UNITED STATES – SUBSIDIES ON UPLAND COTTON:

Recourse to Article 21.5 of the DSU by Brazil

(WT/DS267)

Comments of the United States of America
on Brazil's "Oral" Presentation in the Meeting with the Panel

March 9, 2007

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Canada – Aircraft (AB)	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999
Canada – Aircraft II	Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R, adopted 19 February 2002
EC – DRAMs	Panel Report, *European Communities – Countervailing Measures on Dynamic Random Access Memory Chips from Korea*, WT/DS299/R, adopted 3 August 2005
Korea – Commercial Vessels	Panel Report, *Korea – Measures Affecting Trade in Commercial Vessels*, WT/DS273/R, adopted 11 April 2005
US – Upland Cotton (AB)	Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, adopted 21 March 2005

I. INTRODUCTION

1. The United States appreciates the opportunity provided by the Panel to comment on Brazil's "oral" presentation at the meeting with the Panel. In that meeting, Brazil not only presented 77 pages of arguments and evidence orally over the course of approximately four and a half hours – unilaterally consuming almost the entire first day of the meeting with the Panel – but it also submitted 42 new "exhibits" (and 9 resubmitted exhibits) containing information that Brazil did *not* present orally but simply attached to its oral statement.

2. The "exhibits" included with Brazil's oral statement include a third written submission produced by Brazil allegedly to address issues "which there was not time to discuss in [Brazil's economists'] brief statement before the Panel."[1] Leaving aside the irony of describing a four and a half hour oral presentation – of which a substantial portion was taken up by Brazil's economist – as "brief," Brazil's written submission was made in breach of the Panel's working procedures. The working procedures provide for two written submissions, a first written submission and a rebuttal submission, both of which are to be submitted "[b]efore the substantive meeting of the Panel with the parties to the dispute."[2] The working procedures do not contemplate any third written submission either in or after the meeting of the Panel with the parties. While the Panel's working procedures do contemplate – indeed, require – that the parties submit a written product either at or shortly after the meeting with the Panel, the procedures are very clear as to what that written product must be. Specifically, parties must submit "a written version *of their oral statement*" presented to the Panel and the other parties during the meeting.[3] The Panel's working procedures neither contemplate nor permit the submission of arguments and evidence which were *not* part of any oral statement ("which there was [allegedly] not time to discuss in" an oral presentation that otherwise spanned almost an entire day).[4] Given that the third written submission in BRA-659 is not permitted under the Panel's working procedures, the United States respectfully requests that the Panel reject that submission.

3. The United States also notes that much of the new evidence and arguments presented by Brazil in its oral statement was known and available to Brazil well before the date of the Panel meeting. Yet Brazil appears to have chosen to withhold it until the meeting with the Panel when little time remained to subject it to scrutiny. Upon review of this new evidence and argument, it is apparent why Brazil would be anxious to avoid any meaningful assessment thereof.[5] Although voluminous, this evidence and argument offer little support for Brazil's claims. In fact, much of the data newly submitted by Brazil confirms the U.S. arguments that the United States has complied with its obligations to implement the DSB's recommendations and rulings.

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[1] *See* Supplementary Statement of Daniel Sumner, para. 1 (Exhibit BRA-659).

[2] *See* United States – Subsidies on Upland Cotton (DS267), Working Procedures for the Panel, para. 4 (November 8, 2006).

[3] *See* United States – Subsidies on Upland Cotton (DS267), Working Procedures for the Panel, para. 4 (November 8, 2006).

[4] *See* Supplementary Statement of Daniel Sumner, para. 1 (Exhibit BRA-659).

[5] In this regard, the United States recalls Brazil's efforts at the Panel meeting and thereafter to preclude or limit any opportunity for the United States to respond in writing to Brazil's "oral" presentation.

II. THE EXPORT CREDIT GUARANTEE PROGRAMS MEET THE TESTS IN THE SCM AGREEMENT FOR NOT BEING EXPORT SUBSIDIES

4. In the case of the export credit guarantees, the fact remains that:

- the United States has provided no GSM 103 guarantees since July 1, 2005;
- the United States has provided no Supplier Credit Guarantee Program (or "SCGP") guarantees since October 1, 2005 and there are, presently, no longer any guarantees even "outstanding" under that program;
- following carefully the guidance provided by the original panel, the United States imposed a new fee schedule with respect to GSM-102 guarantees under which higher fees are assessed for obligations in higher-risk countries;
- the United States reclassified into an ineligible risk category twenty-two countries posing a higher risk of default that had been eligible for GSM-102 guarantees before July 1, 2005;
- as a result of the changes in the fee schedule, fees have increased 46 percent on average over fiscal year 2004, the last year in which the old fee schedule applied;
- all of the U.S. changes, together, increased the premiums and decreased the likelihood of incurring substantial operating costs and losses over the long-term of the portfolio of programs examined by the original panel; and
- according to the U.S. budget data, premiums under the three U.S. export credit guarantee programs were more than adequate to cover their long-term operating costs and losses even before the United States took steps to implement the DSB's recommendations and rulings and are even more assured of doing so in the future given all of the changes made by the United States.

5. The substantial evidence before the Panel thus shows that the United States is not providing any export subsidies within the meaning of item (j) in Annex I of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"). Under the proper interpretation of the *SCM Agreement*, the assessment of whether or not export credit guarantees constitute prohibited export subsidies can – indeed should – begin and end with that assessment under item (j).

6. Nothing in Brazil's oral presentation – nor in any of its submissions prior to that – undermine the evidence of profitability before the Panel or the fact that the U.S. export credit

guarantee programs are entirely consistent with item (j) of the Illustrative List.[6] Rather, Brazil seeks to invent new obligations not provided for in the *SCM Agreement*, in particular, by asserting a separate standard for "export subsidy" under the general definitional elements of Articles 1.1 and 3.1(a). Even leaving aside that Brazil's approach is unsupported by the text, that approach fails even on its own terms.

A. There Is No Difference Between the Amount Paid On Loans Subject to a GSM-102 Guarantee and Other Comparable Commercial Loans

7. The substantial evidence before the Panel, thus, shows that the United States is not providing any export subsidies within the meaning of item (j). In the view of the United States, under a proper interpretation of *SCM Agreement*, the assessment of whether or not export credit guarantees constitute prohibited export subsidies begins and ends with that assessment under item (j).

8. Nothing in Brazil's oral presentation – nor in any of its prior submissions – undermine the evidence of profitability before the Panel or the fact that the United States export credit guarantee programs are entirely consistent with item (j) of the Illustrative List. Rather, Brazil seeks to invent new obligations not provided for in the *SCM Agreement*, in particular, by asserting a separate standard for "export subsidy" under the general definitional elements of Articles 1.1 and 3.1(a). Even leaving aside that Brazil's approach is unsupported by the text, that approach fails even on its own terms.

B. Brazil Fails to Show That There Is a Difference Between the Amount Paid on Loans Subject to a GSM-102 Guarantee and Other Comparable Commercial Loans, and Fails to Rebut the U.S. Evidence in this Regard

9. Article 14 of the *SCM Agreement* sets out the conditions under which a "benefit" may be considered to be "conferred" for countervailing duty purposes and defines how to measure "benefit" in such a case. While Article 14 does not apply directly in the case of actions under Part II of the *SCM Agreement*, it interprets and applies the definition of "benefit" set out in Article 1.1. Thus, the Appellate Body has relied upon Article 14 as important contextual guidance in interpreting "benefit."[7] Indeed, its was Brazil that originally invoked Article 14 to justify its prohibited export subsidy arguments against the export credit guarantees in the present

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[6] The United States does not address here Brazil's arguments attempting to undermine the substantial evidence showing that the U.S. export credit guarantee programs have historically been profitable even without the recent changes made to implement the recommendations and rulings of the DSB. Nor does the United States address Brazil's arguments about export credit guarantees issued prior to July 1, 2005 and rescheduled debt. Brazil's oral presentation contain nothing new in respect of those arguments and the United States has them in its submissions already before the Panel. The U.S. arguments can be found in the U.S. first written submission at paragraphs 71-104, the U.S. Rebuttal Submission at paragraphs 84-133, and the U.S. oral statement at paragraphs 16-49.

[7] *Canada – Aircraft (AB)*, para. 155.

proceeding.[8]

10. Paragraph (c) of Article 14 provides that a government-provided loan guarantee confers a benefit for countervailing duty purposes *only* where there is "a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee." The "benefit" is measured as "the difference between these two amounts adjusted for any differences in fees."

11. Even by this standard, however, Brazil fails to show that the U.S. GSM-102 guarantees constitute prohibited export subsidies. In fact, Brazil does not submit a single piece of evidence to show – with respect to *any* loans subject to a GSM-102 guarantee – that there is "a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee."

12. Moreover, Brazil has failed to rebut the U.S. evidence showing that commercial lenders regularly involved in both the GSM-102 program and other lending in the foreign agricultural sector, in fact, do provide – and have provided – unsecured financing to foreign banks that are CCC-approved obligors on terms the annualized cost of which was less than that available under the GSM-102 program.[9] In fact, Mr. Sundaram, the consultant retained by Brazil for purposes of this proceeding, acknowledged that the examples the United States provided, as supplied by [ ], show "lower annualized costs than under GSM-102."[10]

13. While Mr. Sundaram went on to criticize the U.S. examples, his criticism is without basis. According to Mr. Sundaram, the "average life" is allegedly insufficient to capture some hypothesized riskiness that is greater in a three-year term GSM transaction than in a two year bullet payment.[11] However, in each of the examples provided by the United States, the short-term and long-term ratings for each of the banks are comparable.[12] Indeed, Mr. Sundaram acknowledged that the Panamanian and Mexican banks are both "investment grade."[13] Thus, the theoretical difficulty that Brazil tries to create is inapplicable to those comparisons as a matter of fact. Despite Brazil's allegations to the contrary,[14] the comparisons offered by the United States are fully "apples-to-apples" comparisons.

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[8] Brazil First Written Submission, paras. 371-375

[9] U.S. First Written Submission, paras. 119-130 and Exhibit US-22; U.S. Rebuttal Submission, paras. 145-170.

[10] Brazil Oral Statement, para. 214

[11] Brazil Oral Statement, para. 219

[12] U.S. Rebuttal Submission, para. 150.

[13] Brazil Oral Statement, para. 223.

[14] Brazil Oral Statement, para. 222.

14. Moreover, Brazil appears to ignore the pricing of risk inherent in the transactions. While it emphasizes that "fully one-third of the principal remains at risk after two years"[15] in a GSM-guaranteed transaction, Brazil fails to acknowledge that *fully one-third of the principal has been paid* after *one* year in the same transaction. In contrast, the entire bullet payment remains outstanding for the first two years. As a matter of commercial logic, the risk inherent in an obligor's capacity to service debt increases with the amount of debt outstanding. The repayment term of the GSM transaction compels an early payment of principal reducing the outstanding debt.[16]

15. Finally, the United States notes Brazil's assertion that "the examples provided by the United States do not appear to prove anything about the ability of GSM-102's target foreign obligors [allegedly non-investment grade] to secure foreign credit."[17] However, this assertion serves to undermine what has been Brazil's own – entirely unfounded – argument in this proceeding; namely, that the United States allegedly "targets" and services only non-investment grade foreign obligors. The United States welcomes Brazil's acknowledgment that GSM credit guarantees are offered in *many* markets where other financing is readily obtained, including in Mexico and Panama – two of the countries involved in the examples provided by the United States. And the U.S. examples are not the only ones involving investment grade participants in the GSM program; scores of CCC-approved foreign bank obligors enjoy an investment grade rating.[18] Brazil's sweeping assertions that GSM-102 guarantees are provided only where there is no financing available to foreign obligors is undermined not only by the particular examples provided by the United States, but also by this evidence of the large number of investment-grade participants.

C. There is No Basis to Ignore All of Textual Provisions Dealing With Export Credit Guarantees and Loan Guarantees and to Use Instead a "Severable Benefit" Approach Specifically Precluded Under the *SCM Agreement* With Respect to Such Measures

16. Unable to make its case under *any* provision of the *SCM Agreement* dealing either with export credit guarantees or loan guarantees, Brazil essentially asks the Panel to ignore the *SCM Agreement* altogether and to create and impose obligations not found anywhere in the text. Towards this end, Brazil argues that other panels have disregarded the text as well. Brazil's arguments are simply not tenable.

17. Brazil asserts, for example, that the panel in *EC-DRAMs* "agreed that a government

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[15] Brazil Oral Statement, para. 221.

[16] In fact, GSM-102 guarantees often require semi-annual payments of principal.

[17] Brazil Oral Statement, para. 223. Brazil appears to make the same incorrect and irrelevant point in paragraph 177 of its oral statement.

[18] U.S. First Written Submission, para. 110.

guarantee confers a 'benefit' *per se* if without the guarantee, commercial lending would not have been available. Where commercial lending would not have been available without the government guarantee, the panel in *EC-DRAMs* did not require the type of quantitative assessment on which the United States here insists."[19] As a threshold matter, however, that panel did not – indeed, could not – "undo" the disciplines agreed upon in Article 14(c) of the *SCM Agreement*. To the contrary, the *EC-DRAMs* panel expressly *acknowledged* the proper approach for the determination of "benefit" in the context of a government guaranteed loan in Article 14(c) of the *SCM Agreement*: "[I]t appears that the examination is to focus on the difference between the amount paid on a loan guaranteed by the government, compared to the amount that would have to be paid on a comparable commercial loan, absent the government guarantee."[20] The panel's ultimate finding – that the EC could properly find a "benefit" where there was no "evidence on the record . . . to contradict the EC's conclusion that, absent the government guarantee, the banks would not have been willing to agree to the [financing] at all"[21] – is entirely consistent with the standard in Article 14(c) of the *SCM Agreement*. But the facts of that dispute are not the same as the facts before this Panel. As the United States has shown, this is *not* a situation where "absent the government guarantee" banks "would not have been willing to agree to . . . [financing] at all."

18. Brazil also cites the panel report in *Canada-Aircraft II* for the proposition that "even in assessing 'benefit' under Article 14(c), the legal standard boiled down to an assessment whether fees for the government guarantee were consistent with fees for commercial guarantees."[22] There, too, however, the panel expressly acknowledged that the appropriate standard was set out in Article 14(c) of the *SCM Agreement*. The panel found that under the circumstances of that dispute, it was "safe to assume" that it the fees charged for the loan guarantee were not "market based," the test in Article 14(c) would be met. Moreover, even while it asserted that it was "safe" to make such an assumption, the panel actually *required* Brazil, as the complaining party, to provide "arguments or information regarding what the [airline] might have had to pay on a *comparable commercial loan* absent the *IQ* loan guarantee."[23] The panel noted that:

> Brazil has made no arguments to the effect that 'there is a difference between the amount that the [Mesa Air Group] pays on a loan guaranteed by [IQ] and the amount that the [Mesa Air Group] would pay on a comparable commercial loan absent the [IQ] guarantee', adjusted for any difference in fees. In particular, although Brazil does not deny that loan guarantees are available on a commercial basis, Brazil has failed to adduce any arguments or information regarding what Mesa Air Group might have had to pay on a comparable commercial loan absent

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[19] Brazil Oral Statement, para. 194.

[20] *EC-DRAMs*, para. 7.190.

[21] *EC-DRAMs,* para. 7.190.

[22] Rebuttal Submission of Brazil, para. 410.

[23] *Canada-Aircraft II*, para. 7.399 (emphasis added).

the IQ loan guarantee.[24]

19. On the basis of *that* failure on the part of Brazil – as well as Brazil's failure to "make any other argument to the effect that IQ's fee for its loan guarantee to Mesa Air Group is not market based" – the panel "reject[ed] Brazil's claim that the IQ loan guarantee to Mesa Air Group confers a 'benefit.'"[25]

20. Brazil has, thus, failed to provide any basis for the panel to disregard all of the textual provisions relating to export credit guarantees and loan guarantees and to use, instead, its "severable benefit" approach. As the United States explained in the meeting with the Panel, Brazil's approach fundamentally undermines the drafters' acknowledgment, expressed in Article 14(c), that the provision of a loan guarantee is fundamentally different from the provision of other government services. While a comparison of fees for a government service against the fees charged in the market for a comparable service is the proper approach in the case of other government services – as provided in Article 14(d) – Article 14(c) specifically *precludes* such an approach for loan guarantees. Instead, it recognizes that a loan guarantee is made for the sole purpose of *supporting a loan transaction*; the guarantee becomes an integral part of that transaction and has no value beyond it. An assessment of the total costs of the transaction is necessary to assess whether a "benefit" is actually conferred by the guarantee. A simple comparison of the fee charged for the issuance of one loan guarantee to the fee charged for another may provide an incomplete and distorted picture in this regard.

D. Brazil's Argument That GSM-102 Guarantees Necessarily Provide a Benefit Because They Constitute a "Unique Financial Instrument" Is Legally and Factually Unfounded

21. In its oral presentation, Brazil once again asserts that the GSM-102 export credit guarantee is "a unique financial instrument without any parallel at market."[26] In Brazil's view, "that is the beginning and end of the analysis" and demonstrates that the GSM-102 program confers benefits *per se*.[27] Brazil has not shown any textual basis for this kind of *per se* test.

22. Indeed, the United States wonders if Brazil has thought through fully the consequences of its argument. If the *SCM Agreement* were found to actually contain the standard advocated by Brazil, one would have expected *Brazil – Aircraft (Article 21.5 II)* to have been decided differently. There, Canada challenged certain "PROEX" interest rate equalization payments made "in support of export credits extended to the purchaser, and not to the producer, of

[24] *Canada-Aircraft II*, para. 7.399.

[25] *Canada-Aircraft II*, para. 7.399.

[26] Oral Statement of Brazil, para. 174.

[27] Oral Statement of Brazil, para. 174.

Brazilian regional aircraft."[28] The panel noted that, in those circumstances, Canada could make a *prima facie* showing of "benefit" if it established that "PROEX III payments allow the purchasers of a product to obtain export credits on terms more favourable than those available to them in the market, this will, at a minimum, represent a prima facie case that the payments confer a benefit on the producers of that product as well, as it lowers the cost of the product to their purchasers and thus makes their product more attractive relative to competing products."[29] The panel did not consider whether PROEX payments were a "unique financial instrument." Brazil did not argue there, as it has attempted to do here, that "the beginning and end of the analysis" was the question of whether PROEX III payments were "a unique financial instrument without any parallel at market."[30] Indeed, that question could presumably have been answered fairly easily, because unlike PROEX, commercial actors are not in the business of making payments for nothing.

23. In any event, the United States has provided examples of other international financial institutions – such as such as the European Bank for Reconstruction and Development ("EBRD"), the International Finance Corporation ("IFC"), and the Inter-American Development Bank ("IDB") – that provide similar guarantees to the GSM-102. While Brazil attempts to dismiss these examples by arguing that these entities cannot, by definition, provide commercial products, Brazil's argument is without merit.[31] As the principal basis for this argument, Brazil continues to focus on the ability of such entities to "borrow from government treasuries," asserting that "as a result, public entities tend to enjoy a lower cost of funds than their market-based counterparts."[32] Brazil further suggests that these entities cannot provide commercial products because they "enjoy a guarantee flowing from the full faith and credit of governments."[33]

24. However, Brazil has not shown that the entities identified by the United States rely on such borrowing for their operations or that they enjoy such guarantees from governments. The IFC, for example, receives no sovereign guarantee.[34] Furthermore, the IFC indicates that "the major source of IFC's borrowings is the international capital markets. Under the Articles of Agreement, the Corporation may borrow in the public markets of a member country only with approvals from that member and also the member in whose currency is denominated."[35] Further, "market borrowings are generally swapped into floating-rate obligations denominated in US

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[28] *Brazil – Aircraft (Article 21.5 II)*, para. 5.28, n. 42.

[29] *Brazil – Aircraft (Article 21.5 II)*, para. 5.28, n. 42.

[30] Oral Statement of Brazil, para. 174.

[31] Brazil Oral Statement, para. 187.

[32] Brazil Oral Statement, para. 188.

[33] Brazil Oral Statement, para. 188.

[34] U.S. Rebuttal Submission, para. 166.

[35] Exhibit US-79, p. 13.

dollars."[36] EBRD issues medium and long-term debt obligations on the market.[37]

25. Moreover, the ability of an entity to borrow from a government does not necessarily preclude an entity from providing *products* on commercial terms.[38] For example, the panel recognized in *Korea – Commercial Vessels* that:

> The fact that KEXIM may receive subsidized government funding does not mean that it will inevitably provide subsidized financing to its customers. It is possible that KEXIM might charge market rates and increase its profit margin instead."[39]

26. Brazil also asserts that a former U.S. official – specifically, a former Secretary of the U.S. Treasury – has recognized that international financial institutions cannot offer commercial products.[40] However, Brazil's own exhibit shows that the statement referenced by Brazil did *not* relate to any of the international financial institutions noted above, but, rather, to state-owned or controlled "market window" institutions of individual OECD members that restrict financing to national exporters. International financial institutions such as IFC, IDB, and EBRD are fundamentally different entities. They do not operate at the behest of any single government. Indeed, Brazil itself has noted that the IDB is owned by 47 member countries[41]; EBRD by 60 governments[42]; and IFC by 178 member countries.[43] Rather, they operate commercially without benefitting any particular government or citizen constituency. Brazil has provided no legitimate basis for asserting that such financial institutions can never provide commercial products.

27. In short, Brazil fails to show *either* that its "unique financial instrument" test is required under the *SCM Agreement* or that the measures it challenges are in fact "unique financial instruments."

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[36] Exhibit US-79, p. 13.

[37] Exhibit US-77, p.10.

[38] U.S. Rebuttal Submission, para. 156.

[39] *Korea – Commercial Vessels*, para. 7.84.

[40] Brazil Oral Statement, para. 186 and Exhibit Bra-654.

[41] Rebuttal Submission of Brazil, para. 442.

[42] Rebuttal Submission of Brazil, para. 441.

[43] Rebuttal Submission of Brazil, para. 440. Brazil also criticizes the United States for finding "significance in that fact that public entities like the EBRD, IDB and IFC are 'profitable'."Brazil Oral Statement, para. 189. The United States, however, was merely responding to the significance that *Brazil* had ascribed to its assertion that such institutions are incapable of providing commercial products because they are "not a private sector actor motivated by profit." Rebuttal Submission of Brazil, para. 441.

E. Brazil's Argument Would Effectively Render Most, If Not All, Export Credit Guarantees Prohibited Export Subsidies

28. Brazil's ultimate argument appears to be that export credit guarantees are prohibited export subsidies unless there is a purely private bank (like a Citibank, for example) already providing the same export credit guarantees and, even in that case, the guarantees are prohibited subsidies unless the *fees* charged by the private bank for the export credit guarantees are lower than the *fees* charged by the government entity. These assertions are without basis in the *SCM Agreement* and, given the nature of the market for export credit guarantees, would effectively render *all* export credit guarantees provided by any Member anywhere in the world to be prohibited subsidies.

29. As Brazil is well aware, export credit guarantees and other similar loan guarantees are now and have always been instruments provided predominantly – if not exclusively – by governments and international financial institutions, as opposed to purely private banking institutions. It is hardly surprising then that Members would have agreed to a standard for "prohibited export subsidy" in item (j) that imposes disciplines based on the net costs of a program.[44] Nor is it surprising that, in the context of countervailing duty investigations, Members would have agreed to a standard that looks to the effect of a guarantee on the underlying loan. Brazil's efforts to have the Panel ignore the text itself – what Members actually agreed to given the particular nature of the measure and the market – and to impose instead a fee-based comparison to some theoretical purely private bank is untenable.

30. This would effectively render most if not all export credit guarantees to be prohibited export subsidies, in contravention of the express intent of the drafters in item (j) and Article 14(c) of the *SCM Agreement*. Furthermore, Brazil's approach is contradicted by Article 10.2 of the *Agreement on Agriculture*. If the test for being a prohibited export subsidy were as simple as Brazil claims, then there would have been no need for the negotiators of the WTO agreements to have specifically called for the development of international disciplines on export credit guarantees. Indeed, by calling for the development of additional disciplines on export credit guarantees, Article 10.2 of the *Agreement on Agriculture* supports the fact that at present the analysis can – indeed should – begin and end with the disciplines currently in item (j).

31. The ramifications of such an impermissible interpretation are significant. The compliance panel will recall India provides similar services through the Export Credit Guarantee Corporation of India, Ltd. Further examples include the following:

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[44] The United States notes in this regard that in the Illustrative List to the Tokyo Round Subsidies Code, item (j) provided that premium rates could not be "*manifestly* inadequate operating costs and losses of the programmes." (Emphasis added). In the Uruguay Round, the negotiators deleted the word "manifestly" from item (j). It is difficult to accept that the negotiators would have gone to the trouble of modifying the standard in item (j) if, as argued by Brazil, that standard could readily be ignored in favor of a different standard.

- The Export Finance and Insurance Corporation of Australia, which offers export credit insurance (also subject to item(j)) "when the private market lacks capacity or willingness, filling the market gap."[45] EFIC operates "primarily in that part of the market that is not served by the private market."[46]

- Euler Hermes, the provider of export credit guarantees for the Federal Republic of Germany, provides such products "to support German enterprises to open difficult markets."[47]

- The Korea Export Insurance Corporation – an official export credit agency of Korea – provides "agro-fishery" export insurance that "compensates the losses arising from export transactions and overseas investments that *cannot be handled by the general insurance systems*."[48]

- Banco Nacional de Comercio Exterior of Mexico, a bank "owned by the Mexican government, offers "export credit insurance to cover Mexican firms against default of credit sales to foreign [] customers."[49]

32. Are each of these Members, as well as scores of other Members, breaching their WTO obligations simply because purely private banks do not now, and have not historically, operated in this particular segment of the market? Brazil has utterly failed to show anything in the text of the *SCM Agreement* indicating that Members agreed upon such an absurd result.

33. The text confirms, instead, that the standards reflected in item (j) provide the exclusive test for whether export credit guarantees provide prohibited export subsidies. As discussed above, in the U.S. submissions, and in the meeting with the Panel, the U.S. budget data show – definitively – that premiums collected under the U.S. export credit guarantee program are more than adequate to cover the long-term operating costs and losses of the programs. In short, the United States is fully in compliance with the standard in item (j).

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[45] Export Finance and Insurance Corporation (Australia) - Mission and Objectives; http://www.efic.gov.au/static/efi/corporateinfo/mission.htm (Exhibit US-131).

[46] Export Finance and Insurance Corporation (Australia) - Mission and Objectives; http://www.efic.gov.au/static/efi/corporateinfo/mission.htm (Exhibit US-131).

[47] AuslandsGeschaftsAbsicherung der Budesrepublik Deutschland, Federal Export Credit Guarantees, Basics: Main Features of Export Credit Cover; http://www.agaportal.de/en/aga/grundzuege/grundzuege_exportkredit.html (Exhibit US-132).

[48] Korea Export Insurance Corporation , preface (emphasis added); http://www.keic.or.kr/homepage2/english/main.html. (Exhibit US-133); *see also* East-West Debt: "about the Korea Export Insurance Corporation" http://www.eastwest.be/east_west/keic.htm (Exhibit US-133).

[49] Bancomext 2005 Annual Report, pp. 2, 26; http://www.bancomext.com/Bancomext/publicasecciones/secciones/7304/AnnualReportBancomext2005.pdf (Exhibit US-134).

III. BRAZIL HAS FAILED TO ESTABLISH ITS CLAIMS REGARDING THE STEP 2, MARKETING LOAN, AND COUNTER-CYCLICAL PAYMENT PROGRAMS AND ALL PAYMENTS THEREUNDER

34. Brazil's "oral" presentation also fails to remedy the fact that Brazil has provided virtually *no empirical evidence* to support its claims that (a) termination of the Step 2 program "will likely have *no impact* on the level of U.S. production or exports" and "*little positive impact* on the world price for cotton in the long term;"[50] or (b) that "the effect" of U.S. marketing loan and counter-cyclical payment programs is "present" significant price suppression within the meaning of Article 5(c) and 6.3(c) of the *SCM Agreement*.

A. Brazil's Arguments About the Effects of the Step 2 Program and World Market Price Effects Continue to Shift

35. Although Brazil has argued throughout the original panel proceedings and in this proceeding that allegedly high levels of U.S. exports are the cause of significantly suppressed world market prices,[51] Brazil attempts now to change its basic theory of significant price suppression. Indeed, it does so after having attempted to simply dismiss the evidence of declining U.S. exports as a temporary phenomenon that was simply a function of U.S. producers "cleaning out the stocks in their warehouses" prior to the termination of the Step 2 program.[52] In the face of the substantial countervailing evidence, Brazil has been forced to seek a new theory to fit the facts. In its "oral" presentation, Brazil now argues that it is increasing U.S. stocks of upland cotton – not the export of U.S. cotton – that is suppressing world market prices.

36. Brazil has submitted no evidence – or even fully laid out the arguments – to support its 11th hour theory of significant price suppression. And Brazil cannot simply transpose its earlier arguments regarding the effects of exports. While stocks of any commodity are an important factor influencing the world supply and demand balance and, therefore, prices, there is no basis – and Brazil has not provided any – for suggesting that an increase in stocks can have the same impact on world market prices as actual exports. When stocks are held – *i.e.*, are removed from trade on the world market – any possible impact on prices is necessarily substantially less than if they were being traded.

37. Moreover, the price impact of existing U.S. stocks is necessarily greater *within* the United States than it is in the world market. And, consistent with this, U.S. prices have been lower than normal in relation to the A index almost throughout the entire 2006 marketing year.[53] Between August 2001 and July 2005, the A Index averaged 4.69 cents above the nearby NY futures.

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[50] Brazil First Written Submission, para. 206 (quoting Brazil First Written Submission, Annex II, paras. 41-43).

[51] *See, e.g.*, Brazil First Written Submission, para. 2.

[52] Brazil Rebuttal Submission, para. 82.

[53] Daily A-Index and NY Futures Price Data (Exhibit US-135).

Since August 2006, the "A" has averaged between 5 and 10 cents above NY futures.[54] As a result of this and other market signals, U.S. producers are reducing plantings. Returns to cotton producers are below expectations and plantings in the United States are expected to decline 14 percent or more in 2007.[55] In short, the evidence concerning the effects of stocks on U.S. prices and the corresponding response of U.S. farmers is *not* consistent with Brazil's new theory that U.S. stocks are suppressing world market prices.

38. This conclusion is reinforced when one considers other factors in the world market. For example, *total* world stocks are expected to decline in 2006 from 2005 levels.[56] Moreover, the world stocks-to-use ratio for cotton has declined for the second year in a row, meaning that the world is using more cotton than is being produced.[57] This is consistent with the fact that world market prices are rising and are expected to continue to do so. While Brazil asserts these prices should be even higher, it has offered no evidence – other than unfounded allegations by its hired economist – to support that assertion.

39. Similarly, the behavior of other market participants – including Brazil – does not evidence any perception of significant price suppression as a result of U.S. stocks. To the contrary, Brazil and India are expected to increase production in 2007, with recent reports from Brazil anticipating a near-record crop in 2007.[58] By planting and producing more cotton in 2007, India's and Brazil's farmers would appear to be receiving positive signals from current world prices. U.S. production, meanwhile, decreased in 2006, exports are declining in 2006, and U.S. planting is expected to decline substantially in 2007. Again, these are not facts indicative of significant price suppression as a result of U.S. stocks.

40. Thus, Brazil's last minute theory that U.S. *stocks* – not exports – are causing significant price suppression is unsupported by evidence.

B. Brazil's Arguments About the Alleged Effects of the Marketing Loan and Counter-Cyclical Payment Programs Are Misleading, and the Evidence Brazil Submits Actually Confirms the U.S. Position Regarding the Marketing Loan and Counter-Cyclical Payment Program

41. Brazil's "oral" statement seeks to respond to the U.S. observation that Brazil has failed to provide an evidentiary basis for its claims that the marketing loan and counter-cyclical payment

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[54] Daily A-Index and NY Futures Price Data (Exhibit US-135).
[55] National Cotton Council 2007 Acreage Survey available at http://www.cotton.org/econ/reports/intentions.cfm.
[56] USDA Foreign Agricultural Service, Cotton: World Markets and Trade, February 2007 (available at http://www.fas.usda.gov/currwmt.asp).
[57] USDA Foreign Agricultural Service, Cotton: World Markets and Trade, February 2007 (available at http://www.fas.usda.gov/currwmt.asp).
[58] ICAC Cotton This Month (March 1, 2007) (Exhibit US -136).

programs are presently causing significant price suppression. Brazil asserts that certain allegedly "key" pieces of evidence support its claims of a breach of Articles 5(c) and 6.3(c) of the *SCM Agreement*.[59] None of this evidence withstands scrutiny, however.

1. None of the Evidence Submitted By Brazil Regarding the Nature, Magnitude and Effects of the Marketing Loan and Counter-Cyclical Payments Indicates That the Payments Are Having Significant Price Suppressive Effects

42. ***Counter-cyclical Payments:*** Brazil's "oral" presentation contains no empirical evidence to support Brazil's claims that counter-cyclical payments are having significant production- or export-inducing effects, or that they are significantly suppressing world market prices. Indeed, Brazil's "empirical evidence" appears to consist of little more than the naked assertion that counter-cyclical payments "restrict planting flexibility," "reduce the risk associated with producing the base crop" "increase the ability of farmers to invest in production-enhancing equipment" and "smooth revenue flow. . . and ease access to credit."[60] While all these things may well be true to some extent, Brazil has not explained why they support a finding that the payments cause significant price suppression. Indeed, almost all of these consequences asserted by Brazil also can be attributed to direct payments and, indeed, to *any* payment to a producer of a crop. The *exact* same planting flexibility restrictions apply in the case of both direct and counter-cyclical payments. Moreover, *any* payment to producers will "increase the ability of farmers to invest in production-enhancing equipment," "smooth revenue flow. . . and ease access to credit."[61] However, those factors did not support any finding of significant price suppression with respect to direct payments in the original proceeding. And, in indeed, the negotiators of the WTO agreement expressly found that Members could provide a whole range of payments to agricultural producers, all of which presumably would have the general effects Brazil attributes to counter-cyclical payments, and yet still have "no, or at most minimal, trade-distorting effects or effects on production."[62]

43. Indeed, from a structural standpoint, Brazil recognizes that the "crucial difference" between the direct and counter-cyclical payments is that the farmer is assured of receiving the former each year but not the latter, because counter-cyclical payments are provided only if the season-average farm price ends up being below the threshold set out in the statute.[63] As the United States has explained in response to questions from the Panel, some analysts have examined whether this difference results in any substantial differences in the *effects* of the two programs, and they have concluded that it likely *does not*.[64] For example, Westcott *et. al.*

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[59] Brazil Oral Statement, para. 25.
[60] Brazil Oral Statement, para. 41.
[61] Brazil Oral Statement, para. 41.
[62] *See* Annex 2 of the *Agreement on Agriculture*.
[63] Brazil Oral Statement, para. 50.
[64] *See* U.S. Answers to Parts D-E of the First Set of Panel Questions, para. 27 (March 6, 2007).

determined that the link to prices may, in some circumstances, result in indirect production effects stemming primarily from lowered risk of price volatility. However, they concluded that the degree of any such production effects is likely to be minimal and mitigated by a number of factors including that:

(a) where prices are expected to be above maximum threshold – counter-cyclical payments behave just like the fixed direct payments;[65]

(b) "cross-commodity effect[s] suggest[] that CCPs may provide a general reduction in revenue risks rather than a crop-specific effect. Net returns among alternative crops would remain the primary consideration underlying production choices;"[66]

(c) "while a number of studies indicate that farmers are risk averse (Chavas and Holt, 1990, 1996, for example), other risk reduction instruments already exist to manage risks. Thus, with revenue risk reduction now provided by CCPs as part of farm programs, farmers may adjust their use of these other farm and nonfarm risk management strategies;"[67] and

(d) "a large portion of output in the U.S. agricultural sector is produced by a small share of large producers. . . . Evidence that risk aversion decreases as income rises (Chavas and Holt, 1990, 1996) suggests that risk aversion may also tend to decline as the size of farms increases. Thus, with larger farms that account for most production being less averse to facing risk, this lowers potential production effects of CCPs due to risk reduction. And while smaller farms may be more risk averse in their farm enterprise, off-farm income may reduce the overall level of household income risk."[68]

44. Studies looking to the actual effects of counter-cyclical payments confirm their minimal impacts on planted acreage and production. For example, as the United States has explained, a 2007 study by Lin & Dismukes found that "[t]he effect of CCPs on producers' planting decisions . . . appears to be *very negligible* – an increase in the acreage of major field crops of less than 1% ... ."[69] The United States has submitted this and other studies examining the

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[65] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 203 (Exhibit US-35).

[66] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[67] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[68] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[69] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter- cyclical Payments' Production Impacts," *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 83 (Exhibit US-85) (emphasis added).

empirical evidence regarding the actual effects of counter-cyclical payments on corn, wheat, and soybean producers in recent years, including MY 2005, the marketing year on which Brazil has placed special emphasis. The United States also has provided studies taking a more qualitative assessment of the question at hand.[70] These studies support a finding that counter-cyclical payments have – at best – minimal effects on plantings and production (and, thus, are likely to have negligible effects on world market prices).

45. In its unsolicited third written submission – BRA-659 – Brazil asks the Panel simply to disregard all of these studies.[71] For the reasons discussed above, Brazil's submission was made in breach of the Panel's working procedures and is not properly part of the record before the Panel. Nonetheless, the United States would make the following points as to why the arguments made by Brazil therein are unavailing. Brazil complains that the studies do not relate specifically to counter-cyclical payments made in respect of upland cotton. However, as the United States has explained, there is no reason why that should preclude the Panel from considering the studies as being highly relevant.[72] Indeed, Brazil has not submitted any evidence – save for the unsupported assertions of its hired economist – to show that the effects would be substantially different in the case of upland cotton, especially given that *no base acre holder has to produce anything, let alone the base crop, in order to receive any payments under the program.* More importantly, Brazil appears to forget that *it is Brazil that bears the burden of proving its claims in this proceeding*. Indeed, while Brazil insists that only cotton-specific studies may be considered as relevant, Brazil has not itself provided *a single* study that examines the actual effects of counter-cyclical payments made specifically in respect of upland cotton production. Moreover, what studies Brazil has provided do not detract from the substantial evidence showing that – as a matter of fact – counter-cyclical payments have minimal acreage and production effects.[73] Therefore, Brazil's allegations of significant planting effects are just that – allegations.

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[70] U.S. Rebuttal Submission, para. 226-252.

[71] Supplementary Statement of Daniel Sumner, paras. 18-38.

[72] Brazil also makes the inexplicable argument that a number of the studies submitted by the United States are not relevant because they allegedly do "not examine whether CCPs are decoupled from production. Rather, [they] examine whether CCPs increase acreage." Supplementary Statement of Daniel Sumner, para. 21. Brazil applies this criticism, for example, to the 2007 study by Lin & Dismukes finding "very negligible" increases in the acreage of major field crops. Brazil appears to be confused about its own claims and arguments in this proceeding. As the United States understands it, Brazil's claim here is that marketing loan and counter-cyclical payments are presently significantly suppressing world market prices. Brazil's theory to support this claim has been that these payments affect the planting decision, causing U.S. producers to plant more than they otherwise would and that this ultimately leads to oversupply and suppressed world market prices. It is remarkable, therefore, that Brazil would attempt to *dismiss* studies because they look at effects of payments on acreage and suggest that what is relevant is some undefined inquiry into whether payments are "coupled" to production (an inquiry, incidentally, that has no basis in the text of Articles 5(c) and 6.3(c)).

[73] Indeed, the study that Brazil has touted as "more recent and more relevant" than the numerous studies submitted by the United States does not even examine the behavior of actual farmers – let alone upland cotton farmers. *See* McIntosh, Christopher R, Jason F. Shogren and Erik Dohlman,"Supply Response to Counter-Cyclical Payments and Base Updating under Uncertainty: An Experimental Study,: forthcoming paper in the *American Journal of Agricultural Economics*, November 2006, page 18 (Exhibit BRA-565). Rather, it looks to the results of a

They are supported neither by the empirical evidence nor any studies conducted in light of such evidence.

46. Brazil has no answer either to the studies finding that a substantial part of counter-cyclical payments are capitalized into land values and land rents. Although Brazil argues that the Panel should simply disregard this evidence, Brazil has not explained why the following conclusion of the OECD is not valid and entirely relevant to the question at hand:

> Empirical work suggests that PFC and MLA payments had a significant effect on land values and rental rates. Given the importance of the rental market for land in the United States, it appears that *there was a relatively high "pass-through" of the additional income generated by the payments to landowners, many of whom are not the actual operators of the land*. It appears that the payments primarily had the effect of increasing the value of the principal fixed asset in agriculture—land.[74]

47. Indeed, the United States recalls that Brazil has argued that the more certainty there is about whether payments will be received, the more likely they are to be capitalized into land values and rents.[75] Given that MLA payments were provided as part of *ad hoc* legislation – unlike counter-cyclical payments which have been established well ahead of time as a part of the FSRI Act of 2002 – farmers were presumably even less likely to have anticipated MLA payments than counter-cyclical payments. Thus, the degree of capitalization into land values and rents is presumably even *greater* than that found in the OECD study for MLA payments. And, as the OECD study concluded:

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laboratory experiment conducted using University students as "laboratory decision-makers." Brazil criticizes the United States for allegedly "attempt[ing] to discredit research findings in economics simply because they derive from controlled experiments." Supplementary Statement of Daniel Sumner, para. 38. According to Brazil, this is "30 years out of date." Supplementary Statement of Daniel Sumner, para. 38. However, Brazil makes no effort to reconcile this view with its own arguments that U.S. studies should be dismissed if they do not examine the precise acreage responses of *upland cotton* farmers. Nor does Brazil address the fundamental limitations noted by authors themselves in respect of the laboratory experiment. *See* McIntosh, Christopher R, Jason F. Shogren and Erik Dohlman,"Supply Response to Counter-Cyclical Payments and Base Updating under Uncertainty: An Experimental Study,: forthcoming paper in the *American Journal of Agricultural Economics*, November 2006, page 18 (Exhibit BRA-565) ("Our design did not address two features of the 2002 Act which could affect the interpretation of our results. First, there are no adjustments made in our bonuses for the fact that direct and counter-cyclical payments are made only on a percentage (85 percent) of base acres. If these adjustments were incorporated, the lump sum bonuses would have been lower, implying our results could overstate the effects of CCPs. Second, we excluded the marketing loan program to focus on the basic CCP structure—target price, market price, and direct rate. Adding the marketing loan program into our design would temper the basic effects of CCPs by providing an additional price support mechanism.")

[74] Abler, David, and David Blandford. A Review Of Empirical Studies Of The Acreage And Production Response To US Production Flexibility Contract Payments Under The Fair Act And Related Payments Under Supplementary Legislation, Directorate For Food, Agriculture And Fisheries Committee For Agriculture, OECD, Paris, AGR/CA/APM(2004)21/FINAL, p.17 (March 25, 2005) (Exhibit US-32) (emphasis added).

[75] Brazil Rebuttal Submission, para. 146.

> If PFC and MLA payments were captured largely by landowners through higher land values and land rents, then the scope for these payments to influence agricultural production would be narrowed. Farmers renting land would not be able to use payments associated with their rented land to cover fixed or variable costs. These farmers would be no more able to secure capital from traditional lenders than in the absence of the payments. They would see no increase in wealth, at least on the land that they rent, ruling out a risk-related wealth effect. Expectations of future payments associated with rented land would not affect decisions by renters because they would not capture these payments. The payments would not affect a renter's decision to remain in or to exit from agriculture, although they could affect a landlord's decision to keep land in agriculture.[76]

48. Brazil's only response to this evidence is that it is "mathematically impossible" that direct and counter-cyclical payments "are capitalized into land rents and captured by the land owner."[77] Brazil has not explained why – if this were so – the OECD could have come to such a fatally flawed conclusion (especially given that the OECD conclusions cited above were actually reached after reviewing a *number* of different studies all examining the pass-through effects of PFC and MLA payments).

49. In fact, the flaw is in the data that Brazil uses to allege its "mathematical impossibility." As the United States explained in its rebuttal submission, instead of examining actual land rents – as Brazil purports to do – Brazil actually considers an *imputed* economic cost to land that the USDA calculates by valuing the alternative uses of the asset (for example, renting it to another producer).[78] To make matters worse, Brazil looks at average imputed rental values for land on farms *with* payment base acres and *without* payments base acres, despite the fact that the former would have a substantially higher rental value precisely *because* of the payments associated with them. Brazil's response that *different* levels of payments are made on different base acres because of differences in historical yields misses the point entirely, and is no justification for comparing farmland linked to payment base with farmland *not* linked to payment base acres as Brazil attempts to do.

50. While it is sparse, it is also instructive to consider the type of evidence that Brazil actually *does* rely upon to support its claims regarding counter-cyclical payments. Brazil invokes as evidence of "present" significant price suppression resulting from counter-cyclical payments, a statement made *in February 2001 – i.e.,* before either the 2002 FSRI Act or the counter-cyclical

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[76] Abler, David, and David Blandford. A Review Of Empirical Studies Of The Acreage And Production Response To US Production Flexibility Contract Payments Under The Fair Act And Related Payments Under Supplementary Legislation, Directorate For Food, Agriculture And Fisheries Committee For Agriculture, OECD, Paris, AGR/CA/APM(2004)21/FINAL, p.17 (March 25, 2005) (Exhibit US-32).

[77] Brazil Oral Statement, para. 46.

[78] U.S. Rebuttal Submission, para. 259.

payments authorized thereunder went into effect – by a National Cotton Council representative about *emergency relief provided under the FAIR Act of 1996* as to whether that relief helped cotton farmers "avoid bankruptcy" in the period MY 1999-2001.[79] This statement – quoted out of context – about emergency relief under the FAIR Act of 1996 including production flexibility contract payments, marketing loss assistance payments, and disaster payments, offers no insight regarding the role of counter-cyclical payments in production decisions or about U.S. farmers' costs and revenues today. Certainly it does nothing to detract from the actual data regarding "present" costs and revenue, which, as discussed below, flatly contradict Brazil's claims that U.S. upland cotton farmers would be bankrupt without the marketing loan and counter-cyclical payment programs. In fact, while this "evidence" makes no substantive contribution to the issues before the Panel, the fact that this is the type and quality of "empirical evidence" upon which Brazil must rely speaks volumes about the lack of an evidentiary basis for Brazil's claims.

51. ***Marketing Loan Payments:*** Brazil's arguments regarding marketing loan payments are no more availing than its arguments about the counter-cyclical payments. Indeed, rather than providing actual evidence regarding the effects of the marketing loan payments, Brazil attempts to simply sidestep the issue by, again, (a) asserting that the matter has already been resolved by the original panel while at the same time (b) mischaracterizing the U.S. arguments to avoid engaging on the real issues at hand. Brazil's approach lacks merit.

52. First, the United States reiterates that the question of whether or not marketing loan payments are causing "present" significant price suppression today was not considered by the original panel. To the contrary, that panel expressly declined to consider the effects of any future payments allegedly "mandated" to be made under the Step 2, marketing loan, and counter-cyclical payment programs. The original panel also declined to consider whether the marketing loan and counter-cyclical payment *programs* would necessarily have adverse effects in the future; a finding that – by Brazil's own admission – would have been *required* for the original panel to have made a finding against the programs as such.[80] Moreover, as Brazil has conceded, the market conditions that existed at the time of the original proceeding are very different from those that prevail at present.[81]

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[79] Brazil Oral Statement, para. 43.

[80] For example, in the case of its claims against the challenged programs, *per se*, Brazil asked the Panel "to find that the mandatory provisions of the 2002 FSRI Act and the 2000 ARP Act together with their implementing regulations, as listed above, *cannot be applied in a WTO consistent manner*." Brazil's 9 September 2003 Further Submission, para. 435-436. Explaining what this would mean in the context of this dispute, Brazil argued "[f]irst, the Panel needs to evaluate whether the U.S. subsidies will *necessarily threaten* to cause serious prejudice at price levels below the trigger prices of the U.S. subsidies. Second, the Panel needs to consider whether the U.S. subsidies threaten to cause serious prejudice *even at price levels at which only crop insurance subsidies and direct payments are made*." Brazil's 9 September 2003 Further Submission, para. 426 (emphasis added). The original panel did not conduct the requested evaluation and did not make the requested findings.

[81] *See* Brazil Rebuttal Submission, paras. 235-236 (In an effort to excuse itself from having even to show any *coincidence* of U.S. payments and price suppression, Brazil argued that "the underlying statutory and regulatory bases for U.S. upland cotton subsidies and market conditions provided the original panel with a fairly dynamic

53. Indeed, the market conditions are even more different now than Brazil cares to admit. The Step 2 program is no longer in effect, and since the termination of the program, U.S. exports in MY 2006 are sharply lower than in recent years. U.S. exports for MY 2006 are *down 30 percent* from the levels observed at the same time last year.[82] Weekly cotton sales are *31 percent below* the 5-year average.[83] And total U.S. export commitments are currently approximately *40 percent below* last year's level and *27 percent* below the 5-year average.[84] Forecasts for the future are similarly gloomy. As the United States explained in the panel meeting, in February, USDA lowered the U.S. cotton export forecast for MY 2006 by nearly 8 percent, following a 2 percent downward revision in January.[85] These downward revisions are taking place at the same time that USDA estimates record *high* foreign cotton mill use, which means that U.S. share of foreign consumption is expected to drop from 16 percent in MY 2005 to 12 percent in MY 2006. Moreover, U.S. share of world exports is expected to drop from 40 percent in MY 2005 to 36 percent in MY 2006. U.S. domestic mill use for MY 2006 is projected at just 5 million bales, the lowest since MY 1931. The declining demand for U.S. upland cotton is also being reflected in planting and production decisions. The annual survey of planting intentions conducted by the National Cotton Council indicates that U.S. upland cotton plantings are likely to be down an average of 14 percent in MY 2007 from 2006 levels.[86]

54. To the extent that Brazil asserts that the original panel already examined and resolved the question of what effects the marketing loan has under such market circumstances as prevail now, the United States submits that Brazil's argument is wholly without merit.

55. Second, it is astonishing that Brazil yet again asserts that "the United States never explains how marketing loan subsidies could have no effect on producers' decision to plant cotton ... ."[87] Not only has the United States never *alleged* that " marketing loan subsidies could have no effect on producers' decision to plant cotton,"[88] but the United States and Brazil's own

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environment in which to examine temporal coincidences. The period MY 2001-2005 (principally under the FSRI Act of 2002) was more stable. After MY 2001, it did not involve the same extreme declines in the world market prices for upland cotton or significant additional increases in the U.S. share of world production and exports, compared to the period MY 1998-2002.")

[82] Weekly Export Performance Report for week ending February 15, 2007 (Exhibit US-113).

[83] Weekly Export Performance Report for week ending February 15, 2007 (Exhibit US-113).

[84] Weekly Export Performance Report for week ending February 15, 2007 (Exhibit US-113).

[85] February 2007 World Agricultural Supply and Demand Estimates (WASDE) Report (Exhibit US-114).

[86] National Cotton Council Planting Intentions Survey MY 2007 (Exhibit US-115).

[87] Brazil Oral Statement, para. 35.

[88] This is the second time that the United States has addressed the same mischaracterization of the U.S. position. *See e.g.,* U.S. Rebuttal Submission, para. 268 ("Brazil's rebuttal arguments about the structure, design, and operation of the marketing loan program are, yet again, premised on a mischaracterization of the U.S. arguments. Brazil asserts that 'the United States argues that upland cotton producers do not expect to receive marketing loan payments. . . .The United States argues that marketing loan payments . . . have no effect on planted acreage, no effect on production, no effect on exports, and no effect on the world price of cotton.' Brazil Rebuttal Submission, para.101. This is not what the United States has argued and the United States respectfully refers the Panel to the U.S. first written submission at paragraphs 203-225 where the actual U.S. arguments are set out in detail.")

economist appear to agree on precisely the conditions under which marketing loan payments might affect producers' decision to plant cotton. Specifically, to determine whether marketing loan payments have effects in any given year, it is necessary to examine the planting decisions made by U.S. producers in light of the conditions as they existed as of the time of planting for each marketing year (i.e., January-March).[89] A producer's expectations at that time about market revenue and/or revenue from government payments, costs and other factors will determine whether cotton or some other crop is planted, or if the land is put to other use. Brazil conceded this point both in this proceeding,[90] and in the original proceeding.[91]

56. Nonetheless, while Brazil agrees with the United States as to the correct analysis, Brazil continues to present evidence that directly contradicts this analysis. For example, in its "oral" presentation, Brazil alleges that marketing loan payments in MY 2005 were 29 percent higher than in MY 2002 and, according to Brazil, this "*alone* strongly suggests that its effects on U.S. production and exports as well as on world market prices are much greater [than in the period before the original panel]."[92] Yet Brazil concedes that the *effects* of the marketing loan payments are a function of expectations regarding payments, not actual payments received. Indeed, in its modeling exercise purporting to examine the effects of marketing loans, Brazil's economist does not even include actual payments, explaining:

> U.S. producers respond to revenue they expect to receive from market prices and expected government subsidies, where relevant expectations are those that are held around the time that planting and other key production decisions are made. U.S. producers do not know with certainty what actual prices and subsidies will turn out to be as they unfold during the marketing year. *Therefore, as in reality, the model assumes that actual prices or subsidies in a marketing year do not affect cotton growers' behavior in that marketing year*.[93]

57. It is telling that Brazil repeatedly misstates the U.S. position and continues to offer evidence that is fundamentally at odds with the correct analysis of possible price effects (which it has expressly acknowledged). The fact is that Brazil has not – indeed, cannot – show that U.S.

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[89] *See e.g.,* Cotton Percent Planted, 15 Selected States (Exhibit US-44).

[90] *See* Brazil First Written Submission, Annex I, para. 36 ("U.S. cotton producers respond to the *expected* prices and *expected* rates of subsidy that apply at the time planting and other key decisions are made in the production cycle") (emphasis added) and Brazil First Written Submission, Annex I, para. 58 ("[t]he magnitude of the impact on incentives to produce cotton is equal to the *expected* difference between the loan rate, which is known at planting time, and the grower's *expectations* at the time of planting about the AWP for cotton that will apply when the grower makes that marketing loan transaction.") (emphasis added). Brazil Further Submission, Annex I, para. 17-18.

[91] *US – Upland Cotton (AB)*, para. 440 ("Brazil counters that farmers decide what to plant based on expected market prices as well as expected payments under the challenged subsidy programs, such that planted acreage responds to both these factors.")

[92] Brazil Oral Statement, para. 31.

[93] Brazil First Written Submission, Annex I, para. 4 (emphasis added).

cotton producers' expectations regarding marketing loan payments in have actually led to "present" significant shifts in planting. Indeed, as discussed next, the data submitted by Brazil regarding producers' expected revenues and costs show that producing upland cotton was both economically viable and rational in every year under the FSRI Act, including MY 2006 (the relevant year for purposes of Brazil's "present" serious prejudice claims).

2. *The Cost of Production Analysis Submitted By Brazil Is Fundamentally Flawed and the Proper Assessment of the Data Supports the U.S. Argument That Marketing Loan and Counter-Cyclical Payments Are Not Having Any Significant Price Suppressive Effects*

58. The centerpiece of Brazil's oral presentation regarding serious prejudice is a series of six charts[94] and accompanying discussion that Brazil presents to show the allegedly "economically irrational business of growing cotton in the United States within marketing loan and CCP subsidies."[95] Brazil submits that this evidence establishes that U.S. upland cotton producers would not plant upland cotton and could not survive without marketing loan and counter-cyclical payments. As the United States shows below, however, Brazil's analysis is inconsistent with the economic literature regarding the role of costs in planting decisions, the findings of the Appellate Body regarding the relevance of variable versus total costs, and the approach taken in all econometric models of which the United States is aware that look to costs as a factor in planting decisions (including Brazil's own model in the original proceeding). Indeed, viewed consistently with the principles recognized therein, the data show that (a) upland cotton producers expected and were able to meet their variable costs in every year under the FSRI Act solely with market revenue; (b) that upland cotton was the most attractive crop from a cost/revenue perspective in most years; (c) upland cotton producers met and exceeded even their *total* cash costs in almost every year under the FSRI Act of 2002.

59. What Brazil's analysis lays bare is not the "economically irrational business of growing cotton in the United States within marketing loan and CCP subsidies,"[96] as Brazil alleges, but rather the distortive and unfounded nature of Brazil's cost analysis.

a. Variable costs – not total costs – are the relevant measure in assessing year-to-year planting decisions

60. It is useful to begin with a summary of what Brazil purports to show. Specifically, Brazil asserts that it is providing: (a) a chart showing expected market revenue net of total costs of production for corn, soybeans, and cotton in MY 2005; (b) a chart showing expected market revenue net of total costs of production for corn, soybeans, and cotton in MY 2007; and (c) a

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[94] In fact, there are only three charts, with a second associated chart for each that isolates one of the columns therein.

[95] Brazil Oral Statement, para. 57 and paras. 57-91.

[96] Brazil Oral Statement, para. 57 and paras. 57-91.

chart showing average market revenue net of total costs of production for corn, soybeans, and cotton in MY 2002-2006. Brazil argues that in each of these time periods, U.S. farmers would have lost money *across the board* producing *any* of these crops (or would have expected to do so) "but for" marketing loan and counter-cyclical payments. According to Brazil, this analysis shows that U.S. farmers producing cotton, soybeans, or corn can only survive because of those payments. Brazil further alleges that it is only when those payments are taken into account that *upland cotton* becomes an attractive crop relative to the others. Brazil is wrong.

61. Even before addressing the numerous technical flaws in Brazil's analysis, it is useful to put Brazil's argument in perspective; in particular, the remarkable assertion that U.S. farmers could not produce *soybeans*, *corn*, or *cotton* in the United States in any of the periods examined absent marketing loan and counter-cyclical payments. Indeed, although the United States has almost one billion acres of farmland, and although corn and soybeans were two of the top five top agricultural commodities in MY 2005, Brazil would have the Panel believe that producing those crops and cotton – indeed, perhaps even agriculture itself – is an ""economically irrational business" in the United States. This premise is simply untenable. In fact, it demonstrates precisely the flaws in the analysis presented by Brazil – that ***total costs in each year are not the proper considerations in assessing the viability of farmer's year-to-year planting decisions.***

62. Rather, for a farmer, the relevant costs in deciding what to plant in each year are variable costs of production. Recall the simplified example examined in the first U.S. submission of a farmer deciding in January of a particular year whether to plant all soybeans, some soybeans and some cotton, all cotton, or to allow the land to sit idle. This farmer will consider, *inter alia*, the expected price of cotton at harvest, the expected price of soybeans at harvest, as well as the anticipated costs of growing each crop. In so doing, he does not need to consider fixed asset and overhead costs. He has already incurred those costs; they will not differ based on whether the farmer plants soybeans, cotton, a mix, or nothing. Rather, the farmer will consider projected net revenues taking into account costs for such items as seed, fertilizer, chemicals, and other expenses that are directly related to planting, harvesting, and marketing each crop. The economically rational decision for him will be to plant the crop, or mix of crops, that *both* covers his variable costs *and* maximizes his net revenue. In other words, the farmer will choose the option that gives him the largest margin above variable costs. This will not only allow him to cover his variable expenses but will also give him the most revenue to pay down total costs.

63. That variable costs are the relevant consideration in year-to-year planting decisions is well-accepted in agricultural economics. The United States discussed the extensive literature in this regard in its submissions to the panel in the original proceeding.[97] To supplement that discussion, the United States submits two other studies that confirm that variable costs are the

[97] *See e.g.*, U.S. Further Rebuttal Submission in the Original Proceeding, paras. 117-122 (18 November 2003).

appropriate consideration in assessing year-to-year planting decisions.[98] Considering the evidence submitted earlier in the dispute, the Appellate Body expressly recognized that:

> We agree with the general proposition of the United States that *variable costs may play a role in farmers' decision-making as to whether to plant upland cotton or some alternative crop, and how much of each crop to plant*. From a short-term perspective, variable costs may be *particularly important*.[99]

64. Moreover, the fact that variable costs – not total costs – is the appropriate measure is also evidenced by the fact that there is *no economic model* of which the United States is aware that uses total costs in its supply response equations (that is, to examine the planting decision). Indeed, FAPRI uses variable costs in its modeling framework. And even Brazil's model in the original proceeding – purportedly based on the FAPRI model – used variable costs in the net revenue equation that determined the planting decision of farmers.

65. Thus, there is no basis whatsoever for Brazil's use of total costs to examine planting decisions in any particular year.

b. U.S. farmers expected to meet and exceed variable costs in each year, and in most years upland cotton was the most attractive option

66. When a proper examination is undertaken regarding the expected returns and variable costs, the data show that U.S. farmers expected to cover their variable costs regardless of whether they decided to grown cotton, corn, or soybeans. Brazil has acknowledged that if a "farmer would not be able to cover even variable costs, he or she would not plant anything at all to minimize losses."[100] Conversely, where, as here, the farmer *is* covering his variable costs, it is economically rational for him to plant *something*. The question is then *what* to plant. On that question, the assessment depends on a number of factors including the relative net revenue, considerations of weather, and considerations of other factors affecting yields (such as pests and disease). As shown below, in most years, upland cotton was the most attractive option from the standpoint of costs and revenues.

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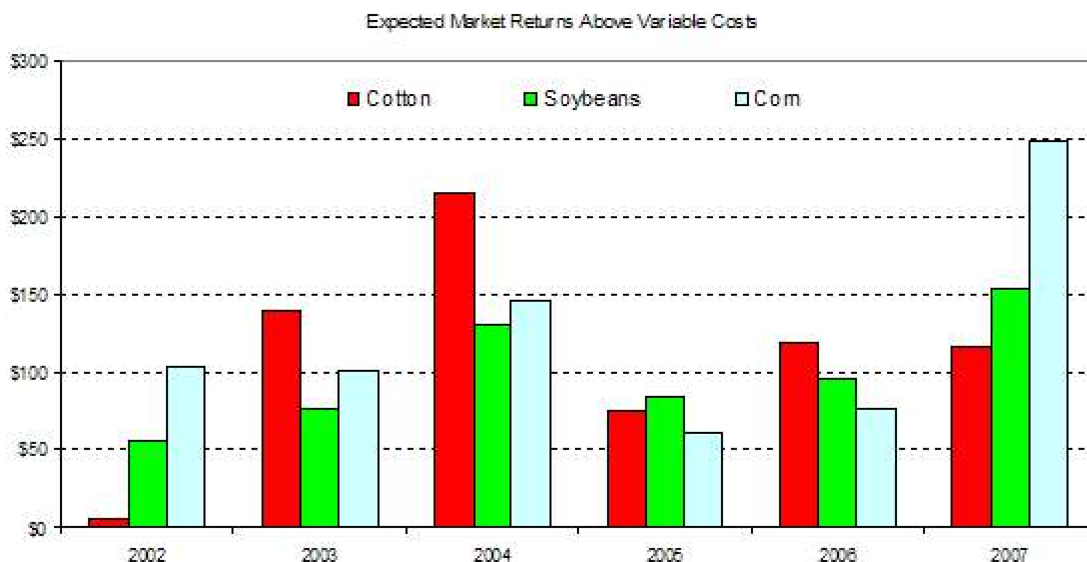
[98] *See* Cecil Davison and Brad Crowder, "Northeast Soybean Acreage Response Using Expected Net Returns" *Northeastern Journal of Agriculture and Resource Economics*, April 1991, pp. 33-41 (Exhibit US-137) and Duncan M. Chembezi and Abner W. Womack, "Regional Acreage Response for U.S. Corn and Wheat: The Effects of Government Programs", *Southern Journal of Agricultural Economics*, July 1992, pp 187-198 (Exhibit US-138).

[99] *US – Upland Cotton (AB)*, para. 453.

[100] Brazil Oral Statement, para. 67.



67. The U.S. analysis above seeks to replicate the revenue expected and variable costs faced by actual U.S. cotton farmers. Each aspect of the calculation is described in Annex I.[101] As discussed therein, the United States has examined relative costs and revenue of growing upland cotton, corn, and soybeans in the 17 U.S. cotton-producing states.[102]

68. The analysis shows that for the entire period MY 2002-2007, U.S. cotton farmers expected to meet or exceed their variable costs of planting cotton, corn, *or* soybeans. Therefore, it was economically rational for those farmers to plant *something*, rather than leaving the land idle. In terms of *what* to plant, upland cotton was the most attractive option – from the standpoint of costs and revenue – in at least three of the years (MY 2003, MY 2004, and MY 2006). In MY 2002, 2005, and 2007, cotton was not the most attractive option. It is instructive to examine more closely shifts in upland cotton acreage in those years because that shows precisely that, contrary to Brazil's assertions, U.S. farmers' planting decisions correspond to market signals.

69. In MY 2002, upland cotton was least attractive of the three options, and U.S. planted acreage declined correspondingly from 15.5 million acres in MY 2001 to 13.7 million acres in MY 2002.

70. In MY 2005, soybeans appeared to be the most attractive crop, followed by cotton. In

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[101] The back-up data is also provided in Exhibit US-139.

[102] In other states, cotton does is not a competitor crop and, therefore, corn and soybean costs from those states would distort the picture.

this circumstance, the expectation was that cotton acreage would fall slightly. In fact, however, it increased slightly – by approximately 600,000 acres. What explains this increase? Brazil has attempted repeatedly to attribute this to the alleged effects of marketing loans and counter-cyclical payments. However, the data point fairly precisely to the reason for the slight increase in cotton acreage in MY 2005 – a shift away from soybean acreage due to concerns about an outbreak of Asian soybean rust at the end of MY 2004. Soybean rust, a recurrent problem for soybean producers in much of the southern hemisphere, was first detected in the United States in the Fall of 2004, late enough in the season that it posed no threat to that year's soybean crop. After overwintering in the South, soybean rust posed a new, uncertain, and potentially large threat at the beginning of the 2005 U.S. soybean season.[103] Soybean rust has been detected in eight states in the Delta and Southeast regions since late 2004.[104] It was in these regions that the shift from soybean acreage to upland cotton acreage occurred in MY 2005. Of the 600,000 acre increase from MY 2004 to MY 2005, almost the entire shift occurred in the Delta region, where an *increase* in 530,000 acres of cotton was offset precisely by a *decrease* of 530,000 acres of soybeans. Thus, it was soybean rust, and not marketing loan or counter-cyclical payments, that was responsible for increased acreage in MY 2005.

Changes in planted acreage, 2004 to 2005

State/ Region	Cotton		Soybeans	
	Change in acres	*% change*	*Change in acres*	*% change*
DELTA	530	15.6	-530	-4.4
Arkansas	**140**	**15.4**	**-170**	**-5.3**
Louisiana	**110**	**22.0**	**-220**	**-20.0**
Mississippi	**110**	**10.0**	**-60**	**-3.6**
Missouri	**60**	**15.8**	**0**	**0**
Tennessee	**110**	**20.6**	**-80**	**-6.6**
SOUTHEAST	74	2.5	-330	-10.6
Alabama	**0**	**0**	**-60**	**-28.6**
Florida	**-3**	**-3.3**	**-10**	**-52.6**
Georgia	**-70**	**-5.4**	**-100**	**-35.7**
North Carolina	**85**	**11.6**	**-40**	**-2.6**
South Carolina	**51**	**23.7**	**-110**	**-20.3**
Virginia	**11**	**13.4**	**-110**	**-1.9**
SOUTHWEST	94	1.5	75	2.2
Kansas	**-11**	**-12.9**	**100**	**3.6**
Oklahoma	**50**	**2.2**	**5**	**1.6**
Texas	**100**	**1.7**	**-30**	**-10.3**

[103] The Value of Plant Disease Early-Warning Systems: A Case Study of USDA's Soybean Rust Coordinated Framework/ERR-18. Econ. Res. Ser., USDA., pg. 1. http://www.ers.usda.gov/publications/err18/err18.pdf

[104] As of October 3, 2006, National Soybean Rust Commentary, South Carolina officials reported a new county with soybean rust, Saluda County. Soybean rust was found in Washington and Sampson Counties in North Carolina on soybeans. Currently rust has been found infecting this year's soybeans in 68 different counties in eight states: AL, FL, GA, LA, MS, SC, TX, and NC. Including reports on kudzu, there are a total of 88 counties in eight states with rust this year, including 7 in Alabama; 15 in Florida; 18 in Louisiana and South Carolina; 13 in Georgia; 3 in Texas; 2 in Mississippi; and 12 in North Carolina. http://www.sbrusa.net/

Source: *Crop Production,* October 2006, Agricultural Statistics Board, NASS, USDA.

71. In MY 2007, corn is expected to provide greater net revenue than either cotton or soybeans. Cotton acreage is shifting consistent with these, and other, market signals. As the United States noted in the meeting with the Panel, the annual survey of planting intentions conducted by the National Cotton Council indicates that U.S. upland cotton plantings are likely to be down an average of 14 percent in MY 2007 from 2006 levels.[105] While Brazil attempts to dismiss this data – arguing that acreage shifts should be *even* higher – it provides no basis for this assertion. Indeed, a 14 percent shift in acreage would be substantial, amounting to more than a 2 million acre drop in planted acreage and – applying MY 2006 yields – a 3.7 million bale decline in production.[106] Brazil has not explained why this Panel should ignore this important evidence.

72. In any event, what the data show is quite different from what Brazil has asserted about the allegedly "economically irrational business of growing cotton in the United States within marketing loan and CCP subsidies."[107] Even without considering those payments, it is clear that U.S. farmers can – and do – meet their variable costs of production. Moreover, under the circumstances, upland cotton is often the most economically rational choice among the available competing crops. Where it has not been, declines in acreage have ordinarily resulted.

c. U.S. farmers actually met and exceeded variable costs and even total cash costs in most years under the FSRI Act of 2002

73. Finally, the United States recalls that total costs may be a relevant consideration in more long-term decisions such as whether or not to exit farming altogether (*i.e.,* not year-to-year planting decisions).[108] However, Brazil's consideration of total costs of growing upland cotton suffers from a number of flaws.

74. First, Brazil considers total costs of growing upland cotton as the *only* consideration for a farmer in deciding whether to continue to exit farming altogether. This is not accurate. Indeed, as the economic literature confirms, whole-farm costs and revenues – including off-farm revenue and revenue from other sources – are also important considerations in making those kinds of decisions.[109] Brazil's attempts to show that U.S. producers would have exited upland cotton production in the long-term solely on the basis of a comparison of costs and revenues for cotton

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[105] National Cotton Council Planting Intentions Survey MY 2007 (Exhibit US-115).

[106] February 2007 World Agricultural Supply and Demand Estimates (WASDE) Report (Exhibit US-114).

[107] Brazil Oral Statement, para. 57 and paras. 57-91.

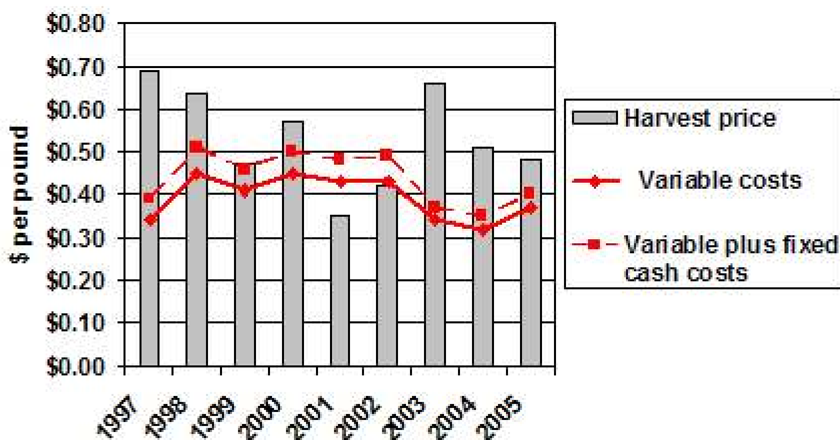
[108] U.S. First Written Submission, paras. 295-297.

[109] *See e.g.,* Hoppe, Robert A. and Korb, Penni. Understanding U.S. Farm Exits. Economic Research Report 21. June 2006, p. 20 (Exhibit US-46) ("Off-farm work has become important to farm operators. About one-third of farmers have worked off the farm at least 200 days per year—essentially full-time—since 1978. Off-farm work could hypothetically affect exits in two ways. First, off-farm work may be the first step in an exit from farming, which would be reflected in higher exits for farms the operators of which work off-farm. Second, off-farm work might lower the probability of exit by providing farm operator households with another source of income.")

are, thus, not sound. Brazil has never been able to submit any literature, study, report, or empirical evidence to contradict the evidence submitted by the United States regarding the consideration of whole-farm costs and revenues. Nor has Brazil provided any evidence that takes into account whole-farm costs and revenues, and that shows that, absent the marketing loan and counter-cyclical payment programs, U.S. upland cotton producers would have exited upland cotton farming.

75. Second, Brazil includes in its assessment imputed opportunity costs. These are not actual expenditures, but instead are an economic concept used to capture the alternative uses of the land, unpaid family labor and capital; for example, how much a farmer would pay himself for his own labor. These are not like year-to-year cash costs without which a farmer would be unable to continue on in business. It is only through the inclusion of such imputed costs that Brazil seeks to show returns less than total costs.

76. The fact is that even if one includes additional fixed cash costs, which are not part of variable costs, the outcome remains much the same as for variable costs; that is, in most years the market revenues from cotton cover variable plus fixed cash costs. As shown below, in most years, U.S. farmers are able to meet and exceed their *total* cash costs. Therefore, Brazil's claims of widespread bankruptcies in the absence of marketing loan and counter-cyclical payments are not realistic.[110]



[110] The United States notes that this chart and the back-up spreadsheets were submitted to the Panel and Brazil during the meeting with the Panel. *See* Exhibit US-124.

77. Moreover, Brazil has claimed on several occasions that a large cost-revenue gap exists for U.S. cotton producers, such that except for U.S. subsidies, farmers would not plant cotton. Examining the cost data properly for the period 2000-2005, instead of the cumulative $663 *deficit* per acre asserted by Brazil, the cumulative returns over the same period were a *positive* return of $161 per acre. Moreover, for MY 2000-2006, instead of the $837 *deficit* per acre alleged by Brazil, the cumulative net returns were a positive $133 per acre.

d. Conclusion

78. Notwithstanding Brazil attempts to skew the cost data, that data show clearly that U.S. producers actually meet – and, in fact, exceed – their variable costs of producing upland cotton. Moreover, in most years, a relative consideration of variable costs and expected returns shows upland cotton to be the most attractive among competing crops. Where it is not, U.S. farmers behave in exactly the way they would be expected to behave given the particular market signals – they pull back on production except where other considerations (for example, concerns regarding weather, pests or disease) suggest a different approach.

3. The Sumner II Model Is Oversimplified and Relies on Arbitrary Parameters and Assumptions That Have No Basis in the Economic Literature

79. The third piece of allegedly "key evidence" referenced by Brazil in support of its claims of present significant price suppression are the results of the Sumner II model that Brazil commissioned for purposes of this proceeding. As the United States has explained, that model suffers from substantial flaws, both in its structure and operation and in the parameters and

assumptions used therein.[111] As a result, the model is overly simplified and produces grossly biased results.

80. Indeed, despite Brazil's efforts to explain it away, Dr. Sumner's own critical assessment of the model – made outside this proceeding – stands. "The simple model" laid out in the 2005 CATO paper – which is virtually identical to the one Brazil has presented in this proceeding – "does not represent the depth of analysis that would be appropriate to support a trade remedy proceeding or a serious prejudice claim before a WTO panel."[112] As Dr. Sumner acknowledged, much of the fault lies with the oversimplifications in the model itself, which "abstract from many complexities that would be important to get more precise estimates."[113] Unfortunately, Dr. Sumner substantially compounded these flaws through his deliberate selection of modeling assumptions and parameters that exaggerate any possible effects of the counter-cyclical and marketing loan programs. As the United States demonstrated at the meeting with the Panel and as shown in the table below, between the original panel proceeding and this Article 21.5 panel proceeding, Dr. Sumner *changed every single elasticity estimate in his modeling exercise, except one* (U.S. mill demand elasticity). And, in *each one of these cases*, he substituted an elasticity that would produce even greater impacts on production and prices than would even the elasticities used for purposes of the original modeling exercise.[114]

Supply and Demand Elasticities Used in Sumner I and II

Parameter	Effects of change to Sumner II elasticity (impact on world price due to removal of marketing loans and counter-cyclical payments)	Sumner I (FAPRI)	Sumner II (CATO)
U.S. cotton supply elasticity	**INCREASED IMPACT**	0.361 - 0.466	0.80
ROW cotton supply elasticity	**INCREASED IMPACT**	0.30	0.20
US mill demand elasticity	no change	-0.20	-0.20
US stocks demand elasticity	**INCREASED IMPACT**	-1.40*	no
ROW mill demand elasticity	**INCREASED IMPACT**	-0.25	-0.20
ROW stocks demand elasticity	**INCREASED IMPACT**	-0.463*	no

*Parameter estimate not presented in original Sumner model; estimates drawn from FAPRI model documentation discussed in Annex I to the US Rebutal Submission, paras 23-25. (Exhibit US-56, Exhibit US-109, Exhibit US-65)

[111] *See e.g.,* U.S. First Written Submission, Annex I and U.S. Rebuttal Submission, Annex I.

[112] Daniel A. Sumner. "Boxed In: Conflicts Between U.S. Farm Policies and WTO Obligations." Center for Trade Policy Studies, The Cato Institute, December 2005. (Exhibit US-108)

[113] Daniel A. Sumner. "Boxed In: Conflicts Between U.S. Farm Policies and WTO Obligations." Center for Trade Policy Studies, The Cato Institute, December 2005. (Exhibit US-108)

[114] Of course, many of the elasticities in the model used for purposes of the original proceeding were already overstated.

81. In Brazil's "oral" presentation, it offers no justification for the flaws in the Sumner II model's structure or its arbitrary and unfounded elasticity assumptions. Nonetheless, the United States addresses below a few of the key aspects of Brazil's "oral" presentation regarding its modeling exercise.

82. First, the United States notes that Brazil continues to attempt to discredit the FAPRI model that it relied upon in the original proceeding (and that Brazil goes as far as to assert *the original panel* relied upon).[115] Now, for example, Brazil derides the years of research embodied in the FAPRI framework and parameters by characterizing it as "piece-mill development." This is presumably intended to establish the superiority of Brazil's model, which was developed by Dr. Sumner alone after the original panel proceeding and which has never been subjected to any peer review or examination. Brazil's criticisms are remarkable given that – in an effort to have the original panel accept its allegedly FAPRI-based model in the original proceeding – Brazil specifically lauded the fact that FAPRI "continually update[d] [its] analytical capabilities and . . . market intelligence."[116] Thus, the fact that Brazil's new Sumner II model has not been subjected to the same kind of peer review and development renders it less – not more – reliable than the FAPRI framework.

83. Second, Brazil now claims that FAPRI parameters are inappropriate for analyzing the "permanent" removal of payments such as the marketing loan and counter-cyclical payments.[117] However, in the original proceeding Brazil asserted that "FAPRI is the most influential organization in the United States analyzing farm policy and its effects on U.S. and world commodity markets, i.e., that has the highest reputation and experience *in answering the kind of "but for" questions faced by this Panel*,"[118] Indeed, as Brazil expressly acknowledged in the original proceeding:

> The FAPRI model has been widely used for policy analysis in the United States and elsewhere for almost 20 years. U.S. commodity groups, including the U.S. cotton industry, have regularly used the FAPRI model to analyze farm commodity program options. The FAPRI model is also the key model used by the U.S. Congress in considering farm program options. For almost two decades the U.S. Congress has provided special appropriations to support the continued use and development of the FAPRI model. In both the 1996 and the 2002 Farm Bill processes, the FAPRI model provided the most influential projections of likely

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[115] *See e.g.,* Brazil Rebuttal Submission, para. 292. Brazil neglects to mention, however, that the original panel expressly stated that "[w]e have taken note of the outcomes of the simulations submitted by Brazil1, and the parties' exchanges of views thereon. We have not relied upon the quantitative results of the modelling exercise – in terms of estimating any numerical value for the effects of the United States subsidies, nor, indirectly, in our examination of the causal link required under Articles 5 and 6.3(c) of the *SCM Agreement*."

[116] Answers of Brazil to Questions from the Panel After 2nd Meeting, para 21 (December 22, 2003).

[117] Brazil Oral Statement, para. 103.

[118] Answers of Brazil to Questions from the Panel After 2nd Meeting, para 24 (December 22, 2003) (emphasis added).

program impacts. FAPRI received the USDA highest honor for its analysis of certain proposals leading to the adoption of the 2002 FSRI Act.[119]

84. FAPRI has used their modeling system to analyze the removal of domestic subsidies under trade liberalization scenarios and the reduction of farm subsidies under various farm bill scenarios, including the "permanent" removal of payments. Indeed, in attempting to argue that elimination of the Step 2 program has had no effects on exports or prices, Brazil itself submitted and repeatedly cites to a FAPRI assessment of the effects of eliminating that program.[120] FAPRI economists did not find it necessary to change their model or modeling parameters to address that question (involving a total and permanent removal of payments). And Brazil did not complain that the FAPRI assessment of eliminating the Step 2 program was "biased downwards." To the contrary, in that context, Brazil *wants* the Panel to accept that FAPRI allegedly shows "relatively modest effects from the removal of the Step 2 subsidy." Brazil argues that the Panel should *rely* on FAPRI's analysis of that scenario in assessing the effects of eliminating the Step 2 program. Yet Brazil asserts that the same FAPRI analysis is somehow inappropriate for analyzing the counterfactual situation without marketing loan and counter-cyclical payments.[121] Brazil's arguments in this regard are internally inconsistent and lack credibility.

85. Third, the United States notes that Brazil has applied a long-run elasticity for U.S. supply response while imposing very conservative short-run elasticities for international supply and demand response. If the analysis is to be performed in the long run – and the United States considers that it must for the reasons explained at the meeting with the Panel – then long-run elasticities must be assumed throughout the model. In that time, foreign cotton producers will make full adjustments and respond as well. Similarly, over the long-term, U.S. and foreign mill demand become more responsive to permanent price changes. There is no basis whatsoever for the kind of mix-and-match approach that Brazil has adopted in an effort to exaggerate any possible effects of the marketing loan and counter-cyclical payments.

86. Fourth, another key source of bias in Dr. Sumner's analysis is the fact that it does not incorporate, either explicitly or implicitly, any stock behavior.[122] Yet, stock adjustments may have important effects on overall price movements in the short-run. As future prices increase relative to current prices, warehouses will tend to carry more inventory, choosing to sell their cotton in future periods when prices are higher. Likewise, if current prices are high relative to futures prices, sellers find it more attractive to market their cotton rather than holding it for sale in the future. In this way, stocks act to buffer prices. If prices fall, potential sellers will sell less

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[119] Brazil Further Submission, para. 214 (September 9, 2003).

[120] *See* Brazil First Written Submission, para. 203 (addressing FAPRI, "Impacts of Commodity and Conservation Reserve Program Provisions in House and Senate Reconciliation Bills," FAPRI-UMC Report #15-05, December 2005(Exhibit Bra-484).)

[121] Brazil Oral Statement, para. 103.

[122] The absence of such an analysis is especially remarkable given Brazil's new theory that it is stocks – not exports – that are suppressing world market prices.

and hold more in stock, thus bolstering prices. If prices rise, inventory holders will sell stocks, thus dampening prices. Ignoring stockholding behavior in the kind of predominantly short-run assessment that Brazil attempts to conduct exacerbates any possible effects of removal of marketing loans and counter-cyclical payments on world price.

87. Fifth, the United States contests Brazil's efforts to explain away the fact that it uses counter-cyclical payments rates that are in excess of the statutory maximum. According to Dr. Sumner, this results from calculation of counter-cyclical payment rates on a per-pound of production basis:[123] "[The Sumner II model] uses the CCP rate per pound of production for each year. Since cotton production is smaller than cotton base, the CCP rate per pound of production can exceed 13.73 cents per pound when the CCP rate per pound of base remains at the maximum."[124] In other words, Brazil admits that it attempts to attribute to upland cotton production *all* counter-cyclical payments made in respect of upland cotton base acres regardless of whether upland cotton or some other crop was grown. More precisely, Brazil attempts to attribute *cotton* production-inducing effects in respect of payments even when the payments were made on farms that did not produce upland cotton or on farms where other crops were grown, instead of upland cotton, on acres historically planted to cotton. This is an illogical approach that serves no purpose other than to inflate the results of the modeling exercise.

88. In sum, the evidence and arguments before the Panel show that the Sumner II model lacks the rigor or detail to address the complexities of the global fiber market. Moreover, the model's choice of elasticities introduces biased results. Even ignoring the structural issues with the model, the United States has demonstrated that the use of more reasonable, independent elasticities produce dramatically smaller impacts on world price.

III. CONCLUSION

89. The United States has implemented the DSB's recommendations and rulings in this dispute and that it has done so consistently with its WTO obligations. The United States has eliminated two export credit guarantee programs entirely. And the United States has substantially overhauled the third, lowest-risk program. The United States has also eliminated a third program, the Step 2 program, payments under which were claimed by Brazil to be prohibited export subsidies, among the most distortive of subsidy measures.

90. Moreover, substantial evidence confirms that payments under the marketing loan and counter-cyclical payment programs are not causing present significant price suppression, as Brazil alleges. Brazil has not been able to rebut this evidence. Rather, it continues to rely on the heavily biased results of the modeling exercise commissioned for purposes of this dispute. The United States has shown that exercise to be unreliable and, as its author has noted in another

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[123] Brazil Oral Statement, para. 120.
[124] Brazil Oral Statement, para. 120.

context, not "appropriate to support [Brazil's] serious prejudice claim before [this] WTO panel."[125]

91. Finally, the United States again would like to thank the Panel for providing this opportunity to comment on Brazil's "oral" statement. While we recognize that such an opportunity is unusual in WTO panel proceedings, the approach taken by Brazil to the Panel meeting was, itself, unusual. Brazil's approach had the unfortunate consequence of limiting the chance for an oral dialogue with the Panel to a single afternoon. Fortunately, by allowing this opportunity for comment, the Panel has allowed the dialogue to take place, albeit in written form.

[125] Daniel A. Sumner. "Boxed In: Conflicts Between U.S. Farm Policies and WTO Obligations." Center for Trade Policy Studies, The Cato Institute, December 2005. (Exhibit US-108)