United States – Subsidies on Upland Cotton:
Arbitration Under Article 22.6 of the DSU
and Article 4.11 of the SCM Agreement
(WT/DS267)

United States – Subsidies on Upland Cotton:
Arbitration Under Article 22.6 of the DSU
and Article 7.10 of the SCM Agreement
(WT/DS267)

Written Submissions of the United States

December 9, 2008

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I.   Introduction

1.   The Submission by Brazil Concerning the Methodology for the Calculation of Countermeasures ("Brazil Methodology Paper") sets out how Brazil reaches the huge sums for the countermeasures for which it is requesting authorization from the DSB. Despite the vast number of pages Brazil has submitted, its Methodology Paper fails to support its requests to suspend concessions.

2.   With respect to prohibited subsidies, Brazil's Methodology Paper requests the Arbitrators to find that authorization for a staggering $1.644 billion in countermeasures would be appropriate. Brazil's request to the DSB for authorization to suspend concessions for prohibited subsidies was made in July 2005. The DSB's recommendations and rulings concerning prohibited subsidies covered export credit guarantees under three programs, GSM 102, GSM 103, and SCGP, and the Step 2 program payments. All of these were included in Brazil's request.[1] After the DSB adopted its recommendations and rulings, the United States made fundamental changes in respect of all of these programs.   The United States stopped providing guarantees under GSM 103 and SCGP in 2005.[2] The United States then repealed Step 2 by legislation in 2006. Of the programs covered by the original panel's findings on prohibited subsidies, only export credit guarantees under a modified GSM 102 program remain.

3.   The $1.644 billion in countermeasures brazil seeks consists of two parts: $1.294 billion in annual countermeasures for GSM 102 and $350 million for an unprecedented one-time payment for the repealed Step 2 program. Neither number withstands scrutiny.

4.   With respect to GSM 102, Brazil has taken an approach that is untethered from the DSB's recommendations and rulings and finds no basis in the findings of the original panel or the compliance panel. The reports adopted by the DSB in the *Cotton* proceedings found that the United States was providing export subsidies under the standard set out in item (j) of the Illustrative List of Export Subsidies in Annex I of the Agreement on Subsidies and Countervailing Measures ("*SCM Agreement*"). It is that standard, therefore, that is of relevance to the Arbitrators in determining the level of any appropriate countermeasures. In spite of this, in these arbitrations, Brazil asks the Arbitrators adopt an entirely unrelated approach that was not accepted during the earlier proceedings. Moreover, the approach that Brazil takes includes fundamental errors with respect to the use of the U.S. Department of Commerce approach for calculating benchmark interest rates, imputation of creditworthiness classification for obligors, determination of which borrowers are creditworthy, and other errors that are fatal to use of its calculations. Brazil's approach also would allow Brazil to take countermeasures for the operation of the GSM 102 guarantees throughout the world, without regard to the particular impact on Brazil, if any.

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[1] WT/DS267/21.

[2] As of July 1, 2005 for GSM-103 and October 1, 2005 for SCGP. (Appellate Body Report, *US - Upland Cotton (21.5),* para. 258; *Upland Cotton (21.5)*, paras. 3.16, 14.119).

4.   In contrast, the finding that the GSM 102 program confers an export subsidy was made solely "by applying the standard set out in item (j) of the Illustrative List" of Export Subsidies,[3] the United States offers an alternative approach to calculate the extent of any prohibited subsidy, based on the net cost of the GSM 102 guarantees to the United States government. This approach examines the U.S. budget data depicting the subsidy net of re-estimates that the Appellate Body has indicated are "an important indicator of the revised GSM 102 program's likely future performance."[4] The most recent data published in U.S. budget documents show that as of July 1, 2005, the GSM 102 program has operated at no net cost in the long term.

5.   With respect to Step 2, Brazil's request fails as a legal matter. It is not disputed that the Step 2 program has been repealed and the United States is now in compliance with respect to all rulings and recommendations of the DSB with respect to Step 2. Thus, there is no basis to impose countermeasures of any kind.

6.   For actionable subsidies, Brazil's Methodology Paper asks for $1.037 billion in annual countermeasures. This is the total amount that Brazil requested, with respect to one year, in its October 2005 request to the DSB for authorization to impose countermeasures for actionable subsidies. The $1.037 billion figure included countermeasures for all of the findings of the original panel, and noted not only marketing loan and counter-cyclical payments but also market loss assistance payments and Step 2.[5] The situation has fundamentally changed since that time. The United States repealed the Step 2 program by legislation, with payments ending in July 2006, and the last market loss assistance were made in respect of Marketing Year 2001. Moreover, in the time leading up to Brazil's request to resume arbitration, these payments fluctuated, at times dropping to very low levels.

7.   Brazil bases the calculation for countermeasures for actionable subsidies on a flawed model it used before the compliance panel. As a result, Brazil's use of this model is raises serious issues, as described below. In addition, there are legal errors in the way Brazil has used the model, including its failure to limit its request to the adverse effects of marketing loan and counter-cyclical payments on Brazil alone. Brazil's request for countermeasures far exceeds what would be permissible as countermeasures even using its own calculation of the total effects of marketing loan and counter-cyclical payments.   The United States has made corrections to Brazil's approach, and with these corrections it is clear that countermeasures commensurate with the nature and degree of the adverse effects of marketing loan and countercyclical payments must be less 30.4.

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[3]Appellate Body Report, *US - Upland Cotton (21.5),* para. 260.

[4]Appellate Body Report, *US - Upland Cotton (21.5),* para. 299.

[5]WT/DS267/26.

8.   Finally, Brazil's request for countermeasures in TRIPS and GATS should not be
authorized. Brazil offers no explanation for how it has met the specific requirements of Article
22.3 of the DSU with respect to cross-sectoral suspension of concessions. Nor could it. With an
economy of the size and diversity of Brazil's, it would be possible to suspend concessions in the
entire amount Brazil requested without resort to suspension of concessions in sectors entirely
unrelated to cotton.

II.   Brazil's Methodology Paper Does Not Support Appropriate Countermeasures Under DSU 4.10

9.   Brazil's request for large countermeasures against the GSM 102 program must be
considered in the context of the current upheaval in world credit markets and the importance of
credit availability.

10.   The WTO Secretariat has recently noted "the effects of the current banking and financial
crisis on international trade have been felt directly through the tightening of the market for trade
finance (letters of credit, credit lines, insurance and guarantees."[6] In the WTO Expert Group
Meeting on Trade Finance held on November 12, 2008, in light of current conditions in trade
finance markets, one of the "key problems identified" was "a shortage of liquidity to finance
trade credit, which translated into unusually high spreads for customers."

11.   Brazil itself has noted "the difficulties encountered by its exporters in accessing trade
finance facilities."[7]   Banks in Brazil use the guarantees through GSM 102 to facilitate
transactions – in fact, Brazil itself is one of the major participants in the GSM 102 program.

12.   Historically, "a significant share of the market is serviced by national export credit and
investment insurance agencies (e.g. ExIm banks.)."[8] The United States' Commodity Credit
Corporation is of course one of those. The participants in the Expert Group approvingly noted
that the Berne Union, the primary international organization of public and private sector
providers of export credits and investment insurance,[9] reported that export credit agencies "had

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[6] Trade Financing and the Financial Crisis, Background Note by the Secretariat,
Job(08)/111 (3 November 2008).

[7] WT/WGTDF/W/39.

[8] Trade Financing and the Financial Crisis, Background Note by the Secretariat,
Job(08)/111 (3 November 2008), para. 7.

[9] http://www.berneunion.org.uk/.

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increased their business by more than 30 percent in the last twelve months, with a recent acceleration" "to respond to this difficult situation."[10]

13.   The participants succinctly exhorted export credit agencies and their governments to provide more, not less: "As to what [is] needed to be done in the future, the priority task was to enhance capacity to mitigate the effects of increased perception of risks and to provide the market with earmarked liquidity for trade finance. Both the international financial institutions and export credit agencies had possibilities to expand their contributions to cover risk and provide additional liquidity under existing instruments, although this would not happen without public authorities stepping in to provide them with more support. As to the coverage of the estimated liquidity gap, commercial banks generally believed that it could be filled reasonably comfortably through increased co-sharing partnerships with international financial institutions and export credit agencies to the extent that the trade and finance and insurance programmes of these institutions are supported by their shareholder governments."[11]

14.   In this climate, countermeasures of the order Brazil proposes could run counter to important policy goals.   A continuing irony of this dispute is that Brazil itself is one of the major participants in the GSM 102 program. Albeit deriving its calculations erroneously, Brazil completely coincidentally correctly ascribes 54 percent of the share of the South America region to itself.[12] In 2006, Brazilian banks participated in over $76 million of GSM 102 transactions or about 5.6 percent of the total program.[13]

A.   Brazil's Countermeasures Must be Based on the Cost to Government Given the Limited Scope of the Panel's Findings Concerning Prohibited Subsidies

15.   With respect to prohibited subsidies, pursuant to Article 4.10 of the *SCM Agreement* the role of the Arbitrators is to determine the level of "appropriate countermeasures" to be

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[10] Expert Group Meeting on Trade Finance - 12 November 2008, Note by the Secretariat, WT/WGTDF/W/40 (18 November 2008), para. 5.

[11] Expert Group Meeting on Trade Finance - 12 November 2008, Note by the Secretariat, WT/WGTDF/W/40 (18 November 2008), para. 7. Among the participant was BNDES, the Brazil Development Bank (para. 1 refers to BNES, which the United States believes is a typographical error.) BNDES is associated with the Brazilian Ministry of Industry, Development and Foreign Trade. http://www.bndes.gov.br/english/thecompany.asp

[12] Exhibit Bra-0695, Worksheet 1.

[13] Brazil's share of the Caribbean Region was about 20.7% and about 13.5 % of the Central America Region.

authorized. Footnote 9 of the *SCM Agreement* further specifically clarifies that the expression "appropriate countermeasures" "is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited."

16.   In that context, with particular focus on assigning countermeasures that are appropriate to the finding made, the Arbitrators should recall the limited scope of the adopted findings in this dispute with respect to prohibited subsidies. As explained below, the compliance panel's findings were narrow in several ways. Most importantly though, the DSB's recommendations and rulings in this dispute are based only on findings that the United States conferred export subsidies via GSM 102 because the program operated at a net cost to the U.S. government – that is, that the premiums charged were inadequate to cover the program's long-term operating costs and losses. The original and compliance panels both declined Brazil's request to make findings based on some alternative theory of why these subsidies were financial contributions that provide a benefit based on export performance.[14] Given the particular rulings in this case, appropriate countermeasures should be tightly tied to the specific standard underlying the findings adopted by the DSB. As the United States explains below, the GSM 102 operates at no net cost to government.

17.   It is also important to underscore that it would not be appropriate for Brazil to impose countermeasures for any calculation for GSM 102 that covers the world. If Brazil were permitted to do so, it would create a difficult situation with respect to other Members' interests. The first Member to bring an issue to the WTO might seek countermeasures for a subsidy without regard to the subsidy's impact on that Member, and any subsequent countermeasures by another Member would be duplicative and potentially punitive.

1.   Findings of the Compliance Panel

18.   The compliance panel's findings were circumscribed. First, although three export credit guarantee programs were at issue before the original panel (the Supplier Credit Guarantee Program, the GSM 103 program, and the GSM 102 program), only GSM 102 was at issue before the compliance panel, and its findings involve only that program.[15]

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[14]Appellate Body Report, *US - Upland Cotton (21.5),* para. 260, fn. 525. As to the U.S. arguments in this regard, *see generally, e.g.,* U.S. Rebuttal Submission, paras. 134-170; *Upland Cotton (Panel)*, para. 6.31; Appellate Body Report, *US - Upland Cotton*, para. 732.

[15]*Upland Cotton (21.5),* para. 15.1(c).

19.   Second, the findings are specifically limited in time to "export credit guarantees issued after 1 July 2005."[16]

20.   Third, not all GSM 102 export credit guarantees issued after 1 July 2005 constitute prohibited export subsidies. As the compliance panel noted: "the United States' export subsidy commitments [with respect to goods within the product coverage of the *Agreement on Agriculture*] vary depending on whether scheduled or unscheduled products are at issue. For unscheduled products, 'circumvention' will occur if any export subsidies (in the form of GSM 102 export credit guarantees) are provided in respect of any quantity of exports of the product in question. For scheduled products, 'circumvention' will occur if the United States provides export subsidies to volumes of exports of the product at issue in excess of its 'quantity' reduction commitments or of its 'budgetary outlay' reduction commitments."[17]

21.   Fourth, the compliance panel has determined only that the United States circumvented its export subsidy commitments by issuing GSM 102 export credit guarantees after 1 July 2005 and only with respect to certain scheduled and unscheduled products. Further, with respect to such specific scheduled and unscheduled products, the findings are limited to discrete periods of time. "The unscheduled products at issue are (i) in the period 1 July-30 September 2005: cotton, oilseeds (including soybeans/soybean meal), protein meals, fresh vegetables, hides/skins and tallow; and (ii) in the period 1 October 2005 -30 September 2006: cotton, oilseeds, soybeans/soybean meal, protein meals, hides/skins, tallow and corn products."[18] "The scheduled products at issue are: (i) in the period 1 July -30 September 2005: rice and poultry meat; and (ii) in the period 1 October 2005 -30 September 2006: rice, poultry meat and pig meat."[19]

22.   Fifth, and very importantly, the determination that the GSM 102 program confers an export subsidy was made *solely* "by applying the standard set out in item (j) of the Illustrative List."[20] The United States robustly contested, and, more importantly, the compliance panel specifically *did not address* Brazil's request for findings on the alternative theory "that the export credit guarantees meet the definition of an export subsidy under the terms of Articles 1.1 and 3.1(a) of the *SCM Agreement* (that is, that they are 'financial contributions' that confer a 'benefit'

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[16]*Upland Cotton (21.5),* para. 15.1(c). The Appellate Body report refers to "the Panel's conclusion that export credit guarantees issued after *31* July 2005 under the revised GSM 102 program constitute export subsidies." (emphasis added) Appellate Body Report, *US - Upland Cotton (21.5),* para. 255. This appears to be a typographical error.

[17]*Upland Cotton (21.5),* para. 14.137.

[18]*Upland Cotton (21.5),* para. 15.1(c), fn. 1.

[19]*Upland Cotton (21.5),* para. 15.1(c), fn. 2.

[20]Appellate Body Report, *US - Upland Cotton (21.5),* para. 260.

and are contingent upon export performance)."[21] The original panel similarly declined to make findings on such claims of Brazil.[22] As a result, the only basis for the finding that the GSM 102 guarantees confer an export subsidy is that the program was provided at premium rates which were inadequate to meet the long-term operating costs and losses of the GSM 102 guarantees. Consequently, the appropriate basis on which to evaluate countermeasures is the extent to which, if at all, such premia are or are not adequate to meet such costs and losses.

23.   The compliance panel determined that the GSM 102 export credit guarantee program confers an export subsidy solely because, in the view of the compliance panel, it "fall[s] within the scope of item (j) of the Illustrative List"[23] in that the United States provides guarantees under such program "at premium rates which are inadequate to cover the long-term operating costs and losses" of the program. In a manner similar to the original panel,[24] the compliance panel applied a test of "net cost to government:" "We recall that, in this case, we are only interested in the presence of a net cost to the U.S. Government resulting from the provision of GSM 102 export credit guarantees."[25]

2.   Appropriate Countermeasures Are Equal to the Net Cost to the United States Government of the GSM 102 Guarantee Program

24.   Article 4.10 of the SCM Agreement provides for countermeasures that are "appropriate" to the prohibited subsidy finding of the panel. Appropriate connotes the close relationship between countermeasures and the particular circumstances of a given case. The American Heritage Dictionary defines appropriate as "suitable for a particular person, condition, occasion, or place; proper; fitting." The Shorter Oxford English Dictionary defines appropriate as "attached or belonging (to) as an attribute, quality, or right; peculiar (to); inherent, characteristic; specially suitable (for); proper, fitting."

25.   The appropriate countermeasures are those that have a concrete basis in the specific findings adopted by the DSB. In this case, the adopted findings support *only* Brazil's theory that there was a net cost to the U.S. government. Both the original panel and the compliance panel specifically refused to reach Brazil's alternative theory that there was a subsidy under Articles 1.1

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[21]Appellate Body Report, *US - Upland Cotton (21.5),* para. 260, fn. 525. As to the U.S. arguments in this regard, *see generally, e.g.,* U.S. Rebuttal Submission (21.5), paras. 134-170.

[22]*Upland Cotton (Panel)*, para. 6.31; Appellate Body Report, *US - Upland Cotton*, para. 732.

[23]*Upland Cotton (21.5),* para. 14.90.

[24]*Upland Cotton (Panel)*, para. 7.804 and fn. 952.

[25]*Upland Cotton (21.5),* para. 14.76.

and 3.1(a), namely a financial contribution that provided a benefit based on export performance. As such, the appropriate countermeasures are those based on the net cost to the U.S. government. Any other countermeasures do not have their foundation in the specific circumstances of this case.

26.   This approach is consistent with that of the Appellate Body. "The Appellate Body has explained that 'the measure of value under item (j) is the overall cost to the government, as the service provider, of providing the service.'"[26]

27.   Brazil's Methodology Paper, however, makes no attempt to base its theory of countermeasures on the premise of the adopted findings in this dispute: item (j) of the Illustrative List of Export Subsidies. Instead, its methodology is exclusively based on an alternative theory for why the export credit guarantees should be considered to be export subsidies. However, Brazil's alternative theory has no support in any findings of the DSB recommendations and rulings. There are no findings adopted by the DSB that would make countermeasures based on this alternative theory appropriate.

28.   Previous arbitrations, several of which have also involved export financing or export credits, have determined that, in the case of prohibited export subsidies the amount of the subsidy is a proper basis upon which "appropriate countermeasures" may be calculated.[27] In this particular case, the appropriate methodology is to use the amount of the subsidy as reflected in net cost to government.

3.   As of July 1, 2005, the GSM 102 Program Operates at No Net Cost to the U.S. Government

29.   As we describe below, the United States uses a "net present value" approach in its budget accounting to calculate the cost of export credit guarantees. Under United States domestic law, this is an approach that the U.S. government agencies are required to use for all credit guarantee and direct loan programs. Net present value calculations are updated annually. Since July 1, 2005, there has been no net cost to the United States government from the GSM 102 program.

a.   The Most Reliable Basis for Calculating Net Cost is Re-estimate Data

30.   It is well understood from earlier *Cotton* proceedings that the U.S. government uses a "net present value" approach to budget accounting for its export credit guarantee programs throughout

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[26]Appellate Body Report, *US - Upland Cotton (21.5),* para. 277, citing Appellate Body Report, *Canada-Dairy (Article 21.5 - New Zealand and US 1)*, para. 93.

[27]*See, e.g., Brazil -Aircraft (22.6)*; US-FSC (22.6); *Canada - Aircraft (22.6)*.

the federal government.[28] The net present value analysis attempts to calculate the value today of a future stream of income or cost, and under its budget accounting approach, the U.S. government identifies an annual 'cost' in terms of the 'net present value' associated with its export credit guarantee programs.[29] Such net present values are then re-calculated iteratively each year through a re-estimation process, based on updated data.

31.   Much of the history of this dispute in respect of the findings under item (j) of the Illustrative List for GSM 102 has centered on the significance of U.S. budget figures and whether or not, as a matter of government accounting, the U.S. official numbers show historic profitability and project future profitability of the program. Before the original panel, at the time considering the question with respect to three programs,[30] the United States presented evidence reflecting cumulative re-estimates on a cohort-specific basis for all 3 programs since fiscal year 1992. Those figures admittedly showed a positive subsidy of approximately $230 million, which approximated a figure of $211 million submitted by Brazil.[31]

32.   Although the United States presented evidence to the original panel the trend over time toward profitability (downward re-estimates of budgetary subsidy) of $1.9 billion,[32] the fact remained that as of the snapshot in time when considered by the original panel, notwithstanding the favorable trend line, "netting re-estimates against original subsidy estimates on a cohort-

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[28]*Upland Cotton (Panel)*, para. 7.842.

[29]*Upland Cotton (Panel)*, para. 7.842.

[30]In addition to GSM 102 the original panel was also examining the longer term GSM-103 program and the Supplier Credit Guarantee Program. Following adoption of the original panel report, the United States announced that it would:
      (1) cease accepting applications under the longer term GSM 103 program;
      (2) apply a new fee structure to the GSM 102 program, under which fees were increased by 46 percent on average (23 percent on a weighted-average basis);
      (3) render ineligible for export credit guarantees exports to countries in the highest risk categories;
      (4) impose incrementally higher fees on export credit guarantees for exports to countries in higher risk categories;
      (5) cease issuing export credit guarantees under the Supplier Credit Guarantee Program (SCGP) (Appellate Body Report, *US - Upland Cotton (21.5),* para. 258; *Upland Cotton (21.5)*, paras. 3.16, 14.119)

[31] *Upland Cotton (Original panel)*, para. 7.852.

[32] *Upland Cotton (Original panel)*, para. 7.853.

specific basis yields a positive subsidy which reveals that over the long term the United States government anticipates that it may not break even with its export credit guarantee programs."[33]

33.   In addition to the re-estimates data, which did show a positive subsidy at the time of the original panel, the original panel looked at CCC financial statements for an indication of whether the GSM 102 program was profitable. That panel indicated its view that these were "another indicator" that the CCC "may not, even over the long term be able to operate the export credit guarantee programs without some net cost to government." The CCC financial statements for the years 2002 and 2003 indicated a "credit guarantee liability" of $411 million and $22 million, respectively. At the same time, the panel observed "that these amounts are not actual losses.".[34]

34.   Before the compliance panel, the United States submitted more recent budget re-estimate data to demonstrate that the three programs were profitable.[35] Brazil countered that the CCC financial statements reported a positive "credit guarantee liability" of $220 million "for guarantees outstanding as of 30 September 2006."[36]

35.   Although the United States vigorously argued, as the original panel had acknowledged, that the credit guarantee liability figure does not represent losses, the compliance panel effectively found that the credit guarantee liability figure, together with other information, supported a conclusion that the program operated at a net cost to the U.S. government.[37]

36.   The use of net present value as a basis for evaluating net cost to the U.S. Government of the GSM-102 program is largely agreed during the *Cotton* proceedings. As Brazil has noted, "U.S. law requires [net present value] projections because they 'measure more accurately the costs of Federal credit programs' than does cash-basis accounting."[38] Net present value in accordance with the Federal Credit Reform Act of 1990 ("FCRA") is reflected in the US data on GSM 102.[39]

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[33] *Upland Cotton (Original panel)*, para. 7.854.

[34] *Upland Cotton (Original panel)*, para. 7.855.

[35] *Upland Cotton (21.5),* paras. 14.66, 14.79.

[36] *Upland Cotton (21.5),* paras. 14.67, 14.81.

[37] *Upland Cotton (21.5),* para. 14.83.

[38]Brazil's Answers to Panel (21.5) Question 102, para. 273 (2 April 2007), citing Exhibit Bra-545 (2 U.S.C. § 661(1)).

[39]As Brazil articulated before the original panel: "[p]rior to passage of the [Federal Credit Reform Act of 1990 ("FCRA")], loan guarantees were recorded on a cash basis, which distorted their costs. [R]ecording guarantees on a 'cash basis distorted the timing of when costs would

37.   In budgetary accounting terms, a *positive* net present value means that the United States government is extending a "subsidy" to borrowers; a negative present value means that the program generates a 'profit' (excluding administrative costs) to the United States government.[40] In other words, if there is a "profit" in net present value terms, there is no net cost to government for the purposes of the subsidy finding for GSM 102.

38.   The budget process establishes an initial estimate of this figure, but in accordance with the FCRA, the federal statute governing budget accounting of all U.S. government export credit activity, "such 'estimates' are subject to re-estimations over the lifetime of the guarantees involved."[41] Over time, subsequent re-estimates become more accurate estimates, as actual performance becomes known and measurable.

39.   As the Appellate Body observed, "these re-estimates 'take into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults,

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actually be incurred.'" Statement of Brazil - First (Original) Panel Meeting (22 July 2003), para. 128. Accordingly, Brazil extolled credit reform accounting as:

> an ideal basis on which to determine whether the CCC's export credit loan guarantee programs are offered a premium rates that are inadequate to cover the long-term operating costs and losses of the programs, within the meaning of item (j) of the Illustrative List of Export Subsidies. It functions as a more sophisticated alternative to constructed cost formulas, and thoroughly accounts for all of the premium and operating cost and loss elements required by item (j). Moreover, it has the virtue of serving as the actual, real-world calculation used by the U.S. Congress, the President of the United States, and federal agencies like the CCC to 'measure more accurately the costs of Federal credit programs.'"

Statement of Brazil - First (Original) Panel Meeting (22 July 2003), para. 129; *see also*, Appellate Body Report, *US - Upland Cotton (21.5),* para. 281; *Upland Cotton (21.5)*, para. 14.69, fn. 668.

[40]*Upland Cotton (Panel)*, para. 7.842; OMB Circular A-11, section 185.2, pp. 185-3 and 185-4 (Exhibit Bra-116).

[41]*Upland Cotton (Panel)*, para. 7.843.   The United States, in its budget, is required to make annual subsidy estimates of the cost (in net present value terms) associated with the export credit guarantees issued in a given year (referred to as a 'cohort'). Appellate Body Report, *US - Upland Cotton (21.5),* para. 281; *Upland Cotton (21.5)*, para. 14.69, fn. 668. In accordance with the FCRA, the initial estimate in respect of each cohort is "subject to annual re-estimates over the lifetime of the cohort, that is until all guarantees in a cohort are closed." Appellate Body Report, *US - Upland Cotton (21.5),* para. 281; *Upland Cotton (21.5)*, para. 14.78.

delinquencies, and recoveries, to the extent that those factors have changed since the initial estimate was made.' Consequently, re-estimates are 'revisions of the subsidy cost estimate of a cohort . . . based on information about the actual performance and/or estimated changes in future cash flows of the cohort.'"[42]

b.   Re-estimates of the GSM 102 Program Have Shown No Net Cost to Government

40.   The United States demonstrated to the compliance panel that the subsidy re-estimate data, which concerned guarantees issued in the 15-year period of 1992-2006,[43] revealed an overall negative subsidy (i.e., profit) net of re-estimates. As a result, for those 15 cohorts of guarantees, the export credit guarantee programs were not provided at a net cost to the United States government even before it took measures to comply with DSB recommendations and rulings resulting from the original panel findings.[44]

41.   The Appellate Body stated: "As the Panel noted, the table shows an aggregate overall anticipated profit of US$926 million for the 1992-2002 cohorts (the cohorts examined by the original panel) and US$403 million anticipated profit for the 1992-2006 cohorts."[45]

42.   The Appellate Body observed that "the United States asserts that the retrospective data, showing profitability over 15 years under the three export credit guarantee programs examined by the original panel, is 'compelling' evidence as to what one should anticipate under the revised GSM 102 program, particularly because two programs have ceased to be operational, and the revision to the fee structure of the remaining GSM 102 program has resulted in higher fees."[46]

43.   The trend toward profitability was also suggested before the original panel, notwithstanding that there was a positive subsidy estimate at the particular point in time examined by that panel. Over the lifetime of the guarantees that were under consideration, an overall

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[42] Appellate Body Report, *US - Upland Cotton (21.5),* para. 281*; Upland Cotton (Panel)*, para. 7.843 and footnote 1005 thereto. *See also*, *Upland Cotton (21.5)*, para. 14.78, footnote 686.

[43] Appellate Body Report, *US - Upland Cotton (21.5),* paras. 279, 282. *See*, U.S. Answer to Panel Questions 110 and 111, paras. 275-278 (2 April 2007).

[44] *Upland Cotton (21.5)*, para. 14.78; Appellate Body Report, *US - Upland Cotton (21.5),* para. 279.

[45]Appellate Body Report, *US - Upland Cotton (21.5),* paras. 282, 285; *Upland Cotton (21.5)*, para. 14.79.

[46]Appellate Body Report, *US - Upland Cotton (21.5),* para. 283.

favorable re-estimate of US$1.9 billion had occurred; the trend for all cohorts was uniformly favorable; and over time the positive subsidy would be supplanted with a figure reflecting profitability of the programs.[47]

44.   This prediction ultimately proved true. As the United States pointed out to the compliance panel, the data for the 1992-2002 cohorts that had previously reflected a positive subsidy eventually radically turned around to show a negative subsidy (i.e., profit) of $762 million.[48] "The re-estimates data before the [compliance] Panel project overall profits for the period 1992-2006, and the two cohorts that have already closed show actual profits."[49]

45.   As the Appellate Body pointed out, the re-estimate data in the past are highly relevant to an examination of the current GSM 102 program, as revised in July 2005; as noted by the compliance panel, "GSM 102 export credit guarantees made up 93 percent of the CCC guarantees portfolio."[50] "Under the revised fee structure, fees for GSM 102 export credit guarantees were increased by 23 percent (on a weighted-average basis). It is not unreasonable to assume that the increase of fees resulting from the revision of the GSM 102 program would accentuate the downward trend shown in the re-estimates data for the 15-year period. Thus, we consider that the re-estimates data, which show better-than-expected historical performance, are an important indicator of the revised GSM 102 program's likely future performance."[51]

46.   As the Arbitrators consider even more recent budget data of the United States presented below, the United States asks the Arbitrators to note this history. The United States also notes the discussion in the Appellate Body report in the compliance proceedings, wherein the Appellate Body specifically criticized the compliance panel's dismissal of the importance of the reestimates data.[52]

c.   Most Recent Re-estimates Show No Net Cost to Government

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[47]*Upland Cotton (Panel)*, para.7.853; U.S. First Written Submission (15 December 2006), para. 85.

[48] U.S. First Written Submission (15 December 2006), paras. 87-88; U.S. Opening Statement (27 February 2007), paras. 20-23.

[49] Appellate Body Report, *US - Upland Cotton (21.5),* para. 286.

[50] Appellate Body Report, *US - Upland Cotton (21.5),* para. 299; *Upland Cotton (21.5),* para. 14.118.

[51] Appellate Body Report, *US - Upland Cotton (21.5),* para. 299.

[52] Appellate Body Report, *US - Upland Cotton (21.5),* paras. 295, 448(b)(i).

47.   In light of the foregoing, the United States offers the following table of the U.S. budget subsidy estimates net of re-estimates for the GSM 102 export credit guarantee program for each of the 2005, 2006, and 2007 fiscal year cohorts, reflecting the most recent data as published in the annual U.S. Government Budget appendices and Federal Credit Supplements, including those for fiscal year 2009.[53]

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[53] The 2008 fiscal year just ended on September 30, 2008. As a result, published data for this cohort is not yet available.

Figure 1 - GSM 102 Export Credit

Guarantee Program
Subsidy Estimates & Reestimates by Cohort

Cohort	Original Subsidy Estimate		Subsidy Reestimates by Fiscal Year of Apportionment			Total Reestimates	Subsidy Net of Reestimates
			FY 2006 a/	FY 2007 b/	FY 2008 c/		
2005	142,000,000	d/	-22,806,000	-69,403,000	-39,516,000	-131,725,000	10,275,000
2006	71,000,000	e/	0	-18,324,000	-37,463,000	-55,787,000	15,213,000
2007	39,000,000	f/	0	0	-20,895,000	-20,895,000	18,105,000
Total	252,000,000		-22,806,000	-87,727,000	-97,874,000	-208,407,000	43,593,000
						Average	14,531,000

a/ FY 2007 Federal Credit Supplement: Budget of the U.S. Government; Table 8 Loan Guarantees: Subsidy Reestimates; p. 43. **Exhibit US-A1**

b/ FY 2008 Federal Credit Supplement: Budget of the U.S. Government; Table 8 Loan Guarantees: Subsidy Reestimates; p. 45. **Exhibit US-A2**

c/ FY 2009 Federal Credit Supplement: Budget of the U.S. Government; Table 8 Loan Guarantees: Subsidy Reestimates; p. 45. **Exhibit US-A3**

d/ 2007 U.S. Government Budget Appendix: CCC Export Loans Program Account, line 233001; p. 116. **Exhibit US-A4**

e/ 2008 U.S. Government Budget Appendix: CCC Export Loans Program Account, line 233001; p. 105. **Exhibit US-A5**

f/ 2009 U.S. Government Budget Appendix: CCC Export Loans Program Account, line 233001; p. 120. **Exhibit US-A6**

48.   This data is presented on the same basis and in the same format as the data previously submitted with respect to export credit guarantees issued from 1992-2006.[54]

49.   In any event, the relationship between the reestimates and the original subsidy estimates for the three cohorts is strikingly similar to the relationship previously observed with respect to the 1992-2006 cohorts. For cohort 2005, the original subsidy estimate was a positive subsidy of $142 million. That has since been reduced by 92.8 percent: a negative re-estimate of

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[54] *See*, U.S. Answer to Panel Questions 110 and 111, paras. 275-278 (2 April 2007). The United States also notes at the outset that the reformed fee structure for the GSM 102 program was not instituted until July 1, 2005. Consequently, the 2005 cohort is comprised predominantly of pre-reform guarantees, and this would have the effect of skewing the estimate data for such cohort more toward a positive subsidy than it would otherwise if the reformed fee structure applied to the entirety of the cohort.

$131,725,000. For cohort 2006, the original subsidy estimate of $71 million has been reduced by $55,787,000, or 78.6 percent. The 2007 cohort has already been reduced by over half.

50.   For the 1992-2006 cohorts, this signifies an additional favorable negative subsidy of $37,463,000 for cohort 2006 and of $39,516,000 for cohort 2005 from that previously presented to the compliance panel.[55] These changes alone would increase the total profitability of all of the export credit programs since 1992 from over $403 million to over $585 million.[56]

51.   The 2009 budget was published on February 4, 2008. As of that moment in time the total subsidy net of re-estimates for the three cohorts was $43,593,000.[57] As a result, as of the snapshot on February 4, 2008, the average annual subsidy net of reestimates for the three cohorts of 2005, 2006, and 2007 is $14,531,000.

52.   Just as the retrospective data showing profitability over 15 years under the three export credit guarantee programs examined by the original panel is compelling and, in the words of the Appellate Body, "more reliable" evidence as to what one should anticipate under the revised GSM 102 program, the reestimate data applicable to guarantees issued since July 1, 2005 is compelling confirmation of the same.

53.   As explained above, the data presented in the original proceeding and compliance proceeding demonstrate a uniform trend of the re-estimate data for these cohorts, turning the corresponding subsidy net of re-estimate to a negative figure, reflecting a profit to the government. Perhaps the most readily accessible fact to explain this result is that as of the date of this submission, and notwithstanding the current tumult in world credit markets, for each of cohorts 2005, 2006, 2007, and, indeed, 2008, the GSM 102 program has experienced *not a single default*. This is especially remarkable in the current environment, as the GSM 102 program is fundamentally a program that guarantees payments due from foreign banks.[58] The United States further submits this illustrates the fiscally conservative management of the program to avoid net cost to the government.

54.   The United States has presented U.S. budget subsidy estimates net of re-estimates for the 2005-2007 cohorts, as those are both the most recent cohorts for which published data exists, as well as the first cohorts for which budget information is published for the GSM 102 program

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[55] See table accompanying U.S. Answer to Panel Question 110, para. 275.

[56]Compare, U.S. Answer to Panel Question 111, paras. 277-278 (2 April 2007).

[57]The sum of the three individual cohorts' subsidy net of reestimates ($10,275,000 + 15,213,000 + 18,105,000).

[58] *See, e.g., Upland Cotton (21.5)*, para. 3.14.

separately from the other now-repealed programs.[59] The already very low subsidy net of reestimates must be examined in light of the continuing precipitous decline in the subsidy net of re-estimate for these cohorts, the overall profitability of the program historically, and the reliability of the re-estimate data as "an important indicator of the revised GSM 102 program's likely future performance."[60] As a result, the appropriate conclusion for the GSM 102 program, as modified on July 1, 2005, is that it operates at no net cost to government. As a result, no countermeasures should be authorized for GSM 102.

4. **Alternative Measures of Cost to Government Are Inferior to reestimates**

a. **Initial Estimates Are Less Reliable Than Reestimates**

55. Brazil has previously (in prior *Cotton* proceedings) urged focus on the initial estimates, to the exclusion of the re-estimates data. The Appellate Body correctly observed, however, that the "re-estimates show a consistent downward trend in the estimated cost of the export credit guarantee programs, thus calling into question the reliability of the initial estimates for purposes of evaluating the program's 'long-term operating costs and losses.'"[61] The Appellate Body further stated: "the [Compliance] Panel erred in its intermediate conclusion that 'the initial subsidy estimates provide a strong indication that GSM 102 export credit guarantees are provided against premia which are inadequate to cover the long-term operating costs and losses of the GSM 102 program."[62]

56. In the compliance panel proceedings, Brazil argued that "specifically, CCC projects losses of USD 125 million and USD 114 million, respectively, for GSM 102 ECGs issued in FY 2006 and FY 2007 (before accounting for the costs of administering the program); these losses amount to 5.05 percent of the value of the GSM 102 ECGs to be issued in FY 2006, and 4.48 percent of the value of GSM 102 ECGs to be issued in FY 2007."[63]

57. First, those percentages are themselves merely calculations derived from the discredited initial estimates. Looking at the exhibit from which Brazil cites these figures,[64] one can readily

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[59]U.S. Answer to Panel Question 110, para. 275 (2 April 2007).

[60]Appellate Body Report, *US - Upland Cotton (21.5),* para. 299

[61] Appellate Body Report, *US - Upland Cotton (21.5),* para. 298.

[62] Appellate Body Report, *US - Upland Cotton (21.5),* paras. 295, 448(b)(i).

[63] First Written Submission of Brazil (17 November 2006), para. 433 and fn. 606.

[64] Exhibit Bra-544.

see that for the GSM 102 program the 2006 cohort "loan guarantee level" is $2,485 million. The initial subsidy estimate is the $125 million figure Brazil cites. Dividing 125 million by 2,485 million yields 5.03 percent. (The difference between 5.03 and 5.05 is probably the result of rounding.) Similarly, for cohort 2007, dividing 114 million into 2,535 million yields 4.50 percent (similar rounding disparity with 4.48).

58.　　Second, disregarding for the moment the fact that these percentages are derived solely from initial estimates, an examination of the exact same line of the 2009 budget for the 2007, 2008, and 2009 cohorts[65] shows that the percentages are now considerably lower: 2.92 percent (2007); 2.39 percent (2008); and 0.87 percent (2009).

59.　　Third, the Arbitrators will recall that "re-estimates are tracked in Table 8 of the Federal Credit Supplement accompanying the budget."[66] As part of this tracking, the Federal Credit Supplement includes a "current reestimated rate" for federal loan guarantee programs, including the GSM 102. In the most recent Federal Credit Supplement, published in February 2008, the current reestimated rate for each of the 2005, 2006, and 2007 cohorts of GSM 102 guarantees are, respectively: *negative* 0.12 percent; positive 0.30 percent; and positive 0.69 percent.[67]

b.　　**The Credit Guarantee Liability Figure in the CCC Financial Statements Does Not Represent Net Cost to Government**

i.　　**The Difference Between Net Present Value and the Liability Figure**

60.　　Another source of information that has been focused on in the *Cotton* proceedings is the CCC Consolidated Financial Statements. Brazil has previously focused attention on these as a means to calculate the net cost of the GSM 102 program to the U.S. Government. In particular, Brazil focused on the "credit guarantee liability" figure of such financial statements.[68] However,

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[65] Exhibit US-6, Budget of the United States Government, Fiscal Year 2009, Appendix regarding Department of Agriculture, p. 120, line 232001.

[66] Appellate Body Report, *US - Upland Cotton (21.5),* para. 281; *Upland Cotton (21.5)*, para. 14.76, fn. 681.

[67]Exhibit US-4, Budget of the United States Government, Fiscal Year 2009, Federal Credit Supplement, Table 8 (Loan Guarantees: Subsidy Re-estimates), p. 1

[68] Appellate Body Report, *US - Upland Cotton (21.5),* para. 279. Brazil focuses on the "credit guarantee liability" figure of $220 million for fiscal years 2005 and 2006 in relation not just to the GSM 102 program, but to all three programs subsumed within the original dispute. The corresponding figure for CCC consolidated financial statements for fiscal years 2006 and

the "credit guarantee liability" figure does *not* represent the same thing as the subsidy estimate net of re-estimates. The latter reflects the overall profit or loss associated with a particular cohort over the arc of the entire life of a particular cohort. In contrast, when the "credit guarantee liability" figure is defined to "represent the estimated net cash outflow (loss) of the guarantees on a net present value basis"[69] it refers to net cash flows originally estimated prior to any default and does *not* incorporate the net present value of revenues from ongoing recoveries associated with defaults that have already occurred.[70] Those appear on the asset side of the CCC balance sheet.[71] Cash fees received similarly appear on the asset side of the balance sheet, and as explained in subsection ii, below, actually simultaneously and commensurately *increase* credit guarantee liability.

61.   Brazil has in the past characterized the credit guarantee liability figure as signifying that "CCC records a liability and an expense to the extent, in management's estimate, CCC will be unable to recover claim payments under the Credit Reform Export Credit Guarantee programs."[72] At its core, Brazil's argument has been that because the credit guarantee liability figure is described as the present value of *net* cash flows, then it must reflect a projection of overall loss.[73] The credit guarantee liability figure is not an estimate of losses and is, therefore, not an appropriate proxy (particularly given the availability of net present value re-estimates) for the program's cost to government.

ii.   A Brief Explanation of the United States Federal Credit Reform System

62.   Two logical questions are implicit in Brazil's argument. How is it possible for a profitable program under the Federal Credit Reform system still to have a positive credit guarantee liability figure? And, how can a figure that is limited only to the liability side of a balance sheet still be a "net" figure?

63.   To answer these questions requires a brief review of the fundamental structure of the accounting and budget methodology under the Federal Credit Reform Act of 1990. That act

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2007 is $184 million. *See,* Exhibit US-7; Commodity Credit Corporation Annual Report, Fiscal Year 2007, Note 5 to Financial Statements, p. 65. http://www.usda.gov/oig/webdocs/06401-22-FM.pdf

[69] Appellate Body Report, *US - Upland Cotton (21.5),* para. 288.

[70] *See, para. 70-77, infra.*

[71] *See, para. 70-77, infra.*

[72] *Upland Cotton (21.5),* para. 14.82.

[73] Brazil's Comments on U.S. Answers (24 April 2007), para. 298.

"required that budget authority to cover the cost to the government of new loans and loan guarantees (or modifications to existing credits) be provided before the credits are made. Credit reform requirements specified a net present value cost approach using estimates for future loan repayments and defaults as elements of the cost to be recorded in the budget."[74]

64. That act "defines the subsidy cost of loan guarantees as the present value of cash flows from estimated payments by the government (for defaults and delinquencies, interest rate subsidies, and other payments) minus estimated payments to the government (for loan origination and other fees, penalties, and recoveries."[75]

65. "Credit programs have a positive subsidy - that is, they lose money - when the present value of estimated payments by the government exceeds the present value of estimated receipts. Conversely, negative subsidy programs are those in which the present value of estimated collections is expected to exceed the present value of estimated payments; in other words, the programs make money (aside from administrative expenses)."[76]

66. Of particular relevance to the ultimate question of the significance of the credit guarantee liability is the special budget accounting system established to implement this system. Stated succinctly, the estimated subsidy costs (plus administrative costs) reflect the cost of the transactions at inception. The subsidy cost is subject to re-estimation over time. The financing account simply represents the manner in which the estimated subsidy costs are subsequently paid for. As the United States Government Accountability Office explains, the act "set up a special budget accounting system to record the budget information necessary to implement credit reform. It provides for three types of accounts to handle credit transactions. The program and financing accounts are used by credit obligations made since [October 1,] 1991.[77] The program account receives appropriations for administrative and subsidy costs of a credit activity and is included in budget totals. When a direct loan or a loan guarantee is disbursed, the program account pays the associated subsidy cost for that loan to the financing account. The financing account, which is nonbudgetary, is used to record the cash flow associated with loans or loan guarantees over their lives. Nonbudgetary accounts may appear in the budget document for information purposes but are

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[74] Exhibit US-73, p. 79.

[75] Exhibit US-73, p. 79.

[76] Exhibit US-73, p. 79. Administrative expenses for GSM 102 in fiscal year 2006 are $5 million. Exhibit US-5, Fiscal Year 2008 U.S. Government Budget Appendix : CCC Export Loans Program Account, line 00.09, p. 105 http://www.gpoaccess.gov/usbudget/fy08/pdf/appendix/agr.pdf

[77] The third account is the liquidating account and pertains only to guarantees issued before then.

not included in the budget totals for budget authority or budget outlay. They do not belong in the budget, because they show only how something is financed and do not represent the use of resources. The financing account finances loan disbursements and the payments for loan guarantee defaults with (1) the subsidy cost payment from the program account, (2) loans from Treasury, and (3) collections received by the government."[78]

67.   Figure 8 on page 80 of Exhibit US-73 (resubmitted exhibit) illustrates program and finance account budgeting for the Export-Import Bank of the United States under credit reform. As credit reform is required throughout the U.S. government for credit guarantee programs, the illustration is equally applicable to CCC.

Figure 8: Program and Finance Account Budgeting for Ex-Im Bank under Credit Reform

Source: GAO analysis of credit reform guidance.

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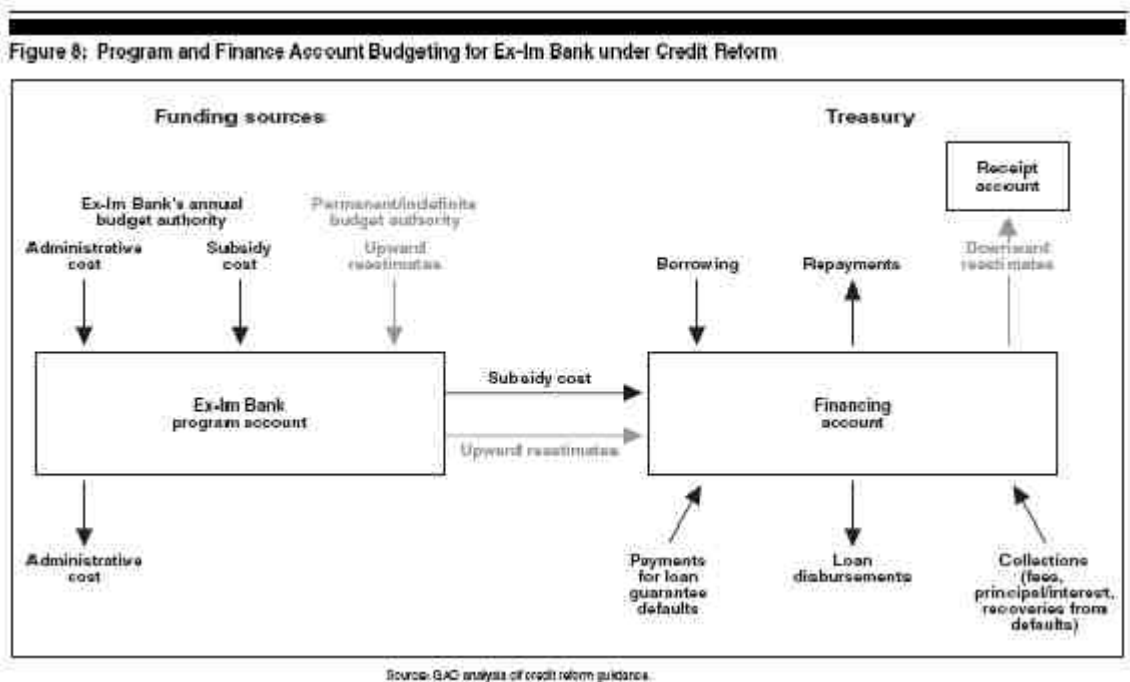
[78] Exhibit US-73, p. 79-80. *See also,* Exhibit US-8: United States Office of Management and Budget (OMB) Circular A-11 (2008), Part 5, Section 185, p. 4. : "The actual cash flows…are recorded in separate financing accounts…. The transactions of the financing account are displayed in the budget Appendix for informational and analytical purposes, together with the related program accounts, but are excluded from the budget totals because the net cash flows do not represent a cost to the Government…. The loan guarantee financing account holds the subsidy payment from the program account as a reserve against default claims. The reserve, together with interest earnings on this reserve from Treasury, is used to pay default claims over the life of the loans." http://www.whitehouse.gov/omb/circulars/a11/current_year/s185.pdf

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68.   As described above, the left hand side of Figure 8 reflects the budgetary program account. As set forth in the diagram, CCC would receive its annual budgetary subsidy amount, reflecting the net present value of estimated costs. All subsequent budget authority under the program is then conducted in the financing account, which is illustrated on the right hand side of the diagram, and is excluded from the budget totals for the U.S. Government. This includes issuance of guarantees, payments under guarantees, collections associated with guarantees (fees and recoveries), and booking of liabilities associated with such guarantees.

69.   In August 1993, the Federal Accounting Standards Advisory Board required that agencies' accounting procedures be consistent with their budgetary procedures for their federal credit programs.[79] The Balanced Budget Act of 1997 also codified various requirements of symmetry for budget purposes and agency accounting purposes.[80]

iii.   An Example of Federal Credit Guarantees under Net Present Value Terms and Liability Terms

70.   For any federal credit guarantee program, an initial estimate of the net present value of the cost of the subsidy to provide guarantees is established. For purposes of discussion, let us assume that this estimate is 10 percent of the credits to be guaranteed. Let us further assume that $600 million of guarantees is contemplated. To achieve that, $60 million must be appropriated into the program account. The estimate of 10 percent and ensuing appropriation of such subsidy amount comprises the result of a series of assumptions about the net present value of such $600 million of guarantee transactions at the time of issuance. These assumptions pertain to both estimated in-flows and out-flows.

71.   To illustrate, let us assume the federal agency issues a guarantee on a $15 million credit within the $600 million contemplated guarantees. Applying the 10 percent subsidy rate, the estimated subsidy cost of that guarantee is $1.5 million. The estimated subsidy cost (or expense) of issuance of a guarantee is itself comprised of several constituent elements. The primary element is the default risk associated with the country of the obligor. For example, if country X has a risk grade that gives rise to an estimated risk of default of 15 percent, then a 15 percent subsidy cost becomes one element of the subsidy cost. In addition, however a simultaneous estimate is made on the amount that would ultimately be recovered from any such default. For example, if an estimate

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[79] Exhibit US-9, "Federal Credit Reform: Implementation of the Changed Budgetary Treatment of Direct Loans and Loan Guarantees"; Congressional Research Service Report for Congress, updated June 23, 2003, Summary.
http://digital.library.unt.edu/govdocs/crs/data/2003/upl-meta-crs-7706/RL30346_2003Jun23.pdf

[80] Exhibit US-9, "Federal Credit Reform: Implementation of the Changed Budgetary Treatment of Direct Loans and Loan Guarantees"; Congressional Research Service Report for Congress, updated June 23, 2003, p. 11.

is also made that any default of country X would subsequently result in a 20 percent recovery, then that would be a subtraction from the initial estimated subsidy cost, resulting in a net 12 percent subsidy (15%- (.2)(15%)). Finally, a further assumption is made about fees that will be received upon issuance of guarantees in respect of country X. If the assumption is that fees of 2 percent will be received, then that too is subtracted from the estimated subsidy cost, yielding a final estimated subsidy cost of 10 percent (15%- (.2)(15%) - 2% = 10%). All of this comprises the estimated subsidy cost at inception that must be paid from the program account to the financing account upon issuance of the guarantee.[81]

72.   Upon issuance of the guarantee, $1.5 million is paid from the program account to the financing account. One should then note what happens when cash fees are actually received, as distinguished from merely anticipated (or estimated) to be received. Any fee paid for issuance of the guarantee is deposited into the financing account. The fee is cash, and such cash is an asset of the financing account. In the year of receipt, the net present value of such cash is necessarily 100 percent of the cash value.

73.   On the books of the federal agency, the estimated cost of $1.5 million is recorded as the credit guarantee liability associated with this guarantee.[82] This $1.5 million is the net present value of future fee receipts (in-flows), future default payments (out-flows), and future recoveries (in-flows). The combination of these three offsetting components net to a single, $1.5 million anticipated out-flow. The $1.5 million appropriated budgetary subsidy is positioned in the financing account as an asset to finance this net liability. Consequently, and counterintuitively, the actual receipt of the cash fee *increases* the credit guarantee liability figure as an adjustment,[83] because the fee matriculates from the anticipated to the collected. This action simultaneously increases the liability *and* the cash deposits in the financing account, thereby increasing both the

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[81] Exhibit US-10, OMB Circular A-136, *Financial Reporting Requirements* (rev. 2008), Schedule for Reconciling Loan Guarantee Liability Balances, p. 96 http://www.whitehouse.gov/omb/circulars/a136/a136_revised_2008.pdf .
        Similarly, Exhibit US-8, OMB Circular A-11, Part 5, Section 185, p. 9: "Loan guarantee subsidy cost means []specifically, the cost of a loan guarantee is the net present value, at the time when the guaranteed loan is disbursed by the lender of the following estimated cash flows:
  - Payments by the Government to cover defaults and delinquencies, interest subsidies, and other requirements; and
  - Payments to the Government, including origination and other fees, penalties and recoveries."

[82] *See, generally,* Exhibit US-9, "Federal Credit Reform: Implementation of the Changed Budgetary Treatment of Direct Loans and Loan Guarantees"; Congressional Research Service Report for Congress, updated June 23, 2003, Appendix C.

[83] Exhibit US-10, OMB Circular A-136, *Financial Reporting Requirements* (rev. 2008), Schedule for Reconciling Loan Guarantee Liability Balances, p. 96.

liability *and* assets to cover the liability. The credit guarantee liability and the fee are then, respectively, liabilities and assets in the financing account. Contrary to Brazil's characterizations of the significance of credit guarantee liability in prior *Cotton* proceedings, it does not represent a projection of overall loss.

74.   In the event of any default under a particular loan guarantee, cash is disbursed from the financing account to pay claims. Such disbursement has no effect on the subsidy cost, which has already been accounted for. Upon payment of claims, the federal agency acquires the right to collect from the defaulting party. This becomes a receivable, which is an asset. At the end of each fiscal year, the agency makes a net present value calculation with respect to such asset, and such net present value becomes an asset within the financing account. Such present value calculation remains separate from the present value calculation of credit guarantee liability.   To the extent cash is realized from the receivable it is paid into the financing account.

75.   The separation of the calculation of net present value of assets from net present value of liabilities (credit guarantee liability) can be seen in the most recent (end of fiscal year 2007) Balance Sheet of the Commodity Credit Corporation Export Guarantee Financing Account.[84]   One can readily see on the asset side of the balance sheet the amount of $535 million on "net present value of assets related to defaulted guaranteed loans."[85] One can similarly readily see on the liability side of the balance sheet $184 million of "liabilities for loan guarantees." *This is the exact same $184 million that is the credit guarantee liability in the CCC Financial Statement at the end of fiscal year 2007*.[86] The net present value of such assets *exceeds* the net present value of such liabilities.

76.   The net present value calculation of the liability can also vary over time. For example, the government-wide risk ratings are assigned to obligations, depending on the country of such obligation.[87] The greater such risk the higher the present value of the liability associated with such guarantee and, similarly, the higher the estimated subsidy cost associated with such guarantee. To the extent the assigned riskiness of such country is subsequently reduced, the net present value of the liability is commensurately reduced. This would constitute an "in-flow" (or reduced "out-

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[84] Exhibit US-6, 2009 U.S. Government Budget Appendix: CCC Export Loans Financing Account Balance Sheet, p. 122.

[85] The specific net present value calculation was to discount the $649 million face (gross) value of the receivables by $114 million to arrive at a net present value calculation of $535 million.

[86] Exhibit US-7: Commodity Credit Corporation Annual Report, Fiscal Year 2007, Note 5 to Financial Statements, p. 65 .

[87] *See, e.g., Upland Cotton (21.5),* para. 14.111.

flow") in the net present value calculation of the liability figure alone. Such "in-flows" are netted against the "out-flows" of additional liabilities incurred or out-flows associated with increased riskiness of obligors to calculate a net present value calculation of liability. This becomes part of the net present value calculation subsumed within the credit guarantee liability number.

77.   A last component of both the budget and accounting process involves re-estimation. The Arbitrators will recall that the amount of subsidy necessary for a particular cohort is re-estimated on a net present value basis annually throughout the life of the cohort. An upward re-estimate means that more subsidy than originally appropriated to the program is necessary. A downward re-estimate means that more subsidy than necessary has been made available to the program. As the United States has demonstrated, downward re-estimates to the point of negative subsidy (i.e., profit) have occurred for the period 1992-2006.

78.   To the extent a program enjoys a downward re-estimate, it must actually remit such amount back to the U.S. Treasury.[88] As reestimates must be made immediately as of the end of each fiscal year, if the result is a downward re-estimate, a commensurate payable (to an account established for effecting such payments to the Treasury) is recorded in the financing account, and this becomes a payable of the CCC financing account.[89]

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[88]   As provided in OMB-Circular A-11 (Exhibit US-8): "Reestimates mean revisions of the subsidy cost estimate of a cohort (or risk category) based on information about the actual performance and/or estimated changes in future cash flows of the cohort. Reestimates must be made immediately after the end of each fiscal year, as long as any loans in the cohort are outstanding, unless a different plan is approved by OMB (see section 185.6). An upward reestimate indicates that insufficient funds had been paid to the financing account, so the increase (plus interest on reestimates) is paid from the program account to the financing account to make it whole. Permanent indefinite budget authority is available for this purpose pursuant to section 504(f) of the FCRA. A downward reestimate indicates that too much subsidy had been paid to the financing account. The excess (plus interest) is disbursed to a downward reestimate receipt account." Section 185.3(y), p. 12

[89]   "If the reestimate indicates a net decrease in the subsidy cost of the cohort as a whole since the last estimate or reestimate, there is a downward reestimate. To keep the correct amount of balances in the financing account, an obligation and a financing disbursement in the amount of the net decrease (plus interest on the reestimate) must be recorded in the financing account. . . . .In the case of loan guarantees, the obligation will be financed with unobligated balances. The obligation will be recorded in the program and financing schedule as 'payment of downward reestimates' (and as 'interest on downward reestimates'). The interest rate to calculate the interest on downward reestimates is the same rate that is used to discount cash flows for the cohort.

"As a general rule, the financing disbursement for a downward reestimate (plus interest

79.   Such downward re-estimates and resulting profitability are largely explained by performance on rescheduled debt far better than originally expected (in addition to fees collected), which cause overcapitalization of the financing account, prompting the need to return funds to the United States Treasury.[90]

80.   This illustrates how profitability, as manifest by negative subsidy net of re-estimates, can co-exist with a positive credit guarantee liability. Profit from the program is remitted back to the Treasury by the calculation of downward re-estimates. This has no impact on the net present value calculation of credit guarantee liability.

81.   Consequently, the credit guarantee liability figure in the CCC financial statements is not an accurate measure of net cost to the U.S. government of providing the GSM 102 program. It is therefore not an appropriate basis on which to base countermeasures.

> **5.   Even if the Arbitrators Conclude that GSM 102 is Provided at a Net Cost to Government, then the Amount of the Prohibited Subsidy Cannot Include (a) Permitted Export Subsidies for Scheduled Products and (b) GSM 102 Transactions on Products Not in Dispute**

82.   If, in spite of the foregoing, the Arbitrators conclude that there is a net cost to government for the GSM 102 program, the United States submits an argument with calculations in the alternative. Under this alternative, the annual amount of such net cost – and therefore the amount of any countermeasures by Brazil – cannot exceed the average annual subsidy net of reestimates for the three cohorts of 2005, 2006, and 2007, as most recently published in the U.S. budget, with adjustments for export guarantees for which there have been no findings of WTO inconsistency. As the United States has already noted, the Appellate Body has observed that the subsidy estimate net of re-estimate is the "most reliable" basis for calculation of the subsidy. The average for the three cohorts is $14,531,000. Below, the United States explains how to reduce this figure to account for permitted export subsidies and those GSM 102 transactions not in dispute.

> **a.   Exclusions from Net Reestimates for Permitted Export Subsidies for Scheduled Products**

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on the reestimate) will be made from the financing account to a general fund downward reestimate receipt account established for each credit program. The receipts will be recorded as offsetting receipts, which will offset the total budget authority and outlays of the agency and the budget subfunction of the program." OMB Circular A-11 (Exhibit US-8), Section 185.6, p. 18.

[90] For each of fiscal years 2004, 2005, and 2006, for example, actual repayments under rescheduled debt have outperformed estimates by 226%, 180%, and 363%, respectively. See U.S. Answers to Panel Question 102 (2 April 2007), paras. 241-242.

83.   Unlike in the case of industrial goods, "in general terms the export subsidy provisions of the *Agreement on Agriculture* permit a limited number of Members [including the United States] to use export subsidies, as defined in that Agreement, within the limits of the budgetary outlay and/or quantitative commitments specified in Section II of Part IV of its Schedule and only with respect to the agricultural products described therein."[91] These products are commonly referred to as "scheduled products."

84.   The United States has scheduled export subsidy reduction commitments in respect of 13 scheduled products: wheat, coarse grains, rice, vegetable oils, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, pigmeat, poultry meat, live dairy cattle and eggs.[92]

85.   "For scheduled products, 'circumvention' will occur if the United States provides export subsidies to volumes of exports of the product at issue *in excess* of its 'quantity' reduction commitments or of its 'budgetary outlay' reduction commitments."[93] To the extent export subsidies are provided, with respect to scheduled products, not in excess of such reduction commitments, then such subsidies are permitted. Such export subsidies would include any arising from export credit guarantees.

86.   The finding that the GSM 102 program conferred an export subsidy extended to the program as a whole,[94] but any calculation of an amount of prohibited subsidy in this case must necessarily make allowance for permitted export subsidies pertaining to scheduled products. Of these, the only products at issue in this dispute are rice, pigmeat, and poultry meat.   The United States has not provided other agricultural export subsidies in 2005-2007 – nor has Brazil alleged otherwise. As a result, the only potential export subsidy of the United States applicable to the scheduled commodities for which allowance is therefore necessary is the export credit guarantee program.

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[91] *Upland Cotton (Panel),* para. 7.664; s*ee also, generally, Agreement on Agriculture*, Articles 3.3 and 8; *Upland Cotton (Panel),* paras. 7.658-7.667; Appellate Body Report (*Upland Cotton)*, para. 676.

[92] Appellate Body Report (*Upland Cotton*), para. 676, fn. 1024; *Upland Cotton (Panel)*, para. 7.876, fn. 1057 (referring to Schedule XX of the United States of America, Part IV, Section II, entitled "Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments"; Exhibits Bra-83 and US-13).

[93] *Upland Cotton (21.5)*, para.14.137 (emphasis in original), citing Appellate Body Report, *US - FSC*, para. 150.

[94]*Upland Cotton (21.5)*, paras.14.133, 14.134.

87.   Such permitted export subsidies are not the only GSM 102 transactions that should be excluded from the calculation of subsidy. Brazil submitted evidence to the compliance panel to the effect that CCC, subsequent to July 1, 2005, provided GSM 102 guarantees to support the export of only a specifically enumerated set of *unscheduled* products:

> (i) "between 1 July and 30 September 2005: cotton, oilseeds (including soybeans/soybean meal), protein meals, fresh vegetables, hides/skins and tallow;"

> (ii) "in FY 2006 (1 October 2005-30 September 2006: cotton, oilseeds, soybeans/soybean meal, protein meals, hides/skins, tallow and corn products."[95]

88.   Brazil had also originally included in its claims certain products that were wholly outside the scope of coverage of the *Agreement on Agriculture*,[96] but Brazil subsequently withdrew such claims under the *Agreement on Agriculture*.[97] The compliance panel then found that "Brazil's claims under Articles 3.1(a) and 3.2 of the *SCM Agreement* are contingent upon a finding by the Panel that the United States has applied export subsidies inconsistently with its obligations under the *Agreement on Agriculture,* and only to the extent of that inconsistency,"[98] and therefore "lyocell, lysine and wood products are not covered by Brazil's request for the establishment of a panel and are therefore not part of its terms of reference."[99] Consequently, those products and any other products outside the scope of coverage of the *Agreement on Agriculture* should be excluded from the calculation of subsidy.

89.   The findings of the compliance panel, based on the limited evidence submitted by Brazil and the product coverage of the Agreement on Agriculture, were therefore limited both temporally and in terms of scope of unscheduled products as follows: "The unscheduled products at issue are (i) in the period 1 July-30 September 2005: cotton, oilseeds (including soybeans/soybean meal), protein meals, fresh vegetables, hides/skins and tallow; and (ii) in the period 1 October 2005 -30 September 2006: cotton, oilseeds, soybeans/soybean meal, protein meals, hides/skins, tallow and corn products."[100]

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[95] *Upland Cotton (21.5)*, para.14.139.

[96] These products consisted of lysine, lyocell and wood products (wood pulp). *See, Upland Cotton (21.5)*, paras. 14.158 and 14.139, fn. 771.

[97] *Upland Cotton (21.5)*, paras. 14.158.

[98] *Upland Cotton (21.5)*, paras. 14.161. *See also,* para. 14.162.

[99] *Upland Cotton (21.5)*, paras. 14.164.

[100]*Upland Cotton (21.5),* para. 15.1(c), fn. 1.

90.   Accordingly, the United States has prepared an appropriate methodology for subtracting GSM 102 transactions not subject to this dispute from the subsidy calculation. Exhibit US-13[101] breaks out data for each of the scheduled products of the United States. The applicable quantitative commitments are set forth in the column so labeled and are associated with the respective scheduled products.[102] The total registration guaranteed value number corresponds, for each GSM 102 cohort respectively, to the total amount of export credit guarantees issued for both scheduled and unscheduled products.

91.   The starting point for adjusting the subsidy to account for these three groups of commodities is the total value of registration guarantees for all products (A in table 1).[103] As each

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[101]GSM 102 Subsidy Based on Registration Value.

[102] For example, with respect to wheat and wheat flour, the United States has an annual export subsidy permitted quantity limit of 14,522,060 metric tons.

[103] For example, total registrations for the 2006 cohort are $1,359,810,921. This data is taken from the internal USDA data base that tracks GSM 102 transactions. This figure of total registrations is slightly below the figure that Brazil has used: $1,363,300,000. Compare, Exhibit Bra-513. Total registrations for the 2005 cohort are $2,170,833,377, which is in fact slightly higher than Exhibit Bra-513 reports: $2,169,810,000. These minor differences (the overall difference for the two years is less than $2.5 million on over $3.5 billion of transactions) are presumably artifacts of accounting for transactions at the very beginning and end of the fiscal year, as well as some rounding. Furthermore, the source material on which Brazil relies for its assertions of the magnitude of U.S. export credit guarantees (e.g, Exhibit Bra -513, Bra-551, Bra-552, Bra-553, Bra-554) cautions that the number of applications at any particular moment in time can vary considerably from the actual value of guarantee transactions consummated. *See, e.g,*, the front page of the Monthly Summary of Export Credit Guarantee Program Activity:

      CAUTIONARY INFORMATION ON USE OF THIS REPORT

      The enclosed tables reflect only exporter applications for guarantees which have been entered into the GSM 102/103 computerized System. At any given time, exporter applications are in process, and not all of those received (e.g., by facsimile) have been entered into the System. Moreover, all applications are initially entered into the System on a provisional basis until price review has been completed, the guarantee fee has been received, and the written guarantee has been issued. Thus, some applications now in the System may in the future be removed, and the commodity balances correspondingly increased. Users of this Report should be aware of these characteristics/limitations of the enclosed tables.

http://www.fas.usda.gov/excredits/Monthly/ecg.html

guarantee extends to 98 percent of the principal of the underlying transaction, the value of registrations for guarantees equals 98% of the value of registered sales applications. This value is then first reduced by the value of registrations made for products not within the scope of coverage of the *Agreement on Agriculture* (item B: cotton yarn, fish/shellfish, and wood products), to give an adjusted value C.

b. GSM 102 Transactions on Products Not in Dispute

92. The second adjustment accounts for U.S. export subsidy reduction commitments for the 13 scheduled products for which the U.S. is permitted export subsidies. Quantity reduction commitments are notified to the WTO on a July – June year, and value commitments are notified on an October – September year (also the U.S. fiscal year).[104] Using the applicable registered quantities and the quantity commitments, one can calculate the relative percentages of registered quantities that are within and without the relevant quantity commitment. For example, the rice quantity commitment is 38,544 metric tons. The United States can therefore confer export subsidies in respect of 38,544 metric tons.[105]

93. Data are available on the value and quantity of GSM 102 registrations for the commodities with export subsidy commitments to reflect the transactions in a manner consistent with such notification periods (table 2). For each scheduled product, the United States has determined from its data base the corresponding quantity subsumed under registered guarantees for GSM 102 guarantees in each of the periods July-June 2005, 2006, and 2007.

94. The value of registration guarantees, adjusted for products not within the scope of coverage of the *Agreement on Agriculture*, is reduced by the full value of registrations for those commodities that did not exceed the quantity commitments – wheat, coarse grains, vegetable oils, dairy products, bovine meat, dairy cattle, and eggs. However, exports of rice, pigmeat, and poultry meat exceeded the quantity commitments for 2005, 2006, and 2007. For these three products, the value of registrations is reduced proportionally by the quantity of exports covered by the quantity reduction commitment (items D, E, F, and G).

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[104] Schedule XX of the United States of America, Part IV, Section II, entitled "Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments" (Exhibits Bra-83 and US-13); *see also, Upland Cotton (21.5)*, paras. 14.145-14.146.

[105] Data that Brazil presented to the compliance panel in this respect presented quantity data only on the basis of 1 July to 30 September 2005 and 1 October to September 30, 2006. *See, Upland Cotton (21.5)*, para. 14.145 -.146 and footnotes 779 and 780. Brazil's claims with respect to scheduled products were limited to the quantity reduction commitments for rice, pigmeat, and poultry meat and no other scheduled products. Brazil has made no claims regarding budgetary value commitments for any products.

95.   For example, in 2005 the U.S. commitment for poultry meat/offals was 27,994 tons. Exports under the GSM 102 program were 235,656 tons. The value of registration guarantees for poultry meat/offals in 2005 was $288,012,099. Since 12% of the quantity exported was permitted by the export subsidy commitment, the value of registrations is adjusted to equal 88% of the registration value, or $253,798,624. This calculation was done for each of the 3 commodities for 2005, 2006, and 2007, because in each year the quantity exported exceeded the export subsidy reduction commitment.

Table 1 – GSM 102 subsidy after accounting for products outside the scope of *Agreement on Agriculture*, export subsidy reduction commitments, and other unscheduled products

Item	Formula	2005	2006	2007
		$U.S.		
Registrations, all products	A	2,170,833,377	1,359,810,921	1,484,472,033
Products outside the scope of *Agreement on Agriculture*	B	17,185,559	22,771,537	23,897,616
Registrations minus products outside *Agreement on Agriculture*	C = A-B	2,153,647,818	1,337,039,384	1,460,574,417
Registrations for scheduled products	D	817,481,946	570,326,093	695,406,627
Registrations that exceed permitted export subsidies	E	304,723,706	339,905,682	389,411,599
Registrations that do not exceed permitted export subsidies	F=D-E	512,758,240	230,420,411	305,995,028
Registrations minus permitted export subsidies	G = C-F	1,640,889,579	1,106,618,973	1,154,579,389
Registrations of other unscheduled products	H	51,170,370	278,239,565	0
Registrations minus other unscheduled products	I = G-H	1,589,719,209	828,379,387	1,154,579,389
Total cohort subsidy net of reestimates	J	10,275,000	15,213,000	18,105,000
Subsidy rate (%)	K = J/A	0.47%	1.12%	1.22%
Adjusted subsidy	L = I*K	7,524,467	9,267,565	14,081,545

Source: Exhibits US-13 and US-14

96.   The final adjustment takes into account the panel finding on the scope of unscheduled products at issue not otherwise already taken into account as outside the scope of the *Agreement on Agriculture*. As noted above, the panel specifically found that: "The unscheduled products at issue are (i) in the period 1 July-30 September 2005: cotton, oilseeds (including soybeans/soybean meal), protein meals, fresh vegetables, hides/skins and tallow; and (ii) in the period 1 October 2005 -30 September 2006: cotton, oilseeds, soybeans/soybean meal, protein meals, hides/skins, tallow and corn products." This adjustment subtracts the value of registrations for those unscheduled products not specifically enumerated by the panel in its finding for the two periods at issue. For July – September 2005 these unscheduled products are corn gluten meal, corn oil, pork offals, white corn, and yellow corn. For October 2005 – September 2006 these unscheduled products are distillers dried grains, corn oil, pork offals, breeding swine, white corn, and yellow corn (item H). Although Brazil did not submit evidence in respect of 2007, in the absence of any finding specific to 2007, the United States has simply not excluded any unscheduled products for that year. Subtracting these products comprising item H in each year yields an adjusted registration value of I.[106]

c.   Application of the Exclusions

97.   The final subsidy is calculated by using, contrary to the historical experience of the program presented above, for the annual amount of the subsidy for the program as a whole, the subsidy estimate net of reestimates for each of the 2005, 2006, and 2007 cohorts as reflected in the most recent data published in the annual U.S. Government Budget appendices and Federal Credit Supplements, including those for fiscal year 2009.[107]: (2005) $10,275,000; (2006) $15,213,000; (2007) $18,105,000 (labeled as "J" in table 1).

98.   For each cohort year, a subsidy rate for the GSM 102 program as a whole is then calculable by dividing the applicable subsidy estimate net of reestimate for a particular year by the total value of registered guarantees for the same year (before any adjustments) (result: item K). For example, for 2005, $10,275,000 is divided by $2,170,833,377 to obtain a subsidy rate of 0.47 percent. For 2006 and 2007, the corresponding subsidy rates would be 1.12 percent and 1.22 percent, respectively. The Arbitrators will note that the United States is using a conservative approach here, because in each case this method results in a more unfavorable rate than that found in the Federal Credit Supplement.[108]

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[106] Source: Exhibits US-14 and US-15 (for July-Sept. 2005).

[107] See chart, *supra*.

[108] Compare paras. 70 *et seq*., *supra*.

99.   This rate is then applied to the value of adjusted registrations to determine the adjusted subsidy. The final subsidy value for all products in dispute is labeled "L" in table 1 and accounts for all three adjustments.   For 2005, the total subsidy is $7,524,467. For 2006, it is $9,267,565. For 2007, it is $14,081,545. The average of these three figures is $10,291,192.

Table 2 – U.S. export subsidy quantity commitments and exports under GSM 102 program, July – June, in metric tons

Commodity or group	WTO commitment	Quantity exported under GSM 102 by delivery year		
		2005	2006	2007
Wheat/wheat flour	14,522,060	2,709,735	1,196,048	811,895
Coarse grains 1/	1,560,599	11,887	35,500	0
Rice	38,544	265,070	148,159	127,357
Vegetable oils 2/	141,299	46,705	3,626	7,535
Butter	21,097	0	0	0
Skim milk powder	68,201	96	0	0
Cheese	3,030	0	0	0
Other milk products	34	0	0	0
Bovine meat	17,589	0	0	0
Pigmeat	395	1,705	550	534
Poultry meat/offals	27,994	235,656	388,520	365,494
Live dairy cattle 3/	11,024	0	0	0
Eggs 4/	6,919,603	0	0	0

1/ Includes barley, grain sorghum, barley malt, and mixed feed ingredients.

2/ Includes soybean oil and cottonseed oil.

3/ Number of head.

4/ Dozen.

100.   Even this methodology and result actually *overstates* the amount of subsidy by including both guarantees subsequently cancelled and guaranteed amounts corresponding to quantities ultimately not shipped. To the extent actual transactions delivered lesser quantities of commodities and therefore lower overall transaction values, the total credit guarantee exposure would be correspondingly reduced.[109]

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[109] Any claim on a guarantee would have to substantiate entitlement to payment based on the actual export quantities and values. *See,* 7 CFR §1493.110(b)(4)(v) and 7 CFR §1493.80(a).

101.   USDA maintains data on every registration transaction. An extract of this data is presented in Exhibit US-14. An exporter initially registers a sale to receive a GSM 102 guarantee. The Registration Guarantee Value is the maximum principal amount (excluding eligible/guaranteed interest) that CCC will pay to the exporter for defaults under the program, usually 98% of the sales registration value. The exporter will also register a provisional price for the sale, although the final price on many contracts is not fixed until the date of delivery. Thus, the Registration Guarantee Value and the provisional price imply a quantity that will be exported.[110] The Registration Guarantee Value includes both value of the commodities and freight cost.

102.   The data system also tracks the value of the goods actually exported (the Delivery Phase Out Amount). In many instances, the Delivery Phase Out Amount (actual export shipment) is smaller than the Guarantee Registration Value. This difference could reflect a change in the provisional price or simply reflect that the exporter shipped an amount different from that contemplated in the value initially registered.

103.   To the extent actual shipments are less than the guaranteed registration amounts, the quantity data used to account for the permitted export subsidies overstates the value of the subsidy for those products. For example, the value of deliveries for all products was smaller than the value of registrations for all 3 years (Table 3).

104.   In addition, cancellations of GSM 102 registrations occur for any number of commercial reasons. (Table 3). As in the case of undershipments, to the extent quantities actually exported are lower than indicated by the registration value as a result of cancellations, the subsidy is overestimated. Of the three scheduled products in dispute, the largest cancellations were for poultry meat/offals (table 4).

105.   The same subsidy rate (Item K in table 1) is then applied to the delivery value and the registration value minus cancellations (Table 5). These adjustments result in a smaller subsidy for GSM 102 than the method based on using registration values.

Table 3 – Comparison of Registration Guarantee Values, Delivery Phase Out Values

Item	2005	2006	2007
	$U.S.		
Guarantee Registration value	2,170,833,377	1,359,810,921	1,484,472,033
Delivery Phase Out Amount	2,022,921,799	1,254,779,040	1,399,533,339

Exhibit US-17.

[110] Exhibit US-16 is an example.

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Registrations for scheduled products	817,481,946	570,326,093	695,406,627
Delivery Phase Out Amount for scheduled products	775,399,542	518,161,905	637,783,035

Source: Exhibit US-A13

Table 4 – Registered Quantities Under Guarantees and Quantities Cancelled, for Rice, Pigmeat and Poultry meat/offals

Item	2005	2006	2007
	July – June, metric tons		
Rice			
Guarantees	265,070	148,159	127,357
Cancellations	0	0	0
Poultry/offals			
Guarantees	235,656	388,520	365,494
Cancellations	0	34,261	63,434
Pigmeat			
Guarantees	1,705	550	534
Cancellations	282	0	108

Source: Exhibit US-A13

Table 5 – Alternative Subsidy Estimates

Item	2005	2006	2007
	$U.S.		
Subsidy based on registration values	7,524,467	9,267,565	14,081,545
Subsidy based on delivered amounts, including cancellations	6,974,227	8,316,243	13,080,142

Source: Exhibit US-A13

106.   Using the figures based on delivered amounts, averaged over the three years, yields a prohibited subsidy calculation of $9,456,871.

107.   Finally, if the Arbitrators use such a figure – or any figure – to authorize countermeasures by Brazil, a reduction must be made to Brazil may only take such countermeasures with respect to the impact of the alleged subsidy on itself.   If Brazil were permitted to take countermeasures for the entire amount of the subsidy, it would create a conflict for other Members who may have an interest in the GSM 102 program. If another Members chose to bring a claim with regard to GSM 102, and there was a finding of inconsistency with a WTO commitment, would that Member also be permitted to impose the same countermeasures? If so, it would surely be punitive. If not, the other Member might have a basis for countermeasures, but the DSB could not authorize them. Indeed, the DSB could have confronted this exact situation in this dispute if Brazil had prevailed on its claims against U.S. measures concerning Foreign Sales Corporations ("FSC"). The arbitrator in the dispute involving the European Communities ("EC") on these measures had already awarded to the EC the full amount of the subsidy based on an erroneous and misplaced theory of "*erga omnes*."[111] As a result, had Brazil prevailed, the DSB would have been unable to authorize any countermeasures for Brazil with respect to FSC.

108.   With regard to the findings in this case, it is difficult to assess the portion of the subsidy that might be allotted to Brazil. The proper way to measure appropriate countermeasures here is net cost to government, but excluding two things: 1) the figure must be reduced to account for the participation of Brazilian banks in the GSM 102 program; and 2) the figure must be reduced to

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[111] The United States recalls some of the many problems with the theory of *erga omnes*. This concept is drawn from public international *criminal* law, and describes an obligation which is owed to all states. The concept *erga omnes* is squarely at odds with the fundamentally bilateral nature of WTO and GATT dispute settlement and with the notion that WTO disputes concern nullification and impairment of negotiated benefits to a particular Member. WTO adjudicators are tasked with resolving disputes between specific complaining and defending parties. Adjudicators may not, through improper importation of the concept *erga omnes*, enforce WTO obligations on behalf of non-parties to a dispute. Moreover, the arbitrator in the FSC dispute made no attempt to explain how *erga omnes* or any other concept of public international law could have been relevant to its analysis. DSU Article 1.1 limits WTO adjudicators to applying the covered agreements, although DSU Article 3.2 provides that adjudicators may apply rules of *interpretation* of public international law. The concept of *erga omnes* is *not* a rule of interpretation of public international law, and it is not reflected in Articles 31 or 32 of the *Vienna Convention on the Law of Treaties.* Reliance on public international legal concepts outside of rules of interpretation is not permitted under either DSU provision, and the arbitrator erred in importing this concept as a means to justify its award.

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account for only Brazil's producers' interests in the program, such as by using the percent of Brazilian exports in the covered products.

> **B.** **Brazil's Calculations of Proposed Countermeasures for GSM 102 Are Based on Numerous and Incorrect Assumptions that Result in a Figure Far Higher Than Is Appropriate Under Article 4.10 of the DSU**

109. In its methodology paper, Brazil calculates a level for countermeasures for GSM 102 export credit guarantees in three parts[112]: (1) an alleged interest rate subsidy of $270 million[113] ; (2) alleged "full additionality," of $985 million,[114] which Brazil measures "as the entire value of a transaction backed by GSM 102 ECGs"[115] (based on its conclusion that in the absence of the guarantee no economic activity whatsoever would have taken place); and 3) alleged "marginal additionality" of $38.93 million, which Brazil measures as a full pass-through of an interest rate subsidy to "foreign importers [who] effectively enjoy a price reduced by the entire interest rate subsidy flowing from a GSM 102 ECG."[116] Because of the way Brazil makes its calculations, this "marginal" additionality is effectively equivalent to full additionality. Brazil's methodology purports to apply this three-part calculation solely to export transactions in fiscal year 2006 and solely to unscheduled products, rice, pig meat and poultry meat.

110. Using its methodology, Brazil reaches a total of $1.294 billion[117] for proposed countermeasures. Yet, this sum exceeds what could be appropriate in this case. In Section II.A., the United States explains that the findings adopted by the DSB in this dispute may only support the use of the cost to government standard under item (j) with respect to GSM 102. Brazil takes an entirely different approach, which has multiple with methodological errors. In each part of its calculation – interest rate, full additionality, and marginal additionality – Brazil makes serious errors that greatly inflate its calculation.

111. In evaluating GSM 102, it is important to recall that the program is for loan *guarantees*. It is not for loans, nor for grants. Yet, the $1.294 billion figure Brazil proposes for countermeasures

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[112] Brazil Methodology Paper, para. 64.

[113] Brazil Methodology Paper, para.38.

[114] Brazil Methodology Paper, para. 44.

[115] Brazil Methodology Paper, para. 40.

[116] Brazil Methodology Paper, para. 45.

[117] Brazil Methodology Paper, para. 5.

actually exceeds the full transaction value that Brazil uses, which is $1,110,394,000.[118] Brazil
therefore argues that the total subsidy for the transactions at issue equals *116.5 percent* of the total
value of the loans themselves.

112.   The United States addresses the errors in Brazil's methodology below. The United States
explains particular problems with Brazil's methodology for calculating the interest rate subsidy, full
additionality, and marginal additionality; and the United States demonstrates, by way of general
critiques and specific examples, how Brazil's erroneous methods inflate the figure Brazil proposes
for countermeasures.

1.   Brazil's Methodology for Calculating Interest Rate Subsidy Is Filled with Flaws and False Assumptions

113.   In the next several sections, the United States will present specific critiques of each
component of Brazil's calculation. In this section, the United States begins by analyzing Brazil's
construction of the interest rate subsidy. The United States then discuss the flaws in Brazil's
methodology for full additionality and marginal additionality. Each of these components – the
interest rate subsidy, full additionality, and marginal additionality – is a necessary block in Brazil's
construction of its countermeasures request, yet each of these components is fundamentally flawed.

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[118] Exhibit Bra-700, Worksheet 1. Brazil has, however, based its calculations on more
products than those in dispute. Brazil characterizes "the commodities at issue" as "unscheduled
products, rice pig meat and poultry meat" and has purported to apply this to fiscal year 2006 (1
October 2005 - September 30, 2006). Brazil Methodology Paper, paras. 5, 14. Brazil further
asserts that its calculations are based on the same commodities. Brazil Methodology Paper, para.
16. However, its calculations include more than those. For that period, the unscheduled
products in dispute are cotton, oilseeds, soybeans/soybean meal, protein meals, hides/skins,
tallow and corn products. Brazil, however, has also improperly included feed grains, the most
significant of which are white corn and yellow corn. Exhibit Bra-695, worksheet 2, footnote 4;
Exhibit Bra-702. Such grain corn is clearly not subsumed within the category of corn products in
dispute. For purposes of the GSM 102 program, corn products are explicitly defined as: "flour,
grits, flakes, starch, meal and gluten feed." Feed grains, which includes white and yellow corn, is
an entirely distinct category for GSM 102 program purposes and was not part of the compliance
panel's findings. Exhibit US-18: Eligible Commodities under the GSM 102 Program; Standard
Products for GSM 102 Updated October 1, 2005.
    Brazil estimated the amount of corn and oats in the feed grain category based on the
share of grain corn and oats in total U.S. feed grain exports. The total exports included in
Brazil's feed grains category is approximately $176 million and should be excluded.
    Secondly, with respect to rice, pigmeat, and poultry meat, Brazil has made no attempt to
subtract permitted amounts of export subsidies.

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114.   The first component is the interest rate subsidy. The results of Brazil's calculations of the interest rate subsidy are used in both the full additionality and marginal additionality components. Therefore, the problems in its calculation undermine Brazil's entire amount for proposed countermeasures. The problems include: 1) Use of false premises in attribution of GSM 102 guarantees to countries; 2) Flawed imputation of risk to bank obligors; 3) Misapplication of an approach of the U.S. Department of Commerce to determine purported market interest rates; and 4) Distortion by use of country-wide averages.

2.   Errors Cascade Through Brazil's Methodology for Imputing Risk Based on 1) Non- Existent Obligors 2) Potential Obligors that Are Not Necessarily Actual Obligors

115.   In the case of countries with *no* approved obligors (Dominican Republic, Macedonia, Uruguay),[119] – that is, countries for which no guarantees could be issued – Brazil nevertheless imputes extremely high risk.[120]   Brazil correspondingly assigns extremely high interest subsidy rates in these cases.[121] But in these cases, CCC was, by definition, exposed to *no* such risk.

116.   For countries where there is an approved potential obligor, Brazil uses a multi-part process to determine risk and, in turn, interest rate subsidy. The process starts from the erroneous approach of allocation unrelated to actual transactions, and the error cascades.[122]

117.   The steps in the process are as follows:

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[119] Exhibit Bra-696, Worksheet 1

[120] Exhibit Bra-696, Worksheet 3, p. 2. Brazil assigns the worst possible risk to both the Dominican Republic and Uruguay (18) and therefore also to all transactions it associates with those countries. It assigns a rating only three notches better (16) to Macedonia and transactions Brazil associates with it.

[121] Exhibit Bra-698, Worksheet 4 (Column K or L). Brazil imputes an identical interest rate subsidy to the 3 countries' alleged transactions of 28.98 percent.

[122] The cascade of errors is encapsulated in Exhibit Bra-698, Worksheet 4 and Brazil Methodology Paper para. 38, where the calculation of interest rate subsidy is dependent on a series of calculations, all of which are fundamentally grounded in the misuse of the CCC Exposure Report. Column A of such worksheet starts with the erroneous list of countries allegedly representing 2006 obligors.

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(a) "Brazil assigns a particular credit rating to each foreign obligor";[123]

(b) "For foreign obligors that have not received credit ratings,[124] Brazil applies a methodology designed to determine and assign a rating"[125];

(c) Brazil imputes[126] a credit rating for every Brazil-hypothesized obligor that does not have a S& P rating (irrespective of whether it may have a Moody's[127] or Fitch's rating[128]);

(d) Brazil constructs a supposed market rate based on the foreign obligors it has assumed to participate in 2006 transactions;[129]

(e) Brazil then purports to calculate on this ill-founded basis "country-specific credit-risk averages"[130];

(f) Brazil then purports to determine the credit risk differential between average [S&P only] rated banks and purports to derive a credit-risk differential between a S&P-only rated bank and Brazil's own misguided "country-specific risk."[131] Brazil proclaims its result to provide a "distinct

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[123] Brazil Methodology Paper, para. 24.

[124] In fact, what Brazil means by this is only that the bank has not received a Standard and Poor's credit rating. Brazil Methodology Paper, paras. 26, 28, footnotes 38, 40. Any bank that has been rated by another agency but not S&P is, improperly, considered as "unrated" under Brazil's methodology. The United States notes, however, that another rating agency (Moody's) is apparently perfectly satisfactory for the calculation of default probabilities. Brazil Methodology Paper, para. 33.

[125] Brazil Methodology Paper, para. 24.

[126] Brazil Methodology Paper, para. 25.

[127] *Compare* Brazil Methodology Paper para. 22 and footnote 33 *with* Brazil Methodology Paper footnote 38 (para. 26).

[128] *See* Exhibit US-75.

[129] Brazil Methodology Paper, para. 19.

[130] Brazil Methodology Paper, para. 29.

[131] Brazil Methodology Paper, para. 30; *See,* Exhibit Bra-698, Worksheet 4, where the significance of this compounded error is manifest in its use for calculation of interest rate subsidy.

credit rating for every obligor in every GSM 102 recipient country,"[132] but its parameters at inception have little to no grounding in the actual GSM 102 transactions and obligors for FY 2006; and

(g) Brazil then calculates alleged market interest rates based on the same conceptual problems: they are calculated "for each CCC-approved obligor categorized in risk groups identified above."[133]

118.   There are errors throughout this process. The United States discusses key errors below.

2.   Brazil's Use of the CCC Exposure Report Results in an Erroneous Allocation of Guarantees by Countries

a.   Allocation of Loans to Countries

119.   The first fundamental building block of Brazil's methodology is the initial imputation of "the value of transactions supported by GSM 102 ECGs on a foreign obligor-specific basis."[134]   In this part of the calculation, Brazil allocates the GSM 102 guarantees by country and then calculates share to "determine the share of GSM 102 ECGs for individual countries within a certain region."[135] In short, Brazil's model requires that every GSM 102 transaction be attributed to a specific country. Brazil uses a particular report of CCC (the CCC "Exposure Report")[136] to do this, regardless of the fact that the report does not track the "historical share of GSM 102 activity by country."[137] This "historical share" is then "used as an attribution factor to distribute GSM 102 activity in FY 2006 to individual countries within the regions."[138] But because Brazil misuses the CCC Exposure Report, these allocations are wrong and misleading. This error reverberates throughout its entire methodology and grossly exaggerates results.

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[132] Brazil Methodology Paper, para. 30.

[133] Brazil Methodology Paper, para. 31.

[134] Brazil Methodology Paper, para. 13.

[135] Brazil Methodology Paper, para. 14.

[136] Exhibit Bra-587 (Commodity Credit Corporation, Guarantee Loan Program Summary for Foreign Agricultural Service as of June 30, 2006)

[137] Brazil Methodology Paper, para. 15.

[138] Brazil Methodology Paper, para. 15.

120.   First, it is important for the Arbitrator to understand what the CCC Exposure Report is and is not. Even a basic examination of the CCC Exposure Report demonstrates it is not suitable for Brazil's purpose of deriving a distribution of GSM 102 guarantees by country in fiscal year 2006.[139] Specifically, the CCC Exposure Report:

(a) is not limited to transactions in FY 2006;[140]

(b) includes data on transactions that occurred long before the period under examination, and indeed extends to residual information from transactions that occurred in the early 1980s.[141]

(c) is not even limited to financial exposure to CCC as a result of issued export credit guarantee transactions at all, but extends to financial information on amounts *due* CCC as a *receivable*.[142]

121.   The way Brazil uses this report even results in incongruities among Brazil's own figures. For example, for purposes of its calculations, Brazil observes that the total value of GSM 102 guarantees issued in fiscal year 2006 is $1.363 billion.[143] However, for purposes of its allocation exercise, it bases its figure for regional activity on a number that, if applied uniformly to all 2006 activity, would equal $5.726 billion.[144]

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[139] Aside from the substantive problems in using the Exposure Report for the purpose Brazil intends, the report itself is dated as of 30 June 2006. To the extent it contains any information related to GSM 102 transactions for FY 2006, such information would extend to only 9 of the 12 months of that fiscal year.

[140] A simple illustration of this point is that it includes data for both GSM-103 and SCGP, neither of which issued any guarantees in FY 2006.

[141] The CCC Exposure Report includes, for example, information related to the GSM-5 program, which was a direct credit program of CCC last used in *1984*.

[142] For GSM 102, for example, of the total "GSM Outstanding" figure of $5.7 billion, nearly $2.5 billion consists of "Rescheduled Outstanding," which refers to amounts to be *received* by CCC. This figure does not refer to the value of export credit guarantees issued in 2006 or indeed in *any year*.

[143] Brazil Methodology Paper, para. 14**;** Exhibit-Bra 513; Exhibit Bra-695, Worksheet 2. The figure on this worksheet is $1.088 billion, ostensibly to exclude certain products not in dispute. Brazil Methodology Paper, para. 16. As noted, however, Brazil has still included in its calculations some products not in dispute.

[144] The exact total is $5,725,947,311. This total is the "GSM Outstanding" figure in the CCC Exposure Report. (Exhibit Bra-587)

122.   Brazil's approach creates large errors in allocation of GSM 102 guarantees. The extent of the errors is evident from a few pertinent examples, relating to the allocation for individual countries and allocations within regions.

       b.   **Specific Examples of Brazil's Misuse of the "Total" Number in the Exposure Report**

123.   Brazil attributes a nearly $71 million share of 2006 export credit guarantee activity to the Dominican Republic.[145] The Exposure Report, however, shows *no* contingent liability for principal or interest of the Dominican Republic *at all* attributable to *any year*. In fact, in fiscal year 2006 no GSM 102 guarantees were issued in respect of any Dominican obligor. Indeed, as Brazil acknowledges, no Dominican obligors were even approved in 2006.[146] The entire amount of $71 million is "rescheduled outstanding" - meaning money due CCC - and is completely unrelated to any 2006 guarantees.[147]

124.   For Peru, Brazil attributes over $291 million[148] of GSM 102 activity in fiscal year 2006, but of this amount $245.5 million is "rescheduled outstanding" and thus not related to issuance of guarantees at all.[149]

125.   For Jamaica, over two-thirds of supposed activity is also "rescheduled outstanding."[150]

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[145] Exhibit Bra-695.

[146] Exhibit Bra-696, Worksheet 1, p. 1

[147] Exhibit Bra-587. As a result, Brazil's characterization of its Exhibit Bra-695, Worksheet 1 as "list[ing] countries with outstanding GSM 102-guaranteed credits" is misleading in the extreme. Brazil Methodology Paper, para. 15

[148] Exhibit Bra-695.

[149] Exhibit Bra-587. In fact, for FY 2006 internal USDA data indicates that GSM 102 guarantees were issued in respect of only one Peruvian obligor in the total amount of approximately $5 million. This also illustrates the inappropriate use even of the figures for contingent liability of principal, which as of the date of the CCC Exposure Report (June 30, 2006), on 3-year guarantees, could have extended as far back to guarantees issued on or after approximately June 30, 2003. Although only $5 million of guarantees on Peruvian obligations were extended in FY 2006, Exhibit Bra-587 shows contingent liability of principal for Peru of approximately $40.6 million.

[150] Exhibit Bra-587.

126.   These countries are among the most obvious examples. Such misuse of the CCC Exposure Report is throughout this attribution exercise of Brazil's methodology in Exhibit Bra-695.

127.   In terms of errors in regional allocation, of the countries to which Brazil attributes "activity within region" in Exhibit Bra-695, three countries had no obligor to which a 2006 GSM 102 guarantee applied: the Dominican Republic, Macedonia, and Uruguay.

c. Further Error with Regards to Regional Assignments

128.   Brazil compounds the error of its misuse of the CCC exposure report by also making the false assumption that the obligors in GSM 102 transactions in a region are necessarily limited to obligors located within that region. To the contrary, however, obligors within the Caribbean, Central American, South American regions were eligible for transactions into the other regions.[151] In contrast, under Brazil's methodology, all Caribbean region guarantees are associated with obligors located in countries in the Caribbean region. For FY 2006, however, South American banks (Brazil, Colombia, and Peru) accounted for one-third of all Caribbean activity.[152]

129.   A simple illustrative example of the consequence of this false assumption is that Brazil ascribes a 50 percent share of the Southeast Balkan region to Macedonia.[153] However, no

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[151] *See,* http://www.fas.usda.gov/excredits/foreignbanks.html*.* There eligible banks are listed, and the cross-regional eligibility is described. For example, in relevant part, it provides for the Caribbean Region:

"Caribbean Region
CCC has determined that the following countries in this region are bank eligible: Antigua and Barbuda, Aruba, Bahamas, Barbados, Cayman Islands, Dominica, Dominican Republic, Grenada, Guadeloupe, Jamaica, Montserrat, Netherlands Antilles, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and Grenadines, Trinidad and Tobago, and British Virgin Islands. Banks interested in becoming approved by CCC should visit the Foreign Banks Eligibility page for more information.

Note: In addition to the banks listed below, the banks listed under Central America Region, Mexico and South America Region are approved to transact business in the Caribbean Region. Also, banks in the Caribbean Region are approved to transact business in Central America Region, South America Region, and Mexico."

[152] In fact, ironically, Brazilian banks are among the most active cross-regional participants, accounting for over 20 percent of FY 2006 Caribbean region activity and over 13 percent of Central American activity in the same year.

[153] Exhibit Bra-695, worksheet 1, footnote 3: "Macedonia was added as eligible by the CCC in FY 2006. Therefore, Brazil assumes that Macedonia is being allocated 50 percent of the ECGs issued to the region "Southeast Balkan" in FY 2006."

Macedonian bank is approved now,[154] nor was any Macedonian bank approved in 2006. Brazil's methodology paper appears to recognizes this,[155] but despite the resulting impossibility of a guaranteed transaction with a Macedonian obligor in 2006, Brazil ascribes to Macedonian obligors a 50 percent share of the Southeast Balkan regional activity.[156] In this respect, Macedonia is like the Dominican Republic, for which no approved obligor existed, but to which Brazil ascribes 45 percent of the share of 2006 GSM 102 activity within the Caribbean region.[157]

d.   The Effects of Brazil's Misuse of the CCC Export Liability Report in its Calculations

130.   Therefore, to use the CCC Exposure Report to derive a "historical share of GSM 102 activity by country [which is] then used as an attribution factor to distribute GSM 102 activity in FY 2006 to individual countries within each region,"[158] as Brazil has done, does not result in allocations that reflect the facts. These conclusions do not relate to the actual distribution of GSM 102 export credit guarantees, because of the way Brazil derives them.

131.   These erroneous allocations of GSM 102 activity are a result of the steps that Brazil takes to use the Exposure Report information. The steps are the following. First, Worksheet 2 of Bra-695[159] employs the "activity share" to assign values to exports to such region by commodity. So, for example, Brazil uses the 45 percent share it derived for the Dominican Republic to allocate by commodity export credit guarantees issued in respect of Dominican obligors, despite the fact that no Dominican obligors existed.

132.   Second, Brazil applies this derived "share" to make the resulting incorrect allocation in a series of steps that begins with the identification of a total value of export credit guarantees for a particular region from Exhibit Bra-513. As an example, in the case of the Caribbean Region that total regional value is $97 million. In Exhibit Bra-513, that total regional value is broken down by

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[154] Brazil Methodology Paper, para. 14, fn. 18

[155] Exhibit Bra-696, worksheet 1, page 4. (No Macedonian obligor appears on this list of 2006 approved foreign obligors).

[156] Even though no Macedonian obligor was approved, and therefore no Macedonian obligor could exist, Brazil allocates 50 percent of the $2 million of total pigmeat GSM 102 guarantees in the Eastern Balkan Region to Macedonia. In addition, Brazil again makes no attempt to make allowance for permitted amounts of pigmeat export subsidies.

[157] Exhibit Bra-695, Worksheet 1.

[158] Brazil Methodology Paper, para. 15

[159] *See also*, Brazil Methodology Paper, para. 16

commodity groups (for example, $5.4 million for rice; $11.6 million for wheat, and $45.5 million for feed grains) Brazil subtracts from the total value amounts that Brazil necessarily recognizes are not in dispute (e.g., all $11.6 million for wheat).[160] Brazil takes its net result for GSM 102 guarantees - in this case $77.7 million for the Caribbean Region - and allocates it among its fictitiously derived obligor countries. The resulting 45 percent share for the Dominican Republic is applied to $77.7 million and results in an overall allocation to that country of $34.953 million. Brazil then distributes that amount proportionately among the hypothesized exports by commodity to that country.

133.   Third, Brazil subsequently uses these erroneous allocations to calculate a proportional transaction value, which is in turn used as one component in Brazil's calculation of an interest rate subsidy.[161]

134.   To illustrate the significance of the error of Brazil's foundational country and commodity allocations one can simply compare official U.S. export data for the period in question. Exhibits US-19 and US-20 (Comparison of Brazil's Method for Determining Country Destination of Exports Under GSM 102 with Actual U.S. Exports for FY2006 and supporting data) compares Brazil's estimated exports under the GSM 102 program for FY 2006 with actual U.S. exports for 20 key country and commodity pairs that under Brazil's methodology purportedly account for a large share of GSM 102 transactions. Brazil's calculation of GSM 102 transactions greatly exceeds total exports from the United States for 11 pairs.[162]

135.   For example, in Exhibit Bra-695 Worksheet 2, Brazil ascribes $28.708 million of GSM 102 guaranteed exports of pigmeat to Kazakhstan. U.S. census data, however, shows *no* exports of pigmeat to Kazakhstan for the relevant period. Similarly, Brazil alleges $23.892 million of guaranteed exports of pigmeat to Ukraine. Again, U.S. census data shows *zero* pigmeat exports to Ukraine.

136.   Recall that these guarantees allocations are later used for the "additionality" component of Brazil's calculation. This, of course, also has major ramifications for Brazil's assertions of "full additionality" – in some cases, Brazil is calculating additionality based on exports that did not occur at all.

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[160]Brazil, however, makes no allowance for permitted export subsidies for rice, and overstates the amount of feed grains in dispute by failing to subtract grain corn.

[161] Brazil Methodology Paper, para. 38; Exhibit Bra-698, Worksheet 4, columns B, C, K, I. The interest rate subsidy (column M) = (this transaction value of column C) x (column K)

[162] Panama (cotton, oilseeds, feed grains, rice); Trinidad (feed grains); Hong Kong (oilseeds); Kazakhstan (poultry meat and pigmeat), Ukraine (poultry meat and pigmeat), Phillippines (oilseeds).

137.   Even from the first step of the interest rate subsidy calculation, Brazil's approach is without sound foundation, or indeed any foundation at all. As the United States has demonstrated, those allocations are derived from a process that has almost nothing to do with GSM 102 guarantees issued in fiscal year 2006. All of the ensuing calculations in Brazil's methodology therefore part from this false premise. This same kind of error is manifest throughout Brazil's methodology with respect to all countries in regional programs.[163]

3.   Brazil's Methodology for Imputing Risk Omits a Reasonable Inquiry into Obligors and Results in Exaggerated Estimates of Risk

138.   The next building block Brazil places on its foundation is imputation of risk. Brazil uses its erroneously determined countries of obligor to "distribute GSM 102 export credit guarantees issued for a particular country equally amongst all approved obligors of that country."[164] Specifically, Brazil takes the total guarantees assigned to the country and divides the loan guarantee amounts equally among the approved (bank) obligors. This involves determining credit ratings and market interest rates for obligors, and then using this to derive country-specific risk. As detailed below, Brazil commits numerous methodological errors in assigning obligor risk. The results of Brazil's methodology are that obligors in 19 out 21 countries (Brazil aggregates the individual obligor findings to the country level) are uncreditworthy – including those of Brazil. This finding makes the interest rate subsidy estimate, and calculations of marginal and full additionality, far too high.

a.   Brazil Assigns Credit Ratings to Obligors Seemingly Without Regard to Available Information on the Obligors

139.   In the process Brazil uses to impute risk and determine interest rate subsidy, a correct assignment of credit ratings to obligors is crucial. Brazil's method to calculate interest rate subsidy (and thereby additionality) depends in large measure on its method of assignment of credit ratings to

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[163] With respect to countries not within regional programs, such distribution among all approved obligors has no necessary correlation with the actual distribution among obligors that actually entered into 2006 GSM 102 transactions.

[164] Brazil Methodology Paper, para. 17. The United States would also note that mere status as an approved obligor does not necessarily mean that the particular obligor engaged in any GSM 102 transactions in fiscal year 2006, or any other particular time.

those obligors as erroneously identified by Brazil.[165] Yet Brazil's assignment of credit ratings relies almost exclusively on unfounded assumptions and the single metric of availability of S&P ratings.

140.   Brazil's method of assignment of credit ratings makes a number of assumptions:

(1) the lack of a S&P rating means a bank is "unrated";[166]

(2) "unrated" (i.e., not rated by S&P) banks in a particular country should be treated as "one 'notch' (or credit risk group) below the worst-[S&P] rated obligor in that country;"[167]

(3) "unrated" (i.e., not rated by S&P) banks in a particular country "in which not a single CCC-approved foreign obligor has received an S&P credit rating" should be treated as "having a credit rating that is four 'notches' below sovereign risk";[168] and

(4) obligors possessing or imputed by Brazil to have a credit rating inferior to 10 are "uncreditworthy," therefore unable to secure credit,[169] and thus exports would not have occurred but for the existence of GSM 102 guarantees.[170]

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[165] One can readily see the significance of the assignment of risk ratings to putative obligors in the sequential steps of Brazil's interest rate calculation described in Brazil Methodology Paper, paras. 37, 38 and Exhibit Bra-698. As noted above, in the first place, some of Brazil's putative obligors in fact had no transactions in FY 2006 under the GSM 102 program. Brazil simply asserts that "full additionality accrues to U.S. exporters from GSM 102-backed transactions involving obligors with a credit rating of "11" or worse." Brazil Methodology Paper, para. 44 .

[166] Brazil Methodology Paper, paras. 26, 28, footnote 38. Brazil itself notes that Moody's has an entire risk rating system that corresponds to the S&P system. Brazil Methodology Paper, para. 22 and fn. 33. The United States has also previously described Fitch's rating system. Exhibit US-75.

[167] Brazil Methodology Paper, para. 27.

[168] Brazil Methodology Paper, paras. 28-30.

[169] Brazil Methodology Paper, paras. 36, 34.

[170] Brazil Methodology Paper, paras. 42-44. A further unstated assumption of Brazil is that CCC's own bank risk analysis is utterly meaningless. However, CCC establishes internal bank limits to govern exposure to potential defaults by obligor banks in individual transactions, and all foreign banks must be approved before a guarantee can be issued in respect of any transaction. *See, e.g,. Upland Cotton (21.5), para. 14.105*

141.   Brazil's assumptions lead to absurd results. Under Brazil's method to assign credit ratings, *all* "unrated" banks in *all* countries that Brazil has asserted are recipient countries, with the exception of Korea (*i.e.*, 20 of 21 countries), are uncreditworthy.[171]

142.   With respect to "unrated" obligors in "unrated" countries (*i.e.*, no S&P rated bank among the CCC-approved potential obligors in the country), Brazil simply imputes a rating four notches below the corresponding sovereign rating.[172]   For 8 of these 9 countries, this results in a single country rating for all banks correspondingly 4 notches below sovereign rating (for the other country, it is 3 notches below sovereign grade.)[173]   The result of this approach is that if a country does not have at least one CCC-approved obligor with a S&P rating, then no creditworthy bank exists in the *country at all*. It is as if the country's entire banking system exists only to service GSM 102 guaranteed transactions.

        b.   **Numerous Examples Show that the Assumptions Brazil Uses to Determine Credit Ratings Are False**

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[171]   Exhibit Bra-696. First, in the case of 11 of the 12 countries in which Brazil has identified at least one S&P-rated bank among CCC-approved potential obligors, the worst-rated bank has an S&P rating of 10 or inferior. As a result, by Brazil's arbitrary designation of any bank with a rating of 10 or inferior as "uncreditworthy," all "unrated" banks in such countries are necessarily deemed uncreditworthy. Worksheet 1 of Exhibit Bra-696 provides the S&P rating for CCC-approved obligors by country, as well as the sovereign rating of each country. In Worksheet 3, for the 12 countries that have at least one rated obligor, Brazil imposes its "one notch worse" methodology to rate unrated banks (Column C, black font. Rated banks are in red font). Using Brazil as an example, the worst S&P rated bank is 15. Therefore, all "unrated" banks in Brazil are deemed to receive a rating of 16. Brazil then matches such rating to a corresponding Default Probability (DP) using Worksheet 2. Brazil does not provide more precise or accurate information, notwithstanding that information on Brazilian obligor banks is likely to be available to it.

[172] Brazil Methodology Paper, para. 30, fn. 47*; Exhibit Bra-696, Worksheet 4, Column N.

[173]   Exhibit Bra-696, Worksheet 4, Compare Columns C and N. All but the Dominican Republic are 4 below sovereign rating. The method by which Brazil derives the single country rating is opaque. Brazil calculates an average country rating for countries that have "rated" banks. Then Brazil uses this rating to derive country ratings for those countries with no "rated" banks. Exhibit Bra-696, worksheet 3 presents an average default probability (DP) for "rated" banks and another for all banks (including the false assumption that "unrated" banks should receive a rating one notch lower, result to in incorrect assumptions of uncreditworthiness). Worksheet 4 purports to match credit risk groups to "unrated" obligors, but no explanation is provided, for example, of the derivation of "corresponding average rated bank rating (numerical)". From this rating a ratio is subtracted, which is also not explained.

143.   These assumptions are demonstrably false.   The United States has compiled sets of examples that plainly show that Brazil's approach is insupportable. The examples are illustrative, not exhaustive.

144.   The first set of examples consists of banks that are not rated by S&P, but which are rated by another rating agency as investment grade. Brazil's assumption that a bank is "unrated" if it does not have an S&P rating is not specific to 2006, but the United States can offer some examples directly applicable to 2006 to illustrate that an allegedly "unrated" bank may in fact rise to the level of investment grade. These examples are as follows:

> (1) *Russian Agricultural Bank (Rosselkhozbank).* This is among the most dramatic illustrations of the fallacy of Brazil's assumption. Unrated by S&P in 2006, this bank is treated by Brazil as "unrated" and is imputed a rating one notch lower than the worst S&P-rated Russian bank that was a potential obligor in 2006. The worst S&P rating among those that received such a rating was a dismal 17.[174] Brazil therefore imputes to Rosselkhozbank the absolute worst possible rating of 18.[175] However, in 2006, Rosselkhozbank enjoyed an investment grade rating from another ratings service. At the beginning of 2006, this bank had a Fitch Rating of BBB (numeric rating of 9), which was upgraded in July 2006 to BBB+ (numeric rating of 8);[176]

> (2) *Industry and Construction Bank (now known as Bank VTB North-West OJSC).* Rated an absolute worst 18 for identical reasons under Brazil's methodology,[177] this bank enjoyed in 2006 a Fitch rating of BBB (numeric rating 9) in 2006;[178]

> (3) *Banco Nacional de Comercio Exterior of Mexico (Bancomext).* Unrated by S&P in 2006, this bank is assigned by Brazil a rating one notch lower than the worst-rated Mexican bank that was a potential obligor in 2006. As a result, Brazil assigns Bancomext a rating of 11, one notch below investment grade, rendering it uncreditworthy under Brazil's

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[174] Exhibit Bra-696, Worksheet 1, p. 2 (International Bank of St. Petersburg)

[175] Exhibit Bra-696, Worksheet 3.

[176] Exhibit US-21, Bankscope bank report on Rosselkhozbank - Russian Agricultural Bank, p. 5   Bankscope is a comprehensive, global database containing information on public and private banks. It includes information on 29,000 banks around the world. It combines data from the main information provider, Fitch Ratings, and nine other sources. http://www.bvdep.com/en/bankscope.html.

[177] Exhibit Bra-696, Worksheet 3.

[178] Exhibit US-22, Bankscope bank report on Bank VTB North-West OJSC (previous name - Industry & Construction Bank), p. 5.

methodology.[179] However, in 2006, Bancomext enjoyed a BBB Fitch rating, which is investment grade;[180]

(4) *RBTT Bank Limited of Trinidad and Tobago.* Brazil treats this bank as "unrated," with an uncreditworthy rating of 11.[181] However, in 2006, Fitch rated this bank as investment grade;[182]

(5) *Scotiabank El Salvador, S.A. of El Salvador.* Brazil treats this bank as "unrated", with an uncreditworthy rating of 13.[183] However, Fitch rated this bank in 2006 as investment grade;[184]

(6) *Banco Multisectorial de Inversiones of El Salvador.* Brazil also treats this bank as "unrated"and also imputes to it a rating of 13,[185] but Moody's assigned an investment grade rating of Baa3 to this bank in 2006.[186]

145.   These examples serve directly to refute each of Brazil's assumptions (1) , (2), and (3) noted in above: these banks are not only rated, but they also have an investment grade. They are also far superior to one notch below the worst-rated obligor in the applicable country.

146.   The second set of examples consists of banks that are not rated by S&P but nonetheless are better than one notch below the worst-rated S&P bank in that country (even if not investment grade). The examples here are three banks from Kazakhstan.

147.   The examples are:

(1) *Alliance Bank, Kazakhstan.* Unrated by S&P in 2006, this bank is assigned by Brazil a rating one "notch" lower than the only S&P-rated Kazakh bank (Nurbank, rated at 15) that

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[179] Exhibit Bra-696, Worksheet 1, p. 2; Worksheet 3, p. 2.

[180] Exhibit US-B23, Bankscope bank report on Bancomext, p. 10.

[181] Exhibit Bra-696, Worksheet 1, p. 1. Worksheet 3, p. 2.

[182] Exhibit US-24, Bankscope bank report on RBTT Bank Limited, p. 2.

[183]   Exhibit Bra-696, Worksheet 1, p. 1. Worksheet 3, p. 2.

[184]   Exhibit US-25, Bankscope bank report on Scotiabank El Salvador, S.A., p. 5

[185] Exhibit Bra-696, Worksheet 1, p. 1. Worksheet 3, p. 2

[186]   Exhibit US-26, Bankscope bank report on Banco Multisectorial de Inversiones, p. 8

was a potential obligor in 2006. As a result, Brazil assigns Alliance Bank a rating of 16.[187] In 2006, however, Alliance Bank had a Fitch rating of BB- , corresponding to a rating of 13;[188]

(2) *Bank Center Credit, Kazakhstan*. Brazil imputes to this bank a rating of 16 for the same reasons.[189] Yet, in 2006, Fitch also rated this bank as BB- (13);[190]

(3) *Bank Caspian, Kazakhstan*. Brazil imputes to this bank a rating of 16 for the same reasons.[191] Yet, in 2006, Fitch rated Bank Caspian at B+ (14).[192]

148.   The third set of examples is banks that are not rated by S&P, but are better than four "notches" below sovereign risk of the respective country.

149.   The examples are:

(1) *Banco Industrial, S.A. of Guatemala.* As Brazil did not identify an S&P rating among CCC-approved obligors for 2006, it treats the entire country as "unrated"and assigns a uniform rating of 17 to all Guatemalan banks, which is 4 notches below the sovereign risk rating of 13.[193] In 2006, however, Fitch rated Banco Industrial as BB (numerical rating of 12), which is not only better than 4 notches below sovereign rating, it is superior to the sovereign rating of Guatemala;[194]

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[187] Exhibit Bra-696, Worksheet 1, p. 2; Worksheet 3, p. 2.

[188] Exhibit US-27, Bankscope bank report on Alliance Bank, p. 5.

[189] Exhibit Bra-696, Worksheet 1, p. 2; Worksheet 3, p. 2.

[190] Exhibit US-28, Bankscope bank report on Bank Center Credit, p. 5.

[191] Exhibit Bra-696, Worksheet 1, p. 2; Worksheet 3, p. 2.

[192] Exhibit US-29, Bankscope bank report on Bank Caspian, p. 6.

[193] Exhibit Bra-696, Worksheet 4, Columns C and N.

[194] Exhibit US-30, Bankscope bank report on Banco Industrial, S.A.. P. 4.

(2) *UkrSibbank, JSIB of Ukraine.* Brazil similarly assigned a uniform rating of 17 to all Ukrainian banks, where the sovereign risk rating was 13.[195]   In 2006, however, UkrSibbank was rated BB- by Fitch (numerical rating of 13).[196]

(3) *Bank Forum, Ukraine.* In 2006, this Ukranian bank had a Fitch rating of B- (16).[197]

(4) *Denizbank of Turkey.* As in the cases of Guatemala and Ukraine, Brazil treated Turkey as an entirely "unrated" country, assigning a uniform rating of 17 to Turkish banks, 4 notches below the sovereign rating of 13.[198] In 2006, however, Fitch rated Denizbank as BB- (numerical rating of 13), equal to the sovereign rating, and in October, 2006, Fitch upgraded the rating to BB (numerical rating of 12), superior to the sovereign rating.

(5) *Turk Ekonomi Bankasi, Turkey.* As with all Turkish banks, Brazil imputes a rating of 17 to this bank. This bank, however, began 2006 with a Fitch rating of BB- (13), and in August, 2006 received a rating of BB (12), superior to the sovereign rating.[199]

(6) *Bancolombia, Colombia.* Like Turkey, Ukraine, Guatemala, and Kazakhstan, Colombia is treated by Brazil as an "unrated" country. As a result, all banks receive a rating of 16, which is 4 notches below the sovereign rating of 12.[200] In 2006, however, Bancolombia was rated BB+ (11) by Fitch, which is one notch below investment grade.[201]

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[195] Exhibit Bra-696, Worksheet 4, Columns C and N.

[196] Exhibit US-31, Bankscope bank report on JSIB UkrSibbank.

[197] Exhibit US-32, Bankscope bank report on Bank Forum, p. 9.

[198] Exhibit Bra-696, Worksheet 4, Columns C and N

[199] Exhibit US-33, Bankscope bank report on Turk Ekonomi Bankasi, p. 8. Moody's rated the bank as a 14 in 2006 (see p. 7 *id.)*, but that is still clearly superior than the 17 Brazil imputes to this bank. Other Turkish banks were rated by other services and provide additional examples: Bank Yapi ve Kredi started 2006 with a Fitch rating of BB- (13), and was upgraded to BB (12) in August, 2006. Exhibit US-34, Bankscope bank report on Bank Yapi ve Kredi, p.7 Asya Katilim Bankasi, had Fitch rating of B (15) in 2006. Exhibit US-35, Bankscope bank report on Asya Katilim Bankasi, p. 7.   MNG Bank, now known as Turkland Bank had a Fitch rating in 2006 of B- (16). Exhibit US-36, Bankscope bank report on Turkland Bank, p. 7

[200] Exhibit Bra-696 Worksheet 4, Columns C and N.

[201] Exhibit US-37, Bankscope bank report on Bancolombia, p.2

150.   The fourth set of examples is banks with a credit rating inferior to 10 (and consequently "uncreditworthy" under Brazil's methodology) that were nevertheless demonstrably able to secure credit in ordinary credit markets.

151.   The examples are:

(1) *Banco BBM, S.A., Brazil.* In its submission, Brazil treats this S&P "unrated" bank as having a risk rating of 16.[202] Notwithstanding this imputed rating, Banco BBM's financial statement demonstrates ready access to credit markets in 2006. For example, funding related to import and export credit line operations from "borrowings abroad" amounted to nearly 80 million Brazilian reais. Interestingly, stated interest rates range only from 4.49 percent to 6.85 per cent per year.[203]   The Arbitrators should contrast such interest rates with the interest rates calculated by Brazil in its Methodology Paper: CCC-guaranteed rate of 5.18 percent[204] and a subsidy rate of 29.18 percent.[205]

The United States would particularly note Brazil's implication for its own banking sector. Brazil here alleges that *all* potential Brazilian obligor banks in 2006 had a credit rating inferior to 10 and were therefore uncreditworthy. Exhibit Bra-696, Worksheet 3. As a result, "those borrowers could not [without GSM 102] have secured credit at market at all." Brazil Methodology Paper, para. 40. "In the absence of the guarantee no economic activity whatsoever would have taken place." Brazil Methodology Paper, para. 40.

(2) *Banco Industrial de Guatemala.* Brazil treats this bank as an "unrated" bank in an "unrated" country and imputes a rating of 17 to it, 4 notches below the sovereign rating of 13. Its financial statement indicates, however, that as of December 31, 2006,[206] this bank reports that it had "uncommitted lines of credit with foreign banks to finance advances for pre-export activities, letters of credit and loans to the small and medium-sized business." As of December 31, 2006 the bank had such "authorized uncommitted lines of credit pending use in the amount of [quetzales]1,177,046,000." It further indicates it had "obtained

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[202] Exhibit Bra-696, Worksheet 3.

[203] Exhibit US-38, Banco BBM, Management's Notes to Financial Statements, (December 31, 2007 and 2006)Note 13, page 32, Borrowings and Repass Obligations.

[204] Brazil calculates this rate as LIBOR plus **[[ ]]** basis points. Brazil Methodology Paper, para. 9, fn. 14.

[205] Exhibit Bra-698, Worksheet 4.

[206] Exhibit US-39. Banco Industrial and Subsidiaries. Consolidated Financial Statements, December 31, 2007, 2006, and 2005. Note 14, Liabilities with Other Financial Institutions, pp. 23-24. All quotes in the paragraph are from this source.

financing in the international capital markets through two facilities amounting to US$300,000,000. . . . These facilities bear interest at an annual rate of LIBOR plus 1% and mature in April 2015."[207] As of December 31, 2006, "liabilities with other financial institutions bore annual interest rates fluctuating between 5.52 percent and 6.82 percent." The Arbitrators should again contrast such rates with the alleged CCC-guaranteed rate of 5.18 percent and Brazil's imputed interest subsidy rate for all Guatemalan banks of 29.18 percent.[208]

(3) *Asya Katilim Bankasi,[209] Turkey*. Another "unrated" bank from an "unrated" country with a Brazil-imputed rating of 17, this Turkish bank reports in its 2006 financial statement USD $81.657 million (126.696 million Turkish lira) in dollar-denominated loans with one to six-year maturities from foreign banks and institutions.[210]

(4) *Turkland Bank,[211] formerly known as MNG Bank, Turkey*. This bank received a $40 million one-year internationally syndicated loan involving banks from 6 different countries at an interest rate of LIBOR plus 70 basis points.[212] Brazil, however, imputes an interest subsidy rate of 29.18 percent.[213]

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[207] Such tenor indicates that the financing cannot be related to GSM 102.

[208] Exhibit Bra-698, Worksheet 4.

[209] 2006 Fitch rating of B (15), see, *supra*.

[210] Exhibit US-40. Asya Katilim Bankasi A.S. Notes to the Unconsolidated Financial Statements for the year ended December 31, 2006, p. 45.

[211] 2006 Fitch rating of B- (16), see, *supra*.

[212] Exhibit US-41. Turkland Bank (MNB Bank A.S.) 2006 Annual Report, p. 13. Yet another "unrated" Turkish bank, Yapi ve Kredi also had ready access to considerable foreign-currency denominated short and medium-term loans. Exhibit US-42. Unconsolidated Financial Statements at 31 December 2006 and 2005, Notes c-1 through c-3, pp. 181-182

[213] Exhibit Bra-698, Worksheet 4.

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(5) *Bank Caspian, Kazakhstan*. This bank received substantial foreign bank loans in 2006, with maturities in 2007 and 2008 at interest rates between 6.55% and 7.3%.[214] For Kazakhstan, however, Brazil imputes an interest rate subsidy of 24.75 percent.[215]

(6) *Bank Center Credit, Kazakhstan*. Financial statements for 2006 show several substantial international syndicated loans to this bank. Loans with maturities in 2007 do not bear interest rates higher than 6.99 percent.[216]

(7) *Bank Forum, Ukraine.* Notwithstanding its low Fitch rating of 16 in 2006, this bank's financial statements show substantial dollar-denominated borrowings with maturities in 2007, the funds of which were used to finance import trade, at interest rates not exceeding 9.8 percent, and as low as LIBOR plus 3.5 percent.[217] In contrast, Brazil calculates an interest rate subsidy for Ukraine of 24.69 percent.[218]

152. The fifth set of examples directly refutes one of Brazil's premises: that a bank not formally rated by a ratings service is significantly less creditworthy. Brazil explicitly asserts that "it is valid to assume that unrated banks are significantly less creditworthy than their rated counterparts."[219] This is not a valid assumption and the United States offers several examples of banks unrated by any ratings agency that are nevertheless demonstrably creditworthy.

153. The examples are:

(1) *Multi Credit Bank of Panama (now known as Multibank)* similarly does not appear to have received any rating in 2006. Nevertheless, its consolidated financial statements for the year ended December 31, 2006, describes various sources of borrowed funds in 2006 on both a secured and unsecured basis, including working capital term loans maturing in 2008

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[214] Exhibit US-43, Bank Caspian Consolidated Financial Statement for the years ended 31 December, 2006 and 2005, Note 21 "Due to Banks", p. 32; *see also*, Exhibit US-44, Fitch Ratings, Kazakhstan Credit Analysis, Bank Caspian, p. 6.

[215] Exhibit Bra-698, Worksheet 4.

[216] Exhibit US-45, Bank Center Credit, Consolidated Financial Statements for the years ended 31 December 2006, 2005, and 2004, Note 22 "Due to Banks", p. 35.

[217] Exhibit US-46, Bank Forum, Independent Auditors Report, Financial Statements for the year ended 31 December 2006, Note 20, Other Borrowed Funds, p. 28.

[218] Exhibit Bra-698, Worksheet 4.

[219] Brazil Methodology Paper, fn. 39 at para. 27.

(8.47% annual interest) and 2009 (4.94% to 6.96 % annual interest).[220] For Panama, Brazil imputes an interest rate subsidy of 29.18 percent.[221]

(2) *Banco Reformador, Guatemala.* Lacking any rating in 2006, this Guatemalan bank secured dollar-denominated credit exceeding USD$146 million.[222] These were obtained at interest rates between 6% and 13%.[223] For Guatemala, as an "unrated" country, Brazil imputes an interest rate subsidy of 29.18 percent.[224]

(3) *Banco Financiero del Peru.* In 2006, it does not appear that this bank received a rating from any of S&P, Moody's, or Fitch. Despite the absence of such a rating, this bank was able to participate actively in credit markets. Its 2006 financial statements describe extensive loan obligations incurred from various sources, including other banks, contemporaneous with the U.S. government fiscal year 2006.[225]

(4) *Finansbank, Romania.* Under Brazil's methodology, Finansbank is an "unrated" bank in an "unrated" country. Accordingly, Brazil has imputed to this bank a rating 4 notches below the sovereign rating. Finansbank is therefore assigned a rating of 14.[226] The United States is unaware that Finansbank received a rating in 2006 from any ratings service. Nevertheless, during FY 2006, Finansbank obtained two syndicated loans for 55 million and 60 million euros, respectively, "to finance export loans" and "to finance general corporate purposes."[227]

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[220] Exhibit US-47. Multi Credit Bank, Inc. and Subsidiaries, Independent Auditor's Report, Consolidated Financial Statements, Year Ended December 31, 2006. Note 13 "Borrowed Funds", p. 22

[221] Exhibit Bra-698, Worksheet 4.

[222] Exhibit US-48. Banco Reformador, S.A. Dictamen de los Auditores Independientes, Estados Financieros, por los años terminados el 31 de Diciembre de 2006 y 2005, p. 2 (1.114248 billion Guatemalan quetzales exceeds $146 million) and Note 10, Créditos Obtenidos, p. 16.

[223] *Id.*, Note 4, Cartera de Creditos, p. 11.

[224] Exhibit Bra-698, Worksheet 4.

[225] Exhibit US-49. Banco Financiero del Peru, 2006 Financial Statement, p. 30, Note 12 "Deudas a Bancos y Corresponales".

[226] Exhibit Bra-696, Worksheet 4.

[227] Exhibit US-50. Finansbank (Romania) S.A. Consolidated Financial Statements as of and for the year ended 31 December 2006, Note 24, Debt Issued and Other Borrowed Funds, p. 36.

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These loans, again respectively, were for one-year and two-year maturities, at interest rates of EURIBOR[228] plus 90 basis points and EURIBOR plus 105 basis points. On October 17, 2005, the date of disbursement of the former loan, the 12-month EURIBOR rate was 2.409%.[229] On June 23, 2006, the date of disbursement of the latter loan, the 12-month EURIBOR rate was 3.437%.[230] For 2006, however, Brazil ascribes to all Romanian banks a CCC-guaranteed rate of 5.18 percent and a subsidy rate of 29.18 percent.[231]

154.   These numerous and diverse examples demonstrate that Brazil's methodology for determining whether a bank is "creditworthy," which relies on whether a bank has a S&P rating, is not sound. Yet, it is fundamental to the process by which Brazil derives the interest rate subsidy. Like the erroneous use of the CCC Exposure Report to construct its false attribution of GSM 102 activity, Brazil's reliance on its methodology for imputing credit risk and lumping scores of banks into an "uncreditworthy" category is fundamental to its computation of interest rate subsidy.[232] Because the methodology for determining creditworthiness does not withstand scrutiny, the Arbitrators should dismiss Brazil's calculations on interest rate subsidy. In addition, note further that Brazil's argument regarding full additionality, in turn, fundamentally hinges on the determination of "non-creditworthy" obligors and the value of transactions ascribed to them through Brazil's false attribution methodology.[233] Because of the problems with Brazil's determination of credit risk, the calculation on additionality should also be rejected.

4.   Brazil's Calculation of Market Interest Rates Misconstrues and Misapplies the U.S. Department of Commerce Approach

155.   After allocation of guarantees and imputation of creditworthiness, the next step in Brazil's methodology is the calculation building block of determination of a market interest rate for individual obligors. Brazil claims it uses "a methodology used by the U.S. Department of

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[228] "The EURIBOR (or euro interbank offered rate) is the rate at which a prime bank is willing to lend funds in euro to another prime bank. The EURIBOR is computed daily for interbank deposits with a maturity of one week and one to 12 months as the average of the daily offer rates of a representative panel of prime banks, rounded to three decimal places." http://stats.oecd.org/glossary/detail.asp?ID=3072. This is similar to LIBOR. Compare, Brazil Methodology Paper, fn. 15 at para. 11.

[229] http://www.euribor.org/html/download/euribor_2005.txt.

[230] http://www.euribor.org/html/download/euribor_2006.txt.

[231] Exhibit Bra-698, Worksheet 4.

[232] See, e.g, Brazil Methodology Paper, para. 37.

[233] Brazil Methodology Paper, paras. 40, 43, and 44.

Commerce in countervailing duty investigations."[234] However, on examination, it is clear that this step in Brazil's methodology is as flawed as the others.

156.   According to Brazil, "USDOC distinguishes between two risk groups, and therefore two probabilities of default: non-creditworthy borrowers and creditworthy borrowers."[235] Brazil then purports to divide all theoretical obligors into a binary world of "creditworthy" and "non-creditworthy," ostensibly "to operationalize the USDOC methodology."[236]

157.   However, this is not the Department of Commerce approach, notwithstanding that Brazil refers to it as "the USDOC methodology." The Department of Commerce applies this formula to construct a counterfactual market interest rate only *if* the particular firm under examination is first determined to be "uncreditworthy" after a detailed analysis of financial statements.[237]

158.   Before making any such determination, the Department of Commerce first looks for the interest rate of a "comparable commercial loan that the firm could actually obtain on the market."[238] In selecting a comparable commercial loan, Department of Commerce "normally will use a loan taken out by the firm from a commercial lending institution or a debt instrument issued by the firm in a commercial market"[239] and "rely on the actual experience of the firm in question in obtaining comparable commercial loans for both short-term and long-term loans."[240]

159.   This evaluation applies irrespective of any credit rating of the firm. Applicable Department of Commerce regulations make no reference to credit rating. Indeed, "in the case of firms not owned by the government, the receipt by the firm of comparable long-term commercial loans unaccompanied by a government-provided guarantee will normally constitute dispositive evidence that the firm is not uncreditworthy."[241]

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[234] Brazil Methodology Paper, para. 19.

[235] Brazil Methodology Paper, para. 21.

[236] *Id.*

[237] 19 CFR Sections 351.505 (a)(3)(iii); 351.505(a)(4) . Exhibit US-51 **.**

[238] 19 CFR Section 351.505 (a)(1).

[239] 19 CFR Sections 351.505 (a)(2)(ii).

[240] 19 CFR Sections 351.505 (a)(3)(i).

[241] 19 CFR Sections 351.505 (a)(4)(ii).

160.   Even if the firm did not take out a comparable commercial loan during the relevant period, the Department of Commerce "may use a national average interest rate for comparable commercial loans."[242]

161.   Brazil, however, has made no attempt to discern any comparable commercial loans taken out by any of the supposed obligors during the relevant time period, nor has it even attempted to consider national average interest rates in its assertion that obligors are uncreditworthy. Indicative interest rates published by the International Monetary Fund for the relevant period for numerous countries, for example, are generally well below the interest rates Brazil purports to be applicable at the time. For example, the IMF reports for Panama in 2006, the "weighted [by loan amount] average rate charged by banks on one-to-five year loans for trading activities" was 8.39 percent.[243] This contrasts markedly with Brazil's methodology, which imputes an interest rate subsidy alone for Panama of 29.18 percent and a resulting interest rate subsidy amount of $44.51 million, which is by itself nearly 16.5 percent of Brazil's total alleged interest rate subsidy amount.[244]

162.   Instead, Brazil simply *assumes* that any borrower without a S&P[245] credit rating of BBB-
          (numeric rating of 10) or worse is "non-creditworthy."[246]

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        [242] 19 CFR Sections 351.505 (a)(3)(ii).

        [243] *See,* Exhibit US-55, extract from IMF International Financial Statistics Yearbook 2007 and Country Notes 2007.

        [244] Exhibit Bra-698, Worksheet 4.

        [245] The United States would again note that this treats any obligor not rated by S&P, irrespective of a rating by Moody's or Fitch, as "unrated." Brazil Methodology Paper, paras. 26, 28, footnote 38. In addition, without any support, Brazil simply erroneously asserts that the absence of a rating signifies that the bank "either do[es] not have the capacity to compile all the relevant information that must be disclosed to rating agencies, or lack[s] the willingness to do so for fear of a rating outcome that puts them at a disadvantage in the market. For these reasons it is valid to assume that unrated banks are significantly less creditworthy than their rated counterparts." Brazil Methodology Paper, fn. 39 at para. 27. However, banks opt not to obtain ratings for myriad prosaic reasons, not the least of which is the sheer expense of obtaining a rating. More generally, if a bank does not intend to issue debt instruments in the international credit market, it may not have any particular financial need to obtain a rating from a rating service.

        [246] Brazil Methodology Paper, paras. 36, 23, and 24. Even the Standard and Poor's "Long-Term Issuer Credit Ratings" do not starkly characterize obligors rated below BBB- as "uncreditworthy." They simply state that "obligors rated 'BB', 'B', 'CCC', and 'CC' are regarded as having significant speculative characteristics," and in fact, for example, even an obligor rated as low as "B" "currently has the capacity to meet its financial commitments."

163.   Claiming that it "follows the USDOC methodology," Brazil, with respect to such "non-creditworthy" obligors, summarily "applies a single default probability . . . of group '18' (corresponding to [the absolutely worst possible rating] of Caa-C/CCC-C on the Moody's S&P scale)."[247] As a result, Brazil constructs an astronomically high "counterfactual market interest rate applicable" to these obligors deemed "non-creditworthy" by its flawed methodology.[248]

164.   However, Brazil's failure to consider comparable commercial loans or national average interest rates is not the only misapplication of the approach it takes from the Department of Commerce in its calculation of benchmark interest rates for obligors with a credit rating inferior to 10. Brazil has mistakenly interpreted the calculation that it takes from the Department of Commerce to treat only firms with a credit rating of 10 or better as creditworthy. Department of Commerce precedent makes clear, however, that lending rates assigned to companies in the Moody's Aaa to Baa range (corresponding to numeric ratings 1 to 10) "would likely reflect lending to companies in a ratings range broader than Aaa to Baa."[249] Summary assignment of a default probability associated with the abysmal rating of 18 to all obligors below investment grade, even to obligors rated at 11, and the attendant exaggeratedly large calculated benchmark interest rates is not consistent with what the Department of Commerce does.

See, Standard & Poor's Ratings Definitions, Long-Term Issuer Credit Ratings. http://www2.standardandpoors.com/portal/site/sp/en/us/page.article/2,1,4,0,1204840817021.html #ID489.

[247] Brazil Methodology Paper, para. 36.

[248] Brazil Methodology Paper, para. 36; Exhibit Bra-698, Worksheet 2, lines 16-23. In addition, Brazil calculates this artificially inflated counterfactual market interest rate for 2 and 3 year tenors. Brazil does the same for its category of "creditworthy" obligors. Brazil Methodology Paper, para. 35. Brazil limits it to such tenors because Exhibit Bra-513 supposedly "demonstrates that no GSM 102 export credit guarantees for the relevant commodities were issued in FY 2006 for transactions involving tenors of less than 24 months." Brazil Methodology Paper, footnote 58 at para. 35.   Exhibit Bra-513, however, does not so demonstrate. It indicates periods of *maximum* tenor available, but it does not preclude application for and issuance of guarantees of shorter tenor. Indeed, in FY 2006, nearly $148 million of GSM 102 guarantees were issued with tenors of less than 24 months.

[249] Citric Acid and Certain Citrate Salts, (C-570-938), Preliminary Affirmative Countervailing Duty Determination and Alignment of Final Countervailing Duty Determination With Final Antidumping Duty Determination, September 19, 2008, p. 54374; http://ia.ita.doc.gov/frn/0809frn/E8-21949.txt. Exhibit US-52

165.   By its misapplication of the Department of Commerce approach and consequent treatment of all obligors with a credit rating inferior to 10 as uncreditworthy, Brazil has caused a very high result in its interest rate subsidy calculations.

166.   Brazil compounds its error by also misapplying the approach it takes from the Department of Commerce even with respect to obligors that Brazil recognizes as "creditworthy" (i.e., enjoying a credit rating of 1-10). Brazil omits any attempt to ascertain comparable commercial loans or even national average interest rates for such obligors.[250] Brazil simply applies the formula that Department of Commerce regulations make clear is only applicable in the limited circumstances of a finding of uncreditworthiness.[251]

167.   In sum, Brazil has simply applied the Department of Commerce "uncreditworthy" formula to all foreign obligors.[252] This effort to determine a "market" interest rate for obligors is not sound, and this further undermines Brazil's calculations.

5.   Brazil's Use of an Average Obligor Rating by Country Significantly and Artificially Increases its Calculation of Interest Rate Subsidy

168.   The next building block in the interest rate subsidy calculation is the determination of risk by country, and the resulting effect on the interest rate subsidy itself. Wholly apart from the faulty manner in which Brazil purports to determine risk and creditworthiness, the manner in which Brazil *calculates* interest rate subsidy on the basis of such determinations is inappropriate and renders invalid the interest rate subsidy results.   This also necessarily invalidates Brazil's calculations in respect of "full additionality," as many of the obligors alleged to be uncreditworthy would in fact have been able to obtain credit and facilitate importers' purchase of U.S. goods without a GSM 102 guarantee.[253]

169.   Although Brazil begins its calculation by looking at individual obligors, it uses a country-wide average of obligor ratings to calculate each country's alleged interest rate subsidy.[254] This means that countries with an average obligor rating inferior to 10 are treated as if all obligors in the country are uncreditworthy. This approach causes the results to show a very high interest rate subsidy.

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[250] Brazil Methodology Paper, para. 34.

[251] 19 CFR Section 351.505(a)(3)(iii).

[252] Brazil Methodology Paper, paras. 35, 36; Exhibit Bra-69, Worksheet 2

[253] *See*, Brazil Methodology Paper, para. 44.

[254] Exhibit Bra-696, Worksheets 3 and 4; Exhibit Bra-698, Worksheet 4.

         a.   **Brazil's Use of Average Risk by Country Has Results That Are Plainly False**

170.   Averaging obligor risk yields results that defy common sense. For example, in Hong Kong, 7 of the 9 obligors are rated 10 or superior (creditworthy),[255] yet Brazil calculates the average obligor rating as 12.[256] Under Brazil's methodology, therefore, one observes the absurd result that all obligors in Hong Kong are treated as uncreditworthy and assigned the highest possible default probability and corresponding interest rate.[257]

171.   Under Brazil's asserted theory, only those obligors with a rating inferior to 10 should be treated as uncreditworthy.[258] Yet, by use of the country-wide average, Brazil ignores this standard and effectively treats creditworthy obligors as if they are uncreditworthy.

         b.   **Addressing the Country-Average Issue Alone Significantly Lowers the Interest Rate Subsidy Calculation**

172.   Simply by averaging obligor ratings and applying the average rating to the entire country, Brazil increases the results of its interest subsidy calculations. The United States provides just one illustration of the effect of Brazil's calculation method below, which illustration retains Brazil's faulty assumptions and premises. This calculation does not attempt to correct all the erroneous assumptions and failures of Brazil in the construction of its methodology, but it illustrates the effect of averaging obligor risk by country.

173.   This method simply calculates the interest rate subsidy for each obligor and, for each country, sums the obligors' subsidies. In this way, each specific obligor's creditworthiness is taken into account (again retaining all of Brazil's assumptions in that regard). Examples of this calculation method are provided for two countries: Hong Kong and Panama.[259]

174.   Before showing the effect of the calculation on Hong Kong and Panama, two caveats must be clear. First, this calculation results in different values for countries in which at least one obligor is "creditworthy" (*i.e.*, rated 10 or better). Under Brazil's approach, only six countries have creditworthy obligors. For those countries in which Brazil deems every obligor uncreditworthy, the calculation on this particular issue would not change the result.

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[255] Exhibit Bra-698, Worksheet 1, page 2.

[256] Exhibit Bra-698, Worksheet 4, Column N.

[257] Exhibit Bra-698, Worksheet 4.

[258] *See, e.g.,* Brazil Methodology Paper, paras. 34, 36.

[259] Exhibit US-B53.

175.   Second, of the six countries with a "creditworthy" obligor, only Trinidad and South Korea are creditworthy on average, using Brazil's methodology. As a result, this single change in the calculation would cause the subsidy for these countries to rise slightly. The overall effect of the change calculation is therefore somewhat reduced. However, it is important to understand that if this change in average obligor risk by country were combined with a more appropriate approach to other components of Brazil's methodology, such as a more realistic assignment of credit ratings to obligors unrated by S&P, then the significance of the change in calculation of average country risk increases. For example, if a handful of obligors in a particular country were deemed more creditworthy than rated by Brazil, that fact alone might not lower the country's average credit rating significantly, and under Brazil's approach, as a result, the interest rate subsidy calculation would also not be significantly affected. Using the different averaging method, however, the revision of even a single obligor's credit rating will result in a lower subsidy calculation.

176.   For Hong Kong and Panama, the United States has supplied a sample of the calculation in the spreadsheet, Interest Rate Subsidy Calculation with Different Approach to Country Average.[260] The spreadsheet consists of 7 worksheets. Five are from Exhibits Bra-696 and Bra-698. The worksheets "Hong Kong" and "Panama" contain the changed interest rate subsidy calculations for those two countries, which calculations are very similar to those of worksheet 4 of Exhibit Bra-698, except they list calculations for each obligor, instead of each country.

177.   In order to isolate the effect of the change in the calculation for country average, the United States applied Brazil's assumptions and approach for the initial steps of the calculation. The steps are described below.

178.   To calculate an interest rate subsidy for each obligor, one must first assign an export credit guarantee value for each obligor. In this regard, Brazil assumes the following:

> "Since the United States does not publish data regarding GSM 102 activity per specific foreign obligor, Brazil distributes GSM 102 ECGs issued for a particular country equally amongst all approved obligors in that country."[261]

179.   Following Brazil's assumption, the ECGs for each country in 2006 are divided by the number of obligors in each country, arriving at an equal distribution of ECGs for all obligors.[262] Next a numerical credit rating is needed.[263] Whereas in Exhibit Bra-698 Brazil used an average

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[260] Exhibit US-53.

[261] Brazil Methodology Paper, para. 17.

[262] See cells B3-B5, and column B.

[263] See column D.

obligor rating for each country, the actual obligor ratings listed in worksheet 1 of Exhibit Bra-696 are used. All obligors in Hong Kong are rated.[264] However, Panama has several "unrated" obligors. Following Brazil's approach, a rating one level worse than the worst rated obligor in the country is assigned to "unrated" obligors in Panama.[265]

180.   Maturity of the credit[266] is from Exhibit Bra-698. It is 3 years for both Hong Kong and Panama.

181.   For the cumulative default probability and benchmark interest rate,[267] the calculation uses the same calculations that Brazil used in worksheet 4 of Exhibit Bra-698. The only difference is the obligor rating, which is now for that specific obligor, instead of a country average.

182.   The payments per year, CCC-guaranteed rate, and CCC risk-based fee[268]all remain the same for the countries in question.

183.   The Ohlin formula[269] also remains unchanged. The only difference is that if an obligor is so creditworthy that the Ohlin formula would calculate a subsidy rate that is less than zero, zero is used instead. Brazil made the same assumption for South Korea in worksheet 4 of Exhibit Bra-698.

184.   The interest rate subsidy calculation[270] also remains unchanged. The only difference is the use of the new subsidy rates calculated by the Ohlin formula for each obligor.

185.   The results of this calculation method are significant and instructive. They show the difference to the bottom line that results when Brazil's faulty approach to averaging obligor risk by country is corrected.

Results –Interest Rate Subsidy Calculation with Different Approach to Country Average

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[264] Exhibit Bra-696, Worksheet 1, p. 2.

[265] Brazil Methodology Paper, para. 27

[266] See column E

[267] See columns F, G

[268] See columns H, I, J

[269] See column K

[270] See column M

Interest Rate Subsidy (mUSD$)				
	Brazil's Method	With Change	Reduction in mUSD$	% change
Hong Kong	5.195	1.155	4.040	-78%
Panama	44.510	28.484	16.026	-36%

186.   As illustrated by the foregoing table, by using country level credit rating averages rather than obligor level credit rating averages, Brazil overestimated the interest rate subsidies in Hong Kong and Panama by a total of $20 million. This one simple correction *for only two countries* reduces Brazil's interest rate subsidy estimate by almost 10 percent. The United States reiterates that this calculation otherwise retained *all* of the already discredited fallacious assumptions and premises of Brazil's methodology. This serves as an indication of how grossly overstated is Brazil's interest rate subsidy for the GSM 102 guarantees.

6.   The Errors in Each Part of Brazil's Interest Rate Subsidy Calculation Show that Brazil's Construction Must Fall

187.   Each of the components of Brazil's calculation of interest rate subsidy is set forth in Exhibit Bra-698, Worksheet 4. The United States has discredited each of the major components, from allocation of guarantees, assignment of credit risk, determination of market interest rate, and finally to the use of country-average obligor risk to calculate an interest rate subsidy. To recall the details of these problems and summarize why Brazil's calculation of interest rate subsidy cannot be used, the United States will walk through the columns in Brazil's worksheet.

188.   In columns A and B, Brazil imputes to various countries a dollar value of 2006 export credit guarantees. This imputation is based on a wholly improper use of the CCC Exposure Report that is in significant respect wholly unrelated to 2006 guarantees. This results, in some instances, to imputations of transactions that did not occur to obligors who do not exist. In no case, however, does the CCC Exposure Report have any direct correlation to issuance of guarantees in 2006.

189.   Column C suffers from the same defect. Brazil uses its erroneous allocations to calculate a proportional transaction value, while simultaneously being overinclusive as to products in dispute and failing to take into account permitted export subsidies.

190.   Column D employs an average obligor rating that is both grounded in the imputation of risk ratings replete with innumerable significant false assumptions and which, by its very manner of application, imparts an unjustified magnitude to the ultimate calculation of interest rate subsidy.

191.   Column E assumes the maturity of the credit is either two or three years. Although that is true in most cases, over 10 percent of GSM 102 guarantees issued in fiscal year 2006 were for tenors of less than one year.

192.   Column F purports to set forth cumulative default probabilities for each country. But these are derived directly from the application of the discredited imputed ratings seen in Column D.

193.   Column G reflects the purported application of a U.S. Department of Commerce approach to construct benchmark interest rates. Brazil, however, has utterly misapplied the technique and so achieves exaggerated results.

194.   Column H purports to set forth a CCC-guaranteed rate. This rate very low, and based on only two isolated examples.

195.   These grossly distorted components conspire, when aggregated in the application of the Ohlin formula, to produce a large overall subsidy rate of 24.3 percent and total dollar amount of subsidy of $270.48 million. These figures are so flawed as to render invalid Brazil's proposed approach.

7.   Brazil's Calculation of "Full Additionality" Is Wholly Unjustified and Should be Dismissed

196.   After interest rate subsidy, the next component of Brazil's calculation for proposed countermeasures is full additionality. Brazil's calculation of additionality relies on its fatally flawed calculation of interest rate subsidy, particularly with respect to treatment of "uncreditworthy" obligors. Therefore, it must fail.

197.   It should also be noted at the outset that the notion of additionality as presented by Brazil is entirely speculative. Moreover, it would account for an additional, indirect element to the interest rate subsidy Brazil asserts as the first component for countermeasures.

198.   Under Brazil's construct: "*Full* additionality is generated by GSM 102-subsidized business involving *non-creditworthy* foreign obligors, *i.e.*, those borrowers that could not otherwise have secured credit at market at all. *Full* additionality is measured as the entire value of a transaction backed by GSM 102 ECGs, because in the absence of the guarantee no economic activity whatsoever would have taken place."[271]

199.   Consequently, according to Brazil, "whenever a GSM 102 ECG is extended to non-creditworthy borrowers, the entire volume of the exports constitutes the advantage conferred on U.S. exporters, because in the absence of the GSM 102 ECG, credit would not be available and exports would not have occurred."[272] "For non-creditworthy borrowers... credit could not have been obtained without GSM 102 at any viable price; thus, export transactions would not have occurred in

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[271] Brazil Methodology Paper, para. 40 (italics in original).

[272] Brazil Methodology Paper, para. 42.

the absence of GSM 102."[273] This assumption ignores the existence of alternatives for access to credit, and the possibility of cash transactions.

200.   Therefore, full additionality hinges entirely on a determination of "uncreditworthiness." As Brazil succinctly notes: "Full additionality accrues to U.S. exporters from GSM 102-backed transactions involving obligors with a credit rating of '11' or worse."[274]

201.   Brazil's thoroughly flawed approach to distinguishing allegedly uncreditworthy obligors from creditworthy obligors results in total uncreditworthiness for 19 of the 21 countries Brazil purports to evaluate. All supposed transactions for all of these 19 countries are treated as full additionality, and Brazil's calculation of the full value of these transactions is simply tallied as subsidy.[275] Not surprisingly, this grossly distorted approach results in a calculation of full additionality equal to 88.7 percent of Brazil's calculation of full transaction value.[276]

202.   In light of the myriad defects previously noted in Brazil's methodology for imputing risk, this measure of full additionality does not withstand scrutiny.

203.   In addition, however, the facts contradict the results of Brazil's approach. The United States again offers official U.S. export data to refute Brazil's methodology. The United States has compared Brazil's estimated exports under the GSM 102 program for FY 2006 with actual U.S. exports for 20 key country and commodity pairs that under Brazil's methodology purportedly account for a large share of GSM 102 transactions. The United States previously noted that Brazil's calculations of GSM 102 transactions greatly exceeds total exports from the United States for 11 pairs.[277] For 10 of these pairs (excluding Trinidad), at the very least to the extent of the difference, Brazil is calculating full additionality based on exports that not only did not occur under GSM 102, but did not occur *at all*.[278]

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[273] Brazil Methodology Paper, para. 43.

[274] Brazil Methodology Paper, para. 44.

[275] Exhibit Bra-700, Worksheet 1. The only creditworthy countries are South Korea and Trinidad. Totally uncreditworthy countries include Hong Kong, Mexico, and even Brazil itself.

[276] (984.861/1110.394). Exhibit Bra-700, Worksheet 1.

[277] See Exhibit US-19 and US-20 (Census data).

[278] Panama (cotton, oilseeds, feed grains, rice); Hong Kong (oilseeds); Kazakhstan (poultry meat and pigmeat), Ukraine (poultry meat and pigmeat), Phillippines (oilseeds). For example, in Exhibit Bra-695 Worksheet 2, Brazil ascribes $28.708 million of GSM 102 guaranteed exports of pigmeat to Kazakhstan. U.S. census data, however, shows *no* exports of pigmeat to Kazakhstan for the relevant period. Similarly, Brazil alleges $23.892 million of

204.   With respect to 6 of those pairs where the reverse is true[279] (*i.e.* U.S. exports exceed Brazil's quantification of GSM 102 transactions), Brazil's methodology would indicate that such exports beyond the GSM 102 transactions could not have occurred: "export transactions would not have occurred in the absence of GSM 102."[280]

205.   For example, U.S. exports of cotton to Turkey were $480.13 million in FY 2006.[281] Brazil claims that $99.2 million occurred with GSM 102 guarantees,[282] but the additional $380.93 million of exports are irreconcilable with Brazil's theory of full additionality.

206.   Exports of poultry meat to Russia in FY 2006 totaled over $548 million.[283] Brazil attributes $200 million to GSM 102 transactions,[284] but Brazil's theory of full additionality cannot sustain the remaining $348 million of such poultry exports.

207.   Fully *99.6 percent* of 2006 exports of oilseeds to Mexico occurred *without* any GSM 102 guarantee.[285]

208.   Brazil's theory of full additionality is grounded in false assumptions and exaggerated imputation of risk, and belied by real export data. The Arbitrators should reject it completely.

> **8.**   **Brazil's Approach to Marginal Additionality Merely Repeats the Errors of the Full Additionality Approach, Ignores its Own Model, and Is**

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guaranteed exports of pigmeat to Ukraine. Again, U.S. census data shows *zero* pigmeat exports to Ukraine.

[279] Three of the 9 examples involve South Korea, and are therefore excluded from discussion of full additionality because South Korea is "creditworthy" under Brazil's approach. The 6 remaining pairs are: Dominican Republic (feed grains); El Salvador (feed grains), Mexico (oilseeds), Russia (poultry), Turkey (cotton and oilseeds).

[280] Brazil Methodology Paper, para. 43.

[281] Exhibit US-19 and US-20.

[282] Exhibit Bra-695, Worksheet 2, Column F.

[283] Exhibit US-19 and US-20.

[284] Exhibit Bra-695, Worksheet 2, Column O.

[285] Compare Exhibit US-19 and US-20 with Exhibit Bra-695, Worksheet 2, Column G (984.46/988.298).

United States – Subsidies on Upland Cotton: Arbitrations Under
Article 22.6 of the DSU and Articles 4.11 and 7.10 of the SCM Agreement

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**Inconsistent with its Analytical Approach to Counter-cyclical Payments
and Marketing Loan Benefits**

209.   The final component of Brazil's calculation of proposed countermeasures is "marginal additionality." This too must be rejected. Brazil's method to estimate the so-called marginal additionality of the GSM 102 program is built on the same set of flawed assumptions as the full additionality exercise. These items include the grossly overstated interest rate subsidy, full pass-through of the interest rate subsidy to the import price, failure to account for permitted U.S. export subsidies, and the incorrectly specified country-commodity allocations. In addition, Brazil has constructed a flawed model to measure the effect on U.S. exports of removing GSM 102. At the end of its modeling exercise, Brazil arrives at an estimate of marginal additionality that is actually larger than its estimate of full additionality, a nonsensical result. It is only by, in essence, ignoring its own modeling results, that Brazil arrives at an estimate of $38.93 million for marginal additionality. For all these reasons, Brazil's estimate does not withstand scrutiny.

        a.   **Brazil Uses Its Erroneous Methodology to Calculate
                 "Marginal Additionality," and Ignores the Untenable
                 Results**

210.   A key component of Brazil's method to measure marginal additionality is the interest rate subsidy. Brazil asserts that "foreign importers effectively enjoy a price reduced by the entire interest rate subsidy flowing from a GSM 102 ECG."[286] The United States has already shown Brazil's method of estimating the interest rate subsidy to be completely erroneous.   Recall that these subsidies are about 24 percent for two countries, 29 percent for 17 countries, 0.45 percent for Trinidad, and zero for Korea.[287]

211.   Not only do Brazil's estimates completely overstate any subsidy inherent in the GSM 102 program, Brazil treats the interest rate subsidy as having 100-percent pass-through to the importer. That is, U.S. exporters sell their products into a foreign market at a price minus the full subsidy.[288] Brazil's presumption of pass-through is not supported.

212.   The proposition that the price of the relevant commodity export under a GSM 102 program is affected *at all* by the export credit is not supported by economic research. As described in one study cited by Brazil, the total cost of an import is the price of the commodity plus the financing

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[286] Brazil Methodology Paper, para 45.

[287] Exhibit Bra-698, Worksheet 4.

[288] Brazil's Methodology Paper, para. 58.

cost.[289] The financing cost *may* be reduced by the export credit guarantee because the guarantee is assumed to provide for an interest rate that is lower than what the importer could have received in the market without the guarantee. The total cost of importing may be lower as a result of the guarantee, but that is due entirely to the interest rate subsidy, not to a change in the price of the commodity.

213.   In addition to these obvious flaws, Brazil's model results raise immediate questions. Brazil estimates a marginal additionality figure for every country/commodity pair. But the estimate of marginal additionality for each country is exactly the same as full additionality, which is nothing more than the full transaction value of the GSM 102 program (except for Korea).[290] How can this be?

214.   The result of Brazil's theoretical exercise described in paragraphs 45-62 of its Methodology Paper is to derive two elasticities – the elasticity of demand facing U.S. suppliers in Country A and the elasticity of supply of U.S. suppliers into Country A. These are used to derive an elasticity of U.S. exports into A as a response to subsidy elimination, which then is adjusted by the flawed interest rate subsidy.[291]   The same interest rate subsidy for each country is used for every relevant commodity, which assumes every commodity market in a country behaves in an identical fashion. This is a very simplistic assumption and not consistent with behavior of international commodity markets, which differ greatly depending upon the factors involved (for example, countries, policies, weather, institutions, etc.). Brazil claims that Equation J in its model "is a partial-equilibrium examination employing a standard technique in industry analysis and microeconomics."[292] Brazil offers no references or research to support that claim.

215.   Brazil states additional U.S. exports (as a result of GSM 102) can range between 0-100 percent.[293] In fact, Brazil offers a modeling exercise that provides results that are actually *always* greater than 100 percent (except Korea, because the interest rate subsidy is zero). How can the loss of U.S. exports from the removal of GSM 102 be greater than 100 percent? This outcome, for every commodity and country (again, except Korea) certainly suggests that the model overstates the effects of GSM 102 on U.S. exports.

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[289] Exhibit Bra-707, pages 28-29.

[290] Exhibit Bra-700, Worksheet 3.

[291] Exhibit Bra-700, Worksheet 5, Columns AC, AD, and AE.

[292] Brazil's Methodology Paper, para. 53.

[293] Brazil's Methodology Paper, para. 46 and Footnote 78.

216.   For example, in the case of cotton in Panama, the United States finds it impossible to interpret a demand elasticity of -42788503 or a supply elasticity of 51984727.[294] The completely unrealistic elasticity results are the result of a flawed model structure, which assumes linear supply and demand relationships over which elasticities can change dramatically at different points on the demand curve. Moving along the demand curve to increasingly smaller quantities gives point estimates for demand elasticities that are increasing in absolute magnitude. Likewise, moving along the demand curve to larger quantities yields declining elasticities in absolute magnitude. In the case of Brazil's estimates, the unrealistic elasticities are the result of weighting by extremely small shares (for example, weighting world production of a commodity by rest-of-world imports into Country A). This is easily demonstrated by the fact that the reported cotton elasticities in column AE of sheet 5) Marg. Add. Rate 2006 of Exhibit 700 is perfectly correlated with the shares in column Q of the same sheet.

217.   The purpose of including the extensive calculations for marginal additionality is completely unclear. The flawed approach produces such unrealistic results that Brazil itself dismisses in its own submission. Brazil's admits that the export loss from removing GSM 102 cannot exceed 100 percent of the transaction.[295] Since marginal additionality, as shown by Brazil's own model, actually exceeds full additionality, Brazil simply ignores its own model results and instead uses an elasticity of -1.0 to estimate the export loss. This meaningless convention is done to limit the loss to no more than the full value of the GSM 102 transaction.[296]

218.   In the end, Brazil's method to estimate the marginal additionality is applied to only two countries – a result of the contrived division of countries into creditworthy and non-creditworthy categories. Only two countries were deemed creditworthy – Trinidad and Korea – using Brazil's flawed interest rate subsidy method.[297] Korea was found not to have benefitted from an interest rate subsidy; as a result, there was no marginal additionality. Therefore, the only country (foreign

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[294] Note that the elasticities in Columns AC, AD, and AE are sometimes as large as 8 digits. The United States is not aware of any economic research, in any field, that produces such extraordinarily large estimates. Recall that an elasticity is simply the measure of the responsiveness of a variable to a change in price. For example, if the price of wheat goes up by 10 percent, a decline in demand by 5 percent implies a demand elasticity of -0.5. If supply goes up by 3 percent in response to the 10-percent price increase, that gives a supply elasticity of 0.3. The United States finds it impossible to interpret a demand elasticity of -42788503 or a supply elasticity of 51984727 (the results for Panama cotton in Exhibit Bra-700, Worksheet 5).

[295] Id, footnote 78.

[296] Exhibit Bra-700, Worksheet 5.

[297] Exhibit Bra-700, Worksheet 3.

obligor) for which Brazil estimates a value for marginal additionality is Trinidad and Tobago (Trinidad).

219.   Brazil claims that $38.155 million in ECGs were issued to Trinidad, and the full transaction value was $38.934 million.[298] But the results of its marginal additionality exercise show the full value of the ECG transactions, or $38.934 million.[299] This is not marginal additionality; this is full additionality. As has been previously discussed the use of full face value of a transaction as a measure of additionality is not supported by any economic research, and the United States has amply demonstrated its inapplicability to the GSM 102 program specifically. Brazil's attempt to construct a world supply-demand model to estimate so-called marginal additionality produces the same untenable result as the full additionality exercise.

220.   As was done for the full additionality exercise, one can simply compare U.S. exports for the relevant commodities to Trinidad for FY2006 with Brazil's commodity allocation to see the inappropriateness of Brazil's method. Once again, Brazil would attribute marginal additionality (which in this exercise is equivalent to full additionality) to exports which did not even occur.

Comparison of Brazil's Method of Estimating Marginal Additionality and U.S. Exports to Trinidad for FY2006 — Table 7

Commodity	Brazil's method ($US mil.)	U.S. export data ($US mil.)
Oilseeds	0.098	0 1/
Protein meals	15.273	9.654 2/
Feed grains	20.132	12.326
Rice	2.652	0.854
TOTAL	38.934	22.834

1/ Soybeans only. 2/ Soybean meal only. Source: U.S. Exports to Trinidad and Tobago, U.S. Census data, Exhibit US-54.

> **b.   Brazil's Use of Elasticities in the "Marginal Additionality" Calculation Is Inconsistent with the Calculation It Provides for Actionable Subsidies**

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[298] Exhibit Bra-700, Worksheet 1.

[299] Exhibit Bra-700, Worksheet 2.

221.   Because the GSM 102 subsidies at issue here are prohibited subsidies, the assumption behind the marginal additionality analysis is the complete and permanent removal of GSM 102 for the relevant commodities. Brazil gives sources for elasticities used in this exercise (FAPRI and World Bank), and notes that "FAPRI's elasticity estimates are appropriate in the context of basic supply and demand responses to small changes in volumes and prices."[300] Yet Brazil is assuming the full pass-through of the GSM 102 interest rate subsidy to the U.S. export price, sometimes according to Brazil as large as 29 percent. This would not be considered a small change in price under any reasonable economic scenario.

222.   It is useful to look at the elasticities Brazil uses for cotton in its marginal additionality model. Brazil uses a short run elasticity of supply for the U.S. from FAPRI. For example, the U.S. cotton supply elasticity is 0.24. (Note this is nearly identical with the supply elasticity that the United States argued was the appropriate elasticity in previous submissions: 0.21.[301]) Recall that Brazil argues that the complete removal of CCPs and marketing loan benefits requires a larger elasticity than a short run FAPRI elasticity.[302] This suggests that Brazil does not believe that a "larger" U.S. supply elasticity is needed for the complete removal of GSM 102 subsidies for prohibited commodities, even when the price effect is as large as 29 percent, a much larger price effect than Brazil estimated for the complete and permanent removal of two U.S. cotton subsidies.

223.   The general rest-of-world supply elasticity used by Brazil is 0.34. This, too, is inconsistent with Brazil's parameters in its simulation model for estimating the adverse effects of U.S. domestic cotton subsidies.[303] Brazil argues that the rest-of-world supply elasticity for cotton is smaller than the U.S. supply elasticity because "there is an *imperfect* and *slack transmission* of price changes generated by U.S. cotton policy changes on producers in other regions."[304] In contrast, here Brazil argues there is complete and perfect price transmission of changes in U.S. cotton prices to the rest of the world. Recall that the United States argued previously that an appropriate rest-of-world cotton elasticity was 0.33, nearly identical to what Brazil has used in this model.[305]

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[300] Brazil's Methodology Paper, footnote 86.

[301] U.S. First Written Submission (21.5), Annex I a Review of the Simulation Analysis Presented by Dr. Sumner, para. 19 (December 15, 2006).

[302] Brazil's Methodology Paper, para. 98.

[303] Brazil's Methodology Paper, paras. 103-105.

[304] Brazil's Methodology Paper, para. 105.

[305] United States – Subsidies on Upland Cotton, Article 21.5, Annex I a Review of the Simulation Analysis Presented by Dr. Sumner, December 15, 2006, para. 23.

224.   Interestingly, Brazil uses -0.2 for a general demand elasticity for rest-of-world. This is identical to the elasticity Brazil uses in the simulation model for estimating adverse effects.[306] This simply reinforces the inconsistent use of elasticities (and therefore economic logic) between the two models. For this parameter, unlike the other elasticities, Brazil adopts a FAPRI elasticity, whereas for the other elasticities, Brazil proposes a more convenient parameter.

225.   In summary, the "marginal additionality" calculation relies on the same flawed methodology as the interest rate subsidy and "full additionality" Brazil provides. It also underscores the inconsistent way Brazil has used elasticities in the different sections of the Methodology Paper. In the end, it produces absurd results, which are not in fact used by Brazil. The Arbitrators should reject Brazil's calculations on marginal additionality.

III.   Countermeasures for Step 2 Payments Are not Appropriate Because the Program Has Been Brought into Conformity with the DSB's Recommendations and Rulings Through Withdrawal

226.   There is no basis for Brazil's request for a one-time additional amount of countermeasures. There is no dispute between the parties that no Step 2 payments are being made as the Step 2 program was terminated as from August 2006. Therefore, there is no disagreement between the parties that the United States has brought the Step 2 program into conformity with the DSB's recommendations and rulings. There is no basis for Brazil's request for authorization to take countermeasures (the appropriate level is none).

227.   Brazil argued to the compliance panel that the United States failed to withdraw the Step 2 program within the reasonable period of time. The compliance panel declined to make a finding on this issue, however, and the issue was not appealed by Brazil.[307] As such, there is no basis to authorize countermeasures for Step 2. Brazil is seeking authorization for retroactive remedies not permitted by the DSU.

228.   Brazil can impose countermeasures only for areas where there is not compliance with the DSB's recommendations and rulings.

IV.   Brazil's Proposed Countermeasures for Marketing Loan and Counter-cyclical Payments Far Exceed What Would Be Commensurate with the Adverse Effects Determined to Exist from These Payments

A.   Current U.S. Cotton Situation

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[306] Brazil's Methodology Paper, para. 108.

[307] *Upland Cotton (21.5),* para. 9.71.

229.   Before examining the model Brazil submitted, which purports to measure the effects of U.S. marketing loan and counter-cyclical payments, it is instructive to review the current cotton situation in the United States. The model utilized by Brazil posits that U.S. marketing loan and counter-cyclical payments have increased U.S. production beyond what it would be otherwise, that "but for" these payments, U.S. production in 2005 would have declined 18.83% and world prices would have responded by increasing 10.75%.   Thus, current conditions for United States cotton producers provide guidance for the effects of U.S. cotton support payments, and, therefore, what countermeasures would be commensurate with the nature and degree of these effects.

230.   Since the 2006 marketing year, the U.S. cotton sector has experienced a significant contraction in production, exports, and domestic use. From the level of 2006/2007, U.S. planted area for upland cotton has dropped 38 percent and harvested area 39 percent.[308]   Average production in the 2004 and 2005 marketing years was 23.6 million bales, but fell in each of the subsequent years. This sharp decline occurred even as world prices, as measured by the A Index, increased in the 2006 and 2007 marketing years. Alongside the decrease in production, U.S. exports slowed dramatically. U.S. cotton producers have responded to market signals, shifting area in response to sharply higher corn and soybean prices. In 2007 cotton acres shifted predominantly into corn, and in 2008 there was another shift predominantly into soybeans (Table 8).

Table 8 – Harvested Acres of Upland Cotton Compared to Corn and Soybeans

by Region and Marketing Year

Region	Delta	Southeast	Southwest	West	Total
Up. Cotton					
2006	4,201	3,298	4,390	1,491	12,408
2007	2,724	2,168	4,908	401	10,201
2008	1,847	1,926	3,533	279	7,585
Corn					
2006	3,925	1,765	4,670	155	10,515
2007	6,295	2,525	5,970	255	15,045
2008	4,880	2,065	6,030	275	13,250
Soybeans					
2006	11,800	2,550	3,450	0	17,800
2007	10,540	2,790	2,882	0	16,212
2008	12,730	3,510	3,770	0	20,010

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[308]   All material is from Exhibits US-56-59.

Delta = Arkansas, Louisiana, Mississippi, Missouri, Tennessee

Southeast = Alabama, Florida, Georgia, North Carolina, South Carolina, Virginia

Southwest = Kansas, Oklahoma, Texas

West = Arizona, California, New Mexico

Sources: Crop Production, November, 2007 & 2008, Agricultural Statistics Board, NASS, USDA, (Exhibit US-58-59)

231.   Lower cotton production is expected to continue. Total cotton harvested area for the United States is forecast at only 7.8 million acres in 2008, the lowest in 25 years. For the same year, U.S. abandonment (planted acres that are not harvested) is one of the highest on record at nearly 18 percent. Production for 2008/09 is projected to be 13.5 million bales, a 43-percent drop. The U.S. share of world production has fallen to its lowest level in decades, now projected to be only 12 percent for the 2008 marketing year.

232.   With the global economic and financial crisis growing worse by the day, global demand for textiles and clothing has fallen, directly affecting the demand for U.S. cotton exports. Exports have been steady at slightly above 13 million bales for the last 2 years and are projected at about the same level for the current marketing year, a 25-percent drop from the peak in 2005/06. The U.S. share of world exports has declined for five years, from a high of 41 percent, and is now projected at 36 percent. In sum, in 2008, U.S. shares of exports and world production will reflect several years of decline, U.S. production will be 43% below the 2005 crop, and U.S. harvested acreage will be the lowest in 25 years.

233.   Even as the U.S. cotton sector shrinks, Brazilian cotton production trended up through the 2007 marketing year. Brazilian area has remained steady and yields have improved significantly. Domestic use has grown slowly, but exports are projected to reach a record in the 2008 marketing year. Government support to cotton has increased sharply in recent years, as Brazil's agricultural sector has faced financial difficulties.[309]

234.   It is against this context – dramatically lower U.S. acreage, production in the United States, and exports and increasing production in Brazil – that Brazil is requesting authorization for annual countermeasures of more than $1 billion.

> **B.   Marketing Loan and Counter-cyclical Payments at Issue Under the 2002 Farm Bill Will No Longer Be Made**

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[309] Exhibit US-57.

235.   Next, it is important to understand the current situation for the marketing loan and counter-cyclical payments challenged by Brazil. Both types of payments were authorized by the Farm Security and Rural Investment Act of 2002 ("2002 Farm Bill"). Both the original and compliance panels examined the payments in the context of this legislative authorization and its structure, design and operation. It has now expired.

236.   No further payments like those at issue before the original panel or the compliance panel will be made. Therefore, the Arbitrators should not make any determination authorizing countermeasures for payments under the expired programs. Under Article 7.8 of the SCM Agreement, when there has been a finding that a subsidy has resulted in adverse effects within the meaning of Article 5, the Member providing the subsidy is to "take appropriate steps to remove the adverse effects or shall withdraw the subsidy." Given that the 2002 Farm Bill under which marketing loan and counter-cyclical payments have been made has expired, the subsidy has been withdrawn. As a result, there is no longer a basis to authorize countermeasures with respect to these payments.

237.   In addition, countermeasures should not be authorized at this time because countermeasures are intended to be only temporary and to end once there is no basis for them to continue. Article 22.8 of the DSU provides that "suspension of concessions or other obligations shall be temporary" and states the suspension shall only be applied until one of several conditions, such as removal of the inconsistent measure, has been met.

238.   Here, the payments examined by the original panel and compliance panel, which were the basis for the findings of the DSB, no longer exist, and the time when countermeasures might have been imposed has ended.

C.   Legal, Economic, and Conceptual Errors in Brazil's Methodology

239.   Even aside from the fact that the marketing loan and counter-cyclical payments at issue have expired, Brazil's methodology suffers from a number of defects so serious that its proposed approach should be rejected. Those defects include: 1) its decision not to limit its calculations to only the effects of U.S. programs on Brazil; 2) its flawed choices for key parameters in the model; 3) its isolation of data for a single year, which is not representative of the fluctuation of marketing loan and countercyclical payments and their effects; and 4) its failure to limit the proposed countermeasures to the portion of the effects of the marketing loan and counter-cyclical payments that result the finding of inconsistency with the *SCM Agreement*. Finally, the United States demonstrates the results of the flaws in Brazil's model.

1.   Brazil Calculates the Effects to the Rest of the World, But the Adverse Effects of Concern to the Arbitrators Are Limited to the Adverse Effects on Brazil

240.   Brazil's calculations include the alleged effects of U.S. domestic support payments on the entire world, excluding the United States. This exceeds what is permissible for countermeasures in

this case, where the DSB's recommendations and rulings were based on a finding of "'present' serious prejudice to the interests of Brazil within the meaning of Article 5 (c) of the *SCM Agreement*[310] – in other words, with respect to Brazil's rights only. Under the approach in its methodology paper, Brazil is claiming for its own the alleged effects of U.S. marketing loan and counter-cyclical payments on the entire world.

241.   Article 7.10 of the SCM Agreement explicitly links the permissible countermeasures for actionable subsidies to the underlying determination, and the finding of adverse effects particular to the case. Specifically, countermeasures must be commensurate with the nature and degree of *the adverse effects determined to exist.* Article 5 of the *SCM Agreement* – titled "Adverse Effects" – lists the different types of effects that can be the basis of a finding with respect to actionable subsidies.

242.   Brazil relied on one type of "adverse effects" provided for under Article 5 of the SCM Agreement: "serious prejudice to the interests of another *Member*" under Article 5(c) (emphasis added). Reading the plain language of this provision, the adverse effects referred to in Article 7.10 are the effects on the complaining Member in the particular case. It is this provision that provides the basis for the finding of adverse effects in this case. Here, the adverse effects of concern to the Arbitrators are the adverse effects to the interests of Brazil.

243.   For the finding of significant price suppression in this particular case – pursuant to Article 6.3(c) of the *SCM Agreement* – the original and compliance panel looked at the "world price" for upland cotton to evaluate whether there was price suppression as a result of the U.S. marketing loan and counter-cyclical payments and, if so, whether that suppression was significant.[311] Price effects on the "world price" would affect Brazil, and so suppression of the world price could be used for an inquiry that was, in the final analysis, focused on serious prejudice to that country. But, there is an important distinction between world price and world effects.

244.   Notably, the use of a world price does not mean that the finding of serious prejudice concerned the entire world, excluding the United States. This finding was with respect to Brazil, consistent with the text of Article 5(c), which provides that the "adverse effects" determined under that article are with respect to a particular Member, or, in the words of the Agreement, "serious prejudice to the interests of another Member."

245.   Because Brazil's calculations disregard the fact that the finding of serious prejudice is in relation to Brazil, the calculations reach a number that far exceeds an amount that would be commensurate with the panel's determination. Brazil's calculation is based upon its incorrect estimates of the effects on the entire world, excluding the United States, and reaches an astronomical

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[310]*Upland Cotton (Panel)*, para. 10.256.

[311]*Upland Cotton, (Panel),* para. 7.1252.

total of $3.335 billion.   The findings with respect to Brazil itself are only $30.4[312]. Brazil's decision to sum effects throughout the world results in a figure more than 100 times what it would be under the correct interpretation of the applicable legal standard. Brazil's request, therefore, is not at all "commensurate" with the nature and degree of the adverse effects, but is, in fact, grossly exaggerated.

2.   Critique of Brazil's Use of the Sumner Model

a.   Brazil Uses the Flawed Model Presented to Compliance Panel

246.   In its methodology paper, Brazil uses a simulation model from its consultant (the Sumner model) that was developed for and presented during the compliance panel phase of the *Cotton* case, when the critical issue before the panel was the yes/no question of whether the U.S. marketing loan and counter-cyclical payments were causing serious prejudice to Brazil. At that time, the U.S. explained the fundamental flaws in using inappropriate values for parameters such as elasticities and coupling factors.[313]

247.   These flaws persist, and, given the calculation task before the Arbitrators, the consequences of these flaws are even more acute for the Arbitrators than they were for the compliance panel. Brazil is now asking the Arbitrators to use the Sumner model to determine not only the answer to the yes/no question on serious prejudice, but also to determine the final result of the entire serious prejudice determination for marketing loan and counter-cyclical payments. The model, as presented by Brazil, cannot be used in this way.

248.   During the compliance panel, the panel reviewed the Sumner model, noting the U.S. criticisms of the parameters of the model, including the elasticities and the counter-cyclical payment coupling factor. The compliance panel recognized that if the changes the United States recommended were made, the simulation showed a much smaller price effect from the removal of marketing loan and counter-cyclical payments.[314] The compliance panel determined that to use the simulation as part of its findings on the marketing loan and counter-cyclical payments, did not require it to decide which set of parameters were accurate. In fact, the compliance panel explicitly disclaimed taking a position on the correct figure for measuring effects, stating, "the Panel is not in a

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[312]This figure also includes corrections of parameters in Brazil's model. Without correcting the parameters in Brazil's model, the calculation for Brazil only is $134.3 Million.

[313]*See, e.g.,* U.S. Annex I.

[314]*Upland Cotton (21.5)*, para. 10.203.

position to judge the claims of the parties about the exact magnitude by which the world price would rise were marketing loan and counter-cyclical payments to cease entirely."[315]

249.   Instead, to the extent the compliance panel used the simulation model at all, it was only to observe that under both Brazil's consultants parameters and the corrected parameters offered by the United States, the model showed a price effect at all. In the section of its report on the Sumner model, the compliance panel concludes:

> While the Panel has refrained from making a determination about the magnitude of the impact of the U.S. subsidies on the world price, the Panel nevertheless finds that all the simulations conducted by the parties support the view that US marketing loan and counter-cyclical payments have led to an increase in US production and exports of cotton that have then suppressed world prices. The Panel takes note of the fact that price suppression has been the outcome of all the simulation results whether one uses the parameter values proposed by Brazil or the FAPRI and ATPSM parameter values proposed by the United States.[316]

250.   This was sufficient in answering the yes/no question before the compliance panel. Now, however, the Arbitrators have a different question to answer. Whereas the compliance panel did not judge "the exact magnitude by which the world price would rise were marketing loan and counter-cyclical payments to cease entirely," the Arbitrators must look at precisely this question.[317] The compliance panel also did not fix a number to the amount of price suppression in its findings of "significant" price suppression, but the Arbitrators must do so in order to fix a number to the calculation of the adverse effects of this suppression on Brazil.

251.   The difference between the exaggerated number proposed by Brazil and the lower figure is a result of the serious in the way the Sumner model is premised and applied and by Brazil's expansion of the Panel's findings to somehow justify a level of countermeasures to reflect alleged effects on the entire world. The United States discusses these issues below, as they relate to critical parameters such as 1) elasticities used in the modeling; 2) the coupling factor for counter-cyclical payments; 3) the price expectations; and 4) the time period chosen for the modeling exercise. These are not the only problems with Brazil's methodology; and the United States provides a detailed analysis of the problems with Brazil's consultant's model in U.S. Annex I [318]. However, serious problems with Brazil's methodology are obvious even on examination of a few key flaws.

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[315]*Upland Cotton (21.5),* para. 10.221.

[316]*Upland Cotton (21.5)*, para. 10.222.

[317]*Upland Cotton (21.5),* para. 10.221.

[318]Submitted to the compliance panel and resubmitted to the Arbitrators.

252.   When these problems with Brazil's methodology are corrected, and the methodology is properly applied only to measure the adverse effects on Brazil, the amount for possible countermeasures drops considerably. Brazil has asserted that the adverse effects to its interests of the U.S. marketing loan and counter-cyclical payments total $3.335 billion, more than three times the figure Brazil named in its original request for authorization for countermeasures. When Brazil's methodology is corrected, this figure is less than $30.4 million.

> **b.   Brazil's Mix of Elasticities Exaggerates the Price Effect of U.S. Marketing Loan and Counter-cyclical Payments and Does Not Correctly Represent the Counterfactual of Complete Removal of these Payments**

253.   As a starting point, it is understood that Brazil's model describes a situation where the marketing loan and counter-cyclical payments have been permanently withdrawn.[319]   As there is no recent representative period without these programs in place, the model uses estimates to describe the characteristics of that counter-factual situation and estimate the resulting effects. More specifically, Brazil uses a counterfactual under which marketing loan and counter-cyclical payments are completely withdrawn from MY 2005, with the announcement of the withdrawal "reasonably long before the planting of the 2005 crop."[320]

254.   Under Brazil's comparative static analysis, the counterfactual has a baseline that includes the non-compliance. To determine the level of effects, the non-compliance must be completely removed and the result is compared with the baseline. In this framework, the most appropriate method of ensuring that the non-compliance no longer affects decision-making by market participants is to utilize long-run elasticities. Long-run elasticities reflect a situation in which all actors fully adjust to the policy change, thereby removing any influences of the non-compliance.

255.   In spite of Brazil's assertion that it is using the counterfactual of complete, permanent withdrawal of marketing loan and counter-cyclical payments, the model it uses does not use the long-run elasticities that should apply. As a result, Brazil's model does not support its counterfactual. During the compliance panel proceedings, Brazil's economic consultant stated that the modeling he did was a short run analysis.[321]   Brazil's analysis for this proceeding uses the exact same parameters and coupling factors as the analysis provided in the compliance panel proceedings. Based on the rationale provided by Brazil for its parameter choices, the United States believes that the modeling is some type of hybrid of short run and long run.

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[319]Brazil Methodology Paper, para. 74.

[320]Brazil Methodology Paper, paras. 72-73.

[321]Rebuttal Submission of Brazil to the Panel (21.5), para. 304.

256.   As the next sections elaborate, this choice of a hybrid model with short-term and long-term elasticities dramatically inflates the effects of the US cotton subsidies. This internal inconsistency in the modeling provides a distorted, exaggerated estimate of the subsidies' effects. Recall that the model was originally provided to show the effect of changes in subsidies on U.S. production and, as a result, world price. Accordingly, the elasticity for this effect (additional U.S. production) is the largest, and suggests a complete, long run response to the change in subsidy payments. In the model, this shows a correspondingly large change in U.S. supply. By contrast, other moving parts in the model – U.S. demand elasticity and rest-of-world supply and demand elasticities – are lower, showing less responsiveness, as would occur in a short run period before there is a full response to a change. Thus, the magnitude of the other responses represented by these other elasticities, which would mitigate the effect of the change in U.S. production on price, is lower. For example, if U.S. producers decrease production, but others increase production, the price effect of the change in U.S. production is less. Overall, the mix of long-run and short run elasticities in Brazil's model exaggerates the U.S. supply response relative to other demand and supply responses in the model. As a result, it shows an exaggerated level of price effects.

c.   U.S. Supply Elasticity

257.   Brazil claims to be using a short-run U.S. supply elasticity but is, in fact, using a long-run supply elasticity. The United States and Brazil agree that the U.S. supply response elasticity should reflect the long run view. Although Brazil's claim that it is using a short-run elasticity is false, the decision to use long-run elasticities is methodologically correct (and should be applied throughout the model).

258.   Brazil's model uses a U.S. supply response elasticity of 0.8.[322] Brazil attempts to ground this choice in prior findings about cost of production for cotton producers, and likelihood of exiting cotton farming.[323] However, all of Brazil's supporting arguments cite long-run events. For instance, Brazil draws attention to a large and permanent loss of revenue to US producers, and the possibility of US producers taking the significant step of exiting cotton farming altogether in response to the US withdrawal of subsidies.[324] These events are usually associated with a long run scenario.[325]

259.   In fact, the compliance panel referred to "a perspective that focuses on how the subsidy affects decisions of producers to enter or to exit a given industry" as "longer-term." [326] Brazil's

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[322]Brazil Methodology Paper, para. 98.

[323]Brazil Methodology Paper, para. 100.

[324] Brazil Methodology Paper, para 100.

[325]*See, e.g.* US-61, pages 8-9.

[326]*Upland Cotton (21.5),* para. 10.83.

consultant's model assumes that there would be a complete permanent withdrawal of the programs providing for marketing loan and counter-cyclical payments and also that U.S. producers fully adjust to this change in U.S. policy within the terms of the model. Brazil itself emphasizes the long-term nature of these events when it explains that:

> If revenue shortfall is expected to be temporary – as occurs in the year-to-year flux in market prices that generated the historical data for much of the econometric estimation of supply elasticity – farmers would naturally delay making full adjustments to changes in price. (Under those circumstances, farmers reasonably would expect profitability to return soon, and that the costs associated with switching to other crops would outweigh temporary losses; a lower supply elasticity would, hence, be appropriate for such a situation. However, such a counterfactual is not before the Arbitrators here.)[327]

260.   The fact that U.S. producers would fully adjust to the policy change, implies a long-run estimate. Yet, Brazil characterizes it as short term, perhaps to avoid creating conflict on the short run/long run issue with the inappropriate short-term parameters it has selected (described below). The U.S. agrees that Brazil may appropriately use a supply elasticity of 0.8 to approximate a long-run adjustment process for U.S. producers but disagrees with Brazil's choice to mix in short-run elasticities in other parts of its analysis. Brazil should use appropriate long-run elasticities for all of its analysis.

d.   Rest of World Supply Elasticity

261.   For the suppliers from the rest of the world, Brazil has chosen an apparent short run-elasticity that is not consistent with the counterfactual is posits nor the long-run elasticity it uses for U.S. supply elasticity. The supply elasticity selected by Brazil is far too low; it is clearly not a long-run elasticity and it is even lower than some short-run elasticities found in the literature (See Table X below). As a result, Brazil's model shows an extremely low response by the foreigner suppliers to the higher prices of cotton with the removal of the two U.S. programs, while assuming an extremely quick response by US producers to the same event.

262.   Brazil argues that this very low response is appropriate because there is imperfect and slack transmission of price changes generated by U.S. cotton policy on producers in the rest of the world. While it may be true that there is a lag and price changes may not fully be transmitted in the short run, in the long run, this is less the case and in any event does not mean that producers in the rest of the world never fully adjust to policy change. In fact, in some countries where farmers typically work on small farms and additional land is available, such as India and Pakistan, farmers will likely

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[327]Brazil Methodology Paper, fn 124.

adjust to such changes in policy without delay.[328] Moreover, there are drawbacks to using the same supply and demand elasticities across different countries.[329]

263.   Additionally, Brazil argues for a low response from foreign suppliers because the foreign suppliers would not be able to distinguish whether the change in prices was a temporary market condition or the change in U.S. policy. This argument lacks any foundation given the continuous press coverage and major cotton producing states' focus on the impacts of the U.S. programs.

e.   U.S. and Foreign Demand Elasticities

264.   In terms of the U.S. demand and rest of world demand elasticities, Brazil has argued for extremely inelastic demand. In fact, their choice of demand elasticities are near the lower bound of that found in the literature on studies looking at impact of the removal of U.S. cotton programs.[330] Brazil's rationale for the very inelastic demand response is that cotton is such a small cost component of the final good and therefore has almost no impact on demand for the final good. The premise of very inelastic demand is doubtful even in the short run. Researchers at FAO have questioned the underpinnings of Brazil's rationale for the very inelastic demand elasticities. They argue that the actual demand for cotton is at the Mill, where the cost of cotton accounts for nearly 70 percent of Mill production costs. Additionally, it is the mills that decide the mix of fibers in producing yarn and therefore the mix is affected by relative prices of available fibers. Hence demand response to changes in cotton prices is probably not as inelastic as many studies looking at the impact of removing cotton support programs have incorporated.[331]

265.   Even if we accept Brazil's premise that demand is highly inelastic in the short run, mills will adjust their use of cotton over a longer time period. Moreover, in light of the type of significant shock that Brazil posits in its counterfactual, such adjustment would be expected. In fact, with the global financial crisis and economic slowdown, declining cotton demand is already being seen.[332]

Table 9 –Parameter values used in simulating the removal of counter-cyclical payments and marketing loans

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[328]Exhibit US-61.

[329]Exhibit US-61.

[330]Exhibit US-68.

[331] Poonyth, Daneswar, et al. *The Impact of Domestic and Trade Policies on the World Cotton Market* FAO Commodity and Trade Policy Research Working Paper No 8, 2004.

[332]Exhibits US-56, 60.

		Analysis	
Parameter	Brazil	Short run	Long run
		(FAPRI)[333]	(ATPSM)[334]
U.S. cotton supply elasticity	0.80	0.21	0.80
ROW cotton supply elasticity	0.20	0.33	0.94
US demand elasticity	-0.20	-0.82	-0.60
ROW demand elasticity	-0.20	-0.39	-0.84

266.   As the United State has demonstrated, Brazil has provided an analysis that selectively picks between long-run and short-run elasticities, and fails to consistently provide parameters that are appropriate for the question before the Arbitrators. With the mix of long-run and short-run elasticities, Brazil's consultant's analysis results in a counterfactual resulting in an equilibrium that represents one of many possible temporary points along the transition path to the "permanent" equilibrium without the programs. It does not depict the situation that would exist when cotton markets worldwide adjust to permanent removal of marketing loan and counter-cyclical payments. As such, Brazil is proposing a model that eliminates the benefits of subsides to US production numbers but largely keeps the alleged effects of U.S. subsidies to non-U.S. production. This distorts the effects that U.S. subsidies may have.[335] The model needs to be even-handed: if U.S. production responds to the elimination of U.S. cotton subsidies than foreign production must respond to a similar degree.

f.   Brazil Overstates the Coupling Effect of Counter-Cyclical Payments

267.   The next critical problem with the parameters used by Brazil's consultant is the coupling factor for counter-cyclical payments. To the extent there is any coupling of these payments to production decisions, the United States believes they are minimal and much less than the 0.4 coupling factor that Brazil attributes in their modeling. (In fact, consistent with the fact that

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[333]Exhibits US-56 (Compliance Panel) and Annex I.

[334]Exhibit US-61.

[335]If short run were used consistently for each parameter, then the effects on Brazil would be $20.4Million (using FAPRI short-run elasticities).

increased cotton production is not required at all to receive these payments, and payments do not increase for increased production, the United States considers counter-cyclical payments to be fully decoupled.) In justifying this arbitrary impact of counter-cyclical payments to production, Brazil posits several rationales, none of which provide the support it claims for the 0.4 coupling factor.

268.   One rationale for this high coupling effect that Brazil posits (without any evidence) is that farmers expect that payment acres would be updated in the next farm bill resulting in them planting cotton now to ensure larger acreage for the next farm bill. Brazil has made this assertion before in these proceedings, also without evidence. The original panel stated that there was no evidence before it regarding farmers' expectations relating to base updating, and the Appellate Body agreed with the panel's determination not to find such expectations.[336] Brazil's reference to the compliance panel finding in para. 125 of its Methodology Paper is entirely misleading, because the compliance panel report also noted: " The Panel understands that the issue of base acreage updating is not an issue before it."[337] There have been no findings on base updating throughout the entire history of this dispute.

269.   Recent facts further erode Brazil's claims about base updating. On June 18, 2008 (effective May 22, 2008), the United States enacted the Food, Conservation, and Energy Act of 2008 ("2008 Farm Bill"). Thus, if farmers ever expected there to be base updating, they would have no basis for such an expectation today. Furthermore, if cotton farmers had been expecting to update their base acres in the 2008 Farm Bill, and this expectation had positively influenced their planting decisions, one would not expect to see U.S. farmers planting less and less cotton over recent years. In fact, planted acres have declined by almost 40 percent over the past three marketing years, and *planted acres are now significantly less than half of base acres*, when viewed on an aggregate basis. Estimated planted acres in 2008 of 7.6 million are only about 40 percent of an estimated 18.3 million base acres. Brazil's argument falls flat, and cannot support its higher decoupling factor.

270.   A second rationale provided by Brazil is the notion that legal restrictions on land use undermine planting and commercial flexibility, thereby discouraging cotton-base holders from growing other crops than cotton. This argument is without basis. Data on planting show that farmers holding cotton base acres widely plant crops other than cotton, facts that are inconsistent with an alleged effect on planting decisions.

271.   For example, Table 10 shows that on farms with upland cotton base in California, the ratio of planted cotton acres to base acres was only 32.7 percent in 2005. Moreover, on farms with upland cotton base, the Farm Service Agency data show that more than 600,000 acres were planted to fruits and vegetables in 2005 in California alone (and over 1 million acres nationwide), suggesting that base payment restrictions had little effect on upland cotton plantings.

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[336] Panel Report, para 7.393. Appellate Body Report, para. 344.

[337] *Panel Report, U.S.-Upland Cotton (21.5)*, footnote 338.

Table 10–Cotton base acres versus cotton planted acres, 2005 crop year

State	Total upland cotton base acres	Upland cotton planted acres on farms with cotton base acres	Ratio of planted acres to base acres for cotton	Acres planted to fruits and vegetables on same farms
ALABAMA	706,660	405,031	57.3%	10,488
ARIZONA	454,060	194,026	42.7%	128,151
ARKANSAS	1,160,612	848,081	73.1%	6,348
CALIFORNIA	1,122,422	366,570	32.7%	602,635
FLORIDA	113,434	59,062	52.1%	10,800
GEORGIA	1,520,959	941,842	61.9%	134,552
KANSAS	20,159	8,267	41.0%	20
KENTUCKY	110	82	74.3%	0
LOUISIANA	1,086,678	521,361	48.0%	16,504
MARYLAND	99	69	69.8%	0
MISSISSIPPI	1,699,301	1,016,967	59.8%	18,195
MISSOURI	440,272	335,432	76.2%	16,182
NEBRASKA	8	0	0.0%	0
NEW MEXICO	113,245	40,033	35.4%	29,205
NORTH CAROLINA	883,365	580,135	65.7%	56,058
OKLAHOMA	598,372	175,769	29.4%	10,480
SOUTH CAROLINA	363,906	187,570	51.5%	12,936
TENNESSEE	760,316	493,273	64.9%	1,645
TEXAS	7,372,619	4,920,156	66.7%	118,574
VIRGINIA	105,414	61,883	58.7%	3,296
United States	18,522,013	11,155,611	60.2%	1,176,069

Source: Farm Service Agency[338]

272.   Recent developments in the U.S. cotton sector also make one question the appropriateness of the coupling factor used by Brazil for counter-cyclical payments. Over the past two years, there has been a huge shift in the production on farms holding cotton base acres. When faced with relative prices that favored the planting of another crop, when agronomic conditions are favorable, producers have responded in a significant way. The claim that legal restrictions on land use discourage cotton

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[338] 2005 Crop Year Subcategories (Exhibit US-64)

base-holders from planting other crops is not supported by the facts. Cotton producers with cotton base acres have many alternatives for planting, and recent planting history bears that out.

273.   Brazil also posits that the counter-cyclical payments reduce risk and therefore the income guarantee from these payments allows U.S. cotton farmers to take on greater business risk (i.e., maintain or increase cotton acreage), provide U.S. cotton farmers additional income beyond the marketing loan payments, and can be used to get commercial credit for further productive investments. The United States would note that these rationales would apply to any additional income that these farmers received whether it be income support not tied to production or off-farm income. Under a broad metric like this, a Member might go so far as to raise concerns with regard to payments included in Annex 2 of the Agreement on Agriculture, such as decoupled income support, that Members never intended to be raised.

274.   Despite Brazil's assertions, counter-cyclical payments act more like a decoupled payment. Therefore, a much smaller coupling factor than that proposed by Brazil is correct. To be conservative, and for the purposes of this modeling exercise only, the United States employs the FAPRI approach of modeling these payments with a coupling factor of 0.25. Westhoff et al. explain the FAPRI specification as follows:

> Also included [in the expected net revenue equation] are 25 percent of expected CCPs. Because CCPs are made on a fixed base, they can be considered at least partially decoupled from production decisions (thus their inclusion in the decoupled payment term in the area equations). However, CCPs do depend on prices, and risk-averse producers may have a positive supply response to the price insurance offered by the program. The 0.25 parameter is based on analyst judgement, reflecting the notion that the crop-specific effect of CCPs on production is likely to be positive, but modest.[339]

Without prejudice to the U.S. view that the correct coupling factor would approach zero, this 0.25 parameter is used in the U.S. calculations below.

g.   Brazil's Choice of Price Expectations Indicator

275.   Both parties agree that price expectations at the time at planting are important in determining the effect of the U.S. programs. However, in its model, Brazil has ignored the available data on price expectations and instead used the previous year's price as the price expectations. It may be necessary to use such a "lag price" in some cases, such as in the FAPRI model used by Brazil in the original panel where the model included other products for which no future expectation price was available.

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[339] Westhoff, Patrick, Scott Brown and Chad Hart. "When Point Estimates Miss the Point: Stochastic Modeling of WTO Restrictions" FAPRI Policy Working Paper #01-05, December 2005, page 6 (Exhibit US-58).

However, there is now no barrier to using future prices for price expectations. The United States believes that the futures price provides for a better measure of price expectations than the previous year's price because the futures price incorporates the latest information available and is the result of market participants views. That is, Brazil provides no evidence that farmers make their planting decisions based on last year's prices. On the other hand, the U.S. approach of using future prices employs data from a real-world market in which relevant economic actors, including farmers and merchants, come together and through real transactions engage in price discovery.

3.   Time Period of Analysis
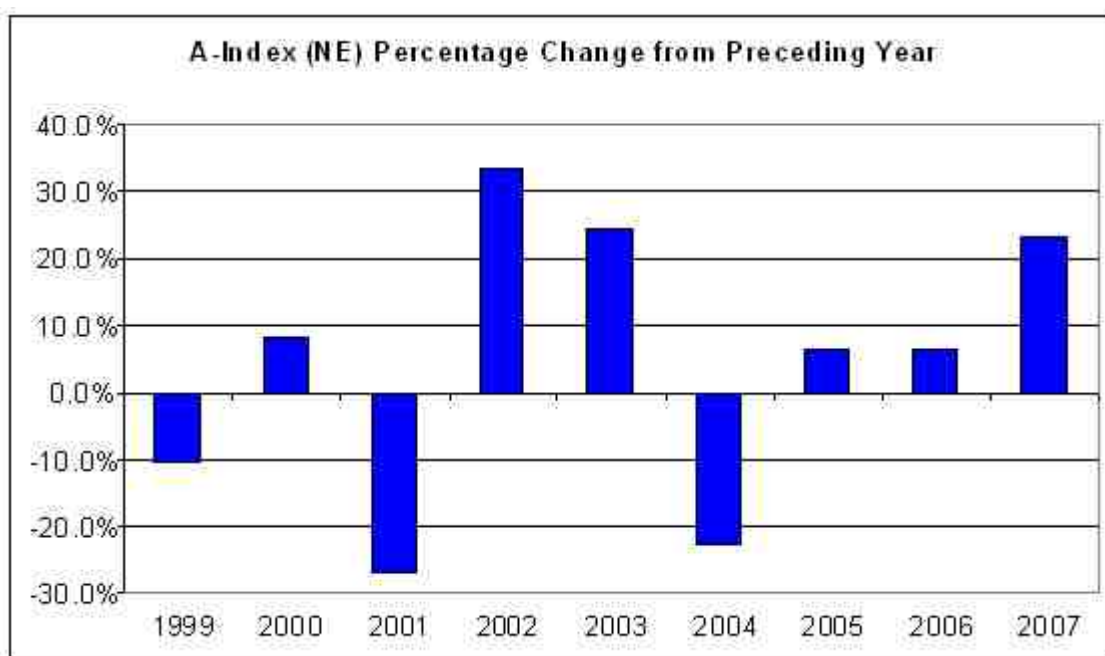
276.   In its modeling to demonstrate the impact of the counter-cyclical payments and marketing loan payments programs, Brazil has relied solely on data from MY2005. While MY2005 may have been the marketing year that bridged the end of the reasonable period of time to comply with the original panel's rulings and recommendations – September 21, 2005 -- using a single year for an agricultural product that has volatile prices is not representative of the potential effects going forward to Brazil. As Figure 2 below demonstrates, cotton prices have moved considerably from one year to the next.

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277.   For this reason, the United States suggests that a 3 year period be used to estimate the effects on Brazil. The task of the Arbitrators is to determine the amount of countermeasures permitted based on the findings of the compliance panel and, in this case, due to the dynamics of this case, the Arbitrators will be making its determination over 3 years after the end of the reasonable period. It therefore, makes sense that the Arbitrators use actual data of the period following the end of the reasonable period to provide more information about the likely harm to Brazil.

278.   In addition, it should be noted that prior arbitrations do not suggest a narrow, one-year analysis like Brazil uses. In terms of taking into account more recent data, arbitrators have taken into account current conditions -- including evaluation of changes to policies at issue.[340] Arbitrators have also taken approaches that use multi-year time horizons, whether in projections of several years for a subsidy or in the use of formulas.[341] Thus, as a result, the United States suggests that the analysis be the 3 year period of MY2005-MY2007 and the level of countermeasures be the average of the outcomes of these three marketing years.

279.   As an additional matter, the United States observe that a formula may be another possible approach. This could be done by using the results of the simulation model over a period of years to determine a coefficient. For example, a coefficient could be based on the average ratio of payments to adverse effects.

4.   Countermeasures Must Meet the Limitations of the Legal Standard for Actionable Subsidies

280.   Brazil's proposed countermeasures also far exceeds what would be permissible under the limitations of the legal standard for actionable subsidies. Under the SCM Agreement, proposed countermeasures on actionable subsidies are evaluated under a special and additional rule particular to these subsidies. The analysis under these provisions must take account of the treatment of actionable subsidies in the WTO Agreement, and the characteristics of actionable subsidies such as domestic support payments for agriculture. The special rule related to actionable subsidies reflect the fact that actionable subsidies are only inconsistent with WTO obligations if they result in certain adverse effects to another Member. Members are permitted to have such subsidies so long as the effects of the subsidies do not cross that boundary.

281.   The special rule also assures that any countermeasures that are authorized will be closely tailored to the adverse effects of subsidy payments, and will not impose additional, punitive measures that would penalize the existence of such payments even when they do not cause adverse effects.

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[340] *US/EC Bananas (22.6)*

[341] *US-CDSOA (22.6); US-Antidumping Act of 1916 (22.6)*.

282.   The standard for the Arbitrators to evaluate countermeasures with respect to actionable subsidies is provided in Article 7.10 of the SCM Agreement. It states:

> "In the event that a party to the dispute requests arbitration under paragraph 6 of Article 22 of the DSU, the arbitrator shall determine whether the countermeasures are commensurate with the degree and nature of the adverse effects determined to exist."

283.   This standard only applies to "actionable" subsidies that cause adverse effects to the interests of other Members within the meaning of Article 5 of the SCM Agreement.

284.   The fact that there is a special and additional rule for actionable subsidies indicates the drafters intent that actionable subsidies, with their specific characteristics, require their own assessment for countermeasures.

a.   Countermeasures Cannot Be Permanent or Punitive Under any of the Standards

285.   Before turning in more detail to the more specific points about the way the special rule for actionable subsidies fits the object and purpose of the drafters of the SCM Agreement with respect to these subsidies, it is important to set out two of the basic limitations that apply to all countermeasures. Namely, countermeasures must not be punitive and they must not be permanent.

286.   The purpose of countermeasures under the WTO system is to rebalance concessions. It is a forward-looking system, and not intended to act as a form of punishment or retribution for past harms. For example, in FSC (concerning prohibited subsidies), the arbitrator recognized that countermeasures should not be "manifestly punitive." [342] When a WTO member undertakes countermeasures, that Member is also taking action inconsistent with its obligations. The goal of the system is not to have multiple parties acting inconsistently with their WTO obligations as would occur with adding an inconsistent measure and, as a second inconsistent measure, a punitive countermeasure. Instead, the goal is to rebalance concessions when such inconsistencies occur.

287.   Further to this goal, countermeasures are temporary. Article 22.8 of the DSU provides: "The suspension of concessions or other obligations shall be temporary and shall only be applied until such time as the measure found to be inconsistent with a covered agreement has been removed, or the Member that must implement recommendations or rulings provides a solution to the nullification or impairment of benefits, or a mutually satisfactory solution is reached."

b.   Because Actionable Subsidies Are Not Prohibited, the Legal Standard Only Permits Countermeasures to the Extent the Effects of the Subsides Are Inconsistent with WTO Obligations

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[342] *US-FSC (22.6)*, para. 5.62.

288.   The standard for actionable subsidies – "commensurate with the nature and degree of the adverse effects determined to exist" – allows for determination of countermeasures that can meet the goals of the Members in a way that is suitable for these subsidies. These subsidies are distinguished within the context of the SCM Agreement by the fact that the subsidies in themselves are permitted. Members are allowed to have subsidy programs like those that provide marketing loan and counter-cyclical payments, and the disciplines of the SCM Agreement only come into play when such payments cause adverse effects as defined in Article 5. Therefore, the special standard for these subsidies is narrowly directed to target only these adverse effects.

289.   A close examination of the ordinary meaning of the terms in 7.9 and 7.10 of the SCM Agreement shows how the standard is suited to actionable subsidies. Under Article 3.2 of the DSU, the Arbitrators should read these provisions utilizing the customary rules of interpretation of public international law. As reflected in Article 31 of the Vienna Convention, treaty text should be read "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." Keeping in mind the purpose of rebalancing concessions, a basic examination of the terms of the special rule shows how the terms that the drafters selected fit the purpose of Agreement in general and of possible countermeasures in particular.

290.   This is underscored by other points in the structure of the agreement that place limits on or otherwise govern the way the respective standards can be applied. For example, a key element of the *nature* of actionable subsidies (as opposed to prohibited subsidies) is that they are *not* prohibited. In determining the countermeasures that Brazil can take the Arbitrators should take account of the fact that to the extent that the marketing loan and counter-cyclical payments do not cause serious prejudice to Brazil, they are not inconsistent with the SCM Agreement.

291.   The Arbitrators are also tasked with looking at the precise *degree* of adverse effects determined to exist. The challenges of identifying and quantifying effects are well known, and have already been faced by panels and the Appellate Body in this case. As part of its examination, the original panel and the compliance panel both considered detailed information, including the simulation model Brazil is used to support its Methodology Paper.   The panels used this information to answer the yes/no question of whether the domestic subsidy payments at issue caused significant price suppression.

292.   Both panels declined to identify where the threshold for "significant" is precisely, but nonetheless determined that the effect of the United States payments was sufficient to cross that threshold. In finding that the effect of United States payments was significant, however, it was acknowledged the important part that threshold plays in the analysis. After examining Articles 6.3(c), 5(c), and 15.2 of the SCM Agreement, the original panel stated:

> This reading of the text in its context confirms to us that it is the degree of price suppression or depression itself that must be 'significant' (i.e., important, notable or consequential) under Article 6.3(c) of the *SCM Agreement*. In determining whether the price suppression is 'significant', it may be relevant to look at the degree of the price suppression or depression in

the context of the prices that have been affected – that is, at the *degree* of significance of suppression or depression."[343]

293.   In other words, under Article 7.10 of the SCM Agreement, countermeasures in respect of marketing loan and counter-cyclical payments can only be authorized by the Arbitrators *to the extent* they result in *significant* price suppression and *serious* prejudice – the necessary thresholds for a finding of WTO inconsistency.

294.   At this point in the proceedings, the Arbitrators must consider the question of "degree" once again, now to answer the question of what countermeasures would be commensurate with the degree of adverse effects determined to result from marketing loan and counter-cyclical payments.

295.   In the analysis of the original panel and of the compliance panel, the difficulties of defining the extent to which subsidy payments cause serious prejudice were evident. As the Appellate Body recognized, the original panel did not identify what degree of price suppression was significant.[344] Further, the original panel believed that "'significance' of price suppression could, depending on the circumstances, have both quantitative and qualitative aspects." [345] The panel stated that "significance may be manifest in a number of ways. The 'significance' of any degree of price suppression may vary from case to case, depending upon the factual circumstances, and may not solely depend upon a given level of numeric significance."[346]

296.   The compliance panel also declined to identify the degree of price suppression that resulted in the finding of "significant" price suppression. In particular, in its review of the economic models presented by the parties, the panel recognized the range of potential increase in the price of cotton that was indicated by the simulations when marketing loan and counter-cyclical payments were not made. Including the results of the simulations from the United States and from Brazil, the range was from 1.14% to 8.9%.[347] But the panel did not identify at what point the price change indicated by the models crossed the threshold for "significant price suppression." Instead, the panel took the range of numbers from the simulations and evaluated the group of numbers with other factors to answer the question about "significant price suppression" as a yes-or-no proposition. And the panel answered,

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[343] *Upland Cotton (Panel)*, para. 7.138.

[344] Appellate Body Report, *Upland Cotton,* para. 490, citing *Upland Cotton*, para. 7.1329.

[345] Appellate Body Report, *Upland Cotton,* para. 490, citing *Upland Cotton,* paras. 7.1316-7.1333.

[346] *Upland Cotton*, *(Panel),* para. 7.139.

[347] *Upland Cotton (21.5)*, para. 10.201-202.

"yes," without naming the degree of the price suppression. This approach was upheld by the Appellate Body.[348]

297.   Given the difficulties in quantifying significant price suppression and adverse effects, and given that price suppression short of a certain threshold is not prohibited under the SCM Agreement, the negotiators agreed to a metric for assessing countermeasures that, carefully applied, would not result in countermeasures beyond those that should reasonably be permitted.

298.   The requirement that the countermeasure be commensurate in "nature" and "degree" with the adverse effects determined to exist is a reminder that countermeasures should fit only that part of the subsidy that is inconsistent, and, to the extent quantities are compared, the Arbitrators should compare the proposed countermeasures with the part of the subsidy causing the price suppression over the "significant" threshold, not the effects of the entire subsidy.

299.   If it were otherwise, countermeasures could be far too high, to the extent that they would be punitive. Countermeasures equivalent to all the effects of marketing loan and counter-cyclical payments would be just such an additional dimension. Parties are not required to eliminate all subsidy payments in the event of a finding of significant price suppression.   Instead, the applicable rule – Article 7.8 of the SCM Agreement – provides that parties may withdraw a subsidy or eliminate its adverse effects. So long as the adverse effects are addressed, there is no inconsistency with the SCM Agreement. Countermeasures beyond what is necessary to address the adverse effects would be punitive and not permitted.

300.   Therefore, in determining what countermeasures are commensurate with the nature and degree of the adverse effects determined to exist, the Arbitrators must be satisfied that the countermeasure does not exceed what would be sufficient to respond to that part of the effects of the actionable subsides that has been found to cause significant price suppression and adverse effects on Brazil.

301.   In its calculations, the United States has taken into account the considerations described above regarding the *nature* of the actionable subsidies and the *degree* of their adverse effects as required by Article 7.10 of the SCM Agreement.

5.   When Flaws in Brazil's Methodology Are Corrected, the Amount of Possible Countermeasures Falls Dramatically

302.   The United States has prepared a set of calculations that corrects the key flaws in Brazil's methodology paper.   With these corrections, the annual amount for the possible countermeasures is based on a more realistic set of assumptions about the market for upland cotton and producers' decisions about their crops. In addition, the United States has properly applied the legal requirement

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[348]Appellate Body Report, *Upland Cotton (21.5)*, para. 365.

of the SCM Agreement that countermeasures are "commensurate with the degree and nature of the adverse effects determined to exist."

a.   The U.S. Calculations Correct Errors in Brazil's Calculation

303.   In its calculations, the United States has corrected Brazil's methodology with respect to the critical parameters discussed above. These corrections are as follows:

304.   *Elasticities.* As discussed above, the counterfactual in the Sumner model assumes complete, permanent removal of marketing loan and counter-cyclical payments, and adjustment of cotton production to that change. This is consistent with a long-run scenario. Therefore, in its calculations, the United States has used all long-run elasticities, taken from the UNCTAD-FAO Agricultural Trade Policy Simulation Model (ATPSM).

305.   *Counter-cyclical Payment Coupling Factor.* Because the coupling factor for counter-cyclical payments that Brazil used is far too high, the United States has used a more published, lower (albeit still too-high) figure. The United States used a coupling factor of 0.25. The United States has selected this figure because it mitigates the error of Brazil's high 0.40 coupling factor, and it has been used by FAPRI, an independent third party. Notwithstanding the use of the FAPRI number, the United States notes that it believes that even 0.25 is too high, given that counter-cyclical payments are more like decoupled payments.

306.   *Price Expectations*. Brazil used lagged prices (that is, prices in the past) for the price that producers expect. Instead, the United States has used futures prices, because these incorporate the latest views of market participants about their expectations of the market. In particular, the United States used the average for January-March futures for December delivery. Since the price quoted on the futures market is not the actual price the U.S. farmer would receive, the United States deducted 5 cents off the average futures price. Futures prices include costs for delivery to a set location, so this deduction is needed to bring back the price to value the U.S. farmer is likely to receive.

307.   *Time Period*. As discussed above, the Arbitrators should use the most current, representative information available and not (as Brazil suggests) a single marketing year three years ago. In its calculations, the United States used MY2005-MY2007. This sample provides data over time that takes into account the fluctuations from year to year that are typical of cotton prices and marketing loan and counter-cyclical payments. These fluctuations result in differences in price effect in each year: 1.53 percent, 0.47 percent and 0.5 percent respectively.

308.   The results of the simulation run with Brazil's model, with the corrections noted above, in relation to the effect on the entire world are shown in Table 11. They range from about $7 million in 2005 to about $2.7 million in 2006, far lower than the $3.335 billion advance by Brazil. However, because the findings in this case concern serious prejudice *to Brazil* alone, it is necessary to separate the effects on Brazil in particular from the world-wide effects.

Table 11 Impact on Rest of World with Corrected Parameters					
MY	Actual Production (million lbs)	Lost Revenue (valued by A-index)	Additional Production (million lbs)	Value of Additional Production	Total Estimated Effects
2005	44,490.72	$387,069,264	640.7	$371,009,894	$758,079,158
2006	48,192.96	$139,759,584	212.0	$129,498,339	$269,257,923
2007	48,639.36	$184,829,568	228.6	$172,619,629	$357,449,197

309. To determine the effect on Brazil, the United States took the percentage change in prices from the model simulation from the permanent removal of the counter-cyclical payment and marketing loan payment programs. The United States then applied this percentage change to a representative Brazilian cotton price to determine lost revenue for production that actually occurred for each marketing year. The United States used the CEPEA/ESALQ price index, as this is the most appropriate price to evaluate the value of Brazilian cotton.[349]

310. Using this calculation, the additional revenue Brazil would have received for the cotton production that occurred in each marketing year is as follows:

  MY 2005 $18,724,800

  MY2006 $9,744,000

  MY2007 $12,698,400

311. Under the simulation model, a change in price would also affect the total production. Determining the additional production (and resulting revenue) in Brazil is the next step in the calculation. To determine the additional production, the United States applied the supply elasticity for Brazil from the ATPSM to determine the additional production given the simulated price change for each marketing year. The ATPSM supply elasticity for Brazil is 1.2. This additional production then was valued using simulated price increase applied to the CEPEA/ESALQ price index.

  Additional production (lbs)   Value of additional production

MY2005 41,420,160 $22,876,354

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[349]The CEPEA/ESALQ price index involves daily price collection through players in the market, at the first moment, and, after that, statistical prices analysis collected in both producing and consuming regions. See CEPEA's website, link http://cepea.esalq.usp.br/english/cotton/?id_page=233 , Exhibit US-68.

MY2006   18,950,400 $11,908,431

MY2007   20,592,000 $15,159,830

312.   The total effects on Brazil for each marketing year are the sum of 1) the additional revenue from the production that occurred in each year, plus 2) the additional revenue that Brazil would receive from the additional production. Thus, the total effects on Brazil of permanent withdrawal of marketing loan and counter-cyclical payments, pursuant to Brazil's own model (with corrections noted above) is as follows:

          MY 2005 $41.6 million

          MY2006 $21.7 million

          MY2007 $27.9 million

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          Average MY 05-07 $30.4 million

> **b.   The Total of the Effects of Marketing Loan and Counter-cyclical Payments Should Be Reduced to No More Than the Portion of the Effects Commensurate with the Adverse Effects**

313.   The preceding calculations are for total effects of marketing loan and counter-cyclical payments on Brazil. Brazil's version of the model, as set out in its methodology paper, also measure *total* effects.   However, the findings of the panel were only in regard to the adverse effects determined to be caused by significant price suppression. The total effects measured by the calculations are larger than that portion of the effects that resulted in the panel's findings, and a countermeasure equal to the total effects would not be commensurate with the adverse effects in accordance with Article 7.10 of the SCM Agreement.

314.   Put another way, a countermeasure equal to the total effects of the marketing loan and counter-cyclical payments would be equal to the effects of the total price suppression determined by the model, while the findings of the panel only related to the extent to which any price suppression was significant. In sum, a countermeasure commensurate with the nature and degree of the adverse effects determined to exist must be *less than* the total effects of the marketing loan and counter-cyclical payments, that is, must exclude the portion of the total effects that is not "significant."

315.   Therefore, the Arbitrators should make a downward adjustment to the measure of total effects in order to meet the legal standard under Article 7.10 of the SCM Agreement. The precise amount of the deduction is difficult to determine. It relates specifically to determining what the exact degree of significant price suppression, which both the original panel and compliance panel declined to name.

Although it is difficult to determine what the threshold is for "significant" price suppression, it is nonetheless critical.

316.   Based on the model, the total effects on Brazil average $30.4 million. The *adverse* effects – that result in significant price suppression and the finding of serious prejudice to Brazil – are less than that total and would correlate with the degree of price suppression that was "significant." Thus, if the price suppression did not meet the threshold of "significant" – as the United States has argued – the adverse effects would be zero even if the total effects are $30.4 million.   Between the total of $30.4 million and zero, different thresholds for "significant" price suppression would result in different levels of adverse effects on Brazil, as follows:

% of Effects Caused by the Degree of Price Suppression that Is Significant	Adverse Effect on Brazil
25%	$7.5 million
50%	$15.2 million
75%	$22.8 million

317.   The level of authorized countermeasures should be based on these numbers. These are the figures tied to the actual findings of the panel with respect to *significant* price suppression resulting in *serious prejudice to Brazil*. It is these numbers that are *commensurate with the degree and nature of the adverse effects determined to exist* under Article 7.9 of the SCM Agreement.

V.   Brazil Should Not Be Authorized to Suspend Concessions in Other Sectors or Agreements

318.   There are formally two arbitrations involved in this dispute. In the first arbitration, concerning the GSM 102 export credit guarantees and Step 2, Brazil is requesting $1.644 billion in countermeasures, of which $1.294 billion would be annual countermeasures. In the second arbitration, regarding actionable subsidies, Brazil is requesting $1.037 billion in annual countermeasures. Brazil is additionally requesting the right to apply countermeasures across agreements, specifically in the GATS and TRIPS Agreement. As explained below, Brazil cannot justify its claim that applying countermeasures with respect to goods is not practicable or effective.

A.   Application of the DSU to this Dispute

319.   Brazil's request for countermeasures in TRIPS and GATS should not be authorized. Article 22.3 of the Dispute Settlement Understanding (DSU) limits when Members can apply countermeasures across agreements. Given the size and diversity of the Brazilian economy, Brazil

cannot demonstrate that it is not practicable or effective to suspend concessions with respect to goods.

320.   At the outset, we recall that the DSU disciplines regarding suspension of concessions apply to this dispute. Brazil suggests it disagrees when it states in its methodology paper that the suspension of concessions "must be assessed solely against the requirements of Article 4.10 and 7.9 of the SCM Agreement."[350] In this, Brazil is mistaken. By the terms of both the DSU and the SCM agreement, the DSU disciplines regarding suspension of concessions, including Article 22.3, apply to the SCM agreement.

321.   The text of the DSU explicitly states that DSU rules and procedures apply to this dispute. DSU Article 1.1 establishes in no uncertain terms that SCM agreement is covered by dispute settlement procedures, stating that "The rules and procedures of this Understanding shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding (referred to in this Understanding as the "covered agreements")." Appendix 1 includes the SCM Agreement.

322.   The SCM agreement also explicitly requires the application of DSU rules and procedures for disputes regarding the subsidy agreement. Articles 4.11 and 7.10 both note that "in the event a party to the dispute requests arbitration under paragraph 6 of Article 22 of the DSU, the arbitrator shall determine whether the countermeasures are appropriate" (for prohibited subsidies) or "commensurate with the degree and nature of adverse effects determined to exist" (for actionable subsidies). Turning to paragraph 6 of Article 22 of the DSU, the text is unequivocal that the Article 22.3 disciplines regarding suspension of concessions apply. The paragraph reiterates that "if the Member concerned objects to the level of suspension proposed, or claims that the principles and procedures set forth in paragraph 3 have not been followed when a complaining party has requested authorization to suspend concessions or other obligations pursuant to paragraph 3(b) or (c), the matter shall be referred to arbitration."

323.   If the drafters of the SCM agreement had wished to provide different rules or procedures when calculating the extent of the permissible suspension of concessions with respect to other sectors or under other Agreements, they could have easily done so. In fact, the SCM agreement drafters did wish to provide for a shortened time frame for the disputes regarding prohibited subsidies and explicitly did so in Article 4.12.[351] That the SCM Agreement does not provide for rules relating to cross-sectoral suspension of concessions independent of DSU Article 22.3, when special rules for other issues were carved out, further suggests the level of suspension of concessions remains securely tied to the existing DSU rules and procedures.

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[350] Brazil Methodology Paper, paras. 142, 144.
[351] Article 4.12 of the SCM agreement states "For purposes of disputes conducted pursuant to this Article, except for time-periods specifically prescribed in this Article, time-periods application under the DSU for the conduct of such disputes shall be half the time prescribed therein."

324.   Thus the SCM agreement does not displace the limits on cross-agreement suspension of concessions under Article 22.3 of the DSU. The SCM agreement – even if relied on "exclusively" – does not call for remedies distinct from those that are available under Article 22.6. Indeed, the SCM agreement specifically limits the Members to the remedies available by the DSU procedures. Consequently, Article 22.3 must be incorporated into the Arbitrators' analysis of what is an "appropriate" countermeasure under Art. 4.10 of the SCM agreement and a "commensurate" countermeasure under Article 7.9.

B.   The Disciplines of Article 22.3

325.   The text of the DSU lays out a specific institutional structure that was the result of debates by the Members. During negotiations, the Members actively considered different remedies schemes. The proposals varied from a regime where cross-agreement or sector suspension of concessions was prohibited (in the words of the negotiators, each agreement would be self-contained) to a regime where Members were unconstrained in their decision to use cross-agreement or sector suspension of concessions if the suspension of concessions or other obligations was authorized by the DSB. The compromise position that the negotiators wrote into the DSU was that of *disciplined* cross-sectoral or cross agreement suspension of concessions; suspending concessions across sectors and agreements was to the exception rather than the rule. Article 22.3 establishes a hierarchy of suspension: Members must first try to suspend concessions within the same sector. If that is not practicable or effective, then parties can request permission to suspend in a different sector. This distinction is important in the GATS and TRIPS agreements where there are multiple sectors, but is of less importance with respect to goods. The bar for suspending concessions under other agreements is higher still. Not only does the suspension within the agreement have to be neither practicable nor effective, but the violation must be serious enough to warrant cross-agreement suspension.

326.   The disciplines of Article 22.3 are an integral part of the dispute resolution process and the rebalancing of concessions. As stated by the arbitrator in the *US/EC Bananas* arbitration, "the basic rationale of these disciplines is to ensure that the suspension of concessions or other obligations across sectors or across agreements (beyond those sectors or agreements under which a panel or the Appellate Body has found violations) remains the exception and does not become the rule."[352] In this proceeding, it is necessary to determine whether Brazil has objectively followed these procedures.[353] Brazil is entitled to a certain margin of appreciation in making this determination, but the Arbitrators also have an obligation to judge whether Brazil has objectively reviewed the facts and has reached a plausible conclusion.[354]

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[352] *US/EC Bananas (22.6)*, para. 3.7

[353] *Ecuador/EC Bananas (22.6)*, para. 52.

[354] The Ecuador/EC Bananas arbitrator noted that the complaining parties margin of appreciation in following the procedures of Art. 22.3 is subject to review by the arbitrator (para. 52): "In our view, the margin of review by the Arbitrators implies the authority to broadly judge whether the complaining party in question has considered the necessary facts objectively and whether, on the basis of these facts, it could plausibly arrive at the conclusion that it was not

327.   In these arbitrations, we are only concerned with cross-agreement suspension of concessions. This type of suspension of concessions is subject to the highest degree of discipline under the DSU's remedial framework.[355] For a party to request cross-agreement suspension of concessions, it must find that:

(a)   it is not practicable or effective to suspend concessions or other obligations with respect to other sectors under the same agreement *and*

(b)   that the circumstances are serious enough to warrant cross-agreement suspension of concessions

328.   When analyzing these requirements, the party must take into account, (1) the trade in the sector or under the agreement under which the panel or Appellate Body has found a violation or other nullification or impairment, and the importance of such trade to that party, and (2) the broader economic elements related to the nullification or impairment and the broader economic consequences of the suspension of concessions or other obligations. The complaining party must

practicable or effective to seek suspension within the same sector under the same agreements, or only under another agreement provided that the circumstances were serious enough."

[355] Article 22.3 requires that: "In considering what concessions or other obligations to suspend, the complaining party shall apply the following principles and procedures:

(c)   if that party considers that it is not practicable or effective to suspend concessions or other obligations with respect to other sectors under the same agreement, and that the circumstances are serious enough, it may seek to suspend concessions or other obligations under another covered agreement;

(d)   in applying the above principles, that party shall take into account:

(i)   the trade in the sector or under the agreement under which the panel or Appellate Body has found a violation or other nullification or impairment, and the importance of such trade to that party;

(ii)   the broader economic elements related to the nullification or impairment and the broader economic consequences of the suspension of concessions or other obligations;

(e)   if that party decides to request authorization to suspend concessions or other obligations pursuant to subparagraphs (b) or (c), it shall state the reasons therefor in its request. At the same time as the request is forwarded to the DSB, it also shall be forwarded to the relevant Councils and also, in the case of a request pursuant to subparagraph (b), the relevant sectoral bodies;"

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further explain how it has reached the conclusion that cross-agreement suspension of concessions is warranted.

1. Structure of the DSU

329. The DSU is uncompromising in its requirement that cross-agreement or cross sectoral suspension of concessions be restricted to specific circumstances. The DSU text does not explicitly define what countermeasures are "practicable or effective," but the negotiators were clear in their intention that this be a high bar. Brazil does not reach this bar. Brazil advances a claim for cross-agreement and sector suspension of concessions that is contrary to the Article 22.3 disciplines. In its methodology paper, Brazil states that it does not consider it adequate to suspend concessions "by creating barriers to Brazilian imports of U.S. goods and thereby imposing additional costs on the Brazilian economy in general."[356] This claim runs head long into the thoughtful and purposeful design of the DSU system. The treaty negotiators specifically created a system where Members had to first resort to suspension of concessions within the agreement. Suspension of concessions with respect to goods *always* entails creating barriers to another member's goods and thereby imposing additional costs on the sanctioning state's economy. The negotiators of DSU were well aware that suspension of concessions with respect to goods would be painful for both the sanctioned government and the sanctioning government.

330. Brazil's claim that suspension of concessions on goods was not practical or effective because it imposed additional costs on the Brazilian economy undercuts all of Article 22.3. If the mere fact of additional cost were sufficient for suspension of concessions in the same sector to be not practical or effective, it could be argued that any and all violations with respect to goods would warrant cross-agreement suspension of concessions. This approach is not compatible with the fact that designers of the DSU chose to impose disciplines on suspension of concessions.

331. Brazil has the right to request countermeasures only to the extent that they are consistent with the DSU, including the hierarchy set out in Article 22.3. This is the treaty design to which the Members bound themselves. Although Brazil may now wish to depart from the disciplines of the DSU, Brazil continues to have the legal obligation to abide by the terms of the Understanding.

2. Previous Arbitrations

332. Previous Article 22.6 arbitrators have consistently upheld the DSU disciplines. In the Ecuador/EC Bananas arbitration, the arbitrator considered the request of Ecuador to suspend concessions against the EC *for its GATT violation* across agreements. In rejecting Ecuador's request to suspend concessions across sectors, the arbitrator found that "Ecuador could not plausibly arrive at the conclusion that suspension of concessions on consumer goods is not a practicable or effective for Ecuador in this case."[357] The arbitrator reached this conclusion even while acknowledging that

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[356]Brazil Methodology Paper, para. 143.

[357] *Ecuador/EC Bananas (22.6)*, para.100.

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Ecuador was a small and developing country and that its suspension of concessions in goods was unlikely to have a significant effect on the demand for EC exports.[358] By contrast the Ecuador/EC Banana 22.6 arbitrator found that Ecuador was not able to practicable or effectively suspend concessions against the EC *for its GATS violation* by suspending concessions in the services agreement.   The arbitrator agreed with Ecuador that there was not sufficient capacity in Ecuador's services sector to permit practicable or effective suspension of concessions.

333.   These tandem findings are particularly notable because the findings provide bookends on the issue of what is practicable and effective. If the developing country, even one with a relatively small and undiversified economy such as Ecuador, has sufficient bilateral trade in consumer goods to impose suspension of concessions then it must do so. Only where the government lacks the capacity to suspend concessions in the same agreement does the DSU permit the cross agreement suspension of concessions.

334.   This definition of practical and effective was also applied in the US Gambling Art. 22.6 arbitration. There, the arbitrator similarly found that Antigua had followed the Art. 22.3 procedures when requesting suspension of concessions for the US GATS violation. [359]

C.   Applying the DSU Remedial Disciplines to the Present Dispute

335.   The United States can demonstrate that Brazil can effectively and practicably suspend concessions with respect to goods. Any request by Brazil to suspend concessions across sectors or across agreements is not a reasonable and objective assessment of the conditions established by Article 22.3.

336.   Brazil imports sufficient goods from the United States to provide practicable and effective suspension of concessions. Between 2005-2007, Brazil imported between $15.3 billion to $24.6 billion annually in U.S. goods. In consumer goods, excluding food and automotive goods, Brazil imported between $1.125 billion and $1.676 billion annually in the same time period. Including food and automotive goods in the consumer goods category, the level of imports jumps to between $1.826 billion and $2.717 billion annually.[360] The level of bilateral trade between the United States and Brazil is thus sufficient to provide for suspension of concessions with respect to goods alone. Moreover, given Brazil's large and diverse economy the actual level of nullification and impairment incurred by the U.S. policies at issue, suspension in consumer goods alone should be effective and practicable.

D.   Cross-Agreement or Sector Suspension of Concessions Cannot Be Justified on Compliance Rationale

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[358] Ecuador/EC Bananas (22.6), para. 95.
[359] US Gambling (22.6), para. 4.113
[360] Exhibit US-62, US-ITC Export Data to Brazil.

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337.   Brazil also cannot justify its claim for cross-agreement or sector suspension of concessions on compliance grounds. In its Methodology Paper, Brazil supports its claim for cross-agreement or sector suspension of concessions arguing that "the countermeasures that are best tailored to provide such a response are those that can maximize the likelihood of compliance."[361] While the ultimate goal of the DSU is to settle disputes where a Member considers that benefits under the covered agreements are being impaired, while maintaining the balance of rights and obligations of Members, likelihood of compliance is not a factor that the DSU includes in assessing the appropriate level or nature of the countermeasures.

338.   Under the analysis specified in the DSU, the likelihood of compliance should not affect either the level of countermeasures approved or the nature of those countermeasures. Article 22.4 of the DSU sets out the proper measure for "the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of nullification or impairment." The standard set in Article 22.4 is one of rebalancing of concessions. The DSB authorization of countermeasures is tied to the effects of the nullification or impairment, not the level of sanctioning that would motivate a Member to comply with the DSB ruling.

339.   The DSU encourages Members to comply with their trade obligations and authorizes the rebalancing of trade concessions if they do not. Tailoring countermeasures to what measures are most likely to promote compliance invites Members to act *disproportionately*. Rebalancing the trade effects is a goal entirely unrelated to the political analysis of what would best lead any specific government to comply with the DSB ruling.

340.   Articles 4.10 and 7.9 of the SCM agreement – which specify that countermeasures should be "appropriate" and "commensurate," respectively – are consistent with the DSU's focus on rebalancing concessions. Like Article 22.4 of the DSU, these standards focus on the effects of the disputed measure, not the level of countermeasures necessary to create sufficient political will to change the measure. Indeed, the footnote accompanying Article 4.10 notes that countermeasures (even in response to prohibited subsidies) shall not be "disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited." An action can be prohibited by one of the WTO agreements and yet Article 22.4 of the DSU only authorizes rebalancing. For instance, violations of the Most Favored Nation principle is similarly prohibited with respect to goods and the appropriate level of countermeasures is nonetheless tied level of nullification and impairment.[362]

341.   The ultimate *political* goal of the DSU is to promote compliance with the WTO agreements, but the DSU negotiators specifically did *not* make compliance the touchstone by which to set countermeasures. Rather, the DSU negotiators deliberately established a *legal* standard for assessing

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[361] Brazil Methodology Paper, Paragraph 143.

[362] Article I:1 of GATT 1994 states "any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country *shall* be accorded immediate and unconditionally the like product originating in or destine for the territories of all the other contracting parties."

countermeasures – the effect of the nullification and impairment – rather than the standard Brazil advocates – whatever measures would be best tailored to the political goal of achieving compliance. The DSU regime establishes remedies that could potentially be insufficient to lead the government to comply with the DSB ruling, but this outcome was knowingly considered and selected by Members when negotiating the DSU. The political goal of compliance and the legal standard for assessing countermeasures are decoupled.

VI.   Conclusion

342.   For all the forgoing reasons, the United States asks that the Arbitrators reject the proposed countermeasures with respect to Step 2, GSM 102, and marketing loan and counter-cyclical payments and also reject the request to suspend concessions with respect to TRIPs and GATS. Brazil's methodology is riddled with errors, and its proposals are not supported by the facts. For the reasons set out in these submissions, the United States requests the Arbitrators to find that:

(1) Countermeasures with respect to Step 2 are not appropriate as the program has been withdrawn, and there is no dispute that the DSB's recommendations and rulings on Step 2 have been implemented;

(2) On GSM 102, under the correct approach of item (j) of the Illustrative List of Export Subsidies, there is no net cost to government, and countermeasures are not appropriate;

(3) On marketing loan and counter-cyclical payments, Brazil's proposal exceeds the amount that is commensurate with the nature and degree of any adverse effects on Brazil; and

(4) Brazil does meet the requirements of Article 22.3 of the DSU.