

## ANNEX A

### INITIAL BRIEFS OF PARTIES AND THIRD PARTIES

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## ANNEX A-1

### BRAZIL'S BRIEF ON PRELIMINARY ISSUE REGARDING THE "PEACE CLAUSE" OF THE AGREEMENT ON AGRICULTURE

5 June 2003

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#### **I. INTRODUCTION AND SUMMARY**

1. Brazil responds to the Panel's 28 May 2003 request for a briefing on the following issue:

*Whether Article 13 of the Agreement on Agriculture precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled.<sup>1</sup>*

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<sup>1</sup> The Panel also "invites the parties to explain their interpretation of the words 'exempt from actions' as used in Article 13 of the Agreement on Agriculture, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue."

2. The short answer to this question is “no”. There is no procedural rule or legal requirement for a panel to make such a preliminary finding. The phrase “exempt from actions” in Article 13(b)(ii) and 13(c)(ii) of the Agreement on Agriculture (AoA) means that *if all* the conditions of Article 13(b)(ii) and 13(c)(ii) are fulfilled (i.e., there is peace clause protection), a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member’s domestic and export support measures that otherwise would be subject to the disciplines of certain provisions of the Agreement on Subsidies and Countervailing Measures (ASCM or SCM Agreement) or Article XVI of GATT 1994. But neither the phrase “exempt from actions” nor AoA Article 13 compel the Panel to *first* make a peace clause finding before considering the substance of Brazil’s ASCM and GATT Article XVI claims.

3. Article 13 of the Agreement on Agriculture is not a “special and additional” rule set out in Appendix 2 to the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). Article 19 of the AoA makes all DSU provisions applicable to the AoA. Pursuant to DSU Article 11, a panel must make an “objective assessment of the facts of the case”. Assessing and weighing all relevant facts – including rebuttal facts – obtained during the normal two meeting panel process is essential to resolve properly fact-intensive issues relating to the peace clause. This Panel should follow the lead of previous panels that made similar complex threshold findings in final panel reports.

4. Brazil will be prejudiced by delays in the process because a number of Brazil’s claims are not dependent on any resolution of the “peace clause”. Much of the proof required for demonstrating that the US has no peace clause protection under Articles 13(b)(ii) and 13(c)(ii) is the same evidence demonstrating US violations under the SCM Agreement. Requiring separate briefings, hearing, presentation of factual evidence and legal argument for such inter-connected “peace clause” issues would seriously disrupt Brazil’s presentation of its evidence, lead to duplication of its efforts, delay the proceeding, and increase Brazil’s financial and human resource costs.

## II. ANALYSIS OF THE PHRASE “EXEMPT FROM ACTIONS”

1. The Panel has requested that Brazil address the meaning of the phrase “exempt from actions” in AoA Article 13. In the view of Brazil, this phrase means that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member’s domestic or export support measures that otherwise would be subject to the disciplines of certain ASCM and GATT 1994 provisions if those measures are in compliance with the various peace clause provisions. It does not mean that a Panel may not hear evidence or consider Brazil’s ASCM or GATT 1994 claims while it decides whether all the peace clause conditions have been fulfilled. In sum, this phrase in no way suggests that a panel must make a finding that the peace clause provisions are unfulfilled before proceeding with the other claims.

2. The phrase “exempt from actions” is used, as relevant to this dispute, in AoA Articles 13(a), 13(b)(ii), and 13(c)(ii). The dictionary definition of “actions” is “the taking of legal steps to establish a claim or obtain a remedy.”<sup>2</sup> In a multilateral system such as the WTO (like GATT 1947<sup>3</sup> before it), “actions” are taken collectively by Members. DSU Article 2.1 (last sentence) emphasizes this notion

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<sup>2</sup> New Shorter Oxford Dictionary, Volume 1 (1993 Edition), at 22.

<sup>3</sup> Article XXV of GATT 1994 provides for “joint action” by the contracting parties to “further the objectives of this Agreement”. The decision by the contracting parties to approve the Tokyo Round results in 1979 was entitled “Action by the CONTRACTING PARTIES on the Multilateral Trade Negotiations”. BISD 26S/201.

in stating that “only those Members that are parties to that Agreement may participate in decisions or *actions* taken by the DSB with respect to that dispute.” (emphasis added) “Actions” include decisions made by the Dispute Settlement Body (DSB) to adopt rulings and recommendations of panels and the Appellate Body. Article XVI:1 of GATT 1994 also provides for another action, a decision by the relevant WTO body to hold consultations with a subsidizing Member to discuss what steps that Member will take to remove the serious prejudice or threat caused by its subsidies.<sup>4</sup> And “actions” also include the enforcement of remedies authorized by the DSB pursuant to DSU Article 22. In sum, “actions” are multilaterally agreed decisions of WTO bodies including the DSB.

3. The ordinary meaning of the word “exempt” is “grant immunity or freedom from liability to which others are subject”.<sup>5</sup> The chapeau of Article 13 states that the period of exemption is “during the implementation period”, *i.e.*, until 1 January 2004.

4. Combining these definitions of “actions” and “exempt,” the term “exempt from action” in Article 13(b)(ii) means that before 1 January 2004, a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member’s domestic support measures that otherwise would be subject to the disciplines of Article XVI:1 and ASCM Articles 5 and 6. And “exempt from action” in the context of Article XVI:1 would mean that the WTO could not take a decision to require a Member to consult with the WTO on how the Member will eliminate serious prejudice or the threat of serious prejudice caused by that subsidy. However, the immediate context of the phrase “exempt from actions” in Articles 13(a), 13 (b)(ii) and 13(c)(ii) make clear that the “exemption” is not *absolute* but rather subject to a number of conditions:

- Article 13(a) only permits green box domestic subsidies to be exempt from the types of determinations listed in Article 13(a) (i), (ii) or (iii) if they “conform fully to the provisions of Annex 2” of the AoA. If a domestic support measure does not comply with one of a number of requirements of the “green box” provisions of Annex 2, then such domestic support would be evaluated under the peace clause provisions of Article 13(b) and could be subject to a remedy determination by the DSB and/or the WTO.
- Under the provisions of peace clause Article 13(b)(ii), “amber” and “blue” box domestic support measures provided during any marketing year between 1995-2003 are only exempt from determinations by the DSB and/or the WTO relating to paragraph 1 of Article XVI of GATT 1994 (not Article XVI, paragraph 3) and Articles 5 and 6 (not Article 3) of the SCM Agreement “provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year”. If the quantity of amber and/or blue box support granted in any marketing year from the 1995-2003 period is greater than that decided during marketing year 1992, then the subsidy programme is not “exempt” from such determinations.
- Export subsidies under the peace clause provisions of AoA Article 13(c)(ii) are only exempt from determinations by the DSB and/or the WTO relating to Article XVI of GATT 1994 or Articles 3, 5 and 6 of the SCM Agreement *if* they “conform fully to the provisions of Part V of [the AoA]”. Thus, if export subsidy measures are inconsistent with the provisions of AoA Articles 8, 9 or 10, then they are no longer exempt from such determinations.

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<sup>4</sup> See, *e.g.*, Report of the Working Party on Article XVI:1 discussions on *EC- Refunds on Exports of Sugar*, BISD 28S/80.

<sup>5</sup> New Shorter Oxford Dictionary, Volume 1 (1993 Edition), at 878.

5. In sum, “exempt from actions” means that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member’s domestic or export support measures that are “peace clause” protected. Yet, as described below, the phrase “exempt from actions” when viewed in the broader context of DSU provisions *does not require* the Panel to *first* make a peace clause compliance finding before hearing or considering any of the evidence or arguments relating to the various ASCM or GATT 1994 claims.

**III. THE CONTEXT OF ARTICLE 13 DEMONSTRATES THAT THERE IS NO LEGAL REQUIREMENT FOR THE PANEL TO FIRST MAKE A FINDING ON THE PEACE CLAUSE BEFORE PERMITTING BRAZIL TO SET OUT ITS ARGUMENT AND CLAIMS REGARDING US VIOLATIONS OF THE SCM AGREEMENT**

1. There is nothing in the text of Article 13 or other provisions of the AoA, the SCM Agreement, or any other WTO Agreement *requiring* the Panel to make a preliminary factual and legal finding on the applicability of the peace clause before examining Brazil’s evidence and argument regarding US violations of the SCM Agreement or GATT 1994.

2. First, and most importantly, Annex 2 of the DSU Agreement is the closed list of “special and additional” rules and procedures that trump the normal rules of dispute settlement. This list does not include Article 13 or any other AoA provisions. Thus, resolution of the “peace clause” issues, like other issues raised by Brazil’s request for establishment of a panel, must be resolved using normal DSU rules and procedures.

3. Second, AoA Article 13 does not exclude AoA Article 19 which states that the “provisions of Articles XXII and XXIII of GATT 1994, as elaborated and applied by the Dispute Settlement Understanding, shall apply to consultations and *the settlement of disputes under this Agreement*” (emphasis added). Among the DSU procedures applicable to AoA Article 13 is DSU Article 11 which provides, in part:

[a] panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements.

4. Article 11 contemplates that a panel must make an “objective assessment of the facts of the case”. It does not state that a panel must conduct such an assessment by first examining *part* of the facts of a case before it then examines *other* facts. Further, Article 11 contemplates that the parties will have the full opportunity to search for and present rebuttal facts. This is accomplished through the normal two meeting panel process – not in a single truncated meeting. It is also accomplished through the exchange of rebuttal submissions.

5. Review by a panel of all the facts including rebuttal facts is necessary *before* deciding whether the peace clause is applicable or not. This follows from the inter-related nature of the proof necessary to demonstrate the peace clause and ASCM actionable and prohibited export subsidy claims. As the Panel will discover shortly upon reviewing Brazil’s First Submission, the facts relevant to the application of the “peace clause” largely overlap with facts relevant to determining whether the programmes at issue are “actionable” or “prohibited export subsidies”. Consider the following:

- Each of the domestic support subsidies at issue in Brazil's actionable subsidy claims are also at issue in Brazil's proof regarding the absence of US peace clause protection for marketing years 1999-2002. For the purposes of AoA Article 13(b)(ii) the "amber" box subsidies include marketing loan/loan deficiency payments; crop insurance payments; Step-2 payments; production flexibility contract payments; direct payments; marketing loss assistance payments; counter-cyclical payments, and cottonseed payments. Proof of both peace clause and actionable subsidies require the same detailed descriptions of the type, nature, extent, and history of each of these US domestic support programmes.
- Brazil has made claims under the AoA and the ASCM regarding prohibited export subsidies under the US Step-2 programme and US export credit guarantee programmes. Brazil will demonstrate that these two export subsidies do not "conform fully to the provisions of Part V of this Agreement" in the sense of AoA Article 13(c); obviously, Brazil's evidence and argument regarding the lack of conformity of these two measures with Part V of the AoA largely overlaps with the evidence and argument necessary to demonstrate a violation of ASCM Articles 3.1(a) and (b).

6. This close overlap of proof for both peace clause and actionable and prohibited subsidy claims highlights the need for the Panel to examine all the "facts of the case" together – including rebuttal facts presented by Brazil to contest US assertions. Such a determination can only be made after collecting information in an iterative process.

7. DSU Article 11 also requires a panel to consider the "applicability" of the "relevant covered agreements". This includes deciding whether actions are exempt from the *covered* agreements. But Article 11 contains no requirement for a special briefing, meeting or determination by a panel to resolve such applicability or exemption.

8. Of course, when fulfilling its obligations under DSU Article 11, the Panel may well need to organize its assessment of the facts in its final determination by first examining and deciding issues related to the peace clause. The Appellate Body in *Brazil Aircraft* held that this is what the panel should have done in deciding the very similar peace-clause-like issues under ASCM Articles 27.2(b) and 27.4.<sup>6</sup> But there is nothing in DSU Article 11 or any other WTO provision mandating that Brazil present its evidence relating to the peace clause alone, divorced from factual evidence and argument relating to the SCM Agreement. As described below, such a requirement would be inconsistent with the previous practice of panels and prejudicial to Brazil's efforts to make a coherent and unified presentation of its case.

#### **IV. RESOLUTION OF THRESHOLD ISSUES PRIOR TO PROVIDING PARTIES THE OPPORTUNITY TO PRESENT ALL OF ITS EVIDENCE IS CONTRARY TO THE PRACTICE OF EARLIER PANELS**

1. Many panels have faced preliminary threshold issues under DSU Article 6.2 and other WTO Agreements. These preliminary issues have involved whether panels have the jurisdiction to resolve and make recommendations concerning certain claims and measures. Many of these preliminary issues involved far less complex facts than are presented by the peace clause in this dispute. Despite this, many panels waited to resolve these threshold jurisdictional issues until the final determination

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<sup>6</sup> Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R (adopted 2 August 1999), paras. 143-44.

after reviewing all the evidence and arguments.<sup>7</sup> Other panels have decided these threshold issues after the first meeting of the panel with the parties where the complaining party had an opportunity to present its evidence.<sup>8</sup>

2. The closest case to the peace clause issue presented here was addressed in *Brazil – Export Financing Programme for Aircraft*<sup>9</sup> That dispute involved Articles 27.2(b) and 27.4 of the SCM Agreement, which exempts certain developing country Members from obligations under ASCM Article 3.1(a) provided that such a Member has complied with certain stated conditions.<sup>10</sup> The Appellate Body discussed the application of this peace-clause-like provision in *Brazil Aircraft*.<sup>11</sup>

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<sup>7</sup> WTO Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R (adopted 20 August 1999), para. 9.15 (Panel rejected request for preliminary ruling based claims under DSU Article 6.2 and decided issues in final report); WTO Panel Report, *Egypt – Definitive Anti-Dumping Measures on Steel Rebar from Turkey*, WT/DS211/R (adopted 1 October 2002), para. 7.27-7.31 (Panel determined in final report that certain claims were not within its terms of reference); WTO Panel Report, *India – Measures Affecting the Automotive Sector*, WT/DS146/R and WT/DS175/R (adopted 5 April 2002), paras. 7.44-7.103 (Panel rejected India's threshold *res judicata* claims in final panel report); WTO Panel Report, *United States – Anti-Dumping Duty and Dynamic Random Access Semiconductors (DRAMs) of One Megabit or more From Korea*, WT/DS99/R (adopted 19 March 1999), para. 6.17 (Panel ruled in final report granting US's preliminary objections that certain AD measures predated the WTO and could therefore not be subject to challenge); WTO Panel Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/R, WT/DS10/R and WT/DS11/R (adopted 1 November 1996), para. 6.5 (Final report determined that a claim was outside of the Panel's terms of reference); WTO Panel Report *United States – Definitive Safeguard Measures on Circular Welded Carbon Quality Line Pipe from Korea*, WT/DS202/R (adopted 8 March 2002), para. 7.121-7.126 (Panel rejected a Korean claim as beyond its terms of reference in the final panel report); WTO Panel Report, *United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan*, WT/DS184/R (adopted 23 August 2001), para. 7.22 (final report determined that the “adverse facts available” claim was beyond its terms of reference).

<sup>8</sup> WTO Panel Report, *European Communities – Anti-Dumping Duties on Malleable Cast Iron Tube or Pipe Fittings from Brazil*, WT/DS219/R (not yet adopted), para. 7.14 (preliminary finding made following first meeting with the parties that certain claims were not within its terms of reference); WTO Panel Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WTDS213/R (adopted 19 December 2002), para. 8.1 –8.2 and footnote 224 (Panel decided at end of first meeting that two claims were outside its terms of reference and provided reasoning in final Panel report); WTO Panel Report, *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/R (adopted 10 January 2001), para. 6.11 (Panel issued preliminary ruling regarding scope of measures within its terms of reference at the end of the second meeting with the parties); WTO Panel Report, *United States – Safeguard Measures on Imports of Certain Fresh, Chilled and Frozen Lamb from New Zealand and Australia*, WT/DS177/R and WT/DS178/R (adopted 16 May 2001), para. 5.15 (Panel ruled during first meeting that panel request was sufficient in covering all the claims brought by Australia and New Zealand).

<sup>9</sup> WTO Panel Report, WT/DS46/AB/R (adopted 2 August 1999).

<sup>10</sup> These provisions provide as follows:

27.2: The prohibition of paragraph 1(a) of Article 3 [prohibited export subsidies] shall not apply to:

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(b) other developing country Members for a period of eight years from the date of entry into force of the WTO Agreement, subject to compliance with the provisions in paragraph 4.

27.4: Any developing country Member referred to in paragraph 2(b) shall phase out its export subsidies within the eight-year period, preferably in a progressive manner. However, a developing country Member shall not increase the level of its export subsidies, and shall eliminate them within a period shorter than that provided for in this paragraph when the use of such export subsidies is inconsistent with its development needs. . .

<sup>11</sup> Appellate Body Report, WT/DS46/AB/R (adopted 2 August 1999).

In our view, too, paragraph 4 of Article 27 provides certain obligations that developing country Members must fulfill if they are to benefit from this special and differential treatment during the transitional period. . . . If a developing country Member complies with the obligations in Article 27.4, the prohibition on export subsidies in Article 3.1(a) simply does not apply. . . . If [. . .] non-compliance is demonstrated, then, and only then, does the prohibition of Article 3.1(a) *apply* to that developing country Member.<sup>12</sup> (*emphasis added*)

3. The Appellate Body found that the panel should have considered first the threshold issue of whether Brazil was in compliance with Article 27.4 before deciding whether Brazil was in violation of ASCM Article 3.1(a).<sup>13</sup> Yet, there was never a suggestion or finding that the Panel erred by not conducting a special briefing and special determination *before* even accepting arguments of Brazil and Canada regarding the ASCM Article 3.1(a) issue. A finding on the threshold issue in that case, as here, was conditioned upon other crucial determinations such as: the definition of subsidy; the moment when a subsidy was granted; the relevant level, etc. In that case, the threshold issue was decided by the Panel in the final report only after the parties had a chance to discuss all the related issues during the full course of the Panel proceedings.

4. There are a number of other threshold issues in WTO Agreements. No claim may be brought against a measure under the General Agreement on Trade in Services (GATS) unless the measure falls within the scope of the General Agreement on Trade in Services as defined in GATS Article I. No claim may be brought under Article 2 of the Agreement on Technical Barriers to Trade except in respect of a measure that is a “technical regulation” as defined by that agreement. Claims under the Agreement on Government Procurement may only be brought concerning procurement of an entity covered by Annex I of that agreement. While the language of these provisions differs, the effect is the same as the operation of the AoA Article 13 and ASCM Articles 27.2(b) and 27.4 – if the threshold objections are granted, the Panel cannot make a finding that the defending Member has acted contrary to the covered agreements. Yet none of these provisions have special and additional rules to provide for extraordinary preliminary briefings, meetings, and determinations prior to a panel hearing all of the claims presented.

## **V. BRAZIL WILL BE PREJUDICED BY SEPARATE HEARINGS AND BRIEFINGS ON THE PEACE CLAUSE ISSUE**

1. Brazil has previously described in its letter of 23 May 2003 to the Panel the prejudice that will occur if special meetings and briefings are imposed to resolve peace clause issues. Such prejudice includes requiring Brazil to present the *same* evidence three – not two times – and in having to bring its legal and economic experts to Geneva for an extra meeting.

2. In addition, Brazil would note that such special proceedings would cause it prejudice because there would be significant delays in the resolution of its claims – many of which do not implicate the peace clause. These non-peace clause claims include the following:

1. Article XVI:3 of GATT 1994 involving all domestic and export subsidies challenged by Brazil;
2. Article III:4 of GATT 1994 regarding Step-2 domestic payments;

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<sup>12</sup> Appellate Body Report, WT/DS46/AB/R, paras. 140-41 .

<sup>13</sup> Appellate Body Report, WT/DS46/AB/R, paras. 143-44.



1. Articles 3.1(b) and 3.2 of SCM Agreement regarding prohibited local content Step-2 domestic payments;
  2. Articles 3.3 and 9.1(a) of the AoA regarding export subsidies including Step-2 export payments;
  3. Articles 8 and 10.1 of the AoA regarding the GSM 102, GSM 103, and SCGP export credit guarantee programmes;
  1. Articles 8 and 10.1 of the AoA regarding ETI measure (FSC replacement measure).
3. Moreover, Brazil's proof of these claims involves evidence overlapping with that relevant to Brazil's peace clause claims, as well as with its actionable and prohibited export subsidy claims. Given this overlap, a special proceeding on only the peace clause would negatively impact on Brazil's ability to present a coherent and unified presentation of its case.

## **VI. CONCLUSION**

1. For the reasons set forth above, Brazil requests that this Panel find that it is not precluded from hearing evidence and considering Brazil's claims under the ASCM or Article XVI of GATT 1994 without first concluding that the peace clause conditions of AoA Article 13(b)(ii) and 13(c)(ii) remain unfulfilled.

## ANNEX A-2

### INITIAL BRIEF OF THE UNITED STATES ON THE QUESTION POSED BY THE PANEL

5 June 2003

#### A. INTRODUCTION

1. The United States thanks the Panel for this opportunity to comment on the question concerning Article 13 of the *Agreement on Agriculture* ("Agriculture Agreement") posed by the Panel in its fax of 28 May 2003. The Panel asked the parties to address:

[W]hether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions in Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue.

2. Article 13 (the "Peace Clause") precludes the Panel from considering Brazil's claims under Article XVI of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") and the *Agreement on Subsidies and Countervailing Measures* ("Subsidies Agreement") since the US support measures at issue conform with the Peace Clause. The Peace Clause "exempt[s]" conforming support measures "from actions based on" the corresponding provisions of the Subsidies Agreement and the GATT 1994.<sup>1</sup> Read in accordance with the customary rules of interpretation of public international law, the phrase "exempt from actions" means "not exposed or subject to" a "legal process or suit" or the "taking of legal steps to establish a claim". Therefore, Brazil cannot maintain any action – and the United States cannot be required to defend any such action – based on provisions specified in the Peace Clause<sup>2</sup> since the US support measures for upland cotton conform to the Peace Clause. In light of the correct interpretation of the Peace Clause, the United States respectfully requests the Panel to organize its procedures to first determine whether Brazil may maintain any action based on provisions exempted by the Peace Clause.

3. Consider the alternative approach proposed by Brazil in its 23 May letter – that is, requiring the United States to defend the substantive claims at the same time as arguing the Peace Clause issues. If the Panel were to allow Brazil to proceed with its substantive claims under the Subsidies Agreement and GATT 1994 now, and only conclude later (for example, at the time of the issuance of its report) that the US measures at issue conform to the Peace Clause based on the facts of this dispute, US measures would already have been subject to Brazil's action based on those claims. As the United States will explain, this would contradict the ordinary meaning of the phrase "exempt from actions" in Article 13, read in its context, and in light of the object and purpose of the Agriculture

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<sup>1</sup> For example, Article XVI of the GATT 1994 and Part III of the Subsidies Agreement correspond to Article 13(a)(ii) of the Agriculture Agreement, GATT 1994 Article XVI:1 and Articles 5 and 6 of the Subsidies Agreement correspond to Article 13(b)(ii) of the Agriculture Agreement, and GATT 1994 Article XVI and Articles 3, 5, and 6 of the Subsidies Agreement correspond to Article 13(c)(ii) of the Agriculture Agreement..

<sup>2</sup> See WT/DS267/7, at 3 (asserting claims based on Subsidies Agreement Articles 3.1(a), 3.1(b), 3.2, 5(a), 5(c), 6.3(b), 6.3(c), and 6.3(d) and GATT 1994 Articles XVI:1 and Article XVI:3).

Agreement. Consequently, to allow Brazil to proceed with any action against these US measures that are exempt from actions based on such claims would contravene the Peace Clause and upset the balance of rights and obligations of WTO Members.

## B. LEGAL INTERPRETATION OF THE PEACE CLAUSE

4. The Peace Clause, Article 13 of the Agriculture Agreement<sup>3</sup>, governs the treatment during the implementation period of the Agreement of certain domestic support measures and export subsidies “notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures”.<sup>4</sup> For purposes of the Panel’s question, there would appear to be two interpretive issues. The first is straightforward and apparently not in dispute: whether the Peace Clause is in effect for the measures at issue. The second is what is the nature of the treatment under the Peace Clause of conforming measures – i.e., what does it mean to say that conforming measures are “exempt from actions”.

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<sup>3</sup> The Peace Clause reads:

During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures (referred to in this Article as the “Subsidies Agreement”):

- (a) domestic support measures that conform fully to the provisions of Annex 2 to this Agreement shall be:
  - (i) non-actionable subsidies for purposes of countervailing duties;
  - (ii) exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement; and
  - (iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994;
- (b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:
  - (i) exempt from the imposition of countervailing duties unless a determination of injury or threat thereof is made in accordance with Article VI of GATT 1994 and Part V of the Subsidies Agreement, and due restraint shall be shown in initiating any countervailing duty investigations;
  - (ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year; and
  - (iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year;
- (c) export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be:
  - (i) subject to countervailing duties only upon a determination of injury or threat thereof based on volume, effect on prices, or consequent impact in accordance with Article VI of GATT 1994 and Part V of the Subsidies Agreement, and due restraint shall be shown in initiating any countervailing duty investigations; and
  - (ii) exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement.

Agriculture Agreement, Article 13 (footnote omitted).

<sup>4</sup> Agriculture Agreement, Article 13 (chapeau). Article 21.1 of the Agriculture Agreement also makes it clear that the Subsidies Agreement and GATT 1994 only apply “subject to” the provisions of the Agriculture Agreement, including Article 13 (the Peace Clause).

## 1. Duration of the Peace Clause: The “Implementation Period”

5. The Peace Clause is in force at present. The first words of the Peace Clause (“During the implementation period”) establish the duration of the treatment afforded by this provision. Article 1(f) of the Agriculture Agreement defines “implementation period” as “the six-year period commencing in the year 1995” but goes on to specify that “for purposes of Article 13, it means the nine-year period commencing in 1995”. That is, Members determined that exempting certain measures from certain actions based on otherwise applicable WTO provisions was desirable for a time period *longer* than the period for the phase-in of all other commitments under the Agriculture Agreement. Thus, the Peace Clause currently continues to exempt conforming measures – whether US, Brazilian, or of any other Member – from actions under the corresponding provisions of the GATT 1994 and the Subsidies Agreement.

## 2. Effect of the Peace Clause: “Exempt from Actions”

6. For purposes of this dispute, all of the relevant provisions of the Peace Clause utilize the same language and construction: conforming measures “shall be . . . exempt from actions based on” specified provisions of the WTO agreements. The critical phrase “exempt from actions” is not defined in the Agriculture Agreement. According to the customary rules of interpretation of public international law<sup>5</sup>, these terms should be interpreted according to their ordinary meaning in their context, in light of the object and purpose of the Agreement.<sup>6</sup>

7. The ordinary meaning of the word “exempt” is “[n]ot exposed or subject to something unpleasant or inconvenient; not liable to a charge, tax, etc. (Foll. by *from, of*).”<sup>7</sup> The ordinary meaning of the word “action” is “[t]he taking of legal steps to establish a claim or obtain remedy; the right to institute a legal process” and “[a] legal process or suit”.<sup>8</sup> A legal dictionary provides further explanation of the term “action”:

Term in its *usual legal sense* means a *lawsuit* brought in a court; a *formal complaint* within the jurisdiction of a court of law. . . . The *legal or formal demand of one's right* from another person or party made and insisted on in a court of justice. An *ordinary proceeding in a court of justice* by which one party prosecutes another for the enforcement or protection of a right, the redress or prevention of a wrong, or the punishment of a public offence. It includes *all the formal proceedings* in a court of justice attendant upon the demand of a right made by one person of another in such court, *including an adjudication* upon the right and its enforcement or denial by the court.<sup>9</sup>

Thus, according to the ordinary meaning of the terms, “exempt from action” means “not exposed or subject to” the “taking of legal steps to establish a claim”, such as a “formal complaint” or any “formal proceedings”, including an “adjudication” of the claim. An even simpler formulation would be “not liable to” a “legal process or suit”.

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<sup>5</sup> See *Understanding on Rules and Procedures Governing the Settlement of Disputes*, Article 3.2 (The dispute settlement system “serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law.”).

<sup>6</sup> The customary rules of interpretation of public international law are reflected in part in Article 31(1) of the Vienna Convention, which reads: “A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”

<sup>7</sup> *The New Shorter Oxford English Dictionary*, vol. 1, at 878 (first definition as adjective & noun) (italics in original).

<sup>8</sup> *The New Shorter Oxford English Dictionary*, vol. 1, at 22 (first and second definitions).

<sup>9</sup> *Black's Law Dictionary* at 28 (6th ed. 1990) (emphasis added).

8. Relevant context for the phrase “exempt from actions” includes the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (“DSU”), which applies to “disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding (referred to in this Understanding as the ‘covered agreements’)”. The covered agreements, of course, include the Agriculture Agreement and the Subsidies Agreement. Article 3.7 of the DSU states: “*Before bringing a case*, a Member shall exercise its judgement as to whether *action* under these procedures would be fruitful” (emphasis added). Similarly, Article 4.5 of the DSU states: “*In the course of consultations* in accordance with the provisions of a covered agreement, before resorting to *further action* under this Understanding, Members should attempt to obtain satisfactory adjustment of the matter” (emphasis added). Thus, these provisions suggest that “action” based on the relevant provisions would include all stages of a dispute, including the “bringing [of] a case”, consultations, and panel proceedings.<sup>10</sup>

9. In addition, Article 7, which forms part of Part III of the Subsidies Agreement (entitled “Actionable Subsidies”), serves as context for the term “exempt from actions.” Article 7 provides procedures (including consultations, panel proceedings, and remedies) to enforce the legal rights contained in Article 5 (on “adverse effects”) and Article 6 (on “serious prejudice”). Article 7 states in its introductory phrase that its procedures apply “[e]xcept as provided in Article 13 of the Agreement on Agriculture”.<sup>11</sup> Thus, these provisions also support reading “exempt from actions” in Article 13 to mean “not subject to” the “taking of legal steps to establish a claim”. Footnote 35 of the Subsidies Agreement provides additional context that may help explain that “exempt from action” includes not resorting to dispute settlement. Footnote 35, which deals with “non-actionable”<sup>12</sup> subsidies, states that “[t]he provisions of Parts III [on actionable subsidies] and V [on countervailing measures] *shall not be invoked* regarding measures considered non-actionable in accordance with the provisions of Part IV”.<sup>13</sup> As otherwise relevant provisions cannot be “invoked” for non-actionable subsidies, footnote 35 supports reading “exempt from action” as not resorting to dispute settlement by asserting legal claims.

10. This interpretation of “exempt from actions” meshes with the object and purpose of the Agriculture Agreement. The Agreement represents the outcome of long and difficult negotiations to move towards the “long-term objective . . . to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets”.<sup>14</sup> Members therefore agreed to the Peace Clause, recognizing that agricultural subsidies could not be eliminated immediately and needed, under certain conditions, to be exempted from the Subsidies Agreement and GATT 1994 subsidies disciplines.

C. CONCLUSION: BRAZIL MAY NOT BRING, AND THE PANEL MAY NOT ADJUDICATE, A SUBSIDIES AGREEMENT OR GATT 1994 ARTICLE XVI ACTION AGAINST US MEASURES CONFORMING TO THE PEACE CLAUSE

11. Brazil’s approach – that both the applicability of the Peace Clause and Brazil’s Subsidies Agreement and GATT 1994 Article XVI claims be considered at the same time – would contravene the plain meaning of the Peace Clause by subjecting US measures to the “taking of legal steps to establish a claim”. Under Brazil’s approach, the US measures would be subject to an action based on the

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<sup>10</sup> As further support for the fact that “action” includes dispute settlement, DSU Article 3.10 provides that: “It is understood that requests for conciliation and the use of the dispute settlement procedures should not be intended or considered as contentious *acts* . . .” (emphasis added).

<sup>11</sup> Subsidies Agreement, Article 7.1.

<sup>12</sup> The ordinary meaning of the term “actionable” is “[a]ffording ground for an action at law”. *The New Shorter Oxford English Dictionary*, vol. 1, at 22.

<sup>13</sup> Subsidies Agreement, Article 10 fn. 35 (emphasis added).

<sup>14</sup> Agriculture Agreement, preamble (third paragraph).

corresponding provisions of the Subsidies Agreement and GATT 1994 at the same time that the Panel would be reviewing the applicability of the Peace Clause. Brazil's approach would ignore the plain meaning of the provisions of the Peace Clause exempting these measures from actions.

12. Accordingly, the United States respectfully requests the Panel to find that measures that conform to the Peace Clause are exempt from any action, including action under the DSU, based on the corresponding provisions of the Subsidies Agreement and the GATT 1994. As a result, the United States is not required to defend those measures in any action based on Brazilian claims exempted by the Peace Clause.

## ANNEX A-3

### ARGENTINA'S THIRD PARTY INITIAL BRIEF

10 June 2003

1. Argentina would like to thank the Panel for the opportunity to submit, as third party to the dispute, written comments concerning whether Article 13 of the Agreement on Agriculture (AoA) precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures (SCM Agreement) in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. To that respect, Argentina states the following:

2. The text of Article 13 of the AoA does not require the Panel to make a preliminary finding on the applicability of the peace clause before examining Brazil's claims under the SCM Agreement or GATT 1994. If the negotiators had considered such preliminary finding was necessary, they would have set it forth.

3. Indeed, a textual analysis of Article 13 of the AoA reveals that "*actions*", and not the analysis of claims under Article XVI of GATT 1994 or Articles 3, 5 or 6 of the SCM Agreement, can only be precluded if all conditions established in paragraphs b) (ii) or c) (ii) of the referred Article 13 are met.

4. To that regard, the Appellate Body has established:

*"The duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties. This should be done in accordance with the principles of treaty interpretation set out in Article 31 of the Vienna Convention. But these principles of interpretation neither require nor condone the imputation into a treaty of words that are not there or the importation into a treaty of concepts that were not intended."<sup>1</sup>*

• **The terms "*exempt from actions*" as stated in Article 13 of the Agreement on Agriculture:**

5. From Argentina's point of view, in the context of Article 13 of the AoA the words "*exempt from actions*" do not amount to an impossibility to request a panel procedure. "*Exempt from actions*" means that a finding of inconsistency with Articles XVI of GATT 1994 or Articles 3, 5 and 6 of SCM Agreement will not be possible if the legal requirements for the exemption are fulfilled. The immediate context of the terms "*exempt from actions*" -i.e., paragraphs b) and c)- confirms this interpretation since that exemption require a particular threshold, i.e., that domestic support measures and export subsidies "conform fully" (to different provisions of the AoA).

6. Nevertheless, it is precisely through the panel procedures that the fulfilment of those legal requirements will be determined. Argentina agrees with Brazil's statement in paragraph 6 of its Brief that the word "*actions*" in the context of Article 13 of the AoA refers to decisions of WTO competent bodies, such as the DSB when it discharges its duties by establishing a panel. A different interpretation would imply giving the measures allegedly covered by the Peace Clause a character of absolute immunity, independent of whether the legal requirements established in Article 13 are fulfilled or not. This would contradict the principle of *in dubio mitius*, constituting a more onerous interpretation of the treaty provisions

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<sup>1</sup> Appellate Body Report, *India-Patents*, adopted 16 January 1998, WT/DS50/AB/R, para. 45. (Emphasis added).

7. Therefore, the words “*exempt from actions*” do not preclude a Panel from considering a claim under the SCM Agreement or GATT 1994 while it decides whether the Peace Clause conditions have been fulfilled.

8. Argentina considers that there is no doubt that “the Peace Clause currently continues to exempt conforming measures from actions under the corresponding provisions of the GATT 1994 and the Subsidies Agreement”.<sup>2</sup> Indeed, the key words in Article 13 b) (ii) and c) (ii) of the AoA are “*that conform fully*” and “*provided that*” and “*that conform fully*”, respectively. These words imply that the exception is not absolute, but rather subject to the fulfilment of certain conditions. When considering the interpretative issues for purposes of the Panel's question at paragraph 4 of its Brief, the US seems to omit this issue by stating that what appears to be in dispute is the nature of the treatment of conforming measures under the Peace Clause. However, from Argentina's point of view, what is important here is to determine at this stage of the proceedings the treatment under the Peace Clause of measures that are supposed not to be in conformity with the legal requirements needed to be exempted from actions.

9. In addition, the fulfilment of the legal conditions set forth under Article 13 is a matter of fact that necessarily requires to be elucidated during panel procedures. If not, how can this issue be elucidated where, as in the present case, the US did not state which was its 1992 domestic support level and did not answer the specific questions during the consultations? Only through panel proceedings could those issues be elucidated.

10. On the other hand, as Brazil stated in paragraph 17 of its Brief<sup>3</sup>, there is no WTO provision obliging a Member to present evidence relating to the Peace Clause in a manner that is divorced from factual evidence and allegations under the SCM Agreement and/or GATT 1994. As stated by Brazil in paragraphs 13 and 14 of its Brief, according to Article 11 of the DSU a panel must make an objective assessment of the facts of the case and not of part of them before examining others, specially when, as in the case at hand, there is an overlap between the evidence related to the requirements of Art. 13 of the AoA and the evidence related to the actionable and prohibited subsidy claims.

11. Argentina considers that the text of Article 13 of the AoA does not ban a Panel from considering altogether a defence invoked under the Peace Clause and the allegations of inconsistency under GATT 1994 or the SCM Agreement. If a preliminary ruling on the applicability of the Peace Clause were necessary before being able to examine Brazil's claims under the SCM Agreement or GATT 1994, the terms “*exempt from actions*” would have too broad a sense. It would amount to the creation of a new obligations for Members clearly not envisaged in the text of Art. 13.

12. Finally, the same reasoning could apply to other preliminary issues, such as the objections to the consistency of a Panel's terms of reference with Article 6.2 of the DSU or the general exceptions under Article XX of GATT 1994. However, different Panels and the Appellate Body have made their findings on those issues altogether with their findings regarding substantive claims.

• **Other relevant provisions of the covered agreements:**

13. The SCM Agreement is applicable both for agricultural and non-agricultural products. It is true that Article 7 of the SCM Agreement states that the request of consultations is subject to Article 13 of the AoA. However, in the case at hand the US did not put it forward neither during

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<sup>2</sup> US Initial Brief on Question Posed by Panel, 5 June 2003.

<sup>3</sup> Brazil's Brief on Preliminary Issue Regarding the “Peace Clause” of the Agreement on Agriculture, 5 June 2003.



consultations nor during the meetings where the establishment of the Panel was requested, thus engaging itself in such procedures.

- **Other considerations that should guide the assessment of this issue :**

14. Argentina considers that the provisions contained in Article 13 of the AoA have an exceptional nature. This would imply that the Member who alleges to be protected by the Peace Clause has the burden of proving the fulfilment of its legal requirements. As long as the US does not demonstrate *prima facie* that it fulfils all the conditions that would allow a protection against a claim by virtue of Article 13 of the AoA, the Panel should consider as appropriate the claims under Article XVI of GATT 1994 or Articles 3, 5 and 6 of the SCM Agreement.

15. Finally, as stated by Brazil in paragraphs 13 and 14 of its Brief, according to DSU Article 11 a panel must make an objective assessment of the facts of the case and not of part of them before examining others, specially when, as in the case at hand, there is a need to clarify closely related issues of fact that relate both to the fulfilment of the conditions set forth by the Peace Clause and to the substantive claims regarding actionable and prohibited subsidies.

### **Conclusion**

16. According to the above statements, Argentina considers that Article 13 of the AoA does not preclude the Panel from hearing evidence and considering Brazil's claims under the SCM Agreement or GATT 1994 while it decides whether the Peace Clause conditions of Article 13 have or have not been met.

## ANNEX A-4

### AUSTRALIA'S WRITTEN COMMENTS

10 June 2003

1. I refer to your faxed letter of 28 May 2003 in which you invited third parties to the dispute to submit any written comments they may have in relation to the following:

whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. In particular, the Panel invite the parties to explain their interpretation of the words "exempt from action" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue. For greater clarity, the Panel invites the parties, during this initial stage of the proceedings, to focus on matters of legal interpretation, rather than upon the submission of any factual evidence that might be associated with the substantive elements of Article 13.

2. Please note that, for the purposes of Australia's comments in relation to the issues identified in the previous paragraph, references to "Article 13" refer to Article 13(a)(ii), 13(b)(ii) and 13(c)(ii). There is nothing in Article 13 of the *Agreement on Agriculture* – nor indeed in the *Dispute Settlement Understanding* ("the DSU") – that would preclude the Panel from considering claims under the *Agreement on Subsidies and Countervailing Measures* in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled.

3. Article 13 of the *Agreement on Agriculture* provides a limited, conditional and time-limited exemption from actions based on Article XVI of GATT 1994 and certain provisions of the *Agreement on Subsidies and Countervailing Measures* ("the specified provisions") in respect of measures which conform fully to the respective provisions of the *Agreement on Agriculture* and to Article 13 itself. Article 13 does not preclude *per se* claims based on the specified provisions, that is, Article 13 does not prevent the specified provisions being invoked. Rather, Article 13 is in the nature of an "affirmative defence" for measures which are inconsistent with the specified provisions.<sup>1</sup>

4. Viewing Article 13 of the *Agreement on Agriculture* as an affirmative defence gives proper meaning to that provision, as well as to Article 21 of the *Agreement on Agriculture* and Articles 3.1, 6.9 and 7.1 of the *Agreement on Subsidies and Countervailing Measures*. This view would also be consistent with the interpretive principle of effectiveness, which the Appellate Body has found should guide the interpretation of the WTO Agreement.<sup>2</sup>

5. In assessing an affirmative defence based on Article 13 of the *Agreement on Agriculture*, the proper application of that provision would require the Panel to consider the conditions listed in Article 13 ("the prescribed conditions"), that is:

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<sup>1</sup> See, for example, *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, page 16.

<sup>2</sup> *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/AB/R, WT/DS234/AB/R, paragraph 271.

- as appropriate, whether the measure at issue constitutes a domestic support measure or an export subsidy within the meaning of Annex 2 to, or Articles 6 or 1(e) of, the *Agreement on Agriculture*; and, if so,
- as appropriate, whether the measure at issue conforms fully to the provisions of Annex 2 to, or Article 6 or Part V of, the *Agreement on Agriculture*; and
- as appropriate, whether measures falling within the provisions of Article 6 of the *Agreement on Agriculture* grant support to a specific commodity not in excess of that decided during the 1992 marketing year.

6. Only if the Panel determines that Article 13 of the *Agreement on Agriculture* is relevant because the prescribed conditions are met would it need to consider whether the measures at issue are “exempt from actions based on” the specified provisions. In that event, the Panel would need to consider whether the measures at issue are “free or released from a duty or liability to which others are held”<sup>3</sup> in relation to a proceeding “found[ed], built or construct[ed] on”<sup>4</sup> the specified provisions. In other words, if the prescribed conditions are met, a Member will be immune from liability for a measure’s inconsistency with the specified provisions for the period for which Article 13 applies.

7. In this dispute, there is disagreement between the parties to the dispute whether the measures at issue conform fully to the respective provisions of the *Agreement on Agriculture*. However, disagreement between the parties to the dispute does not serve to limit the Panel’s mandate. There is no provision in the covered agreements that a disagreement between the parties to the dispute about conformity would serve as a barrier to a Panel’s legal mandate to examine claims in accordance with the provisions of Article 3.2 and 11 of the DSU. There is, therefore, no requirement that the Panel reach a conclusion that certain conditions of Article 13 of the *Agreement on Agriculture* remain unfulfilled before considering claims under the *Agreement on Subsidies and Countervailing Measures*.

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<sup>3</sup> *Black’s Law Dictionary*, Seventh Edition, Bryan A Garner, Editor in Chief, West Group, St Paul, Minn., 1999, page 593.

<sup>4</sup> *The New Shorter Oxford English Dictionary*, Ed. Lesley Brown, Volume 1, Clarendon Press, Oxford, 1993, page 187.

## ANNEX A-5

### COMMENTS BY THE EUROPEAN COMMUNITIES ON CERTAIN ISSUES RAISED ON AN INITIAL BASIS BY THE PANEL

10 June 2002

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#### **I. INTRODUCTION**

1. The Panel has asked the Parties to this dispute, together with the third parties, to comment on the following question:

[W]hether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions in Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue.

2. The European Communities understands the positions of the two parties as follows. The United States is arguing for a multi stage procedure – first the Panel should deal with this initial issue, second, it should examine whether the US measures at issue fall under Article 13 of the *Agreement on Agriculture*, and finally, and only if the measures do not fall under Article 13 of the *Agreement on Agriculture*, should the Panel examine whether these measures are consistent with the *Agreement on*

*Subsidies and Countervailing Duties (SCM Agreement)*.<sup>1</sup> On the other hand, Brazil considers that the Panel should, after settling this initial issue, examine Brazil's claims under Article 13 of the *Agreement on Agriculture* and the *SCM Agreement* simultaneously, treating Brazil's claims under Article 13 of the *Agreement on Agriculture* as a threshold issue.<sup>2</sup> Neither party appears to suggest that this issue is anything other than a substantive issue.<sup>3</sup>

3. The parties' submissions concern the manner in which the Panel should organise its procedures. In other words, should it hear arguments and evidence on Brazil's claims under Article XVI GATT and the *SCM Agreement* before it has decided whether the United States can avail itself of Article 13 of the *Agreement on Agriculture*. The European Communities considers that this issue falls within the Panel's discretion as to the organization of its procedures. Such discretion is, nevertheless, not without its limits. The European Communities considers that there are a number of factors which require the Panel to exercise its discretion so as to examine the evidence and arguments presented by the parties with respect to both Article 13 of the *Agreement on Agriculture* and Article XVI GATT and the *SCM Agreement* at the same time. The European Communities sets out its arguments on these issues in more detail in the sections below.

## II. THE QUESTION AT ISSUE FALLS WITHIN THE PANEL'S DISCRETION AS TO THE ORGANISATION OF ITS OWN PROCEDURES

4. Both parties seem to consider that the Panel is required to rule, as a matter of substance, on whether the US measures fall under Article 13 of the *Agreement on Agriculture*, and if not, whether they are consistent with Article XVI GATT and the *SCM Agreement*. Brazil's contention that the US measures are inconsistent with Article XVI GATT and the *SCM Agreement*, because they are not covered by Article 13 of the *Agreement on Agriculture*, requires the Panel to determine whether Article 13 is applicable. Similarly, the United States' claim that Article 13 of the *Agreement on Agriculture* prevents the Panel from ruling on Brazil's other claims requires adjudication of the issue of the applicability of Article 13.

5. The European Communities finds support for its view that the choice between a single and multistage procedure is a matter for the Panel's discretion in the fact that Article 13 of the *Agreement on Agriculture* is not set up as a specific rule which can be distinguished from the normal DSU procedures. Thus, for instance, Article 13 is not mentioned in Annex 2 of the DSU listing special or additional rules and procedures contained in the covered agreements. Moreover, Article 19 of the *Agreement on Agriculture* states that the provisions of Article XXII and XXIII GATT, as elaborated in the DSU, apply to the *Agreement on Agriculture*. Consequently, there are no special rules foreseen in respect of Article 13 in the event that a Member requests dispute settlement in which it may be raised as an issue.

6. In order further to demonstrate that this is a matter for the Panel's discretion, it is instructive to consider the United States' arguments on the meaning of exempt from action". The United States argues that the meaning of the term "exempt from action" is that no formal proceedings can be

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<sup>1</sup> In para. 2 of its initial brief, the US argues

"[t]he United States respectfully requests the Panel to organize its procedures to first determine whether Brazil may maintain any action based on provisions exempted by the Peace Clause."

<sup>2</sup> Brazil concludes its initial brief as follows:

"[...] Brazil requests that this Panel find that it is not precluded from hearing evidence and considering Brazil's claims under the ASCM or Article XVI of GATT 1994 without first concluding that the peace clause conditions of AoA Article 13(b)(ii) and 13(c)(ii) remain unfulfilled."

<sup>3</sup> For instance, that the arguments on Article XVI GATT and the *SCM Agreement* are not within the terms of reference of the Panel.

launched with respect to the matter exempt from action, and that in the WTO, this would mean that a Member could not request consultations and later request the establishment of a panel.<sup>4</sup> The implications of this are unclear however. The logical conclusion would appear to be that the United States is suggesting that Brazil should first bring a panel arguing that Article 13 of the *Agreement on Agriculture* is not applicable, and then (if it is successful) bring a second panel to adjudicate its claims under Article XVI GATT and the *SCM Agreement*? This notion seems implausible for a number of reasons. First, in considering whether Article 13 of the *Agreement on Agriculture* is applicable, the first Panel would not be adjudicating a dispute but would be requested to issue a declaratory judgement. Second, a Member is not under an obligation to act consistently with Article 13 of the *Agreement on Agriculture* – failing to respect Article 13 implies that a Member no longer enjoys the protection thereof. Consequently, and third, Article 13 of the *Agreement on Agriculture* can only be seen as a defence against a claim brought under other aspects of the WTO Agreements which regulate the provision of subsidies. It would seem bizarre if, before Brazil could bring a claim with respect to subsidies which it considered did not respect the US's WTO obligations, Brazil had first to establish that potential US defences did not apply.

7. The European Communities notes that, although this situation is the logical continuation of the US interpretation of the term “exempt from action”, the United States does not suggest that Brazil should have launched two successive WTO panels. Rather it maintains that the Panel’s hearing argument and evidence on Article XVI GATT and the *SCM Agreement* would amount to an “action” which cannot be brought against it until it is determined that the US measures do not conform to Article 13 of the *Agreement on Agriculture*. Why the United States considers that hearing evidence would amount to such a prohibited “action”, while requesting consultations or the establishment of a panel does not amount to maintaining an “action” is unclear. Indeed, the European Communities would presume that the United States would agree that Article 13 of the *Agreement on Agriculture* has the ultimate effect of not requiring any subsidy maintained consistently with Article 13 of the *Agreement on Agriculture* and otherwise inconsistent with the *SCM Agreement* to be brought into conformity with the provisions of the *SCM Agreement* (typically through its withdrawal). For the European Communities, therefore, the issue of whether a measure falls under Article 13 is necessarily a question which a Panel must decide before it decides whether the measure might violate Article XVI GATT or the *SCM Agreement*. However, the mere fact that the Article 13 issues must be decided before the other claims are decided does not imply that a panel, when it is examining evidence and considering arguments with respect to Article 13 of the *Agreement on Agriculture*, is precluded from hearing the evidence and arguments relating to Article XVI GATT or the *SCM Agreement* until after it has decided on the applicability of Article 13 of the *Agreement on Agriculture*.

8. In conclusion, the Panel has substantial discretion in deciding how it will manage these issues. Article 12.1 DSU makes it quite clear that the Working Procedures set out in Appendix 3 of the DSU may be departed from if the Panel decides this is appropriate. Therefore, it is a matter for the Panel’s discretion whether to arrange a multistage procedure as proposed by the United States or a single stage procedure as proposed by Brazil.

9. The European Communities considers that the normal procedure proposed by Brazil should be followed by the Panel for the reasons set out in the next section.

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<sup>4</sup> See paras. 7 and 8 of the US initial Submission.

### III. SEVERAL FACTORS MILITATE IN FAVOUR OF EXAMINING THE EVIDENCE AND ARGUMENTS PRESENTED IN RESPECT OF ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE AT THE SAME TIME AS THE OTHER CLAIMS

10. The European Communities submits that the Panel should consider evidence and argument relating to both the applicability of Article 13 of the *Agreement on Agriculture*, and the other provisions which Brazil has alleged the United States has acted inconsistently with.

#### A. THE APPLICATION OF ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE IS DEPENDENT ON THE EXAMINATION OF QUESTIONS OF SUBSTANCE

11. As the United States and Brazil appear to have recognised, the question of the applicability of Article 13 of the *Agreement on Agriculture* is dependent on the assessment of substantive issues, notably the conformity of the measures in question with other provisions of the *Agreement on Agriculture*. In order for the Panel to establish whether Article 13 applies, the Panel will have to consider detailed arguments and evidence. For that reason, the applicability of Article 13 should be subjected to the normally applicable procedures by which Panel deal with complex issues of fact and law and not adjudicated in some form of preliminary procedure. The European Communities note, for instance, that this was the approach taken by the panel in the *United States – Export Restraints* dispute, which refused to rule on a number of preliminary objections brought by the United States (as the defendant) which went to the substance of the matter.<sup>5</sup>

#### B. ASSESSING THE APPLICABILITY OF ARTICLE 13 AS A PRELIMINARY MEASURE MAY DELAY THE ISSUANCE OF THE REPORT

12. In the same vein, it can be noted that hearing evidence and considering arguments on the applicability of Article 13 would inevitably require a considerable amount of time, as will hearing and assessing the arguments and evidence on the other issues which could only be considered after the preliminary decision on Article 13 was taken. Given the substantial number of claims brought, their complex nature, and the substantial interest in this dispute from third parties, the Panel may, if it splits up the dispute into three stages, have problems issuing its report within nine months, as it is required to do under the Article 12.9 DSU.

13. The European Communities also has some sympathy for the concerns set out by Brazil, in section V of its Initial Submission, as to the effect of splitting the procedure on Brazil's ability to present its case.

#### C. THIRD PARTY DUE PROCESS RIGHTS MAY BE INFRINGED BY A DECISION TO SPLIT THE PROCEDURE INTO THREE STAGES

14. As the Panel is aware, Article 10.3 DSU provides that third parties are entitled to receive the submissions of the parties to the first meeting with the Panel. If the first panel meeting is limited to considering the applicability of Article 13 of the *Agreement on Agriculture* and thus parties submissions are limited to that question, the third parties will not have an opportunity to be heard on issues other than Article 13 of the *Agreement on Agriculture*. If the Panel decides to adopt a three stage procedure, in order to avoid such a situation arising, the European Communities respectfully submits that the Panel should make provision to ensure that third parties have adequate access, and the opportunity to be heard on all matters (that is, also in the third stage of procedures). Inevitably,

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<sup>5</sup> Panel report, *United States – Measures Treating Export Restraints as Subsidies*, WT/DS194/R, adopted 23 August 2001, para. 8.2.

however, setting up such a procedure will involve additional work for both the Panel and the Secretariat.

#### **IV. CONCLUSION**

15. In conclusion, the European Communities respectfully submits that, while the Panel is obliged to decide on the applicability of Article 13 of the *Agreement on Agriculture* before it may take a decision with respect to Brazil's claims under Article XVI GATT and the *SCM Agreement* it is not precluded from considering evidence or argument on these claims until after it has decided on the applicability of Article 13 of the *Agreement on Agriculture*. As the European Communities has explained above, there are several reasons militating in favour of the Panel considering all arguments and evidence simultaneously.



## ANNEX A-6

### INDIA'S COMMENTS ON PRELIMINARY ISSUE REGARDING THE PEACE CLAUSE OF THE AGREEMENT ON AGRICULTURE

10 June 2003

1. India thanks the panel for being provided an opportunity to comment on the submissions of Brazil and the United States on the following question concerning Article 13 of the Agreement on Agriculture posed by the Panel:

*Whether Article 13 of the Agreement on Agriculture precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled.<sup>1</sup>*

2. India notes that both Brazil and the United States evidently agree that "exempt from actions" means that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic or export support measures that are in compliance with various provisions of the Peace Clause. In other words, a measure must be in conformity with: (a) provisions of Annex 2 of the Agreement on Agriculture in respect of green box domestic support measures; (b) provisions of Article 6 of the Agreement on Agriculture in respect of amber and blue box support measures; and (c) Part V of the Agreement on Agriculture as reflected in each member's Schedule in respect of export subsidies to attract the exemption from obtaining a remedy under the Peace Clause.

3. However the United States seems to argue in various paragraphs of its submission, including in paragraphs 7, 9 and 12, that this exemption extends to "any action, including action under the DSU, based on the corresponding provisions of the Subsidies Agreement and GATT 1994". The United States thereby suggests that resort cannot be had to the dispute settlement proceedings by asserting legal claims in respect of measures claimed by a Member to be Peace Clause protected.

4. Thus, on the question posed by the Panel, the United States is of the view that the Panel should organize its procedures to first determine whether Brazil may maintain any "action" based on provisions exempted by the Peace Clause. On the other hand, Brazil has asserted that the phrase "exempt from actions" in Article 13 of the Agreement on Agriculture does not compel the Panel to *first* make a Peace Clause finding before considering the substance of Brazil's other claims.

5. The United States seeks to interpret "action" to "include all stages of a dispute, including the "bringing [of] a case," consultations, and panel proceedings." Subsequently, the United States suggests a reading of "exempt from actions" in Article 13 to mean "not subject to" the "taking of legal steps to establish a claim" or "not resorting to dispute settlement by asserting legal claims".

6. In India's view, if the interpretation of "exempt from actions" under Article 13 of the Agreement on Agriculture, as sought by the United States, extends to exemption from "any action"

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<sup>1</sup> The Panel also "invites the parties to explain their interpretation of the words 'exempt from actions' as used in Article 13 of the Agreement on Agriculture, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue."

such that resorting to dispute settlement by asserting legal claims is precluded in respect of Peace Clause protected measures, then consequences follow that have systemic implications. This interpretation would result in countries being precluded from even resorting to the dispute settlement process in respect of measures claimed by the country to be complained against to be conforming to the Peace Clause unless there is a prior finding on the lack of conformity of the measure with the Peace Clause. This interpretation of “exempt from actions” taken to its logical end would imply that even consultations under the DSU cannot be sought in respect of such a measure, unless there is a prior finding on non-conformity of the measure with the Peace Clause. A complaining country would therefore have to resort to the dispute settlement process twice in respect of the same measure; first, for obtaining a finding whether the measure is in conformity with the Peace Clause and, if not, then whether the measure is in conformity with obligations under various WTO Agreements. In India’s view this result is neither desirable nor envisaged under the DSU or any other covered agreements.

7. India believes that neither the phrase “exempt from actions” nor Article 13 of the Agreement on Agriculture compel the Panel to *first* make a peace clause finding before considering the substance of Brazil’s claims in various issues in this dispute. India is of the view that Article 13 of the Agreement on Agriculture is not a “special and additional” rule set out in Appendix 2 to the DSU. Article 19 of the Agreement on Agriculture makes all DSU provisions applicable to the Agreement on Agriculture. Thus there is no legal basis under the DSU or any of the covered agreements that would support the two stage approach suggested by the United States in this dispute whereby the Panel would first make a Peace Clause finding before considering claims on other agreements.

8. In conclusion, India believes that the phrase “exempt from actions” when viewed in the context of DSU provisions *does not require* the Panel to *first* make a Peace Clause non-compliance finding before hearing or considering any of the evidence or arguments relating to the various claims under other agreements.

**ANNEX A-7**

**THIRD PARTY COMMENTS BY NEW ZEALAND  
ON PRELIMINARY ISSUE REGARDING  
ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE  
("THE PEACE CLAUSE")**

10 June 2003

New Zealand welcomes the opportunity to comment on the preliminary issue addressed in the Panel's 28 May 2003 request:

"Whether Article 13 of the Agreement on Agriculture precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures in these proceedings in the absence of a prior conclusion of the Panel that certain conditions of Article 13 remain unfulfilled ..."

In New Zealand's view, a Panel is not required to make any prior conclusion concerning the applicability of Article 13 (the "Peace Clause") before proceeding to hear evidence and submissions relating to substance of legal claims brought under the Agreement on Subsidies and Countervailing Measures (ASCM) and GATT Article XVI. New Zealand notes in this regard that the overlapping nature of the evidence required to establish both the applicability of the Peace Clause as well as actionable and prohibited subsidies claims would make a separation of submissions and hearings on each aspect artificial.

In relation to the Panel's request for views on the term "exempt from actions" in Article 13(b)(ii) and 13(c)(ii), New Zealand considers that these words simply mean that a Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic or export support measures that are otherwise protected by the "Peace Clause". New Zealand does not consider that this phrase should be interpreted so as to suggest that substantive claims under the ASCM and GATT Article XVI can only be addressed in written or oral submissions after a Panel has made a ruling that the Peace Clause apply.

In summary, New Zealand considers that the Panel is not precluded from hearing evidence and considering claims under the Agreement on Subsidies and Countervailing Measures or Article XVI of the GATT without first concluding that Peace Clause conditions remain unfulfilled.

## ANNEX A-8

### SUBMISSION OF PARAGUAY COMMENTS ON THE "PEACE CLAUSE"

10 June 2003

Paraguay does not see how, under the provisions of the Dispute Settlement Understanding (DSU), the Panel can establish that a matter calls for a "preliminary and special ruling" when the DSU does not provide for such a procedure.

If this were so, many complaints would be subject to the prior demonstration of the existence of the conditions for bringing the action, when in fact, what needs to be resolved is the main subject of the dispute and the effects caused by the failure to comply with the rules and regulations of world trade.

Paraguay considers that to set a precedent of this kind would be to undermine the DSU's purpose of providing a flexible and prompt dispute settlement procedure, since countries would be faced with an unnecessary delay in the process involving costs and time beyond their "predictions".

Since there is no established procedural rule in this respect, the Panel must proceed to the analysis of the substantive issue, and permit the parties, in this case especially Brazil as complainant – and by extension Paraguay – to demonstrate that the subsidies and support measures benefiting upland cotton have effects on trade and production by the cotton industry in the world.

Paraguay has a supreme interest in ensuring the application of strict justice with respect to this complaint, since cotton production is the sustenance of the poorest segments of its population. Indeed, 70 per cent of the country's small farmers depend on cotton production for their living.

As already stated in the past, of Paraguay's population of approximately 5,300,000, some 150,000 families work in cotton production, and the damage caused by the kinds of subsidies and support measures at issue in this case have caused an exodus of this rural population to urban areas with no relief or solution in sight, further aggravating the country's economic situation.

In view of the above, Paraguay considers that since Article XIII is not a rule forming part of the procedural system established by the DSU, a preliminary ruling by the Panel on the "Peace Clause" would be inappropriate.

## **ANNEX A-9**

**BRAZIL'S COMMENTS ON THE BRIEFS BY THE UNITED STATES  
AND THE THIRD PARTIES ON CERTAIN PRELIMINARY ISSUES  
REGARDING THE "PEACE CLAUSE" OF THE  
AGREEMENT ON AGRICULTURE**

13 June 2003

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## I. INTRODUCTION

1. Brazil welcomes the opportunity to provide its comments regarding the third party submissions of Argentina, Australia, the European Communities, India, New Zealand, and Paraguay filed on 10 June 2003, and to respond to the *Initial Brief of the United States of America on the Questions Posed by the Panel (US Initial Brief)*, filed on 5 June 2003.

## II. THE US TEXTUAL AND CONTEXTUAL ARGUMENTS CONCERNING “EXEMPT FROM ACTIONS” ARE INCONSISTENT WITH THE MULTILATERAL NATURE OF “ACTIONS” UNDER THE DSU AND WITH US CONDUCT IN THIS DISPUTE

2. The customary rules of interpretation of public international law do not support the United States’ reading of Article 13 of the Agreement on Agriculture (AoA). The United States relies on a legal dictionary for a definition of “action” and then concludes incorrectly that “action” means any “proceeding in a court of justice” including any “legal steps to establish a claim”.<sup>1</sup> This interpretation misreads Article 13 because it starts from fundamentally mistaken premises.

3. A WTO panel is not a “court” because the WTO panel process is founded on, and guided by, *collective* action by the Members. A lawsuit in a US or Brazilian court of law starts automatically when a plaintiff takes the “action” of filing papers that are in the proper form. But a DSU panel proceeding commences only when the Members of the WTO take *collective* “action” to establish the panel. The DSU rules “elaborate and apply”<sup>2</sup> the rules in GATT Article XXIII:2, which speak of an investigation by the CONTRACTING PARTIES – which under GATT Article XXV:1 are all the contracting parties “acting jointly”. Whereas a US or Brazilian judge has broad powers conferred on him or her constitutionally, a WTO panel is a body of limited jurisdiction acting only with powers delegated to it by the DSB. For example, defending parties challenge claims as going beyond the terms of reference under DSU 6.2, because the terms of reference define the limits of the powers delegated to the panel by the DSB through the DSB’s action to establish the panel.

4. The “negative consensus” provisions in DSU Article 16.4 further support Brazil’s position that “action” in AoA Article 13 must be interpreted as *joint* action by WTO Members. Decisions of a court are directly and immediately binding on the parties to the litigation, but such is not the case for decisions of a panel or the Appellate Body. Instead, the drafters of the DSU decided that the Members acting jointly would retain ultimate control of whether a panel or Appellate Body report has any binding effect. Similarly, the recommendations and rulings referred to in DSU Articles 21 and 22 are not recommendations and rulings of a panel or the Appellate Body, but are recommendations and rulings of the DSB. Accordingly, DSU 21.7 refers to *further* actions that the DSB must consider when a matter (not an “action”) has been raised by a developing country.

5. The United States misinterprets DSU Article 3.7.<sup>3</sup> In this provision (“Before bringing a case, a Member shall exercise its judgment as to whether action under these procedures would be fruitful”), “actions” could and should be read in a *collective* context, as referring to the DSB’s *action* to adopt a panel report and (if need be) to authorize suspension of concessions. DSU Article 3.7 transposed a provision in the 1979 Understanding Regarding Notification, Dispute Settlement and Surveillance<sup>4</sup>

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<sup>1</sup> US Initial Brief, para. 7.

<sup>2</sup> AoA Article 19: provides that “The provisions of Articles XXII and XXIII of GATT 1994, as elaborated and applied by the Dispute Settlement Understanding, shall apply to consultations and the settlement of disputes under this Agreement.”

<sup>3</sup> US Initial Brief, para. 8.

<sup>4</sup> Adopted on 28 November 1979; BISD 26S/210. The full text is set out in the GATT Analytical Index (6th Ed., 1995) at page 632. DSU Article 3.7 transposes paragraph 4 of the Agreed Description of the

which refers to "action under Article XXIII:2." As discussed in Brazil's Initial Brief, such "action" has always meant *joint* action by the CONTRACTING PARTIES, not individual action by a particular contracting party. Article 3.7 simply restates the common-sense advice that litigants must consider in advance whether the persuasive effect of a collective determination of rule violation and a collective authorization of suspension of concessions would be useful in eliminating the concrete problem. It cannot be read to suggest that any Member should be able to pressure another into dropping a valid legal claim by arguing that enforcing rights through litigation is not "fruitful."

6. The United States also misinterprets DSU Article 4.5 ("before resorting to further action under this Understanding, Members should attempt to obtain satisfactory adjustment of the matter.").<sup>5</sup> Read correctly, DSU Article 4.5 simply refers to the "action" of the DSB to grant a request for establishment of a panel.<sup>6</sup> Thus, Article 4.5 urges a Member to attempt to obtain satisfactory adjustment of the "matter" (not the "action") before it requests the DSB to take action to establish a panel.

7. The United States also cites footnote 35 of the SCM Agreement ("The provisions of Parts III and V *shall not be invoked* regarding measures considered non-actionable in accordance with the provisions of Part IV.")<sup>7</sup> Yet "shall not be invoked" is a different legal standard that goes substantially farther than "shall be . . . exempt from actions." Under footnote 35, no DSB authorization could be obtained to establish a panel against a non-actionable subsidy granted by another Member. By contrast, AoA Article 13 exempts certain agricultural subsidies from actions by the DSB adopting a panel or Appellate Body report or authorizing suspension of concessions, but only *under certain conditions*. The DSB can only take "actions" against such subsidies if it decides that those conditions are unfulfilled (based on the recommendations in the report of the panel and/or Appellate Body). But this *conditionality* means that a panel must address the conditions of the peace clause if they are invoked by the Member providing the domestic support – as the United States appears to have indicated it will do in this dispute. If the drafters had intended to protect agricultural subsidies against even an *invocation* of Part II and III of the SCM Agreement, they would have said so, and they did not.

8. The United States argues in paragraph 9 that its subsidies are even "exempt" from consultations under the DSU. Paragraph 9 highlights the logical challenges presented by the US argument—particularly in light of the fact, discussed below, that Article 13 does not create *any* exception to the normal rules of WTO dispute settlement.

9. Moreover, the United States' own conduct in this dispute is at odds with paragraph 9 of the US brief. Brazil's consultation request dated 3 October 2002 clearly stated that "the United States has no basis to assert a defence under Article 13(b)(ii) . . . [and] Article 13(c)(ii) of the Agreement on Agriculture . . .".<sup>8</sup> Yet, the United States said nothing during three rounds of consultations about any requirement for a separate panel proceeding regarding the peace clause. Brazil's panel request also referred to the lack of any basis for the United States to assert a peace clause "defence".<sup>9</sup> The DSB minutes reflect that the United States did not mention the peace clause at all in the meetings of the

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Customary Practice of the GATT in the Field of Dispute Settlement (Article XXIII:2) annexed to the 1979 Understanding; paragraph 4 appears on page 635.

<sup>5</sup> US Initial Brief, para. 8.

<sup>6</sup> DSU Article 4.5 was a transposition of paragraph 4 in the Agreed Description of the Customary Practice of the GATT in the Field of Dispute Settlement annexed to the (Tokyo Round) Understanding Regarding Notification (BISD 26S/210; The full text is set out in the GATT Analytical Index on page 635). That provision refers to "action under Article XXIII:2." As discussed by Brazil, such "actions" are multilateral actions by the CONTRACTING PARTIES, not individual action by a particular contracting party.

<sup>7</sup> US Initial Brief, para. 9.

<sup>8</sup> WT/DS267/1 at 3.

<sup>9</sup> WT/DS267/7.

DSB that considered the panel request.<sup>10</sup> The first official US assertion regarding special procedural requirements relating to the peace clause did not come until a meeting in the office of the Director of the Legal Services Division, on 25 March 2003, one week after the Panel was established on 18 March 2003.

10. In considering the US request for a special “peace clause” proceeding, the Panel should take note that the panel and Appellate Body in the *US - FSC* dispute rejected US procedural claims of an allegedly defective EC consultation request. In that dispute the United States engaged in three rounds of consultations without mentioning the problem once and then attempted to raise the defect consultations request as a preliminary objection to the panel. The panel and the Appellate Body both rejected the objection. As the Appellate Body found:

It seems to us that, by engaging in consultations on three separate occasions, and not even raising its objections in the two DSB meetings at which the request for establishment of a panel was on the agenda, the United States acted as if it had accepted the establishment of the Panel in this dispute, as well as the consultations preceding such establishment. In these circumstances, the United States cannot now, in our view, assert that the European Communities' claims under Article 3 of the *SCM Agreement* should have been dismissed and that the Panel's findings on these issues should be reversed.<sup>11</sup>

11. In this dispute, the United States sat mute on the subject of peace clause procedures through three rounds of consultations and two DSB meetings. Had the United States raised this particular procedural issue on a timely basis, other WTO Members may have reserved their rights under DSU Article 10. To permit such an issue to be raised on such an untimely basis also denies those other Members their rights under the DSU.

### **III. THE NARROW INTERPRETATION OF THE WORD “ACTION” SUGGESTED BY THE UNITED STATES IS NOT SUPPORTED BY ALL THREE AUTHENTIC VERSIONS OF THE AOA**

12. As argued in Brazil's Initial Brief of 5 June, Brazil believes that the word action refers to collective actions of the WTO Members, and not to actions by individual Members. Brazil further submits that the meaning the United States tries to impute to the word “action” is too narrow and inadequate.

13. Brazil recalls that the three versions of the WTO Agreements are authentic. The US interprets the word “action” in the English version as “legal process or suit”. Brazil agrees that this is a possible meaning of the word, but so is “the process or condition of acting or doing”; or “a thing done, a deed, an act...; habitual or ordinary deeds”.<sup>12</sup> Therefore, the word action in the English language could mean either a legal process or a simple act or deed.

14. The French version uses the word “action” which also allows both connotations. It could have the ordinary connotation of: “ce que fait qqn et par quoi il réalise une intention ou un impulsion;” “exercice de la faculté d'agir;” but it could also have the more specific meaning of the “exercice d'un droit en justice”.<sup>13</sup>

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<sup>10</sup> WT/DSB/M/143, WT/DSB/M/145.

<sup>11</sup> WT/DS108/AB/R, “United States – Tax Treatment for “Foreign Sales Corporations”, para. 165.

<sup>12</sup> The New Shorter Oxford English Dictionary, 1993 edition.

<sup>13</sup> Le Petit Robert, Nouvelle édition ... 1982.



15. The Spanish version however does not allow such interpretative flexibility. The word used in Article 13 is not the word “acción”, which would allow the arguable double meaning of the English and French versions: “resultado de hacer” or “[e]n sentido procesal, derecho a acudir a un juez o tribunal ...”<sup>14</sup> (emphasis added). The word used in Article 13 of the Spanish version is “medidas.” While “medidas” could mean “disposición, prevención ... tomar, adoptar medidas”<sup>15</sup>, it could not possibly have the connotation of a legal action. Again, while the dictionary meanings of the word “acción” do include the possibility of a judicial measure, the same is not true for the word “medidas”.

16. Therefore, the Panel must avoid an interpretation of Article 13 that is possible in only two of the authentic versions, while there is another plausible – and in fact more adequate – interpretation that is equally possible in all three authentic versions. The Panel must accordingly reject the narrow interpretation suggested by the United States for the word “action”.

#### **IV. THE OVERLY-BROAD US DEFINITION OF “EXEMPT FROM ACTION” IMPROPERLY CREATES NEW OBLIGATIONS AND PROCEDURES NOT CONTEMPLATED IN THE AOA OR THE DSU**

17. The United States argues that the word “action” means “all stages of the dispute, including the ‘bringing [of] a case,’ consultations, and panel proceedings”.<sup>16</sup> Brazil agrees with the arguments advanced by Argentina<sup>17</sup>, the European Communities<sup>18</sup> and India<sup>19</sup> that this broad US interpretation would exempt measures allegedly covered by the “peace clause” exemption from any aspect of the DSU, including consultations. As India and the European Communities correctly point out, the result would logically lead to two separate panel proceedings – an initial proceeding deciding the peace clause issues, and after the issuance of a decision, the initiation of a second proceeding beginning with consultations to challenge the measures under the ASCM.<sup>20</sup> Yet, as these and other third parties highlight, there is no textual requirement or provision in the AoA, the DSU, or any other WTO provision for such a two-panel or two-stage process to resolve peace clause issues.

#### **V. THE US PROPOSAL FOR A SEPARATE PROCEEDING FOR PEACE CLAUSE ISSUES WOULD EFFECTIVELY ADD AOA ARTICLE 13 TO THE CLOSED LIST OF SPECIAL AND ADDITIONAL PROVISIONS IN DSU APPENDIX 2 AND GIVE AOA ARTICLE 13 A SCOPE THAT WAS NOT INTENDED BY AOA DRAFTERS**

18. The United States’ initial brief makes no reference to DSU Appendix 2, even though this provision was a key issue raised in Brazil’s 23 May letter to the Panel. Brazil repeats that Appendix 2 provides a closed list of all the “special and additional” provisions that trump the normal rules of dispute settlement under the DSU. Article 13 does not appear in Appendix 2. Set forth below are two additional reasons in support of this argument.

19. First, providing a special proceeding for determining peace clause defences would effectively add Article 13 to DSU Appendix 2. In the first dispute settlement proceeding on *Guatemala Cement*, the panel found that Article 17 of the *Anti-Dumping Agreement* (ADA) replaced the DSU system as a whole because ADA Articles 17.4-17.7 were listed as special and additional provisions in Appendix 2

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<sup>14</sup> Diccionario de la Lengua Española (Real Academia Española), vigésima segunda edición, 2001.

<sup>15</sup> *Id.*

<sup>16</sup> US Initial Brief para. 8.

<sup>17</sup> Argentina’s Third Party Initial Brief, para. 6;

<sup>18</sup> Initial Submission by the European Communities, paras. 6-7;

<sup>19</sup> India’s comments on preliminary issue regarding the Peace Clause of the Agreement on Agriculture, para. 6.

<sup>20</sup> Initial Submission by the European Communities, paras. 6-7; India’s comments on preliminary issue regarding the Peace Clause of the Agreement on Agriculture, para. 6.

even though ADA Articles 17.1-17.3 were not included.<sup>21</sup> The Appellate Body reversed the panel's implied determination to treat ADA Articles 17.1-17.3 as special and additional rules when it found that DSU provisions generally do not apply to disputes brought pursuant to the ADA:

Article 17.3 of the *Anti-Dumping Agreement* is not listed in Appendix 2 of the DSU as a special or additional rule and procedure. It is not listed precisely because it provides the legal basis for consultations to be requested by a complaining Member under the *Anti-Dumping Agreement*.<sup>22</sup>

The special or additional provisions listed in Appendix 2 of the DSU are designed to deal with the particularities of dispute settlement relating to obligations arising under a specific covered agreement, while Article 1 of the DSU seeks to establish an integrated and comprehensive dispute settlement system for all of the covered agreements of the *WTO Agreements* as a whole. . .<sup>23</sup>

20. The effect of the United States argument and interpretation of “action” in this case would be to include AoA Article 13 as a special and additional rule in Appendix 2. Were the Panel to agree with the United States, it would create a precedent for applying a special procedure whenever a peace clause defence might be invoked. However, this is precisely what the Appellate Body rejected in *Guatemala Cement*, emphasizing that the WTO's dispute settlement system is a *unified* system, not one fragmented according to topic.<sup>24</sup>

21. Second, the negotiating history confirms that AoA Article 13 was not intended to alter normal dispute settlement procedures. The concept of “due restraint” first appeared in Article 18.2 of the Agriculture text in the Dunkel Draft of December 1991, which provided:

On the basis of the commitments undertaken in the framework of this Agreement, Members will exercise due restraint in the application of their rights under the General Agreement in relation to products included in the reform programme.<sup>25</sup>

The concept of special and additional provisions and Appendix 2 then emerged during the work of the Legal Drafting Group on dispute settlement in Spring 1992. The final Legal Drafting Group DSU text dated 15 June 1992 included AoA Article 18.2 in its Appendix 2, as a special and additional provision.<sup>26</sup>

22. The United States and the EC then reached the Blair House Agreements in November 1992, providing *inter alia* for the Dunkel Draft text of Article 18.2 to be deleted, and for the insertion in the AoA of a text corresponding to the present Article 13. In the fall of 1993, the Institutions Group discussed both institutions and dispute settlement; the DSU text resulting from its work, as circulated on 15 November 1993, placed AoA Article 18.2 in brackets.<sup>27</sup>

23. During this period, further discussions also took place on the AoA. After a US-EU settlement in early December 1993 adjusting the Blair House deal, the Blair House changes as adjusted were

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<sup>21</sup> *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/R,

<sup>22</sup> WT/DS60/AB/R, para. 64.

<sup>23</sup> *Id.*, para. 66.

<sup>24</sup> *Id.*, para. 67.

<sup>25</sup> MTN/TNC/W/FA, 20 December 1991, page L.11.

<sup>26</sup> Brazil Exhibit 1 (hereinafter Brazil will refer to its exhibits as “Exhibit Bra-1, 2, 3 etc.”) Excerpt of *Draft Understanding on Rules and Procedures Governing the Settlement of Disputes*, Job No. 968, 15 June 1992.

<sup>27</sup> Exhibit Bra-2. Excerpt of *Draft Understanding on Rules and Procedures Governing the Settlement of Disputes*, 15 November 1993.

made to the AoA. In the December 15, 1993 Final Act, the text of the AoA reflected those changes<sup>28</sup>, and Appendix 2 of the DSU<sup>29</sup> included no reference to the AoA. The negotiating record thus confirms that if negotiators had intended to include the peace clause in Appendix 2, they had ample opportunity to do so. The changes in the “peace clause” component of the Blair House agreements involved deleting former Article 18.2, which *was* a dispute settlement provision listed in Appendix 2, and substituting Article 13. However, although Article 13 limits the ultimate “action” that the DSB may take, as a drafting matter it is *not* placed together with the dispute settlement provisions of the AoA, it is not labeled as a dispute settlement provision, and it is not included in Appendix 2 of the DSU. Reading Article 13 as the United States requests would be inconsistent with DSU Article 3.2 by impermissibly altering the balance of rights and obligations in the WTO and its dispute settlement procedures.

24. Furthermore, AoA Article 13 deliberately makes no reference to any provisions relating to dispute settlement under the Agreement on Agriculture itself (Article 19) or other relevant WTO Agreements (ASCM Articles 4 and 7; DSU or GATT 1994 Articles XXII and XXIII). The AoA Article 13 drafting denotes that Uruguay Round negotiators were concerned about the relationship between substantive provisions of the SCM Agreement (Articles 3, 5 and 6) and GATT 1994 (Article XVI) and the substantive provisions on domestic support and export subsidies under the AoA. In short, what Article 13 does is to protect Members that comply with Article 13 conditions from actions derived from a violation of the substantive provisions cited therein, namely ASCM Articles 3, 5 and 6 and GATT 1994 Article XVI. What Article 13 does not, given the way it was drafted, is to shield Members from the dispute settlement procedures which would be necessary to identify or to confirm the substantive violation of those Articles.

25. Had the AoA drafters intended to carve domestic support and/or export subsidy measures out of the WTO dispute settlement mechanism they would have done it expressly, but they did not. This is further confirmed by the example of Article 6 of the TRIPS Agreement, which clearly states that the issue of the exhaustion of intellectual property rights cannot be addressed through dispute settlement.<sup>30</sup> Unlike AoA Article 13, TRIPS Article 6 expressly prohibits a Member from resorting to the WTO dispute settlement mechanism to challenge certain matters. Against all these evident facts, the only argument the US has to read a prohibition to resort to dispute settlement into Article 13 is based on a groundless definition of “action”, as shown above.

## **VI. A SPECIAL PEACE CLAUSE PROCEDURE WOULD AMOUNT TO HAVING THE PANEL ISSUE A DECLARATORY JUDGMENT FOR THE US AFFIRMATIVE DEFENCE**

26. Brazil’s request for the establishment of a panel (as well as its consultation request) stated that the “United States has no basis to assert a defence under Article 13(b)(ii) . . . and Article 13(c)(ii) of the Agreement on Agriculture . . .”.<sup>31</sup> The third-party statements of the European Communities, Australia, and Argentina agree with Brazil’s description of the peace clause as a “defence”. Each of these third parties agree that the United States is required to assert and prove that all the peace clause conditions apply. For example, the European Communities stated that AoA Article 13

can only be seen as a defence against a claim brought under other aspects of the WTO Agreements which regulate the provision of subsidies. It would seem bizarre if,

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<sup>28</sup> MTN/FA II/A1A-3, Arts. 13, 19.

<sup>29</sup> MTN/FA II/A2, Appendix 2.

<sup>30</sup> TRIPS Article 6 reads: “*For the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights.*”

<sup>31</sup> WT/DS267/7

before Brazil could bring a claim with respect to subsidies which it considered did not respect the US's WTO obligations, Brazil had first to establish that potential US defences did not apply.<sup>32</sup>

27. In addition, Australia argues that "Article 13 is in the nature of an 'affirmative defence' for measures which are inconsistent with the specified provisions".<sup>33</sup> Argentina also takes the view that this provision is in the nature of an affirmative defence, stating that "the Member who alleges to be protected by the Peace Clause has the burden of proving the fulfillment of its legal requirement".<sup>34</sup>

28. The United States' Initial Brief alleges in paragraph 2 that "the US support measures at issue conform with the Peace Clause". Based on this allegation, the United States concludes that "Brazil cannot maintain any action – and the United States cannot be required to defend any such action. . .".<sup>35</sup> The United States has not labeled this as a defence, or an "affirmative defence". However, this assertion by the United States suggests its intent to invoke such a defence as part of its First Submission that it will file on 11 July 2003.<sup>36</sup>

29. Brazil agrees with the European Communities, Australia and Argentina that the peace clause is a defence requiring the United States – not Brazil – to demonstrate that it has met all of its conditions. Brazil also agrees with the European Communities that it would be bizarre if Brazil were required to establish that potential US defences did not apply before it could bring its own claims. And Brazil further agrees with the European Communities that what the United States is requesting in this dispute is effectively a "declaratory judgment" that the United States defences of the peace clause do or do not apply.

30. Brazil will present evidence in its First Submission that the US measures do not meet the conditions of the various peace clause provisions. Brazil will do this because the United States is on record before this Panel in asserting that its support measures are fully in compliance with the peace clause. However, Brazil is not required to present any evidence on the peace clause to assert its actionable and prohibited subsidy claims under the ASCM. Rather, this is the US burden defending against Brazil's various claims. The time and place for the Panel to hear and consider any evidence proffered by the US in any such defence is during the normal panel process, as Brazil has argued in this Comments, in its Initial Brief and in its letter dated 23 May 2003. There is no basis for the United States to demand, or for the Panel to grant, a declaratory judgment that the US peace clause defences are legitimate or not.

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<sup>32</sup> EC Initial Submission, para. 6.

<sup>33</sup> Australia Initial Submission paras. 4-7.

<sup>34</sup> Argentina Initial Submission, para. 14.

<sup>35</sup> US Initial Brief, para. 2.

<sup>36</sup> By contrast, the United States did *not* invoke the peace clause defence in *US - FSC* even though the EC request for the establishment of a panel included claims under ASCM Article 3.1(a) with respect to export subsidies for agricultural products. AoA Article 13(c) conditionally exempts those claims from "actions."

## **VII. CONCLUSION**

31. For the reasons set forth above, Brazil's Initial Brief and its letter dated 23 May 2003, Brazil requests that this Panel find that it is not precluded from hearing evidence and considering Brazil's claims under the ASCM or Article XVI of GATT 1994 without first concluding that the peace clause conditions of AoA Article 13(b)(ii) and 13(c)(ii) remain unfulfilled.

## ANNEX A-10

COMMENTS OF THE UNITED STATES ON THE  
COMMENTS BY BRAZIL AND THE THIRD PARTIES  
ON THE QUESTION POSED BY THE PANEL

13 June 2003

## I. OVERVIEW

1. The United States thanks the Panel for this opportunity to provide its views on the comments by Brazil and the third parties on the question concerning Article 13 of the *Agreement on Agriculture* ("Agriculture Agreement") posed by the Panel in its fax of 28 May 2003.<sup>1</sup> The interpretation of Article 13 (the "Peace Clause") advanced by Brazil and endorsed by some of the third parties is deeply flawed. Simply put, Brazil fails to read the Peace Clause according to the customary rules of interpretation of public international law. Its interpretation does not read the terms of the Peace Clause according to their ordinary meaning, ignores relevant context, and would lead to an absurd result.

2. Brazil reads the Peace Clause phrase "exempt from actions" to mean only that "a complaining Member cannot receive authorization from the DSB [Dispute Settlement Body] *to obtain a remedy* against another Member's domestic and export support measures that otherwise would be subject to the disciplines of certain provisions of the Agreement on Subsidies and Countervailing Measures . . . or Article XVI of GATT 1994".<sup>2</sup> However, Brazil's reading simply ignores parts of the definition of "actions" that it quotes: "The dictionary definition of 'actions' is 'the *taking of legal steps to establish a claim* or obtain a remedy'.<sup>3</sup> Thus, while the United States would agree that the phrase "exempt from actions" precludes "the taking of legal steps to . . . obtain a remedy", Brazil provides no explanation of why the term "exempt from actions" would not, based on its ordinary meaning, also preclude "the taking of legal steps to establish a claim".<sup>4</sup>

3. Brazil also bases its reading in part on the assertion that "[i]n a multilateral system such as the WTO (like GATT 1947 before it), 'actions' are taken collectively by Members".<sup>5</sup> Brazil cannot explain, however, why "actions" should be limited to *only* those actions taken collectively. Read in the context of provisions in the WTO agreements in which the term "action" does not refer to collective action by Members, "action" in the Peace Clause refers broadly to the "taking of legal steps to establish a claim or obtain a remedy".

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<sup>1</sup> The Panel asked the parties to address: "[W]hether Article 13 of the Agreement on Agriculture precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures in these proceedings in the absence of a prior conclusion by the Panel that certain conditions in Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the Agreement on Agriculture, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue."

<sup>2</sup> Brazil's Brief on Preliminary Issue Regarding the "Peace Clause" of the Agreement on Agriculture, para. 2 (5 June 2003) ("Brazil's Initial Brief") (emphasis added).

<sup>3</sup> Brazil's Initial Brief, para. 6 (emphasis added).

<sup>4</sup> See *infra* part II.A.

<sup>5</sup> Brazil's Initial Brief, para. 6 (footnote omitted).

4. In addition, Brazil's suggested reading of the Peace Clause would lead to an absurd result. If the phrase "exempt from actions" means nothing more than that "a complaining Member cannot receive authorization from the DSB to obtain a remedy", then a panel would be perfectly free to make findings that a measure that conforms to the Peace Clause is inconsistent with the relevant provisions of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") or the *Agreement on Subsidies and Countervailing Measures* ("Subsidies Agreement"). Under the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), the DSB would be unable to avoid adopting the panel findings of inconsistency with the Subsidies Agreement or GATT 1994 or recommendations to bring the measure into conformity, thus depriving the Peace Clause of any meaning.

5. The remainder of Brazil's arguments do not go to a proper interpretation of the Peace Clause under the customary rules of interpretation of public international law and so do not assist in answering the question posed by the Panel concerning the Peace Clause. Nonetheless, the United States addresses various of these misplaced concerns. For example, Brazil argues that the Peace Clause is not a special or additional rule set out in Appendix 2 of the DSU; however, the Peace Clause need not be a special or additional rule because the Panel may properly deal with the Peace Clause issue under normal DSU rules. Brazil also tries to cite to unrelated issues in completely distinct disputes, arguing that some of these other panels have delayed making "complex threshold findings" until final panel reports. None of these panels is relevant since none of them has been presented with the issues presented by the Peace Clause. Brazil also asserts that consideration of alleged administrative burdens should override the plain meaning of the text of the Agriculture Agreement – an obviously erroneous approach.

6. As the United States explained in its initial brief on the Panel's question<sup>6</sup>, the phrase "exempt from actions" (read in accordance with the customary rules of interpretation of public international law) means "not exposed or subject to" a "legal process or suit" or the "taking of legal steps to establish a claim". Therefore, Brazil cannot maintain any action – and the United States cannot be required to defend any such action – based on provisions specified in the Peace Clause since the US support measures for upland cotton conform to the Peace Clause.

7. In light of the correct interpretation of the Peace Clause, the United States affirms that it respectfully requests the Panel to organize its procedures to first determine whether Brazil may maintain any action based on provisions exempted by the Peace Clause. Bifurcation of the legal issues in this proceeding is not only required under the Peace Clause but, as an exercise of the Panel's discretion to organize its procedures, would assist the Panel in resolving the complex issues involved in this dispute in a logical and orderly fashion.

## **II. BRAZIL'S INITIAL BRIEF DOES NOT READ THE PEACE CLAUSE ACCORDING TO THE CUSTOMARY RULES OF INTERPRETATION OF PUBLIC INTERNATIONAL LAW AND LEADS TO ABSURD RESULTS**

### **A. THE ORDINARY MEANING OF "EXEMPT FROM ACTIONS" DOES NOT SUPPORT BRAZIL'S READING**

8. According to the customary rules of interpretation of public international law<sup>7</sup>, the terms of the Peace Clause should be interpreted according to their ordinary meaning in their context, in light of

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<sup>6</sup> Initial Brief of the United States of America on the Question Posed by the Panel, paras. 610 (5 June 2003) ("US Initial Brief").

<sup>7</sup> See DSU Article 3.2 (The dispute settlement system "serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law.").

the object and purpose of the Agriculture Agreement.<sup>8</sup> The United States agrees completely with Brazil in terms of the dictionary definition of “actions”. Under that definition, “action” means “the *taking of legal steps to establish a claim* or obtain a remedy”.<sup>9</sup> As the Panel’s question has highlighted, one of the key issues in this dispute is whether the Peace Clause permits Brazil to “take legal steps” so Brazil can “establish” its Subsidies Agreement “claims”.

9. Yet, as soon as Brazil provides the correct definition of “action”, Brazil urges an approach that would ignore it. Combining this definition with that for the word “exempt”<sup>10</sup>, Brazil reads the term “exempt from actions” to mean “that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member’s domestic or export support measures that are ‘peace clause’ protected”.<sup>11</sup> Strikingly, neither Brazil nor any of the third parties who share this interpretation<sup>12</sup> provides any basis in the text of the Peace Clause for ignoring that portion of the definition of “actions” that refers to “the *taking of legal steps to establish a claim*”.<sup>13</sup>

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<sup>8</sup> The customary rules of interpretation of public international law are reflected in part in Article 31(1) of the Vienna Convention, which reads: “A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”

<sup>9</sup> Brazil’s Initial Brief, para. 6 (emphasis added).

<sup>10</sup> Brazil has quoted the definition of the word “exempt” when used as a verb. *See The New Shorter Oxford English Dictionary*, vol. 1, at 878 (1993 ed.) (first definition as transitive verb: “Grant immunity or freedom from or *from* a liability to which others are subject”) (italics in original). However, if used as a verb in the Peace Clause, the correct form of “exempt” would be “shall be *exempted* from actions.” *See id.*, vol. 1, at 878 (examples for first definition of “exempt” as verb: ‘J. A. FROUDE Clergy who committed felony were no longer *exempted* from the penalties of their crimes. R. D. LAING I was *exempted* from military service because of asthma.’) (italics added). As used in the Peace Clause in the construction “shall be . . . *exempt* from actions,” “exempt” is an adjective. *See id.*, vol. 1, at 878 (examples of “exempt” as used in first definition as adjective: “R.C. TRENCH They whom Christ loves are no more *exempt* than others *from* their share of earthly trouble and anguish. J. BERGER He is *exempt* on medical grounds *from* military service.”) (italics added). Therefore, the correct definition of “exempt” as used in the Peace Clause is “[n]ot exposed or subject to something unpleasant or inconvenient; not liable to a charge, tax, etc. (Foll. by *from, of*.)” *Id.*, vol. 1, at 878 (first definition as adjective) (italics in original).

<sup>11</sup> Brazil’s Initial Brief, para. 9; *see id.*, para. 8.

<sup>12</sup> Regrettably, *none* of the third parties (save Australia) even attempts to read the Peace Clause – and in particular the phrase “exempt from actions” – according to the customary rules of interpretation of public international law. Australia does offer an interpretation of “exempt from actions based on” purportedly using the ordinary meaning of the terms, but it appears that Australia has interpreted “exempt from actions” merely by quoting a definition for “exempt.” *Compare* Comments of Australia on Question Posed by Panel, para. 7 & n. 3, with *Black’s Law Dictionary* at 593 (7th ed. 1999) (definition of “exempt” as adjective: “Free or released from a duty or liability to which others are held.”). That is, Australia’s interpretation ascribes no meaning to the words “from actions,” reducing them to inutility. In addition to failing to provide any definition for “actions,” Australia also fails to examine any context for that term in the DSU and the Subsidies Agreement. *See* US Initial Brief, paras. 7-10.

<sup>13</sup> Argentina reads “exempt from actions” as meaning that “a finding of inconsistency with Articles XVI of GATT 1994 or Articles 3, 5 and 6 of SCM Agreement will not be possible if the legal requirements for the exemption are fulfilled.” Comments by Argentina on Question Posed by Panel, para. 5. However, in making this assertion, Argentina neither provides nor attempts to distinguish the ordinary meaning of “action” as the “taking of legal steps to establish a claim or obtain a remedy.” Nor does Argentina explain why, if Members only meant to preclude “a finding of inconsistency” with specified provisions, they did not simply use the word “finding” – for example, “measures . . . shall be . . . exempt from findings based on” certain specified provisions – when the term “finding” is used at least 12 times in the DSU. *See, e.g.*, DSU Article 7.1 (standard panel terms of reference include “mak[ing] such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in that/those agreement(s)”; DSU Article 11 (panel should make an objective assessment of matter before it, including “such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements”); DSU



10. As the United States has demonstrated, the ordinary meaning of “action” encompasses not only the “taking of legal steps to . . . obtain a remedy” but also the “taking of legal steps to establish a claim”. Other dictionary definitions of “action” – such as “the right to institute a legal process”, “[a] legal process or suit”, “a lawsuit brought in court”, “a formal complaint”, “a legal or formal demand of one’s right”, and “all the formal proceedings in a court of justice attendant upon the demand of a right made by one person of another in such court”<sup>14</sup> – provide additional support for this reading. Thus, while the United States agrees that the phrase “exempt from actions” would also preclude “the taking of legal steps to . . . obtain a remedy”<sup>15</sup>, the United States disagrees with Brazil that one may ignore that “exempt from actions” also precludes “the taking of legal steps to establish a claim.” Nothing in the text of the Peace Clause authorizes departing from the ordinary meaning of the Peace Clause phrase “exempt from actions” to narrow this text to refer *solely* to “obtaining a remedy”.<sup>16</sup>

#### B. THE CONTEXT FOR “EXEMPT FROM ACTIONS” DOES NOT SUPPORT BRAZIL’S READING

11. In its analysis of the phrase “exempt from actions”, Brazil quickly moves beyond the ordinary meaning of the term “action” it quotes (which encompasses “the taking of legal steps to establish a claim”) to examine what it deems relevant context for the term. Brazil asserts that “[i]n a multilateral system such as the WTO (like GATT 1947 before it), ‘actions’ are taken collectively by Members”<sup>17</sup>, citing DSU Article 2.1 (last sentence), GATT 1994 Article XVI:1, and DSU Article 22<sup>18</sup>, and concludes: “In sum, ‘actions’ are multilaterally agreed decisions of WTO bodies including the DSB.”<sup>19</sup> Brazil’s argument overlooks the fact that there are numerous instances in various WTO agreements in which the term “action” is used to refer to action by an individual Member, not just collective action by Members.

12. Brazil notes that the term “actions” is sometimes used in the DSU to refer to collective “decisions or actions” by the DSB.<sup>20</sup> This observation is accurate, but the conclusion that Brazil draws from it is a *non sequitur*. The fact that the term “action” can mean “collective decision or action by the DSB” does not imply that the term “action” can mean *only* “collective decision or action by the DSB”.

13. Brazil has moreover failed to consider those instances in which the term “action” is used to refer to individual action by Members.<sup>21</sup> For example, Article 3.7 of the DSU, which states that “[b]efore bringing a case, a Member shall exercise its judgement as to whether action under these

Article 12.7 (panel “shall submit its findings in the form of a written report to the DSB”). There is no basis in the text or context of the Peace Clause to read “actions” to be limited to “panel findings”.

<sup>14</sup> US Initial Brief, para. 7.

<sup>15</sup> Indeed, this necessarily follows from the fact that, if a party cannot take legal steps to establish a claim, it will also be precluded from obtaining a remedy.

<sup>16</sup> We also note that Brazil’s approach of interpreting “exempt from actions” as “cannot receive authorization . . . to obtain a remedy” appears to overlook the “taking of legal steps” component of even the “remedy” portion of the definition of “action”.

<sup>17</sup> Brazil’s Initial Brief, para. 6 (footnote omitted).

<sup>18</sup> Brazil also asserts that “[a]ctions’ include decisions made by the Dispute Settlement Body (DSB) to adopt rulings and recommendations of panels and the Appellate Body” but provides no reference to a provision of the DSU to support the assertion. Neither DSU Article 16.4 (on adoption of panel reports) nor DSU Article 17.14 (on adoption of Appellate Body reports) uses the term “action” to describe a DSB decision to adopt panel and Appellate Body rulings and recommendations.

<sup>19</sup> Brazil’s Initial Brief, para. 6.

<sup>20</sup> For example, Brazil quotes DSU Article 2.1, which states that “[w]here the DSB administers the dispute settlement provisions of a Plurilateral Trade Agreement, only those Members that are parties to that Agreement may participate in decisions or actions taken by the DSB with respect to that dispute.”

<sup>21</sup> See US Initial Brief, paras. 8-9.

procedures would be fruitful,” does not by its terms refer to “multilaterally agreed decisions of WTO bodies including the DSB”. Similarly, Article 4.5 of the DSU states: “*In the course of consultations* in accordance with the provisions of a covered agreement, before resorting to *further action* under this Understanding, Members should attempt to obtain satisfactory adjustment of the matter” (emphasis added). In the Subsidies Agreement, subsidies are divided into prohibited, actionable, and non-actionable categories, and a Member may impose countervailing duties against prohibited and “actionable” subsidies without first obtaining authorization through a “multilaterally agreed decision[] of WTO bodies including the DSB”.<sup>22</sup> Brazil’s interpretation is at odds with all of these provisions – for example, since during consultations the DSB will not have taken *any* action with respect to a dispute, how could a Member attempt to settle a matter before resorting to *further* action? These provisions make clear that, read in the context of the DSU and the Subsidies Agreement, “actions” has a broader scope than Brazil would like: as indicated by its ordinary meaning, “actions” refers to “the taking of legal steps to establish a claim or obtain a remedy,” encompassing all stages of a dispute – obtaining DSB authorization for retaliation would only constitute one, final step.<sup>23</sup>

14. Indeed, had Members intended the scope of the Peace Clause to be limited solely to collective decisions taken by the DSB, they could have used in the Peace Clause the same construction as used in DSU Article 2.1 – for example, “measures . . . shall be . . . exempt from actions taken by the DSB based on” specified provisions. Members did not do so, however.

15. Finally, the United States notes that Brazil has asserted that GATT 1994 Article XVI:1 and DSU Article 22 provide relevant context for the term “actions”. However, neither of these provisions uses the term “action” at all<sup>24</sup>, and they do not support Brazil’s assertion that “actions” in the Peace Clause must be read to refer solely to “multilaterally agreed decisions of WTO bodies including the DSB.” Similarly, Brazil refers to GATT 1994 Article XXV, entitled “Joint Action by the Contracting Parties.” The fact that the drafters referred to this one kind of “action” as *joint* action only reinforces that the term “action” by itself is not intended to be limited to *only* “joint” or “collective” action. The phrase “contracting parties acting jointly” in Article XXV would be unnecessary if Brazil’s interpretation of “action” were correct.<sup>25</sup>

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<sup>22</sup> Members are obligated to “take all necessary steps to ensure that the imposition of a countervailing duty on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement.” Subsidies Agreement, Article 10 (footnote omitted). *See also* GATT 1994 Article VI:6 (requiring multilateral approval of certain exceptional anti-dumping and countervailing duties).

<sup>23</sup> We note that Argentina implicitly concedes that relevant context in the Subsidies Agreement for the phrase “exempt from actions” suggests that the term is not limited to decisions or actions taken by the DSB. Argentina recognizes that “[i]t is true that Article 7 of the SCM Agreement states that the request of consultations is subject to Article 13 of the AoA”. Argentina’s Third Party Initial Brief, para. 13. This would appear to contradict its reading of “the word ‘actions’ in the context of Article 13 of the AoA [as] refer[ring] to decisions of WTO competent bodies, such as the DSB when it discharges its duties by establishing a panel,” *id.*, para. 6. That is, if the Peace Clause precludes a request for consultations by a Member under Article 7 of the Subsidies Agreement, the term “actions” in the Peace Clause cannot solely refer to “decisions of WTO competent bodies”.

<sup>24</sup> *See, e.g.*, GATT 1994 Article XVI:1 (“In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or contracting parties concerned, or with the CONTRACTING PARTIES, the possibility of limiting the subsidization.”); DSU Article 22.6 (“When the situation described in paragraph 2 occurs, the DSB, upon request, shall grant authorization to suspend concessions or other obligations within 30 days of the expiry of the reasonable period of time unless the DSB decides by consensus to reject the request.”).

<sup>25</sup> *See* GATT 1994 Article XXV (“Wherever reference is made in this Agreement to the contracting parties acting jointly they are designated as the CONTRACTING PARTIES.”).

C. BRAZIL'S INTERPRETATION OF THE PEACE CLAUSE WOULD LEAD TO ABSURD RESULTS

16. Brazil's suggested reading of the Peace Clause would rob this provision of any real meaning. Brazil would expose measures that conform to the Peace Clause to finding of inconsistency with the relevant GATT 1994 and Subsidies Agreement provisions and would expose them to retaliation *unless* the complaining party were to agree *not* to adopt the findings or authorize retaliation.

17. Under Brazil's interpretation, the phrase "exempt from actions" means only that "a complaining Member cannot receive authorization from the DSB to obtain a remedy" – that is, the Peace Clause would exempt conforming measures from actions taken by the DSB to authorize remedies but not from findings by the Panel. A panel would therefore be perfectly free to make findings in its final report that a challenged measure that conforms to the Peace Clause is inconsistent with, *inter alia*, the Subsidies Agreement. Under the DSU, the DSB would be unable to avoid adopting the panel findings of inconsistency with the relevant GATT 1994 or Subsidies Agreement provisions or recommendations to bring the measure into conformity.<sup>26</sup> Panel reports are adopted automatically by the DSB under the "negative consensus" rule<sup>27</sup> and authorization to retaliate is also automatically given unless the DSB decides by consensus against this.<sup>28</sup> As a result, the DSB could not decline to adopt the report or authorize remedies unless the complaining party agreed. Thus, under Brazil's reading, the phrase "measures . . . shall be . . . exempt from actions" in the Peace Clause would exempt conforming measures from DSB authorization to retaliate, but *only if* the complaining Member itself agreed not to authorize a remedy. This would be a strange and strained interpretation of the Peace Clause indeed and would effectively render it inutile, contrary to customary rules of treaty interpretation.

18. This absurd result would also conflict with the object and purpose of the Peace Clause and the Agriculture Agreement: namely, to exempt agricultural subsidies, under certain conditions, from the subsidies disciplines of the Subsidies Agreement and GATT 1994 while Members continue negotiations to move towards the "long-term objective . . . to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time".<sup>29</sup> Brazil also has not explained why, on its reading, Members would have chosen to allow actions, with all of their attendant burden on Members' (and the WTO's) resources, up to but not including authorization for retaliation.

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<sup>26</sup> Under DSU Article 19, "[w]here a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement." DSU Article 19 (emphasis added) (footnote omitted).

<sup>27</sup> Under DSU Article 16, a panel report "shall be adopted at a DSB meeting unless a party to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report". DSU Article 16.4 (footnote omitted).

<sup>28</sup> When a Member "fails to bring the measure found to be inconsistent with a covered agreement into compliance therewith or otherwise comply with the recommendations and rulings" and compensation cannot be agreed, the complaining party Member may request authorization from the DSB to suspend concessions, DSU Article 22.2, and "the DSB, upon request, shall grant authorization to suspend concessions or other obligations within 30 days of the expiry of the reasonable period of time unless the DSB decides by consensus to reject the request", DSU Article 22.6.

<sup>29</sup> Agriculture Agreement, preamble (third paragraph).

**III. BRAZIL'S INITIAL BRIEF RAISES A NUMBER OF MISGUIDED CONCERNS WHICH CANNOT UPSET THE BALANCE OF RIGHTS AND OBLIGATIONS OF MEMBERS UNDER THE PEACE CLAUSE AND DO NOT SUPPORT CONSIDERING BOTH THE APPLICABILITY OF THE PEACE CLAUSE AND BRAZIL'S SUBSTANTIVE CLAIMS TOGETHER**

19. Brazil has advanced a number of other arguments, which relate neither to the ordinary meaning and context of the phrase "exempt from actions" nor to the object and purpose of the Peace Clause and the *Agreement on Agriculture*. These arguments are thus not relevant to the Panel's task of clarifying the meaning of the Peace Clause in accordance with customary rules of interpretation of public international law. Nonetheless, an examination of each of Brazil's arguments reveals that none of these concerns is well-founded.

**A. THE PANEL MAY EXAMINE THE APPLICABILITY OF THE PEACE CLAUSE UNDER NORMAL DSU RULES**

20. Brazil argues that because Article 13 is not a special or additional rule set out in Appendix 2 of the DSU, Peace Clause issues must be resolved using normal DSU rules and procedures, which Brazil believes would prohibit reaching the Peace Clause issue first. Brazil errs on two counts. There was no need to designate Article 13 of the Agriculture Agreement as a special or additional rule *precisely because* the Panel may properly deal with the Peace Clause issue using the flexibility inherent in the normal DSU rules. The DSU, in Articles 12.1 and 12.2, provides the Panel with all the authority it needs to organize its working procedures as it considers best to resolve the matter in dispute.<sup>30</sup> Under DSU Article 12.1, the Panel is given the authority to determine its own working procedures "after consulting the parties to the dispute".<sup>31</sup> Under DSU Article 12.2, moreover, the Panel is charged with establishing panel procedures with "sufficient flexibility so as to ensure high-quality panel reports".<sup>32</sup>

21. Brazil itself has conceded the Panel's broad authority to establish its procedures in its letter of 23 May 2003, when it wrote of objections relating to the scope of a panel request under DSU Article 6.2: "The decision on how to handle such preliminary objections procedurally *is a matter of panel discretion*".<sup>33</sup> Thus, Brazil implicitly recognizes that the Panel already has the flexibility and the authority under normal DSU rules to organize its procedures to consider and dispose of the Peace Clause issue first. There is no need for the Peace Clause to be listed as a "special or additional rule and procedure" in DSU Appendix 2 because under normal DSU rules the Panel may bifurcate the proceedings in order to respect the balance of rights and obligations of Members under the Peace Clause and the Agriculture Agreement – that is, to ensure that conforming US measures are "exempt from actions based on" provisions specified in the Peace Clause.

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<sup>30</sup> See Comments by the European Communities on certain issues raised on an initial basis by the Panel, para. 8 ("In conclusion, the Panel has substantial discretion in deciding how it will manage these issues. Article 12.1 DSU makes it quite clear that the Working Procedures set out in Appendix 3 of the DSU may be departed from if the Panel decides this is appropriate.").

<sup>31</sup> DSU Article 12.1 ("Panels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting with the parties to the dispute.").

<sup>32</sup> DSU Article 12.2 ("Panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process.").

<sup>33</sup> Letter from Ambassador Luiz Felipe de Seixas Corrêa, Permanent Mission of Brazil, to Mr. Dariusz Rosati, Chairman of Panel, at 3 (23 May 2003) (emphasis added). The carry-over paragraph continues: "Where preliminary objections have been resolved in advance of other claims, normally they have been resolved in the panel's first meeting, on the basis of the first round of submissions and oral statements."

22. The United States notes that the Appellate Body has urged panels to adopt working procedures providing for preliminary rulings to deal with threshold jurisdictional issues<sup>34</sup>, even though there are no “special and additional rules” in the DSU providing for these. In addition, we note that Article 10.3 of the Agriculture Agreement (the same agreement at issue here) is not listed as a “special and additional rule,” but panels and the Appellate Body have made clear that this provision nonetheless governs dispute settlement proceedings by shifting the burden of proof to the responding party.<sup>35</sup>

23. Finally, Brazil relies on Article 11 of the DSU – pursuant to which a panel “should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements” – to support its position. Brazil’s reliance on Article 11 is misplaced as shown by a simple examination of the text of Article 11. Article 11 provides the standard of review for panels; it does not guide the procedure used by panels. According to Brazil, DSU Article 11 somehow mandates that a panel review “all the facts including rebuttal facts,” hold two panel meetings, and allow for the exchange of rebuttal submissions.<sup>36</sup> Brazil’s argument is untenable; it would read Article 11 to *mandate* a particular series of meetings and submissions when Article 11 does *not* set out *any* particular procedural steps through which a panel “should make an objective assessment of the matter before it.” At the same time, Brazil argues that the Panel *may not*, consistent with Article 11, consider the applicability of the Peace Clause first because “Article 11 contains no requirement for a special briefing, meeting or determination by a panel to resolve such applicability or exemption.”<sup>37</sup> Of course, there is nothing in the text of Article 11 that supports reading this provision to preclude the Panel’s bifurcating the proceeding to respect the balance of rights and obligations in the Peace Clause. However, to be consistent with its own argument, Brazil should also read Article 11 not to mandate any particular number or sequence of procedural steps (such as those set out in DSU Appendix 3) that are not required under its terms.

B. NO PREVIOUS PANEL REPORT HAS EXAMINED THE PEACE CLAUSE, AND OTHER PROCEDURAL PROVISIONS CITED BY BRAZIL DO NOT CONTAIN THE PHRASE “SHALL BE . . . EXEMPT FROM ACTIONS”

24. Brazil suggests that deciding the issue of the applicability of the Peace Clause in advance of Brazil’s substantive Subsidies Agreement and GATT 1994 claims is “contrary to the practice of earlier panels”.<sup>38</sup> Of course, there is no such practice since this is the first dispute to face this issue.

25. Brazil also argues that there are “a number of other threshold issues in WTO Agreements” but that “none of these provisions have special and additional rules to provide for extraordinary preliminary briefings, meetings, and determinations prior to a panel hearing on all of the claims presented”.<sup>39</sup> Brazil’s invocation of previous panel proceedings is inapt. Brazil has not asserted that any of the “threshold” provisions in other WTO agreements that it cites or that have been interpreted by previous panels contain the same language as the Peace Clause (that is, “shall be . . . exempt from

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<sup>34</sup> See Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, para. 144.

<sup>35</sup> See Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/RW2, WT/DS113/AB/RW2, paras. 67-75 (second recourse to DSU Article 21.5).

<sup>36</sup> See Brazil’s Initial Brief, paras. 11-16.

<sup>37</sup> Brazil’s Initial Brief, para. 16; *see id.*, para. 11 (“Thus, resolution of the ‘peace clause’ issues . . . must be resolved using normal DSU rules and procedures.”).

<sup>38</sup> Brazil’s Initial Brief at 7 (heading IV).

<sup>39</sup> Brazil’s Initial Brief, para. 21.

actions”).<sup>40</sup> Indeed, it is striking that Brazil studiously avoids comparing the text of any of these provisions with the text of the Peace Clause.<sup>41</sup>

26. Given the fact that *none* of the other provisions cited by Brazil contains Peace Clause-like language, these provisions have little relevance for the Panel’s interpretation of the Peace Clause. At most, the relevance of these provisions lies in the fact that such “threshold” provisions do *not* use language that certain measures “shall be . . . exempt from actions.” This suggests that the distinct language of the Peace Clause was intended to provide a distinct right, and one that differs from rights provided by these other WTO provisions.

27. We also note Brazil’s argument that in the “closest case to the peace clause issue presented here” – that is, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R – there was “never a suggestion or finding that the panel erred by not conducting a special briefing and special determination” on the “threshold issue whether Brazil was in compliance with Article 27.4” of the Subsidies Agreement. From the Appellate Body report, it would appear that the Appellate Body did not address it because no party suggested that this threshold issue had to be taken up as a first stage of the proceeding. Nonetheless, the Appellate Body found that the panel erred in not considering the threshold Article 27.4 issue first. The Peace Clause language (“measures . . . shall be . . . exempt from actions”) is different and even stronger in requiring that the Peace Clause be taken up first and separately, with findings, prior to any consideration of the relevant GATT 1994 and Subsidies Agreement provisions.

#### C. BRAZIL WILL NOT BE PREJUDICED BY SEPARATE HEARINGS AND BRIEFINGS ON THE PEACE CLAUSE ISSUE

28. Brazil, referring to its 23 May letter, argues that it will be prejudiced if the Panel considers separately the issue of the applicability of the Peace Clause from Brazil’s substantive claims as this will disrupt “Brazil’s efforts to make a coherent and unified presentation of its case”<sup>42</sup> and result in greater expense to Brazil “in having to bring its legal and economic experts to Geneva for an extra meeting.”<sup>43</sup> Of course, any concerns that Brazil’s presentation of its case may be affected cannot supersede the rights and obligations of Members as set out in the covered agreements – including the Peace Clause. In fact, the Peace Clause resolves any issue of how to account for burdens on parties since it provides that the responding party’s measures are exempt from any action based on the relevant GATT 1994 and Subsidies Agreement provisions – it exempts the responding party from the burden of having to respond to the complaining party’s claims. Brazil ignores this aspect of the Peace Clause. In any event, we note that bifurcating this proceeding to ensure that these conforming US measures are exempt from action based on Peace Clause-specified provisions will *reduce*, rather than increase, the amount of work involved for *both* parties. Here, dealing with the Peace Clause issue first will resolve that part of the dispute, saving both parties further work, since the US measures conform to the Peace Clause. And in general, such an approach simply means that a panel would deal

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<sup>40</sup> For example, arguments that a particular claim is not within a panel’s terms of reference under DSU Article 6.2 do not involve any textual mandate that measures “shall be . . . exempt from actions.” What Brazil calls the “closest case to the peace clause issue presented here” involved Articles 27.2(b) and 27.4 of the Subsidies Agreement, neither of which says that measures “shall be . . . exempt from actions based on” specified provisions. See Brazil’s Initial Brief, para. 19 (quoting Appellate Body discussion of Subsidies Agreement Articles 27.2(b) and 27.4 in *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R; Subsidies Agreement Article 27.2 states that the “prohibition of paragraph 1(a) of Article 3 shall not apply to” developing country Members in compliance with Article 27.4). Other provisions cited by Brazil (Article 1 of the *General Agreement on Trade in Services*, Article 2 of the *Agreement on Technical Barriers to Trade*, and Annex I of the *Agreement on Government Procurement*) similarly do not provide a legal right not to be subject to actions.

<sup>41</sup> See Brazil’s Initial Brief, paras. 18-21.

<sup>42</sup> See Brazil’s Initial Brief, paras. 17.

<sup>43</sup> Brazil’s Initial Brief, para. 22.

in sequence with the issues it would otherwise have to confront in a dispute. Because no additional issues would be covered (and needless work on certain claims might be avoided), it would not appear that additional effort on the part of a panel or the parties would be required.

29. We also note in any event that Brazil's concerns about duplication of its factual presentation and increased expense seem overstated. Even if this were a dispute where the relevant measures did not conform to the Peace Clause, Brazil misunderstands the process. The fact that some of the same evidence might be relevant to Peace Clause as well as Subsidies Agreement claims does *not* mean that the evidence would have to be introduced twice. Once Brazil's factual evidence were introduced, if it were relevant to later stages of the proceeding, it could of course be used for that purpose.<sup>44</sup> Thus, there should be no duplication of its factual presentation and no additional burden to Brazil on that count. Similarly, with respect to concerns about the additional expenditure of resources should the Panel bifurcate this proceeding, the full-time presence of Brazil's private-sector counsel in Geneva should alleviate some of the expense that extra meetings (which there is no reason to assume would be needed since the US measures conform to the Peace Clause) might entail. In any event, however, the United States finds it difficult to believe that Brazil would bring an action with claims under 17 different provisions of the WTO agreements with respect to programs under at least 12 US statutes and not expect that the resulting dispute would involve additional complications and all the accompanying demands for time and resources.

30. Finally, the United States notes that Brazil has raised the issue that separate hearings and briefing on the Peace Clause issue "would cause it prejudice because there would be significant[] delays in the resolution of its claims – many of which do not implicate the peace clause".<sup>45</sup> While, on its face, Brazil's list of "non-peace clause claims" appears to include claims based on provisions specified in the Peace Clause<sup>46</sup>, Brazil's point is not raised by the Panel's question. If the Panel requests the parties to give their views on the question of what should happen with any claims in this action based on provisions not specified by the Peace Clause, the United States would be pleased to do so.

**IV. WERE THE PANEL TO CONSIDER THAT THE PEACE CLAUSE DOES NOT REQUIRE THAT THE PANEL DETERMINE WHETHER US MEASURES ARE EXEMPT FROM ACTIONS BEFORE CONSIDERING BRAZIL'S SUBSIDIES AGREEMENT AND GATT 1994 ARTICLE XVI ACTION, THE PANEL SHOULD EXERCISE ITS DISCRETION TO BIFURCATE THE PROCEEDING**

31. Putting aside the arguments related to prejudice and expense which have been discussed above, the United States notes that, in the course of allegedly discussing the "context" for the Peace Clause, Brazil makes an argument that speaks not to any relevant context but to the Panel's exercise of its discretion to organize its procedures. Brazil argues that the "close overlap of proof for both peace clause and actionable and prohibited subsidy claims highlights the need for the Panel to examine all the 'facts of the case' together".<sup>47</sup> First, in this context, the United States has noted, and Brazil and the European Communities apparently agree, that the Panel enjoys significant discretion under DSU Articles 12.1 and 12.2 to organize its working procedures as it considers best to resolve the matter in dispute.

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<sup>44</sup> To put it simply, "Brazil exhibit 419" (for example) would remain "Brazil exhibit 419" – it would not change simply because it was now being cited in a different argument.

<sup>45</sup> Brazil's Initial Brief, para. 23.

<sup>46</sup> Brazil argues that its "non-peace clause claims include . . . Article XVI:3 of GATT 1994 involving all domestic and export subsidies challenged by Brazil." Brazil's Initial Brief, para. 23. However, the Peace Clause explicitly states that conforming "export subsidies . . . shall be . . . exempt from actions based on Article XVI of GATT 1994." Agriculture Agreement, Article 13(c)(ii).

<sup>47</sup> Brazil's Initial Brief, para. 15.

32. However, even were the Panel to conclude that Article 13 does not require the Panel to determine whether US measures are in breach of the Peace Clause and no longer “exempt from actions based on” specified provisions, the significance and wording of the Peace Clause in this dispute would mean that the Panel should exercise its discretion to bifurcate this proceeding. The Peace Clause would remain a significant, decisive issue. As noted above, bifurcating the proceedings would save both parties as well as the Panel significant time and work since it will render it unnecessary to address the relevant GATT 1994 and Subsidies Agreement claims.

33. Furthermore, given that Brazil has signalled that its Peace Clause arguments alone will involve “the presentation of considerable factual evidence and expert econometric testimony”<sup>48</sup>, it would appear that to hear Brazil’s substantive claims at the same time would significantly complicate the Panel’s work. The apparent complexity of Brazil’s Peace Clause evidence also calls into significant question the likelihood that the timetable requested by Brazil is realistic with respect to the legitimate interests of the United States to defend its position. Finally, we note that, by seeking to have the Panel consider both the Peace Clause issue and Brazil’s substantive claims at the same time, Brazil may be attempting to prejudice the US rights of defence – particularly since, even on Brazil’s mis-reading of the Peace Clause, the US measures are “exempt from actions”, Brazil is not entitled to obtain any remedy from the DSB.<sup>49</sup>

34. The United States also disagrees in any event that the “close overlap of proof for both peace clause and actionable and prohibited subsidy claims highlights the need for the Panel to examine all the ‘facts of the case’ together”. For example, to establish its “serious prejudice” claims, Brazil must present evidence showing that the United States has caused “adverse effects” through “the use of any subsidy” (Subsidies Agreement, Article 5(c)) and evidence on “the effect of the subsidy” (Subsidies Agreement, Article 6.3(b), (c), (d)). Neither of these showings is relevant to the issue of whether US measures have breached the Peace Clause.

35. Frankly, if Brazil’s Peace Clause arguments will involve extensive factual and econometric evidence, it is difficult to understand why the Panel would be *better* served by considering this “considerable” evidence and testimony at the same time that it receives even *more* evidence and testimony on other, unrelated issues. Thus, even if one hypothesized that the Peace Clause does not require the Panel to consider the issue of its applicability prior to examining Brazil’s substantive claims and that the Panel solely needed to consider how to take the Peace Clause issue into account in exercising its discretion to organize its procedures, the United States submits that the Panel’s work would be facilitated by focusing on the legally and logically distinct Peace Clause issue first.<sup>50</sup>

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<sup>48</sup> Letter from Ambassador Luiz Felipe de Seixas Corrêa, Permanent Mission of Brazil, to Mr. Dariusz Rosati, Chairman of Panel, at 4.

<sup>49</sup> See Brazil’s Initial Brief, para. 9 (“In sum, ‘exempt from actions’ means that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member’s domestic or export support measures that are ‘peace clause’ protected.”).

<sup>50</sup> See Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, paras. 142-44 (finding that panel should have considered threshold Article 27.4 issue before examining whether export subsidy had been provided under Subsidies Agreement Article 3.1(a)); *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, para. 144 (noting that panels would be better served by adopting working procedures providing for preliminary rulings to deal with threshold jurisdictional issues).



## V. OTHER ARGUMENTS BY THIRD PARTIES

### A. GIVEN DSU RULES, THE PANEL'S ORGANIZATION OF ITS PROCEDURES REPRESENTS THE FIRST OPPORTUNITY TO ARREST BRAZIL'S ACTION

36. India and the European Communities have suggested that, taken to its logical extreme, reading "actions" as the "taking of legal steps to establish a claim" would require a complaining party to bring two actions: first, an action to establish that the Peace Clause does not apply to certain measures, and second, if a panel were to find the Peace Clause inapplicable, an action challenging the measures based on the provisions specified in the Peace Clause. While this issue is not pertinent to the Panel's question concerning Article 13, the United States notes that it has not advanced such an interpretation by, for example, asking the Panel to find that it could not be established.<sup>51</sup> Thus, this issue is not before the Panel, and India's and the EC's arguments are irrelevant. Rather, we have requested more modestly that the Panel, consistent with the Peace Clause, structure its procedures so that US measures will in fact be exempted from Brazil's action based on provisions specified in the Peace Clause at the earliest possible juncture under the DSU.

37. As these third parties apparently fail to appreciate, prior to this moment, DSU rules provided for the dispute to proceed through consultations and panel establishment automatically, regardless of the US insistence that its measures conform to the Peace Clause. Although the United States has maintained at each and every stage that the challenged measures conform to the Peace Clause, the United States could not have stopped Brazil from asking for consultations<sup>52</sup>, nor could it reasonably have been expected to refuse an entire request for consultations because it contains a request contrary to the Peace Clause, nor could the United States have prevented the establishment of this Panel. As a responding party cannot prevent panel establishment from occurring, it will inevitably be forced to argue to a panel that the panel's procedures should be structured so that the party's challenged measures are not subject, from that point on, to actions based on provisions specified in the Peace Clause. Thus, given the automaticity in DSU rules relating to consultations and panel establishment, the Panel's organization of its procedures provides the first opportunity to arrest Brazil's "taking of legal steps to establish a claim", and this is all the United States has asked the Panel to do.

### B. CONTRARY TO THE SUGGESTION BY SEVERAL THIRD PARTIES, THE PEACE CLAUSE IS NOT AN AFFIRMATIVE DEFENCE

38. Australia and the European Communities have each asserted that the Peace Clause is an affirmative defence.<sup>53</sup> The United States believes that they are in error. However, this issue is not

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<sup>51</sup> We also note that this potential question relating to whether a panel could have been established given the applicability of the Peace Clause could arise even under Brazil's interpretation of "exempt from actions". Brazil states that "actions are multilaterally agreed decisions of WTO bodies including the DSB". However, "exempt from actions" would then seem to reach DSU Article 6.1, under which the DSB takes a "multilaterally agreed decision" to establish a panel to consider a matter. Thus, under Brazil's own logic, "exempt from actions" in the Peace Clause should also preclude a decision by the DSB to establish a panel and not just a decision to authorize remedies. Argentina implicitly concedes the point when it states that it "agrees with Brazil's statement in paragraph 6 of its Brief that the word 'actions' in the context of Article 13 of the AoA refers to decisions of WTO competent bodies, *such as the DSB when it discharges its duties by establishing a panel*". Argentina's Third Party Initial Brief, para. 6 (emphasis added).

<sup>52</sup> However, the United States notes that Argentina (in paragraph 13 of its "Third Party Initial Brief") accepts that under Article 7 of the Subsidies Agreement, a Member is not to request consultations on measures conforming to the Peace Clause.

<sup>53</sup> See Comments by Australia, para. 4 (10 June 2003); Comments by the European Communities on certain issues raised on an initial basis by the Panel, para. 6 (dated 10 June "2002" on first page, 2003 in the heading).

raised by the Panel's question concerning Article 13, and there is no need to discuss it further at this time.

**VI. CONCLUSION: BRAZIL MAY NOT BRING, AND THE PANEL MAY NOT ADJUDICATE, A SUBSIDIES AGREEMENT OR GATT 1994 ARTICLE XVI ACTION AGAINST US MEASURES CONFORMING TO THE PEACE CLAUSE**

39. For the reasons set out above and in its initial brief on the Panel's question concerning the Peace Clause, the United States respectfully requests the Panel to find that measures that conform to the Peace Clause are exempt from any action, including action under the DSU, based on the corresponding provisions of the Subsidies Agreement and the GATT 1994. As a result, the United States is not required to defend those measures in any action based on Brazilian claims exempted by the Peace Clause.

**ANNEX B****SUBMISSION OF PARTIES AND THIRD PARTIES FOR THE  
FIRST SESSION OF THE FIRST SUBSTANTIVE MEETING**

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## **ANNEX B-1**

### **EXECUTIVE SUMMARY OF BRAZIL'S FIRST SUBMISSION TO THE PANEL REGARDING THE "PEACE CLAUSE" AND NON-PEACE CLAUSE RELATED CLAIMS**

#### **Introduction**

1. Brazil's first submission initially addresses issues relating to the substantive interpretation of Article 13 of the Agreement on Agriculture (AoA), known as the "peace clause," and details the evidence demonstrating that the United States has no basis to assert a peace clause defence regarding Brazil's actionable and prohibited subsidy claims. The second part of Brazil's first submission sets forth the evidence and arguments concerning claims involving the following US measures: Step 2 export payments, the US export credit guarantee programmes (GSM 102, GSM 103 and SCGP) and the ETI Act subsidies. These three subsidies do not fully conform to the provisions of Part V of the Agreement on Agriculture and, thus, the United States has no peace clause protection from claims under the SCM Agreement. Step 2 export payments, the three export credit guarantee programmes and the ETI Act subsidies also violate ASCM Article 3.1(a) and 3.2. Finally, Brazil demonstrates that Step 2 domestic payments violate ASCM Article 3.1(b) and GATT Article III:4.

#### **Issues Regarding the Peace Clause in AoA Article 13**

2. The peace clause of AoA Article 13 is in the nature of an affirmative defence. The United States has indicated that it will invoke a peace clause defence. To do so, the United States bears the burden of proof that US domestic support and export subsidies to upland cotton are provided in conformity with the requirements of the peace clause. Based on public international law and Appellate Body jurisprudence on the allocation of the burden of proof, AoA Article 13 is an affirmative defence because it provides an exception to a legal regime otherwise applying to agricultural support measures. It does not alter the scope of other provisions providing positive obligations on Members, and is not itself a positive obligation. It simply allows Members to maintain measures otherwise inconsistent with their WTO obligations exempt from actions, provided that the measures meet the conditions specified in AoA Article 13.

3. In accordance with Article 31 of the *Vienna Convention*, the appropriate interpretation of AoA Article 13(b)(ii) is the following: Members may assert a peace clause defence under AoA Article 13(b)(ii) *only* if the total quantity of support granted through all non-"green box" domestic support measures (*i.e.*, measures that do not fully comply with the provisions of AoA Annex 2) to a specific commodity in any marketing year from 1995-2003 does not exceed the quantity of non-"green box" domestic support decided to be granted in MY 1992. The only "decision" made by the United States "during" MY 1992 was to grant (*i.e.*, make actual expenditures) of \$1.994 billion in non-"green box" support to upland cotton pursuant to the terms of the 1990 FACT Act.

4. The evidence regarding the amount of non-"green box" US support to upland cotton granted in MY 1999-2002 is based largely on USDA documents, which show that US non-"green box" domestic support decided to be authorized and paid to upland cotton increased to \$3,445 million in MY 1999, was \$2,311 million in MY 2000, and increased to a new record high of \$4,093 million in MY 2001 (for a crop valued at \$3,312 million). Brazil estimates that US non-"green box" domestic support for MY 2002 (which will end on 31 July 2003) is \$3,113 million. This estimate is based on the last available data and the requirements set out in the 2002 FSRI Act.

5. Thus, the evidence reveals that the amount of non-“green box” support granted in MY 1999-2002 exceeds the level of support “decided” by the United States in MY 1992. Therefore, the United States does not enjoy peace clause exemption from actions based on ASCM Article 5 and 6 and Article XVI:1 of GATT 1994 involving non-“green box” domestic support to upland cotton.

6. Brazil’s calculation of the MY 1999-2002 reflects the appropriate set of non-“green box” domestic support measures granted to upland cotton. The United States notified to the WTO Committee on Agriculture that the following programmes are “amber box” support for MY 1999: Step 2 payments, loan deficiency payments, marketing loan gains, crop insurance payments, cottonseed payments, and market loss assistance payments. The structure of the first five of these domestic support programmes is substantially the same in MY 2000-2001 and under the 2002 FSRI Act as it was in MY 1999. There is also no indication that these five programmes should not continue to be treated as non-“green box” domestic support to upland cotton for the purposes of MY 2002. Therefore, the support under these five programmes, as well as market loss assistance payments, are non-“green box” support to upland cotton and are properly included in the set of domestic support measures for purposes of assessing possible US peace clause exemption from action.

7. With respect to production flexibility contract payments (PFC), direct payments (DP) and counter-cyclical payments (CCP), the evidence demonstrates that these payments are also non-“green box” support granted to upland cotton. The basis of this conclusion is summarized below.

8. *Production Flexibility Contract Payments (PFC)*: There are two reasons why PFC payments are not properly “green box” support. First, PFC payments are inconsistent with AoA Annex 2 paragraph 6(b), because Section 118(b) of the 1996 FAIR Act and the regulations implementing the PFC programme eliminates or reduces payments if producers grow certain products – fruits, vegetables and wild rice – on contract acreage.

9. AoA Annex 2 paragraph 6(b) requires that the “amount” of payments “shall not be related to or based on, the type of production...” The object and purpose of paragraph 6(b), based on its text and context, is to ensure that decoupled “green box” payments are not focused or channelled for a single product or a particular sub-set of products. It covers only *completely* decoupled domestic support measures. Paragraph 6(b) seeks to guarantee that a producer who receives such payments can produce any product covered by the Agreement on Agriculture.

10. Section 118(b) of the 1996 FAIR Act and its regulations make it clear that the *amount* of PFC payments in any given marketing year between 1996 and 2001 was related to or was based on the *type* of production undertaken by a producer who entered into a PFC contract. The general rule is that “planting fruits and vegetables (except lentils, mung beans, and dry peas) shall be prohibited on contract acreage”. If fruits and vegetables are grown on contract acreage, then the regulations provide that “the Deputy Administrator shall terminate the contract with respect to the producer on each farm in which the producer has an interest”. The regulations also provide that in less serious cases of violation, the penalty may be a reduction of contract payments equal to the market value of the fruits and vegetables or the contract payment for each acre used for fruits and vegetables. Thus, the PFC payments are not “decoupled income support” as set out in AoA Annex 2 paragraph 6(b) and therefore, are not “green box” support.

11. The second reason that PFC payments provided to upland cotton producers are not properly “green box” support is that they are inconsistent with the “fundamental” requirement in AoA Annex 2 paragraph 1 that they have “no, or at most minimal, trade distorting effects or effects on production”. The quantity or level of production or trade distorting effects need only be very minimal to trigger denial of “green box” status under AoA Annex 2. This follows from the text of AoA Annex 2 paragraph 1, which contains the phrases “no,” “at most,” and “fundamental”.

12. The record in this case demonstrates that PFC payments have had more than “at most” a “minimal” effect on production of US upland cotton during MY 1999-2002. Almost all upland cotton producers participated in the PFC programme. Furthermore, domestic US upland cotton producers view PFC payments as an important component of payments provided to upland cotton farmers. The percentage of subsidization by PFC payments relative to the market value measured by the price received by US upland cotton producers represents between 14 and 17 per cent for period MY 1999-2001. This provides US producers with a significant advantage in export competition with producers in the rest of the world who do not receive such a level of (or any) subsidies.

13. The PFC payments also have production effects because of the very high cost of production for upland cotton in the United States. Given the high US costs, without 14-17 per cent subsidies some higher-cost US producers would likely stop producing upland cotton. This would have resulted in lower levels of US upland cotton production. USDA economists have acknowledged the production-enhancing effects of PFC payments. They have also identified likely patterns of production effects.

14. Because the *quantity* or *level* or trade distorting effects need only be very minimal to trigger denial of “green box” status under AoA Annex 2, the evidence of the production enhancing effects of PFC payments necessitates the conclusion that PFC payments are not properly included within the AoA Annex 2 “green box”. They are, thus, properly included within the domestic support measures to be used for the calculation of the amount of domestic support to upland cotton for MY 1999, 2000 and 2001.

15. *Direct payments (DP)*: with the passage of the new FSRI Act in May 2002, PFC payments were discontinued and replaced with DP. These began to be paid in MY 2002 and will be paid until the end of MY 2007. USDA has identified the DP programme as the direct successor to the PFC programme under the 1996 FAIR Act.

16. There are three reasons why DP are not properly within AoA Annex 2. First, as with PFC payments, the amount of DP are related to or based on the type of production undertaken in any year after the base period in violation of AoA Annex 2 paragraph 6(b). The 2002 FSRI Act and its implementing regulations eliminate or limit the amount of DP if base acreage is used for the production of certain crops, i.e., fruits, vegetables and wild rice.

17. Second, the DP provisions of the 2002 FSRI Act violate AoA Annex 2, paragraph 6(a) and (b) because producers were permitted to “update” their base acreage using MY 1998-2001 production totals. This is inconsistent with Annex 2, paragraph 6(a), which requires a *single, fixed* base period for a programme of support. The object and purpose of AoA Annex 2 paragraph 6(a) and (b) is to ensure that Members do not permit payments to increase over time in a manner linked to increases in production over time. This also follows from the AoA Annex 2 paragraph 1 requirement that “green box” support measures have no or at most minimal production effects. That can only occur if the base (i.e., the base for increased payments) does not adapt to recent changes in the production of a farmer.

18. The major structural elements of the PFC programme and the DP programme are the same for both programmes in terms of the basic types of crops covered, the producer’s obligations to receive payments, prohibited plantings of certain crops, and freedom to receive payments for one crop and farm another crop. The change from the PFC programme to the DP programme is not “de-coupling” but rather “re-coupling” of MY 2002 and future DP with MY 1998-2001 production.

19. One third of farms receiving PFC payments between MY 1996-2001 updated their acreage for the DP programme using MY 1998-2001 production data. Thus, interpreting AoA Annex 2 paragraph 6(a) and (b) to permit an updating of the “fixed” base period by essentially changing the name of the “PFC payment” programme to DP programme would render these provisions a nullity.

20. Third, DP also have more than “at most minimal” production and trade-distorting effects contrary to the chapeau of AoA Annex 2 paragraph 1. DP, like PFC payments, can increase production of upland cotton through (1) a direct wealth effect through risk aversion reduction, (2) a wealth facilitated increased investment reflecting reduced credit constraints, and (3) a secondary wealth effect resulting from the increase in investment. In addition, the updating of base acres in the 2002 FSRI Act created an ongoing production-enhancing effect because farmers will expect future updates and continue to maintain high levels and even increase production between MY 2002 - 2007. Continued low cotton prices will increase the need of producers to protect their base as a hedge against low prices. In addition, US upland cotton producers are among the world’s highest cost producers. That means that the amount of DP (and CCP) is critical to the economic survival of many US upland cotton producers. Thus, there will be a very strong incentive to maintain and increase upland cotton base in anticipation of future base updates in future farm legislation to offset potentially lower world prices.

21. In sum, DP are properly included within the set of domestic support measures to be used for calculating the amount of domestic support to upland cotton for MY 2002.

22. *Counter-Cyclical Payments (CCP)*: are non-“green box” domestic support because they are inconsistent with AoA Annex 2 paragraphs 6(a), 6(b) and 6(c). First, like PFC and DP, CCP are inconsistent with Annex 2 paragraph 6(b) because the CCP programme eliminates or limits the amount of payments for *those* producers who grow fruits, vegetables and wild rice on base acres.

23. Second, CCP also violate AoA Annex 2 paragraph 6(c) because the amount of payments is based on current market prices. The ordinary meaning of AoA Annex 2 paragraph 6(c) is that any direct income support to a producer of agricultural products must not be linked to an international or domestic price established after the base period, *i.e.*, to a current price. CCP are not based on the prices of upland cotton production that took place in a prior base period but rather on prices of present production. As the current upland cotton prices received by US farmers fluctuate between \$0.52 and \$0.6573 per pound, the amount of payments for each year between MY 2002-2007 changes. This is inconsistent with AoA Annex 2 paragraph 6(c), which requires that payments cannot be based on “the prices...applying to any production undertaken in any period after the base period”. But the CCP programme has no fixed “base period” for the purposes of setting “prices”. It uses current prices, *i.e.*, prices that apply to current production and, thus, to a “production undertaken in a period after the base period”.

24. Third, like PFC and DP, CCP have production and trade distorting effects in violation of AoA Annex 2 paragraph 1. The new CCP programme for upland cotton is one of the main sources of increased payments for US cotton producers between the 1996 FAIR Act and the 2002 FSRI Act. The payments to US upland cotton farmers in MY 2002 will exceed \$1 billion and represent over 32 per cent of the market value of US upland cotton. USDA economists have acknowledged that CCP have identifiable and measurable production effects.

25. In sum, CCP are non-“green box” domestic support properly included within the set of domestic support measures to be used for calculating the amount of domestic support to upland cotton for MY 2002.

26. *DP and CCP are support to upland cotton*: DP and CCP made in MY 2002 are support to upland cotton within the meaning of AoA Article 13(b)(ii). The great majority of upland cotton producers are enrolled in the programmes and will receive the full amount of these payments in MY 2002. Most of the producers of upland cotton in MY 2002 used upland cotton base acres to produce upland cotton. US farms growing the bulk of upland cotton tend to grow upland cotton year after year because of considerable investments in cotton-specific equipment and the lack of alternative crops. Thus, most farmers with cotton “base acreage” generally do not use that base acreage to grow other

crops. In addition, CCP create incentives to maintain upland cotton production at the level of the base period in order to minimize the risk of low revenues.

27. In sum, the United States cannot successfully invoke peace clause protection against Brazil's actionable subsidy claims under ASCM Articles 5 and 6 or Brazil's claims under GATT Article XVI:1.

28. *Export Subsidy Peace Clause Issues Under AoA Article 13 (c)*: The United States also has no peace clause protection under AoA Article 13(c) for claims against export subsidies under the SCM Agreement regarding Step 2 export payments, the export credit guarantees and subsidies provided under the ETI Act. AoA Article 13(c) can only be invoked by a WTO Member as an affirmative defence if that WTO Member can demonstrate that its export subsidies "conform fully to the provisions of Part V" of the AoA. Part V of the AoA consists of Articles 8 to 11. A Member violates Part V of the AoA if it provides export subsidies for products for which it has not undertaken any export subsidy reduction commitments; or second, if it has export subsidy reduction commitments for the product under consideration, but exceeds the maximum amount of export subsidies to or the maximum value of the product that it has scheduled to be exported with the assistance of export subsidies. The United States does not enjoy peace clause protection for the agricultural export subsidies challenged by Brazil under the SCM Agreement because – as Brazil demonstrates – each of the subsidies at issue does not fully conform to Part V of the AoA.

#### **Brazil's Claims Regarding Prohibited US Export and Local Content Subsidies**

29. The United States maintains three types of export subsidies related to US upland cotton and other commodities. These subsidies violate AoA Articles 3.3, 8 and 10.1 and are prohibited under ASCM Articles 3.1(a) and 3.2. Brazil challenges all three measures to the extent they provide subsidies to upland cotton. In addition, it challenges the export credit guarantee programmes for all products covered.

30. The first measure, the Step 2 export programme, relates solely to exports of US upland cotton and provides grants to exporters. The second group of measures are three export credit guarantee programmes – the General Sales Manager 102 ("GSM 102"), the General Sales Manager 103 ("GSM 103") and the Supplier Credit Guarantee Programme ("SCGP") – provided by the United States in connection with the export of agricultural goods in general. The third measure providing export subsidies is the FSC Repeal and Extraterritorial Income (ETI) Act of 2000, by which the United States provides tax breaks for exporters of US products, including agricultural products such as upland cotton.

31. *Step 2 Export Payments*: Section 1207(a) of the 2002 FSRI Act mandates Step 2 export payments contingent on the export of US upland cotton lint. Section 1207(a) of the 2002 FSRI Act requires USDA to pay US exporters the difference between higher priced US upland cotton and the average of the five lowest price quotes for exports of upland cotton worldwide (Cotlook's A-Index). The size of this subsidy averaged 8 per cent of the price received by US producers between MY 1999-2001 and an estimated 9.9 per cent in MY 2002.

32. Step 2 export payments constitute export subsidies within the meaning of the AoA. The Appellate Body has indicated that context for interpretation of an "export subsidy" under the AoA is found in the ASCM. Step 2 export payments involve grants within the meaning of ASCM Article 1.1(a)(1)(i), as the US Government pays money to US exporters. Such grants are direct transfers of economic resources for which the US Government receives no consideration. Step 2 export payments constitute "free money" for which exporters incur no corresponding obligations and, thus are made for "less than full consideration". They, therefore, confer a benefit within the meaning of ASCM Article 1.1(b). Finally, Step 2 payments are also export contingent within the meaning of ASCM



Article 3.1(a) because exporters are only eligible to receive Step 2 export payments if they produce evidence that they have exported an amount of US upland cotton.

33. Section 1207(a) of the 2002 FSRI Act requires the US Secretary of Agriculture to make Step 2 export payments to eligible exporters upon proof of the export of US cotton. Therefore, Section 1207(a) of the 2002 FSRI Act is inconsistent with AoA Articles 3.3 and 8, because it requires payments of export subsidies to upland cotton without the United States having undertaken any export subsidy reduction commitments under the AoA. Thus, the United States has no peace clause protection against claims made under the ASCM for Step 2 export payments. In addition, for the same reasons the Step 2 export payments violate AoA Articles 3.3 and 8, Section 1207(a) of the 2002 FSRI Act also mandates payment of export subsidies in violation of ASCM Articles 3.1(a) and 3.2.

34. *Export Credit Guarantee Programmes:* The United States, through the US Commodity Credit Corporation (CCC), operates three export credit guarantee programmes – General Sales Manager 102 (GSM 102), General Sales Manager 103 (GSM 103) and the Supplier Credit Guarantee Programme (SCGP). The programmes guarantee the repayment of loans granted to foreign importers of all US agricultural commodities and are not limited to upland cotton. Brazil's also challenges the whole programmes, not just as they relate to upland cotton.

35. USDA export data demonstrates that US exports of most scheduled commodities exceed the respective US quantitative export subsidy reduction commitment. For unscheduled commitments, there is no such commitment, which means *that* every export of these commodities is in excess of the United States' commitments. In *Canada – Dairy Article 21.5 (II)*, the Appellate Body characterized export subsidy claims under the AoA as involving both a "quantitative aspect" and an "export subsidization aspect". It held that AoA Article 10.3 allocates the burden of proof for the export subsidization part to the defending Member – in this case the United States – if the complaining Member – in this case Brazil – establishes that the level of exports in exceeds of the export subsidy reduction commitments. Therefore, the United States bears the burden to prove that its excess exports did not benefit from export subsidies, including export credit guarantees

36. Nevertheless, Brazil also provides evidence that the three export credit guarantee programmes are export subsidies within the meaning of the AoA. The Appellate Body in *US – FSC* held that export subsidies within the meaning of the SCM Agreement are also export subsidies for the purposes of the AoA. Brazil demonstrates in two distinct ways that GSM 102, GSM 103 and SCGP are "export subsidies". First, context for determining whether the US programmes are export subsidies under the AoA is provided by reference to ASCM Annex I, Item (j) of the Illustrative List of Export Subsidies. Item (j) provides that export credit guarantee programmes are export subsidies if they are operated "at premium rates which are inadequate to cover the long-term operating costs and losses of the programme". Second, export credit guarantees also constitute export subsidies under the AoA and in light of the Appellate Body decisions in *US- FSC* and *Canada – Dairy*, if they involve "financial contributions" that confer "benefits" and are contingent upon export performance within the meaning of ASCM Articles 1.1 and 3.1(a).

37. US documents demonstrate that GSM 102, GSM 103 and SCGP are export subsidies because they are operated at premium rates which are far below the level necessary to cover the programmes operating costs and losses. The programmes are, thus, export subsidies as defined in item (j) of the Illustrative List of Export Subsidies. Under Appellate Body and panel jurisprudence, export subsidies defined in the ASCM Agreement are relevant context for a finding of export subsidies under the AoA. Therefore these three programmes constitute export subsidies within the meaning of the AoA.

38. In addition, GSM 102, GSM 103 and SCGP are export subsidies within the meaning of the AoA because they are financial contributions consistent with ASCM Article 1.1(a)(1)(i), and confer benefits within the meaning of ASCM Article 1.1(b). The United States itself, in its budget, treats them as subsidies. In addition, no such guarantees are commercially available in the marketplace.

GSM 102, GSM 103 and SCGP are, furthermore, contingent upon export performance within the meaning of ASCM Article 3.1(a). Thus, the programme constitutes export subsidies within the meaning of both the SCM Agreement and the AoA.

39. The export subsidies GSM 102, GSM 103 and SCGP result in, or threaten to lead to, circumvention of the United States' export subsidy commitments within the meaning of AoA Article 10.1. GSM 102, GSM 103 and SCGP, in so far as they are available for unscheduled products, violate AoA Articles 10.1 and 8 because they make export subsidies available for unscheduled products. The Appellate Body has held that for unscheduled products, it is inconsistent with AoA Article 3.3 to provide export subsidies listed in AoA Article 9.1, and that it is inconsistent with AoA Articles 10.1 and 8 to provide any other export subsidy. GSM 102, GSM 103 and SCGP provide export subsidies to unscheduled products, and thus violate AoA Article 10.1 and 8.

40. With respect to scheduled products, GSM 102, GSM 103 and SCGP as such also threaten to lead to circumvention of the US export subsidy reduction commitments. The United States provides monetary allocations for export credit guarantees to individual third countries either on a commodity specific basis or on a non-commodity specific basis. This common feature of the three export credit guarantee programmes creates a threat that the United States will exceed its quantitative export subsidy reduction commitment for scheduled products in violation of AoA Articles 10.1 and 8.

41. In sum, the export credit guarantee programmes GSM 102, GSM 103 and SCGP are inconsistent with AoA Articles 10.1 and 8. As they do not fully conform to AoA Part V, they do not enjoy peace clause protection under AoA Article 13(c)(ii).

42. Brazil has already established that GSM 102, GSM 103 and SCGP are export subsidies within the meaning of item (j) of the Illustrative List of Export Subsidies attached as Annex I to the SCM Agreement, and within the meaning of ASCM Article 3.1(a). It follows that GSM 102, GSM 103 and SCGP are prohibited export subsidies within the meaning of ASCM Articles 3.1(a) and 3.2.

43. *ETI Act Export Subsidies*: The third export subsidy provided by the United States to upland cotton consists of tax cuts under the FSC Repeal and Extraterritorial Income Act of 2000. This Act eliminates tax liabilities for exporters, *inter alia*, of upland cotton. A WTO panel and the Appellate Body have previously found that the ETI Act violates AoA Articles 10.1 and 8 and ASCM Articles 3.1(a) and 3.2. The tax breaks provided for under the ETI Act constitute export subsidies within the meaning of AoA Article 10.1. The ETI Act threatens to circumvent the US export subsidy commitments by providing an export subsidy to upland cotton while the United States does not have any export subsidy reduction commitments for upland cotton in violation of AoA Articles 10.1 and 8. As the ETI Act subsidies do not fully conform to AoA Part V, there is no peace clause exemption from actions under the SCM Agreement. Consequently, the ETI Act *also* constitutes a prohibited export subsidy within the meaning of ASCM Article 3.1(a) and 3.2.

44. *Step 2 Domestic Payments*: Section 1207(a) of the 2002 FSRI Act mandates the payment of the Step 2 domestic payments. Step 2 domestic payments are subsidies within the meaning of the ASCM Article 1.1. They involve grants because the US Government pays domestic users of US upland cotton the difference between higher priced US upland cotton and the average of the five lowest upland cotton price quotes for exports (A-Index) without receiving any consideration in return. These grants are direct transfers of funds and constitute a financial contribution by a Government within the meaning of ASCM Article 1.1(a)(1)(i). They confer a "benefit" within the meaning of ASCM Article 1.1(b) because the domestic user of US upland cotton receives the financial contribution on terms more favorable than those available in the market. Step 2 domestic payments constitute "free money" for which domestic users of US upland cotton incur no corresponding obligations. Finally, Step 2 domestic payments are contingent on the use of domestic over imported goods. Domestic users of US cotton can only receive payments upon proof of opening a bale of domestic US upland cotton. In sum, Section 1207(a) of the 2002 FSRI Act mandating Step 2 domestic

payments violates ASCM Articles 3.1(b) and 3.2 by requiring the provision of subsidies contingent upon the use of domestic over imported goods.

45. The Step 2 domestic payment programme also constitutes a violation of GATT Article III:4. Section 1207(a) requires the US Secretary of Agriculture to treat upland cotton of non-US source less favorable than like US upland cotton. Only upland cotton that “is domestically produced baled upland cotton” is eligible for the Step 2 domestic payment programme. Paying a subsidy to like domestic upland cotton while denying such payments to imported like cotton negatively affects the competitiveness of imported cotton by making it less attractive to US purchasers. The Step 2 domestic payment programme therefore extends “less favorable treatment” to imported goods within the meaning of GATT Article III:4.

### **Conclusion**

46. In Brazil’s further submission (scheduled for 4 September 2003 following the Panels expression of its views on AoA Article 13 on 1 September 2003) Brazil will present its arguments concerning its claims under ASCM Articles 5(c), 6.3(b), 6.3(c) and 6.3(d), as well as under GATT Article XVI.

## ANNEX B-2

### EXECUTIVE SUMMARY OF THE FIRST WRITTEN SUBMISSION OF THE UNITED STATES

1. In this submission, the United States principally focuses on the issues involving the Peace Clause. However, three sets of measures identified by Brazil – (1) export credit guarantee measures relating to eligible US agricultural commodities other than US upland cotton; (2) production flexibility contract payments and market loss assistance payments; and (3) cottonseed payments – were, respectively, not the subject of consultations, had expired before consultations were requested, or had not yet been adopted at the time of the consultation and panel requests. With respect to these measures, the United States requests that the Panel make preliminary rulings that they are not within the Panel’s terms of reference.

2. **General Interpretation of the Peace Clause and “Exempt from Actions”:** As set out in more previous submissions, read in accordance with the customary rules of interpretation of public international law, the key Peace Clause phrase “exempt from actions” means “not exposed or subject to” a “legal process or suit” or the “taking of legal steps to establish a claim or obtain a remedy”. Relevant context in DSU Article 3.7 and 4.5 and Subsidies Agreement Article 7 supports this reading. For example, contrary to Brazil’s suggestion that “action” only refers to “collective action” by the Dispute Settlement Body, DSU Article 4.5 uses the phrase “further” action. Since no “action” will have been taken by the DSB “in the course of consultations,” the phrase “further action” suggests that requesting consultations is part of the action brought by a complaining party. Thus, these provisions suggest that “action” based on the relevant provisions would include all stages of a dispute, including the “bringing [of] a case”, consultations, and panel proceedings and would support reading “exempt from actions” in Article 13 to mean “not subject to” the “taking of legal steps to establish a claim”.

3. Prior to this point in the process, DSU rules did not afford the United States any opportunity to prevent the dispute from proceeding through consultations and panel establishment automatically, regardless of the US insistence that its measures conform to the Peace Clause. As a responding party cannot prevent panel establishment from occurring, it will inevitably be forced to argue to a panel that its procedures should be structured so that the party’s challenged measures are not subject, from that point on, to actions based on provisions specified in the Peace Clause. Thus, the Panel’s organization of its procedures provided the first opportunity to arrest Brazil’s “taking of legal steps to establish a claim”.

4. **The Peace Clause Is Not an Affirmative Defence:** The Peace Clause applies “[n]otwithstanding the provisions of GATT 1994” and the Subsidies Agreement – that is, *in spite of* and *without regard to or prevention by* the subsidies obligations contained in those agreements. Article 21.1 of the Agriculture Agreement further clarifies that the obligations of Members under the Subsidies Agreement and GATT 1994 *only* apply “*subject to*” the provisions of the Agriculture Agreement, including the Peace Clause. There is no need to determine if a measure is inconsistent with WTO subsidies disciplines before applying the Peace Clause as would be the case if the Peace Clause were an affirmative defence to those obligations.

5. As in *United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, in which the Appellate Body explained that a provision that was described as an “exception” was not an affirmative defence and in fact was “an integral part” of the arrangement under the *Agreement on Textiles and Clothing* that “reflects an equally carefully drawn balance of rights and obligations of Members”, here, too, the Peace Clause is part and parcel of the balance of rights and

obligations with the subsidies disciplines of GATT 1994 and the Subsidies Agreement and explains which measures are subject to actions based on those disciplines.

6. Article 13(a)(i) establishes that green box measures are “non-actionable subsidies for purposes of countervailing duties”. This obligation is not contingent on whether a Member asserts an “affirmative defence” that a particular measure is “green box”; that is, one Member is not free to impose a countervailing duty until another establishes a Peace Clause “affirmative defence”. There is no textual basis to interpret the Peace Clause to be an affirmative defence under one provision (Article 13(b)(ii)) but not another. In fact, rather than a defence, the Peace Clause could be used on the *offense* (as a cause of action) if, for example, a Member imposed a countervailing duty on a “green box” measure while the Peace Clause was in force.

7. Brazil has erroneously asserted that the Peace Clause “provides no positive obligations itself”. Brazil overlooks the text of, for example, Article 13(a)(ii) and (b)(ii), which incorporates positive obligations of Annex 2 and Article 6 by reference. The Peace Clause also differs from the fifth sentence of footnote 59 to item (e) and under the second paragraph of item (k) of the Illustrative List, under which it appears that a measure otherwise prohibited under Article 3 of the Subsidies Agreement would nonetheless be permitted given the existence of circumstances detailed in those provisions. However, under the Peace Clause, conforming measures are not even exposed or subject to the taking of legal steps to establish a claim or obtain a remedy based on Peace Clause-specified provisions. Further, Subsidies Agreement Articles 3, 5, and 6 recognize that measures conforming to the Peace Clause are not subject to those disciplines by expressly excluding such measures from the scope of those obligations.

8. Brazil asserted in both its panel and consultation requests that the Peace Clause does not exempt the challenged US measures from action. Brazil implicitly recognized in these documents that it must surmount the Peace Clause hurdle to bring this action against US agricultural support measures. Even were the United States to present no arguments on the applicability of the Peace Clause, Article 13 would bar Brazil’s claims unless Brazil made a *prima facie* case that the US measures breach the Peace Clause.

9. **US Direct Payments Meet and Conform to the Criteria in Article 13(a):** Pursuant to Agriculture Agreement Article 13(a)(ii) domestic support measures that “conform fully to the provisions of Annex 2 to this Agreement” are “exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement”. The 2002 Act establishes several types of measures that qualify for green box protection, including one, direct payments, that is challenged by Brazil.

10. Direct payments under the 2002 Act conform fully to the basic criteria in paragraph 1, Annex 2, as well as the five “policy-specific criteria and conditions” in paragraph 6, Annex 2, for “decoupled income support”. Consistent with paragraph 1, direct payments are provided by a publicly-funded government programme and do not provide price support. Consistent with paragraph 6, direct payments establish eligibility by reference to the clearly-defined criteria of factor use or production level in a defined and fixed base period. Payments are not related to production or prices or the factors of production employed in any year after the base period, and no production is required in order to receive such payments.

11. In short, direct payments do not provide support for upland cotton because they are not linked to current cotton production. These payments are made with respect to farm acreage that was devoted to agricultural production in the past, including previous upland cotton production. Direct payments, however, are made regardless of whether cotton is currently produced on those acres or whether anything is produced at all. Because all of the criteria in paragraphs 1, 5, and 6 are met, direct payments conform to the requirements of Annex 2 and are “exempt from actions” based on Part III of the Subsidies Agreement and GATT 1994 Article XVI.

12. **Applicability of Agriculture Agreement Article 13(b)(ii):** Pursuant to Agriculture Agreement Article 13(b)(ii), “domestic support measures that conform fully to the provisions of Article 6” are “exempt from actions” based on GATT 1994 Article XVI:1 and Subsidies Agreement Articles 5 and 6. Brazil does not contest that US non-green box domestic support measures conform fully to the requirements of Article 6. Thus, the only question is whether US non-green box domestic support measures do or do not “grant support to a specific commodity in excess of that decided during the 1992 marketing year.”

13. The phrase “grant support to a specific commodity” is not explicitly defined. Read according to its ordinary meaning, this phrase means to “give” or “confer” formally a “subsidy” (“assistance, backing”) “specially . . . pertaining to a particular” “agricultural crop”. Read in the context of, *inter alia*, the definition of “Aggregate Measurement of Support” in Article 1(a), “support to a specific commodity” refers to support “provided for an agricultural product in favour of the producers of the basic agricultural product” or “product-specific support”.

14. The product-specific support granted by such Article 6 measures must be compared to “that decided during the 1992 marketing year”. According to its ordinary meaning, this phrase would mean the product-specific support that was “determined” or “pronounced” during the 1992 marketing year. With reference to support or subsidies, the term “decided” is not used elsewhere in the Agriculture Agreement nor in the Subsidies Agreement. Various provisions that define the overall domestic support in favour of agricultural producers that has been, is being, and may be provided by a Member use the phrase “support *provided*” in favour of an agricultural product or agricultural producers no fewer than 13 times. Context thus suggests that the use of the term “*decided*” in Article 13(b) was deliberate so as to make the availability of the Peace Clause not dependent upon the support – for example, as measured through budgetary outlays – actually “provided” during the 1992 marketing year. This interpretation is further supported by Members’ decision not to use the term “Aggregate Measurement of Support” in this part of Article 13(b)(ii). That is, Members did not choose to make the applicability of the Peace Clause contingent on comparison of a Member’s product-specific Aggregate Measurement of Support.

15. The Peace Clause thus exempts from certain actions a Member’s non-green box domestic support measures that conform to that Member’s overall reduction commitments under Article 6, provided that such measures do not currently “give” or “confer” “product-specific support” in excess of that “determined” or “pronounced” during the 1992 marketing year. The relevant test for the applicability of Article 13(b)(ii) is to compare the product-specific support as it was decided in 1992 versus the product-specific support that existing measures currently grant.

16. **US Measures Conform to the Criteria in Article 13(b) and Are Exempt from Actions:** US domestic support measures under the 2002 Act were written to grant support for upland cotton within the 1992 marketing year level so that such measures would conform to the Peace Clause criteria. In particular, the 2002 Act shifts support away from the product-specific support that prevailed in 1992 to reduce support linked to the production of upland cotton.

17. **The Product-Specific Support for Upland Cotton Decided During 1992 Was To Ensure Income of 72.9 Cents per Pound:** The product-specific support in favour of upland cotton decided during the 1992 marketing year was to ensure a level of income (\$0.729) for upland cotton farmers for each pound of upland cotton production. That is, US domestic support measures set a *rate* of support, rather than deciding *ex ante* a level of budgetary outlay or expenditures. This support was granted by the 1990 Act through two programmes: marketing loans (including marketing loan gains and loan deficiency payments) and deficiency payments.

18. Through marketing bans, the United States in effect guaranteed that cotton producers would realize income equivalent to at least 52.35 cents per pound of upland cotton produced. The United States further ensured cotton farmers would realize income equivalent to 72.9 cents per pound

of upland cotton produced by making “deficiency payments”. By the terms of the 1990 Act and all subsequent implementing regulations, the support “decided” (that is, “determined” or “pronounced”) in favour of upland cotton was *not* expressed in terms of outlays or appropriations but rather as a *rate*: that is, through both marketing loans and deficiency payments, producer income of 72.9 cents per pound of upland cotton. Thus, budgetary outlays, which reflect the difference between the rates set out in US legislation and regulations (which *were* decided by the US Government) and market prices (which obviously were *not*), do not represent the product-specific support “decided” during the 1992 marketing year.

19. **US Domestic Support Measures Currently Grant Product-Specific Support to Upland Cotton to Ensure Producer Income of 52 Cents per Pound:** Under the 2002 Act, product-specific support is again granted to upland cotton through the marketing loan programme and through user marketing (step 2) payments. Despite a small adjustment in the user marketing (step 2) payment formula, US measures currently in effect grant product-specific support to upland cotton far lower than that decided in the 1992 marketing year. Through the marketing loan programme, the US Government has in effect guaranteed that cotton producers will realize income equivalent to at least 52 cents (\$0.52) per pound (the “2002 loan rate”) of upland cotton produced. Marketing loans and loan deficiency payments are contingent on a farm’s actual production of upland cotton in the current marketing year.

20. Product-specific support decided during the 1992 marketing year for upland cotton was to ensure producer income of 72.9 cents per pound; US domestic support measures currently grant product-specific support only at the rate of 52 cents per pound of production. Even taking into account the minor differences in payment rates for user marketing payments, this comparison indicates that US measures do not grant product-specific support to upland cotton in excess of that decided during the 1992 marketing year; in fact, current US measures grant product-specific support at a rate more than 20 cents per pound *less* than that decided during 1992.

21. **US Payments That Brazil Has Mischaracterized As Providing Support to a Specific Commodity Do Not Form Part of the Peace Clause Comparison:** Direct payments, counter-cyclical payments, and crop insurance are not product-specific support for upland cotton and are therefore irrelevant to the 1992 to 2002 Peace Clause comparison. Direct payments are green box support because they conform to the applicable general and policy-specific criteria under Annex 2 of the Agriculture Agreement. As green box measures, direct payments are not part of the comparison of “product-specific” support under Article 13(b)(ii). Because direct payments are based on quantities of acreage that historically produced certain commodities, including upland cotton, and there is no requirement to produce upland cotton to receive these payments, however, direct payments are non-product-specific.

22. With respect to counter-cyclical payments, the United States notes that these measures do not grant product-specific support to upland cotton. Product-specific support is “provided for an agricultural product” for the benefit of “the *producers* of the basic agricultural product”. The payment formula for counter-cyclical payments demonstrates that these payments are not “provided for an agricultural product” because it is not current production of upland cotton that qualifies a recipient to receive payment. In addition, it is not “the producers of the basic agricultural product” – that is, current upland cotton growers – that are entitled to receive the counter-cyclical payments but rather persons (farmers and landowners) on farm acres with *past histories* of producing covered commodities, including upland cotton. Because counter-cyclical payments are not product-specific support for upland cotton, such payments are not properly part of the Peace Clause comparison under Article 13(b)(ii).

23. Neither does crop insurance grant product-specific support to upland cotton. A variety of insurance plans are now subsidized and reinsured by the United States. The basic programme provisions for crop insurance are generic, not commodity-specific. For example, the US Government

provides an incentive to participate in the crop insurance programme by subsidizing the premium paid by the farmer. This premium subsidy is available to a broad array of commodities around the country and does not vary by commodity. Thus, while the United States notifies crop insurance as “amber box” domestic support subject to US reduction commitments, crop insurance is “non-product-specific support in favour of agricultural producers in general”.

24. **Conclusion: US Non-Green Box Domestic Support Measures Are Exempt from Brazil’s Subsidies Agreement and GATT 1994 Article XVI Action:** Brazil has asserted that US domestic support measures breach the Peace Clause by comparing US budgetary outlays for the 1992 marketing year to US budgetary outlays for marketing years 1999-2001 and its “reasonable” estimates of US outlays for the 2002 marketing year. As noted above, Brazil’s interpretation of the Peace Clause and resulting analysis is fundamentally in error. Because the level of income support granted to upland cotton producers is far lower now than the support decided in marketing year 1992, Brazil may not maintain this action and advance claims under GATT 1994 Article XVI:1 or Subsidies Agreement Articles 5 and 6 with respect to US non-green box domestic support measures – marketing loan programme payments, user marketing (step 2) certificates, counter-cyclical payments, and crop insurance subsidies.

25. **US Step 2 Payments Are Not an Export Subsidy for Upland Cotton:** User marketing (Step 2) payments are made to users of upland cotton. Under section 1207 of the 2002 Act, the Secretary of Agriculture is authorized to issue marketing certificates or cash payments *to domestic users and exporters* of upland cotton *for documented purchases by domestic users and sales for export by exporters*. The programme is indifferent to whether recipients of the benefit of this programme are parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States or exporters. Accordingly, the United States reports the benefits conferred under the Step 2 programme as product-specific amber box domestic support.

26. The Step 2 programme is not an export subsidy under Agriculture Agreement Article 9.1 and not an export subsidy in circumvention of the US obligation not to confer an export subsidy with respect to cotton, contrary to Article 10.1. Article 1(e) of the Agriculture Agreement states that “‘export subsidies’ refers to subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement”. Consequently, to constitute an “export subsidy” for any purposes of the Agreement, the subsidy must first be “contingent on export performance”. The benefits of the Step 2 programme are not contingent on export performance.

27. A WTO dispute settlement panel has already determined that such facts do not involve an export subsidy for purposes of both Articles 9 and 10 of the Agriculture Agreement, because the subsidy is not “contingent on export performance”. The panel in *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products* concluded that where a subsidy was available in connection with the exported product but also to processors producing for the domestic market, “access to milk under such other classes is not ‘contingent on export performance.’ We therefore find that such other milk classes do not involve an export subsidy under Article 9.1(a)”. For precisely the same reasons, the panel also found that “these other milk classes do not involve an export subsidy in the sense of Article 10.1”. Similarly, the Step 2 programme is not an export subsidy inconsistent with Articles 9 and 10 of because the subsidy is not contingent on export performance and therefore is not an export subsidy.

28. **Brazil Bears the Burden of Proof to Demonstrate the Existence of an Export Subsidy for Upland Cotton:** Brazil as complainant bears the burden of proof with respect to any export subsidy claim relating to upland cotton. Brazil cites Agriculture Agreement Article 10.3 to assert that the United States bears this burden. However, the burden-shift set forth in Article 10.3 is only applicable with respect to exports in excess of a *reduction* commitment level. As Brazil correctly points out, the United States does not have such a *reduction* commitment level with respect to upland cotton. Article 10.3 therefore does not apply with respect to US cotton exports. With respect to products for



which a Member has no scheduled export subsidy reduction commitments, the burden of proof remains with the complainant.

29. **US Step 2 Payments Are Not a Prohibited Subsidy Under Article 3 of the Subsidies Agreement:** With respect to domestic support, the negotiators of the Agriculture Agreement devised the novel concept of “Aggregate Measurement of Support” (AMS), defined in Article 1(a). As the definition provides, all annual domestic support provided for an agricultural product, like cotton, in favour of the producers of that product that is not otherwise exempt under the “green box” (Annex 2) from reduction commitments, or as otherwise provided in Articles 6.4 and 6.5 of the Agreement, is included in the AMS. The definition further contemplates that support provided during any one year is to be calculated in accordance with the provisions of Annex 3. Paragraph 7 of Annex 3 requires that “measures directed at agricultural processors shall be included [in the AMS] to the extent such measures benefit the producers of the basic agricultural products”.

30. Accordingly, Step 2 user payments, directed at upland cotton processors and other users but intended to benefit US producers of upland cotton, are included in the annual AMS calculation of the United States. As a result, such payments are subject to reduction commitments applicable to the United States. Agriculture Agreement Article 6.3 provides that “a Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member’s Schedule”. Where a particular programme exists in favour of agricultural producers within such Current Total AMS, the Agriculture Agreement is entirely agnostic as to the method of delivery of such support.

31. The United States is in compliance with its domestic support reduction commitments, of which support in the form of the Step 2 programme is a constituent part, as provided in the Agriculture Agreement. Articles 3.1(a) and 3.1(b) of the Subsidies Agreement apply “except as provided in the Agreement on Agriculture”. The conformity of the Step 2 programmes with the terms, object and purpose of the Agriculture Agreement – and in particular the domestic support reduction commitments – constitute precisely the kind of exception contemplated in the introductory words of Article 3. Inasmuch as Articles 3.1(a) and (b) do not apply to Step 2 payments, the Step 2 programme also cannot violate Subsidies Agreement Article 3.2.

32. **US Step 2 Payments Are Not Inconsistent with GATT 1994 Article III:4:** As contemplated by the terms of the Step 2 programme itself, as well as Annex 3 of the Agriculture Agreement, the Step 2 programme provides benefits in favour of US upland cotton producers. As noted above, the Step 2 programme is in conformity with Agriculture Agreement Article 6. In addition, Agriculture Agreement Article 3.1 provides that the domestic support commitments in Part IV of each Member’s Schedule are made an integral part of GATT 1994. The domestic support commitments of the United States are therefore an integral part of GATT 1994 itself, and Agriculture Agreement Article 21.1 expressly states that “the provisions of GATT 1994 . . . shall apply subject to the provisions of this Agreement”.

33. Pursuant to Article 6.3 of the Agriculture Agreement, “a Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member’s Schedule”. Annex 3, paragraph 7, specifically requires that “[m]easures directed at processors shall be included” in the calculation of AMS to subject these measures to the domestic support reduction commitments established for the first time in the Agriculture Agreement. The Step 2 programme exists in favour of agricultural producers within such Current Total AMS, and the text of the Agriculture Agreement does not prohibit any particular form of delivery of such amber box domestic support.

34. The Agriculture Agreement imposed for the first time rigorous disciplines on agricultural support. The domestic support reduction commitments of the United States constitute an integral part of GATT 1994. A coherent reading of the Agriculture Agreement with the GATT 1994 indicates that the Step 2 programme does not violate GATT 1994 Article III:4.

35. **The Commodity Credit Corporation Export Credit Guarantee Programmes are Not Export Subsidies:** During the Uruguay Round, negotiators did not reach agreement on disciplines on all areas that had been the subject of negotiations, in several cases agreeing to continue negotiating after the close of the Round and the entry into force of the WTO Agreement. The simple fact is that during the Uruguay Round WTO Members did not agree on disciplines to be applicable to export credits, export credit guarantees, and insurance programmes. Unable to reach agreement on such disciplines within the Uruguay Round, Members opted to continue discussions in an appropriate forum, deferring the imposition of substantive disciplines until a consensus was achieved.

36. Following the entry into force of the WTO Agreement, numerous WTO Members commenced negotiations under the auspices of the OECD to achieve such internationally agreed disciplines. When such negotiations failed to achieve an agreement, negotiations on disciplines for export credits and export credit guarantees have subsequently continued both under the reform process contemplated under Article 20 of the Agriculture Agreement and the mandate of the Doha Ministerial Declaration.

37. The scope and detail of the current agriculture negotiations as reflected in the Harbinson text demonstrate that the Members are currently engaged in active negotiations on disciplines for export credits and credit guarantees. Among the areas under active discussion include disciplines on the relationship between premiums, term, and long-term operating costs and losses. These discussions would be unnecessary if existing disciplines applied to such programmes in agriculture. The Panel should not pre-empt such negotiations.

38. The text of Article 10.2 of the Agriculture Agreement reflects the deferral of disciplines on export credit guarantee programmes contemplated by WTO Members. As simply reflected in the structure and text of the Agriculture Agreement, Members came to no agreement with respect to substantive disciplines on export credit guarantee programmes. Article 10.2 stands in stark contrast to Article 9.1. Article 9.1 sets forth a list of six very specific practices known to the drafters and deemed to constitute export subsidies under the Agriculture Agreement. Significantly, the Illustrative List of Export Subsidies in the Subsidies Agreement explicitly addresses export credit and credit guarantee practices in its item (j). Conspicuously absent in Article 9.1 is any provision addressing such practices, even though US export credit guarantee programmes had been in existence for nearly fifteen years preceding the inception of obligations under the WTO.

39. To include US export credit guarantee programmes within the ambit of Article 10.1 or within the definition of export subsidy under Article 1(e) of the Agreement would render the work programme envisioned by Article 10.2 unnecessary. Further, to adhere to the approach that Brazil advocates would allow for the utter irrelevance of Article 10.2. Indeed, Brazil unabashedly makes not one reference to Article 10.2 in its initial submission.

40. **CCC Export Credit Guarantees are Not Prohibited Export Subsidies Under the Subsidies Agreement:** Brazil has alleged that the CCC export credit guarantee programmes are prohibited subsidies under Article 3.1(a) of the Subsidies Agreement. The very first words of Article 3.1 of the Subsidies Agreement, however, are: "Except as provided in the Agreement on Agriculture." Article 10.2 of the Agriculture Agreement, as noted above, provides for the deferral of disciplines unless and until internationally agreed disciplines are in fact achieved. Brazil has conveniently ignored both Article 10.2 and the explicit introductory words of the Subsidies Agreement Article 3.1 in its first submission. However, Brazil concedes that the export credit guarantees are "exempt from action under ASCM Article 3.1(a) if they fully conform to the provisions of [Agreement

on Agriculture] Part V". These programmes are in conformity with Article 10.2, which is within such Part V. In addition, Article 21.1 explicitly provides that the Multilateral Trade Agreements in Annex 1A to the WTO Agreement, which include the Subsidies Agreement, shall apply *subject* to the Agriculture Agreement.

41. Brazil alleges that the export credit guarantee programmes constitute an export subsidy for purposes of the Subsidies Agreement because such programmes fall within item (j) of the Illustrative List of Export Subsidies. Brazil alleges the United States provides export credit guarantees for cotton "at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes" and that a ten-fiscal-year period "fulfils the criterion of being 'long-term' within the meaning of item (j)". Quite simply, with respect to cotton, for the last 10 fiscal years for which complete data is available, premiums paid exceed claims paid. As with any other insurance-type programme, moreover, a proper analysis of "losses" should involve the calculation of the net result of premiums collected, plus claims amounts repaid or rescheduled, minus claims paid. Such calculation would properly reflect the net position of the programme.

42. For the 10-year period from fiscal year 1993 through fiscal year 2002, premiums collected total \$16,026,202 and losses incurred via claims total \$4,768,096. Consequently, even *before* any post-default recoveries, premiums exceeded claims paid. Of claims incurred, \$1,015,365 were subsequently directly recovered, and an additional \$8,175,570 have been rescheduled. Brazil argues that the United States "must at the very least recover their operating costs by virtue of fees or premiums collected". Without conceding that this is the applicable test by which the conformity of export credit guarantee programmes with WTO obligations should be assessed, nevertheless, the US programmes for cotton satisfy this Brazilian suggestion.

43. Brazil, like any complainant, bears the burden of establishing that export credit programmes fall within the terms of item (j). Brazil, the United States, and the Appellate Body would apparently agree, however, that *a contrario*, to the extent a WTO Member provides, as the United States has already demonstrated with respect to cotton, export credit guarantees at premium rates which *do* cover long-term operating costs and losses of the programmes, then it is *not* an export subsidy within the meaning of item (j) and the Subsidies Agreement. Premiums collected for US export credit guarantees in connection with cotton transactions over the last 10 fiscal years exceed long-term operating costs and losses. Under the criteria of item (j) alone, these programmes do not constitute a prohibited export subsidy within the meaning of the Subsidies Agreement and are not prohibited under Article 3.1(a) nor inconsistent with Article 3.2.

44. **Brazil Has Failed to Make a Prima Facie Case Regarding the FSC Repeal and Extraterritorial Income Exclusion Act of 2000:** With respect to its claims concerning the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 ("ETI Act"), in its first submission Brazil has not presented any evidence regarding the ETI Act itself and does nothing more than "reiterate[] the claims brought by the European Communities under the [Agriculture Agreement] and the Subsidies Agreement in *US – FSC* (21.5), and ask[] the Panel to apply the reasoning as developed by the panel and as modified by the Appellate Body in that case *mutatis mutandis*". In so doing, Brazil has failed to make a *prima facie* case with respect to the ETI Act. Brazil's approach would put the Panel in the position of having to violate its obligation under DSU Article 11 to "make an *objective assessment of the matter* before it, including an *objective assessment of the facts* of the case and the *applicability of and conformity with* the relevant covered agreements". As a result of Brazil's approach, the Panel is in no position to exercise its judgment to follow, or decline to follow, prior reports concerning the ETI Act, nor even in a position to make factual findings concerning the Act. In the absence of a *prima facie* case by Brazil, the Panel should reject Brazil's claims concerning the ETI Act.

**ANNEX B-3****THIRD-PARTY SUBMISSION BY ARGENTINA**

15 July 2003

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## I. INTRODUCTION

1. Argentina thanks the Panel for this opportunity to present its views as a third party to these proceedings and will address Brazil's claims<sup>1</sup> of inconsistency of the subsidy programmes provided by the United States to US producers, users and exporters of upland cotton, as well as legislation, regulations and statutory instruments and amendments thereto providing such subsidies.

In addition, Argentina will discuss the export credit guarantee programmes provided by the United States for exports of cotton and other commodities that are also exported by Argentina.

2. Given the little time available between the receipt on 11 July of the responding party submission of the United States and the date fixed for this third-party submission, Argentina will comment on the US submission at the meeting of the Panel with the parties and third parties scheduled on 24 July.

3. Firstly, Argentina proposes to argue the absence of US protection under Article 13(b)(ii) and (c)(ii) of the Agreement on Agriculture (hereinafter "AoA"), since the United States does not fulfil the legal requirements for protection against claims under Article XVI of the GATT 1994 and Articles 3, 5 and 6 of the Agreement on Subsidies and Countervailing Measures (hereinafter "SCM Agreement").

4. Secondly, Argentina will argue that the domestic support measures challenged by Brazil are inconsistent with Articles 5 and 6 of the SCM Agreement to the extent that they cause adverse effects to the interests of other Members, including Argentina. It will also argue that the United States grants export subsidies that are prohibited under Article 3(a) and (b) of the SCM Agreement.

5. Nevertheless, Argentina has taken note of the Panel's decision of 20 June to express its views, by 1 September next, on whether the measures at issue satisfy the conditions in Article 13 of the AoA and to differ its consideration of the claims under Article XVI of the GATT 1994 and Articles 3, 5 and 6 of the SCM Agreement as those provisions are referred to in Article 13 of the AoA.

6. Argentina will therefore address the inconsistency of the US subsidies with Articles 5 and 6 of the SCM Agreement in the submission of 22 September next, providing evidence that the US may not invoke protection under Article 13 of the AoA since it does not fulfil the conditions for protection under that provision.

7. Lastly, Argentina maintains that US cotton export subsidies are inconsistent with Articles 3.3, 8 and 10.1 of the AoA, since the Peace Clause cannot be used as a defence in respect of such claims.

## II. WORLD COTTON MARKET SITUATION AND IMPACT OF THE US SUBSIDIES IN ARGENTINA

### II.1. WORLD COTTON MARKET SITUATION

8. According to data from the Statement of the 61<sup>st</sup> Plenary Meeting of the International Cotton Advisory Committee (ICAC), held in Cairo, Egypt, from 20 to 25 October 2002<sup>2</sup>, world cotton

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<sup>1</sup> "Brazil's First Submission to the Panel regarding the 'Peace Clause' and Non-Peace Clause Related Claims", 24 June 2003. (Hereinafter "Brazil's Submission").

<sup>2</sup> Representatives of 38 governments and eight international organizations took part in the meeting. MEMBER GOVERNMENTS: Argentina, Australia, Belgium, Brazil, Burkina Faso, Cameroon, Chad, Chinese Taipei, Colombia, Côte d'Ivoire, Egypt, Finland, France, Germany, Greece, India, Iran, Israel, Italy, Japan, Republic of Korea, Mali, Netherlands, Nigeria, Pakistan, Paraguay, Philippines, Poland, Russia, South Africa,

production reached a record 21.5 million tons in marketing year 2001/2002, exceeding global consumption by 1.3 millions tons.

9. Over the same period, world cotton exports increased by 10 per cent to an unprecedented 6.5 million tons, while international cotton prices fell to the lowest average level in 30 years of US\$0.418 per pound (according to Cotlook Index A).

10. The value of world production declined by US\$5 billion from the previous season, affecting the incomes of millions of growers, input suppliers and service providers in unsubsidized countries.

11. Since the mid-1990s, the world cotton economy has been marked by chronic price depression. Average international cotton prices, adjusted for inflation, are at their lowest since the Great Depression of 1930, having remained below US\$0.60 per pound for the last four consecutive years (1998/1999 to 2001/2002) against an average of US\$0.725 per pound over the past 25 years.

12. According to the ICAC, at 1 July 2003 the average international cotton price in marketing year 2002/2003 was estimated at US\$0.56 per pound, still well below the average of the last 30 years. Under such conditions, even the most efficient producers find themselves operating at a loss, unable to cover even their production costs. ICAC projections suggest that prices will remain chronically depressed for the foreseeable future. Forecasts point to a modest recovery in 2003/2004, but prices will stay within the US\$0.50-0.60/lb range until 2015.

## II.2. COTTON SITUATION IN THE UNITED STATES

13. As a rule, when prices slump production undergoes a similar downturn. However, while world cotton prices have fallen by 54 per cent since the mid-1990s, the United States has increased its output and exports.

14. Since 1998, US cotton production has experienced 42 per cent growth from 14 million metric tons to a record 20.3 million metric tons in 2001.

15. Likewise, at a time of dramatically declining international cotton prices the volume of US exports has expanded to unprecedented levels, from 946,000 tons in 1998 to 2,395,000 tons in 2002.<sup>3</sup>

16. In addition, US cotton production costs are among the highest in the world. According to a recent ICAC study<sup>4</sup>, the cost of production in the United States was US\$0.81 per pound of cotton in marketing year 1999,<sup>5</sup> while US producers market prices fell from US\$0.60 to US\$0.30 per pound.

17. The only possible explanation how the United States bridged the widening gap between production costs and market prices is subsidies, for without them many US producers would have been compelled to cease production.

18. Hence the factor underlying the world cotton market crisis is the US subsidies. As Brazil points out at paragraph 2 of its Submission, it was the subsidies that enabled the United States to

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Spain, Sudan, Switzerland, Syria, Tanzania, Togo, Turkey, Uganda, United Kingdom, United States, Uzbekistan and Zimbabwe.

<sup>3</sup> According to data from "*Cultivating Poverty: The Impact of U.S. Cotton Subsidies on Africa*", Oxfam Briefing Paper 30, 27 September 2002 (See Exhibit Bra-15) and ICAC Secretariat.

<sup>4</sup> "Cotton: World Statistics". Bulletin of the International Cotton Advisory Committee, September 2002. (Exhibit Bra-9).

<sup>5</sup> As stated by Brazil at paragraph 32 of its Submission, the cost of production in Argentina averaged 59 cents/lb of cotton, according to the ICAC study (See Exhibit Bra-9).

increase production and exports while market prices remained far below the cost of production over marketing years 1999 to 2002.

19. The total value of US cotton subsidies during this period – as stated at paragraph 3 of Brazil's Submission – amounted to almost US\$13 billion and the average cotton subsidization rate was 95 per cent.<sup>6</sup>

20. While there are 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. Most of the cotton is used in the producing country itself. The great exception to this rule is the United States, which exports over half of the cotton it produces<sup>7</sup> and is the world's leading exporter. This is why the level of subsidization in the United States is so important as far as the world cotton market is concerned.

### II.3. COTTON SITUATION IN ARGENTINA

21. Argentina's cotton sector is a substantial source of employment and income for many of the country's provinces. The Argentine cotton sector has been contracting since 1998, as a result of declining international prices. In 2001/2002, cultivated area and production plummeted to historic low levels. Cultivated area has shrunk by 76 per cent since 1998, with 174,000 hectares planted to cotton, and production has fallen by 63 per cent compared to 1998, with an estimated 73,000 tons of cotton fibre produced.<sup>8</sup>

22. According to the Argentine Ministry of Agriculture, Livestock, Fisheries and Food, provisional estimates as at 13 June 2003 for marketing year 2002/2003 were 157,930 hectares of cultivated area and 60,000 tons of cotton produced.

23. The decline is even more significant when considered in terms of a 10-year annual average, record prices in 1994/1995 (US\$0.9275/lb Cotlook A Index) having led to record figures for both cultivated area and production (1,010,000 hectares and 437,000 tons of cotton fibre in 1995/1996).

24. The contraction of the cotton sector started in 1997/1998. Since then, steadily falling prices and increased US government support have gradually driven raw cotton<sup>9</sup> producer prices down to their lowest level (US\$192/ton) since 1991/1992, which in turn has entailed constant reductions in cultivated area and production.

25. Although domestic consumption is dwindling, Argentine exports of cotton fibre set another historic low record of 18,366 tons in 2001/2002. Data updated at 31 May 2003 show even worse results, since exports for marketing year 2002/2003 barely reached 2,000 metric tons.

#### (a) *Impact of low international prices on Argentine production*

26. Over the last three years, low international prices – because of the huge US subsidies – have impacted heavily on producers' decisions, with only 309,287 cultivated hectares, representing a 58 per cent reduction from a 10-year annual average (1989/1990 to 1998/1999). This has led to sharp reductions in cotton fibre production. Over that same three-year period (1999/2000 to 2001/2002), production averaged 122,883 tons – a 62 per cent fall from the annual average of 327,360 tons

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<sup>6</sup> USDA Fact Sheet: Upland Cotton (January 2003). (See Exhibit Bra-4).

<sup>7</sup> As indicated at paragraph 10 of Brazil's Submission, domestic cotton consumption in the United States is dwindling steadily.

<sup>8</sup> "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.

<sup>9</sup> Seed cotton; unginned.

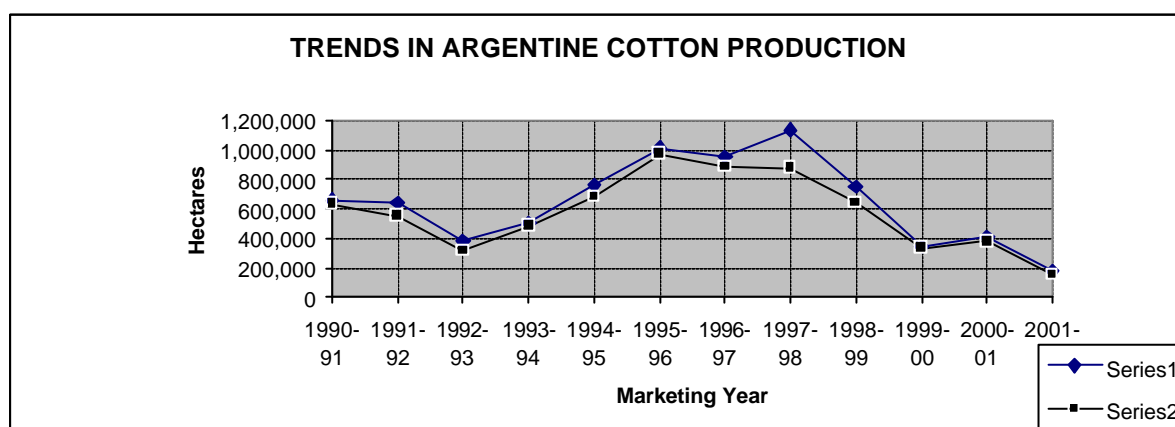
between 1994/1995 and 1998/1999. Worse still, production in 2001/2002 was estimated at 69,810 tons and in 2002/2003 at 60,000 tons, against 163,000 tons in 2000/2001.

27. This collapse of the Argentine cotton sector is reflected in the high level of indebtedness of producers estimated at US\$600 million and equivalent to twice the size of agricultural GDP of Argentina's largest cotton producing province.

28. The table below shows the direct relationship between the area of cultivated and harvested cotton and fibre production in Argentina, and trends in world cotton prices according to Cotlook A Index.

Season	Cotton area (hectares)		Fibre production (Metric tons)	World price A Index (US cents/lb)
	<i>Cultivated</i>	<i>Harvested</i>		
<b>1995/96</b>	<b>1,010,000</b>	<b>969,400</b>	<b>437,000</b>	<b>85.60</b>
1996/97	955,600	887,140	338,000	78.55
1997/98	1,133,500	877,900	311,000	72.20
1998/99	751,000	639,700	200,000	58.90
1999/00	345,950	332,100	134,000	52.80
2000/01	407,980	384,850	165,000	57.20
2001/02	173,930	170,000	73,000	41.80
<b>2002/03*</b>	<b>157,930</b>	<b>147,410</b>	<b>60,000</b>	<b>55.30</b>

\* Estimate



(b) *Impact of low international prices on employment*

29. Total employment in raw cotton production in Argentina amounts to 93,470 workers; this figure includes 32,060 cotton producers and is based on an average harvested area of 810,828 hectares. The ginning sector employs 3,946 workers and the marketing and input supply chain represents 12,550 additional jobs.

30. Between 1999/2000 and 2001/2002, employment in the cotton sector decreased to an average of 70,400 workers, i.e. a **reduction in employment of 64 per cent**. These figures were obtained from the official employment records of registered workers but they are probably underestimated. According to private estimates, there are 50,000 non-registered workers, which would increase labour loss to 102,000 jobs.

31. Argentina's cotton production is concentrated in 11 provinces and, according to a 1999 World Bank study, 56.6 per cent of the population in these provinces live under the poverty line and 18.2 per cent below the indigence line. The same study shows that 36.1 per cent of Argentina's population live



under the poverty line and 8.6 per cent below the indigence line, which reflects the higher level of poverty in the cotton producing provinces.<sup>10</sup>

(c) *Impact of low international prices on income*

32. Between 1999/2000 and 2001/2002, average raw cotton production<sup>11</sup> was 652,872 tons lower than the 1994/1995 to 1998/1999 average. Using an average price received by producers of US\$358/ton<sup>12</sup> between 1994/1995 and 1998/1999, annual gross revenue has dropped by US\$255 million over the past three years.

(d) *Impact of low international prices on the value and volume of Argentine exports*

33. In marketing year 2002/2003, planted area shrank to a mere 157,930 hectares, its lowest level in the last 66 years, and production will not even succeed in meeting domestic demand. Even in circumstances like these, it might have been possible to generate sufficient export supply had international prices not been artificially depressed.

34. It should be emphasized that in 1996 Argentina exported 70 per cent of its production, ranking that year as the world's fourth largest exporter.

35. The table below shows the trends in Argentine cotton exports.

#### TRENDS IN ARGENTINE COTTON EXPORTS

Years	Volume (tons)	FOB value (US\$ millions)	Argentina's per cent share of world exports
1995	243,474	432.8	4%
1996	357,447	497.0	6%
1997	214,904	332.3	3.6%
1998	177,025	224.3	3.2%
1999	180,897	177.9	3%
2000	53,637	53.2	0.9%
2001	89,262	72.8	1.5%
2002	18,366	11.9	0.1%
2003*	1,985	1.6	--

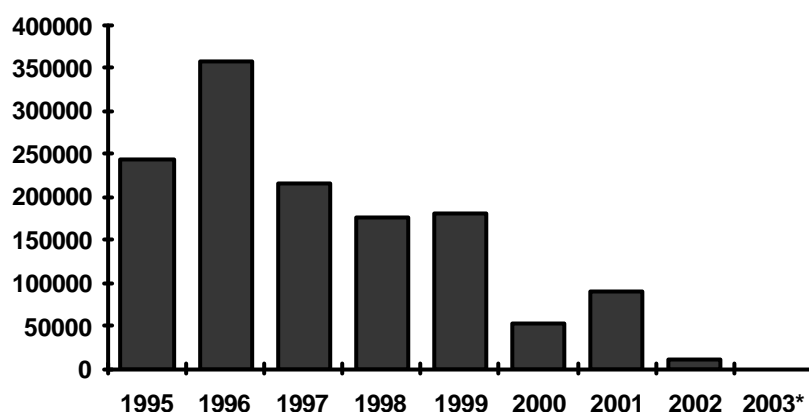
\*(Estimate at 31 May 2003)

<sup>10</sup> *Id.*

<sup>11</sup> Seed cotton; unginned.

<sup>12</sup> For a quality equal to a C-1/2 grade.

36. In chart form, Argentine cotton exports (tons) since 1995 show the following trends:

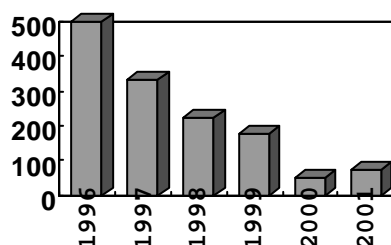


37. This chart shows – as does the table below – a direct relationship between the decline in international cotton prices, which began in 1996/1997, along with the implementation of the 1996 US Farm Act, and the collapse of the Argentine cotton economy.

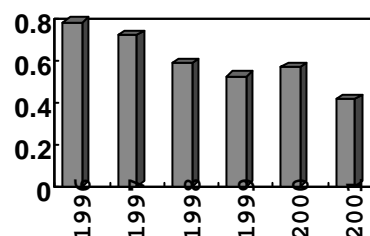
Years	Argentine cotton exports (FOB value in US\$ millions)	Cotlook A Index (US\$/lb)
1996	497.0	0.7855
1997	332.3	0.7220
1998	224.3	0.5890
1999	177.9	0.5280
2000	53.2	0.5720
2001	72.8	0.4180
2002	11.9	0.5530
2003*	1.6	---

38. The following chart clearly illustrates the direct relationship (except for the year 2000) between Argentine exports and international cotton prices.

Argentine cotton exports (f.o.b. value in US\$ millions)



Cotlook A Index (US\$/lb)



### III. LOSS OF PROTECTION UNDER THE PEACE CLAUSE: ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE (AOA)

39. As stated in paragraph 6 above, Argentina will address the inconsistency of the United States subsidies with Articles 5 and 6 of the SCM Agreement in the 22 September submission. On that occasion, Argentina will explain why the United States cannot seek the protection of Article 13 of the AoA because of non-compliance with the legal requirements for protection under that provision.

## PEACE CLAUSE DEFENCE SUBJECT TO CONDITIONS

40. The "Peace Clause" – Article 13 of the AoA – precludes actions against a Member's agricultural subsidies up to 1 January 2004 if such measures comply with certain legal requirements.

41. As stated by Argentina in its Third Party Initial Brief:

"... a textual analysis of Article 13 of the AoA reveals that "*actions*" ... can only be precluded if all conditions established in paragraphs (b) (ii) or (c) (ii) of the referred Article 13 are met".<sup>13</sup> (Emphasis added).

...

"... '*Exempt from actions*' means that a finding of inconsistency with Article XVI of GATT 1994 or Articles 3, 5 and 6 of the SCM Agreement will not be possible if the legal requirements for the exemption are fulfilled. The immediate context of the term '*exempt from actions*' – i.e., paragraphs (b) and (c) – confirms this interpretation since that exemption requires a particular threshold, i.e. that domestic support measures and export subsidies 'conform fully' (to different provisions of the AoA)".<sup>14</sup>

...

"... A different interpretation would imply giving the measures allegedly covered by the Peace Clause a character of absolute immunity, independent of whether the legal requirements established in Article 13 are fulfilled or not. This would contradict the principle of *in dubio mitius*, constituting a more onerous interpretation of the treaty provisions".<sup>15</sup>

...

"... Indeed, the key words in Article 13 (b) (ii) and (c) (ii) of the AoA are "*that conform fully*" and "*provided that*" and "*that conform fully*", respectively. These words imply that the exception is not absolute, but rather subject to the fulfilment of certain conditions ... ".<sup>16</sup>

## BURDEN OF PROOF WITH RESPECT TO THE CONDITIONS FOR THE PEACE CLAUSE DEFENCE

42. As Argentina stated in its Third Party Initial Brief, the defence under Article 13 of the AoA is in the nature of an exception (affirmative defence).

43. It follows that in accordance with the WTO rules on the burden of proof (laid down by the Appellate Body in *(United States – Shirts and Blouses from India)*, the burden is on the party invoking the exception to show that its use is justified. In the present case, it is clearly for the party invoking the protection of Article 13 of the AoA to show that the conditions stipulated in that Article are satisfied.

44. Accordingly, for the United States domestic support measures to be exempt from actions based on Article XVI.1 of GATT 1994 or Articles 5 and 6 of the SCM Agreement, the United States must show that:

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<sup>13</sup> See Argentina's Third Party Initial Brief of 10 June 2003, paragraph 3.

<sup>14</sup> *Ibidem* paragraph 5.

<sup>15</sup> *Ibidem*, paragraph 6.

<sup>16</sup> *Ibidem*, paragraph 8.

- The domestic support measures for cotton conform fully to the provisions of Annex 2 to the AoA (or belong in the "green box", at the risk of being included in the Current Total AMS in accordance with Article 7.2 (a) of the AoA), or that
- the domestic support measures that do not belong in the "green box" and grant support to cotton do not exceed the support decided during the 1992 marketing year.

45. Likewise in order for the export subsidies granted by the United States to be exempt from actions based on Article XVI of GATT 1994 and Articles 3, 5 and 6 of the SCM Agreement the United States must show that these export subsidies conform fully to Articles 8 to 11 of the AoA (Part V).

### III.1 LOSS OF PEACE CLAUSE PROTECTION IN RELATION TO DOMESTIC SUPPORT MEASURES: ARTICLE 13 (B) (II) OF THE AoA

46. In particular, in relation to domestic support measures, Article 13 (b) (ii) of the AoA states that:

*"During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies ... :*

*... domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within de minimis levels and in conformity with paragraph 2 of Article 6, shall be:*

*...*

*exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year; ..." (emphasis added).*

47. In Argentina's opinion, in the present case, for lack of a specific WTO notification or known US laws or regulations, the support "*decided during the 1992 marketing year*" by the United States should be considered to be the non-"green box" domestic support granted by that country to cotton during the 1992 marketing year.

48. Argentina agrees with Brazil that the level of subsidies granted by the United States to its cotton sector during marketing years 1999 to 2002 exceeded that of 1992, thereby depriving the United States of Peace Clause protection, for non-compliance with the legal requirements of Article 13 (b) (ii) of the AoA.

49. In this respect, the Oxfam Briefing Paper ("*Cultivating Poverty: The impact of US Cotton Subsidies on Africa*")<sup>17</sup> states that:

*"The US has lost this protection (the Peace Clause protection) by virtue of the fact that **the level of subsidies it provided in 2001 was double that provided in 1992**".*

*...*

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<sup>17</sup> See Exhibit Bra – 15.

*"Every acre of cotton farmland in the US attracts a subsidy of \$230, or around five times the transfer for cereals. In 2001/02 farmers reaped a bumper harvest of subsidies amounting to \$3.9bn – double the level in 1992. This increase in subsidies is a breach of the "Peace Clause" in the WTO Agreement on Agriculture ..."*

...

*"The United States accounts for approximately one-half of the world's production subsidies for cotton. In 2001/02 the value of US cotton production amounted to \$3bn at world market prices. In the same year, the value of outlays in the form of subsidies to cotton farmers by the USDA's Commodity Credit Corporation (CCC) was \$3.9bn. In other words, cotton was being produced at a net cost to the American economy".*

50. The domestic support measures which, in Argentina's view, do not enjoy Peace Clause protection under Article 13 (b) (ii) are the following programmes established in the United States legislation as described by Brazil in its First Submission: Deficiency Payments<sup>18</sup>, Loan Deficiency Payments<sup>19</sup>, Production Flexibility Contract Payments<sup>20</sup>, Direct Payments<sup>21</sup>, Market Loss Assistance<sup>22</sup>, Counter-Cyclical Payments<sup>23</sup>, Marketing Loan Gains<sup>24</sup>, Crop Insurance Subsidies<sup>25</sup>, Step 2 Domestic Payments<sup>26</sup>, and Cottonseed Payments<sup>27</sup>.

51. It should be pointed out that in the consultations held on 3, 4 and 19 December 2002 – in which Argentina was joined – in relation to the above-mentioned programmes Argentina requested the United States for information on the amount of support granted to cotton producers in the years 1999, 2000 and 2001, considering that the last domestic support notification had been for the year 1998<sup>28</sup>.

52. In this connection, the United States confined itself to pointing out that various answers to the Argentine questions could be found in US domestic support notifications in the process of being submitted to the Committee on Agriculture, without specifying what these answers were or when these notifications would be made.

*The programmes Production Flexibility Contract (PFC), Direct Payment (DP) and Counter-Cyclical Payment (CCP) are non-"green box"*

53. As Brazil shows in its Submission, the PFC, DP and CCP programmes are not subsidies that can be classified as "domestic support measures that conform fully to the provisions of Annex 2" of the AoA.

54. Accordingly, the amounts granted to cotton producers under these programmes must be treated as domestic support in calculating total support under Article 13(b)(ii).

55. These three programmes are inconsistent with Annex 2 of the AoA, *inter alia*, because they are not in accordance with the provisions of paragraph 6 (b) of that Annex in as much as the amount of

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<sup>18</sup> Submission by Brazil, paragraphs 45 to 47.

<sup>19</sup> *Ibidem*, paragraphs 70 to 78 and Exhibits Bra – 28, Bra – 29 and Bra – 36.

<sup>20</sup> *Ibidem*, Sections 2.6.1 and 3.2.6.

<sup>21</sup> *Ibidem*, Sections 2.6.2 and 3.2.7.

<sup>22</sup> *Ibidem*, Section 2.6.3.

<sup>23</sup> *Ibidem*, Sections 2.6.4 and 3.2.8.

<sup>24</sup> *Ibidem*, Section 2.6.5.

<sup>25</sup> *Ibidem*, Section 2.6.6.

<sup>26</sup> *Ibidem*, Section 2.6.8.

<sup>27</sup> *Ibidem*, Section 2.6.10.

<sup>28</sup> It should be noted that after the consultations the United States notified the Committee on Agriculture of the amount of domestic support for the year 1999 (G/AG/N/USA/43; Exhibit Bra – 47).

payments is related with the type of production undertaken by the producer in years after the base period.

56. In this respect, Argentina agrees with Brazil that the term "type ... of production ..." means the type of crop planted and not the production method employed.

*Failure of the United States to comply with its notification obligations*

57. Considering (i) that the last domestic support notification available is that for the year 1999<sup>29</sup> and (ii) the delay of more than three years, since the end of that year, in submitting a notification, Argentina wishes to make the following points:

58. Argentina considers that the United States has failed to fulfil its notification obligations under Article 18.2 of the AoA, the Decision on Notification Procedures adopted on 15 December 1993 and the Notification Requirements and Formats (G/AG/2) adopted by the Committee on Agriculture on 8 June 1995.

59. This failure to comply with notification obligations makes it very difficult to verify the domestic support provided from 2000 onwards as regards compliance with the commitments under Article 3.2 of the AoA, that is to say, whether or not the United States' non-"green box" subsidy programmes remain within the limits to which it is committed in its Schedule. The lack of notification also makes it difficult to verify whether the domestic support measures "conform fully to Article 6" of the AoA.

60. It is also difficult to review the implementation of the AoA by the United States under Article 18.2 in relation to the categorization of its subsidies, in particular whether some of them are "green box" or not.

61. The seriousness of failure to comply with the obligation to inform Members is such that paragraph 7 of Annex V to the SCM Agreement actually sanctions instances of non-cooperation by requiring the Panel to draw adverse inferences.

62. Argentina considers that this failure should be taken into account in deciding whether the United States' domestic support is consistent with Article 3.2 of the AoA and whether that domestic support should be included among the subsidies of Annex II to the Agreement.

THE US LEVELS OF DOMESTIC SUPPORT FOR COTTON EXCEED THE 1992 LEVEL

63. Argentina agrees with Brazil's figures in paragraphs 144, 148 and 149 of its First Submission showing that the United States budgetary outlays for domestic support for the cotton sector have been as follows (in millions of dollars), on the basis of information supplied by the USDA itself<sup>30</sup>:

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<sup>29</sup> G/AG/N/USA/43 (Exhibit Bra-47).

<sup>30</sup> See Exhibits Bra-6, Bra-76, Bra-4, Bra-57, Bra-55, Bra-47, and footnotes 301 and 321.

<b>Domestic Support</b>	<b>Marketing Year 1992</b>	<b>Marketing Year 1999</b>	<b>Marketing Year 2000</b>	<b>Marketing Year 2001</b>	<b>Marketing Year 2002*</b>
<b>Loan Deficiency Payments</b>	268	685	152	743	206 <sup>31</sup>
<b>Marketing Loan Gains</b>	476	860	390	1,763	602 <sup>32</sup>
<b>(Total Marketing Loan Payments)</b>	---	---	---	---	952 <sup>33</sup>
<b>Deficiency Payments</b>	1,017	---	---	---	---
<b>Production Flexibility Contract Payments<sup>34</sup></b>	---	616	575	474	---
<b>Direct Payments<sup>35</sup></b>	---	---	---	---	523
<b>Step 2 Payments</b>	207	422	236	196	317
<b>Crop Insurance Payments</b>	26.5	170	161	263	194
<b>Market Loss Assistance Payments</b>	---	613	612	654	---
<b>Counter-Cyclical Payments<sup>36</sup></b>	---	---	---	---	1,077
<b>Cottonseed Payments</b>	---	79	185	---	50
<b>TOTAL</b>	<b>1,994.5</b>	<b>3,445</b>	<b>2,311</b>	<b>4,093</b>	<b>3,113</b>

\* The information relating to United States support for cotton during marketing year 2002 is not yet complete as the marketing year does not end until 31 July 2003. Nevertheless, Argentina has used the best available evidence provided by Brazil in paragraph 149 of its Submission using partial USDA data and estimates based on criteria and provisions of support under the 1996 FAIR Act.

64. Thus, the subsidy levels for cotton in 1999, 2000, 2001 and 2002 are considerably in excess of the level for 1992 and, as already pointed out, the United States therefore lacks a basis for its claim,

<sup>31</sup> See Exhibit Bra-55.

<sup>32</sup> See Exhibit Bra-55.

<sup>33</sup> See footnote 338 of Brazil's Submission.

<sup>34</sup> According to paragraph 45 of Brazil's Submission, PFC payments replaced the Deficiency Payment Programme that had existed for years and had been renewed in the 1990 FACT Act.

<sup>35</sup> As indicated by Brazil in paragraph 49 of its Submission, direct payments began to be paid in marketing year 2002 with the passage of the new Farm Act in May 2002 (2002 FSRI Act) and will be paid until the end of marketing year 2007, in place of the Production Flexibility Contract payments.

<sup>36</sup> As indicated by Brazil in paragraph 63 of its Submission, the 2002 Farm Act (2002 FSRI Act) institutionalized the market loss assistance payments that the United States enacted in marketing years 1998- 2001 with a new programme of counter-cyclical payments up to the end of marketing year 2007.

under Article 13(b)(ii) of the AoA, that its domestic support measures for cotton are exempt from actions based on Article XVI.1 of GATT 1994 or Articles 5 and 6 of the SCM Agreement.

### III.2 LOSS OF PEACE CLAUSE PROTECTION IN RELATION TO EXPORT SUBSIDIES: ARTICLE 13(c)(ii) OF THE AoA

65. With respect to export subsidies, Article 13(c)(ii) of the AoA states that:

*"During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies ... :*

*...*

*export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be:*

*...*

*exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement". (Emphasis added).*

66. In relation to export subsidies, the Peace Clause could only be invoked by the United States if its export subsidies conformed fully to the provisions of Part V of the AoA, that is, Articles 8-11 of the AoA.

67. According to Article 8 of the AoA, "Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule".

68. Thus, as Brazil asserts in paragraph 222 of its Submission, the United States can provide export subsidies for agricultural products if it satisfies two conditions: (i) has a reduction commitment for the product in question and (ii) the amount of export subsidies provided does not exceed this reduction commitment.

69. In this case, the measures that Argentina considers to be inconsistent with WTO rules are:

- I. the export subsidies for US (upland) cotton established in the United States legislation under the Step 2 Export Program<sup>37</sup>;
- II. the export credit guarantee programmes for cotton and other products, General Sales Manager 102 (GSM 102), General Sales Manager 103 (GSM 103), and Supplied Credit Guarantee Programme (SCGP), as described by Brazil in its First Submission<sup>38</sup>; and
- III. the cotton export subsidies granted under the FSC Repeal and Extraterritorial Income Act of 2000(ETI Act).

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<sup>37</sup> CFR 1427.103 to 1427.107.

<sup>38</sup> Submission by Brazil, sections 2.6.7, 4.1 and 4.1.1 and 2.6.9.



*Inconsistency with the provisions of Part V (Articles 8 to 11) of the AoA*

70. Article 3.3 of the AoA prohibits the granting of export subsidies in respect of agricultural products not specified in Section II of Part IV of a Member's Schedule<sup>39</sup>. This provision forms part of the reference to "unconformity with this Agreement and with the commitments as specified in that Member's Schedule" in Article 8 of the AoA.<sup>40</sup>

71. In fact, Schedule XX of the United States, Part IV (Agricultural Products: Commitments Limiting Subsidization), Section II (Export Subsidies: Budgetary Outlay and Quantity Reduction Commitments)<sup>41</sup>, **does not specify cotton among the products subject to commitments**.

72. Consequently, because its export subsidies are not in conformity with the provisions of Part V of the AoA, the United States has no basis for invoking, under Article 13 (c) (ii) of the AoA, the exception to the effect that its cotton export subsidies are exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the SCM Agreement.

73. Moreover, as described in Section IV of this submission, neither the US (upland) cotton export subsidies established in the United States legislation under the Step 2 Export programme, nor the export credit guarantee programmes for cotton and other products General Sales Manager 102 (GSM 102), General Sales Manager 103 (GSM 103) and Supplied Guarantee Programme (SCG), nor the subsidies granted to cotton exports under the FSC Repeal and Extraterritorial Income Act of 2000 (ETI Act) are in conformity with Part V of the AoA since they are inconsistent with Articles 3.3, 8 and 10.1 of the AoA.

#### **IV. INCONSISTENCY WITH ARTICLES 3.3, 8 AND 10.1 OF THE AoA AND ARTICLE 3 OF THE SCM AGREEMENT**

74. In accordance with paragraph 7 above, Argentina maintains that the United States cotton export subsidies are inconsistent with Articles 3.3, 8 and 10.1 of the AoA.

75. As already pointed out, Schedule XX of the United States, Part IV (Agricultural Products: Commitments Limiting Subsidization), Section II (Export Subsidies: Budgetary Outlay and Quantity Reduction Commitments)<sup>42</sup>, **does not specify cotton among the products subject to commitments**.

76. Consequently, as noted by Brazil in paragraph 237 of its Submission, any export subsidy provided by the United States to its cotton industry will be inconsistent with Articles 3.3 and 8 of the AoA. In other words, as it has not specified cotton as a product subject to subsidy reduction commitments, the United States has no right to grant this type of support for the product in question, any support granted or proposed constituting a breach of the provisions of Articles 3.3 and 8 of the AoA:

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<sup>39</sup> Article 3.3 of the AoA reads as follows: "...a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule". (Emphasis added).

<sup>40</sup> Article 8 of the AoA reads as follows:

"Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule".

<sup>41</sup> See Exhibit Bra-83.

<sup>42</sup> See Exhibit Bra-83.

## ARTICLE 10.3 OF THE AoA

77. Argentina wishes to point out that, in accordance with Article 10.3 of the AoA and the Appellate Body's interpretation in "*Canada - Dairy Products: Article 21.5 DSU (II)*"<sup>43</sup>, it is for the United States to show that quantities exported in excess of the export subsidy reduction commitment level have not been subsidized.

78. Figures 18 and 19 in paragraphs 265 and 266 of Brazil's submission clearly indicate that in the case of both cotton and other agricultural commodities exports of which qualify for the export credit guarantee programmes GSM 102, GSM 103 and SCGP United States exports during the year 2001 were well in excess of the reduction commitments in its Schedule.

79. Consequently, the United States bears the burden of proving that both for cotton and for other products that benefit from export credit guarantee programmes the export segment in excess of the scheduled reduction commitment has not received any export subsidy.

## THE INDIVIDUAL EXPORT SUBSIDY PROGRAMMES

### - *Step 2 Export Programme*

80. Referring to Brazil's observations in paragraphs 244 and 245 of its Submission, Argentina agrees that Section 1207(a) of the Farm Act of 2002 (*2002 FSRI Act*)<sup>44</sup> – establishing the *Step 2 Export Programme* – constitutes a *per se* violation of AoA Articles 3.3 and 8 as it is a mandatory provision, in the same way that the *Step 2 Export Programme* also constitutes a *per se* violation of those provisions because of its mandatory nature.

81. Both the corresponding section of the 2002 FSRI Act and the provisions of Section 1427.100 ff. of the *Code of Federal Regulations* clearly establish that the *Commodity Credit Corporation* (CCC) *must* issue marketing certificates or cash payments to exporters and/or users of US (upland) cotton.

82. The purpose of the programme is to provide a direct incentive for US cotton exports and consists of a direct payment to exporters based on the difference between the US domestic cotton price and the world market price. There can be no doubt that whenever the former is higher than the latter an export subsidy is present in as much as the existence of these payments enables the US product to compete artificially with the lower-cost products of more efficient producers. All these aspects are dealt with *in extenso* by Brazil in its Submission dated 24 June 2003<sup>45</sup>, and Argentina therefore considers it unnecessary to dwell on a description of the operational details of the programme itself.

83. What Argentina wishes to make clear is the fact – to which attention has already been drawn by Brazil – that the programme known as *Step 2* establishes the right of exporters to receive a subsidy for shipments made in connection with foreign sale operations, while establishing an obligation upon the CCC to grant that subsidy once the particular requirements are satisfied.

84. In "*US EXPORT CREDITS: Denials and Double Standards*"<sup>46</sup>, published by Oxfam America, it is noted that:

*"In the case of cotton, developing countries are clearly losing out because of the unfair competitive advantage given to US cotton exports. For the marketing year*

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<sup>43</sup> WT/DS103/AB/RW2, WT/DS113/AB/RW2, adopted 17 January 2003.

<sup>44</sup> See Exhibit Bra-29.

<sup>45</sup> Submission by Brazil, Sections 4.1, 4.1.1, 4.1.2, 4.2 ff.

<sup>46</sup> Oxfam American Briefing Note, March 2003.

*2001/2002, US subsidies to cotton amounted to \$4 billion, including, among other programs, export credits. In the 2001/2002 marketing year, the transfer linked with Step 2 cotton subsidies ranged from 0-7 cents per pound, or up to 18 per cent of the world market price. Total export subsidization under this heading was around \$197 million in 2001".*

85. Insofar as the United States does not specify Upland Cotton in its Schedule of Commitments (see paragraphs 72 and 75 above) and this type of subsidy is granted to cotton under the *Step 2* programme, any provision in the legal texts with respect to the granting of such a subsidy makes those texts inconsistent *per se* with Articles 3.3 and 8 of the AoA, while for the same reason any sum distributed, budgeted or provided for under this programme constitutes a prohibited subsidy within the meaning of Article 3 of the SCM Agreement, which expressly establishes a reservation in respect of the Agreement on Agriculture.

- *The programmes GSM 102, GSM 103 and SCGP:*

86. In its submission of 24 June, Brazil establishes unequivocally that the US export credit guarantee programmes constitute export subsidies. For this purpose Brazil carries out a combined analysis of the provisions of the AoA and the SCM Agreement, while also basing its arguments on the relevant WTO case-law<sup>47</sup>.

87. Argentina agrees with the Brazilian analysis and therefore considers it unnecessary to repeat the description of the operational programmes or the analysis of their legal coverage under the Agreement on Agriculture and the SCM Agreement. Suffice it to note that Argentina also considers that these programmes constitute export subsidies under item (j) of the Illustrative List in Annex I to the SCM Agreement – in as much as the export credit guarantees are granted "*at premium rates which are inadequate to cover the long term operating costs and losses of the programmes*" – thereby resulting in a violation of the provisions of Article 10.1 of the AoA.

88. At the same time, Argentina wishes to emphasize the impact and distorting effect on trade of these export credit guarantees.

89. The export credit guarantee programmes provide incentives for exports for United States agricultural products, in this case cotton and other agricultural products, and the credits are granted on terms more favourable than those available on the market. This situation is clearly reflected in paragraphs 275 to 286 of Brazil's First Written Submission and further illustrated by the Oxfam study "*US EXPORT CREDITS: Denials and Double Standards*"<sup>48</sup> which on page 3 states:

*" ... those favourable conditions include lower interest rates, a longer loan repayment period, a smaller down payment, less frequent payments per year and/or the virtual waiver of a fee or premium designed to provide the US government with adequate protection against potential defaults".*

90. Likewise, a study carried out by the OECD in 2000, in which the effects of export subsidies granted by various countries are evaluated, indicates that the United States credit guarantee programmes are the most trade-distorting of all those analyzed, in as much as the premiums paid by the beneficiaries are too low to cover the high level of the guarantees granted for long term credits.<sup>49</sup>

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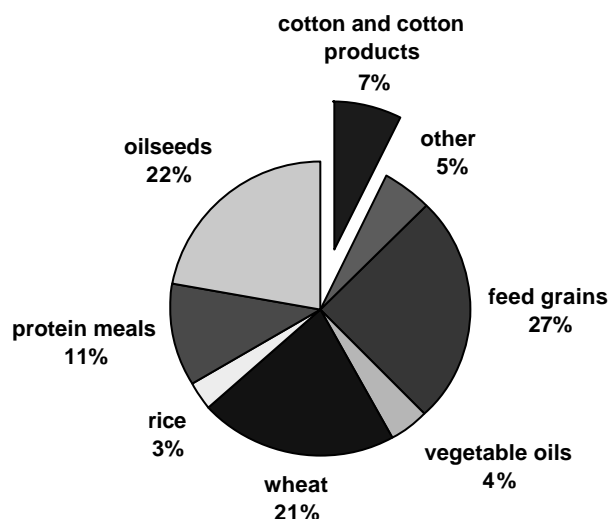
<sup>47</sup> Submission by Brazil, Section 4.2.1.4.2.

<sup>48</sup> Oxfam America Briefing Note, March 2003.

<sup>49</sup> "An analysis of officially supported export credits in agriculture", OECD, 2000.

91. According to the *Summary of FY 2002 Export Credit Guarantee Programme Activity*, published on the Federal Agricultural Service (FAS) Website<sup>50</sup>, the percent shares of export credit guarantee applications, by commodity, for fiscal year 2002 were as follows:

**Applications for export credit guarantees, by commodity,  
Fiscal year 2002, Percent share**



92. Thus, as the United States does not have export subsidy reduction commitments specified in its Schedule for cotton and other products such as soya, maize (corn) and oilseeds and given the existence of United States export subsidies for cotton and other products, the United States is in violation of Articles 3.3, 8 and 10.1 of the Agreement on Agriculture.

93. Finally, it should be noted that the GSM 102, GSM 103 and SCGP programmes can be granted both to products for which reduction commitments exist and to those for which no such commitments exist<sup>51</sup>. With the respect to the products for which there are reduction commitments, the amounts exported by the United States are well in excess of the levels of those commitments.<sup>52</sup> Accordingly, Argentina considers – as indicated by Brazil<sup>53</sup> – that the burden lies with the United States to prove that its excess exports did not benefit from export subsidies, including export credit guarantees.

94. Moreover, since the GSM 102, GSM 103 and SCGP programmes are intended to promote exports of cotton, confirmation of their export subsidy component would imply the presence of a subsidy prohibited within the meaning of Article 3.1 (a) of the SCM Agreement and a violation of Article 10.1 of the AoA –

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<sup>50</sup> "US EXPORT CREDITS: Denials and Double Standards", Oxfam America Briefing Note, March 2003.

<sup>51</sup> See Exhibit Bra-84, pages 9, 12 and 17, and Exhibit Bra-73.

<sup>52</sup> Submission by Brazil, paragraphs 265 and 266.

<sup>53</sup> Submission by Brazil, paragraph 268.

- *ETI ACT*

95. With respect to the export subsidies granted to cotton under the ETI Act, which provides tax exemptions for US exporters who sell products outside the United States, Argentina refers to the fact that this Act was declared inconsistent with Article 3.1 (a) of the SCM Agreement and Articles 10.1 and 8 of the AoA in the "*United States - FSC*<sup>54</sup>" dispute.

**V. CONCLUSION**

96. For the above reasons Argentina considers that both the domestic support measures and the export subsidies granted by the United States to its cotton sector and called into question in these proceedings do not qualify for the protection provided under Article 13, paragraphs (b) (ii) and (c) (ii) of the Agreement on Agriculture.

97. Furthermore, the export subsidies for cotton and other products provided for in the United States legislation in the form of export credit guarantees (GSM 102, GSM 103, and SCGP) are likewise not protected by Article 13 (c) (ii).

98. Argentina also maintains that the subsidies for cotton exports provided for in the United States legislation are inconsistent with Articles 3.3, 8 and 10.1 of the Agreement on Agriculture.

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<sup>54</sup> WT/DS108/AB/R adopted on 20 March 2000.

## ANNEX B-4

### AUSTRALIA'S THIRD PARTY SUBMISSION

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## I. INTRODUCTION

1. Australia welcomes the opportunity to present its views in this proceeding on US subsidies for upland cotton.

2. Australia notes that this dispute is the first to involve the interpretation and application of Article 13 of the *Agreement on Agriculture* (AA), the so-called “peace clause”. As such, this dispute has particular systemic as well as commercial significance.

3. In this third party Submission, Australia addresses:

- I. the nature of AA Article 13 as an affirmative defence, and the meaning of Article 13(b)(ii);
- II. whether “production flexibility contract payments” and their successor “direct payments” may be claimed as “green box” support within the meaning of AA Annex 2;
- III. whether s.1207(a) of the Farm Security and Rural Investment Act of 2002 (“the FSRI Act”) mandating payments to exporters of US cotton (“Step 2” export payments) is inconsistent with AA Articles 3.3 and 8 and thus is also inconsistent with Article 3 of the *Agreement on Subsidies and Countervailing Measures* (the *SCM Agreement*); and
- IV. whether s.1207(a) of the FSRI Act mandating payments to domestic users of US cotton (“Step 2” domestic payments) is inconsistent with Article 3 of the *SCM Agreement*.

4. Because of the very limited time that has been available to consider the First Written Submission of the United States, Australia will address issues raised in that Submission in its oral statement before the Panel.

## II. ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE

A. AA ARTICLE 13 IS IN THE NATURE OF AN AFFIRMATIVE DEFENCE AND THE UNITED STATES HAS THE BURDEN OF PROOF

5. Australia agrees with Brazil that AA Article 13 is in the nature of an affirmative defence and that the United States has the burden of proof on the question of whether the measures at issue fully conform with the applicable conditions of Article 13.

6. Like Article XX of the *General Agreement on Tariffs and Trade* (“GATT”), AA Article 13 “does not establish any ‘positive obligations’ relevant to determining the proper scope of the obligations under [the specified provisions of GATT 1994 and the SCM Agreement]. Instead, it sets out circumstances in which Members are entitled to ‘adopt or maintain’ measures that are inconsistent with the obligations imposed under other provisions of [the GATT 1994 and the SCM Agreement]”.<sup>1</sup>

7. AA Article 13 does not of itself impose any obligation on a Member granting domestic support measures falling within Annex 2 or Article 6 or granting export subsidies falling within Part V of the *Agreement on Agriculture*.

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<sup>1</sup> *United States – Tax Treatment for “Foreign Sales Corporations”*, Recourse to Article 21.5 of the DSU by the European Communities, Report of the Appellate Body, WT/DS108/AB/RW, paragraph 127.



8. Instead, AA Article 13 sets out the circumstances in which Members will be immune, either wholly or partially, from the consequences of granting domestic support measures or export subsidies that otherwise constitute grounds for a claim of infringement of the obligations contained in the provisions of GATT 1994 and the *SCM Agreement* specified in that Article. Thus, for example, under AA Article 13(b)(ii), “domestic support measures that conform fully to the provisions of Article 6 of [the *Agreement on Agriculture*] ... shall be: ... exempt from actions based on” the specified provisions of GATT 1994 and the *SCM Agreement*, “provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year”.

9. The nature of AA Article 13 as an affirmative defence is confirmed by an examination of the protection afforded by Article 13.

10. Under AA Article 13(a)(i), domestic support measures that conform fully to the provisions of AA Annex 2 “shall be non-actionable subsidies for purposes of countervailing duties”. Under AA Article 13(b)(i), domestic support measures that conform fully to AA Article 6 shall be “exempt from the imposition of countervailing duties unless ...”. Under AA Article 13(c)(i), export subsidies that conform fully to the provisions of AA Part V shall be “subject to countervailing duties only upon a determination of ...”.

11. Under the other provisions of AA Article 13, domestic support measures or export subsidies that conform fully with the prescribed conditions “shall be exempt from actions based on ...” the specified provisions of GATT 1994 and the *SCM Agreement*. If domestic support measures or export subsidies infringe the relevant provisions specified in Article 13, they are nevertheless “free or released from a duty or liability to which others are held”<sup>2</sup> in relation to a proceeding<sup>3</sup> “found[ed], built[t] or construct[ed] on”<sup>4</sup> those provisions, as long as the measures meet the relevant conditions specified in Article 13.

12. Thus, the protection afforded by AA Article 13 becomes available only in circumstances where the domestic support measures or export subsidies at issue have been found:

- V. to be actionable subsidies, or to be otherwise countervailable, under Article 13(a)(i), 13(b)(i) or 13(c)(i); or
- VI. in all other cases, to be inconsistent with the relevant specified provisions of GATT 1994 and/or the *SCM Agreement*;

and if the applicable conditions for the availability of that protection as specified in Article 13 are met.

13. Further, had the negotiators of the *Agreement on Agriculture* intended that AA Article 13 should mean that a Member would not be liable to a legal process of dispute, it is reasonable to assume that they would have said so. For example, the negotiators could have provided that the specified provisions of GATT and the *SCM Agreement* could not be “invoked”, as they did in footnote 35 to Article 10 of the *SCM Agreement* in relation to non-actionable subsidy measures.

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<sup>2</sup> *Black's Law Dictionary*, Seventh Edition, Bryan A Garner, Editor in Chief, West Group, St Paul, Minn., 1999, page 593.

<sup>3</sup> *Black's Law Dictionary*, page 593, defines “action” as “1. The process of doing something; conduct of behaviour. 2. A thing done; act. 3. A civil or criminal judicial proceeding.”

<sup>4</sup> *The New Shorter Oxford English Dictionary*, Ed. Lesley Brown, Volume 1, Clarendon Press, Oxford, 1993, page 187.

14. The Appellate Body has previously clarified that “the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence”<sup>5</sup>, and that “[i]t is only reasonable that the burden of establishing [*an affirmative defence*] should rest on the party asserting it”.<sup>6</sup>

15. Thus, in order to qualify for the protection afforded by AA Article 13, the United States must prove that the measures at issue conform fully to the applicable provisions of the *Agreement on Agriculture*. Further, in the case of the protection potentially afforded by Article 13(b)(ii), as well as by Article 13(b)(iii), the United States must prove that it has not granted, and does not grant, support to a specific commodity in excess of that decided during the 1992 marketing year.

#### B. THE MEANING OF AA ARTICLE 13(B)(II)<sup>7</sup>

16. In its First Written Submission, Brazil correctly highlights that there are a number of interpretative issues raised by the text of AA Article 13(b)(ii).<sup>8</sup>

##### (i) “Implementation period”

17. Under AA Article 1(f) and 1(i) read together, the “implementation period” is, for the purposes of Article 13, defined as the nine-year period commencing in 1995 according to the calendar, financial or marketing year specified in the Schedule relating to that Member.

##### (ii) “Domestic support measures that conform fully to the provisions of [AA] Article 6”

18. Australia supports Brazil’s interpretation that the chapeau of AA Article 13(b) includes all non-“green box” domestic support measures, including product specific and non-product specific, *de minimis* and production-limiting domestic support, as well as investment subsidies and “diversification” support in developing countries.<sup>9</sup>

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<sup>5</sup> *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, Report of the Appellate Body, WT/DS33/AB/R, page 14.

<sup>6</sup> *United States – Woven Wool Shirts and Blouses*, WT/DS33/AB/R, page 16.

<sup>7</sup> Article 13(b)(ii) of the *Agreement on Agriculture* provides as follows:

During the implementation period, notwithstanding the provisions of GATT 1994 and [*the SCM Agreement*]:

...

(b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member’s Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:

...

(ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the [*SCM Agreement*], provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year; and

...

<sup>8</sup> First Submission of Brazil, paragraph 127.

<sup>9</sup> First Submission of Brazil, paragraph 133.

- (iii) “Exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the *[SCM Agreement]*”

19. As noted in Section II.A above, if domestic support measures within the scope of the chapeau of AA Article 13(b) infringe the specified provisions, they are nevertheless “free or released from a duty or liability to which others are held”<sup>10</sup> in relation to a proceeding<sup>11</sup> “found[ed], buil[t] or construct[ed] on”<sup>12</sup> those provisions as long as the conditions specified in Article 13 are met. Again, had the negotiators of the *Agreement on Agriculture* intended that a Member would not be liable to a legal process of dispute, it is reasonable to assume that they would have said so, for example, by providing that the specified provisions may not be “invoked” as in footnote 35 to Article 10 of the SCM Agreement in relation to non-actionable subsidy measures.

20. Australia notes, however, that only actions based on paragraph 1 of GATT Article XVI and Articles 5 and 6 of the SCM Agreement are covered under AA Article 13(b)(ii). Thus, for example, any actions based on paragraph 3 of GATT Article XVI or on SCM Article 3 would not benefit from the protection afforded by AA Article 13(b)(ii). In Australia’s view, the limitation of protection under Article 13(b)(ii) to actions based on GATT Article XVI:1 and on SCM Articles 5 and 6 is consistent with the object and purpose of the *Agreement on Agriculture* as expressed in the preamble to the Agreement, including to “[prevent] ... distortions in world agricultural markets” and “to [achieve] specific binding commitments in ... export competition”. The attainment of those objectives would be too easily subverted if commitments in regard to export subsidies could be circumvented through the provision of domestic support.

- (iv) “Such measures”

21. In Australia’s view, the phrase “such measures” in AA Article 13(b)(ii) refers to the universe of non-“green box” measures covered by the chapeau of Article 13(b), consistent with the ordinary meaning of “such” as “of the kind, degree, or category previously specified or implied contextually”.<sup>13</sup>

- (v) “Grant support”

22. In Australia’s view, having regard to the ordinary meaning of the words in their context and in light of the object and purpose of the *Agreement on Agriculture*, “support” means the actual support, other than legitimate “green box” support, provided to an agricultural product. Thus, to “grant support” is to “agree to”, “promise”, “bestow”, “allow”, “give”, “confer” or “transfer”<sup>14</sup> non-“green box” domestic support of the type referred to in the chapeau of AA Article 13(b), which calculation must include that portion of non-product specific support that benefits the specific commodity at issue.

- (vi) “To a specific commodity”

23. Australia agrees with Brazil’s interpretation<sup>15</sup> that the ordinary meaning of this phrase, read in its context and in light of the object and purpose of the *Agreement on Agriculture*, is support granted

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<sup>10</sup> *Black’s Law Dictionary*, page 593.

<sup>11</sup> *Black’s Law Dictionary*, page 28, defines “action” as “1. The process of doing something; conduct of behaviour. 2. A thing done; act. 3. A civil or criminal judicial proceeding.”

<sup>12</sup> *The New Shorter Oxford English Dictionary*, Volume 1, page 187.

<sup>13</sup> *The New Shorter Oxford English Dictionary*. Volume II, page 3129.

<sup>14</sup> *The New Shorter Oxford English Dictionary*. Volume I, page 1131.

<sup>15</sup> First Submission of Brazil, paragraph 136.

to an individual agricultural commodity covered by AA Annex 1, such as upland cotton, whether through product specific, or non-product specific, support.

(vii) “That decided during the 1992 marketing year”

24. In Australia’s view, this phrase, read in its context and in light of the object and purpose of the *Agreement on Agriculture*, means the level of non-“green box” domestic support, including support provided through non-product specific non-“green box” domestic support measures, “decided” by a Member in the course of the 1992 marketing year to be provided to the benefit of a specific agricultural commodity in the future.

25. The use of the word “decided” in this context was deliberate.

26. Australia notes that the other operative provision of the *Agreement on Agriculture* in which the word “decided” is used is Article 13(b)(iii), which relates to non-violation nullification or impairment actions. Australia notes too that Article 13(b)(iii) contains precisely the same language – “provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year” – as used in Article 13(b)(ii). Thus, the meaning of the word “decided” in the context of Article 13(b)(ii) must be capable of having that same meaning in the context of non-violation nullification and impairment actions under Article 13(b)(iii).

(viii) Summary of the meaning of AA Article 13(b)(ii)

27. During the nine calendar, financial or marketing year period specified in a Member’s Schedule period commencing in 1995, all non-“green box” domestic support measures that conform fully to the provisions of AA Article 6 are immune from the consequences of infringing GATT Article XVI:1 or Part V of the SCM Agreement, provided that the level of support to an individual commodity does not exceed the level of support for that commodity that was decided by the Member to be made available during the relevant 1992 marketing year.

### **III. “PRODUCTION FLEXIBILITY CONTRACT PAYMENTS” AND “DIRECT PAYMENTS” MAY NOT BE CLAIMED AS “GREEN BOX” MEASURES UNDER ANNEX 2 TO THE AGREEMENT ON AGRICULTURE**

28. The United States has previously notified “Production Flexibility Contract (PFC) Payments”<sup>16</sup> as AA Annex 2 “green box” measures.<sup>17</sup> The United States has not made a domestic support notification since PFC payments were replaced by “Direct Payments” (DP)<sup>18</sup> under the 2002 FSRI Act. Like Brazil<sup>19</sup>, Australia considers that neither of these payments programs may be claimed as “green box” measures for the reasons outlined below.

#### **A. THE RELEVANT REQUIREMENTS OF PARAGRAPHS 1 AND 6(B) OF AA ANNEX 2**

29. AA Annex 2.1 provides that “[d]omestic support measures for which exemption from reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production”.

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<sup>16</sup> “Production Flexibility Contract Payments” are described at Section 2.6.1 of the First Submission of Brazil.

<sup>17</sup> See, for example, WTO document G/AG/N/USA/43 of 5 February 2003, page 8, Exhibit Bra -47.

<sup>18</sup> “Direct Payments” are described at Section 2.6.2 of the First Submission of Brazil.

<sup>19</sup> First Submission of Brazil, Sections 3.2.6 and 3.2.7.

30. In addition, in relation to decoupled income support, AA Annex 2.6(b) provides that “[t]he amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period”.

- (i) “No, or at most minimal, trade-distorting effects or effects on production”

31. In requiring that domestic support measures “shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production”, AA Annex 2.1 imposes a stringent standard. Annex 2.1 requires that such measures must, as a primary or essential condition, not “bias” or “unnaturally alter”<sup>20</sup> trade or production. Alternatively, Annex 2.1 requires that, at most, such measures must have “extremely small; of a minimum amount, quantity or degree; very slight, negligible”<sup>21</sup> effects on trade or production.

32. In Australia’s view, this standard cannot be met if the domestic support measure at issue directly and specifically stimulates production and/or trade of a particular commodity, or if that support measure directly retards or halts the transfer of economic resources to other forms of economic activity, other than as specifically provided for under paragraphs 2-13 of AA Annex 2. If a domestic support measure results in a level of production and/or trade in a particular product or group of products higher than would otherwise be the case except as specifically provided for in Annex 2, the support measure cannot meet the standard established in Annex 2.1. Thus, if the direct effect of a support measure is that farmers keep producing, or keep producing a particular product, in circumstances that would be uneconomic but for the support measure, that measure cannot meet the requirements of Annex 2.1.

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

33. Paragraph 6 of AA Annex 2 is headed “decoupled income support”. Paragraph 6(a) provides that “[e]ligibility for [*decoupled income support*] payments shall be determined by clearly defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period”. Thus, consistent with the customary rules of interpretation codified at Article 31 of the *Vienna Convention on the Law of Treaties*, “after the base period” in paragraph 6(b) means after the base period defined and fixed pursuant to paragraph 6(a).

34. Accordingly, the meaning of paragraph 6(b) of AA Annex 2 is clear. Once a base period has been defined and fixed pursuant to paragraph 6(a), decoupled income support payments may not be “connected”<sup>22</sup> to or “found[ed], buil[t] or construct[ed] on”<sup>23</sup> the type of production or the volume of production undertaken by a producer in a later period.

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<sup>20</sup> *The New Shorter Oxford English Dictionary*. Volume I, page 707.

<sup>21</sup> *The New Shorter Oxford English Dictionary*. Volume I, page 1781.

<sup>22</sup> *The New Shorter Oxford English Dictionary*. Volume II, page 2534.

<sup>23</sup> *The New Shorter Oxford English Dictionary*, Volume 1, page 187.

B. “PRODUCTION FLEXIBILITY CONTRACT (PFC) PAYMENTS” COULD NOT BE CLAIMED AS “GREEN BOX” PAYMENTS

- (i) PFC payments had more than a negligible trade-distorting effect or effect on production, contrary to paragraph 1 of AA Annex 2\$

35. Like Brazil, Australia considers that PFC payments directly stimulated, and stimulated by more than a negligible amount, US production of, and trade in, upland cotton and Australia endorses Brazil’s arguments in this respect.<sup>24</sup>

36. Further, the value of PFC payments rates as a proportion of the marketing year average farm price received by US upland cotton growers can be seen from data published by the United States Department of Agriculture (USDA) and included in Table 1 below.

*Table 1: The value of PFC payments as a percentage proportion of the marketing year average farm price received by US upland cotton growers*

<i>Marketing or Crop Year</i>	<i>Production flexibility contract (PFC) payment rates US¢/lb.<sup>25</sup></i>	<i>Average farm price US¢/lb.<sup>26</sup></i>	<i>PFC payment rates as a proportion of the marketing year average farm price %</i>
1996/97	8.882	69.3	12.82
1997/98	7.625	65.2	11.69
1998/99	8.173	60.2	13.58
1999/2000	7.990	45.0	17.76
2000/01	7.330	49.8	14.72
2001/02	5.990	29.8	20.10

37. In addition, data published by the USDA for this period show that PFC payments constituted 26.37%, 36.5% and 22.90% of government payments by crop year for the 1999, 2000 and 2001 years respectively.<sup>27</sup>

38. PFC payments constituting such high proportions of the marketing year average farm prices and of domestic support measures must have a production and trade-distorting effect.

39. But this view is further confirmed when the marketing year average farm prices as shown in Table 1 are considered against the fact that in 1997 the average of total economic costs for all US cotton farms was approximately 73 cents per pound and operating costs averaged 38 cents per pound<sup>28</sup>. In such circumstances, economically rational producers should have begun to transfer resources to other forms of economic activity. This did not happen. USDA data shows that the area planted to cotton in the United States over this period increased, from 13.1 million acres in 1998 to 15.5 million acres in 2001.<sup>29</sup> It is clear that many US producers of upland cotton could only have

<sup>24</sup> First Submission of Brazil, Section 3.2.6.2.

<sup>25</sup> Figures extracted from *Agricultural Outlook*, USDA, May 2000 and May 2002, Table 19, available at <http://www.ers.usda.gov/publications/agoutlook/may2000/ao271k.pdf> and <http://www.ers.usda.gov/publications/agoutlook/May2002/ao291j.pdf> respectively.

<sup>26</sup> . *Fact Sheet: Upland Cotton: Summary of 2002 Commodity Loan and Payment Program*, USDA, January 2003, page 5, Exhibit Bra-4.

<sup>27</sup> *Fact Sheet: Upland Cotton*, page 6, Exhibit Bra-4.

<sup>28</sup> *Cotton: Background and Issues for Farm Legislation*, USDA, July 2001, page 6, Exhibit Bra-46.

<sup>29</sup> *Fact Sheet: Upland Cotton*, page 4, Exhibit Bra-4.

remained viable over this period through subsidisation. Further, US exports of upland cotton increased from 4.1 million bales in 1998 to 10.6 million bales in 2001.<sup>30</sup>

40. In Australia's view, PFC payments during this period contributed directly to increased production and export levels and that they did so contrary to the express requirement of AA Annex 2.1 that the domestic support measures at issue not, or only negligibly, bias or unnaturally alter trade or production.

- (ii) PFC payments were related to the type of production undertaken by the producer, contrary to paragraph 6(b) of AA Annex 2

41. By excluding fruits and vegetables (other than lentils, mung beans, and dry peas) from the planting flexibility otherwise available in respect of the contract acreage for which PFC payments could be made, s.118 of the Federal Agriculture Improvement and Reform Act of 1996 (the FAIR Act) related, or connected, PFC payments to the type of production undertaken by the producer in any year after the base period, contrary to the requirements of AA Annex 2.6(a).

C. "DIRECT PAYMENTS" FOR UPLAND COTTON MAY NOT BE CLAIMED AS "GREEN BOX" PAYMENTS

- (i) Direct payments are likely to have more than a negligible trade-distorting effect or effect on production, contrary to paragraph 1 of AA Annex 2

42. Australia considers that direct payments for upland cotton are likely to stimulate, by more than a negligible amount, US production of, and trade in, upland cotton. The 2002 FSRI Act has established a direct payment rate for upland cotton of 6.67 cents per pound for each of the 2002 through 2007 crop years.

43. In addition to the arguments put forward by Brazil<sup>31</sup>, which Australia endorses, Australia considers that, so long as there is a reasonable possibility of continuing and significant longer-term volatility in the gross returns to producers (as measured by the marketing year average farm price), the assured availability of a direct payment for upland cotton at the rate of 6.67 cents per pound must be presumed to influence directly and specifically the decisions of growers to continue producing upland cotton, notwithstanding significant peaks and troughs in their income, rather than to transfer resources to other forms of economic activity.

- (ii) Direct payments are related to the type of production undertaken by the producer, contrary to paragraph 6(b) of Annex 2 of the Agreement on Agriculture

44. Under s.1106(b) of the 2002 FSRI Act, fruits, vegetables (other than lentils, mung beans and dry peas) and wild rice are generally prohibited from being planted on base acreage unless the commodity, if planted, is destroyed before harvest except that trees and other perennial plants are prohibited. The implementing regulations make clear that, where it is determined that a producer made a good faith effort to comply with the "planting flexibility" provisions of s.1106 of the FSRI Act but that that producer's acreage report of fruits, vegetables or wild rice planted on a farm's base acreage is inaccurate and exceeds the allowed tolerance levels, the producer "shall accept a reduction in the direct and counter-cyclical payments for the farm ...".<sup>32</sup>

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<sup>30</sup> *Fact Sheet: Upland Cotton*, page 5, Exhibit Bra-4.

<sup>31</sup> First Submission of Brazil, at Section 3.2.7.3.

<sup>32</sup> 7 CFR 1412.602(a)(2), Exhibit Bra-35.

45. Thus, direct payments are related, or connected, to the type of production undertaken by the producer, contrary to paragraph 6(a) of AA Annex 2.

- (iii) Direct payments are related to, or based on, the type or volume of production undertaken by the producer in a year after the base period, contrary to paragraph 6(b) of Annex 2 of the Agreement on Agriculture

46. Sections 1101 and 1102 of the 2002 FSRI Act allow producers to update their base acres and payment yields respectively for the purposes of receiving direct payments. As set out in Section III.A.ii above, only one base period is possible for the purposes of paragraph 6 of AA Annex 2. Once the base period has been defined and fixed, no further updating of either the type or volume of production is permissible if a support program is to comply with the conditions of paragraph 6 of Annex 2.

47. Under the 2002 FSRI Act, direct payments replaced PFC payments.<sup>33</sup> Since the United States has claimed PFC payments as “green box” decoupled income support<sup>34</sup>, Australia considers that the United States has selected the base period that it used to determine base acres and payment yields under the 1996 FAIR Act as its defined and fixed base period for the purposes of paragraph 6 of AA Annex 2.

48. By providing for base acres and payment yields to be updated under the 2002 FSRI Act, the United States has related the amount of direct payments to, or based the amount of direct payments on, the type and volume of production undertaken by a producer in any year after the base period, contrary to paragraph 6(b) of AA Annex 2.

#### **IV. “STEP 2” PAYMENTS ARE PROHIBITED SUBSIDIES CONTRARY TO ARTICLES 3.3 AND 8 OF THE AGREEMENT ON AGRICULTURE AND/OR ARTICLE 3 OF THE SCM AGREEMENT**

49. Section 1207(a)(1) of the 2002 FSRI Act provides: “... the Secretary shall issue marketing certificates or cash payments ... to domestic users and exporters for documented purchases by domestic users and sales for export by exporters ...”. Section 136 of the 1996 FAIR Act provided similarly that “... the Secretary shall issue marketing certificates or cash payments to domestic users and exporters ...”.

50. The regulations to implement s.1207(a)(1) of the FSRI Act provide:

Eligible upland cotton must not be: ... (2) imported cotton ...<sup>35</sup>

Payments ... shall be made available to eligible domestic users and exporters who have entered into an Upland Cotton Domestic User/Export Agreement with CCC and who have complied with the terms and conditions in this subpart, the Upland Cotton Domestic User/Exporter Agreement and instructions issued by CCC.<sup>36</sup>

51. The standard Upland Cotton Domestic User/Export Agreement<sup>37</sup> provides *inter alia*:

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<sup>33</sup> *Fact Sheet: Upland Cotton*, Exhibit Bra-4.

<sup>34</sup> WTO document G/AG/N/USA/43, page 8, Exhibit Bra-47.

<sup>35</sup> 7 CFR 1427.103(c), Exhibit Bra-37.

<sup>36</sup> 7 CFR 1427.105(a), Exhibit Bra-37.

<sup>37</sup> Exhibit Bra-65.



Upland cotton eligible for payment is cotton consumed by the Domestic User in the United States ... (Section B-2)

Eligible upland cotton will be considered consumed by the Domestic User on the date the bagging and ties are removed from the bale in the normal opening area, immediately prior to use, ... (Section B-3(b))

Upland cotton eligible for payment is cotton which is shipped by an eligible Exporter ... (Section C-2)

Eligible upland cotton will be considered exported based on the on-board-vessel-date as shown on the bill of lading. (Section C-3)

52. A “Step 2” payment is unquestionably a subsidy within the meaning of the *Agreement on Agriculture* and the *SCM Agreement*. A “Step 2” payment involves a direct transfer of economic resources (cash or the equivalent value in ownership of goods) to a domestic user or exporter of US upland cotton.

53. The Article 21.5 stage of *United States – Tax Treatment for “Foreign Sales Corporations” (US – FSC (21.5))* involved provisions under which more favourable tax treatment was available in either of two, mutually exclusive, situations. The availability of the favourable tax treatment was found to be a prohibited export subsidy in one of those situations notwithstanding that the favourable tax treatment was freely available in both situations, subject to the prescribed conditions for entitlement being met. The Appellate Body said:

In our view, it is ... necessary, under Article 3.1(a) of the *SCM Agreement*, to examine separately the conditions pertaining to the grant of the subsidy in the two different situations addressed by the measure. We find it difficult to accept the United States’ arguments that such examination involves an ‘artificial bifurcation’ of the measure. The measure itself identifies the two situations which must be different since the very same property cannot be produced both within and outside the United States.<sup>38</sup>

54. The availability of “Step 2” payments under s.1207(a)(1) is analogous to the situation examined in *US – FSC (21.5)*. “Step 2” payments are available only to exporters (“Step 2” export payments) or to domestic users (“Step 2” domestic payments). Section 1207(a)(1) “identifies the two situations which must be different since the very same property cannot be” exported or used within the United States.

A. “STEP 2” EXPORT PAYMENTS ARE PROHIBITED EXPORT SUBSIDIES CONTRARY TO ARTICLES 3.3 AND 8 OF THE AGREEMENT ON AGRICULTURE AND ARTICLE 3.1(A) AND 3.2 OF THE SCM AGREEMENT

(i) “Step 2” export payments are subsidies contingent upon export performance

55. For “Step 2” export payments, the export contingency is expressly provided for in s.1207(a)(1), which provides “... the Secretary shall issue marketing certificates or cash payments ... to exporters for ... sales for export by exporters ...” and in the implementing regulations.

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<sup>38</sup> *United States – Tax Treatment for “Foreign Sales Corporations”*, Recourse to Article 21.5 of the DSU by the European Communities, WT/DS108/AB/RW, paragraph 115.

56 “Step 2” export payments are only payable once US-produced upland cotton has been placed aboard a vessel: they are “conditional” upon the cotton actually being exported. Thus, “Step 2” export payments are contingent upon export performance.

- (ii) “Step 2” export payments are export subsidies contrary to Articles 3.3 and 8 of the Agreement on Agriculture

57. “Step 2” export payments are a type of export subsidy expressly foreseen by AA Article 9.1(a) and subject to budgetary outlay and quantity reduction commitments thereunder. They are a direct subsidy, including through payment-in-kind, to an industry, to producers of an agricultural product, or to a cooperative or other association of such producers, contingent on export performance.

58. The United States has not specified any reduction commitments in its Schedule for upland cotton.

59. Consequently, by providing “Step 2” export payments under both the 1996 FAIR Act and the 2002 FSI Act, the United States has provided export subsidies contrary to its obligations:

- VII. pursuant to AA Article 3.3 not to provide export subsidies in respect of any agricultural product not specified in Section II of Part IV of its Schedule; and

- VIII. pursuant to its obligation pursuant to Article 8 not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in its Schedule.

- (iii) “Step 2” export payments are prohibited export subsidies contrary to SCM Article 3

60. Because “Step 2” export payments are export subsidies that do not conform fully to the provisions of Part V of the *Agreement on Agriculture*, Article 13(c)(ii) of that Agreement is not applicable and the payments are not protected from the operation of SCM Article 3.

61. A “Step 2” export payment is a subsidy within the meaning of SCM Article 1.1(a)(1)(i) for the purposes of SCM Article 3.1: it involves a direct transfer of economic resources to a domestic user or exporter of US upland cotton, and confers a benefit on the recipient by making US upland cotton commercially competitive.

62. Further, a “Step 2” export payment is contingent upon export performance: it is only payable once the upland cotton has been placed aboard a vessel for export. The Appellate Body has said:

We see no reason, and none has been pointed out to us, to read the requirement of “contingent upon export performance” in the *Agreement on Agriculture* differently from the same requirement imposed by the *SCM Agreement*.<sup>39</sup>

63. As a consequence, because “Step 2” export payments mandated by s.1207(a)(1) of the FSRI Act are export subsidies that are not being made “as provided in the *Agreement on Agriculture*”, they are prohibited export subsidies pursuant to SCM Article 3.1(a), and the United States is acting contrary to its obligations under SCM Article 3.2 by granting or maintaining such subsidies pursuant to s.1207(a)(1) of the FSRI Act. Consistent with the provisions of SCM Article 4.7, Australia

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<sup>39</sup> *United States – Tax Treatment for “Foreign Sales Corporations”*, Report of the Appellate Body, WT/DS108/AB/R, paragraph 141.

endorses Brazil's request<sup>40</sup> that the Panel recommend that the United States withdraw the "Step 2" export payments without delay.

B. "STEP 2" DOMESTIC PAYMENTS ARE LOCAL CONTENT SUBSIDIES CONTRARY TO ARTICLE 3 OF THE SCM AGREEMENT

64. For "Step 2" domestic payments, the local content requirement is expressly provided for in s.1207(a)(1), which provides "... the Secretary shall issue marketing certificates or cash payments ... to domestic users ... for documented purchases by domestic users ..." and in the implementing regulations, which provide that "eligible cotton must not be ... imported cotton".

65. "Step 2" domestic payments are only payable once US-produced upland cotton is consumed by a domestic user. "Step 2" domestic payments are contingent upon the use of domestic over imported goods.

66. Thus, s.1207(a)(1) of the FSRI Act mandates the payment of subsidies which are prohibited pursuant to SCM Article 3.1(b), and the United States is acting contrary to its obligations under SCM Article 3.2 by granting or maintaining such subsidies. Consistent with the provisions of SCM Article 4.7, Australia endorses Brazil's request<sup>41</sup> that the Panel recommend that the United States withdraw the "Step 2" domestic payments without delay.

C. THE UNITED STATES CANNOT AVOID ITS OBLIGATIONS RELATING TO PROHIBITED SUBSIDIES BY DESIGNING A MEASURE UNDER WHICH ENTITLEMENTS ARE OSTENSIBLY AVAILABLE IN MULTIPLE CIRCUMSTANCES

67. In Australia's view, the United States cannot avoid its obligations relating to prohibited subsidies under the *Agreement on Agriculture* and the *SCM Agreement* by designing a measure under which entitlements are ostensibly available in multiple circumstances. As the Appellate Body concluded in *US – FSC (21.5)*:

Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances.<sup>42</sup>

68. Moreover, in the circumstances of the present case, it would be a manifestly inequitable outcome if a WTO Member was able to avoid its obligations relating to prohibited subsidies under the *Agreement on Agriculture* and the *SCM Agreement* on the basis that there is a second set of circumstances in which a subsidy can be paid, when the second set of circumstances is itself a prohibited subsidy.

69. Australia considers that, through the "Step 2" payments mandated by s.1207(a)(1) of the FSRI Act, the United States is paying: (1) export subsidies contrary to its obligations pursuant to AA Articles 3.3 and 8 and SCM Article 3.1(a) and 3.2; and (2) local content subsidies contrary to its obligations pursuant to SCM Article 3.1(b) and 3.2.

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<sup>40</sup> First Submission of Brazil, paragraph 251.

<sup>41</sup> First Submission of Brazil, paragraph 341.

<sup>42</sup> *United States – Tax Treatment for "Foreign Sales Corporations"*, Recourse to Article 21.5 of the DSU by the European Communities, Report of the Appellate Body, WT/DS108/AB/RW, paragraph 119

## V. CONCLUSION

70. This dispute raises fundamental issues concerning the object and purpose of the *Agreement on Agriculture*, and the balance of rights and obligations accepted by all Members under the *Marrakesh Agreement Establishing the World Trade Organization*. The outcome of this dispute will determine whether, in fact, Members accepted any meaningful obligations in relation to domestic support measures pursuant to the *Agreement on Agriculture*.

71. In Australia's view, Brazil has provided *prima facie* evidence that the United States has not acted consistently with its obligations in relation to domestic support measures and export subsidies provided to upland cotton under the *Agreement on Agriculture*. Further, Australia considers that the "Step 2" payments for domestic users and exporters of upland cotton are clearly subsidies prohibited by the *SCM Agreement*, and endorses Brazil's request that these be withdrawn without delay.

## ANNEX B-5

### THIRD PARTY SUBMISSION OF BENIN

15 July 2003

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#### **I. INTRODUCTION**

1. The issue in this dispute is of critical importance for Benin, West Africa, and many developing countries: whether WTO Members must respect agreed disciplines for the provision of agricultural subsidies.

2. The right to grant agricultural subsidies is by no means absolute. During the Uruguay Round, the drafters of the *Agreement on Agriculture* and the SCM Agreement established a number of preconditions for the provision of WTO-consistent subsidies. These preconditions, including those embodied in Article 13 of the *Agreement on Agriculture* - the so-called “peace clause” - were part of the overall balance of rights and obligations accepted by the United States and other participants at the conclusion of the Round.

3. Benin, upon its accession to the WTO in 1996, accepted the Uruguay Round package. In doing so, it expected that the subsidies provided by its trading partners, including the United States, would remain within these agreed parameters.

4. However, contrary to its WTO obligations, the United States has provided huge subsidies for the production, use and export of US cotton. These WTO-inconsistent subsidies have been highly damaging to Benin.

5. Benin supports the positions advanced by Brazil in this dispute, particularly those set out in Brazil’s first submission of June 24. Benin welcomes the opportunity to provide its views to the Panel, divided into two headings:

- (a) Benin and US cotton subsidies, which provides appropriate additional context to the issues facing the Panel; and
- (b) WTO legal issues.

## II. BENIN AND US COTTON SUBSIDIES

6. Benin is a least-developed country, with a GNP per capita of US \$380. Of the 175 countries listed in the 2003 Human Development Index of the United Nations Development Programme, Benin is ranked 159<sup>th</sup>.<sup>1</sup>

7. Cotton plays a crucial role in the development of Benin. It is the most important cash crop in the national economy. Cotton accounts for 90 per cent of agricultural exports, and has provided around 75 per cent of the country's export earnings over the past four years. Benin is the 12<sup>th</sup> largest exporter of cotton in the world.

8. Cotton generates 25 per cent of the country's revenues. A third of all households in Benin depend on the cultivation of cotton, and a fifth of wage-earning workers are employed in the cotton sector. Overall, about a million people in Benin – out of a population of six million – are dependant on cotton, or cotton-related activities.

9. The cotton sector in Benin, which is mainly in the rural regions, has suffered considerable hardship. As the International Monetary Fund noted in a report earlier this year, "poverty is prevalent in cotton-producing areas".<sup>2</sup> Cotton growers are concentrated in the north of the country, a more arid region where the potential for any agricultural diversification is lower, and where opportunities for non-farm employment are scarce.<sup>3</sup>

10. Despite these problems of persistent poverty, the cotton sector in Benin and the region remains highly competitive by world standards. The cost of producing cotton in West Africa is 50 per cent lower than comparable costs in the United States.<sup>4</sup>

11. As recent report noted: "West Africa is one of the world's most efficient cotton producing regions. The IMF estimates that the sector can operate profitably at world price levels of around 50 cents/lb. Few producers in the US could compete at this price. Indeed, the USDA estimates average production costs at 75 cents/lb."<sup>5</sup>

12. Moreover, the sector has also undergone major structural reforms in recent years to increase efficiency. The IMF reported that: "Benin has moved away from the integrated monopoly that characterized the organization of cotton production and marketing of seed cotton in western and central Africa. Benin's reform process is among the most advanced in the region."<sup>6</sup>

13. Unfortunately, the benefits of such reforms have been completely negated by massive US subsidies. As noted by Brazil in its First Submission, total upland cotton subsidies amounted to

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<sup>1</sup> *Human Development Report 2003*, United Nations Development Programme, <http://www.undp.org/hdr2003>.

<sup>2</sup> According to the IMF, "The cotton zone in central Benin (the Zou and Borgou) presents one of the highest incidences of poverty, while the deepest poverty (as measured by the poverty gap index) can be found in the north (cotton-producing area in northern Borgou). International Monetary Fund, Country Report No. 03/120. *Benin: Fourth Review Under the Poverty Reduction and Growth Facility – Staff Report*. April 2003. Page 28.

<sup>3</sup> *Impact of Global Cotton Markets on Rural Poverty in Benin*. Nicholas Minot and Lisa Daniels. International Food Policy Research Institute, Washington, D.C. November 2002. Page 19.

<sup>4</sup> See Louis Goreux, "*Préjudices causés par les subventions aux filières cotonnières de l'AOC*." March 2003. Cited in TN/AG/GEN/4, 16 May 2003.

<sup>5</sup> *Northern Agricultural Policies and World Poverty: Will the Doha 'Development Round' Make a Difference?* Kevin Watkins, Head of Research, Oxfam Great Britain. Paper presented to the Annual World Bank Conference of Development Economics. 15-16 May, 2003. Page 65.

<sup>6</sup> IMF Country Report, *Op. Cit.*, page 23

US\$12.9 billion during the 1999-2002 marketing years.<sup>7</sup> The International Cotton Advisory Cotton estimates that US subsidies are equivalent to 24 cents per pound of cotton produced.<sup>8</sup>

14. Subsidies of this magnitude have sharply increased supplies on the international market, thereby producing a collapse in global cotton prices. From January, 2001 to May, 2002, world cotton prices fell by nearly 40 per cent, from 64 cents to about 39 cents per pound, the lowest level since the 1930s. Although prices have improved since last year, the world market for cotton remains characterized by oversupply as a result of US subsidies. This has extremely serious consequences for Benin and other West African countries.

15. Benin is highly vulnerable to changes in the world price of this cash crop. The International Food Policy Research Institute has estimated that a 40 per cent reduction in farm-level prices of cotton results in an increase in rural poverty in Benin of 8 per cent in the short term, and 6-7 per cent in the long term. An increase of 8 per cent is equivalent to pushing an additional 334,000 people below the poverty line.<sup>9</sup> This, in turn, has produced a deterioration in the social conditions of many rural communities, including conditions pertaining to housing, schooling, sanitation, nutrition and other basic needs.

16. The overwhelming magnitude of US cotton subsidies, and the impossibility of Benin competing with them, are well illustrated in the table below.<sup>10</sup> As the table indicates, the subsidies paid by the United States to 25,000 US cotton farmers exceeds the gross national income of Benin. These subsidies also exceed the gross national income of Burkina Faso, the Central African Republic, Chad, Mali and Togo.

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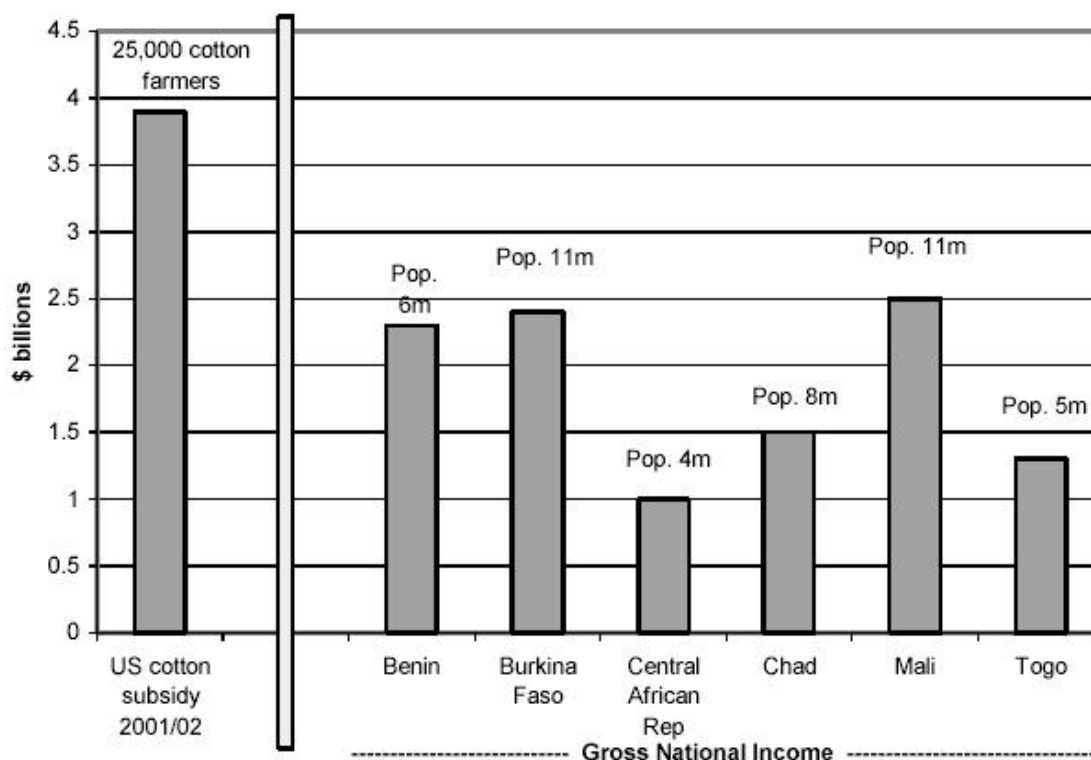
<sup>7</sup> First Submission of Brazil, paragraph 3.

<sup>8</sup> Minot and Daniels, *op. cit.*, page 1.

<sup>9</sup> Minot and Daniels, *op cit.*, page 50.

<sup>10</sup> This table is from *Cultivating Poverty: The Impact of US Cotton Subsidies on Africa*. Oxfam Briefing Paper 30. 27 September 2002. Brazil has filed the full Oxfam report as exhibit Bra-15.

**Figure 3: US cotton subsidy and the gross national incomes for selected West African countries in 2000 (\$billions)**



Source: World Development Indicators, World Bank, 2002, and US Department of Agriculture

17. Thus, when cotton from Benin enters world markets, it must compete against such massively subsidized US cotton.

18. Oxfam has estimated that US subsidies have caused Benin to lose US \$33 million in foreign exchange earnings, equivalent to 9 per cent of the country's export earnings.<sup>11</sup>

19. Indeed, the shock of such subsidies, and their attendant effect on prices, threatens the very existence of the cotton sector in Benin. It has created a genuine economic crisis in the sector, and it is possible that the cotton sector in Benin could simply disappear during the 2003/04 marketing year. This would have catastrophic effects both for the national economy, and for the social cohesion of the country in regions where cotton production predominates. This also poses a significant threat to Benin's efforts at poverty alleviation in economically precarious rural areas.

20. With these preliminary comments as additional context, Benin now comments briefly on some of the legal issues raised in Brazil's submission.

### III. WTO LEGAL ISSUES

21. Benin agrees with Brazil that the United States cannot successfully invoke the peace clause to bar the actionable subsidy claims that have been advanced in this dispute.

<sup>11</sup> *Ibid.*, page 17.



22. The peace clause is an affirmative defence. The United States, not Brazil, must bear of burden of demonstrating that US domestic support and export subsidies comply with the requirements of Article 13.

23. Affirmative defences, as the Appellate Body made clear in *United States – Wool Shirts and Blouses*, are “limited exceptions from obligations under certain other provisions”, not “positive rules establishing obligations in themselves”. In the view of the Appellate Body, “[i]t is only reasonable that the burden of establishing such a defence should rest on the party asserting it”.

24. The language in Article 13 shows the clear intent of the drafters that the Member seeking to invoke the peace clause must bear the burden of demonstrating full compliance with all of the preconditions set out in this provision.

25. In addition to the arguments advanced by Brazil, Benin would note that the use of the proviso “provided that” in Article 13(b)(ii) and (iii) also shows the intent of the drafters to shift the burden to the Member seeking to invoke this exception. In both subsections, the exemption from actions has been qualified by the addition of this proviso:

- (b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:
  - (ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year; and
  - (iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year...” [emphasis added]

26. A similar proviso can be found in GATT Article XVIII:11, dealing with the elimination of restrictions imposed for balance of payments purposes:

“[T] he contracting party concerned... shall progressively relax any restrictions applied under this Section as conditions improve, maintaining them only to the extent necessary under the terms of paragraph 9 of this Article and shall eliminate them when conditions no longer justify such maintenance; Provided that no contracting party shall be required to withdraw or modify restrictions on the ground that a change in its development policy would render unnecessary the restrictions which it is applying under this Section.” [emphasis added]

27. In construing GATT Article XVIII:11, the Appellate Body made clear in the *Quantitative Restrictions* case that the burden of proof lay clearly on the responding party – in that case, India – seeking to invoke the proviso:

“The proviso precludes a Member, which is challenging the consistency of balance-of payments restrictions, from arguing that such restrictions would be unnecessary if the developing country Member maintaining them were to change its development policy. In effect, the proviso places an obligation on Members not to require a developing country Member imposing balance-of payments restrictions to change its development policy....

[W]e do not exclude the possibility that a situation might arise in which an assertion regarding development policy does involve a burden of proof issue. Assuming that the complaining party has successfully established a *prima facie* case of inconsistency with Article XVIII:11 and the Ad Note, the responding party may, in its defence, either rebut the evidence adduced in support of the inconsistency or invoke the proviso. In the latter case, it would have to demonstrate that the complaining party violated its obligation not to require the responding party to change its development policy. This is an assertion with respect to which the responding party must bear the burden of proof. We, therefore, agree with the Panel that the burden of proof with respect to the proviso is on India.<sup>12</sup>

28. Although the use of the proviso “provided that” is not determinative, it does provide strong textual support for the proposition that the drafters of Article 13 of the *Agreement on Agriculture*, like the drafters of GATT Article XVIII:11, intended the burden of proof to shift to the party seeking to invoke the proviso.

29. Indeed, the situation in the Cotton dispute is very similar to that examined by the Appellate Body in the *Quantitative Restrictions* case. The United States is seeking to invoke the “provided that” proviso set out in Article 13. This is, as the Appellate Body reasoned, “an assertion with respect to which the responding party must bear the burden of proof”. Therefore, as with India in *Quantitative Restrictions*, the burden of proof with respect to the proviso is on the United States.

30. Article 13, construed as a whole, also supports the position that if the United States seeks entry into the “safe harbour”, it bears the burden of demonstrating that it has met the preconditions necessary to justify entry.

31. For example, the chapeau to paragraphs (a), (b) and (c) all provide that the measures or subsidies “must conform fully” with the applicable disciplines. Domestic support measures or export subsidies that do not “conform fully” to the specified provisions cannot benefit from the peace clause. Since the United States claims that it “conforms fully” to the relevant provisions of the *Agreement on Agriculture*, the SCM Agreement, and the GATT 1994, and it is up to the United States to provide sufficient evidence in support of this defence.

32. Thus, as argued above, the burden falls on the United States if it wishes successfully to invoke the affirmative defence of Article 13.

33. However, even if the burden rested on Brazil – which it does not – Brazil has amply demonstrated in its First Submission that the United States is providing domestic support and export subsidies far in excess of WTO commitments.

34. For example, as Brazil demonstrated in its submission, US non-“green box” domestic support to upland cotton in the 1992 marketing year was \$1,994.4 million. By 2001, US non-“green box” domestic support increased to \$4,093 million. Thus, the defence that may have been conditionally available to the United States – had it “conformed fully” to the requirements of Article 13 – is unavailable.

35. Brazil presents compelling evidence on the WTO-inconsistency of all of the impugned US measures, encompassing both domestic support payments and export payments. Benin agrees with Brazil that the US measures violate the *Agreement on Agriculture*, the SCM Agreement, and the GATT 1994.

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<sup>12</sup> Appellate Body Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, WT/DS90/AB/R, paragraph 134 and 136.

36. The United States, in its submission of July 11, has done nothing to rebut the presumption of WTO-inconsistency established by Brazil.

#### **IV. CONCLUSIONS**

37. As noted above, US cotton subsidies exceed the Gross National Income of Benin. Benin has few options available to it to respond to subsidies of such magnitude. The resulting impact on the economy of the country has been devastating.

38. Benin is not seeking any special and differential treatment in this dispute. It simply asks the Panel to ensure that the relevant provisions of the WTO Agreements, including Article 13 of the *Agreement on Agriculture*, are interpreted and applied as negotiated. The United States must respect the disciplines that it, and other WTO Members, agreed to at the end of the Uruguay Round.

39. Benin is grateful for the opportunity to present its views to the Panel in this extremely important dispute. Benin notes that further submissions are intended, and reserves the right to provide additional views to the Panel (including in response to the US First Written Submission of 11 July) as necessary and appropriate, at a later stage.

## **ANNEX B-6**

### **THIRD PARTY SUBMISSION OF CANADA**

15 July 2003

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## I. INTRODUCTION

1. Canada has a systemic interest in the correct interpretation of Annex 2 of the *Agreement on Agriculture (Agriculture Agreement)*, as well as the export subsidy provisions of both the *Agriculture Agreement* and the *Agreement on Subsidies and Countervailing Measures (SCM Agreement)*.

2. In its first written submission, Brazil makes a number of claims. Canada's comments relate to the claims of Brazil in respect of the following:

- IX. Whether US production flexibility contract payments (PFC payments) made under the Federal Agriculture Improvement and Reform Act of 1996 and US direct payments made under the US Farm Security and Rural Investment Act of 2002 (2002 FSRI Act) satisfy the policy-specific criteria for decoupled income support in Annex 2, paragraph 6(b) of the *Agriculture Agreement*; and
- X. Whether US GSM-102, GSM-103, and the SCG export credit guarantee programmes provide export subsidies in violation of Articles 8 and 10.1 of the *Agriculture Agreement*.

## II. CLAIMS REGARDING US DOMESTIC AGRICULTURAL SUPPORT MEASURES

3. Among the claims brought by Brazil against the United States in this dispute are those concerning the conformity of US domestic subsidies with US obligations under Part III of the *SCM Agreement* and Article XVI of the *General Agreement on Tariffs and Trade 1994 (GATT 1994)*.

4. On 20 June 2003, the Panel preliminarily ruled that it would defer consideration of Brazil's claims under Part III of the *SCM Agreement* and Article XVI of *GATT 1994* until after it had expressed views on whether the US measures satisfy the conditions of Article 13 of the *Agriculture Agreement* (the so-called "Peace Clause"). Accordingly, Brazil argues in its first written submission that PFC payments and direct payments (US measures involving direct payments to US agricultural producers) are not exempt from action under the Peace Clause because they do not conform fully to the criteria in Annex 2 of the *Agriculture Agreement*.<sup>1</sup> The United States argues in response that PFC payments are not within the Panel's terms of reference because they were no longer in effect at the time of the consultation or panel requests.<sup>2</sup> Regarding direct payments, the United States argues that these measures are exempt from action because they conform fully to the provisions of Annex 2 and are therefore covered by Article 13(a)(ii) of the *Agriculture Agreement*.<sup>3</sup>

5. Canada provides views in this submission on the conformity of PFC payments and direct payments with criteria in Annex 2 of the *Agriculture Agreement*.

### A. PFC PAYMENTS AND DIRECT PAYMENTS DO NOT QUALIFY AS EXEMPT DECOUPLED INCOME SUPPORT UNDER THE AGRICULTURE AGREEMENT

6. It is Canada's view that PFC payments and direct payments do not fully conform to the provisions of paragraph 6(b) of Annex 2 of the *Agriculture Agreement* for the reasons set out below.

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<sup>1</sup> First Written Submission of Brazil, 24 June 2003, at paras. 153 and 173 [hereinafter Brazil First Written Submission].

<sup>2</sup> First Written Submission of the United States, 11 July 2003, at paras. 190 and 207-211 [hereinafter "US First Written Submission"].

<sup>3</sup> US First Written Submission, paras. 64-68.

**1. Decoupled income support under Annex 2 of the *Agriculture Agreement* is exempt from action under the *SCM Agreement* and *GATT 1994***

7. Annex 2 of the *Agriculture Agreement* is relevant to actionable subsidy cases under the *SCM Agreement* and *GATT 1994* because the *Agriculture Agreement* provides for certain conditional exemptions. In this section, Canada sets out the relationship between these three agreements in this respect.

8. Action under Part III of the *SCM Agreement* and Article XVI of *GATT 1994* depends on a determination of the existence of a “subsidy”.<sup>4</sup> Article 1.1 of the *SCM Agreement* sets out the definition of a subsidy:

**1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:**

(a)(1) there is a financial contribution by a government or any public body within the territory of a Member...

or

(a)(2) there is any form of income or price support in the sense of Article XVI of *GATT 1994*;

and

(b) a benefit is thereby conferred.

9. Article 1.2 provides that a subsidy is actionable under Part III of the Agreement if it is “specific” in accordance with the provisions of Article 2.

10. Article 5 begins Part III of the *SCM Agreement* on actionable subsidies by providing that “[n]o Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members...”. Articles 5 and 6 describe “adverse effects” and set out the basis for determining whether they exist. Article 7 sets out the available remedies where adverse effects do exist. All of these provisions are subject to Article 13 of the *Agriculture Agreement*.<sup>5</sup>

11. Article 13 of the *Agriculture Agreement* conditionally exempts domestic support measures from actionable subsidy complaints. It provides in relevant part:

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<sup>4</sup> See *United States – Tax Treatment for “Foreign Sales Corporations”*, Report of the Appellate Body, WT/DS108/AB/R, adopted March 20, 2000 at para. 93 [hereinafter *US FSC AB Report*]:

Article 1.1 sets forth the general definition of the term “subsidy” which applies “for the purpose of this Agreement”. This definition, therefore, applies wherever the word “subsidy” occurs throughout the *SCM Agreement* and conditions the application of the provisions of that Agreement regarding *prohibited* subsidies in Part II, *actionable* subsidies in Part III, *non-actionable* subsidies in Part IV and countervailing measures in Part V [emphasis in original].

<sup>5</sup> Article 5 ends with: “This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture”. Article 6.9 contains identical language. Article 7.1 begins: “Except as provided in Article 13 of the Agreement on Agriculture, ...”.

Regarding action under Article XVI of *GATT 1994*, in addition to the provisions in Article 13 of the *Agriculture Agreement*, Article 21.1 states: “The provisions of *GATT 1994*... shall apply subject to the provisions of this Agreement.”

During the implementation period, notwithstanding the provisions of *GATT 1994* and the SCM Agreement on Subsidies and Countervailing Measures (referred to in this Article as the “Subsidies Agreement”):

- (a) domestic support measures that conform fully to the provisions of Annex 2 to this Agreement shall be:  
...
- (ii) exempt from actions based on Article XVI of *GATT 1994* and Part III of the Subsidies Agreement;  
...
- (b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:  
...
- (ii) exempt from actions based on paragraph 1 of Article XVI of *GATT 1994* or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year...

12. Accordingly, domestic subsidies are exempt from application of the provisions in Part III of the *Subsidies Agreement* and of Article XVI of *GATT 1994* if they conform to Annex 2 of the *Agriculture Agreement*. Domestic subsidies that do not conform to Annex 2 are exempt if such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

**2. Decoupled income support must not be linked to the type of commodity produced in any year after the base period**

13. To determine whether a measure is exempt under Article 13(a) of the *Agriculture Agreement*, it must be assessed under the criteria of Annex 2. Canada sets out the relevant Annex 2 provisions.

14. Annex 2 is the basis for the conditional exemption of domestic subsidies, under Article 13(a) of the *Agriculture Agreement*, from the application of Part III of the *SCM Agreement* and Article XVI of *GATT 1994*. Annex 2 also conditionally (and principally) exempts domestic support measures from reduction commitments pursuant to exceptions under Articles 3.2, 6 and 7 of the Agreement. Paragraph 1 of Annex 2 reads as follows:

- 1. Domestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production. Accordingly, all measures for which exemption is claimed shall conform to the following basic criteria:
  - (a) the support in question shall be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers; and,
  - (b) the support in question shall not have the effect of providing price support to producers;

plus policy-specific criteria and conditions as set out below.

15. The policy-specific criteria are for each of the following measures: general services (paragraph 2); public stockholding (paragraph 3); domestic food aid (paragraph 4); and direct payments to producers (paragraphs 5-13).

16. Paragraph 5 of Annex 2 provides that direct payments to producers are exempt only if they meet the basic criteria in paragraph 1 of Annex 2 and the “specific criteria applying to individual types of direct payment as set out in paragraphs 6 through 13...”. Paragraph 5 further specifies that, to be exempt, any measure that does *not* constitute a type of direct payment covered by paragraphs 6-13 must conform to the criteria in paragraph 6(b) through (e) as well as the basic criteria listed in paragraph 1.

17. Paragraph 6 of Annex 2 reads:

6. Decoupled income support

- (a) Eligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period.
- (b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.
- (c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.
- (d) The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period.
- (e) No production shall be required in order to receive such payments.

18. For direct payments to qualify as decoupled income support, paragraph 6(b) requires that the amount of the payments not be “related to, or based on, the type... of production... undertaken by the producer in any year after the base period.” The ordinary meaning of “production” is “something which is produced by an action, process, etc.; a product”.<sup>6</sup> Nothing in the context or in the object and purpose of this subparagraph, of Annex 2, or of the *Agriculture Agreement* as a whole detracts from this ordinary meaning. Accordingly, under paragraph 6(b), the amount of the payment must not be linked to the kind of product that is produced.

**3. PFC payments and direct payments do not conform to Annex 2 of the *Agriculture Agreement* because the amount of these payments is linked to the type of commodity produced after the base period**

19. Based on the evidence and arguments presented in the submissions of the disputing parties at this stage of the proceedings, it is Canada’s assessment that the amount of PFC payments and direct payments are based on the type of commodity produced after the base period. Were the Panel to accept the evidence submitted by Brazil, it would find that PFC payments and direct payments are inconsistent with paragraph 6(b) of Annex 2 of the *Agriculture Agreement*.

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<sup>6</sup> *The New Shorter Oxford English Dictionary*, p. 2367 [Exhibit CDA-1.].



20. Brazil asserts that under US law implementing PFC payments, the amount of such payments “could fluctuate from 100 percent of the PFC payments if [a producer] did not grow any fruits and vegetables, to zero percent in case such prohibited products are grown” or “[to] a reduced and pro-rated decrease based on acreage and/or value of the fruit or vegetable crop grown on PFC contract acres.”<sup>7</sup> According to Brazil, US implementing law also provides that “PFC payments are reduced for each acre of wild rice that is produced.”<sup>8</sup> Regarding direct payments, Brazil argues that under US implementing law, current fruit, vegetable, or wild rice production affects the amount of the direct payment in the same manner as such production affects the amount of the PFC payment.<sup>9</sup>

21. The United States describes direct payments under the 2002 FSRI Act as direct payments “to persons (farmers and landowners) with farm acres that formerly produced any of a series of commodities during the base period.”<sup>10</sup> The United States claims that these payments constitute “decoupled income support” under Annex 2 of the *Agriculture Agreement* because they: (1) are provided through a publicly-funded government programme not involving transfers from consumers; (2) do not have the effect of providing price support to producers; and (3) conform to the five policy-specific criteria and conditions set out in paragraph 6.<sup>11</sup> The United States claims in particular that the direct payments are “decoupled from production” because the amount of the payments is not based on the type of production undertaken after the base period, in conformity with paragraph 6(b). In this respect, the United States argues:

Not only is there no requirement that a direct payment recipient engage in any *particular* type or volume of production, a recipient need not engage in *any* current agricultural production in order to receive the direct payment.<sup>12</sup> [emphasis in original]

22. The United States does not describe or assess PFC payments, given its request for a preliminary ruling by the Panel that such payments are not within its terms of reference.<sup>13</sup>

23. Canada’s assessment of the facts and arguments presented so far in this case is that the United States has incorrectly classified PFC payments as decoupled income support,<sup>14</sup> and that US direct payments do not qualify as such support.<sup>15</sup> Nowhere in its submission does the United States address the evidence of implementing legislation and regulations regarding either measure. Its argument that direct payment recipients are not required to engage in any particular type or volume of production (or any current agricultural production at all) to receive direct payments fails to address the evidence indicating that the amount of the payment may change based on whether base acreage is used for current production of fruits, vegetables, or wild rice. For both measures, the evidence indicates that the amount of the payment is based on the type of production: payments are full, nil, or some amount in between where base acres are used for current fruit, vegetable or wild rice production.

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<sup>7</sup> Brazil First Written Submission, para. 160.

<sup>8</sup> *Ibid.*, para. 161.

<sup>9</sup> Brazil First Written Submission, para 174.

<sup>10</sup> US First Written Submission, para. 57.

<sup>11</sup> *Ibid.*, paras. 64-68.

<sup>12</sup> *Ibid.*, para. 67.

<sup>13</sup> *Ibid.*, para. 211.

<sup>14</sup> Brazil First Written Submission, para. 153.

<sup>15</sup> *Ibid.*, paras. 175 and 198.

### III. CLAIMS REGARDING US EXPORT CREDIT GUARANTEE PROGRAMMES

24. Brazil asserts that the US GSM-102, GSM-103, and SCG programmes provide export subsidies with respect to upland cotton and other agricultural commodities in violation of Articles 8 and 10.1 of the *Agriculture Agreement*.<sup>16</sup> According to Brazil, the United States violates Articles 8 and 10.1 of the *Agriculture Agreement* because these programmes:

- XI. provide export subsidies under item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*;<sup>17</sup> and
- XII. provide “subsidies” that are “contingent upon export performance” under Articles 1.1 and 3.1(a) of that Agreement.<sup>18</sup>

25. As a result, Brazil argues, these measures do not fully conform to the provisions of Part V of the *Agriculture Agreement* and the Peace Clause, therefore, does not exempt them from actions based on Article 3 of the *SCM Agreement*.<sup>19</sup> Brazil also argues that these programmes provide prohibited export subsidies within the meaning of Article 3.1(a) of the *SCM Agreement* and requests the Panel to recommend to the DSB that the measures be withdrawn without delay under Article 4.7.<sup>20</sup>

26. The United States argues in response that its export credit guarantee programmes are not export subsidies subject to Article 10.1 of the *Agriculture Agreement* because Article 10.2 permits export credit guarantee practices “to continue, unaffected by export subsidy disciplines otherwise negotiated and reflected in the text of the Agreement”.<sup>21</sup> The United States asserts that these programmes do not provide prohibited export subsidies under Article 3.1(a) of the *SCM Agreement* because export credit guarantees are carved out from export subsidy commitments by virtue of Article 10.2 of the *Agriculture Agreement* and any application of Article 3 of the *SCM Agreement* is subject to the provisions of the *Agriculture Agreement*.<sup>22</sup> Finally, according to the United States, its measures do not satisfy the standard in item (j) of Annex I of the *SCM Agreement* and are not, for that reason alone, export subsidies under Article 3.1(a).<sup>23</sup>

27. The United States also requests the Panel to rule preliminarily that Brazil’s arguments in connection with all commodities other than upland cotton are not properly before the Panel, and limits its arguments to upland cotton accordingly.<sup>24</sup>

28. In this submission, Canada limits its views to whether the United States has violated Articles 8 and 10.1 of the *Agriculture Agreement* by providing export subsidies in the form of export credit guarantees resulting in the circumvention of US export subsidy commitments with respect to upland cotton. Canada notes that this aspect of Brazil’s claim is both independent and determinative of the applicability in this dispute of the Peace Clause under Article 13(c)(ii) of the *Agriculture Agreement*. That is, a violation of Articles 8 and 10.1 in this case would itself form the basis for both a recommendation by the DSB to the United States to bring its measures into conformity and would also form the basis for continued action by Brazil under Article 3 of the *SCM Agreement*.

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<sup>16</sup> *Ibid.*, para. 304.

<sup>17</sup> *Ibid.*, paras. 272-286.

<sup>18</sup> *Ibid.*, paras. 287-294.

<sup>19</sup> *Ibid.*, para. 306.

<sup>20</sup> *Ibid.*, para. 306.

<sup>21</sup> US First Written Submission, para. 160.

<sup>22</sup> *Ibid.*, para. 167.

<sup>23</sup> *Ibid.*, paras. 171 to 183.

<sup>24</sup> US First Written Submission, paras. 171 and 218.

A. EXPORT CREDIT GUARANTEES MAY PROVIDE “EXPORT SUBSIDIES” UNDER THE AGRICULTURE AGREEMENT

29. Under the *SCM Agreement*, export subsidies are prohibited. Under the *Agriculture Agreement*, certain export subsidies are allowed up to certain limits. The export subsidy disciplines of the *SCM Agreement* apply subject to the export subsidy disciplines of the *Agriculture Agreement*.<sup>25</sup> The Appellate Body confirmed in its first *Canada - Dairy* implementation report that “the WTO-consistency of an export subsidy for agricultural products has to be examined, in the first place, under the *Agreement on Agriculture*.”<sup>26</sup> Canada sets out the relevant provisions of both Agreements in this section.

30. Article 1(e) of the *Agriculture Agreement* defines “export subsidies” as “subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement”. Article 3.3 sets out the obligation of Members not to provide export subsidies listed in Article 9 in excess of scheduled commitment levels:

Subject to the provisions of paragraphs 2(b) and 4 of Article 9, a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule.

31. Article 8 of the *Agriculture Agreement* confirms the fundamental obligations of Members with respect to the provision of export subsidies:

Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule.

32. Article 9 of the *Agriculture Agreement* lists and describes certain export subsidies that are subject to reduction commitments. All other export subsidies fall within the scope of Article 10.1, which reads:

Export subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall non-commercial transactions be used to circumvent such commitments.

33. The *Agriculture Agreement* does not define the term “subsidy” in the definition of “export subsidy” in Article 1(e) of the Agreement. The Appellate Body drew upon the definition of a “subsidy” in Article 1.1 of the *SCM Agreement* as context to the term “subsidy” in Article 1(e) of the *Agriculture Agreement* in both its original *Canada – Dairy* report and its original and implementation

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<sup>25</sup> See Article 3.1 of the *SCM Agreement* and Articles 13(c)(ii) and 21.1 of the *Agriculture Agreement*.

<sup>26</sup> *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products: Recourse to Article 21.5 of the DSU by New Zealand and the United States*, Report of the Appellate Body, WT/DS103/AB/RW, WT/DS113/AB/RW, adopted 18 December 2001, paras. 123-124.

reports in *US - FSC*.<sup>27</sup> The Appellate Body also held in *US - FSC* that the “contingent upon export performance” requirements in the *Agriculture Agreement* and the *SCM Agreement* are the same.<sup>28</sup>

34. Article 1.1 of the *SCM Agreement* sets out the definition of a subsidy, which reads in relevant part:

1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:

(a)(1) there is a financial contribution by a government or any public body within the territory of a Member..., i.e. where:

(i) a government practice involves... potential direct transfers of funds or liabilities (e.g. loan guarantees); ...

and

(b) a benefit is thereby conferred.

35. Article 3.1(a) of the *SCM Agreement* describes export subsidies as follows:

3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

(a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I...

36. Annex I of the *SCM Agreement* includes in particular item (j), which reads:

The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.

37. Canada provides views only on key elements of Articles 1 and 3.1(a) of the *SCM Agreement* that are applicable to a determination of whether the US programmes provide “export subsidies” under Article 1(e) of the *Agriculture Agreement*. If they do, then they are subject to US obligations under Articles 8 and 10.1 of the *Agriculture Agreement*.

B. US EXPORT CREDIT GUARANTEES MAY GRANT EXPORT SUBSIDIES UNDER ARTICLE 1(E) OF THE *AGRICULTURE AGREEMENT* AND ARTICLE 3.1(A) OF THE *SCM AGREEMENT*

38. Based on the evidence and arguments presented by the disputing parties at this stage in the proceedings, it is Canada’s assessment that US export credit guarantee programmes may provide “subsidies contingent upon export performance” under Article 1(e) of the *Agriculture Agreement* that

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<sup>27</sup> See *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, Report of the Appellate Body, WT/DS103/AB/R, WT/DS113/R, adopted 27 October 1999, para. 87; *US - FSC* AB Report, paras. 136-137; *United States - Tax Treatment for “Foreign Sales Corporations: Recourse to Article 21.5 of the DSU by the European Communities*, Report of the Appellate Body, WT/DS108/AB/RW, adopted 29 January 2002, para. 194 [hereinafter *US - FSC Article 21.5 AB Report*].

<sup>28</sup> *US - FSC* AB Report, paras. 141-142; *US - FSC Article 21.5 AB Report*, para. 192.

are “not listed in paragraph 1 of Article 9”, pursuant to Article 10.1. Because the United States has no export subsidy reduction commitments for upland cotton, it may have violated Article 10.1 by applying such subsidies in a manner that results in circumvention of its export subsidy commitments. The United States may have also therefore violated Article 8 by providing export subsidies “otherwise than in conformity with this Agreement”.

39. Evidence submitted by Brazil indicates that the United States has exceeded its quantitative export subsidy reduction commitment level for various agricultural commodities, including upland cotton.<sup>29</sup> Accordingly, were the Panel to accept such evidence, the United States would bear the burden of establishing that no export subsidies have been granted in respect of the quantity of exports in question pursuant to Article 10.3 of the *Agriculture Agreement*.<sup>30</sup>

40. The United States cannot deny that US export credit guarantees involve a “financial contribution” in the form of a “potential direct transfer of funds” under Article 1.1(a)(1)(i) of the *SCM Agreement*. Export credit guarantees are loan guarantees. Nor can the United States deny that the export guarantees are contingent upon export performance under Article 3.1(a) of the Agreement. Canada therefore addresses only the “benefit” requirement of the subsidy definition under Article 1.1(b) of the *SCM Agreement*.

41. The determination of a “benefit” in transactions involving agricultural commodities is necessarily factual. However, any assessment of the facts in this dispute must be undertaken within an appropriate legal framework. The applicable framework in this dispute is based on well-established WTO case law.

42. In *Canada – Aircraft*, the panel found that:

... a financial contribution will only confer a “benefit”, *i.e.*, an advantage, if it is provided on terms that are more advantageous than those that would have been available to the recipient on the market.<sup>31</sup>

43. The Appellate Body upheld this finding:

We ... believe that the word “benefit”, as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no “benefit” to the recipient unless the “financial contribution” makes the recipient “better off” than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a “benefit” has been “conferred”, because the trade-distorting potential of a “financial contribution” can be identified by determining whether the recipient has received a “financial contribution” on terms more favourable than those available to the recipient in the market.<sup>32</sup>

44. Based on this reasoning, the question is whether there is a difference between the amount that the firm receiving the guarantee pays on credit guaranteed under the US programmes and the amount that the firm would pay on a comparable commercial loan absent that guarantee. The benefit is the

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<sup>29</sup> Brazil First Written Submission, paras. 265-266.

<sup>30</sup> See *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products: Second Recourse to Article 21.5 of the DSU by New Zealand and the United States*, Report of the Appellate Body, WT/DS103/AB/RW2, WT/DS113/AB/RW2, adopted 17 January 2003, para. 73.

<sup>31</sup> *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Panel, WT/DS70/R, adopted 20 August 1999, para. 9.112.

<sup>32</sup> *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, adopted August 20, 1999 at para. 157.

difference between these two amounts adjusted for any differences in fees. The useful context provided by Article 14(c) of the *SCM Agreement* supports such a standard. Article 14(c) reads:

[A] loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees[.]

45. The panel in *Canada - Aircraft II* established a similar standard in respect of equity guarantees provided through a Canadian provincial government financing institution called *Investissement Québec (IQ)*.<sup>33</sup> The panel reasoned as follows:

Consistent with the findings of the panel and Appellate Body in *Canada – Aircraft*, we consider that *IQ* equity guarantees will confer a “benefit” to the extent that they are made available to Bombardier customers on terms more favourable than those on which such Bombardier customers could obtain comparable equity guarantees in the market. We note that the parties appear to agree that this standard can be applied by reviewing the fees, if any, charged by *IQ* for providing its equity guarantees. We agree that the “benefit” standard could be applied to *IQ* equity guarantees in this manner. Thus, to the extent that *IQ*’s fees are more favourable than fees that would be charged by guarantors with Québec’s credit rating in the market for comparable transactions, *IQ*’s equity guarantees may be deemed to confer a “benefit”.<sup>34</sup>

46. The panel went on to find that:

... a “benefit” could arise if there is a difference between the cost of equity with and without an *IQ* equity guarantee, to the extent that such difference is not covered by the fees charged by *IQ* for providing the equity guarantee. In our opinion, it is safe to assume that such cost difference would not be covered by *IQ*’s fees if it is established that *IQ*’s fees are not market-based.<sup>35</sup>

47. Regarding *IQ* loan guarantees, the panel applied the same reasoning:

In considering precisely what Brazil must show in order to demonstrate the existence of a “benefit”, we note the findings of the panel and Appellate Body in *Canada – Aircraft*. We therefore consider that *IQ* loan guarantees will confer a “benefit” to the extent that they are made available to Bombardier customers on terms more favourable than those on which such Bombardier customers could obtain comparable loan guarantees in the market. In applying this standard, we are guided by Article 14(c) of the *SCM Agreement*, which provides contextual guidance for interpreting the term “benefit” in the context of loan guarantees.

(...)

In our view, and taking into account the contextual guidance afforded by Article 14(c), we consider that an *IQ* loan guarantee will confer a “benefit” when

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<sup>33</sup> *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, Report of the Panel, WT/DS222/R, adopted 19 February 2002, para. 7.397 [hereinafter *Canada – Export Credits*, Panel Report].

<sup>34</sup> *Canada – Export Credits*, Panel Report, para. 7.344.

<sup>35</sup> *Canada – Export Credits*, Panel Report, para. 7.345.

“there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by [IQ] and the amount that the firm would pay on a comparable commercial loan absent the [IQ] guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees”. In other words, there will be a “benefit” when the cost-saving for a Bombardier customer for securing a loan with an IQ loan guarantee is not offset by IQ’s fees. In our opinion, it is safe to assume that this will be the case if it is established that IQ’s fees are not market-based.<sup>36</sup>

48. The same standard applies in the current dispute.

49. The United States avoids addressing the standard under Article 1.1(b) and argues simply that its export credit guarantee programmes “do not run afoul of the criteria of item (j)” of Annex I of the *SCM Agreement* and that, therefore, “...they are not a prohibited export subsidy under Article 3.1(a) of the Subsidies Agreement.”<sup>37</sup> The United States asks the panel to interpret item (j) *a contrario*, meaning that if its measures meet the description of the programmes in the provisions but do not meet the standard for being considered a subsidy *per se*, the measures must be deemed not to confer export subsidies. However, item (j) does not create a “safe haven” for export credit guarantees where “premium rates... are [adequate] to cover the long-term operating costs and losses of the [programme].” To the contrary, item (j) “sets out the circumstances in which the grant of loan guarantees is *per se* deemed to be an export subsidy.”<sup>38</sup> It simply “illustrates” deemed export subsidy practices. Nothing in the context or object and purpose of the *SCM Agreement* supports the US interpretation.

50. The issue of whether the premium rates under the US programmes are adequate under item (j) of Annex I of the *SCM Agreement* is necessarily factual. However, even if the US programmes charge adequate fees under the item (j) standard, the United States must nevertheless demonstrate that no export subsidies have been granted in respect of the quantity of exports in question in accordance with Articles 10.1 and 10.3 of the *Agriculture Agreement*. In other words, it must demonstrate the absence of subsidization on a transaction-by-transaction basis under Articles 1 and 3.1(a) of the *SCM Agreement*.

51. The United States also argues at length that Article 10.2 of the *Agriculture Agreement* exempts export credit practices from subsidy disciplines under the Agreement. This argument is untenable.

52. Article 10.2 of the Agreement on Agriculture reads:

Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.

53. Article 10.2 refers to “disciplines to govern the provision of export credits, export credit guarantees or insurance programmes” and not to “disciplines to govern the provision of *export subsidies in the form of* export credits, export credit guarantees or insurance programmes”. This provision sets out an intention on the part of Members to undertake further work regarding these measures – the simple fact of agreeing to do so, however, does not amount to a permission to use those measures to confer export subsidies without consequence and without limit. The US

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<sup>36</sup> Canada – Export Credits, Panel Report, paras. 7.397 and 7.398.

<sup>37</sup> US First Written Submission, para. 183.

<sup>38</sup> Canada – Export Credits, Panel Report, para. 7.395.

interpretation of Article 10.2 ignores the important context provided by Article 10.1. It also directly contradicts the stated object and purpose of Article 10 as a whole: “Prevention of Circumvention of Export Subsidy Commitments”.<sup>39</sup>

54. Article 10.2 of the *Agriculture Agreement* does not exempt the United States from its obligation to demonstrate, under Article 10.3, that no export subsidies have been granted in respect of the quantity of exports in question in this dispute contrary to Article 10.1. For the United States to meet the requirements of Article 10.3, it must demonstrate the absence of subsidization as understood under Article 1(e) of the *Agriculture Agreement*. Indeed, the United States does not address Articles 1(e) or 10.1, or any prior panel and Appellate Body findings thereon.

#### IV. CONCLUSION

55. At this stage of the proceedings, it is Canada’s view that if the panel accepts the evidence presented by Brazil in its first written submission, it would find that PFC payments and direct payments do not satisfy the policy-specific criteria in paragraph 6(b) of Annex 2 of the *Agriculture Agreement*. Contrary to those requirements, the amount of these payments would be found to vary based on current production of certain fruit, vegetables and wild rice.

56. Regarding the US export credit guarantee programmes, in Canada’s view, were the Panel to find that these programs provide export subsidies within the meaning of Article 1(e) of the *Agriculture Agreement*, then it would also find that the United States has violated Articles 8 and 10.1 at the very least in respect of exports of upland cotton.

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<sup>39</sup> See also “Export Credits and Related Facilities”, Background Paper by the Secretariat, G/AG/NG/S/13, 26 June 2000 [Exhibit CDA-2.] at para. 44:

[A]s matters currently stand the only rules and disciplines on agricultural export credits are those of the Agreement on Agriculture but only to the extent that such measures constitute export subsidies for the purposes of the Agreement on Agriculture. Where exports of an agricultural product are considered to be subsidised through export credits or related facilities, ascertaining the exported quantities benefitting [sic] from such measures for the purposes of determining conformity with export quantity reduction commitments would be reasonably straight forward. Quantifying related budgetary outlays and revenue foregone for the annual commitment level in question, using market-related premium or interest rate benchmarks for example (it is not clear what, if any, role there might be for export credit “subsidy equivalents” in this context), may be less straight forward but not necessarily problematic.



## **ANNEX B-7**

### **THIRD PARTY SUBMISSION OF CHINA**

15 July 2003

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## 1. INTRODUCTION

1. China is appreciative of this opportunity to present its views to the Panel in this proceeding on various domestic supports and export subsidies granted by the United States (the "US") for the production, use and export of US upland cotton.

2. In line with this Panel's decision dated 20 June 2003, China will focus its submission to issues relating to

- (1) the burden of proof under Article 13 of the *Agreement on Agriculture* (the "Peace Clause");
- (2) proper categorization of direct payments under the US Farm Security and Rural Investment Act of 2002 ("FSRI"); and
- (3) treatment of a non-complying measure by this Panel.

In China's opinion, these three issues, amongst others, call for close attention and analysis by the Panel.

## 2. ARGUMENTS

### 2.1. The Burden Of Proof Under The Peace Clause

3. China agrees with Brazil that "the [P]eace [C]lause is in the nature of an affirmative defense, and that the burden of proof that US domestic support and export subsidies to upland cotton are provided in conformity with the requirements of the [P]eace [C]lause lies with the United States and not with Brazil as the complainant"<sup>1</sup>.

4. The burden of proof issue has been squarely dealt with by the Appellate Body in the *US – Shirts and Blouses* Case<sup>2</sup>. It stated that a complaining party asserting a claim under a positive rule, establishing obligations in themselves, first has the burden of proof to establish a prima facie case of an infringement of obligations by the responding Member, then the burden shift to the responding Member to adduces sufficient evidence to rebut the presumption<sup>3</sup>. However, with respect to rules providing "limited exceptions from obligations under certain other provisions of the GATT 1994", the Appellate Body is of the view that they are "in the nature of affirmative defense, thus it is only reasonable that the burden of establishing such a defense should rest on the party asserting it"<sup>4</sup>.

5. The parties to this dispute disagree on the nature of the Peace Clause. The US does not see the Peace Clause as an affirmative defense; it argues that portions of the Peace Clause impose positive obligations. It cites Articles 13(a)(i), 13(a)(ii) and 13(b)(ii) of the Peace Clause to prove that by incorporating obligations under Article 6 and Annex 2 within the "conform fully to" requirement, the Peace Clause contains positive obligations on members<sup>5</sup>.

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<sup>1</sup> Para. 107, Page 50, *First Submission of Brazil*, 24 June 2003.

<sup>2</sup> Section IV, Appellate Body Report, *US - Shirts and Blouses*, WT/DS33/AB/R.

<sup>3</sup> Page 13-14, Section IV Burden of Proof, Appellate Body Report, *US - Shirts and Blouses*, WT/DS33/AB/R.

<sup>4</sup> Page 15-16, Section IV and Text at Note 23, Appellate Body Report, *US - Shirts and Blouses*, WT/DS33/AB/R.

<sup>5</sup> Paras. 43 and 45, *US First Written Submission*, 11 July 2003.

6. China has a different opinion. When stand-alone, Article 6 in and Annex 2 to the *Agreement on Agriculture* and may contain positive obligations on Members. However, when cross-referred to by Articles 13(a)(ii) and 13(b)(ii) respectively, they are brought under the Peace Clause to form part and parcel of pre-conditions to its application. Generic components of the relevant Peace Clause provisions<sup>6</sup> are (i) domestic support measures or export subsidies; (ii) that fully conform to Annex 2 and/or Article 6 of the *Agreement on Agriculture*; (iii) are exempt from actions; (iv) provided that...<sup>7</sup> The thrust of the relevant provisions of the Peace Clause lies in its exemption of measures from certain actions. To qualify under the exemption, a measure under item (i) above must first meet the requirements under items (ii) and (iv) above. The moment either Annex 2 or Article 6 are brought into “fully conform to” formula under item (ii) above, it ranks *pari passu* with the other requirement under item (iv) above to form conditions precedent to a successful exemption.

7. China believes the US errs on seeing no distinction between “obligation” and “condition”. The Peace Clause requirement for full conformity to Article 6 and Annex 2 does not create new obligations because Members have to comply with Article 6 and Annex 2 whether Article 13 exists or not. Within the Peace Clause, these requirements do not stand to impose obligations on Members, but to set conditions precedent for a Members intending to invoke Peace Clause protection. Positive obligations to comply with Article 6 and Annex 2, lie under where they are, i.e. under Article 6 and Annex 2, but not under the Peace Clause.

8. China does not see any “absurdity” as described by the United States in its written submission<sup>8</sup>. No such “absurdity” would be instilled into the process if at the first stage, the party alleging protection of Peace Clause for its measures is required to discharge its burden to prove that such measures do conform to the relevant Peace Clause conditions; if it cannot so prove, the measures would lose Peace Clause protection. A second stage will follow for the party claiming against the measures to establish its substantive case, without the Peace Clause shield.

9. China hopes the above two-step approach will help both this Panel and the parties to move the procedures on towards resolution of the case.

## 2.2 Proper Categorization Of US FSRI 2002 Direct Payments

10. The United States in its first written submission argues that direct payments (“DP”) under FSRI conforms fully to Annex 2 of the *Agreement on Agriculture*<sup>9</sup> and are therefore “Green Box” in nature. Brazil argues that DP programme is inconsistent with Paras. 1, 6(a) and (b) of Annex 2 to the *Agreement on Agriculture*, as

- (1) it conditions the type of production undertaken by the producer<sup>10</sup>;
- (2) it sanctions base period updating<sup>11</sup>; and
- (3) it has production and trade-distorting effects<sup>12</sup>.

11. Para. 6(a) of Annex 2 to the *Agreement on Agriculture* provides to the effect that eligibility for “Green Box” direct payment support measures “shall be determined by clearly-defined criteria”

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<sup>6</sup> Articles 13(b)(ii), 13(b)(iii) and 13(c)(ii), the *Agreement on Agriculture*.

<sup>7</sup> Note that Article 13(c)(ii) of the Peace Clause has no such proviso.

<sup>8</sup> Para. 36, *US First Written Submission*, 11 July 2003.

<sup>9</sup> Paras. 54 through to 68, *US First Written Submission*, 11 July 2003.

<sup>10</sup> Para. 174, *First Submission of Brazil*, 24 June 2003.

<sup>11</sup> Paras. 176 through to 182, *First Submission of Brazil*, 24 June 2003.

<sup>12</sup> Paras. 183 through to 191, *First Submission of Brazil*, 24 June 2003.

“in a defined and fixed base period.” The word “in” requires a link between the “criteria” and the “defined and fixed base period”. In other words, to qualify for “Green Box” direct payment measure under Para. 6(a), a criterion adopted by a Member must be tied, in a chronological sense, to a starting time frame that cannot be moved up on the calendar.

12. As the United States concedes, production acreage is a criterion for making FSRI DP<sup>13</sup>. However, under FSRI, production acreage for the purpose of DP is not tied to a defined and fixed base period. It moves progressively along the calendar.

13. Under the FSRI DP scheme, payment acreage, being one factor in calculating payment<sup>14</sup>, is 85% of a person’s base acreage. Base acreage, in turn, are either (i) “a four year average (1998-2001) of plantings of covered commodities (including upland cotton)”, or (ii) the total of production flexibility contract (“PFC”) acreage under the US 1996 Federal Agricultural Reform Improvement and Reform Act (“FAIR”) and the four-year average (1998-2001) of plantings of eligible oilseeds<sup>15</sup>. With respect to base acreage calculation method (i) above, the United States explains, FSRI DP allowed landowners to retain PFC base acres and “add 1998-2001 acres of eligible oilseeds or simply declare base acreage for all covered commodities” (including upland cotton)<sup>16</sup>. With respect to base acreage calculation method (ii) above, the United States explains that while a landowner may elect to simply utilize acres devoted to covered commodities during the 1998-2001 period for purpose of DP, a landowner need not do so; base acres may remain those under FAIR, implying no cotton production need have occurred since the 1993-1995 period for a landowner to have “cotton base acres”. The United States then concludes that “[t]hese ... base acres are defined in the 2002 [FSRI] Act and fixed for the duration of the legislation (that it, from marketing year 2002-2007)”<sup>17</sup>. Such a conclusion ignores the fact that during the progression from PFC to DP, the requisite link between the programme acreage as a criterion and the “defined and fixed” starting time frame is broken. The change of legislation from FAIR to FSRI and the replacement of PFC with DP were utilized for producers to leap from their previous coverage acreage, which should have been tied to the base period, to a new updated acreage in 2002.

14. Enticement certainly exists for a producer to obtain more payments by leaping over the calendar and updating production acreage. The fundamental requirement that “no, or at most minimal trade distorting effects or effects on production” as required by Article 1 of Annex 2 to the *Agreement on Agriculture* is therefore not met.

15. In China’s opinion, without dwelling upon the burden of proof issue, the preponderance of evidence as produced by the parties indicates that the US DP under FSRI fails to meet the “tie” requirement under Para. 6(a) of Annex 2 of the *Agreement on Agriculture* and shall be properly categorized as non-“Green Box” measures.

### **2.3 Panel Treatment Of Measures Found By Earlier Proceedings To Be In Violation**

16. Brazil also brought claims against export subsidy support granted for upland cotton export sales by US “Foreign Sales Corporations” (“FSCs”) under the “FSC Repeal and Extraterritorial Income Act of 2000” (“ETI Act”)<sup>18</sup>.

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<sup>13</sup> Paras. 56 and 67, *US. First Written Submission*, July 11, 2003.,

<sup>14</sup> Para. 58, *Ibid.*

<sup>15</sup> Para. 59, *Ibid.*

<sup>16</sup> Para. 60, *Ibid.*

<sup>17</sup> Subpara. 67(1), *Ibid.*

<sup>18</sup> Paras. 315 through to 330, *First Submission of Brazil*.

17. The US ETI Act has previously been found to violate the *Agreement on Agriculture* and the *Subsidies Agreement* by both the panel<sup>19</sup> and the Appellate Body<sup>20</sup> in *US – FSC (21.5)*. On 29 January 2002, the WTO Dispute Settlement Body (the “DSB”) adopted the panel and Appellate Body reports, declaring that the ETI Act violates Articles 3.1(a) and 4.7 of the *Subsidies Agreement*, Articles 8 and 10.1 of the *Agreement on Agriculture* and Article III:4 of *GATT 1994*.

18. As the United States had failed to implement the DSB recommendations and rulings within the prescribed time framework, on 25 April 2003, the European Communities (the “EC”) requested the DSB authorization to take appropriate countermeasures and to suspend concessions pursuant to Article 4.10 of the *Subsidies Agreement* and Article 22.7 of the *DSU*<sup>21</sup>. On 7 May 2003, the DSB authorized the EC to impose countermeasures against the US.

19. Brazil quoted main EC arguments and portions of the panel’s and the Appellate Body’s reasoning from *their* respective reports in *US – FSC (21.5)*, all to persuade this Panel into taking the same reasoning and conclusion<sup>22</sup>.

20. China believes that the panel and the Appellate Body’s reasoning and their conclusion in *US – FSC (21.5)* are of extraordinary value to the current Panel.

21. First, “[a]dopted panel reports are an important part of the *GATT acquis*. They are often considered by subsequent panels. They create *legitimate expectations* among WTO members, and, therefore, *should be taken into account where they are relevant to any dispute*. [emphasis added].”<sup>23</sup> Export subsidy support provided to upland cotton export sales by US “Foreign Sales Corporations” under the ETI Act as challenged by Brazil in this case, is exactly the very same one challenged by the EC and found to violate the *Agreement on Agriculture* and the *Subsidies Agreement* by the panel<sup>24</sup> and the Appellate Body<sup>25</sup> in *US – FSC (21.5)*. The panel and the Appellate Body’s decisions, as well as DSB’s adoption of same in *US – FSC (21.5)*, have already created “legitimate expectations” among WTO members. Should this Panel re-consider the arguments, analysis and conclusions in respect of the same measure adopted by the same Member in dispute, and re-decide with even the slightest difference, the WTO Members’ legitimate expectations will be seriously disturbed and offended. Unless the current Panel finds the FSC export subsidies under the ETI Act challenged by Brazil in this case different from the FSC export subsidies under the ETI Act challenged by the EC in the *US – FSC (21.5)*, relevancy is fulfilled to the maximum extent possible. The very same export subsidies shall be governed by the same juridical analysis, rule and conclusion. Substantive deviation from that the reasoning and conclusion of the earlier case on the same measure may well cast misgivings on the established DSB authority and reputation.

22. The United States in its *First Written Submission* argues that:

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<sup>19</sup> Panel Report, *US - FSC (21.5)*, WT/DS108/RW, adopted on 29 January, 2002.

<sup>20</sup> Appellate Body Report in *US - FSC (21.5)*, AB-2002-1, WT/DS108/AB/RW, adopted on 29 January, 2002.

<sup>21</sup> Recourse by the European Communities to Article 4.10 of the *Subsidies Agreement* and Article 22.7 of the *DSU*, WT/DS/108/26, circulated on April 25, 2003.

<sup>22</sup> Paras. 315 through to 327, *First Submission of Brazil*.

<sup>23</sup> Para. E, Report of the Appellate Body, *Japan - Taxes on Alcoholic Beverages*, AB-1996-2, adopted on 1 November 1996).

<sup>24</sup> Paras. 8.30, 8.46, 8.48, 8.50, 8.74, 8.75, and 9.1(a.), Panel Report, *US - FSC (21.5)*, WT/DS108/RW, adopted on 29 January 2002.

<sup>25</sup> Paras. 111, 116 through to 120, 122, 194, 196, and 256(d), Appellate Body Report, *US - FSC (21.5)*, AB-2002-1, WT/DS108/AB/RW, adopted on 29 January 2002.

It also is well-established that even though panels may take into account prior panel and Appellate Body reports, “panels are not *bound* by previous decisions of panels or the Appellate Body even if the subject-matter is the same.”<sup>26</sup>

China notes that US had omitted the immediate subsequent paragraph, in which the panel states:

However, in the course of "normal dispute settlement procedures" required under Article 10.4 of the DSU, we *will take into account the conclusions and reasoning* in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination, we believe that we *should give significant weight to both Article 3.2 of the DSU*, which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, *and to the need to avoid inconsistent rulings* (which concern has been referred to by both parties). In our view, these considerations form the basis of the requirement of the referral to the "original panel" wherever possible under Article 10.4 of the DSU.<sup>27</sup> [emphasis added]

China believes that second sentence following the US quote from the panel's report could not be more relevant to the US ETI Act before this Panel.

23. Secondly, the DSB has already, upon request by the EC, authorized the EC to impose countermeasures against the US, for its failure to implement the DSB recommendations and rulings within the prescribed time framework. DSB's authorization to counteract

- (1) further strengthens the weight of the panel and the Appellate Body's decisions in *US – FSC (21.5)*. Authorization by the DSB for countermeasures against the very same measures is a collective reflection that the measures shall have been withdrawn, and;
- (2) brings up the need for efficiency. Given the DSB's heavy caseload, as well as workload of this Panel, benefits of efficiency far overweighs whatever need for repeating the work that had been completely accomplished by a previous panel and the Appellate Body.

24. Thirdly, in light of difficulties encountered by the DSB in encouraging compliance subsequent to the *US – FSC (21.5)* proceedings, a different finding by this Panel in relation to ETI in the current dispute will frustrate WTO's effectiveness as reflected in the DSB mechanism. The essence of “[p]rompt compliance with recommendations or rulings of the DSB” “to ensure effective resolution of disputes to the benefit of all Members” called for under Article 21.1 of the *DSU* will evaporate.

25. Being a multilateral system, the WTO cannot afford to permit non-compliance by any Member in its face. One dispute settled will definitively involve several legal issues having been clarified and practices of certain members adjudicated. Such clarification and adjudication in one case must serve to benefit all members in the multilateral system. As Article 3.2 of the *DSU* tries to impress, the dispute settlement system of the WTO is a pivotal element in providing uniform security and predictability to the multilateral trading system and to avoid multiplication of the same practices being disputed in separate but non-distinct cases. To compel panels in later instances to re-visit the

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<sup>26</sup> Para. 185, *First Written Submission of the US*, 11 July 2003, quoting in quotation marks Para. 7.30, Panel Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS79/R, adopted 22 September 1998.

<sup>27</sup> Para. 7.30, Panel Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Product*, WT/DS79/R, adopted 22 September 1998.

same legal issue and re-adjudicate the same practices the DSB recommends against on a second or even indefinite analytical journey would relegate WTO dispute settlement regime into disrepute.

26. The concern is not unfounded. The fact that Brazil had to resort to the WTO dispute settlement system and bring the ETI Act before this Panel is distinctly telling. This current Panel must put an end to that concern by ruling that the panel and the Appellate Body's reasoning *and* their conclusion in *US – FSC (21.5)* be taken by this Panel, unless by the time the current Panel makes its decision, such measures will have already been withdrawn by the US.

### 3. CONCLUSION

27. To sum up, China is of the following opinion:

- (1) The Peace Clause is an affirmative defense in nature, and a party seeking its protection bears the burden of proof;
- (2) The US DP, which removes production acreage from its required nexus with a defined and fixed based period by allowing acreage updating, is not "Green Box" measure within the meaning of Para. 6(a) of Annex 2 to the *Agreement on Agriculture*; and
- (3) The US ETI Act has been found by a prior panel and the Appellate Body to violate the *Agreement on Agriculture* and the *Subsidies Agreement*. In addition, the DSB has authorized the complaining party in the prior proceeding to take countermeasures. In light of coherency and efficiency of the WTO dispute settlement mechanism, this Panel shall take the reasoning and conclusion of the Appellate Body in the earlier case.

28. China thanks this Panel for granting this opportunity to present its views on issues related to this proceeding, and hopes that this Panel will find the above points helpful.

## **ANNEX B-8**

### **FIRST THIRD PARTY SUBMISSION BY THE EUROPEAN COMMUNITIES**

15 July 2003

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## I. INTRODUCTION

1. This dispute raises a number of complex yet important questions in respect of the applicable WTO regime for trade in agricultural goods. In this First Third Party Submission, the European Communities has submitted arguments on a number of questions raised by Brazil's First Written Submission.<sup>1</sup> However, the present submission should not be seen as exhaustive. Given the very short period between the deadline for the US First Written Submission and the deadline for submissions from third parties, the European Communities has not been able to incorporate in this submission a response to all of the arguments brought in the US First Written Submission which might merit a comment. Consequently, the European Communities reserves its right to submit argument on other questions (or to further develop the arguments set out here) at the First Session of the First Substantive Meeting with the Parties.

2. Following the Panel's invitation of 20 June 2003, the European Communities has essentially limited itself to questions related to the interpretation of Article 13 of the *Agreement on Agriculture*, and some of the "non-peace clause" related claims brought by Brazil. The European Communities will therefore argue that :

- ? As a preliminary matter, Brazil is incorrect to consider that only legislation which mandates a particular action can be found inconsistent with the WTO Agreements;
- ? Article 13 *Agreement on Agriculture* is not an affirmative defence;
- ? The first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture* does not create a free-standing obligation, separate from the basic criteria set out in the second sentence of paragraph 1; and,
- ? Article 10.2 of the *Agreement on Agriculture* does not exempt export credits and export credit guarantees from the disciplines of the *Agreement on Agriculture*.

3. The European Communities does not express an opinion on the application of the relevant legal interpretations to the facts of this dispute.

## II. PRELIMINARY ISSUE - BRAZIL'S REFERENCE TO A "MANDATORY / DISCRETIONARY DOCTRINE" IS UNFOUNDED

4. Before turning to the substantive questions of interpretation the European Communities would like to touch briefly upon one systemic issue raised in Brazil's submission. Brazil states in its First Written Submission that:

"It is established under WTO law that a Member can only challenge measures of another Member *per se* if such measures mandate a violation of the WTO Agreement."<sup>2</sup>

5. Brazil cites as authority for this position para. 88 of the Appellate Body's Report in *United States – 1916 Act*. However, the Appellate Body did not "establish" that measures can only be

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<sup>1</sup> Brazil's First Submission to the Panel regarding the "Peace Clause" and Non-Peace Clause Related Claims, 24 June 2003 ("Brazil's First Written Submission").

<sup>2</sup> Brazil's First Written Submission, para. 244. See, in the same sense, paras. 250 and 341.

challenged if they mandate a violation of the WTO Agreements. In that case, the Appellate Body upheld the panel's finding that the legislation in question was not discretionary and thus;

“[did] not find it necessary to consider [...] whether Article 18.4, or any other provision of the *Anti-Dumping Agreement*, has supplanted or modified the distinction between mandatory and discretionary legislation”.<sup>3</sup>

6. Panels have taken different approaches to this issue. The panel in *United States – Section 301* found that discretionary legislation may violate certain WTO obligations.<sup>4</sup> This approach can be contrasted with that of the panel in *United States – Export Restraints*.<sup>5</sup> More recently, the Appellate Body in considering an EC claim against US legislation noted that;

“[it did not] preclud[e] the possibility that a Member could violate its WTO obligations by enacting legislation granting discretion to its authorities to act in violation of its WTO obligations. We [the Appellate Body] make no finding in this respect”.<sup>6</sup>

7. Consequently, it is far from established that only mandatory legislation can be found *per se* inconsistent with the WTO Agreements. The European Communities, for one, is convinced that discretionary legislation may, in certain circumstances, be found to be inconsistent with WTO obligations. However, further discussion of this issue does not appear necessary at present, since Brazil claims that the legislation in question permits of no discretion and the United States does not appear to dispute this point.<sup>7</sup> Consequently, the European Communities will not develop its arguments on this issue further in this submission.

### III. ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE CANNOT BE CONSIDERED AN AFFIRMATIVE DEFENCE

8. Brazil argues that Article 13 of the *Agreement on Agriculture* should be understood as an affirmative defence and thus that the United States bears the burden of proof.<sup>8</sup> The United States has indicated that it disagrees with this characterisation, and considers that Article 13 is not an affirmative defence.<sup>9</sup>

9. The European Communities shares the view of the United States that there are compelling reasons to consider that Article 13 is not an affirmative defence.<sup>10</sup> Article 13 cannot be considered an

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<sup>3</sup> Appellate Body Report, *United States – Anti-Dumping Act of 1916* (“*United States – 1916 Act*”), WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000, para. 99

<sup>4</sup> Panel Report, *United States – Sections 301-310 of the Trade Act of 1974* (“*United States – Section 301*”), WT/DS152/R, adopted 27 January 2000, footnote 23, paras. 7.53-7.54. Note that the Appellate Body in *United States – 1916 Act* mentioned this finding, without suggesting that it was incorrect (see footnote 59 of the Appellate Body Report).

<sup>5</sup> Panel report, *United States – Measures Treating Export Restraints as Subsidies*, WT/DS194/R, adopted 23 August 2001, paras. 8.8 and 8.9.

<sup>6</sup> Footnote 334, Appellate Body Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, adopted 8 January 2003.

<sup>7</sup> Brazil's First Written Submission, para. 245.

<sup>8</sup> Brazil's First Written Submission, paras. 110 to 121.

<sup>9</sup> Para. 38, Comments of the United States of America on the Comments by Brazil and the Third Parties on the Question Posed by the Panel, 13 June 2003. See also First Written Submission of the United States of America, 11 July 2003 (“US First Written Submission”), paras. 38 to 47.

<sup>10</sup> The European Communities is aware of the fact that it used the term “defence” in its Initial Submission to the Panel of 10 June 2003 (Para. 6, Comments by the European Communities on certain issues raised on an initial basis by the Panel, 10 June 2003). It did so, however, in the context of a discussion of what

affirmative defence which will excuse a violation of another provision of the WTO Agreements. Rather, it seems to the European Communities, Article 13 is a form of “gateway” or “threshold” provision, which regulates the use of certain mechanisms (countervailing duties, serious prejudice claims, non-violation complaints) in respect of certain types of subsidies. Conformity with the conditions of Article 13 has the effect of providing an exemption from action under Article XVI GATT 1994 and the *SCM Agreement*. Consequently, once a panel has determined whether or not agricultural subsidies conform to the conditions of Article 13, it need not, indeed cannot, rule on whether those agricultural subsidies are consistent with Article XVI GATT 1994 and the *SCM Agreement*. For that reason, it cannot be equated to a defence to a violation of a provision of a WTO Agreement, in the way, for instance, Article XX may be considered a defence to a violation of Article I or III GATT 1994.

10. Even assuming, *arguendo*, Brazil’s contention that Article 13 of the *Agreement on Agriculture* is an exception to the otherwise applicable disciplines<sup>11</sup>, the Appellate Body has pointed out in *EC-Hormones* that merely characterising a provision as an “exception” and consequently an affirmative defence is insufficient to shift the burden of proof in dispute settlement proceedings.<sup>12</sup> Any finding reversing the ordinary rule that the complaining party bears the burden of proof to establish a *prima facie* case must be derived from an application of the normal rules of treaty interpretation. The ordinary rules of treaty interpretation do not lead to such a conclusion in this case.

11. First, as noted above, the Panel is not asked to examine a general rule – exception situation with respect to Article 13. Article 13 is more akin to a threshold permitting further action if that threshold is not complied with.

12. Second, Article 13 is an integral part of the *Agreement on Agriculture*. In that sense, it is comparable to Article 6 of the *Agreement on Textiles and Clothing*, Article 3.3 of the *Sanitary and Phytosanitary Agreement* and the second sentence of Article 2.4 of the *Agreement on Technical Barriers to Trade* which were found not to be affirmative defences by the Appellate Body.<sup>13</sup> Article 13 incorporates the obligations which a WTO Member assumes under the *Agreement on Agriculture* should it decide to provide agricultural subsidies to its producers, and regulates the status of such subsidies with respect to potential dispute settlement and the application of countervailing duties. In a similar fashion, Article 6 of the *Agreement on Textiles and Clothing* provides certain obligations which a WTO Member assumes if it decides to dis-apply the disciplines of the ATC in the form of a “transitional safeguard measure”. Likewise, Article 3.3 of the *Sanitary and Phytosanitary*

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appeared to be the extreme logical conclusion of the arguments which the United States made, in order to refute the proposition that the issue of conformity with Article 13 could only be dealt with in a separate panel proceeding, divorced from a panel proceeding which dealt with the claims conditional upon Article 13 not being applicable. The term “defence” was used in a general sense to connote an argument which could be invoked in reaction to another argument. Moreover, the European Communities did not use the term “affirmative defence” and did not use the term “defence” in the sense of a “defence [...] to a claim of violation of a GATT obligation” or as a “limited exception from certain other provisions of the [WTO Agreements]” (Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India* (“United States – Shirts and Blouses”), WT/DS33/AB/R, adopted 23 May 1997, page 15-16). Finally, the European Communities was addressing only the question posed by the Panel and not the question of the burden of proof applicable to Article 13.

<sup>11</sup> Brazil’s First Written Submission, para. 120.

<sup>12</sup> Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)* (“European Communities – Hormones”), WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 104.

<sup>13</sup> Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India* (“United States – Shirts and Blouses”), WT/DS33/AB/R, adopted 23 May 1997, page 16. *European Communities – Hormones* Para. 104, Appellate Body Report, *European Communities – Trade Description of Sardines (European Communities – Sardines)*, WT/DS231/AB/R, adopted 23 October 2002. Paras. 274-275.

*Agreement* sets out obligations on a Member wishing to maintain a higher level of sanitary or phytosanitary protection than provided for in international standards. These provisions, like Article 13 of the *Agreement on Agriculture* provide certain rights to WTO Members, but cannot be seen as exceptions.

13. Third, as pointed out by the United States, considering Article 13 as an affirmative defence leads to perverse effects.<sup>14</sup> If a complaining Member makes a claim that a Member has acted inconsistently with the *Agreement on Agriculture*, the complaining Member will bear the burden of proof to establish a breach of the Agreement. However, if Article 13 is considered an affirmative defence, where a complaining Member brings a claim arguing breach of both the *Agreement on Agriculture* and the *SCM Agreement* the complaining Member would bear the burden of establishing a breach of the *Agreement on Agriculture*, the responding Member would bear the burden of proving that it was in compliance with the same provisions of the *Agreement on Agriculture* in order to apply Article 13, and the complaining Member would bear the burden of proof under the *SCM Agreement*. This cannot be what WTO Members intended when they negotiated Article 13. Indeed, the negotiators were aware of the issue of burden of proof and explicitly reversed the burden of proof in Article 10.3 *Agreement on Agriculture* with respect to potential circumvention of export subsidy commitments. That they did not agree on similar language with respect to Article 13 suggests that they intended the ordinary rules of burden of proof to apply.

14. Consequently, the European Communities respectfully requests that the Panel find that Article 13 is not an affirmative defence.

#### **IV. THE INTERPRETATION OF ANNEX 2 OF THE AGREEMENT ON AGRICULTURE**

##### **A. THE RELEVANCE OF THE FIRST SENTENCE OF PARAGRAPH 1 OF ANNEX 2**

15. Brazil argues in several instances that the first sentence of paragraph 1 of Annex 2 of the *Agreement on Agriculture* is an independent obligation which must be satisfied in addition to the basic criteria set out in paragraph 1 and the policy-specific criteria set out in paragraphs 2 to 13 of Annex 2.<sup>15</sup> The European Communities considers that this interpretation is incorrect. The first sentence does not set out an independent obligation. It simply signals the objective of Annex 2.

16. Paragraph 1 of Annex 2 reads as follows:

1. Domestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production. Accordingly, all measures for which exemption is claimed shall conform to the following basic criteria:
  - (a) the support in question shall be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers; and,
  - (b) the support in question shall not have the effect of providing price support to producers;

plus policy-specific criteria and conditions as set out below.

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<sup>14</sup> US First Written Submission, para. 44

<sup>15</sup> See, e.g. Brazil's First Written Submission, paras. 163-172, 183-191 and 199-201.

17. The European Communities will set out its understanding of the first sentence below. While some ambiguity as to the effect of the first sentence might arise when considering its ordinary meaning in isolation, as Brazil does, it is quite clear that, when seen in context, the first sentence should not be considered to be a free-standing obligation. This result also follows from a consideration of the objective of Annex 2.

18. It should be recalled that the provision of domestic subsidies for industrial products (i.e. non-export contingent subsidies) is not prohibited as such under the *SCM Agreement* or other *WTO Agreements*.<sup>16</sup> Such subsidies will only be actionable if they meet the requirements of Articles 1 and 2 of the *SCM Agreement*, and cause adverse effects to the interests of another Member in the sense of Article 5 of the *SCM Agreement*.

19. The *Agreement on Agriculture* initiated a process of reform for domestic support for agricultural products.<sup>17</sup> Negotiators recognised that domestic support for agricultural products required discipline and binding limits on the amount of domestic support. However, given that the provision of domestic subsidies to industrial products can be unlimited, provided there is no infringement of Article 5 of the *SCM Agreement*, it would have been inequitable to subject all types of domestic support to the strict discipline and limitations of the *Agreement on Agriculture* when the economic effects of different types of measures are not comparable. Consequently, it was necessary for the negotiators to differentiate between those types of support measures whose economic effect was deemed significant<sup>18</sup>, and those types of measures whose economic effects were deemed less significant. This differentiation was achieved, not by defining those measures deemed to have a significant effect, but rather those deemed to have a less significant effect. The result was Annex 2 to the *Agreement on Agriculture*.

20. The first sentence of paragraph 1 announces the differentiation which is achieved by the criteria set out in Annex 2.<sup>19</sup> It sets out the logic for distinguishing between the types of domestic support which come under Annex 2 and are exempt from reduction commitments and other domestic support measures. That the first sentence does not set out an independent obligation can be seen from the next sentence of Paragraph 1 which starts with the word “accordingly”. “Accordingly” means “in accordance with the logical premises; correspondingly”.<sup>20</sup> “Accordingly” consequently links the “fundamental requirement” in the first sentence with the “basic criteria” in the second sentence making it clear that in order to be considered to have “no, or at most minimal, trade-distorting effects or effects on production” the measure must meet the basic criteria in the second sentence of paragraph 1 together with the policy-specific criteria set out in paragraphs 2 to 13.

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<sup>16</sup> Provided the subsidisation is not contingent upon the use of domestic over imported goods, in the sense of Article 3.1(b) of the *SCM Agreement*.

<sup>17</sup> See the Preamble to the *Agreement on Agriculture*.

<sup>18</sup> Without analysing whether the effects would, in the absence of the *Agreement on Agriculture* and assuming the *SCM Agreement* to be applicable to agricultural goods, lead, in a particular case, for a particular product, to a finding of inconsistency with the *SCM Agreement*.

<sup>19</sup> It can be noted that one commentator, who has undertaken one of the most comprehensive reviews of the *Agreement on Agriculture*, notes that the requirement in the first sentence of paragraph 1 is:

“[t]oo vague to translate into concrete and enforceable obligations. As an appreciation of this fact, the Agreement on Agriculture has gone to great lengths to provide a detailed and comprehensive [...] list of measures along with the general and specific criteria they have to satisfy before they are exempted from the reduction commitments.”

P. 420-421, M. G. Desta, *The Law of International Trade in Agricultural Products* (Kluwer Law International 2002).

<sup>20</sup> The New Shorter Oxford English Dictionary, 1993.

21. Contextual support for this position can be found in Annex 2 itself and in Articles 6 and 7 of the *Agreement on Agriculture*.

22. Paragraph 5 of Annex 2 states that support provided through direct payments which are to be exempted from reduction commitments “shall meet the basic criteria set out in paragraph 1 above, plus specific criteria applying to individual types of direct payment as set out in paragraphs 6 through 13.” It is quite clear that the “basic criteria” referred to here is the “basic criteria” referred to in the second sentence of paragraph 1 of Annex 1. There is no reference to the fundamental requirement and thus that the measures should have “no or at least minimal trade distorting effects or effects on production”. Consequently, this fundamental requirement cannot be an additional criteria for a domestic measure to be exempted from reduction commitments under Annex 2.

23. Further support for this view is found in the *Agreement on Agriculture*. Article 6.1 applies to domestic support measures other than those “which are not subject to reduction in terms of the criteria set out in this Article and in Annex 2” (emphasis added). Article 7.1 obliges Members to ensure that domestic support measures “not subject to reduction commitments because they qualify under the criteria set out in Annex 2 to this Agreement are maintained in conformity therewith” (emphasis added). Article 7.2(a) goes on to state that “any measure that is subsequently introduced that cannot be shown to satisfy the criteria in Annex 2 to this Agreement [...] shall be included in the Member’s calculation of its Current Total AMS” (emphasis added). Annex 2 itself clearly distinguishes between the “fundamental requirement” of the first sentence of paragraph 1 and the “basic criteria” of the second sentence of paragraph 1 and the “policy-specific criteria” set out in paragraphs 1 to 13. The use of the word “criteria” in Articles 6 and 7, and its use in Annex 2 make it quite clear that in order to be exempted from reduction commitments by virtue of inclusion in the green box a domestic support measure must meet the criteria. It is obvious that the negotiators developed the criteria in order to determine whether a policy could be deemed to meet the “fundamental requirement” set out in paragraph 1 of Annex 2 and did not intend the first sentence to set out an independent obligation.

24. This interpretation is also supported by the objective behind Annex 2 and the *Agreement on Agriculture* more generally. In the administration of its agricultural policy, in order to ensure respect for their reduction commitments, a WTO Member must know how to classify its support measures. It is thus vital, for reasons of legal security and predictability, that a Member can determine the classification of its measures. The clear and specific criteria set out in Annex 2 provides WTO Members with guidance on how to approach this task. Assuming Brazil’s argument to be correct, a Member would also have to determine whether a particular measure to be taken might have a more than minimal trade distorting effect or effect on production. This is inevitably a difficult exercise, based on a subjective appreciation of a particular situation, which often may only be performed on an *ex post facto* basis. This is not a reasonable basis for advancing reform of trade in agriculture, and promoting the predictability of the system. Moreover, it can be noted that there is no such “effects” text in respect of other exempted domestic support measures *viz.* “de minimis payments” under Article 6.4 of the *Agreement on Agriculture* and “blue box payments” under Article 6.5 of the *Agreement on Agriculture*.

25. On the basis of the above, the European Communities respectfully requests the Panel to conclude that the first sentence of Paragraph 1 of Annex 2 of the *Agreement on Agriculture* does not impose an obligation independent of the basic and policy-specific criteria set out in Annex 2.

#### B. INTERPRETATION OF PARAGRAPH 6 OF ANNEX 2

26. Brazil’s first written submission raises a number of questions as to the correct interpretation of paragraph 6 of Annex 2. The European Communities attaches the utmost importance to the correct interpretation of these provisions. While the European Communities is still analysing the Brazilian

and US arguments, it already takes note of the fact that the US does not claim that its counter-cyclical payments qualify as exempt under the green box.<sup>21</sup>

## V. INTERPRETATION OF ARTICLES 10.1 AND 10.2 OF THE AGREEMENT ON AGRICULTURE (EXPORT CREDIT GUARANTEES)

27. Brazil argues that the US export credit guarantee schemes violate the *Agreement on Agriculture* and the *SCM Agreement*.<sup>22</sup> The European Communities can concur with this argument to the extent it can be confirmed that the export credit guarantees in question are to be considered export subsidies.

28. The European Communities points out, in this regard, that Article 10.2 of the *Agreement on Agriculture* cannot be considered to exempt export credit guarantees from the disciplines of Article 10.1 of the *Agreement on Agriculture*.<sup>23</sup> Article 10.2 states:

Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.

29. Article 10.2 makes it clear that the provision of export credit guarantees is not one of the types of export subsidies listed in Article 9.1 which a Member is given a limited authorisation to apply. Article 10.1 provides that non-listed export subsidies may not be applied in order to circumvent export subsidy commitments. Since export credit guarantees may be “export subsidies not listed in paragraph 1 of Article 9” they may be applied in a manner which “results in or threatens to lead to, circumvention of export subsidy commitments” and thus may be prohibited by Article 10.1. For unscheduled products, since the listed export subsidies cannot be provided, the Appellate Body has found that the transfer of economic resources in the form of non-listed export subsidies (e.g. export credit guarantees) threatens to circumvent the prohibition on giving listed export subsidies to such products.<sup>24</sup> Thus, export credit guarantees which qualify as export subsidies may be illegal under Article 10.1 where they might lead to circumvention of the export subsidy commitments.

30. Such a conclusion does not render Article 10.2 devoid of meaning. Article 10.2 is designed to develop disciplines of a broader nature than simply the regulation of export credits and export credit guarantees which operate as an export subsidy, since whether an export credit guarantee is an export subsidy depends on an analysis of the structure of that instrument. One reason why Article 10.2 was necessary is that export credits and export credit guarantees for agricultural commodities are not covered by the OECD Arrangement on Guidelines for Officially Supported Export Credits (see Article 3d).<sup>25</sup> Export credits which conform to this arrangement are considered not to be prohibited export subsidies.<sup>26</sup> Consequently, Article 10.2 sets up an obligation to develop disciplines for export credits and export credit guarantees irrespective of the question whether such instruments operate as

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<sup>21</sup> US First Written Submission, para 5, para. 118.

<sup>22</sup> Brazil's First Written Submission, paras. 252-314.

<sup>23</sup> The European Communities notes that the US has made this argument in paras. 154-166 of its First Written Submission.

<sup>24</sup> Appellate Body Report, *United States – Tax Treatment for “Foreign Sales Corporations”* (“*United States – FSC*”), WT/DS108/AB/R, adopted 20 March 2000, para. 150.

<sup>25</sup> OECD Arrangement on Guidelines for Officially Supported Export Credits of 15 October 2002 available at [www.oecd.org/dataoecd/52/3/2763846.pdf](http://www.oecd.org/dataoecd/52/3/2763846.pdf).

<sup>26</sup> See Item K of the Illustrative List of Export Subsidies, Annex 1 to the *SCM Agreement*.

export subsidies. It does not permit any differentiation in treatment between export credits, export credit guarantees or insurance programmes and other non-listed export subsidies.<sup>27</sup>

31. The European Communities submits, therefore, that Article 10.2 cannot be seen as exempting export credit guarantees granted to agriculture products from WTO disciplines.

## VI. CONCLUSION

32. By way of conclusion, the European Communities respectfully requests the Panel to find that:

- ? Article 13 *Agreement on Agriculture* should not be considered an affirmative defence;
- ? The first sentence of the first paragraph of Annex 2 to the *Agreement on Agriculture* should not be interpreted as a free-standing obligation; and,
- ? Article 10.2 of the *Agreement on Agriculture* does not exempt export credits and export credit guarantees, which are export subsidies, from the disciplines of the *Agreement on Agriculture*.

33. The European Communities reserves its right to address new arguments, and further develop the arguments set out herein, in its oral statement to the first session of the first substantive meeting.

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<sup>27</sup> Note that Desta arrives at a similar conclusion:

“To the extent that no such agreement [on the provision of export credits etc] has been reached, this provision simply remains to be an agreement to maintain good faith for a planned future negotiation devoid of any substantive additional obligation for some time to come. Until then, there seems to exist no legal distinction in the treatment of these three practices and the other forms of export subsidies not listed under Article 9.1.”

See Desta, p. 234 op cit. footnote 19.



## ANNEX B-9

### THIRD PARTY SUBMISSION OF NEW ZEALAND

15 July 2003

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## I. INTRODUCTION

1.01 The present dispute between Brazil and the United States regarding United States subsidies to upland cotton, as well as being important in respect of addressing the rights and obligations of the parties concerned, is also timely. New Zealand hopes this dispute will give greater clarity to the proper interpretation of important WTO disciplines applicable to agricultural trade. Although New Zealand is not a producer or exporter of cotton, New Zealand has a systemic interest in ensuring the continued integrity of these disciplines and has therefore joined this dispute as a third party.

1.02 New Zealand also acknowledges the importance of the cotton sector for a number of developing countries. In this regard New Zealand recalls the recent joint proposal made in the context of the Doha Development Agenda negotiations by Benin, Burkina Faso, Chad, Mali entitled 'Poverty Reduction: Sectoral initiative in favour of cotton'.<sup>1</sup> The joint proposal calls for recognition of the strategic nature of cotton for development and poverty reduction in many least developed countries and for the complete phasing out of support measures for the production and export of cotton. As the paper points out, the efforts of cotton producers in West and Central African countries towards liberalisation and competitiveness are virtually nullified by the fact that certain WTO Members continue to apply support measures to cotton that distort global markets.

1.03 The joint proposal outlines the damage caused by the very high levels of support given to cotton producers in certain WTO Member countries, including artificially increasing supply in international markets and bringing down export prices. This is the very same damage that Brazil is attempting to address through this dispute.

1.04 With respect to WTO disciplines, one of the biggest achievements of the Uruguay Round was the recognition that domestic support policies were instrumental in determining the overall nature of international agricultural trade. For the first time specific disciplines were placed on the ability of Members to use domestic support programmes in an unfettered manner. Trade-distorting or production-distorting domestic support measures became subject to reduction commitments.

1.05 New Zealand is concerned to ensure trade-distorting or "amber box" measures cannot be used contrary to the "peace clause" in a manner that negatively affects other Members.

1.06 At the same time as addressing trade-distorting support, Members recognized that some forms of domestic support were less trade-distorting than others and that certain types of programmes should continue to play a role in Members' policy "tool box". Accordingly the "green box", as set out in Annex 2 of the *Agreement on Agriculture*, was designed to allow Members to pursue agricultural objectives such as the provision of general services, disaster relief, food security and structural adjustment assistance and to support incomes as long as that was done in a way totally "decoupled" from production. The "green box" therefore allows WTO Members to meet legitimate non-trade objectives in a non-trade distorting way.

1.07 Strict eligibility criteria have been set down in Articles 6 and 7 and Annex 2 of the *Agreement on Agriculture* to ensure that only genuine non-trade distorting measures escape reduction commitments, including explicit inclusion of the "fundamental requirement" that such measures "have no, or at most minimal, trade-distorting effects or effects on production".<sup>2</sup>

1.08 The fact that basic and policy-specific criteria were included in the *Agreement on Agriculture* shows Members recognised the potential for the "green box" to be abused and domestic support commitments circumvented. In New Zealand's view it is critical that the integrity of the disciplines

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<sup>1</sup> TN/AG/GEN/4

<sup>2</sup> *Agreement on Agriculture* Annex 2, paragraph 1.

on “green box” measures are not weakened or their legitimate purpose undermined through the inclusion of measures that fail to meet the strict requirements of Annex 2, including the fundamental criterion that such measures are non-trade or production distorting. Accordingly one of New Zealand’s key objectives in joining this dispute as a third party is to ensure that the “green box” cannot be used to circumvent commitments on trade-distorting measures.

1.09 Under the Uruguay Round Members also agreed to a “peace clause” (Article 13 of the *Agreement on Agriculture*). Of particular relevance to this dispute is Members’ agreement that provided non-“green box” measures meet the requirements of the *Agreement on Agriculture* and the levels of support did not exceed 1992 levels, such measures would be exempt during the implementation period of the *Agreement* from certain actions that would otherwise be available to Members under the *Agreement on Subsidies and Countervailing Measures* (the “SCM Agreement”) and *General Agreement on Tariffs and Trade 1994* (the “GATT 1994”). “Peace clause” protection was also extended to export subsidies conforming with the requirements of the *Agreement on Agriculture*.

1.10 Accordingly, New Zealand is also concerned to ensure that Members are able to utilise their rights under the *SCM Agreement* and *GATT 1994* to take action in respect of domestic support measures and export subsidies where the requirements of the “peace clause” have not been respected.

1.11 New Zealand believes that the arguments put forward by Brazil<sup>3</sup> show that the “peace clause” has not been respected in relation to domestic support and export subsidies provided by the United States to upland cotton in the marketing years (“MY”) 1999, 2000, 2001 and 2002, and that accordingly Brazil is entitled to bring actionable and prohibited subsidy claims against the United States under the *GATT 1994* and the *SCM Agreement*.

1.12 This submission, as requested by the Panel<sup>4</sup>, primarily addresses issues raised in the submissions of Brazil and the United States relating to the substantive interpretation of Article 13 of the *Agreement on Agriculture*. As further elaborated in this submission New Zealand supports the claims made by Brazil. New Zealand has had only limited time to consider the First Written Submission of the United States<sup>5</sup> and therefore addresses only some of the issues raised therein. In particular New Zealand addresses, at the end of this submission,<sup>6</sup> the request by the United States for a Preliminary Ruling on certain matters.<sup>7</sup> New Zealand looks forward to the next phase of the case which will examine Brazil’s claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*.

## II. DOMESTIC SUPPORT MEASURES

### A. THE UNITED STATES HAS NO “PEACE CLAUSE” PROTECTION AGAINST ACTIONABLE SUBSIDY CLAIMS RELATED TO SUPPORT PROVIDED TO UPLAND COTTON IN MARKETING YEARS 1999, 2000, 2001 AND 2002

2.01 New Zealand agrees with Brazil that Members may assert a “peace clause” defence under *Agreement on Agriculture* Article 13(b)(ii) only if the total quantity of support granted through all

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<sup>3</sup> Brazil’s First Submission to the Panel Regarding the “Peace Clause” and Non-“Peace Clause” Related Claims, 24 June 2003 (“First Written Submission of Brazil”).

<sup>4</sup> Panel communication to the Parties, 20 June 2003.

<sup>5</sup> First Written Submission of the United States of America, July 11 2003 (“First Written Submission of the United States”).

<sup>6</sup> Para 5.01-5.02.

<sup>7</sup> First Written Submission of the United States, Pt V.

non-“green box” domestic support measures to a specific commodity does not exceed the quantity of non-green box domestic support decided to be granted in MY 1992.

2.02 New Zealand endorses the process outlined by Brazil<sup>8</sup> for determining whether the United States can claim peace clause protection against serious prejudice claims under *SCM Agreement* Articles 5(c) and 6.3 and *GATT 1994* Article XVI.1.

2.03 Specifically New Zealand agrees that the first step is to identify and quantify all the United States non-“green box” support for the production of upland cotton in MY 1992. The second step is to identify and quantify all non-“green box” United States payments that grant support to upland cotton in MY 1999, 2000, 2001 and to provide estimates for MY 2002. The final step is to determine whether United States support to upland cotton in MY 1999-2002 exceeded its 1992 support to upland cotton.

2.04 The information provided by Brazil<sup>9</sup> demonstrates that the level of domestic support for upland cotton in each of those marketing years did in fact exceed the level decided during the 1992 marketing year and therefore such domestic support measures may be subject to claims based on *GATT 1994* Article XVI or *SCM Agreement* Articles 5 and 6.

2.05 New Zealand notes that the United States argues that the relevant concept for the comparison required by Article 13(b)(ii) is only the ‘per pound’ rate of support set by the relevant domestic support measures.<sup>10</sup> Using this concept the United States argues that the support currently granted to upland cotton (\$0.52 per pound) does not exceed that granted to upland cotton in the 1992 marketing year (\$0.729 per pound).<sup>11</sup>

2.06 New Zealand agrees that the measures concerned (the loan rate) contribute to the effect of guaranteeing a producer price at a specified rate per pound of production and that the per pound rate of guaranteed price for producers is one of the relevant factors in making the comparison required by Article 13(b)(ii). However New Zealand does not agree that the use of the word “decided” in Article 13(b)(ii) was intended to be, or should be, construed to mean that the per pound rate of guaranteed price to producers of a commodity is the only factor to be considered in determining the amount of support granted. Indeed, New Zealand sees no support for such an approach in either the specific wording of Article 13(b)(ii) or in its object and purpose.

2.07 New Zealand considers that the comparison must take into account the totality of payments to upland cotton producers in order to reflect the true nature of the support that is being granted to a producer – the United States approach ignores this objective. For example, in relation to support granted to United States producers of upland cotton, Step 2 payments and crop insurance payments are also factors which affect farmers production decisions as is, of course, the “counter-cyclical” payments programme that effectively guarantees a price of \$0.724 per pound. Therefore even under the United States assumption that the use of a “rate” is key, the story is very different from that claimed by the United States.

2.08 Further, New Zealand considers that an evaluation of budgetary payments is also essential in order to see the real effects of the support programmes. Focussing solely on a rate per pound ignores the actual levels of domestic support represented by budgetary outlays that must be granted in order to maintain those rates and the other payments received.

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<sup>8</sup> First Written Submission of Brazil, para 123.

<sup>9</sup> *Ibid*, para 124.

<sup>10</sup> First Written Submission of the United States, paras 94 and 105.

<sup>11</sup> *Ibid*, para 125.

2.09 In this respect New Zealand recalls that the rationale behind the proviso in Article 13(b)(ii) that such measures not grant support to a specific commodity in excess of that decided during the 1992 marketing year is to create an upper limit in the level of trade or production distortion caused by such measures. The clear overarching intention of WTO Members in the negotiation of the *Agreement on Agriculture* was that henceforth such distortions would be reduced, consistent with the long term objective of “correcting and preventing restrictions and distortions in world agriculture markets”.<sup>12</sup> Accordingly it would be inconsistent with the object and purpose of the *Agreement*, and Article 13(b)(ii) specifically, to adopt an interpretation that artificially limits consideration of the scope of support granted to that of a ‘per pound rate’ of guaranteed price to a producer rather than the totality of the support granted that creates the trade and production distortions.

2.10 In that respect the fact that United States budgetary outlays have increased from their 1992 levels is not coincidental. Such increases are due, at least in part, to the production and market distorting effects of the United States measures that have lead to higher export levels of upland cotton from the United States that have in turn pushed world market prices for cotton down. In essence, the level of trade distortion has increased as the gap between the price farmers expect to receive and the world price has increased. Looking at it the other way around, had the United States maintained the 1992 level of support its producers would be far more aware of the realities of the world market for cotton and have less incentive to add further to the trade distortion.

# **1. Step 2 payments, loan deficiency payments, marketing loan gains and cottonseed payments**

2.11 These payments are clearly non-“green box” support, as implied by the notification by the United States to the WTO Committee on Agriculture for MY 1999.<sup>13</sup> As Brazil points out, the structure of most of these programmes is substantially the same in MY 2000-2001 and under the Farm Security and Rural Investment Act of 2002 (the “2002 FSRI Act”)<sup>14</sup> as it was in MY 1999. New Zealand considers that these payments should continue to be treated as non-“green box” support to upland cotton and must therefore be used in calculating the total quantity of support granted to upland cotton in MY 1999-2002.

# **2. Marketing loss payments, counter-cyclical payments and crop insurance payments**

2.12 The United States has notified crop insurance payments and marketing loss assistance payments as “amber box” domestic support.<sup>15</sup> Brazil notes that the 2002 FSRI Act institutionalised marketing loss assistance payments with a new program of “counter-cyclical” payments (“CCP”).<sup>16</sup>

2.13 New Zealand notes that Brazil argues that CCP subsidies do not meet the criteria set out in *Agreement on Agriculture* Annex 2, specifically paragraphs 6(b) and (c), and fail to meet the fundamental requirement that “green box” measures “have no, or at most minimal, trade-distorting effects or effects on production”.

2.14 Brazil argues that the CCP programme is not a “green box” measure because payments are not based on prices of upland cotton that took place in a prior base period but are linked to present prices for the product concerned, contrary to the requirements of Annex 2 paragraph 6(c).<sup>17</sup>

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<sup>12</sup> Preambular paragraph 3 of the *Agreement on Agriculture*.

<sup>13</sup> G/AG/N/USA/43, Exhibit BRA-47.

<sup>14</sup> Exhibit BRA-29.

<sup>15</sup> G/AG/N/USA/43 page 37. Exhibit BRA-47.

<sup>16</sup> First Written Submission of Brazil, para 62.

<sup>17</sup> *Ibid*, para 197.

2.15 Paragraph 6(c) of Annex 2 makes it clear that the amount of decoupled income support payments “shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.” As Brazil notes, the amount of the payment under the CCP programme varies with fluctuations in the national average market price, that is, it is linked to a current price. Accordingly, in New Zealand’s view this is sufficient to support a finding by the Panel that the CCP programme involves payments that are not “green box” support measures in accordance with Annex 2 of the *Agreement on Agriculture* and must therefore be used in calculating the total quantity of domestic support granted to upland cotton for MY 2002. Indeed, the United States endorses this approach.<sup>18</sup>

2.16 New Zealand notes, however, that the United States has argued that the term “support to a specific commodity” used in Article 13(b)(ii) should be interpreted to mean “product-specific support”.<sup>19</sup> On this basis the United States argues that the CCP programme and crop insurance programme should be excluded from the scope of support granted to upland cotton for the purposes of Article 13(b)(ii).<sup>20</sup>

2.17 While New Zealand notes that the United States has notified marketing loss assistance and crop insurance (and presumably will notify CCP payments) as non-product specific domestic support,<sup>21</sup> it is clear from discussion in the WTO Committee on Agriculture that Members, including New Zealand, have questioned whether that is appropriate.<sup>22</sup>

2.18 The United States asserts that CCP payments are non-product specific because they are not coupled to current production of any specific commodity but rather are based on historical fixed base acreage and yields.<sup>23</sup> However in New Zealand’s view Brazil has brought forward significant evidence of a strong linkage between the CCP payments and production of upland cotton, such that farmers with upland cotton base acreage are likely to continue to produce upland cotton.

2.19 In particular Brazil points out that most cotton farmers have made considerable investments in cotton-specific equipment, or farm in locations where cotton is the most productive crop, and are therefore more likely to continue to produce cotton.<sup>24</sup> The linkage between the receipt of CCP payments and production of cotton is further reinforced by the CCP payments being explicitly calculated on the basis of current cotton prices.

2.20 Brazil also points out that CCP payments create incentives for farmers with upland cotton base acreage to maintain upland cotton production.<sup>25</sup> In fact under the CCP programme the only way a farmer can guarantee a particular outcome is to continue to grow the same crop, otherwise the farmer runs the risk of missing out. For example, if he or she chooses to produce wheat and cotton prices are high enough that no CCP payment is made but wheat prices fall, the farmer will make a loss they would not have made had they stayed with cotton production.

2.21 Irrespective of whether or not these payments are notified as product-specific or not, they must still be considered “support granted to a specific commodity” for the purposes of Article 13(b)(ii). There is no foundation for the assertion by the United States that “support granted to a specific commodity” should be read as meaning “product-specific support”. Given the detailed listing

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<sup>18</sup> First Written Submission of the United States, para 118.

<sup>19</sup> *Ibid*, para 78.

<sup>20</sup> *Ibid*, para 122.

<sup>21</sup> G/AG/N/USA/43, Exhibit BRA-47.

<sup>22</sup> See for example, G/AG/R/34 ‘Summary report of the meeting held on 27 March 2003’ at page 32.

<sup>23</sup> First Written Submission of the United States, para 115.

<sup>24</sup> First Written Submission of Brazil, para 207.

<sup>25</sup> *Ibid*, para 211.

of domestic support measures potentially exempt in the chapeau to Article 13(b)(ii) itself, had Members intended to exclude non-product specific support they would surely have said so. Further, had they meant that “support granted to a specific commodity” was to be read as “product specific” support they would have said so – the phrase was used at least five times elsewhere in the *Agreement*.

2.22 Rather, the reference to support to a “specific commodity” in Article 13(b)(ii) was used to distinguish the nature of the “peace clause” from the domestic support commitments more generally which are on a “Total” (i.e. over all agriculture) Aggregate Measurement of Support (“AMS”) basis. Only if support increases for a particular product can it be open to challenge under the *SCM Agreement*. Without such clarification “peace clause” protection could potentially be lost for any agricultural product if Total AMS increases, even though support to that specific product had not increased. This would have unpredictable results for individual products and cannot have been the intended effect of the “peace clause”.

2.23 Nothing in Article 6 suggests that treating product-specific and non-product specific support separately under Article 13 is warranted. New Zealand sees no basis on which to suggest that support to a specific commodity should be excluded simply because other commodities may receive similar support. Support provided through generally available programmes (which, New Zealand notes, the marketing loss assistance programme and now the CCP programme are not) is still support received for the individual products. Taking the United States argument to its logical extreme would effectively render all agricultural support non-product specific so long as the same kind of support was being provided to more than one product.

2.24 Accordingly, New Zealand considers that the United States incorrectly categorises CCP payments as non-product specific support. But whether they are product-specific or non-product specific is, in fact, irrelevant for the purposes of Article 13(b)(ii) as there is no basis upon which to read such a limitation on the kinds of domestic support to be considered within the meaning of that provision. Instead, the portion of any non-product specific support granted to a specific commodity, in this case to upland cotton, must be included in the comparative analysis required by Article 13(b)(ii). In this respect New Zealand notes that what Brazil is proposing is no more than what the United States has done in relation to export credits in its First Written Submission where it has allocated export credit administrative costs to the specific product of upland cotton.<sup>26</sup>

2.25 The same arguments can be made with respect to the payments under the crop insurance programmes.

### **3. Production Flexibility Contract Payments, Direct Payments**

2.26 In New Zealand’s view one important aspect of the “Direct Payments” (“DP”) programme rules out inclusion of those payments in the “green box”, specifically the ability of farmers to update the base acreage used for calculation of DP payments.<sup>27</sup> As outlined by Brazil, the DP programme is the successor to the Production Flexibility Contract Payments (“PFC”) programme and to permit an updating of the ‘fixed’ base period by changing the name of the PFC programme to a DP program would render the provisions of paragraph 6(a) and (b) of *Agreement on Agriculture Annex 2* a nullity.<sup>28</sup>

2.27 The option for farmers to update base acreage under the 2002 FSRI Act directly violates the requirement under Annex 2 paragraph 6 that decoupled income support be determined in relation to a

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<sup>26</sup> First Written Submission of the United States, para 175.

<sup>27</sup> First Written Submission of Brazil, para 52; Exhibit BRA-35.

<sup>28</sup> *Ibid*, para 182.

“defined and fixed base period”. New Zealand agrees with Brazil’s interpretation that paragraph 6(a) and (b) contemplates only one base period that is fixed and unchanging.

2.28 As Brazil points out, permitting the updating of the base period to capture additional payment acreage (as one third of all United States farms with eligible acreage opted to do)<sup>29</sup> would link increased recent volumes of production with the amount of current payments.<sup>30</sup> Brazil is also correct to state that this is contrary to the object and purpose of “de-coupled income support”, which is to break the link between production and the amount of support and thereby ensure that such measures “have no, or at most minimal” effects on production. As the evidence brought forward by Brazil shows, an expectation of being able to update base acreage and payment yields influences production in a number of ways,<sup>31</sup> particularly as, having had one opportunity to update their base acreage, farmers could reasonably expect further opportunities to do so in the future.

2.29 In New Zealand’s view the updating of base acreage for the DP programme alone is sufficient to exclude it from the scope of permitted “green box” measures as set out in Annex 2. Instead such payments are “amber box” measures that, in accordance with Article 6 of the *Agreement on Agriculture*, are domestic support to upland cotton in MY 2002.

2.30 Brazil has also argued that the PFC and DP programmes have more than a minimal effect on production and trade and therefore fail to meet the “fundamental requirement” of “green box” domestic support measures.

2.31 New Zealand agrees with Brazil’s interpretation that the “fundamental requirement” that “green box” domestic support measures “have no, or at most minimal, trade-distorting effects or effects on production” means that the quantity or level of production or trade distorting effects need only be very small to trigger denial of “green box” status under Annex 2 of the *Agreement on Agriculture*.<sup>32</sup> The language of paragraph 1 of Annex 2 makes it clear that this fundamental requirement and the other criteria set out in Annex 2 are to be strictly applied to any measures in order to obtain exemption from reduction commitments.

2.32 The trade-distorting effects or effects on production of any domestic support measure must be determined on a case-by-case basis, looking at the specific circumstances and characteristics of each particular measure. Brazil has provided comprehensive information regarding the effects of the PFC and DP programmes to enable the Panel to determine whether those payments have even very minimal production or trade distorting effects and thus fail to meet the “fundamental requirement” for “green box” measures as provided in *Agreement on Agriculture* Annex 2.

2.33 New Zealand notes that the United States provides no response to any of Brazil’s arguments regarding the PFC/DP programme and the level of production distortion it causes other than to claim that changing the name of the programme indemnifies it from consideration. Accordingly Brazil’s arguments should stand.

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<sup>29</sup> *Ibid*, para 181.

<sup>30</sup> *Ibid*, para 179.

<sup>31</sup> *Ibid*, paras 185 – 190.

<sup>32</sup> *Ibid*, para 165.



### III. PROHIBITED EXPORT SUBSIDIES

#### A. THE UNITED STATES HAS NO “PEACE CLAUSE” PROTECTION AGAINST PROHIBITED AND ACTIONABLE SUBSIDY CLAIMS RELATED TO EXPORT SUBSIDIES

3.01 New Zealand supports the arguments made by Brazil that the three types of export subsidies applied to upland cotton and other commodities by the United States (the Step 2 Export Programme, the Export Credit Guarantee Programme, and the FSC Replacement Programme) violate Articles 3.3, 8 and 10.1 of the *Agreement on Agriculture* and therefore fail to meet the requirement of conformity with Part V of the *Agreement*, with the result that such subsidies are not exempt from claims by Brazil based on Article XVI of *GATT 1994* or Articles 3, 5 and 6 of the *SCM Agreement*.

#### B. THE UNITED STATES EXPORT SUBSIDIES VIOLATE THE AGREEMENT ON AGRICULTURE AND THE SCM AGREEMENT

##### 1. Step 2 Export Payments

(a) Per se violation of Articles 3.3 and 8 of the *Agreement on Agriculture*

3.02 As outlined by Brazil,<sup>33</sup> Step 2 export payments clearly fall within the description of an export subsidy set out in Article 9.1(a) of the *Agreement on Agriculture* in that it is a direct subsidy provided by the United States government to exporters of upland cotton contingent upon export.

3.03 Even if the Panel were to find that Step 2 export payments did not fall within the description set out in Article 9.1(a) of the *Agreement on Agriculture*, the Appellate Body has determined, as Brazil notes, that the effect of Article 10.1 is that a Member can only provide export subsidies in conformity with the *Agreement on Agriculture* if it has scheduled export subsidy reduction commitment levels for the agricultural product concerned.<sup>34</sup> The use of any other type of export subsidy will “at the very least” threaten circumvention of subsidy reduction commitments within the meaning of Article 10.1.

3.04 Accordingly New Zealand agrees with Brazil that the Step 2 export payments violate *per se* Articles 3.3 and 8 of the *Agreement on Agriculture*

3.05 New Zealand notes that the United States has argued that Step 2 export payments are not export subsidies as defined by Article 9.1(a) and 10 of the *Agreement on Agriculture* (and Article 3.1(a) of the *SCM Agreement*) because the Step 2 payments are available to domestic users as well as exporters of upland cotton.<sup>35</sup> As the Appellate Body in *US-FSC Recourse to Article 21.5*<sup>36</sup> recognised, the fact that a scheme allows for payments to be made otherwise than contingently on export does not diminish the export contingency of those that are.

3.06 In *US-FSC Recourse to Article 21.5* the United States argued that a measure that provided tax exclusion for exported products, but also allowed tax exclusion to be obtained without exportation, could not be considered to be ‘contingent upon export performance’. The Appellate Body disagreed.

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<sup>33</sup> *Ibid*, paras 238-243.

<sup>34</sup> Report of the Appellate Body, *United States – Tax Treatment for “Foreign Sales Corporations”*, WT/DS108/AB/R (“*US-FSC*”), para 150-152; First Written Submission of Brazil, para 237.

<sup>35</sup> First Written Submission of the United States, para 132.

<sup>36</sup> Report of the Appellate Body, *United States – Tax Treatment for “Foreign Sales Corporations” Recourse to Article 21.5 of the Dispute Settlement Understanding by the European Communities*, WT/DS108/AB/RW (“*US-FSC Recourse to Article 21.5*”).

3.07 The Appellate Body said that the measure “contemplates two different factual situations”; where property is produced within the United States and held for use outside the United States, and where property is produced outside the United States and held for use outside the United States. The Appellate Body said that “the fact that the subsidies granted in the second set of circumstances might not be export contingent does not dissolve the export contingency arising in the first set of circumstances”.<sup>37</sup>

3.08 New Zealand considers that the fact that payments are also able to be made to domestic users of upland cotton does not ‘dissolve’ the export contingency of the payments that are made to exporters. Payments to eligible exporters of upland cotton are dependent on proof of export being provided and are therefore contingent on export performance.

3.09 Accordingly Step 2 export payments breach the obligation of the United States under Article 3.3 not to provide such subsidies in respect of any agricultural product that it has not specified in Section II of Part IV of its Schedule and therefore violates *per se* the undertaking by the United States in Article 8 not to provide export subsidies otherwise than in conformity with the *Agreement on Agriculture*.

(b) Violation of Article 3.1(a) and 3.2 of the *SCM Agreement*

3.10 New Zealand supports Brazil’s conclusion that the Step 2 export payments meet the requirements of a subsidy under Article 1.1(a)(1)(i) and Article 1.1(a)(2) of the *SCM Agreement* and are contingent upon export within the meaning of Article 3.1(a) of the *SCM Agreement*.

3.11 Accordingly if the Panel finds, as New Zealand believes it should, that Step 2 export payments constitute *per se* prohibited subsidies under Article 3.1(a) and 3.2 of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the programme without delay. New Zealand therefore supports Brazil’s request that the Panel expressly make such a recommendation.

## 2. Export Credit Guarantee Programme

(a) Violation of Articles 8 and 10.1 of the *Agreement on Agriculture*

3.12 New Zealand supports Brazil’s arguments that the export credit guarantee programme provides export subsidies that can lead to, or threaten to lead to, circumvention of export subsidy commitments under Article 10.1. As established by the Appellate Body in *US-FSC*,<sup>38</sup> Article 10.1 of the *Agreement on Agriculture* is violated where an export subsidy is available for unscheduled agricultural products for which no reduction commitments have been made, as, “at the very least”, this threatens to lead to circumvention of export subsidy commitments.

3.13 It is evident that Members considered that export credit programmes could provide export subsidies through the specific reference to such programmes in *Agreement on Agriculture* Article 10.2. While not all government export credit programmes necessarily provide export subsidies, it is clear that the United States programme does so in both of the ways demonstrated by Brazil (ie because it clearly falls within Item j of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*<sup>39</sup> or is otherwise an export subsidy as defined in Articles 1.1 and 3.1(a) of the

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<sup>37</sup> *Ibid*, para 119.

<sup>38</sup> Report of the Appellate Body, *US-FSC*, para 150-152.

<sup>39</sup> First Written Submission of Brazil, paras 272-286.

*SCM Agreement*)<sup>40</sup> The export credit scheme is therefore a subsidy contingent on export in the context of Article 10.1 of the *Agreement on Agriculture*.

3.14 New Zealand notes that the United States has argued that “the plain words of Article 10.2 (of the *Agreement on Agriculture*) indicate that the export credit guarantee programs are not subject in any way to the export subsidy disciplines of that *Agreement*.”<sup>41</sup> New Zealand disagrees with this assertion. The heading of Article 10 is ‘Prevention of circumvention of export subsidy commitments’ and the inclusion of reference to export credits under that Article clearly reflects Members’ concern that export credits can provide export subsidies.

3.15 Nor does Article 10.2 in any way suggest that it provides an exception from the disciplines of Article 10.1. New Zealand agrees with the United States that Article 10.2 does not say “in addition to the export subsidy commitments” of the *Agreement*.<sup>42</sup> That is because it did not have to, coming as it does directly after the general prohibition against circumvention in Article 10.1. While Article 10.1 currently provides the only discipline on the use of export credits, it is expected that the work envisaged in Article 10.2 will elaborate further and more specific disciplines that will presumably make identification of the extent to which such export credit programmes constitute export subsidies more straightforward. However it is incorrect to assume that there is a vacuum in the meantime. Item j of the Illustrative List of the *SCM Agreement* clearly already provides guidance on when export credit guarantee or insurance programmes are to be considered to be ‘export subsidies’ and beyond this the general definition in Articles 1.1 and 3.1(a) of the *SCM Agreement* also applies. While the provisions of Item j do not apply to agricultural products *mutatis mutandis* there is no reason to believe that the guidance there and elsewhere in the *SCM Agreement* is not appropriate for analyses under the *Agreement on Agriculture*.

3.16 Nor should the application of the disciplines in the *Agreement on Agriculture* in the meantime obviate the need for continued negotiations as envisaged by Article 10.2, as New Zealand hopes that those negotiations will result in clearer and more specific rules. Indeed it may even be that the result of the negotiations is that an export credit programme that is considered to be an export subsidy under the current, more generally applicable rules, will be deemed not to be an export subsidy in the future. However in that respect New Zealand notes, for example, that the United States Intermediate Export Credit Guarantee Program (GSM-103) provides for a repayment term of between 3 and 10 years<sup>43</sup>, terms clearly well outside the scope of disciplines to govern the use of export credit guarantee programmes currently being considered in the negotiations.

(b) Violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*

3.17 As export credits are not in conformity with Part V of the *Agreement on Agriculture* and thus do not benefit from protection under the “peace clause”, they can equally be examined under the *SCM Agreement*. If the Panel finds, as New Zealand believes it should, that export credit guarantee payments are prohibited subsidies under Article 3.1(a) of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the payments without delay. New Zealand therefore supports Brazil’s request that the Panel expressly make such a recommendation.

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<sup>40</sup> *Ibid*, paras 287-293.

<sup>41</sup> First Written Submission of the United States, para 164.

<sup>42</sup> *Ibid*.

<sup>43</sup> *Ibid*, para 151.

### 3. FSC Replacement Measure

3.18 New Zealand supports the claims made by Brazil,<sup>44</sup> based on the findings already made by the Appellate Body in *US-FSC Recourse to Article 21.5*, that the tax cuts under the FSC Repeal and Extraterritorial Income Act of 2000 threaten to circumvent United States export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture* and therefore cannot be exempt from actions under the *SCM Agreement* under Article 13(c)(ii) of the *Agreement on Agriculture*. In addition the Appellate Body found that there was a prohibited subsidy under Article 3.1(a) of the *SCM Agreement*.

3.19 Accordingly if the Panel finds, as New Zealand believes it should, that the tax cuts under the FSC Repeal and Extraterritorial Income Act of 2000 are prohibited subsidies under Article 3.1(a) of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the subsidies without delay. New Zealand therefore supports Brazil's request that the Panel expressly make such a recommendation.

## IV. PROHIBITED SUBSIDIES

### A. STEP 2 DOMESTIC PAYMENTS VIOLATE THE SCM AGREEMENT AND GATT ARTICLE III:4

4.01 New Zealand supports Brazil's argument that the "peace clause" provides no immunity for "amber box" subsidies from prohibited subsidy claims under Article 3.1(b) of the *SCM Agreement*.<sup>45</sup> New Zealand believes that Brazil has demonstrated that Step 2 domestic payments are a prohibited subsidy under Article 3.1(b) in that the payments are contingent on the use of domestic over imported upland cotton. On that basis they also violate Article III.4 of *GATT 1994*.

4.02 Accordingly if the Panel finds, as New Zealand believes it should, that Step 2 domestic payments violate per se Article 3.2 of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the payments without delay. New Zealand therefore supports Brazil's request that the Panel expressly make such a recommendation.

## V. UNITED STATES REQUEST FOR A PRELIMINARY RULING ON CERTAIN MATTERS

5.01 New Zealand rejects the arguments of the United States that measures no longer in effect are not within the Panel's terms of reference.<sup>46</sup> Such measures should be within the scope of the Panel's consideration, particularly when the programmes in question have effectively only been renamed and in fact continue in a slightly different form. In addition, the nature of serious prejudice claims may necessitate consideration of data beyond a single year and may in fact require a Panel to consider trends over a number of years. Accordingly New Zealand rejects the United States claim that market loss assistance payments and PFC payments should be excluded from the Panel's consideration of Brazil's claims.

5.02 New Zealand also considers that the Panel should reject the United States request that that Panel rule that export credit guarantee measures relating to eligible United States agricultural commodities (other than upland cotton) are not within its terms of reference.<sup>47</sup> While New Zealand did not participate in the consultations, in New Zealand's view Brazil had little choice but to look at a broader commodity coverage in relation to export credits because the information specific to upland

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<sup>44</sup> First Written Submission of Brazil, paras 315-330.

<sup>45</sup> First Written Submission of Brazil, para 332.

<sup>46</sup> First Written Submission of the United States, paras 207-211.

<sup>47</sup> *Ibid*, paras 191-206.

cotton alone was not available. To prevent Brazil from doing so would unjustly allow a lack of transparency to preclude scrutiny of measures by Members taking disputes, especially where the information at a higher level of aggregation showed there was clearly a case to answer in respect of a particular measure, in this instance export credits. While more time is needed to analyse the information brought forward by the United States (which does not appear to be sourced from publicly available documents), at this stage of the Panel's consideration of Brazil's claims, New Zealand considers that the Panel should not make the ruling requested by the United States.

## **VI. CONCLUSION**

6.01 In conclusion, New Zealand believes that Brazil had demonstrated that the "peace clause" has not been respected in relation to domestic support and export subsidies provided by the United States to upland cotton in the marketing years 1999, 2000, 2001 and 2002, and that accordingly Brazil is entitled to bring actionable and prohibited subsidy claims against the United States under the *GATT 1994* and the *SCM Agreement*. New Zealand looks forward to the next phase of the case which will examine Brazil's claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*.

## **ANNEX B-10**

### **THIRD PARTY SUBMISSION BY PARAGUAY**

#### **INTRODUCTION**

1. Paraguay is grateful for the opportunity to express its views on the matter at issue in this dispute.

2. Because Paraguay is a firm believer in a fair system of international trade, it feels that it should explain its position on this issue which is of particular interest to its economy.

#### **Applicable rules**

3. In the Marrakesh Ministerial Declaration of April 1994 itself, Ministers affirmed that the establishment of the WTO ushered in a new era of global economic cooperation, reflecting the widespread desire to operate in a fairer and more open multilateral trading system for the benefit and welfare of their peoples, and expressed their determination to resist protectionist pressures of all kinds as well as their belief that the strengthened rules achieved in the Uruguay Round would lead to a progressively more open world trading environment.

4. Moreover, in October 2002, on the occasion of the meeting of the International Cotton Advisory Committee, governments observed the critical situation that the world cotton industry was going through and its link to subsidies, suggesting the establishment of a schedule for the elimination of measures that distorted world production and trade in cotton, and stressing the need to submit complaints before the WTO for violation of the applicable rules.

5. Paraguay considers that the subsidies and support granted by the United States to its cotton production are inconsistent with the Agreement on Subsidies and Countervailing Measures, the Agreement on Agriculture and the rules and principles of the GATT 1994, and that for the purposes of this dispute it is therefore essential to take account of WTO legislation, which was carefully drafted to avoid causing distortions in international trade and prejudice to developing countries such as Paraguay.

6. WTO jurisprudence and the principles of interpretation of international law applied to the various cases suggests that the applicable rules should be read cumulatively, taking account of all elements applied to the case in order to support the system as an integrated whole.

7. Paraguay considers Brazil's complaint and the legal justifications invoked with respect to the inconsistency of the United States' laws, regulations and administrative procedures with the applicable WTO rules to be fully consistent with the law.

#### **PEACE CLAUSE**

8. With respect to the applicability of Article 13(b)(ii) concerning domestic support measures that conform fully to the provisions of Article 6 of the Agreement including direct payments that conform to the requirements to paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, Paraguay considers they shall be exempt from actions based on paragraph 1 of Article XVI of GATT

1994 or Articles 5 and 6 of Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

9. This implies that it is not limited or confined to specific products. Thus, it can be concluded that the United States does not enjoy protection from actions relating to subsidies using 1999, 2001 and 2002 as a basis, as Brazil duly proved.

10. In interpreting the Peace Clause, account must be taken of the serious prejudice that Member economies could suffer, and an assessment made of the overall significance of all of the agreements relating to the case.

11. Paraguay does not grant subsidies, either under the Subsidies Agreement or under the Agreement on Agriculture. Paraguay did notify the Committee on Agriculture, on 22 July 2002, of its domestic support commitments for 2000 and 2001 (G/AG/N/PRY/10, supporting table DS.1 and related supporting tables) as required under the Agreement on Agriculture and the Agreement on Subsidies and Countervailing Measures.

12. Consequently, as long as discriminatory support not provided for under WTO Agreement on Agriculture or the WTO Agreement on Subsidies on Countervailing Measures continues to be granted, Paraguay will have no choice but to file complaints with the relevant bodies.

#### **Inconsistency with the Agreement on Agriculture**

13. The Step 2 programme introduced by the United States to stimulate exports and the competitiveness of its products on the international market is inconsistent with Articles 3.3 and 8 of the Agreement on Agriculture.

14. Article 3 of the Agreement on Agriculture refers to the incorporation of concessions and commitments. Paragraph 3 thereof stipulates that:

*Subject to the provisions of paragraphs 2(b) and 4 of Article 9 of this Agreement, a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule.*

15. The above paragraph enables Members to provide the subsidies listed in Article 9.1 of the Agreement on Agriculture subject to fulfilment of the commitments assumed.

16. Similarly, Article 8 of the said Agreement regulates export competition commitments, stipulating that:

*Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and the commitments as specified in that Member's Schedule.*

17. For the above reasons, and because it does not consider the provisions of the Agreement on Agriculture to have been complied with, Paraguay believes that the export subsidies granted by the United States to its cotton industry are inconsistent with Articles 3.3, 8 and 9.1 of the Agreement on Agriculture.

### **Inconsistency with the Agreement on Subsidies and Countervailing Measures**

18. The agricultural subsidies cause "serious prejudice" to the domestic industry of other Members under Articles 5 and 6 of the Agreement on Subsidies and Countervailing Measures.

19. The introductory paragraph of part III, Article 5 of the said Agreement provides that no Member should cause, through the use of any subsidy – specific and not exempted under the Agreement – adverse effects to the interests of other Members, more specifically, as categorically stated in the indents that follow, (a) injury to the domestic industry of another Member and (c) serious prejudice to the interests of another Member.

20. Article 6 specifically refers to cases in which "serious prejudice" is deemed to exist in the sense of paragraph (c) of Article 5.

### **Effects of agricultural subsidies**

21. Agricultural subsidies have effects on world trade, and measures such as those applied by the United States have a significant impact on developing countries like Paraguay.

22. Indeed, Paraguay is all the more affected by the said measures in that it is precisely cotton production that provides sustenance for the most needy segments of the population.

23. Paraguay has a total population of approximately 5,300,000, of which more than 500,000 are linked to cotton production. If we add the related industries and activities, the figure reaches an estimated 1,500,000, or approximately 30 per cent of the country's total population.

24. Any slump in the cotton trade causes an exodus of rural population towards the urban areas which do not offer any relief or solution, and this further undermines the economic situation of a country that depends on its agriculture.

25. As regards exports, in 1991, the foreign exchange revenue generated by sales of cotton and byproducts thereof reached US\$318,912,000, approximately 43 per cent of the total for the country's exports that year. At the time, a total of 299,259 farms, 190,000 were cultivating cotton.

26. By 2001, the figures had changed considerably. Export revenue had fallen to US\$90,505,000, a 72 per cent drop in the value of exports. The number of farms producing cotton decreased to about 90,000, representing a 52 per cent decrease in farms, employment and small farmer income. In other words, the impoverishment was real.

27. Regarding international cotton fibre prices, in 1991, the price per ton of Paraguayan type fibre was quoted on the New York Exchange at US\$1,624, while in 2001, it was quoted at US\$934.

28. In Paraguay, some 60 per cent of cotton is produced on farms of less than 10 hectares, making it the main or only source of income for small farmers and the main source of employment for the rural workforce in the most disadvantaged segment of society where access to capital and technology is more restricted and the leading socio-economic welfare indicators are lower than anywhere else.

### **CONCLUSION**

29. Paraguay is a small economy. It is a land-locked country that has no oil, gas, gold or other natural resources of a kind that could make it of particular interest to the developed countries. The Paraguayan economy is essentially based on agricultural production, including the production and sale of cotton.



30. Paraguay therefore considers that the measures adopted by the United States cause serious prejudice to world trade, affecting Paraguay in particular, and that the necessary steps should be taken to eliminate the adverse effects and seek to achieve a balance in world trade.

31. Paraguay respectfully requests the Panel to conclude that the measure applied by the United States is inconsistent with its WTO obligations under the various provisions of the Agreement on Agriculture, the GATT 1994 and the Agreement on Subsidies and Countervailing Measures.

## **ANNEX B-11**

### **THIRD PARTY SUBMISSION OF THE SEPARATE CUSTOMS TERRITORY OF TAIWAN, PENGHU, KINMEN AND MATSU.**

15 July 2003

1. In its fax of 28 May 2003 to the parties to this dispute, the Panel poses questions regarding the correct interpretation of Article 13 of the Agreement on Agriculture and the on the issue of preliminary rulings. As the Panel's questions raise an important point of law and the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu has a systemic interest in the proper interpretation and operation of these and other relevant provisions involved in the procedures, we would like to submit our views on the following aspects:

#### **I. THE BURDEN OF PROOF REQUIRED BY ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE (THE "PEACE CLAUSE"), AND**

#### **II. THE QUESTION OF PRELIMINARY RULINGS.**

##### **I. BURDEN OF PROOF IN THE "PEACE CLAUSE"**

2. In attempting to arrive at a proper interpretation of the burden of proof as provided in Article 13 of the Agreement on Agriculture, we suggest comparing different types of exemptions, defences, or carving-out under different agreements.

3. It could happen that a matter is brought under an agreement not covered by the DSU. Since Article 1 of the DSU provides that the DSU shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to the DSU and the WTO Agreement, it follows that consultation or dispute arising from or in connection with any non-covered agreement would not be within the scope of the dispute settlement procedures under the DSU. Thus, if a Member brings a complaint alleging a breach of certain international environmental treaties, for example, the complaining party would bear the burden to prove that the issue in dispute falls within the purview of the DSB.

4. It could also be that a matter is specifically excluded from the dispute settlement procedures by certain relevant agreements. A typical example of this would be the provision in Article 6 of the TRIPS agreement, which provides that "for the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights". It is apparent that as long as it is an "issue of the exhaustion of intellectual property rights," the dispute settlement procedure shall not be used. There is no threshold or prerequisite for applying such provision. The Member applying this provision would be able to prevent such dispute settlement procedures unless the complaining party asserts and proves that the measure concerned is not such an "exhaustion issue".

5. It could also happen that exceptions or exemptions are granted under relevant agreements providing specific obligations. There are different ways of providing exceptions for specific activities or measures. Examples include paragraph 2 of Article XI of the GATT stating "...shall not extend to the following"; Articles XX and XXI of the GATT stating "nothing in this Agreement shall be

construed to..." These are in the nature of an affirmative defence. Here, the burden of proof rests on the party invoking the exception.

6. It is clear that Article 13 of the Agreement on Agriculture is not a "matter under an agreement not covered under the DSU". Neither is it a matter specifically excluded from the dispute settlement procedures as provided in Article 6 of the TRIPS Agreement. It is also not typical of the type of exception as contained in Articles XI, XX or XXI of the GATT. In our view, Article 13 falls between the type of exception in Article 6 of the TRIPS and that in Article XI, XX or XXI of the GATT. Thus the procedures for applying the provision should be interpreted differently.

7. In its First Written Submission, Brazil asserted that, "Article 13 is in the nature of an affirmative defense, because it provides an exception to a legal regime otherwise applying to agricultural support measures. It does not alter the scope of other provisions providing positive obligations on Members, and is not itself a positive obligation" and as a consequence, in this proceeding the United States has the burden of proof on the question of whether its subsidies "are in conformity with the AOA Article 13"<sup>1</sup>.

8. In our view, the very nature of Article 13 is such that it is not appropriate for any particular description or "label" such as an "affirmative defence", or "exception", to be ascribed to it, simply for the convenience of resolving the question of burden of proof.<sup>2</sup> We consider that Article 13 in itself contains both rights and obligations of Members. The right conferred by Article 13, i.e. entitlement to "exempt from actions" is conditional; conditional upon a positive obligation of full conformity to the requirements as set out in the relevant provisions of the Agreement on Agriculture. We agree with the view put forward by the United States at paragraph 43 of its First Written Submission which purports to identify such positive obligations. If the contention that Article 13 confers a right as well as imposes a positive obligation, is accepted, then, as a complainant, it is for Brazil to prove a breach of this positive obligation by demonstrating non-conformity rather than for the United States to bear the burden of proving conformity. We consider that the above contention is the only logical conclusion in giving effect to Article 13. Since there is no scheme for a Member under Article 13 to prevent the initiation and the establishment of a panel, suppose Article 13 is interpreted in such a way as to still require the United States to bear the burden of proving the conformity of relevant provisions of the Agreement of Agriculture, it would mean Article 13 having less than its originally intended effect.

9. In addition to the above, drafters' intent should be taken into account when interpreting this Article. Domestic support measures are expressly allowed under this Article with the intention of giving Members some flexibility on domestic support measures to help the progressive liberalization of their agriculture. Requiring the respondent to bear the burden to prove that the subsidy measure in question is consistent with this Agreement will, to a certain degree, offset the respondent's right to claim for the exceptions provided by this Provision, which is contrary to the drafters' intention.

10. To impose the burden of proof on the respondent has another negative implication. In the case before us, if Brazil's argument stands, it would render the words "exempt from actions" pointless as the result would inevitably be a full-blown dispute settlement proceeding with Brazil submitting evidence to substantiate its complaints and the US filing its defence by invoking Article 13 and submitting proof of conformity thereto.

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<sup>1</sup> Brazil first Written Submission, paragraph 23.

<sup>2</sup> In *EC-Hormones*, the Appellate Body is of the view that the particular description of "exception" did not discharge the burden of the complaining party in establishing a prima facie case. At para 104, the Appellate Body stated: the general rule in a dispute settlement proceeding requiring a complaining party to establish a prima facie case of inconsistency of a provision...before the burden of showing consistency with that provision is taken by the defending party is not avoided by simply describing the same provision as an exception."

## II. THE QUESTION OF PRELIMINARY RULINGS

11. Although on the evidence of past dispute settlement cases the normal practice of the Panel tends to be that it hears preliminary issues, provides indicative rulings and consolidates detailed reasoning only in the final Panel report, the questions associated with the correct interpretation of Article 13 are such that they merit the Panel's consideration and disposition at the earliest opportunity.

12. We consider that the preliminary issues raised in this dispute determine the manner in which the parties to this proceeding prepare their case. If the question of the correct interpretation of the words "exempt from actions" is not resolved along with the question of the allocation of burden of proof, considerable resources will be wasted both by complaining and defending claims. Needless to say, due process will not be properly served in such a case. Accordingly, we respectfully urge this Panel to adopt a special procedure to deal with this preliminary issue at the earliest opportunity so that parties to this dispute will not be prejudiced.<sup>3</sup>

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<sup>3</sup> This Panel may recall that the Appellant Body in *EC-Banana* indicated its opinion that "...this kind of issue could be decided early in panel proceedings, without causing prejudice and unfairness to any party or third party..." WT/DS27/AB/R, at para. 144.

## ANNEX C

### ORAL STATEMENTS OF PARTIES AND THIRD PARTIES AT THE FIRST SESSION OF THE FIRST SUBSTANTIVE MEETING

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## ANNEX C-1

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

#### I. INTRODUCTION

1. Brazil addresses first various peace clause issues, followed by Step 2 export and domestic payments, export credit guarantees and the ETI Act subsidies. Finally, Brazil addresses the “preliminary issues” raised by the United States.

#### II. PEACE CLAUSE ISSUES

##### **The Peace Clause is an Affirmative Defence**

2. The peace clause is in the nature of an affirmative defence and it is, thus, the US burden to prove that Brazil’s claims under the SCM Agreement are “exempt from actions”. An affirmative defence is a provision that does not set out any positive obligations but enables Members to maintain measures that are otherwise inconsistent with its WTO obligations. The peace clause does not in itself set out any positive obligations for Members, but simply provides a conditional shelter against certain actionable and prohibited export subsidy claims under the SCM Agreement. The peace clause meets the criteria set forth by the Appellate Body for an affirmative defence in *US – FSC* and in the *Aircraft* disputes, by being an exception to a legal regime otherwise applicable. Given the extraordinary protection it provides, it is not “bizarre”, as the United States argues, that the peace clause requires the defending Member to prove that its domestic and export subsidies meet the conditions for peace clause protection.

##### **“such measures do not grant support to a specific commodity”**

3. This phrase in AoA Article 13(b)(ii) means that in calculating the amount of support for any marketing year between 1995-2003, all non-“green box” support provided to a specific commodity must be tabulated, regardless of whether the *type* or *form* of the support is “product-specific”, “non-product specific”, *de minimis*, or “blue box”. This is certainly evidenced by the decision of negotiators *not* to use the phrases “product-specific” and “AMS” in Article 13(b)(ii) to qualify the type of support to a specific commodity. The US attempt to read “product-specific” into Article 13(b)(ii) is inconsistent not only with the text but also the context of the phrase “such measures” in Article 13(b)(ii). The US interpretation of “product-specific support” is further incompatible with the object and purpose of the Agreement on Agriculture. It would create a new category of non-actionable trade-distorting non-“green box” subsidies and sanction huge increases in spending for “amber box” and, therefore trade-distorting, domestic support as long as it took the form of support for *multiple* commodities. This is contrary to the presumption of trade and production-distorting effects for individual products from non-“green box” domestic support, which flows from a domestic measure being inconsistent with the “green box” requirements of AoA Annex 2.

**“that decided during the 1992 marketing year”**

4. This word “decided” does not require any particular *type* of “decision”. As a neutral term, the meaning of “decided” must be interpreted in a way that does justice to the ordinary meaning of other terms in Article 13(b)(ii) that are *not* neutral. Most importantly, the term “decided” must be interpreted in a manner that permits a comparison between a “*grant*” of non-“green box” “*support*” to a specific commodity for individual marketing years between 1995-2003, and a “decision” regarding such support in MY 1992. A textual interpretation reveals that the term “that” refers back to “support” and that support is accompanied by the term “granted”.

5. The Appellate Body agreed with the panel in *Brazil – Aircraft* that the phrase “the *level* of export subsidies *granted*” meant “something actually provided”, which means actual budgetary expenditures. Thus, the neutral term “decision” (for MY 1992) can only be read harmoniously with the term “grant support” (for MY 1995-2003) where the “decision” is to fund non-“green box” support to a specific commodity for marketing year 1992.

6. In addition, even if Article 13 would refer to a *level* of (income) support, as the United States alleges, the Appellate Body has held in *Brazil – Aircraft* that the “level” of export subsidies refers to actual expenditures.

7. The US interpretation of a “level of support” is furthermore inconsistent with its own interpretation of Article 13(b)(ii) in its Statement of Administrative Action (SAA). In the SAA, it stated that governments would have peace clause protection from adverse effects and serious prejudice challenges in the WTO “*unless the AMS for the particular commodity exceeds the level decided in the 1992 marketing year*”. Brazil strongly disagrees with the notion of “AMS” as the relevant standard for the peace clause, *but* this official US interpretation of the peace clause in 1995 is nevertheless compelling evidence of the United States view of the “decision” it had taken during MY 1992. The calculation of the AMS for a particular commodity requires the calculation of the support provided in monetary terms. AoA Annex 3 offers two options for the calculation of AMS: budgetary outlays or the price gap formula detailed on paragraphs 10 and 11. Under either option, the AMS represents a measurement of support in monetary terms.

8. In sum, Brazil is of the firm view that the text of Article 13(b)(ii) requires comparing MY 1992 support with MY 1995-2003 support by comparing actual expenditures. This methodology produces an ‘amount’ of support – not a “rate”. Thus, any decision under Article 13(b)(ii), by definition, must relate in some way to an “amount” of expenditures. Only this methodology allows a clear comparison between the two time periods, regardless of the *type* of support.

9. However, even if the Panel were to decide that the relevant standard is a “rate of support” standard, Brazil has provided the testimony of Professor Daniel Sumner indicating that – following the US approach to measuring “support to upland cotton” – the “rate of support” to upland cotton in MY 1999-2002 was much higher than the “rate of support” to upland cotton in MY 1992. Based on the evidence and analysis presented by Professor Sumner, Brazil also asserts that even under the US “rate of support” methodology, the United States has failed to demonstrate that its MY 1999-2002 support does not exceed its support to upland cotton decided in MY 1992.

**US “statute of limitations” interpretation of the peace clause**

10. There is no express or implied “statute of limitations” in the peace clause. Subsidizing Members such as the United States are offered conditional protection under the peace clause during a 9-year period. But the rights of Members injured by subsidies provided in excess of 1992 marketing year levels are preserved throughout the implementation period as well. This is the balance struck by the peace clause.

11. The US “statute of limitations” argument in this case is very similar to one rejected by the Appellate Body in *US – Lead Bars*. This argument is further inconsistent with the views of the *Indonesia – Automobiles* panel, which held that measures applied in the past must be examined to assess present serious prejudice. The US interpretation would cut off a Member’s right to challenge such measures because it missed an imaginary deadline. This US interpretation is inconsistent with the object and purpose of the AoA because it would permit Members to provide huge “non-green” box support one year without peace clause protection, and then claim absolution as soon as the next marketing year began.

### **“Support to Upland Cotton”**

12. Brazil has produced extensive evidence providing the factual basis for the Panel to find that CCP, DP, market loss, and PFC payments are “support to” upland cotton within the meaning of the peace clause. USDA categorizes the PFC and market loss payments as part of “total payments” to upland cotton. US National Cotton Council officials repeatedly testified and produced documents revealing that their producer members requested, received, and depended on all four of these subsidies. Crop insurance is also support to cotton as evidenced by specific upland cotton crop insurance policies and groups of policies for upland cotton. Moreover, USDA specifically identifies and tabulates crop insurance subsidies for upland cotton. In addition, all five domestic support measures fail to meet the requirements of AoA Annex 2. Therefore, they constitute non-“green box” support that is presumed to be production and trade distorting. Such distortions can, however, only occur with respect to the production of or the trade in a particular commodity. Because, PFC, market loss assistance, direct and counter-cyclical payments as well as crop insurance subsidies are available to producers of upland cotton, these production and trade-distorting subsidies affect the production of and trade in upland cotton. The Panel should, therefore, find that all five of these programmes granted support to upland cotton in MY 1999-2002.

### **Restrictions on Plantings of Fruits and Vegetables under the PFC and DP Programmes**

13. Brazil presents evidence that PFC and direct payments are not “decoupled” domestic support. These payments are dependent on the requirement that a farmer does not produce fruits, vegetables, nuts or wild rice on the contract acreage. This restriction has the effect of channelling production on contract acreage into production of programme crops, including upland cotton, and is of particular importance for upland cotton base acreage located in regions of the United States where production of fruits and vegetables is a viable alternative to the production of upland cotton.

## **III. STEP 2 EXPORT AND DOMESTIC PAYMENTS**

14. The US Step 2 export payments clearly constitute subsidies contingent upon proof of export of US upland cotton. Step 2 export payments are export subsidies that violate AoA Articles 3.3 and 8 and that are prohibited by ASCM Articles 3.1(a) and 3.2.

15. Similarly, US Step 2 domestic payments are prohibited local content subsidies in violation of ASCM Article 3.1(b). There is no explicit derogation of ASCM Article 3.1(b) built into the Agriculture Agreement. In fact, the opposite is true, since AoA Article 13(b)(ii) provides a conditional exemption only for claims under ASCM Articles 5 and 6, but not for claims under ASCM Article 3. There is also no conflict between ASCM Article 3.1(b) and AoA Article 6 or Annex 3, paragraph 7, because there are two types of domestic support, including domestic support to processors of agricultural commodities – those that comply with Article 3.1(b) of the SCM Agreement and those that do not.



#### IV. EXPORT CREDIT GUARANTEES

16. With respect to the consultations regarding the US export credit guarantee programmes, there is no doubt that the United States and Brazil consulted on three occasions about the GSM 102, GSM 103, and SCGP programmes as they relate to all eligible products. Thus, these measures are properly within the Panel's terms of reference and the Panel should reject the US request for a preliminary ruling.

17. With respect to Brazil's claims regarding the GSM 102, GSM 103 and SCGP export credit guarantee programmes, the United States interpretation of AoA Article 10.2 should be rejected. AoA Article 10.2 does not carve out export credit guarantees from the disciplines on export subsidies under the AoA. Nowhere does the provision exempt export credit guarantees from the disciplines on export subsidies, while exemption need to be made explicit in the text of an agreement following the Appellate Body reports in *EC – Hormones* and *EC – Sardines*. Similarly the context of AoA Article 10 as well as its object and purpose do not support the US view of AoA Article 10.2 as enabling Members to grant export credit support at zero percent interest and for unlimited terms – all for *free* – until Members complete negotiations on specific disciplines for export credits.

18. Concerning the substance of Brazil's claims against export credit guarantees, the United States has not even addressed Brazil's claim that since there is no commercial market for export credit guarantees on terms such as those provided by the CCC programmes, those programmes confer benefits *per se*. Brazil furthermore demonstrates that under the US formula accounting for the budgetary costs of contingent liabilities of CCC export credit guarantees, operating costs and losses for GSM 102, GSM 103 and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992. These figures represent *actual* costs and losses of the US export credit guarantee programmes.

19. Thus, the programmes constitute export subsidies within the meaning of ASCM Articles 1.1 and 3.1(a), item (j) of the Illustrative List, and AoA Articles 10.1, 1(e) and 8. They "at the very least" threaten to circumvent US export subsidy commitments, in violation of Articles 10.1 and 8 and are prohibited under ASCM Articles 3.1(a) and 3.2.

#### V. ETI ACT

20. Lastly, the United States argues that Brazil has failed to meet its burden of proof that ETI Act subsidies constitute export subsidies violating the AoA and prohibited by the SCM Agreement. Brazil has adopted and reiterated all of the successful arguments of the EC in the *US – FSC (21.5)* dispute. Brazil asks the Panel to follow the panel in *India – Patents (EC)* and to give "significant weight" to the rulings in the *US – FSC (21.5)* dispute and to avoid "inconsistent rulings", while recognizing that the Panel is not formally bound by that decision.

#### VI. PRELIMINARY ISSUES

21. Brazil has addressed the US request for a preliminary ruling on export credit guarantees above.

22. Concerning the US request for a preliminary ruling on the MY 2002 cottonseed payments, the record indicates that Brazil's consultation request covered "future" measures related to existing measures; it indicates further that Brazil and the United States consulted about the "Cottonseed Payment Programme", and that the Agricultural Assistance Act of 2003 provided funding for the existing administrative structure of the Cottonseed Payment Programme. Therefore, following the Appellate Body decision in *Chile – Agricultural Products (Price Band)*, the Agricultural Assistance Act of 2003 is properly within the Panel's terms of reference. In any event, the \$50 million in

cottonseed payments are properly treated as “support to cotton” for the purposes of the peace clause calculation of the amount of support granted in MY 2002.

23. Regarding the US arguments that PFC and market loss assistance payments are outside the Panels terms of reference, as they constitute expired measures, Brazil asks the Panel to reject this third US request for a preliminary ruling. Brazil has properly included PFC and market loss assistance payments as part of its claims relating to *present* serious prejudice. Consultations under DSU Article 4.2 may be held concerning measures affecting the operation of a covered agreement. ASCM Article 5 requires a Member to avoid causing adverse effects, which may be the effects of current or previous, expired subsidies. As in the *Indonesia – Automobiles* dispute, expired measures are eminently within the Panel's terms of reference. Denying Members the possibility to challenge expired measures would yield the result that a Member could enact “one-time” subsidy measures that could never be challenged and the provisions of ASCM Articles 5 and 6 would thereby be rendered a nullity.

## **VI. CONCLUSION**

24. Brazil requests the Panel to reject all three US requests for preliminary rulings and to rule that AoA Article 13 does not exempt US domestic support and export subsidies from actions under the SCM Agreement.

## ANNEX C-2

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

#### I. INTRODUCTION

1. Brazil addresses first the “preliminary issues” raised by the United States, and then the various peace clause issues. Finally, Brazil addresses the Step 2, ETI Act and export credit guarantee measures.

#### II. PRELIMINARY ISSUES

2. With respect to the consultations regarding the US export credit guarantee programmes, there is no doubt that the United States and Brazil consulted on three occasions about the GSM 102, GSM 103, and SCGP programmes as they relate to all eligible products. Thus, these measures are properly within the Panel’s terms of reference.

3. Regarding the MY 2002 cottonseed payments, the record indicates that Brazil’s consultation request covered “future” measures related to existing measures; it indicates further that Brazil and the United States consulted about the “Cottonseed Payment Programme”, and that the Agricultural Assistance Act of 2003 provided funding for the existing administrative structure of the Cottonseed Payment Programme. Therefore, the Agricultural Assistance Act of 2003 is properly within the Panel’s terms of reference. In any event, the \$50 million in cottonseed payments are properly treated as “support to cotton” for the purposes of the peace clause calculation of the amount of support granted in MY 2002.

4. Regarding the US arguments that PFC and market loss assistance payments are outside the Panels terms of reference, as they constitute expired measures, Brazil asks the Panel to reject this third US request for a preliminary ruling. Brazil has properly included PFC and market loss assistance payments as part of its claims relating to *present* serious prejudice. ASCM Article 5 requires a Member to avoid causing adverse effects, which may be the effects of current or previous, expired subsidies. Adverse present effects caused by both types of measures are eminently within the Panel's terms of reference. As a factual matter, the Panel must decide on the question whether a particular expired subsidy has an actual causal connection with currently existing adverse effects. Yet, by granting the US request for a preliminary ruling the Panel would effectively dismiss Brazil’s claim. Therefore, the fact that a subsidy measure has expired cannot be the basis for *a priori* excluding it from the Panel's terms of reference.

5. Furthermore, DSU Article 4.2 and 6.2 – invoked by the United States – must be applied in the context of the remedies provided for actionable subsidies under ASCM Articles 7.2-7.10. Under DSU Article 19 a panel can only recommend that the Member bring a wrongful measure into conformity with the covered agreement(s) at issue. However, for disputes concerning ASCM Articles 5 and 6, ASCM Article 7.8 contemplates two different remedies: removal of the adverse effects or withdrawal of the subsidy. While a Member cannot bring an expired measure into conformity with the covered agreements, both of the ASCM Article 7.8 remedies are valid options even for remedying the effects of a subsidy measure no longer in effect (as in the *Australia – Leather* dispute). As ASCM Articles 7.2-7.10 are “special and additional rules and procedures” under DSU Article 1.2 and DSU

Appendix 2, they must prevail to the extent there is a difference between them and DSU Articles 4 and 6. This means that contrary to disputes involving other covered agreements, the Panel is required to address the adverse effects of expired subsidy measures.

6. Further, ASCM Articles 5 and 6.3 make no distinction between subsidies that are now being paid and subsidies that are no longer being paid but have a causal relationship to continuing adverse effects, as evidenced by the Panel report in *Indonesia – Automobiles*, which found serious prejudice arising, *inter alia*, from expired subsidy measures that had been provided for one year and – like the market loss assistance payments – been terminated.

### III. PEACE CLAUSE ISSUES

#### **“such measures do not grant support to a specific commodity”**

7. This phrase in Article 13(b)(ii) means that in calculating the amount of support for any marketing year between 1995-2003, all non-“green box” support provided to a specific commodity must be tabulated, regardless of whether the *type* or *form* of the support is “product-specific,” “non-product specific,” *de minimis*, or “blue box”. This is certainly evidenced by the decision of negotiators *not* to use the phrases “product-specific” and “AMS” in Article 13(b)(ii) to qualify the type of support to a specific commodity. The US attempt to read “product-specific” into Article 13(b)(ii) is inconsistent not only with the text but also the context of the phrase “such measures” in Article 13(b)(ii). The US interpretation is further incompatible with the object and purpose of the Agreement on Agriculture. It would create a new category of non-actionable trade-distorting non-“green box” subsidies and sanction huge increases in spending for “amber box” and, therefore trade-distorting, domestic support as long as it took the form of support for *multiple* commodities. This is contrary to the presumption of trade and production-distorting effects for individual products from non-“green box” domestic support, which flows from a domestic measure being inconsistent with the “green box” requirements of Annex 2 of the Agriculture Agreement.

#### **“that decided during the 1992 marketing year”**

8. This word “decided” does not require any particular *type* of “decision”. As a neutral term, the meaning of “decided” must be interpreted in a way that does justice to the ordinary meaning of other terms in Article 13(b)(ii) that are *not* neutral. Most importantly, the term “decided” must be interpreted in a manner that permits a comparison between a “*grant*” of non-“green box” “*support*” to a specific commodity for individual marketing years between 1995-2003, and a “decision” regarding such support in MY 1992. The Appellate Body agreed with the panel in *Brazil – Aircraft* that the phrase “the *level* of export subsidies *granted*” meant “something actually provided”, which means actual budgetary expenditures. Thus, the neutral term “decision” (for MY 1992) can only be read harmoniously with the term “grant support” (for MY 1995-2003) where the “decision” is to fund non-“green box” support to a specific commodity for marketing year 1992.

9. The US argument that the only decision it took during MY 1992 was a “fixed rate of support” for MY 1992 is totally inconsistent with the US Statement of Administrative Action (SAA), in which the United States provided its official interpretation of the peace clause. In the SAA, the United States stated that governments would have peace clause protection from adverse effects and serious prejudice challenges in the WTO “*unless the AMS for the particular commodity exceeds the level decided in the 1992 marketing year.*” Brazil strongly disagrees with the notion of “AMS” as the relevant standard for the peace clause, and draws the attention of the Panel to the fact that the United States now admits that “AMS” is nowhere found in the text of Article 13(b)(ii). *But* this official US interpretation of the peace clause in 1995 is nevertheless compelling evidence of the United States view of the “decision” it had taken during MY 1992. And this interpretation did not

reflect a decision regarding only a rate of support. Instead, the only two “decision” options were set out in the AoA Annex 3, where “AMS” is calculated. This calculation is based on either budgetary outlays, or a calculated *amount* based on the difference between a fixed reference price and the applied administered price multiplied by the amount of production eligible to receive the administered price. Under either option, the United States’ interpretation indicates that an “amount” (not a “rate of support”) is the measure of support under the peace clause.

10. The SAA statement is also strong evidence that the alleged US “decision” to continue the 1990 FACT Act level of support at 72.9 cents per pound is simply *post hoc* rationalization. Brazil presents evidence that prior to this dispute, the United States had not made up its mind on what would constitute the relevant decision for peace clause purposes. A series of questions asked by Brazil in the Committee on Agriculture and answers provided by the United States reveals that as of 28 June 2002, the United States had not yet made a “decision” regarding which year the United States was using with respect to Article 13(b)(ii). These questions provided the United States with every opportunity to announce the decision that it had allegedly taken 10 years before. Yet, it said nothing about a “rate of support”.

11. In sum, Brazil is of the firm view that the text of Article 13(b)(ii) requires comparing MY 1992 support with MY 1995-2003 support by comparing actual expenditures. This methodology produces an “amount” of support – not a “rate”. Thus, any decision under Article 13(b)(ii), by definition, must relate in some way to an “amount” of expenditures. Only such methodology allows a clear comparison between the two time periods, regardless of the *type* of support.

12. However, even if the Panel were to decide that the relevant standard is a “rate of support” standard, Brazil has provided the testimony of Professor Daniel Sumner indicating that the “rate of support” to upland cotton in MY 1999-2002 was much higher than the “rate of support” to upland cotton in MY 1992. Based on the evidence and analysis presented by Professor Sumner, Brazil also asserts that even under the US “rate of support” methodology, the United States has failed to demonstrate that its MY 1999-2002 support does not exceed its support to upland cotton decided in MY 1992.

### **US “statute of limitations” interpretation of the peace clause**

13. There is no express or implied “statute of limitations” in the peace clause. Subsidizing Members such as the United States are offered conditional protection under the peace clause during a 9-year period. But the rights of Members injured by subsidies provided in excess of 1992 marketing year levels are preserved throughout the implementation period as well. This is the balance struck by the peace clause.

14. The US “statute of limitations” argument in this case is very similar to one rejected by the Appellate Body in *US – Lead Bars*. This argument is further inconsistent with the views of the *Indonesia – Automobiles* panel, which held that measures applied in the past must be examined to assess present serious prejudice. The US interpretation would cut off a Member’s right to challenge such measures because it missed an imaginary deadline. This US interpretation is inconsistent with the object and purpose of the AoA because it would permit Members to provide huge “non-green” box support one year without peace clause protection, and then claim absolution as soon as the next marketing year began.

### **“Support to Upland Cotton”**

15. Brazil has produced extensive evidence providing the factual basis for the Panel to find that CCP, DP, market loss, and PFC payments are “support to” upland cotton within the meaning of the peace clause. USDA categorizes the PFC and market loss payments as part of “total payments” to upland cotton. US National Cotton Council officials repeatedly testified and produced documents revealing that their producer members requested, received, and depended on all four of these subsidies. Crop insurance is also support to cotton as evidenced by specific upland cotton crop insurance policies and groups of policies for upland cotton. Moreover, USDA specifically identifies and tabulates crop insurance subsidies for upland cotton. Thus, the Panel should find that all five of these programmes granted support to upland cotton in MY 1999-2002.

## **IV. STEP 2 PAYMENTS**

16. The US Step 2 export subsidies clearly constitute export subsidies that violate Articles 3.3 and 8 of the Agriculture Agreement and that are prohibited by Articles 3.1(a) and 3.2 of the SCM Agreement because they are contingent upon proof of export of US upland cotton.

17. Similarly, US domestic Step 2 subsidies are prohibited local content subsidies in violation of Article 3.1(b) of the SCM Agreement. There is no explicit derogation of Article 3.1(b) built into the Agriculture Agreement. In fact, the opposite is true, since Article 13(b)(ii) provides a conditional exemption only for claims under Articles 5 and 6 of the SCM Agreement, but not for claims under Article 3 of the SCM Agreement. There is also no conflict between Article 3.1(b) of the SCM Agreement and Agriculture Agreement Article 6 or Annex 3, paragraph 7, because there are two types of domestic subsidies – those that comply with Article 3.1(b) of the SCM Agreement and those that do not.

## **V. EXPORT CREDIT GUARANTEES**

18. With respect to Brazil’s claims regarding the GSM 102, GSM 103 and SCGP export guarantee programmes, the United States interpretation of AoA Article 10.2 should be rejected. Under the US view of Article 10.2, it can grant export credit support at zero percent interest and for unlimited terms – all for *free* – at least until Members complete negotiations on specific disciplines for export credits. This interpretation is not supported by a Vienna Convention analysis.

19. The United States has not even addressed Brazil’s claim that since there is no commercial market for export credit guarantees on terms such as those provided by the CCC programmes, those programmes confer benefits *per se*. And Brazil has demonstrated that under the cost formula used by the White House, the US Congress, US government accountants and the CCC itself, operating costs and losses for GSM 102, GSM 103 and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992. These figures represent *actual* costs and losses of the US export credit guarantee programmes. The programmes therefore constitute export subsidies within the meaning of ASCM Articles 1.1 and 3.1(a), item (j) of the Illustrative List, and AoA Articles 10.1, 1(e) and 8. They “at the very least” threaten to circumvent US export subsidy commitments, in violation of Articles 10.1 and 8 and are prohibited under ASCM Articles 3.1(a) and 3.2.

## **VI. CONCLUSION**

20. Brazil requests the Panel to reject the numerous attempts by the United States to delay the initiation of Brazil’s serious prejudice claims. Brazilian upland cotton producers are experiencing present serious prejudice from continued huge amounts of US subsidies to upland cotton. Applying

either methodology of calculating the support for peace clause purposes, the United States has no basis to claim peace clause protection.

## ANNEX C-3

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

1. The United States has stayed within the disciplines and acted consistently with its WTO obligations negotiated and agreed in the Uruguay Round. We share many of Brazil's objectives with respect to reform of measures that affect agricultural trade, but we obviously do not endorse the means by which Brazil is attempting to obtain changes to WTO-consistent US support measures for upland cotton. Brazil seeks to impose disciplines and achieve results through this litigation that were not agreed in the Uruguay Round through negotiation.
2. Brazil suggests that whether a Member's measures are in breach of the Peace Clause should be judged by comparing the *aggregate outlays* that may be *attributed* to a commodity to the aggregate outlays that were made during the 1992 marketing year that, again, may be attributed to that commodity. Brazil's erroneous analysis stems from three interpretive missteps.
3. First, with respect to measures currently in effect, Brazil mistakenly suggests that support under previous measures in past years is relevant to the Peace Clause comparison. The proviso, however, is written in the present tense and thus, with respect to measures *currently* in effect, calls for a determination of the support that challenged measures *currently* grant. Brazil *nowhere* explains how the support in any previous years is relevant to the present-tense criterion that Peace Clause-exempted measures "do not grant support" in excess of a certain level. In fact, Brazil's analysis of the ordinary meaning and context of the phrase "grant support" assigns no meaning to Members' choice of verb tense.
4. Second, Brazil misunderstands the support that is relevant to the Peace Clause comparison because it misreads the phrase "support to a specific commodity". Brazil and New Zealand have asserted that, had Members intended for the phrase "support to a specific commodity" to mean "product-specific support", they would have used the latter phrase. With respect, this pushes the general interpretive aid of reading different word choices to carry different meanings too far. It ignores the relevant task for an interpreter, which is to read the text according to its ordinary meaning, in context, and in light of the object and purpose of the agreement. The ordinary meaning of the phrase "support to a specific commodity," in the context of the Agriculture Agreement, is "product-specific support".
5. We note that the Agriculture Agreement suggests that domestic support consists, in part, of product-specific and non-product-specific support. Brazil's interpretation of "support to a specific commodity," however, would apparently also capture "non-product-specific support". Absent a clear indication that such a contrary-to-logic result was intended, the interpreter should read "support to a specific commodity" to exclude "non-product-specific support". We note that the Agriculture Agreement suggests that domestic support consists, in part, of product-specific support and non-product-specific support. Brazil's interpretation of "support to a specific commodity", however, would apparently also capture "non-product-specific support". Absent a clear indication that such a contrary-to-logic result was intended, the interpreter should read "support to a specific commodity" to exclude "non-product-specific support".



6. Third, Brazil ignores the way in which the United States “decided” (that is, “determined” or “pronounced”) the product-specific support for upland cotton during the 1992 marketing year. As Brazil explained in its first submission, the Peace Clause text resulted from the EC’s desire to protect from challenge measures “decided” in 1992 for purposes of CAP reform, rather than support “provided” during marketing year 1992. That is precisely the approach the United States suggests: examine the product-specific support “decided” during marketing year 1992 and compare it to the product-specific support that measures currently in effect grant. Brazil fails to explain to the Panel how US measures *actually* decided support during the 1992 marketing year in favour of Brazil’s pre-baked conclusion that the “term ‘decided during the 1992 marketing year’ requires an examination of the *amount or quantity of support* . . . for a specific commodity that a WTO Member ‘decided’ to provide during the 1992 marketing year”. In fact, US measures “decided” support in the 1992 marketing year by ensuring upland cotton producer income at a rate of 72.9 cents per pound. Brazil nowhere explains how US domestic support measures could have “decided” the amount of outlays since those outlays resulted from the difference between the income support level and world prices during Marketing Year 1992 beyond the US Government’s control.

7. Brazil has argued that the US approach would create an annual “statute of limitations” for the applicability of the Peace Clause and that the problem with this approach is budgetary outlays are not known until after a given marketing year is completed. This comment, rather, points out the difficulties of *Brazil’s* approach that *only* budgetary outlays may be examined under the Peace Clause. That is, Brazil effectively concedes that under *its* approach there would be no certainty for Members whether measures are exempt from actions. For example, it would be difficult to know whether budgetary outlays under the 2002 Act exceeded 1992 outlays as of Brazil’s panel request in February 2003.

8. With respect to US direct payments, which the United States believes are “green box” measures, Brazil argues that these payments do not satisfy the “fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production” under the first sentence of paragraph 1 of Annex 2. However, the text of Annex 2 indicates that “domestic support measures” shall be deemed to have met this “fundamental requirement” if the measures “conform to the . . . basic criteria” of the second sentence, plus any applicable policy-specific criteria, by beginning the second sentence with “accordingly”. This interpretation is supported by relevant context in the Agreement; as the European Communities notes in its third party submission, Articles 6.1, 7.1, and 7.2 refer to the measures “which are not subject to reduction commitments because they qualify under the *criteria* set out in Annex 2”.

9. In addition to the basic criteria in paragraph 1, US direct payments must also conform to the five “policy-specific criteria and conditions” set out in paragraph 6 of Annex 2. Brazil brings forward two arguments that direct payments do not satisfy the criterion under paragraph 6(b) of Annex 2 that the amount of payments not be related to, or based on, production undertaken in any year after the base period. First, Brazil argues that by eliminating or reducing payments if recipients harvest certain fruits or vegetables, payments are related to production in a year after the base period. However, no particular type of production is required in order to receive such payments – indeed, no production is necessary at all. Brazil’s argument, moreover, proves too much. Under Brazil’s analysis, *any* limitation on a producer’s choices in a year after the base period that would alter the amount of payment would be inconsistent with paragraph 6(b). However, a requirement that a recipient of direct payments produce *nothing at all* (or see the payment reduced or eliminated) *would* link the amount of payment to the type or volume of production in the current year. Such a requirement would also *ensure* that such payments meet the “fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production” because there would be no production at all. Thus, under Brazil’s analysis, paragraph 6(b) would *prevent* a payment that would demonstrably achieve the “fundamental requirement” of Annex 2. This result is not required by the text of paragraph 6(b) and should be avoided.

10. Second, Brazil argues that direct payments are based on production in a year after the base period because once one type of direct payment to producers under Annex 2 has been made, *all* subsequent measures providing direct payments must be made with respect to the same base period. The Annex 2 text does not support such a reading, however. Annex 2 says that “[d]omestic support measures for which exemption from the reduction commitments is claimed” shall meet the fundamental requirement of the first sentence through the relevant basic and policy-specific criteria of the second sentence. For example, in the case of decoupled income support, the particular “domestic support measure” must meet “policy-specific criteria and conditions as set out” in paragraph 6. Paragraph 6(a), (b), (c), and (d) relate “such payments” to “a defined and fixed base period”. Thus, payments with respect to a given “domestic support measure for which exemption from the reduction commitments is claimed” must satisfy conditions relating to “a defined and fixed base period”. There is no textual requirement that *all* domestic support measures for which exemption from the reduction commitments is claimed utilize the *same* “defined and fixed base period”. Brazil also reads paragraph 6 as though the text were “*the* defined and fixed base period”. However, this is not what the text says nor what the negotiators agreed.

11. Brazil and the rest of the Cairns Group seek to address this very issue by proposing in the ongoing agriculture negotiations that Annex 2, paragraph 6, be amended to change the reference from “a defined and fixed base period” to “a defined, fixed *and unchanging historical* base period”. The revised Harbinson text, in Attachment 8, incorporates this Cairns Group proposal by proposing adding to paragraphs 5, 6, 11, and 13 of Annex 2 the text: “Payments shall be based on activities in a fixed and *unchanging historical* base period.” Again, Brazil is seeking to gain through litigation what it has not yet gained through negotiation.

12. The Step 2 programme has been constructed and implemented in a manner to support the price paid to US upland cotton producers by purchasers of their product. Step 2 is a single programme that provides for payments on all sales of all upland cotton produced in the United States in a given marketing year – whether those sales are for export or for domestic consumption. Step 2 payments are provided to merchandisers or manufacturers who use upland cotton as they represent the first step in the marketing chain where these payments could be made and have the greatest impact on producer prices.

13. The authorizing statute plainly does not state that the Step 2 payment is contingent upon export. The statute provides for Step 2 payments to a class of eligible users who constitute the entire universe of potential purchasers of upland cotton from producers. Payment occurs upon demonstration of the requisite use of the cotton. Unlike the facts of *United States - FSC (Recourse to Article 21.5)*, the Step 2 subsidy involves a universally available subsidy on sales of one agricultural product produced entirely in the United States, not tied to exportation or foreign commerce. Stated most simply, US upland cotton does *not* have to be exported to receive the payment. Assuming the conditions in the payment formula are met, all US upland cotton is sold with an entitlement to the Step 2 subsidy, whether it leaves the United States or is consumed there.

14. For nearly 15 years before the inception of obligations under the Agreement on Agriculture, as well as since that time, the core features of the two main agricultural export credit guarantee programmes of the United States (GSM-102 and GSM-103) have remained substantially the same. They are well-known and well-established export credit guarantee programmes, specifically discussed by negotiators during the Uruguay Round, as well as in the OECD and in the current Doha Round.

15. Article 9.1 of the Agriculture Agreement identifies and lists specific export subsidy programmes, also well-known to the negotiators, who wanted to assure that such specific practices were embraced within the definition of an export subsidy for purposes of the Agreement on Agriculture. Other export subsidies are captured within the anti-circumvention provision of

Article 10.1. In contrast, export credit guarantees were not included in either Article 9.1 or 10.1. Instead, as part of the balance struck in the Uruguay Round, negotiators opted to extend the negotiations on this subject but determined to hold Members to a commitment that if and when internationally agreed disciplines emerged, the United States, like all other WTO Members, could only grant export credit guarantees in conformity with such disciplines. To do otherwise would at that time constitute a violation of the Member's obligations under the Agreement on Agriculture.

16. Article 10.2 expresses the two commitments of the Members in this regard: (1) to engage in such negotiations notwithstanding the conclusion of the Uruguay Round and (2) upon development of internationally agreed disciplines to render them WTO commitments through the portal of Article 10.2. Article 10.2 does not state that export credit guarantees shall be subject to such future negotiated disciplines *in addition to* the anti-circumvention provisions of Article 10.1. To the contrary, Article 10.2 and the reference to export credit guarantees is juxtaposed to Article 10.1 to reflect the intention of the drafters to distinguish export credit guarantee programmes from other programmes that otherwise would be export subsidies subject to Article 10.1.

17. For the foregoing reasons and those set out in our first written submission, the United States believes that US non-green box measures are exempt from actions pursuant to Agriculture Agreement Article 13(b)(ii); US direct payments are exempt from actions pursuant to Agriculture Agreement Article 13(a)(ii); and US export credit guarantee programmes for upland cotton and Step 2 payments are consistent with our WTO obligations.

## ANNEX C-4

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

1. On the US requests for preliminary rulings, the Panel expressed some interest in the question of what prejudice would result to the United States if we were forced to defend export credit guarantees with respect to commodities other than upland cotton. First and foremost, the United States would have lost the benefit of consultations on these measures. Consultations serve a number of important functions, including helping the parties to understand each others' concerns and aiding in efforts to resolve the dispute. The DSU affirms the importance of consultations and requires that a Member cannot proceed to a panel unless the Member has consulted on that measure.
2. Moreover, to require the United States to address Brazil's allegations on these measures would impose additional burdens on the United States and detract from the time and resources available to respond for those measures that *are* within the terms of reference. The United States has export subsidy reduction commitments with respect to 12 commodities. Each such commodity is therefore subject to individual Peace Clause analysis under Article 13(c). In addition, under Brazil's approach, the type of analysis the United States has offered for upland cotton concerning item (j) of the Subsidies Agreement would be appropriate for all commodities subject to the coverage of the Agriculture Agreement. This would necessitate a commodity-by-commodity analysis of the export credit guarantee programmes, as applied, concerning premiums and long-term operating costs and losses (if any).
3. But in the end, the issue of prejudice to the United States does not figure in the question of whether a measure is within the Panel's terms of reference. It is *that* question that underlies the United States' preliminary ruling requests.
4. First, the United States has requested that the Panel find that export credit guarantee measures relating to other eligible agricultural commodities are not within the Panel's terms of reference. While Brazil's *panel* request *did* refer to "export credit guarantees . . . to facilitate the export of US upland cotton and other eligible agricultural commodities," its *consultation* request did not. That consultation request nowhere included the "other eligible agricultural commodities" language, nor did Brazil include these measures in its statement of available evidence. Thus, those measures on other eligible agricultural commodities were not part of the "measures at issue" that Brazil identified in its consultation request as it is required to do under DSU Article 4.4. Contrary to Brazil's statement a few moments ago, the United States and Brazil never consulted on export credit guarantees on commodities other than cotton – not once and certainly not three times. Brazil said as much on the first day of the first panel meeting when it acknowledged that the United States told Brazil at the first consultation that its questions were beyond the scope of the consultations.
5. On the question whether the export credit guarantee programmes were one measure or multiple measures: There is no reason why export guarantees for multiple products cannot be multiple measures. Under DSU Article 4.4, it is incumbent upon Brazil to identify in its consultation request "the measures at issue." Here, Brazil identified the measure as the "export credit guarantees . . . to facilitate the export of US upland cotton," and the United States may, and did, rely on that consultation request (including the attached statement of evidence) for notice.

6. For example, if a Member banned imports of all animal products for a stated health reason, and another Member filed a consultation request on the ban solely with respect to imports of beef, that complaining Member could not then expand the scope of the dispute through its written consultation questions or its panel request to challenge that ban with respect to other affected agricultural commodities. This is, however, what Brazil is attempting to do here.

7. Brazil also relies on footnote 1 of its consultation request, which refers to an explanation “below”. Such an explanation expanding the scope of the request to include “other eligible agricultural commodities” is *not* found in the consultation request. DSU Article 4.4 requires Brazil to provide “an identification of the measures at issue,” not a cryptic reference that is not explained further. Despite notice from the United States and despite ample opportunity to submit a new consultation request, Brazil never did so. Therefore, export credit guarantee measures relating to eligible US agricultural commodities other than US upland cotton were not the subject of consultations and pursuant to DSU Articles 4.4, 4.7, and 6.2 do not form part of the Panel’s terms of reference.

8. With respect to production flexibility contract payments and market loss assistance payments, we have explained that these payments were completed, the programmes terminated, and the statutory instruments providing them were superseded before Brazil’s consultation request was filed. The measures that Brazil challenges are subsidies or payments provided by these programmes. The laws authorizing these payments designated that each such payment was *allocated* to a particular crop or fiscal year. Thus, pursuant to the 1996 Act, the last production flexibility contract payment for fiscal year 2002 was made no later than the end of fiscal year 2002. As Brazil states in its first submission, “[w]ith the passage of the new FSRI Act in May 2002, PFC payments were discontinued”. The last market loss assistance payment was made with respect to the 2001 marketing year (1 August 2001–31 July 2002) pursuant to legislation enacted on 13 August 2001. Because the relevant fiscal year and the relevant marketing year, respectively, had been completed by the time of Brazil’s consultation and/or panel requests, these measures cannot have been consulted upon within the meaning of DSU Article 4.2 *nor* have been “measures at issue” within the meaning of DSU Article 6.2. They therefore do not fall within the Panel’s terms of reference. Brazil’s suggestion that Articles 7.2 to 7.10 of the Subsidies Agreement should supersede the DSU provisions concerning this Panel’s terms of reference is novel. Preliminarily, we note that Article 7.4 does mention the Panel’s terms of reference, but only in the context of setting a 15-day deadline for establishing them, as opposed to the time line under DSU Article 7.1.

9. Finally, with respect to subsidies provided under the Agricultural Assistance Act of 2003 – the cottonseed payment – these are measures that were not even in existence at the time of Brazil’s panel request. As the cottonseed payment had not been made (implementing regulations were not even issued until 25 April 2003) and the legislation authorizing the payments had not been enacted at the time of Brazil’s panel request, this subsidy or measure was not consulted upon and could not have been a measure at issue between the parties. Therefore, the United States requests that the Panel make preliminary rulings that these three sets of measures are not within its terms of reference.

10. To summarize briefly where our discussions on the Peace Clause have brought us: Brazil suggests in *this* dispute that the word “actions” in the phrase “exempt from actions” only refers to “collective action” by the DSB. However, we note that Brazil’s interpretation runs directly contrary to the view it expressed in its consultation request in the dispute *European Communities – Export Subsidies on Sugar* (WT/DS266/1). With respect to Article 13(c)(ii), which uses the same phrase “exempt from actions” at issue in this dispute, Brazil wrote: “In respect of the claims based on Article 3 of the SCM Agreement, because the export subsidies provided by the EC on sugar do not conform fully to the provisions of Part V of the Agreement on Agriculture, those export subsidies are not *exempt from challenge* by virtue of Article 13(c)(ii) of the Agreement on Agriculture.” That is, in that WTO document Brazil does *not* read the phrase “exempt from actions” to mean “exempt from

remedies” or “exempt from collective action by the DSB” but rather “exempt from *challenge*”. Brazil’s interpretation in that WTO consultation request could only result if “exempt from action” in the Peace Clause means “not subject to” the “taking of legal steps to establish a claim” – as the United States has been contending in this dispute. We submit that *this* interpretation by Brazil is correct.

11. The Peace Clause – in Brazil’s words – “exempt[s] from challenge” certain measures. It follows that the Peace Clause is not an affirmative defence but rather a threshold issue for Brazil in this dispute. As Brazil implicitly recognized in both its panel and consultation requests, to even reach the point where it will, as the complaining party, be allowed to pursue its substantive claims, Brazil must first demonstrate that the Peace Clause does not exempt US measures from action – that is “from challenge”.

12. On US direct payments, which the United States believes are “green box” measures because they satisfy the criteria set out in Annex 2: As a question from the Chair to Brazil suggested, assessing the conformity of a claimed green box measure against the “fundamental requirement” of the first sentence of paragraph 1 would be a difficult, if not impossible task, for a Panel. Members foresaw the problem and therefore provided guidance on how a measure would fulfill that fundamental requirement – that is, if the measures “conform to the . . . basic criteria” of the second sentence plus any applicable policy-specific criteria, they shall be deemed to have met the fundamental requirement.

13. With respect to the criterion in paragraph 6(b) that the amount of decoupled income support payments not be based on, or linked to, production undertaken in any year after the base period, this provision need not and should not be read as Brazil suggests. The text supports a reading that a Member may not base or link payments to production requirements. The EC endorsed this view this morning. US direct payments require no particular type of production – indeed, no production is necessary at all. As we have suggested, Brazil’s reading of paragraph 6(b) would prevent a Member from prohibiting a recipient from producing crops – that is, would prevent a measure that bases or links payments to a type or volume of production: none at all. If there is no production at all as a result of the measure, such a measure necessarily can have no “trade-distorting effects or effects on production”. Thus, Brazil’s reading of paragraph 6(b) would *preclude* a Member from establishing a measure that meets the “fundamental requirement” of Annex 2. Paragraph 6(b) need not and should not be read in opposition to that fundamental requirement. In the context provided by the first sentence of Annex 2, then, paragraph 6(b) should be read as establishing that a Member may not base or link payments to requirements to produce any crop in particular – again, US direct payments require no upland cotton production and do not require any production at all.

14. Brazil has repeatedly raised the spectre of unchecked US domestic subsidies should the Panel agree with the US interpretation of the Peace Clause. Brazil’s fears are groundless. Of course the United States may not provide subsidies without any limit. US subsidies are disciplined in several ways, and the US has deliberately kept itself within those limits. There are two main disciplines that apply. The first is the US final bound commitment level under the Current Total Aggregate Measurement of Support. The second, as we have discussed at length, is the Peace Clause itself and its effective limitation to a level of producer support of 72.9 cents per pound. The United States has stayed within the boundaries of those limits despite, as outlined in Brazil’s filings, pressure to do otherwise. We are entitled to the benefit of that compliance.

15. We can understand that Brazil might feel that these limits are not enough. New limits may be negotiated in the ongoing agriculture negotiations, in which the United States shares many of the same goals as Brazil. Until that happens, however, Brazil may not seek to overturn the balance of rights and obligations negotiated and agreed by Members in the Uruguay Round. Brazil’s Peace Clause interpretation would do violence to the text of the Agriculture Agreement and would penalize

the United States for deciding support to upland cotton producers within the limits set by the Agreement. We therefore ask the Panel to find that Brazil has not established that US domestic support measures breach the Peace Clause and that such measures are therefore exempt from Brazil's action at this time.

## ANNEX C-5

### ORAL THIRD PARTY COMMUNICATION BY THE ARGENTINE REPUBLIC

24 July 2003

#### I. INTRODUCTION

1. The Argentine Republic thanks the Panel for the opportunity to present its views as a third party to these proceedings and, in pursuant to its Submission dated 15 July<sup>1</sup>, will comment on the claims contained in the First Written Submission of the United States, dated 11 July.

2. In this connection, Argentina will comment more particularly on:

- (a) The US interpretation of the provisions of the Peace Clause, particularly in Article 13(b)(ii);
- (b) the US interpretations regarding Annex 2 of the Agreement on Agriculture and, lastly;
- (c) the US interpretation whereby Article 10.2 of the Agreement on Agriculture excludes export credit guarantees from the general export subsidy disciplines in the Agreement on Agriculture and the Agreement on Subsidies and Countervailing Measures.

#### II. UNITED STATES CLAIMS

(a) Interpretation of the Peace Clause

3. Argentina will discuss what it regards as a mistaken US interpretation of the terms of the Peace Clause, particularly in Article 13(b) of the Agreement on Agriculture<sup>2</sup>, whereby it draws the conclusion – equally mistaken – that its domestic support measures are exempt from the measures based on Article XVI of the GATT 1994 or Articles 5 and 6 of the Agreement on Subsidies (ASCM).

(i) *Grant support to a specific commodity*

4. First, the United States mistakenly interprets the phrase "grant support to a specific commodity".

5. In paragraph 71 of its Submission, the United States says that counter-cyclical payments and crop insurance payments do not constitute "support to a specific commodity" because they are not linked to specific commodity but are based on *historical* acreage and payment yields.<sup>3</sup>

6. The United States contends that "support to a specific commodity", in Article 13(b)(ii), means "product-specific support". Its argument is thus based on trying to incorporate the phrase "product-

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<sup>1</sup> "Third party Submission by Argentina", paragraph 2.

<sup>2</sup> First Written Submission of the United States of America, 11 July 2003, Section III.D.

<sup>3</sup> *Ibid.*, paragraph 115.



specific support" into Article 13(b)(ii) when the phrase is not to be found in the wording of the article.<sup>4</sup>

7. If the negotiators had meant to say that "product-specific support" was exempt, they would have introduced that phrase into the wording of the article, but they did not do so.<sup>5</sup> Hence, AA Article 13(b)(ii) refers to a Member's non-Green Box domestic support measures, including domestic support measures granted only to individual specific products and also those relating to several specific products.

8. In other words, "support to a specific commodity", in Article 13(b)(ii), includes any non-Green Box domestic support measure providing identifiable support to an individual commodity, regardless of whether the measure can provide support to a larger number of commodities.<sup>6</sup>

9. In its argument, the US ignores the most relevant context of Article 13(b)(ii), namely the chapeau, which refers not to "product-specific support" but to "domestic support measures" in general. This means that the measures which, under Article 13(b)(ii) are relevant in determining whether a Member has granted support to a specific commodity in excess of that decided during the 1992 marketing year necessarily includes non-product-specific domestic support.

10. The US interpretation would mean no claim could be made against any Amber Box domestic support measure granted to more than one commodity. The US argument would thus allow Members to make enormous increases in domestic support to a relatively small number of commodities (such as the ten crops covered by the counter-cyclical payments programme), something which is inconsistent with the object and purpose of the AA, namely, cutting down the level of domestic support, as is apparent from the Preamble.<sup>7</sup>

11. Argentina considers that "support to a specific commodity", in Article 13(b)(ii), indicates that, in calculating the domestic support granted by a Member, the support must relate to a particular or precise commodity, regardless of whether the support is product-specific or specific to more than one product.<sup>8</sup>

12. Contrary to the US suggestion, the phrase "support to a specific commodity" does not mean "support exclusively or only" to a specific commodity. The fact that, through the same domestic

<sup>4</sup> According to the Appellate Body in the *India-Patents Case* (WT/DS50/AB/R, adopted 16 January 1998, paragraph 45):

*"The duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties. This should be done in accordance with the principles of treaty interpretation set out in Article 31 of the Vienna Convention. But these principles of interpretation neither require nor condone the imputation into a treaty of words that are not there or the importation into a treaty of concepts that were not intended."* (Emphasis added)

<sup>5</sup> "... had Members intended to exclude non-product specific support they would surely have said so", *"Third Party Submission of New Zealand"*, 14 July 2003, paragraph 2.21.

<sup>6</sup> In this respect, Argentina agrees with New Zealand: "... New Zealand sees no basis on which to suggest that support to a specific commodity should be excluded simply because other commodities may receive similar support". *Third-party submission of New Zealand*, 15 July 2003, paragraph 2.23.

<sup>7</sup> "... the above-mentioned long-term objective is to provide substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets" (Agreement on Agriculture, third preambular paragraph).

<sup>8</sup> Australia's Third Party Submission to the Panel, 15 July 2003, paragraph 23: "... the ordinary meaning of this phrase ("To a specific commodity"), read in its context and in light of the object and purpose of the Agreement on Agriculture, is support granted to an individual agricultural commodity covered by AA Annex 1, such as upland cotton, whether through product specific, or non-product specific, support".

support measures, the United States grants support to different products does not cancel out the fact that part of the support is granted to one specific product.

(ii) *Support "decided during the 1992 marketing year"*

13. After analysing the phrase "*that decided during the 1992 marketing year*", the United States reaches the conclusion that the phrase does not relate to support actually provided to a specific product during that year<sup>9</sup>, but to support *determined* during the 1992 marketing year and that it consisted in "deciding" or "determining" a level of income support for cotton producers of US\$0.72 per pound.

14. With this interpretation, the United States can get around the need to respond to Brazil's contention<sup>10</sup> - supported by Argentina<sup>11</sup> - that the US budgetary outlays on domestic support for the cotton sector for the 1999, 2000, 2001 and 2002 marketing years were far in excess of the US\$1,994 million granted in 1992.

15. Argentina considers that, under Article 13(b)(ii), the word "decided" means a decision to make payments. The US argument ignores the fact that the text first uses the term "grant support" with reference to the support granted or provided to a specific commodity during the period of implementation (1995-2003). The phrase "grant support", however, is necessarily tied in with the support "decided during the 1992 marketing year"; otherwise, there would be no basis for comparison if one case involved the support granted and the other involved only the support scheduled.

16. In this connection, Argentina contends that the word "decided", in Article 13(b)(ii), should not be interpreted in such a way that the per pound guaranteed price for commodity producers (scheduled support) is the factor to be taken into consideration in determining the amount of support granted. If the criterion advanced by the United States were accepted, it would mean that an unlimited amount of domestic support could be granted to each product provided the total AMS is not exceeded.

17. In other words, the comparison required in Article 13(b)(ii) necessarily entails comparing the same type of support in each of the periods in question (period of implementation versus 1992 marketing year), in other words "comparing the comparable". The "support granted" in each marketing year during the period of implementation must necessarily be tied in with the budgetary outlays in those years.

18. In this respect, the definition of "granted" formulated by the Appellate Body in the "Brazil-Aircraft" case is relevant, namely that it is "*something actually provided*" and, thus, "*to determine the amount of export subsidies 'granted' in a particular year, we believe that the actual amounts provided by a government, and not just those authorized or appropriated in its budget for that year, is the proper measure ... Therefore, ... we believe that the proper reference is to actual expenditures by a government ...*".

19. Similarly, Argentina considers that, under AA Article 13(b)(ii), the definition of the term "support granted" must refer to a government's actual expenditures and not to a scheduled level of costs or a rate of support per unit of production.

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<sup>9</sup> First Written Submission of the United States of America, paragraph 94: "... *no amount of outlays was 'decided' ... during the 1992 marketing year ...*".

<sup>10</sup> First Written Submission by Brazil, paragraphs 144-149.

<sup>11</sup> Third Party Submission by Argentina, paragraphs 64-65.

20. Accordingly, Argentina takes the view that the support "decided during the 1992 marketing year" refers to payments actually made during that marketing year.

(iii) *The time dimension of Peace Clause protection*

21. In contrast to the US interpretation, Argentina contends that the domestic support measures granted in any of the marketing years in the period from 1995 to 2003 are relevant in determining compliance with Article 13(b)(ii). In this connection, we consider that any injurious effects of the subsidies are extended time-wise.

22. An interpretation like the one postulated by the United States would seriously restrict the possibility of questioning whether such subsidies are consistent with ASCM Articles 5 and 6, while effects causing injury, nullification or impairment or serious prejudice can be linked to domestic support measures granted in previous marketing years.

(b) Annex II of the Agreement on Agriculture

(i) *Interpretation of paragraph 1*

23. The United States claims that its direct payments programme is in conformity with AA Annex II<sup>12</sup> and, therefore, is exempt from measures under the protection afforded by Article 13(a). In reaching this conclusion, however, the United States makes a mistaken interpretation of paragraph 1 of AA Annex II.

24. The United States maintains that the structure of this provision, where the second sentence starts with the word "Accordingly", suggests that measures that conform to the two basic criteria set out in paragraph 1(a) and (b), plus the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex II are designed to meet the "fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production"<sup>13</sup>.

25. Argentina considers this interpretation to be erroneous, since the text of the first sentence establishes a clear obligation that the domestic support measures to be exempted from the reduction commitments "... shall meet the fundamental requirement that they have no ... trade-distorting effect or effects on production ...". In Argentina's opinion, the language of this first sentence establishes a general requirement governing the application of all Green Box measures.

26. The structure of paragraph 1 of AA Annex 2 thus creates four types of obligation:

- (i) The fundamental requirement of no, or at least minimal, trade-distorting effects or effects on production;
- (ii) the support given in a government-financed programme does not entail transfers from consumers;
- (iii) the support does not have the effect of providing producers with price support; and
- (iv) the policy-specific criteria and conditions set out in paragraphs 2 to 13 of Annex 2 are also taken into account.

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<sup>12</sup> First Written Submission by the United States of America, paragraph 53.

<sup>13</sup> *Ibid.*, paragraph 50.

27. In this connection, Argentina believes that Green Box measures must respect the guiding principle of avoiding trade-distorting or production effects or at most minimal effects. A measure that meets the two basic criteria set out in paragraph 1(a) and (b), plus the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex 2 could also be at variance with the general principle. The opposite interpretation would render meaningless the first sentence of paragraph 1 of Annex 2, which the text describes as a "fundamental requirement".

28. Therefore, it is Argentina's view that, however much the United States claims that its direct payments programme conforms to the requirement established in the second sentence of paragraph 1 of Annex 2<sup>14</sup>, since it does not meet the fundamental requirement established in the first sentence it cannot be viewed as a Green Box programme.

29. In this respect, Argentina concurs with Australia and New Zealand that the first sentence of Annex 2 paragraph 1, imposes a stringent standard by requiring that the measures to be exempted from reduction commitments must, as a primary or essential condition, not artificially alter trade or production.<sup>15</sup>

30. Consequently, if a domestic support measure leads to a higher level of production of trade in a particular product or group of products, the measure does not meet the standard established in Annex 2, Article 1.

31. It should be emphasized that the US has in no sense answered the statements by Brazil in paragraphs 183 to 191 of its Submission concerning the trade-distorting and production effects of the direct payments programme, according to studies made by the US Department of Agriculture's own economists.

32. In other words, because the direct payments programme does have trade-distorting and production effects, it cannot be included among the domestic support measures exempted from reduction commitments.

(ii) *Interpretation of paragraph 6(b)*

33. The United States maintains that the Production Flexibility Contract Payments (PFC) and Direct Payments programmes are not tied in with production and, therefore, are not Green Box domestic support.

34. Argentina considers that the alleged "flexibility" of producers to plant different crops is in fact seriously restrictive. The amount of payments made depends on the type of production. Indeed, particular crops (fruits, vegetables, etc.) are excluded from these programmes. The effect of this is to channel production to the remaining crops, which do benefit from the programmes. This shows that the amount of the payments made is linked to the type of product sown, as Argentina pointed out in its Third Party Submission<sup>16</sup> and, therefore, the payments are not in conformity with AA Annex 2 paragraph 6(b).

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<sup>14</sup> *Ibid.*, paragraphs 64-68.

<sup>15</sup> Australia's Third Party Submission to the Panel, 15 July 2003, paragraph 31: "... AA Annex 2.1 imposes a stringent standard. Annex 2.1 requires that such measures must, as a primary or essential condition, not "bias" or "unnaturally alter trade or production ..."; Third Party Submission of New Zealand, 15 July 2003, paragraph 1.08: "... In New Zealand's view it is critical that the integrity of the disciplines on "Green Box" measures are not weakened or their legitimate purpose undermined through the inclusion of measures that fail to meet the strict requirements of Annex 2, including the fundamental criterion that such measures are non-trade or production distorting ...".

<sup>16</sup> Third Party Submission by Argentina, 15 July 2003, paragraphs 54-57.

- (c) Article 10.2 of the Agreement on Agriculture does not exclude export credit guarantees from the general export subsidy disciplines of the Agreement on Agriculture and the Agreement on Subsidies.

35. The United States asserts that the text of Article 10.2 of the Agreement on Agriculture permits Members to continue export credit guarantee programmes unaffected by export subsidy disciplines,<sup>17</sup> since the text reflects the fact of that, during the Uruguay Round, Members came to no agreement on the substantive disciplines applicable. In other words, the United States contends that the actual text of Article 10.2 of the Agreement on Agriculture indicates that the export credit guarantee programmes are not subject in any way to the Agreement's export subsidy disciplines.<sup>18</sup>

36. In this regard, Argentina would point out that the fact that WTO Members are negotiating disciplines in order to implement Article 10.2 does not in any way support the US reading to the effect that Article 10.2 excludes export credit guarantees from the general disciplines on export subsidies.<sup>19</sup> A commitment "to work towards the development" of specific international disciplines on the granting export credits, export guarantees or insurance programmes is not the same as excluding them from the general disciplines on export subsidies. If that had been the intention, then the negotiators would have expressly said so.

37. Contrary to the US contention, Argentina does not find any indication of this type in the wording of Article 10.2. The fact that the negotiators did not include an express reference to the effect that export credit guarantees are not included in the definition of export subsidies or are not subject to the disciplines established in AA Articles 3.3, 8 or 10.1 means that such disciplines apply to export credit support measures.

38. In other words, in conformity with the wording of AA Article 10.2, export credit guarantees are not exempt from the general disciplines of the Agreement on Agriculture, and where the measures are not in conformity with that Agreement, from the disciplines of the Agreement on Subsidies.

39. This interpretation is reinforced by the immediate context and the object and purpose of AA Article 10.2. Paragraph 2 forms part of Article 10, which is entitled "*Prevention of Circumvention of Export Subsidy Commitments*". Paragraph 1 of Article 10 establishes that export subsidies not listed in paragraph 1 of Article 9 "... shall not be applied in a manner which results in ... circumvention of export subsidy commitments ...". This provision imposes disciplines on export credit guarantees, just as it imposes disciplines on the whole universe of export subsidies not covered by Article 9.1.

40. In turn, the object and purpose of AA Article 10 is to prevent any form of circumvention of export subsidy commitments.<sup>20</sup> Consequently, the US interpretation of Article 10.2 is completely at variance on the context of the provision and the object and purpose of AA Article 10, since it

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<sup>17</sup> First Written Submission of the United States of America, paragraph 160.

<sup>18</sup> *Ibid.*, paragraph 164.

<sup>19</sup> Third Party Submission of Canada, 15 July 2003, paragraph 53: "*This provision (Article 10.2) sets out an intention on the part of Members to undertake further work regarding these measures – the simple fact of agreeing to do so, however, does not amount to a permission to use those measures to confer export subsidies without consequence and without limit. The US interpretation of Article 10.2 ignores the important context provided by Article 10.1. It also directly contradicts the stated object and purpose of Article 10 as a whole ...*". Similarly, in its Third Party Submission, New Zealand states: "*Nor does Article 10.2 in any way suggest that it provides an exception from the disciplines of Article 10.1...*", paragraph 3.15.

<sup>20</sup> Article 10.3 reverses the burden of proof in cases of export subsidies under the Agreement on Agriculture where exports are in excess of the reduction commitment level. Article 10.4 establishes disciplines on international food aid.

contributes to circumvention of the export subsidy commitment by excluding an entire category of export subsidies from the general disciplines.

41. Lastly, contrary to what the US maintains,<sup>21</sup> the fact that an export subsidy is not included in AA Article 9.1 does not mean that it is not an export subsidy, for Article 9.1 is not an exhaustive list, as is evidenced by the wording of Article 10.1.<sup>22</sup> Nor does it mean that such an export subsidy is not subject to the export subsidy disciplines of the Agreement on Agriculture.

42. Argentina agrees with the European Communities<sup>23</sup> that Article 10.2 makes it clear export credit guarantees are not one of the types of export subsidy listed in Article 9.1 and, in that connection, Article 10.1 establishes that non-listed export subsidy must not be applied in a manner which results in circumvention of export subsidy commitments.

43. Hence, as the European Communities contend, wherever export credit guarantees are export subsidies not listed in Article 9.1, those guarantees could be applied in a manner which would result in circumvention of commitments and, therefore, would be prohibited under Article 10.1.

### III. CONCLUSION

44. In accordance with the foregoing, Argentina considers that the United States has mistakenly interpreted the provisions of the Peace Clause, in particular in Article 13(b)(ii), has failed to bear the burden of proving that the domestic support measures it granted to cotton during the 1999, 2000, 2001 and 2002 marketing years were not in excess of the support "decided during the 1992 marketing year".

45. Second, Argentina considers that the US interpretations regarding Annex 2 of the Agreement on Agriculture are mistaken and that, therefore, the Direct Payments and PFC programmes do not fall under the protection of Article 13(a) of the Agreement on Agriculture for Green Box measures.

46. Third, Argentina considers that the United States export credit guarantee schemes (GSM 102, 103 and SGCP) constitute export subsidies subject to the general export subsidy disciplines of the Agreement on Agriculture (Articles 3.3, 8 and 10.1) and the Agreement on Subsidies and Countervailing Measures (Article 3.1(a) and 3.2).

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<sup>21</sup> First Written Submission of the United States of America, paragraphs 161-162.

<sup>22</sup> Third Party Submission of Canada, 15 July 2003, paragraph 32; *"Article 9 of the Agriculture Agreement lists and describes certain export subsidies that are subject to reduction commitments. All other export subsidies fall within the scope of Article 10-1..."*.

<sup>23</sup> First Third Party Submission by the European Communities, 15 July 2003, Section V.

## ANNEX C-6

### ORAL STATEMENT BY AUSTRALIA

24 July 2003

Mr Chairman, Members of the Panel,

1. I appreciate this further opportunity to present Australia's views on matters at issue in this dispute.

2. In this statement, I will provide some elaboration of Australia's views on the meaning of Article 13(b)(ii) of the *Agreement on Agriculture*. I will also address some of the matters raised in the First Written Submission of the United States and in the First Third Party Submission of the European Communities.

Mr Chairman, Members of the Panel,

3. I will begin with matters relating to the meaning of Article 13(b)(ii) of the *Agreement on Agriculture*.

4. As Australia noted in its Written Submission<sup>1</sup>, the word "decided" appears twice in the operative provisions of the *Agreement on Agriculture* – in subparagraphs (ii) and (iii) of Article 13(b). Further, the immediate context for the word "decided" is exactly the same in each case: "provided that such measures do not grant support to a specific commodity in excess of that *decided* during the 1992 marketing year". Yet Article 13(b)(iii) deals with a completely different type of action: one based on non-violation or impairment under GATT Article XXIII:1(b).

5. Thus, Australia believes that it will be necessary for the Panel to consider two key threshold questions.

6. Firstly, is the meaning of the phrase "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" the same in each of Article 13(b)(ii) and (iii)?

7. Australia recalls that the phrase, as well as draft text for what became Article 13, first appeared in the "Blair House Accord". Also included in the Accord were provisions concerning the *EEC – Oilseeds* dispute.<sup>2</sup>

8. In Australia's view, that dispute is crucially relevant to the interpretation of Article 13(b)(ii) and (iii).

9. Australia recalls that it clearly understood in the resumed Uruguay Round agriculture negotiations in 1993 that the words "decided during the 1992 marketing year" had been chosen to

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<sup>1</sup> Third Party Submission of Australia, paragraph 26.

<sup>2</sup> *European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins* ("EEC – Oilseeds"), Report of the Panel, adopted 25 January 1990, BISD 37S/86, and *Follow-Up on the Panel Report "European Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins"*, DS28/R, BISD 39S/91.

incorporate into the text of Article 13(b)(ii) and (iii) the sense of expectations of “conditions of price competition” as this had been interpreted and applied in the *EEC – Oilseeds* dispute.

10. The panel in *EEC – Oilseeds* described the purpose of GATT Article XXIII:1(b) in the following terms:

... The panel noted that these provisions, as conceived by the drafters and applied by the contracting parties, serve mainly to protect the value of tariff concessions.<sup>3</sup> The idea underlying them is that the improved competitive opportunities that can legitimately be expected from a tariff concession can be frustrated not only by measures proscribed by the General Agreement but also by measures consistent with that Agreement. ...<sup>3</sup>

11. That Panel went on to say:

... The Panel considered that the main value of a tariff concession is that it provides an assurance of better market access through improved price competition. Contracting parties negotiate tariff concessions primarily to obtain that advantage. They must therefore be assumed to base their tariff negotiations on the expectation that the price effect of the tariff concessions will not be systematically offset. ...<sup>4</sup>

12. In any case, having regard to the customary principles of interpretation, Australia considers that the phrase “provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year” must have the same meaning in both Article 13(b)(ii) and (iii).

13. Thus, there is a second threshold question that the Panel needs to consider. That question is: could conditions of price competition for the purposes of a non-violation nullification or impairment claim be assessed solely on the basis of budgetary outlay figures, as argued by Brazil, or on the basis of a rate of payment, as argued by the United States? In Australia’s view, both factors put forward by Brazil and the United States would properly form a part of that assessment, but not the whole.

Mr Chairman, Members of the Panel,

14. I would now like to comment on some matters raised in the First Written Submission of the United States.

15. Firstly, Australia disagrees with the United States’ approach to interpreting the “peace clause” and the meaning of “exempt from action based on”.<sup>5</sup>

16. If the United States’ interpretation is correct and the WTO Agreement negotiators intended the interpretation offered by the United States, surely the negotiators would have included provisions clarifying how such situations should be resolved? At the very least, surely Article 13 of the *Agreement on Agriculture* would have been listed in the Special or Additional Rules and Procedures Contained in the Covered Agreements at Appendix 2 to the *Dispute Settlement Understanding*? Yet the negotiators did neither of these things.

17. The United States argues as well that its interpretation is supported by the fact that the peace clause applies “[n]otwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and

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<sup>3</sup> *EEC – Oilseeds*, paragraph 144.

<sup>4</sup> *EEC – Oilseeds*, paragraph 148.

<sup>5</sup> First Written Submission of the United States, paragraph 33.



Countervailing Measures”.<sup>6</sup> However, the United States ignores that, for its argument to be valid, the peace clause would also have to apply “notwithstanding the provisions of the *Dispute Settlement Understanding*”.

18. The United States argues too that Brazil is in error by asserting that the peace clause itself “provides no positive obligations”.<sup>7</sup> In Australia’s view, however, this argument confuses obligations and conditions: the United States is equating a binding requirement to act in a certain way with a prerequisite for the availability of a right or privilege. Article 13 of the *Agreement on Agriculture* does not of itself establish any binding requirements with which WTO Members are required to comply.

19. That confusion between rights and obligations continues when the United States argues that “Brazil’s approach would produce bizarre results”.<sup>8</sup> Indeed, the United States’ arguments could be considered to confirm the nature of Article 13 as an affirmative defence. Had Brazil alleged a breach of the United States’ obligations under Article 6, Brazil would have had the initial burden of making a *prima facie* case of inconsistency. Article 13, however, is a right or privilege available to the United States, provided that its measures fully conform to the relevant conditions. Thus, it is for the United States to demonstrate that it is entitled to invoke that right or privilege.

20. Secondly, the United States argues that “support to a specific commodity” is equivalent to “product-specific support”.<sup>9</sup>

21. The United States asserts that the definition of Aggregate Measurement of Support – or AMS – at Article 1(a), and Article 6 concerning Domestic Support Commitments, provide relevant context. The United States asserts that because the calculation of AMS, and exemptions from Current Total AMS, differentiate between product specific and non-product specific domestic support, “support” in the context of Article 13(b)(ii) and (iii) means product-specific AMS.

22. Australia does not agree. AMS is defined by Article 1(a) to mean “the annual level of support ... provided for an agricultural product in favour of the producers of the basic agricultural product”. However, Article 13(b)(ii) and (iii) refer to “support to a specific commodity”.

23. Had the negotiators intended that “support to a specific commodity” in the context of Article 13(b)(ii) and (iii) mean product-specific AMS only, they would have said so in the text. They did not. Further, the United States’ argument ignores that a Member’s reduction commitments include both product specific and non-product specific domestic support measures unless they are exempt from inclusion.

24. Thus, in Australia’s view, “support to a specific commodity” means: all non-“green box” support that benefits a specific commodity, whether that support be through product specific, or non-product specific, programmes. Indeed, Australia believes that “support to a specific commodity” in the context of Article 13(b)(ii) and (iii) can include forms of support additional to those captured in an AMS calculation.

25. It follows, of course, that Australia considers – in the context of this dispute – that the portions of the direct payment and counter-cyclical payment programmes that benefit upland cotton should be included in the calculation of “support to a specific commodity” within the meaning of Article 13(b)(ii). Moreover, Australia notes that the counter-cyclical payment programme provides a

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<sup>6</sup> First Written Submission of the United States, paragraph 39.

<sup>7</sup> First Written Submission of the United States, Paragraph 43.

<sup>8</sup> First Written Submission of the United States, paragraph 44.

<sup>9</sup> First Written Submission of the United States, paragraph 78.

target price of 72.4 cents per pound for upland cotton,<sup>10</sup> and that entitlements to “Step 2” payments and some other domestic support programmes are additional to the target price, as they were to the 1992 target price of 72.9 cents per pound.

26. Thirdly, the United States argues that direct payments under the 2002 Farm Act meet the criteria of Annex 2 Decoupled Income Support payments. Australia has already addressed the issue of planting restrictions on fruit and vegetables and wild rice in its Written Submission.

27. The United States argues that “eligibility for direct payments is defined by clearly defined criteria ... in a defined and fixed base period” and that “payment yields and base acres are defined in the 2002 Act and fixed for the duration of the legislation”.<sup>11</sup> The United States’ interpretation means that a WTO Member could re-define and re-fix a base period every time it introduced new domestic support legislation. This cannot be a correct interpretation of the provisions of paragraph 6 of Annex 2 to the *Agreement on Agriculture*.

28. Fourthly, the United States argues that “a Member may choose to provide ‘amber box’ support in any ... manner so long as that Member’s Current Total AMS does not exceed ... [its] commitment level”.<sup>12</sup>

29. Australia disagrees. The United States’ argument ignores that Article 13(b)(ii) does not exempt non-“green box” domestic support measures from actions based on Article 3 of the *SCM Agreement*. It also ignores the provisions of Article 21.1 of the *Agreement on Agriculture*. In an analogous situation in the *EC – Bananas* dispute, the Appellate Body said: “... the provisions of the GATT 1994 ... apply ... except to the extent that the *Agreement on Agriculture* contains specific provisions dealing specifically with the same matter”.<sup>13</sup> The Appellate Body went on to say in that dispute:

... [T]he negotiators of the *Agreement on Agriculture* did not hesitate to specify ... limitations elsewhere in that agreement; had they intended to do so with respect to Article XIII of the GATT 1994, they could, and presumably would, have done so.  
...<sup>14</sup>

30. The Appellate Body’s statement is equally applicable in the context of this dispute. Had the negotiators of the *Agreement on Agriculture* intended that non-“green box” domestic support measures be “exempt from actions based on” Article 3 of the *SCM Agreement*, they would have said so. The negotiators did expressly exempt export subsidies from actions based on SCM Article 3 to the extent that such export subsidies conformed fully to the provisions of Part V of the *Agreement on Agriculture*. In Australia’s view, therefore, the omission from Article 13(b)(ii) of the *Agreement on Agriculture* of an express exemption from actions based on SCM Article 3 for local content subsidies has meaning.

31. Fifthly, the United States has requested that the Panel issue a preliminary ruling that Production Flexibility Contract and Market Loss Assistance payments are not within the Panel’s terms of reference because these programmes have expired. The fact that a measure has expired cannot be sufficient to remove it from the Panel’s purview. If the Panel were to grant the United States’ request

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<sup>10</sup> Section 1104, 2002 FSRI Act, Exhibit Bra-29.

<sup>11</sup> First Written Submission of the United States, paragraph 67.

<sup>12</sup> First Written Submission of the United States, paragraph 144.

<sup>13</sup> *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, Report of the Appellate Body, WT/DS27/AB/R, paragraph 155.

<sup>14</sup> *EC – Bananas*, paragraph 157.

solely on that basis, it would mean that any Member could authorise WTO-inconsistent domestic support programmes through short-lived measures and avoid the consequences of such actions.

Mr Chairman, Members of the Panel,

32. The final matter on which I will comment today concerns the Third Party Submission of the European Communities and its arguments in relation to the interpretation of the first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture*. The European Communities argues that the first sentence “simply signals the objective of Annex 2” and does not set out an independent obligation.<sup>15</sup>

33. That argument ignores the plain meaning of the text and renders the first sentence of paragraph 1 inutile, which of course a treaty interpreter may not do. If an exemption from reduction commitments is being claimed for any domestic support measures, the first sentence says they “shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production”. As explained in Australia’s written submission,<sup>16</sup> a fundamental requirement is a primary or essential condition. To interpret a “fundamental requirement” other than as a separate and independent obligation would be contrary to the plain meaning of the words and thus to the normal rules of treaty interpretation. The use of the words “shall meet” establishes an express obligation to comply with the specified condition that such measures not, or only minimally, bias or unnaturally alter trade or production.<sup>17</sup>

34. The European Communities argues that the word “accordingly” at the beginning of the second sentence of paragraph 1 links the ‘fundamental requirement’ in the first sentence with the ‘basic criteria’ in the second sentence” and thus makes clear that the fundamental requirement is complied with if the basic criteria in the second sentence and the policy-specific criteria set out in paragraphs 2 to 13 are met.<sup>18</sup>

35. However, the meanings for “accordingly” cited by the European Communities – “in accordance with the logical premises” and “correspondingly” – do not compel the interpretation it has offered. Moreover, there are other, equally valid meanings of the word “accordingly”, provided by the same dictionary, such as “harmoniously” and “agreeably”.<sup>19</sup>

36. It is possible to interpret the whole of paragraph 1 to Annex 2 so as to give effect to all of its provisions:

- domestic support measures for which exemption from the reduction commitments is claimed shall not, or shall only minimally, distort trade or production; and
- to the extent that measures of the type described in paragraphs 2 to 13 of the Annex are consistent and harmonious with that fundamental requirement and conform to the basic and policy-specific criteria as set out in the second sentence, they are exempt from reduction commitments.

37. Thus, notwithstanding that they may meet the basic and policy-specific criteria set out in paragraphs 1 and 6 of the Annex, a Member may not claim Decoupled Income Support payments as “green box” where those payments do not meet the fundamental requirement that they shall not, or

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<sup>15</sup> First Third Party Submission by the European Communities, paragraph 15.

<sup>16</sup> Australia’s Third Party Submission to the Panel, paragraph 31.

<sup>17</sup> Australia’s Third Party Submission to the Panel, paragraphs 31-32.

<sup>18</sup> First Third Party Submission by the European Communities, paragraph 20.

<sup>19</sup> *The New Shorter Oxford English Dictionary*, Volume I, Ed. Lesley Brown, Clarendon Press, Oxford, 1993, page 15.

shall only minimally, distort trade or production. Such could be the case, for example, where the level of Decoupled Income Support payments are sufficient to affect directly producer decisions concerning the allocation of economic resources to production of a particular commodity.

Mr Chairman, Members of the Panel,

38. Should you have questions on any matters concerning Australia's Written Submission and Oral Statement, I would be pleased to take these on notice and arrange for written answers to be provided.

Thank you, Mr Chairman, Members of the Panel.

## ANNEX C-7

### THIRD PARTY ORAL STATEMENT OF BENIN

24 July 2003

Mr. Chairman, members of the Panel,

It is my honour to represent Benin at this Third Party session today. The other two members of our delegation are Mr. Eloi Laourou of the Permanent Mission of Benin, and Mr. Brendan McGivern of White & Case, our legal adviser.

Although Benin acceded to the WTO back in 1996, this marks our first entry into WTO dispute settlement. We have been led to take this unprecedented step by the magnitude of the threat posed by US cotton subsidies, and the highly damaging effect that such subsidies have on the exports and economy of our country.

In our third party submission, we sought to provide to the Panel, at the earliest possible stage, information on the impact of the WTO-inconsistent US subsidies on Benin. In our view, this provides essential additional context to the issues facing the panel.

I do not intend to repeat what was in our submission, but it is worth highlighting some key facts.

The importance of the cotton sector to Benin can hardly be overstated. As noted in our submission, it accounts for 90 per cent of our agricultural exports, and three-quarters of our export earnings over the past four years. It generates 25 per cent of national revenues. In total, about a million people in Benin – out of a total population of six million – depend on cotton or cotton-related activities. Cotton plays a particularly important role in rural areas, where national poverty reaches its highest levels.

Mr. Chairman, Members of the Panel: the results of US cotton subsidies are readily apparent in West Africa. The United States provides huge, and WTO-inconsistent, subsidies for cotton. This leads to an oversupply of cotton on the world market, and a consequent decline in prices. Moreover, when cotton from Benin enters world markets, it must compete against massively-subsidized US cotton.

The dollar value of these subsidies dwarfs all other economy activity in Benin. As indicated in our submission, the subsidies paid by the United States to its 25,000 cotton farmers exceed the entire gross national income of Benin – and indeed the other countries in the region as well.

This demonstrates, rather dramatically, the impossibility of Benin ever competing with such subsidies. It is inconceivable that any developing country – let alone a least-developed country in West Africa – could ever match the virtually limitless resources of the United States.

Therefore, for us, the solution to this problem lies in the WTO. We ask simply that the United States respect its WTO obligations regarding subsidies.

Mr. Chairman, we agree with Brazil that the United States cannot invoke the peace clause to bar the claims that have been advanced in this dispute. We agree that the peace clause constitutes an

affirmative defence, and that the burden lies on the United States to demonstrate that has met all the conditions for the successful invocation of this affirmative defence. This it has failed to do.

In any event, whether the peace clause constitutes an affirmative defence, as we believe, or is part of the “balance of rights and obligations of Members”, as the United States argues, the result is the same. Brazil’s First Submission has established, clearly and unambiguously, that the United States is in breach of its WTO obligations. The US First Submission has provided no convincing rebuttal of Brazil’s claims.

Mr. Chairman, Members of the Panel:

In its submission of July 11, the United States argued that the phrase “support to a specific commodity” should be understood to mean “product-specific support”. However, the term “product-specific” does not appear in Article 13(b)(ii). If the drafters of the Agreement on Agriculture had wanted to use this term in Article 13(b)(ii), they obviously could have done so, as they did elsewhere in Agreement, such as in Article 6(4), or in Annex 3. Moreover, if the US interpretation were accepted, measures providing support to more than one commodity could not be challenged under Article 13(b)(ii). This elevates form over substance, and is contrary to both the language and the object and purpose of this provision.

Finally, the United States asks this Panel to exclude from its terms of reference certain measures that it argues were not the subject of consultations. We were not part of the consultations, and will not delve into the facts of this disagreement. However, Benin would recall the statement of the Appellate Body in *Brazil Aircraft* (DS46):

“We do not believe....that Articles 4 and 6 of the DSU, or paragraphs 1 to 4 of the SCM Agreement, require a precise and exact identity between the specific measures that were the subject of consultations and the specific measures identified in the request for the establishment of a panel. As stated by the Panel, ‘[o]ne purpose of consultations, as set forth in Article 4.3 of the SCM Agreement, is to ‘clarify the facts of the situation’, and it can be expected that information obtained during the course of consultations may enable the complainant to focus the scope of the matter with respect to which it seeks establishment of a panel.’ [emphasis added]

Indeed, Benin notes that the United States itself took a similar approach in the recent *Japan – Apples* case. In the US replies to the Panel on October 16, 2002, USTR stated that:

“[T]here is no requirement in the DSU to consult on a particular claim in order to include that claim in a panel request and to have such a claim form part of the panel’s terms of reference. The purpose of consultations is to provide a better understanding of the facts and circumstances of a dispute; logically, then, a party may identify new claims in the course of consultations.”

Although this US reply dealt with claims rather than measures, it is consistent with the ruling of the Appellate Body in *Brazil Aircraft* that panels should not require a “precise and exact identity” between the measures that were the subject of consultations and the measures identified in the panel request.

Mr. Chairman, Members of the Panel:

For Benin, this dispute is of critical national importance. As we stated in our Third Party submission, we are not seeking any special and differential treatment in the present case. We are simply asking that the United States abide by the disciplines that it agreed to at the end of the Uruguay Round.

Thank you for allowing Benin to present its views to the Panel. We would be pleased to reply to any questions you may have.

## **ANNEX C-8**

### **THIRD PARTY ORAL STATEMENT OF CANADA**

24 July 2003

#### **I. INTRODUCTION**

1. Mr. Chairman, members of the Panel, on behalf of my Government, I thank you for your consideration of Canada's views in this dispute.

2. Canada's statement today conveys our systemic interest in the interpretation of certain provisions of the Agriculture Agreement and the SCM Agreement regarding certain aspects of Brazil's claims. The first two points we address relate to US domestic support measures and the applicability of the Peace Clause. In this respect, we set out why:

- first, the updating of the base period for US direct payments renders these payments inconsistent with paragraphs 6(a) and (b) of Annex 2 of the Agriculture Agreement; and
- second, US counter-cyclical payments to producers of upland cotton must be counted as "support to a specific commodity" under Article 13(b)(ii) of the Agriculture Agreement.

3. The last point we address is whether there is any exemption for US export credit guarantee programmes from US export subsidy commitments under the Agriculture Agreement. Here, we set out why:

- first, item (j) of the SCM Agreement may not be interpreted a contrario to deem export credit guarantee practices as not providing export subsidies under Article 10.1 of the Agriculture Agreement; and
- second, Article 10.2 of the Agriculture Agreement does not exempt export subsidies granted under export credit guarantee programmes from US export subsidy commitments in the Agriculture Agreement.

#### **II. US DOMESTIC AGRICULTURAL SUPPORT MEASURES**

##### **A. TO BE EXEMPT UNDER ANNEX 2, DIRECT PAYMENTS MUST HAVE THE SAME BASE PERIOD AS PFC PAYMENTS**

4. We turn first to US direct payments. The United States defends these measures by asserting, among other things, that the 2002 FSRI Act redefines and fixes the base period for the duration of the legislation.<sup>1</sup> According to the United States, direct payments therefore fully conform to Annex 2 of the Agriculture Agreement.

5. This, in Canada's view, raises form over substance. In addition to the views we provided in our written third party submission, Canada observes that US direct payments also do not conform to the base period requirement in paragraphs 6(a) and (b) of Annex 2. The structure of the PFC payment

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<sup>1</sup> US First Written Submission, para. 67.



and direct payment programmes are essentially the same<sup>2</sup>, so are the payment parameters.<sup>3</sup> The applicable base period therefore is that for PFC payments. However, the United States allows base acreage determining the receipt and the amount of direct payments to be updated.<sup>4</sup> The base period is therefore not “fixed”, contrary to subparagraph (a). The amount of the payments may also be increased based on the volume of production undertaken by a producer in a year after the applicable base period, contrary to subparagraph (b).

6. The United States itself demonstrates the linkage between PFC payments and direct payments; they are closely related and successor programmes.<sup>5</sup> Yet, the United States takes the position that because the payments are continued under a separate piece of legislation and new regulations, an updating of the base period does not affect their exempt status.<sup>6</sup> In Canada’s view, such formalistic arguments cannot prevail.

#### B. COUNTER-CYCLICAL PAYMENTS ARE “SUPPORT TO A SPECIFIC COMMODITY”

7. Mr. Chairman and members of the Panel, the formalism of US arguments does not stop there. In an effort to avoid the logical conclusion that counter-cyclical payments “grant support to a specific commodity” within the meaning of Article 13 of the Agriculture Agreement, the United States cites varied meanings of the term “specific” and inappropriately incorporates into Article 13 concepts relating to the calculation of the AMS. These arguments are an attempt to detract from the plain text of Article 13 and its straight-forward application to the facts of this case.

8. In Canada’s view, counter-cyclical payments “grant support to a specific commodity” under Article 13(b)(ii) of the Agriculture Agreement.<sup>7</sup> It is hard to see how a measure that grants support that is specific to a “specific commodity” would not be included in the assessment under Article 13(b). It is uncontested that the US measure provides payments in an amount determined by target prices that are specific to certain covered products.<sup>8</sup> The setting of commodity-specific target prices necessarily leads to different levels of support for different products. The cotton-specific support granted in this respect must be taken into account for the purposes of Article 13(b).

### III. US EXPORT CREDIT GUARANTEE PROGRAMMES

9. I now turn to US export credit guarantee programmes.

10. In Canada’s written third party submission we set out the applicable standard for determining whether transactions under these programmes are subsidized within the meaning of Articles 1(e) and 10.1 of the Agriculture Agreement. Canada takes no position on the facts in this respect, but notes that USDA’s own description of its guarantee programmes implies that a benefit is conferred. I quote: “The programmes encourage exports to buyers in countries where credit is necessary to maintain or increase US sales, but where financing may not be available without CCC guarantees.”<sup>9</sup> The Panel should assess CCC premiums in the light of this admitted reality.

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<sup>2</sup> See Brazil First Written Submission, para. 182; Third Party Submission of New Zealand, para. 2.26; Third Party Submission of Australia, paras. 47-48.

<sup>3</sup> US First Written Submission, paras. 58-63.

<sup>4</sup> US First Written Submission, para. 59.

<sup>5</sup> US First Written Submission, fn. 47.

<sup>6</sup> US First Written Submission, para. 67.

<sup>7</sup> See also Exhibit Br-27 (“Title I - *Commodity Programmes*”; “Counter-cyclical payments for wheat, feed grains, upland cotton, rice, and oilseeds” (emphasis added)).

<sup>8</sup> See US First Written Submission, para. 117.

<sup>9</sup> USDA, “Export Credit Guarantee Programmes”, FAS Online at <http://www.fas.usda.gov/excredits/exp-cred-guar.html>, (second sentence) [Exhibit CDA-3].

11. Today, Canada addresses the two exemptions alleged by the United States in support of its assertion that the US programmes do not grant export subsidies in violation of US export subsidy commitments under Articles 8 and 10.1 the Agriculture Agreement. The claimed exemptions are the following:

- First, item (j) of the SCM Agreement sanctions any US export subsidy provided through CCC-guaranteed credit transactions because the programmes come within the scope of item (j) yet do not meet the standard it establishes. According to the United States, item (j) may be interpreted a contrario to allow subsidized export credit transactions. It follows for the United States that its programmes do not confer export subsidies within the meaning of Article 3.1(a) of the SCM Agreement and Article 1(e) of the Agriculture Agreement;
- Second, Article 10.2 of the Agriculture Agreement exempts outright any subsidized export credit transactions from US export subsidy commitments.

12. The panel in Brazil – Aircraft considered the first type of alleged exemption at length in its first implementation report. The United States was a third party in that case, and argued for an a contrario interpretation of the first paragraph of item (k) of the Illustrative List.<sup>10</sup> The panel rejected all arguments in this respect and concluded that the provision could not be used to establish that a prohibited export subsidy under the SCM Agreement is otherwise permitted.

13. The panel’s reasoning in that case applies with equal force here. Briefly, the panel found that:

- First, Annex I is purely “illustrative” and does not purport to exhaustively list all export subsidy practices<sup>11</sup>,
- Second, a measure that falls within the scope of Annex I is deemed to be a prohibited export subsidy such that where a Member demonstrates that the measure meets the standard in any of the listed items, it does not also have to demonstrate that the measure comes within the scope of Articles 1 and 3.1(a) of the SCM Agreement<sup>12</sup>, and
- Third, footnote 5 of the SCM Agreement provides that practices described in Annex I may be properly considered not to constitute an export subsidy only in two situations. The first situation is where an affirmative statement in the Agreement provides that the measure in question is not an export subsidy; the second is where an affirmative statement in the Agreement provides that measures satisfying the conditions of an item in Annex I are not prohibited.<sup>13</sup> Footnote 5 reads “Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement”.

14. In its second implementation report in Brazil – Aircraft, the panel applied the same reasoning.<sup>14</sup> Applying this reasoning to the case at hand, footnote 5 to the SCM Agreement precludes reliance on an a contrario interpretation of item (j) as an implied exclusion to any finding of subsidized transactions under the US programmes.

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<sup>10</sup> *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW, adopted 4 August 2000, paras. 6.24-6.67 [*Brazil – Aircraft, First Recourse*].

<sup>11</sup> *Ibid.*, para. 6.30.

<sup>12</sup> *Ibid.*, para. 6.31.

<sup>13</sup> *Ibid.*, paras. 6.37.

<sup>14</sup> *Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW2, adopted 23 August 2001 at paras. 5.274 and 5.275.

15. Regarding Article 10.2 of the Agriculture Agreement, Canada's view is that the words of that provision speak for themselves. Members have undertaken to work towards internationally agreed disciplines to govern the provision of export credit guarantees. Nothing in that provision states that the export subsidy obligations in Article 10.1 of the Agreement do not apply to US export credit guarantee practices. Where Members have wanted to exempt measures from export subsidy obligations, they have been clear— such as in the second paragraph of item (k) of the SCM Agreement.<sup>15</sup>

16. In addition, the US interpretation of this provision does not accord with its object and purpose. Canada shares the views of other third party participants in this dispute that the ongoing work under Article 10.2 is expected to further elaborate on current disciplines regarding export credit practices and to perhaps more clearly identify when such practices shall or shall not be deemed to confer export subsidies within the meaning of Article 1(e) of the Agriculture Agreement.<sup>16</sup> The obvious precedent in this respect is the second paragraph of item (k) of the SCM Agreement.

#### IV. CONCLUSION

17. In conclusion, Mr. Chairman and members of the Panel, the Panel should find that the United States rendered direct payments inconsistent with Annex 2 of the Agriculture Agreement by allowing the base period to be updated. This finding would be in addition to a finding that PFC payments and direct payments do not conform to Annex 2 because the amount of the payment is linked to the type of production after the base period. Regarding counter-cyclical payments, the Panel should find that this support to US producers of upland cotton must be counted as “support to a specific commodity” under Article 13(b)(ii) of the Agreement. Finally, regarding US export credit guarantee programmes, the Panel should confirm that neither the Agriculture Agreement nor the SCM Agreement contain an exemption for any US export credit guarantee subsidy found in this case. Were the Panel to find that such subsidies exist – which in Canada's view is the most likely outcome to the Panel's assessment of the facts – then the Panel must conclude that the United States grants export subsidies in violation of its export subsidy commitments under Articles 8 and 10.1 the Agriculture Agreement and that Article 13(c)(ii) therefore does not apply.

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<sup>15</sup> See also *Brazil – Aircraft, First Recourse*, para. 6.36.

<sup>16</sup> See First Third Party Submission by the European Communities, para. 30 and Third Party Submission of New Zealand, paras. 3.15-3.16.

## ANNEX C-9

### ORAL STATEMENT OF CHINA AT THE THIRD PARTY SESSION

24 July 2003

1. Thank you, Mr. Chairman, and members of the Panel. China is appreciative of this opportunity to present its views on the issues raised in this Panel proceeding. In its third party written submission of 15 July, China explained its views in relation to three issues. In this statement, I will summarize China's major points.
2. The first issue that China would like to have this Panel's attention is about the burden of proof issue under the Peace Clause.
3. China agrees with Brazil's argument that the Peace Clause is an affirmative defence in nature. If the United States claims that defence, the burden of proof is on the United States.
4. Contrary to what the United States see, China believes that the Peace Clause does not impose positive obligations. Stand-alone, Annex 2 and Article 6 of the *Agreement on Agriculture* may have positive obligations; but when they are cross-referred to by the Peace Clause, they become part and parcel of conditions that must be met before a Member can move under its safety.
5. China believes the US errs on seeing no distinction between "obligation" and "condition". The Peace Clause requirement for full conformity with Article 6 and Annex 2 does not create new obligations because Members have to comply with Article 6 and Annex 2 whether Article 13 exists or not. Within the Peace Clause, these requirements do not stand to impose obligations on Members, but to set conditions precedent for a Members intending to invoke Peace Clause protection. Positive obligations to comply with these requirements, if there is any, lie under where they are, i.e. under Article 6 and Annex 2, but not under the Peace Clause.
6. China does not see any "absurdity" as described by the United States in its written submission. No such "absurdity" would be instilled into the process if at the first stage, the party alleging protection of Peace Clause for its measures is required to discharge its burden to prove that such measures do conform to the relevant Peace Clause conditions; if it cannot so prove, the measures would lose Peace Clause protection. A second stage will follow for the party claiming against the measures to establish its substantive case, without the Peace Clause shield.
7. With respect, China submits that the burden of proof issue must be resolved first. China also hopes that the above two-step approach will help this Panel and the parties to move the procedures on towards resolution of the case.
8. The second point that China made in its written submission relates to proper categorization of US Direct Payments (shortened as "DP") under the US Fair Security and Rural Investment Act of 2002 (shortened as "FSRI"). Allow me to shorten that act to FSRI. Without repeating the issue of burden of proof, preponderance of evidence suggests that such Direct Payments are not "Green Box" in nature.

9. One of the requirements for “Green Box” Direct Payment support measures lies under Para. 6(a) of Annex 2 to the *Agreement on Agriculture*. The paragraph provides to the effect that eligibility shall be determined by “clearly-defined criteria” “in a defined and fixed base period”.

10. The word “in” requires a link between the “criteria” and the “defined and fixed base period”. In other words, to qualify for “Green Box” direct payment measure under Para. 6(a), a criterion adopted by a Member must be tied, in a chronological sense, to a starting time frame that cannot be moved up on the calendar.

11. As the United States has explained, 2002 FSRI DP allowed landowners to retain PFC base acreage under the 1996 Federal Agriculture Improvement and Reform Act (shortened as “FAIR”) and “add 1998-2001 acres of eligible oilseeds or simply declare base acreage for all covered commodities” (including upland cotton). In addition, while a landowner may elect to simply utilize acres devoted to covered commodities during the 1998-2001 period for purpose of DP, a landowner need not do so; base acres may remain those under FAIR of 1996, implying no cotton production need have occurred since the 1993-1995 period for a landowner to have “cotton base acres”. Consideration the progression from PFC to DP, one can see that contrary to the US argument that “base acres are defined in the 2002 [FSRI] Act and fixed for the duration of the legislation”, the requisite link between the programme acreage as a criterion and the starting time frame under the DP is broken. The change of legislation from FAIR to FSRI and the replacement of PFC with DP were utilized to for producers to leap from their previous coverage acreage, which should have been tied to the base period, to a new updated acreage in 2002.

12. Therefore, in China’s opinion, preponderance of evidence proves that the US direct payments under the FSRI shall be properly categorized as non-“Green Box” measures.

13. The last issue that China considers important is about export subsidy support granted by US “Foreign Sales Corporations” for upland cotton export sales under the “FSC Repeal and Extraterritorial Income Act of 2000”. Its short name is ETI Act.

14. The ETI Act has previously been found to violate the *Agreement on Agriculture* and the *Subsidies Agreement* by both the panel and the Appellate Body in *US – FSC (21.5)* case. On 29 January 2002, the DSB adopted the panel and Appellate Body reports. Following US failure to withdraw such export subsidy support, on 7 May 2003, the DSB authorized the EC to impose countermeasures against the US.

15. China believes that the panel and the Appellate Body’s reasoning and their conclusion in *US – FSC (21.5)* should be considered and taken by this Panel.

16. The measures challenged by Brazil in the current proceeding are exactly the same challenged by the EC in *US – FSC (21.5)*. Reasoning and conclusion by the earlier panel and the Appellate Body are more than relevant to the current case. Their reports, once adopted by DSB not only create legitimate expectations, but also reflect the collective will of the WTO membership.

17. In that respect, allow me to quote the panel in *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, for this Panel:

[I]n the course of “normal dispute settlement procedures” required under Article 10.4 of the DSU, we *will take into account the conclusions and reasoning* in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination, we believe that we *should give significant weight to both Article 3.2 of the DSU*, which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, *and to the need to avoid inconsistent rulings* (which

concern has been referred to by both parties). In our view, these considerations form the basis of the requirement of the referral to the "original panel" wherever possible under Article 10.4 of the DSU.

18. This concludes my oral presentation. China welcomes questions from the Panel regarding these issues.

## ANNEX C-10

### ORAL STATEMENT BY THE EUROPEAN COMMUNITIES

24 July 2003

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## I. INTRODUCTION

1. Mr. Chairman, Distinguished Members of the Panel, the European Communities is grateful for the opportunity to express its views in this third party session.

2. We would first like to welcome the involvement of Benin in this procedure. The European Communities is of the view that the involvement of least developed countries in dispute settlement is highly desirable. We hope that other least developed countries follow Benin's lead.<sup>1</sup>

3. This is a complex case which raises many difficult and important interpretative issues. Those responsible for drafting Article 13 of the *Agreement on Agriculture* have left you with some difficult questions. Despite those difficulties, Article 13 in particular, and the *Agreement on Agriculture* more generally, represent a finely balanced and much fought over package of rights and obligations assumed by WTO Members. The European Communities is confident that this Panel will undertake a careful examination of these very precise terms and preserve the delicate balance of rights and obligations which has been negotiated.

4. This dispute raises a large number of issues. In our interventions, we have concentrated on those issues of principle which we consider are of systemic concern. Today, we will largely address issues which were not addressed in our written submission. At the same time, we also consider it necessary to revisit some issues which we have already addressed in order to rebut some of the arguments raised by other parties.

5. The European Communities starts by setting out its conception of the role of the peace clause (section II). We will then address several questions of interpretation relating to the peace clause (section III). We then turn to consider the interpretation of Annex 2 of the *Agreement on Agriculture* (the Green Box) (Section IV) before considering the status of domestic content subsidies and export credits under the *Agreement on Agriculture* (Section V). We conclude with some comments on one of the requests for preliminary rulings raised by the United States (Section VI).

## II. THE ROLE OF THE PEACE CLAUSE

6. We turn first to consider the role of the Peace Clause (Article 13).

7. The European Communities views Article 13 as one element regulating the interface between the *Agreement on Agriculture* and the *SCM Agreement*. It defines, in some cases, how subsidies granted pursuant to the *Agreement on Agriculture* should be treated for the purposes of countervailing duty investigations, and in other cases exempts such subsidies from actions under the *SCM Agreement*. The European Communities disagrees with both Brazil and the United States as to how the term "exempt from action" should be understood. However, while we disagree with the United States' logic, we do not disagree with the practical result of the application of its logic.

8. The term "exempt from action" cannot mean, as Brazil claims, that, even if the peace clause is applicable, the Panel must examine Brazil's claims under the *SCM Agreement*, and that if the Panel finds that the United States has acted inconsistently with the *SCM Agreement*, the DSB should somehow "refrain" from recommending the United States to bring itself into conformity with the *SCM Agreement*. The European Communities finds it difficult to imagine how the DSB, operating under the negative consensus rule, could refrain from recommending the United States bring itself into conformity should the Panel find that the United States had acted inconsistently with the *SCM Agreement*. Moreover, the United States can reasonably argue that it is not required to bring itself

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<sup>1</sup> This text was not in the written statement circulated at the third party session, but reflects unscripted comments made during that session.



into conformity with the *SCM Agreement* by withdrawing measures which it is perfectly entitled to maintain under the *Agreement on Agriculture*, pursuant to both Article 13 and Article 21. The only answer to this question is that if the United States is entitled to peace clause protection, the Panel cannot find in favour of Brazil's *SCM Agreement* claims.

9. The European Communities does not agree with the United States that Article 13 prevents a Member from requesting consultations or the establishment of a panel with respect to a measure which might be entitled to Article 13 protection. It is not, as the US argues, the mere fact that the defendant Member is unable to block a request for consultations, or for establishment of a panel, that the applicability of the peace clause has come before this Panel. The need for the Panel to adjudicate this issue flows from the fundamental principle underlying the WTO Agreement that every question of interpretation of the WTO Agreements which "affects the operation of any covered agreement" must be subject to the DSU.<sup>2</sup> However, as we have noted, if the Panel determines that the US measures in question are protected by Article 13, it cannot find in favour of Brazil's claims under the *SCM Agreement*.

### III. INTERPRETATION OF THE PEACE CLAUSE

10. The Panel has a number of challenging questions before it on the interpretation of various aspects of Article 13(b). The European Communities turns now to set out its position on some of the issues before the Panel.

#### A ARTICLE 13 IS NOT AN AFFIRMATIVE DEFENCE

11. The European Communities will only briefly touch upon the issue of the burden of proof for Article 13. The European Communities has yet to hear a credible response to the argument that putting the burden of proof on the defendant has perverse effects. As the European Communities and the United States have pointed out, when a complainant brings a case only under the *Agreement on Agriculture* (for instance alleging breach of Article 6) it will bear the burden of proof. However, if Article 13 is considered an affirmative defence, when a complainant brings a dispute under Articles 5 and 6 of the *SCM Agreement* and, for instance, Article 6 of the *Agreement on Agriculture*, the complainant would be required to prove a breach of Article 6 while at the same time the defendant would also be required to prove that it had not infringed Article 6 of the Agreement. The burden of proof cannot switch between parties simply on the basis of whether the complainant cites the *SCM Agreement* or not, but this would be the result of interpreting Article 13 as an affirmative defence.

12. Further confirmation that Article 13 is not an affirmative defence can be drawn from the fact that Article 13 also regulates the application of countervailing duties on agricultural subsidies. In this context, a determination that the subsidy in question is not protected by Article 13 must be taken by an investigating authority before it may impose countervailing duties. Article 13 is consequently a pre-condition for an individual Member in taking action against subsidised exports. It cannot, in that context, be considered as a defence for exporters co-operating in an investigation and may, as the United States have pointed out, be used as the foundation for a claim in a WTO dispute by the exporting Member that countervailing duties have been illegally imposed. There is no reason why that conception of Article 13 should change simply because the issue arises in WTO dispute settlement.

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<sup>2</sup> Article 4.2 DSU.

## B. RELEVANT COMPARISON FOR THE PURPOSES OF ARTICLE 13

13. Brazil has argued that any breach of the 1992 level during the 9 year implementation period removes the protection of Article 13.<sup>3</sup> The European Communities agrees with the United States that this is incorrect.<sup>4</sup> The present tense of the phrase “do not grant support” makes this clear. The comparison for the purpose of Article 13(b) must be between the level of support decided in the 1992 marketing year and that granted by virtue of the measures being challenged. This would typically mean the most recent marketing year.

## C. THE MEANING OF “DECIDED DURING THE 1992 MARKETING YEAR”

14. We now turn to consider the meaning of the phrase “decided during the 1992 marketing year”. Brazil argues that the term “decided” refers to a decision to budget a specific amount of domestic support over a number of years.<sup>5</sup> Brazil then goes on to suggest that because the United States did not make a “decision” during marketing year 1992 with respect to upland cotton, the only decision which the United States can be said to have made during marketing year 1992 was the continued funding of its programmes for upland cotton. Brazil then calculates the US’ budgetary outlays in respect of upland cotton in 1992; in other words, Brazil looks at the support actually granted.<sup>6</sup>

15. The European Communities is concerned that Brazil appears to consider that the support “decided” in the sense of Article 13 can be equated with the support granted as Brazil has done in its use of US budgetary outlays. Such an interpretation ignores the meaning of the word “decided”. That the use of the word “decided” cannot be equated with the term “granted” is illustrated by the following.

16. First, the use of the word “decided” itself is notable. It is, however, notable primarily for what it is not. WTO Members did not use the word “granted” which is the word which one would expect to be used had this phrase been intended to refer only to the domestic support actually used during the 1992 marketing year. The use of the word “decided” stands out particularly when it is compared to the use of the word “grant” in the very same sentence. The United States has made the same point with respect to the decision not to use the word “provided”.<sup>7</sup> If WTO Members had intended that the support granted in the most recent period was to be compared to that granted in marketing year 1992 the word “decided” would not have been used. For this reason, Brazil’s use of US budgetary outlays for marketing year 1992 is clearly flawed.

17. Second, the word “decided”, meaning “settled, certain”,<sup>8</sup> also implies a one-off decision. It would be odd to talk of an administration “deciding” countless applications for support under a particular programme. However, this is what Brazil’s use of US budgetary outlays implies.

18. Finally, the use of the word “during” confirms that WTO Members intended that the decision need not be of application only in marketing year 1992 but may also cover future periods. The use of the word “during” (meaning “in the course of”<sup>9</sup>) implies a one-off decision, and does not suggest that the period of application of the decision must be limited to marketing year 1992. Had WTO Members intended a limitation to the support provided or granted in 1992 the word “for” would have been used

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<sup>3</sup> Brazil’s First Written Submission, paras.142 and 146-150.

<sup>4</sup> US First Written Submission, para. 79 and 90.

<sup>5</sup> Brazil’s First Written Submission, paras. 139 and 140.

<sup>6</sup> Brazil’s First Written Submission, paras. 141-145.

<sup>7</sup> US First Written Submission, paras.83-84.

<sup>8</sup> The New Shorter Oxford English Dictionary, 1993.

<sup>9</sup> The New Shorter Oxford English Dictionary, 1993.

in place of “during”. This further confirms that Brazil's use of US budgetary outlays cannot be considered correct.

19. Consequently, Article 13(b)(ii) and (iii) are intended to set up as a benchmark an amount of support adopted by some form of decision (be it political, legislative or administrative) in which support for a specific product is decided and allocated for future years. It is clearly not intended to set up a comparison between domestic support granted in 1992 and domestic support granted in a more recent period. The European Communities respectfully requests the Panel not to follow Brazil's equation of the term decided with the term granted.

20. For the European Communities, the question of what decision was adopted during 1992 by the United States is a question of fact which we do not take a position on, especially as we are not fully aware of all the elements which might be relevant.

#### D. THE MEANING OF THE TERM “SUPPORT TO A SPECIFIC COMMODITY”

21. The United States has argued that the term “support to a specific commodity” is synonymous with the term “product-specific support”.<sup>10</sup> Brazil had, in its First Written Submission, taken all support which was specific to cotton, and added to it a proportion of generally available support intended to represent the amount of such support which could be attributed to cotton.<sup>11</sup>

22. The European Communities shares the approach of the United States. Quite simply, support which is provided to a number of crops cannot at the same time be considered “support to a specific commodity”. Such support is “support to several commodities” or “support to more than one commodity”.

23. With respect, Brazil and New Zealand are wrong to suggest that the word “specific” was added to make clear that the applicable benchmark under Article 13 was not the overall level of subsidies decided but rather was to be undertaken on a product-by-product basis.<sup>12</sup> A brief glance at the *SCM Agreement* finds it replete with references to “a product” or “a subsidised product”.<sup>13</sup> Consequently, it could make no sense to interpret Article 13 as being based on overall support. The word “specific” was not, therefore, inserted to differentiate the use of Article 13 in respect of specific products to the application of Article 6 to overall agricultural support, but rather as a qualifier to the word “support”.

24. Consequently, the Panel should conclude that the correct comparison is between product specific support decided in 1992 and product specific support currently provided.

### IV. THE INTERPRETATION OF ANNEX 2 OF THE AGREEMENT ON AGRICULTURE (THE “GREEN BOX”)

#### A. FIRST SENTENCE OF THE FIRST PARAGRAPH OF ANNEX 2<sup>14</sup>

25. Australia has argued in its comments today that the European Communities is incorrect to consider that the first sentence of the first paragraph of Annex 2 does not impose a separate obligation. The European Communities notes, however, that Australia does not comment and does not

<sup>10</sup> US First Written Submission, paras. 77-78.

<sup>11</sup> Brazil's First Written Submission, para. 143.

<sup>12</sup> Brazil's First Written Submission, para. 136; New Zealand Third Party Submission Para. 2.22.

<sup>13</sup> See, in particular, Article 6.3.

<sup>14</sup> This section was not in the written statement circulated at the third party session, but reflects unscripted comments made during that session.

attempt to rebut the compelling contextual arguments that the European Communities has made in its written submission.<sup>15</sup> The European Communities pointed out that in several instances that the *Agreement on Agriculture* refers to the "criteria" for inclusion in the green box, specifically in Articles 6 and 7, and most importantly, in paragraph 5 of Annex 2. There is no such reference to the "fundamental requirements". The European Communities recalls that a panel is obliged to follow the accepted canons of interpretation of international law, and therefore, to view the ordinary meaning of the words concerned in light of their context and objective. Consequently, it is clear that the first sentence of paragraph 1 of Annex 2 is not, in and of itself, an independent obligation. This does not render it inutile, as Australia charges. The first sentence sets out an objective and indicates the type of effects which respect for the criteria in the green box is deemed to create. The European Communities urges the Panel to reject Australia's unsubstantiated arguments.

## B. TYPE OF PRODUCTION

26. Brazil has argued that the fact payments are reduced where fruits and vegetables, and certain other crops are grown on contract acreage for the purposes of PFC and direct payments means that the "amount of such payments [is] related to or based on, the type or volume of production [..] in any year after the base period" (Paragraph 6(b) of Annex 2). However, Brazil also appears to recognise that farmers claiming the benefit of direct payments may plant crops other than the programme crops, and may even not produce any crops.<sup>16</sup> The United States asserts that no current agricultural production is required in order to benefit from direct payments.<sup>17</sup>

27. Assuming the US' assertion to be correct (as seems to be acknowledged by Brazil) the Panel is faced with a dilemma. Is the amount of funding provided by a programme, from which a farmer can benefit without producing anything, to be considered to be "based on or linked to a certain type of production", when payments under that programme can be reduced by growing certain crops? Brazil and some third parties simply assume that where payments can be reduced by growing certain crops, the programme is based on or linked to a certain type of production. Such a view does not, however, take account of the complexity of the situation.

28. In the view of the European Communities, reducing payments under a programme, where a farmer grows fruit or vegetables does not mean that the amount of the payment is linked to type of production. This is because the farmer is free to produce a whole range of other crops, or even not to produce at all and receive the full payment.

29. What Brazil and other third parties fail to realise is that the reduction in payment for fruits and vegetables, if the European Communities understands correctly, is in fact designed to avoid unfair competition within the subsidising Member. Brazil and the other third parties have not challenged the right of a subsidising Member to decide decoupled payments based on past production of, or acreage utilised for, certain crops. Indeed, this is permitted in paragraph 6(a) of Annex 2. However, in the case where, for instance, upland cotton production enjoyed support, while fruit and vegetable production did not, decoupled payments based on past cotton production would allow subsidised former cotton farmers to grow fruit and vegetables, and thus unfairly compete with pre-existing fruit and vegetable producers who could not benefit from the decoupled payments because they had not produced cotton or other supported products in the base period. Thus, the reduction in payments is a necessary element in ensuring that the equilibrium established by the market for the production of fruit and vegetables is not artificially disturbed by the introduction of decoupled support.

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<sup>15</sup> EC's First Third Party Submission, paras. 15-25 and in particular paras. 22 and 23.

<sup>16</sup> Brazil's First Written Submission, para. 49.

<sup>17</sup> US First Written Submission, para. 68.

30. Furthermore, finding that Brazil and the other third parties are correct would have perverse effects. The whole *Agreement on Agriculture* is geared at gradually reducing certain types of domestic support. However, if a Member could not reduce decoupled payments when certain types of products which had previously not enjoyed any support are grown, the net effect would be that WTO Members wishing to provide decoupled support would have to increase overall support, and provide producers previously excluded with support which they had not previously enjoyed. This is clearly not an effect which the negotiators of the *Agreement on Agriculture* intended.

31. In this light, this potential reduction of payment is very different from the prohibition set down in paragraph 6(b) of Annex 2. Paragraph 6(b) is intended to prevent an artificial pressure to produce certain crops in order to obtain decoupled payments. Reducing payments where fruit and vegetables are produced does not act to pressure farmers into growing a particular type of crop. Rather, it prevents internal unfair competition. At the same time, as we understand the US measure, it does not oblige a farmer to produce any particular type of crop, in fact requires no production, and therefore should not be considered inconsistent with paragraph 6(b).

#### C. A DEFINED AND FIXED BASE PERIOD

32. The European Communities would also like to comment briefly on the arguments raised by Brazil and some of the third parties with respect to the updating of the base periods in the 2002 FRSI Act. We take note of the US statement that the updating of the base period was necessary in order to bring support for oilseeds production under the direct payments scheme.<sup>18</sup> In order to ensure the progressive movement of production distorting subsidies to decoupled subsidies we consider that it must be possible to have different reference periods where eligibility is based on previous eligibility for production distorting subsidies. We see nothing in paragraph 6 of Annex 2 which might prevent this. At the same time, however, the European Communities is concerned that continued updating of reference periods in respect of the same already decoupled support, creating an expectation that production of certain crops will be rewarded with a greater entitlement to supposedly decoupled payments, tends to undermine the decoupled nature of such payments.

### V. INTERPRETATION OF THE *AGREEMENT ON AGRICULTURE* /RELATIONSHIP WITH THE *SCM AGREEMENT* AND GATT 1994

#### A. ARE DOMESTIC CONTENT SUBSIDIES EXPRESSLY PERMITTED BY THE *AGREEMENT ON AGRICULTURE* ?

33. Brazil has argued that US Step 2 payments, which it alleges are conditional upon use of domestic goods, are inconsistent with Article 3 of the *SCM Agreement* and Article III.4 GATT 1994. New Zealand supports this claim. However, as with other claims, their analysis does not take fully into account the complexities of the situation. The European Communities agrees with the United States that subsidies contingent upon the use of domestic goods, which are maintained consistently with the *Agreement on Agriculture* are not inconsistent with either the *SCM Agreement* or GATT 1994.

34. The first question is whether subsidies contingent upon the use of domestic goods are consistent with the *Agreement on Agriculture*. The answer is a clear yes. Article 3.2 of the *Agreement on Agriculture* requires Members not to:

“...provide support in favour of domestic producers in excess of the commitment levels specified in Section I of Part IV of its Schedule.” (emphasis added).

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<sup>18</sup> US First Written Submission, para. 60.

35. We have emphasised the phrase “in favour of”. This is significant because it does not require that support be “to” domestic producers. The same term is used in Article 1(a) (the definition of AMS) and in Article 1(h) (definition of Total AMS). Moreover, it is established with respect to Article 1 of the *SCM Agreement* that a financial contribution and benefit need not be bestowed on the same person.<sup>19</sup> Consequently, it is simply logical that support may be provided in favour of domestic producers through the provision of funds to processors of the product concerned, and consequently that access to such subsidies be limited to domestic produce, in order to ensure that it is domestic producers who benefit from this subsidy. Indeed, WTO Members, in their wisdom, recognised precisely this possibility in Annex 3 to the *Agreement on Agriculture* where they explained how the AMS was to be calculated. Paragraph 7 thereof explicitly contemplates that:

“measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products.”

36. Consequently, it is clear that a Member has a right to provide subsidies contingent upon use of domestic products under the *Agreement on Agriculture*. On this, the US and the European Communities agree.

37. The second question for the Panel is how does that right relate to the prohibition in Article 3 of the *SCM Agreement* and the national treatment obligation in Article III.4 of GATT. Here, again, we agree with the United States.

38. Article 21.1 of the *Agreement on Agriculture* provides that the other goods agreements will apply “subject to” the provisions of the *Agreement on Agriculture*. That is, the other Annex 1A Agreements will be subordinated to the *Agreement on Agriculture*.<sup>20</sup> A finding that a measure was a domestic content subsidy would mean that such a subsidy would be prohibited under Article 3.1(b) of the *SCM Agreement* and would (in all likelihood) be inconsistent with Article III.4 GATT. In such an event, the consequences of such a finding would have to be subordinated to the right to adopt such measures under the *Agreement on Agriculture* (provided reduction commitments are respected). Moreover, the chapeau of Article 3.1 of the *SCM Agreement* clearly exempts from the scope of that Article domestic content subsidies which are maintained consistently with the *Agreement on Agriculture* and Article III.8 may be relevant to any claim under Article III.4. GATT.

39. Consequently, Brazil’s claims that domestic content subsidies maintained consistently with the *Agreement on Agriculture* can be found to be inconsistent with the *SCM Agreement* and Article III.4 GATT should be dismissed.

#### B. EXPORT CREDIT GUARANTEES WHICH OPERATE AS EXPORT SUBSIDIES ARE SUBJECT TO AGREEMENT ON AGRICULTURE OBLIGATIONS ON EXPORT SUBSIDIES

40. The United States maintains, in its first written submission, that Article 10.2 of the *Agreement on Agriculture* operates so as to exclude export subsidies in the form of export credits or export credit guarantees. This is not borne out by the text of Article 10.2. Article 10.2 provides for disciplines to be negotiated on the provision of export credits and export credit guarantees; it does not provide an exemption to the export subsidy obligations of the *Agreement on Agriculture*.

41. The United States provides numerous examples of instances in which the WTO has foreseen further negotiations. However, none of these examples support the United States argument that there are no disciplines for export credit guarantees which operate as export subsidies.

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<sup>19</sup> See, Appellate Body Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, adopted 8 January 2003, para. 110.

<sup>20</sup> The New Shorter Oxford English Dictionary, 1993.

42. The best example to illustrate this point is the agreement to negotiate disciplines on harmonised rules of origin. The fact that it was agreed to have negotiations on rules of origin simply means that there is no requirement for a WTO Member to apply an as yet un-finalised set of harmonised rules of origin. However, this does not imply that a WTO Member is exempted from other WTO obligations when it comes to apply rules of origin. A WTO Member must, for instance, in applying its rules of origin, respect the most-favoured nation principle set out in Article 1 GATT. Similarly, while there may not be disciplines on the provision of export credits and export credit guarantees, clearly export credits or export credit guarantees which operate as export subsidies are subject to the export subsidy disciplines of the *Agreement on Agriculture* and the *SCM Agreement*.

43. Other examples are equally illustrative. The US cites provisions in the GATS providing for negotiations on government procurement, emergency safeguards and subsidies on trade in services. However, it does not point out the fact that these subjects are clearly not subject to GATS disciplines, and thus negotiations are required to develop even minimal disciplines. Government procurement in services is the best example – GATS disciplines are explicitly excluded by Article XIII GATS. In contrast, there is no clear exclusion of export credits or export credit guarantees which operate as export subsidies from the *Agreement on Agriculture*.

44. Finally, contrary to the US suggestions, such an interpretation does not render Article 10.2 meaningless. Article 10.2 is not intended to regulate export credits and export credit guarantees as export subsidies but rather to provide for a general set of disciplines comparable to the OECD guidelines for export credits for industrial goods. That the Harbinson text (which of course has yet to be agreed) contains provisions on export credit and export credit guarantees is a recognition that disciplines must be negotiated and that clarification must be provided as to which export credits or export credits guarantees are, in the case of agricultural products, to be considered export subsidies, but is not a recognition that such support which operates as an export subsidy are not currently subject to the obligations of the *Agreement on Agriculture*.

## **VI. MEASURES BEFORE THE PANEL (FSC REPLACEMENT SCHEME)**

45. The United States has argued that Brazil has failed to make a prima facie case of the inconsistency of the FSC Replacement scheme (the ETI) with the covered agreements. The European Communities must admit to being surprised that the United States considers that Brazil has to present a prima facie case of inconsistency. According to Article 17.14 of the DSU parties to a dispute must “unconditionally accept” adopted Appellate Body Reports as “a final resolution to that dispute.”<sup>21</sup> Given that the United States must be assumed to have unconditionally accepted the findings of the Appellate Body in the FSC 21.5 dispute, which, by definition also included a finding that the United States was illegally providing export subsidies to unscheduled agricultural products such as upland cotton, the European Communities fails to see how the United States can argue that Brazil needs to establish a prima facie case. On the contrary, Brazil simply needs to assert a claim.

## **VII. CONCLUSION**

46. This brings us to the end of our statement today. Thank you for bearing with us through a statement which was inevitably long, given the complexity of the issues, and the very short time we had to prepare our written submission.

47. There are a few central points which we would like to leave you with:

- The peace clause is not an affirmative defence;

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<sup>21</sup> Appellate Body Report US- Shrimp (21.5 – Malaysia) para. 97.

- The term "decided" cannot be equated with "granted";
- Reducing payments where certain crops are grown for reasons of internal competition does not amount to basing payments on a certain type of production;
- Domestic content subsidies in favour of domestic producers are permitted under the *Agreement on Agriculture*, and can be maintained irrespective of other provisions; and,
- Export credit guarantees which operate as export subsidies are subject to the *Agreement on Agriculture*.

48. Thank you for your attention. We are, of course, happy to answer your questions, here or in writing.



## ANNEX C-11

### INDIA'S ORAL STATEMENT

Mr. Chairman and Members of the Panel,

I thank you for the opportunity to present India's views in this third party session. India has a few short comments to make on the issues in the dispute.

1. Brazil has challenged the US Subsidy programme relating to cotton. The main schemes challenged are
  - (i) Step 2 export payments
  - (ii) US export credit guarantee programmes, and
  - (iii) Extra Territorial Income (ETI) Act export subsidies.
2. These schemes do not conform to the provisions of Part V of the Agreement on Agriculture and thus have no "peace clause" protection from claims under the Subsidies Agreement. These schemes also violate Article 3.1(a) & 3.2 of the Subsidies Agreement.
3. The scheme relating to Step 2 export payments constitutes an export subsidy within the meaning of the Agreement on Agriculture. It also violates the Subsidies Agreement as
  - (i) It involves grants within the meaning of the Subsidies Agreement as the US Government pays money to its exporters
  - (ii) These grants involve direct transfer of economic resources for which the US Government receives no consideration
  - (iii) The scheme confers a benefit within the meaning of Article 1.1(b) of the Subsidies Agreement as they constitute "free money" for which exporters incur no corresponding obligations and they are made for "less than full consideration" and
  - (iv) The Scheme is also export contingent within the meaning of Article 3.1(a) of the Subsidies Agreement because exporters are only eligible for payments if they produce evidence that they have exported an amount of US upland cotton.
4. The three Export Credit Guarantee Programmes (GSM 102, GSM 103 & SCGP) are export subsidies within the meaning of the Agreement on Agriculture (AOA) as
  - (i) They are operated "at premium rates which are inadequate to cover the long term operating costs and losses of the program" as per item (j) of the illustrative list of export subsidies in ASCM.
  - (ii) They involve financial contributions that confer "benefits" and are contingent upon export performance within the meaning of Article 1.1 & 3.1(a) of the Subsidies Agreement. The US itself treats them as subsidies in its budget.
5. The ETI Act constitutes export subsidies within the meaning of Article 10.1 of the Agreement on Agriculture. This Act operates to circumvent the US export subsidy commitments by providing an export subsidy to upland cotton while the US does not have any export subsidy reduction commitments for cotton in violation of Articles 10.1 & 8 of the AOA.

6. The Step 2 Domestic Payment Scheme grants are direct transfers of funds and constitute a financial contribution by a Government within the meaning of Article 1.1(a)(1)(i) of the Subsidies Agreement. They also confer a “benefit” within the meaning of Article 1.1(h) of the Subsidies Agreement because the domestic user of US upland cotton receives the financial contribution on terms more favourable than those available in the market. Moreover these payment are contingent upon the use of domestic over imported goods.

Mr. Chairman, Members of the Panel,

7. Brazil has provided the legal arguments as to why the US has no basis to assert a “peace clause” defence against Brazil’s claims on actionable/prohibited subsidies being given by the US.

8. According to Brazil, the “peace clause” of AOA Article 13 is in the nature of an affirmative defence. The US has indicated that it will invoke a “peace clause” defence in the matter. This means that the burden of proof will be on US to show that the US domestic support and export subsidies to upland cotton are provided in conformity with the requirements of the “peace clause”.

9. Brazil has argued that US has no “peace clause” protection under AOA Article 13(c) as the US while invoking an affirmative defence must demonstrate that its export subsidies conform fully to the provisions of Part V of the AOA. Part V of the AOA consists of Articles 8 to 11. A member violates Part V of the AOA if it provides export subsidies for products for which it has not undertaken any export subsidy reduction commitments.

10. Issues relating to affirmative defence and peace clause defence are mainly legal in nature and should be subject to interpretation under the Vienna Convention on the Law of Treaties and the WTO jurisprudence as seen through Appellate Body findings.

11. As regards subsidies contingent upon export performance, export credit guarantees and premiums, and use of domestic over imported inputs, Mr. Chairman, India believes that they all fall in the category of prohibited subsidies and are actionable under the ASCM.

Thank you for your kind attention.

## ANNEX C-12

### NEW ZEALAND'S ORAL STATEMENT

24 July 2003

1. Mr Chairman, Members of the Panel, New Zealand's views on the issues of concern in this dispute are set out in our Third Party Submission of 15 July and in the time available today it is clearly not possible to canvass all of those views. Accordingly, and as suggested by you in your opening remarks Mr Chairman, I will focus only on some key points.

**(i) New Zealand's systemic interest in the dispute**

2. First, as outlined in our Third Party Submission, New Zealand has joined this dispute because of our systemic interest in ensuring the continued integrity of WTO disciplines applicable to agricultural trade. In particular we are concerned to ensure that trade-distorting or "amber box" measures cannot be used contrary to the "peace clause" in a manner that negatively affects other Members.

3. It is equally important that where the requirements of the "peace clause" have not been respected Members are able to utilise their rights under the *SCM Agreement* and *GATT 1994* to take action in respect of domestic support measures and export subsidies.

**(ii) Brazil's demonstration that the United States cannot claim "peace clause" protection for domestic support provided in marketing years 1999, 2000, 2001 and 2002**

4. Second, Brazil has demonstrated that the level of domestic support for upland cotton granted by the United States in each of the marketing years in question did in fact exceed the level decided during the 1992 marketing year and that there is therefore no "peace clause" protection for those support measures.

5. The United States argues that this is not the case, on the basis that the comparison required by the "peace clause" should be between the 'per pound' rates of support set by the relevant domestic support measures and that certain domestic support measures should be excluded from the comparison.

6. Turning first to the United States claim that the relevant comparison should be between 'per pound' rates of support, in New Zealand's view such an interpretation would be inconsistent with the object and purpose of Article 13(b)(ii). Instead, Article 13(b)(ii) requires a comparison that takes into account the totality of payments to upland cotton producers in order to reflect the true nature of the support that is being granted, including for example, total budgetary outlays. This is especially so when those budgetary outlays have been increasing because of falling world market prices. And those prices are falling due, at least in part, to the fact that United States producers are shielded from true price signals by the guaranteed 'per pound' rates.

7. Furthermore, New Zealand sees no basis for excluding certain domestic support measures from the calculation required by the "peace clause" as requested by the United States.

8. The “counter-cyclical” payments are plainly not “green box” support measures in accordance with Annex 2 of the *Agreement on Agriculture*, as the amount of the payment is linked to current prices for upland cotton, in direct contravention of Annex 2 paragraph 6(c).

9. Nor is the scope of support to be measured under Article 13(b)(ii) limited to “product-specific” support in the sense proposed by the United States. There is no basis for such an interpretation in either the wording or the intent of Article 13(b)(ii). [Just to depart from the prepared statement for a moment, the EC has reminded us this morning of the importance of taking context into account when interpreting WTO Agreements. We would note that it is also important to consider the ordinary and natural meaning of the actual words appearing in the Agreements. Here the words used are “support to a specific commodity” – the text does not say “product-specific support”. If the drafters had intended to mean “product-specific support”, they surely would have said so. After all, the phrase “product-specific support” is used at least five times elsewhere in the *Agreement on Agriculture*. Returning now to the prepared text,] even if such an interpretation as suggested by the US, could be supported, “counter-cyclical” payments are in any event product-specific support because, as Brazil has demonstrated, there is a strong linkage between those payments and production of upland cotton.

10. New Zealand also considers that there is no basis for excluding the Production Flexibility Contract payments or Direct Payments from the required calculation. The ability of farmers to update the base acreage used for calculation of Direct Payments rules out inclusion of those payments in the “green box”, which contemplates only one base period that is fixed and unchanging. To permit a Member to avoid this limitation by simply changing the names of its domestic support programmes would seriously undermine the requirement that there be no link between production and the amount of support.

**(iii) Brazil’s demonstration that the United States cannot claim “peace clause” protection in respect of export subsidies;**

11. Looking now at export subsidies, New Zealand agrees with Brazil that the three types of export subsidies applied to upland cotton and other commodities by the United States (the Step 2 Export Programme, the Export Credit Guarantee Programme, and the FSC Replacement Programme) violate Articles 3.3, 8 and 10.1 of the *Agreement on Agriculture*.

12. New Zealand rejects the argument made by the United States that Step 2 export payments are not export subsidies because payments are available to domestic users as well as exporters of upland cotton. The Appellate Body (in *US-FSC Recourse to Article 21.5*) has made it clear that the fact that payments are also able to be made to domestic users of upland cotton does not ‘dissolve’ the export contingency of the payments that are made to exporters.

13. New Zealand also finds no basis for the assertion by the United States that export credit guarantee programmes are not subject in any way to the export subsidy disciplines of the *Agreement on Agriculture*. In fact the inclusion of reference to such programmes in the context of Article 10 supports the opposite conclusion and demonstrates that Members were in fact concerned at the potential for such programmes to circumvent Members’ export subsidy reduction commitments.

14. In summary Brazil has demonstrated that the export subsidies to upland cotton do not have “peace clause” protection, and also that they are prohibited subsidies under Article 3.1(a) and 3.2 of the *SCM Agreement*.

**(iv) The request by the United States for a Preliminary Ruling**

15. Finally Mr Chairman, New Zealand does not consider that the Panel should grant the preliminary ruling requested by the United States.

16. First, New Zealand believes that measures no longer in effect are not outside the scope of the Panel's consideration, particularly where the programmes in question, while renamed, in fact continue in a slightly different form. Furthermore, the nature of serious prejudice claims means that Panels may need to consider data beyond a single year and consider trends over a number of years.

17. Second, New Zealand considers that export credit guarantee measures relating to eligible United States agricultural commodities (other than upland cotton) are within the Panel's terms of reference. To determine otherwise would be to allow a lack of transparency in the operation of particular measures to shield them from scrutiny by Members taking disputes.

**Conclusion**

18. In conclusion, Mr Chairman, New Zealand believes that Brazil has demonstrated that the "peace clause" has not been respected in relation to domestic support and export subsidies provided by the United States to upland cotton in the marketing years 1999, 2000, 2001 and 2002, and that accordingly Brazil is entitled to bring actionable and prohibited subsidy claims against the United States under the *GATT 1994* and the *SCM Agreement*. New Zealand looks forward to the next phase of the case which will examine those claims.

## ANNEX C-13

### ORAL SUBMISSION BY PARAGUAY

24 July 2003

Mr Chairman, members of the Panel:

1. Paraguay is grateful for the opportunity to participate in these proceedings and to present its views on the matter at issue in this dispute.
2. Because Paraguay is a firm believer in a fair system of multilateral trade, it feels that it should explain its position on this issue as a third party because it is an issue of particular interest to its economy.
3. Paraguay considers that the subsidies and support granted by the United States to its cotton production are inconsistent with the Agreement on Subsidies and Countervailing Measures, the Agreement on Agriculture and the rules and principles of the GATT 1994, and that for the purposes of this dispute it is therefore essential to take account of WTO legislation, which was carefully drafted to avoid causing distortions in international trade and prejudice to developing countries such as Paraguay.
4. WTO jurisprudence and the principles of interpretation of international law applied to the various cases suggests that the applicable rules should be read cumulatively, taking account of all elements applied to the case in order to support the system as an integrated whole.
5. With respect to the applicability of Article 13(b)(ii) concerning domestic support measures that conform fully to the provisions of Article 6 of the Agreement including direct payments that conform to the requirements to paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, Paraguay considers they shall be exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.
6. This implies that it is not limited or confined to specific products. Thus, it can be concluded that the United States does not enjoy protection from actions relating to subsidies using 1999, 2001 and 2002 as a basis, as Brazil duly proved.
7. In interpreting the Peace Clause, account must be taken of the serious prejudice that Member economies could suffer, and an assessment made of the overall significance of all of the agreements relating to the case.
8. Regarding inconsistency with the Agreement on Agriculture, the Step 2 programme introduced by the United States to stimulate exports and the competitiveness of its products on the international market is inconsistent with Articles 3.3 and 8 of the Agreement on Agriculture.
9. Article 3 of the Agreement on Agriculture refers to the incorporation of concessions and commitments. Paragraph 3 thereof stipulates that:

3.3 *"Subject to the provisions of paragraphs 2(b) and 4 of Article 9 of this Agreement, a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule."*

10. The above paragraph enables Members to provide the subsidies listed in Article 9.1 of the Agreement on Agriculture subject to fulfilment of the commitments assumed.

11. Similarly, Article 8 of the said Agreement regulates export competition commitments, stipulating that:

*"Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and the commitments as specified in that Member's Schedule."*

12. For the above reasons, and because it does not consider the provisions of the Agreement on Agriculture to have been complied with, Paraguay believes that the export subsidies granted by the United States to its cotton industry are inconsistent with Articles 3.3, 8 and 9.1 of the Agreement on Agriculture.

13. The agricultural subsidies cause "serious prejudice" to the domestic industry of other Members under Articles 5 and 6 of the Agreement on Subsidies and Countervailing Measures.

14. The introductory paragraph of part III, Article 5 of the said Agreement provides that no Member should cause, through the use of any subsidy – specific and not exempted under the Agreement – adverse effects to the interests of other Members, more specifically, as categorically stated in the indents that follow, (a) injury to the domestic industry of another Member and (c) serious prejudice to the interests of another Member.

15. Article 6 specifically refers to cases in which "serious prejudice" is deemed to exist in the sense of paragraph (c) of Article 5.

16. Agricultural subsidies have effects on world trade, and measures such as those applied by the United States have a significant impact on developing countries like Paraguay.

17. Paraguay has a total population of approximately 5,300,000, of which more than 500,000 are linked to cotton production. If we add the related industries and activities, the figure reaches an estimated 1,500,000, or approximately 30 per cent of the country's total population.

18. Any slump in the cotton trade causes an exodus of rural population towards the urban areas which do not offer any relief or solution, and this further undermines the economic situation of a country that depends on its agriculture.

19. As regards exports, in 1991, the foreign exchange revenue generated by sales of cotton and byproducts thereof reached US\$318,912,000, approximately 43 per cent of the total for the country's exports that year. At the time, of a total of 299,259 farms, 190,000 were cultivating cotton.

20. By 2001, the figures had changed considerably. Export revenue had fallen to US\$90,505,000, a 72 per cent drop in the value of exports. The number of farms producing cotton decreased to about 90,000, representing a 52 per cent decrease in farms, employment and small farmer income. In other words, the impoverishment was real.

21. Regarding international cotton fibre prices, in 1991, the price per ton of Paraguayan type fibre was quoted on the New York Exchange at US\$1,624, while in 2001, it was quoted at US\$934.

22. In Paraguay, some 60 per cent of cotton is produced on farms of less than 10 hectares, making it the main or only source of income for small farmers and the main source of employment for the rural workforce in the most disadvantaged segment of society where access to capital and technology is more restricted and the leading socio-economic welfare indicators are lower than anywhere else.

23. In spite of its marked decline, cotton continues to be an important cash crop for the "capitalized" farms, and the main – if not only – cash crop of the farms that are on the decline.

24. The agricultural sector is fundamental to the Paraguayan economy, accounting for 90 per cent of exports, 35 per cent of employment and 25 per cent of GDP, in addition to which it supports an agro-industry that accounts for 11 per cent of GDP and 10 per cent of total employment.

Mr Chairman, members of the Panel:

25. The importance of cotton for Paraguay, both in social and economic terms, is such that an increase in international cotton fibre prices as a result of the elimination of significant market distortions such as subsidization of production would not only bring about a general improvement in the standard of living of the country's inhabitants, in a very fragile sector in particular, but it would also lead to an improvement in macroeconomic conditions, balance-of-payments, monetary reserves, etc. that would enable Paraguay to be more reliable in meeting its international financial commitments.

26. For the above reasons, and because it does not consider that the provisions of the Agreement on Agriculture have been complied with, Paraguay believes that the export subsidies granted by the United States to its cotton industry are inconsistent with Articles 3.3, 8 and 9.1 of the Agreement on Agriculture.

27. Paraguay therefore considers that the measures adopted by the United States cause serious prejudice to world trade, affecting Paraguay in particular, and that the necessary steps should be taken to eliminate the adverse effects and seek to achieve a balance in world trade.

28. Finally, Paraguay respectfully requests the Panel to conclude that the measure applied by the United States is inconsistent with its WTO obligations under various provisions of the Agreement on Agriculture, the GATT 1994 and the Agreement on Subsidies and Countervailing Measures.



## ANNEX C-14

### ORAL STATEMENT BY THE SEPARATE CUSTOMS TERRITORY OF TAIWAN, PENGHU, KINMEN AND MATSU AS A THIRD PARTY ON THE CASE OF THE UNITED STATES SUBSIDIES ON UPLAND COTTON

The Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu is pleased to be here as a third party in this case. We have a systemic interest in the particular question of the burden of proof required by Article 13 of the AOA, and would like to focus on this issue in our remarks. We have previously submitted our views in writing accordingly.

#### **The Burden of Proof (the “Peace Clause”)**

In the case in point, Brazil asserts in its first written submission that Article 13 is by nature an “affirmative defence” or “exception” and “not itself a positive obligation”, therefore the United States carries the burden of proof on whether its subsidies are in conformity with Article 13.

Our view, in summary, is that it is inappropriate to label Article 13 as an “affirmative defence” or “exception”. Indeed this would mean the Article having much less than its originally intended effect. Article 13 in itself confers rights and imposes positive obligations on Members. It is not there simply for the convenience of resolving the question of the burden of proof. The right that it confers of entitlement to being “exempt from actions”, for example, would be rendered pointless if the burden of proof were on the respondent. It is surely for Brazil, therefore, as a complainant, to prove a breach of a positive obligation by demonstrating non-conformity, rather than for the United States to bear the burden of proof.

In our written submission, we suggest that in arriving at a proper interpretation of the burden of proof in Article 13, it might also be helpful to make some comparisons with the different types of exceptions, exemptions and defences that exist in other Articles of WTO Agreements.

We mention, for example, disputes arising in connection with agreements not covered by the DSU, where the complaining party would bear the burden to prove that the issue in dispute falls within the purview of the DSB.

Also, where a matter is specifically excluded from the dispute settlement procedures by certain relevant agreements – such as Article 6 of the TRIPS agreement - the provision concerned allows the Member applying it to prevent dispute settlement procedures and the burden of proof falls on the complaining party.

And by way of further comparison, we refer to other cases where exceptions or exemptions are granted under relevant agreements providing specific obligations.

While Article 13 of the AOA is clearly in this case not dealing with a matter under a non-covered agreement or a matter that is specifically excluded from the dispute settlement procedures as in Article 6 of TRIPS, it is also not typical of the type of exception contained in a number of the GATT Articles. By its singular nature, Article 13, in our view, falls between these examples, therefore the procedures for applying its provision should be interpreted separately and differently.

And finally, as far as the burden of proof is concerned, we submit that requiring the respondent to prove that the subsidy measure in question is in conformity with the Agreement on Agriculture will, to a certain extent, offset the respondent's right to claim for the exceptions provided by the Article 13 provisions, which is surely contrary to the drafters' intent.

## ANNEX D

### REBUTTAL SUBMISSIONS OF PARTIES

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**ANNEX D-1**

**BRAZIL'S REBUTTAL SUBMISSION TO THE PANEL  
REGARDING THE "PEACE CLAUSE"  
AND NON-PEACE CLAUSE RELATED CLAIMS  
EXECUTIVE SUMMARY**

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# **1. The United States Has No Peace Clause Protection for Non-Green Box Domestic Support Measures to Upland Cotton for MY 1999-2002**

## **1.1. Production Flexibility Contracts and Direct Payments Are Non-Green Box Domestic Support**

### **1.1.1. The Amounts of PFC and Direct Payments Depend on the “Type” of Production**

1. PFC payments and direct payments are non-green box support because both limit the “amount” of payment based on the “type” of production inconsistent with the requirements of Annex 2, paragraph 6(b) of the Agreement on Agriculture. The relevant text of paragraph 6(b) prohibits any linkage of the “amount of payments” to any “type of production” of an agricultural product. The “amount” of payments under the PFC and direct payment programmes *falls* when base acres are used to produce fruits, vegetables and wild rice. Thus, the undisputed evidence demonstrates that PFC and direct payments do not meet the policy-specific criteria for “de-coupled income support” in Annex 2, paragraph 6(b).

2. Prohibiting payments if *certain* types of crops are produced while at the same time permitting payments if *other* types of crops are produced violates Annex 2, paragraph 6(b). Contrary to the US argument, requiring no production, *i.e.*, prohibiting production, does not relate the amount of payments to the “type” of production, as no individual “type” of production would be eligible to payments. The notion of “type of production” in paragraph 6(b) is necessarily linked to the amount of payment to some “type” of commodity that is “produced” and not to a production requirement itself.

3. In addition, Brazil also presented evidence that the US restrictions on fruits, vegetables and wild rice prevent producers with PFC and direct payment base acreage from growing these alternative crops. This restriction, therefore, channels production into particular “types of production” by prohibiting *other* “types of production” and, therefore, violates Annex 2, paragraph 6(b).

### **1.1.2. Direct Payments Are Not Green-Box Because the Base Periods for Determining Eligibility Have Been Updated in the 2002 FSRI Act**

4. Direct payments are also not properly in the green box because the amount of payments are based on an updated “base period” and not on a “fixed” base period as required by Annex 2, paragraphs 6(a) and (b). Paragraphs 6(a) and (b) require a fixed and, therefore, unchanging base period for de-coupled domestic support measures with the same structure, design, and eligibility criteria. The evidence demonstrates that there are no significant changes in the payment eligibility criteria between the PFC programme and its direct successor, the direct payment program. Indeed, PFC payments made during 2002 were deducted from the amount of direct payments due in 2002.

5. Further, the updating permitted under the 2002 FSRI Act for direct payments was significant – one-third of eligible farms updated their PFC base acreage as of June 2003 in order to *increase* the base acreage – and payments – under the direct payment programme. This updating creates production-distorting effects because it creates expectations of future updates and will incite farmers to produce more of the programme crops that qualify for support.

6. The United States interprets the word “fixed” in Annex 2, paragraph 6(a) and (b) as being “fixed” only for the life of a particular legal measure. A Member could change a measure every year, update the “base period” to reflect the prior year’s acreage, increase current payments to reflect the updated (and increased) “historical” acreage, and label it differently under a new law. Thus, the US interpretation would permit payments to be completely “coupled” to production, just with a one-year time lag. It would render any disciplines reflected in the use of the term “a” and “fixed” “base

period” in Annex 2, paragraph 6(a) a nullity. This is contrary not only to the ordinary meaning of the term “fixed” but also to the object and purpose of Annex 2, paragraph 6(a) to not permit Members to increase payments over time in a manner linked to increases in production over time. The re-linkage of payments to production is also inconsistent with the “fundamental requirement” in Annex 2, paragraph 1.

## **1.2. PFC, Market Loss Assistance, Direct and Counter-Cyclical Payments (CCP) and Crop Insurance Subsidies Are “Support To” Upland Cotton**

7. The narrow US specificity test of “tied to production” seeks to impose a “form” of specificity on the text of Article 13(b)(ii) that is not there. It further contradicts the only analogous criteria to Article 13(b)(ii) for calculating annual levels of support – the AMS calculation criteria of Annex 3. In addition, it contradicts the broad definition of “in favour of” in defining AMS in Article 1(a) of the Agreement on Agriculture, and the “in general” language of the same provision. The “substance” the United States seeks to avoid with this unjustified interpretation is the \$12.9 billion dollars in payments for the production of upland cotton from MY 1999-present.

8. Applying its narrow specificity criteria, the United States argues that PFC, market loss assistance, direct and counter-cyclical payments as well as crop insurance subsidies are not “support to” upland cotton. Brazil presents evidence that all five domestic support measures provide “support to” the production of upland cotton between MY 1999-2002.

### **1.2.1. Production Flexibility Contract Payments**

9. Brazil has presented considerable evidence demonstrating that PFC payments to holders of upland cotton base acreage in MY 1999-2001 are support to upland cotton. The 1996 FAIR Act established a specific payment formula permitting those upland cotton farmers who had traditionally farmed upland cotton to continue to receive payments following the elimination of the deficiency payment program. The 1996 FAIR Act singled out upland cotton and only six other crops for such PFC payments. Recipients were “producers” who “shared in the risk of producing a crop”, and who farmed one of the seven crops in the three immediate years prior to the 1996 FAIR Act (MY 1993-95). Only a small minority of the producers of crops in the United States received PFC (and market loss assistance) payments. Brazil has demonstrated that between MY 1999-2001, the seven types of programme crops receiving PFC represented on average between MY 1999-2001 only 14.19 per cent of total US farm revenue. In addition, the total acreage of the seven PFC and market loss assistance crops in MY 2001 represented only 22 per cent of total US farmland. Thus, PFC payments were not provided to US producers *in general*.

10. The best available evidence demonstrates that upland cotton producers during MY 1999-2001 received PFC (and market loss assistance) payments. USDA reported that 97 per cent of farms producing upland cotton representing 99 per cent of upland cotton acreage from MY 1993-95 signed up to receive upland cotton PFC payments for MY 1996-2001. Upland cotton base acreage under the PFC (and market loss assistance) programme was 16.2 million acres. Between MY 1999-2001, the average acreage planted to upland cotton was 15.24 million acres. In addition, USDA reported that 95.7 per cent of the 16.2 million US upland cotton base acreage was planted to PFC programme crops in MY 2001 – a higher percentage than for any of the other 6 types of PFC programme crops. Thus, the evidence suggests that upland cotton producers in MY 1999-2001 were receiving PFC (and market loss assistance) payments.

11. Brazil has presented evidence demonstrating that PFC payments have production and trade distorting effects that arise from the prohibition on planting fruits, vegetables, and wild rice, as well as from the various “wealth effects” that result from the size of the subsidy averaging more than 15 per cent of the market value of upland cotton between MY 1999-2001. These effects provide further

confirming evidence that the selected, targeted PFC (and market loss assistance) payments are support to upland cotton.

### 1.2.2. Market Loss Assistance Payments

12. The evidence provided by Brazil with respect to PFC payments is also relevant to market loss assistance payments because these payments were made only to farmers with PFC contracts for the seven PFC crops, and additionally to soybeans. Thus, historic upland cotton producers (producing upland cotton in MY 1993-1995) received “upland cotton-specific” market loss assistance payments in MY 1998-2001. Even with the addition of soybeans, these 8 crops only represented on average 20.75 per cent of total US farm revenue in MY 1999-2001. PFC crop base acreage and soybean acreage in MY 2001 represented only 29 per cent of total US farmland. Thus, as with PFC payments, market loss assistance payments were not paid to US agricultural producers *in general* but rather to only a select group of US producers.

13. The evidence presented by Brazil indicates that while producers holding PFC/market loss assistance base acreage had the legal “freedom to farm” different crops, if they produced upland cotton, they would suffer adverse financial consequences *unless* they produced upland cotton on *upland cotton, corn or rice* base acres. The evidence highlights the practical impossibility of growing upland cotton without any type of PFC and market loss assistance payment in MY 2001. This evidence confirms NCC statements and supports a conclusion that any upland cotton produced in MY 1999-2001 – as a matter of economic reality and viability – needed and received PFC and market loss assistance payments to meet the high cost of production.

14. Further evidence that market loss assistance payments are support to upland cotton stems from the fact that the United States notified these subsidies as trade and production distorting amber box support. The evidence demonstrates that the targeted market loss assistance payments triggered by market price declines have even more trade and production-distorting effects than PFC payments. Further, as with PFC payments, production and trade distortions occurred because of the prohibition or restriction on receiving such payments based on growing fruits, vegetables, or wild rice. The production and trade-distorting effects on upland cotton are further confirmed by the fact that market loss assistance payments represented on average 17.87 per cent of the market value of upland cotton between MY 1999-2001. Thus, even though upland cotton producers were not *required* to produce upland cotton to receive market loss assistance payments, the record demonstrates that they continued to produce upland cotton between MY 1999-2001, and they continued to benefit from the 17.87 per cent subsidies represented by these payments.

### 1.2.3. Direct Payments

15. Direct payments are targeted support to “producers” farming, *inter alia*, on upland cotton base acreage. The eligible upland cotton producers who grew upland cotton in MY 1998-2001 (or in MY 1993-95) – together with eligible producers of only nine other crops – are a select group, who grew crops representing only 23.49 per cent of total farm cash receipts and 30 per cent of total US farm acreage. Thus, direct payments are *not* available to the great majority of US producers of agricultural commodities, *i.e.*, they are not provided to US agricultural producers *in general*.

16. The United States argues that direct payments and CCP payments are not “support to upland cotton” because there is no *legal requirement* under the 2002 FSRI Act for holders of upland cotton base acreage to grow upland cotton. However, Brazil has demonstrated that the theoretical legal *planting flexibility* in the 2002 FSRI Act is not reflected in the *economic* reality of growing high-cost crops like upland cotton. Farmers who did plant the 14.2 million acres of upland cotton for MY 2002 could only have covered their costs by receiving *upland cotton, rice or peanut* direct payments and counter-cyclical payments. This evidence strongly confirms what the NCC officials have stated

repeatedly, that their members need, rely on, and *receive* direct payment and counter-cyclical payment support. And this evidence refutes the United States argument that the *legal* flexibility to grow other crops – or not produce at all – is the single relevant fact justifying a finding that direct payments and CCP payments did not support upland cotton in MY 2002.

17. Further evidence that direct payments are support to upland cotton is derived from the effects on upland cotton production caused by the updating of the base acreage between the PFC and the direct payment programmes. Brazil has presented evidence indicating that this updating creates a re-linkage between production and the direct (and counter-cyclical) payments. Production effects are also caused by channeling the payments into crops other than fruits, vegetables, and wild rice. Further, the size of the subsidy (over 15 per cent of the current upland cotton market value) also contributes to wealth creation that has production effects. These production effects demonstrate that the direct payments (and CCP payments) are not de-linked from production – as argued by the United States – and support a conclusion that they are support to upland cotton.

#### **1.2.5. Counter-Cyclical Payments**

18. The United States argues that because producers receiving CCP payments are not required to produce upland cotton to receive payments, these payments cannot, as a matter of law, be considered support to upland cotton within the meaning of Article 13(b)(ii). Nevertheless, the evidence provided by Brazil demonstrates that CCP funds in MY 2002 paid to “historic” (i.e., 1998-2001 or 1993-1995) upland cotton producers are paid to a tiny fraction of total US producers of agricultural commodities and not to US producers of agricultural products “in general”. Further, the evidence supports the conclusion that the recipients of these payments in MY 2002 needed these payments to continue producing upland cotton. They constitute “support to upland cotton”.

19. Moreover, CCP payments create additional production effects due to the “base-update” permitted under the 2002 FSRI Act for both base yields and base acreage compared to market loss assistance payments. Further, the fruits, vegetables, and wild rice prohibitions or restrictions channel production into upland cotton. This evidence collectively supports a conclusion that CCP payments are “support to upland cotton”.

#### **1.2.6. Crop Insurance Payments**

20. Brazil has demonstrated that upland cotton farmer benefit from specialized and specific crop insurance policies provided under the 2000 Agricultural Risk protection Act. Premium subsidies are directly tied to the amount of acreage planted by an upland cotton farmer. Also the participation rate, the share of policies at higher buy-up levels and the crop insurance loss ratio are higher for upland cotton than for other crops. This is confirmed by USDA’s own economists, who have found that crop insurance subsidies cause much higher production and export effects for upland cotton than for other crops. In sum, crop insurance subsidies tied directly to the production of upland cotton are “support to a specific commodity” for the purposes of Article 13(b)(ii).

### **1.3. The US Support to Upland Cotton in MY 1999-2002 Exceeded the Support Decided in MY 1992**

21. The United States has raised a number of *post hoc* arguments related to a supposed “rate of support” decision it alleges to have made during MY 1992. In the SAA, the United States stated that Members would have peace clause protection from adverse effects and serious prejudice challenges in the WTO “*unless the AMS for the particular commodity exceeds the level decided in the 1992 marketing year*”. The phrase “AMS for the particular commodity” is an explicit recognition by the United States of the test in Annex 3, paragraph 6 which states: “For each basic agricultural product, a specific AMS shall be established expressed in total monetary terms.” The US “rate of support”



methodology is not an expression in “total monetary terms,” nor does it permit such a calculation. There are only two types of methodologies that would allow an expression in monetary terms of a decision (or decisions) taken by the United States in MY 1992 regarding its level of support to upland cotton: “using budgetary outlays” or the “gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price”.

22. Brazil disagrees with the United States’ assertion that it did not “decide” on budgetary outlays. The alleged US decision to provide a rate of support must necessarily be accompanied by a decision to authorize whatever budgetary outlays would be necessary to meet the rate of support. The United States took specific administrative decisions which meant that the United States decided on the payment rates that resulted from the “rate of support” and, therefore, on the amount of budgetary outlays it would use from its unlimited spending authority. For the United States to argue, *post hoc*, that these decisions did not also include expenditures is inconsistent with its SAA interpretation of the peace clause that the 1992 decision must be expressed in “total monetary terms.”

23. Brazil has demonstrated that expenditures for MY 1992 are lower than they are for any of the marketing years from 1999-2002. Therefore, under this methodology, the United States has no peace clause exemption for MY 1999-2002. While Brazil does not believe that calculating the upland cotton AMS based on the AMS methodology in Annex 3 is the appropriate methodology – based on the absence of the terms “AMS”, “product-specific” and “non-product-specific” in Article 13(b)(ii) – Brazil has provided evidence that by using this methodology the United States support to the basic agricultural commodity “upland cotton” exceeded the support decided during the 1992 marketing year in all marketing years from 1999-2002.

24. In the event the Panel decides not to use a “total monetary value” methodology, then there are two “rate of support” methodologies: (1) budgetary outlays per pound of support, and (2) the expected guaranteed income rate of support set out in Professor Sumner’s analysis. Brazil has provided extensive analysis of each of these two methodologies. However, Brazil does not endorse either methodology.

25. Brazil has demonstrated that the preferable methodology would be to rely on budgetary outlays per pound of upland cotton production. Professor Sumner’s approach should be used only as an alternative to the simplistic US “72.9 methodology” because it is much more accurate than the United States approach accounting for eligibility criteria, effective programme limitations and costs that the US ignores. In any event, Brazil has demonstrated that also under both rate of support methodologies the US support in MY 1999-2002 exceeds the support decided during MY 1992.

26. Any methodology that does not account for eligibility and effective participation criteria is inconsistent with Article 13(b)(ii). It is also inconsistent with the context of Article 13(b)(ii) which includes Annex 3, paragraphs 8 and 10 requiring calculation of the monetary value of support by factoring in “*production eligible to receive the administered price.*” And it is also inconsistent with object and purpose of the Agreement on Agriculture, which is – after all – “correcting and preventing restrictions and distortions in world agricultural markets.”

#### **1.4. Challenges to Actionable Subsidies under Article 5 and 6 of the SCM Agreement and Article XVI of GATT 1994 Are Not Limited to the Marketing Year in which a WTO Panel Is Established**

27. The United States argues that the Panel may only count *current* US non-green box support in determining whether the United States enjoys peace clause exemption under Article 13(b). Applying a strict “statute of limitations” approach, the United States argues that Brazil (1) cannot challenge any US trade and production-distorting agricultural support for MY 2001 (or MY 2000, or MY 1999) because it did not ensure that the Panel was established during MY 2001 (or MY 2000, or MY 1999), and (2) it cannot challenge *all* of the trade and production-distorting support for all of MY 2002 because it did not ensure that the Panel was established by 31 July 2003 – the last day of the 2002 marketing year. The United States goes so far as to argue that the Panel may only compare MY 1992 support decided with *partial* MY 2002 data through 18 March 2003 – the date the Panel was established. According to the US theory, the only date the Panel could have been established to ensure comparison with full MY 2002 data would have been 31 July 2003 – the last day of MY 2002.

28. Brazil has demonstrated that the United States has constructed an irrational interpretation of Article 13(b)(ii). It is bizarre to interpret Article 13(b)(ii) in a way that requires Members to carefully “time” a request for establishment of a panel to maximize the amount of support to be counted for the “current” marketing year. Nothing in the “present tense” of Article 13(b)(ii) compels this result. The Panel must interpret Article 13(b)(ii) according to its ordinary meaning and with regard to its context. The relevant context is Articles 1(h)(ii) and 6.3 of the Agreement on Agriculture. The *Korea – Beef* dispute exemplifies that a Member can challenge violations of “Current Total AMS” at any time after a marketing year ends. The ability of challenging Current Total AMS violations in later years by analogy suggests that non-conformity with the peace clause requirements in much the same way leads to lifting the peace clause exemption also for marketing years other than the current marketing year. Thus, the proper interpretation of Article 13(b)(ii) permits actionable subsidy challenges under the SCM Agreement and GATT Article XVI:1 for any marketing year for which peace clause exemption does not exist – under either its chapeau (Current Total AMS) or the proviso of Article 13(b)(ii).

#### **2. The GSM 102, GSM 103 and SCGP Export Credit Guarantee Programmes Constitute Export Subsidies in Violation of Articles 10.1 and 8 of the Agreement on Agriculture, and Item (j) and Articles 3.1(a) and 3.2 of the SCM Agreement**

29. 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, Article 3.1(a) of the SCM Agreement, and item (j) of the Illustrative List of Export Subsidies attached as Annex I to the SCM Agreement. Brazil 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 3.1(a) and 3.2 of the SCM Agreement.

30. Article 10.2 does not, as the United States asserts, carve out export credit guarantees from the general export subsidy disciplines of the Agreement on Agriculture, including the anti-circumvention provisions of Article 10.1. The Appellate Body concluded that exemptions and carve-outs from general obligations must be provided for explicitly in the text of an agreement. Article 10.2 includes no such explicit carve-out or exemption. Rather, Article 10.2 announces Members’ intent to work toward negotiations on specific disciplines for export credits. In the meantime, the general disciplines on export subsidies included in the Agreement on Agriculture apply to export credits.

## **2.1. CCC Export Credit Guarantees Constitute Export Subsidies under Articles 1 and 3.1(a) of the SCM Agreement**

31. Brazil notes that CCC export credit guarantees are “financial contributions” within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. Since CCC export credit guarantees are unique financing vehicles for agricultural commodity transactions that are not available on the commercial market, let alone on terms consistent with the market, they confer “benefits” within the meaning of Article 1.1(b) of the SCM Agreement. Brazil presents the affidavit of Marcelo Pinheiro Franco from the Brazilian Export Credit Insurance Agency who confirms that no

comparable market-based export credit guarantees or financing instruments for international transactions involving agricultural commodities [exist] that provide these same terms [as the GSM and SCGP programmes].

32. Further, the United States compares agricultural export credit guarantees to export credit insurance for agricultural commodities, which it asserts is available on the private commercial market. However, it acknowledges that insurance coverage is structured altogether differently from guarantee coverage. Thus, even if the United States had proven its assertion with evidence, it acknowledges that the market for private insurance cannot serve as a benchmark against which to determine whether CCC guarantees confer “benefits”.

33. Finally, CCC guarantees are contingent in law on export performance and therefore constitute prohibited export subsidies under Article 3.1(a) of the SCM Agreement.

34. Lastly, Brazil recalls that since the United States surpassed its quantity commitment levels, Article 10.3 of the Agreement on Agriculture allocates the burden to the United States to prove that its excess exports did not benefit from export subsidies, including export credit guarantees.

## **2.2. The CCC Export Credit Guarantee Programmes Constitute Export Subsidies under Item (j) of the Illustrative List of Export Subsidies**

35. Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes also constitute export subsidies because they charge premium rates that are inadequate to cover the long-term operating costs and losses of the programmes, within the meaning of item (j) of the Illustrative List. Item (j) does not require the Panel to endorse any particular methodology or formula for determining whether the CCC programmes cover their long-term operating costs and losses, or to decide by precisely how much those costs and losses exceed premiums collected. Rather, Brazil has provided the Panel with numerous alternatives, each of which demonstrates that long-term operating costs and losses for the GSM 102, GSM 103 and SCGP programmes outpace premiums collected, including data under the FCRA, Brazil’s constructed formula, data from CCC’s 2002 financial statements reporting large uncollectible amounts on post-1991 and pre-1992 guarantees, among others.

36. The United States criticizes the FCRA cost formula as inappropriate because it allegedly relies on “estimated” rather than “actual” data about the costs of the programmes. It is not true that the FCRA cost formula reflects only “an *estimate* of the long-term costs to the Government”. A significant portion of the inputs into the FCRA cost formula reflect actual historical experience with borrowers, and actual contract terms such as interest rates, maturity, fees and grace periods.

37. Moreover, the results of the FCRA cost formula are modified throughout the lifetime of a cohort, pursuant to the “reestimation” process. The results of the reestimate process demonstrate that CCC has “los[t] money” during the period 1992-2002. When these total lifetime reestimates for all

cohorts of guarantees disbursed since 1992 are netted against the total *original* subsidy estimates adopted each budget year during the period 1992-2002, *the resulting loss is nearly \$1.75 billion*.

38. The implication of the United States' position concerning "estimated data" is that it is impossible to judge whether premiums for the GSM 102, GSM 103 and SCGP programmes have covered operating costs and losses until all guarantee cohorts for a period constituting the "long term" are closed, so that purely "actual" rather than partial "estimate" data are available. Because all cohorts disbursed since the inception of federal credit reform remain open, the United States effectively argues that it is impossible for this Panel to judge whether the CCC guarantee programmes satisfy the elements of item (j). Brazil notes however that the US Congress and the President have endorsed the use of the FCRA cost formula as the principal way to "measure more accurately the costs of Federal credit programmes", *even in the budget year column of the US budget*, let alone several years out, when cohorts have been subject to successive rounds of reestimates.

39. In closing, Brazil reminds the Panel that the US criticism regarding the use of "estimated" data does not address the many other bases apart from the FCRA formula on which Brazil has demonstrated that the long-term operating costs and losses of the GSM 102, GSM 103 and SCGP programmes exceed premiums paid.

### **2.3. The CCC Export Credit Guarantee Programmes Threaten to Circumvent US Export Subsidy Reduction Commitments**

40. At paragraphs 295-305 of its First Submission, Brazil demonstrated that with respect to both unscheduled and scheduled commodities, the GSM 102, GSM 103 and SCGP export subsidy programmes result in, or threaten to lead to, circumvention of the United States' export subsidy commitments, in violation of Article 10.1 of the Agreement on Agriculture. For the same reason, the United States violates Article 8, which requires a Member not to provide export subsidies otherwise than in conformity with the Agreement on Agriculture and with its scheduled commitments. The threat of circumvention for scheduled commodities is further enhanced by the fact that CCC is exempt from the requirement in the FCRA that a programme receive new Congressional budget authority before it undertakes new loan guarantee commitments. Mandatory programmes like the CCC export credit guarantee programmes must be available to all eligible borrowers, without regard to appropriations limits. In an important sense, this resembles the United States' FSC regime, which the Appellate Body found is available without limit. The Appellate Body considered that the unlimited nature of the regime posed a significant threat, under Article 10.1, that the United States would surpass its agricultural export subsidy reduction commitments.

### **2.4. The GSM 102, GSM 103 and SCGP Export Credit Guarantee Programmes Constitute Export Subsidies in Violation of Item (j) and Articles 3.1(a) and 3.2 of the SCM Agreement**

41. Since the CCC export credit guarantee programmes violate Articles 10.1 and 8 of the Agreement on Agriculture, the United States is not entitled to the "peace clause" exemption. Therefore, GSM 102, GSM 103 and SCGP programmes constitute prohibited export subsidies, in violation of item (j) of the Illustrative List of Export Subsidies, and of Articles 3.1(a) of the SCM Agreement.

### **3. The Step 2 Export and Domestic Subsidies Are Prohibited Subsidies in Violation of Articles 3.1(a) and 3.1(b) of the SCM Agreement**

42. The United States asserts that all US upland cotton is eligible to receive Step 2 payments and that this removes the export and local content contingency. Brazil refutes the US assertion both as a

matter of law as well as fact. The Step 2 export provisions are not, as the United States now argues, simply domestic support payments made to US producers of upland cotton. Brazil again emphasizes that the *US – FSC* and *Canada – Aircraft* Appellate Body decisions are relevant jurisprudence and apply to the facts of the two situations set out in the regulations to Section 1207(a) of the 2002 FSRI Act. Thus, even if all US production since 1990 or even during MY 1999-2002 received Step 2 payments – which the United States has failed to document with any data – it would not remove the export and local content contingencies mandated by those regulations that violate SCM Agreement Articles 3.1(a) and (b).

43. US domestic Step 2 subsidies are prohibited local content subsidies in violation of Article 3.1(b) of the SCM Agreement. There is no explicit derogation of Article 3.1(b) built into the Agreement on Agriculture. The United States argues that there is an inherent conflict between Annex 3, paragraph 7 and Article 6.3 of the Agreement on Agriculture with Article 3.1(b) of the SCM Agreement because in the view of the United States, there can be no payments to processors of agricultural products included within AMS that do *not* violate Article 3.1(b) of the SCM Agreement. Brazil demonstrates that this is not true and that there are subsidies to agricultural processors that do not violate Article 3.1(b) and presents various examples to that respect.

44. Finally, Brazil notes the EC argument that applying Article 3.1(b) of the SCM Agreement “would lead to stricter disciplines being applied to domestic subsidies than are applicable for industrial goods”. Local content subsidies – whether for agricultural and industrial products – are prohibited by Article 3.1(b). As “prohibited” subsidies, they are subject to the ultimate discipline – they cannot legally exist. The two packages of disciplines for agricultural and industrial products have both been negotiated during the Uruguay Round. The resulting rules have to be interpreted according to the customary rules of treaty interpretation as contained in the *Vienna Convention*. This interpretation results in agricultural local content subsidies being prohibited. Whether that results in there being more or less strict disciplines than would be applicable to industrial subsidies is not a relevant consideration for the interpretation of the disciplines.

#### **4. The ETI Act Subsidies Violate Articles 10.1 and 8 of the Agreement on Agriculture and Are Prohibited by Articles 3.1(a) and 3.2 of the SCM Agreement**

45. Brazil has made a *prima facie* case with respect to its claims against the ETI Act. Brazil challenges exactly the same measure based on the same claims asserted by the EC that the panel and the Appellate Body in *US – FSC (21.5)* held to violate the Agreement on Agriculture and the SCM Agreement. The sole difference is that Brazil limits its claims to ETI Act subsidies benefiting the export of upland cotton only.

## ANNEX D-2

### EXECUTIVE SUMMARY OF THE REBUTTAL SUBMISSION OF THE UNITED STATES

#### Introduction and Overview

1. The comparison under the Peace Clause proviso in Article 13(b)(ii) must be made with respect to the support as “decided” by those measures. In the case of the challenged US measures, the support was decided in terms of a rate, not an amount of budgetary outlay. The rate of support decided during marketing year 1992 was 72.9 cents per pound of upland cotton; the rate of support granted for the 1999-2001 crops was only 51.92 cents per pound; and the rate of support that measures grant for the 2002 crop is only 52 cents per pound. Thus, in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.<sup>1</sup>

2. Brazil has claimed that additional “decisions” by the United States during the 1992 marketing year to impose a 10 per cent acreage reduction programme and 15 per cent “normal flex acres” reduced the level of support below 72.9 cents per pound. However, the 72.9 cents per pound rate of support most accurately expresses the revenue ensured by the United States to upland cotton producers. Even on the unrealistic assumption that these programme elements reduced the level of support by 10 and 15 per cent, respectively (that is, the maximum theoretical effect these programme elements could have had), the 1992 rate of support would still be 67.625 cents per pound, well above the levels for marketing years 1999-2001 and 2002.

3. Although such a comparison would not conform to the text, the result of the Peace Clause comparison is no different if one compares the support via an Aggregate Measurement of Support calculation. Using the price gap methodology (as provided under Annex 3 of the Agriculture Agreement) for US price-based deficiency payments and marketing loan payments, the upland cotton Aggregate Measurement of Support (in US \$, millions) for these years is MY1992: 1,079; MY1999: 717; MY2000: 484; MY2001: 264; MY2002: 205. Again, in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

4. Finally, the analysis presented by Brazil’s expert at the first panel meeting actually supports the United States, not Brazil. Removing the non-product-specific support that Brazil erroneously tries to pass off as support to upland cotton, Brazil’s own expert calculates the total support per unit

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<sup>1</sup> Brazil has asserted that the United States’ approach does not provide any way of taking Step 2 payments into account. Because the availability of Step 2 payments is contingent on certain price conditions existing during the marketing year, the level of support decided must relate to the payment parameters. These have remained the same for Step 2, with the exception of the suspension, through 2006, of the 1.25 cent price difference threshold and payment availability at slightly higher market prices. However, because Step 2 merely provides an alternative avenue of providing support (through processors rather than directly to producers), these minor adjustments do not alter the revenue ensured for producers by the marketing loan rate of 52 cents per pound. In addition, these minor adjustments cannot overcome the greater than 20 cents per pound difference in product-specific support between marketing years 1992 and 1999-2002. Similarly, and without prejudice to whether these measures are within the Panel’s terms of reference, we note that cottonseed payments in 1999, 2000, and 2002 ranged in value between 0.6 to 2.3 cents per pound (factoring expenditures over production); thus, they too do not materially affect the comparison between marketing year 1992 and any other year.

(cents/lb.) as MY1992: 60.05; MY1999: 53.79; MY2000: 55.09; MY2001: 52.82; MY2002: 56.32. Again, in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

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

### **US Green Box Measures are "Exempt from Actions" Pursuant to Article 13(a)(ii)**

6. A measure shall be deemed to meet the "fundamental requirement" of the first sentence of Annex 2 if it meets the basic criteria of the second sentence plus any applicable policy-specific criteria. As suggested by the use of the word "fundamental" ("from which others are derived") and the structure of Annex 2 (that is, beginning the second sentence with the word "accordingly"), compliance with the requirement ("something called for or demanded") of the first sentence will be demonstrated by conforming to the basic criteria of the second sentence plus the applicable policy-specific criteria of paragraphs 6 through 13.

7. **Direct Payments:** Eligibility for direct payments under the 2002 Act is based on criteria in a "defined and fixed base period" (paragraph 6(a)) in the ordinary meaning of those terms: a base period that is "definite" (set out in the 2002 Act) and "stationary or unchanging in a relative position" (does not change in relative position for the six-year duration of the 2002 Act).

8. Paragraph 6(a) establishes that eligibility for payments under a decoupled income support measure shall be determined by clearly-defined criteria in "*a* defined and fixed base period," not "*the* base period" (as in paragraph 9 of Annex 3, which is defined in that same paragraph as "the years 1986 to 1988"). Brazil's reading of "*a* defined and fixed base period" would read into that text the term "unchanging", language Brazil has proposed in the ongoing WTO negotiations but is not currently found in the Agreement.

9. Annex 2, by its terms, sets out the fundamental requirement and basic and (if applicable) policy-specific criteria to which green box "*domestic support measures*" must conform. Other provisions in the Agreement similarly establish that the criteria set out in Annex 2 apply to "*domestic support measures*". Thus, with respect to a given decoupled income support measure, eligibility for payments must be determined by criteria in a "defined and fixed base period".

10. Brazil argues that a *new* decoupled income support measure must be based on the same base period as a previous measure if the new measure "is essentially the same" or "[i]f the structure, design, and eligibility criteria have not significantly changed." There is no provision in Annex 2 or the Agreement on Agriculture that supports Brazil's approach. It is thus irrelevant whether two decoupled income support measures are "essentially the same".

11. Brazil would read paragraph 6(b) as requiring a Member to make support available for *any* type of production; a Member could not preclude a recipient from producing certain crops.<sup>2</sup> While direct payments are reduced if certain crops are produced, a recipient need not produce any "type of"

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<sup>2</sup> Brazil's reading would also seemingly require a Member to make payments even if the recipient's production was illegal – for example, the production of narcotic crops such as opium poppy or the production of unapproved biotech varieties or environmentally damaging production (for example, planting on converted rain forest or wetlands) – because, under Brazil's approach, by reducing or eliminating payments for any of these production activities, a decoupled income support measure could be understood to base or relate the amount of payment to the "type" of production undertaken.

crop in particular in order to receive the full payment for which a farm is eligible; the recipient need merely refrain from producing the forbidden fruit or vegetable. Thus, it is not any “type . . . of production . . . undertaken by the producer” that results in the full direct payment but rather production *not* undertaken by the producer – that is, *ceasing* certain production.

12. ***Production Flexibility Contract Payments:*** Production flexibility contract payments (now expired) were made with respect to farm acreage that was devoted to agricultural production in the past, including acreage previously devoted to upland cotton production. The payments, however, were made regardless of whether upland cotton was produced on those acres or whether anything was produced at all. As with direct payments, because production flexibility contract payments were decoupled from production, they met the five policy-specific criteria set out in paragraph 6 for decoupled income support measures.

13. Brazil has failed to make a *prima facie* case that US green box measures do not satisfy the fundamental requirement of Annex 2.<sup>3</sup> In fact, Brazil’s “evidence” consists simply of selectively quoting and emphasizing conceptual and theoretical statements from the economic literature. *None of the papers Brazil cites concludes that these payments in particular, or decoupled income support measures in general, have more than “minimal[] trade-distorting effects or effects on production.”*

14. The Agreement on Agriculture does not define a numerical threshold on what degree of effects will be considered “minimal[] trade-distorting effects or effects on production”. However, given that *no study has found that these payments have effects on production of more than one per cent*, it would appear that direct payments have and production flexibility contract payments had no more than “minimal[] trade-distorting effects or effects on production”. Thus, not only has Brazil failed to present a *prima facie* case, but the United States has affirmatively shown that these payments satisfy the fundamental requirement of the first sentence of Annex 2.

#### **US Non-Green Box Domestic Support Measures are not in Breach of Article 13(b)(ii)**

15. **: Peace Clause Proviso – Support was “Decided” During Marketing Year 1992 Using a Rate, Not a Budgetary Outlay:** The Peace Clause proviso requires a comparison to the product-specific support “decided” during the 1992 marketing year. A Member cannot “decide” world market prices or actual production or any other element outside a government’s control. Yet Brazil would read the Peace Clause as though Members were omnipotent and could “decide” every factor influencing support.

16. Brazil lists nine different “decisions taken by the United States in relation to MY 1992 upland cotton support programmes”. At least three of these “decisions” relate to the rate of support and *not a single decision relating to budgetary outlays or market prices*. Thus, Brazil’s own answer confirms that the proper analysis of the support “decided” by US measures is to look to the terms of the US measures, which set a rate of support.

17. The use of the term “grant” in the Peace Clause proviso with respect to challenged measures does not compel an examination of budgetary outlays. The ordinary meaning of “grant” is to “bestow as a favour” or “give or confer (a possession, a right, etc.) formally”. Thus, the use of the term “grant” would permit an evaluation of the rate of support that challenged measures “give or confer . . . formally”. Members did not choose to use the word “granted” in place of “decided,” and a valid

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<sup>3</sup> If, as Brazil has argued, the first sentence is “fundamental” and has independent force, then presumably if a measure meets that “fundamental requirement”, it will be deemed to be green box, irrespective of whether it meets the subordinate basic and policy-specific criteria. Thus, on Brazil’s reading, if a measure does not conform to the criteria in Annex 2, it still could meet the “fundamental requirement”, and the complaining party would bear the burden of proof to demonstrate a measure’s inconsistency with that provision.



interpretation must make sense of that choice rather than reading it out of the Agreement. In addition, had Members intended the Peace Clause comparison to be made *solely* on the basis of budgetary outlays, they could have used that term, which is a defined term in Article 1(c) and used frequently in the Agreement.

18. **Peace Clause Proviso – "Support to a Specific Commodity" Means Product-Specific Support:** The phrase "support to a specific commodity" means "product-specific support". That the Peace Clause does not use the phrase "product-specific support" is neither surprising nor telling. The basic definition of product-specific support is given in Article 1(a), as "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product." Article 1(h) also refers to the concept but does not use the exact phrase "product-specific support"; in fact, the language this provision uses ("support for basic agricultural products") is strikingly similar to the Peace Clause proviso ("support to a specific commodity"). Neither Article 1(a) nor 1(h) *even uses the term "specific"* whereas the Peace Clause *contains all three elements of that phrase* (product, specific, and support).

19. **Brazil Simply Ignores the Definition of Product-Specific Support in the Agreement on Agriculture:** Brazil argues that certain challenged US measures are *not* "non-product-specific" and therefore must be "support to a specific commodity." Brazil focuses on the definition of "non-product-specific" support in Article 1(a) but simply fails to interpret that definition in light of the definition of product-specific support that immediately precedes it. The universe of domestic support measures under Article 1(a) consists of product-specific support and non-product-specific support; these two parts must be read together and in harmony.

20. The definition of product-specific support consists of two elements: First, the support must be provided *"for an agricultural product,"* that is, the subsidy is given "in favour of" a product and not in respect of criteria not related to the product or in respect of multiple products. Second, such support is "in favour of the *producers of the basic agricultural product*", which suggests that subsidy benefits those who produce the product – that is, production is necessary for the support to be received. *Both* of these elements must be present for support to be product-specific since, should either be missing, the definition would not be satisfied.

21. The second category of support in Article 1(a) is defined as "non-product-specific support provided in favour of agricultural producers in general." The ordinary meaning of "in general" is "in general terms, generally". Non-product-specific support *cannot* be interpreted as support provided "for *an* agricultural product in favour of the *producers* of the basic agricultural product" because to do so would reduce the first half of the Article 1(a) definition to redundancy or inutility. Thus, non-product-specific support is support in favour of agricultural producers "generally" – that is, a residual category of support covering those measures that do not fall within the more detailed criteria set out in the definition of product-specific support.

22. **Counter-Cyclical Payments are Non-Product-Specific Support:** Counter-cyclical payments are non-product-specific support. The payment formula for counter-cyclical payments demonstrates that these payments are not "provided for an agricultural product" because a recipient need not currently produce upland cotton (or any other crop) to receive payment. In addition, it is not "the producers of the basic agricultural product" – that is, current upland cotton growers – that are entitled to receive the counter-cyclical payments but rather persons (farmers and landowners) on farm acres with *past histories* of producing covered commodities, including upland cotton, during the base period. Thus, counter-cyclical payments satisfy neither element of the definition of product-specific support and do not form part of the Peace Clause comparison.

23. Despite Brazil's attempts to mischaracterize the two as similar, counter-cyclical payments and deficiency payments differ in crucial respects. To receive a deficiency payment, a producer was

*required* to plant upland cotton for harvest and would be paid on the *acres planted to upland cotton for harvest* up to the maximum payment acreage. Thus, deficiency payments were support for an agricultural product (upland cotton) in favour of the *producers* of the product. By contrast, to receive the counter-cyclical payment a person with “upland cotton base acres” *need not plant for harvest or produce upland cotton* (nor any other crop nor any crop at all). Thus, counter-cyclical payments do not provide support for “an agricultural product” in favour of “the producers” of the basic agricultural product and do not form part of the Peace Clause comparison under the proviso in Article 13(b)(ii).

24. **Crop Insurance Payments Provide Non-Product-Specific Support:** Crop insurance is not support “provided for *an* agricultural product”. For marketing year 2002, crop insurance payments are available to approximately 100 agricultural commodities, representing approximately 80 per cent of US area planted and greater than 85 per cent of the value of all US crops. Support which is provided to a number of crops is not “support to a specific commodity”; it is ‘support to several commodities’ or ‘support to more than one commodity’ and does not form part of the Peace Clause comparison. The United States notifies crop insurance as non-product-specific “amber box” domestic support subject to US reduction commitments. *No WTO Member has notified crop insurance programmes as product-specific*; in fact, Hungary, Canada, the EC, and Japan have notified crop insurance programmes as non-product-specific support. The United States is not aware of any other Member’s crop insurance programme that has as broad product coverage as the US programme.

25. **Market Loss Assistance Payments are Non-Product-Specific Support:** As indicated in the US 1999 WTO domestic support notification (G/AG/N/USA/43), the expired market loss assistance payments were non-product-specific support. As with production flexibility contract payments, market loss assistance payments were made to persons with farm acres that previously had been devoted to production of certain crops, including upland cotton, during an historical base period. A recipient was not required to produce upland cotton or any other crop in order to receive payment, and no production was required at all. Thus, these payments are not product-specific support and would not form part of the Peace Clause proviso comparison.

26. **Direct Payments:** Were the Panel to conclude that direct payments do not conform fully to the provisions of Annex 2, direct payments would be non-product-specific support. As with counter-cyclical payments, direct payments are based on quantities of acreage that historically produced cotton, and there is no requirement to produce upland cotton (or any other crop) to receive these payments. Thus, direct payments would not be product-specific support.

27. **Production Flexibility Contract Payments:** Were the Panel to consider that these payments are within its terms of reference, the United States has explained that they would be green box support. Were the Panel to conclude further that production flexibility contract payments do not conform fully to the provisions of Annex 2, these payments would also be non-product-specific support for the reasons given with respect to direct payments. As such, they would not form part of the Peace Clause proviso comparison.

28. **Cottonseed Payments:** The Agricultural Assistance Act of 2003 and the cottonseed payment made pursuant to it is not within the Panel’s terms of reference because the legislation authorizing the payments had not even been enacted at the time of Brazil’s panel request, much less its consultation request. The “legal instruments” pursuant to which prior cottonseed payments were made, moreover, do not appear in Brazil’s consultation or panel requests. Thus, it would appear that cottonseed payments for the 1999 and 2000 crops of cottonseed also do not form part of the Panel’s terms of reference.

29. **Peace Clause Comparison – The Product-Specific AMS for Upland Cotton Also Demonstrates That Challenged US Measures Do Not Breach the Peace Clause:** The United States believes the Peace Clause compels comparing the rate of support decided by US

measures, whether or not adjusted for the acreage reduction programme and normal flex acres, with the current rate of support. Were the Panel to determine to use an Aggregate Measurement of Support calculation, however, the price gap methodology is the only appropriate one for Peace Clause purposes.

30. The price gap methodology eliminates the effect of prevailing market prices on the calculation of support. Instead, paragraphs 10 and 11 of Annex 3 designate that the support be calculated by multiplying the quantity of eligible production by the gap between the applied administered price (for example, the marketing loan rate) and the *fixed reference price* (that is, the actual price for determining payment rates for the years 1986 to 1988). Thus, by holding the reference price “fixed”, support measured using a price gap calculation shows the effect of changes in the level of support (applied administered price) decided by a Member, rather than changes in outlays that result from movements in market prices that a Member does *not* control. In fact, the United States has calculated an AMS for upland cotton using the price gap methodology for both deficiency payments and marketing loan payments (marketing loan gains, certificate exchange gains, and loan deficiency payments) and using budgetary outlays for all other payments. The result is exactly the same as a rate of support comparison: in no marketing year from 1999 through 2002 is the support US measures grant in excess of the 1992 marketing year level.

### **US Export Credit Guarantee Programme**

31. **The Negotiating History of Article 10.2 Reveals that the Negotiators Explicitly Deferred the Application of All Export Subsidy Disciplines on Export Credit Guarantees:** The GATT/WTO negotiating history regarding export credits and export credit guarantees in agriculture supports the US interpretation of Article 10.2. On 24 June 1991, Chairman Dunkel circulated a Note on Options in the Agriculture Negotiations requesting decisions by the principals on “whether subsidized export credits and related practices . . . would be subject to reduction commitments”. Subsequently, on 2 August 1991, he circulated a proposed “Illustrative List of Export Subsidy Practices.” Item (h) is explicitly “Export Credits provided by governments or their agencies on less than fully commercial terms.” Similarly, item (i) is “Subsidized export credit guarantees or insurance programmes.”

32. On 20 December 1991, the “Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations” was issued. Article 10.2 of the Draft Final Act states: “Participants undertake *not* to provide export credits, export credit guarantees or insurance programmes *otherwise than in conformity with* internationally agreed disciplines” (emphasis added). This draft text would clearly prohibit the use of export credit guarantees *except* in conformity with agreed disciplines. Such internationally agreed disciplines would include those contemplated by the SCM Agreement. This would be precisely the language necessary to support Brazil’s reading.

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

34. **Brazil’s approach would result in gross injustice:** As part of the negotiations, the parties had to prepare and submit schedules of quantities and budget outlays during a base period to derive the export subsidy reduction commitments ultimately reflected in the respective schedules of the Members. Had Members’ export credit guarantees been considered export subsidies for these purposes from the outset, then the export credit guarantee activity during the base period would also have to have been added to the base figures from which each Member’s export subsidy reduction commitments were calculated. For example, the United States has no export subsidy reduction

commitment with respect to corn, yet during the 1986-1990 base period an average of over *5.5 million tons* of corn were exported *each year* under the GSM-102 and GSM-103 programmes. The United States would have reduction commitments for many more products than currently and would have had significantly increased commitments for the 13 products that are scheduled. However, Brazil would have the Panel impose the disciplines now but deny Members the corresponding changes in reduction commitments. Brazil's approach would be grossly inequitable and the Panel should reject it.

**35. The Application of Government-Wide Accounting Rules Indicates that the Export Credit Guarantee Programmes are Covering Long-Term Operating Costs and Losses:** The application of the Federal Credit Reform Act of 1990 ("FCRA") over time to the export credit guarantee programmes as a whole currently indicates that the net result of all activity associated with export credit guarantees issued in fiscal years 1994 and 1995 is a total net receipt to the United States of \$29 million. The experience of 1994 and 1995 is viewed as representative, and the United States expects that the net results for other years will be similar to the experience for 1994 and 1995. Re-estimates thus far have resulted in a net reduction in the estimated costs of these programmes of over \$1.9 *billion* since the inception of credit reform budgeting in fiscal year 1992. Based on those results, the Brazilian claim that "operating costs and losses for GSM 102, GSM 103, and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992" is not supportable.

**36.** The United States has gathered cumulative reestimates on a cohort basis: For example, for cohort 1992 (not yet closed) the current data reflects an estimate of a *profit* to the United States of approximately \$124 million; for 1993 (not yet closed), the corresponding current figure is a *profit* of approximately \$56 million; and, as indicated, cohorts 1994 and 1995 together project a *profit* of \$29 million. With the exception of 2002, for which only very recent data is necessarily available, the Panel will note that the trend for all cohorts is uniformly favourable as compared to the original subsidy estimate.

**37.** Brazil asserts that "historically, the majority of GSM support that is rescheduled is 'in arrears'" and that this increases costs. Brazil largely relies, however, on a 1990 government report that is dated and precedes FCRA itself. No rescheduling applicable to export credit guarantees issued in fiscal year 1992 or later is in arrears.

**38. Brazil's Suggestion to Use Estimated Data to Determine Long-Term Costs and Losses Supports the View that the Export Credit Guarantees Do Not Provide Export Subsidies:** The United States notes Brazil's statement that "a certain degree of estimated data would be perfectly acceptable in an analysis of the costs and losses of guarantee programmes under item(j)" for two reasons. First, the re-estimate process for fiscal years 1994, 1995, and virtually every other year since fiscal year 1992 indicates a very strong net positive trend with respect to the programmes and that therefore current premium rates do cover long-term operating costs and losses. Second, it is relevant with respect to Brazil's reliance on the significant losses that the United States admittedly incurred with respect to Poland and Iraq. Presumably, to attempt to recover such losses in any practical time frame would require such a prohibitive fee increase that few, if any, exporters would take advantage of the program. Consequently, the United States would be whipsawed by a prohibition on the export credit guarantee as currently constituted because of the large losses incurred between 10 and 20 years ago, and the inability to create a conforming programme because the fee structure necessary to compensate for such historical losses would foreclose use of the programme. Item (j) cannot be reasonably interpreted to require an examination of all activity since the beginning of a programme, no matter how old it may be. The data provided with respect to fiscal years 1994 and 1995 and for the programmes as a whole indicates that current premium rates are presently adequate to cover long-term operating costs and losses as currently projected. The United States is also in a net positive position with respect to cotton transactions in the ten years commencing with fiscal year 1993.

39. **The Export Credit Guarantee Programmes Are Not Applied in a Manner which Results in or which Threatens to Lead to, Circumvention of Export Subsidy Commitments:** Brazil has challenged the export credit guarantee programmes, GSM 102, GSM 103, and SCGP, as such. Brazil has failed, however, to demonstrate that these programmes as such mandate a violation of US WTO obligations. It is well established under GATT and WTO jurisprudence that legislation of a Member violates that Member's WTO obligations only if the legislation *mandates* action that is inconsistent with those obligations or precludes action that is consistent with those obligations. If the legislation provides discretion to administrative authorities to act in a WTO-consistent manner, the legislation, as such, does not violate a Member's WTO obligations. This distinction has continued under the WTO system.

40. The Commodity Credit Corporation ("CCC") has complete statutory and regulatory discretion at any time not to issue guarantees with respect to any individual application for an export credit guarantee or to suspend the issuance of export credit guarantees under any particular allocation. This is in marked contrast to the situation in *US- FSC*, in which the Appellate Body found a threat of circumvention because the FSC legislation created a legal entitlement to the payment. There is no statutory legal entitlement to an export credit guarantee. Furthermore, even if an application and fee are received, the applicant is not necessarily entitled to receive the guarantee. Issuance is discretionary.

41. Finally, Brazil has alleged that the United States has exceeded its quantitative export subsidy reduction commitments during the period July 2001-June 2002. Even if the export credit guarantee programmes were deemed export subsidies, the United States would be in compliance with the quantitative reduction commitments for that period with respect to wheat, coarse grains, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, live dairy cattle, and eggs. This may also be true with respect to vegetable oil. In fiscal year 2002, it would also be true for poultry meat. The United States did not use the GSM-102 or GSM-103 programmes during 2001-2002 with respect to butter and butter oil, skim milk powder, cheese, other milk products, or eggs.

42. **Financial Arrangements Analogous to the CCC Export Credit Guarantee Programmes are Available in the Marketplace:** In light of Article 10.2, it is neither appropriate nor necessary to analyze the export credit guarantees with respect to Article 1.1(b) of the SCM Agreement. However, we note that financing is available in the marketplace that is analogous to export credit guarantees. A prominent example in the commercial market would be "forfaiting." It would appear, then, that a competitive marketplace exists for trade financing even in emerging markets where more conventional financing is not available. The United States is not privy to the precise terms at any time available in forfaiting transactions because those terms can vary by country, commodity, bank risk, size of transaction and numerous other factors. In addition, like most private financial activity, that information is ordinarily held confidentially by the parties.

### **The Step 2 Programme is not Contingent on Export Performance**

43. Brazil apparently does not contest that all uses of upland cotton are eligible for the Step 2 subsidy. Instead, Brazil suggests, erroneously, that not the entire universe of users of upland cotton is eligible for the subsidy. First, the requirement that a recipient must be "regularly engaged" in the use of cotton is simply an anti-fraud provision to preclude an attempt to receive a payment with respect to cotton on which a payment has already been made. Brazil also correctly notes that "the eligible domestic user criteria exclude all firms that are domestic cotton brokers or simple resellers". These parties are not using the cotton and are therefore ineligible. Brazil suggests a third category of persons who are users but are not eligible to receive the payment: "firms that have not entered into CCC contracts" as either manufacturers or exporters. It is true that CCC cannot pay parties that

choose to remain unknown to it, but this requires an assumption of economic irrationality and does not diminish the point that all who use cotton have it entirely within their power to receive the subsidy.

## ANNEX D-3

### BRAZIL'S COMMENTS ON US REBUTTAL SUBMISSION

27 August 2003

1. Pursuant to the Panel's ruling of 23 August 2003, Brazil presents the following comments on the paragraphs listed below relating to the Rebuttal Submission of the United States of America. In addition, Brazil offers comments on Question 67a posed to the United States by the Panel's Communication of 25 August 2003.

#### Paragraph 43

2. In paragraph 43 of its Rebuttal Submission, the United States argues that "Brazil's reading would seemingly require a Member to make payments even if the recipient's production was illegal, for example the production of narcotic crops such as opium poppy or the production of unapproved biotech varieties or environmentally damaging production." The United States claims this would have "potentially far reaching results." This new argument has no merit.

3. The two examples provided by the United States involving the growing of illegal plants/crops are, by definition, situations in which a national (or state/regional) domestic criminal (or civil) law would prohibit or regulate the growing of such plants/crops. The criminal (or civil) law would operate separately from any de-coupled direct payment to prohibit or regulate all forms of such production. There would be no reason in that situation to have a further statute limiting the payment if such illegal plants (or illegal production methods) – the activity would already be illegal. That is exactly the case with the 1996 FAIR Act and the 2002 FSRI Act regarding PFC and direct payments respectively. Neither limits the amount of payments for the growing of plants that would be illegal under US law. There is no need to because US federal and/or State law already prohibits such activity.

4. In addition, the US example in paragraph 43 about a restriction on "environmentally damaging production" is not relevant because such a restriction does not relate to the "type" of production (*i.e.*, the type of crop) but rather the "manner" of production.<sup>1</sup> Therefore, Annex 2, paragraph 6(b), which focuses on the "type" of production related to the "amount" of payment, it does not address the manner in which production is conducted. The context of Annex 2, paragraph 6(b) includes Annex 2, paragraph 12 ("Payments under environmental programmes") which permits Members to impose specific conditions on the growing of crops in order to receive environmentally related direct payments.

5. Thus, the "potentially far-reaching results"<sup>2</sup> from Brazil's text-based approach to the ordinary meaning of "the amount of such payments" related to or based on the "type of production" do not and

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<sup>1</sup> See First Submission of Brazil, para. 157 in which Brazil makes the distinction between Paragraph 6(b) in which the word "type" relating to the type of crop produced contrasted with Paragraph 6(d) which is concerned with the type of production process. The United States has never contested this distinction.

<sup>2</sup> The United States reference to "potentially far-reaching results" appears also to include its additional new argument in paragraph 43 relating to the EC's possible CAP reform imposing, *inter alia*, fruits and vegetable restrictions. That potential "reform" is obviously not at issue in this case. The EC will have to make a decision how to notify any such measure when it is required to do so under Article 18 of the Agreement on Agriculture. It goes without saying that an improperly categorized green box measure of one Member cannot be justified by relying on a possible future improperly categorized green box measure of another Member.

will not exist. Brazil further notes that in the extraordinary situation in which one Member could theoretically seek to challenge a de-coupled direct payment limiting payments for growing plants such as opium poppy as an actionable subsidy, the Member restricting the “type” of production of such plants could, for instance, assert defences under Article XX(b) or (d) of GATT 1994.<sup>3</sup>

### Paragraphs 96-98

6. The United States raises the new argument that “no other WTO Member has notified crop insurance programmes as product-specific.”<sup>4</sup> At the outset, Brazil notes that it is the US crop insurance programmes and the detailed record of the product-specific nature of the US crop insurance programmes that is at issue in this dispute – not those of other WTO Members.

7. None of the WTO notifications of the EC, Canada, or Japan cited by the United States reflect the existence of the type of special product-specific policies or special treatment for certain crops within a broader insurance programme. In particular, there is no indication that these Members provide any specific crop insurance provisions for a specific crop, such as the insurance programmes provided by the United States for upland cotton.<sup>5</sup> For example, while Canada appears to have a similar programme for “crops” as the United States, there is no indication that Canada provides special policies or groups of policies within its broader programme for individual crops. Thus, in contrast to the evidence of other Member’s insurance policies, the *nature, type, value, and participation rate* of the crop insurance policies provided by the United States differs widely among commodities. As Brazil has explained, it is simply not a “one size fits all” programme. The EC agrees. It has argued before the Committee on Agriculture that the US crop insurance programme is product-specific support.<sup>6</sup>

8. The United States further argues that it “is not aware of any crop insurance programme maintained by any other Member” that covers as many commodities as the United States.<sup>7</sup> However, the Article 13(b)(ii) test is whether a specific commodity receives support from a domestic measure identified in the *chapeau* and whether there is some sort of a link between the support measure and the specific commodity. Evidence of such a link in the case of crop insurance exists, as with the US crop insurance programme, when particular commodities are provided special policies, coverage, or additional subsidies compared to other commodities covered by the crop insurance programme. There is no such evidence reflected in the notifications of Mexico whose notification states that “insurance premium subsidy [is] available for all producers.”<sup>8</sup> Japan’s “Agricultural Insurance Scheme” also includes subsidies for policies covering all crops (except vegetables), all livestock (except poultry) and sericulture.<sup>9</sup> By contrast, the US insurance programmes challenged by Brazil do not provide subsidies for any insurance for livestock or many other commodities. Indeed, the commodities *not* covered by the US 2000 ARP Act and relevant regulations represent more than half of the value of US farm cash receipts.<sup>10</sup>

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<sup>3</sup> These same exceptions would be available in the unlikely event a Member challenged a direct de-coupled payment for any of the three scenarios posed by the United States in paragraph 43.

<sup>4</sup> Rebuttal Submission of the United States, para. 96-98.

<sup>5</sup> See Rebuttal Submission of Brazil, paras 54 (special irrigation-related policies for upland cotton), para. 55 (upland cotton producers have much larger pool of insurance subsidies than other types of crops), para. 56 (specific upland cotton income protection policies and catastrophic risk protection), para 57 (much greater use of insurance subsidies than other crops), para. 58 (reinsurance payments for upland cotton).

<sup>6</sup> Exhibit Bra-144 (G/AG/R/31, para. 31).

<sup>7</sup> Rebuttal Submission of the United States, para. 98.

<sup>8</sup> G/AG/N/MEX/7, p. 4.

<sup>9</sup> Rebuttal Submission of the United States, para. 98.

<sup>10</sup> Rebuttal Submission of Brazil, para. 59 (Excluded agricultural commodities from US insurance programme represent 52 per cent of the value of all US farm cash receipts).



9. Finally, as the United States recognizes, more than half of the notifications (which include part of Japan's) cited by the United States refer to insurance programmes as green box support.<sup>11</sup> Members so notifying are not obliged to make a determination under Article 6 of the Agreement on Agriculture whether such support is product-specific or not because it is exempt from any reduction commitments. The United States has not provided evidence suggesting these green box categorizations are incorrect. For these reasons, these notifications are also irrelevant.

### Paragraphs 114-117

10. The United States argues for the first time in paragraphs 114-117 of its Rebuttal Submission that using the "price-gap" methodology is the appropriate way to calculate the portion of upland cotton AMS that stems from marketing loan gains, certificate exchange gains, and loan deficiency payments (collectively known as "marketing loan payments"). The effect of applying the price gap methodology would be to transform the \$2.5 billion in budgetary expenditures for marketing loan payments in MY 2001 into a "negative" amount for purposes of total current AMS.<sup>12</sup> The United States bases its new argument on an alleged statement by Brazil and "agrees" that "Brazil is correct when it states that a non-exempt direct payment dependent on a price gap may be calculated using a price gap methodology, rather than budgetary outlays. . ."<sup>13</sup>

11. The United States refers to Brazil's 11 August Answer to Question 67, paragraph 130, as the basis for its assertion. Brazil's statement cited by the United States reads as follows:

Brazil notes that the United States has notified the deficiency payments using the price gap methodology provided for in Annex 3. [footnote citing Exhibit Bra-150 (G/AG/N/USA/10)] Brazil considers it appropriate to follow the US decision and will therefore, calculate the amount of support to upland cotton provided by the deficiency payment programme by using the "price gap" approach detailed in Annex 3 paragraph 10 and 11.

Contrary to the US interpretation of this statement, Brazil's point was that any calculation of AMS for deficiency payments (and for the other programmes that require such calculation) must be consistent with the actual choice of methodology originally made by the United States for calculating its domestic support reduction commitments as well as its yearly current AMS notifications. Indeed, the United States' entire argument in paragraphs 114-117 of its Rebuttal Submission is based on the alleged obligation for Brazil "to be consistent."<sup>14</sup> As demonstrated below, it is Brazil's AMS calculation, not that of the United States, that is "consistent."

12. Members are required to notify annually their current total AMS to provide other Members the opportunity to review the consistency with their domestic support reduction commitments pursuant to Article 6.3 of the Agreement on Agriculture.<sup>15</sup> The total AMS reduction commitments were negotiated during the Uruguay Round based on a calculation of "total AMS" provided in marketing years 1986-1988. The initial AMS calculation used for the purposes of the reduction commitments was performed pursuant to Annex 3 of the Agreement on Agriculture with Members choosing either budgetary expenditures or a "price-gap" methodology expressed in total monetary terms. Like Article 13(b)(ii), the comparison between *current* total AMS and the AMS ceiling, *i.e.*,

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<sup>11</sup> Rebuttal Submission of the United States, para. 97.

<sup>12</sup> The United States even claims credit for being conservative by not netting the negative support by the marketing loan benefits against the positive support provided by the other domestic support programmes, Rebuttal Submission of the United States, para. 116 and note 148.

<sup>13</sup> Rebuttal Submission of the United States, para. 114.

<sup>14</sup> Rebuttal Submission of the United States, para 114 (last sentence).

<sup>15</sup> See Article 18.2 of the Agreement on Agriculture and various US notifications cited herein.

the reduction commitment, must allow for an “apples to apples” annual comparison in accounting for the same measures. It follows that once a Member uses a budgetary approach for one measure to establish the AMS ceiling, it cannot use a price gap approach for that same measure in calculating total *current* AMS. Instead, a Member is required to report *current* total AMS consistently with the choice it made for that particular type of support in its *original* total AMS calculation.

13. This interpretation of Annex 3 and Article 6.3 of the Agreement on Agriculture is consistent with its context and object and purpose. Opting for a methodology that would permit Members to change their original methodology (*i.e.*, from budgetary to price-gap) could sanction what the United States proposes – the covering up of billions of dollars of marketing loan payments (originally calculated on a budgetary basis) and turns them into “negative support” by using a “price-gap” formula. This would be inconsistent with the entire reason for the reduction commitments of Article 6 of the Agreement on Agriculture.

14. Brazil’s calculation of AMS for, *inter alia*, marketing loan payments followed the actual decision of the United States during the Uruguay Round<sup>16</sup> as reflected in its notifications.<sup>17</sup> During the Uruguay Round, the United States calculated the upland cotton portion of what would eventually become its domestic support reduction commitment by using the following methodologies: it used the price gap formula for upland cotton deficiency payments<sup>18</sup> and used budgetary outlays for all other domestic support measures.<sup>19</sup> In its MY 1995 notification to the Committee on Agriculture the United States similarly notified deficiency payments using the price-gap formula and using budgetary outlays for all other domestic support measures subject to reduction commitments<sup>20</sup> consistent with its AMS calculation during the Uruguay Round. After the termination of the deficiency payment programme in 1996, all later domestic support (current total AMS) notifications of the United States for upland cotton only use budgetary outlays. Thus, Brazil’s approach to calculating upland cotton AMS for MY 1992 and 1999-2002 is entirely consistent with the US approach as evidenced in its domestic support notifications<sup>21</sup> and with the US obligations under the Agreement on Agriculture.

15. The United States accounted for the marketing loan payments in the same manner as in its notifications when it answered Question 67 in its 11 August submission.<sup>22</sup> This is, furthermore, the methodology the Panel indicated the United States should use – referring to the US notification of MY 1999 domestic support in G/AG/N/USA/43, in which the United States – in line with its obligation – used budgetary outlays.<sup>23</sup>

16. In sum, like many other US arguments in this phase of the dispute, this US argument is designed to cover-up expenditures and support to upland cotton that increased significantly since the US Uruguay Round commitments came into effect. Therefore, the Panel should reject it.

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<sup>16</sup> Exhibit Bra-191 (G/AG/AGST/USA, p. 20)

<sup>17</sup> Exhibit Bra-150 (G/AG/N/USA/10, p. 18)

<sup>18</sup> Exhibit Bra-191 (G/AG/AGST/USA, p. 20 and supporting tables on p. 21-22).

<sup>19</sup> Exhibit Bra-191 (G/AG/AGST/USA, p. 20).

<sup>20</sup> Exhibit Bra-150 (G/AG/N/USA/10, p. 18).

<sup>21</sup> The United States entire argument in paragraphs 114-117 is premised on the alleged need for Brazil “to be consistent” as stated in the last sentence in paragraph 114. As noted, it is Brazil who has been consistent in using actual US notifications and the US calculation method during the Uruguay Round, not the United States who now seeks to ignore them.

<sup>22</sup> US 11 August Answer to Question 67, para. 128-134.

<sup>23</sup> Exhibit Bra-47 (G/AG/N/USA/43, p. 20).

## Paragraphs 124-127 and Exhibit US-24

17. The United States presents an additional critique of Professor Sumner's analysis in Exhibit US-24 prepared by Dr. Joseph W. Glauber, the Deputy Chief Economists of USDA, as well as in paragraphs 124-127 of its Rebuttal Submission.

### Marketing Loan Benefits

18. Dr. Glauber notes that the analysis of Professor Sumner did not include in the upland cotton acres eligible for marketing loans 447,164 acres of upland cotton planted on Flex acres from other programme crops.<sup>24</sup> Dr. Glauber is correct that any such acreage would be eligible for receiving marketing loan payments and therefore should be included in the calculation.<sup>25</sup> Dr. Glauber refers to "Acreage Reduction compliance reports" as his source of this number. Dr. Glauber does not provide a citation for these compliance reports and the United States has not made them available to Brazil. Therefore, Brazil cannot confirm the actual number of acres. Brazil also notes that the number listed is planted acres not harvested acres.<sup>26</sup>

19. Dr. Glauber further rests his finding that 100 per cent of US upland cotton production in MY 1992 benefited from marketing loan payments on his statement that upland cotton farmers "often" report land that had been planted and abandoned as land left idle and therefore never planted. No citation, authority or reference is provided for this assertion. The assumption in this assertion is that farmers report one thing to the US Federal Government, yet actually do something else. Thus, Dr. Glauber's presumption appears to be that farmers engage in what would appear to be widespread misrepresentation. Brazil does not know if such assumed large-scale misrepresentations were legal under the 1992 US programme, but it certainly contradicts "programme" expectations.

20. Professor Sumner concluded that 1.99 million acres used to produce upland cotton in MY 1992 were not eligible for the marketing loan payments because they did not participate in the deficiency programme. Dr. Glauber confirms Professor Sumner's general approach on non-participating acreage in footnote 1 on page 2 where he acknowledges that "some base building occurred during the early 1990's." What this means is that a substantial amount of upland cotton must have been planted outside the programme to accommodate expansion of upland cotton base by 200,000 acres in 1993, as identified by Dr. Glauber. This acknowledgement supports Professor Sumner's analysis that a significant amount of upland cotton must have been grown *outside* the deficiency programme. The basis for this analysis is as follows:

21. Under the rules existing in MY 1992, in order to "build" base a farm was required to plant all of its upland cotton outside the programme.<sup>27</sup> The expansion of upland cotton base is equal to one-

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<sup>24</sup> Exhibit US-24, p. 1.

<sup>25</sup> Neither Brazil nor Professor Sumner were aware of any flex acres from other programme crops planted to upland cotton or of data concerning any such plantings.

<sup>26</sup> Dr. Glauber raises in the first sentence of paragraph 2 what he called "statistical problems in comparing planted acres to programme acres." He points out that "planted acres" information was collected and reported by NASS, while "programme acres" are reported by the Farm Service Agency. (In 1992 this part of USDA was known as the Agricultural Stabilization and Conservation Service.) Dr. Glauber goes on to explain that a significant amount of cotton acreage is planted and abandoned each year. But the relevance of this information in critiquing Professor Sumner's analysis remains unclear. Brazil notes that contrary to Dr. Glauber's assumption, Professor Sumner's calculations do *not* rely on data published by NASS, but instead on published information in the Farm Service Agency's "Fact Sheet: Upland Cotton" (Exhibit Bra-4). This Farm Service Agency source provides data on planted acres, the abandonment rate as well as harvested acres of upland cotton for MY 1992.

<sup>27</sup> Exhibit US-3 (7 CFR 1413.7(c)). ("[T]he crop acreage base shall be equal to the average of the acreage planted and considered planted to such crop for harvest on the farm in each of the 3 crop years

third of the amount of additional cotton acres planted in each of the previous three years. An acre of base is added if an additional acre of cotton is planted for three consecutive years.<sup>28</sup> In order to plant more than the current base, a farm was required to leave the programme *altogether* so that current base acres would also be planted outside the programme. For example, assume a farm had 1000 acres of upland cotton base and wanted to add – over the two-year period 1991-1992 – 200 acres of base by 1993. That farm would withdraw from the programme for those two years and plant 1300 acres of cotton (300 acres more than the previous base) in 1991 and 1992. The 1993 upland cotton base would then be calculated as follows: (1000 acres + 1300 acres + 1300 acres) / 3 equalling 1200 acres, thus 200 acres more than previously. Therefore, to add the 200,000 acres of base in 1993 (which Dr. Glauber stated were actually added) a much larger amount of upland cotton would have been required to be planted *outside* the programme in 1992. In addition to building of additional base, farmers planted upland cotton outside the programme because they did not comply with payment limit rules and for some more idiosyncratic reasons.

22. In summary, the evidence of an expanding base is consistent with the assessment of Professor Sumner that a substantial amount of acreage was planted to upland cotton outside the programme. This evidence is not consistent with Dr. Glauber's undocumented or unsubstantiated claim that *all* upland cotton harvested was eligible for marketing loans.

23. To summarize, if the Panel were to accept the undocumented assertion by Dr. Glauber that 447,164 acres of cotton were planted on flex acres from other programme crop base acreage, then there would be 1.54 million acres (1.99 million acres – 0.45 million acres) that were planted to upland cotton but were not eligible for marketing loan payments. This 1.54 million represents 12 per cent of planted acreage.<sup>29</sup> Thus, adjusting 52.35 cents per pound by 0.88 results in a support from the marketing loan programme of 46.1 cents per pound. This is an increase of 1.76 cents over the marketing loan level of support set forth in Appendix Table 1 to Professor Sumner's 22 July 2003 Statement.

### Deficiency Payments

24. Brazil has already rebutted the US argument that it is inappropriate to adjust the support provided by the deficiency payment programme by non-participation and the resulting non-eligibility to receive payments.<sup>30</sup>

25. The various "decisions" in MY 1992 with respect to the deficiency payment programme were calculated to establish rules that encouraged some producers to forego eligibility of the programme. Furthermore, the record establishes that US policy makers had relatively precise prior knowledge of how many acres would remain out of the programme based on their policy choices on required land idling and loan rates.<sup>31</sup>

26. Dr. Glauber criticizes Professor Sumner for relying on a programme yield of 531 pounds per acre to calculate the ratio of payment yield to expected yield and states that the true programme yield

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preceding such crop year"). For a farmer within the programme the acreage could never change, as all the acreage was planted (or if idled or – in case of flex acreage – if planted to other crop, it was "considered" planted to upland cotton). Thus, an increase of acreage could only take place, if a farmer withdrew from the programme and exceeded the planting limits imposed by the programme. Thus, MY 1992 base acreage is constitutes the 3-year average of acreage planted and considered planted in MY 1989-1991.

<sup>28</sup> Or of 3 additional acres are planted in the previous year, among other possible constellations.

<sup>29</sup> Compare Annex 2 to Exhibit Bra-105, p. 3.

<sup>30</sup> Brazil's 22 August Comment on Question 66, para. 81.

<sup>31</sup> Brazil's 22 August Comment on Question 66, para. 81.

in MY 1992 was 602 pounds per acre.<sup>32</sup> Dr. Glauber references a USDA press release that is not available to those outside the US government as his source of the payment yield information.<sup>33</sup> Assuming that the figure of 602 pounds per acre used by Dr. Glauber is correct, he incorrectly continues to rely on Professor Sumner's calculation of the expected yield by stating that the "expected yield based on an average of the upland cotton yields over the five preceding crop years is 601 pounds per acre." Professor Sumner estimated the payment yield based on actual yields per *planted* acre, whereas the payment yields that Dr. Glauber cites appears to be the approximate average yields per *harvested* acre. To achieve an apples-to-apples comparison, Brazil has re-calculated the expected yield for MY 1992 as the average yield per *harvested* acre during the 1990 to 1994 based on USDA's "Fact Sheet: Upland Cotton" (656.4 pounds per acre).<sup>34</sup> Thus, the relevant adjustment factor is not 1.002 as suggested by Dr. Glauber, but 0.917 (603 / 656.4).

27. Dr. Glauber offers no critique of Professor Sumner's analysis of the mandatory land idling cost component in the calculation of deficiency payment support. However, Dr. Glauber neglected to include these costs associated with the participation in the programme. As Professor Sumner explained, such costs are properly subtracted from the gross benefits of the cotton deficiency payment programme.

28. Brazil provides a revised calculation below, taking account of the revised yield adjustment factor of 0.917 – reflecting the deficiency payment yield as provided by Dr. Glauber's and the expected comparable yield for MY 1992 that Dr. Glauber erroneously did not correct. In addition, Brazil continues to deduct the cost figure calculated by Professor Sumner from the deficiency payment programme. The revised formula is as follows:

$$\begin{aligned} \text{Deficiency payment support} &= 20.55 \text{ cents per pound} * 0.75 * 0.917 - 0.84 \text{ cents per} \\ \text{pound} &= 13.29 \text{ cents per pound} \end{aligned}$$

Using the new payment yield and the new expected yield that is comparable to it, results in a 0.04 cents per pound upward adjustment to the 13.25 cents per pound presented by Professor Sumner in his 22 July Statement.

### Other Payments

29. Brazil has already responded at length to Dr. Glauber's claims endorsing the arguments of the United States that PFC, market loss assistance, direct and CCP payments, as well as crop insurance payments are not "support to" upland cotton. Dr. Glauber's statement simply restates assertions in the legal briefs of the United States and offers no economic analysis to support his assertions.

30. Dr. Glauber asserts that it is relevant that Step 2 payments are not paid directly to producers.<sup>35</sup> As Brazil explains in its 11 August Answer to Question 18, a basic principle is that the effect of a subsidy is independent of who initially receives the subsidy.<sup>36</sup> That is the economic common sense behind the United States notifying Step 2 payments as product-specific support to upland cotton. And it is the basis for including such payments as "support to a specific commodity" "decided" by a

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<sup>32</sup> Exhibit US-24, p. 3.

<sup>33</sup> The United States has not made this document available and thus we are unable to evaluate its applicability to the current situation. Professor Sumner had relied on the best information available to him and Brazil, which was the average upland cotton yield per planted acre during the reference period of MY 1981-1985.

<sup>34</sup> Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

<sup>35</sup> Exhibit US-24, p. 3.

<sup>36</sup> Exhibit Bra-140 (Pindyck, Robert S. and Rubinfeld, Daniel L., *Microeconomics*, 5<sup>th</sup> edition (2002), Prentice Hall, New Jersey, p. 313-317).

Member with respect to MY 1992. The text of Article 13(b)(ii) requires, under any methodology, the calculation of a level of support *to upland cotton*, not *to producers* of upland cotton.

31. Dr. Glauber's assertions about "double counting" are also incorrect. All the support programmes Dr. Glauber discusses (marketing loan payments, CCP payments and deficiency payments) have production and trade effects largely independent of Step 2 payments. But the purpose of calculating a rate of support under Article 13(b)(ii) is not to assess the *amount* of production, export, and price effects of the simultaneous application of all measures of support. Brazil will present an equilibrium analysis of the full economic effects of these support programmes simultaneously for Brazil's "Further Submission." Such an analysis is, however, not required for the purposes of calculating the rate of support under Article 13(b)(ii). The fact that the United States notified Step 2 as "product-specific" support indicates its position that the Step 2 programme provides additional support to upland cotton. This has certainly been the strongly held view of the US National Cotton Council.<sup>37</sup> Thus, it was appropriate for Professor Sumner to include this production and trade-distorting subsidy in the total rate of support.

32. Brazil notes that Dr. Glauber does not criticize any other calculation made by Professor Sumner. For the convenience of the Panel, Brazil reproduces the chart containing Professor Sumner's calculation as amended following the detailed US critique of Professor Sumner's methodology. As the Panel will note, the results do not materially change. The support granted by the United States in MY 1999-2002 exceeds the support decided in MY 1992. Thus, even under this methodology, the United States does not enjoy peace clause exemption from actions based on Articles 5 and 6 of the SCM Agreement or Article XVI:1 of GATT 1994.

Year	1992	1999	2000	2001	2002
	(Cents per pound)				
<b>1. Marketing Loan</b>	46.10	50.36	50.36	50.36	52.00
<b>2. Deficiency Payments</b>	13.29	na	na	na	na
<b>3. Step 2</b>	2.46	2.46	2.46	2.46	3.71
<b>4. Crop Insurance</b>	0.36	2.00	2.00	2.62	2.62
<b>5. PFC Payments</b>	na	6.13	5.70	4.65	na
<b>6. Market Loss</b>	na	6.10	6.07	6.42	na
<b>7. Direct Payments</b>	na	na	na	na	5.31
<b>8. CCP Payments</b>	na	na	na	na	10.65
<b>9. Cottonseed Payments</b>	0.00	0.97	2.27	0.00	0.61
<b>10. Total Support</b>	<b>62.21</b>	<b>68.03</b>	<b>68.87</b>	<b>66.51</b>	<b>74.91</b>

#### Paragraphs 135-146, and Exhibits US-25 through US-29

33. Brazil has demonstrated that under the ordinary meaning of Article 10.2 of the Agreement on Agriculture, in its context and according to the object and purpose of Article 10 and the Agreement on Agriculture overall, export credit guarantees are subject to the general export subsidy disciplines contained in that Agreement.<sup>38</sup> Article 10.2 announces Members' intent to work toward negotiations

<sup>37</sup> Brazil Rebuttal Submission, para. 127.

<sup>38</sup> See Brazil Statement at the First Panel Meeting, paras. 100-115; Brazil 11 August Responses to Panel Questions 70 (para. 138); Brazil 22 August Rebuttal Submission, paras. 99-100; Brazil 22 August Comments on Answers to Panel Questions 74 (paras. 89-90), 80 (para. 98), 88(b) (paras. 117-119).

on specific disciplines for export credits. In the meantime, the general disciplines on export subsidies included in the Agreement on Agriculture apply to export credits, if those export credits constitute export subsidies.<sup>39</sup>

34. The United States asserts that Article 10.2 carves out export credit guarantees from the general export subsidy disciplines of the Agreement on Agriculture, including the anti-circumvention provisions of Article 10.1. The Appellate Body has, however, concluded that to exempt or carve-out particular categories of measures from general obligations such as the export subsidy obligations in the Agreement on Agriculture, the exemption or carve-out must be *explicit* in the text of an agreement.<sup>40</sup> Article 10.2 includes no such explicit carve-out or exemption. The negotiators knew how to make such an exemption or carve-out explicit, as evidenced by, for example, Article 13 of the Agreement on Agriculture, footnote 15 to Article 6.1(a) of the SCM Agreement, and the second paragraph of item (k) of the Illustrative List of Export Subsidies.<sup>41</sup>

35. In support of its interpretation, the United States appeals to “subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation,” within the meaning of Article 31(3)(b) of the *Vienna Convention*.<sup>42</sup> According to the United States, negotiations on agricultural export credit issues that have taken place in the OECD subsequent to the effective date of the WTO Agreement, and a statement by the OECD Secretariat, constitute “subsequent practice” establishing the agreement of WTO Members that Article 10.2 of the Agreement on Agriculture exempts export credits from any and all disciplines.

36. The United States is wrong. The United States has not established “a ‘concordant, common and consistent’ sequence of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties [to a treaty] regarding its interpretation,” which is the standard adopted by the Appellate Body to establish “subsequent practice” under Article 31(3)(b) of the *Vienna Convention*.<sup>43</sup> It is evident from the positions taken by Canada, the European Communities and New Zealand in this dispute that *not even those WTO Members that participated in the OECD negotiations* agree with the United States’ interpretation of Article 10.2.<sup>44</sup> Nor is there any evidence of “subsequent practice” signifying agreement on the United States’ interpretation amongst the 136 WTO Members that did not participate in the OECD negotiations.

37. Brazil notes, moreover, that the WTO Secretariat, which is in a better position to address interpretations of the covered agreements than is the OECD Secretariat, does not appear to agree that

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<sup>39</sup> Export credit guarantees are not *per se* subject to these disciplines, as they would be if they were included in Article 9.1 of the Agreement on Agriculture (See e.g.: Brazil’s 22 August Comment, para. 97, New Zealand’s Answer to Third Party Question 35, EC’s Answers to Third Party Questions 35, para. 70). Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes constitute export subsidies under Articles 1(e) and 10.1 of the Agreement on Agriculture, under Articles 1.1 and 3.1(a) of the SCM Agreement, and under item (j) of the Illustrative List of Export Subsidies annexed to the SCM Agreement.

<sup>40</sup> Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, para. 201-208; Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128. See discussion at paragraphs 107-108 of the Oral Statement of Brazil.

<sup>41</sup> Oral Statement of Brazil, paras. 105-106.

<sup>42</sup> Rebuttal Submission of the United States, para. 135.

<sup>43</sup> Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, para. 213; Appellate Body Report, *Japan – Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, p. 107.

<sup>44</sup> See Third Party Submission of Canada (paras. 51-54); Third Party Submission of the European Communities (paras. 28-31); Third Party Submission of New Zealand (paras. 3.13-3.16).

agricultural export credits are exempt from the general export subsidy disciplines of the Agreement on Agriculture by virtue of Article 10.2.<sup>45</sup>

38. The United States also argues that the negotiating history of Articles 9.1 and 10.2 of the Agreement on Agriculture supports its argument that export credit guarantees are exempt from the general export subsidy disciplines of the Agreement on Agriculture. The United States raises three arguments in this regard.

39. *First*, the United States addresses the negotiating history of Article 9.1.<sup>46</sup>

40. In the DeZeeuw framework agreement, the United States points to paragraph 20(e), which contemplated Members providing “data on financial outlays or revenue foregone . . . in respect of export credits provided by governments or their agencies on less than fully commercial terms.”<sup>47</sup> The United States apparently considers that since paragraph 20(e) was not carried over into the Agreement on Agriculture, export credits are not subject to the export subsidy disciplines in the Agreement.

41. Brazil notes, however, that paragraph 20(g) addressed “export performance-related taxation concessions or incentives.” This provision was also not carried over into the Agreement on Agriculture. Nonetheless, panels and the Appellate Body have ruled that export performance-related taxation concessions or incentives like the United States’ FSC and ETI measures are subject to the general export subsidy disciplines of the Agreement on Agriculture, including Article 10.1.

42. Similarly, the United States points to Addendum 10 of Chairman Dunkel’s Note on Options, which includes an illustrative list of export subsidy practices.<sup>48</sup> A number of the items on that illustrative list were eventually included, with modifications, in Article 9.1 of the Agreement on Agriculture.<sup>49</sup> Others were not, including item (h), which refers to “[e]xport credits provided by governments or their agencies on less than fully commercial terms,” and item (i), which refers to “[s]ubsidized export credit guarantees or insurance programmes.” The United States apparently considers that since items (h) and (i) were not carried over into the Agreement on Agriculture, export credits, including export credit guarantees and insurance programmes, are not subject to the export subsidy disciplines in the Agreement.

43. Brazil notes, however, that item (g) of Chairman Dunkel’s illustrative list refers to “[e]xport performance-related taxation concessions or incentives other than the remission of indirect taxes.” This provision was also not carried over in Article 9.1 of the Agreement on Agriculture. Nonetheless, as Brazil has already noted, panels and the Appellate Body have ruled that export performance-related taxation concessions or incentives like the United States’ FSC and ETI measures are subject to the general export subsidy disciplines of the Agreement on Agriculture, including Article 10.1.

44. Brazil assumes that the United States simply overlooked paragraph 20(g) of the DeZeeuw framework agreement and item (g) from Chairman Dunkel’s illustrative list when it states, in paragraph 143 of its Rebuttal Submission, that

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<sup>45</sup> G/AG/NG/S/13 (26 June 2000), para. 44 (“[A]s matters currently stand the only rules and disciplines on agricultural export credits are those of the Agreement on Agriculture but only to the extent that such measures constitute export subsidies for the purposes of the Agreement on Agriculture.”).

<sup>46</sup> Rebuttal Submission of the United States, paras. 136-138.

<sup>47</sup> See Exhibit US-25.

<sup>48</sup> Exhibit US-27.

<sup>49</sup> Paragraph 48(a) corresponds to Article 9.1(a), paragraph 48(e) to Article 9.1(e), paragraph 48(f) to Article 9.1(d), paragraph 48(j) to Article 9.1(f), paragraph 48(k) to Article 9.1(c).



the negotiating history reveals that the Members very early specifically included export credits and export credit guarantees as a subject for negotiation and specifically elected *not* to include such practices among export subsidies. In contrast, the negotiating history reveals no comparable discussion involving FSC.

45. In light of these facts, it is evident that the negotiating history of Article 9.1 does not offer support for the United States' argument that export credit guarantees are exempt from the general export subsidy disciplines of the Agreement on Agriculture.

46. *Second*, the United States argues that changes introduced to the text of Article 10.2 between the Draft Final Act and the final version of the Agreement on Agriculture mean that export credits are not subject to the export subsidy disciplines included in the Agreement.<sup>50</sup>

47. The version of Article 10.2 included by negotiators in the Draft Final Act read as follows:

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

The United States argues that this version of Article 10.2 “would clearly prohibit the use of export credit guarantees except in conformity with [internationally] agreed disciplines,” which it asserts “would include those contemplated by the SCM Agreement.”<sup>51</sup>

48. The version of Article 10.2 included in the Agreement on Agriculture reads as follows:

Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.

The United States argues that having changed the draft, “[t]he Members clearly subsequently decided *not* to condition the use of export credit guarantees on conformity with the export subsidy disciplines of the Agreement on Agriculture or the SCM Agreement.”<sup>52</sup>

49. The United States' interpretation of the negotiating history requires the Panel to accept that the version of Article 10.2 included in the Draft Final Act would have imposed a *greater burden* on Members than does the version of Article 10.2 ultimately included in the Agreement on Agriculture. In fact, however, Article 10.2 of the Draft Final Act was amended to make it clear that negotiators expected Members actually *to pursue* negotiations on specific disciplines. Whereas the version of Article 10.2 included in the Draft Final Act did not include an undertaking to pursue those negotiations, the final version of Article 10.2 does include such an undertaking. The amendment did not *relieve* the Members of any burden, but instead *increased* the burden.

50. At least some Members understood this to be the case, since soon after the conclusion of the Uruguay Round, they launched negotiations in the OECD on specific export credit disciplines.<sup>53</sup> The

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<sup>50</sup> Rebuttal Submission of the United States, paras. 140-142.

<sup>51</sup> Rebuttal Submission of the United States, para. 140.

<sup>52</sup> Rebuttal Submission of the United States, para. 141.

<sup>53</sup> The United States' assertion that the phrase “internationally agreed disciplines” in Article 10.2 of the Draft Final Act referred to those disciplines “contemplated by the SCM Agreement of the Draft Final Act” is not credible. Where negotiators meant to refer to pending WTO agreements outside of the draft Agreement on

United States implies that Brazil's "admission" that those negotiations have not yet resulted in agreement on specific disciplines for export credits is fatal to its claims. Brazil has demonstrated elsewhere, however, that while those negotiations are pending, nothing in Article 10.2 (or Article 1(e)) exempts export credits from the general disciplines on export subsidies included in, for example, Article 10.1 of the Agreement on Agriculture. If export credits constitute export subsidies, they are subject to those disciplines. As noted above, the Appellate Body has concluded that to exempt particular categories of measures from general obligations such as Article 10.1, the exemption must be explicit.<sup>54</sup> The negotiators knew how to make exemptions explicit, but did not do so in the case of export credits.<sup>55</sup>

51. *Third*, the United States argues that "Brazil's interpretation would require export credit guarantees in agriculture to be subject to more disciplines than any other practice addressed in the Agreement on Agriculture," since "not only would export credit guarantees constitute export subsidies and be subject to all of the export subsidy disciplines, but Member's [sic] would also be specifically obligated to work toward and then apply *additional* disciplines."<sup>56</sup> This statement is incorrect for several reasons:

- As clarified by Brazil, New Zealand and the European Communities, since export credits are not included in Article 9.1, they do not necessarily "constitute export subsidies."<sup>57</sup> They only constitute export subsidies if they are financial contributions that confer benefits and are contingent on export, or if they satisfy the elements of one of the items on the Illustrative List of Export Subsidies annexed to the SCM Agreement.
- Export credits are only "subject to all of the export subsidy disciplines" of the Agreement on Agriculture if they lead to circumvention of a Member's export subsidy reduction commitments.
- It is not clear that any specific disciplines resulting from negotiations undertaken pursuant to Article 10.2 will be "additional" to those already included in the Agreement on Agriculture or the SCM Agreement. Those negotiations are not yet completed. Depending on the agreement negotiated, it is presumably possible that the resulting text could replace the disciplines included in the Agreement on Agriculture.

52. Therefore, the United States' argument is inaccurate, and does not support its assertion that export credit guarantees are exempt from the general export subsidy disciplines in the Agreement on Agriculture, even if they meet the definition of "export subsidy."

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Agriculture, they cited those WTO agreements by name. For example, Article 5.8 of the Draft Final Act (regarding special agricultural safeguards) refers specifically to the GATT and the Safeguards Agreement. Similarly, the final version of Article 13 of the Agreement on Agriculture includes numerous specific citations to the SCM Agreement.

<sup>54</sup> Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, para. 201-208; Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128. See discussion at paragraphs 107-108 of the Oral Statement of Brazil.

<sup>55</sup> See, e.g., Article 13 of the Agreement on Agriculture, footnote 15 to Article 6.1(a) of the SCM Agreement, and the second paragraph of item (k) of the Illustrative List of Export Subsidies.

<sup>56</sup> Rebuttal Submission of the United States, para. 142.

<sup>57</sup> See e.g.: Brazil's 22 August Comment, para. 97, New Zealand's Answer to Third Party Question 35, EC's Answers to Third Party Questions 35, para. 70.

## Paragraphs 147-152

53. The United States argues that it did not include the quantities exported under the CCC programmes in its calculation of average export subsidies during 1986-1990 (the base period from which export subsidy reduction commitments were calculated during the Uruguay Round)<sup>58</sup> because it did not consider that CCC export credit guarantees are export subsidies subject to reduction commitments.<sup>59</sup> According to the United States, subjecting export credit guarantee programmes to export subsidy reduction commitments in the Agreement on Agriculture would therefore lead to “gross injustice.”<sup>60</sup>

54. This is not the logical conclusion to be drawn, however. It appears that during the Uruguay Round negotiations the United States took the same position as it has taken in this dispute – that CCC export credit guarantee programmes do not constitute export subsidies within the meaning of item (j) and Articles 1.1 and 3.1(a) of the SCM Agreement and that CCC export credit guarantees are, therefore, not subject to the general export subsidy disciplines included in the Agreement on Agriculture.<sup>61</sup> The United States did not feel compelled to include the CCC export credit guarantees in its calculation of export subsidy reduction commitments because it did not consider that they constituted export subsidies under those provisions. Brazil agrees that not all export credit guarantees are export subsidies and that, therefore, not all export credit guarantees are subject to export subsidy reduction commitments. However, if those guarantees meet the criteria of item (j) or constitute subsidies contingent upon export performance under Articles 1.1 and 3.1(a) of the SCM Agreement, they are export subsidies.<sup>62</sup> (Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes are export subsidies. It follows that GSM 102, GSM 103 and SCGP are subject to reduction commitments and, in fact, circumvent or threaten to circumvent the US export subsidy commitments.)

## Paragraphs 156-157, 160-162 and Exhibits US-31 and US-32

55. The United States argues that it would not give an accurate picture to compare the reestimates made in any given year (and recorded in the US budget) with the cohort-specific subsidy estimates for guarantees disbursed in that year. Specifically, the United States argues that “upward reestimates and downward reestimates reflected in a single budget cannot necessarily be applied against each other for a notional ‘net reestimate.’”<sup>63</sup> Brazil has never argued otherwise. In the chart included in paragraph 115 of its 22 August Rebuttal Submission, Brazil compares *cohort-specific* original subsidy estimates to *cohort-specific* reestimates, cumulated over the period 1992-2002, to give a picture of the long-term operating costs and losses of the “programmes,” as required by item (j) (rather than costs and losses for a particular cohort). The United States itself uses this same method (albeit with different data) in paragraph 161 of its 22 August Rebuttal Submission.

56. With respect to FCRA-related data, it would in fact only be inappropriate to attempt to tie a cohort-specific subsidy estimate for one year to fiscal year, non-cohort-specific reestimates recorded in the budget for any one year. Brazil has never made this comparison. As the United States notes,

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<sup>58</sup> Rebuttal Submission of the United States, para. 148.

<sup>59</sup> Rebuttal Submission of the United States, para. 149.

<sup>60</sup> Rebuttal Submission of the United States, paras. 147-153, *see* the heading to that section.

<sup>61</sup> Rebuttal Submission of the United States, para. 151. The arguments of the United States in this case demonstrate that it continues to be of the view that its programmes do not constitute export subsidies within the meaning of Articles 1.1 and 3.1(a), including item (j) of the SCM Agreement, nor within the meaning of Articles 1(e), 10.1 and 8 of the Agreement on Agriculture.

<sup>62</sup> Brazil’s 22 August Comment on Question 80, para. 98. *See also* EC’s 11 August Answer to Third Party Question 30, para. 65. New Zealand’s 11 August Answer to Third Party Question 35.

<sup>63</sup> Rebuttal Submission of the United States, para. 160.

this would be inappropriate because reestimates recorded in the budget as made in a year do not necessarily relate to subsidy estimates for guarantees disbursed in that year. If the data is presented cumulatively over a period constituting the long term, however, and does not purport to *tie* cohort-specific subsidy estimates to fiscal year, non-cohort-specific reestimates recorded in the budget for any one year, a comparison is perfectly acceptable. Specifically, comparing the cumulative subsidy estimates to the cumulative reestimates shows whether the “programme” is loss-making or profit-generating over the long term. Making a comparison of the cumulative figures does not require that the estimates and reestimates recorded in the budget for any year correspond.

57. For example, this approach can be applied to the data included in Exhibit US-31 to the United States’ 22 August Rebuttal Submission. The “subsidy” column included in Exhibit US-31 lists the subsidy estimate from the “prior year” column of the US budget for each cohort during the period 1992-2003. Subtracting cumulative annual downward reestimates from and adding cumulative annual upward reestimates to the cumulative original subsidy amount *yields a positive subsidy of \$500 million*.<sup>64</sup> Adding administrative expenses over the period 1992-2003 increases this amount by a further \$43 million.<sup>65</sup> Taking the data provided by the United States in Exhibit US-31 at face value demonstrates that the CCC guarantee programmes are losing money. This result is not tainted by the “apples-to-oranges” criticism levied in paragraph 160 of the United States’ 22 August Rebuttal Submission.

58. Nor does Brazil’s treatment of the data included in the chart at paragraph 165 of its 11 August Answers to Questions suffer from an “apples-to-oranges comparison” between fiscal year and cohort-specific data, as the United States alleges at paragraph 160 of its 22 August Rebuttal Submission. The chart at paragraph 165 is wholly unrelated to the FCRA cost formula. It tracks the results of a formula Brazil has constructed to verify, by alternative means, that long-term operating costs and losses for the CCC export guarantee programmes outpace premiums collected. The data in that chart are not FCRA-related subsidy estimates that are recorded on a cohort basis or that are subject to reestimates mandated by the FCRA. Instead, the left-hand column of that chart records revenue collected on a fiscal year (not a cohort-specific) basis, and the right-hand column of that chart records costs incurred on a fiscal year (not a cohort-specific) basis. Over the period 1993-2002, total revenue in the left-hand column is significantly less than total costs in the right-hand column. This entails no “apples-to-oranges comparison,” and demonstrates that the CCC export guarantee programmes constitute export subsidies under item (j) of the Illustrative List of Export Subsidies.

59. In the chart included at paragraph 161 of its 22 August Rebuttal Submission, the United States nets cumulative reestimates on a cohort basis against the original, cohort-specific subsidy estimate from the US budget. There are some factual problems with the US data.<sup>66</sup>

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<sup>64</sup>  $(2,737 - 297) - (2,629 + 870) + (1,262 + 297) = 500$ . Since no reestimates have yet been made for 2004, Brazil has reduced the original subsidy amount included in Exhibit US-31 by the \$297 million estimate included in the 2004 budget. Had the United States subtracted downward reestimates from and added upward reestimates to the *original* subsidy estimate included in the “budget year” column of the “guaranteed loan subsidy” line of the annual US budget, it would have yielded a positive subsidy, and thus a loss, of \$2.038 billion. See Exhibit Bra-192.

<sup>65</sup> See paragraph 132 of Brazil’s 22 July Statement at the First Panel Meeting, and accompanying citations.

<sup>66</sup> First, the United States has offered no documentation verifying the accuracy of the reestimate figures provided in the chart for the period 1993-2000. In contrast, the chart included in paragraph 115 of Brazil’s 22 August Rebuttal Submission provides cumulative reestimates on a cohort basis that are taken directly from Table 8 of the Federal Credit Supplement included with the 2004 US budget. See Exhibit Bra-182. Second, although the United States asserts that it has netted cumulative reestimates against the “*original* subsidy estimate,” it has in fact netted cumulative reestimates against the “guaranteed loan subsidy” figure included in the “*prior year*” column of the US budget, which yields a lower number. Using, subsidy data from the US budget for “prior year,” the chart included at paragraph 115 of Brazil’s 22 August Rebuttal Submission would

Resolving these problems is not particularly important, however, since the chart included at paragraph 161 of the United States' 22 August Rebuttal Submission itself shows a cumulative positive subsidy for the programmes of over \$381 million for the period 1992-2002.<sup>67</sup> This positive subsidy is consistent with CCC's 2002 financial statements, which provide a cumulative, running tally of the subsidy figure for all post-1991 CCC export credit guarantees in the amount of \$411 million.<sup>68</sup> The CCC export guarantee programmes have lost money over the period 1992-2002.

60. The United States' point seems to be that because subsidy reestimates are generally downward, the CCC programmes generate profits over the long term. However, all this means is that CCC's original estimates were too high.<sup>69</sup> The real test is the result when cohort-specific reestimates are netted against the original subsidy estimates for each cohort and cumulated over a period constituting the long term, so that the long-term costs and losses of the programmes can be determined, as required by item (j). Netting reestimates against original subsidy estimates on a cohort-specific basis yields a positive subsidy, revealing that over the long term, the CCC is losing money with its export guarantee programmes. This result is obtained whether the Panel accepts the chart at paragraph 161 of the United States' 22 August Rebuttal Submission, the chart at paragraph 115 of Brazil's 22 August Rebuttal Submission,<sup>70</sup> or the cumulative subsidy figure included in CCC's 2002 financial statements.<sup>71</sup>

61. The United States may be suggesting that reestimates will always, eventually, result in negative subsidies and profits. The data shows that this is not the case, however. Netting reestimates against original subsidy estimates does not consistently yield a negative subsidy, or profits, on a cohort basis. The charts included at paragraph 161 of the United States' 22 August Rebuttal Submission and at paragraph 115 of Brazil's 22 August Rebuttal Submission demonstrate this. Nor is it even relevant to focus on the results of individual cohorts, since item (j) require an analysis of the "long-term" costs and losses of export guarantee "programmes," rather than cohorts. That is why Brazil, and presumably the United States, has calculated cumulative results for the charts included at

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still yield a positive subsidy of \$211 million, to which the \$43 million in administrative expenses should be added, for a total loss of \$254 million over the period 1992-2002. *See* Exhibit Bra-193. Third, the United States has not included administrative expenses for the CCC export guarantee programmes, which amount to \$43 million for the period 1992-2003.

<sup>67</sup> Even accepting the validity of the data entered in the US chart, Brazil notes that summing up those figures yields a result different from the \$381.35 million total provided by the United States. Using the US data, Brazil reaches a subsidy figure net of reestimates of \$230,127,023.

<sup>68</sup> Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 19).

<sup>69</sup> Brazil notes that according to USDA's Inspector General, CCC estimates are in fact *understated*. In audit reports for fiscal years 1999, 2000 and 2001, CCC's estimates and reestimates were found to have "understated" costs and losses by amounts ranging from to \$11 million to \$430 million. Exhibit Bra-194 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2001*, Audit Report No. 06401-4-KC, February 2002, p. 11); Exhibit Bra-195 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report, Audit Report No. 06401-14-FM, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2000*, June 2001, p. 9); Exhibit Bra-196 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report, US Department of Agriculture Consolidated Financial Statements for Fiscal Year 1999, Report No. 50401-35-FM, February 2000, p. 9).

<sup>70</sup> Again, using "prior year" subsidy figures for this chart results in a positive subsidy of \$211 million over the period 1992-2002. *See* Exhibit Bra-193 (Net Lifetime Reestimates of Guaranteed Loan Subsidy by Cohort)

<sup>71</sup> Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 19).

paragraph 161 of the United States' 22 August Rebuttal Submission and at paragraph 115 of Brazil's 22 August Rebuttal Submission.

62. In any event, if CCC considered that it would eventually make money on its guarantees on a cohort basis, why does it continue to offer original estimates that are so high? While some factors included in the estimation process are dictated by the FCRA and the US Office of Management and Budget, the original subsidy estimate is primarily driven by CCC's historical experience with its guarantees. Brazil has elsewhere noted that according to the US Federal Accounting Standards Advisory Board, the Government-Wide Audited Financial Statements Task Force on Credit Reform, the Office of Management and Budget and the Department of Agriculture itself, "[m]ethods of estimating future cash flows for existing credit programmes need to take account of past experience,"<sup>72</sup> "[a]ctual historical experience of the performance of a risk category is a *primary factor* upon which an estimation of default cost is based,"<sup>73</sup> and technical assumptions underlying subsidy calculations reflect "historical cash reports and loan performance."<sup>74</sup> If historical experience dictated that CCC would consistently make profits, CCC would reflect that historical experience in its subsidy estimates. Actual historical experience is, after all, a "primary factor" on which those estimates are based. That CCC continues to provide significant positive original subsidy estimates demonstrates that its actual historical experience does *not* suggest that it will make money on its loan guarantees. Since those estimates are calculated and recorded on a *net present value basis*, CCC apparently continues to consider that it will incur significant net costs at the time the cohorts are closed.

63. CCC's apparent views regarding its historical experience with the export guarantee programmes are justified. Evidence regarding CCC's actual historical experience confirms that the long-term operating costs and losses for the CCC guarantee programmes outpace premiums collected. At paragraph 109 of its 22 August Rebuttal Submission, Brazil summarizes this evidence.<sup>75</sup> Although, the United States implies at paragraph 172 of its 22 August Rebuttal Submission that Brazil's evidence is all "between 10 and 20 years" old, a cursory review of the evidence, which includes data from the 2004 US budget and CCC's 2002 financial statements proves otherwise. Therefore, even if the Panel agrees with the United States' conclusion, at paragraph 162 of its 22 August Rebuttal Submission, that the FCRA cost formula is not an ideal way to determine the costs of the CCC export guarantee programmes, Brazil has established by alternative means that CCC premiums fail to meet the long-term operating costs and losses of the programmes.

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<sup>72</sup> Exhibit Bra-162 (Government-Wide Audited Financial Statements Task Force on Credit Reform, ISSUE PAPER, *Model Credit Programme methods and Documentation for Estimating Subsidy Rates and the Model Information Store*, 96-CR-7 (1 May 1996), p. 2).

<sup>73</sup> Exhibit Bra-118 (Federal Accounting Standards Advisory Board, STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* (March 2001), p. 16 (para. 36)). See also Exhibit Bra-160 (US Department of Agriculture, Office of the Chief Financial Officer, Credit, Travel, and Accounting Division, *Agriculture Financial Standards Manual* (May 2003), p. 120 ("In estimating default costs, the following risk factors are considered: (1) loan performance experience; . . .")).

<sup>74</sup> Exhibit Bra-163 (Office of Management and Budget Annual Training, Introduction to Federal Credit Budgeting, 24 June 2002, p. 9).

<sup>75</sup> Contrary to the United States' assertion at paragraph 170 of its Rebuttal Submission, Brazil has not misread Note 5 to CCC's 2002 financial statements. The amounts in the "subsidy allowance" column are in fact the amounts of receivables associated with post-1991 CCC guarantees that CCC considers uncollectible. The Panel will recall that under the FCRA, the subsidy allowance is recorded on a net present value basis, which means that it represents the cost CCC considers it will incur on a guarantee cohort at the time that cohorts is closed. The \$770 million listed in the "subsidy allowance" column in the receivables table for post-1991 guarantees is therefore as uncollectible as the \$ 2,567 billion listed in the "uncollectible" column of the pre-1992 CCC guarantee receivables table (See Notes to Financial Statements contained in Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2002, Audit Report N° 06401-15-FM (December 2002) p. 14).

### Paragraph 169 and Exhibit US-33

64. The United States has asserted that there are no “arrearages” with respect to debt reschedulings.<sup>76</sup> Brazil has two comments. First, the United States does not state the source of the data it included at Exhibit US-33. Second, Brazil maintains that it is not appropriate to treat rescheduled debt as recoveries.<sup>77</sup> The US assumption that there will be no arrearages not only ignores the cost of rescheduling but also the fact that there may be further defaults on rescheduled debt.<sup>78</sup> Although rescheduled debt is treated as a receivable, CCC acknowledges in its financial statements that not all receivables are deemed collectible.<sup>79</sup> Moreover, Brazil presumes that rescheduled debt is subject to the FCRA estimation or reestimation process, which involves calculations of net present value of what the CCC expects to lose (or gain) on the rescheduled debt. The CCC does not assume that all rescheduled debt will be collected.

### Paragraphs 172, 174-175

65. The United States has argued that Brazil improperly relies on CCC losses incurred *via* Iraqi and Polish defaults. The United States implies that these defaults occurred between 10 and 20 years ago.<sup>80</sup> This is incorrect. The US General Accounting Office (“GAO”) reports that the losses in Iraq occurred over the period 1990-1997.<sup>81</sup> (The United States makes no specific challenge to the \$2 billion in Polish defaults.) Thus, defaults and losses did not occur as long ago as the United States suggests.

66. Moreover, the United States argues that the Panel should only look into the question whether “*current*” premium rates are adequate to cover the long-term operating costs and losses of the programmes.<sup>82</sup> The United States relies on a “present tense” argument to exclude major defaults in Iraq and Poland that occurred in the recent past. Even if the Panel only looks to “current” premiums, item (j) calls for an analysis of “long-term” operating costs and losses.<sup>83</sup> The United States apparently agrees, since it looks to the performance of the CCC programmes in such years as 1994 and 1995 (a time period even longer ago than part of the defaults in Iraq<sup>84</sup>) to claim that premium rates charged were adequate to meet costs,<sup>85</sup>

67. If the United States believes that it is only appropriate to look at *current* premiums, given the present tense of the term “are” in item (j), then the FCRA cost formula is useful. The FCRA cost formula measures the *net present value* “of the following cash flows: (i) payments by the Government

<sup>76</sup> Rebuttal Submission of the United States, para 169.

<sup>77</sup> Oral Statement of Brazil, para. 122.

<sup>78</sup> Oral Statement of Brazil, para. 122. Brazil’s 11 August Answer to Question 77, para. 162.

<sup>79</sup> See Brazil’s 22 August Comments, para. 99. Exhibit Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation’s Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 14).

<sup>80</sup> Rebuttal Submission of the United States, para. 172.

<sup>81</sup> Bra-157 (US General Accounting Office, REPORT TO THE CHAIRMAN, TASK FORCE ON URGENT FISCAL ISSUES, COMMITTEE ON THE BUDGET, HOUSE OF REPRESENTATIVES, *International Trade: Iraq’s Participation in US Agricultural Export Programmes*, GAO/NSIAD-91-76 (November 1990), p. 27 (Table IV.2)).

<sup>82</sup> Rebuttal Submission of the United States, para. 174.

<sup>83</sup> The United States has elsewhere endorsed a 10-year period (First Submission of the United States, para. 173; Rebuttal Submission of the United States, para. 161).

<sup>84</sup> Compare Rebuttal Submission of the United States, para. 172 and 175.

<sup>85</sup> Rebuttal Submission of the United States, para. 175.

. . . and (ii) payments to the Government” of guarantees at the time they are disbursed.<sup>86</sup> In other words, it measures the amount CCC expects today to lose (or gain) on a guarantee cohort at the time the cohort is closed tomorrow. Even if this involves some estimates, the United States has noted that those estimates are acceptable.<sup>87</sup> In fact, the US budget for fiscal year 2004 demonstrates that current premiums paid for guarantees disbursed in fiscal years 2002-2004 will generate losses worth hundreds of million of dollars.<sup>88</sup> Thus, current premiums are inadequate to cover the long-term operating costs and losses of the CCC export credit guarantee programmes. These programmes constitute export subsidies.

### **Paragraphs 186-191 and Exhibits US-34 through US-37**

68. Brazil has argued that since CCC export credit guarantees from the GSM 102, GSM 103 and SCGP programmes are unique financial instruments for agricultural commodity transactions that are not available on the commercial market – certainly not for terms longer than the marketing cycles of the eligible commodities – they confer “benefits” within the meaning of Article 1.1(b) of the SCM Agreement.<sup>89</sup> The United States asserts that “financing is available in the marketplace that is analogous to the export credit guarantee programmes” – namely, forfaiting.<sup>90</sup>

69. The United States’ assertion should be rejected. As discussed below, the two instruments are not “analogous,” and are, in fact, different.

70. Brazil begins with a very rough sketch of the role a forfait can play in a typical transaction involving agricultural commodities. In a typical transaction, an importer will issue a promissory note to an exporter for the agreed price. The exporter will generally demand that the note be backed by a guarantee (or an aval) from the importer’s bank and/or, as the United States points out in paragraph 187 of its 22 August Rebuttal Submission, by a guarantee from the importer’s government export credit agency.

71. A forfait comes into play because, while both the exporter and the importer want the transaction to occur, they have different interests. The exporter wants to get paid immediately on a cash basis, and the importer wants credit that it can repay on a deferred basis. Even with a guarantee from the importer’s bank or a government export credit agency, the exporter bears responsibility for collecting the receivables (in the absence of default). A forfaiter (which could be the exporter’s own bank) will step in and purchase the promissory note at a discount to face value, without recourse to the exporter.<sup>91</sup> The exporter will receive payment immediately from the forfaiter. The forfait essentially enables the exporter to convert a credit sale into a cash sale.

72. A forfaiter will generally demand that the importer’s obligation is backed by a guarantee from a bank or the importer’s government export credit agency.<sup>92</sup> Rather than *substituting* for a guarantee,

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<sup>86</sup> Exhibit Bra-117 (2 U.S.C. 661a(5)(C)).

<sup>87</sup> Rebuttal Submission of the United States, para. 171.

<sup>88</sup> See chart at paragraph 161 of the Rebuttal Submission of the United States. See also Exhibit Bra-127 (US budget for FY 2004, p. 107) referencing guaranteed loan subsidy amounts of \$97 million, \$294 million and \$297 million respectively. Brazil notes that the figure for FY 2002 has been reestimated to \$137,008,586 since the publication of the FY 2004 budget (See Rebuttal Submission of the United States, chart at para. 161).

<sup>89</sup> First Submission Brazil, para. 289; Oral Statement of Brazil, para. 116; Brazil 11 August Comment and Answer to Questions 71(a) (para. 139), 75 (para. 156); Rebuttal Submission of Brazil, para. 103.

<sup>90</sup> Rebuttal Submission of the United States, para. 186.

<sup>91</sup> See Exhibit Bra-197 (<http://www.nedcor.co.uk/forfait-website/forfaiting.htm>).

<sup>92</sup> United Rebuttal Submission of the United States, para. 187. See also Exhibit Bra-198 (Vincent Whittaker, “The Quick Buck, International Finance, and Forfaiting,” 23 *Thomas Jefferson Law Review* 249, 258 (Spring 2001) (“In most cases, the forfaiter requires the obligation of the importer to be guaranteed by a bank in the importer’s country because of the impossibility of evaluating the credit risk of every importer in



therefore, guarantees and forfaiting are *complementary* instruments. For this reason alone, the US assertion that the two instruments are analogous is incorrect.

73. There are other differences between the two instruments. The importer realizes a tangible and extremely valuable benefit from a CCC guarantee; namely, the bank prices financing to the importer based on the credit rating of the United States, rather than the credit rating of the importer itself. Importantly, the CCC guarantee allows the importer to secure financing in the first place. As the regulations for the GSM and SCGP programmes state, the programmes operate in cases where banks “would be unwilling to provide financing without CCC’s guarantee.”<sup>93</sup> Forfaiting helps an exporter accept deferred payment terms for the importer, but does not otherwise beneficially affect the price for the financing secured by the importer. Nor would a bank require that forfaiting be involved in a transaction as a prerequisite for it to provide financing to the importer.

74. As a further distinction between the two instruments, while there is a secondary forfaiting market,<sup>94</sup> there is no secondary market for CCC guarantees.<sup>95</sup> Purchasers in the secondary market for forfaiting instruments assume that forfeited promissory notes will yield more at maturity than the purchaser paid for them in the secondary market.<sup>96</sup> Since no secondary market exists for CCC guarantees, apparently no such assumption can be made with respect to CCC guarantees (which itself reveals much about the quality of those guarantees).

75. Most importantly, the pricing for forfaiting instruments is substantially different than pricing for CCC guarantees. As noted above, a forfaiter purchases an exporter’s trade receivables at a discount to face value. The discount rate and associated commitment fees are driven by the risks involved – country risk, political risk, currency risk, entity risk (essentially, the risk of the guarantor), etc., and by the length of the underlying credit.<sup>97</sup>

76. Brazil has attached as Exhibit Bra-199 a list of indicative forfaiting rates that vary greatly from market to market.<sup>98</sup> In contrast, the United States has confirmed that country risk “has no impact on the premiums payable” under the GSM 102, GSM 103 and SCGP programmes.<sup>99</sup> Brazil provided the Panel with evidence documenting that GSM and SCGP fees were the same whether guarantees were for transactions with the Dominican Republic, Ghana, Japan, South Korea or Vietnam (among others).<sup>100</sup>

77. Moreover, the *very lowest rate* in the forfaiting rate list included in Exhibit Bra-199 is 1.6638 per cent (6-month tenor). The rates for GSM 102 and GSM 103 guarantees are prohibited by law from being greater than 1 per cent,<sup>101</sup> and are currently (as they have been at least since 1994)<sup>102</sup>

every country, particularly when medium or small sized companies are involved.”). See also *Id.*, p. 259 (“[I]f a bank guarantee is required, it must be unconditional, irrevocable and freely transferable.”).

<sup>93</sup> Exhibit Bra-38 (7 CFR 1493.10(a)(2); 7 CFR 1493.400(a)(2)). See Brazil 11 August Response to Question 82(a) (paras. 183-184).

<sup>94</sup> Exhibit Bra-198 (Vincent Whittaker, “The Quick Buck, International Finance, and Forfaiting,” 23 *Thomas Jefferson Law Review* 249, 251-252 (Spring 2001)).

<sup>95</sup> See US 11 August Answer to Question 86 (para. 184).

<sup>96</sup> Exhibit Bra-198 (Vincent Whittaker, “The Quick Buck, International Finance, and Forfaiting,” 23 *Thomas Jefferson Law Review* 249, 251-252 (Spring 2001)).

<sup>97</sup> Exhibit Bra-198 (Vincent Whittaker, “The Quick Buck, International Finance, and Forfaiting,” 23 *Thomas Jefferson Law Review* 249, 256 (Spring 2001)).

<sup>98</sup> Exhibit Bra-199 (Trade and Forfaiting Review, “Argentina Trade Finance to the Rescue,” Volume 6, Issue 9, July/August 2003).

<sup>99</sup> United States 11 August Response to Question 86 (para. 184).

<sup>100</sup> See Brazil 11 August Comments to Questions 84 (para. 192) and 85 (para. 195).

<sup>101</sup> United States 11 August Responses to Question 84 (para. 179).

<sup>102</sup> Brazil 11 August Comment to Question 84 (para. 193).

no greater than 0.663 per cent for GSM 102 (36-month tenor)<sup>103</sup> and 0.05 per cent for GSM 103 (120-month tenor).<sup>104</sup>

78. Furthermore, although the United States' assertion that the tenor of forfeiting instruments can range from six months to 10 years is accurate, forfeiting instruments *for agricultural commodities* will not exceed tenors of 360 days, or in other words will not exceed a tenor "matching the typical period of consumption of most commodities."<sup>105</sup> This is consistent with Brazil's statement that commercial financing for exports of agricultural goods that exceeds the marketing cycles of the agricultural good is not available on the marketplace.<sup>106</sup>

79. Under Article 10.3 of the Agreement on Agriculture, the United States bears the burden of demonstrating that no export subsidies have been granted in respect of quantities of agricultural commodities exported in excess of its reduction commitments.<sup>107</sup> Although it is not its burden to do so, Brazil has demonstrated that CCC export credit guarantees are financial contributions that confer benefits and are contingent on export, within the meaning of Articles 1.1 and 3.1(a) of the SCM Agreement. With respect to "benefit," CCC regulations concerning the GSM and SCGP programmes demonstrate that the programmes grant better-than-market terms *per se*.<sup>108</sup> Brazil has also demonstrated that CCC export credit guarantees confer benefits *per se* since they are unique financial instruments for agricultural commodity transactions that are not available on the commercial market – and certainly not for terms longer than the marketing cycles of the eligible commodities.

80. The United States has not established that forfeiting is analogous to CCC export credit guarantees. Even if it had done so, and the market terms for forfeiting instruments could theoretically serve as a benchmark against which to judge whether CCC export credit guarantees confer "benefits," the United States has not: (i) established the terms on which forfeiting is provided on the market; or, (ii) demonstrated that CCC export credit guarantees do not provide terms better than those provided for forfeiting instruments. The United States acknowledges, at paragraph 191 of its 22 August Rebuttal Submission, that it has not provided market terms for forfeiting instruments that could serve as a benchmark. Thus, the United States has not met its burden under Article 10.3 of the Agreement on Agriculture.

### **Brazil's Comment on Question 67a posed by Panel to the United States**

81. While Brazil obviously does not know how the United States will ultimately respond, Brazil offers the following information supporting Brazil's calculations of the amounts provided to these four crops as "support to upland cotton."

82. First, to the extent that the United States criticizes Brazil's calculations made to determine the different per acre payments for direct payment and CCP crops in paragraph 42 of its Rebuttal Submission, Brazil notes that these calculations are confirmed by the Food Agricultural Policy Research Institute at the University of Missouri (FAPRI).<sup>109</sup> As Brazil further notes that the FAPRI

<sup>103</sup> Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, "Notice to GSM-102 and GSM-103 Programme Participants," 24 September 2002).

<sup>104</sup> Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, "Notice to GSM-102 and GSM-103 Programme Participants," 24 September 2002).

<sup>105</sup> Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfeiting," 23 *Thomas Jefferson Law Review* 249, 254 (Spring 2001)).

<sup>106</sup> Oral Statement of Brazil, para. 116.

<sup>107</sup> See First Submission of Brazil, paras. 263-268.

<sup>108</sup> See Brazil's 11 August Answer to Question 82, paras. 182-189.

<sup>109</sup> <http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf>. The information on CCP and direct payment per acre payments in US dollars for each of the programme crops is found in the last two lines of pages 55 (wheat), 57 (rice), 59 (corn), 61 (sorghum), 63 (barley), 65 (oats), 69

baseline itself and FAPRI analysis has often been influential in US policy formation process, including in analysis of the FSRI Act of 2002, for which FAPRI won the USDA's highest honour.<sup>110</sup>

83. Second, FAPRI's 2003 US Baseline is a long-run scenario projecting what would happen to various elements of US agriculture under the 2002 FSRI Act. In this analysis, FAPRI includes all of the different types of support provided by the 2002 FSRI Act into its projections of, *inter alia*, upland cotton planted acreage, production, exports, prices, revenue, costs, etc. In doing so, the FAPRI economists assume that, *inter alia*, upland cotton producers were holding upland cotton base acreage and receiving upland cotton CCP and direct payments.<sup>111</sup> These CCP payments and direct payments are reflected in their analysis of "Gross Market Revenue" to upland cotton producers on page 79 of their report, which constitutes the sum of LDP (marketing loan), CCP revenue, and direct payments.<sup>112</sup>

84. In addition, FAPRI states that "US cotton producers do not benefit from the projected price increases. Higher prices are offset by lower payments from the loan programme and the CCP programme."<sup>113</sup> This reflects the FAPRI economists' assumption that upland cotton producers receive upland cotton direct and CCP payments.

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(soybeans), 75 (peanuts) and 79 (upland cotton). Brazil notes that its figures for soybeans and peanuts differ slightly. The underlying reason for this difference is that Brazil had to base its figures on its estimates about the payments yields and it appears that FAPRI's figures for payment yields are slightly different from Brazil's.

<sup>110</sup> See for example, "Analysis of the grain, oilseed and cotton provision of the, 'Agriculture, Conservation, and Rural Enhancement Act of 2001 – S.1731.'" FAPRI-UMC Report #18-01 November 2001. [http://www.fapri.missouri.edu/FAPRI\\_Publications.htm](http://www.fapri.missouri.edu/FAPRI_Publications.htm) Also see

[http://www.card.iastate.edu/about\\_card/news/press\\_releases/Highest\\_Honor.html](http://www.card.iastate.edu/about_card/news/press_releases/Highest_Honor.html)

<sup>111</sup> FAPRI's 2003 US Baseline, <http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf>, p. 78.

<sup>112</sup> FAPRI's 2003 US Baseline, <http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf>, p. 79.

<sup>113</sup> FAPRI's 2003 US Baseline, <http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf>, p. 78.

### **List of Exhibits**

G/AG/AGST/USA	Exhibit Bra- 191
Reestimated Guaranteed Loan Subsidy based on Original Budget Year Estimate.	Exhibit Bra- 192
Net Lifetime Reestimates of Guaranteed Loan Subsidy by Cohort.	Exhibit Bra- 193
US Department of Agriculture Office of Inspector General Great Plains Region Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report N° 06401-4-KC, February 2002	Exhibit Bra- 194
US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report, Audit Report N° 06401-14-FM, Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, June 2001	Exhibit Bra- 195
US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report, US Department of Agriculture Consolidated Financial Statements for Fiscal Year 1999, Report N° 50401-35-FM, February 2000	Exhibit Bra- 196
<a href="http://www.nedcor.co.uk/forfait-website/forfaiting.htm">http://www.nedcor.co.uk/forfait-website/forfaiting.htm</a>	Exhibit Bra- 197
Vincent Whittaker, "The Quick Buck, International Finance and Forfaiting," 23 <i>Thomas Jefferson Law Review</i> (Spring 2001)	Exhibit Bra- 198
Trade and Forfaiting Review, "Argentina Trade Finance to the Rescue" Volume 6, Issue 9 July/August 2003	Exhibit Bra- 199

## **ANNEX D-4**

### **COMMENTS OF THE UNITED STATES ON NEW MATERIAL IN BRAZIL'S REBUTTAL FILINGS AND ANSWER OF THE UNITED STATES TO THE ADDITIONAL QUESTION FROM THE PANEL**

27 August 2003

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#### **I. Introduction**

1. The United States thanks the Panel for its prompt reply to the US request of 25 August 2003, granting an opportunity to comment on new material in Brazil's rebuttal submission and Brazil's comments on the US responses to questions. We also thank the Panel for its additional question. We present both the US comments on new material in Brazil's submissions and our answer to that additional question below.

2. As the United States notes in these comments and answer, Brazil's Peace Clause argument depends on three issues:

- First, Brazil relies on budgetary outlays that reflect prevailing market prices that could not have been "decided" by the United States. Brazil ignores the fact that "support" does not mean "budgetary outlays"; in fact, Annex 3 recognizes that an "Aggregate Measurement of

Support” for price-based support either shall<sup>1</sup> or can<sup>2</sup> be calculated using a price gap methodology, which does not rely on budgetary outlays.

- Second, Brazil conflates “non-product-specific support” with “support to a specific commodity” by attempting to allocate certain payments to upland cotton. To do so, however, Brazil relies on a reading of the definition of “non-product-specific support” in Article 1(a) that ignores the most relevant context for this term – that is, the (immediately preceding) definition of product-specific support in that same article. Indeed, Brazil’s approach would appear to render the concept of “non-product specific support” so narrow that it becomes almost, if not completely, meaningless.
- Third, Brazil mischaracterizes US direct payments and production flexibility contract payments as non-green box support. Brazil has not established that these measures fail to conform to the policy-specific criteria in Annex 2. In fact, Brazil has not even established – pursuant to Brazil’s own reading of the first sentence of Annex 2, paragraph 1, as a stand-alone obligation – that these payments have more than “minimal[] trade-distorting effects or effects on production.”<sup>3</sup>

3. The weakness of Brazil’s interpretation that “support” in the Peace Clause means “budgetary outlays” can be seen in this example. Even if US measures were *exactly* the same in *every year* of the implementation period as they were in the 1992 marketing year (that is, the same deficiency target price, same marketing loan rate, same acreage reduction percentage, same normal flex acres with planting flexibility<sup>4</sup>, etc.), under Brazil’s interpretation, US measures would have breached the Peace Clause in each and every year in which outlays increased due to external factors, for example, whenever market prices dipped below the 1992 level.

- Would 1999-2002 US measures *identical in every respect* to those in 1992 “grant support in excess of that decided during the 1992 marketing year”?
- In other words, if a Member had decided its support during 1992 for the period through 2004 and never changed its decision, could the Member be deemed to grant support in excess of the

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<sup>1</sup> In the case of market price support. In fact, Annex 3, paragraph 8, states: “Budgetary outlays made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS.”

<sup>2</sup> In the case of non-exempt direct payments dependent on a price gap. *See* Agreement on Agriculture, Annex 3, paragraph 10.

<sup>3</sup> Of course, the US view is that the “fundamental requirement” of the first sentence is met by a measure that conforms to the basic criteria and any applicable policy-specific criteria. In this regard, Brazil errs in claiming that the United States has “acknowledged that such effects can be presumed if the specific criteria in paragraph 6 of Annex 2 are not complied with.” Brazil’s Rebuttal Submission, para. 8 fn. 13. In fact, we believe the opposite. Meeting the basic and policy-specific criteria of Annex 2 establishes that a measure meets the “fundamental requirement” of paragraph 1. However, the converse is not necessarily true. So, according to Brazil’s approach, Brazil would bear the burden of establishing that a measure that did not comply with the basic and policy-specific criteria in Annex 2 failed to meet the “fundamental requirement” of paragraph 1 of Annex 2.

<sup>4</sup> Recall that “under 1992 programme provisions, producers of non-cotton programme crops (i.e., wheat, corn, barley, grain sorghum, oats, and rice) could plant up to 25 per cent of their [non-cotton] crop programme base to cotton as Normal Flex Acres or Optional Flex Acres. Acreage Reduction Programme compliance reports indicate that, in 1992, 447,164 acres of cotton were planted on a much larger quantity of available Normal Flex Acres and Option Flex Acres of non-cotton programme base.” Exhibit US-24 (Report by Dr. Joseph Glauber, Deputy Chief Economist, US Department of Agriculture). In 1992, there were 153.9 million acres of non-cotton “complying base” and 197.2 million acres of non-cotton “effective base.” *See* Exhibit US-39. Thus, the marketing loan was effectively available with respect to all upland cotton production.

level decided during 1992 just because outlays increased, for example, because market prices changed?<sup>5</sup>

We believe the answer must be “No” because market prices are not “decided” by a Member (as paragraphs 8 and 10 of Annex 3 recognize). And yet, the situation in this dispute is analogous: the United States has changed its measures to *reduce* the product-specific level of support (by eliminating deficiency payments) since 1992, and yet Brazil claims that the Peace Clause has been breached simply because lower market prices resulted in increased price-based outlays.

4. Market prices are beyond the control of the United States, and therefore the United States cannot “decide” them. Removing the effect of market prices beyond the control of the United States from the measure of support demonstrates that US measures do not and did not grant support in excess of that decided during the 1992 marketing year. In fact, whether gauged (as the United States believes is compelled by the Peace Clause) via the rate of support expressed by US measures<sup>6</sup>, *or* via the AMS for upland cotton (calculated through a price gap methodology), *or* via the erroneous calculations of Brazil’s expert (but limited to product-specific support), the result is exactly the same: in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

## **II. Brazil’s AMS Calculation Is Flawed and, Had It Consistently Reflected a Price Gap Calculation, Would Demonstrate No Peace Clause Breach**

5. We recall that Brazil has argued that budgetary outlays are the only measurement of “support” for purposes of the Peace Clause proviso comparison, without any foundation in the Peace Clause text and despite the context provided by Annex 3, which explicitly indicates that Members have agreed “support” *can* be measured without using budgetary outlays. Brazil itself concedes that US measures do not decide support on the basis of budgetary outlays:

Brazil acknowledges that *the United States could not possibl[y] determine its expenditures* as they would depend to a certain extent on *market prices* that were also influenced by factors *outside the control of the US Government*.<sup>7</sup>

The United States agrees with this statement by Brazil and believes that this statement demonstrates that Brazil’s approach to the Peace Clause comparison is not based on the text nor is it realistic. Instead, in order to hope to succeed, Brazil’s claims *require* Brazil to use budgetary outlays and so to take into account low prevailing market prices. An Aggregate Measurement of Support calculation using a price gap methodology – that is, that eliminates the effect of market prices and reflects instead the eligible production and applied administered price decided by a Member – reveals that in no year from 1999-2002 have US measures breached the Peace Clause.

6. Brazil has argued that “there are only two types of methodologies that would allow an expression in monetary terms of a decision (or decisions) taken by the United States in MY 1992 regarding its level of support to upland cotton. The first is budgetary expenditures. The second is the calculation of AMS for a particular commodity.”<sup>8</sup> In both its table of expenditures<sup>9</sup> and its AMS

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<sup>5</sup> Other factors beyond a Member’s control could also influence outlays, such as whether some additional producers chose to begin participating in the support programmes.

<sup>6</sup> Even taking into account the maximum theoretical effect on the deficiency payment effective price of the 1992 acreage reduction percentage (10 per cent) and normal flex acres (15 per cent) for the 1992 marketing year. Since the acreage reduction percentage was lower for 1993 marketing year (7.5 per cent versus 10 per cent) support, which was also decided during the 1992 marketing year, the adjusted level of support (68.27625 cents per pound) was even higher for the 1993 marketing year.

<sup>7</sup> Brazil’s Comments on US Answers, para. 66 fn. 49.

<sup>8</sup> Brazil’s Rebuttal Submission, para. 71.

table<sup>10</sup>, Brazil has attempted to allocate non-product-specific support to a specific commodity. There is no basis in Annex 3 to do so. Annex 3, paragraph 1, explicitly requires an AMS to be calculated “on a product-specific basis for each basic agricultural product” and separately requires that non-product-specific support be calculated and “totalled into one non-product-specific AMS in total monetary terms.” The point bears emphasis: “for each basic agricultural product,” Annex 3 states that an AMS “shall be calculated on a product-specific basis.” Similarly, were “support to a specific commodity” (upland cotton) to be calculated using an Aggregate Measurement of Support, it *must* be calculated “on a product-specific basis.”

7. As a result, both Brazil’s expenditure table and its AMS table run counter to the terms of Annex 3. Were the Panel to calculate an AMS for upland cotton for marketing years 1992 and 1999-2002, the United States has set forth a calculation consistent with Annex 3 in its rebuttal submission.<sup>11</sup> By using a price-gap methodology for both deficiency payments and marketing loan payments<sup>12</sup>, the upland cotton AMS in 1992 is far higher than in any marketing year from 1999 to 2002, reflecting the US decision to move away from the high support levels of product-specific deficiency payments.

8. In fact, we note that the AMS data presented in paragraph 115 of the US rebuttal submission understates the AMS for marketing year 1992. For example, the United States reduced the price gap calculation for 1992 basic deficiency payments by an adjustment factor (approximately .875) to replicate the calculation used in G/AG/AGST/USA, p. 18. Without the adjustment, which is not called for by paragraphs 10 and 11 of Annex 3, the 1992 deficiency payment calculation would have been \$858 million, rather than \$755 million as reported in paragraph 115.<sup>13</sup> (In case of interest, we also present below the deficiency payment calculation in more detail, reflecting more accurate data, which would increase the deficiency payment calculation slightly, to \$867 million.)<sup>14</sup> This

<sup>9</sup> Brazil’s Rebuttal Submission, para. 73.

<sup>10</sup> Brazil’s Rebuttal Submission, para. 76.

<sup>11</sup> US Rebuttal Submission, paras. 114-118.

<sup>12</sup> Brazil has stated (with respect to deficiency payments) that “the formula approach under Annex 3, paragraphs 10-11 of the Agreement on Agriculture [is] warranted for upland cotton AMS calculations.” Brazil’s Rebuttal Submission, para. 73 fn. 172. Because the Peace Clause proviso comparison must compare the support that challenged measures grant to “that decided during the 1992 marketing year,” the price gap methodology is the only AMS approach that reflects only the United States’ decisions and not market prices beyond the United States’ control. For the same reason, it is equally appropriate to use the price gap methodology for marketing loan payments.

<sup>13</sup> Total deficiency payments calculated via the price gap methodology equal unadjusted basic deficiency payments (\$724 million / 0.875) + 50/92 deficiency payments (\$30 million) – that is, \$858 million. See US Rebuttal Submission, para. 115 fn. 144.

<sup>14</sup> To calculate the deficiency payment support using the price gap methodology and consistent with the 1995 US WTO notification and G/AG/AGST/USA, we made the following calculations.

Total deficiency payments are equal to basic deficiency payments plus 50/92 payments. Basic deficiency payments are equal to eligible production times a price gap measured as the difference between the target price and a fixed reference price. Eligible production is measured as eligible base acreage times average programme yield. Eligible base acreage is equal to participating base acreage minus Acreage Conservation Reserve acres minus Normal Flex Acres minus acres enrolled in the 50/92 programme. The fixed reference price is the 1986-88 average of the higher of the market price or loan rate for each year.

Payments for the 50/92 programme were calculated in a similar fashion by multiplying base acres in the 50/92 programme times the average programme yield times 92 per cent of the price gap.

In 1992, the target price was 72.9 cents per pound and the fixed reference price for 1986-88 was 57.9 cents per pound. This gives a price gap of 15.0 cents per pound. Eligible production for basic deficiency payments in 1992 was equal to 5,544 million pounds (9.226 million acres times the average programme yield of 601 pounds per acre). Multiplying the price gap times eligible production gives basic deficiency payments equal to \$832 million.

The same formula is used to calculate deficiency payments under the 50/92 programme. For 1992, the price gap is the same as that calculated for the basic deficiency payments (15 cents per pound). Eligible



calculation, moreover, uses the actual payment acreage (that is, acres planted for harvest or participating in the 50/92 programme on which payment was received) to calculate the “eligible production.” Using instead the base acreage minus the 10 per cent acreage reduction figure and the 15 per cent normal flex acres (14.9 million effective base acres<sup>15</sup>  $\times$  .75 = 11.175 million acres) and multiplying by the programme yield (602 pounds per acre), the “quantity of production eligible to receive the administered price”<sup>16</sup> is 6,727 million pounds, yielding a price gap deficiency payment calculation of \$1,009 million. Thus, the figure in paragraph 115 of the US rebuttal reflected a conservative approach that understated the support resulting from a price gap calculation.

9. In this regard, the United States notes Brazil’s argument with respect to the 1995 Statement of Administrative Action, which explained that Peace Clause protection would apply “unless the AMS for the particular commodity exceeds the level decided in the 1992 marketing year.”<sup>17</sup> We agree with Brazil that this reference to “AMS” is “non-textual[]” because the Peace Clause uses the term “support decided” and not “AMS.”<sup>18</sup> However, to the extent that the Panel were to examine “the AMS for the particular commodity” – that is, the upland cotton AMS – the United States has demonstrated that in no year from 1999-2002 does that AMS exceed the 1992 level.

### III. The US Level of Support Argument Does Take Into Account All Product-Specific Support That Challenged US Measures Grant

10. Brazil has argued that “the United States ‘72.9 methodology’ does not – and cannot account for cottonseed payments, Step 2 payments, storage payments and interest rate subsidies,” which the United States has identified as product-specific support.<sup>19</sup> Brazil then alleges that the US methodology “would sanction the cover-up of hundreds of millions – if not billions – of dollars of expenditures.”<sup>20</sup> Over-heated rhetoric aside, Brazil’s argument is simply erroneous.

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production under the 50/92 programme was 254 million pounds (404 thousand acres times the average programme yield of 50/92 participants of 628 pounds per acre). Deficiency payments under the 50/92 programme were thus equal to \$35 million (0.92 times 254 million times \$0.15).

Total deficiency payments under the price gap methodology were thus equal to \$867 million (\$832 million plus \$35 million). *Sources:* US Department of Agriculture, Compliance Report for 1992 Acreage Reduction Programme (1993) (Exhibit US-39); Commodity Credit Corporation Commodity Estimates Book for the FY 1995 President's Budget (February 1994); G/AG/AGST/USA, p. 18.

<sup>15</sup> See Exhibit Bra-105, Annex 2 (1st source document: US Department of Agriculture, *Provisions of the Federal Agricultural Improvement and Reform Act of 1996*, at 142) (giving 1992 effective base acreage of 14.9 million acres); *id.*, Annex 2 (2nd source document: Daniel A. Sumner, *Farm Programmes and Related Policy in the United States*, at 4) (same).

<sup>16</sup> Agreement on Agriculture, Annex 3, para. 10.

<sup>17</sup> We also note that Brazil never quotes that passage in full since the first half reflects the US view throughout this dispute that “exempt from actions” means not liable to a legal process or suit. See 1995 Statement, at 68 ( “Under Article 13(b)(ii) and (iii), governments *may not initiate* adverse effects, serious prejudice or non-violation nullification and impairment *challenges* in the WTO . . . .”) (emphasis added). There are numerous other statements in the 1995 Statement that Brazil similarly does not draw to the Panel’s attention. See *id.* at 67 (“Article 13, commonly referred to as the peace clause, reflects *an agreement among WTO countries to refrain from challenging* certain of each other’s agricultural subsidy programmes . . . *through WTO dispute settlement procedures* . . . .”) (emphasis added); *id.* (“Article 13(b) *addresses possible challenges* to domestic support measures falling outside the green box in circumstances in which the WTO member providing the subsidy is meeting its total AMS commitments.”) (emphasis added).

<sup>18</sup> Brazil’s Opening Statement, para. 35; Brazil’s Rebuttal Submission, para. 75; see also 1995 Statement of Administrative Action, at 68 (subsequently in same paragraph quoted by Brazil stating “a WTO Member will not be protected by the Peace Clause if its support for the product is above that decided during the 1992 marketing year.”) (emphasis added).

<sup>19</sup> Brazil’s General Comment on US Answers to Questions 47-69 from the Panel (para. 55).

<sup>20</sup> Brazil’s General Comment on US Answers to Questions 47-69 from the Panel (para. 56).

11. Brazil argues that the United States has not accounted for Step 2 payments. The United States directs the Panel's attention to the US rebuttal submission, paragraphs 111 and 113, and the US first written submission, paragraph 111. The United States has noted that, because the availability of Step 2 payments is contingent on certain price conditions existing during the marketing year, the level of support decided must relate to the payment parameters. While these have changed slightly with the 2002 Act, these minor adjustments do not alter the revenue ensured for producers by the marketing loan rate of 52 cents per pound because Step 2 merely provides an alternative avenue of providing support (through processors rather than directly to producers). In addition, these minor adjustments cannot overcome the greater than 20 cents per pound difference in product-specific support between marketing years 1992 and 1999-2002.

12. Brazil argues that the United States has not accounted for cottonseed payments. The United States directs the Panel's attention to the US rebuttal submission, paragraph 111 fn. 136, 137 and paragraph 113. While the United States maintains that these measures are not within the Panel's terms of reference<sup>21</sup>, we note that cottonseed payments for the 1999, 2000, and 2002 crops ranged in value between 0.6 to 2.3 cents per pound (factoring expenditures – the way these measures were decided – over production). Thus, given the greater than 20 cents per pound difference in product-specific support between marketing years 1992 and 1999-2002, cottonseed payments too do not materially affect the comparison between marketing year 1992 and any other year.

13. With respect to storage payments and interest rate subsidies, we note that these are US Government estimates of support provided through activities relating to operating the upland cotton marketing loan programme.<sup>22</sup> This support is already captured, however, in the level of support expressed by the marketing loan rate. Were these costs not borne by the United States, the costs to the producer would reduce the guaranteed revenue below the loan rate. In fact, Annex 3 of the Agreement on Agriculture explains that, for purposes of market price support calculated using a price gap, "[b]udgetary payments made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS." Similarly, where the support provided by marketing loans is measured using a price gap methodology (the only appropriate AMS calculation for purposes of the Peace Clause)<sup>23</sup>, "payments made to maintain this gap," such as storage payments and interest rate subsidies, should not be counted separately.

#### **IV. Brazil's New Green Box Arguments Are in Error**

14. In its rebuttal submission and comments on US answers to questions from the Panel, Brazil advances two novel arguments. First, Brazil for the first time responds to the US argument that Brazil's interpretation of paragraph 6(b) would create an inconsistency between that provision and the fundamental requirement of the first sentence of Annex 2, paragraph 1.<sup>24</sup> Second, Brazil argues that the US interpretation of Annex 2, paragraph 6(b), would render paragraph 6(e) of that Annex a nullity. Neither of these arguments withstands scrutiny.

15. First, Brazil misunderstands the US argument that Brazil's reading of paragraph 6(b) creates an inconsistency between that paragraph and the fundamental requirement of the first sentence of Annex 2, paragraph 1, and therefore its arguments go astray. The United States has noted that if payments under a decoupled income support measure were reduced or eliminated if a recipient were to produce any commodity, then the amount of payments would be (on Brazil's reading) linked to the type of production and therefore inconsistent with paragraph 6(b), even though such a measure would

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<sup>21</sup> See US Rebuttal Submission, paras. 106-09.

<sup>22</sup> For example, for storage payments we estimate expenses incurred with respect to upland cotton put under loan and pledged as collateral.

<sup>23</sup> See US Rebuttal Submission, paras. 114-17.

<sup>24</sup> Brazil's Rebuttal Submission, paras. 4-9.

meet the fundamental requirement of Annex 2. Brazil does not contest that such a measure would meet that fundamental requirement but instead argues that “requiring no production, *i.e.*, on all base acres is not a ‘type of production’” because “[t]he notion of ‘type of production’ in paragraph 6(b) is necessarily linked to the amount of payment to some ‘type’ of commodity that is ‘produced’ and not to a production requirement itself.”<sup>25</sup>

16. With respect, if one were to credit this argument, then Brazil would appear to have misunderstood its own objection to US direct payments and production flexibility contract payments. That is, in the US example, payments are reduced or eliminated if a recipient produces *any type* of commodity. Similarly, Brazil’s objection to US green box payments is that payments are reduced or eliminated if a recipient produces *certain types* of commodities. Thus, in the former example, the amount of payment is “based on” (in the sense of being reduced by) “the type” of production undertaken by the producer – for example, production of upland cotton, fruits, vegetables, or wild rice – just as in Brazil’s argument on US green box payments, the amount of payment is “based on” (in the sense of being reduced by) “the type” of production undertaken by the producer – that is, fruit, vegetable, or wild rice production. Brazil’s objection to US green box payments under paragraph 6(b) would therefore apply with equal force to the US example,<sup>26</sup> again, posing an inconsistency between Brazil’s interpretation of paragraph 6(b) and the fundamental requirement of Annex 2.<sup>27</sup>

17. Brazil also argues that the US interpretation of paragraph 6(b) “would render Annex 2, paragraph 6(e)[,] a nullity” because the “US interpretation of paragraph 6(b) as not requiring the production of ‘certain crops’ is the same as 6(e)’s prohibition on not requiring production of ‘any crops.’”<sup>28</sup> Brazil’s own re-phrasing of the US argument, however, points to the distinction between the obligations contained in these two provisions. Paragraph 6(e) establishes that under a green box measure: “No production shall be required in order to receive such payments.” Thus, there can be no production requirement “in order to receive such payments,” but the provision is silent with respect to the *amount* of such payments at any particular time and any links to the “type or volume of production.” That is, were paragraph 6(e) alone part of Annex 2, a Member could arguably link the amount of payments to requirements on the “type or volume of production” so long as payment eligibility were not contingent on production.

18. Paragraph 6(b) forecloses that option by prohibiting a green box measure from linking the “amount of such payments in any given year” to “the type or volume of production.” That is, not only may a green box measure not require production, but the measure may not require a particular “type or volume of production” in order to obtain a payment amount. As the United States has noted, both direct payments and production flexibility contract payments meet that test because no “type or volume of production” is required to receive payments. For example, with respect to the fruits, vegetables, and wild rice planting flexibility issue, a payment recipient need not undertake any “type or volume of production” in order to receive the full “amount of payments” to which the farm’s base acres are entitled. Rather, the recipient need only *desist* from planting certain commodities. Thus, Brazil’s objection is nothing more than a statement that, under US green box measures, the amount of payments is linked to production *not* undertaken by the producer.

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<sup>25</sup> Brazil’s Rebuttal Submission, para. 6. Brazil concludes the thought: “Otherwise, it logically could not be a ‘type’ of production. It would be nothing at all.”

<sup>26</sup> See Brazil’s Rebuttal Submission, para. 4 (“The relevant text of paragraph 6(b) prohibits any linkage of the ‘amount of payments’ to *any* ‘type of production’ of an agricultural product.”) (emphasis added).

<sup>27</sup> Brazil’s reference to paragraph 6(e) does not answer this objection. Brazil argues that “negotiators addressed any possible misunderstanding in this regard by including the very concept of prohibiting the requirement to produce in paragraph 6(e).” Brazil’s Rebuttal Submission, para. 6. However, as Brazil immediately points out, conformity with paragraph 6(e) “does not exempt . . . payments from conforming to the requirement of paragraph 6(b).”

<sup>28</sup> Brazil’s Comment on US Answer to Question 32 from the Panel (para. 44).

19. Finally, we note that Brazil's reading of paragraph 6(b) could prevent Members from imposing on decoupled income support payment recipients any conditions relating to the type of production – for example, the planting of illegal crops or production of unapproved biotech varieties or environmentally damaging production. As a practical matter, no Member could accept not being able to impose any such conditions on payment recipients. The result of Brazil's reading, then, would be to read decoupled income support out of Annex 2. This may be a favourable result from the Brazilian perspective, but the Panel should not adopt an interpretation of paragraph 6(b) not required by the text, not consistent with its context (in particular, the fundamental requirement of Annex 2), and with such potentially far-reaching results.

## V. Answer to Additional Question 67bis from the Panel

**67bis. Please state the annual amount granted by the US government in each of the 1999, 2000, 2001 and 2002 marketing years (as applicable) to US upland cotton producers, per pound and in total expenditures, under each of the following programmes: production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments.**

20. The Panel's question would require ascertaining for each programme the amount of upland cotton produced by recipients of payments under the programme. However, the United States does not maintain and cannot calculate this information – that is, it does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers. This is because the payments do not relate to, and do not depend on, what crop, if any, is actually produced. Instead, each of these programmes makes payments with respect to *past* production on base *acreage* in a fixed and defined base period, not with respect to whether one is currently a producer.

21. Thus, the United States did track total expenditures with respect to base acres of wheat, corn, barley, grain sorghum, oats, upland cotton, and rice under the expired production flexibility contract payments and market loss assistance payments and does track total expenditure with respect to base acres of wheat, corn, barley, grain sorghum, oats, upland cotton, rice, peanuts, soybeans, sunflower seed, canola, rapeseed, safflower, flaxseed, mustard seed, crambe, and sesame seed under the direct payments and counter-cyclical payments.<sup>29</sup> However, the fact that a recipient at one time produced one of these crops says nothing about what crops the recipient is currently producing, if any. In other words, payments made on the basis of past production of upland cotton do not tell anything about whether the recipient is currently producing cotton, corn, livestock, hay, or any other crop or is not producing at all. As a result, it is not possible to derive from these payments whether the payment is being received by an upland cotton producer.

22. The Panel's question points to a fundamental difficulty with Brazil's approach. Brazil would have the Panel allocate "support to a specific commodity" – upland cotton – on the basis that certain of these measures determine payment amounts (for base acres) based on current or recent market prices for that commodity. However, how could the payment be "support to a specific commodity" (support "provided for an agricultural product in favour of the producer of the basic agricultural product") if there need be no production of upland cotton in order to receive payment?

23. Brazil attempts to avoid this result by arguing that various US payments (direct, counter-cyclical, production flexibility contract, and market loss assistance payments) are *not* non-product-specific support because they are not payments to "producers in general." The United States has addressed this erroneous interpretation in detail in its rebuttal submission. In short, Brazil's reading requires ignoring the definition of product-specific support in Article 1(a) (that is "support ...

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<sup>29</sup> See US First Written Submission, para. 57 fn. 46.

provided for an agricultural product in favour of the producers of the basic agricultural product”), which Brazil has not interpreted, in over 450 pages of submissions and statements, even once.<sup>30</sup> In fact, Brazil’s reading of the definition of non-product-specific support (“support provided in favour of agricultural producers in general”) reads the phrase “in general” as meaning “in a body; universally; without exception.” However, this dictionary definition is considered “obsolete”<sup>31</sup> and so would hardly be the “ordinary meaning” of the term.

24. As Brazil has conceded, moreover, payments made with respect to upland cotton base acres are not necessarily in favor of upland cotton producers since those acres may not be planted to upland cotton – indeed, may not be planted at all. We note that Brazil has adjusted its entire AMS calculation to reflect its belated realization that, under its own theory, “only the portion of . . . payments [on “upland cotton” base acres] that actually benefits acres planted to upland cotton can be considered support to upland cotton.”<sup>32</sup> But Brazil’s adjustment is not enough. Brazil simply takes the ratio of actual upland cotton acreage to “upland cotton” base acreage under a given programme. However, there is no reason why upland cotton acreage need be planted on “upland cotton” base acreage. Consider this example:

- One farm could have 100 base acres of upland cotton and currently plant those 100 acres to corn; direct and counter-cyclical payments would be made on those 100 “upland cotton” base acres that actually are planted to corn.
- Another farm could have 100 base acres of corn and currently plant those 100 acres to upland cotton; direct and counter-cyclical payments would be made on those 100 “corn” base acres that actually are planted to upland cotton.
- Brazil’s approach (dividing upland cotton planted by upland cotton base acres) would simply say that *all* of the direct and counter-cyclical payments on “upland cotton” base acres are “support to upland cotton” because there are 100 “upland cotton” base acres on which payments were made and 100 acres currently planted to upland cotton, even though these are found on completely separate farms.

Thus, Brazil’s ratio does not identify, *even on Brazil’s own terms*, the alleged support to upland cotton (that is, “payments that actually benefit[] acres planted to upland cotton”) under these programmes.<sup>33</sup>

25. Brazil’s own approach would require Brazil to match up payments for upland cotton base acres with the amount of upland cotton production on those base acres, but Brazil has not done so.<sup>34</sup>

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<sup>30</sup> See, e.g., Brazil’s Rebuttal Submission, para. 19 (again misquoting the definition of product-specific support in Article 1(a) by eliminating the phrase support provided “for an agricultural product” and failing to interpret that definition according to the customary rules of interpretation of public international law); Brazil’s Comments on US Answer to Question 43 from the Panel (paras. 58-60) (criticizing US interpretation of product-specific support but failing to interpret that definition according to the customary rules of interpretation of public international law); Brazil’s Comments on US Answer to Question 38 from the Panel (paras. 48-49) (same).

<sup>31</sup> See *The New Shorter Oxford English Dictionary*, vol. 1, at 1073 (first definition of “in general”: “† (a) in a body; universally; without exception”); *id.*, vol. 1, at xv (sec. 4.5.2: Status symbols) (“The dagger [†] indicates that a word, sense, form, or construction is obsolete. It is placed before the relevant word(s) or relevant sense number.”).

<sup>32</sup> See, e.g., Brazil’s Answer to Question 67 from the Panel (table, fn. 2, 3, 4, 5).

<sup>33</sup> We also would reiterate that such payments would not be “support to a specific commodity” as explained in Article 1(a) and reflected in Annex 3.

<sup>34</sup> For example, Brazil admits that “this acknowledged legal flexibility to grow other crops does not answer the question of whether the producers planting 14.2 million acres of upland cotton in MY 2002 received direct and counter-cyclical payments. Nor does it answer the question of whether the 14.2 million acres planted

At best, Brazil speculates as to the *likelihood* of a person with cotton base acres actually producing upland cotton on those base acres, and even that speculation is flawed.<sup>35</sup> However, such an approach amounts to little more than speculation and, even if Brazil's erroneous interpretation were used, does not meet Brazil's burden of establishing a *prima facie* case.

26. In addition, under Brazil's own approach, the payments made in relation to corn base acres would be support for *corn* even if planted to upland cotton. However, Brazil's approach would appear to result in double counting the support – the same payment would be support to corn (because it was related to corn base acres) and support to upland cotton (because cotton was produced on base acres eligible for payments). In other words, Brazil is trying to have it both ways:

- First, Brazil argues that payments made based on production on base acres during a base period is support to the crop that was produced during that base period, regardless of what is actually produced currently (that is, payments made for upland cotton base acreage is support to upland cotton even if the producer is now growing corn on that acreage).
- Second, Brazil argues that payments made under these programmes are support to the crop that is currently being produced, even if the crop being produced is different from the base crop (that is, payments made for corn base acreage is support to upland cotton if upland cotton is being produced on the corn base).

27. Furthermore, because payments under the cited programmes are made with respect to historic acres and yields during a base period, it is not possible to calculate the “annual amount granted by the US government . . . to US upland cotton producers, per pound.” Counter-cyclical payments, for example, determine the payment rate for base period production as the difference between a target price and the sum of the direct payment rate plus the higher of the market price or the loan rate. However, the per pound payment rate for upland cotton base acres applies only for base period production (base acres  $\times$  payment yields), not current production. Thus, to express these payments per pound begs the question: “Per pound of what?” Any production figure used – whether base period production or production in any year from 1999 through 2002 – results in a highly artificial per pound

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to upland cotton in MY 2002 were planted on *upland cotton* base acreage.” Brazil's Rebuttal Submission, para. 38 (emphasis in original). The United States agrees completely, and while Brazil's approach would require that these questions be answered, Brazil has not answered them, even though under Brazil's approach, Brazil would have the burden of proof in this regard. Rather, Brazil tries to construct a series of assumption based on what Brazil considers “likely” or “maybe” or “probably.”

<sup>35</sup> See Brazil's Rebuttal Submission, paras. 24-50. Brazil makes a lengthy presentation of new data and calculations, including some with respect to crops other than upland cotton, to assert that these four payments are support for upland cotton because without them upland cotton farmers could not cover their costs. However, Brazil's approach is flawed in terms of its facts and the premises on which it relies. In the time available we have not been able to identify and describe all the flaws and inaccuracies in Brazil's presentation of the data. Simply by way of example, however, we note that (1) Brazil includes a figure for cottonseed payments in its graph purporting to show MY 2001 market revenue and government support (Rebuttal Submission, paragraph 30), but Brazil's own table at paragraph 84 of its rebuttal submission reflects that there were no cottonseed payments for the 2001 marketing year; (2) Brazil's theory would appear to be that cotton production on cotton base acres are “necessary” because without government payments costs of production would not be covered, but Brazil presents information only with respect to one year, marketing year 2001, with record low prices - Brazil does not explain its theory or present any data with respect to other years with more typical prices; (3) Brazil asserts that upland cotton production “is produced only in particular regions . . . and producers tend to specialize and not readily switch to other crops” – whereas cotton is produced in 17 of the 50 United States and, for all US cotton farms, average cotton area is approximately 38 per cent of a farm's acres (469 of 1,222 acres) (US Department of Agriculture, Characteristics and Production Costs of US Cotton Farms (October 2001).)

rate since (as noted above) these payments will be or were (as the case may be) received by a recipient regardless of whether he or she produced any upland cotton production.

28. We are able to provide to the Panel the total outlays under the cited programmes with respect to upland cotton base acreage:

<b>Total Outlays Under Certain Programmes with respect to Upland Cotton Base Acres (millions US\$)</b>				
Payments <sup>36</sup>	MY1999	MY2000	MY2001	MY2002
Production flexibility contract	614	575	474	452
Market loss assistance	613	612	524	NA
Direct	NA	NA	NA	not yet available <sup>37</sup>
Counter-cyclical	NA	NA	NA	not yet available <sup>38</sup>

## **VI. Payments With Respect to Base Period Production of Certain Commodities But Not Others Are Not Inherently Product-Specific Support**

29. Brazil has argued that production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments are product-specific support. The United States had addressed some infirmities in Brazil's approach in response to Additional Question 67*bis* from the Panel and in previous submissions.<sup>39</sup> The United States now briefly addresses two arguments presented by Brazil.

30. First, Brazil argues that each of these payments is product-specific because base acreage is defined as acreage on which only some commodities were historically produced during a defined and fixed base period. This argument, again, rests on an "obsolete" definition of "in general" (in the definition of non-product-specific support) as "universal" or "without exception" and a determined refusal to quote accurately and interpret the definition of product-specific support in Article 1(a).<sup>40</sup>

<sup>36</sup> See Exhibit US-38 (<http://www.fsa.usda.gov/dam/BUD/bud1.htm>) (for crop years 1999, 2000, and 2001).

<sup>37</sup> The US Department of Agriculture estimates that direct payments for the 2002 marketing year with respect to upland cotton base acres will total \$173 million. Exhibit US-18 ([www.fsa.usda.gov/dam/BUD/estimatesbook.htm](http://www.fsa.usda.gov/dam/BUD/estimatesbook.htm)).

<sup>38</sup> The US Department of Agriculture estimates that counter-cyclical payments for the 2002 marketing year with respect to upland cotton base acres will total \$873 million. Exhibit US-18 ([www.fsa.usda.gov/dam/BUD/estimatesbook.htm](http://www.fsa.usda.gov/dam/BUD/estimatesbook.htm)).

<sup>39</sup> See, e.g., US Rebuttal Submission, paras. 79-92, 99-105.

<sup>40</sup> We note that, once again, Brazil has misquoted the definition of product-specific support in Article 1(a). Brazil quotes that definition as follows: "For support not provided to agricultural producers *in general*, the test is whether the support is 'provided in favour of the producers of the basic agricultural product.'" Brazil's Rebuttal Submission, para. 19. The actual text of Article 1(a), in pertinent part, reads:

That these payments are made with respect to base acreage for only some commodities is not relevant to the question whether they are support “provided for an agricultural product in favour of the producers of the basic agricultural product.”<sup>41</sup> None of these payments satisfies either part of this definition: they are neither provided “for an agricultural product” (rather, they are made with respect to historic production of several products) nor “in favour of the producers of the basic agricultural product” (no production is necessary for payments to be made).

31. Brazil also appears to now argue that the requirement under paragraph 6(a) of Annex 2 that eligibility for payments under a decoupled income support measure “shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period” requires that these payments be made to *all* producers for *all* commodities. This approach would seriously limit the ability of Members to move to decoupled income support. It is not clear that any Member would be willing to switch to decoupled income support if it required expanding support to whole new classes of producers or commodities. We can find no basis for this approach in the text of paragraph 6(a). This definition does not require comprehensive coverage of all or nearly all production in “a defined and fixed base period”; it merely requires “clearly-defined criteria.” Thus, under Brazil’s reading, a measure could satisfy the requirement of Annex 2, paragraph 6(a), and yet qualify as product-specific support under Article 1(a).

32. Second, Brazil again selectively quotes the statutory definition of “producers” to suggest that recipients of these payments had to be growers who “shared in the risk of producing a crop.”<sup>42</sup> As the United States has previously noted, the statute defines “producers” (those eligible in the first instance to receive payment) as persons who “would have shared had the crop been produced.”<sup>43</sup> Thus, both the 2002 and 1996 Acts make clear that a payment recipient need not produce any crop (including upland cotton) to receive payment. It is thus a serious error to imply that a payment recipient is necessarily a “producer” in the Agreement on Agriculture rather than a “producer” (meaning “recipient”) in the statutory sense.

33. Nowhere in Brazil’s submission is there any suggestion of how its approach can be found in the Agreement on Agriculture. It does not make sense of the definitions of product-specific support and non-product-specific support in Article 1(a), which Brazil has recognized guide the interpretation of the phrase “support to a specific commodity” in the Peace Clause. In sum, Brazil’s argument

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“support . . . provided *for an agricultural product* in favour of the producers of the basic agricultural product” (emphasis added). What Brazil describes as “the narrow US Article 13(b)(ii) specificity standard” in fact flows from an interpretation of Article 13 that makes sense of the *entire* text of Article 1(a) and not just selected parts of it.

<sup>41</sup> Indeed, Brazil’s argument in paragraph 36 of its rebuttal submission rests on a *non sequitur*. Brazil’s statement is that: “Thus, direct payments are *not* available to the great majority of US producers of agricultural commodities, *i.e.*, they are not provided to US agricultural producers *in general*.” (Emphasis in original.) The illogic in Brazil’s statement is that, by removing the requirement to produce any particular crop or any crop at all in order to receive these payments, the United States does in fact make the payments available to producers in general. Recipients are free to produce a broad range of commodities, and so are producers of agricultural commodities “in general.” Brazil appears to acknowledge that the payments are not in fact tied to current production when, in paragraph 50, Brazil concedes that the payments are made to “upland cotton base acreage holders” rather than to upland cotton *producers*.

<sup>42</sup> See Brazil’s Rebuttal Submission, paras. 24 (quoting first half of definition), 29 (“Thus, as with PFC payments, market loss assistance payments were not paid to agricultural producers *in general* but rather to only a select group of US producers), 36 (“Direct payments are targeted support to “producers” farming, *inter alia*, on upland cotton base acreage.”), 48 (“But the evidence demonstrates that CCP funds in MY 2002 paid to “historic” (*i.e.*, 1998-2001 or 1993-1995) upland cotton producers are paid to a tiny fraction of total US producers of agricultural commodities.”).

<sup>43</sup> US Rebuttal Submission, paras. 36-38.



provides ample evidence that the phrase “support to a specific commodity” in the Peace Clause must be interpreted in the context provided by the Agreement on Agriculture. To divorce it from that context may result in an unworkable and illogical interpretation along the lines suggested by Brazil.

## **VII. Brazil’s New Arguments Relating to Crop Insurance Do Not Demonstrate that Crop Insurance Payments Are Product-Specific Support**

34. Brazil presents a number of arguments claiming that crop insurance payments are “support to a specific commodity.” In part, this argument relies on the notion that such payments are not support provided to agricultural producers “in general” and, hence, not non-product-specific support. We note, however, that in making these arguments Brazil avoids any reference to the definition of product-specific support in Article 1(a). This is a fundamental interpretive error: Brazil cannot claim that payments are not support to “agricultural producers in general” under Article 1(a) without providing an interpretation of the other component of support in Article 1(a), namely, product-specific support (support “provided for an agricultural product in favour of the producers of the basic agricultural product”). In fact, given that crop insurance support is available to approximately 100 agricultural commodities, representing approximately 80 per cent of US area planted and greater than 85 per cent of the value of all US crops, crop insurance payments are not support “provided for *an* agricultural product.”<sup>44</sup> The support to these approximately 100 commodities is the same: that is, the crop insurance premium subsidies do not vary by commodity or plan of insurance.

35. Brazil’s specific arguments fail to address the definition of product-specific support in Article 1(a); thus, each fails to demonstrate that crop insurance payments are “support to a specific commodity” rather than “support to several commodities.”

36. First, Brazil argues that certain policies (and accompanying premiums) on irrigation failures are available only to upland cotton and a few other commodities. The United States has previously addressed this argument and directs the Panel’s attention to that argument.<sup>45</sup>

37. Second, Brazil argues that a larger pool of types of insurance policies are offered to upland cotton than most other crops. Brazil has not explained how the types of crop insurance policies offered by private companies<sup>46</sup> can affect whether US crop insurance payments (premium subsidies that do not vary by commodity or insurance plan) are product-specific or not. Brazil’s “facts” are also misleading in some instances and erroneous in others. For example, Brazil suggests that “in many instances, the policies available for cotton enterprises are not available for other crops.”<sup>47</sup> However, we note that commodities other than upland cotton can be insured under the same types of policies as upland cotton.<sup>48</sup>

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<sup>44</sup> US Rebuttal Submission, paras. 93-98.

<sup>45</sup> See US Rebuttal Submission, para. 54.

<sup>46</sup> Under the Agricultural Risk Protection Act, new insurance products must be developed by the private sector and approved by the Board of Directors of the Federal Crop Insurance Corporation. The US Department of Agriculture is expressly prohibited from conducting research and development on new products. Thus, the variety and availability of insurance products reflects the fact that private companies, not the US Government, have developed and offered these products.

<sup>47</sup> Brazil’s Rebuttal Submission, para. 55.

<sup>48</sup> Upland cotton producers can insure their crops under the following types of policies: Actual Production History, Group Risk Plan, Income Protection, Crop Revenue Coverage, and Revenue Assurance. Other crops that are eligible for the policies include:

for Actual Production History – Alfalfa seed, all other grapefruit, almonds, apples, avocados, barley, blueberries, cabbage, canola, cigar binder tobacco, cigar filler tobacco, cigar wrapper tobacco, corn, cotton, ELS cotton, crambe, cranberries, cultivated wild rice, dry beans, dry peas, early and midseason oranges, figs, flax, forage production, fresh apricots, fresh freestone peaches, fresh market tomatoes, fresh nectarines, grain sorghum, grapefruit, grapes, green peas, late oranges, lemons, macadamia nuts, mandarins, Maryland tobacco,

38. Third, Brazil argues that there are specific upland cotton provisions in certain policies.<sup>49</sup> This is true – an insurance product offered by a private company must be tailored for the situation and desires of the insurance purchasers – but also irrelevant as the policies are generally similar in underwriting rules and share the same subsidy schedule.

39. Fourth, Brazil argues that upland cotton producer participation rates in the crop insurance programme “is much higher than for other crops.”<sup>50</sup> We first note that Brazil neglects to mention that participation rates for the major field crops are generally quite high (over 75 per cent of insurable acres). Any producer who received disaster assistance was required to purchase federal crop insurance in the following year; cotton participation may be slightly higher because of droughts that have hit cotton regions in recent years. More importantly, that cotton producers may choose to take up crop insurance more than producers of other commodities might is irrelevant to whether the payments are provided “for an agricultural product.” Again, the crop insurance premium subsidy is identical for all commodities and for each plan of insurance.

40. Fifth, Brazil argues that tracking the cost of reinsurance provided to private companies is “further evidence that USDA treats crop insurance for upland cotton separately from crop insurance provided to other crops.”<sup>51</sup> Of course, the way the US Department of Agriculture “tracks cost[s]” is irrelevant to the analysis of whether crop insurance payments provide support “for an agricultural product.” Brazil also misinterprets the Standard Reinsurance Agreement between the US Government and private insurers. Under that Agreement, net underwriting gains and losses for each insurer are calculated *at the state level over all crops*, not separately for individual crops (such as upland cotton).<sup>52</sup> Thus, Brazil errs when it claims that reinsurance provides evidence that crop insurance for upland cotton is treated separately from crop insurance provided to other crops.

41. Sixth, Brazil claims that “the 2000 ARP Act denies subsidies to producers of other agricultural products.”<sup>53</sup> It is true that there are certain products for which policies have not been developed. However, development of new policies is ongoing; for example, provisions of the Agricultural Risk Protection Act of 2000 allow for the development of livestock insurance products. A number of livestock products are currently available on a pilot basis, including price insurance for hogs and feeder cattle and gross margin insurance. We also note that producers may currently insure livestock and dairy revenue as part of whole farm insurance offered through the Adjusted Gross Revenue Insurance.<sup>54</sup> Finally, Brazil’s argument here again reads domestic producers “in general” to mean “universally” or “without exception”; as noted above, that definition is now considered obsolete.

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millet, Minneola tangelos, mint, mustard, navel oranges, oats, onions, Orlando tangelos, peaches, peanuts, pears, plums, popcorn, potatoes, processing apricots, processing beans, processing cling peaches, processing freestone, prunes, rice, Rio Red and Star Ruby grapefruit, Ruby Red grapefruit, rye, safflower, soybeans, sugar beets, sugarcane, sunflowers, sweet corn, sweet oranges, sweet potatoes, table grapes, tomatoes, Valencia oranges, walnuts, wheat;

for Group Risk – corn, cotton, forage production, grain sorghum, rangeland, soybeans, wheat;

for Income Protection – barley, corn, cotton, grain sorghum, soybeans, wheat; and

for Revenue Assurance – barley, canola, cotton, grain sorghum, rice, soybeans, sunflowers, wheat.

See [http://www3.rma.usda.gov/apps/sob/current\\_week/crop2003.pdf](http://www3.rma.usda.gov/apps/sob/current_week/crop2003.pdf).

<sup>49</sup> Brazil’s Rebuttal Submission, para. 55.

<sup>50</sup> Brazil’s Rebuttal Submission, para. 57.

<sup>51</sup> Brazil’s Rebuttal Submission, para. 58.

<sup>52</sup> The provisions of the Standard Reinsurance Agreement are available on the Risk Management Agency website at: <http://www.rma.usda.gov/pubs/ra/98SRA.pdf>.

<sup>53</sup> Brazil’s Rebuttal Submission, para. 59.

<sup>54</sup> More information on Adjusted Gross Revenue Insurance can be found on the Risk Management Agency website at: <http://www.rma.usda.gov/pubs/2003/PAN-1667-06rev.pdf>.

42. Finally, with respect to Brazil's references to the literature on the effects of crop insurance on production,<sup>55</sup> the findings are (contrary to what Brazil has claimed) mixed. While several studies (such as those cited by Brazil) have suggested crop insurance payments may have a slight effect on acreage, the effects on *production* are less clear.<sup>56</sup> If crop insurance encourages moral hazard problems (as claimed by Brazil), crop yields will be adversely affected as producers attempt to increase crop insurance indemnities. If moral hazard and adverse selection problems are severe, crop insurance support could potentially have a *negative* effect on production.<sup>57</sup> The potential production effects of crop insurance payments, moreover, goes to whether such payments are "amber box" support but does not figure in the question whether such payments (which are offered at the same rate across commodities and policies) can be support "for an agricultural product."

### VIII. Brazil May Not Act Unilaterally on Procedural Matters

43. The United States takes note of Brazil's statement in its 25 August 2003 letter to the Panel<sup>58</sup> that, concerning paragraph 20 of the Panel's determination of 20 June 2003, "Brazil interpreted this ruling as permitting it to provide no later than 22 August all of its evidence and argument that had not already been provided in its earlier submissions. This is the manner in which it treated the new evidence and arguments presented by the United States in its Rebuttal Submissions." The United States is unable to reconcile Brazil's position concerning its own ability to provide evidence and arguments at any time up through August 22 with Brazil's repeated assertions that the United States "should have" provided particular material in its replies to the Panel's questions.<sup>59</sup> There is of course no basis for Brazil's assertions that particular material "should have been" provided in replies to questions rather than in a rebuttal submission. There is no basis for Brazil to dictate to another Member what it may or may not include in its rebuttal submission. Brazil is fabricating an obligation and attempting to impose it on the United States at the same time that it exempts itself from this obligation. In this, Brazil's approach is similar to its repeated attempts in this dispute to add to the obligations in the Agreement on Agriculture and the Subsidies Agreement.

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<sup>55</sup> Brazil's Rebuttal Submission, paras. 60-67.

<sup>56</sup> The US Department of Agriculture, Economic Research Service, studies cited by Brazil only examine the effects of crop insurance subsidies on acreage. They do not consider effects on crop yields.

<sup>57</sup> Recent studies by Smith and Goodwin (1996), Babcock and Hennessy (1996) and Goodwin and Smith (2003) 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 that suggests that crop insurance participation may have a negative effect on yields. See Babcock, B. and D. Hennessy. "Input Demand Under Yield and Revenue Insurance" *American Journal of Agricultural Economics* 78(1996):416-27; Goodwin, B. and V. Smith. "An Ex Post Evaluation of the Conservation Reserve, Federal Crop Insurance, and other Government Programmes: Programme Participation and Soil Erosion." *Journal of Agriculture and Resource Economics* 28(2003):201-216; Smith, V. and B. Goodwin. "Crop Insurance, Moral Hazard and Agricultural Chemical Use." *American Journal of Agricultural Economics* 78(1996):428-38.

<sup>58</sup> The United States also notes that the Panel's communication of 19 August 2003 had not indicated that the parties would have an opportunity to comment on each other's requests to comment. Had there been such an opportunity, the United States would have been happy to comment on Brazil's request of 23 August 2003. Perhaps Brazil could reconsider whether it has a basis to assert a right to decide that it may unilaterally provide comments to the Panel while denying the United States the same procedural rights. Under Brazil's approach, it would not have needed to request permission from the Panel to file comments on Wednesday, August 27, but could have simply provided those comments, unsolicited, while denying equal access for the United States. The United States is grateful that the Panel's extremely prompt reply to the US request obviated any need to respond to Brazil's unauthorized and out of order comments on that request.

<sup>59</sup> See Brazil's 23 August 2003 letter to the Panel.

## **IX. Conclusion**

44. The United States has demonstrated that using any measurement that reflects the support “decided” by the United States rather than factors (such as market prices) beyond the United States’ control, US support to upland cotton in marketing years 1999-2002 has not exceeded the 1992 marketing year level. The question then is whether the Panel will find that the United States has breached the Peace Clause simply because market prices were lower in some recent years than they were in 1992.

45. The United States submits that the Peace Clause must be interpreted in a way that permits Members to comply in good faith – that is, Members must be able to tell if they will breach the Peace Clause or not. Brazil’s budgetary outlays approach does not do that. Brazil’s approach would mean that Members could not know if they had complied with the Peace Clause until it was too late to do anything about it. The best way to interpret the Peace Clause in a way that allows Members to comply is to use the “support” as “decided” by a Member during the 1992 marketing year as the basis for comparison. Recognizing, as the United States believes is required by the Peace Clause text, that “decided” and “grant” cover only those parameters over which Members exercise control would also be consistent with this approach of allowing “good faith” compliance since it would permit Members to control whether their measures conformed to their obligations.

46. The United States has disciplined itself to grant support not in excess of that decided during the 1992 marketing year. Therefore, we are entitled to the protection of the Peace Clause, and we respectfully request the Panel to find that Brazil may not maintain this action challenging these conforming US measures.

**List of Exhibits**

1. US Department of Agriculture, Fiscal Year Actual Budgetary Expenditures by Crop Year (<http://www.fsa.usda.gov/dam/BUD/bud1.htm>)
2. US Department of Agriculture, Compliance Report for 1992 Acreage Reduction Programme



**ANNEX E****SUBMISSIONS OF PARTIES AND THIRD PARTIES FOR THE  
RESUMED SESSION OF THE FIRST SUBSTANTIVE MEETING  
("FURTHER SUBMISSIONS")**

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## ANNEX E-1

### BRAZIL'S FURTHER SUBMISSION TO THE PANEL EXECUTIVE SUMMARY

#### Summary Of The Argument Regarding Brazil's Further Claims

1. Brazil demonstrates in its Further Submission that US subsidies from MY 1999-2007 supporting the production, use and export of US upland cotton cause or threaten to cause serious prejudice to the interests of Brazil within the meaning of Article 5(c), 6.3(c) and 6.3(d) of the SCM Agreement as well as violate GATT Article XVI.
2. The measures challenged by Brazil comprise domestic support subsidies including the marketing loan programme<sup>1</sup>, crop insurance subsidies, market loss assistance payments and their successor counter-cyclical payments, production flexibility contract payments and their successor direct payments, cottonseed payments and "other payments".<sup>2</sup> The measures also include prohibited export and local content subsidies including Step 2 export and domestic payments, and the subsidies provided by the US GSM 102 export credit guarantee programme. These collective subsidies are referred to as "the US subsidies".
3. Table 1 summarizes the amounts of US subsidies in terms of US dollar and as a percentage of subsidization in terms of the market value of US upland cotton:

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<sup>1</sup> Brazil uses the phrase "marketing loan programme" or "marketing loan payment" to encompass marketing loan gains, loan deficiency payment (or "LDP's") and certificate exchange gains. *See* US 11 August Answer to Question 67, para. 133.

<sup>2</sup> The United States qualified "other payments" as product-specific support to upland cotton. *See* US 11 August Answer to Question 67, para. 130-133.



Programme	1999	2000	2001	2002
	Amount of Payment	Amount of Payment	Amount of Payment	Amount of Payment
	Rate of Subsidization	Rate of Subsidization	Rate of Subsidization	Rate of Subsidization
Marketing Loan Gains and LDP's	\$1,545 million	\$573 million	\$2,541 million	\$918 million
	43.71 per cent	14.06 per cent	82.5 per cent	28.23 per cent
Crop Insurance	\$169.6 million	\$161.7 million	\$262.9 million	\$194.1 million
	4.79 per cent	3.97 per cent	8.53 per cent	5.97 per cent
Step 2	\$422 million	\$236 million	\$196 million	\$217 million
	11.94 per cent	5.79 per cent	6.36 per cent	6.67 per cent
PFC Payments/ Direct Payments	\$547.8 million	\$541.3 million	\$453.0 million	\$485.1 million
	15.5 per cent	13.28 per cent	14.7 per cent	14.92 per cent
Market Loss Assistance/ Counter-Cyclical Payments	\$545.1 million	\$576.2 million	\$625.7 million	\$998.6 million
	15.42 per cent	14.14 per cent	20.31 per cent	30.71 per cent
Cottonseed Payments	\$79 million	\$185 million	No payments	\$50 million
	2.23 per cent	4.54 per cent	No payments	1.54 per cent
Other Payments	\$216 million	\$63 million	\$68 million	\$65 million
	6.11 per cent	1.54 per cent	2.20 per cent	1.99 per cent
<b>Total Payments</b>	<b>\$3,524.5</b>	<b>\$2,336.2</b>	<b>\$4,146.6</b>	<b>\$2,927.8</b>
<b>All programmes</b>	<b>97.69 per cent</b>	<b>57.32 per cent</b>	<b>134.6 per cent</b>	<b>90.03 per cent</b>
<b>Value of US Production</b>	\$3,534 million	\$4,073 million	\$3,080 million	\$3,252 million
<b>Average Rate of Subsidization</b>	<b>94.91 per cent</b>			

Table 1<sup>3</sup>

4. Brazil's actionable subsidy claims fall into two basic temporal and legal categories: first, claims of *present* serious prejudice resulting from subsidies provided in MY 1999-2002; second, claims of *threat* of serious prejudice from subsidies that are required to be paid by USDA to the US upland cotton industry during MY 2003-2007 under the Farm Security and Rural Investment Act of 2002 (2002 FSRI Act) and the Agricultural Risk Protection Act of 2000 (2000 ARP Act).

5. Because Brazil's claims involve the adverse effects of "subsidies", Brazil first establishes that each of the US domestic and export programmes is a "subsidy" within the meaning of Article 1.1 of the SCM Agreement. As Table 1 above indicates, each provides a "financial contribution" which confers a "benefit".

<sup>3</sup> The amount of payments reflects the amount presented by Brazil in its 22 August Rebuttal Submission, para. 173. The value of the US upland cotton production has been taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p.5). The value of the US production in MY 2002 has been calculated by multiplying the amount of US production as reported in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p.4) (16.73 million bales \* 480 pounds per bale) with the average price received by US farmers of 40.50 cents per pound (see Exhibit Bra-202 (Agricultural Outlook Tables, USDA, August 2003, Table 5). Differences between the sum of individual rates of subsidization and the total rate of subsidization are due to rounding effects.

6. Each of the subsidies is “specific” within the meaning of Article 2.1(a) and/or (c) of the SCM Agreement. The United States and Brazil agree that the specificity test of Article 2.1 was not intended to function as a loophole through which narrowly focused subsidies provided to or used by discrete segments of an economy could escape review. The four direct subsidies – the PFC, direct payment, market loss assistance, and CCP payments are *de jure* specific because the 1996 FAIR Act and the 2002 FSRI Act explicitly limit access of payments to holders of upland cotton base acreage. The per acre upland cotton base acreage payments of the four programmes are single specific subsidies because the payments are based on individual cotton-based criteria and are significantly higher than payments to most other base acres in each program. Alternatively, even if the total payments to all base acres for each of the four direct subsidies are treated as single subsidies, they are specific because the payments are excluded from the significant majority of US farmland and the value of the crops produced with such payments is less than one-quarter the value of total US commodities.

7. Crop insurance subsidies are specific because there are specific policies and groups of policies available only for upland cotton (or a few other crops) and not for the majority of crops in the programme. Alternatively, crop insurance is not specific because the 2000 ARP Act denies benefits to commodities representing more than half of the value of US agriculture. Further, US crops represent only 0.8 per cent of total US GDP.

8. Within each of the *present* serious prejudice and *threat* of serious prejudice claims, Brazil has asserted three different claims regarding the application of these actionable subsidies.

9. **Present Significant Price Suppression – Article 6.3(c) of the SCM Agreement:** The US subsidies provided during MY 1999-2002 cause present significant price suppression in the world and Brazilian market, as well as in markets where Brazilian producers export. Brazil first establishes that Brazilian upland cotton is “like” US upland cotton based on common tariff classification, USDA’s designation of upland cotton as a separate commodity, and the interchangeability and treatment by the markets of US and Brazilian cotton as like products.

10. The bulk of Brazil’s price suppression analysis involves establishing the causal link between the US subsidies and suppressed prices in the US, world, Brazilian, and other markets. Most of this evidence is also relevant for Brazil’s other present and threat of serious prejudice claims. The enormous size of the MY 1999-2002 US subsidies in terms of amount (\$12.9 billion) and percentage as market value (95 per cent) coupled with the dominating US world market share of 41.6 per cent of a fungible commodity create a *de facto* presumption of production, export, and price-suppressing effects. The effects of the subsidies are also seen in the significant increase of US production, exports, and world market share in MY 1999-2002 while US, A-Index, and Brazilian prices fell to record lows and remained suppressed. The causal link is further confirmed by the fact the average total US upland cotton costs of production was 77 per cent higher than market prices received by US farmers in MY 1999-2001, at the same time that US production and exports increased remained at high levels. Another demonstration of the causal link is the 15 per cent increase in the value of the US dollar between MY 1999-2001 at the same time that US export market share increased 68 per cent and A-Index prices declined by 21 per cent.

11. The link between US subsidies and suppressed A-Index, Brazilian, and other third country upland cotton market prices is further confirmed by the fact that the nature, size and global impact of the US market permits it to drive and suppress world prices. The large size of the US world market share of 41.6 per cent that is generated and sustained by the US subsidies suppresses world market prices. Production and export developments in the US market are widely publicized and impact the New York Cotton Exchange’s futures market, which in turn directly influence and impact A-Index and Brazilian prices.

12. The link between the US subsidies and significant price suppression is also confirmed by USDA and other economists' findings of the individual production, export and price-suppressing effects of each of the US subsidies have . USDA and other economists have identified the US marketing loan payments as having the greatest production, exports and A-Index price-suppressing effects. Crop insurance subsidies, like marketing loan payments, are directly tied to production, and have been found to create similar types of effects by USDA and other economists, as they eliminate risk and induce farmers to put marginal land into production. CCP payments (and to a lesser extent market loss assistance, PFC and direct payments) have production impacts as a result of additional income and wealth effects that keep land in production and maintain base acres in production in anticipation of future base updating like that permitted under the 2002 FSRI Act. Step 2 export payments directly stimulate US exports and permit US exporters to export high-cost US upland cotton with the effect of suppressing A-Index prices. The GSM-102 export credit guarantee programme facilitated the export of more than \$1 billion worth of US upland cotton between FY 1999 and the present, thereby increasing US exports and suppressing world prices.

13. A number of econometric studies found that the US subsidies collectively have the effect of increasing US production, exports and suppressing world prices. The ICAC found that world prices would increase by 11 cents per pound price from the removal of US subsidies in MY 2001 and 6 cents in MY 2000. The University of Tennessee found an average 11.4 per cent price suppressive effects from removing US subsidies during MY 2003-2007. The IMF estimated world prices would increase by 4 per cent based on removing \$1 billion of US subsidies in MY 1998. The World Bank/IMF found a 25-30 per cent increase in world prices from elimination of US upland cotton subsidies in MY 2003-2007. The Centre for International Economics found an increase of world price by 13.4 per cent by eliminating US and Chinese subsidies in MY 1998. Professor Daniel Sumner determined that removing the US subsidies in MY 1999-2002 results in an average increase in the A-Index price of 12.6 per cent.

14. Further, Brazilian prices for domestic Brazilian sales as well as Brazilian export sales are suppressed by the effects of the US subsidies. The small size of the Brazilian market and low applied tariffs mean that Brazilian producers are price takers, not price makers. Negotiations to determine Brazilian domestic and export prices are heavily influenced by New York Cotton Exchange's futures prices and A-Index prices. The movements in prices between the Brazilian prices and prices in these international markets are closely tied. Prices in other third country markets also show a close linkage with Brazilian, New York futures, US spot, US A-Index and other prices included in the A-Index calculation.

15. Finally, the amount of price suppression between MY 1999-2002 as reflected in various econometric studies of world prices varies from 6 cents per pound to 11 cents per pound. Professor Sumner found the A-Index price suppression to be 6.5 cents per pound between MY 1999-2002. This estimated worldwide price suppression is "significant" because it materially affects producers in Brazil and throughout the world. Total income loss from the price suppression is \$3.587 billion and Brazilian producers lost an estimated \$478 million from suppressed prices.

16. **Increasing World Market Share in MY 2001 – Article 6.3(d) of the SCM Agreement:** The US subsidies for upland cotton contributed significantly to the production and export of large quantities of upland cotton in violation of Article 6.3(d) of the SCM Agreement. The three-year average US world market share in MY 1998-2000 was 22.3 per cent. In MY 2001, the subsidy-enhanced US world market share increased to 38.3 per cent. This MY 2001 increase follows a consistent trend since the 1996 FAIR Act was enacted with US world market share increasing from 25 per cent to 38.1 per cent. The evidence linking US subsidies and increasing production and exports in the price suppression analysis is also relevant for the Article 6.3(d) claim. Professor

Sumner finds that *but for* the US subsidies, US exports between MY 1999-2001 would have declined on average by 39 per cent.

17. **Inequitable World Export Share - 1999-2002: Articles XVI:1 and 3 of GATT 1994:** US subsidies provided from MY 1999-2002 contributed significantly to the United States having more than an equitable share of world export trade within the meaning of GATT Article XVI:3. The US share of world exports increased from 17.93 per cent in MY 1998 to 38.3 per cent in MY 2001 and increased further to 41.6 per cent in MY 2002. The causal link between the US subsidies and the increased US export market share is based on the evidence of production and export effects of US subsidies set out in the price suppression analysis. Professor Sumner concluded that *but for* the US subsidies US exports would be 41.2 per cent lower and US production would decline by 28.7 per cent on average between MY 1999-2002. The current US share of world exports of upland cotton is not “equitable” because producers from countries competing with the United States do not receive any or at most only small amounts of subsidies and have costs of productions are far lower than the United States. *But for* the effects of the US subsidies, these producers, including producers in Brazil, would have increased their share of the world export trade.

18. **Threat of Serious Prejudice:** Brazil’s second set of adverse effects claims involves the demonstration of a *threat* of serious prejudice under Article 5(c), 6.3(c), and 6.3(d) of the SCM Agreement and GATT Articles XVI:1 and 3. The record shows that five US subsidies – marketing loan payments, crop insurance subsidies, Step 2, CCP and direct payments – have no production or expenditure limitations and either no or at best no practical payment limitations. These unlimited subsidies are required to be paid by USDA and eligible US producers, users and exporters. These eligible recipients have an enforceable entitlement to receive the payments – regardless of the effect of US subsidies on the world upland cotton market. Based on the *EC – Sugar Exports* GATT panel decisions and the *US – FSC* Appellate Body decision, these facts support a finding of a threat of serious prejudice in the form of significant price suppression, increases in US world market share, and inequitable share of world export trade.

19. A threat of serious prejudice is confirmed by fact that the level of US subsidies has increased by up to 10 cents per pound between MY 2001 and 2002 with the passage of the 2002 FSRI Act. Having established *present* price suppression, increased world market share and inequitable share of world export trade, this evidence also confirms the existence of a *threat* of serious prejudice for MY 2003-2007. A University of Tennessee study predicts removal of the US subsidies will increase US prices by 11.4 per cent between 2003-2007. The IMF predicts that removal of US subsidies would increase world market prices by 25-30 per cent in the short term. Professor Sumner predicts that removal of US subsidies would increase world A-Index prices by 5.9 cents per pound, decrease US production by 4.5 million bales, and decrease exports by 4.4 million bales.

20. A threat of serious prejudice also exists because the US costs of production will increase between MY 2003-2007 with USDA and FAPRI not expecting the large cost-market revenue gap to decline significantly. The most recent FAPRI baseline suggests that marketing loan and CCP payments will be made throughout MY 2003-2007. Additional evidence of a threat of serious prejudice exists from USDA and FAPRI baselines (reflecting mandatory payments under the 2002 FSRI Act) that project that US acreage, production, and exports will continue at existing high levels given the existence of the US subsidies. The increasing export orientation of US production, as US domestic textile production declines, also increases the threat of significant price suppression, increased world market shares, and inequitable shares of world export trade.

21. The evidence demonstrates 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. The threat also exists for MY 2003 as recent USDA projections of 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.

22. **Per Se Challenges to 2002 FSRI Act and 2000 ARP Act:** Brazil also challenges certain provisions of the 2002 FSRI Act and the 2000 ARP Act – in as far as they relate to upland cotton – as *per se* violations of Articles 5(c), 6.3(c), 6.3(d) of the SCM Agreement and GATT Article XVI:3. In particular, Brazil challenges the mandatory provisions requiring the executive branch of the US Government to make marketing loan, Step 2 domestic and export, crop insurance, direct and counter-cyclical payments to eligible upland cotton producers, users and exporters. There is no statutory mechanism in any of the challenged statutes or regulations to limit the guaranteed payments when these payments cause serious prejudice or a threat of serious prejudice. The absence of any statutory upland cotton circuit breaker threatens to cause serious prejudice, including price suppression, increased US export and an inequitable US share of world upland cotton exports.

## ANNEX E-2

### EXECUTIVE SUMMARY OF THE FURTHER SUBMISSION OF THE UNITED STATES

1. **Brazil Has Failed to Demonstrate that Crop Insurance Payments Are “Specific”.** The United States reiterates that the subsidy to any agricultural producer is the premium subsidy paid by the US Government, which is common to all commodities at a chosen coverage level. Thus, Brazil’s repetition that certain policies are not available to all commodities is in part true but wholly irrelevant: the particular *policies* offered to growers of different commodities are issued by private insurers but the *subsidy* by the US Government on the premiums remains the same. Crop insurance subsidies are available to the US agricultural sector as a whole. It is the position of the United States (reflected in domestic law) that such a widely available subsidy does not satisfy the specificity requirement of Article 2. Thus, pursuant to Article 1.2 of the Subsidies Agreement, US crop insurance payments are not “subject to the provisions of . . . Part III” of the Subsidies Agreement, including Articles 5 and 6 on serious prejudice.

2. **Brazil Has Failed to Demonstrate that Challenged US Measures Caused the Decline in World Upland Cotton Prices Because It Simply Ignores Key Factors Behind Those Price Movements.** Brazil has failed to make a *prima facie* case on its claims on the basis of the mere assertion that large US outlays during marketing years with low prevailing upland cotton prices necessarily establishes causation. Brazil has failed to explain to the Panel key factors that affected world cotton markets during the marketing year 1999 - marketing year 2002 period. These factors and not US subsidies were the causes of the dramatic plunge in cotton prices experienced in recent years.

3. – **Persistent weakness in world demand for cotton due to competing, low-priced synthetic fibres and weak world economic growth.** The production of competing, synthetic fibres exploded during the 1990’s, putting downward pressure on world cotton prices. Asian countries added more polyester production capacity between 1991 and 2001 than existed in the entire world in 1990. Asian polyester prices remained below world cotton prices from 1990 to 2001. By 2002, cotton lost the position as the world’s dominant fibre and slipped below polyester’s market share. Consumer purchases outside the United States added over 40 million bales to textile fibre consumption since 1990 but virtually the entire amount was claimed by polyester. Consumers outside the United States buy no more cotton today than they did in 1990.

4. In addition to the price pressure from synthetic production, the world economy grew more slowly since 1997 than any time for many years. Clothing is a semi-durable good, and when income growth slows consumers cut back on current purchases, and postpone replacing clothing until incomes rise more rapidly. Cotton consumption can decline even while income growth remains positive. The 2001-2002 decline in world income occurred just as world cotton production was increasing because of good weather, severely pressuring world prices.

5. – **Burgeoning US textile imports, reflecting the strong US dollar and declining US competitiveness in textile and apparel production, have fundamentally shifted the disposition of US cotton production from domestic mills to export markets.** The United States has supported world cotton prices through its huge demand for cotton textiles and apparel. Imported textile and apparel products continue to displace US mill use of cotton fibre. From 1997 to 2002, US mill use of cotton dropped 32 per cent. For 2002, US cotton textile and apparel imports rose for the 14<sup>th</sup> consecutive year, while exports remained essentially unchanged for the fifth straight year. This huge

trade deficit in textiles and clothing has fundamentally changed the pattern of how US-grown cotton is used. As domestic mill use has fallen drastically, more US cotton has been available for use by foreign mills, which then comes back to the US in the form of cotton products.

6. – **China, the world's largest cotton producer and consumer, released 14 million bales of government stocks between 1999 and 2002, equalling as much as 7 per cent of world consumption in crop year 2000/01.** China's policies were strongly correlated to world cotton price movements through the late 1990's and early 2000's. Through the mid-1990's the Chinese Government was concerned with maintaining farmers' income and directed the state marketing organization to maintain cotton procurement prices at high levels, causing stocks to grow rapidly. At the beginning of the 1999/2000 marketing year, China announced a policy of auctioning cotton from these stockpiles, with the central government accepting the financial loss. China auctioned 11.6 million bales over August 1999 to July 2002 (3 million bales in 1999/2000, 6.5 million in 2000/01, and 2.1 million in 2001/02). Over the entire marketing year in 2000/01, China's auctions equalled 7 per cent of world consumption that year.

7. – **Factors Affecting US Cotton Production.** Cotton planting decisions are driven by numerous factors, including the expected price of cotton, prices of competing crops, farm programme benefits, technological factors and input costs. Contrary to Brazil's claims, US cotton producers have been responsive to world price movements and are not insulated from the world market. Changes in production technology can affect both the risk and the expected returns from cotton production. In recent years, the boll weevil eradication programmes and the introduction and adoption of genetically modified varieties of cotton have lowered production costs, increased yields, and increased net returns for US cotton production.<sup>1</sup>

8. Since 1994 there have only been 2 years when US harvested acres changed from one year to the next in a different fashion than growers in the rest of the world. Those 2 years, 1998 and 1999, are specific to severe drought in the United States. In 1998, US harvested area fell, largely due to disastrous conditions across much of Texas; in 1999, weather was more normal and US harvested acres increased by almost exactly the acres lost in the previous year.

9. In early calendar year 2000, the futures price for cotton had fallen from the previous year's level while corn and soybean prices had risen on the year. US and world cotton growers reduced harvested acreage from the level in 1999 by virtually identical proportions. While cotton harvest futures prices again declined on the year from 2000 to 2001, soybean and corn harvest futures prices fell by a greater per cent. As a result, US and world cotton growers saw an increase in cotton harvested acres in 2001. In considering planting in 2002, growers saw soybean and corn harvest futures prices showing greater percentage increases than cotton. Thus, both US growers and growers in the rest of the world saw harvested acres of cotton decline from the previous year's level.

10. **Brazil Has Not Established a *Prima Facie* Case With Respect to US Decoupled Income Support Measures Because These Measures Have No More than Minimal Effects.** With respect to US green box measures, namely direct payments under the 2002 Act and expired production flexibility contract payments under the 1996 Act, Annex 2 of the Agriculture Agreement makes clear that these payments have no, or at most minimal, trade-distorting effects or effects on production. Under Article 21.1 of the Agriculture Agreement, the Subsidies Agreement applies "subject to" the Agriculture Agreement. Accordingly, Annex 2 makes it clear that US green box measures do not

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<sup>1</sup> Studies indicate that the boll weevil eradication program has lowered the costs of producing cotton and has made cotton a more attractive cropping alternative. US producers have also rapidly expanded plantings of biotech cotton, rising from 25 per cent of plantings during the 1997 crop year, to an estimated 73 per cent of plantings in 2003. Studies suggest that biotech cotton has increased yields and net returns while decreasing pesticide use.

cause serious prejudice. Income payments that vary in amount with market prices, such as counter-cyclical payments under the 2002 Act and expired market loss assistance payments, are also decoupled in the sense of not being linked to current production. Because (according to the economic literature on decoupled payments) the effect on production is negligible, these payments can have no “effect” for purposes of Subsidies Agreement Article 6.3 nor operate to increase exports under GATT 1994 Article XVI:3.

11. Finally, because no production of upland cotton (or any other crop) is necessary to receive these payments, it would be erroneous to attribute to “upland cotton” or “upland cotton producers” all decoupled payments made with respect to upland cotton base acreage. Those acres may be planted to alternative crops or may be growing no crops at all. Accordingly, there is no basis to include those payments in an analysis of whether “subsidies provided to US producers, users and/or exporters of upland cotton” have caused serious prejudice.

12. **Brazil Has Failed to Demonstrate that Challenged US Measures Have Caused Serious Prejudice to Brazil’s Interests Within the Meaning of Article 5(c) and 6.3(c).** – **“Serious Prejudice ... May Arise”:** The introductory sentence of Article 6.3 establishes that serious prejudice “may arise” if “one or more” of four specific circumstances is found, indicating that serious prejudice need not arise even if they are found. As serious prejudice “may” arise if one or more of the four conditions under Article 6.3 are satisfied, Brazil must first show that *at least one* of those conditions is met. Second, if Brazil demonstrates one or more of the criteria in Article 6.3 is met, Brazil must then demonstrate “serious prejudice.” In this dispute, Brazil has not established that any prong of Article 6.3 is met.

13. – **The “Effect of the Subsidy”:** Brazil has not made a *prima facie* case that “the effect of the subsidy” was significant price suppression or depression. Brazil’s argument on causation fails because Brazil has simply not demonstrated the causal connection between the US measures and the price effects. Brazil has not even shown there is a necessary correlation between the measures and the effects it claims, let alone that there is a genuine and substantial link between the US measures and the effects claimed. Brazil has failed to separate and distinguish all the different effects from the various factors at play during the marketing year 1999 - marketing year 2002 period and has erroneously attributed to the US measures the effects of these other causes.

14. – **“Significant price suppression”.** The Agreement does not define “significant”. The ordinary meaning of significant is “important, notable; consequential,” which suggests that the price suppression must reach a level at which it is important, notable, and consequential in order to be inconsistent with Article 6.3(c). The United States further notes that the term “significant” modifies “price suppression or depression”; therefore, it is the effect on *prices* that must be “significant” and not the direct effect on *producers*, as Brazil argues.

15. Under Brazil’s interpretation price suppression would be significant at a level of even 1 cent per pound because this could still “meaningfully affect” producers. Brazil’s interpretation, however, collapses the concept of “significant price suppression or depression” with the concept of “serious prejudice”. It would also greatly expand the effect of Article 6.3(c), which falls under Part III of the Subsidies Agreement on “Actionable Subsidies” rather than Part II on “Prohibited Subsidies”, to encompass *any* subsidy with any production and therefore price effect. Members agreed, however, that any theoretical price effect would not suffice to satisfy Article 6.3(c); they accomplished this by stating that the price suppression or depression had to be “significant” in order to create a situation in which serious prejudice may arise.

16. Brazil’s theory would also create two sets of subsidy rules: one for widely traded products, such as most agricultural products, and another for more differentiated products. The more widely traded a product is, the more *any* price effect could be deemed to “meaningfully affect” producers.



There is no basis in the text of the Agreement for creating such a distinction. Where Members intended a particular rule to apply to a particular type of product – such as a “subsidized primary product or commodity” (Article 6.3(d)) – they said so explicitly.

17. – **“In the Same Market”:** Article 6.3(c) requires that the “significant price suppression [or] depression” that is the “effect of the subsidy” occur “in the same market”. The use of the same “in the same market” phrase as in the price undercutting portion of this Article suggests that the significant price suppression or depression must occur when “the subsidized product” is found “in the same market” as “a like product of another Member”. That is, “in the same market” is meant to require identification of a particular market in which price effects are alleged to have occurred so as to allow a comparison in that market. If a complaining party could merely assert price suppression or depression in the world market, the word “same” in the phrase “the same market” would be rendered inutile because the subsidized and non-subsidized products could always be deemed to be in the same “world market”.

18. – **Time Period for Demonstrating Causal Effects:** The “appropriate representative period” for demonstrating present serious prejudice will depend on the nature of the challenged subsidies. Normally, the most recent period for which data are available will be the appropriate period. In the case of recurring subsidies such as those under the 1996 Act and the 2002 Act, moreover, a past subsidy no longer exists as of the time a new subsidy payment in respect of current production is made and can have no “effect” within the meaning of Article 6.3. As a result, the period for which Brazil must demonstrate present serious prejudice is marketing year 2002. None of the provisions cited by Brazil, moreover, say that the effect of a subsidy 1, 2, or 3 years ago is presently being felt. Thus, at a minimum, the effect of the subsidy must be demonstrated in each year and for each year in which Brazil has alleged effects.

19. **Brazil Has Failed to Demonstrate that Challenged US Measures Have Caused Serious Prejudice to Brazil’s Interests Within the Meaning of Article 5(c) and 6.3(d) – “World Market Share”:** Contrary to Brazil’s interpretation, Article 6.3(d) does not use the phrase “world market for exports”; it uses the phrase “world market share . . . in a particular subsidized primary product or commodity”. This broad term would appear to encompass all consumption of upland cotton, including consumption by a country of its own cotton production. Context supports reading “world market share” as distinct from “world export share”. In fact, GATT 1994 Article XVI:3 uses the phrase “world export trade”, and Brazil interprets Article 6.3(d) and GATT 1994 Article XVI:3 both as applying to “world export trade”. Had Members intended that “world export trade” be the relevant concept to apply in Article 6.3(d), one would have expected use of that phrase. Because Brazil has misinterpreted “world market share”, and all of Brazil’s evidence goes to a comparison of the “world export share” of the United States, Brazil has failed to make a *prima facie* case.

20. – **Appropriate Time Period for Showing Present Serious Prejudice:** Brazil has limited its claim under Article 6.3(d) to “the increased US world market share for MY 2001”. Thus, there can be no finding that subsidies under the 2002 Act or marketing year 2002 subsidies presently cause serious prejudice. As the United States has previously noted, to demonstrate the “effect of the subsidy” it would normally be appropriate to look to the subsidy provided in the most recent year. Brazil has not explained why it challenges marketing year 2002 subsidies (in addition to 1999-2001) under Article 6.3(c) but only marketing year 2001 under Article 6.3(d). Brazil has stated that the 1996 Act introduced a new subsidy scheme; at a minimum, Brazil should demonstrate that in fact there is a “consistent trend” over a period when subsidies have been granted (1996-2001).

21. – **Causation: “The Effect of the Subsidy”:** Brazil has simply not demonstrated the causal connection between the US measures and the effects on world market share. As explained above, Brazil has failed to separate and distinguish other factors that drove prevailing upland cotton prices to historically low levels.

22. **Brazil Has Failed to Demonstrate any Inconsistency with GATT 1994 Article XVI:3 – "More than Equitable Share":** Brazil argues that in determining what is an "equitable" share, the Panel must look at what the US share of world export trade would have been in the absence of subsidies. Brazil cites to no textual basis for its approach, nor could it since the text does not contain one. There is nothing in Article XVI:3 that says that a Member is banned from using any subsidies, let alone that a Member is denied the ability to have any share in world markets if the Member employs subsidies. Any consideration of what is an "equitable" share needs to take into account the fact that Members are generally permitted to provide subsidies. However, any subsidy that has a production effect may increase exports; if so, according to Brazil, the resulting export share would be "inequitable". This interpretation would turn Article XVI:3 into a prohibition on subsidies that potentially could increase exports. Rather than imposing a prohibition, Article XVI:3 states only that Members "should seek to avoid" export subsidies on primary products, with additional conditions if inequitable shares result.

23. In considering the difficulties inherent in applying the "more than equitable world market share" language, the United States recalls the discussion of the Tokyo Round Subsidies Code panel on *Wheat Flour* on the "more than equitable world market share" language. The panel's enumeration of difficulties associated with this concept are the types of considerations that led to the negotiation of the Subsidies Agreement. Brazil now would have the Panel believe that these negotiations were unnecessary, that the disciplines it seeks were all in the language of Article XVI:3 all along. Brazil's approach is in error and should be rejected.

24. – **"Any Special Factors":** Brazil considers that one "special factor[]" that may be affecting trade or that may have affected trade is the low level or even absence of domestic support in other supplying countries. Again, Brazil's proposed rule would suggest that where no other Member were subsidizing (each because of its own sovereign choice not to use resources in that way), a Member would be prevented from subsidizing in any amount that results in increased exports. However, Article XVI does not contemplate a prohibition on agricultural subsidies, even on export subsidies: under Article XVI:3, Members "should seek to avoid" use of export subsidies on primary products. Therefore, "any special factors" should not be interpreted in a way that introduces a meaning that the provision itself avoids.

25. **Brazil Has Failed to Demonstrate a Threat of Serious Prejudice:** Brazil argues that there is no explicit standard for threat of serious prejudice in the Subsidies Agreement nor guidance in WTO reports. The United States considers that the first standard articulated by Brazil is incorrect. Brazil's proposed rule would seemingly transform Articles 5(c) and 6 from actionable subsidy provisions into prohibited subsidy provisions. That is, Brazil's approach would produce a threat determination wherever "subsidies by a large exporter have no effective production or export limitations". There is no such *per se* threat rule in the Subsidies Agreement, however; a finding of serious prejudice requires a fact-intensive demonstration.<sup>2</sup>

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<sup>2</sup> The United States also considers that this proposed standard has not been met by Brazil. First, as explained above, Brazil has not established a *prima facie* case of present serious prejudice, and therefore one cannot presume that there is a threat such prejudice will continue. Second, the Appellate Body report in *United States – FSC* cited by Brazil involved export subsidies under the Agriculture Agreement and a completely separate standard. Under the serious prejudice provision of the Subsidies Agreement, the question is the much more complicated issue of what is the clearly foreseen and imminent effect of measures on a Member's interests, which may depend on future market conditions, world prices, and other factors. Third, Brazil has not demonstrated that the challenged measures are mandatory in the sense that they must be given if an application is made. Even though the Department of Agriculture has the obligation to make such payments available, the obligation only attaches when certain market conditions prevail. Thus, to show that the threat of serious prejudice is (in Brazil's words) "real, clear, and imminent," Brazil would have to show predicted prices over the future period complained of (marketing years 2003-07) and the likelihood of that occurring.

26. The United States believes the second standard proposed by Brazil is correct. To demonstrate a threat of serious prejudice a complaining party must show a clearly foreseen and imminent likelihood of future serious prejudice. The use of the elements of serious prejudice set out in Article 6.3 ensures that a complaining party come forward with sufficient credible evidence.<sup>3</sup>

27. – **Threat of Serious Prejudice Via Price Suppression:** In addition to the reasons just given, the United States notes that price developments over the past several months and expected price movements do not support a conclusion of a clearly foreseen and imminent likelihood of future serious prejudice. Brazil claims that “[b]ase[d] on MY 2002 prices, current prices in August 2003 and price levels projected by FAPRI’s baseline, it is likely that marketing loan and CCP payments will be made during MY2003-2007”. However, current market and futures prices (not reflected in Brazil’s submission) already indicate that the baseline projection of low prices is wrong.<sup>4</sup> Thus, current prices and futures prices do not suggest any clearly foreseen and imminent likelihood of future serious prejudice.

28. **Threat of Serious Prejudice Via Price Suppression:** Brazil again reads “world market share” in Article 6.3(d) as the equivalent of “world export share”. Thus, Brazil’s threat analysis is wrong for the same reason as its serious prejudice analysis, and Brazil has not established a *prima facie* case of threat of serious prejudice under Article 6.3(d).

29. **GATT 1994 Articles XVI:1 and XVI:3.** Brazil asserts that the 2002 Act and 2000 Agricultural Risk Protection Act threaten a high and inequitable share of world exports between MY2003-07. Brazil nowhere cites the text of GATT 1994 Article XVI:3 (or of the Subsidies Agreement) that would support the notion that there is a valid cause of action for “threat” of a “more than equitable share of world export trade”. In the absence of any text relating to Article XVI:3, Brazil’s claim of a “threat” of a “more than equitable share” must be rejected.

30. **Brazil Has Failed to Demonstrate that Challenged US Measures Are *Per Se* Inconsistent with US WTO Obligations.** Brazil argues that the marketing loan, counter-cyclical, direct, and step 2 payments as well as the crop insurance subsidies are *per se* inconsistent with US WTO obligations because they threaten to cause serious prejudice at price levels that require the payment of marketing loan and CCP payments (that is, below 52 cents per pound). For all the reasons set out with respect to Brazil’s present serious prejudice claims and its threat of serious prejudice claims, Brazil’s argument is in error.

31. Brazil also argues that even at high price levels where only direct payments and crop insurance payments would be made, there is necessarily a threat of serious prejudice because these payments necessarily will keep marginal land in production because producers face no down-side revenue risk. Brazil has presented no evidence on the extent of any alleged effect of these two subsidies in keeping marginal production on-line at a time of high prices (as the market currently expects). Second, that some marginal lands may be kept in production cannot alone suffice to

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<sup>3</sup> A similar concern is addressed for purposes of threat of material injury in countervailing duty investigations by Subsidies Agreement Article 15.7; under this article, “[t]he change in circumstances which would create a situation in which the subsidy would cause injury must be clearly foreseen and imminent.” We note the relationship between threat of serious prejudice and threat of material injury, both of which make up part of adverse effects under Article 5.

<sup>4</sup> Instead of continued low prices, the A-Index *average* for September 2003 has risen to 64.06 cents per pound. New York Cotton Exchange futures prices demonstrate that market participants expect cotton prices to climb even further through the 2003 marketing year, strengthening beyond their 20-year average of 67.86 cents per pound (1983-2002) within the current 2003 marketing year. In fact, if cotton prices reach the levels (over 70 cents per pound) indicated by the futures market, prices would be very close to what Brazil calculates as the A-index average (74 cents per pound) for the period *before* Brazil alleges serious prejudice.

demonstrate a *per se* threat of serious prejudice. Otherwise, any subsidy with any production effect would be found to pose a threat, transforming actionable subsidies into prohibited subsidies. Thus, Brazil has not demonstrated that these subsidies *per se* present a real, clear, and imminent threat of serious prejudice.

32. **Export Credit Guarantees – The Negotiating History of Article 10.2 Reveals that the Negotiators Explicitly Deferred the Application of All Export Subsidy Disciplines on Export Credit Guarantees:** The negotiating history of Article 10.2 of the Agreement on Agriculture reveals the explicit deferral by the drafters of the application of export subsidy disciplines on export credit guarantees. In particular, the plain difference between the language of the Draft Final Act and that of Article 10.2 shows that the negotiators specifically opted not to impose the disciplines that Brazil now seeks to impose through litigation. The earlier version was an unambiguous prohibition, unless permitted under internationally agreed disciplines. The latter – and current – version imposes no such prohibition. It only requires Members to work toward the development of yet-to-be-agreed disciplines, and only upon agreement on such disciplines are export credit guarantee programmes required to adhere to them.

33. Brazil's interpretation of Article 10.2 would require export credit guarantees in agriculture to be subject to more disciplines than any other practice addressed in the Agreement on Agriculture. Under Brazil's view, not only would export credit guarantees constitute export subsidies and be subject to all of the export subsidy disciplines, but Members would *also* be specifically obligated to work toward and then apply additional disciplines. Brazil's argument would require an interpretation that the negotiators viewed export credits, credit guarantees, and insurance programmes as more malign than the recognized export subsidies themselves. This implausible conclusion is nowhere manifest in the text of the negotiating history.

34. To the contrary, the text indicates that export credits, credit guarantees, and insurance programmes were not considered export subsidies, because they were explicitly excluded from Article 9.1 of the Agreement on Agriculture, despite their inclusion in negotiating documents culminating in the current text. Brazil argues that the same is true of "[e]xport performance-related taxation concessions or incentives other than the remission of indirect taxes", and yet the Appellate Body has ruled the FSC and ETI measures are subject to the export subsidy disciplines of the Agreement on Agriculture. With respect to those measures, however, no provision like Article 10.2 exists. Export credits, credit guarantees, and insurance programmes were not only removed from the illustrative list evident in Article 9.1 but received the explicit commitment to negotiate disciplines set forth in Article 10.2.

35. – **The Application of Government-Wide Accounting Rules under the Federal Credit Reform Act Indicates that the Export Credit Guarantee Programmes are Covering Long-Term Operating Costs and Losses:** The United States has demonstrated that over time, as indicated by the government-wide accounting rules mandated under the Credit Reform Act, with respect to those years for which nearly complete experiential data is available, programme revenues exceed operating costs and losses. In those years for which the accounting books are nearest to closing (1994 and 1995), the operation of the programme shows a profit. Similarly, current data for 1992, 1993, 1996, and 1999 also indicate a profit. All of this data is on a cohort-specific basis, a methodology with which Brazil agrees.<sup>5</sup>

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<sup>5</sup> Brazil misapplies the cohort-specific accounting methodology, however, to erroneously argue that "when [the] total lifetime reestimates for all cohorts of guarantees disbursed since 1992 are netted against the total *original* subsidy estimates adopted each budget year during the period 1992-2002, *the resulting loss is nearly \$1.75 billion*". To arrive at this fanciful figure Brazil begins not with the estimates based on the "actual" level of guarantees issued, but rather with the original subsidy estimate in the budget year, well before virtually any activity in the programmes has occurred in that fiscal year. The "actual" figure is simply a reflection of the

36. The United States has repeatedly noted that CCC has complete discretion at any time not to issue guarantees with respect to any individual application for an export credit guarantee or to suspend the issuance of export credit guarantees under any particular allocation. In addition, the authorizing statute prohibits CCC from making credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary of Agriculture determines cannot adequately service the debt associated with such sale. Third, availability of export credit guarantees is governed by allocations in effect at any one time for specific commodities and specific destinations. Fourth, the ability of CCC to issue guarantees is constrained by the apportionment process of the President's Office of Management and Budget.

37. – **Forfeiting is Analogous to the CCC Export Credit Guarantee Programmes:** Brazil's argument that forfeiting transactions and CCC export credit guarantee transactions are dissimilar illustrates the comparability of the financing available in these transactions. As Brazil points out, in both cases "the exporter wants to get paid immediately on a cash basis, and the importer wants credit that it can repay on a deferred basis". From the importer's perspective, the export credit guarantee transactions are *less* favourable than forfeiting, because although the importer's bank can repay its obligation over time, the CCC has no control over the terms of the arrangement between the importer and its bank, which may not extend the deferred payment terms to the importer. In forfeiting, the importer "can repay on a deferred basis". In both cases, the transaction (in Brazil's words) "enables the exporter to convert a credit sale into a cash sale." Brazil recognizes that as the complaining party it carries the burden of demonstrating that a "benefit" is conferred with respect to the GSM-102 programme. Brazil has failed to carry this burden.

38. **The Step 2 Programme Does Not Violate Article 3.1(b) of the Subsidies Agreement or Article III:4 of GATT 1994:** Brazil has rotundly stated: "There are no circumstances in which a 'local content subsidy' would comply with Article 3.1(b)". In effect, Brazil's argument would delete the application of the introductory clause of Article 3 to Article 3.1(b) entirely. But the phrase "except as provided in the Agreement on Agriculture" by its terms applies to both export subsidies under Article 3.1(a) and local content subsidies under Article 3.1(b).

39. Brazil would require the Step 2 programme to permit payments for the use of all cotton, whether domestic or imported, but only payments for domestic cotton would be included in the AMS. Such a programme would no longer be in favour of domestic producers. The Step 2 programme provides a benefit to producers because it serves to maintain the price competitiveness of US cotton vis-a-vis foreign cotton through a payment to capture some differential between prevailing foreign and domestic cotton prices. Brazil's hypothetical programme would cause the benefit to US producers to evaporate. Rather than a subsidy "in favour of agricultural producers", the programme would become a simple input subsidy in favour of textile manufacturers outside the coverage of the Agreement on Agriculture altogether. Brazil's interpretation would render Paragraph 3 of Annex 7 of the Agreement on Agriculture inutile.

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actual level of guarantees issued in the particular fiscal year. The original subsidy estimate, in contrast, begins with what is an historically overly optimistic projection of actual use of the programme and then is required to use the government-wide estimation rules without regard to the actual experience specific to the CCC export credit guarantee programmes.

Actual guarantee issuance can first be reflected only in the budget two fiscal years after the original subsidy estimate. Once the actual use of the program is determined all subsequent reestimates are based on that figure, not on the original subsidy estimate. Other than with respect to interest (because of independent market forces), a downward reestimate never occurs based on the original subsidy estimate. It only occurs subsequent to establishment of the actual program use. Consequently, it is wholly inappropriate to calculate net reestimates based on the original subsidy estimate for a particular cohort, as Brazil has done. For these reasons, the United States' calculation indicating increasing profitability within the program is accurate, and the Brazilian calculation is not.

40. Brazil argues that since the Peace Clause provisions for domestic subsidies do not reference Article 3, the Agreement on Agriculture envisioned that local content subsidies would be prohibited. Brazil's conclusion does not necessarily follow from the structure of the text. Indeed, a contrary conclusion is more appropriate. Article 13(b) does not refer to Subsidies Agreement Article 3 because the substantive obligation of Article 3.1(b) does not apply in the case of domestic content subsidies in favour of agricultural producers. Article 13(b) applies to "domestic support measures that conform fully to the provisions of Article 6 of this Agreement". The character of the domestic subsidy is not relevant to the disciplines. The Agriculture Agreement never defines "domestic support", which is permitted in any form so long as the Member adheres to its reduction commitments.

## ANNEX E-3

### SECOND WRITTEN THIRD-PARTY SUBMISSION BY ARGENTINA

3 October 2003

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#### **I. INTRODUCTION**

1. Argentina thanks the Panel for the renewed opportunity to present its views as a third party to these proceedings.

2. Argentina reaffirms the arguments put forward in its written Third-Party Submission and at the meeting of the Panel with the third parties, of 15 and 24 July respectively. It accordingly reiterates its position that the United States has no basis for claiming protection under Article 13 of the Agreement on Agriculture (AoA) and that the US subsidies are therefore actionable under Article XVI of the GATT 1994 and Articles 3, 5 and 6 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement). Argentina further reiterates that the US cotton export subsidies are inconsistent with Articles 3.3, 8 and 10.1 of the AoA and constitute prohibited subsidies within the meaning of Article 3.1(a) and (b) and 3.2 of the SCM Agreement.

3. Argentina will now address the claims put forward by Brazil in its recent Further Submission dated 9 September, regarding the inconsistency of the US cotton subsidies<sup>1</sup> with Articles 5(c) and 6.3(c) and (d) of the SCM Agreement to the extent that, in the case of the subsidies provided in marketing years (MY) 1999-2002, they cause serious prejudice to the interests of other Members, including Argentina. Argentina further proposes to argue that such subsidies threaten to cause serious prejudice<sup>2</sup> in MY 2003-2007.

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<sup>1</sup> The US subsidies the consistency of which is being challenged include both the domestic support measures and the prohibited subsidies and export credit guarantee programme cited at paragraph 7 of Brazil's Further Submission to the Panel of 9 September 2003.

<sup>2</sup> Within the meaning footnote 13 of the SCM Agreement.

4. Given the little time available between the receipt on 30 September of the responding party submission of the United States and the date fixed for this third-party submission, Argentina will comment on the US submission at the meeting of the Panel with the parties and third parties scheduled on 8 October next.

## II. IMPACT OF THE US SUBSIDIES ON THE WORLD COTTON MARKET SITUATION

5. In the first line of the Introduction to its Further Submission of 9 September, Brazil points out that this is a case involving basic economic principles of supply and demand. Indeed, according to the basic principles of a market economy, in an open market prices would follow the costs of the more efficient producers. Thus, higher-cost (i.e. less efficient) producers are gradually compelled to reduce production. In the world cotton market, however, these principles are turned on their head: many highly efficient global producers have been cutting production, while the less efficient US producers are insulated from changes in market prices. Worse still, there is an inverse relationship between the world price of cotton and US production.

6. In the words of US Senator Fred Thompson,

*"These policies defy logic and they defy the most basic laws of economics. The result is that farmers know that they are guaranteed to receive a certain price regardless of market conditions, so they ignore market signals and overproduce. The overproduction further depresses commodity prices, leading to the need for ever increasing government subsidies".<sup>3</sup>*

7. Argentina already emphasized this point in the consultations held in December of last year when it addressed the following questions, *inter alia*, to the United States:

*Could the US explain the reasons behind the fact that in 2001 -fifth year of falling prices- US cotton producers did obtain a record harvest of 20.3 million tons -an increase of 42 per cent compared to 1998- and that the cotton planted area did increase 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 in investment-, and at the same time estimates for this year another record harvest in the U.S. -the fourth biggest ever recorded-?*

*Could the US please explain the reasons for the increase in the volume of US exports from 946,000 tons in 1998 to 1.8 million tons in 2001, while there is a drop in the international prices?*

*According to international standards, the US is not a low-cost producer<sup>4</sup>. Additionally, US productivity levels are lower than those of other exporting countries<sup>5</sup>. However, while international prices fell about 54 per cent since the mid-1990s, the US did expand its cotton area and did increase the production: Could the*

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<sup>3</sup> Exhibit Bra-200 (Congressional Record 107th Congress, Senate) S3990; Brazil's Further Submission, 9 September 2003, Section 4.9.

<sup>4</sup> The USDA estimates the average production cost in the USA at about US\$0.73 per pound. Nevertheless, one third of its production has higher production costs. On the other hand, the average production cost in Burkina Faso, for instance, is US\$0.21 per pound (Data from *International Cotton Advisory Committee, "Survey of the Cost of Production of Raw Cotton", 2001*).

<sup>5</sup> About 20 per cent lower than in Brazil or China, for instance.



*US please explain the lack of correlation between world price for cotton and US production?*

8. At the time, the United States' only response to Argentina's questions was that production was affected by a multiplicity of factors, including the development of fibres, biotechnology, demand, quality, technical progress, the price of inputs, and so forth, without in any way explaining how it could achieve such expansion amidst such a spectacular fall in international cotton prices and high domestic production costs.

9. In this respect, Argentina has already extensively discussed the impact of the decline in international cotton prices on its own cotton economy. As already mentioned, since 1997/98 slumping international prices and increased US government support have consistently driven cotton producer prices down, which in turn has entailed ongoing reductions in cultivated acreage and production.<sup>6</sup>

10. As Argentina stated at the 61<sup>st</sup> Plenary Meeting of the International Cotton Advisory Committee<sup>7</sup> (ICAC), planted and harvested acreage in MY 2001/02 plummeted to its lowest level since MY 1933/34 – that is, the lowest in the past 68 years – as a result of the continuing fall in international prices.

11. Argentina believes that without the subsidies granted by the United States to its cotton sector, U.S. cultivated acreage and production would diminish, as would US exports, and that there would be an ensuing rise in international prices.

12. Argentina further believes that if the United States – being one of the world's leading suppliers – had not increased its world market share as a result of the subsidies, the international price of cotton would have been higher, and hence third-country producers, including in Argentina, would not have been so adversely affected by artificially depressed prices.

13. The following table shows the steady increase in US cotton exports since 1995, whereas Argentina's cotton exports have been shrinking in a general context of declining world cotton prices, as discussed in paragraphs 23 to 25 below.

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<sup>6</sup> Since 1997/98, cultivated acreage has in fact shrunk by 76 per cent, with 174,000 hectares planted to cotton, and production by 63 per cent, with an estimated 73,000 tons of fibre produced. *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.

<sup>7</sup> Held in Cairo, Egypt, from 20 to 25 October 2002.

Marketing Year	US Exports (in 1,000 metric tons)	Argentine Exports (in 1,000 metric tons)
1995/96	1,671	274
1996/97	1,495	269
1997/98	1,633	202
1998/99	946	213
1999/00	1,481	70
2000/01	1,467	97
2001/02	2,395	51
2002/03*	2,351	6

\* Estimate.

Source: ICAC and *Instituto Nacional de Estadística y Censos* (INDEC) (National Institute of Statistics and Censuses).

### III. INCONSISTENCY WITH ARTICLES 5(C) AND 6.3(C) AND (D) OF THE SCM AGREEMENT

#### III.1 ARTICLE 5(C) OF THE SCM AGREEMENT

14. Argentina contends that the United States has failed to meet its obligations under Article 5(c) of the SCM Agreement, which stipulates that "[n]o Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.: ... serious prejudice to the interests of another Member...".

15. In fact Argentina contends that through the granting of subsidies – understood in the sense of paragraphs 1 and 2 of Article 1 of the SCM Agreement<sup>8</sup> – the United States has caused and is threatening to cause serious prejudice to the interests of other Members, including Argentina.

#### III.2 ARTICLE 6.3(C) OF THE SCM AGREEMENT

16. Article 6.3(c) establishes that "[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where... the effect of the subsidy is a significant... price suppression, price depression...".

17. Thus, the existence and threat of serious prejudice to the interests of other Members – including Argentina – is based on the fact that, as established in Article 6.3(c) of the SCM Agreement, the effect of the subsidies provided by the United States to its cotton sector is and will be significant suppression and depression of international cotton prices.

18. Argentina fully concurs with Brazil that the sheer magnitude and percentage of U.S. cotton subsidization suggests a *de facto* presumption that the cotton subsidies are the decisive factor for the high levels of US production and exports as well as the low international cotton prices.<sup>9</sup> Argentina emphasizes that such was precisely the presumption implicit in its questions to the United States during the consultations. (See paragraphs 7 and 8 above.)

<sup>8</sup> As Brazil demonstrates in Section 3.2 of its Further Submission of 9 September 2003.

<sup>9</sup> On the basis of information in the USDA's *Fact Sheet: Upland Cotton*, January 2003, Exhibit Bra-4, Brazil points out that the total amount of US cotton subsidies was nearly US\$13 billion, with an average subsidization rate of 95 per cent. Brazil's Further Submission, 9 September 2003, Section 3.3.4.1.

19. Argentina also agrees that there is a strong temporal link between the increase in the US subsidies over the MY 1999-2002 period and the significant suppression and depression of international cotton prices during that period.<sup>10</sup>

20. Argentina believes that but for the US subsidies international cotton prices would have been higher in MY 1999-2002. By stimulating US cotton production<sup>11</sup> and exports, the subsidies drove international prices down through excess, low-priced US supply – not in fact generated by efficient low-cost production but precisely thanks to the distorting effect of the subsidies.

21. It should be noted in this respect that Argentina (like or perhaps to an even greater extent than Brazil) is a "price-taker" in the world cotton market, which is heavily influenced by the enormous US subsidies that generate a growing world supply.

22. It should also be emphasized that the price movements of US, Cotlook "A" Index and third country (e.g. Brazilian and Argentine) market prices are directly interconnected. US – as indeed Brazilian – cotton forms part of Cotlook's "A" Index "basket". Likewise, US – as indeed Brazilian and Argentine – cotton forms part of Cotlook's "B" Index "basket".<sup>12</sup> Moreover, US, Brazilian and Argentine cotton are varieties of the same species, namely *Gossypium hirsutum*.

23. As in the Brazilian market, domestic price quotes for cotton have suffered a significant downturn.

24. The table below shows the direct relationship between the decline in the "A" Index world price of cotton and the drop in the domestic price quotes for cotton issued by the *Cámara Algodonera Argentina* (CAA) for the MY 1995/96-2001/02 period (in US cents/lb):

Marketing Year	"A" Index World Price*	CAA Price Quote**
1995/96	0.86	0.72
1996/97	0.79	0.69
1997/98	0.72	0.65
1998/99	0.59	0.55
1999/00	0.53	0.54
2000/01	0.57	0.49
2001/02	0.42	0.37

\* CIF Northern European ports

\*\* FREE MILL, grade C 1/2

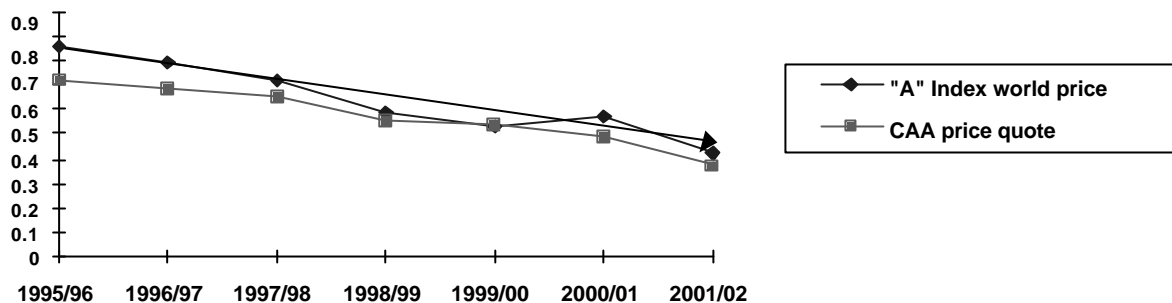
25. The following chart clearly shows the trends in the "A" Index world price of cotton and the domestic price quotes for cotton in recent years:

<sup>10</sup> Brazil's Further Submission, 9 September 2003, Section 3.3.4.2.

<sup>11</sup> Argentina agrees with Brazil (Section 3.3.4.7.7) that without the additional income provided by the subsidies granted by the US to its cotton farmers, acreage devoted to cotton would have been, and would be, much smaller, since US cotton production costs are among the highest in the world. (See Third-Party Submission by Argentina, 15 July 2003, para. 17.)

<sup>12</sup> In addition, the average values of national standards for the technical characteristics of Argentine cotton fibre show that the length, strength and micronaire value of the fibre are considered in the median range at international level.

26. The similarity in the trends in world prices and domestic price quotes for cotton further



supports Brazil's point<sup>13</sup> that the US subsidies have a suppressing and depressing effect on international cotton prices. In other words, in the absence of US subsidies that generate excess global supply, international cotton prices would have been higher, as would the domestic price quotes for cotton in Argentina, which are entirely influenced by the former.

27. To an even greater extent than Brazil because of the smaller scale of its cotton economy, Argentina is basically a "price-taker" in the international cotton market, unlike the United States, which, given the size and global impact of the US cotton market and its 41.6 per cent world market share, is the international market "price-setter" *par excellence*.

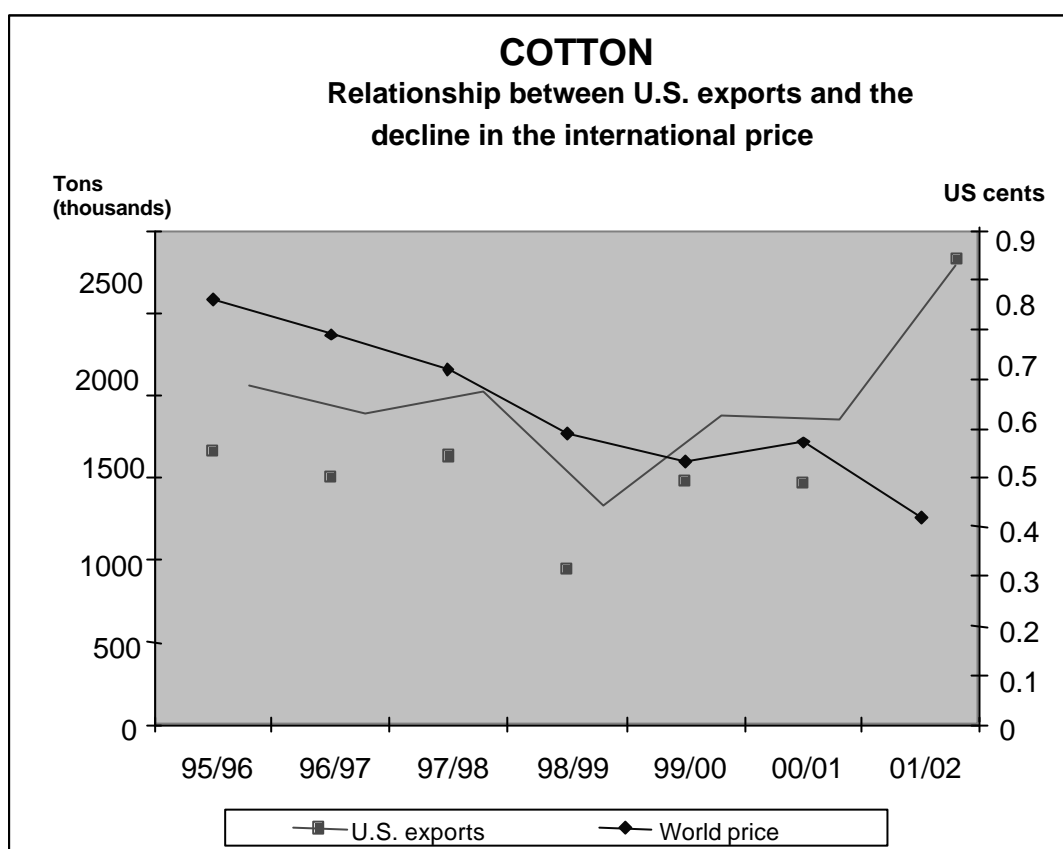
28. In concrete terms, the amount of the US cotton subsidies and the scale of US production and exports are decisive when it comes to determining the extent to which the subsidies impact the fixing of both international and third market prices.

29. As economic theory would suggest and Brazil points out, increased supplies of US cotton in the world market tend to lower international prices since demand remains relatively inelastic.<sup>14</sup>

30. The chart below illustrates the relationship between US cotton exports and the international price of cotton:

<sup>13</sup> Brazil's Further Submission, 9 September 2003, Section 3.3.4.2.

<sup>14</sup> Brazil's Further Submission, 9 September 2003, Section 3.3.4.6; Exhibit Bra-I, para.22.



31. According to a study carried out by the Brazilian National Cotton Exporters' Association (ANEA),<sup>15</sup> the impact of the US subsidies is one of the reasons why cotton production in Argentina has dropped by more than 60 per cent.

32. The study reinforces Brazil's view that an increase in the world price of cotton would enable least-developed and developing countries such as Argentina, Brazil, Benin, Burkina Faso and Chad, *inter alia*, to recover the historically competitive position they enjoyed in the international market.

33. As Argentina indicated previously, the present collapse of the Argentine cotton sector is reflected in the extremely high level of indebtedness of producers, estimated at US\$600 million and equivalent to twice the size of agricultural GDP of Chaco Province, the country's largest cotton producing region, which accounts for between 60 and 65 per cent of domestic cotton production.<sup>16</sup>

34. As regards the effects of the US subsidies on the international price of cotton, Argentina considers that the number and quality of the empirical and econometric analyses presented by Brazil, which were carried out by both international organizations and various prestigious US economic research institutions such as the USDA, provide irrefutable evidence of the *collective* and *individual* effects of each subsidy programme on the price of cotton.

<sup>15</sup> *Características del Mercado Mundial de Algodón* (Features of the World Cotton Market), ANEA, 15 February 2002.

<sup>16</sup> Third-Party Submission by Argentina, 15 July 2003, para. 28.

35. Argentina agrees with the conclusions reached by various studies presented by Brazil in its *Further Submission*<sup>17</sup> and repeats that an increase in the world price of cotton would enable countries such as Brazil and Argentina to recover their competitive position in the world cotton market.

36. Over and above any endorsement that may be given to the conclusions of any one of those studies (and each study's estimate of the price effect of the subsidies), Argentina emphasizes Brazil's point<sup>18</sup> that the suppressing and depressing effect on international cotton prices is significant, even if international prices were to decrease by only 1 cent per pound, for even such a level of decline implies highly prejudicial consequences for the cotton economies of many countries, including Argentina.

### III.3 ARTICLE 6.3(D) OF THE SCM AGREEMENT

37. The existence and threat of serious prejudice to the interests of other Members, including Argentina, is also based on the following provision of the SCM Agreement:

Article 6.3      *"Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:*

...

*(d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted."*

38. As regards the serious prejudice claim, Argentina proposes on the one hand to refer to the U.S. levels of domestic support for cotton, as detailed at paragraph 64 of Argentina's first Third-Party Submission of 15 July 2003. Thus, the US budgetary outlays for support for the cotton sector in marketing years 1999 to 2002 were US\$3.445 million, 2.311 million, 4.093 million and 3.113 million respectively, according to data supplied by the USDA.<sup>19</sup>

39. Such being the US levels of domestic support for cotton, Argentina will now give the US level of cotton exports over that same period, in order to demonstrate that the effect of the subsidies has been to increase the US world export market share for cotton.

40. The US level of cotton exports in recent years – according to data drawn from a USDA report other than the documents on which Brazil based its Article 6.3(d) claim<sup>20</sup> – is as follows:

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<sup>17</sup> Brazil's Further Submission, 9 September 2003, Section 3.3.4.8.1.

<sup>18</sup> Brazil's Further Submission, 9 September 2003, Section 3.3.5.

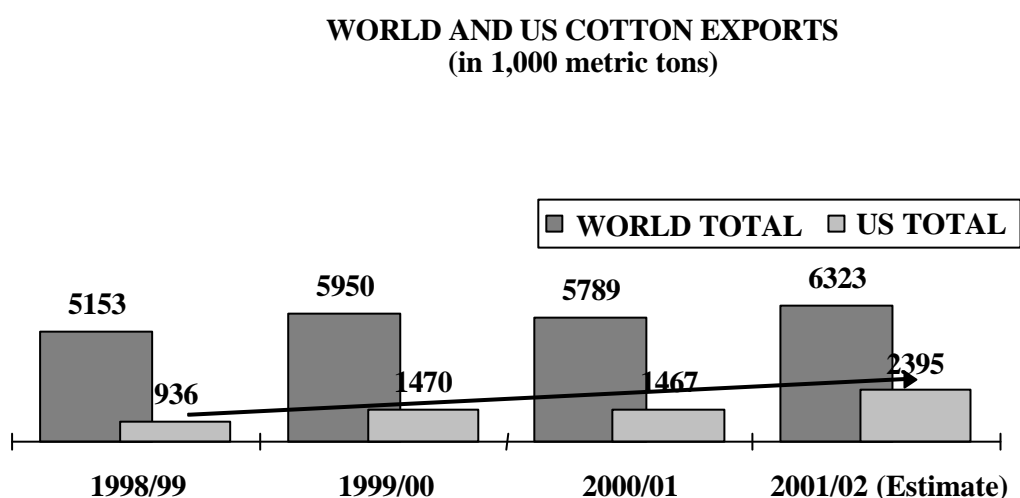
<sup>19</sup> See Exhibits Bra-6, Bra-76, Bra-4, Bra-57, Bra-55, Bra-47, and footnotes 301 and 321. The budgetary outlays for US cotton export credits and credit guarantees have not been taken into account.

<sup>20</sup> *Cotton: World Markets and Trade*, USDA, March 2003, Table 1 (<http://www.fas.usda.gov/export-sales/esrd1.html>).

**COTTON EXPORTS**  
(in 1,000 metric tons)

	1998/99	1999/00	2000/01	2001/02 (Estimate)
<b>WORLD TOTAL</b>	5,153	5,950	5,789	6,323
<b>US TOTAL</b>	936	1,470	1,467	2,395
<b>US WORLD SHARE (percentage)</b>	<b>18.16</b>	<b>24.70</b>	<b>25.34</b>	<b>37.87</b>

41. In chart form, the US share of world cotton exports is as follows:



42. Argentina thus contends that there has been an increase in the world market share of the United States as compared to the average share it had during the previous period of three years and that this increase has followed a consistent trend over a period when the subsidies have been granted, since the average world market share of the United States was 22.73 per cent between 1998/99 and 2000/01 and 37.87 per cent in MY 2001/02, recording **a more than 15 percentage point increase** over the average share during the immediately preceding three-year period.

43. In conclusion, Argentina asserts that, in the absence of subsidies, US cotton production would naturally have been lower than that actually recorded and consequently the volume of US exports and ultimately the impact of the US world market share would also have been smaller.

#### III.4 THREAT OF SERIOUS PREJUDICE: ARTICLE 6.3(C) AND (D)

44. Having established the existing serious prejudice caused by the US cotton subsidies, Argentina agrees with Brazil that the threat of serious prejudice is clearly foreseeable and imminent because of the effects of the even larger subsidies provided under US legislation for the MY 2003 2007 period.

45. As discussed in detail by Brazil,<sup>21</sup> the *marketing loan payments*, *crop insurance subsidies*, *CCP*, *direct payments* and *Step 2 Payments* programmes are mandatory in terms of the US budget for the MY 2003-2007 period, with no limitations on the volume of production and exports or on budgetary expenditure for cotton.

46. By way of example that confirms the above, and subsequently to Brazil's Further Submission, the USDA announced on 17 September 2003 that it would begin issuing counter-cyclical payments for final 2002-crop cotton.<sup>22</sup> The counter-cyclical payment rate for cotton is US\$303.09/ton. This is the amount by which the *target price* (US\$1,596.1/ton<sup>23</sup>) exceeds the *effective price* (the national average market price producers received or the *loan rate* – whichever is higher).

As can be seen from the table below, these payments represent a major portion of the price.

	Current price (US\$/t)	Counter-cyclical payment rate (US\$/t)	Percentage (counter- cyclical payments)
<b>Cotton</b>	1,235	303.09	24.54%

47. Counter-cyclical payments for 2002-crop cotton are at their maximum levels because of this season's low market prices. In other words, the reason why counter-cyclical payments are so high is because this MY's prices are very low. The fact that the target price is maintained regardless of market price fluctuations confirms Argentina's point that US producers are insulated from such changes in market prices (see paragraph 5 above).

48. Argentina contends that this guaranteed flow of subsidies will undoubtedly 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 world market share for cotton, thus creating a source of permanent uncertainty that confirms the threat of serious prejudice generated by the subsidies.

49. Moreover, Argentina also agrees with Brazil<sup>24</sup> that the link between the 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 U.S. producers to bridge the gap between market prices and their total production costs. This will enable U.S. producers to continue competing with more efficient third-country producers, especially considering that the USDA forecasts an increase in total production costs.<sup>25</sup>

## II. CONCLUSION

50. In view of the foregoing, Argentina considers that the subsidies granted by the United States to the US cotton sector over the MY 1999-2002 period have caused and still cause serious prejudice to the interests of other Members, including Argentina, in that:

<sup>21</sup> Brazil's Further Submission, 9 September 2003, Section 4.2.

<sup>22</sup> USDA Release: *USDA ISSUES FINAL 2002-CROP UPLAND COTTON, RICE AND PEANUT COUNTER-CYCLICAL PAYMENTS*.

<sup>23</sup> *Monitoring and Evaluation 2003*, OECD.

<sup>24</sup> Brazil's Further Submission, 9 September 2003, Section 4.5.

<sup>25</sup> See Exhibits 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).



- They have a significant suppressing or depressing effect on international cotton prices, within the meaning of Articles 5(c) and 6.3(c) of the SCM Agreement; and
- they have the effect of increasing the U.S. world market share for cotton, within the meaning of Articles 5(c) and 6.3(d) of the SCM Agreement.

51. Furthermore, Argentina considers that the subsidies provided under US legislation for the MY 2003-2007 period threaten to cause serious prejudice to the interests of other Members, including Argentina, insofar as:

- they will have a significant suppressing or depressing effect on international cotton prices, within the meaning of Article 5(c), its footnote 13, and Article 6.3(c) of the SCM Agreement; and
- they will have the effect of increasing the US world market share for cotton, within the meaning of Article 5(c), its footnote 13 and Article 6.3(d) of the SCM Agreement.

52. Argentina accordingly requests the Panel to find that the aforementioned subsidies granted by the United States to the US cotton sector are inconsistent with Articles 5(c) and 6.3(c) and (d) of the SCM Agreement.

## **ANNEX E-4**

### **FURTHER THIRD PARTY SUBMISSION OF BENIN THIRD PARTY SUBMISSION OF CHAD**

3 October 2003

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## **I. INTRODUCTION**

1. This dispute marks the first time that either Benin or Chad – two least-developed, sub-Saharan African countries – have participated in a WTO dispute. Benin and Chad have taken this unprecedented step in response to the serious threat posed to their economic and social stability by massive, WTO-inconsistent US subsidies on upland cotton.

2. As indicated below, subsidies provided by the United States to its relatively small and prosperous group of cotton farmers exceed the gross national income of Benin, Chad, and every other country in the West African region.

3. Cotton plays a critical role in the economic development of West Africa. The cotton farmers of the region are highly vulnerable to changes in the world price of cotton. These small, subsistence farmers have no ability to influence the international cotton market – they are “price takers”, not “price makers”.

4. When US subsidies cause or contribute to a dramatic fall in world prices, the consequences for Africa are severe: hundreds of thousands of people are pushed from basic subsistence living to stark poverty.

## **II. SERIOUS PREJUDICE UNDER THE SCM AGREEMENT**

5. US subsidies have caused, and are causing, adverse effects to the interests of Benin and Chad within the meaning of Article 5(c) and 6.3 of the SCM Agreement. The United States has caused, and is causing, serious prejudice to the interests of Benin and Chad through the use of WTO-inconsistent subsidies on upland cotton. The serious prejudice to the interests of Benin and Chad arises because the effect of the US subsidies has been the significant price suppression and/or price depression for cotton in the same market, within the meaning of Article 6.3(c).<sup>1</sup>

6. Benin and Chad agree with Brazil that for the purposes of Article 6.3(c), the term “market” could encompass an individual country, a region, or the world market for cotton.<sup>2</sup> In addition, in the view of Benin and Chad, the Further Submission of Brazil has clearly established the causal link between US subsidies and suppressed prices in the world market.

7. Therefore, for the purposes of this Third Party submission, Benin and Chad accept that the causal link has been established by Brazil, and will focus instead on the impact of such suppressed prices on the economies and cotton sectors of Benin and Chad.

## **III. THE COTTON SECTOR IN BENIN**

8. Benin’s Third Party Submission of 15 July 2003, provided the basic facts about its cotton sector. While Benin does not wish to repeat all of this information, it would recall that:

- cotton is the most important cash crop in the national economy, accounting for about 90 per cent of agricultural exports;

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<sup>1</sup> As a threshold matter, upland cotton from Benin and Chad is clearly “like” US upland cotton within the meaning of Article 6.3. Benin and Chad agree with the analysis set out by Brazil in Part 3.3.2 of its Further Submission. Applying the tests set out in previous GATT and WTO cases, the Panel should have little difficulty in concluding that these are “like products”.

<sup>2</sup> Further Submission of Brazil, paragraph 98.

- cotton has provided 75 per cent of the country's export earnings over the past four years;
- cotton generates a quarter of the country's revenues;
- a third of all households depend on the cultivation of cotton, and a fifth of wage-earning workers are employed in the cotton sector; and
- overall, about a million people in Benin – out of a population of six million – are dependent on cotton, or cotton-related activities.

#### IV. THE COTTON SECTOR IN CHAD

9. Since Chad did not file an earlier submission, it takes this opportunity to provide the Panel with brief essential information about the national economy of Chad, and the cotton sector.

10. Chad, like Benin, is one of the poorest countries in the world. Of the 175 countries listed in the 2003 United Nations *Human Development Index*, Chad is ranked 165<sup>th</sup>.<sup>3</sup> It is estimated that 80 per cent of the population of Chad lives on less than US \$1 per day. Average life expectancy is 48 years. Nearly a third of all children in Chad under the age of five suffer from chronic malnutrition.<sup>4</sup>

11. The cotton-producing region of Chad is located in the southern part of the country, in an area covering about 127,000 square kilometres. Cotton is generally grown on small farms, usually no more than one or two hectares. Farmers have to rely on rain for irrigation and animals for traction when working the cotton fields during the sowing season.

12. Cotton production in Chad affects approximately 1.5 million people, out of a total population of about 8.1 million.<sup>5</sup> Cotton exports account for 5.1 per cent of GDP in Chad, and represents 25 per cent of all exports.<sup>6</sup> Cotton is therefore one of Chad's main sources of income, and sustains the livelihood of a large portion of its population.

13. A recent World Bank report on the cotton sector in Chad stated that:

*“Revenue from cotton constitutes the only source of community development for villages in the cotton-producing area to meet their needs and improve their quality of life [original emphasis]....[C]otton payments are received in two ways: as individual lump sums and as rebates/ balances (restourne), depending on the realized level of prices internationally [emphasis added]. Rebates constitute the only source farmers have to invest in village-level public goods such as schools, health centres, credit*

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<sup>3</sup> *Human Development Report 2003*, United Nations Development Programme, <http://undp.org/hdr2003>.

<sup>4</sup> *Chad at a Glance*, World Bank Group, 20 August 2003.

<sup>5</sup> According to the World Bank, there are roughly 400,000 farm households in the cotton-producing areas of Chad, of which about 60 per cent grow cotton. An average farm household has 5 to 6 people. World Bank, *Chad Cotton Sector Reform: A Case Study on Poverty and Social Impact Analysis*. Document available at [http://poverty.worldbank.org/files/13138\\_chadcottonreform.pdf](http://poverty.worldbank.org/files/13138_chadcottonreform.pdf)

<sup>6</sup> P. Fortucci, *The Contributions of Cotton to Economy and Food Security in Developing Countries*. Food and Agriculture Organization of the United Nations. July 2002.

institutions, storage facilities, clean water pumps and wells, *radiers* to limit village isolation during rainy season, and so forth.”<sup>7</sup>

14. Rather more succinctly, the World Bank observed that: “Cotton was introduced in Chad during the colonial period and has dominated the economy since then.”<sup>8</sup>

## V. US COTTON SUBSIDIES – SERIOUS PREJUDICE TO BENIN AND CHAD

15. Brazil’s Further Submission of 9 September 2003 provides compelling evidence of the serious prejudice Brazil has sustained as a result of massive, WTO-inconsistent cotton subsidies. Yet the serious prejudice to the countries of West Africa, including Benin and Chad, has been far worse.<sup>9</sup>

16. The subsidies paid by the United States to its relatively prosperous 25,000 cotton farmers dwarf the economies of West Africa. As indicated in Benin’s Third Party submission of 15 July US cotton subsidies exceed the gross national income of Benin (population 6 million), as well as Chad (population 8 million).

17. US cotton subsidies also exceed the gross national income of Burkina Faso (11 million), Mali (11 million), Togo (5 million) and the Central African Republic (4 million). As the respected international NGO Oxfam noted, “no region is more seriously affected by unfair competition in world cotton markets than sub-Saharan Africa”.<sup>10</sup>

18. The Oxfam report notes that:

“Central and West African countries have suffered far graver injury than any other developing region....The crop...occupies a pivotal position in the macro-economy of many countries....[Cotton] exports are a vital source of foreign exchange, financing essential imports such as food, fuel, and new technologies. They also underpin government revenues, providing the funds needed to invest in health and education....

High levels of poverty and limited government provision of basic services make Central and West Africa acutely vulnerable to adverse trends in world prices. Falling world prices mean that farmers have less to spend on health, education, and investment. Wages for agricultural labour also decline, as does the government’s capacity to provide basic social services.

Prospects for economic growth – a key requirement for poverty reduction – have also been damaged.”<sup>11</sup>

19. The Oxfam report – using data from the International Cotton Advisory Committee - estimates that in 2001 alone, sub-Saharan exporters lost \$302 million as a direct consequence of US cotton subsidies. It notes that Benin’s actual cotton export earnings in 2001/02 were \$124 million.

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<sup>7</sup> World Bank Report on Poverty and Social Impact Analysis – Chad Cotton Sector Reform – Ex-Ante Qualitative Analysis – First Phase. Document available at <http://poverty.worldbank.org/files>.

<sup>8</sup> *Id.*

<sup>9</sup> Benin and Chad also welcome, and endorse, the arguments set out in Part 7 of Brazil’s Further Submission, “Serious Prejudice to the Interests of African Countries by Reason of the US Subsidies on Upland Cotton.”

<sup>10</sup> *Cultivating Poverty: The Impact of US Cotton Subsidies on Africa*. Oxfam Briefing Paper 30. 27 September 2002. Brazil has filed the full Oxfam report as exhibit Bra-15.

<sup>11</sup> *Id.*, pages 8-9.

However, had US subsidies been withdrawn, Benin's export earnings are estimated to have been \$157 million. Therefore, the value lost to Benin as a result of US subsidies was \$33 million.<sup>12</sup>

20. Chad's cotton export earnings in 2001/02 were \$63 million, although in the absence of US subsidies, Chad would have earned \$79 million, thus reflecting a loss of \$16 million.<sup>13</sup>

21. For the period from 1999/2000 to 2001/2002, Oxfam estimates a total cumulative loss of export earnings of \$61 million for Benin and \$28 million for Chad.<sup>14</sup> As Oxfam rightly emphasizes, "the small size of several West African economies and their high levels of dependence on cotton inevitably magnify the adverse effects of US subsidies. For several countries, US policy has generated what can only be described as a major economic shock".<sup>15</sup>

22. Indeed, for the subsistence cotton farmers of Benin and Chad, already highly vulnerable to fluctuations in the world price of cotton, the price suppression caused by US subsidies can and does have a highly destabilizing effect. According to the empirical data analyzed by two US economists, Nicholas Minot of the International Food Policy Research Institute and Lisa Daniels of Washington College:

*"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 individuals in families below the poverty line. In the long run, as households adjust to the new prices, the poverty rate settles down somewhat, remaining 67 percentage points higher than originally...."*

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.*"<sup>16</sup> [emphasis added]

23. Thus, as the Minot/Daniels paper indicates, a drop in world cotton prices of 40 per cent pushes an additional 334,000 people below the poverty line in Benin. Moreover, the Minot/Daniels study adopted a *relative* poverty line, equivalent to US\$123 per person per year, far below the US\$1 per day used by the World Bank.<sup>17</sup>

24. The Minot/Daniels paper describes what this means in human terms. The detailed household surveys carried out in Benin describe the living conditions for cotton farmers:

- 85 per cent of the cotton farmers in Benin have houses with mud or mud-brick walls.
- 62 per cent live in houses with a dirt floor.

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<sup>12</sup> *Id.*, page 17-18.

<sup>13</sup> *Id.*, page 17-18.

<sup>14</sup> *Id.*, page 32.

<sup>15</sup> *Id.*, pages 17 and 32.

<sup>16</sup> Nicholas Minot and Lisa Daniels, *Effect of Falling Cotton Prices on Rural Poverty in Benin*. Exhibit BEN-CHA 1, paragraphs 36 and 38.

<sup>17</sup> *Id.*, paragraph 13.

- 72 per cent have corrugated metal roofs and 28 per cent have straw roofs.
- 53 per cent of the cotton farmer households get drinking water from a public well, while another 18 per cent use water from a river or lake.
- Less than 2 per cent have electric lights, and 98 per cent use oil or kerosene lamps.
- On average, the nearest source of potable water is 430 m away, and the nearest paved road is 36 km away.
- About 34 per cent of the cotton farmers do not own a chair, 38 per cent do not own a table, and 34 per cent do not own a bed.<sup>18</sup>

25. Needless to say, farmers living in such conditions are “price takers”, not “price makers” in the global cotton market.

26. While comparable household surveys have not been conducted in Chad, conditions in Chad are, if anything, worse than in Benin. Moreover, as in Benin, the cotton farmers of Chad are highly vulnerable to changes in the international price of cotton.

27. Yet despite this situation of poverty, cotton farmers in both Benin and Chad are, and remain, efficient producers. As noted in Benin’s submission of 15 July the cost of producing cotton in West Africa is 50 per cent lower than comparable costs in the United States. Indeed, a recent World Bank Policy Research Working Paper found that West African countries were among the world’s lowest cost producers of cotton.<sup>19</sup>

28. Moreover, as Benin noted in its Submission of 15 July the IMF reported that Benin’s reform process in the cotton sector is among the most advanced in the region. However, to re-iterate a key point of Benin’s earlier submission, these economic efficiencies have been vitiated by the plunge in world cotton prices caused in no small part by US subsidies.

29. Similarly, since 1999, Chad has undertaken major reforms in its cotton production system. The aim of these reforms has been to improve production and productivity with a view to generating supplementary income, which could then be used to reduce widespread poverty in cotton-growing areas, and indeed in the country as a whole. The method for achieving this goal is a progressive liberalization of the cotton industry, similar to methods employed in other African cotton-producing countries.

30. However, as in Benin, the reforms in Chad are being seriously undermined by huge US subsidies. As stated by the World Bank:

This analysis<sup>20</sup> appears to be all the more urgent today, given the current situation on the international market and the low price of cotton deriving from the recently-introduced US subsidies. These can have the effect of thwarting the reform and of having a considerable social and poverty impact. *Unless the international situation*

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<sup>18</sup> *Id.*, paragraph 23.

<sup>19</sup> *Cotton Sector Strategies in West and Central Africa*. World Bank Policy Research Paper 2867, July 2002, page 9. Brazil has filed this Working Paper as exhibit Bra-265.

<sup>20</sup> The report’s analysis was: “the findings ... suggest that privatisation and liberalization will not automatically lead to price competition nor will they automatically solve some of the structural problems that plague the current cotton system in Chad”.

*changes and the US subsidies are removed, any liberalization and privatization of the cotton sector is unlikely to be successful. [original emphasis].*<sup>21</sup>

31. The World Bank Policy Paper adds that:

“...subsidies to cotton farmers in major cotton producing countries increase artificially the supply in international markets and depress export prices for WCA [West and Central Africa] countries. Downward pressures on export prices have been exacerbated by generous (and in the case of the United States, rapidly increasing) subsidies for cotton production in the United States, China and the European Union.”<sup>22</sup>

32. The Policy Paper ultimately concluded that:

“Removal of these subsidies would benefit WCA countries, and allow them to better exploit their comparative advantage in cotton production for growth and poverty reduction.”<sup>23</sup>

## VI. CONCLUSION

33. On 10 June 2003, the President of Burkina Faso, H.E. Blaise Compaoré, presented the joint proposal on cotton to the Trade Negotiations Committee on behalf of Benin, Burkina Faso, Chad and Mali.<sup>24</sup> In presenting the proposal, President Compaoré remarked that:

“More than ten millions of people in West and Central Africa directly depend on cotton production, and several other millions of people are indirectly affected by the distortion of world market prices due to production and export subsidies to this agricultural product....

While cotton accounts for only a small portion of economic activity in industrialized countries, in all our States, it represents a determining and critical factor for poverty reduction policies as well as for political and social stability. Through induced effects on infrastructure development, education and basic health services, cotton production acts as an essential link within our countries’ development strategies....

Arguments in favour of sector-based modalities for cotton are straightforward: *our countries are not asking for charity, neither are we requesting preferential treatment or additional aid. We solely demand that, in conformity with WTO basic principles, the free market rule be applied. Our producers are ready to face competition on the world cotton market – under the condition that it is not distorted by subsidies.*<sup>25</sup> [emphasis added]

34. Similar remarks were made following the Cancun Ministerial by Dr. Kipkorir Aly Azad Rana, a Deputy Director-General of the WTO. Speaking to the Second East African Business Summit in Kenya (18-21 September 2003), he stated that:

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<sup>21</sup> World Bank Report on *Poverty and Social Impact Analysis – Chad Cotton Sector Reform – Ex-Ante Qualitative Analysis – First Phase*. *Op cit.*, page 35.

<sup>22</sup> *Cotton Sector Strategies in West and Central Africa*. World Bank Policy Research Paper 2867, July 2002.

<sup>23</sup> *Id.*

<sup>24</sup> *Poverty Reduction: Sectoral Initiative in Favour of Cotton*. WT/MIN(03)/W/2.

<sup>25</sup> WTO News: Address by President Blaise Compaoré to the Trade Negotiations Committee, 10 June 2003. [www.wto.org](http://www.wto.org).



"A strong call for action in addressing subsidy issues in cotton was made earlier this year by Benin, Burkina Faso, Mali and Chad....West African negotiators put the spotlight, before and at Cancún, on cotton subsidies leading to overproduction by less efficient farmers in rich countries and depressing global market prices....The countries who brought this issue to the table do not have a broad range of export possibilities to choose from, but in cotton, they produce high quality merchandise at competitive prices. In recognition of the benefits of export-led growth for development, they have turned, at the highest level, to the WTO. *They do not ask for aid, which is the World Bank's remit, nor do they make political appeals that belong to the United Nations. They have just asked that WTO rules and disciplines apply also in sectors of interest to the poor - that a fair and market-oriented system be established in agriculture and that rich countries' wasteful export and production subsidies be abolished and cease to undermine their comparative advantage.*"<sup>26</sup>  
[emphasis added]

35. Both President Compaoré and Deputy Director General Rana were speaking about WTO negotiations, not dispute settlement. Yet their messages are equally valid for the purposes of this Panel proceeding. In this dispute, Benin and Chad are not seeking charity or preferential treatment. Similarly, Benin and Chad do not wish to make political appeals.

36. In the context of this proceeding, Benin and Chad ask the Panel simply to find that the United States must adhere to the WTO rules and disciplines on subsidies that it accepted at the conclusion of the Uruguay Round. This includes the clear prohibition in Part III of the SCM Agreement against causing serious prejudice to the interests of other Members. US subsidies on upland cotton have demonstrably caused serious prejudice to the interests of Benin and Chad by suppressing world prices for upland cotton. The results have been devastating for West Africa.

37. Benin and Chad therefore respectfully request the Panel to grant the relief requested by Brazil in Part 9 of its Further Submission.

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<sup>26</sup> WTO News: Address by Dr. Kipkorir Aly Azad Rana, Deputy Director-General to the Second East African Business Summit, "The Multilateral Trading System: Why East Africa Must Remain Engaged." 18-21 September 2003. [www.wto.org](http://www.wto.org).

**Exhibit Ben-Cha 1**

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## Effect of falling cotton prices on rural poverty in Benin

### Summary

This paper combines farm survey data from Benin with assumptions about the decline in farm-level prices to estimate the direct and indirect effects of cotton price reductions on rural income and poverty in Benin. The results indicate 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 results in an increase in rural poverty of 8 percentage points in the short-run and 6-7 percentage points in the long run. The short-run impact is equivalent to an increase of 334 thousand in the number of individuals in families below the poverty line.

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.

## Introduction

1. From January 2001 to May 2002, world cotton prices fell almost 40 per cent, from 64 cents per pound to 39 cents/pound<sup>1</sup>. Since then, prices have rebounded to about 60 cents/pound, but cotton prices still show a long-term downward trend from the mid-1990s when cotton prices were over 80 cents/pound (see Figure 1). One reason for the long-term decline is that world demand for cotton has been stagnant at 20 million tons since the mid-1990s, in part due to competition with synthetic fibers. Short-term fluctuations in cotton prices are often driven by shifts in the net trade of China, the largest cotton producer and consumer in the world.

2. In addition to these two effects, cotton prices are pushed below what they otherwise would be by government support to cotton growers. The International Cotton Advisory Committee (ICAC) estimates that world-wide 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 (Oxfam, 2002). Until 2002, US cotton policy consisted of various programs<sup>2</sup>, including two (the marketing loan program and loan deficiency payments) that ensure that farmers receive at least 52 cents/pound. This has the effect of insulating US farmers from the 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 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<sup>3</sup>.

3. 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 (ICAC, 2002). And most recently, Sumner (2003) estimates that, in the

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<sup>1</sup> These prices are based on the A-Index cotton price, calculated as the average of the five lowest prices for US cotton in Northern European markets based on a grade of middling 1-3/32 inch fibre length.

<sup>2</sup> The 1996 Farm Bill introduced production flexibility contract (PFC) payments, which were related to historical (not current) production and would decline over time as part of an effort to phase out farm subsidies. PFC payments to cotton farmers fell steadily from US\$ 700 million in 1996 to US\$ 474 million in 2002. Loan deficiency payments and marketing loan gains are, on the other hand, tied to current output and market prices. Low commodity prices over the last 3-4 years have sharply increased the cost of these programs. Payments to cotton growers were negligible in 1997, but rose to US\$ 1.5 billion in 1999 and almost US\$ 2.5 billion in 2002. In addition, Congress has authorized ad hoc market loss assistance (MLA) payments almost annually. MLA payments to cotton farmers were US\$ 600 million in 1999 and US\$ 650 million in 2002. Cotton exporters and US mills also receive roughly US\$ 200 million per year in "Step 2" payments, designed to keep US cotton exports competitive (USDA, 2002b and Oxfam, 2002).

<sup>3</sup> The 2002 Farm Bill introduces two new commodity programs: direct fixed payments and counter-cyclical payments. In the case of upland cotton, the fixed direct payment is set at 6.7 cents/pound and is paid on the basis of 85 per cent of the "base acreage". The counter-cyclical payments involve payments of up to 13 cents/pound on 85 per cent of the base acreage depending on the gap between the market price (or the loan rate, whichever is higher) and the target price. These programs replace the production flexibility contract system and (supposedly) eliminate the need for the market loss assistance. The marketing loan and loan deficiency payments continue under the new Farm Bill with the same loan rate: 52 cents/pound for upland cotton. In addition, farmers are allowed to update their base acreage, providing them incentive to maintain or increase acreage in the event future opportunities to update acreage (USDA, 2002c).

absence of US subsidies, the world cotton price would have been 12.6 percent higher over 1999-2002. This estimate is probably the most authoritative because it takes into account the 2002 Farm Bill, it incorporates a detailed treatment of various US subsidy programs, and it uses a standard modelling framework and parameter estimates.

4. The World Bank estimates that removing US cotton subsidies would generate US\$250 million per year in additional revenues for West African cotton farmers (Badiane et al, 2002). An Oxfam report calculates the losses to three West African nations at 1-2 per cent of gross domestic product. It points out that, in Mali and Benin, losses in export revenue associated with US cotton subsidies are greater than US development assistance to those countries (Oxfam, 2002).

5. 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.

6. This paper examines the impact of changes in cotton prices on rural poverty in Benin. In particular, it has 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.

## Background

7. The Republic of Benin is a small West African nation of about 6.0 million inhabitants, 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 20 per cent of countries. The per capita income of Benin is lower than the average for sub-Saharan Africa (World Bank, 2000).

8. In 1989, Benin entered a period of economic and political reform. Elections were held in which the military government was voted out of office, and Benin entered into the first of several structural adjustment programs with the International Monetary Fund and the World Bank. In the agricultural sector, state farms and cooperatives were disbanded, food crop prices and marketing were liberalized, and many state-owned enterprises, including agro-processing enterprises, were privatized or closed (République du Benin, 1997). In January 1994, the CFA franc (FCFA) 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 consumers that had become accustomed to cheap imports, it stimulated the local production of cotton, rice, and other tradable goods.

9. Although the cotton sector benefited from the 1994 devaluation, structural reform in cotton marketing was limited. The cotton sector in Benin remained under the control of the state-owned *Société Nationale pour la Promotion Agricole* (SONAPRA). In the past two years, Benin has begun to implement reforms to reduce the role of SONAPRA and introduce 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. According to ICAC (2002), the government provides modest support for the cotton price, equivalent to 5 cents/pound. Currently, cotton represents 90 percent of agricultural exports and 60-70 per cent of its total exports (excluding re-exports<sup>4</sup>).

10. The economic reforms carried out in the 1990s and the growth in cotton production during this period resulted in concrete benefits for rural households. The 1994-95 *Enquête sur les Conditions de Vie en Milieu Rural* (Survey on Living Conditions in Rural Areas) estimated the poverty rate at 33 per cent (UNDP-MDR, 1996: 13). Adopting a similar definition of expenditure and the same poverty line (adjusted for inflation), the poverty rate in the 1998 survey had fallen to 21 per cent. Qualitative questions in the latter survey appear to support the view that rural conditions improved in the 1990s. According to the IFPRI-LARES survey, 52 percent of the households reported that they were better off at the time of the survey (1998) than in 1992 and only 28 per cent reported being worse off. Furthermore, those reporting improvement tended to attribute these gains to economic factors such as crop prices and off-farm income opportunities, while those reporting worsening conditions tended to cite health and weather factors. Cotton farmers, those in the north of the country, and poor households were more likely to report improved conditions than others. (IFPRI, 2001)

11. These results suggest that there is a strong link between market-oriented policies and cotton expansion on the one hand and the living conditions of farmers in Benin on the other hand. The analysis presented in this paper will further examine this link, focusing on the impact of changes in cotton prices on rural income and poverty.

## Methods

12. The data used in this paper come from the *Enquête des Petits Agriculteurs* (EPP) or Small Farmer Survey, carried out in 1998 by the International Food Policy Research Institute (IFPRI) and the *Laboratoire d'Analyse Régionale et d'Expertise Sociale* (LARES). The survey used a 24-page questionnaire, divided into 16 sections<sup>5</sup>. The households were selected using a two-stage stratified random sample procedure based on the 1997 Pre-Census of Agriculture. In each of the six departments<sup>6</sup>, villages were randomly selected, with the number of villages proportional to the volume of agricultural production, subject to a minimum of 10 villages per department. 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. The survey was carried out from August to November 1998. In a few villages, the number of interviewed households was eight or ten, resulting in a final sample size of 899 agricultural households. Sampling weights are used in calculating the results presented here (see IFPRI, 2001 for more detail).

13. In this study, we adopt a *relative* poverty line, set at the 40<sup>th</sup> percentile of per capita consumption expenditure. Per capita expenditure is calculated as cash expenditure on consumption goods, the imputed 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 poverty line is far below the US\$ 1 per day frequently used by the World Bank.

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<sup>4</sup> Re-exports of manufactured goods to Nigeria and other countries accounts for a large share of total exports.

<sup>5</sup> The 16 sections are household characteristics, housing characteristics, land, agricultural production, labour use, input use, changes regarding input use, credit, crop marketing, storage, sources of information, food and non-food consumption, allocation of time, asset ownership, sources of income, and perceptions of farmers.

<sup>6</sup> Since this study was carried out, an administrative reorganization has resulted in an increase in the number of departments from 6 to 12. The analysis in this report retains the old definitions of departments because this was the basis for the sampling design of the survey.

14. We simulate the impact of various percentage reductions in cotton prices on the incomes of rural households. In the short run (before the household responds to lower prices), the change in income of each household is simply the change in the value of cotton production, assuming the farmer grows the same amount of cotton. This can be calculated as follows:

$$y_{1i} - y_{0i} = (Q_{ci} \Delta P_c) / H_i \quad (1)$$

where  $y_{1i}$  is per capita income<sup>7</sup> of household  $i$  after the shock,  $y_{0i}$  is per capita income before the shock,  $Q_c$  is the quantity of cotton produced by household  $i$ ,  $\Delta P_c$  is the change in the price of cotton, and  $H_i$  is the number of members in household  $i$ .

15. In the long run, lower cotton prices will lead farmers to substitute away from cotton and reduce input use, so the long-run direct impact is smaller than the short-run direct impact of the change in cotton prices. In this analysis, we use the concept of producer surplus to measure the welfare impact of the change in cotton price. This is calculated using the following equation:

$$y_{1i} - y_{0i} = (Q_{ci} \Delta P_c) / H_i + \left( \frac{1}{2} (\Delta P_c)^2 \epsilon_c \frac{Q_{ci}}{P_c} \right) / H_i \quad (2)$$

where  $\epsilon_c$  is the general equilibrium supply elasticity of cotton and  $P_c$  is the price of cotton<sup>8</sup>.

16. In the absence of estimated elasticities of supply for cotton in Benin, we use a range of plausible elasticities to calculate the range of plausible welfare impacts<sup>9</sup>. The elasticities used are 0.5, 1.0, and 1.5. As in the analysis of the short-run effect, we simulate the impact of these changes on the income of each household in the sample (micro-simulation) in order to estimate the impact on different types of households in terms of income and poverty.

17. The simulations are run with farm-level reductions in cotton price ( $\Delta P_c$ ) of 10%, 20%, 30%, and 40%. The other variables ( $y_{0i}$  and  $Q_{ci}$ ) are all defined at the household level, allowing the changes in per capita income to be calculated for each household in the sample. This “micro-simulation” approach allows us to estimate the change in income for any sub-group in rural areas, defined by income, farm-size, or other variables.

18. The impact of price changes on poverty is measured using the Foster-Greer-Thorbecke measures of poverty<sup>10</sup>, the most widely used of which are known as  $P_0$ ,  $P_1$ , and  $P_2$ .  $P_0$  is just the

<sup>7</sup> As mentioned above, we use per capita expenditure as a proxy for per capita income

<sup>8</sup> This expression is more accurate for small changes in price than large ones. These are third-order effects in that they would be captured by the third term in a Taylor-series expansion. It will be shown later that the results are not very sensitive even to second-order effects (alternative assumptions about supply elasticities).

<sup>9</sup> Two studies have estimated the supply elasticity of cotton in Tanzania. Dercon (1993) estimated an elasticity of 0.63, while Delgado and Minot (2000), using more recent data, obtained an estimate of 1.0.

<sup>10</sup> The Foster-Greer-Thorbecke measures of poverty are calculated as

$$P_\alpha = \frac{1}{N} \sum_i \left[ \frac{\mu - y_i}{\mu} \right]^\alpha$$

where  $P_\alpha$  is the poverty measure,  $N$  is the number of households,  $\mu$  is the poverty line, and  $y_i$  is the income or expenditure of poor household  $i$  (the summation occurs only over poor households). When  $\alpha=0$ , the poverty measure,  $P_0$ , is the incidence of poverty, that is, the proportion of households whose income is below the poverty line. When  $\alpha=1$ , the poverty measure,  $P_1$ , is the poverty-gap measure. The poverty gap is equal to the incidence of poverty multiplied by the average gap between the poverty line and the income of a poor household, expressed as a percentage of the poverty line. Thus, it takes into account the depth of poverty as

proportion of the population below the poverty line.  $P_1$ , sometimes called the poverty gap measure, takes into account how far below the poverty line the poor are, on average. And  $P_2$ , sometimes called the poverty gap squared, takes into account the degree of inequality among poor households, giving greater weight to extreme poverty.

### Characteristics of Cotton Farmers in Benin

19. Before estimating the impact of changing cotton prices on rural households, it is useful to describe the role of cotton in the rural economy and the characteristics of cotton growers. According to the IFPRI-LARES Small Farmer 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<sup>11</sup>. The value of this output is US\$ 901 per cotton farm<sup>12</sup>.

20. Another measure of the importance of cotton in the rural economy is its contribution to cash income. Farmers in Benin are quite market oriented, selling over half the output of cowpeas, groundnuts, manioc, and sweet potatoes, and selling almost half of the output of the “staple” foodcrop, maize. Nonetheless, cotton accounts for about one-third of the value of crop sales carried out by farm households in Benin (IFPRI, 2002).

21. Who are the cotton growers in Benin and how do they differ from other farmers? As mentioned earlier, cotton production is concentrated in the north and center of Benin. About two-thirds of the farmers in the large northern department of Borgou grow cotton, as do 37 per cent of those in nearby Atacora and 64 per cent of those in the central department of Zou. By contrast, in the three departments in the south (Atlantique, Mono, and Ouémé), the percentage ranges from zero to 25 per cent. If we divide the farm households into quintiles, the proportion of farmers growing cotton does not seem to vary consistently across quintiles. If anything, the proportion of cotton growers is lower (28 per cent) in the richest quintile (see Table 1).

22. Cotton growers tend to have farms that are, on average, twice as large as those of non-growers (5.3 hectares compared to 2.3 hectares). Nonetheless, cotton growers are similar to other farmers in terms of various measures of well-being. The incidence of poverty rate is slightly lower among cotton farmers (37 per cent) than among other farmers (42 percent), but the per capita expenditure of cotton growers is about 8 per cent lower than that of others, and the budget share allocated to food is almost identical to that of non-growers (see Table 2). The reason that the larger farms do not translate into a higher standard of living is that cotton growers are concentrated in the more arid north, where the agricultural potential is lower and where there are fewer opportunities for non-farm employment.

23. To give a more concrete idea of the living standards of cotton growers, it is useful to describe some indicators of living conditions, according to the farm surveys:

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well as the percentage of the households that are poor. If  $a=2$ , then the poverty measure,  $P_2$ , takes into account the degree of inequality among poor households, as well as the depth of poverty and the number of poor households.  $P_2$ , sometimes called the poverty-gap squared, will be referred to as a measure of the severity of poverty (see Foster, Greer, and Thorbecke, 1984).

<sup>11</sup> It is worth noting that the average yield is calculated at the household level and aggregated, so it is not necessarily equal to the average quantity divided by the average area. A similar qualification applies to production, price, and value of output.

<sup>12</sup> When the Small Farmer Survey was carried out, the exchange rate was around 630 FCFA/US\$, so that the value of cotton production was US\$ 901 per cotton farm.



- 85% of the cotton farmers in Benin have houses with mud or mud-brick walls,
- 62% live in houses with a dirt floor,
- 72% have corrugated metal roofs and 28% have straw roofs,
- 53% of the cotton farmer households get drinking water from a public well, while another 18% use water from a river or lake,
- Less than 2 percent have electric lights,
- On average, the nearest source of potable water is 430 m away, and the nearest paved road is 36 km away,
- About 34% of the cotton farmers do not own a chair, 38% do not own a table, and 34% do not own a bed.

These figures are fairly typical of farmers in Benin. Thus, it is not that cotton farmers are poorer than average, but rather that almost all farmers in Benin, including cotton farmers, are quite poor.

### **Effect of lower cotton prices**

24. In this section, we use the data from the IFPRI-LARES Small Farmer Survey to estimate the impact of lower cotton prices in Benin. First, we examine the impact of lower prices on the income and poverty of cotton farmers in the short-run, before they have an opportunity to respond to the lower prices. Next, we estimate the impact on cotton farmers in the longer run, after they have responded to the shock of reduced prices.

### **Short-term direct effects of lower cotton prices**

25. As described earlier, we estimate the short-term change in income associated with lower cotton prices using household-level information on per capita expenditures and the volume of cotton production, combined with different assumptions about the reduction in cotton price. 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 falls 7 per cent. Smaller reductions in the cotton price cause roughly proportionate changes in income (see Table 3).

26. 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 (see Table 3). In absolute terms, this implies that about 334 thousand people would fall below the poverty line as a result of a 40 per cent reduction in cotton prices.<sup>13</sup> A 40 per cent decrease in the price of cotton results in a 40% increase in the poverty gap for all farm households in Benin, while the poverty gap squared ( $P_2$ ) or severity of poverty increases 61 per cent.

27. This analysis can be broken down by department to evaluate regional differences in the impact of falling cotton prices<sup>14</sup> (see Table 3). In Atlantique and Ouémé, the reduction in cotton prices has negligible effects on income and poverty because there are virtually no cotton farmers in these departments. On the other hand, the impact on the departments of Borgou and Zou are large. In Zou, a 40 per cent reduction in cotton prices results a 15 percent fall in per capita income and a 17 percentage point increase in the incidence of poverty. In Borgou, the same decrease in cotton

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<sup>13</sup> This estimate is obtained by multiplying the percentage point increase in poverty (.08), the number of farm households in Benin based on the sum of the sampling weights (474,964), and the average household size of farms in Benin according to the survey (8.8).

<sup>14</sup> As mentioned earlier, since the survey was carried out, the number of departments has increased from 6 to 12. The sample size of the survey is too small to allow disaggregation of results by the newly defined departments.

prices causes an 18 per cent reduction in per capita income and a 18 percentage point increase in the incidence of poverty. In fact, the department of Borgou moves from having an “average” poverty rate (greater than in two departments and less than in two others) to having the highest incidence of poverty, 62 per cent. Similarly, the poverty-gap ( $P_1$ ) in Borgou increases by a factor of three and the severity of poverty ( $P_2$ ) doubles as a result of the 40 percent reduction in cotton prices.

28. Finally, we look at the effect of falling cotton prices on the cumulative distribution of income per capita (see Figure 2). Among other things, it gives us information about the sensitivity of the results to alternative poverty lines, an important consideration given that our poverty lines is relative (set at the 40<sup>th</sup> percentile in the base distribution). The point where the cumulative distribution cross the poverty line is the poverty rate (note that the base distribution cross the poverty line at the 40<sup>th</sup> percentile). It is clear from the graph that similar results would have been obtained for higher and lower poverty lines.

### **Long-term direct effect of lower cotton prices**

29. Because of uncertainty regarding the supply elasticity of cotton, we carry out this analysis using three elasticities: 0.5, 1.0, and 1.5. In order to simplify the discussion, we present only the impact of a 40 percent reduction in cotton prices. These results are presented with the base levels and with the short-run impact. Since the assumption behind the short-run impact is that the supply elasticity is zero ( $e=0$ ), they are labelled as such.

30. As described earlier, the short-run impact of the lower cotton price is to reduce average per capita income by 7 per cent. If the general equilibrium supply elasticity of cotton is 0.5, the average income after the price reduction falls 6 percent from the base. At the other extreme, if the supply elasticity is 1.5, then the average income falls 5 per cent from the base (see Table 4 ).

31. In the long run, a reduction of 40 percent in the price of cotton is associated with a 6 - 7 percentage point increase in the overall rural poverty rate, depending on the assumption regarding the supply elasticity. The poverty gap measure ( $P_1$ ) rises from 0.10 to 0.12 - 0.13, again depending on the elasticity assumption. And the poverty gap squared ( $P_2$ ) increases from 0.036 to 0.047 - 0.058 (see Table 4). As expected, the long-run impact of the 40 per cent reduction in cotton prices is somewhat less adverse than the short-run impact. It is notable, however, that the results are not very sensitive to the elasticity assumption.

32. The long-run effects on each department are given in Table 4. For example, in Borgou, per capita income falls 18 percent in the short-run, but rebounds 4 percentage points if the supply elasticity is 1.0 and 7 percentage points if the elasticity is 1.5. Similarly, the per capita income in Zou falls 15 per cent in the short-run, but rebounds 3 percentage points in the long-run if the elasticity is 1.0.

33. The poverty rates in each department follow the same pattern in reverse. In the short-run, they rise as a result of the 40 percent fall in cotton prices, but in the long-run they fall back down part of the way. In Borgou, the poverty rate rises from 44 per cent to 62 per cent in the short run, falling back to 58-60 per cent in the long run, depending on which elasticity assumption is used. Similarly, the incidence of poverty in Zou increases from 33 per cent to 50 per cent in the short run, then falls to 47-49 per cent in the long run. As described above, there is little or no change in poverty in the three southern departments (Atlantique, Mono, and Ouémé) because there are very few cotton growers in these departments.

34. In Figure 3, we show the cumulative distribution of income in the base scenario, with a 40 per cent reduction in cotton prices in the short run ( $e=0$ ), and with a 40 per cent reduction in cotton prices in the long run ( $e=1.5$ ). Although the long-run supply elasticity used in this figure is at the upper end

of what we believe is plausible, the difference between the short-run and long-run results is not very large. In other words, the long-term results are not very sensitive to the assumption regarding the supply elasticity of cotton. Even with a relatively elastic supply ( $\epsilon=1.5$ ), the response of farmers only offsets about one-third of the initial negative short-run impact.

## Conclusions

35. This paper analyzes 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 a nationally representative survey suggest that rural living conditions improved over the 1990s. Furthermore, farmers tend 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.

36. The link between cotton markets and rural living conditions can, however, work against farmers as well. The analysis in this paper is motivated by the 39 percent decline in the world price of cotton between January 2001 and May 2002. We combine 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. We also use the survey data to study two types of indirect effects: the impact of lower cotton production on the demand for agricultural labour by cotton growers and the impact of lower cotton prices on other households through the multiplier effect.

37. The results indicate 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 individuals in families below the poverty line. In the long run, as households adjust to the new prices, the poverty rate settles down somewhat, remaining 6-7 percentage points higher than originally.

38. 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 the demand for goods and services these neighbours consume. 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. 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<sup>15</sup>. 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 (see Minot et al, 2001). 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.

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<sup>15</sup> 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.

39. 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.

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• **Table 1. Proportion of farm households**  
 • **growing maize and cotton**

	Maize	Cotton
Department		
Atacora	76	37
Atlantique	100	0
Borgou	96	68
Mono	83	25
Ouémé	91	4
Zou	95	64
Quintile		
Poorest	91	35
2 <sup>nd</sup>	93	30
3 <sup>rd</sup>	90	44
4 <sup>th</sup>	88	38
Richest	90	28
Benin	89	34

Source: IFPRI-LARES Small Farmer Survey.

**Table 2. Characteristics of cotton growers and other farmers**

	Cotton growers	Other farmers	Total
Household size	10.1	8.1	8.8
Dependency ratio	49	48	48
Sown area (ha)	6.5	3.2	4.4
Farm size (ha)	5.3	2.3	3.3
Expenditure (FCFA/person/year)	99,437	108,315	105,203
Food share	57	56	57
Home production share	35	24	28
Percent growing cotton	100	0	35
Cotton area (ha)	2.3	0	0.8
Cotton output (kg)	2,559	0	897
Cotton yield (kg/ha)	1,084		1,084
Cotton sales (FCFA)	505,584	0	177,217
Poverty measures			
P <sub>0</sub>	0.37	0.42	0.40
P <sub>1</sub>	0.095	0.103	0.100
P <sub>2</sub>	0.033	0.037	0.036

Source: IFPRI-LARES Small Farmer Survey.

**Table 3. Short-run direct impact of reductions in cotton prices by department**

	Atacora	Atlantique	Borgou	Mono	Ouémé	Zou	Total
<b>Per capita expenditure</b>							
Base	84,672	139,290	94,803	88,034	116,479	110,108	105,203
10% reduction	83,559	139,290	90,455	87,547	116,414	106,115	103,388
20% reduction	82,446	139,290	86,106	87,060	116,349	102,123	101,574
30% reduction	81,333	139,290	81,758	86,573	116,284	98,130	99,759
40% reduction	80,219	139,290	77,409	86,086	116,219	94,137	97,944
<b>Incidence of poverty (P0)</b>							
Base	0.54	0.14	0.44	0.50	0.44	0.33	0.40
10% reduction	0.55	0.14	0.46	0.50	0.44	0.37	0.42
20% reduction	0.56	0.14	0.53	0.50	0.44	0.43	0.44
30% reduction	0.56	0.14	0.58	0.52	0.44	0.47	0.46
40% reduction	0.57	0.14	0.62	0.53	0.44	0.50	0.48
<b>Poverty gap (P1)</b>							
Base	0.161	0.034	0.098	0.131	0.110	0.071	0.100
10% reduction	0.166	0.034	0.114	0.134	0.110	0.081	0.106
20% reduction	0.172	0.034	0.137	0.137	0.111	0.097	0.115
30% reduction	0.178	0.034	0.167	0.140	0.111	0.118	0.126
40% reduction	0.185	0.034	0.202	0.143	0.111	0.144	0.138
<b>Severity of poverty (P2)</b>							
Base	0.065	0.012	0.031	0.046	0.042	0.022	0.036
10% reduction	0.068	0.012	0.039	0.048	0.042	0.025	0.038
20% reduction	0.070	0.012	0.052	0.050	0.042	0.031	0.042
30% reduction	0.074	0.012	0.071	0.052	0.042	0.041	0.049
40% reduction	0.078	0.012	0.100	0.055	0.042	0.057	0.058

Source: IFPRI-LARES Small Farmer Survey.

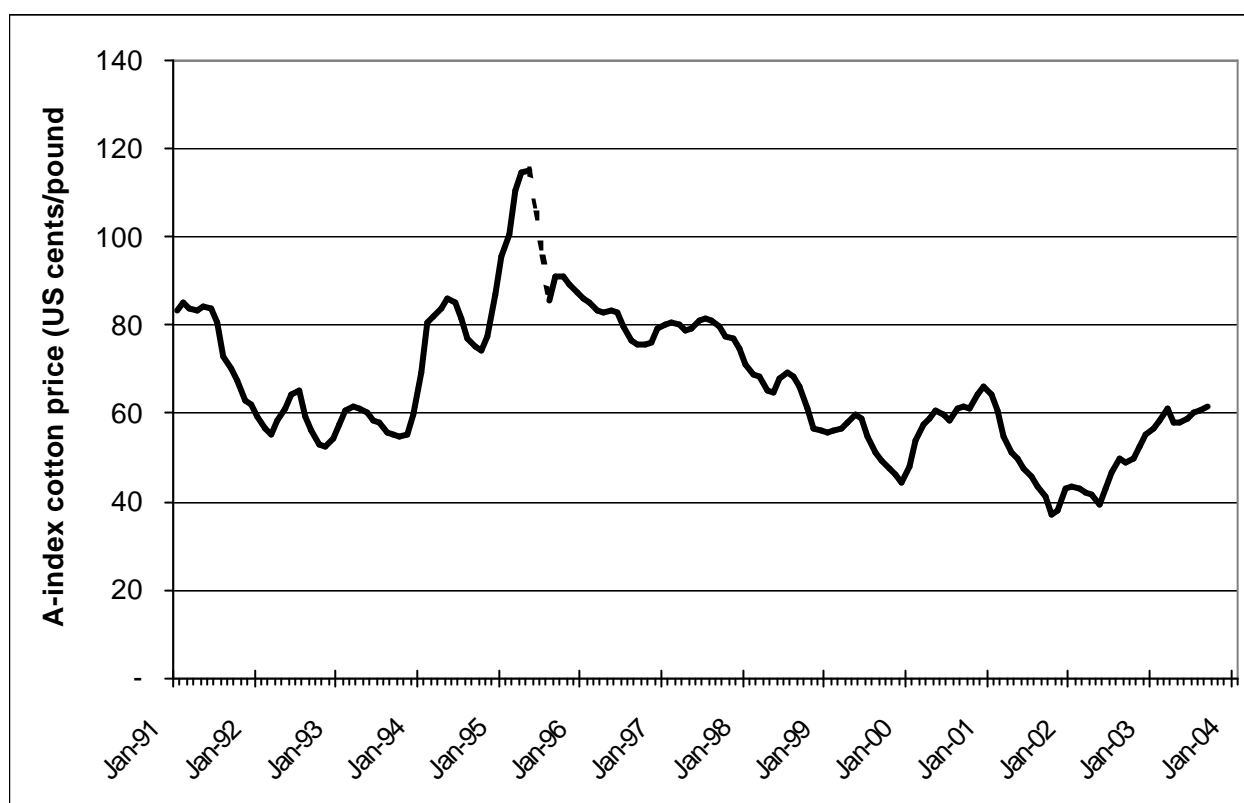


**Table 4. Long-run direct impact of a 40% reduction in cotton price by department**

	Atacora	Atlantique	Borgou	Mono	Ouémé	Zou	Total
Per capita expenditure							
Base	84,672	139,290	94,803	88,034	116,479	110,108	105,203
e = 0	80,219	139,290	77,409	86,086	116,219	94,137	97,944
e = 0.5	80,665	139,290	79,149	86,280	116,245	95,734	98,670
e = 1.0	81,110	139,290	80,888	86,475	116,271	97,331	99,396
e = 1.5	81,555	139,290	82,627	86,670	116,297	98,928	100,122
Incidence of poverty (P0)							
Base	0.54	0.14	0.44	0.50	0.44	0.33	0.40
e = 0	0.57	0.14	0.62	0.53	0.44	0.50	0.48
e = 0.5	0.57	0.14	0.60	0.53	0.44	0.49	0.47
e = 1.0	0.57	0.14	0.59	0.52	0.44	0.48	0.47
e = 1.5	0.56	0.14	0.58	0.52	0.44	0.47	0.46
Poverty gap (P1)							
Base	0.161	0.034	0.098	0.131	0.110	0.071	0.100
e = 0	0.185	0.034	0.202	0.143	0.111	0.144	0.138
e = 0.5	0.182	0.034	0.188	0.142	0.111	0.133	0.133
e = 1.0	0.179	0.034	0.174	0.140	0.111	0.123	0.128
e = 1.5	0.177	0.034	0.161	0.139	0.111	0.113	0.123
Severity of poverty (P2)							
Base	0.065	0.012	0.031	0.046	0.042	0.022	0.036
e = 0	0.078	0.012	0.100	0.055	0.042	0.057	0.058
e = 0.5	0.077	0.012	0.088	0.054	0.042	0.050	0.054
e = 1.0	0.075	0.012	0.076	0.053	0.042	0.044	0.050
e = 1.5	0.073	0.012	0.067	0.052	0.042	0.039	0.047

Source: IFPRI-LARES Small Farmer Survey.

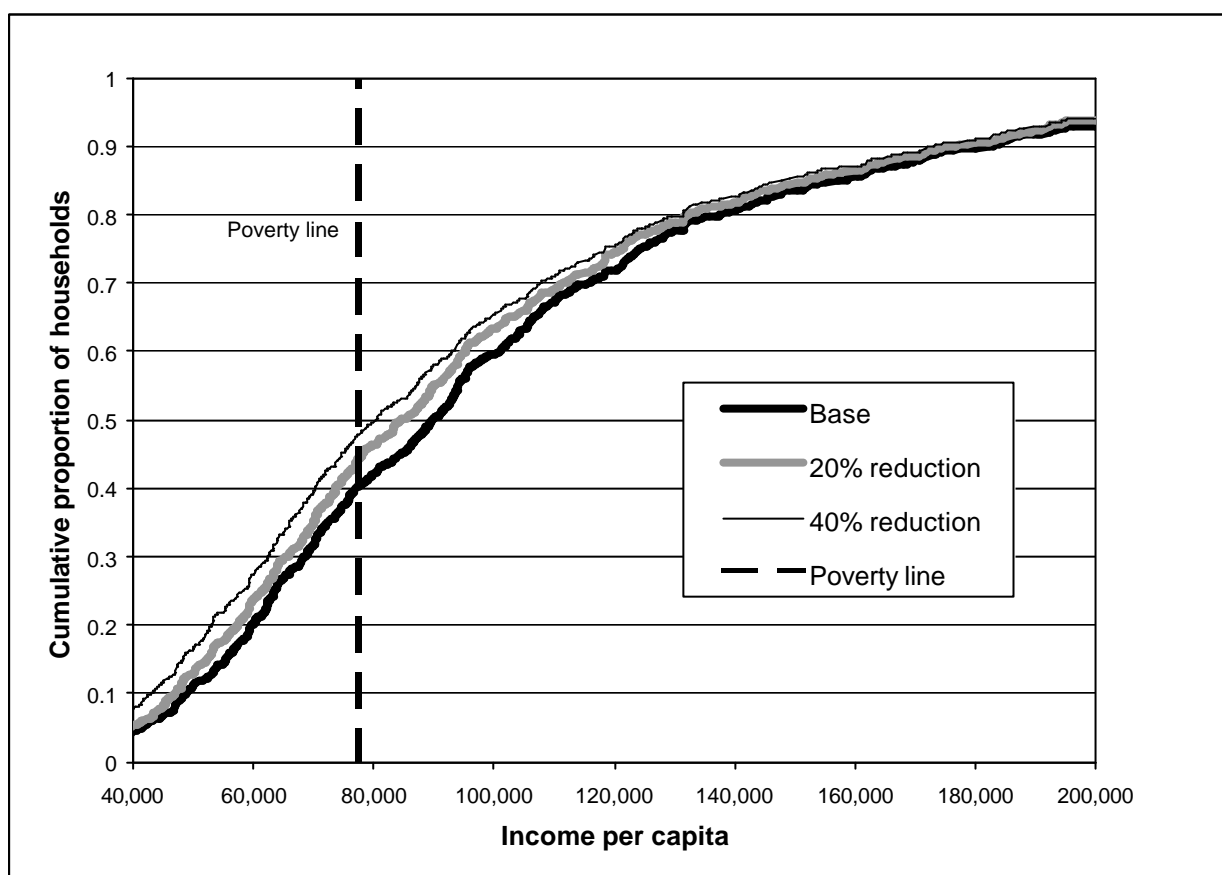
- **Figure 1. Cotton prices in Northern Europe (A-Index)**



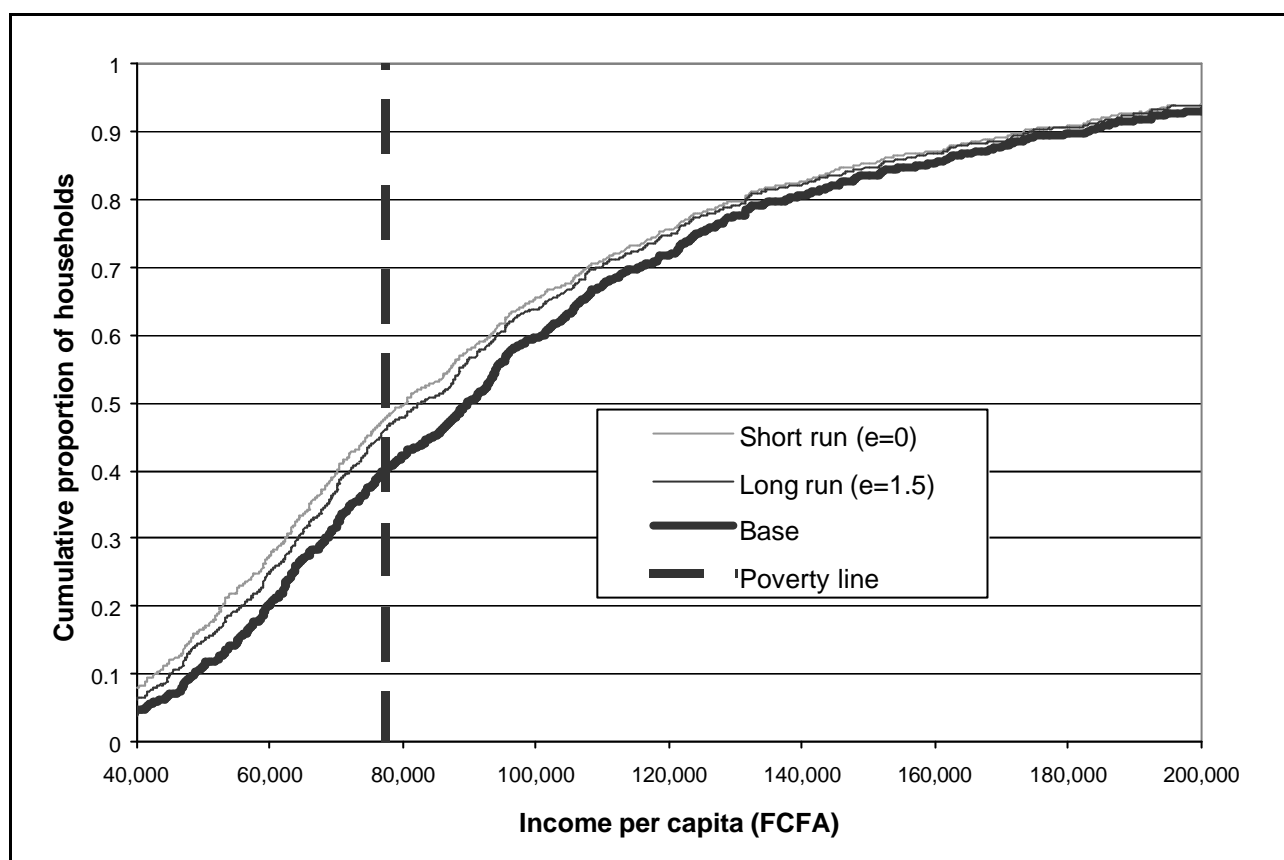
- Source: USDA, 2002; USDA, 2001.

- Note: The A-Index is the average of the five lowest prices of cotton in Northern European markets for middling 1 3/32 inch fiber length. For June and July 1995, there was no A-Index quotation; the dotted line represents a simple linear interpolation.

- **Figure 2. Short-run impact of lower cotton prices on the cumulative distribution of income**



- **Figure 3. Long-run impact of a 40% reduction in cotton prices on the cumulative distribution of income**



## ANNEX E-5

### CANADA'S FURTHER THIRD PARTY SUBMISSION

3 October 2003

Canada's systemic interest in this case lies in the interpretation of the provisions of Article 13 and Annex 2 of the *Agreement on Agriculture*, as they related to certain US domestic support measures. It also lies in the interpretation of the export subsidy provisions of both the *Agreement on Agriculture* and the *SCM Agreement*, as they related to US export credit guarantee programmes.

Regarding US domestic support measures, were the Panel to accept the evidence presented by Brazil, it would find that US PFC payments and direct payments do not satisfy the policy-specific criteria in paragraph 6 of Annex 2 of the *Agreement on Agriculture*. The Panel should also count US counter-cyclical payments going to US producers of upland cotton as "support to a specific commodity" under Article 13(b)(ii) of the Agreement.

Regarding US export credit guarantees, were the Panel to find that the programs provide export subsidies within the meaning of Article 1(e) of the *Agreement on Agriculture*, then it would also find that the United States has violated Articles 8 and 10.1 at the very least in respect of exports of upland cotton. In this respect, the Panel should confirm that neither the *Agreement on Agriculture* nor the *SCM Agreement* contain an exemption for any US export credit guarantee subsidy found to exist in this case.

Canada has no further views to provide to the Panel at this point in the proceedings.

## **ANNEX E-6**

### **FURTHER THIRD PARTY SUBMISSION OF THE EUROPEAN COMMUNITIES**

3 October 2003

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## 1. Introduction

1. The European Communities (the “EC”) makes this submission because of its systemic interest in the correct interpretation of the *Agreement on Subsidies and Countervailing Measures* (the “SCM Agreement”), the *Agreement on Agriculture* (the “AA”) and the *General Agreement on Tariffs and Trade 1994* (the “GATT”).

2. This submission provides the views of the EC with respect to Brazil’s further submission of 9 September 2003. Due to the short deadline imparted to third parties, this submission does not address the further submission made by United States on 30 September 2003. The EC intends to provide its comments on the US submission at the meeting with the Panel.

3. Many of the issues raised in Brazil’s further submission concern factual matters on which the EC is not in a position to comment. Accordingly, the EC will limit itself to provide its views with respect to a number of issues of legal interpretation to which it attaches particular importance. More specifically, the EC will argue in this submission that:

- in assessing the “significance” of price depression or suppression for the purposes of Article 6.3 (c) of the *SCM Agreement*, only their impact on the producers concerned is relevant;
- Brazil cannot complain about the continuing effects of recurring subsidies while expensing the full amount of such subsidies to the year in which they were granted;
- the phrase “world market share” in Article 6.3(d) of the *SCM Agreement* includes also the market of the subsidising Member;
- the mere fact that a subsidy is not subject to “pre-established limitations” is not sufficient for a finding of “threat of serious prejudice”;
- Articles 5 and 6 of the *SCM Agreement* do not prohibit *per se* legislation that mandates subsidies that threaten serious prejudice “in certain circumstances”.

4. The EC reserves the right to address other issues raised by Brazil’s further submission at the meeting with the Panel.

## 2. The meaning of “significant” in Article 6.3 (c) of the SCM Agreement

5. Brazil argues that, in assessing the “significance” of price depression or suppression for the purposes of Article 6.3 (c), it is relevant to consider not only their impact on the producers concerned, but also on the Government of the complaining Member. Specifically, Brazil contends that

A developing country Government facing foreign reserve or fiscal problems may find the loss of foreign exchange or tax revenue from its producers to be significant even if the level of price suppression is relatively small. In this regard, the amount of actual and potential revenue losses suffered by a complaining Member as a result of price suppression may be evidence of the significance of the price suppression.<sup>1</sup>

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<sup>1</sup> Brazil’s submission, para. 96.

6. The EC takes issue with this interpretation. As rightly argued by Brazil elsewhere in its submission<sup>2</sup>, the existence of serious prejudice must be presumed whenever it is established that the effect of the subsidy is to cause *inter alia* significant price depression or suppression, without it being necessary to show, as an additional and separate requirement, that such price depression or suppression causes a serious prejudice to the interest of the Member concerned. Brazil's interpretation, however, amounts to reading such a separate requirement into the term "significant".

7. In *Indonesia – Autos*, which is cited with approval by Brazil, the panel held that

Although the term 'significant' is not defined, the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not meaningfully affect suppliers of the imported product whose price was undercut are not considered to rise to serious prejudice ...<sup>3</sup>

8. The above interpretation takes into account only the effects of price undercutting on the performance of the domestic producers of the complaining party, to the exclusion of any indirect effects on Government revenue. By the same token, where serious prejudice takes the form of price suppression or price depression, its significance should be evaluated only with respect to the producers concerned.

9. In any event, the EC rejects Brazil's suggestion that the threshold for establishing the existence of serious prejudice should be lower when the complaining party is a developing country Member. Article 6.3 (c) is not a provision on Special and Differential Treatment. There is no basis for giving different meanings to the term "significant" depending on the identity of the parties to a dispute.

### 3. Continuing effects of recurring subsidies

10. Brazil alleges that the effects of the subsidies paid during Marketing Years ("MY") 1999-2002 continue after they have been provided. More precisely, according to Brazil, by providing farmers with a significant source of income, these payments result in increased investment and production.

11. The EC finds it difficult to understand what point, if any, Brazil is trying to make. Brazil does not seem to be arguing that part of the benefit conferred by the subsidies granted during MY 1999-2002 should be allocated to subsequent years. That position would depart from the usual practice of most countervailing duty authorities, which is to consider that recurring subsidies must, in principle, be deemed "expensed" during the time period in which they are made. Similarly, the report of the Informal Group of Experts concerning Article 6.1(a) of the *SCM Agreement* recommended that subsidies should be expensed rather than allocated unless: (1) the purpose of the subsidy is linked to the purchase of fixed assets; (2) the subsidy is non-recurring or large; (3) the subsidy is oriented towards future production; (4) the subsidy consists of equity; or (5) is carried forward in the recipient's accounting records.<sup>4</sup>

12. Elsewhere in its submission Brazil appears to have expensed the full amount of the subsidies paid during each marketing year to that marketing year, rather than allocate it over a number of marketing years. Brazil cannot have it both ways. If it considers that part of the benefit should be allocated to subsequent marketing years, it should justify that position in light of the criteria outlined

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<sup>2</sup> Ibid., paras 437-443.

<sup>3</sup> Panel report, *Indonesia – Automobiles*, WT/DS54/R, para. 14.254.

<sup>4</sup> Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures, 25 July 1997, G/SCM/W/415, paras. 5-12.



above and provide the Panel with a detailed allocation. Moreover, Brazil should deduct the amounts allocated to subsequent years from the yearly amounts for the period 1999-2001, so as to avoid any “double counting” of benefits. Needless to say, this could make more difficult for Brazil to establish that the subsidies paid during MY 1999 – 2001 have caused serious prejudice during that period.

13. In any event, while Brazil claims that the subsidies continue to have effects after MY 1999-2001, the alleged continuing effects (increased investments and production) do not of themselves amount to “serious prejudice” within the meaning of Article 5. Brazil has not explained, let alone proved, how those effects translated into one of the categories of “serious prejudice” described under Article 6.3 after 2001.

#### **4. World Market Share in Article 6.3(d)**

14. Brazil contends that the phrase “world market share” in Article 6.3(d) of the *SCM Agreement* means the “share of world market for exports”.<sup>5</sup> The EC sees no basis for this proposition. The ordinary meaning of “world market” is the sum of all the geographical markets for the product concerned, including also the domestic market of the subsidising Member.

15. This reading is supported by the context. As evidenced by paragraph (a) of Article 6.3, the notion of “serious prejudice” may include also the prejudice suffered in the market of the subsidising Member. There is no reason, therefore, why the effects of a subsidy in that market should be excluded from the analysis under paragraph (d).

16. The phrase “world market share” may be contrasted with the phrase “share of world export trade”, which is used in Article XVI:3 of the GATT. Surely, if the drafters of Article 6.3(d) had meant the “share of world market for exports”, as argued by Brazil, they would have used the same terms as in Article XVI:3. Moreover, in the context of Article XVI:3, it makes perfect sense to use as a benchmark the “share of the world market for exports” because that provision is concerned exclusively with export subsidies, which have no direct effect on the domestic market of the subsidising Member. In contrast, the disciplines on “serious prejudice” contained in Articles 5 and 6 of the *SCM Agreement* apply equally to both export and domestic subsidies and, in practice, are meant to address primarily the effects of the latter, since export subsidies are prohibited by Article 3 (except where provided in conformity with the *Agreement on Agriculture* or Article 27 of the *SCM Agreement*).

#### **5. Threat of injury**

17. Brazil sets forth two legal standards in order to analyse the existence of threat of serious prejudice. According to the first standard, there is threat of serious prejudice whenever “the legislation and practice of granting subsidies has no effective limits in terms of the volume of exports or domestic subsidies production eligible to receive subsidies”.<sup>6</sup> Brazil contends that this standard can be “distilled” from the two GATT panel reports in *EC – Sugar* and from the Appellate Body report in *US – FSC*.<sup>7</sup>

18. For the reasons explained below, the EC considers that, while the fact that a subsidy is not subject to any “pre-established limitations” is certainly a relevant factor in considering the existence of threat of serious prejudice, it is not necessarily dispositive.

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<sup>5</sup> Brazil’s submission, para. 265.

<sup>6</sup> Brazil’s submission, para. 301.

<sup>7</sup> Ibid.

19. The two GATT reports in *EC – Sugar* are of questionable authority on this point. Neither of the panels made any attempt to provide a generally applicable interpretation of the notion of “threat of serious prejudice”. The findings cited by Brazil are just bare assertions, without any supporting reasoning. Furthermore, other passages of the reports indicate that both panels took the view that the unlimited availability of subsidies could not be, of itself, a cause of serious prejudice. Thus, the panel in *EC – Sugar (Australia)* noted that

The Panel felt that since the Community sugar exporters were leading the world market for white sugar, traditionally covering more than half of the world market for refined sugar, the availability of exportable Community surpluses of sugar combined with the possibility of non-limited amounts available to cover export refunds, may well have had a depressing effect on world market prices for both white and raw sugar.<sup>8</sup>

Similarly, the panel in *EC – Sugar (Brazil)* observed that

The Panel concluded that in view of the Community sugar made available for export with maximum refunds and the non-limited funds available to finance export refunds, the Community system of granting export refunds on sugar had been applied in a manner which in the particular situation prevailing in 1978 and 1979 contributed to depress sugar prices in the world market, and that this constitutes a serious prejudice to Brazilian interests, in terms of Article XVI:1.<sup>9</sup>

20. The above passages suggest that both panels considered that the unlimited availability of the EC subsidies was a cause of serious prejudice only because, in conjunction with the availability of supplies of sugar in the EC and with the “particular situation” prevailing during the years 1978 and 1979, it had a depressing effect on prices. It follows that, unless the same or similar circumstances were also present or imminent in this case, the mere availability of subsidies could not be considered to pose, as such, a threat of serious prejudice.

21. Brazil’s arguments based on *US – FSC* are also without merit. Unlike Articles 5 and 6 of the *SCM Agreement*, Article 10.1 of the *Agreement on Agriculture* is not subject to a “trade effects” test. It prohibits any export subsidies not covered by Article 9, which exceed, or threaten to exceed, a Member’s reduction commitments (in terms of budgetary outlays or exported volumes), regardless of the trade effects of the subsidy. In contrast, Articles 5 and 6 do not stipulate any limitations on the volume or value of subsidies. Rather, they prohibit the granting of subsidies in so far as they have certain “adverse effects” for the interests of another Member. Whether or not a subsidy has such effects will depend not only on the amount of the subsidy or the volume of subsidised goods but also on other circumstances. For that reason, the mere fact that a subsidy is not subject to “pre-established limitations” is not a sufficient reason to conclude that it threatens to cause serious prejudice.

22. Brazil appears to agree with the view that the elements of a threat of serious prejudice injury are the same as those of a serious prejudice case, the only difference between the two being that “in a serious prejudice case, all the elements already exist, whereas in a threat of serious prejudice case, all of the elements need not have come to pass.”<sup>10</sup> Yet that view cannot be reconciled with Brazil’s first standard. Article 6 of the *SCM Agreement* makes it clear that the existence of “serious prejudice” cannot be established by looking only at the value of the subsidy (with the exception of the no-longer operational presumption in Article 6.1 (a)) or to the absolute volume of subsidised goods (as opposed

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<sup>8</sup> Panel report, *European Communities – Refunds on Exports of Sugar (Australia)*, BISD 26S/290, para. 4.31

<sup>9</sup> Panel report, *European Communities – Refunds on Exports of Sugar (Brazil)*, BISD 27S/69, V(f).

<sup>10</sup> Brazil’s submission, para. 304.

to their market share). Therefore, a determination of threat of serious prejudice cannot be based on those factors alone either.

23. The EC considers that Article 15.7 of the *SCM Agreement* provides relevant context for the interpretation of the notion of “threat of serious prejudice”. Both “injury to the domestic industry” and “serious prejudice” are “adverse effects” within the meaning of Article 5. There is no good reason why the threshold for establishing the existence of “threat of injury” should be higher than the threshold for establishing the existence of “threat of serious prejudice”. The EC is of the view, therefore, that the requirements set out in Article 15.7 of the *SCM Agreement* must be deemed implicit in the notion of “threat of serious prejudice”. Accordingly, a determination of threat of serious prejudice, like a determination of injury, must “be based on facts and not merely on allegation, conjecture or remote possibility”. Also, the relevant “changes in circumstances” must be “clearly foreseen and imminent”.

24. As recalled by Brazil, Article 15.7(i) of the *SCM Agreement* provides that the “nature of the subsidy or subsidies in question and the trade effects likely to arise therefrom” is one of the factors that should be considered for the purposes of a threat of injury determination.<sup>11</sup> The EC agrees that this is also one of the factors that should be considered for the purposes of a determination of threat of serious prejudice. But it is not the only relevant factor. Brazil glosses over the last sentence of Article 15.7, which provides that no one of the factors listed in that provision “can necessarily give guidance”. Rather, “the totality of the factors considered must lead to the conclusion that further subsidised exports are imminent and that, unless protective action is taken, material injury would occur”. This confirms that, while the absence of “pre-established limitations” is a relevant factor, it is not necessarily dispositive.

25. Brazil further asserts that the other factors listed in Article 15.7 “are not directly relevant to a threat of serious prejudice case because they address the situation of imports that would harm the domestic industry in the country of importation.”<sup>12</sup> This is, of course, correct. Nonetheless, Article 15.7 suggests that analogous factors may be relevant for a determination of serious prejudice. For example, the following factors could be relevant for establishing the existence of serious prejudice in an export market:

- a significant rate of increase of subsidised exports to the export market;
- sufficiently freely disposable, or an imminent, substantial increase in, capacity of the exporter indicating the likelihood of substantially increased subsidised exports, taking into account the availability of other export markets to absorb any additional exports;
- whether subsidised exports are entering into the export market at prices that will have a significant depressing or suppressing effect in prices, and would likely increase demand for further imports; and
- inventories of the product investigated.

26. In sum, the EC is of the view that, while the fact that a subsidy is not subject to any “pre-established limitations” as regards the value of the subsidies or the volume of subsidised goods is a relevant factor in order to establish the existence of threat of serious prejudice, it is not necessarily dispositive. Other factors, including in particular factors analogous to those listed in Article 15.7 (ii)-(v) of the *SCM Agreement*, may also be relevant and should be examined as well.

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<sup>11</sup> Ibid., para. 302.

<sup>12</sup> Ibid., para. 303.

## 6. *Per se claims*

27. Brazil claims that the US legislation conferring the subsidies at issue in this case is inconsistent *per se* with Article 5(c) of the *SCM Agreement* and Article XVI:3 of the GATT because it *mandates* the payment of subsidies that will necessarily threaten serious prejudice *in certain circumstances*. This claim is based on the assumption that

It is established under WTO law that a Member can challenge measures of another Member on a *per se* basis when those measures mandate, in certain circumstances, a violation of its WTO obligations.<sup>13</sup>

28. The above proposition, however, is nowhere stated in the WTO Agreement and, as noted already in its first submission<sup>14</sup>, the EC disputes its validity. True, some panels have asserted this position on the basis of an erroneous interpretation of the panel report in *US - Superfund*. Other panels, however, have taken a contrary, or at least more qualified view.<sup>15</sup> In particular, the panel in *US - Section 301* observed that

we believe that resolving the dispute as to which type of legislation, *in abstract*, is capable of violating WTO obligations is not germane to the resolution of the type of claims before us. In our view the appropriate method in cases such as this is to examine with care the nature of the WTO obligation at issue and to evaluate the Measure in question in the light of such examination. The question is then whether, on the correct interpretation of the specific WTO obligation at issue, only mandatory or also discretionary national laws are prohibited. We do not accept the legal logic that there has to be one fast and hard rule covering all domestic legislation. After all, is it so implausible that the framers of the WTO Agreement, in their wisdom, would have crafted some obligations which would render illegal even discretionary legislation and crafted other obligations prohibiting only mandatory legislation? Whether or not Section 304 violates Article 23 depends, thus, first and foremost on the precise obligations contained in Article 23.<sup>16</sup>

29. The Appellate Body has not pronounced itself yet clearly on this issue. Thus, in *US - 1916 Act*, which is sometimes cited erroneously as an endorsement of the principle invoked by Brazil, the Appellate Body noted that

... the 1916 Act is clearly not discretionary legislation, as that term has been understood for purposes of distinguishing between mandatory and discretionary legislation. Therefore, we do not find it necessary to consider, in these cases, whether

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<sup>13</sup> Brazil's submission, para. 417.

<sup>14</sup> EC's First Third Party Submission, paras. 4-7.

<sup>15</sup> See e.g. the Panel report on *United States - Countervailing Measures Concerning Certain products from the European Communities*, WT/DS212/R, para. 7.123:

While only legislation that mandates a violation of WTO obligations can be WTO-inconsistent, we are of the view that the existence of some form of executive discretion alone is not enough for a law to be *prima facie* WTO - consistent, what is important is whether the government has an effective discretion to interpret and apply its legislation in a WTO-inconsistent manner.

<sup>16</sup> Panel report, *United States - Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, para. 7.53.  
[footnotes omitted]

Article 18.4, or any other provision of the Anti-Dumping Agreement, has supplanted or modified the distinction between mandatory and discretionary legislation.<sup>17</sup>

30. The Appellate Body was even more cautious in a subsequent case, *US – Lead and Bismuth II*, where it noted that

We are not, by implication, precluding the possibility that a Member could violate its WTO obligations by enacting legislation granting discretion to its authorities to act in violation of its WTO obligation. We make no finding in this respect.<sup>18</sup>

31. The EC agrees with the panel in *US – Section 301* that whether or not *discretionary* legislation may be subject to challenge depends on the specific obligations imposed by each provision of the WTO Agreement. Thus, for example, it is arguable that Article XI:1 of the GATT prohibits not only mandatory legislation, but also legislation which authorises expressly the executive branch to apply an import restriction under well specified circumstances, because such authorisation, of itself, may have a chilling effect on imports.

32. For the same reasons, it would be mistaken to assume, as Brazil does, that legislation which mandates action that would result in a violation of a WTO provision *in certain circumstances* is necessarily inconsistent with that provision. As illustrated by the present case, this notion would have absurd and unacceptable results when applied to WTO provisions which, like Article 5(c) of the *SCM Agreement* and Article XVI:3 of the GATT, incorporate a “trade effects” test. The EC considers that, once again, whether or not legislation that mandates a violation *in certain circumstances* can be challenged *per se* will depend on the specific obligations imposed by the WTO provision at issue.

33. It is often overlooked that in *US– Superfund* the panel justified its finding that the tax legislation at issue could be challenged, even though it had not entered into effect, by reasoning that Article III of the GATT is not concerned with trade volumes, but rather with competitive opportunities<sup>19</sup>:

The Panel noted that the United States objected to an examination of this tax because it did not go into effect before 1 January 1989, and - having no immediate effect on trade and therefore not causing nullification or impairment – fell outside the framework of Article XXIII. [...]

[...] The general prohibition of quantitative restrictions under Article XI, which the Panel on Japanese Measures on Imports of Leather examined, and the national treatment obligation of Article III ... have essentially the same rationale, namely to protect expectations of the contracting parties as to the competitive relationship between their products and those of the other contracting parties. Both articles are not only to protect current trade but also to create the predictability needed to plan future trade. That objective could not be attained if contracting parties could not challenge existing legislation mandating actions at variance with the General Agreement until the administrative acts implementing it had actually been applied to their trade. Just as the very existence of a regulation providing for a quota, without it restricting particular imports, has been recognized to constitute a violation of Article XI:1, the

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<sup>17</sup> Appellate Body report, *United States – Anti-Dumping Act of 1916*, WT/DS136/AB/R, WT/DS162/AB/R, para. 99.

<sup>18</sup> Appellate Body report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, footnote 334.

<sup>19</sup> Panel report, *United States – Taxes on Petroleum and Certain Imported Products*, BISD 34/136, 160, paras.5.2.1-5.2.2.

very existence of mandatory legislation providing for an internal tax, without it being applied to a particular imported product, should be regarded as falling within the scope of Article III:2, first sentence. ...

34. It is also a common mistake to assume that, like Articles III or IX of the GATT, all other WTO provisions are concerned also with competitive opportunities. Some WTO provisions, however, are not concerned with competitive opportunities, but instead with trade effects. Article 5(c) of the *SCM Agreement* and Article XVI:3 of the GATT fall within that category. They prohibit the granting of subsidies only to the extent that the subsidies cause “adverse effects” in the form of “serious prejudice”. Such effects must be actual or threatened, not just theoretical.

35. The “mandatory” standard invoked upon by Brazil would result in the creation of third category of prohibited adverse effects in addition to actual and threatened serious prejudice, which is nowhere mentioned in Article 5(c): the mere possibility of threat of serious prejudice *in certain circumstances*. Furthermore, as a result, Brazil’s interpretation would render redundant the two categories of effects which are mentioned in Article 5(c). As explained above, threat of serious prejudice must be *imminent* and *foreseeable*. Yet, on Brazil’s interpretation, it would be sufficient, in order to establish a *per se* violation, to show that the legislation at issue mandates action that threatens serious prejudice *in certain circumstances*, no matter how remote the likelihood that such circumstances will ever materialise. For example, on Brazil’s interpretation, it would be enough to show that the legislation mandates the payment of subsidies that will threaten serious prejudice in a purely hypothetical situation where world prices fall to an extremely low level, even if the chances that prices may actually fall to such level are negligible in practice.

36. In sum, Brazil’s *per se* claim is an ingenious but misguided attempt to avoid the requirements of Article 5(c) of the *SCM Agreement*, which should be rejected by the Panel.

**ANNEX E-7****FURTHER THIRD PARTY SUBMISSION OF NEW ZEALAND**

3 October 2003

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## I. INTRODUCTION

1.01 Although New Zealand is not a producer or exporter of cotton, New Zealand has a systemic interest in ensuring the continued integrity of important WTO disciplines applicable to agricultural trade and has therefore joined this dispute as a third party. As outlined in New Zealand's First Submission to the Panel<sup>1</sup>, New Zealand is concerned to ensure that Members are able to utilise their rights under the *Agreement on Subsidies and Countervailing Measures* (the *SCM Agreement*) and GATT 1994 to take action in respect of domestic support measures and export subsidies where the requirements of the "peace clause" have not been respected.

1.02 New Zealand believes that Brazil has demonstrated that the "peace clause" has not been respected in relation to domestic support and export subsidies provided by the United States to upland cotton in the marketing years ("MY") 1999, 2000, 2001 and 2002, and that accordingly Brazil is entitled to bring actionable and prohibited subsidy claims against the United States under the GATT 1994 and the *SCM Agreement*.

1.03 In its Further Submission to the Panel,<sup>2</sup> Brazil has provided the legal and factual basis upon which the Panel should conclude that the United States subsidies cause or threaten to cause serious prejudice to the interests of Brazil within the meaning of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement* and violate GATT Article XVI. New Zealand therefore considers that the Panel should make the findings and recommendations requested by Brazil.

1.04 This submission addresses issues raised in the Further Submissions of Brazil and the United States<sup>3</sup> and should be read in conjunction with New Zealand's First Submission. As recognised by the Panel in its communication of 24 September 2003, New Zealand has had only limited time to consider the Further Submission of the United States and therefore reserves the right present arguments in addition to those set out in this written submission in its oral statement to the Panel on 8 October 2003.

## II. PRESENT SERIOUS PREJUDICE

2.01 Brazil has demonstrated that the United States subsidies<sup>4</sup> cause serious prejudice to the interests of Brazil within the meaning of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement* and violate GATT Article XVI.

2.02 Brazil has demonstrated that the United States subsidies during marketing year (MY) 1999-2002:

- cause present significant price suppression<sup>5</sup> in the world and Brazilian markets, as well as in markets where Brazilian producers export, within the meaning of Article 6.3(c) of the *SCM Agreement*;

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<sup>1</sup> *United States – Subsidies on Upland Cotton*, Third Party Submission of New Zealand, 15 July 2003 ("New Zealand's First Submission").

<sup>2</sup> *United States – Subsidies on Upland Cotton*, Brazil's Further Submission to the Panel, 9 September 2003 ("Further Submission of Brazil").

<sup>3</sup> *United States – Subsidies on Upland Cotton*, Further Submission of the United States of America, 30 September 2003 ("Further Submission of the US").

<sup>4</sup> New Zealand uses that term as it is used by Brazil in its Further Submission (para 7). Details of these programmes were provided by Brazil in its First Submission to the Panel Regarding the "Peace Clause" and Non-"Peace Clause" Related Claims, 24 June 2003 ("First Written Submission of Brazil"), paras 45 – 106.

<sup>5</sup> New Zealand uses the term as it is used by Brazil in its Further Submission to also encompass circumstances showing price depression characteristics.



- had the effect of increasing the United States share of the world upland cotton market within the meaning of Article 6.3(d) of the *SCM Agreement*, and
- contributed significantly to the United States having more than an equitable share of world export trade within the meaning of GATT Article XVI:3.

New Zealand will focus in particular on Brazil's claim that the United States subsidies cause "significant price suppression".

## 1. The effect of the United States subsidies is significant price suppression

2.03 Brazil has demonstrated that the United States subsidies during marketing year (MY) 1999-2002 cause present significant price suppression in the Brazilian and world markets, including in markets where Brazilian and United States producers export, within the meaning of Article 6.3(c) of the *SCM Agreement* and thus cause serious prejudice. Brazil has demonstrated that the United States subsidies suppressed A-index prices by an average of 12.6% over MY 1999-2002.<sup>6</sup> That translates into a total amount of lost revenue for Brazilian producers of \$478 million<sup>7</sup> and suppressed revenue worldwide of \$3.587 billion.<sup>8</sup>

2.04 With subsidisation at levels of 95 per cent on average<sup>9</sup>, subsidies are the greater part of 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, when prices for upland cotton were falling<sup>10</sup>, and the value of the United States dollar<sup>11</sup> and costs of production were rising<sup>12</sup>, production of upland cotton and United States exports of upland cotton significantly increased.<sup>13</sup> United States farmers planted 13.5 per cent more acres with upland cotton.<sup>14</sup> United States production hit a record high.<sup>15</sup> United States exports and the United States share of the world market increased.<sup>16</sup>

2.05 Professor Sumner estimates that if all United States government support to upland cotton were eliminated, United States exports would have been 41 per cent less in MY 1999-2002.<sup>17</sup> By contrast, *with* the subsidies the United States world market share in fact more than doubled over that period.<sup>18</sup>

2.06 This subsidy-fuelled production and export growth resulted in significant price suppression within the meaning of Article 6.3(c). Prices were suppressed by the increased world supply of upland cotton and increased competition from United States upland cotton in world markets. Brazil has also outlined the influence that the United States has on world prices for upland cotton<sup>19</sup> - the sheer size of

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<sup>6</sup> Further Submission of Brazil, para 229.

<sup>7</sup> *Ibid*, para 446.

<sup>8</sup> *Ibid*, para 256.

<sup>9</sup> *Ibid*, para 105.

<sup>10</sup> *Ibid*, part 3.3.4.2.

<sup>11</sup> *Ibid*, part 3.3.4.4.

<sup>12</sup> *Ibid*, Part 3.3.4.3. Brazil has demonstrated that by the end of MY 2001 the cost-revenue gap had increased to 39 cents per pound (para 121).

<sup>13</sup> See *Ibid*, para 105. Between 1998 and 2001 production increased by 45.5 per cent and exports by 161 per cent.

<sup>14</sup> *Ibid*, para 130.

<sup>15</sup> In MY 2001 United States production reached 19.603 million bales (*Ibid*, para 131).

<sup>16</sup> *Ibid*, para 132.

<sup>17</sup> *Ibid*, para 288.

<sup>18</sup> *Ibid*, para 283.

<sup>19</sup> *Ibid*, para 3.3.4.6.

the United States share of total world production<sup>20</sup> and of world exports magnifies the trade distorting effects of the United States subsidies. Any doubt about the impact that United States subsidies have on the world market for upland cotton should be quickly dispelled by the graphic demonstration of United States dominance of the world market illustrated by Brazil in Figure 26.

2.07 New Zealand agrees with Brazil that the absolute size and average subsidisation level of the United States subsidies creates a strong *de facto* presumption of production, export and price effects.<sup>21</sup> However Brazil has not simply relied on such a presumption. Brazil has produced econometric analysis demonstrating that the United States subsidies caused significant price suppression, as actual market prices throughout MY 1999-2002 would have been higher but for the effects of the United States subsidies.<sup>22</sup>

2.08 At no point in its submission does the United States dispute the accuracy of this econometric analysis. Instead, in response to Brazil's claims, the United States seeks to argue that Brazil's case "suffers from a failure of factual proof"<sup>23</sup> and that Brazil has failed to make a *prima facie* case of serious prejudice or more than equitable market share because Brazil has done no more than assert that causation is established because there were large United States outlays during marketing years with low prevailing upland cotton prices.<sup>24</sup> According to the United States, factors other than United States subsidies "were the causes of the dramatic plunge in cotton prices experienced in recent years,"<sup>25</sup> namely: competition from low price polyester; flat retail consumption of cotton outside of the United States; slow world economic growth; burgeoning United States textile imports leading to more United States cotton exports; a stronger United States dollar leading to weakened commodity prices and China's trade position.

2.09 However 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. It is Brazil's contention, backed up by sound econometric analysis, that the United States subsidies have a significant price-suppressing effect. And that effect exists regardless of whether cotton prices are rising or falling.<sup>26</sup> Nor did Brazil's analysis fail to take into account the impact of other adverse factors affecting upland cotton prices as alleged by the United States.<sup>27</sup> The econometric models used by Brazil, in particular FAPRI, hold other relevant factors affecting the price of cotton constant while cotton subsidies are removed, thereby isolating the effect of those subsidies. Therefore Brazil's analysis did not attribute to cotton subsidies the effects of other factors affecting cotton prices. As noted above, at no point in its submission does the United States question the integrity of the models referred to by Brazil and upon which the estimated impacts of the removal of United States cotton subsidies is based.

(i) *Interpretation of Article 6.3(c)*

2.10 New Zealand disagrees with the United States interpretation of Article 6.3. Essentially the United States reached the wrong conclusion from its comparison of the language of Article 6.1 with that of Article 6.3. The United States concluded that because Article 6.3 used the phrase "*may arise in*

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<sup>20</sup> 19.5 per cent in MY 2002 (*Ibid*, para 135).

<sup>21</sup> *Ibid*, paras 106 and 107.

<sup>22</sup> Evidence adduced by Brazil, specifically the Quantitative Simulation Analysis by Professor Daniel Sumner, shows that but for the United States subsidies A-Index prices between MY 1999-2002 would have been, on average, 12.6 per cent higher.

<sup>23</sup> Further Submission of the US, para 16.

<sup>24</sup> *Ibid*, para 17.

<sup>25</sup> *Ibid*.

<sup>26</sup> Further Submission of Brazil, para 231.

<sup>27</sup> Further Submission of the US, para 80.

any case where one or several of the following apply”, whereas Article 6.1 states “serious prejudice *shall be deemed to exist* in the case of ...”, that this means that serious prejudice “need not arise even under Article 6.3 even where one of the listed effects is found”.<sup>28</sup> 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*. The United States states that a complainant must show that the “prejudice” suffered is “serious”.<sup>29</sup>

2.11 First, the example given by the United States in footnote 43 seems to be covered by the terms of Article 6.4. Second, and more importantly, there is no basis for drawing from a comparison of language used in Articles 6.1 and 6.3 the conclusion that there is some other standard, independent of Article 6, that must be demonstrated in order to show “serious prejudice”. In fact, as New Zealand will show, a comparison of both the language *and substance* of Articles 6.1 and 6.3, in the context of Articles 5 and 6 of the *SCM Agreement*, supports the contrary conclusion – that if a complainant has demonstrated the existence of one or more of the effects enumerated in Article 6.3 there is “serious prejudice” that is an adverse effect of the subsidy within the meaning of Article 5.

2.12 That is because the difference in language simply reflects the different way in which both Article 6.1 and Article 6.3 give meaning to the term “serious prejudice”. Both must be seen in the context of concern in this part of the *SCM Agreement* with the effects of subsidies on other Members. In relation to Article 6.1, “serious prejudice” was given meaning by reference to specific types of subsidies or qualities of a subsidy that were “deemed” to have effects that were adverse to the interests of other Members. However, it was open to a subsidising Member under Article 6.2 to overturn that presumption by showing that in fact the subsidy did not cause serious prejudice – i.e. that the subsidy *had not resulted in any of the effects enumerated in Article 6.3*.

2.13 The terms of Article 6.2 make it clear that the effects enumerated in Article 6.3 equate to “serious prejudice” and that nothing more than demonstration that one of those effects exists is necessary to find serious prejudice.

2.14 Further, by contrast with Article 6.1, Article 6.3 looks more broadly at the effects of the subsidy, rather than its specific characteristics. There is thus no need to “deem” certain effects to arise from certain types or characteristics of a subsidy as there was in Article 6.1. Instead Article 6.3 is more broadly cast to take an effects-based approach – in essence it is designed to encompass any kind of subsidy that has the adverse effects enumerated and is therefore “actionable”. However there is no basis to draw from this difference in approach, and therefore in language, the conclusion that more is required under Article 6.3 than simply demonstrating that one or more of the prescribed effects exists in order show that there is serious prejudice. Such an interpretation undermines the careful structure of Article 6 and the clear intent of Article 5 and must be rejected.

2.15 Nor does the use of the word “may” in Article 6.3 lead to any other conclusion. In that respect it is important to note that Article 5(c) incorporates, as specified in Footnote 13 to the *Agreement*, GATT Article XVI.1 which includes *inter alia* the threat of serious prejudice. Therefore it was appropriate to state that serious prejudice in the sense of paragraph (c) of Article 5 *may* arise where any of the listed effects exists because there may be other circumstances in which serious prejudice can be demonstrated, including, for example, where there is a threat of serious prejudice. If the word “shall” had been used this would have been taken to mean that Article 6.3 provides the definitive set of circumstances in which serious prejudice can arise. By virtue of Footnote 13 that is not the case.

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<sup>28</sup> *Ibid*, para 77.

<sup>29</sup> *Ibid*, para 79.

2.16 Consideration of Article 6.3 in the context of the rest of Article 6 provides further support for the interpretation outlined above. First, it makes little sense to have gone to such detail in Article 6.4 to describe what is required to meet the requirements of Article 6.3(b) if there is another set of undefined requirements that must also be demonstrated in order to find serious prejudice.

2.17 Second, in terms of Article 6.2, if there were other elements outside those in Article 6.3 that had to be demonstrated to show serious prejudice, why would a subsidising Member not also have had to show that those elements were not present in order to avoid the presumption in Article 6.1?

2.18 Third, Article 27.8 (although now defunct because Article 6.1 is no longer in effect), also provides that serious prejudice arising from subsidies by developing country Members “shall be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6”. This makes it clear that serious prejudice need only be determined by reference to Articles 6.3–6.8 of the *SCM Agreement*.

2.19 Finally, Article 6.8 provides that “in the absence of circumstances referred to in paragraph 7, the existence of serious prejudice should be determined on the basis of the information submitted in accordance with the provisions of Annex V”. This confirms that paragraph 7 of Article 6 outlines the only set of circumstances in which it is not possible to make a determination as to the existence of serious prejudice when one of the situations in Article 6.3 is demonstrated to exist. The direction in Article 6.8 to determine the “existence” of serious prejudice on the basis of the record would be deprived of meaning if a determination of serious prejudice also had to be made by reference to additional criteria not specified by the *SCM Agreement* that could lead to a materially different outcome as a matter of fact and law.

2.20 Serious prejudice is not the abstract concept the United States attempts to portray it as. Serious prejudice refers to the concrete adverse effects of a subsidy on the interests of another Member that are clearly elaborated in Article 6.3. However, even if the United States is right and a complainant, having demonstrated the existence of significant price suppression within the meaning of Article 6.3(c), must also meet a separate test of “serious prejudice” under Article 5(c), Brazil has demonstrated that serious prejudice exists by providing the Panel with additional information outlining the harm caused to its upland cotton producers as well as to the Brazilian economy.<sup>30</sup>

(a) “Significant”

2.21 Article 6.3(c) of the *SCM Agreement* requires that the level of price suppression caused by the United States subsidies must be “significant”, that is, it may not be so small as to have no meaningful effect on other producers or suppliers of the same product.<sup>31</sup> Logically, price suppression that is so small as to have no meaningful effect could not give rise to serious prejudice. However, such an interpretation does not mean that a very small level of price suppression may not have a meaningful effect, for example where large volumes of a product may be traded.<sup>32</sup> As Brazil demonstrates, even a 1 cent per pound price-suppressing effect can reduce worldwide export revenue by \$552 million. Average price declines of 12.6 per cent for upland cotton clearly have a meaningful affect on

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<sup>30</sup> Further Submission of Brazil, Part 6.

<sup>31</sup> Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, adopted 23 July 1998 (“*Indonesia – Automobiles*”). The Panel considered (at para 254) the meaning of “significant” in the context of Article 6.3(c) and concluded:

Although the term “significant” is not defined, the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not meaningfully effect suppliers of the imported product whose price was being undercut are not considered to give rise to serious prejudice.

<sup>32</sup> Further Submission of Brazil, para 95 and para 256.

Brazilian producers of upland cotton. New Zealand fully agrees with Brazil that such price suppression is thus “far beyond any legitimate threshold of ‘significance’”.<sup>33</sup>

2.22 The United States argues that Brazil’s interpretation of “significant” collapses the concept of “significant price suppression or depression” with the concept of “serious prejudice” because Brazil’s assessment of the significance of the price suppression has wrongly focussed on the effect of the subsidy on producers rather than on prices. As outlined in paragraphs 2.10–2.20 above, in New Zealand’s view the construction of Articles 5 and 6 makes it clear that “significant price suppression or depression” is simply a form or manifestation of “serious prejudice” and therefore it is artificial to make into two separate inquiries what is clearly meant to be only one.

2.23 In any event the United States argument that the significance of the price suppressive effect of the subsidy can only be determined by reference to the effect on ‘price’ should be rejected. Articles 5 and 6 are concerned with the *adverse effects* of a subsidy – Article 5 states that “no Member should cause, through the use of any subsidy ... *adverse effects* to the interests of other Members.” Therefore it is entirely appropriate under Article 6.3(c) to consider whether price suppression is “significant” by reference to the effect of the price suppression on the Member alleging adverse effects to its interests. In other words, what renders price suppression significant or insignificant is whether or not it causes adverse effects to the Member concerned, not whether or not an arbitrary level of numeric significance is achieved as implied by the United States. Under the United States approach, a numerically small suppressive effect on prices could be disregarded, even though it may have significant adverse effects on the complainant Member. Thus, using the example given by Brazil, price suppression by only 1 cent per pound may not be “significant” enough under the United States standard and therefore could not give rise to serious prejudice, even though that level of price suppression would reduce worldwide export revenue by \$552 million.<sup>34</sup>

2.24 Nor does the United States explain how ‘significance’ is to be determined under its proposed approach. That is because such an approach would require Panels to apply some kind of arbitrary standard of significance – would 5 per cent be significant? Would 10 per cent or 20 per cent? Would the level of required significance vary from case to case, and if so how is a Panel to determine what that level should be?

2.25 By contrast, the approach taken by Brazil of interpreting “significant” as requiring the level of price suppression to be “meaningful” in its effect, reflecting the Panel’s reasoning in *Indonesia – Automobiles*, provides a more logical and consistent basis upon which to determine whether the price suppression is “significant”. It is also consistent with the objective of Articles 5 and 6 which is to address subsidies that have an adverse effect on the interests of other WTO members. Nor is such an approach inconsistent with the United States assertion that the drafters of Article 6.3(c) used the term “significant” to create a threshold to ensure that not just “any theoretical price effect”<sup>35</sup> would suffice. In fact the Panel in *Indonesia – Automobiles* appears to have made the same assessment of the intention of the drafters when it stated that

the inclusion of this qualifier (ie ‘significant’) in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not

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<sup>33</sup> *Ibid*, para 95.

<sup>34</sup> This example is of course based on the effect of subsidies on “like products”, which, as Brazil has demonstrated (Further Submission of Brazil, part 3.3.2), United States upland cotton and Brazilian upland cotton are.

<sup>35</sup> Further Submission of the US, para 84.

meaningfully affect suppliers of the imported product whose price was being undercut are not considered to give rise to serious prejudice.<sup>36</sup>

2.26 Nor does the United States argument find support in the reference to the price suppression being “in the same market” in Article 6.3(c). The United States argues this means that the price suppression must be significant in “market terms” and therefore the question is the effect of the price suppression on the market and not on the Member concerned.<sup>37</sup> While New Zealand agrees that the effect of the price suppression on the market may be relevant to considering whether that price suppression is “significant”, New Zealand notes that the phrase “in the same market” simply serves to locate the price suppressive effects rather than define their substance. In fact the United States acknowledges as much further on it in its submission.<sup>38</sup> Further, the United States has not attempted to claim that its exports are not to the same market as exports from Brazil. And of course it cannot, because, as Brazil has demonstrated, Brazilian upland cotton and United States upland cotton are like products and are treated by upland cotton traders as interchangeable and substitutable.<sup>39</sup>

2.27 Finally, New Zealand notes that the United States arguments do not seek to suggest that the level of price suppression found to exist in the present case - 12.6 per cent - is not “significant” within the meaning of Article 6.3(c). Therefore the Panel should find that “significant price suppression” exists as a result of the United States subsidies and that therefore the United States subsidies cause serious prejudice to the interests of Brazil.

(b) Time Period for Demonstrating Causal Effects

2.28 The United States argues that “a past subsidy no longer exists as of the time a new subsidy payment in respect of current production is made”.<sup>40</sup> Therefore, argues the United States, subsidies prior to the most recent period, MY 2002, can have no “effect” within the meaning of Article 6.3 and the “effect of the subsidy must be demonstrated in each year and for each year that Brazil has challenged”.<sup>41</sup>

2.29 By the United States reasoning a complainant may only take a serious prejudice case in the year in which the serious prejudice is caused. To say that a “past subsidy no longer exists” once a further payment is made under the same subsidy scheme is entirely artificial. Leaving aside the practical difficulties the United States approach would pose given the nature of the evidence that is required and the timelines for WTO dispute settlement – which would effectively preclude any Members from ever taking serious prejudice cases – this approach ignores that fact that the subsidy programmes are in existence for a period of years and have effects on the decisions of producers beyond simply the year in which they have been paid.<sup>42</sup> Producers expectations of continued subsidies are integral to planting decisions and it is clear that United States producers expect ongoing subsidies as these have been legislatively mandated until MY 2007.

2.30 Similarly the serious prejudice caused to a WTO Member over the lifetime of a subsidy programme is not easily compartmentalised into a particular year and such an artificial constraint on the appropriate time period for consideration by a Panel would seem to undermine the object and

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<sup>36</sup> Panel Report, *Indonesia – Automobiles*, para 14.254.

<sup>37</sup> Further Submission of the US, para 87.

<sup>38</sup> *Ibid*, para 90.

<sup>39</sup> Further Submission of Brazil, para 80.

<sup>40</sup> Further Submission of the US, para 94.

<sup>41</sup> *Ibid*, para 95.

<sup>42</sup> Brazil has demonstrated that the effects of the United States subsidies continue after they have been provided because, for example, they have “wealth” and “investment” effects (Further Submission of Brazil, part 3.3.4.7.7).

purpose of the disciplines on actionable subsidies in the Agreement. New Zealand therefore agrees with Brazil that MY 1999-2002 is a reasonable period for the Panel to use for the present serious prejudice claims.

## **2. The effect of the United States subsidies is an increase in the United States world market share**

2.31 Brazil has demonstrated that the United States subsidies resulted in an increase in the United States world market share for upland cotton in MY 2001 within the meaning of Article 6.3(d). The data provided by Brazil shows that the United States world market share in MY 2001 of 38.3 per cent is considerably higher than the previous three-year average,<sup>43</sup> and that this was due to the effect of the United States subsidies.<sup>44</sup>

2.32 The United States argues that the term “world market share” refers to “all consumption” of upland cotton and thus would include “consumption by a country of its own cotton production”. The United States appears to suggest that Article 6.3(d) is thus concerned with the effect of the subsidy on world consumption of cotton.

2.33 It is true that GATT Article XVI:3 uses the phrase “world export trade”. However it is quite a leap of logic to then conclude that because Article 6.3(d) uses the term “world market share” then it must refer to a Member’s share of world consumption. The United States makes this leap on the basis that the relevant context for determining what “world market share” means is GATT Article XVI:3. However the first point of reference should in fact be Article 6.3 itself, and Article 5 to which it is so integrally related. Thus the appropriate context in which to give meaning to “world market share” is the aim of Articles 5 and 6, ie to address the adverse effects of subsidies on the interests of other Members.

2.34 Subsidies are the concern of WTO members to the extent that they distort trade – hence the differentiation in treatment of trade-distorting and non-trade distorting subsidies. Therefore the adverse effects with which Article 6.3 is concerned is the effect of subsidies on trade in the world market. Specifically, it is concerned with adverse effects to other Members caused when one Member uses subsidies in order to increase its share of the world market for a particular product. To construe “world market share” as referring to a Member’s share of world consumption of a product would therefore completely subvert the underlying rationale of Article 6.3(d).

## **3. The United States has a “more than equitable share” of world export trade in upland cotton**

2.35 Brazil has demonstrated that the United States subsidies have operated to increase United States exports of upland cotton resulting in the United States having a “more than equitable share” of world export trade in upland cotton within the meaning of GATT Article XVI:3 and has thus caused serious prejudice to the interests of Brazil within the meaning of GATT Article XVI:1.<sup>45</sup>

2.36 The United States seeks to dismiss the relevance of GATT Article XVI:3 by reference to pre-Uruguay Round comment by the Panel on Wheat Flour<sup>46</sup>, addressing the Tokyo Round Subsidies Code, in an unadopted report, that there are “difficulties inherent in the concept of ‘more than equitable share’”.<sup>47</sup> The United States also seeks to assert that “Members are generally permitted to

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<sup>43</sup> Further Submission of Brazil, para 267 and Figure 24.

<sup>44</sup> *Ibid.*, paras 271 – 272.

<sup>45</sup> Further Submission of Brazil, part 3.5.

<sup>46</sup> GATT Panel Report, *EEC – Subsidies on Export of Wheat Flour*, SCM/42, (unadopted).

<sup>47</sup> Further Submission of the US, paras 108 and 109.

provide subsidies.”<sup>48</sup> That is true up to the point at which those subsidies cause serious prejudice to the interests of the other Members. And in this context the Panel should consider whether, as the world’s largest exporter of upland cotton with average levels of subsidisation of 95 per cent, the United States has a “more than equitable” share of world export trade. New Zealand submits that Brazil has demonstrated that the United States does.

#### 4. Issues relating to particular United States subsidies

2.37 Brazil sets out arguments relating to the full complement of United States subsidies and the serious prejudice they cause both individually and collectively. New Zealand will comment only on marketing loan payments, Step 2 payments and market loss assistance/counter-cyclical payments.

##### (i) *Marketing Loan Payments*

2.38 Brazil has highlighted that these payments are considered by the USDA and by other economists as having the greatest production and export enhancing effects and thus the greatest A-Index price suppressing effects of all the United States subsidies.<sup>49</sup> Brazil has described how the effect of the marketing loan programme is to increase production, increase exports of upland cotton, and suppress upland cotton prices (on average by 5.75% in MY 1999-2002).<sup>50</sup> The marketing loan programme is thus responsible for almost half of the estimated average price suppressing effects of the United States subsidies.

##### (ii) *Step 2 Payments*

2.39 The availability of Step 2 payments increases production in the United States, displaces imports of lower priced foreign upland cotton and enables additional United States exports of upland cotton. The Step 2 payment programme is specifically designed to stimulate export demand for United States upland cotton. Brazil has shown that the trade distorting effect of the Step 2 payments is widely acknowledged.<sup>51</sup> Professor Sumner estimates that Step 2 payments suppressed world prices between MY 1999-2002 by 3.04 per cent.<sup>52</sup>

2.40 Brazil has demonstrated that Step 2 domestic payments are a prohibited subsidy under Article 3.1(b) of the *SCM Agreement* in that the payments are contingent on the use of domestic over imported upland cotton and thus also violate Article III.4 of GATT 1994.

##### (iii) *Market loss assistance/Counter-cyclical payments*

2.41 The United States continues to argue that market loss assistance payments and counter-cyclical payments (CCP) are not linked to production and accordingly cannot have “effects” for the purposes of Article 6.3(c) nor operate to increase exports as required by GATT Article XVI:3.<sup>53</sup> The United States implies that their production effects are less than one percent.<sup>54</sup> However Professor Sumner’s analysis shows that although their production effects were less than one percent in 1999, since then they have been significantly higher and are projected to increase in the future.<sup>55</sup> He

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<sup>48</sup> *Ibid*, para 105.

<sup>49</sup> Further Submission of Brazil, para 17.

<sup>50</sup> *Ibid*, para 157.

<sup>51</sup> *Ibid*, para 287.

<sup>52</sup> *Ibid*, Table 12.

<sup>53</sup> Further Submission of the US, para 74.

<sup>54</sup> *Ibid*, paras 73 and 74.

<sup>55</sup> Further Submission of Brazil, Annex 1, Table I.4.



concluded that these payments have a production impact because their effect is to keep land in the production of upland cotton that would not be otherwise because of low prices.<sup>56</sup>

2.42 As outlined by New Zealand in its First Written Submission to the Panel, the CCP payments create incentives for farmers with upland cotton base acreage to maintain upland cotton production.<sup>57</sup> New Zealand pointed out that in fact under the CCP programme the only way a farmer can guarantee a particular income is to continue to grow the same crop, otherwise the farmer runs the risk of missing out. For example, if he or she chooses to produce wheat and cotton prices are high enough that no CCP payment is made but wheat prices fall, the farmer will make a loss they would not have made had they stayed with cotton production. This, combined with other factors set out by Brazil,<sup>58</sup> for example the investment by farmers in cotton-specific machinery, virtually guarantees farmers will continue to produce cotton. The CCP payments are thus far from “de-coupled” in effect.

2.43 In fact Professor Sumner concluded that the CCP payments (as the institutionalised marketing loss assistance payments are now known under the Farm Security and Rural Investment Act 2002<sup>59</sup>) create *more* production incentive than the market loss payments, through base and yield updating and the increased per pound amount of support.<sup>60</sup> Professor Sumner determined that the market loss assistance payments and the CCP payments stimulated production by an average of 1.34% during MY 1999-2002.<sup>61</sup> And, as noted by Brazil, the full effects of the greater production incentives inherent in the CCP programme will only be realised in MY 2003.

### III. THREAT OF SERIOUS PREJUDICE

3.01 Brazil has brought evidence to show that the United States subsidies are not only causing serious prejudice to Brazil’s interests today, but also threaten to cause serious prejudice to Brazil’s interests in the future. Brazil has demonstrated that the United States subsidies cause a threat of serious prejudice to Brazil’s interests within the meaning of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*, as well as GATT Article XVI:3 in the period MY 2003-2007 because of the continued operation of the Farm Security and Rural Investment Act 2002 and the Agricultural Risk Protection Act 2000.

3.02 Brazil has demonstrated that the very same factors creating present serious prejudice also create a threat of serious prejudice in the future. The United States subsidies are mandated to continue until MY 2007. They are effectively unlimited. Brazil has demonstrated that they have already caused serious prejudice to Brazil’s interests. Their continued operation for a further four years cannot but be considered to threaten further serious prejudice to Brazil’s interests.

3.03 The United States argues that the two standards proposed by Brazil are incorrect and that Brazil has, in any event, met neither of them.

3.04 To take Brazil’s first proposed legal standard, Brazil argues, drawing on the findings of the GATT Panel in *EC – Sugar Exports I*<sup>62</sup> and *EC – Sugar Exports II*<sup>63</sup> and the Appellate Body in *US –*

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<sup>56</sup> *Ibid*, para 169.

<sup>57</sup> New Zealand’s First Submission, para 2.20.

<sup>58</sup> Further Submission of Brazil, para 207.

<sup>59</sup> *Ibid*, para 62.

<sup>60</sup> *Ibid*, para 171.

<sup>61</sup> *Ibid*, para 172.

<sup>62</sup> GATT Panel Report, *European Communities – Refunds on Exports of Sugar (Complaint by Australia)*, L4833 – 26S/290, adopted 6 November 1979.

<sup>63</sup> GATT Panel Report, *European Communities – Refunds on Exports of Sugar (Complaint by Brazil)*, L5011 – 27S/69, adopted 10 November 1980.

*FSC*,<sup>64</sup> that where there is effectively no limit on the provision of a subsidy a permanent source of uncertainty exists that threatens serious prejudice to other WTO Members. In such circumstances there is no check on the provision of a subsidy that would prevent it from causing adverse effects to the interests of other Members.

3.05 That is the precise situation in the present case. United States legislation requires the provision of the subsidies irrespective of whether or not those subsidies have adverse effects on other Members. In that respect it is important to bear in mind that 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 possibility that United States subsidies will continue to cause serious prejudice to the interests of Brazil in the future, is a real one – it is well removed from the realm of “allegations, conjecture or remote possibility” alluded to by the United States.<sup>65</sup>

3.06 In that respect Brazil’s second proposed legal standard for determining whether such a threat exists is highly relevant. As Brazil has demonstrated, all of the factors that currently exist that mean that the United States subsidies cause serious prejudice to their interests will continue to exist in the future. Furthermore, United States producers of upland cotton will act in the expectation of future subsidy payments and will make their planting decisions accordingly. Therefore the fact that the legislation creating those subsidies will continue until 2007, and United States producers know that those subsidy programmes will continue until 2007, creates a very strong *prima facie* case that those subsidies will continue to cause serious prejudice to Brazil for the full term of their existence.

3.07 Finally New Zealand supports Brazil’s request that if the Panel makes a finding of present serious prejudice, it should not feel constrained in making a further finding that the subsidies also create a threat of serious prejudice in the future.<sup>66</sup> Firstly, even though the present effects of the subsidies are already being felt, their future effects have not yet eventuated and therefore necessarily remain a threat. Secondly, the purpose of dispute settlement is to assist Members in the resolution of disputes – in this case a finding by the Panel on the threat of future serious prejudice is important to resolve this dispute.

#### **IV. EXPORT CREDIT GUARANTEE PROGRAMMES**

4.01 New Zealand notes that the United States raises further arguments in relation to the negotiating history and appropriate interpretation of Article 10.2 of the *Agreement on Agriculture* in order to support its claim that there are currently no export subsidy disciplines on the use of export credit guarantee programmes.

4.02 However the United States does not address the applicability of Article 10.1. As outlined by New Zealand in its First Submission, Article 10.2 does not in any way suggest that it provides an exception from the disciplines of Article 10.1. While Article 10.1 currently provides the only discipline on the use of export credits, it is expected that the work envisaged in Article 10.2 will elaborate further and more specific disciplines that will presumably make identification of the extent to which such export credit programmes constitute export subsidies more straightforward. However it is incorrect to assume that there is a vacuum in the meantime. Item j of the Illustrative List of the *SCM Agreement* clearly already provides guidance on when export credit guarantee or insurance programmes are to be considered to be ‘export subsidies’ and beyond this the general definition in Articles 1.1 and 3.1(a) of the *SCM Agreement* also applies.

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<sup>64</sup> Appellate Body Report, *United States – Tax Treatment for “Foreign Sales Corporation”*, WT/DS108/AB/R, adopted 20 March 2000.

<sup>65</sup> Further Submission of the US, para 115.

<sup>66</sup> Further Submission of Brazil, para 291.

## V. CONCLUSION

5.01 In conclusion, New Zealand considers that Brazil has provided the legal and factual basis upon which the Panel should conclude that the United States subsidies cause or threaten to cause serious prejudice to the interests of Brazil within the meaning of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement* and violate GATT Article XVI. New Zealand therefore requests the Panel to make the findings and recommendations requested by Brazil.

## ANNEX E-8

### SECOND WRITTEN SUBMISSION OF PARAGUAY (THIRD PARTY)

3 October 2003

1. Paraguay is grateful for the opportunity to express its views in this dispute.
2. As already stated, Paraguay maintains that the subsidies and support granted to cotton production of the type at issue are inconsistent with the Agreement on Subsidies and Countervailing Measures and other WTO rules.
3. The agricultural subsidies cause serious prejudice to the domestic industries of many WTO Members, in violation of Articles 5 and 6 of the Agreement on Subsidies and Countervailing Measures. Indeed, these measures involve a financial contribution which, by conferring a benefit, could adversely affect the determination of the world price of the product.
4. Article 5(c) stipulates that "no Member should cause, through the use of any subsidy [-specific and not exempted under the Agreement –] adverse effects to the interests of other Members, i.e.: ... (c) serious prejudice to the interests of another Member."
5. The threat of serious prejudice takes the form of price undercutting and unfairness in international trade, particularly as regards developing countries like Paraguay, which is highly dependent on its cotton production.
6. Article 6, which concerns serious prejudice, states that serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist in the case of subsidies to cover operating losses sustained by an enterprise, other than one-time measures which are non-recurrent and cannot be repeated for that enterprise and which are given merely to provide time for the development of long-term solutions and to avoid acute social problems; and direct forgiveness of debt, i.e. forgiveness of government-held debt, and grants to cover debt repayment.
7. Paraguay submits that the measures adopted by the United States do not fit these descriptions and cause injury to its economy, Paraguay being a predominantly agricultural country.
8. Because of the amounts involved, the subsidies granted to the cotton industry have a significant impact on the world market as reflected in increased production and export and price variations on the global market.
9. In the International Cotton Advisory Committee (ICAC) as in other forums, governments have remarked on the critical situation that the world cotton industry is going through and its link to subsidies, stressing the need to submit complaints before the WTO for violation of the applicable rules. The Committee considers that without the subsidization, the average world cotton price would undergo a reasonable increase.
10. Paraguay's cotton trade is affected by such measures because cotton production has a considerable impact on its economy, and especially on its rural populations which depend on cotton for their livelihood. In the sectors involved, such as transport and related industries, the impact is considerable, with approximately 30 per cent of the population affected.

11. Thus, the impact on trade in countries like Paraguay is devastating and causes the migration of rural populations to the urban areas, further aggravating the economic situation of a country dependent on its agriculture.

12. As shown in the attached table, cotton fibre exports to the United States was 518 tons, for a value of US\$898,000.

13. The effect is clear: in 2001, the volume of exports to the same market practically doubled, reaching 924 tons, and yet the price decreased in equal proportions, with exports generating US\$830,000. The world cotton trade figures reflect the same trend.

## **CONCLUSION**

14. There is sufficient evidence to prove that the subsidies are causing problems to the international marketing of cotton and that the American subsidies are further aggravating the situation of cotton exports from Paraguay.

15. We respectfully request the Panel to find that the measure applied by the United States is inconsistent with the obligations laid down by the WTO in various provisions of the GATT 1994 and the Agreement on Subsidies on Countervailing Measures, and to take account of the arguments put forward by Brazil.

**PARAGUAYAN COTTON EXPORTS BY DESTINATION**  
(Tons / ThUS\$)

	<b>1997</b>		<b>1998</b>		<b>1999</b>		<b>2000</b>		<b>2001</b>		<b>2002</b>	
	VOLUME	VALUE	VOLUME	VALUE	VOLUME	VALUE	VOLUME	VALUE	VOLUME	VALUE	VOLUME	VALUE
GERMANY	0	0	0	0	193	179	1,215	1,229	6,029	4,594	2,877	1,981
ARGENTINA	150	46	4,623	6,594	649	759	1,250	1,460	250	231	5,001	4,132
BANGLADESH	0	0	0	0	0	0	461	532	630	568	155	119
BELGIUM	0	0	0	0	0	0	0	0	266	215	149	128
BERMUDA	473	757	0	0	0	0	0	0	0	0	0	0
BOLIVIA	0	0	0	0	0	0	1,200	1,084	0	0	0	0
BRAZIL	39,898	64,492	47,267	64,914	47,115	55,933	56,726	61,113	31,063	29,465	29,599	22,877
COLOMBIA	0	0	0	0	0	0	1,660	1,556	200	224	0	0
SOUTH KOREA	0	0	79	102	0	0	0	0	98	92	0	0
NORTH KOREA	0	0	0	0	0	0	0	0	605	557	0	0
CHILE	845	1,509	624	938	1,107	1,208	1,183	1,309	424	404	1,675	1,262
NATIONALIST CHINA (TAIWAN)	0	0	191	219	0	0	0	0	2,126	1,865	579	450
CHINA, PEOPLE'S REPUBLIC OF	0	0	0	0	0	0	698	769	1,310	1,230	0	0
DENMARK	0	0	0	0	0	0	0	0	0	0	128	102
SLOVAKIA	0	0	0	0	0	0	0	0	100	76	0	0
SPAIN							313	364	18	19	0	0
UNITED STATES	518	898	0	0	0	0	60	67	924	830	0	0
PHILIPPINES	0	0	0	0	102	119	33	39	569	616	155	132
FRANCE	0	0	0	0	0	0	0	0	231	187	104	83
HONG KONG	0	0	0	0	0	0	1,116	1,188	148	111	185	123
NETHERLANDS	0	0	0	0	500	606	0	0	62	41	0	0
INDIA	0	0	0	0	0	0	526	408	33,463	28,267	3,088	2,738
INDONESIA	0	0	0	0	0	0	120	116	2,461	2,295	582	453
ITALY	0	0	462	550	0	0	25	23	360	345	363	271
MALAYSIA	0	0	0	0	0	0	500	449	130	109	0	0
NIGERIA	0	0	0	0	0	0	0	0	241	229	0	0
PAKISTAN	0	0	0	0	0	0	68	65	1,006	790	0	0

PANAMA	0	0	0	0	0	0	0	0	0	0	48	29
	<b>1997</b>		<b>1998</b>		<b>1999</b>		<b>2000</b>		<b>2001</b>		<b>2002</b>	
	VOLUME	VALUE	VOLUME	VALUE	VOLUME	VALUE	VOLUME	VALUE	VOLUME	VALUE	VOLUME	VALUE
PORTUGAL	0	0	0	0	0	0	0	0	989	702	200	133
UNITED KINGDOM	0	0	0	0	0	0	0	0	2	1	0	0
SWITZERLAND	0	0	0	0	0	0	200	216	592	551	251	169
THAILAND	0	0	0	0	0	0	397	403	2,298	1,959	294	198
TURKEY	0	0	0	0	0	0	819	886	2,244	2,431	0	0
URUGUAY	2,684	3,927	1,165	1,453	501	601	475	529	198	200	65	53
VENEZUELA	720	1,227	459	649	1,942	2,140	4,403	4,687	4,035	3,731	632	528
VIETNAM	0	0	0	0	0	0	0	0	602	533	0	0
TOTAL	45,288	72,856	54,870	75,419	52,109	61,545	73,448	78,492	93,674	83,468	46,130	35,961

Prepared by the Paraguayan Directorate of Foreign Trade.

Source: Central Bank of Paraguay.





## 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.<sup>1</sup> 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.<sup>2</sup>

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<sup>1</sup> 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*."

<sup>2</sup> 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 subsidies<sup>3</sup> 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.<sup>4</sup> 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

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<sup>3</sup> 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.

<sup>4</sup> 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.<sup>5</sup>

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.<sup>6</sup> 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

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<sup>5</sup> 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.

<sup>6</sup> 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".<sup>7</sup> 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.<sup>8</sup> 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".<sup>9</sup> Brazil has not suggested that the analysis under Articles 15.2 and 6.3(c) should be different.

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<sup>7</sup> 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)

<sup>8</sup> 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.

<sup>9</sup> 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.

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*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.<sup>1</sup> 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.)

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<sup>1</sup> 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 2003<sup>2</sup>), 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*

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<sup>2</sup> 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.<sup>3</sup>

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.

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<sup>3</sup> 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 October<sup>1</sup>, it will be commenting on some of the claims made by the United States in its written submission of 30 September.<sup>2</sup>

#### **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.<sup>3</sup>

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

<sup>2</sup> Further Submission of United States, 30 September 2003.

<sup>3</sup> 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.<sup>4</sup> 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.<sup>5</sup>

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 submission<sup>6</sup>, some of which will be considered by Argentina further on), Article 6.3 of the SCM Agreement<sup>7</sup> 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.<sup>8</sup> 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.<sup>9</sup>

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.<sup>10</sup>

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<sup>4</sup> Brazil's First Submission to the Panel, 24 June 2003.

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

<sup>6</sup> Further Submission of the United States, Section IV.B and C.

<sup>7</sup> Agreement on Subsidies and Countervailing Measures.

<sup>8</sup> "*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 ...*".

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

<sup>10</sup> 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 stated<sup>11</sup>, the number and quality of the empirical and econometric analyses presented by Brazil in its Further Submission<sup>12</sup>, 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 Brazil<sup>13</sup> 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.<sup>14</sup>

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 lower<sup>15</sup> (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 out<sup>16</sup>, 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.<sup>17</sup>

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

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<sup>11</sup> Second Written Third-Party Submission by Argentina, paragraphs 34-36.

<sup>12</sup> Further Submission of Brazil, Section 3.3.4.8.1.

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

<sup>14</sup> Written Third-Party Submission by Argentina, 15 July 2003, paragraph 20.

<sup>15</sup> Further Submission of the United States, paragraph 26.

<sup>16</sup> Second Written Third-Party Submission by Argentina, paragraph 22.

<sup>17</sup> *Idem*, paragraph 28.

United States and in third markets.<sup>18</sup> 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 2002<sup>19</sup> 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 out<sup>20</sup> 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.<sup>21</sup> We can only repeat some of the questions that we addressed to the United States during the consultations<sup>22</sup>, 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 producer<sup>23</sup> (despite its claim that pest eradication programmes and the adoption of genetically modified varieties of cotton have lowered its production costs<sup>24</sup>), 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

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<sup>18</sup> Further Submission of the United States, paragraph 35.

<sup>19</sup> *Idem*, paragraph 32.

<sup>20</sup> Written Third-Party Submission by Argentina, 15 July 2003, paragraph 21.

<sup>21</sup> Further Submission of the United States, paragraph 45.

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

<sup>23</sup> International Cotton Advisory Committee, "Survey of the Cost of Production of Raw Cotton", 2001.

<sup>24</sup> 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.<sup>25</sup>

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.<sup>26</sup>

28. SIXTH: The United States claims that the eradication of pests and the adoption of genetically modified varieties of cotton have lowered production costs.<sup>27</sup> 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 Argentina<sup>28</sup>, 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.<sup>29</sup> 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.<sup>30</sup>

## II.2 Exclusion of measures

32. Regarding the US argument that some of its domestic support measures should not be included in the analysis<sup>31</sup>, 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.

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

<sup>26</sup> *Idem*, paragraph 5.

<sup>27</sup> Further Submission of the United States, 30 September 2003, paragraph 46.

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

<sup>29</sup> 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).

<sup>30</sup> "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.

<sup>31</sup> 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*<sup>32</sup>, 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 itself<sup>33</sup>, 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.<sup>34</sup>

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 claimed<sup>35</sup>, 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 earlier<sup>36</sup>, price movements of the United States, of the Cotlook "A" Index and third

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<sup>32</sup> *Idem*, paragraph 82.

<sup>33</sup> Further Submission of Brazil, 9 September 2002, Section 3.3.4.8.1.

<sup>34</sup> 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".

<sup>35</sup> Further Submission of the United States, paragraphs 90 to 92.

<sup>36</sup> 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"<sup>37</sup>, 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.<sup>38</sup>

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.<sup>39</sup>

## 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".<sup>40</sup> 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).<sup>41</sup>

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<sup>37</sup> Further Submission of the United States, paragraph 94.

<sup>38</sup> 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.

<sup>39</sup> 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".

<sup>40</sup> Further Submission of the United States, paragraph 97.

<sup>41</sup> 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 increasing<sup>42</sup>, 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.<sup>43</sup>

## 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.

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<sup>42</sup> *Idem*, paragraph 101.

<sup>43</sup> 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).

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."*<sup>44</sup>

#### 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.

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<sup>44</sup> See Oral Third-Party Submission by Argentina, paragraphs 35 to 43.

## **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 40<sup>th</sup> 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.<sup>1</sup>

6. The EC understands, however, that different crop insurance policies apply to different agricultural products.<sup>2</sup> 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.<sup>3</sup>

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".<sup>4</sup> 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

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<sup>1</sup> US further submission, para. 14.

<sup>2</sup> Ibid., para. 15.

<sup>3</sup> Ibid., para. 72.

<sup>4</sup> Ibid., paras. 90-92.

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.

## 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.<sup>1</sup> 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

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<sup>1</sup> 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.<sup>2</sup>

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

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<sup>2</sup> 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".<sup>3</sup> 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.<sup>4</sup>

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.

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<sup>3</sup> 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".

<sup>4</sup> 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.<sup>5</sup> The fact that high US payments were made when cotton prices were low does not establish causation.

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<sup>5</sup> 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.<sup>6</sup>

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

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

<sup>6</sup> 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.<sup>7</sup> 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.<sup>8</sup> 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.<sup>9</sup> More fundamentally, the existence of a "gap" does not establish

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<sup>7</sup> 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.

<sup>8</sup> (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.

<sup>9</sup> 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*.<sup>10</sup> 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.

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<sup>10</sup> 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 indicating 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.<sup>1</sup>

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.<sup>2</sup> 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

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<sup>1</sup> 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.

<sup>2</sup> 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".<sup>3</sup>

### 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.<sup>4</sup>

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.

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<sup>3</sup> 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.

<sup>4</sup> 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 challenged<sup>5</sup>, 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".<sup>6</sup> 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.<sup>7</sup> Thus, there is no basis to ascribe production-distorting

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<sup>5</sup> 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.

<sup>6</sup> 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 . . .").

<sup>7</sup> 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<sup>8</sup>

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.<sup>9</sup>

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".<sup>10</sup> 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

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<sup>8</sup> 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.

<sup>9</sup> 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.

<sup>10</sup> 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.<sup>11</sup> 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.<sup>12</sup> 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.

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<sup>11</sup> 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.

<sup>12</sup> 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*.<sup>1</sup> 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.<sup>2</sup> 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,

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

<sup>2</sup> 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".<sup>3</sup>

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.<sup>4</sup>

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.<sup>5</sup> 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.<sup>6</sup>

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

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<sup>3</sup> See, e.g., Article 18.5, 18.6, and 18.7.

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

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

<sup>6</sup> 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.<sup>7</sup> As the United States has previously observed, CCC has never remotely approached issuing any such fancifully large amount of export credit guarantees.<sup>8</sup>

## 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.

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<sup>7</sup> 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.

<sup>8</sup> 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.

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