

UNITED STATES – SUBSIDIES ON UPLAND COTTON:

Recourse to Article 21.5 of the DSU by Brazil

(WT/DS267)

**Answers of the United States of America
to Parts D-E of the Questions from the Panel to the Parties
prior to the Meeting with the Panel**

March 6, 2007

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130	<i>The New Shorter Oxford English Dictionary at 195, Volume 1, (1993 Edition)</i>

D. CLAIMS OF BRAZIL REGARDING PRESENT SERIOUS PREJUDICE

1. General

Questions to both parties

24. *Could the parties explain how they interpret the phrases "take appropriate steps to remove the adverse effects" and "withdraw the subsidy" in Article 7.8 of the SCM Agreement ?*

1. “[T]ake appropriate steps to remove the adverse effects” and “withdraw the subsidy” in Article 7.8 refer to the two options available to a responding Member “where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy [of the responding Member] has resulted in adverse effects to the interests of another Member within the meaning of Article 5.” To interpret these two phrases, it is necessary to examine the “ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”¹

2. With respect to the first option – “take appropriate steps to remove the adverse effects” – “take” refers, *inter alia*, to “undertake and perform” “make oneself responsible for (a duty etc.)” “adopt or choose for a particular purpose” or “receive or obtain (something given, bestowed, or administered).”² “Steps” – especially in the sense of “taking steps” – refers to “an action, measure, or proceeding, esp. one of a series, which leads towards a result.”³

3. In the context of Article 7.8 of the *SCM Agreement*, the particular “result” towards which steps are to be taken is the removal of adverse effects. “Remove” is defined, *inter alia*, as “the action of taking away or getting rid of a thing.”⁴ The thing to be “removed,” under Article 7.8 of the *SCM Agreement*, is “the adverse effects.” Although Article 7.8 does not specify that it is the adverse effects of the subsidy, as found in the adopted panel report or Appellate Body report, that should be “removed,” this is apparent from the context.⁵

4. Article 7.8 does not specify what precise steps are to be taken to “remove the adverse effects.” But it does provide that these steps must be “appropriate.” In other words, they must be “specially suitable (*for, to*)” the removal of the adverse effects found to exist in the panel and Appellate Body reports.⁶ This confirms the fact-specific nature of adverse effects findings and remedies in respect thereof. What is “appropriate” – i.e., “specially suitable (*for, to*)” – for removing the adverse effects in a particular case will depend on the facts of the situation and the particular adverse effects found to exist.

5. With respect to the second option – “withdraw the subsidy” – “withdraw” means, among

¹ See e.g., *EC – Chicken Classification (AB)*, paras. 175.

² *The New Shorter Oxford English Dictionary* at 3206, Volume 2, (1993 Edition) (Exhibit US-125).

³ *The New Shorter Oxford English Dictionary* at 3050, Volume 2, (1993 Edition) (Exhibit US-126).

⁴ *The New Shorter Oxford English Dictionary* at 2543, Volume 2, (1993 Edition) (Exhibit US-127).

⁵ For example, the very next provision, Article 7.9 of the *SCM Agreement*, discusses the situation where a Member “has not taken appropriate steps to remove the adverse effects of the subsidy. . . .”

⁶ *The New Shorter Oxford English Dictionary* at 103, Volume 1, (1993 Edition) (Exhibit US-128).

other things, “cause to decrease or disappear” and “take back or away (something bestowed or enjoyed).”⁷ According to Article 7.8 of the *SCM Agreement*, the thing to be “caused to decrease or disappear” or “taken back or away” is the “subsidy.” Again, the context makes clear that the “subsidy” at issue is the one identified in the panel or Appellate Body report as resulting in adverse effects to the interests of another Member within the meaning of Article 5 of the *SCM Agreement*.

25. *How do the parties interpret the relationship between Article 7.8 of the SCM Agreement and Article 21.5 of the DSU?*

6. Article 7.8 of the *SCM Agreement* establishes the obligation of a responding Member “where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy [of the responding Member] has resulted in adverse effects to the interests of another Member within the meaning of Article 5.” In that situation, the responding Member has two available options under Article 7.8. As discussed above, the Member may either (a) “take appropriate steps to remove the adverse effects” or (b) may “withdraw the subsidy.”

7. Article 21.5 of the DSU deals with the use of dispute settlement procedures to decide disagreements about the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings of the DSB.

8. There is no cross-reference in either Article 7.8 of the *SCM Agreement* or Article 21.5 of the DSU to the other provision. However, given the obligation under Article 7.8 to either “take appropriate steps to remove the adverse effects” or “withdraw the subsidy,” to the extent there is disagreement as to whether the responding Member has satisfied its obligations, Article 21.5 of the DSU provides for dispute settlement procedures to decide the disagreement. In other words, a complaining party could have recourse under Article 21.5 of the DSU to claim that there is no measure taken to comply by the Member concerned (i.e., the adverse effects have not been removed or the subsidy not withdrawn) or that the measure taken to comply is not consistent with a covered agreement.

26. *Could the parties explain whether they agree or disagree with the arguments of New Zealand in its Third Party Submission that Article 7.8 of the SCM Agreement has certain consequences for the burden of proof in an Article 21.5 proceeding? [Paragraphs 5.04-5.06 of the Third party Submission of New Zealand]*

9. The United States disagrees with New Zealand’s argument that “Article 7.8 of the *SCM Agreement* operates to distribute the burden of proof somewhat differently” in a compliance proceeding.⁸ That argument has no legal basis. Article 7.8 provides the following:

Where a panel report or an Appellate Body report is adopted in which it is

⁷ *The New Shorter Oxford English Dictionary* at 3704, Volume 2, (1993 Edition) (Exhibit US-118).

⁸ New Zealand Third Party Submission, para. 5.06.

determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy.

10. This provision says nothing about the burden of proof in Article 21.5 proceedings, let alone that it reverses the well-established rule that a complaining party – whether in an original proceeding or a compliance proceeding – bears the burden of proving its claims.⁹ Just as in any other Article 21.5 proceeding, the complaining party continues to have the burden to prove its claim that a measure taken to comply does not exist (i.e., the adverse effects have not been removed or the subsidy not withdrawn) or that a measure taken to comply is not consistent with a covered agreement.

27. *Could the parties comment on the following statement of the European Communities:*

"The text of Article 7.8 of the SCM Agreement does not state expressly that a Member that has been requested by the DSB to implement its recommendations and rulings under Article 7.8 of the SCM Agreement has to do anything" (original emphasis)

11. The United States agrees with the European Communities' statement to the extent that it means that Article 7.8 does not specify any particular steps for removing the adverse effects of a subsidy or withdrawing a subsidy. The decision is left to the responding Member. In the case of the first option (removing the adverse effects), the only guidance provided in the text is that the steps taken must be "appropriate."¹⁰ What is "appropriate" in a particular case is to be determined on a fact-specific basis given the particular subsidy, adverse effects, and other circumstances at issue. In the case of the second option (withdrawing the subsidy), there is no limitation whatsoever on how to remove the subsidy. And it may not always be necessary to change the measure itself. It is possible that market or other conditions may change such that a subsidy is no longer causing adverse effects or the measure is no longer a subsidy (e.g., because it no longer confers a benefit).

28. *The parties present divergent views with respect to the relevant marketing year to be considered by the panel in its analysis of Brazil's serious prejudice claims.*

⁹ See e.g., *Canada – Dairy (21.5 – U.S. and New Zealand)*, para. 6.4 ("The Panel does not consider that the rules on the allocation of the burden of proof change simply because a claim is made in the context of Article 21.5 DSU proceedings.") (citing to Appellate Body report in *Brazil – Aircraft (21.5 – Canada)*, para. 66). The United States also notes that New Zealand's argument is based on a flawed reading of the findings in the original proceeding. New Zealand assumes that the original panel found the marketing loan, counter-cyclical payment and step 2 "programs" to be causing serious prejudice. However, as is clear from the original panel report, the original panel expressly stated it was declining to do so. See U.S. First Written Submission, paras. 31-44; U.S. Rebuttal Submission, paras. 16-63.

¹⁰ See discussion of "appropriate" in response to Question 24 above.

- a. Could the parties explain what they consider to be the relevant legal considerations by which the Panel should be guided in determining whether MY 2005 or MY 2006 is the appropriate marketing year?**

12. The United States considers that the present marketing year – MY 2006 – is the relevant period to consider whether the present “effect” of any subsidy “is . . . significant price suppression in the same market” within the meaning of Article 6.3(c) of the *SCM Agreement*. This is compelled by the use of the present-tense term “is” in that provision. “Is” means “that which exists, that which is; the fact or quality of existence.”¹¹ “Is” comes from the verb “to be,” which itself means, *inter alia*, “have place in the realm of fact, exist, live” “be the case or the fact; obtain.”¹² To determine the effect (if any) of a subsidy that “exists” at present, it is plainly necessary to look at the present period (or marketing year). It is possible that certain data for MY 2006, the present marketing year, may not be available. In that circumstance, it is appropriate to look at historical data as a *proxy* for the “present” period.¹³ However, where reliable data is available for MY 2006, or any part thereof, the Panel should consider that data in assessing Brazil’s “present” serious prejudice claims. This is especially apt where the particular data for MY 2006 *is* available and complete, including, for example, futures data that would have been considered by U.S. producers at the time of planting for MY 2006 (*i.e.*, in the period January-March 2006).

- b. Do the parties agree or disagree with the argument of the European Communities that in a dispute involving a claim of present serious prejudice the parties must provide the “most recent reasonably available” data? [Paragraphs 43 and 54-55 of the Third Party Submission of the European Communities]**

13. As noted above, the United States agrees that, for a claim of “present” serious prejudice, the present marketing year and any (reliable) data relating to that marketing year are the most relevant.¹⁴

Questions to the United States

¹¹ *The New Shorter Oxford English Dictionary* at 1421, Volume 1, (1993 Edition) (Exhibit US-129).

¹² *The New Shorter Oxford English Dictionary* at 195, Volume 1, (1993 Edition) (Exhibit US-130).

¹³ See Brazil First Written Submission, para. 49 (“Full-year data on marketing loan and counter-cyclical payments to U.S. upland cotton farmers for MY 2006 – the first year in which Step 2 is not provided – will not be available until September 2007. *Nevertheless*, the compliance Panel can determine whether the repeal of the Step 2 program is sufficient to bring the new “basket of measures” supporting U.S. upland cotton farmers into conformity with the covered agreements, based on data covering the full 2005 marketing year.”) (emphasis added)

¹⁴ The United States does not necessarily endorse, however, all of the additional positions that the European Communities takes regarding the alleged “obligation” of a responding party to refer to the most recently-available data in its first written submission, regardless of what the complaining party argues. See European Communities’ Third Party Submission, para. 55. These additional arguments appear to touch on the issue of burden of proof in an Article 21.5 proceeding. As the United States notes above, the burden in a DSU Article 21.5 proceeding is on a *complaining party* to prove a breach of the identified covered agreements; it does *not* fall in the first instance on the responding party.

29. *Does the United States contest the fact that a "strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production" exists?*¹⁵ *In particular, does the US disagree with the following statements:*¹⁶

- *a very large proportion of farms with upland cotton base acres continue to plant upland cotton in the year of payment;*
- *the overwhelming majority of farms enrolled in the programs which plant upland cotton also hold upland cotton base;*

14. To clarify, the United States considers “strong positive relationship” to be a characterization of facts, rather than facts themselves. The facts are the following.

- On farms that have upland cotton base acres (and thus may receive cotton counter-cyclical payments), the ratio of cotton *planted* acres to total upland cotton *base* acres was only 60 percent in MY 2002-2005. In other words, U.S. upland cotton farmers were planting only approximately 60 percent of the cotton acres that they planted in the historical period used to calculate base acres.
- Second, a significant portion of U.S. upland cotton planted acreage (over MY 2002-2005, an average of about 17 percent) is on farms with cotton planted acreage that exceeds cotton base acres, or, indeed, on farms with no cotton base acres at all.

15. The debate between the parties is as to what these facts signify. In the view of the United States, these facts support a number of the U.S. arguments. For example, these facts confirm that U.S. farmers do, in fact, use the planting flexibility afforded by the direct and counter-cyclical payment programs. By contrast, Brazil argues that U.S. farmers are somehow induced to plant upland cotton simply because they hold base acres on which they may receive payments based on upland cotton payment rates. But Brazil has not explained why, if this is so, payment recipients are planting 40 percent fewer acres than they planted in the historical period used to calculate base acres.

16. The second fact is also notable in the U.S. view. It shows that a significant – and growing percentage – of cotton is grown on farms that do not hold *any* upland cotton base acreage or on planted acreage that is in excess of the upland cotton base acreage held by a farm. That is, for these cotton farmers, there can be no link – even alleged – between cotton base counter-cyclical payments and current production because these farmers are growing cotton on

¹⁵ [ORIGINAL FOOTNOTE: See para. 131 of Brazil’s first submission. The Panel clarifies that this phrase refers to the fact that “the recipients who hold upland cotton base acres” and “those who continue to plant upland cotton” overlap with each other to a great extent. (See para. 7.637 of the report of the original panel.) The Panel understands that Brazil uses this phrase in the same sense.]

¹⁶ [ORIGINAL FOOTNOTE: These passages are reproduced from para. 7.636 of the report of the original panel.]

acreage *beyond* their cotton base acreage, if any. This data reinforces other evidence submitted by the United States; for example, data regarding cost of production shows that most U.S. production (at least 92 percent) market revenue not only covers variable costs of production but also *all* total costs of production. Thus, even on Brazil's own theory, counter-cyclical payments play no part in inducing continued cotton production for the vast majority of U.S. cotton production. And, as for the other 8 percent of U.S. production, Brazil has not even related its theory to them, to show any “significant” price suppression resulting from marketing loan and counter-cyclical payments.

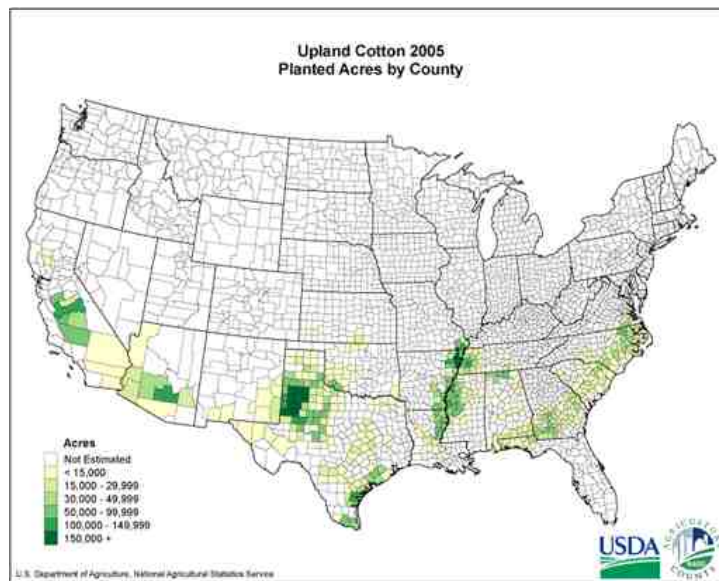
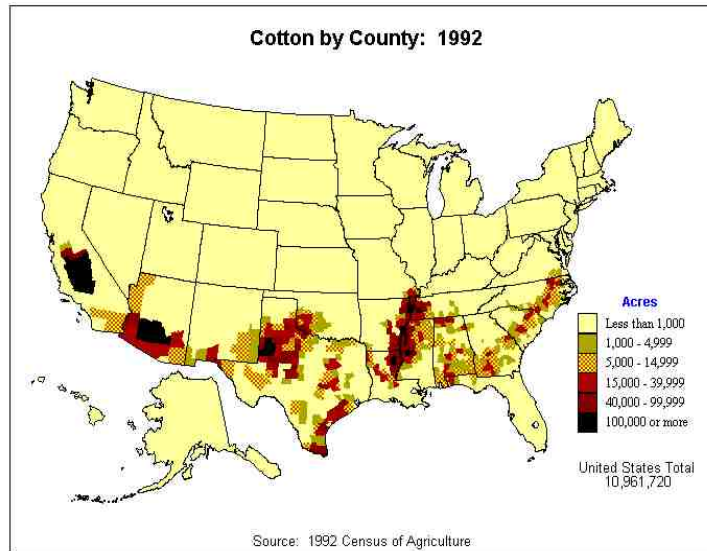
17. These are the facts that the United States considers to be the most relevant because they focus on the level of upland cotton *planting* and *production* and the relationship that these bear – if any – to payments. The United States recalls in this regard that Brazil’s claim focuses on *precisely* this same relationship. Yet, inexplicably, Brazil seeks to dismiss these facts as “unimportant statistics.”¹⁷ Rather, Brazil argues that the focus should be on whether upland cotton is grown on farms that hold even one base acre of upland cotton. Brazil notes, in this regard, that “95 percent of actual U.S. upland cotton planted acreage was planted on farms that received upland cotton counter-cyclical payments in MY 2005.”¹⁸

18. The United States does not contest this figure but strongly disagrees with the conclusions that Brazil asks the Panel to draw from this; namely, that this is somehow evidence of the allegedly production-inducing *effects* of the counter-cyclical payment program. In fact, Brazil appears to confuse cause and effects.

19. Upland cotton is grown in a limited number of areas in the United States, primarily in a few southern and western states, where the weather and other conditions are ideal for upland cotton production. Upland cotton was grown in these areas well before the counter-cyclical payment program came into effect and continues to be grown there now. Continued planting of upland cotton on this farmland is not the effect of any government payment; it is a function of the fact that upland cotton can be grown easily in these areas but cannot be grown in others (for example, cotton seedlings would likely freeze if planted in April in Montana but flourish in the warmer temperatures in Texas at that time). As shown in the maps below, cotton is grown in the same states and – in large part – the same counties in 2005 as it was in 1992, well before the counter-cyclical payments came into effect. The same would be true if one were to go back even decades earlier in time.

¹⁷ Brazil Rebuttal Submission, para. 157.

¹⁸ Brazil Rebuttal Submission, para. 157.



20. Base acres were assigned based on what U.S. farmers were producing in a historical

period. If U.S. farmers were planting upland cotton in the historical period, they were able to enrol upland cotton base acres for purposes of the direct and counter-cyclical payment programs. Many farmers in the southern United States were planting upland cotton – often, as one in a rotation of crops – in the historical period because it made sense for them to do so as an agronomical matter. Many of the same farms produce *some* upland cotton today for the same reasons that they did so at the time that base acres were enrolled – farmers have experience and expertise growing upland cotton in those areas, they have equipment that they can use in that production, and they know they can grow upland cotton with good results given the particular growing conditions in the region.

21. Brazil seeks to claim whatever planting continuity exists as evidence that counter-cyclical payments cause U.S. producers to plant upland cotton where they would otherwise not have done so. But there is no basis for such a conclusion. That is the equivalent of claiming as “evidence” of the effects of subsidies that wine grapes have historically been grown and continue to be grown today in certain regions of France, or that olives have been grown and are grown today in certain Mediterranean regions. The fact that some amount of farmland historically used to produce cotton continues to be good – from an agronomical standpoint – for the production of that crop and continues to be used to grow that crop is hardly remarkable and is *not* evidence of any production-inducing effects of the counter-cyclical payment program.

22. In short, Brazil has yet to establish either the relevance of the farm data it seeks to have the Panel consider or why the other – more relevant – acreage data presented by the United States should be ignored. Brazil’s only argument appears to be that the original panel considered similar data to that pressed by Brazil in the panel’s assessment of payments made in MY 1999-2002. But this argument does not withstand scrutiny. The original panel may have looked at how much upland cotton is grown on farms today that historically produced cotton. However, it could *not* have considered this to be persuasive evidence of any alleged production-inducing effects of the U.S. government payments because it did not find *direct* payments (or, in earlier years, the production flexibility contract payments) to have significant production and price effects. The exact same relationship exists between counter-cyclical payments and upland cotton base acreage as between direct payments and upland cotton base acreage. Indeed, the base acreage is exactly the *same* for both programs. If this relationship was strong evidence of production and price effects, as Brazil alleges, there would have been little basis for the original panel to find against the counter-cyclical/market loss assistance payments, but not direct/production flexibility contract payments, made in MY 1999-2002. The fact that the panel did not make the same finding of significant price suppression with respect to direct/production flexibility contract payments confirms that the relationship to base acreage is not persuasive evidence of any price-inducing effects of either program. It is simply evidence that certain regions in the United States are well-suited to growing upland cotton. Cotton was a viable crop for most farmers to include in their rotation before the counter-cyclical payment program (and direct payment program) came into effect and it continues to be a viable crop now.

23. Turning back to the question regarding the two statements above, for the reasons just

explained, the United States considers that the relevant question for assessing the effects of counter-cyclical payments is not the percentage of farms, but the level of acreage planted to upland cotton (vis-a-vis upland cotton base acres). The data regarding such planted acreage are consistent with the fact that farmers use the planting flexibility afforded by the counter-cyclical payment program and make choices based on market considerations, not any “inducement” by counter-cyclical payments.

Question to Brazil

30. *How does Brazil respond to the argument of the United States that "whether or not the marketing loan and counter-cyclical payment programs or payments under the programs cause significant price suppression is a question of first impression"? [Rebuttal Submission of the United States, paragraph 219]*

2. The structure, design and operation of the countercyclical and marketing loan payment programs

Question to the United States

31. *Brazil claims that the structure, design and operation of US counter-cyclical payments stimulate US upland cotton production. Both Brazil and the United States have referred to the Westcott (2005)¹⁹ study to provide support for their opposing analysis of the possible production impact of counter-cyclical payments. In its rebuttal, Brazil quotes the following passage from Westcott:*

So where do CCPs fit compared with other farm commodity programs in the 2002 Farm Act? Marketing loans are fully coupled since they are available on all production and their link to market prices means they affect production decisions of farmers. Direct payments are mostly decoupled, since they are paid on a fixed, historically-based quantity rather than on current production and are not dependent on market prices or other factors that would affect production. ...

CCPs fall in between these two programs, having some properties similar to mostly decoupled direct payments and other properties similar to fully coupled marketing loans. Like direct payments, CCPs do not depend on current production since they are paid on a fixed, historically-based quantity. However, similar to marketing loans, CCPs are linked to market prices so there may be some influence on current production decisions of farmers, which would potentially make CCPs at least partially or somewhat coupled.

¹⁹ [ORIGINAL FOOTNOTE: Paul A. Westcott, “Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited” (Exhibit US-35).]

a. Does the United States agree with this characterization of the CCP?

24. The United States agrees that counter-cyclical payments differ from direct payments in one respect; namely, they are provided on the basis of historical base acres and payment yields *when the season-average farm price falls below a certain threshold*. Direct payments, by contrast, are paid *regardless of prices* on the basis of historical base acres and payment yields. The United States also agrees that, to the extent that payments under the counter-cyclical payment program are provided only when certain price conditions prevail, this conditionality is an aspect in which counter-cyclical payments are similar to marketing loan payments.

25. That said, the question under Articles 5 and 6.3(c) of the *SCM Agreement* is not on the form of subsidies but their *effects*. And, as the United States has explained, the possible effects of payments under the counter-cyclical payment program on acreage decisions are much closer to those of direct payments than marketing loan payments. As discussed below, marketing loan payments are paid in respect of actual production. By contrast, “farmers retain nearly full planting flexibility and may receive CCPs for the base acreage crop regardless of whether that crop (or any crop) is planted on those acres.”²⁰ This is *precisely* the same as for direct payments.

26. Given that the only salient difference between the structure of direct payments and counter-cyclical payments is that the latter are only provided when certain market conditions prevail, rather than automatically in each year, the question is whether this fact somehow results in a production effect in the case of the latter that does not obtain in the case of the former. Some researchers – including Westcott – conclude that the link to prices may, in some circumstances result in indirect production effects stemming primarily from lowered risk of price volatility. The United States agrees. However, the United States also agrees with Westcott and others that the degree of any such production effects is likely to be minimal and mitigated by a number of factors. For example, Westcott notes in this regard that:

- (a) where prices are expected to be above maximum threshold – counter-cyclical payments behave just like the fixed direct payments;²¹
- (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;”²²

²⁰ Paul A. Westcott, “Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited” at 202 (Exhibit US-35).

²¹ Paul A. Westcott, “Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited” at 203 (Exhibit US-35).

²² Paul A. Westcott, “Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited” at 204 (Exhibit US-35).

- (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;”²³ 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.”²⁴

27. On the basis of these and other factors, Westcott concludes that “there are several mitigating factors which suggest that overall production effects of CCPs through revenue risk reduction are likely to be limited.”²⁵ The United States agrees with that assessment. Other studies submitted by the United States examining the empirical evidence of production effects – for example, a 2007 study by Lin & Dismukes in which the authors 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%”²⁶ – confirm that the effects of the counter-cyclical payments are, in fact, very limited.

b. How would the United States respond to the argument that, by design, counter-cyclical payments are in some measure coupled to production decisions because part of the payments is contingent on the actual realization of market prices?

28. The United States does not consider counter-cyclical payments to be “coupled to production decisions” at all because, as Westcott notes, “farmers retain nearly full planting flexibility and may receive CCPs for the base acreage crop regardless of whether that crop (or

²³ Paul A. Westcott, “Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited” at 204 (Exhibit US-35).

²⁴ Paul A. Westcott, “Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited” at 204 (Exhibit US-35).

²⁵ Paul A. Westcott, “Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited” at 205 (Exhibit US-35).

²⁶ 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).

any crop) is planted on those acres.”²⁷ A farmer simply does not have to produce upland cotton to get payments on upland cotton base acres. Indeed, the question reflects this because it notes that the contingency is realization of particular market *prices*, not the realization of any production by an individual producers. The market price is an independent trigger.

29. Nonetheless, as noted above, the United States agrees that counter-cyclical payments – like direct payments – may have some limited effects on risk and wealth which in turn translate into some limited effect on production. For example, the link between counter-cyclical payments and season-average farm prices may, in some circumstances, result in indirect production effects stemming from lowered risk of price volatility. This question of effects is the one that is important under Article 6.3(c) of the *SCM Agreement*. And, in that context, the question is one of *degree* – *i.e.*, whether any risk and wealth effects are such that they are substantially impacting production, and exports, and, ultimately, suppressing world market prices to a “significant” degree. The evidence before the Panel confirms that they are not. Indeed, as Westcott concluded, “there are several mitigating factors which suggest that overall production effects of counter-cyclical payments through revenue risk reduction are likely to be limited.”²⁸ This is confirmed by recent empirical studies examining the effects of counter-cyclical payments.²⁹

3. Economic simulation model

Question to the United States

32. *Brazil has presented a partial equilibrium model to simulate the effects of eliminating US upland cotton payments, particularly the marketing loan and counter-cyclical payments. In both its submission and rebuttal, the United States has provided reactions to the simulation model.*

a. Would it be accurate to describe the United States’ response as constituting a general acceptance of the framework of analysis adopted by Brazil but contesting the assumptions made regarding the values of the parameters, the supply and demand elasticities and the “coupling factor”, used in the model? (The coupling factor is the amount by which the expected price is increased by each dollar per unit of subsidy payments.)

30. Before addressing the Panel’s question, the United States clarifies that the coupling factor, as used in FAPRI models and the Sumner II model, are coefficients used in an effort to compare the effects of payments that are not coupled to any production (such as direct payments

²⁷ Paul A. Westcott, “Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited” at 202 (Exhibit US-35).

²⁸ Paul A. Westcott, “Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited” at 205 (Exhibit US-35).

²⁹ See U.S. First Written Submission, paras. 207-214; U.S. Rebuttal Submission, paras. 226-252.

and counter-cyclical payments) with the effects of other payments (for example, market revenue), which are made directly in respect of production. In the case of direct payments and counter-cyclical payments, most of the coupling factors currently used have been based on the analyst's judgment. As more empirical data become available, the data provide a guide for analysts in determining the appropriate coupling factor to assign.

31. Turning to the Panel's question, although the United States considers that a partial equilibrium model may be an appropriate tool for conducting an assessment of the effects of the Step 2, marketing loan, and counter-cyclical payment programs on world market prices, the United States does not consider that Brazil's new model is appropriate. The United States has identified a number of important flaws in the model, including that the model:

- lacks cross-commodity impacts and cross-price elasticities, potentially leading to biased price effects;
- is static with no explicit relationships for changes in cotton stock levels and no stocks equation;
- contains foreign supply elasticities that are different from FAPRI that underestimate the response of foreign producers to changes in world prices;
- treats production flexibility payments and direct payments differently even though they operate in the same way;
- incorporates Step 2 payments directly into the producer revenue function as fully coupled payment, and
- appears to ignore statutory parameters, for example by including counter-cyclical payment rates in each of the various price expectations that sometimes exceed the statutory maximum.³⁰

32. These are some of the problems that arise as a result of the general structure of the model itself, and the simplified, reduced nature of the assessment it attempts to conduct. Further, and

³⁰ The maximum counter-cyclical payments paid on 85 percent of base and program yields can not exceed 13.73 cents. Yet Dr. Sumner incorporates a value as high as 19.10 cents, which is 39 percent greater than the maximum allowed rate. Brazil attempts to explain this away at the Panel meeting are unavailing. Brazil explained that Dr. Sumner divided total counter-cyclical payments by production to determine a per-pound rate. But this does not track how farmers view counter-cyclical payments. The question if one of farmers' expectations and farmers do not enter the planting season with an assumption that the counter-cyclical payment rate could be as much as 30% above the statutory maximum. Moreover, all upland cotton base acres are not planted to upland cotton. Brazil's approach fails to take that fact into account. It should also be noted that Brazil chose not to adopt this approach in the cost-of-production analysis included in Brazil's oral statement. In that analysis, Brazil correctly used the statutory maximum rate for counter-cyclical payments.

even more substantial, biases result from the flawed econometric parameters used by the model. These have been addressed in detail in the U.S. submissions.

33. Not only does the United States not accept the particular model used by Brazil and the parameters and assumptions that it utilizes, but the United States disagrees with Brazil regarding the question that the model aims to address. Brazil appears to assume that the question before the Panel is the “short-run” impact of “shocking” the system with complete elimination of the marketing loan and counter-cyclical payment programs.³¹ It is not. Under Article 6.3(c) the question is what, if any, degree of price suppression exists *presently* as a result of the marketing loan and counter-cyclical payments and whether this degree of price suppression is “significant.” To the extent a counterfactual assessment is undertaken, it is only to assess what the price equilibrium would be at present if marketing loan and counter-cyclical payments had been lower, different, or did not exist. The question is not what prices will look like in the short-run adjustment period if the marketing loan and counter-cyclical payments are suddenly eliminated. Indeed, Members are not even required to eliminate measures found to be actionable subsidies; they are given a choice between “withdrawing” the subsidy or removing its adverse effects. Thus, in addition to the fact that the economic literature supports a long-term assessment, Brazil’s argument that it is necessary to look at the short-run effects of total elimination of the programs is incorrect as a matter of textual interpretation.

34. The total effect of all of these flaws in Brazil’s model is to grossly overstate any possible effects of the marketing loan and counter-cyclical payments. The United States demonstrated that without changing the structural flaws in the model, but simply re-calibrating the “key elasticities” and some other basic assumptions to reflect FAPRI and other well-established parameters – many of which Brazil acknowledged and used in the original proceeding – the effects estimated by Brazil’s new model decline sharply. *Complete* removal of the marketing loan and counter-cyclical payment programs results in world prices increasing by only 1.41 percent over baseline levels over the period MY 2002-2005 and 0.96 percent over the period MY 2006-2008. Long-run values for supply and demand elasticities taken from the UNCTAD-FAO ATPSM model shows removal of marketing loans and counter-cyclical programs resulting in an increase in world prices of 2.26 percent over the period MY 2002-2005 and 1.52 percent over the period MY 2006-2008. *These dramatically lower price impacts result from only some very basic, preliminary adjustments to Dr. Sumner’s model.* More detailed analysis and re-calibration would reduce the price effects even more.

35. It is critical that the Panel understand the flaws in the Sumner II model and their significance to this dispute because Brazil has submitted virtually no valid empirical evidence to

³¹ See e.g., Brazil First Written Submission, Annex I, paras. 28-29. Brazil’s economist attempts to justify, for example, the use of an unrealistic and disproportionately small rest-of-world supply elasticity on the basis that Brazil is seeking to assess the short-run effects of “the shock of removing U.S. cotton subsidies.” See Brazil First Written Submission, Annex I, para. 28. It is puzzling, therefore, that Brazil’s economist denied in the meeting with the Panel that Brazil had used such language or such an approach.

support its claims that the U.S. marketing loan and counter-cyclical payment programs are causing “present” significant price suppression. Rather, Brazil’s claim depends, critically, on the new econometric modeling conducted for purposes this dispute. The fact that even this econometric modeling is fundamentally flawed confirms that Brazil has no basis for its claims.

- b. In its First Written Submission and Rebuttal Submission, the United States uses the same value of 1 that Brazil adopts for the coupling factor assigned to marketing loan payments. Does this imply an acceptance by the United States that, by design, marketing loan payments provide a one-for-one incentive to upland cotton production?*

36. The United States does not agree with the characterization that marketing loan payments provide a “one-for-one incentive to production.” This may be understood to suggest that every dollar of marketing loan expenditures in a particular year can be assigned a production effect, which is not the case. As the United States has argued, whether or not the marketing loan creates any incentive to produce depends upon the expected prices that exist at planting time. Even Brazil, through its economic model, accepts – and ostensibly attempts to implement – this principle in this proceeding.³²

37. Nonetheless, the fact that a coupling factor of 1 is attributed to marketing loan payments means that a dollar anticipated under the marketing loan program is expected to have the same effect in respect of production as a dollar anticipated in market revenue. As payments are made on a per-unit basis with respect to upland cotton that is ultimately produced, a common modeling convention is to assume a coupling factor of 1 for the marketing loan program. The United States has not disputed the use of this coupling factor by Brazil in this proceeding.

- c. In its First Written Submission and Rebuttal Submission, the United States used a non-zero value of 0.25 (not much lower from the 0.4 that Brazil adopts) for the coupling factor assigned to counter-cyclical payments. Does this imply an acceptance by the United States that, by design, counter-cyclical payments are partially tied to upland cotton production, and of a magnitude (25 cents to a dollar of counter-cyclical payments) not very far from Brazil’s own estimate (of 40 cents to a dollar of counter-cyclical payments)?*

38. No. 0.25 percent was the coupling factor used in the FAPRI model, which was originally relied upon by Brazil itself and was lauded by Brazil as follows:

The FAPRI model has been widely used for policy analysis in the United States

³² 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, paras. 17-18.

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 program impacts.³³

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.³⁴

39. FAPRI assumes a 0.25 coupling factor for counter-cyclical payments on the following basis:

Because CCPs are made on a fixed base, they can be considered at least partially decoupled from production decisions (thus their inclusion in the decoupled payment term in the area equations). However, CCPs do depend on prices, and risk-averse producers may have a positive supply response to the price insurance offered by the program. The 0.25 parameter is based on analyst judgment, reflecting the notion that the crop-specific effect of CCPs on production is likely to be positive, but modest.³⁵

40. The United States adopted the FAPRI coupling factor because of Brazil’s express acknowledgment of the expertise and reputation of FAPRI researchers in assessing “likely program impacts” and “in answering the kind of ‘but for’ questions faced by this Panel.”³⁶ But the United States considers that this coupling factor is high. In fact, the empirical research supports a lower coupling factor, closer to zero. For example, the United States has discussed a 2007 study by Lin & Dismukes in which the authors examined the following question: “[g]iven the market price scenario for major field crops [corn, wheat, and soybeans] perceived by producers at planting decision times, how would CCPs have affected plantings of 2005 major

³³ Brazil Further Submission, para. 214.

³⁴ Answers of Brazil to Questions from the Panel After 2nd Meeting, paras. 21-24 (22 December 2003).

³⁵ Westhoff, Patrick, Scott Brown and Chad Hart. “When Point Estimates Miss the Point: Stochastic Modeling of WTO Restrictions” FAPRI Policy Working Paper #01-05, December 2005, page 6 (Exhibit US-58).

³⁶ Answers of Brazil to Questions from the Panel After 2nd Meeting, paras. 21-24 (22 December 2003).

field crops in the North Central region.”³⁷ The authors 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%”³⁸

41. Similarly, the United States discussed a 2005 study by Goodwin & Mishra reported the results of a survey of farmers asking them to rate the factors important to their acreage decisions on a 5-point scale ranging from “not at all important” to “very important.”³⁹ The study finds that almost half of farmers surveyed (44 percent) – in a nationwide survey comprising about 4,125 observations – indicated that counter-cyclical payments were strongly “not at all important” to their acreage decisions. The other substantial percentage (43 percent) indicated either ambivalence (that counter-cyclical payments were “neither important or unimportant”) or that counter-cyclical payments were “unimportant” to their acreage decisions. This too confirms that counter-cyclical payments have minimal effects on production.

42. Although these studies and the others discussed in the U.S. submissions support a coupling factor much lower than 0.25, the United States has used that factor as a conservative measure and to illustrate the grossly exaggerated nature of Brazil’s modeling results. Brazil does not even use this 0.25 factor, which may be too high in and of itself. Rather, Brazil has used a much higher 0.40 factor that finds *no support* in empirical research or the economic literature. The 0.40 factor is not – in the U.S. view – close to the 0.25 factor used by FAPRI, as suggested in the question above. Indeed, Brazil’s coupling factor is more than 60 percent higher than the FAPRI factor, and it is without any legitimate basis in the economic literature or in empirical analysis. This, once again, confirms that the econometric modeling upon which much of Brazil’s case depends is flawed and not capable of supporting Brazil’s claims of significant price suppression.

E. EXPORT CREDIT GUARANTEES

1. Permissibility of an *a contrario* interpretation of item (j) of the Illustrative List

Questions to the United States

33. *Please discuss whether (and if so, how) the panel rulings in Korea – Vessels and Brazil - Aircraft (21.5) (I and II) affect the United States' approach to the interpretation of the*

³⁷ 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*, (Spring 2007), p. 81 (Exhibit US-85). See U.S. Rebuttal Submission, para. 229-234.

³⁸ 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).

³⁹ Goodwin, B. and A. Mishra. “Another Look at Decoupling: Additional Evidence on the Production Effects of Direct Payments.” *American Journal of Agricultural Economics* 87(5):1200-1210, 2005 (Exhibit US-41).

relationship between item (j) of the Illustrative List and Article 3.1(a) of the SCM Agreement.

43. As the Panel’s questions 33 and 34 both deal with the question of the proper interpretation of item (j) and Articles 1.1 and 3.1(a) of the *SCM Agreement*, and the relationship between those provisions, the United States addresses the questions together here.

44. At the outset, the United States recalls that the issue is whether item (j) of the Illustrative List demonstrates definitively how the general definitional elements in Articles 1 and 3.1(a) of the *SCM Agreement* apply in the case of the export credit guarantees. The text of the *SCM Agreement* confirms that it does. As the United States has explained,⁴⁰ item(j) “illustrates” the application of the general definition of “export subsidy” set out in Articles 1.1 and 3.1(a) to the specific context of export credit guarantees. “Illustrate,” means, *inter alia*, “shed light on, light up, illumine” and “make clear, elucidate, explain; esp. clarify or support using examples, give an example or illustration of, exemplify.”⁴¹ According to the ordinary meaning of the term “illustrate,” therefore, item (j) “makes clear” how the Article 1/3.1(a) definition applies in respect of each particular type of measure set out in the Illustrate List. It clarifies which export credit guarantees *do* provide export subsidies within the meaning of Article 1.1 and 3.1(a) and those that *do not*. The distinguishing factor – under item (j) – is whether the premium rates charged under the export credit guarantee program are inadequate to cover the long-term operating costs and losses of the program.

45. This interpretation of item (j) is supported not only by the ordinary meaning of the term “illustrate” but also by other provisions relating to the relationship between item (j) and the general definition in Articles 1.1 and 3.1(a) of the *SCM Agreement*. Thus, for example, Article 1 of the *SCM Agreement* provides that “[f]or the purpose of this Agreement, a subsidy shall be deemed to exist if . . . there is a financial contribution by a government . . . and a benefit is thereby conferred.”⁴² Moreover, Article 3.1(a) of the *SCM Agreement* expressly includes as subsidies “within the meaning of Article 1” any “subsidies contingent . . . upon export performance, *including those illustrated in Annex I.*”⁴³ It is, therefore, plain that item (j) applies the general definition of “export subsidy” set out in 1.1 and 3.1(a) of the *SCM Agreement*. It does not establish any second or alternative standards for “export subsidy” as Brazil has argued in this dispute.

A. *Footnote 5 of the SCM Agreement is entirely consistent with the U.S. interpretation*

46. Brazil argues, nonetheless, that footnote 5 of the *SCM Agreement* somehow erases all of

⁴⁰ U.S. First Written Submission, paras. 62-70

⁴¹ *The New Shorter Oxford English Dictionary* at 1311, Volume 1, (1993 Edition) (Exhibit US-24).

⁴² Emphasis added.

⁴³ Emphasis added.

the textual guidance discussed above. Specifically, Brazil argues that the U.S. approach would require what Brazil terms an “*a contrario*” reading of item (j) and, according to Brazil, such an interpretation is “definitively foreclose[d]” by footnote 5.⁴⁴ This argument does not withstand scrutiny, as Brazil has itself recognized in other disputes.⁴⁵

47. Footnote 5 – which modifies the prohibition on export subsidies contained in Article 3.1(a) – provides that “[m]easures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.” As such, Footnote 5 confirms two things – first, that Annex I is relevant in determining whether or not measures constitute “export subsidies” and, second, that where Annex I “refer[s] to” measures as not constituting export subsidies, no further analysis is necessary to determine whether the measures are prohibited subsidies under Article 3.1(a).

48. Brazil’s argument – for purposes of this dispute – is that, under footnote 5, item (j) can only be understood to provide dispositive clarification as to what constitutes an “export subsidy” in the case of export credit guarantees if it were to include an “affirmative statement” about the conditions under which export subsidies do *not* exist.⁴⁶ However, footnote 5 says nothing about an “affirmative statement.” Nor is an “affirmative statement” required under the ordinary meaning of the term “refer.” Indeed, “refer” means, *inter alia*, “to make reference or allusion or direct the attention to something.”⁴⁷ And “allusion,” in turn, means “[a] covert, passing, or indirect reference (to); *popularly* any reference to.”⁴⁸ It is, thus, clear that measures “referred to” in Annex I as not constituting export subsidies can include *both* measures that are *expressly* referred to as not constituting export subsidies (though there is actually only one such measure, described in the second paragraph of item (k))⁴⁹ and measures that are *implicitly* referred to as not constituting export subsidies, such as the provision of export credit guarantee programs at premium rates which *are* adequate to cover the long-term operating costs and losses of the programs. Brazil confirmed to the Appellate Body in *Brazil – Aircraft (21.5)* that item (j) contains just such an implicit reference:

Footnote 5 of the SCM Agreement specifies that Annex I contains not only a list of prohibited export subsidies, but also measures that do not constitute export

⁴⁴ Brazil Rebuttal Submission, para.563.

⁴⁵ See e.g., *Brazil – Aircraft (AB)*, paras. 14 and 19.

⁴⁶ See Brazil Rebuttal Submission, para. 465 and 467.

⁴⁷ See *The New Shorter Oxford English Dictionary* at 2520, Volume 1, (1993 Edition) (Exhibit US-116).

⁴⁸ See *The New Shorter Oxford English Dictionary* at 57, Volume 1, (1993 Edition) (Exhibit US-117) (emphasis in original).

⁴⁹ The second paragraph of item (k) provides that “if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.”

subsidies, such as in items (b), (h), (i) and (k). Comparing the structure of item (j) and item (k), the two provisions share a similar structure in that they define practices that constitute prohibited export subsidies with *language that limits the scope of the definition*. In the case of item (j) regarding export credit guarantee or insurance programs, the limiting language is “premium rates which are inadequate to cover the long-term operating costs and losses of the programs.”⁵⁰

49. Because Brazil ultimately argued that its legal theory in that dispute was grounded “on an ‘a contrario’ interpretation of the text of the first paragraph of item (k),” and not footnote 5, the Appellate Body did not end up interpreting that provision. Nonetheless, the Appellate Body did indicate that it accepted Brazil’s argument that the first paragraph of item (k) could be read *a contrario* to determine when measures are “justified.”⁵¹ That result is equally appropriate here.

50. There are also other factors that undermine Brazil’s interpretation of footnote 5 of the *SCM Agreement*. For example, Brazil’s interpretation is undermined by the negotiating history of the provision. The negotiating history shows that Members agreed to delete from an earlier draft language that would have required an *express* reference in order for the provisions of the footnote to apply. Specifically, footnote 5 first appeared in the third draft agreement prepared by the Chairman of the Negotiating Group on Subsidies.⁵² In that draft, footnote 5 read as follows: “[m]embers *expressly* referred to in the Illustrative List as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.”⁵³ The word “expressly” was not retained, however. In the very next draft, the word was deleted from the footnote,⁵⁴ demonstrating that the drafters intended to expand the scope of footnote 5 beyond those measures containing an “affirmative statement” that particular measures do not constitute export subsidies.

51. The U.S. interpretation of item (j) and the relationship between that provision and the general definition of “export subsidy” in Article 1.1 and 3.1(a) is not only textually sound and consistent with the negotiating history, it is the only logical interpretation.⁵⁵ There is no reason

⁵⁰ *Brazil – Aircraft (AB)*, para. 19 (emphasis added).

⁵¹ *Brazil – Aircraft (21.5) (AB)*, para. 80 (arguing that, if Brazil had made the correct factual showing under paragraph 1, “we would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List.”)

⁵² MTN.GNG/NG10/W/38/Rev. 2 (2 November 1990).

⁵³ MTN.GNG/NG10/W/38/Rev. 2 (2 November 1990) (emphasis added).

⁵⁴ MTN.GNG/NG10/W/38/Rev. 3 (6 November 1990).

⁵⁵ The United States notes, in this regard, the principle of *generalia specialibus non derogant*, which holds that “a matter governed by a specific provision, dealing with it as such, is thereby taken out of the scope of the general provision dealing with the category of subject to which that matter belongs, and which otherwise might govern it as part of that category.” Gerald Fitzmaurice, *The Law and Procedure of the Court of International Justice, 1951-4: Treaty Interpretation and Other Treaty Points*, 1957 British Y.B. Int’l L. 236; see also *Case Concerning Payment of Serbian Loans*, P.C.I.J. Ser. A, No. 20/21, page 30; and Grotius, *De Iure Belli Ac Pacis*, Lib.

why drafters would have gone to the trouble of crafting in the Illustrative List specific and detailed rules for particular types of measures, such as those for export credit guarantees in item (j), if those rules could be ignored in favor of more general rules elsewhere in the *SCM Agreement*.

52. By contrast, Brazil’s interpretation ignores the textual guidance in the *SCM Agreement* regarding the relationship between Articles 1.1/3.1(a) and item (j), but it would – if applied – nullify or render redundant a number of provisions of the *SCM Agreement*. For example, under Brazil’s interpretation, footnote 5 would become largely redundant. Specifically, Brazil’s argument assumes that footnote 5 only exempts from the prohibition on export subsidies those measures that are *expressly* referred to in the Illustrative List as not constituting export subsidies. However, to the extent that measures *are* expressly referred to as not constituting export subsidies in the Illustrative List, they are not subject to the prohibition on “export subsidies” in any event. In other words, the language of Articles 1, 3.1(a), and the Illustrative List would be sufficiently clear – without footnote 5 – to establish that measures expressly identified as not constituting export subsidies will not be subject to prohibitions on export subsidies. If – as Brazil argues – the point of footnote 5 is simply to reiterate that point, footnote 5 would serve a purely redundant function. Such an interpretation is disfavored under customary rules of treaty interpretation. As the Appellate Body has explained, “[a]n interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.”⁵⁶

53. Similarly, Brazil’s interpretation would call into question the need for item (d) of the Illustrative List.⁵⁷ Brazil contends that Articles 1 and 3.1(a) provide an independent basis to challenge as an export subsidy *any* export-contingent financial contribution that places the recipient in a better position than in the market. Item (d), however, establishes a two part test that requires *both* a showing of preferential treatment of products for export vis-a-vis products for domestic consumption *and*, in the case of goods, a showing that goods are being provided on terms and conditions more favorable than those available in the market. In the case of goods, the showing that would have to be made to satisfy the second part of the two-part test appears to be exactly the same showing that, under Brazil’s interpretation, would – alone – be sufficient to demonstrate the existence of an export subsidy under Articles 1 and 3.1(a) of the *SCM Agreement*. Why would any rational complaining party choose to use the two-part test in item (d) if it could simply demonstrate the existence of an export subsidy under Articles 1.1 and

II, Cap. XVI, XXIX (Classics, 3, 1929). While the United States does not suggest that this principle applies directly here, the United States finds the logic of the principle compelling and notes that the U.S. interpretation of Articles 1, 3.1(a), and item (j), discussed above, is consistent with this logic.

⁵⁶ *United States – Gasoline (AB)*, p. 23.

⁵⁷ Item (d) of the Illustrative List identifies as an export subsidy “[t]he provision by governments or their agencies . . . of imported or domestic products or services for use in the production of exported goods, on terms or conditions more favourable than for provision of like or directly competitive products or services for use in the production of goods for domestic consumption, *if (in the case of products) such terms or conditions are more favourable than those commercially available on world markets to their exporters.*” (Emphasis added)

3.1(a) on the basis of one of the two parts? Again, Brazil’s interpretation simply leads to manifestly absurd results.

54. For the reasons above, the more plausible textual interpretation is that there is only one definition of “export subsidy” in the *SCM Agreement* – its elements are laid out in Articles 1.1 and 3.1(a) – and item (j) of the Illustrative List controls on the question of how that definition applies in the case of export credit guarantees.

B. The panel reports in Korea – Ships and Brazil – Aircraft do not detract from the proper interpretation of item (j)

55. The panel reports in *Brazil – Aircraft* and *Korea – Ships* do not detract from the proper interpretation of item (j) of the Illustrative List discussed above. For one, all of these reports consider the relevant question to be whether the items of the Illustrative List are available as an “affirmative defense;” in other words, whether measures found to be “export subsidies” under the general definitional elements set out in Articles 1.1 and 3.1(a) can nonetheless be excused if the conditions in the Illustrative List are satisfied.⁵⁸ The United States does not consider this to be the relevant question here. Indeed, the United States has never argued that item (j) constitutes an “affirmative defense.” Rather, as explained above, the United States view is that item (j) “clarifies” dispositively how the elements of “export subsidy” in Articles 1.1 and 3.1(a) apply in the case of export credit guarantees. The suggestion that item (j) provides an “affirmative defense” suggests that the standard contained therein is different from the standard in Articles 1.1 and 3.1(a); an argument that Brazil – not the United States – has made in this proceeding. This is an argument with which the United States disagrees. And, in that limited sense, the U.S. position is consistent with that of the panels in *Brazil – Aircraft* and *Korea – Ships*.

56. The United States does not, however, consider that the panels in *Brazil – Aircraft* and *Korea – Ships* properly interpreted footnote 5 of the *SCM Agreement*. In particular, neither panel considered the full breadth of the ordinary meaning of the term “referred to” in footnote 5; namely, the fact that the term may well encompass both measures that are *expressly* referred to as not constituting export subsidies and measures that are *implicitly* referred to as not constituting export subsidies. Indeed, in *Korea – Ships*, even the European Communities – the complaining party in that dispute – agreed that “in law item (j) could be read to include a proviso, and thereby ‘refer’ to export credit guarantees as not constituting export subsidies to the

⁵⁸ See e.g., *Brazil – Aircraft (21.5 II – Canada)*, paras. 5.272 ([t]he question before us is whether a measure which has been found to be a subsidy contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement* is nevertheless not prohibited if it is a ‘payment’ which is not ‘used to secure a material advantage in the field of export credit terms’ within the meaning of the first paragraph of item (k).”) and 5.276 (“[w]e have concluded that . . . the first paragraph of item (k) cannot, as a legal matter, be invoked as an affirmative defence.”); *Korea – Ships (21.5 – EC)*, para. 7.193 (“[i]n light of our findings that certain [guarantees] constitute subsidies, and that such subsidies are contingent on export performance, we will be required to find that such [guarantees] are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement* unless we uphold Korea’s claim that they benefit from a safe haven pursuant to item (j) of the Illustrative List.”)

extent that the premium rates cover the long-term operating costs and losses of the programmes.”⁵⁹ This is the same point made by Brazil in the *Brazil – Aircraft* dispute about the implicit reference in item (j) to measures that do not constitute prohibited export subsidies:

Footnote 5 of the SCM Agreement specifies that Annex I contains not only a list of prohibited export subsidies, but also measures that do not constitute export subsidies, such as in items (b), (h), (i) and (k). Comparing the structure of item (j) and item (k), the two provisions share a similar structure in that they define practices that constitute prohibited export subsidies with *language that limits the scope of the definition*. In the case of item (j) regarding export credit guarantee or insurance programs, the limiting language is “premium rates which are inadequate to cover the long-term operating costs and losses of the programs.”⁶⁰

57. The United States agrees with Brazil’s – and the European Communities’ – assessment of item (j) and the implicit reference therein to the measures that do not constitute prohibited export subsidies.

58. The United States also considers that the panels in *Brazil – Aircraft* and *Korea – Ships* failed to give due consideration to the Appellate Body’s analysis in *Brazil – Aircraft* in which it indicated that it accepted Brazil’s argument that the first paragraph of item (k) can be read in an *a contrario* fashion.⁶¹ Brazil concedes that the Appellate Body made this finding but argues that such an *a contrario* reading must be limited to the first paragraph in item (k).⁶² There is no legitimate or principled basis for that assertion and, in fact, Brazil expressly argued in the *Brazil – Aircraft* dispute that “[t]here is nothing in the text of either item (j) or (k) to support the conclusion that an *a contrario* argument is permitted in one but not the other.”⁶³ If item (k) can be read *a contrario* – and Brazil has conceded that it can – then item (j) can be read *a contrario* as well.

34. ***Does the United States considers that item (j) of the Illustrative List is one of the provisions to which footnote 5 of the SCM Agreement applies? What impact does this have for the United States' interpretation of the interaction between item (j) of the Illustrative List and Article 3.1(a) of the SCM Agreement?***

⁵⁹ *Korea – Ships (21.5 – EC)*, para. 7.1299. The EC simply “reject[ed] the application of item (j) on the facts of [that] case.” *Korea – Ships (21.5 – EC)*, para. 7.1299.

⁶⁰ *Brazil – Aircraft (AB)*, para. 19 (emphasis added).

⁶¹ *Brazil – Aircraft (21.5) (AB)*, para. 80 (arguing that, if Brazil had made the correct factual showing under paragraph 1, “we would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List.”)

⁶² See e.g., Brazil Oral Statement, para. 235 (“Brazil’s position is not inconsistent with the Appellate Body’s dicta, in *Brazil – Aircraft (Article 21.5 proceeding)*, that it ‘would have been prepared,’ in effect, to accept an *a contrario* reading of the first paragraph of item (k) of the Illustrative List.”)

⁶³ See *Brazil – Aircraft (21.5 – Canada)*, para. 6.59, n. 58 (quoting Oral Statement of Brazil at the Meeting of the Panel, para. 34) (underlining added).

59. Please see response to Question 33 above.

35. *How does the United States address Brazil's argument that permitting an a contrario reading of item (j) would prevent a Member from challenging specific export credit guarantees or cohorts of such guarantees granted by a Member, as opposed to export credit guarantee programs [see paragraphs 472 ff. of Brazil's Rebuttal]*

60. Brazil appears to confuse the question of the measures that may be challenged as providing prohibited export subsidies and the standard for whether the measures are prohibited export subsidies in item (j). WTO Members agreed, in item(j), that a prohibited export subsidy would exist when premia under an export credit guarantee program are not adequate to cover the long-term operating costs and losses of the program. This is the test to apply in considering whether export credit guarantees are prohibited export subsidies or not. This test applies regardless of whether a Member chooses to challenge all guarantees under a program or particular guarantees. Indeed, the United States recalls, in this regard, that Brazil only successfully challenged those export credit guarantees in respect of exports of unscheduled products and rice in the original proceeding. Therefore, even the facts of this dispute undermine Brazil's assertion that a complaining Member could only challenge an export credit guarantee program as a whole, not any subset of guarantees. A complaining Member may challenge whatever guarantees it chooses, but to establish whether or not they are prohibited export subsidies, the relevant consideration is whether the program is being operated in such a way that the premiums collected are inadequate to cover the long-term costs and losses of the program.

61. Brazil suggests that the U.S. interpretation is "not compatible with Article 1.1(a)(1)(i)" because that provision identifies loan *guarantees* and not export credit guarantee *programs* as financial contributions.⁶⁴ Here, again, Brazil's argument incorrectly conflates the measures that can be challenged as conferring export subsidies and the standard for whether those measures do, in fact, do so. The fact that loan guarantees – or more specifically, export credit guarantees – constitute financial contributions does not change the analysis of the conditions under which those guarantees may be deemed to be prohibited export subsidies for purposes of the *SCM Agreement*.⁶⁵

Questions to Brazil

36. *What is Brazil's reading of the Appellate Body's statement in paragraph 80 of its Report in Brazil – Aircraft (21.5) that it "... would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List"? Should the Panel take this statement into account in deciding whether item (j) can be interpreted a contrario?*

⁶⁴ Rebuttal Submission of Brazil, para. 473

⁶⁵ The same flaw is apparent in Brazil's arguments relating to Article 3.1(a) of the *SCM Agreement*.

2. Outstanding export credit guarantees / measures taken to comply

Questions to Brazil

37. *Brazil relies on the panel and Appellate Body Reports in Brazil – Aircraft (21.5) in support of its arguments that the United States has not "withdrawn" the subsidy and is, "[a]t a minimum... prohibited from making 'payments' on claims against" any outstanding export credit guarantees [Paragraph 397 of Brazil's Rebuttal Submission]. Please discuss how the findings of the panel and Appellate Body in that case apply to the provision of the US export credit guarantees at issue.*

3. “Benefit” under Articles 1 and 3.1(a) of the SCM Agreement

Question to the United States

38. *Please discuss the relevance of the original panel's characterization, in paragraph 6.31 of its report, of Brazil's reliance on Articles 1 and 3.1(a) of the SCM Agreement as "not a separate claim, but merely another argument" on the United States' view in this respect (and notably the United States statement, in paragraph 67 of its First Written Submission, that "... the panel in the original proceeding specifically declined to address Brazil's alleged 'claim' under Articles 1 and 3.1(a) of the SCM Agreement")?*

62. As reflected in the U.S. statement quoted by the Panel above, Brazil has erroneously alleged both in this proceeding and in the original proceeding that it presents separate “claims” under item (j) of the Illustrative List on the one hand and Articles 1 and 3.1(a) on the other, regarding whether the export credit guarantees at issue are prohibited export subsidies. The original panel disagreed. Instead, the original panel found that “Brazil's allegation invoking the elements of Articles 1 and 3.1(a) of the SCM Agreement is not a separate claim, but merely another argument, on a different factual basis, as to how the United States export credit guarantee programmes would meet the definition of an export subsidy in Article 3.1(a) of the SCM Agreement.”⁶⁶

63. The original panel then went on to *decline* to address what Brazil had alleged was its “claim” – and what the panel properly re-classified as an “argument” – under Articles 1 and 3.1(a) of the *SCM Agreement*. The original panel explained that “[g]iven our finding in paragraphs 7.946-7.948 [regarding item (j)], we do not believe that it is necessary to address Brazil's additional arguments about how the Article 3.1(a) definitional elements would be fulfilled on another factual basis in order to resolve this dispute.”⁶⁷ In other words, it was the original panel’s view that this dispute could and should be resolved through implementation of the recommendations and rulings of the DSB based on the factual findings under item (j).

⁶⁶ *Upland Cotton (Panel)*, para. 6.31.

⁶⁷ *Upland Cotton (Panel)*, para. 6.31.

64. The same views were shared by the Appellate Body, which rejected Brazil's arguments that the "[original] Panel's failure 'to examine Brazil's claim [or, argument, according to the original panel] . . . leaves open a dispute and creates uncertainty concerning the scope of the United States' obligations, and the consistency of its existing measures with those obligations.'"⁶⁸ According to the Appellate Body, "[t]he Panel found that the United States' export credit guarantee programs constitute a prohibited export subsidy under Article 3.1(a) because they do not meet the criteria in item (j) of the Illustrative List of Export Subsidies. This finding, in our view, is sufficient to resolve the matter."⁶⁹

65. The United States has implemented the DSB's recommendations and rulings relating to export credit guarantees; in particular, paying close attention to the guidance provided by the original panel regarding the standard in item (j) of the *SCM Agreement*. As the United States has shown, export credit guarantees under the GSM 102 program are provided at premium rates that are more than adequate to cover the long-term costs and losses of the program. The panel and Appellate Body properly found that this inquiry resolved the dispute in the original proceeding. The same result is appropriate here as well for all the reasons discussed above.

Questions to Brazil

39. *The Panel understands the United States to argue that it has relied on the Panel's findings under item (j) to implement the DSB recommendations with respect to export credit guarantees. How would this, in Brazil's view, affect the compliance panel's role in this proceeding? Was the United States also expected to implement changes in order to make its export credit guarantee programmes consistent with article 1.1 and 3.1(a) of the SCM Agreement, even though there were no findings of the original panel in this respect?*
40. *In paragraph 410 of its Rebuttal, Brazil refers to paragraph 7.398 of the Panel Report in Canada – Aircraft II. The Panel notes, however, that in the same paragraph, the Canada -- Aircraft II panel also indicated that there would be a "'benefit' when the cost-saving for a Bombardier customer for securing a loan with an IQ loan guarantee is not offset by IQ's fees". Please discuss, in light of this sentence, whether the Panel should read the Canada – Aircraft II panel as having rejected the "total cost of funds" as the proper benchmark under Article 14(c) of the SCM Agreement.*

Questions to both parties

41. *What are the relevant considerations to guide the Panel in the selection of a market benchmark in this case?:*
- a. *That the institution that provides the product is, on the whole, or on a program or product-specific basis, profitable? If so, is "any" profit sufficient to qualify an*

⁶⁸ *Upland Cotton (AB)*, para. 727.

⁶⁹ *Upland Cotton (AB)*, para. 732.

institution/ product/program as a relevant "market benchmark" or must the institution/product/program achieve a certain level of profit? Must the Panel conduct an examination of the level of profit achieved by commercial or private actors operating in the field?

- b. Are the institution/program/products' stated goals relevant in assessing whether they can be used as a "market benchmark"?*
- c. Is the "governance" of the institution relevant?*
- d. What other factors are relevant?*

66. The issue of what is an appropriate benchmark cannot be addressed in the abstract. It is necessary to determine, first, what the text of the *SCM Agreement* provides about the particular benchmark to be selected in the circumstances of the particular case. If the question presented is whether export credit guarantees provided prohibited export subsidies within the meaning of the *SCM Agreement*, the precise measure by which this is determined is set out in item (j) of the Illustrative List in Annex I. That provision clarifies that the relevant consideration is the long-term operating costs and losses of a program. Where the premiums collected are inadequate to cover the long-term operating costs and losses of a program, the export credit guarantees confer prohibited export subsidies. Where the premiums collected are *not* inadequate to cover the long-term operating costs and losses of a program, the export credit guarantees do *not* confer prohibited export subsidies.

67. Brazil argues that Article 1.1 and 3.1(a) establish a second, alternative benchmark for prohibited export subsidies. For the reasons discussed above, the United States strongly disagrees. Nonetheless, even under Brazil's (incorrect) argument, it is the text of the *SCM Agreement* from which one can draw guidance as to the particular "benchmark" to be used. Specifically, Article 14 of the *SCM Agreement* interprets and applies the definition of "benefit" set out in Article 1.1 and has been relied upon by the Appellate Body as important contextual guidance in interpreting "benefit" for purposes of Article 1.1 of the *SCM Agreement*.⁷⁰ Indeed, it has even been invoked by Brazil to justify its arguments in this proceeding.⁷¹ Article 14 specifically identifies the different benchmarks that are relevant with respect to different types of government-provided measures.

68. Article 14(c) deals with loan guarantees and provides that the proper comparison – in assessing whether a benefit has been conferred (and the amount thereof) – is 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." Under Article 14(c), the "market benchmark" that must be sought is, thus, a

⁷⁰ *Canada – Aircraft (AB)*, para. 155.

⁷¹ Brazil First Written Submission, paras. 371-375

commercially-available loan that could be obtained without the government guarantee. A “benefit” is deemed to be conferred pursuant to Article 14(c) where there is a positive 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.”

69. The question, then, is how to identify a “comparable commercial loan” within the meaning of Article 14(c). As the text indicates, the focus of the analysis is on the loan itself – it is the loan that must be “commercial” and “comparable.” The characteristics of the entity providing the loan are not necessarily determinative as to whether or not the loan itself is “commercial” and, therefore, appropriate for use as a benchmark under Article 14(c). While these characteristics may well be relevant considerations in assessing whether the loan itself is a “commercial” loan in a particular case, factors such as the overall profitability of a particular institution or its stated goals, or the manner of its governance, may not necessarily – and in all cases – correlate to whether the loan is “commercial.” In short, the question of what constitutes an appropriate “market benchmark” – a “comparable commercial loan” under Article 14(c) – is a fact-specific question that looks to the (non-government guaranteed) loans that a particular obligor is actually able to obtain on the market.

70. Although Brazil bears the burden of proof, it has not even attempted to make the kind of particularized showing contemplated under Article 14(c) of the *SCM Agreement*; it has not shown that the overall cost, including fees, of each of the loans guaranteed by the government is less than overall cost of a comparable commercial loan that could actually be obtained without a government guarantee. Instead, Brazil has relied on sweeping and erroneous assertions that obligors on loans guaranteed under the GSM 102 program can *never* obtain any other financing of any kind and that the United States could *never* provide an export credit guarantee without also providing an export subsidy. These arguments simply do not square with the evidence submitted by the United States showing that such obligors are in fact able to obtain financing even without GSM 102 guarantees and on terms better than those available *with* GSM 102 guarantees. The declining level of use of the GSM 102 program in recent years is even further evidence of this.

4. Claims under item (j) of the Illustrative List

Question to the United States

42. *How does the United States address Brazil's arguments with respect to the MPRs under the OECD Arrangement?*

71. There is no merit to Brazil’s argument that GSM 102 export credit guarantees should be deemed to fail to meet the standard in item (j) of the Illustrative List because – allegedly – “the fees for GSM 102 [export credit guarantees] fall below the minimum premium rates (‘MPRs’) provided in the Organization for Economic Co-operation and Development’s (‘OECD’)”

Arrangement on Officially Supported Export Credits . . .”⁷² First, item (j) of the *SCM Agreement* clearly provides that the proper comparison is between the “premium rates” charged under the particular programs and “the long-term operating costs and losses” of the programs themselves. The text of the *SCM Agreement* does *not* provide that the Arrangement on Officially Supported Export Credits sets the standard by which to assess whether export credit guarantees constitute export subsidies under item (j) of the *SCM Agreement*.

72. Indeed, this is in contrast to the very next item in the Illustrative List – item (k), dealing with export credits – which *does* expressly refer to such an Arrangement⁷³ and *does* provide that it establishes a basis for determining whether or not a measure constitutes a prohibited export subsidy. It is, therefore, clear that when the drafters intended that a separate undertaking establish a standard for assessing WTO-consistency, they knew precisely how to reflect this in the text. The fact that no such reference is found in item (j) is clear evidence that the OECD Arrangement does not establish the standard for the fees that ought to be charged for export credit guarantees in order to meet the standard set in item (j).

Question to Brazil

43. *What is Brazil's reaction to paragraph 25 of Japan's Third Party Submission?*

⁷² Brazil First Written Submission, para. 438.

⁷³ Item (k) refers to “an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members).” The Appellate Body explained in *Brazil – Aircraft* that “[t]he OECD Arrangement is an ‘international undertaking on official export credits’ that satisfies the requirements of the proviso in the second paragraph in item (k).”