United States – Subsidies on Upland Cotton **(WT/DS267)**

Arbitration under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement

Oral Statement of the United States

March 2, 2009

I. Introduction

1. In two separate requests, Brazil has asked for authorization to impose countermeasures under the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (DSU) *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement). The United States objected to the proposed countermeasures, and thereby referred the matters to two arbitrations. After the years of the cotton dispute to date, during which the DSB was asked to determine whether certain U.S. measures were consistent or inconsistent with the WTO agreements, the Arbitrators are being asked a new question: what countermeasures is Brazil entitled to take in light of those findings.

2. We appreciate the opportunity to appear before you today to present the views of the United States with respect to this question. In short, appropriate countermeasures in this dispute should, consistent with the findings of the DSB, be measured by net cost to government for providing GSM 102 guarantees, with an adjustment so that the countermeasures will not exceed the impact of the guarantees on Brazil.

3. The U.S. approach stands in stark contrast to that of Brazil. Brazil's approach would be to sum an alleged interest rate subsidy provided by GSM 102 guarantees *and* an alleged effect on

trade. And that approach has not even remained constant in the course of this arbitration proceeding. One thing has remained constant however – Brazil has consistently overstated the countermeasures to which it is entitled, by failing to respect the DSB findings in this dispute, by presenting erroneous explanations of the applicable legal standards, and by disregarding the approaches of other arbitrators, including in proceedings to which Brazil was a party.

4. The United States has in its submission and answers to questions demonstrated that the countermeasures on both prohibited and actionable subsidies advanced by Brazil in this proceeding cannot be justified under the appropriate legal standards. We will turn to Brazil's proposed actionable subsidies countermeasures tomorrow. Today, our statement will focus on GSM 102, on which Brazil continues to assert wildly inflated and inappropriate levels as "appropriate." We will also address Step 2, to affirm that it no longer exists and therefore is not even properly a subject of this arbitration any more. In this statement, we will again demonstrate how the proposed countermeasures are not "appropriate."

5. Before we turn to that, it's worth taking a step back and recalling the history of Brazil's request. Brazil in July 2005 requested authorization from the DSB to impose approximately $3 billion in countermeasures in respect of GSM 102 and in respect of Step 2. The United States objected to that request, referring the matter to arbitration. Had the United States not done so, the DSB would have would have authorized by negative consensus the request that Brazil said totaled approximately $3 billion. But in this proceeding, Brazil has clarified that, with respect to GSM 102, in its view only countermeasures applied to a formula presented in its methodology

paper, but not its DSB request, which would result in $1.2 billion in countermeasures is "appropriate." That is, its initial request to the DSB was vastly overstated, and when Brazil had to detail in its methodology paper how it explained a request that would have resulted in approximately $3 billion in countermeasures, Brazil no longer asserted that the countermeasures should correspond "to the total of exporter applications received under GSM 102, GSM 103, and SCGP for the most recent concluded fiscal year" – as it had set out in its DSB request. Rather, it revealed that it could only construct a methodology to support only about one-third what it first requested.

6. We, of course, welcome Brazil's recognition that the U.S. objection was correct and that the original $3 billion request was not well-founded. On that basis alone, the U.S. has already carried its burden of showing that Brazil's request to the DSB is not "appropriate," and consistent with past arbitrations the arbitrator will have to determine the correct amount.

7. But even Brazil revised figures of $1.2 or $1.1 billion are grossly in error and continue the exaggeration of the initial amount requested. In this statement, we will detail how Brazil's calculation of each component of this standard is inflated, cannot be reconciled with the appropriate legal standard, and has no relation to the DSB's findings and pertinent facts.

8. And similarly, Brazil's approach on Step 2– that it is entitled to impose countermeasures equal to the amount of the subsidy even though Step 2 was repealed more than two and one-half years ago -- is another effort to produce an exaggerated result. We are struck by the fact that

under Brazil's approach, it would be entitled to authorization from the DSB to impose these countermeasures in perpetuity – that is, even if Brazil had waited 5 or 10 or more years to reactivate the arbitration, it could still argue that it should be granted authorization for a "one-time" set of countermeasures. Such an approach cannot ensure that authorized countermeasures are "appropriate."

9. And with respect to cross-retaliation, Brazil in this arbitration makes the previously unheard-of suggestion that cross-retaliation in the case of countermeasures under the SCM Agreement is completely divorced from the disciplines set out in the DSU. This argument would result in Brazil evading limits on cross-retaliation that it agreed to in the DSU. As we have explained, and will explain, the argument is incorrect as a matter of law and cannot be reconciled with the text of the DSU. Moreover, the argument cannot be reconciled with Brazil's own request for authorization from the DSB, which cited to and used the terms of Article 22.3. The United States objected to that request, which forms the terms of reference for this arbitration. Thus, Brazil has attempted another argument that would distort the outcome of this arbitration.

10. The arbitrator's task would be simpler without these arguments that go well beyond the legal standards set out in the DSU and the SCM Agreement. Indeed, there is still time for Brazil to amend its arguments again so that the arbitrator can focus on the economic issues with the appropriate legal standard in hand. Until that time, however, the United States will address Brazil's arguments as they stand today.

11. This statement will proceed as follows. First, the United States will describe how "appropriate" countermeasures should be calculated in this dispute with respect to GSM 102. Then, the United States will explain why the flaws in Brazil's model with respect to decisions on "creditworthiness" and on purported marginal additionality preclude the use of the model to calculate appropriate countermeasures. Next, the United States will respond to Brazil's request regarding retrospective countermeasures for Step 2. Finally, the United States will discuss Brazil's request for cross-agreement suspension of concessions.

II. Given the Findings of the DSB, Appropriate Countermeasures for GSM 102 Must Be Based on Net Cost to Government

12. To recall, today's meeting is focused on Brazil's request for countermeasures under Article 4.10 of the SCM Agreement and Article 22.6 of the DSU. The proceedings are governed by both the DSU and the SCM Agreement, as applied to the specific facts of this dispute. Both parties agree that Article 4.10 of the SCM Agreement applies to Brazil's proposed countermeasures. This article provides the standard for the Arbitrator to assess countermeasures for GSM 102 guarantees, which is whether the proposed countermeasures are "appropriate." Footnote 9 to Article 4.10 provides further limitation on the scope of possible countermeasures, stating that countermeasures cannot be "disproportionate." Standards like the "appropriate" standard under Article 4 ensure that such countermeasures are limited.

13. Brazil's proposed countermeasures for GSM-102 total more than US$1 billion. The United States has explained, in its submission and in the responses to the questions from the

Arbitrator, that this sum far exceeds an "appropriate" amount. Even on its own terms, Brazil has conceded that its request to the DSB was not "appropriate." Brazil requested annual countermeasures that would total approximately $3 billion. But, now that Brazil has been asked to detail the basis for its request, and show what amount of countermeasures it considers appropriate in this dispute, it has reduced the amount. In effect, the question of whether Brazil's initial request to the DSB was "appropriate" has already been answered, by Brazil, in the negative. To be clear, while the United States has the burden in these proceedings to show that Brazil's request to the DSB is not "appropriate," the United States has already discharged this burden.

14. As to how the requirement that countermeasures be "appropriate" and not "disproportionate" applies in this dispute, recall the DSB findings in the compliance panel. The DSB found that GSM 102 guarantees provided after July 1, 2005 were provided at premia that were inadequate to cover the long-term operating costs and losses of the program, and therefore, under the terms of item (j) of the Illustrative list of Export Subsidies, these guarantees were a prohibited export subsidy under Article 4 of the SCM Agreement. The DSB, in the original proceeding, used a test of "net cost to government" in order to determine whether GSM 102 guarantees were a prohibited export subsidy under the terms of item(j) of the Illustrative List of Export Subsidies.

15. In fact, both the original panel and the compliance panel specifically refused to reach Brazil's alternative theory that there was a subsidy under Articles 1.1 and 3.1(a) of the SCM

Agreement, namely a financial contribution that provided a benefit and was contingent on export performance. As such, the appropriate countermeasures are those based on the net cost to the U.S. government. Any other countermeasures do not have their foundation in the specific DSB recommendations and rulings of this case. Recall the practice of past arbitrators of applying a "counterfactual" to contrast the situation without compliance with the situation with compliance. Here, the counterfactual should be based on the item (j) net cost findings of the DSB.

16. Accordingly, the United States has presented the most recent data, as published in the annual U.S. Government Budget appendices and Federal Credit Supplement, including those for fiscal year 2009, showing subsidy estimates net of re-estimates for the GSM 102 export credit guarantee program for each of the 2005, 2006, and 2007 fiscal year cohorts.[1]

17. Brazil dismissively responds that "the time to entertain U.S. assertions that the 'GSM 102 program, as modified on July 1, 2005, operates at no net cost to government' is well past.[2]

18. With respect, as the Arbitrator is charged with evaluating Brazil's request for countermeasures of $1.155 billion, the United States believes submission of the most recent U.S. budget data is appropriate for consideration, particularly as item (j) formed the exclusive basis for a finding of export subsidy under the GSM 102 program.

[1] U.S. Submission, para. 47, Table 1.

[2] Brazil Response to Arbitrator Question 18, para. 246.

19. Brazil also attempts to substantively dismiss the significance of such re-estimates, but in so doing Brazil flatly contradicts the Appellate Body when it asserts that "initial projections calculated on a net present value basis are a more appropriate way to assess certain long-term costs."[3] The Arbitrator will recall that Brazil argued before the Appellate Body, as here, that "re-estimates have serious limitations because they merely reflect one possible outcome (in this case, profits), whereas the initial estimates reflect an evaluation of all possible outcomes regarding the programmes' financial performance."[4] The Appellate Body rejected this approach: "[R]e-estimates show a consistent downward trend in the estimated costs of the export credit guarantee programmes, thus calling into question the reliability of the initial estimates for purposes of evaluating the programme's 'long-term operating costs and losses.'"[5]

20. Brazil acknowledges that initial projections would be "unreliable if the methodology used to generate them suffered from some flaw, for example by overstating the risk of default as compared with actual experience."[6] As the United States has explained, the initial estimate methodology under FCRA, as applied to GSM 102 guarantees suffers from such a flaw.[7]

21. Brazil similarly ignores the Appellate Body when it asserts that "netting subsequent

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[3] Brazil Response to Question 17, para. 214

[4] *US-Upland Cotton (21.5)(AB)*, para. 297.

[5] *US-Upland Cotton (21.5)(AB)*, para. 298.

[6] Brazil Response to Arbitrator's Question 17, para. 222, fn. 166.

[7] *See,* U.S. Response to Arbitrator's Question 47, paras. 84-87

FCRA re-estimates against initial FCRA projections is not a valid means of assessing costs."[8]

22. To the contrary, the Appellate Body observed that "if anything, the re-estimates might be expected to be more reliable [than initial estimates] because they reflect the historical performance of the programme. They also include two closed cohorts (1994 and 1995) for which the data is final. Moreover, the re-estimates data cover a longer period of time and thus provide a basis for a long-term assessment, the very question at issue under item (j)."[9] "Re-estimates 'take into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies, and recoveries, to the extent that those factors have changes since the initial estimate was made.' Consequently, re-estimates are 'revisions of the subsidy cost estimate of a cohort . . . based on information about the actual performance and or estimated changes in future cash flows of the cohort."[10]

23. After noting that "the [compliance] panel erred in its intermediate conclusion that 'the initial subsidy estimates provide a strong indication that the GSM 102 export credit guarantees are provided against premia which are inadequate to cover the long-term operating costs and losses of the GSM 102 programme,"[11] the Appellate Body stated that "we consider the re-

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[8] Brazil Response to Arbitrator's Question 17, paras. 216, 230.

[9] *US-Upland Cotton (21.5)(AB)*, para. 287

[10] *US-Upland Cotton (21.5)(AB)*, para. 281.

[11] *US-Upland Cotton (21.5)(AB)*, para. 295.

estimates data, which show better-than-expected historical performance, are an important indicator of the revised GSM 102 programme's likely future performance."[12]

24. Although Brazil recognizes that re-estimates "account for the subsequent performance of [export credit] programs,"[13] Brazil nevertheless paradoxically characterizes such re-estimates as "meaningless."[14]

25. Brazil appears to assert that in the panel and Appellate Body proceedings, item (j) of the *Illustrative List of Export Subsidies* has been interpreted to exclusively "encompass a forward-looking assessment of projected costs over the long term,"[15] with no role for a retrospective analysis of historical performance, and that the adequacy of premia under item (j) may also therefore only be examined prospectively.[16] This is simply not correct. The Appellate Body has clearly stated: "An analysis under item (j) may examine both retrospective data relating to a programme's historical performance and projections of its future performance."[17] Both the compliance panel and the original panel noted only that "the item (j) analysis need not be a

[12] *US-Upland Cotton (21.5)(AB)*, para. 299.

[13] Brazil Response to Question 17, para. 247.

[14] Brazil Response to Question 17, para. 238.

[15] Brazil Response to Question 17, para. 218

[16] Brazil Response to Question 17, para. 218

[17] *US-Upland Cotton (21.5)(AB)*, para. 278

purely retrospective one."[18]

26. Because of the specific findings of the DSB and the observations of the Appellate Body, the proper basis for examining countermeasures is the subsidy estimate net of re-estimates reflected in the United States budget.

III. Brazil's Methodology Cannot Support Appropriate Countermeasures

27. Notwithstanding the reliance of the panels on cost to government, and the availability of data to perform the calculation of net cost to government, Brazil takes an entirely different approach to measuring the amount of "appropriate" countermeasures. This billion-dollar methodology for countermeasures for GSM 102 cannot be used as a legal matter and cannot be used as a matter of economic theory.

28. As a legal matter, Brazil's approach finds no support in previous efforts to define what "appropriate" countermeasures in relation to trade effects would be. Brazil is asking for both the subsidy (measured as an interest rate subsidy) and also for trade effects that it argues are consequences of the GSM 102 program as a whole. Moreover, Brazil's methodology does not relate either the subsidy amount or the trade effects to the impact of GSM 102 on Brazil. Both components of Brazil's methodology are speculative, and should be rejected on that basis alone. But the fact that Brazil has combined two approaches to measuring subsidy makes its approach

[18] *US-Upland Cotton (Panel)*, para. 7.835*; US-Upland Cotton (21.5) (Panel)*, para. 14.55.

untenable as a basis for "appropriate" countermeasures.

29. At this point, however, we would note that Brazil's approach, again, goes well beyond previous arbitrations related to prohibited subsidies and even what Brazil itself has previously argued. For example, the *Canada – Aircraft* arbitration report records: "According to Brazil, both the *Brazil – Aircraft* and *US – FSC* arbitrations allow the Member authorized to retaliate to choose to base the level of countermeasures on either the level of the subsidy or the effect of the subsidy."[19] Here, in contradiction, Brazil seeks countermeasures based on both.

30. Separate from the legal issues with Brazil's approach, Brazil's approach must be rejected as a matter of economic theory. Brazil's calculation of the alleged interest rate subsidy is fundamentally flawed. The United States has addressed these flaws at length previously. Let me now focus on some of the most important of these flaws in terms of driving up the number in Brazil's calculation, including Brazil's attempt to deem whole classes of creditworthy obligors as being "uncreditworthy."

31. The Arbitrator will have noted that Brazil's calculation of countermeasures hinges on its choice of whether each Commodity Credit Corporation obligor is "creditworthy." For all of the supposedly "uncreditworthy" obligors, Brazil applies "full additionality," on the assumption that they could not otherwise have secured credit in the market at all. According to Brazil,"Full

[19] *Canada-Aircraft (22.6/4.11)*, para. 3.31 (italics added).

additionality is measured as the entire value of a transaction backed by GSM 102 [export credit guarantees], because in the absence of the guarantee no economic activity would have taken place." Or, in other words: the higher the number of "uncreditworthy" obligors receiving guarantees, the higher the "additionality." Brazil's methodology treats fully 85.7 percent of all CCC-approved banks - whether rated or unrated by a ratings agency - as "uncreditworthy."[20][21]

32. It is important to emphasize that this point pertains not merely to banks Brazil treats as "unrated," but to all banks that Brazil treats as "uncreditworthy." The Arbitrator will recall that the United States has supplied abundant examples of both rated and unrated banks that Brazil deems uncreditworthy[22] which have nonetheless secured credit during the very period of time Brazil identifies as "the appropriate reference period."[23]

33. Brazil's inaccurate attribution of uncreditworthiness of course also has a direct impact on its calculation of the interest rate subsidy. For any obligor with a rating inferior to 10, Brazil calculates the interest rate subsidy not on the basis of the actual credit rating but on the lowest default probability, 18, which should only be applied to truly uncreditworthy obligors.[24]

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[20] Exhibit Bra-722 lists 210 banks, of which Brazil deems 180 uncreditworthy.

[21] Brazil Methodology Paper para. 40.

[22] *See,* U.S. Submission paras 144-154; U.S Responses to Arbitrator's Questions, paras 113-115.

[23] Brazil Responses to Arbitrator's Question 3, para. 5

[24] Brazil's Methodology Paper, paras. 34, 36

34. The effect of this misattribution is dramatic. As the United States has pointed out, applying all of the other parameters of Brazil's methodology, but calculating interest rate subsidy on the basis of default probabilities corresponding to the actual or otherwise imputed credit rating, causes the interest rate subsidy calculation to fall by more than 57 percent.[25]

35. Brazil is simply wrong to treat an entity rated at 11 or inferior as automatically the equivalent of an uncreditworthy 18. For Brazil nothing exists in between investment grade and uncreditworthy. Brazil's methodology makes no allowance for the creditworthiness of banks below investment grade. As the United States previously noted, even the Standard and Poor's "Long-Term Issuer Credit Ratings" do not starkly characterize obligors rated below BBB- as "uncreditworthy." They simply state that "obligors rated 'BB', 'B', 'CCC', and 'CC' are regarded as having significant speculative characteristics," and in fact, for example, even an obligor rated as low as "B" "currently has the capacity to meet its financial commitments."[26]

36. In response to the Arbitrator's question of "why Brazil cannot take additional steps to further refine its method for distinguishing between creditworthy and uncreditworthy obligors," Brazil responds that "in theory, Brazil could substitute its own judgment of the credit quality of a

[25] U.S. Responses to Arbitrator's Questions, para. 109; Exhibit US-79

[26] *See,* U.S. Responses to Arbitrator's Question 51, paras 106-108; U.S. Written Submissions, para. 162, fn. 246; Standard & Poor's Ratings Definitions, Long-Term Issuer Credit Ratings, *available at* http://www2.standardandpoors.com/portal/site/sp/en/us/page.article/2,1,4,0,1204840817021.html #ID489.

particular obligor for that of the credit ratings agencies,"[27] but in *fact* Brazil has already done that by substituting a default probability of 18 for every obligor rated by a credit rating agency at 11 to 17.

37. Brazil criticizes the United States for offering no alternative method to assign credit ratings or an approach in the alternative to Brazil's.[28] However, if the exercise is to ascertain applicable interest rates, why is it necessary to start with the assignment of credit ratings when direct evidence of actual interest rates is available?[29] Brazil, however, apparently asks the Arbitrator to completely disregard as irrelevant any loans that banks received unless they are a perfect match for dollar-denominated[30], uncollateralized loans with maturities of 24-36 months.[31]

38. The approach the United States suggests is the approach the United States in fact uses in its own determination of subsidies provided by other Members. In determining, in the first instance, *whether* an obligor is or is not creditworthy, the U.S. Department of Commerce, unlike Brazil's methodology, first looks at objective criteria, such as "the actual experience of the firm

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[27] Brazil Response to Arbitrator Question 25, para. 281

[28] Brazil Response to Arbitrator's Questions , paras. 289, 294, 304, 320

[29] U.S. Submission, paras. 151-154; U.S. Responses to Arbitrator's Questions, paras. 115. *See also,* U.S. Submission, para. 161; Exhibit US-55.

[30] "Only foreign currency borrowings would be relevant." Brazil Response to Arbitrator's Question 24, para. 297.

[31] "Only borrowings with 24-36 months would be relevant." Brazil Response to Arbitrator's Question 24, para. 297. Is one to infer that even borrowings with *longer* terms are irrelevant? Compare, e.g. U.S. Responses to Arbitrator's Questions, para. 115

in question in obtaining comparable commercial loans." Brazil asserts that it is using a Department of Commerce methodology "to calculate a counterfactual market interest rate associated with a single probability of default common to the entire class of uncreditworthy obligors."[32] Unlike the Department of Commerce, Brazil *assumes* that *all* obligors with a credit rating inferior to 10 are uncreditworthy. The Department of Commerce makes no such assumption. As the United States has previously explained, the Department of Commerce first makes a determination, based on independent criteria, whether or not a bank is creditworthy, and only upon a specific determination of uncreditworthiness does it employ a corresponding default probability. Consistent with the foregoing description of "non-investment grade," the Department of Commerce recognizes that banks that are not investment grade may indeed be creditworthy and should not have the default probability for uncreditworthy borrowers automatically ascribed to them.

39. The United States notes Brazil's recent introduction of a concept of "scaling" of full additionality for obligors Brazil treats as "uncreditworthy."[33] This appears to be a belated recognition of the inappropriateness of Brazil's overreaching in its determinations of "uncreditworthiness". The United States observes, however, that Brazil's proposal to make scaling adjustments to additionality of 0, "10 percent", or "similar adjustments" is presented without any theoretical underpinning to justify any of it, and appears to be simply arbitrary. That

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[32] Written Submission of Brazil, para. 196. *See also*, Written Submission of Brazil, para. 200.

[33] Brazil Response to Arbitrator's Questions, paras. 291, 322

Brazil's methodology can accommodate such arbitrariness suggests an inherent arbitrariness in Brazil's methodology as a whole. In contrast, the United States has offered numerous examples of real-world interest rates available to actual banks and indicative interest rates published by the International Monetary Fund for the relevant period for numerous countries, which are generally well below the interest rates Brazil purports to be applicable during that time.[34]

40. In addition to the flaws arising from Brazil's attempt to classify whole categories of creditworthy obligors as "uncreditworthy", there are also flaws in the way Brazil approaches additionality. Brazil seeks to divide additionality into "full" and "marginal," yet this is an artificial bifurcation. Brazil's distinction between "full" and "marginal" additionality is without basis in any of the economic literature. In truth, one model should produce an estimate of "additionality." There is no distinction between "full" and "marginal" additionality.

41. The economic literature substantiates that Brazil is overreaching with regard to both its interest rate subsidy calculations and alleged additionality. First, the literature simply does not support Brazil's assumption that transactions would not occur in the absence of GSM 102 guarantees. Further, with respect to the interest rate subsidy, the range of potential interest rate subsidies in export credit guarantee programs examined in the literature start at nearly zero and have a maximum, in a single instance, of 11 percent, starkly contrasting with Brazil's claim of an

[34] U.S. Submission, para. 161; Exhibit US-55.

interest rate subsidy of over 20 percent. Brazil has more than a mere "data" problem; the literature objectively indicates that Brazil's methodology is altogether unsound.

42. Brazil's comments on its concept of "marginal additionality" in the responses to the questions from the Arbitrators and the comments annexed to its Written Submission only demonstrate that Brazil's methodological approach is so flawed as to render it worthless for these proceedings. Brazil's approach is internally inconsistent. Brazil's own theory is that GSM 102 operates by reducing the effective import price and increasing demand. Yet Brazil models "marginal additionality" on the supply side instead of the demand side. Brazil's choice to use supply side modeling, and the structure of the model itself, resulted in extraordinarily large, exaggerated additionality numbers. These numbers in turn require Brazil to introduce yet another arbitrary assumption to ratchet down the results: Brazil's "capping" assumption. The data fixes Brazil undertook, such as calculations on an obligor-specific basis, cannot undo the flaws inherent in Brazil's model.

43. Brazil states that the purpose of the marginal additionality model is "to calculate the benefits afforded to U.S. exporters from being able to grant otherwise creditworthy foreign obligors a substantial sales discount in the form of cheaper financing conditions."

44. Brazil states its task for calculating marginal additionality as: "To calculate marginal additionality benefits to U.S. exporters, we applied a "but-for" methodology that effectively asks: What is the fraction of a GSM 102-backed transaction to a specific foreign obligor that U.S.

exporters would *forego* if the United States were to withdraw its GSM 102 subsidies in a given fiscal year?"[35]

45. But if the theory is – as Brazil stated – that export credit guarantees offer a sales discount that creates additional demand for U.S. exports, the better question is "What is the change in an importer's demand from a change in the effective price as a result of removing the GSM 102 credit guarantee? "

46. In various places in its submissions, Brazil specifically rules out that the provision of GSM 102 credit guarantees changes supply and increases price.[36] But Brazil spends much time answering the Arbitrator's question 14, 27, and 28 using graphical analysis that models the provision of GSM 102 as changing supply and increasing price. In these answers, Brazil specifically posits that the removal of GSM 102 subsidies causes the world price to rise, albeit marginally.[37] This increase causes U.S. production to increase, as well as world production.[38] At the same time, Brazil has emphasized the targeted and limited nature of GSM 102, and the very small market penetration. This fundamental inconsistency pervades Brazil's model.

[35] Annex I, January 13, 2009, para. 16.

[36] Written Submission of Brazil, para. 229; Annex I, January 13, para. 29.

[37] Brazil Responses to Arbitrator Questions, para. 361.

[38] Brazil Responses to Arbitrator Questions, para. 313, 359, 375.

47. Brazil downplays its choice to use a supply side model, claiming that "the modeling of the export subsidy as a subsidy to sellers or to foreign obligors is a choice of the modeler and does not affect the conclusion of the model." In arguing this equivalence, Brazil relies on the well known result that a reduction in the unit price to the buyer has the same effect on equilibrium price and quantity as an equivalent dollar reduction in the supplier's unit cost of production. Brazil attempts to illustrate this well-known equivalence in Figure 14-4.[39] But Brazil does not explain how the equivalence between a reduction in unit price on the demand side and a reduction in unit cost on the supply side applies to the GSM 102 situation.

48. If GSM 102 is modeled on the demand side as a reduction in an importer's effective unit price, then, in theory, it could be modeled as a reduction in the exporter's unit cost of supply. Brazil could also have done the modeling on the supply side using some other type of producer-subsidy equivalent of the GSM-102 that the exporter "sees" (as in "receives"). But Brazil does neither. Brazil simply shifts the full (overstated, as explained previously) interest rate subsidy from the demand side to the supply side, as if the supplier "sees" the full interest rate subsidy, and models it as an addition to the exporter's price, essentially treating GSM 102 as a grant, which it is not. But the supplier does not "see" the IRS; to an exporter financing is a cost, not a benefit. So there is no basis whatsoever to model GSM 102 guarantees this way.

49. The U.S. submitted three studies that explicitly modeled the effects of export credit guarantees from the demand side (Exhibits US 93, 94, 97). Each study modeled export credit

[39] Brazil's Responses to Arbitrator Questions, paragraph 347.

guarantees, including GSM guarantees, as a reduction in importer costs.[40] The United States is not aware of any study that modeled export credit guarantee programs only from the supply side, with no account taken of import demand.

50. The three studies that address the impact of export credit guarantees use models, based on import demand, that produce results that flow from the model. Brazil's model resulted in an estimate that withdrawal of GSM 102 guarantees would reduce U.S. exports by an average of more than 300 million percent. This result requires an arbitrary "capping" procedure to bind additionality estimates between zero and 100 percent of the existing sales. Brazil further then simply assumes the upper range of 100 percent prevails, which of course is not a measure of "marginal additionality" but a measure of full additionality.

51. These absurd results, which require capping, stem from the model structure. The United States raised this issue in its Written Submission, questioning the derivation of the large elasticities, [41] which drive the model results. Brazil provided the uncapped results but no explanation for their extraordinary magnitude.

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[40] See OECD, *An Analysis of Officially Supported Export Credits in Agriculture*. Paris: OECD, page 22 ("'Additionality' is defined as the ability of a policy to expand demand."); Diersen, Wilson, Dahl, Satyanarayana, *Additionality of Credit guarantees for U.S. Wheat Exports*, Agricultural Economics Report, July 1997, page 6 ("The guarantee subsidy, in turn, affects the demand for wheat purchased under guarantees.")

[41] Written Submission of the United States, para. 216.

52. Finally, to illustrate just one result from the model, it is instructive to compare the results from Prof. Sumner's first model used to examine the effects of cotton subsidies (the so-called FAPRI model), which included modeling regarding GSM 102, with the model Brazil now offers. To model the effect of GSM programs on cotton, Prof. Sumner took a number of 500,000 bales published by the National Cotton Council as the increase in demand for U.S. cotton from GSM programs. He treated this quantity as a direct shift in quantity demanded by importers, not as price subsidy to the U.S. exporter. Professor Sumner estimated the effect of all GSM programs on the world cotton price to be one percent for the period 1999/2000-2007/08. The marginal additionality model, left uncapped, says that without GSM 102 the value of lost U.S. cotton sales in FY2006 is about $64,000,000 million (64 followed by twelve zeroes), or around 250,000 million (250 followed by nine zeroes) bales using an average price of about $250/bale. These numbers bear no relation to the U.S. cotton sector, or indeed any cotton market. The results of the two models are not strictly analogous but certainly make clear that Brazil's results for so-called marginal additionality are completely out of line with Brazil's original assessment of the program's effects.

53. So the model fails on numerous grounds. The conceptual approach is wrong (supply side not demand side); the interest rate subsidy is overstated; the interest rate subsidy is treated as a full price enhancer to the exporter, and the model structure produces results that cannot be accepted without an arbitrary capping procedure.

54. In addition to these critiques of the methodological underpinnings of Brazil's approach,

the United States also would like to emphasize that much of Brazil's theory of additionality appears to be grounded in two fallacious premises:

(1) The GSM 102 program is "designed for use by uncreditworthy obligors."[42]

(2) "The GSM 102 regulations specifically enshrine in law" such alleged designed use.[43]

55. Both Brazil's own methodology and the facts on the ground, however, belie these allegations. Brazil's description of its own creditworthiness threshold notes that it must "account for the fact that some CCC-approved foreign obligors are (or that some future approved foreign obligors might be) creditworthy."[44] This of course would be unnecessary if the "design for use by uncreditworthy obligors" were "enshrined in law."

56. Brazil further asserts that the "administrator [of the GSM 102 program] confirms the application of the factor in practice."[45] In practice, however, Brazil's own methodology[46]

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[42] Brazil Response to Arbitrator Question 25, para. 274.

[43] Brazil Response to Arbitrator Question 25, para. 274.

[44] Brazil Response to Arbitrator Question 24, para. 303.

[45] Brazil Response to Arbitrator Question 25, para. 274. *See also,* Brazil Responses to Arbitrator's Questions at paras. 309, 312, 314, 365.

[46] Exhibit Bra-722. Contrary to Brazil's allegations, furthermore, "most GSM 102 foreign obligors" are not "classed as uncreditworthy (with direct consequences for additionality)". Brazil Response to Arbitrator Question 25, para. 278. Only Brazil, in this dispute, so classes them.

recognizes the following "creditworthy" obligors under the program in FY 2006:

(1) Hong Kong and *all* of the banks therein;

(2) South Korea and *all* of the banks therein;

(3) Trinidad and Tobago and 3 of its 4 CCC-approved banks;

(4) Mexico and 4 of its CCC-approved banks;

(5) Russia and 2 of its CCC-approved banks;

(6) Two banks in Panama;

(7) One bank in Ukraine;

(8) Romania; and

(9) Kazahkstan.

57. A closer examination of the legal provisions themselves contradict Brazil's assertion of a "legal requirement"[47] of "use by uncreditworthy obligors." In 2006 as now, the relevant statute for the GSM 102 program states: "The Commodity Credit Corporation shall not make credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary [of Agriculture] determines cannot adequately service the debt associated

[47] Brazil Response to Arbitrator Question 25, para. 276.

with such sale."[48] The program regulations mirror that prohibition.[49] In fact, they specifically provide the program regulations specifically provide: "The program [is] targeted toward those countries . . . which have sufficient financial strength so that foreign exchange will be available for scheduled payments."[50] As a result, the Arbitrator will recall, many countries are wholly ineligible under the GSM 102 program.[51] Under Brazil's theory of "enshrined design," however, such ineligibility would not only be contrary to the "definition of program success"[52] but contrary to law.

58. Finally, the United States notes that Brazil's methodology does not provide an explanation of how any additional U.S. exports resulting from the use of GSM 102 guarantees affect Brazil directly, nor more generally has Brazil described the impact of GSM 102 on Brazil. Yet, if the improper importation of the concept of *erga omnes* is to be avoided – as it must be avoided – the appropriate amount of countermeasures must be limited to the impact of GSM 102 on Brazil.

59. In summary, the basic precepts of Brazil's approach – including Brazil's choices regarding "creditworthiness" and "additionality," are without foundation, not supported by

[48] 7 USC §5622(d).

[49] 7 CFR §1493.3(a)(2).

[50] 7 CFR §1493.10(a)(2)

[51] *US-Upland Cotton (21.5)(AB)*, paras. 192, 258; *US-Upland Cotton (21.5)*, para. 3.16 and fn. 39; U.S. Responses to Arbitrator's Questions, para. 86

[52] Brazil Response to Arbitrator Question 25, para. 277

evidence, and result in proposed countermeasures far out of proportion with what would be appropriate in this dispute.

IV. There Is No Basis for Countermeasures for Step 2, a Repealed Program

60. Next, the United States would like to respond to Brazil's arguments with respect to the old findings on the repealed "Step 2" program. Brazil asked for a $350 million one-time amount of countermeasures for Step 2.[53]

61. As the United States explained in its Written Submission, this request must be rejected.[54] There is no Step 2 program; the program that the original panel found inconsistent with U.S. commitments was ended as from August 1, 2006. Before the compliance panel, there was no disagreement that the United States had repealed Step 2. Instead, Brazil requested findings with regard to the timing of the U.S. repeal of Step 2. The panel declined to make any such findings.[55] Brazil did not appeal this decision by the compliance panel and the DSB recommendations and rulings did not include any recommendation or ruling with respect to Step 2.

62. Having failed to prevail in the compliance proceeding, Brazil is essentially asking the

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[53] Brazil Methodology Paper, para. 4.

[54] U.S. Written Submission, paras. 226-228.

[55] *US–Upland Cotton* (21.5), para. 9.71.

Arbitrator to reverse the compliance proceeding recommendations and rulings and provide Brazil an award to which it is not entitled. Simply put, there is no basis for any countermeasures for Step 2. Ironically, in its request for authorization for countermeasures with respect to Step 2, Brazil asks for countermeasures "in an amount that corresponds: (i) to the STEP 2 payments made in the most recent concluded marketing year," and the amount resulting from application of that formula would be zero (since no payments were made in MY2007)

63. So not only is Brazil asking the Arbitrator to reverse the compliance proceedings, it is asking the Arbitrator to authorize an amount in excess of the amount Brazil requested. There is no basis for any such action.

V. Brazil's Claims Regarding Programs That Have Not Been Subject to DSU Proceedings Are Not Relevant and Are Outside the Terms of Reference of this Arbitration

64. The United States was surprised to see Brazil's claims that two aspects of the 2008 Farm Bill are prohibited subsidies: an aspect of marketing loan payments and economic adjustment assistance.[56] Neither of these has been the subject of proceedings under the DSU, there are no DSB recommendations and rulings with respect to them, and they were not within the terms of reference of the compliance proceedings nor are they within the terms of reference of this arbitration. Accordingly, when Brazil asserts its claim to be a "fact" and requests the

[56] Brazil Written Submission, paras. 265-277.

Arbitrator to base its award with respect to countermeasures on it, Brazil appears to be "seeking redress of a violation of obligations" under the covered agreements without having "recourse to, and abide by, the rules and procedures of" the DSU. In addition, Brazil appears to be making a determination regarding a violation without doing so through recourse to the DSU. For all these reasons, the Arbitrator should reject Brazil's claim and blatant disregard for the DSU.

VI. Brazil Must Follow the Requirements of DSU Article 22.3 and It Has Not Done So

65. Finally, the United States will address Brazil's claims for cross-sectoral suspension of concessions. Such suspension is exceptional; an arbitrator has only accepted it in two instances, and no Member has yet acted on it.

66. Brazil requested authorization to suspend concessions under the TRIPS and GATS. It made this request in the request for countermeasures for prohibited subsidies, and in its request on actionable subsidies. Brazil explicitly invoked Article 22.3 of the DSU, which also provides the analysis for suspension of concessions in other sectors or agreements. (Brazil also invoked Article 22.3 of the DSU in its request for countermeasures for actionable subsidies.) Brazil has already conceded that its requests are subject to Article 22.3 of the DSU.

67. Yet, now that the issue is before the Arbitrators, Brazil claims that it does not need to

meet the requirements of the DSU with respect to cross-sectoral suspension of concessions. Brazil's interpretation is baseless. By its own terms, Article 22.3 of the Dispute Settlement Understanding applies to requests for countermeasures under the SCM Agreement – Article 22.3(g) cross-references the agreements to which it applies, as those listed in Annex 1A of the WTO Agreement. Annex 1A includes the SCM Agreement. The United States has addressed this suggestion by Brazil in its Written Submission and in its responses to the questions from the Arbitrators. It is nothing more than an attempt by Brazil to evade the disciplines of the DSU.

68. Understanding that Brazil is obligated to follow the provisions of Article 22.3, the most determinative factor in the Arbitrators' decisions on cross-sectoral suspension of concessions is the amount of countermeasures, which neither the parties nor the Arbitrator yet know. At the appropriate level of suspension of concessions, cross-sectoral suspension of concessions would plainly not be necessary. But even if the Arbitrator decides that the DSB should authorize countermeasures for GSM 102 guarantees, Brazil's request for cross-sectoral countermeasures is over-reaching.

69. Most fundamentally, Brazil has a $2 trillion dollar economy, diversified across sectors from airplanes to agriculture.[57] It is an important market for the United States, which exported between $15.3 and $24.6 billion annually to Brazil between 2005-2007.[58] If Brazil suspends

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[57] CIA World Factbook.

[58] Exhibit US-62.

concessions against the United States in the goods sector, it would deprive the United States of access to the important Brazilian market. At a time of economic challenges, loss of this large market would exact a serious economic cost.

70. With fewer imports from the United States, Brazil could increase imports from other sources or use domestically produced goods. Brazil has ample choice. Even in the specific areas that Brazil would exclude from goods for the purposes of suspension of concessions (medical and educational supplies, goods, automotive goods and arms)[59] there are ready counter-examples showing how little Brazil depends on the U.S., and how nimble purchasers can be in finding alternative supplies.

- For passenger cars, the United States accounted for less than 2% of imports to Brazil in 2007-2008. Auto parts, similarly, ranged from about 6% to about 8%.
- For antibiotics, both China and South Korea exported about twice as much into Brazil as the United States in 2008, by value. China and Korea both substantially increased their share of exports to Brazil from the prior year (19.4% to 33% for China and 13% to 31% for South Korea).
- For computers, exports from China to Brazil continue to outpace those from the United States, at 36.7% in 2008 compared to 18.5%.

[59] Brazil Written Submission, para. 516.

- For food, in 2007, all Brazil's salmon imports were from the United States. But in the very next year, 100% of imported salmon came from Chile. [60]

71. These examples underscore the diversity of options that Brazil has, and show that it is not so constrained that it would not be practicable or effective for it to suspend concessions in the goods sector, should they be authorized by the DSB. Moreover, Brazil has in the past sought countermeasures of more than $3 billion – a billion more than it seeks here – without requesting that it be permitted to resort to suspension of concessions under other agreements. In *Canada-Aircraft*, Brazil proposed suspension of concessions in the amount of $3.36 billion when it had only $942 million in annual imports from Canada. How could Brazil consider it be practicable and effective to suspend concession in that situation and not consider it practicable and effective here, where U.S. exports range from $15-$24 billion annually?

VII. Conclusion

72. In conclusion, as the United States has explained in its written submission and responses to questions from the Arbitrators, Brazil's proposed countermeasures are not "appropriate" in this dispute. Because of the combination of different approaches of assessing countermeasures – a subsidy and a trade effect – as well as the unsupportable economic approach, any countermeasures calculated with Brazil's methodology would be disproportionate. The Arbitrator should instead follow the approach of the DSB findings with respect to GSM 102, and assess appropriate countermeasures on the basis of net cost to

[60] Source, World Trade Atlas.

government. Brazil's over-reaching request for retroactive countermeasures for Step 2 also fails as a legal matter, as the Step 2 program has been repealed. Finally, Brazil's request for cross-agreement suspension of concessions – which is premised in any event on its request for disproportionate countermeasures – fails because Brazil cannot meet the requirements of Article 22.3 of the DSU.