

United States – Subsidies on Upland Cotton

(WT/DS267)

**Comments of the United States of America
on the Answers of Brazil
to Further Questions from the Panel to the Parties
following the Second Panel Meeting**

January 28, 2004

A. Terms of Reference

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

1. Brazil's answer conflates two issues: the measures a Panel is to examine and the evidence a Panel may examine. As stated in the U.S. response, Brazil has challenged certain statutory measures "as such"; Brazil has also challenged certain "payments" as measures. With respect to payments, it is only those payments made through panel establishment that can be "specific measures at issue" between the parties. Payments made after panel establishment necessarily had not been made as of the time of establishment; therefore, those "measures" did not exist and cannot have been within the Panel's terms of reference as set out by the DSB.

2. The situation here is different from that in *Chile – Price Bands*¹ where the question was whether an amendment made to a measure that both parties agreed were within the panel's terms of reference had altered the "essence" of the measure such that it was no longer a measure within the panel's terms of reference. Here, the question concerns measures (payments) that it is without dispute did not exist at the time of panel establishment. Accordingly, the request for a panel could not have "identified" non-existent measures, nor could Brazil have consulted on measures "affecting" (present tense) the operation of a covered agreement. To find these measures to be within the Panel's terms of reference would therefore be in contravention of Articles 4 and 6 of the DSU. It was Brazil's choice to request establishment of the Panel part way through marketing year 2002; thus, Brazil's timing sets the parameters for what payments are properly before the Panel.² In this connection, we note that Brazil has finally conceded the correctness of the U.S. view that this Panel's terms of reference cannot expand beyond their scope of the date of panel establishment. In its answer to the Panel's Question 247 (paragraph 149), Brazil states: "Thus, the 'matter' before the Panel has not changed (*and cannot*) since the establishment of the Panel" (emphasis added). Brazil should of course also have acknowledged that, despite this statement, it has in fact attempted to change the matter before the Panel.

3. This is not to say that a Panel may not examine evidence that is developed after panel establishment.³ In fact, the United States would largely agree with Brazil's statement that "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 [panels] in their objective assessment of the facts under DSU Article 11."⁴ The Panel should

¹WT/DS207/AB/R.

²Past panels have examined measures subject to a dispute as they exist on the date of panel establishment.

See, e.g., Panel Report, India -- Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products, WT/DS90/R, adopted 22 September 1999, paras. 5.159-5.163.

³*See, e.g., Japan – Measures Affecting the Importation of Apples*, WT/DS245/R, para. 4.15 (15 July 2003) (rejecting Japan's preliminary ruling request to strike certain affirmative evidence developed and submitted after the date of panel establishment but no later than during the first panel meeting).

⁴Brazil's Answer to Question 194, para. 5.

carefully consider the import of this statement by Brazil, given the existence of three telling pieces of evidence that Brazil has sought to minimize or neglected:

- First, Brazil largely ignores the undisputed fact that no marketing loan payments have been made since September 19, 2003; thus, given expected prices, U.S. outlays will be dramatically lower in marketing year 2003.
- Second, Brazil seeks to minimize the fact that futures prices indicate that the market expects cotton prices to remain high through marketing years 2003 and 2004.
- Third, and perhaps most disconcerting, Brazil has neglected to inform the Panel that, with respect to its preferred baseline approach, FAPRI has produced a (preliminary) November 2003 baseline that revises projected prices significantly upwards as compared to the outdated baseline on which Mr. Sumner's economic analysis relies.

4. The first piece of evidence demonstrates not only that marketing loan payments will be sharply lower in marketing year 2003 than in previous years, but fatally undercuts Brazil's economic analysis. The Panel will recall that in Brazil's economic analysis, the marketing loan program alone accounted for almost 43 percent of the effect of removal of all challenged U.S. subsidies. Given that no marketing loan payments are being made and that futures prices and the November 2003 FAPRI baseline suggest that no marketing loan payments will be made over the remainder of marketing year 2003, the evidence does not support Brazil's argument that U.S. marketing loans for upland cotton create a threat of serious prejudice.

5. The second piece of evidence is that futures prices indicate that the market expects cotton prices to remain high through marketing years 2003 and 2004. The table below shows settlement prices on January 27, 2004, for contracts through marketing year 2004.

New York Cotton Exchange, Cotton No. 2, January 27, 2004^s	
Contract	Settlement (cents per pound)
March 2004	73.76
May 2004	75.06
July 2004	75.90
October 2004	68.25
December 2004	69.05
March 2005	71.05
May 2005	71.70
July 2005	72.40

6. The following table of futures prices for December 2004 upland cotton contracts further demonstrates that price expectations have risen over time, and market participants expect cotton prices to remain high through December 2004.

Futures Prices for December 2004 Cotton

Month ending	Open for the Month	High for the Month	Low for the Month	Close for the Month	Average Close for the Month
12/31/2002	60.63	62.20	60.49	60.50	61.34
1/31/2003	61.25	62.50	60.50	62.70	61.69
2/28/2003	62.90	63.00	61.30	62.87	62.53
3/31/2003	62.90	63.25	61.70	62.45	62.57
4/30/2003	62.40	64.00	62.00	62.45	62.69
5/31/2003	62.50	64.00	60.58	60.75	62.60
6/30/2003	60.50	64.60	59.00	65.25	62.55
7/31/2003	66.90	66.90	63.32	62.85	65.29
8/31/2003	62.90	63.25	60.70	63.68	61.95
9/30/2003	63.95	66.95	62.20	66.25	64.99
10/31/2003	65.75	71.00	64.80	68.85	67.72
11/30/2003	68.85	70.00	62.50	65.65	67.54
12/31/2003	67.50	68.45	63.25	68.28	65.60
1/22/2004	68.40	69.70	67.62	69.62	68.78

Source: New York Board of Trade, NY Cotton Exchange

^sExhibit US-142.

7. Third, Brazil has not provided the Panel with any information relating to the most recent FAPRI November 2003 baseline. This preliminary baseline further undermines Brazil's economic analysis, which was predicated on projections of continued low cotton prices. As noted with respect to the cessation of marketing loan payments and high futures prices, that low-cotton-price projection on which Mr. Sumner relies has proven to be dramatically off-base. The November 2003 baseline now recognizes that fact.

- For example, the FAPRI November 2002 baseline used by Mr. Sumner projected an A-index of 50.7 cents per pound for marketing year 2003.
- The actual A-index in 2004 (through January 22) has varied between a low of 75.45 cents per pound on January 2 to a high of 76.95 cents per pound on January 22, 2004 – that is, *roughly 50 percent higher* than the FAPRI November 2002 projection.

8. The price outlook for cotton has improved considerably since publication of the November 2002 FAPRI baseline used by Dr. Sumner to estimate the effects of subsidies on U.S. cotton production. The table below shows that projections for the Adjusted World Price are as much as *54.1 percent higher*, or 20 cents per pound, for marketing year 2003 in the November 2003 baseline as under the November 2002 baseline.

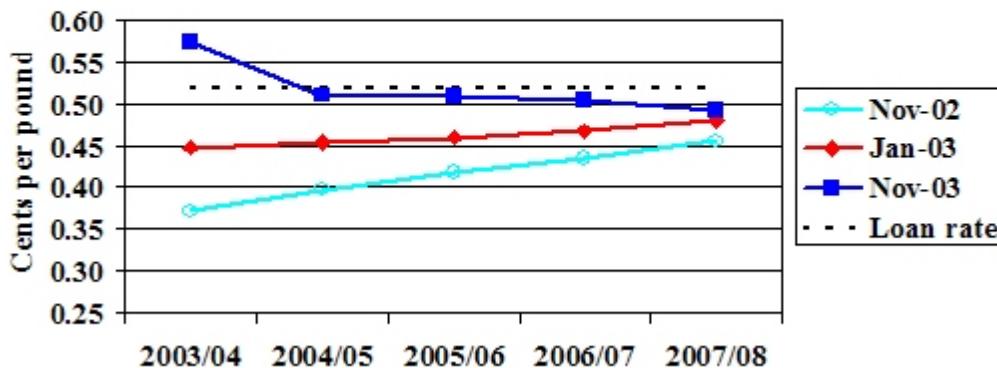
FAPRI's Upwards Revisions to Adjusted World Price Baseline Projections

Year	Adjusted World Price (cents/lb)			
	Nov 2002 (Sumner)	Jan 2003	Nov 2003 ^{1/}	Increase from Sumner Nov02 baseline to Nov03
2003/04	37.22	44.8	57.36	54.1 %
2004/05	39.83	45.4	50.96	27.9 %
2005/06	41.94	46	50.82	21.2 %
2006/07	43.6	46.7	50.35	15.5 %
2007/08	45.48	48	49.24	8.3 %
Average	41.61	46.18	51.75	24.4 %

1/ Source: FAPRI Baseline, November 2003 (Exhibit US-132)

The chart below sets out the same data graphically, showing how much FAPRI's projections have been revised upwards since the November 2002 baseline on which Mr. Sumner's analysis relies.

FAPRI's AWP Projections Have Been Revised Steadily Upwards



9. As a result of this large upwards revision in FAPRI's projected adjusted world price, FAPRI's estimated marketing loan gains have been reduced considerably.

- Under the November 2003 baseline, *the estimated marketing loan gain for marketing year 2003 is now zero*, compared to almost 15 cents per pound under the November 2002 baseline used by Dr. Sumner.
- For marketing year 2004, the estimated marketing loan gain under the November 2003 baseline is 1.04 cents per pound, *a reduction of 91.5 percent* from the 12.17 cents per pound estimated marketing loan gain in the November 2002 baseline used by Dr. Sumner.
- In fact, over the five-year period from marketing year 2003 to marketing year 2007, the average marketing loan gain is estimated in the November 2003 baseline as 1.32 cents per pound, *87.3 percent lower* than the 10.39 cents per pound average using the November 2002 baseline on which Dr. Sumner relied.

FAPRI's Downwards Revisions to Its Marketing Loan Gain Baseline Projections

Year	Estimated marketing loan gain ^{1/} (cents/lb)			
	Nov 2002 (Sumner)	Jan 2003	Nov 2003 ^{2/}	Decrease from Sumner Nov02 baseline to Nov03
2003/04	14.78	7.2	0	100.0 %
2004/05	12.17	6.6	1.04	91.5 %
2005/06	10.06	6	1.18	88.3 %
2006/07	8.4	5.3	1.65	80.4 %
2007/08	6.52	4	2.76	57.7 %
Average	10.39	5.82	1.32	87.3 %

1/ The estimated marketing loan gain is the difference, if positive, between the loan rate (52 cents per lb) and the Adjusted World Price.

2/ Source: FAPRI Baseline, November 2003 (Exhibit US-132)

10. Recall that the marketing loan program accounted for more than 42 percent of the estimated effects of removing all U.S. subsidies over MY 1999-2007 on production under the model developed by Dr. Sumner.⁶ Thus, updating the model to the November 2003 baseline would virtually eliminate the estimated effect of the marketing loan program and significantly reducing the overall estimated effect on production. Any remaining effects would largely be attributed to direct payments under Dr. Sumner's flawed model, with which we strongly disagree.

11. In addition, the FAPRI baseline from November 2002 projected 50.7 cents per pound for the A-Index for marketing year 2003 and the January 2003 baseline projected 58.4 cents per pound for the A-index for marketing year 2003. The FAPRI November 2003 projection for the MY2003 A-Index is 70.9 cents per pound, *40 percent higher* than the FAPRI November 2002 projections used by Dr. Sumner. Even this revision could be low as the actual A-index for January 2004 (through January 22) has varied between a low of 75.45 cents per pound on January 2 to a high of 76.95 cents per pound on January 22, 2004. We also note that FAPRI's November 2002 projections that Dr. Sumner employed did not show, through marketing year 2012, the A-Index *ever* rising as high as current prices.

⁶See Brazil's Further Submission, Annex I, table 1.4.

FAPRI Baseline Projections for A-Index (cents per pound)

A-Index	Nov 2002 (Sumner)	Jan 2003	Nov 2003 1/	Increase from Sumner Nov02 baseline to Nov03
2003/04	50.7	58.4	70.9	39.8%
2004/05	53.4	58.8	64.5	18.9%
2005/06	55.8	59.4	64.3	15.2%
2006/07	57.6	60.1	63.8	10.8%
2007/08	59.6	61.5	62.7	5.2%

1/ Source: FAPRI Baseline, November 2003 (Exhibit US-132)

12. The current high cotton prices and market expectations of continued high prices are crucially relevant because, as mentioned, marketing loan payments will not be made if cotton prices are above the loan rate of 52 cents per pound and, further, counter-cyclical payments will not be made if the season average farm price is above 65.73 cents per pound (the target price of 72.5 cents minus the direct payment rate of 6.67 cents). The weighted average farm price for August-November was 62.4 cents per pound, as reported by USDA on January 11, 2004.⁷

13. Without even referencing the U.S. critique of the modeling used by Brazil with respect to the challenged U.S. measures, this evidence relating to prices indicates that Brazil's economic analysis is founded on price projections that are almost 40 percent below actual prices; thus, the economic analysis put forward by Brazil does not support a finding of threat of serious prejudice. Furthermore, we recall that Brazil has argued that the 2002 Act increased the support provided to upland cotton producers, threatening continued high levels of production, exports, and price suppression. And yet, U.S. acreage declined in both MY2002 and MY2003, and prices have steadily recovered from their MY2001-2002 trough to five-year highs. Market participants expect those high prices to continue. Thus, the evidence does not support the view that the effects of challenged U.S. subsidies are significant price suppression.

B. ECONOMIC DATA

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

14. In its reply, Brazil makes several unfounded accusations and misrepresentations of fact. In this comment, the United States attempts to disentangle fact from fiction for the Panel.

⁷ *World Agricultural Supply and Demand Estimates*, USDA, WAOB, WASDE-406, January 11, 2004.

15. Brazil asserts that through its December 18, 2003 letter, “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 upland cotton in MY 2002.” There are several errors in this passage. First, the United States recalls that it was the United States itself at the second session of the first panel meeting that brought to the Panel’s and Brazil’s attention the planting reporting requirement that was introduced by Section 1105 of the 2002 Act (7 USC 7915). Thus, the United States did not “finally confirm[]” the maintenance of planting data on December 18.

16. Second, the United States never asserted that it did not have contract base acreage and contract yield information. The United States explained that it did not track decoupled payments by recipients’ production and thus did not maintain information on the payments made for upland cotton base acres to upland cotton producers. That statement remains true today. In fact, while Brazil’s statement asserts that “planted acreage, contract base acreage, contract yields, and . . . payment data” can be used to calculate the amount of decoupled payments “made to current producers of upland cotton,” this information would allow the calculation of decoupled payments made to farms that reported *planting* upland cotton. As stated, the United States does not collect information relating to whether a farm *produces* upland cotton. Therefore, the data referenced by Brazil would allow calculation of payments made to upland cotton “planters,” and in fact the United States has provided the contract data to perform this calculation on December 18 and 19, 2003.

17. Brazil claims that it “cannot calculate direct payment and counter-cyclical payment figures” because it was not provided (ignoring that Brazil bears the burden of proof in this dispute) “farm-specific identifying numbers, thus rendering any matching of farm-level information on contract payments with information on farm-specific plantings impossible.” This statement was indecipherable to the United States until the Panel insisted that Brazil explain its proposed methodology for calculating those payments in Question 258. The United States comments on this proposed methodology, which lacks any basis in the Subsidies Agreement, any WTO agreement, or in economic logic, in its comment on Brazil’s answer to Question 258.

18. It is, of course, ironic to read Brazil’s suggestion that only the “unique farm number (or a substitute number protecting the alleged confidentiality of farmers) would allow any matching” since *the United States expressly asked Brazil at the second panel meeting whether it could act to protect the privacy interests of U.S. cotton producers*, perhaps by obscuring farm numbers. The Panel Chairman also inquired of Brazil whether obscuring the farm numbers would be acceptable, *but Brazil refused to agree to any such step, insisting that all of the information, including farm numbers, be provided as set out in Exhibit BRA-369*. Thus, it is Brazil that refused to allow “a substitute number protecting the . . . confidentiality of farmers” – or any other step to maintain farmer confidentiality – to be used. The United States again notes Brazil’s reference to “a private U.S. citizen making a simple FOIA request,” who was in fact a member of

Brazil's delegation, and reminds Brazil for the third time of the U.S. request for assistance in curing the breach of privacy that resulted from providing that planting information.

19. We also note that in Brazil's response, Brazil references several payments that were not included in the Panel's question, namely, crop insurance payments, cottonseed payments, and "other payments." Brazil does not state for what year these payments apply.

20. With regards to crop insurance payments,⁸ we note that the data provided by Brazil for crop insurance net indemnities with respect to upland cotton in 2002 is incorrect.⁹ However, the only crop insurance payments within the scope of Brazil's panel request are payments to "upland cotton producers, users, and exporters."¹⁰ Thus, Brazil is once again attempting to broaden the scope of this dispute to measures beyond its panel request, and the Panel should reject that effort.

21. With respect to cottonseed payments, the United States recalls the panel's communication of 8 December 2003 in which it stated that "[t]he Panel intends to rule that cottonseed payments made under the Agricultural Assistance Act of 2003 are not within its terms of reference." Thus, Brazil's citation to the amount of cottonseed payments made under this Act are not only outside the scope of the question but also outside the scope of this dispute. With respect to "other payments," the United States recalls its preliminary ruling request that these payments are not with the Panel's terms of reference.¹¹

22. With respect to direct and counter-cyclical payments, Brazil continues to put forward erroneous figures before the Panel. Brazil fails to make any adjustment in the amount of payment to reflect the proportion of cotton planted acreage that is rented or owned. However, those "subsidies" to cotton producers that are the subject of Brazil's panel request must "benefit"

⁸We also note that Brazil has insisted that crop insurance premium payments are "specific" subsidies within the meaning of Article 2 of the Subsidies Agreement because the crop insurance statute precludes coverage of livestock. *See, e.g.*, Brazil's Further Rebuttal Submission, para. 163. At one time there was such an exclusion, but as we have previously pointed out, it was removed. In fact, Brazil simply and repeatedly misquotes its own exhibit, which does not contain the "excluding livestock" language of the old statute. *See Exhibit BRA-30, at 1-44 to 1-45* (extending coverage to enumerated products and "any other agricultural commodity, excluding stored grain, determined by the Board, or any one or more of such commodities, as the context may indicate").

⁹Total indemnity payments paid to upland cotton producers in 2002 was \$400,686,555. Total upland cotton premiums were \$317,610,012 of which the government provided premium subsidies of \$194,111,641 and \$123,498,371 was paid by producers. Thus, net indemnities (that is, indemnities minus producer-paid premiums) paid to upland cotton producers in 2002 was \$277,188,184 (\$400,686,555 minus \$123,498,371), not \$298.3 million as reported by Brazil.

¹⁰*See WT/DS267/7, at 1 ("The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton.").*

¹¹U.S. Further Written Submission, Section II. The United States also recalls its point above, namely Brazil has conceded the correctness of the U.S. view that this Panel's terms of reference cannot expand beyond their scope of the date of panel establishment. In its answer to the Panel's Question 247, Brazil states: "Thus, the 'matter' before the Panel has not changed (*and cannot*) since the establishment of the Panel." Brazil should also have acknowledged that, despite this assurance, it has in fact attempted to change the matter before the Panel.

producers.¹² Brazil itself has conceded that land rental rates as of marketing year 1997 – that is, one year after introduction of the decoupled production flexibility contract payments – reflect the capture of more than one-third of the subsidy by landowners. Finally, Brazil has not allocated these decoupled payments that are not tied to the production, use, or sale of any product across the total value of the recipient's production, the only allocation methodology set out in the Subsidies Agreement and, in fact, applied by Brazil itself for countervailing duty purposes.¹³

23. With respect to the export credit guarantee programs, Brazil “estimates the amount of payments using the ‘guaranteed loan subsidy’ estimate FY 2003.”¹⁴ This figure is of course not a payment at all, but merely a prospective budgetary *estimate* calculated under the Federal Credit Reform Act of 1990. As the United States noted in its answer, for all cotton for fiscal year 2003 (October 2002 - September 2003), outstanding claims are \$280,898, less than one-tenth of one percent of the value of registrations – further evidence, specific to cotton export credit guarantees in particular, that premiums are more than sufficient to cover operating costs and losses.

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

24. With respect to the explanations of Brazil of the A-Index, we note that the A-Index is not a price for a “world market” for purposes of Article 6.3(c). As Brazil's answer puts it, the A-Index is an “average price,” a “composite of quotations from the major producing regions around the world, much like a poll” (para. 11). The A-Index is also not a “price” in a “world market”; it is a Northern Europe-delivered price quote. We note the statement in paragraph 16 of Brazil's answer that “the average A-index price” in the week of export “would only be an estimate and would not necessarily reflect the price received by the U.S. producers, or the prices received by the exporters.” Finally, we note that there are 16 different quotes, and the A-Index consists of the average of the lowest 5. The fact that the prices differ also indicates that there is not one “world market” price. There is also a B-Index composed of upland cotton price quotes of lower quality growths, again suggesting that the A-Index is not a “world market price.”

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

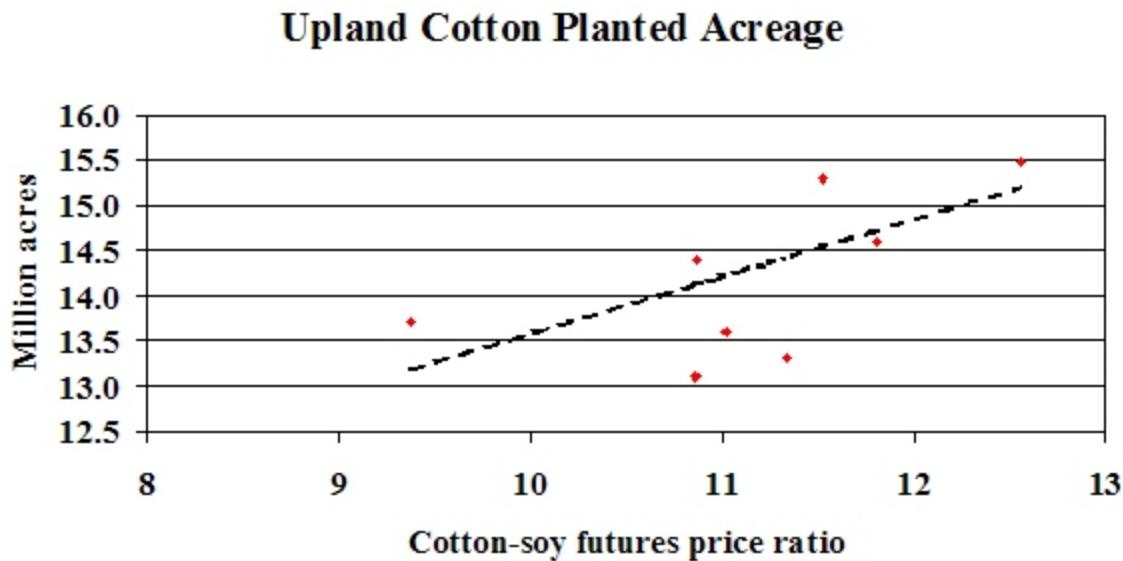
¹²See Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/R, adopted 7 June 2000, paras. 6.65 and 6.66 (quoting and agreeing with *Canada – Aircraft* panel: “A “benefit” does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a “benefit” can be said to arise only if a person . . . has in fact received something.””).

¹³See U.S. Comment on Brazil's Answer to Question 258 from the Panel.

¹⁴Brazil's Answer to Question 196 from the Panel, para. 9.

25. Brazil asserts that U.S. producers are largely unresponsive to market price movements and cites a chart provided in their oral statement of December 2 that showed cotton future prices and planted cotton acreage. However, using a simple cotton price is inappropriate to measure price responsiveness. Prices for cotton alternatives also fell from 1999 to 2002. A farmer cannot just consider cotton prices but must instead consider the opportunity cost at the time of planting. Operating costs being covered (as the United States has already shown the farmer expected to do in each year), he must decide which crop to plant, and this requires looking at the cotton price relative to alternatives. In fact, this is the approach taken by FAPRI and Dr. Sumner in considering net returns of cotton versus other crops.¹⁵

26. When one considers movements of cotton futures versus the price of a substitute like soybeans, a far different picture emerges than the one promoted by Brazil in its response to question 200. The graph below uses the same planted area numbers and time period as Brazil. It shows planted area is price responsive when judged against the more appropriate ratio of cotton to soybeans harvest season futures prices at the time of planting.¹⁶



27. In the U.S. *Comments Concerning Brazil's Econometric Model*, we point out that the correlation between planted acreage and the ratio of cotton futures to soybean futures is 0.69 over the 1996 to 2002 period. This compares to a correlation of 0.40 for lagged prices to planted acreage, and a *negative correlation* using Dr. Sumner's expected net return calculation and planted acreage. Thus, in contrast to statements by Brazil that futures prices are poor predictors

¹⁵Indeed, our objections to their approach focuses on the use of lagged prices rather than futures prices as a proxy for producer price expectations.

¹⁶The cotton-soybeans futures price ratio is drawn from the U.S. answer to question 175 from the Panel, paragraph 118.

of planted acreage, the correlation data suggest that the futures price ratios are better predictors of planted acreage than the arbitrary net return calculations as constructed by Dr. Sumner.

28. In conclusion, the United States has demonstrated that because the harvest season cotton futures price at planting was above the marketing loan rate (in MY99-01), farmers were planting for the market, not the loan rate. But it is simplistic for Brazil to put compare cotton plantings to futures and judge U.S. farmers not to be price responsive. The United States has never claimed (nor would it) that cotton futures are the only variable that matters for purposes of planting decisions. The correlation data on cotton planted acres to the cotton / soybeans futures ratio shows that competing crops must be factored into any planted acreage analysis. Thus, if Brazil had been interested in presenting an accurate analysis to the Panel, it could have presented such data, or even incorporated alternative crops besides soy from each relevant growing region. Brazil preferred to put forward an analysis that could only serve to obscure the issue.

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

29. As was pointed out in the U.S. response to question 201, cotton producers' use of futures and option markets is high relative to other crops. Based on survey data from the 1996 USDA Agricultural Resource Management Study, it is estimated that between 35 and 57 percent of cotton farmers used a hedging instrument in 1996. (The ranges reflect a 95 percent confidence interval.) In addition, an estimated 63 to 89 percent of cotton farms used cash forward contracts in 1996.¹⁷ 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.

30. Moreover, futures markets provide producers information regarding the future price outlook even if they do not hedge directly on the exchange. For example, the January 16, 2004 newsletter by cotton market analyst O.A.. Cleveland states:

With December [futures contract price] exhibiting signals of breaking away from old crop prices, *hedging of new crop has increased*. Now above 69 cents, *December will need to move higher to prevent acreage loss to both soybeans and corn*. A soybean/cotton ratio of 9.5 to 1 is enough to begin moving some land from cotton to soybeans (November soybeans to December cotton). A 10 to 1 ratio accelerates the switch. A September

¹⁷A 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 on pricing mechanism (such as a futures or options market). See Exhibit US-121, page 22.

corn ratio of 4 to 1 over December cotton takes more cotton acreage. With both management and capital risk greatly reduced for both of these crops, relative to cotton, significant cotton acreage can be loss if cotton becomes less favorable. With world cotton carryover at a decade low, the new crop December must maintain its tie to the grain/oilseed complex instead of the old crop cotton contracts.¹⁸

Note that Dr. Cleveland refers not just to cotton futures but to the cotton to soybean ratio and the ratio between cotton futures and corn futures. He confirms not just the importance of cotton futures prices in guiding cotton planted acreage decisions but, more significantly, the relationship of cotton futures prices to the futures prices of competing crops like soybeans and corn.

31. Brazil has presented no evidence that any farmer ever planted based on “lagged prices” (or its “estimated adjusted world price”). Despite Brazil’s criticisms of looking at December futures prices to gauge producer price expectations, farm publications are full of references (like that by O.A. Cleveland, above) to the use of December futures for upland cotton planting and hedging purposes. Consider USDA’s “Weekly Cotton Market Review” of January 9, 2004.¹⁹ It reported:

- “Most producers [in southeastern markets] have turned their focus to marketing the remainder of their 2003 crop and to *making initial preparations for planting the 2004 crop. Some producers inquired about forward contracts on 2004-crop cotton.* These inquiries were preliminary and no cotton was booked. Merchants offered contracts in Georgia at 350 to 400 points off NY December futures” (emphasis added).

Two weeks later, the most recent “Weekly Cotton Market Review” reported:²⁰

- “Producers in Georgia booked a very light volume of 2004-crop cotton at 275 to 300 basis points off NY December futures.”
- “Merchants continued to offer contracts in Georgia at 300 to 375 points off NY December futures.”
- “Contracts in North Carolina were offered at 450 to 475 points off NY December futures.”
- “Merchants offered forward contracts at 350 points off NY December futures [in south central markets].”

¹⁸O.A. Cleveland Newsletter, January 16, 2004. Exhibit US-133.

¹⁹USDA, Weekly Cotton Market Review at 1-2 (January 9, 2004) (Exhibit US-139)

²⁰USDA, Weekly Cotton Market Review at 1-2 (Jan. 23, 2004) (Exhibit US-140).

That is, as the United States has explained, producers are beginning to make planting decisions for MY2004 and are using the December futures price as a guide to their expected returns from planting cotton. A farmer in Georgia can currently lock in a price for the 2004 crop of approximately 65-66 cents per pound (Jan. 27, 2004 December futures price of 69.05 cents per pound less 300 to 375 points), and farmers have begun to do just that. Thus, Brazil asserts that the U.S. methodology of looking to the December futures price to gauge producer price expectations is far less valid than using the (outdated November 2002) FAPRI baseline, but cotton producers disagree. In the final analysis, it is producer decisions – and not FAPRI's nor Dr. Sumner's decision to use "lagged prices" – that must drive the Panel's analysis of the effect of removal of marketing loan payments.²¹

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

32. The United States agrees with Brazil's general characterization of FAPRI as a preeminent research institution focused on providing comprehensive analysis of the food and agricultural system. As noted by Brazil in its answer, the United States takes issue with the modifications of the FAPRI model by Dr. Sumner. These differences are outlined in detail in the *U.S. Comments Concerning Brazil's Econometric Model* of December 22, 2003. Chief among these differences is that manner in which Dr. Sumner modeled the effects direct and counter-cyclical payments. FAPRI allows for modest effects of direct payments on all crop acreage. Their result is consistent with the literature on decoupled payments, showing no or minimal effects on production.²² By contrast, Dr. Sumner has included an arbitrary and completely *ad hoc* formulation that exaggerates the effects of these payments on acreage decisions. As compared to FAPRI's modeling, Dr. Sumner assumes and then finds effects some 50 times larger.²³

33. The differences between the FAPRI baseline and Dr. Sumner's model were highlighted as well by Dr. Bruce Babcock, the economist who assisted Dr. Sumner in preparing the Annex I results. In a letter to Dr. Glauber, Dr. Babcock states, that the analysis of Dr. Sumner 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 U.S. cotton subsidies on world prices." Thus, to cloak Dr. Sumner's analysis in the reputation of "the award-winning FAPRI model" is grossly misleading. The differences between FAPRI and the Brazil analysis reflected in Annex I are

²¹We also note an argument by Brazil in paragraph 19 that farmers generate a combined revenue from the market and the marketing loan program that exceeds 52 cents per pound. Brazil's analysis is once again partial. The premise is that a farmer is able to sell when prices have *increased* relative to the price on the date they claimed the marketing loan gain. However, in reality, there is no guarantee that prices will have increased. It is equally possible that prices will fall *below* the price on the date when the claim was made. 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.

²²See U.S. Further Rebuttal Submission, paras. 81-82 (reviewing literature, which finds less than one percent effect on production, even making unrealistic assumptions on wealth effects).

²³See U.S. Comments on Brazil's Economic Model, para. 20.

substantial and, as detailed in the U.S. Comments of December 22, lead to the biased results presented by Brazil.

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

34. In this answer on “support to upland cotton,” Brazil makes reference to “contract payments from base acreage other than upland cotton” and the “allocation of these payments.”²⁴ This answer makes clear that Brazil proposes that such payments with respect to non-upland cotton base acres can be “support to upland cotton.” The United States comments on the methodology proposed by Brazil for allocating such payments, which lacks any basis in the Subsidies Agreement, any WTO agreement, or in economic logic, in its comment on Brazil’s answer to Question 258. Here, we take issue with Brazil’s attempt to amend this Panel’s terms of reference to include such payments, and to do so at such a late stage in this proceeding.²⁵

35. Nowhere in Brazil’s consultation request or request for the establishment of this Panel does Brazil reference these payments under programs unrelated to upland cotton. Accordingly these payments are not within this Panel’s terms of reference. Moreover, Brazil’s attempt to raise these payments at the very end of this proceeding deprives the United States of fundamental rights of due process. The United States, as well as all WTO Members, had a right, as of the date of Brazil’s request for the establishment of this Panel, to know the “*specific*” measures at issue in this dispute.²⁶ Brazil cannot make vague allegations of “support” and then change at will the measures that it is challenging as its own position changes and to suit its convenience.

36. Brazil’s own submissions to this Panel demonstrate that Brazil did not consider these payments to be measures within the Panel’s terms of reference. In particular, the measures Brazil has alleged are “support to upland cotton” govern both Brazil’s serious prejudice claims as well as its Peace Clause analysis. That is, the same measures that are “support for upland cotton” under Brazil’s subsidies claims must be the measures that Brazil claims are “support to a specific commodity” for purposes of the analysis under Article 13(b)(ii) of the support that current measures grant versus the support decided during the 1992 marketing year. However, by seeking to allocate to upland cotton “contract payments from base acreage other than upland cotton,” Brazil directly contradicts the arguments it set forth in the Peace Clause phase of this dispute. For example, in response to Question 41 from the Panel, Brazil wrote:

The only U.S. domestic support measures that Brazil is aware of that would meet the test of being ‘support to upland cotton’ are those that it listed for purposes of

²⁴Brazil’s Answer to Question 204, para. 27.

²⁵As previously noted, Brazil’s answers to the Panel’s questions contain an important concession: in its answer to the Panel’s Question 247, Brazil states: “Thus, the ‘matter’ before the Panel has not changed (and cannot) since the establishment of the Panel.”

²⁶See DSU, Article 6.2.

calculating the level of Peace Clause support in its First Written Submission. In the view of Brazil, these non-green box domestic support measures are the measures that constitute "support to" upland cotton for the purpose of Article 13(b).²⁷

The footnote to the first quoted sentence cited paragraphs 144, 148, and 149 of Brazil's first written submission. These paragraphs, in turn, contain the tables in which calculated that budgetary outlays it alleged were support to upland cotton; crucially, these tables list production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments *for upland cotton base acres only*.²⁸

37. Similarly, in response to Question 19, in which the Panel asked Brazil to identify "the measures . . . in respect of which Brazil seeks relief," Brazil wrote:

The first type of domestic support "measure" is the payment of subsidies for the production and use of upland cotton. . . . 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.²⁹

Again, the referenced paragraphs list production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments *for upland cotton base acres only*.³⁰

38. Further, in explaining to the Panel why it did not allocate any portion of other payments notified by the United States to the WTO as non-product-specific, "some of which" (in the Panel's words) "presumably deliver support to upland cotton (e.g. state credit programmes, irrigation subsidies etc)," Brazil explained:

None[] of these other measures notified by the United States as non-product specific had *any 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 *any other specific upland cotton provisions*.³¹

Of course, the same analysis applies to decoupled income support payments made with respect to base acres for wheat, corn, soy, oats, sorghum, barley, flax, sunflower, safflower, rice, rapeseed, mustard, canola, crambe, and sesame. *None* of these payments has any "upland cotton specific"

²⁷Brazil's Answer to Question 41 from the Panel, para. 58 (footnote omitted) (italics added).

²⁸See Brazil's First Written Submission, paras. 144, 148, 149.

²⁹Brazil's Answer to Question 19 from the Panel, para. 15.

³⁰See Brazil's First Written Submission, paras. 146-49.

³¹Brazil's Answer to Question 41 from the Panel, para. 57 (italics added).

link in terms of upland cotton acreage, production, prices, or “any other specific upland cotton provisions.” Indeed, these other payments are related to acreage historically planted to these other crops and may be (in the case of counter-cyclical payments) related to current prices of these other crops, *not upland cotton*. It is for that reason, presumably, that Brazil did not identify any of these payments among the measures it challenged.

39. Indeed, an important element in Brazil’s argument that the decoupled income support measures it challenged were *not* non-product-specific – and thus constitute “support to a specific commodity” – was that the challenged measures contained upland cotton-specific parameters. For example, with respect to counter-cyclical payments, Brazil wrote:

For the purpose of calculating AMS, counter-cyclical payments (CCP) are ‘product-specific’ support for two main reasons: (i) they are not "support provided in favour of agricultural producers in general," and (ii) they are directly linked to *upland cotton-specific parameters* (current prices and historical acreage and yield).³²

Brazil similarly argued that other decoupled income support measures were product-specific support in favor of upland cotton because they allegedly contain upland cotton-specific parameters.³³

40. We also note that Brazil’s request to the Panel to make rulings and recommendations does not reference any decoupled payments made with respect to non-upland cotton base acres. In fact, Brazil specifically stated that its “as such” challenge to “Sections of the 2002 FSRI Act and the referenced regulations thereto,” including provisions relating to counter-cyclical payments and direct payments, were only made “to the extent that they relate to upland cotton.”³⁴

41. In sum, Brazil’s arguments on the Peace Clause explicitly limited its claims with respect to decoupled income support measures to payments made with respect to upland cotton base acres. In fact, Brazil relied on the notion that such measures contained “upland cotton-specific” parameters to support its argument that those measures were “support to upland cotton” rather than non-product-specific support.

42. Under its serious prejudice claims, however, Brazil now seeks to expand the challenged measures to include decoupled income support measures with respect to non-upland cotton base

³²Brazil’s Answer to Question 44 from the Panel, para. 61 (italics added).

³³See, e.g., Brazil’s First Written Submission, para. 60 (“Between MY 1998-2001, upland cotton producers thereby received an additional amount of money, which was calculated based on their respective share of total upland cotton base times the amount of budgetary outlays allocated for upland cotton.”).

³⁴Brazil’s Further Submission, para. 471(vii).

acres,³⁵ despite repeatedly arguing that the challenged U.S. subsidies provided \$12.9 billion in support over marketing years 1999-2002, a figure based on payments made under specific programs, *including decoupled income support with respect to upland cotton base acres only.*³⁶ Decoupled payments made with respect to non-upland cotton base acres would not be within the terms of reference of this dispute; Brazil as complaining party cannot unilaterally expand the terms of reference at the conclusion of a dispute and claim that additional programs, other than those at issue throughout the dispute, are now also challenged measures providing “subsidies to upland cotton.”³⁷

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

43. We note that Brazil acknowledges that a comparison of “planted to planted” area would be best. Harvested area can only be used as a proxy for planted area, and as indicated by the U.S. data in the U.S. Opening Statement of December 2, 2003, the two measures can diverge significantly. This divergence is especially important to note in light of Brazil’s answer to Panel Question 210.

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

44. After noting in its response that consistent world-wide planting data for upland cotton are not available, Brazil continues to insist that world-wide harvested area data are a good proxy for planted area. Brazil offers a theoretical justification for using harvested area as a proxy for planted area (annual abandonment will average out over all cotton producing countries and be relatively stable over time). But Brazil has no empirical evidence to support the theory and continues to mix “apples and oranges” in its charts. For example, we note the chart at paragraph

³⁵The United States notes that Brazil does not appear to seriously believe that these measures are within the Panel’s terms of reference since Brazil has not presented the 1992 levels of support that would include these additional payments, which Brazil would have had to do to make the Peace Clause comparison.

³⁶We note that Brazil seeks to have it both ways. That is, it now argues that decoupled payments made with respect to non-upland cotton base acres can be allocated to, and become support to, upland cotton, yet at the same time, when it suits its purposes, it continues to argue that decoupled payments are support to upland cotton because of their alleged upland cotton-specific parameters. *See, e.g.,* Brazil’s Opening Statement at Second Panel Meeting, para. 60 (“[T]he 72.4 cent target price triggers CCP payments when *cotton* prices are lower – not corn, or soybeans prices – but *cotton*.”).

³⁷Indeed, although Brazil attempted to argue at the second panel meeting that it sought information on payments made with respect to *non-upland cotton base acres* through the Annex V procedure that the DSB did not agree to initiate, Brazil itself stated in its first written submission that its Annex V request was *limited to upland cotton base acres*: “Brazil requested the United States during the Annex V procedure to provide information on the amount of the *total upland cotton base acreage and yield under the CCP (and DP) program*.” Brazil’s First Written Submission, para. 68 (italics added). If so, this would be consistent with Brazil’s Peace Clause argumentation in this dispute that only payments on upland cotton base acres could be product-specific support for upland cotton.

33 of Brazil's answers is misleading: it is not a chart of "Percent Change in Planted Acres" as labeled. Rather, it compares changes in U.S. *planted* area for upland cotton with changes in non-U.S. *harvested* area. This comparison is not appropriate.

45. As noted in the U.S. answers to Question 209 from the Panel, U.S. planted and harvested area generally move in the same direction but occasionally move in opposite directions. We note that, once again, Brazil has relied on a period that begins with marketing year 1998 to present a biased analysis. The period 1998 - 2000 that Brazil focuses on in para. 33 was an unusual period for U.S. cotton because of weather. As noted in the U.S. Opening Statement of December 2 (para. 6), abandonment was especially high in 1998 and area rebounded sharply in 1999. The year 2000 was a year when U.S. planted and harvested area moved in opposite directions.

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

Crop year	Planted acres	Harvested acres
1998	13,064	10,449
1999	14,584	13,138
2000	15,347	12,884

Source: USDA, National Agricultural Statistics Service, *Acreage*, various issues, as submitted in the U.S. Opening Statement of December 2 (para. 6).

46. Because foreign planted area data are not available, it is not possible to observe whether foreign planted and harvested area similarly diverged in these years. Therefore, using U.S. planted area and foreign harvested area is a misleading comparison. Brazil uses its mislabeled chart to simplistically conclude that whenever U.S. planted area moves in a divergent direction from foreign harvested area, the only reason must be because U.S. subsidies insulate U.S. upland cotton producers. That conclusion ignores any other possible factors that may affect area planted – for example, weather or competing crop prices – and is not supported by the data.

47. In para. 34, Brazil again complains that the U.S. chart in the U.S. Opening Statement of Dec. 2 (para. 6) is inappropriate. Brazil has it completely backwards. The U.S. chart is the only appropriate comparison. We agree that a comparison of planted area data would be the best method, but the data are not available. Therefore, Brazil's conclusions based on a "planted versus harvested" comparison are not valid.

48. We again present a comparison of changes in U.S. harvested area for upland cotton with changes in harvested area for the rest of the world. (These data are found in Exhibit US-63, but 2002 data are updated and estimated data for 2003-04 are included.) We note again the anomalous years of 1998 and 1999 for the U.S., where harvested area was sharply below planted area in 1998 because of severe adverse weather but then planted (and harvested) area increased sharply in 1999 in reaction both to the previous year's high abandonment and to favorable prices

relative to competing crops. For the years 2000 - 2002 harvested area in the U.S. and the rest of the world moved in tandem – declining in 2000, rising in 2001, and declining again in 2002. Brazil's claim of "distinctly different reactions"³⁸ are not supported by the data.

49. Brazil further claims that U.S. area should have declined during the period 1999 - 2002. In fact, it is hard to discern any trend in U.S. (or foreign) harvested area during this period. But since 1999, an admitted high year because of unique weather factors and favorable cotton prices relative to competing crops, U.S. upland cotton area has generally declined. The new data provided for 2003 reinforce this conclusion: U.S. area declined while the rest of the world, including Brazil, increased.

Harvested Area for Upland Cotton (1,000 hectares and percent change from previous year)

Crop year	1998	1999	2000	2001	2002	2003(p)
<hr/>						
U.S. area	4,324	5,433	5,282	5,596	5,030	4,881
Foreign area	28,559	26,955	26,904	28,308	25,470	28,090
Brazil area	685	752	853	748	735	940
<hr/>						
U.S. (% change)	-20.3	25.6	-2.8	5.9	-10.1	-3.0
Foreign (% change)	0.5	-5.6	-0.2	5.2	-9.9	10.3
Brazil (% change)	-10.5	9.8	13.4	-12.3	-1.7	27.9

Sources: USDA, Foreign Agricultural Service, Production, Supply, and Distribution Database; World Agricultural Supply and Demand Estimates, World Agricultural Outlook Board, USDA, January 11, 2004. Exhibit US-63, with 2003 added.

50. The data show that U.S. harvested cotton area moves consistently with the rest of the world, when there are not abnormal weather events. Brazil conceded as much (in para. 36) that U.S. acreage movements were relatively consistent with the rest of the world. How could that be if U.S. producers are insulated from price movements because of subsidies? In marketing year 2003, U.S. cotton area declined 3 percent while the rest of the world rose 10 percent. These divergent results again suggest that cotton area around the world is affected by different factors and these need to be accounted for carefully. But a *decline* in U.S. harvested acreage in marketing year 2003, following a decline in marketing year 2002, is certainly not consistent with Brazil's theory that the United States increased support in the 2002 Act and that these "higher" payments will result in U.S. overproduction of cotton, threatening to cause serious prejudice.

³⁸Brazil's Answer to Question 210 from the Panel, para. 35.

51. In discussing how producers react to price signals, we would note recent trends in Brazil's cotton area. In MY2002, Brazil's harvested area declined about 2 percent while the U.S. and foreign cotton area dropped 10 percent. In MY2003, Brazil's cotton area is estimated to have increased 28 percent while U.S. cotton area fell 3 percent. In fact, since the collapse in Brazil's cotton area in 1996, Brazil's cotton area has shown a much more consistent upward trend than U.S. or foreign cotton area. We also note that in marketing years 1998, 1999, 2000 and 2001, Brazil's harvested area moved in the *opposite direction* from non-U.S. cotton area. Those different responses, in absolute values, ranged from 11 percent in MY1998 to 17.5 percent in MY2001. In MY2002, Brazil's harvested area declined much less than the (non-U.S.) rest of the world (1.7 percent versus 9.9 percent), and in MY2003 Brazil's harvested area is forecast to expand by far more than the (non-U.S.) rest of the world (27.9 percent versus 10.3 percent). Thus, it would appear that, in terms of changes in harvested acres, Brazil deviates far more from the non-U.S. rest of the world than does the United States.

52. Finally, in paragraph 35, even when Brazil's misleading data do show a consistent decline between U.S. planted and non-U.S. harvested area, Brazil does not accept that U.S. cotton producers were responding to market signals. Brazil simply claims that U.S. cotton area should have declined more than it did.³⁹

53. Brazil has tried to explain away similarities in acreage movements by asserting that Dr. Sumner's analysis suggests that U.S. cotton acreage should have even been lower. Not only do we disagree with that analysis, but we note that it fails to explain why U.S. and non-U.S. harvested acreage moves commensurately from 1997-2002. If U.S. producers were insulated from price movements, as Brazil claims, one would not expect U.S. acreage to be highly correlated with acreage movements in the rest of the world. In fact, the data suggests the opposite; i.e., that U.S. producers respond in similar fashion with cotton producers around the world.

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

³⁹In paragraph 35, Brazil again tries to buttress its claims by arguing that U.S. exports increased during a period when the U.S. dollar was appreciating in value. The exchange rate analysis put forward by Brazil is incomplete and inadequate. Brazil has ignored the fact that cotton is a raw material for apparel and textile products. The increase in foreign demand for raw cotton drove an increase in U.S. exports. For example, with a strong U.S. dollar, imported cotton textile and apparel became relatively cheaper, thereby increasing demand for such products. Increased textile and apparel demand in the United States from the higher dollar resulted in increased demand for raw cotton by foreign textile and apparel manufacturers. Foreign use of cotton increased from 80.8 million bales in MY 1999 to 91 million bales in MY 2002. Foreign production, however, remained basically the same, 70.5 million bales in MY 1999 to 70.8 million bales in MY2002. Therefore, U.S. exports were responding to demand that was not met by foreign production. Source: Cotton and Wool Situation and Outlook Yearbook, Economic Research Service, USDA, November 2003, pg. 32.

54. Brazil points out that 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.

55. Models such as used by FAPRI, USDA and the Congressional Budget Office has been developed not for retrospective analysis but for *prospective* analysis. If one wants to project out over a period for which futures prices are not available, it makes sense to rely on lagged prices since the models will produce prices for a given year that can then be used as the price expectation for the following year.

56. 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 Brazil has pointed to here, when unexpected exogenous shocks such as China dumping stocks (late 1990s) and unexpected yields worldwide due to good weather conditions such as 2001, lagged prices are poor predictors of expected prices. Future prices, by contrast, are more efficient because they are based on more current information. Moreover, as we have argued elsewhere (see comments to question 200 and 201 above), producers base acreage decisions on futures markets. Where futures prices diverge from lagged prices, there is reason to believe that planted acreage decisions will diverge from forecast acreage from models based on lagged prices.

57. For example, during marketing years 2000, 2001, 2002, and 2003, lagged prices significantly underestimate 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 percent, depending on the year, to equal the harvest season price actually expected by producers as indicated by the futures price.⁴⁰

- For the period MY 1999-2003, when futures prices are used to gauge producer price expectations, only in MY 2002 were expected cash prices below the marketing loan rate.
- 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. In fact, despite the hundreds of exhibits it has filed, Brazil has provided not one

⁴⁰U.S. Further Rebuttal Submission, paras. 164-65.

single piece of evidence that any farmers use or have ever used lagged prices to make planting decisions.

58. While the United States would agree with Brazil that it is impossible to know precisely what individual farmers' price expectations are, the United States (and Brazil's expert, Mr. McDonald) believe that futures prices provide the most current expectations of market participants. As such, futures prices incorporate the views of numerous market participants, including producers, regarding expectations of future market conditions. 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, modeling convenience is no justification to ignore these objective, market-based price expectations. The Panel cannot rely on Brazil's economic analysis that uses a proxy for expected prices that would have to be increased by up to 25 percent to accurately reflect futures prices, the only objective data on the record reflecting actual price expectations of market participants. The biased results from using lagged prices do not assist the Panel in making an objective assessment of what is the effect of the U.S. marketing loan program.

59. Brazil ignores the fact that expected cash prices based on futures prices were above the loan rate from MY1999-2001, whereas the lagged price was below the loan rate for 2000-2002. That is, withdrawal of the marketing loan would not have greater acreage impacts because producers are planting for market prices, not loan rate.

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

60. In the U.S. response to question 211 (b), we demonstrate that market returns have exceeded variable costs for cotton producers in every year but one (2001) over the period of investigation. Brazil continues to argue that producers require direct payments to cover total costs of production, but this ignores the evidence that significant acreage is planted to cotton by cotton producers who have no cotton base acreage and hence are ineligible for cotton direct payments.

61. Brazil claims U.S. producers will continue to plant upland cotton because they face no revenue risk, but this argument ignores the substantial evidence on record of huge acreage shifts, both on state level and within three categories of farms (i.e., those who plant cotton with cotton base; those who do not plant cotton but have cotton base; those farms who planted cotton but have no cotton base). Moreover, Brazil ignores the decline in plantings over last two years as other commodities have become more attractive and expected cotton prices less so. Finally, the claim that direct and counter cyclical payments remove risk of revenue loss runs contrary to theory on decoupled payments. Farmers will plant the crop that maximizes their expected revenue since the decoupled payment will be made whether they plant or not.

62. Brazil's argument that direct payments have significant effects on production runs counter to the empirical literature as well as running counter to the estimated effects from the FAPRI model that they purport to use. As pointed out in Dr. Glauber's literature review⁴¹ and in the U.S. discussion of direct payments in the U.S. further submission and further rebuttal submission, empirical studies suggest that direct payments have only minimal effects on production. Indeed, as pointed out in the U.S. Comments Concerning Brazil's Econometric Model of December 22, the FAPRI baseline model (that is, the original FAPRI model as distinct from the model modified by Dr. Sumner) suggests that the effect of direct payments on cotton acreage is less than one percent.

63. It is only when Dr. Sumner explicitly modifies the FAPRI model to *include* an *ad hoc* production specification for direct payments that Brazil obtains the tautological result that direct payments have a significant effect on cotton production.

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

64. In this answer the matter addressed has to do with base issues and whether farmers could or could not update their bases in the period that followed 1985. In our December 22 response we gave a full answer on that topic. We would note that in the U.S. answer it is indicated that under the 1990 Act the running base provisions for cotton called for a five-year running average. This was an error. The running base period was a five-year period for other program crops, but cotton and rice used a three-year period.

65. Brazil's contention that the United States has a base building policy is belied by Brazil's own recitation that there has been only one chance to add base cost-free (that is, without loss of benefits); that was in the 2002 Act, in which new crops were added to the program mix, necessitating a recalculation. There is no guarantee nor any reason to believe that this will ever happen again. Brazil is simply speculating on the likelihood that updating could occur. What could happen in some cases is program termination, such as that which occurred with the elimination of peanut quotas in the 2002 Act.

66. Brazil further speculates that some farmers could be upset by the new program because they did not plant as much as they could have over 1998-2001 and that such farmers will now plant more than they would otherwise have. Brazil's speculation is devoid of any facts. In fact, the United States has pointed to planting data (for example, that submitted on December 18 and 19, 2003) that demonstrates just the opposite – that is, cotton plantings are declining. Further, Brazil's own scenario suggests that there was no such understood policy of base building –

⁴¹Exhibit US-23.

otherwise, why would any farmer be surprised? Farmers will always speculate on the shape of the future, but these speculations (for which Brazil has presented no evidence) cannot drive determinations of consistency or inconsistency of measures with WTO obligations.

67. Finally, to the extent that Members would wish to limit the ability of Members to choose a new “defined and fixed base period” for purposes of paragraph 6(a) of Annex 2 to the Agreement on Agriculture, they may do so as a result of the current Doha negotiations. However, no such limitation currently appears in the text, and Brazil is acting in contravention of Article 3.2 of the DSU in seeking to have a panel “add to or diminish” the rights and obligations of Members through dispute settlement. The United States would also note that Brazil’s response to this question appears to assume that Members will not accept the U.S. proposal for significant reductions in domestic support under the Doha negotiations. The overall AMS reduction commitment would be relevant for the amount of support, including base acres, that a Member would provide.

D. EXPORT CREDIT GUARANTEES

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

68. Brazil’s response to this question demonstrates that Brazil continues to ignore the text of Article 10.2 itself. Article 10.2 is clear that once disciplines are internationally agreed, then Members undertake “to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.” No “amendment” to Articles 9 or 10 would be needed. Article 10.2 has already specified the obligations once the negotiations are completed. In this sense, Article 10.2 goes further than, for example, Articles XIII:2 and XV:1 of the GATS, which also call for negotiations to develop additional disciplines but do not on their face already commit Members to abide by the results of those negotiations.

69. Brazil mischaracterizes the views of the United States with respect to the role of the OECD and the interpretation of Article 10.2 of the *Agreement on Agriculture*. Brazil stated that “some participants [in the Uruguay Round negotiations] may have been seeking additional obligations regarding notification, consultation and information exchange, like those included in the OECD Arrangement on Officially Supported Export Credits for industrial products.”⁴² Brazil alluded to no other potential disciplines available under the OECD Arrangement. In its Closing Statement of December 3, 2003, the United States responded that Brazil minimizes the significance of Article 10.2 as reflecting:

⁴²Opening Statement of Brazil, 2 December 2003, para. 74

merely a banal compromise to accommodate potential ‘additional obligations regarding notification, consultation, and information exchange.’ Brazil implausibly asserts that the obvious transition between the language of the Draft Final Act that would have imposed significant substantive disciplines on export credit guarantees and the absence of such language in the Article 10.2 ultimately adopted can be fully explained as reflecting merely an agreement to work on such pedestrian disciplines as information exchange.”⁴³

70. Brazil, however, mischaracterizes the U.S. statement as a dismissal of other disciplines that Brazil itself never mentioned: “permitted exceptions, matching of derogations, non-conforming non-notified items, and terms granted by countries that are not parties to the OECD Arrangement.”⁴⁴

71. Ironically, the United States – not Brazil – has emphasized the significance of the OECD in the interpretation of Article 10.2. During the Uruguay Round, WTO Members did not agree on disciplines to be applicable to export credit guarantee programs and therefore opted “to work toward the development of internationally agreed disciplines,” as contemplated by the text of Article 10.2, in the appropriate forum of the OECD to achieve such disciplines. As the United States has pointed out, the OECD was the logical forum for such negotiations because of the institutional experience of that organization in the development of disciplines on officially supported export credits in the industrial sector.⁴⁵ Six years of negotiations continued there until 2001.

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).

(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.

⁴³Closing Statement of the United States, 3 December 2003, para. 3.

⁴⁴Answers of Brazil (22 December 2003), Question 220, para. 54.

⁴⁵U.S. First Written Submission (11 July 2003), paras. 155-160

72. Brazil quotes selective excerpts of 1998 testimony of then- General Sales Manager Christopher Goldthwait but misconstrues them to draw the absurd proposition that export credit premia cover only administrative expenses of the program. These excerpts on their face not only do not say what Brazil claims - they contradict Brazil's claim. Both Brazil and the United States have noted that administrative expenses of the program are between \$3 and 4 million per year.⁴⁶ Premia collected, of course, consistently far exceed that amount.⁴⁷

73. Moreover, Mr. Goldthwait's testimony does not state that premia cover *only* administrative expenses (even in the excerpt quoted by Brazil he twice says that the money collected is "more" than the amount of administrative expenses), and the actual figures for premia reveal the inaccuracy of Brazil's claim.

74. The testimony in Exhibit Bra-87 in fact supports the argument of the United States that it exercises considerable discretion in the administration of the program and that contrary to Brazil's repeated mischaracterizations, CCC can "stem[], or otherwise control, the flow of" CCC export credit guarantees.⁴⁸

75. Then Undersecretary August Schumacher stated:

"On GSM we are continually revising the changing creditworthiness of these overseas buyers. We are extremely prudent in the use. We follow this very, very carefully. Without the [International Monetary Fund], we would be very reluctant to operate and allocate these GSM programs as required by the Agricultural Trade Act of 1978.

"Actual credit packages are subject to interagency review. Overall, we will continue to achieve balance between our twin objectives of promoting U.S. agricultural exports and operating Federal programs such as the GSM with fiduciary responsibility to the taxpayers and to you in Congress."⁴⁹

76. Further testimony not quoted by Brazil included the following:

Congressman Minge:

"I would like to ask if you could explain to us why you feel that this program is one that will not expose the American taxpayer or the U.S. Treasury to a loss, particularly if private sector lenders are competing with the Federal Government for repayment of their

⁴⁶See, e.g., Oral Statement of Brazil (22 July 2003), para. 132.

⁴⁷Exhibit US-128.

⁴⁸The most recent invocation of Brazil's misapplied mantra appears in Brazil's Answer to Additional Question 257(c) (20 January 2004), para. 38

⁴⁹Exhibit Bra-87, page 10.

loans and these countries in Southeast Asia find their financial condition further deteriorates? Is this a risk that we are creating for the U.S. Treasurer, or is this something you feel we are adequately protected on?"

Mr. Goldthwait:

"We developed our program allocations by beginning with a country risk analysis. It is very much the same sort of analysis that a private bank will do in setting its . . . confirmation line for transactions with a particular foreign country.

"We . . . evaluate very carefully the financial situation of the country and the banks involved and the letters of credit that we will eventually guarantee in determining exactly how far further we can go and still remain prudent with the taxpayers' money."

Congressman Minge: "So you do not expect any greater exposure to loss here than you have had historically in the operation of the program?"

Mr. Goldthwait: "We do not."⁵⁰

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

77. Brazil asserts that "premium rates for the three CCC guarantee programs are not subject to regular review."⁵¹ This is incorrect. As the United States noted in its response to this question, premium rates are reviewed annually. They may or may not increase in any given year as a result of such annual review.

78. To avoid any potential misunderstanding the United States would also point out that the statutory cap on premia of one percent applies only to GSM-102. Brazil correctly notes this in paragraph 66 of its December 22 answers, but paragraph 64 could be interpreted to imply that the cap similarly applies to GSM-103, which it does not.

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

⁵⁰ *Id.*, page. 12.

⁵¹ Answers of Brazil to Question 223 of the Panel (22 December 2003), para. 63.

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

79. In addition to its own response to this question from the Panel, the United States would reiterate that the \$411 million figure is an *estimate* and the "results of the reestimate process."⁵² In addition, the \$770 million in the 'subsidy allowance' is not an uncollectible amount. It is merely a loan loss *allowance* based on annual re-estimates reflected in the budget. It is obviously not an amount deemed uncollectible, because from 2001 to 2002, as reflected in the very next line of the financial statement, the number itself *declined* from \$1.043 billion to \$770 million.⁵³ Similarly, the figure applicable to pre-1992 credit guarantees in the column "allowance for uncollectible accounts" is itself only a prospective *allowance*, which may or may not ultimately correspond to actual uncollectability. As with the subsidy allowance noted above, in this case, too, the allowance declined from 2002 to 2003 by \$389 million.⁵⁴

80. Office of Management and Budget Circular A-11 defines "allowance" as follows:

"Allowance means a lump-sum included in the budget to represent certain transactions that are expected to increase or decrease budget authority, outlays, or receipts but that are not, for various reasons, reflected in the program details. For example, the budget might include an allowance to show the effect on the budget totals of a proposal that would affect many accounts by relatively small amounts, in order to avoid unnecessary detail in the presentations for the individual accounts. The President doesn't propose that Congress enact an allowance as such, but rather that it modify specific legislative measures as necessary to produce the increases or decreases represented by the allowance."⁵⁵

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

81. Brazil incorrectly asserts that "U.S. government's own accounting principles lead to a conclusion that premium rates are inadequate to meet the long-term operating costs and losses of

⁵²Rebuttal Submission of Brazil (August 22, 2003), para. 109; U.S. Further Submission (September 30, 2003), fn. 94; See Exhibit Bra-158, Notes to Financial Statement, page 19.

⁵³See Exhibit Bra-158, Notes to Financial Statement, p. 14.

⁵⁴See Exhibit US-129, Notes to 2003 Financial Statement, p. 15.

⁵⁵OMB Circular A-11 (2003), Section 20.3, p. 20-2.

http://www.whitehouse.gov/omb/circulars/a11/current_year/s20.pdf

the CCC guarantee programs.”⁵⁶ To the contrary, under current GAAP for Federal Entities, including the application of such principles related to the Federal Credit Reform Act of 1990, the program reflects profitability for all of the first five cohorts (1992-1996). In addition, the cohort for 1999 is already showing profitability.⁵⁷ Exhibit US-128 also reflects the long-term profitability of the programs.

82. The United States has every reason to believe this trend will continue with respect to more recent cohorts. Contrary to the assertions of Brazil, the United States is not “carefully selecting” or “cherry-picking” years that “did not lose money.”⁵⁸ For the reasons set forth in U.S. answers to Panel Questions 221(f), (g), (h), and (i)⁵⁹, chronologically more recent – not “carefully selected” – years are reflected unnecessarily negatively in the U.S. budget.

E. 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

83. Brazil states that “[t]he phrase ‘one or several’ must be read according to its ordinary meaning” and reads this phrase to mean “at least one.” Brazil then states that it “disagrees with the possibility that the words *one or several* indicate that one of the Article 6.3 paragraphs may not be sufficient to establish serious prejudice.”⁶⁰ However, Brazil’s answer simply neglects to read *all* of “the words” quoted in the Panel’s question (drawn from the chapeau of Article 6.3) according to their ordinary meaning: “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*? ” Crucially, Brazil simply neglects to read the words “may arise” according to their ordinary meaning.⁶¹ The ordinary meaning of “may” is “have ability or power to; can”⁶² and “to express possibility, opportunity, or permission.”⁶³ Therefore, the ordinary meaning of the chapeau to Article 6.3 (that is, including the phrase “may arise” as well as “one or several”)

⁵⁶ Answers of Brazil to Panel Question 228 (22 December 2003), para. 68.

⁵⁷ See Exhibit Bra-182 and U.S. Answers to Panel Question 221(b) (22 December 2003, paras. 83-86.

⁵⁸ See, e.g., Answer of Brazil to Panel Question 228 (22 December 2003), para. 73.

⁵⁹ U.S. Answers to Panel Questions (22 December 2003), paras. 91-104.

⁶⁰ Brazil’s Answer to Question 229 from the Panel, paras. 76-77.

⁶¹ See Brazil’s Answer to Question 229 from the Panel, paras. 79-80 (setting forth no interpretation of “may arise” according to its ordinary meaning).

⁶² *The New Shorter Oxford English Dictionary*, vol. 1, at 1721 (1993 ed.).

⁶³ *The Random House Dictionary of the English Language, Unabridged Edition* at 886 (1983).

would be that there is a “possibility” or “opportunity” for serious prejudice in the sense of Article 5(c) to “arise” where one or more of the effects listed in Article 6.3 is found.⁶⁴

84. Thus, when Brazil “disagrees with the possibility that the words *one or several* indicate that one of the Article 6.3 paragraphs may not be sufficient to establish serious prejudice,” Brazil is not reading the chapeau of Article 6.3 according to the ordinary meaning of all of the words in the provision. Such a selective approach fails to read the treaty text according to the customary rules of interpretation of public international law. Indeed, if Article 6.3 had been intended to mean that any one of the subparagraphs would *necessarily* suffice to show serious prejudice, the text would have used obligatory language in favor of a finding of serious prejudice (such as, “serious prejudice . . . shall arise in any case where at least one of the following apply”).⁶⁵

85. Brazil’s discussion of various provisions of the Antidumping Agreement and Subsidies Agreement that contain language that no one factor can necessarily “give decisive guidance” towards a pertinent finding is inapt. That is, simply because the “may arise” language in the chapeau of Article 6.3 does not necessarily *preclude* a finding of serious prejudice where the effect in only one subparagraph has been demonstrated does not convert the “possibility” or “opportunity” that serious prejudice arise into an *obligation* to find serious prejudice. Rather, serious prejudice “may arise” or it may not, for example, where a panel concludes that one or more subparagraphs is technically met but the effect is not sufficient to cause serious prejudice.

86. Finally, we note Brazil’s new argument that the “may arise” language “is necessary because while the facts may demonstrate that the effects of the subsidies *may* create the one, two, or three enumerated types of serious prejudice, these effects may not be actionable.”⁶⁶ Brazil’s argument misunderstands the nature of the serious prejudice analysis. As stated above, the plain language of Article 6.3 establishes that demonstrating one or several of the effects of the subparagraphs does not *necessarily* suffice to demonstrate serious prejudice. Thus, it is not the case that “serious prejudice” will arise where one of the effects is demonstrated but an “exemption” (in Brazil’s words) in Article 6 applies; rather, the “exemptions” cited by Brazil preclude the very finding of “serious prejudice.”

- For example, Brazil argues that the effect in Article 6.3(d) (an increase in world market share) may be demonstrated but may “not be actionable” because multilaterally agreed rules exist within the meaning of footnote 17. But the effect of footnote 17 is to remove certain primary products or commodities subject to such rules from the 6.3(d) analysis

⁶⁴See U.S. Answer to Question 149 from the Panel, paras. 71-75.

⁶⁵Indeed, Article 6.1 demonstrates that Members knew how to create a presumption of serious prejudice: they did so by explicitly stating that, in certain cases, “[s]erious prejudice . . . shall be deemed to exist” (italics added). Article 6.2, while providing a means to rebut that presumption, does not by its terms establish that serious prejudice “shall be deemed to exist” if one of the effects in Article 6.3 exists.

⁶⁶Brazil’s Answer to Question 229, para. 80.

altogether.⁶⁷ Thus, no finding of “serious prejudice” for such a product would be possible.

- Neither does Article 6.7 support the conclusion that serious prejudice “may arise” but may not be actionable. Rather, that provision establishes that “[d]isplacement or impediment resulting in serious prejudice shall not arise under paragraph 3 where any one of the following circumstances exist”; that is, even where the effect of displacement or impediment is demonstrated under Article 6.3, a finding of serious prejudice is precluded (“shall not arise”).
- Finally, Brazil points to Article 6.9 and claims that this provision “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.” Article 6.9 does not “exempt[] serious prejudice that exists,” however. The text reads: “*This Article does not apply* to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture” (emphasis added). Because the entire “Article does not apply,” no finding of “serious prejudice” is possible.⁶⁸

87. Finally, we note that Brazil’s argument that the “may arise” language is “necessary” because certain circumstances may exist in which a finding of serious prejudice is precluded would suggest that whenever an exception exists to a “shall” obligation, that obligation should be expressed using “may”. For example, because there is an exception to the prohibition on export subsidies in Article 3.1 of the Subsidies Agreement, presumably Brazil would consider that the provision should have been written: “Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, [may] be prohibited.” The use of “may” in place of “shall,” however, changes the meaning of that provision from mandatory to permissive. Similarly, the use of “may” instead of “shall” in Article 6.3 means that there is a “possibility” or “opportunity” for serious prejudice to arise where one or more of the effects listed in Article 6.3 is found, rather than a certainty or necessity that serious prejudice have arisen.

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

⁶⁷Footnote 17 to Article 6.3(d) follows the words “the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity” and reads: “Unless other multilaterally agreed specific rules apply to the trade in the product or commodity in question.”

⁶⁸Brazil’s argument echoes its erroneous interpretation of the “exempt from actions” language of the Peace Clause. Indeed, as the United States has pointed out, Brazil has never explained how it is that the Panel, if it ultimately determines that U.S. measures are “exempt from actions” based on Articles 5 and 6 of the Subsidies Agreement, could nonetheless make findings on those claims without resulting in the DSB making rulings and recommendations with respect to those claims and measures. Given the automaticity in adoption of panel and Appellate Body reports, the only means by which Peace Clause-compliant U.S. measures may be “exempt from actions” is for the Panel to decline to reach Brazil’s claims based on those provisions specified in the Peace Clause.

compared to others, how would this be done? What would be relevant "factors" for this purpose? BRA

88. Causation is a key issue in this dispute, and Brazil continues to gloss over this issue. The United States is interested to see Brazil argue that an econometric analysis by definition satisfies the causation requirements under the WTO.⁶⁹ Brazil's position in this dispute is at odds with its position in other disputes, such as *Steel*. Brazil appears to change its view on the correct approach to causation depending on whether it bears the burden or not. For example, Brazil now argues in its response to this question: “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 U.S. subsidies had been provided.” In other words, Brazil appears to claim that it is entitled to a finding in its favor on causation unless someone else (not Brazil) shows that other factors accounted for all the effects, rather than that Brazil must show that it is not attributing to the U.S. measures at issue effects that are due to other factors. This is in error.

89. Brazil must establish that effect of the challenged subsidies was “significant price suppression” or an increase in world market share. Brazil has not established that it has accounted for “the effect of” other factors at play, even though it concedes that “[t]his world market share is the result of several key factors *including U.S. subsidies*, weather effects in many countries, and exchange rate effects” (italics added). How then can Brazil claim that the effect of the subsidies is “significant”? That is, if Brazil itself argues that U.S. subsidies were only one of “several key factors,” its analysis must allow the Panel to distinguish the effects of these other factors. Brazil has not even attempted to explain what those effects were, nor did Brazil demonstrate that its economic model accounted for these factors.

90. Brazil did not answer the Panel’s question about what relevant factors should be taken into account nor did it respond to the question about how this should be done. Brazil simply claims, through Dr. Sumner’s analysis, that it has taken various other factors into account. Until forced to respond to the U.S. Further Submission of Sept. 30, Brazil had not acknowledged that any factor besides U.S. subsidies had any effect on world cotton markets.

91. In paragraph 82, we find it curious that Brazil refers to the material on other factors presented by the United States⁷⁰ as covering “only” weak cotton demand, flat retail consumption, falling world incomes, increasing U.S. textile imports, and China’s releasing of stocks. Brazil also errs in referring to these as all “demand-related”. For example, China’s release of stocks affects the supply of cotton. (The U.S. Further Submission also included an analysis of the effects of the strong U.S. dollar on cotton prices.) These six factors were the “only” ones presented because they, in fact, provide a compelling explanation of the factors driving down

⁶⁹Brazil’s approach would certainly simplify the causation discussion in numerous other disputes.

⁷⁰U.S. Further Submission, paras. 22 - 44.

world cotton prices at that time and encouraging the shift in U.S. cotton use from domestic processing to export markets.

92. The Panel asks how it should take into account the effect of other factors. In paragraph 85, Brazil argues that *but for* the effect of U.S. subsidies, world cotton prices would have been significantly higher. One could just as easily analyze and claim *but for* the effect of China's releasing 11.6 million bales of subsidized cotton onto world markets between 1999-2001 world prices would have been significantly higher. In other words, Dr. Sumner can claim his analysis accounts for various factors because he calibrated his model to actual data for the recent past, but Brazil's analysis has not provided an explanation of the various events and actions at play that would allow the Panel to form a reasoned conclusion that the effects of U.S. subsidies are not in fact the effects of these other factors.

93. Finally, in paragraph 87, Brazil's repeats oft-stated arguments about the presumed revenue-cost gap faced by U.S. cotton producers using total costs of production. Brazil has not replied to U.S. counter arguments that using *total average costs* is misleading and inappropriate. We refer the panel to the U.S. further rebuttal submission, paras. 116-41, and the U.S. answer to Question 211(b). As for Brazil's exchange rate argument, we refer the panel to the U.S. answer to Question 210 above.

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

94. In this answer, Brazil continues to make serious interpretive errors with respect to Article 6.3(c). In addition, the evidence and arguments made by Brazil with respect to each of the "markets" it identifies do not satisfy the requirements of Article 6.3(c). The United States treats each of these issues in turn.

Brazil Misinterprets Article 6.3(c) and Fails to Bring Forward Evidence and Arguments to Establish Its Claims

95. The United States is gratified that in this answer Brazil finally appears to recognize that the "in the same market" language of Article 6.3(c) requires that Brazil make claims with respect to markets in which both Brazilian and U.S. upland cotton are found.⁷¹ This follows from the use of the words "same" and "market." "Market" means "[a] place or group with a demand for a commodity or service."⁷² "Same" means "[i]dentical with what has been indicated in the

⁷¹See, e.g., Brazil's Answer to Question 233 from the Panel, para. 113 ("[T]hese indices are benchmarks for prices in those 'same markets' where U.S. and Brazilian cotton were exported . . .") (emphasis added).

⁷²The New Shorter Oxford English Dictionary, vol. 1, at 1699 (1993 ed.).

preceding context” and “previously alluded to, just mentioned, aforesaid.”⁷³ In the context of Article 6.3(c), the market that is “[i]dential with what has been indicated in the preceding context” would be that market in which there is “significant price undercutting by the subsidized product as compared with the price of a like product of another Member” (the phrase immediately preceding the phrase on significant price suppression, depression, or lost sales). Thus, Brazil may only advance claims with respect to those markets in which U.S. upland cotton and Brazilian cotton are both found .

96. Brazil continues to argue that there is a “world market” for upland cotton in which it may demonstrate significant price suppression, depression, or lost sales. However, the text and context of Article 6.3(c) do not support the view that Brazil may assert a generalized “world” price effect. First, the significant price suppression, depression, or lost sales must be “in the same market.” As explained above, this “same market” would be the market in which both Brazilian and U.S. cotton are found and there is significant price undercutting. In asserting that a “world” market can be this “same” market, Brazil renders the “same market” phrase inutile since the products of both the complaining and responding parties will always be in the “world.” Consider that one of the effects under Article 6.3(c) is “lost sales in the same market.” Brazil’s interpretation would mean that a complaining party could advance a claim with respect to a lost sale anywhere in the “world,” even if the responding party did not export to the market in which the lost sale occurred. Again, such a result would render the “in the same market” language meaningless.

97. Brazil’s interpretation also does not make sense of important context for Article 6.3(c). Article 6.6 states that “[e]ach Member *in the market of which* serious prejudice is alleged to have arisen shall . . . make available . . . all relevant information . . . as to the changes in market shares of the parties to the dispute as well as concerning *prices of the products involved*” (emphasis added). If the “world” could be a “market” for purposes of Article 6.3, which WTO Members should provide market data? Read literally, Article 6.6 would seemingly oblige *every* WTO Member to provide data on market share and prices since every Member would be a “Member in the market of which serious prejudice is alleged to have arisen.” Annex V similarly suggests that the “same market” must be an actual market, be it that of the subsidizing Member or a third-country. For example, where Article 7.4 has been invoked “any third-country Member concerned” – for example, any Member in whose market significant price suppression is alleged to have occurred – “shall notify to the DSB” the organization responsible for responding to information requests and the procedures to be used to comply.⁷⁴ Furthermore, the information gathered during the information-gathering process “should include, *inter alia*, data concerning the amount of the subsidy in question (and, where appropriate, the value of total sales of the subsidized firms), *prices of the subsidized product, prices of the non-subsidized product, prices of other suppliers to the market*, changes in the supply of the subsidized product *to the market in*

⁷³*The New Shorter Oxford English Dictionary*, vol. 2, at 2678 (1993 ed.).

⁷⁴Subsidies Agreement, Annex V, para. 1.

question and changes in market shares.”⁷⁵ Again, these provisions suggest (as does Article 6.6) that Article 6.3(c) is directed at particular markets where competition exists between Brazilian and U.S. upland cotton.

98. Because Brazil must demonstrate price suppression by U.S. imports of Brazilian imports in the same market, Brazil must bring forward evidence and arguments on import volumes and prices. In numerous instances, Brazil has simply failed to present prices for Brazilian cotton and U.S. cotton in an identified market, much less import volumes relating to the parties or other suppliers. This failure to present, *inter alia*, prices for each market sufficient to demonstrate price suppression is fatal to Brazil’s claim with respect to each such market. The necessity of presenting price information for each market is suggested by the fact that each “same market” in which significant price suppression is alleged to occur is a market in which there is significant price undercutting. Article 6.6 refers to each Member “in the market of which serious prejudice is alleged to have arisen” providing the “prices of the products involved,” also suggesting that prices for both Brazilian and U.S. cotton must be examined. Further, Annex V, paragraph 5, states that a panel should examine “prices of the subsidized product, prices of the non-subsidized product, [and] prices of other suppliers *to the market*.”

There is No “World Market Price” for Upland Cotton that Can Be Significantly Suppressed

99. The preceding legal interpretation that the “same market” means a particular market in which competition between Brazilian and U.S. cotton imports occurs is confirmed when one considers that nature of the “world price” that Brazil claims is significantly suppressed. This “world market price” turns out not to be a price at all but several “benchmarks” or indicia of prices. As Brazil states: “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*.⁷⁶ That is, this alleged “market” does *not* have or set any price for U.S. and Brazilian upland cotton; rather, this “price” is “reflected” in not one, but two price indices, the NY futures price and A-index price.

100. Brazil must argue that the “world market price” is “reflected” in the NY futures and A-index because *neither* of these relates to an abstract “world market.”

- Rather, the NY futures price relates to a New York-based exchange trading in contracts for future delivery with various physical delivery points in the United States: Galveston, Houston, New Orleans, Memphis, or Greenville/Spartenburg (South Carolina).⁷⁷

⁷⁵Subsidies Agreement, Annex V, para. 5.

⁷⁶Brazil’s Answer to Question 233 from the Panel, para. 91.

⁷⁷See www.nybot.com (search No. 2 Cotton Futures Contract Specifications).

Indeed, Brazil concedes that “[w]hile 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.”⁷⁸

- The A-index “price” reflects delivery to Northern Europe of upland cotton with certain quality specifications (Middling, 1-1/32 inch staple length). Further, the A-index is not a “price” but an average of the five lowest *price quotes* obtained by Cotlook, a private organization based in London, from various merchants of 15 cotton growths.

101. Thus, the A-index reflects price offers but does not reflect actual prices in Northern Europe of either Brazilian or U.S. (or any other) upland cotton. The A-index relates to the Northern European market, not to the “world” market. In fact, the A-index, with its disparate price quotes from around the world, demonstrates that prices differ around the world, not that there is a uniform, harmonious “world” market price. The fact that Brazil points to *two* disparate price indices, which deviate significantly,⁷⁹ also demonstrates that there is not a “world market price” for upland cotton. Thus, neither the NY futures price nor the A-index are a “world market price” for upland cotton.

Brazil Cannot Demonstrate Significant Price Suppression in the United States Because There Were No Brazilian Imports

102. Brazil also identifies the U.S. market as a “same market.” However, Brazil does not advance any arguments nor evidence establishing that there were *any* Brazilian imports into the United States in marketing years 1999-2002. In fact, our information is that there have not been any imports of Brazilian cotton to the United States since marketing year 1996.⁸⁰ Neither (and perhaps for that reason) does Brazil present any arguments or evidence on Brazilian cotton prices in the United States. Thus, Brazil has failed to establish that the United States is a “same market” for purposes of Article 6.3(c).

Brazil’s Effort to Expand the Scope of Its Claims and Arguments to 40 Third-Country Markets is Untimely

103. Brazil belatedly attempts to argue that it is alleging “significant price suppression” in 40 third-country markets; for only seven of these had Brazil previously even attempted to make argument. Brazil has not attempted to justify presenting this new affirmative evidence at this late stage in the proceeding, contrary to the Panel’s working procedures. To do so prejudices the

⁷⁸Brazil’s Answer to Question 233 from the Panel, para. 93 (italics added).

⁷⁹See Brazil’s Answer to Question 233 from the Panel, para. 93 (“[P]rice 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.”).

⁸⁰See U.S. Department of Agriculture trade statistics at www.fas.usda.gov/ustrade (search on Imports/HS-4 for Brazil).

United States, which has necessarily participated in this dispute on the basis of the claims and arguments Brazil has previously set out, and would circumvent the notification obligations of the complaining party. For example, we note that in its request to the DSB to initiate the Annex V information-gathering process, which the DSB was not able to agree to in light of the Peace Clause issue, Brazil did not notify these 40 WTO Members that they were markets in which serious prejudice was alleged to have occurred. By not naming these markets at the outset of the dispute, but seeking to name them now, Brazil would preclude these Members from fulfilling their notification obligations under paragraph 1 of Annex V.

104. We also note that none of these 40 markets are listed in Brazil's request for rulings and recommendations from the Panel. That request, in pertinent part, reads: "The U.S. subsidies provided during MY 1999-2002 caused and continue to cause serious prejudice to the interest of Brazil by *suppressing upland cotton prices in the U.S., world and Brazilian markets* for upland cotton in violation of Articles 5(c) and 6.3(c) of the SCM Agreement."⁸¹ The United States is entitled to rely on Brazil's representations with respect to the scope of its claims and arguments.

105. Even in the markets that Brazil has raised in a timely manner, there are other suppliers into that market, and Brazil has failed to explain why any price suppression should be attributed to U.S. sales rather than to sales from other countries. One cannot presume that U.S. sales are the only factor that could cause any price suppression. Thus, with respect to these markets, Brazil has failed to establish a *prima facie* case on its claims.

Brazil Incorrectly Argues that Significant Price Suppression in All Markets Can Be Shown Through Suppression of "World Market Prices"

106. The foregoing considerations are dispositive of Brazil's claims with respect to significant price suppression in the same market. In this portion of its comment, the United States further examines the evidence and arguments Brazil has brought forward and points out that they do not establish the elements necessary to demonstrate a claim under Article 6.3(c).

107. Brazil argues that the U.S. suppression of "world market prices" is transmitted to all markets as evidenced by the fact that price movements in individual markets are similar to the general trends of the A-index. Brazil alleges that the proof of the U.S. suppression of the A-index is the results of Dr. Sumner's analysis and studies by USDA economists. The United States has already explained in great detail to the Panel the conceptual flaws of Dr. Sumner's analysis and will not repeat those here. Additionally, the USDA studies provided by Brazil to the Panel did not address impacts on the A-index or futures prices, but the impact of U.S. programs on U.S. prices. While interesting academic exercises, moreover, those studies do not analyze the question before the Panel.⁸²

⁸¹Brazil's Further Submission, para. 471(i).

⁸²See U.S. Answer to Question 212 from the Panel, paras. 48-55.

108. As a factual matter, the United States has provided evidence that disproves Brazil's allegation that the United States suppresses the A-index. Exhibit US-46 demonstrates that the low U.S. quote (either Memphis or California) for the A-Index has rarely been one of the 5 low bids. If both U.S. quotes are always above (but for one month) the 5 lowest quotes used in the A-Index, the United States cannot be suppressing the A-Index. Nevertheless, even if one were to follow the Brazilian approach, the data provided by Brazil does not provide evidence of price suppression by the United States.

109. As set out above, a generalized claim of price suppression is not contemplated by Article 6.3(c), which requires price suppression "in the same market" – that is, that market in which there is "significant price undercutting by the subsidized product as compared to the price of a like product of another Member." Thus, we proceed here to examine Brazil's evidence with respect to those "same markets" identified in its answer.

Comparison based on Export Unit Values

110. Brazil begins its analysis by comparing U.S. and Brazilian export unit values in various markets to the A-index. It should be noted that the proper analysis would be U.S. and Brazilian market *prices* in the market in question. The export price does not represent the final selling price in the market in question. Given the short time the United States had to review all of this new data, the discussion here will focus on those countries included in the main text of the Brazilian response. To the extent that Brazil has provided data in its exhibits on various markets that it does not examine or explain, we do not consider that Brazil has advanced arguments with respect to such markets sufficient to carry its burden of establishing a *prima facie* case, and we ask the Panel to so find.

111. The fact that U.S. or Brazil export prices to the seven markets, Argentina, China, India, Indonesia, Philippines, Portugal, and South Korea generally may have had movements similar to the A-Index does not demonstrate price suppression by the United States. In fact, Brazil does not in its main text show comparisons of U.S. and Brazilian export unit values in each market (this is only provided in Exhibit BRA-386), much less other relevant market information, such as import prices from other suppliers or import volumes. This absence of relevant argument alone demonstrates that Brazil has not met its burden of establishing its price suppression claims. However, the United States has updated the Brazilian export unit value graphs to include data through November 2003 in order to set out a cursory analysis of each "same market" for the Panel.⁸³ On the whole, we find that it is the Brazilian price that undercuts the U.S. price to these markets.

⁸³ Exhibit US-134.

112. Brazil alleges price suppression in the Argentine market due to the United States. The data, however, does not support such a claim. As can be seen in the graph, the United States is an infrequent supplier to the Argentine market. For those time periods when no U.S. imports were found in Argentina, there could be no price suppression by the U.S. subsidized product of the prices of Brazilian cotton “in the same market.” Of the 15 periods that both are in the market, the United States’ export price was greater than Brazil’s export price 8 times, below Brazil 6 times, and the same once.

113. Comparing U.S. and Brazilian export unit values to China does not demonstrate price suppression by the United States. Brazil is not a frequent participant in the China market. For those time periods when no Brazilian imports were found in China, there could be no price suppression by the U.S. subsidized product of the prices of Brazilian cotton “in the same market.” From August 1999 to June 2003, Brazil only shipped to China in 13 months. Of these 13 months, Brazil’s export unit value was below the U.S. export unit value 8 times, above the U.S. price 4 times, and the same once. Evidence of Brazilian price undercutting the U.S. price is inconsistent with the argument that the United States suppresses Brazilian prices to the China market.

114. India was one of the few markets Brazil discussed in which there were a good number of months in which both parties supplied cotton. Of the 25 months in which both provided cotton, the U.S. price was narrowly below the Brazil price in 12 months, was above Brazil in 12 months, and at the same level in 1 months. The time during which the U.S. price was below the Brazil price was during the period April 2001 to December 2001, in which the high yields of MY2001 influenced. However, during August 2000 to January 2001 period, U.S. unit values were high and were consistently undercut by Brazil by a large margin. This Brazilian undercutting led to a plunge in U.S. unit values. We also note that U.S. unit values appear to increase when Brazilian cotton is not in the market. Brazilian unit values, on the other hand, show very little change; this lack of price movement is not consistent with price suppression since the Brazilian price is unresponsive. As the graph shows, there is no systemic relationship between the U.S. and Brazilian unit values to indicate that the United States is suppressing Brazilian prices to this market.

115. Indonesia also was another country in which both the United States and Brazil were active participants, and each had the low price about an equal number of times. However, the majority of times the U.S. had a lower price occurred during MY2001, a period in which the United States had higher than expected yields which reduced U.S. unit values while Brazil had lower than normal yields, driving up the price for Brazilian cotton. In MY2002, Brazil returned to general undercutting of U.S. unit values, failing to follow U.S. price increases in early 2003. There does not seem to be any support for price suppression in this market as the movements between the U.S. and Brazilian export unit values are not the same. For example, during the period October 2000 to January 2001, U.S. export unit values increased, whereas Brazil’s export unit values declined. Again in the period December 2001 to June 2002, the wide swings in the

Brazil price relative to the steady U.S. movements demonstrate that U.S. prices are not suppressing Brazil's.

116. Philippines is a market in which Brazil had sporadic shipments over the period. For those time periods when no Brazilian imports were found in Philippines, there could be no price suppression by the U.S. subsidized product of the prices of Brazilian cotton "in the same market." There were 19 months in which both parties supplied the Philippines. Part of the difference in price is probably due to the shipment sizes. As Exhibit BRA-383 reports, the quantities shipped are quite different between Brazil and the United States. Smaller shipments typically have higher per unit costs. Many of the months in which Brazil exhibited higher export unit values to the Philippines was during MY 2001, a year in which the U.S. had higher than expected yields, driving down its price while Brazil had lower than expected yields, increasing its price.

117. Brazil and the United States overlapped in the Portuguese market in 27 months, a good number of samples. In all instances except for November 2003, the U.S. unit value was greater than the Brazilian unit value, generally by a large margin. The fact the U.S. unit value was greater than the Brazilian unit value is not consistent with price suppression by the United States. Even if there was a quality difference between the two, the spread between the two should be relatively constant. However, the movements of unit values do differ. When the U.S. had big swings in the late 2000 and late 2001 early 2002, Brazil saw only modest changes in unit values. Since MY2003, U.S. prices first increased and have slightly declined whereas Brazilian prices first declined and have been increasing slightly. The fact that the price movements are not consistent would weaken arguments that the United States is causing or threatens to cause price suppression to Brazil.

118. The final country market discussed directly in Brazil's response was South Korea. As the graph depicts, Brazil only supplied cotton to this market in one month. Since no Brazilian imports were found in South Korea over the complained of period, during those times there could be no price suppression by the U.S. subsidized product of the prices of Brazilian cotton "in the same market."

Comparing Import Values ("Import Prices") to A-Index

119. Brazil continues its analysis by comparing average import prices to specific markets with the A-Index. As with the "export prices" these import prices are not the prices at which the product were sold but its value at the border of the importing country. Again a proper analysis would not use border valuation of the product but the actual market prices the product was sold. Also it is not clear how averaging import prices from the different sources would provide evidence that the United States has caused price suppression. In fact the various graphs provided by Brazil put in doubt their theory of world price transmission.

120. The yearly import price data in paragraphs 106-108 is too general to be of any assistance. Looking at the various graphs of monthly individual country import prices against the A-Index (paragraphs 106-107) also shows discrepancies between markets. For example, looking at the graph of Japan's prices against the A-Index, it is notable that their import prices never fell below 48 cents even though the A-Index fell to as low as 38 cents and that the gap between import prices and the A-Index were quite large when prices were falling but minimal when prices were rising. A similar pattern seems to have been present in Ecuador. On the face of it, these graphs would seem to imply that some mechanism was at work to impede the transmission of declining "world market prices." This undermines Brazil's assertion that price suppression can be shown in all third-country markets through alleged effects on a "world market price." The Hong Kong graph is exactly opposite in these respects from the Japanese and Ecuador graphs. This could mean that Hong Kong is less protected from world prices, but the great deal of inconsistency both within and between all of these graphs indicates the uncertainty surrounding Brazil's claims that "all these third country markets are heavily influenced by the A-Index and New York futures prices".

Comparison of Domestic Prices and the A-Index

121. Brazil then compares for a few countries in which it could get domestic prices, those domestic prices to the A-index. Again their analysis concludes that the A-index influences domestic prices in these markets and therefore, the United States is guilty of price suppression. We have explained that a claim of significant price suppression requires that U.S. and Brazilian cotton be found "in the same market." In addition, there are problems with the connection between the A-Index and domestic prices as presented by Brazil. To demonstrate the problems with Brazil's analysis, the United States will look at the analysis on China.

122. We agree that China's domestic prices have always been significantly above the A-index and tracked it rather well. Indeed we include a full series below including all the data currently available to us. This starts September, 1999 and runs through April 2003 (Southern China prices as reported by East-West Inc. a Beijing agricultural consulting group). It is consistent with Brazil's data although Brazil's only starts in January 2001. These data reveal that China's domestic prices are not consistent with China's export and import prices.

123. China's export prices, as can be seen in Exhibit US-141, are well below the A-index during most of the time China exported heavily (MY 1999 through the first half of MY 20001, and the last quarter of MY 2001 through the third quarter of MY 2002). Contrary to Brazil's assertion in paragraph 113 that export prices from all suppliers move with the A-Index, more often than not China's export price did not, staying relatively flat during the periods from August 1999 to January 2001 and from February 2002 to July 2003. What is more, as can be seen from the China Prices graph in Exhibit US-141, China's export prices were significantly lower than the Chinese domestic price when China was exporting heavily.

124. The imports are different but still problematic. During those times when China has imported heavily, from the beginning of MY 2002 until the present, prices have tracked A-Index prices fairly well.

125. These data, not presented or explained by Brazil, show that Chinese domestic prices have some connection to the A-index but hardly the “heavily influenced” and “consistent” relationship Brazil asserts. As noted in the U.S. further submission, the Chinese Government during this time had the goal of reducing their massive, undisclosed cotton stocks in a way that would insulate there cotton producers and processors from changes in prices. The aim was to maximize cotton prices received by Chinese farmers while still insuring their cotton textile exports were competitive in world export markets. China sold as much as it could on the world market as long as the A-Index stayed at or above a trigger price around 50 cents a pound – hence the flat export price line until the stock situation was finally resolved in late MY 2002.

Conclusion

126. Brazil has not done a proper analysis to support its price suppression claims. To demonstrate significant price suppression that leads to serious prejudice, Brazil must provide evidence showing that U.S. prices in a given market are suppressing Brazilian prices in that market. Brazil has not presented and explained evidence on actual market prices of U.S. and Brazilian cotton in third-country markets. Thus, Brazil has not established a *prima facie* case with respect to its price suppression claims. In fact, the market-by-market data presented above does not support a finding of significant price suppression by U.S. cotton.

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

127. Brazil's interpretation that whether price suppression is “significant” can only “be assessed with reference to the quality of the impacts of *whatever* level of price suppression exists on the producers of the like product” raises concerns. Brazil provides the example that even where “large amounts of price suppression” have been demonstrated, this might not be “significant” if the producers of the complaining party “had *de minimis* production, or no exports, and/or that the total value of lost revenue from suppressed prices was minimal.”⁸⁴ The United States believes that the conditions of the producers of the complaining party would not enter into an analysis of whether a given level of price suppression is “significant.” Brazil’s interpretation would create, out of one legal standard (“significant price suppression”), different thresholds that would apply to different Members depending on their financial well-being. For example, a Member with a strong position in a given third-country market might not be able to

⁸⁴Brazil's Answer to Question 234 from the Panel, para. 114.

utilize Article 6.3(c) (for significant price undercutting or significant price suppression or depression”) simply on the basis that “the total value of lost revenue from suppressed prices was minimal” even if the level of price suppression was large. Conversely, a Member with a nascent exporting industry might not be able to utilize Article 6.3(c) if it “had *de minimis* production, or no exports,” despite a desire to increase both production and exports. Neither scenario appears to fit with the text of Article 6.3(c).

128. In addition, Brazil fails to explain how the two different terms in the text of Article 6 (“serious prejudice” and “significant price suppression”) result in there being only one and the same test for both terms. This would appear to render one of the terms superfluous, contrary to customary rules of treaty interpretation.

129. Finally, we note Brazil’s reference to the impacts on “complaining party producers” of the like product. We take this to mean that, contrary to its earlier position, Brazil has now conceded that “adverse effects” to other Members are irrelevant for Brazil’s claims. This follows from the text of the Subsidies Agreement. Under Article 5(c), no Member is to cause “serious prejudice *to the interests of another Member*,” and a request for consultations under Article 7.2 “shall include a statement of available evidence with regard to . . . serious prejudice *caused to the interests of the Member requesting consultations*.”

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

130. Brazil’s answer to Question 235 does not refute the U.S. evidence that Brazilian cotton prices undercut U.S. prices from 1999-2002. Brazil does not go so far as to claim the United States undercut Brazil’s prices – except in the Brazilian market, an argument that is based on prices that are not directly comparable, as will be discussed later. Instead Brazil argues that U.S. and Brazilian prices exhibited an “absolute closeness” with Brazil’s export prices sometimes higher and sometimes lower than U.S. prices.

131. Except for their own market, Brazil does not provide data or analysis on country markets. Instead they examine aggregate data for forty markets that both the United States and Brazil exported to in MY1999 to MY 2002. As the United States explained in our comments on Question 233, this aggregate approach is not the proper method of analysis for price suppression claims under Article 6.3(c). However, even if we accept the Brazil approach, close analysis of the aggregated data presented in Brazil’s response further supports the U.S. claim of Brazilian undercutting by showing that consistently and on average Brazilian [unit values] prices were lower than those of the United States, even though there were periods when factors not related to subsidies led to lower U.S. unit values.

Average Unit Value Comparison

132. First, Brazil in the graph following paragraph 121 compares the average unit values of Brazilian and U.S. exports. It is this graph that Brazil uses to support its claim of “absolute closeness” between the two countries’ export prices and the absence of Brazil undercutting, but it simply does not do this. Of the 45 months when both the U.S. and Brazil were exporting, Brazil prices were lower 25 months as opposed to the United States’ 20. Further eight of the United States low-price months were in MY 2001, when good weather allowed the United States to realize record yields as opposed to sub-par yields for Brazil. The U.S. yield of 790 kgs/hectare was 6 percent above the five year average for MY 1999 to 2003.⁸⁵ Brazil’s 1073/kgs/hectare for MY 2001 was 5 percent below its 1999-2001 average.⁸⁶ Also Brazil planting half a year later than the United States saw a much different price signal as cotton prices dropped sharply and soybean prices, the main alternative crop for both countries, rose slightly from February to August 2001.⁸⁷ The United States increased planted area by 6 percent but Brazil reduced planted area by 12 percent. U.S. production consequently rose 18 percent to 20.3 million bales in MY 2001, whereas Brazil’s dropped to 18 percent to 3.5 million bales. This naturally drove U.S. export prices down compared to Brazil’s. Brazilian prices followed the U.S. prices down in the last half of MY 2001 and have stayed equal to or below U.S. prices ever since.

133. Setting aside MY1999 and MY 2001 for the moment, two years that are not representative of normal conditions, Brazil prices undercut U.S. prices in 18 of the 24 months for MY 2000 and MY 2002.⁸⁸ This is consistent with Brazilian production changes in the two years. In MY 2000 Brazil production increased 34 percent while U.S. barely 1 percent from the year earlier. In MY 2002, Brazil production fell 2 percent while U.S. production fell 15 percent.⁸⁹ So, even using Brazil’s own methods we can see that Brazil undercut the United States in 2 of the 3 relevant marketing years and in that third year lower U.S. prices are clearly related to yield and normal market price signals

134. The same conclusions are apparent when looking at the graph following paragraph 118 where Brazil looks at the aggregated weighted average of the 8 countries originally analyzed by the United States. Looking at the data available in this graph for MY 1999-2002, in 16 of 37 months when both countries exported to these countries, the United States price was higher 21 times as opposed to only 16 for Brazil. Six of the 16 periods when Brazil was higher came in

⁸⁵ Exhibit U.S.-135.

⁸⁶ Exhibit U.S.-135.

⁸⁷The relevant futures prices ratio of cotton to soybean for Brazil in August 2001 was the May2002 cotton and May 2002 soy which was 8.63. The relevant ratio for U.S. farmers in February 2001 was the Dec 2001 cotton to Nov 2001 soybean which was 12.55. (New York Board of Trade and Chicago Board of Trade).

⁸⁸ In MY 1999, Brazil only exported 12,000 bales of cotton compared to an average of 438,000 bales in MY 2000, MY 2001, and MY 2002. (See Exhibit U.S.-135) As discussed in the preceding paragraph, MY 2001 was a year of atypical yields for both Brazil and the United States.

⁸⁹ Exhibit U.S.-135 (Production data)

MY 2001, consistent with the analysis above, and 6 came in MY 1999 when results were distorted because the volume of total Brazil exports was extremely small.

Looking at All U.S. and Brazil Exports

135. To better look at the issue of Brazil's undercutting of U.S. prices, it is appropriate to expand Brazil's analysis. Although Brazil emphasizes the closely interconnected world market, as noted before, their analysis looks only at data from countries to which Brazil and the United States both exported. The graph below looks at unit values for the entirety of U.S. and Brazilian exports during this period, which Brazil would argue is appropriate if in fact there is a "world price" that is transmitted with little interference to all cotton markets. The graph presents data obtained directly from the Foreign Agricultural Service/USDA web site⁹⁰ and Brazilian customs data provided through the World Trade Atlas, a for-fee service that collects and enters in an easily accessible database official data from Brazil and numerous other countries (produced by Global Trade Information Service Inc.) showing value, quantity and unit values.⁹¹ It also expands Brazil's data by incorporating data through November 2003.



136. This graph reenforces what was discussed above regarding Brazil's 40-same-markets data. In this case though, Brazil export unit values are lower than the United States in all but one of the 24 months in MY 2000 and MY2002. Although very similar to Brazil's graph, it is even clearer here that Brazil's export prices were consistently and often significantly lower than those of the United States. As the graph depicts, Brazil undercuts the United States during MY 2000, resulting in a decline in U.S. unit values. In MY2001, both continued to decline because of

⁹⁰ Exhibit U.S.-136 (FAS U.S. trade data)

⁹¹ Exhibit U.S.-137 (WTA Brazilian trade data)

record yields and slack demand. But at the beginning of MY2002, U.S. export values rebound whereas Brazil's remain low, undercutting the U.S. export values. In the start of MY 2003, U.S. prices begin a sharp increase, but Brazilian prices decline slightly before making a slight increase resulting in an increased spread between the United States and Brazil.

Cumulative Average Values Using all the Data

137. Going further and looking at the cumulative weighted price as Brazil did in paragraph 120, but again using the entirety of U.S. and Brazilian exports, the average U.S. price for MY 1999-2002 was 47.59 cents per pound for the United States as compared to an average for Brazil of 44.70 (Brazil calculation was almost exactly the same at 44.65). This means the United States average export value during the period was 2.89 cents per pound (6 percent) higher than that of Brazil. Looking at just the 40 markets, Brazil still found U.S. prices were higher but by only 0.68 cents. This is an important point in itself when addressing the question of Brazil's price undercutting. This means the increased spread between average U.S. and Brazilian prices when looking at all exports – as compared to just the 40 countries identified by Brazil – was due almost entirely to United States exporters being able to charge higher prices in markets where Brazil was not competing. This is clearly consistent with Brazil undercutting.

138. Looking at the cumulative averages for the atypical MY 2001 when there were weather-related reasons for low U.S. prices, Brazil's method showed a cumulative U.S. average export price lower than Brazil's by 5.22 cents (44.05 for Brazil and 38.83 for the United States). Looking at the entirety of exports, the difference was only 3.65 cents (44.14 for Brazil and 40.49 for the United States). In addition, a distortion in Brazil's cumulative analysis magnifies the importance of MY2001. Nearly 45 percent of Brazil's exports during this 4-year period came in MY 2001.⁹² By contrast, the United States only exported 30 percent of its 4-year total in MY 2001.⁹³ This means the difference between the unit average values is even further skewed. Looking at the difference in average unit values for years other than MY2001 (that is, in MY1999, MY2000 and MY2002 combined), the average unit value for the United States is 50.83. In Brazil it is 45.15. *U.S. prices are higher by 5.68 percent or almost 12 percent.*

Prices in the Brazil Market

139. It is also misleading for Brazil to claim as they do in paragraph 130 that U.S. cotton imported into Brazil undercuts domestic Brazilian cotton. This claim is based on comparing U.S. FOB export prices to Brazil domestic prices. That is, it ignores Brazil's tariff on cotton imports as well as transportation and other costs incurred shipping cotton to Brazil, which would raise the U.S. price significantly. The Brazilian tariff was 8 percent in 1999 and 2000, 8.5 percent in

⁹² Exhibit U.S.-135.

⁹³ Exhibit U.S.-135.

2001, 10 percent in 2002 and 9.5 percent in 2003.⁹⁴ In all years except 1999, the difference between Brazil domestic and U.S. export prices fell well short of even covering the tariff. In 1999 the difference of 10.27 percent only exceeded the tariff by 2.27 percent. Recent trader price quotes for transportation to Brazil exceed 10 cents a pound, more than offsetting the difference. In sum, Brazil's use of non-comparable prices cannot support a finding of price suppression, much less significant price suppression.

Price Suppression

140. Even using Brazil's method of looking at the average unit value of exports, rather than actual third-country domestic prices, strong evidence of Brazilian price undercutting exists – contrary to Brazil's arguments. Brazil's second line of argument is that price undercutting is irrelevant, arguing that it is not a question of undercutting but price suppression and that the global marketplace instantaneously translates subsidy-induced lower prices in the United States into lower prices world-wide. Brazil further contends that "prices in each of those 40 third country markets as well as the Brazilian and U.S. market were already suppressed before any cotton was shipped by U.S. or Brazilian exporters" (paragraph 131).

141. The price mechanism in cotton is relatively sophisticated, but Brazil's explanation is unrealistic. It says essentially that everyone in the market has perfect knowledge of the market and can adjust instantly. If over the period when U.S. subsidies increased, they had a significant suppressing effect on world markets, this would have been manifested in the United States continually lowering prices to take more market share with other suppliers being forced to follow. It is implausible to assume that this would have occurred without some time lag between U.S. and Brazilian prices that would have been evident in monthly export data – and yet, no such dynamic can be seen in the price data.⁹⁵

142. The fact that, other than in MY2001, U.S. prices generally stayed above Brazilian prices indicates that it was not U.S. subsidies, but other factors that drove down prices. The textile market was extremely competitive during this period. China's industry, operating in a tightly controlled market with access to cheap government stocks was pushing down prices. Also a sluggish world economy kept consumption growth in the same 1.5 to 1.75 percent annual growth

⁹⁴ Source: Various USDA/FAS Attache Reports (available at: www.fas.usda.gov (search on Attache Reports, Brazil, Cotton, 1999-2003)).

⁹⁵ Prices take time to adjust. Suppliers are hesitant to lower prices particularly when they have not seen a reduction in their own costs and cannot be sure the prices will stay lower. They will be willing to allow stocks to build until the need to drop prices is inevitable. Similarly, customers will not immediately switch since changing to a new unfamiliar supplier has costs particularly if the new lower prices do not continue. Additionally, as put forth by Brazil in its response to question 233 (para. 104), even if Brazilian suppliers and their customers had through the global pricing system perfect knowledge of U.S. prices and their future direction, they would still have contractual commitments at higher prices that must be met and thus would delay the transmission of declines in price movements. Brazil, however, in its discussion ignored that this delayed transmission due to contracts also could bind a supplier to a lower price although spot prices are increasing.

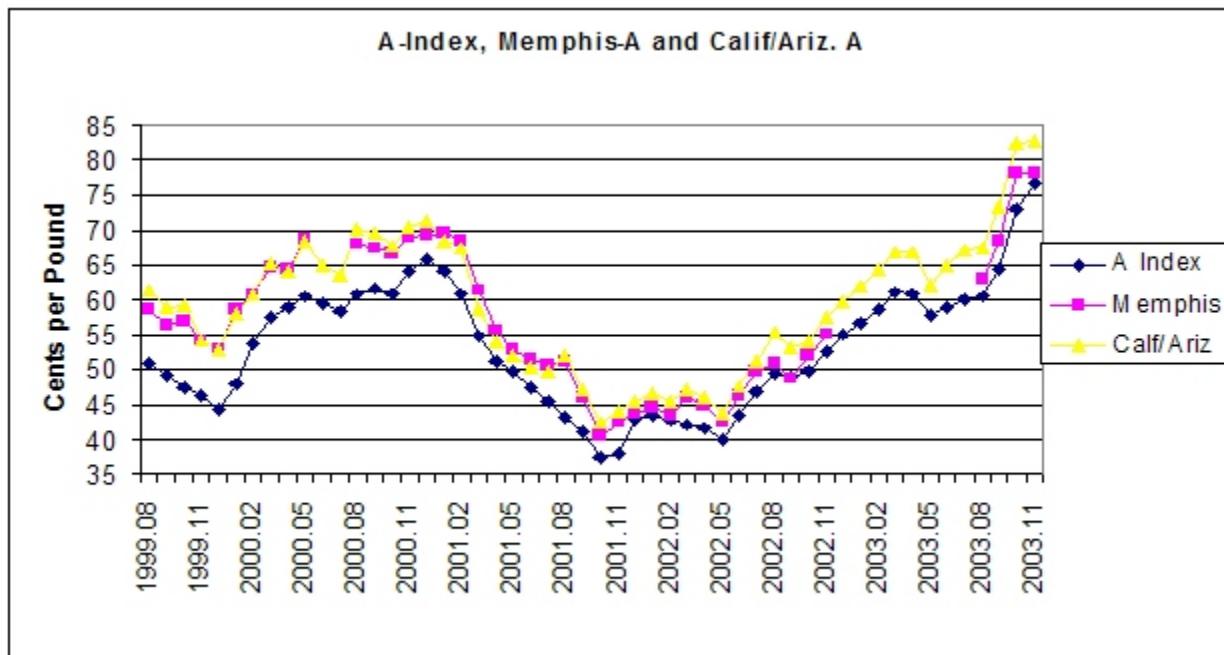
range it had been in the previous 4 years despite markedly lower cotton prices. Processors of raw cotton, other than those in China, demanded lower prices from suppliers in order to remain competitive with the Chinese. At the same time, the U.S. textile and apparel industry was faced with increasing textile and apparel imports, domestic raw cotton use fell sharply, and U.S. cotton growers and merchants had to turn to exports. The fact that U.S. stocks grew significantly during this time also indicates that U.S. suppliers were the price takers and not the price setters in this market.⁹⁶ Further, the shift in raw cotton consumption from the United States to other countries (much of which is shipped back to the United States in the form of cotton apparel) explains why U.S. cotton exports increased as the U.S. world market share was unchanged.

143. The point is reinforced by looking at the A-Index and the corresponding quotes for the United States and Brazil. Again one would expect that a U.S. cotton industry with subsidized excess production to dispose of on export markets would have been consistently pricing below the average represented by the A-Index (the 5 lowest price quotes obtained by Cotlook CIF Northern Europe). But this is not the case as can be seen in the graph below of the A-Index and the U.S. Memphis and California / Arizona A-Index quotes.

- At no point during MY1999-2003 to date was the California / Arizona quote below the A-Index.
- Only once during MY1999-2003 to date, September 2002, was the Memphis quote below the A-Index.

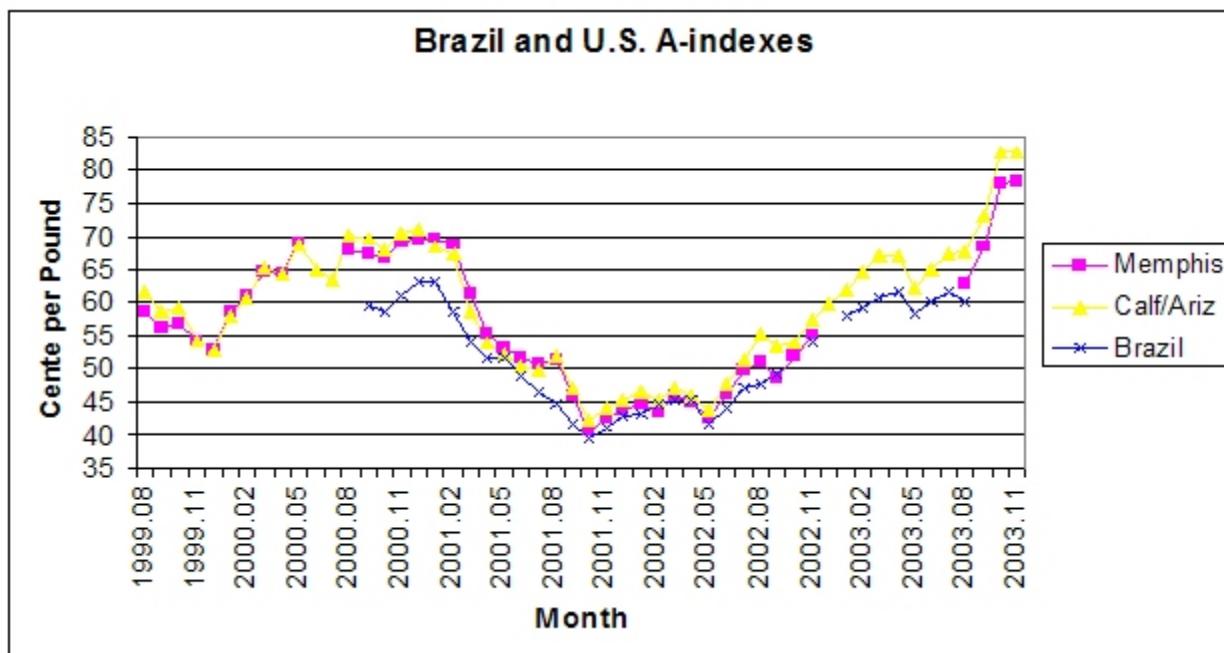
144. Consistent with what was discussed before, a tightening of the gap between the A-Index and U.S. quotes is apparent in MY 2001. However, Brazil aside, a number of countries had good weather and significantly increased area in that year so that U.S. prices were still above the average as measured by the A-Index.

⁹⁶ Exhibit U.S.-135.

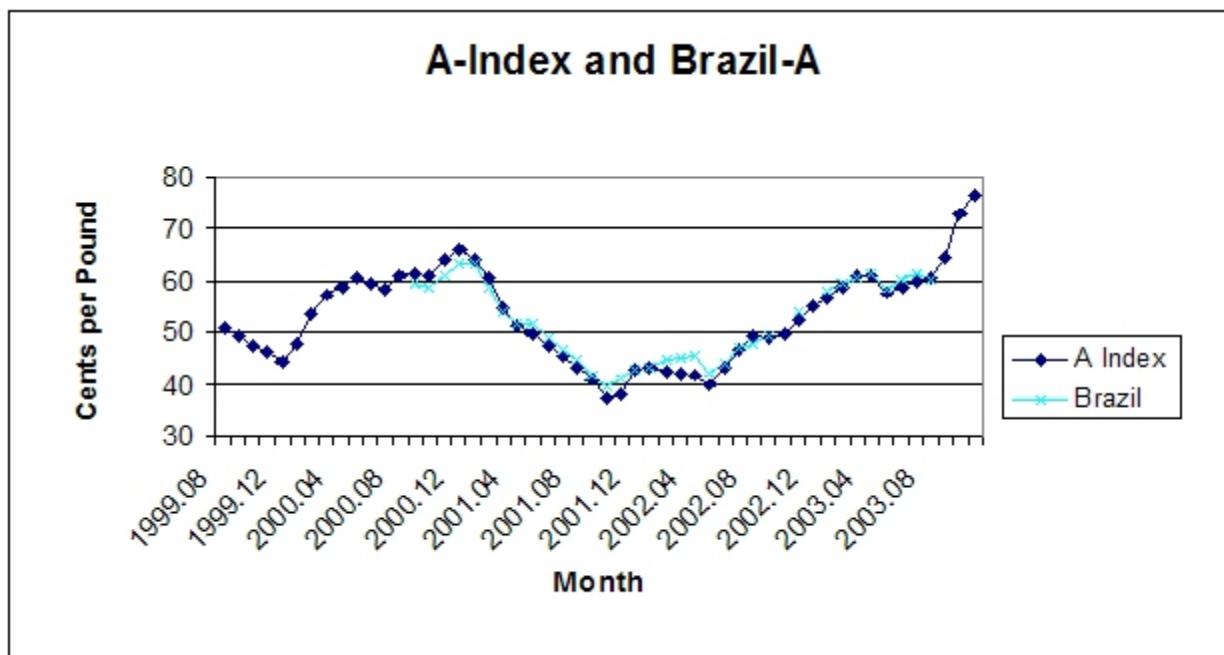


145. A parallel analysis can be made by comparing the U.S. and Brazilian A-Index quotes (data from Brazil Exhibit 242). This graph is the same as that used by Brazil in paragraph 128 (although the last 3 data points are not in the exhibit). Again, U.S. price quotes are well above Brazil quotes in marketing years 1999, 2000, 2002, and 2003 to date. In MY 2001 quotes grew closer, and for a few months the Memphis quote fell below the Brazilian.

- At all other times, the evidence demonstrates that Brazilian exporters were offering cotton at prices well below the U.S. A-index quote.



146. Indeed, looking at the graph below comparing the A-Index to the Brazilian A-index quote, there are considerable periods, particularly in MY 2000, when Brazil was consistently quoting below the A-Index. This evidence of low price quotes by Brazilian exporters is consistent with the view that Brazilian price undercutting exerted downward pressure on prices.



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

147. Although not entirely clear from Brazil's answer, Brazil appears to assert that as long as there is an increase in a Member's world market share over the preceding three-year average, the fact that the Member's world market share remains at approximately the same level could be compatible with a finding of an "increase" following a "consistent trend" within the meaning of Article 6.3(d). We would disagree. A flat world market share over a three-year period followed by a one-year increase would not demonstrate that the last year's "increase follows a consistent trend over a period when subsidies have been granted" (in the words of Article 6.3(d)). A flat "consistent trend" would not suffice since an "increase" could not "follow[] a [flat] consistent trend." In that situation, the "increase" would be deviating from, not following, the flat "consistent trend."

148. From a statistical standpoint, we would agree with Brazil's comment in paragraph 137 that due to the limited number of observations it is difficult to calculate a trend that is statistically significant. However, the United States strongly disagrees with the analysis presented by Brazil in the graphs accompanying paragraph 139. Note that if the trend line were calculated between 1986 and 2000 or 1996 to 2000, the trend line would be flat or slightly negative. As we have argued in the Second Submission to the Panel, the change in export share is due primarily to the decline in the U.S. textile industry which resulted in almost two-thirds of U.S. cotton being exported in 2002 compared to almost two-thirds milled domestically in 1998.

149. Indeed, if we observe the trend in the U.S. market share as presented in our Second Submission to the Panel and in the Concluding statements to the panel of October 8, the share of the world market for upland cotton supplied by U.S. cotton has been flat over the period from marketing year 1999-2002. And of course Article 6.3(d) is talking about "the effect of the subsidy" which requires that it be the same subsidy at issue for each year of the "consistent trend".

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

150. USDA did not require handlers of cottonseed to report their payments to producer, rather the payments went to first handlers. Handlers were allowed to settle up with their producers as they saw fit. The program, however, *ipso facto*, did give the producers a basis for possible

complaint against handlers who had effectively moved low seed prices back to their producers. If so, the remedy was lay in whatever civil remedies might be available in a particular jurisdiction.

151. It would appear that to the extent that the cost of low cottonseed prices were charged against the producer so as to create a duty for the handler to pass on the payment to the producer, the recovery by the producer would have been simply for higher ginning costs paid by the producer. That is, the producer would have suffered the loss to the extent the ginner charged more for ginning because the return to the ginner from the seed was too low.

152. Payments here are disaster-like in that the cost that was suffered and passed through to producers, to the extent that it was passed through, was after the fact. The season was long over and thus payments could not have induced the planting of the crop. In short, if there was a pass through, it was a wash to reflect higher ginning costs. Those costs were not associated with the marketing of upland cotton, but of cottonseed.

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

153. Brazil and the United States agree that green box subsidies may not be taken into account in considering the effects of non-green box subsidies in an action based on Articles 5 and 6 of the Subsidies Agreement. Article 13(a)(ii) of the Agreement on Agriculture states that green box measures are “exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement.” We recall that previously in this dispute Brazil asserted that the phrase “exempt from actions” did not preclude the Panel from considering Brazil’s serious prejudice claims but only from imposing remedies.⁹⁷ Nonetheless, in its answer, Brazil appears to have read this “exempt from actions” phrase to “prohibit . . . the effects of these subsidies being included along with other effects of non-green box subsidies *in assessing Brazil’s actionable subsidies claims.*”⁹⁸ Thus, Brazil here appears to read this phrase according to its ordinary meaning – that is, “not exposed or subject to” a “legal process or suit” or the “taking of legal steps *to establish a claim or obtain a remedy.*”⁹⁹ This is the definition that the United States has advanced in this dispute, and the Panel should consider Brazil’s answer to this question an endorsement of that definition.

⁹⁷Brazil’s Brief on Preliminary Issue Regarding the “Peace Clause” of the Agreement on Agriculture, para. 2 (5 June 2003) (interpreting “exempt from actions” to mean that “a complaining Member cannot receive authorization from the DSB *to obtain a remedy* against another Member’s domestic and export support measures that otherwise would be subject to the disciplines of certain provisions of the Agreement on Subsidies and Countervailing Measures . . . or Article XVI of GATT 1994”) (emphasis added).

⁹⁸Brazil’s Answer to Question 245 from the Panel, para. 145.

⁹⁹See, e.g., Comments of the United States of America on the Comments by Brazil and the Third Parties on the Question Posed by the Panel, paras. 8-10 (June 13, 2003).

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

154. Brazil errs when it claims in its response to this question that “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.” The Panel has discretion in assessing Brazil’s claims. The United States would note, for example, that Article 6.3(c) and (d) each refer to the “effect of the subsidy,” which clearly permits the Panel to examine the effect of each subsidy individually.

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

155. The United States does not disagree that facts arising after the date of panel establishment may be taken into account, for example, in analyzing Brazil’s threat of serious prejudice claim. As we have explained, as market prices have recovered strongly over marketing year 2003 (continuing their upwards trend since the trough reached in marketing year 2001), Brazil has jettisoned its proposed legal standard that the Panel examine whether there is a clearly foreseen and imminent likelihood of future serious prejudice. One could speculate that it has done so because the facts are no longer favorable – that is, high cotton prices will result in significantly lower budgetary outlays for two price-based measures (marketing loan payments and counter-cyclical payments) in marketing year 2003 than seen in previous years.

156. Brazil describes the task for the Panel “in an Article 5 and 6 claim” is to “assess[] whether present or threatened effects presently exist.”¹⁰⁰ We would agree but note that Brazil has provided no basis to conclude that past subsidies, such as payments made for the 1999-2001 marketing years, that were fully expensed in past years could have “present . . . effects [that] presently exist.” To the contrary, to the extent that these subsidies are *not* allocated to future production – and the Panel will recall that Brazil itself has both expensed these payments for purposes of its Peace Clause calculation as well as recognized that these recurring subsidies payments would be expensed for countervailing duty purposes – no lingering effects can exist because the subsidies themselves are deemed to have been used up. Thus, the question before the Panel is whether present subsidies – that is, those made for marketing year 2002 through the date of panel establishment – were causing certain adverse effects to presently exist and whether the U.S. laws and regulations in existence as of the date of establishment of the Panel threaten serious prejudice. Any payments not in existence as of the date of establishment are not measures within the Panel’s terms of reference.¹⁰¹

¹⁰⁰Brazil’s Answer to Question 247 from the Panel, para. 150.

¹⁰¹We recall once again that Brazil now admits that the matter before the Panel cannot change after establishment. Answer to Panel Question 247.

157. We also note that Brazil cites two reports in support of its arguments: *Argentina Footwear* and *Argentina Peaches*. Those citations are misplaced for several reasons. First, Brazil entirely ignores that both reports interpreted the *Agreement on Safeguards*, not the Subsidies Agreement, and that the two agreements have different texts. Brazil compounds the problem by failing to mention that the paragraphs it quotes in both reports dealt not with the issue of threat of injury, but with the issue of whether imports had “increased” (within the meaning of the Safeguards Agreement). Finally, while Brazil does acknowledge the existence of the Appellate Body report in *U.S. Lamb*, it fails to point out that, in the context of a discussion of threat of serious injury under the Safeguards Agreement, in that report the Appellate Body made a finding that undercuts Brazil’s position dramatically:

Like the Panel, we note that the *Agreement on Safeguards* provides no particular methodology to be followed in making determinations of serious injury or threat thereof. However, whatever methodology is chosen, we believe that data relating to the most recent past will provide competent authorities with an essential, and, usually, the most reliable, basis for a determination of a threat of serious injury. The likely state of the domestic industry in the very near future can best be gauged from data from the most recent past. Thus, we agree with the Panel that, in principle, within the period of investigation as a whole, evidence from the most recent past will provide the strongest indication of the likely future state of the domestic industry.¹⁰²

158. The strong recovery in market prices and futures prices demonstrate that there is no clearly foreseen and imminent likelihood of future serious prejudice. As we have previously seen with respect to the December 2004 future contract, price recovery has been sustained and steady; the contract average monthly close was 61.34 cents per pound in December 2002, and the current (as of January 22, 2004) monthly average close is 68.78 cents per pound. As a result of higher prices, U.S. outlays are markedly down, with no marketing loan payments being made. In addition, the expectation of continuing high prices embodied in current future price suggests that no further marketing loan payments will be made this marketing year and that counter-cyclical payments will be dramatically lower.

159. In assessing the credibility of Brazil’s argument that the baseline projections of FAPRI are more probative than futures prices, the Panel should recall the “testimony” of Brazil’s own economic expert, Mr. MacDonald. Brazil has presented no evidence or analysis to suggest that FAPRI’s baselines are more accurate price projections than what the NY futures indicates; in fact, the United States has put before the Panel evidence showing that FAPRI’s baseline projections have been far off the mark.

¹⁰² Appellate Body Report, *United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia*, WT/DS177/AB/R, WT/DS178/AB/R, adopted 16 May 2001, para. 137 (footnote omitted).

160. For corroboration, the Panel need only consider the marketing year 2003-2008 baseline projections made by FAPRI in November 2002, January 2003, and November 2003. The price outlook for cotton has improved considerably since publication of the November 2002 FAPRI baseline used by Dr. Sumner in his Annex I estimate of the effects of U.S. subsidies on U.S. cotton production.

- The table below shows that FAPRI's projections for the MY2003 Adjusted World Price (used for calculating the marketing loan payments) are as much as *20 cents per pound, or 54 percent, higher* in the November 2003 baseline as under the November 2002 baseline.
- Even so, FAPRI's November 2003 projected Adjusted World Price is still almost 6 cents per pound lower than the current Adjusted World Price.¹⁰³

161. As a result of these revisions, FAPRI's estimated marketing loan gains (the difference between the marketing loan rate and the estimated Adjusted World Price) are reduced considerably.

- Under the November 2003 baseline, the estimated marketing loan gain for 2003/04 is *zero*, compared to *almost 15 cents per pound* under the November 2002 baseline used by Dr. Sumner.
- Over the five-year period 2003/04 to 2007/08, the average marketing loan gain under the November 2003 baseline is estimated to be only *1.32 cents per pound*. This is compared to *10.39 cents per pound* using the November 2002 baseline used by Dr. Sumner.

¹⁰³The Adjusted World Price for January 23-29, 2004, is 63.25 cents per pound.

FAPRI's Revised Price and Marketing Loan Gain Baseline Projections

Year	Adjusted World Price (cents/lb)			Est. marketing loan gain ^{1/} (cents/lb)		
	Nov 2002	Jan 2003	Nov 2003 ^{2/}	Nov 2002	Jan 2003	Nov 2003 ^{2/}
2003/04	37.22	44.8	57.36	14.78	7.2	0
2004/05	39.83	45.4	50.96	12.17	6.6	1.04
2005/06	41.94	46	50.82	10.06	6	1.18
2006/07	43.6	46.7	50.35	8.4	5.3	1.65
2007/08	45.48	48	49.24	6.52	4	2.76
Average	41.61	46.18	51.75	10.39	5.82	1.32

1/ The estimated marketing loan gain is the difference, if positive, between the loan rate (52 cents per lb) and the Adjusted World Price.

2/ Source: FAPRI Baseline, November 2003 (Exhibit US-132)

162. We also note the New York Cotton Exchange closing prices for January 23, 2004, showed the March 2004 contract at 75.94 cents, the May 2004 contract at 77.02 cents, and the July 2004 contract at 77.90 cents. Based on these futures prices, the latest (although preliminary) FAPRI baseline still appears to have projected near-term future cotton prices too low.

163. The marketing loan program contributes to over 42 percent of the estimated effects of removing subsidies on production under the model developed by Dr. Sumner.¹⁰⁴ As the November 2002 baseline projected significant marketing loan payments through 2008 whereas the November 2003 baseline projects no or minimal marketing loan payments, updating Dr. Sumner's model to the November 2003 baseline would significantly reduce the overall estimated effect of U.S. payments on production. Any remaining effects would largely be those incorrectly attributed to decoupled income support payments under Dr. Sumner's flawed model.

164. Finally, in paragraph 154 of its answer, Brazil again tries to muddy the waters by referencing the wholly arbitrary “expected adjusted world price first mentioned in its opening statement at the second substantive meeting of the Panel with the parties. There, Brazil attempted to provide an alternative to the U.S. futures analysis. Brazil's alternative was that farmers look to an “expected adjusted world price” when making planting decisions since the marketing loan program benefits are ultimately determined by the Adjusted World Price. Whereas the United States has provided references to numerous sources that demonstrate farmers look to the futures prices in making planting decisions,¹⁰⁵ Brazil has not provided any evidence to

¹⁰⁴See Brazil's Further Submission, Annex I, table 1.4.

¹⁰⁵See U.S. Answers to Questions 200 and 201.

support its assertion that farmers look to an “expected adjusted world price” in making planting decisions.

165. Without any sources to back up its assertion, Brazil implied that farmers could readily calculate an “expected adjusted world price” in making planting decisions.¹⁰⁶ According to Brazil, a farmer at planting time for MY 1999 would take the December 1999 futures price and subtract 18.5 cents to get the “expected adjusted world price” (which would then be compared to the marketing loan rate). Why 18.5 cents? For each of MY 1996-MY2002, Brazil calculated the difference between the December futures price and the average adjusted world price for that marketing year. Brazil then calculated the average of the differences for these 7 years as 18.5 cents.

166. As with Brazil’s lagged price calculation, however, this formula has never been, nor could it ever be, applied by a farmer in real-life. First, calculating the “average adjusted world price” for a given year – say, MY 1999 – requires knowledge of the adjusted world prices that actually result in that year. Thus, a farmer making a planting decision for MY 1999 (that is, in January-March 1999) has no way of calculating the “average adjusted world price” for marketing year 1999 (August 1, 1999 - July 31, 2000). Moreover, the same farmer making a planting decision for MY 1999 could not possibly know the December futures prices for MY2000 - MY2002; nor could that farmer know the “average adjusted world price” for MY2000 - MY2002. Thus, that farmer could not have calculated the 18.5 cents per pound average for the “average adjusted world price,” nor could he have calculated the “expected adjusted world price”,¹⁰⁷ as set out by Brazil.¹⁰⁸ Thus, Brazil’s critique of the U.S. futures price approach to planting decisions is not only incorrect but grossly misleading.

167. Brazil’s assertions relating to “lagged prices,” “average adjusted world prices,” and “expected adjusted world prices” are utterly irrelevant to an analysis of the effect of the marketing loan program because they are simply not knowable by the farmer at the time of planting. In fact, the *only* parts of Brazil’s spurious methodology that are objectively knowable at the time of planting – and undisputed facts on the record of this dispute – are (1) the December futures price at the time of planting and (2) the marketing loan rate. These are precisely the elements that make up the U.S. analysis of the effect of the marketing loan program.

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**

¹⁰⁶The methodology is set out in Brazil’s opening statement at the second panel meeting and in Exhibits BRA-356 and BRA-357.

¹⁰⁷December futures - 7-year average of “average adjusted world price”.

¹⁰⁸See Brazil’s Opening Statement at the Second Panel Meeting, paras. 44-47; Exhibit BRA-356, -357, -358; Brazil’s Answer to Question 247, para. 154.

relevant for an analysis of the issue of export contingency under the Agreement on Agriculture or the SCM Agreement? BRA

168. In response to Brazil's statement that Step 2 "payments are conditional upon proof of export,"¹⁰⁹ the United States would simply remind the Panel that such payments are made to users of upland cotton upon demonstration of the use of cotton. Such use can be manifest either by opening the bale of cotton or by export. The program is indifferent to whether recipients of the benefit of this subsidy are exporters or parties that open bales for the manufacture of raw cotton into cotton products. Indeed, to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the payment upon submission of the requisite documentation. This subsidy is therefore not contingent on export performance and is not an export subsidy.¹¹⁰ The situation here is analogous to that in the Ad Note to Article III of the GATT 1994 which makes clear that just because a measure that covers all products evenly is applied in the case of imports (here exports) at the border, does not change it to a border measure.

169. As was pointed out in the *Opening Statement of the United States of America at the Second Session of the First Meeting of the Panel with the Parties*, Brazil's analysis of Step 2 payments exaggerates the effect of Step 2 payments on world prices. Because demand for cotton is more price responsive than supply, the incidence of processor subsidies like Step 2 accrue to supply rather than demand. That is, producers gain through higher prices paid to producers while world prices are relatively unaffected. This is consistent with a previous analysis of Step 2 by FAPRI in 1999 (Exhibit US-61). In that study, FAPRI estimated an average Step 2 payment of 5.3 cents per pound. (By way of contrast, the Step 2 payment rate in effect for January 23 - 29, 2004, is 1.62 cents per pound.) These payments resulted in an increase of the spot price of U.S. cotton by 4 cents and a fall in the world cotton price of less than 0.5 cents.

170. While it is true as Brazil points out that the margin of difference that is required between the relevant delivered U.S. price and the A index has been adjusted slightly by the 2002 farm bill, the Brazil answer shortchanges several aspects of the continued limitations on Step 2 payments. The statute continues to allow payments only when the delivered U.S. price in Northern Europe is higher than the going local Northern European price, and only when that difference has existed for four weeks straight, and only when the prevailing local Northern European price (adjusted for price and location) is not more than 134 percent of the U.S. loan rate of 52 cents per pound. That figure, 134 percent of the loan rate, would be about 69.6 cents, and the current adjustment for location and quality is about 13 cents per pound. This means that where the prevailing local N.E. price was more than about 82 cents, there would be no Step 2 payments irrespective of the amount of difference in the two prices that are otherwise compared to determine whether Step 2 payments are made. Also missing in the Brazil answer is a reference to reflect that the relief

¹⁰⁹Answers of Brazil to Question 249(a) (22 December 2003), para. 163.

¹¹⁰See, e.g., U.S. First Written Submission (11 July 2003), paras. 127-135.

from the additional 1.25 cent differential is temporary as under current law that 1.25 cents will return on August 1, 2006.¹¹¹

G. 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

171. In Brazil's answer, it states that it does not seek relief "under . . . Article XVI of GATT 1994" in respect of "the legal instruments consisting of the 1996 U.S. Farm Bill providing, *inter alia*, for production flexibility contract payments, as well as various emergency appropriation Acts in 1998-2001 providing, *inter alia*, for market loss assistance payments." However, Brazil also clarifies that "Brazil's claims under Articles 5(a) and 6(c) of the SCM Agreement do include the adverse effects today and in the future of subsidies *provided* under these expired legal provisions."¹¹² Brazil's answer points out the difficulty in its approach to actionable subsidies.

172. As Brazil acknowledges, "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." Simply put, if a measure does not exist at the time of panel establishment, then that "measure" is not part of the "matter" referred to the panel and cannot be within the panel's terms of reference. Furthermore, there is nothing to be brought into conformity. In this dispute, recurring subsidies "provided" (in Brazil's words) with respect to past years and fully expensed to those years no longer exist once a new marketing year, for which new recurring subsidies are paid, commences. Thus, not only did these measures (subsidies) for past marketing years (1999-2001) not exist at the time Brazil's panel request was filed and the panel established (during marketing year 2002), they do not exist today (half way through marketing year 2003) and cannot be the subject of any recommendation to be brought into conformity.¹¹³

173. For this reason, Brazil's insistence that its serious prejudice "claims . . . do include the continuing adverse effects today and in the future of subsidies provided under these expired legal provisions" is troubling. Were the Panel to consider that expired subsidies have some continuing effect (and we note that Brazil has never explained how long those effects could be deemed to

¹¹¹We have sought additional information on whether producers in the capacity of manufacturers or exporters ever receive Step 2 payments. As we indicated, this would only occur with very large producers, if at all. We have examined recent Step 2 payment lists, and they indicate that at the very best any such payments would be highly isolated. Cooperatives would not, in this sense, be considered "producers" since a cooperative does not, as such, have a risk in the crop during the growing season. Step 2 payments are never paid more than once for the same cotton and absent export are only paid in connection with the manufacturing process for breaking open bundles. A producer who simply bundled cotton just to break the bundle would not be eligible for the payment.

¹¹²Brazil's Answer to Question 250 from the Panel, para. 164 (emphasis added).

¹¹³This is so for all the reasons we have given earlier in this dispute, as well as for the reason that Brazil gives: the matter before a Panel "cannot" change after establishment. Brazil's Answers to Panel Question 247.

last nor how they would be distinguished from the present effects of current subsidies), “include” them as part of its analysis of Brazil’s serious prejudice claims, and render a finding of present serious prejudice, the Panel could not recommend that these expired measures be brought into conformity. On the other hand, a recommendation that the adverse effects be removed would be of questionable use since those “effects” would have included the effects of expired measures. Thus, Brazil’s claims of present serious prejudice should be limited to those measures that currently existed at the time of Brazil’s panel request and panel establishment.

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

174. The United States disagrees with Brazil’s answer. There is no recommendation made “pursuant to Article 7.8 of the SCM Agreement.” Rather, there is an obligation under Article 7.8 on a Member granting or maintaining a subsidy inconsistently with Article 5 to “remove the adverse effects or . . . withdraw the subsidy” *after adoption* of the relevant reports “in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member.” Article 19.1 of the DSU addresses the entirely separate question of what recommendations should be *in the report*.¹¹⁴ We also note the contrast between Subsidies Agreement Articles 4.7 and 7.8 in that the text of Article 4.7 specifically authorizes the Panel to take an action (“shall recommend that the subsidizing Member withdraw the subsidy without delay”) while Article 7.8 does not.

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

175. In its answer, Brazil sets forth no considerations that could guide the Panel in making a recommendation under Article 4.7 relating to the relevant period of time, other than to say that the period should be 90 days. The United States understands that different time periods have been set by panels that have made findings of prohibited subsidies given the nature of the measure in question. For example, in several disputes in which it appears that solely administrative action would be necessary to withdraw the measure, it appears that panels have set 90-day periods. In the *United States – FSC* dispute, the panel found that withdrawal of the

¹¹⁴DSU Article 19.1 (“Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, *it shall recommend that the Member concerned bring the measures into conformity with that agreement.*”) (emphasis added; footnote omitted).

measure would require legislative action and provided an appropriate period of time. The time for appeal and adoption would also be a relevant consideration. The United States has explained on several occasions the intricacies of the U.S. legislative process and the time needed to enact legislation, including in submissions to arbitrators acting under Article 21.3(c) of the DSU. No such arbitrator has ever concluded that a period as short as 90 days is a reasonable period of time for the United States to complete implementation of the DSB's recommendations and rulings where legislative action is needed.¹¹⁵

176. Brazil has challenged Step 2 payments, the export credit guarantee programs, and FSC benefits to upland cotton as prohibited subsidies. Brazil has also asserted that these measures are "mandatory," such that officials have no discretion to implement the measures in a WTO-consistent fashion. While the United States does not accept Brazil's assertion, the United States would suggest that the 90-day period given with respect to measures requiring only administrative fixes would not be appropriate.

177. With respect to the FSC legislation, should the Panel find this to be inconsistent with U.S. obligations under Article 3.2 of the SCM Agreement, it is not a practical possibility that the United States could withdraw the subsidy within 90 days, given that legislative action would be required. However, the United States notes that there already are bills before both houses of Congress that would repeal the FSC and that have been reported out of their respective committees. In the event of a prohibited subsidy finding, the United States should be given until the end of this year to complete the legislative process and enact this legislation into law.

H. MISCELLANEOUS

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

178. The United States provides comments on the mandatory / discretionary analysis in its comments on Brazil's answer to question 257.

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

¹¹⁵The Panel may wish to refer, *inter alia*, to the 21.3(c) arbitrations conducted in the dispute *United States – Continued Dumping and Subsidy Offset Act of 2000* (WT/DS217/14, WT/DS234/22, award circulated 13 June 2003), to which Brazil was a party. Other such arbitrations include *United States - Anti-Dumping Measures on Certain Hot-Rolled Steel Products From Japan* and *United States - Antidumping Act of 1916*.

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:

179. Brazil's response to question 257 begins with a general discussion of the Appellate Body report in *United States – Sunset Review*.¹¹⁶ As reflected in the U.S. answer to the same question, the United States agrees with the view expressed in paragraphs one and two of Brazil's response that the *United States – Sunset Review* report has no significant impact on this dispute and that the Appellate Body in *United States – Sunset Review* in fact undertook an analysis of whether the measure at issue in that dispute was mandatory based on a traditional "mandatory / discretionary" analysis. The language cited in the Panel's question was drawn from a separate section of the *United States – Sunset Review* report addressing the preliminary jurisdictional issue of what is a measure, and that question is not present here.

180. While the United States agrees that the *U.S.–Sunset* report is not relevant to the analysis in this dispute, the United States nevertheless disagrees with Brazil's further characterizations of that report.

181. For example, in paragraph three of Brazil's answer, Brazil addresses the Appellate Body discussion on the interpretation of a Member's domestic law. In its statement at the January 9, 2004, meeting of the DSB at which the report was adopted (attached as Exhibit US-138), the United States placed the Appellate Body statement which Brazil cites in its proper context, which is that the meaning of a domestic law must be determined based on applicable *domestic* legal principles of interpretation. It is simple error to conclude that a measure mandates behavior by government officials of a Member if, under the domestic law of that Member, the behavior is not mandated. Thus, Brazil's speculations in paragraph four of its answer that it is permissible to examine whether "the operation of a measure" creates requirements for government officials to act in a WTO-inconsistent manner is both groundless and meaningless. U.S. officials are required to do what U.S. laws require, and there is no principle of U.S. law indicating that a law's "operation" requires anything.

¹¹⁶Appellate Body Report, *United States – Sunset Review of Anti-Dumping Duties on Corrosion Resistant Carbon Steel Flat Products from Japan*, WT/DS244/AB/R (adopted 9 January 2004) ("United States – Sunset Review").

182. Brazil elaborates on its discussion of the “operation of a measure” with a reference to the Appellate Body’s discussion of “normative” requirements. However, the United States notes, as it did in its answer to Question 257(d), that the Appellate Body’s discussion of an instrument’s “normative” character came in the context of its analysis of whether an instrument can be a measure, and not the separate question of whether a measure mandates a breach of any WTO obligation. It is only this latter question that is before this Panel.

183. Likewise, the Appellate Body statement on protecting future trade which Brazil cites in paragraph five of its answer and analyzes in paragraph six came in the context of the Appellate Body’s discussion of why certain instruments should be considered measures, and not in the Appellate Body’s separate analysis of whether that measure mandates a WTO breach. Again, it is not disputed that the measures at issue in this case *are* “measures.” Thus, as Brazil itself notes, the Panel “need not examine whether the subsidy measures that Brazil has challenged are mandatory as a preliminary jurisdictional matter,” but should do so only in the context of determining whether the measures breach U.S. obligations.¹¹⁷

- (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**

184. Brazil has challenged Section 1207(a) of the 2002 Act providing for Step 2 payments as both a prohibited export subsidy under Subsidies Agreement Article 3.1(a) and an import-substitution subsidy under Subsidies Agreement Article 3.1(b).¹¹⁸ Brazil argues that the statute mandates payments inconsistent with WTO obligations and therefore is *per se* WTO inconsistent.¹¹⁹

185. The *United States – Sunset Review* Appellate Body report did not analyze or alter the mandatory / discretionary analysis that has been used in past WTO disputes. Thus, for purposes of Brazil’s *per se* challenge to Section 1207(a) of the 2002 Act, the relevant issue is whether that

¹¹⁷See Brazil’s Answer to Question 257 from the Panel, para. 2.

¹¹⁸Brazil’s First Written Submission, para. 235 (“The measure Brazil challenges as a *per se* violation of the Agreement on Agriculture and the SCM Agreement is the Step 2 export payment program as set forth in Section 1207(a) of the 2002 FSRI Act.”); *id.*, para. 331 (“The measure Brazil challenges is therefore Section 1207(a) of the 2002 FSRI Act, which mandates the payment of Step 2 domestic payments.”).

¹¹⁹Brazil’s First Written Submission, para. 250 (“Section 1207(a) of the 2002 FSRI Act mandates Step 2 export payments that are prohibited export subsidies within the meaning of SCM Agreement Article 3.1(a).”; *id.*, para. 341 (“The program also constitutes a *per se* violation of ASCM Articles 3.1(b) and 3.2, because payments are mandatory under U.S. law. Section 1207(a) of the 2002 FSRI Act gives no discretion to the U.S. Secretary of Agriculture to apply the measure in a WTO consistent manner.”).

measure mandates a violation of the WTO Agreement.¹²⁰ It does not, and therefore Brazil's *per se* claim must fail.

186. The United States has explained 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."¹²¹ That is, the United States may not arbitrarily deny payment to eligible recipients when the price conditions for payment have been met. However, the absence of discretion given these conditions does not mean the measure mandate a violation of Articles 3.1(a), 3.1(b), and 3.2 of the Subsidies Agreement.

187. Brazil states that "U.S. government officials are not provided with any flexibility under Section 1207(a) of the 2002 FSRI Act" and therefore "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."¹²² Whether or not U.S. government officials have flexibility with regard to administration of the Step 2 program, Step 2 subsidies can violate Articles 3.3 and 8 of the Agreement on Agriculture only if they constitute export subsidies. For the reasons summarized in the U.S. Comment to Brazil Answer to Panel Question 249, Step 2 subsidies are not export subsidies.

188. The Step 2 subsidy payments are included in the Total Aggregate Measurement of Support reported by the United States. The United States has also remained within its domestic support reduction commitments as set forth in Part IV of its Schedule. Pursuant to Article 6.3 of the Agreement on Agriculture and Paragraph 7 of Annex 3 of that Agreement, the United States therefore "shall be considered to be in compliance with its domestic support reduction commitments." Under Article 6.3 a Member may choose to provide "amber box" support in any direct or indirect manner so long as that Member's "Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule." Furthermore, the first words of Article 3 of the SCM Agreement render that article subject to the terms of the Agreement on Agriculture. The terms of Articles 3.1(a) and 3.1(b) of the SCM Agreement apply "except as provided in the Agreement on Agriculture."¹²³ Therefore, without regard to flexibility in operation of the Step 2 program, to the extent the United States has not exceeded its domestic support reduction commitments, the Step 2 program and its authorizing legislation do not constitute a *per se* violation of Article 3.1(a) or 3.1(b) of the Subsidies Agreement.¹²⁴

¹²⁰Appellate Body Report, *U.S. – Anti-Dumping Act of 1916*, WT/DS136/AB/R, para. 88 (adopted 26 September 2000).

¹²¹U.S. Answer to Question 109 from the Panel.

¹²²Brazil's Answers to Question 257(a)(i) (20 January 2004), para. 8.

¹²³See U.S. First Written Submission (11 July 2003), paras. 138-145. See also, Answers of the United States to Panel questions 111-116 (22 August 2003), paras. 222-226; U.S. Further Submission (30 September 2003), paras. 165-176.

¹²⁴Step 2 payments are available to all users of domestic upland cotton within the United States, be they domestic users or exporters. Thus, payment is not contingent upon export performance, and Section 1207(a) does not mandate the grant or maintenance of a prohibited export subsidy within the meaning of Article 3.1(a).

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

189. With respect to export credit guarantee programs, the United States will not reiterate its myriad points regarding the carve-out conferred by Article 10.2 of the Agreement on Agriculture and the data indicating that, in any event, premia are sufficient to cover long-term operating costs and losses.¹²⁵ We do note that, as Brazil recognizes, the programs are currently below the 1% cap on premiums. Because the United States has discretion to raise the fees to the cap, which along with other elements of discretion over provision of actual guarantees, creates a “discretionary” aspect to the program that does not “mandate” WTO inconsistent measures.

190. However, the United States notes the disingenuous response of Brazil, in paragraph 16 of its response to Question 257(a)(i). On the one hand Brazil claims to have “looked at historical data concerning premiums collected and costs and losses incurred” to allegedly make its case under item(j), but in the very same paragraph it states that “Brazil does not agree with the United States that item(j) necessarily ‘requires a certain retrospection.’” Brazil literally uses retrospection in an effort to make its case on this very point: “Brazil has demonstrated that, *retrospectively* [italics added], costs and losses incurred by the programs exceeded premiums collected over a 10-year period.”¹²⁶ The United States of course disagrees with the factual premise of the statement, but Brazil cannot credibly disagree that “a certain retrospection” is necessary for a proper analysis under item(j).

(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

191. Brazil's answer does not explain the significance of assigning the “mandatory” label to challenged measures for purposes of its serious prejudice claim. Brazil has challenged certain statutory and regulatory provisions as *per se* inconsistent with Articles 5(c) and 6.3(c) and (d) of the Subsidies Agreement and Article XVI:1 and :3 of GATT 1994.¹²⁷ Brazil's challenge to these

¹²⁵In the view of the United States, the relevant analysis under the Subsidies Agreement whether export credit guarantees are export subsidies could only be the cost-to-government approach set out in item (j) of the Illustrative List of export subsidies.

¹²⁶Brazil's Answer to Question 257(c) (20 January 2004), para. 40.

¹²⁷Brazil's Further Submission, para 413 (“Brazil challenges as *per se* violations of Articles 5(c), 6.3(c), and 6.3(d) of the SCM Agreement, and Article XVI:1 and 3 of GATT 1994 selected mandatory provisions of the 2002 FSRI Act and the 2000 ARP Act, as they cause a threat of serious prejudice within the meaning of those provisions.”).

measures is “as such.”¹²⁸ As explained above with respect to Section 1207(a) of the 2002 Act, under Brazil’s *per se* challenge, the relevant issue is whether the challenged measures mandate a violation of the WTO Agreement.¹²⁹ They do not.

192. Both Brazil and the United States agree that, given certain conditions such as price levels, these challenged measures would be “mandatory” in the sense that the United States could not arbitrarily decline to provide them. However, for purposes of a mandatory / discretionary analysis, no WTO-inconsistency is mandated by those measures because serious prejudice does not necessarily result, even where there is no discretion not to provide payment.

- For example, a finding of serious prejudice based on Article 6.3(d) requires that there be an increase in the world market share of the subsidizing Member in a subsidized primary product and the increase follow a consistent trend over a period when subsidies have been granted. This finding cannot be made in the abstract but depends upon real-world conditions, such as the current and recent shares of the world market for upland cotton held by the United States.
- Similarly, a finding of serious prejudice based on Article 6.3(c) requires that there be “significant price suppression” in the “same market” where imports of both the complaining and responding party are found. This finding also cannot be made in the abstract but requires an examination of actual prices, import levels, and an analysis of the effects of challenged subsidies.

Thus, that certain U.S. measures “mandate” payments given certain conditions (such as price levels) does not establish that these measures mandate a WTO-inconsistency under a mandatory / discretionary analysis of Brazil’s *per se* serious prejudice claim.

193. With respect to Brazil’s threat of serious prejudice claims “that do not involve claims regarding the ‘*per se*’ validity of the statutes,” Brazil colloquially describes the 5 U.S. subsidies in the Panel’s question as “mandatory,” but the mandatory / discretionary analysis is inapplicable to this threat claim. In this context, it is significant that certain of the challenged payments are not mandated if price conditions are not met. Thus, in evaluating the threat of serious prejudice resulting from these measures, the *likelihood* that price conditions will be satisfied must be taken into account. (For example, the price conditions have not been met for marketing loan payments since September 2003, and none are currently being made. Furthermore, farm prices have risen to the point that the counter-cyclical payment for marketing year 2003 is projected at one-third or less of its statutory maximum.)

¹²⁸Brazil’s Further Submission, para. 471(vii) (“The following Sections of the 2002 FSRI Act and the referenced regulations thereto violate, as such, Articles 5(c), 6.3(c), 6.3(d) of the SCM Agreement and Articles XVI: 1 and 3 of GATT 1994 to the extent that they relate to upland cotton.”).

¹²⁹Appellate Body Report, *U.S. – Anti-Dumping Act of 1916*, WT/DS136/AB/R, para. 88 (adopted 26 September 2000).

194. Brazil argues that “a threat of serious prejudice under Articles 6.3 and 5(c) will be more likely to exist if the subsidies are mandatory” and that “there are no provisions in U.S. law limiting the payments, and, thus, limiting the threat of prejudice.” Putting aside the fact that the “circuit breaker” provision could serve to “limit[] the payments,”¹³⁰ Brazil’s argument rests on the flawed notion that the absence of a “legal mechanism to limit the amount of potential subsidies that could be paid” necessarily creates a threat of serious prejudice. This proposed standard does not withstand scrutiny.

195. As the United States has noted,¹³¹ Brazil looks to the Appellate Body report in *United States – FSC*, but that report involved the “threat of circumvention” of export subsidies standard of Article 10.1 of the Agreement on Agriculture. Because agricultural export subsidies *are* subject to volume and value limits, it may be appropriate in that particular circumstance to conclude that the absence of a mechanism to control the flow of subsidies could threaten circumvention of those absolute commitment levels. However, the commitment in the case of Articles 5(c) and 6.3 is not to threaten serious prejudice – that is, not threaten a particular form of adverse *effect*. Whether a particular type and level of subsidy could threaten that effect necessarily depends upon a fact-intensive examination of, *inter alia*, the subsidy, the relevant market or markets, supply and demand factors, etc. Thus, the *FSC* standard for claims of “threat of circumvention” of export subsidy commitments is not relevant in this context.

196. Brazil’s continued reliance on *EC – Sugar Export Subsidies* is misplaced. In that dispute, the panel found that as there was no legal mechanism to control the EC’s sugar export subsidies, the subsidy constituted a permanent threat of instability. That panel, however, provided no basis for selecting that standard, which is not reflected in the text of the Subsidies Agreement or GATT 1994 Article XVI:1.¹³² We further note that Brazil itself, when it first presented this report to the Panel, commented that “[t]he panel’s conclusion was based on several key factual findings.”¹³³ Thus, even that GATT panel report’s finding of threat was based on the particular factual circumstances it reviewed, and that report would not support an abstract standard that the lack of a legal mechanism to control the flow of subsidies suffices to create a threat of serious prejudice.

¹³⁰Although the trigger for the circuit breaker provision is compliance with the United States’ AMS commitments, the Secretary would appear to have discretion over what “adjustments in the amount of such expenditures” would be made. That is, the Secretary could determine to make adjustments in expenditures for one product or multiple products or decoupled income supports.

¹³¹See, e.g., U.S. Opening Statement at the Second Panel Meeting, paras. 83-85.

¹³²Indeed, the GATT panel’s conclusion that “the Community system and its application constituted a permanent source of uncertainty in world sugar markets and therefore constituted a threat of serious prejudice in terms of Article XVI:1” does not clarify any standard to distinguish subsidies that threaten serious prejudice from those that do not since any subsidy that has some production effect could be deemed to “constitute[] a permanent source of uncertainty.” See GATT Panel Report, *EC – Sugar Exports II(Brazil)*, L/5011, 27S/69, part V(g).

¹³³Brazil’s Further Submission, paras. 296-97.

(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

197. Given the way in which Brazil structured its answer, the United States directs the Panel's attention to its comment on Brazil's answer to question 257(a)(ii). We do note, however, that Brazil has not commented on or rebutted that portion of the U.S. oral statement referred to in the Panel's question. There, we pointed out that Brazil had asserted that in either of two price circumstances, the United States is required to act in a manner inconsistent with U.S. WTO obligations. The first price circumstance is that "both USDA's and FAPRI's baseline expect marketing loan and counter-cyclical payments to be made during the lifespan of the 2002 FSRI Act, i.e., through MY 2007. Thus, the circumstances that will exist during the lifespan of the 2002 FSRI Act are such that all of the five mandatory subsidies will be paid until MY 2007 and that they will threaten to cause serious prejudice."¹³⁴ Brazil avoids discussing the fact that market price developments during marketing year 2003 have already superseded this analysis by Brazil.

198. The second price circumstance Brazil posits is when prices are sufficiently high that only direct payments and crop insurance payments are made. Brazil has provided no analysis of the estimated effects of direct payments and crop insurance payments at such high market price levels – that is, its economic analysis is made using baseline prices that are *not* sufficiently high that only direct payments and crop insurance payments are made. Neither has Brazil responded to this criticism.

(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

199. As explained in the U.S. answer to question 257(d), 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. 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. Since there is no dispute that the cited legal and regulatory provisions are "measures," the "normative" character of those measures is not at issue. Indeed, Brazil recognizes this in stating that, "[a]s used by the Appellate Body, the term 'normative' includes as a subcategory the group of measures that are mandatory, within the meaning of the

¹³⁴Brazil's Further Submission, para. 430.

traditional mandatory/discretionary distinction.”¹³⁵ In other words, “normative” measures may or may not mandate a WTO-breach, as analyzed based on the “traditional mandatory / discretionary distinction.”

200. Brazil further notes correctly that “[t]he focus for deciding whether a measure is mandatory or discretionary is on whether it provides government officials with the discretion to implement the measure in a WTO-consistent manner.”¹³⁶ However, discretion is only one reason why a measure may not be found to mandate a breach of a WTO obligation. Here, Brazil’s challenge is fact-dependent. There is no basis for presuming the existence of a particular set of facts, and hence no basis for presuming that measures mandate a breach of WTO obligations. Brazil erroneously denies the relevance of the conditions attached to payments.¹³⁷ For example, if, when those conditions are met, only *some* of the elements which establish a breach have been shown to exist, then there is no breach.

201. The United States has explained that, given the existence of certain conditions (for example, in the case of marketing loan payments, an adjusted world price less than 52 cents per pound), the five sets of measures Brazil challenges on a *per se* basis would mandate that payments be made. However, as set out in the U.S. comment on Brazil’s answer to question 257(a)(ii), these measures do not mandate any inconsistency with the obligation not to cause serious prejudice because payment alone is not sufficient to establish a breach of the obligation. Even if all the conditions mandating payment have been met, one cannot simply presume that serious prejudice will result; it must also be demonstrated that the effect of the subsidy is one or more of the effects listed in Article 6.3 of the Subsidies Agreement and that serious prejudice results from such effect(s). Moreover, it cannot be disregarded that when those conditions have not been met, those payments will *not* be made and therefore cannot cause serious prejudice.

(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

202. With respect to Brazil’s arguments relating to its threat of serious prejudice claims, the United States refers the Panel to its comment on Brazil’s answer to question 257(a)(ii). We do find it revealing that, as in its further rebuttal submission and its statements at the second panel meeting, Brazil makes no reference to the “clearly foreseen and imminent” standard it set forth in its further submission.¹³⁸ The absence is even more striking when one considers Brazil’s

¹³⁵Brazil’s Answer to Question 257(b), para. 24.

¹³⁶Brazil’s Answer to Question 257(b), para. 27.

¹³⁷Brazil’s Answer to Question 257(b), para. 29.

¹³⁸See, e.g., Brazil’s Further Submission, para. 292 (“Prior to addressing the specifics of these three claims, Brazil sets forth two legal standards that could be used to analyze the threat of serious prejudice. The first is the standard established by the GATT Panels in *EC – Sugar Exports I (Australia)* and *EC – Sugar Exports II (Brazil)* of a “permanent source of uncertainty” requiring a demonstration that guaranteed subsidies by a large exporter have no

argument that, “[h]aving established the existence of present serious prejudice from the actionable subsidies, demonstrating that such prejudice is ‘clearly foreseen and imminent’ from the effects of the same and even larger subsidies is not difficult.”¹³⁹

203. We would suggest that to argue that “such prejudice is ‘clearly foreseen and imminent’” became much more difficult for Brazil as upland cotton prices recovered over the course of marketing year 2003. That is, the increase in prices had the simultaneous effect of reducing current outlays (for example, no marketing loan payments have been made since September and projected counter-cyclical payments have been reduced by two-thirds) and invalidating Brazil’s (flawed) economic analysis for marketing years 2003-2007, which was based on an outdated FAPRI baseline projection that understates the MY2003 AWP by 54 percent and overstates the estimated marketing loan gain by nearly 15 cents per pound (or 100 percent). The 5-year high prices reached in marketing year 2003, and the high futures prices for the remainder of marketing years 2003 and for the marketing year 2004 crop, also severely undercut Brazil’s rhetorical linking of the large amount of outlays in past marketing years with the extremely low prices experienced.

- That is, if U.S. subsidies caused “significant price suppression” in marketing years 1999-2001, and Brazil claims that support under the 2002 Act has “*significantly increased*” from those levels,¹⁴⁰ then how can prices have rebounded to 5-year highs?

Thus, Brazil has good reason not to focus the Panel’s attention on actual market developments,¹⁴¹ which demonstrate that there is no “clearly foreseen and imminent” likelihood of future serious prejudice. To the contrary, there is a clearly foreseen and imminent likelihood of record cotton plantings in Brazil¹⁴² and of continued high cotton prices in marketing year 2004.

204. With respect to Brazil’s arguments relating to the export credit guarantee programs, the United States refers the Panel to its comment on Brazil’s answer to question 257(a)(i). In addition to those observations, the United States further notes that Brazil has not explained why

effective production or export limitations. The second standard includes the same elements necessary to demonstrate present serious prejudice focusing on the likely effects of the subsidies in suppressing world prices and in increasing and maintaining a high level of world export market share.”).

¹³⁹Brazil’s Further Submission, para. 308.

¹⁴⁰See Brazil’s Further Submission, para. 309 (“The 2002 FSRI Act, along with the 2000 ARP Act, create a legal structure guaranteeing and mandating the payment of *significantly increased levels of spending* for the production, use and export of U.S. upland cotton beyond the 1996 FAIR Act and special appropriation bills in 1998-2001.”) (emphasis added).

¹⁴¹See Brazil’s Further Submission, para. 308 (“The evidence presented by Brazil below is based on facts regarding the mandated and unlimited nature of the U.S. subsidies, as well as on actual market conditions demonstrating the present and likely future effects of the U.S. subsidies.”). As the Panel will have noted, subsequent to Brazil’s further submission, Brazil focused on the first half of this passage and sought to minimize the latter half.

¹⁴²Exhibit US-131 (“Brazil’s Mato Grosso to triple winter cotton area,” Reuters, 2004-01-20 (“Increased winter cotton planting will result in a record overall area.”)).

premium rates at any particular level, let alone if they were significantly increased to the one percent rate of GSM-102, will *necessarily* not be sufficient to cover long-term operating costs and losses. The United States has numerous mechanisms, such as evaluation of creditworthiness of particular countries and the establishment of individual bank limits, to insulate itself from “credit risks and meet costs.”¹⁴³ Brazil does not suggest a “magic bullet” rate that would under *all* circumstances necessarily cover long-term operating costs and losses because it cannot, nor does it explain why the flexibility inherent in the operation of the export credit guarantee program is necessarily less effective than some unknown rate.

205. With respect to Brazil’s threat of circumvention claim against the CCC programs “as such,” this claim cannot stand. Assuming *arguendo* that Article 10.2 of the Agreement on Agriculture contrary to its terms did not obligate Members to work towards internationally agreed disciplines on export credit guarantees and thereafter provide export credits only in conformity with such disciplines, then the only way to judge whether the export credit guarantee programs provide an export subsidy – and hence either circumvent U.S. export subsidy reduction commitments or threaten to – is to look to item (j) of the Illustrative List. Under item (j), the relevant inquiry examines whether premiums are sufficient to cover long-term *operating* costs and losses. That is, it is the operating experience of the programs that would matter. Thus, the programs “as such” could not threaten circumvention.

206. Brazil argues in paragraph 39 that the export credit guarantee programs themselves “confer ‘benefits’ *per se*.” The United States has previously noted Article 10.2 provides the appropriate analysis for claims against export credit guarantee programs for agricultural products. Were the Subsidies Agreement relevant to such programs, the relevant test would be that of item(j) of the Illustrative List of Export Subsidies; the United States has shown that the export credit guarantee programs meet that test. Further, we would note that Brazil has not demonstrated that any benefit is conferred by these programs; in fact, Brazil has conceded that it “is not in a position to quantify the benefit to the recipients that has arisen from the application of the GSM 102 export credit guarantee program to exports of U.S. upland cotton between MY 1999-2002.”¹⁴⁴ Neither has Brazil attempted to quantify any alleged benefit to recipients of export credit guarantees for any other agricultural products. Thus, Brazil may not obtain findings under Articles 1.1 and 3.1(a) of the Subsidies Agreement by virtue of Articles 10.2 and 21.2 of the Agreement on Agriculture, nor has Brazil established any *per se* inconsistency with Article 1.1 and 3.1(a).

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

¹⁴³Brazil’s Answer to Question 257(c) (20 January 2004), para. 40.

¹⁴⁴Brazil’s Answer to Question 140, para. 82.

207. The Panel's question highlights Brazil's failure to provide its methodology prior to this late stage of the proceedings. The United States is gratified that the Panel's question has finally compelled Brazil to come forward and explain its methodology for allocating decoupled income support payments. Brazil states that it "appreciates the opportunity to describe to the Panel" this methodology, but Brazil needed no invitation to do so. In fact, as the complaining party alleging that certain decoupled income support payments are support to upland cotton for purposes of Article 13(b)(ii) of the Agreement on Agriculture and actionable subsidies for purposes of Articles 1, 5(c), 6.3, and 7 of the Subsidies Agreement, it has always been Brazil's burden to make claims and arguments with respect to these measures. Rather, Brazil's answer demonstrates that Brazil's proposed methodology lacks any basis in the Subsidies Agreement, any WTO agreement, or in economic logic. Thus, the Panel should find that Brazil has not made a *prima facie* case of WTO inconsistency with respect to these measures.

208. Furthermore, Brazil's response demonstrates that it is attempting to add new measures to its claims in this proceeding, an attempt that is inconsistent with the Panel's terms of reference. Payments for programs other than upland cotton are not within the terms of reference and are to be excluded from Brazil's claims. Brazil cannot now alter the terms of reference to add programs for base acreage for other crops. As Brazil itself has admitted (in its response to question 247): "Thus, the 'matter' before the Panel has not changed (*and cannot*) since the establishment of the Panel" (emphasis added).

Brazil's Proposed Methodology is not Based on Any Text, Nor Does It Adequately Deal with Fundamental Subsidies Issues

209. By way of introduction, we recall the proper approach to attributing a non-tied (or decoupled) subsidy to particular products. The United States has explained that a complaining party in a serious prejudice dispute must demonstrate which product or products benefit from the challenged subsidy.¹⁴⁵ This requirement flows from several sources. First, Article 6.3 and provisions explaining it specifically identify certain effects – for example, displacement or impediment, significant price undercutting, suppression, or depression, and increase in world market share) – caused through a "subsidized product."¹⁴⁶ Thus, to determine whether "the effect of the subsidy" is one of those listed in Article 6.3 requires a finding that upland cotton is a "subsidized product" with respect to that subsidy.

¹⁴⁵See, e.g., U.S. Further Rebuttal Submission, paras. 6-17.

¹⁴⁶For example, for purposes of a claim under Article 6.3(c) of the Subsidies Agreement, the "effect of the subsidy" must be "significant price undercutting" or "significant price suppression, price depression, or lost sales" caused by "*the subsidized product*." Article 6.5 confirms that price undercutting includes "any case in which such price undercutting has been demonstrated through a comparison of prices of the *subsidized product* with prices of a non-subsidized like product supplied to the same market." Similarly, under Article 6.3(d) "the effect of the subsidy" must be an increase in world market share "in a particular *subsidized primary product or commodity*." Finally, under Articles 6.4 and 6.3(b), pursuant to which Brazil is not claiming serious prejudice, the "change in relevant market shares" involves an examination of the "relative shares of the market" of the non-subsidized like product and "*the subsidized product*."

210. Second, a “subsidy” does not exist within the meaning of Article 1 of the Subsidies Agreement if a “benefit” is not conferred.¹⁴⁷ As Brazil is asserting the existence of serious prejudice with respect to upland cotton, the challenged subsidy must actually “benefit” cotton and not any other crop.

211. With respect to decoupled income support, a recipient need not produce upland cotton in order to receive payment. In fact, the recipient need not produce anything at all – hence, the support is “decoupled” from production requirements. Since decoupled income support payments do not, on their face, provide a “benefit” to upland cotton, the question of what products benefit from the subsidy arises.

212. Brazil now answers this question by inventing a methodology by which “excess” base acres – that is, base acres of a crop historically grown on the farm in excess of the planted acres of that crop in a given year – are allocated to other crops with “excess” planted acres (but only if they are “program crops”) – that is, planted acres in excess of the base acres of that crop historically grown on the farm. It is ironic to recall that Brazil criticized the U.S. approach to this issue by writing that the “alleged requirement” to allocate untied subsidies across the total value of production on a recipient’s farm “lacks any textual basis.”¹⁴⁸

- In fact, the Panel will search Brazil’s answer to question 258 in vain for a *single citation* to a WTO provision that sets out or even indirectly supports its proposed allocation methodology.

213. The methodology explained by the United States, on the other hand, is rooted in the text and context of the Subsidies Agreement. As set out above, to establish that the effect of a subsidy is serious prejudice with respect to upland cotton, Brazil must identify the subsidized products – that is, the products that benefit from the payment and the portion of those payments that benefit upland cotton. Annex IV provides useful context in its methodology for calculating an *ad valorem* subsidization rate. An *ad valorem* subsidy rate is the quotient of a numerator (subsidy amount) and a denominator (value of the subsidized product). Thus, to perform the calculation, one must know what the subsidized product is.

- Paragraph 2 of Annex IV provides that “*the value of the product* shall be calculated as the *total value of the recipient firm’s sales* in the most recent 12-month period, for which

¹⁴⁷See Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/R, adopted 7 June 2000, paras. 6.65 and 6.66 (quoting and agreeing with *Canada – Aircraft* panel: “A “benefit” does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a “benefit” can be said to arise only if a person . . . has in fact received something.””).

¹⁴⁸Brazil’s Further Rebuttal Submission, para. 103.

sales data is available, preceding the period in which the subsidy is granted” (footnotes omitted & italics added).

- Paragraph 3 of Annex IV modifies the general principle of paragraph 2, providing that “[w]here the subsidy is *tied to the production or sale of a given product*, the value of the product shall be calculated as the *total value of the recipient firm’s sales of that product* in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted” (italics added).

Thus, “[w]here the subsidy is [not] tied to the production or sale of a given product,” the general methodology of paragraph 2 applies. Because the “value of the [subsidized] product” is the “total value of the recipient firm’s sales,” it follows that the subsidized product is the entirety of what the recipient sells. To determine the share of the subsidy that is attributable to upland cotton, one would multiply the value of the payment by the share of the total value of production accounted for by upland cotton. Brazil does not deny that both the EC and Brazil apply this very methodology for purposes of their domestic countervailing duty procedures,¹⁴⁹ nor that Brazil has proposed that Members adopt this very methodology as a “guideline” on calculating the amount of the subsidy.¹⁵⁰

214. Brazil can only assert that the allocation methodology set out in Annex IV of the Subsidies Agreement and applied by Brazil itself and the EC for purposes of their countervailing duty procedures “are irrelevant to Article 6.3 claims.”¹⁵¹ And yet, *some* allocation methodology for purposes of Article 6.3 is necessary to deal with non-tied (decoupled) payments – to assert otherwise is to deny the relevance of the “subsidy” definition of Article 1 as well as those provisions of Article 6 contingent on the existence of a “subsidized product.” However, Brazil’s proposed methodology is not even based on a Subsidies Agreement text, nor based on *its own* procedures for determining the subsidized product that benefits from a non-tied (decoupled) payment. One could reasonably ask how Brazil’s own countervailing duty procedures could deal with non-tied subsidies in one way while Brazil proposes a contradictory approach for purposes of its serious prejudice claims, given that both situations are faced with the same issues of whether a subsidy benefits a particular product.

215. In judging the credibility of Brazil’s proposed methodology in comparison to the methodology explained by the United States, the Panel may wish to compare the sources that Brazil and the United States, respectively, have drawn upon:

¹⁴⁹See Brazil’s Opening Oral Statement at the Second Panel Meeting, para. 4.

¹⁵⁰Paper 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.”).

¹⁵¹Brazil’s Opening Statement at the Second Panel Meeting, para. 4.

Comparison of Allocation Methodologies for Non-Tied (Decoupled) Payments		
Party	Methodology	Interpretive and Other Sources
Brazil	Payments for base acres for historically grown crop are attributed to current plantings of that crop, if any; payments for base acres in excess of plantings are attributed to all crops planted in excess of base acres for that historically grown crop by the proportion of a crop's excess planted acres to total excess planted acres	None ¹⁵²
United States	Payments that are not tied to the production or sale of a given product are attributed to all the products the recipient produces; the subsidy benefits a particular product by its share of the total value of production	SCM Agreement, Article 1.1(a); Articles 6.3, 6.4, 6.5; Annex IV, paras. 2-3 CVD practice, Brazil and EC Brazilian CVD proposal ¹⁵³

Simply put, Brazil has pointed to nothing in the WTO agreements that would support its approach to the allocation of non-tied (decoupled) payments.

216. Finally, Brazil's argument that the Annex IV methodology *cannot* apply to claims of serious prejudice does not withstand scrutiny. Although the provision to which Annex IV relates – Article 6.1(a) – is no longer in effect, it may still be relevant for purposes of interpreting the Subsidies Agreement. For example, in *United States – Countervailing Measures (EC)*, the Appellate Body relied on Annex IV as context in interpreting another provision of the Subsidies Agreement.¹⁵⁴ 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.”¹⁵⁵

217. There is a difference between looking to the expired provisions of Article 6.1 for a legal obligation (for example, the presumption created by a 5 percent *ad valorem* subsidization rate) and looking to the provisions of Annex IV for a methodology, or logical approach to identifying the subsidized product. In the former case, it is precisely the expiry of the provision that indicates that the presumption created by that rule no longer has effect. In the latter case, unless there is some basis to draw a negative implication from the expiry of the rule in Article 6.1, the methodology can be examined for its underlying logic. If the methodology fits with pertinent subsidies concepts, it may provide useful guidance in determining the product that benefits from the subsidy. In this regard, we note Brazil's statement that the Annex IV methodology existed only because “[n]egotiators wanted to be certain that if such a presumption [of serious prejudice] was created [by virtue of Article 6.1(a)], the precise *level* of subsidization was carefully

¹⁵²See Brazil's Answer to Question 258, paras. 43-55.

¹⁵³U.S. Further Rebuttal Submission, paras. 9-13.

¹⁵⁴WT/DS212/AB/R, para. 112.

¹⁵⁵WT/DS108/ARB, note 56.

calculated.”¹⁵⁶ To the extent that the Panel agrees that it must “be certain” that the non-tied subsidies at issue benefit upland cotton and that “the precise level of subsidization [must be] carefully calculated,” we suggest that Annex IV provides the appropriate methodology.

Brazil's Allocation Methodology Does Not Make Economic Sense

218. The foregoing discussion suffices to show that Brazil's allocation methodology has no basis in the Subsidies Agreement. As Brazil has not demonstrated, for each challenged decoupled payment (production flexibility contract, market loss assistance, direct, and counter-cyclical payments), what is the subsidized product nor what is the benefit to upland cotton, Brazil cannot and has not made a *prima facie* case with respect to these payments. That is, Brazil cannot begin to demonstrate “the effect of the subsidy” if it has not shown the subsidy benefit and the subsidized product.

219. It may be of interest to the Panel, however, that Brazil's allocation methodology does not make economic sense. In essence, Brazil's approach arbitrarily assigns payments for base acreage to particular planted acres, as if the current crop was “planted on” base acreage, even though “base acres” do not correspond to any physical acres on a farm; they are a mere accounting concept. At the same time, however, any “excess” base acres are assigned to crops that have “excess” planted acres. This methodology leads to situations in which a particular crop could be subsidized at different rates, depending on whether it is planted on “excess” acreage or base acreage. It leads to situations in which a particular crop could receive a greater subsidy than another crop that accounts for more acreage on the farm. It also allocates payments only to certain “program” crops, ignoring the fact that the subsidy recipient may grow crops for which no base acreage exists and may engage in other types of production. Neither situation makes sense from an economic perspective, and neither results from the correct (Annex IV) methodology explained above.

220. The first situation is one in which a particular crop, such as upland cotton, could be subsidized at different rates, depending on what type of acreage it is “planted on.” For example, consider a farm with 200 base acres, 100 of cotton and 100 of soybeans, and 200 planted acres, 150 of cotton and 50 of soybeans. According to Brazil's proposed methodology, 100 base acres of cotton are allocated to 100 acres of planted cotton, leaving 50 planted acres of cotton; similarly, the 50 of the 100 base acres of soybeans are allocated to the 50 base acres of soybeans, leaving 50 “excess” soy base acres that can be allocated to the 50 “excess” cotton planted acres. However, this allocation methodology results in two different rates of subsidization for cotton acreage. The 100 cotton acres deemed to be “planted on” cotton base acreage is subsidized at the rate corresponding to decoupled payments for upland cotton base acres while the 50 cotton acres deemed to be “planted on” soy base acreage is subsidized at the rate corresponding to decoupled

¹⁵⁶Brazil's Further Rebuttal Submission, para. 103.

payments for soy base acres.¹⁵⁷ There is no rationale for deeming one acre of cotton to receive one subsidy and deeming the next acre of cotton to receive an entirely different subsidy. These decoupled payments are not tied to production of a particular commodity; in fact, the “upland cotton” base acreage could now be “planted to” soybeans or nothing at all. In economic terms, money is fungible, and payments received through decoupled payments are deemed to subsidize whatever the recipient chooses to produce. As all of the recipient’s production is the “subsidized product,” the subsidy should be neutrally allocated to all of those products.

221. The second situation is one in which a particular crop that is with “excess” plantings could receive a greater subsidy than another crop that accounts for more acreage on the farm. For example, consider a farm with 200 base acres of soybeans and none of cotton and with 75 planted acres of cotton and 50 planted acres of soybeans. Seventy-five base acres of soybeans are attributed to the 75 planted acres of soybeans, and “[p]ayments on any further base acreage for [that] program crop[is] allocated to the crops for which planted acres exceed base acres.”¹⁵⁸ Since cotton is the only crop “for which planted acres exceed base acres, payments for 125 base acres of soybeans are allocated the 50 acres of cotton.¹⁵⁹ This produces the anomalous result that the lesser planted crop (upland cotton, with 50 planted acres) would be deemed to receive a greater subsidy than the crop with greater planted acreage (soybeans, with 75 planted acres). If the same farm decided to plant 75 acres of soybeans and only *one* acre of cotton, again, all of the “excess” base acres would be allocated to the one acre of cotton. Again, this result makes no economic sense since the farm “allocated” its plantings 75 to 1, soy over cotton. The allocation of payments not tied to production of a particular commodity should reflect the recipient’s decisions on what production to undertake.

222. Brazil’s erroneous methodology also allocates payments only to certain “program” crops, for which base acreage exists.¹⁶⁰ This ignores the fact that the subsidy recipient may grow crops for which no base acreage exists and may engage in other types of production. A farmer’s activities and plantings are not restricted to “program” crops. In the production flexibility contract era, farmers who planted cotton did not just plant wheat, oats, rice, corn, sorghum, and barley. They also planted other crops, like peanuts, sugar, soybeans, and perhaps tobacco. They may have also planted fruits and vegetables on any acreage exceeding their base acreage. They may have produced hay or had livestock operations on the farm. The possibilities are numerous. Given the myriad production activities that a payment recipient could (and did) choose to

¹⁵⁷See, e.g., Brazil’s Answer to Question 258, para. 48 (Sample Farm 4: 160 planted acres of cotton are allocated 100 base acres of cotton and 60 base acres of rice).

¹⁵⁸Brazil’s Answer to Question 258, para. 48.

¹⁵⁹See, e.g., Brazil’s Answer to Question 258, para. 51 (Sample Farm 5: 140 planted acres of cotton are allocated payments for 160 base acres (100 cotton, 40 wheat, 20 rice)).

¹⁶⁰See, e.g., Brazil’s Answer to Question 258, para. 50 (“In Brazil’s methodology, payments available for allocation – i.e., not allocated to the program crop itself – are pooled and allocated proportionally to the remaining program crop acreage.”).

undertake, there is no basis to allocate non-tied (decoupled) payments solely to program crops and not to the entirety of a farm's production.

223. In sum, these illogical results follow from a methodology in which payments on "excess" base acreage are allocated only to those crops for which plantings "exceed" their base. If Brazil believes a decoupled payment is capable of allocation when base acreage "exceeds" planted acreage, Brazil must concede that the payment is not tied to production, use, or sale of particular commodity. However, the same consideration must apply to those payments with respect to base acreage for which there is an equal amount of planted acres – that is, those legally indistinguishable payments on "non-excess" base acres are not tied to production, use, or sale of a particular commodity either. Thus, one, consistent allocation methodology must apply to the entire amount of a recipient's decoupled payments. Brazil's erroneous allocation methodology does not provide that. The methodology set out in Annex IV and also applied by Brazil for purposes of its countervailing duty procedures under Part V of the Subsidies Agreement does.

Implications of Brazil's Erroneous Methodology for Subsidies Claims and Peace Clause

224. As Brazil's answer makes perfectly clear, and as it had previously stated,¹⁶¹ Brazil rejects the allocation methodology for non-tied (decoupled) payments suggested, *inter alia*, by Annex IV to the Subsidies Agreement. That is, Brazil has refused to acknowledge that such payments must be allocated across the total value of the recipient's production. Therefore, as the United States suggested in its answer to question 256, Brazil has not advanced claims and arguments that would allow the Panel to determine the subsidy benefit to upland cotton. It follows that Brazil has failed to make a *prima facie* case that decoupled income support payments cause or threaten to cause serious prejudice.

225. Brazil's refusal to adopt a proper methodology for determining the subsidy benefit and subsidized product also has important implications for its Peace Clause arguments. The Panel will recall that Brazil argued that "support to a specific commodity" in the Peace Clause proviso could only be gauged by using budgetary outlays. However, calculating the subsidy benefit to upland cotton is indispensable – on Brazil's approach – to determining the "support to" upland cotton. To the extent that Brazil has not utilized the correct methodology, its Peace Clause calculation of the support to upland cotton from decoupled payments is erroneous.

226. In addition, the fact that Brazil seeks to attribute upland cotton decoupled payments made for "excess" base acres is an important point. Brazil acknowledges that these decoupled payments are not tied to production, and therefore can be attributed across production. Our difficulty with Brazil's approach, is that it claims the attribution is only made to crops with "excess" acreage. As explained above, there is no basis for attributing part of a payment to only

¹⁶¹Brazil's Further Rebuttal Submission, paras. 103-05; Brazil's Opening Statement at the Second Panel Meeting, para. 4.

some crops planted on the farm, rather than attributing the entire value of such payments across all production. Thus, Brazil has not established that U.S. domestic support measures breach the Peace Clause, and the U.S. domestic support measures are entitled to Peace Clause protection.

227. Brazil's answer also highlights that decoupled income support payments do not grant "support to a specific commodity" within the meaning of Article 13(b)(ii). Brazil has asserted that such support can be any support that benefits upland cotton. Thus, Brazil would seek to allocate decoupled payments to the products on the farm as set out in its methodology. However, Brazil's approach is incompatible with important Agreement on Agriculture concepts. As is clear from Brazil's answer, a payment made with respect to base acreage historically planted to one crop can be support to that crop *and* support to any other "program" crop at the same time. Such a result is inconsistent on its face with the ordinary meaning of "support to a specific commodity" since such a payment would in fact be 'support to multiple commodities.'

228. In addition, Brazil's approach would render nugatory non-product-specific support for purposes of the Peace Clause. Brazil has argued that the decoupled income support payments it challenges are not non-product-specific support because they are not support to producers "in general." And yet, the recipients of decoupled payments *are* producers "in general" because they are free, with limited exceptions, to plant any commodity and are free, without exception, to undertake other agricultural activities. Thus, they are producers generally of whatever products they choose to produce. By asserting that the allocation of such non-product-specific support to the commodities a recipient produces renders such payments "support to a specific commodity," Brazil reads non-product-specific support out of the scope of the Peace Clause. If non-product-specific support could simply be allocated to a recipient's production and thereby become support to each specific commodity produced, there would simply be no reason to have a category of non-product-specific support in the Agreement on Agriculture.

229. In fact, the Agreement on Agriculture does not permit an interpretation that would allocate all non-product-specific support to specific commodities. First, the precise definition of product-specific support in Article 1(f) ensures that support that is *not* "provided for an agricultural product in favour of the producers of the basic agricultural product" must be categorized as non-product-specific ("support provided in favour of agricultural producers in general"). Second, paragraph 1 of Annex 3 establishes that non-product-specific support must be kept separate from product-specific support for purposes of AMS calculation.¹⁶² Brazil has stated that "support to a specific commodity" under the Peace Clause may be measured either using budgetary outlays or an "AMS-like methodology using rules in Annex 3."¹⁶³ Therefore, since Annex 3 specifically provides that non-product-specific support must be kept separate from product-specific support, non-product-specific support must also be kept separate from "support to a specific commodity" for purposes of the Peace Clause analysis. Brazil may not allocate non-

¹⁶²Agreement on Agriculture, Annex 3, para. 1 ("Support which is non-product-specific shall be totalled into one non-product-specific AMS in total monetary terms.").

¹⁶³Brazil's Rebuttal Submission, para. 87.

product-specific decoupled payments to certain products for Subsidies Agreement purposes and then, on that basis, assert that such allocated payments are “support to a specific commodity” for Peace Clause purposes. The product-specific / non-product-specific categories in the Agreement on Agriculture are *sui generis* and may not be rendered inutile by the application of Subsidies Agreement concepts (subsidy, benefit, subsidized product) not used in nor directly applicable to the Peace Clause.

List of Exhibits

- US-131 Brazil's Mato Grosso to triple winter cotton area 2004-01-20 20:10:01 GMT (Reuters),
By Inae Riveras
- US-132 Chart, US Crops Cotton supply and utilization, and Baseline
- US-133 Statement By O A Cleveland 1/16/04
- US-134 Charts of U.S. and Brazilian Export Unit Values to 7 Destinations
- US-135 Production, Yield, Trade, and Stocks Data, MY99-02
- US-136 USDA/FAS U.S. trade data, MY99-03
- US-137 World Trade Atlas official Brazilian trade data, MY99-03
- US-138 Statement of the United States at the DSB (January 9, 2004) on adoption of the reports
in *United States- Sunset Review of Anti-Dumping Duties on Corrosion-Resistant
Carbon Steel Flat Products for Japan*
- US-139 USDA Weekly Cotton Market Review 1/9/04
- US-140 USDA Weekly Cotton Market Review 1/23/04
- US-141 Charts of Chinese (Domestic, Import, Export) Prices vs. A-Index
- US-142 NY Board of Trade, NY Cotton Exchange, January 27, 2004 futures data