

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

**(WT/DS267)**

**Rebuttal Submission of the United States of America**

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## I. Introduction and Overview

1. In this rebuttal submission, the United States demonstrates that the challenged U.S. measures are not in breach of the Peace Clause. Specifically, U.S. direct payments under the 2002 Act<sup>1</sup> and the expired production flexibility contract payments under the 1996 Act<sup>2</sup> conform fully to the provisions of Annex 2 of the *Agreement on Agriculture* and are, therefore, exempt from actions pursuant to Article 13(a)(ii). In addition, U.S. marketing loan payments, counter-cyclical payments, and Step 2 payments under the 2002 Act, U.S. marketing loan payments and Step 2 payments under the 1996 Act, crop insurance payments under the Agricultural Risk Protection Act of 2000, and market loss assistance payments (under various pieces of legislation) are exempt from actions pursuant to Article 13(b)(ii). The United States also provides further arguments and evidence demonstrating that Step 2 payments and U.S. export credit guarantees are not inconsistent with U.S. WTO obligations.

2. As this may be the last opportunity for the United States to present arguments with respect to Peace Clause issues before the Panel makes its preliminary findings, this submission focuses on key points of interpretation and those points on which the parties fundamentally disagree.

3. The Panel is well aware of the U.S. position that the comparison under the Peace Clause proviso in Article 13(b)(ii) must be made with respect to the support as “decided” by those measures. In the case of the challenged U.S. measures, the support was decided in terms of a rate; there was no decision on an amount of budgetary outlays. The amount of support decided during marketing year 1992 was 72.9 cents per pound of upland cotton; the amount of support granted for the 1999-2001 crops was only 51.92 cents per pound; and the amount of support that measures grant for the 2002 crop is only 52 cents per pound. Thus, in no marketing year from 1999 through 2002 have U.S. measures breached the Peace Clause.

4. Brazil has claimed that additional “decisions” by the United States during the 1992 marketing year to impose a 10 percent acreage reduction program and 15 percent “normal flex acres” reduced the level of support below 72.9 cents per pound. However, the 72.9 cents per pound rate of support most accurately expresses the revenue ensured by the United States to upland cotton producers. Even on the unrealistic assumption that these program elements reduced the level of support by 10 and 15 percent, respectively (that is, the maximum effect these program elements could have had), the 1992 rate of support would still be 67.625 cents per

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<sup>1</sup> Farm Security and Rural Investment Act of 2002, Public Law 107-171, 116 Stat. 134 (May 13, 2002) (“2002 Act”) (Title I) (Exhibit US-1).

<sup>2</sup> Federal Agriculture Improvement Act of 1996, Public Law No. 104-127 (April 4, 1996) (“1996 Act”) (Title I) (Exhibit US-22).

pound,<sup>3</sup> well above the 51.92 cents per pound rate for marketing years 1999-2001 and the 52 cents per pound for marketing year 2002.

5. While the United States does not believe this is the correct approach under the Peace Clause, we also note that the result of the Peace Clause comparison is no different if one compares the support via an Aggregate Measurement of Support calculation. Using the price gap methodology (as provided under the Agriculture Agreement) for U.S. price-based deficiency payments and marketing loan payments, the upland cotton Aggregate Measurement of Support for these years is:

<b>U.S. Upland Cotton Aggregate Measurement of Support</b>	
<b>Marketing Year</b>	<b>AMS (U.S. \$, millions)</b>
1992	1,079
1999	717
2000	484
2001	264
2002 <sup>4</sup>	205

Again, in no marketing year from 1999 through 2002 have U.S. measures breached the Peace Clause.

6. Finally, in light of the attention given this issue at the first panel meeting, it may be of interest to the Panel that the analysis presented by Brazil's expert actually supports the United States, not Brazil. In this submission, we discuss conceptual, methodological, and data flaws in this analysis. Nonetheless, we note that, removing the non-product-specific support that Brazil erroneously tries to pass off as support to upland cotton, Brazil's own expert calculates the following:

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<sup>3</sup> The 67.7625 cents per pound figure is derived by reducing the maximum deficiency payment rate by 25 percent (10 percent + 15 percent) and adding this figure to the marketing loan rate. The maximum deficiency payment rate is the difference between the 72.9 cents per pound effective price for the deficiency payment and the 52.35 cents per pound marketing loan rate, or 20.55 cents per pound. Reduced by 25 percent, the adjusted deficiency payment rate would be 15.4125 cents per pound. Adding this figure to the marketing loan rate of 52.35 cents per pound gives an adjusted rate of support of 67.7625 cents per pound.

<sup>4</sup> As of the date of panel establishment, March 18, 2003.

Total Product-Specific Support (cents/lb.) in Sumner's per Unit Subsidy Rates Table <sup>5</sup>				
MY 1992	MY 1999	MY 2000	MY 2001	MY 2002
60.05	53.79	55.09	52.82	56.32

Again, in no marketing year from 1999 through 2002 have U.S. measures breached the Peace Clause.

7. Thus, whether gauged via the rate of support expressed by U.S. measures (as the United States believes is compelled by the Peace Clause), whether or not adjusted for the acreage reduction program and normal flex acres, *or* via the AMS for upland cotton (calculated through a price gap methodology), *or* via the calculations of Brazil's expert (limited to product-specific support), the result is exactly the same: in no marketing year from 1999 through 2002 have U.S. measures breached the Peace Clause.

## II. The Peace Clause Is a Threshold Issue for Brazil

8. The Peace Clause is a threshold issue for Brazil in this dispute. Unless Brazil demonstrates that U.S. measures are in breach of the Peace Clause and therefore not "exempt from actions based on" WTO subsidies provisions specified in the Peace Clause, Brazil cannot even advance those substantive claims with respect to challenged U.S. measures. This conclusion flows from the Peace Clause text, in particular, the phrase "exempt from actions."

9. "Exempt from actions" means just that and not "exempt from DSB actions" or "exempt from remedies." The ordinary meaning of those terms in the Peace Clause is "not exposed or subject to" the "taking of legal steps to establish a claim or obtain a remedy" or "a legal process or suit."<sup>6</sup> Relevant context supports this plain meaning as "action" in the dispute settlement context includes seeking consultations and requesting the establishment of a panel.<sup>7</sup> Thus, during the implementation period applicable to the Peace Clause, agricultural support measures are not exposed or subject to dispute settlement proceedings unless they can be shown not to conform to the criteria set out in the Peace Clause.

10. The United States has explained that reading "exempt from actions" as "exempt from DSB action" or "exempt from remedies" is untenable because it would rob the Peace Clause of any practical effect. That is, if the Peace Clause does not preclude the Panel from making

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<sup>5</sup> See Exhibit Bra-105 (Appendix table 1).

<sup>6</sup> See Initial Brief of the United States of America on the Question Posed by the Panel, para. 7 (June 5, 2003) (providing citations to dictionary definitions of "exempt" and "actions").

<sup>7</sup> See DSU Article 3.7 ("*Before bringing a case*, a Member shall exercise its judgement as to whether *action under these procedures* would be fruitful.") (emphasis added); DSU Article 4.5 ("*In the course of consultations* in accordance with the provisions of a covered agreement, *before resorting to further action under this Understanding*, Members should attempt to obtain satisfactory adjustment of the matter.") (emphasis added).

findings on Brazil's subsidies claims, then the DSB will adopt any Panel subsidies findings by negative consensus – that is, they will be adopted *unless Brazil itself agrees otherwise*. Thus, Brazil's reading of the Peace Clause would create a legal entitlement (to be "exempt from actions") contingent on the complaining party's acquiescence in the exercise of that right. Notably, neither Brazil nor any third party that has supported its Peace Clause interpretation has answered or even addressed this logical outcome of its interpretation.

11. Brazil has in this dispute sought to evade the protection provided by the Peace Clause by:
  - (1) trying to re-characterize U.S. "green box" measures as being "non-green box";
  - (2) interpreting "support to a specific commodity" as including "*non-product specific support*"; and
  - (3) arguing that a Member can only "decide" support in terms of the level of budgetary outlays and cannot decide support in any other manner.

However, each of these attempts by Brazil is fatally flawed.

### **III. U.S. Green Box Measures Conform Fully to the Provisions of Annex 2 and Are "Exempt from Actions" Based on Part III of the Subsidies Agreement and GATT 1994 Article XVI**

#### **A. Annex 2 Framework and Criteria**

12. Brazil has challenged two U.S. measures that conform fully to the provisions of Annex 2 of the Agreement on Agriculture: direct payments under the 2002 Act and the expired production flexibility contract payments under the 1996 Act. Both of these are green box measures "exempt from actions" pursuant to Article 13(a)(ii) of the Agreement on Agriculture.

13. Annex 2, paragraph 1, provides that domestic support measures "for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production." The second sentence of paragraph 1 goes on to explain that, "[a]ccordingly, all measures for which exemption is claimed shall conform to the . . . basic criteria" that (1) the support be provided through a publicly-funded government program not involving transfers from consumers and (2) the support not have the effect of providing price support to producers as well as (3) detailed "policy-specific criteria and conditions" as set out in the Annex. In this section, we explain certain issues relating to the interpretation of the fundamental requirement and certain policy-specific criteria contested by the parties.

## 1. The “Fundamental Requirement” of the First Sentence

14. As the United States has explained,<sup>8</sup> the text and context of this provision indicates that a measure shall be deemed to meet the “fundamental requirement” of the first sentence if it meets the basic criteria of the second sentence plus any applicable policy-specific criteria.

15. “Fundamental” means “[s]erving as the base or foundation” and “primary, original; from which others are derived.”<sup>9</sup> A “requirement” is “[s]omething called for or demanded.”<sup>10</sup> Thus, the “fundamental requirement” that measures for which exemption from reduction commitments under Article 6 is claimed must have “no, or at most minimal, trade-distorting effects or effects on production” is “something called for or demanded” “from which others are derived.”

16. As suggested by the use of the word “fundamental” (“from which others are derived”) and the structure of Annex 2 (that is, beginning the second sentence with the word “accordingly”),<sup>11</sup> compliance with the requirement (“something called for or demanded”) of the first sentence will be demonstrated by conforming to the basic criteria of the second sentence plus the applicable policy-specific criteria of paragraph 6 through 13. Relevant context supports this interpretation: Articles 6.1, 7.1, and 7.2 refer to measures which are not subject to reduction commitments because they qualify under “*the criteria* set out in Annex 2.” Annex 2 itself, in describing the policy-specific criteria that must be met under paragraphs 2 and 5, emphasizes that measures must meet the “*basic criteria* set out in paragraph 1” rather than the “fundamental requirement” of that paragraph.<sup>12</sup>

17. This reading of the text and context of Annex 2, paragraph 1, is also supported by the object and purpose of the Agreement on Agriculture. In order for Members to meet their binding reduction commitments on domestic support, they must be able to design green box measures with certainty that these measures will be exempt from such commitments. Assessing the conformity of a claimed green box measure against the “fundamental requirement” of the first sentence in isolation would be a difficult task for a Member and for a Panel. Therefore, Members agreed that if a measure “conform[s] to the . . . basic criteria” of the second sentence plus any applicable policy-specific criteria, it shall be deemed to have met the fundamental requirement of the first sentence of Annex 2.

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<sup>8</sup> See, e.g., U.S. Answer to Question 29 from the Panel; U.S. First Written Submission, paras. 49-54.

<sup>9</sup> *The New Shorter Oxford English Dictionary*, vol. 1, at 1042 (1993 ed.)

<sup>10</sup> *The New Shorter Oxford English Dictionary*, vol. 2, at 2557 (1993 ed.)

<sup>11</sup> The ordinary meaning of “accordingly” is “[i]n accordance with the logical premises; correspondingly.” *The New Shorter Oxford English Dictionary*, vol. 1, at 15 (third definition).

<sup>12</sup> See also Agreement on Agriculture Article 18.3 (requiring a Member to notify “details of the new or modified measure and its conformity with the *agreed criteria* as set out either in Article 6 or in Annex 2”) (emphasis added).



18. We note that Brazil has not followed its own interpretation of the first sentence of Annex 2, paragraph 1, through to its logical conclusion. If, as Brazil has argued, the first sentence is “fundamental” and has independent force, then presumably if a measure meets that “fundamental requirement,” it will be deemed to be green box, irrespective of whether it meets the subordinate basic and policy-specific criteria. (If not, Brazil’s interpretation would lead to the potential subordination of the “fundamental requirement” to the Annex 2 criteria.) Thus, on Brazil’s reading, if a measure does not conform to the criteria in Annex 2, it still could meet the “fundamental requirement” of the first sentence, and Brazil, as the complaining party, would bear the burden of proof to demonstrate a measure’s inconsistency with that provision. As the United States will demonstrate with respect to direct payments and production flexibility contract payments, Brazil has not met the burden of its own interpretation of the first sentence.

## **2. The Basic Criteria of the Second Sentence**

19. The “basic criteria” referred to in paragraph 1 of Annex 2 are: (a) the support in question shall be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers and (b) the support in question shall not have the effect of providing price support to producers. The United States has explained that direct payments under the 2002 Act meet these basic criteria, and the expired production flexibility contract payments under the 1996 Act met these criteria as well.<sup>13</sup>

20. As the United States noted in its answer to Question 30 from the Panel, Brazil had not contested that U.S. direct payments satisfy and U.S. production flexibility contract payments satisfied both “basic criteria” under paragraph 1 of Annex 2. Brazil has now explicitly confirmed the point.<sup>14</sup>

## **3. Policy-Specific Criteria under Paragraph 6 of Annex 2**

21. Brazil has alleged, and the United States agrees, that direct payments under the 2002 Act are, and the expired production flexibility contract payments under the 1996 Act were, decoupled income support measures. Paragraph 6 of Annex 2, entitled “Decoupled income support,” sets out 5 criteria for this type of payment. The United States has previously explained how direct payments satisfy the five policy-specific criteria set out in paragraph 6 of Annex 2.<sup>15</sup>

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<sup>13</sup> U.S. Answer to Question 26 from the Panel.

<sup>14</sup> Brazil’s Answer to Question 30 from the Panel (“The direct payments and production flexibility contract payments meet the first basic criteria in paragraph 1(a) of Annex 2. With respect to the second basic criteria, Brazil is not alleging that either of these two types of payments ‘have the effect of providing price support to producers.’”) (para. 44).

<sup>15</sup> U.S. First Written Submission, para. 67.

22. Only paragraphs 6(a) and (b) are at issue between the parties. These subparagraphs read:

(a) Eligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period.

(b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.

Brazil argues that direct payments under the 2002 Act do not satisfy the criteria in paragraph 6(a) or 6(b) and do not satisfy the fundamental requirement under the first sentence in paragraph 1. Brazil has also argued that the expired production flexibility contract payments under the 1996 Act do not satisfy the criteria in paragraph 6(b) and the fundamental requirement under the first sentence in paragraph 1.

23. Brazil is wrong on all counts. We first explain how each of the respective programs fully satisfies the policy-specific criteria on which Brazil has made arguments. We then explain how Brazil has not met the burden of its own interpretation of the first sentence of Annex 2, paragraph 1, because it has not demonstrated that these programs do not meet the fundamental requirement.

## **B. Direct Payments under the 2002 Act Satisfy the Criteria in Annex 2**

### **1. “A Defined and Fixed Base Period” under Paragraph 6(a)**

24. Brazil has argued that because direct payments under the 2002 Act utilize a different base period than that used for production flexibility contract payments under the 1996 Act, eligibility for direct payments is not determined by criteria “in a defined and fixed base period.” Brazil argues that the reference to “a” base period means that there can be only a single base period. Brazil further argues that direct payments are sufficiently similar to production flexibility contract payments that these programs must share the same base period. Neither argument is based in the text of Annex 2 or withstands scrutiny.

25. We start with the fact that eligibility for direct payments under the 2002 Act *is* based on criteria in a “defined and fixed base period.” Brazil concedes as much when it notes that a farm’s contract or base acreage for direct payments is the acreage “resulting from either MY 1993-95 *or* MY 1998-2001 production.”<sup>16</sup> Thus, eligibility for direct payments is determined by criteria in a “defined and fixed base period” in the ordinary meaning of those terms: a base period that is “definite” and “stationary or unchanging in relative position.”<sup>17</sup> The base period for U.S. direct

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<sup>16</sup> Brazil’s Answer to Question 23 from the Panel (paras. 24-25) (*italics in original*).

<sup>17</sup> U.S. Answer to Question 22 from the Panel (para. 49).

payments is “definite” (set out in the 2002 Act) and “stationary or unchanging in a relative position” (does not change in relative position for the six-year duration of the 2002 Act).

26. Paragraph 6(a) establishes that eligibility for payments under a decoupled income support measure shall be determined by clearly-defined criteria in “a defined and fixed base period.” That is, paragraph 6(a) does not mandate that any *particular* base period be used for a decoupled income support measure and does not mandate that the *same* base period be used for all decoupled income support measures. This contrasts with the use of the phrase “the base period” in paragraph 9 of Annex 3, which is defined in that same paragraph as “the years 1986 to 1988.”<sup>18</sup> In fact, Brazil’s reading of “a defined and fixed base period” would read into that text the term “unchanging,” language that Brazil has proposed in the ongoing agriculture negotiations<sup>19</sup> but does not currently form part of the Agriculture Agreement.

27. In its answer to Question 23 from the Panel, Brazil advances a novel argument to circumvent the evident lack of fit between its interpretation of paragraph 6(a) and the text of that provision. Brazil argues that while the plain language of paragraph 6(a) only “establishes that there can only be ‘a’ (single) ‘fixed’ base period *for a particular de-coupled income support measure*,”<sup>20</sup> nonetheless, a new decoupled income support measure must be based on the same “defined and fixed base period” as a previous decoupled income support measure if the new measure “is essentially the same” or “[i]f the structure, design, and eligibility criteria have not significantly changed.”<sup>21</sup>

28. There is no provision in Annex 2 or the Agreement on Agriculture that supports Brazil’s approach. Brazil merely concocts new concepts to suit its needs: there is no reference in Annex 2 to a “single” base period, no provision on comparing whether two green box measures are “essentially the same,” and no text pointing to the relevance of the “structure, design, and eligibility criteria” of two different measures. In fact, Brazil has cited no provisions other than the phrases “clearly defined criteria” and “in a defined and fixed base period” to support its approach.

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<sup>18</sup> Agriculture Agreement, Annex 3, paragraph 9 (“The fixed external reference price *shall be based on the years 1986 to 1988* and shall generally be the average f.o.b. unit value for the basic agricultural product concerned in a net exporting country and the average c.i.f. unit value for the basic agricultural product concerned in a net importing country *in the base period*.”) (emphasis added). See also *id.*, Annex 3, paragraph 5 (“The AMS calculated as outlined below for *the base period* shall constitute the base level for the implementation of the reduction commitment on domestic support”) (emphasis added). Appellate Body Report, *Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R - WT/DS169/AB/R, adopted 10 January 2001, paras. 115-16.

<sup>19</sup> Brazil and the rest of the Cairns Group have proposed in the ongoing agriculture negotiations that Annex 2, paragraph 6, be amended to change the reference from “a defined and fixed base period” to “a defined, fixed *and unchanging* historical base period.” Cairns Group Negotiating Proposal, *Domestic Support*, JOB(02)/132, at 3, 5, 6 (4 October 2002) (Attachment - Tightening the Green Box - Amendments to Annex 2, paras. 5, 6, 11, and 13) (emphasis added).

<sup>20</sup> See Brazil’s Answer to Question 23 from the Panel (para. 21) (emphasis added); see also *id.* (para. 21) (“Thus, a de-coupled income support measure can have only one ‘fixed’ base period.”).

<sup>21</sup> See Brazil’s Answer to Question 23 from the Panel (para. 22).

29. Annex 2, by its terms, sets out the fundamental requirement and basic and (if applicable) policy-specific criteria to which “*domestic support measures*” must conform.<sup>22</sup> Other provisions in the Agreement similarly establish that the criteria set out in Annex 2 apply to “domestic support measures.”<sup>23</sup> Thus, with respect to a given decoupled income support measure, eligibility for payments must be determined by criteria in a “defined and fixed base period.” As noted above, direct payments under the 2002 Act satisfy this criterion. It is thus irrelevant whether two decoupled income support measures are “essentially the same.”

30. However, as a factual matter, Brazil errs in asserting that direct payments and production flexibility contract payments are “essentially the same.” They differ in terms of the type of contract signed, the base period, the crops the historical production of which entitles a recipient to payment, and the payment rate. While Brazil attempts to elide these distinctions, a close reading of its answer to Question 23 reveals that it concedes these points.

31. **Type of contract signed:** Brazil concedes that the type of contract signed for direct payments and production flexibility contract payments differs. For direct payments, the recipient must enter into an “[a]nnual contract” whereas for production flexibility contract payments recipients entered into a “7 year contract” for the life of the program.<sup>24</sup>

32. **Base period:** Brazil states that direct payments and production flexibility contract payments differ in their base period.<sup>25</sup> For purposes of direct payments, the base period for determining base acres is either marketing years 1998-2001 (average plantings of eligible commodities) or marketing years 1993-1995 (average plantings of eligible commodities other than oilseeds and peanuts). For production flexibility contract payments, the base period for determining base acres was marketing years 1993-1995 for all eligible commodities.<sup>26</sup>

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<sup>22</sup> Agreement on Agriculture, Annex 2, paragraph 1 (“*Domestic support measures* for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that *they* have no, or at most minimal, trade-distorting effects or effects on production. Accordingly, *all measures* for which exemption is claimed shall conform to the following basic criteria . . . plus policy-specific criteria and conditions as set out below.”) (emphasis added).

<sup>23</sup> See Agreement on Agriculture, Article 6.1 (“The domestic support reduction commitments of each Member contained in Part IV of its Schedule shall apply to *all of its domestic support measures* in favour of agricultural producers *with the exception of domestic measures* which are not subject to reduction in terms of the criteria set out . . . in Annex 2 to this Agreement.”) (emphasis added); *id.*, Article 7.1 (“Each Member shall ensure that *any domestic support measures* in favour of agricultural producers *which are not subject to reduction commitments because they qualify under the criteria set out in Annex 2* to this Agreement are maintained in conformity therewith.”) (emphasis added); *id.*, Article 7.2(a) (“*Any domestic support measure* in favour of agricultural producers, including any modification to such measure, and *any measure* that is subsequently introduced *that cannot be shown to satisfy the criteria in Annex 2* to this Agreement . . . shall be included in the Member’s calculation of its Current Total AMS.”) (emphasis added).

<sup>24</sup> Brazil’s Answer to Question 23 (para. 24, table).

<sup>25</sup> Brazil’s Answer to Question 23 (para. 24, table).

<sup>26</sup> See U.S. First Written Submission, paras. 59-60.

33. **Historically produced commodities:** Brazil states that production flexibility contract payments are made with respect to seven crops and direct payments are made with respect to the same crops plus soybeans, other oilseeds, and peanuts.<sup>27</sup> It would have been more accurate for Brazil to have clarified that it is *historic* production of certain commodities during the base period that establishes a farm's eligibility for these payments. It also would have been more accurate to specify that these additional historically produced commodities consist of (1) peanuts, (2) soybeans, (3) sunflower seed, (4) canola, (5) rapeseed, (6) safflower, (7) flaxseed, (8) mustard seed, (9) crambe, (10) sesame seed, and (11) other oilseeds at the discretion of the U.S. Secretary of Agriculture.<sup>28</sup> Nonetheless, payment with respect to the acres historically dedicated to the production of these additional 10 commodities (at this time) is a significant difference between the two measures. The U.S. Department of Agriculture has estimated that approximately 71.5 million acres that historically produced these commodities will be covered by the direct payment program.<sup>29</sup>

34. **Payment rate:** Brazil states that the payment rate for production flexibility contract payments was "7.07 cents per pound on average between 1999-2001 for upland cotton" and that the payment rate for direct payments is "6.67 cents per pound for upland cotton."<sup>30</sup> However, the cited production flexibility contract payment rate is merely Brazil's average of the actual payment rates determined under the program. As Brazil discloses in footnote 40 to the table in paragraph 24, those actual yearly "payment rates were not statutory rates but resulted from the allocation of a fixed amount of budgetary outlays to holders of upland cotton base under the PFC program in MY 1999-2001." That is, the payment rates for production flexibility contracts were derived by dividing the total budgetary outlay available by the base level of production (base acres x payment yield). As the budgetary outlays declined, so too did the payment rates in each marketing year. In contrast, the payment rate for direct payments is set by statute as 6.67 cents per pound of base period production for the life of the 2002 Act (marketing years 2002-2007).

35. **Conclusion:** Thus, direct payments and production flexibility contract payments are not "essentially the same"; they differ in terms of the type of contract signed, the base period, the historically produced crops for which a recipient may receive payment, and the payment rate. That is, direct payments and production flexibility contract payments differ in important respects for at least four of the eight "eligibility criteria" identified by Brazil. Even under Brazil's approach, direct payments and production flexibility contract payments would not be "identical" or "essentially the same" because the differences between them are more than "minor adjustments." The use of a different base period for purposes of determining eligibility for direct payments would be entirely consistent with Annex 2.

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<sup>27</sup> Brazil's Answer to Question 23 (para. 24, table).

<sup>28</sup> See, e.g., U.S. First Written Submission, para. 57 n. 46.

<sup>29</sup> U.S. Department of Agriculture, Commodity Estimates Book for the FY 2004 President's Budget (February 3, 2003).

<sup>30</sup> Brazil's Answer to Question 23 (para. 24, table).

36. ***Brazil's repeated errors concerning eligible recipients:*** Finally, although not relevant to the foregoing analysis, the United States feels compelled to bring to the Panel's attention a serious error made by Brazil in the course of comparing production flexibility contract payments and direct payments.

- In the table in paragraph 24 of Brazil's answer to Question 23 from the Panel, Brazil writes that the eligible recipients for both types of payments are “‘producers’ who assume all or part of the risk of producing a crop.”
- Again, in paragraph 26, Brazil writes that “eligible recipients under both programs are ‘producers,’ defined in each program as ‘an owner, operator, landlord, tenant, or sharecropper that shares in the risk of producing a crop.’”
- In its opening statement at the first panel meeting, Brazil also stated: “The term ‘producer’ is defined in Section 1001(12) as an ‘owner, operator, landlord, tenant, or sharecropper that *shares in the risk of producing a crop* and is *entitled to share in the crop available for marketing from the farm . . .*’ The notion that eligible recipients of annual [direct and counter-cyclical] contracts payments are required to ‘share in the risk of producing a crop’ also suggests some type of linkage with production.”<sup>31</sup>

Thus, Brazil three times erroneously creates the impression that only “producers” who share in the risk of producing a crop may receive direct payments and production flexibility contract payments.<sup>32</sup>

37. It is surprising that Brazil would make this mistake as it has, in each instance, quoted *only the first half* of the statutory definition of “producers.” That definition in the 2002 Act, in full, provides:

The term “producer” means an owner, operator, landlord, tenant or sharecropper that shares in the risk of producing a crop and is entitled to share in the crop available for marketing from the farm, *or would have shared had the crop been produced.*<sup>33</sup>

The 1996 Act and implementing regulations under both Acts contained the identical “or would have shared had the crop been produced” language.<sup>34</sup> Thus, the statutory definition expressly provides for a situation in which *no* crop is produced on a farm entitled to receive direct

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<sup>31</sup> Brazil's Opening Statement at the First Panel Meeting, para. 57 (italics in original) (footnote omitted).

<sup>32</sup> Brazil uses the term “producer” seven times in paragraphs 26 through 28. See Brazil's Answer to Question 23 from the Panel.

<sup>33</sup> 2002 Act, § 1001(12) (emphasis added) (Exhibit US-1).

<sup>34</sup> 1996 Act, § 102(12) (Exhibit US-22); 7 Code of Federal Regulations 718.2 (“CFR”).

payments. In that case, the payment recipient (“producer”) is “an owner, operator, landlord, tenant or sharecropper” who “*would have shared [in the risk of producing a crop and in the crop available for marketing] had the crop been produced.*”

38. We would also note that this statutory definition provides a default rule establishing who, as a matter of law, is entitled to the payment in the absence of other arrangements. However, this definition does not limit the ability of the “producer” (in the statutory sense) to contract away his or her entitlement to payment. In fact, the 2002 Act expressly contemplates that payments may be assigned by a recipient.<sup>35</sup>

## 2. “Type of Production” under Paragraph 6(b)

39. Brazil has also suggested that U.S. direct payments do not conform to paragraph 6(b) of Annex 2, arguing that the amount of direct payments is related to or based on the “type of” production in a year after the base period because the amount of payment would be reduced or eliminated if certain commodities (primarily fruits and vegetables) are planted on base acres. However, the context provided by the first sentence of paragraph 1 of Annex 2 indicates that Brazil’s argument and interpretation of paragraph 6(b) is in error. Interpreted according to the ordinary meaning of the terms, in context, and in light of the object and purpose of the Agriculture Agreement, this provision means that a decoupled income support measure may not base or link payments to production requirements, whether by type or volume.

40. Brazil would read paragraph 6(b) as requiring a Member to make support available for *any* type of production; a Member could not preclude a recipient from producing certain crops. However, the phrase “type . . . of production” must be read in its context and in light of the object and purpose of the Agreement. The criteria in paragraph 6 are designed to ensure that green box measures fulfill the fundamental requirement that they have “no, or at most minimal, trade-distorting effects or effects on production.” As the United States has previously explained, Brazil’s interpretation leads to a conflict between paragraph 6(b) and the fundamental requirement of the first sentence of paragraph 1.

41. A decoupled income support measure that requires production of *no crops at all* demonstrably meets the fundamental requirement because such a measure necessarily can have no “trade-distorting effects or effects on production.” However, on Brazil’s interpretation, such a measure would also be inconsistent with paragraph 6(b) because the amount of payment would be based on the type of production (production of no crops) in a year after the base period. Thus, Brazil’s reading of paragraph 6(b) would preclude a Member from establishing a measure that meets the “fundamental requirement” of Annex 2. Despite numerous opportunities to do so,

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<sup>35</sup> 2002 Act, § 1612 (“The provision of section 8(g) of the Soil Conservation and Domestic Allotment Act (16 U.S.C. 590h(g)), relating to assignment of payments, shall apply to payments made under the authority of this Act. The producer making the assignment, or the assignee, shall provide the Secretary with notice, in such manner as the Secretary may require, of any assignment made under this section.”) (Exhibit US-1).

Brazil has as yet provided no answer to the apparent conflict its interpretation creates between paragraph 6(b) and the fundamental requirement in the first sentence of paragraph 1.

42. A proper interpretation of paragraph 6(b) does not create any such opposition between that provision and the first sentence of paragraph 1. We note that, while direct payments are reduced if certain crops are produced,<sup>36</sup> a recipient need not produce any crop in particular or any crop at all in order to receive the full payment for which a farm is eligible; the recipient need merely refrain from producing the forbidden fruit or vegetable. To put it in concrete terms, if a farm had 100 base acres that had historically been used to produce eligible commodities, and in a subsequent year 10 of those base acres were devoted to production of a prohibited product, the base acres eligible for direct payments could be reduced in that year to 90 acres.<sup>37</sup> How would the direct payment recipient receive payment for the additional 10 base acres? The recipient need not produce any particular crop nor any crop at all. That is, payment on those additional 10 acres is not based on or related to any additional production; the recipient need merely desist from planting the prohibited product. Thus, in the scenario on which Brazil has focused its argument, it is not any “type . . . of production . . . undertaken by the producer” that results in the full direct payment amount but rather production *not* undertaken by the producer – that is, *ceasing* certain production – that results in full payment.

43. We also note that Brazil’s interpretation of paragraph 6(b) could have serious repercussions for Members. For example, without expressing any view on whether such a payment would be green box, we note that the EC has reached a tentative agreement to reform aspects of the Common Agricultural Policy, the primary change of which will be the introduction of a “single decoupled farm income payment”; however, under the proposal, land on which payments are received cannot be used for growing fruits and vegetables, permanent crops, and table potatoes.<sup>38</sup> Further, Brazil’s reading would seemingly require a Member to make payments even if the recipient’s production was illegal, for example, the production of narcotic crops such as opium poppy or the production of unapproved biotech varieties or environmentally damaging production (for example, planting on converted rain forest or wetlands). Under Brazil’s approach, by reducing or eliminating payments for any of these production activities, a decoupled income support measure could be understood to base or relate the amount of payment to the

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<sup>36</sup> U.S. Answer to Question 26 from the Panel (para. 56).

<sup>37</sup> If, for example, the farm, the area, or the producer had a history of growing that product.

<sup>38</sup> Under the proposed reform, a single decoupled farm income payment will be introduced from 2005.

Agricultural land (except for land used for permanent crops) is eligible for payments, based on historic reference amounts. The land can be used for any type of agricultural activity except for growing fruit and vegetables, permanent crops, and table potatoes. There is no obligation to produce any crop to receive the single farm payment, but the land must be maintained in ‘good agricultural condition,’ and several other environmental, food safety, animal health and welfare criteria must be met. See [http://europa.eu.int/comm/agriculture/mtr/avap\\_en.pdf](http://europa.eu.int/comm/agriculture/mtr/avap_en.pdf).



“type” of production undertaken.<sup>39</sup> Brazil may be unaware of this implication of its argument.<sup>40</sup> The Panel, however, should not endorse an interpretation of paragraph 6(b) with such potentially far-reaching results.

44. As these examples demonstrate, reading paragraph 6(b) to preclude a Member from imposing conditions on recipients of decoupled income support – for example, by reducing or eliminating payments should a recipient produce a particular crop or produce on a particular type of land – creates serious inconsistencies with other provisions of the Agreement on Agriculture, including the key context provided by the first sentence of Annex 2, paragraph 1. In light of that context, paragraph 6(b) should be read to prevent a Member from requiring a recipient *to produce* certain crops. U.S. direct payments do not require a recipient to produce upland cotton or any other crop in order to receive payment. Thus, direct payments satisfy the paragraph 6(b) criterion that a Member may not base or link payments to production requirements.

### **3. Conclusion: Direct Payments Conform to the Criteria in Annex 2 and Are Exempt from Actions**

45. Because direct payments under the 2002 Act satisfy the two general criteria under Annex 2, paragraph 1, and the five policy-specific criteria and conditions of Annex 2, paragraph 6, direct payments qualify as “decoupled income support” exempt from the reduction commitments of the Agriculture Agreement. Further, because direct payments under the 2002 Act are “domestic support measures that conform fully to the provisions of Annex 2 to this Agreement,” under subparagraph (a)(ii) of the Peace Clause, direct payments are “exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement.” As a result, Brazil may not maintain this action and advance the claims under the specified provisions with respect to U.S. direct payments.

### **C. Production Flexibility Contract Payments under the 1996 Act**

#### **1. Description of Production Flexibility Contract Payments**

46. The production flexibility contract program terminated when the 1996 Act was superseded with the 2002 Act. Brazil has clarified that it only challenges the “legal instruments as such” for measures that currently exist – that is, “those involving the 2002 FSRI Act and the

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<sup>39</sup> “Type” means “a kind, a sort.” *The New Shorter Oxford English Dictionary*, vol. 2, at 3441 (1993 ed.). Thus, the “type of production” in paragraph 6(b) could also refer to the “kind” or “sort” of production, for example, through the things produced or production methods employed.

<sup>40</sup> Brazil notes, but does not comment on, the fact that both direct payments and the expired production flexibility contract payments require a recipient to abide by conservation and wetland protection requirements (that is, *not* to farm certain types of environmentally sensitive land). Brazil’s Answer to Question 23 (paragraph 24, table). *See* 2002 Act, § 1105(a)(1) (producer must agree “to comply with applicable conservation requirements” and “to comply with applicable wetland protection requirements”) (Exhibit US-1); 1996 Act, § 111(a)(1), (2) (Exhibit US-22).

2000 Agricultural Risk Protection Act.”<sup>41</sup> Production flexibility contract payments were made from fiscal years 1996 through 2002, with the last payment made “not later than” September 30, 2002.<sup>42</sup> These payments were made with respect to farm acreage that was devoted to agricultural production in the past, including acreage previously devoted to upland cotton production. The payments, however, were made regardless of whether upland cotton was produced on those acres or whether anything was produced at all.

47. Production flexibility contract payments were made to eligible landowners or producers with eligible cropland. Eligible cropland consisted of farm acres that formerly produced any of a series of commodities (wheat, corn, sorghum, barley, oats, cotton, and rice) during the base period of marketing years 1993-1995. The recipient was required to enroll in the contract during the 1996 sign-up period (only acreage returning from conservation reserve was allowed subsequently to enroll).

48. The annual contract payment was the product of the contract payment quantity and the annual payment rate. The contract payment quantity was the product of 85 percent of base acres  $\times$  the farm program payment yield.

49. As mentioned above, base acres for a farm were those acres that formerly produced any of a series of commodities during the base period of marketing years 1993-1995. The 1996 Act established base (contract) acreage as that quantity of acres which would have been determined under the 1990 Act,<sup>43</sup> plus acreage returning from the Conservation Reserve Program. Under the 1990 Act, base acres<sup>44</sup> for cotton were the average acres planted and “considered planted” during the previous three years.<sup>45</sup> Thus, for 1996, base cotton acres were the average acres during the 1993-1995 period.

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<sup>41</sup> Brazil’s Answer to Question 19 from the Panel (para. 16). Thus, with respect to production flexibility contracts, Brazil challenges only “the payment of subsidies for the production and use of upland cotton.” Brazil’s Answer to Question 19 from the Panel (para. 15). Production flexibility contract payments were recurring subsidies, provided year-after-year and allocated to a particular fiscal year by the authorizing legislation. Thus, once the 2002 fiscal year had been completed, and the measure had been replaced or superseded, there was no longer any measure in existence to challenge. In contrast to disputes (such as *Indonesia – Automobiles*) in which the legal instruments under which a subsidy is provided have still been in existence after panel establishment or disputes (such as *Australia – Leather*) which involved a non-recurring subsidy, in this dispute, by the time of Brazil’s consultation and/or panel requests, there were no measures to consult upon nor to be at issue under the DSU.

<sup>42</sup> Federal Agriculture Improvement and Reform Act of 1996, § 112(d)(1), Public Law No. 104-127 (April 4, 1996); 7 U.S. Code § 7212(d)(1).

<sup>43</sup> Food, Agriculture, Conservation, and Trade Act of 1990, Public Law No. 101-624, 104 Stat. 3440 (“1990 Act”).

<sup>44</sup> These were “base acres” for purposes of the classic deficiency payments under the 1990 Act, which were linked to production of cotton. No income support decoupled from production was provided under the 1990 Act.

<sup>45</sup> 1990 Act, § 1101, amending Agricultural Act of 1949, § 503(b)(2), 7 U.S.C. § 1463(b)(2).

50. The farm program payment yield was the payment yield established on the farm for the 1995 crop.<sup>46</sup> Payment yields for 1991-1995 were set by the 1990 Act as 1990 payment yields. 1990 payment yields, in turn, were set by the 1985 Act as a farm's 1981-1985 average yield.<sup>47</sup>

51. An annual payment rate was established for each of the covered commodities that previously were produced on a farm's base acres. The rate was determined by dividing the total amount of payment available by the annual payment quantity. With respect to "upland cotton" base acres, the total amount of payment decreased from \$648 million in fiscal year 1995 to \$466 million in fiscal year 2002.

52. Finally, in exchange for annual contract payments, a recipient (landowner or producer) agreed to (1) comply with certain conservation requirements regarding use of highly erodible land and wetlands, (2) comply with planting flexibility requirements, and (3) use contract acreage for agricultural or conserving uses but not for non-agricultural commercial or industrial use. If an owner or producer enrolled in a production flexibility contract violated any of these eligibility requirements, the contract was subject to termination. If prohibited products (fruits or vegetables other than lentils, mung beans, and dry peas) were grown on contract acreage, production flexibility contract payments could be reduced or eliminated.<sup>48</sup>

### **3. Production Flexibility Contract Payments Met the Criteria in Annex 2**

53. As noted above, Brazil does not contest that expired production flexibility contract payments met the basic criteria set out in the second sentence of paragraph 1 of Annex 2. In addition, production flexibility contract payments met the five policy-specific criteria set out in paragraph 6 for decoupled income support measures.

54. First, eligibility for production flexibility contract payments were determined by clearly-defined criteria, such as factor use and production level in a defined and fixed base period. Such payments were made to persons on farms for which payment yields and base acres were established. These payment yields and base acres were defined in the 1996 Act and fixed for the duration of the legislation (that is, from fiscal years 1996-2002).

55. Second, as explained with respect to direct payments, the amount of production flexibility contract payments in any given year was not related to, or based on, the type or volume of production undertaken by the producer in any year after the base period. As with direct payments, production flexibility contract payments could be reduced or eliminated if certain products were planted on a farm's base acres. However, there was no requirement to engage in

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<sup>46</sup> For purposes of the production flexibility contracts under the 1996 Act, payment yields were frozen at the 1995 level. Federal Agriculture Improvement Act of 1996, Public Law No. 104-127 (April 4, 1996) ("1996 Act"), § 114(c), 7 U.S.C. § 7214(c).

<sup>47</sup> Food Security Act of 1985, § 506, Public Law No. 99-198, 99 Stat. 1354, 7 U.S.C. § 1466 ("1985 Act").

<sup>48</sup> 1996 Act, § 118(b) (Exhibit US-22).

any *particular* type or volume of production and no requirement to engage in *any* agricultural production in order to receive the payment. The only production that was required was *historical* production during the base period.

56. Third, the amount of production flexibility contract payments in any given year was not related to, or based on domestic or international prices applying to any production undertaken in any year after the base period. The production flexibility contract payment formula was linked to, for each covered commodity, payment acres (85 percent of acres in the base period), payment yields (yields in the base period), and the payment rate for that commodity but was not related to, or based on, any prices in any given year after the base period.

57. Fourth, the amount of production flexibility contract payments in any given year was not related to, or based on, the factors of production employed in any year after the base period. As shown in the payment formula above, payments were linked to, for each covered commodity, payment acres (85 percent of acres in the base period), payment yields (yields in the base period), and the payment rate for that commodity but not related to, or based on, factors of production employed in any given year after the base period.

58. Finally, no production was required in order to receive production flexibility contract payments. The payment formula is linked to, for each covered commodity, historic base acres and payment yields but no current production.

**D. Brazil Has Not Shown that Direct Payments and Production Flexibility Contract Payments Are More than Minimally Trade- or Production-Distorting**

59. Brazil argues, at length, that direct payments and the expired production flexibility contract payments do not satisfy the fundamental requirement of the first sentence of Annex 2, paragraph 1 – that is, “that they have no, or at most minimal, trade-distorting effects or effects on production.” The United States has explained above that both direct payments and production flexibility contract payments satisfy the basic criteria of paragraph 1 as well as the policy-specific criteria for decoupled income support of paragraph 6. Thus, these payments are deemed to meet the fundamental requirement of the first sentence.

60. As noted, however, on Brazil’s reading, if a measure does not conform to the criteria in Annex 2, it still could meet the “fundamental requirement” of the first sentence. Brazil, as the complaining party, would bear the burden of proof to demonstrate a measure’s inconsistency with that requirement. Brazil has failed to make a *prima facie* case. In fact, Brazil’s “evidence,” both in its first written submission as well as in its expert’s statement at the first panel meeting, consists simply of selectively quoting and emphasizing conceptual and theoretical statements from the economic literature. *None of the papers Brazil cites concludes that these payments in particular, or decoupled income support measures in general, have more than “minimal[] trade-distorting effects or effects on production.”*

61. The United States has reviewed the economic literature put forward by Brazil as well as the literature on decoupled payments more generally. (For the Panel's convenience, we attach a report on this literature review as Exhibit US-23.) These papers make the commonsense point that decoupled payments may *potentially* distort production because direct payments can increase wealth and reduce the risk of growing crops in general. If an increase in wealth through decoupled payments provokes producers to take on more risk, distortions in markets may potentially result. However, empirical studies show that the effects of direct payments and production flexibility contract payments on production are minimal:<sup>49</sup>

- A 2003 analysis by the Organization for Economic Cooperation and Development (OECD) of the 2002 Act decomposed the market effect of different U.S. commodity programs. This analysis estimated that direct payments could result in increases in harvested area *between 0.1 percent and 0.3 percent*.
- A 2002 report by Westcott *et al.* of the U.S. Department of Agriculture, relying on earlier research (discussed below) on production effects of production flexibility contracts, concluded that the production effects of direct payments under the 2002 Act would also be expected to be minimal.
- An October 2000 report by Westcott and Young of the U.S. Department of Agriculture estimated that, even assuming that savings and investment are increased by as much as one-fourth of production flexibility contract payments, such payments increase aggregate plantings by 225,000 to 725,000 acres or *less than 0.3 percent* of total U.S. cropland.
- An August 2000 paper by Young and Westcott estimated that, assuming certain wealth elasticities and that farmers' wealth increases by the full amount of the production flexibility contract payments, such payments could increase acreage by 180,000 to 570,000 acres<sup>50</sup> – that is, expressed as a percentage of total acreage planted to wheat, feed grains, rice, and cotton, this increase is *less than 0.3 percent*.
- A 2000 report by Burfisher *et al.* examined the effect of an increase in decoupled payments for four field crops in the United States, Mexico, and Canada and estimated that a 50 percent increase in decoupled payments increased output by *one percent or less*.

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<sup>49</sup> Full citations and descriptions of these reports may be found in the literature review on decoupled income support presented in Exhibit US-23.

<sup>50</sup> To our knowledge, this is the one quantitative estimate that Brazil actually presents in the course of its first written submission, oral statements at the first panel meeting, and answers to questions from the Panel. Brazil does not, however, set this estimated acreage increase against total U.S. cropland, preventing an evaluation of whether the effect is "minimal" or not.

The Agreement on Agriculture does not define a numerical threshold on what degree of effects will be considered “minimal[] trade-distorting effects or effects on production.”<sup>51</sup> However, given that *no study has found that these payments have effects on production of more than one percent*, it would appear that direct payments have and production flexibility contract payments had no more than “minimal[] trade-distorting effects or effects on production.”<sup>52</sup>

62. With the exception of the August 2000 Westcott and Young paper, Brazil does not acknowledge or discuss these evaluations of the *degree* of trade or production effects which decoupled income support may have, which would seem to be the crucial issue with respect to whether a measure has more than “minimal” effects. Instead, Brazil simply and repeatedly emphasizes statements in the economic literature that provide *explanations* as to why decoupled income support *may* have production effects but do not provide *evaluations of the extent* of any such hypothesized production effect. Consider the following statements of Brazil or its expert:

- “USDA economists have acknowledged the *possibility* that PFC payments can have production-enhancing effects *under certain circumstances*.”<sup>53</sup>

*Comment:* This statement reflects the commonsense point that increases in wealth may *possibly* alter producer decisions but does not present any evaluation of the extent of any such effect.

- “The authors [Young and Westcott] submit that PFC payments ‘are at least partially coupled since they increase farm operator wealth, which has several *potential effects* on production. First, lenders are more willing to make loans to farmers with higher guaranteed incomes because of a lower risk of default. This increase in loan availability *may facilitate* additional agricultural production. Second, with increased income from PFC payments, farmers can more easily invest in their farm operations. For example, increased income *may facilitate* additional agricultural investments by farmers who are constrained by debt or limited liquidity. The resulting increased investment in farm

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<sup>51</sup> We note that Brazil several times subtly attempts to re-write the fundamental requirement. For example, Brazil states: “One of two elements must exist to reject a measure based on the first sentence of AoA Annex 2 – the creation of *any discernable or identifiable* ‘trade-distorting effects’ or ‘effects on production.’” Brazil’s First Written Submission, para. 164 (emphasis added). Later, Brazil states: “The *quantity* or *level* of production or trade distorting effects need only be *very minimal* to trigger denial of ‘green box’ status under AoA Annex 2.” Brazil’s First Written Submission, para. 165 (second set of italics added). Of course, Annex 2 does not say “any discernable or identifiable” or “very minimal” effects; it says “at most minimal” effects – that is, no more than minimal.

<sup>52</sup> By way of comparison, under Article 6.4(a), product-specific and non-product-specific support offered by a developed country Member is considered *de minimis* if it does “not exceed 5 per cent” of that Member’s total value of production of a basic agricultural product or that Member’s total agricultural production, respectively. Under Article 6.4(b), for “developing country Members, the *de minimis* percentage under this paragraph shall be 10 per cent.”

<sup>53</sup> Brazil’s First Written Submission, para. 169 (citing USDA publication) (emphasis added) (footnote omitted).

operations contributes to higher agricultural production in the long run. Another *potential effect* of PFC payments on production is that a guaranteed income stream *may make* farmers more willing to undertake riskier crops or strategies which have the possibility of higher returns.”<sup>54</sup>

*Comment:* As the italicized language demonstrates, this passage sets out the hypothesis that decoupled payments *may* have “potential” production effects but does not purport to evaluate whether such an effect would be more than minimal. We were also quite surprised to see Brazil attribute this statement to Young and Westcott since the words immediately preceding the passage quoted by Brazil are, “*These authors* argue that PFC payments,” referring to “Tielu and Roberts” and “Hennessey” in the immediately preceding sentence.<sup>55</sup>

• “USDA economists have suggested that DP, like PFC payments, *can potentially* affect production decisions by (1) a direct wealth effect through risk aversion reduction, (2) a wealth-facilitated increased investment effect partly reflecting reduced credit constraints, and (3) a secondary wealth effect resulting from the increase in investment.”<sup>56</sup>

*Comment:* Again, this statement reflects the commonsense point that increases in wealth “can potentially” alter producer decisions but does not present any evaluation of the degree of any such effect.

• ““These base acreage and payment yield updates *may influence* current production choices *if farmers expect* that future legislation will again allow them to update these program parameters for their farms. For example, farmers *may not fully use* planting flexibility to move from historically planted and supported crops *if they expect* future farm programs to permit an updating of their base acreage. Instead, farmers *would have* incentives to build and maintain a planting history for program crops to use for possible future base acreage updating, thereby constraining their response to market signals. Similarly, use of nonland inputs that affect current yields *may be influenced if farmers expect* that future farm legislation will permit an updating of payment yields. Such updates *may* also reduce incentives to grow lower yielding varieties of program crops that have other marketable characteristics.”<sup>57</sup>

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<sup>54</sup> Brazil’s First Written Submission, para. 169 (quoting Young and Westcott (August 2000)) (emphasis added) (footnote omitted).

<sup>55</sup> See Exhibit Bra-80 (Young and Westcott, *How Decoupled Is U.S. Agricultural Support for Major Crops*, American Journal of Agricultural Economy 82, at 763 (August 2000) (emphasis added)).

<sup>56</sup> Brazil’s First Written Submission, para. 169 (citing USDA publication) (emphasis added) (footnote omitted).

<sup>57</sup> Brazil’s First Written Submission, para. 186 (quoting USDA publication) (emphasis added) (footnote omitted).

*Comment:* As the italicized language demonstrates, this passage sets out the authors' hypothesis that expectations of future base period changes could, under certain conditions, have production effects but does not present any evidence nor evaluate whether such an effect would be more than minimal.

- Brazil's expert quoted a report by the U.S. Department of Agriculture as follows: "This report concludes that PFC, marketing loss, DP and CCP payments 'can affect production and, thus, market prices and export availability.'"<sup>58</sup>

*Comment:* Once again, this quote sets forth a commonsense supposition that decoupled income support "can" affect production. We were surprised to find, however, that Brazil's expert failed to convey to the Panel that the report he quotes also mentions explicitly Westcott and Young's estimates that *production flexibility contracts have minimal production effects*: "Impacts of PFC payments on aggregate plantings have been estimated to be fairly small, generally less than 1 percent (Westcott and Young)."<sup>59</sup> Thus, even when quoting and drawing from a document that reports estimates of the minimal production effects of challenged U.S. measures, Brazil's expert has not presented that information to the Panel.

- Finally, the United States would note that the statement of Brazil's expert at the first panel meeting on production flexibility contracts and direct payments is, again, a recitation of the *hypothesis* that decoupled income support may have production effects, but *the statement presents no evidence relating to the extent of any such hypothesized production effect*.<sup>60</sup> In fact, of the five pieces of literature that the United States has noted above that estimate minimal production effects from decoupled payments, Brazil's expert cited to three of these (Westcott *et al.* (2002),<sup>61</sup> Westcott and Young (October 2000),<sup>62</sup> Young and Westcott (August 2000)<sup>63</sup>). *However, he neglected to mention to the Panel that these papers estimated production effects of no more than 0.3 percent, a "minimal" effect by any definition.*

In sum, Brazil's "evidence" that direct payments and production flexibility contract payments have more than "minimal[] trade-distorting effects or effects on production" rests entirely on theoretical statements attempting to explain the "potential" production effects of increased

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<sup>58</sup> Exhibit Bra-105, para. 28 (Statement of Mr. Sumner, citing and quoting report *Farm Program Payments and the Economic Viability of Production Agriculture* (Exhibit Bra-130)).

<sup>59</sup> See Exhibit Bra-130 (U.S. Department of Agriculture, *Farm Program Payments and the Economic Viability of Production Agriculture* at 12 (August 2002)).

<sup>60</sup> See Exhibit Bra-105, at 9-13.

<sup>61</sup> Exhibit Bra-105, at 9 fn. 2.

<sup>62</sup> Exhibit Bra-105, at 9 fn. 2.

<sup>63</sup> Exhibit Bra-105, at 10 fn. 4.



producer wealth or expectations relating to future program parameters. None of this evidence goes to an evaluation of *the extent* of any such hypothesized production effect.

63. In fact, the economic literature presented by the United States above on the estimated effects on production of direct payments and production flexibility contract payments finds that these payments do not have (on any reasonable interpretation) more than “minimal[] trade-distorting effects or effects on production.” Thus, not only has Brazil failed to present a *prima facie* case, but the United States has affirmatively demonstrated that direct payments and production flexibility contract payments satisfy the fundamental requirement of the first sentence of Annex 2, paragraph 1.

64. The fact that the economic literature estimates that U.S. direct payments and production flexibility contract payments do *not* have more than a minimal production effect points out the foresight Members demonstrated in agreeing to the detailed basic and policy-specific criteria in Annex 2. The detailed criteria establish a safe harbor for conforming measures. Such measures are presumed to meet the fundamental requirement of the first sentence. As the economic literature on U.S. direct payments and production flexibility contract payments suggests, those detailed criteria *do* serve their intended purpose of identifying measures that will satisfy the fundamental requirement of the first sentence of Annex 2, paragraph 1.

### **III. U.S. Non-Green Box Domestic Support Measures Are Exempt from Actions Based on Articles 5 and 6 of the Subsidies Agreement and GATT 1994 Article XVI:1**

#### **A. The Peace Clause Proviso: Support “Decided” and “Support to a Specific Commodity”**

65. The parties have discussed at length their respective interpretations of the proviso in Article 13(b)(ii), that is, “provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.” Rather than repeat all of the U.S. arguments here, we focus on two interpretive issues on which the parties have taken opposing views. First, how should the Panel compare the support that challenged measures “grant” to the support “decided” during the 1992 marketing year? Second, what support is relevant to the comparison under the proviso – that is, how should the Panel interpret the phrase “support to a specific commodity”? We address each of these issues in turn.

#### **1. Support Was “Decided” During Marketing Year 1992 Using a Rate, Not a Budgetary Outlay**

66. The proviso to Article 13(b)(ii) requires a comparison of the product-specific support that challenged measures grant (in this case, for upland cotton) to the product-specific support decided during the 1992 marketing year. For the proviso to be given effect, these terms must be

capable of allowing an apples-to-apples comparison. The United States believes the basis for this comparison is established by the use of the word “decided.”<sup>64</sup>

67. The term “decided” is not defined in the Agreement and is not used elsewhere in the Agriculture Agreement nor in the Subsidies Agreement to refer to support or subsidies. Members’ choice of words must be given meaning. “Decide” means to “[d]etermine” or “pronounce” and to “[c]ome to a determination or resolution *that, to do, whether.*”<sup>65</sup> Thus, the basis for the comparison under the Peace Clause proviso is the product-specific support that was “determined” or “pronounced” during the 1992 marketing year. There are only so many parameters that a Member can “decide.” A Member cannot decide world market prices or actual production or any other element outside a government’s control. Yet Brazil would read the Peace Clause as though Members were omnipotent and could “decide” every factor influencing support. Brazil’s approach is not compatible with the ordinary meaning of “decide” in context and in light of the object and purpose of the *Agreement on Agriculture*. And in fact, the United States during 1992 “decided” product-specific support for upland cotton in terms of a rate of 72.9 cents per pound through the combination of marketing loans and deficiency payments.<sup>66</sup>

68. That U.S. measures “decided” a *rate* of support and not a budgetary outlay is evident in Brazil’s answer to Question 54 from the Panel, requesting the parties to identify the instruments that decided support for upland cotton during the marketing year 1992. Brazil lists nine different “decisions taken by the United States in relation to MY 1992 upland cotton support programs.” Without agreeing that every item on Brazil’s list was a U.S. Government decision, nonetheless, with respect to deficiency payments and marketing loan payments, we note that Brazil has identified “decisions” relating to the rate of support,<sup>67</sup> for example:

- “Continuation of the upland cotton target price under the deficiency payment program at the 1990 level of 72.9 cents per pound set by the 1990 FACT Act.”
- “Concerning the deficiency payment program, the United States finally had to decide on the payment rate for upland cotton.”

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<sup>64</sup> As the United States will explain in the following section, Brazil’s proposed comparison (the budgetary outlays that may be allocated to a commodity, whether product-specific or non-product-specific) has no grounding in the text or context of the Peace Clause.

<sup>65</sup> *The New Shorter Oxford English Dictionary*, vol. 1, at 607 (first and third definitions) (italics in original).

<sup>66</sup> As the United States has noted in its answer to Question 54 from the Panel, this 72.9 cents per pound rate of support holds true no matter whether the Panel determines to examine the marketing year 1992 level (as the United States has argued) or the marketing year 1993 level (which was initially decided during the 1992 marketing year, on March 24, 1993). One distinction made by the March 24, 1993 regulations between the 1993 crop and the 1992 crop was that the acreage reduction program percentage was lowered from 10 percent in 1992 to 7.5 percent in 1993.

<sup>67</sup> See Brazil’s Answer to Question 54 from the Panel (para. 86).

- “Concerning the marketing loan program, the United States had to take a decision setting the marketing loan rate for upland cotton.”

It is also revealing to consider what Brazil did *not* list as U.S. Government decisions: *not a single decision listed relates to budgetary outlays or market prices*. Brazil thus contradicts its own argument in its first written submission that “[t]he only ‘decision’ that could be said to have been made ‘during’ MY 1992 with respect to upland cotton was to provide the appropriations and continued funding for upland cotton pursuant to the terms of the 1990 FACT Act.”<sup>68</sup> Brazil’s own answer to Question 54 from the Panel confirms that the proper analysis of the support “decided” by U.S. measures is to look to the terms of the U.S. measures, which set a rate of support.

69. In light of the fact that U.S. measures decided product-specific support through the combination of the deficiency target price and the marketing loan rate in marketing year 1992, and through the marketing loan rate from 1999-2002, Brazil at times describes the “support” U.S. measures grant in terms of a “rate” or “level” of support – that is, in precisely those terms which it struggles *not* to find in the Peace Clause.<sup>69</sup> For example:

- “[T]he marketing loan payment in MY 2002 *guarantees a return of 52 cents per pound*.”<sup>70</sup>
- “For marketing loan benefits, *the loan rate can be considered the maximum support available to eligible production in case the market price would fall to zero*.”<sup>71</sup>
- “Similarly, for deficiency . . . payments, *the difference between the loan rate and the target price can be considered the maximum support available, albeit again only for the eligible production*.”<sup>72</sup>

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<sup>68</sup> Brazil’s First Written Submission, para. 141.

<sup>69</sup> It is instructive to consider Brazil’s efforts to read out the term “decided” from the Peace Clause text. For example, Brazil argues that the “most natural measure of support is budgetary expenditures,” but this “most natural” standard is not found in the Peace Clause; “decided” is. Brazil also argues against using the “rate of support” that actually *can* be found in U.S. measures (that is, the target price in 1992 and loan rate thereafter) by arguing that, “without taking market prices into account, it is impossible to translate a ‘rate of support’ into *actual support provided* and to give meaning to the term ‘support.’” However, the Peace Clause text pointedly *does not use the “support provided” language* found in, for example, Articles 1(a) (definition of AMS) and 1(h) (definition of Total AMS). Thus, Brazil’s budgetary outlays approach fails to make sense of Members’ use of the terms “decided” in the Peace Clause proviso and attempts to read into the text words (for example, “actual support provided”) that are not there. See Brazil’s Answer to Question 59 (paras. 91, 93).

<sup>70</sup> Brazil’s Answer to Question 62 from the Panel (para. 99) (emphasis added).

<sup>71</sup> Brazil’s Answer to Question 64 from the Panel (para. 107) (emphasis added).

<sup>72</sup> Brazil’s Answer to Question 64 from the Panel (para. 107) (emphasis added). The ellipsis replaces the phrase “and counter-cyclical” in the original quote; as explained later, counter-cyclical payments are non-product-specific and do not depend upon production of upland cotton or any other commodity. Thus, counter-cyclical payments are not relevant when considering the support to a specific commodity, upland cotton.

- “With lower market prices, the gap between the adjusted world price and the loan rate, i.e., the basis for the calculation of the marketing loan benefit, widens and the payments per pound increase. . . . Therefore, even for an identical set of programs *providing an identical ‘rate of support,’* budgetary outlays would have vastly increased due to the drop in prices.”<sup>73</sup>
- “In the U.S. ‘rate of support’ methodology, because the AWP is expected to be positively related to the price received by individual farmers in the United States, *the loan rate of 52.35 cents per pound in MY 1992 can be considered an approximate rate of support* per unit of eligible production.”<sup>74</sup>
- “*The deficiency payment rate of support* is similar to the marketing loan rate of support and *represents the maximum rate of support per eligible unit,* where eligibility is measured by the rules applicable in 1992.”<sup>75</sup>
- “The other programs [besides Step 2 payments] reduce Government payments with increasing prices, so that *the total rate of support remains basically the same,* or are not price-related.”<sup>76</sup>

The “total rate of support” alluded to in the last statement is expressed – as the preceding statements make clear – via the 72.9 cents per pound deficiency effective price in marketing year 1992, the 51.92 cents per pound marketing loan rate in marketing years 1999-2001, and the 52 cents per pound loan rate in marketing year 2002. That is, Brazil repeatedly slips into the “most natural” way of explaining the support challenged U.S. measures grant and the support “decided” during marketing year 1992: the *rate of support* as set out in the target prices and marketing loan rates set by the U.S. Government.

70. The use of the term “grant” in the Peace Clause proviso with respect to challenged measures does not compel an examination of budgetary outlays. The ordinary meaning of “grant” is to “bestow as a favour” or “give or confer (a possession, a right, etc.) formally.”<sup>77</sup> Thus, the use of the term “grant” would permit an evaluation of the rate of support that challenged measures “give or confer . . . formally.” Members did not choose to use the word “granted” in place of “decided,” and a valid interpretation must make sense of that choice rather than reading it out of the Agreement. In addition, had Members intended the Peace Clause comparison to be made *solely* on the basis of budgetary outlays, they could have used that term, which is a defined term in Article 1(c).<sup>78</sup>

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<sup>73</sup> Brazil’s Answer to Question 62 from the Panel (para. 99) (emphasis added).

<sup>74</sup> Brazil’s Answer to Question 68 from the Panel (para. 134) (emphasis added).

<sup>75</sup> Brazil’s Answer to Question 68 from the Panel (para. 135) (emphasis added).

<sup>76</sup> Brazil’s Answer to Question 62 from the Panel (para. 102 fn. 105) (emphasis added).

<sup>77</sup> *The New Shorter Oxford English Dictionary*, vol. 1, at 1131 (fourth & fifth definitions).

<sup>78</sup> See Agriculture Agreement, Articles 3.3, 9.2; *id.*, Annex 3, paras. 2, 10, 12, 13; *id.*, Annex 4, para. 2.

71. That budgetary outlays are not the only way of measuring the support that domestic support measures “give or confer . . . formally” is evident from Annex 3, which defines the Aggregate Measurement of Support calculations through which Members must meet their binding domestic support reduction commitments. For measures granting market price support, the AMS calculation:

[S]hall be calculated using the gap between a fixed external reference price and the applied administered price multiplied by the quantity of production eligible to receive the applied administered price. *Budgetary payments made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS.*<sup>79</sup>

In addition, for non-exempt direct payments which are dependent on a price gap, the Aggregate Measurement of Support calculation:

[S]hall be calculated *either* using the gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price, *or* using budgetary outlays.<sup>80</sup>

Support as measured by the Aggregate Measurement of Support need not (and in the case of market price support *shall* not) be calculated using budgetary outlays.<sup>81</sup> There is no basis to find that the Peace Clause proviso solely allows support to be measured according to outlays.

72. In sum, the comparison of the product-specific support “decided” during the 1992 marketing year to the support challenged measures “grant” must be made on the terms established by U.S. measures themselves. The United States decided to ensure producer support at a rate of 72.9 cents per pound of upland cotton during the 1992 marketing year. In this case, the comparison presents no difficulty because the challenged measures also grant a rate of support (51.92 cents per pound in marketing years 1999-2001 and 52 cents per pound in marketing year 2002).<sup>82</sup> Because the rate of support in none of these years is higher than the

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<sup>79</sup> Agreement on Agriculture, Annex 3, para. 8 (emphasis added).

<sup>80</sup> Agreement on Agriculture, Annex 3, para. 10 (emphasis added).

<sup>81</sup> See EC’s Answer to Question 22 from the Panel (para. 47) (“With respect, the European Communities does not consider that support is equated in Annex 3 to total outlays.”); New Zealand’s Answer to Question 22 from the Panel (“Annex 3 refers to budgetary outlays as a component of the Aggregate Measurement of Support (‘AMS’) calculation.”). New Zealand goes on to write: “There is nothing to suggest that budgetary outlays should not also be a component of the calculation of ‘support’ in the context of Article 13(b)(ii).” However, New Zealand’s assertion takes no account of the support as “decided” by U.S. measures during marketing year 1992 – that is, on the basis of a rate of support, rather than budgetary outlays.

<sup>82</sup> The United States notes Brazil’s hypothetical scenario of measures that provided market price support in 1992 versus challenged measures that provide non-price-based direct payments. However, Brazil is compelled to resort to this hypothetical and not to pose the question with respect to challenged U.S. measures because those measures grant support using a rate of support, just as in marketing year 1992. See Brazil’s Answer to Question 53

1992 level, challenged U.S. domestic support measures are exempt from actions pursuant to Article 13(b)(ii).

## 2. “Support to a Specific Commodity” Means Product-Specific Support

73. The parties have also spilled a significant amount of ink on the phrase “support to a specific commodity” in the Peace Clause proviso. The United States has explained that, read according to the ordinary meaning of the terms,<sup>83</sup> in context, and in light of the object and purpose of the Agreement, this phrase means “product-specific support” as defined – although not by name – in Article 1(a). The United States wishes to emphasize two points.

74. First, that the Peace Clause does not use the phrase “product-specific support” is neither surprising nor telling. The phrase “product-specific support” is not a defined term to be found in Agriculture Agreement Article 1, and in different provisions the Agriculture Agreement uses different words to describe the concept of product-specific support. The basic definition of product-specific support is given in Article 1(a), as “support . . . provided for an agricultural product in favour of the producers of the basic agricultural product.” That is, the phrase “product-specific support” is defined in Article 1(a) – as Brazil implicitly concedes<sup>84</sup> – but that provision neither uses that exact phrase nor even the word “specific.”

75. Another provision that refers to the concept but does not use the exact phrase “product-specific support” is Article 1(h); in fact, the language it uses is strikingly similar to the Peace Clause proviso:

Provision	Phrase referring to “product-specific support”
Article 1(h)	“support for basic agricultural products”
Article 13(b)(ii), (iii)	“support to a specific commodity”

Again, Article 1(h) *does not even use the term “specific”* whereas the Peace Clause phrase “support to a specific commodity” *contains all three elements of that phrase* (product, specific, and support), using “commodity” in place of “product.”

76. Thus, the United States finds the meaning of “support to a specific commodity” in the ordinary meaning of those terms and in the context provided by these multiple examples of different words in the Agreement that describe the concept “product-specific support.” Brazil, by

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from the Panel (para. 82).

<sup>83</sup> The ordinary meaning of “grant support to a specific commodity” would be to “confer formally” “assistance” or “backing” “specially pertaining to a particular” “agricultural crop.” U.S. First Written Submission, para. 77 (citing dictionary definitions of each term).

<sup>84</sup> See Brazil’s Answer to Question 40 from the Panel (para. 54).

contrast, concedes that it “is not aware of any provision of the Agreement on Agriculture requiring the dis-aggregation” of non-product-specific support in terms of specific commodities.<sup>85</sup> That is, Brazil’s approach ignores the fundamental distinction between product-specific and non-product-specific support in the Agreement on Agriculture.<sup>86</sup>

77. Second, Brazil and several third parties assume that there is only one way to express any given concept in an agreement text. That is, they persist in interpreting a text that is *not* there, and, having interpreted that hypothetical text, assume that the actual text must mean something different from their hypothetical text. This approach is both logically unsound and not in keeping with the customary rules of interpretation of public international law.

78. The question the Panel should consider is what the text actually there means and, in particular, what the existing word “specific” adds to the phrase in question. The Panel can tell that by looking at the context of “specific” – that is, in this case, by looking at what is it that the phrase “grant support to a specific commodity” would have meant if “specific” had been omitted and the text had thus read “grant support to a commodity.” The United States submits that such a phrase would have had a broad meaning, for example, potentially covering all support (“assistance” or “backing”) received in respect of “a” given commodity. The word “specific” must have been chosen to add a limiting force to indicate what kind of support is meant to be covered. Such support is that granted for a specific (i.e., particular) commodity, not support that is granted broadly and happens to go, in part, to cotton as well as to many other commodities. Such support is “support for a basic agricultural product” or “product-specific support” but is not “non-product-specific support.”

**B. In an Effort to Sweep in as Many Measures as Possible into the Peace Clause Comparison, Brazil Simply Ignores the Definition of Product-Specific Support in the Agreement on Agriculture**

79. The United States has explained that the phrase “support to a specific commodity” means “product-specific support” and that Brazil’s approach of allocating to a commodity a share of any non-product-specific support which producers of that commodity may receive has no basis in the Agreement on Agriculture and would erase the fundamental distinction between product-specific and non-product-specific support. In its answers to the Panel’s questions, Brazil stakes out a fall-back position. Brazil now argues that challenged U.S. measures – counter-cyclical payments, direct payments, crop insurance, market loss assistance payments, and production flexibility contract payments – are *not* “non-product-specific” and therefore must be “support to a specific commodity.”<sup>87</sup>

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<sup>85</sup> See Brazil’s Answer to Question 40 from the Panel (para. 56).

<sup>86</sup> The United States also notes that under paragraph 1 of Annex 3, non-product-specific support is to be aggregated into one separate AMS, which supports the notion that non-product-specific support is *not* to be allocated to specific products, contrary to what Brazil urges the Panel to do here.

<sup>87</sup> See, e.g., Brazil’s Answers to Questions 40, 41, and 44 from the Panel.

80. Brazil argues that the definition of non-product-specific support (that is, “support provided in favour of agricultural producers in general”) in Article 1(a) “provides the essential meaning as to the scope of what is and is not ‘product-specific.’”<sup>88</sup> In so doing, Brazil avoids explicitly taking a position on the U.S. argument that “product-specific support” is defined by the first half of the definition of “Aggregate Measurement of Support” given in Article 1(a) although Brazil implicitly concedes the point.<sup>89</sup> In fact, Brazil simply fails to interpret the definition of non-product-specific support in Article 1(a) in light of the definition of product-specific support that immediately precedes it. As a result, Brazil’s interpretation fails to give proper meaning and effect to the entirety of Article 1(a).

81. As Brazil notes, the universe of domestic support measures under Article 1(a) consists of product-specific support and non-product-specific support. Thus, those two elements to the Article 1(a) definition must be read together and in harmony. It is worth setting out that definition in pertinent part:

"Aggregate Measurement of Support" and "AMS" mean the annual level of support, expressed in monetary terms, provided for an agricultural product in favour of the producers of the basic agricultural product or non-product-specific support provided in favour of agricultural producers in general, other than support provided under programmes that qualify as exempt from reduction under Annex 2 to this Agreement . . . .

Thus, other than green box measures, the Aggregate Measurement of Support consists of “support . . . provided for an agricultural product in favour of the producers of the basic agricultural product *or* non-product-specific support provided in favour of agricultural producers in general” (italics added). These two categories of support must be read in light of the context one provides the other.

82. The first category of support consists of “product-specific support.”<sup>90</sup> We note that, not only does Brazil studiously avoid interpreting that first half of the definition, Brazil actually *mis-quotes* that definition:

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<sup>88</sup> Brazil’s Answer to Question 40 from the Panel (para. 55). Brazil also argues that “the United States latches on to only the first part of Article 1(a), and ignores the ‘in general’ qualification in the second part.” *Id.* This is demonstrably wrong. The United States has interpreted both parts of the definition in Article 1(a) in the course of explaining which U.S. measures are product-specific and which are non-product-specific. See, e.g., U.S. First Written Submission, paras. 78, 121; see also U.S. Answer to Question 38 from the Panel.

<sup>89</sup> See Brazil’s Answer to Question 40 from the Panel (para. 54) (“Because the universe of domestic support measures includes either ‘product-specific’ or ‘non-product-specific’ domestic support measures, it follows that any domestic support that is not provided ‘in favour of agricultural producers *in general*’ is deemed to be ‘in favour of the producers of the basic agricultural product.’”).

<sup>90</sup> Despite the consistent U.S. explanation that the first half of Article 1(a) refers to product-specific support, neither Brazil nor any third party has objected nor pointed to any alternative definition in the Agreement.



Article 1(a)	“support . . . provided for an agricultural product in favour of the producers of the basic agricultural product”
Brazil’s quote <sup>91</sup>	support “(a) ‘in favour of the producers of the basic agricultural product’”

Thus, contrary to Brazil’s erroneous quotation, the definition of product-specific support in Article 1(a) consists of *two* elements:

- First, the support must be provided “*for an agricultural product*,” which suggests that the subsidy is given “in favour of”<sup>92</sup> a product and not in respect of criteria not related to the product or in respect of multiple products.
- Second, such support is “in favour of the *producers of the basic agricultural product*,” which suggests that subsidy benefits those who produce the product – that is, production is necessary for the support to be received.

The text of Article 1(a) also suggests that *both* of these elements must be present for support to be product-specific since, should either element be missing, the definition would not be satisfied.

83. The second category of support in Article 1(a) is defined as “non-product-specific support provided in favour of agricultural producers in general.” Brazil reads “general” as “including, involving, or affecting all or nearly all the parts of a (specified or implied) whole” and from this declares that “any domestic support not provided ‘in favor of agricultural producers *in general*’ is deemed to be ‘in favour of the producers of the basic agricultural product.’”<sup>93</sup> We note that the ordinary meaning of “in general” is “in general terms, generally.”<sup>94</sup> We also note that non-product-specific support *cannot* be interpreted as support provided “for *an* agricultural product in favor of the *producers* of the basic agricultural product” because to do so would reduce the first half of the Article 1(a) definition to redundancy or inutility.<sup>95</sup> Thus, read according to its ordinary meaning and in the context of Article 1(a), non-product-specific support is support in

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<sup>91</sup> Brazil’s Answer to Question 40 from the Panel (para. 54) (In full, this quote reads: “‘Aggregate Measurement of Support’ and ‘AMS’ are defined in Article 1(a) as the ‘annual level of support, expressed in monetary terms’ (a) ‘in favour of the producers of the basic agricultural product’ or (b) ‘non-product-specific support provided in favour of agricultural producers in general . . .’ (emphasis added).”).

<sup>92</sup> *The New Shorter Oxford English Dictionary*, vol. 1, at 996 (1993 ed.) (definition of “for”: “in favour of”; “[w]ith the purpose or result of benefitting”).

<sup>93</sup> Brazil’s Answer to Question 40 from the Panel (para. 54).

<sup>94</sup> “In general” means “in general terms, generally” and “as a rule, usually.” *The New Shorter Oxford English Dictionary*, vol. 1, at 1073 (1993 ed.).

<sup>95</sup> Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, p. 23 (“An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.”) (footnote omitted).

favor of agricultural producers “generally” – that is, a residual category of support covering those measures that do not fall within the more detailed criteria set out in the definition of product-specific support.

84. The definitions in Article 1(a), then, *do* cover “the universe of domestic support measures,” but not as Brazil has interpreted them. The definition of product-specific support contains two precise elements; the failure to meet either one would mean that support is not product-specific. The definition of non-product-specific covers support for agricultural producers “in general” (that is, “generally”); this residual category is meant to cover any support that does not fall within the more precise definition of product-specific.

85. By interpreting “non-product-specific support” in isolation,<sup>96</sup> Brazil invites the Panel to find that any measure that does not benefit agricultural producers of all or nearly all agricultural products must be product-specific support. To reach this result, however, Brazil must ignore the text of Article 1(a) defining product-specific support. The Panel should not follow Brazil’s invitation to commit clear error. Instead, the Panel should read the definitions of product-specific and non-product-specific support in Article 1(a) together and in harmony, giving effect to the text as agreed by Members. Given the meaning set out above, Brazil’s assertion that certain challenged U.S. measures<sup>97</sup> are *not* non-product-specific does not withstand scrutiny.

### **1. Counter-Cyclical Payments Are Non-Product-Specific Support**

86. The United States has described counter-cyclical payments<sup>98</sup> under the 2002 Act, which will be provided for the 2002-2007 marketing years, in its first written submission.<sup>99</sup> In brief,

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<sup>96</sup> See, e.g., Brazil’s Answer to Question 40 from the Panel (para. 54: failing to interpret definition of product-specific; para. 55: same); Brazil’s Answer to Question 41 from the Panel (para. 57: same); Brazil’s Answer to Question 44 from the Panel (para. 64: same).

<sup>97</sup> These measures are counter-cyclical payments, direct payments, crop insurance, market loss assistance payments, and production flexibility contract payments. As the United States has explained, direct payments and production flexibility contract payments are green box measures and thus are considered neither product-specific nor non-product-specific. See Agreement on Agriculture, Article 1(a) (excluding green box measures from product-specific and non-product-specific categories).

<sup>98</sup> The formula for determining a landowner’s counter-cyclical payment is: Payment acres x payment yield x payment rate. 2002 Act, § 1103(c), 7 U.S.C. § 7913(c) (Exhibit US-1). Each of these terms is explained in the text above.

<sup>99</sup> U.S. First Written Submission, paras. 114-18.

such payments are based on *historical* acreage bases<sup>100</sup> and payment yields<sup>101</sup> for certain commodities during a fixed and defined base period, similar to the direct payments described earlier. As with direct payments, no current production of any crop is necessary in order to receive counter-cyclical payments as these are based on past, not current, production.

87. However, unlike U.S. direct payments, counter-cyclical payments *are* related to current market prices for covered commodities (including upland cotton). That is, the payment acreage (85 percent of base acreage) and the payment yield (yield during a base period) are multiplied by a payment rate, which is defined as the difference between the target price (for each covered commodity) and the sum of (1) the direct payment rate plus (2) the higher of the national average *market price* or the loan rate.<sup>102</sup> Counter-cyclical payments therefore do not satisfy the criterion in paragraph 6(c) of Annex 2, under which the “amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.”<sup>103</sup>

88. Whether or not counter-cyclical payments are green box measures exempt from U.S. reduction commitments, they are non-product-specific support. We recall that, under Article 1(a), product-specific support is “provided for an agricultural product” for the benefit of “the producers of the basic agricultural product” and that non-product-specific support is “provided in favour of agricultural producers in general.”

- The payment formula for counter-cyclical payments demonstrates that these payments are not “provided for an agricultural product” because a recipient need not currently produce upland cotton (or any other crop) to receive payment.

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<sup>100</sup> A person’s “payment acres” are 85 percent of “base acres,” 2002 Act, § 1101(f) (Exhibit US-1), defined as either (1) the sum of contract acreage for production flexibility contracts under the 1996 Act (that is, the average acres planted and considered planted during the 1993-1995 period) and the four-year average (1998-2001) of plantings of eligible oilseeds or (2) a four-year average (1998-2001) of plantings of covered commodities. 2002 Act, § 1101, 7 U.S.C. § 1101 (Exhibit US-1).

<sup>101</sup> In general, if a landowner chose to use 1998-2001 average plantings for the acreage base, the landowner could elect a payment yield equal to either the direct payments yield (that is, the 1995 payment yield, which is the 1981-1985 yield for those acres) plus 70 percent of the difference between the farm’s average 1998-2001 yield and the direct payments yield or 93.5 percent of the farm’s average 1998-2001 yield. 2002 Act, § 1102(e) (Exhibit US-1). The landowner could also simply choose the 1995 payment yield – the 1981-1985 yield for those acres. 2002 Act, § 1102(b), 7 U.S.C. § 7912(b) (Exhibit US-1).

<sup>102</sup> For example, the payment rate for counter-cyclical payments on base acreage previously devoted to upland cotton production is the difference between 65.73 cents per pound (the target price of 72.4 cents per pound minus the direct payment rate of 6.67 cents per pound) and the higher of the market price or the loan rate (52 cents per pound). Thus, if the market price falls below the loan rate, the maximum counter-cyclical payment rate is 13.73 cents per pound (65.73 cents per pound minus 52 cents per pound).

<sup>103</sup> The United States notes that, under Brazil’s approach that the first sentence of Annex 2, paragraph 1, is a stand-alone obligation, Brazil would bear the burden of proving that counter-cyclical payments are not green box because they do not satisfy the fundamental requirement of the first sentence. However, the economic literature suggests that payments decoupled from production, such as counter-cyclical payments, have no more than minimal trade or production effects. *See* Exhibit US-23.

- In addition, it is not “the producers of the basic agricultural product” – that is, current upland cotton growers – that are entitled to receive the counter-cyclical payments but rather persons (farmers and landowners) on farm acres with *past histories* of producing covered commodities, including upland cotton, during the base period.

Thus, counter-cyclical payments satisfy neither element of the definition of product-specific support; as a result, they must fall in the residual category of non-product-specific support “provided in favour of agricultural producers in general.”

89. Brazil attempts to argue that counter-cyclical payments are similar to deficiency payments and, since the United States has stated that deficiency payments are product-specific support to upland cotton, counter-cyclical payments must also be. While counter-cyclical payments and deficiency payments may be similar in some respects, they differ in crucial ones. As noted in the U.S. answer to Question 43 from the Panel, the crucial differences between these payments may be summarized as follows:

Deficiency Payments	Counter-Cyclical Payments
Farmer must plant upland cotton to receive payment	No requirement to plant upland cotton (or any crop)
Payment based on acres “planted for harvest” to upland cotton in that crop year	Payment based on historical “base acres” irrespective of acres currently planted to upland cotton

That is, in order to receive a deficiency payment, a producer was *required* to plant upland cotton for harvest; a farmer would be paid on the *acres planted to upland cotton for harvest* up to the maximum payment acreage.<sup>104</sup> By contrast, as noted above, to receive the counter-cyclical payment a person with “upland cotton base acres” need not produce upland cotton (nor any other crop nor any crop at all) to receive the payment. Thus, deficiency payments were support for an agricultural product in favor of the producers of the product because recipients had to have planted upland cotton for harvest to receive payment in a given crop year. Counter-cyclical payments do *not* require planting for harvest or production and therefore are support to agricultural producers in general.

90. It follows that a series of statements by Brazil are erroneous and must be corrected:

- “Thus, like the deficiency payment program, CCP program payments are not based on the current year’s production.”<sup>105</sup>

*Correction:* While counter-cyclical payments are not based on current production, the deficiency payment program *required* a producer to plant upland

<sup>104</sup> The maximum payment acres were defined with respect to the farm’s base acres.

<sup>105</sup> Brazil’s Opening Statement at the First Panel Meeting, para. 55.

cotton for harvest. Brazil's expert, in a document written well before his involvement in this dispute, explains the point well: "With the introduction of normal flex acres in 1990, the maximum payment acreage (MPA) is calculated as base [acres] minus ARP acres minus normal flex acreage. . . . Deficiency payments are made on acres planted [for harvest] up to the MPA."<sup>106</sup>

- "Thus, similar to the CCP program, the deficiency payment program allowed farmers to receive payments [without] planting on part of their base acres."<sup>107</sup>

*Correction:* The counter-cyclical payment program allows persons to receive payments without planting any crop at all; the deficiency payment program *required* a producer to plant upland cotton for harvest.

- "[P]ayments under both programs were not based on *current* production but were based on historical production and yields and *current* prices . . . ."<sup>108</sup>

*Correction:* This statement is only correct with respect to counter-cyclical payments. Deficiency payments *were* based on current production – that is, the acres planted to upland cotton for harvest up to the maximum payment acreage. Historical production (base acres) were used to define the maximum payment acres.

- "The notion that eligible recipients of annual [counter-cyclical] contracts payments are required to 'share in the risk of producing a crop' also suggests some type of linkage with production."<sup>109</sup>

*Correction:* Brazil only quotes the first half of the statutory definition of "producer," omitting the portion which reads "or would have shared had the crop been produced."<sup>110</sup> Under the counter-cyclical program, a recipient need not produce upland cotton nor any crop at all in order to receive payment.

91. Brazil's best efforts cannot obscure the fact that counter-cyclical payments are based on quantities of acreage that historically produced cotton, and there is *no requirement to produce upland cotton (or any other commodity) to receive these payments*. Thus, counter-cyclical

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<sup>106</sup> Exhibit Bra-105, Annex 2, attachment (Daniel A. Sumner, *Farm Programs and Related Policy in the United States*, in *Understanding Canada - United States Grain Disputes*, at 66 (Loynes *et al.*, eds.) (1995)).

<sup>107</sup> Brazil's Opening Statement at the First Panel Meeting, para. 55.

<sup>108</sup> Brazil's Opening Statement at the First Panel Meeting, para. 56.

<sup>109</sup> Brazil's Opening Statement at the First Panel Meeting, para. 57 (quoting only first half of statutory definition of "producer": "The term 'producer' is defined in Section 1001(12) as an 'owner, operator, landlord, tenant, or sharecropper that *shares in the risk of producing a crop* and is *entitled to share in the crop available for marketing from the farm . . .*'") (italics in original) (footnote omitted).

<sup>110</sup> 2002 Act, § 1001(12) (Exhibit US-1).

payments do *not* provide product-specific support – that is, “support . . . provided for an agricultural product in favour of the *producers* of the basic agricultural product” – and such payments are not properly part of the Peace Clause comparison under the proviso in Article 13(b)(ii).

92. Finally, we note that, were the Panel to conclude that the first sentence of Annex 2, paragraph 1, imposes a stand-alone obligation, it presumably would be open to the United States to argue that counter-cyclical payments meet “the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production.” The United States does not at this time assert that counter-cyclical payments are green box because they do not meet the requirement that the amount of payments not be based on “any production” in a year after the base period (Annex 2, paragraph 6(c)). However, we note that the economic literature suggests that these payments are *not* more than minimally trade-distorting. In particular, a recent analysis by the Organization for Economic Cooperation and Development (OECD) of the 2002 Act estimated that counter-cyclical payments could result in increases in harvested area between 0.1 percent and 0.25 percent, which by any definition would appear “minimal.”

## **2. Crop Insurance Payments Provide Non-Product-Specific Support**

93. In the U.S. first written submission, the United States explained that under the Agricultural Risk Protection Act of 2000 the United States subsidizes and reinsures a variety of annual crop yield or revenue insurance plans for most agricultural crops, including upland cotton. The basic program provisions for crop insurance are generic, not commodity-specific. The contracted-for insurance premiums are subsidized. This premium subsidy is available to a broad array of commodities around the country and does not vary by commodity. Because premium calculations are prescribed by plan of insurance, premium calculations for a given insurance plan for upland cotton are identical to premium calculations for every other crop insured under that plan. Thus, these generally available subsidies are not specific to upland cotton. Indeed, when Brazil identifies the “legal instruments as such” that it challenges, for crop insurance payments it specifies various statutory provisions “to the extent that these provisions *apply* to upland cotton.”<sup>111</sup>

94. Crop insurance subsidies are not product-specific support – that is, support “provided for an agricultural product in favour of the producers of the basic agricultural product.” Crop insurance is not support “provided for *an* agricultural product.” For marketing year 2002, crop insurance subsidies are available to approximately 100 agricultural commodities, representing approximately 80 percent of U.S. area planted and greater than 85 percent of the value of all U.S. crops. Those commodities are:

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<sup>111</sup> Brazil’s Answer to Question 19 from the Panel (para. 16) (italics added).

Almonds, apples, avocado, avocado trees, barley, blackberries, blueberries, burley tobacco, cabbage, canola, cherries, chile peppers, cigar binder tobacco, cigar filler tobacco, cigar wrapper tobacco, citrus (grapefruit, lemons, limes, mandarins, murcotts, navel orange dollar, oranges, tangelos, tangerines), citrus trees, corn, cotton, cotton extra long staple, crambe, cranberries, cultivated clams, cultivated wild rice, dark air tobacco, dry beans, dry peas, figs, fire-cured tobacco, flax, Florida fruit trees, carambola, flue-cured tobacco, forage production, forage seed, forage seeding, fresh apricots, fresh nectarines, fresh market beans, fresh market sweet corn, fresh market tomatoes, grain sorghum, grapes, green peas, hybrid corn seed, hybrid sorghum seed, macadamia nuts, macadamia trees, mango trees, Maryland tobacco, millet, mint, mustard, nursery, oats, onions, peaches, peanuts, pears, pecans, peppers, plums, popcorn, potatoes, processing apricots, processing beans, processing cucumbers, prunes, raisins, rangeland, rapeseed, raspberries, rice, rye, safflower, soybeans, stonefruit (processing apricots, processing cling peaches, processing freestone), strawberries, sugar beets, sugarcane, sunflowers, sweet corn, sweet potatoes, table grapes, tomatoes (canning and processing), walnuts, wheat, and winter squash.<sup>112</sup>

As the EC has noted, “support which is provided to a number of crops cannot at the same time be considered ‘support to a specific commodity’. Such support is ‘support to several commodities’ or ‘support to more than one commodity.’”<sup>113</sup> Thus, crop insurance subsidies are “non-product-specific support provided in favor of agricultural producers in general.”

95. None of Brazil’s arguments overcome the extremely broad availability of this support. Brazil argues that “for each policy, there are crop-specific provisions.”<sup>114</sup> However, this issue goes to the policy issued by private companies, which must suit each crop covered (say, by specifying appropriate coverage dates), and not to the *support* (premium subsidy) provided by the U.S. Government, which does not vary by commodity or plan of insurance. Second, Brazil argues that certain crop insurance policies under the Agricultural Risk Protection Act of 2000 are offered specifically for upland cotton;<sup>115</sup> however, the policies identified by Brazil (insurance against failure of irrigation water supply) are not limited to upland cotton but have been made generally available for all crops insured by the Federal Crop Insurance Corporation.<sup>116</sup> Moreover, the crop insurance subsidy applicable to those policies is the same as the subsidy applicable to

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<sup>112</sup> Exhibit Bra-62 (U.S. Department of Agriculture, Crops Covered Under the 2002 Crop Insurance Program) ([www.rma.usda.gov/policies/02croplist.html](http://www.rma.usda.gov/policies/02croplist.html)).

<sup>113</sup> Oral Statement by the EC at the First Panel Meeting, para. 21.

<sup>114</sup> Brazil’s Opening Statement at the First Panel Meeting, para. 62.

<sup>115</sup> Brazil’s Opening Statement at the First Panel Meeting, para. 62.

<sup>116</sup> For example, for the basic provisions for coarse grains, see <http://www.rma.usda.gov/FTP/Policies/1998/crops/pdf/98041CG.pdf>.

other policies with the same level of coverage.<sup>117</sup> Finally, Brazil’s “most compelling evidence that crop insurance subsidies provide support to upland cotton” is a document that “shows USDA’s separate accounting for the amount of premium subsidies to cotton farmers, and the maintenance of a cotton-specific account calculating the premium and indemnity payments to cotton”<sup>118</sup> Of course, once the coverage level and policy type have been selected, coverage and subsidy totals by commodity can be calculated based on which crops have been insured. However, this is a function of producer choices, not the program itself, which makes crop insurance available generally to producers. Thus, Brazil’s “compelling evidence” is nothing more than an accounting entry that is not germane to the product-specific / non-product-specific analysis.

96. The United States notifies crop insurance as non-product-specific “amber box” domestic support subject to U.S. reduction commitments.<sup>119</sup> This notification is consistent with that of other Members, including Brazil. *No WTO Member has notified crop insurance programs as product-specific.*

97. As of early 2003, 11 WTO Members had notified crop insurance programs as part of their annual domestic support (DS:1) notifications to the WTO Committee on Agriculture. About half of these Members,<sup>120</sup> including Brazil, notified crop insurance programs as “green box” measures consistent with the criteria (Annex 2, para. 8) for “payments (made either directly or by way of government financial participation in crop insurance schemes) for relief from natural disasters.” One Member<sup>121</sup> notified a crop insurance program under the special and differential provisions of Article 6.2. The other Members,<sup>122</sup> including the United States, Canada, the EC, and Japan, notified crop insurance programs as non-product-specific support.

98. As noted above, the U.S. crop insurance program has extremely broad coverage and is generally available to producers of approximately 100 commodities. We are not aware of any crop insurance program maintained by any other Member that has a similar scope. In the following table, we summarize information from WTO Notifications and other sources with respect to the programs of certain Members:

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<sup>117</sup> All crops are covered by the same subsidy schedule. The level of subsidy depends on the coverage level and the type of policy, not the crop. The premium subsidy schedule is available on the Risk Management Agency website: <http://www.rma.usda.gov/FTP/References/subsidy/subsidy.pdf>

<sup>118</sup> Brazil’s Opening Statement at the First Panel Meeting, para. 63.

<sup>119</sup> See G/AG/N/USA/43, at 37 (Supporting Table DS:9: Non-Product-Specific AMS).

<sup>120</sup> Brazil (G/AG/N/BRA/18), Costa Rica (G/AG/N/CRI/6), Cyprus (G/AG/N/CYP/11), India (G/AG/N/IND/2), Japan (G/AG/N/J72), and Philippines (G/AG/N/PHL/14/Add.1).

<sup>121</sup> Mexico (G/AG/N/MEX/7).

<sup>122</sup> Canada (G/AG/N/CAN/49), EEC (G/AG/N/EEC/38), Hungary (G/AG/N/28), Japan (G/AG/N/72), and United States (G/AG/N/USA/43).



Member	Program	Product Coverage	WTO Notification
United States	Crop and revenue insurance subsidized by the Federal Crop Insurance Corporation	Nearly 100 crops, including grains, oilseeds, fruits, vegetables, planting seeds, tobacco, cotton, sugar beet and cane, forage crops, trees, nursery products	Non-product-specific AMS
Canada <sup>123</sup>	Crop Insurance Program	Grains, oilseeds, legumes, forage crops	Non-product-specific AMS
EC <sup>124</sup>	Crop Insurance Subsidies	Varies by member State	Non-product-specific AMS
Japan <sup>125</sup>	Crop Insurance Subsidies	Rice, wheat, and barley; sericulture; livestock; fruit and fruit-trees; field crops; and greenhouse products. Does not cover vegetables, flowers, and live poultry	Some expenditures notified as green box, rest notified as non-product specific AMS

Thus, as can be seen by comparing the U.S. crop insurance program with those of certain other Members, the U.S. program provides “support in favour of agricultural producers in general” and not support “for an agricultural product.” Thus, the U.S. crop insurance program is non-product-specific support.

### 3. Market Loss Assistance Payments

#### a. Market Loss Assistance Payments Are Non-Product-Specific Support

99. The expired market loss assistance payments<sup>126</sup> can be thought of as adjuncts to the production flexibility contract program. The 1998 legislation<sup>127</sup> authorized an additional 50 percent payment over the production flexibility contracts (the total amount authorized by the

<sup>123</sup> G/AG/CAN/49; Agri and Agri-Food Canada website on crop insurance.

<sup>124</sup> G/AG/N/EEC/38; EU Commission, *Risk Management Tools for EU Agriculture, with a special focus on insurance*, Working Document (January 2001).

<sup>125</sup> G/AG/N/72; H. Fukuda *et al.*, *Rice Sector Policies in Japan*, U.S. Department of Agriculture Outlook Report No. RCS0303-01 (March 2003).

<sup>126</sup> Market loss assistance payments were recurring subsidies provided in three consecutive and allocated to a particular marketing year by the authorizing legislation. Brazil challenges only “the payment of subsidies for the production and use of upland cotton.” Brazil’s Answer to Question 19 from the Panel (para. 15). Pursuant to legislation enacted on August 13, 2001, the last market loss assistance payment was for the 2001 marketing year (August 1, 2001 - July 31, 2002), that is, for market conditions prevailing in that year. Public Law No. 107-25, § 1(a) (Aug. 23, 2001) (“The Secretary of Agriculture . . . shall, to the maximum extent practicable, use \$ 4,622,240,000 of funds of the Commodity Credit Corporation to make a market loss assistance payment to owners and producers on a farm that are eligible for a final payment for fiscal year 2001 under a production flexibility contract for the farm under the Agriculture Market Transition Act.”). Once the relevant marketing year had been completed, and the measure had been replaced or superseded, there was no longer any measure in existence to challenge.

<sup>127</sup> Public Law No. 105-277 (October 21, 1998).

legislation, \$3.057 billion, was divided among production flexibility contract payment recipients according to the same payment formula used for production flexibility contracts). For 1999, the legislation<sup>128</sup> provided authorization for \$5.544 billion, again, divided according to the production flexibility contract formula. For 2000,<sup>129</sup> the legislation provided that the same rate of payment would be made as in the previous year, with outlays of \$5.46 billion. Finally, in fiscal year 2001,<sup>130</sup> the payments amounted to \$4.622 billion.

100. As indicated in the U.S. 1999 WTO domestic support notification (G/AG/N/USA/43), market loss assistance payments were non-product-specific support. The United States did not notify these payments as amber box because they were made in response to low prevailing commodity prices. As such, the United States does not consider that they conform to the criterion in paragraph 6(c) of Annex 2 that the amount of decoupled income support payments “in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.”

101. As with production flexibility contract payments, however, market loss assistance payments were made to persons with farm acres that previously had been devoted to production of certain crops, including upland cotton, during an historical base period. A recipient was not required to produce upland cotton or any other crop in order to receive payment, and no production was required at all. Thus, these payments do not meet the definition of product-specific support – support provided for an agricultural product in favor of the *producers* of the basic agricultural product – in Annex 1(a), and the market loss assistance payments would not form part of the Peace Clause comparison under the proviso to Article 13(b)(ii).

102. As for counter-cyclical payments, we also note that, were the Panel to conclude that the first sentence of Annex 2, paragraph 1, imposes a stand-alone obligation, it presumably would be open to the United States to argue that market loss assistance payments meet “the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production.” The United States does not at this time assert that counter-cyclical payments are green box; because they were based on low prevailing market prices, they may not meet the requirement that the amount of payments not be based on “any production” in a year after the base period (Annex 2, paragraph 6(c)). However, as market loss assistance payments were essentially *ad hoc*, additional production flexibility contract payments, all of the economic literature discussed earlier with respect to the minimal production effects of production flexibility contract payments could be deemed to apply to market loss assistance payments as well.

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<sup>128</sup> Public Law No. 106-78 (October 22, 1999).

<sup>129</sup> Public Law No. 106-224 (June 20, 2000).

<sup>130</sup> Public Law No. 107-25 (August 13, 2001).

#### **4. Direct Payments**

103. With respect to direct payments, the United States has previously explained that these payments are green box support because they conform to the applicable general and policy-specific criteria under Annex 2 of the Agriculture Agreement. These measures are thus exempt from actions based on Part III of the Subsidies Agreement and GATT 1994 Article XVI pursuant to Article 13(a)(ii) and do not form part of the comparison under the proviso of Article 13(b)(ii).

104. Were the Panel to conclude that direct payments do not conform fully to the provisions of Annex 2, however, we note that direct payments would be non-product-specific support. As with counter-cyclical payments, direct payments are based on quantities of acreage that historically produced cotton, and there is no requirement to produce upland cotton (or any other crop) to receive these payments. Thus, direct payments would not be support “for an agricultural product in favor of the producers of the basic agricultural product.” Rather, they would be non-product-specific support provided in favor agricultural producers in general. As such, they would not form part of the Peace Clause comparison under the proviso to Article 13(b)(ii).

#### **5. Production Flexibility Contract Payments**

105. With respect to production flexibility contract payments, the United States has explained that these payments are not within the Panel’s terms of reference and that, were the Panel to proceed to consider them, they would be green box support because they conform to the applicable general and policy-specific criteria under Annex 2 of the Agriculture Agreement. For the same reasons as set out above for direct payments, we further note that, were the Panel to conclude that production flexibility contract payments do not conform fully to the provisions of Annex 2, these payments would also be non-product-specific support. As such, they would not form part of the Peace Clause comparison under the proviso to Article 13(b)(ii).

#### **6. Cottonseed Payments**

106. The United States has explained that the Agricultural Assistance Act of 2003 and the cottonseed payment made pursuant to it is not within the Panel’s terms of reference because the legislation authorizing the payments had not even been enacted at the time of Brazil’s panel request, much less its consultation request. Nor was there any similar measure in effect at the time of Brazil’s consultation and panel requests.<sup>131</sup> As Exhibit Bra-129 demonstrates, moreover, the marketing year 2002 cottonseed payments did not begin to be made until June 5, 2003,<sup>132</sup>

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<sup>131</sup> The situation here is thus different from that presented in *Aircraft*. In fact, since there was no measure at all in existence when the Panel was established, how could Brazil expect the Panel to make any findings about a non-existent measure?

<sup>132</sup> Exhibit Bra-129 (U.S. Department of Agriculture Press Release: “Agriculture Secretary Ann M. Veneman announced that \$50 million in payments for the 2002-crop cottonseed payment program will be made starting June 5, 2003.”).

months after this Panel had been established. Contrary to Brazil's assertion, the 2003 cottonseed payment does not form part of an ongoing, continuing program; each cottonseed payment has been *ad hoc* and, in fact, there was no payment in 2002 or 2001 for the 2002 or 2001 crop. As this subsidy or measure was not consulted upon and could not have been a measure at issue between the parties, we respectfully request that the Panel determine this payment not to be within its terms of reference.

107. In the course of preparing the U.S. answer to Question 17 from the Panel and reviewing Brazil's answers to Questions 17 and 19, we became aware of another difficulty with respect to past cottonseed payments. Brazil claims that the measures it challenges, in part, consist of payments made between marketing year 1999 to the present that were "provided under" or "mandated to be provided" under "various listed statutory or regulatory instruments" listed "on pages 2-3 of Brazil's Panel Request."<sup>133</sup> In Question 17, Brazil indicates the "legal instruments" under which cottonseed payments were provided were: Public Law 106-113, for the 1999 crop of cottonseed; Public Law 106-224, for the 2000 crop of cottonseed; and Public Law 107-25, for the same 2000 crop of cottonseed.<sup>134</sup> The United States agrees that these were the legal instruments authorizing cottonseed payments for the 1999 and 2000 cottonseed crops;<sup>135</sup> however, none of these legal instruments appears in Brazil's consultation or panel requests.

108. In fact, although Brazil asserts that "the Cottonseed Payment Program in MY 2002 was a continuation of the Cottonseed Payment Program with respect to MY 1999 and 2000," that term ("Cottonseed Payment Program") is not found in Brazil's consultation or panel requests either. Thus, it would appear that cottonseed payments for the 1999 and 2000 crops of cottonseed were not identified as "measures at issue" for purposes of DSU Article 4.4 or "specific measures at issue" for purposes of DSU Article 6.2; thus, they do not form part of the Panel's terms of reference.

109. Were the Panel to conclude that cottonseed payments are within the scope of this dispute, these payments would be deemed product-specific. For example, the authorizing legislation for the cottonseed payment for the 2002 cotton crop stated that "[t]he Secretary shall use \$ 50,000,000 of funds of the Commodity Credit Corporation to provide assistance to producers and first-handlers of the 2002 crop of cottonseed." Thus, this payment was support ("assistance") provided for an agricultural product (cottonseed) in favor of the producers of the basic agricultural product.

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<sup>133</sup> Brazil's Answer to Question 19 from the Panel (para. 15).

<sup>134</sup> Brazil's Answer to Question 17 from the Panel (para. 9).

<sup>135</sup> See U.S. Answer to Question 17 from the Panel (para. 40).

**C. The Product-Specific Support Decided in Marketing Year 1992 is Greater than Product-Specific Support Challenged Measures Grant**

**1. The U.S. Approach Using Rates of Support Set out in U.S. Measures**

110. Brazil simply attempts to sweep every challenged U.S. measure within the comparison mandated by the Peace Clause proviso; as noted above, as a fall-back position, Brazil argues that every challenged U.S. measure provides product-specific support. However, when the definitions of product-specific support and non-product-specific support are read together and in harmony and applied to U.S. measures, it is apparent that several challenged U.S. measures provide non-product-specific support within the meaning of Article 1(a). It may be useful to set out here the proper characterization of the measures Brazil challenges:

- **Product-specific support:** marketing loan payments, user marketing certificates (Step 2), cottonseed payments (not within Panel’s terms of reference)
- **Non-product-specific support:** counter-cyclical payments, crop insurance payments, expired market loss assistance payments
- **Green box support:** direct payments, expired production flexibility contract payments

In addition, for purposes of the support decided in marketing year 1992, deficiency payments provided product-specific support. It is only the first category of measures, the product-specific support to upland cotton, that is relevant for purposes of the Peace Clause proviso comparison.

111. The United States has previously explained how, with respect to the particular U.S. measures at issue in this dispute, the support “decided during the 1992 marketing year” must be gauged and how that support should be compared to the support the challenged measures grant. The result of this comparison is set out in the following table:

Marketing Year	Measures	Support
MY 1992	<ul style="list-style-type: none"> <li>• Deficiency payments + Marketing loan payments</li> <li>• User marketing certificates (Step 2)</li> </ul>	<ul style="list-style-type: none"> <li>• 72.9 cents per pound</li> <li>• Difference greater than 1.25 cents per pound between U.S. N. Europe price and A-index</li> </ul>
MY 1999-200 <sup>136</sup>	<ul style="list-style-type: none"> <li>• Marketing loan payments</li> <li>• User marketing certificates (Step 2)</li> </ul>	<ul style="list-style-type: none"> <li>• 51.92 cents per pound</li> <li>• Difference greater than 1.25 cents per pound between U.S. N. Europe price and A-index</li> </ul>
MY2002 <sup>137</sup>	<ul style="list-style-type: none"> <li>• Marketing loan payments</li> <li>• User marketing certificates (Step 2)</li> </ul>	<ul style="list-style-type: none"> <li>• 52 cents per pound</li> <li>• Difference between U.S. N. Europe price and A-index</li> </ul>

112. As reflected in this table, with the post-Uruguay Round 1996 Act, the United States deliberately moved away from the high-effective-price deficiency payments, for which one had to plant upland cotton for harvest to receive payment. In its place, the United States provided green box support and non-product-specific support which do not require production of upland cotton. Thus, the product-specific support decided during the 1992 marketing year was to ensure producer revenue of 72.9 cents per pound. From 1999-2001, the support challenged measures grant was 51.92 cents per pound. In marketing year 2002, challenged measures grant support at a rate of 52 cents per pound. In no year has support been granted in excess of that decided during the 1992 marketing year.

113. Brazil has asserted that the United States' approach does not provide any way of taking Step 2 payments into account. Because the availability of Step 2 payments is contingent on certain price conditions existing during the marketing year, the level of support decided must relate to the payment parameters. These have remained the same for Step 2, with the exception of the suspension, through 2006, of the 1.25 cent price difference threshold and payment availability at slightly higher market prices.<sup>138</sup> However, because Step 2 merely provides an alternative avenue of providing support (through processors rather than directly to producers), these minor adjustments do not alter the revenue ensured for producers by the marketing loan

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<sup>136</sup> Cottonseed payments are not with the scope of the dispute. The \$79 million cottonseed payment for the 1999 crop provided 1 cent per pound to 1999 cotton production of 7.821 million pounds. The \$185 million cottonseed payment for the 2000 crop provided 2.3 cents per pound to 2000 cotton production of 8.064 million pounds. See Exhibit Bra-4 (Upland Cotton Fact Sheet, at 4) (production figures).

<sup>137</sup> Cottonseed payments are not with the scope of the dispute. The \$50 million cottonseed payment for the 2002 crop provided 0.6 cents per pound to 2002 cotton production of 8.030 million pounds. See Exhibit Bra-4 (Upland Cotton Fact Sheet, at 4) (production figures).

<sup>138</sup> See U.S. First Written Submission, para. 109.

rate of 52 cents per pound.<sup>139</sup> In addition, these minor adjustments cannot overcome the greater than 20 cents per pound difference in product-specific support between marketing years 1992 and 1999-2002. Similarly, and without prejudice to whether these measures are within the Panel's terms of reference, we note that cottonseed payments in 1999, 2000, and 2002 ranged in value between 0.6 to 2.3 cents per pound (factoring expenditures over production); thus, they too do not materially affect the comparison between marketing year 1992 and any other year.

## **2. The Product-Specific AMS for Upland Cotton Also Demonstrates That Challenged U.S. Measures Do Not Breach the Peace Clause**

114. In Question 67, the Panel requested the parties to provide an estimate of the AMS for upland cotton for marketing years 1992, 1999, 2000, 2001, and 2002 using budgetary outlays. We note that Brazil attempted to construct a "price-gap" calculation for purposes of deficiency payments in marketing year 1992, rather than using the higher budgetary outlay figure found in Exhibit Bra-4. While Brazil's answer was not fully consistent with the Panel's request, we note nonetheless that Brazil is correct when it states that a non-exempt direct payment dependent on a price gap may be calculated using a price gap methodology rather than budgetary outlays, pursuant to paragraphs 10 and 11 of Annex 3.<sup>140</sup> However, marketing loan payments (marketing loan gains, certificate exchange gains, and loan deficiency payments) are also dependent on a price gap: the difference between the loan rate (currently 52 cents per pound) and the adjusted world price (as determined by the U.S. Department of Agriculture).<sup>141</sup> To be consistent, then, Brazil should have calculated the marketing loan portion of the upland cotton AMS using a price gap methodology as well, rather than relying on budgetary outlays.<sup>142</sup>

115. The United States has calculated an AMS for upland cotton using the price gap methodology for both deficiency payments and marketing loan payments and retaining the budgetary outlays set out in the U.S. answer to Question 67 for all other payments.<sup>143</sup> The results are as follows:

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<sup>139</sup> We note that, to the extent that Step 2 payments result in higher prices being paid to producers, under the 2002 Act they would also have the effect of reducing the payments necessary under the counter-cyclical program, which is linked to current market prices.

<sup>140</sup> Brazil's Answer to Question 67 from the Panel (para. 130).

<sup>141</sup> See Brazil's First Written Submission, para. 70; U.S. First Written Submission, paras. 20-21.

<sup>142</sup> See Brazil's Answer to Question 67 from the Panel (para. 130, table fn. 6) (indicating that marketing loan payment amounts were drawn from paragraphs 144, 148, and 149 of Brazil's first written submission, which presented budgetary outlays).

<sup>143</sup> See Agreement on Agriculture, Annex 3, para. 12 ("Non-exempt direct payments which are based on factors other than price shall be measured using budgetary outlays.").

<b>U.S. Upland Cotton Aggregate Measurement of Support</b>	
<b>Marketing Year</b>	<b>AMS (U.S. \$, millions)</b>
1992	1,079 <sup>144</sup>
1999	717
2000	484
2001	264
2002 <sup>145</sup>	205

That is, *in no marketing year from 1999 through 2002 did the upland cotton Aggregate Measurement of Support exceed that in marketing year 1992.* Were the Panel to examine the upland cotton Aggregate Measurement of Support as the “support to a specific commodity” within the meaning of the Peace Clause proviso, the United States suggests that this table, calculated using the price gap methodology for deficiency payments and marketing loan payments, presents the appropriate analysis.<sup>146</sup>

116. What accounts for the difference between these figures and those presented in the U.S. answer to Question 67 from the Panel? The price gap methodology eliminates the effect of

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<sup>144</sup> To calculate the deficiency payment support using the price gap methodology and consistent with the 1995 U.S. WTO notification, we have made the following calculation:

Basic deficiency payments are dependent on a price gap: Target price - Fixed reference price. The fixed reference price is the 1986-88 average of the higher of market prices or loan rates. Basic deficiency payments are calculated as: Price gap \* Eligible production. Eligible production is calculated as the product of eligible acreage and payment yields. The same formula is used to calculate 50/92 payments.

There is also an adjustment factor used to account for the effect of payment limitations and other factors that reduce actual payments. That factor is calculated by dividing actual basic deficiency payments (as reported by FSA) by the estimated basic deficiency payments (determined using the above formula). The estimated deficiency payments are multiplied by that factor to produce the estimated basic payments. The same process is used to calculate estimated 50/92 payments.

Using this methodology for 1992, the target price was 72.9 cents per pound and the fixed reference price was 57.9 cents per pound, giving a price gap of 15.0 cents per pound. Eligible production was 5,507 million pounds. Using an adjustment factor (approx .875) to take into consideration payment limitations, the basic deficiency payments were approximately \$724 million.

The same formula is used to calculate 0-50/92 payments. For 1992, the price gap is the same as that calculated for the basic deficiency payments (.15 cents per pound). Eligible production was 201.596 million pounds. All 0-50/92 were eligible so the adjustment factor was 1. The 0-50/92 deficiency payments were \$30 million.

Finally, the basic payments and the 0-50/92 payments are added together to get an estimated total deficiency payment for the AMS. This was \$755 million for 1992.

<sup>145</sup> As of the date of panel establishment, March 18, 2003.

<sup>146</sup> We also note that, pursuant to paragraphs 10 and 11 of Annex 3, the choice whether to use budgetary outlays or a price gap calculation is within the discretion of the Member.



prevailing market prices on the calculation of support. Instead, paragraphs 10 and 11 of Annex 3<sup>147</sup> designate that the support be calculated by multiplying the quantity of eligible production by the gap between the applied administered price (for example, the marketing loan rate) and the *fixed reference price* (that is, the actual price for determining payment rates for the years 1986 to 1988).<sup>148</sup> Thus, by holding the reference price “fixed,” support measured using a price gap calculation shows the effect of changes in the level of support (applied administered price) decided by a Member, rather than changes in outlays that may result from movements in market prices that a Member does *not* control.

117. Because the price gap calculation reflects changes in the level of support decided by a Member, it provides an appropriate methodology (within the context of an AMS calculation) to compare the support “decided” during the 1992 marketing year with the “support to a specific commodity” that challenged measures “grant.” Not surprisingly, the results are identical to a comparison made using the U.S. approach of looking at the rate of support as decided by U.S. measures: the Peace Clause has not been breached because the support that challenged measures grant is not in excess of that decided during the 1992 marketing year.

118. The United States does not believe that the Peace Clause proviso calls for using an Aggregate Measurement of Support calculation. “Support” (“assistance” or “backing”) does not mean “AMS.” The Aggregate Measurement of Support is one particular way of measuring support, a yearly amount expressed in monetary values, calculated according to the rules set out in Annex 3. The Aggregate Measurement of Support was closely negotiated by Members but is not the only way to measure support. For example, “market price support” could be expressed

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<sup>147</sup> Annex 3, paragraphs 10 and 11, provide, in full:

10. Non-exempt direct payments: non-exempt direct payments which are dependent on a price gap shall be calculated either using the gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price, or using budgetary outlays.

11. The fixed reference price shall be based on the years 1986 to 1988 and shall generally be the actual price used for determining payment rates.

<sup>148</sup> The methodology for calculating marketing loan payments using the “price gap” method uses the formula: Marketing loan payments = Price gap \* Eligible production. The price gap equals the Applied administered Price - Fixed reference price (1986-88 average). The applied administered price is the loan rate. The fixed reference price is the average of the Adjusted World Price (AWP) (USDA) for 1986-88. Eligible production is total production of upland cotton.

Since the average AWP for 1986-1988 is 53.65 cents per pound and thereby higher than the loan rate for each of the years relevant in the proceedings (51.92 cents per pound for 1999-2001; 52.00 cents per pound for 2002), the price gap is always negative. To be conservative, rather than apply a negative number to the AMS calculation as might be implied by the price gap methodology, we have simply entered a “0” for marketing loan payments (marketing loan gains, certificate exchange gains, and loan deficiency payments) in each crop year AMS calculation in paragraphs 129 through 133 of the U.S. answer to Question 67.

simply as the price supported or as the difference between the support price and the current international price (rather than the reference price in the 1986-88 base period).

119. Further, we note that it would not be possible to calculate an Aggregate Measurement of Support for upland cotton *ex ante*; for example, under paragraph 12 of Annex 3, non-exempt direct payments “based on factors other than price shall be measured using budgetary outlays.” Thus, if “support” were read to mean “AMS,” Members would have no certainty whether U.S. payments for a given year could be challenged until some time after those payments had been completed, at which time a new set of measures (payments) would exist. We also note that, at the time the Uruguay Round closed in December 1993, the United States (and other Members) would not have known what the support “decided during the 1992 marketing year” was – and therefore what the Peace Clause limit would be – since 1992 marketing loans were still being repaid until February 1994. For the same reason, it is not possible to know today whether the 2002 Aggregate Measurement of Support for upland cotton will exceed the marketing year 1992 level. Thus, the United States continues to believe that, because U.S. measures decide support by setting a rate, the Peace Clause comparison must look at the level of support, expressed as a rate.

### **3. The Alternative Approach of Brazil’s Expert Does Not Reflect the Support “Decided” by U.S. Measures and Is Riddled with Errors**

120. Brazil has presented an extensive analysis by its expert which purports to show that, even taking an *ex ante* approach to the level of support, various “decisions” by the U.S. Government resulted in the level of support in marketing year 1992 being lower than in every marketing year from 1999-2002. As indicated in the U.S. answer to Question 66(d) from the Panel, the United States finds the approach of Brazil’s expert to be conceptually flawed and, on close review, riddled with factual errors. We attach a report that attempts to catalogue these numerous errors.<sup>149</sup>

121. At the outset, we note that, even using Mr. Sumner’s flawed calculations, if one excludes the non-product-specific support that Brazil is attempting to “allocate” to upland cotton from the table, Sumner’s analysis supports the United States, not Brazil. That is, Sumner’s estimated per unit rate of support was *lower* in every year from marketing year 1999 through marketing year 2002 than the level of support during marketing year 1992:

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<sup>149</sup> Exhibit USA-24.

<b>Product-Specific Support in Sumner’s per Unit Subsidy Rates (Cents per Pound) by Program and Year<sup>150</sup></b>					
	<b>MY1992</b>	<b>MY1999</b>	<b>MY2000</b>	<b>MY2001</b>	<b>MY2002</b>
Marketing Loan	44.34	50.36	50.36	50.36	52.00
Deficiency	13.25	na	na	na	na
Step 2	2.46	2.46	2.46	2.46	3.71
Cottonseed <sup>151</sup>	na	0.97	2.27	na	0.61
<b>Total</b>	<b>60.05</b>	<b>53.79</b>	<b>55.09</b>	<b>52.82</b>	<b>56.32</b>

122. Thus, even were one to accept for purposes of argument Mr. Sumner’s approach, comparing the product-specific support the challenged measures grant to the product-specific support decided during marketing year 1992 reveals that in no marketing year from 1999 through 2002 did the level of support exceed the marketing year 1992 level. That is, the result (if not the analysis) is *identical* to the result under the U.S. approach of comparing the levels of support decided by U.S. measures and *identical* to the result under an approach comparing the AMS for upland cotton using a price gap methodology. Under any of these approaches, including Sumner’s own analysis, U.S. domestic support measures that conform fully to the provisions of Article 6 are exempt from actions based on Peace Clause-specified WTO subsidies provisions under Article 13(b)(ii).

123. With respect, Mr. Sumner’s per unit expected rate of support analysis is conceptually flawed. We have already mentioned one serious conceptual flaw, namely, attempting to adjust the per unit rate of support to take account of producers that chose not to participate in the program. This approach ascribes to the United States choices made by producers themselves.<sup>152</sup> The support measures were available and could have been taken up by additional producers in 1992; that additional producers did not reflects their calculations of what was in their best interest, not the level of support decided by the U.S. Government. In economic terms, a farmer that participated in the upland cotton program received full program benefits; a farmer who chose not to participate did not. Averaging these numbers produces a “per unit rate of support” that no cotton farmer ever could have expected to receive and was not “decided” by the U.S. Government. Because individual producer choices on program participation do not reflect any

<sup>150</sup> See Exhibit Bra-105 (Appendix table 1).

<sup>151</sup> The United States includes the cottonseed amounts from the table without prejudice to whether these payments are within the scope of this dispute.

<sup>152</sup> See, e.g., Exhibit BRA-105 (Statement of Mr. Daniel Sumner, para. 10) (“The following qualifications and adjustments must [] be made to the level of support provided by the deficiency payment program: (1) payments were made *only if a farm chose to participate* in the deficiency payment program; in 1992, farms representing 11 percent (1.64 million acres) of the total ‘effective’ upland cotton acreage base (14.9 million acres) *did not agree to participate in the program* and hence cotton production on this land could not receive support.”) (emphasis added).

decision by the U.S. Government, estimated rates of support that reflect these producer decisions are not relevant to the Peace Clause analysis under Article 13(b)(ii).

124. Mr. Sumner argues that the deficiency payment rate and marketing loan rate must be adjusted to account for the 10 percent acreage reduction program in effect for 1992 and the 15 percent “normal flex acres,” on which deficiency payments could not be received. We believe these program elements affected eligibility and not the rate of support decided by U.S. measures. A producer determining whether to produce upland cotton would have considered the guaranteed revenue expressed by the deficiency payment target price, not any discounted rate.

125. While these elements of the 1992 upland cotton program were “decisions” taken by the U.S. Government, moreover, the actual impact of these elements of the program is unclear. Both of these elements related to “base acres” and not actual planted acres in a given year. Thus, producers could alter their behavior to take account of those elements, for example, by dropping out of the program in a given year to “build base” (that is, plant cotton acres without limit). In addition, acres planted but abandoned by producers could have been considered to have been “idled” for purposes of these program elements but would not have represented any diminution of support. It is not at all clear, then, that these elements of the program actually resulted in lower payments to cotton producers than would have resulted in the absence of those elements.<sup>153</sup>

126. Were Sumner correct that these program elements did in fact reduce program outlays and should be factored into the rate of support, there is a far more direct way of doing so that does not repeat the error of taking into account producer participation decisions. One could simply reduce the maximum deficiency payment rate (20.55 cents per pound, the difference between the effective price of 72.9 cents per pound and the loan rate of 52.35 cents per pound) by the 10 percent acreage reduction percentage and the 15 percent “normal flex acres,” which makes the unrealistic assumption that in the absence of these program elements producers would have produced on *all* of their base acres. This reduction yields an adjusted maximum deficiency payment rate of 15.4125 cents per pound. Adding this rate to the marketing loan rate gives guaranteed producer revenue of 67.7625 cents per pound. Thus, even taking into account the maximum effect the acreage reduction program and 15 percent normal flex acres could have had, the rate of support decided by U.S. measures during the 1992 marketing year is higher than the 51.92 cents per pound rate in marketing years 1999-2001 or the 52 cents per pound rate in marketing year 2002.

127. In sum, we believe the rate of support as reflected in U.S. measures accurately reflects the rate of support given to upland cotton producers. Mr. Sumner’s approach, attempting to

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<sup>153</sup> It would appear that Sumner reached a similar conclusion in 1995 when, after discussing target prices, acreage reduction percentages, and 85 percent payment limits, he wrote: “For cotton the current program likely has relatively little impact on acreage.” Exhibit Bra-105, Annex 2, Attachment (Daniel A. Sumner, *Farm Programs and Related Policy in the United States*, in *Understanding Canada - United States Grain Disputes* at 69 (Loyns *et al.*, eds. 1995).

construct an “expected” rate of per unit support is conceptually flawed. His analysis takes into account producer choices that cannot lower the level of support “decided” by the U.S. Government. Taking full and excessive account of the 10 percent acreage reduction program and the 15 percent normal flex acres, moreover, the 1992 rate of support is still well above the rate for any of marketing years 1999-2002. Sumner’s own analysis supports this conclusion: his calculations purport to take the acreage reduction program and normal flex acres into account, and, once non-product-specific support has been removed from the equation, his total expected rate of per unit support favors the U.S. view, not that of Brazil. Finally, the United States would note that Mr. Sumner’s analysis is riddled with errors, many of which have the effect of artificially lowering the 1992 level of support, even within the parameters of Sumner’s calculations. Should the Panel be interested in reviewing these numerous errors, we attach as Exhibit US-24 a detailed report setting out our critique of Sumner, both on a conceptual and a technical level, detailing the many flaws in data and methodology employed.

#### **4. Conclusion: Challenged U.S. Measures Are Not in Breach of the Peace Clause**

128. Following the Uruguay Round, the United States decided to shift away from product-specific support towards less distortive forms of support. In fact, the level of income support granted to upland cotton producers is far lower now than in 1992. The product-specific support decided during the 1992 marketing year for upland cotton was to ensure producer income of 72.9 cents per pound through a combination of deficiency payments and marketing loans, both of which were linked to production of upland cotton. Now, U.S. domestic support measures grant product-specific support to upland cotton only at the rate of 52 cents per pound of production through marketing loans to upland cotton producers.<sup>154</sup>

129. We note that, stripping away the non-product-specific support Brazil attempts to interject into the analysis, the information provided by Brazil’s own expert supports this conclusion. In fact, whether the analysis is the rate of support as reflected in U.S. measures, or the upland cotton AMS measured through a price gap methodology, or the “expected rate of per unit support” of Brazil’s expert, the result (as reflected in the table below) is the same: challenged U.S. measures are not in breach of the Peace Clause.

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<sup>154</sup> While the current formula for calculating user marketing payments is slightly more generous now than in 1992, such a minor difference cannot alter the conclusion that the production-linked level of income support decided in 1992 was more than 20 cents per pound higher compared to the support that production-linked measures grant today.

<b>Comparison under Peace Clause Proviso of Support Decided During Marketing Year 1992 to Support Challenged U.S. Measures Grant</b>	
<b>Approach</b>	<b>Result</b>
United States: rate of support	No Peace Clause breach in any marketing year from 1999-2002
Upland cotton AMS using price gap	No Peace Clause breach in any marketing year from 1999-2002
Summer: expected rate of support, limited to product-specific support	No Peace Clause breach in any marketing year from 1999-2002

130. Because the product-specific support that challenged U.S. measures grant to upland cotton is not in excess of that product-specific support to upland cotton decided during the 1992 marketing year, U.S. non-green box domestic support measures are “exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement.” As a result, Brazil may not maintain this action and advance claims under the specified provisions with respect to U.S. non-green box domestic support measures.

#### **IV. U.S. Export Credit Guarantee Programs**

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

131. Article 10.2 of the Agreement on Agriculture provides: “Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programs and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programs only in conformity therewith.”

132. Even though Brazil acknowledges that no agreement within the meaning of Article 10.2 has been achieved<sup>155</sup>, it nevertheless argues that such “internationally agreed disciplines” already apply. Brazil asserts that the export subsidy disciplines of the Agreement on Agriculture and the SCM Agreement apply fully to the CCC export credit guarantee programs.

133. However, as the United States has argued, if export credit guarantee programs were already subject to export subsidy disciplines, then Article 10.2 would be unnecessary. That is, Members would *already* have “to provide . . . export credit guarantees . . . only in conformity” with the internationally agreed disciplines of the WTO. In Brazil’s oral statement, Brazil attempts to avoid this implication of its reading by repeatedly attempting to insert the word

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<sup>155</sup> Oral Statement of Brazil, para. 103.

"specific" into the text of Article 10.2 – that is, “undertake to work toward the development of *specific* internationally agreed disciplines .”<sup>156</sup> That word is not there, however. The United States' interpretation of Article 10.2 gives meaning to the text of Article 10.2 as drafted and agreed by Members whereas Brazil's reading would effectively read it out of the Agreement on Agriculture.

134. Brazil has also focused on the absence of an explicit affirmative statement of exemption of export credit guarantees from such disciplines.<sup>157</sup> The United States submits that the language of Article 10.2 is clear. The negotiating history with respect to that Article also confirms the interpretation that the United States advances. Under Article 31.3(b)<sup>158</sup> of the Vienna Convention on the Law of Treaties it is appropriate to take into account the subsequent practice of the Members in the application of Article 10.2; and under Article 32<sup>159</sup> of the Vienna

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<sup>156</sup> See, e.g., Brazil's Oral Statement, para. 100 (“Article 10.2 instead announces Members’ intent to work toward negotiations on *specific* disciplines for export credits.”) (italics in original); *id.* (“In the meantime, while those *specific* disciplines are being discussed . . .”) (emphasis added); *id.*, para. 102 (“Under the first part of Article 10.2, therefore, WTO Members have pledged to work toward the development of *specific* disciplines . . .”) (emphasis added); *id.*, para. 103 (“If Members do conclude an agreement on these *specific* disciplines . . .”) (emphasis added); *id.* (Brazil and the United States agree that there has been no agreement on any such *specific* disciplines . . .”) (emphasis added).

<sup>157</sup> Oral Statement of Brazil, paras. 104, 105.

<sup>158</sup> Article 31:General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
  - (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
  - (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
  - (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
  - (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
  - (c) any relevant rules of international law applicable in the relations between the parties.
4. A special meaning shall be given to a term if it is established that the parties so intended.

<sup>159</sup> Article 32:Supplementary means of interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of

Convention the Panel may revert to supplementary means of interpretation, including “the preparatory work of the treaty and the circumstances of its conclusion.”

135. In its First Written Submission the United States has already noted that years of negotiations to develop the internationally agreed disciplines envisioned under Article 10.2 ensued immediately following the conclusion of the Uruguay Round. These occurred under the auspices of the Organization for Economic Cooperation and Development (OECD) and subsequently in the WTO itself under the mandate of the Doha Ministerial Declaration.<sup>160</sup> Documents prepared for the OECD reflect the understanding of that organization as of late 2000, that as a result of Article 10.2 “governments are currently free to provide credits to importers at any terms, no matter the degree to which they effectively subsidize the importer, as long as there is no protocol governing or limiting their use in agriculture.”<sup>161</sup> Numerous WTO members, including many third parties in this dispute, were active participants in the OECD negotiations.<sup>162</sup>

136. The GATT/WTO negotiating history regarding export credits and export credit guarantees in agriculture also definitively supports this view. On July 11, 1990, the so-called “DeZeeuw Text” was circulated<sup>163</sup>. Paragraph 20(e) of that text contemplated that Members would provide “data on financial outlays or revenue forgone . . . in respect of export credits provided by governments or their agencies on less than fully commercial terms.” Under paragraph 22, the document envisioned concurrent negotiations to govern the use of export assistance, including “disciplines on export credits.”<sup>164</sup>

137. Chairman DeZeeuw was succeeded by Chairman Dunkel, and on June 24, 1991, he circulated a Note on Options in the Agriculture Negotiations<sup>165</sup>. In paragraph 48 of that Note, the Chairman requested decisions by the principals on “whether subsidized export credits and related practices . . . would be subject to reduction commitments.” Subsequently, on August 2, 1991, he circulated a series of addenda on the Note on Options “aimed at exploring certain options in greater detail.”<sup>166</sup>

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article 31, or to determine the meaning when the interpretation according to article 31:

- (a) leaves the meaning ambiguous or obscure; or
- (b) leads to a result which is manifestly absurd or unreasonable.

<sup>160</sup> U.S. First Written Submission, paras. 157-159

<sup>161</sup> U.S. First Written Submission, fn. 149. OECD document: “An Analysis of Officially Supported Export Credits in Agriculture,” para. 8.

<sup>162</sup> The ten participants in the OECD negotiations were Argentina, Australia, Canada, the European Community, Japan, Korea, New Zealand, Norway, Switzerland, and the United States. See Exhibit US-7, p. 3.

<sup>163</sup> MTN.GNG/NG5/W/170 (Exhibit US-25).

<sup>164</sup> The Commodity Credit Corporation did not then, and does not now, provide direct export credits in agriculture (nor export insurance). The United States provides export credit guarantees.

<sup>165</sup> MTN.GNG/AG/W/1 (24 June 1991) (Exhibit US-26).

<sup>166</sup> MTN.GNG/AG/W/1/Add.1 (2 August 1991) (Exhibit US-27).



138. Included among the addenda was Addendum 10 on “Export Competition: Export Subsidies to be subject to the terms of the Final Agreement.”<sup>167</sup> Section 3 of that Addendum sets forth a proposed “Illustrative List of Export Subsidy Practices.” Item (h) is explicitly “Export Credits provided by governments or their agencies on less than fully commercial terms.” Similarly, item (i) is “Subsidized export credit guarantees or insurance programs.”

139. On December 12, 1991, the chairman circulated for discussion a “Draft Text on Agriculture.”<sup>168</sup> As the Panel will note, Article 8.2 of that Draft Text is substantially similar to the current Article 9.1 of the Agreement on Agriculture.<sup>169</sup> Article 9.1 of the Draft Text is virtually identical to Article 10.1 of the current Agreement.<sup>170</sup>

140. Only 8 days later, the Chairman of the Trade Negotiations Committee issued the “Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations.”<sup>171</sup> It is important to compare and contrast the relevant provisions of the Draft Final Act with the text that ultimately emerged. Article 10.2 of the Draft Final Act reads as follows:

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

This draft text would clearly prohibit the use of export credit guarantees except in conformity with agreed disciplines. Such internationally agreed disciplines would include those contemplated by the SCM Agreement of the Draft Final Act.<sup>172</sup> This would be precisely the language necessary to support the arguments that Brazil propounds before this Panel.

141. *But the language of Article 10.2 of the Draft Final Act is not the language of Article 10.2 of the Agreement on Agriculture.* The Members clearly subsequently decided *not* to condition the use of export credit guarantees on conformity with the export subsidy disciplines of the Agreement on Agriculture or the SCM Agreement. They changed the previously drafted language to an agreement to *work toward the development of internationally agreed disciplines*

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<sup>167</sup> MTN.GNG/AG/W/1/Add.10 (2 August 1991) (Exhibit US-27).

<sup>168</sup> Exhibit US-28.

<sup>169</sup> See also Annex 7 of the Draft Text (Exhibit US-28).

<sup>170</sup> Article 9.3 of the Draft Text states that “for purposes of this Article” - meaning the entirety of the anti-circumvention provisions - “whether export credits, export credit guarantees or insurance programs provided by governments or their agencies constitute export subsidies shall be determined on the basis of paragraphs (j) and (k) of Annex 1 to the Agreement ( . . . ) On Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade [the Tokyo Round Subsidies Code].” The entire application of the export subsidy anti-circumvention provisions of this draft text to export credit guarantees is hinged on items (j) and (k) of the Illustrative List of Export Subsidies under the Tokyo Round Subsidies Code, which items emerged virtually unchanged in the comparable Illustrative List of the current SCM Agreement. It clearly does *not* relate in any way to any concept of benefit.

<sup>171</sup> MTN.TNC/W/FA (20 December 1991); the Agriculture text of the Draft Final Act is Exhibit US-29.

<sup>172</sup> Articles 1-3 and the Illustrative List of Export Subsidies within the Draft SCM Agreement are Exhibit US-30.

and only *after* agreement on such disciplines - which Brazil admits has not yet occurred - are Members obligated to provide export credit guarantees only in conformity with such disciplines. The Members did not come to agreement on the application of disciplines, and instead agreed to defer any such disciplines subject to the results of the negotiations that followed in the OECD.<sup>173</sup>

142. Brazil's interpretation would require export credit guarantees in agriculture to be subject to more disciplines than any other practice addressed in the Agreement on Agriculture. Under Brazil's view, not only would export credit guarantees constitute export subsidies and be subject to all of the export subsidy disciplines, but Member's would also be specifically obligated to work toward and then apply *additional* disciplines.

143. Brazil further suggests that the absence of export credit guarantees as a named export subsidy in Article 9.1 is not surprising, and notes the Foreign Sales Corporation (FSC) export subsidy of the United States also was not included.<sup>174</sup> The obvious point, however, is that the negotiating history reveals that the Members very early specifically included export credits and export credit guarantees as a subject for negotiation and specifically elected *not* to include such practices among export subsidies. In contrast, the negotiating history reveals no comparable discussion involving FSC.

144. New Zealand suggests the omission of export credit guarantees from Article 9.1 is "because export credit guarantees are not, *per se*, export subsidies."<sup>175</sup> New Zealand further suggests that export credit guarantees may or may not involve export subsidies, relative to the marketplace (i.e., "the extent to which the premium rates charged on current export credit guarantees are lower than the corresponding financing rates that a commercial bank would normally require given a similar level of risk.")<sup>176</sup>

145. The negotiating history, however, reveals that as early as 1991 the Members understood that "Export credits provided by governments or their agencies on less than fully commercial terms" and "Subsidized export credit guarantees or insurance programs" were export practices subject to discussion and negotiation.<sup>177</sup> Yet neither of these two formulations, seemingly the precise kind of export credits and export credit guarantees that New Zealand and Brazil would posit as export subsidies, appears in Article 9.1.

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<sup>173</sup> Similarly, Article 3.1 of the version of the SCM Agreement in the Draft Final Act contains no reference to the Agreement on Agriculture. It is clear that the negotiators recognized a need to set forth clearly the nature of the relation between the two agreements after circulation of the Draft Final Act .

<sup>174</sup> Brazil Answer to Panel Question 80; Brazil's First Oral Statement, para. 114.

<sup>175</sup> New Zealand Answers to Question 35 of Panel to Third Parties.

<sup>176</sup> Brazil obliquely concurs in its Answer to Panel Question 71(a): "Although export credit guarantees do not automatically confer benefits . . . ."

<sup>177</sup> MTN.GNG/AG/W/1/Add.10 (2 August 1991) (Exhibit US-27).

146. Canada succinctly acknowledges that “export credit guarantees were not included in Article 9.1 of the Agreement on Agriculture because the Members could not agree on specific language.”<sup>178</sup> As reflected in the negotiating history, not only could the Members not agree on language that would cause export credit guarantees - whether offered on “less than fully commercial terms” or otherwise - to be listed among export subsidies, they very clearly could not agree to impose on export credit guarantees the disciplines on which they had in fact agreed. That would have been the result if the language of the Draft Final Act had been adopted. It was not, however.

***Brazil’s approach would result in gross injustice***

147. As part of the negotiations, the parties had to prepare and submit schedules of quantities and budget outlays during a base period to derive the export subsidy reduction commitments ultimately reflected in the respective schedules of the Members.<sup>179</sup> Had Members’ export credit guarantees been considered export subsidies for these purposes from the outset, as Brazil’s argument would compel, then the export credit guarantee activity during the relevant period would also have to have been added to the base figures from which each Member’s export subsidy reduction commitments were calculated.

148. In the case of the United States, for example, the following table sets forth the amounts of exports under the GSM-102 and GSM-103 programs during the 1986-1990 base period.<sup>180</sup> For convenience of comparison, the actual export subsidy quantity average for the 1986-1990 base period in the schedule of the United States is also set forth. The export credit guarantee average quantity data is displayed first for the same commodity groupings to which export subsidy reduction commitments of the United States apply. This is followed by the average quantities of export credit guarantee activity for all other commodities during the 1986-1990 base period.

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<sup>178</sup> Canada’s Responses to Panel Question 35 to Third Parties.

<sup>179</sup> See Draft Final Act MTN.TNC/W/FA, Section L. Text on Agriculture, Part B: Agreement on the Modalities for the Establishment of Specific Binding Commitments under the Reform Program, para. 11, and Annex 8: Modalities of Export Competition Commitments. Exhibit US-29.

<sup>180</sup> U.S. export subsidy reduction commitments per year are for the period July-June. Data with respect to the export credit guarantee program activity is maintained on the basis of fiscal years, which are October - September. As a result, the data portrayed is not an exact match, but the purpose of the data is to reflect the order of magnitude of the activity.

UR SKINS 491,769metric tons

Commodity <sup>181</sup>	1986-90 Base Period Export Subsidy Quantity <sup>182</sup>	1986-90 Base Period Export Credit Guarantee Quantity	Unit of Measure
WHEAT	18,382,354	8,678,156	metric tons
COARSE GRAINS	1,975,442	1,801,988	metric tons
RICE	48,802	578,778	metric tons
VEGETABLE OILS	178,860	381,851	metric tons
BUTTER AND BUTTER OIL	26,705	1,250	metric tons
SKIM MILK POWDER	86,331	11,747	metric tons
CHEESE	3,836	346	metric tons
OTHER MILK PRODUCTS	43	73,467	metric tons
BOVINE MEAT	22,265	241,125	metric tons
PIGMEAT	500	788	metric tons
POULTRY MEAT	35,436	15,032	metric tons
LIVE DAIRY CATTLE (head)	13,955	12,575	head
EGGS (dozen)	8,758,991	8,971,681	dozen eggs
BEANS, DRY		106,994	metric tons
BEEF OFFALS		139	metric tons
BREEDING HORSES		3	head
CATTLE EMBRYOS		200	metric tons
CATTLE HIDES		254,920	metric tons
CATTLE, BEEF BREED		27,170	head
CATTLE, BREEDING		756	head
CHICKS, BREEDER		736,527	chicks

<sup>181</sup> In earlier submissions to the Panel the United States has noted that it has export subsidy reduction commitments with respect to 12 commodity groups. In fact, the correct number is 13: wheat/flour; coarse grains; rice; vegetable oils; butter and butter oil; skim milk powder; cheese; other milk products; bovine meat; pigmeat; poultry meat; live dairy cattle, and eggs.

<sup>182</sup> See Exhibit Bra-83 (Schedule XX of the United States of America, Part IV, Section II, entitled Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments).

CORN GLUTEN MEAL		19,726	metric tons
CORN OIL		9,144	metric tons
CORN STARCH		1,040	metric tons
COTTON		859,259	metric tons
COTTONSEED		12,228	metric tons
COTTONSEED MEAL		1,300	metric tons
FUR SKINS		491,769	metric tons
GREASE, YELLOW		1,687	metric tons
HOG/PIG SKINS		723,840	pieces
HOP EXTRACT		10	metric tons
HOPS		30	metric tons
LEATHER		4,082,328	metric tons
LENTILS		1,135	metric tons
MEAT/BONE MEAL		9,883	metric tons
PEAS, DRY		9,312	metric tons
PLANTING SEEDS		7,343	metric tons
PORK OFFAL		94	metric tons
PROTEIN SUPPLEMENT		86,142	metric tons
SEMEN		90,781	metric tons
SOFT DRINKS		42,920	metric tons
SOYBEAN MEAL		788,836	metric tons
SOYBEANS		1,291,225	metric tons
SUGAR		119,760	metric tons
SUNFLOWER SEED		134,341	metric tons
TALLOW		302,727	metric tons
TOBACCO		11,133	metric tons
WHITE CORN		32,700	metric tons
WOOL		788	metric tons
YELLOW CORN		5,498,494	metric tons

149. If the export credit guarantee programs of the United States were to be considered export subsidies, then the base period export subsidy quantity in Schedule XX of the United States for each commodity should be the *sum* of the two columns. The size of the quantities involved in the export credit guarantee programs during the 1986-90 period indicate that the United States obviously understood that export credit guarantees were not subject to export subsidy commitments.<sup>183</sup>

150. For example, the United States has no export subsidy reduction commitment with respect to corn. It is therefore prohibited from providing any export subsidy at all with respect to corn. Yet during the 1986-1990 base period an average of over 5.5 million tons of corn were exported each year under the GSM-102 and GSM-103 programs. Cotton itself is another prominent example. The *yearly* average during the base period was over 859,000 metric tons. The base for coarse grains would nearly double. For vegetable oils it would more than triple. The bovine meat base would increase more than ten fold. The rice base would increase by almost 13 fold. For “other milk products” the base would increase by a multiple of over 1,700. Such glaring omissions also would have been obvious to Members, including those who participated in the subsequent negotiations in the OECD.

151. This data highlights the inequity of Brazil’s argument. The United States understood that its export credit guarantees were not export subsidies and were not subject to export subsidy disciplines. As a result, to our knowledge no Member (and certainly not the United States) included any of the export credit guarantee activity that occurred in the base period amounts. The amount of exports involved was obviously very significant and would have meant a significant difference in the level of export subsidy reduction commitments from which all Members would now be negotiating.

152. Brazil offers an *ex post facto* tortured textual interpretation to subject export credit guarantees to a discipline that was never meant to apply. Brazil’s argument would result in a gross injustice – Members in good faith calculated their export subsidy reduction commitments without regard to export credits and credit guarantees. Had Members agreed to include export credits and credit guarantees in the export subsidy disciplines, they would have also included them in their reduction commitment calculations. The United States alone would have reduction commitments for many more products than currently and would have had significantly increased commitments for the 13 products that are scheduled. However, Brazil would have the Panel impose the disciplines now but deny Members the corresponding changes in reduction commitments. Brazil’s approach would be grossly inequitable and the Panel should reject it.

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<sup>183</sup> This observation is compounded by the fact that Member States had a certain incentive to maximize the export subsidy base amounts to enable an increased level of export subsidies.

153. Contrary to the arguments of Brazil, Members were unable to agree and therefore did not agree to impose on export credit guarantees the export subsidy disciplines reflected in the Agreement on Agriculture and the SCM Agreement. They agreed only to work toward such disciplines and apply them only upon agreement on such disciplines.

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

154. Brazil has seized upon the application of the Federal Credit Reform Act of 1990 (FCRA) as “an ideal basis on which to determine whether the CCC’s export credit loan guarantee programs are offered at premium rates that are inadequate to cover the long-term operating costs and losses of the programs, within the meaning of item (j) of the Illustrative List of Export Subsidies.”<sup>184</sup> The application of FCRA over time to the export credit guarantee programs as a whole, currently indicates that the net result of all activity associated with export credit guarantees issued in fiscal years 1994 and 1995 is a total net receipt to the United States of \$29 million. The experience of 1994 and 1995 is viewed as representative, and the United States expects that once it closes the accounting books for other fiscal years, the net results will be similar to the experience for 1994 and 1995.<sup>185</sup>

155. The estimates reflected in the budget are being revised annually to reflect actual performance and, until all activity associated with all export credit guarantees issued in a given fiscal year have been closed out, the actual costs cannot be determined definitively.<sup>186</sup> However,

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<sup>184</sup> First Oral Statement of Brazil, para. 129. We note in this connection that the analysis in Brazil’s response to the Panel’s question 72 does not withstand close scrutiny. Brazil says that it does not agree with the U.S. position on the viability of an *a contrario* interpretation of item (j) of the SCM Agreement Illustrative List because the panel in the *Brazil Aircraft* dispute rejected the U.S. (and then-Brazilian) analysis of the List and of footnote 5 to the SCM Agreement. Brazil’s answer to question 72, para. 147. Brazil does note that the Appellate Body explicitly disagreed with the panel and said that *a contrario* interpretations of Illustrative List items could indeed be permissible, but adds that the Appellate Body’s statements were “dicta.” In fact, the Appellate Body said that because Brazil had not demonstrated that certain conditions of item (k) had been met in that dispute, it would not reach those questions -- and more importantly, it found that the panel finding upon which Brazil now relies was “moot, and, thus, ... of no legal effect.” Appellate Body Report, *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/AB/RW, adopted 4 August 2000, para. 81. Brazil cannot pick and choose among the jurisprudence this way: if it wishes to quote *panel* findings “of no legal effect” in support of its argument, it should be prepared to accept such *Appellate Body* findings as well.

<sup>185</sup> Although the provisions of FCRA began to apply in fiscal year 1992, the first fiscal years projected to close are fiscal years 1994 and 1995. Fiscal years 1992 and 1993 will not close before 1994 and 1995, because certain financial activity under reschedulings associated with 1992 and 1993 is projected to extend beyond the last financial activity of 1994 and 1995.

<sup>186</sup> Loan guarantee subsidy estimates also inflate the cost of the CCC export credit guarantee programs because “for purposes of calculating loan guarantee subsidy estimates, the loan guarantee commitment is the full principal amount of the loan that is guaranteed, not just the portion guaranteed by the Government.” See OMB Circular A-11, page 185-14, Section.185.5(a), Exhibit Bra-116.

Exhibit Bra-116 is the 2002 version of the OMB Circular. The current version was issued in July 2003.

as demonstrated in the table below entitled “Budget Summary GSM 102, 103 and Supplier Credit Subsidy Estimates and Reestimates by Fiscal Year, Fiscal Years 1992 through 2004” and in the response of the United States to Panel Question 81(d), the re-estimates thus far have resulted in a net reduction in the estimated costs of these programs of over \$1.9 billion since the inception of credit reform budgeting in fiscal year 1992. Based on those results, the Brazilian claim that “operating costs and losses for GSM 102, GSM 103, and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992”<sup>187</sup> is not supportable.

156. Brazil fixates on the “guaranteed loan subsidy” line of the U.S. budget.<sup>188</sup> Brazil evidently now understands that the budget figures are estimates and may involve both upward reestimates, indicating a projection of a higher cost, and downward reestimates that reflect projections of more favorable results than originally estimated. *However, the “guaranteed loan subsidy” line on which Brazil relies only includes upward reestimates.* Downward reestimates with respect to the export credit guarantee programs are reflected in the financing account portions of the U.S. budget.<sup>189</sup>

157. Brazil has initiated the discussion of U.S. government budget figures and has repeatedly emphasized their significance.<sup>190</sup> Yet Brazil continues to get it wrong. Brazil has completely ignored the downward re-estimates set forth in the budget and as a result has misrepresented the figures reflected in the U.S. budget. Brazil has only cited the numbers of the program account.<sup>191</sup> Downward reestimates totalling approximately \$3.5 billion are reflected in the President’s Budgets for fiscal years 1996, 1998, 1999, 2003, and 2004. A table setting forth these reestimates is attached as Exhibit US-31.

158. A fundamental tenet of credit reform accounting is the requirement that the performance of the credit be tracked over its lifetime. This is accomplished by tracking each cohort of credit until the credit period has expired or lapsed. A cohort consists of all transactions associated with

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However, all citations in this submission to the OMB Circular are identical in the 2002 and 2003 versions.

<sup>187</sup> Closing Statement of Brazil, para. 24

<sup>188</sup> Brazil Comment on Panel Question 81(g), para. 176; Brazil’s Oral Statement para. 125-133.

<sup>189</sup> Section 185.3(x), page 185-12, OMB Circular A-11 (Exhibit Bra-116) defines reestimates. Reestimates mean revisions of the subsidy cost estimate of a cohort (or risk category) based on information about the actual performance and/or estimated changes in future cash flows of the cohort. Reestimates generally must be made immediately after the end of each fiscal year as long as any loans in the cohort are outstanding. A downward reestimate indicates that too much subsidy had been paid to the financing account. For mandatory programs, like the CCC export credit guarantee programs, the excess (plus interest) may be credited to a downward receipt account rather than the budget account, and CCC does so. Section 185.3(t) defines a negative subsidy as “subsidy costs that are less than zero. They occur if the present value of cash inflows to the Government exceeds the present value of cash outflows.

<sup>190</sup> First Written Submission of Brazil, paras. 281, 282 and Figure 20.

<sup>191</sup> Oral Statement of Brazil, para. 132.



each type of guarantee issued during a particular year.<sup>192</sup> For example, all guarantees issued during fiscal year 2002 comprise a distinct cohort.

159. As discussed in the response of the United States to Panel Question 81(c), it is necessary to understand the difference between activity that occurs on a fiscal year basis as opposed to the estimates and re-estimates of subsidy that calculate net present value over the life of the program. Although estimates and re-estimates are made annually for each cohort, these include both actual data to date and estimates of future activity for the remainder of the life of the cohort.

160. Budget figures are on a fiscal year basis and do not reflect re-estimates on a cohort basis. For that reason upward reestimates and downward reestimates reflected in a single budget cannot necessarily be applied against each other for a notional “net reestimate.” The only re-estimates that may be applied directly against one another are upward reestimates and downward reestimates for the same cohort. This distinction constitutes the fundamental flaw of Brazil’s table in paragraph 165 of Brazil’s Answers to the Panel’s questions. Brazil has improperly cumulated figures on a fiscal year basis and not on a cohort basis. This results in an unhelpful apples-to-oranges comparison.

161. In contrast, the table below, “Subsidy Estimates and Reestimates by Cohort,” reflects cumulative reestimates on a cohort basis. Horizontally, the figures are presented by cohort. Vertically, the numbers correspond to the numbers reflected in the budget for particular fiscal year.<sup>193</sup> So, for example, for cohort 1992 the current data reflects an estimate of a *profit* to the United States of approximately \$124 million. For 1993, the corresponding current figure is a *profit* of approximately \$56 million. As the United States has indicated, those cohorts are projected to close later than 1994 and 1995, which together project a *profit* of \$29 million. With the exception of 2002, for which only very recent data is necessarily available, the Panel will note that the trend for all cohorts is uniformly favorable as compared to the original subsidy amount. As stated in the notes to the financial statements of CCC, and as reflected in the specific experience of the CCC export credit guarantee programs, “actual performance on foreign credits was better than had been previously forecast.”<sup>194</sup>

GSM 102/GSM-103/SCGP				
Subsidy Estimates and Reestimates By Cohort				
	Original Subsidy	Cohort Reestimates by Fiscal Year		Subsidy Estimate
			Total	

<sup>192</sup> A “cohort” is defined in OMB Circular A-11, Section 185.3(c), page 185-6 (Exhibit Bra-116).

<sup>193</sup> Internal U.S. Government support documentation for the reestimates for fiscal years 2001, 2002, and 2003 are attached as Exhibit US-32. Corresponding specific documentation has not yet been located for prior years, but carryforward figures retained for budget purposes are reflected for fiscal years 1993-2000.

<sup>194</sup> Commodity Credit Corporation, Notes to Financial Statements, September 30, 2002 and 2001, p. 10.  
Exhibit Bra-158

Cohort	Estimate	FY93-00	FY01	FY02	FY 03	Reestimates	Net of Reestimate
1992	267,426,000	166,136,256	-599,604,000	27,030,201	14,823,708	-391,613,835	-124,187,835
1993	171,786,000	-10,556,906	-257,206,000	23,017,631	16,571,778	-228,173,497	-56,387,497
1994	122,921,000	-82,345,960	-77,135,000	2,228,985	41,521,000	-115,730,975	7,190,025
1995	113,000,000	-40,555,149	-105,216,000	2,823,516	-6,351,460	-149,299,093	-36,299,093
1996	328,000,000	896,907	-386,916,000	7,611,330	44,934,327	-333,473,436	-5,473,436
1997	289,000,000	0	-237,316,000	19,845,279	50,733,713	-166,737,008	122,262,992
1998	301,000,000	0	-237,271,000	14,661,079	-15,693,431	-238,303,352	62,696,648
1999	158,000,000	0	-68,758,000	51,146,455	-144,434,351	-162,045,896	-4,045,896
2000	195,000,000	0		-91,987,247	-61,534,936	-153,522,183	41,477,817
2001	103,000,000			-33,497,152	16,381,864	-17,115,288	85,884,712
2002	97,000,000				40,008,586	40,008,586	137,008,586
<b>Total for all Cohorts</b>	<b>2,146,133,000</b>	<b>33,575,148</b>	<b>-1,969,422,000</b>	<b>22,880,077</b>	<b>-3,039,202</b>	<b>-1,497,361,941</b>	<b>381,345,059</b>
Source: FSA Budget Division Reestimate Documentation and Apportionment Documents There were no reestimates apportioned during FY 1998 through FY 2000.							

162. This experience with re-estimates indicates that performance under the program has been better than originally projected and that the original cost estimates for those programming years as presented in the annual U.S. budget were too high.<sup>195</sup> This experience also demonstrates that the assertion by Brazil at paragraph 129 of its oral statement that the original estimate of "guaranteed loan subsidy" line in the budget is an "ideal basis" for determining the costs of the program is in error. Those estimates will be re-estimated on an annual basis until each cohort is closed and, as demonstrated above, to date the re-estimates for each cohort on a net basis have been almost exclusively downward.

163. Brazil has also repeatedly argued that the United States has misrepresented the significance of the interest figures in the budget. Under the guidelines for credit reform

<sup>195</sup> In para. 167 and fn. 209 of Brazil's Answers to Panel Questions, Brazil cites estimates of the U.S. General Accounting Office from 1991 and 1992 in support of its arguments regarding estimates of costs for the GSM-102 and GSM-103 programs. Subsequent history, as reflected in the current data presented by the United States, however, indicates that such 12- and 13-year-old estimates have proven grossly inaccurate.

budgeting as established in the Credit Reform Act of 1990, there are two kinds of interest calculations that affect the CCC export guarantee programs. These calculations are "snapshots" in time and will change annually for a cohort until the cohort has closed. Therefore, any one number shown in the budget for a given year is an estimate. The actual cost of the program can be determined only when all financial activity for the cohort is completed.

164. An interest rate re-estimate is a component of the annual re-estimates of a cohort, which are made for as long as the guarantees are outstanding. The interest rate re-estimate calculates the difference between the estimated interest at the time the guarantee program was budgeted and the prevailing rate of interest in fact at the time the guarantee is issued. If the actual interest is higher, the additional cost is shown in the program account as a re-estimate. It should be noted that this cost would change with subsequent re-estimates in future years depending on the timing of issuance of the guarantee.

165. Interest on borrowings occurs in the financing account only if additional funds beyond those budgeted for a cohort is needed to pay claims. Again, these costs will vary from year to year as borrowings with a particular cohort change and the interest rate varies.

166. It is important to understand that should any interest on borrowings occur, they would be fully reflected in the costs attributed to the individual cohort. Thus, as the costs of the cohort are adjusted during the period it is active, any costs associated with the interest on borrowings are fully reflected in the program costs.<sup>196</sup> It is, therefore, incorrect to state as Brazil asserts in paragraph 123 that those payments are not fully reflected in the operating costs of the CCC export credit guarantee programs.

167. Brazil also misinterprets the significance of the "actual" column in the U.S. budget, and consequently misapplies it. Brazil asserts that the column heading in the budget for the last completed fiscal year represents "actual" costs for the program for that particular year.<sup>197</sup> In fact, the numbers appearing in that column simply represent the latest, revised *estimate* of the costs of the program for the fiscal year just completed. The estimate of those costs will change over the lifetime of the credit as the cohort for that year is tracked. The term "actual" is used in the column only because the revised estimate is based on an actual level of guarantees issued by CCC during the year just completed.

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<sup>196</sup> See Exhibit Bra-116, OMB Circular A-11, Section 185.2, page 185-4, describing Interest Rate Reestimate: There are two types of reestimates. Interest rate reestimates adjust for the effect on the subsidy of differences between actual interest rates and the interest rates assumed when estimates were made for budget formulation and obligation. Technical reestimates adjust for revised assumptions about loan performance, such as differences between assumed and actual default rates or new projections of prepayments. See also, Section 185.6(e), page 185-18.

<sup>197</sup> Oral Statement of Brazil para. 131; closing statement of Brazil, para. 24; Brazil's Answers to Panel Questions paras. 166, 176, 179.

168. Frequently, the level of guarantees issued by CCC in any given year is less than the level projected in the original budget for that year. In the case of the 2002 budget that was released in February 2001, it projected that \$3.9 billion of guarantees would be issued by CCC during that year<sup>198</sup>. However, only \$3.266 billion of guarantees were actually issued. Thus, the estimate of program costs in the 2002 column of the 2004 budget has been revised to reflect that actual level of activity.<sup>199</sup> Nevertheless, the cost presented in the column remains an estimate, and the estimate will continue to be revised as long as the cohort for 2002 remains active.

169. Another component of the figures reflected in the budget are reschedulings of debt arising in the connection with the export credit guarantee programs. Brazil asserts that “historically, the majority of GSM support that is rescheduled is ‘in arrears’” and that this increases costs.<sup>200</sup> Brazil largely relies, however, on a 1990 government report that is dated and precedes the Credit Reform Act itself. As reflected in Exhibit US-33, no rescheduling applicable to export credit guarantees issued in fiscal year 1992 or later is in arrears.<sup>201</sup> For cohorts for fiscal years 1992-2002, CCC has rescheduled debt in connection with the export credit guarantee programs only with respect to transactions involving Algeria, Ecuador, Pakistan, and Russia (both private and public sector). No arrearages exist under these reschedulings.

170. Brazil also apparently simply misreads Note 5 to CCC Financial Statements September 30, 2002 and 2001 to “report that uncollectible amounts on post-1991 CCC guarantees total \$770 million.”<sup>202</sup> Brazil apparently has simply made an error in overlooking that the \$770 million figure is for a “subsidy allowance” and is not part of the column immediately above it for activity prior to fiscal year 1992, which is entitled “allowance for uncollectible accounts.”

**C. Brazil’s Suggestion to Use Estimated Data to Determine Long-Term Costs and Losses Supports the View that the Export Credit Guarantees Do Not Provide Export Subsidies**

171. Helpfully, “Brazil notes that a certain degree of estimated data would be perfectly acceptable in an analysis of the costs and losses of guarantee programs under item(j).”<sup>203</sup> The United States notes this for two reasons. First, the re-estimate process for fiscal years 1994, 1995, and virtually other years since fiscal year 1992 indicates a very strong net positive trend with respect to the programs and that therefore current premium rates do cover long-term operating costs and losses.

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<sup>198</sup> Exhibit Bra-89, lines 2150 and 2159

<sup>199</sup> Exhibit Bra-127, p.107, line 215001

<sup>200</sup> Brazil’s Answers to Panel Questions, para. 162

<sup>201</sup> This Exhibit reflects all reschedulings for cohorts 1992 to date. The date of this particular report is as of March 31, 2003, but CCC reports no arrearages with respect to these reschedulings as of August 21, 2003.

<sup>202</sup> Brazil’s Answers para. 167

<sup>203</sup> Brazil’s Answers to Panel Questions, para.179

172. Secondly, it is relevant with respect to Brazil's reliance on the significant losses that the United States admittedly incurred with respect to Poland and Iraq.<sup>204</sup> Under Brazil's theory of the application of item(j) of the Illustrative List, the United States would be forever foreclosed from granting export credit guarantees in agriculture at all. Without commenting on the accuracy of Brazil's calculations, the United States notes that Brazil states: "At the current maximum premium rate . . . it would take more than 180 years, as of today, to recover the \$4 billion in losses [to Poland and Iraq]."<sup>205</sup> Presumably, to attempt to recover such losses in any practical time frame would require such a prohibitive fee increase that few, if any, exporters would take advantage of the program. Consequently, the United States would be whipsawed by a prohibition on the export credit guarantee as currently constituted because of the large losses incurred between 10 and 20 years ago, and the inability to create a conforming program because the fee structure necessary to compensate for such historical losses would foreclose use of the program.

173. This would be an absurd and unreasonable consequence and interpretation of item (j). It also would not recognize the politically unique circumstances giving rise to those particular defaults, including Iraq's invasion of Kuwait and the ensuing Persian Gulf War. In any event, item (j) cannot be reasonably interpreted to require an examination of all activity since the beginning of a program, no matter how old it may be.

174. Item (j) focuses on premium rates currently charged. Specifically, it focuses on "the provision by governments . . . of export credit guarantee[s] . . . at premium rates which are inadequate to cover the long-term operating costs and losses of the programs." It is the provision of guarantees at premium rates which *are* inadequate to cover the long-term operating costs and losses.<sup>206</sup> Item (j) does not say premium rates which "historically have been" inadequate.

175. Admittedly, it would be very difficult to evaluate the long-term efficacy of current premia without some retrospective examination of costs and losses. However, the data provided with this submission with respect to fiscal years 1994 and 1995 and for the programs as a whole indicates that current premia rates are presently adequate to cover long-term operating costs and losses as currently projected. And as the United States has noted in its First Written Submission, the United States is in a net positive position with respect to cotton transactions in the ten years commencing with fiscal year 1993.<sup>207</sup>

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<sup>204</sup> See, for example, Brazil's Answers to Panel Questions, para. 167, First Submission of Brazil, paras. 283-285.

<sup>205</sup> First Written Submission of Brazil, para. 285.

<sup>206</sup> The comparable item(j) in the Illustrative List of Export Subsidies in the Tokyo Round Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade ("Tokyo Round Subsidies Code") is identical to the SCM item(j) except the standard for premia was "manifestly inadequate to cover the long-term operating costs and losses of the program."

<sup>207</sup> U.S. First Written Submission, para. 173.

**D. The Export Credit Guarantee Programs Are Not Applied in a Manner which Results in or which Threatens to Lead to, Circumvention of Export Subsidy Commitments**

176. The United States of course maintains that its export credit guarantee programs are not export subsidies within the meaning of the Agriculture Agreement, and are not subject to the export subsidy disciplines of that agreement.<sup>208</sup>

177. Brazil has challenged the export credit guarantee programs, GSM 102, GSM 103, and SCGP, as such.<sup>209</sup> Brazil has failed, however, to demonstrate that these programs as such mandate a violation of U.S. WTO obligations.

178. It is well established under GATT and WTO jurisprudence that legislation of a Member violates that Member's WTO obligations only if the legislation *mandates* action that is inconsistent with those obligations or precludes action that is consistent with those obligations. If the legislation provides discretion to administrative authorities to act in a WTO-consistent manner, the legislation, as such, does not violate a Member's WTO obligations.

179. The Appellate Body has explained that “the concept of mandatory as distinguished from discretionary legislation was developed by a number of GATT panels as a threshold consideration in determining when legislation as such – rather than a specific application of that legislation – was inconsistent with a Contracting Party's GATT 1947 obligations.”<sup>210</sup> This doctrine has continued under the WTO system, as panels and the Appellate Body have continued to apply the mandatory/discretionary distinction in considering whether a Member's legislation is WTO-consistent.<sup>211</sup>

180. As the United States pointed out in its First Written Submission, the Commodity Credit Corporation has complete statutory and regulatory discretion at any time not to issue guarantees with respect to any individual application for an export credit guarantee or to suspend the

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<sup>208</sup> The export credit guarantee programs also could not constitute export subsidies to the extent applied to goods outside the scope of the product coverage of Annex I of the Agreement on Agriculture. For example, wood products and textiles are not subsumed within Annex I.

<sup>209</sup> See, e.g., Brazil First Written Submission, para. 304.

<sup>210</sup> Appellate Body Report, *United States - Anti-Dumping Act of 1916*, WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000, para. 88.

<sup>211</sup> See, e.g., Panel Report, *United States – Measures Treating Export Restraints as Subsidies*, WT/DS194/R, adopted 23 August 2001, paras. 8.4 - 8.131 (finding that certain provisions of the U.S. countervailing duty law did not mandate action inconsistent with provisions of the SCM Agreement, and describing the mandatory/discretionary distinction as a “classical test” with longstanding historical support); and Panel Report, *United States – Anti-dumping and Countervailing Measures on Steel Plate from India*, WT/DS206/R, adopted 29 July 2002, paras. 7.88 - 7.89 (similar).

issuance of export credit guarantees under any particular allocation.<sup>212</sup> This is in marked contrast to the situation in *U.S.- FSC*.<sup>213</sup>

181. In that case, the Appellate Body specifically addressed the issue of whether the FSC subsidies “have been ‘applied in a manner which *results in*, or which *threatens to lead to*, circumvention of export subsidy commitments”<sup>214</sup> (italics in original). The Appellate Body emphasized that in determining whether the measure is so applied:

[I]t is important to consider the structure and other characteristics of that measure. The FSC measure creates, in itself, a *legal entitlement* [italics in original] for recipients to receive export subsidies, not listed in Article 9.1. . . . As we understand it, that legal entitlement arises in the recipient when it complies with the statutory requirements and, at that point, the government of the United States must grant FSC tax exemptions. There is, therefore, no discretionary element in the provision by the government of the FSC export subsidies. If the statutory eligibility requirements are met, then an FSC is entitled by law to the statutorily established tax exemption. Furthermore, there is no limitation on the amount of exempt foreign trade income that may be earned by an FSC. Therefore, the legal entitlement that the FSC measure establishes is unqualified as to the *amount* of export subsidies that may be claimed by FSCs. There is, in other words, no mechanism in the measure for stemming, or otherwise controlling, the flow of FSC subsidies that may be claimed with respect to any agricultural products. In this respect, the FSC measure is unlimited.<sup>215</sup>

For these reasons the Appellate Body concluded that FSC subsidies “are applied in a manner that . . . *threatens to lead to*, circumvention of the export subsidy commitments.”<sup>216</sup>

182. In this regard, the CCC export credit guarantee programs could not be more different. There is no statutory legal entitlement<sup>217</sup> to an export credit guarantee. Furthermore, even if an application and fee are received, the applicant is not necessarily entitled to receive the guarantee.

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<sup>212</sup> See, e.g., 7 C.F.R. Sections 1493.10(d), 1493.40(b) (Exhibit US-6) and First Written Submission of the United States, fn. 134.

<sup>213</sup> WT/DS108/AB/R.

<sup>214</sup> *Id.*, para. 143.

<sup>215</sup> *Id.*, para. 149.

<sup>216</sup> *Id.*, para. 153.

<sup>217</sup> In paragraph 19 of Brazil’s Answers to the Questions of the Panel, Brazil states that it “challenges 7 U.S.C. 5622 (a)(1) and (b), which provide for the extension of export credit guarantees on terms better than those available on the marketplace.” The United States hastens to point out that those statutory provisions say no such thing. Indeed, 7 U.S.C. 5622(e) prohibits the use of export credit guarantees for foreign aid or debt rescheduling purposes, and 7 U.S.C. 5622(f) prohibits CCC from making credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary of Agriculture determines cannot adequately service the debt associated with such sale. Exhibit Bra-141.

Issuance is discretionary. In addition, availability of export credit guarantees is governed by allocations in effect at any one time for specific commodities and specific destinations.<sup>218</sup> The structure and characteristics of the export credit guarantee programs do not support a determination that they threaten to lead to circumvention of commitments.

183. Finally, Brazil has alleged that the United States has exceeded its quantitative export subsidy reduction commitments (i.e., quantitative commitments with respect to scheduled commodities) during the period July 2001-June 2002.<sup>219</sup> With respect to these allegations, the United States notes that even if the export credit guarantee programs were deemed export subsidies, the United States would be in compliance with the scheduled quantitative reduction commitments for that period with respect to wheat, coarse grains, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, live dairy cattle, and eggs. This may also be true with respect to vegetable oil. In fiscal year 2002 it would also be true for poultry meat. The United States did not use the GSM-102 or GSM-103 programs during 2001-2002 with respect to butter and butter oil, skim milk powder, cheese, other milk products, or eggs.<sup>220</sup>

**E. Financial Arrangements Analogous to the CCC Export Credit Guarantee Programs are Available in the Marketplace**

184. Brazil claims that “no such financing vehicles for agricultural commodities are available on the commercial market. To the best of Brazil’s knowledge, export credit guarantees for exports of agricultural exports [*sic*] are not available on the marketplace from commercial lenders.”<sup>221</sup> Brazil further asserts that such financial products are “certainly not [available] for terms longer than the marketing cycles of the eligible commodities - and that this means that the programs confer ‘benefits’ as such, within the meaning of Article 1.1(b) of the SCM Agreement.”<sup>222</sup>

185. The United States believes it is neither appropriate nor necessary to analyze the export credit guarantees with respect to the term “benefit” under Article 1.1(b) of the SCM Agreement.

<sup>218</sup> See Exhibit US-12

<sup>219</sup> First Written Submission of Brazil, para. 265 and Figure 18.

<sup>220</sup> Quantities exported under the GSM-102 and GSM-103 for fiscal years 2001 and 2002 with respect to the other scheduled commodities are as follows. The data on use are based on fiscal year.

Commodity	2001 Commitment	2001 GSM quantity	2002 Commitment	2002 GSM use
Wheat	14,522,060 mt	3,913,980 mt	14,522,060 mt	4,228,529 mt
Coarse Grains	1,560,599 mt	337,197 mt	1,560,599 mt	674,102 mt
Vegetable Oils	141,299 mt	71,620 mt	141,299 mt	162,915 mt
Bovine Meat	17,589 mt	11,427 mt	17,589 mt	7,959 mt
Pigmeat	395 mt	679 mt	395 mt	-0-
Poultry Meat	27,994 mt	74,283 mt	27,994 mt	3,728 mt
Dairy Cattle	11,024 head	230 head	11,024 head	-0-

<sup>221</sup> First Written Submission of Brazil, para. 289

<sup>222</sup> Oral Statement of Brazil, para. 116.



For the reasons already elaborated by the United States, both the text and negotiating history of Article 10.2 of the Agreement on Agriculture reflect that export credit guarantees are not export subsidies for purposes of both the Agreement on Agriculture and the SCM Agreement and are not subject to the export subsidy commitments of the Agreement on Agriculture.

186. The United States believes, however, that financing is available in the marketplace that is analogous to the export credit guarantee programs. A prominent example in the commercial market is the practice of “forfaiting.”

187. As stated in a “Glossary for International Business”<sup>223</sup>

Forfaiting is a form of supplier credit in which an exporter surrenders possession of export receivables, which are usually guaranteed by a bank in the importer’s country, by selling them at a discount to a ‘forfeiter’ in exchange for cash. These instruments may also carry the guarantee of the foreign government. In a typical forfaiting transaction, an exporter approaches a forfeiter before completing a transaction’s structure. Once the forfeiter commits to the deal and sets the discount rate, the exporter can incorporate the discount into the selling price. Forfaiters usually work with bills of exchange or promissory notes, which are unconditional and easily transferable debt instruments that can be sold on the secondary market. . . . Forfaiters generally work with medium and long-term receivable (180 days to seven years) . . . . Forfaiters usually work with capital goods, commodities, and large projects. . . . [Since] forfaiters usually require a bank guarantee, most are willing to work with receivables from these countries.

188. As also noted in the December 1998 *World Trade* magazine,<sup>224</sup> the tenor of forfaiting transactions as well as the nature of the risk is similar to that evident in the export credit guarantee programs. “Forfaiting terms usually extend out for five years, but can be generally be [sic] found ranging anywhere from six months to ten years.” Also similar to the structure of the export credit guarantee transactions, “to protect itself from default, the forfeiter usually requires that the importer who issues the notes gets a guarantee, or, in Latin-America an ‘aval’ from a bank. This not only provides protection to the forfeiter, but also makes it much easier for the forfeiter to analyze the risk, because financial information about a bank is generally more readily accessible and easier to analyze than other business in emerging markets.”

189. In that article, a forfaiting executive is quoted to state that “the interest rate charged is LIBOR plus a risk premium. We don’t much care who the buyer is as long as it’s a legitimate company. Our main focus will be on the bank.” It is often difficult to make direct comparisons

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<sup>223</sup> <http://www.geocities.com/WallStreet/Floor/3266/glossary-f.html>

<sup>224</sup> Exhibit US-34.

of the pricing of forfeited transactions, because as the article points out, “forfeiting can give exporters a marketing advantage by shifting some of the cost of the financing into the principal.”

190. Export credit guarantees and forfeiting transactions are also typically used in “emerging markets”. The export credit guarantee programs are used in middle-tier economies. As another forfeiting executive states in the *Journal of Commerce* of June 14, 1995,<sup>225</sup> “Forfeiting is best suited to transactions involving difficult markets where alternative sources of finance are unavailable.” Similarly, the *Financial Times* noted on January 27, 1994<sup>226</sup> that forfeiting markets are “principally in Latin-America, the Asia-Pacific region, and Eastern Europe. Funding for deals in Brazil, China, and Slovakia have all featured in forfeiters’ books in recent months. Moreover, forfeiting is also providing a way in to markets as difficult and diverse as Romania, Vietnam, and Peru.” Press accounts as recent as October, 2002, reconfirm this trend.<sup>227</sup>

191. Clearly, a competitive marketplace exists for trade financing even in emerging markets where more conventional financing is not available. The United States is not privy to the precise terms at any time available in forfeiting transactions, because those terms can vary by country, commodity, bank risk, size of transaction and numerous other factors. In addition, like most private financial activity, that information is ordinarily held confidentially by the parties. While use of forfeiting appears on the increase as a vehicle for trade financing, use of the export credit guarantee programs is in relative decline, as noted in the chart provided in paragraph 177 of the Answer of the United States to Panel question 82(b).

## V. The Step 2 Program is Not Contingent on Export Performance

192. The United States has previously noted that all U.S. upland cotton is eligible to receive the benefit of a Step 2 payment. If such cotton is used during the time in which the conditions of the statutory formula is in effect the user is entitled to receive the payment.<sup>228</sup> The United States has noted that the program is indifferent to the particular method of use, and all uses are covered.<sup>229</sup>

193. Brazil apparently does not contest that all uses of upland cotton are eligible for subsidy. Instead, Brazil suggests, erroneously, that not the entire universe of users of upland cotton is eligible for the subsidy.<sup>230</sup> Brazil first highlights the requirement that a recipient must be “regularly engaged” in the use of cotton. The focus of the requirements is on use of the cotton.

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<sup>225</sup> Exhibit US-35.

<sup>226</sup> Exhibit US-36.

<sup>227</sup> Exhibit US-37.

<sup>228</sup> Unlike the export credit guarantee program, this is a statutory entitlement to payment.

<sup>229</sup> Brazil has attempted to distort the United States argument by focusing on whether a particular user is indifferent to the manner of use. Brazil’s Answers to Questions of the Panel, para. 205. This misstates the point. The question is whether or not the conferral of the *subsidy* is contingent on export performance.

<sup>230</sup> Brazil’s Answers to Panel Questions paras. 205, 209

The phrase “regularly engaged” is simply an anti-fraud provision to preclude a party, such as a producer, from baling his own cotton, cutting the bale to demonstrate “use” and then attempting to re-sell the cotton to a legitimate user while still claiming the subsidy as a user. Similarly, other persons are engaged in the business of retrieving and recycling remnants of cotton from the manufacturing floor after cotton bales have been opened and used to manufacture cotton products. The “regularly engaged” language serves, in part, to preclude an attempt from such parties to receive a payment with respect to cotton on which a payment has already been made. If either the hypothetical producer or recycler did in fact open a bale for manufacture or export cotton, then they would in fact be entitled to the payment.

194. Brazil also correctly notes that “the eligible domestic user criteria exclude all firms that are domestic cotton brokers or simple resellers.”<sup>231</sup> These parties are not using the cotton. They are therefore ineligible.

195. Brazil suggests a third category of persons who are users but are not eligible to receive the payment: “firms that have not entered into CCC contracts” as either manufacturers or exporters.<sup>232</sup> It is true that CCC cannot pay parties that choose to remain unknown to it, but this requires an assumption of economic irrationality and does not diminish the point that all who use cotton have it entirely within their power to receive the subsidy.

196. Most interesting to the United States is Brazil’s description of a group “who open bales but do not use them in the manufacture of upland cotton products.”<sup>233</sup> The Panel will recall that in its Answer to Panel Question 99<sup>234</sup>, the United States noted that “if upland cotton could be used in a third or fourth way, this would not change the eligibility for subsidy but would necessitate a parallel third or fourth set of instructions to demonstrate that form of use as well.” The United States would appreciate receiving further information from Brazil on those “who open bales but do not use them in the manufacture of upland cotton products” to enable the United States to amend its regulations to include such heretofore unknown use.

197. The fact remains that all U.S. upland cotton produced in the United States is eligible for the Step 2 payment without regard to how such cotton is used, and all actual users of such cotton are eligible for the payment. Brazil has not indicated a single real-world example of an eligible person who was denied such payment. The program has no contingency on export performance. The only contingency is use. For that reason, parties in the cotton market who do not use cotton are the only parties not eligible for the payment.

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<sup>231</sup> Brazil Answers to Panel Questions, para. 209

<sup>232</sup> Brazil Answers para. 209.

<sup>233</sup> Brazil’s Answers para. 209

<sup>234</sup> U.S. Answers para. 208

**VI. Conclusion**

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

- (1) with respect to certain measures previously identified by the United States, these measures are not within the Panel's terms of reference and
- (2) with respect to those measures properly within the Panel's terms of reference, these measure are fully consistent with U.S. WTO obligations, including with the terms of the Peace Clause.

### List of Exhibits

- US-22 The Agricultural Market Transition Act, Title I of the Federal Agriculture Improvement Act of 1996, Public Law No. 104-127 (April 4, 1996) (“1996 Act”)
- US-23 The Production Effects of Decoupled Payments, by Dr. Joseph W. Glauber, Deputy Chief Economist, U.S. Department of Agriculture
- US-24 Calculating the Per-Unit Rate of Support, by Dr. Joseph W. Glauber, Deputy Chief Economist, U.S. Department of Agriculture (22 August 2003)
- US-25 MTN.GNG/NG5/W/170
- US-26 MTN.GNG/AG/W/1 (24 June 1991)
- US-27 MTN.GNG/AG/W/1/Add.1 to Add.11 (2 August 1991)
- US-28 Uruguay Round Agriculture Negotiations, Discussion Paper, Draft Text on Agriculture (December 12, 1991)
- US-29 Agriculture text of the Draft Final Act, MTN.TNC/W/FA (20 December 1991)
- US-30 Articles 1 - 3 and the Illustrative List of Export Subsidies within the Draft SCM Agreement of the Draft Final Act, MTN.TNC/W/FA
- US-31 Budget Summary GSM-102, 103 and Supplier Credit; Subsidy Estimates and Reestimates by Fiscal Year; Fiscal Years 1992 through 2004
- US-32 United States Department of Agriculture, Advice of Allotment, Allotment Numbers 01-CCC-47; 02-CCC-28; 02-CCC-27; 03-CCC-26
- US-33 Status of Reschedulings for CCC Export Credit Guarantee Program activity for fiscal years 1992-2002
- US-34 *World Trade* (December 1998)
- US-35 “Financial Know-How Pays Off,” *Journal of Commerce* (June 14, 1995)
- US-36 *Financial Times* (January 27, 1994)
- US-37 *Latin Finance*, 1 June 1999, “Brazil Bounces Back,” pg. S16; *Trade Finance*, 1 October 2002. “Forfaiters Seek Eastern Promise,” No. 8, vol. 5, pg. SS7