

ANNEX F**ORAL STATEMENTS OF PARTIES AND THIRD PARTIES AT THE
RESUMED SESSION OF THE FIRST SUBSTANTIVE MEETING**

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ANNEX F-1

EXECUTIVE SUMMARY STATEMENT OF BRAZIL AT THE RESUMED FIRST SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

1. **Brazil's Claims of Present Serious Prejudice Relating to Subsidies Provided in MY 1999-2002**

1. Brazil's *present* serious prejudice claims relate to US subsidies provided for the production, export and use of US upland cotton during the period MY 1999-2002. This period covers the measures challenged by Brazil and represents the relevant period of investigation to examine *present* serious prejudice caused by the US subsidies under Articles 5(c) and 6.3 of the SCM Agreement. This four-year period is long enough to allow the Panel to make a determination (in the words of the Appellate Body in the recent *EC – Pipe Fittings* decision) “that is less likely to be subject to market fluctuations or other vagaries that may distort a proper evaluation.”

2. **Brazil Has Established That the US Subsidies between MY 1999-2002 Caused Significant Price Suppression within the Meaning of Article 6.3(c) of the SCM Agreement**

2. Brazil has shown in its Further Submission the amount and the subsidization rate of the US subsidies which cause serious prejudice to Brazil as well as demonstrated that all of the US subsidies are specific within the meaning of Article 2 of the SCM Agreement. The United States asserts that crop insurance subsidies provided to upland cotton producers by the 2000 Agricultural Risk Protection (“ARP”) Act are not specific. In seeking to rebut Brazil's evidence that more than 50 per cent of the value of US agricultural commodities did not benefit from crop insurance benefits, the United States now argues that livestock is covered in “pilot programmes”. Yet, a close examination of the “pilot” programmes indicates that the great majority of livestock production was *not* covered by the crop insurance programmes during the period of investigation. Therefore, the crop insurance programme is specific.

3. Contrary to the US arguments, the Panel is required by Article 5 of the SCM Agreement to examine the collective and interactive effects of *all* US subsidies. While different economists have estimated varying degrees of acreage, production, export and price effects of the US subsidies, no economist has ever found or suggested that removing all of the US subsidies would have only minimal effects.

4. The conditions of competition in the upland cotton market that existed during MY 1999-2002 (and that exist today) explain why: **First**, upland cotton is a basic fungible commodity that is widely traded throughout the world; **Second**, demand for upland cotton is relatively price-inelastic and consumption increased steadily during MY 1999-2002, whether upland cotton prices rose or fell; **Third**, world market prices for upland cotton as reflected in the New York futures price and the A-Index are sensitive to changes in supply – prices tend to rise when world supply decreases and fall when world supply increases; **Fourth**, US producers in MY 2002 supplied 41.6 per cent of world export market demand – the next largest exporter (Uzbekistan) had only 13 per cent of the world market share. **Fifth**, US producers of upland cotton are among the world's highest cost producers and total average costs between MY 1999-2002 were 77 per cent higher than market revenue received for

upland cotton lint; and **Sixth**, US upland cotton subsidies covered the cost-revenue gap with subsidies averaging 95 per cent which are 19 times greater than the five per cent subsidization rate formerly deemed to create a presumption of serious prejudice under Article 6.1(a) of the SCM Agreement.

5. US subsidies are a key element of the conditions of competition in the world market for upland cotton. The US subsidies create a situation in which USDA's Chief Economist has acknowledged that many US upland cotton producers are immune from market forces. This is readily illustrated by the extensive record provided by Brazil.

6. The United States now argues that US upland cotton farmers are sensitive to changes in market prices. Yet, US planted acreage *increased* as prices *declined* between MY 1999-2001. There can be little doubt that without the US subsidies, many US upland cotton producers would have to switch to crops providing a higher market return or take marginal land out of production. This means that without subsidies, US acreage and production would fall considerably. In addition to falling US production, the removal of US subsidies would also result in significant reductions in US exports contributing to increased world prices. Professor Sumner found that, *but for* the US subsidies between MY 1999-2002, US exports would fall from the annual *actual* average exports of 8.62 million bales by 41.2 per cent to 5.07 million bales. This reduction of 3.55 million bales represents 13.4 per cent of the total average world export market between MY 1999-2002. Given the relatively inelastic demand for upland cotton, it would be remarkable if world prices did not increase with a 13.4 per cent decrease in the supply of upland cotton to the world export market.

7. Brazil has examined some of the non-subsidy market factors that the United States apparently now claims account for *all* of the fall in prices in MY 1998-2002. Even though some of these factors may have contributed to lower and suppressed prices during MY 1999-2002, the US arguments and evidence do not refute Brazil's evidence that the impact of \$12.9 billion in US subsidies on US acreage, production, exports and prices was significant. Moreover, Brazil does not dispute that there were other factors causing world prices to fluctuate throughout MY 1999-2002. And these same types of factors are causing prices to fluctuate today – and they will do so tomorrow. Changes in weather, exchange rates, economic growth, and financial conditions, among other factors, will always play a role in price discovery in world commodity markets. But it is simply not credible for the United States to argue now that \$12.9 billion in subsidies to US producers faced with an average 24.3 cents per pound cost-revenue gap, who nevertheless increased their world market share to 41.6 per cent at times of record low prices, had no impact on production or world prices.

8. Having established that US production and exports would fall significantly if US upland cotton subsidies were eliminated, Brazil also demonstrated that the effects of lower US exports would result in world upland cotton prices being higher by an amount that is "significant". Brazil presents additional evidence on the price-suppressing effect of the US subsidies from the Report of the Commission on the Application of Payment Limitations for Agriculture. At the request of the Commission, USDA economists Westcott and Price examined the effects of eliminating marketing loan benefits for MY 2000 and MY 2001 finding significant acreage and price effects representing 33.6 per cent of the average prices received by US farmers in MY 2001. The record contains the results of a number of different simulations of price suppression effects caused by all or some of the US subsidies. All of these results reveal "significant" price suppression within the meaning of Article 6.3(c). They are "significant" because these results of price suppression are far from *de minimis*.

9. Finally, Brazil has demonstrated the close link between world A-Index prices, Brazilian internal prices and prices received by Brazilian producers in the export markets.

10. Andrew Macdonald has provided his expert testimony and described the importance of US market factors in influencing the perception of traders in the New York futures market and in shaping the perceptions of price movements by traders in international transactions as reflected in the A-Index price development. Mr. Macdonald has also provided evidence of the close relationship between these two sets of prices and the determination of prices in the Brazilian market. This evidence fully supports the pricing data reflecting the close connection between US domestic prices, US export prices, A-Index prices, Brazilian prices, and the prices received by Brazilian and third country exporters.

11. The United States has asserted that the term world market share in Article 6.3(d) “would appear to encompass all consumption of upland cotton, including consumption by a country of its own production”. This is incorrect. The ordinary meaning of the term “world market share” in Article 6.3(d) of the SCM Agreement is not “world production share” or “world consumption share”. Rather, it is the share of the world market for exports. This interpretation is consistent with USDA’s and the EC’s use of the term “world market share”. In addition, footnote 17 to Article 6.3(d) states: “Unless other multilaterally agreed specific rules apply to the *trade* in the product or commodity in question.” This provision refers explicitly to “trade” referring to international commercial sales and purchases in export markets, not global consumption or production.

3. Threat of Serious Prejudice

12. By guaranteeing a level of support of approximately 75 cents per pound, the US Subsidies create a continuing threat of excess US acreage, production, and exports, and continued suppressed world prices. This threat is a seamless continuation of the *present* serious prejudice that Brazil has already demonstrated. The threat exists today and will exist throughout the lifetime of the 2002 US Farm Act – until the end of MY 2007. A key initial issue for the Panel to decide is the time period for assessing data regarding the existence of a threat of serious prejudice. The Appellate Body has noted that a threat analysis requires examination of “facts” not “conjecture” and requires the “use of facts from the present and the past to justify the conclusion about the future”. The Appellate Body also has held it is important to examine data for the entire period of investigation “to allow the investigating authority to make a . . . determination that is less likely to be subject to market fluctuations or other vagaries that may distort a proper evaluation”.

13. A threat of serious prejudice exists for the following reasons: The mandatory US subsidies in the 2002 US Farm Act create a guaranteed revenue stream for US producers of 75 cents per pound. This revenue cannot be stopped between MY 2003-2007 regardless of how *low* US and world prices may fall, regardless of how much US production of upland cotton *increases*, and regardless of the amount of US exports. As found by the *EC – Sugar Exports* panels, and the Appellate Body in *US – FSC*, the absence of any legal mechanism to limit the quantity of subsidies is a critical factor to assess in determining the existence of threat.

14. Brazil has demonstrated the existence of *present* price suppression, increases in world market share and an inequitable share of world export trade based on actual data and market conditions for MY 1999-2002. This four-year period of serious prejudice is the best guide for the Panel to assess whether during the remaining five years of the 2002 US Farm Act there is a significant threat that serious prejudice will occur *again*. In making this assessment, the Panel should also consider the fact that the US National Cotton Council estimated that the 2002 US Farm Act *increased* the revenue stream to US producers by 10 cents a pound over that provided in MY 1999-2001.

15. US planted acreage during MY 2003-2007 will remain at significant levels – around 14 million acres (slightly less than the average for MY 1999-2002). USDA and FAPRI both estimate that there will be *no* significant reduction in US acreage or production between MY 2003-2007. The

guaranteed high US acreage between MY 2003-2007 means high levels of production and exports. It also means suppressed world prices.

16. USDA estimates that US producers' cost of production will increase during MY 2003-2007 and remain high relative to market revenue. The most recent data shows that US producers' cost of production in MY 2002 was 83.59 cents per pound. At these cost levels, many US upland cotton producers will not be able to meet total costs of production without receiving all of the US subsidies. This fact demonstrates the clear causal connection between US subsidies and continuously high acreage, production, and exports along with significantly suppressed prices throughout MY 2003-2007.

17. With respect to Brazil's threat claim under Article 6.3(d), Brazil notes that the threat of an increased US world market share in MY 2002 has already materialized, as the US world market share continued to increase in MY 2002 to 41.6 per cent, well above the MY 1999-2001 three-year average of 29.1 per cent. Brazil also notes that there is a real and clear threat of an Article 6.3(d) violation for MY 2003 as recent USDA projections for MY 2003 US exports indicate that the likely US share will be 38.8 per cent in MY 2003 – an increase over the three-year (MY 2000-2002) average of 34.9 per cent. This evidence further supports the finding of a threat that the US share of world export trade will continue to be inequitable for MY 2003-2007.

18. Finally, Brazil has established that GATT Articles XVI:1 and 3 allow for threat claims to be based on this provision. Brazil has also demonstrated that a threat of the United States to have a more than equitable share of world export trade exists.

5. Export Credit Guarantees

19. Contrary to the US allegation, Brazil has demonstrated that the CCC export credit guarantee programmes are "mandatory" programmes. Moreover, the CCC export credit guarantee programmes are expressly exempt from the requirement that a programme receive new Congressional budget authority before it undertakes new loan guarantee commitments. The Appellate Body considered that the unlimited nature of the FSC regime posed a significant threat, under Article 10.1 of the Agriculture Agreement, that the United States would surpass its agricultural export subsidy reduction commitments. In addition, Brazil again notes that for guarantees, the United States, through the Federal Credit Reform Act, has concluded that costs and losses are best measured and recorded on a net present value basis, rather than on a cash basis, at the time the guarantees are issued.

6. New US Requests for Preliminary Rulings

20. The United States' "new" request for a preliminary ruling addresses Brazil's failure to provide a statement of available evidence with respect to export credit guarantees for commodities other than upland cotton. This request is in fact not "new".

21. The US request for a preliminary ruling that Brazil should have included more information in its statement of available evidence has no merit. Brazil has already addressed this issue. Brazil was required to file a statement of the evidence available to it at the time.

22. Second, the United States claims that cottonseed payments for 1999 and 2000, and 2002 are not within the terms of reference of the Panel because the measures allegedly were not identified within Brazil's consultation or panel request, and because Brazil and the United States allegedly did not consult regarding these measures. Both of these claims are false. Brazil and the United States did consult about "any programme providing support to the US upland cotton industry for the production, processing, use, sale, promotion or export of cottonseed or products derived from cottonseed."

Similarly, Brazil's Panel request specifically identified in four different places "measures" that would encompass all forms of cottonseed payments from MY 1999-2007.

23. Finally, the United States argues that the "other payments" such as "storage payments" and "interest subsidies" allegedly were not included in Brazil's consultation or panel request, that Brazil and the United States did not consult about such payments, and that these payments are not properly within the Panel's terms of reference. These assertions are also false. Both the consultation and panel requests identify in four different paragraphs as "measures" payments which encompass "other payments" and "storage" and "interest subsidy" payments. Further, Brazil understands that "storage payment" and "interest subsidy" are part of the operation of the marketing loan programme, which Brazil specifically identified in both the consultation and panel requests, as well as in its questions to the United States during the consultations. The record demonstrates that Brazil and the United States consulted about all marketing loan and loan deficiency payments, as well as "any other support to or government funding for the US upland cotton industry". Therefore, it is properly before the Panel.

ANNEX F-2

EXECUTIVE SUMMARY CLOSING STATEMENT OF BRAZIL AT THE RESUMED FIRST SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

1. Introduction

1. In its Closing Statement, Brazil reiterates that at the core of this case are \$12.9 billion of US subsidies for upland cotton for MY 1999-2002. These subsidies increase and maintain the production of high-cost US upland cotton, increase US upland cotton exports, suppress US, world and Brazilian prices and lead to the United States having a more than equitable share of world export trade. In short, these US subsidies cause and will continue to cause serious prejudice to the interests of Brazil.

2. Direct, CCP, PFC, and Market Loss Assistance payments were received by producers of upland cotton

2. In its Oral Statement of 7 October, the United States alleged that Brazil has not substantiated the amount of PFC, market loss assistance, direct and counter-cyclical payments to US upland cotton producers. Brazil requested this information from the United States more than a year ago in the consultation phase of this dispute but never received any information. Yesterday, the United States indicated to the Panel that it did not collect or have this information. In similar circumstances, WTO panels have held that “[i]n situations where direct evidence is not available, relying on inferences drawn from relevant facts . . . to determine whether applicable and un rebutted inferences are sufficient for satisfying the burden of proof”. In lieu of this non-existent *direct* proof, Brazil presented extensive *circumstantial* evidence that all or nearly all of these producers of upland cotton in MY 1999-2002 received PFC, market loss assistance, direct and counter-cyclical payments.

3. Brazil previously set forth this circumstantial evidence in a number of different Submissions between 24 June and 9 September 2003. To assist the Panel, Brazil has collected this evidence in Annex I to its Closing Statement.

4. A summary of the evidence set out in the Annex is the following: It demonstrates very high production levels of cotton relative to total upland cotton base acreage throughout MY 1999-2002. It shows near universal participation of eligible upland cotton producers in the 1996 PFC programme and 95.7 per cent participation of upland cotton base acreage planted to programme crops in MY 2001. By June 2003, nearly all eligible farms producing upland cotton in MY 1993-95 or MY 1998-2001 signed up for the direct and counter-cyclical payments. USDA recognized that cotton farmers benefited from PFC and market loss assistance payments and even treated such payments as part of “Government Payments by Crop Year” to upland cotton. Additional evidence shows relatively small fluctuation of cotton planted acreage between MY 1999-2002 and the strong cotton equipment and geographic forces maintaining historic cotton producers in current cotton production. Numerous statements by the National Cotton Council establish that their members received PFC and market loss assistance payments, and would (and do) receive direct and counter-cyclical payments.

5. In addition, the 2002 FSRI Act provides much higher per acre payments for upland cotton than other programme crops (except rice and peanuts). The 1996 FAIR Act similarly provided higher per acre payments for upland cotton (except rice). The only possible rationale for the much higher

upland cotton per acre payments for PFC, market loss assistance, direct and counter-cyclical payment base acreage than other programme crops was the expectation that historical producers of upland cotton needed the higher per-acre income to continue to produce high-cost upland cotton on base acreage. This conclusion is further supported by the fact that given their high costs of production, US upland cotton producers would have lost 10 cents per pound in MY 2002 if they had planted on corn (or six other programme crops) direct and counter-cyclical payment base acreage in MY 2002. Similar losses would also have been experienced in MY 1999-2001 if upland cotton were grown on most other programme crop base acreage.

6. The evidence in Annex I supports Brazil's methodology to calculate the amount of PFC, market loss assistance, direct and counter-cyclical payments by using the ratio of actual US upland cotton production and the amount of upland cotton base acres for programme payments. For example, total planted upland cotton acreage in MY 2002 was 14.1 million acres. The total amount of upland cotton base acreage in MY 2002 was 16.2 million acres. The ratio of these two amounts is 0.87. Brazil used this ratio to adjust the amount of total upland cotton direct and counter-cyclical payments for the marketing year to obtain the amount of subsidies received by upland cotton producers. Out of the 16.2 million upland cotton base acres, 2.1 million acres were not planted to upland cotton in MY 2002. Thus, holders of these 2.1 million cotton base acres either did not plant any crops or planted other crops. Consequently, Brazil has not included direct and counter-cyclical payments on these 2.1 million acres in its calculation of payments to upland cotton producers.

7. The total amount of upland cotton base acreage for direct payments in MY 2002 (which include the portion of PFC payments that were deemed to be direct payments) was \$558 million. USDA paid out the maximum amount of upland cotton CCP payments in MY 2002 – \$1.148 billion. Multiplying those figures by 0.87 results in \$485 million in direct payments and \$998 million in counter-cyclical payments to US upland cotton producers.

8. The United States refuses to offer a methodology for calculating the amount of direct and counter-cyclical (or PFC and market loss assistance) payments made to upland cotton farmers. Brazil's suggested methodology is based on the conclusion that all upland cotton producers received these payments. In particular, the evidence suggests that the amount of payments can be best calculated by finding that US upland cotton producers received those payments using upland cotton base acreage. This follows from the evidence listed in Annex I to Brazil's Closing Statement.

9. The United States asserts that "Brazil has presented no evidence that the recipients of these decoupled payments on upland cotton base acres are, in fact, upland cotton producers". Apparently what the United States had in mind in making this statement is that Brazil must produce data detailing the amount of each direct payment received by every single upland cotton farmer between MY 1999-2002. This is data the United States admits does not exist. But such a burden would require the Panel to disregard all the circumstantial evidence provided by Brazil. DSU Article 11 requires the Panel to "make an objective assessment of the facts of the case". In the absence of any alternative methodology proposed by the United States, the "facts of the case" are those presented by Brazil.

10. Therefore, what the United States suggests is that the Panel ignores \$1.7 billion in PFC and direct payments simply because the United States does not collect data that could ascertain the precise figure – which will be very small – of upland cotton farmers that did not receive those payments. Such an approach would permit WTO Members to write off large amounts of subsidies by simply refusing to collect data. The Panel must not allow this position to prevail.

3. Brazil's Article 6.3(c) Price Suppression Claims and the Econometric Studies

11. Brazil has offered considerable evidence in the form of documents and witness statements demonstrating the existence and payment of subsidies, as well as the causal link between the subsidies

and significant price suppression. In addition, Brazil presented the Panel with evidence of a number of different studies that show significant price suppressing effects. Notably among these are the two Westcott/Meyer USDA studies (referred to and commissioned by the Payment Limitation Commission) showing 10 per cent price suppression for MY 2000 and an estimated 33.6 per cent price suppression in MY 2001 from *only* the effects of removing the marketing loan subsidies. By contrast, Professor Sumner found that US prices were suppressed by 32.7 per cent by the effects of *all* US subsidies that applied during MY 2001. In light of the lower level of price effects found by Professor Sumner, the United States claim that Professor Sumner's analysis is not "conservative" is curious. Other studies by the ICAC – of which the United States and Brazil are both Members – show increases in world prices from the removal of some US subsidies of 10.5 per cent for MY 2000 and 26.3 per cent for MY 2001. Professor Sumner found that the effects of a removal of *all* US subsidies that applied during MY 2000 and MY 2001 would have resulted in world price increases of 7.74 per cent and 17.7 per cent respectively. Brazil has presented many other studies as evidence. They all show significant price suppression.

12. What has been the US reaction to every one of these studies? As they indicated over the past two days, they have found many initial problems with all of them. But they reserved the broad scale attack for Professor Sumner's FAPRI model that has been repeatedly relied on by the US Congress and USDA. The United States even identified flaws in the results of the Westcott/Meyer 2000 and 2001 marketing loan studies. And the United States promises they will be busy for the next six weeks in critiquing all the studies cited by Brazil.

13. But the Panel must ask whether *all* these economists, including some of USDA's own leading economists, could be wrong although their results support USDA's own Chief Economist's views that US producers are insulated from market forces by these subsidies? Could these economists be wrong because they made the mistake of applying the fundamental notion that large production subsidies create larger supplies, and larger supplies result in significantly lower prices?

14. In the final analysis, these econometric studies are useful tools to confirm what common sense already tells us. That \$12.9 billion in subsidies provided between MY 1999-2002 have production effects. That the National Cotton Council was correct when it argued that US upland cotton farmers could not exist without all of the cotton-specific subsidies. That many US producers needed subsidies to bridge the huge gap between their total costs and market revenue. That US acreage did not decrease as prices plummeted to record lows between MY 1999-2001 – rather planted US acreage increased. That US producers planted 14.1 million acres of upland cotton when prices were at record lows in the spring of 2002. That US exports did not decrease as prices plunged and the US dollar appreciated, rather they increased. And that the effects of US subsidies on suppressed prices are transmitted to the world and individual country markets, including Brazil.

4. Brazil has established a claim under Article 6.3(d)

15. With respect to Brazil's claim under Article 6.3(d), Brazil demonstrated that the ordinary meaning of the term "world market share" is the world market share of exports. USDA, the EC and Canada all use this term to refer to export market share, not share of world consumption. This interpretation is consistent with the use of the term "trade" in footnote 17 of the SCM Agreement which means the "sale and distribution of goods and services across international borders". It is also consistent with the object and purpose of Article 6.3(d) which is to prevent a Member from using its subsidies to *increase* its share of the world market for a particular product.

16. Undisputed facts show that the US share of world trade increased considerably from MY 1998 to MY 2002, and is projected to remain at very high levels in MY 2003. This increase follows a consistent trend from MY 1996. The "consistent trend" need not be an unbroken line of increases during the trend period examined, as the United States appears to argue. Because of severe

weather problems, such as occurred in the United States in MY 1998, export market share in agricultural problems will always be susceptible to some annual variations not caused by subsidies. Rather the trend must reflect an overall increase and not reflect a number of wide swings within the period examined. The trend for US world market share of upland cotton from MY 1996, and particularly the period from MY 1998 onward, shows a sustained and significant increase in the US world market share. And the undisputed facts show that the record US world market share reached in MY 2001 and 2002 occurred at the same time as record high levels of US subsidies.

5. Brazil has established that the US share of world export trade is not equitable

17. The notion of “equitable share of world export trade” necessarily depends on the facts of each case. The fact-intensive nature of each case is reflected in the text of Article XVI:3, which requires the Panel to examine “special factors”. Brazil suggests that examining whether there were any subsidy-induced *increases* in market share is one factor to consider. Another factor is the relative cost of production of the Members competing for world market share. The undisputed facts show (based on September 2003 ICAC data) that the US share of world exports of cotton more than *doubled* between MY 1998-2002 – from 18.7 to 39.3 per cent. At the same time, the African producers’ collective share of world exports *decreased* from 10.2 to 8.1 per cent of world trade. Figure 26 shows these trends. If a picture is worth a thousand words, it is this one.

18. Brazil submits it is not equitable for a heavily subsidized WTO Member to more than double its share of competitive world markets for upland cotton in only five years reflecting a significant contribution of subsidies. And it is not equitable for that Member to do so when its costs of production were double those of the poorest and neediest producers in the world. Yet, when faced with these facts, the United States’ only response is that the definition of “inequitable” is hopelessly vague. Brazil does not believe the inequity in this case is so difficult to determine.

ANNEX F-3

EXECUTIVE SUMMARY OF THE OPENING STATEMENT OF THE UNITED STATES AT THE SECOND SESSION OF THE FIRST MEETING OF THE PANEL WITH THE PARTIES

1. **Brazil's Analysis Fails to Establish to Whom Certain Payments Go and Whether Certain Payments May Properly Be Attributed to Exported Upland Cotton.** One of the fundamental elements of Brazil's claims is that Brazil needs to identify the "subsidized product" that is causing the serious prejudice that Brazil claims its interests are suffering.¹ Brazil has not even explained, however, what is the "subsidized product" for each of the types of subsidies from which it claims serious prejudice. Brazil appears to assume that the "subsidized product" is upland cotton in the form traded on the world market. Yet many of the subsidies at issue are paid to producers of cotton. Cotton is processed and sold before being traded. Brazil has made no showing of how the subsidy to the producer can be assumed to pass through to the exporter.
2. Brazil's panel request identifies the challenged measures as "subsidies provided to US producers, users, and/or exporters of upland cotton". However, it is for Brazil as the complaining party to establish who are the recipients of the subsidies and that the subsidies are properly attributed to upland cotton. Brazil's failure to do so means that it has not carried its burden in demonstrating that cotton is subsidized for purposes of considering adverse effects.
3. In the Peace Clause portion of this dispute, the United States has discussed at length certain decoupled payments that are not linked to production of upland cotton. With respect to these decoupled payments, Brazil has failed to demonstrate who the recipients of these payments are in connection with any exported upland cotton. Brazil simply presumes that every upland cotton producer is an upland cotton base acreage holder and receives a decoupled payment. Brazil has brought forward no facts to demonstrate that this is the case.
4. Even if Brazil had brought forward evidence that the recipients of these payments were upland cotton producers, that would not be enough. Brazil would still need to allocate these payments, which Brazil concedes are not linked to current production of upland cotton, over total production on a recipient's farm.²

¹ For example, for purposes of a claim under Article 6.3(c) of the Subsidies Agreement, the "effect of the subsidy" must be "significant price undercutting" or "significant price suppression, price depression, or lost sales" caused by "the subsidized product." Similarly, under Article 6.3(d) "the effect of the subsidy" must be an increase in world market share "in a particular *subsidized primary product or commodity*."

² Subsidies Agreement, Annex IV, paras. 1-3 (We note the context provided by Annex IV of the Subsidies Agreement, which explained the calculation of the ad valorem subsidization of a product under the now-defunct Article 6.1(a) of the Subsidies Agreement. This Annex provided that (among other conditions), unless "the subsidy is tied to the production or sale of a given product," the overall rate of subsidization of a "product" is found by taking the amount of the subsidy over the "total value of the recipient firm's sales in the most recent 12-month period".).

5. Thus, Brazil assumes that the subsidies³ at issue are received by someone currently producing cotton, based simply on the fact that the subsidy is based on past production of cotton. Brazil has not explained how this makes upland cotton currently for sale on the export market the “subsidized product” with respect to these payments. Brazil has failed to demonstrate that the recipients of the subsidies are involved in current cotton production, nor has it demonstrated how much of the subsidy, even under Brazil’s approach, should be allocated to other products produced by the recipient, such as corn or soybeans.

6. **Brazil Has Not Established that US Subsidies Have Suppressed or Depressed Prices in the Same Market.** As noted above, Brazil has in fact not even demonstrated the subsidized product for each of the subsidies it challenges or the size of the subsidies to exported upland cotton. However, without relieving Brazil of its burden on these issues, we note that even Brazil’s overly simplified approach does not suffice to demonstrate causation. US subsidies largely resulted from low market prices, not the other way around.

7. This is nowhere more evident than in marketing year 2001, a year with historically low market prices. Brazil has failed to explain that market signals (futures prices) at the time when planting decisions were taken by US producers suggested prices would remain high. Thus, the large marketing loan payments ultimately made in marketing year 2001 do not demonstrate that marketing year 2001 payments had the effect of increasing US production. Brazil’s expert acknowledges this very point, but Brazil has not presented in its further submission *any* information on “the expectations about production incentives that growers hold at the time they make their planting decisions”, information on which its own expert has stated “cotton plantings depend”. Thus, Brazil’s simple explanation of the conditions in marketing years 1999 through 2002 ignores “the basic economic principles” its own expert says are relevant in this case.

8. **The Sumner Model Presented by Brazil Is Inadequately Explained, Inappropriately Applied for a Retrospective Analysis, and Apparently Uses Faulty Assumptions and Estimations.** In presenting this reaction to Brazil’s expert’s analysis, the United States notes that the use of a simulation model to explore the counter-factual of removal of US subsidies cannot be made without answers to previous questions on the subsidized product and size of the subsidies. That is, the use of a simulation model cannot relieve Brazil of its burden of arguing the elements necessary to establish its claims. This critique of Dr. Sumner’s analysis is made to show that Brazil’s approach is fundamentally flawed in all aspects.

9. Since Brazil has not provided access to the model itself, one cannot say with certainty how the modelling affects the results.⁴ Nonetheless, based on what has been presented in Annex I, Brazil’s analysis appears flawed in several respects and as a result, the conclusions drawn are biased and misleading. While the modelling approach used is well accepted for forward-looking projections, using a baseline model to simulate counterfactual outcomes over the historical period 1999-2002 is

³ Brazil purports to include export credit guarantees under the GSM-102 programme within its actionable subsidy claims. However, Brazil has merely alleged the quantities of export credit guarantees benefitting cotton and the value of exports. Brazil has nowhere presented evidence on any alleged subsidy rate resulting from this programme nor the amount of the subsidy. Therefore, Brazil again has not provided any evidence with respect to the amount of the subsidy alleged to be provided by US export credit guarantees.

⁴ The report provided by Brazil as Annex I to its further submission does not provide the model itself, including detailed specifications of the equations used therein. As a result, Brazil is essentially asking the Panel and the United States to accept Dr. Sumner’s results on faith alone. The United States points out why Brazil’s expert’s approach is inappropriate for a retrospective analysis of the effect of US subsidies. Even were Brazil’s expert’s approach appropriate, however, Brazil has failed to provide sufficient evidence to allow the Panel to fully understand and evaluate that model. Thus, quite apart from flaws identified by the United States, Brazil’s reliance on Dr. Sumner’s inadequately explained results, evident throughout Brazil’s latest submission, further demonstrates that Brazil has not established a *prima facie* case that US subsidies have the effects complained of.

problematic because of the implicit assumption of perfect foresight by producers of actual conditions in the historical year. This potentially overstates the effects of the programme because the model assumes outcomes that were unanticipated by producers when they made their planting decisions. Also, it is not clear to what extent actual observed data enter into the solution process. The difference is not merely conceptual: the choice of values can potentially affect the reported results.

10. Brazil's use of lagged prices as a proxy for expected prices is also problematic. Recent studies have criticized the use of lagged variables as substitutes for expectations, and numerous papers use the futures price for next year's crop as the best proxy for expected price. The use of futures prices in a multi-commodity modelling framework for extended time projection is cumbersome. Nonetheless, the use of lagged prices as a modelling convenience does not preclude the possibility of bias. In those years where there are large shocks, lagged prices are poor predictors of expected price. Futures prices, by contrast, are more efficient because they are based on more current information.⁵

11. Brazil's expert's estimates of US programme impacts after marketing year 2001 are further inflated by his choice of a low-price baseline for the counter-factual comparison.⁶ The low-price baseline exaggerates the 2003-07 results and ensures projections of significant marketing loan payments throughout 2003-07.

12. The economic literature on decoupled payments acknowledges the programmes may have some impact on production, and that those impacts depend in part on farmer's expectations. However, the research concludes that the impact appears negligible. Brazil's expert, on the other hand, uses a stylized logic to come up with the estimates for the impact of production flexibility contract (PFC) payments that have neither empirical nor theoretical grounding. It is widely accepted that these programmes have whole farm impacts rather than crop specific impacts. Furthermore, the impact is much smaller than Brazil has estimated; the whole farm impact is, at its upper estimate, perhaps one-quarter to one-fifth the impact Brazil's expert cites for cotton alone.

13. Brazil argues that market loss assistance (MLA) payments have a larger effect on area than do PFC payments, despite the fact that MLA payments were paid on the identical payment base as the PFC payments. Supplemental legislation authorizing each of these MLA payments was passed several months after planting for the crop year in question had occurred. Brazil asserts that producers had expectations about MLA payments at the time of planting. However, if producers had expectations of payment, then they also knew that they would be eligible to receive such a payment whether or not they planted cotton. Indeed, they could choose not to plant any crop at all and still be eligible for the payment.

14. Brazil argues that counter-cyclical payments "clearly provide more production incentive than the market loss or the direct payments," yet offers no empirical evidence to justify such a claim. The claim, as well as Brazil's expert's treatment of decoupled payments in general, is particularly puzzling

⁵ Consider as an example the 2002 crop year. In Brazil's analysis, area response to the removal of the cotton loan programme results in a 36-per cent reduction in US planted area—the largest single effect for any of the years considered in his analysis. Based on lagged prices, price expectations for 2002 were 29.8 cents per pound, a 40 per cent reduction from 2001 levels. Yet, the futures market data suggests a far smaller reduction in expected price. December futures prices taken as an average in February 2002 averaged 42.18 cents per pound, a 28 per cent drop from year earlier levels. Based on Brazil's range of supply response elasticities of 0.36 to 0.47, a decline of this magnitude would suggest a drop in acreage of 10 to 13 per cent from the preceding year. In fact, actual US cotton acreage dropped 12 per cent (from 15.5 million acres in 2001 to 13.7 million acres in 2002) suggesting acreage levels entirely consistent with world market conditions and price expectations.

⁶ Brazil's expert's estimate for the 2002 A-Index is 51 cents, compared with 54 cents in FAPRI's March 2003 baseline, and an actual price of 56 cents. For 2003, Brazil's expert's A-Index is estimated again at 51 cents, whereas FAPRI's baseline has a 58.4 cent forecast; as of 15 September 2003, the A-Index is at 65.5 cents.

given a recent paper by Brazil's expert in which he concludes that the 2002 farm bill would have a minimal effect on cotton area and world prices. Brazil's expert also remarked that: "The impacts of the FSRIA will be hard to isolate amid the normal flux of world markets".⁷ We agree with Dr. Sumner's previously *published* conclusions on these points.

15. Crop insurance subsidies are generally available for most crop producers and hence do not give a specific advantage to one crop over another. Thus, their effects are not commodity specific, and have no or minimal impacts on cotton markets. Moreover, crop insurance purchases by cotton growers have generally been at lower coverage levels than for other row crops. Over 2002-03, roughly 90 per cent of cotton acreage insured was at coverage levels at 70 per cent or less, consistent with the criterion under paragraph 8(a) of Annex 2 of the Agreement on Agriculture. This suggests that even if one were to consider cotton crop insurance subsidies as crop specific, over 90 per cent of insured cotton area would be exempt as having no or minimal trade-distorting effects.

16. Lastly, while some studies like the ones cited by Brazil have suggested crop insurance subsidies may have a slight effect on acreage, the effects on production are less clear. Recent studies suggest that farms with more insurance tend to use less inputs like fertilizer and pesticides and vice versa. This demonstrates a potential moral hazard problem with crop insurance: a negative effect on yields, which may well offset any marginal effects on crop area.

17. The size of Step 2 payments under Brazil's baseline appears to be biased upwards, in part, due to the low-price baseline discussed earlier. Brazil's results are inconsistent with other analyses of Step 2.⁸ Thus, contrary to the results of Brazil's expert's model, the benefits of Step 2 payments would appear to largely accrue to the producer, with only negligible effects on world markets. While Brazil's model documentation is lacking, one explanation for the difference may be a more price responsive acreage equation by Brazil.

18. While Brazil has presented a modelling framework that is conventional, much of how Brazil's expert has modelled US farm payments can be considered "unconventional". Thus, the analysis presented by Brazil in Annex I is not "conservative", but rather produces results that are inconsistent with a wider body of academic research.

19. **Additional Legal Arguments.** With respect to price suppression or depression under Article 6.3(c) of the Subsidies Agreement, Brazil believes that it is the effect on the producers of the complaining Member that must be "significant". We find it implausible that the Subsidies Agreement was intended to create multiple standards for panels to apply: that is, what may be "significant" to one Member's producers may be "insignificant" to another's. Context for rejecting Brazil's approach can be found in Article 15.2 of the Subsidies Agreement, which sets out for countervailing duty purposes the same effects found in Article 6.3. This text makes it even more clear that the analysis is whether the level of price suppression or depression itself is "significant".⁹ Brazil has not suggested that the analysis under Articles 15.2 and 6.3(c) should be different.

⁷ Sumner, D.A. "Implications of the US Farm Bill of 2002 for Agricultural Trade Negotiations." Australian Journal of Agricultural and Resource Economics. 47(2003): 99-123, at 114. (See Exhibit US-56)

⁸ In Brazil's baseline, Step 2 payments average 5.6 cents per pound over the 2003-07 period, elimination of Step 2 payments raises world prices by an average of 1.6 cents, while farm prices fall by 2.5 cents per pound. These alleged effects are higher than those found by others. For example, in 1999, when Congress was debating whether to reauthorize Step 2 subsidies, the FAPRI analyzed the effects of reauthorization for the Senate Committee on Agriculture, Nutrition and Forestry. Their analysis estimated an average Step 2 payment of 5.3 cents per pound, resulting in an increase of the US spot price by 4 cents and a fall in the world cotton price of less than 0.5 cents.

⁹ Subsidies Agreement, Article 15.2 ("With regard to the effect of subsidized imports on prices, the investigating authorities shall consider whether . . . the effect of such imports is otherwise to depress prices *to a*

20. With respect to GATT 1994 Article XVI:3, Brazil appears to assume that it may advance a claim under this provision on all challenged US subsidies. However, Article XVI:3 only applies to export subsidies. Therefore, as Brazil has predicated its claim under Article XVI:3 on evidence relating to all challenged US subsidies and not only those subsidies it alleges are export subsidies, Brazil has failed to establish a *prima facie* case on its claims.

21. Finally, with respect to Brazil's claims of a threat of serious prejudice, the United States notes Brazil's failure to present recent market and futures price data, which belie the notion that there is a clearly demonstrated and imminent likelihood of future serious prejudice. In fact, prices are currently above the level at which the marketing loan programme confers any benefit on US upland cotton producers and are expected to remain so. If there is not a "clearly demonstrated and imminent likelihood" of serious prejudice in marketing year 2003, it follows that there cannot be a threat of serious prejudice for marketing years 2004-07, either.

significant degree or to prevent price increases, which otherwise would have occurred, *to a significant degree.*").

ANNEX F-4

EXECUTIVE SUMMARY OF THE CLOSING STATEMENT OF THE UNITED STATES AT THE SECOND SESSION OF THE FIRST MEETING OF THE PANEL WITH THE PARTIES

1. The US comments speak briefly to Brazil's allegations regarding "the effect" of US subsidies. Brazil has not shown causation between the US subsidies and the effects Brazil attributes to those subsidies. The United States has pointed out the failure of Brazil to separate and distinguish evidence on the effect of other factors from the alleged effect of the challenged US subsidies. Ultimately, this issue goes to the quality of the evidence before the Panel and whether Brazil has established a *prima facie* case on its claims.

2. There are three main elements of Brazil's argument. First is the "temporal proximity" argument – that is, that low world prices correspond in time with high US subsidies.¹ Mr. Chairman, there are subsidies and there are subsidies. For example, there is a difference if I give you a \$10 subsidy to produce versus \$10 whether you produce or not. Depending on the nature of the payment, one would estimate different effects. Therefore, one cannot merely aggregate the value of all US payments and claim that those subsidies have had "an effect" on production and prices.

3. In this part of its argument, Brazil misuses the data on production by making comparisons using marketing years 1998 and 2001. In 1998, production was driven downward by drought and record crop abandonment. In 2001, production was driven upward by record yields. To use 1998 and 2001 as the beginning and end of a comparison therefore distorts a proper analysis.

4. Brazil stated yesterday that the increase in US production in marketing year 2001 was not solely due to record yields but also to an increase in acreage. That is true – there was some increase in acreage in 2001, but Brazil has failed to make the proper comparison to put that information in context. Brazil should have compared the US acreage increase between marketing years 2000 and 2001 with that in the rest of the world. The United States invites the Panel's attention to Exhibit US-63 circulated today. This exhibit reflects, for marketing years 1996-2002, the percentage change in harvested acreage over the previous marketing year in the United States and the rest of the world.

5. In marketing year 1996, when the programmes challenged by Brazil were introduced, you see a large decrease in US acreage compared to the rest of the world. The United States draws your attention to marketing year 1998, in which there is a large decline in US harvested acreage due to drought, followed by a large increase in marketing year 1999, which largely cancel each other out. In marketing year 2001, we see that the increase in acreage in the United States corresponds to the increase in acreage for the rest of the world. In marketing year 2002, the percent decline in harvested acreage in the United States is *greater* than that observed in the rest of the world. Thus, the data do not support Brazil's contention that US producers are insulated from market forces. In fact, US harvested acreage largely increases and decreases in line with the rest of the world.

6. (Yesterday Mr. Moulis asked about the data in the upland cotton fact sheet. The data in Exhibit US-63 does not come from that fact sheet but from the most recent US Department of Agriculture data base – the specific source is indicated on the second page of the exhibit. Brazil has used this same source for numerous exhibits in its submissions.)

¹ The United States has addressed the disconnect between low world prices and the level of subsidy in Exhibit US-44.

7. The second element of Brazil's arguments that the United States would like to address is its reliance on Mr. Sumner's model. We first would like to comment on something Mr. Sumner said today in his statement to the effect that the United States does not object to the use of the FAPRI baseline model. In fact, as reflected in the portion of the US opening statement delivered by Dr. Glauber, we do criticize as inappropriate the use of a baseline simulation model for retrospective analysis, a type of analysis for which it is not designed and is poorly suited.

8. Mr. Sumner's analysis also uses an inappropriately low baseline for his prospective analysis of future years. I noted with interest Mr. Sumner's statement that he used the November 2002 preliminary FAPRI baseline because this was available when he ran his model and that the results would have been even more extreme had he used FAPRI's published 2002 baseline "released the previous winter". The United States realizes it would have been inconvenient for Mr. Sumner to re-run his model, but FAPRI released a more recent baseline in January 2003 (published in March 2003²), many months before Brazil submitted the results of its model to the Panel and the United States. We believe this more recent FAPRI baseline would have been a more appropriate baseline with which to do calculations, but Brazil has chosen not to do so, instead presenting to the Panel results based on more out-of-date and inaccurate data. We wonder what would arise from a prospective analysis using such more recent data.

9. The third issue concerns the allegations of high US costs, an issue we have touched on only briefly in this hearing and will return to in more detail in our submissions. Brazil asks: without subsidies how could high-cost US producers have stayed in business? It is important first to point out that all of the cost projections by the US Department of Agriculture cited by Brazil are merely updates of a 1997 cost survey. In every year subsequent to 1997, the Department simply takes the results of the 1997 cost survey and updates it to reflect the general increase in prices according to the producer price index.

10. This approach assumes that the mix of inputs remains the same in 1997 as in subsequent years. However, this causes a presentation of inaccurate data on what costs are now. Brazil has several times in this hearing stated that it is not denying that factors reducing costs have occurred – for example, pest eradication bringing new, low-cost areas of the United States into production or the adoption of biotech cotton which requires fewer pesticide applications. Brazil, however, has not updated the cost information it presents to the Panel to account for such new developments and information.

11. The United States also notes Brazil's repeated references to a so-called cost/revenue gap. In fact, Brazil presents another such comparison for marketing year 2002 at page 5 to the annex to its Closing Statement. However, Brazil's so-called "gap" is the difference between an inaccurate average total cost per pound and the average marketing year farm price. Mr. Chairman, this is a faulty comparison. Total costs are relevant over the long-term, but Brazil uses this (inaccurate) number to compare to revenue in the short term – that is, the market price for one year. Such a comparison tells you nothing and does not establish that it is only the effect of US subsidies to keep US cotton farmers in business.

12. In fact, Brazil has apparently not listened to the testimony of its own farmer witness, Mr. Christopher Ward. In his statement during the first day of this hearing, he said the following (and I quote from paragraph 6 of his statement):

But even with these high yields and the excellent quality of our land, *we were not able to fully recover all of our variable costs of production during the 2000/01 and*

² Exhibit US-52.

*2001/02 seasons. These variable costs included depreciation and maintenance of equipment, seed and fertilizer, labor, insurance, and fuel. **Nor were we able to meet our total costs** which include the additional fixed costs.*³

That is, Mr. Ward says he has not been able to cover *either* his variable costs *or* his total costs for a period of two marketing years, and yet he continues producing. Under Brazil's analysis, he should be out of the business of producing cotton. He is not, and Brazil claims he is not subsidized, so how can Brazil claim that it is "the effect of the subsidy" to keep US farmers in business when they allegedly were not able to cover their total costs in marketing year 2002? What's true for Brazil should also be true for the United States.

13. Mr. Chairman, members of the Panel, on the basis of these arguments and the evidence presented to date, the United States does not believe that Brazil has established a *prima facie* case that the challenged US subsidies have caused the effects complained of. We will continue to develop and provide our response to the voluminous submissions of Brazil in our answers to your questions and in our rebuttal submission. Thank you.

³ Statement of Mr. Christopher Ward at the Second Session of the First Panel Meeting, para. 6 (emphasis added). Mr. Ward goes on to state: "Based on my discussions with many producers relating to Mato Grosso cotton production and revenue, *I know that most other producers in State of Mato Grosso were in the same situation as we were during the 1999-2002 period.*" *Id.* (emphasis added).

ANNEX F-5

ORAL STATEMENT OF ARGENTINA

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I. INTRODUCTION

1. Argentina would like thank the Panel for this renewed opportunity to submit its views as a third party in these proceedings, and as stated in its submission of 3 October¹, it will be commenting on some of the claims made by the United States in its written submission of 30 September.²

II. CLAIMS OF THE UNITED STATES

II.1 Causal relationship and other factors which affected and still affect the world cotton economy

2. In paragraph 5 of its submission, the United States asserts with respect to marketing loan payments and step 2 payments that Brazil seeks to ascribe extraordinarily low cotton market prices in recent years to US subsidy payments without presenting or explaining to the Panel the factors that led to this low market price level that in turn resulted in larger US subsidies.

3. Similarly, in paragraph 80 of its submission, the United States claims that Brazil's argument rests largely on the assertion that large US outlays under the challenged measures necessarily demonstrate that US measures caused those price declines.³

¹ Second Written Third-Party Submission of Argentina, 3 October 2003, paragraph 4.

² Further Submission of United States, 30 September 2003.

³ Further Submission of the United States, paragraph 80.

4. The United States claims that Brazil has not been able to demonstrate the causal connection between the US measures and their effects, nor has it considered other factors which affected and still affect the world cotton economy.

5. Argentina believes that Brazil, in its First Written Submission, provided a precise and comprehensive description of the world cotton market situation, backing the facts with considerable evidence and documentation.⁴ Similarly, in its Further Submission, Brazil took account of other factors which also contributed to demonstrating the suppressing or depressing effect on prices of the US subsidies.⁵

6. Argentina would further like to point out that despite the existence of factors other than the US subsidies that could also have had a depressing effect on international prices (such as the development of synthetic fibres, Chinese trade policies and other factors raised by the United States in its further submission⁶, some of which will be considered by Argentina further on), Article 6.3 of the SCM Agreement⁷ clearly states that "*serious prejudice ... may arise in **any case** where ... the effect of the subsidy...*".

7. In other words, Argentina considers that Brazil has demonstrated the causal relationship between the subsidies that the United States has granted and continues to grant to its cotton sector and the fall in international cotton prices.

8. That is, Argentina considers that under the SCM Agreement **it is not necessary for a subsidy to be the only factor** in the decline in international prices in order to be able to establish a causal relationship between that subsidy and the serious prejudice.⁸ Rather, the subsidy must be a determining factor or, according to the text of Article 6.3(c), its effect must be a "**significant**" price suppression or price depression, and this was demonstrated by Brazil.

9. Argentina recalls that the United States, given the size and global impact of its cotton market – with a 41.6 per cent share of the world market – is the international market "price-setter" *par excellence*.

10. Thus, without the US subsidies which generate a world market surplus, international cotton prices would have been higher or would not have fallen as much. Similarly, if the US share in the world market had not increased as a result of the subsidies, the international price of cotton would have been higher or would have not fallen as much, and as a result, third-country producers, including Argentina, would not have suffered as much prejudice as a result of artificially depressed prices.⁹

11. Argentina does not agree with the US statement that Brazil has not established a *prima facie* case because it has failed to provide sufficient evidence of the causal relationship between the enormous budgetary outlays and the low international cotton prices.¹⁰

⁴ Brazil's First Submission to the Panel, 24 June 2003.

⁵ Brazil's Further Submission to the Panel, 9 September 2003, Section 3.3.4.4.

⁶ Further Submission of the United States, Section IV.B and C.

⁷ Agreement on Subsidies and Countervailing Measures.

⁸ "Further Third Party Submission of New Zealand" (3 October 2003), para. 2.09: "*Brazil's argument is not that declining cotton prices were due solely to the impact of the United States subsidies. Nor does Article 6.3(c) require that to be the case ...*".

⁹ Second Written Third-Party Submission of Argentina, 3 October 2003, paragraphs 21, 26 and 27.

¹⁰ Further Submission of the United States, paragraphs 17 and 80.

12. Brazil has not based its claims on a mere assertion, but rather, as we have already stated¹¹, the number and quality of the empirical and econometric analyses presented by Brazil in its Further Submission¹², which were carried out both by international organizations and by various prestigious US institutions, not to mention the USDA itself, provide irrefutable evidence of the *collective* and *individual* effects of each subsidy programme on the price of cotton.

13. It is therefore difficult for Argentina to understand how the United States can claim that other factors, and not its subsidies, were the cause of the dramatic fall in cotton prices over the past few years. Nor does Argentina understand how the United States can disregard the evidence provided by Brazil¹³ to the effect that during the marketing years 1999 to 2002, the total value of US cotton subsidies amounted to almost US\$13 billion while the average cotton subsidization rate was 95 per cent.¹⁴

14. In the paragraphs that follow, Argentina will refute some of the arguments put forward by the United States concerning other factors that may have influenced the fall in international cotton prices:

15. FIRST: the United States claims that the explosion in the production of synthetic fibres played a considerable part in causing cotton prices to fall. Argentina submits that the contrary appears to be true.

16. Indeed, the "Fibre Prices" Table in paragraph 23 of the US Further Submission shows that polyester prices have always been lower than cotton prices (see: "US mill" as compared to "US spot" and "Asia poly") and, moreover, they appear to follow cotton prices (see 1995, when cotton prices reached their record level for the series and polyester happened to follow the same trend).

17. The fact that polyester had to adapt to cotton prices, and not the reverse as the United States claims, is confirmed by the very close correlation between cotton and polyester prices. On the other hand, the last few years do not show any correlation between the price per barrel of oil and the price of polyester fibres.

18. SECOND: Argentina does not understand how the United States can claim that without the increase in US retail consumption, international cotton prices would currently be lower¹⁵ (which is not being questioned), while disregarding the role that its enormous subsidies have played and still play in the fall of international cotton prices.

19. As we have already pointed out¹⁶, price movements of the US Cotlook "A" Index and third country (e.g. Brazilian and Argentine) market prices are directly interconnected, and this is an unquestioned and irrefutable fact. This being the case, the amount of the US subsidies granted to the cotton sector added to the scale of US production and exports are decisive when it comes to determining the extent to which the subsidies affect the fixing of both international and third market prices.¹⁷

20. THIRD: The United States correctly points out that since the world's cotton trade is managed in US dollars, an appreciation of the dollar will lead to a fall in the price of cotton both in the

¹¹ Second Written Third-Party Submission by Argentina, paragraphs 34-36.

¹² Further Submission of Brazil, Section 3.3.4.8.1.

¹³ USDA's "Fact Sheet: Upland Cotton" (January 2003). (See Annex BRA-4).

¹⁴ Written Third-Party Submission by Argentina, 15 July 2003, paragraph 20.

¹⁵ Further Submission of the United States, paragraph 26.

¹⁶ Second Written Third-Party Submission by Argentina, paragraph 22.

¹⁷ *Idem*, paragraph 28.

United States and in third markets.¹⁸ What the United States does not explain in connection with this fact is why this appreciation of the dollar by some 37 per cent between 1995 and 2002¹⁹ did not also result in a fall in production, and consequently, in US cotton exports. The National Cotton Council (NCC) gives us the answer, pointing out that without its subsidies, the United States' share in the world cotton market would have declined.

21. FOURTH: Regarding the United States argument that China is the giant of the world cotton industry, and hence the impact of its trade policies and stocks, we note that neither Brazil nor third parties, such as Argentina, overlooked this fact. We repeat, Argentina has already pointed out²⁰ that while there were a great many cotton producing countries, four of them (China, the United States, India and Pakistan, in descending order) alone account for two thirds of world cotton production.

22. However, Argentina also pointed out that most of the cotton was used in the producing country itself, and that the great exception to that rule was the United States, which exported over a half of the cotton it produced and was the world's leading exporter. This was why the level of subsidization in the United States was the main factor in determining the world cotton market price. In other words, while China may be the giant in the world cotton **industry**, the United States is the giant in world cotton **trade**.

23. FIFTH: The United States claims that the decisions of farmers are based on expected cotton prices for the upcoming crop year and not prices from the previous crop year as cited by Brazil, and that US cotton producers are not insulated from international price movements.²¹ We can only repeat some of the questions that we addressed to the United States during the consultations²², namely:

24. If this is so, how does the United States explain the fact that in 2001 – the fifth year of falling prices – US cotton producers achieved a record harvest of 20.3 million tons, an increase of 42 per cent compared to 1998, and that the cotton planted area increased by 6 per cent during the same period? Why does the USDA estimate a 10 per cent drop in the world production for 2002 – reflecting the impact of world prices on investment – and at the same time estimate for this year another record harvest in the US – the fourth biggest ever recorded? How does the US explain the reasons for the increase in the volume of its cotton exports from 946,000 tons in 1998 to 1.8 million tons in 2001, while there was a drop in international prices?

25. Besides, the United States is not a low-cost producer²³ (despite its claim that pest eradication programmes and the adoption of genetically modified varieties of cotton have lowered its production costs²⁴), and its productivity levels are lower than those of other exporting countries. Nevertheless, while international prices have fallen by some 54 per cent since the middle of the 1990s, the United States has expanded the area under cotton and increased its production. How does the United States explain the lack of correlation between the world cotton price and US cotton production?

26. Brazil has given answers to all of these questions. Argentina has also pointed out that if the United States did not grant subsidies to its cotton sector, the US cultivated acreage and production

¹⁸ Further Submission of the United States, paragraph 35.

¹⁹ *Idem*, paragraph 32.

²⁰ Written Third-Party Submission by Argentina, 15 July 2003, paragraph 21.

²¹ Further Submission of the United States, paragraph 45.

²² Second Written Third-Party Submission by Argentina, 3 October 2003, paragraph 7.

²³ International Cotton Advisory Committee, "Survey of the Cost of Production of Raw Cotton", 2001.

²⁴ Further submission of the United States, paragraph 46.

would diminish. US exports would also diminish and, the US being the world's leading supplier of cotton, international prices would be higher or would not have decreased as much.²⁵

27. Argentina considers that the evidence submitted with respect to the increase in US production and exports which took place entirely independently or in isolation from the fall in the international price clearly demonstrates that US cotton producers are immune to changes in the market prices for cotton.²⁶

28. SIXTH: The United States claims that the eradication of pests and the adoption of genetically modified varieties of cotton have lowered production costs.²⁷ We stress that even so, there continues to be a widening gap between those costs and market prices.

29. We repeat what has already been stated by Brazil and Argentina²⁸, namely that while US cotton production costs are among the highest in the world, US producers' market prices have fallen from US\$0.60 to US\$0.30 per pound.²⁹ The only possible explanation of how the United States has been and continues to be able to bridge the widening gap between production costs and market prices is subsidies, since without them many US producers would have been or would be compelled to cease cotton production.

30. SEVENTH: Argentina does not understand how the United States can claim that US cotton producers are highly sensitive to price changes when in spite of a 54 per cent fall in international prices since the middle of 1990s, the area under cotton and the production of cotton in the United States expanded considerably. In other words, contrary to what the United States has claimed, the area under cotton has responded to the fall in international prices by increasing steadily. The only way to achieve such a result is to grant enormous subsidies, since without them the cultivated area, and hence production, would have decreased.

31. EIGHTH: Argentina does not understand how the United States can state that its cotton producers show greater sensitivity to price changes than is demonstrated by third markets when, for example in Argentina – which is basically a "price-taker" in the international cotton market – the cultivated area shrank by 76 per cent during the marketing year 2001/2002, while production fell by 63 per cent compared to 1998.³⁰

II.2 Exclusion of measures

32. Regarding the US argument that some of its domestic support measures should not be included in the analysis³¹, Argentina considers that the Panel should examine the collective effects of all of the support measures that are not green box measures. Argentina does not agree with the US statement that direct payments and counter-cyclical payments should be excluded from the analysis simply because their individual effects may not be that significant.

²⁵ Second Written Third-Party Submission by Argentina, 3 October 2003, paragraphs 11 and 12.

²⁶ *Idem*, paragraph 5.

²⁷ Further Submission of the United States, 30 September 2003, paragraph 46.

²⁸ Written Third-Party Submission by Argentina, 15 July 2003, paragraphs 17 and 18.

²⁹ According to a recent ICAC study, the cost of production in the United States was US\$0.81 per pound of cotton in the marketing year 1999. In contrast, as pointed out by Brazil in paragraph 32 of its submission, Argentina's production costs averaged 59 cents per pound of cotton. "Cotton: World Statistics", Bulletin of the International Cotton Advisory Committee, September 2002 (Annex BRA-9).

³⁰ "Argentina: Economic Injury to the Cotton Sector as a Result of Low Prices", Working Group on government Measures of the International Cotton Advisory Committee, 2002. Written Third-Party Submission by Argentina, 15 July 2003, paragraph 22.

³¹ Further submission of the United States, 30 September 2003, paragraphs 71 to 75.

33. It is the collective impact of all of the US subsidies that has effects on the cultivated area, production, exports and prices.

II.3. Interpretation of Article 6.3(c)

II.3.1 Effect of the subsidy

34. Argentina considers that Brazil has made a proper *prima facie* case with respect to its claim of inconsistency with Article 6.3(c) of the SCM Agreement, conclusively demonstrating the significant price suppression or depression effect.

35. Firstly, Argentina does not understand how the United States can simply brush aside the Panel's findings in *Indonesia-Automobiles*³², since this was the only dispute under the GATT-WTO which dealt with the interpretation of the term "significant".

36. Secondly, Argentina fails to understand how the United States can claim that Brazil argued that it is the effect on producers that must be significant, and not on prices, when Brazil has submitted copious evidence, based on numerous empirical and econometric analyses, of the effects of the subsidies on prices.

37. It is remarkable that the United States should completely disregard these analyses, especially considering they were conducted by international organizations and by different prestigious US institutions, not to mention the USDA itself³³, in an attempt to distort Brazil's evidence.

38. Argentina repeats that over and above any endorsement that may be given to the conclusions of any one of these studies (and each study's estimate of the price effect of the subsidies), an increase in the world price of cotton would be significant, even if international price suppression or depression were to amount to only one per cent per pound, since such an increase would enable countries such as Brazil and Argentina to recover their competitive positions in the world cotton market.³⁴

39. Finally, at no time does the United States seem to suggest that a suppression or depression effect of 12.6 per cent on international cotton prices is not "significant" within the meaning of Article 6.3(c). The Panel should therefore find that the subsidies in question have caused and still cause significant depression of cotton prices in the world market resulting in serious prejudice to Brazil's interests.

II.3.2 "In the same market"

40. Contrary to what the United States has claimed³⁵, Argentina considers that Brazil has presented sufficient evidence with respect to the significant effect of subsidies on prices for each relevant geographical market, including the United States, Brazil, the African Countries, other producer countries and Brazilian export markets.

41. The United States provides no legitimate reason why the Panel should not consider the world market. As stated earlier³⁶, price movements of the United States, of the Cotlook "A" Index and third

³² *Idem*, paragraph 82.

³³ Further Submission of Brazil, 9 September 2002, Section 3.3.4.8.1.

³⁴ Second Written Third-Party Submission by Argentina, 3 October 2003, paragraph 34 to 36. See also Further Third-Party Submission of New Zealand (3 October 2003), paragraph 2.21: "...As Brazil demonstrates even a 1 cent per pound price-suppressing effect can reduce world wide export revenue by 552 million dollars".

³⁵ Further Submission of the United States, paragraphs 90 to 92.

³⁶ See paragraph 17 above.

country (e.g. Brazilian and Argentine) market prices are directly interconnected, and this is an unquestioned and irrefutable fact.

42. Moreover, US cotton forms part of Cotlook's "A" Index basket, so that the Panel cannot ignore the fact that the US subsidies have a decisive impact on the price of cotton in the world market.

43. Indeed, this being the case, the amount of US subsidies granted to the cotton sector added to the scale of US production and exports is decisive when it comes to determining the extent to which the subsidies affect the fixing of both third market and world market prices.

II.3.3 Time period to be considered

44. Regarding the US argument that subsidies that have ceased to exist can have no "effect"³⁷, Argentina would like to recall the Panel's remarks in the *Indonesia-Automobiles* concerning the irrelevance of serious prejudice having been caused by programmes that are no longer in force. Upon examining whether the subsidies caused serious prejudice to the interests of the complainants, the Panel in the said case rejected the argument that the effects of an expired subsidy programme could not be considered.³⁸

45. Moreover, Argentina considers that it is necessary to consider a sufficiently extensive period to reflect market trends, and a period of one year as suggested by the United States is not sufficient.³⁹

II.4 Interpretation of article 6.3(d)

II.4.1 World market share

46. The United States errs in its interpretation of the expression "world market share" by trying to identify it with "share in world consumption".⁴⁰ If, as the United States contends, the expression "world market share" in Article 6.3(d) refers to the increase in consumption of the country granting the subsidy, it would be contrary to the object and purpose of Articles 5 and 6 of the SCM Agreement, namely to avoid adverse effects of subsidies to the interests of other Members.

47. Indeed, if there were an increase in the share in world consumption of the product subsidized by the Member granting the subsidy, this would very probably lead to an increase in the international price of the product in question, and hence, there would be no adverse effects for other Members. In other words, to identify "world market share" with "share of world consumption" would completely subvert the underlying rationale of Article 6.3(d).⁴¹

³⁷ Further Submission of the United States, paragraph 94.

³⁸ The Panel stated that: "[W]e must assess the 'effect of the subsidies' on the interests of another Member to determine whether serious prejudice exists, not the effect of 'subsidy programmes'. We note that at any given moment in time some payments of subsidies have occurred in the past while others have yet to occur in the future. If we were to consider that past subsidies were not relevant to our serious prejudice analysis as they were 'expired measures' while future measures could not yet have caused actual serious prejudice, it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice." Panel Report on *Indonesia – Automobiles*, paragraph 14.206.

³⁹ See WT/DS219/AB/R, paragraph 80: " ... we understand a POI to provide data collected over a sustained period of time, which period can allow the investigating authority to make a dumping determination that is less likely to be subject to market fluctuations or other vagaries that may distort a proper evaluation".

⁴⁰ Further Submission of the United States, paragraph 97.

⁴¹ See also Further Third-Party Submission of New Zealand, paragraph 2.34.

48. Moreover, if we take account of the immediate context of Article 6.3(d), i.e. footnote 17, which states "*unless other ... rules apply to trade ...*", we have a clear indication that the expression "world market share" can only refer to the share in world exports.

II.4.2 Time period to be considered

49. Contrary to the US claim that the trend in the period considered is not consistent because it includes years in which the United States world market share decreased rather than increasing⁴², the fact is that there will always be peaks and troughs in agricultural production and export for climatic and other reasons. This does not mean that a trend over the years cannot be "consistent".

50. In other words, the word "consistent" cannot be interpreted in such a way as to allow a decrease in world market share during a given year to invalidate a trend over several years. On the contrary, the word "consistent" should be interpreted in the context of the investigation period, disregarding the market variations.

II.5 Threat of serious injury

51. Argentina considers that since Brazil has established the existence of serious prejudice caused by the US subsidies, the threat of serious prejudice is clearly foreseeable and imminent as a result of the even higher subsidies planned under mandatory US legislation for the marketing years 2003-2007. Consequently, Argentina maintains that Brazil has established a prima facie case that these subsidies threaten to cause serious prejudice to Brazil.

52. Argentina contends that this guaranteed flow of subsidies will unquestionably lead to a higher level of US cotton production and exports. This will inevitably result in price suppression and depression as well as an increasing and inequitable US market share for cotton, thus creating a source of permanent uncertainty that confirms the threat of serious prejudice generated by the subsidies.

53. Argentina further considers that the link between US cotton subsidies and the threat of significant price suppression and depression and of an increase in the US world market share for cotton stems from the fact that the future subsidies will be as necessary as the current ones for US producers to bridge the gap between market prices and their total production costs. This will enable US producers to continue competing with more efficient third country producers, especially considering that the USDA itself forecasts an increase in total production costs.⁴³

III. EXPORT CREDIT GUARANTEES

54. In its Further Submission, the United States reverts to its argument in connection with the negotiating history for the interpretation of Article 10.2 of the Agreement on Agriculture, maintaining that there are no disciplines regulating the use of export credit guarantees.

55. Argentina repeats what it stated in its oral submission of 24 July 2003, namely that Article 10.2 in no way provides an exception to the general disciplines on export subsidies, and in particular, to the applicability to Article 10.1. As Argentina has pointed out, "*if that had been the intention, then the negotiators would have expressly said so.*"⁴⁴

⁴² *Idem*, paragraph 101.

⁴³ See Annexes BRA-7 (ERS Data: Commodity Costs and Returns); BRA-257 ("Cost of Farm Production Up in 2003", USDA, 6 May 2003) and BRA-82 (USDA Agricultural Baseline Projections until 2012, USDA, February 2003, p.48).

⁴⁴ See Oral Third-Party Submission by Argentina, paragraphs 35 to 43.

IV. CONCLUSION

56. For the reasons set forth both in this statement and in previous submissions, Argentina requests the Panel to issue the findings and recommendations requested by Brazil throughout these proceedings.

ANNEX F-6

ORAL STATEMENT OF BENIN

8 October 2003

Mr. Chairman, members of the Panel,

1. My name is Eloi Laourou from the Mission of Benin. I am joined by Mr. Nicholas Minot of the International Food Policy Research Institute in Washington, D.C., the co-author of the study that has been annexed to our Third Party submission, "Effect of Falling Cotton Prices on Rural Poverty in Benin". I will ask Mr. Minot to speak to you in a moment. The other members of our delegation are our legal advisers, Mr. Brendan McGivern and Mr. Stefan Ramel, both from White & Case.

2. As noted in our Third Party submission, this is the first time that Benin has participated in a WTO dispute. We have not taken the decision to participate lightly. Indeed, it was only the serious threat posed to the economic and social stability of our country by massive, WTO-inconsistent US subsidies on cotton that has led us to take this unprecedented step.

3. The cotton farmers of Benin are efficient producers. The World Bank has estimated that the cost of producing cotton in West Africa is about 50 per cent of the cost of production in the United States. Moreover, the cotton sectors of both countries have undergone considerable structural reforms.

4. Yet the economic efficiencies of our producers, and the painful reforms they have accepted, have in the end proved to be almost completely irrelevant. US subsidies have had a ruinous effect on the world price of cotton, which in turn has had devastating effects on the economies of West Africa.

5. US cotton subsidies do not just dwarf the cotton sectors of West Africa. They dwarf all economic activity in the region. As noted in our submission, the subsidies paid by the United States to its prosperous 25,000 cotton farmers exceed the gross national income of Benin, Chad, Burkina Faso, Mali, Togo and the Central African Republic.

6. Oxfam estimates that for the period from 1999/2000 to 2001/2002, Benin suffered a total cumulative loss of \$61 million in export earnings. Mr. Chairman, this is not an abstract, anodyne statistic. This translates into genuine suffering on the ground, as hundreds of thousands of people, deprived of export earnings, are pushed from bare subsistence to absolute poverty. Indeed, Dr. Minot estimates that a 40 per cent reduction in farm-level prices of cotton has the effect of pushing an additional 334,000 thousand people below the poverty line in Benin.

7. This is an important point, one that should be considered carefully by the panel as it assesses the meaning of "serious prejudice" to one of the poorest countries in the world.

8. With your permission, I would now ask Mr. Minot to summarize briefly the results of his study on how depressed world prices for cotton translate into poverty in Benin.

Dr Minot:

9. Thank you for the opportunity to present the results of a study that I hope will be relevant to the dispute. Before I begin, I would like to provide some background. I am a Research Fellow at the International Food Policy Research Institute, a Washington-based international organization whose mandate is to generate information to address problems of hunger and poverty in developing countries. I received my Ph.D. in agricultural economics from Michigan State University and have worked on issues of agriculture in developing countries for more than 15 years, including four years living in sub-Saharan Africa.

10. From 1998 to 2000, I led a German-funded study of the impact of agricultural reforms on farmers in Benin. In collaboration with a local research firm, we carried out four surveys in Benin: surveys of farmers, traders, market managers, and village cooperatives. In 2002, I was contracted by the World Bank to use these survey data to examine the impact of falling world cotton prices on poverty in Benin. My co-author, Lisa Daniels, and I finished the report later that year and a version of it was distributed as an IFPRI working paper in November.

11. Cotton prices are affected by competition with synthetic fibres, weather-related supply shocks, the rate of growth in the global economy, and government policies, among other factors. Cotton prices are pushed below what they otherwise would be by government support to cotton growers. The International Cotton Advisory Committee estimates that worldwide direct assistance to cotton growers was US\$ 4.9 billion in 2001/02. Of this amount, the United States accounted for US\$2.3 billion, equivalent to 24 cents per pound of cotton produced. Other sources, using a broader definition of assistance, estimate that the government provides US\$ 3.9 billion to the cotton sector.

12. Until 2002, US cotton policy consisted of various programs, including two (the marketing loan program and loan deficiency payments) that ensured that farmers receive at least 52 cents/pound. This has the effect of insulating US farmers from falling world prices. In 2001, in spite of low world prices, the US posted record cotton production and near-record export volumes. Furthermore, US subsidies to cotton have increased since these studies were carried out. The 2002 Farm Bill introduced target prices for the major commodities and programs that effectively pay US farmers most of the difference between market prices and the target price. For upland cotton, the target price is 72 cents/pound. In addition, by allowing farmers to update their "base acreage", the new policy provides incentives for farmers to expand production.

13. Several recent studies have attempted to assess the impact of subsidies on world prices. The Centre for International Economics in Canberra uses a five-region world model of fibre, textile, and garment markets in 2000-01 to simulate the impact of US and European subsidies on cotton production and export. They find that removing US and European subsidies to cotton growers would raise the world cotton price by 6 cents/pound or 11 per cent. Another study, carried out by ICAC, estimates that removing US production subsidies would have increased the world price by 11 cents/pound in 2001/02. And most recently, Sumner estimates that, in the absence of US subsidies, the world cotton price would have been 12.6 per cent higher over 1999-2002.

14. The adverse impact of lower cotton prices on export revenue and GDP in cotton exporting nations is clear, but does this translate into higher incidence of rural poverty? If cotton is grown mainly by larger farmers with relatively high incomes, then the effect of changes in cotton prices on rural poverty may be modest. Even if cotton is grown primarily by small farmers, the magnitude of the effect on rural poverty will be small if few farmers grow cotton or if it accounts for a small share of rural income. Assessing the direct impact of changes in cotton prices on rural poverty requires detailed household-survey data on incomes and expenditures.

15. The paper examined the impact of changes in cotton prices on rural poverty in Benin. In particular, it had two objectives:

- to describe the living conditions and level of poverty for cotton growers and other farmers in Benin; and
- to estimate the short and long-run impact of lower cotton prices on the income of cotton growers and on the incidence of poverty in rural Benin.

16. The Republic of Benin has a population of about six million, 59 per cent of whom live in rural areas. Its rural economy is based on maize, sorghum, millet, yams, cotton, and livestock production. The per capita gross national product is US\$380, placing Benin among the poorest countries in the world. Indeed, the per capita income of Benin is lower than the average for sub-Saharan Africa.

17. In 1989, Benin entered a period of economic and political reform. It made a peaceful transition from a military government to a constitutional multi-party democracy. It also began to move from a quasi-socialist economy to a free-market economy. In the agricultural sector, state farms and cooperatives were disbanded, food crop prices and marketing were liberalized, and many state-owned enterprises were privatized or closed. In January 1994, the CFA franc was devalued by 50 per cent, effectively doubling the price of imports and the returns to exports. Although this imposed hardship on manufacturing firms and urban consumers, it stimulated the local production of cotton, rice, and other tradable goods.

18. In the past two years, Benin has greatly reduced the role of the state cotton marketing board, introducing competition in the distribution of inputs and the marketing of cotton. The fall in world cotton prices has led to political pressure for the government to support the domestic price or even to re-assume control of the sector to protect farmer interests. Cotton represents 90 per cent of agricultural exports and around 70 per cent of its total exports (excluding re-exports).

19. Because the reliability of the results depends heavily on the quality of the survey data, it is worth briefly describing the survey methods. The survey, called the *Enquête des Petits Agriculteurs* (EPP) or Small Farmer Survey, was carried out in 1998 by the IFPRI and a local research firm, the *Laboratoire d'Analyse Régionale et d'Expertise Sociale* (LARES). The survey used a 24-page questionnaire covering 16 topics. The households were selected using a two-stage stratified random sample procedure based on the 1997 Pre-Census of Agriculture. In total, one hundred villages were selected. In each village, nine households were randomly selected using household lists prepared for the pre-Census of Agriculture. Due to some variation in the number of households interviewed in each village, the final sample was 899 rural households. The interviews were carried out in local languages by two teams of Benin interviewers, supervised by staff from LARES and IFPRI.

20. In order to study poverty, we need to define it. In this analysis, the poor are defined as those living in households whose per capita expenditure is below the 40th percentile in rural areas. Expenditure is used instead of income because it is more reliably measured and is a better measure of household well-being. It includes cash spending on consumption goods, the value of home-produced food, and the rental equivalent of owner-occupied housing. The resulting poverty line is equivalent to US\$123 per person per year. It is worth noting that this is a low poverty line, far below the US\$1 per day frequently used by the World Bank.

21. We simulated the impact of various percentage reductions in cotton prices on the incomes of rural households using the concept of producer surplus. The details of the calculation are shown in the paper, but these are standard formulas used in economic analysis. In the short run (before households respond to lower prices), the change in income of each household is simply the percentage

change in the value of cotton production multiplied by the quantity produced. In the long run, lower cotton prices will cause farmers to substitute away from cotton, so the impact is smaller. We simulated the impact of these cotton price changes in the short and long run on each of the 899 household in the sample to generate estimates of the impact on rural income and poverty.

22. Before turning to the simulation results, I will describe the role of cotton in the rural economy and the characteristics of cotton growers. According to the IFPRI-LARES survey, cotton is grown by roughly one-third of the farm households. Cotton accounts for about 18 per cent of the area planted by farm households and 22 per cent of the gross value of crop production. In value terms, cotton is the second most important crop, after maize. Among cotton farmers, the average area planted with cotton is 2.3 hectares, producing 2.7 tons of seed cotton. The value of this output is US\$ 901 per cotton farm. Cotton accounts for about one-third of the value of crop sales (these figures are shown in Table 2 of our paper).

23. Cotton growers tend to have farms that are larger than other farmers, but they are similar to other farmers in terms of the poverty rate and average per capita expenditure. The larger farms do not translate into a higher standard of living because cotton production is concentrated in the north, which is more arid and has fewer opportunities for non-farm employment. It is not that cotton farmers are poorer than average, but rather that almost all farmers in Benin, including cotton farmers, are quite poor.

24. Turning to the simulations, the short-term impact of a 40 per cent reduction in the farm-gate price of cotton reduces the income of cotton growers 21 per cent. Taking into account the incomes of non-growers, which do not change in this simulation, the average income of rural households falls 7 per cent. Smaller reductions in the cotton price cause roughly proportional changes in income, as shown in Table 3 of our paper.

25. With a 40 per cent fall in the cotton price, the average incidence of poverty, including both cotton growers and other farmers rises 8 percentage points, from 40 per cent to 48 per cent. In absolute terms, this implies that about 334 thousand people would fall below the poverty line. A 40 per cent decrease in the price of cotton results in a 40 per cent increase in the depth of poverty (P_1) and a 61 per cent increase in the severity of poverty (P_2).

26. Does it matter what poverty line we use? By looking at the cumulative distribution of income with and without the price change, we can evaluate the sensitivity of the results to alternative poverty lines. As shown in Figure 2 in our paper, similar results would have been obtained for higher and lower poverty lines. The results are not very sensitive to the elasticity assumption.

27. In summary, our paper analyzed the impact of changes in world cotton prices on farmers in Benin. Both quantitative measures of per capita expenditure from household surveys and qualitative responses to our 1998 survey suggest that rural living conditions improved over the 1990s. Furthermore, farmers tended to attribute this improvement in rural living conditions to economic factors such as crop prices, availability of food, and access to non-farm employment. Although the causal link is difficult to establish with certainty, it appears the economic reforms of the 1990s (including the 1994 devaluation) and the growth of cotton production during this period contributed to a noticeable improvement in rural standards of living.

28. The link between world cotton markets and rural living conditions can, however, work against farmers as well. The analysis in this paper is based on the 39 per cent decline in the world price of cotton between January 2001 and May 2002. We combined farm survey data from 1998 with assumptions about the decline in farm-level prices to estimate the short- and long-term direct effects of cotton price reductions on rural income and various measures of poverty.

29. The results indicated that there is a strong link between cotton prices and rural welfare in Benin. A 40 per cent reduction in farm-level prices of cotton is likely to result in a reduction in rural per capita income of 7 per cent in the short-run and 5-6 per cent in the long-run. Furthermore, poverty rises 8 percentage points in the short-run, equivalent to an increase of 334 thousand in the number of people below the poverty line. In the long run, as household adjust to the new prices, the poverty rate settles down somewhat, remaining 6-7 percentage points higher than it was originally.

30. Furthermore, these estimates may well underestimate the actual effect of lower cotton prices on rural poverty in Benin. First, in an economy with unemployed resources and excess capacity, an external shock affecting income (such as a change in cotton prices) has a multiplier effect. Changes in cotton farmer income result in changes in demand for goods and services produced by their non-cotton-growing neighbours, which in turn influences their income and their demand for goods and services. Estimates for four countries in sub-Saharan Africa suggest that the multiplier is in the range of 1.7 to 2.2, meaning that the total effect on income (positive or negative) is 1.7 to 2.2 times greater than the direct impact.

31. Second, we assume that farm prices change by the same proportion as world prices. In competitive markets with a fixed marketing margin, the percentage change in farm prices will be greater than the percentage change in world prices. Until recently, the effect of changes in world prices on farm-level prices in Benin was muted by government regulation of the market which stabilized prices. Under market reforms being carried out in Benin and elsewhere in West Africa, markets are becoming more competitive and changes in farm prices will closely match changes in world prices.

32. Third, our estimates do not take into account other indirect effects associated with declining cotton production. An earlier analysis of the Small Farmer Survey data from Benin indicated that cotton farmers are three times more likely to apply fertilizer to their maize crops compared to non-cotton farmers. This is because growing cotton gives farmers access to fertilizer on credit, some of which they "divert" to their maize fields. The implication is that lower cotton prices will indirectly reduce the yields of food crops.

33. Overall, the results in this paper challenge the stereotype of the rural poor in developing countries as consisting of subsistence farmers that are relatively unconnected to, and thus unaffected, by swings in world commodity markets. At least in the case of Benin, to the extent that fluctuations in world cotton prices are transmitted to farmers, they will have a significant effect on rural incomes and poverty. The broader implication is that policies that subsidize cotton production in the United States and elsewhere, dampening world prices, have an adverse impact on rural poverty in Benin and (by extension) other poor cotton-exporting countries. Thank you, Mr. Chairman and members of the Panel.

Mr. Laourou:

34. Thank you for allowing Dr. Minot to present his paper, and for allow Benin to present its views.

35. This concludes our oral statement. We respectfully ask this Panel to find that the United States is in breach of its WTO obligations, including by causing serious prejudice to the interests of Benin and other Members. We would be pleased to answer any questions that you may have.

ANNEX F-7

ORAL STATEMENT OF CHAD

8 October 2003

Mr. Chairman, members of the Panel,

I am Abderahim Yacoub N'Diaye, the Ambassador of Chad to the WTO. The other members of my delegation are Mr. Mouata Nanrabaye, as well as our legal advisers, Mr. Brendan McGivern and Mr. Stefan Ramel, both from White & Case.

Chad stands by its written Third Party submission of 3 October 2003. In addition, I wanted to supplement this by reading to the Panel a recent statement by Mr. Ibrahim Malloum, who is both the President of the Société Cotonnière du Tchad, as well as the President of the African Cotton Association. Given his unique qualifications, I asked him to prepare a statement for this third party session. Unfortunately, however, he could not attend the hearing, since he had to be in Chad this week. However, his statement is of direct relevance to the issues facing the Panel, and so with your permission, Mr. Chairman, I would like to read it to you.

“Statement by Mr Ibrahim Malloum

Introduction

1. My name is Ibrahim Malloum. I am the President of the Société Cotonnière du Tchad, commonly known as Cotontchad. Cotontchad is a public/private organization that controls the production and marketing of cotton in Chad. Cotontchad is responsible for supplying farmers with inputs on credit, purchasing and collecting the harvested seed-cotton, ginning the crop into upland cotton lint, as traded internationally, and finally selling the finished product. Cotontchad is required to purchase all cotton produced by Chad cotton farmers. In addition, Cotontchad is responsible for selling and marketing the cotton produced by more than 2.5 million people in Chad involved in the production of cotton.

2. I am also currently President of the African Cotton Association (ACA). The ACA was formally created during a summit meeting of African cotton producers in Cotonou, Benin, in September 2002. It includes all the West, Central and East African producers, ginner and merchants. Many international merchants, shipping companies, and banks are also members of this Association. The ACA's goals are to defend and promote African cotton in the world market and to encourage knowledge sharing among African cotton producers.

3. I have been involved with selling and marketing cotton for more than 18 years for Cotontchad, during which time I have been involved in all the cotton activities:

- I was in Memphis Cotton School in 1985.
- From the end of 1997 to 1999 I was the General Manager of Cotontchad.
- When I was General Manager I was in charge of supplying the farmers with fertilizers, and pesticides; we buy all the production from farmers, we gin the cotton, we classify and export the cotton.

- Today I am in charge of marketing all Chad cotton production around the world. I am thus selling in more than 30 countries (Europe, Far East, Africa and South America.).
- Our selling prices are based on the international prices driven by the New York Cotton Futures Market and the Liverpool “A” Index.

Cotton in Chad

4. Cotton is essential to the livelihood of more than 2.5 million people in Chad. It has been the major cash crop and driver of Chad’s economy dating back to the 1920s and continues to be today. Cotton represents 25 per cent of Chad’s export earnings and 5.1 per cent of its GDP.

5. Chad has about 8.1 million inhabitants of which over 2.5 million are in one way or the other involved in the production of cotton. Cotton is typically produced on small family farms that lack mechanization and modern equipment, and electricity. Irrigation is completely reliant on rain and all harvesting is done by hand. Many farms are not even accessible by road. Despite these handicaps, production costs are approximately between 54 and 58 cents per pound. This is approximately one-half of the costs of producing cotton in the United States.

6. In order to streamline the production of cotton, farmers are organized into roughly 5,000 Village Associations (Associations Villageoises), each comprising about 100 households of both cotton and non-cotton producers. These Associations Villageoises also provide some basic social structure for about 80 per cent of Chad’s eight million people who live in rural areas and that depend on subsistence farming. Normally cotton production in each Association Villageoise is a group effort with everyone in the community contributing to the production process. The cotton harvest and the amount produced is a source of both pride and prestige in each Association Villageoise.

The Role of Prices for Chadian Cotton

7. As already mentioned, Cotontchad plays a central role in the production of cotton in Chad. The production cycle of cotton in Chad starts when each Association Villageoise requests input supplies from Cotontchad’s field agents or “interface”, based on their planned land cultivation. Cotontchad then allocates inputs to each Association Villageoise on credit using future cotton harvests as collateral. The amount of inputs acquired and distributed is influenced directly by the prices that are able to be obtained by Cotontchad in its international sales. When prices are low, as they were during 2001-2002, Cotontchad cannot afford to provide all of the imports demanded by the Associations Villageoises. This in turn reduces the amount of cotton produced by each Association Villageoise and in Chad in general. When prices increase, more inputs are purchased which are then provided to each of the Association Villageoise and causes cotton production – and incomes generated by those Associations – to increase. Thus, higher prices obtained in international markets directly impacts the amount of present and future income received by cotton producers in Chad.

8. Cotontchad purchases upland cotton from each Association Villageoise at its 2,500 nationwide weigh stations. The price received by the producers is a countrywide uniform price that is set each year by a committee representing both farmers and Cotontchad. The price determined by the committee is a function of the price received by Cotontchad in its physical sales of cotton. Cotontchad can only offer a price to the farmers that is consistent with the international market price.

9. Cotontchad then transports the upland cotton to its nine ginning stations to be sorted, ginned and commercialized. Finally Cotontchad sells the finished cotton in physical markets on the spot and forward market. Cotontchad markets its cotton on both an immediate (spot) and on a forward contract

basis. I am the principal negotiator for sales of Chad cotton. In marketing cotton, I provide information to a number of purchasers concerning the availability of Chad cotton. In some countries (Europe, Japan, and partially India) Cotontchad uses the agent channels to sell directly to the spinning mills. In other countries, we sell directly to the international merchants. We fix prices in relation with New York Future prices, Liverpool "A" index and also in relation to the competition prices offered in the market. Everyday we inform our agents and merchants of the available quantities and the prices of the different qualities we are offering.

10. In negotiations for the spot market or immediate shipment of cotton, the price negotiation involves reference to the current N.Y. futures contract price as well as the A and B-index prices. I will always make reference to the N.Y. futures price if prices are increasing and the N.Y. futures price is higher than the A-index price.

11. The New York Cotton futures market is the main cotton market place in the world. It goes without saying that the cotton price is dictated by New York. All the business men can forecast the index "A" by looking to what New York did the night before.

12. The vast majority of cotton produced in Chad is exported (about 95 per cent). Cotton produced in Chad is in direct competition with other regional and foreign exporters of cotton. The extremely small world market share of Chadian cotton exports (about 1 per cent) invariably makes Chad a price taker.

The United States and Its Influence on World Cotton Prices

13. The United States' production of upland cotton has a large influence on the world market price for cotton. All traders of upland cotton keep a close watch on developments in the United States. As the largest exporter of cotton, the United States supplies more than 40 per cent of cotton sold in international sales. The United States is by far the largest exporter of upland cotton. Because of the large size of the US production and exports, when stocks of US cotton for sale decrease because of weather problems in the United States, then the world price of upland cotton invariably increases. This is normally first reflected in increased N.Y. futures prices and then later by increases in prices in the A-Index. On the other hand, when US production of upland cotton increases because of increased land planted to cotton or because of favourable weather conditions, then the increased stocks of US upland cotton in the world markets press world prices lower. I have seen this process repeatedly over the years that I have been trading upland cotton on world markets. In my view, it is obvious that if the US producers did not have access to very large subsidies, they would plant less cotton and world upland cotton prices would increase. There is no doubt in my mind that the large US subsidies keep world prices lower. This includes prices received by Chad cotton.

14. To give the Panel some idea of the impact of the large US exports, I frequently encounter during negotiations purchasers who indicate that they can purchase US cotton at a price lower than what I am seeking to obtain in negotiations. These purchasers frequently tell me that US upland cotton is available to them at a lower price because of the US Step 2 payments. These payments are well known in the industry and are reported in trade publications. The Step 2 payments for US cotton allows exporters selling US cotton to underbid my bids when I am in direct competition for sales. This has happened to me on a number of occasions. Again, the result is lower prices for cotton that I am able to negotiate for Cotontchad.

Suppressed Cotton Prices and Their Effect on Chad

15. I would tell you that the low prices received by Chad producers contributes to poverty in Chad. The description of what happened in Benin is the same as what has been happening in Chad. Cotton for most Associations Villageoises in Chad is the only source of outside income. Therefore Chadian schools, hospitals and local governments rely directly on money received from cotton sales. The cotton industry in Chad is still trying to recover from record low prices from 2001-2002. While prices are now increasing, prices will have to increase considerably more to make up for the unprecedented crisis caused by extremely low prices last year. In my view, the continuing high levels of US production are still depressing world prices. I look forward to the day when I do not have to compete with US upland cotton for every sale. Increased prices will allow Chad producers and Chad communities to obtain additional income and improve the life of our very poor people”.

Thank you for your attention. I would be happy to answer any questions you may have.

ANNEX F-8

ORAL STATEMENT OF THE EUROPEAN COMMUNITIES

8 October 2003

1. Introduction

1. The European Communities (the "EC") welcomes this opportunity to submit orally its views to the Panel.

2. The EC has already submitted in writing its views with respect to Brazil's further submission of 9 September 2003. Today, the EC will provide its comments on the further submission of the United States of 30 September 2003. Many of the issues raised in the US submission concern factual matters. The EC will limit itself to address three of questions of legal interpretation. Specifically, the EC will argue in this Statement that:

- III. the crop insurance payments made by the United States would be "specific" in so far as it can be established that different insurance policies result in different benefits being conferred with respect to different products;
- IV. the issue of whether green box payments can cause "serious prejudice" within the meaning of Article 5(c) of the *Agreement on Subsidies and Countervailing Measures* (the "SCM Agreement") does not arise in this dispute;
- V. the term *same market* in Article 6.3 (c) may refer to any geographical market, including also the world market, provided that there is such a world market for the product under consideration.

3. Before addressing these issues, the EC would like to put on record its agreement with the United States with respect to a number of questions on which it does not consider it necessary to submit additional arguments:

- VI. the EC agrees with the US interpretation of the term "world market share" in Article 6.3(d) of the *SCM Agreement*;
- VII. the EC endorses the U.S. interpretation of the term "more than equitable share" in Article XVI:3 of the GATT;
- VIII. the EC also agrees with the US position that Brazil's first standard to establish the existence of "threat of serious prejudice" for the purposes of Article 5(c) of the *SCM Agreement* is incorrect;
- IX. finally, the EC agrees with the United States that the *Agreement on Agriculture* (the "AA") excludes the application of Article III:4 of the GATT and of Article 3.1 (b) of the *SCM Agreement* to subsidies "in favour of agricultural producers" which are paid to the processors.

4. On the other hand, the EC would like to restate its disagreement with the US position that Article 10.1 of the AA does not apply to export credits and guarantees.

2. Specificity of crop insurance payments

5. The United States contests Brazil's claim that the subsidies allegedly provided in the form of crop insurance payments are specific. The United States argues that crop insurance is not "specific" because it is available, in one way or another, with respect to all agricultural products.¹

6. The EC understands, however, that different crop insurance policies apply to different agricultural products.² If such differences had the consequence that some agricultural products will receive a benefit in circumstances where other products will receive no benefit, or only a smaller benefit, the difference would be clearly "specific".

3. Green Box subsidies

7. The United States argues that Brazil has failed to make a prima facie case that the payments for which it claims green box status cause serious prejudice. The United States recalls that paragraph 1 of Annex 2 of the AA makes clear that green box payments have no, or at most minimal, trade-distorting effects and that, under Article 21.1 of the AA, the *SCM Agreement* applies "subject to" the AA.³

8. This is correct. But this argument does not appear to be relevant in the context of this dispute. If the payments at issue meet all the criteria of Annex 2, they would be exempted from action under the *SCM Agreement* in accordance with Article 13 (a)(i) AA. If not, the United States could not invoke their conformity with Annex 2 and Article 21.1 in order to argue that they have no or minimal trade-distorting effects. Logically, the issue raised by the United States could arise only in the absence of the peace clause, or if the peace clause had expired at the initiation of this dispute.

4. The meaning of "same market" in Article 6.3 (c)

9. The United States contends that the term "same market" in Article 6.3 (c) cannot be interpreted to include the world market, because that would render redundant the word "same".⁴ The EC disagrees. In accordance with its ordinary meaning, the term "market" may refer to any geographical market, including not only national or regional markets but also the world market, provided that there is such a world market for the product under consideration.

10. The US argument is based on the assumption that there will always be a world market for any given product. That assumption is incorrect. In order to characterise a certain geographical area, whether it is the territory of one or more Members or the entire world, as a "market" it must be shown that the conditions of competition prevailing within that geographical area are sufficiently homogenous. If there are significant trade barriers between Members, or between groups of Members, with the consequence that conditions of competition are significantly different within each Member or group of Members, it will not be possible to consider that there is a world market for the purposes of Article 6.3(c), but only national or regional markets.

¹ US further submission, para. 14.

² Ibid., para. 15.

³ Ibid., para. 72.

⁴ Ibid., paras. 90-92.

ANNEX F-9

ORAL STATEMENT OF INDIA

8 October 2003

1. We thank you for giving us the opportunity to present India's views in this third party session. India is the third largest producer of cotton in the world and has the highest area under cotton cultivation in the world. India has a substantial trade interest as well as systemic interest in this dispute. In the first part of this session on 24 July 2003, we had presented some views on the three US subsidy programmes that we consider as violative of the Agreement on Subsidies and Countervailing Measures (SCM Agreement). Today we wish to present our views on the term 'serious prejudice' used in Article 6.3 of the Agreement.

2. The measures challenged by Brazil in its claims of *present* serious prejudice include the payment of subsidies through various programmes which include marketing loan payments, counter-cyclical payments, direct payments, production flexibility contract payments, market loss assistance payments, crop insurance subsidies, Step 2 payments, and GSM 102 export credit guarantees. The legal instruments providing these subsidies include the 1996 FAIR Act, the 2002 FSRI Act and the 2000 ARP Act as well as various appropriations bills for Marketing Years (MY) 1999-2002.

3. The subsidies given by US at issue are explicitly limited to certain enterprises or industries. None of the subsidies at issue are widely available throughout the US economy across industries. Eligibility for the domestic support and export subsidies at issue in this dispute is either "explicitly" limited to the subset of the US industry producing *agricultural crops*, to subgroups of industries producing *certain* agricultural crops, or to *only* upland cotton. None of the subsidies are available for any non-agricultural product. Thus the subsidies given by US to cotton are "specific" as understood under the SCM Agreement.

Mr. Chairman, Members of the Panel,

4. For establishing serious prejudice caused by the subsidies given by the US to cotton, Brazil has provided numerous facts that independently as well as collectively demonstrate the causal link between these subsidies and significant price suppression in upland cotton markets in MY 1999-2002.

5. It has been demonstrated, *inter-alia* through the analysis of Professor Daniel Sumner, details of which are available in Section 3.3.4.8.2 of Brazil's Further Submission to the Panel, that in terms of significant price suppression, removal of the subsidies given by the US would increase the A-index prices by an average of 12.6 per cent or 6.5 cents per pound between MY 1999 and 2002. Brazil has demonstrated that the subsidies given by the US during MY 1999-2002 cause *present* significant price suppression within the meaning of Article 6.3(c) of the SCM Agreement in the Brazilian and world markets, including in markets where both Brazilian and United States producers export, and thus cause serious prejudice.

6. The average rate of subsidisation of cotton in the US during MY 1999-2002 as revealed in the Table at page 4 of Brazil's Further Submission was as high as 95 per cent. These subsidies, therefore, almost entirely constitute the farmers' incomes and have a major impact on farmers' production decisions. Producers of upland cotton in the United States are thereby largely insulated from the effects of the market. Thus, even when prices for upland cotton were falling, and the value of the United States dollar and costs of production were rising, production and exports of upland cotton by

the United States increased significantly. Similarly, the acreage under upland cotton in the US increased by 13.5 per cent between MY 1998 and MY 2001. Thus, in our view, Brazil has made a prima facie case of having suffered “serious prejudice” on account of the subsidies given by the US to cotton.

7. In its Further Submission, the United States has argued that after Brazil demonstrates that one or more of the effects of the subsidy mentioned in Article 6.3 is applicable, Brazil must then further demonstrate that the “prejudice” caused by the effects of the subsidy were “serious” enough to constitute “serious prejudice” within the meaning of the term in that Article. The argument of the United States appears to be based on the use of the words “may arise” in Article 6.3 as against the use of the words “shall be deemed to exist” in Article 6.1. The US seems to conclude that serious prejudice need not arise even if one or more of the effects of the subsidy listed in Article 6.3 is found. The United States goes on to infer from this difference in language that a complainant, in addition to demonstrating the existence of one of the listed effects, must also meet a separate “serious prejudice” standard – the content of which is undefined by the SCM Agreement.

8. In India’s view nothing more than the demonstration that one of the effects enumerated in Article 6.3 exists is necessary to arrive at a finding of “serious prejudice”. Subsidies listed under Article 6.1 are *deemed* to cause serious prejudice, hence such a presumption is rebuttable under Article 6.2 if the subsidy does not result in any of the effects enumerated in Article 6.3. No such rebuttal is envisaged under Article 6.3. There is, thus, no obligation under the SCM Agreement to demonstrate serious prejudice separately after establishing that one of the effects of a subsidy listed under Article 6.3 applies, as the effects listed in Article 6.3 themselves equate to serious prejudice. This interpretation is also confirmed by a reading of Article 6.2, which equates serious prejudice to effects listed under Article 6.3. India disagrees with the US interpretation of Article 6.3.

9. In conclusion, Mr. Chairman and Members of the Panel, India holds the view that the subsidies given by the US on upland cotton are specific, causal link exists between these subsidies and the significant price depression, and these subsidies given by the US have caused serious prejudice within the meaning of the term in Article 6.3 of the SCM Agreement.

ANNEX F-10

NEW ZEALAND'S ORAL STATEMENT

8 October 2003

1. Mr Chairman, Members of the Panel, New Zealand's Further Submission to the Panel of 3 October outlines New Zealand's support for the claims made by Brazil and its views on the issues raised in the Further Submission of the United States. The evidence brought by Brazil in support of its claims is overwhelming and conclusive.

2. New Zealand's submission, and our statement today, focuses in particular on Brazil's demonstration that the United States subsidies cause significant price suppression within the meaning of Article 6.3(c) of the *Agreement on Subsidies and Countervailing Measures* (or the *SCM Agreement*). Evidence brought by Brazil shows that the United States subsidies suppressed A-index prices by an average of 12.6 per cent over MY 1999-2002. That means a total amount of lost revenue for Brazilian producers of \$478 million and suppressed revenue worldwide of \$3.587 billion.

3. The United States has produced no evidence or argument to rebut this claim. Instead the United States points to a number of factors that it says caused prices for upland cotton to fall. However, those factors are entirely irrelevant to the issue of whether the United States subsidies cause significant price suppression. Nothing in the *SCM Agreement* requires a complainant to show that the subsidies at issue are the sole or major cause of prices falling in order to demonstrate serious prejudice.

4. In fact, the *SCM Agreement* does not even require prices to fall for there to be price suppression. As demonstrated by Brazil, price suppression can occur even when prices are rising. All a complainant is required to show to satisfy Article 6.3(c) is that significant price suppression is caused by the subsidies at issue. Brazil has done that, and the econometric models Brazil has used have not been challenged by the United States. Furthermore, those models isolate the effects of the subsidy from other factors, and thereby ensure that the effects of other factors affecting cotton prices are not attributed to cotton subsidies.

5. By contrast, the United States advocates an interpretation of Articles 5 and 6 that would completely undermine their objective, which is of course to allow WTO Members to act when adversely affected by other Members' use of subsidies.

6. In particular the United States draws the wrong conclusion from a comparison of Article 6.1 and Article 6.3, namely that it is not sufficient for a complainant to show that one of the effects set out in Article 6.3 exists for there to be serious prejudice. A closer look at the substance and nature of those provisions in the broader context of Articles 5 and 6 makes it clear that once a Member has demonstrated the existence of significant price suppression within the meaning of Article 6.3, there is serious prejudice. We note that the EC agrees with this interpretation in its Further Third Party Submission. New Zealand has described in detail in its Further Submission why the United States interpretation of Article 6 should be rejected.

7. The United States takes a similar approach to interpretation of the phrase "significant" in Article 6.3(c). The United States approach would require "significant price suppression" to be demonstrable solely by reference to some arbitrary level of numeric significance. Yet the United States does not suggest what level of significance would be appropriate in the present case, nor

does the United States go so far as to suggest that 12.6 per cent is not “significant”. The United States offers no explanation at all of how “significance” is to be determined under its proposed approach. This is perhaps because such an approach is unworkable in practice.

8. Whether or not price suppression is significant within the meaning of Article 6.3(c) will depend on the circumstances of the case. And such a determination must be anchored in the overall context of consideration of the adverse effects of the subsidy if the *Agreement* is to operate as Members intended it to. Thus Brazil’s approach of considering whether the level of price suppression is “meaningful” in its effect is entirely appropriate and workable, and offers the best means of ensuring that Article 6.3(c) is effectively and consistently applied.

9. These are but two examples of attempts by the United States to read into the *SCM Agreement* additional requirements that are simply not there and distort the requirements that are there. If accepted, such interpretations would make it virtually impossible for Members to show the existence of serious prejudice. Such an erosion of the rights negotiated by Members under the *SCM Agreement* cannot be permitted.

Threat of Serious Prejudice

10. New Zealand’s Further Third Party Submission also outlines why the Panel should find that the United States subsidies create a threat of serious prejudice to the interests of Brazil in the future. The fact that Brazil’s interests are already suffering serious prejudice as a result of the United States subsidies leads to a strong presumption that they will continue to do so. United States legislation requires the continued provision of the subsidies irrespective of whether or not they have adverse effects on other Members. The present case involves a level of subsidisation of, on average, 95 per cent, with a dollar value of US\$12.9 billion, being provided by a country that currently has a 41.6 per cent share of the world market for upland cotton. The threat of future serious prejudice is therefore a real one.

11. In addition to the points addressed in New Zealand’s Further Submission, New Zealand takes this opportunity to record its views on two further issues raised by the United States.

Crop Insurance

12. The first is the United States argument that crop insurance payments fail to meet the requirement for specificity in Article 2 of the *SCM Agreement*. As demonstrated by Brazil, the crop insurance subsidies to upland cotton producers enhanced United States upland cotton production. The payments act as a direct production stimulant by keeping marginal upland cotton land in production. Professor Sumner’s analysis concludes that in the period MY 1999-2002 United States crop insurance subsidies resulted in suppression of world prices by 1.2 per cent.

13. Brazil has demonstrated that the crop insurance programme is limited to certain enterprises and thus is not generally available but is effectively available only in respect of crops. The crop insurance programme is therefore specific within the meaning of Article 2 of the *SCM Agreement*.

Step 2 domestic payments

14. Second, New Zealand wishes to elaborate its view in support of Brazil’s claim that the Step 2 domestic payments are prohibited subsidies under Article 3.1(b) of the *SCM Agreement* and GATT Article III.4. There is no basis upon which to claim that the *Agreement on Agriculture* gives Members a right to use whatever domestic support they wish with complete impunity from action under other WTO Agreements. The *Agreement on Agriculture* is silent on the issue of local content subsidies. Such silence cannot be taken as creating an “entitlement”.

15. Nor does New Zealand accept that Members could have so encroached on the fundamental GATT principle of national treatment any way other than explicitly and expressly. The United States has been unable to demonstrate that Members intended, through the *Agreement on Agriculture*, to effectively waive their rights under GATT Article III in respect of agricultural products. Nor is there any evidence that Members traded those rights in return for reduction commitments on domestic support. Where there was a trade-off was between the application of Articles 5 and 6 of the *SCM Agreement* (for a limited period of time) and reduction commitments, as set out explicitly in the peace clause. There is no such trade-off in the peace clause for Article 3.1(b) of the *SCM Agreement*.

16. Paragraph 7 of Annex 3 of the *Agreement on Agriculture*, relied upon by the United States and EC as evidence that the *Agreement* authorises the use of local content subsidies, provides no basis for such a conclusion. All paragraph 7 does is recognise that it is possible for measures directed at agricultural processors to benefit the producers of basic agricultural products. For example, a government may pay a subsidy to a processor which it is required to pass on to the domestic producers. This can occur without affecting the competitive relationship between imports and domestic production. The measure would be consistent with Article 3.1(b) of the *SCM Agreement* and GATT Article III, and the support rightly counted against the Member's AMS. Nothing in paragraph 7 suggests that it should be interpreted as referring to domestic content subsidies, let alone that it authorises them in contravention of Article 3.1(b) of the *SCM Agreement* or GATT Article III.

Conclusion

17. In conclusion, New Zealand considers that Brazil has presented the factual evidence necessary to substantiate its claims under the *SCM Agreement*. Brazil has also demonstrated that the United States cannot avail itself of protection under the peace clause. The interpretation advanced by the United States of the provisions of the *SCM Agreement* would render actionable subsidies inactionable, thereby undermining the carefully negotiated balance of rights and obligations in the *SCM Agreement* and the *Agreement on Agriculture*. New Zealand therefore requests the Panel to make the findings and recommendations requested by Brazil.

ANNEX G

FURTHER REBUTTAL SUBMISSIONS OF PARTIES

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ANNEX G-1

EXECUTIVE SUMMARY OF BRAZIL'S FURTHER REBUTTAL SUBMISSION

1. Brazil responds in its Further Rebuttal Submission to various arguments raised and evidence presented by the United States in earlier stages of this proceeding.

2. Brazil presents new evidence in rebuttal of US assertions that it has failed to demonstrate that contract payments were paid to current producers of upland cotton in MY 1999-2002. This evidence is in the form of USDA payment data obtained and analyzed by the Environmental Working Group (EWG) concerning, *inter alia*, upland cotton and other crop base contract payments between MY 2000-2002, as well as upland cotton marketing loan payments. The EWG database matches the upland cotton recipients and farms receiving each type of payment. It shows that the great majority of upland cotton producers grew upland cotton on upland cotton base acreage. It also shows that upland cotton producers received approximately three-quarters of all upland cotton contract payments between MY 2000-2002. Additional contract payments supporting upland cotton are found by attributing contract payments on non-cotton base acreage. While the EWG data underestimates the amount of contract payments in support of upland cotton, it nevertheless corroborates and supports Brazil's "14/16" methodology. Moreover, this data is also consistent with the large body of evidence demonstrating that upland cotton producers receive, rely on, and need upland cotton contract payments to make "ends meet."

3. Better evidence of the amount of contract payments in support of upland cotton would come from an examination of the amount of upland cotton currently planted on upland cotton (or other) contract acreage. This evidence is collected and exclusively in the control of the United States. Brazil rebuts the US assertions that it does not collect or maintain information permitting it to respond to the Panel's Question 67bis or to Brazil's repeated requests for information regarding the amount of contract payments received by current producers of upland cotton. In fact, the United States has access to all of the farm-specific and commodity specific commodity acreage and payment data from both current upland cotton producers as well as holders of crop base under contract payment programmes that would permit it to (1) provide a close approximation of the PFC and market loss assistance payments to current upland cotton producers in MY 1999-2001, and (2) provide the precise amount of direct and counter-cyclical payments to current upland cotton producers in MY 2002. Brazil requests the Panel to ask the United States, for the third time, to produce this information.

4. In the absence of information within the exclusive control of the United States, the information on marketing loan and contract payments in the EWG database, together with the considerable other evidence presented by Brazil, is the best information available to assist the Panel in making the determination concerning the amount of "support to upland cotton" for the purposes of the peace clause.

5. Regarding Brazil's price suppression and increase in world market share claims under Articles 6.3(c) and 6.3(d) of the SCM Agreement, Brazil first responds to US arguments that only variable costs are relevant to any cost of production analysis. This is the wrong legal as well as economic benchmark. Brazil notes the Appellate Body's decisions in the *Canada – Dairy (21.5)* disputes held that a cost of production analysis should focus on *total*, not *variable*, costs. That is, only an analysis of the total cost of production takes account of the economic resources the producer

invests in the product. The Appellate Body's jurisprudence on this issue reflects the economic reality that, over the long term, producers have to recover *all* their costs and make profits to stay in business. To the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source.

6. USDA cost data shows that US producers would have lost \$871 per acre if they had grown upland cotton without subsidies between MY 1997-2002. With subsidies, these upland cotton producers made a per-acre "profit" of \$120 over the six-year period. Further, most of the fixed costs of US producers must be covered over a long-term six-year period, or upland cotton producers would be forced to halt production. This evidence supports the close causal link between US subsidies and continued high levels of US upland cotton production and exports, as well as suppressed prices. These facts demonstrate the veracity of the National Cotton Council's Chairman's statement that US upland cotton producers "can't exist without subsidies".

7. The United States' argument that a cost of production analysis may be limited to variable costs defies all economic logic. This is particularly true in light of the items that the United States counts towards fixed costs, including hired labour, opportunity cost of unpaid labour, capital recovery of machinery and equipment, opportunity cost of land, taxes and insurance, and general farm overhead. These facts confirm the common sense notion that without the US subsidies, a significant portion of the US upland cotton production would not be economically viable and would not be produced.

8. Brazil rebuts US arguments that US subsidies had no price-suppressing effects by demonstrating the close relationship between increases or decreases in world cotton stocks and A-Index prices. USDA's own economists estimate that US subsidies increased US upland cotton world supply by 1.9 million bales in MY 2000 and 4.3 million bales in MY 2001. Because the United States has admitted that the injection of 11.6 million bales of Chinese government stocks into world supply between MY 1999-2001 depressed prices, it is not surprising that USDA economists, as well as Professor Sumner, found that the addition of similar quantities of US subsidy-generated upland cotton had similar price-suppressing effects. Moreover, if Chinese Government sales of stocks significantly depressed prices, as the US claims, then withdrawing a similar amount of US upland cotton during the same period certainly would significantly increase prices.

9. In addition, market experts predict that a 14 million bale US crop in MY 2004 (resulting from a potential crop failure) would have a significant impact in MY 2004 on increasing the New York futures price – and the world (and Brazilian) price of cotton. Brazil demonstrated the interconnected nature of world upland cotton market and the direct relationship between large US subsidies in sustaining US production and in lowering world and Brazilian prices.

10. Brazil rebuts US arguments that the appreciation of the US dollar does not demonstrate any causal link between US subsidies and increased US world market share and suppressed prices. Using data from Exhibit US-69, Brazil demonstrates that there has been a dramatic increase in the appreciation of the US dollar against a cotton-trade weighted basket of currencies of other world cotton producers by 154 per cent between the period 1996-2003. US exports – instead of falling as predicted by USDA economists – almost doubled.

11. The impact of the subsidies on international cotton trade is best assessed by analyzing the cotton trade-weighted exchange rate for cotton-exporting countries in general. This where the competition exists and where the impact of exchange rate movements on the competitiveness of countries should be found. With their currencies depreciating dramatically against the US dollar, US competitors should have been able to increase their market share and their exports compared to high-priced and high-cost US exports of the same commodity product. But since these competitors do not

have access to subsidies averaging 95 per cent of the value of their production, as a result, these competitors saw their exports and world market share reduced.

12. Brazil responds to US arguments that US producers are responsive to changes in futures prices at the time of planting. Brazil demonstrates that average January-March futures prices *declined* between MY 1998-2002, while US planted acreage *increased*. This is exactly opposite of what would be expected without the effect of US subsidies (that *increased* significantly during the same period). All of the analysis presented by Brazil is consistent with Congressional testimony by USDA's Chief Economist Keith Collins that there is little supply (i.e., planted acreage) response from US upland cotton farmers because of the subsidies they receive.

13. Further, the 72.4 cents target price support level available to US upland cotton producers in MY 2002 meant that US producers could not expect to receive higher revenue even if prices increased throughout MY 2002. In fact, US planted acreage declined in MY 2002 because some US upland cotton producers had suffered significant losses even with US subsidies, as they could not recover their cost of production.

14. Brazil responds to US legal arguments seeking to impose countervailing duty concepts in adverse effects claims by demonstrating that there is no textual basis in either Article 1 or Part III (adverse effects) of the SCM Agreement for the imposition of "pass-through," "value of subsidy", "subsidized product" or "tied-untied" methodologies. Unlike a countervailing duty investigation, it is the cumulative effects of the US subsidies that are the focus of price suppression and increase in world market share claims under Articles 6.3(c) and (d) of the SCM Agreement. The current US position is directly contrary to its arguments in Indonesia – Automobiles, where the United States rejected Indonesian efforts to have the Panel examine each subsidy of the National Car Programme" individually.

15. The focus of Articles 5 and 6 of the SCM Agreement is on the effect of the subsidies in suppressing prices or increasing world market share. These cumulative effects of a variety of US subsidies caused price suppression and an increase in the US world market share between MY 1999-2002, and will continue to do so through the end of MY 2007.

16. Contrary to the US argument to sustain its serious prejudice claims, Brazil does not have to prove "that the 'prejudice' caused by the effects of the subsidies were 'serious'". Brazil's interpretation of the chapeau of Article 6.3 of the SCM Agreement does not read "may" to mean "shall". Rather, the term "may" refers to various situations in which the four enumerated types of serious prejudice exist but are not actionable.

17. Brazil highlights the collective effects of the US subsidies by noting that numerous econometric studies that Brazil has presented to the Panel, all conclude that US subsidies significantly increase US production and suppress US and world prices. Moreover, no study has ever found that the US subsidies to upland cotton would not have a significant production and export-enhancing as well as a price-suppressing effect.

18. Furthermore, Brazil rebuts US arguments that Professor Sumner's results, using the November 2002 FAPRI baseline misrepresent the real effects. Brazil demonstrates that using the most recent January 2003 FAPRI baseline, Professor Sumner's results also show significant production and export-enhancing and price-suppressing effects. Brazil further argues that a USDA study and an IMF study that the United States claims show that Professor Sumner's analysis was inflated are, in fact, consistent with Professor Sumner's findings.

19. Therefore, the US assertion that Professor Sumner's results are grossly overstated due to the use of a baseline projecting artificially low upland cotton prices is false. Whether the results of the modified or the original model and whether the November 2002 or the January 2003 baseline are used, continue to fully support that the US subsidies cause significant price suppression and an increase in the US world market share, as well as that those subsidies caused the United States to have more than an equitable share of world export trade.

20. Brazil further demonstrates the causal link between US subsidies and price suppression and increased exports by showing that the individual effects of the various US subsidies increase US production and exports, and result in suppressed prices. USDA and other economists are unanimous in finding that marketing loan payments to upland cotton created significant production- and export-enhancing and price-suppressing effects during the period of investigation. The effect of this subsidy alone caused serious prejudice to the interests of Brazil in MY 1999-2002.

21. Furthermore, USDA economists also found that crop insurance subsidies for upland cotton have far more production-enhancing effects than for other crops.

22. The National Cotton Council and cotton market experts have repeatedly emphasized the importance of the Step 2 subsidy in stimulating US production and exports. Brazil has provided compelling evidence that the Step 2 subsidies are trade-distorting and have caused increased US upland cotton exports and suppressed world prices.

23. Lastly, Brazil rebuts the United States so-called "literature review" for contract payment subsidies by pointing out that none of the studies addresses the specific situation of upland cotton during the period of investigation, none focuses on the impact of the restrictions on planting fruits and vegetables, none examine the impact of the updating of the base acreage and yield in 2002, and none focuses on the production effects caused when CCP payments are triggered by lower prices, or the production effects of more than \$1 billion paid to producers of upland cotton in MY 2002. Finally, the studies do not explain the much higher per acre cotton payments than other base acres or the fact that US average upland cotton producers could not have covered their total costs without contract payments during MY 2000-2002.

24. Therefore, the evidence submitted to the Panel demonstrates that the decoupled payments have production-enhancing effects. While these effects are smaller than the effects of the marketing loan payments, they are an important part of the collective effects of the US subsidies in creating price suppression and increased and inequitable world market share.

25. Brazil demonstrates that crop insurance subsidies are specific within the meaning of Article 2 of the SCM Agreement. There are different crop insurance policies that are available for only limited products, as well as groups of policies available for certain crops. Therefore, the US crop insurance system is simply not the "one size fits all" programme as argued by the United States. Furthermore, Brazil rebuts US arguments concerning the specificity of crop insurance subsidies by showing that there are no crop insurance policies available for livestock, with the exception of four pilot programmes. Even these pilot programmes are very limited in terms of recipients, and have only a total budget of \$20 million, a tiny fraction of the crop insurance subsidies paid for crops.

26. Additionally, the *US – Softwood Lumber CVD* panel report endorsed a finding by USDOC that subsidies paid to only a handful of industries in an economically diverse economy are "limited" (and therefore "specific") within the meaning of Article 2.1 of the SCM Agreement. The record continues to demonstrate that agricultural products representing approximately 50 per cent of the value of US agricultural commodities are not covered by crop insurance subsidies. This, together with the evidence submitted of specific policies and groups of coverage that are provided to only

selected crops such as upland cotton, highlight the fact that only certain enterprises receive the benefits of these subsidies.

27. Regarding Brazil's Article 6.3(d) claim, the United States is incorrect in claiming that Brazil's claims relate only to MY 2001. As discussed in Section 3.9, those claims also include claims for MY 2002, 2003 and the period from 2004-2007.

28. Furthermore, the United States argues that the term "world market share" in Article 6.3(d) of the SCM Agreement means "world consumption share". Contrary to the US arguments, the "world market share" does not refer to "all the markets in the entire 'world', including the market of the subsidizing Member. Brazil has demonstrated that the ordinary meaning of "world market share" refers to the share of a Member in the world export trade.

29. This interpretation is further supported by the context of Article 6.3(d), which includes the reference to the word "trade" in footnote 17. Additional context can also be found in the close similarity between the concepts used in Article 6.3(d) and Article XVI:3, second sentence (both involve primary products, increase in exports, representative periods, effects of any subsidy). Given the similarities between these provisions, the use of the terms "world market share" and "share of world export trade" does not state that both provisions deal with separate situations, as the United States argues. Instead, both terms refer to a share of export transactions in the world market. Therefore, the phrase "world market share" means the world market share of exports, not consumption.

30. In sum, Brazil has demonstrated that the US subsidies caused serious prejudice and threat thereof to the interests of Brazil, because for each marketing year between 2001-2003 the US world market share in upland cotton increased over its previous three-year average. These increases followed a consistent trend, within the meaning of Article 6.3(d) of the SCM Agreement.

31. Brazil rebuts US arguments that GATT Article XVI:3 only applies to export subsidies and, thus, has been superseded by Article 3.1(a) of the SCM Agreement. GATT Article XVI:3 is an actionable subsidy provision that applies to all subsidies having the effect of increasing exports. The phrase "which operates to increase the export" is quite different from the phrase "subsidy on the export". Furthermore, the phrase "operates to increase the export" does not contain any export contingency requirement. Therefore, read in the context of the SCM Agreement and GATT 1994, Article XVI:3, second sentence refers to export-related subsidies, which is a far broader notion than subsidies that are "contingent upon export performance".

32. In sum, GATT Article XVI:3 is not superseded by the export subsidy provisions of the Agreement of Agriculture and the SCM Agreement. Instead, it provides obligations concerning any form of subsidy, independent of the obligations set forth in Article 3 of the SCM Agreement.

33. Brazil also conclusively demonstrates that US upland cotton subsidies violate GATT Article XVI:3 by causing the United States to have a more than equitable share of world export trade in upland cotton.

34. With respect to Brazil's threat serious prejudice claims, Brazil argues that the appropriate standard for serious prejudice claims is not the "imminent threat" standard argued by the United States, but rather whether the unlimited and mandatory US subsidies create a structural and permanent source of uncertainty in suppressing prices, increasing world market share, and securing an inequitable share of world trade.

35. Brazil has demonstrated that it is appropriate for the Panel to rely on the standard proposed by the GATT *EC-Sugar Exports* panels to determine whether the mandatory and unlimited US subsidies on upland cotton create a permanent source of uncertainty in the world upland cotton market. The facts of this dispute meet that standard. The United States has admitted that the US subsidies are both mandatory and unlimited. Given the large US world market share and share of total world production, the US subsidies will have the effect of locking in large amounts of US production, of creating an ongoing significant threat of suppressed prices, and of securing an increasing and inequitable US world market share throughout MY 2003-2007.

36. The “imminent threat” standard is not found in the text of Part III of the SCM Agreement, and is only applicable to investigations by investigating authorities in countervailing duty, anti-dumping, or safeguard contexts. It is inconsistent with the remedies provided for in Article 7.8 of the SCM Agreement, which are imposed well after the period of investigation examined by a Panel.

37. Therefore, the collective effects of the mandated and unlimited US subsidies in MY 2003-2007 threaten to maintain a large US upland cotton production, to increase and maintain US exports, and to significantly suppress world upland cotton prices during MY 2003-2007, in violation of Articles 5(c), 6.3(c), and (d), and GATT Articles XVI:1 and 3.

38. In sum, the mandatory and unlimited US upland cotton subsidies cause threat of serious prejudice to the interests of Brazil. They constitute a structural and permanent source of uncertainty in the world upland cotton market, in which the United States enjoys a dominant position. This conclusion is further supported by the trade-distorting nature of the US subsidies, their effects in causing present serious prejudice in MY 1999-2002.

39. Finally, with respect to export credit guarantees, Brazil offers the Panel a recounting of its evidence and argument in support of its claims against the CCC export credit guarantee programmes, along with footnote citations to all of the places in its various submissions in which it makes those arguments and offers that evidence. Brazil also responds to particular points raised by the United States that Brazil has not yet addressed. The GSM 102, GSM 103 and SCGP export credit guarantee programmes constitute export subsidies that circumvent, or threaten to circumvent, the US export subsidy reduction commitment, within the meaning of Articles 10.1 and 8 of the Agreement on Agriculture. They also constitute prohibited export subsidies within the meaning of Articles 3.1(a) and 3.2 of the SCM Agreement and item (j) of the Illustrative List of Export Subsidies.

ANNEX G-2

EXECUTIVE SUMMARY OF THE UNITED STATES FURTHER REBUTTAL SUBMISSION

1. **Brazil has failed to establish all of the elements necessary to establish its subsidies claims**

1. For the Panel to make the findings Brazil requests, Brazil must adduce evidence and arguments sufficient for the Panel to identify the product(s) that a particular subsidy benefits. This requirement of identification can come up in a variety of ways, but the two most frequently encountered questions are: Which product(s) benefits from the subsidy? and Should the benefits of a subsidy be allocated to future production and sales of the product in question, or should such benefits be "expensed" – that is, allocated only to current production and sales during the time period in which the subsidy is received? Brazil has not provided a basis for a clear and unambiguous explanation on its conclusions for each of these points in order for the Panel to fulfil its obligations under Article 12.7 of the DSU.

2. With respect to the first question – which product(s) benefits from the subsidy? – Annex IV to the Subsidies Agreement provides guidance. Annex IV provides guidelines for calculating total *ad valorem* subsidization for purposes of the now-expired Article 6.1(a). A subsidy not "tied to the production or sale of" cotton ("a given product") cannot be regarded as subsidizing merely "that product"; rather, the subsidy benefits all of the "recipient firm's sales". In the Negotiating Group on Rules, Brazil has proposed that Members adopt a "guideline" on calculating the amount of the subsidy precisely along these lines.

3. Implicit in both paragraphs 2 and 3 of Annex IV is the principle that a subsidy provides a benefit with respect to products that the recipient produces. A corollary of this principle is that a subsidy does not provide a benefit with respect to products that the recipient does *not* produce. Thus, a subsidy provided to a recipient who does not produce upland cotton cannot be said to provide a benefit to upland cotton. Such a subsidy cannot be regarded as having one of the effects described in Article 6.3 insofar as upland cotton is concerned.

4. The foregoing analysis suggests that, for each challenged subsidy, Brazil must identify (as would the Panel in its report) the product that benefits. In the case of product-specific support – that is, a payment that is linked to production of a specific product – such as the marketing loan payments and Step 2 payments, the issue is not difficult. In the case of a payment in which the subsidy is not "tied to the production or sale of a given product", the product subsidized by that payment is all the products produced by the recipient. To determine the portion of a payment not tied to the production or sale of a given product that benefits upland cotton, the value of the payment must be allocated over the "total value of the recipient firm's sales".

5. With respect to the second question – how should subsidies be allocated over time? – Annex IV also provides guidance. Paragraph 7 provides that: "Subsidies granted prior to the date of entry into force of the WTO Agreement, *the benefits of which are allocated to future production*, shall be included in the overall rate of subsidization" (emphasis added). A corollary of this principle – that the benefits of certain subsidies should be allocated to future production – is that if subsidy benefits are *not* allocated to future production, they must be expensed – that is, allocated to production in the time period during which the subsidy is received. Thus, in the context of this dispute, a subsidy the benefits of which are expensed to production/sales in 2001 cannot be said to be causing serious prejudice in 2002 because the subsidy has ceased to exist. The "benefit" – one of the constituent

elements of a "subsidy" under Article 1 – was used up in 2001. Once the benefit was exhausted, the subsidy ceased to exist.

6. The Subsidies Agreement does not expressly identify those subsidies "the benefits of which are allocated to future production". However, guidance is available on this question, and it suggests that subsidies that are "non-recurring" should be allocated over time, while subsidies that are "recurring" should be expensed to the year of receipt.¹ For example, the Informal Group of Experts recommended to the Subsidies Committee that, as a general proposition, recurring subsidies be expensed and non-recurring subsidies be allocated. The Group also specifically recommended that price support payments generally be expensed. In making these recommendations, the Group follows the logic noted above: where there are *not* reasons to allocate subsidy benefits to future production, the subsidy must be expensed, and once the benefit was exhausted in the time period during which the subsidy is received, the subsidy ceased to exist. The analysis presented above and the conclusions and recommendations of the Group are not controversial. The domestic countervailing duty regulations of various Members, including those of Brazil and the European Communities, reflect this very approach.

7. Thus, it is appropriate for the Panel to expense the value of these payments – that is, allocate them to production in the time period during which the subsidy is received. No payment at issue is made for the acquisition of fixed assets. Rather, the challenged payments are recurring. Brazil's own arguments endorse the notion of expensing these payments. That is, for purposes of its Peace Clause arguments, *Brazil expenses these payments* by allocating the total value of each of these payments to the marketing year for which the payment is received. For purposes of Brazil's actionable subsidies claims, *Brazil adopts the identical approach and expenses these payments to the marketing year for which the payment is received*. Thus, despite Brazil's silence on the issue of expensing recurring subsidies, its actions and arguments reveal that it accepts and applies the concept to the challenged US subsidies.

8. The United States has explained, and Brazil tacitly accepts, that the payments challenged in this dispute are recurring subsidies that *are* expensed – that is, allocated to production in the time period during which the subsidy is received. It follows that a recurring subsidy provided in marketing years 1999, 2000, or 2001, respectively, cannot be said to be causing serious prejudice in marketing year 2002. Because the payments in each of those prior years was allocated to production in those years, no "benefit" exists after each of those years – a benefit could only exist in a subsequent year if the payment had been allocated to future production and not expensed.

9. Because the recurring subsidies provided in each of marketing years 1999, 2000, and 2001 ceased to exist when the benefit was used up for production in those years, the effect of those subsidies cannot be the subject of subsidies claims in marketing year 2002. Under Article 5(c) and 6.3, Brazil must demonstrate what "the effect of the subsidy is". Similarly, under GATT 1994 Article XVI:3, Brazil must demonstrate that the United States grants or maintains export subsidies "which operate[] to increase the export of any primary product," resulting in a more than equitable

¹ First, Article 2.2.1.1 of the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* ("Anti-Dumping Agreement"), which deals with the calculation of cost of production, singles out "non-recurring items of cost which benefit *future and/or current* production" (emphasis added). Second, the Appellate Body has acknowledged that non-recurring subsidies may be allocated over time. In *US - Lead Bar II*, the Appellate Body found that it was permissible for an investigating authority in a countervailing duty proceeding to rely on a rebuttable presumption "that a 'benefit' continues to flow from an untied, non-recurring 'financial contribution'" (emphasis added). Third, the *Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures*, G/SCM/W/415/Rev.2 (15 May 1998), recommends that certain subsidies be expensed to the year of receipt and that the benefits from other subsidies be allocated over time.

share of world export trade. Subsidies that were expensed and benefited historical production in marketing years 1999, 2000, and 2001 cannot also benefit current production. Thus, these past payments would not form part of Brazil's subsidies claims nor the Panel's analysis. Serious prejudice has to be based on findings for the 2002 marketing year.

2. Brazil's legal interpretive errors also demonstrate that it has failed to make a *prima facie* case on its subsidies claims

10. As complainant Brazil must identify properly the measures within the Panel's terms of reference – that is, "subsidies provided to US producers, users and/or exporters of upland cotton" in respect of upland cotton, the subsidized product. The challenged measures are subsidies, or payments, and in order to assess their effect, one needs to know, *inter alia*, how large the subsidy is. Brazil has not properly identified the size of each challenged subsidy.²

11. **Brazil Misinterprets Article 6.3(c) on Price Suppression or Depression.** Brazil has not alleged any facts to establish that US and Brazilian cotton are found "in the same market" pursuant to Article 6.3(c) – that is, in each of the markets identified by Brazil (at various times, the United States, Brazil, Argentina, Bolivia, India, Indonesia, Italy, Paraguay, Philippines, and Portugal). Brazil has not identified the extent of subsidization of the US cotton in each market (the subsidized volume) – that is, which exports benefit from which challenged subsidy. Brazil has also not shown a price-suppressing effect by those US imports in each market. Brazil simply asserts that prices in those markets are correlated to the NY futures and A-index prices. This allegation of a generalized price effect cannot satisfy Brazil's burden of showing a price effect by the subsidized product of a like product of another Member "in the same market".

12. Brazilian price quotes in fact consistently undercut US price quotes for delivery CIF Northern Europe. It is also the case that in most of the markets identified by Brazil (Argentina, Bolivia, India, Indonesia, Italy, Paraguay, Philippines, and Portugal), Brazilian prices have been consistently lower than US prices. Thus, rather than US upland cotton suppressing Brazilian prices, the data suggests that it is Brazilian cotton that is undercutting US prices.

13. Article 6.3(c) does *not* establish that serious prejudice may arise if the effect of the subsidy is *any* price suppression or depression. Indeed, were the term "significant" omitted from Article 6.3(c), it would be the case that any production subsidy that was granted on a per-unit basis could be deemed to result in serious prejudice: any increase in production resulting from the subsidy would theoretically lead to some price effect. The use of the term "significant" prevents such theoretical or minor effects from rising to the level of serious prejudice.

14. Because "significant" modifies "price suppression" or "depression", it is the level of price suppression or depression itself that must be significant. One way of examining whether any alleged price suppression is significant would be to examine that degree or level in light of the price of the product itself. Another analytical tool that suggests itself is to look at the nature of the product's price. Strong or frequent fluctuations in price would themselves tend to cut against a finding that any alleged suppression or depression is "significant", especially if the variability frequently brings the

² For example, Brazil includes payments made to recipients that do not produce upland cotton and fails to allocate non-product-specific payments across the total value of the recipient firm's sales. Brazil has not reduced the value of decoupled income support payments to account for the capture by landowners of those payments made to farms on which cotton cropland is rented (65 per cent of total cotton cropland). Further, Brazil has not identified the value of the cotton export credit guarantees under the GSM-102 programme, conceding that it "is not in a position to quantify the benefit to the recipients that has arisen from the application of the GSM 102 export credit guarantee programme to exports of US upland cotton between MY 1999-2002".

price of the product to a level at which the alleged suppression or depression (judged in light of that price) would not be significant. The United States notes that the price of upland cotton is highly variable, with frequent swings of substantial degree. Thus, this evidence relating to the price variability of upland cotton must be taken into account in any analysis of whether alleged price suppression or depression is "significant".

15. **Brazil Misinterprets Article 6.3(d) on an Increase in World Market Share.** Brazil misinterprets the phrase "world market share" in Article 6.3(d) as the share of world export trade. The plain meaning of the phrase "world market share" is not limited to export trade in products but includes all worldwide consumption – that is, the aggregate of all markets that make up the world. The United States is a "market" for upland cotton and part of the "world"; therefore, its domestic consumption forms part of the "world market" for upland cotton.

16. Context supports this reading of "world market share". For example, Article 6.3(a) identifies the "market of the subsidizing Member" as a relevant market from which a complaining Member's exports can be displaced or impeded. Logically, then, the market of the subsidizing Member should also be relevant for determining the "world market share". Various provisions also provide context for *not* reading "world market share" as relating to "world export trade".³ Given repeated examples of the use of the terms "trade," "world trade," and "world export trade" in the covered agreements, the choice of the phrase "world market share" must be given meaning in accordance with the plain meaning of those terms.

17. The challenged US payments were only introduced in marketing year 2002; therefore, there can be no "trend" in US world market share with respect to those payments. Nonetheless, were the Panel to examine US world market share using data under the 1996 Act (consumption data, not the export data presented by Brazil), the criteria of Article 6.3(d) are not met.⁴

18. **Brazil Has Not Demonstrated a Clear and Imminent Likelihood of Future Serious Prejudice.** Although Brazil has presented evidence after the date of panel establishment (indeed, after conclusion of its three-year period of investigation), it advises the Panel to consider more probative, for purposes of explaining price developments in marketing year 2003, the conditions *in marketing year 1999* than the actual price developments *in marketing year 2003*. Brazil's approach carries with it a high potential for erroneous findings by the Panel. Given current high market prices and the expectations embodied in futures prices that such high prices will remain through the course of the 2003 marketing year, it would appear that US price-related payments (marketing loan payments and counter-cyclical payments) will decline dramatically, contrary to Brazil's assertions. In such a circumstance, it is difficult to see how challenged US payments would pose a clearly foreseen and imminent likelihood of future serious prejudice.

³ First, footnote 17 to Article 6.3(d) provides an exception to the provision where "[o]ther multilaterally agreed specific rules apply to the trade in the product or commodity in question". This exception applies only to "trade" because "multilaterally agreed specific rules" would be unlikely to apply exclusively to domestic consumption; however, the use of the word "trade" in the *footnote* to Article 6.3(d) but *not* in the text of the Article itself suggests that "world market share" does not merely encompass shares in world "trade". Second, Article 27.6 speaks of a developing country Member reaching export competitiveness when its "share . . . in world trade of that product" reaches a certain level. This use of "world trade" stands in contrast to the phrase "world market share" in Article 6.3(d). Third, GATT 1994 Article XVI:3 uses the phrase "world export trade", which also stands in contrast to the phrase "world market share".

⁴ While US share of world consumption in MY2002 was projected to be higher than the preceding three-year average, that increase has not followed "a consistent trend over a period when subsidies have been granted" – in this case, for purposes of argument, since the 1996 Act came into effect. Reversing direction every year since marketing year 1996 cannot constitute "a consistent trend".

19. **Brazil Has Misinterpreted GATT 1994 Article XVI:3.** Contrary to Brazil's arguments in this dispute, Brazil has previously agreed in a GATT plurilateral setting that GATT 1994 Article XVI:3 is limited in scope to export subsidies. Both the United States and Brazil were signatories to the Tokyo Round *Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade*, commonly known as the Subsidies Code. Article 10 of the Subsidies Code is entitled "Export subsidies on certain primary products" and states (in paragraph 1): "*In accordance with the provisions of Article XVI:3 of the General Agreement, signatories agree not to grant directly or indirectly any export subsidy on certain primary products in a manner which results in the signatory granting such subsidy having more than an equitable share of world export trade in such product . . .*" Thus, Article 10.1 of the Subsidies Code makes clear the understanding of both the United States and Brazil that GATT 1994 Article XVI:3 applies only to "export subsid[ies] on certain primary products". Therefore, Brazil has not made a *prima facie* case under Article XVI:3 on the basis of its arguments relating to *all* challenged US payments.

20. **Brazil Errs in Asserting that Threat of Serious Prejudice Includes "More than an Equitable Share" under GATT 1994 Article XVI:3.** There is no textual basis to assert that a claim of "threat of serious prejudice" under GATT 1994 Article XVI:1 may be founded on the "more than equitable share" language of GATT 1994 Article XVI:3. Neither Brazil nor the *EC – Sugar Exports* GATT panel report on which it relies cites any and that panel report does not appear to explain the basis for its decision to read the standard of Article XVI:3 into Article XVI:1. By way of contrast, footnote 13 to Article 5(c) of the Subsidies Agreement states that "[t]he term serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI:1 of GATT 1994, and includes threat of serious prejudice". This footnote does not reference Article XVI:3, and as there is no "more than equitable share" prong to Article 6.3, there would not appear to be any basis to advance a threat of serious prejudice claim using that standard under Article 5(c) of the Subsidies Agreement. Footnote 13 states that "serious prejudice" in the Subsidies Agreement and GATT 1994 Article XVI:1 should be read "in the same sense". Therefore, footnote 13 provides a further textual basis for finding that a threat of serious prejudice claim under GATT 1994 Article XVI:1 may not be based on the "more than equitable share" language of Article XVI:3.

3. Brazil has failed to demonstrate the challenged US subsidies caused the effects complained of

21. **The "Temporal Proximity" of US Payments and Low Cotton Prices Fails to Demonstrate that US Subsidies Caused Low Prices.** Brazil has failed to make a *prima facie* case based on the assertion that large US outlays during marketing years with low prevailing upland cotton prices necessarily establishes causation. Brazil makes selective use of data to present a number of erroneous claims about US production or exports during a period of low and declining cotton prices. Brazil repeatedly begins the period of comparison with marketing year 1998 or ends it with marketing year 2001. Such comparisons are inappropriate for several reasons and can produce misleading results.⁵ The fact that high US payments were made when cotton prices were low does not establish causation.

⁵ First, to use either marketing years 1998 or 2001 as one end of a period for comparison contradicts Brazil's own argument that the "period of investigation" should be marketing years 1999-2002. Second, marketing year 1998 was a year in which US harvested acreage and production were severely impacted by weather conditions, in particular, drought. The record shows record abandonment during that year (that is, the difference between planted acres and harvested acres). Thus, to begin a comparison of harvested acreage or production with marketing year 1998 will overstate any resulting increase. Third, marketing year 2001 was a year in which US production increased, primarily because of record yields (as Brazil has acknowledged). That is, while planted acreage increased over marketing year 2000 in large part due to the decline in expected returns from competing crops, production increased by a much greater percentage because of uncommonly favourable

22. **Brazil Erroneously Alleges Production Effects from Decoupled Payments, Contrary to the Economic Literature.** A fundamental error made by Brazil throughout its submissions and statements is to assert that decoupled payments are production-distorting. Brazil's conclusion that decoupled payments have had a large effect on cotton prices appears to be a direct consequence of Dr. Sumner's faulty analysis – one that is inconsistent with the empirical and theoretical literature on such payments. Economic theory suggests that, if producers are seeking to maximize profits, the decision of which crop to plant is based on expected returns offered by the market or government payments above operating (variable) costs. Decoupled income support payments do not figure in this decision because such payments will be paid to the producer regardless of the programme crop that is planted or whether any crop is planted at all.⁶

23. The main impact of decoupled payments is likely on land values. In well-functioning markets, asset prices reflect expectations about the future returns from their ownership. The direct link between base acres for decoupled payments and the known programme benefits allowed the future stream of payments to be efficiently capitalized into land values. Thus, much of the increase in wealth from farm payments accrues to non-operator landlords (Burfisher and Hopkins, 2003). Thus, the effects of increased wealth largely accrue to non-operators, and any theoretical production effects are further minimized. In fact, land values set by sales and rental markets have diverged from commodity prices, suggesting that land markets have additionally capitalized the present and expected future value of government payments.

24. Data also indicate that decoupled payments, by increasing income and wealth, have allowed households to increase their leisure and reduce their work hours. If the downturn in labour comes from agricultural activities, the effect of such payments could be to *decrease* the household's agricultural production, which would support world commodity prices. Data indicate that farm households that received decoupled payments in 2001 consumed more than farm households with similar incomes not participating in the programme. Thus, these data suggest that decoupled payments allow recipients to consume more out of income and may allow them to draw down savings that they typically carry as a precaution against income shortfalls.

25. Empirical studies have generally concluded that the effects of decoupled payments are minimal. For example, using an intertemporal Computable General Equilibrium model, Burfisher et al. (2003) estimate that production flexibility contract payments had "no effects on agricultural production in either the short run or the long run". These and other results are fully consistent with the fundamental requirement of Annex 2 of the Agreement on Agriculture that green box decoupled income support have no or at most minimal trade or production effects.

26. The available data also show large shifts in cotton acreage. Based on a preliminary review of a sampling of marketing year 2002 acreage reports, the United States estimates that nearly half (47 per cent) of farms receiving direct and counter-cyclical payments in 2002 for upland cotton base acreage in fact planted no cotton at all. Preliminary estimates from the Farm Services Agency indicates that cotton producers enrolled upwards of 2 million acres for the 2002 Direct and Counter-Cyclical Programme that had not been enrolled under the 2002 Production Flexibility Contract programme. Marketing year 1999 planted acreage deviated substantially from base acreage, both by region and by

weather conditions. Thus, to end any comparison of production with marketing year 2001 will overstate any resulting increase.

⁶ Brazil has alleged that increased income can induce producers to take riskier choices, thus potentially increasing production and distorting markets. The economic literature suggests any such effects are empirically trivial. Recipients of decoupled payments use many market mechanisms to reduce their risk exposure in their farm operation. These strategies to manage risk reduce the extent to which changes in risk attitude due to decoupled payments, if any, will be evidenced in their production levels or demand for inputs.

State.⁷ Thus, the data indicate that recipients of "upland cotton base acreage" decoupled payments plant alternative crops or no crops at all, and other farmers who do not hold upland cotton base acres choose to produce upland cotton.

27. Third-Party Economic Studies Have Not Properly Modeled Cotton Production Decisions and Therefore Cannot Assist in Determining the Effect of US Subsidies on Cotton Production. Brazil has pointed to various third-party economic studies which find price effects from US payments. Upon review, the United States concludes that they do not present relevant results because they generally suffer from two conceptual flaws. These fundamental flaws establish that these papers do not provide a basis to find a causal link between US payments and the effects of which Brazil complains.

28. First, several of these studies do not model the marketing loan programme appropriately.⁸ Simply put, if Dr. Sumner and FAPRI's understanding of producer decisions is correct, then Brazil would have to agree that these papers do not properly model farmers' production decisions and any potential impact of marketing loans on those decisions. As a result, these models do not provide insight into the question this Panel has been asked to examine.

29. Second, most of these studies do not distinguish between payments linked to production and payments decoupled from any requirement to produce, instead treating them as having equal impacts on production. Again, Brazil's own expert recognizes that decoupled payments do *not* have the same impact as, for example, product-specific marketing loan payments. Thus, Dr. Sumner's own modelling of the impact of decoupled payments (with which the United States disagrees as contrary to the economic literature in ascribing *any* impact on production to these payments) indicates that these papers treat decoupled payments inappropriately.

30. Brazil's "Total Costs of Production / Revenue Gap" is Meaningless and Cannot Establish Causation. Brazil's so-called "gap" between the average total cost of production per pound of cotton for US cotton producers and the revenue such producers received from the market is an economically meaningless measure and is based on a simplistic calculation that misstates both the revenue and cost sides of the calculation. Brazil's revenue calculation is based on an erroneous representation of government support, especially crop insurance, decoupled payments, and Step 2 payments, and of market revenue.⁹ More fundamentally, the existence of a "gap" does not establish

⁷ Comparing marketing year 1999 planted acreage to base acreage, the ratio of planted to enrolled acreage, by region, in 1999 ranged from only 51% in the West to 141.25% in the Southeast. In the Southeastern United States (Alabama, Florida, Georgia, North Carolina, South Carolina and Virginia), for example, upland cotton planted acreage *exceeded* base acreage *by over 1 million acres*. In each of the other three regions, planted acreage was between 879,000 and 1 million acres *less than* base acreage. The variations by State are even more extreme.

⁸ (a) Specifically, several of these papers simply remove the full outlay of the marketing loan program. This implies that farmers at the time of planting knew what actual prices would be at harvest time. Brazil's own expert recognizes that it is producers' expectations of harvest season prices that drive planting decisions. Thus, using the full outlays will overstate the influence of the marketing loan programme on the planting/production decision when actual prices turn out to be below the expected prices at the time of the planting/production decision.

⁹ In three different submissions, Brazil presents three different per pound revenue figures derived from market revenue and US support programmes, and purports to represent this figure as average revenue received by upland cotton farmers in that year for every pound of cotton produced. This combined per pound figure in no way represents what a cotton farmer would have received – or even could have expected to receive – in the specific year in the way of government support. In addition, Brazil's measure of revenue for upland cotton producers – revenue from sales of cotton lint and cottonseed – is incomplete. Revenue from all sources – commodity sales, contracts in futures markets, off-farm employment, investment income – are needed to put the costs into perspective.

that US production would necessarily decline without the US payments Brazil has decided to challenge. For example, Brazil concedes that a substantial amount of US upland cotton in recent years was grown on non-upland cotton base acreage, at the same time that government payments were allegedly "necessary" for US producers to remain in business. Brazil fails to explain how it accounts for these inconvenient facts that do not support its cost-revenue gap theory.

31. On the cost side, Brazil's use of average total cost of production for US cotton to make its revenue gap argument is the wrong figure to measure costs – it is operating costs, not total costs, that figure in production decisions. Brazil also has made no effort to update cost data that is based on a 1997 survey and so does not take into account any technological or structural changes that have occurred in the interim. Since 1997, significant technological changes have occurred in US cotton production, changes which are not reflected in the estimated costs of production, such as increased production in low-cost regions and the introduction and adoption of genetically modified varieties of cotton with significantly increased yields while reducing pest control costs.

32. Finally, Brazil has used data from the International Cotton Advisory Committee (ICAC) to compare costs of production across countries arguing that the United States is a higher-cost producer than many other countries. Even when good survey data are available for one country, using cost of production data to draw valid economic conclusions is fraught with difficulties. The comparison of costs across countries poses greater difficulties, rendering such comparisons invalid. The ICAC itself notes that the cost data it presents is not appropriate for making these kinds of cross-country comparisons.

33. **Brazil Has Failed to Make A Proper Analysis of Conditions Actually Faced by Producers in Making Production Decisions Using Futures Prices, Which Reveals No Expected Impact from Marketing Loans Except for MY2002.** An analysis of the effect of marketing loan payments must begin with an understanding of farmers' planting decisions. The United States agrees with Mr. MacDonald, Brazil's expert on cotton markets, that the New York futures price provides the principal indicator of how market participants expect cotton prices to develop in the future. Unfortunately, Brazil's other expert, Dr. Sumner, has ignored Mr. MacDonald's testimony in modelling producers' expectations of harvest season market prices by using "lagged prices" instead of futures prices. Had Dr. Sumner conferred with Mr. MacDonald, Dr. Sumner would have learned that "[t]he 'New York futures price' is a key mechanism *used by cotton growers . . . in determining the current market values as well as the contract prices for forward deliveries.*"

34. Comparing the planting-time (February) New York futures price for the following harvest season (December delivery) to the marketing loan rate for upland cotton for each marketing year reveals that in every year but marketing year 2002, *the planting time futures price was above the marketing loan rate*. That is, New York futures prices indicated to producers that in every year but marketing year 2002 the return from the market would *exceed* the marketing loan rate. Thus, the marketing loan programme in marketing years 1999-2001 would not be expected to have had an effect on the decision to plant.

35. Only in marketing year 1999 does Dr. Sumner's "lagged price" approach result in a value for producers' expectations that equals or exceeds the futures price. In every other marketing year, *the "lagged price" method significantly understates the harvest season price expected by producers* and thus would distort an analysis of the effect of US subsidies. In fact, the use of "lagged prices" would lead to the erroneous conclusion that expected prices in every year but marketing year 1999 were *below* the applicable marketing loan rate. However, market price expectations actually were *above* the loan rate in every year but marketing year 2002. Thus, the use of "lagged prices" instead of futures prices to gauge producers' price expectations at the time of planting in the specific years in which Brazil has alleged effects from US subsidies would seriously overstate the expected impact of

US marketing loans. To the extent Brazil relies on Dr. Sumner's analysis, which uses lagged prices rather than futures prices, Brazil's analysis is fundamentally flawed.

36. The futures price data and "lagged price" data above also reveal that, despite declining market prices over the course of marketing years 1999-2002, *market participants persisted in expecting prices to recover*.¹⁰ Thus, Brazil's reliance on actual market year prices to claim that US cotton plantings should have been declining ignores the fact that harvest season cotton futures prices at the time of planting were fairly stable from marketing year 1999 through marketing year 2001, even as futures for other competing crops fell in value.

37. In marketing year 2002, harvest season futures prices at the time of planting had fallen below the loan rate. In this marketing year, there is at least the possibility that producers were planting for the loan rate and not for the harvest season expected price. However, the decline in US planted cotton acreage was within the range of expected values given the decline in the harvest season futures price from the previous year. Had US producers been planting for the 52 cents per pound marketing loan rate, one would have expected to see only one-tenth of the decline in planted acreage that actually occurred from marketing year 2001 to 2002.

38. Moreover, the per cent decline from marketing year 2001 to 2002 in US harvested acreage was very similar to (but larger than) the change in harvested acreage in the rest of the world. Despite the *theoretical* possibility that the marketing loan rate could have had some impact on planting decisions in marketing year 2002, the *actual* decline in US planted and harvested acreage suggests that US acreage levels were entirely consistent with price expectations and world market conditions. Thus, even in marketing year 2002, there is no evidence on this record that the marketing loan rate serves to insulate US producers' planting decisions from market price movements. To the contrary, the evidence suggests that US producers do respond to changes in expected prices (for cotton and for other competing crops) and are as responsive if not more so than producers in other countries.

¹⁰ The marketing year 2000 harvest season futures price at planting time was 61.31 cents per pound, suggesting that the market expected prices in marketing year 2000 to recover from the previous year's levels. For marketing year 2001, the harvest season futures price at planting time was 58.63 cents per pound (nearly the same as futures in marketing years 1999 and 2000), once again indicting that market participants expected prices in marketing year 2001 to recover from their marketing year 2000 levels. It is only in marketing year 2002 that persistent lower-than-expected farm prices translated into a lower harvest season futures price at planting. For marketing year 2002, the February average futures price for December delivery fell to 42.18 cents per pound. However, even in marketing year 2002, market participants expected prices to recover and run higher than the "lagged price" of 29.80 cents per pound suggested.

ANNEX H

ORAL STATEMENTS OF PARTIES AT THE SECOND SUBSTANTIVE MEETING

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ANNEX H-1

EXECUTIVE SUMMARY STATEMENT OF BRAZIL AT THE SECOND SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

The United States Has Invented Threshold Burdens for Serious Prejudice Challenges that Do Not Exist in the Text of Articles 5 and 6.3 of the SCM Agreement

1. The United States' has raised a number of threshold burdens that an Article 6.3 complainant allegedly must meet to establish a claim which are not based in the text of the serious prejudice provisions of the SCM Agreement.

2. First, the United States incorrectly asserts that under Article 6.3, Brazil must show an *ad valorem* subsidy rate and the amount for each of the challenged US subsidies. The only textual basis the United States provides is Annex IV of the SCM Agreement, which has expired with the text of Article 6.1(a) that contained the now-expired presumption of serious prejudice from a 5 per cent *ad valorem* subsidization. The United States further relies on *countervailing duty* measure procedures and interpretations of Brazil and the EC. But these allocation methodologies are irrelevant to Article 6.3 claims because unlike the expired Article 6.1(a) or Part V of the SCM Agreement, the focus of Articles 5(c) and 6.3 is on an examination of the *effects* of subsidies that are provided either directly or indirectly to producers of a product, such as cotton. In any event, Brazil has demonstrated a collective subsidization rate averaging 95 per cent and subsidies in the amount of \$12.9 billion.

3. Second, the United States makes the sweeping argument that there is a legal prohibition on bringing adverse effects claims against subsidies that it alleges cannot be "expensed" or allocated to future years. The United States argues that all subsidies to cotton are "recurring" and therefore, as a matter of law, "cannot be said to be causing serious prejudice" except in the year in which they are provided. In fact, there is *no* textual basis in Part III or Article 6.3 of the SCM Agreement (or Article XVI:3 of GATT 1994) for distinguishing between the adverse effects of "recurring or non-recurring" subsidies. Nor is there any basis for "expensing" subsidies in one year or another year, as is often done in a countervailing duty investigation. Because Article 5 requires Members to *prevent effects*, a breach of Article 5 does not necessarily arise when a subsidy is granted, but only when actionable adverse effects occur.

4. The US argument is also inconsistent with the object and purpose of the SCM Agreement which is to protect Members from *any* subsidy causing serious prejudice. Under the US interpretation, a Member can permanently avoid any liability under Article 6.3 simply by carefully constructing the form of the payment as a recurring annual subsidy. Brazil has also presented evidence of continuing effects from subsidies provided in MY 1999-2002.

Brazil Has Established the Existence of Price Suppression in the US, World, Brazilian, and Other Markets Where Brazilian Producers Export

5. The United States now asserts that even though there may be evidence that New York futures market and A-Index prices as well as prices in other countries are suppressed by a "generalized effect," the "in the same market" language in Article 6.3(c) requires that US exports be present in the same geographical markets in which Brazilian cotton is present.

6. Brazil has established, consistent with the requirements of Article 6.3(c), that the effects of the US subsidies were to suppress prices in the “same market” in which Brazilian producers marketed their “like” cotton – i.e., in the world’s, Brazil and in third countries. First, Brazil demonstrated the impact of US overproduction on the US and the “world market” prices (A-Index and New York futures market prices). Brazil then demonstrated that prices in Brazil and the countries to which Brazilian exporters shipped their cotton between MY 1999-2002 were suppressed and heavily influenced by US subsidies. The effects of those subsidies are communicated world-wide via a global price discovery mechanism. The parties agree that US, Brazilian and other countries’ cotton are “like products”. Throughout the world, prices for this fungible, price-sensitive commodity are determined by reference to the New York futures market and A-Index prices. Thus, Brazil established that the effect of the US subsidies is significant price suppression in the United States and Brazil, and in countries to which Brazilian producers exported their cotton. Further, the evidence shows that US subsidized cotton was present and contributed to the suppression of prices in 37 of the countries in which Brazilian producers marketed their cotton.

Brazil Has Established the Causal Link between the US Subsidies and Significant Price Suppression, Increased US World Market Shares, and the Inequitable US Share of World Trade

7. Brazil has properly analyzed both US revenues and costs using USDA’s own data and conclusively demonstrated that the US industry producing cotton is heavily dependent on all US subsidies to cover total costs over the short and long run. This finding provides a key economic rationale for the large production-enhancing effects from the US cotton subsidies found by USDA, as well as by US and international economists.

8. Over the long term, even the United States agrees that producers must recover all of their costs and make a profit to stay in business. USDA’s own cost and planted acreage data shows that US producers’ long-term costs from MY 1997-2002 were \$12.5 billion greater than their market revenue received. The United States argues that off-farm income should have been included in Brazil’s revenue calculations. This US approach is conceptually as well as legally wrong. The relevant question is whether the “US cotton industry” is profitable from market revenue, not whether this industry is kept alive by cross-financing from other (non-subsidy) sources, such as social security payments.

9. US cotton producers would have suffered a cumulative loss of \$332.79 per acre of cotton during MY 1997-2002 if they did not receive contract payments. But USDA’s own data in the Environmental Working Group database demonstrates that almost all US producers of cotton did receive contract payments. And as a result, they made cumulative 6-year “profit” of \$106 per acre by MY 2002, allowing them to plant significant acreage to cotton in MY 2002 and 2003.

10. Finally, the United States criticizes Brazil’s comparison of costs of production among various countries. While Brazil agrees that the ICAC “data must be used carefully”, the problems with ICAC’s data do not render them unusable. Comparing ICAC “Variable Cash Costs” – which the United States does not challenge – demonstrates that it is much cheaper to produce a kilogram of cotton in Brazil than the United States.

11. The United States has argued that “in no year from marketing year 1999-2001 would the marketing loan rate be expected to have much of an impact, if any, on producer planting decisions,” and that it did not affect producer decisions in MY 2002. This new US argument contradicts numerous USDA studies. In assessing the credibility of the new US argument that marketing loans provided no production incentives, the Panel should consider that USDA’s own economists Westcott and Price found considerable effects of the marketing loan programme on US cotton production. The results of the Westcott and Price study are neither unique nor unexpected. Numerous other

economists have found similar results. Looking at futures prices also reveals that US producers are unresponsive to price changes at planting time.

12. Moreover, the basic US assumption is that if the *futures* price (minus five cents) is above the marketing loan rate of 52 cents per pound, then “economic logic” demands that the marketing loan can have no impact on planting decisions.

13. The United States’ analysis of the marketing loan programme is based on a completely irrelevant comparison between the “expected cash price” and the marketing loan rate. Cotton marketing loan payments are based on the difference between the loan rate (52 cents) and the adjusted world price (“AWP”) not the price received by US farmers. The AWP is typically far lower than the price received by U.S. farmers. The average spread between the December contract futures price during the period January-March and the adjusted world price of the following marketing year was 18.5 cents per pound. Thus, even using the US “futures price” methodology at planting time, for every year between MY 1999-2002, there was the expectation at planting time that significant marketing loan payments would be made.

14. Even if the expected AWP is above the loan rate, this does not mean that farmers expect a zero marketing loan payment. If the expected AWP lies above the loan rate, farmers would still expect, with a certain likelihood, that the actual AWP could be below the loan rate because the expectations about the AWP is a probability distribution. Thus, they would still expect a positive marketing loan payment.

15. Brazil emphasizes that the US futures price approach suffers from several significant shortcomings. Both farmers’ decisions about planting and marketing of cotton are more complex. Planting decisions take place between January-March and the marketing of cotton takes place during the whole marketing year. Thus, just the February quote of the December futures contract does not properly address the complexity of farmers decisions.

16. The evidence is that the US cotton industry is sceptical of relying too heavily on present futures market prices as an accurate guide to future prices. Farmers have seen such volatility in the past as well as today. Therefore, any cotton farmer planting in the MY 1996-2002 period who actually relied on futures prices would know that the futures market is far from constituting a perfect predictor of future prices. Thus, as Professor Sumner correctly stated, “it is impossible to know what precisely individual farmers expect;” price expectations are “fundamentally unobservable”.

17. The record supports a finding by the Panel that more than \$4 billion in contract payments were provided to *current* producers of cotton in MY 1999-2002. Brazil has demonstrated that the publications listed in the US review literature were largely irrelevant because they are not cotton-specific, as they do not address the re-coupling of production due to the base acreage updating for direct and CCP payments, or the huge target price CCP payments provided to cotton producers. Brazil has also shown that the US subsidies do not meet the criteria of paragraph 6 of Annex 2 of the Agreement on Agriculture, and are therefore not “decoupled”.

18. The record supports a finding by the Panel that the “other effects” apart from increased rental costs include significant production effects tied to upland cotton. First, the large majority of current cotton producers receive much higher per-acre payments for cotton than for other programme crops. The Panel must ask why much higher per acre direct and CCP payments are made to cotton base acreage *if* these payments are totally de-connected from current production? If that were the intention, as the United States argues and USDA presumes, then all contract payments in the same state or county would provide the same per acre benefit. The reason for the higher payments, of course, is that cotton is a high-cost crop and that cotton farmers insisted they were not receiving enough payments during MY 1999-2001 “to make ends meet”.

19. Second, the United States has now admitted that two million additional cotton base acres were added to the total contract “base” acreage. This means that in MY 2002, an additional \$227 million in payments were made to farmers producing cotton during MY 1998-2001. This is not “decoupling” payments from production, but re-coupling to reward farmers for increasing their recent production. And the prospect of future updates will keep many farmers planting cotton in order to protect and even increase future bases. Even USDA economists agree that this creates a link to current production.

20. Third, the 72.4 cent target price triggers CCP payments when *cotton* prices are lower – not corn, or soybeans prices – but *cotton*. Why is that? Because the NCC argued and Congress agreed that given the high costs of producing cotton in the United States, *current* and *future* cotton farmers will need high payments when prices decline. There would be no reason to set a “target price” to protect against low cotton prices if Congress expected that most farmers with upland cotton base acreage would start planting apple trees.

21. Fourth, Brazil presented the Panel with information from USDA’s own electronic payment data showing that during MY 2000-2002 at least 71.3 to 76.9 per cent of total so-called “de-coupled” cotton base acreage payments were paid to producers of cotton. The data further shows that, in MY 2002, these producers of cotton received 85 per cent of their contract payments from cotton base acreage.

The US Subsidies Increase Exports, in Violation of Article 6.3(d) of the SCM Agreement

22. Brazil has demonstrated that, in violation of Article 6.3(d) of the SCM Agreement, the effect of the US subsidies played a significant role in the increase of the US world market share in MY 2001-2003 over its previous three-year average, following a consistent trend since MY 1996.

23. The US argues that “[u]nder Brazil’s reading, a Member would be free to provide subsidies that increased the share of its own domestic consumption that its producers supplied without any disciplines under Article 6.3(d)”. But this argument ignores the fact that Article 6.3(a) disciplines subsidies that increase domestic production in the market of the subsidizing Member. Further, Article 6.3(b) addresses any export displacement or impedance effects of subsidies in third country markets.

24. Second, the United States now argues explicitly that Article 6.3 has superseded Article XVI:3, second sentence. Assuming *arguendo* that the United States is correct, the effect of the US interpretation of “world market share” as meaning “world market share of consumption” would be to eliminate any WTO disciplines on production-enhancing subsidies that increase a Member’s world market share of exports. As Brazil has pointed out, this would be contrary to the fact that the language and scope of both Article XVI:3, second sentence and the text of Article 6.3(d) are very closely related.

25. Finally, the entire concept of a “world market share of consumption” is flawed for the purposes of Article 6.3(d) as it results in double counting. The United States argues that “the US share of the world market for upland cotton should be defined as US consumption plus US exports over world consumption”. However, the ordinary meaning in a trade remedy context of “domestic consumption” is total domestic “shipments” (i.e., net use from production or stocks) plus imports *minus* exports. Total “world consumption” is the sum of each country’s domestic shipments plus imports *minus* exports. But the US methodology addresses as “consumption” both imports and exports and thus, double counts.

CCC Export Credit Guarantee Programmes

26. The United States considers that Article 10.2 exempts export credit guarantees from the disciplines included in Article 10.1. In Article 10.2, the negotiators reached a good faith agreement to work toward specific disciplines on export credits. That need for a good faith commitment to negotiate explains the difference between the Draft Final Act and the final version of Article 10.2. Given the “magnitude” of those programmes, the United States argues that no Member could possibly have intended for its agricultural export credit programmes to be subject to Article 10.1. But, among others, the EC and Canada, both massive users of export credits, have told the Panel that they consider export credits to be subject to Article 10.1 if they meet the definition of an “export subsidy”. The United States did not think it needed to account for the CCC programmes in its reduction commitments, since it did not consider them to be export subsidies.

27. The United States says that it has offered “uncontroverted evidence” that for 12 of 13 scheduled products, US exports under the CCC export credit guarantee programmes did not exceed the United States’ reduction commitment levels. The correct question, however, is whether *total* US exports of a scheduled product exceed the quantitative reduction commitments, which Brazil has demonstrated. It is for the United States, under Article 10.3, to prove that those excess quantities did not receive export subsidies.

28. Whomever bears the burden, Brazil has demonstrated that the CCC export credit guarantee programmes confer “benefits” *per se*, and also constitute export subsidies within the meaning of item (j). The United States argues that even if the CCC programmes constitute export subsidies, because “the quantities were within the applicable US export subsidy reduction commitments[,] they would conform fully to the provisions of Part V of the Agreement on Agriculture”. The United States is in error.

29. With respect to *unscheduled* products, Brazil has established both actual circumvention and the threat of circumvention. Brazil’s Exhibits 73 and 299 and Exhibit US-41 list the billions of dollars of CCC guarantee support that have been provided for exports of unscheduled products during fiscal years 1992-2003, thereby circumventing the US commitment not to provide export subsidies. The mere availability of CCC guarantees for unscheduled products threatens circumvention, since Article 10.1 prohibits *any* export subsidy for such products.

30. With respect to *scheduled* products, Brazil has demonstrated actual circumvention for US rice exports benefiting from CCC guarantees that have exceeded the US quantitative export subsidy reduction commitment. In its 18 November submission, the United States argues that because CCC has not disbursed the minimum amounts (at least \$5.5 billion in guarantees each year, plus an additional annual amount of at least \$1 billion in direct credits or guarantees for exports to “emerging markets”) there is no threat of circumvention. The United States misunderstands the test set out by the Appellate Body in US – FSC. The lack of a legal mechanism that stems, or otherwise controls, the flow of CCC guarantees threatens circumvention. There is no limit on the amount of CCC guarantees and CCC’s is exempt from the standard requirement of new Congressional budget authority for new guarantees.

ANNEX H-2

EXECUTIVE SUMMARY CLOSING STATEMENT OF BRAZIL AT THE SECOND SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

1. The United States enjoys No Peace Clause Protection

1. The record demonstrates that the United States enjoys no peace clause immunity for its upland cotton subsidies. Under any of three methodologies – a “budgetary outlay/expenditure”, an “aggregate measure of support”, or a “rate of support” methodology – the level of support provided in MY 1999-2002 exceeds the level of support decided in MY 1992. The United States has acknowledged that all challenged US subsidies, except PFC and direct payments, are non-green box (trade and production-distorting) subsidies. Brazil and all third parties agree that direct payments under the 2002 FSRI Act are non-green box because of the updating of a fixed base period contrary to Annex 2, paragraphs 6(a) and (b) of the Agreement on Agriculture. Further, PFC and direct payments are non-green box support because of the prohibition on fruits and vegetables contrary to Annex 2, paragraph 6(b). Moreover, payments for cotton base acreage are higher than those for other crop base acreage. The weight of evidence shows that all the challenged US subsidies are “support to” upland cotton within the meaning of Article 13(b)(ii) because they were received by current producers or by users and exporters of US upland cotton. Brazil’s “14/16ths” methodology for estimating the amount of the four contract payments is reasonable and supported by the EWG database and considerable circumstantial evidence.

2. Brazil has established the Elements to Support its Significant Price Suppression Claims under Article 6.3(c)

2. Upland cotton is a basic, widely-traded commodity. Both Brazil and the United States agree that Brazilian upland cotton and other upland cottons are “like” subsidized US upland cotton. Because of this widespread interchangeability among world cottons, increases in world cotton supply by major cotton-producing countries have a major impact on discovery or establishment of world prices reflected in the A-Index and the New York cotton futures exchange.

3. The United States has made a great deal about what it terms some “fundamental” issues about the nature and amount of subsidies. Brazil has demonstrated the absence of any textual basis for incorporating various countervailing duty principles from Part V of the SCM Agreement into Part III and resurrecting Annex IV from the dead. However, Brazil used USDA’s own data to show both the amount and rate of subsidization for each of the subsidies. To make up for US acreage and yield information the US has hidden from Brazil and the Panel for 16 months, Brazil has demonstrated through the EWG database and other circumstantial evidence that its “14/16th” methodology is reasonable. This methodology allocates payments only to current producers of upland cotton and does not “double count” payments provided to other producers of crops. And since the peace clause phase of this proceeding, Brazil has demonstrated that all the US subsidies are “tied” to the production of upland cotton and are “support to” upland cotton.

4. The US government has poured \$12.9 billion over the past four years into a number of subsidy programmes specifically targeted at US upland cotton. No other US commodity has a Step 2 programme and no other US commodity received subsidies as high as 136 per cent *ad valorem*. Even

the so-called decoupled contract payments for “historical” cotton base acreage are much higher than for any other crop except rice. The subsidies provide a specific “target price support” of 72.4 cents per pound for upland cotton – not for other crops. And Congress insisted that USDA has no discretion to limit any of the required payments, all of which are mandatory and place no limit on the amount of upland cotton that could be produced with the support of these subsidy programmes.

5. The United States has agreed that all of the challenged US subsidies are “specific” except crop insurance. But USDA’s own evidence showed that this programme is also specific since it is targeted at the industry growing crops, not livestock and thus covers only half of the value of US agricultural commodities and 38 per cent of farmland.

6. While Brazil continues to wait for farm-specific acreage and yield information from the United States, the incomplete Environmental Working Group data based on USDA farm-specific data show almost \$3 billion in contract payments paid to upland cotton producers in MY 2000-2002 alone. And the great bulk of the other evidence shows that US upland cotton farmers are dependent upon, need and, in fact, receive such payments to “make ends meet” and “to survive”.

7. Having established the fungible nature of the product and the existence and specificity of the subsidies, Brazil must link the effects of the subsidies to significant price suppression. The first important fact is that the United States is by far the world’s largest exporter, with a world market share of 41.6 per cent, and the second largest producer of upland cotton in the world, with a 20 per cent share. The US subsidization rate of 95 per cent provided by the second largest producer and largest exporter creates the potential of causing serious prejudice to the interests of other Members, including Brazil. It is useful to recall the size of these subsidies compared to the 5 per cent *ad valorem* rate establishing a presumption of serious prejudice under Article 6.1(a) and compared to the amount, if any, of subsidies received by US competitors.

8. But what was the impact of the large US subsidies on production and world supplies of cotton? One answer to this question is found in the difference between market revenue and the US producers’ total costs. While claiming that only variable costs are important in the short term, the United States admits that in the long-term, US producers have to make a profit to stay in business. Using only USDA’s data for the period MY 1997-2002, the *average* US upland cotton producer received market revenue that was \$872 dollars *per acre less* than its total costs. This means the cost/revenue gap for all upland cotton farmers between MY 1997-2002 was \$12.5 billion.

9. The United States has attempted to leave you with the impression that its upland cotton producers do not rely or need any subsidies between MY 1997-2002 to make up this \$12.5 billion gap. In assessing the credibility of these claims, consider that during this same 6-year period, US cotton producers received \$16 billion in US subsidies and ended up with a 6-year “profit” of \$127 per acre. The US claims that the PFC, market loss assistance, direct payment and CCP payments were not support to cotton. But without those 4 payments, US cotton producers would have lost \$333 per acre between MY 1997-2002. The US further claims that the marketing loan payments in MY 1999-2002 made no difference to producers’ planting decisions. But this argument ignores the impact of the subsidies in those producers’ costs. By MY 2002, the average US producer would have been faced with a 3-year loss of \$372 per acre if they had *not* received marketing loan payments during MY 1999-2001. This evidence confirms the conclusion of the Chief USDA economist that by making marketing loan payments “*you don’t get cutbacks in production*”. Clearly, the marketing loan programme kept many producers from reducing their planted acreage between MY 1999-2002.

10. Indeed, US producers planted between 14.2 – 15.5 million acres of upland cotton between MY 1999-2002 as prices fell to record lows. The combined revenue from *all* the US subsidies and market prices allowed producers to earn a long-term “profit” of \$17.67 per year over the 6-year period. What is most amazing is that after having received record low prices for their cotton in MY

2001 and with futures prices at the time of planting suggesting market prices would remain at record low levels, US producers still planted 14.2 million acres of upland cotton – a similar amount of acreage that was planted when prices were much higher in MY 1996-1998. However, even 135 per cent *ad valorem* subsidies in MY 2001 were not sufficient to provide a profit to the highest-cost and lowest-yield US producers. This explains why US planted acreage declined to 1996-98 levels in MY 2002.

11. Having established that the US subsidies prevented production cutbacks, the Panel has to estimate how much of a cutback would have been made without US subsidies. USDA economists Westcott and Price estimate a 20 per cent cutback in MY 2001 from only the marketing loan programme. Professor Sumner estimates an average production cutback of 28.7 per cent or a total of 19.8 million bales between MY 1999-2002 from eliminating all subsidies.

12. The Panel then must estimate the effect of these estimated US production cutbacks on world prices. First, Brazil demonstrated the impact of US overproduction on the US and the “world market” prices (A-Index and New York futures market prices). Brazil then demonstrated that prices in Brazil and the countries to which Brazilian exporters shipped their cotton between MY 1999-2002 were also suppressed and heavily influenced by US subsidies. The effects of those subsidies are communicated world-wide *via* a global price discovery mechanism. Throughout the world, prices for this fungible, price-sensitive commodity are determined by reference to the New York futures market and A-Index prices. There is a world market for upland cotton. Subsidized US cotton and Brazilian cotton compete in this world market, i.e., “in the same market”, as used in Article 6.3(c) of the SCM Agreement. Brazil established that the effect of the US subsidies is significant price suppression in that world market.

13. There are numerous studies from a number of economists finding clear and identifiable amounts of price suppression ranging from 10-33 per cent for the US price and 10-26 per cent of the world A-Index price. Professor Sumner responded to the US critiques of these studies by showing that they are not biased and correcting for some shortcomings are consistent with his results. The United States also claims these studies are useless for this dispute because they did not use “futures prices”, but then admits that USDA and FAPRI models also use “lagged prices” because it is not possible to use futures prices in models to judge farmers’ revenue expectations. Brazil also demonstrated that, using the US futures methodology, farmers expected significant revenue from marketing loan programmes in MY 1999-2002.

14. Finally, the Panel should judge the “significance” of the price suppression by the extent of the impact on Brazilian producers. But even judged in relation to objective levels, any of the price suppression estimated in the various econometric studies is sufficient to establish “significance”.

3. Claims under Article 6.3(d) of the SCM Agreement

15. The facts strongly support Brazil’s claims that US subsidies contributed to an increased US world market share of exports. USDA’s data show that US exports increased in MY 2001, MY 2002, and are projected to increase in MY 2003 to levels well above the previous 3-year averages as required by Article 6.3(d).

16. The US domestic subsidies played a major role in the increased US exports by maintaining high-cost US production. Similarly, the Step 2 subsidy was paid in 188 out of 208 weeks and more than \$1.6 billion worth of US upland cotton exports received GSM 102 export credit guarantee financing. The NCC confirmed that both subsidies played a major role in the significant expansion of US exports, in particular against the background of a rapidly appreciating US dollar. Professor Sumner’s analysis estimates that on average, US exports would be 41.2 per cent lower without any of the US subsidies between MY 1999-2002. US world export market share expanded

rapidly from MY 1999 even as prices plunged to record lows. After reaching 41.6 per cent in MY 2002, the US market share is projected to remain very high at 39 per cent in MY 2003.

17. The United States response to this evidence is to argue that the term “world market share” means “world market share of consumption”. But USDA, Canada, and the EC agricultural experts, among others, use and interpret the phrase as “world market share of exports”. This is the correct meaning as confirmed by the use of the word “trade” in the footnote qualifying Article 6.3(d), and by the close similarity between the scope and text of Article 6.3(d) and Article XVI:3, second sentence, which also deals with world market share of exports. Further, as we demonstrated yesterday, the US “consumption” interpretation is unworkable and illogical because US consumption is total domestic “shipments” (i.e. net use from production or stocks) plus imports *minus* exports. To count US exports as consumption means double counting other countries’ imports as consumption.

4. Claims under GATT Article XVI:1 and 3

18. The facts strongly support a finding that the US share of world export trade is inequitable. While world market prices plunged and the US dollar appreciated rapidly, the huge US subsidies allowed US exporters to purchase a record high share of 41.6 per cent. At the same time, the share of much lower cost and non-subsidized producers declined between MY 1999-2002. The text of Article XVI:3, second sentence, covers any type of subsidy that “operates to increase the export” of a primary product such as upland cotton. Contrary to the US arguments, nothing in the text of the WTO or GATT 1994 suggests that Article XVI:3, second sentence, has been superseded by Article 6.3.

5. Claims of Threat of Serious Prejudice

19. Brazil has also established that there is a present threat of serious prejudice during the lifespan of the 2002 FSRI Act. This threat covers the threat of significant price suppression, threat of a further increased US world market share and the threat that the United States continues to have a more than equitable share of world export trade. The mandatory and unlimited nature of the production and trade-distorting US upland cotton subsidies and the absence of a legal mechanism that stems, or otherwise controls, the flow of these subsidies constitutes the actionable threat of serious prejudice to the interests of Brazil. The timing and nature of actionable subsidy cases, as well as the remedies available under the SCM Agreement compel that such a threat need not be “imminent”, but instead “present” to be actionable.

20. Brazil has demonstrated that there is a present threat of serious prejudice from the existence of the US subsidies. There is no dispute between the United States and Brazil that the US marketing loan, Step 2, crop insurance and contract payments are mandatory subsidies. There is no limit on the amount of upland cotton that can be produced, used and exported from farmers receiving these payments. Brazil has also demonstrated that all of these subsidies are production and trade-distorting and have caused present serious prejudice between MY 1999-2002.

21. The most recent USDA and FAPRI baselines project continued high levels of US planting and continued high costs that will not be covered by market revenue. Therefore, the US subsidies will continue to have large production and export-enhancing and price-suppressing effects. In particular, until MY 2007, the US subsidies threaten to cause significant price suppression in the US, world, Brazilian and in third-country markets to which Brazil exports its upland cotton.

22. Finally, the US subsidies mandated until the end of MY 2007 will cause serious prejudice under any market conditions. Thus, the provisions mandating marketing loan, Step 2, crop insurance and direct and counter-cyclical payments constitute per se violations of Articles 5 and 6.3(c) and (d) of the SCM Agreement.

6. Brazil's Claims regarding Step 2 Export and Domestic Payments under Article 3.1(a) and (b) of the SCM Agreement

23. The Step 2 export and Step 2 domestic subsidies are prohibited subsidies under Article 3.1(a) and (b) of the SCM Agreement. The Step 2 export subsidies violate Article 3.1(b) because they are subsidies expressly contingent upon proof of export of US upland cotton and are paid only to eligible exporters. The NCC describes the Step 2 programme as "export assistance" and the USDA acknowledges it makes U.S. exports of upland cotton more "competitive".

24. The United States acknowledges that Step 2 domestic subsidies are local content subsidies within the meaning of Article 3.1(b) of the SCM Agreement. Local content subsidies to processors of agricultural commodities are not expressly exempted from the disciplines in the SCM Agreement by either Agreement on Agriculture or by the chapeau of Article 3.1. In particular, Annex 3, paragraph 7 and Article 6.3 of the Agreement on Agriculture do not create rights and obligations that by necessity conflict with Article 3.1(b). Brazil has demonstrated the absence of any inherent conflict because it is possible to provide domestic support to processors of agricultural products without violating Article 3.1(b). Further, Article 13(b)(ii) is properly read as meaning that even if a local content domestic support measure may conform to Article 6.3 of the Agreement on Agriculture, it is not exempted from claims under Article 3 of the SCM Agreement. If the drafters had intended to exempt agricultural local content subsidies from Article 3 claims, they would have included Article 3 in Article 13(b)(ii), the same way that they included Article 3 of the SCM Agreement in Article 13(c)(ii) for purposes of exempted export subsidies for scheduled products.

7. Brazil's Claims regarding the CCC Export Credit Guarantees

25. Brazil has demonstrated that the GSM 102, GSM 103 and SCGP export credit guarantee programmes administered by the CCC constitute export subsidies within the meaning of Articles 10.1, 1(e) and 8 of the Agreement on Agriculture, Articles 1.1 and 3.1(a) of the SCM Agreement, and item (j) of the Illustrative List of Export Subsidies. Brazil has also demonstrated that those export subsidies circumvent, or threaten to circumvent, the United States' export subsidy reduction commitments, in violation of Articles 10.1 and 8 of the Agreement on Agriculture. Additionally, because they violate the Agreement on Agriculture, these programmes are not exempt from actions by Article 13(c)(ii) of the Agreement on Agriculture, and constitute prohibited export subsidies within the meaning of item (j) and Articles 1.1, 3.1(a) and 3.2 of the SCM Agreement.

8. Brazil's Claims regarding the ETI Act Subsidies

26. With respect to the ETI Act, Brazil and the United States agree that the Panel should follow the precedent of the panel in *India – Patents (EC)*. Indeed, the United States has effectively admitted the inconsistency of the ETI Act by repeatedly stressing to the Panel that it intends to implement the rulings and recommendations of the Dispute Settlement Body to bring the ETI Act into conformity with the Articles 10.1 and 8 of the Agreement on Agriculture and Articles 3.1(a) and 3.2 of the SCM Agreement.

ANNEX H-3

EXECUTIVE SUMMARY OPENING STATEMENT OF THE UNITED STATES AT THE SECOND MEETING OF THE PANEL WITH THE PARTIES

I. THE EFFECT OF US SUBSIDIES IS NOT SIGNIFICANT PRICE SUPPRESSION

1. Brazil's theory of its case is that subsidies result in greater production, increased exports, and suppressed world prices for upland cotton. Brazil does not, because it cannot, refute the fact that US producers have increased and decreased acreage commensurately with producers in the rest of the world. Thus, there is no evidence that US producers are insulated from market forces in making production decisions.

2. In every year but one in which Brazil has alleged price suppression, and in marketing year 2003 in which it alleges a threat of price suppression, expected harvest season prices at the time of planting have been *above* the US marketing loan rate. In marketing year 2002, the only year in which expected harvest season price was below that rate, US harvested acres fell by a slightly *larger* percentage than the rest of the world. In fact, US planted acres fell by the amount expected from the decline in expected harvest season prices from marketing year 2001 to 2002 and by *far more* than would have been expected had producers been planting for the marketing loan rate. Therefore, rather than supporting Brazil's argument – that the effect of US payments is to make US producers unresponsive to market price changes – the evidence contradicts it.¹

3. Brazil's allegation that the effect of US subsidies is price suppression is dispelled by the fact that Brazilian cotton undercuts the US price in various third-country markets.² Aggregated data on average US and Brazilian upland cotton prices to various markets identified by Brazil unambiguously show that Brazilian cotton undercuts the US price in these third-country markets. Thus, these data demonstrate that it is not US upland cotton that has suppressed Brazilian upland cotton prices, but Brazilian cotton prices that have undercut US prices.

II. THE EFFECT OF US SUBSIDIES IS NOT AN INCREASE IN WORLD MARKET SHARE

4. The facts do not demonstrate any increase in US world market share. While US world market share in marketing year 2002 was projected to be higher than the average of the preceding three-year period, the 2002 subsidies are different from the subsidies for prior marketing years, and 2002 payments were only introduced with the 2002 Act. It is the effect of the 2002 subsidies that Brazil must demonstrate under Article 6.3(d) of the SCM Agreement establishes an increase that follows a

¹ We also recall that Brazil failed to properly analyze marketing loan payments through its use of "lagged prices" instead of futures prices. During marketing years 2000-2003, lagged prices significantly understate the harvest season prices expected by producers, thereby inflating the expected effect of the marketing loan rate.

² Brazil's evidence under Article 6.3(c) must establish the volume of subsidized US upland cotton that is "in the same market" as Brazilian upland cotton, the extent of subsidization, and the prices of those respective products sufficient to establish its claim of "significant price suppression". Brazil has not even shown that for each foreign market, there have been *any* US exports of upland cotton.

"consistent trend." One year does not make a "consistent trend". Thus, there can be no "consistent trend over a period when subsidies have been granted".³

III. THE EFFECT OF US SUBSIDIES IS NOT A THREAT OF SERIOUS PREJUDICE

5. The facts do not support a finding of threat of serious prejudice. We submit that Brazil seeks to have the Panel reject the "imminent threat" standard, even though it was Brazil itself that previously suggested this standard to the Panel, because market prices have recovered to the point that *no marketing loan payments have been made since 18 September 2003*, and counter-cyclical payments are expected to be well below their statutory maximum for marketing year 2003.⁴

6. Brazil concedes that "market prices [may] increase to the point where the present effects of the subsidies are minimal". Given current and expected prices for marketing year 2003, even Brazil might have to concede that the present effects of US subsidies could be "minimal". However, Brazil seeks to prevent the Panel from basing its threat of serious prejudice analysis on that same marketing year 2003 data. If Brazil cannot demonstrate an imminent threat of serious prejudice in marketing year 2003, logically, neither can it demonstrate a threat of serious prejudice in farther off years, given that (in Brazil's words) "market[] prices move up and down," and "[n]o Member . . . can predict the course of future prices".

IV. BRAZIL HAS FAILED TO SHOW THE ELEMENTS NECESSARY TO ESTABLISH ITS SUBSIDIES CLAIMS

7. Brazil has argued that no concepts or analysis drawn from other parts of the SCM Agreement or provisions from other agreements may be applied to claims under Part III of the Subsidies Agreement. This position is untenable. The United States is not suggesting some radical methodology dreamt up for purposes of this dispute but instead is proposing methods based on principles set forth in the SCM Agreement and accepted and applied by other WTO Members, including Brazil, for purposes of their countervailing duty practice.

8. Brazil says there is no need for it to quantify the subsidy benefit attributable to the product at issue nor the rate of subsidization but does not explain how to evaluate the effect of the subsidy without identifying the amount or rate of support. Further, Brazil has repeatedly alleged a subsidy amount and subsidization rate for the marketing year 1999-2002 period. Presumably, then, the value of the subsidy and the subsidization rate of exported US upland cotton would be highly relevant to the Panel's analysis of the effect of the challenged subsidies; Brazil's position would deprive the Panel of that crucial element.

³ Even if one were to look to the period since the 1996 Act when different subsidies were in place, there is no consistent trend over a period when those subsidies have been granted. The facts demonstrate that since marketing year 1996, US world market share has increased and decreased in alternating years, and US world market share in marketing year 2002 is lower than in marketing years 1996-1997. These data cannot support a finding of a consistent trend. Brazil seeks to evade these facts by ignoring the change in subsidies over the years and by interpreting "world market share" contrary to the ordinary meaning of those terms.

⁴ The effect of such higher market prices is vividly suggested by Brazil's use of the January 2003 FAPRI baseline versus the November 2002 preliminary FAPRI baseline in Dr. Sumner's new model. We, of course, strongly disagree with what we understand to have been the way in which Dr. Sumner has most recently modeled all of the US payments at issue, but we note that a mere change in baselines that increased the baseline A-index price by an average of *4.24 cents per pound* per year over MY 2003-2007 *reduced* the estimated impact of removal of all US subsidies on A-index prices by *nearly one-third*. Price movements since January 2003 would suggest that Dr. Sumner's estimated impacts using more current data would be smaller still. For example, the January 2003 FAPRI baseline projected a 2003 marketing year A-index price of 58.40 cents per pound while the year-to-date A-index price has been *68.73 cents per pound*, an increase of more than 10 cents per pound over the January baseline.

9. Brazil errs in asserting that it need not identify the "subsidized product", ignoring or selectively quoting various provisions – Subsidies Agreement Articles 6.1(a), 6.3(c), 6.3(d), 6.4, and 6.5 – that expressly mention the "subsidized product". Subsidies to products other than upland cotton would not be within the Panel's terms of reference nor relevant to the Panel's analysis of the effect of the challenged subsidies. Again, Brazil's position would deprive the Panel of a crucial element in determining, for example, whether and to what extent the US product in the same market as the Brazilian product was a subsidized product.

10. Brazil also errs in arguing that it need not attribute payments not tied to production across the recipient's total value of production. The methodology of attributing subsidies not tied to production across the value of a recipient's production is spelled out in Annex IV to Part III of the Subsidies Agreement. Attributing such non-tied payments across the total value of the recipient's production is necessary to avoid double-counting of the subsidy.

11. The United States does not see how decoupled payments made with respect to non-upland cotton base acres would be within the scope of this dispute. Given Brazil's own explanation of the measures it has challenged⁵, it cannot be possible that one set of measures was within the scope of the dispute at one point but that Brazil has the sole discretion to change the scope of that dispute by changing its legal position as to what it is challenging as support to upland cotton.

12. Finally, Brazil says effects of subsidies can linger, even if allocated to a particular year for countervailing duty purposes. It is clear in Annex IV, paragraph 7, that Members took it for granted that some subsidies are allocated to future production and others are not. Brazil, however, does violence to this principle by essentially asserting that all subsidies – including so-called "recurring" subsidies that most experts and national authorities (including its own) would expense to current production – should be allocated to future production. Brazil has now conceded that the subsidies at issue in this dispute are "recurring".⁶ Brazil cannot have it both ways: it cannot expense the entire value of a payment to a particular crop year but also claim that the subsidy continues to exist in a later year in which new recurring subsidies are made.

III. BRAZIL'S HAS FAILED TO SHOW THE EFFECT OF THE CHALLENGED SUBSIDIES

13. **Decoupled Payments.** Brazil has fundamentally erred in its explanation and modelling of decoupled payments by ascribing a production effect to them that is based on little more than conjecture. This assertion contradicts basic economic theory, the economic literature on such payments, and the available data showing large shifts in cotton acreage as recipients of decoupled payments plant alternative crops or no crops at all and other farmers who do not hold upland cotton base acres choose to produce upland cotton.⁷ Thus, there is no basis to ascribe production-distorting

⁵ For example, Brazil has repeatedly argued that the challenged US subsidies provided \$12.9 billion in support over marketing years 1999-2002; this figure was based on payments made under specific programmes, including decoupled income support with respect to upland cotton base acres only. Brazil also has argued that decoupled payments for upland cotton base acres (net of base acres not "planted to cotton") are all support to upland cotton irrespective of what is planted on the land now.

⁶ See Brazil's Further Rebuttal Submission, para. 208 n. 344 ("Brazil agrees that the recurring subsidies at issue would be allocated to the year in which they are paid for purposes of a CVD analysis . . .").

⁷ For example, the marketing year 2002 base acreage increase means that, on average over marketing years 1998-2001, 2.6 million acres of upland cotton were planted on farms without upland cotton base acreage or in excess of those farms' upland cotton base acreage, suggesting that Brazil's theory that upland cotton must be planted on upland cotton base acreage is not supported by the facts.

effects to decoupled payments. In fact, most empirical studies have concluded that the effects of decoupled payments are minimal.⁸

14. **Third-Party Papers.** Brazil cannot cite to results from papers that employ an approach fundamentally at odds with its own. These third-party economic studies do not provide insight into the question this Panel has been asked to examine because they generally suffer from two crucial conceptual flaws. First, most of the cited studies do not distinguish between payments linked to production of upland cotton and payments decoupled from any requirement to produce, instead treating them as having equal production impacts. Second, most of the third party studies do not model the marketing loan programme appropriately, simply removing revenue from the producer without focusing on the producer's expected harvest season price at the time of planting. Thus, Brazil would have to agree that these third party papers do not properly model farmers' production decisions.

IV. BRAZIL HAS ADVANCED ERRONEOUS LEGAL STANDARDS UNDER ITS CLAIM IN THIS DISPUTE

15. **Threat of Serious Prejudice/Article XVI:3.** Brazil may not advance a claim of threat of serious prejudice using the "more than equitable share of world export trade" standard from GATT 1994 Article XVI:3. Nothing in the text of GATT 1994 Article XVI indicates that a threat claim under paragraph 1 may utilize the more than equitable share standard under paragraph 3. Neither is there any analysis in the *EC – Sugar Exports* GATT panel report that provides a textual basis to import that standard. Further, Brazil's interpretation would also introduce a contradiction between GATT 1994 Article XVI:1 and SCM Agreement Articles 5 and 6 even though the term "serious prejudice" is used "in the same sense" in these provisions.⁹

16. **Threat of Serious Prejudice and *Per Se* Serious Prejudice Standard.** Brazil's argument is that "[c]onsistent with prior precedent [the GATT *EC – Sugar Export Subsidies* panel report], the threat of serious prejudice is caused by the absence of any legal mechanism that stems or otherwise controls the flow of mandatory and unlimited US subsidies". The GATT *Sugar Export Subsidies* panel report, however, provided no basis for selecting that standard, and neither we nor Brazil find any basis for that standard in the text of the Subsidies Agreement or GATT 1994 Article XVI:1.

17. Brazil is simply wrong that US payments are "mandatory" and "unlimited".¹⁰ More fundamentally, however, Brazil's argument that "the availability of a mandatory subsidy for an unlimited amount of production and exports will inevitably create a threat and support a finding of a per se violation" proves too much. Brazil's standard means that only way a Member could act consistently with its WTO obligations would be to have a cap on expenditures with respect to a

⁸ A recent study concluded that production flexibility payments had "no effects on agricultural production in either the short run or the long run". USDA, ERS, *Decoupled Payments: Household Income Transfers in Contemporary US Agriculture*, M.E. Burfisher and J. Hopkins, Eds. (February 2003), at 23. (See Exhibit US-53). Other studies cited in Exhibit US-23 and discussed in the US rebuttal and further rebuttal submissions suggest that the effects of decoupled payments on planted area are less than 0.5 per cent.

⁹ Under Articles 5 and 6 a Member cannot claim threat of serious prejudice using the "more than equitable share" standard because that standard is not enumerated in SCM Agreement Article 6.3(c). Therefore, under Brazil's interpretation, a Member could show a threat of "serious prejudice" (under GATT 1994 Article XVI:1) by showing a threat of something that is not "serious prejudice" within the meaning of Articles 5 and 6.

¹⁰ The payments Brazil identifies as "mandatory" are "mandatory" only if price conditions are fulfilled. Thus, the *likelihood* that price conditions will be satisfied must be taken into account. The payments Brazil identifies are also not "unlimited". For decoupled payments, the payments are set by multiplying fixed base acres times fixed base yields times the fixed or statutory maximum payment rate. The challenged payments are also not unlimited because a "circuit breaker" in the 2002 Act could result in these "mandatory" payments not being made.

particular product. It is not at all clear at what level such a cap would have to be set. But Members rejected product-specific expenditure caps in the Uruguay Round, instead agreeing on a commitment across *all* commodities (the Total and Final Aggregate Measurement of Support).

V. BRAZIL'S SUBSIDIES AND PEACE CLAUSE ARGUMENTS MUST BE CONSISTENT

18. Brazil's arguments in this dispute must be consistent. First, it is evident that Brazil has conceded that various payments it previously claimed were product-specific – namely, decoupled income support and crop insurance – are, in fact, non-product-specific support. That is, these subsidies are provided to "agricultural producers in general", either because they do not specify any production that must occur for receipt of payment or because they are provided to producers of a wide range of products.¹¹ As non-product-specific support, they should not be included in the comparison under Article 13(b)(ii) of the Agreement on Agriculture. This contradicts the Brazilian approach, and is consistent with the US approach, to the Peace Clause.

19. Second, Brazil not only recognizes that support to upland cotton *may* be measured in terms of a rate but also that this is the only way to gauge the support decided by the United States for future years; therefore, Brazil relies on the rate of support concept for its threat and *per se* claims.¹² By advancing such arguments, Brazil has effectively conceded the basis for the US Peace Clause analysis – that is, that the only way for Members to know whether US measures for any given year will comply with Peace Clause requirements is to examine the way in which they "decide" support: that is, the rate of support. If Brazil makes arguments under its subsidy claims based on the rate of support, it cannot credibly assert that the rate of support is inapt in the context of the Peace Clause. As demonstrated during the Peace Clause phase, the United States disciplined itself to remain within those limits by deliberately moving away from production-linked deficiency payments with a high target price to decoupled income support.

¹¹ For example, if a recipient of decoupled income support can choose to produce cotton, something else, or nothing at all, the payment is not tied to production of a particular product. There is nothing in the Agreement on Agriculture to suggest that support may be at one and the same time "product-specific support" and "non-product-specific support". Thus, in attributing part of the decoupled payments on upland cotton base acres to producers and part to non-producers, Brazil concedes that such payments are non-product-specific support.

¹² Brazil's Further Submission, para. 432 ("When US upland cotton farmers plant their crop in spring, farmers expect a certain price level. But, by no means is it ensured that this price level will be accomplished. However, given the US subsidies, that is irrelevant. . . . *The single fact that these programmes exist ensures a guaranteed revenue amount from the production of upland cotton.*") (italics added).

ANNEX H-4

EXECUTIVE SUMMARY CLOSING STATEMENT OF THE UNITED STATES AT THE SECOND MEETING OF THE PANEL WITH THE PARTIES

I. CCC EXPORT CREDIT GUARANTEE PROGRAMMES ISSUES

A. BRAZIL WRONGLY MINIMIZES THE SIGNIFICANCE OF ARTICLE 10.2 OF THE AGREEMENT ON AGRICULTURE

1. Brazil's assertions in its opening oral statement regarding the CCC export credit guarantee programmes invite a brief response.

2. First, as discussed with the Panel during this meeting, Brazil asserts that Article 10.2 of the Agreement on Agriculture reflects merely a banal compromise to accommodate potential "additional obligations regarding notification, consultation, and information exchange". Brazil implausibly asserts that the obvious transition between the language of the Draft Final Act that would have imposed significant substantive disciplines on export credit guarantees and the absence of such language in the Article 10.2 ultimately adopted can be fully explained as reflecting merely an agreement to work on such pedestrian disciplines as information exchange.

3. Brazil asserts that the Members had agreed on the applicability of export subsidy disciplines to export credit guarantees and that Article 10.2 was an apparently insignificant "good faith agreement". However, Article 10.2 did not arise only because "other participants were not willing to offer more than general disciplines included in Article 10.1". It arose because part of the grand compromise of the Agreement on Agriculture was that export credit guarantees were excluded from the export subsidy disciplines.

4. Ironically, however, Brazil's statement further serves to illustrate that export credit guarantees were *not* considered export subsidies under the Agreement on Agriculture. In December 1994, the Preparatory Committee for the World Trade Organization issued *Notification Requirements and Formats Under the WTO Agreement on Agriculture*.¹ These notification requirements remain in effect. Elaborate reporting requirements are set forth for Members with respect to numerous aspects of the disciplines of the agreement, including with respect to export subsidies.² However, no reporting requirement is indicated for export credit guarantees. This is consistent with treatment of such programmes as outside export subsidy disciplines. Had the parties agreed that all were "willing to offer" at least "the general disciplines included in Article 10.1", as Brazil asserts, then it would have been logical to include reporting requirements for such purposes. It is hard to imagine parties willing to make such an offer in the absence of the United States, among the largest providers of export credit guarantees. In fact, the United States never offered to include export credit guarantees in Article 10.1, and the Members never so agreed. Indeed, the agreement reflected in Article 10.2 is expressly to the contrary.

5. Article 10.2, furthermore, would be unnecessary for mere "notification, consultation, and information exchange". Had export credit guarantees been subject to export subsidy disciplines,

¹ PC/IPL/12, circulated 2 December 1994 (exhibit US-99).

² See, e.g., Exhibit US-99, paras. 1(c), 1(e), 1(i), 2; Table ES:1 and Supporting Tables ES:1 and ES:2.

Article 18 of the Agreement on Agriculture, to review the progress in the implementation of commitments negotiated under the Uruguay Round reform programme, and the Notification Requirements, which are still in effect, could amply accommodate any "notification, consultation, and information exchange".³

B. BRAZIL INVENTS A STANDARD NOT REQUIRED UNDER ARTICLE 10.3 OF THE AGREEMENT ON AGRICULTURE

6. Second, with respect to Article 10.3 of the Agreement on Agriculture, Brazil asserts that the only way for the United States to satisfy any burden applicable under that provision is "to demonstrate the absence of subsidization on a transaction-by-transaction basis". Such a standard would obviously be impossible to satisfy. Perhaps more importantly, Article 10.3 requires no such demonstration. Brazil simply invents this. The only authority it offers for this novel proposition is a Third Party Submission of Canada, which itself offers no authority for the assertion.

7. Article 10.3 applies only to export subsidy *reduction* commitments. We believe that Brazil agrees at least with that. Brazil has alleged that the United States has exceeded only its quantitative export subsidy reduction commitments and only during the period July 2001-June 2002. The United States has demonstrated that with respect to 12 of the 13 commodities for which the United States has reduction commitments the respective exports during that period under the export credit guarantee programme did not exceed applicable quantitative reduction commitments. Other than the Dairy Export Incentive Programme applicable to cheese and skim milk powder, with respect to which the United States previously noted in a prior submission the issuance of export subsidies, the United States provided no export subsidies for the other scheduled commodities. To avoid any further ambiguity the United States submits a copy of its notification concerning export subsidy commitments for fiscal year 2001, which reflects no export subsidies provided by the United States other than for cheese and skim milk powder.⁴

C. BRAZIL'S RECENT STATEMENTS CONCERNING THE CORRECT ANALYSIS UNDER ITEM(J) ARE INCONSISTENT AND INCORRECT

8. Third, with respect to item (j) Brazil directly acknowledges its view that the relevant period of time for examination is 10 years.⁵ Yet Brazil disingenuously urges the Panel to examine allegedly "uncollectible amounts" on pre-1992 guarantees, and defaults of Iraq and Poland, which commenced in 1990 and the 1980's, respectively.⁶

9. Brazil also mysteriously alleges that "according to CCC's 2002 financial statements, CCC has been relieved of what the United States argues are onerous government-wide accounting rules that 'compel' projection of enormous losses". CCC, however, has never been so "relieved". It remains compelled to adhere to the requirements of the federal Credit Reform Act of 1990, and relevant provisions of the Office of Management and Budget Circular A-11, implementing that legislation. CCC remains subject to government-wide requirements for subsidy estimates and the risk categories mandated by OMB with respect to exposure to debt from different countries. The government-wide rules continue to dictate the methodology for calculation of estimates, and reestimates, and as the United States has previously noted, a principal reason for overly high initial estimates is continuously overly optimistic projections of programme use. Also, as the United States has previously noted, the result of the estimate (and reestimate) process is simply carried forward to the CCC financial statements; Brazil continues to misrepresent the \$411 million figure in the 2002 financial statement

³ See, e.g., Article 18.5, 18.6, and 18.7.

⁴ *Notification*, G/AG/N/USA/47, circulated 6 June 2003 (exhibit US-100).

⁵ Statement of Brazil - Second Panel Meeting (2 December 2003), para. 81.

⁶ Statement of Brazil - Second Panel Meeting (2 December 2003), para. 84.

as well as to mistakenly assert the inclusion of "enormous uncollectible amounts . . . on post-1991 guarantees".

D. BRAZIL CONTINUES TO WRONGFULLY ASSERT THAT THE ISSUANCE OF CCC EXPORT CREDIT GUARANTEES IS UNBOUNDED

10. Fourth, with respect to Brazil's circumvention arguments, Brazil continues to insist that notwithstanding the myriad programmatic impediments to issuance of guarantees the export credit guarantee programmes are a runaway train, beyond the ability of CCC to "stem or otherwise control the flow of" CCC export credit guarantees. With respect, this is simply not so.

11. Similarly, in its oral statement, Brazil has increased the supposed annual mandatory minimum dollar amount of guarantees to \$6.5 billion from \$5.5 billion.⁷ As the United States has previously observed, CCC has never remotely approached issuing any such fancifully large amount of export credit guarantees.⁸

II. ACTIONABLE SUBSIDY ISSUES

12. The United States has reviewed Brazil's evidence and arguments underlying Brazil's actionable subsidy claims and found them lacking. We will not repeat our criticisms of fundamental errors in Brazil's legal interpretations. We do note that the evidence on the record does not demonstrate that US producers are unresponsive to market price signals, does not demonstrate significant price suppression in any "same market", does not demonstrate an increase in world market share, and does not demonstrate a threat of serious prejudice. Our comments today go principally to the consistency, or lack thereof, in Brazil's arguments.

A. BRAZIL HAS FAILED TO ESTABLISH ALL OF THE ELEMENTS NECESSARY TO ESTABLISH ITS SUBSIDIES CLAIMS

13. Consider the fundamental issue of identifying the subsidized product and the subsidy.

1. Brazil has not identified which products benefit from the subsidy

14. If Brazil cannot distinguish the benefit to cotton provided by a subsidy from the benefit to other products – that is, attribute the subsidy to the recipient's production – then it will lead to double-counting of the subsidy benefit. Recall the example the United States provided in the opening statement with respect to soybeans and cotton. If a producer grows both soybeans and cotton and receives a \$1 payment not tied to the production of any crop, according to Brazil's approach, the *entire* \$1 payment is attributed to and support for upland cotton. However, were Brazil to bring a dispute settlement proceeding against US support for soybeans (as was reported almost occurred roughly two years ago), under Brazil's approach, the entire \$1 payment would *also* be support for soybeans. The same \$1 payment cannot provide both \$1 in benefit to cotton and \$1 in benefit to soybeans – that's double-counting. Therefore, the payment must be attributed across the value of the recipient's production. As noted in the US further rebuttal submission, Brazil *would* attribute the value of the payment across all of a recipient's production for countervailing duty purposes.

⁷ Compare Statement of Brazil - Second Panel Meeting (2 December 2003), para. 91, with Answer of Brazil to Panel Question 142 (October 27, 1993) paras. 95, 100.

⁸ US Further Rebuttal Submission (18 November 2003), para. 201.

2. Brazil has not quantified the subsidy benefit attributable to upland cotton

15. If Brazil cannot properly quantify the amount of subsidy benefit to upland cotton producers, how can the Panel analyze the effect of the subsidy? Brazil cannot both claim that it need not quantify the benefit and at the same time argue that the subsidies provide \$12.9 billion in aggregate support.

16. Similarly, if Brazil cannot properly identify the level of subsidization of the exported product, the Panel's analysis will be impacted. Again, Brazil cannot claim that it need not identify the subsidization rate and at the same time claim a 95 per cent subsidization rate over the 1999-2002 marketing year period.

3. Brazil has not expensed the recurring payments at issue, contrary to its countervailing duty practice and inconsistent with its arguments in this dispute

17. Finally, Brazil cannot both expense the *entire* amount of these subsidies it admits are "recurring" to the year for which the payment was received (for example, marketing year 1999) and *also* claim that the subsidy continues to exist in a later year in which new recurring subsidies are made (for example, marketing year 2002). That is, if the subsidy continues to exist in a later year, it *must* have been allocated to future production. Indeed, Brazil would expense these recurring payments for purposes of countervailing duties.

18. The Panel must demand consistency from Brazil. It is not enough for Brazil to say that those concepts are for countervailing duty purposes, not for serious prejudice purposes. We were not aware that the concept and definition of "subsidy" as used in Part III and Part V of the Subsidies Agreement were intended to have different meanings. In fact, there is nothing in the Subsidies Agreement to suggest that they should mean different things.

19. Brazil not only rejects the Subsidies Agreement Annex IV methodology with respect to these issues, and not only rejects its own countervailing duty methodology, but does not provide any rational method of approaching these issues. Brazil's approach results in dramatically inflated quantities of support and dramatically inflated levels of subsidization. The Panel should reject Brazil's unprincipled approach to subsidy identification issues.

B. BRAZIL'S APPROACH TO ITS SERIOUS PREJUDICE CLAIMS AND THE PEACE CLAUSE MUST BE CONSISTENT

20. Similarly, as indicated in the US opening statement, the Panel must demand consistency from Brazil between its arguments for purposes of serious prejudice and the Peace Clause. First, Brazil cannot rely on the *rate* of support in US law and regulations for purposes of its threat and *per se* claims and *deny* their relevancy to the Panel's Peace Clause analysis.

21. Second, with respect to decoupled payments (such as direct payments), Brazil cannot attribute part of a decoupled payment to upland cotton producers and part to non-producers, and *simultaneously* claim that such decoupled payments are not non-product-specific support. They are non-product-specific support because they are (in the language of Article 1(a) of the Agreement on Agriculture) "support provided to agricultural producers in general" and because they are not (in the language of Article 1(a)) "support provided *for an agricultural product* in favour of the producers of an agricultural product". That is, Brazil has acknowledged that some recipients of, for example, direct payments are not producers of upland cotton; they are, rather, "producers in general". Under the Agreement on Agriculture, support (such as direct payments) cannot at the same time be both product-specific support and non-product-specific support. Thus, these payments would not form part of the Peace Clause (Article 13(b)(ii)) analysis.

22. Finally, it is clear that, under Brazil's approach, there can be *no* non-product-specific support for purposes of the Peace Clause. This results because a subsidy payment can always be traced to a final recipient and then can always be attributed to whatever products he or she produces. One problem with this result is that a Member can then have no certainty that it will be in compliance with the Peace Clause in any given year.

23. Consider a hypothetical: under Brazil's outlay approach to the Peace Clause, if a Member gave only decoupled support to producers, but in a given year all the recipients of the payment decided *only* to produce one commodity, the support (outlays) attributed to that commodity in that year could exceed the 1992 support level. But that would purely be a function of the recipients' decisions, not the decision of the United States. Brazil's approach therefore would rob Members of the ability to decide their support in a way to ensure conformity with Peace Clause requirements, and it must be rejected.
