 1999-2002.²⁰⁸ And they will no doubt exist during MY 2003-2007.

152. In assessing whether there is a threat of serious prejudice, the Panel should be cautious about relying too heavily on only 3-4 months worth of the most recent data. Indeed, the Appellate Body has cautioned that "competent authorities are required to examine the trends in [data] over the entire period of investigation," because the "analysis could be easily manipulated to lead to different results, depending on the choice of end points."²⁰⁹ Similarly, in *Argentina – Footwear* the Appellate Body held that "competent authorities are required to consider the trends in imports over the period of investigation (rather than just comparing the end points)."²¹⁰ The panel in *Argentina – Peach Safeguards* stated that "[t]he most recent past should not be considered separately from the overall

²⁰⁴ See Brazil's 18 November Further Rebuttal Submission, Section 4.

²⁰⁵ Brazil repeatedly in its many submission to the Panel refers to data that originates after the establishment of the Panel, including in these answers to the Panel's questions.

²⁰⁶ Panel Report, *India – Quantitative Restrictions*, WT/DS90/R, para. 5.161-5.163 ("In this case the parties and the IMF have supplied information concerning the evolution of India's balance of payments and reserve situation until June 1998. To the extent that such information is relevant to our determination of the consistency of India's balance of payments measures with GATT rules as of the date of establishment of the Panel [18 November 1997], we take it into account."); Panel Report, *Japan – Apples*, WT/DS245/R, para. 8.49; GATT Panel Report, *Korea – Beef*, BISD 36S/268, paras. 122-123.

²⁰⁷ Exhibit Bra-393 (Futures Prices as of 19 December 2003).

²⁰⁸ See Exhibit Bra-311 (Side-By-Side Chart of the Weekly US Adjusted World Price, the A-Index, the nearby New York Futures Price, the Average Spot Market Price and Prices Received by US Producers from January 1996 to the Present).

²⁰⁹ Appellate Body Report, *US – Steel Safeguards*, WT/DS248/AB/R, paras 353-356.

²¹⁰ Appellate Body Report, *Argentina – Footwear*, WT/DS121/AB/R, para. 129.

trends during the period of analysis,” as otherwise the resulting picture may be “quite misleading.”²¹¹ The Panel in this case performs a task similar to a domestic competent authority in a trade remedy case.

153. The Panel has before it two different methodologies to judge the present price levels and threat of serious prejudice. The first methodology before the Panel is the use of baseline projections such as the USDA’s and FAPRI’s baseline projections to assess the effects of mandated US subsidies in the year ahead. Professor Sumner’s analysis based on the January 2003 FAPRI baseline, shows that the US subsidies continue to maintain large amounts of US production whether prices are high or low. Professor Sumner found that during MY 2003-2007 annual US production would be 19.4 per cent lower leading to a reduction in projected US exports by 32.4 per cent annually and world prices that would be 8.3 per cent higher absent the US subsidies.²¹² Similarly, Professor Ray of the University of Tennessee also found significant production, export, and price suppressing effects from the US subsidies from MY 2003-2007.²¹³ These findings by two of the leading US economists cannot be ignored by the Panel.

154. A second far less valid methodology would be to use the US “futures methodology.” This methodology would examine the December futures price at the time of planting (January-March 2004). What is significant about current futures prices (in December 2003) is that the “futures market” is predicting that prices will fall in MY 2004. The December 2003 price of the December 2004 futures contract is 65.85 cents per pound as of 19 December 2003, while the March 2004 futures contract is 72.32 cents per pound.²¹⁴ Assuming that the current 65.85 cents per pound December 2004 futures contract price will continue during the planting decision marking time between January-March 2004, the expected adjusted world price will be 52.48 cents per pound²¹⁵ and the expected average MY 2004 price received by US producers would be 59.73 cents per pound.²¹⁶ This means that US producers “expect” to receive a considerable CCP payment of 6 cents per pound in MY 2004 (65.73 cents minus 59.73 cents).

155. As discussed by Professor Sumner on 3 December, given the probability distribution of the expected adjusted world price,²¹⁷ producers would also expect to receive some marketing loan payments because producers expect with a certain probability that the adjusted world price would be below the marketing loan rate triggering marketing loan payments.

156. As with the period MY 1999-2002, the existing (December 2003) price levels in the upland cotton world and US markets mean that US producers will be planting in 2004 for government support during MY 2004, not for the market. This constant theme was recently emphasized by the world’s largest cotton trader, William Dunavant:

The [US] farm programme can return more when prices are low rather than when prices are high . . . [and] [t]he loan deficiency payment created by the farm programme is the name of the game – not necessarily the futures price or the cash price . . .

²¹¹ Panel Report, *Argentina – Peach Safeguards*, WT/DS238/R, para. 7.64-7.65 citing para. 138 of the Appellate Body Report in *US – Lamb*.

²¹² Exhibit Bra-326 (Results of Professor Sumner’s Modified Model, Table B).

²¹³ See Brazil’s 9 September Further Submission, paras. 204-205.

²¹⁴ Exhibit Bra-393 (Futures Prices as of 19 December 2003).

²¹⁵ Exhibit Bra-370 (The Difference between the Average World Price and the Nearby December Futures Contract Price).

²¹⁶ The spread of 6.12 cents has been calculated based on the data in Exhibit Bra-370 (The Difference between the Average World Price and the Nearby December Futures Contract Price) and the average farm price in Exhibit Bra-4 (“Fact Sheet: Upland Cotton,” USDA, January 2003, p. 5).

²¹⁷ See Exhibit Bra-371 (Simple Example of the Calculations of Marketing Loan Benefits (Probability Distribution)).

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 this country [*i.e.*, the United States]."²¹⁹ These statements by the world's leading cotton trader confirm the significant effects that have existed and will continue to exist at current price levels because of the mandatory nature of the subsidy programmes.

157. Finally, nothing about the price levels that have increased since 18 March 2003 has changed in any way the mandatory nature of the US subsidies. At current price levels, producers would receive benefits from crop insurance subsidies, direct payments, and indirectly from Step 2 payments and export credit guarantees. Whether prices are at 70 cents per pound or 30 cents per pound, US producers know and expect that they will be protected by the wide range of US subsidies. When US prices decline, as they inevitable will, US producers will be provided direct production incentives to continue producing at any price level. Historical data convincingly demonstrates that this downside risk protection guarantees high levels of production. Brazil proved that US planted acreage remains high within relatively narrow ranges whether market prices increase or decrease. This lack of US producers' production response to huge costs overruns of \$12.5 billion over six years or to record low prices, or even to increasing prices, is at the heart of Brazil's threat case. While the cumulative price-suppressing and export-enhancing effects of the US subsidies may be smaller now than they were on 18 March 2003, they are, and will remain significant for MY 2003 and for MY 2004 based on current prices.

158. In sum, Brazil reiterates its arguments that taking all available data into account, the US subsidies pose a threat of serious prejudice to the interests of Brazil, in violation of Articles 5(c) and 6.3 of the SCM Agreement and GATT Articles XVI:1 and XVI:3.²²⁰

VI. 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 18 November further rebuttal submission; and Exhibit BRA-350. Have Step 2 payments ever been zero since the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002? In what circumstances could a Step 2 payment be zero? How does the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002 affect your response? BRA, USA

Brazil's Answer:

159. Under the 2002 FSRI Act (with the elimination of the 1.25 cent per pound threshold), Step 2 payments will be zero when the lowest US A-Index quote is equal or below the average A-Index.²²¹ Thus, for Step 2 payments to expire, the lowest US quote will have to be one of the cheapest of the

²¹⁸ Exhibit Bra-392 ("William Dunavant Says: Overproduction Thwarts Cotton Price Upturn," Western Farm Press).

²¹⁹ Exhibit Bra-392 ("William Dunavant Says: Overproduction Thwarts Cotton Price Upturn," Western Farm Press).

²²⁰ See Section 4 of Brazil's 18 November Further Rebuttal Submission.

²²¹ Exhibit Bra-29 (Section 1207 (a) of the FSRI Act).

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 upland cotton. In sum, the fact that producers – in their capacity as exporters – may benefit from Step 2 export payments does not impact the export contingency of these payments.

²²² Exhibit Bra-350 (Weekly Step 2 Certificate Values).

²²³ Exhibit Bra-350 (Weekly Step 2 Certificate Values).

²²⁴ For example, Brazil's response to Panel Question 125, paragraph 14.

²²⁵ Brazil's 27 August Answers to Question, para. 14.

²²⁶ Exhibit Bra-37 (7 CFR 1427.104(a)(2)).

²²⁷ See Brazil's 9 September Further Submission, Annex I, table I.5f.

²²⁸ Sections 2.6.7, 2.6.8, 4.1, 5.1 and 5.2 of Brazil's 24 June First Submission; Section 3 of Brazil's 22 July Oral Statement; Brazil's 24 July Closing Statement, paras. 21-22; Section 4 of Brazil's 22 August Rebuttal Submission; Section 3.3.4.7.5 of Brazil's 9 September Further Submission; Section 3.7.3 of Brazil's 18 November Further Rebuttal Submission.

- (b) How does this reconcile with Dr. Glauber's statement in Exhibit US-24, p. 3 (referring to "the 1990 Farm Bill and subsequent legislation") that Step 2 payments do *not* go directly to the producer? USA
- (c) What proportion of Step 2 "export payments" go to producers? Please supply supporting evidence. USA

VII. Remedies

250. Does Brazil seek relief under Article XVI of GATT 1994 in respect of expired measures? What type of recommendation would the Panel be authorized to make? (Brazil further submission, paragraph 471 (iii)) BRA

Brazil's Answer:

164. Brazil does not seek relief under GATT Article XVI of GATT 1994 in respect of expired measures, which Brazil understands the Panel to mean only the legal instruments consisting of the 1996 US Farm Bill providing, *inter alia*, for production flexibility contract payments, as well as the various emergency appropriation Acts in 1998-2001 providing, *inter alia*, for market loss assistance payments.²²⁹

165. With respect to the second question, the Appellate Body held in *US – Certain EC Products*, that a panel may *not* make a recommendation to the DSB that a Member bring a measure into conformity with its WTO obligations if that measure no longer exists.²³⁰ Therefore, as detailed in paragraph 471(x) of Brazil's 9 September Further Submission, Brazil requests the Panel to recommend that the United States bring its existing measures providing or facilitating the payment of subsidies to producers, users and exporters of upland cotton into conformity with GATT Article XVI.

251. In light, *inter alia*, of Article 7.8 of the SCM Agreement, if the Panel were to find that any subsidies have resulted in adverse effects to the interests of another Member within the meaning of Article 5 of the SCM Agreement, should it make any recommendation other than the one set out in the first sentence of Article 19.1 of the DSU? BRA

Brazil's Answer:

166. Yes. If the Panel agrees with Brazil that the US subsidies to upland cotton cause and threaten to cause serious prejudice to the interests of Brazil, in violation of Article 5 of the SCM Agreement, the Panel should recommend pursuant to Article 7.8 of the SCM Agreement that the United States remove these adverse effects or withdraw the subsidies.²³¹

252. Without prejudice to any findings by the Panel, if the Panel were to find that any of the challenged measures constitute prohibited subsidies within the meaning of Article 3 of the SCM Agreement, what are the considerations that should guide the Panel in making a recommendation under Article 4.7 of the SCM Agreement relating to the time period "within which the measure must be withdrawn"? What should that time period be? BRA

²²⁹ Brazil's claims under Articles 5(a) and 6(c) of the SCM Agreement do include the continuing adverse effects today and in the future of subsidies provided under these expired legal provisions. *See* Brazil's 24 July Closing Statement, paras 4-7.

²³⁰ Appellate Body Report, *US – Certain EC Products*, WT/DS165/AB/R, para. 81

²³¹ *See* Brazil's 9 September Further Submission, paras. 471(viii) and 471(ix).

Brazil's Answer:

167. Brazil suggests that the Panel follow the precedent of all previous WTO panels²³² that made findings of prohibited subsidies and specify that the measure must be withdrawn within 90 days.²³³

VIII. Miscellaneous

253. Regarding the adjustment authority related to Uruguay Round compliance in s.1601(e) of the FSRI Act of 2002 (the so-called "circuit-breaker provision"):

- (a) Does it relate to export credit guarantees, crop insurance and cottonseed payments?
- (b) Does it relate only to compliance with AMS commitments?
- (c) Is the authority discretionary? If so, can its exercise be limited by the legislative branch of government?
- (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?
- (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

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

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

Brazil's Answer:

168. The United States has admitted what the text of the "circuit breaker" provision in Section 1601(e)(1) of the 2002 FSRI Act already makes clear, *i.e.* that it only applies to "total allowable domestic support levels under the Uruguay Round Agreements," *i.e.*, "total AMS."²³⁴ The United States further acknowledges that this provision "is not specifically addressed to forestalling

²³² Panel Report, *Brazil – Aircraft*, WT/DS46/R, para. 8.5; Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 10.4; Panel Report, *Australia – Leather*, WT/DS126/R, paras. 10.6-10.7, Panel Report, WT/DS139/R and WT/DS142/R, paras. 11.6-11.7 and Panel Report, *Canada – Aircraft II*, WT/DS222/R, para. 8.4.

²³³ Brazil notes that the panel in *US – FSC* took account of the fact that the US tax system could only be changed from the beginning of the next fiscal year and therefore set the 1 October 2001 as the deadline for withdrawing the FSC subsidies "without delay."

²³⁴ US 2 December Oral Statement, para. 82

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 level, there is no legal provision in the 2002 FSRI Act granting the Secretary of Agriculture any authority to stem, or otherwise control, the amount of upland cotton subsidies. Indeed, the numerous mandatory provisions of the 2002 FSRI Act text cited in Brazil’s earlier submissions²³⁶ *requires* the Secretary to make the payments to which eligible producers, users and exporters have a legal entitlement. No exceptions for upland cotton are provided for. Thus, these provisions continue to be mandatory in all circumstances where the US total AMS is below \$19.1 billion. The Appellate Body and WTO panels have held that measures are mandatory where they cannot be applied in a WTO consistent manner in certain circumstances.²³⁷

170. And even were the US total AMS to exceed \$19.1 billion, the text of Section 1601(e)(1) does not mandate any reductions if it is not “practicable” to do so. Nor does the text mandate an even, across the board, cut for *all* programme crops. For example, the Secretary appears to have the discretion to cut corn or wheat subsidies but retain the full amount of upland cotton subsidies. Brazil will provide further comments on the “circuit breaker” provision on 19 January in response to the US Answers to Questions 253-254.

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

²³⁵ US 2 December Oral Statement, para. 82.

²³⁶ Brazil’s 9 September Further Submission, para. 423 (summarizing the evidence and the specific statutory provisions of the 2002 FSRI Act and the 2000 ARP Act mandating payments by USDA).

²³⁷ Appellate Body Report, *Argentina – Textiles and Apparel*, WT/DS56/AB/R, paras. 48-54, 62; Panel Report, *US – Export Restraints*, WT/DS194/R, para. 877.

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 under which they were provided during the marketing years 1996-2002;

1. For interest subsidies and storage payments under the 1996 Act (marketing years 1996-2002), the relevant regulations are found at 7 CFR 1427.13 and 1427.19 (2000 ed.) (first published at 61 FR 37601, 18 July 1996).¹ Under the 2002 Act, those rules are found at 7 CFR 1427.13 and 1427.19 (2003 ed.) (first published at 67 FR 64459, 18 October 2002).² We describe and discuss these provisions below in response to part "(b)" of this question.

(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

2. Interest subsidies and storage payments are support provided in connection with the marketing loan programme. On a forfeit of warehouse-stored upland cotton under loan, the Commodity Credit Corporation (CCC) pays warehouse charges for the loan period (even though the farmer had title during that period) and forgives interest. 7 CFR 1427.13 (2000 ed. and 2003 ed.). As for redemption of cotton under loan, repayment rates depend on the world market price. If the repayment amount set on that price is low enough, CCC may have to forgive interest and pay storage charges because the repayment amount will not be enough to satisfy the loan amount and those charges. *See* 1427.19(e) (2000 and 2002). By contrast, if the repayment rate set on the world market price is high enough, the producer pays both. *Id.* In general, if the loan is repaid, there is not an interest subsidy at all; rather, in 7 CFR Part 1405, it is provided that CCC will charge the sum of (1) the rate that CCC pays the Treasury and (2) another 1 per cent per annum. We are not aware of any other payments that would be responsive to the panel's question.

¹ *See* Exhibit US-117 (7 CFR 1427.13 and 1427.19 (2000 ed.)).

² *See* Exhibit US-118 (7 CFR 1427.13 and 1427.19 (2003 ed.)).

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

3. In response to the Panel's Question 67, which asked the parties "to calculate and submit estimates of the AMS for upland cotton for marketing years 1992, 1999, 2000, 2001 and 2002," the United States stated, in the context of its calculation of the AMS for marketing year 2002, that "it would not be appropriate for the Panel to examine payments made after the date of panel establishment, on which the Panel's terms of reference were set. Measures taken after the Panel was established cannot be within the Panel's terms of reference."³ The United States continues to believe that this statement is accurate. Past panels have frequently been confronted with the issue of the date as of which measures should be examined. Panels have generally determined to examine those measures as of the date of panel establishment as a matter both of terms of reference as well as for practical reasons (for example, so as to allow findings to be made with respect to a measure withdrawn after the panel was established but before panel proceedings were completed).

4. The Panel's terms of reference were set by the DSB at its meeting on 18 March 2003, namely, "[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 and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."⁴ In that panel request, Brazil identifies the measures at issue as "prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton."⁵ In Brazil's answer to question 19 from the Panel, Brazil clarified: "Brazil's Request for Establishment of a Panel ('Panel Request') challenges two types of domestic support 'measures' provided to upland cotton and various different types of export subsidy measures. *The first type of domestic support "measure" is the payment of subsidies* for the production and use of upland cotton. These payments were and continue to be made between MY 1999 to the present (and will be made through MY 2007) through the various statutory and regulatory instruments listed on pages 2-3 of Brazil's Panel Request. Brazil referred to these payments at pages 2-3 of the Panel Request as 'subsidies and domestic support provided under' or 'mandated to be provided' under the various listed statutory and regulatory instruments. Brazil has tabulated the *different types of payments (i.e., the measures)* made under these legal instruments in paragraphs 146-149 of its First Submission."⁶ That is, to the extent that "payments" are at issue (as opposed to Brazil's challenge of certain legal instruments "as such")⁷, the "measure" is "the payment of subsidies for the production and use of upland cotton." Only those payments made through the date of panel establishment could be "measures at issue" within the meaning of DSU Article 6.2 (as opposed to measures not yet taken, such as the Agricultural Assistance Act of 2003, which had not been enacted at the time of Brazil's panel request).

5. Thus, for purposes of the Panel's Peace Clause analysis or the evaluation of the "effect of the subsidy" for purposes of the Panel's actionable subsidies analysis, Brazil's choice to obtain establishment of this Panel several months into the 2002 marketing year but well before that marketing year was completed necessarily impacts the payments ("measure") that the Panel may examine. The payment of subsidies *after* panel establishment cannot alter the measures within the Panel's terms of reference and properly before the Panel, just as the cessation of payments after panel establishment would not prevent the Panel from making findings as to those payments that had been made as of the date of establishment.

³ US Answer to Question 67 from the Panel, para. 134 (11 August 2003).

⁴ WT/DSB/M/145, para. 35.

⁵ WT/DS267/7, at 1.

⁶ Brazil's Answer to Question 19 from the Panel, para 15 (emphasis added).

⁷ Brazil's Answer to Question 19 from the Panel, para. 16.

B. ECONOMIC DATA

195. Does the United States wish to revise its response to the Panel's Question No. 67bis, 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?

6. Question No. 67bis inquired about annual amounts granted to upland cotton producers per pound and in total expenditures under each of the decoupled payment programmes. The United States of course conferred with US Department of Agriculture personnel, including FSA personnel, concerning this question and reported to the Panel that USDA "does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers."⁸ That response remains accurate today: because those payments are decoupled from current production, expenditures under such programmes are not tracked by whether the recipient produces upland cotton. In fact, the United States does not collect production data based on actual harvesting figures reported by farmers; we do not understand Brazil to have asserted the contrary.⁹

7. Brazil has also not asserted that the United States maintains information on the receipt of decoupled payments for upland cotton base acres by upland cotton producers. Rather, it has presented a novel methodology developed by the Environmental Working Group (EWG) to compare disparate data separately collected by the United States to attempt to infer that information.¹⁰ EWG compared the farm numbers of recipients of decoupled payments for upland cotton base acres with the farm numbers of recipients of marketing loan payments in marketing years 2000-2002. It bears emphasis that the latter database is not a production database based on actual harvesting figures reported by farmers; the marketing loan database merely records the quantities of cotton on which a recipient has received payments. By comparing the matches by farm number between the two databases, EWG calculated that the share of decoupled payments for upland cotton base acres paid to upland cotton "producers" (that is, recipients of marketing loan payments) was 71.3 per cent in marketing year 2000, 76.9 per cent in marketing year 2001, and 73.6 per cent in marketing year 2002.

8. As we have previously mentioned¹¹, using the marketing loan payments database to identify "producers" would be contingent on marketing year prices; only if prices are sufficiently low would a high proportion of production of a crop receive marketing loan payments. This appears to have been the case for upland cotton in some recent marketing years but will not always be so (for example, no marketing loan payments are being made in the 2003 marketing year) and was not the case for other commodities (in marketing year 2002, *total* marketing loan payments of only \$16.3 million for soybeans, \$16.3 million for corn, and \$16.1 million for wheat were made).¹²

⁸ US Comments and Answer to Additional Question, para. 20.

⁹ We do note that the record reflects the extensive evidence the United States has presented on the programmes and crop in question, from the actual data of amounts paid under the programmes to the amounts of cotton that have been planted from year to year. Further, in response to a Brazilian request for certain information that was presented for the first time at the second panel meeting, the United States generated, through significant expenditures of time and resources, aggregate and farm-by-farm records for both the "PFC" and "DCP" period for every "cotton farm" in the United States, including the planting records for all such farms. These data were transmitted on 18 and 19 December 2003.

¹⁰ See Brazil's Further Rebuttal Submission, para. 31 ("If USDA was able to provide comprehensive payment data for all (or most) payments in an electronic format, it is also able to *generate information* on subsidy payments made to farms.") (emphasis added).

¹¹ US Opening Oral Statement at Second Panel Meeting, para. 29.

¹² Exhibit US-93. For this reason, it is fallacious for Brazil to argue that the specialization of cotton farms on cotton is shown by the alleged fact that "[i]n MY 2002, 92.45 per cent of marketing loan payments for all crops made to farms producing upland cotton were made with respect to upland cotton." Brazil's Further

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
2002 Direct	523	485.1	451.4
2002 CC	1077	998.6	893.5

The Panel can see a rather striking decline in the decoupled payments at issue that have not been reflected in Brazil's argumentation to the Panel.

10. We note further, however, that the EWG figures do not end the story. These figures represent only the first step in a proper calculation of the decoupled payments received by upland cotton producers that benefit upland cotton. For example, as detailed in the US answer to question 242 from the Panel, the literature on decoupled payments indicates that these payments benefit the owners of the base acres on which payments are made; payments made on rented acres will be captured by landowners through increased rent or other arrangements. Brazil itself has conceded that as of marketing year 1997 – that is, only the first year after introduction of the production flexibility contracts – already *34-41 cents per dollar* of production flexibility contract payment were capitalized into land rents.¹⁶ Thus, *based on its own evidence*, Brazil should have adjusted the EWG figures *downwards by 22 to 27 per cent* to reflect the capture by landowners (who are not producers) through increased rent of 34-41 per cent of decoupled payments on the 65 per cent of cotton acres that are rented.¹⁷ Furthermore, this study as of marketing year 1997 is consistent with the evidence presented by the United States that as rental contracts come up for renewal the full value of the decoupled

Rebuttal Submission, para. 26. If prices were above the respective loan rates for other crops produced by a farm also producing upland cotton, then logically the share of marketing loan payments for upland cotton will be high, given that upland cotton prices were so low in marketing year 2002. The fallacy of Brazil's argument is further demonstrated by reviewing the data submitted by the United States on 19 December 2003. In the aggregated data file "Dcpsum.xls", for marketing year 2002 upland cotton planted area represented only 30.7 per cent of total cropland for "cotton farms" (13.541 million acres out of total cropland of 44.036 million acres).

¹³ Brazil's First Written Submission, paras. 148-49.

¹⁴ Brazil's Answer to Question 67 from the Panel, para. 130 (adjusted amount of decoupled payments for upland cotton base acres estimated as "support for upland cotton").

¹⁵ Brazil's Further Rebuttal Submission, para. 23 (EWG data on amount of decoupled payments for upland cotton base acres received by upland cotton "producers")

¹⁶ Brazil's Answer to Question 179 from the Panel, para. 165; Brazil's Opening Oral Statement at the Second Panel Meeting, para. 57.

¹⁷ See Exhibit US-69 (cost of production data published by the Economic Research Service, based on the 1997 ARMS survey, showing cotton producers owning 35 per cent of land they operate).

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

registrations (further evidence, specific to cotton export credit guarantees in particular, that premiums are more than sufficient to cover operating costs and losses).

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

15. The 11 December 2003 *World Agricultural Supply and Demand Estimates* report, published by USDA's Office of the Chief Economist, the Department's official commodity estimates, provide the latest data available. Note that 2002/03 is still considered an estimate and 2003/04 is considered a projection.²³

US and World Cotton Consumption (1,000 480-lb bales)

	2002/03 (e)	2003/04 (p)
US exports	11,900	13,200
US mill use	7,270	6,200
Total US consumption ²⁴	19,170	19,400
World consumption	97,930	97,690
US as a per cent of world	19.6%	19.9%

The updated data show that the US world market share is basically unchanged from Exhibit US-47; in fact, US world market share using the 11 December 2003 data is the same (19.6 per cent) as reported in the exhibit.²⁵ Viewed in conjunction with the data in Exhibit US-47, the data further confirm that there has been no increase in US world market share following a consistent trend over a period when subsidies to upland cotton have been granted.

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).

16. The two calculations use similar methodologies to measure MY 1992 deficiency payments. Both measures calculate deficiency payments as the deficiency payment rate times eligible production. Both the US and Brazil measures use the same deficiency payment rate for MY 1992 of 15 cents per pound. The difference between the two measures can thus be attributed to how each calculated the amount of production eligible for deficiency payments.

17. In their response to the Panel's Question No. 67, Brazil provides a simplistic calculation of payment production by multiplying the upland cotton programme yield times the amount of area eligible for deficiency payments. But as the United States previously indicated²⁶, the average programme yield for deficiency payment recipients in MY 1992 was 601 pounds per acre and the average programme yield for 50/92 recipients was 628 pounds per acre. By contrast, Brazil

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.

²³ USDA Office of the Chief Economist, *World Agricultural Supply and Demand Estimates*, 11 December 2003 (Exhibit US-119).

²⁴ The US consumption figure includes imports. However, US cotton imports are often zero and, even when positive, have accounted for less than one per cent of consumption over the past decade. See USDA, Economic Research Service, *Fibers Yearbook*, Appendix Table 2, Upland Cotton Supply and Use (Exhibit US-120).

²⁵ See also US Opening Oral Statement at the Second Panel Meeting, para. 13.

²⁶ US Comments and Answer to Additional Question, para. 8 fn. 14.

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 WTO notification, payment production is the sum of production eligible for basic deficiency payments and production eligible for 50/92 payments. Eligible production for basic deficiency payments in 1992 was equal to 5,544 million pounds (9.226 million acres times the average programme yield of 601 pounds per acre). Multiplying the price gap times eligible production gives basic deficiency payments equal to \$832 million. The same formula is used to calculate deficiency payments under the 50/92 programme. For 1992, the price gap is the same as that calculated for the basic deficiency payments (15 cents per pound). Eligible production under the 50/92 programme was 254 million pounds (404 thousand acres times the average programme yield of 50/92 participants of 628 pounds per acre). Deficiency payments under the 50/92 programme were thus equal to \$35 million (0.92 times 254 million times \$0.15). Total deficiency payments under the price gap methodology were thus equal to \$867 million (\$832 million plus \$35 million).

19. We also note that this calculation is conservative in that it uses the actual payment acreage (that is, acres planted for harvest or participating in the 50/92 programme on which payment was received) rather than eligible acreage to calculate the "quantity of production eligible to receive the applied administered price."²⁷ Using instead the base acreage minus the 10 per cent acreage reduction figure and the 15 per cent normal flex acres (14.9 million effective base acres²⁸ \times 0.75 = 11.175 million acres) and multiplying by the programme yield (602 pounds per acre), the "quantity of production eligible to receive the administered price" is 6,727 million pounds, yielding a price gap deficiency payment calculation of \$1,009 million.

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

20. In April 1999, the US General Accounting Office published a report on farmers' use of risk management strategies.²⁹ Based on survey data from the 1996 USDA Agricultural Resource Management Study, the study showed that between 35 and 57 per cent of cotton farmers used a hedging instrument in 1996. (The ranges reflect a 95 per cent confidence interval.) In addition, an estimated 63 to 89 per cent of cotton farms used cash forward contracts in 1996.³⁰ These survey results suggest that even seven years ago a large proportion of cotton farmers either directly or indirectly priced their cotton off of organized futures and options markets.

21. For 18 December 2003, total open interest for all cotton futures contracts on the New York Board of Trade was 79,283 contracts³¹ while open interest for all cotton options contracts on the

²⁷ Agreement on Agriculture, Annex 3, para. 10.

²⁸ See Exhibit Bra-105, Annex 2 (1st source document: US Department of Agriculture, *Provisions of the Federal Agricultural Improvement and Reform Act of 1996*, at 142) (giving 1992 effective base acreage of 14.9 million acres); *id.*, Annex 2 (2nd source document: Daniel A. Sumner, *Farm Programmes and Related Policy in the United States*, at 4) (same).

²⁹ US General Accounting Office. *Agriculture in Transition: Farmers' Use of Risk Management Strategies*. GAO/RCED-99-90. April 1999. See page 9, table 4 (Exhibit US-121)

³⁰ A forward contract is defined as a cash market transaction in which two parties agree to buy or sell a commodity or asset under agreed-upon conditions. For example, a farmer agrees sell, and a ginner or warehouse agrees to buy, cotton at a specific future time for an agreed-upon price or on the basis of an agreed-upon pricing mechanism (such as a futures or options market). See Exhibit US-121, page 22.

³¹ See, Exhibit US-122.

NYBOT totalled 320,657 contracts.³² Based on a contract size of 50,000 pounds, total open interest on futures and options contracts represent 41.7 million bales. While a bale of cotton may be hedged several times throughout the marketing chain, we note that 41 million bales is approximately 2.3 times the total size of the US upland cotton crop. A futures or options contract transaction has no effect on a producer's entitlement to marketing loan programme payments.

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

22. The following tables show the average daily closing futures price for the December contract for January, February and March, as well as the average for the three months. As the United States previously noted³³, the differences between months is small. As outlined in paragraph 162 of the US further rebuttal submission, the expected cash price is calculated as the futures prices minus a 5-cent basis.

Average Daily December Futures Closing Prices (\$/lb)

Month	Contract Month				
	DEC 1999	DEC 2000	DEC 2001	DEC 2002	DEC 2003
January	0.6335	0.5912	0.6188	0.4295	0.5808
February	0.6027	0.6131	0.5863	0.4218	0.5960
March	0.5980	0.6233	0.5321	0.4292	0.5975
Average January – March	0.6114	0.6092	0.5791	0.4268	0.5914

Source: New York Board of Trade (Exhibit US-124)

Expected Cash Price (\$/lb)

Month	MY 1999	MY 2000	MY 2001	MY 2002	MY 2003
January	0.5835	0.5412	0.5688	0.3795	0.5308
February	0.5527	0.5631	0.5363	0.3718	0.5460
March	0.5480	0.5733	0.4821	0.3792	0.5475
Average January – March	0.5614	0.5592	0.5291	0.3768	0.5414

Source: Futures Price minus 5-cent cash basis.

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

23. USDA provided the EWG with payment data under a Freedom of Information Act Request. Although the United States can confirm the data transmitted to EWG was correct, we do not know if the data has changed after EWG further processed the information. Taking that data at face value, the United States would note the following.

³² See, Exhibit US-123.

³³ US Further Rebuttal Submission, para. 162 fn. 124 ("The United States notes that the January-March average futures price for December delivery does not differ significantly from the February average presented in the text.").

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 accounted for only 29.4 per cent of total cropland of those farms receiving production flexibility contract payments for upland cotton base acreage. Thus, the EWG data on marketing loan payments does *not* support an inference that farms producing upland cotton are so "specialized in upland cotton"³⁷ that it would be "reasonable" to attribute decoupled payments for upland cotton base acres almost entirely (87 per cent) to upland cotton.

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

27. The data were based on official export data reported by the United States and Brazil, as obtained and published in the "World Trade Atlas". The World Trade Atlas is a service that monthly provides world-wide trade information for a fee.

28. The United States reports its export values to the World Trade Atlas as F.A.S. and Brazil reports its values as F.O.B.

³⁴ Brazil's Further Rebuttal Submission, para 23.

³⁵ Indeed, even Brazil states that "the evidence still suggests that there are a *large number of very small farms* (with base acreage resulting from production dating back as far as MY 1981-85) *that no longer produce upland cotton*," Brazil's Further Rebuttal Submission, para. 27 (emphasis added), which would seem to support the US view that contract payments are decoupled from production decisions.

³⁶ See US Opening Oral Statement at the Second Panel Meeting, para. 29.

³⁷ See Brazil's Further Rebuttal Submission, para. 26.

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							
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											
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
Portugal	0.97	0.93	0.92	0.92	0.98	0.75	1.17	1.14	0.92	0.57	1.03	0.94
Average	0.78	0.72	0.68	0.65	0.70	0.78	0.79	0.72	0.64	0.50	0.61	0.58

Brazil

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	0.54	0.51	0.58	0.54	0.54	0.52	0.50	na	0.38	0.35	0.37	na
Bolivia	na	na	na	na	0.47	0.48	0.47	na	na	na	na	na
India	na	na	na	na	0.49	0.50	0.50	0.53	0.49	0.43	0.36	0.36
Indonesia	na	na	na	na	0.49	0.49	0.48	0.47	0.50	0.47	0.47	0.45
Italy	na	na	na	na	0.48	0.51	0.54	0.56	0.46	0.44	0.39	0.37
Paraguay	na	na	0.50	na	na	0.55	na	na	0.50	na	na	na
Philippines	na	na	na	na	na	0.59	0.52	0.53	0.52	0.49	0.36	na
Portugal	na	na	na	na	0.49	0.51	0.54	0.56	0.47	0.42	0.35	0.37
Average	0.54	0.51	0.54	0.54	0.49	0.52	0.51	0.53	0.47	0.43	0.38	0.39

Source: *World Trade Atlas*

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).

31. One programme at issue in this dispute requires that a cotton farmer harvest upland cotton in order to receive payment: the marketing loan programme. In addition, the user marketing certificate programme (Step 2) requires that upland cotton have been harvested and marketed although payment is made to upland cotton users and not to farmers directly.

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.

32. The marketing loan programme is a direct payment to support producer income that is "dependent on a price gap," namely, the difference between the loan rate and the Adjusted World Price. Thus, the price-gap calculation of support would be calculated under paragraphs 10 and 11 of Annex 3 of the Agreement on Agriculture on "non-exempt direct payments," not paragraph 8 on "market price support." That said, the calculations to quantify the support under these provisions are similar. Under paragraph 10, "non-exempt direct payments which are dependent on a price gap shall be calculated either using the gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price, or using budgetary outlays."

33. Under the 1990 Act, only production produced on cotton base acres or other programme crop base acres was eligible for marketing loans. Based on the 1992 *Compliance Report* (Exhibit US-39), 11,164,726 acres programme acres were planted to upland cotton. Based on an average crop yield of 694 pounds per acre³⁸, 7,748,319,844 pounds or 16,142,333 480-lb bales, would have been eligible for marketing loans in 1992.

34. Under provisions of the 1996 farm bill, upland cotton planted on farms with any programme crop base were eligible for marketing loans. While production data are not collected by the Farm Service Agency, the following quantities of upland cotton were put under loan or collected a loan deficiency payment in 1999, 2000, 2001 and 2002.

Upland cotton loan activity (pounds)

	Quantity receiving loan deficiency payment	Quantity placed under loan	Total
1999	3,393,678,940	4,290,958,570	7,684,637,510
2000	3,499,431,430	4,349,621,850	7,849,053,280
2001	2,618,109,300	6,718,513,500	9,336,622,800
2002	1,603,527,850	6,292,102,810	7,895,630,660

Source: USDA, Farm Service Agency, *Loan Deficiency Payment and Price Support Cumulative Activity as of 10 December 2003*. Available at: <http://www.fsa.usda.gov/dafp/psd>

35. Thus, compared to MY1992, the quantity of cotton placed under marketing loans or receiving loan deficiency payments in MYs 1999, 2000, and 2002 were similar. In MY 2001, as a result of exceptional weather conditions and yields, a much larger quantity of cotton was eligible.

36. As noted above, the price gap calculation involves comparing a fixed reference price to an applied administered price. Under paragraph 11 of Annex 3, the fixed reference price "shall be based

³⁸ See Upland Cotton Fact Sheet at 4 (Exhibit BRA-4).

on the years 1986 to 1988 and shall generally be the actual price used for determining payment rates." The applied administered price for marketing loan payments is the marketing loan rate. The fixed reference price is the average over 1986 to 1988 of the Adjusted World Price (the "actual price used for determining payment rate").

37. The average Adjusted World Price for 1986-88 was 53.65 cents per pound – that is, higher than the loan rate in marketing years 1992 (52.35 cents per pound), 1999-2001 (51.92 cents per pound), and 2002 (52 cents per pound). The result is that the gap between the fixed reference price and the applied administered price is always negative as would be the AMS calculation. When these price gap calculations for marketing loan payments are utilized, negative numbers result, reflecting the decrease in support from the 1986-88 level. Similarly, if the applied administered price for marketing years 1999-2002 were compared to the 1992 applied administered price, the resulting negative numbers would again show the decrease in the level of support from MY 1992. Thus, the large budgetary expenditures for marketing loan payments in recent years obscures the fact that the level of support decided by the United States had declined; the price gap calculation, on the other hand, reflects this reduction in support. As the United States demonstrated in its rebuttal submission, by calculating both deficiency payments and marketing loan payments using a price gap methodology, the upland cotton AMS reveals that in no year have the challenged US measures granted support in excess of that decided during the 1992 marketing year.³⁹

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

38. The planted and harvested area differ because of abandonment. Over the period 1965 to 2003, the rate of abandonment (abandoned acres divided by total acres) for US upland cotton averaged 8.3 per cent, but the rate will vary from year to year primarily because of weather, primarily in the Southwest. In 1997, for example, weather in the Southwest was generally good and the abandonment rate for that year was only 3.6 per cent. By contrast, dry weather in Texas, Oklahoma and parts of the Southeast in 1998 led many farmers to abandon their cotton crop because of poor yields, resulting in an abandonment rate of 20 per cent.

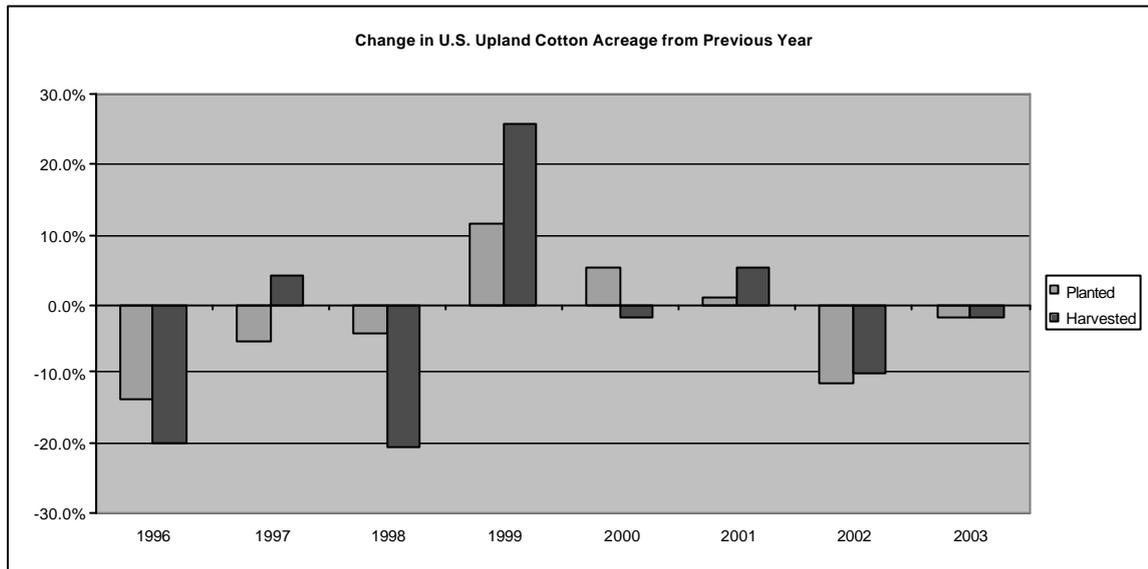
Planted and Harvested Upland Cotton Acres (1,000 acres)

Crop year	Planted acres	Harvested acres	Abandoned acres	Rate of abandonment
1995	16,717	15,796	921	5.5%
1996	14,395	12,632	1,763	12.2%
1997	13,648	13,157	491	3.6%
1998	13,064	10,449	2,615	20.0%
1999	14,584	13,138	1,446	9.9%
2000	15,347	12,884	2,463	16.0%
2001	15,499	13,560	1,939	12.5%
2002	13,714	12,184	1,530	11.2%

³⁹ See US Rebuttal Submission, paras. 115. In that calculation, the United States conservatively assigned a value of zero to marketing loan payments that in every instance were negative under the price gap methodology. Had the United States used the actual negative values resulting from the calculation, the AMS would have been even smaller for those years with a lower loan rate (marketing years 1999-2001) and larger eligible production (marketing year 2001). The end result would have been the same, however: in no year would upland cotton support (as measured by an upland cotton AMS) have exceeded the 1992 marketing year level.

Crop year	Planted acres	Harvested acres	Abandoned acres	Rate of abandonment
2003	13,451	11,939	1,512	11.2%

Source: USDA, National Agricultural Statistics Service, *Acreage*, various issues.



39. Comparing the per cent change from the prior year of planted and harvested US upland cotton acreage shows that movements in acreage figures are fairly similar, as one would expect.

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

40. To our knowledge, planted acreage figures are not available on a consistent basis across countries. No other sources (including ICAC) carry worldwide-planted area. Harvested area is the standard, but in reality many countries do not have a sophisticated system for data collection. To provide a comparative analysis of US acreage changes to the rest of the world, the United States has therefore used harvested acreage, the most reliable acreage measure available.

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?**

41. Brazil's cost of production argument is based on erroneous facts and arguments. Brazil points to dated *average total cost* of production data over a randomly selected period, compares this to market revenue, and proclaims that any "gap" must be covered by subsidies. The United States has identified several fatal conceptual and factual flaws in Brazil's analysis.⁴⁰ For example, Brazil ignores the evidence on record that a significant number (approximately 47 per cent) of traditional (and likely high-cost) upland cotton producers no longer plant upland cotton. This structural shift in

⁴⁰ US Further Rebuttal Submission, paras. 105-51.

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 submissions⁴³, 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

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 cotton farmers regularly cover their variable costs – and then some – they can survive a year like 2001.

Cumulative net returns (\$ per acre)

Item	1997	1998	1999	2000	2001	2002
Variable costs	271.46	230.87	244.26	296.38	284.24	278
Market revenue	545.55	356.1	314.8	375.18	271.4	307.83
Net return	274.09	125.23	70.54	105.8	-12.84	29.83
Cumulative net return	274.09	399.32	469.86	575.66	562.82	592.65

Source: USDA, Economic Research Service, www.ers.usda.gov/data/costsandreturns

⁴⁶ US Further Rebuttal Submission, 18 November 2003, para. 117. Brazil continues to inappropriately make all its cost-revenue arguments using total costs. Brazil cites the Appellate Body decision in Canada – Dairy 21.5 III as support for using a total cost of production figure but that decision was unique to those circumstances and involved export subsidies. That decision does not refute accepted wisdom and long-standing economic theory, as well as farmers' usual business practices.

⁴⁷ Exhibit Bra-222.

⁴⁸ See <http://www.ers.usda.gov/data/costsandreturns/>.

⁴⁹ Further Rebuttal Submission of Brazil, 18 November 2003, para. 58.

⁵⁰ Even Mr. Christopher Ward was unable to cover his variable costs in 2001. Statement of Mr. Christopher Ward at the Second Session of the First Panel Meeting, para. 6.

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 programmes have impacted prices. Since the study is based on projected prices, the analysis is not useful for the Panel in determining whether US support programmes have caused serious prejudice to Brazil.

50. Putting aside the issue that the study is based on projections and not actual market conditions for the 1999-2001 period, the United States believes the study results overstate the impacts of the US marketing loan programme for two reasons: (1) the expectation of prices used and (2) the overstated additional marketing loan facilitated revenue.

51. As previously discussed, the authors used USDA's 2000 baseline as the input into the USDA FAPSIM model. To represent farmers' price expectations, the simulation uses lagged prices from the projections in the USDA's 2000 baseline. The model uses the higher of lagged market prices or the loan rate plus additional marketing loan facilitated revenue (fixed at 14 cents per pound for cotton). Using the price projections in the USDA 2000 baseline, farmers would expect the marketing loan programme to kick in for the period 1999-2001. The problem here is that the price expectations used by the model are not consistent with the price expectations the farmers *actually held* at the time of planting for prices at harvest. As the United States provided in its opening statement at the Second Meeting of the Panel with the Parties, the futures prices at the time of planting indicated that prices would be above the marketing loan rate during this period.

Harvest Futures Prices at Planting Time Compared to USDA Baseline Expected Prices (cents per pound)			
	MY1999	MY2000	MY2001
Futures Price 1/	60.27	61.31	58.63
Expected Cash Price 2/	55.27	56.31	53.63
1/ February New York futures price for December delivery.			
2/ Futures price minus 5 cent cash basis.			

⁵¹ In fact, the study found marketing loans to have negligible impacts in 1998. See Exhibit BRA-222, p. 16.

As the futures prices demonstrate, market expectations at the time of planting for marketing years 1999-2001 was that prices would be above the marketing loan rate and hence no marketing loan benefits. Therefore, the marketing loan programme would not have had the impact this study found.

52. In addition to having the wrong expectations about price levels and the marketing loan programme being tripped, the study has overstated the potential additional market loan facilitated revenue that can be achieved. The authors used a fixed rate of 14 cents to represent this additional revenue above the loan rate when the marketing loan programme kicks in. Their justification for this figure is that this was their calculation for 1998. The authors do not provide any discussion as to why conditions in 1998 were indicative of conditions to continue for the near future that would keep this margin at 14 cents. This margin is based on the fact that farmers can pick the date to make the claim for the marketing loan gain/deficiency payment and then sell the cotton at a later date. The premise is that a farmer is able to sell when prices have increased relative to the date they made their claim. However, in reality, there is no such guarantee. It is just as possible that prices will fall below the price when the claim was made. In fact, the additional revenue has not been as large as in MY1998.⁵² In MY1999, the annual average was 6.1 cents, MY2000 was 5.8 cents, and MY2001 was 1.3 cents. As Exhibit US-126 demonstrates, the margin fluctuates from month to month, with the value in several months even negative, implying that a farmer that did not sell his crop at the time he received the marketing loan payment earned *less than* the marketing loan rate. Using a much lower value for this additional revenue above the loan rate when the marketing loan rate kicks in would have reduced the impact of the study's result.

53. By request of the Payment Limitations Commission, Westcott and Price updated this analysis using actual prices for MY2001. As the United States has discussed at the panel meetings and in its further rebuttal submission, this will overstate the impact of the marketing loan programme because it assumes that farmers had perfect foresight. That is, the model is calibrated to the actual values that occurred in that year while, in fact, producers could not have anticipated such events when planting decisions occurred. This overstates the effects of the programme because the model assumes outcomes that were unanticipated by producers when they made their planting decisions.

54. This overstatement is similar to the other third party studies that used actual outlays for marketing loans when calculating the price wedge. As the United States argued when critiquing those models, a more appropriate method to determine the impact is to look at expectations based on futures prices relative to the marketing loan rate. If the futures prices are above the loan rate, the programme will have a negligible impact on planting decisions since farmers are not expecting benefits from the programme.

55. For these reasons, the United States finds the results from these studies not relevant for the Panel in making its assessment of the effect of the marketing loan programme.

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

56. In this dispute two approaches have been advocated in determining farmers' expectations about prices. Brazil and its economic consultant have used lagged prices as the mechanism to gauge farmers' expectations about prices. Dr. Sumner wrote:

Of course, it is impossible to know precisely what individual growers expect. I have adopted the long-standing approach of FAPRI, and other models[,] to approximate

⁵² See Exhibit US-126 for calculations using the authors' formulation of the additional marketing loan facilitated revenue realized per unit for MY 1998-2003 (partial year), using actual data.

these expectations by using the current year final realized market prices as the expectation for the following season's price.⁵³

The lagged prices used by Brazil and its economic consultant can at best, be an approximation of farmers' price expectations. That is because the lagged prices used in Brazil's analysis incorporate pricing information that occurs *after US farmers make their planting decision* (that is, prices from April through July of a given marketing year when planting decisions are taken in the January to March period). Therefore, by necessity, farmers cannot be looking at a lagged price that incorporates prices that do not yet exist.

57. The United States, on the other hand, has advocated the use of futures prices, a market determined expectation of prices. As Mr. MacDonald, Brazil's own witness, has explained, the New York futures price is a key mechanism used by cotton growers, traders and consumers in determining current market values as well as the contract prices for forward deliveries, in the domestic US and non-US markets.⁵⁴

58. The use of futures by market participants is supported by a US government study. In April 1999, the US General Accounting Office published a report on farmers' use of risk management strategies.⁵⁵ Based on survey data from the 1996 USDA Agricultural Resource Management Study, the study showed that between 35 and 57 per cent of cotton farmers used a hedging instrument in 1996. (The ranges reflect a 95 per cent confidence interval.) In addition, an estimated 63 to 89 per cent of cotton farms used cash forward contracts in 1996.⁵⁶ These survey results suggest that a large proportion of cotton farmers either directly or indirectly price their cotton off of organized futures and options markets.

59. Furthermore, economic literature supports the United States' approach. For example, in his classic paper on rational price expectations, Muth (Exhibit US-48) argued that there is little evidence that expectations based on past prices are economically meaningful. Additionally, in a 1976 paper Gardner (Exhibit US-49) contended that the future price for next year's crop is the best proxy for expected price.

60. Unfortunately, the use of futures prices in a multi-commodity modelling framework for extended time projection is cumbersome. First, equations must be developed that can predict values for futures contracts in simulation analysis. Second, many commodities lack an organized futures exchange (e.g., grain sorghum). For these reasons, large-scale models like those used by FAPRI, USDA and the US Congressional Budget Office typically use lagged prices rather than futures prices as proxies for price expectations.

61. Nonetheless, the use of lagged prices may result in biased results. Over the long term, where there is reasonable stability in markets, lagged prices function adequately as a proxy for price expectations. However, in those years, as in the period under investigation here, when unexpected exogenous shocks such as China dumping stocks and unexpected yields worldwide due to good weather conditions, lagged prices are poor predictors of expected prices. Future prices, by contrast, are more efficient because they are based on more current information.

⁵³ Brazil's Further Submission, Annex I, para 18.

⁵⁴ Exhibit BRA-281, para 13 (statement by Andrew MacDonald)

⁵⁵ US General Accounting Office. *Agriculture in Transition: Farmers' Use of Risk Management Strategies*. GAO/RCED-99-90. April 1999. See page 9, table 4 (Exhibit US-125).

⁵⁶ A forward contract is defined as a cash market transaction in which two parties agree to buy or sell a commodity or asset under agreed-upon conditions. For example, a farmer agrees to sell, and a ginner or warehouse agrees to buy, cotton at a specific future time for an agreed-upon price or on the basis of an agreed on pricing mechanism (such as a futures or options market). See Exhibit US-125, page 22.

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	59.6
Expected Cash Price 2/	55.27	56.31	53.63	37.18	54.6
Lagged Prices 3/	60.2	45	49.8	29.8	44.5
Difference	-4.93	11.31	3.83	7.38	10.1

1/ February New York futures price for December delivery.

2/ Futures price minus 5 cent cash basis.

3/ Prior crop year average farm price, weighted by monthly marketings.⁵⁸

63. Looking more specifically at Dr. Sumner's analysis in Annex I provides further evidence of the bias of lagged prices relative to future prices. Consider the 2002 crop year. In the Sumner analysis, area response to the removal of the cotton loan programme results in a 36 per cent reduction in US planted area – the largest single effect for any of the years considered in his analysis. Based on lagged prices, price expectations for 2002 were 29.8 cents per pound, a 40 per cent reduction from 2001 levels. Yet, the futures market data suggests a far smaller reduction in expected price. December futures prices taken as the average daily closing values in February 2002 averaged 42.18 cents per pound, a 28 per cent drop from year earlier levels. Based on Dr. Sumner's range of supply response elasticities of 0.36 to 0.47, a decline of this magnitude would suggest a drop in acreage of 10 to 13 per cent from the preceding year. In fact, actual US cotton acreage dropped 12 per cent (from 15.5 million acres in 2001 to 13.7 million acres in 2002) suggesting acreage levels entirely consistent with world market conditions and price expectations. Thus, in marketing year 2002, lagged prices would significantly overestimate the decline in plantings in the absence of a marketing loan rate.

64. While the United States would agree with Brazil that it is impossible to know precisely what individual farmers' price expectations are, the United States argues that futures prices provide the most current expectations of market participants. The United States disagrees with the approach used by Brazil in its analysis to rely solely on lagged prices and ignore information provided by futures prices. While it may be impractical to include futures prices in some models, modelling convenience is no justification to ignore these objective, market-based price expectations, and the biased results from using lagged prices do not assist the Panel in making an objective assessment of what is the effect of the US marketing loan programme.

⁵⁷ US Further Rebuttal Submission, paras. 164-65.

⁵⁸ Exhibit US-90.

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 payment will be reduced or eliminated.

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

67. Under the 1990 Act, base acreage for purposes of deficiency payments was calculated as the average, minus the high and low year, of the previous five years plantings. There was no updating of base acres by upland cotton producers since the base period was always a rolling average of the previous five years. In effect, to increase acreage base, a producer had to overplant his or her current acreage base. The 1990 Act penalized producers who overplanted their base by declaring them ineligible for farm programme payments in the year they overplanted their base. For this reason, participation in the programme was quite high.

68. The 1996 Act eliminated deficiency payments in favour of decoupled production flexibility contract payments. The Act also did away with the rolling five-year average approach for base acreage. Instead, crop base acreage was based on the amount of base acreage that would have been in effect under the 1990 farm bill for the 1996 crop year. Producers maintained the same acreage base over the 1996 through 2001 crop years, without current plantings affecting their base acreage.

69. The 2002 Act allowed producers either to retain base acreage as under the production flexibility contracts or to update their base area equal to the average acreage planted and prevented in 1998-2001. The latter option allowed decoupled payments to be made with respect to soybeans and other oilseeds, which did not have base acreage under the 1990 Act. This new crop acreage base cannot be updated as it extends for the life of the 2002 Act (that is, through the 2006 crop year).

70. We note that the likelihood of further base updating would appear small. Currently, there is no authority for future base updating. Any changes would have to originate in Congress where there

⁵⁹ 7 USC 1444-2 (Exhibit US-5).

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 loan payments as cotton-specific amber box payments in its WTO Domestic Support notifications. The issue in this dispute is not whether marketing loan payments are potentially production- and trade-distorting, but the degree to which they have actually distorted production and trade in a particular year, given market prices and other relevant factors.

75. The degree of distortion caused by the marketing loan programme depends on the relationship of the expected harvest price to the loan rate at the time of planting. If the expected price is below the loan rate, the loan rate may provide an incentive to plant cotton because farmers will receive a

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 circulated by Chairman Dunkel⁶¹. That item(h) addressed: "Export credits provided by governments or their agencies on less than fully commercial terms."

81. However, instead of making any connection between "non-commercial transactions" and export credits, the Members agreed in the very next section - Article 10.2 as ultimately adopted - to provide wholly distinct treatment to export credits, export credit guarantees and insurance. The reference to circumvention for non-commercial transactions in the current Article 10.1 would have been the obvious place to draw the distinction that New Zealand and Brazil claim the Members allegedly made between "commercial" and "non-commercial" export credits.⁶² But the text simply does not support this fictional argument.

82. Article 10.4 provides further support that export credits are part of a work programme to develop disciplines for them and consequently are not currently subject to the other disciplines of Article 10. Article 10.4 of the Agreement on Agriculture ties the discipline on food aid to terms negotiated elsewhere: the Food Aid Convention and the United Nations' Food and Agriculture Organization (FAO). This specific set of disciplines applicable to food aid demonstrate the situation that will apply once the negotiations mandated under Article 10.2 are completed. They also illustrate an approach comparable to the negotiations that subsequently occurred in the OECD and as contemplated in paragraph 5 of Attachment 5 of the Harbinson Text.⁶³ Once internationally agreed disciplines are achieved, then it will be possible for a given export credit practice to circumvent export subsidy disciplines as a result of failure to comply with the export credit disciplines.⁶⁴

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 November further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August 2003 comments on US rebuttal submission) that the total figure net of re-estimates should be \$230,127,023 instead of the figure which originally appeared (\$381,345,059).

(a) Please submit a corrected table reflecting all of the necessary information to produce this result, to the extent this is possible for the reasons indicated in footnote 96 in US further submission of 30 September 2003.

⁶¹ MTN.GNG/AG/W/1/Add. 10 (2 August 1991) (Exhibit US-27)

⁶² See, New Zealand Answers to Question 35 of Panel to Third Parties, Brazil Answer to Panel Question 71(a); US Rebuttal Submission (22 August 2003), para. 144-145

⁶³ Exhibit US-9

⁶⁴ See US First Written Submission (11 July 2003), fn. 150.

GSM 102/GSM103/SCGP Subsidy Estimates and Reestimates By Cohort							
Original Subsidy	Cohort Reestimates by Fiscal Year Estimate					Total	Subsidy Estimate
Cohort		FY93-00	FY01	FY02	FY 03	Reestimates	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 reestimate amount" in Exhibit Bra-182 in lieu of the column entitled "Reestimates" in the table that accompanied paragraph 161 of the US Rebuttal Submission (22 August 2003) and reproduced in the response to question 221(a) immediately above. The figures are intended to represent the same thing.

84. The Panel will first note that with respect to the figures corresponding to cohorts 1997-2002, Exhibit Bra-182 and the table previously submitted by the United States match.

85. Differences appear with respect to cohorts 1992-1996. The United States attempted to explain the disparity in footnote 96 of its Further Submission of 30 September 2003. These differences would appear to be related to the cumulative re-estimates applied to these cohorts within the calculations of the budgets in fiscal years 1993-2000. The United States noted that it was searching for internal documentation to corroborate the figures included in the table previously submitted to the Panel. In the absence of such documentation and unable to explain the relatively minor disparity in figures, the United States necessarily accepts Exhibit Bra-182.

86. In fact, the United States' initial figures were more conservative than these official figures which show profitability in every year during the period 1992-1996. The following table illustrates this result:

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
2001	103000000	-17115000	85885000
2002	97000000	40009000	137009000

These figures show that all of the first five cohorts (1992-1996), including 1994, are profitable. The figures for these years, unlike the more recent cohorts, reflect much more complete data for actual operating experience (although 1999 is already showing profitability).

- (c) **The Panel notes that the CCC 2002 financial statement in Exhibit BRA-158 refers to annual "administrative" expenses of \$4 million, and that the US has also referred to this figure in its submissions (e.g. US first written submission, paragraph 175). Please confirm whether the figures in the table in paragraph 161 of the US August 22 rebuttal submission (or a corrected version thereof) includes "administrative expenses", of approximately \$4 million per year over the period 1992-2002, and explain why (or why not) this affects the substantive result.**

87. The figures in the table in paragraph 161 do not include administrative expenses. Imputed administrative costs are not subject to the re-estimation process but are reflected separately in the budget.⁶⁵ The United States has previously acknowledged that it would be appropriate to apply an administrative expense as an operating cost of the programme.⁶⁶ Consequently, it would be appropriate to add the administrative expense applicable to a particular cohort as an operating cost.

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

88. The Commodity Credit Corporation (CCC) has no physical presence. It also has no employees. The "administrative expense" in the budget is simply a reasonable approximation for budgetary purposes of the value of services supplied by US Department of Agriculture agencies and personnel in the administration of this particular programme subsumed within the CCC.

89. The relevant provision from the applicable appropriations legislation for fiscal year 2003 reads as follows:

**COMMODITY CREDIT CORPORATION EXPORT LOANS PROGRAMME ACCOUNT
(INCLUDING TRANSFERS OF FUNDS)**

For administrative expenses to carry out the Commodity Credit Corporation's export guarantee programme, GSM 102 and GSM 103, \$4,058,000; to cover common overhead expenses as permitted by section 11 of the Commodity Credit Corporation Charter Act and in conformity with the Federal Credit Reform Act of 1990, of which \$3,224,000 may be

⁶⁵ See US First Written Submission (11 July 2003), para. 175 and fn. 160.

⁶⁶ US Answers to Panel Question 77 (11 August 2003), para. 146.

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. 2⁶⁷, originally issued 23 August 1993⁶⁸, 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

⁶⁷ See Answer to Question 228, *infra*, regarding the Federal Accounting Standards Advisory Board

⁶⁸ Statement of Federal Financial Accounting Standards No. 2: Accounting for Direct Loans and Loan Guarantees, issued 23 August 1993, pp. 187-267. (Exhibit US-127)

⁶⁹ See OMB Circular A-11 (Exhibit Bra- 116), section 185.6, page 185-15. See also, US Rebuttal Submission (22 August 2003), paras. 155-156 and fn. 189; US Answers to Panel Question 81(d) (11 August 2003), paras. 162-163.

⁷⁰ OMB Circular A-11 (Exhibit Bra - 116), Section 185.3(x), p. 185-12

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.

94. With respect to 1997 and 1998, the United States of course cannot with absolute certainty predict the future. A principal issue with respect to the 1997 cohort concerns Pakistani and Ecuadorean defaults. All of this debt has been rescheduled and is now fully performing. These rescheduled amounts currently involve approximately \$209 million of outstanding principal alone. Consequently, the United States has every reason to believe that 1997 cohort will ultimately reflect profitability.

95. With respect to the 1998 cohort over \$30 million of Ecuadorean and Russian (private sector) outstanding principal are in performing reschedulings.

(g) Why should the Panel "eliminate" the 2001 and 2002 cohorts from its examination, as suggested in paragraph 198 of the US further rebuttal submission?

96. The United States has previously noted that the original subsidy estimate in the US budget begins with an historically overly optimistic projection of the actual use of the programme and then the use of government-wide estimation rules is required, including mandated risk assessment country grades without regard to the actual experience specific to the CCC export credit guarantee programmes.⁷¹ The original subsidy estimate for these cohorts, like the original subsidy estimate for all cohorts, necessarily reflects no actual operating experience with respect to that cohort.

97. Subsequent downward reestimates (i.e., good performance) are calculated not from the original subsidy estimate but from the actual figure corresponding to amounts of guarantees actually issued.⁷² Although this budgetary convention exaggerates the apparent negative performance in all years, this exaggeration is particularly acute in the nearer term. As reflected in the table entitled "CCC Export Credit Guarantee Programme Levels - Annual President's Budgets and Actual Sales Registrations - FYs 1992-2004" accompanying paragraph 148 of the US Further Submission (30 September 2003), actual sales registrations are only reflected in budgetary figures two fiscal years following the fiscal year of the particular cohort. For the 2002 cohort, therefore, the actual sales registrations of \$3,388 million contrasts with the estimated programme level of \$3,926 million in the immediately preceding budget. Similarly, for the 2001 cohort, the actual figure of \$3,227 million is also more than one-half billion dollars less than the anticipated programme level of \$3,792 million reflected in the preceding budgets. For this reason, the tables set forth in response to questions 221(a) and 221(b) commence with an "estimate" figure corresponding to the actual level of sales registrations.

98. More significant in direct response to the question, as reflected in the tables above in response to questions 221(a) and 221(b), is the trend of negative reestimates (i.e., better than expected performance). They are uniformly large for all cohorts for 1999-2000. This trend has also commenced with respect to the 2001 cohort. It is reasonable to expect that in the fullness of time the data will similarly reflect further negative reestimates for cohorts 2001 and 2002. This is likely to become more pronounced as the terms of the guarantees issued during this time expire.

99. For the foregoing reasons, the United States submits that the current budgetary subsidy estimate figures do not accurately reflect the proper relationship of premia to long-term operating costs and losses (if any) with respect to cohorts 2001 and 2002. Although over the long-term the

⁷¹ US Further Submission (30 September 2003), paras. 147-148.

⁷² See US Further Submission (30 September 2003), paras. 148-149.

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.

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 cost of forfeiting transactions and with premiums for export credit insurance? USA

107. Premium rates applicable to GSM-102, GSM-103, and SCGP are reviewed annually. The premia rates vary by programme, length of coverage, and repayment interval. For GSM-102, the premium ranges from 15.3 cents per \$100 of coverage to about 66 cents per \$100 of coverage. Under SCGP, a two-tier fee schedule exists. For up to 90 days, the fee is 45 cents per \$100 of coverage. For 91 to 180 days, the fee is 90 cents per \$100 of coverage. A higher fee structure for longer term is viewed as an incentive to exporters to opt for a shorter term and correspondingly reduce the likelihood of claims, and therefore potential operating losses, associated with the programmes. Premia for both GSM-102 and SCGP are currently subject to a statutory cap of one per cent.⁷⁵

108. Private commercial quotes for export credit insurance are simply not available to the United States. As the United States has previously noted, however⁷⁶, commercial insurers do offer export credit insurance covering agricultural commodities. According to a background paper on export credits prepared by the WTO Secretariat: "While guarantees could be unconditional, they usually have conditions attached to them, so that in practice there is little distinction between credits which are guaranteed and credits which are subject to insurance."⁷⁷

109. With respect to forfeiting, the United States similarly does not have access to specific implicit rates available in the marketplace. The United States notes, however, that an importer does not necessarily realize any benefit from a CCC export credit guarantee. CCC has no role in the arrangements between the foreign bank issuing the letter of credit and the importer, which is typically

⁷⁵ See US Answer to Panel Question 85 (11 August 2003), paras. 181-183.

⁷⁶ US Answer to Panel Question 76 (11 August 2003), para. 144

⁷⁷ *Export Credits and Related Facilities*, G/AG/NG/S/13 (26 June 2000)

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)
Programming Years 1992 – 2002
(\$ Millions)**

Annual President's Budgets											
Programme Year	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
<u>1992 Actuals</u>											
Interest on Borrowings	\$0										
Interest Earned	(1)										
<u>1993 Actuals</u>											
Interest on Borrowings		\$0									
Interest Earned		(16)									
<u>1994 Actuals</u>											
Interest on Borrowings			\$0								
Interest Earned			(0)								
<u>1995 Actuals</u>											
Interest on Borrowings				\$10							
Interest Earned				(0)							
<u>1996 Actuals</u>											
Interest on Borrowings					\$61						
Interest Earned					(26)						
<u>1997 Actuals</u>											
Interest on Borrowings						\$62					
Interest Earned						(26)					
<u>1998 Actuals</u>											
Interest on Borrowings							\$62				
Interest Earned							(54)				
<u>1999 Actuals</u>											
Interest on Borrowings								\$62			
Interest Earned								(0)			
<u>2000 Actuals</u>											
Interest on Borrowings									\$62		
Interest Earned									(99)		

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 2002⁸³, the \$411 million figure has declined to \$22 million.

120. As reflected on page 19⁸⁴ 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

⁸¹ Exhibit US-127.

⁸² The most recent example of this repeated assertion is in paragraph 84 of the 2 December 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 Federal Financial Accounting Standards No. 2, Appendix B: Schedule B, entitled "Schedule for Reconciling Loan Guarantee Liability Balances." Exhibit US-125, p. 990 (Exhibit US-125: <http://www.fasab.gov/pdf/cod4.pdf> pages 967-993).

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 subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture" (emphasis added). The language of Article 6.9 indicates that it applies to *all* of the provisions under "[t]his Article." Thus, according to Brazil's logic, every affirmative use of the word "shall" in Article 6 (for example, Article 6.1: "Serious prejudice shall be deemed to exist . . ."; Article 6.4: "[D]isplacement or impeding of exports shall include . . ."; Article 6.5: "[P]rice undercutting shall include . . .") should have been written "may" to reflect the fact that "even where the requirements of [that provision] are fulfilled," the "subsidies are exempt from action by virtue of the peace clause of Article 13 of the Agreement on Agriculture." Those other provisions *do* use the term "shall," however, suggesting that the term "may" in Article 6.3 was used deliberately and according to its ordinary meaning.

128. Finally, Brazil asserts that "Article 6 is silent on the nature of the alleged additional requirements for a finding of 'serious' prejudice."⁸⁹ This is not wholly accurate. For example, as Question 229 from the Panel to Brazil notes, the chapeau to Article 6.3 indicates that "[s]erious prejudice . . . may arise in any case *where one or several of the following apply*" (emphasis added). Therefore, the Panel could conclude that where more than one prong of Article 6.3 is satisfied, the likelihood that the result is "serious prejudice" increases. Furthermore, Brazil points to additional details provided in Article 6.4 on displacement or impedance and in Article 6.5 on price undercutting as suggesting that a finding of "serious prejudice" must result if one prong of Article 6.3 is satisfied. However, Brazil draws no consequence from the lack of "detailed definitions" capable of application for Articles 6.3(a), 6.3(c) (significant prices suppression, price depression, or lost sales), or 6.3(d).

129. Finally, Brazil claims that the United States did not assert and the panel in *Indonesia - Automobiles* did not find any separate "serious prejudice" requirement in Article 6.3. As the United States notes in its answer to Question 234, the permissive ("may") language of the chapeau to Article 6.3 would not preclude the Panel from concluding that a finding under one prong of Article 6.3 suffices to establish serious prejudice. As Article 6.8 suggests, "the existence of serious prejudice should be determined on the basis of the information submitted to or obtained by the panel" – that is, on a case-by-case basis. Thus, the Panel will be called upon to exercise its judgment on the quality of the evidence on causation and on the extent of any alleged effects. To reiterate one hypothetical example suggested at the second panel meeting, were a complaining party to make a *prima facie* case that *one unit* of its exports had been displaced from the market of the subsidizing Member, the situation in Article 6.3(a) would technically have been demonstrated. Such a situation, however, would lend itself to the exercise of the Panel's discretion not to find serious prejudice. This is the type of flexibility that the chapeau to Article 6.3 gives the Panel and which Brazil's interpretation would read out of the Subsidies Agreement.

⁸⁹ Brazil's Further Rebuttal Submission, para. 94.

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

130. The United States believes that both Article 6.1 and Annex IV of the Subsidies Agreement provide relevant context for interpreting "serious prejudice" within the meaning of Article 5(c) and Article 6.3. As the Panel's question notes, Article 6.1 has expired pursuant to Article 31, which established that Article 6.1 would "apply for a period of five years, beginning with the date of entry into force of the WTO Agreement," unless the Committee on Subsidies and Countervailing Measures determined to extend its application. Annex IV is entitled, "Calculation of the Total Ad Valorem Subsidization (Paragraph 1(a) of Article 6)," and by its terms establishes a methodology to calculate "the amount of a subsidy for the purpose of paragraph 1(a) of Article 6." Thus, since the provision it is meant to implement is no longer in effect, Annex IV as well is no longer directly applicable.

131. The context provided by these provisions, of course, must be judged in light of the fact that Members did *not* agree to extend Article 6.1(a). That is, it is highly relevant that the provision establishing a rebuttable presumption of serious prejudice upon a showing of a 5 per cent *ad valorem* subsidization rate was allowed by Members to lapse. On the other hand, no decision on whether to extend Annex IV was contemplated or taken pursuant to Article 31. In addition, we note that in *United States – Countervailing Measures (EC)*, the Appellate Body relied on Annex IV as context in interpreting another provision of the Subsidies Agreement.⁹⁰ Thus, although the underlying provision attaching a consequence to a certain subsidization rate lapsed, it is appropriate to examine how Members agreed in Annex IV a subsidy not tied to the production or sale of a given product would be allocated across the total value of the recipient's production.

132. The Panel must utilize some methodology to determine the benefit to upland cotton from a subsidy not tied to production of upland cotton. For example, Part V does not expressly set out an allocation methodology, but the same methodology of allocating an untied subsidy across the total value of the recipient's production is applied by several Members (for example, the European Communities and the United States) for purposes of their countervailing duty law. Indeed, Brazil itself has proposed in the Negotiating Group on Rules that Members adopt a "guideline" on calculating the amount of the subsidy for countervailing duty purposes precisely setting out the methodology contained in Annex IV.⁹¹ The Panel should consider whether Brazil's refusal to countenance any allocation of the decoupled payments it has challenged is credible given the fact that Brazil in its Rules proposal and Annex IV as agreed by Members both express the same approach to allocating non-tied subsidies across production. Thus, the United States believes that Annex IV continues to provide useful context for the necessary task of identifying the products that benefit from a subsidy not tied to the production or sale of a given product.

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"?

133. "Significant" price suppression under Article 6.3(c) does not necessarily amount to "serious prejudice" within the meaning of Article 5(c). This conclusion flows from the ordinary meaning of

⁹⁰ WT/DS212/AB/R, para. 112. Similarly, in *United States – FSC: Article 22.6*, Arbitrator cited the expired Articles 8 and 9 as "helpful . . . in understanding the overall architecture of the Agreement with respect to the different types of subsidies it sought and seeks to address." WT/DS108/ARB, note 56.

⁹¹ Paper by Brazil, Countervailing Measures: Illustrative Major Issues, TN/RL/W/19, at 6 (7 October 2002) ("If the benefit of a subsidy is limited to a particular product, the denominator should reflect only sales [production/exports] of that product. If this is not the case, the denominator should be the recipient's total sales.").

the text of Article 6.3(c): "Serious prejudice in the sense of paragraph (c) of Article 5 *may* arise in any case where one or several of the following apply." The ordinary meaning of "may" is "have ability or power to; can." Therefore, the existence of one of the situations in Article 6.3 is a necessary condition for a finding of serious prejudice but may not be sufficient.

134. Brazil argues that the use of "may" in Article 6.3 is merely intended to reflect that Article 6.7 delineates certain circumstances in which displacement or impeding of exports shall not arise. However, 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. Further, the text of Article 6 reflects Members' decision to create just such a mandatory presumption / exception structure in Article 6.1 and 6.2. 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). Article 6.3 and 6.7 do *not* use mandatory language ("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.

135. At the same time, the United States does not believe the text of the chapeau to Article 6.3 *precludes* a finding of serious prejudice where only "significant price suppression" by the subsidized product "in the same market" as a like product and no other situation in Article 6.3 has been demonstrated. Thus, it is conceivable that the effect of a subsidy could be price suppression so significant that it alone rises to the level of serious prejudice to the interests of another Member.

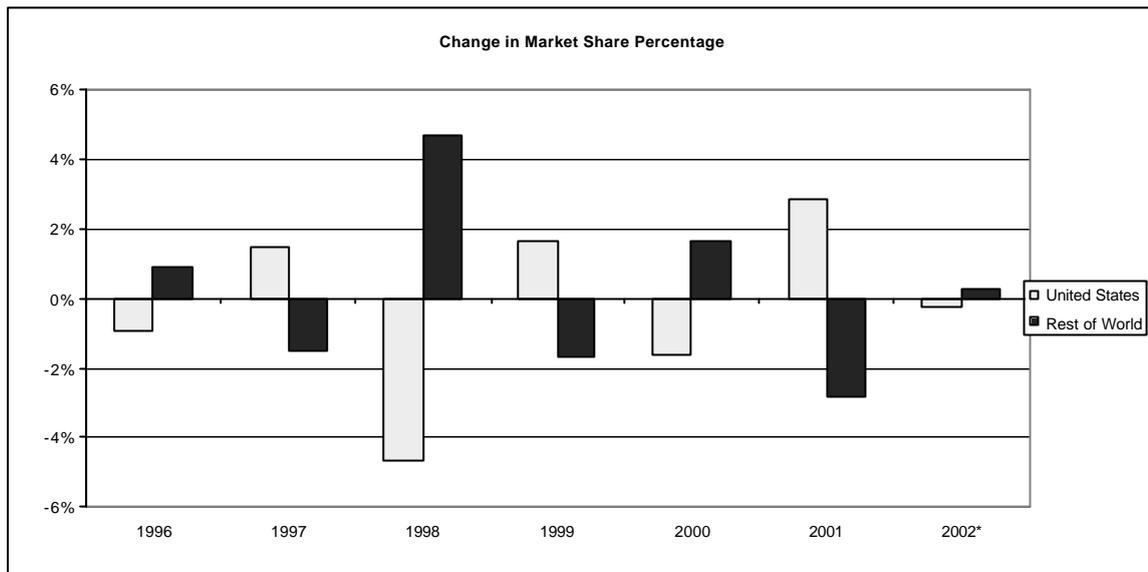
136. We recall that Brazil's interpretation is that price suppression would be "significant" even at a level of 1 cent per pound because this could still "meaningfully affect" its producers.⁹² The use of the term "significant," however, would seem to be intended to prevent insignificant price effects from rising to the level of serious prejudice. For example, were the term "significant" omitted from Article 6.3(c), *any* production subsidy (for example, a per-unit payment of 0.0001 cents per pound of production) would be deemed to satisfy Article 6.3(c) because *any* increase in production resulting from the subsidy would *theoretically* result in some price effect. Coupled with Brazil's reading of "may arise" in the chapeau of Article 6.3, this would result in any production subsidy running afoul of Articles 5 and 6, effectively undermining the separation of Part III of the Subsidies Agreement on "Actionable Subsidies" from Part II on "Prohibited Subsidies."

236. The Panel notes Exhibit US-47 (and the chart in paragraph 13 of the US 2 December oral statement). Please provide a conceptually analogous chart to Exhibit US-63 with respect to data relating to the US interpretation of "world market share".

137. The graph shows the year-over-year percentage change in the world market share over 1996-2002. US world market share is defined as in Exhibit US-47 as the quantity of consumption of US cotton (domestic mill use + exports) relative to world cotton consumption.

138. The annual change in the US market share is relatively slight with the exception of 1998 when severe drought, primarily in Texas, caused US production to fall significantly.

⁹² See Brazil's Further Submission, para. 256.



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 alternating 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).").

matter the size of that market. Such a result runs contrary to the ordinary meaning of the terms of the provision.

141. We note that excluding consumption from "closed markets" in the world market share calculation would increase the overall market share of the United States (and other suppliers) because the total world consumption figure would be lower. However, the variation in market share across years would not change appreciably assuming that the level of consumption in closed markets was relatively constant.

- (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?**

142. The United States interprets this question as asking whether the US market share would increase if an increase in US cotton consumption was completely supplied by increased US production without any changes to the consumption and supply patterns of the rest of the world. Under the US approach to "world market share," US world market share would increase.⁹⁴ The amount of increase in the US world market share would depend largely on the size of US consumption relative to world consumption.

143. Under Brazil's approach to Article 6.3(d), however, an increase in a Member's cotton consumption that was completely supplied by increased production by that Member would result in no change in that Member's world market share since there was no change in the Member's exports. Brazil's approach, therefore, would allow a larger or even dominant cotton consumer to provide huge per-unit production subsidies that increased the share of its own domestic consumption that its producers supplied without any discipline under Article 6.3(d), regardless of the impact on other Members who could potentially supply that increasing domestic consumption. Such a result runs contrary to the ordinary meaning of "world market share" in Article 6.3(d) since the term "world market" would capture impacts both in the market of the subsidizing Member (as in Article 6.3(a)) and in third-country markets (Articles 6.3(b) and 6.3(c)).

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

144. The relevance of this question is not entirely clear since Article 6.3(d) does not speak of "large" or "small" world market shares. That is, it is only a certain *increase* in world market share, from whatever level, that follows a consistent trend over a period when subsidies have been granted that is relevant to the 6.3(d) analysis.

145. Nonetheless, we note that Saudi Arabia exports crude oil but also refines petroleum into products that it consumes and refines as well. Based on 2000 world petroleum supply and disposition data for 2000, Saudi crude oil exports account for about 16 per cent of total world exports. Using an analogous measure for consumption (exports plus domestic consumption—i.e., refining—divided by total world consumption) gives a market share of 12 per cent.

- 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);**

⁹⁴ US world market share = (US domestic use of US cotton + US exports)/world consumption of cotton

- (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)**

146. (a) We note that Brazil must repeatedly insert the term "export" into the phrase "world market share of export" or "world export share" in order to convey a meaning restricting the term "market share" to exports. That is because the ordinary meaning of "world market share" would be all those markets in which cotton is consumed. Further, Brazil's argument is overstated. There would be disciplines on production-enhancing subsidies, even those that increase a Member's world market share *of exports* (even though that is not an WTO obligation in and of itself). Under Article 6.3(d), for example, a Member's world market share is determined by its domestic consumption plus exports of the product it produces. If a subsidy increased the Member's exports, and domestic consumption and world consumption remained the same, the increase in the Member's exports alone would increase that Member's world market share.

147. Further, production-enhancing subsidies with export effects could be inconsistent with Article 5(a) (injury), Article 6.3(b) (displace or impede exports to third country markets), Article 6.3(c) (lost sales), or GATT 1994 XVI:1 (serious prejudice).

148. (b) It is interesting that Brazil, which roundly rejects the use of any concepts from Part V or Annex IV of the Subsidies Agreement or from the Safeguards or Anti-Dumping Agreements when these are inconvenient for it, here tries to introduce "the ordinary meaning in a trade remedy context of 'domestic consumption'." The Panel's task is not to interpret the term "domestic consumption" but rather the "world market share of the subsidizing Member in a particular subsidized primary product or commodity". The United States has proposed that the US share of the world market for upland cotton must be measured by that portion of world consumption of upland cotton satisfied by US upland cotton. That necessarily must include US domestic consumption satisfied by US upland cotton. Again, we note that a relevant "market" for serious prejudice purposes is the market of the subsidizing Member under Article 6.3(a). There is no basis in the text or context of 6.3(d) to exclude that market from the "world market" identified in 6.3(d).

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"?

149. GATT 1994 Article XVI:3 provides some context to reading Article 6.3(d). Both provisions are addressed to subsidies that have effects on primary products. However, the context they provide also consists of the *differences* in their respective texts. GATT 1994 Article XVI:3 is limited to export subsidies, as Brazil acknowledged and agreed in the Tokyo Round Subsidies Code. (Brazil does not, because it cannot, deny that in the Tokyo Round it expressed its understanding that GATT 1994 Article XVI:3 applies only to export subsidies. The Panel can judge how credible it finds Brazil's change of opinion in this dispute.) GATT 1994 Article XVI:3 relies on an "equitable share" concept that panels and Members found incapable of definition or application. Moreover, Brazil has not provided any objective definition in this dispute of the "equitable share" concept but to argue that anything other than a non-subsidized level of exports is inequitable, a reading that would convert Article XVI:3 into a prohibition on domestic subsidies with production effects.

150. Article 6.3(d) of the Subsidies Agreement, on the other hand, applies to all subsidies and has objective criteria that are capable of application. This provision sets forward a mechanical test: a Member's share of the world market for a product must be greater than preceding 3-year average, and the increase must follow a consistent trend over a period when subsidies have been granted. Therefore, there is no "inequitable share" concept to deal with, and the consistency of a Member with its obligations is a straightforward matter to determine.

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" requires that one look at all places where upland cotton is consumed and determine what portion of world consumption of is satisfied with US upland cotton.

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-47 or US-71? USA

152. In paragraph 34 of the 30 September submission and in the accompanying table, "consumption" is used to capture both the domestic use of raw cotton production (that is, the "mill use" figure), plus the raw cotton equivalent of textile imports (that is, how much raw cotton is incorporated into manufactured cotton textile imports). This point is crucial to understanding how the growth in cotton textile imports has contributed to the decline in consumption of US domestically produced raw cotton for domestic manufacturing, which has resulted in more US domestic cotton finding a home in off-shore markets. That is, much US domestic cotton that is exported returns to the United States in the form of textiles and apparel.⁹⁵

153. In Exhibits 40, 47, and 71, the data on consumption correspond to the "mill use" data described above. The only difference is that these data are on a crop year basis (August - July). Therefore, the mill use figure in paragraph 34 of the US further submission will differ slightly from the consumption figure in the other exhibits. They are the same data, adjusted for different periods. The most recent domestic consumption (that is, mill use) figure is given in the response to Question 197.

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

154. As noted in the US further rebuttal submission, the literature on direct payments suggest that a large portion of direct payments get capitalized into land values. As Burfisher and Hopkins (2003) note: "Not all operators can . . . 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."⁹⁶ Thus, the effects of increased wealth largely accrue to non-operators, and any theoretical production effects are further minimized.

155. In well-functioning markets, asset prices reflect expectations about the future returns from their ownership. The PFC programme covered a fixed number of base cropland acres, established in 1996 when farmers enrolled in the programme, and benefits did not require current production. The direct link between base acres and the known programme benefits allowed the future stream of payments to be efficiently capitalized into land values:

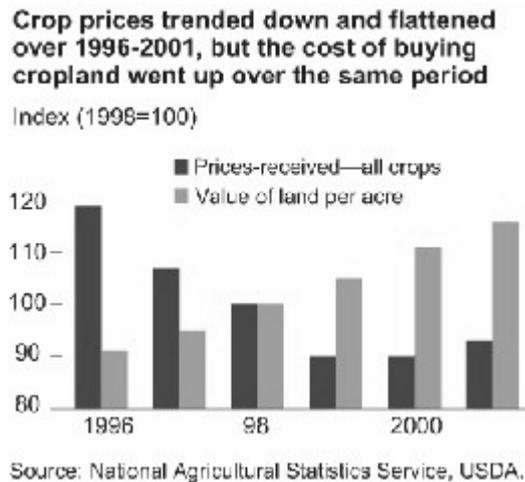
Decoupled payments clearly increase the well-being of the operators who receive them, but only when they are owners of base acres. Otherwise, land markets allow a pass-through of payments from operators to landowners, via modified rental

⁹⁵ The data in the table in paragraph 34 are on a calendar year basis in order to match them with the import data from the US Bureau of the Census.

⁹⁶ 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)

arrangements. Despite uncertainty over future policy, land values already reflect the market's expectations about future programme benefits.⁹⁷

156. Land values set by sales and rental markets can be examined to see whether they track commodity price trends. If these values diverge from prices, it suggests that land markets have additionally capitalized the present and expected future value of government payments. As the figure from Burfisher and Hopkins (2003) below demonstrates, commodity prices have fallen since 1996 due to a number of factors while land values have trended upward, consistent with land capitalization of payments. Land rent data, although more fragmented, follow the same trend as land values.



157. In its 27 October answer to Question 179 and in paragraph 57 of its oral presentation of 2 December, Brazil attempts to minimize the effects of direct payments on land by citing a recent study that showed that 34-41 cents per dollar of PFC payment were capitalized into land rents in MY 1997. However, in citing this study, Brazil effectively concedes the US analysis. The study cited by Brazil analyzes cash rent data in only *the first year* following implementation of the 1996 Act and the decoupled production flexibility contract payments. As the authors of the study acknowledge, cash rents may be "sticky" and adjust over the long run.⁹⁸ For example, not all rental contracts would be year-to-year; as additional multi-year rental contracts expire, landowners would be expected to adjust rents to capture the value of the decoupled payments made with respect to the base acreage on the land.

158. In the long run, only those upland cotton producers who are owners of upland cotton base acres will receive the benefit of those decoupled payments. Based on 1997 cost of production data, about 35 per cent of cotton production is grown by owner-operators. Therefore, only 35 per cent of the value of decoupled payments would benefit upland cotton producers, and this subsidy benefit would then have to be attributed across the total value of the recipient's production in order to determine the benefit to upland cotton.

243. Can the Panel assume that any support at all, even marketing loan programme payments, benefits upland cotton if an upland cotton producer has other agricultural production besides upland cotton? USA

⁹⁷ 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 45 (Exhibit US-78)

⁹⁸ See Roberts *et al.*, at 769 (Exhibit Bra-310).

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 commodity (for example, marketing loan payments for soybeans) are deemed to benefit that commodity exclusively. Thus, such payments – which depend upon production of a commodity other than upland cotton – would not be deemed to benefit upland cotton.

160. In the third case, a subsidy not tied to the production or sale of a given product (for example, decoupled income payments) would be deemed to subsidize any product sold by the recipient. Annex IV establishes that the value of the subsidized product for such a payment is "the total value of the recipient firm's sales."¹⁰⁰ Logically, a subsidy not tied to a particular product provides a benefit to the recipient in the form of increased income. Since money is fungible, the benefit can be deemed to inure to all of the products the recipient produces; a neutral way of attributing the subsidy to particular products is according to their proportion of the firm's sales. Thus, for purposes of Subsidies Agreement analysis, such a non-tied payment would be deemed to benefit upland cotton and any other commodity the recipient produces.

161. It is worthwhile to compare these Subsidies Agreement concepts of payments tied to productions or sale and payments not tied to production or sale to Agriculture Agreement concepts of product-specific and non-product-specific. The two sets of concepts are not identical. Recall that Article 1(a) of the Agreement on Agriculture establishes that product-specific support is "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product" while non-product-specific support is a residual category of "support provided in favour of agricultural producers in general." Thus, product-specific support is "tied to the production or sale of a given product" within the meaning of the Subsidies Agreement (Annex IV, para. 3) because it must be "provided for *an* agricultural product" and must be "in favour of *the producers of the* basic agricultural product."

162. Non-product-specific support is not tied to the production or sale of a particular product since it is provided to producers in general – for example, decoupled payments for which the recipient need not produce any particular commodity or any commodity at all. However, as noted above, such a non-tied payment will be allocated over the total value of the recipient's production. Hence, it could be possible to derive the benefit to upland cotton for purposes of the Subsidies Agreement from non-product-specific support.

163. Brazil would take these different concepts and suggest that any support that is not tied to production must be allocated to a particular crop; such support would be "support to a specific commodity" within the meaning of the Peace Clause. However, Brazil's approach eliminates the concept of non-product-specific support for purposes of Peace Clause since a non-tied payment may always be allocated according to the recipient's production (and, in Brazil's approach, then be deemed "support to a specific commodity"). It would appear anomalous to import into Article 13 of the Agreement on Agriculture a concept from the Subsidies Agreement (that itself is only reflected in Annex IV, which Brazil does not believe is relevant to actionable subsidies claims) that renders inutile such a key concept from the Agreement on Agriculture. Such an interpretation, moreover, runs contrary to the ordinary meaning of the phrase "support to a specific commodity." As the EC pointed out, support cannot at the same time be "support to a specific commodity" and "support to multiple

⁹⁹ See Subsidies Agreement, Annex IV, para. 3.

¹⁰⁰ See Subsidies Agreement, Annex IV, para. 2.

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 of 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 18 November further rebuttal submission; and Exhibit BRA-350. Have Step 2 payments ever been zero since the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002? In what circumstances could a Step 2 payment be zero? How does the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002 affect your response? BRA, USA

169. Step 2 payments have been zero since the elimination of the 1.25 cents per pound threshold in the 2002 farm bill. This occurred in 5 consecutive weeks beginning 19 September 2002.

170. A Step 2 payment could be zero when the AWP exceeds 134 per cent of the base loan rate (52 cents) or the US/North Europe price is less than the Northern Europe price. If either occurs, the rate will be zero for at least 4 consecutive weeks.

171. Elimination of the 1.25 cent per pound threshold increases the range of price differences in which a step 2 payment could be triggered and raises the resulting payment by 1.25 cents. To some degree, as compared with prior years, the 1.25 cent threshold elimination may correct for some long term changes in the valuation of currencies. Further, at certain price levels where the market price used to determine countercyclical payments is above the loan rate but below 65.73 cents per pound, the additional impact that the Step 2 payment can have on the market price for US cotton can reduce the amount of countercyclical payments received by US producers.

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? 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

¹⁰³ The futures price in the text is the average daily February closing price for the December contract. As noted in the US further rebuttal submission, para. 162 fn. 124., the January through March average daily closing price (59.10 cents per pound) is not markedly different.

¹⁰⁴ See, e.g., US Opening Statement at the Second Panel Meeting, paras. 5-6.

(b) How does this reconcile with Dr. Glauber's statement in Exhibit US-24, p. 3 (referring to "the 1990 Farm Bill and subsequent legislation") that Step 2 payments do not go directly to the producer? USA

172. By referring to "producers" in this context, the US has referred to producers acting in their capacity as producers of cotton, that is as persons with a risk of loss in cotton that they have planted and harvested. It could be that some large producers of cotton in that sense could also be persons who are manufacturers of cotton or exporters who marketed their cotton directly overseas. In that sense, they could receive payments just as any other manufacturer or exporter could do, but they would be receiving the payment not as a producer of raw cotton but in their other capacity.

173. In short, the regulations are drafted simply to reflect that there may be many ways in which the public may organize itself, but we are assured that the same bundle of cotton will only produce one payment and the breaking of the bundle would only come in connection with the manufacturing process. Officials know of no instance in which a payment was made other than for a legitimate export or for some sort of legitimate manufacturing effort. Again, these payments are received by such persons in their other capacities and not as producers of raw cotton. Such payments simply reflect the universal application of the programme to all cotton uses without a market-interfering government restriction on who may be a manufacturer or exporter of cotton.

(c) What proportion of Step 2 "export payments" go to producers? Please supply supporting evidence. USA

174. As of the present writing, the United States does not have any data or information on how many producer/manufacturers there are, or how many producer/exporters there are. We do not think that there are many but we continue to search for additional information that might be relevant in this regard.

H. MISCELLANEOUS

253. Regarding the adjustment authority related to Uruguay Round compliance in s.1601(e) of the FSRI Act of 2002 (the so-called "circuit-breaker provision"):

(a) Does it relate to export credit guarantees, crop insurance and cottonseed payments?

175. The adjustment authority would not reach export credit guarantees, crop insurance premium payments, or the 2003 cottonseed payment. Section 1601(e) of the 2002 Act, codified at 7 USC 7991(e), states that if the Secretary determines that expenditures under subtitles A through E of Title I of the Farm Bill (which cover the "programme crops") subject to the total allowable domestic support levels under the Uruguay Round Agreements (as defined in section 2 of the Uruguay Round Agreements Act as in effect on the date of enactment of this Act) "will exceed such allowable levels for any applicable reporting period, the Secretary shall, to the maximum extent practicable, make adjustments in the amount of such expenditures during that period to ensure that such expenditures do not exceed such allowable levels." Further the statute provides as to procedure that before making any adjustment under that authority, "the Secretary shall submit to the Committee on Agriculture, Nutrition, and Forestry of the Senate and the Committee on Agriculture of the House of Representatives a report describing the determination made under that paragraph and the extent of the adjustment to be made."

176. It should be noted that interpretation of this language should take into account that, as we have noted throughout, the government cannot predict how much actual expenditures for programme crops will be since those expenditures are sensitive to factors outside the control of the government.

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 payments. There was no contemplation that the mere fact of support, because of the size of the United States, would ipso fact result in a WTO violation, as Brazil would have the Panel make it through its threat of serious prejudice and *per se* claims. This point is made clear in the conference report on the 2002 Act, in which the Congress says:

*The Conference has made it a priority to craft a programme that provides assistance to producers in a way that is consistent with our obligations under the Uruguay Round Agreement on Agriculture.*¹⁰⁵

177. That said, the circuit breaker provision by its terms applies only to the cited subtitles of the 2002 Farm Bill and as such does not address expenditures under the export credit guarantees programme, crop insurance, or cottonseed programme, provided for elsewhere. Rather, the circuit breaker provision addresses only expenditures under the programme crop programmes that are covered in the cited subtitles – namely, the direct and countercyclical payments, the marketing loan payment, and Step 2, for all of the programme addressed in Title I. Those programmes would include, in addition to other crops that are the more traditional "programme crops," payments related to sugar, wool, mohair, and peanuts, and various oilseeds.

(b) Does it relate only to compliance with AMS commitments?

178. By reference to 19 USC 3501, the reference in Section 1601 is to the entirety of the Uruguay Round Agreements, which is identified in 19 USC 3501 and described there. Consequently, the provision would arguably recognize any total limits provided for in that agreement; thus, section 1601(e) applies to the Aggregate Measurement of Support commitments under the Uruguay Round Agreement on Agriculture. To this point, there has been no specific test to determine the precise nature of its limits. Again, however, it must be presumed in light of the history outlined above that the Congress contemplated that if there was to be a problem it would be with the AMS limit. Thus, if there is an AMS problem, the Secretary could limit the expenditures for upland cotton; in that sense, those expenditures are not "without limit."

(c) Is the authority discretionary? If so, can its exercise be limited by the legislative branch of government?

179. The authority is not discretionary, but rather requires that the Secretary take action as the statute provides that "the Secretary *shall*, to the maximum extent practicable, make adjustments" (emphasis added). In adopting this language, the Senate and House conference members rejected "circuit breaker" provisions proposed in the original House version of the farm bill (HR 2646) and original Senate version (Senate amendment to HR2646) which would have made the adjustment discretionary.¹⁰⁶ However, it should be noted that the statute does contain a Congressional referral

¹⁰⁵ Report 107-424, page 469 (printed at 148 Cong. Rec.H1916, May 1, 2002).

¹⁰⁶ Under the original House version: "[T]he Secretary *may* make adjustments in the amount of such expenditures during that period to ensure that such expenditures don not exceed, but in no case are less than, such allowable levels" (emphasis added). Under the original Senate version: "Amends Section 161 of the FAIR Act *to allow* the Secretary to adjust the amount of domestic support to assure compliance with Uruguay Round obligations." See Farm Security and Rural Investment Act of 2002, Conference Report to Accompany HR 2646. House of Representatives, Report 107-424, 1 May 2002, page 468.

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, borrowing authority which must be replenished from time to time. Rarely has CCC run out of funds, but it has happened for brief periods of time -- and of course, Congress can change the programme at any time.

- 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**

183. Under DSU Article 11, the Panel is called upon to make an objective assessment of the matter before it, which consists of the measures challenged by Brazil and the claims Brazil has advanced. This assessment must include an objective assessment of the facts of the case. It is well-established, however, that a Panel is not to make claims for a party, nor to develop evidence for a party. As the Appellate Body explained in *Japan – Varietal Testing*, it is for the complaining party to bring forward

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 assigning subsidy benefits to one product over another or would result in double-counting of a subsidy as providing a greater benefit than the value of the payment.

185. Brazil has not identified evidence that would allow for the challenged decoupled payments to be allocated across their recipients' production (that is, attributed to upland cotton and any other commodities produced by those recipients). Thus, Brazil has not established facts necessary for the Panel to identify the amount of the challenged subsidy nor evaluate its effects. Even if there were evidence on the record from which "reasonable assumptions" (in the words of the question) could be drawn, the Panel could not make those assumptions because Brazil has not claimed that allocating the value of these decoupled payments across the total value of each recipient's production is necessary. That is, while Brazil has improperly sought to expand the scope of this dispute by allocating decoupled payments received for non-upland cotton base acres to upland cotton producers, Brazil has *not* claimed that all such payments must be allocated across the value of the recipient's production. To the contrary, Brazil has argued that such payments would *exclusively* be support to upland cotton.¹⁰⁸

186. As a result, this dispute presents a situation analogous to that in the *Japan – Varietals* dispute. Were the Panel to agree that to determine the subsidy benefit to upland cotton decoupled payments not tied to upland cotton production must be allocated across the total value of the recipient's production, the Panel could not then seek evidence or make "reasonable assumptions" relating to such an allocation because to do so would be to make a claim that Brazil has not advanced. Brazil has chosen *solely* to argue that decoupled payments for base acreage up to the amount of upland cotton planted on the farm are support to upland cotton, ignoring the production of any other crops on the farm. (For example, with respect to plantings and not production, the data provided to the Panel and Brazil on December 18 and 19, 2003, demonstrate that, in the aggregate for farms planting upland cotton in marketing year 2002, upland cotton planted acres represented only 48 per cent of total cropland on those farms. One could surmise that Brazil refuses to recognize that decoupled payments must be allocated because to do so would invalidate both Brazil's Peace Clause analysis, which merely took the value of decoupled payments for upland cotton base acres and factored such payments by approximately 14/16, and Brazil's serious prejudice analysis by eliminating a substantial portion of the "\$12.9 billion" in payments alleged to have been made to upland cotton. Nonetheless, Brazil has chosen what arguments and evidence to advance to support its claims – as is its

¹⁰⁷ In the language of Annex IV, "the value of the [subsidized] product shall be calculated as the total value of the recipient firm's sales of *that product*." Subsidies Agreement, Annex IV, para. 3 (italics added).

¹⁰⁸ See Brazil's Further Rebuttal Submission, para. 24 ("This EWG data also provides the amount of upland cotton contract payments attributable to upland cotton producers, broken down by PFC, market loss assistance, direct and counter-cyclical payments. These figures are also set out in the table above. However, because some upland cotton was produced on non-upland cotton contract base, it would be necessary to calculate an amount of non-upland cotton contract payments, based on the EWG data, that also constitutes support to upland cotton received by producers of upland cotton.").

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 to the FAPRI model with respect to various components of the US cotton programme, such as direct payments or export credit guarantees, continue to be the key reason his model displayed the results presented in Annex I and are carried

¹ In evaluating Dr. Sumner's impacts (and this critique of them), the Panel should take into consideration that Annex I results have not been, and apparently cannot be, confirmed. The models used and outputs obtained were, by their own admission, not retained by Dr. Sumner nor Dr. Babcock. *See*, Letter dated 31 October 2003 from Dr. Bruce Babcock to Dr. Dan Sumner, submitted to Panel by Brazil on 5 November 2003. The record remains incomplete with respect to Dr. Sumner's adaptations. The United States has attempted in this critique to note where it has been forced to make assumptions due to missing data.

² The United States has based its critique on three Excel spreadsheets that have been provided by Brazil and/or Dr. Bruce Babcock. These include the CARD international cotton model, delivered by Brazil on 13 November, the cotton-only US model provided by Brazil on 18 November; and the US crops model provided by Dr. Babcock on November 26. A graphical representation of the scope and disclosure of Brazil's modelling system is provided in Exhibit US-113.

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;
- Thus, Dr. Babcock has stated that the Sumner analysis is "in no way" an official FAPRI analysis.

6. In a recent letter, Dr. Babcock, an economist at the CARD located at Iowa State University and the "technician" that carried out much of Dr. Sumner's economic analysis³, cleared up some of the confusion regarding the models used in Brazil's analysis. In Dr. Babcock's opinion, a true FAPRI analysis would have used different models and applied different assumptions to those models to arrive at the type of estimate presented by Brazil in its Annex I. In his letter Dr. Babcock states that the analysis carried out by Dr. Sumner and used by Brazil was

"in no way an official FAPRI analysis and if FAPRI had done the analysis, FAPRI would have come up with different estimates of the effects of US cotton subsidies on world prices."⁴

7. Dr. Babcock also stresses the differences between FAPRI and Dr. Sumner's assumptions used to estimate the effects of various components of US cotton policy. Many of these different assumptions are described in Bra-313 and will be discussed in detail.

8. Dr. Babcock indicates a FAPRI analysis would have used different models. He states that FAPRI would have used different models entirely.

"The domestic model used was not based on the models used for the FAPRI 2003 baseline. ... the model that FAPRI uses to conduct domestic and international US policy analysis is the US stochastic model and the FAPRI international models. The

³ Opening Statement of Dr. Sumner, 2 Dec. 2003, "I have specified equations and parameters which adapt the systems to apply to the specific questions of interest in this dispute and I have worked closely with skilled and experienced technicians who have operated the details of the system. This is the same procedure that economists routinely use in performing simulation modelling in academic research and that they use in performing complex econometric statistical analysis. I rely on the technician to operate the "machinery" of the models just as a medical doctor would rely on an X-ray or Magnetic Resonance Imaging technician to operate those systems and generate results for analysis and interpretation."

⁴ Letter from Dr. Bruce Babcock, Exhibit US-114.

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

"... FAPRI would have used different models ..."⁵

9. Dr. Babcock's letter confirms that the concerns of the United States have been well-founded. While cloaking itself in the FAPRI model's reputation, Brazil and Dr. Sumner's analysis is, in fact, something quite different. The differences between FAPRI and the Brazil analysis reflected in Annex I involve much more than small, "conservative" changes. As the United States will demonstrate, Brazil's Annex I analysis relies too heavily on adaptations, modifications and adjustments to suggest acceptance based upon FAPRI's reputation. Brazil's estimates, to a very great extent, distort the FAPRI system for the express purpose of achieving pre-conceived results.

10. The United States, after completing as complete a critique of Annex I results as possible in this proceeding, respectfully submits that the results indicated in Annex I are significantly exaggerated, due either to economic errors or to Dr. Sumner's introduced biases (most of which are discussed in Bra-313 and in Annex I, and many of which contain errors). Brazil's results set out in Annex I and subsequent submissions have no explanatory power.

11. The United States submits that the results in Annex I provide very little guidance to the Panel in terms of overall impacts of the US cotton programme. The United States has stated that the FAPRI model as used by Dr. Sumner was an inappropriate tool for the intended job. This opinion has now been confirmed by Dr. Sumner's chief "technician" on this project⁶, who has directly stated that FAPRI would not have used the models used by Dr. Sumner and would not have made the adaptations to that model that he discusses in Annex I and in Bra 313 if it had been requested as an organization to conduct this analysis.

A. BRAZIL MODEL NOT COMPARABLE TO FAPRI SYSTEM

12. The differences between Dr. Sumner's analysis and the FAPRI framework are significant. Those differences arise primarily as a result of Brazil's disagreement with FAPRI and many other agricultural economists over the impact of payment programmes that are not directly linked to production decisions. There are other important differences. Most notably, FAPRI does not include crop insurance as a production-distorting programme. The FAPRI model also does not contain components designed to estimate production effects from the export credit guarantee programme, a seemingly appropriate choice since Brazil itself has stated that it cannot quantify the alleged benefit to upland cotton provided by the export credit guarantee programmes.⁷

13. Whenever the FAPRI modeling system did not tend to show acreage impacts high enough to satisfy Brazil in this case, Dr. Sumner simply made modifications to encourage it to do so. The United States disagrees with these modifications, but still cannot confirm all of these changes or the specific components of each of them. Second, whenever the FAPRI modeling system did not include a programme component challenged by Brazil, Dr. Sumner simply forced acreage impacts of that programme onto the system - showing little or no economic foundation for the introduced variables.⁸

⁵ *Id.*

⁶ "...FAPRI would have used different models". Letter from Dr. Babcock, Exhibit US-114.

⁷ Paragraph 82 of Answers of Brazil to Questions from the Panel, 27 October 2003.

⁸ For example, Brazil cites export impacts ascribed to the export credit guarantee programme by the National Cotton Council of America and uses those impacts without further foundation. The National Cotton Council of America's economic analysis in this instance has no foundation and no demonstrated methodology.

14. All of these effects, displayed in Annex I, were introduced into the FAPRI system by Dr. Sumner. Dr. Sumner discusses some of his modifications in Bra-313, but not all of them. Dr. Sumner has never provided the United States with an electronic, verifiable version of his modifications. Efforts by the United States to replicate the Sumner formula using a FAPRI model have been unsuccessful, leading to the conclusion that other modifications, adaptations or calibrations are involved.

B. ADAPTATIONS TO AND MODIFICATIONS OF FAPRI MODEL RESULTED IN EXAGGERATED RESULTS

15. Dr. Sumner's treatment of decoupled payments, crop insurance, and export credits are significant deviations from the FAPRI modelling framework. These changes are forced onto the FAPRI system resulting acreage effects that are much greater than would ever be anticipated by a true FAPRI analysis. Again, as Dr. Babcock has now candidly stated:

"In addition, the modeling assumptions that Dan used to estimate the effects of the various US domestic programme components of US policy are different than FAPRI would use if asked to answer the same questions."⁹

1. Dr. Sumner exaggerates the impact of decoupled payments as compared to FAPRI's modelling of those payments

16. FAPRI analysis of the impacts of decoupled programmes (like Production Flexibility Contract payments (PFC), Direct Payments (DP), Market Loss Assistance payments (MLA) and Counter-cyclical Payments (CCP) was discarded by Dr. Sumner and replaced with an approach not supported by FAPRI, nor supported by the bulk of economic literature on the subject.

17. Dr. Sumner's decoupled effects are different than those normally used by FAPRI and were supposedly justified by Dr. Sumner's own estimation of producers' "anticipation" of future programme changes and on his, now proven incorrect, contrived assumptions about actual planting patterns in the United States.¹⁰

18. The FAPRI baseline reflects their "most-likely" outcome for acreage, production, consumption and prices under a defined set of assumptions. Acreage projections for each of the crops reflect assumptions and outcomes for market indicators and government policy. 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:

$$CTPLT_i = a_o + a_o * CTENR_i / PD + A * (\text{Vector of Competing Crop Returns}_i) / PD + \text{Decoupled Payment Impacts}_i + CRP^{11} \text{ Impacts}_i + ?_i$$

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.

⁹ For example, Brazil cites export impacts ascribed to the export credit guarantee programme by the National Cotton Council of America and uses those impacts without further foundation. The National Cotton Council of America's economic analysis in this instance has no foundation and no demonstrated methodology.

¹⁰ Paragraphs 39-44 of US Opening Statement at the Second Session of the First Panel Meeting, 7 October 2003.

¹¹ CRP = Conservation Reserve Programme.

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.

21. The following table provides a comparison of acreage impacts included in the FAPRI model to those calculated by Dr. Sumner. In the FAPRI model, the acreage contribution of all decoupled payments across all major programme crops ranges between 1.4 and 2.6 million acres. Decoupled payments to all crops contribute between 69 and 123 thousand acres to upland cotton. If we isolate the impact of decoupled payments for upland cotton base acres, the FAPRI model indicates that the shift in total cotton plantings ranges between 23 and 45 thousand acres, or less than three-tenths of one percent of upland cotton area. Impacts of this magnitude would not have appreciable impact on production and prices.

22. In stark contrast to the FAPRI model are the contrived impacts calculated by Dr. Sumner. In order to present a complete picture to the Panel, the United States presents Dr. Sumner's impacts in two ways. In Dr. Sumner's analysis of decoupled payments, equations (5) and (6) of Exhibit Bra-313 document his formulas for determining "the amount of cotton acreage that was held in cotton by these programme payments". This acreage is subtracted from the error term of the equation or the impact can also be thought of as a shift in the supply curve. This impact will be termed the "gross impact" on cotton acreage of the programme in question. Values for these "gross impacts" have been taken from the file FINAL_US2003CropsModel_WORKOUT.xls (received by the United States on 18 November). Dr. Sumner's "gross impacts" of cotton decoupled payments on cotton plantings range from a low of 352 thousand acres to a high of 2.2 million acres. In contrast, the FAPRI model shows a gross impact of 23 to 45 thousand acres. Dr. Sumner's impacts are almost 50 times larger than those included in the FAPRI model.

23. To avoid any confusion by the Panel, the gross impacts of the programmes are not the same values as the impacts shown in Annex I and Exhibit Bra-325. The results of Dr. Sumner's scenarios reflect his estimate of the net impact of removing various aspects of the cotton programme. Net impacts will reflect the fact that producers have responded to the higher cotton prices under the scenario and increased plantings to partially offset the initial loss in acreage.

24. The following table also provides a comparison of Dr. Sumner's net acreage impacts of removing decoupled payments. These impacts correspond to the results presented in Annex I. It is

¹² Westcott, P., Young, C. E., and Price, M., USDA, ERS, The 2002 Farm Act, Provisions and Implications for Commodity markets, Economic Research Service, November 2002. (See Exhibit Bra-42)

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 suggested¹³, 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 Crop Insurance Program on Cotton Acreage (1) % of Upland Cotton Area	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 Cotton Crop Insurance Program on Cotton Acreage (2) % of Upland Cotton Area	0.584	0.541	0.798	0.808	1.040	1.018	1.056	0.979	0.974	0.683	1.013
Sumner's Net Impact of Cotton Crop Insurance Program on Cotton Acreage (3) % of Upland Cotton Area	0.580	0.360	0.600	0.540	0.590	0.550	0.420	0.440	0.430	0.520	0.486

(1) Source: No impact included in file US CROPS MODEL 2002.xls.

(2) Source: File FINAL US2003CropsModel WORKOUT.xls, Equations sheet, Row 752.

(3) Source: Table I.5d of Annex I.

¹³ US Opening Statement at the Second Session of the First Panel Meeting, 7 Oct. 2003, paras. 45-47.

¹⁴ See Exhibits US-57 through US-60.

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.

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 192-194, Brazil carried out another economic sleight of hand by implying that Dr. Sumner's export estimates with respect to the export credit guarantee program were more conservative than the unsubstantiated estimate it cites from the National Cotton Council. Paragraph 194 of that submission acts as if the NCC estimate of a possible 3 cent per pound US price impact and Dr. Sumner's estimate of a .57 cent per pound world price impact are somehow independent analyses - and demonstrate Dr. Sumner's conservative approach. However, as demonstrated in Bra-313, all Dr. Sumner did was force a reduction in US export estimates of 500,000 bales (using the NCC testimony as his sole economic foundation), which correspondingly reduced prices in the US, which correspondingly both reduced US acreage and slightly increased exports - cutting into the initially imposed 500,000 bale shift. Further, the "different" price estimates were, in fact, estimates of two different set of prices - US and world. Brazil inappropriately characterized Dr. Sumner's results as being conservative relative to the NCC estimate. (Paragraph 192, Brazil's Further Submission to the Panel, 9 September 2003) Later when the Panel raised a question about the results, Dr. Sumner somehow forced a full 500,000 bale decline in US exports, ignoring the impacts of price response. (See, for example, Bra-325, last category of tables - export credit guarantee with fixed 500,000 bale impact) In that response, Brazil also maintained the stance that these two "analyses," neither demonstrating economic foundation, were somehow independent, while fairly clearly demonstrating that Dr. Sumner merely took the NCC testimony and imposed a 500,000 bale demand shift.

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. 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 actually used the November 2002 FAPRI baseline and, as stated in Bra-313, "none of the other equations in the FAPRI specification are modified to explicitly analyze the removal of US cotton programmes".²⁰

IV. BRAZIL'S MODEL HAS NO EXPLANATORY POWER

39. It would be anticipated that a model proposed to demonstrate effects of removing programme components of the US cotton programme and the impact of that removal on planting decisions would also demonstrate the ability to correctly predict planted acreage of upland cotton, given prices and other factors.

40. The Sumner-modified model presented in Annex I does not explain cotton planting decisions.

¹⁹ Brazil's later submissions refer to the November 2002 baseline, paragraph 114 of Brazil's Further Rebuttal Submission of 18 Nov 2003.

²⁰ Bra-313, page 5.

41. In fact, the simple ratio of cotton to soybeans expected harvest season futures prices at the time of planting, discussed by the United States²¹, does a much better job of explaining the movement in US cotton acreage than what is found in Dr. Sumner's formulation.

42. Even an analysis of planting decisions based on lagged prices, while not as correlated as the ratio of expected futures prices, also does a better job of explaining producer planting decisions than does Dr. Sumner's net returns formulation.

43. In fact, the formulation presented in Annex I actually contains a negative correlation between expected net revenue and planting decisions in most cotton regions of the United States.

44. In other words, the Annex I model tends to predict that cotton producers will plant less cotton in response to higher returns.

45. In Annex I, Dr. Sumner reports the functional form of expected net revenue used in determining planted acreage of upland cotton (equation 1 on page 13). Empirical results indicate that Dr. Sumner's contrived formulation of expected net revenue does not explain the movement in US plantings of upland cotton.²² The following table presents correlation coefficients between the explanatory variables in Dr. Sumner's acreage equations and actual acreage levels for each region and for the United States over the 1996-2002 period.

46. Cotton expected net revenue, in nominal terms, calculated according to equation (1) of Annex I has a negative correlation with planted acreage in 4 of the 6 cotton-producing regions modelled by Dr. Sumner. Over the 1996-2002 period, those 4 regions accounted for 93% of US acreage. Dr. Sumner's equations for planted acreage are not solely based on nominal net revenue of cotton. They also take into account competing crops in each region, and returns are converted to real dollars by dividing by a general price deflator.

47. The lack of predictive ability of Dr. Sumner's acreage equations is best illustrated by the correlation between acreage and the Weighted Expected Net Returns for all Crops in real terms. This aggregate net return is calculated by multiplying each parameter estimate by the respective real net returns for that crop calculated according to equation (1) of Annex I and then summing the resulting values. This calculation incorporates all explanatory variables that are included in Dr. Sumner's acreage equations with the appropriate elasticity.

48. The correlation results indicate that Dr. Sumner's equations are not accurate predictors of the movements in cotton acreage. The correlation in 3 regions is negative, and in two other regions, the correlation is weakly positive. Only in the smallest production region in the US is there a positive correlation that is statistically significant.

²¹ Paragraphs 152-167 of US Further Rebuttal Submission, 18 November 2003.

²² The calculation of expected net revenue follows the general form indicated by equation (1) of Annex I. Data for expected market and marketing loan benefits are taken directly from the file FINAL US2003CropsModel WORKOUT.xls, which is a cotton-only US model supplied by Brazil. Exact calculations of per-acre PFC, DP, MLA and CCP payments, as well as crop insurance were not included in the file. Nor has this exact documentation been provided by Brazil. In the absence of a complete explanation regarding these calculations, the US has adopted the following formulas for expected per-acre payments for each region i:

$$PFC_i = 0.85 * (\text{PFC Payment Rate}) * (\text{Programme Yield})_i,$$

$$MLA_i = 0.85 * (\text{MLA Payment Rate}) * (\text{Programme Yield})_i,$$

$$DP_i = 0.85 * (\text{Direct Payment Rate}) * (\text{Programme Yield})_i,$$

$$CCP_i = 0.85 * \max(0, \text{Target Price} - \max(\text{Loan Rate}, \text{Farm Price})) (\text{Programme Yield})_i,$$

The variables for decoupled payments and crop insurance have been calculated for each crop and region and included in expected net revenue for the determination of correlation coefficients and explanatory power.

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.

$$\begin{aligned} \text{PFC}_i &= 0.85 * (\text{PFC Payment Rate}) * (\text{Programme Yield})_i, \\ \text{MLA}_i &= 0.85 * (\text{MLA Payment Rate}) * (\text{Programme Yield})_i, \\ \text{DP}_i &= 0.85 * (\text{Direct Payment Rate}) * (\text{Programme Yield})_i, \\ \text{CCP}_i &= 0.85 * \max(0, \text{Target Price} - \max(\text{Loan Rate}, \text{Farm Price})) (\text{Programme Yield})_i, \end{aligned}$$

The variables for decoupled payments and crop insurance have been calculated for each crop and region and included in expected net revenue for the determination of correlation coefficients and explanatory power.

²⁴ Paragraphs 152-167 of US Further Rebuttal Submission, 18 November 2003.

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:

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

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:

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

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 $a_i * (\text{Change in returns}) / PD$. 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. Specifically, acreage shifts for the 2003-07 period are much larger than those reported for the 1999-02 period. The larger impacts are not consistent with

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 system. That notwithstanding, we do know that the impact on net revenue is the same in all years of the analysis. If that is the case, then the linear specification presented in equation (1) of Annex I would generate roughly the same acreage shift in each year of the analysis, with the exception of the impact of the change in the general price deflator. Since the price deflator, which is a measure of general price inflation, generally increases over time, then the actual impact on acreage should get modestly smaller over time. Instead, Dr. Sumner's acreage shifts due to crop insurance increase dramatically over the analysis period. In the early years, the impact of \$19 in net revenue amounts to fewer than 600 thousand acres, while it grows to more than 1 million acres in 2003.

62. Despite the fact that the perceived benefit did not change, Dr. Sumner's methodology produced an acreage impact over the 2003-07 period that is roughly 1.5 times larger than over the 1999-2002 period. Furthermore, in the case of the Corn Belt, Dr. Sumner's analysis actually indicates that the presence of the crop insurance programme has removed acres from cotton production - a result that is implausible.

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:

$$CTPLT_i = a_o + a_o * CTENR_i / PD + A * (\text{Vector of Competing Crop Returns}_i) / PD + ?_1$$

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, analyzing the impacts of no decoupled payments would be done by simply setting the decoupled payments to zero. However, in Exhibit Bra-313, equations (4)-(6) suggest a very different methodology for deriving impacts. Dr. Sumner reports to use the following approach:

$$\begin{aligned} &\text{Percentage difference in acreage due to programme} \\ &= (\text{Expected programme payments} / (\text{Expected programme payments} + (\text{cotton market \& market loan net revenue}))) * \text{Acreage elasticity.} \end{aligned}$$

Acreage impacts would be derived by multiplying the percentage difference in acreage by the baseline level of acreage.

66. The new methodology yields acreage impacts that vary depending on the level of returns from the market and marketing loan. This methodology explains how Dr. Sumner is able to derive varying impacts in a scenario where the change introduced into the system is constant, such as the crop insurance scenario.

D. SUMNER FORMULATION IGNORES PRESENCE OF OTHER PROGRAMMES AND THEREFORE EXAGGERATES IMPACTS

67. Dr. Sumner's formulation for isolating the impacts of each individual programme produces exaggerated results. It is logical to assume that Dr. Sumner's baseline acreage represents his most likely view based on the presence of all US cotton programmes. As such, determining the acreage impact of each individual programme should be done by comparing returns from the programme in question with total returns, where total returns are defined as

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

68. Dr. Sumner's approach of comparing returns for the programme in question to returns from the market and marketing loan ignores the presence of other programmes. Since returns from the market and marketing loan are less than total returns, then the acreage impacts for a given programme based on Dr. Sumner's formulation will be larger. The following table uses data for the Southern Plains in 2005 to illustrate the differences. Following Dr. Sumner's documentation of Exhibit Bra-313, the acreage impacts of decoupled payments and crop insurance total 671 thousand acres. If the methodology was based on total revenue, then the estimated acreage impact is 543 thousand acres. Full details of the calculations are presented in the file FINAL US2003CropsModel Correl 1 (Exhibit US-115).

E. UNITED STATES HAS DIFFICULTY REPLICATING SUMNER RESULTS - EVEN AFTER ADOPTING SUMNER METHODOLOGY

69. The estimates prepared by the US are substantially smaller than those reported by Dr. Sumner in the file FINAL US2003CropsModel WORKOUT.xls (submitted on 18 November). The discrepancies are particularly large over the 2003-07 period. Dr. Sumner reports an average acreage

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.

70. Brazil may cite the fact that the elasticity with respect to net returns is lower than the estimates published in Table I.3 of Annex I. While the United States is not able to verify the discrepancy, the elasticities used in the US calculations are based on data provided in the file FINAL US2003CropsModel WORKOUT.xls. Specifically, the elasticity in each year is determined by the formula $(a_i / \text{Value of price deflator}) * (\text{Value of net returns} / \text{Value of cotton acres})$, where a_i is the coefficient on cotton net returns in the regional cotton acreage equation. The value of net returns and cotton acres are based on regional numbers in each year. This formulation is consistent with Dr. Sumner's documentation presented in Exhibit Bra-313.

Example of Southern Plains Acreage Impacts, 2005

	(1)	(2)	(3) = (2)/((1) + (2))	(4)	(5)	(6) = (3)*(4)*(5)	(7)
Program	Market Revenue	Program Revenue	% of Market + Program Revenue	Elasticity	Planted	Estimated Impact	Sumner Impact
Direct Payments	\$109.04	\$6.08	5.28%	0.28	6.046	0.090	0.145
CCP's	\$109.04	\$20.02	15.51%	0.28	6.046	0.265	0.416
Crop Insurance	\$109.04	\$24.67	18.45%	0.28	6.046	0.316	0.446
Total Area Impact						0.671	1.007

Example of Southern Plains Acreage Impacts, 2005

	(1)	(2)	(3) = (2)/(1)	(4)	(5)	(6) = (3)*(4)*(5)	(7)
Program	Total Revenue	Program Revenue	% of Total Revenue	Elasticity	Planted	Estimated Impact	Sumner Impact
Direct Payments	\$159.81	\$6.08	3.80%	0.28	6.046	0.065	0.145
CCP's	\$159.81	\$20.02	12.53%	0.28	6.046	0.214	0.416
Crop Insurance	\$159.81	\$24.67	15.44%	0.28	6.046	0.264	0.446
Total Area Impact						0.543	1.007

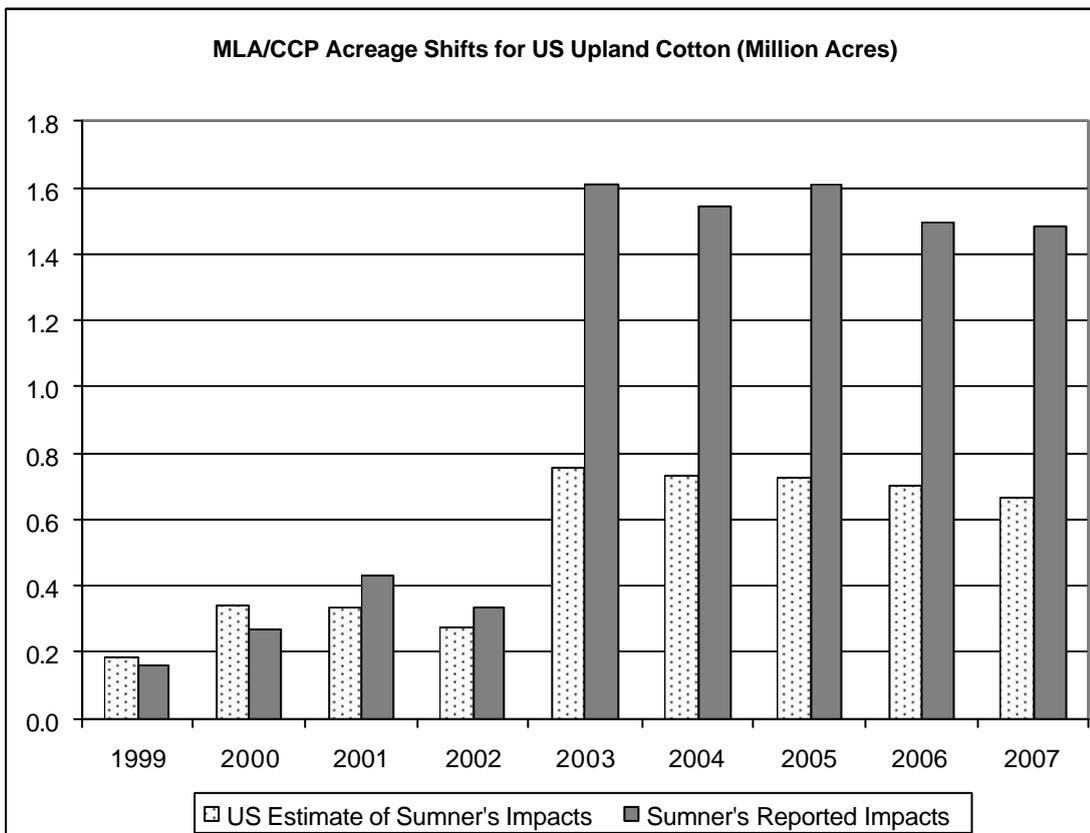
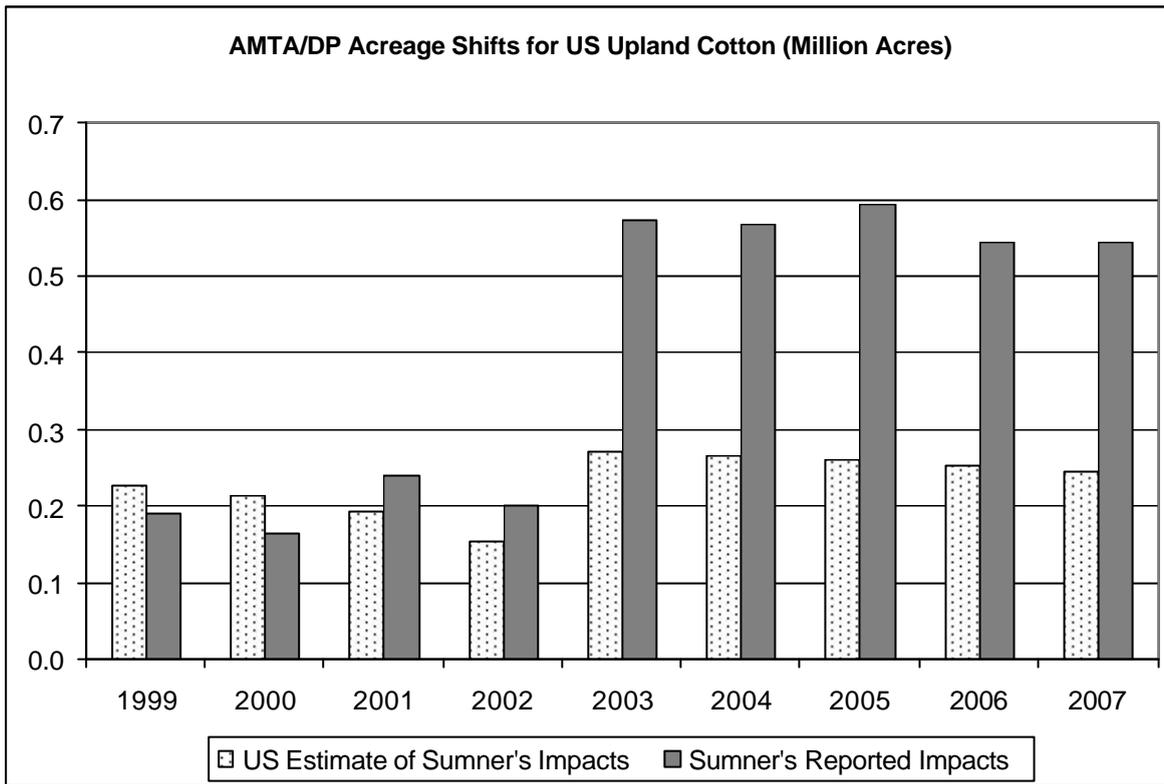
	1999-2002 Average Acreage Impact (Million Acres)			
	AMTA/DP	MLA/CCP	Crop Insurance	Total
Sumner Reported Impact	0.199	0.300	0.683	1.182
Estimate of Sumner Approach Using Market Returns	0.197	0.286	0.636	1.119
Estimate of Sumner Approach Using Total Returns	0.166	0.243	0.587	0.996

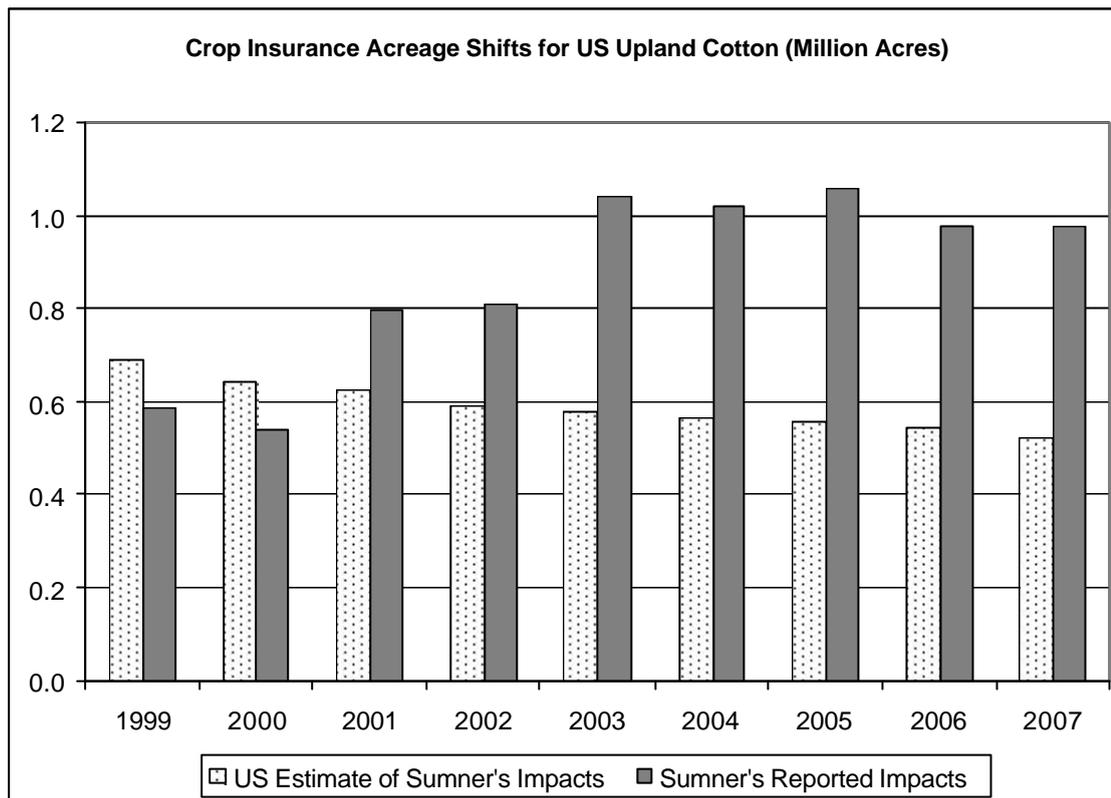
	2003-2007 Average Acreage Impact (Million Acres)			
	AMTA/DP	MLA/CCP	Crop Insurance	Total
Sumner Reported Impact	0.565	1.548	1.013	3.127
Estimate of Sumner Approach Using Market Returns	0.258	0.718	0.553	1.529
Estimate of Sumner Approach Using Total Returns	0.179	0.591	0.432	1.202

71. The following charts provide a year-by-year comparison between Dr. Sumner's reported impacts and estimates prepared by the United States. The formulas use to generate these estimates follow the documentation provided by Dr. Sumner. In cases where the information was incomplete, reasonable assumptions were made to facilitate the calculations. Complete details are provided in the file FINAL US2003CropsModel Correl 1²⁵.

72. Estimates by the United States for the 1999-2002 period are reasonably close to those offered by Dr. Sumner. However, there are large discrepancies over the 2003-07 period. It is inexplicable how the impact between the two periods can be so different. The differences cannot be explained by Dr. Sumner's method of incorporating alternative "coupling" factors.

²⁵ Exhibit US-115.





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. Babcock²⁶, 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 earlier²⁷, 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.

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. If overall supply and demand are more elastic, or more responsive, then an external shock to the system will generate a smaller change in price than a system that is more inelastic.

78. In the case of the scenarios examined by Dr. Sumner, the external shocks to the model are the elimination of various aspects of the US cotton programme. According to Dr. Sumner's analysis, the removal of the US cotton programme leads to a reduction in planted area, production, and subsequently exports onto the world market. The reduced supplies into the world market generate an increase in world price, with the magnitude of the price increase determined by the overall elasticities embodied within the models for foreign production and consumption.

79. The following table provides a comparison of aggregate supply and demand elasticities for foreign area and mill use. Based on individual country elasticities, the response of aggregate foreign area and consumption can be calculated based on weights derived from recent historical data. The elasticities reported in Table I.3 of Annex I are used to derive the aggregate elasticities of the Sumner-CARD international cotton²⁸ model provided by Brazil on 13 November. These are compared to published research from Dr. Seth Meyer at FAPRI-University of Missouri, which reports more responsiveness in both area and consumption.²⁹

Comparison of Model Elasticities				
	Meyer – FAPRI		Sumner – CARD	
	Short Run	Long Run	Short Run	Long Run
Foreign Area	0.45	0.78	0.24	N/A
Foreign Mill Use	-0.37	-0.49	-0.25	N/A

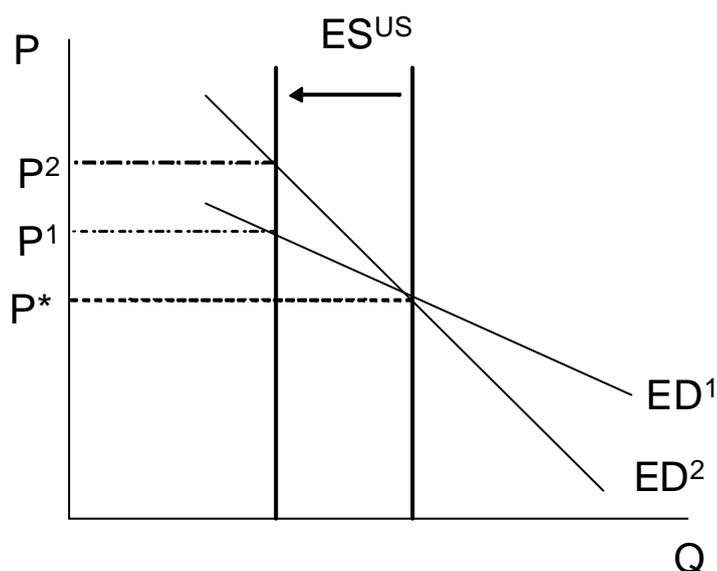
80. The net trade position of countries outside of the US is one of a net importer. Since their consumption exceeds their production, their excess demand (ED) is defined as demand (D) – supply (S). The responsiveness of their excess demand (ED) is approximated by the elasticity of the

²⁷ Section V.c of this document.

²⁸ File WDCT2002 Meltdown WORKOUT.xls, provided by Brazil on 13 November 2003. (Exhibit US-115.)

²⁹ Seth D. Meyer, *A Model of Textile Fiber Supply and Inter-Fiber Competition with Emphasis on the United States of America*, Food & Agricultural Policy Research Institute, University of Missouri, 2002.

domestic demand less the elasticity of their domestic supply. In the case of the Meyer model, the elasticity of excess demand is $-0.37 - 0.45 = -0.82$. For the Sumner model, the elasticity of excess demand is $-0.25 - 0.24 = -0.49$. This fundamental difference has a direct impact on the price impacts generated by the model, as evidenced by the following chart. The line ED1 represents an excess demand curve with more price responsiveness, while ED2 is an excess demand curve with less elasticity. The intersection of excess demand outside of the United States with excess supply (ESUS) from the United States generates an equilibrium price. When there is a reduction in the excess supply from the United States, the elasticity of excess demand, which is reflected by the slope of the line has a direct impact on the change in price. Dr. Sumner's choice of international supply and demand elasticities leads to exaggerated price impacts.



VIII. CONCLUSION

81. The Sumner models, as presented by Brazil, are so laden with faulty theory on programme impacts and so deviate from the FAPRI standards that they cannot provide any foundation for the Panel's analysis of the effect of challenged United States programmes with respect to upland cotton. Not only does the Sumner model contain major differences from previous FAPRI work, it also appears to be internally inconsistent as the United States has noted changes in described methodology from the original Annex I submission to later submissions, such as Exhibit Bra-313 and subsequent documentation.

82. Virtually all of the concerns of the United States cited in this critique are directed toward Brazil economic manipulation that exaggerates acreage impacts of the United States upland cotton programme.

- Brazil's impacts attributed to decoupled programmes deviate from traditional FAPRI analysis.
- Brazil's impacts attributed to crop insurance programme are not supported by FAPRI analysis.
- Brazil's impacts attributed to the export credit guarantee programme have no demonstrated economic foundation.
- Brazil's Annex I results used baselines that were inexplicably lower than even FAPRI's preliminary November 2002 baseline.
- Brazil's non-linear approach to results deviated from the traditional FAPRI methodology.

- 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

<i>EC – Sugar Exports I (Australia)</i>	GATT Panel Report, <i>European Communities – Refunds on Exports of Sugar (Complaint by Australia)</i> , L4833 - 26S/290, adopted 6 November 1979
<i>EC – Sugar Exports II (Brazil)</i>	GATT Panel Report, <i>European Communities – Refunds on Exports of Sugar (Complaint by Brazil)</i> , L/5011 – 27S/69, adopted 10 November, 1980.
<i>US – FSC</i>	Appellate Body Report, <i>United States – Tax Treatment for “Foreign Sales Corporation”</i> , WT/DS108/AB/R, adopted 20 March 2000.
<i>US – 1916 Act</i>	Appellate Body Report, <i>United States – Anti-Dumping Act of 1916</i> , WT/DS136/AB/R, adopted 26 September 2000.
<i>US – Corrosion-Resistant Steel</i>	Appellate Body Report, <i>United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan</i> , WT/DS244/AB/R, adopted 9 January 2004.

List of Exhibits

Agricultural Outlook Tables, USDA, November 2003, Table 19	Exhibit Bra- 394
“Trade Issues Facing the US Cotton Industry,” Speech by Dr. Mark Lange, President and CEO, National Cotton Council, 6 January 2004.	Exhibit Bra- 395
“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
Acreage Discrepancies.xls	Exhibit Bra- 399
List of Publications of Professors Babcock and Beghin	Exhibit Bra- 400

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 that 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

The Appellate Body's Decision

1. Prior to answering the Panel's specific questions, Brazil makes the following introductory comments. Generally speaking, with respect to the Panel's Questions 257(a) – (c), Brazil does not believe that the Appellate Body Report in *US – Corrosion-Resistant Steel* has a significant impact on the legal standards or the elements of Brazil's "per se" or threat of serious prejudice claims. This is because, unlike the USDOC Policy Bulletin in *US – Corrosion-Resistant Steel*, the measures at issue in this dispute, on their face, require the payment of subsidies to eligible producers, users, and exporters. The record in this dispute shows that US government officials enjoy no flexibility to apply the US subsidy programmes in a WTO-consistent manner.

2. The *US – Corrosion-Resistant Steel* decision does make the important conclusion that panels cannot reject on a jurisdictional basis "per se" claims against measures that on their face are not mandatory.¹ This Panel therefore need not examine whether the subsidy measures that Brazil has challenged are mandatory as a preliminary jurisdictional matter. However, this does not mean that the mandatory nature of measure is not important in deciding the merits of a "per se" (or threat of serious prejudice) claim. Indeed, the Appellate Body's analysis of the merits of Japan's "per se" claims in *US – Corrosion-Resistant Steel* appeared to turn largely on whether the measure was "mandatory", i.e., whether it required USDOC officials to analyze sunset reviews in a WTO-inconsistent manner.

¹ Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 88.

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*” challenges require demonstration that either the text or the operation of a measure creates requirements for government officials to act in a WTO-inconsistent manner. Where the text is not completely clear, the Appellate Body found that panels must determine whether the measure creates “normative” requirements, i.e., whether the measures are treated as binding by government officials, are interpreted as binding on executive branch officials by courts, or are consistently applied in a manner suggesting that the measures are considered to be mandates for action.⁶

5. Further, the *US – Corrosion-Resistant Steel* decision highlights the importance of challenges to legal/regulatory measures as a way to avoid repeated WTO dispute settlement challenges in “as applied” claims. In describing what is a “measure,” the Appellate Body recalled:

[I]n GATT and WTO dispute settlement practice, panels have frequently examined measures consisting not only of particular acts applied only to a specific situation, but also of acts setting forth rules or norms that are intended to have general and prospective application. In other words, instruments of a Member containing rules or norms could constitute a “measure”, irrespective of how or whether those rules or norms are applied in a particular instance. This is so because *the disciplines of the GATT and the WTO, as well as the dispute settlement system, are intended to protect not only existing trade but also the security and predictability needed to conduct future trade*. This objective would be frustrated if instruments setting out rules or norms inconsistent with a Member's obligations could not be brought before a panel once they have been adopted and irrespective of any particular instance of application of such rules or norms. *It would also lead to a multiplicity of litigation if instruments embodying rules or norms could not be challenged as such, but only in the instances of their application. Thus, allowing claims against measures, as such, serves the purpose of preventing future disputes by allowing the root of WTO-inconsistent behaviour to be eliminated.*⁷

6. Consistent with the language quoted above, Brazil’s various challenges to US legal/regulatory instruments “*per se*” are intended to protect the security and predictability that Brazil’s upland cotton producers need to conduct future trade. In addition, resolution of Brazil’s separate threat of serious

² Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 168.

³ Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 178.

⁴ Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, paras. 182-184, 187-189.

⁵ Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, paras. 189-190.

⁶ Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, paras. 99, 168.

⁷ Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 83 (emphasis added; references in original omitted).

prejudice claim under the *EC – Sugar Exports and US – FSC* rationales will prevent future disputes by addressing the root cause of the United States’ WTO-inconsistent behaviour – the absence of any legal or regulatory limitations on subsidy payments, which creates a structural and permanent source of uncertainty in upland cotton markets.⁸ Brazil has demonstrated that the mandatory US subsidy measures function to guarantee a high level of US upland cotton production and exports, and by definition, act to suppress world prices because of the increased supply by US producers of a fungible commodity.⁹ Brazil further demonstrated that Brazilian producers are reluctant to engage in significant investments in leasing or purchasing land for upland cotton production because of the uncertainty caused by locked-in US production.¹⁰ Brazil also recalls its position that requiring an “imminent threat” standard, as proposed by the United States, would in effect require Members such as Brazil to litigate claim after claim on the *application* of these measures, which threaten to cause serious prejudice to its interests.

7. Finally, Brazil notes that the Appellate Body’s conclusions in *US – Corrosion-Resistant Steel* regarding the mandatory/discretionary distinction, although based on provisions of the Anti-Dumping Agreement, are equally relevant to claims under any of the covered agreements, including Brazil’s claims under the SCM Agreement, the Agreement on Agriculture, and Article XVI of GATT 1994.¹¹

- (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**

Brazil’s Answer

8. Application of the *US – Corrosion-Resistant Steel* criteria requires a complainant bringing a per se claim to demonstrate that a measure does not provide relevant government officials with the flexibility to apply the measure in a WTO-consistent manner. As Brazil has argued¹², US government officials are not provided with any flexibility to make Step 2 subsidies under Section 1207(a) of the 2002 FSRI Act in a WTO-consistent manner. Thus, the Act violates Articles 3.3 and 8 of the Agreement on Agriculture, and Articles 3.1(a) and 3.1(b) of the SCM Agreement. The United States has conceded that “subject to the availability of funds (that is, the availability of CCC borrowing authority), Step 2 payments must be made to all those who meet the conditions for eligibility”.¹³ The

⁸ Brazil’s 18 November 2003 Further Rebuttal Submission, paras. 203-216; Brazil’s 9 September 2003 Further Submission, paras. 413-436.

⁹ Brazil’s 18 November 2003 Further Rebuttal Submission, paras. 200-202.

¹⁰ See Annex III of Brazil’s 9 September 2003 Further Submission; Brazil’s 9 September 2003 Further Submission, Section 6.3; Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003); Brazil’s 18 November 2003 Further Rebuttal Submission, para. 203.

¹¹ The Appellate Body noted with respect to Article 17.3, the consultation clause of the Anti-Dumping Agreement, that there is “no threshold requirement, in Article 17.3, that the measure in question be of a certain type”. Moreover, it has drawn the conclusion from the phrasing of Article 18.4 of the Anti-Dumping Agreement that “the entire body of generally applicable rules, norms and standards adopted by Members in connection with the conduct of anti-dumping proceedings” should be potentially subject to dispute settlement.¹¹ The provisions of Article 17.3 of the Anti-Dumping Agreement are closely modeled on those of GATT Article XXIII:1 which are cross-referenced in Article 30 of the SCM Agreement and Article 19 of the Agreement on Agriculture, and the provisions of Article 18.4 are virtually identical to Article XVI:3 of the Marrakesh Agreement Establishing the WTO.

¹² Brazil’s 24 June 2003 First Submission, paras. 93-96, 244-45 and 250; Brazil’s 22 August 2003 Comments to the US 11 August 2003 Answers to Questions 92-93, 96, 99 and 107.

¹³ US 11 August 2003 Answer to Question 109.

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 products¹⁷ and at least one scheduled product¹⁸, the United States has in fact circumvented its export subsidy reduction commitments. This is somewhat akin to an “as applied” claim, 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 products²⁰, 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” as opposed to “discretionary”. Rather, to determine whether CCC export credit guarantees for scheduled products threaten to lead to circumvention of the US export

¹⁴ US 22 December 2003 Answers to Question 254.

¹⁵ Brazil’s 24 June 2003 First Submission, para. 95.

¹⁶ US 22 December 2003 Answer to Question 196, para. 12 (based on October 2002-September 2003 fiscal year data).

¹⁷ See Brazil’s 2 December 2003 Oral Statement, para. 87.

¹⁸ See Brazil’s 2 December 2003 Oral Statement, para. 89 (and note 179).

¹⁹ Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 150.

²⁰ See Brazil’s 18 November 2003 Further Rebuttal Submission, para. 256 (and note 414).

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 will continue not to meet costs because they do not, and are not adjusted to, offset credit risks, and are, further, capped at one per cent.²⁵ Given the forward-looking nature of this analysis, Brazil does not agree with the United States that item (j) necessarily “requires a certain retrospection”.²⁶

(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"

²¹ See Brazil’s 2 December 2003 Oral Statement, paras. 90-91; Brazil’s November 2003 Further Rebuttal Submission, paras. 258-262.

²² Exhibit Bra-295 (2004 US Budget, Federal Credit Supplement, Introduction and Table 2 (CCC Export Loan Guarantee Programme classified as “Mandatory” in Table 2, and in the “Introduction”, the Office of Management and Budget states that Table 2 provides “the programme’s BEA classification under the Budget Enforcement Act (BEA) of 1990 as discretionary or mandatory”).

²³ Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 93.

²⁴ See Brazil’s 18 November 2003 Further Rebuttal Submission, paras. 243, 245-253 and the references cited therein.

²⁵ See Brazil’s 18 November 2003 Further Rebuttal Submission, para. 252 (and all citations). Given the forward-looking nature of this analysis, Brazil does not agree with the United States that item (j) necessarily “requires a certain retrospection”. (US 22 December 2003 Answers to Questions, para. 103).

²⁶ US 22 December 2003 Answers to Questions, para. 103.

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

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* and *EC – Sugar Exports*, there was no legal mechanism to limit the amount of potential subsidies that could be paid. The threat was and is tangible

20. The price-trigger mechanism contained in certain of the programmes does not minimize the threat of serious prejudice. In fact, the very existence of the mandatory marketing loan, Step 2 and counter-cyclical payment programme alone impacts farmers’ planting decisions. Even when farmers expect market price levels that would not trigger these payments, farmers know that there is a certain likelihood that their expectations will turn out to be wrong and prices will turn out much lower than anticipated. However, history has taught US upland cotton producers to know with certainty that they will not suffer any economic harm from their misperception of prices for the upcoming marketing year. Any downside market revenue risk is covered by the combined effects of the marketing loan and counter-cyclical payment programmes, as well as by the effects of certain crop insurance policies such as revenue insurance. In short, the mandatory US subsidies mean that high US production and exports are guaranteed.

21. Further, these programmes have effects on production decisions of US farmers *via* a second mechanism, as Brazil and Professor Sumner have detailed at the second meeting of the Panel.³³ Even if farmers expect upland cotton prices (cash prices as well as the adjusted world price) to be above the trigger prices for marketing loan, counter-cyclical and Step 2 payments, farmers will expect with a certain likelihood that prices might nevertheless turn out to be below these trigger prices, i.e., farmers have a probability distribution for expected prices. Given this probability distribution, Professor Sumner explained at the second meeting of the Panel that farmers would still expect some payments from these programmes.³⁴ Thus, these programmes impact farmers planting decisions, increasing and locking in a high US supply of upland cotton that causes adverse effects.

22. Finally, Brazil has demonstrated that the “chilling effect” of guaranteed US subsidies leads to reduced investment of Brazilian farmers in upland cotton production.³⁵ Indeed, USDA itself acknowledges – with respect to soybeans, but equally applicable to upland cotton – that low international prices have had negative impacts on additional investments and increases in production in Brazil.³⁶ This “chilling effect” is the result of Brazilian and other countries’ farmers’ perception of the threat of serious prejudice from the US upland cotton subsidies.

(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.)?

³² Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

³³ See Brazil’s 2 December 2003 Oral Statement, para. 48 and Exhibit Bra-371 (Simple Example of the Calculation of Expected Marketing Loan Benefit); Brazil’s 22 December 2003 Answers to Questions, para. 155.

³⁴ Exhibit Bra-371 (Simple Example of the Calculation of Expected Marketing Loan Benefit).

³⁵ Brazil’s 9 September 2003 Further Submission, Section 6.3 and Annex III; Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003); Brazil’s 18 November 2003 Further Rebuttal Submission, para. 203.

³⁶ Brazil’s 9 September 2003 Further Submission, para. 455 and Exhibit Bra-263 (“Argentina & Brazil Sharpen Their Competitive Edge,” USDA, Agricultural Outlook, September 2001, p. 32).

Brazil's Answer

23. As detailed in Brazil's answer to Question 257(a)(ii) and (b), marketing loan, Step 2, crop insurance, direct and counter-cyclical payment subsidies are mandatory within the traditional mandatory/discretionary distinction. Thus, the Appellate Body decision in *US – Corrosion-Resistant Steel* does not affect the legal standard and elements for Brazil's *per se* claims against those subsidy programmes.³⁷

(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

Brazil's Answer

24. Brazil understands the ordinary meaning of "normative" to be "establishing a norm or standard of; deriving from or implying a standard or norm; prescriptive".³⁸ In the sense of the term used by the Appellate Body in *US – Corrosion-Resistant Steel*, the US statutes and regulations summarized in paragraphs 415 and 423 of Brazil's 9 September Further Submission³⁹ are "normative" because they establish (a) obligations for US officials to make payments, and (b) legal rights for eligible producers, users, and exporters to receive the payments. As used by the Appellate Body, the term "normative" includes as a subcategory the group of measures that are mandatory, within the meaning of the traditional mandatory/discretionary distinction.

25. The United States has acknowledged that 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".⁴⁰ In addition, the direct payment provisions of the 2002 FSRI Act similarly provide that "payment [is] required" and the "Secretary shall make direct payments to producers on farms for which payment yields and base acres are established".⁴¹ Finally, the crop insurance payment provisions of the 2000 ARP Act also create "norms" in the form of mandated payments of subsidies for "catastrophic risk protection" and "alternative catastrophic coverage" that "shall" be provided to all eligible producers.⁴² Thus, the statutory and regulatory provisions mandating payments for each of these five types of subsidies are, by any reasonable definition, "normative" measures.

26. The Panel asks further whether Brazil's response differs depending on whether the payments are dependent upon market price conditions. The answer is "no".

27. As Brazil has argued before, the fact that marketing loan, counter-cyclical and Step 2 payments may not be made due to higher prices does not mean that these subsidy programmes are not mandatory.⁴³ The focus for deciding whether a measure is mandatory or discretionary is on whether it

³⁷ While a *per se* claims against non-mandatory measures under Article 5(c) and footnote 13 of the SCM Agreement seems possible, the Panel is not faced with such a situation in this case, as all the measures challenged by Brazil are, in fact, of a mandatory nature.

³⁸ New Shorter Oxford Dictionary, 1993 edition, p. 1941.

³⁹ Each of these statutory and regulatory provisions were discussed in more detail in paragraphs 312-341 of Brazil's 9 September 2003 Further Submission.

⁴⁰ US 27 October 2003 Answer to Question 162, para 95.

⁴¹ Brazil's 9 September 2003 Further Submission, para. 333 citing Section 1103(a) of the 2002 FSRI Act.

⁴² Brazil's 9 September 2003 Further Submission, para. 319 citing Section 508(b)(1), (2), and 508(c)(1)(A) of the 2000 ARP Act.

⁴³ Brazil's 7 October 2003 Oral Statement, paras. 50-51.

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 largely unlimited subsidies required to be provided in MY 2003-2007 under the 2002 FSRI Act and the 2000 ARP Act (and implementing regulations) is key evidence demonstrating an ongoing, significant threat of significant price suppression and increased and inequitable US world market shares in the period MY 2003-2007.

34. In Brazil's view, a "threat of serious prejudice" claim is, in the Panel's word, "something else" – a *sui generis* claim. Brazil considers that the Appellate Body was advising against slavish adherence to the "*per se*" and "as applied" labels – intimately related to the traditional mandatory/discretionary distinction – when it cautioned in *US – Corrosion Resistant Steel* "against the application of this distinction in a mechanistic fashion".⁴⁶ If a claimant proves the elements of a threat claim, as set out in *EC – Sugar Exports* and *US – FSC*, it succeeds on the merits, regardless whether the claim is labelled "*per se*" or "as applied" – terms which are not themselves found in Part III of the SCM Agreement.

35. In the case of a "threat" claim, this note of caution is particularly apt. In proving its threat of serious prejudice claim, Brazil has followed the rationale in *EC – Sugar Exports* and *US – FSC*, demonstrating the "mandatory" nature of the legal/regulatory instruments by which the subsidies are paid, together with the unlimited amount of products that may receive the subsidies, and the extent to which those legal/regulatory instruments fail to stem or control the flow of the subsidies.⁴⁷ Brazil has backed up this evidence with historical data regarding the unlimited way in which the legal/regulatory instruments have been applied to grant payments to US upland cotton farmers during the period MY 1999-2002.

36. This data gives context to the nature and extent of the threat posed by the mandatory legal/regulatory instruments at hand. The data is critical, because it demonstrates that even if the measures are not mandatory (which they are), the US authorities have always applied the measures in a way that would cause serious prejudice. Since payments have never been withheld, the data demonstrates, at the very least, that the US authorities treat the measures as "normative", as that term was used by the Appellate Body in *US – Corrosion Resistant Steel*.⁴⁸

37. Brazil turns now to its claims regarding the three CCC export credit guarantee programmes. As discussed in Brazil's response to question 257(a)(i), Article 10.1 prohibits circumvention, and the threat of circumvention, of export subsidy reduction commitments. As discussed above, Brazil has demonstrated actual circumvention with respect to both unscheduled products and at least one scheduled product. This is somewhat akin to an "as applied" claim against guarantees issued under the CCC programmes. It is therefore not relevant to this claim whether the CCC programmes are mandatory or discretionary.

38. Brazil has also demonstrated that the three CCC programmes pose a threat of circumvention. Brazil's threat of circumvention claims are against the programmes as such. With respect to unscheduled products, it constitutes threat of circumvention to provide *any* export subsidies for

⁴⁵ Brazil's 9 September 2003 Further Submission, paras. 422-423.

⁴⁶ Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 93.

⁴⁷ Brazil refers the Panel to the additional discussion regarding the mandatory nature of the US measures and Brazil's threat of serious prejudice claim in its Answer to Question 257(a)(ii) *supra*.

⁴⁸ Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 93.

unscheduled products. Under *US – FSC*, it does not appear to be relevant to this claim whether the CCC programmes are mandatory or discretionary. With respect to unscheduled products, the test under Article 10.1 is whether export subsidies are made available to those products. With respect to scheduled products, the test under Article 10.1 is also not whether the CCC programmes are “mandatory” as opposed to “discretionary”. Rather, the question set out 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.

39. Brazil turns now to its claims under Articles 1.1 and 3.1(a) of the SCM Agreement, which are against the CCC programmes themselves. 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 demonstrated 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 themselves “mandate” a violation, under the traditional meaning of the mandatory/discretionary principle.

40. Finally, Brazil’s claims under item (j) of the Illustrative List of Export Subsidies are both against guarantees granted under the three CCC programmes, and against the CCC programmes themselves. First, Brazil has demonstrated that, retrospectively, costs and losses incurred by the programmes exceeded premiums collected over a 10-year period. This is somewhat akin to an “as applied” claim against guarantees issued under the CCC programmes. It is therefore not relevant to this claim whether the CCC programmes are mandatory or discretionary. Second, Brazil has demonstrated that, looking forward, premium rates for the CCC programmes, and not just premiums collected, do not and will continue not to meet costs because they do not, and are not adjusted to, offset credit risks, and are, further, capped at one percent.⁴⁹ As statements by USDA’s Office of the Inspector General and the US General Accounting Office demonstrate, the CCC programmes do not have the flexibility under US law to offset credit risks and meet costs. This is effectively the equivalent of saying that the CCC programmes themselves “mandate” a violation, under the traditional meaning of the mandatory/discretionary principle.

(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

Brazil's Comment

41. Brazil offered the evidence mentioned by the Panel (as well as evidence regarding CCC’s obligation to make available an additional annual amount of at least \$1 billion in direct credits or guarantees for exports to “emerging markets”⁵⁰) to demonstrate, with respect to scheduled products, its threat of circumvention claim under Article 10.1 of the Agreement on Agriculture. Brazil has already noted that the test under Article 10.1 is not whether the CCC programmes are “mandatory” as opposed to “discretionary”. Rather, to determine whether CCC export credit guarantees for scheduled

⁴⁹ For this reason, Brazil does not agree with the United States that an item (j) analysis necessarily “requires a certain retrospection” (US 22 December 2003 Answers to Questions, para. 102).

⁵⁰ See Exhibit Bra-366 (7 U.S.C. § 5622 note, “Promotion of Agricultural Exports to Emerging Markets, para. (a) (“The Commodity Credit Corporation shall make available for fiscal years 1996 through 2002 not less than \$1,000,000,000 of direct credits or export credit guarantees for exports to emerging markets under section 201 or 202 of the Agricultural Trade Act of 1978 (7 U.S.C. 5621 and 5622), in addition to the amounts acquired or authorized under section 211 of the Act (7 U.S.C. 5641) for the programme.”)). See also Exhibit Bra-367 (Section 3203 of the 2002 FSRI Act (extending mandate to 2007)).

products threaten to lead to circumvention of the US export subsidy reduction commitments, 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.

- (e) **Does the US agree that, under the Budget Enforcement Act of 1990, the Office of Management and Budget classifies the export credit guarantee programmes as "mandatory" (see Brazil's response to Panel Question 142, para. 89)? Does this exempt the programmes from the requirement to receive new Congressional budget authority before it undertakes new guarantee commitments (e.g. Exhibit BRA-117 (2 USC 661(c)(2)))? USA**

Brazil's Comment

42. As noted in Brazil's response to question 257(a)(i), Brazil has provided evidence that the CCC programmes are “mandatory,” within the meaning of that term under US law (although that is not to say that the CCC programmes are not also mandatory, within the meaning of WTO/GATT law).

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

Brazil's Answer

43. Brazil appreciates the opportunity to describe to the Panel the methodology that it will apply to the data, should the United States produce it on 20 January 2004. As the Panel noted in its 12 January Communication, the United States failed on 18/19 December 2003 to comply with its obligation to provide the requested data in a non-“scrambled” form. Therefore, Brazil is not in a position to apply the methodology discussed below and to present its results to the Panel today. If the United States does not produce non-scrambled and otherwise complete data responsive to the Panel's request, on 28 January 2004, Brazil will provide further comments and make requests as appropriate.

44. Generally, Brazil's methodology will calculate the amount of expenditures that support upland cotton production by examining farm-specific contract and planted acreage data. For each of these farms, Brazil would calculate the amount of contract payments for each crop for which the upland cotton farm has base acreage.⁵¹ To that end, for each crop, the amount of contract payment units (as provided by the United States⁵²) would be multiplied by the payment rate for the subsidy programme (PFC, market loss assistance, direct and counter-cyclical payments) in the marketing year in question.⁵³ Brazil will allocate crop contract payments to the respective crop for which they are made for each farm, up to the amount of acreage actually planted to that crop. For example, any contract payment for an upland cotton base acre that is actually planted to upland cotton is deemed

⁵¹ These crops include all crops that constitute programme crops for purposes of the PFC, market loss assistance, direct and counter-cyclical payment programmes.

⁵² In case the United States does not provide the payments units with its 20 January 2004 data, they can be easily calculated by multiplying the contract acreage for a crop with the payment yield for that crop. The payments units are calculated as 85 percent of that figure.

⁵³ Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19 provides payment rates for PFC, direct and counter-cyclical payments in a column called “income support rates” for marketing years 1999-2002. However, rice payments for MY 2002 appear to be reported in error, since no rice counter-cyclical payments were made. In fact, the full rice counter-cyclical payment was made in MY 2002 (*see* Exhibit Bra-173 (Revised Estimate of Support Granted by Commodity via Counter-Cyclical Payments)). The full rice CCP is \$1.65 (*see* Exhibit Bra-27 (“Side by Side Comparison of the 1996 and 2002 Farm Act, p. 2-5) report the rice target price as \$10.50 per cwt, the direct payment rate as \$2.35 per cwt and the loan rate as \$6.50 per cwt, resulting in a full CCP payment of \$1.65 per cwt or \$0.00748 per pound).

support to upland cotton. If non-upland cotton base acres on a farm are planted to upland cotton, payments made for these base acres would also be deemed to constitute support to upland cotton.

45. Application of Brazil's methodology would require the writing of a simple computer programme that calculates the contract payments that constitute support to upland cotton for any farm in the United States that receives contract payments and plants upland cotton. The individual farm data would then be tabulated to calculate a total amount of expenditures provided in support of the production of upland cotton.

46. Brazil provides below additional details concerning its methodology. The data that has been withheld by the United States will show farms with many different combinations of base acreage and upland cotton plantings. There may be farms with more upland cotton base acres than planted acres, or with less base acres than planted acres. There may be farms that plant only upland cotton, or farms that have other programme crops as well. Finally, farms may have more or less crop base acreage than they plant to programme crops. Brazil systematically presents below a number of sample farms and illustrates how its allocation methodology will be applied to the actual data for each type of farms.

47. In a first step, Brazil considers three general categories of upland cotton farms: (1) those with fewer planted upland cotton acres than upland cotton base acres, (2) those with more planted upland cotton acres than upland cotton base acres, and (3) those planting cotton without any upland cotton base acres.⁵⁴ The table below illustrates this for the three categories of farms:

Sample Farm No.	Farm 1	Farm 2	Farm 3
Type of Cotton Farm	Farm With Cotton Plantings Below Cotton Base	Farm With Cotton Plantings Exceeding Cotton Base	Farm With Cotton Plantings But No Cotton Base
Cotton Base	100 acres	100 acres	0 acres
Cotton Plantings	50 acres	150 acres	100 acres
Payments Allocated In A First Step	Payments for 50 Cotton Base Acres	Payments for 100 Cotton Base Acres	No Payments for Cotton Base Acres

Sample Farm 1 plants 50 acres of its 100 upland cotton base acres to upland cotton. Thus, any payments for these 50 upland cotton base acres constitute support to upland cotton.⁵⁵ Since contract payments for all acres planted to upland cotton are allocated therewith, the calculation ends for this farm (and any farm in a similar position). Any payments associated with the other 50 upland cotton base acres are not considered, as they do not constitute support to upland cotton. Sample Farm 2 plants 150 acres of upland cotton, but has only 100 acres of upland cotton base. The entire upland cotton base payments, therefore, constitute support to upland cotton. Sample Farm 3 plants 100 acres of upland cotton, but has no upland cotton base. No upland cotton base payments can be allocated in this case. Thus, in this overly simple methodology, support to upland cotton would be calculated only by adding up the amount of upland cotton payments received on land that currently produces upland cotton. However, Brazil believes the Panel should also include as support to upland cotton contract payments on non-upland cotton base acreage that is currently planted to upland cotton. For example, for Sample Farms 2 and 3 above, for which payments for less upland cotton acres than actually planted were allocated in this first step, additional contract payments made for other contract crop base could be allocated as support to upland cotton in a second step, provided they are available on

⁵⁴ In later steps, Brazil will discuss what happens when the farms have other crop contract payment base and how this may be allocated.

⁵⁵ The amount payments results from multiplying the payment rate for the contract crop, including for upland cotton, by the amount of base acres involved. The respective contract payment amounts to 85 per cent of this figure. Payment rates are published by USDA, *see* Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19).

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			
Crop	Cotton	Rice	Corn
Crop Base	100 acres	100 acres	100 acres
Crop Plantings	160 acres	40 acres	100 acres
Crop Base Allocated as Support for the Crop in Question	100 acres	40 acres	100 acres
Remaining Crop Base Available for Allocation	0 acres	60 acres	0 acres
Crop Plantings To Which Additional Payments Will Be Allocated	60 rice acres	0 acres	0 acres

Sample Farm 4 plants three crops (upland cotton, rice and corn) having 100 base acres for each crop. All 100 corn base acres are planted to corn and, thus, any corn contract payments made for the corn base constitute support to corn. However, only 40 of the 100 rice base acres are planted to rice and, consequently, only payments for those 40 rice base acres constitute support to rice. Sample Farm 4 plants 160 acres of upland cotton, but has only 100 upland cotton base acres. Thus, all payments on the entire 100 upland cotton base acres represent support to cotton. In addition, payments for the 60 rice base acres not planted to rice but to upland cotton also represent support to upland cotton.

49. Sample Farm 4 was a farm for which the total base acreage and the total acreage planted to programme crops were equal. However, there may be instances in which farms plant more (or less) acreage to programme crops than they used to do in the past establishing their base acreage.

50. The following two tables explain how Brazil's methodology addresses the issue of farms that plant more acreage to programme crops than they have base acreage (Sample Farm 5) and farms that plant less acreage to programme crops than they have base acreage (Sample Farm 6).⁵⁶ In Brazil's methodology, payments available for allocation – i.e., not allocated to the programme crop itself – are pooled and allocated proportionally to the remaining programme crop acreage.⁵⁷ Brazil's approach of pooling payments from additional base acres not planted to the respective programme crop and allocating these payments proportionally as support to crops, for which plantings exceeds base acreage, ensures that a single dollar is not allocated to two different crops, resulting in double

⁵⁶ Brazil exemplifies the principle for farms with less upland cotton base than upland cotton plantings, but the same principle applies to farms without any upland cotton base.

⁵⁷ Since the United States has not provided the data necessary to do this allocation, Brazil has no information on how often such situations actually occur. However, the record strongly suggests that not many farms would be able to plant more program crops than they have base acreage. In particular for upland cotton, Brazil has demonstrated that it is not economically possible to produce this crop without contract payments. *See inter alia* Brazil's 2 December 2003 Oral Statement, paras. 26-27 and Exhibit Bra-353 (Cumulative Loss From Upland Cotton Production MY 1997-2002 Without Contract Payments).

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 rd	20/60th or 1/3 rd	0	0
Allocation	100 Cotton Base Acres and 2/3 rd of 60 Wheat and 30 Rice Base Acres (40 and 20)	100 Corn Base Acres and 1/3 rd of 60 Wheat and 30 Rice Base Acres (20 and 10)	70 Wheat Base Acres	30 Rice Base Acres

52. The second table shows the allocation of contract payments on Sample Farm 6, a farm with more planted (410 acres) than base acres (400 acres).

⁵⁸ The United States alleges that Brazil's 14/16th methodology would allocate the same contract payments to two different crops resulting in double counting (*see e.g.* US 2 December 2003 Oral Statement, para. 27). The US claim about double counting by Brazil originates in an entirely erroneous understanding of Brazil's 14/16th methodology. As explained many times, Brazil used this methodology only as a proxy, since the United States refused to provide the very data that would allow the calculation of the exact amount of support to upland cotton from contract payments. It makes the assumption that for any acre planted to upland cotton an average contract payment in the amount of an upland cotton contract payment is received.

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 THE SECOND PANEL MEETING

20 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.

(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

1. With respect to the Panel's first question, the United States notes that the Appellate Body's discussion of the "normative character and operation" of an instrument came in the context of its explanation of how to determine whether an instrument is a "measure" subject to challenge in dispute settlement and that the Appellate Body distinguished this question from the separate question of whether the instrument, if a measure, mandates a breach of a WTO obligation under a "mandatory/discretionary" analysis.¹ The Appellate Body explicitly noted that it was not undertaking a comprehensive examination of the relevance or significance of that analysis and, indeed, simply applied it.² An analysis of the normative character and operation of this "requirement" to make available not less than \$5.5 billion in guarantees is not necessary because the parties do not dispute whether the "requirement" is a "measure."

2. Under a "mandatory/discretionary" analysis, the relevant question would be not whether the requirement to make available \$5.5 billion in guarantees per year is as such inconsistent with a provision of the WTO agreements (since Brazil has not claimed that it is), but rather whether the provisions establishing the export credit guarantee programmes mandate a breach of any WTO obligation. As we have explained, they do not. As an initial matter, the requirement that the CCC "make available . . . not less than \$5,500,000,000 in credit guarantees" does not mandate that the CCC actually issue any particular level of credit guarantees.³ This law merely requires that CCC "make available" certain guarantees; the actual issuance of guarantees, however, is within the discretion of the Commodity Credit Corporation, which "may guarantee the repayment of credit made available to

¹ Appellate Body report, *United States - Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan* ("US -Sunset Review"), WT/DS244/AB/R, adopted 9 January 2004, paras. 78, 81-82, 89, and 93.

² *US Sunset Review*, paras. 93, 156, and 172-174.

³ As the United States has previously noted, except for programme year 1992, CCC has *never* issued \$5.5 billion in guarantees in any year during the period 1992 to the present. Sales registrations have been as low as \$2.876 billion for programme year 1997 and have generally hovered in the range of \$3.0 billion - \$3.2 billion. Further Rebuttal Submission of the United States (18 November 2003), para. 201; US Further Submission (30 September 2003), para. 148 and accompanying table entitled CCC Export Credit Guarantee Program Levels, Annual President's Budgets and Actual Sales Registrations, Fiscal Years 1992-2004.

finance commercial export sales of agricultural commodities”.⁴ The statute makes clear that “[e]xport credit guarantees issued pursuant to this section shall contain such terms and conditions as the Commodity Credit Corporation determines to be necessary”.⁵

3. The United States has elsewhere noted the various discretionary elements in the operation of the programme that tamp down the actual issuance of guarantees. These include the regulatory authorities permitting non-issuance of guarantees with respect to any individual application for an export credit guarantee or to suspend the issuance of export credit guarantees under any particular allocation; limitations on commodities with respect to which guarantees may be made available, total guarantee value for individual commodities, destination, time within which export must occur, and internally established exposure limits applicable to individual bank obligors.⁶

4. Furthermore, and more importantly, Brazil’s own approach would require a showing that the programmes mandate that the premium rates will be insufficient to cover long-term operating costs and losses of the programmes. Brazil has not made such a showing, for the simple reason that the programmes do not so mandate. The Commodity Credit Corporation (“CCC”) has discretion concerning numerous aspects of any guarantees it may issue, such as the destinations, types of commodities, and length of term of the guarantee. All of these aspects could affect the question of the long-term operating costs and losses of the programmes. For example, the credit risk involved in some destinations may be less than for others. Similarly, the risk associated with a guarantee of credit extended for one year may be less than for credit extended for three years.

5. Thus, while the provisions establishing the export credit guarantee programmes are measures, they do not mandate an inconsistency with any WTO obligation. Putting aside the US argument that export credit guarantees are not subject to export subsidy disciplines by virtue of Article 10.2 of the Agreement on Agriculture until Members conclude their ongoing negotiations and agree on such disciplines, there is no basis to presume, on the basis of the law itself, that the export credit guarantee programmes provide export subsidies and threaten to lead to circumvention of US export subsidy reduction commitments.⁷ Because the CCC retains the discretion to issue particular guarantees and attach terms and conditions as set out above, the statute alone does not allow a presumption that premium rates will be insufficient to cover long-term operating costs and losses of the programmes. Thus, Brazil’s argument that the CCC is mandated to “make available” \$5.5 billion in export credit guarantees cannot alter the fact that the CCC has discretion to control the guarantees actually provided and the terms of those guarantees; as a result, no WTO inconsistency is mandated.

(e) Does the US agree that, under the Budget Enforcement Act of 1990, the Office of Management and Budget classifies the export credit guarantee programmes as "mandatory" (see Brazil's response to Panel Question 142, para. 89)? Does this exempt the programmes from the requirement to receive new Congressional budget authority before it undertakes new guarantee commitments (e.g. Exhibit BRA-117 (2 USC 661(c)(2)))? USA

6. The Budget Enforcement Act of 1990 (“BEA”) divides spending into two types: “discretionary” spending and “direct” spending.⁸ “Discretionary” spending means budget authority

⁴ 7 U.S.C. 5622(a)(1), (b); *see also id.* 5622(k) (imposing requirement that certain percentages “of the total amount of credit guarantees *issued* for a fiscal year [be] *issued*,” not merely made available, with respect to certain products) (italics added).

⁵ 7 U.S.C. 5622(g).

⁶ US First Written Submission (11 July 2003), fn. 134; 7 C.F.R. Sections 1493.10(d), 1493.40(b) (Exhibit US-6); US Answer to Panel Question 5 (11 August 2003), para. 12 (Exhibit US-12); US Rebuttal Submission (22 August 2003), paras. 180-182; US Further Submission (30 September 2003), paras. 153-156; US Answer to Panel Question 142 (27 October 2003), paras. 56-57.

⁷ *See* Brazil’s Answer to Question 142 from the Panel, para. 88 (27 October 2003).

⁸ *See* OMB Circular A-11 (2003), Section 15: Basic Budget Laws (available at: http://www.whitehouse.gov/omb/circulars/a11/current_year/s15.pdf).

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.

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

TABLE OF CONTENTS

I.	BRAZIL'S INTRODUCTORY COMMENTS.....	441
II.	PROFESSOR SUMNER'S COMMENTS CONCERNING THE US CRITIQUE OF HIS MODEL.....	447

List of Exhibits

Agricultural Outlook Tables, USDA, November 2003, Table 19	Exhibit Bra- 394
“Trade Issues Facing the US Cotton Industry,” Speech by Dr. Mark Lange, President and CEO, National Cotton Council, 6 January 2004.	Exhibit Bra- 395
“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
Acreage Discrepancies.xls	Exhibit Bra- 399
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. The United States Critique asserts that Professor Sumner's choice of baselines has prejudiced the outcome to such an extent that his results are not usable.¹ But the record shows that the significant acreage, production, export and price effects found in Professor Sumner's Annex I results using the CARD international cotton model and the amended FAPRI US crops model based off the (recalibrated) FAPRI preliminary November 2002 baseline are essentially the same even when used against other baselines.² The United States first argued that Professor Sumner should have used the FAPRI 2003 baseline.³ Professor Sumner responded by running his model on that later baseline.⁴ There were no significant changes between Annex I and those results for either the period from MY 1999-2002 or in the period from MY 2003-2007.⁵ The United States Critique raises a new argument that Professor Sumner manipulated the FAPRI preliminary November 2002 baseline.⁶ This allegation is wrong. Any differences are the result of a necessary recalibration of the model following the use of the CARD international cotton model rather than the FAPRI international crops models and some update incorporating more recent macroeconomic data.⁷ As Professor Sumner demonstrates below, there are no significant differences with his Annex I result by using this slightly modified baseline.⁸ Indeed, the fact that Professor Sumner's simulation model generates nearly identical results regardless of the baselines used demonstrates the robustness of the Sumner model.

4. In criticizing Professor Sumner's modelling of the four different types of contract payments, the United States repeats its baseless arguments that the contract payments have absolutely no effect on production decisions for upland cotton. The notion that an estimated⁹ \$4.7 billion¹⁰ of amber box

¹ US 22 December 2003 Comments on Brazil's Econometric Model, paras. 35-38, especially para. 38.

² These other baselines include the original FAPRI preliminary November 2002 baseline and the official FAPRI January 2003 baseline.

³ US 7 October 2003 Oral Statement, paras. 36-39.

⁴ Exhibit Bra-325 (Results of Professor Sumner's Modified Model Based on the January 2003 FAPRI baseline); Exhibit Bra-326 (Results of Professor Sumner's Modified Model) and Exhibit Bra-331 (Description of Methodology Comparing the Analysis of US Upland Cotton Subsidies Under the January 2003 Baseline to Analysis under the November 2002 Baseline, Daniel A. Sumner, November 2003).

⁵ See Exhibit Bra-326 (Results of Professor Sumner's Modified Model).

⁶ US 22 December 2003 Comments on Brazil's Econometric Model, para. 36.

⁷ See Professor Sumner's discussions below, Response to Section III.

⁸ See Professor Sumner's discussions below, Response to Section III.

⁹ Brazil is still waiting the United States to provide the data that would permit the calculation of the exact amount of support to upland cotton from the contract payments. Brazil hopes that the United States will produce the data on 20 January 2004.

(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 effects¹⁵ 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

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 acres to be planted to upland cotton with an implied price decline of 10 cents per pound (or 33 percent of the MY 2001 price).²⁸ Brazil has already addressed the various US critiques of the use of so-called “lagged prices” by noting that USDA, FAPRI, Professor Sumner and a host of other economists have used these prices in countless models and that any use of futures market prices in large-scale simulation models is impossible.²⁹ Further, the faulty and primitive US futures methodology for estimating the production effects of marketing loan programmes is no substitute for the comprehensive models used by USDA, FAPRI and Professor Sumner.³⁰ Most pointedly, the US futures methodology suffers from the fatal flaw that it does not even focus on the price that does get

¹⁹ Brazil’s 9 September 2003 Further Submission, para. 189.

²⁰ Brazil’s 9 September 2003 Further Submission, Annex II (Statement of Andrew Macdonald, paras 49-50).

²¹ US 22 December 2003 Comments on Brazil’s Econometric Model, paras 25-30.

²² Brazil’s 9 September 2003 Further Submission, Table 1, para. 8.

²³ Brazil’s 22 August 2003 Rebuttal Submission, paras. 62-66.

²⁴ Exhibit Bra-63 (C.Edwin Young, Randall D. Schnepf, Jerry R. Skees and William W. Lin: “Production and Price Impacts of US Crop Insurance Subsidies: Some Preliminary Results, p. 4).

²⁵ Brazil’s 22 August 2003 Rebuttal Submission, para. 53.

²⁶ The United States points out a typo (US 22 December 2003 Comments on Brazil’s Econometric Model, paras. 73-74) that did not affect the actual analysis undertaken by Professor Sumner (*see below*, Comments on Section VI).

²⁷ *See below*, Comments on Section VI.

²⁸ Brazil’s 7 October 2003 Oral Statement, paras. 31-33 and the references contained therein.

²⁹ *See* Professor Sumner’s 9 October 2003 Closing Statement attached as Annex II to Brazil’s 9 October 2003 Closing Statement, his 2 December 2003 Oral Statement (Exhibit Bra-342, paras. 24-28), Exhibit Bra-345 (paras. 6-14) as well as Brazil’s 22 December 2003 Answers to Questions, paras. 37-42).

³⁰ *See* Brazil’s 2 December 2003 Oral Statement, paras. 42-55.

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

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.³⁹

13. While the US Government has attacked Professor Sumner's professional integrity, the leaders and members of the US National Cotton Council have gone further during this long dispute. They have met with and pressured Professor Sumner to discontinue his work before the Panel.⁴⁰ Moreover, NCC members have and continue to seek to cut off research and scholarship funds for the University of California at Davis, in protest of Professor's Sumner's work in this dispute.⁴¹ One NCC member representative even went so far as to be quoted as saying that "if this had been a military issue, what Dr. Sumner did would be called treason".⁴² Recently, the President of the NCC threatened both Professors Sumner and Babcock with unspecified action following the end of the WTO proceedings, stating "[i]n another time and venue there will be a full examination of the actions taken by these 2 economists".⁴³ This threat was elaborated in a recent analysis in a leading Agricultural Newspaper, the Western Farm Press:

In the trade issue with Brazil, NCC President and CEO Mark Lange remains incensed at [Brazil's] WTO action. More specifically, he is angry because two US economists hired on to Brazil's payroll and prepared testimony against the United States in the WTO action. University of California economist Dan Sumner, former assistant secretary of agriculture, was hired to assist in the case. Lange added that Sumner 'appears to have hired' Professor Bruce Babcock, an agricultural economist at Iowa State University and director of the Center for Agricultural and Rural Development to attempt to modify the Food and Agricultural Policy Research Institute baseline projections for use by the Brazilians. "This action was taken without the knowledge of FAPRI," said Lange of the University of Missouri-based facility. Lange said Babcock receives federal funds for the CARD programme and he pledged "a full examination of the actions of these two guys" once the WTO issue is settled. California cotton industry leaders and others have protested Sumner's actions to the dean of U.C. Davis school of agriculture and have lobbied for private research and scholarship funds to be withdrawn from the University in protest of Sumner's actions.⁴⁴

14. Over the past six months, NCC members have been instrumental in coordinating efforts to attempt to force officials of the University of California at Davis to require Professor Sumner to stop

³⁹ Exhibit Bra-397 ("Report of the Commission on the Application of Payment Limitations for Agriculture," August 2003).

⁴⁰ Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute", Western Farm Press, 2 September 2003)("group of representatives from cotton, wheat and rice met with Professor Sumner in mid-August to express their displeasure over his testimony before the Panel").

⁴¹ Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute", Western Farm Press, 2 September 2003)(Earl Williams, President of the California Cotton Ginners and Growers Associations was quoted as stating "And we are going to bring pressure to bear on the university that would allow someone from a public, taxpayer supported institution to have such latitude that can reap such harm on the supporters of the University").

⁴² Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute", Western Farm Press, 2 September 2003) quoting Earl Williams.

⁴³ Exhibit Bra-395 ("Trade Issues Facing the US Cotton Industry," Speech by Dr. Mark Lange, President and CEO, National Cotton Council, San Antonio, January 6)(underlining added); See also Exhibit Bra- 398 (Western Farm Press, 7 January 2004 , p. 3).

⁴⁴ Exhibit Bra-398 (Western Farm Press, 7 January 2004, p. 2).

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 FAPRI and CARD models. Professor Babcock's letter⁴⁶ is addressed to leading House and Senate staff members who have "relied on FAPRI and CARD to provide objective and high quality quantitative and qualitative assessment of US farm policy alternatives". Professor Babcock's letter states he is "prepared to do whatever it takes to mend this relationship, including disassociating myself from future official FAPRI analyses if so desired". The letter provides the Panel with insights into the type of pressure imposed by the NCC on the economists providing the Panel with assistance in this dispute.

16. These efforts by the representatives of the US upland cotton producers who are heavily dependent upon US subsidies and US Congressional support for their economic survival is perhaps understandable, but nonetheless deplorable. Professor Sumner has demonstrated considerable courage and fortitude in continuing his work to assist the Panel and ultimately all WTO Members in this dispute. Brazil has no doubts that the United States is also appalled at the prospect that either of these two distinguished economists would suffer any adverse professional consequences from their assistance to the Panel and the Parties in this dispute. Given the obligation of all WTO Members to cooperate and assist the Panel in making an objective assessment of the facts of a dispute, Brazil is certain the United States will unequivocally condemn any such threats, including those now being made by the US National Cotton Council.

17. With these introductory remarks in mind, Brazil presents below Professor Sumner's response to the US 22 December 2003 Comments Concerning Brazil's Econometric Model.

⁴⁵ Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute," Western Farm Press, 2 September 2003).

⁴⁶ Exhibit US-114.

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

21. Most of the substantive issues raised in the US critique are simply re-statements of assertions that the United States disagrees with the modelling choices made in Annex I.⁵⁰ My arguments for why I modelled the policies as I did have been provided to the Panel on several previous occasions and there is no reason to repeat those arguments in this document. I will refer to those arguments as necessary in footnotes.

⁴⁷ See my Closing Statement on 9 October 2003, attached as Annex II to Brazil's 9 October 2003 Closing Statement, and my statements in Exhibits Bra-313 to 315, my 2 December 2003 Statement to the Panel in Exhibit Bra-342, as well as the detailed reactions to US criticism of my model in Exhibits Bra-343-345.

⁴⁸ See Annex I to Brazil's 9 September 2003 Further Submission and Exhibit Bra-313.

⁴⁹ Some of the economic material presented by the United States in this case has been authored directly by Dr. Glauber. I note that the 22 December 2003 "Comments" are not attributed to anyone by name, therefore I am unable to respond directly to any individual person with respect to these personal charges.

⁵⁰ However, the United States does not propose other methods for modelling the subsidy programmes in case they disagree with my model choices. They simply state that these programmes should not cause any effects – a position that is clearly untenable given the other economic evidence about the effects of the programs, including statements by the users and beneficiaries of the programmes.

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 documentation⁵¹, 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 economists⁵² who are familiar with “official” FAPRI analysis of US policy questions, but who have not followed these proceedings closely. In that letter, Professor Babcock explained to them what he and I have always been clear about and had already stated to this Panel. My analysis used part of the FAPRI modelling system, but was not conducted by the full FAPRI team and was not “official” FAPRI analysis. These Congressional staff members had not had access to Annex I or other material submitted to this Panel and Professor Babcock felt a need to clarify these facts. There was no new information in the letter that he sent these staff members that was not already included in Annex I and in the subsequent material provided to the Panel.

24. For example, Professor Babcock points out that the baseline was the November 2002 preliminary FAPRI baseline not the official 2003 FAPRI baseline that became available after I undertook my analysis. He also points out that I used the CARD international cotton model rather than the FAPRI full international model in my analysis.⁵³ This is not new to those of us who have participated in this Panel proceeding, but Professor Babcock decided to make these clarifications to the Congressional staff members.⁵⁴

25. One point made in the Babcock letter – and emphasized in the US critique – is the obvious fact that if a different team of analysts with a different model had conducted the analysis the results would have been different. That is always true. Different analysts to whom the same question is posed would come up with at least a somewhat different model. Obviously a FAPRI team conducting an official “FAPRI” analysis would have developed a model that is at least somewhat different from my adaptations. In part this occurs because, with complex issues involved, the questions themselves may be interpreted slightly differently, and because, in many cases, there are a range of equally acceptable approaches to an economic modelling choice. It is much less clear how the direction of the results would have changed if different teams with different models conducted analyses. As the review of the independent literature and the independent models in this case suggests, most analyses of US cotton subsidies have found larger impacts than I found in my research.⁵⁵ It is not clear whether an “official” FAPRI analysis would have found larger or smaller impacts if FAPRI would have been posed the same questions as those posed in Annex I, and if the FAPRI team analyzing these questions had considered all the evidence presented to this Panel.

⁵¹ See in particular Exhibit Bra-313.

⁵² Exhibit US-114.

⁵³ I will discuss the latter issue in greater detail in my comment on Section VII.

⁵⁴ The letter responds a perception of concern among some in the United States about the participation of US economists and US based models providing evidence on behalf of Brazil. In particular, Professor Babcock clarified that his FAPRI colleagues at the University of Missouri had not participated in the analysis and that this work was done in a private capacity not at a part of an “official” FAPRI project.

⁵⁵ See for example the review of independent studies in Exhibit Bra-344.

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 below. 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); Exhibits Bra-280, Bra-313, and Bra-345 (paras 18-34). Some of the key arguments I made can be summarized as follows:

- none of the studies in the literature analyzes the amount of payments made in connection with a specific crop that are received by current producers of that crop,
- none of the studies in the literature focuses on the specific effects of these payments for cotton due to
 - the high per-acre payments for cotton reflecting higher costs of production,
 - the restrictions on planting fruits and vegetables affect particularly cotton production,
- direct and counter-cyclical payments give farmers an incentive to produce the crop for which they have base acreage,
- future updates of base induce farmers to plant their base acreage to the programme crop or even expand the area planted to the programme crop.

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. Notwithstanding 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 As noted above, the FAPRI framework includes the value of crop insurance subsidies implicitly and has not previously been used to analyze the impact of eliminating crop insurance for cotton. Crop insurance for cotton is a service purchased by farmers on a per-acre basis in their business of producing cotton. The subsidy provided by the US government lowers the cost of this service. It is a principle of basic economics that a subsidy that lowers marginal costs results in the same impact as a direct price subsidy on output. Following this principle, I first calculate the regional cotton crop insurance subsidy rate per acre of cotton as a percentage of net revenue and then multiply those subsidy ratios times the elasticity of cotton acreage response applicable to that region. The United States is right that there are more complex ways to model the impact of crop insurance, for example, by noting that crop insurance has an additional acreage impact due to risk reduction. But, the methodology I apply is straightforward, conservative and based on intuitive economic logic and basic principles.

Section II.B.3

34. Paragraphs 31 through 34 and the table to which they refer again simply repeat the US assertion that billions of dollars of subsidized export credit guarantees for cotton exports have zero effect on US production and exports. I find this implausible on its face and based my quantification of the impact on estimates provided by representative of users of the programme. This seems to me to be a reasonable approximation. My use of that estimate was conservative relative to the National

⁵⁸ See also Exhibit Bra-313.

⁵⁹ While there is no specific equation modelling the effects of crop insurance, its effects are part of the baseline that projects a level of planted acreage against the background of the continuation of the crop insurance programme.

⁶⁰ Paragraph 29 of the US Critique.

Cotton Councils estimates, as explained in detail in response to questions from the Panel⁶¹, 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 Babcock⁶⁵ 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's 27 October Answers to Questions, paras. 104-107.

⁶² In table 5.Ig of Annex I, I report an average export effect of 300,000 bales and an average US price effect of about 0.5 cents per pound, as opposed to the NCC estimate of 500,000 bales and 3 cents per pound.

⁶³ See Exhibit Bra-346.

⁶⁴ Paragraph 38 of the US critique.

⁶⁵ Exhibit Bra-343, para. 11 and Exhibit Bra-346.

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 the results using the FAPRI November 2002 preliminary baseline and the modification applied. The United States assertion that the Annex I baseline meaningfully affects (“exaggerate[s]”⁶⁷) the effects of removing US cotton subsidies is, therefore, unfounded.

41. To analyze the validity of the US assertion, we have recalibrated the CARD international cotton model (used to generate the Annex I results) to replicate exactly the FAPRI November 2002 preliminary baseline. We also used the macroeconomic projections used by FAPRI in November 2002.⁶⁸ Rerunning the model of Annex I yields results that are nearly identical to those reported in Annex I. Removal of US cotton subsidies would decrease US production by an average of 24.9 per cent from 2003 to 2007.⁶⁹ Mill use would decrease by 6.4 per cent.⁷⁰ US exports would decrease by 41.5 per cent.⁷¹ The US Season average price would increase by 15.1 per cent.⁷² Importantly, the A index price would increase by 10.6 per cent. In Annex I, I reported a change in the A index price of 10.8 per cent relative to the baseline.⁷³ This difference of less than 0.2 percentage points is simply not material.

42. In sum, it is unfortunate that this confusion occurred in the labeling of the baseline used in Annex I. The important point, however, is that it has not affected the results of my analysis. Indeed, having run the Annex I model off the non-modified version of the FAPRI November 2002 preliminary baseline projections provides one more indication of the robustness of those results.

⁶⁶ This includes my Annex I model based off the FAPRI preliminary November 2002 baseline, my cotton-focussed model based off the FAPRI preliminary November 2002 baseline and the FAPRI January 2003 baseline, as well as a number of independent third party studies (Exhibit Bra-344).

⁶⁷ Paragraph 38 of the US critique.

⁶⁸ Both of these modifications result in an Annex I modelling system that is calibrated to exactly generate the FAPRI preliminary November 2002 baseline. It no longer contains any modifications that the United States criticizes as generating overstated resulting effects (paragraphs 36-37 of the US critique).

⁶⁹ The Annex I result was 26.3 percent (paragraph 65).

⁷⁰ The Annex I result was equally 6.4 percent (Table I.5a).

⁷¹ The Annex I result was 44 percent (paragraph 68).

⁷² The Annex I result was 15.3 percent (paragraph 69).

⁷³ The Annex I result was 10.8 percent (paragraph 70).

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 policy variables were to change.

47. Forecasting models are typically based on multivariate time series regression analysis that accounts for short-run and long-run trends, serial correlation of times series and exogenous factors. In agriculture, projecting acreage choices would likely involve projecting climate variations, pest trends, and many other variables. (Any standard econometrics textbook provides the basics for forecasting economic time series.⁷⁷)

48. Neither my Annex I model nor the FAPRI policy model (nor the USDA policy models) provides an appropriate framework for statistical analysis explaining historical variations in acreage or for forecasting future acreage.⁷⁸ The purpose of simulation models is to isolate the effects of, for instance, subsidy programmes as they occur against the baseline results. Policy simulation models do not claim to be useful for forecasting purposes and they are not. But this is irrelevant to their stated purpose as “but for” (counterfactual) policy analysis tools.

49. My simulation model assumes “average” trends for many variables that change in real world situations, but are set at averages in the baseline (or at historical outcomes). For example, my model assumed average weather conditions for marketing years 2002-2007. However, no doubt, there will be years with weather better than the average and years with weather worse than the average. The model cannot predict this, and, therefore, any deviations in the real world that impact on, for instance, planting decisions, would result in “projections” by the model to be necessarily wrong – to the extent that important outcomes of variables, such as weather, deviate from the baseline.

⁷⁵ I note that the claims made by the United States about the “Sumner model” apply with equal (lack of) force to the FAPRI models themselves. No one uses these models to forecast, nor should they. The models are used and useful to ask “but for” questions, which forecasting models are not in a position to do.

⁷⁶ Thus, any assertions of the United States that my model cannot predict future or explain past outcomes of cotton planting is not a relevant factual statement that helps this Panel determine the effects of the US cotton subsidies.

⁷⁷ See for example, William H. Greene, *Econometric Analysis* Prentice Hall; 5th edition (2002) (cited in Brazil’s 22 December Answers to Questions, para. 42) A classic and still useful reference is Charles R. Nelson, *Applied Time Series Analysis for Managerial Forecasting*, Holden Day, San Francisco. (1973).

⁷⁸ Running the same correlation calculations that the United States applied to my model off the FAPRI or USDA’s FAPSIM model would very likely not reveal significantly higher correlations as these simulations models are – like my adaptation of the FAPRI model – not designed for that purpose.

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 will adequately isolate the effects from the cotton subsidy programme hidden in the regression analysis.

52. Similarly, policy simulation models are not usually very good at forecasting future or explaining past events, as explained above. Does this mean that the simulation analyzed the effects of the subsidy programmes incorrect?⁷⁹ No, of course not, if they are properly designed.

53. The United States further claims that there are small positive or negative correlations between the expected net revenue and planting decisions, as a result of my model.⁸⁰ The table referred to in paragraphs 43 through 52 of the US critique and the discussion in those paragraphs also illustrate the misunderstanding that the United States evidently has about model evaluation and the meaning of the statistics they produce. The table at paragraph 49 reports simple correlations coefficients based on seven observations for a few variables. First, I note that the sample size for these variables is simply too small for any meaningful statistical analysis. Second, simple (univariate) correlation coefficients are not measures of explanatory power as the United States implies, for example, in paragraph 42 of its critique.⁸¹ Simple correlation coefficients tell us nothing of interest when many variables affect an outcome.⁸² This again highlights the difference between forecasting or explanatory models and policy simulations models that ask “but for” counterfactual questions. Nothing in this section of the US critique relates in any way to the usefulness of models for policy analysis.

54. Correlation coefficients measure linear statistical relationships between two variables in isolation from all other influences. They do not indicate causation and they do not even indicate a statistical relationship between variables that takes place in the real-world situation when there are many simultaneous statistical and causal relationships in place. It follows that the figures presented in the table at paragraph 49 are not indicative of causation or even of the contribution to statistical explanatory power in the current case where many variable are interrelated. Whether the figures are

⁷⁹ The United States implies this in paragraphs 40-50 of its critique.

⁸⁰ Paragraphs 43-46 and table at paragraph 49 of the US critique

⁸¹ Paragraphs 41-42 and 45-49.

⁸² The case of cotton plantings is a good example. Planting decisions are a function of expected revenue itself determined by expected market revenue and expected government payments. It is further a function of expected revenue for other crops, of weather conditions at planting time, of expected demand for the crop, expected weather during the growing season and so forth. Simple univariate correlation measures linear statistical relationships, not causation or even statistical relationships if there are many factors that potentially affect the outcome of a variable. This explains that there may be a negative correlation where one intuitively expects a positive correlation as a result of ignoring the effects of all other factors on the variable to be explained.

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 operational equations. These operational specification are made explicit in equations (4), (5) and (6) in Exhibit Bra-313. As explained in Exhibit Bra-313, my approach to the PFC, MLA, DP and CCP payment programmes and for crop insurance was to use a constant regional acreage elasticity (taken from the FAPRI crops model publications).⁸⁸ These elasticities were the averages of the time-varying elasticities used over previous periods, as reported by the FAPRI US crops model that I adapted. I

⁸³ See my 9 October Closing Statement attached as Annex II to Brazil’s 9 October Closing Statement, my 2 December Oral Statement (Exhibit Bra-342, paras. 24-28), Exhibit Bra-345 (paras.6-14) as well as Brazil’s answers to question 213 from the Panel on which I have provided input (Brazil’s 22 December Answers to Questions, paras. 37-42).

⁸⁴ See paragraphs 51-52 of the US critique.

⁸⁵ Brazil’s 2 December Oral Statement, Section 5.2 and the accompanying exhibits, as well as my oral explanations on 3 December, including Exhibit Bra-371.

⁸⁶ See my oral statement on 2 December (Exhibit Bra-342, para. 5 and 8), Exhibit Bra-331 (para. 10), letter of Professor Bruce Babcock attached to Brazil’s 5 November letter to the Panel

⁸⁷ See section V

⁸⁸ The regional supply elasticities used for the constant elasticity calculations to determine the PFC, DP, MLA and CCP effects and the crop insurance effects are as follows: Corn Belt, 0.219; Central Plains, 0.942; Delta, 0.544; Far West, 0.041; South East, 0.615; and Southern Plains, 0.362.

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 United 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

⁸⁹ See Sumner, Daniel A., and Michael Wohlgenant, "Effects of an Increase in the Federal Excise Tax on Cigarettes," *American Journal of Agricultural Economics*, 1985, vol. 67, 235-242.

⁹⁰ I note that contrary to the US assertion in paragraph 66, my methodology has not changed between Annex I and Exhibit Bra-313.

⁹¹ The United States claims in paragraph 62 that the existence of crop insurance had a negative impact in the acreage in the Corn Belt and that this would be an implausible result (paragraph 62 of the US Critique and

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 acre⁹⁶, 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

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. These problems also apply to the calculations in section V.D.⁹⁷ The United States improperly applied my model and, therefore, it is not surprising that they found different results. I note that the United States in paragraphs 71 of its critique states that “reasonable assumptions were made to facilitate the calculations”. I repeat again that Professor Babcock and myself offered the United States our assistance in replicating the results. Any request for assistance would have avoided these problems and the need for the United States to make “reasonable assumptions ... to facilitate the calculations”.

69. One important problem that vitiates any claims in this section is that the numbers that are labeled “Sumner’s Reported Impacts” in the three charts that follow paragraph 72 are not what I reported in Annex I Tables I.5.b, I.5.c and I.5.d.⁹⁸ The United States compares two sets of numbers that were evidently generated by the United States, neither of which is the result that I actually reported to this Panel.

70. As noted above, it seems that the United States provides direct acreage effects (so-called first-round effects) that do not take into account feedback effects from either the US crops model or the CARD international cotton model. These feedback adjustments are very large and the US figures do not represent the new, much smaller, equilibrium effects.

71. With this in mind, I will address the US arguments in section V.E. The United States claims that my approach to estimating the acreage impacts of removing PFC/DP, CCP/MLA, and crop insurance subsidies is deeply flawed because their attempted replication of the my methodology showed sharply lower impacts in 2002 – 2007 than what they claim were my estimated impacts.⁹⁹ As I will demonstrate, the difference between the two sets of estimates of the United States is primarily due to differences in the magnitude of elasticities of supply the United States used, as compared to the elasticities that I actually used. The United States applied time-varying, linear elasticities¹⁰⁰ because this is what is suggested by the FAPRI linear modelling framework. My Annex I results of the effects

⁹⁷ I have combined the discussion of these points to avoid any repetition in an already lengthy and technical document.

⁹⁸ Nor are these the figures that I have reported using the FAPRI January 2003 baseline (Exhibit Bra-325)

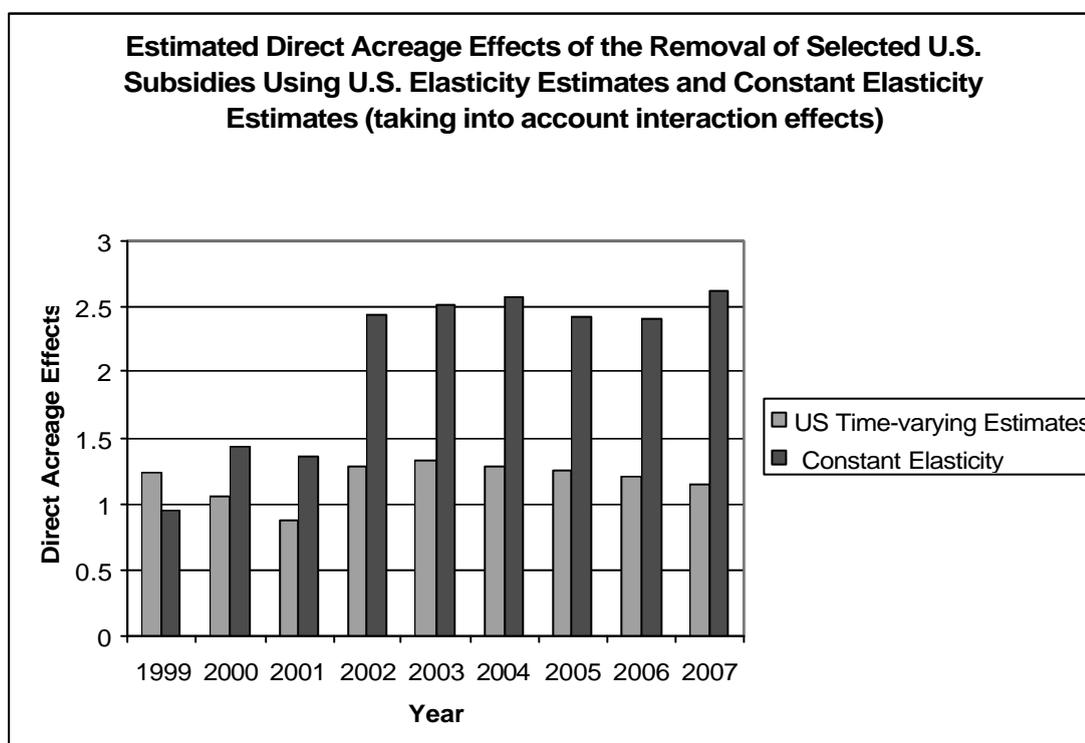
⁹⁹ Paragraph 69 of the US Critique and second set of tables following paragraph 70 of the US Critique, as well as the three charts following paragraph 72 of the US Critique.

¹⁰⁰ I have explained that in my comments on section V.A-V.C.

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 elasticities that does not vary with time. The first chart below shows how the different elasticity estimates change the estimated acreage effects of removing PFC/DP, CCP/MLA, and crop insurance subsidies.¹⁰³

Chart 1



73. I note again that these acreage effects are “first-round” effects that represent an intermediate calculation step towards estimating the new equilibrium results. Therefore, these figures are conceptually different from the equilibrium acreage effects reported in Annex I.¹⁰⁴

74. These effects are also not the same as the first-round acreage effects that I have estimated using the Annex I model because of differing subsidy levels, as explained below.

¹⁰¹ All calculations are presented in Exhibit Bra-399 ('AcreageDiscrepancies.xls') attached to the electronic version of this document.

¹⁰² Base acres are the acreage planted under the baseline scenario.

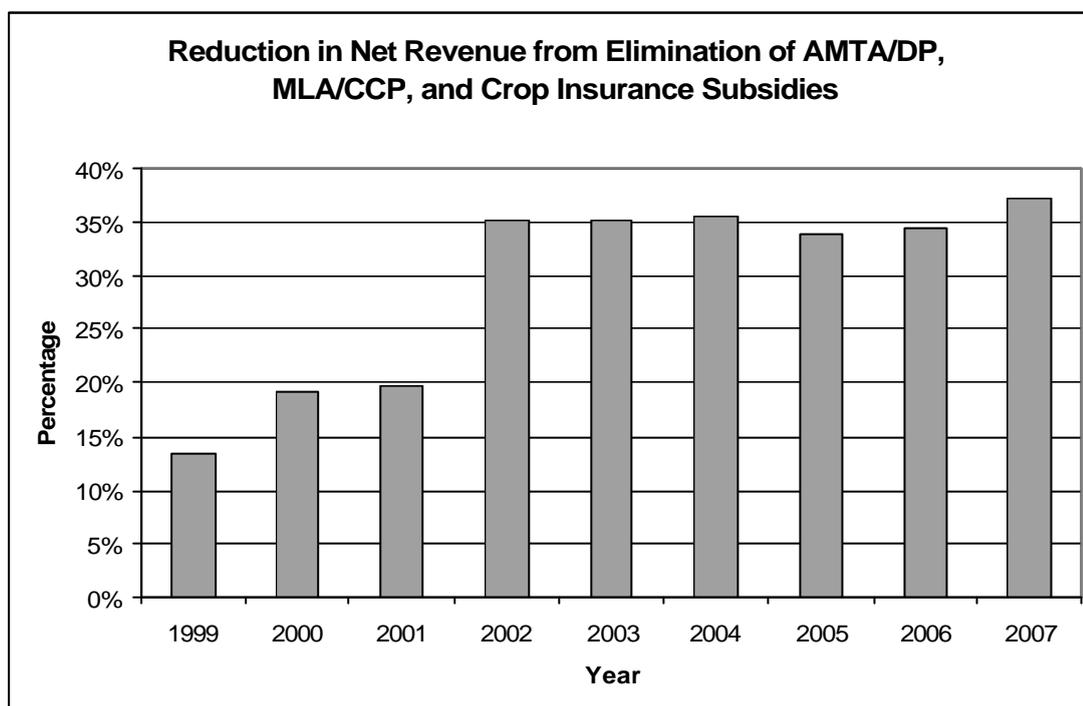
¹⁰³ The chart presents total effects from all three subsidy programs (PFC/DP, MLA/CCP and crop insurance) and controls for interaction effects.

¹⁰⁴ The Annex I effects take into account second round effects on price and quantities resulting from the first round effects and also the feedback from the CARD international cotton model leading to an equilibrium effect.

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 specification¹⁰⁶ 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 corrected.¹⁰⁷ As documented in the Final USCROPS2003.xls file¹⁰⁸, the United States calculates the supply elasticity by multiplying the slope parameter by real net revenue and then dividing it by base acreage. Net revenue in this calculation includes marketing loan

¹⁰⁵ They are not identical, as the United States used the FAPRI January 2003 baseline provided with my cotton-focused model for these calculations. The similarity of the figures demonstrates again the robustness of the model if different baselines are used.

¹⁰⁶ I have discussed this feature of a constant elasticity model in my comments on section V.A-V.C above.

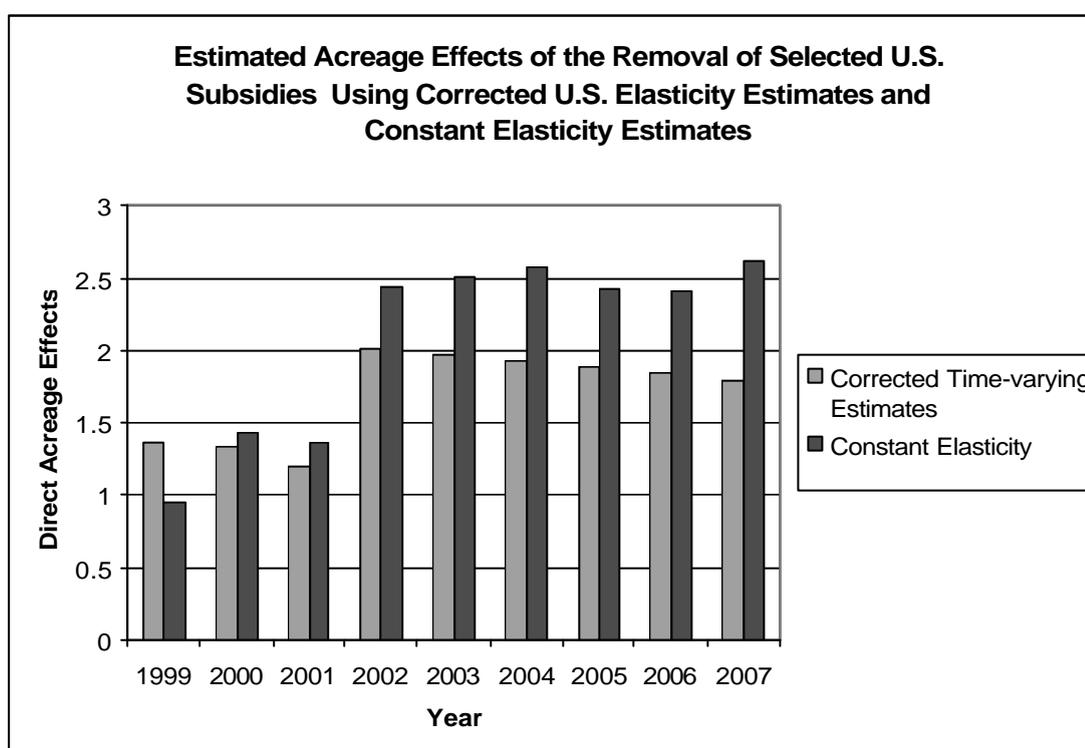
¹⁰⁷ As discussed below, the United States also compares results from two different baselines.

¹⁰⁸ Exhibit US-115.

gains and expected market revenue, but it does not include crop insurance subsidies and the other government subsidies that are to be removed in this simulation.¹⁰⁹ As the United States correctly points out when they question whether I included these subsidies for the calculation of the percentage change in net revenue from subsidy removal¹¹⁰, these subsidies should also be counted towards net revenue when calculating the elasticity of supply.¹¹¹ The mistaken assumption by the United States that I have not done so seems to have let the United States to also leave these revenue components out of their calculation, thereby generating misleading results.

79. The following chart 3 shows that when the time-varying, linear elasticities are correctly calculated, then the choice of time-varying, linear elasticities or constant elasticities makes much less difference to the estimated impacts of subsidy removal than suggested by the United States in the three charts following paragraph 72 of the US critique.

Chart 3



80. Finally, one last source of difference is that the United States uses the model calibrated to the FAPRI 2003 baseline¹¹² rather than the baseline used to estimate the effects reported in Annex I. The next chart (4) compares the actual direct acreage effects (first round effects) from removal of PFC/DP, CCP/MLA, and crop insurance subsidies based off the baseline used to generate the Annex I results to those that would have resulted from using the correct US time-varying, linear elasticity approach, the correct net revenue estimates and the same baseline. As shown below, adopting the corrected United States procedure compared to my constant elasticities approach would have resulted in a dramatic increase in the estimated impacts of removing these subsidies in 1999, somewhat higher estimates in 2000 and 2001, and a bit lower estimates in 2003 to 2007.

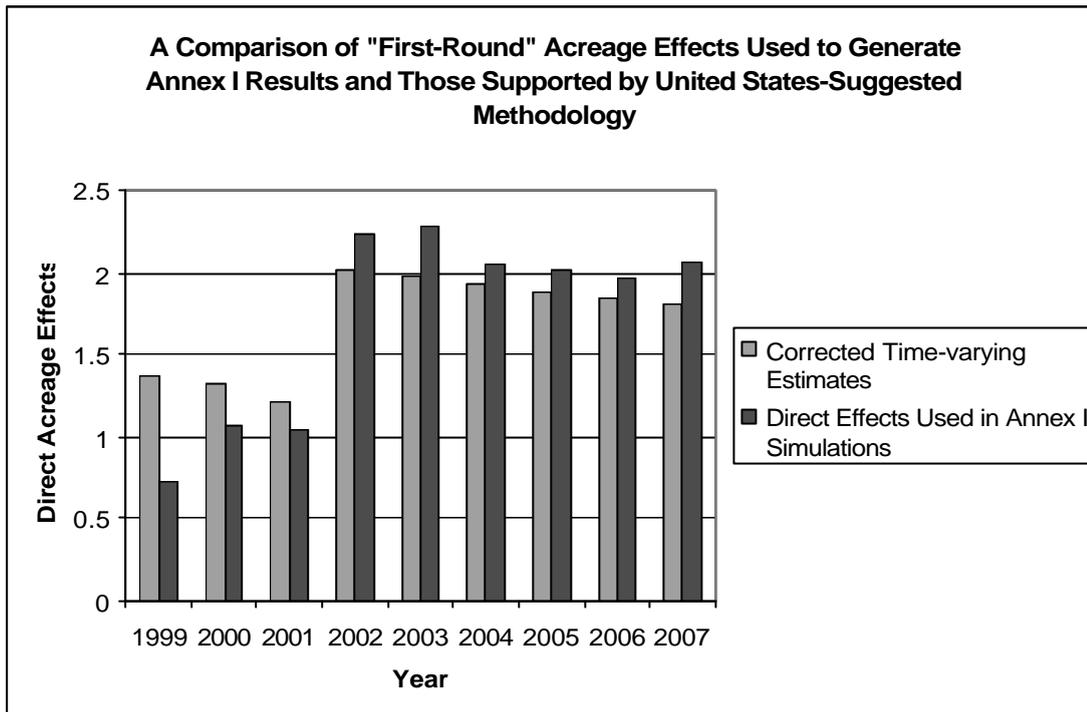
¹⁰⁹ I note that I also made this point in my comments on section V.D above.

¹¹⁰ See paragraph 68 of the US Critique.

¹¹¹ I note that I correctly included these subsidies.

¹¹² Provided by Brazil as an attachment to its 18 November 2003 Further Rebuttal Submission.

Chart 4



81. In sum, the bottom line of these calculations is that, if the United States had followed the approach that they and I agree would be correct for calculating total net revenue and resulting time-varying, linear elasticities, the resulting effects would not be significantly different whether simulated using constant elasticities or time-varying, linear elasticities. I used the constant elasticity method because it makes the common sense assumption that equal percentage changes in net revenue should give rise to similar changes in acreage.¹¹³ As noted above, this is also a standard approach in economic literature.

82. Finally, I would like to stress that any remaining differences from using different elasticity approaches are still on the level of "first round" effects, not equilibrium effects. The resulting equilibrium effects would show results that are even less different based on the choice of time-varying, linear versus constant elasticities. In short, this choice does not meaningfully affect my Annex I results.

Section VI.

83. In paragraphs 73-74 of the US critique, the United States calls into questions my modelling approach for the marketing loan programme by describing it as revealing a "lack of knowledge of the programme, a broader deficiency in economics or some previously unknown modification of the FAPRI or CARD models". These allegations are baseless. Indeed, the United States simply identified a typo in the transcription of equation 2 in Exhibit Bra-313. This transcription typo was not made in the electronic model and, therefore, does not affect the results of my Annex I model. In the Annex I model, as in the FAPRI US crops model, the acreage in year 't' is affected by the loan rate in year 't' (not the loan rate in 't-1' as erroneously reported in Exhibit Bra-313). I regret the inconvenience if this typo caused some confusion.

¹¹³ I have discussed this above providing the example of a \$100 payments and base revenues of \$200 and \$1000.

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 have been used and relied upon in a number of different studies and been published in professionally referred publications.¹¹⁶

91. Third, the elasticity parameters incorporated in the CARD model are well within the range of estimates found and applied for many agricultural commodities. Finally, the United States provides no evidence to support a suggestion that the Meyer estimates are in any way more appropriate for the questions posed by this Panel than the estimates imbedded in the CARD model. Therefore, United States assertion that use of the CARD model somehow “exaggerates” impacts is simply unfounded.¹¹⁷

Conclusion

92. The Annex I model adapted from the FAPRI US crops model and the CARD international cotton model is an appropriate tool for both forward- and backward-looking “but for” counterfactual US agricultural policy analysis questions, such as those facing this Panel. The conservative results from my Annex I model are well within any plausible range and supported by other economic and econometric evidence.

93. Over the past months of this lengthy proceeding, I have responded to each criticism raised by the United States at various occasions¹¹⁸ and have explained why none affects the validity of my model or its results.

94. Professor Babcock and I have been fully transparent about the manner in which the effects of the US subsidies have been simulated and I have rebutted any US allegations that I made my modelling choices to achieve pre-conceived results. To that end, I have explained each of my

¹¹⁶ Refereed articles using CARD international models:

Fuller F., J. Beghin, J. Fabiosa, C. Fang, H. Matthey, and S. De Cara. “China’s Accession to the WTO. What Is at Stakes for Agricultural Markets?” *Review of Agricultural Economics* 25(2) (2003): 399-414.

Beghin J., B. El Osta, J. Cherlow, and S. Mohanty. “The Cost of the US Sugar Program Revisited,” *Contemporary Economic Policy* 21 (1) (2003): 106-116. Reprinted in *International Sugar Journal* 105 (2003): 293-303.

Fuller F., J. Beghin, S. Mohanty, J. Fabiosa, C. Fang, and P. Kaus. “Accession of the Czech Republic, Hungary, and Poland to the European Union: Impacts on Agricultural Markets,” *The World Economy* 25(3) (2002): 407-428.

Fang C., and J. Beghin. “Urban Demand for Edible Oils and Fats in China. Evidence from Household Survey Data,” *Journal of Comparative Economics*, 30 (4) (2002): 732-753.

Fabiosa, J.F., D.J. Hayes and H.H. Jensen. 2002. “Technology Choices and the Economic Effect of a Ban in the Use of Over-the-Counter antibiotics in US Swine Rations.” *Food Control* 13(2), 97-101.

Hayes, D.J., H.H. Jensen, L. Backstrom, and J.F. Fabiosa. 2001. “Economic Impact of a Ban on the Use of Over-the-Counter Antibiotics in US Swine Rations.” *International Food and Agribusiness Management Review* Vol 4., p 81-97.

Fuller F., J. Beghin, S. Mohanty, J. Fabiosa, C. Fang, and P. Kaus. “The Impact of the Berlin Accord and European Enlargement on Dairy Markets,” *Canadian Journal of Agricultural Economics*, 47 (5) (1999 – appeared in 2000): 117-130.

¹¹⁷ It is also useful to remind ourselves that larger elasticities may mean smaller price impact, but also imply larger impacts on quantities and in particular larger acreage elasticities mean more acreage in the non-subsidized countries that is driven out of cotton by the US cotton subsidy programmes.

¹¹⁸ See *inter alia* US 7 October 2003 Oral Statement, paras. 26-50 and US 22 December 2003 Comments on Brazil’s Econometric Model.

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

TABLE OF CONTENTS

I.	TERMS OF REFERENCE.....	472
II.	ECONOMIC DATA	474
III.	DOMESTIC SUPPORT	497
IV.	EXPORT CREDIT GUARANTEES.....	500
V.	SERIOUS PREJUDICE.....	518
VI.	STEP 2.....	539
VII.	REMEDIES.....	540
VIII.	MISCELLANEOUS.....	540
IX.	ADDITIONAL QUESTIONS POSED ON 23 DECEMBER 2003 AND 12 JANUARY 2004.....	545

Table of Cases

Short Title	Full Case and Citation
<i>EC – Sugar Exports I (Australia)</i>	GATT Panel Report, <i>European Communities – Refunds on Exports of Sugar Complaint by Australia</i> , L/4833 – 26S/290, adopted 6 November, 1979.
<i>EC – Sugar Exports II (Brazil)</i>	GATT Panel Report, <i>European Communities – Refunds on Exports of Sugar Complaint by Brazil</i> , L/5011 – 27S/69, adopted 10 November, 1980.
<i>US – Gasoline</i>	Appellate Body Report, <i>United States – Standards for Reformulated and Conventional Gasoline</i> , WT/DS2/AB/R, adopted 20 May 1996.
<i>EC – Hormones</i>	Appellate Body Report, <i>European Communities - Measures Concerning Meat and Meat Products (Hormones)</i> , WT/DS26/AB/R, adopted 13 February 1998.
<i>Australia – Salmon</i>	Panel Report, <i>Australia – Measures Affecting Importation of Salmon</i> , WT/DS18/R, adopted 6 November 1998.
<i>EC – Bananas</i>	Panel Report, <i>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</i> , WT/DS27/ARB, adopted 9 April 1999.
<i>Brazil – Aircraft</i>	Panel Report, <i>Brazil – Export Financing Programme for Aircraft</i> , WT/DS46/RW, adopted 28 August 2000.
<i>Indonesia – Automobiles</i>	Panel Report, <i>Indonesia – Certain Measures Affecting the Automobile Industry</i> , WT/DS54/R, adopted 23 July 1998.-
<i>Argentina – Textiles and Apparel</i>	Panel Report, <i>Argentina – Measures affecting Imports of Footwear, Textiles, Apparel and Other Items</i> , WT/DS56/R, adopted 22 April 1998.
<i>Canada – Aircraft</i>	Panel Report, <i>Canada – Measures affecting the Exports of Civilian Aircraft</i> , WT/DS70/R, adopted 20 August 1999.
<i>Canada – Aircraft</i>	Appellate Body Report, <i>Canada – Measures affecting the Exports of Civilian Aircraft</i> , WT/DS70/R, adopted 20 August 1999.
<i>Japan – Agricultural Products</i>	Appellate Body Report, <i>Japan – Measures Affecting Agricultural Products</i> , WT/DS76/AB/R, adopted 19 March 1999.
<i>Korea – Dairy Safeguards</i>	Appellate Body Report, <i>Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products</i> , WT/DS98/AB/R, adopted 12 January 2000.
<i>Canada – Dairy</i>	Appellate Body Report, <i>Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products</i> , WT/DS103/AB/R, adopted 27 October 1999.
<i>Canada – Dairy (21.5) (II)</i>	Appellate Body Report, <i>Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products</i> , WT/DS103/AB/RW, adopted 17 January 2003.
<i>US – FSC</i>	Appellate Body Report, <i>United States – Tax Treatment for “Foreign Sales Corporation”</i> , WT/DS108/AB/R, adopted 20 March 2000.
<i>Australia – Leather</i>	Panel Report, <i>Australia – Subsidies Provided to Producers and Exporters of Automotive Leather</i> , WT/DS126/R, adopted 16 June 1999.
<i>Australia – Leather (21.5)</i>	Panel Report, <i>Australia – Subsidies Provided to Producers and Exporters of Automotive Leather</i> , WT/DS126/RW, adopted 11 February 2000.
<i>US – 1916 Act</i>	Appellate Body Report, <i>United States – Anti-Dumping Act of 1916</i> , WT/DS136/AB/R, adopted 26 September 2000.

<i>US – Wheat Gluten</i>	Panel Report, <i>United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities</i> , WT/DS166/R, adopted 19 January 2001.
<i>US – Wheat Gluten</i>	Panel Report, <i>United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities</i> , WT/DS166/R, adopted 19 January 2001.
<i>Chile – Agricultural Products (Price Band)</i>	Appellate Body Report, <i>Chile- Price Band System and Safeguard Measures Relating to Certain Agricultural Products</i> , WT/DS207/AB/R, adopted 23 October 2002.
<i>US – CVD's on EC Products</i>	Appellate Body Report, <i>United States – Countervailing Duties on EC Products</i> , WT/DS212/AB/R, adopted 8 January 2003.
<i>Canada – Aircraft II</i>	Panel Report, <i>Canada – Measures Affecting the Export of Civilian Aircraft</i> , WT/DS222/R, adopted 19 February 2002.
<i>EC – Sardines</i>	Appellate Body Report, <i>European Communities – Trade Description of Sardines</i> , WT/DS231/AB/R, adopted 23 October 2002.
<i>EC – Sardines</i>	Panel Report, <i>European Communities – Trade Description of Sardines</i> , WT/DS231/R, adopted 23 October 2002.
<i>Japan – Apples</i>	Appellate Body Report, <i>Japan – Measures affecting the Importation of Apples</i> , WT/DS245/AB/R, adopted 10 December 2003.

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 Bra- 416
“Commodity Program Entitlements: Deficiency Payments”, USDA, May 1993.	Exhibit Bra- 417
Washington Post v. United States Department of Agriculture, 943 F. Supp. 31 (D.D.C. 1996).	Exhibit Bra- 418
Allocation Calculations Based on Brazil’s Methodology and US Summary Data.	Exhibit Bra- 419

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 In *Indonesia – Automobiles*,⁶ the measures at issue provided for past, present, and future subsidy payments. Indonesia argued, similar to the US arguments here, that the effects of expired measures could no longer be examined for the purposes of current serious prejudice under Articles 5 and 6 of the SCM Agreement. Rejecting such a restrictive interpretation of Articles 5 and 6, the panel noted that:

If we were to consider that past subsidies were not relevant to our serious prejudice analysis as they were “expired measures” while future measures could not yet have caused actual serious prejudice, it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice. Thus, we decline to proceed on the course suggested by Indonesia.⁷

At no time did the panel find, as Indonesia argued, that only non-expired subsidies paid under the measures at issue up until the date of establishment of the panel should have been considered for the purposes of assessing serious prejudice. Indeed, the US position in this dispute is practically the same as what Indonesia argued – and the US argued against⁸ – in *Indonesia – Automobiles*. Brazil recalls the consistent US positions that (a) so-called “recurring” subsidies for MY 1999-2001 cannot be the basis for any serious prejudice claims⁹, combined with (b) its claim that only *current* 2002 subsidies up to 18 March 2003 (*i.e.*, eight months of subsidies for MY 2002) can be the basis for any serious prejudice claims.¹⁰ Given these two arguments, in the words of the *Indonesia – Automobiles* panel, “it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice”.

5. As in *Indonesia – Automobiles*, the legal statutes and regulations set out in the Panel Request that mandate the payment of subsidies did not change between 18 March 2003 and 20 January 2004. Indeed, the 2002 FSRI Act and its implementing regulations will remain identical (unless amended by the US Congress) until the end of MY 2007. Nor has the 2000 ARP changed since 18 March 2003. The mandated subsidies from these statutes and regulations were flowing before 18 March 2003 and they will continue to flow thereafter. This case does not present the situation where a new legal instrument providing subsidies is enacted after the panel request was established. Nor is it even a situation as in *Chile – Agricultural Products (Price Band)*,¹¹ in which a significant amendment to the legal instrument covered in the panel request was made long after the panel was established. The rationale of the Appellate Body in *Chile – Agricultural Products (Price Band)* and of the panel in *Indonesia – Automobiles* is to allow the Panel to conduct the required objective assessment under

⁵ US 22 December 2003 Answers to Questions, paras. 3-5.

⁶ Panel Report, *Indonesia – Automobiles*, WT/DS54/R.

⁷ Panel Report, *Indonesia – Automobiles*, WT/DS54/R, para. 14.206.

⁸ Panel Report, *Indonesia – Automobiles*, WT/DS54/R, paras. 4.44-4.50.

⁹ US 30 September 2003 Further Submission, para. 94.

¹⁰ US 11 August 2003 Answers to Questions, para. 134; US 22 December 2003 Answers to Questions, paras. 3-5.

¹¹ Panel Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/R, paras. 7.3-7.8.

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. 67bis, 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 request¹⁷, 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

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 maintains information on the receipt of decoupled payments for upland cotton base acres by upland cotton producers”.¹⁹ Once again, the United States misleads and misrepresents. What Brazil asserted was that the United States maintains information in a centralized database on the amount of contract acreage, contract yields, and upland cotton plantings on contract acreage that would permit the ready calculation of the exact amount of contract payments received by current producers of upland cotton.²⁰ The fact that the United States claims not to have performed the simple calculation from this data does not mean the United States does not maintain the information requested by Brazil and the Panel.

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 (step2) programmes and export credit guarantee programmes. BRA, USA

Brazil’s Comment:

10. Brazil notes the new and increased figures (\$415 million) that the US 22 December response presented for Step 2 payments during MY 2002. This figure should replace Brazil’s figure presented at paragraph 8 of its 22 December 2003 Answers to Questions.²¹

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

Brazil’s Comment:

11. The US 22 December 2003 response admits at note 24 to the table at paragraph 15 that the US “consumption” standard for “world market share”, within the meaning of Article 6.3(d) of the SCM Agreement, includes tabulating US exports and US imports and US domestic consumption of US origin upland cotton.²² This acknowledgement that imports are also included highlights the fact that the United States is double counting exports as part of the world market share of the exporting country and part of the world market share of the *importing* country.²³ Since internationally-traded upland cotton is not similarly included twice in the total “world consumption,” summing up the individual world market shares of all countries generates a total world market share vastly exceeding 100 per cent – a manifestly absurd result.²⁴ As Brazil has stated before, the Panel should not rely on the US interpretation of world market share as share of world consumption – the proper interpretation of the term refers to the share of world exports.²⁵

12. Further, Brazil notes the new information presented by the United States concerning US upland cotton exports in MY 2002 and 2003. These figures (11.9 million bales and 13.2 million bales respectively) would replace Brazil’s latest information, as contained in Exhibit Bra-302 (11.3 million bales and 11.2 million bales respectively). These new facts support Brazil’s threat of serious prejudice claim under Article 6.3(d) and footnote 13 of the SCM Agreement. For both marketing

¹⁹ US 22 December 2003 Answers to Questions, para. 7.

²⁰ Brazil’s 18 November 2003 Further Rebuttal Submission, Section 2.2.

²¹ See Brazil’s comment on US 22 December 2003 Answer to Question 192(b) above concerning the treatment of “other payments.” US 22 December 2003 Answers to Questions, para. 2. This US statement eliminates any doubt that “other payments” are within the Panel’s terms of reference.

²² US 22 December 2003 Answers to Questions, para. 15 (note 24).

²³ See Brazil’s 2 December 2003 Oral Statement, para. 66. See also Brazil’s comment on Question 136, below.

²⁴ See Brazil’s comment on Question 136, below.

²⁵ See Brazil’s 7 October 2003, Oral Statement, paras. 38-41; Brazil’s 18 November 2003 Further Rebuttal Submission, paras. 170-173; Brazil’s 2 December 2003 Oral Statement, para. 66.

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 December Answers to Questions, Brazil agrees with the US methodology of calculating MY 1992 deficiency payments²⁷ 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

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 States³² 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

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 expert analyst that the EWG data undercounts the amount of contract payment and marketing loan payment subsidies.³⁹ While it undercounts the data, the EWG data and the estimates generated by Brazil's 14/16th methodology for MY 2002 are very close. Brazil estimates the MY 2002 direct payments to current cotton producers at \$454.5 million⁴⁰, while the EWG data shows MY 2002 direct payments to current cotton producers of \$451.4 million.⁴¹ Similarly, Brazil's estimates that the MY 2002 CCP payments to current cotton producers were \$935.6 million⁴², while the EWG data shows \$893 million.⁴³ Thus, as Brazil has argued, the EWG data could certainly be used by the Panel as evidence *supporting* Brazil's 14/16th methodology, as explained previously and elaborated further below.

20. The US 22 December 2003 response asserts, at paragraph 25, that Brazil has overestimated the support to upland cotton from contract payments. However, the summary US data produced on 18 and 19 December 2003 seems to show that only between 10-20 per cent of US upland cotton producers planted upland cotton on non-cotton base acreage.⁴⁴ The EWG data showed that, in MY 2002, 15 per cent of the contract payments received by current producers of upland cotton were from other contract acreage crops.⁴⁵ The United States refused to produce any information regarding current upland cotton production on non-upland cotton base acreage.⁴⁶ However, the EWG database—although understating the amounts—supports a finding that farms producing upland cotton received a significant amount of non-upland cotton contract payments. The EWG database therefore also supports an adverse inference by the Panel that the actual data withheld by the United States would show even higher payments to current upland cotton producers than the EWG data or the Brazilian estimates. It also demonstrates that the EWG data is not a comparable substitute for the information requested by the Panel on 8 December 2003 and 12 January 2004.⁴⁷ The EWG data contains no information about acreage planted and, thus, does not allow for any farm-specific allocation. It is also incomplete in terms of actual payments made.

21. The US statement in paragraph 24 of its 22 December 2003 response focuses on the large number of farms not receiving direct payments. What the United States largely ignores is the predominance of very small non-cotton producing farms that receive very small upland cotton base payments. In fact, according to the US summary data, the 45 per cent of farms that received upland cotton contract payments (but did not produce upland cotton) received only between 15 and 25 per cent of the upland cotton contract payments.⁴⁸ It is undisputed that the bulk of upland cotton is

³⁹ Brazil's 18 November 2003 Further Rebuttal Submission, paras. 29-30; Exhibit Bra-316 (Statement of Christopher Campbell, paras. 12-15); Brazil's 22 December 2003 Answer to Question 204, paras. 25-26.

⁴⁰ Brazil's 18 November 2003 Further Rebuttal Submission, para. 8.

⁴¹ Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 2).

⁴² Brazil's 18 November 2003 Further Rebuttal Submission, para. 8.

⁴³ Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 2).

⁴⁴ See Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively, data for upland cotton production on farms without upland cotton base. Brazil notes that this does not mean that these farms have no contract base acreage whatsoever. Instead, the United States has withheld that data (Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 2).

⁴⁵ Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 5 (MY 2002)).

⁴⁶ US 18 and 19 December 2003 Letters to the Panel and US 20 January 2004 Letter to the Panel. See also Brazil's 28 January 2004 Comments and Requests Regarding US Data, Sections 2-3.

⁴⁷ See Brazil's 28 January 2004 Comments and Requests Regarding US Data which details the information that could have been adduced with the information withheld by the United States.

⁴⁸ See Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively. The upland cotton contract acreage on farms not producing upland cotton represents between 15 and 25 per cent of total upland cotton contract acreage. Brazil has used contract acreage

produced in very large operations⁴⁹, and the EWG data confirms this.⁵⁰ The EWG data shows that 5 per cent of farms receiving the highest amounts of upland cotton payments account for 41-45 per cent of marketing loan payments, *i.e.*, 41-45 per cent of production. The top 10 per cent of farms account for 55-58 per cent of production, and the top 20 per cent of farms account for 70-72 per cent of production.⁵¹

22. The United States makes the assertion in paragraph 25 of its 22 December 2003 response that in MY 2000-2002, “only 71, 77, and 74 per cent respectively of upland cotton base acreage payments went to farms that planted upland cotton”. The United States claims this EWG data shows that Brazil’s 14/16th methodology overestimates the amount of contract payments to upland cotton. This is incorrect. First, even the incomplete EWG data shows a very high percentage of upland cotton contract payments directly connected with the current production of upland cotton. Second, the EWG data cannot be used to calculate the amount of non-upland cotton base payments attributable to current producers of upland cotton.⁵² Because the EWG data cannot match contract acreage and planted acreage of the same farm – it is payment data, not acreage data. Given the fact that 10-20 per cent of US upland cotton is planted on farms without upland cotton base (but some other base acreage)⁵³, non-upland cotton contract payments would make up for the shortfall alleged by the United States.⁵⁴ This further highlights the need for the withheld US data. The United States obviously knows what the data shows and can easily calculate the amount of non-cotton base payments allocable to upland cotton production. The US decision not to release even “non-confidential” data that would show the amount of allocated payments is strong evidence that it knows that the actual data is larger than the EWG and Brazilian estimates.

23. Finally, the United States in paragraph 26 argues that summary data it produced on 18/19 December 2003 shows that in MY 2002, 29.4 per cent of total cropland on farms receiving upland cotton contract acreage payments was planted to upland cotton. This figure is highly misleading, because it includes all of the acreage from farms with upland cotton base acreage that do not plant upland cotton. When only farms that currently produce upland cotton are included, then about 50 per cent of the cropland acreage on these farms that actually produce upland cotton was planted to upland cotton. Indeed, the United States acknowledges this fact in paragraph 186 of its 22 December 2003 Answers to Questions.

24. Further, because of the US refusal to provide the information requested by the Panel on 8 December 2003 and 12 January 2004, it is impossible to determine from the US incomplete summary data the diversity of the cropland for upland cotton producers accounting for the majority of upland cotton production. Indeed, strong evidence that upland cotton producers concentrate in upland cotton production is found in the EWG data, which shows that 85 per cent of the contract payments

as a proxy for payments, which is a conservative proxy, as presumably the less productive farms (*i.e.* those with lower yields and thus fewer payment units per payments acre and fewer payments per acre) stopped producing upland cotton.

⁴⁹ Brazil’s 27 October 2003 Answer to Questions, paras 7-8.

⁵⁰ Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 3).

⁵¹ Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 3).

⁵² Without the farm-specific data the United States has refused to produce, it is impossible to know for certain what non-upland cotton contract payments received by current upland cotton producers are properly allocated to upland cotton production.

⁵³ Even for those farms that mainly plant on upland cotton base, additional non-upland cotton contract payments would need to be allocated. *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively. *See* also Brazil’s 20 January 2004 Answers to Additional Questions, paras. 43-55 and Brazil’s 28 January 2004 Comments and Requests Regarding US Data, Section 9.

⁵⁴ *See* Brazil’s 28 January 2004 Comments and Requests Regarding US Data, Section 9.

received by upland cotton producers were *upland cotton* payments.⁵⁵ This supports USDA's own reports on cotton specialization, which indicate that the considerable bulk of cotton is produced in farms that specialize largely in upland cotton production.⁵⁶

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

Brazil's Comment:

25. The United States asserts in paragraph 28 of its 22 December 2003 response that "FOB is greater than FAS except where the vessel is not changed at the port of export, in which case the values are equal". As set forth in the Second Declaration of Andrew Macdonald, "in practice there is in fact no difference in cost between FAS and FOB, since the ship loads and unloads the cargo, and thus, the difference in selling price between cotton which is sold FAS and cotton which is sold FOB is negligible".⁵⁷ Further, Mr. Macdonald agreed with the US statement quoted above, but noted that "vessels are rarely 'changed' in the port," and even if they were, "there would be an insignificant interest loss and thus, no difference between FAS and FOB values".⁵⁸ Brazil directs the Panel to Mr. Macdonald's Second Declaration, in which he provides additional details supporting his expert opinion.⁵⁹

26. Brazil notes that the United States does not appear to have any difficulty with comparing Brazilian FOB prices with US FAS prices since it makes this comparison in the graph in paragraph 30 of its 22 December 2003 Answers to Questions. Because of the negligible difference between these two types of prices based on export value, Brazil agrees that there is no difficulty in comparing such FOB and FAS prices. This would include the various pricing comparisons between US and Brazilian prices set out in Brazil's 22 December 2003 Answers to Questions 233 and 235.

27. Finally, Brazil notes the US acknowledgement that the United States used only a "simple average unit price" comparison between US and Brazilian prices in paragraph 30 of its 22 December 2003 response. As Brazil has indicated, from a statistical point of view this is a totally inappropriate way to compare prices because of the enormous distortions it creates.⁶⁰ The United States should have used "weighted average" unit value pricing comparisons.

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

Brazil's Comment:

28. The United States confirms that the marketing loan programme requires farmers to harvest their upland cotton to receive marketing loan payments.⁶¹ In addition, the Step 2 programme requires

⁵⁵ Exhibit Bra-317 (EWG Database: Table of Results, Table 5, MY 2002, top line, far right side under "percentage of total contract payments", 85.07 per cent).

⁵⁶ Brazil's 27 October 2003 Answer to Question 125(a), paras. 7-10.

⁵⁷ Exhibit Bra-401 (Second Declaration of Andrew Macdonald, 27 January 2004, p. 2).

⁵⁸ Exhibit Bra-401 (Second Declaration of Andrew Macdonald, 27 January 2004, p. 2).

⁵⁹ Exhibit Bra-401 (Second Declaration of Andrew Macdonald, 27 January 2004).

⁶⁰ See following webpages which discuss, in a variety of contexts, the significant distortions that can occur with statistics by using simple averages as opposed to weighted averages:
<http://www.statcan.ca/english/edu/power/ch13/estimation/estimation.htm>

<http://www.grantedc.com/publications/Grant%20Co%20Washington%20W&FB%20Report%202003.pdf>

⁶¹ US 22 December 2003 Answers to Questions, para. 31.

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 a price-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-191⁶⁶, 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-191⁶⁷ 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 arguments that permitting a Member to change its election under Annex 3, paragraph 10 to calculate *current* AMS would lead to the nullification of a Member’s obligations under Articles 3.2 and 6.3. Indeed, the US Answer to Question 208 provides the best example of such a nullification, when the United States admits that “if the applied administered price for marketing years 1999-2002 were compared to the 1992 applied administered price, the resulting negative numbers . . . show the decrease in the level of support from MY 1992.”⁶⁹ Translated, this means that the huge increase in marketing loan payments to \$2.5 billion in marketing loan payments in MY 2001 would not be counted towards US total AMS for MY 2001.

35. Brazil emphasizes again that while the United States makes what are theoretical arguments in this dispute, its WTO partners properly rely on the past and most recent US notifications.⁷⁰ And these notifications consistently demonstrate that the United States properly treats the *budgetary outlays* for marketing loan payments for cotton as well as other programme crops as part of its total current AMS. These notifications further demonstrate that US budgeted outlays for marketing loans have significantly increased in MY 1999-2002 over the level of such loans in MY 1992.⁷¹

36. In light of the arguments and evidence set out above, there is little need for Brazil to comment on the calculations provided by the US 22 December 2003 response. Brazil notes that the US applies a contradictory approach to the quantity of eligible production for MY 1992 and MY 1999-2002. For example, the United States uses actual production figures calculated from *harvested* acreage for MY 1999-2002, while it calculates eligible production for MY 1992 as *planted* eligible acreage multiplied

⁶⁸ Brazil’s 27 August 2003 Comments on US 22 August 2003 Rebuttal Submission, paras. 10-16.

⁶⁹ US 22 December 2003 Answer to Question 208, para. 37.

⁷⁰ 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).

⁷¹ Brazil’s 9 September 2003 Further Submission, Table 1.

by the *yield on harvested* acreage.⁷² This grossly overstates the eligible production. In fact, the US “eligible production” figures even overstate *actual* production in MY 1992 by 432,333 bales.⁷³ The actual eligible production for MY 1992 was 6.485 billion pounds⁷⁴, not the 7.748 billion calculated by the United States.⁷⁵ When compared to the actual production eligible for marketing loans in MY 1999-2002, the Panel can see that significantly greater US upland cotton production was provided marketing loan benefits in each of those later years compared to MY 1992.

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 Comment:

37. Brazil reemphasizes its position that only planted acres constitute a reliable measure for planting decisions in a single country, such as the United States.⁷⁶ This is highlighted by the fact that changes in planted and harvested acreage for the United States during MY 1996-2003 do not move in parallel. Contrary to the US assertion that the “movements in acreage figures are *fairly similar*”⁷⁷, in fact, the US planted and harvested acreage changes are in entirely opposite directions in 3 out of 8 marketing years⁷⁸, vary by great magnitudes in a further 3 out of 8 marketing years⁷⁹, and are “fairly similar” only in 2 out of 8 marketing years.⁸⁰ This overall picture can hardly be called “fairly similar” movements. Brazil refers the Panel to its 22 December 2003 Answer to Question 210⁸¹, demonstrating that in fact US planted acreage and a proxy for worldwide planted acreage move in quite opposite directions, demonstrating that US producers of upland cotton do not take their planting decisions based on the same market-based price factors as other producers worldwide.⁸²

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

Brazil's Comment:

38. Brazil agrees that no data on harvested acres is available on a worldwide basis. However, Brazil strongly disagrees that the only possible comparison between US and worldwide upland cotton acreage needs to be done on the basis of harvested acreage.⁸³ As discussed before, the only valid measure of farmers planting decisions is planted acres, as harvested acres figures are distorted by variations over time in the abandonment rate.⁸⁴ Therefore, it is critical to use planted acreage for the

⁷² US 22 December 2003 Answer to Question 208, paras 33-35.

⁷³ Compare US figure at paragraph 33 of its 22 December 2003 Answers to Questions (16,142,333 bales) with the actual production in MY 1992 of 15,710,000 bales, as reported in Exhibit Bra-4 (“Fact Sheet: Upland Cotton”, USDA, January 2003, p. 4).

⁷⁴ 11,164,726 planted eligible acres times 0.837 (share of planted acres that was harvested (Exhibit Bra-4 (“Fact Sheet: Upland Cotton,” USDA, January 2003, p. 4 (Abandonment Rate))) times 694 pounds per harvested acre (Exhibit Bra-4 (“Fact Sheet: Upland Cotton,” USDA, January 2003, p. 4 (Yield))).

⁷⁵ US 22 December 2003 Answers to Questions, para. 33.

⁷⁶ Brazil's 27 October 2003 Answers to Questions, paras. 27-28; Brazil's 18 November 2003 Further Rebuttal Submission, para. 87; Brazil's 22 December 2003 Answers to Questions, paras. 30-32.

⁷⁷ US 22 December 2003 Answers to Questions, para. 39.

⁷⁸ MY 1997, 1999, 2000.

⁷⁹ MY 1996, 1998, 2001.

⁸⁰ MY 2002, 2003.

⁸¹ Brazil's 22 December 2003 Answers to Questions, para. 31-36.

⁸² Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.4 (containing further references).

⁸³ US 22 December 2003 Answers to Questions, para. 40.

⁸⁴ Brazil's 27 October 2003 Answers to Questions, paras. 27-28; Brazil's 18 November 2003 Further Rebuttal Submission, para. 87; Brazil's 22 December 2003 Answers to Questions, paras. 30-32.

United States in any analysis of congruence in planting decisions between the United States and the rest of the world. However, harvested acres may serve as a proxy for planted acreage on a worldwide basis.⁸⁵ On this basis, no congruence exists between the planting decisions of US upland cotton farmers and upland cotton farmers worldwide.⁸⁶ But, even if one were to look at harvested acres for both US and worldwide planting decisions, there is no congruence in the movements.⁸⁷

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?

Brazil's Comment:

39. Brazil reads the Panel's question as requesting the United States to provide an estimate of how much the updated 2003 USDA ARMS 1997 survey overstates the \$872 per acre deficit between total costs and market revenue for the period MY 1997-2002. The United States' 22 December 2003 response declines to provide any dollar per acre estimate. Indeed, the US response appears to raise more questions than it provides answers.

40. The United States has claimed that the 2003 USDA cost data used by Brazil in calculating the \$872 per acre deficit⁸⁸ cannot be relied on by the Panel.⁸⁹ Because this is a fact asserted by the United States, it has the burden of establishing it.⁹⁰ The Panel should expect the United States, which employees the USDA personnel who created the 2003 cotton update of the 1997 ARMS study, to have provided statements or other evidence from these cost experts explaining why the 2003 update is unreliable and cannot be used by the Panel. No such statements were provided. Brazil has examined the websites of USDA and the US National Cotton Council carefully and cannot find any warnings that the 2003 upland cotton costs and revenue are unreliable. Indeed, the current NCC website provides a direct link to the ERS-USDA costs and returns website for each major US region.⁹¹ Presumably, the NCC intended its Members to rely on such data or they would not have included the link. Further, the United States neglected to inform the Panel that the 2003 upland cotton cost and revenue data has benefited from a "new costs of production estimation methodology" implementing the American Agricultural Economics Association (AAEA) Recommendations.⁹² It is reasonable for the Panel to find that the 2003 cotton updates to the 1997 ARMS study using this new AAEA-recommended methodology results in a more accurate estimate of cotton costs and revenues – not a less accurate estimate.

41. What the United States attempts to prove in its 22 December 2003 Answer to Question 211(a) is that the use of biotechnology cotton ("BT cotton") has lowered costs, and that somehow these lower costs were not reflected in the annual updated USDA costs and returns surveys. It is noteworthy that the United States now admits that the USDA personnel updating the 1997 ARMS study *properly*

⁸⁵ Brazil's 22 December 2003 Answers to Questions, para. 32.

⁸⁶ Brazil's 22 December 2003 Answers to Questions, para. 33.

⁸⁷ Brazil's 22 December 2003 Answers to Questions, para. 34.

⁸⁸ Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.1.

⁸⁹ See e.g. US 22 December 2003 Answers to Questions, para. 43.

⁹⁰ 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.")

⁹¹ <http://risk.cotton.org/CotBudgets/cotbudget.htm>, visited 20 January 2004.

⁹² See www.ers.usda.gov/briefing/FarmIncome/Glossary/compare.htm visited 28 January 2004. A link to this ERS page is provided on the NCC Webpage.

updated the cost of production data to show increased upland cotton seed costs.⁹³ But, without citing any proof, the United States asserts that these same personnel that *properly* updated the cotton cost data (to reflect *increased* (BT-cotton and overall) seed costs) improperly failed to “capture the *cost savings* from technological changes that alter the mix of production activities and inputs.”⁹⁴

42. The credibility of this assertion is difficult to accept given the fact that the US government during the period of investigation touted the productivity benefits of using, *inter alia*, BT-cotton.⁹⁵ Indeed, an Economic Research Service-USDA Report updated through 27 October 1999 analyzed ARMS data concerning the use of BT cotton.⁹⁶ The ERS report identified increased yields and lower use (and hence costs) of pesticides as indicated below:

Comparison of mean yields shows that in most cases (4 of 7 region/year cases for which data were sufficient) adopters of Bt cotton appear to obtain statistically significant higher yields than nonadopters. Although less prevalent, similar results (2 of 5 cases) were observed for Bt corn. For the case of herbicide-tolerant crops, the results are mixed: only for a few regions and in some years are yields higher for adopters. Most of the time (4 of 5 for corn, 9 of 13 for soybeans, 3 of 5 for cotton), differences in yields are statistically insignificant.

Comparison of mean pesticide acre-treatments for 1997 shows that in most cases (2 of 3) the adoption of Bt cotton reduces treatments of insecticides normally used on the pests targeted by Bt. In 1 of 3 cases, total treatments for all other cotton pests are higher for adopters than nonadopters. Insecticide treatments for Bt-targeted pests on corn are significantly lower for Bt users than for nonusers. Adoption of herbicide-tolerant varieties accompanied statistically significant reductions in herbicide treatments in 4 of 8 cases across all crops, mostly for soybeans.

It is difficult to imagine how USDA ERS personnel working with ARMS survey data could arrive at the conclusions of (a) higher yields for BT cotton and (b) lower use of pesticides and chemicals in 1999 as detailed above, but the USDA personnel updating the cotton cost data in 1999-2002 could *not*. This evidence suggests that because information on the cost savings for using BT cotton were widely available for farmers and the ERS, then they would also be known to those updating the cotton cost survey. Thus, the Panel can conclude that the published USDA cost survey properly identified both cost increases and cost savings.

43. Finally, to attempt to answer the Panel’s question concerning the graph at paragraph 59 of Brazil’s 18 November 2003 Further Rebuttal Submission, Brazil analyzed the extent to which any alleged overstating of costs could impact on the huge \$872 per acre cost-revenue gap. The answer, as outlined below, is very little.

44. To conduct this analysis, Brazil first assumed, contrary to the evidence outlined above, that the USDA employees updating the cost savings data⁹⁷ “got it wrong”. Brazil then determined that the largest published estimate of the possible cost savings for using BT-cotton was \$20 per acre.⁹⁸ The

⁹³ US 22 December 2003 Answer to Question 211(a), para. 45.

⁹⁴ US 22 December 2003 Answer to Question 211(a), para. 45.

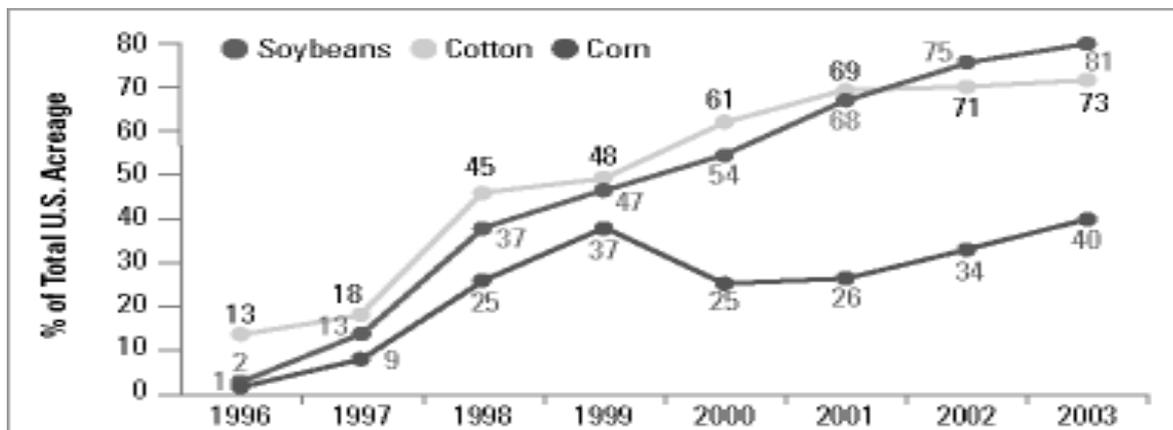
⁹⁵ See <http://www.ers.usda.gov/publications/tb1906/tb1906b.pdf> visited 28 January 2004; US 22 December 2003 Answers to Questions, para. 44 (note 44).

⁹⁶ <http://www.pestlaw.com/x/guide/1999/USDA-19990625A.html> visited 28 January 2004.

⁹⁷ Brazil’s 27 October 2003 Answers to Questions, p. 56 (setting out USDA data).

⁹⁸ Exhibit Bra-404 (Monsanto Imagine, “Benefits – BT Cotton” downloaded from www.monsanto.co/monsanto/layout/our_pledge/benefits/bt_cotton.asp visited 28 January 2004). The document concludes that the average US cotton farmer using BT –cotton has “average net incomes . . . increased by \$50 per hectare in the United States” The Monsanto assertion of \$50 per hectare translates into \$20.2 per acre because one hectare constitutes 2.47 acres.

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.

⁹⁹ <http://www.whynbiotech.com/index.asp?id=> visited 28 January 2004.

¹⁰⁰ This was done by subtracting the amount of increased seed costs in Exhibit Bra-323 (Costs and Returns of US Upland Cotton Farmers, MY 1997-2002) from MY 1997 – this was 0 in 1998, \$1 in 1999, \$13 in 2000, \$20 in 2001, and \$30 in 2002.

¹⁰¹ Brazil's 18 November 2003 Further Rebuttal Submission, paras. 59-62.

¹⁰² This figure has been calculated by applying the \$12 per acre time five years (which is conservative, because in earlier years less Bt-cotton was planted) and also deducting the yearly increases in seed costs (compared to the 1997 basis), since the \$12 represented a net cost saving, *i.e.*, net of cost increases to due higher seed costs.

(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 credibility of these new US arguments, it is instructive to review what the United States argued before the Appellate Body in *Canada – Dairy*. First, on the issue of whether average cost of production data should be used, the United States made the following arguments in *Canada – Dairy*:

[T]he Panel correctly recognized that an individual producer cost of production benchmark was unworkable. The Panel noted that governments rarely have the sort of detailed, producer-specific information that such a test would require. Indeed, as discussed below, Canada itself was unable to supply the necessary data regarding individual producer participation in the CEM market to support its claim that no payments were being made. ... In sum, the Panel's reliance on the CDC's average total cost of production data as a 'sufficient, albeit conservative, approximation of the average total cost of production of the Canadian dairy industry' is consistent with the Appellate Body's instruction to sue an average total cost of production benchmark in this case.

49. The Panel will recall that the United States in this dispute has argued that using an average total cost of production was not appropriate.¹⁰³ Yet, as in *Canada – Dairy*, the issue in this dispute is not whether there are *certain* producers that may sell cotton (or milk) below their total cost of production. Of course, there will be some efficient producers who will be able to do so, even with few or no subsidies. Rather, the issue generally in both cases is whether, on *average*, the producers' total costs of production are above the prices received by the producers in the relevant markets. Thus, as in *Canada – Dairy*, the average total cost of production generated by USDA and used by Brazil is more than a "useful approximation".

50. The United States' arguments in this dispute that fixed costs should *not* be considered by the Panel mirrored arguments made by Canada in *Canada – Dairy*. Consider the following arguments made by the United States (which were accepted by the Appellate Body) in *Canada – Dairy* and which are practically identical to arguments made by Brazil in this dispute:

With respect to imputed costs, the Panel correctly recognized that these are "real costs" that a producer must recoup in order to stay in business over time. In economic terms, these costs represent opportunity costs or the costs associated with opportunities that are foregone by not putting the producers' resources to their best use. The producers' resources include family labour, its managerial services, and its capital. There is a cost associated with using all of these resources. For example, if a farmer foregoes the opportunity to earn cash wages off the farm in order to contribute his labour to the farm's production, the value of his labour is properly counted as an economic cost to the farm even though the farmer does not pay cash wages to himself. Likewise, it makes no sense to suggest, as Canada does, that the farm which hires labour and management services is incurring a cost, while the farm that uses family labour and management is making a profit.¹⁰⁴

Likewise, the Panel correctly concluded that there was no basis to exclude the marketing, transportation, and administrative costs included in the CDC cost of production data. ... [T]he panel properly concluded that these are also 'real costs'

¹⁰³ US 18 November 2003 Further Rebuttal Submission, Section IV.F.3(1) – (4).

¹⁰⁴ Appellee Submission of the United States, *Canada – Dairy (21.5)(II)*, para. 40 (see <http://www.ustr.gov/enforcement/briefs.shtml>).

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 suggest¹¹¹ 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.

¹⁰⁵ Appellee Submission of the United States, *Canada – Dairy (21.5)(II)*, para. 42 (*see* <http://www.ustr.gov/enforcement/briefs.shtml>).

¹⁰⁶ US 22 December 2003 Answer to Question 211, para. 42.

¹⁰⁷ Brazil's 22 August 2003 Rebuttal Submission, paras. 30-41; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 59-72; Brazil's 2 December 2003 Oral Statement, paras. 25-33.

¹⁰⁸ Compare the prices set out in Brazil's 22 December 2003 Answers to Questions 233 and 235, and in Exhibits Bra-383 – Bra-388, with US total cost of production data in Exhibit Bra-323 (Costs and Returns of US upland cotton Farmers MY 1997-2002).

¹⁰⁹ US 9 October 2003 Closing Statement, para. 12 (The full context of the quote is as follows: "Total costs are relevant over the long-term, but Brazil uses this (inaccurate) number to compare to revenue in the short term – that is, the market price for one year.").

¹¹⁰ See Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, paras. 7-10).

¹¹¹ See in particular the graph at paragraph 47 of the US 22 December 2003 Answer to Question 211(b).

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 years¹¹³, and Christopher Ward testified that the normal recovery period for cotton equipment investments is 5-7 years.¹¹⁴ In light of this evidence, Brazil focused on *total costs* for a six-year period of time between MY 1997-2002 in analyzing the long-term cost/revenue gap.¹¹⁵ By contrast, the US graph at paragraph 47 of its 22 December 2003 Answer to Question 211(b) improperly focuses on only operating costs. Neither the US graph nor the US response provides any hint as to how US cotton producers could survive for six years without market revenue covering their fixed costs, *i.e.*, covering lease or mortgage payments, paying labor, recovering equipment costs, and paying taxes and insurance.¹¹⁶ In fact, the land-specific costs must be paid every year simply to be able to continue farming on leased land or to avoid foreclosure in the case of owner-operators.¹¹⁷

55. The US arguments that economists are only concerned with examining operating costs, and not total costs, are simply not correct. For example, the University of California Cooperative Extension economists conduct a large number of studies regarding costs of production for different types of, *inter alia*, upland cotton farms in California. Every one of these studies, which are relied on throughout the agricultural industry in California and other states, contains a detailed examination of all types of costs.¹¹⁸ Other economic studies of the cost of production similarly provide for total costs, including the land charge and rents.¹¹⁹

56. Additional evidence that total costs are relevant to planting decisions even in the short term of one year is found in several documents on an intended but not introduced “Cost of Production Insurance Plan for Cotton”. The entire intent of this project to develop new a insurance programme was to provide comprehensive insurance covering *total costs* – not just operating costs.¹²⁰ If upland cotton producers were solely concerned with covering only their operating costs each year, then the project would not also have sought to provide cotton producers with protection from increased fixed

¹¹² US 18 November 2003 Further Rebuttal Submission, para. 122.

¹¹³ Exhibit US-84 (Production Costs Critical To Farming Decisions, William D. McBride, ERS, p. 40 (quoted in US 18 November 2003 Further Rebuttal Submission, para. 118).

¹¹⁴ Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, para. 10).

¹¹⁵ This was not, therefore, a “randomly selected period,” as the United States alleges in paragraph 41 of its 22 December 2003 Answer to Question 211(a).

¹¹⁶ See Brazil’s 18 November 2003 Further Rebuttal Submission, paras. 64-69 (setting forth composition of fixed costs. This evidence has never been rebutted by the United States).

¹¹⁷ See Brazil’s 18 November 2003 Further Rebuttal Submission, paras. 64-69 (setting forth composition of fixed costs. This evidence has never been rebutted by the United States).

¹¹⁸ Exhibit Bra-405 (Sample Cost to Produce Cotton – Transgenic Herbicide-Resistant Alacla Variety, San Joaquin Valley, University of California Cooperative Extension, 2003). A large number of cost of production studies by the University of California Cooperative Extension for cotton, as well as for many other crops, can be found at www.ucanr.org/CES.CEA.shtml.

¹¹⁹ Exhibit Bra-406 (Cotton Cost-Return Budget in Southwest Kansas, Kansas State University Agricultural Experiment Station and Cooperative Extensive Service, October 2003).

¹²⁰ Exhibit Bra-407 (Documents on Cost of Production Insurance Plan for Cotton)(“Review of the FCIC Cost of Production Insurance Plan for Cotton,” Sparks Companies, Inc., 15 September 2003, p. 11, 12 and 16. (COP insurance policy is based on the *farmer’s total cost*.”)); “Underwriting Review of FCIC Cost of Production Insurance Plan for Cotton,” Jeffrey T. LaFrance, Ph.D, 13 September 2003, p. 5 (“... the basis for the guarantee is not a farmer-chosen percentage of expected or predicted revenue; rather it is a percentage of an estimate of the *total cost of production*.”); “Review of Proposed ‘Cost of Production Insurance Plan for Cotton,’ Jerry R. Skees, Dr. Barry J. Barnett, Dr. J. Roy Black, and James Long, 15 September 2003, p.32 (“Purchasers will be required to provide estimates of variable expenses per acre, *fixed expenses per acre*, and *land expenses per acre* in addition to the acreage and historical yield information required for existing cotton insurance products.”)emphasis added

costs such as leasing land, employing workers, and annual financing costs for replacement equipment. Yet, the “Cost of Production Insurance Plan for Cotton” programme focused on *annual* protection that would include all types of costs, because that is what the sponsors perceived farmers needed.

57. Finally, the Panel should recognize that the most efficient low-cost US producers will be able to withstand lower market prices without the need for significant subsidies for a year or two. But higher-cost producers will not. The ERS study on production costs cited by the United States highlighted the ability of higher-cost producers to survive in the shorter term only through government payments:

Low-cost producers are generally better able to survive periods of low prices and thrive when prices improve, while high-cost producers are often the first to exit farming when prices are low.¹²¹

** ** ** **

Also, this cost-price squeeze has put an emphasis on enhancing revenues through a variety of sources, such as government programmes, and on controlling or cutting costs. Government programme support has likely helped many producers remain in business and may explain why structural adjustments in these industries have been gradual.¹²²

Many US upland cotton producers are “high-cost” producers, according to USDA’s latest comprehensive cost of production survey.¹²³ Brazil notes that Professor Sumner found that roughly 70 per cent of US planted acreage would continue to be planted to upland cotton even without the US subsidies.¹²⁴ This finding that 30 per cent of the US cotton acreage would not remain planted to cotton is consistent with the conclusion that it is the category of high-cost cotton producers that would not be able to survive without US subsidies – even in the short term.

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

Brazil’s Comment:

58. At the outset, Brazil notes that USDA economists Westcott and Price are among the most experienced and well-respected USDA analysts, who both have long records of publication of US government reports and other research studies. They have an in-depth knowledge of the marketing loan programme. Further, they received comments and suggestions for their study from leading US agricultural economists such as Professor Bruce Gardner.¹²⁵ Westcott and Price’s study was their best estimate of the effects of the marketing loan programme. It bears repeating that they developed their study independently of this dispute in 2000.

¹²¹ Exhibit US-84 (Production Costs Critical To Farming Decisions, William D. McBride, ERS, p. 40). This study includes a graph regarding wheat farmers on page 41 which illustrates that low-cost producers can survive much lower prices while higher-cost wheat farmers require much higher prices even to meet their operating costs. The same dynamic exists for US cotton farmers.

¹²² Exhibit US-84 (Production Costs Critical To Farming Decisions, William D. McBride, ERS, p. 41).

¹²³ Exhibit Bra-16 (“Characteristics and Production Costs of US Cotton Farms”, USDA, October 2001).

¹²⁴ Brazil’s 9 September 2003 Further Submission, Annex I, Table 5a.

¹²⁵ Exhibit Bra-222 (“Analysis of the US Commodity Loan Program with Marketing Loan Provisions,” USDA, AER 801, cover page).

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 programme using actual MY 1999-2001 data.¹³³ Not surprisingly, the overall results of both Westcott/Price studies are in line with Professor Sumner's results.¹³⁴

62. The United States also rejects the Westcott/Price study because its lagged price analysis based on the 2000 USDA baseline allegedly would not reflect farmers' actual price expectations.¹³⁵ Brazil and Professor Sumner have addressed the issues of the inappropriateness of using futures prices in complex modeling systems before.¹³⁶ The undisputed evidence is that – as the United States itself admits¹³⁷ – futures market prices cannot be used for such modeling systems.¹³⁸

63. Brazil also notes that Westcott and Price in their updated MY 2001 analysis used actual MY 2001 prices as farmers' price expectations. This credits farmers with accurate information about

¹²⁶ Exhibit Bra-222 ("Analysis of the US Commodity Loan Programme with Marketing Loan Provisions", USDA, AER 801).

¹²⁷ US 22 December 2003 Answers to Questions, para. 48.

¹²⁸ Brazil's 7 October 2003 Oral Statement, paras. 31-34.

¹²⁹ US 22 December 2003 Answers to Questions, para. 48.

¹³⁰ US 22 December 2003 Answers to Questions, para. 49. Brazil notes that the United States understands "actual conditions" to refer to actual price expectations held by US upland cotton producers. These are, however, as Brazil and the United States agree, "fundamentally unobservable".

¹³¹ Brazil also notes that the 2000 USDA baseline contained actual data for MY 1998, *i.e.*, the Westcott/Price study used USDA's FAPSIM model for retrospective analysis.

¹³² See Brazil's 7 October 2003 Oral Statement, paras. 31-34.

¹³³ See Annex I of Brazil's 9 September 2003 Further Submission, para. 4, Table I.5e (regarding the data used, baseline and resulting effects of the marketing loan programme).

¹³⁴ See *inter alia* Brazil's 7 October 2003 Oral Statement, paras. 9, 34.

¹³⁵ US 22 December 2003 Answers to Questions, paras. 50-51.

¹³⁶ See Brazil's 20 January 2004 Comments on US Model Critique, para. 56 (for further references).

¹³⁷ US 7 October 2003 Oral Statement, para. 34.

¹³⁸ Brazil offers additional rebuttal arguments in its comment on the US 22 December 2003 Answer to Question 213, below.

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 cents¹⁴³ (if measured against the average AWP for the following marketing year) or (ii) 12.22 cents¹⁴⁴ (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 marketing year or at some particular AWP for a specific month such as

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 a certain likelihood that the adjusted world price will be below (or above) the mean of the expectation.¹⁴⁹ It follows that even if farmers expect the mean of the probability distribution for the AWP to be above the loan rate, they will nevertheless expect some marketing loan payments to be made.¹⁵⁰

67. In sum, Brazil emphasizes that the Westcott/Price studies are important evidence of the effects of the upland cotton marketing loan programme that corroborate the effects found by Professor Sumner and the effects that are implied by all the non-econometric evidence for the effects of the US upland cotton subsidies presented by Brazil.

68. Finally, Brazil notes a new US argument that undercuts the US arguments regarding the peace clause. The United States argues for the first time in its 22 December 2003 Answers to Questions that the marketing loan programme *does not guarantee* US upland cotton producers 52 cents per pound in income.¹⁵¹ Rather, there is additional revenue generated by the marketing loan programme that increases the effective support level – so-called “marketing loan facilitated revenue”.¹⁵² This revenue results from several sources. First, US farmers receive a domestic farm price when selling their crop. This price is consistently above the adjusted world price, off which the marketing loan payments are based.¹⁵³ It follows that US farmers receive additional revenue, as the US farm price plus the difference between the loan rate (52 cents) and the adjusted world price (below the US farm price) will exceed 52 cents.¹⁵⁴ Second, by cleverly marketing their upland cotton crop, US farmers can maximize this additional marketing loan facilitated revenue, which Westcott and Price assumed to be 14 cents.¹⁵⁵

69. In Exhibit US-126, the United States provides monthly data on the amount of additional marketing loan facilitated revenue. This actual data demonstrates considerable additional positive revenue “facilitated” by the marketing loan programme. Thus, using an adjusted world price as the loan repayment rate for upland cotton (as opposed to a local posted county price used for other crops

¹⁴⁸ See Brazil’s 2 December 2003 Oral Statement, paras. 43-47, and Professor Sumner’s oral explanation on 3 December 2003.

¹⁴⁹ See Exhibit Bra-371 (Simple Example of the Calculation of Expected Marketing Loan Benefit).

¹⁵⁰ Professor Sumner’s oral explanations on 3 December 2003; Brazil’s 2 December 2003 Oral Statement, para. 48; Brazil’s 22 December 2003 Answers to Questions, para. 155.

¹⁵¹ In passing, Brazil notes that the use of 14 cents as marketing loan facilitated revenue was taken from the assumptions in USDA’s own FAPSIM policy simulation model (Exhibit Bra-222 (“Analysis of the US Commodity Loan Program with Marketing Loan Provisions,” USDA, AER 801, p. 11)). In addition, Westcott and Price demonstrate that the additional marketing loan facilitated revenue for MY 1999 is 12.7 cents – very close to the authors’ assumption (Exhibit Bra-222 (“Analysis of the US Commodity Loan Programme with Marketing Loan Provisions,” USDA, AER 801, p. 8)). Finally, Exhibit US-126 does not contradict the appropriateness of using 14 cents, as Exhibit US-126 does not provide the entire marketing loan facilitated revenue received by farmers (see Brazil’s arguments in the main body of its comment).

¹⁵² US 22 December 2003 Answers to Questions, paras. 50-52. Brazil notes that this additional revenue in rare circumstances can also turn out to be negative.

¹⁵³ See Brazil’s 27 October 2003 Answers to Questions, chart at paragraph 172 and Exhibit Bra-311 (Side by Side Chart of the Weekly US Adjusted World Price, the A-Index, the nearby New York Futures Price, the Average US Spot Market Price and Prices Received by US Producers from 1996 to the present).

¹⁵⁴ US 22 December 2003 Answers to Questions, paras. 50-52. Brazil notes that this additional revenue may also turn out to be negative, as shown by Exhibit US-126.

¹⁵⁵ US 22 December 2003 Answers to Questions, para. 52.

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 conditions¹⁵⁷, 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

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 best, be an approximation of farmers' price expectations".¹⁶⁵ This is an obvious fact; the actual price expectations of thousands of farmers are "fundamentally unobservable".¹⁶⁶

77. There are three basic approaches to modeling farmers' price expectations: (1) using lagged prices, (2) using futures market prices if available, and (3) using rational expectations in various forms, including crediting farmers with complete information (*i.e.*, using the actual price as the expected price¹⁶⁷).

78. It is not clear that any of these approaches lead to *a priori* biased results. However, it is standard practice among economists to use lagged prices in a large-scale, multi-commodity econometric policy simulation framework. FAPRI, USDA and the US Congressional Budget Office ("CBO") use lagged prices in their models. Indeed the United States admits that using futures prices for these models is not feasible and has never been done.¹⁶⁸ Had Brazil attempted to use this unconventional and untested approach for its model, the United States could have raised legitimate concerns as to the reliability of the model results. Any such results would have been purely speculative.¹⁶⁹

79. Indeed, Brazil would have had to develop equations to predict futures prices for those commodities for which a functioning futures market exists. It also would have had to use an altogether different modeling approach for price expectations for crops for which there is no futures market. Again, this would have been purely speculative.¹⁷⁰

¹⁶¹ US 22 December 2003 Answers to Questions, para. 57

¹⁶² Exhibit Bra-281 (Statement by Andrew Macdonald – 7 October 2003, para. 13, even clearer paras. 17, 28, 31).

¹⁶³ US 22 December 2003 Answers to Questions, para. 58.

¹⁶⁴ See Brazil's comment on Question 201, above.

¹⁶⁵ US 22 December 2003 Answers to Questions, para. 56, *see also* para. 64.

¹⁶⁶ Brazil's 9 September 2003 Further Submission, Annex I, para. 18.

¹⁶⁷ Westcott/Price have chosen this approach for the update of their study for purposes of the Payment Limitations Commission.

¹⁶⁸ US 7 October 2003 Oral Statement, para. 34.

¹⁶⁹ 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).

¹⁷⁰ 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).

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 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

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

Brazil's Comment:

84. In addition to its own answer¹⁸², Brazil offers two comments to the US response to this question. First, the United States makes a factual mistake in describing the calculation of base acreage under the deficiency payment programme.¹⁸³ While the United States' description of the calculation of deficiency payment crop base as the rolling five-year average minus the high and low year would be correct for other deficiency payment crops, upland cotton (and rice) had a special provision.¹⁸⁴ 7 CFR 1413.7(c) mandates the calculation of upland cotton base as "the average of the acreages planted and considered planted to such crop for harvest on the farm in each of the 3 crop years preceding such crop year."¹⁸⁵ For farms participating in the programme, all current base acreage was "considered planted".¹⁸⁶ Therefore, for the base to change, farmers had to opt out of the programme.¹⁸⁷

85. Second, Brazil does not consider credible or relevant a statement by the United States that "[g]iven the current US fiscal situation,"¹⁸⁸ any further base update four years from now seems "unlikely". The Panel must determine whether the 2002 FSRI Act update of the direct and counter-cyclical payment base is a violation of paragraphs 6(a) and (b) of Annex 2 of the Agreement on Agriculture.

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). USA

¹⁸¹ See Brazil's comment on Question 212, above.

¹⁸² Brazil's 22 December 2003 Answers to Questions, paras. 47-50.

¹⁸³ US 22 December 2003 Answers to Questions, paras. 67-68.

¹⁸⁴ Exhibit Bra-26 (7 CFR 1413, Deficiency Payment Program, 1993 edition).

¹⁸⁵ Exhibit Bra-26 (7 CFR 1413.7(c)).

¹⁸⁶ Exhibit Bra-26 (7 CFR 1413.3, "Considered planted acreage").

¹⁸⁷ Brazil's 22 December 2003 Answers to Questions, para. 47.

¹⁸⁸ US 22 December 2003 Answers to Questions, para. 70.

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 has the effect of maintaining production in the 40 per cent of the value of crops for which programme payments are received.¹⁹³ This "distorts" the trade in the agricultural crops receiving the payment by *maintaining or increasing their production*. The practical effect of the PFC and direct payment restriction is that the resources are targeted towards certain "types" of crops only. Negotiators intended that measures that were so linked to current production were not properly part of the green box.

90. In light of this evidence, the EC's argument boils down to asserting that trade distortions for products that traditionally have been subsidized should be permitted in order to prevent trade distortion in markets for non-subsidized products. Thus, the EC's argument is not one that would avoid distortions; it is one of *maintaining* existing distortions, contrary to the object and purpose of the Agreement on Agriculture.¹⁹⁴

¹⁸⁹ EC 23 July 2003 Oral Statement, para. 29.

¹⁹⁰ EC 11 August 2003 Answer to Third Party Question 11, para. 30.

¹⁹¹ EC 11 August 2003 Answer to Third Party Questions 6 and 9, paras. 17, 23-25.

¹⁹² Indeed, the United States has acknowledged that such effects can be presumed if the specific criteria in paragraph 6 of Annex 2 are not complied with. See US 11 August Answer to Question 31, para. 65 ("if a new measure does not conform to the basic and applicable policy-specific criteria in Annex 2, it will not have the benefit of the presumption that it meets the fundamental requirement of the first sentence.").

¹⁹³ Exhibit Bra-105 ("Statement of Professor Daniel Sumner at the First Meeting," para. 24); Oral Statement of Brazil, paras. 65-66.

¹⁹⁴ See Brazil's 22 August 2003 Rebuttal Submission, paras. 8-9, note 15.

91. The only thing the US 22 December 2003 response does is to repeat earlier faulty arguments attempting to defend the fruits, vegetables, and wild rice payment limitation.¹⁹⁵ The US response is useful because it finally clarifies that the US argument boils down to the assertion that if a direct payment measure does not *require* production, then it cannot violate Annex 2, paragraph 6. The US 22 December 2003 response states, at paragraph 73, that “paragraph 6 [no subsection listed] prohibits basing payments on production requirements ...”.¹⁹⁶ It further states that the reduced PFC and direct payments “are not ‘related to, or based on, the type or volume of production’ *since the recipient need not produce anything at all*”.¹⁹⁷ But there has never been an issue whether PFC and direct payments require production. All this means is that they comply with Annex 2, paragraph 6(e), in that “no production shall be required in order to receive such payments”. But what about Annex 2, paragraph 6(b), which must be interpreted to have a separate meaning apart from paragraph 6(e)?

92. Paragraph 6(b) focuses on the amount of payments related to the type of production. In other words, if a farmer decides to produce something (recognizing that he or she need not under Annex 2, paragraph 6(e)), does the direct payment provision condition the amount of payment on the type of production undertaken? The answer with respect to the 1996 FAIR and the 2002 FSRI Act for PFC and direct payments is a clear “yes”. The amount of the PFC or direct payments falls when prohibited crops are grown – and increases when the prohibited crops cease to be grown. These legal provisions send a fairly compelling message to the farmer – channel your current production into *certain* crops to continue receiving the full amount of direct payments today. This re-couples payments to current production.

93. The United States claims, at paragraph 73 of its 22 December 2003 response, that all a producer need do to receive the full payment is to “*merely* refrain from producing fruit, vegetables, or wild rice”.¹⁹⁸ This is an interesting dismissal given that the practical effect of this provision is to direct production away from crops that represent up to 60 per cent of the value of available options for cotton farmers in states such as Florida, California, and Arizona.

94. Moreover, the logic of the US argument leads to an evisceration of any disciplines in Annex 2, paragraph 6, and is therefore contrary to the object and purpose of that provision. Consider the following hypothetical: a measure provides for a direct payment that was reduced by 75 per cent if a farmer produced any of 99 per cent of the available crop options; as a practical matter, farmers could only plant one or two crops (or no crops) and still receive the full payment. Under the US argument, because the farmer had no obligation to grow any crops, it could “*merely* refrain” from producing 99 per cent of available crops. Like the fruits, vegetables and wild rice exception, this argument would emasculate the green box requirement of Annex 2, paragraph 6(b).

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. USA

Brazil's Comment:

95. The United States states in its response to this question “that marketing loan payments are *potentially* production- and trade-distorting”.¹⁹⁹ Yet, Keith Collins' statement did not say “*potentially*” production- and trade-distorting. Dr. Collins stated that marketing loan payments “are

¹⁹⁵ US 22 December 2003 Answers to Questions, para. 73.

¹⁹⁶ US 22 December 2003 Answers to Questions, para. 73.

¹⁹⁷ US 22 December 2003 Answers to Questions, para. 73.

¹⁹⁸ Emphasis added.

¹⁹⁹ US 22 December 2003, Answers to Questions, para. 74 (emphasis added).

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**

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.

(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

Brazil's Comment:

97. Brazil agrees with the United States that Article 8 of the Agreement on Agriculture assumes the role the Panel suggests one might have expected Article 3.3 to play.²⁰⁶ Article 8 prohibits the use of both those export subsidies listed in Article 9.1 and those not listed in Article 9.1 other than in conformity with the Agreement on Agriculture and the commitments specified by a Member in its Schedule.

98. However, Brazil does not consider that this fact provides illuminating context for the interpretation of Article 10, including Articles 10.1 and 10.2. The question is whether Article 10.2 of the Agreement on Agriculture exempts or carves-out export credits from the disciplines included in Article 10.1. The Appellate Body has concluded that to exempt or carve-out particular categories of measures from general obligations such as the export subsidy obligations in the Agreement on Agriculture, the exemption or carve-out must be *explicit* in the text of an agreement.²⁰⁷ Article 10.2 includes no such explicit exemption or carve-out.²⁰⁸ The negotiators knew how to make such an exemption or carve-out explicit, as evidenced by, for example, Article 13 of the Agreement on Agriculture, footnote 15 to Article 6.1(a) of the SCM Agreement, and the second paragraph of item (k) of the Illustrative List of Export Subsidies.²⁰⁹ The United States has not rebutted these arguments.

99. Instead, the United States appeals to what it considers to be “similarity” between the treatment of export credit instruments and international food aid in Articles 10.2 and 10.4.²¹⁰ These two provisions are fundamentally different, however. Article 10.2 announces Members’ intent to work toward negotiations on specific disciplines for export credits, and calls on Members to adhere to those disciplines once they are adopted. As Brazil noted in its 22 December 2003 Answers to Questions, the nature of the disciplines negotiated and the way in which they are transposed into the WTO will dictate the effect they will have on claims against export credits under Article 10.1.²¹¹ At least for the time being, however, Article 10.2 does not meet the standard for carve-outs or exemptions set by the Appellate Body in *EC – Sardines* and *EC – Hormones*, and export credits are subject to the disciplines of Article 10.1.²¹²

100. Article 10.4 similarly does not meet the standard for exemptions or carve-outs set by the Appellate Body in *EC – Sardines* and *EC – Hormones*. However, it does provide specific disciplines for international food aid through reference to FAO and Food Aid Convention provisions. In Brazil’s

²⁰⁶ See US 22 December 2003 Answers to Questions, para. 79.

²⁰⁷ Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, para. 201-208; Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128.

²⁰⁸ See Brazil’s 22 July 2003 Oral Statement, paras. 100-115; Brazil’s 22 August 2003 Rebuttal Submission, paras. 99-100; Brazil’s 27 August 2003 Comments on US Rebuttal Submission, paras. 33-52; Brazil’s 18 November 2003 Further Rebuttal Submission, paras. 219-220; Brazil’s 2 December 2003 Oral Statement, paras. 73-76; Brazil’s 22 December 2003 Answers to Questions, paras. 51-57.

²⁰⁹ See, e.g., Brazil’s 2 December 2003 Oral Statement, para. 75.

²¹⁰ US 22 December 2003 Answers to Questions, paras. 80-82.

²¹¹ Brazil’s 22 December 2003 Answers to Questions, paras. 51-57.

²¹² See Brazil’s 22 July 2003 Oral Statement, paras. 100-115; Brazil’s 22 August 2003 Rebuttal Submission, paras. 99-100; Brazil’s 27 August 2003 Comments on US Rebuttal Submission, paras. 33-52; Brazil’s 18 November 2003 Further Rebuttal Submission, paras. 219-220; Brazil’s 2 December 2003 Oral Statement, paras. 73-76; Brazil’s 22 December 2003 Answers to Questions, paras. 51-57.

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 November further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August 2003 comments on US rebuttal submission) that the total figure net of re-estimates should be \$230,127,023 instead of the figure which originally appeared (\$381,345,059).

(a) Please submit a corrected table reflecting all of the necessary information to produce this result, to the extent this is possible for the reasons indicated in footnote 96 in US further submission of 30 September 2003.

Brazil's Comment:

101. The data provided by the United States in the chart accompanying its response demonstrates that using the net present value methodology imposed by the US Federal Credit Reform Act ("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.²¹⁷ For a complete assessment under item (j), administrative expenses in the amount of approximately \$39 million should be added.²¹⁸

102. Brazil addresses further the US chart in its comments on other US answers, below.

(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.

²¹³ Brazil's 22 December 2003 Answers to Questions, para. 56.

²¹⁴ Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 136-140.

²¹⁵ Appellate Body Report, *Canada – Dairy*, WT/DS103/AB/R and WT/DS113/AB/R, paras. 87-90.

²¹⁶ *See, e.g.*, Exhibit Bra-99 (G/AG/N/USA/39, p. 2).

²¹⁷ US 22 December 2003 Answers to Questions, chart included in response to Question 221(a).

²¹⁸ Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

Brazil's Comment:

103. The United States' response is inaccurate. In stating that "all of the first five cohorts (1992-1996), including 1994, are profitable",²¹⁹ the United States oddly neglects to account for the most recent reestimate data, which it has included in its own chart, provided with its response to question 221(a). That chart shows massive upward reestimates in 2003 for the 1992, 1993, 1994, 1996, 1997 and 2001 cohorts. Accounting for those reestimates, the 1994 cohort, which the United States asserts is nearly closed²²⁰, does *not* show profitability. Nor do the 1997, 1998, 2000, 2001 or 2002 cohorts.

104. The United States is implying that over time, cohorts will turn out to be positive. The data does not support this implication. Upward reestimates continue, even on "older" cohorts, and net results do not suggest profitability with anywhere near the uniformity suggested by the United States.

105. Finally, Brazil emphasizes 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.²²¹

- (c) **The Panel notes that the CCC 2002 financial statement in Exhibit BRA-158 refers to annual "administrative" expenses of \$4 million, and that the US has also referred to this figure in its submissions (e.g. US first written submission, paragraph 175). Please confirm whether the figures in the table in paragraph 161 of the US August 22 rebuttal submission (or a corrected version thereof) includes "administrative expenses", of approximately \$4 million per year over the period 1992-2002, and explain why (or why not) this affects the substantive result.**

Brazil's Comment:

106. Brazil agrees that for a complete assessment under item (j), administrative expenses in the amount of approximately \$39 million²²² should be added to the \$230 million of losses recorded in the chart accompanying the US response to question 221(a), or to \$211 million of losses recorded in the Brazilian chart included as Exhibit Bra-193.

- (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.**

Brazil's Comment:

107. The United States' response is inaccurate. Using the most recent data available, provided by the United States with its response to question 221(a), the subsidy figure net of reestimates for the 1994 cohort will in fact be positive, indicating losses. Based on this same data, the same thing can be said for other "older" cohorts, such as 1997 and 1998. Moreover, the United States' data demonstrates that 2002 and 2003 reestimates for "older" cohorts 1992, 1993, 1994, 1996 and 1997 are all *upward*, indicating adjustments for even greater losses than previously anticipated.

²¹⁹ US 22 December 2003 Answers to Questions, para. 86.

²²⁰ US 22 December 2003 Answers to Questions, para. 93.

²²¹ See Brazil's 2 December 2003 Oral Statement, para. 81; Brazil's 18 November 2003 Further Rebuttal Submission, para. 248; Brazil's 27 August 2003 Comments on US Rebuttal Submission, para. 61.

²²² Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

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 most recent data available, however, provided by the United States with its 22 December 2003 response to question 221(a), the subsidy figure net of reestimates for the 1994 cohort will in fact be positive, indicating losses. Based on this same data, the same thing can be said for other “older” cohorts, such as 1997 and 1998. Moreover, the United States' data demonstrates that 2002 and 2003 reestimates for “older” cohorts 1992, 1993, 1994, 1996, 1997 are all *upward*, indicating adjustments for even greater losses than previously anticipated.

110. The United States shows *no evidence* to support its assertion that Pakistani and Ecuadorean defaults account for an important part of the poor performance of the 1997 cohort.²²⁴ Nor does it offer any evidence to show that those defaults were rescheduled, or that they are performing. Additionally, the United States' assertion that it expects the 1998 cohort to show profitability is not supported by the data included with its response to question 221(a).²²⁵ As recently as 2002, upward reestimates were made to the 1998 cohort, indicating that there is no discernible trend of profitability.

111. In any event, Brazil notes that showing gains or losses for a particular *cohort* is not relevant for the purposes of item (j), which calls for the assessment of a “*programme*” across its entire portfolio.²²⁶

- (g) **Why should the Panel "eliminate" the 2001 and 2002 cohorts from its examination, as suggested in paragraph 198 of the US further rebuttal submission?**

Brazil's Comment:

112. The United States confuses two issues in paragraphs 96-97 of its response.²²⁷ First, it notes that reestimates need to be applied to the subsidy estimate included in the prior, actual year column of the US budget, since the original subsidy estimate included in the budget year column of the US budget includes subsidy figures for some guarantees that are budgeted but not in fact granted. In other words, fewer guarantees are granted than were budgeted to be granted. Brazil recognized this in Exhibit Bra-193, as does the United States in the chart included with the US response to question 221(a). Nonetheless, both Brazil and the United States reach the same conclusion – over the 10-year period, operating costs and losses outpace premiums collected for the CCC programmes (even before administrative expenses are included in the calculation). The United States tracks losses of \$230

²²³ US 22 December 2003 Answers to Questions, para. 93.

²²⁴ US 22 December 2003 Answers to Questions, para. 94.

²²⁵ US 22 December 2003 Answers to Questions, para. 94.

²²⁶ See Brazil's 2 December 2003 Oral Statement, para. 81; Brazil's 18 November 2003 Further Rebuttal Submission, para. 248; Brazil's 27 August 2003 Comments on US Rebuttal Submission, para. 61.

²²⁷ US 22 December 2003 Answers to Questions, paras. 96-97.

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.

114. Finally, the United States’ assertion that there is a “trend of negative reestimates”²³⁰ is not borne out by the data provided by the United States itself, in its response to question 221(a). In 2002, upward reestimates were made for the 1992, 1993, 1994, 1995, 1996, 1997 and 1999 cohorts. Similarly, in 2003, upward reestimates were made for the 1992, 1993, 1994, 1996, 1997, 2001 and 2002 cohorts. It is not at all “reasonable to expect that in the fullness of time the data will ... reflect further negative reestimates for cohorts 2001 and 2002”,²³¹ as the United States asserts, for the simple reason that recent data provided by the United States shows significant upward reestimates *across all cohorts*, including “older” cohorts that are presumably closer to closing.

115. For all of these reasons, the US suggestion that the 2001 and 2002 cohorts should be disregarded by the Panel in its item (j) analysis should be rejected.

(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"?

Brazil’s Comment:

116. The United States notes that the original subsidy estimate for the 2000 cohort was reduced to reflect the fact that fewer guarantees were granted than were budgeted to be granted.²³² This is wholly irrelevant, and does not even remotely imply *profitability* for those guarantees that were actually issued in fiscal year 2000. As the data provided by the United States in its response to question 221(a) demonstrates, there is still a large positive subsidy estimate, indicating losses, for the 2000 cohort.

117. Moreover, the data provided by the United States in its response to question 221(a) shows that, as cohorts age, downward reestimates can not be assumed. In 2002, upward reestimates were made for the 1992, 1993, 1994, 1995, 1996, 1997 and 1999 cohorts. Similarly, in 2003, upward reestimates were made for the 1992, 1993, 1994, 1996, 1997, 2001 and 2002 cohorts. Brazil also notes that cohorts that are “older” than the 2000 cohort – such as the 1994, 1997 and 1998 cohorts, continue to show positive subsidy estimates, or losses.

²²⁸ US 22 December 2003 Answers to Questions, paras. 96, 99.

²²⁹ See e.g. Brazil’s 22 August Rebuttal Submission, para. 113 (including notes 234-235), Exhibit Bra-118 (Federal Accounting Standards Advisory Board, STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* (March 2001), p. 16 (para. 36) (“Actual historical experience of the performance of a risk category is a *primary factor* upon which an estimation of default cost is based.”)).

²³⁰ US 22 December 2003 Answers to Questions, para. 98.

²³¹ US 22 December 2003 Answers to Questions, para. 98.

²³² US 22 December 2003 Answers to Questions, para. 101.

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 paragraph 199 of its 18 November further rebuttal submission? USA**

Brazil's Comment:

119. Brazil notes that the United States has not answered the Panel's question. In the United States' view, it is only appropriate to make an assessment of a programme under item (j) using a net present value accounting methodology once all cohorts in a period are closed. The United States specifically argues as follows:

Not until the cohort is closed can one make an assessment as to whether or not that particular cohort represents a cost to the Federal Government.²³³

120. According to the United States, no cohort in the period 1992-2002 has yet closed. Therefore, in the United States' view, were the Panel to undertake a 10-year assessment of the CCC programmes under item (j) using a net present value accounting methodology, it could only do so for the period 1982-1991. Of course, since net present value accounting for the CCC programmes only began in 1992, following passage of the FCRA in 1990, subsidy estimate and reestimate figures would be unavailable for this period.

121. In insisting that it is necessary to wait until cohorts are closed to be used for the purposes of item (j), the United States is effectively saying that net present value accounting is not an appropriate way to assess a programme under item (j). As the United States is well aware, the whole point of net present value accounting, endorsed by the US Congress and the President of the United States in the FCRA, is to assess the costs of contingent liabilities, like guarantees, when they are issued, rather than when they are paid (on a default of the underlying loan). Brazil notes that there are important retrospective elements to the net present value accounting methodology imposed by the FCRA – initial estimates of costs and losses are based, first and foremost, on historical experience with borrowers²³⁴, and reestimates are calculated annually to adjust initial estimates as dictated by actual results. In any 10-year period, of course, the most recent years will have been subject to fewer reestimates than the earlier years. This is not, as the United States suggests, a flaw in the methodology. It is the methodology. The methodology records what the US Congress, the US President and US government accountants agree is a more actuarially appropriate means of assessing the costs and losses of contingent liabilities like guarantees.²³⁵

122. The United States' rejection of net present value accounting as an accurate way to make an assessment under item (j) is particularly odd given the United States' conclusion that it would be

²³³ See e.g. US 11 August 2003 Answers to Questions, para. 159.

²³⁴ See e.g. Brazil's 22 August 2003 Rebuttal Submission, para. 113 (including notes 234-235), Exhibit Bra-118 (Federal Accounting Standards Advisory Board, STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* (March 2001), p. 16 (para. 36) ("Actual historical experience of the performance of a risk category is a *primary factor* upon which an estimation of default cost is based.")).

²³⁵ Brazil's 22 July 2003 Oral Statement, para. 128.

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 assertion²³⁸, 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 separately²⁴⁰, 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.

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.”).

²³⁹ Brazil’s 27 August 2003 Comments, para. 65 (and document cited at note 81).

²⁴⁰ *See e.g.* Exhibit Bra-116 (Office of Management and Budget, Circular No. A-11, Section 185, p. 185-4); Notes to Financial Statements contained in Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation’s Financial Statements for Fiscal Years 2003 and 2002, Audit Report N° 06401-16-FM (November 2003) p. 15).

²⁴¹ Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

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 to Questions, para. 99.

²⁴³ US 22 December 2003 Answers to Questions, para. 103.

²⁴⁴ See Brazil’s 2 December 2003 Oral Statement, para. 81; Brazil’s 18 November 2003 Further Rebuttal Submission, para. 248; Brazil’s 27 August 2003 Comments on US Rebuttal Submission, para. 61.

²⁴⁵ US 22 December 2003 Answers to Questions, chart included in response to Question 221(a). See also Exhibit Bra-193.

²⁴⁶ Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

Fiscal year	Premiums collected (88.40) + Recovered principal and interest (88.40) + Interest revenue (88.25)	Admin. expenses (00.09) + Default claims (00.01) + Interest expense (00.02)
1993	\$27,608,000 + \$12,793,000 + \$15,672,000 ²⁴⁷ = \$56,073,000	\$3,320,000 ²⁴⁸ + \$570,000,000 ²⁴⁹ + \$0 ²⁵⁰ = \$573,320,000
1994	\$20,893,000 + \$458,954,000 + \$0 ²⁵¹ = \$479,847,000	\$3,381,000 ²⁵² + \$422,363,000 ²⁵³ + \$0 ²⁵⁴ = \$425,744,000
1995	\$18,000,000 + \$62,000,000 + \$0 ²⁵⁵ = \$80,000,000	\$3,000,000 + \$551,000,000 + \$10,000,000 ²⁵⁶ = \$564,000,000
1996	\$20,000,000 + \$68,000,000 + \$26,000,000 ²⁵⁷ = \$114,000,000	\$3,000,000 ²⁵⁸ + \$202,000,000 ²⁵⁹ + \$61,000,000 ²⁶⁰ = \$266,000,000
1997	\$14,000,000 + \$104,000,000 + \$26,000,000 ²⁶¹ = \$144,000,000	\$4,000,000 ²⁶² + \$11,000,000 ²⁶³ + \$62,000,000 ²⁶⁴ = \$77,000,000
1998	\$17,000,000 + \$81,000,000 + \$54,000,000 ²⁶⁵ = \$152,000,000	\$4,000,000 ²⁶⁶ + \$72,000,000 ²⁶⁷ + \$62,000,000 ²⁶⁸ = \$138,000,000
1999	\$14,000,000 + \$58,000,000 + \$0 ²⁶⁹ = \$72,000,000	\$4,000,000 ²⁷⁰ + \$244,000,000 + \$62,000,000 ²⁷¹ = \$310,000,000
2000	\$16,000,000 + \$100,000,000 + \$99,000,000 ²⁷² = \$215,000,000	\$4,000,000 ²⁷³ + \$208,000,000 ²⁷⁴ + \$62,000,000 ²⁷⁵ = \$274,000,000
2001	\$18,000,000 + \$149,000,000 + \$125,000,000 ²⁷⁶ = \$292,000,000	\$4,000,000 ²⁷⁷ + \$52,000,000 ²⁷⁸ + \$104,000,000 ²⁷⁹ = \$160,000,000

- ²⁴⁷ Exhibit Bra-126 (US budget for FY 1995, p. 156).
²⁴⁸ Exhibit Bra-126 (US budget for FY 1995, p. 156).
²⁴⁹ Exhibit Bra-126 (US budget for FY 1995, p. 156).
²⁵⁰ No budget line, Exhibit Bra-126 (US budget for FY 1995, p. 156).
²⁵¹ Exhibit Bra-95 (US budget for FY 1996, p. 162).
²⁵² Exhibit Bra-95 (US budget for FY 1996, p. 161).
²⁵³ Exhibit Bra-95 (US budget for FY 1996, p. 162).
²⁵⁴ Exhibit Bra-95 (US budget for FY 1996, p. 162).
²⁵⁵ Exhibit Bra-94 (US budget for FY 1997, p. 176).
²⁵⁶ Exhibit Bra-94 (US budget for FY 1997, p. 175).
²⁵⁷ Exhibit Bra-93 (US budget for FY 1998, p. 175).
²⁵⁸ Exhibit Bra-93 (US budget for FY 1998, p. 174).
²⁵⁹ Exhibit Bra-93 (US budget for FY 1998, p. 175).
²⁶⁰ Exhibit Bra-93 (US budget for FY 1998, p. 175).
²⁶¹ Exhibit Bra-92 (US budget for FY 1999, p. 106).
²⁶² Exhibit Bra-92 (US budget for FY 1999, p. 105).
²⁶³ Exhibit Bra-92 (US budget for FY 1999, p. 106).
²⁶⁴ Exhibit Bra-92 (US budget for FY 1999, p. 106).
²⁶⁵ Exhibit Bra-91 (US budget for FY 2000, p. 112).
²⁶⁶ Exhibit Bra-91 (US budget for FY 2000, p. 111).
²⁶⁷ Exhibit Bra-91 (US budget for FY 2000, p. 112).
²⁶⁸ Exhibit Bra-91 (US budget for FY 2000, p. 112).
²⁶⁹ Exhibit Bra-90 (US budget for FY 2001, p. 112).
²⁷⁰ Exhibit Bra-90 (US budget for FY 2001, p. 110).
²⁷¹ Exhibit Bra-90 (US budget for FY 2001, p. 111).
²⁷² Exhibit Bra-89 (US budget for FY 2002, p. 118).
²⁷³ Exhibit Bra-89 (US budget for FY 2002, p. 116).
²⁷⁴ Exhibit Bra-89 (US budget for FY 2002, p. 117).
²⁷⁵ Exhibit Bra-89 (US budget for FY 2002, p. 117).
²⁷⁶ Exhibit Bra-88 (US budget for FY 2003, p. 120).

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*

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.,* 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."). In fact, according to the US General Accounting Office, rescheduling of GSM defaults has not historically been "performing," and has rather been in arrears. *See* Brazil's 22 August 2003 Comments, para. 99 (and note 94).

²⁸⁵ *See* Brazil's 11 August 2003 Answers to Questions, para. 167 (second bullet point), *citing* Exhibit Bra-87 ("Testimony of August Schumacher Jr., Under Secretary, Farm and Foreign Agricultural Service, USDA, before the Subcommittee on General Farm Commodities, Hearing on the Asian Financial Crisis, 4 February 1998," p. 10-11) and Exhibit Bra-157 (US General Accounting Office, REPORT TO THE CHAIRMAN, TASK FORCE ON URGENT FISCAL ISSUES, COMMITTEE ON THE BUDGET, HOUSE OF REPRESENTATIVES, *International Trade: Iraq's Participation in US Agricultural Export Programs*, GAO/NSIAD-91-76 (November 1990), p. 27 (Table IV.2)). *See also* Brazil's 18 November 2003 Further Submission, para. 251.

²⁸⁶ *See* Brazil's 22 August 2003 Rebuttal Submission, para. 109 (note 226), *citing* Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 50-52 and Table 2.6). *See also* Brazil's 18 November 2003 Further Submission, para. 251.

over \$5.5 billion.²⁸⁷ Brazil emphasizes that this is just taking account of the defaults about which Brazil is aware. Brazil also notes that while the United States emphasizes the role of rescheduling in the recovery of defaults (which Brazil disputes in its comments on the US answer to question 222 below), the more than \$6 billion in defaults discussed here *have not been rescheduled*, or at least where they have been (in the case of Russian and Former Soviet Union), they are in arrears.²⁸⁸ This demonstrates that long-term operating un-recovered and non-recoverable costs and losses for the CCC programmes have outpaced premiums collected by a considerable amount.

133. Item (j) does not require the Panel to adopt or to reject any particular methodology to assess the CCC guarantee programmes.²⁸⁹ Nor do the *facts* require the Panel to endorse any one methodology to determine that the CCC guarantee programmes constitute export subsidies under item (j). Brazil has demonstrated that under *any* methodology, properly applied, premiums for the CCC guarantee programmes over the period 1992-2002 were inadequate to cover the 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

Brazil's Comment:

134. Exhibit US-128, provided by the United States in response to this question, allegedly demonstrates that using a cash basis accounting methodology, the CCC export credit guarantee programmes generate money. In fact, the United States claims that revenue collected outpaces total expenses for the three programmes by \$666 million. Brazil has offered a similar chart at paragraph 165 of its 11 August 2003 Answers. Brazil's chart demonstrates that the CCC programmes lost \$1.048 billion over the period of FY 1993-2002. The total difference between the US result and Brazil's result is \$1.75 billion.

135. This figure closely corresponds to the total "Claims Rescheduled" figure reported by the United States in Exhibit US-128.²⁹⁰ Indeed, the difference between the chart provided by the United States in Exhibit US-128 and Brazil's chart in paragraph 165 of its 11 August 2003 Answers lies in the treatment of rescheduled debt.²⁹¹ The United States treats defaulted guarantees that have

²⁸⁷ Brazil has calculated that the highest amount of premiums that could have been generated would amount to approximately \$450 million. See Brazil's 11 August 2003 Answers to Questions, para. 167 (second bullet point). Data included in Exhibit US-128 suggests that Brazil is over-estimating the amounts of premia collected.

²⁸⁸ The US General Accounting Office noted that defaults on Russian and Former Soviet Union guarantees reached \$2 billion by the end of 1993, and that despite repeated rescheduling agreements, those debts were not being repaid. Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 50-52 and Table 2.6). Brazil raised this point in its 22 August 2003 Rebuttal Submission (at para. 109, note 226) and its 18 November 2003 Further Submission (para. 251). It remains unrebutted by the United States.

²⁸⁹ See Brazil's 22 December 2003 Answers to Questions, paras. 68-75.

²⁹⁰ The fact that both figures do not match exactly is explained by the fact that the United States analyses data covering FY 1992-2003 on a cohort-specific basis, while the data available to Brazil covers FY 1993-2002 and represents actual performance of the CCC programs during a given fiscal year.

²⁹¹ If the Panel were to compare all other totals, it would readily see that the totals correspond, taking into account that the US data covers FY 1992-2003 and is on the basis of cohorts, while Brazil's data covers only FY 1993-2002 and represents the actual performance of the programs in a fiscal year. Brazil does not have

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) The US approach, therefore, overstates the effect rescheduled guarantees have on claims paid, by automatically treating rescheduled guarantees, in every instance, as actual recoveries of claims paid, at the moment the terms of the rescheduling are agreed. (Indeed, the CCC’s Financial Statement for FY 2002 and 2003 confirm that rescheduling of export credit guarantee receivables covered both principle and interest, thereby confirming that not all of the rescheduled debt performs and that additional interest charges were also rescheduled.)²⁹⁸

access to FY 2003 data, as the actual figures for that year will only be published in connection with the FY 2005 budget.

²⁹² See Exhibit US-128. The United States defines “Claims Outstanding” (G) as “Claim Payments” (D) minus “Claims Recovered” (E) minus “Claims Rescheduled” (F). It follows that a rescheduled claim no longer constitutes an outstanding claim at the moment the terms of the rescheduling are agreed. Instead, for accounting purposes, the rescheduling is simply treated as 100 percent recovered.

²⁹³ This is the reason that Brazil treats recovered principle as a revenue inflow for accounting purposes. The principle recovered is netted against the claims paid by CCC (see Brazil’s 11 August 2003 Answers to Questions, para. 163).

²⁹⁴ Contrary to this approach, the United States nets defaults paid against the sum of recovered and rescheduled defaults (see Exhibit US-128). However, it only *hopes* to eventually recover rescheduled debt; the rescheduling alone does not mean it will do so.

²⁹⁵ See Exhibit Bra-115 (US General Accounting Office (“GAO”), Report to the Chairman, Subcommittee on Criminal Justice, US House of Representatives Committee on the Judiciary, “Loan Guarantees: Export Credit Guarantee Programs’ Long-Run Costs Are High,” GAO/NSIAD-91-180, 19 April 1991, p. 3 (Table 1, Note a) (“GAO/NSIAD-91-180”) (accounts receivable for the GSM programmes “[i]ncludes delinquent payments and *rescheduled debt not yet due.*”) (emphasis added).

²⁹⁶ Brazil’s 27 August 2003 Comments on US Rebuttal Submission, para. 64.

²⁹⁷ Brazil’s 22 August 2003 Comments, para. 99. See also Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 50-52 and Table 2.6 (noting that in 1995 defaults on Russian and Former Soviet Union guarantees reached \$2 billion by the end of 1993, and that despite repeated rescheduling agreements, those debts were not being repaid.); Exhibit Bra-152 (GAO, Statement of Allan I. Mendelowitz, Director, Trade, Energy and Finance Issues, National Security and International Affairs Division, before the Task Force on Urgent Fiscal Issues of the Committee on Budget of the US House of Representatives, *Status Report on GAO’s Reviews of the Targeted Export Assistance Programme, the Export Enhancement Programme, and the GSM-102/103 Export Credit Guarantee Programmes*, GAO/T-NSIAD-90-53, 28 June 1990, p. 14 (noting that historically, the majority of GSM support that is rescheduled is “in arrears.”).

²⁹⁸ Exhibit US-129 (CCC Financial Statements for FY 2002 and 2003 – Audit Report, USDA, Office of the Inspector General, Report No. 06401-16-FM, November 2003, Note 5, p. 22).

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 forfeiting 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 forfeits and CCC export credit guarantees are not similar financial instruments, and therefore that the terms for forfeits 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.

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 Questions, paras. 63-64.

³⁰² *See* Exhibit Bra-190 (Affidavit of Marcelo Franco, Seguradora Brasileira de Crédito à Exportação).

³⁰³ Brazil’s 22 August 2003 Rebuttal Submission, paras. 103-105; Brazil’s 27 August 2003 Comments on US Rebuttal Submission, paras. 68-70; Brazil’s 7 October 2003 Oral Statement, para. 72; Brazil’s 18 November 2003 Further Rebuttal Submission, paras. 233-241; Brazil’s 2 December 2003 Oral Statement, para. 79; Brazil’s 22 December 2003 Answers to Questions, paras. 65-66.

³⁰⁴ US 22 December 2003 Answers to Questions, para. 109.

³⁰⁵ US 22 December 2003 Answers to Questions, para. 109.

³⁰⁶ Exhibit Bra-38 (7 CFR 1493.10(a)(2) (GSM 102 and GSM 103 regulations)). *See also* Exhibit Bra-38 ((7 CFR 1493.400(a)(2) (SCGP regulations)).

³⁰⁷ *See, e.g.*, Brazil’s 18 November 2003 Further Rebuttal Submission, para. 237.

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 forfeiting 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 forfeiting fees five months ago, with its 27 August 2003 submission. That evidence demonstrates that forfeiting 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 – forfeiting fees additionally vary according to the risks involved in the transaction³¹⁰, 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

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 Forfeiting 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 forfeits. 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.

fees levied by a market-based institution are accounted for, the differences become even more pronounced.³¹⁸

144. This comparison likely understates the extent to which CCC rates are below-market, for two reasons. First, government support from Ex-Im Bank does not constitute a market benchmark for the purposes of Article 1.1(b) of the SCM Agreement.³¹⁹ Nonetheless, this comparison demonstrates that the CCC guarantee programmes do not even meet *non-market* benchmarks.³²⁰ Second, the comparison involves export credit insurance for small businesses. As noted by the US International Trade Administration's Foreign Commercial Service, export credit insurance for small businesses is offered at reduced premium rates.³²¹

145. Finally, because the provisions address somewhat different disciplines and could require different means of implementation, Brazil reiterates its earlier request that the Panel find that the CCC programmes constitute export subsidies by virtue of *both* Articles 1 and 3.1(a) of the SCM Agreement *and* item (j).³²²

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

Brazil's Comment:

146. Brazil notes that it has accounted for CCC's interest expense and revenue figures (lines 00.02 and 88.25 of the US budget) in its cash-basis accounting methodology.³²³

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

Brazil's Comment:

147. As noted in Brazil's comment on the US response to question 221(i), if the Panel uses a net present value accounting methodology to assess the CCC programmes under item (j), the United States would not be held accountable (in these proceedings, at least) for write-offs on pre-1992 cohorts. Activity on CCC guarantees issued before 1992 is not in any way included in the net present

³¹⁸ Compare Export Insurance Services, Inc. fee schedule in Exhibit Bra-410 (p. 6-7) with CCC fee schedule in Exhibit Bra-155.

³¹⁹ See Appellate Body Report, *United States – Countervailing Duties on EC Products*, WT/DS212/AB/R, para. 124 (Appellate Body questions whether a “fair market price” is reached when a government “shapes” the market, stating that “[t]he Panel’s absolute rule of ‘no benefit’ may be defensible in the context of transactions between two private parties taking place in reasonably competitive markets; however, it overlooks the ability of governments to obtain certain results from markets by shaping the circumstances and conditions in which markets operate.”). See also Arbitrator’s Decision, *Brazil Aircraft*, WT/DS46/RW, para. 6.95 (One reason the Panel offered for rejecting a proposed benchmark was that the benchmark was “the direct result of a *government* guarantee,” rather than an indication of the “commercial or market rate of interest.”). See also *id.*, paras. 6.90-6.92, 6.104.

³²⁰ The Panel will recall that Brazil made a similar comparison between Ex-Im Bank export guarantee fees and CCC export guarantee fees, and reached the same result. See Brazil’s 22 August 2003 Comments, para. 110.

³²¹ Exhibit Bra-411 (*The Federal Scoop: US Government Financing for Service Exports*, EXPORT AMERICA (May 2000), p. 33).

³²² Brazil’s 18 November 2003 Further Rebuttal Submission, para. 228.

³²³ See Brazil’s 11 August 2003 Answers to Questions, para. 165. See also Brazil’s comments on Question 221(i), above.

value data provided by the United States in its response to question 221(a), or by Brazil in Exhibit Bra-193.³²⁴ Even without the effect of the write-offs detailed in paragraph 114 of the US 22 December 2003 response – all of which relate to pre-1992 cohorts – 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).³²⁵ (For a complete assessment under item (j), administrative expenses in the amount of approximately \$39 million should be added.³²⁶)

148. Under a cash-basis accounting methodology of assessing the CCC programmes under item (j), the United States should be held accountable for write-offs and “debt forgiveness” (as defined in paragraph 113 of the US response) that occurred during the period 1992-2002, even if it relates to guarantees that were issued before 1992. Although this is not clear from the US 22 December 2003 response, to the extent that the write-offs catalogued in paragraph 114 of the US 22 December 2003 response are related to *defaults* that occurred in the period 1992-2002, Brazil presumes that the defaults themselves would be included in the line item (00.01) for default claims, which are tracked in the chart included at paragraph 165 of Brazil’s 11 August 2003 Answers to Questions, and reproduced in Brazil’s comments on the US response to question 221(i), *supra*. Applying a cash-basis accounting methodology, Brazil demonstrated that long-term operating costs and losses outpace premiums collected over the period 1992-2002 for the CCC programmes, by \$1.083 billion.

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

Brazil’s Comment:

149. As discussed in Brazil’s comment on the US response to question 225, if the Panel uses a net present value accounting methodology to assess the CCC programmes under item (j), the United States would not be held accountable (in these proceedings, at least) for write-offs that occurred more than 10 years ago. The reason is that those write-offs would relate to guarantees issued prior to 1992. Activity on CCC guarantees issued before 1992 is not in any way included in the net present value data provided by the United States in its response to question 221(a), or by Brazil in Exhibit Bra-193.³²⁷

150. Under a cash-basis accounting methodology of assessing the CCC programmes under item (j), the United States would not be held accountable for write-offs and “debt forgiveness” that occurred more than 10 years ago (at least in this proceeding), assuming that the period of review is 1993-2002. This is because the underlying defaults would also have occurred more than 10 years ago, even before the write-offs or forgiveness.

151. However, Brazil would like to correct the United States’ mischaracterization of Brazil’s position about the 10-year period of review for an assessment under item (j). Brazil does not agree, as the United States asserts, that an examination beyond 10 years is “inappropriate”.³²⁸ Rather, Brazil

³²⁴ As Brazil notes in its comment on Question 221(g), however, estimates of costs and losses made in the context of the FCRA formula are based, first and foremost, on historical experience with borrowers. Thus, prior defaults would tend to lead to positive subsidy estimates on new guarantees.

³²⁵ See US 22 December 2003 Answers to Questions, response to Question 221(a); Brazil’s Exhibit Bra-193.

³²⁶ Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

³²⁷ As Brazil notes in its comment on the US response to Question 221(g), however, estimates of costs and losses made in the context of the FCRA formula are based, first and foremost, on historical experience with borrowers. Thus, prior defaults would tend to lead to positive subsidy estimates on new guarantees.

³²⁸ US 22 December 2003 Answers to Questions, para. 102.

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 – 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:

152. In paragraphs 117-118 of its 22 December 2003 response, the United States again rejects use of the FCRA formula as an appropriate methodology to make an assessment of the CCC programmes under item (j), since it is based on "estimates". As noted above, the United States' view is that it is only appropriate to use a net present value accounting methodology once all cohorts in a period are closed.³³⁰ In paragraphs 117 and 121 of its 22 December 2003 response, the United States argues that the "credit guarantee liability" figure included in the CCC financial statements, which is calculated using a net present value accounting methodology, does not reflect "losses", within the meaning of item (j), but instead only estimated losses.

153. This does not stop the United States from appealing to the FCRA formula when it believes it suits its purposes to do so. In paragraph 119, the United States cites with approval the \$22 million credit guarantee liability figure used in CCC's 2003 financial statements as evidence of "good performance" by the CCC guarantee programmes. Brazil notes, however, that at page 4 of the notes to its 2003 financial statements, CCC defines the term "credit guarantee liability" as "the estimated net cash outflows (loss) of the guarantees on a net present value basis".³³¹ Thus, the \$22 million figure still represents a "loss", as does the \$230 million cumulative figure listed in the chart included with the US response to question 221(a). For a complete assessment under item (j), administrative expenses in the amount of approximately \$39 million should be added.³³²

154. Finally, Brazil directs the Panel's attention to the massive increase from 2002 to 2003 in the losses CCC considers it will incur at the time all post-1991 guarantee cohorts are closed. At page 15 of the notes to its 2003 financial statements, CCC estimates that when all post-1991 cohorts close, it

³²⁹ Notes to Financial Statements contained in Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002, Audit Report N° 06401-16-FM (November 2003) p. 15). Brazil notes that unlike the CCC 2002 financial statements included in Exhibit Bra-158, the CCC 2003 financial statements included in Exhibit US-129 are not publicly available on the USDA website. See <http://www.usda.gov/oig/rptsauditsccc.htm>.

³³⁰ See e.g. US 11 August 2003 Answers to Questions, para. 159 ("Not until the cohort is closed can one make an assessment as to whether or not that particular cohort represents a cost to the Federal Government.").

³³¹ Notes to Financial Statements contained in Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002, Audit Report N° 06401-16-FM (November 2003) p. 4).

³³² Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

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

³³³ Notes to Financial Statements contained in Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002, Audit Report N° 06401-16-FM (November 2003) p. 15). The United States reports that premiums of \$246 million were collected on CCC guarantees over the period 1992-2003. See Exhibit US-128.

³³⁴ Brazil's 18 November 2003 Further Rebuttal Submission, paras. 96-107; Brazil's 2 December 2003 Oral Statement, paras. 4-6.

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 producers³³⁶, 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

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 suppression³⁴² 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

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 non-subsidized Member. Only production subsidies that generate price suppression significant enough to “materially affect” competitors would be subject to the disciplines of Part III. This is far from an insignificant threshold, and gives meaning to the word “significant”.

165. Second, this US argument is similar to other arguments it has made to the effect that any limitations on the amount of subsidies would change “actionable” subsidies to “prohibited” subsidies.³⁴⁷ The United States loses sight of the basic fact that an actionable subsidy that creates adverse effects is a violation of WTO rules. No Member has the right to provide unlimited production subsidies *if* they cause serious prejudice. Members deciding to impose discretionary or mandatory limits on the amount of production subsidies may significantly diminish the possibility that such subsidies create significant price suppression or an ongoing threat of serious prejudice. But it is wrong for the United States to argue that because the only practical way to impose limitations on production subsidies may be some sort of a cap on such subsidies necessarily an actionable subsidy is turned into a “prohibited subsidy”.³⁴⁸

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

236. The Panel notes Exhibit US-47 (and the chart in paragraph 13 of the US 2 December oral statement). Please provide a conceptually analogous chart to Exhibit US-63 with respect to data relating to the US interpretation of "world market share". USA

Brazil’s Comment:

166. Brazil considers it telling that the United States does not provide the percentage figures underlying the chart at paragraph 138 of its 22 December 2003 response. This is because the percentage figures reveal that the US methodology suffers from a fatal flaw. The sum of the US world market share, as defined by the United States³⁴⁹, and the “rest of the world” market share, as

³⁴⁵ Brazil’s 9 September 2003 Further Submission, Table 22; Brazil’s 7 October Oral Statement, paras. 30-34.

³⁴⁶ See Brazil’s 9 September 2003 Further Submission, paras. 148-161, 190, 200-232, 254, 379-384 and Table 23.

³⁴⁷ US 2 December 2003 Oral Statement, paras 83-84.

³⁴⁸ US 2 December 2003 Oral Statement, paras 83-84.

³⁴⁹ “(Domestic Mill Use + Exports)” / Total World Consumption; *see* US 22 December 2003 Answers to Questions, para. 137.

defined by the United States³⁵⁰, far exceeds 100 per cent. To clarify this point, Brazil presents the following table, based on the data provided by the United States in Exhibit US-47 and in response to question 197.³⁵¹

	US Domestic Consumption	US Exports	World Consumption	Non-US ³⁵² Domestic Consumption	Non-US Exports	US Share ³⁵³	Non-US Share	Total Share
	million bales					per cent		
1995	10.647	7.675	86.040	75.393	19.900	21.29	110.75	132.05
1996	11.126	6.865	88.031	76.905	20.100	20.44	110.19	130.63
1997	11.349	7.500	87.138	75.789	19.300	21.63	109.12	130.76
1998	10.401	4.298	84.640	74.239	19.400	17.37	110.63	128.00
1999	10.194	6.750	90.957	80.763	20.600	18.63	111.44	130.07
2000	8.862	6.740	92.172	83.310	19.800	16.93	111.87	128.79
2001	7.696	11.000	94.381	86.685	18.100	19.81	111.02	130.83
2002	7.270	11.900	97.930	90.660	18.700	19.58	111.67	131.25
2003	6.200	13.200	97.690	91.490	19.100	19.86	113.20	133.06

167. Indeed, as the Panel can readily see, the “rest of the world” “world market share”, as defined by the United States, exceeds 100 per cent – a result that defies any logic.

168. For the ease of the Panel’s reference, Brazil presents an excerpt from its own figures originally presented in Exhibit Bra-302,³⁵⁴ showing that, under Brazil’s and USDA’s definition of the “world market share,” the total world market share equals 100 per cent.

³⁵⁰ “(Non-US Domestic Mill Use (*i.e.* consumption) + Non-US Exports) / Total World Consumption.

³⁵¹ US 22 December 2003 Answers to Question, para. 15 and Exhibit US-120. Since the United States did not provide any data on “Non-US Exports,” Brazil has used USDA published figures on “Foreign Cotton Exports” from USDA’s Cotton and Wool Yearbook (Exhibit Bra-412 (Cotton and Wool Situation and Outlook Yearbook, USDA, November 2003, Table 16).

³⁵² “World Consumption minus US Domestic Consumption.”

³⁵³ The 2003 figure differs a little from what would seem to be the 2003 figure in the US table at paragraph 138 of the US 22 December 2003 Answers to Questions. It appears that the reason is the United States use of its non-updated figures from Exhibit US-47, rather than the updated MY 2002 and 2003 figures from its 22 December 2003 response to Question 197, para. 15.

³⁵⁴ See also Brazil’s 27 October 2003 Answers to Questions, paras. 123-129.

	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 clearly establishes that, in MY 2001, 2002 and 2003, there is an increase in the US world market share over the previous three-year average, and that this increase follows a consistent trend since MY 1996 (and MY 1986).³⁵⁶ In response to this question, the United States again relies on an utterly wrong interpretation of the term "world market share" in Article 6.3(d) of the SCM Agreement. The term

³⁵⁵ Brazil's 22 December 2003 Answers to Questions, para. 134.

³⁵⁶ Brazil's 22 December 2003 Answers to Questions, paras. 133-139; Brazil's 27 October 2003 Answers to Questions, paras 123-129. Brazil further notes the new information presented by the United States concerning US upland cotton exports in MY 2002 and 2003. These figures (11.9 million bales and 13.2 million bales respectively) would replace Brazil's latest information, as contained in Exhibit Bra-302 (11.3 million bales and 11.2 million bales respectively). These new facts strengthen Brazil's threat of serious prejudice claim under Article 6.3(d) and footnote 13 of the SCM Agreement. See US 22 December 2003 Answers to Questions, para. 15 and Brazil's comment to US 22 December 2003 Answer to Question 197, above.

does not mean “world consumption share”, but world market share of exports, as detailed by Brazil many times, including in these comments.

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?

Brazil's Comment:

171. Brazil understands that the Panel's question referred to the distinction between “competitive markets,” where world upland cotton producers/exporters compete for available share of world exports, and “closed markets”, where no competition for export market share can take place because of subsidies like the domestic Step 2 programme, tariffs, or non-tariff barriers.³⁵⁷ The US 22 December 2003 response, at paragraph 140, affirms that the United States would greatly increase and distort the Article 6.3(d) denominator by including, *inter alia*, all sales of US upland cotton in the US market. Yet, there is little “international trade” in the US domestic upland cotton market, because there were only marginal imports during MY 1999-2002.³⁵⁸ The effect of the US argument is to obscure and hide the huge volume and market share increase in US exports in “competitive” markets during MY 1998-2003. As Brazil has argued, the US focus on “consumption” as opposed to “trade” is contrary to the text, context, and object and purpose of Article 6.3(d).³⁵⁹ Article 6.3(d) focuses on “trade”, not domestic consumption, and thus involves competitive world markets where exports and trade take place.³⁶⁰

172. It is noteworthy that the US answer ignores un-rebutted evidence that USDA's top economists and analysts repeatedly use the phrase “world market share” to describe and analyze how US agricultural exporters are performing in competitive world markets for exports.³⁶¹ The United States never provided a single instance in which USDA economists – or any other Member's economists – included domestic US consumption in their analysis of the US “world market share”. This is because the unique US notion of “consumption” (which combines exports, domestic use, and imports as part of “consumption”) simply does not exist (in the literature or trade statistics) outside of the US arguments in this case.

(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?

Brazil's Comment:

173. The US 22 December 2003 response in effect acknowledges, at paragraph 142, that the US subsidies could be subject to a challenge under Article 6.3(d) even though those subsidies did not cause any increase in US exports. Under the US theory, even though none of the non-subsidized producer/exporters of upland cotton would have lost any world export market share, these producers could initiate a claim against the United States under Article 6.3(d), in addition to Article 6.3(a), because the US domestic production and domestic consumption increased. This US response

³⁵⁷ Brazil detailed its arguments concerning the focus of Article 6.3(d) on competitive markets and where “trade” takes place in its 7 October 2003 Oral Statement, paras. 38-41.

³⁵⁸ For example, between MY 1999-2001, US imports represented only 0.2 percent of total US mill use of upland cotton. See Exhibit Bra-4 (“Fact Sheet: Upland Cotton,” USDA, January 2003, p. 4-5).

³⁵⁹ Brazil's 7 October 2003 Oral Statement, paras 38-41; Brazil's 27 October 2003 Answers to Question, paraa. 202-206; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 170-172; Brazil's 2 December 2003 Oral Statement, paras. 62-65.

³⁶⁰ Brazil's 7 October 2003 Oral Statement, para. 39.

³⁶¹ Brazil's 7 October 2003 Oral Statement, note 78.

highlights the disconnect between its theory and the reality of what Article 6.3(d) really is about – the impact of subsidies on trade in the product in question in competitive international markets.

174. Of course, the Part III of the SCM Agreement discipline addressing the Panel’s hypothetical factual situation is Article 6.3(a). The United States argues in paragraph 143 that “Brazil’s approach ... would allow a larger or even dominant upland cotton consumer to provide huge per-unit production subsidies that increased the share of its own domestic consumption that its production supplied *without any disciplines under Article 6.3(d)*, regardless of the impact on other Members who could potentially supply that increasing domestic consumption” (emphasis added). But what the US-positing hypothetical outlines is a classic “displacement or impedence” case under Article 6.3(a). “But for” the “huge per-unit production subsidies”, the non-subsidized Member exporters would have increased or maintained their export market share in the market of the subsidizing Member. Thus, interpreting Article 6.3(d) to mean the “world market share of exports” does not leave non-subsidized Member producers who are squeezed out of the subsidizing Member’s market without a remedy. And the fact that Article 6.3(d) does not *also* discipline the situation covered by Article 6.3(a) is hardly surprising, since negotiators presumably intended different provisions to cover different situations.

175. Indeed, the US argument in paragraph 143 highlights the fallacy of its interpretation. It argues that “the ordinary meaning of ‘world market share’ in Article 6.3(d) ... would capture impacts both on the market of the subsidizing Member (as in Article 6.3(a)) and in third-country markets (Articles 6.3(b) and 6.3(c))”.³⁶² But if that were true, then there would be no need for Articles 6.3(a) and 6.3(b).³⁶³ The US interpretation would render one of the sets of disciplines a nullity, in violation of the customary rules of treaty interpretation as codified in the *Vienna Convention*.

176. Finally, rather than capturing all the possible instances where subsidies can cause serious prejudice in world markets, the US “consumption” interpretation of “world market share” leaves a gaping hole in the serious prejudice remedies. The facts of this case show how the US interpretation would completely hide the huge US increase in world market share of exports – from 25 per cent in MY 1999 to 41.6 per cent in MY 2002. Where a Member uses subsidies to capture export market share in the competitive world market, it causes serious prejudice by limiting the opportunities for non-subsidized Members to increase their exports.³⁶⁴ The record shows that African upland cotton producers, with among the lowest world production costs, actually *lost* world market share to the United States between MY 1998-2002.³⁶⁵ Yet, the US interpretation of Article 6.3(d) would deny them, as well as Brazil, any remedy to challenge such an increase in the US world market share of exports.

³⁶² US 22 December 2003 Answers to Questions, para. 143.

³⁶³ Article 6.3(a) disciplines the situation described in the Panel’s question: a Member using subsidies to increase the share of domestic consumption satisfied by domestic supply (*i.e.*, displacing or impeding imports into the market of the subsidizing Member). Article 6.3(b) disciplines such effects of a Member’s subsidies (displacing or impeding exports) in a third country market. Article 6.3(c) disciplines significant price effects of a Member’s subsidies in all markets. Brazil’s 2 December 2003 Oral Statement, para. 63.

³⁶⁴ See Brazil’s 9 September Further Submission, paras. 451-456; paras 444-453 (facts supporting the interconnected relationship between the serious prejudiced due to price suppression and the serious prejudice due to increased world market share); Annex III Statements by Brazilian producers Christopher Ward, Jaime Naito, Aloysio Lerner and Ronaldo Spirlandelli de Oliveria, among others.

³⁶⁵ Brazil’s 9 September 2003 Further Rebuttal Submission, Section 7.1 and Figure 26 following para. 282.

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

Brazil's Comment:

177. Contrary to the US 22 December 2003 response, Brazil has no difficulty appreciating the relevance of the Panel's question. Even accepting the US figures, which include Saudi Arabian consumption of crude oil to produce refined products that are then exported, the US response highlights the significant (25 per cent) difference between their "consumption" methodology and a world market share of exports methodology.³⁶⁶

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);**

Brazil's Comment:

178. The US 22 December 2003 response confirms Brazil's arguments that the US interpretation leaves no direct remedy for a Member who either loses or is not able to increase its world market share of exports as a result of another Member's subsidies.³⁶⁷ The United States asserts in paragraph 147 of its answer, that Article 6.3(b) provides such a remedy. But that provision only addresses a non-subsidizing Member's right to contest the effects of subsidies in, *inter alia*, increasing a subsidizing Member's export market share in an *individual* third country market. The *EC – Sugar Exports I (Australia)* and *EC- Sugar Exports II (Brazil)*³⁶⁸ disputes demonstrated how difficult it can be for a non-subsidizing Member to demonstrate displacement or impedence in an individual third country market. Article 6.3(d) helped to address this legal vacuum by providing clear, objective guidelines for subsidizing Members to know when their increase in world market share of exports would be subject to disciplines, and to provide an objective basis for the injured non-subsidized exporting Member to evaluate and protect its rights.

179. The United States further argues, in paragraph 147 of its response, that Article 5(a) of the SCM Agreement would provide a remedy for a non-subsidized Member who lost world market share in exports. But while that provision relates to "injury to the domestic industry of another Member", footnote 11 of the SCM Agreement qualifies that the "injury" "is used in the same sense as it is used in Part V". "Injury" is defined in Article 15.1 *et seq.* of the SCM Agreement as that caused by (a) the volume of the subsidized *imports* and the effect of the subsidized imports on prices in the domestic market for like products, and (b) the consequent impact of these imports on the domestic producers of such products. In the context of this dispute, this remedy would appear to apply only to US subsidized exports to the Brazilian market (*i.e.*, the "domestic" market). Contrary to the US argument, Article 5(a) would not address the situation covered by Article 6.3(d), where Brazilian exporters suffer serious prejudice by an increase in the US world market share of exports.

180. Finally, the United States claims, at paragraph 147 of its response, that Article XVI:1 of GATT 1994 would provide Brazil with the right to challenge the US world market share for exports. Brazil agrees that GATT Article XVI:1, as read in conjunction with GATT Article XVI:3, provides for a very analogous recourse as that provided for in Article 6.3(d), *i.e.*, any subsidies that increase exports and lead to an inequitable share of world export trade. But the United States contradicts itself

³⁶⁶ US 22 December 2003 Answers to Questions, para. 145.

³⁶⁷ See *e.g.* Brazil's 2 December 2003 Oral Statement, para. 64.

³⁶⁸ GATT Panel Report, *EC – Sugar Exports I (Australia)*, L/4833 – 26S/290, para. 4.26-4.27; GATT Panel Report, *EC – Sugar Exports II (Brazil)*, L/5011-27S/69, para. 414.

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 6.3.³⁶⁹

181. In sum, the Panel is left with the US interpretations that (a) there is no longer any disciplines for a Member suffering from a decrease in its world market share for exports under Article XVI:3, second sentence on the one hand³⁷⁰, and (b) Article XVI:3's presumed successor, Article 6.3(d), does not apply to the world market share of exports. In effect, Members are left without any explicit protection for their loss of world market share of exports due to massive subsidization. Such a result defies the text, context, and object and purpose of Article 6.3(d), as Brazil has repeatedly argued.

182. In any event, whether there may be – outside Article 6.3(d) of the SCM Agreement – indirect disciplines that may provide some relief to non-subsidizing Members whose rights have been nullified and impaired by a subsidizing Member's increase in world market share of exports does not free the Panel from its obligation to interpret the term “world market share” in Article 6.3(d) in accordance with its “ordinary meaning, in their context and in light of the treaty's object and purpose”. Brazil demonstrated that under a *Vienna Convention* analysis, the term “world market share” means world market share of exports – not consumption.³⁷¹

(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

Brazil's Comment:

183. In paragraph 148 of its 22 December 2003 response, the United States does not address the substance of the Panel's question or Brazil's earlier arguments. That is, the United States does not respond to the fact that its methodology double counts exports as part of the world market share of the exporting country *and* the importing country.³⁷² In effect, the United States requires this Panel to ignore this illogical conceptual error in its interpretation of the term “world market share”. Instead, the United States insists that it is not incumbent upon the Panel “to interpret the term ‘domestic consumption’”.³⁷³ Brazil agrees, but that is because the term “domestic consumption” is nowhere to be found in the text or context of Article 6.3(d) of the SCM Agreement. Nor is it consistent with the object and purpose of Article 6.3(d). But since the United States would read “consumption” into that text, then the Panel must closely examine its meaning, using appropriate context to do so. And it should reject the use of that term if it leads to an interpretation that is illogical, leads to absurd results, and otherwise fails to live up to the standards on the interpretation of international treaties, as set out in the *Vienna Convention*.

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

³⁶⁹ US 22 December 2003 Answers to Questions, para. 149.

³⁷⁰ US 22 December 2003 Answers to Questions, para. 146.

³⁷¹ Brazil's 7 October 2003 Oral Statement, paras. 38-41; Brazil's 27 October 2003 Answers to Question, para. 202-206; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 170-172; Brazil's 2 December 2003 Oral Statement, paras 62-65.

³⁷² The United States admits that its methodology counts imports as part of domestic consumption. See US 22 December 2003 Answers to Questions, Table at para. 15 and note 24.

³⁷³ US 22 December 2003 Answers to Questions, para. 148.

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 fundamental key to its interpretation. The US argument would include *all* markets where upland cotton is produced, consumed, or used when it states that Article 6.3(d) is *not* limited to "markets in international trade". But this argument ignores the fundamental focus of Article 6.3 (as well as Part III of the SCM Agreement itself) on *international* trade and the impact of subsidies on *competition* between subsidized and non-subsidized producers and their products. For example, Article 6.3(a) involves situation, in which exporters are impeded or displaced from the market of the subsidizing Member. Articles 6.3(b) and 6.4 involve the situation, in which the export share of a subsidizing Member squeezes out or limits the export share of the non-subsidizing Member in a third

³⁷⁴ Brazil's 18 November 2003 Further Rebuttal Submission, para. 172.

³⁷⁵ Brazil's 27 October 2003 Answer to Question 161, para. 130 and Question 196(b), paras. 202-206.

³⁷⁶ Brazil's 18 November 2003 Further Rebuttal Submission, paras 170-172; Brazil's 7 October Oral Statement, paras. 38-41.

³⁷⁷ Brazil's 27 October 2003 Answer to Question 185, paras. 194-201; Brazil's 18 November 2003 Further Rebuttal Submission, paras 178-179.

³⁷⁸ US 22 December 2003 Answers to Questions, para. 149.

³⁷⁹ US 27 October 2003 Answers to Questions, para. 130. For purposes of Article XVI:3 of the General Agreement and paragraph 1 above:

- (a) "more than an equitable share of world export trade" shall include any case in which the effect of an export subsidy granted by a signatory is to displace the exports of another signatory bearing in mind the developments on world markets;
- (b) with regard to new markets traditional patterns of supply of the product concerned to the world market, region or country, in which the new market is situated shall be taken into account in determining 'equitable share of world export trade' [.]

³⁸⁰ See US 27 October 2003 Answers to Questions, para. 130.

³⁸¹ US 22 December 2003 Answers to Questions, para. 149; US 27 October 2003 Answers to Questions, paras. 131-132.

country market. And the United States has argued that Article 6.3(c) only involves situations, in which prices are suppressed in markets where competition between the subsidized products and the non-subsidized like products take place.³⁸² In essence, the key to initiating a claim under all three of these provisions is demonstrating that “trade” and “competition” have been affected through the use of subsidies.

188. The Panel must ask how is it possible that Articles 6.3(a) – (c) only apply to situations where international trade and competition actually take place (or are impeded from taking place), while Article 6.3(d) is totally different – it is to be read without any reference to competition and trade *at all*? The United States asserts that the “world” in “world market share” means the “entire world,” without regard to whether there is trade or competition between subsidizing Member products and those of non-subsidizing Members.³⁸³ But this slavishly literal reading goes too far. Brazil submits that read in this context, along with the other contextual provisions such as “trade” in footnote 17 of the SCM Agreement, and Article XVI:3, second sentence, that the US interpretation is simply wrong.

189. The United States further argues, at paragraph 149 of its response, that “Brazil has not offered any objective definition” of “equitable share”. This is incorrect.³⁸⁴ Further, the fact that certain GATT and WTO provisions express disciplines in broad terms, such as “equitable” or “reasonable” or “serious” or “significant,” does not mean that a treaty interpreter can simply throw up his or her hands and find, as the United States urges, that a provision is incapable of interpretation. Article 31 of the *Vienna Convention* provides that “the words of a treaty are to be given their ordinary meaning, in their context and in light of the treaty’s object and purpose”.³⁸⁵ Further, the Appellate Body held in *US – Gasoline* that “an interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility”.³⁸⁶ Thus, the Panel should reject this US attempt to condemn Article XVI:3.

190. However, should the Panel decide that GATT Article XVI:3, second sentence is, indeed, inapplicable, then this certainly strengthens the basis for the Panel to interpret the phrase “world market share” in Article 6.3(d) as meaning the “share of world export trade”. It is inconceivable that negotiators – who certainly did not expressly terminate the application of Article XVI:3, second sentence – would also intend, without making it explicit, that there would be no disciplines for subsidies that allowed Members to seize world market share of exports in competitive markets.

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-47 or US-71? USA

Brazil’s Comment:

191. The US 22 December 2003 response appears to have clarified that the graph in paragraph 34 of its 30 September 2003 Further Submission relates to US finished cotton fibre consumption, while the “consumption” referred to in Exhibits US-40, US-47 and US-71 relates to upland cotton lint consumption by US textile mills. Brazil has demonstrated the irrationality of the US world market share of upland cotton consumption data in terms of Article 6.3(d). Brazil has also demonstrated the irrelevance of the US arguments concerning the US consumption of finished textile products.³⁸⁷

³⁸² US 18 November 2003 Further Rebuttal Submission, paras. 37-40.

³⁸³ US 22 December 2003 Answer to Questions, para. 151.

³⁸⁴ Brazil refers the Panel and the United States to its oral answers to the Chairman’s questions during the October 2003 meeting of the Panel, paragraphs 17-18 of Brazil’s 9 October 2003 Closing Statement, and paragraphs 189-193 of Brazil’s 27 October 2003 Answers to Questions.

³⁸⁵ Appellate Body Report, *US – Gasoline*, WT/DS2/AB/R, p. 17.

³⁸⁶ Appellate Body Report, *US – Gasoline*, WT/DS2/AB/R, p. 23.

³⁸⁷ Brazil’s 7 October 2003 Oral Statement, para.25.

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 comment with respect to the definition of the term "benefit" as it is used in Article 1.1(b) of the SCM Agreement. Second, the question also appears to address "benefit" in a more generic sense, as it relates to the effects of contract payments on US production, exports, and the world price of upland cotton. Brazil believes it is this second sense of the term "benefit" to which the Panel's question was directed. However, the United States' answer concludes by asserting that "35 per cent of the value of decoupled payments would benefit upland cotton producers"³⁸⁸, suggesting that it interpreted the Panel's question as directed at the term "benefit" in the sense of Article 1.1(b) of the SCM Agreement. The United States also suggests that the remaining 65 per cent of the US contract payments do not constitute a benefit within the meaning of Article 1.1(b) of the SCM Agreement.

"Benefit" under Article 1.1(b) of the SCM Agreement

193. As set forth below, for the purposes of Article 1 of the SCM Agreement, the record shows that 100 per cent of contract payments are paid to the bank accounts of current upland cotton producers on terms that constitute "benefits".

194. Under the 2002 FSRI Act, direct and counter-cyclical payments are *only* paid to "producers on farms for which payment yields and base acres are established".³⁸⁹ "Producers" are defined in the Act as "an owner, operator, landlord, tenant, or sharecropper that shares in the risk of producing a crop and is entitled to share in the crop availability for marketing from the farm, or would have shared had the crop been produced". A similar definition of "producer" existed for the 1996 FAIR Act³⁹⁰ As implemented, USDA acknowledges that contract payments "are paid only to farm operators rather than farmland owners, with payment benefits split between the operator and owners in the case of crop-share rental arrangements".³⁹¹ Thus, the only "landlords" or "owners" who directly receive contract payments are those who are producers of upland cotton, *i.e.*, those that share in the risk of producing an upland cotton crop.³⁹² The USDA study further states that "[t]he operators' receipt of the PFC payments compensates for higher land costs that may result from the effects of the PFC programme".³⁹³

195. Brazil has proved that without the receipt of the PFC, market loss assistance, direct and counter-cyclical payments in their bank accounts, US upland cotton producers could not meet their costs – including their lease and land-related costs. Even if these current producers may subsequently write checks to their landlords who do not share in the risk of producing a crop, that does not mean that the subsidies that the producers are legally entitled to receive from USDA do not provide them with a "benefit", within the meaning of Article 1.1(b) of the SCM Agreement, as the United States appears to argue. Rather, the full amount of the payment is made to the current producers.

³⁸⁸ US 22 December 2003 Answers to Questions, para. 158.

³⁸⁹ Exhibit Bra-29 (Sections 1103 and 1104 of the 2002 FSRI Act).

³⁹⁰ Exhibit Bra-28 (Section 111(b) of the 1996 FAIR Act).

³⁹¹ Exhibit US-78, p. 44.

³⁹² See Brazil's 22 July 2003 Oral Statement, para. 57; Brazil's 22 August 2003 Rebuttal Submission, paras. 19, 24.

³⁹³ Exhibit US-78, p. 44.

196. The Appellate Body has held that a “benefit” exists if a financial contribution is received by a “recipient” or a “producer” of the subsidized good on terms more favourable than those available to the recipient in the market.³⁹⁴ Producers of US crops who have contract base acreage receive these payments from USDA. In *Canada – Aircraft*, the Appellate Body established that “a benefit does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient”, noting that “the term benefit, therefore, implies that there must be a recipient”.³⁹⁵ The Appellate Body in *US – CVD’s on EC Products* held that “the focus of any analysis of whether a ‘benefit’ exists should be on ‘legal or natural persons’ instead of on productive operations”.³⁹⁶ Contrary to the US arguments, it is legally irrelevant for purposes of determining the existence of a “benefit” under the SCM Agreement whether a benefit received by a “recipient” is subsequently transferred to other non-recipients.

197. The United States’ 22 December 2003 response continues its efforts to transform this dispute into a countervailing duty investigation based on now-defunct Annex IV of the SCM Agreement. The United States alleges in paragraph 158 of its 22 December 2003 response that only 35 per cent of PFC, market loss, CCP and direct payments “would benefit upland cotton producers”. If the United States is using the word “benefit” in the sense of Article 1.1(b) of the SCM Agreement, then the statement is legally as well as factually wrong. As Brazil has demonstrated above, 100 per cent of the four types of contract payments are paid to the bank accounts of current upland cotton producers. Thus, there is no doubt that each of the four contract payment subsidies confers a “benefit” to upland cotton producers.

198. Finally, even if this case was a countervailing duty investigation, under existing CVD procedures, 100 per cent of the contract payments – not 35 per cent – would be allocated across the production value of the producers. This is, again, because, first, the total amount of benefits to the company producing the subsidized goods would be calculated. No deductions are made depending on how the subsidy is used by the recipients (*i.e.*, to pay rents). 100 per cent of the subsidy is countervailable. Only in case the subsidy is not *de facto* tied to the production of the subsidized product, is there in a second step an allocation of the benefit (100 per cent) over the total value of the company’s production.

Use of “benefit” to assess the amount of subsidies that could cause serious prejudice

199. The more likely use of the term “benefit” in the Panel’s question is the extent to which contract payments contributed to and will contribute to the serious prejudice suffered by Brazil. In other words, to what extent do contract payments enhance and support the production and exports of US upland cotton, and to what extent do they suppress world prices? Brazil has produced evidence, *inter alia*, through Professor Sumner’s analysis, that the contract payments have various effects on production, exports and world prices. The isolated effects of these contract payments are less than those created by the marketing loan programme. Brazil acknowledged that one reason why the serious prejudice effects of PFC payments are relatively small is because a certain percentage of the payments were capitalized into land values and subsequently into land rents.³⁹⁷ Brazil noted that this

³⁹⁴ In *Canada – Aircraft*, the Appellate Body found that:

...the word “benefit”, as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no “benefit” to the recipient unless the “financial contribution” makes the recipient “better off” than it would otherwise have been, absent that contribution. In our view, *the marketplace provides an appropriate basis for comparison* in determining whether a “benefit” has been “conferred” because the trade distorting potential of a “financial contribution” can be identified by determining whether the recipient has received a “financial contribution” on terms more favourable than those available to the recipient in the market. (emphasis in original and underlining added)

Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 157; The same language is included in Appellate Body Report, *US – CVD’s on EC Products*, WT/DS212/AB/R, para. 106.

³⁹⁵ Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 154.

³⁹⁶ Appellate Body Report, *US – CVD’s on EC Products*, WT/DS212/AB/R, para. 110.

³⁹⁷ Brazil’s 27 October 2003 Answer to Question 179, paras. 164-167.

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.⁴⁰¹ But even a cursory look at the evidence proffered by the United States shows that this assertion is simply not true.

201. The US assumption is that every dollar of every contract payment placed into the bank accounts of producers *leasing* land (approximately 65 per cent of upland cotton land is "leased" or "rented") is immediately required to be paid to non-producer landlords.⁴⁰² The United States produced no evidence that 100 per cent of even PFC payments (let alone market loss assistance, direct or counter-cyclical payments) to cash rent cotton producers were consumed by increased rents during the period of investigation or since contract payments began in 1996.⁴⁰³ Further, the United States produces no evidence that 65 per cent of the upland cotton land is cash-rented. In fact, only 25 per cent of the US upland cotton land is cash-rented, whereas 40 per cent is share-rented.⁴⁰⁴ As established above, share-rent lease agreements mean that the landlord is considered a producer of upland cotton. Therefore, even under the flawed US theory, much more than just 35 per cent, in fact at least 75 per cent, should be considered benefits to upland cotton producers.

202. But do the facts even support the US allegation that rents increased because of the contract payments? Indeed, the most recent USDA cotton cost of production data shows that the opportunity cost of land decreased from \$58.33 per acre in MY 1997 to \$46.76 per acre in MY 2002.⁴⁰⁵ This data was reinforced by testimony in 2001 by the NCC President, who disagreed with the suggestion that "the payments that we are receiving are increasing land values or holding them up".⁴⁰⁶ Instead of PFC payments, the NCC President stated his belief that the "strong economy outside of agriculture ... has supported land values ...".⁴⁰⁷ This cotton-specific cost data and testimony by the recipients of PFC payments contradicts the US "35 per cent" assumption.

³⁹⁸ Brazil's 27 October 2003 Answer to Question 179, para. 167.

³⁹⁹ Brazil's 27 October 2003 Answer to Question 179, para. 167.

⁴⁰⁰ US 22 December 2003 Answers to Questions, para. 157.

⁴⁰¹ As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* 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.").

⁴⁰² US 22 December 2003 Answers to Questions, para. 158.

⁴⁰³ Furthermore, even cash-rent landlords also make decisions that affect production such as land levelling, irrigation installation and related investments. Therefore benefits to landlord have significant effects on yields and acreage planted to cotton.

⁴⁰⁴ Exhibit Bra-16 (Characteristics and Production Costs of US Cotton Farms, USDA, October 2001, p. 23).

⁴⁰⁵ Exhibit Bra-323 (Costs and Returns of US Upland Cotton Farmers, MY 1997-2002, USDA).

⁴⁰⁶ Exhibit Bra-41 (Congressional Hearing, "The Future of the Federal Farm Commodity Programmes (Cotton)," House of Representatives, 15 February 2001, Testimony of Robert McLendon, p. 21). Mr. McLendon responded to a question by Congressman Dooley who stated: "I am concerned that a significant portion of that is going to be capitalized in rents, land values – and, you know, I hope we find ways in which we can structure our program so ... we can actually see asset valuations that are more commensurate with actual market conditions ..."

⁴⁰⁷ Mr. McLendon was accompanied at the Congressional Hearing by now-President of the NCC, Mark Lange (then Chief NCC Economist), who said nothing to contradict Mr. McLendon's sworn testimony. *See* Exhibit Bra-41 (Congressional Hearing, "The Future of the Federal Farm Commodity Programs (Cotton)," House of Representatives, 15 February 2001, p. 6).

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	\$54.00	\$9.00	20.0 per cent
Alabama	\$39.00	\$36.00	- \$3.00	-7.7 per cent
Florida	\$30.00	\$32.00	\$2.00	6.7 per cent
Georgia	\$36.40	\$39.00	\$2.60	7.1 per cent
South Carolina	\$23.80	\$28.50	\$4.70	19.7 per cent

⁴⁰⁸ Exhibit Bra-413 (USDA, NASS “Agricultural Cash Rents, July 1999, p. 23); Exhibit Bra-414 (USDA, NASS “Agricultural Land Values and Cash Rents,” August 2003, p. 12-13.)(examining cropland cash rent values).

⁴⁰⁹ Exhibit Bra-415 (USDA, NASS, “Agricultural Land Values”, April 1999, p. 4); Exhibit Bra-414 (USDA, NASS, “Agricultural Land Values and Cash Rents,” August 2003, p. 12-13).

⁴¹⁰ Exhibit Bra-413 (USDA, NASS “Agricultural Cash Rents, July 1999, p. 23); Exhibit Bra-414 (USDA, NASS “Agricultural Land Values and Cash Rents”, August 2003, p. 12-13.)(examining cropland cash rent values).

⁴¹¹ <http://woodrow.mpls.frb.fed.us/research/data/us/calc/> (\$1.00 in 1996 is worth \$1.17 in 2003).

⁴¹² Exhibit Bra-413 (USDA, NASS “Agricultural Cash Rents, July 1999, p. 23); Exhibit Bra-414 (USDA, NASS “Agricultural Land Values and Cash Rents”, August 2003, p. 12-13.)(examining cropland cash rent values).

⁴¹³ Data for several other states is distorted by the fact that cash rents for irrigated land, which is not used for upland cotton production, are shown.

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 million⁴¹⁴ 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 President⁴¹⁹, 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

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 2003 Answer to Question 242, para. 158.

payments. Therefore, there is little, if any, basis for a non-producing landlord to demand increased rents to capture CCP payments.

210. The evidence that is before the Panel indicates that every eligible upland cotton producer planting on upland cotton base acreage (approximately 75 per cent of such producers), received a CCP check in MY 2002.⁴²¹ The record shows that the high costs of these producers meant that they had to use this money to cover their production costs, including the costs related to the cash rents they were required to pay. Thus, in an immediate “cover your annual costs” sense, 100 per cent of the payments each year of the period of investigation “benefited” the producers of upland cotton.⁴²²

211. Similarly, the United States provides no evidence concerning how much of the market loss assistance payments during MY 1998-2001 did not benefit upland cotton farmers. Brazil demonstrated that all producers (not non-producing landlords) planting on upland cotton or other base acreage were entitled to receive market loss assistance payments. The producers had the legal right to receive these payments. Thus, the United States did not meet its burden of showing that only 35 per cent of the market loss payments “benefited” upland cotton production.

212. Finally, the United States provides no evidence to support its argument that only “35 per cent” of the amount of direct payments under the 2002 FSRI Act “benefit” producers of upland cotton. As Brazil demonstrated, in MY 2002, US cotton producers needed all of the direct payment subsidies to cover their production costs and to re-coup losses from MY 2001.

213. Brazil recalls its showing that even under the US approach, the percentage should be 75 per cent rather than 35 per cent, *i.e.*, including land that is owned or share rented by producers. However, also for producers that cash rent their upland cotton land, not all of their contract payments are capitalized in land values and translated into higher cash rents. Thus, by far the greatest portion of contract payments is available to cause production effects along the lines discussed in the literature and by Professor Sumner⁴²³, as well as by Brazil.⁴²⁴

214. In conclusion, 100 per cent of the contract payments paid to, received, and deposited in the accounts of current “producers” of upland cotton (applying Brazil’s allocation methodology) in MY 1999-2002 constituted a “benefit” within the meaning of Article 1.1(b) of the SCM Agreement.⁴²⁵ The relevant issue regarding “benefit” to production is not, as the United States argues, the amount of the funds paid; this dispute does not involve a countervailing duty investigation. Rather, the focus of any generic “benefit” analysis is on the *effects* of the subsidies. The record shows that the various types of contract payments stimulated US production of upland cotton to different extents, ranging from 15 per cent for PFC payments to 40 per cent for CCP payments, as estimated by Professor Sumner.⁴²⁶

243. Can the Panel assume that any support at all, even marketing loan programme payments, benefits upland cotton if an upland cotton producer has other agricultural production besides upland cotton? USA

⁴²¹ Brazil’s 18 November 2003 Further Rebuttal Submission, Section 2.1, para. 23; Brazil’s 9 September 2003 Further Submission, paras. 59-331; Brazil’s 22 August 2003 Rebuttal Submission, para. 50 *citing* Exhibit Bra-173 (Revised Estimate of Support Granted by Commodity via Counter-Cyclical Payments).

⁴²² Brazil’s 27 October 2003 Answers to Question 125(c), paras. 15-25.

⁴²³ Brazil’s 9 September 2003 Further Submission, Annex I, paras. 37-42 and Exhibits Bra-280 and Bra-345 (paras. 18-34).

⁴²⁴ Brazil’s 18 November 2003 Further Rebuttal Submission, Section 3.7.5.

⁴²⁵ Similarly, 100 per cent of the contract payments, as allocated by Brazil, were “support to” upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture.

⁴²⁶ Brazil’s 9 September 2003 Further Submission, Annex I, paras. 43-51.

Brazil's Comment:

215. Contrary to the assumption permeating the US 22 December 2003 response, Brazil reiterates that there is no legal requirement for a claimant under Part III of the SCM Agreement to quantify on an *ad valorem* basis the amount of the challenged US subsidies.⁴²⁷ Annex IV – which the US response shows is the *only* legal basis for its arguments – is dead. Even when alive, it only applied to Article 6.1(a), not Article 6.3 of the SCM Agreement. The Panel's obligation under Part III of the SCM Agreement is to conduct an objective assessment of the evidence regarding the "effects" of the challenged subsidies. This means it must first examine the evidence regarding whether each of the supports is a "financial contribution," confers a "benefit," and is "specific".

216. Detailing the precise amount of the financial contribution ending up in the bank accounts of US upland cotton producers is not a legal pre-requisite to Brazil's actionable subsidy claims. If the Panel finds that Brazil is legally required to examine the exact *amount* of the subsidies in order to assess their "effects," then it need only ask why the United States has refused to produce the evidence to determine such an amount.⁴²⁸ In the absence of the most accurate evidence, withheld by the United States, Brazil refers the Panel to evidence and the allocation of the amount of "support to upland cotton" it has presented in the peace clause portion of its various submissions.⁴²⁹ This evidence is part of the record pursuant to Brazil's alternative arguments and is offered as evidence of the amount of such subsidy payments.

217. With the above-referenced qualifications, Brazil would answer the Panel's question with a qualified "yes". First, Brazil agrees with the United States' assumption, in paragraph 159 of its 22 December 2003 response, that the full amount of marketing loan payments for upland cotton production "benefits" US producers even if they also produce other crops. The logic of the US assumption means that the full amount of crop insurance and Step 2 payments, which are also *de jure* linked to production, sale or export of upland cotton, would "benefit" upland cotton production. With respect to contract payments, Brazil's allocation methodology first considers every acre of upland cotton grown on an acre of upland cotton contract base to "benefit" (or constitute "support to") upland cotton.⁴³⁰ In other words, Brazil's allocation methodology does assume that all such cotton to cotton matches do "benefit" upland cotton, regardless of the other agricultural production of the farm.⁴³¹ Brazil notes that the cotton to cotton matches accounts for most of the contract payments to current upland cotton producers.⁴³² However, for those cotton producers growing cotton on non-upland cotton base acres, Brazil does *not* ignore other agricultural production of the particular farm. Rather, it allocates the payments attributable to upland cotton based on the overall composition of programme crops for that particular farm.⁴³³ Of course, Brazil's methodology could not be fully applied because of the refusal of the United States to produce the necessary farm-specific information.⁴³⁴

⁴²⁷ Brazil's 18 November 2003 Further Rebuttal Submission, paras. 96-107; Brazil's 2 December 2003 Oral Statement, paras. 4-6. See also Brazil's comment on Question 231, above.

⁴²⁸ US 18 and 19 2003 December Letters to the Panel; US 20 January 2004 Letter to the Panel; See also Brazil's 28 January 2004 Comments and Requests Regarding US Data.

⁴²⁹ These facts are summarized in Annex 1 to Brazil's 9 October 2003 Closing Statement, but are also contained in a number of Brazil's earlier submissions to the Panel beginning with its 24 June 2003 First Submission; See also Brazil's 18 November 2003 Further Rebuttal Submission, Sections 2.1 and 2.4; Brazil's 2 December 2003 Oral Statement, Sections 5.1 and 5.3.

⁴³⁰ Brazil's 20 January 2004 Answers to Additional Questions, para. 47.

⁴³¹ Brazil's 20 January 2004 Answers to Additional Questions, paras. 44-48.

⁴³² See Electronic PFC and DCP Summary Files provided on 18 and 19 December 2003 respectively. See also Brazil's 18 November 2003 Further Rebuttal Submission, paras. 22-24.

⁴³³ Brazil's 20 January 2004 Answers to Additional Questions, paras. 48-55. Thus, contrary to the US assertions in the last sentence of paragraph 163, Brazil does not advocate allocating a non-tied payment across the total value of the recipients production.

⁴³⁴ Brazil's 28 January 2004 Comments and Requests Regarding US Data, Sections 4, 8 and 9.

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 relevant for assessing Brazil’s claims under Part III of the SCM Agreement.

219. Brazil’s position is that the allocation⁴³⁵ of contract payments is required in the peace clause portion of the proceeding. Brazil has set forth in considerable detail the factual evidence supporting the *de facto* link between the contract payments and the production of upland cotton.⁴³⁶ Brazil further provided considerable detail concerning its allocation methodology and the application of that methodology.⁴³⁷ Brazil even attempted to apply the US “across the value of the farm” methodology, based on the incomplete and scrambled US data.⁴³⁸ Brazil presented extensive legal arguments supporting the requirement under Article 13(b)(ii) to collect and tabulate any and all support for a specific commodity such as upland cotton.⁴³⁹ For example, Brazil’s 22 August 2003 Rebuttal Submission stated:

[T]he phrase “support to a specific commodity” ... read in its context, requires the Panel to tabulate any non-green box domestic support payments that are linked in some manner to the production of upland cotton. Contrary to the US arguments,⁴⁴⁰ there is nothing in the text of Article 13(b)(ii) limiting the support to only that provided to a single commodity. Nor does the text limit support to only that *requiring* a recipient to produce or to produce a specific commodity as the United States alleges.⁴⁴¹ Rather, it requires examining whether a specific commodity receives support from a domestic support measure identified in the chapeau of Article 13(b) and whether there is some sort of link between the support at issue and the specific commodity.⁴⁴² Thus, the question of “support to a specific commodity” is fundamentally a factual question requiring an examination of different types of support set out in the *chapeau* of Article 13(b).⁴⁴³

⁴³⁵ Brazil’s 11 August 2003 Answer to Question 40 provided detailed analysis regarding the application of its 14/16th methodology. Brazil explained in its Rebuttal Submission that: “Necessarily, this process requires allocation of support that may be provided to producers of more than one type of agricultural product, but which is not provided to producers *in general*.” See Brazil’s 11 August Answer to Question 40. An allocation process is also required with respect to Annex 3 paragraph 7 support to processors of agricultural products,” ‘to the extent that such measures benefit the producers of the basic agricultural product.’” Brazil’s 22 August 2003 Rebuttal Submission, note 33.

⁴³⁶ The United States has refused to produce the most relevant information – the precise amount of contract payments received by current US upland cotton producers. Brazil summarized much of the available evidence, demonstrating that the contract payments are, *de facto*, tied to the production of upland cotton, in its 9 October 2003 Closing Statement, Annex I.

⁴³⁷ Brazil’s 11 August 2003 Answer to Question 40. Brazil’s 22 December 2003 Answer to Question 258, paras. 43-55; Brazil’s 28 January 2004 Comments and Requests Regarding US Data, Sections 9 and 10. See also Brazil’s 11 August 2003 Answer to Question 40. An allocation process is also required with respect to Annex 3 paragraph 7 support to processors of agricultural products,” ‘to the extent that such measures benefit the producers of the basic agricultural product.’” Brazil’s 22 August 2003 Rebuttal Submission, note 33.

⁴³⁸ Brazil’s 28 January 2004 Comments on Data Provided by United States, Section 10.

⁴³⁹ See Brazil’s 22 August Rebuttal Submission, paras. 13-22; Brazil’s 22 August 2003 Comments on US Answers, paras. 48-53, 58, 61; Brazil’s 11 August 2003 Answers to Questions, paras. 54-55, 57-58, 61-64, 66-72, 129-132; Brazil’s 24 July 2003 Closing Statement, para. 8; Brazil’s 22 July 2003 Oral Statement, paras. 13-26; Brazil’s 24 June 2003 First Submission, paras 130-134.

⁴⁴⁰ US 11 August Answer 2003 to Question 38, para. 81.

⁴⁴¹ US 11 August 2003 Answer to Question 38, para. 81.

⁴⁴² Compare Brazil’s 11 August 2003 Answer to Question 41, paras. 57-58.

⁴⁴³ Brazil’s 22 August 2003 Rebuttal Submission, para. 14.

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 subsidies 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 “support to a specific commodity”, which requires the tabulation – and allocation if necessary – of any and all support provided to producers, users, or exporters of a particular product. The test is not whether the domestic support *requires* production, but rather whether the domestic support provides support for the production of a particular commodity.⁴⁴⁸

222. Further, as Brazil noted in its 11 August 2003 response, all of the domestic support measures challenged by Brazil have an “upland cotton specific link in terms of historic, updated, or present upland cotton acreage, present upland cotton production or prices, or upland cotton groups of insurance policies or other specific upland cotton provisions”⁴⁴⁹ The ordinary meaning of the terms “non-product specific” support that is provided “in general” is support to producers of all or almost all commodities or agricultural products, such as irrigation, state credit programmes, and other infrastructure subsidies such as farm roads. Thus, even if the peace clause test were “product-specific support,” Brazil’s interpretation does not read out any meaning to “non-product specific support”.

223. In sum, Brazil’s methodology for allocating the various subsidy payments that “benefit” or “support” upland cotton is reasonable and based on an extensive factual record demonstrating the link between such payments and current upland cotton production. If the United States disagreed, it was required to do more than simply assert the *de jure* form of the legal instruments of the contract payments. Rather, it must produce the farm-specific evidence that would permit a detailed assessment of the “other agricultural production” (and the value) of each producer of upland cotton. It has refused to do so. Therefore, the US 22 December 2003 response to Question 243, besides being

⁴⁴⁴ See, in particular, Brazil’s 22 August 2003 Rebuttal Submission, paras. 15-22 (legal arguments), as well as factual evidence regarding each direct payment subsidy, in paras. 24-52. Since August, Brazil has presented considerable additional evidence establishing the *de facto* link between each type of contract payment and the production of US upland cotton. See Annex 1 of Brazil’s 9 October 2003 Closing Statement; Brazil’s 27 October 2003 Answers to Questions, paras. 726, 37-40; Brazil’s 18 November 2003 Further Rebuttal Submission, Section 3.7.5; Brazil’s 2 December 2003 Oral Statement, Section 5.3.

⁴⁴⁵ Brazil’s 22 July 2003 Oral Statement, paras. 21-25.

⁴⁴⁶ Brazil’s 22 December 2003 Answers to Question 196, para 8.

⁴⁴⁷ See e.g. Brazil’s 9 October 2003 Closing Statement, Annex I; Brazil’s 27 October 2003 Answers to Question 125(2)(a), paras. 7-25; Brazil’s 18 November 2003 Further Rebuttal Submission, Section 3.7.5.

⁴⁴⁸ Brazil’s 22 August 2003 Rebuttal Submission, paras. 15-22.

⁴⁴⁹ Brazil’s 11 August 2003 Answer to Question 41, paras. 57-58.

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. 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

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

Brazil's Comment:

224. The Panel is well aware that Brazil considers Article 5 and its reference to "any" subsidy to require the Panel to take prohibited subsidies into account for a serious prejudice claim.⁴⁵⁰ There is no contradiction between the implementing obligations of a Member under Articles 4.7 and 7.8 of the SCM Agreement. Thus, the Panel must take prohibited subsidies into account in considering the effects of subsidies in an action based on Articles 5 and 6 of the SCM Agreement.

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

Brazil's Comment:

225. Brazil's 22 December 2003 response to this question covers most of the points raised in the US 22 December 2003 response. In response to the US argument at paragraph 149 that the Panel's terms of reference as well as Brazil's threat claims are limited to subsidy payments up to, but not after, 18 March 2003, Brazil refers the Panel to its Comments to Question 194 above, and to its 20 January 2004 Answer to Questions 257(ii), at paragraphs 17-22. Brazil has, further, responded to improper use of futures prices at the time of planting, instead of the adjusted world price, in its Comments to Questions 212 and 213, above.

VI. 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 18 November further rebuttal submission; and Exhibit BRA-350. Have Step 2 payments ever been zero since the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002? In what circumstances could a Step 2 payment be zero? How does the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002 affect your response? BRA, USA

Brazil's Comment:

226. Brazil notes the US admission that one of the reasons for the elimination of the 1.25 cent threshold is to "correct for some long term changes in the valuation of currencies".⁴⁵¹ Thus, the United States effectively admits that Step 2 payments cause US exports to increase despite the

⁴⁵⁰ Brazil's 22 December 2003 Answers to Questions, para. 147; Brazil's 27 October 2003 Answers to Questions, paras. 108-110.

⁴⁵¹ US 22 December 2003 Answers to Questions, para. 171.

appreciation of the US dollar. In fact, the United States has never rebutted the considerable evidence that one of the main effects of the US upland cotton subsidies is to cause US exports of upland cotton to increase even when the US dollar is appreciating rapidly.⁴⁵²

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?⁴⁵³ 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**
- (b) **How does this reconcile with Dr. Glauber's statement in Exhibit US-24, p. 3 (referring to "the 1990 Farm Bill and subsequent legislation") that Step 2 payments do *not* go directly to the producer? USA**
- (c) **What proportion of Step 2 "export payments" go to producers? Please supply supporting evidence. USA**

VII. REMEDIES

250. Does Brazil seek relief under Article XVI of *GATT 1994* in respect of expired measures? What type of recommendation would the Panel be authorized to make? (Brazil further submission, paragraph 471 (iii)) BRA

251. In light, *inter alia*, of Article 7.8 of the *SCM Agreement*, if the Panel were to find that any subsidies have resulted in adverse effects to the interests of another Member within the meaning of Article 5 of the *SCM Agreement*, should it make any recommendation other than the one set out in the first sentence of Article 19.1 of the DSU? BRA

252. Without prejudice to any findings by the Panel, if the Panel were to find that any of the challenged measures constitute prohibited subsidies within the meaning of Article 3 of the *SCM Agreement*, what are the considerations that should guide the Panel in making a recommendation under Article 4.7 of the *SCM Agreement* relating to the time period "within which the measure must be withdrawn"? What should that time period be? BRA

VIII. MISCELLANEOUS

253. Regarding the adjustment authority related to Uruguay Round compliance in s.1601(e) of the FSRI Act of 2002 (the so-called "circuit-breaker provision"):

- (a) **Does it relate to export credit guarantees, crop insurance and cottonseed payments?**
- (b) **Does it relate only to compliance with AMS commitments?**
- (c) **Is the authority discretionary? If so, can its exercise be limited by the legislative branch of government?**
- (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**

⁴⁵² Brazil's 9 September 2003 Further Submission, paras. 124-128 and the Exhibits cited therein; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 78-80.

⁴⁵³ For example, Brazil's response to Panel Question 125, paragraph 14.

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 Congressional debates on the 2002 FSRI Act. Speculation about legislative (or negotiators') intentions not backed up by reference to the record of the debates is not positive evidence. Further, if any Member could successfully plead compliance with WTO rules by simply inserting language asserting the provision "provides assistance to producers in a way that is consistent with [its] obligations under the Uruguay Round Agreement on Agriculture"⁴⁵⁴, then there would be little role for any WTO panel. The only "evidence" of US legislators' intent before the Panel is the text of the 2002 FSRI Act.

228. In sum, the record now shows that both Brazil and the United States agree that (1) Section 1601(e) applies only to Total AMS⁴⁵⁵, (2) Section 1601(e) does not apply to serious prejudice caused to US trading partners by US subsidies to upland cotton covered by the 2002 FSRI Act⁴⁵⁶, and, (3) the 2002 FSRI Act does not provide any discretion for the USDA Secretary specifically to limit the amount of *upland cotton* marketing loan, Step 2, direct or counter-cyclical payments.⁴⁵⁷

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

Brazil's Comment:

229. Brazil established that marketing loan, Step 2, direct and counter-cyclical payments are mandatory, within the traditional mandatory/discretionary distinction under GATT/WTO law.⁴⁵⁸ In its 20 January 2004 Answers to Additional Questions, Brazil has responded to US arguments that conditions attached to the payment of subsidies would make these subsidies non-mandatory.⁴⁵⁹

230. Brazil notes further that the listed programmes are not only mandatory within the meaning of WTO law, but are also mandatory under US budget law. They create a legal entitlement to the payment.⁴⁶⁰ While the United States now argues that payments depend on the availability of funds⁴⁶¹,

⁴⁵⁴ US 22 December 2003 Answer to Question 253(a), para. 176.

⁴⁵⁵ US 22 December 2003 Answer to Question 253(b), para. 178.

⁴⁵⁶ US 22 December 2003 Answer to Question 253(d), para. 180.

⁴⁵⁷ 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 programs 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.").

⁴⁵⁸ See Brazil's 20 January 2004 Answers to Additional Questions, paras. 17 (with further references), 24-30.

⁴⁵⁹ Brazil's 20 January 2004 Answers to Additional Questions, paras. 27-30.

⁴⁶⁰ Exhibit Bra-416 ("What Is A Farm Bill," Congressional Research Service, Report for Congress, 5 May 2001) ("Commodity programmes are entitlements. Expenditures are based upon programme rules and commodity market conditions. Eligible farmers are guaranteed legislatively-specified support based on these rules and conditions."). USDA noted with respect to an earlier commodity program – the deficiency payment

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 it 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 inferences from the best information available in the record in order to comply with the requirements of Article 11 of the DSU.⁴⁶⁶ For example, in the *US – Wheat Gluten* case, the panel requested that the United States supply it with certain information that had been redacted from the public version of a USITC Report, but despite several requests, the United States refused to submit the information.⁴⁶⁷ The panel decided that while having access to all the requested information from the United States would have furnished a more extensive basis for its examination and have facilitated an objective assessment of the facts, there were other facts of record that the panel was required to include in its “objective assessment”.⁴⁶⁸ Ultimately, the panel determined that the United States violated provisions of the Agreement on Safeguards on the basis of the available factual record.⁴⁶⁹ When the

program – that “[d]eficiency payments are entitlements; that is, spending is determined by rules that define eligibility and govern benefit levels rather than by the annual appropriations process. USDA and Congress have no control over deficiency payment outlays.” (Exhibit Bra-417 (“Commodity Program Entitlements: Deficiency Payments”, USDA, May 1993).

⁴⁶¹ US 22 December 2003 Answers to Questions, para. 182.

⁴⁶² In the context of the peace clause arguments, the United States argued that it could not control the amount of budgetary outlays under the programmes.

⁴⁶³ Brazil's 20 January 2004 Answers to Additional Questions, paras. 18-22 (with further references).

⁴⁶⁴ Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 6.

⁴⁶⁵ See also Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 11.

⁴⁶⁶ Brazil's 9 October 2003 Closing Statement, paras. 2, 9 (citing Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.39).

⁴⁶⁷ Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 168.

⁴⁶⁸ Panel Report, *US – Wheat Gluten*, WT/DS166/R, para. 8.12.

⁴⁶⁹ Panel Report, *US – Wheat Gluten*, WT/DS166/R, para. 8.12.

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 inferences drawn from relevant facts of each case facilitates the duty of international tribunals in determining whether or not the burden of proof has been met”.⁴⁷⁶ The panel further held that there is a requirement for collaboration of the parties in the presentation of the facts and evidence to the panel, and emphasized especially the role of the respondent in that process.⁴⁷⁷

235. Applying these concepts to the allocation issues involved in the peace clause portion of this dispute indicates that the Panel has more than sufficient evidence in the record to support a reasonable estimate of the amount of contract payment support provided to upland cotton in MY 1999-2002.⁴⁷⁸ Brazil detailed its views concerning the appropriate allocation methodology for purposes of the peace clause.⁴⁷⁹ Faced with the US refusal to provide the data necessary to calculate the precise amount of support to upland cotton from the US contract payments using Brazil’s (and the US) allocation methodology, Brazil offered extensive circumstantial evidence in support of its alternative so-called “14/16th methodology”.⁴⁸⁰ The Panel may properly draw adverse inferences that the United States data would, if produced, have shown that Brazil’s 14/16th methodology undercounted the amount of support to upland cotton.⁴⁸¹ Such an adverse inference supports the other extensive evidence that the 14/16th methodology provides a reasonable estimate.⁴⁸²

⁴⁷⁰ Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 174.

⁴⁷¹ Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 171.

⁴⁷² Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.54.

⁴⁷³ Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.56.

⁴⁷⁴ Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.33.

⁴⁷⁵ Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.65 (emphasis added).

⁴⁷⁶ Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.39.

⁴⁷⁷ Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.40.

⁴⁷⁸ Brazil recalls that the United States has invoked the peace clause of Article 13 of the Agreement on Agriculture. As demonstrated by Brazil, the peace clause is in the nature of an affirmative defense. And even if the Panel were to disagree, Brazil established a *prima facie* case of inconsistency of the US measures with Article 13(b)(ii) of the Agreement on Agriculture. Neither the claim nor the measures to which it relates are outside the Panel’s terms of reference, within the meaning of the Appellate Body decision in *Japan – Agricultural Products*, paras. 129-130.

⁴⁷⁹ Brazil’s 20 January 2004 Answers to Additional Questions, paras. 43-55.

⁴⁸⁰ These facts are summarized in Annex 1 to Brazil’s 9 October 2003 Closing Statement, but are also contained in a number of Brazil’s earlier submissions to the Panel, beginning with its 24 June 2003 First Submission. See also Brazil’s 18 November 2003 Further Rebuttal Submission, Sections 2.1 and 2.4; Brazil’s 2 December 2003 Oral Statement, Sections 5.1 and 5.3.

⁴⁸¹ Brazil’s 28 January 2004 Comments and Requests Regarding US Data, Section 6.

⁴⁸² Brazil’s 28 January 2004 Comments and Requests Regarding US Data, Section 6.

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. Even if it would be Brazil's burden to establish this fact, the United States has done everything to frustrate Brazil's ability to do so. In particular, the United States first wrongly asserted that data on plantings of farms was not available to it and – after Brazil demonstrated that this was incorrect⁴⁸⁶ – refused to produce the evidence.⁴⁸⁷

238. Indeed, even if the Panel were of the view that the US allocation methodology would provide the best means of evaluating the amount of support to upland cotton, the refusal of the United States to produce the requested data prevents the Panel from applying that methodology. In the face of this lack of cooperation, the Panel is required to apply some other methodology to estimate the amount of contract payment support, *i.e.*, Brazil's 14/16th methodology, or some variant thereof. To hold otherwise would obviously penalize Brazil, who sought the information, *inter alia*, for the purpose of demonstrating that the US methodology would reveal amounts of support similar to those estimated by Brazil's own 14/16th methodology.

239. It is ironic that among the evidence that supports Brazil's 14/16th methodology is the incomplete summary data provided by the United States. Brazil attempted to use that data to perform a simplified version of the (improper) US allocation methodology.⁴⁸⁸ Brazil does not believe, as the Panel's question suggests, that it can make reasonable assumptions using this methodology based on the fragmented summary data provided by the United States. Nevertheless, although Brazil cautions against the use of its results, and although this methodology is not relevant for purposes of the peace clause, Brazil notes that these results are only marginally smaller than the results of Brazil's own 14/16th methodology.⁴⁸⁹

240. Thus, contrary to the US 22 December 2003 arguments⁴⁹⁰, there is evidence provided by Brazil in the record on which the Panel can rely in making an objective assessment of the facts and in deciding on Brazil's claims under Part III of the SCM Agreement and GATT Article XVI (as well as under Article 13(b)(ii) of the Agreement on Agriculture). Brazil has also met its burden of proof in establishing a *prima facie* case concerning its claims of inconsistency of the US measures with these provisions.

⁴⁸³ See Brazil's comment on Question 243, above.

⁴⁸⁴ See *inter alia* Brazil's 2 December 2003 Oral Statement, paras. 46 (and the references cited therein).

⁴⁸⁵ See US 22 December 2003 Answers to Questions, paras. 185-186, 10-11, 160-164.

⁴⁸⁶ Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.2; Exhibits Bra-368 – Bra-369.

⁴⁸⁷ See generally Brazil's 28 January 2004 Comments and Requests Regarding US Data.

⁴⁸⁸ Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 10.

⁴⁸⁹ Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 10.

⁴⁹⁰ US. 22 December 2003 Answers to Questions, paras. 185-186.

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 the 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

- (e) **Does the US agree that, under the Budget Enforcement Act of 1990, the Office of Management and Budget classifies the export credit guarantee programmes as "mandatory" (see Brazil's response to Panel Question 142, para. 89)? Does this exempt the programmes from the requirement to receive new Congressional budget authority before it undertakes new guarantee commitments (e.g. Exhibit BRA-117 (2 USC 661(c)(2)))? USA**

Brazil's Comment:

241. Brazil makes several observations with respect to the United States' 20 January 2004 responses to Questions 257(d) and 257(e).

242. First, the evidence discussed in the Panel's questions and the US responses is only relevant to a determination whether the United States is in compliance with Article 10.1 of the Agreement on Agriculture with respect to scheduled products. For unscheduled products, the Appellate Body held that it is inconsistent with Article 10.1 to provide *any* export subsidies.⁴⁹¹ Brazil has demonstrated that CCC guarantees were extended for unscheduled products during the period 1992-2003. Having also demonstrated that the CCC programmes constitute export subsidies (under Articles 1.1 and 3.1(a) of the SCM Agreement, and under item (j)), Brazil has therefore established that the United States has circumvented its export subsidy commitments with respect to unscheduled products, in violation of Article 10.1. Brazil has also demonstrated that CCC guarantees continue to be available for unscheduled products.⁴⁹² Since it is inconsistent with Article 10.1 to provide *any* export subsidies, the availability of CCC guarantees leads to a threat of circumvention of the US export subsidy commitments.

243. Second, the test to determine whether the United States is threatening to circumvent its export subsidy commitments with respect to scheduled products is not whether the CCC guarantee programmes are "mandatory" as opposed to "discretionary."⁴⁹³ Rather, to determine whether export subsidies result in, or threaten to lead to, circumvention of the United States' export subsidy commitments, the test set out by the Appellate Body in *US – FSC* is whether there is a "mechanism in the measure" for CCC to "stem[, or otherwise control[, the flow of" CCC export credit guarantees.⁴⁹⁴

244. Under this test, the threat of circumvention is not abated simply because, as the United States notes, the CCC is not actually required to issue the "not less than \$5,500,000,000 in credit guarantees" that it must, as a matter of law, make available every year.⁴⁹⁵ The threat arises because, year-on-year, the CCC announces its plans to extend over \$6 billion in guarantees, as it did for fiscal year 2004.⁴⁹⁶

⁴⁹¹ Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 150.

⁴⁹² Exhibit Bra-299 ("Summary of FY 2003 Export Credit Guarantee Program Activity," USDA, covering GSM-102, GSM-103 and SCGP). For 1999-2002, *see also* Exhibit Bra-73 ("Summary of Export Credit Guarantee Program Activity," USDA, covering GSM 102, GSM 103 and SCGP for US fiscal years 1999-2003). For 1992-1998, *see* Exhibit US-41.

⁴⁹³ The Panel will recall that in addition to its threat of circumvention claims with respect to scheduled products, Brazil has also demonstrated that the United States has used the CCC guarantee programs to circumvent its export subsidy commitments with respect to rice (a scheduled product). *See* Exhibit Bra-300 (Calculation on US Rice Exports Benefiting from GSM 102, GSM 103 and SCGP). The United States has not rebutted this evidence.

⁴⁹⁴ Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149. Brazil's 27 October 2003 Answers to Questions, para. 88; Brazil's 18 November 2003 Further Rebuttal Submission, para. 257; Brazil's 2 December 2003 Oral Statement, paras. 90-91; Brazil's 20 January 2004 Answers to Additional Questions, para. 13.

⁴⁹⁵ Brazil is aware of no other provision of US law that provides a floor, and not a corresponding ceiling, for support to US industry.

⁴⁹⁶ Exhibit Bra-296 ("USDA Announces \$2.8 Billion in Export Credit Guarantees," FAS Press Release, 30 September 2003).

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 foreign competitors of US farmers know with a degree of assurance that the threat of

⁴⁹⁷ Brazil's 18 November 2003 Further Rebuttal Submission, para. 261, *citing* Exhibit Bra-297 (7 U.S.C. § 5641(b)(1); 7 U.S.C. § 5622(a), (b)). *See also* Brazil's 2 December 2003 Oral Statement, para. 91, *citing* Exhibit Bra-366 (7 U.S.C. § 5622 note, "Promotion of Agricultural Exports to Emerging Markets, para. (a) ("The Commodity Credit Corporation shall make available for fiscal years 1996 through 2002 not less than \$1,000,000,000 of direct credits or export credit guarantees for exports to emerging markets under section 201 or 202 of the Agricultural Trade Act of 1978 (7 U.S.C. 5621 and 5622), in addition to the amounts acquired or authorized under section 211 of the Act (7 U.S.C. 5641) for the program.")). *See also* Exhibit Bra-367 (Section 3203 of the 2002 FSRI Act (extending mandate to 2007)).

⁴⁹⁸ Exhibit Bra-295 (2004 US Budget, Federal Credit Supplement, Introduction and Table 2 (CCC Export Loan Guarantee Programme classified as "Mandatory" in Table 2, and in the "Introduction," the Office of Management and Budget states that Table 2 provides "the program's BEA classification under the Budget Enforcement Act (BEA) of 1990 as discretionary or mandatory"); Exhibit Bra-117 (2 U.S.C. § 661(c)(2)) (exempting CCC programmes from appropriations requirement); Exhibit Bra-185 (Congressional Budget Office Staff Memorandum, "An Explanation of the Budgetary Changes under Credit Reform," April 1991, p. 7 (for quote provided in text above)).

⁴⁹⁹ Brazil's 27 October 2003 Answers to Questions, para. 95, *citing* the archived list of USDA press releases announcing supplemental allocations extended throughout fiscal year 2003 (<http://www.fas.usda.gov/excredits/exp-cred-guar.asp>).

⁵⁰⁰ Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

⁵⁰¹ Exhibit Bra-300 (Calculation on US Rice Exports Benefiting from GSM 102, GSM 103 and SCGP). The United States has never rebutted Brazil's showing. The CCC announced guarantee allocations of \$5.762 billion in 2001, \$6.158 billion in 2002, and \$6.247 billion in 2003, while granting guarantees in the amount of \$3.227 billion in 2001, \$3.388 billion in 2002, and \$3.223 billion in 2003. *See* Exhibit US-41.

⁵⁰² US 20 January 2004 Answers to Questions, para. 3.

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 asserts⁵⁰³ abate the threat posed by its annual announcement that it will issue over \$6 billion in CCC export credit guarantees are an illusion, for at least two reasons.⁵⁰⁴

249. First, the United States has offered no evidence that the CCC may reject "any individual application"⁵⁰⁵ (much less that there is a "mechanism" to do so in order to avoid circumvention of US export subsidy commitments). As Brazil has previously noted, the CCC guarantee programmes are classified as "mandatory" under US law.⁵⁰⁶ The Congressional Budget Office ("CBO") and the Congressional Research Service ("CRS") (legislative branch agencies charged with servicing the US Congress) have both noted the inability of executive branch agencies charged with implementing mandatory programmes to deny support to eligible borrowers.⁵⁰⁷ The United States cites a non-programme specific document for a generic principle that mandatory and discretionary classifications under the Budget and Enforcement Act "do not determine whether a programme provides legal entitlement to a payment or benefit".⁵⁰⁸ Speaking specifically with respect to USDA mandatory programmes, however, the CRS states that "[e]ligibility for mandatory programmes is written into law, and any individual or entity that meets the eligibility requirements is entitled to a payment as authorized by the law".⁵⁰⁹

⁵⁰³ US 20 January 2004 Answers to Additional Questions, para. 3.

⁵⁰⁴ Brazil has elsewhere explained the CCC's authority to undertake an inquiry into whether particular countries are creditworthy, and the possibility that this inquiry could end up reducing the amount of CCC guarantees, does not prevent a conclusion that nothing "stem[s], or otherwise control[s], the flow of" CCC guarantees. Brazil's 27 October 2003 Answers to Questions, para. 92. Under the United States' FSC measure, US authorities were permitted to undertake a factual inquiry into, among other things, whether the foreign-source income of the foreign corporation was "effectively connected with the conduct of a trade or business within the United States." Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 16. This authority, and the possibility that the factual inquiry could limit the amount of income that would qualify for the FSC exemption, did not prevent the Appellate Body from concluding that nothing in the FSC measure "stem[ed], or otherwise control[led], the flow of" FSC benefits, leading to a threat of circumvention of the United States' export subsidy reduction commitments.

⁵⁰⁵ US 20 January 2004 Answers to Additional Questions, para. 3. The United States has not offered any support for its assertion that CCC has the authority "to suspend the issuance of export credit guarantees under any particular allocation". In any event, Brazil demonstrates *infra* that the allocation process does not remotely abate the threat that the United States will circumvent its *quantitative* export subsidy reduction commitments.

⁵⁰⁶ Exhibit Bra-295 (2004 US Budget, Federal Credit Supplement, Introduction and Table 2 (CCC Export Loan Guarantee Program classified as "Mandatory" in Table 2, and in the "Introduction", the Office of Management and Budget states that Table 2 provides "the programme's BEA classification under the Budget Enforcement Act (BEA) of 1990 as discretionary or mandatory").

⁵⁰⁷ See Exhibit Bra-117 (2 U.S.C. § 661(c)(2)); Exhibit Bra-185 (Congressional Budget Office Staff Memorandum, "An Explanation of the Budgetary Changes under Credit Reform," April 1991, p. 7 and Table 2); Exhibit Bra-186 (Congressional Research Service Issue Brief for Congress, "Agriculture and the Budget," IB95031 (16 February 1996), p. 3).

⁵⁰⁸ US 20 January 2004 Answers to Additional Questions, para. 7.

⁵⁰⁹ Exhibit Bra-186 (Congressional Research Service Issue Brief for Congress, "Agriculture and the Budget," IB95031 (16 February 1996), p. 3). The United States made a similar error in its 30 September 2003 Further Submission, at paragraph 156, when it cited the very same generic, non-agency-specific document (Circular A-11) for the principle that "the ability of CCC to issue guarantees is constrained by the apportionment process . . ." As Brazil has demonstrated, the CCC programs are exempt from the requirement that to receive new Congressional budget authority before undertaking new guarantee commitments. See Exhibit Bra-117 (2 U.S.C. § 661(c)(2)).

250. Second, the “discretionary elements” cited by the United States do not in any way abate the threat that the United States will circumvent its export subsidy commitments for scheduled products:

- The existence of eligibility criteria does not abate the threat. The focus for deciding whether a measure is discretionary is on whether it provides government officials with the discretion to implement the measure in a WTO-consistent manner.⁵¹⁰ Objective conditions, such as 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 commitments. Similarly, CCC guarantees are only available if an exporter meets the eligibility criteria set out in 7 C.F.R. § 1493.30.⁵¹¹ The fact that a CCC official cannot legally issue a CCC guarantee to a non-eligible exporter does not make the CCC programmes “discretionary”.
- The authority to limit guarantees given for exports to particular “destination[s]” and the authority to employ “exposure limits applicable to individual bank obligors”⁵¹², like the authority to determine that particular destination countries are uncreditworthy and are ineligible for guarantees⁵¹³, do not reduce the threat of circumvention. The United States’ export subsidy commitments are undertaken on a quantitative basis, and not on a destination or individual bank basis. Removing particular destination countries or banks from the list of those countries or banks eligible for CCC guarantees is utterly irrelevant to the CCC programmes’ absolute activity levels – CCC can simply shift those guarantees to other countries and banks.
- Nor does the authority to limit the “time within which export must occur”⁵¹⁴ reduce the threat of circumvention. A requirement that the export that is the subject of a guarantee occur within a certain period of time following issuance of the guarantee only matters if the guarantee is issued in the first place; the requirement does nothing to control the flow of those guarantees or to abate the threat that they will circumvent the US export subsidy commitments.
- Nor does the allegedly commodity-specific allocation process that the United States cites⁵¹⁵ reduce the threat of circumvention. More than 95 per cent of allocations are made on a country-specific basis only, with less than 5 per cent of 2003 allocations made on a scheduled product-specific basis.⁵¹⁶ And the press release announcing initial allocations for 2004 contains no product-specific allocations.⁵¹⁷ More importantly, the allocations are made on a *monetary* basis, which provides virtually no assurance that the United States will not surpass

⁵¹⁰ Appellate Body Report, *US – 1916 Act*, WT/DS136/AB/R, para. 100.

⁵¹¹ Exhibit US-6.

⁵¹² US 20 January 2004 Answers to Additional Questions, para. 3.

⁵¹³ See US 30 September 2003 Further Submission, para. 154.

⁵¹⁴ US 20 January 2004 Answers to Additional Questions, para. 3.

⁵¹⁵ US 20 January 2004 Answers to Additional Questions, para. 3. See also US 30 September 2003 Further Submission, para. 155.

⁵¹⁶ See Brazil’s 27 October Answers to Questions, para. 99, note 136 and Exhibit Bra-299 (“Summary of FY 2003 Export Credit Guarantee Programme Activity,” USDA, covering GSM-102, GSM-103 and SCGP (Total GSM 102, GSM 103 and SCGP allocations for fiscal year 2003 are listed as \$6.025 billion, with product-specific allocations for scheduled products as follows: \$200 million for wheat to Korea; \$85 million for wheat to Pakistan; and, \$10 million for vegetable oils for Tunisia.). See also Brazil’s 18 November 2003 Further Rebuttal Submission, para. 261 (second bullet point).

⁵¹⁷ Exhibit Bra-296 (“USDA Announces \$2.8 Billion in Export Credit Guarantees,” FAS Press Release, 30 September 2003).

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.

251. Thus the “discretionary elements” cited by the United States do not abate the threat of circumvention of its export subsidy commitments. The United States erroneously states that “Brazil’s own approach would require a showing that the programmes mandate that the premium rates will be insufficient to cover long-term operating costs and losses of the programmes”.⁵²⁰ The Panel will recall Brazil’s demonstration that the United States has exported quantities of scheduled products in excess of US quantitative reduction commitments.⁵²¹ Thus, under Article 10.3 of the Agreement on Agriculture, the burden falls on the United States to prove that those excess quantities of scheduled products did not receive “export subsidies,” within the meaning of Article 10.1. The burden is on the United States to show, in its own words, that the CCC programmes mandate that premium rates will be sufficient to cover long-term operating costs and losses of the programmes, within the meaning of item (j), and that CCC guarantees do not constitute financial contributions that confer benefits and are contingent on export, with the meaning of Articles 1.1 and 3.1(a) of the SCM Agreement.

252. But whomever bears the burden, Brazil has shown that the CCC does not have the discretion to charge fees that will enable it to meet its long-term operating costs and losses. 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 in particular the maximum one-per cent premium rate imposed by US law*⁵²² – as evidence of a failure and inability to cover costs and losses.⁵²³ There is no affirmative “mechanism” in place to stop the CCC programmes from constituting export subsidies under item (j), and in fact the fee ceiling imposed by US law is a mechanism that ensures that the programmes will operate as export subsidies.

253. Moreover, Brazil has demonstrated that the CCC export credit guarantee 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 contingent on export), and therefore that they constitute *per se* export subsidies for the purposes of Article 10.1.⁵²⁴ Among other reasons (*e.g.*, the regulations for the CCC programmes, and a comparison to non-market benchmarks established by the US Export-Import Bank)⁵²⁵, Brazil has made this *per se* showing by demonstrating that CCC export credit guarantees are unique financing instruments for agricultural commodity transactions that are not available on the commercial market for terms longer than the marketing cycles of the eligible commodities.⁵²⁶ Far from an affirmative “mechanism” to prevent CCC guarantees from constituting export subsidies, guarantees under the CCC programmes constitute export subsidies *per se*.

⁵¹⁸ Brazil’s 27 October 2003 Answers to Questions, para. 100.

⁵¹⁹ Exhibit Bra-300 (Calculation on US Rice Exports Benefiting from GSM 102, GSM 103 and SCGP).

⁵²⁰ US 20 January 2004 Answers to Additional Questions, para. 4.

⁵²¹ Brazil’s 2 December 2003 Oral Statement, para. 78; Brazil’s 24 June 2003 First Submission, para. 265.

⁵²² US 11 August 2003 Answers to Questions, para. 180. *See also* Exhibit Bra-297 (7 U.S.C. § 5641(b)(2)).

⁵²³ Brazil’s 22 December 2003 Answers to Questions, paras. 63-64.

⁵²⁴ *See, e.g.*, Brazil’s 18 November 2003 Further Rebuttal Submission, paras. 233-241.

⁵²⁵ This evidence is summarized at paragraphs 231-241 of Brazil’s 18 November 2003 Further Rebuttal Submission.

⁵²⁶ *See* Brazil’s 24 June 2003 First Submission, paras. 289-292; Brazil’s 22 July 2003 Oral Statement, para. 116; Brazil’s 11 August 2003 Answers to Questions, paras. 139-140, 152-157, 183-187; Brazil’s 22 August 2003 Rebuttal Submission, paras. 103-105; Brazil’s 22 August 2003 Comments, paras. 92-93, 109-113; Brazil’s 27 August 2003 Comments on US Rebuttal Submission, paras. 68-80; Brazil’s 7 October 2003 Oral Statement, para. 72; Brazil’s 18 November 2003 Further Rebuttal Submission, paras. 230-242; Brazil’s 2 December 2003 Oral Statement, para. 79.

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).