

***United States – Subsidies on Upland Cotton***

**(WT/DS267)**

**First Written Submission of the United States of America**

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## I. Introduction and Overview

1. The United States welcomes this opportunity to present its views to the Panel on the issues raised in this dispute. Brazil's 135-page submission of June 24, 2003, raises a large number of issues, both factual and legal. The United States has, in the limited time since June 24, tried to review those issues as well as possible and to consider how we might best assist the Panel in considering the issues. In this submission, the United States principally focuses on the issues involving the Peace Clause. The United States will need to respond to some of the other issues in later stages of this proceeding.

2. First, we distinguish between those measures that are within the Panel's terms of reference and those that are not. In closely reviewing Brazil's consultation and panel requests, we have become aware of three measures – (1) export credit guarantee measures relating to eligible U.S. agricultural commodities other than U.S. upland cotton, (2) production flexibility contract payments and market loss assistance payments, and (3) subsidies provided under the Agricultural Assistance Act of 2003 – that were not the subject of consultations; had expired before consultations were requested; or had not yet been adopted at the time of the consultation and panel requests. As none of these measures is properly before the Panel, the United States includes in this submission a request that the Panel issue a preliminary ruling that these measures are not within the Panel's terms of reference.

3. Second, with respect to challenged U.S. domestic support measures, the United States presents a detailed analysis of the terms of the Peace Clause and demonstrates that the Peace Clause is an essential part of the balance of rights and obligations under the WTO agreements and is not an "affirmative defense" contrary to Brazil's claim. Brazil must establish that it is able to proceed with its claims in light of the Peace Clause, and Brazil has not done so. Furthermore, the U.S. measures are "exempt from actions" under the Peace Clause.

4. In brief, the U.S. direct payments (a form of income support for farmers that is not linked to production) under the 2002 Act<sup>1</sup> conform fully to the provisions of Annex 2 of the *Agreement on Agriculture* ("Agriculture Agreement" or "Agreement on Agriculture") – that is, they qualify as minimally trade- and production-distorting measures exempt from the domestic support reduction commitments of the Agriculture Agreement.<sup>2</sup> As a result, under subparagraph (a)(ii) of the Peace Clause, the direct payments are "exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement."

5. The non-green box U.S. domestic support measures that Brazil challenges conform fully to the provisions of Agriculture Agreement Article 6 and are exempt from actions at this time pursuant to Peace Clause subparagraph (b)(ii). These measures are marketing loan program payments, user marketing (step 2) certificates, counter-cyclical payments, and crop insurance subsidies.

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<sup>1</sup> Farm Security and Rural Investment Act of 2002, Public Law 107-171, 116 Stat. 134 (May 13, 2002) ("2002 Act") (Title I) (Exhibit US-1).

<sup>2</sup> Such support is referred to as "green box" support.

6. Brazil fundamentally misunderstands the correct approach to Peace Clause analysis, relying simply on a purported comparison of outlays (which are nowhere mentioned in the Peace Clause) rather than heeding the text of the Peace Clause. Reading Article 13(b)(ii) according to the customary rules of interpretation of public international law, the relevant test for the applicability of the Peace Clause to non-green box domestic support measures is to compare the product-specific support “decided” during the 1992 marketing year versus the product-specific support that challenged measures currently in effect grant. In fact, the level of support granted to upland cotton producers is far lower now than in 1992.

7. The amount of support decided in 1992 was 72.9 cents per pound of upland cotton production. The amount of support granted for the 2002 crop is only 52 cents per pound. In 135 pages of a submission that was supposed to be devoted to the Peace Clause, Brazil did not even bother to describe to the Panel those measures by which support was decided in marketing year 1992. However, the Peace Clause requires an examination of those measures.

8. Brazil would also have the Panel believe that any breach of the Peace Clause at any time during the implementation period would result in forfeiture of that protection altogether. However, the Peace Clause by its terms is written in the present tense (“provided that such measures *do not grant support*”). Thus, with respect to measures currently in effect, the Peace Clause calls for a determination of the support that challenged measures *currently* grant.

9. Brazil misunderstands the support that is relevant to the Peace Clause comparison because it fails to read the phrase “support to a specific commodity” as a whole. As the United States will explain, the phrase “support to a specific commodity” should be understood to mean “product-specific support.” Brazil ignores this meaning in favor of trying to aggregate the outlays under as many different payments as it can – whether or not these payments grant support for a basic agricultural product in favor of the producers of the product. In so doing, Brazil fails to respect the Peace Clause text.

10. Because the product-specific support that non-green box U.S. domestic support measures grant to upland cotton is not in excess of that product-specific support to upland cotton decided during the 1992 marketing year, U.S. non-green box domestic support measures are “exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement.” As a result, Brazil may not maintain this action and advance claims under the specified provisions with respect to marketing loan program payments, user marketing (step 2) certificates, counter-cyclical payments, and crop insurance subsidies.

11. Finally, the United States turns to the other claims made by Brazil in its first submission. With respect to user marketing (step 2) payments, which are notified by the United States to the WTO as product-specific support for cotton, the United States contends that these payments are not an export subsidy under the Agriculture Agreement, not a prohibited subsidy under the

*Agreement on Subsidies and Countervailing Duties* (“Subsidies Agreement”), and not inconsistent with national treatment obligations under GATT 1994.

12. With respect to Brazil’s challenge to export credit guarantee programs to facilitate the export of upland cotton, the United States believes that these programs are not export subsidies under the Agriculture Agreement and are not prohibited export subsidies under the Subsidies Agreement. Finally, with respect to Brazil’s challenge to alleged support provided for upland cotton export sales through the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (“ETI Act”), we note that Brazil has not presented *any* evidence regarding the ETI Act itself and thus cannot be deemed to have made a *prima facie* case.

## II. Procedural and Factual Background

### A. Procedural Background

13. On September 27, 2002, Brazil requested consultations with the United States pursuant to Articles 4.1, 7.1, and 30 of the *Agreement on Subsidies and Countervailing Measures* (“Subsidies Agreement”), Article 19 of the *Agreement on Agriculture* (“Agriculture Agreement”), Article XXII of the *General Agreement on Tariffs and Trade 1994* (“GATT 1994”), and Article 4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (“DSU”) concerning “prohibited and actionable subsidies provided to U.S. producers, users and/or exporters of upland cotton, as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies (including export credits), grants, and any other assistance to the U.S. producers, users and exporters of upland cotton.”<sup>3</sup> Brazil and the United States held consultations in Geneva on December 3-4 and 19, 2002, and January 17, 2003. Unfortunately, the consultations failed to settle the dispute.

14. On February 6, 2003, Brazil requested that the WTO Dispute Settlement Body (“DSB”) establish a panel to examine this dispute.<sup>4</sup> The DSB established the panel on March 18, 2003, with standard terms of reference.<sup>5</sup> The terms of reference of the panel are as follows:

To examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/7, the matter referred to the DSB by Brazil in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.<sup>6</sup>

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<sup>3</sup> WT/DS267/1 (footnote omitted).

<sup>4</sup> WT/DS267/7.

<sup>5</sup> *Dispute Settlement Body: Minutes of Meeting Held on 18 March 2003*, WT/DSB/M/145, circulated 7 May 2003, para. 35.

<sup>6</sup> *United States – Subsidies on Upland Cotton: Constitution of the Panel Established at the Request of Brazil: Note by the Secretariat*, WT/DS267/15, circulated 23 May 2003, para. 2.

15. Brazil at various points asserts that the United States refused to provide certain information under the procedures called for by Annex V of the Subsidies Agreement. It does so for the first time in its description of counter-cyclical payments.<sup>7</sup> In fact, the DSB has not taken the decision required by paragraph 2 of Annex V to initiate those procedures. The DSB has also not taken the decision necessary to appoint the representative contemplated by paragraph 4 of that Annex. There have been extensive debates on these issues at meetings of the DSB, including at the meetings held on March 18, March 31, April 15, and May 19, 2003. The minutes of those meetings record the positions expressed by various Members, including the view of the United States that Brazil is not entitled to use Annex V procedures at this time because the Peace Clause precluded Brazil's claims and the U.S. proposal for a pragmatic way forward to safeguard the positions of both parties to this dispute. (Regrettably, Brazil did not accept that proposal.) Brazil's suggestion that the United States has refused to provide information under the Annex V procedures is therefore unfounded. In any case, however, these issues are not before the Panel or within its terms of reference.

## **B. Description of Challenged U.S. Measures**

### **1. Identification of Measures Within Panel's Terms of Reference**

16. Brazil has challenged U.S. support measures for "upland cotton."<sup>8</sup> In its first submission, Brazil identifies "the various subsidy programs that Brazil challenges in this dispute" as:

- (1) marketing loan program payments,<sup>9</sup>
- (2) user marketing (step 2) certificates (what Brazil calls "step 2 export payments"<sup>10</sup> and "step 2 domestic payments"<sup>11</sup>),
- (3) direct payments,<sup>12</sup>

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<sup>7</sup> Brazil's First Submission to the Panel Regarding the "Peace Clause" and Non-Peace Clause Related Claims, para. 68 (24 June 2003) ("Brazil's First Submission").

<sup>8</sup> Brazil's panel request states: "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, as well as legislation, regulations and statutory instruments and amendments thereto providing such subsidies (including export credit guarantees), grants, and any other assistance to the US producers, users and exporters of upland cotton ('US upland cotton industry')." WT/DS267/7, at 1 (footnote omitted). As Brazil makes clear in its First Submission, upland cotton is distinguished from extra-long staple cotton, which is produced from a different plant species, and upland cotton "is treated differently from extra-long staple cotton by [the U.S. Department of Agriculture] for purposes of U.S. farm programs, *i.e.*, U.S. agricultural support." Brazil's First Submission to the Panel Regarding the "Peace Clause" and Non-Peace Clause Related Claims, para. 27 (footnote omitted) (24 June 2003) ("Brazil's First Submission"). Thus, the measures within the scope of this dispute are limited to support for upland cotton rather than cotton generally.

<sup>9</sup> Brazil's First Submission, para. 70.

<sup>10</sup> Brazil's First Submission, para. 90.

<sup>11</sup> Brazil's First Submission, para. 97.

<sup>12</sup> Brazil's First Submission, para. 49.



- (4) counter-cyclical payments,<sup>13</sup>
- (5) crop insurance subsidies,<sup>14</sup>
- (6) export credit guarantees,<sup>15</sup>
- (7) alleged support provided for upland cotton export sales through the FSC Repeal and Extraterritorial Income Exclusion Act of 2000,<sup>16</sup>
- (8) production flexibility contract payments,<sup>17</sup>
- (9) market loss assistance payments,<sup>18</sup> and
- (10) cottonseed payments.<sup>19</sup>

Fortunately for the Panel's work, however, not all of these measures are within the Panel's terms of reference, and therefore not all of them need be considered in this dispute. In particular, the Panel need not consider items (8), (9), and (10).

17. Within the Panel's terms of reference is current U.S. domestic support for upland cotton provided under the Farm Security and Rural Investment Act of 2002 (the "2002 Act"). Programs that provide support to upland cotton under the 2002 Act are the **marketing loan program** (loans made on current production of upland cotton) and **user marketing (step 2) payments** (payments made to consumers of cotton).<sup>20</sup> In addition, properly within the Panel's terms of reference are payments under the 2002 Act that do *not* provide support to upland cotton – that is, **direct payments** and **counter-cyclical payments** that are based on *historical* acreage and yields during a base period, including acreage and yields for past production of upland cotton.

18. Brazil challenges other measures not part of the 2002 Act. First, there are **export credit guarantee programs for upland cotton** provided under the Agricultural Trade Act of 1978, as amended. Second, **crop insurance payments** under the Agricultural Risk Protection Act of 2000 that inure to the benefit of upland cotton producers (in the form of subsidized crop insurance premiums) too form part of the matter in dispute – although the United States notes that these subsidies are not specific to upland cotton but are generally available to U.S. crops. Brazil also challenges alleged support provided for upland cotton export sales through the **FSC Repeal and Extraterritorial Income Exclusion Act of 2000**. The United States presents a brief description of each of these measures in this section and provides greater detail as necessary in the course of this submission.

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<sup>13</sup> Brazil's First Submission, para. 63.

<sup>14</sup> Brazil's First Submission, para. 79.

<sup>15</sup> Brazil's First Submission, para. 101.

<sup>16</sup> Brazil's First Submission, para. 315. As the United States notes later, Brazil has not even presented a description of this measure. *See infra* § VI.

<sup>17</sup> Brazil's First Submission, para. 45.

<sup>18</sup> Brazil's First Submission, para. 60.

<sup>19</sup> Brazil's First Submission, para. 106.

<sup>20</sup> Brazil has challenged that portion of user marketing payments made to domestic consumers of cotton as domestic support and that portion of user marketing payments made to exporters as export subsidies.

19. We note, however, that Brazil has over-reached by seeking to include within this dispute three types of measures that are not within the Panel's terms of reference. First, Brazil seeks findings from the Panel on export credit guarantee measures relating to eligible U.S. agricultural commodities other than U.S. upland cotton. However, these measures were not the subject of consultations and thus were not properly included in Brazil's panel request. Second, Brazil seeks findings with respect to production flexibility contract payments and market loss assistance payments that were made under superseded U.S. legislation. These measures are no longer in effect and had, in fact, terminated before Brazil's consultation and panel requests. Thus, they could not be measures at issue between the parties. Third, Brazil challenges subsidies provided under the Agricultural Assistance Act of 2003 although these are measures that were not even in existence at the time of Brazil's panel request. As a result, the United States later in this submission includes a request that the Panel make preliminary rulings that none of these measures is within its terms of reference.<sup>21</sup> In light of this request, the United States will neither describe nor discuss these measures, and the Panel need not consider these measures, further.

## 2. Upland Cotton Marketing Loans

20. As mentioned, Brazil challenges two payments that provide support for the 2002 crop of upland cotton. The first, and most important, is the upland cotton marketing loan program under the 2002 Act. Under the marketing loan program, eligible producers may receive non-recourse loans on all production of upland cotton.<sup>22</sup> The loan rate is established by the statute as \$0.52 per pound of upland cotton. Loans are available for a term of 9 months beginning on the first day of the month after the loan is made and may be repaid at the lower of the world market price (as calculated by the U.S. Department of Agriculture) or the loan rate. Because the loan is "non-recourse," a producer may forfeit the cotton placed under the loan to the U.S. Government when the loan term expires in full satisfaction of the loan; the U.S. Government has no recourse against the producer and must accept the forfeiture.

21. Through the marketing loan program, the U.S. Government has in effect guaranteed that cotton producers will realize income equivalent to at least 52 cents per pound of upland cotton produced. Benefits to upland cotton producers result when the world market price falls below the loan rate. Instead of forfeiting the cotton to the government when world market prices fall below 52 cents per pound, producers have the option to repay the loan at the lower world market price. The difference between the loan rate and a lower world market price is referred to as a "marketing loan gain." Alternatively, a producer foregoing a marketing loan may choose to

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<sup>21</sup> See *infra* Part VII (Requests for Preliminary Ruling: Brazil's Panel Request Includes Measures That Were Not the Subject of Consultations, Brazil's Panel Request Includes Measures that Expired Long Ago, and Brazil's Submission Includes Measures that Had Not Been Adopted at the Time of its Panel Request).

<sup>22</sup> For cotton to be eligible for a marketing loan or a loan deficiency payment, producers must, *inter alia*, comply with applicable conservation and wetland requirements. In addition, for marketing loans, the cotton must be ginned and be placed in a U.S. Government-approved warehouse. See 67 Federal Register 64454 (October 18, 2002) (upland cotton marketing loan regulations) ("Fed. Reg.").

receive a “loan deficiency payment” in the amount of the difference between the loan rate and a lower prevailing world price. In either case, if the producer then sells the cotton on which the marketing loan gain or loan deficiency payment has been received at the prevailing world market price, the producer realizes income at a rate of 52 cents per pound of upland cotton.

### **3. User Marketing (Step 2) Payments**

22. The second payment for the 2002 crop that provides support for upland cotton is user marketing (“step 2”) payments under the 2002 Act. These payments to buyers of upland cotton are available only when the price of U.S. cotton exceeds prices of cotton from other producers. Specifically, payments are made to users of upland cotton if the 5-day average price of the lowest-quoted growth of U.S. cotton (cost, insurance, freight (c.i.f.) Northern Europe) is greater than the price (c.i.f. Northern Europe) for the five lowest-priced world growths of upland cotton (the “adjusted world price”) for four consecutive weeks. The adjusted world price must also be within 134 percent of the upland cotton loan rate (52 cents per pound for 2002-2007). When these conditions are satisfied, payments for the price difference set out in the formula will be made to documented buyers of upland cotton, whether domestic consumers or exporters.

### **4. Direct Payments and Counter-Cyclical Payments**

23. Brazil has also challenged two payments under the 2002 Act that do not provide support for upland cotton because they are not linked to current upland cotton production: direct payments and counter-cyclical payments. These payments are made with respect to farm acreage that was devoted to agricultural production in the past; the payments, however, are made *regardless* of whether upland cotton is currently produced on those acres or whether anything is produced at all. Thus, although the payment criteria differ somewhat, direct and counter-cyclical payments are each made based on *historical* acreage and yields, including historical cotton acreage and yields. Because neither of these payments is tied to current production of upland cotton, *neither* is relevant (contrary to Brazil’s analysis) to the applicability of the Peace Clause under Agriculture Agreement Article 13(b)(ii).

24. Both direct payments and counter-cyclical payments utilize a payment formula: Payment acres  $\times$  Payment yields  $\times$  Payment rate. These concepts are defined in some detail by the 2002 Act and later in this submission. In essence, however, because payment acres and payment yields are based on historical acres and yields for former production of any of a series of commodities,<sup>23</sup> including upland cotton, during a base period, both direct and counter-cyclical payments can be thought of as relating to a theoretical snapshot of U.S. agricultural production during that base period and not to current U.S. production. As stated, no current production of upland cotton (or

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<sup>23</sup> The 2002 Act and implementing regulations specify that the former production of wheat, corn, barley, grain sorghum, oats, upland cotton, rice, soybeans, other oilseeds (sunflower seed, canola, rapeseed, safflower, flaxseed, mustard seed, crambe, sesame seed, and others at the discretion of the U.S. Secretary of Agriculture), or peanuts qualifies for these direct and counter-cyclical payments.

any other crop) is required to receive payment – or, put another way, the payment is the same regardless of how much, or any, upland cotton is produced.

25. One important difference between the two payments is the payment rate. For direct payments, a set amount of monies is distributed among all eligible recipients (those with farm acres that produced crops in the historical base period); thus, the 2002 Act sets out a fixed payment rate (\$0.0667 per pound) for marketing years 2002-2007 for land that was used to produce upland cotton during the historical period. For counter-cyclical payments, the payment rate will vary depending on market prices. For all those farm acres that produced a given crop in the historical base period, the counter-cyclical payment rate is the difference between a target price for that crop set by statute and the sum of (1) the direct payment rate for that crop plus (2) the higher of (a) the national average market price for the crop for the marketing year or (b) the loan rate for the crop. Thus, the lower the market price for a crop previously produced on a landowner's base acres, the higher the counter-cyclical payment rate, and vice-versa. In sum, both direct payments and counter-cyclical payments are decoupled from current production of any crop (in fact, a recipient need not produce any crop at all), but the counter-cyclical payment rate is linked to current market prices.

## **5. Export Credit Guarantees for Upland Cotton**

26. The United States notes that it is requesting the Panel to issue a preliminary ruling that “export credit guarantee measures relating to eligible US agricultural commodities” other than upland cotton are not properly within the scope of Brazil's panel request and therefore do not form part of the panel's terms of reference. In light of this request, the United States here provides a description of export credit guarantee programs with respect to upland cotton only and without prejudice to the operation of any such programs with respect to other agricultural commodities.

27. Since late 1980, the Commodity Credit Corporation (“CCC”), a federally-chartered corporation within the U.S. Department of Agriculture has issued fee-based export credit guarantees to U.S. exporters against the risk of payment default by certain banks outside the United States. The exporters typically assign the benefit of these guarantees to financial institutions in the United States, which then finance the U.S. dollar-denominated repayment obligation of the foreign bank over a period of time. In the case of the Export Credit Guarantee Program (GSM-102) this may be up to 3 years. In the case of the Intermediate Export Credit Guarantee Program (GSM-103), far less frequently used than GSM-102, the repayment term may be between 3 and 10 years. Otherwise, these two programs are substantially similar. Under GSM-102 and GSM-103, CCC guarantees repayment of a substantial amount of principal installments due (typically 98 percent) and a significantly lesser amount of interest.

28. Under the Supplier Credit Guarantee Program (SCGP), no letter of credit is involved. The importer issues a promissory note in favor of the exporter. The CCC guarantee extends to 65 percent of principal installments and does not cover interest. These guarantees currently

extend to a maximum 180-day term. The guarantee is often assigned to a financial institution in the United States.

## 6. Crop Insurance

29. Under the Agricultural Risk Protection Act of 2000, the United States provides crop insurance subsidies in the form of subsidized crop insurance premiums for most agricultural crops, including upland cotton. The basic program provisions for crop insurance are generic, not commodity-specific. Thus, these generally available subsidies are not specific to upland cotton. Federal disaster and crop insurance programs have existed for several decades, but the passage of the Federal Crop Insurance Act in 1980 made crop insurance the primary form of disaster protection.<sup>24</sup> A variety of annual insurance plans are now subsidized and reinsured by the Federal Government, including yield insurance (available both for individual farm yields and based on county-wide yield experiences) and several forms of revenue insurance. Participants in these programs may choose from various generic coverage and protection levels. Also, agricultural producers may obtain catastrophic risk protection, which provides a minimum amount of coverage (50 percent of yield at 60 percent of the expected price) for a small, fixed fee.

## 7. FSC Repeal and Extraterritorial Income Exclusion Act of 2000

30. Finally, Brazil challenges alleged support provided for upland cotton export sales through the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (“ETI Act”). We note that, although Brazil’s “Request for Relief” asks the Panel to make findings with respect to “the ETI Act” writ large,<sup>25</sup> Brazil’s panel request and therefore the Panel’s terms of reference with respect to this measure are limited to “[e]xport subsidies provided to exporters of US upland cotton under the FSC Repeal and Extraterritorial Income Exclusion Act of 2000.”<sup>26</sup> We further note that Brazil has not presented *any* evidence regarding the ETI Act itself, instead merely citing to and quoting from prior panel and Appellate Body reports. Brazil cannot be deemed to have made a *prima facie* case without even describing the challenged measure, and the United States

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<sup>24</sup> Pre-1994, producers could purchase yield coverage at 50, 65, and 75 percent of their normal yields. In 1994, the Crop Insurance Reform Act was passed, which required farmers to purchase crop insurance as an eligibility condition for deficiency payments and loan benefits. This requirement was repealed in 1996. Under the 1994 Crop Insurance Reform Act, producers of insurable crops were eligible to receive catastrophic risk protection, which initially covered 50% of a producer’s approved yield at 60% of the expected price, and could also purchase additional coverage. New insurance products covering revenue losses were also developed. Due to significant disaster-related losses in 1998 and 1999 and the enactment of two corresponding *ad hoc* disaster programs, the Agricultural Risk Protection Act of 2000 was passed to improve the performance of crop insurance by making “buy-up” coverage (policies providing protection at higher percentages of normal yields, for example) more attractive to farmers. That Act increased premium subsidies for most “buy-up” levels of coverage and also encouraged private sector development of new types of insurance products.

<sup>25</sup> Brazil’s First Submission, para. 352(h), (i).

<sup>26</sup> WT/DS267/7, at 2 (italics added).

declines to assume Brazil's initial burden of argumentation by providing a description of the ETI Act.

### **III. U.S. Measures Conform to the Peace Clause and Are Exempt from Brazil's Subsidies Agreement and GATT 1994 Article XVI Action**

#### **A. General Interpretation of the Peace Clause and "Exempt from Actions"**

31. As set out in more detail in the U.S. initial brief on the Panel's question concerning the Peace Clause and the U.S. comments on the initial briefs of Brazil and the third parties, the Peace Clause, Article 13 of the Agriculture Agreement,<sup>27</sup> governs the treatment during the

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<sup>27</sup> The Peace Clause reads:

During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures (referred to in this Article as the "Subsidies Agreement"):

- (a) domestic support measures that conform fully to the provisions of Annex 2 to this Agreement shall be:
  - (i) non-actionable subsidies for purposes of countervailing duties;
  - (ii) exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement; and
  - (iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994;
- (b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:
  - (i) exempt from the imposition of countervailing duties unless a determination of injury or threat thereof is made in accordance with Article VI of GATT 1994 and Part V of the Subsidies Agreement, and due restraint shall be shown in initiating any countervailing duty investigations;
  - (ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year; and
  - (iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year;
- (c) export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be:
  - (i) subject to countervailing duties only upon a determination of injury or threat thereof based on volume, effect on prices, or consequent impact in accordance with Article VI of GATT 1994 and Part V of the Subsidies Agreement, and due restraint shall be shown in initiating any countervailing duty investigations; and
  - (ii) exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement.

implementation period of the Agreement of certain domestic support measures and export subsidies “notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures.”<sup>28</sup>

32. Both parties agree the Peace Clause is in force at present as the implementation period referred to in the first words of the Peace Clause (“During the implementation period”) – that is, under Article 1(f) of the Agriculture Agreement, the “nine-year period commencing in 1995” – has not yet expired. The parties, of course, disagree on what the Peace Clause, and particularly the words “exempt from actions,” means for this dispute. Brazil reads the phrase “exempt from actions” to mean that “a complaining Member cannot receive authorization from the DSB to obtain a remedy,” but there is no support for this reading in the ordinary meaning of the terms, in their context, and in light of the object and purpose of the Agriculture Agreement.<sup>29</sup> Perversely, Brazil’s interpretation would also rob the Peace Clause of any real meaning by exposing conforming measures to retaliation unless the complaining party were to agree not to authorize retaliation.

33. As the United States has explained previously, read in accordance with the customary rules of interpretation of public international law, the key Peace Clause phrase “exempt from actions” means “not exposed or subject to” a “legal process or suit” or the “taking of legal steps to establish a claim or obtain a remedy.”

34. Relevant context supports this reading. Article 3.7 of the DSU states: “*Before bringing a case*, a Member shall exercise its judgement as to whether *action* under these procedures would be fruitful” (emphasis added). Similarly, Article 4.5 of the DSU states: “*In the course of consultations* in accordance with the provisions of a covered agreement, before resorting to *further action* under this Understanding, Members should attempt to obtain satisfactory adjustment of the matter” (emphasis added). Contrary to Brazil’s suggestion that “action” only refers to “collective action” by the Dispute Settlement Body, Article 4.5 uses the phrase “further” action; since no “action” will have been taken by the DSB “in the course of consultations,” the phrase “further action” suggests that requesting consultations is part of the action brought by a complaining party.

35. Similarly, Article 7 of the Subsidies Agreement, which provides procedures (including consultations, panel proceedings, and remedies) to enforce the legal rights contained in Article 5 (on “adverse effects”) and Article 6 (on “serious prejudice”), states: “*Except as provided in*

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Agriculture Agreement, Article 13 (footnote omitted).

<sup>28</sup> Agriculture Agreement, Article 13 (chapeau). Article 21.1 of the Agriculture Agreement also makes it clear that the Subsidies Agreement and GATT 1994 only apply “subject to” the provisions of the Agriculture Agreement, including Article 13 (the Peace Clause).

<sup>29</sup> We do note that Brazil would appear to have reversed its view that “action” can only mean collective action by the DSB when it writes: “Article 13 provides a qualified ‘safe haven’ against actions by other Members, nothing more.” Brazil’s First Submission, para. 119.

*Article 13 of the Agreement on Agriculture*, whenever a Member has reason to believe that any subsidy referred to in Article 1, granted or maintained by another Member, results in injury to its domestic industry, nullification or impairment or serious prejudice, *such Member may request consultations* with such other Member.”<sup>30</sup> Thus, these provisions suggest that “action” based on the relevant provisions would include all stages of a dispute, including the “bringing [of] a case,” consultations, and panel proceedings and would support reading “exempt from actions” in Article 13 to mean “not subject to” the “taking of legal steps to establish a claim.”

36. The United States notes that, prior to this point in the process, the DSU rules did not afford the United States any opportunity to prevent the dispute from proceeding through consultations and panel establishment automatically, regardless of the U.S. insistence that its measures conform to the Peace Clause. As a responding party cannot prevent panel establishment from occurring, it will inevitably be forced to argue to a panel that its procedures should be structured so that the party’s challenged measures are not subject, from that point on, to actions based on provisions specified in the Peace Clause. Thus, given the automaticity in DSU rules relating to consultations and panel establishment, the Panel’s organization of its procedures provided the first opportunity to arrest Brazil’s “taking of legal steps to establish a claim.” The United States thanks the Panel for bifurcating its proceeding to allow the Peace Clause issue to be considered first.

37. Brazil has not met its burden of demonstrating that challenged U.S. measures are in breach of the Peace Clause. In fact, as the United States will explain in this submission, the Peace Clause does exempt U.S. measures from Brazil’s action based on Peace Clause-specified provisions. Thus, the United States respectfully requests the Panel to find that Peace Clause-conforming U.S. measures are exempt from any action based on the corresponding provisions of the Subsidies Agreement and the GATT 1994 and that the United States is not required to defend those measures in any action based on Brazilian claims exempted by the Peace Clause.

## **B. The Peace Clause Is Not an Affirmative Defense**

38. Brazil asserts that “Article 13 is in the nature of an affirmative defense” and, “[a]s a consequence, in this proceeding the United States has the burden of proof on the question whether its subsidies are in conformity with the terms” of this provision.<sup>31</sup> Essentially, Brazil’s argument flows from its view that the Peace Clause “does not alter the scope of other provisions providing positive obligations on Members. It also provides no positive obligations in itself. It . . . simply permits Members to maintain those measures exempt from actions, if the measures meet the conditions specified” in the Peace Clause.<sup>32</sup> However, the text of the Peace Clause does not support reading this provision as an affirmative defense; rather, the Peace Clause forms part

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<sup>30</sup> Subsidies Agreement, Article 7.1 (italics added).

<sup>31</sup> Brazil’s First Submission, para. 110.

<sup>32</sup> Brazil’s First Submission, para. 117.



of the balance of rights and obligations of Members and is a threshold procedural hurdle for Brazil to meet.

39. In light of the Peace Clause, Brazil may not even go forward with an action based on Peace Clause-specified provisions (that is, may not take legal steps to establish a claim or obtain a remedy) if U.S. measures are not in breach of the Peace Clause. The Peace Clause applies “[n]otwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures.” “Notwithstanding,” by its ordinary dictionary definition, means “In spite of, without regard to or prevention by.”<sup>33</sup> Thus, pursuant to the Peace Clause, conforming measures “shall be . . . exempt from actions based on” the provisions specified *in spite of* and *without regard to or prevention by* the subsidies obligations contained in the GATT 1994 and the Subsidies Agreement. Article 21.1 of the Agriculture Agreement further clarifies that the obligations of Members under the Subsidies Agreement and GATT 1994 *only* apply “*subject to*” the provisions of the Agriculture Agreement, including Article 13 (the Peace Clause).<sup>34</sup>

40. Thus, not only is there no need to determine if a measure is inconsistent with the subsidies disciplines of GATT 1994 and the Subsidies Agreement before applying the Peace Clause (as would be the case if the Peace Clause were an affirmative defense to those obligations), but the text of the Peace Clause and Article 21.1 makes clear that, without regard to WTO subsidies obligations, conforming measures “shall be . . . exempt from actions based on” Peace Clause-specified provisions.

41. In this dispute, it is Brazil that seeks to bring an action based on Subsidies Agreement and GATT 1994 provisions specified in the Peace Clause. Brazil cannot bring that action if the U.S. measures conform to the Peace Clause. Accordingly the burden is on Brazil to show that the conditions exist that would permit it to bring its action<sup>35</sup> – that is, that the U.S. measures do not conform to the Peace Clause. The Peace Clause is not an affirmative defense.

42. The situation here is much as the situation confronted by the Appellate Body in *United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India*. There, the Appellate Body explained that a provision that was described as an “exception” was not an affirmative defense and in fact was “an integral part” of the arrangement under the *Agreement on Textiles and Clothing* that “reflects an equally carefully drawn balance of rights and obligations of Members.”<sup>36</sup> Here, too, the Peace Clause is part and parcel of the balance of rights and

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<sup>33</sup> *The New Shorter Oxford English Dictionary*, vol. 2, at 1947 (definition as preposition).

<sup>34</sup> Agriculture Agreement, Art. 21.1 (“The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement.”).

<sup>35</sup> We note that Brazil attempts to re-write the Peace Clause when it asserts: Article 13 “simply permits Members to *maintain those measures exempt from actions*, if the measures meet the conditions specified.” Brazil’s First Submission, para. 117 (emphasis added). Of course, the Peace Clause does not speak of permitting Members “to maintain” measures; it says that measures “shall be exempt from actions,” such as the one brought by Brazil.

<sup>36</sup> Appellate Body Report, *United States – Measures Affecting the Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R at 16 (23 May 1997).

obligations with the subsidies disciplines of GATT 1994 and the Subsidies Agreement and serves to explain which measures are subject to actions based on those disciplines.

43. We note that Brazil has erroneously asserted that the Peace Clause “provides no positive obligations itself.”<sup>37</sup> Brazil overlooks the text of the Peace Clause. For example, under Article 13(b)(ii), to be “exempt from actions” based on certain WTO provisions, a Member must be in compliance with its domestic support reduction obligations under Article 6 of the Agriculture Agreement. Further, under Article 13(a)(ii), a Member’s domestic support measures must conform fully to the provisions of Annex 2 to the Agreement. Presumably, Brazil would agree that Article 6 and Annex 2 contain positive obligations, and these obligations are incorporated into the Peace Clause by reference.

44. Brazil’s approach would produce bizarre results. For example, if Brazil claimed that U.S. measures breached Article 6, the burden would be on Brazil to prove that breach.<sup>38</sup> Yet one of the tests under the Peace Clause is whether the U.S. measures breach Article 6. Brazil’s approach would argue that if Brazil had, for example, alleged a breach of Article 6 of the Agriculture Agreement *and* of Article 5 of the Subsidies Agreement, the burden would be reversed. In other words, the burden would be on the United States to show that its measures conformed to Article 6 (one of the requirements of the Peace Clause). Again, the burden is on Brazil to show that they do not - to show that there is a breach of Article 6. There is no basis for concluding that the burden of showing a breach of Article 6 is reversed just because a Member were to allege a breach of Article 6 *and* one of the Subsidies Agreement provisions subject to the Peace Clause.

45. If there were any remaining doubt that the Peace Clause is not an affirmative defense, then that doubt would be dispelled by Article 13(a)(i) of the Peace Clause. Under this provision, green box measures are “non-actionable subsidies for purposes of countervailing duties.” That is, a Member may not impose countervailing duties on such subsidies.<sup>39</sup> Clearly, this obligation is not contingent on whether or not another Member asserts an “affirmative defense” that a particular measure is “green box.” Rather, the Member investigating is under an obligation to ascertain whether the Peace Clause applies. A Member is not free to impose a countervailing duty until a responding party establishes a Peace Clause “affirmative defense.” There is no basis in the text to interpret the Peace Clause to be an affirmative defense under one provision (Article 13(b)(ii)) but not another. In fact, rather than a defense, the Peace Clause could be used on the *offense* (as a cause of action) if, for example, a Member imposed a countervailing duty on a “green box” measure while the Peace Clause was in force.

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<sup>37</sup> Brazil’s First Submission, para. 117.

<sup>38</sup> For example, Brazil would have the burden to prove that measures are not “green box” (conform fully to the provisions of Annex 2).

<sup>39</sup> See Subsidies Agreement, Part V, fn. 35 (“The provisions of Parts III and V shall not be invoked regarding measures considered non-actionable in accordance with the provisions of Part IV.”).

46. The Peace Clause differs from the provisions at issue in the disputes cited by Brazil in its first submission. Under the fifth sentence of footnote 59 to item (e) and under the second paragraph of item (k) of the Illustrative List,<sup>40</sup> it appears that a measure otherwise prohibited under Article 3 of the Subsidies Agreement would nonetheless be permitted given the existence of circumstances detailed in those provisions. However, under the Peace Clause, conforming measures are “exempt from actions based on” specified provisions of the Subsidies Agreement and GATT 1994 Article XVI altogether; that is, such measures are not exposed or subject to the taking of legal steps to establish a claim or obtain a remedy based on those provisions. Thus, the Peace Clause is not an affirmative defense to claims based on Peace Clause-specified provisions since actions based on such provisions cannot be maintained in the WTO at this time. Further, Subsidies Agreement Articles 3, 5, and 6 recognize that measures conforming to the Peace Clause are not subject to those disciplines by expressly excluding such measures from the scope of those obligations.<sup>41</sup>

47. It is for Brazil to demonstrate that the U.S. measures do not conform to the Peace Clause. Indeed, although Brazil argues that the Peace Clause is an “affirmative defense” for the United States to raise, we note that Brazil asserted in both its panel request (WT/DS267/7, at 3) and its consultation request (WT/DS267/1, at 3) that the Peace Clause does not exempt the challenged U.S. measures from action. It would be peculiar for the complaining party to anticipate a “defense” to be raised by the responding party. We believe that Brazil implicitly recognized in these documents that the Peace Clause is a necessary hurdle for it to surmount to maintain this action against U.S. agricultural support measures. Even were the United States to present no arguments on the applicability of the Peace Clause, Article 13 would bar Brazil’s claims unless Brazil made a *prima facie* case that the U.S. measures are in breach of the Peace Clause.

### **C. U.S. Green Box Measures Are Exempt from Actions Based on Part III of the Subsidies Agreement and GATT 1994 Article XVI**

48. The Peace Clause protects measures from certain actions; however, those measures must conform to certain criteria laid out in the provision. The three subparagraphs of the Peace Clause track three categories of support as defined in the Agreement: Article 13(a) covers domestic support not subject to reduction commitments in terms of the criteria set out in Annex 2 to the Agreement (“green box” support); Article 13(b) covers domestic support measures in favor of agricultural producers, subject to the disciplines of Article 6 (“amber box” and “blue box”

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<sup>40</sup> At issue in, respectively, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/RW/2 (23 August 2001) and *United States – Tax Treatment for “Foreign Sales Corporation”*, WT/DS108/RW, WT/DS108/AB/RW (29 January 2002) (Recourse to Article 21.5)

<sup>41</sup> Article 3 on prohibited subsidies states: “*Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of paragraph 1, shall be prohibited . . . (italics added).*” Similarly, Article 5 on actionable subsidies that cause “adverse effects” and Article 6.8 on actionable subsidies that cause “serious prejudice” each state: “This Article *does not apply* to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture (italics added).”

support, including non-product-specific support and *de minimis* support); and Article 13(c) covers export subsidies. In this section, the United States presents the meaning of Article 13(a) on green box support and how U.S. green box measures conform to the requirements of this provision.

### **1. Article 13(a) of the Agriculture Agreement: Meaning and Criteria**

49. Of the three categories of support, green box support receives the broadest exemption from actions in the WTO at this time. Of the challenged U.S. measures, direct payments under the 2002 Act provide green box support. With respect to green box support, the Peace Clause provides:

During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures (referred to in this Article as the “Subsidies Agreement”):

- (a) domestic support measures that conform fully to the provisions of Annex 2 to this Agreement shall be:
  - (i) non-actionable subsidies for purposes of countervailing duties;
  - (ii) exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement; and
  - (iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994[.]

Thus, to receive Peace Clause protection under this provision, the only criterion a “domestic support measure[.]” must fulfill is to “conform fully to the provisions of Annex 2 to this Agreement.”

50. Annex 2, paragraph 1, provides that domestic support measures “for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production.” The second sentence of paragraph 1 goes on to explain that, “[a]ccordingly, all measures for which exemption is claimed shall conform to the . . . basic criteria” that (1) the support be provided through a publicly-funded government program not involving transfers from consumers and

(2) the support not have the effect of providing price support to producers as well as (3) detailed “policy-specific criteria and conditions” as set out in the Annex.<sup>42</sup> The structure of this provision (beginning the second sentence with “accordingly” and then setting out relevant criteria)<sup>43</sup> suggests that measures that conform to the two “basic criteria” plus any applicable “policy-specific criteria and conditions” will be deemed to “meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production.”

51. Domestic support measures meeting the Annex 2 criteria are given broad protection in the WTO through the implementation period. Such measures are “non-actionable for purposes of countervailing duties,” “exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement,” and “exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions . . . in the sense of paragraph 1(b) of Article XXIII of GATT 1994.”<sup>44</sup>

## **2. U.S. Measures Conform to the Criteria in Article 13(a) and Are Exempt from Actions**

52. Brazil’s action does not relate to countervailing duties or non-violation nullification or impairment; thus, the United States limits its discussion to Agriculture Agreement Article 13(a)(ii), pursuant to which domestic support measures that “conform fully to the provisions of Annex 2 to this Agreement” are “exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement.” In this action, Brazil has alleged that a broad range of U.S. support measures are inconsistent with GATT 1994 Article XVI and Articles 5 and 6 of the Subsidies Agreement. Thus, to the extent that any U.S. domestic support measures conform fully to the provisions of Annex 2 to the Agriculture Agreement, the Peace Clause provides that these

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<sup>42</sup> In full, this provision reads:

Domestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production. Accordingly, all measures for which exemption is claimed shall conform to the following basic criteria:

(a) the support in question shall be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers; and,

(b) the support in question shall not have the effect of providing price support to producers;

plus policy-specific criteria and conditions as set out below.

Agriculture Agreement, Annex 2, para. 1.

<sup>43</sup> The ordinary meaning of “accordingly” is “[i]n accordance with the logical premises; correspondingly.” *The New Shorter Oxford English Dictionary*, vol. 1, at 15 (third definition).

<sup>44</sup> Agriculture Agreement, Article 13(a)(i)-(iii).

measures are not subject to the taking of legal steps by Brazil to establish a claim, including pursuing these dispute settlement proceedings.

53. The Farm Security and Rural Investment Act of 2002 (“2002 Act”) establishes several types of measures that qualify for green box protection. Brazil challenges one of these, direct payments, and claims that this is not a green box measure. The United States describes this program and how it conforms fully to the criteria set out in Annex 2 to the Agreement.

### **3. Direct Payments**

#### **a. Annex 2 Criteria for Decoupled Income Support**

54. The 2002 Act provides for “direct payments,” which, in the parlance of the Agriculture Agreement, are “direct payments to producers” of “decoupled income support.”<sup>45</sup> As noted above, Annex 2 provides that domestic support measures “for which exemption from the reduction commitments is claimed” must meet the basic criteria that (1) the support be provided through a publicly-funded government program not involving transfers from consumers, (2) the support not have the effect of providing price support to producers, and (3) the support conform to” policy-specific criteria and conditions” as set out in the Annex. Under paragraph 5 of Annex 2, direct payments to producers “for which exemption from reduction commitments is claimed shall meet the basic criteria set out in paragraph 1 above, plus specific criteria applying to individual types of direct payment as set out in paragraphs 6 through 13 below.” Paragraph 6 of Annex 2, entitled “Decoupled income support,” sets out 5 criteria for this type of payment:

(a) Eligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period.

(b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.

(c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.

(d) The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period.

(e) No production shall be required in order to receive such payments.

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<sup>45</sup> Agriculture Agreement, Annex 2, paras. 5, 6.

55. In brief, the direct payments under the 2002 Act establish eligibility by reference to the clearly-defined criteria of factor use or production level in a defined and fixed base period. Payments are not related to production or prices or the factors of production employed in any year after the base period, and no production is required in order to receive such payments. Rather, a set amount of monies is distributed among all eligible recipients according to their proportion of a theoretical value of U.S. agricultural production. Because all of the criteria in paragraphs 1, 5, and 6 of Annex 2 of the Agreement are met, direct payments conform to the requirements of Annex 2 and are “exempt from actions” based on part III of the Subsidies Agreement and GATT 1994 Article XVI under the Peace Clause.

**b. Description of U.S. Direct Payments**

56. Direct payments do not provide support for upland cotton because they are not linked to current upland cotton production. These payments are made with respect to farm acreage that was devoted to agricultural production in the past, including acreage previously devoted to upland cotton production. The payments, however, are made regardless of what is currently produced on those acres or whether anything is produced at all.

57. U.S. direct payments are made to persons (farmers and landowners) with farm acres that formerly produced any of a series of commodities<sup>46</sup> during the base period.<sup>47</sup> The payment is decoupled from production: there is no requirement that the recipient engage in any production to receive payment, and there is no requirement that the farm acres for which payment is made be utilized for production. A farm’s historical, “base” acres cannot exceed the farm’s available cropland (minus land committed to acreage conservation programs). Thus, if all persons with eligible acres entered into contracts for direct payments, payments could be received on all acres devoted to covered commodities during the historical base period. Furthermore, multiplying those eligible acres by the historical yields for the respective covered commodity would give a theoretical snapshot of U.S. agricultural production of covered commodities during the base period.

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<sup>46</sup> The 2002 Act and implementing regulations define those formerly produced commodities as wheat, corn, barley, grain sorghum, oats, upland cotton, rice, peanuts, soybeans, sunflower seed, canola, rapeseed, safflower, flaxseed, mustard seed, crambe, sesame seed, and other oilseeds at the discretion of the U.S. Secretary of Agriculture.

<sup>47</sup> As noted above, direct payments under the 2002 Act are decoupled income support. A similar payment, the production flexibility contract, existed under the Federal Agriculture Improvement Act of 1996 (“1996 Act”). The 2002 crop (marketing year 2002) was subject to the 1996 Act before being superseded by the 2002 Act. Thus, because production flexibility contract payments may have been received under the 1996 Act for the 2002 crop, the 2002 Act establishes that any production flexibility contract payments are deducted from direct payments under the 2002 Act for the 2002 crop. 2002 Act, § 1107, 7 U.S. Code § 7917 (“U.S.C.”) (Exhibit US-1).

58. To determine the direct payment for a particular recipient, the 2002 Act establishes a formula: Payment acres  $\times$  Payment yields  $\times$  Payment rate.<sup>48</sup> Each of these elements is defined by the statute.

59. “Payment acres” are defined as 85 percent of a person’s “base acres.” Base acres, in turn, are defined as either (1) a four-year average (1998-2001) of plantings of covered commodities or (2) the sum of contract acreage for decoupled income support (production flexibility contracts) under the Federal Agriculture Improvement Act of 1996 (“1996 Act”) and the four-year average (1998-2001) of plantings of eligible oilseeds. There are two points worth noting here.

60. First, under the 1996 Act, the decoupled income support program (production flexibility contracts) did not make payments for historical acreage devoted to oilseeds (such as soybeans, canola, safflower, etc.). In order to bring acreage previously devoted to these crops within the scope of direct payments under the 2002 Act, some mechanism was needed to account for those acres. Rather than compel all recipients to use the 1998-2001 average plantings for all covered commodities, which would have penalized those farmers and landowners who had chosen not to produce during that period (which did not alter their payments under the 1996 Act production flexibility contracts), the 2002 Act instead allowed landowners to retain base acres under the 1996 Act and add 1998-2001 acres (if any) of eligible oilseeds *or* simply declare base acres for all covered commodities (including oilseeds) using the 1998-2001 average.

61. Second, the contract acreage for production flexibility contracts under the 1996 Act was that quantity of acres which would have been determined under the 1990 Act,<sup>49</sup> plus acreage returning from the Conservation Reserve Program. Under the 1990 Act, base acres<sup>50</sup> for cotton were the average acres planted and “considered planted” during the previous three years.<sup>51</sup> Thus, for 1996, base cotton acres were the average acres during the 1993-1995 period. As a result, while a landowner may elect to simply utilize acres devoted to covered commodities during the 1998-2001 period for purposes of direct payments, a landowner need not do so; base acres may remain those under the 1996 Act, implying that no cotton production need have occurred since the 1993-1995 period for a landowner to have “cotton base acres.”

62. “Payment yield” is defined in the 2002 Act as the yield for each covered commodity established for the 1995 crop<sup>52</sup> (with a specific provision to provide for payment yields for

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<sup>48</sup> 2002 Act, § 1103, 7 U.S.C. § 7913 (Exhibit US-1).

<sup>49</sup> Food, Agriculture, Conservation, and Trade Act of 1990, Public Law No. 101-624, 104 Stat. 3440 (“1990 Act”).

<sup>50</sup> These were “base acres” for purposes of the classic deficiency payments under the 1990 Act, which were linked to production of cotton. No income support decoupled from production was provided under the 1990 Act.

<sup>51</sup> 1990 Act, § 1101, *amending* Agricultural Act of 1949, § 503(b)(2), 7 U.S.C. § 1463(b)(2).

<sup>52</sup> 2002 Act, § 1102(b), 7 U.S.C. § 7912(b) (Exhibit US-1). For purposes of the production flexibility contracts under the 1996 Act, payment yields were also frozen at the 1995 level. Federal Agriculture Improvement Act of 1996, Public Law No. 104-127 (April 4, 1996) (“1996 Act”), § 114(c), 7 U.S.C. § 7214(c).



oilseeds, which were not covered under the production flexibility contracts under the 1996 Act).<sup>53</sup> Payment yields for 1991-1995 were set by the 1990 Act as 1990 payment yields. 1990 payment yields, in turn, were set by the 1985 Act as a farm's 1981-1985 average yield.<sup>54</sup> Thus, "payment yields" for purposes of direct payments under the 2002 Act are set as a farm's 1981-1985 average yield.

63. A "payment rate" is set by the statute for each of the covered commodities that in the aggregate form the theoretical U.S. agricultural production for which direct payments are made. For payment acres on which cotton had been produced during the base period, the payment rate is defined as \$0.0667 per pound.<sup>55</sup>

**c. Direct Payments Meet the Criteria of Annex 2 of the Agriculture Agreement for Decoupled Income Support**

64. As noted above, direct payments qualify as "decoupled income support" exempt from the reduction commitments of the Agriculture Agreement if the following basic criteria are met: (1) the support must be provided through a publicly-funded government program not involving transfers from consumers, (2) the support must not have the effect of providing price support to producers, and (3) the support must conform to the five "policy-specific criteria and conditions" set out in paragraph 6 of Annex 2. Direct payments under the 2002 Act satisfy all of these criteria.

65. Direct payments under the 2002 Act are support provided through a publicly-funded government program not involving transfers from consumers. Under Section 1103 of the 2002 Act, the Secretary of Agriculture "shall make direct payments to producers on farms [including landowners where no production occurs] for which payment yields and base acres are established," and, under Section 1601 of the Act, the Secretary "shall use the funds, facilities, and authorities of the Commodity Credit Corporation to carry out this title."<sup>56</sup> Thus, no transfers from consumers are involved, and the first criterion is fulfilled.

66. Direct payments under the 2002 Act do not have the effect of providing price support to producers. Direct payments are made to persons on farms based on historic acres and yields and do not support prices for any commodity. Annex 3 of the Agriculture Agreement (on "Calculation of Aggregate Measurement of Support") establishes that "market price support shall

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<sup>53</sup> Oilseed payment yields are determined by taking a farm's 1998-2001 average yield multiplied by the national average yield for 1981-1985, divided by the national average yield for 1998-2001. 2002 Act, § 1102(d), 7 U.S.C. § 7912(d) (Exhibit US-1).

<sup>54</sup> Food Security Act of 1985, § 506, Public Law No. 99-198, 99 Stat. 1354, 7 U.S.C. § 1466 ("1985 Act").

<sup>55</sup> 2002 Act, § 1103(b), 7 U.S.C. § 7913(b) (Exhibit US-1).

<sup>56</sup> 2002 Act, § 1601, 7 U.S.C. § 7991 (Exhibit US-1). The Commodity Credit Corporation has \$30 billion in borrowing authority from the U.S. Treasury. 15 U.S.C. § 713a-4. Thus, when authorized by statute, the Secretary of Agriculture can use Commodity Credit Corporation funds to make payments without relying on direct appropriations for such expenditures.

be calculated using the gap between the fixed external reference price and the applied administered price multiplied by the quantity of production eligible to receive the applied administered price.”<sup>57</sup> Under Section 1501 of the 2002 Act (entitled “Milk Price Support Program”), for example, the U.S. Secretary of Agriculture “shall support the price of milk . . . through the purchase of cheese, butter, and nonfat dry milk produced from milk,” and “the price of milk shall be supported at a rate equal to \$9.90 per hundredweight for milk containing 3.67 percent butterfat.”<sup>58</sup> In contrast, direct payments are not made to support any “applied administered price” for upland cotton production (or that for any other commodity) and thus do not have the effect of providing price support, satisfying the second criterion.

67. Direct payments under the 2002 Act also satisfy the five policy-specific criteria and conditions set out in paragraph 6 of Annex 2.

First, eligibility for direct payments is determined by clearly-defined criteria, such as factor use and production level in a defined and fixed base period. Direct payments are made to persons on farms for which payment yields and base acres are established. These payment yields and base acres are defined in the 2002 Act and fixed for the duration of the legislation (that is, from marketing year 2002-2007).

Second, the amount of direct payments in any given year is not related to, or based on, the type or volume of production undertaken by the producer in any year after the base period. The amount of direct payments are related to, or based on, only *historical* production, by multiplying, for each covered commodity, payment acres (85 percent of acres in the base period) by payment yields (yields in the base period) by the payment rate for that commodity (set by the 2002 Act). Not only is there no requirement that a direct payment recipient engage in any *particular* type or volume of production, a recipient need not engage in *any* current agricultural production in order to receive the direct payment. Thus, contrary to Brazil’s erroneous assertion, the amount of direct payment in any year from 2002-2007 (the duration of the 2002 Act) is not related to, or based on, the type or volume of production in any of those years.

Third, the amount of direct payments in any given year is not related to, or based on domestic or international prices applying to any production undertaken in any year after the base period. The direct payment formula detailed above is linked to, for each covered commodity, payment acres (85 percent of acres in the base period), payment yields (yields in the base period), and the payment rate for that commodity but is not related to, or based on, any prices in any given year after the base period.

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<sup>57</sup> Agriculture Agreement, Annex 3, para. 8.

<sup>58</sup> 2002 Act, § 1501(a), (b) (Exhibit US-1).

Fourth, the amount of direct payments in any given year are not related to, or based on, the factors of production employed in any year after the base period. Again, the payment formula detailed above is linked to, for each covered commodity, payment acres (85 percent of acres in the base period), payment yields (yields in the base period), and the payment rate for that commodity but is not related to, or based on, factors of production employed in any given year after the base period.

Finally, no production is required in order to receive direct payments. The payment formula is linked to, for each covered commodity, historic base acres and payment yields but no current production.

68. Thus, because direct payments under the 2002 Act satisfy the two general criteria under Annex 2, paragraph 1, and the five policy-specific criteria and conditions of Annex 2, paragraph 6, direct payments qualify as “decoupled income support” exempt from the reduction commitments of the Agriculture Agreement. Further, because direct payments under the 2002 Act are “domestic support measures that conform fully to the provisions of Annex 2 to this Agreement,” under subparagraph (a)(ii) of the Peace Clause, direct payments are “exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement.” As a result, Brazil may not maintain this action and advance the claims under the specified provisions with respect to U.S. direct payments.

**D. U.S. Non-Green Box Domestic Support Measures Are Exempt from Actions Based on Articles 5 and 6 of the Subsidies Agreement and GATT 1994 Article XVI:1**

69. The Peace Clause exempts a second category of domestic support measures from certain actions: subparagraph (b) covers domestic support measures in favor of agricultural producers (“amber box” and “blue box” support, including non-product-specific support and *de minimis* support) that do not conform to the criteria set out in Annex 2 to the Agreement. In this section, the United States explains the meaning of and criteria in Article 13(b) on non-green box support and how U.S. domestic support measures are exempt from actions based on Peace Clause-specified provisions.

70. In brief, a proper interpretation of the Peace Clause as pertinent to this dispute (Article 13(b)(ii)) requires a comparison between (1) the product-specific support for upland cotton that non-green box measures currently grant and (2) the product-specific support decided during marketing year 1992. If the former is not in excess of the latter, all of U.S. non-green box domestic support measures at issue in this dispute are exempt from actions based on Peace Clause-specified provisions.

71. Further, of the five U.S. domestic support measures within the scope of this dispute that Brazil has challenged (marketing loans, user marketing certificates, direct payments, counter-

cyclical payments, and crop insurance),<sup>59</sup> only marketing loans and user marketing (step 2) certificates grant product-specific support to upland cotton and therefore are pertinent to the comparison under Article 13(b)(ii). As indicated above, direct payments are green box and therefore are subject to Article 13(a)(ii) rather than Article 13(b)(ii). Counter-cyclical payments and crop insurance, moreover, are non-product-specific because they are not linked to production of upland cotton and are available to agricultural producers in general. Because the product-specific support that marketing loans and user marketing certificates grant to upland cotton is not in excess of the product-specific support decided during the 1992 marketing year, U.S. non-green box domestic support measures conform to the Peace Clause requirements and are exempt from action.

### 1. Article 13(b) of the Agriculture Agreement: Meaning and Criteria

72. The second category of support receiving protection under the Peace Clause consists of non-green box “domestic support measures that conform fully to the provisions of Article 6 of this Agreement.”<sup>60</sup> With respect to these domestic support measures, the Peace Clause provides:

During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures (referred to in this Article as the “Subsidies Agreement”):

...;

(b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member’s Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:

(i) exempt from the imposition of countervailing duties unless a determination of injury or threat thereof is made in accordance with Article VI of GATT 1994 and Part V of the Subsidies Agreement, and due restraint shall be shown in initiating any countervailing duty investigations;

(ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year; and

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<sup>59</sup> Recall that production flexibility contracts and marketing loss assistance payments are not within the panel’s terms of reference because they were no longer in effect at the time of the consultation or panel requests. In addition, a cottonseed payment under the Agricultural Assistance Act of 2003 is not within the panel’s terms of reference because the legislation was not enacted until some two weeks after the date of Brazil’s panel request.

<sup>60</sup> Agriculture Agreement, Article 13(b).

(iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year[.]

73. Brazil's action does not relate to countervailing duties or non-violation nullification or impairment; thus, the United States limits its discussion to Agriculture Agreement Article 13(b)(ii), pursuant to which conforming domestic support measures are "exempt from actions" based on GATT 1994 Article XVI:1, Subsidies Agreement Article 5 (adverse effects), and Subsidies Agreement Article 6 (serious prejudice) claims.

**a. First criterion: "Domestic support measures that conform fully to the provisions of Article 6"**

74. Subparagraph (b) by its terms encompasses "domestic support measures that conform fully to the provisions of Article 6," which would appear to include product-specific and non-product-specific "amber box" support in favor of agricultural producers (Articles 6.1, 6.3), certain developing country support (Article 6.2), *de minimis* support (Article 6.4), and "blue box" (production-limiting) support (Article 6.5).

75. We agree with Brazil that "conformity with the obligations of . . . Article 6 requires a Member's compliance with reducing *total* levels of domestic support – not individual levels of domestic support for particular commodities,"<sup>61</sup> and Brazil does not contest that U.S. non-green box domestic support measures conform fully to the requirements of Article 6.<sup>62</sup> Thus, the only question is whether U.S. non-green box domestic support measures do or "do not grant support to a specific commodity in excess of that decided during the 1992 marketing year."

**b. Second criterion: "Provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year"**

76. The applicability of the Peace Clause to non-green box domestic support measures is also contingent upon a second important limitation: such measures receive Peace Clause treatment "provided that such measures do not grant support to a specific commodity in excess of that

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<sup>61</sup> Brazil's First Submission, para. 129 (italics in original). See Agriculture Agreement, Article 6.1 ("The domestic support commitments of each Member contained in Part IV of its Schedule shall apply to all of its domestic support measures in favour of agricultural producers with the exception of domestic measures which are not subject to reduction in terms of the criteria set out in this Article and in Annex 2 to this Agreement."); *id.*, Article 6.3 ("A Member shall be considered to be in compliance with its domestic support commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule.").

<sup>62</sup> The U.S. Final Bound Commitment Level for the Total Aggregate Measurement of Support is \$19.1 billion. See G/AG/N/USA/43 (Exhibit Bra-47).

decided during the 1992 marketing year.” The proviso suggests two elements to the comparison. First, one must determine the “support to a specific commodity” that challenged measures “grant.” Second, the support to a specific commodity such measures grant must be compared to “that decided during the 1992 marketing year.” As the United States will demonstrate, because the product-specific support for upland cotton decided during the 1992 marketing year (\$0.729 per pound of upland cotton) is greater than the product-specific support that challenged U.S. non-green box measures currently grant to upland cotton (\$0.52), the Peace Clause exempts U.S. non-green box domestic support measures from actions based on Peace Clause-specified provisions.

77. **First Element: “Grant support to a specific commodity”:** The phrase “grant support to a specific commodity” is not explicitly defined in the Agreement. Once again, the phrase should be interpreted using the customary rules of interpretation of public international law. The ordinary meaning of “grant” is to “bestow as a favour” or “give or confer (a possession, a right, etc.) formally.”<sup>63</sup> “Support” means “assistance, backing” and “[t]he bearing or defraying of a charge or expense”<sup>64</sup> and is used in the Agriculture Agreement in place of “subsidies” (as in “domestic support”).<sup>65</sup> “Specific” means “[s]pecially or peculiarly pertaining to a particular thing or person, or a class of these; peculiar (*to*). Also as 2nd elem. of comb.”<sup>66</sup> “Commodity” means a “thing or use of value; *spec.* a thing that is an object of trade, *esp.* a raw material or agricultural crop.”<sup>67</sup> Thus, the ordinary meaning of “grant support to a specific commodity” would be to “confer” formally a “subsidy” (“assistance, backing”) “specially . . . pertaining to a particular” “agricultural crop.”

78. Context for the phrase “support to a specific commodity” is provided by Agriculture Agreement Article 1 (Definition of Terms) and Article 6 (Domestic Support Commitments). Article 6.4 allows a developed-country Member to exclude from its calculation of its Current Total Aggregate Measurement of Support “product-specific domestic support . . . where such support does not exceed 5 per cent of the Member’s total value of production of the basic agricultural product” and “non-product-specific support . . . where such support does not exceed 5 per cent of the value of that Member’s total agricultural production.”<sup>68</sup> Similarly, the definition of “Aggregate Measurement of Support” distinguishes between “support . . . provided for an agricultural product in favour of the producers of the basic agricultural product *or* non-product-

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<sup>63</sup> *The New Shorter Oxford English Dictionary*, vol. 1, at 1131 (fourth & fifth definitions).

<sup>64</sup> *The New Shorter Oxford English Dictionary*, vol. 2, at 3152-53 (definition I.1a & 1e).

<sup>65</sup> *Cf.* Subsidies Agreement, Articles 5 and 6.9 (“This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture.”).

<sup>66</sup> *The New Shorter Oxford English Dictionary*, vol. 2, at 2972 (second definition); *see also id.* (fifth definition: “Clearly or explicitly defined; precise, exact, definite.”).

<sup>67</sup> *The New Shorter Oxford English Dictionary*, vol. 1, at 452 (fourth definition).

<sup>68</sup> For developing country Members, the applicable *de minimis* percentages are 10 percent, rather than 5 percent. Agriculture Agreement, Article 6.4(b).

specific support provided in favour of agricultural producers in general.”<sup>69</sup> Thus, read in context, the phrase “support to a specific commodity” would appear to refer to support “provided for an agricultural product in favour of the producers of the basic agricultural product” rather than support in favor of agricultural producers generally. Indeed, the phrase “support to a specific commodity” can be written as “commodity-specific support,”<sup>70</sup> which in the context of the Agriculture Agreement would be equivalent to “product-specific support.”<sup>71</sup>

79. Finally, the phrase “such measures do not grant support to a specific commodity” is expressed in the present tense, rather than the past (“have not granted,” “did not grant”) or the future (“will not grant”). This present-tense criterion (“do not grant support”) indicates that whether measures currently in effect are exempt from actions depends upon the support they currently grant.

80. Indeed, the panel considering the first recourse to Article 21.5 of the DSU in the *Canada – Dairy* dispute reached a similar conclusion. After making a finding of inconsistency with respect to Article 9.1(c) of the Agriculture Agreement, that panel found that under Article 8 of the Agriculture Agreement, Canada had the right to provide export subsidies on the products at issue as long as it acted in conformity with the relevant provisions of the Agreement.<sup>72</sup> The panel therefore concluded that – even if it had examined the compliance of Canada’s measures with Article 3.1 of the Subsidies Agreement – it could not make the withdrawal recommendation contemplated by Article 4.7 of that Agreement. For that reason, the panel found that there was no need for it to make findings of inconsistency under the Subsidies Agreement. To put it another way, the panel understood that Canada could take steps to make its measures “conform fully” to its export subsidy commitments and then continue providing such subsidies – a result that could not be possible if Canada’s violation of Article 9.1(c) had removed Canada’s Peace Clause protection under Article 13(c).

81. Thus, Brazil errs when it suggests that a breach of the Peace Clause at any time during the implementation period would strip challenged measures currently in effect of Peace Clause

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<sup>69</sup> Agriculture Agreement, Article 1(a) (italics added). *See also id.* Article 1(h) (making same distinction in definition of “Total Aggregate Measurement of Support”); *id.*, Annex 3, para. 1 (Domestic Support: Calculation of Aggregate Measurement of Support) (making same distinction).

<sup>70</sup> The definition of “specific” quoted above suggests that the term is used “[a]lso as 2nd elem. of comb.” *The New Shorter Oxford English Dictionary*, vol. 2, at 2972 (second definition). Thus, “support to a specific commodity” could be re-written “commodity-specific support” without changing its meaning.

<sup>71</sup> The Agriculture Agreement “applies to the products listed in Annex 1 to this Agreement,” which lists HS chapters 1 to 24 less fish and fish products plus certain other products, including HS Headings 52.01 to 52.03 (raw cotton, waste and cotton carded and combed). Agriculture Agreement, Article 2 & Annex 1. Thus, cotton is both a “product” subject to the Agreement and a “commodity” (an “agricultural crop”).

<sup>72</sup> Panel Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products: Recourse to Article 21.5 of the DSU by New Zealand and the United States*, WT/DS103/RW, WT/DS113/RW, adopted as reversed by the Appellate Body in other respects on 18 December 2001, paras. 6.99-6.100.

protection.<sup>73</sup> Putting these parts together, then, the first element to the proviso means that conforming domestic support measures must not currently confer assistance or backing specially pertaining to a particular agricultural crop – that is, confer product-specific support – in excess of the level set forth in the second element of this criterion.

82. **Second Element: “That decided during the 1992 marketing year”:** Turning to the second element of this criterion, the product-specific support granted by such Article 6 measures must be compared to “that decided during the 1992 marketing year.” “That” refers back to “support to a specific commodity.” The key term in this phrase is “decided,” which again is not explicitly defined in the Agreement. “Decide” means “[d]etermine on as a settlement, pronounce in judgement” and “[c]ome to a determination or resolution *that, to do, whether.*”<sup>74</sup> Thus, according to its ordinary meaning, the phrase “decided during the 1992 marketing year” would mean the product-specific support that was “determined” or “pronounced” during the 1992 marketing year.

83. With reference to support or subsidies, the term “decided” is not used elsewhere in the Agriculture Agreement nor in the Subsidies Agreement.<sup>75</sup> However, relevant context is provided by numerous other provisions in the Agriculture Agreement that do *not* use the term “decided.” In particular, the various provisions that define the overall domestic support in favor of agricultural producers that has been, is being, and may be provided by a Member – that is, that define the central disciplines on domestic support in the Agriculture Agreement – use the phrase “support *provided*” in favor of an agricultural product or agricultural producers no fewer than 13 times.

84. “Aggregate Measurement of Support,” for example, is defined as “the annual level of *support*, expressed in monetary terms, *provided* for an agricultural product in favour of the producers of the basic agricultural product or non-product-specific *support provided* in favour of agricultural producers in general, other than *support provided* under other programmes that qualify as exempt from reduction under Annex 2 to this Agreement.”<sup>76</sup> The definitions of “Equivalent Measurement of Support”<sup>77</sup> and “Total Aggregate Measurement of Support”<sup>78</sup> also

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<sup>73</sup> See Brazil’s First Submission, paras. 142, 148.

<sup>74</sup> *The New Shorter Oxford English Dictionary*, vol. 1, at 607 (first and third definitions) (italics in original).

<sup>75</sup> Article 15.8 of the Subsidies Agreement does use the term “decided” but not to refer to subsidies or support: “With respect to cases where injury is threatened by subsidized imports, the application of countervailing measures shall be considered and decided with special care.”

<sup>76</sup> Agriculture Agreement, Article 1(a) (emphasis added). The definition goes on to use the “support provided” language two more times.

<sup>77</sup> Agriculture Agreement, Article 1(d) (using phrase “support provided” four times).

<sup>78</sup> Agriculture Agreement, Article 1(h) (using phrase “support provided” four times, including in definitions of “Base Total AMS” (“support provided during the base period”), “Annual and Final Bound Commitment Levels” (“maximum support permitted to be provided during any year of the implementation period or thereafter”), and “Current Total AMS” (“support actually provided during any year of the implementation period or thereafter”).



exclusively use the phrase “support provided.” Accordingly, Annex 3 to the Agreement specifies that the Aggregate Measurement of Support is calculated (on both a product-specific and non-product-specific basis) by budgetary outlays, revenue foregone by governments or their agents, or a “price gap” methodology,<sup>79</sup> depending on how the support is provided.

85. Were the relevant concept for the Peace Clause comparison the amount of support “provided” during the 1992 marketing year (calculated by budgetary outlays, revenue foregone, or a price gap methodology), one would have expected Members to use that term, which is prevalent throughout the Agreement. Context thus suggests that the use of the term “*decided*” in Article 13(b) was deliberate so as to make the availability of the Peace Clause not dependent upon the support – for example, as measured through budgetary outlays – actually “provided” during the 1992 marketing year.

86. This interpretation is further supported by Members’ decision not to use the term “Aggregate Measurement of Support” in this part of Article 13(b)(ii). Under Article 1(a), the Aggregate Measurement of Support (or AMS) is defined, in part, as “the annual level of *support, expressed in monetary terms, provided for an agricultural product* in favour of the producers of the basic agricultural product.” Annex 3 (entitled “Domestic Support: Calculation of Aggregate Measurement of Support”), paragraph 1, indicates: “Subject to the provisions of Article 6, an *Aggregate Measurement of Support* (AMS) shall be calculated *on a product-specific basis* for each basic agricultural product receiving market price support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment (‘other non-exempt policies’) (italics added).” Further, paragraph 6 of Annex 3 states: “*For each basic agricultural product, a specific AMS shall be established, expressed in total monetary value terms* (italics added).”

87. Thus, had Members intended the Peace Clause comparison to *require* the use of the product-specific Aggregate Measurement of Support, calculated in total monetary value terms, they could have used that term in Article 13(b)(ii) – for example, “provided that such measures do not provide an Aggregate Measurement of Support for a specific commodity in excess of that provided during the 1992 marketing year.” Despite the ready availability of the term and the fact that the Aggregate Measurement of Support calculation is key to each Member’s fundamental commitment to limit its overall domestic support to the level indicated in its WTO Schedule,<sup>80</sup> Members did not choose to make the applicability of the Peace Clause contingent on comparison of a Member’s product-specific Aggregate Measurement of Support.

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<sup>79</sup> Where a Member provides “market price support,” such support “shall be calculated using the gap between a fixed external reference price and the applied administered price multiplied by the quantity of production eligible to receive the applied administered price. Budgetary payments made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS.” Agriculture Agreement, Annex 3, para. 8.

<sup>80</sup> See Agriculture Agreement, Article 6.3 (“A Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member’s Schedule.”).

88. **Conclusion: “Provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year”:** Read according to their ordinary meaning and in their context, the two elements of this proviso mean that the Peace Clause exempts from certain actions a Member’s non-green box domestic support measures that conform to that Member’s overall reduction commitments under Article 6, provided that such measures do not currently “give” or “confer” “product-specific support” in excess of that “determined” or “pronounced” during the 1992 marketing year. Thus, the relevant test for the applicability of Article 13(b)(ii) is to compare the product-specific support as it was decided in 1992 versus the product-specific support that existing measures currently grant.

**c. Brazil’s Interpretation of Article 13(b)(ii) Is Flawed Because It Ignores Key Elements of the Text**

89. Brazil’s interpretation of Article 13(b)(ii) fails to read this provision according to its ordinary meaning, in its context, and to make sense of the text actually agreed by Members. In essence, Brazil suggests that whether a Member’s measures are in breach of the Peace Clause should be judged by comparing the aggregate outlays that may be attributed to a commodity (or producers of the commodity) to the aggregate outlays that were made during the 1992 marketing year that, again, may be attributed to that commodity. Three principal flaws in Brazil’s reading emerge.

90. First, as noted above, Brazil misunderstands the comparison that must occur under the proviso (second criterion) in Article 13(b)(ii). The proviso is written in the present tense (“provided that such measures *do not grant support*”) and thus, with respect to measures currently in effect, calls for a determination of the support that challenged measures currently grant. Instead, Brazil asserts that the Peace Clause applies “*only if the total quantity of support granted through all non-‘green box’ domestic support measures to a specific commodity in any marketing year from 1995-2003 does not exceed the quantity of . . . support decided to be granted in MY 1992.*”<sup>81</sup> However, Brazil *nowhere* explains how the support in any previous years are relevant to the present-tense criterion that Peace Clause-exempted measures “do not grant support” in excess of a certain level.<sup>82</sup> Thus, Brazil’s interpretation would ignore the ordinary meaning of the text of the Peace Clause, contrary to the customary rules of interpretation of public international law.

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<sup>81</sup> Brazil’s First Submission, para. 142 (second set of italics added). Indeed, Brazil goes on to examine in some detail support provided (in the form of budgetary outlays) during marketing years 1999-2002. Brazil’s First Submission, para. 148.

<sup>82</sup> Brazil’s interpretation of Article 13(b)(ii) avoids any mention or interpretation of the words “do not,” Brazil’s First Submission, paras. 128-42, and its analysis of the ordinary meaning and context of the phrase “grant support” assigns no meaning to Members’ choice of the verb tense, *see* Brazil’s First Submission, para. 135.

91. Second, Brazil misunderstands the support that is relevant to the Peace Clause comparison because it misreads the phrase “support to a specific commodity.” Brazil’s interpretive error may stem from the fact that it does not read this phrase together, instead first reading “grant support” and then separately reading “specific commodity.”<sup>83</sup> The Peace Clause proviso, however, links “support” with “a specific commodity” by using the word “to.” As the United States has noted, read according to the ordinary meaning of the terms in the context of the Agriculture Agreement, the phrase “support to a specific commodity” means “product-specific support.” Brazil ignores this meaning of “support to a specific commodity” when it asserts (again, without any basis in the Peace Clause text) that “grant support” requires “allocating the portion of support (by measures that are provided to more than one commodity) to the individual commodity under consideration.”<sup>84</sup> Brazil’s reading, however, would apparently capture “non-product-specific support,” which (as long as recipients are known) could always be allocated to individual commodities; non-product-specific support, however, on its face and in the context of the Agriculture Agreement is not “support to a specific commodity.”<sup>85</sup>

92. Brazil also asserts that the “use of the word ‘specific’ makes clear that . . . Article 13(b)(ii) addresses actionable subsidy challenges made on a product-by-product basis, as opposed to challenges regarding support for multiple commodities or even the Total Current AMS.”<sup>86</sup> Again, the plain text of the Peace Clause does not support Brazil’s reading the phrase “*support to a specific commodity*” to address the types of “actionable subsidy *challenges*” that may be brought rather than the *type of support* (product-specific) relevant to the Article 13(b)(ii) comparison.

93. Third, Brazil ignores the way in which the United States “decided” (“determined” or “pronounced”) the product-specific support for upland cotton during the 1992 marketing year. Brazil simply asserts that the “term ‘decided during the 1992 marketing year’ requires an examination of the *amount or quantity of support* (of the type mentioned in the *chapeau* of . . . Article 13(b)(ii) for a specific commodity that a WTO Member ‘decided’ to provide during the 1992 marketing year”<sup>87</sup> and that the “only ‘decision’ that could be said to have been made ‘during’ MY 1992 with respect to upland cotton was *to provide appropriations and continued funding* for upland cotton pursuant to the 1990 FACT Act.”<sup>88</sup> Notably for a brief that seemingly goes into matters in exhaustive detail, Brazil simply fails to provide the Panel with *any* description or explanation of the U.S. domestic support measures in effect during the 1992

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<sup>83</sup> Brazil’s First Submission, paras. 135-36.

<sup>84</sup> Brazil’s First Submission, para. 135.

<sup>85</sup> See Agriculture Agreement, Article 1(a) (“Aggregate Measurement of Support means, in part, the annual level of *support, expressed in monetary terms, provided for an agricultural product* in favour of the producers of the basic agricultural product *or non-product-specific support* provided in favour of agricultural producers in general, other than support provided under programmes that qualify as exempt from reduction under Annex 2 to this Agreement) (emphasis added); see also Agriculture Agreement, Article 1(h); *id.*, Article 6.4(a); *id.*, Annex 3, para. 1.

<sup>86</sup> Brazil’s First Submission, para. 136.

<sup>87</sup> Brazil’s First Submission, para. 139 (italics added).

<sup>88</sup> Brazil’s First Submission, para. 141 (italics added).

marketing year (such as the 1990 Act) and the way in which such measures “decided” the level of support for upland cotton.

94. As the United States will detail in the following section of this brief, U.S. domestic support measures did *not* decide on an outlay or expenditure amount in favor of upland cotton. Rather, U.S. measures “determined” a level of income support during the 1992 marketing year that the U.S. Government ensured that upland cotton farmers would receive for each unit of production – that is, *the measures set a rate of support*: \$0.729 per pound of upland cotton. The outlays or expenditures needed to provide this level of income support were neither known nor completed until *after* the marketing year ended and market prices reported.<sup>89</sup> Thus, no amount of outlays was “decided” (“determined” or “pronounced”) during the 1992 marketing year; indeed, Brazil nowhere explains how U.S. domestic support measures could have “decided” the amount of outlays since those outlays resulted from the difference between the income support level and world prices beyond the U.S. Government’s control.

95. Thus, Brazil’s analysis is in error because it fails to make sense of the Peace Clause text actually agreed by Members. Brazil’s presentation of 1999-2001 data is irrelevant; Brazil fails to focus the analysis on product-specific support; and Brazil mistakenly argues over budgetary outlays rather than the rate of income support. Correcting for these errors, U.S. domestic support measures do not grant product-specific support for upland cotton in excess of that decided during the 1992 marketing year.

## **2. U.S. Measures Conform to the Criteria in Article 13(b) and Are Exempt from Actions**

96. As the United States explained in the preceding section, a proper interpretation of the Peace Clause demonstrates that the relevant test for the applicability of Article 13(b)(ii) is to compare the product-specific support as it was decided in 1992 versus the product-specific support that existing measures currently grant. U.S. domestic support measures under the 2002 Act were written to grant support for upland cotton within the 1992 marketing year level so that such measures would conform to the Peace Clause criteria. In particular, the 2002 Act shifts support away from the product-specific support that prevailed in 1992 to reduce support linked to the production of upland cotton.

97. Brazil has asserted that U.S. domestic support measures for upland cotton grant support in excess of that decided during the 1992 marketing year by comparing U.S. budgetary outlays for the 1992 marketing year to U.S. budgetary outlays for marketing years 1999-2001 and its “reasonable” estimates of U.S. outlays for the 2002 marketing year. As noted above, Brazil’s interpretation of the Peace Clause and resulting analysis is fundamentally in error.

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<sup>89</sup> For example, deficiency payments for the 1992 crop of upland cotton were made during fiscal years 1992 (marketing year 91-92), 1993 (marketing year 92-93), and 1994 (marketing year 93-94). These payments were approximately \$399 million, \$621 million, and -\$2 million, respectively.

98. In this portion of its brief, the United States first explains the product-specific level of support decided during the 1992 marketing year, including the measures relevant to that analysis, and explains the errors in Brazil's analysis of the product-specific support "decided" in 1992. Then, the United States explains the product-specific level of support that U.S. measures now grant to upland cotton and the errors in Brazil's analysis. Finally, the United States explains how Brazil has mischaracterized various forms of support as product-specific support for cotton; properly understood, such measures are irrelevant to the 1992 to 2002 Peace Clause comparison.

99. The conclusion that results from this comparison is that U.S. measures do not grant product-specific support to upland cotton in excess of that decided during the 1992 marketing year. In fact, consistent with the United States' decision in the wake of the Uruguay Round to re-orient its support towards less trade- and production-distorting forms of support, the product-specific level of support for upland cotton now is far lower than in 1992.

**a. The Product-Specific Support for Upland Cotton Decided During 1992 Was To Ensure Income of 72.9 Cents per Pound**

100. The product-specific support in favor of upland cotton decided during the 1992 marketing year by U.S. domestic support measures was to ensure a level of income (\$0.729) for upland cotton farmers for each pound of upland cotton production. That is, U.S. domestic support measures set a *rate* of support, rather than deciding *ex ante* a level of budgetary outlay or expenditures. This support was granted by the 1990 Act through two programs: marketing loans (including marketing loan gains and loan deficiency payments) and deficiency payments.<sup>90</sup>

101. Through marketing loans, the U.S. Government in effect guaranteed that cotton producers would realize income equivalent to at least 52.35 cents (\$0.5235) per pound (the "1992 loan rate") of upland cotton produced.<sup>91</sup> The producer could take out a non-recourse marketing loan at the 1992 loan rate and repay at the prevailing world market price (receiving a "marketing loan gain" in the amount of the difference). Alternatively, a producer foregoing a marketing loan could choose to receive a "loan deficiency payment" in the amount of the difference between the loan rate and the prevailing world price. Marketing loans were available for every pound of upland cotton grown on a farm's permitted acres.<sup>92</sup>

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<sup>90</sup> Brazil appears to agree that marketing loans, deficiency payments, and user marketing (step 2) payments constitute product-specific support in favor of upland cotton. See Brazil's First Submission, para. 144 (listing these payments for marketing year 1992). Brazil also would include crop insurance payments as product-specific support; for an explanation why crop insurance is not product-specific, see *infra* § III.D.2.c.

<sup>91</sup> 57 Fed. Reg. 14326 (April 20, 1992) (Exhibit US-2); 7 Code of Federal Regulations part 1413 (1993 ed.) ("C.F.R.") (Exhibit US-3).

<sup>92</sup> Permitted acres were defined as a farm's base acres minus any acres required to be set aside under an acreage reduction program. 7 C.F.R. § 1413.3 (January 1, 1993) (Exhibit US-3). A ten percent acreage reduction program was in effect for 1992. Five percent of base acres (or 50 percent of the set-aside) was required to be planted to a conserving use. 7 C.F.R. § 1413.53-.54, .63 (January 1, 1993) (Exhibit US-3). Base acres were defined as the

102. The U.S. Government further ensured that cotton farmers would realize income equivalent to 72.9 cents per pound of upland cotton by making “deficiency payments.”<sup>93</sup> The payment rate for the deficiency payments was equal to the difference between 72.9 cents per pound (the “effective price”) and the higher of (1) the national average market price or (2) the loan rate (in 1992, 52.35 cents per pound).<sup>94</sup> Thus, when market prices were below the loan rate, marketing loans and deficiency payments working in concert ensured producer income of 72.9 cents per pound. When market prices were above the loan rate but below the effective price (72.9 cents per pound), deficiency payments alone ensured producer income of 72.9 cents per pound. To receive deficiency payments, upland cotton producers were required to have planted upland cotton, and under the 1990 Act payments could be received on planted acres up to 85 percent of a farm’s base acres.<sup>95</sup>

103. From the perspective of a farmer deciding whether to produce upland cotton, then, U.S. domestic support measures decided to grant that support necessary to ensure income of 72.9 cents per pound of production.<sup>96</sup> The support *actually* provided in 1992 as measured by the product-specific Aggregate Measurement of Support depended, of course, on market prices – that is, if prices had been higher than the effective price for the deficiency payment, no outlay would have been made, and if prices were lower (as they turned out to be) than the effective price, the U.S. Government would make deficiency payments to make up the shortfall in producer income.

104. Under the 1990 Act, the United States also decided to provide support in the form of user marketing (“step 2”) payments.<sup>97</sup> Among other conditions, these payments were wholly

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three-year average number of acres planted to upland cotton plus those acres considered planted (for example, acres not planted under an acreage reduction program). 7 C.F.R. § 1413.3, .7 (January 1, 1993) (Exhibit US-3).

<sup>93</sup> 1990 Act, § 501, *adding* Agricultural Act of 1949, § 103B(c)(1)(B)(ii), 7 U.S.C. § 1444-2(c)(1)(B)(ii) (Exhibit US-5); 7 C.F.R. § 1413.104(a)(3) (January 1, 1993) (Exhibit US-3).

<sup>94</sup> The formula for the *amount* of deficiency payment an upland cotton producer would receive was Payment rate  $\times$  Program yield  $\times$  Payment acres. Program yield for the 1991-1995 marketing years was defined as a farm’s 1981-1985 average yield per acre. 7 C.F.R. § 1413.6 (January 1, 1993) (Exhibit US-3); *see* 7 C.F.R. § 1413.6 (January 1, 1991) (Exhibit US-4). Payment acres are described further below.

<sup>95</sup> Deficiency payments were tied to a farm’s “payment acres,” which could be the actual planted acres up to 85 percent of base acres minus any acres required to be set-aside under an acreage reduction program. 7 C.F.R. § 1413.3 (January 1, 1993). As indicated earlier, in 1992 a ten percent set-aside was required. 7 C.F.R. § 1413.53-.54 (January 1, 1993).

<sup>96</sup> As noted, deficiency payments were made in general on the basis of the payment acres for the crop, which within certain limits were the planted acres of upland cotton. Thus, current production of cotton was required to receive deficiency payments in a given year. 1990 Act, § 501, *adding* Agricultural Act of 1949, § 103B(c)(1)(C); 7 C.F.R. §§ 1413.3, 1413.104, 1414.108 (January 1, 1993) (deficiency payment formula) (Exhibit US-3).

<sup>97</sup> Brazil agrees that user marketing (step 2) payments should be included for purposes of the Peace Clause comparison. However, we note that in presenting its erroneous comparison of outlays (rather than payment rates), Brazil includes the *entire* amount of user marketing payments for a given marketing year. *Compare* Brazil’s First Submission, para. 148 (including official “step 2” outlay data for purposes of Peace Clause comparison) *with id.*, para. 95 (presenting unofficial “step 2” outlay data related solely to exports). This would seem to contradict Brazil’s own argument that user marketing payments to exporters constitute export subsidies. *See* Brazil’s First Submission,

contingent on the price of U.S. cotton exceeding the price of the five lowest-priced growths of upland cotton from other countries by more than 1.25 cents per pound over four consecutive weeks.<sup>98</sup> If conditions were satisfied, payments of the price difference greater than 1.25 cents per pound were made to users of upland cotton. Thus, the level of support decided during the 1992 marketing year for user marketing (step 2) payments would be the difference prescribed by this formula.

105. Brazil does not bother to examine the terms on which support was “decided” by pertinent U.S. legislation and regulations during the 1992 marketing year. Indeed, Brazil’s entire Peace Clause analysis is predicated on the mistaken notion that the “only ‘decision’ that could be said to have been made ‘during’ MY 1992 with respect to upland cotton was to provide the appropriations and continued funding for upland cotton pursuant to the terms of the 1990 FACT Act.”<sup>99</sup> On this basis, Brazil assumes that the Peace Clause comparison is contingent on the outlays or expenditures provided for upland cotton under that legislation. However, by the terms of the 1990 Act and all subsequent implementing regulations, the support “decided” (that is, “determined” or “pronounced”) in favor of upland cotton was *not* expressed in terms of outlays or appropriations, but rather as a rate: that is, through both marketing loans and deficiency payments, producer income of 72.9 cents per pound of upland cotton. Both the 1990 legislation and regulations implementing the payments, which were originally published prior to the 1992 marketing year so that producers could become familiar with the programs, remained in effect during the 1992 marketing year, reflecting the decision of the U.S. Government to maintain the support set out in the 1990 Act.<sup>100</sup>

106. Thus, budgetary outlays, which reflect the difference between the rates set out in U.S. legislation and regulations (which *were* decided by the U.S. Government) and market prices (which obviously were *not*), do not represent the product-specific support “decided” during the 1992 marketing year. Rather, the product-specific support decided during the 1992 marketing year for upland cotton was to ensure producer income of 72.9 cents per pound and to promise, given certain conditions, user marketing payments according to the formula set out above.

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paras. 235-51. That is, to the extent Brazil considers some quantity of user marketing payments to be export subsidies, that amount should not be included in its erroneous comparison of outlays for purposes of determining whether Article 13(b) applies. Under this provision, the only relevant measures are “domestic support measures that conform fully to the provisions of Article 6.”

<sup>98</sup> More specifically, payments were made to users of upland cotton if there was a difference greater than 1.25 cents per pound between the price for U.S. cotton c.i.f. Northern Europe and the Northern Europe-delivered price for the five lowest-priced world growths of upland cotton for four consecutive weeks. The prevailing world price, moreover, could not exceed 130 percent of the upland cotton loan rate (52.35 cents per pound in 1992). 1990 Act, § 501, *adding* Agricultural Act of 1949, § 103B(a)(5)(E), 7 U.S.C. § 1444-2 (1992 ed.) (Exhibit US-5).

<sup>99</sup> Brazil’s First Submission, para. 141.

<sup>100</sup> See 7 C.F.R. part 1413 (January 1, 1993) (collecting upland cotton regulations in effect for 1992 marketing year) (Exhibit US-3); 57 Fed. Reg. 14326 (April 20, 1992) (regulations to establish 1992 marketing year upland cotton loan rate and regulations) (Exhibit US-2); 56 Fed. Reg. 16156 (April 19, 1991) (regulations implementing deficiency payment program and rate, including for upland cotton, under 1990 Act).

**b. U.S. Domestic Support Measures Currently Grant Product-Specific Support to Upland Cotton to Ensure Producer Income of 52 Cents per Pound**

107. Under the 2002 Act, product-specific support is again granted to upland cotton through the marketing loan program and through user marketing (step 2) payments. Despite a small adjustment in the user marketing (step 2) payment formula, U.S. measures currently in effect grant product-specific support to upland cotton far lower than that decided in the 1992 marketing year. This is a function of the United States' decision to shift support away from support linked to production of the specific commodity into less-distorting and non-distorting forms. The result is that the product-specific support for upland cotton under current measures is to ensure producer income at a rate of 52 cents per pound of production – that is, approximately 20 cents per pound less than the level decided in 1992, even taking into account the adjustment in the user marketing support formula.

108. Through the marketing loan program, the U.S. Government has in effect guaranteed that cotton producers will realize income equivalent to at least 52 cents (\$0.52) per pound (the “2002 loan rate”) of upland cotton produced.<sup>101</sup> Again, the producer may take out a marketing loan at the 2002 loan rate and repay at a lower prevailing world market price (receiving a “marketing loan gain” in the amount of the difference); alternatively, a producer foregoing a marketing loan may choose to receive a “loan deficiency payment” per pound of upland cotton produced in the amount of the difference between the loan rate and a lower prevailing world price.<sup>102</sup> Marketing loans and loan deficiency payments are contingent on a farm's actual production of upland cotton in the current marketing year.<sup>103</sup>

109. User marketing (Step 2) certificates are also authorized by the 2002 Act. These payments will be made under conditions similar to those set under the 1990 Act, with two relevant changes. First, payments will be made to buyers of upland cotton on the entire difference in price (rather than the price difference greater than 1.25 cents per pound) between the Northern Europe price of U.S. cotton and the price of the five lowest-priced growths of upland cotton from other countries.<sup>104</sup> Second, as a condition for payments to be made, the prevailing world price may not exceed 134 percent of the upland cotton loan rate (that is, 69.68 cents per pound) rather than 130 percent of the 1992 loan rate (that is, 68.055 cents per pound). Thus, user marketing payments

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<sup>101</sup> 2002 Act, § 1202(a), (b), 7 U.S.C. § 7932(a), (b) (Exhibit US-1).

<sup>102</sup> In the latter case, if the producer then sells the upland cotton at the prevailing world price, he or she realizes income of 52 cents per pound.

<sup>103</sup> 2002 Act, § 1201(b), 7 U.S.C. § 7931 (“The producers on a farm shall be eligible for a marketing assistance loan under subsection (a) for any quantity of the loan commodity produced on the farm.”) (Exhibit US-1); *id.*, § 1205(a)(1), (b), 7 U.S.C. § 7935(a)(1), (b) (Exhibit US-1).

<sup>104</sup> Payments are made to users of upland cotton if there is a difference between the price for U.S. cotton c.i.f. Northern Europe and the Northern Europe-delivered price for the five lowest-priced world growths of upland cotton for four consecutive weeks. 2002 Act, § 1207, 7 U.S.C. § 7937 (Exhibit US-1).



are potentially available now at a slightly higher world price than in 1992, and when such payments are made, the per pound payment rate is 1.25 cents more than under the 1992 formula.

110. Again, from the perspective of a farmer deciding whether to produce upland cotton, the incentive to produce is set by the level of income support that U.S. measures currently grant: that is, the loan rate of 52 cents per pound. The support *actually* provided during the 2002 marketing year as measured by the product-specific Aggregate Measurement of Support will not be known until *after* the marketing year has closed and will depend on market prices at the time a producer repays the marketing loan or receives a loan deficiency payment. For example, producers could have requested marketing loans on 2002 upland cotton through May 31, 2003; because loans are available for a term of 9 months beginning the first day of the month after the loan was made, producers may repay those loans as late as February 2004.<sup>105</sup>

111. Recall that the product-specific support decided during the 1992 marketing year for upland cotton was to ensure producer income of 72.9 cents per pound; U.S. domestic support measures currently grant product-specific support to upland cotton only at the rate of 52 cents per pound of production. In addition, U.S. measures both now and in 1992 promised, given certain conditions, to make user marketing (step 2) payments according to the formulas set out above. While the current formula suggests that user marketing payments will be 1.25 cents per pound greater now than in 1992 under identical circumstances, such a 1.25 cent difference cannot overcome the greater than 20 cent per pound difference in income support between that decided in 1992 compared to the support current measures grant. Thus, even taking into account the differences in payment rates for user marketing (step 2) payments, the conclusion that results from this comparison is that U.S. measures do not grant product-specific support to upland cotton in excess of that decided during the 1992 marketing year; in fact, current U.S. measures grant product-specific support at a rate more than 20 cents per pound *less* than that decided during 1992.

**c. U.S. Payments That Brazil Has Mischaracterized As Providing Support to a Specific Commodity Do Not Form Part of the Peace Clause Comparison**

112. As explained earlier, Brazil has failed to interpret properly the terms “support to a specific commodity” in Article 13(b)(ii). Read according to the ordinary meaning of its terms in their context, the phrase refers to product-specific support as understood in the Agriculture Agreement. As a result, Brazil improperly characterizes certain forms of U.S. payments – direct payments, counter-cyclical payments, and crop insurance – as providing support for a specific commodity, upland cotton. Properly understood, such payments are not product-specific support for upland cotton and are therefore irrelevant to the 1992 to 2002 Peace Clause comparison.

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<sup>105</sup> See 2002 Act, § 1203(a) (Exhibit US-1).

113. **Direct Payments:** With respect to direct payments, the United States has previously explained that these payments are green box support because they conform to the applicable general and policy-specific criteria under Annex 2 of the Agriculture Agreement.<sup>106</sup> Accordingly, direct payments are exempt from actions based on Part III of the Subsidies Agreement and GATT 1994 Article XVI pursuant to Article 13(a)(ii). As green box measures, direct payments are not part of the comparison under Article 13(b)(ii) between (a) the product-specific support which measures “that conform fully to the provisions of Article 6” grant and (b) the product-specific support decided during the 1992 marketing year. We do note, however, that because direct payments are based on quantities of acreage that historically produced cotton, and there is no requirement to produce upland cotton to receive these payments, direct payments are non-product-specific support.

114. **Counter-Cyclical Payments:** With respect to counter-cyclical payments, the United States notes that these measures do not grant product-specific support to upland cotton. Recall that the Agriculture Agreement distinguishes between product-specific support and non-product-specific support. For example, Article 1(a) defines the Aggregate Measurement of Support as “the annual level of support, expressed in monetary terms, provided *for an agricultural product* in favour of *the producers of the basic agricultural product* or non-product-specific support provided in favour of agricultural producers in general (italics added).” Thus, product-specific support is “provided for an agricultural product” for the benefit of “the *producers* of the basic agricultural product.” The payment formula for counter-cyclical payments demonstrates that these payments are not “provided for an agricultural product” because it is not current production of upland cotton that qualifies a recipient to receive payment. In addition, it is not “the producers of the basic agricultural product” – that is, current upland cotton growers – that are entitled to receive the counter-cyclical payments but rather persons (farmers and landowners) on farm acres with *past histories* of producing covered commodities, including upland cotton. Again, there is no requirement that the recipient of the counter-cyclical payment currently produce upland cotton. Thus, counter-cyclical payments do not provide support “for an agricultural product in favour of the producers of the basic agricultural product.”

115. The 2002 Act introduced counter-cyclical payments for the 2002-2007 marketing years.<sup>107</sup> Such payments are based on *historical* acreage bases and payment yields, similar to the direct payments described earlier. Owners of farm acres that were used to produce covered commodities (including upland cotton) in the base period are eligible to receive the payments. A person’s “payment acres” are 85 percent of “base acres,”<sup>108</sup> defined as either (1) the sum of

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<sup>106</sup> See *supra* § III.C.3.

<sup>107</sup> The formula for determining a landowner’s counter-cyclical payment is: Payment acres x payment yield x payment rate. 2002 Act, § 1103(c), 7 U.S.C. § 7913(c) (Exhibit US-1). Each of these terms is explained in the text above.

<sup>108</sup> 2002 Act, § 1101(f) (Exhibit US-1).

contract acreage for production flexibility contracts under the 1996 Act<sup>109</sup> and the four-year average (1998-2001) of plantings of eligible oilseeds or (2) a four-year average (1998-2001) of plantings of covered commodities.<sup>110</sup>

116. If a landowner chose to use the latter base acreage option, the landowner could elect a payment yield equal to *either* the direct payments yield (that is, the 1995 payment yield, which is the 1981-1985 yield for those acres) plus 70 percent of the difference between the farm's average 1998-2001 yield and the direct payments yield *or* 93.5 percent of the farm's average 1998-2001 yield.<sup>111</sup> The landowner could also simply choose the 1995 payment yield – again, which is the 1981-1985 yield for those acres.<sup>112</sup> Thus, both payment acres and payment yields are based on past, not current, production.

117. However, unlike direct payments, counter-cyclical payments *are* related to current market prices for covered commodities (including upland cotton). The payment rate for counter-cyclical payments made for past production of a covered commodity is the difference between (for each covered commodity) the target price<sup>113</sup> and the sum of (1) the direct payment rate plus (2) the higher of (a) the national average market price for the marketing year or (b) the loan rate.<sup>114</sup> Thus, the higher the market price for a covered commodity previously produced on a landowner's base acres, the lower the counter-cyclical payment rate; if the market price for

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<sup>109</sup> The contract acreage for production flexibility contracts under the 1996 Act was that quantity of acres which would have been determined under the 1990 Act, plus acreage returning from the Conservation Reserve Program. Under the 1990 Act, base acres for cotton were the average acres planted and considered planted during the previous three years. 1990 Act, § 1101, *amending* Agricultural Act of 1949, § 503, 7 U.S.C. § 1463. Thus, for 1996, base cotton acres were the average acres planted and considered planted during the 1993-1995 period. As a result, while a landowner may elect to simply utilize acres devoted to covered commodities during the 1998-2001 period for purposes of direct payments, a landowner need not do so; base acres may remain those under the 1996 Act, implying that no cotton production need have occurred since 1993-1995 for a landowner to have "cotton base acres."

<sup>110</sup> 2002 Act, § 1101, 7 U.S.C. § 1101 (Exhibit US-1). As noted with respect to direct payments, under the 1996 Act decoupled income support in the form of production flexibility contracts excluded acreage devoted to oilseeds (such as soybeans, canola, safflower, etc.) from eligibility for payments. In order to bring such acreage within the scope of payments under the 2002 Act, some mechanism was needed to account for those acres. Rather than compel all producers to use the 1998-2001 average plantings for all covered commodities, which would have penalized those producers who had chosen not to produce during that period (which did not alter their payments under the production flexibility contracts under the 1996 Act), the 2002 Act instead allowed producers either to retain base acres under the 1996 Act and add 1998-2001 acres (if any) of eligible oilseeds or simply declare base acres for all covered commodities (including oilseeds) using the 1998-2001 average.

<sup>111</sup> 2002 Act, § 1102(e) (Exhibit US-1).

<sup>112</sup> 2002 Act, § 1102(b), 7 U.S.C. § 7912(b) (Exhibit US-1). Payment yields for oilseeds, which were not covered under the production flexibility contracts under the 1996 Act, are determined by taking a farm's 1998-2001 average yield multiplied by the national average yield for 1981-1985, divided by the national average yield for 1998-2001. 2002 Act, § 1102(d), 7 U.S.C. § 7912(d) (Exhibit US-1).

<sup>113</sup> For marketing years 2002-2007, the target price for upland cotton 72.4 cents per pound. 2002 Act, § 1104(c), 7 U.S.C. 7914(c) (Exhibit US-1).

<sup>114</sup> 2002 Act, § 1104, 7 U.S.C. § 7914 (Exhibit US-1).

upland cotton equals or exceeds 65.73 cents per pound (that is, the target price of 72.4 cents per pound minus the direct payment rate of 6.67 cents per pound), no counter-cyclical payment will be made. Conversely, the lower the market price for a covered commodity previously produced on a landowner's base acres, the higher the counter-cyclical payment rate; if the market price for upland cotton falls below the loan rate, the counter-cyclical payment rate will be a maximum of 13.73 cents per pound (the difference between the target price and the sum of the direct payment rate plus the loan rate).

118. Thus, although counter-cyclical payments are made using a similar formula to that used for direct payments, the United States would not characterize counter-cyclical payments as “green box” because the “amount of such payments in any given year [is] related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.”<sup>115</sup> However, because counter-cyclical payments are based on quantities of acreage that historically produced cotton, and there is no requirement to produce upland cotton (or any other commodity) to receive these payments, counter-cyclical payments do *not* provide product-specific support – that is, “support . . . provided for an agricultural product in favour of the *producers* of the basic agricultural product.”<sup>116</sup> Because counter-cyclical payments are not product-specific support for upland cotton, such payments are not properly part of the Peace Clause comparison under Article 13(b)(ii).

119. **Crop insurance:** Neither does crop insurance grant product-specific support to upland cotton. As noted earlier, a variety of annual insurance plans are now subsidized and reinsured by the Federal Government. Multiple-Peril Crop Insurance protects producers from effects of reduced yields on individual farms. Under the Group Risk Plan, payments are made to participants based county-wide yield experiences. Revenue insurance plans have been available since 1996 and include Group Revenue Insurance Policy, Adjusted Gross Revenue, Crop Revenue Coverage, and Revenue Assurance. Participants in these programs may choose from various generic coverage and protection levels to insure greater than 100 types of crops. Also, producers may obtain catastrophic risk protection, which provides a minimum amount of coverage (50 percent of yield at 60 percent of the expected price) for a small, fixed fee for eligible commodities.

120. The basic program provisions for crop insurance are generic, not commodity-specific. For example, the U.S. Government provides an incentive to participate in the crop insurance program by subsidizing the premium paid by the farmer. This premium subsidy is available to a broad array of commodities around the country and does not vary by commodity. Because premium calculations are prescribed by plan of insurance, premium calculations for a given insurance plan for upland cotton are identical to premium calculations for every other crop insured under that plan.

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<sup>115</sup> Agriculture Agreement, Annex 2, para. 6(c).

<sup>116</sup> Agriculture Agreement, Article 1(a) (italics added).

121. Other coverage parameters, such as yields or market price, are also determined based on the policy, not by commodity. For example, all commodities are treated the same way in regard to their actual production history. The actual production history is a 4-10 year average of past yields. Once coverage level and policy type have been selected, of course, coverage and subsidy totals by commodity can be calculated based on which crops have been insured. However, this is a function of producer choices, not the program itself, which makes crop insurance available generally to producers. Thus, while the United States notifies crop insurance as “amber box” domestic support subject to U.S. reduction commitments,<sup>117</sup> crop insurance is “non-product-specific support in favour of agricultural producers in general” rather than “support . . . provided for an agricultural product in favour of the producers of the basic agricultural product.”<sup>118</sup>

122. **Conclusion:** Article 13(b)(ii) requires a comparison between the product-specific support for upland cotton that current measures grant and the product-specific support decided during the 1992 marketing year. In addition to other errors of interpretation and analysis Brazil has made with respect to this provision, Brazil has improperly attempted to characterize three U.S. payments – direct payments, counter-cyclical payments, and crop insurance – as providing support for a specific product commodity, upland cotton. However, direct payments provide green box support because they conform fully to the provisions of Agriculture Agreement Annex 2, and counter-cyclical payments and crop insurance grant non-product-specific support. Thus, none of these payments is product-specific support for upland cotton; all are therefore irrelevant to the 1992 to 2002 Peace Clause comparison.

**d. Conclusion: U.S. Non-Green Box Domestic Support Measures Are Exempt from Brazil’s Subsidies Agreement and GATT 1994 Article XVI Action**

123. Reading Article 13(b)(ii) according to the customary rules of interpretation of public international law, the relevant test for the applicability of the Peace Clause to non-green box domestic support measures is to compare the product-specific support decided during the 1992 marketing year versus the product-specific support that challenged measures currently in effect grant. Because the 2002 Act shifts support away from the product-specific support that prevailed in 1992 to reduce support linked to the production of upland cotton, the currently effective marketing loan program and user marketing (step 2) payments grant support not in excess of that decided during the 1992 marketing year.

124. Brazil has asserted that U.S. domestic support measures for upland cotton grant support in excess of that decided during the 1992 marketing year by comparing U.S. budgetary outlays for the 1992 marketing year to U.S. budgetary outlays for marketing years 1999-2001 and its

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<sup>117</sup> See G/AG/N/USA/43, at 37 (Supporting Table DS:9: Non-Product-Specific AMS).

<sup>118</sup> Agriculture Agreement, Article 1(a).

“reasonable” estimates of U.S. outlays for the 2002 marketing year. As noted above, Brazil’s interpretation of the Peace Clause and resulting analysis is fundamentally in error.

125. In fact, the level of income support granted to upland cotton producers is far lower now than in 1992. The product-specific support decided during the 1992 marketing year for upland cotton was to ensure producer income of 72.9 cents per pound through a combination of deficiency payments and marketing loans, both of which were linked to production of upland cotton. Now, U.S. domestic support measures grant product-specific support to upland cotton only at the rate of 52 cents per pound of production through marketing loans to upland cotton producers. While the current formula for calculating user marketing payments is slightly more generous now than in 1992, such a minor difference cannot alter the conclusion that the production-linked level of income support decided in 1992 was more than 20 cents per pound higher compared to the support that production-linked measures grant today.

126. Because the product-specific support that challenged U.S. measures grant to upland cotton is not in excess of that product-specific support to upland cotton decided during the 1992 marketing year, U.S. non-green box domestic support measures are “exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement.” As a result, Brazil may not maintain this action and advance claims under the specified provisions with respect to U.S. non-green box domestic support measures – marketing loan program payments, user marketing (step 2) certificates, counter-cyclical payments, and crop insurance subsidies.

#### **IV. U.S. Step 2 Payments Are Not an Export Subsidy, Not an Import-Substitution Subsidy, and Not Inconsistent with National Treatment Obligations**

##### **A. U.S. Step 2 Payments Are Not an Export Subsidy for Upland Cotton**

127. User marketing (Step 2) payments are made only when the price of the lowest-priced U.S. cotton exceeds the price of equivalent lowest-priced growths of upland cotton from other countries over four consecutive weeks. These payments are made to users of upland cotton. Such use can be manifest either by opening the bale of cotton or by export.

128. The Special Marketing Loan Provisions for Upland Cotton are currently authorized under section 1207 of the Farm Security and Rural Investment Act of 2002. Under this provision, the Secretary of Agriculture is authorized to issue marketing certificates or cash payments *to domestic users and exporters of upland cotton for documented purchases by domestic users and sales for export by exporters*. To assure that such payments are made to bona fide users of cotton, documentation is required.

129. Subject to the availability of funds, the federal government may issue marketing certificates or make payments under such program, only with respect to eligible upland cotton. Eligible upland cotton can be either baled upland cotton opened by an eligible domestic user or

exported by an eligible exporter. The program is indifferent to whether recipients of the benefit of this program are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States.<sup>119</sup> Accordingly, the United States reports the benefits conferred under the Step 2 program as product-specific amber box domestic support for cotton within its Aggregate Measure of Support under Part IV of U.S. Schedule XX.<sup>120</sup>

130. Brazil incorrectly asserts that the Step 2 program is an export subsidy as described under Article 9.1 of the Agreement or, in the alternative, is an export subsidy in circumvention of its obligation not to confer an export subsidy with respect to cotton, in contravention of Article 10.1 of the Agreement.

131. Article 1(e) of the Agreement on Agriculture states that “‘export subsidies’ refers to subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement.” Consequently, to constitute an “export subsidy” for any purposes of the Agreement, the subsidy must first be “contingent on export performance.”

132. The benefits of the Step 2 program are not contingent on export performance. The benefits of the program are subject to the availability of funds appropriated for the program, and theoretically, for any given year the benefits may as a result be available exclusively for domestic consumption.

133. A WTO dispute settlement panel has already determined that such facts do not involve an export subsidy for purposes of both Articles 9 and 10 of the Agreement on Agriculture, because the subsidy is not “contingent on export performance.” In *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products*<sup>121</sup> the United States and New Zealand challenged numerous aspects of Canada’s dairy export regime as contrary to its applicable export subsidy commitments. The United States and New Zealand successfully asserted that certain milk classes within the milk class system of Canada conferred export subsidies upon dairy processors. These classes were denominated “Special Classes 5(d) and 5(e).”

134. In addition, however, the United States challenged the application of milk Classes 5(a) to 5(c). These classes “covered milk for domestic use as well as milk for export.”<sup>122</sup> The panel specifically noted “that milk under such other classes is also available (often exclusively) to processors which produce for the domestic market.” The subsidy of these classes was also of course available in connection with exported product. Nevertheless, the panel found that because

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<sup>119</sup> Indeed, to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation.

<sup>120</sup> G/AG/N/USA/43, at 20 (Supporting Table DS:6) (Exhibit Bra-47).

<sup>121</sup> Panel Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products* (“*Canada – Dairy*”), WT/DS103/R; WT/DS113/R, adopted as modified by the Appellate Body on 27 October 1999.

<sup>122</sup> *Canada – Dairy*, fn. 373 & para. 7.41.

of the availability of the subsidy to processors producing for the domestic market, “access to milk under such other classes is not ‘contingent on export performance.’ We therefore find that such other milk classes do not involve an export subsidy under Article 9.1(a).”<sup>123</sup> For precisely the same reasons, the panel also found that “these other milk classes do not involve an export subsidy in the sense of Article 10.1.”<sup>124</sup> This element of the panel report was not appealed and therefore was adopted by the DSB.

135. Brazil asserts that the Step 2 program enhances the export competitiveness of U.S.-produced upland cotton, and further asserts that this is an effect consistent with the expressed purpose of the program. Whether or not this is an effect of the program is irrelevant to whether the program is an export subsidy that is inconsistent with the obligations of the United States under Articles 9 and 10 of the Agreement on Agriculture. The question must remain whether the United States confers an export subsidy with respect to upland cotton within the meaning of the Agreement on Agriculture. The subsidy is not contingent on export performance and therefore is not an export subsidy. Expenditures to upgrade port facilities and airports could enhance the export competitiveness of upland cotton and other U.S. agricultural commodities, but such expenditures in no way would constitute export subsidies under the Agreement.

#### **B. Brazil Bears the Burden of Proof to Demonstrate the Existence of an Export Subsidy for Upland Cotton**

136. Notwithstanding its arguments to the contrary, Brazil as complainant bears the burden of proof with respect to any claim of export subsidy of upland cotton by the United States.<sup>125</sup> Brazil cites Article 10.3 of the Agreement on Agriculture to assert that the United States bears this burden. However, the burden-shift set forth in Article 10.3 is only applicable with respect to exports in excess of a *reduction* commitment level.<sup>126</sup>

137. Brazil correctly points out that the United States does not have such a *reduction* commitment level with respect to upland cotton. Article 10.3 of the Agreement on Agriculture therefore does not apply with respect to United States exports of cotton. As one WTO dispute panel has noted:

In considering this issue, the question before us is whether products which do not appear in a Member’s schedule are subject to “reduction commitment” within the meaning of Article 10.3. In our view, a Member which has not scheduled a given product may well have a *commitment* with respect to that product, in as much as it

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<sup>123</sup> *Canada – Dairy*, para. 7.41.

<sup>124</sup> *Canada – Dairy*, fn. 496, para. 7.124.

<sup>125</sup> Brazil’s First Submission, paras. 263-68.

<sup>126</sup> Article 10.3 provides: “Any Member which claims that any quantity exported in excess of a reduction commitment level is not subsidized must establish that no export subsidy, whether listed in Article 9 or not, has been granted in respect of the quantity of exports in question.”



is precluded by Article 3.3 of the Agreement from providing export subsidies listed in Article 9.1 with respect to that product. We do not consider, however, that the Member has a *reduction* commitment with respect to an unscheduled product.<sup>127</sup>

The Panel found that with respect to unscheduled products the burden remained with the complainant.

### **C. U.S. Step 2 Payments Are Not a Prohibited Subsidy Under Article 3 of the Subsidies Agreement**

138. With respect to domestic support, the negotiators of the Agreement on Agriculture devised the novel concept of “Aggregate Measurement of Support” (AMS), defined in Article 1(a) of the Agreement.<sup>128</sup> As the definition provides, all annual domestic support provided for an agricultural product, like cotton, in favor of the producers of that product that is not otherwise exempt under the “green box” (Annex 2 of the Agreement on Agriculture) from reduction commitments, or as otherwise provided in Articles 6.4 and 6.5 of the Agreement, is included in the AMS.

139. The definition further contemplates that support provided during any one year is to be calculated in accordance with the provisions of Annex 3 of the Agreement on Agriculture. Paragraph 7 of Annex 3 requires that “measures directed at agricultural processors shall be included [in the AMS] to the extent such measures benefit the producers of the basic agricultural products.” Accordingly, Step 2 user payments, directed at upland cotton processors and other users but intended to benefit U.S. producers of upland cotton, are included in the annual AMS

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<sup>127</sup> Panel Report, *United States - Tax Treatment for “Foreign Sales Corporations,”* WT/DS108/R, adopted as modified by the Appellate Body on 20 March 2000, paras. 7.138-7.143.

<sup>128</sup> That definition provides that:

In this Agreement, unless the context otherwise requires:

(a) “Aggregate Measurement of Support” and “AMS” mean the annual level of support, expressed in monetary terms, provided for an agricultural product in favour of the producers of the basic agricultural product or non-product-specific support provided in favour of agricultural producers in general, other than support provided under programmes that qualify as exempt from reduction under Annex 2 to this Agreement, which is:

(i) with respect to support provided during the base period, specified in the relevant tables of supporting material incorporated by reference in Part IV of a Member’s Schedule; and

(ii) with respect to support provided during any year of the implementation period and thereafter, calculated in accordance with the provisions of Annex 3 of this Agreement and taking into account the constituent data and methodology used in the tables of supporting material incorporated by reference in Part IV of the Member’s Schedule[.]

calculation of the United States. As a result, such payments are subject to reduction commitments applicable to the United States.

140. This approach and the inclusion of such payments is consistent with the articulated objective of the Agreement on Agriculture “to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time.”

141. Since the inception of the Uruguay Round Agreements, Step 2 benefits have been reported among the domestic support measures of the United States in favor of its agricultural producers.<sup>129</sup> The United States has consistently reported Step 2 as “amber box” product-specific support included within its calculation of its Total Aggregate Measure of Support<sup>130</sup> and therefore within its domestic support reduction commitments as set forth in Part IV of its Schedule.

142. Article 6.3 of the Agreement on Agriculture provides that “a Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favor of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member’s Schedule.”

143. Where a particular program exists in favor of agricultural producers within such Current Total AMS, the text of the Agreement on Agriculture is entirely agnostic as to the method of delivery of such support. This is in contrast, for example, to the detailed criteria for eligibility for exemption from such domestic support reduction commitments under Annex 2 (so-called “green box” support) or Article 6.5 (so-called “blue box” support).

144. As a result, under Article 6.3 of the Agreement on Agriculture 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.” As noted above, a significant part of the object and purpose of the Agreement on Agriculture is to achieve specific binding commitments in the area of domestic support, including substantial progressive reductions in such support. The text is not hide-bound on the manner in which such support is provided. This is similar to the approach on export subsidies in which commitments are expressed in terms of quantity and budgetary outlays,

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<sup>129</sup> Linked directly to world prices and U.S. domestic loan rates for upland cotton, the availability of payments under the Step 2 program is a component of domestic support for U.S. cotton producers. The statutory authority for the Step 2 program, set forth in Section 1207 of the Farm Security and Rural Investment Act of 2002 (7 U.S.C. 7937) imposes a specific cap on the availability of payment as a function of loan rates for non-recourse marketing assistance loans to domestic upland cotton producers under Sections 1202(a)(6) and 1202(b)(6) of that act. Under Section 1207(a)(1)(B) Step 2 payments are simply not available if “the prevailing world market price for upland cotton (adjusted to United States quality and location) [exceeds] 134 percent of the loan rate for upland cotton established under section 1202.”

<sup>130</sup> Total Aggregate Measurement of Support is also a defined term in the Agreement on Agriculture in Article 1(h).

but without any prohibition on a particular method of providing such subsidies. In contrast, only when a party seeks to take advantage of exemptions from domestic support reduction commitments must it conform with the policy-specific criteria for programs elaborated in Annex 2 of the Agreement. Accordingly, the United States is in compliance with its domestic support reduction commitments, of which support in the form of the Step 2 program is a constituent part, as provided in the Agreement on Agriculture.

145. The first words of Article 3 of the Subsidies 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 Agreement on Agriculture apply “except as provided in the Agreement on Agriculture”.<sup>131</sup> Thus, Article 3.1(a) and 3.1(b) of the Subsidies Agreement can apply to the Step 2 program, “except as provided in the Agreement on Agriculture.” The conformity of the Step 2 programs with the terms, object and purpose of the Agreement on Agriculture constitute precisely the kind of exception contemplated in the introductory words of Article 3 of the Subsidies Agreement. Inasmuch as Articles 3.1(a) and (b) do not apply, the operation of the Step 2 program also cannot violate Article 3.2 of the Subsidies Agreement.

#### **D. U.S. Step 2 Payments Are Not Inconsistent with GATT 1994 Article III:4**

146. As contemplated by the terms of the Step 2 program itself, as well as Annex 3 of the Agreement on Agriculture the Step 2 program provides benefits in favor of U.S. upland cotton producers. As noted above, the Step 2 program is in conformity with Article 6 of the Agreement on Agriculture. In addition, Article 3.1 of the Agreement on Agriculture provides that the domestic support commitments in Part IV of each Member’s Schedule are made an integral part of GATT 1994. The domestic support commitments of the United States are therefore an integral part of GATT 1994 itself and, Article 21.1 of that Agreement on Agriculture expressly states that “the provisions of GATT 1994 . . . shall apply subject to the provisions of this Agreement.”

147. Pursuant to Article 6.3 of the Agreement on Agriculture, “a Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favor of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member’s Schedule.” The Step 2 program exists in favor of agricultural producers within such Current Total AMS, and the text of the Agreement on Agriculture does not prohibit any particular form of delivery of such amber box domestic support.

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<sup>131</sup> In addition, Article 21.1 of the Agreement on Agriculture expressly makes “the provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement” apply “subject to the provisions of [the Agreement on Agriculture].” The Agreement on Subsidies and Countervailing Measures is such an Annex 1A agreement.

148. Brazil focuses exclusively on GATT jurisprudence involving Article III:8(b), which sets forth the long-standing exception to otherwise applicable national treatment obligations for payment of subsidies exclusively to domestic producers. All of this jurisprudence precedes the Uruguay Round Agreements, however.

149. The Agreement on Agriculture imposed for the first time rigorous disciplines on agricultural support. The commitments of the United States constitute an integral part of GATT 1994. Under the general rule of interpretation set forth in Article 31 of the Vienna Convention on the Law of Treaties, such commitments, in conjunction with the provisions of the Agreement on Agriculture itself, should be interpreted in good faith in accordance with the ordinary meaning to be given the GATT 1994 and the Agreement on Agriculture in their context and in the light of their object and purpose.

150. Annex 3, paragraph 7, of the Agreement on Agriculture specifically requires that “[m]easures directed at processors shall be included” in the calculation of AMS to subject these measures to the domestic support reduction commitments established for the first time in the Agreement on Agriculture. It would be illogical to include such payments in the required calculations and subject them to reduction commitments if they were already prohibited under Article III:4 of GATT 1994. A coherent reading of the Agreement on Agriculture with the GATT 1994 indicates that the Step 2 program, in conformity with the Agreement on Agriculture, does not violate Article III:4 of GATT 1994.

## **V. The Commodity Credit Corporation Export Credit Guarantee Programs are Not Export Subsidies**

### **A. Description of the Programs**

151. Since late 1980, the Commodity Credit Corporation, a federally-chartered corporation within the U.S. Department of Agriculture, has issued fee-based export credit guarantees to U.S. exporters against the risk of payment default by certain banks outside the United States. The exporters typically assign the benefit of these guarantees to financial institutions in the United States, which then finance the U.S. dollar-denominated repayment obligation of the foreign bank over a period of time. In the case of the Export Credit Guarantee Program (GSM-102) this may be up to 3 years. In the case of the Intermediate Export Credit Guarantee Program (GSM-103), far less frequently used than GSM-102, the repayment term may be between 3 and 10 years. Otherwise, these two programs are substantially similar. The amount financed corresponds to the amount owing under the documentary letter of credit issued by the foreign bank. Under GSM-102 and GSM-103 CCC guarantees repayment of a substantial amount of principal installments due (typically 98 percent) and a significantly lesser amount of interest.<sup>132</sup>

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<sup>132</sup> Each guarantee will state a maximum amount of eligible interest, which in any event may not exceed the average investment rate of the most recent U.S. Treasury 52-week bill auction in effect at that time. 7 C.F.R. § 1493.20(g) (Exhibit US-6).

152. Under the Supplier Credit Guarantee Program (SCGP),<sup>133</sup> no letter of credit is involved. The importer issues a promissory note in favor of the exporter. The CCC guarantee extends to 65 percent of principal installments and does not cover interest. These guarantees currently extend to a maximum 180 day term. The guarantee is often assigned to a financial institution in the United States.

153. CCC does not loan any money at all under any of these programs to the U.S. exporter, the financial institution in the United States, the foreign bank or the importer.<sup>134</sup> CCC also has no role in the arrangements between the foreign bank issuing the letter of credit and the importer, which is typically the account party under the letter of credit.<sup>135</sup> CCC also does not confirm any letter of credit.<sup>136</sup>

#### **B. CCC Export Credit Guarantee Programs Are Not Export Subsidies Under the Agreement on Agriculture**

154. During the Uruguay Round, negotiators reached agreement on disciplines that covered a large number of areas that had been the subject of negotiations. They did not, however, reach agreement on all such areas. Indeed, in several cases, negotiators agreed to continue negotiating after the close of the Round and the entry into force of the WTO Agreement. For example, negotiators agreed that after the entry into force of the WTO Agreement Members would undertake a harmonization work program on rules of origin,<sup>137</sup> negotiations concerning the

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<sup>133</sup> Unlike GSM-102 and GSM-103, the Supplier Credit Guarantee Program did not begin until 1996.

<sup>134</sup> Contrary to the assertion of Brazil, Brazil's First Submission, para. 300, the United States does *not* provide monetary allocations to any countries. Any allocations announced under the program are purely *potential* availability of export credit guarantees for certain export transactions to certain countries. Importing countries receive neither the benefit of any such guarantee nor any cash payment. In addition, also contrary to the arguments of Brazil, the Commodity Credit Corporation has complete discretion at any time not to issue guarantees with respect to any individual application for an export credit guarantee or to suspend the issuance of export credit guarantees under any particular allocation. *See, e.g.*, 7 C.F.R. §§ 1493.10(d), 1493.40(b) (Exhibit US-6).

<sup>135</sup> In paragraph 29 of its submission, Brazil incorrectly describes certain aspects of the GSM-102 and GSM-103 programs. Brazil states that "the programs guarantee the repayment of loans granted to foreign importers of U.S. agricultural goods." To the contrary, CCC guarantees no loans granted to foreign importers. It guarantees only certain repayment obligations of foreign banks to U.S. financial institutions. Whether or not the foreign bank has extended a loan to the importer – and the terms of any such loan – is exclusively an issue between such foreign bank and its importer customer. CCC has no role in that financial relationship. Consequently, the importer may have to pay its bank in full upon disbursement under the documentary letter of credit, but the foreign bank itself may be able to repay the U.S. financial institution over time for the amount disbursed under the letter of credit. That bank, however, continues to bear the risk of fluctuation in rates of foreign exchange, because all obligations must be denominated in dollars to be eligible for an export credit guarantee. The CCC guarantee provides no coverage for foreign exchange risk.

<sup>136</sup> Brazil misstates the role of CCC in paragraph 102 of its submission. Confirmed letters of credit are not required under the program. Private banks may enter into their own arrangements with each other for confirmation of documentary letters of credit. CCC is not a bank and neither confirms nor advises documentary letters of credit.

<sup>137</sup> *Agreement on Rules of Origin*, Article 9.

establishment of a multilateral system of notification and registration of geographical indications for wines,<sup>138</sup> multilateral negotiations on the question of emergency safeguards with respect to trade in services,<sup>139</sup> multilateral negotiations on government procurement in services,<sup>140</sup> and negotiations with a view to developing multilateral disciplines to avoid distortive effects of subsidies on trade in services.<sup>141</sup> Negotiators also agreed to continuing negotiating specific commitments in several service sectors beyond the close of the Uruguay Round, including in maritime transport services and basic telecommunications.<sup>142</sup>

155. The simple fact is that during the Uruguay Round WTO Members did not agree on disciplines to be applicable to export credits, export credit guarantees, and insurance programs. Unable to reach agreement on such disciplines within the Uruguay Round, Members opted to continue discussions in an appropriate forum, deferring the imposition of substantive disciplines until a consensus was achieved.

156. As a result, following the entry into force of the WTO Agreement, numerous WTO Members commenced negotiations under the auspices of the Organization for Economic Cooperation and Development (OECD) to achieve such internationally agreed disciplines, which in the OECD was described as a proposed sector understanding on export credits for agricultural products. The OECD was the logical forum for such negotiations because of the institutional experience of the OECD in the development of disciplines on officially supported export credits, export credit guarantees and insurance programs in the industrial sector.<sup>143</sup>

157. Many Members, including the United States, were actively engaged in such negotiations until well into 2001 but regrettably failed to achieve an agreement.<sup>144</sup> Negotiations on disciplines for export credits and export credit guarantees have subsequently continued both under the reform process contemplated under Article 20 of the Agreement on Agriculture and the mandate of the Doha Ministerial Declaration.

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<sup>138</sup> *Agreement on Trade-Related Aspects of Intellectual Property Rights*, Article 23.4.

<sup>139</sup> *General Agreement on Trade in Services* (“GATS”), Article X.

<sup>140</sup> GATS, Article XIII.

<sup>141</sup> GATS, Article XV.

<sup>142</sup> GATS, *Annex on Negotiations on Maritime Transport Services* and *Annex on Negotiations on Basic Telecommunications*.

<sup>143</sup> The WTO Agreement already recognizes the authoritative role of the OECD in the area of official export credits, as reflected in item (k) of the Illustrative List of Export Subsidies in Annex I of the Subsidies Agreement.

<sup>144</sup> The final state of negotiations is reflected in “The Chairman’s Revised Proposal for a Sector Understanding on Export Credits for Agricultural Products,” TD/CONSENSUS(2000)25/REV4, (16 November 2000, replaced 09 July 2002) (<http://www.oecd.org/dataoecd/31/12/1939746.pdf>) (Exhibit US-7). As explicitly reflected in Paragraph A(ii) of the Chairman’s Proposal, the participants expected the draft understanding to constitute the internationally agreed disciplines contemplated by Agriculture Agreement Article 10.2.

158. Building upon the work in the OECD, numerous Members,<sup>145</sup> including the United States, have submitted proposals in an effort to achieve the internationally agreed disciplines contemplated under Article 10.2.<sup>146</sup> MERCOSUR, including Brazil, in its own proposal in the WTO on Export Credits for Agricultural Products quotes Article 10.2 at the outset and then states: “This set of disciplines has not yet been developed in the WTO, which is the appropriate forum for the negotiation of the ‘internationally agreed disciplines’ on export credits. Thus, Article 10.2 of the Agreement on Agriculture remains unimplemented.”<sup>147</sup> In that same document, MERCOSUR observes: “The lack of disciplines to govern the granting of export credits to agricultural products is, therefore, an outstanding issue, which requires priority in the WTO in order to prevent its use to circumvent export subsidy commitments.”

159. The scope and detail of the current agriculture negotiations as reflected in the Harbinson text demonstrate that the Members are currently engaged in active negotiations on disciplines for export credits and credit guarantees. Among the areas under active discussion include disciplines on the relationship between premiums, term, and long-term operating costs and losses.<sup>148</sup> These discussions would be unnecessary if existing disciplines applied to such programs in agriculture. The Panel should not pre-empt such negotiations.

160. The text of the Agreement on Agriculture reflects the deferral of disciplines on export credit guarantee programs contemplated by WTO Members:

*Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.*

As simply reflected in the structure and text of the Agreement on Agriculture, Members came to no agreement with respect to substantive disciplines on export credit guarantee programs. Consequently, they are permitted to continue, unaffected by export subsidy disciplines otherwise negotiated and reflected in the text of the Agreement.<sup>149</sup> The export credit guarantee programs

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<sup>145</sup> For example, the Cairns Group submitted specific input on November 20, 2002, in the form of a Negotiating Proposal on Export Competition, which included extensive proposals for discipline on export credits. JOB(02)/186 (20 November 2002) (Exhibit US-8).

<sup>146</sup> The current state of this subject in the Negotiations on Agriculture under the mandate of the Doha Ministerial Declaration is reflected in Attachment 5 of the first revision of the First Draft of Modalities for Further Commitments, dated March 18, 2003 (TN/AG/W/1/Rev. 1), promulgated by Mr. Stuart Harbinson, the chairman of the Negotiations on Agriculture. This document is commonly referred to as “the Harbinson text”. See Exhibit US-9.

<sup>147</sup> G/AG/NG/W/139; G/AG/W/50 (21 March 2001) (Exhibit US-10).

<sup>148</sup> Harbinson text, TN/AG/W/1/Rev. 1, Attachment 5, para. 4.

<sup>149</sup> Although admittedly not dispositive as a matter of interpretation for purposes of the WTO, this view was clearly held within the OECD. An OECD document entitled “An Analysis of Officially Supported Export Credits in Agriculture” notes:

are therefore not export subsidies under the Agreement on Agriculture and are not subject to the export subsidy disciplines of that agreement.<sup>150</sup>

161. Article 10.2 stands in stark contrast to Article 9.1 in the Agreement. Article 9.1 sets forth a list of six very specific practices known to the drafters and deemed to constitute export subsidies under the Agreement on Agriculture. In this respect, Article 9.1 serves a function not unlike the Illustrative List of Export Subsidies in Annex I of the Subsidies Agreement. Significantly, that Illustrative List of Export Subsidies explicitly addresses export credit and credit guarantee practices in its item (j). In contrast, conspicuously absent in Article 9.1 is any provision addressing such practices, even though U.S. export credit guarantee programs had been in existence for nearly fifteen years preceding the inception of obligations under the Uruguay Round Agreements.

162. Export credits and credit guarantee programs were obviously debated during the Uruguay Round. They are therefore mentioned in Article 10.2. However, consistent with the approach to defer negotiations on disciplines on these practices, no export credit guarantee practices are reflected in Article 9.1 at all. Brazil does not allege that the export credit guarantee programs of the United States are described in Article 9, because in fact they are not.

163. Article 10.2 specifically addresses export credit guarantees and defers the imposition of any disciplines with respect to such programs. To include the long-established U.S. export credit

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[O]fficially supported export credits for agricultural products were at issue during the URAA. Under the WTO Agreement on Agriculture, signatory countries undertook to ‘work towards the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes.’ An Arrangement on Guidelines for Officially Supported Export Credits has existed in the context of the OECD for over 20 years. . . . However, agricultural products are specifically excluded from the scope of the Export Credit Arrangement. In a meeting in July 1994, negotiators agreed to begin to consider a sector Understanding for agriculture products, taking into account earlier work including a survey on practices in this sector. . . . [T]he OECD Ministerial Meeting Communique of 2000 expressed that the Ministers ‘regretted the failure of the Participants to the Export Credit Arrangement to reach an agreement on an Understanding covering agriculture as mandated in the Uruguay Round’ and went on to state a need ‘for negotiations to be resumed and successfully completed by the end of July 2000 if possible and by the end of 2000 at the latest’, yet no agreement has been reached as of October 2000. *Hence, governments are currently free to provide credits to importers at any terms, no matter the degree to which they effectively subsidize the importer, as long as there is no protocol governing or limiting their use in agriculture.*

*Id.*, para. 8 (emphasis added) (<http://www.oecd.org/dataoecd/48/45/1911035.pdf>).

<sup>150</sup> Once internationally agreed disciplines on export credits are achieved, then it would be possible for a given export credit practice to circumvent export subsidy disciplines as a result of failure to comply with the export credit disciplines. Indeed, paragraph 5 of Attachment 5 of the Harbinson text contemplates precisely that approach. Such approach would be not unlike the current disciplines applicable to international food aid under Article 10.4. The Members recognized the possibility that food aid could be applied in a manner that would circumvent export subsidy disciplines. Accordingly, the Agreement on Agriculture ties the discipline on food aid to terms negotiated elsewhere: the Food Aid Convention and the FAO.



guarantee programs within the ambit of Article 10.1 or within the definition of export subsidy under Article 1(e) of the Agreement would render the work program envisioned by Article 10.2 unnecessary. Further, to adhere to the approach that Brazil advocates would allow for the utter irrelevance of Article 10.2. Such an absurd and unreasonable result is disfavored under the rules of interpretation of public international law that are reflected in the Vienna Convention on the Law of Treaties.<sup>151</sup> Indeed, Brazil unabashedly makes not one reference to Article 10.2 in its initial submission.

164. Article 10.2 pointedly does *not* say “in addition to the export subsidy commitments” of this Agreement. The plain words of Article 10.2 indicate that the export credit guarantee programs are not subject in any way to the export subsidy disciplines of that Agreement. To the contrary, the Article plainly provides that the WTO Members would work toward the development of “internationally agreed disciplines”, not “additional internationally agreed disciplines”. And only “*after* agreement on such disciplines” would the Members “provide export credits, export credit guarantees or insurance programs only in conformity therewith.”

165. If the export credit guarantee programs were to be subject to the export subsidy disciplines of the Agreement on Agriculture, why would there be a need for Article 10.2? Indeed, why would there be a need to contemplate further internationally agreed disciplines applicable for export credit guarantees at all? Brazil’s argument would require the export subsidy disciplines to apply already. Brazil’s argument also would obviate the need for the extensive negotiations currently underway and reflected in the Harbinson text. Brazil’s argument would render Article 10.2 and the subsequent 7 years of work in the OECD, as well as the ongoing negotiations in the Doha Round, a redundancy or “inutility”. This would yield an absurd result both as a matter of textual interpretation and as a matter of logic and history.

166. The export credit guarantee programs are not subject to discipline under the Agreement on Agriculture *until* Members achieve “internationally agreed disciplines to govern the provision of export credit guarantees.” The export credit guarantee programs of the United States are not export subsidies under the Agreement on Agriculture.

**C. CCC Export Credit Guarantees are Not Prohibited Export Subsidies Under the Subsidies Agreement**

**1. Article 10.2 of the Agriculture Agreement Is an Explicit Exception from Article 3.1 of the Subsidies Agreement**

167. Brazil has alleged that the CCC export credit guarantee programs are prohibited subsidies under Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures. The very first words of Article 3.1 of the Subsidies Agreement, however, are: “Except as provided in the

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<sup>151</sup> Vienna Convention on the Law of Treaties, Article 32(b).

Agreement on Agriculture.” Article 10.2 of the Agreement on Agriculture, as noted above, provides for the deferral of disciplines unless and until the internationally agreed disciplines contemplated are in fact achieved.

168. Brazil has conveniently ignored both Article 10.2 of the Agreement on Agriculture and the explicit introductory words of the Article 3.1 of the Subsidies Agreement. Neither appears in Brazil’s first submission.

169. Brazil further concedes that the export credit guarantees are “exempt from action under ASCM Article 3.1(a) if they fully conform to the provisions of [Agreement on Agriculture] Part V.”<sup>152</sup> These programs are in conformity with Article 10.2, which is within such Part V.

170. In addition, Article 21 of the Agreement on Agriculture reinforces the direct relationship between Article 3 of the Subsidies Agreement and Article 10.2 of the Agreement on Agriculture. Article 21.1 explicitly provides that the Multilateral Trade Agreement in Annex 1A to the WTO Agreement, which includes the Subsidies Agreement, shall apply subject to the Agreement on Agriculture.

## **2. The Export Credit Guarantee Programs, As Applied to Exports of Upland Cotton, Do Not Constitute an Export Subsidy Under the Subsidies Agreement**

171. The United States has submitted a request for preliminary ruling to uphold the position of the United States that Brazil’s arguments with respect to the export credit guarantee programs in connection with all commodities other than upland cotton are not properly before the panel. As a result, the United States limits its arguments with respect to export credits in this submission to the only commodity properly before the panel: upland cotton.

172. Fundamentally, Brazil alleges that the export credit guarantee programs constitute an export subsidy for purposes of the Subsidies Agreement because such programs fall within item (j) of the Illustrative List of Export Subsidies set forth in Annex I of the Subsidies Agreement. In effect, Brazil alleges the United States provides export credit guarantees for cotton “at premium rates which are inadequate to cover the long-term operating costs and losses of the programs.” Brazil further argues that a ten-fiscal-year period “fulfills the criterion of being ‘long-term’ within the meaning of item (j).”<sup>153</sup>

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<sup>152</sup> Brazil’s First Submission, para. 306.

<sup>153</sup> Brazil’s First Submission, para. 282.

173. Quite simply, with respect to cotton, as reflected in the tables below, for the last 10 fiscal years for which complete data is available (fiscal years 1993 - 2002)<sup>154</sup>, premiums paid exceed claims paid.<sup>155</sup> Although claims paid may be the simplest depiction of “losses”, in the context of the export credit guarantee programs it is not the most appropriate. Although CCC may initially incur an expenditure as a result of a claim, it also may subsequently recover monies related to such expenditures. Such recoveries may be simple late payments of the original obligations or may be payments in accordance with terms of a rescheduling.<sup>156</sup> As with any other insurance-type program, therefore, a proper analysis of “losses” should involve the calculation of the net result of premiums collected, plus claims amounts repaid or rescheduled, minus claims paid. Such calculation would properly reflect the net position of the program.

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<sup>154</sup> Prior to the initiation of this dispute, the United States did not compile the data in this format. To compile the data required obtaining different portions from different sources within the U.S. government. As a result of this process, the United States also concluded that much of its data prior to fiscal year 1992 may be unreliable.

<sup>155</sup> The initial table reflects only the CCC Export Credit Guarantee Program (GSM-102). No cotton transactions occurred in connection with the Intermediate Export Credit Guarantee Program (GSM-103) during the period of time reflected in the table. The Supplier Credit Guarantee Program only began in 1996. No cotton transactions occurred under that program until fiscal year 1998. As a result, it is impossible to make any conclusion about long-term operating costs and losses with respect to that program.

<sup>156</sup> The vast majority of debt that CCC agrees to reschedule occurs within the context of multilateral debt rescheduling in the Paris Club. As reflected on the website of the Paris club: “The Paris Club is an informal group of official creditors whose role is to find co-ordinated and sustainable solutions to the payment difficulties experienced by debtor nations. Paris Club creditors agree in changing the profile of payments on debts due to them.” See <http://www.clubdeparis.org/en/tools/faq.php?BATCH=B04WP01>. There are 19 permanent members of the Paris Club, and other official bilateral creditors may participate. Paris Club permanent members are: Austria, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Netherlands, Norway, Russian Federation, Spain, Sweden, Switzerland, United Kingdom, and United States of America.

<b>Claims Paid, Recoveries, and Reschedulings for Cotton, Fiscal Years : 1993- 2002</b>					
<b>GSM-102<sup>157</sup></b>					
<b><u>Fiscal Year</u></b>	<b><u>Claims Paid</u></b>	<b><u>Claims Recovered</u></b>	<b><u>Claims Rescheduled</u></b>	<b><u>Claims Outstanding</u></b>	<b><u>Fees</u></b>
	Claims data as of 6/30/2003				
1993	\$7,253,135	\$0	\$7,253,135	\$0	\$1,445,618
1994	\$0	\$0	\$0	\$0	\$1,183,878
1995	\$0	\$0	\$0	\$0	\$1,463,888
1996	\$59,626	\$0	\$59,626	\$0	\$835,077
1997	\$704,852	\$383,882	\$315,789	\$5,181	\$1,981,818
1998	\$4,304,219	\$470,433	\$547,020	\$3,286,766	\$3,059,967
1999	\$197,668	\$161,050	\$0	\$36,618	\$1,203,168
2000	\$530,458	\$0	\$0	\$530,458	\$1,814,246
2001	\$500,244	\$0	\$0	\$500,244	\$1,842,650
2002	\$0	\$0	\$0	\$0	\$1,128,495
<b>TOTALS</b>	<b>\$13,550,202</b>	<b>\$1,015,365</b>	<b>\$8,175,570</b>	<b>\$4,359,267</b>	<b>\$15,958,805</b>

<b>SCGP</b>					
<b><u>Fiscal Year</u></b>	<b><u>Claims Paid</u></b>	<b><u>Claims Recovered</u></b>	<b><u>Claims Rescheduled</u></b>	<b><u>Claims Outstanding</u></b>	<b><u>Fees</u></b>
1997	\$0	\$0	\$0	\$0	\$0
1998	\$0	\$0	\$0	\$0	\$21,269
1999	\$0	\$0	\$0	\$0	\$702
2000	\$0	\$0	\$0	\$0	\$8,332
2001	\$248,675	\$0	\$0	\$248,675	\$5,878
2002	\$160,154	\$0	\$0	\$160,154	\$31,216
<b>TOTALS</b>	<b>\$408,829</b>	<b>\$0</b>	<b>\$0</b>	<b>\$408,829</b>	<b>\$67,397</b>
<b>Total Claims Outstanding for Cotton, All Programs, 1993 - 2002:</b>				<b>\$4,768,096</b>	
<b>Total Fees Collected for Cotton, All Programs, 1993 - 2002:</b>					<b>\$16,026,202</b>

<sup>157</sup> During this time, no cotton transactions occurred under GSM-103.

As noted in the tables above, for the 10-year period from fiscal year 1993 through fiscal year 2002, premiums collected total \$16,026,202 and losses incurred via claims total \$4,768,096.<sup>158</sup> Consequently, even before any post-default recoveries, premiums exceeded claims paid. In addition, of the claims incurred, \$1,015,365 were subsequently directly recovered, and an additional \$8,175,570 have been rescheduled.

174. Brazil argues that the United States “must at the very least recover their operating costs by virtue of fees or premiums collected.”<sup>159</sup> In this case, they do. Although the United States does not concede that this is the applicable criterion by which the conformity of the United States export credit guarantees programs with WTO obligations should be assessed, nevertheless, the programs, as applied to cotton, satisfy this Brazilian suggestion.

175. Brazil would also include “administrative costs” within the calculation of “operating costs”. Since fiscal year 1994, the United States has included in its budget an estimate of administrative costs associated with the programs.<sup>160</sup> These budget numbers are imputed administrative costs. They are estimates. And they apply for the *total* export credit guarantee programs. These imputed costs range between \$3.4 million and \$4.0 million per year. The value of export credit guarantees for cotton for the last 10 fiscal years is approximately 11 percent of the total value of export credit guarantees for all commodities during that time. Consequently, applying that percentage to the maximum administrative cost would yield an administrative cost of approximately \$440,000 allocable to cotton transactions over the entire 10-year period. Even if one were to add this small figure to losses incurred, the total would remain less than premiums collected.

176. Brazil also erroneously attributes “interest” figures and “subsidy” and “cost” amounts set forth in the U.S. budget to operating costs allocable to the export credit guarantee program. Brazil completely misunderstands and therefore misstates the significance of the various figures it cites from the U.S. budget. These figures are largely *estimates* concerning anticipated future activity for internal government budgeting purposes but are not a depiction of costs actually historically incurred. The costs and losses set forth in Brazil’s Figure 20 are not “operating costs and losses” in the conventional sense of the term, but mere estimates strictly for budgetary purposes.

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<sup>158</sup> Brazil errs when it alleges that the United States “refused” to provide the requested information during consultations. Brazil’s First Submission, para. 280. As explained repeatedly to Brazil, the United States had to compile data from various sources and various locations to respond to Brazil’s hundreds of questions. Brazil opted to seek the establishment of this panel rather than wait for the United States to appropriately compile its data and respond thoroughly and accurately to Brazil.

<sup>159</sup> Brazil’s First Submission, para. 275.

<sup>160</sup> U.S. Department of Agriculture, New Budget (Obligational) Authority by Appropriation, Fiscal years 1994 through 2001 and Estimates for 2002 and 2003, at 1 (<http://www.usda.gov/agency/obpa/Budget-Summary/2003/Bud%20Auth%2094-03.pdf>) (See: Commodity Credit Corporation: CCC Export Loans Program Account).

177. Similarly, contrary to the argument of Brazil,<sup>161</sup> “subsidies” reflected in the U.S. budget have nothing to do with any theoretical comparison between what the recipient of the export credit guarantee pays for it and what it might pay in other hypothetical circumstances. They are not in any way a measure of a “benefit” to any party. The “subsidies” reflected in the U.S. budget are merely an accounting function of *estimated future* costs without regard to the effect on the recipient of the guarantee.

178. For similar reasons, “interest on debt to Treasury” reflected in the CCC portions of the budget is mischaracterized by Brazil as “money that backs the export credit guarantees.”<sup>162</sup> CCC occasionally borrows money from the Treasury to cover short-term liquidity needs in its operations. In addition, government-wide accounting rules require CCC to reflect in its books a “borrowing” when there is an increase in the *estimated future* costs of the program for a particular fiscal year.<sup>163</sup>

179. Brazil has argued that to provide export credit guarantees for cotton “at premium rates which are inadequate to cover the long-term operating costs and losses of the programs” would constitute an export subsidy within the meaning of item (j) of the Subsidies Agreement Illustrative List of Export Subsidies. Brazil, like any complainant, bears the burden of establishing that export credit programs fall within the terms of item (j).

180. Brazil and the United States apparently agree, however, that *a contrario*, to the extent a WTO Member provides, as the United States has already demonstrated with respect to cotton, export credit guarantees at premium rates which *do* cover long-term operating costs and losses of the programs, then it is *not* an export subsidy within the meaning of the Subsidies Agreement. Brazil argued as follows before the Appellate Body:

Footnote 5 of the SCM Agreement specifies that Annex I contains not only a list of prohibited export subsidies, but also measures that do not constitute export subsidies, such as in items (b), (h), (i) and (k). Comparing the structure of item (j) and item (k), the two provisions share a similar structure in that they define practices that constitute prohibited export subsidies with language that limits the scope of the definition. In the case of item (j) regarding export credit guarantee or insurance programs, the limiting language is “premium rates which are inadequate to cover the long-term operating costs and losses of the programs”. In the case of item (k) regarding export credit terms, the limiting language is “in so far as [government payments] are not used to secure a material advantage in the field of export credit terms.” Thus, practices covered by the first paragraph of item (k) are prohibited only “in so far as they are used to secure a material advantage in the

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<sup>161</sup> Brazil’s First Submission, para. 290

<sup>162</sup> Brazil’s First Submission, para. 281

<sup>163</sup> The concepts of “interest,” “subsidy,” and “cost” as reflected under U.S. government-wide budgetary accounting all stem from the Credit Reform Act, codified at 2 U.S.C. §§ 661 *et seq.* See Exhibit US-11.

field of export credit terms.” Otherwise, Brazil contends, they are *a contrario*, permitted.<sup>164</sup>

181. In the initial proceeding in *Brazil – Aircraft*, the Appellate Body did not address the *a contrario* issue raised by Brazil. However, in the Article 21.5 proceeding in the same dispute, the Appellate Body did address it and clearly stated that:

If Brazil had demonstrated that the payments made under the revised PROEX were not “used to secure a material advantage in the field of export credit terms”, and that such payments were “payments” by Brazil of “all or part of the costs incurred by exporters or financial institutions in obtaining credits”, then we would have been prepared to find that the payments made under the revised PROEX are *justified* under item (k) of the Illustrative List.<sup>165</sup>

In other words, the Appellate Body accepted Brazil’s legal interpretation but found that Brazil had not made the type of factual demonstration needed to take advantage of that interpretation.

182. By direct analogy, Brazil’s view would be that to the extent premiums cover long-term operating costs and losses, then export credit guarantees are not export subsidies for purposes of item (j). The United States shares this view both then and now. As a third party in the *Brazil-Aircraft* appellate body proceeding, the United States supported Brazil’s position on this point:

[I]n addition to listing practices that *do* constitute prohibited export subsidies, the Illustrative List also lists some practices that do *not* constitute prohibited export subsidies. The intent of the drafters in using the term “illustrative” was to signify that not all types of potential export subsidy practices are addressed by the Illustrative List. However, where an item of the Illustrative List does address a particular type of practice, that item sets forth the standard for determining whether that practice is, or is not, a prohibited export subsidy. Thus, when item (k) provides that export credits constitute prohibited export subsidies “in so far as they are used to secure a material advantage in the field of export credit terms”, item (k), by necessary implication, also provides, *a contrario*, that export credits do not constitute prohibited export subsidies if they are not “used to secure a material advantage in the field of export credit terms”.<sup>166</sup>

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<sup>164</sup> Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, adopted 20 August 1999, para. 19; *see also id.*, para. 14.

<sup>165</sup> Appellate Body Report, *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/AB/RW, para. 80 (emphasis added).

<sup>166</sup> *Id.*, para. 90. The Appellate Body specifically declined to make findings on this point. *Id.*, para. 187. However, as noted in the text above, in the *Brazil – Aircraft* 21.5 proceeding, the Appellate Body addressed the issue and agreed with Brazil.

183. Premiums collected by the United States for export credit guarantees issued in connection with cotton transactions over the last 10 fiscal years exceed long-term operating costs and losses. Under the criteria of item (j) alone these programs of the United States do not constitute a prohibited export subsidy within the meaning of the Subsidies Agreement. Since the export credit guarantee programs do not run afoul of the criteria of item (j), then they are not a prohibited export subsidy under Article 3.1(a) of the Subsidies Agreement and are not inconsistent with Article 3.2 of that Agreement.

## **VI. Brazil Has Failed to Make a Prima Facie Case Regarding the FSC Repeal and Extraterritorial Income Exclusion Act of 2000**

184. With respect to its claims concerning the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (“ETI Act”), in its first submission Brazil does nothing more than “reiterate[] the claims brought by the European Communities under the [Agriculture Agreement] and the Subsidies Agreement in *U.S. – FSC (21.5)*, and ask[] the Panel to apply the reasoning as developed by the panel and as modified by the Appellate Body in that case *mutatis mutandis*.”<sup>167</sup> In so doing, Brazil has failed to make a *prima facie* case with respect to the ETI Act.

185. It is by now well-established that the complainant in a WTO dispute – in this case, Brazil – bears the burden of presenting evidence sufficient to establish a presumption that a challenged measure is WTO-inconsistent.<sup>168</sup> It also is well-established that even though panels may take into account prior panel and Appellate Body reports, “panels are not *bound* by previous decisions of panels or the Appellate Body even if the subject-matter is the same.”<sup>169</sup>

186. Each of these principles serves to reinforce the fundamental requirement of Article 11 of the DSU, that each panel “make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements.”

187. Unfortunately, Brazil’s approach, if accepted, would put the Panel in the position of having to violate its obligation under Article 11. Brazil has not presented any evidence regarding the ETI Act itself. Instead, Brazil has done nothing more than cite to and quote from prior panel and Appellate Body reports, essentially demanding that the Panel consider itself bound by these reports. Indeed, the Panel is not even in a position to make factual findings concerning the Act, because Brazil has not offered a description of it. In short, as a result of Brazil’s approach, the Panel is in no position to exercise its judgment to follow, or decline to follow, the prior reports concerning the ETI Act, the very type of “objective assessment” called for by Article 11.

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<sup>167</sup> Brazil’s First Submission, para. 327.

<sup>168</sup> See, e.g., Appellate Body Report, *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, adopted 23 May 1997, at 13 .

<sup>169</sup> Panel Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products (Complaint brought by EC)*, WT/DS79/R, adopted 22 September 1998, para. 7.30 (italics in original).



188. Brazil may be hoping that the Panel will do its work for it; for example, by conducting its own factual research concerning the ETI Act. However, as the Appellate Body has stated, while a panel has the authority to seek information under Article 13 of the DSU, that authority is not to be used “to make the case for a complaining party.”<sup>170</sup> Similarly, Brazil cannot shift the initial burden of making a *prima facie* case to the United States. Accordingly, in the absence of a *prima facie* case by Brazil, the Panel should reject Brazil’s claims concerning the ETI Act.

189. Putting aside Brazil’s failure to make a *prima facie* case, the United States nonetheless would note that President Bush has made clear his commitment to work with the U.S. Congress to fully comply with the prior recommendations and rulings of the DSB concerning the ETI Act. Indeed, at this moment, both branches of Congress are considering legislative proposals that would repeal the ETI Act. While the United States cannot specify the precise date on which this will occur, the United States is confident that the ETI Act will be repealed in the reasonably near future.

## **VII. Requests for Preliminary Ruling: Brazil’s Panel Request Includes Measures That Were Not the Subject of Consultations, Brazil’s Panel Request Includes Measures that Expired Long Ago, and Brazil’s Submission Includes Measures that Had Not Been Adopted at the Time of its Panel Request**

### **A. Introduction**

190. Among the scattershot of measures on which Brazil seeks findings from this Panel are several that are not within the Panel’s terms of reference. There are three such sets of measures: (1) export credit guarantee measures relating to eligible U.S. agricultural commodities other than U.S. upland cotton – these are measures which were not the subject of consultations; (2) production flexibility contract payments and market loss assistance payments – these measures are no longer in effect and had, in fact, terminated before Brazil’s consultation and panel requests; and (3) subsidies provided under the Agricultural Assistance Act of 2003 – these are measures that were not even in existence at the time of Brazil’s panel request. The United States requests that the Panel make preliminary rulings that none of these measures is within its terms of reference. We take up each of these in turn below.

### **B. Export Credit Guarantees for Other Eligible Agricultural Commodities**

191. Brazil requested that this panel be established to examine, in part, “export credit guarantee measures relating to eligible US agricultural commodities.” However, this measure was not a subject of Brazil’s consultation request, which covered only “subsidies provided to US

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<sup>170</sup> Appellate Body Report, *Japan – Measures Affecting Agricultural Products*, WT/DS76/AB/R, adopted 19 March 1999, para. 129.

producers, users and/or exporters of upland cotton,” including “export credit guarantees . . . to facilitate the export of US upland cotton.” Thus, Brazil is seeking to expand the matter in this dispute beyond the measures consulted on, in violation of Articles 4.4, 4.7 and 6.2 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (“DSU”).

192. A panel’s terms of reference are determined by the complaining party’s request for the establishment of a panel, which pursuant to Article 6.2 of the DSU, must “identify *the specific measures at issue*” (emphasis added). However, a Member may not request the establishment of a panel with regard to *any* measure; rather, it may only file a panel request with respect to a measure upon which the consultations process has run its course. Specifically, Article 4.7 of the DSU provides that a complaining party may request establishment of a panel only if “the consultations fail to settle a dispute.”

193. In turn, Article 4.4 of the DSU provides that a request for consultations must state the reasons for the request “including identification of *the measures at issue* and an indication of the legal basis for the complaint” (emphasis added).

194. Thus, there is a clear progression between the measures discussed in consultations conducted pursuant to Article 4 of the DSU and the measures identified in the request to establish a panel which in turn, form the basis of the panel’s terms of reference. Indeed, the Appellate Body in *Brazil – Aircraft* considered that:

Articles 4 and 6 of the DSU . . . set forth a process by which a complaining party must request consultations, and consultations must be held, before a matter may be referred to the DSB for the establishment of a panel.<sup>171</sup>

195. Brazil’s request that the Panel examine “export credit guarantee measures relating to eligible US agricultural commodities” is inconsistent with Articles 4.4, 4.7 and 6.2 of the DSU, because it asks for an examination of measures that were not included in the request for consultations, which covered exclusively “subsidies provided to US producers, users and/or exporters of upland cotton,” including “export credit guarantees . . . to facilitate the export of US upland cotton.” We address these points further below.

196. In its consultation request, Brazil identified the challenged measures as follows:

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, as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies (including export credits), grants, and any other

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<sup>171</sup> See Appellate Body Report, *Brazil – Export Financing Programme for Aircraft* (“Brazil Aircraft”), WT/DS46/AB/R, adopted 20 August 1999, para. 131.

assistance to the US producers, users and exporters of upland cotton (“US upland cotton industry”).<sup>172</sup>

Thus, on its face, the challenged measures were “subsidies provided to US producers, users and/or exporters of upland cotton.” Footnote 1 following the first reference to “upland cotton” read: “Except with respect to export credit guarantee programs as explained below.” However, there were only two subsequent references to export credit guarantee programs – and thus the only two possible “explan[ations] below” – in the consultation request. The first such reference was the following further description of the export credit measure in Brazil’s list of challenged measures:

Export subsidies, exporter assistance, *export credit guarantees*, export and market access enhancement *to facilitate the export of US upland cotton* provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others.<sup>173</sup>

In Brazil’s list of claims applying to those measures it had previously identified, moreover, the consultation request added no reference to any other commodities:

Regarding export credit guarantees, export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, Brazil is of the view that these programs, as applied and as such, violate Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are prohibited export subsidies under Article 3.1(a) and item (j) of the Illustrative List of Export Subsidies included as Annex I to the SCM Agreement.<sup>174</sup>

Thus, Brazil identified one challenged measure as export credit guarantees “to facilitate the export of upland cotton” and did not make reference to export credits with respect to any other commodity.

197. The statement of evidence attached to Brazil’s consultation request provides further proof that the request did not extend beyond export credit guarantees for upland cotton.<sup>175</sup> That statement of evidence is limited throughout to those measures providing support for upland cotton. The statement of evidence is required by Articles 4.2 and 7.2 of the Subsidies Agreement and is a condition for the requesting of consultations. If Brazil did not provide a statement of evidence for measures other than those relating to upland cotton, then Brazil could not consult on

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<sup>172</sup> WT/DS267/1, at 1 (footnote omitted).

<sup>173</sup> WT/DS267/1, at 2 (italics added).

<sup>174</sup> WT/DS267/1, at 4.

<sup>175</sup> See WT/DS267/1, at 5-9 (Annex).

them, and it could not request a panel on them. The Subsidies Agreement makes it clear that the United States and other Members could rely on the statement of evidence to show the scope of the request for consultations.

198. In light of consultation questions from Brazil that extended beyond upland cotton, the United States alerted Brazil at consultations that its consultation request with respect to export credit guarantees was clearly limited to upland cotton and that therefore the consultations could cover only that commodity. Despite this notice, Brazil chose to continue consultations for another three months, focusing exclusively on upland cotton, without ever submitting a new or revised consultation request.

199. However, when Brazil filed its panel request, the language referring to export credits had been altered.<sup>176</sup> The first reference to export credits in the panel request was broadened dramatically:

Export subsidies, exporter assistance, *export credit guarantees*, export and market access enhancement *to facilitate the export of US upland cotton, and other eligible agricultural commodities as addressed herein*, provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others.<sup>177</sup>

Thus, Brazil added an entirely new reference to “export credit guarantees . . . to facilitate the export of . . . other eligible agricultural commodities” that did not appear in the consultation request.

200. A second reference to export credits in Brazil’s list of claims relating to the measures previously identified was similarly enhanced:

Regarding export credit guarantees and export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and *export credit guarantee measures relating to eligible US agricultural commodities*, such as the GSM-102, GSM-103, and SCGP programmes, these programs violate, as applied and as such, Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are

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<sup>176</sup> One other significant change between the consultations request and the panel request occurred in the footnote quoted above following the first reference to “upland cotton” in the first paragraph identifying the challenged measures. The footnote in the panel request was changed to read: “The term ‘upland cotton’ means raw upland cotton as well as the primary processed forms of such cotton including upland cotton lint and cottonseed. The focus of Brazil’s claims relate to upland cotton with the exception of the US export credit guarantee programs as explained below.” WT/DS267/7, at 1 n.1.

<sup>177</sup> WT/DS267/7, at 2 (emphasis added).

prohibited export subsidies under Articles 3.1(a), 3.2 and item (j) of the Illustrated List of Export Subsidies included as Annex I to the SCM Agreement.<sup>178</sup>

The italicized language above was entirely new; in its consultation request, Brazil had simply written: “and other measures such as the GSM-102, GSM-103, and SCGP programs.”<sup>179</sup> Thus, the language in the panel request was plainly re-written in order to bring within its scope “export credit guarantee measures relating to [other] eligible US agricultural commodities” whereas the consultation request specifies measures, including export credits, relating *only* to upland cotton.

201. Again, the United States brought this issue to the attention of Brazil. During the February 19, 2003, meeting of the WTO Dispute Settlement Body (“DSB”) at which Brazil first requested the establishment of a panel, the United States noted that:

As a procedural matter, the United States also noted that, in its panel request, Brazil had referred to a measure which was not the subject of consultations. Brazil’s consultation request concerning “[e]xport subsidies, exporter assistance, export credit guarantees, [and] export and market access enhancement” was limited to upland cotton. Brazil was now attempting to expand the challenged measures to include measures for other eligible agricultural commodities. There was no basis for Brazil’s panel request on these newly identified measures relating to “other eligible agricultural commodities” on which Brazil had not requested consultations.<sup>180</sup>

Brazil took no action in response to the efforts by the United States to draw this defect to their attention.

202. Similar issues have arisen in a previous dispute. For instance, in the *U.S. Import Measures* dispute, the Appellate Body upheld the panel’s finding that a particular action taken by the United States was not part of the panel’s terms of reference, because the EC, while referring to that action in its panel request, had failed to consult upon it. In particular, the EC’s request for consultations made reference to the increased bonding requirements levied by the United States as of March 3, 1999, on EC listed products in connection with the *EC Bananas* dispute, but *not* to U.S. action taken on April 19, 1999, to impose 100 percent duties on certain designated EC products.<sup>181</sup> When the EC sought findings with respect to both the March 3<sup>rd</sup> measure *and* the

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<sup>178</sup> WT/DS267/7, at 5 (emphasis added).

<sup>179</sup> WT/DS267/1, at 4.

<sup>180</sup> WT/DSB/M/143, para. 27. The United States made a similar statement at the March 18, 2003, meeting. See WT/DSB/M/145, para. 24.

<sup>181</sup> Appellate Body Report, *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/AB/R, adopted on January 10, 2001, para. 70.

April 19<sup>th</sup> action, the panel found that the March 3<sup>rd</sup> measure and April 19<sup>th</sup> action were legally distinct, and that the April 19<sup>th</sup> action did not fall within the panel’s terms of reference.<sup>182</sup>

203. The Appellate Body upheld the Panel’s finding. The Appellate Body concluded that because the consultation request did not refer to the April 19<sup>th</sup> action, and as the EC admitted at the oral hearing that the April 19<sup>th</sup> action “was not *formally* the subject of the consultations,” it was not a measure in that dispute and fell outside the panel’s terms of reference.<sup>183</sup>

204. The situation in this dispute resembles that in *U.S. Import Measures*. As in that or any other dispute, the scope of the measures subject to consultation is delineated by the consultation request and, absent consultations, a measure may not be placed before a panel. Brazil’s consultation request made no mention of any agricultural commodity other than upland cotton. Furthermore, just as the additional reference in the EC’s panel request to a measure not referred to in the consultation request could not cure the EC’s failure to consult on that measure in *U.S. Import Measures*, the addition of the phrase “other agricultural commodities” in Brazil’s panel request cannot bring those measures within the panel’s terms of reference.<sup>184</sup>

205. Finally, we note that permitting Brazil to request a panel with respect to measures on which consultations have not been held would also have dangerous systemic consequences for the WTO dispute settlement system. The very purpose of consultations and any practical utility that they provide would be completely undermined if a complainant could append completely new measures upon which no consultations had been held, to a request for the establishment of a panel. To allow a complaining party to have recourse to panel proceedings without having consulted on a measure would deny both parties the opportunity to attempt to settle their differences and resolve the dispute, contradicting the chief aim of the dispute settlement system, which as stated in Article 3.3 of the DSU, is the “prompt settlement” of disputes. It is also unclear how such an outcome would advance the purpose of consultations; we note in this connection that Article 4.1 of the DSU calls on Members “to strengthen and improve the effectiveness of the consultation procedures employed by Members.”<sup>185</sup>

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<sup>182</sup> Appellate Body Report, *U.S. Import Measures*, para. 82.

<sup>183</sup> Appellate Body Report, *U.S. Import Measures*, para. 70.

<sup>184</sup> We note that the situation in this dispute is unlike that presented in *Brazil – Aircraft*, in which the Panel examined a measure which was substantively the same as that consulted on. See Appellate Body Report, *Brazil – Aircraft*, paras. 127-133. In this dispute, the export credit guarantee programs mentioned in the panel request – covering a large and indeterminate number of products – are distinct from those in the consultation request, which were explicitly limited to upland cotton.

<sup>185</sup> The special and additional rules for disputes arising under the SCM Agreement do not change this result. If anything, they buttress it. With respect to the prohibited subsidy claims, Article 4.4 of the SCM Agreement allows a “matter” to be referred to the DSB for the establishment of a panel only if consultations do not result in a mutually agreed solution. The specific measure to which the word “matter” in Article 4.4 refers is the “prohibited subsidy” upon which consultations are initiated pursuant to Article 4.1 of the SCM Agreement (and subsequently referred to as the “subsidy in question” in Articles 4.2 and 4.3 of the SCM Agreement). Similarly, with respect to actionable subsidy claims, the first sentence of Article 7.4 of the SCM Agreement closely tracks the language of Article 4.4 (the only substantive difference being the length of the consultation period). The specific measure to

206. For these reasons, we respectfully request the Panel to rule that export credit guarantee measures relating to eligible U.S. agricultural commodities (other than upland cotton) are not within its terms of reference.

### **C. Production Flexibility Contract Payments and Market Loss Assistance Payments**

207. Brazil has also challenged two types of measures, production flexibility contract payments and market loss assistance payments, that are no longer in effect and had, in fact, terminated prior to Brazil's consultation and panel requests.

208. Production flexibility contracts were a form of decoupled income support (that is, not linked to current production) that existed under the Federal Agriculture Improvement and Reform Act of 1996.<sup>186</sup> As Brazil concedes, however, “[w]ith the passage of the new FSRI [Farm Security and Rural Investment] Act in May 2002, PFC [production flexibility contract] payments were discontinued.”<sup>187</sup> Thus, at the time of Brazil's consultation request dated September 27, 2002, the production flexibility contract program no longer existed.

209. Similarly, with respect to market loss assistance payments, Brazil acknowledges that “[t]he U.S. Congress enacted annual appropriation payments referred to as ‘market loss assistance payments’ between 1998 and 2001.”<sup>188</sup> Each “annual appropriation payment[.]” was made through a separate piece of legislation, the last of which was enacted on August 13, 2001,<sup>189</sup> for the marketing year 2001 (August 1, 2001 - July 31, 2002) crop. Again, at the time of Brazil's consultation and panel requests the market loss assistance payments were no longer in place.

210. As a result, neither the production flexibility contract payments nor the market loss assistance payments (referred to solely as unnamed “[s]ubsidies provided under” various pieces

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which the word “matter” in Article 7.4 refers is the “subsidy” that is being consulted upon, which Article 7.1 identifies as “any subsidy referred to in Article 1.”

<sup>186</sup> Federal Agriculture Improvement and Reform Act, Public Law No. 104-127 (April 4, 1996) (“1996 Act”).

<sup>187</sup> Brazil's First Submission, para. 49.

<sup>188</sup> Brazil's First Submission, para. 60. The footnote to this sentence gives the names and dates of the relevant legislation: “Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 1999 (October 1998), Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2000 (October 1999), Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001 (October 2000) and Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2002 (November 2001).” *Id.* para. 60 fn. 129.

<sup>189</sup> Public Law No. 107-25, 115 Stat. 201 (August 13, 2001).

of legislation)<sup>190</sup> are within the Panel’s terms of reference. As explained in detail above, a panel’s terms of reference cannot include measures that were not the subject of consultations. Article 4.2 of the DSU provides a limitation on what measures may be the subject of consultations. Under DSU Article 4.2, consultations are to cover “any representations made by another Member *concerning measures affecting the operation of any covered agreement* taken within the territory of the former” (emphasis added). As the production flexibility contract payments and the market loss assistance payments were no longer in effect at the time of the request for consultations, these measures cannot have been “affecting the operation of any covered agreement” at that time. These measures therefore cannot have been the subject of consultations within the meaning of DSU Article 4.2, and they therefore do not fall within the Panel’s terms of reference.

211. For these reasons, we respectfully request that the Panel rule that these two types of measures are not within its terms of reference.

#### **D. Cottonseed Payment Under the Agricultural Assistance Act of 2003**

212. Brazil’s panel request also included in the list of challenged measures “[s]ubsidies provided under the Agricultural Assistance Act of 2003.”<sup>191</sup> Brazil’s panel request is dated February 6, 2003, and was circulated to Members on February 7.<sup>192</sup> However, the Agricultural Assistance Act of 2003, including those portions of the Act that provide a one-time cottonseed payment, was not enacted until February 20, 2003.<sup>193</sup> Since this legislation did not exist at the time of Brazil’s panel request, it could not have been a measure challenged in that request, and, of course, could not have been consulted upon.

213. As explained above, Article 4.2 of the DSU provides that consultations are to cover “any representations made by another Member concerning measures affecting the operation of any covered agreement taken within the territory of the former.” A measure that is not yet in existence can obviously not be “affecting the operation of any covered agreement.” It therefore

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<sup>190</sup> We also note that the lack of clarity in identifying the market loss assistance payments in Brazil’s panel request raises concerns under DSU Article 6.2, pursuant to which a complaining party must “identify the specific measures at issue.” In Brazil’s panel request, there is no reference to the “market loss assistance payments” that Brazil readily names in its first submission. Rather, in the panel request Brazil simply included the titles of five pieces of appropriations legislation within which, as it results, the market loss assistance payments were authorized. *See* WT/DS267/7, at 2.

<sup>191</sup> WT/DS267/1, at 2 (final paragraph).

<sup>192</sup> WT/DS267/7, at 1.

<sup>193</sup> Agricultural Assistance Act of 2003, Public Law No. 108-7 (February 20, 2003).



cannot be the subject of dispute settlement consultations.<sup>194</sup> Indeed, Brazil did not mention the Act in its consultation request.

214. Despite not having consulted on the measure, however, Brazil did include the Agricultural Assistance Act of 2003 in its panel request. For the reasons already given in Part B above with respect to export credit guarantees for agricultural commodities other than upland cotton, by doing so Brazil acted inconsistently with DSU Articles 4.4, 4.7 and 6.2. On that basis alone, the Agricultural Assistance Act of 2003 is not within the Panel's terms of reference.

215. There is, however, an additional legal difficulty with Brazil's inclusion of the Agricultural Assistance Act of 2003 in its panel request. That difficulty arises from the fact that, on the date of Brazil's panel request, the Agricultural Assistance Act of 2003 *still* did not exist. Indeed, the Act would not be enacted until two weeks after the request was made. Under Article 6.2 of the DSU, the panel request must "identify the specific *measures at issue*" (emphasis added). Something that does not exist is not a measure in the first place, let alone a measure that can be "at issue" between the Parties to a dispute. As a result, the Agricultural Assistance Act of 2003 could not properly have been included in Brazil's panel request, and it therefore does not form part of the panel's terms of reference.<sup>195</sup>

216. Further, allowing Brazil to request the establishment of a panel to examine a non-existent measure would raise systemic concerns. Permitting Members to "jump the gun" and begin a dispute before a measure has even been adopted would also result in a waste of resources if the measure, if and when it is eventually enacted, were different from what the complaining Member anticipated. It would be difficult as well to reconcile allowing Members to challenge unadopted measures with the presumption that Members adhere to their WTO obligations in good faith and that therefore a measure, when finally adopted, should be presumed to be consistent with the adopting Member's obligations.

217. For these reasons, we request the Panel to find that any measure under the Agricultural Assistance Act of 2003, including a cottonseed payment under that Act, is not within its terms of reference.

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<sup>194</sup> For example, Subsidies Agreement Article 4.1 provides that a "Member may request consultations" when that Member believes "a prohibited subsidy *is being granted or maintained*" (emphasis added). Further, Article 4.2 states that such a consultation request "shall include a statement of available evidence with regard to *the existence and nature of the subsidy*" (emphasis added). Both of these provisions highlight the fact that the dispute settlement process is only to be utilized against a measure that actually exists.

<sup>195</sup> As the panel noted in *United States – Preliminary Determinations with Respect to Certain Softwood Lumber from Canada*, WT/DS236/R, adopted 1 November 2002, para. 7.157: "The WTO dispute settlement system allows a Member to challenge a law as such or its actual application in a particular case, but not its possible future application."

### **E. Summary of Request for Preliminary Ruling**

218. In summary, Brazil has attempted to have the Panel examine a series of measures that were not the subject of consultations; had expired before consultations were requested; or had not yet been adopted at the time of the consultation and panel requests. None of those measures is properly before the Panel. The United States respectfully requests that the Panel issue a preliminary ruling that (1) export credit guarantee measures relating to eligible U.S. agricultural commodities other than U.S. upland cotton, (2) production flexibility contract payments and market loss assistance payments, and (3) the Agricultural Assistance Act of 2003 are not within the Panel's terms of reference.

### **VIII. Conclusion**

219. In light of the foregoing, the United States asks the Panel to find that:

(1) Agriculture Agreement Article 13 (the Peace Clause) is part of the balance of rights and obligations of Members and is not an affirmative defense;

(2) pursuant to Agriculture Agreement Article 13(a)(ii), direct payments under the 2002 Act “conform fully to the provisions of Annex 2 to [the Agriculture] Agreement” and are “exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement”;

(3) pursuant to Agriculture Agreement Article 13(b)(ii), U.S. domestic support measures that conform fully to the provisions of Article 6 of the Agriculture Agreement, including the marketing loan program (including marketing loan gains and loan deficiency payments), user marketing (step 2) payments, direct payments, counter-cyclical payments, and crop insurance payments, “do not grant support to a specific commodity in excess of that decided during the 1992 marketing year” and are “exempt from actions based on paragraph 1 of Article XVI and Articles 5 and 6 of the Subsidies Agreement”;

(4) Brazil may not bring or maintain any action against such measures “based on” the provisions specified in the respective Peace Clause provisions;

(5) Section 1207(a) of the 2002 Act does not mandate Step 2 payments that are inconsistent with Agriculture Agreement Articles 3.3 and 8, Subsidies Agreement Articles 3.1(a), 3.1(b), and 3.2, and GATT 1994 Article III:4.

(6) U.S. export credit guarantee programs (GSM 102, GSM 103 and SCGP) for upland cotton are not export subsidies within the meaning of the Agriculture Agreement, are not inconsistent with Agriculture Agreement Articles 10.1 and Article 8, and are not a prohibited export subsidy within the meaning of item (j) of the Illustrative List of Export Subsidies or within the meaning of Subsidies Agreement Articles 3.1(a) and 3.2; and

(7) Brazil has failed to make a *prima facie* case that the ETI Act is inconsistent with Agriculture Agreement Articles 10.1 and 8 and inconsistent with Subsidies Agreement Articles 3.1(a) and 3.2.

220. In addition, the United States asks the Panel to make preliminary findings that:

(1) export credit guarantee measures relating to eligible U.S. agricultural commodities other than U.S. upland cotton are not within the Panel's terms of reference;

(2) production flexibility contract payments and market loss assistance payments are not within the Panel's terms of reference; and

(3) subsidies provided under the Agricultural Assistance Act of 2003 are not within the Panel's terms of reference.

## EXHIBIT LIST

- US-1 2002 Farm Security and Rural Investment Act, Public Law 107-171, 116 Stat. 134 (May 13, 2002) (Title I)
- US-2 57 *Federal Register* 14,326 (April 20, 1992)
- US-3 7 C.F.R. Part 1413 (January 1, 1993)
- US-4 7 C.F.R. 1413.6 (1991 ed.)
- US-5 7 U.S.C. § 1444-2 (1992 supp.)
- US-6 7 C.F.R. Part 1493 (2003) (excerpts)
- US-7 Organization for Economic Co-operation and Development, *The Chairman's Revised Proposal for a Sector Understanding on Export Credits for Agricultural Products*, TD/CONSENSUS(2000)25/REV4 (9 July 2002)
- US-8 Cairns Group, *Negotiating Proposal on Export Competition*, JOB(02)/186 (20 November 2002)
- US-9 *Negotiations on Agriculture: First Draft of Modalities for the Further Commitments*, TN/AG/W/1/Rev.1 (18 March 2003)
- US-10 MERCOSUR *et al.*, *Export Credits for Agricultural Products*, G/AG/NG/W/139, G/AG/W/50 (21 March 2001)
- US-11 2 U.S.C. §§ 661 *et seq.* (2003)