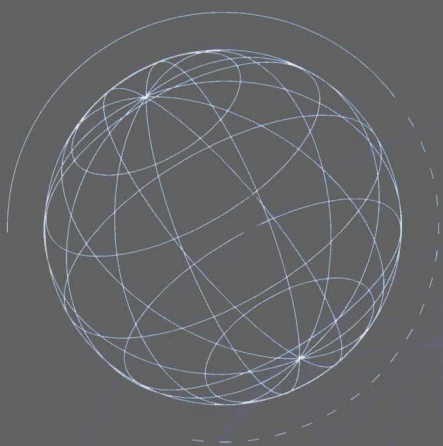




**Dispute Settlement Reports 2008**  
**Volume IV: Pages 1283 to 1680**

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## UNITED STATES – SUBSIDIES ON UPLAND COTTON

### **Recourse by Brazil to Article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes**

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WT/DS267/RW

*Adopted by the Dispute Settlement Body  
on 20 June 2008  
as Modified by the Appellate Body Report*

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## ANNEX A-1

### EXECUTIVE SUMMARY OF THE FIRST WRITTEN SUBMISSION OF BRAZIL

(Executive summary submitted on 24 November 2006)

1. This dispute results from the United States' failure to implement, in a timely and complete manner, the recommendations and rulings of the Dispute Settlement Body ("DSB") in *U.S. – Upland Cotton*. Brazil challenges both the *existence* and *consistency* of U.S. measures taken to comply with the "adverse effects"- and "export credit guarantee"-related recommendations and rulings of the DSB.

#### **Brazilian Claims Concerning Adverse Effects-Related Recommendations and Rulings of the DSB**

2. In its adverse effects-related recommendations and rulings, the original panel, as affirmed by the Appellate Body, found that the price-contingent U.S. marketing loan program, counter-cyclical payment program and Step 2 program of the FSRI Act of 2002 caused significant price suppression in the world market for upland cotton, in violation of Articles 5(c) and 6.3(c) of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"). The panel found that "the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our 'present' serious prejudice findings."<sup>1</sup> The Dispute Settlement Body adopted the panel and Appellate Body reports that obliged the United States to remove the adverse effects caused by the subsidies, or to withdraw the subsidies, by 21 September 2005.

3. The United States did not repeal or amend any of the three price-contingent subsidy programs until 1 August 2006, when it finally discontinued solely the Step 2 program. The far larger marketing loan and counter-cyclical payment programs have not been removed or amended to this day. Brazil asserts four claims related to adverse effects implementation.

4. **First**, Brazil claims that between the expiry of the implementation period on 21 September 2005 and elimination of Step 2 payments on 1 August 2006,

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<sup>1</sup> Panel Report, *U.S. – Upland Cotton*, para. 7.1501.

there did not "exist" any U.S. "measures taken to comply" with the adverse effects-related recommendations and rulings of the DSB.<sup>2</sup>

5. **Second**, Brazil claims that the non-repealed price-contingent U.S. marketing loan and counter-cyclical payment programs cause present serious prejudice in the form of significant price suppression in the world market for upland cotton, and an increase in the U.S. world market share, in violation of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*. In other words, Brazil claims that, to the extent measures taken to comply with the adverse-effects related recommendations and rulings of the DSB exist (*i.e.*, the repeal of Step 2 and the non-repeal of the marketing loan and counter-cyclical payment programs), those measures continue to result in inconsistencies with the covered agreements, within the meaning of Article 21.5 of the DSU.<sup>3</sup>

6. Brazil establishes serious prejudice to its interests based on data for the most recently completed marketing year ("MY") – MY 2005. Full-year data on marketing loan and counter-cyclical payments to U.S. upland cotton farmers for MY 2006 – the first year in which Step 2 is not provided – will not be available until September 2007. Nevertheless, the compliance Panel, like the original panel, can use a counter-factual analysis to evaluate the effects of marketing loan and counter-cyclical payments alone, and factor out any additional effects of Step 2 (or other subsidy) payments made in MY 2005.

7. As a preliminary step, Brazil establishes that the marketing loan and counter-cyclical payment programs of the FSRI Act of 2002 constitute subsidies that are specific, within the meaning of Articles 1 and 2 of the *SCM Agreement*.<sup>4</sup> In addition, upland cotton from Brazil continues to be a like product with subsidized U.S. upland cotton and there continues to be a world market and the A-index continues to constitute the world market price for upland cotton.<sup>5</sup>

8. To demonstrate a causal link between U.S. marketing loan and counter-cyclical payments and significant price suppression, within the meaning of Article 5(c) and 6.3(c) of the *SCM Agreement*, Brazil examines the same factors relied upon by the original panel.

9. As the largest exporter of upland cotton in the world, the United States remains the single most important market influencing world market prices. Changes in the volume of U.S. production, carry-over stocks, and exports have a

<sup>2</sup> See Section 6 of Brazil's First Written Submission.

<sup>3</sup> See Section 7 of Brazil's First Written Submission.

<sup>4</sup> See Section 7.3 of Brazil's First Written Submission.

<sup>5</sup> See Section 7.4 of Brazil's First Written Submission.

significant impact on world market prices.<sup>6</sup> In addition, movements in U.S., Brazilian, A-Index and futures market prices continue to show a broad similarity and remain low relative to long term averages.<sup>7</sup>

10. The magnitude of marketing loan and counter-cyclical payments in MY 2005 was massive, amounting to \$2.17 billion, or 42 percent of the market value of U.S. upland cotton production.<sup>8</sup> As the original panel found, the structure, design and operation of these subsidies continue to insulate U.S. upland cotton producers from market forces<sup>9</sup>, leading to high levels of U.S. planted acreage, production and exports and, ultimately, suppressed world market prices.<sup>10</sup> Thus, there remains a discernable temporal coincidence between these subsidies and suppressed world market prices.<sup>11</sup>

11. Over the long term (six years), U.S. costs of production for upland cotton continue to greatly exceed market revenues. Without subsidies, the average acre planted to upland cotton between MY 2000-2005 would have lost \$663, or \$9.84 billion for all acres. However, when revenue from marketing loan and counter-cyclical payments is included with market revenue, the average acre would have made a total six-year profit of \$127, or \$1.44 billion in aggregate. These facts succinctly demonstrate that the effect of marketing loan and counter-cyclical payments is to sustain higher levels of output than would otherwise exist.<sup>12</sup>

12. Economic studies by leading academics show that marketing loan and counter-cyclical payments continue to stimulate U.S. production and exports and result in lower world market prices than would prevail in their absence. Professor Daniel Sumner finds that the world market price of upland cotton would have been between 9 and 11 percent higher in MY 2005 in the absence of these two U.S. subsidy programs.<sup>13</sup>

13. In view of the size and nature of U.S. upland cotton subsidies and the commanding U.S. market share, the price suppression is unmistakably significant.<sup>14</sup> Any price-suppressing effects of Step 2 payments do not diminish the significant and independent price-suppressing effects of marketing loan and counter-cyclical payments. Indeed, the U.S. Congressional Budget Office concludes that counter-cyclical payments will be even larger in the absence of Step

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<sup>6</sup> See Section 7.5 of Brazil's First Written Submission.

<sup>7</sup> See Section 7.6 of Brazil's First Written Submission.

<sup>8</sup> See Section 7.7 of Brazil's First Written Submission.

<sup>9</sup> See Section 7.8 of Brazil's First Written Submission.

<sup>10</sup> See Section 7.9 of Brazil's First Written Submission.

<sup>11</sup> See Section 7.10 of Brazil's First Written Submission.

<sup>12</sup> See Section 7.11 of Brazil's First Written Submission.

<sup>13</sup> See Section 7.12 of Brazil's First Written Submission.

<sup>14</sup> See Section 7.13 of Brazil's First Written Submission.

2 payments.<sup>15</sup> Similarly, other non-subsidy factors that impact the world market price of upland cotton do not account for the price suppression caused by marketing loan and counter-cyclical payments.<sup>16</sup>

14. Brazil also claims that the U.S. marketing loan and counter-cyclical payments cause serious prejudice to the interests of Brazil by increasing the U.S. share of the world upland cotton market, within the meaning of Article 5(c) and 6.3(d) of the *SCM Agreement*. The U.S. world market share of upland cotton increased from an average of 19.32 percent in MY 2002-2004 to 20.85 percent in MY 2005, or from 16.98 percent in MY 2002-2004 to 17.44 percent in MY 2005, depending on approach used to measure supply. The same effects from marketing loan and counter-cyclical payments that stimulate excessive U.S. production and exports and lower world market prices – despite high costs and low market revenue and prices – also causes the increase in U.S. world market share.<sup>17</sup>

15. In sum, Brazil requests the compliance Panel to find that the U.S. measure eventually taken to comply, *i.e.*, the amendment of the FSRI Act of 2002 to repeal Section 1207(a), providing for Step 2 payments, is insufficient to ensure compliance with the recommendations and rulings of the DSB, because the resulting basket of measures is inconsistent with Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*.

16. **Third**, Brazil claims that despite the repeal of the Step 2 program, the marketing loan and counter-cyclical payments mandated under the FSRI Act of 2002 to be made in MY 2006, and beyond, cause a *threat* of serious prejudice to the interests of Brazil, within the meaning of Articles 5(c) and 6.3(c), as well as footnote 13 of the *SCM Agreement*. Brazil again claims that, to the extent measures taken to comply with the adverse-effects related recommendations and rulings of the DSB exist (*i.e.*, the repeal of the Step 2 program and the non-repeal of the marketing loan and counter-cyclical payment programs), those measures are deficient, and result in inconsistencies with the covered agreements, within the meaning of Article 21.5 of the DSU. Brazil notes that this claim is contingent on the compliance Panel not being able to find that the marketing loan and counter-cyclical payment programs cause present serious prejudice (Brazil's second adverse effects-related claim).

17. Key evidence supporting Brazil's threat claim includes the fact that the two remaining subsidy programs – the marketing loan and counter-cyclical payment programs – are mandatory, result in guaranteed high levels of U.S. planted

<sup>15</sup> See Section 7.14 of Brazil's First Written Submission.

<sup>16</sup> See Section 7.15 of Brazil's First Written Submission.

<sup>17</sup> See Section 7.17 of Brazil's First Written Submission.

acreage, production and exports and have caused significant price suppression throughout the history of the FSRI Act of 2002. With the repeal of the Step 2 program and the resulting lower *domestic* market prices in the United States, the effects of the remaining two price-contingent U.S. subsidy programs will be, if anything, bigger in MY 2006, and beyond. In fact, USDA and FAPRI projections regarding U.S. subsidy outlays under these programs, upland cotton production, exports, prices and developments in U.S. cost of production for upland cotton support a finding of a threat of serious prejudice from the U.S. marketing loan and counter-cyclical payments for upland cotton. These two subsidy programs under the FSRI Act of 2002 constitute a continuing threat of significantly suppressed world market prices for Brazilian and other developing country producers that will continue until these measures are repealed or significantly amended. Indeed, these subsidies caused serious prejudice during the first four years of the FSRI Act of 2002, continue to cause present serious prejudice, and continue to cause a threat thereof.<sup>18</sup>

18. **Fourth**, Brazil claims, on a contingent basis, that during the period 21 September 2005 to 31 July 2006, all three of the price-contingent subsidy programs of the FSRI Act of 2002, mentioned above, have caused serious prejudice to Brazil. Brazil requests that the compliance Panel address this claim only if it rejects Brazil's first, second and third claim, as outlined above. Brazil claims that the failure of the United States to take any measures to remove the adverse effects or withdraw the three price-contingent subsidy programs during this period has caused serious prejudice to the interests of Brazil, in violation of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*.<sup>19</sup>

19. In sum, with respect to the adverse effects-related recommendations and rulings of the DSB, Brazil requests the compliance Panel to conclude that the original recommendation adopted by the DSB – to "remove the adverse effects or [to] the subsidy" under Article 7.8 of the *SCM Agreement* – remains in effect, and applies to the full extent of the findings requested by Brazil in these Article 21.5 proceedings.<sup>20</sup>

### **Brazilian Claims Concerning Export Credit Guarantee-Related Recommendations and Rulings of the DSB**

20. The DSB recommended that the United States withdraw the three export credit guarantee ("ECG") subsidies maintained by the U.S. Commodity Credit Corporation ("CCC") – the GSM 102, GSM 103 and SCGP programs – and oth-

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<sup>18</sup> See Section 8 of Brazil's First Written Submission.

<sup>19</sup> See Section 9 of Brazil's First Written Submission.

<sup>20</sup> See Section 10.3.3 of Brazil's First Written Submission.



erwise bring itself into compliance with its obligations by the implementation deadline of 1 July 2005. To implement the DSB's recommendations and rulings, the United States announced, on 1 July 2005, that CCC would no longer take applications for ECGs under GSM 103, which underwrote credit for 3- to 10-year periods, and amended the fee schedules for ECGs issued under the GSM 102 and SCGP programs.<sup>21</sup> Brazil raises two claims with respect to the U.S. measures taken to comply with the ECG-related recommendations and rulings of the DSB.

21. **First**, with respect to ECGs issued under the GSM 102, GSM 103 and SCGP programs prior to 1 July 2005, but still outstanding subsequent to 1 July 2005, the United States has taken no action whatsoever to withdraw the subsidy and otherwise bring itself into conformity with its obligations. In regard to these outstanding ECGs, Brazil claims that measures taken to comply do not exist.<sup>22</sup>

22. **Second**, with respect to ECGs issued subsequent to 1 July 2005, they continue to be export subsidies, and continue to be provided in a manner that results in circumvention of the United States' export subsidy commitments. In this regard, the United States' measures taken to comply are not consistent with Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*.<sup>23</sup>

23. Since 1 October 2005 – the beginning of FY 2006 – the United States has not issued any SCGP ECGs. Nor have any GSM 103 ECGs been issued since 1 July 2005, the implementation deadline. Thus, Brazil's second claim, of continued inconsistency with the *Agreement on Agriculture* and the *SCM Agreement*, applies solely to GSM 102, and not to GSM 103 or SCGP.<sup>24</sup>

24. GSM 102 ECGs guarantee the repayment of credit made available to finance commercial exports of U.S. agricultural products. The guarantees cover 98 percent of the principal and a portion of the interest, and have a duration of 30 days to three years. GSM 102 operates solely in circumstances where a foreign bank could not, without the U.S. government's assistance, secure the credit necessary to on-lend to its customer, the purchaser of U.S. agricultural exports.<sup>25</sup>

25. Using the context of Articles 1 and 3.1(a) of the *SCM Agreement*, GSM 102 ECGs constitute export subsidies for the purposes of Article 10.1 of the *Agreement on Agriculture*. Specifically, GSM 102 ECGs (i) are "financial con-

<sup>21</sup> See Section 10.2 of Brazil's First Written Submission.

<sup>22</sup> See Section 10.3.1 of Brazil's First Written Submission.

<sup>23</sup> See Section 10.3.2 of Brazil's First Written Submission.

<sup>24</sup> *Ibid.*

<sup>25</sup> See Section 10.3.2.1 of Brazil's First Written Submission.