

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

**(WT/DS267)**

**Further Submission of the United States of America**

September 30, 2003

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## I. Introduction and Overview

1. Given the complexity of this dispute, it may be worth reviewing at this point where we are. Brazil has filed a further submission challenging numerous U.S. support measures under provisions specified in the Peace Clause of the *Agreement on Agriculture* (“Agriculture Agreement” or “Agreement on Agriculture”).

- If the Panel agrees that Brazil has not demonstrated that direct payments under the Farm Security and Rural Investment Act of 2002 (“2002 Act”) and production flexibility contract payments under the Federal Agricultural Improvement and Reform Act of 1996 (“1996 Act”) fail to conform fully to the criteria set out in Annex 2 to the Agreement on Agriculture, then these payments are exempt from Brazil’s action pursuant to Agreement on Agriculture Article 13(a)(ii).
- If the Panel agrees that Brazil has not demonstrated that challenged U.S. non-green box measures grant support to upland cotton in excess of that decided during the 1992 marketing year, then those measures (marketing loan payments, step 2 payments, and counter-cyclical payments under the 2002 Act; marketing loan payments and step 2 payments under the 1996 Act; market loss assistance payments; and crop insurance payments) are exempt from Brazil’s action pursuant to Agreement on Agriculture Article 13(b)(ii).

In this submission, the United States begins to make an in-the-alternative argument (that is, an argument in the event the Panel were to find that Brazil has demonstrated that the U.S. measures breach the Peace Clause) to answer the myriad of assertions and arguments put forward by Brazil

2. In its further submission, Brazil brings claims of serious prejudice under Article 5(c), 6.3(c), and 6.3(d) of the *Agreement on Subsidies and Countervailing Measures* (“Subsidies Agreement”) and Articles XVI:1 of the *General Agreement on Tariffs and Trade 1994* (“GATT 1994”) and a claim of an inequitable U.S. share of world export trade under GATT 1994 Article XVI:3. Brazil challenges subsidies for upland cotton in the form of marketing loan payments, step 2 payments, counter-cyclical payments, direct payments, crop insurance payments, export credit guarantees, production flexibility contract payments, market loss assistance payments, cottonseed payments, and “other payments” as these were variously made during marketing years 1999-2002. Brazil also challenges marketing loan payments, step 2 payments, crop insurance payments, counter-cyclical payments, and direct payments under the cited provisions alleging a threat of serious prejudice. Finally, Brazil alleges that certain provisions of the 2002 Act and 2000 Agricultural Risk Protection Act are *per se* violations of the cited provisions.

3. In the course of this submission, the United States first explains that several of these measures are not within the scope of this dispute. In particular, neither cottonseed payments made for the 1999 and 2000 crops nor “other payments” for upland cotton were included in Brazil’s consultation and panel requests. The United States makes a preliminary ruling request that the Panel find these payments to be outside the Panel’s terms of reference.

4. Next, the United States explains that crop insurance payments are not subject to the provisions of Part III of the Subsidies Agreement (and therefore cannot give rise to the claims brought by Brazil). In particular, crop insurance payments are not “specific” within the meaning of Article 2 of the Subsidies Agreement.

5. Finally, with respect to the remaining measures, Brazil has not shown serious prejudice, nor a more than equitable share of world export trade, nor threat thereof. More particularly:

- U.S. green box payments – direct payments under the 2002 Act and production flexibility contract payments – are no more than minimally trade- or production-distorting and thus by definition do not cause serious prejudice to the interests of Brazil.
- Other U.S. decoupled income support – counter-cyclical payments under the 2002 Act and market loss assistance payments under various pieces of authorizing legislation – also do not have more than minimal trade- or production-distorting effects because, although linked to current prices, they are not paid with respect to upland cotton production. These payments therefore also do not cause serious prejudice to the interests of Brazil.
- With respect to marketing loan payments and step 2 payments (and, indeed, all U.S. payments cumulatively), Brazil seeks to ascribe extraordinarily low market prices in recent years to U.S. payments. However, Brazil has not presented or explained to the Panel the factors driving market prices that in turn resulted in larger U.S. price-based payments. Brazil’s failure to put forward a complete picture of world cotton markets illustrates Brazil’s failure to establish causation – that is, that the challenged U.S. measures have had the effects Brazil alleges.

## II. Request for Preliminary Rulings

### A. Brazil Purports to Challenge “Other Payments” Not Within the Scope of the Dispute

6. In its further submission, Brazil identifies the U.S. support measures that it challenges as follows:

The measures challenged by Brazil comprise domestic support subsidies including the marketing loan program, crop insurance subsidies, market loss assistance payments and their successor counter-cyclical payments, production flexibility contract payments and their successor direct payments, cottonseed payments and “other payments.” The measures also include prohibited export and local content subsidies including Step 2 export and domestic payments, and the subsidies

provided by the U.S. GSM 102 export credit guarantee program. These collective subsidies are referred to as “the U.S. subsidies”.<sup>1</sup>

However, the “other payments” to which Brazil refers – that is, “storage payments” and “interest subsidy” estimated by the U.S. Department of Agriculture – were not included in Brazil’s consultation or panel requests.<sup>2</sup> These “other payments” were first identified by the United States in response to the Panel’s request for a calculation of the Aggregate Measurement of Support for upland cotton for marketing years 1992 and 1999-2002.<sup>3</sup>

7. As a result, Brazil did not consult on these measures and could not include these measures in its panel request; to do so would have been inconsistent with Articles 4.4, 4.7 and 6.2 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (“DSU”). Moreover, Brazil in fact did not include them in its panel request, which is the document that defines the Panel’s terms of reference. The United States recalls that under Article 6.2 of the DSU, the panel request must “identify the specific *measures at issue*” (emphasis added). Thus, the United States requests a preliminary ruling by the Panel that these “other payments” are not within the Panel’s terms of reference. These payments should not be considered by the Panel for purposes of Brazil’s claims under Articles 5 and 6 of the Subsidies Agreement or Article XVI of the GATT 1994. This request could not have been made any earlier than this first U.S. submission on the Subsidies Agreement claims because it is only in its further submission that Brazil has included these measures in its claims.

## **B. Brazil Purports to Challenge Cottonseed Payments Not Within the Scope of the Dispute**

8. Cottonseed payments should not be considered by the Panel for purposes of Brazil’s claims under Articles 5 and 6 of the Subsidies Agreement or Article XVI of the GATT 1994. The United States recalls its previous preliminary ruling request that the Panel conclude that a cottonseed payment under the Agricultural Assistance Act of 2003 is not within the scope of this dispute because this measure was not in existence at the time of the consultation and panel requests<sup>4</sup> nor was there any substantially identical measure in existence at that time. The United States has similarly argued previously that cottonseed payments made for the 1999 and 2000 crops are not within the scope of this dispute as these measures were not identified in Brazil’s consultation or panel requests.<sup>5</sup> To date, Brazil has not contested this fact. Because Brazil did not consult on these measures and did not include these measures in its panel request, inconsistent with DSU Articles 4.4, 4.7 and 6.2, at this time, the United States respectfully reiterates that cottonseed payments made for the 1999 and 2000 crops (as well as the cottonseed

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<sup>1</sup> Brazil’s Further Submission, para. 7 (footnote omitted).

<sup>2</sup> See WT/DS267/1 & WT/DS267/7.

<sup>3</sup> See, e.g., U.S. Answer to Question 67 from the Panel, para. 129 (August 11, 2003).

<sup>4</sup> See U.S. First Written Submission, paras. 212-18.

<sup>5</sup> U.S. Rebuttal Submission, paras. 106-08; U.S. Answer to Question 17 from the Panel.

payment made in 2003) are not within the Panel’s terms of reference and requests that the Panel make a preliminary ruling to that effect.

**C. Brazil Failed to Provide a Statement of Available Evidence With Respect to Export Credit Guarantees for Commodities Other than Upland Cotton**

9. The Panel has found that export credit guarantees for commodities other than upland cotton are within the Panel’s terms of reference. As indicated earlier,<sup>6</sup> the United States is now making a request for a preliminary ruling that the Panel determine that Brazil may not advance claims under either Article 4 or Article 7 of the Subsidies Agreement because Brazil did not include a statement of available evidence with respect to these measures. The United States is making this request now because this is its first submission since the Panel’s preliminary finding that these measures are within its terms of reference. Prior to this point, the United States had understood that these measures were not within the Panel’s terms of reference and so there was no need for a request for a preliminary ruling on the separate issues concerning Brazil’s statement of available evidence.

10. For prohibited subsidies, Article 4.2 of the Subsidies Agreement requires that a request for consultations “include a statement of available evidence with regard to the existence and nature of the subsidy in question.” For actionable subsidies, Article 7.2 requires that a request for consultations “include a statement of available evidence with regard to (a) the existence and nature of the subsidy in question, and (b) the injury caused to the domestic industry, or the nullification or impairment, or serious prejudice caused to the interests of the Member requesting consultations.” As the Appellate Body noted in *United States – FSC*, Article 4.2 of the Subsidies Agreement is a “special or additional rule or procedure”; thus, this provision must be satisfied in a dispute brought pursuant to Article 4.<sup>7</sup> The same applies to Article 7.2.

11. Brazil has acted inconsistently with these provision by failing to present a statement of available evidence with respect to export credit guarantees for products other than upland cotton. Brazil’s statement of evidence on export credit guarantees is limited to two points:

- US export credit guarantee programs have caused serious prejudice to Brazilian upland cotton producers by providing below-market financing benefits for the export of competing US upland cotton;
- US export credit guarantee programs, since their origin in 1980 and up the present, provide premium rates that are inadequate to cover the long-term

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<sup>6</sup> U.S. Answer to Question 3 from the Panel, para. 7 fn. 3. The United States notes that it was not in a position to make this request earlier because it considered that export credit guarantees for other eligible agricultural commodities were not measures within the Panel’s terms of reference.

<sup>7</sup> *United States – Tax Treatment for Foreign Sales Corporations*, WT/DS108/AB/R, paras. 159-60 (“*United States – FSC*”).

operating costs and losses of the programs; in particular there were losses caused by large-scale defaults totalling billions of dollars that have not been reflected in increased premiums to cover such losses[.]<sup>8</sup>

We note in passing that, even taking these two points together, is it difficult to conceive (given the extensive evidence on U.S. export credit guarantee programs that Brazil has presented to the Panel) that the evidence “available” to Brazil at the time it requested consultations consisted solely of the allegations of “below-market financing benefits” and “losses caused by large-scale defaults totalling billions of dollars.” More to the point, however, nothing suggests that this statement of available evidence applied to any product other than upland cotton. The first point by its terms refers to “benefits for the export of competing US upland cotton” (not other agricultural commodities), and the second point does nothing to expand that scope.<sup>9</sup> Brazil provided no evidence at all of the “existence” or “nature” of these “subsidies” with respect to any other commodity. As noted below, Brazil’s challenge appears to be to these programs as applied, rather than as such. It is therefore all the more striking that Brazil did not name the commodities for which the programs were provided, the amounts provided, or even indicate that they existed beyond upland cotton.<sup>10</sup> Brazil was under an obligation to provide the evidence available to it. Brazil’s statement of “evidence” falls far short of this obligation.<sup>11</sup>

12. In its 22 August 2003 comments on the U.S. answers to the Panel questions, Brazil states that the “Panel will also note that there is no limitation in this sentence to any particular commodity or commodities”<sup>12</sup> as though this were a virtue on the part of Brazil’s statement of available evidence rather than a flaw. The United States fails to understand how Brazil’s failure to provide *any* evidence that these programs applied beyond upland cotton, or the nature or existence of the programs beyond upland cotton, could be helpful in showing that Brazil had provided the evidence “available” to it. Brazil appears to admit that it knew of the nature and existence of these programs with respect to commodities other than upland cotton, but that Brazil deliberately withheld that information in its statement of evidence. This action cannot satisfy the requirements of Articles 4.2 and 7.2.

13. Because Brazil failed to include with its consultation request a statement of available evidence on export credit guarantees for agricultural commodities other than upland cotton,

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<sup>8</sup> WT/DS267/1, at 7.

<sup>9</sup> Indeed, any other interpretation of these two points would mean that Brazil was alleging that U.S. export credit guarantee programs to other agricultural products do not provide below-market financing benefits.

<sup>10</sup> Brazil does not even provide any citation to the programs it labels “export credit guarantee programs.” Its statement that “Regarding export credit guarantees, export and market access enhancements provided under the Agricultural Trade Act of 1978, as amended, and *other* measures such as the GSM-102, GSM-103, and SCGP programs” (emphasis added) would imply that Brazil saw export credit guarantees as something *other than* the GSM-102, GSM-103, and SCGP programs, but never provides any evidence as to what that is.

<sup>11</sup> This is in marked contrast with the level of detail provided in Brazil’s statement of available evidence for other measures that it challenges, again indicating that Brazil was *not* providing all the evidence available to it.

<sup>12</sup> Paragraph 3.



Brazil has failed to satisfy the conditions to bring its claims in this proceeding and Brazil's claims pursuant to Articles 4 and 7 of the Subsidies Agreement with respect to those measures are not properly before the Panel. The United States respectfully requests the Panel to issue a preliminary ruling to this effect.

### **III. Brazil Has Failed to Demonstrate that Crop Insurance Payments Are “Specific” Within the Meaning of the Subsidies Agreement**

14. Brazil has failed to demonstrate that the specificity requirement of Article 2 has been met with respect to crop insurance payments. Many of the points raised by Brazil in its further submission have previously been addressed by the United States in the context of explaining that crop insurance is non-product-specific within the meaning of Agreement on Agriculture (a different concept from specificity under Article 2).<sup>13</sup> We reiterate that the subsidy to any agricultural producer is the premium subsidy paid by the U.S. Government, which is common to all commodities at a chosen coverage level. Thus, Brazil's repetition that certain policies are not available to all commodities is in part true<sup>14</sup> but wholly irrelevant: the particular policies offered to growers of different commodities are issued by private insurers but the *subsidy* by the U.S. Government on the premiums remains the same.

15. In addition, the United States notes that, while there are certain agricultural products for which specific policies have not yet been developed, it is incorrect for Brazil to claim the United States denies crop insurance subsidies to producers of livestock and dairy.<sup>15</sup> Not only are a number of livestock products currently being developed and available on a pilot basis, but U.S. producers may currently insure livestock and dairy revenue as part of whole farm insurance offered through the Adjusted Gross Revenue Insurance.<sup>16</sup> Thus, crop insurance subsidies are available to the U.S. agricultural sector as a whole. It is the position of the United States that such a widely available subsidy does not satisfy the specificity requirement of Article 2.<sup>17</sup> Thus, pursuant to Article 1.2 of the Subsidies Agreement, U.S. crop insurance payments are not

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<sup>13</sup> U.S. Comments on Brazil's Rebuttal Submission, paras. 34-42; U.S. Rebuttal Submission, paras. 93-98.

<sup>14</sup> However, when Brazil asserts that the Agricultural Risk Protection Act of 2000 “contains a special provision explicitly limiting subsidies to upland cotton” through certain policies for failure of irrigation water supplies, Brazil errs. *See* Brazil's Further Submission, para. 63. In fact, Brazil's error is evident on the face of the statutory provision it quotes; the statute merely directs that the Federal Crop Insurance Corporation “shall offer plans of insurance, including prevented planting coverage and replanting coverage, under this title that cover losses of upland cotton, extra long staple cotton, and rice resulting from failure of irrigation water supplies due to drought and saltwater intrusion.” *Id.*, para. 63 fn. 68. That is, the statute does *not* direct the Corporation to limit those plans to the specified commodities, and (as the United States has previously clarified) the Corporation has made those plans generally available for all insured crops. U.S. Rebuttal Submission, para. 95.

<sup>15</sup> Brazil's Further Submission, para. 67.

<sup>16</sup> U.S. Comments on Brazil's Rebuttal Submission, para. 41.

<sup>17</sup> *See* 19 Code of Federal Regulations 351.502(d) (“The Secretary [of Commerce] will not regard a subsidy as being specific under section 771(5A)(D) of the Act solely because the subsidy is limited to the agricultural sector.”).

“subject to the provisions of . . . Part III” of the Subsidies Agreement, including Articles 5 and 6 on serious prejudice.

#### **IV. Brazil Has Failed to Demonstrate that Challenged U.S. Measures Caused the Decline in World Upland Cotton Prices Because It Simply Ignores Key Factors Behind Those Price Movements**

##### **A. Introduction**

16. Brazil alleges that challenged U.S. subsidies have caused serious prejudice to Brazil’s interests within the meaning of Articles 5(c), 6.3(c), and 6.3(d) of the Subsidies Agreement and have resulted in the United States having more than an equitable share of world export trade in upland cotton within the meaning of GATT 1994 Article XVI:3. Each of these provisions requires a showing of causation. Under Articles 6.3(c) and 6.3(d), Brazil must demonstrate that “the effect of the subsidy” is significant price suppression or depression or an increase in world market share. Under GATT 1994 Article XVI:3, Brazil must demonstrate that the “subsidy . . . operates directly or indirectly to increase the export of any primary product.” Brazil’s case suffers from a failure of factual proof.

17. As demonstrated in this section, Brazil has failed to make a *prima facie* case on these claims on the basis of the mere assertion that large U.S. outlays during marketing years with low prevailing upland cotton prices necessarily establishes causation. However, Brazil has failed to explain to the Panel key factors that affected world cotton markets during the marketing year 1999 - marketing year 2002 period. These factors and not U.S. subsidies were the causes of the dramatic plunge in cotton prices experienced in recent years; therefore, Brazil cannot and has not demonstrated causation.

18. To facilitate the Panel’s understanding, the United States first presents an explanation of factors driving recent supply, demand, and price developments in world cotton markets. This narrative demonstrates that U.S. payments have been a reaction to, not a driver of, low world cotton prices. Having laid out the factual groundwork, in subsequent sections the United States examines each of Brazil’s claims in turn, dealing with Brazil’s errors in legal interpretation and evidentiary failings.

##### **B. Other Significant Economic Factors Must Be Considered in Evaluating Alleged Effects of the U.S. Cotton Program**

19. Brazil relies almost exclusively on world cotton market conditions beginning in 1998. However, context prior to 1998 is essential to understanding the unusual events that occurred in the world cotton market between 1999-2002. Furthermore, 1998 was an unusual year for the

United States, making it an inappropriate basis for comparison.<sup>18</sup> With this background in mind, we explain a variety of significant economic factors in the period 1999-2002 that led to the decline in world cotton prices and the increase in U.S. exports, which are unrelated to challenged U.S. measures. For more detail and explanation of the factors affecting the world cotton situation over the past decade, please see Exhibit US-40.

20. World cotton prices fell steadily during the 7-year period from 1994/95, when the A-index reached a record of 91 cents, until 2001/02, when it averaged 42 cents, its lowest in 30 years. A number of economic and policy changes account for the persistence in recent years of unusually low cotton prices. Prices have been historically low because:

- Persistent weakness in world demand for cotton due to competing, low-priced synthetic fibers and weak world economic growth. The Asian financial crisis of 1998 depressed world consumption and reconfigured the world's textile industry. A world wide recession began in late 2001, in part, due to the terrorist attacks of September 11, 2001 in the United States.
- Burgeoning U.S. textile imports, reflecting the strong U.S. dollar and declining U.S. competitiveness in textile and apparel production, have fundamentally shifted the disposition of U.S. cotton production from domestic mills to export markets. In fact, the growing U.S. cotton-equivalent trade deficit has supported world cotton prices.
- The strong U.S. dollar since the mid-1990's has had an inverse effect on the world price of cotton, because cotton is traded internationally in dollars.
- China, the world's largest cotton producer and consumer, subsidized the release of 14 million bales of government stocks between 1999 and 2002, equaling as much as 7 percent of world consumption in crop year 2000/01.

21. The unprecedented fall in world cotton prices between 1998-2001 occurred for many reasons unaffected by U.S. support policy for cotton. In fact, these events and factors were all intertwined, and it is the combination of these factors that worked to bring about the historical decline in world cotton prices. The U.S. cotton program expenditures are a response to – not a cause of – low world prices.

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<sup>18</sup> The use of 1998 as a base year is misleading for a number of reasons. In 1998, U.S. harvested cotton acreage fell to 10.4 million acres because of severe drought affecting Texas and much of the southeast. As a result, production fell to 13.5 million bales, 26 percent below year earlier levels and almost 25 percent below the previous 5-year average. For the 1998 marketing year, U.S. exports of upland cotton were only 4 million bales, the smallest since 1985. The sharp drop in U.S. production and exports provided no support for world prices, as the A Index of cotton prices fell by 18 percent from the 1997 level. In addition, world demand was greatly affected by the Asian financial crisis that had drastic impacts on key Asian cotton importers and world GDP growth. These factors suggest there it is other factors that drive world cotton prices rather than the level of U.S. cotton support.

**1. Persistent Weakness in World Demand for Cotton Due to Competing, Low-priced Synthetic Fibers and Weak World Economic Growth**

22. The production of competing, synthetic fibers exploded during the 1990's, putting downward pressure on world cotton prices, especially as Asian production of textile polyester grew tremendously. The largest polyester producing economies are Korea, Chinese Taipei, India, China and Indonesia. Asian countries, from the Republic of Korea to the Indian sub-continent, added more polyester production capacity between 1991 and 2001 than existed in the entire world in 1990. China manufactured 5 million 480-lb. bale equivalents of polyester in 1990 and today manufactures over 37 million bale-equivalents. China alone accounted for two-thirds of the increase in textile polyester production between 1991 and 2001. This increase is of unprecedented proportions. World production of textile polyester was 39.7 million bales in 1990 and China accounted for just over 12 percent of production. By 2002, China alone was producing 37 million bales and held 39.5 percent of the world's production.

<b>World Fiber Production</b>		
Million 480-lb. Bales		
	Cotton 1/	Polyester 2/
<b>1990</b>	87.2	39.7
<b>1991</b>	95.4	42.3
<b>1992</b>	82.3	46.1
<b>1993</b>	77.5	48.2
<b>1994</b>	85.9	53.2
<b>1995</b>	93.4	56.2
<b>1996</b>	89.9	60.5
<b>1997</b>	92.0	70.8
<b>1998</b>	85.3	75.5
<b>1999</b>	87.5	82.0
<b>2000</b>	88.7	87.9
<b>2001</b>	98.5	89.0
<b>2002</b>	87.9	93.7

1/ USDA; 2/ Fiber Organon

23. Polyester is formed from petrochemicals. Despite the volatility of petroleum prices since 1990, textile polyester has remained at or below raw cotton prices since 1990. For calendar years 1995, 1997, 1998, 1999 and 2000 the per-pound value of U.S. polyester was below U.S. and world prices for raw cotton. Asian polyester prices remained below world cotton prices from 1990 to 2001. Moreover, the incredible increase in polyester production has contributed to weakened prices for cotton fiber across all markets. By 2002, cotton lost the position as the world's dominant fiber and slipped below polyester's market share.

<b>Fiber Prices (U.S. cents per pound)</b>					
	U.S. poly	U.S. spot	A Index	U.S. mill	Asian poly
1990	82.6	71.3	82.7	79.3	51.0
1991	73.5	69.7	76.8	79.1	48.6
1992	73.5	53.9	57.9	61.9	47.8
1993	72.5	55.4	58.1	62.4	46.4
1994	74.9	73.2	80.0	78.7	62.8
1995	88.8	93.5	98.1	100.8	82.1
1996	79.6	77.9	80.4	84.9	71.6
1997	68.6	69.8	79.2	76.3	60.9
1998	60.7	67.0	65.3	74.2	41.9
1999	51.7	52.2	53.1	59.9	43.7
2000	57.1	57.5	58.5	64.1	40.6
2001	60.4	39.7	48.0	46.9	40.1
2002	61.2	37.0	46.3	45.4	39.1

Source: Cotton Outlook, for annual Asian and U.S. mill delivered polyester. USDA for U.S. average spot price for 4134 cotton, U.S. mill delivered cotton, and the A Index.

## **2. Outside of the United States, Retail Consumption of Cotton Has Been Flat**

24. The United States is the world's largest market for cotton. Over 22 percent of all cotton produced in the world is sold in the U.S. retail market. However, those retail sales are sourced by ever-larger imports of cotton products. Imported textile and apparel cotton products claimed 84 percent of the U.S. retail market in 2002.

25. Consumer purchases outside the United States added over 40 million bales to textile fiber consumption since 1990 and virtually the entire amount was claimed by polyester. Consumers outside the United States buy no more cotton today than they did in 1990. The increased use of polyester is almost entirely a non-U.S. market phenomenon, and has had a devastating impact on the world cotton market. Consumers outside the United States actually reduced their annual cotton purchases after 1990 and only regained their consumption level of 1990 by the year 2002.

26. The United States has been the only source of growth in retail purchases of cotton since 1990. World cotton consumption was supported entirely by expansion of the U.S. retail market

for cotton textiles and apparel for the past 13 years. U.S. consumers added 8.6 million bales to their annual purchases of cotton products between 1990 and 2002. If U.S. consumers were not adding to cotton consumption, world cotton prices would be materially lower than they are today.

27. The growth in the U.S. retail cotton market has directly contributed to strengthening world cotton prices. If U.S. cotton consumption fails to continue to grow at the rates observed in the last 13 years, the result will be a further weakening of world cotton prices.

Retail Purchases of Fiber Millions of 480-lb. Bales				
	Cotton			Polyester /3
YEAR	U.S. 1/	Rest of World	Total 2/	
1990	12.3	73.1	85.4	39.8
1991	13.0	72.3	85.3	42.2
1992	14.9	70.7	85.6	45.8
1993	15.8	69.4	85.2	48.0
1994	16.6	68.1	84.7	52.8
1995	16.5	68.5	85.0	56.1
1996	16.5	70.8	87.3	60.4
1997	18.2	70.6	88.8	70.7
1998	19.4	68.2	87.6	74.6
1999	20.0	69.2	89.2	82.1
2000	20.5	70.2	90.7	87.7
2001	19.3	72.1	91.4	89.2
2002	20.9	73.1	94.0	94.8
1/ US consumption estimated by USDA.				
2/ World consumption estimated by ICAC, RoW is residual				
3/ Fiber Organon.				

US Retail Cotton Market Millions of 480-lb. Bales			
YEAR	Imported	U.S. Market	Import Share
1990	5.0	12.3	41.0%
1991	5.4	13.0	41.3%
1992	6.7	14.9	44.5%
1993	7.5	15.8	47.1%
1994	8.0	16.6	48.0%
1995	8.5	16.5	51.5%
1996	8.8	16.5	53.3%
1997	10.6	18.2	58.2%
1998	12.6	19.4	64.8%
1999	14.0	20.0	69.9%
2000	15.7	20.5	76.6%
2001	15.7	19.3	81.4%
2002	17.7	20.9	84.9%
Estimated by USDA			

### 3. Changing World Incomes Affect World Cotton Consumption More Than Consumption of Other Farm Products

28. In addition to the price pressure from synthetic production, the world economy grew more slowly since 1997 than any time for many years. Since 1998, non-U.S. GDP growth has been less than 2 percent in 4 out of 6 years, which directly affects the demand for cotton.

29. Other farm products are largely food, and consumers have less discretion to adjust food consumption than they do non-food purchases. Clothing is a semi-durable good, and when income growth slows consumers cut back on current purchases, and postpone replacing clothing until incomes rise more rapidly. Between 1980 and 2001, the correlation between changes in world income and world consumption of rice, corn, soybeans, and wheat ranged from –3 percent (rice) to 17 percent (wheat). For cotton the correlation was 54 percent, meaning the consumption of cotton is more closely tied to world GDP movements than consumption of other commodities.

30. Cotton consumption and income are correlated, but cotton consumption can decline even while income growth remains positive. Typically, if world GDP growth as measured by the International Monetary Fund (IMF) falls below 2.8 percent in a given year, world cotton consumption declines or fails to grow. Only in 2 of the last 7 times since 1974 that world GDP growth slipped below the 2.8 percent threshold did cotton consumption grow, and then at a below average rate. (Note that IMF GDP growth data is typically about 1 percentage point higher than other forecasters' data due to the use of Purchasing Power Parity exchange rates.)

31. According to the IMF, world GDP growth averaged 3.5 percent during 1993-2002. However, in 2001 world growth slipped to 2.2 percent, and by 2002 it had only recovered to 2.8 percent. This decline in world income occurred just as world cotton production was increasing because of good weather, severely pressuring world prices.

**4. Burgeoning U.S. Textile Imports, Spurred by A Strengthening U.S. Dollar, Adversely Affected The U.S. Textile Industry and Altered U.S. Cotton Use Patterns From Domestic Uses To Exports**

32. U.S. cotton textile imports have increased steadily for decades, reflecting increased competitiveness of foreign producers, liberalization of world textile and apparel trade under the *Agreement on Textiles and Clothing*, and a strengthening U.S. dollar. Since reaching a low in 1995, the U.S. dollar steadily appreciated until 2002 (using the ERS index on a trade-weighted basis for all agricultural trade). Between 1995 and 2002, the U.S. dollar appreciated 37 percent. When measured against cotton markets, the dollar rose 18 percent.<sup>19</sup>

33. Imported textile and apparel products continue to displace U.S. mill use of cotton fiber. Since peaking in 1997 at 11.3 million bales, U.S. mill use of cotton has dropped precipitously to only 7.7 million bales in 2002 – a 32 percent fall in only 6 years. For 2002, U.S. cotton textile and apparel imports rose for the 14<sup>th</sup> consecutive year, while exports remained essentially unchanged for the fifth straight year. Imports in 2002 are estimated to reach 18 million bales of cotton equivalent, a 13-percent increase over 2001. This huge trade deficit in textiles and clothing has fundamentally changed the pattern of how U.S.-grown cotton is used. As domestic mill use has fallen drastically, more U.S. cotton has been available for use by foreign mills, which then comes back to the U.S. in the form of cotton products. The share of world cotton consumption supplied by U.S. cotton has been roughly the same since 1991/92.

34. Growth in U.S. domestic cotton consumption far outweighs growth in U.S. cotton exports. The United States has not caused depressed world cotton prices but has in fact supported prices through its huge demand for cotton textiles and apparel.

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<sup>19</sup> Brazil's Further Submission, para. 124 and figure 10.



**U.S. cotton fiber consumption (million bales)**

Year	U.S. mill use	U.S. cotton textile exports 1/	U.S. cotton textile imports 1/	Net U.S. cotton textile imports 1/	Total domestic consumption 2/
1990	8.574	1.385	5.034	3.649	12.223
1991	9.057	1.506	5.402	3.896	12.953
1992	9.920	1.760	6.653	4.892	14.812
1993	10.287	1.906	7.452	5.546	15.833
1994	10.897	2.252	7.972	5.720	16.617
1995	10.799	2.773	8.520	5.747	16.546
1996	10.889	3.176	8.798	5.621	16.510
1997	11.336	3.734	10.592	6.858	18.194
1998	10.905	4.077	12.555	8.477	19.382
1999	10.338	4.320	13.982	9.662	20.000
2000	9.890	5.090	15.711	10.622	20.511
2001	8.018	4.425	15.719	11.295	19.312
2002	7.696	4.554	17.713	13.159	20.855

Source: USDA. 1/ Cotton fiber equivalent. 2/ U.S. mill use plus net cotton textile imports

**5. A Strengthening U.S. Dollar Also Led To Weaker Commodity Prices, Including Cotton**

35. A strong recurring relationship exists between the value of the dollar and the average world price of cotton. The world's cotton trade is essentially dollar denominated. Non-U.S. growths of cotton are commonly sold on dollar terms. Thus, if the dollar appreciates, other things being equal, the cash prices of cotton, both U.S. and non-U.S., will decline in the international market.

36. According to numerous economic studies, changes in the dollar's exchange rate and changes in dollar-denominated commodity prices largely parallel each other.<sup>20</sup> Generally speaking, when a country's currency appreciates, then either its share of world trade will decline or its prices must drop in terms of its own currency. As explained previously, because of declining mill use in the United States, U.S. cotton shifted from domestic use to export markets. Since 1995 the inflation-adjusted price of world cotton has dropped about 50 percent.<sup>21</sup>

<sup>20</sup> Rogoff, K. "The Purchasing Power Parity Puzzle," *Journal of Economic Literature*, XXXIV: 647-668. Dornbusch, R. "Exchange rates and prices," *The American Economic Review*, Vol. 77, No. 1 (Mar., 1987), pp. 93-106.

<sup>21</sup> MacDonald, Stephen. "U.S. Cotton and the Appreciation of the U.S. Dollar." Agricultural Outlook. Economic Research Service, U.S. Department of Agriculture. April, 2002.

## 6. China's Trade and Stock Policies Had a Huge Impact on World Cotton Markets and Prices in the 1999-2002 Period

37. China is the giant of the world cotton industry, producing and spinning one-fourth of the world's cotton. In addition to its importance in sheer volume, China's cotton sector adds a dimension of unpredictability to world cotton trade. Uncertainty about China's likely trade position stems from both the diffuse structure of China's cotton industry, which makes it difficult to gather reliable information, and from frequent shifts in government policies affecting cotton. China's erratic and changing policies were an especially significant factor affecting world cotton markets and prices during the period between 1999-2002.

38. China's policies were strongly correlated to world cotton price movements through the late 1990's and early 2000's. Through the mid-1990's the Chinese Government was concerned with maintaining farmers' income and directed the state marketing organization (the Bureau of Cotton and Jute (BJC)) to maintain cotton procurement prices at high levels. At the same time concerned with supporting a key export industry, China continued to allow cotton imports for processing and re-export. These actions created a domestic supply of cotton well beyond the demand created by the artificially high procurement prices. To keep domestic prices high, the BJC held on to a large portion of the cotton they procured and their stocks grew rapidly.<sup>22</sup>

39. The government was facing similar problems with its other main price-support commodities, rice, corn, and wheat. After procuring the 1998 crops the situation was becoming untenable with the cotton and grain procurement agencies amassing huge debts and storage costs that had to be subsidized by the government. The government decided that a change needed to be made. For cotton they in part publicized their intentions, with senior officials and official news sources in the summer of 1999 noting the government's intention to now let market prices guide farmers' decisions. Accordingly, procurement prices dropped precipitously and the government allowed the BJC to gradually start selling off stocks at a significant loss. Domestic Chinese prices that had once been well above world prices now fell well below.

40. The biggest unknown behind China's import demand for cotton has been cotton stocks. Until recently, the size of China's cotton stocks was officially a state secret. While this is no longer the case, there is great uncertainty, with a wide range of estimates. USDA has revised its own estimates substantially in recent years. China was widely believed to have accumulated substantial stocks during the last half of the 1990's, but it was unclear how much of those stocks were actually spinnable – that is, in good enough condition for yarn production. Furthermore, these stocks were acquired by the government at high prices and would require acknowledging financial losses to be released onto the market. Finally, many of these stocks were in the

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<sup>22</sup> Colby, Hunter and Stephen MacDonald, "China's Cotton Sector Under Stress," *Cotton and Wool Situation and Outlook Yearbook*, November 1998, Economic Research Service, U. S. Department of Agriculture. Found at [www.ers.usda.gov/briefing/cotton](http://www.ers.usda.gov/briefing/cotton).

government's "strategic reserve," and the government's strategic objectives in holding this reserve were unclear.

41. At the beginning of the 1999/2000 marketing year, China announced a policy of auctioning cotton from these stockpiles, with the central government accepting the financial loss. China's auctions got underway in earnest in April 2000 and continued through January 2001. This was a period of relatively high world prices compared with the preceding 8 months and the 24 months that followed. By November 2000, China's government was auctioning as much as 2.1 million bales in a single month. (World consumption of cotton in 2000/01 was 92.2 million bales for the entire year. Thus, China's government released from its stocks in one month the equivalent to 2.3 percent of the world's *annual* consumption.) Although China auctioned only a small amount of cotton over February-June 2001, world cotton prices fell more or less continuously through October 2001. There was a brief surge toward earlier auction levels in July and August before dropping to zero from October 2001 to April 2002.<sup>23</sup>

42. The unpredictability of Chinese auctions had a tremendous impact on world cotton prices in 2000/01. Over the entire marketing year in 2000/01, China auctioned 6.5 million bales of cotton from its stocks, equal to 7 percent of world consumption that year.

43. As China's auctions continued, it became clear that the rest of the world had underestimated China's cotton stocks. China auctioned 11.6 million bales over August 1999 to July 2002 (3 million bales in 1999/2000, 6.5 million in 2000/01, and 2.1 million in 2001/02). In April 2000 USDA revised its estimates of China's 1999/2000 ending stocks up by 2.7 million bales. In July 2002 USDA raised its estimate of China's 2001/02 ending stocks by 2.4 million bales. The realization that the world supply of cotton was higher than previously believed depressed prices.<sup>24</sup>

44. In addition to the stock release, the price effects were compounded by the lagged effect on world markets, as the cheap cotton released from stocks was processed into yarn and fabric and exported. Cotton yarn and fabric exports, which had fallen 15 percent during the years of price supports rose by 40 percent between MY 1998/99 and MY 2001/02. The flood of Chinese cotton

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<sup>23</sup> International Cotton Advisory Committee, *Review of World Cotton Situation*, various issues. September 2002, Vol. 54, Issue 1; July 2001, Vol. 54, Issue 6; September 2002, Vol. 56, Issue 1. See also USDA Outlook Forum papers: website address: [usda.gov/oce/waob/index.htm](http://usda.gov/oce/waob/index.htm). 2003: "The U.S. and World Cotton Outlook," Stephen MacDonald. 2002: "The U.S. and World Cotton Outlook," and Carol Skelly. "China's Cotton Trade under the WTO," Hunter Colby. 2001: "The USDA Perspective on the Outlook for Cotton," Leslie Meyer. 2000: "The USDA Outlook for Cotton," Andrew Levin and "The Effects of China's Cotton Reforms on Price Formation, Production, and Trade," Ding Haowu. 1999: "The USDA Perspective on the Outlook for Cotton," Pete Burr and "New Directions in China's Cotton Policy," Shi Jianwei.

<sup>24</sup> Foreign Agricultural Service, U.S. Department of Agriculture, *Cotton: World Markets and Trade*, April 2000 and July 2002. Found at: <http://www.fas.usda.gov/cotton/circular/>.

products onto the world market eventually was instrumental in pushing down world cotton prices to the very low levels of MY 2000/01 and 2001/02.<sup>25</sup>

### **C. Factors Affecting U.S. Cotton Production**

45. Cotton planting decisions are driven by numerous factors, including the expected price of cotton, prices of competing crops, farm program benefits, technological factors and input costs. Cotton planting decisions in the United States are most heavily influenced by expected prices for the upcoming crop year, not prices from the previous crop year as cited by Brazil. U.S. cotton producers have been responsive to world price movements and are not insulated from the world market. U.S. upland cotton acreage response is similar to that of other countries, and, on a relative basis, actually respond more than other countries to changes in market conditions. Cross-commodity effects cannot be ignored when evaluating acreage responses in the United States, particularly since most payments under the U.S. cotton program are not linked to the production of cotton.

#### **1. The effects of technological factors on cotton production**

46. Changes in production technology can affect both the risk and the expected returns from cotton production. In recent years, the boll weevil eradication programs and the introduction and adoption of genetically modified varieties of cotton have lowered production costs, increased yields, and increased net returns for U.S. cotton production.

47. Boll weevil eradication. The initial U.S. boll weevil eradication program was begun in 1978 and included Virginia, North Carolina, South Carolina, Georgia, Florida, and the southern part of Alabama. Eradication efforts for the remainder of Alabama and middle Tennessee were begun in 1993. The boll weevil has now been largely eradicated from the southeastern United States.<sup>26</sup> Eradication efforts are currently ongoing in the delta region of Mississippi, Arkansas, Louisiana, and west Tennessee (with the exception of the northeastern delta of Arkansas). Eradication is complete in the southern plains of Texas, but is ongoing in other regions of Texas, Oklahoma, and Missouri (El-Lissy and Grefenstette 2003).<sup>27</sup> Most ELS cotton regions have also completed boll weevil eradication programs.

48. The boll weevil eradication program has lowered the costs of producing cotton and has made cotton a more attractive cropping alternative. Ahouissoussi et al. documented the net benefits of the program in Alabama, Florida and Georgia in the early 1990s and concluded that even before complete eradication had occurred in the region, the program was providing net

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<sup>25</sup> Economic Research Service, U.S. Department of Agriculture, *Cotton and Wool Situation and Outlook Yearbook*, September 2001 and November 2002. <http://www.ers.usda.gov/Briefing/Cotton/>.

<sup>26</sup> For more detail, see: [www.cotton.org/tech/pest/bollweevil/index.cfm](http://www.cotton.org/tech/pest/bollweevil/index.cfm).

<sup>27</sup> El-Lissy, O. and B. Grefenstette. "Boll Weevil Eradication in the US, 2002" 2003 National Cotton Council. *Proceedings of the Beltwide Cotton Conference*. Vol. 1:1359-1369. 2003.

benefits to producers and contributing to the rapid expansion of cotton area.<sup>28</sup> Similarly, in a study of Texas High Plains cotton producers, Carpio et al. estimate that the net benefits of the program is \$56.80 per acre per year once the boll weevil has become completely eradicated.<sup>29</sup>

49. Even in low-yielding regions, the boll weevil eradication program has increased profitability. Johnson et al. (2000) estimate that the annual discounted net benefits of the boll weevil eradication program in the Southern Rolling Plains region of Texas totaled more than \$5 per acre over 1994-2000.<sup>30</sup> The average yield in this region over the period was 300 lbs per acre, which means that the discounted net benefit per pound was 1.67 cents per pound.

50. In a study of the boll weevil eradication program in West Tennessee, Larson et al. estimate that the benefits to Tennessee cotton producers will likely result in an increase in cotton area of 10 percent by the time the program is completed.<sup>31</sup>

51. The effect of the boll weevil eradication program has been to bring millions of acres into production in regions that were formerly plagued by boll weevil infestation. For example, in 1978 when the boll weevil eradication program went into effect in the Southeast, planted upland cotton area in Virginia, North Carolina, Florida, Georgia, South Carolina and Alabama totaled less than 600,000 and accounted for less than 5 percent of total U.S. planted cotton. By 2003, over 3,250,000 acres were planted in the region and accounted for over 25 percent of total U.S. upland cotton plantings. The increase in Georgia's acreage was even more dramatic, from 120,000 in 1978 to 1.4 million acres in 2003.<sup>32</sup>

52. Genetically modified cotton. Genetically modified cotton varieties became commercially available on a limited basis in 1996 with the introduction of insect-resistant (Bt) cotton. Bt cotton contains a gene that triggers production in the plant tissue of a protein that is toxic to many larvae of the *lepidoptera* order, including tobacco budworm and cotton bollworm. Thus, Bt cotton reduces the need for spray applications of synthetic insecticides. The technology does not control all cotton pests and thus does not eliminate the need for all insecticide applications. Crop monitoring is still critical. Further, farmers must pay a technology fee when they purchase

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<sup>28</sup> Ahouissoussi, N.B.C., M.E. Wetzstein, and P.A. Duffy. "Economic Returns to the Boll Weevil Eradication Program." *Journal of Agricultural and Applied Economics* 25(1993, no 2):46-55.

<sup>29</sup> Carpio, C., O. Ramirez, and S. Armstrong. "Economics of the Cotton Boll Weevil Control in the Texas High Plains." National Cotton Council. *Proceedings of the Beltwide Cotton Conference*. Vol. 1:256-262. 2001.

<sup>30</sup> Johnson, J.L., C.G. Sansone, T.W. Fuchs, and R.R. Minzenmayer. "Grower-Level Benefit Cost Analysis of Boll Weevil Eradication in the Southern Rolling Plains of Texas." National Cotton Council. *Proceedings of the Beltwide Cotton Conference*. Vol. 1:227-230. 2001.

<sup>31</sup> Larson, J.A., B.C. English, and O.P. Suarez. "Economic Impact of the Boll Weevil Eradication Program in West Tennessee." National Cotton Council. *Proceedings of the Beltwide Cotton Conference*. Vol. 1:353-355. 2001.

<sup>32</sup> U.S. Department of Agriculture, Economic Research Service, Cotton and Wool Situation and Outlook Yearbook., CWS-2002. November 2002. Appendix table 4, p. 21 Available at: <http://www.ers.usda.gov/publications/so/view.asp?f=field/cws-bb> .

Bt cottonseed. However, the extent to which farmers have adopted Bt cotton varieties would indicate that the benefits are perceived as outweighing the costs.

53. In 1997, varieties containing herbicide-tolerant traits were introduced commercially as well as limited quantities of varieties that combined this trait along with the Bt trait (so called “stacked gene” varieties). During the 1997 crop year, industry estimates were that approximately 25 percent (3.4 million acres) of U.S. upland cotton acreage was planted to genetically modified varieties. Since then producers have rapidly adopted genetically modified varieties. In 2000, an estimated 61 percent (9.4 million acres) of U.S. upland cotton acreage was planted to a genetically modified variety – insect-resistant, herbicide-tolerant, or stacked-gene. The percentage of acreage planted to these crops continues to expand. In 2003, the National Agricultural Statistics Service estimated that 73 percent of upland cotton acres surveyed were planted with genetically modified cotton varieties.

54. Economic studies suggest that Bt cotton has increased both yields and net returns while decreasing pesticide use (Fernandez-Cornejo and McBride 2000;<sup>33</sup> ReJesus, Greene, Hamming and Curtis 1997;<sup>34</sup> Shoemaker 2002<sup>35</sup>). This has effectively lowered the costs of producing cotton in the United States and increased net returns from cotton relative to other crops, particularly in the MidSouth and Southeast regions where over 90 percent of the cotton acres were planted with genetically modified cotton varieties.<sup>36</sup>

## **2. Cross Commodity Effects on Upland Cotton Area Response, 1996-2003**

55. Brazil has argued that U.S. cotton producers have been unresponsive to market prices. This section examines recent movements in cotton prices relative to its primary planting alternative, soybeans.

56. Market prices for cotton and most competing field crops reached record levels during the mid-1990s. The following table shows expected prices for cotton and the major competing crop, soybeans, at planting time of each crop year. Futures prices are chosen as the best proxy for expected prices since they reflect current market expectations of future prices (Gardner 1976).<sup>37</sup>

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<sup>33</sup> Fernandez-Cornejo, J, and W. McBride. *Genetically Engineered Crops for Pest Management in U.S. Agriculture*. U.S. Department of Agriculture, Economic Research Service, Agricultural Economics Report No. 786. May 2000.

<sup>34</sup> ReJesus, R., J.K.Green, M. Hamming, and C. Curtis. “Economic Analysis of Insect Management Strategies for Transgenic Bt Cotton Production in South Carolina.” *Proceedings of the Beltwide Cotton Conferences*. Cotton Economics and Marketing Conference. 1997. v.1. pp. 247-251.

<sup>35</sup> Shoemaker, R. (ed.) *Economic Issues in Agricultural Biotechnology* U.S. Department of Agriculture, Economic Research Service, Agriculture Information Bulletin No. 762. February 2001.

<sup>36</sup> U.S. Department of Agriculture, National Agricultural Statistics Service, *Acreage*, June 30, 2003. p. 25.

<sup>37</sup> Gardner, B.L. “Futures Prices in Supply Analysis,” *American Journal of Agricultural Economics* 58(1976):81-84.

The expected price for cotton is calculated as the February average closing price on the December New York Board of Trade cotton futures contract. The expected price for soybeans is calculated as the February average closing price on the November Chicago Board of Trade soybean futures contract.

57. A look at average harvest-time futures prices taken at planting reveals prices for cotton and soybeans well above loan rate levels through 1998. During the period 1996-1998, the ratio of expected soybean prices to expected cotton prices was fairly steady. There was a slight increase in expected soybean prices relative to expected cotton prices in 1998. During this period cotton acreage decreased as farmers took advantage of the planting flexibility created by the 1996 FAIR Act.

58. As world supplies responded to high prices and the Asian financial crisis (1998-2000) reduced demand for commodities including cotton and soybeans, prices fell precipitously in late 1998 and early 1999. By February 1999, the futures price of cotton for December delivery averaged less than 61 cents per pound, 15.3 percent below the average for the previous spring. The price of soybeans had fallen even further in relative terms – down almost 20 percent from Spring 1998 levels. The ratio of expected soybean prices to expected cotton prices was lower than it had been over the previous three years. In other words, compared to the previous three years, expected cotton prices were higher relative to expected soybean prices over the period 1999-2001. This increase in expected cotton prices relative to expected soybean prices corresponds to increases in cotton acreage over the same period.

59. In 2002, the ratio of expected soybean price to expected cotton price increased dramatically, due to extremely low expected cotton prices. This corresponds to an expected sharp decrease in cotton planted acreage.

60. The analysis suggests that, contrary to Brazil’s assertion, U.S. cotton producers have not remained insulated from world price movements. Rather, U.S. cotton producers have based planting decisions on the relative movement of cotton prices to prices of competing crops such as soybeans.

**Expected cotton and soybean prices and planted cotton acreage**

Year	December cotton futures (cents/lb)	November soybean futures (\$/bushel)	Ratio of cotton futures to soybean futures	Planted cotton acres (million acres)
1996	78.58	7.23	9.20	14.4
1997	76.82	6.97	9.07	13.6
1998	72.13	6.64	9.21	13.1
1999	60.32	5.11	8.47	14.6
2000	61.31	5.32	8.68	15.3
2001	58.63	4.67	7.96	15.5
2002	42.18	4.50	10.66	13.7
2003	59.60	5.26	8.82	13.5

**3. U.S. Upland Cotton Area Response Is Similar to Other Countries**

61. As explained in the previous section, U.S. cotton area has responded to market prices. In fact, an examination of year-to-year movements in prices for cotton and competing crops reveals that U.S. cotton producers show greater sensitivity (in cotton harvested acres) to price changes than is demonstrated by their foreign counterparts.

62. Since 1994 there have only been 2 years when U.S. harvested acres changed from one year to the next in a different fashion than growers in the rest of the world. Those 2 years, 1998 and 1999, are specific to severe drought in the United States. In 1998, U.S. harvested area fell more than 2,000,000 acres compared to the previous year while growers in the rest of the world increased harvested area about 100,000 acres. This difference was largely due to disastrous conditions across much of Texas where abandonment of planted acres exceeded 2,000,000 acres. In 1999, weather was more normal and the harvested acres increased by almost exactly the acres lost to drought in the previous year. That same year harvested acres in the rest of the world fell by more than 2 million acres.

63. The absolute shift in harvest acres does not represent the full picture because average foreign harvested acres are several multiples of U.S. harvested acres. Comparing the acreage shift on a percentage basis shows much larger relative shifts by U.S. cotton growers.

64. It is important to recognize that the cotton price alone does not determine grower intentions. Many growers, in United States and elsewhere, have several alternative crops to consider. Northern hemisphere growers, and the marketing outlets with which they interact, are



typically looking at the harvest time futures prices during a window early in the calendar year. Thus, during January, February and March growers would be looking at the levels of the upcoming December futures contract on cotton, September futures contract for corn, and November futures contract for soybeans.

65. In early calendar year 1999, the futures price for cotton was trading below the futures price observed in the previous year. However, soybean and corn futures had fallen by greater percentages. The result was that U.S. growers increased their harvested cotton acres in 1999 over the level of 1998. This was also due to extraordinary abandonment of acres in the previous year in Texas. Thus, U.S. harvested acres increased significantly in 1999.

66. In early calendar year 2000, the futures price for cotton had fallen from the previous year's level while corn and soybean prices had risen on the year. U.S. cotton growers reduced harvested acreage from the level in 1999. World and U.S. cotton growers followed virtually identical patterns in the year 2000.

67. While cotton harvest futures prices again declined on the year, from 2000 to 2001, soybean and corn harvest futures prices fell by a greater percent. As a result U.S. cotton growers saw an increase in cotton harvested acres in 2001. This same pattern was repeated with cotton growers outside the United States. This increase outside the United States was entirely concentrated in other northern hemisphere growers.

68. It is important to note that the cataclysmic drop in prices in the fall of 2001 occurred just prior to the planting of cotton crops in the southern hemisphere. Thus, all of the major southern hemisphere cotton-producers – Argentina, Australia, Brazil, Paraguay, and Zimbabwe – made sharp reductions in area in response to market information that was not available to their northern hemisphere counterparts six months earlier.

69. In considering planting in 2002, growers saw cotton prices rise over the level of harvest futures in the previous year, but soybean and corn harvest futures prices had greater percentage increases. Both U.S. growers and growers in the rest of the world saw harvested acres of cotton decline from the previous year's level.

70. Thus, absolute levels of cotton prices may change and the resulting movement in harvested acreage may not necessarily move in the expected direction. Movements in prices of competing crops can have a significant impact on grower decisions, both inside and outside the United States.

<b>Harvested area (1,000 hectare)</b>							
Country	1996	1997	1998	1999	2000	2001	2002
United States	5,216	5,425	4,324	5,433	5,282	5,596	5,029
Australia	396	448	534	464	505	420	225
Brazil	695	765	685	752	853	750	740
China	4,722	4,491	4,459	3,726	4,058	4,820	4,184
India	9,122	8,904	9,287	8,791	8,576	8,730	7,600
EU	497	497	510	539	501	501	453
FSU	2,535	2,472	2,503	2,490	2,407	2,493	2,434
Africa Franc Zone	1,699	1,995	2,075	2,037	1,750	2,442	2,332
World Total	33,845	33,842	33,883	32,388	32,186	33,904	33,533

Source: U.S. Department of Agriculture, Foreign Agricultural Service, *Production, Supply, and Distribution Database*, available at: <http://www.fas.usda.gov/psd/>

**V. Brazil Has Not Established a *Prima Facie* Case With Respect to U.S. Decoupled Income Support Measures Because These Measures Have No More than Minimal Effects**

71. As explained earlier, in order to pursue its actionable claims under Subsidies Agreement Articles 5(c), 6.3(c), 6.3(d) and GATT 1994 Article XVI:1, Brazil must demonstrate that the “effect of the subsidy” is to cause serious prejudice through significant price suppression or depression or an increase in world market share. Under GATT 1994 XVI:3, Brazil must demonstrate that the “subsidy . . . operates directly or indirectly to increase the export of any primary product.” With respect to two sets of challenged measures, green box and non-green-box decoupled income support, Brazil’s claims under the cited provisions fail because these measures have no or at most minimal trade- or production-distorting effects on upland cotton.

72. With respect to U.S. green box measures, namely direct payments under the 2002 Act and expired production flexibility contract payments under the 1996 Act, Annex 2 of the Agriculture Agreement makes clear that these payments have no, or at most minimal, trade-distorting effects or effects on production. The United States recalls that under Article 21.1 of the Agriculture Agreement, the Subsidies Agreement applies “subject to” the Agriculture Agreement.

Accordingly, Annex 2 makes it clear that U.S. green box measures do not cause serious prejudice.

73. As further support, the United States has previously presented a review of the economic literature on decoupled payments generally, some of which examined the U.S. payments at issue in this dispute.<sup>38</sup> The United States reported that no study has found that these decoupled payments have effects of production of more than one percent. (Significantly, Brazil has not contradicted the U.S. reading of the literature.) Because the effect on production is negligible, these payments can have no “effects” for purposes of Article 6.3 nor operate to increase the export of upland cotton under GATT 1994 Article XVI:3. Thus, Brazil has not established a *prima facie* case under each of its claims.

74. Similarly, decoupled income payments that vary in amount with market prices, such as counter-cyclical payments under the 2002 Act and expired market loss assistance payments, are also decoupled in the sense of not being linked to current production. While the United States does not consider these payments to be under the policy-specific criteria of Annex 2, nonetheless the economic effects are likely to be similar (that is, none or minimal) to U.S. green box payments.<sup>39</sup> Because these payments are not linked to production and have no “effects” for purposes of Article 6.3(c) nor operate to increase the export of upland cotton under GATT 1994 Article XVI:3, Brazil has not established a *prima facie* case under each of its claims.

75. Finally, as discussed at length in previous submissions, because no production of upland cotton (or any other crop) is necessary to receive these payments, it would be erroneous to attribute to “upland cotton” or “upland cotton producers” all decoupled payments made with respect to upland cotton base acreage.<sup>40</sup> Those acres may be planted to alternative crops or may be growing no crops at all; simply put, Brazil has not even shown that these are subsidies to upland cotton. Accordingly, there is no basis to include those payments in an analysis of whether “subsidies provided to US producers, users and/or exporters of upland cotton”<sup>41</sup> have caused serious prejudice to the interests of Brazil.

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<sup>38</sup> See U.S. Rebuttal Submission, para. 61.

<sup>39</sup> See V. H. Smith *et al.*, “Risk Management and Direct Payment Programs: Implications for Agricultural Trade Policy.” Paper presented to the International Agricultural Trade Research Consortium meetings, Capri, Italy, June 2003. This paper argues that while market loss assistance payments and payments under the counter-cyclical payment program are triggered by low prices, they are clearly independent of current planting and harvesting decisions and, therefore, essentially decoupled. The authors conclude it is difficult to argue that either of these types of payments have much of a role to play in determining farm level production decisions.

<sup>40</sup> See, e.g., U.S. Answer to Additional Question 67*bis* from the Panel, paras. 20-27.

<sup>41</sup> WT/DS267/7, at 1 (measures identified in Brazil’s panel request).

## **VI. Brazil Has Failed to Demonstrate that Challenged U.S. Measures Have Caused Serious Prejudice to Brazil’s Interests Within the Meaning of Article 5(c) and 6.3(c)**

### **A. Introduction**

76. Brazil alleges that in each of marketing years 1999 through 2002, challenged U.S. subsidies have caused serious prejudice to Brazil’s interests through price suppression or depression, within the meaning of Subsidies Agreement Articles 5 and 6.3(c). The latter provision reads:

Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:

...;

(c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market[.]

In this section, the United States explains the meaning of this text and notes that Brazil’s errors in interpretation preclude Brazil from making a *prima facie* case on this claim.

### **B. Framework: “Serious Prejudice . . . May Arise”**

77. Article 6.3 begins: “Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or more of the following apply.” The provision then goes on to enumerate four specific circumstances. The introductory sentence establishes that serious prejudice “may arise” if “one or more” of those circumstances is found, indicating that serious prejudice need not arise even if they are found. By way of contrast, Article 6.1, the now-expired “dark amber” category of actionable subsidy, began, “Serious prejudice in the sense of paragraph (c) of Article 5 *shall be deemed to exist* in the case of,” creating a rebuttable presumption of serious prejudice where one of those criteria were met.<sup>42</sup>

78. Brazil argues that in *Indonesia – Automobiles*, the panel did not consider that it had to look at serious prejudice separately from its finding of price undercutting under Article 6.3(c). However, it is not clear that the issue was argued before the panel, and the panel’s procedure cannot alter the text of Article 6.3.

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<sup>42</sup> Article 6.2 made it clear that the presumption could have been rebutted by a showing that the subsidies failed to result in any of the effects in Article 6.3.

79. As serious prejudice “may” arise if one or more of the four conditions under Article 6.3 are satisfied, Brazil must first show that *at least one* of those conditions is met. Without such a showing, there can be no serious prejudice. Second, if Brazil demonstrates one or more of the criteria in Article 6.3 is met, Brazil must then demonstrate “serious prejudice” – that is, that the “prejudice” caused by the effects of the subsidy were “serious.”<sup>43</sup> In this dispute, Brazil has not established that any prong of Article 6.3 is met; therefore, Brazil has not made a *prima facie* case of serious prejudice.

### C. Causation: “The Effect of the Subsidy”

80. Article 6.3(c) requires that Brazil establish causation – that is, that “the effect of the subsidy is . . . significant price suppression [or] depression . . . in the same market.” As noted above, Brazil’s argument rests largely on the assertion that large U.S. outlays under the challenged measures during marketing years with low prevailing upland cotton prices necessarily demonstrate that U.S. measures caused those price declines. This argument fails because Brazil has simply not demonstrated the causal connection between the U.S. measures and the price effects. Brazil has not even shown there is a necessary correlation between the measures and the effects it claims, let alone that there is a genuine and substantial link between the U.S. measures and the effects claimed. Nor has Brazil examined or explained key factors that affected world cotton markets during the marketing year 1999 - marketing year 2002 period. As explained, these factors were the causes of the dramatic plunge in cotton prices experienced in recent years. Brazil has failed to separate and distinguish all the different effects from the various factors at play and has erroneously attributed to the U.S. measures the effects of these other causes. Brazil has not made a *prima facie* case that “the effect of the subsidy” was significant price suppression or depression.

### D. “Significant Price Suppression”

81. Article 6.3(c) requires that “the effect of the subsidy” is “significant price suppression.” The Agreement does not define “significant.”

82. Brazil argues that the Panel should follow the standard employed by the *Indonesia – Automobiles* panel report in a dispute involving price undercutting under Article 6.3(c).<sup>44</sup> In that report, the panel wrote that the word “significant” was included in the text on price undercutting “presumably” to ensure that the text did not capture “margins of undercutting so small that they could not meaningfully affect suppliers of the imported product.” (In practice, the panel

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<sup>43</sup> For example, if a complaining party were to show that under Article 6.2 effect of a subsidy was to displace its exports to a third country market, but that the amount displaced was just \$1 (which could for example represent less than 0.00000001 percent of total exports), it would be difficult to understand how that alone would mean that there was “serious prejudice” to that Member’s interests.

<sup>44</sup> *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54, 55, 59, 64/R, para. 14.254 (adopted 23 March 1998) (“*Indonesia – Automobiles*”).

concluded that a price that is 33.77 percent lower is a significant price undercutting.) It is difficult to ascribe much weight to that panel’s finding, however, given that (1) the panel did not conduct a textual analysis of the provision, and (2) the panel itself explained that it was making an assumption about the provision’s meaning.

83. A textual analysis of this provision would, as always, begin with its ordinary meaning. The ordinary meaning of significant is “important, notable; consequential,”<sup>45</sup> which suggests that the price suppression must reach a level at which it is important, notable, and consequential in order to be inconsistent with Article 6.3(c). The United States further notes that the term “significant” modifies “price suppression or depression”; therefore, it is the effect on *prices* that must be “significant” and not the direct effect on *producers*, as Brazil argues.

84. Brazil makes clear that under its interpretation price suppression would be significant at a level of even 1 cent per pound because this could still “meaningfully affect” producers.<sup>46</sup> Brazil’s interpretation, however, collapses the concept of “significant price suppression or depression” with the concept of “serious prejudice.” It would also greatly expand the effect of Article 6.3(c), which falls under Part III of the Subsidies Agreement on “Actionable Subsidies” rather than Part II on “Prohibited Subsidies” to encompass *any* subsidy with any price effect. Any subsidy that has a production effect will theoretically have a price-reducing effect by introducing more supply into the market. Members agreed, however, that any theoretical price effect would not suffice to satisfy Article 6.3(c); they accomplished this by stating that the price suppression or depression had to be “significant” in order to create a situation in which serious prejudice may arise.

85. Brazil’s theory would also appear to create two sets of subsidy rules in the WTO: one for widely traded products, such as most agricultural products, and another for more differentiated products. This would occur because the more widely traded a product is, the more *any* price effect could be deemed to “meaningfully affect” producers. There is no basis in the text of the Agreement, however, for creating such a distinction. In fact, where Members intended a particular rule to apply to a particular type of product – such as a “subsidized primary product or commodity” (Article 6.3(d)) – they said so explicitly. Finally, we note that, given the history of negotiations over domestic support reduction commitments and Peace Clause, it would seem anomalous to impose a higher burden on domestic support for agricultural products than for other types of products.

86. Finally, we note two further Brazilian arguments. First, Brazil proposes that “significant price suppression” must be sufficient to meaningfully affect any non-U.S. suppliers. However, only Brazil’s producers would be relevant to Brazil’s case. Article 5(c) creates a cause of action for “serious prejudice to the interests of another Member,” and Article 7.2 requires a complaining

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<sup>45</sup> *The New Shorter Oxford English Dictionary*, vol. 2, at 2860 (1993 ed.) (second definition).

<sup>46</sup> Brazil’s Further Submission, para. 256.

Member's statement of available evidence to include evidence of "serious prejudice caused to the interests of the Member requesting consultations." Therefore, "significant price suppression or depression" must be demonstrated with respect to Brazilian products. The United States recalls that the panel in *Indonesia – Automobiles* considered a U.S. claim of serious prejudice on behalf of a U.S. company manufacturing products at a European factory. The panel analyzed this question in some detail and concluded that a serious prejudice claim must be made with respect to products produced within a Member's territory and that one Member could not bring a claim that another Member has suffered serious prejudice.<sup>47</sup>

87. Second, Brazil argues that the meaning of "significant" may vary by complaining Member, for example, to a developing country that needs tax revenue / foreign exchange. Brazil's developmental status is irrelevant for purposes of Article 6.3(c). There is no text in the Subsidies Agreement to support Brazil's position, and as a result Brazil has cited none. Brazil overlooks the fact that "significant" is linked to "in the market" – Article 6.3(c) is aimed at price suppression or depression that is significant in market terms. It is not a question of the effect on the Member, but on the market. The effect on the Member is captured by the separate review as to whether these price effects result in "serious prejudice" to the interests of that Member.

88. We also note that Article 27 of the Subsidies Agreement is devoted to the topic of special and differential treatment for developing country Members and contains many modifications and/or exceptions from the otherwise applicable rules of the Agreement. However, all of these rules relate to a developing country Member's use of subsidies and the application of remedies against those subsidies. None of the provisions of Article 27 talk about modifications of the rules for a developing country Member as a complainant seeking a remedy against subsidies.<sup>48</sup> Thus, the drafters thought about special and differential rules for developing countries but declined to draft the type of rule suggested by Brazil.

89. In conclusion, by failing to set forth a proper interpretation of "significant price suppression or depression," Brazil has failed to make a *prima facie* case supporting its claim of inconsistency with Article 6.3(c).

#### **E. "In the Same Market"**

90. Article 6.3(c) requires that the "significant price suppression [or] depression" that is the "effect of the subsidy" occur "in the same market." The immediately preceding phrase describes "price undercutting by the subsidized product as compared with the price of a like product of another Member *in the same market* (italics added)." Thus, the later use of the same "in the same market" phrase suggests that the significant price suppression or depression must occur when "the subsidized product" is found "in the same market" as "a like product of another Member."

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<sup>47</sup> *Indonesia – Automobiles*, WT/DS54, 55, 59, 64/R, para. 14.202.

<sup>48</sup> One wonders what would happen if Brazil were challenging a developing country Member.

That is, “in the same market” is meant to require identification of a particular market in which price effects are alleged to have occurred so as to allow a comparison in that market.<sup>49</sup>

91. Brazil has only presented evidence with respect to effects on prices in the “world market”; its “evidence” with respect to prices in the Brazilian market and several third-country markets consists primarily of an argument that world prices are reflected in local prices. Brazil also argues that the context provided by Article 6.3(a), (b) suggests that the relevant “market” can be that of the subsidizing Member, a third-country market, or the “world market.” However, if a complaining party could merely assert price suppression or depression in the world market, the word “same” in the phrase “the same market” would be rendered inutile because the subsidized and non-subsidized products could always be deemed to be in the same “world market.” A subsidy could be shown to have a price suppressing effect in the “world” market, moreover, but to have no effect in the particular markets to which the complaining Member exports. In such a case, there would be no “significant price suppression, depression, or lost sales in the same market” – that is, a market in which both the subsidized product and the like product of another Member is found.<sup>50</sup>

92. Thus, by failing to properly interpret the phrase “in the same market” and provide evidence of “significant price suppression or depression” by allegedly subsidized U.S. exports in that market, Brazil has failed to make a *prima facie* case supporting its claim of inconsistency with Article 6.3(c).

#### **F. Time Period for Demonstrating Causal Effects**

93. Brazil asserts that it is “reasonable” to analyze the effects of U.S. subsidies over the marketing years 1999-2002 period for price suppression / depression. Brazil believes this period is “reasonable” because national investigating authorities for trade remedies also utilize a recent representative period. In addition, Brazil believes that Articles 6.3(d) (requiring analysis of world market share compared to previous three years) and 6.4 (directing look at changes in market share over a representative period of “at least one year”) provide context supporting Brazil’s chosen period.

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<sup>49</sup> Indeed, even Brazil appears to recognize this point when it states: “The ordinary meaning of the term ‘market’ is a geographic location where competition for sales of a particular commodity takes place.” Brazil’s Further Submission, para. 265.

<sup>50</sup> Article 6.5, which further explains price undercutting, further demonstrates that “in the same market” means a particular market in which both products are found: “For the purpose of paragraph 3(c), price undercutting shall include any case in which such price undercutting has been demonstrated through a comparison of prices of the subsidized product with prices of a non-subsidized like product *supplied to the same market*. The comparison shall be made at the same level of trade and at comparable times, due account being taken of any other factor affecting price comparability. However, if such a direct comparison is not possible, the existence of price undercutting may be demonstrated on the basis of export unit values.”



94. The United States believes that the “appropriate representative period” for demonstrating present serious prejudice will depend on the nature of the challenged subsidies. Normally, the most recent period for which data are available will be the appropriate period. In the case of recurring subsidies such as those under the 1996 Act and the 2002 Act, moreover, a past subsidy no longer exists as of the time a new subsidy payment in respect of current production is made. Thus, subsidies made in respect of marketing year 1999 production ceased to exist when subsidies in respect of marketing year 2000 production were made, and so forth, and can have no “effect” within the meaning of Article 6.3. As a result, the period for which Brazil must demonstrate present serious prejudice is marketing year 2002.

95. None of the provisions cited by Brazil, moreover, say that the effect of a subsidy 1, 2, or 3 years ago is presently being felt. Thus, at a minimum, the effect of the subsidy must be demonstrated in each year and for each year that Brazil has challenged.

## **VII. Brazil Has Failed to Demonstrate that Challenged U.S. Measures Have Caused Serious Prejudice to Brazil’s Interests Within the Meaning of Article 5(c) and 6.3(d)**

### **A. Introduction**

96. Brazil alleges that in marketing year 2001, challenged U.S. subsidies have caused serious prejudice to Brazil’s interests through an increase in the world market share, within the meaning of Subsidies Agreement Articles 5 and 6.3(d). The latter provision reads:

Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:

...;

(d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted (footnote omitted).

Again, the United States disagrees with the interpretation set out by Brazil in crucial respects. Given these mistakes, Brazil has not made a *prima facie* case with respect to its claim under Article 6.3(d).

## B. “World Market Share”

97. Brazil asserts that the term “world market share” means “the share of the world market for exports.”<sup>51</sup> However, Article 6.3(d) does not use the phrase “world market for exports”; it uses the phrase “world market share . . . in a particular subsidized primary product or commodity.” That is, the relevant “world market” is that for upland cotton. This broad term would appear to encompass all consumption of upland cotton, including consumption by a country of its own cotton production.

98. Context supports reading “world market share” as distinct from “world export share.” In fact, GATT 1994 Article XVI:3 uses the phrase “world export trade,” and Brazil interprets Article 6.3(d) and GATT 1994 Article XVI:3 both as applying to “world export trade.” However, had Members intended that “world export trade” be the relevant concept to apply in Article 6.3(d), one would have expected use of that phrase. The ordinary meaning of “world market share” is different than that of “world export trade,” suggesting that different words were chosen to impose a different standard.

99. Because Brazil has misinterpreted “world market share,” and all of Brazil’s evidence goes to a comparison of the “world export share” of the United States, Brazil has failed to make a *prima facie* case of inconsistency with Article 6.3(d). In fact, U.S. world market share has remained fairly constant over the past decade and is expected to be below its 15-year average at approximately 18.6 percent of world consumption in marketing year 2003.<sup>52</sup>

## C. Appropriate Time Period for Showing Present Serious Prejudice

100. Brazil has limited its claim under Article 6.3(d) to “the increased U.S. world market share for MY 2001.”<sup>53</sup> Thus, there can be no finding that subsidies under the 2002 Act or marketing year 2002 subsidies presently cause serious prejudice. As the United States has previously noted, to demonstrate the “effect of the subsidy” it would normally be appropriate to look to the subsidy provided in the most recent year – particularly in the case of recurring subsidies, in which the past year’s subsidy expires with the granting of a subsidy in respect of the current year’s

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<sup>51</sup> Brazil’s Further Submission, para. 265 (“The notion of a ‘world market’ is the sum of the various markets where export sales of a particular commodity take place.”).

<sup>52</sup> See U.S. Department of Agriculture, Cotton: World Markets and Trade at 1 (“While the ration of domestic to foreign demand for U.S. cotton has changed dramatically in recent years, the share of world cotton demand met by U.S. cotton has not. U.S. cotton’s share of total world consumption (U.S. exports plus domestic U.S. consumption divided by total world consumption) has remained relatively flat over the last 15 years. U.S. cotton is expected to account for 18.6 percent of the total world consumption in 2003/04. That level is down slightly from 2002/03 and below the averages for the 1990’s and the previous three years.”) (August 2003). Using production figures as a proxy, U.S. market share has hovered around 20 percent over the last decade and is expected to be below that figure in marketing year 2003. See Exhibit US-40, Figure 1.

<sup>53</sup> Brazil’s Further Submission, para. 260.

production. Brazil has not explained why it challenges marketing year 2002 subsidies (in addition to 1999-2001) under Article 6.3(c) but only marketing year 2001 under Article 6.3(d).

101. Brazil errs, moreover, in its interpretation of the requirement that the increase in world market share “follow[] a consistent trend over a period when subsidies have been granted.” Brazil has stated that the 1996 Act introduced a new subsidy scheme;<sup>54</sup> at a minimum, Brazil should demonstrate that in fact there is a consistent trend over a period when subsidies have been granted (1996-2001). However, even using Brazil’s flawed (world export trade) data, there has been no consistent trend over the period. In two of five years, the U.S. share of world export trade decreased rather than increased; in a third year, the share was stable. Thus, Brazil has failed to make a *prima facie* case of inconsistency with Article 6.3(d).

#### **D. Causation: “The Effect of the Subsidy”**

102. Article 6.3(d) requires that Brazil establish causation – that is, that “the effect of the subsidy is an increase in the world market share of the subsidizing Member.” Brazil however has simply not demonstrated the causal connection between the U.S. measures and the effects on world market share. Brazil has not even shown there is a necessary correlation between the measures and the effects it claims, let alone that there is a genuine and substantial link between the U.S. measures and the effects claimed. As explained above, Brazil has failed to separate and distinguish other factors that drove prevailing upland cotton prices to historically low levels. By failing to separate and distinguish the effects of key factors that affected world cotton markets during the marketing year 1999 - marketing year 2002 period, Brazil has not made a *prima facie* case that “the effect of the subsidy” was an increase in the U.S. world market share.

### **VIII. Brazil Has Failed to Demonstrate any Inconsistency with GATT 1994 Article XVI:3**

#### **A. Introduction**

103. In this portion of the submission, we address certain legal interpretive issues surrounding GATT 1994 Article XVI:3. This provision reads as follows:

If, however, a [Member] grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that [Member] having more than an equitable share of world export trade in that product, account being taken of the shares of the [Members] in such trade in the product during a previous representative period, and any special factors which may have affected or may be affecting such trade in the product.

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<sup>54</sup> Brazil’s Further Submission, para. 269.

104. Brazil has erred in interpreting the phrase “more than equitable share” and “any special factors.” We address each of these issues in turn.

**B. “More Than Equitable Share”**

105. Brazil argues that in determining what is an "equitable" share, the Panel must look at what the U.S. share of world export trade would have been in the absence of subsidies.<sup>55</sup> However, Brazil is applying an incorrect standard. Brazil cites to no textual basis for its approach, nor could it since the text does not contain one. There is nothing in Article XVI:3 that says that a Member is banned from using any subsidies, let alone that a Member is denied the ability to have any share in world markets if the Member employs subsidies. Any consideration of what is an “equitable” share needs to take into account the fact that Members are generally permitted to provide subsidies. However, any subsidy that has a production effect may increase exports; if so, according to Brazil, the resulting export share would be “inequitable.” This interpretation would turn Article XVI:3 into a prohibition on subsidies other than export subsidies. But Article XVI:3 does not ban subsidies on exports. Rather than imposing a prohibition on subsidies that potentially could increase exports, Article XVI:3 states only that Members “should seek to avoid” export subsidies on primary products, with additional conditions if inequitable shares result.

106. The Ad Note to Article XVI:3 makes it clear that a Member that has not shipped a product during a representative period may nonetheless establish “its right” to a share of the trade in that product. It does not say the Member only has such a “right” if the Member is not using any subsidies.

107. Brazil also purports to interpret the phrase “more than equitable share” with "account being taken of shares of the [Members] during a previous representative period". Brazil then reports export shares of various Members since 1998. However, marketing year 1998 was a year in which significant U.S. cotton-producing regions experienced natural disasters, dramatically increasing abandoned acres and lowering yields and production. For example, for the 1998 marketing year, 20 percent of U.S. cotton acreage was abandoned, the highest rate of abandonment since 1933.<sup>56</sup> In marketing year 1998, U.S. exports equaled only 4.0 million bales, down from 7.1 million bales the previous year, and the lowest level since 1985.<sup>57</sup> Thus, any comparisons made using marketing year 1998 as the base will necessarily be skewed by understating traditional U.S. production.

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<sup>55</sup> Brazil’s Further Submission, paras. 288-89.

<sup>56</sup> See Exhibit Bra-4 (U.S. Department of Agriculture, Upland Cotton Fact Sheet, at 4 (Jan. 2003)).

<sup>57</sup> See Exhibit Bra-4 (U.S. Department of Agriculture, Upland Cotton Fact Sheet, at 5 (Jan. 2003)).

108. Finally, in considering the difficulties inherent in applying the "more than equitable world market share" language, the United States recalls the discussion of the Tokyo Round Subsidies Code panel on Wheat Flour on the "more than equitable world market share" language:

The Panel found however that it was unable to conclude as to whether the increased share has resulted in the EEC "having more than an equitable share" in terms of Article 10, in light of the highly artificial levels and conditions of trade in wheat flour, the complexity of developments in the markets, including the interplay of a number of special factors, the relative importance of which it was impossible to assess, and, *most importantly, the difficulties inherent in the concept of "more than equitable share"*.<sup>58</sup>

That panel report is instructive. There the panel examined a number of other factors at play other than the EC export subsidies that could have been affecting market share, including shipping costs, political factors, and non-commercial sales. Even more instructive are the concluding thoughts of the Panel:

5.8 Finally, from a broader economic and trade policy perspective, the Panel considered the situation as regards export subsidies and other aspects of trade in wheat flour to be highly unsatisfactory and was concerned over what this implied for the effectiveness of the legal provisions in this area. The artificial level and conditions of much of the trade in this product typified the current problems and prospective risks. In this connection it found it anomalous, for instance, that the EEC which without the application of export subsidies would generally not be in a position to export substantial quantities of wheat flour, had over time increased its share of the world market to become by far the largest exporter.

5.9 The Panel considered that certain problems might be reduced by improved transparency and possibly other forms of multilateral co-operation in either the IWC or the GATT. It was of the view, however, that solutions to the problem of export subsidies in this area could only be found in making the pertinent provisions of the Code more operational, stringent and effective in application. Areas which deserve attention in this regard are, *inter alia*:

- (i) a clearer and common understanding of the concept of "more than equitable share", and rendering the concept more operational,
- (ii) consideration of whether international understandings relating to sales on other than commercial terms adequately complement and support intended disciplines on export subsidies.

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<sup>58</sup> *European Economic Community – Subsidies on Export of Wheat Flour*, Report of the Panel, at 5.3 (SCM/42) (unadopted).

109. These are the types of considerations that led to the negotiation of the Subsidies Agreement. Brazil now would have us believe that these negotiations were unnecessary, that the disciplines it seeks were all in the language of Article XVI:3 all along. Brazil's approach is in error and should be rejected.

### **C. “Any Special Factors”**

110. Article XVI:3 also directs a panel to take into account “any special factors” that may be affecting trade or that may have affected trade. One such factor, according to Brazil, is the low level or even absence of domestic support in other supplying countries. Once again, the United States must take issue with Brazil's argument. Brazil's approach would make the very providing of subsidies “inequitable,” but all Members have the right to provide domestic subsidies. Members have only agreed to limit the manner in which they provide these subsidies so as not to create “adverse effects” to the interests of others or take more than an equitable share of world export trade. Again, Brazil's proposed rule would suggest that where no other Member were subsidizing (each because of its own sovereign choice not to use resources in that way), a Member would be prevented from subsidizing in any amount that results in increased exports. However, Article XVI:3 does not contemplate a prohibition on subsidies, even on export subsidies: Members “should seek to avoid” use of export subsidies on primary products. Therefore, “any special factors” should not be interpreted in a way that introduces a meaning that the provision itself avoids.

## **IX. Brazil Has Failed to Demonstrate a Threat of Serious Prejudice**

### **A. Introduction: Threat of Serious Prejudice Under Subsidies Agreement Articles 5(c), 6.3**

111. Brazil purports to assert three claims of “threat of serious prejudice”: a threat of “significant price suppression” under Article 6.3(c), an threat of an increase in world market share under Article 6.3(d), and a threat of a more than equitable share of world export trade under GATT 1994 Article XVI. Brazil argues that there is no explicit standard for threat of serious prejudice in the Subsidies Agreement nor guidance in WTO reports. Brazil offers two possible standards.

112. Brazil argues the first is “the standard established by the GATT Panels in EC - Sugar Exports I (Australia) and EC - Sugar Exports II (Brazil) of a ‘permanent source of uncertainty’ requiring a demonstration that guaranteed subsidies by a large exporter have no effective production or export limitations.”<sup>59</sup> Brazil states that the second standard “includes the same elements necessary to demonstrate present serious prejudice focusing on the likely effects of the subsidies in suppressing world prices and in increasing and maintaining a high level of world

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<sup>59</sup> Brazil's Further Submission, para. 292.

export market share.”<sup>60</sup> Brazil does not choose between these standards; rather, it claims to have presented “evidence under both of the legal standards outlined above. Regardless of the standard used, the mandatory and effectively unlimited U.S. subsidies create a threat of serious prejudice that is real, clear, and imminent.”<sup>61</sup>

113. The United States considers that the first standard articulated by Brazil is incorrect. Brazil’s proposed rule would seemingly transform Articles 5(c) and 6 from actionable subsidy provisions into prohibited subsidy provisions. That is, Brazil’s approach would produce a threat determination wherever “subsidies by a large exporter have no effective production or export limitations.” There is no such *per se* threat rule in the Subsidies Agreement, however; a finding of serious prejudice requires a fact-intensive demonstration that at least one of the specific criteria in Article 6 are met.

114. The United States also considers that this proposed standard has not been met by Brazil.

- First, as explained above, Brazil has not established a *prima facie* case of present serious prejudice, and therefore one cannot presume that there is a threat such prejudice will continue.
- Second, • Second, the Appellate Body report in *United States – FSC* cited by Brazil involved export subsidies under the Agriculture Agreement and a completely separate standard. There, the question was whether the measures could threaten to circumvent a Member’s commitments on export subsidies. The comparison was between the maximum level to which a Member had agreed to limit its export subsidies and the level that could actually enjoy export subsidies. However, under the Subsidies Agreement, the question is the much more complicated issue of what is the clearly foreseen and imminent effect of measures on a Member’s interests, which may depend on future market conditions, world prices, and other factors.
- Third, Brazil has not demonstrated that the challenged measures are mandatory in the sense that they must be given if an application is made. In fact, several of them (marketing loan, step 2, and counter-cyclical payments) are dependent on market prices. Therefore, even though the Department of Agriculture has the obligation to make such payments available, the obligation only attaches when certain market conditions prevail. Thus, to show that the threat of serious prejudice is (in Brazil’s words) “real, clear, and imminent,” Brazil would have to show predicted prices over the future period complained of (marketing years 2003-07) and likelihood of that occurring.

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<sup>60</sup> Brazil’s Further Submission, para. 292.

<sup>61</sup> Brazil’s Further Submission, para. 308.

115. The United States believes the second standard proposed by Brazil is correct. To demonstrate a threat of serious prejudice a complaining party must show a clearly foreseen and imminent likelihood of future serious prejudice. As the United States stated in *Indonesia – Automobiles*:

Although the SCM Agreement does not address in detail the elements of a threat of serious prejudice case, logically, the elements for such a case should be the same as for a serious prejudice case. The principal difference between the two types of cases is that in a serious prejudice case, all the elements already exist, whereas in a threat of serious prejudice case, all of the elements need not have come to pass.<sup>62</sup>

The use of the elements of serious prejudice set out in Article 6.3 ensures that a complaining party come forward with sufficient credible evidence. A similar concern is addressed for purposes of threat of material injury in countervailing duty investigations by Subsidies Agreement Article 15.7, pursuant to which a determination “shall be based on facts and not merely on allegations, conjecture or remote possibility.” Under this article, “[t]he change in circumstances which would create a situation in which the subsidy would cause injury must be clearly foreseen and imminent.” We note the relationship between threat of serious prejudice and threat of material injury, both of which make up part of adverse effects under Article 5. Moreover, Article 6.3(c) on significant price undertaking, suppression, or depression finds its counterpart in Article 15.7(iv). Thus, it would appear appropriate to ensure that remedies under Articles 5, 6, and 7 of the Subsidies Agreement are subject to the same standard to which countervailing measures are held.

## **B. Threat of Serious Prejudice Via Price Suppression**

116. Brazil has not demonstrated a clearly foreseen and imminent likelihood of future serious prejudice. First, as explained above, Brazil has not established a *prima facie* case of present serious prejudice, and therefore one cannot presume that similar support levels under the 2002 Act as under the 1996 Act will create a threat of serious prejudice. Second, Brazil argues that U.S. support payments are mandatory, but, for certain measures (marketing loans, step 2, and counter-cyclical payments), certain price conditions must be met before a recipient is entitled to payment. Thus, in an important sense, these measures are not mandatory – whether the United States will be required to make payments will depend on the likelihood of those price conditions being fulfilled.

117. Third, price developments over the past several months and expected price movements do not support a conclusion of a clearly foreseen and imminent likelihood of future serious prejudice. In addition to relying on the same evidence for its threat claim as for its serious

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<sup>62</sup> *Indonesia – Automobiles*, para. 8.450.



prejudice via price suppression claim under Article 6.3(c), Brazil introduces econometric model results of production and price effects. For example, Brazil claims that “[b]ase[d] on MY 2002 prices, current prices in August 2003 and price levels projected by FAPRI’s baseline, it is likely that marketing loan and CCP payments will be made during MY2003-2007.”<sup>63</sup>

118. However, the facts (not reflected in Brazil’s submission) already indicate that the baseline is wrong. Instead of continued low prices, the A-Index *average* for September 2003 has been 64.06 cents per pound. New York Cotton Exchange futures prices demonstrate that market participants expect cotton prices to climb even further:

<b>New York Cotton Exchange, Closing Futures Prices Monday, September 29, 2003</b>	
October 2003 contract	66.70 cents per pound
December 2003 contract	67.75 cents per pound
March 2004 contract	69.68 cents per pound
May 2004 contract	70.40 cents per pound
July 2004 contract	70.60 cents per pound

To put this in perspective, these futures prices indicate that the market expects cotton prices to strengthen beyond their 20-year average of 67.86 cents per pound (1983-2002) within the current 2003 marketing year. In fact, if cotton prices reach the levels indicated by the futures market, prices would be very close to what Brazil calculates as the 1980-98 A-index average (74 cents per pound) – that is, the average for the period *before* Brazil alleges serious prejudice through significant price suppression or depression.<sup>64</sup> We also note that the A-Index already *exceeds* the level used by FAPRI in their 2003 annual world baseline projections; FAPRI did not have the A-Index reaching even 61 cents per pound until the 2007/08 crop year.<sup>65</sup>

119. Thus, given current upland cotton prices and expected cotton prices reflected in futures contracts, Brazil has not demonstrated any clearly foreseen and imminent likelihood of future serious prejudice. Brazil has not established a *prima facie* case of threat of serious prejudice under Article 6.3(c).

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<sup>63</sup> Brazil’s Further Submission, para. 366.

<sup>64</sup> Brazil’s Further Submission, para. 114, figure 6.

<sup>65</sup> FAPRI, 2003 U.S. and World Agricultural Outlook.

### **C. Threat of Serious Prejudice Via World Market Share**

120. Brazil reiterates and relies on all the same evidence for its threat of an increase in world market share claim as for its serious prejudice claim under Article 6.3(d), adding econometric model results of future production effects. However, Brazil again reads “world market share” in Article 6.3(d) as the equivalent of “world export share.” Thus, Brazil’s threat analysis is wrong for the same reason as its serious prejudice analysis and Brazil has not established a *prima facie* case of threat of serious prejudice under Article 6.3(d).

### **D. GATT 1994 Articles XVI:1 and XVI:3**

121. Brazil asserts that the 2002 Act and 2000 Agricultural Risk Protection Act threaten a high and inequitable share of world exports between MY2003-07. However, Brazil nowhere cites the text of GATT 1994 Article XVI:3 (or of the Subsidies Agreement) that would support the notion that there is a valid cause of action for “threat” of a “more than equitable share of world export trade.”

122. In contrast, GATT 1994 Article XVI:1 covers cases in which “serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization.” Subsidies Agreement Article 5(c), fn. 13, says that “serious prejudice to the interests of another Member is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice.” In the absence of any similar text relating to Article XVI:3, Brazil’s claim of a “threat” of a “more than equitable share” must be rejected.

123. The United States notes, moreover, that Brazil’s claim of a threat of serious prejudice under GATT 1994 Article XVI:1 is based on an alleged “clear and imminent threat” of “an increased (and inequitable) U.S. share of world export trade in upland cotton for MY 2003-2007.”<sup>66</sup> It is not clear how short a period is covered by “imminent,” but certainly any year beyond 2003 would not appear to be “imminent.” Nothing in the text of Article XVI:1, moreover, suggests that a threat of serious prejudice can be demonstrated through “an increased (and inequitable) . . . share of world export trade.” Therefore, Brazil has failed to make a *prima facie* case with respect to both GATT 1994 Articles XVI:1 and XVI:3.

### **X. Brazil Has Failed to Demonstrate that Challenged U.S. Measures Are *Per Se* Inconsistent with U.S. WTO Obligations**

124. Brazil argues that the statutory and regulatory instruments providing marketing loans, counter-cyclical payments, direct payments, step 2 payments, and crop insurance payments are *per se* violations because “in certain circumstances the required payments will necessarily cause

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<sup>66</sup> Brazil’s Further Submission, para. 411.

the serious prejudice prohibited by Articles 5(c), 6.3(c), and 6.3(d) . . . and the situation prohibited by Article XVI:3.<sup>67</sup> In light of the fact that not all of the challenged payments are made all the time, Brazil identifies two situations in which its *per se* claim must be analyzed.

125. First, Brazil argues that the marketing loan, counter-cyclical, direct, and step 2 payments as well as the crop insurance subsidies will threaten to cause serious prejudice at price levels that require the payment of marketing loan and CCP payments (that is, below 52 cents per pound). Drawing on the Appellate Body report in *United States – FSC*, Brazil argues that “without this type of control [*i.e.*, legislation that would limit the amount of subsidy from rising to the level of serious prejudice], the five subsidy measures, as in *U.S. – FSC* constitute *per se* violations because they create an unabated threat of serious prejudice when prices are low.”<sup>68</sup> Brazil’s argument is in error.

126. First, Brazil assumes that it can show a threat of serious prejudice on the basis that it has established serious prejudice. It has not. Second, the situation is different in important ways than that in *FSC*. In *FSC*, the threat of circumvention of export subsidy commitments was real – for example, for unscheduled commitments any export subsidy would be inconsistent with a Member’s commitments – so the risk of circumvention is constant. This is very different from a serious prejudice case, in which a finding of inconsistency depends upon effects in a market and the complaining Member.

127. In *FSC*, the AB said that a lack of any “mechanism in the measure for stemming, or otherwise controlling, the flow of FSC subsidies that may be claimed with respect to any agricultural products” threatened to lead to circumvention of export subsidy commitments.<sup>69</sup> Here, on the other hand, limitations on the flow of subsidies do exist. For example, counter-cyclical and direct payments are limited by the base acreage (fixed and defined for marketing years 2002-07), base yield (also fixed and defined), and payment rate (for example, 6.67 cents per pound of base production for direct payments); therefore, these payments are not unlimited. Further limitations are provided in the form of payment limitations for certain measures and the statutory requirement that the Secretary of Agriculture “make adjustments in the amount” of expenditures for the cotton program and others should such adjustments be necessary for the United States to meet its domestic support reduction commitments.<sup>70</sup>

128. In addition, in its FSC report, the Appellate Body reasoned that the “legal entitlement arises in the recipient when it complies with the statutory requirements and, at that point, the government of the United States must grant the FSC exemptions.”<sup>71</sup> Here, on the other hand, the

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<sup>67</sup> Brazil’s Further Submission, para. 416.

<sup>68</sup> Brazil’s Further Submission, para. 431.

<sup>69</sup> *United States – FSC*, WT/DS108/AB/R, para. 149.

<sup>70</sup> 2002 Act, § 1603(e) (Exhibit US-1).

<sup>71</sup> *United States – FSC*, para. 149.

legal entitlement is not solely contingent on producer compliance with statutory requirements. For marketing loan, step 2, and counter-cyclical payments, market price conditions must be met.

129. We further note that, even if prices are low (the condition in which more subsidies are likely to be paid), serious prejudice does not necessarily result. That would depend on whether a threat of at least one of the conditions in Article 6.3 could be shown. For example, in a year of low prices, alternative crops could present very attractive returns and draw acreage away from upland cotton. And, as noted above, upland cotton prices have in fact been strengthening, with the market expecting prices to rise close to their 20-year average within the current marketing year. Thus, Brazil has not demonstrated that these subsidies *per se* present a real, clear, and imminent threat of serious prejudice through increased world market share or price suppression.

130. Brazil also argues that even at high price levels where only direct payments and crop insurance payments would be made, there is necessarily a threat of serious prejudice because these payments necessarily will keep marginal land in production because producers face no down-side revenue risk. This argument too cannot be credited.

131. First, we note that Brazil has presented no evidence on the extent of any alleged effect of these two subsidies in keeping marginal production on-line at a time of high prices. Both Brazil's econometric model results and the FAPRI baseline to which it frequently refers assume continued low prices. Second, that some marginal lands may be kept in production cannot alone suffice to demonstrate a *per se* threat of serious prejudice. Otherwise, any subsidy with any production effect would be found to pose a threat, transforming actionable subsidies into prohibited subsidies.

132. Thus, Brazil has not demonstrated that these subsidies *per se* present a real, clear, and imminent threat of serious prejudice through increased world market share, price suppression, or an inequitable share of world exports.

133. As a final note, the United States was gratified to see Brazil finally acknowledge that the rate of support for U.S. measures is a meaningful way of expressing the level of support a producer receives. That is, after arguing for budgetary outlays as the only way to capture "support to a specific commodity" in the Peace Clause, Brazil now for purposes of its *per se* argument endorses a rate of support analysis:

When U.S. upland cotton farmers plant their crop in spring, farmers expect a certain price level. But, by no means is it ensured that this price level will be accomplished. However, given the U.S. subsidies, that is irrelevant. The existence of the 72.4 cents per pound support price under the 2002 FSRI Act alone causes production-enhancing and price-suppressing effects. The single fact that these programs exist ensures a guaranteed revenue amount from the production of upland cotton. This revenue floor is a guaranteed entitlement. That guaranteed revenue floor has the effect of removing any uncertainty and risk

about the revenue farmers will receive for the crop. It means that regardless of the actual price development during the marketing year, a farmer knows that he or she will receive at the very least the loan rate for their product, plus price-triggered revenue support granted by the CCP program.<sup>72</sup>

While Brazil errs in suggesting that the 72.4 cents per pound combined target price for the counter-cyclical, direct, and marketing loan payment is a “guaranteed revenue amount from the *production* of upland cotton,” rather than a decoupled payment, nonetheless, Brazil now concedes that the rate of support by which U.S. measures provide support is a meaningful concept.

## **XI. Export Credit Guarantees**

### **A. The Negotiating History of Article 10.2 Reveals that the Negotiators Explicitly Deferred the Application of All Export Subsidy Disciplines on Export Credit Guarantees**

134. In its Rebuttal Submission the United States demonstrated that the negotiating history and textual evolution of Article 10.2 of the Agreement on Agriculture reveals the explicit deferral by the drafters of the application of all export subsidy disciplines on export credit guarantees.<sup>73</sup> In particular, the plain difference between the language of the Draft Final Act<sup>74</sup> and that of Article 10.2 shows that the negotiators specifically opted not to impose the disciplines that Brazil now seeks to impose through litigation.

135. Article 10.2 of the Draft Final Act read as follows:

Participants undertake not to provide export credits, export credit guarantees or insurance programs otherwise than in conformity with internationally agreed disciplines.

Article 10.2 of the Agreement on Agriculture reads as follows:

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

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<sup>72</sup> Brazil’s Further Submission, para. 432.

<sup>73</sup> U.S. Rebuttal Submission, paras. 131-153.

<sup>74</sup> MTN.TNC/W/FA, 20 December 1991 (Exhibit US-29).

The earlier version is an unambiguous prohibition, unless permitted under internationally agreed disciplines. The latter – and current – version imposes no such prohibition. Indeed, it imposes no restriction at all until agreement on disciplines. It only requires Members to work toward the development of yet-to-be-agreed disciplines, and only upon agreement on such disciplines are export credit guarantee programs required to adhere to them.

136. The United States observed that Brazil’s interpretation of Article 10.2 would require export credit guarantees in agriculture to be subject to more disciplines than any other practice addressed in the Agreement on Agriculture. Under Brazil’s view, not only would export credit guarantees constitute export subsidies and be subject to all of the export subsidy disciplines, but Members would *also* be specifically obligated to work toward and then apply additional disciplines.<sup>75</sup>

137. Brazil acknowledges this. In paragraph 49 of its comments on the U.S. Rebuttal Submission, Brazil states: “The United States’ interpretation of the negotiating history requires the Panel to accept that the version of Article 10.2 included in the Draft Final Act would have imposed a *greater burden* on Members than does the version of Article 10.2 ultimately included in the Agreement on Agriculture. In fact, however, Article 10.2 of the Draft Final Act was amended to make it clear that negotiators expected Members actually *to pursue* negotiations on specific disciplines. Whereas the version of Article 10.2 included in the Draft Final Act did not include an undertaking to pursue those negotiations, the final version of Article 10.2 does include such an undertaking. The amendment did not *relieve* the Members of any burden, but instead *increased* the burden”(italics in original).

138. There the issue is joined. The United States does believe that the Draft Final Act would have imposed a greater burden than that of the current Article 10.2. The Panel will of course decide which language imposes the greater burden. Brazil argues that the current Article 10.2 imposes a greater burden in that it “includes an undertaking to pursue those negotiations.” The United States notes, however, that Brazil has previously argued that Article 10.2 “does not require Members to actually negotiate.”<sup>76</sup>

139. Brazil now argues that “at least some Members understood” that the “undertaking to pursue negotiations” increased the burden, because they “launched negotiations in the OECD on specific export credit disciplines.”<sup>77</sup> The United States has always maintained that Article 10.2 imposed an obligation to work toward internationally agreed disciplines, but the fact that such negotiations occurred certainly does not indicate that it supplemented otherwise supposedly

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<sup>75</sup> U.S. Rebuttal Submission, para. 142.

<sup>76</sup> Oral Statement of Brazil, para. 102.

<sup>77</sup> Brazil’s Comments on U.S. Rebuttal Submission, para. 50.

applicable disciplines. To the contrary, such negotiations were to develop the disciplines Brazil argues already existed.<sup>78</sup>

140. In any event, the United States further notes that Brazil’s argument would also require an interpretation that the negotiators viewed export credits, credit guarantees, and insurance programs as more malign than the recognized export subsidies themselves. This implausible conclusion is nowhere manifest in the text of the negotiating history of the Agreement on Agriculture.

141. To the contrary, the text indicates that export credits, credit guarantees, and insurance programs were not considered export subsidies, because they were explicitly excluded from Article 9.1 of the Agreement on Agriculture, despite their inclusion in negotiating documents culminating in the current text.<sup>79</sup> Brazil argues that the same is true of “[e]xport performance-related taxation concessions or incentives other than the remission of indirect taxes,” and yet the Appellate Body has ruled the FSC and ETI measures are subject to the export subsidy disciplines of the Agreement on Agriculture.<sup>80</sup> With respect to those measures, however, no provision like Article 10.2 exists. Export credits, credit guarantees, and insurance programs were not only removed from the illustrative list evident in Article 9.1 but received the explicit commitment to negotiate disciplines set forth in Article 10.2.

**B. Brazil’s Export Credit Guarantee Claims, to the Extent “As Such” Claims, Must Fail, and, to the Extent “As Applied” Claims, Confirm the Inadequacy of Brazil’s Statement of Available Evidence**

142. It is unclear from Brazil’s submissions whether its export credit guarantee claims are made on an “as such” or an “as applied” basis. Its request for relief does not clarify this point. On the one hand, that portion of Brazil’s further submission dealing with its *per se* claim does not include argumentation on U.S. export credit guarantees. However, to the extent that Brazil is making “as such” claims, these claims must fail. Nowhere does Brazil assert – nor could it – that legislation authorizing U.S. export credit guarantee programs require any expenditure at all, let alone any expenditure that might exceed U.S. export subsidy reduction commitments for scheduled commodities.

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<sup>78</sup> Brazil argues that “export credits are only ‘subject to all of the export subsidy disciplines’ of the Agreement on Agriculture if they lead to circumvention of a Member’s export subsidy reduction commitments.” Brazil’s Comments on Rebuttal Submission, para. 51. With respect, this point is meaningless. First, export subsidy reduction commitments (and the prohibition on providing export subsidies on unscheduled commodities) are themselves disciplines. Second, under this view undisputed export subsidies would only be “subject to all of the export subsidy disciplines” if they led to circumvention of export subsidy disciplines. This circular formulation serves only as a simple restatement of Brazil’s view that the U.S. export credit guarantees are within the definition of export subsidies, which under the text they clearly are not.

<sup>79</sup> See generally, U.S. Rebuttal Submission paras. 143-146.

<sup>80</sup> Brazil’s Comments on U.S. Rebuttal Submission, para. 43.

143. In light of Brazil's argumentation on actual expenditures and loss experience in the operation of the programs, it appears that in fact Brazil is making "as applied" claims with respect to U.S. export credit guarantees. For the reasons described below, these claims must fail as a matter of substance. However, inasmuch as Brazil failed to adequately set forth the nature and existence of the challenged measures in its statement of available evidence, the Panel should not even reach Brazil's substantive claims. As described above, the extensive information Brazil has provided in this dispute belies the notion that the threadbare description provided in its statement of available evidence met the requirements of Subsidies Agreement Articles 4.2 and 7.2.

**C. The Application of Government-Wide Accounting Rules under the Federal Credit Reform Act Indicates that the Export Credit Guarantee Programs are Covering Long-Term Operating Costs and Losses**

144. The United States has demonstrated that over time, as indicated by the government-wide accounting rules mandated under the Credit Reform Act, with respect to those years for which nearly complete experiential data is available, program revenues exceed operating costs and losses.<sup>81</sup> In those years for which the accounting books are nearest to closing (1994 and 1995), the operation of the program shows a profit. Similarly, current data for 1992, 1993, 1996, and 1999 also indicate a profit.<sup>82</sup> All of this data is on a cohort-specific basis, a methodology with which Brazil agrees.<sup>83</sup> Brazil further concurs with the United States that the net downward reestimates - meaning results better than previously estimated - for all cohorts for guarantees issued since 1992 currently stands at \$1.9 billion<sup>84</sup>.

145. Brazil misapplies the cohort-specific accounting methodology, however, to erroneously argue that "when [the] total lifetime reestimates for all cohorts of guarantees disbursed since

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<sup>81</sup> Brazil erroneously argues that item (j) compels consideration only of premiums on the revenue side of the ledger for purposes of covering long-term operating costs and losses. In Brazil's Comment on the U.S. answer to Panel question 77 (para. 94), Brazil states that "item (j) limits the revenue to be used to offset operating costs and losses to 'premium rates.' With respect, this cannot be. Item (j) envisions an examination of whether premium rates are inadequate to cover long-term operating costs and losses. It does not say that all other revenue must be excluded from the calculation of whether a loss has occurred. Brazil would argue that if the United States paid a claim on day 1 and recouped in full on day 2 the amount it had paid, it could not include such recovery in a determination of whether the program satisfied item (j). This is a wrong-headed reading of item (j).

<sup>82</sup> See the chart of Subsidy Estimates and Reestimates by Cohort, U.S. Rebuttal Submission, para. 161. Brazil is correct to point out that the total subsidy figure net of reestimates should be \$230,127,023, and not \$381.35 million. See Brazil's Comments on U.S. Rebuttal Submission, fn. 67. This error apparently occurred in the conversion of spreadsheet software to word-processing software. The United States apologizes for the error. The individual figures in the chart did not suffer from the conversion error, however.

<sup>83</sup> See Brazil's Comments on U.S. Rebuttal Submission, paras. 55-56.

<sup>84</sup> U.S. Answers to Panel Question 81(d), para. 163; Rebuttal Submission of Brazil para. 115; Brazil's Comments on Answer of U.S. to Panel Question 81(d), para. 104.



1992 are netted against the total *original* subsidy estimates adopted each budget year during the period 1992-2002, *the resulting loss is nearly \$1.75 billion.*”<sup>85</sup>

146. To arrive at this fanciful figure Brazil begins not with the estimates based on the actual level of guarantees issued, but rather with the original subsidy estimate in the budget year, well before virtually any activity in the programs has occurred in that fiscal year.<sup>86</sup> As the United States has previously explained, the “actual” figure is simply a reflection of the actual level of guarantees issued in the particular fiscal year.

147. The original subsidy estimate, in contrast, begins with what is an historically overly optimistic projection of actual use of the program and then is required to use the government-wide estimation rules, including mandated risk assessment country grades without regard to the actual experience specific to the CCC export credit guarantee programs.<sup>87</sup> These two factors are the answer to Brazil’s question, “why does [CCC] continue to offer original estimates that are so high?”<sup>88</sup>

148. The following tables illustrate the foregoing. The first compares (a) the initial projected level of program activity for a particular program year (cohort) in a particular budget year with (b) actual sales registrations. In each case the projected use is overly optimistic, often significantly so. The second compares in a similar format the program subsidy estimates in the corresponding annual budgets.

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<sup>85</sup> Comments of Brazil to Answers of the United States to Question 81(d), para. 104 (italics in original).

<sup>86</sup> Compare the chart in para. 162 of Brazil’s Oral Statement to the Panel with the chart in para. 115 of Brazil’s Rebuttal Submission. The total of the column in the latter entitled “Original guarantee loan subsidy estimate” is \$3.684 billion, whereas the total of the “Guaranteed loan subsidy” column in the former is \$2.146 billion.

<sup>87</sup> See, e.g., Exhibit BRA-158, page 10.

<sup>88</sup> Brazil’s Comments on U.S. Rebuttal Submission, para. 62.

CCC Export Credit Guarantee Program Levels  
Annual President's Budgets<sup>89</sup> and Actual Sales Registrations<sup>90</sup>  
FYs 1992 - 2004 (\$ Millions)

Annual President's Budgets (Years 1 and 2); Actual Sales Registrations (Year 3)													
Program Year	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
1992	5,700	5,700	5,684										
1993		5,700	5,700	3,882									
1994			5,700	5,700	3,220								
1995				5,700	5,700	2,921							
1996					5,700	5,700	3,230						
1997						5,500	5,500	2,876					
1998							5,700	5,000	4,037				
1999								4,615	4,721	3,045			
2000									4,506	3,787	3,082		
2001										3,792	3,792	3,227	
2002											3,904	3,926	3,388
2003												4,225	4,225
2004													4,155

<sup>89</sup> Figures are located on line 2150 (or 215001) of table entitled "Summary of Loan Levels, Subsidy Budget Authority and Outlays by Program."

FY 1992 Budget - Exhibit Bra-183, p. 360

FY 1993 Budget - Exhibit Bra-184, p. 343

FY 1994 Budget - Exhibit Bra-125, p. 383

FY 1995 Budget - Exhibit Bra-126, p. 156

FY 1996 Budget - Exhibit Bra- 95, p. 162

FY 1997 Budget - Exhibit Bra- 94, p. 175

FY 1998 Budget - Exhibit Bra- 93, p. 174

FY 1999 Budget - Exhibit Bra- 92, p. 105

FY 2000 Budget - Exhibit Bra- 91, p. 111

FY 2001 Budget - Exhibit Bra- 90, p. 111

FY 2002 Budget - Exhibit Bra- 89, p. 117

FY 2003 Budget - Exhibit Bra- 88, p. 119

FY 2004 Budget - Exhibit Bra-127, p. 107

<sup>90</sup> Sales registration data for fiscal year 1999 and subsequent is available from the website of the Foreign Agricultural Service, U.S. Department of Agriculture: <http://www.fas.usda.gov/excredits/Monthly/ecg.html>. Data in the table is from the relevant September end-of-year report. Data for prior years is obtained from internal USDA records. Exhibit US-41.

**CCC Export Credit Guarantee Program Subsidy Estimates**  
**Annual President's Budgets**  
**FYs 1992 - 2004<sup>91</sup> (\$ Millions)**

Annual President's Budgets													
Program Year	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
1992	156	156	267										
1993		158	388	172									
1994			403	403	123								
1995				394	394	113							
1996					372	374	328						
1997						390	390	289					
1998							528	408	301				
1999								253	437	158			
2000									439	320	195		
2001										323	305	103	
2002											266	265	97
2003												294	294
2004													297

149. Actual guarantee issuance can first be reflected only in the budget two fiscal years after the original subsidy estimate. Once the actual use of the program is determined all subsequent reestimates are based on that figure, not on the original subsidy estimate. Other than with respect to interest (because of independent market forces), a downward reestimate never occurs based on

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<sup>91</sup> FY 1992 Budget - Exhibit Bra-183, p. 360  
 FY 1993 Budget - Exhibit Bra-184, p. 342  
 FY 1994 Budget - Exhibit Bra-125, p. 383  
 FY 1995 Budget - Exhibit Bra-126, p. 156  
 FY 1996 Budget - Exhibit Bra- 95, p. 161  
 FY 1997 Budget - Exhibit Bra- 94, p. 175  
 FY 1998 Budget - Exhibit Bra- 93, p. 174  
 FY 1999 Budget - Exhibit Bra- 92, p. 105  
 FY 2000 Budget - Exhibit Bra- 91, p. 111  
 FY 2001 Budget - Exhibit Bra- 90, p. 110  
 FY 2002 Budget - Exhibit Bra- 89, p. 116  
 FY 2003 Budget - Exhibit Bra- 88, p. 118  
 FY 2004 Budget - Exhibit Bra-127, p. 107

the original subsidy estimate.<sup>92</sup> It only occurs subsequent to establishment of the actual program use.<sup>93</sup> Consequently, it is wholly inappropriate to calculate net reestimates based on the original subsidy estimate for a particular cohort, as Brazil has done.<sup>94</sup>

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<sup>92</sup> For example, for the cohort corresponding to fiscal year **1995**, the original subsidy estimate is **\$394 million**. Two budget cycles later, the actual program use is known, and the subsidy is estimated at **\$113 million**. All subsequent reestimates are calculated from **\$113 million**, and the difference between **\$394 million and \$113 million** is never subject to reestimation. That is, subsequent re-estimates only apply to the \$113 million figure. As the Panel can observe, the significant decline in estimate corresponds with the significant difference between projected program utilization and actual sales registrations..

<sup>93</sup> As OMB Circular No. A-11 provides: “The purpose of technical reestimates is to adjust the subsidy estimate for differences between the original projection of cash flows (*as estimated at obligation*) and the amount and timing of cash flows that are expected based on actual experience, new forecasts about future economic conditions, and other events and improvements in the methods used to estimate future cash flows.” Exhibit BRA-116, Section 185.6(a), page 185-16. (Emphasis added). The reestimate only occurs based on the estimate at obligation. It does not occur based on the original subsidy estimate. Only upon close of a particular fiscal year does one know the level of such obligation: OMB Circular A-11, sections 20.5(a); 20.5(f), pages 20-19, 20-22 (Exhibit US-42).

<sup>94</sup> Brazil similarly mischaracterizes the \$411 million listed as Export Credit Guarantee Program Liabilities as signifying that “CCC has ‘lost money’ during the period 1992-2002.” 11 August Comment of Brazil to Question 81(g), para. 178; Rebuttal Submission of Brazil, para. 109. As Brazil acknowledges, this figure, like those in the budget, are *estimates* and are the “results of the reestimate process.” See Exhibit BRA-158, page 19. It therefore suffers from the same inadequacies for purposes of the analysis here as the budget figures themselves.

In addition, despite Brazil’s denial (Brazil’s Comments on U.S. Rebuttal Submission, fn. 75), the \$770 million in the “subsidy allowance” column of the CCC Financial Statement is not an “uncollectible amount”. It is merely a loan loss *allowance* based on annual re-estimates reflected in the budget. It is obviously not an amount deemed uncollectible, because from 2001 to 2002, as reflected in the very next line of the financial statement, the number itself *declined* from \$1.043 billion to \$770 million.

The United States has also observed that the vast majority of the defaults incurred with respect to Iraq occurred over 10 years ago. ( U.S. Rebuttal Submission, para. 172) Brazil has cited a report of the General Accounting Office issued in 1990 for the proposition that losses in Iraq occurred over the period 1990-1997 (Brazil’s Comments on U.S. Rebuttal Submission, para. 65). Although this is true, defaults beyond 1993 are wholly attributable to the very small amount of guarantees issued under the Intermediate Term CCC Export Credit Guarantee Program (GSM-103) before the invasion of Kuwait. The total amount of Iraqi defaults incurred by CCC after fiscal year 1993 was approximately \$517,000.

150. For these reasons, the approach reflected in the table that the United States has presented on a cohort-basis<sup>95</sup>, indicating increasing profitability within the program is accurate and the Brazil calculation is not.<sup>96</sup>

151. Brazil also erroneously argues that budgeting and appropriation for the export credit guarantee programs “suggests that the CCC export credit guarantee programs are not self-sustaining [and] in turn that the CCC export [credit] guarantee programs meet the elements of item(j) and, thus, constitute export subsidies.”<sup>97</sup> The simple response is that budgeting and appropriation are based on the estimates set forth in the budget. As the data presented by the United States has indicated, over time the actual performance of the programs indicates they are in fact self-sustaining.

152. Brazil similarly misconstrues the budget authority to argue that it “enhances the threat of circumvention for scheduled commodities . . . [I]t appears that there are no effective limits on the amount of guarantees that can (and indeed must) be provided by the CCC.”<sup>98</sup> This is simply untrue. Brazil elsewhere implicitly recognizes that the export credit guarantee programs are not “mandatory”. In paragraph 311 of Brazil’s Further Submission to the Panel, it alleges only “five actionable subsidies with ‘mandatory’ payments to eligible recipients,” among which the export credit guarantee programs are not included.<sup>99</sup>

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<sup>95</sup> In paragraphs 122-23 of its Answers to Panel Question 81(c), the United States noted that “[a] cohort consists of all transactions associated with each type of guarantee issued during a particular year.” In its comment on this answer para. 103, Brazil, citing the OMB Circular A-11 (Exhibit Bra-116), makes the irrelevant point “that a ‘cohort’ is not necessarily composed of *all* guarantees issued in a particular year.” Brazil notes that cohorts may also be divided according to risk categories.” However, the OMB Circular does not require cohorts to be so divided, and as illustrated in the U.S. budgets and Exhibit US-32 cohorts for the CCC export credit guarantee programs are not so divided.

<sup>96</sup> As Brazil has correctly noted in footnote 66 of Brazil’s Comments on U.S. Rebuttal Submission, the United States did not offer documentation to corroborate the accuracy of the reestimate figures provided in the U.S. chart for the period 1993-2000. As the United States noted in footnote 193 of its Rebuttal Submission, it was looking for the internal documentation to support those particular figures. In the absence of such documentation and unable to explain the minor disparity in the figures, the United States notes that Table 8 of the Federal Credit Supplement included with the U.S. budget (Exhibit Bra-182) does not change the substantive point. Substituting the reestimates reflected there for the net lifetime reestimates for the cohorts for each of fiscal year 1992-1996 in the table accompanying para. 161 of the U.S. Rebuttal Submission, each of 1992, 1993, 1994, 1995, and 1996 remain profitable. Indeed, the numbers offered by Brazil from the Federal Credit Supplement show profitability in *every* year during that period and greater overall profitability than the United States had indicated in its table. Addition of administrative costs (Oral Statement of Brazil, para. 132) also does not affect the substantive result.

<sup>97</sup> Brazil’s comment on U.S. Answer to Panel Question 87, para. 114.

<sup>98</sup> Brazil’s Rebuttal Submission, para. 121.

<sup>99</sup> Contrast with paragraph 304 of the First Submission of Brazil in which “Brazil claims that GSM-102, GSM-103 and SCGP violate [the Agreement on Agriculture] as such for scheduled and unscheduled commodities.”

153. The United States has repeatedly noted that CCC 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.<sup>100</sup>

154. In addition, the authorizing statute prohibits CCC from making credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary of Agriculture determines cannot adequately service the debt associated with such sale.<sup>101</sup>

155. Third, availability of export credit guarantees is governed by allocations in effect at any one time for specific commodities and specific destinations.<sup>102</sup> There would be no need for any such allocations for any commodity or destination if the guarantee program were as unbounded as Brazil suggests.

156. Fourth, the ability of CCC to issue guarantees is constrained by the apportionment process of the President's Office of Management and Budget. OMB Circular A-11 and the Antideficiency Act (31 USC 1341) provides that all credit program accounts, financing accounts, and liquidating accounts must be apportioned unless exempted by OMB or a specific statute.<sup>103</sup> No such exemption exists with respect to the CCC export credit guarantee programs. An apportionment "is a plan, approved by OMB, to spend resources provided by law."<sup>104</sup> The budgetary figures generally constitute the maximum available for apportionment.

#### **D. Forfeiting is Analogous to the CCC Export Credit Guarantee Programs**

157. In its Comments on the U.S. Rebuttal Submission, Brazil argues that forfeiting transactions and CCC export credit guarantee transactions are dissimilar.<sup>105</sup> Brazil's argument, however, serves only to illustrate the comparability of the financing available in these transactions. As Brazil correctly and simply points out, in both cases "the exporter wants to get paid immediately on a cash basis, and the importer wants credit that it can repay on a deferred basis."<sup>106</sup>

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<sup>100</sup> U.S. First Written Submission, fn. 134; 7 CFR Sections 1493.10(d), 1493.40(b) (Exhibit US-6); U.S. Rebuttal Submission, para. 182.

<sup>101</sup> 7 U.S.C. Section 5622(f) (Exhibit BRA-141).

<sup>102</sup> See, e.g., Exhibit US-12.

<sup>103</sup> OMB Circular A-11, Section 185.14, page. 185-41 (Exhibit BRA-116).

<sup>104</sup> OMB Circular No. A-11 (July 2003), Part 4, Instructions on Budget Execution, Section 120.1, page 120-2 (Exhibit US- 43).

<sup>105</sup> Brazil Comments on U.S. Rebuttal Submission, paras. 68-80.

<sup>106</sup> Brazil Comments on U.S. Rebuttal Submission, para. 71.

158. In “a typical [forfait] transaction, an importer will issue a promissory note to an exporter for the agreed price. The exporter will generally demand that the note be backed by a guarantee (or an aval) from the importer’s bank.”<sup>107</sup> In an export credit guarantee transaction, the exporter and importer will agree on a price, and the exporter will demand (and the program requires) a documentary letter of credit issued in favor of the exporter, payable upon presentation of the requisite documents under such letter of credit.<sup>108</sup> In addition, the exporter will generally demand “as the United States points out in paragraph 187 of its 22 August Rebuttal Submission, a guarantee from the importer’s government export credit agency.”<sup>109</sup> In a CCC export credit guarantee transaction, the United States government provides the analogous guarantee of repayment, albeit repayment by the bank issuing the letter of credit rather than the importer. In the Supplier Credit Guarantee Program, the transaction is even more similar. The importer issues a promissory note in favor of the exporter, and the United States government guarantees a certain amount of repayment by the importer.

159. “A forfaiter (which could be the exporter’s own bank) will step in and purchase the promissory note at a discount to face value to the exporter.”<sup>110</sup> Similarly, under the export credit guarantee transactions the exporter will present the requisite documents to the exporter’s bank, which will serve in the role of negotiating bank and pay the exporter, which may be at a discount, taking assignment of the CCC export credit guarantee as well as the right to receive payment from the the bank issuing the documentary letter of credit.<sup>111</sup> From the importer’s perspective, the export credit guarantee transactions are *less* favorable than forfaiting, because although the importer’s bank can repay its obligation over time the CCC has no control over the terms of the arrangement between the importer and its bank, which may not extend the deferred payment terms to the importer. In forfaiting, the importer “can repay on a deferred basis.” In both cases, the transaction “enables the exporter to convert a credit sale into a cash sale.”<sup>112</sup>

160. The direct analogy to the forfaiter is the assignee U.S. financial institution in the export credit guarantee transaction. The U.S. financial institution pays cash to the exporter and takes assignment of the right to receive proceeds from the debtor foreign banking institution. The U.S. financial institution requires the existence of the export credit guarantee transaction to accept the deferred payment arrangement. Similarly, as Brazil notes, “a forfaiter will generally demand that the importer’s obligation is backed by a guarantee from a . . . government export credit agency.”<sup>113</sup>

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<sup>107</sup> Brazil Comments on U.S. Rebuttal Submission, para. 70.

<sup>108</sup> 7 CFR Sections 1493.10(b), 1493.10(k), 1493.10(x), 1493.60(a) (Exhibit Bra-38).

<sup>109</sup> Brazil Comments on U.S. Rebuttal Submission, para 70.

<sup>110</sup> Brazil Comments on U.S. Rebuttal Submission, para. 71.

<sup>111</sup> 7 CFR Section 1493.140(a); 1493.60(a) (Exhibit Bra-38).

<sup>112</sup> Brazil Comments on U.S. Rebuttal Submission, para. 71.

<sup>113</sup> Comments on U.S. Rebuttal Submission, para. 72.

161. Brazil erroneously attempts to distinguish the two transactions by asserting that “rather than *substituting* for a guarantee, therefore, guarantees and forfaiting are *complementary* instruments.”<sup>114</sup> (Emphasis in original) In both instances, however, a financial intermediary may perform a discounting role, but it does so only if a guarantee from an export credit agency applies.<sup>115</sup>

162. Contrary to the argument of Brazil, the importer does not necessarily realize any benefit from a CCC guarantee. As the United States noted in its First Written Submission, CCC 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>116</sup> Consequently, the importer may have to pay its bank in full upon disbursement under the documentary letter of credit, but the foreign bank may be able to repay over time the amount the U.S. financial institution has disbursed as negotiating bank under the letter of credit. Similarly, the existence of an export credit guarantee transaction has no necessary effect on the pricing of financing or letter of credit fees that the importer’s bank may charge. In this respect the export credit guarantee transaction is less favorable to the importer than the forfaiting transaction.

163. Brazil also erroneously concludes that the absence of a secondary market for CCC guarantees indicates something about the quality of the guarantees, yield at maturity, and the perceptions about the marketplace with respect to such guarantees.<sup>117</sup> The simple fact is that no secondary market exists, because, other than in a few highly unusual circumstances, CCC does not permit reassignment of its guarantees.<sup>118</sup>

164. Brazil recognizes that as the complaining party it carries the burden of demonstrating, in terms of the definition of a subsidy pursuant to Article 1 of the Subsidies Agreement, that a benefit is conferred with respect to the GSM-102 program. However, as detailed in this and

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<sup>114</sup> *Id.*

<sup>115</sup> For this reason, the comparison that Brazil draws in paragraphs 76 and 77 between alleged indicative forfaiting rates and CCC export credit guarantee fees is inapt. CCC does not provide a discounting role in the transaction. It provides the guarantee. The United States further notes that it is not unique in providing agricultural export credit guarantees for periods longer than one year. The OECD has noted that Spain, for example, has provided export credits for a period of 2 - 3 years. “An Analysis of Officially supported Export Credits in Agriculture”, Annex, Method and Data used to Evaluate Export Credits; COM/AGR/TD/WP(2000)91/Final, para.51 (<http://www.oecd.org/dataoecd/48/45/1911035.pdf>).

<sup>116</sup> First Written Submission of the United States, para. 153.

<sup>117</sup> Brazil Comments on U.S. Rebuttal Submission, para. 74.

<sup>118</sup> 7 CFR Section 1493.140(a)(1)(ii): “The exporter may assign the proceeds which are, or may become payable, by CCC under a payment guarantee or the right to such proceeds only to a financial institution in the U.S. The assignment must cover all amounts payable under the payment guarantee not already paid, may not be made to more than one party, and may not, unless approved in advance by CCC, be subject to further assignment.” (Exhibit Bra-138.)



previous U.S. submissions, Brazil has not demonstrated that a “benefit” is conferred by this program.<sup>119</sup> Therefore, Brazil has not established that the GSM-102 export credit guarantee program provides subsidies within the meaning of Article 1 and Article 5 of the Subsidies Agreement.

## **XII. The Step 2 Program Does Not Violate Article 3.1(b) of the Subsidies Agreement or Article III:4 of GATT 1994**

165. Article 3 of the Subsidies Agreement (footnotes deleted) reads in its entirety:

3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

(a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;

(b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1.

The introductory clause “Except as provided in the Agreement on Agriculture” applies to *both* Articles 3.1(a) and 3.1(b). Brazil has rotundly stated: “There are no circumstances in which a ‘local content subsidy’ would comply with Article 3.1(b).”<sup>120</sup> In effect, Brazil’s argument would delete the application of the introductory clause to Article 3.1(b) entirely. But the phrase “except as provided in the Agreement on Agriculture” does not just apply to export subsidies under Article 3.1(a). It also applies to local content subsidies, like the Step 2 program, under Article 3.1(b).

166. The negotiating history corroborates the direct applicability plainly evident from the text itself. In the Draft Final Act circulated on December 20, 1991,<sup>121</sup> the draft text on agriculture not only envisioned export subsidy reduction commitments but also the domestic support reduction commitments and general disciplines on domestic support subsequently reflected in the current Agreement on Agriculture. Paragraph 7 of Annex 5 of the Draft Final Act Agreement on Agriculture is substantively identical to the current Paragraph 7 of Annex 3 of the Agreement on

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<sup>119</sup> See U.S. Rebuttal Submission, paras. 184-91.

<sup>120</sup> Brazil Answer to Question 114 from the Panel, para. 214.

<sup>121</sup> MTN.TNC/W/FA (20 December 1991) (Exhibit US-29).

Agriculture. Consequently, it was necessary to accommodate in the final Subsidies Agreement the ultimate substantive agreement in the agricultural sector with respect to both export subsidies and domestic content subsidies paid to processors of agricultural products.

167. As the European Communities and the United States have pointed out, the Agreement on Agriculture does permit domestic content subsidies in favor of agricultural producers, albeit paid to processors, provided such subsidies are provided consistently with the Member's domestic support reduction commitments.<sup>122</sup> Indeed, Paragraph 7 of Annex 3 requires that “measures directed at agricultural processors shall be included [in the calculation of the Aggregate Measure of Support] to the extent that such measures benefit the producers of the basic agricultural products.”

168. Brazil argues that “payments to processors of agricultural products such as upland cotton can be provided consistent with both Article 3.1(b) of the Subsidies Agreement and GATT Article III:4.”<sup>123</sup> Brazil offers this conclusory statement without further explanation of how it could be so. In the instant case of the Step 2 program before the Panel, the payment is made for use of the cotton in the manufacture of cotton products. Brazil alleges an inconsistency with Article 3.1(b) of the Subsidies Agreement only with respect to what it describes as “Step 2 domestic payments.”<sup>124</sup> Brazil would require the program to permit payments for the use of all cotton, whether domestic or imported, but only those payments made for the use of domestic cotton would have to be included in the calculation of the AMS. Brazil ignores the inconvenient fact, however, that such a program would no longer be in favor of domestic producers.

169. The Step 2 program is viewed as providing a benefit to producers<sup>125</sup> because it serves to maintain the price competitiveness of U.S. cotton vis-a-vis foreign cotton through a payment to capture some differential between prevailing foreign and domestic cotton prices. The hypothetical program Brazil would require would cause the benefit to U.S. producers to evaporate. Use of any imported cotton would receive the same payment as for use of U.S. cotton. The subsidy would be transformed from a subsidy “in favor of agricultural producers” to a simple input subsidy in favor of industrial manufacturers. It would be a textile subsidy and outside the

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<sup>122</sup> See First Written Submission of the United States, paras. 146-150; Answers of the European Communities to Panel Question 40, paras. 72-78; Oral Statement of the European Communities paras. 31-37.

<sup>123</sup> Oral Statement of Brazil, para. 85.

<sup>124</sup> Brazil Answer to Panel Question 94, para. 204.

<sup>125</sup> In its Comments on the U.S. Answer to Question 93 (para. 126), Brazil argues that “no Step 2 payment is made for upland cotton exported or used by ineligible persons, or for upland cotton that is neither used domestically or exported, but that is for instance stored, stolen or incidentally destroyed by for example fire.” The United States concedes that the program is not designed to make payments to arsonists, thieves, or vandals.

coverage of the Agreement on Agriculture altogether,<sup>126</sup> and would render Paragraph 3 of Annex 7 of the Agreement on Agriculture an “inutility.”

170. Brazil also incorrectly asserts that the argument of the United States “would lead to a conflict between WTO Agreements.”<sup>127</sup> To the contrary, the United States offers a position entirely harmonious with the Subsidies Agreement and the GATT 1994.

171. In the case of Article 3.1(b), an explicit carve-out of its applicability exists in the introductory phrase “except as provided in the Agreement on Agriculture.” That phrase is not limited in its applicability to Article 3.1(a) but applies to both Articles 3.1(a) and 3.1(b). As Brazil points out, “all of the WTO agreements were negotiated at the same time, by the same Members and in the same forum, and all must be given meaning.”<sup>128</sup> The Members must have perceived a need to render Article 3.1(b) inapplicable to something provided in the Agreement on Agriculture. Why else so provide? The only logical conclusion is that the drafters understood that domestic content subsidies in favor of agricultural producers delivered through processors were permitted and disciplined only by the domestic support reduction commitments of the Agreement on Agriculture.

172. Under the United States view, the Agreement on Agriculture and Article III:4 of GATT 1994 are also compatible. Article 21.1 of the Agreement on Agriculture states that “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.” The European Communities observe that to find the Step 2 domestic content subsidy inconsistent with Article III:4 (and the Subsidies Agreement Article 3.1(b)) would stand the relationship between the agreements, as set forth under Article 21.1, on its head.<sup>129</sup>

173. Brazil asserts, in contrast, for Article 21.1 to apply “there must be a provision of the Agreement on Agriculture that is relevant in order for this priority provision to apply.”<sup>130</sup> Otherwise, Brazil argues the obligations of the GATT 1994 and the Agreement on Agriculture apply cumulatively and simultaneously. Brazil argues no such relevant provision exists and therefore domestic content subsidies are strictly prohibited.

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<sup>126</sup> Annex I of the Agreement on Agriculture only extends to raw cotton, waste and cotton carded or combed (HS 52.01-52.03). In contrast the Article I:7 of the Agreement on Textiles and Clothing and the Annex to that Agreement set forth the list of products covered by that Agreement. That Annex includes a wide array of manufactured cotton goods under the remainder of Chapter 52 of the HTS.

<sup>127</sup> Oral Statement of Brazil, para. 81.

<sup>128</sup> *Id.*, para. 81.

<sup>129</sup> Answers of the European Communities, para. 77.

<sup>130</sup> Oral Statement of Brazil, para. 82 and fn. 96.

174. Numerous provision of the Agreement on Agriculture are “relevant,” however. The Aggregate Measure of Support (AMS), a core concept of the Agreement is defined, in part, in terms of the calculations “in accordance with the provisions of Annex 3 of this Agreement.”<sup>131</sup> Total Aggregate Measurement of Support is derived, in turn, from the calculations of the AMS. Article 3.2 obligates Members not to provide domestic support in favor of domestic producers in excess of the applicable commitment levels. Under Article 6.3 a Member is in compliance with its 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.” The Agreement on Agriculture nowhere otherwise indicates a restriction on the manner in which such domestic support is delivered. And, of course, Paragraph 7 of Annex 3 requires that “measures directed at agricultural processors shall be included [in the calculation of the Aggregate Measure of Support] to the extent that such measures benefit the producers off the basic agricultural products,” which would not constitute domestic support in favor of agricultural producers if required to apply equally to domestic and foreign product.

175. Finally, Brazil argues that “since Article 13(b)(ii) [of the Agreement on Agriculture] provides a conditional exemption only for claims under Articles 5 and 6 of the SCM Agreement, but not for claims under Article 3 of the SCM Agreement” indicates that the Agreement on Agriculture envisioned that local content subsidies would be prohibited.<sup>132</sup>

176. Brazil’s conclusion does not necessarily follow from the structure of the text. Indeed, a contrary conclusion is more appropriate. Article 13(b) does not refer to Subsidies Agreement Article 3 because the substantive obligation of Article 3.1(b) does not apply in the case of domestic content subsidies in favor of agricultural producers. It would be no more necessary to refer to such a potential claim than a potential claim under, say, the Agreement on Safeguards or any other equally irrelevant provision of the WTO Agreements. Article 13(b) applies to “domestic support measures that conform fully to the provisions of Article 6 of this Agreement.” The character of the domestic subsidy is not relevant to the disciplines. The Agriculture Agreement never defines “domestic support”. Domestic support in any form is permitted so long as the Member adheres to its reduction commitments. Under the Agreement on Agriculture domestic content subsidies are permitted. The only qualification on any form of domestic support is the domestic support reduction commitments. In contrast, although it is not the case in this dispute, it is certainly possible that a domestic support measure in conformity with Article 6 of the Agreement on Agriculture could cause adverse effects or serious prejudice within the meaning of Articles 5 and 6 of the Subsidies Agreement or Article XVI:1 of GATT 1994.

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<sup>131</sup> Article I(a)(ii).

<sup>132</sup> Closing Statement of Brazil, para. 22.

### **XIII. Conclusion**

177. For the reasons set out above and in previous U.S. submissions and presentations to the Panel, the United States asks the Panel to find that:

- (1) Cottonseed payments made for the 1999 and 2000 crops and “other payments” for upland cotton are outside the Panel’s terms of reference;
- (2) Crop insurance payments are not specific within the meaning of Article 2 of the Subsidies Agreement and are not subject to the provisions of Part III of the Subsidies Agreement;
- (3) U.S. direct payments, expired production flexibility contract payments, counter-cyclical payments, and expired market loss assistance payments are no more than minimally trade- or production-distorting and Brazil’s claims under Subsidies Agreement Articles 5(c), 6.3 and GATT 1994 Article XVI fail; and
- (4) with respect to measures properly within the Panel’s terms of reference, those measures are fully consistent with U.S. WTO obligations.

### **List of Exhibits**

- US-40 U.S. Department of Agriculture, *Understanding Factors Driving World Cotton Markets is Crucial for Explaining What Affected World Cotton Prices and U.S. Production and Exports between 1995-2002* (2003)
- US-41 Foreign Agricultural Service, U.S. Department of Agriculture, Export Credits Sales Registration Data
- US-42 OMB Circular No. A-11, sections 20.5(a); 20.5(f), pages 20-19, 20-22 (July 2003)
- US-43 OMB Circular No. A-11, Part 4, Instructions on Budget Execution, Section 120.1, page 120-2 (July 2003)