United States – Subsidies on Upland Cotton

(WT/DS267)

**Answers of the United States of America
to the Questions from the Panel to the Parties
following the Second Session
of the First Substantive Panel Meeting**

October 27, 2003

A. REQUEST FOR PRELIMINARY RULINGS

122. Does Brazil allege that cottonseed payments, interest subsidies and storage payments are included in the subsidies that cause serious prejudice? Do they appear in the economic calculations? BRA

123. Does Brazil's request for the establishment of the Panel name the statute authorizing cottonseed payments for the 1999 crop? BRA

B. EXEMPTION FROM ACTIONS

124. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the Agreement on Agriculture? BRA, US

1. The scheduled issuance of the Panel's report after the end of the 2003 calendar year has no impact on the applicability of Article 13(a)(ii), (b)(ii) and (c)(ii) of the Agreement on Agriculture to the U.S. measures in this dispute. There is no question, and Brazil has not contested, that Article 13 was in effect at the time of the Panel's establishment, and the Panel's terms of reference set on that date are to examine the matter raised in Brazil's panel request in light of the covered agreements, which include the Agreement on Agriculture.

2. As a separate matter not presented by this dispute, the United States notes that the commitments of the United States with respect to cotton are specified by *marketing* year, not *calendar* year. Therefore, the end of the 2003 calendar year would in any case not be relevant to the question of when the provisions of Article 13 cease to have effect with respect to U.S. support measures for upland cotton.[1]

C. IDENTIFICATION OF THE SUBSIDIZED PRODUCT

125.

(1) In view of requirements in the FAIR Act of 1996 and the FSRI Act of 2002 that contract acreage remain in agricultural or conservation uses and which impose penalties if the producer grows fruits or vegetables, how likely is it that the producer with upland cotton base acreage will not use his or her land to produce program crops or covered commodities? US

3. With respect to contract acreage on a farm, the 2002 Act generally allows any commodity or crop to be planted on base acres on a farm for which direct payments are made, with

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[1] *See* Agreement on Agriculture Article 1(i) ("'[Y]ear' in paragraph (f) above and in relation to the specific commitments of a Member refers to the calendar, financial or marketing year specified in the Schedule relating to that Member.")

limitations for certain commodities (fruits, vegetables (other than lentils, mung beans, and dry peas), and wild rice). With some exceptions, planting of those limited commodities on base acres is prohibited and could lead to reduced or eliminated direct payments.[2] Otherwise, a producer (or landowner) is permitted to make any other use of the land so long as the land on the farm in a quantity equal to base acreage is used for an agricultural or conserving use.[3] Thus, the direct payment recipient has the flexibility to plant and harvest any other commodity or crop on the land representing their upland cotton base acreage; indeed, direct payment recipients may plant nothing at all and still receive payment. (We note that the foregoing description of the "planting flexibility" under the 2002 Act is relevant only to base acres on a farm for which direct payments are made; other acres on the farm need not comply with any of the contract requirements set out in Sections 1105 and 1106 of the 2002 Act.)

4. The data demonstrate that planting and harvesting decisions by U.S. producers result in U.S. upland cotton area varying significantly. In marketing year 2003, for example, U.S. farmers planted 13,748,000 acres, a decline of 11.3 percent from the recent high reached in marketing year 2001.[4] As indicated in the U.S. closing statement at the second session of the first panel meeting, U.S. harvested acreage largely increases and decreases in line with the rest of the world.[5] In marketing year 2001, U.S. area harvested increased by almost the exact same percentage as did the rest of the world. In marketing year 2002, the percent decline in harvested acreage in the United States was *greater* than that observed in the rest of the world. Thus, regardless of whether U.S. farmers who plant upland cotton may also be holders of upland cotton base acres, and contrary to Brazil's assertions, U.S. farmers respond to market signals by planting or harvesting upland cotton much as producers in the rest of the world do.

(2) Brazil has submitted that "The record suggests that historic producers are current producers." It points to factors including the specialization of upland cotton producers, the need to recoup expensive investments in cotton-specific equipment, and the geographic focus and climatic requirements of upland cotton production in the "cotton belt". (Brazil's rebuttal submission, footnote 98, on page 24)

(a) Regarding the specialization of upland cotton producers and the geographic focus of upland cotton production, how does Brazil take account of the fact that cotton is produced in 17 of the 50 states of the United States and that average cotton area is approximately 38% of a cotton farm's acres? (This information is taken from the US's response to question 67bis, footnote 35). BRA

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[2] *See* U.S. Answer to Question 26 from the Panel, para. 56.

[3] 2002 Act, § 1105(a)(1)(D) (Exhibit US-1).

[4] U.S. Department of Agriculture, National Agricultural Statistics Service, *Acreage*. Cr Pr 2-5 (6-03). June 30, 2003. Available at: http://usda.mannlib.cornell.edu/reports/nassr/field/pcp-bba/acrg0603.pdf

[5] *See* U.S. Closing Statement at the Second Session of the First Panel Meeting, paras. 5-6; Exhibit US-63.

(b) Regarding the geographic focus of upland cotton production, how many other crops can upland cotton producers viably grow in the cotton belt, other than fruits and vegetables? US

5. Based on planted acreage data as reported by National Agricultural Statistics Service,[6] U.S. upland cotton is produced in several diverse regions across the Cottonbelt, generally known as the Southeast, Delta, Southwest, and West regions. Across the regions (as well as within a given region), producers are faced with differing physical growing environments as well as economic factors that help determine the viability of upland cotton or some other alternative crop in any given year. Over the last several years, producers have reduced plantings of upland cotton and increased plantings to alternatives. A list of the full range of alternative crops that are viable in these areas would be extensive. Below we present a regional breakdown of some principal alternative crops to upland cotton as well as historical plantings since 1996 of these crops compared with upland cotton.

6. Upland cotton producers in the Southeast region (Alabama, Florida, Georgia, North Carolina, South Carolina, and Virginia) have corn and soybeans as principal alternative crops. Peanuts are also an alternative, though mainly in Georgia. Between 1996 and 2003, area planted to upland cotton, corn, and soybeans in the Southeast averaged about 8.6 million acres, ranging from 8.2 to 9.1 million acres. During this same period, upland cotton area ranged from 3.0 to 3.6 million acres. Since 2001, upland cotton has been reduced in favor of corn and soybeans in this region.

7. Upland producers in the Delta region (Arkansas, Louisiana, Mississippi, Missouri, and Tennessee) also have corn and soybeans as an alternative and, to a lesser extent, rice in some areas. Between 1996 and 2003, area planted to these 4 crops averaged 22.9 million acres, ranging from 22.2 to 23.8 million. At the same time, upland cotton area ranged from 3.2 to 4.6 million acres. Like the Southeast region, the Delta area planted to upland has declined since 2001 in favor of corn and soybeans.

8. The Southwest region (Texas, Oklahoma, and Kansas) has the most diverse growing environment of the 4 regions. In the northern part of the region – where most of upland cotton is grown – principal alternatives to upland cotton may include wheat and sorghum. In the southern part, however, corn, soybeans, and sorghum are generally an alternative to upland cotton. The Southwest region planted an average of 26.3 million acres to these 5 crops between 1996 and 2003.[7] Area ranged from 24.5 to 27.9 million acres during this period. Meanwhile, upland cotton area ranged from 5.7 to 6.7 million acres. Since 2000, upland area in the Southwest has fallen in favor of sorghum, wheat, and corn.

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[6] See Exhibit Q125(2)(b).

[7] To be conservative, we have excluded Kansas wheat and sorghum acreage from the totals presented due to the state's large production of these crops and relatively small production of cotton.

9. In the West region (California, Arizona, and New Mexico), upland producers have a variety of alternatives, including corn, extra-long staple (ELS) cotton, alfalfa, and wheat. Between 1996 and 2003, area planted to these 5 crops averaged 4.3 million acres in the region, ranging from 4.0 to 4.6 million. At the same time, upland cotton area has ranged from 0.7 to 1.4 million acres. The last several years, however, have seen upland area decline in favor of one or more of the alternative crops.

(c) Regarding the high cost of upland cotton production, can Brazil show that farms who planted upland cotton could only have covered their costs by receiving upland cotton, rice or peanut payments in every year from 1999 through 2002? BRA

(d) Regarding the need to recoup investments in cotton-specific equipment, is it important to planting decisions that upland cotton producers cannot run any other crop through their cotton-pickers? How does this affect the likelihood that they will grow other crops? US

10. The National Agricultural Statistics Service (NASS) reported that in 2002, farmers paid an average of $225,000 for a cotton picker.[8] Farmers may respond to machinery costs through the contracting-out of harvesting operations and rental or leasing of cotton-picking machinery.

11. In the short run, investment costs may slow acreage adjustments to market prices. This does not mean, however, that cotton producers do not respond to changes in market prices. Research by Lin et al. suggest that cotton producers may, in fact, be *more* responsive to own price changes (that is, the response of cotton acreage to changes in cotton prices as opposed to changes in prices of competing crops) than other competing crops are.[9] In the long run, fixed assets like cotton pickers are less of a constraint to entry, and thus one would expect the acreage response to changes in price to be larger.

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[8] U.S. Department of Agriculture, National Agricultural Statistics Service, *Agricultural Prices 2002 Summary*. Pr 1-3 (03)a July 2003. Available at: http://usda.mannlib.cornell.edu/reports/nassr/price/zap-bb/agpran03.pdf

[9] Lin, W., *et al.*. *Supply Response Under the 1996 Farm Act and Implications for the U.S. Field Crops Sector.* U.S. Department of Agriculture, Economic Research Service, Technical Bulletin No. 1888, Appendix table 21 (Exhibit US-64).

Acreage own-price elasticity for major field crops

Crop	National acreage price elasticity
Wheat	0.34
Corn	0.293
Sorghum	0.55
Barley	0.282
Oats	0.442
Soybeans	0.269
Cotton	0.466

Source: Lin *et al.*, Appendix table 21 (Exhibit US-64).

(3) In calculating the amount of PFC, MLA, direct and counter-cyclical payments that went on upland cotton, Brazil made an adjustment for the ratio of current acreage to base acreage (see its answer to question 67, footnotes 2, 3, 4 and 5). Is this an appropriate adjustment for the particular factors referred to above? Why or why not? BRA, US

12. Brazil's adjustment is not appropriate. It does not explicitly take into account any of the factors referred to above. Instead, Brazil's belated adjustment is simply based on the assumption that all of the planted cotton acreage was by producers who had cotton base acreage exactly equal to their planted acreage. This assumption is inaccurate and causes Brazil's figures to be in error. For some producers, cotton planted acres exceed their historical base, and some cotton acres are planted by producers who have no cotton base. As noted in the U.S. further submission, important changes such as lowered costs from pest eradication and adoption of biotechnology have lowered costs and brought new areas and farmers into cotton production. Brazil's adjustment takes no account of these changes.

13. More fundamentally, the relevant point is that any producers who have upland cotton base will receive direct and counter-cyclical payments *regardless* of whether they plant upland cotton. Thus, the decision to plant upland cotton will be based on expected economic returns of cotton and competing crops – not the level of direct and counter-cyclical payments that are decoupled from the decision to produce upland cotton. And the fact that these are decoupled payments means that the amount of the payment could not in any event be allocated only to cotton production.

(4) Dr. Glauber has alleged that there are statistical problems in comparing planted acres to program acres because of abandonment of crops and also because planted acres are only survey estimates, not reported figures (See Exhibit US-24, the first

full paragraph in P2). Would it be more appropriate to divide harvested acreage by base acreage? What margin of error is there between the survey estimates and reported figures? BRA, US

14. Exhibit US-24 outlines the statistical problems associated with dividing complying base acres by planted acres. The discussion addressed complying base acres under the Acreage Reduction Program of 1990 Farm Bill and did not address program payment acres as defined under the 1996 Farm Bill. Dividing harvested acreage by base acreage could potentially overstate the difference if there is significant acreage abandonment *after* producers reported their payment acres to the Farm Service Agency. Also, there remains a problem with the comparison since harvested acres are survey-based while base acres are reported numbers.

15. In the June *Acreage* report, the National Agricultural Statistics Service reports reliability estimates for selected crops. The reliability of acreage estimates is computed by expressing the deviations between the planted acreage estimates and the final estimates as a percent of the final estimates and averaging the squared percentage deviations for the 1983-2002 twenty-year period; the square root of this average becomes statistically the "Root Mean Square Error." Probability statements can be made concerning expected differences in the current estimates relative to the final estimates assuming that factors affecting this year's estimate are not different from those influencing the past 20 years. For example, the "Root Mean Square Error" for the upland cotton planted estimate is 2.4 percent. This means that chances are 2 out of 3 that the current cotton acreage will not be above or below the final estimate by more than 2.4 percent. NASS reports that the 90 percent confidence interval for the upland cotton estimate is 4.1 percent. This means that chances are 9 out of 10 (90 percent confidence level) that the difference will not exceed 4.1 percent.[10]

(5) Do the acreage reports under section 1105(c) of the FSRI Act of 2002 indicate or assist in determining the number or proportion of acres of upland cotton planted on upland cotton base acres? Was there an acreage reporting requirement for upland cotton during MY1996 through 2002? BRA, US

16. The acreage reports filed under Section 1105(c) of the 2002 Act by farms receiving direct and counter-cyclical payments indicate what crops are planted on a farm. A farm is an administrative construct that consists of tracts of land that are operated as one unit. The farm may be operated by more than one producer, and a producer may produce crops on more than one farm. The acreage report does not indicate the quantity of base acres on the farm. Because the acreage reports are filed after the planting season but before the harvest, the reports do not contain information on the quantity of production on each farm.

[10] U.S. Department of Agriculture. National Agricultural Statistics Service. *Acreage.* CrPr 2-5 (6-03). June 30, 2003. Pp 38-39.

17. Based on a very preliminary review of a sampling of marketing year 2002 acreage reports, the United States estimates that roughly 53 percent of farms that were eligible for direct and counter-cyclical payments for upland cotton base acreage also planted at least one acre of upland cotton in 2002. That is, approximately 47 percent of farms receiving direct and counter-cyclical payments in 2002 for upland cotton base acreage planted no upland cotton at all.

18. Over the period 1996 through 2002, there was no statutory requirement for acreage reports by recipients of decoupled payments or marketing loan payments. By regulation, producers who signed up for disaster assistance or who received marketing loan benefits (including loan deficiency payments) were asked to file planting acreage reports. Reports for producers receiving disaster assistance were to cover all acreage on the farm while reports for producers receiving marketing loan benefits were to cover only acreage for the crop receiving benefits. As a result, acreage reports over the period of the 1996 Act are incomplete.

(6) Please prepare a chart showing upland cotton base acreage, planted acreage and harvested acreage for MY1996 through 2002. Does the planted acreage fluctuate within a broad band? If not, does this indicate any stability in decisions to plant the same acres to upland cotton? BRA, US

19. The following chart shows upland cotton base acreage, planted acreage and harvested acreage for marketing years 1996 through 2002:

U.S. upland cotton area (thousand acres)

Crop year	Base acreage 1/	Planted acreage 2/	Harvested acreage 2/
1996	16128	14395	12632
1997	16213	13648	13157
1998	16412	13064	10449
1999	16377	14584	13138
2000	16268	15347	12884
2001	16239	15499	13560
2002	16217 (est.)	13714	12184

1/ U.S. Department of Agriculture, Farm Service Agency
2/ U.S. Department of Agriculture, National Agricultural Statistics Service, selected *Acreage* reports

20. Over the period 1996-2002, U.S. upland cotton planted acres ranged considerably, from 13,064,000 acres to 15,499,000 acres. Year-over-year, planted and harvested acreage can rise or fall significantly. For example, from marketing year 2001 to marketing year 2002, planted acreage fell by 1.785 million acres or 11.5 percent; harvested acreage fell by 1.376 million acres or 10.1 percent. As was pointed out in the U.S. closing statement at the second session of the first substantive meeting of the Panel and in Exhibit US-63, year-over-year changes in U.S.

harvested cotton acreage have been similar to year-over-year changes for harvested cotton acreage outside of the United States. These data do not provide any information on whether the same or different acres are planted to upland cotton.

21. As noted above in the U.S. answer to Question 125(5), based on a preliminary review of a sampling of marketing year 2002 acreage reports, it would appear that nearly half of farms receiving direct and counter-cyclical payments in 2002 for upland cotton base acreage planted no upland cotton at all. That so many farms that produced upland cotton during the historical base period of 1993-1995 or 1998-2001 no longer plant even a single acre of upland cotton suggests that there has been a large exit of past cotton producers and a large entry of new producers or a large expansion by other historical cotton producers.

(7) Brazil states that one third of all US farms with eligible acreage decided to update their base acreage under the direct payments and counter-cyclical payments programmes using their MY1998-2001 acreage. What is the proportion of the current base acreage for upland cotton resulting from such updating? Is the observed updating of base acreage consistent with Brazil's argument that it is only profitable to grow upland cotton on base acreage (and peanut and rice base acreage)? BRA

(8) How could one take account of upland cotton producers who receive PFC, MLA, direct and counter-cyclical payments for other covered commodity base acreage? BRA, US

22. Under Brazil's approach, one would need to take account of upland cotton producers receiving decoupled payments only for base acreage for other covered commodities. This follows from Brazil's explanation that "only the portion of upland cotton [decoupled] payments that actually benefits acres planted to upland cotton can be considered support to upland cotton."[11] Thus, under Brazil's approach, one would need to deduct any production (or acreage) attributable to such producers from the acreage figures Brazil has used to adjust the amount of decoupled payments on upland cotton base acreage.

(9) Assuming that Brazil's payment figures were to amount to a prima facie case, please answer the following questions: US

(a) How would the United States calculate or estimate the proportion of upland cotton producers who receive subsidy payments for upland cotton base acreage?

(b) Should any adjustment estimates be made for any factors besides those listed by Brazil?

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[11] Brazil's Answer to Question 67 from the Panel, fn. 2-5.

(c) What adjustment estimate would it be appropriate to make?

(d) How could one take account of upland cotton producers who receive decoupled payments for other program crop base acreage?

(e) Could the US specifically indicate what, in its view, are the flaws in the approach summarized in paras. 6-7 of Brazil's closing oral statement on 9 October (i.e. the use of the ration of 0.87 to adjust the amount of total upland cotton direct and CCPs for the MY to obtain the amount of subsidies received by upland cotton producers)? Can the US suggest an alternative approach that would yield reliable results in its view?

23. Putting Peace Clause and green box issues to one side, the United States believes that the issue of what payments may be attributed to upland cotton production is fundamentally part of Brazil's burden to present evidence substantiating the amount of the subsidy that it is challenging. However, the United States would note that this issue is not a matter of "the proportion of upland cotton producers who receive subsidy payments for upland cotton base acreage." Rather, the issue is, first, what is the quantity of decoupled payments received by upland cotton producers; second, how are those payments allocated across the total value of each farm's agricultural production; and third, how much and in what amount are U.S. cotton exports subsidized by these payments.

24. Brazil has conceded that decoupled payments made with respect to upland cotton base acreage are not "tied to the production or sale" of upland cotton, by adjusting such payments by 0.87.[12] That is, Brazil recognizes that, even on its theory, at least 0.13 of these payments "can[not] be considered support to upland cotton" because at least that fraction of upland cotton base acres were not planted to upland cotton in marketing year 2002. Because these payments are not "tied to the production or sale" of upland cotton, as suggested by Annex IV of the Subsidies Agreement, they must be allocated across the total value of production of each recipient. Brazil has not denied the applicability of the allocation methodology set out in Annex IV, but neither has Brazil provided any evidence relating to the total value of production of decoupled payment recipients.[13]

25. Brazil claims that its "suggested methodology is based on the conclusion that all upland cotton producers received these payments."[14] In fact, Brazil's methodology is based on the

[12]In addition to issues relating to the "adjustment," the United States disagrees with the total amount of decoupled payments paid with respect to upland cotton base acreage that Brazil calculates and uses as the base for its adjusted payment amounts. *See* U.S. Answer to Additional Question 67*bis* from the Panel, para. 28, fn. 37, 38.

[13]As noted in the Panel's Question 125(2)(a), average cotton area is approximately 38 percent of a cotton farm's acres. Thus, a substantial portion of the average cotton farm's agricultural production will be derived from production of other crops.

[14]Brazil's Closing Statement at the Second Session of the First Panel Meeting, para. 8.

further assumptions that (1) every acre of upland cotton in marketing year 2002 was planted by a holder of upland cotton base acreage and (2) no such base acreage holder planted more upland cotton than his or her base acres.[15] Brazil has provided no evidence to support these assumptions, which is no surprise since the evidence is to the contrary. For example, the fluctuations in upland cotton planted and harvested area in recent years and the fact that one-third of all U.S. farms with eligible acreage decided to update their base acreage using their MY1998-2001 acreage, imply substantial new entrants or new acreage that were not included in the base period figures under the 1996 Act. In fact, as noted above in the U.S. answer to Question 125(5), based on a preliminary review of marketing year 2002 acreage reports, the United States estimates that nearly half of all farms receiving direct and counter-cyclical payments in 2002 for upland cotton base acreage planted no upland cotton at all.

26. We also note that there are substantial requirements with which a payment recipient must comply (see U.S. answer to Question 162), such as highly erodable cropland conservation requirements and wetland conservation requirements.

D. "LIKE PRODUCT"

126. Does the US agree that the product at issue is upland cotton lint and that Brazilian upland cotton lint is "like" US upland cotton lint within the meaning of Article 6.3(c) of the SCM Agreement in that it is a separate like product that is identical or has characteristics similar to the upland cotton lint from the United States? (e.g. Brazil's further submission, para. 81) US

27. For purposes of this dispute, the United States is not arguing that all U.S. cotton is "unlike" Brazilian cotton. There are some grades of cotton that both produce. Such grades would have similar characteristics although, as noted by Mr. Ward at the second session of the first panel meeting, Brazilian lint has been sold in the past at a substantial discount to the New York futures price. That discount has been declining over time as Brazil, a relatively new supplier internationally, works to establish a reputation for quality and reliability.

E. "SUBSIDIES"

127. The Panel notes that the US contests that export credit guarantees constitute "subsidies". The Panel recalls that the US agrees that Step 2 payments are

[15]Using figures for marketing year 2002 planted acreage and base acreage, Brazil claims, "Out of the 16.2 million upland cotton base acres, 2.1 million were not planted to upland cotton in MY2002." Brazil's Closing Statement at the Second Session of the First Panel Meeting, para. 6. However, given the planting and base acreage numbers, the most Brazil can logically claim is that "*at least* 2.1 million [base acres] were not planted to upland cotton in MY2002." That is, if in 2002 new producers without base acres planted upland cotton or if some historical producers planted more than their base acres, then some portion of the 14.1 million planted acres in MY2002 were not planted "on" upland cotton base acres.

"subsidies" and wishes to have confirmation that it is correct in understanding that the US does not disagree that the following are "subsidies" for the purposes of Article 1 of the SCM Agreement: marketing loan/loan deficiency payments, PFC, direct payments, market loss assistance and CCP payments, crop insurance payments, cottonseed payments, storage payments and interest subsidy (without prejudice to the Panel's rulings on the US requests for preliminary rulings on the latter two payments). US

28. With respect to marketing loan payments, the United States agrees that these product-specific amber box payments that are made to producers of upland cotton for the production of upland cotton are subsidies within the meaning of Article 1 of the Subsidies Agreement.

29. With respect to crop insurance payments, through which the United States pays a portion of the crop insurance premium for producers, the United States agrees that these amber box payments are subsidies within the meaning of Article 1 of the Subsidies Agreement. We note, however, that these payments are not product-specific because they are not made to upland cotton producers for the production of upland cotton. Rather, they are non-product-specific support made to "producers in general" (that is, generally). Further, these crop insurance payments are not specific within the meaning of Article 2 of the Subsidies Agreement because they are available with respect to all agricultural products for which policies are offered by private companies. Therefore, pursuant to Article 1.2, this "subsidy" is not subject to the provisions of Part III of the Subsidies Agreement.

30. With respect to cottonseed payments, we recall that these payments are not within the terms of reference of the Panel.[16] With respect to "other payments" for upland cotton notified by the United States to the WTO – that is, storage payments and interest subsidy – the United States also recalls that these payments are not within the Panel's terms of reference.[17] Without prejudice to the U.S. request for preliminary rulings on these three types of payments, the United States considers that these product-specific amber box payments are subsidies within the meaning of Article 1.

31. With respect to green box production flexibility contract payments under the 1996 Act and direct payments under the 2002 Act, the United States does not consider that Brazil has demonstrated what is the amount of the subsidy attributable to upland cotton producers pursuant to Article 1. Article 1 requires that a financial contribution by a government or public body or income or price support confers a benefit. The subsidies Brazil challenges are subsidies to producers, users, and/or exporters of upland cotton. However, Brazil has not identified the portion of the production flexibility contract payments that is properly attributable to upland cotton producers as opposed to other recipients of this subsidy. In fact, Brazil concedes that the

[16]*See, e.g.*, U.S. Further Submission, para. 8.
[17]*See* U.S. Further Submission, paras. 6-7.

entire amount of these payments does *not* confer a benefit on upland cotton producers by reducing the amount of production flexibility contract payments and direct payments on upland cotton base acres by the proportion 14/16. However, Brazil has provided no evidence of the amount of these decoupled payments received by producers that currently produce cotton. Nor has Brazil demonstrated how much or to what extent U.S. cotton exports are subsidized.

32. With respect to *ad hoc* market loss assistance and counter-cyclical payments under the 2002 Act, the United States also does not consider that Brazil has demonstrated what is the amount of the subsidy attributable to upland cotton producers pursuant to Article 1. Specifically, as with production flexibility contract payments and direct payments, Brazil has not identified the portion of the subsidy that is properly attributable to producers of upland cotton as opposed to other recipients of this subsidy. Brazil has not identified the benefit to upland cotton producers conferred by these payments. Rather, Brazil merely assumes that for every upland cotton harvested acre, upland cotton producers had a corresponding upland cotton base acre. However, Brazil has provided no evidence of the amount of these decoupled payments received by producers that currently produce cotton.

F. PROHIBITED SUBSIDIES

128. Could the US respond to Brazil's assertions relating to the meaning and effect of the introductory phrase of Article 3 ("Except as provided in the Agreement on Agriculture....")? Would the meaning/effect change if Article 13 of the Agreement on Agriculture did not exist? BRA, US

33. It is not entirely clear to the United States to which assertions of Brazil the Panel refers in its question. Moreover, the United States does not believe Brazil has purported to ascribe a specific meaning to that particular phrase. Indeed, with respect to Article 3.1(b), Brazil's arguments would effectively delete the introductory phrase in its entirety.[18]

G. SPECIFICITY / CROP INSURANCE

129. In the event that the Panel does not consider that the alleged prohibited subsidies fall within the provisions of Article 3 and are therefore, pursuant to Article 2.3, "deemed to be specific", are there any other grounds on which Brazil would rely in order to support the view that such measures are "specific" within the meaning of Article 2 of the SCM Agreement (see, for example, fn 16 of Brazil's further submission)? BRA

[18] See Answer of the United States to Panel Question 144, *infra*.

130. Does Brazil agree that the US insurance premium subsidy is available in respect of all agricultural products? Please cite relevant portions of the record. BRA

131. How should the concept of specificity - and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" -- in Article 2 of the SCM Agreement apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the SCM Agreement: BRA, US

a) is a subsidy in respect of all agricultural, but not other, products specific?

34. The United States does not regard a domestic subsidy as being specific solely because the subsidy is limited to the agricultural sector. As previously noted, this proposition is codified in the U.S. countervailing duty regulations, at 19 C.F.R. § 351.502(d). Thus, the United States is of the view that the agricultural sector is too broad and too diverse to constitute a single "enterprise or industry or group of enterprises or industries."

b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?

35. It is difficult to opine on this question in the abstract. However, this fact pattern does not apply to the U.S. insurance premium subsidies, which are also available in respect of livestock.

c) is a subsidy in respect of certain identified agricultural products specific?

36. It is difficult to opine on this question in the abstract. However, this fact pattern does not apply to the U.S. insurance premium subsidies since the premium subsidy is a single subsidy program available in respect of all products (while policies issued by private parties are in certain instances available in respect of certain identified products).

d) is a subsidy in respect of upland cotton, but not other products, specific?

37. The United States assumes that this would require that the subsidy be limited to certain entities or the upland cotton industry and so would be specific. This fact pattern, however, does not apply to the U.S. insurance premium subsidies since the premium subsidy is a single subsidy program available with respect to all products (while policies issued by private parties are in certain instances available in respect of certain identified products).

e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?

38. In principle, a subsidy that is limited to a sufficiently small proportion of U.S. commodities would be "limited," and, thus, "specific" within the meaning of Article 2.1(c). However, the Subsidies Agreement does not establish any quantitative standards for determining when a subsidy is so limited, and a proposal to establish such standards was rejected during the Uruguay Round. Therefore, the determination must be made on the basis of the facts of the particular case. This is the approach taken by the U.S. Department of Commerce for purposes of the U.S. countervailing duty law.

f) is a subsidy in respect of a certain proportion of total US farmland specific?

39. This question is not presented in this dispute, but the United States would note that "land" is neither an "enterprise" nor an "industry," and so the proportion of farmland as such would not be appear to be relevant to the analysis under Article 2 of the Subsidies Agreement. The issue also does not appear to fall within the scope of Article 2.2, which deals with regional specificity – that is, "total US farmland" does not correspond to a "designated geographical region."

132. Please state the amount and percentage of upland cotton acreage covered by each crop insurance program and/or policy under the ARP Act of 2000. US

40. There is one crop insurance program, through which the United States provides premium subsidies on crop insurance policies that are offered by private insurance companies under the authority of the Federal Crop Insurance Act. There is no specific crop insurance program or policies for cotton authorized under the Agricultural Risk Protection Act of 2000. Within this crop insurance program, there are different plans of insurance that offer different types of coverage, such as production plans of insurance or revenue plans of insurance. All such plans of insurance are reinsured by FCIC and a premium subsidy paid by the U.S. Government, is available. The amount and percentage of upland cotton acreage covered by each plan of insurance is shown in Exhibit US-65.

133. Concerning Brazil's arguments in its oral statement, para. 7, can the US indicate if any producers of livestock outside a pilot program are covered by the crop insurance program? US

41. Yes, producers of livestock outside of pilot programs are covered by the crop insurance program. In addition, there are policies being developed pursuant to pilot programs in order to expand the scope of insurance products offered by private insurers to livestock producers. Thus, U.S. crop insurance payments on premiums are made to a broad range of agricultural producers across the agricultural sector, including many livestock producers.

42. Livestock producers are eligible for several forms of "crop insurance" benefits under the provisions of the same operational statute that provides for benefits for "crops." Under the Federal Crop Insurance Act (7 USC 1501-1524), the Federal Crop Insurance Corporation (FCIC), an entity within the U.S. Department of Agriculture, can approve insurance products if there is

"sufficient actuarial data" to justify it to producers of "agricultural commodities."[19] *See* 7 USC 1508(a). The Act defines "agricultural commodity" to include a lengthy list of commodities, including such non-plant commodities as "finfish" and "mollusks." The definition also includes any "other agricultural commodity,"except stored grain (the crop that produced the grain would be eligible for coverage), as determined by the Board of Directors of FCIC.

43. Thus, FCIC has the authority to offer insurance for livestock under its regular insurance programs. The FCIC has approved products providing income protection to producers with livestock on t heir farm as contemplated in the statute. In addition, with the enactment of the Agricultural Risk Protection Act of 2000 (ARPA) (Pub. Law 106-224), Congress specifically mandated that FCIC offer pilot programs for livestock. See 7 USC 1523.

44. The Adjusted Gross Revenue (AGR) product provides protection against low revenue due to unavoidable natural disasters and market fluctuations that occur during the insurance year. Covered farm revenue consists of income from all agricultural commodities, including amounts of income from animals and animal products and aquaculture reared in a controlled environment. To be eligible to purchase an AGR policy, the producer can earn no more than 35 percent of expected allowable income from animals and animal products. Because the amount of livestock is considered incidental, the expenditures are not counted against the funding limitations for livestock contained in 7 USC 1523 (which have never been reached).

45. The 35 percent limit does not apply in the so-called "AGR-lite" program, which was developed by, and originally available only in, Pennsylvania , the state that developed the policy. However, beginning with the 2004 crop year, an "AGR-lite" product will be expanded to counties in Connecticut, Delaware, Maine, Vermont, Massachusetts, New Hampshire, New Jersey and Rhode Island, and selected counties in West Virginia, New York, and Maryland, as approved by RMA. In all, the AGR-lite program will now cover about 300 counties. That expansion of AGR-Lite was announced in an August 18, 2003, press release, available on the RMA website.

46. There are at least four kinds of products specifically for livestock available to livestock producers, and they are described at the website of the Risk Management Agency (RMA) (www.rma.usda.gov). There are two different policies that are available for swine producers. The first is Livestock Risk Protect (LRP- Swine). Originally that product was available only in Iowa. RMA recently announced that the policy may be offered to swine producers in 10 additional states: Illinois, Indiana, Kansas, Minnesota, Nebraska, Nevada, Oklahoma, Texas, Utah and Wyoming. The other policy available to swine producers is Livestock Gross Margin (LGM), which is available in Iowa. For cattle, there are two specialized policies available. Livestock producers may purchase a LRP-Feeder Cattle policy in Colorado, Iowa, Kansas,

[19] *See* 7 U.S. Code § 1508.

Nebraska, Nevada, Oklahoma, South Dakota, Texas, Utah, and Wyoming. Finally, there are "LRP-Fed Cattle" policies in Illinois, Iowa and Nebraska.

134. Please state the annual amount of premiums paid or contributions made by US upland cotton farmers relating to each of the crop insurance programs and/or policies supported by the US Risk Management Agency and the Federal Crop Insurance Corporation in each year from 1992 through 2002. US

47. Please see Exhibit US-66.

135. Please state the annual amount of insurance indemnity payments made by the US government; or insurance companies participating in crop insurance programs and/or policies under the ARP Act of 2000 to upland cotton farmers in each year from 1992 through 2002. US

48. Please see Exhibit US-67.

136. Is the US arguing that crop insurance subsidies corresponding to "over 90 per cent of insured cotton area" (US 7 October oral statement, para. 46) in MY1999 through 2002 are consistent with paragraph 8(a) of Annex 2 of the Agreement on Agriculture? Is it correct that in the past these subsidies were nonetheless notified to the Committee on Agriculture as non-product specific AMS (see, for example, G/AG/N/USA/43 in Exhibit BRA-47)? US

49. The United States has notified crop insurance payments to the Committee on Agriculture as non-product specific support. This is consistent with the U.S. position that crop insurance subsidies are generally available subsidies to the agricultural sector as a whole.[20] In the U.S. oral statement of October 7, 2003, it is pointed out that over 90 percent of the cotton area currently under the program is insured at coverage levels of 70 percent or less of expected yield (or revenue). Over all commodities, almost 70 percent of total insured area is insured at 70 percent or less of expected yield or revenue. Thus, associated subsidies would be consistent with paragraph 8(a) of Annex 2 of the Agreement on Agriculture – that is, payments for relief from natural disasters that Members have agreed have no or at most minimal trade-distorting effects or effects on production. The point is made to stress that such subsidies that satisfy green box criteria are likely non-production distorting, contrary to the assertions made by Brazil.

H. EXPORT CREDIT GUARANTEES

[20] U.S. Comments on Brazil's Rebuttal Submission, paras. 34-42; U.S. Rebuttal Submission, paras. 93-98; U.S. Further Submission of September 30, 2003, paras. 14-15.

137. Please elaborate the meaning of "net losses" as is used in paragraph 70 of Brazil's 7 October oral statement. BRA

138. Please comment on Brazil's views stated in paragraph 70 of its 7 October oral statement. US

50. In specific response to Brazil's views stated in that paragraph, the United States invites the attention of the Panel to paragraphs 157-162 of the August 22 U.S. Rebuttal Submission, the table accompanying paragraph 161 of that submission, and paragraphs 144-150 of the September 30 Further Submission of the United States. Paragraph 70 of Brazil's October 7 oral statement is simply a recapitulation of arguments it had previously advanced.

51. As noted in paragraph 144 of the U.S. Further Submission, current data for each of the cohorts for 1992, 1993, 1994, 1995, 1996, and 1999 indicates a profit.[21] As stated in OMB Circular No. A-11: "The subsidy cost is the estimated present value of the cash flows . . . resulting from a direct loan or loan guarantee . . . . A positive net present value means that the Government is extending a subsidy to borrowers; *a negative present value means that the credit program generates a 'profit' (excluding administrative costs) to the Government.*"[22]

139. In the context of export credit guarantees, is the Panel correct in understanding that Brazil's claims of inconsistency with the Agriculture Agreement involve GSM 102, GSM 103 and SCGP, but that it limits its "serious prejudice" allegations in respect of export credit guarantee programmes to the GSM 102 programme, and does not challenge GSM 103 and SCGP in this respect? If so,

(a) could Brazil please explain why it did so, and confirm that all the data relied upon in its further submissions (e.g. in Table 13) relate to the GSM 102 programme rather than to GSM 102, GSM 103 and SCGP (and, if the data needs to be adjusted to take account of a narrower "serious prejudice" focus, supply GSM-102-relevant data)? BRA

(b) for the purposes of Article 13(c)(ii) of the Agreement on Agriculture, is it necessary for the Panel to examine only GSM 102 or should the Panel's examination include also GSM 103 and SCGP? Why or why not? BRA

140. Could Brazil explain how, if at all, it has treated export credit guarantees for the purpose of Table 1 of its further submission? BRA

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[21] *See also* U.S. Rebuttal Submission, para. 161 (chart of Subsidy Estimates and Reestimates by Cohort); U.S. Further Submission, fns. 82 and 96.

[22] OMB Circular No. A-11, section 185.2, pp. 185-3 and 185-4 (italics added) (Exhibit Bra-116).

141. The Panel notes the US argument, inter alia in its further submission, that the export credit guarantee programmes are "self-sustaining". Recalling that item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement refers to "premium rates", could the US expand upon how it takes into account the premium rates for the export credit guarantee programmes in its analysis. US

52. Item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement is concerned with whether premium rates are inadequate to cover the long-term operating costs and losses of the programs. A rate is applied against a transaction amount to generate revenue to cover any costs and losses. In the context of the export credit guarantee programs, the premium rate is applied against the volume of a particular transaction to generate revenue. The mere rate as an abstract number cannot generate revenue. Consequently, premium rates as applied to the volume of transactions is necessarily the principal source of program revenue. In addition, recoveries – whether direct or through rescheduling – are an additional source of revenue. Revenue from all these sources are applied against its operating costs (e.g., administrative expenses) and losses from its claims experience. Alternatively, such recoveries may be viewed not as revenue but as a reduction of loss arising from claims experience. For example, a full recovery of an amount already paid as a claim yields a net loss of zero. Arithmetically, this would yield the same result as treating the recovery as revenue, offsetting the equivalent amount of prior loss.

53. As the United States noted in footnote 81 of its September 30 Further Submission, Brazil has erroneously argued 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'." To the contrary, 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). Such a draconian result is economically illogical and certainly not compelled by the text. As noted above, whether the recovery is viewed as revenue or as a subtraction from loss, the net result would be the same, but it must be included in any evaluation of whether premium rates cover long-term operating costs and losses.

54. As the United States further noted in its response to Panel question 77 (August 11 Answers to Panel Questions, para. 145), item (j) applies to three different types of programs: export credits, export credit guarantees, and insurance. In the case of export credit guarantees and insurance, the provider will occasionally incur claims. To the extent such claims or defaults exceed revenue from whatever source it may be derived, the net result would be a loss arising from operations. In an accounting sense such result would constitute an 'operating loss.'

55. Revenues derived from fees paid in connection with the export credit guarantee programs form an integral part of the estimate and re-estimate process that currently indicate profitability for each of the cohorts in 1992, 1993, 1994, 1995, 1996, and 1999.[23] The application of the rates in this regard to the analysis is properly extended to 1992, as this is the first fiscal year of applicability of government-wide accounting for federal credit programs under the Credit Reform Act of 1990. This period also conforms with the period that Brazil recognizes as appropriate for analysis under item (j).[24] As a result of such profitability, the programs are self-sustaining.

142. The US has pointed out that there are many limitations on granting export credit guarantees and that there is no requirement to issue any particular guarantee (US further submission, paras 153-156). Can the Commodity Credit Corporation decline to grant an export credit guarantee even in cases where the program conditions are met? US

56. A proper response to this question requires one to define by what is meant by "program conditions." The arguments of Brazil would appear to create a tautological circularity: if one assumes that none of the various discretionary programmatic and budgetary bases that would permit the Commodity Credit Corporation not to issue a particular export credit guarantee are in effect, then can the CCC decline to grant that particular guarantee? Under those circumstances the question itself dictates that the answer must be "no". The United States submits, however, that assuming away all of the real-world bases that would permit CCC to decline issuance of a guarantee is not a proper basis for analysis.

57. The fact remains, as the United States has pointed out, that numerous bases exist for denial of a guarantee.[25] Brazil has argued, however, that "CCC does not enjoy the discretion to refuse to issue a guarantee to an eligible individual."[26] This is simply not true. Perhaps a practical example would further illustrate the point. As the United States mentioned during the first substantive meeting of the Panel, CCC internally maintains limits on the amount of its exposure to obligations of particular foreign banks.[27] Although a qualified applicant might apply for an export credit guarantee for an eligible good to an eligible destination (each of those elements themselves constituting potential bases for denying an application), notwithstanding the eligibility of the applicant, good, and destination, if the foreign-bank obligor envisioned in the transaction would exceed the applicable *internally established* exposure limit if it consummated the transaction, CCC could and would deny the application for the guarantee. Thus, while it is

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[23]*See* Answer of the United States to Panel Question 138, *supra*. *See also* U.S. Rebuttal Submission, para. 161 (chart of subsidy estimates and reestimates by cohort); U.S. Further Submission, fns. 82 and 96.

[24]See First Submission of Brazil (24 June 2003), para. 282: "[A] ten-year period . . . fulfills the criterion of being 'long-term' within the meaning of item (j)." In contrast, no such long-term analysis is possible with respect to the Supplier Credit Guarantee Program, the regulations for which were first promulgated only on July 1, 1996, with transactions commencing during fiscal year 1997.

[25] See, e.g., U.S. Further Submission (September 30), paras. 153-156

[26]Second Oral Statement of Brazil (October 7), para. 67.

[27]See http://www.fsa.usda.gov/ccc/banks_foreign_rqts.htm.

true that the CCC does not engage in any *arbitrary* or standard-less denials, the point is that no exporter seeking to engage in a particular export transaction can be certain of obtaining a credit because of CCC decisions relating to the conditions for issuance of export credit guarantees.

143. Brazil agrees with National Cotton Council estimates of the effects of the GSM 102 programs (Brazil's further submission, para. 190) but it also cites a different conclusion by Prof. Sumner (paragraph 192). Brazil cites other estimates by Prof. Sumner throughout its further submission. Does Brazil adopt Prof. Sumner's conclusions and estimates as part of its submission? BRA

I. STEP 2 PAYMENTS

144. Is the Panel correct in understanding that the US does not dispute that Step 2 (domestic) payments are contingent upon import substitution, and that it argues that such measures are permitted due to the operation of the provisions of the Agreement on Agriculture? How is that relevant to a claim under Articles 5 and 6 of the SCM Agreement? US

58. The United States acknowledges that to receive a payment under the Step 2 program a domestic user must open a bale of domestically produced baled upland cotton. As the United States noted in its Further Submission of September 30, 2003,[28] the introductory clause of Article 3.1 of the Subsidies Agreement, "Except as provided in the Agreement on Agriculture", applies to both Articles 3.1(a) *and* 3.1(b). Brazil's arguments would delete the application of the introductory clause to Article 3.1(b). As the exception's applicability to Article 3.1(b) must be given meaning, the United States has noted that the Agreement on Agriculture does permit domestic content subsidies in favor of agricultural producers, albeit paid to processors, if such subsidies are provided consistently with the Member's domestic support reduction commitments.[29] The European Communities concur.[30]

59. As the United States has previously indicated to the Panel[31], the United States reports all Step 2 payments as product-specific domestic support to cotton. As the United States is entitled to the protection of the Peace Clause under Article 13(b)(ii) of the Agreement on Agriculture, the United States is exempt from action under Articles 5 and 6 of the Subsidies Agreement. By their express terms, Articles 5 and 6 do "not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture."

[28]Paras. 165-176.

[29]U.S. Further Submission (September 30, 2003), para. 167; First Written Submission of the United States, paras. 146-150.

[30]Answers of the European Communities to Panel Question 40, paras. 72-78; First Oral Statement of the European Communities, paras. 31-37.

[31]See, e.g., First Written Submission of the United States, para. 129; G/AG/N/USA/43, at 20 (Supporting Table DS:6) (Exhibit Bra-47)

60. The question of "import substitution" is otherwise irrelevant to Brazil's claims under Articles 5(c) and 6, which focus on the effect of the particular subsidy without regard to the origin requirements of the subsidy. In contrast, Article 3.1(b) focuses on whether a subsidy is contingent upon use of domestic over imported goods to determine whether a particular subsidy is a prohibited subsidy irrespective of its effect.

J. ACTIONABLE SUBSIDIES

145. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Articles 4.7 and 7.8 of the SCM Agreement. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the SCM Agreement to withdraw the subsidy without delay, can the Panel:

(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel? BRA, US

(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the SCM Agreement? BRA, US

61. As a practical matter, there may be limited value in a particular dispute from making a finding that a particular subsidy is both a prohibited subsidy and causes adverse effects. If a subsidy is prohibited, then the remedy *required* to be recommended under Article 4.7 is to withdraw the subsidy without delay. A finding at the same time that a subsidy causes serious prejudice, if done cumulatively with an analysis of other subsidies, would mean that it would leave unclear the question of whether the other, non-prohibited subsidies cause adverse effects. That may diminish the value (in terms of resolving the dispute) of any finding concerning those other subsidies.

62. On the other hand, if the Panel were to make a separate "adverse effects" analysis for each of the non-prohibited subsidies, there would be no reason to so analyze any prohibited subsidy. First, an adverse effects analysis of a prohibited subsidy could not affect a panel's findings with respect to each non-prohibited subsidy. Second, since under Article 4 the panel would have recommended withdrawal of the prohibited subsidy, compliance with Article 4 would also comply with a recommendation under Article 7. Therefore, having made a recommendation under Article 4 with respect to a subsidy, there would be no utility to also making a recommendation under Article 7.

146. Brazil acknowledges that there are some interaction effects that may increase or decrease the overall effects of the subsidies (Brazil's further submission, para.

225). How would your analysis under Articles 5(c) and 6.3 of the SCM Agreement and Article XVI of GATT 1994 differ if it excluded, for example, crop insurance subsidies, PFC and/or direct payments? BRA

147. Does the US agree that subsidies provided under the marketing loan program, counter-cyclical payments and market loss assistance are or were more than minimally trade-distorting? If so, please elaborate on the type of effects which are more than minimally trade-distorting within the meaning of Annex 2 of the Agreement on Agriculture but less than adverse effects within the meaning of Article 5 of the SCM Agreement. US

63. The issues of whether a measure is more than minimally trade-distorting and whether a measure has adverse effects require two different analyses. While it may be a necessary condition that a subsidy has trade- or production-distorting effects in order to find that it causes adverse effects, it is not a sufficient condition. The question under an adverse effects analysis is one of the effect on a particular Member's "interests" – for example, whether injury to the domestic industry of another Member, nullification or impairment, or serious prejudice to the interests of another Member. Therefore, the mere showing that a subsidy can distort trade or production does not necessarily mean it has, for example, seriously prejudiced a particular Member's interests.

64. Marketing loan payments, counter-cyclical payments, and market loss assistance payments provide different types of support that can be expected to have different effects. As noted in the U.S. answer to Question 127, the United States notifies marketing loan payments as product-specific amber box support. These payments are linked to production of upland cotton in favor of the producers of upland cotton – a producer must have harvested cotton to receive the payment. Therefore, the United States considers that marketing loan payments could not satisfy the general and policy-specific criteria set out in Annex 2 of the Agreement on Agriculture and therefore could not be deemed to have met the fundamental requirement of that Annex.

65. That a particular support measure does not conform to the general and policy-specific criteria of Annex 2 is relevant to the type of support it is deemed to be, which has meaning for a Member's compliance with its reduction commitments. That a particular measure is not green box, however, would not suffice to demonstrate that a measure has "adverse effects" within the meaning of Articles 5 and 6 of the Subsidies Agreement. A finding that a subsidy has caused adverse effects is a fact-intensive analysis. In the case of a claim of serious prejudice, for example, one of the four effects set out in Article 6.3 must be demonstrated (such as significant price suppression or depression by the subsidized product in the same market as the non-subsidized product is found) and the effects caused by the subsidy must rise to the level of "serious prejudice." Such a fact-intensive analysis must take into account, *inter alia*, the nature and amount of the subsidy, market conditions, and other factors affecting production, consumption, and prices.

66. Therefore, a conclusion that a measure does not provide green box support and therefore would not be deemed to have no or at most minimal trade-distorting effects or effects on production cannot take the place of the fact-intensive examination required to show causation under the WTO Agreements. For example, marketing loan payments provide a revenue floor of 52 cents per pound for U.S. upland cotton producers. The effect of this subsidy would depend in large part on the producer's expected market revenue at the time of planting – that is, whether this expected revenue was above or below 52 cents per pound. Thus, the effect of this subsidy would be quite different from a subsidy that merely provided an unchanging per unit payment (e.g., 10 cents per pound), even if as a result of prices that actually develop over the course of a marketing year the per-unit payments under these two measures turn out to be the same. As another example, a measure that provided, in the aggregate, $1 of support linked to production of upland cotton could not satisfy the general and policy-specific criteria of Annex 2 of the Agreement on Agriculture,[32] but it would be difficult to conceive that the effect of $1 in subsidies could be "significant price suppression [or] price depression" or "an increase in the world market share of the subsidizing Member" given the large number of market participants (including cotton producers worldwide), highly developed cotton markets, and volume and value of cotton trade.

67. With respect to counter-cyclical payments under the 2002 Act, the United States recalls that according to Brazil's interpretation of the first sentence of Annex 2 as a stand-alone requirement, if a measure has no more than minimal trade-distorting effects or effects on production, it follows that such a measure must be deemed green box. As the United States has demonstrated, the economic literature on decoupled payments (counter-cyclical payments are decoupled from production although linked to current prices) suggests that the effects on production of such income transfers are no more than minimal.[33] Therefore, although the United States would not contend that counter-cyclical payments conform fully to the policy-specific criteria in Annex 2, there is not only no evidence that such payments have more than minimal trade-distorting effects or effect on production, but the evidence suggests the contrary. In such a case, the effect of a payment that does not have more than minimal effects on production would not appear to be "significant price suppression [or] depression" or an "increase in the world market share of the subsidizing Member," much less "serious prejudice."

68. The expired market loss assistance payments were *ad hoc* payments made during the 1999, 2000, and 2001 marketing years to holders of base acreage. These payments were not linked to production – that is, a recipient need not have produced upland cotton or any crop at all

[32]For example, the measure would not qualify as decoupled income support because, by requiring that recipients have produced upland cotton, the amount of the payment would be "related to, or based on, the type or volume of production . . . undertaken by the producer in any year after the base period." *See* Agreement on Agriculture, Annex 2, para. 6(b).

[33]*See, e.g.*, U.S. Rebuttal Submission, paras. 59-64.

in order to receive the payment.[34] However, because these payments were explicitly made in reaction to low commodity prices, the United States considered that these payments would not conform fully to the criteria in Annex 2 of the Agreement on Agriculture and therefore notified these payments as non-product-specific amber box support. As noted above with respect to the 2002 counter-cyclical payments, however, the economic literature on payments decoupled from production suggests that the effects on production of income transfers such as the market loss assistance payments are no more than minimal.[35] Therefore, the evidence suggests that the effect of such payments could not be "significant price suppression [or] depression" or an "increase in the world market share of the subsidizing Member" resulting in "serious prejudice."

148. How should the significance of price suppression or depression be assessed under Article 6.3(c) of the SCM Agreement? In terms of a meaningful effect? Or another concept? BRA, US

69. As the United States has previously noted,[36] in Article 6.3(c) the term "significant" modifies the phrase "price suppression or depression," suggesting that it is the level of price suppression or depression itself that must be "important, notable" or "consequential."[37] As Brazil agrees,[38] important context for interpreting this phrase can be found in Article 15.2 of the Subsidies Agreement, which sets out for countervailing duty purposes the same effects found in Article 6.3.[39] This text confirms that the relevant analysis is whether the *level* of price suppression or depression itself is "significant":

> With regard to the effect of subsidized imports on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the subsidized imports as compared with the price of a like product of the importing Member, or whether the effect of such imports is otherwise *to depress*

[34]Supplemental legislation authorizing each of these payments was passed several months after planting for the crop year in question had occurred. Even if producers had some expectations of payment at planting time, they were eligible to receive such a payment regardless of what crop they planted. Indeed, they could choose not to plant and still be eligible for the payment. This would argue that market loss assistance payments, like production flexibility contract payments, direct payments, and counter-cyclical payments, are decoupled from planting decisions.

[35]*See, e.g.*, U.S. Rebuttal Submission, paras. 59-64.

[36]U.S. Opening Statement at the Second para. 58.

[37]U.S. Further Submission, para. 83.

[38]*See* Brazil's Further Submission, para. 88 ("This interpretation of price suppression and price depression is consistent with the *relevant context of Article 6.3(c), which includes Article 15.2 of the SCM Agreement.* That provision discusses standards for the determination of injury in countervailing duty cases and provides that the investigating authorities should consider whether the effect of imports is 'to depress prices' or 'to prevent price increases, which otherwise would have occurred . . .'[.]") (emphasis added).

[39]Effects on prices form one part of a determination of injury for countervailing duty purposes. Pursuant to Article 15.1, such a determination of injury involves an objective examination of (a) the volume of subsidized imports and the effect of the subsidized imports on prices in the domestic market for like products and (b) the consequent impact of these imports on the domestic producers of such products.

> *prices to a significant degree* or *to prevent price increases*, which otherwise would have occurred, *to a significant degree*.[40]

Thus, Article 15.2 provides contextual support for reading the term "significant price suppression [or] depression" in Article 6.3(c) according to the ordinary meaning of its terms – that is, it is the degree of price suppression or depression itself that must be "significant."

70. As suggested by this analysis, it is not the effect on the producers of the complaining Member that must be "significant." In determining whether the alleged price suppression or depression is "important" or "notable," it will of course be relevant to look at that suppression or depression in the context of the prices that have been affected – that is, at the *degree* of suppression or depression. One absolute level of suppression or depression could be significant in the context of prices for one product but not for another and meaning must be given to the phrase "in the same market."

> **149. What is the meaning of "may" in the chapeau of Article 6.3(c) in the context of Brazil's assertion that there is no need to conduct a distinct analysis of "serious prejudice" under Article 5(c) after having made a finding under 6.3(c) or (d)? (Brazil's further submission, paras 437 ff). How, if at all, are Articles 6.2 and 6.8 relevant in this context? What context should the Panel use for assessing serious prejudice under Article 5(c) of the SCM Agreement if the Panel takes the view that Article 6.3(c) and (d) are permissive conditions for a determination of serious prejudice? US**

71. The chapeau of Article 6.3 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or more of the following apply." The Article then goes on to detail four effects that "may" result in serious prejudice arising. Brazil's reading would re-write the chapeau of Article 6.3, changing the permissive "may" into the obligatory "shall." The ordinary meaning of "may" is "to express possibility, opportunity, or permission."[41] Therefore, the ordinary meaning of the chapeau of Article 6.3 would be that there is a "possibility" or "opportunity" for serious prejudice in the sense of Article 5(c) to arise where one or more of the effects listed in Article 6.3 is found.

72. Article 6.2 clarifies that a prerequisite for a finding of serious prejudice is that at least one of the four effects in Article 6.3 must be demonstrated. That is, Article 6.2 precludes a panel from finding serious prejudice ("serious prejudice shall not be found") if a subsidizing Member demonstrates that the subsidy has not had any of the effects listed in Article 6.3. This provided a subsidizing Member with a means to overcome the presumption created through the operation of Article 6.1 while that provision was still in effect. However, Article 6.1 demonstrates that

[40] Subsidies Agreement, Article 15.2 (italics added).
[41] *The Random House Dictionary of the English Language, Unabridged Edition* at 886 (1983).

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

73. Article 6.4 lends further contextual support to the interpretation that the use of the term "may" in the chapeau of Article 6.3 signifies that the effects listed in Article 6.3 are permissive conditions for a determination of serious prejudice. Article 6.4 states that "displacement or impeding of exports shall include any case in which, subject to the provisions of paragraph 7, it has been demonstrated that there has been a change in the relative shares of the market to the disadvantage of the non-subsidized like product." Thus, given certain situations further explained in Article 6.4, displacement or impeding of exports "shall" exist. However, Article 6.3 does not state that, given those situations, displacement or impeding of exports *resulting in serious prejudice* shall exist. That is, the situations in Article 6.4 which must result in a finding of displacement or impeding of export do *not*, by the terms of the Article, also result in a finding of serious prejudice.

74. Article 6.5 similarly defines a situation in which "price undercutting" under Article 6.3(c) "shall" be found but does not also mandate a finding of serious prejudice. Had Members intended (as Brazil contends) that a finding under Article 6.3 would necessarily suffice to demonstrate serious prejudice, one also would have expected Articles 6.4 and 6.5 to mandate a finding of serious prejudice where a finding of one of the effects under Article 6.3 is mandated.

75. Article 6.8 provides further contextual support for reading Article 6.3 as setting out certain permissive conditions that could result in a panel finding that serious prejudice to the interests of a Member exist. Article 6.8 states that, "in the absence of circumstances referred to in paragraph 7," which merely preclude a panel from finding displacement or impediment resulting in serious prejudice, "the existence of serious prejudice *should be determined* on the basis of the information submitted to or obtained by the panel" (italics added). Again, this provision does not mandate a finding of serious prejudice should one or more of the effects set out in Article 6.3 be demonstrated. Rather, it emphasizes that "the existence of serious prejudice" (rather than the existence of one of the effects in Article 6.3) "should be determined" by the panel based on the information before it. Thus, while a panel may be *precluded* from making a finding of serious prejudice (where, for example, a complaining party has only alleged displacement or impediment under Article 6.3, but one of the conditions in Article 6.7 exist), there is no currently effective provision under which a panel is *compelled* to find serious prejudice.

150. Is the list in Article 6.3 of the SCM Agreement exhaustive, or could serious prejudice arise in circumstances other than those listed in paragraphs (a) through (d)? US

76. Article 6.3 sets out four circumstances in which the effects of subsidies "may" give rise to a finding of serious prejudice. Article 6.2 establishes that "serious prejudice shall *not* be found" if a subsidizing Member demonstrates that a challenged subsidy has not resulted in any of those four effects. Therefore, Articles 6.3 and 6.2 indicate that serious prejudice may not be deemed to have arisen without at least one of the four effects listed in Article 6.3 having been demonstrated.

151. Where in the text of Article 6.3(d) of the SCM Agreement is there a basis to take into account that 1998 may be a "misleading" year for the purposes of comparison? For example, unlike the text of Article XVI:3 of the GATT 1994, there does not seem to be a general reference to "special factors". US

77. Article 6.3(d) requires that a complaining party demonstrate that the effect of a challenged subsidy is an increase in the world market share 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. Where the evidence offered by a complaining party relies in large part on abnormal production and trade data evidently caused by factors unrelated to the challenged subsidy (in the case of the United States in 1998, severe drought and record abandonment of planted acres), use of that data cannot satisfy the complaining party's burden of demonstrating causation – that is, the "effect of the subsidy."

78. Article 6.3(d) sets out a fairly mechanical two-part test: first, there must be an increase in world market share as compared to the average over the preceding period of three years. Thus, assuming *arguendo* that Brazil could challenge expired marketing year 2001 support measures, this test would compare the world market share of U.S. upland cotton in that year to the average over the preceding three years. Brazil, however, has misinterpreted Article 6.3(d) and examined the U.S. world *export* share.

79. The second part of the test is that any such increase over the average of the preceding three-year period "follows a consistent trend over a period when subsidies have been granted." The marketing year 2001 payments challenged by Brazil were first introduced for the 1996 marketing year by the 1996 Act. Thus, Brazil must demonstrate that the alleged increase in world market share follows a "consistent trend" between marketing years 1996-2001. In fact, there is no consistent trend showing an increasing U.S. world market share over this period; that world market share has been inconsistent but showing a tendency to decline over that period. As demonstrated in Exhibit US-47, U.S. world market share surpassed 20 percent in both marketing years 1996 and 1997 but has not thereafter.

80. Finally, as the United States has noted in its further submission, Brazil has limited its claim under Article 6.3(d) to alleged effects in marketing year 2001.[42] Thus, there can be no

[42]U.S. Further Submission, para. 100.

finding that challenged U.S. subsidies under the 2002 Act presently cause serious prejudice within the meaning of Article 6.3(d). As the United States has previously noted, moreover, payments with respect to marketing year 2001 expired with the granting of support in respect of the 2002 marketing year's production, which began on August 1, 2002 – that is, seven months before this Panel's terms of reference were established. The result is that Brazil is asking the Panel to make findings and a recommendation with respect to subsidies that had been replaced at the time of panel establishment and that no longer exist to be withdrawn even were a recommendation to be made.

152. If the US is correct in asserting that the Article 13(b)(ii) Agreement on Agriculture analysis is a year-by-year analysis, how would this affect the Panel's examination of Brazil's claims of serious prejudice, including the three year period and the trend period in Article 6.3(d) of the SCM Agreement? US

81. Article 13(b)(ii) exempts from action measures that, *inter alia*, conform fully to the provisions of Article 6 of the Agreement on Agriculture. Chief among those provisions is the obligation that a Member remain within its Annual and Final Bound Commitment Levels for its Aggregate Measurement of Support, a commitment that is expressed by year. Therefore, while a Member may breach the Peace Clause in a given year by exceeding its bound commitment level, that Member may in the following year not breach the Peace Clause if its domestic support measures once again do not exceed its commitment levels. Thus, to gauge whether domestic support measures have breached the Peace Clause requires a year-by-year analysis.[43]

82. The year-by-year analysis under the Peace Clause does not affect how the Panel would undertake a serious prejudice analysis; it affects only the Panel's analysis of which of the U.S. measures that Brazil has challenged may be the subject of the serious prejudice analysis. In the event, Brazil has only claimed that the effect of U.S. subsidies in marketing year 2001 was inconsistent with Article 6.3(d). Therefore, the Panel's task is first to analyze whether U.S. domestic support measures in marketing year 2001 breached the Peace Clause. If so, then the Panel would be able to undertake a serious prejudice analysis – and that second analysis is distinct from the first one. The United States has demonstrated that U.S. measures in marketing year 2001 do not grant product-specific support to upland cotton in excess of that decided during the 1992 marketing year, whether measured according to the level of support granted by those measures or a price-gap AMS calculation.

83. With respect to the two-part test of the three-year average and consistent trend over a period when subsidies have been granted, the Peace Clause would have no impact on these tests. That is, assuming *arguendo* that marketing year 2001 measures were not exempt from action, the

[43]Brazil agrees that the Peace Clause requires a year-by-year comparison. Brazil insists, however, that once a Member has breached the Peace Clause once, that Member can never thereafter regain Peace Clause protection. There is nothing in the text of the Peace Clause that supports Brazil's view on this point – nor, as a result, has Brazil pointed to any supporting text.

fact that the Peace Clause exempts from action measures for other marketing years would not preclude the Panel from examining data and evidence from those years as part of its serious prejudice analysis of the 2001 measures. The payments made in those other marketing years (that is, the marketing year 1999 measures and the marketing year 2000 measures) would be exempt from action; evidence relating to those years would not be sheltered from examination by the Panel in its serious prejudice analysis of the 2001 measures.

153. Would the conditions in Article 6.3(d) of the SCM Agreement be satisfied in respect of time periods other than the one specified? What relevance, if any, would this have for Brazil's claims? BRA

154. Does the US agree that upland cotton is a "primary product or commodity" within the meaning of Article 6.3(d) of the SCM Agreement? (ref. Brazil's further submission, para. 262) and within the meaning of Article XVI:3 of the GATT 1994? US

84. Yes.

155. Please respond to Brazil's identification of the seven-year period beginning with MY1996 (following the passage of the FAIR Act of 1996) as the "most representative period" for the purposes of Article 6.3(d)? (ref. Brazil further submission, para. 269) US

85. Brazil has challenged only those U.S. subsidies that allegedly had the effect of increasing U.S. world market share in marketing year 2001 – that is, marketing year 2001 payments. The second part of the test under Article 6.3(d) is that any increase in world market share that is the effect of the challenged subsidy over the average of the preceding three-year period "follows a consistent trend over a period when subsidies have been granted." The marketing year 2001 payments were granted under the 1996 Act. Therefore, the "period when subsidies have been granted" for purposes of an analysis of the effect of marketing year 2001 support would be the marketing year 1996-2001 period.

86. The United States believes that marketing year 2001 support cannot cause present serious prejudice because these payments expired when marketing year 2002 payments began to be made. Nonetheless, if marketing year 2001 payments are the challenged measures for purposes of Brazil's Article 6.3(d) claim, there is no basis to include marketing year 2002 within the period when subsidies have been granted. (We also note that Brazil identifies a seven-year period beginning with marketing year 1996 but presents data only for the six-year period through marketing year 2001.)

156. Does the US agree that "...footnote 17 [of the SCM Agreement] does not carve out upland cotton from the scope of Article 6.3(d) of the SCM Agreement"? (ref. Brazil further submission, para. 275). US

87. The United States is not aware of any "other multilaterally agreed specific rules apply to the trade in the product or commodity in question" within the meaning of footnote 17 to Article 6.3(d) of the Subsidies Agreement.

157. Does the reference to "trade" in footnote 17 of the SCM Agreement have any impact on the interpretation of "world market share" in Article 6.3(d)) If so, what is it? US

88. The use of the term "trade" in footnote 17 provides useful context in interpreting the phrase "world market share" in Article 6.3(d). Specifically, Article 6.3(d) speaks of an increase in a Member's "world market share," not an increase in a Member's "world trade share." By using the term "market" and not "trade," Article 6.3(d) establishes that its scope is *not* limited to cross-border movements of a primary product or commodity. That is, the "world market" for a primary product or commodity encompasses all the markets in the entire "world," including the market of the allegedly subsidizing Member. Had Members desired instead to restrict the analysis under Article 6.3(d) to cross-border shipments, they could have used the phrase "world trade share" or, in Brazil's preferred formulation, "world export share," or even (as in GATT 1994 Article XVI:3) "world export trade." They did not. Finally, we note that, rather than elaborating on the test under Article 6.3(d), footnote 17 was intended to describe those products or commodities *not* covered by Article 6.3(d) and therefore could use the term "trade."

158. Please respond to Brazil's assertion that "...the absence of any payment, production or expenditure limitations in the US marketing loan program is analogous to the EC sugar regime that was challenged in EC - Sugar Exports II (Brazil) and EC - Sugar Exports I (Australia)." (ref. Brazil further submission, para. 317) US

89. The EC sugar export regime challenged by Australia and Brazil under the GATT 1947 was manifestly different than the U.S. marketing loan program, primarily in that the challenged program was an export subsidy providing export refunds on exportable surpluses of sugar. The *Sugar Exports* panel concluded that in the particular market situation prevailing in 1978 and 1979, the EC system had caused serious prejudice to Brazil's interests because it had been applied in a manner which contributed to depress sugar prices. The panel also concluded that the lack of "pre-established effective limitations" on those export refunds and the application of that refund system "constituted a permanent source of uncertainty in world sugar markets and therefore constituted a threat of serious prejudice. The panel's finding on serious prejudice was made carefully, circumscribed by "the particular market situation prevailing in 1978 and 1979." However, the panel's finding on threat of serious prejudice was made without any explanation and apparently without argument by the parties. Therefore, it is difficult to see how the Panel could draw useful guidance from this finding by that panel or draw conclusions on relevant types of payments.

159. The EC, in its oral statement (paras 9 and 10), disagrees with the US interpretation of the terms "same market". Can the US comment on the EC's view? US

90. The United States still has difficulty with the EC view. The United States cannot understand how the "world" can be one "market" for purposes of Article 6.3(c), which by its nature calls for a comparison of the prices of the goods of one Member when competing in a market with the goods of another Member. Goods are not sold to the "world" – they are sold in the market of a particular country.

91. The EC on the other hand evidently considers that it is at least possible that the world could function as one market and therefore constitute a "same market" for purposes of analyzing whether the "effect of the subsidy" is "significant price suppression [or] depression" of the price of a non-subsidized product in the same market. For the reasons set forth in the U.S. further submission, the United States considers that such an interpretation would render the "in the same market" language inutile because the subsidized and non-subsidized products could never be found in the same geographic market and still be considered to be in the same "world market." Furthermore, under the EC's approach, a Member could be selling at a price well above another Member's price in the same country, and yet be found to be depressing prices on the "world market" due to a comparison between sales prices of the Member in one country compared to sales prices of the other Member in a different country.

92. However, the EC itself concedes that a "world market" could only be deemed to exist if there were not significant barriers to trade in the product at issue, such as customs duties, technical barriers to trade, etc. The EC's own explanation suggests that such a "world market" is unlikely to exist because of significant barriers to trade somewhere in the world. Thus, even under the EC's approach, it is not the case that there is a "world market" for upland cotton.

160. Without prejudice to the meaning of "world market share" as used in Article 6.3(d) of the SCM Agreement, can you confirm the world export share statistics provided in Exhibit BRA-206? US

93. The table below reflects most recent updates for 2002-03 and 2003-04. We caution that, as noted in the footnotes in the table, the data are drawn from different sources and data sets. Also, we have corrected data in BRA-206 for 1997-98 for total world exports, world upland exports, and U.S. export share.

World cotton exports (million bales)

Year	U.S. upland exports (1)	Total world exports (2)	ELS world exports (3)	World upland exports (4)	U.S. Share of World Exports (5)
1996-97	6.399	26.929	1.017	25.912	24.70%
1997-98	7.06	26.838	1.106	25.732	27.44%
1998-99	4.01	23.668	1.085	22.583	17.76%

1999-00	6.303	27.326	1.193	26.133	24.12%
2000-01	6.303	26.589	1.127	25.462	24.75%
2001-02	10.603	29.052	1.325	27.727	38.24%
2002-03	11.266	30.629	1.989	28.640	39.34%
Average: 98/99 - 00/01	5.539	25.861	1.135	24.726	22.40%
99/00 - 01/02	7.736	27.656	1.215	26.441	29.26%
00/01 - 02/03	9.391	28.757	1.480	27.276	34.43%

Source:
(1) USDA,Fact Sheet Upland Cotton, 2003 p.5
(2) USDA, ERS. Cotton and Wool Yearbook, 2002, p. 31; Fact Sheet Upland Outlook, USDA, Oct 2003 table 2
(3) ICAC, Cotton World Statistics, Sept. 2003, p. 7.
(4) Calculation: (2) - (3)
*(5) Calculation: (1)*100/(4)*

161. Would a finding of serious prejudice under Article 5(c) of the SCM Agreement be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the SCM Agreement in this context? BRA, US

94. Article 5(c) establishes that one of the adverse effects that a subsidizing Member should not cause to the interests of other Members is "serious prejudice," and footnote 13 to that Article states that the term "'serious prejudice to the interests of another Member' is used in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994." Therefore, "serious prejudice" under Subsidies Agreement Article 5(c) and GATT 1994 Article XVI:1 must be read to have the same meaning. As Article 5(c), and Article 6 which explains it, are the more detailed provisions on "serious prejudice" and contain a more effective remedy than the consultation envisioned under GATT 1994 Article XVI:1, the Panel's analysis should begin with the Subsidies Agreement provisions. Were the Panel to agree that Brazil has not established that the effect of the challenged subsidy is "serious prejudice" within the meaning of the Subsidies Agreement, it would be difficult to see how the Panel could then determine that "serious prejudice" exists within the meaning of GATT 1994 Article XVI:1 since the term is used "in the same sense" in these provisions.

162. Can the US confirm that marketing loan/LDP, step 2 and counter-cyclical payments are mandatory if the price conditions are fulfilled? US

95. The statutory authority for marketing loan payments, step 2 payments, and counter-cyclical payments does not provide the Secretary with the authority to arbitrarily decline to make these payments to qualified recipients. However, certain conditions must be met before these payments will be made: price conditions must be met, the producer must meet all conditions for payment, including compliance with "sodbuster" and "swampbuster" provisions and any planting restrictions, the Commodity Credit Corporation (CCC) must not have exhausted its statutory borrowing authority, and Congress must not have cut back on the program, by an appropriations bill or otherwise.

96. As the question notes, different price conditions apply to each of these payments. For example, in the case of marketing loan payments, the adjusted world price (as calculated by the Department of Agriculture) must be below 52 cents per pound. Recently, the adjusted world price has been above 52 cents per pound and thus no marketing loan payments have been made to qualified recipients.

97. There is no preset limit on the total amount of payments that can be made under each of these programs although for counter-cyclical payments a maximum total outlay can be calculated using the base acres, base yields, and maximum payment rate for each commodity produced during the historical base period. In addition, for certain recipients, per-person payment limits may apply. We also note that under Section 1601(e) of the 2002 Act, the Secretary has the authority (so-called "circuit breaker" authority) to make adjustments to farm programs because of WTO domestic support reduction commitments. Presumably, this authority could result in refusals to make certain payments.

98. Conditions for receiving counter-cyclical and marketing loan payments are numerous. The program contract for counter-cyclical payments is required by section 1105 of the 2002 Act. That section provides explicitly that the producers must agree: (A) to comply with the requirements dealing with the highly erodible cropland conservation found at 16 USC 3811 *et seq.*; (B) comply with the wetland conservation requirements found at 16 USC 3821 *et seq.*; (C) comply with the planting flexibility requirement of Section 1106 of the 2002 Act; (D) use the land representing the base acres for an agricultural or conserving use but not for a non-agricultural, commercial, or industrial use, as determined by the Secretary; and (E) control noxious weeds and otherwise maintain the land in accordance with sound agricultural practices as determined by the Secretary of Agriculture, if the agricultural or conserving use involves the noncultivation of any portion of the land as permitted under the specification just set out in (D). For marketing loans, the loan agreement and loan regulations, contained in 7 CFR part 1421, specify various conditions that must be met and followed by the producer. Under 16 USC 3811 *et seq.*, the wetland and conservation provisions cited above are made applicable to all commodity benefits, including loans.

> **163. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims ? US, BRA**

99. The United States notes that even using cost data that reflects 1997 cost structures,[44] U.S. producers appear to have been able to cover variable costs through the sale of cotton at harvest

[44] Recall that the Department of Agriculture conducted a survey of cotton farmers in 1997. For any cost data published by the Department since that time, the 1997 data has merely been updated by applying the producer price index to 'update' input costs. *See* U.S. Closing Statement at the Second Session of the First Panel Meeting, paras. 10-11.

time in every year but marketing years 2001 and (more narrowly) 2002. In this, U.S. producers were no different than Brazil's farmer witness, Christopher Ward, who stated: "But even with these high yields and the excellent quality of our land, *we were not able to fully recover all of our variable costs of production* during the 2000/01 and 2001/02 seasons[,]" a position evidently shared by most producers in Mato Grosso, Brazil's leading cotton-producing state.[45]

100. Furthermore, even in years in which U.S. producers may not have been able to cover fixed and variable costs, it does not follow that it is subsidies that covered these costs. Again, Mr. Ward explained that in marketing years 2000 and 2001, "Nor were we able to meet our total costs which include the additional fixed costs." Therefore, producers can cover costs from revenue sources other than subsidies. That harvest prices at times fall below costs does not necessarily mean that subsidies have had the effect of maintaining production.

U.S. upland cotton operating costs compared to harvest cotton price

Year	Cotton price at harvest ($/lb)	Average operating cost ($/lb)
1998	0.64	0.481
1999	0.47	0.418
2000	0.57	0.473
2001	0.35	0.447
2002	0.42	0.453

Source: USDA, Economic Research Service, Agricultural Resources Management Survey (www.ers.usda.gov/data/costsandreturns/testpick.htm)

K. CAUSATION

164. When the US points, in its oral statement of 7 October, to the alleged "bias" of Prof. Sumner's model, is it arguing that US subsidies are irrelevant to the movement in prices and production (acreage) of upland cotton? US

101. The United States recognizes that subsidies can potentially affect production and prices of upland cotton. The question is one of the nature of the subsidy examined and the degree of any predicted effect, which could range from significant to negligible. The criticisms of Dr.

[45] Statement of Mr. Christopher Ward at the Second Session of the First Panel Meeting, para. 6 (emphasis added). Mr. Ward goes on to state: "Based on my discussions with many producers relating to Mato Grosso cotton production and revenue, *I know that most other producers in State of Mato Grosso were in the same situation as we were during the 1999-2002 period.*" *Id.* (emphasis added).

Sumner's model outlined in the U.S. oral statement of October 7, 2002 take issue with many of the underlying assumptions in the model, particularly in regards to how decoupled payments were modelled and the choice of baselines used by Dr. Sumner, which have led to results that have exaggerated the impact of U.S. subsidies on world cotton markets.

165. Please comment (and submit substantiating evidence) on the US assertion that the FAPRI model has been designed and developed for prospective analysis, and is not suitable for retrospective counterfactual analysis. What is the reliability of past FAPRI-produced analyses when compared with actual data for the period covered by them? Is there any other instrument that can be used to try to identify the effect of subsidies already granted, or of their removal? BRA, US

102. FAPRI uses its models for prospective analyses; that is, they analyze the future effects of proposed program changes against a baseline that assumes current programs are in place. Recent examples of FAPRI analyses include the effects of stricter payment limitations on U.S. farmers,[46] an analysis of the European Union's 2003 CAP Reform Agreement,[47] and the effects on the U.S. dairy industry of removing current Federal regulations.[48] These analyses are forward-looking examinations of the effects of policy changes.[49]

103. Econometric modeling systems similar to the ones maintained by FAPRI and USDA are designed for prospective analyses of alternative policy assumptions. The foundation for forward-looking analyses is the baseline projections, which are conditioned on specific

[46]FAPRI. *FAPRI Analysis of Stricter Payment Limitations* FAPRI-UMC Report #05-03 June 17, 2003. 15 pp. Available at: http://www.fapri.missouri.edu/FAPRI_Publications.htm

[47]FAPRI. *Analysis of the 2003 CAP Reform Agreement.* FAPRI Staff Report #2-03, September 9, 2003. 16 pp. Available at: http://www.fapri.missouri.edu/FAPRI_Publications.htm

[48]FAPRI. *The Effects on the United States Dairy Industry of Removing Current Federal Regulations.* FAPRI-UMC Report #03-03. April 2003. 14 pp. Available at http://www.fapri.missouri.edu/FAPRI_Publications.htm

[49]FAPRI recognizes the forward-looking nature of its analyses and the limitations of those baselines quite clearly:

> Each year, FAPRI prepares a set of baseline projections that provide information about the outlook for agricultural markets, farm program spending, farm income, and a variety of other indicators. The baseline then serves as the point of comparison for analyses of alternative policy options....
>
> The baseline is not a forecast of what will happen, but rather a projection of what could happen under a particular set of assumptions. Current global policies are held in place, even when there is reason to suspect changes are likely....
>
> In reality, these assumptions are certain to be violated and actual market outcomes will differ from the deterministic baseline projections presented in the supply-demand tables....

FAPRI 2003 U.S. Baseline Briefing Book, Foreward, page 1. FAPRI-UMC Technical Data Report 04-03 (March 2003) (www.fapri.missouri.edu).

assumptions for exogenous variables, i.e., those that are independent of the modeling system. The baseline model is also conditioned to incorporate the current structure of specific commodity markets through equation specifications, elasticity estimates, and structural shift and dummy variables. As a result, the baseline models will not be appropriately structured to analyze changes over a historical period. For example, models calibrated for the current structure of the U.S. textile industry may not be appropriate to assess the structure present in the late 1990's due to the tremendous changes that have occurred. Another difficulty of using the system over a historical period is the degree of external shocks that impact the model. In prospective analysis, assessing the impacts of alternative policies occurs absent of extreme shocks from independent variables.

104. As mentioned by Dr. Sumner in Annex I to Brazil's submission of 30 September, baseline models such as the one utilized by FAPRI or USDA are not forecasting models. They are used to analyse proposed policy changes.[50] The attached table shows the forecast accuracy for year ahead price forecasts by FAPRI.

[50]For example, the U.S. Department of Agriculture explains:

The projections are a conditional scenario with no shocks and are based on specific assumptions regarding the macroeconomy, agricultural policy, the weather, and international developments. In particular, the baseline incorporates provisions of the Farm Security and Rural Investment Act of 2002 (2002 Farm Act) and assumes that current farm legislation remains in effect through the projections period. The projections are not intended to be a Departmental forecast of what the future will be, but instead a description of what would be expected to happen under a continuation of the 2002 Farm Act, with very specific external circumstances. Thus, the baseline provides a point of departure for discussion of alternative farm sector outcomes that could result under different domestic or international assumptions."

USDA Agricultural Baseline Projections to 2012. Office of the Chief Economist, U.S. Department of Agriculture.

FAPRI farm price projections for upland cotton compared to actual prices, MY1999-2003 ($/lb)

FAPRI published baseline	Marketing year	FAPRI projected price	Actual price 1/	Difference 2/
January 1998	1999/00	0.689	0.45	-0.239
January 1999	2000/01	0.531	0.498	-0.033
January 2000	2001/02	0.479	0.298	-0.181
January 2001	2002/03	0.554	0.43	-0.124
January 2002	2003/04	0.385	0.463 3/	0.078

Source: FAPRI, USDA World Agricultural Supply and Demand Estimates
1/ Marketing year average farm price reported by USDA.
2/ Actual farm price minus forecast price
3/ Average cotton farm price for August 2003. USDA is prohibited from publishing cotton price forecasts.

105. One potential approach to using a baseline model to estimate the effects of subsidies during a historical period would be to use an *ex post* prospective analysis. Under an *ex post* analysis, instead of using the current baseline for measurement, one would use a past baseline to make year-ahead projections of the effects of subsidies on the cotton market. For example, to analyze the effects of subsidies on the 1998/99 marketing year, one could use the January 1998 FAPRI baseline model to project the effects of removing subsidies and compare them to baseline levels for the 1998/99 marketing year. To analyze the 1999/00 marketing year, one would update the baseline to the January 1999 baseline and so on, until the current baseline. This would provide baseline comparisons that would reflect the estimated effects of the programs at the time of planting in each year.

166. The US states that "futures prices demonstrate that market participants predict increasing upland prices over the course of the marketing year" (US 7 October oral statement, para. 62). Please elaborate on this argument including citing specific futures prices. US

106. Exhibit US-68 shows average daily closing prices for the December 2003 cotton futures contract. Daily futures prices for December 2003 and May 2004 delivery have increased by as much as 35 percent from January 2003 levels.

107. Futures prices reflect a price that a buyer is willing to pay to secure a supply at a given price and protect against the possibility of prices rising even higher. Thus, where futures contract prices are higher than current market prices, the futures prices suggest that cotton buyers are concerned about the possibility of cotton prices rising still higher and are willing to lock in a purchase price that carries a premium over current prices.

108. In fact, current futures prices reveal that market participants anticipate upland cotton prices rising over the current 2003 marketing year.

New York Cotton Exchange, Closing Futures Prices MY03 Friday, October 24, 2003[51]	
December 2003 contract	82.11 cents per pound
March 2004 contract	84.34 cents per pound
May 2004 contract	84.50 cents per pound
July 2004 contract	84.64 cents per pound

That is, a producer may sell cotton futures for December delivery at 82.11 cents per pound, but for deliver later in marketing year 2003 the price rises to greater than 84 cents per pound. To update the information provided by the United States to the Panel in its further submission,[52] these futures prices indicate that the market expects cotton prices to remain well above their 20-year average of 67.86 cents per pound (1983-2002) within the current 2003 marketing year and well above 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.[53] Thus, given expected cotton prices reflected in futures contracts, Brazil has not demonstrated any clearly foreseen and imminent likelihood of serious prejudice. Quite the contrary: in marketing year 2003, upland cotton producers expect high and increasing prices.

167. How does Brazil react to Exhibit US-44? BRA

168. Please confirm that the production figures cited in Exhibit US-47 are for upland cotton only and do not include textiles. US

109. Yes, the production figures cited in Exhibit US-47 are for upland cotton production only. They do not include the raw cotton equivalent of textile production.

169. Can the US confirm the accuracy of the facts and figures cited in the four bullet points in paragraph 12 of Brazil's 7 October oral statement? US

110. From paragraph 12 of Brazil's 7 October oral statement:

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[51]Current futures contract prices are available at: http://www.nybot.com/cotton/ (click on "Futures").
[52]*See, e.g.*, U.S. Further Submission, para. 118.
[53]Brazil's Further Submission, para. 114, figure 6.

- *Between MY 1999-2001, prices received by U.S. upland cotton farmers fell by 34 percent, yet U.S. production increased by 20.3 percent. . . . .*

  Fact check: We can confirm the price and production figures given and would note again Brazil's selective use of marketing year 2001 as the end-point for its comparison. As Brazil complains of effects over marketing years 1999-2002, it would appear that Brazil has simply chosen to use MY2001 figures to inflate the figures it presents.

- *Between MY 1999-2002, the average U.S. upland cotton farmer would have lost 24.3 cents per pound for every pound of cotton produced if revenue were based only on market revenue. The U.S. response to this huge gap between market prices and costs was to increase production leading to an increase of U.S. exports by 78.7 percent and to an increase in the U.S. world market share from 24.1 percent to 41.6 percent. . . . .*

  Fact check: Based on Economic Research Service (ERS) estimates provided in Exhibit US-69, the market value of upland cotton (including the value of cottonseed) averaged $325.06 per acre over MY 1999-2002. Operating costs averaged $261.35 per acre over MY 1999-2002. The value of upland cotton production less operating costs averaged $63.71 per acre. Based on an average upland cotton yield of 577 pounds per planted acre, upland cotton producers received 11.05 cents per pound *above* their operating costs.

  We can confirm the export figure but note that the U.S. share of "world exports" rose from 24.1 percent in 1999/00 to 39.34 percent in 2002/03. (See U.S. response to Question 160). In addition, we note that U.S. world market share over the marketing year 1999-2002 period fell from 18.6% in MY1999 to 16.9% in MY2000, rose to 19.8% in MY2001, and fell again to 19.6% in MY2002.[54]

- *Between MY 1999-2001, the U.S. dollar appreciated approximately 15 percent against the currencies of other worldwide cotton producers. . . . U.S. exports increased by 68 percent. . . . .*

  Fact check: ERS calculates a commodity-weighted exchange rate index for upland cotton based on the real exchange rates of importing countries, weighted by the share of U.S. cotton exports.[55] Based on this index, the dollar appreciated by 6.2 percent from 1999 to 2001. ERS also calculates a commodity weighted

[54] *See* Exhibit US-47.
[55] *See* Exhibit US-69.

exchange rate index based on the currencies of other cotton producers and their share in world cotton trade. Based on this index, the dollar appreciated by 11 percent from 1999 to 2001.

Fact check: We can confirm the U.S. upland cotton export figure and again note Brazil's use of marketing year 2001 for its comparison.

- *U.S. costs of production are much higher than those of most other exporters of upland cotton, yet the U.S. export market share increased from 24.1 percent to 41.6 percent between MY 1999-2002.*

Fact check: In paras. 284 and 285 of its Further Submission of 9 September 2003, Brazil uses data from the International Cotton Advisory Committee (ICAC) to compare costs of production across countries, which represents the most complete published comparisons of costs of cotton production for major cotton producing countries. Nevertheless, even when good survey data are available for one country, using cost of production data to draw valid economic conclusions is fraught with difficulties. In fact, the ICAC specifically discourages this kind of cross-country comparison: "***Because of a number of limitations, it is not advisable to compare the costs of production among several countries at the same time.***"[56]

Fact check: Over the period 1999/00 to 2002/03, the U.S. share of world exports rose from 24.1 percent to 39.34 percent. (See U.S. response to Question 160).

170. Brazil quotes a report that states that a 10% increase in soybean prices reduces upland cotton acreage by only 0.25% (Brazil's 7 October oral statement, para. 27). Could Brazil indicate if this analysis is done on a short-run basis or a long-run basis? BRA

171. In paragraphs 22 and 23 of its further submission, we understand that the US is, in short, claiming that increased total supply (i.e. including polyester) drove prices down. On the other hand, we note that, according to the figures in the chart in paragraph 22 of the same submission, the world production of cotton during this period has basically been steady. Do all polyester fibres as represented by these figures compete directly with cotton? That is to say, do these figures for polyester fibres include, for example, those that are used for textiles that technically cannot be substituted by cotton? US

[56] M. Raffiq Chaudhry, International Cotton Advisory Committee, "Cost of Producing Raw Cotton." Presented at the III Brazilian Cotton Congress, Brazil, August 31, 2001 (emphasis added).

111. The figures in the chart in paragraph 22 represent world polyester textile production. Polyester competes with cotton either directly in the fiber market or indirectly through apparel and other intermediate products.

> **172. Please estimate the price effect, in cents per pound, of the growth in the US retail market which it is said has directly contributed to strengthening world cotton prices. US**

112. As was presented in the table in paragraph 27 of the Further Submission of the United States of 30 September 2003, U.S. retail purchases of raw cotton fiber increased from 12.3 million bales in 1990 to 20.9 million bales in 2002, an increase of 8.6 million bales. This increase accounted for the entire increase in world retail purchases of raw cotton fiber over the same period and reflects an increase at the world level of 10 percent. Based on the average demand elasticity of -0.25 used by Dr. Sumner in his analysis (see Annex 1 of Brazil's Further Submission to the Panel, para 23), an equivalent price decline of 40 percent would be necessary to generate a 10 percent increase in demand of cotton, all else held equal. Of course, this omits other factors such as supply response of world cotton producers and competition of manmade fibres. Nonetheless, it is clear that the growth in retail purchases of cotton fibres in the United States has strengthened world prices.

> **173. The US asserts that "burgeoning US textile imports … shifted the disposition of US cotton production from domestic mills to export markets" (US further submission, para. 20). A similar description appears in paragraph 33, together with the explanation that "the share of world cotton consumption supplied by US cotton has been roughly the same since 1991/92". Why have sales of US cotton for export increased and sales of cotton imported into the US increased? US**

113. The role and impact of rapidly growing U.S. textile and apparel imports is fundamental in explaining the shift in the use of U.S. cotton production from domestic mills to foreign mills. As noted at paragraphs 20 and 33 of the U.S. further submission, the U.S. textile and apparel industry has suffered from declining competitiveness compared with off-shore producers for many years, reflecting many factors, including higher wage costs, a strong U.S. dollar, etc. As domestic mills have shut down in the United States, and production has moved overseas, domestic demand for U.S. cotton by domestic mills has declined sharply.

114. But U.S. consumer demand for cotton products has not declined. That demand has increasingly been met by lower-priced imports of cotton textiles and apparel. As can be seen in the table following paragraph 34 of the U.S. further submission, U.S. imports of cotton textiles (in cotton equivalents) have more than tripled since 1990. It is important to note that the import, export, and consumption data in that table are expressed in bales of cotton-equivalent. In other

words, the data are not "sales of cotton imports," but rather represent the amount of cotton imbedded in the particular products.[57]

115. U.S. cotton is grown to be used to make cotton textiles and apparel. The point of the U.S. submission is to explain how the location of where U.S. cotton is manufactured into products has shifted. U.S. and world consumers continue to purchase cotton products. But increasingly U.S. consumers purchase those cotton products, made from exported U.S. cotton, from overseas manufacturers as U.S. manufacturers are less able to compete. That is the structural transformation that paras. 33-34 and the accompanying table seeks to present and explains at least in part some of the changes in U.S. exports.

174. How, if at all, did the Asian financial crisis affect the United States' world market share? Did it disproportionately affect the US as compared to other exporters? US

116. The Asian financial crisis disrupted cotton consumption (spinning) in the major consuming countries of Thailand, Indonesia, and the Republic of Korea in 1997/98, reducing their mill use 9 percent from the preceding year. In addition, the decline in world economic growth induced by the crisis reduced total world cotton consumption 3.4 percent in 1998/99 from the pre-crisis level in 1996/97. Subsequently, however, the depreciation of currencies in these three countries boosted their cotton consumption due to expanding textile exports. World cotton consumption rose 11 percent between 1996/97 and 2002/03, while consumption in Thailand, Indonesia, and Korea collectively rose 16 percent. During this same period, U.S. spinners lost market share to textile imports, due in large part to currency effects, and U.S. domestic mill use fell 35 percent.

117. U.S. export share in these markets is influenced by total supply availability, qualities produced, and price. For example, U.S. export share of the three countries' consumption fell by more than half in 1998/99, due to the drought-devastated U.S. crop. Export share has since returned to the pre-crisis level of about 30 percent and, with higher consumption, this added about 400,000 bales to U.S. exports between 1996/97 and 2002/03. Since the combined total consumption increase for Thailand, Indonesia, and Korea was about 800,000 bales, this indicates that other exporters also increased exports by about 400,000 bales. As U.S. mill use of cotton declined while exports increased, U.S. world market share was left relatively unchanged (with a slight downward bent) by the Asian financial crisis.

175. With reference to paragraphs 57-58 and the related table on page 21 of the US further submission, could you please clarify the arguments regarding the ratio of

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[57] These estimates of the "cotton equivalent" of textile imports are done by USDA's Economic Research Service, based an a set of internationally-accepted conversion factors. See Cotton and Wool Situation and Outlook Yearbook. Market and Trade Economics Division, Economic Research Service. U.S. Department of Agriculture, November 2002, CWS-2002.

the soybean futures to the cotton futures prices since in the table the inverse ratio is used? US

118. Attached is a corrected version of the table. The ratio of cotton futures price to soybean futures prices is positively correlated with movement in planted cotton area.

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	10.87	14.4
1997	76.82	6.97	11.02	13.6
1998	72.13	6.64	10.86	13.1
1999	60.32	5.11	11.8	14.6
2000	61.31	5.32	11.52	15.3
2001	58.63	4.67	12.55	15.5
2002	42.18	4.50	9.37	13.7
2003	59.6	5.26	11.33	13.5

176. With reference to Figure 4 of Brazil's Further Submission, how does Brazil explain the apparent decrease in prices in 2001 and the increase of the A-Index in recent months, despite the continued use of US subsidies on upland cotton? BRA

177. Could the United States further elaborate on paragraph 50 of its 7 October oral statement? US

119. Lin et al. estimated that the own-price elasticity of cotton acreage under the FAIR Act was 0.466.[58] This is identical to the 2003 net-return elasticity reported by Dr. Sumner. However, it is incorrect to equate a price elasticity to net-return elasticity given the linear specification utilized by Dr. Sumner. The implied price elasticity from Dr. Sumner's model would be approximately 50% larger than the net-return elasticity. Larger elasticities imply greater acreage shifts to change in policies or prices.

120. The relationship between the price elasticity and a net revenue elasticity can be shown as follows. Given a linear specification as described by Dr. Sumner, then cotton area (CA) can be expressed:

(1) $CA = a_0 + a_1*CNR + a_2*Z$,

[58] Lin, W., P.C. Westcott, R. Skinner, S. Sanford, and D.G. De La Torre Ugarte. *Supply Response Under the 1996 Farm Act and Implications for the U.S. Field Crops Sector.* U.S. Department of Agriculture, Economic Research Service, Technical Bulletin No. 1888, Appendix table 21.

where CNR is Expected Cotton Net Returns and Z is a vector of other variables including returns from competing crops.

The elasticity with respect to CNR is found by differentiating the equation with respect to CNR. The derivative is the coefficient a_1. The elasticity, e_{NR}, is expressed as follows:

(2) $e_{NR} = a_1 * CNR / CA.$

With CNR a function of the cotton price P, the elasticity with respect to P can be determined by taking the derivative of the equation with respect to price P. Based on equation (1) from page 13 of Annex I, the derivative with respect to price P is a_1*Y, where Y is expected yield.

It follows that the price elasticity is $e_P = a_1 * Y * P / CA$. One can then conclude that eNR/eP = ENR / (Y*P).

The relationship between e_{NR} and e_P can be found by looking at the relationship between CNR and Y*P. Specifically, $e_P = ((Y * P) / CNR) * e_{NR}$.

In recent years, the ratio of (Y * P) / CNR has been approximately 1.5, implying that $e_P = 1.5 * e_{NR} = 1.5 * 0.466 = 0.699$.

178. The Panel notes Exhibit US-63. Could the US please provide a conceptually analogous graph concerning US export sales during the same period? US

121. Exhibit US-70 shows in table and graph form the percent change over the previous year for upland cotton exports by the United States and the rest of the world. In addition, the United States provides in Exhibit US-71 a table and graph demonstrating the absolute levels of U.S. exports and domestic consumption. As the figures show, over the last seven years domestic consumption has declined by almost the same amount by which exports have increased, leaving U.S. world market share largely unchanged.

179. Could Brazil comment on the argument that decoupled payments and other subsidies to upland cotton are largely being capitalized into land values and that removing these subsidies would reduce the cost of production of upland cotton producers (US 7 October oral statement, para. 48). What would be the net effect of these adjustments? BRA

180. Please describe the precise formula as to how USDA determines the "adjusted world price" using the Liverpool A-Index, the NY futures price and any other relevant price indicators. Please submit substantiating evidence. BRA, US

122. The Adjusted World Price (AWP) is equal to the Northern Europe (NE) price (the 5-day average of the 5 lowest-priced growths for Middling 1-3/32 inch cotton, cost, insurance and

freight [CIF] northern Europe), adjusted to U.S. base quality and average location. The AWP for individual qualities is determined using the schedule of loan premiums and discounts and location differentials. A "coarse count adjustment" (CCA) may be applicable for cotton with a staple length of 1-1/32 inches or shorter and for certain lower grades with a staple length of 1-1/16 inches and longer. The AWP and CCA are announced each Thursday.[59]

123. A Step 1 adjustment to the AWP may be made when the 5-day average of the lowest U.S. growth quote for Middling 1-3/32 inch cotton, CIF United States-northern Europe (USNE) price, exceeds the NE price and the AWP is less than 115 percent of the loan level. The Secretary of Agriculture may lower the AWP up to the difference between the USNE price and the NE price. A Step 1 adjustment has never been made, although the conditions have been met many times.

181. Please provide a side-by-side chart of the weekly US adjusted world price, the Liverpool A-Index, the NY futures price, and spot market prices from 1996-present. What, if anything, does this reveal? BRA, US

124. Exhibit Q181 sets out weekly price movements for the Adjusted World Price, the Liverpool A Index, the nearby New York cotton futures price and the spot market price from January 1996 to present.

182. Please explain why the US can be taken to be price leaders, or price setters, (and not just takers) when US producers receive large subsidy payment to support the difference between world prices and their own costs? BRA

L. ARTICLE XVI OF GATT 1994

183. Why does Brazil believe that the appropriate "previous representative period" is the term of the previous Farm Bill, MY1996-2002? (Brazil's further submission, para. 282) BRA

184. Why does Brazil believe that an "equitable share" is one which factors out all subsidies? To the extent that domestic support and export subsidies are permitted by the Agreement on Agriculture, why should they not be accepted as being normal conditions in analyzing an equitable market share? (See Brazil's further submission, paras 288-289) BRA

185. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the Agreement on Agriculture and the disciplines on prohibited

[59] *See* Exhibit US-72.

export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the SCM Agreement. BRA, US

a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on *export subsidies*" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions of the Agreement on Agriculture, relevant?

125. As indicated in the U.S. opening statement at the recent panel meeting,[60] GATT 1994 Article XVI:3 applies only to export subsidies. Paragraph 3 is found in Part B of Article XVI, entitled "Additional Provisions on Export Subsidies," as opposed to Part A, which is entitled "Subsidies in General." Paragraph 2 (also in Part B) states that "[c]ontracting parties recognize that the granting of a *subsidy on the export* of any product may have harmful effects for other contracting parties" (emphasis added). Paragraph 3 begins with the word "[a]ccordingly," the ordinary meaning of which is "[i]n accordance with the logical premises; correspondingly,"[61] and follows with "contracting parties should seek to avoid the use of *subsidies on the export* of primary products" (emphasis added). That is, "in accordance with" the recognition in paragraph 2 that export subsidies may have harmful effects, paragraph 3 address the use of "subsidies on the export of primary products." The second sentence of paragraph 3 follows this hortatory statement with the obligation not to apply subsidies "which operate[] to increase the export of any primary product" in a manner that "results in a contracting party having more than an equitable share of world export trade in that product." Paragraph 4 "[f]urther" addresses export subsidies for "any product other than a primary product." Thus, the text and context of paragraph 3 indicate that this provision is addressed to export subsidies and not domestic support programs.

126. The Peace Clause provides further context supporting this interpretation. Article 13(c)(ii) exempts export subsidies that conform fully with Part V of the Agreement on Agriculture from, *inter alia*, "actions based on Article XVI of GATT 1994" – that is, including Article XVI:3 on export subsidies. Article 13(b)(ii), on the other hand, exempts conforming domestic support measures from, *inter alia*, "actions based on paragraph 1 of Article XVI of GATT 1994" but does not mention Article XVI:3. Thus, Article 13 lends contextual support to the notion that Article XVI:3 applies to export subsidies on primary products or commodities but does *not* apply to domestic subsidies on such products.

b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the SCM Agreement, or in any other provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in US-FSC, para. 117 here?

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[60]U.S. Opening Statement at the Second Session of the First Panel Meeting, para. 60.

[61]*The New Shorter Oxford English Dictionary*, vol. 1, at 15 (1993 ed.) (third definition).

127. Article 6.3(d) of the Subsidies Agreement does not, by its terms, interpret or replace GATT 1994 Article XVI:3. In fact, the range of measures potentially actionable under Article 6.3 is broader than the export subsidies subject to GATT 1994 Article XVI:3. In addition, the analysis under these two provisions is different. Article 6.3(d) is concerned with whether the effect of a subsidy is to increase the world market share of the subsidizing Member; GATT 1994 Article XVI:3 is concerned with whether export subsidies result in a Member having "more than an equitable share in world export trade" in a particular product. However, an important similarity between these two provisions is the scope of products covered by their respective disciplines. GATT 1994 Article XVI:3 is concerned with export subsidies on primary products; Article 6.3(d) is concerned with any subsidy on "a particular subsidized primary product or commodity." This similar product coverage resulted because Members desired to provide more operationally effective subsidies disciplines with respect to these products but had found the "more than equitable share" language of GATT 1994 Article XVI:3 to be unworkable. For further discussion, please see the U.S. response to Question 186 from the Panel.

c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the SCM Agreement and the prohibition on subsidies contingent upon export in Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?

128. The United States notes the Appellate Body's discussion of relevant differences between the provisions of the Subsidies Agreement and those of GATT 1994 in *United States – FSC*.

186. Could the United States please expand upon its statement that "[t]hese are the types of considerations that led to the negotiation of the Subsidies Agreement...." (US further submission, para. 109)? Is there any relevant material, including, for example, drafting history that might support this statement? US

129. Dissatisfaction with the difficulties in applying the "more than equitable share" standard of GATT 1994 Article XVI:3 was an important motivation for the negotiation of stronger and more operational disciplines in the WTO Subsidies Agreement. In two separate challenges in 1979 and 1980 to the sugar export subsidy program of the European Communities by Australia and Brazil, panels were unable to find that the export refunds provided by the Communities resulted in a "more than equitable share" of world export trade.[62] Similarly, in the 1983 U.S. challenge to export subsidies on wheat flour by the European Communities (quoted in the U.S. further submission), "[t]he [p]anel found that it was unable to conclude as to whether the increased [EC] share [of world exports of wheat flour] has resulted in the EEC 'having more than an equitable share' in terms of Article 10 [of the Subsidies Code], in light of the highly artificial

[62] *European Communities – Refunds on Exports of Sugar*, L/4833, 26S/290 (adopted 6 November 1979) (complaint by Australia); *European Communities – Refunds on Exports of Sugar*, L/5011, 27S/69 (adopted 10 November 1980).

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.'"[63]

130. Significantly, the latter two of these panel reports explicitly considered the 1979 Tokyo Round Subsidies Code and its interpretive gloss on the "more than equitable share language." Article 10.2 of the 1979 Subsidies Code (of which both Brazil and the United States were signatories) stated, in pertinent part:

> For purposes of Article XVI:3 of the General Agreement and paragraph 1 above:
>
> (a) "more than an equitable share of world export trade" shall include any case in which the effect of an export subsidy granted by a signatory is to displace the exports of another signatory bearing in mind the developments on world markets;
>
> (b) with regard to new markets traditional patterns of supply of the product concerned to the world market, region or country, in which the new market is situated shall be taken into account in determining 'equitable share of world export trade'[.]

That is, the 1979 Subsidies Code represented an effort to make operational the discipline provided in GATT 1994 Article XVI:3 by giving additional meaning to the phrase "more than an equitable share of world export trade." Despite that effort, however, the panel considering the Brazilian challenge to EC sugar export subsidies and the panel considering the U.S. challenge to EC wheat flour export subsidies remained unable to find any inconsistency with GATT 1994 Article XVI:3 (in the words of the Wheat Flour panel) "in light of . . . , most importantly, the difficulties inherent in the concept of 'more than equitable share.'"

131. Thus, there was a recognition in the Uruguay Round subsidies negotiations that the effort in the 1979 Subsidies Code to make GATT 1994 Article XVI:3 more operationally effective had not succeeded. For example, a reference paper on GATT subsidies rules and the existing status of discussion of these rules prepared by the GATT Secretariat for the Negotiating Group on Subsidies and Countervailing Measures states:

> The most pronounced difficulties have occurred in connection with the concept of "more than an equitable share" embodied in Article XVI:3 of the GATT. The Agreement on Subsidies and Countervailing Measures (Article 10) attempted to

[63] *European Economic Community – Subsidies on Export of Wheat Flour*, SCM/42, para. 5.3 (unadopted 21 March 1983).

> bring precision to Article XVI:3 but it has not always been found to give clear guidance on its interpretation. Consequently a number of disputes involving the concept of "more than an equitable share" have not found a satisfactory solution and in some cases have provoked retaliatory subsidization. The case-by-case application of this concept has revealed its imprecisions and the fact that it largely refers to notions which escape objective criteria. There is, for example, sufficient imprecision in this concept to allow countries using export subsidies to argue that these subsidies do not result in obtaining more than equitable share. On the other hand it is not always possible to provide causality between the subsidy and the increase share. Furthermore, it is impossible to derive a general line of case law from the decisions of panels, some of which have given divergent interpretations.[64]

132. A checklist of issues for the negotiations based on Contracting Parties' written submissions and oral statements prepared by the Secretariat demonstrates that Contracting Parties were well aware of these difficulties and the need to move away from the "more than an equitable share" concept:

> There is a need for review, with a view to improving GATT disciplines, of the provisions of Article XVI:2 and 3. Notably there is a need to build on the recognition embodied in Article XVI:2 and the exhortation in the first sentence of XVI:3 in the direction of improving the conditions of competition on world markets for primary products currently covered by the equitable share criterion in the second sentence of Article XVI:3.
>
> The review should examine the application of the "more than an equitable share" rule for primary products. This rule has serious conceptual flaws and in practice has failed to provide clear guidance as to the permissible scope of primary product subsidization. . . . .
>
> The Negotiating Group should consider negotiating a similar prohibition to that of Article 9 of the Code on the use of export subsidies for forest, fishery and farm products.
>
> The prohibition on export subsidies for products other than basic or primary products under Article XVI:4 and Article 9 of the Code should be extended to agricultural, forestry and fishery products, in other words to all basic or primary products.

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[64] *Subsidies and Countervailing Measures: Note by the Secretariat*, MTN.GNG/NG10/W/4, at 79 (28 April 1987) (Section VI.3).

> A major objective of these negotiations should be to extend the existing prohibition on export subsidies to cover all products, primary as well as non-primary.
>
> There are serious deficiencies in Article XVI:3 of the GATT and in Article 10 of the Code, notably the fundamental problems connected with the 'more than equitable share' concept. However, these problems arise from the basic fact that current disciplines for primary products are significantly weaker than those which apply to manufactured goods. They cannot be resolved merely by making minor adjustments to rules which are intrinsically defective. The only genuine, long-term solution is an effective prohibition on all export subsidies. Accordingly at this stage of the negotiating process, there is little value in trying to improve the "more than equitable share" rule, which is only relevant so long as there is no general prohibition on export subsidies.[65]

133. Reflecting the desire of Members to move away from the "more than an equitable share" concept which had repeatedly been found by panels to be incapable of application, the WTO Subsidies Agreement does not provide any further definition or interpretation of GATT 1994 Article XVI:3. Instead, it contains the general prohibition on export subsidies in Article 3 and rules on adverse effects, including serious prejudice.

M. THREAT CLAIMS

187. Please provide USDA's projections of marketing loan/LDP payments, direct payments and counter-cyclical payments to be made during MY2003 through 2007 based on the most recent USDA baseline projection. US

134. The following table shows projections for cotton marketing loan/LDP payments, direct payment and counter-cyclical payments for crop years 2003 through 2008, as published in the FY2004 Mid-Session Review on July 15, 2003. We note that projected outlays for marketing year 2003 are likely to be significantly overstated given the increase in prices and futures prices over the course of this marketing year. For example, no marketing loan payments are currently being made because the adjusted world price is above the marketing loan rate.

Projected outlays (million dollars)

Item	2003	2004	2005	2006	2007	2008
Direct payments	587	587	587	587	587	587

[65] *Checklist of Issues for Negotiations: Note by the Secretariat*, MTN.GNG/NG10/W/9/Rev.4, at 26-28 (12 December 1988).

Counter-cyclical payments	929	602	521	521	521	521
Loan deficiency payments	420	298	193	137	137	82
Marketing loan gains	22	13	8	6	6	3
Certificate gains 1/	196	114	75	55	52	29

1/ Includes value of non-cash marketing loan transactions.

188. Can the United States comment on the FAPRI projections for cotton provided in Exhibit BRA-202? US

135. The FAPRI projections presented by Brazil in Exhibit BRA-203 reflect the January 2003 FAPRI projections. These projections were published by Iowa State University in January 2003.[66] The same projections were published by FAPRI at the University of Missouri in March 2003 and were referenced by the United States in Exhibit US-52.

136. Of significance is the difference between the January 2003 baseline and the preliminary baseline of November 2002 utilized by Dr. Sumner in his analysis. Under the January 2003 baseline, the Adjusted World Price (AWP) forecasts for 2002/03 to 2007/08 are considerably higher than the forecasts made in the preliminary November 2002 baseline. Because loan deficiency payments and marketing loan gains are calculated based on the difference between the loan rate and the AWP, this means that expected marketing loan subsidies under the November 2002 baseline are far higher than expected marketing loan subsidies under the January 2003 baseline. Thus, the effects of eliminating marketing loans would tend to be biased upwards using the preliminary November 2002 baseline.

[66]Food and Agricultural Policy Research Institute. *FAPRI 2003: U.S. and World Agricultural Outlook.* Iowa State University Staff Report 1-03. January 2003.

Differences in the Adjusted World Price forecast between the November 2002 and January 2003 FAPRI baseline ($/lb)

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
November 2002 baseline 1/	0.3597	0.3722	0.3983	0.4194	0.436	0.4548
January 2003 baseline 2/	0.448	0.454	0.46	0.46	0.467	0.48
Difference	0.0883	0.0818	0.0617	0.0406	0.031	0.0252

1/ As presented by Dr. Sumner in Annex I and oral statement of 7 October 2003.
2/ As reported in Exhibit BRA-203 and Exhibit US-52

N. CLARIFICATIONS

189. Please indicate whether the correct figure in paragraph 37 of Brazil's 7 October oral statement is 38.1% or 38.3%? BRA

190. Please confirm that the figure "17.5" in paragraph 43 of Brazil's 7 October oral statement, is "percentage point". BRA

191. Could Brazil clarify its statement in para. 12 of its 9 September further submission: "Alternatively crop insurance is not specific because the 2000 ARP Act denies benefits to commodities representing more than half of the value of US agriculture. Further US crops represent only 0.8 per cent of total US GDP." (emphasis added) BRA

List of Exhibits

US-64	Lin, W., et al.. Supply Response Under the 1996 Farm Act and Implications for the U.S. Field Crops Sector. U.S. Department of Agriculture, Economic Research Service, Technical Bulletin No. 1888, Appendix table 21
US-65	Amount and percentage of upland cotton acreage coverage by crop insurance policy
US-66	Premiums paid by upland cotton producers
US-67	Insurance indemnity payments to upland cotton producers
US-68	New York Cotton Futures, Average Daily Closing Prices for December 2003 Contract (chart and data)
US-69	U.S. Department of Agriculture, Economic Research Service, Cost of Production Estimates; Commodity-Weighted Exchange Rate Estimates
US-70	U.S. and Rest of World Exports of Upland Cotton, Year-Over-Year Percent Change, 1996-2002
US-71	U.S. Exports and Domestic Consumption of Upland Cotton, 1996-2002
US-72	U.S. Department of Agriculture, Press Release on Adjusted World Price (18 October 2003)
US-73	Weekly Price Movements: Adjusted World Price, Liverpool A-Index, New York cotton futures, spot market price, January 1996 to present
US-74	National Agricultural Statistics Service, Planted Acreage of Selected Crops by Region and State