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UNITED STATES – CONTINUED DUMPING AND SUBSIDY OFFSET ACT OF 2000

(ORIGINAL COMPLAINT BY JAPAN)

Recourse to Arbitration by the United States under Article 22.6 of the DSU

DECISION BY THE ARBITRATOR

The Decision by the Arbitrator on *United States – Continued Dumping and Subsidy Offset Act of 2000 (Original Complaint by Japan) – Recourse to Arbitration by the United States under Article 22.6 of the DSU* is being circulated to all Members, pursuant to the DSU. The Decision is being circulated as an unrestricted document from 31 August 2004 pursuant to the Procedures for the Circulation and Derestriction of WTO Documents (WT/L/452).

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I. INTRODUCTION

A. I

over one year additional duties in an amount no greater than the level of suspension of concessions and other obligations authorized by the DSB. The amount will be established by adding:

(a)

1.11 On 19 February 2004, the United States submitted a request for preliminary ruling from the Arbitrator applicable to all requests for arbitration. Following consideration of the request, the Arbitrator informed all parties on 23 February that, having regard to the issues raised in the request, the Arbitrator deemed it more appropriate to address the content of the United States' communication of 19 February together with all the other issues and arguments that might be raised throughout the proceedings. The Arbitrator added that parties should feel free to include comments on the United States' request in their submissions, as they saw fit.

1.12 In accordance with the timetable, the Requesting Parties submitted communications concerning the methodology supporting their requests for authorization to suspend concessions or other obligations (hereafter the "methodology paper(s)") on 23 February.[10]

1.13 The United States submitted a single written submission, applicable to all its requests for arbitration, on 12 March 2004.

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preliminary ruling was not appropriate to the matters the United States had raised. The purpose of that process is essentially to eliminate from an arbitration issues that could not be deemed to fall within the mandate of the Arbitrator.[14]

2.6 Indeed, a core issue in this arbitration is whether the level of nullification or impairment

the case, in our opinion, with the United States' claim regarding the type of measure which the Requesting Parties plan to apply, if they are allowed to suspend concessions or other obligations.[16] We consider that such claims are more appropriately addressed as part of our review of the substance of the case. We nonetheless found that certain aspects of these claims should be discussed separately to the extent that they relate to specific procedural rights of the United States in these proceedings, which ought to be protected.

2.12 We consider this to be the case in relation to the claim that there should be a minimum degree of specificity supporting any request for suspension of concessions or other obligations so as to allow the respondent in the main dispute to exercise its right to request arbitration.[17]

2. Main arguments of the parties

(a) United States

2.13 The United States claims that the Requesting Parties have failed to specify the level of suspension of concessions and the level of nullification or impairment, both in their requests under Article 22.2 of the DSU and subsequently in the course of this arbitration, in a way that enables the Arbitrator to determine equivalence. The United States presents this issue as one of specificity of the request under Article 22.2 of the DSU and, more generally as a question of duty to cooperate with the Arbitrator by providing information on the level of nullification or impairment.[18]

2.14 The United States contends that the Requesting Parties have failed to quantify either the level of suspension or the level of nullification or impairment. The Requesting Parties replace specific values with general concepts and ask the Arbitrator to determine that two amounts are equivalent to one another without knowing what those amounts are. The United States adds that the Requesting Parties decline to provide any information on the level of suspension requested or to base their request on trade effect.[19]

2.15 The United States notes that the Requesting Parties intend to impose a yet unidentified duty to an unspecified value of imports, thus failing to identify the amount of trade that would be covered by their request. Without more information, it is impossible to "determine" the level of suspension proposed and the actual impact of the duty on imports from the United States.[20]

(b) Japan

2.16 According to Japan, the argument of the United States that the Requesting parties failed to identify a level of suspension or a level of nullification or impairment, thus making it impossible for the Arbitrator to fulfil its mandate, is based on the assumption that these levels can only be determined in terms of trade effect. Japan considers that Article 22 of the DSU does not require a "trade effect" test. In any event, Japan's request for retaliation clearly sets out a quantifiable level of suspension of concessions and related obligations. The Requesting Parties specified that the amount of the annual offset payments constitutes the level of nullification or impairment up to which each

[16] The United States contests in substance the intention of the Requesting Parties to impose a tariff surcharge on a list of products to be calculated so as to generate, over a period of one year, an income equivalent to the offset payments made in the latest annual distribution under the CDSOA. The United States argues that this approach places no limit on the level of suspension that will be effectively imposed and is contrary to past practice.

[17] We leave aside the question of the usefulness of a sufficiently specific request to allow the DSB to reach an informed decision.

[18] United States preliminary request, 19 February 2004, paras. 21-27.

[19] United States written submission, para. 25.

[20] United States written submission, para. 28.

Requesting Party may suspend concessions or other obligations. As the amount of disbursement is published each year by the United States' authorities, the corresponding levels are clearly defined. Japan adds that the arbitrator in *US – 1916 Act (EC) (Article 22.6 – US)* acknowledged that the fact that the requested suspension had not been stated in quantitative terms did not, in and of itself, render a request for suspension of concessions or other obligations inconsistent with Article 22.[21] *A fortiori*, in this case, the level of nullification or impairment and the level of suspension are quantifiable and identified at each moment, thus allowing the Arbitrator to determine their equivalence.[22]

2.17 Regarding the allegation according to which the Requesting Parties failed to identify an amount of trade that would be covered by their request, Japan argues that nothing in Article 22 of the DSU requires a "trade effect" test for determining the level of suspension. Japan further argues that it is hardly possible to predict the particular "trade effect" of a tariff increase. In addition, arbitrators have never previously considered the trade effect of a requested suspension.[23]

3. Does Japan's request fail to meet the minimum specificity standard applicable in an Article 22.6 arbitration?

2.18 In *EC – Bananas III (Ecuador) (Article 22.6 – EC)*, the arbitrators stated that "the specificity standards, which are well established in WTO jurisprudence under Article 6.2 of the DSU were relevant for requests for authorization to suspend concessions under Article 22.2 and for requests for referral of such matter to arbitration under Article 22.6".[24] More particularly, the arbitrator considered that:

(a) the request under Article 22.2 must set out the specific level of suspension (i.e. a level deemed equivalent to the nullification or impairment caused by the WTO-inconsistent measure, pursuant to Article 22.4 of the DSU); and

(b) the request must specify the agreement and sector(s) under which concessions or other obligations would be s

decision to request, or not, arbitration under Article 22.6 and to argue its case before the Arbitrator).[26] This question may be answered by reviewing the United States' submissions in these proceedings. Having reviewed those submissions, we note that the degree of specification of the level of suspension proposed by Japan in no way prejudiced the ability of the United States to exercise its rights under Article 22.6.

2.22 We therefore conclude that the request of Japan for authorization to suspend concessions or other obligation, while it could have certainly been more informative, is acceptable in terms of the minimum specificity requirement applicable to Article 22.2 requests. In this respect, we consider that the United States did not demonstrate that either its ability to reach an informed decision to request arbitration, or its ability to defend itself in these proceedings had been prejudiced as a result of the way Japan's request was formulated.

C. BURDEN OF PROOF

1. Main arguments of the parties

2.23 The parties have repeatedly raised the question of the burden of proof in these proceedings. Japan recalls that, according to the numerous precedents in Article 22.6 proceedings, the United States has to prove that the requested level of suspension of obligations is not equivalent to the level of nullification or impairment. As the United States asserts that the nullification or impairment of the CDSOA is "zero", it also bears the burden of proof for such an allegation.[27]

2.24 The United States acknowledges that it bears the burden of proof in these proceedings. However, it argues that it only has to submit evidence sufficient to establish a "presumption" that the level of suspension proposed is not equivalent to the level of nullification or impairment. According to the United States, it does not bear the burden to show that the level of nullification or impairment is "zero". By contrast, the Requesting Parties failed to substantiate their claim that the level of nullification or impairment corresponds to the full amount of disbursements made under the CDSOA, despite the fact that Japan itself asserts that the level of nullification or impairment must be based to the extent possible, on credible, factual and verifiable information, and not on speculation.[28]

2. Position of the Arbitrator

2.25 Since burden of proof has been extensively addressed in previous Article 22.6 arbitrations, we need not dwell on this matter. Like the arbitrator in *EC – Bananas III (Ecuador) (Article 22.6 – EC)*, we simply note the considerations of the arbitrator in *EC – Hormones*, Article

> However, at the same time and as soon as it can, Canada is required to come forward with evidence explaining how it arrived at its proposal and showing why its proposal *is* equivalent to the trade impairment it has suffered. Some of the evidence – such as data on trade with third countries, export capabilities and affected exporters – may, indeed, be in the sole possession of Canada, being the party that suffered the trade impairment. This explains why we requested Canada to submit a so-called methodology paper."[29]

2.27 Having regard to the duty of the parties to supply evidence and, more generally, to collaborate with the Arbitrator, and following the approach of the arbitrators in *Brazil – Aircraft (Article 22.6 – Brazil)*[30] and *in Canada – Export Credit and Guarantees (Article 22.6 – Canada)*[31], we are of the view that if a party makes a particular claim but fails to cooperate and provide evidence sufficiently supporting its claim, we may reach a conclusion on the basis of the evidence available, including evidence submitted by the other party or data publicly available.

III. DETERMINATION OF THE LEVEL OF NULLIFICATION OR IMPAIRMENT

A. MAIN ARGUMENTS OF THE PARTIES

1. United States

3.1 The United States considers that the Requesting Parties, by arguing that a breach is itself a nullification or impairment ignore the critical distinction that the drafters of the WTO agreements have drawn between, on the one hand, a breach of a WTO commitment and, on the other hand, the economic impact that is "the result of" that breach. The United States refers to Article XXIII of GATT 1994, but also to Article 22.8 of the DSU.[32] The United States further claims that the level of nullification or impairment must be established on the basis of the trade loss suffered directly by each Requesting Party. The United States argues that an analysis of the level of nullification or impairment must focus on the "benefit" allegedly nullified or impaired as a result of the failure of the responding party to bring the measure at issue into conformity with the recommendations and rulings of the DSB.[33] In previous cases, arbitrators have compared the actual amount of exports affected by the WTO-inconsistent measure to the amount of exports in a "counterfactual".[34] The difference between the two values typically represented the level of nullification or impairment. The United States is also of the view that the Appellate Body confirmed this approach by focusing on the "trade effect" of the CDSOA, as a non-permissible specific action against dumping or a subsidy. A change in the "conditions of competition" arising from a government payment to producers is different from a subsidies analysis since there has been no finding against the CDSOA as an "actionable subsidy". The focus on trade effect is consistent with past practice in Article 22.6 arbitrations.[35] Moreover, the level of nullification or impairment must be measured in terms of the effect the CDSOA has on producers/exporters subject to anti-dumping or countervailing duty orders.

3.2 The United States also claims that, under the Appellate Body analysis, any effect that the CDSOA offset payments might have on competitors that are not subject to anti-dumping or countervailing duties (i.e. other United States' producers and foreign producers/exporters not subject to an anti-dumping or countervailing duty order) was not relevant to the findings of the Panel or the

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[29] See, e.g., *EC – Hormones (Canada) (Article 22.6 – EC)*, paras. 9-11.
[30] Paras. 2.9-2.11.
[31] Para. 3.76.
[32] United States oral statement, paras. 7-13.
[33] United States written submission, para. 40.
[34] i.e., the situation which would exist if the responding party had brought the WTO-inconsistent measure into conformity within the reasonable period of time (United States written submission, para. 41).
[35] United States written submission, para. 47.

Appellate Body under Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement. A Member cannot suffer nullification or impairment as a result of a non-permissible specific action against dumping or against a subsidy if no order is in place and if no duties can be collected on that Member's products. The allocation of the total annual disbursements advocated by the Requesting parties shows that the Requesting Parties have not even attempted to relate the levels of suspension proposed to the level of nullification or impairment suffered.

3.3 In addition, the United States argues that special accounts relating to revoked orders should not be considered because, in the case of revoked orders, a link does not exist between offset payments and an anti-dumping or countervailing duty order. When there is no anti-dumping or countervailing duty order in place, any payment received by an affected domestic producer in 2003 cannot nullify or impair any benefits related to Article 18.1 of the Anti-Dumping Agreement or Article 32.1 of the SCM Agreement.[36]

3.4 The United States further claims that disbursements under the CDSOA, i.e. the concrete application of the CDSOA, are not part of the measure found inconsistent with the WTO Agreement. As a result, an examination of the actual disbursements made under the CDSOA would go beyond the terms of reference of the original disputes.[37]

3.5 Yet, even if one were to consider these payments, the United States recalls that the DSB found that the CDSOA offset payments caused no adverse effect[38] and there is no evidence that CDSOA offset payments have in reality affected Requesting Parties' dumped or subsidized trade. There is no requirement under the CDSOA for how offset payments are to be used. Likewise, a substantial share of the "qualifying expenditures" reported reflect expenditures made after the issuance of the anti-dumping duty finding or order or countervailing duty order, but long before the

its trade effect, which is neither referred to in the DSU or the GATT

EC – Hormones (US) (Article 22.6 – EC) and *EC – Bananas III (Article 22.6 – EC)* dealt with traditional market access barriers such as tariffs, quotas and other import restrictions. The situation is different in the case of the CDSOA. Japan also contests the argument of the United States that the CDSOA does not have any trade effect because the use of the disbursements by the recipient companies is not pre-determined or the trade effect of such disbursements is *de minimis*. It also contests the attempt of the United states to equate the findings of the Panel that the CDSOA causes no "adverse effects" under Article 5(b) of the SCM Agreement to an absence of "nullification or impairment". The Panel explicitly drew a distinction between the two concepts. Japan also notes that the arbitrator in *US – 1916 Act (Article 22.6 – US)* based its conclusion on the broader notion of "economic effects" of the measure at issue. The arbitrator in that case did not examine the economic effect of the application or the economic consequence of the measure (i.e. the court judgements or the settlement agreements). If the same logic were to be applied in this case, it would ensue that only the economic effect of the CDSOA (i.e. the offset payments made there under) should be taken into account for determining the quantitative level of nullification or impairment of the CDSOA. As for the relationship between offset payments and anti-dumping and countervailing duty orders, Japan recalls that neither the Appellate Body nor the Panel excluded any offset payments from their analysis. Likewise, Japan notes that, even in case of revoked orders, the United States domestic industry would still receive a disbursement as part of the CDSOA offset payment. The adverse effect on foreign producers/exporters would remain the same.

3.12 Japan also contests the fact that the level of nullification or impairment could be "zero". The Panel concluded that nullification or impairment existed and the Appellate Body upheld this conclusion. For Japan, claiming that a level of nullification or impairment is "zero" amounts to saying that there is no nullification or impairment. While the arbitrator in *EC – Bananas III (Article 22.6 – EC)* stated that the presumption under Article 3.8 of the DSU cannot be taken as evidence of a particular level of nullification or impairment, this does not mean that no nullification or impairment exists. Japan notes that the arbitrator in *US – 1916 Act (Article 22.6 – US)* acknowledged that any amount payable pursuant to court judgements or settlement agreements would constitute nullification or impairment. The issue in that case was one of proving the amount of those payments. It had nothing to do with the substantive determination of the level of nullification or impairment. The arbitrator did not conclude that the level of nullification or impairment was *de facto* "zero".[45]

3.13 Finally, regarding the risk alleged by the United States that the approach advocated by Japan would lead to each Requesting Party suspending obligations in excess of its respective level of nullification or impairment, Japan argues that this approach is based on an objective concept of nullification or impairment in relation to the violating measure as such, not in relation to individual nullifications or impairments. As all offset payments constitute nullification or impairment, the suspension of obligations should be authorized to the same amount.[46]

B. ANALYSIS OF THE ARBITRATOR

1. Introduction

3.14 The approaches of the parties are – in appearance at least – based on diametrically opposed conceptions of "nullification or impairment". However, while the United States' approach seems to rely largely on the practice of other arbitrations under Article 22.6 of the DSU, the approach defended by Japan is, if one excludes the arbitrations carried out under Article 4.10 and 4.11 of the SCM Agreement, novel in the context of Article 22.6 of the DSU.

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[45] Written submission of Brazil, the European Communities, India, Japan, Korea and Mexico, paras. 45-68.

[46] Written submission of Brazil, the European Communities, India, Japan, Korea and Mexico, paras. 73-80.

3.20 Considered in the context of Article XXIII of GATT 1994, nullification or impairment and violation are clearly separate concepts. Article XXIII:1 basically provides that nullification or impairment of benefits is what must be ultimately demonstrated.[50] Nullification or impairment may essentially exist "as a result of": (a) a violation; (b) a situation of non-violation; or (c) "any other situation". Therefore, violation is not to be confused with nullification or impairment of a benefit.

3.21 We find support for this position in Article 3.8 of the DSU, which reads as follows:

> "In cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment. This means that there is normally a presumption that a breach of the rules has an adverse impact on other Members parties to that covered agreement, and in such cases, it shall be up to the Member against whom the complaint has been brought to rebut the charge."

3.22 A violation generates, pursuant to Article 3.8 of the DSU, a *presumption* of nullification or impairment. Article 3.8 does not treat violation as *a form* of nullification or impairment. Article 3.8 merely exempts the party having demonstrated the violation from also having to demonstrate nullification or impairment. It does not modify the fundamental requirement that what is ultimately to be demonstrated is nullification or impairment.

3.23 This is confirmed by the last sentence of Article 3.8, which provides the opportunity for the alleged violating party to rebut the presumption of nullification or impairment. If violation was conceptually equated by Article 3.8 to nullification or impairment, there would be no reason to provide for a possibility to rebut the presumption. The theoretical possibility to rebut the presumption established by Article 3.8 can only exist because violation and nullification or impairment are two different concepts.

3.24 In fact, Article 3.8 deals with the establishment of the *existence* of nullification or impairment during proceedings before a panel. It does not address the *valuation* or *quantification* of such nullification or impairment.

3.25 Referring to the arbitrator's decision in *EC – Bananas III (US) (Article 22.6 – EC)*, Japan argues that, even though the presumption under Article 3.8 cannot be taken as evidence of a particular level of nullification or impairment, that nullification or impairment exists and cannot be "zero". Japan also cites the *US – 1916 Act (EC) (Article 22.6 – US)* arbitration in support of its position.

3.26 We accept the view that some nullification or impairment should exist if it has not been rebutted. However, the quantification of the level of nullification or impairment remains to be established. Article 3.8 does not address how nullification or impairment should be valued.

3.27 We note that Japan refers to Articles 22.3(a) and 23.1 of the DSU in support of its position that violation is a form of nullification or impairment.

3.28 Article 22.3(a) reads as follows:

> "[T]he general principle is that the complaining party should first seek to suspend concessions or other obligations with respect to the same sector(s) as that in which the panel or Appellate Body has found a violation or other nullification or impairment."

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[50] Since "impediment of the attainment of an objective of the Agreement" is not discussed in this case, we refrain from referring to it.

obligations under Article 22 of the DSU. Such authorization would only arise at a much later stage of the dispute settlement process. The arbitrator added that:

> "The review of the level of nullification or impairment by Arbitrators from the objective benchmark foreseen by Article 22 of the DSU, is a separate process that is independent from the finding of infringements of WTO rules by a panel or the Appellate Body. As a result, a Member's potential interests in trade in goods or services and its interest in a determination of rights and obligations under the WTO Agreements are each sufficient to establish a right to pursue a WTO dispute settlement proceeding. However, a Member's legal interest in compliance by other Members does not, in our view, automatically imply that it is entitled to obtain authorization to suspend concessions under Article 22 of the DSU."[52]

(iii) Consideration of benefits nullified or impaired in terms of economic or trade effect

3.37 As a preliminary observation, we note that all parties to these proceedings agree that the level of nullification or impairment must, in this case, be monetarily quantified. Disagreement arises regarding whether this monetary quantification has to be based on some economic effect of the violation, or whether it can be directly based on the disbursements made under the CDSOA.

3.38 We note that the arbitrators in *US – Section 110(5) Copyright Act (Article 25.3)* r7Dauthoriz2X1e.25 0 TD

> Arbitrators will proceed on the assumption that the licensing royalties realizable by copyright holders constitute an adequate measure of the economic benefits arising from Articles 11*bis*(1)(iii) and 11(1)(ii)."

3.39 We further note that, with the exception of the arbitrations carried out under Article 4.11 of

3.44 The position adopted by Japan seems to be based essentially on the approach followed by the arbitrator in *US – FSC (Article 22.6 – US)*, who relied on the *prohibited nature* of the subsidy concerned and the *erga onmes* nature of the violation to conclude that "appropriate countermeasures" under Article 4.10 SCM could correspond to the full amount of the subsidy illegally granted, irrespective of its trade effect.

3.45 First, we note that disbursements under the CDSOA are different from the export subsidy addressed by the *US – FSC (Article 22.6 – US)* arbitrator.

3.46 Second, we consider that the reasoning underlying the *US – FSC (Article 22.6 – US)* decision cannot be extended to the present case. One reason is that the mandate of arbitrators under Article 4.11 of the SCM agreement is different from that of arbitrators under Article 22.7 of the DSU. In this regard, Article 4.11 reads as follows:

> "In the event a party to the dispute requests arbitration under paragraph 6 of Article 22 of the Dispute Settlement Understanding ("DSU"), the arbitrator shall determine whether the countermeasures are appropriate."[58]

3.47 The *US – FSC (Article 22.6 – US)* arbitrator expressly differentiated the situation under Article 4.10 and 4.11 of the SCM Agreement and that under Article 22.4 of the DSU:

> "We recall that Article 22.4 of the *DSU* provides as follows:
>
> > 'The level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification or impairment.'
>
> The drafters have explicitly set a quantitative benchmark to the level of suspension of concessions or other obligations that might be authorized. This is similarly reflected in Article 22.7, which defines the arbitrators' mandate in such proceedings as follows:
>
> > 'The arbitrator acting pursuant to paragraph 6 … shall determine whether the level of such suspension is equivalent to the level of nullification or impairment….' (footnote omitted)
>
> As we have already noted in our analysis of the text of Article 4.10 of the *SCM Agreement* above, there is, by contrast, no such indication of an explicit quantitative benchmark in that provision. It should be recalled here that Articles 4.10 and 4.11 of the *SCM Agreement* are 'special or additional rules' under Appendix 2 of the *DSU*, and that in accordance with Article 1.2 of the *DSU*, it is possible for such rules or procedures to prevail over those of the *DSU*. There can be no presumption, therefore, that the drafters intended the standard under Article 4.10 to be necessarily coextensive with that under Article 22.4 so that the notion of 'appropriate countermeasures' under Article 4.10 would limit such countermeasures to an amount 'equivalent to the level of nullification or impairment' suffered by the complaining Member. Rather, Articles 4.10 and 4.11 of the *SCM Agreement* use distinct language and that difference must be given meaning."[59]

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[58] *(footnote original)* This expression is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited.

[59] *US – FSC (Article 22.6 –US)*, paras. 5.45-5.47.

3.48 Like the *US – FSC (Article 22.6 – US)* arbitrator, we consider that Article 4.11 of the SCM Agreement is a special or additional dispute settlement provision which provides for a *sui generis* approach applicable to prohibited subsidies only. Article 4.11 instructs arbitrators to determine "appropriate countermeasures" rather than whether the level of suspension of concessions or other obligations is equivalent to the level of nullification or impairment. This would seem to leave more discretion to arbitrators in assessing the amount of countermeasures. This was confirmed by the arbitrator in *US – FSC (Article 22.6 – US)*:

> "Thus, as we interpret Article 4.10 of the *SCM Agreement*, a Member is entitled to act with countermeasures that properly take into account the gravity of the breach and the nature of the upset in the balance of rights and obligations in question. This cannot

(b) a separate and subsequent process where a Member requests the authorization to suspend concessions or other obligations and an arbitrator, under Article 22.6 of the DSU, is requested to determine the *level* of the benefit nullified or impaired.

3.54 This implies, in our view, that no assimilation can be made between, on the one hand, a violation or the right breached and, on the other hand, the benefit nullified or impaired as a result of that violation. Under the WTO dispute settlement mechanism, a violation is the *precursor* to establishing the nullification or impairment of a benefit.

3.55 In that context, the benefit nullified or impaired must necessarily be something else. In this respect, we recall that past arbitrators under Article 22.6 of the DSU have deemed that benefit to correspond to the trade directly affected by the maintenance of the illegal measure.

3.56 For the reasons stated above, we reject the approach proposed by Japan in this case.

3. Reliance on specific instances of disbursements to assess nullification or impairment

(a) Main arguments of the parties

3.57 The United States claims that an examination of the actual disbursements made under the CDSOA would go beyond the terms of reference of the original disputes. Disbursements are not part of the "measure found to be inconsistent with a covered agreement" under Article 22.2 of the DSU. In the absence of an actual finding, it is not permissible under the DSU to assume that any application breaches any WTO obligation or nullifies or impairs any benefit.[62] The United States adds that, since there are no recommendations or rulings concerning any payments made under the CDSOA, there is certainly no recommendation or ruling about future payments – i.e., there is no legal basis for the Arbitrator to make an award for alleged nullification or impairment supposedly caused by measures not even in existence.[63]

3.58 Japan argues that, while the United States directly nullifies or impairs benefits under the covered agreements by enacting the CDSOA, the United States further nullifies or impairs benefits under the WTO Agreement with each disbursement to domestic producers. These disbursements are the direct economic consequence of the violating measure and constitute the very essence of the CDSOA. In the opinion of Japan, the CDSOA is not conceivable without disbursements and the disbursements are not possible without the CDSOA. Any attempt to draw a distinction between the existence of the CDSOA and its disbursements is impossible. Japan concludes from the approach of the arbitrator in *US – 1916 Act (Article 22.6 – US)* that the existence of the CDSOA cannot be legally distinguished from its application when determining the nullification or impairment caused by this Act. Following the United States approach would mean that, when a measure violates the WTO Agreement *per se*, the requesting party could not suspend concessions or other obligations. It would have to bring a dispute against each specific application of a measure. This would generate more disputes in disregard of the principle of "prompt settlement" of disputes expressed in Article 3.3 of the DSU.[64]

(b) Analysis of the Arbitrator

3.59 First, we recall that the Requesting Parties have not identified nullification or impairment beyond that resulting from the instances of application of the CDSOA.

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[62] United States written submission, paras. 15-19.

[63] United States oral statement, paras. 39-40.

[64] Written submission of Brazil, the European Communities, India, Japan, Korea and Mexico, paras. 35-40.

fact "zero" in terms of direct trade loss. As we see it, the Requesting Parties in effect use the amount of disbursements under the CDSOA as simply a proxy for the conduct of an economic analysis of the impact of the CDSOA disbursements on their exports or, more generally, on the competitive situation of the businesses concerned. Under those circumstances, we believe that our decision to rely on the trade effect resulting from the violation to determine the level of nullification or impairment does not, in economic terms, significantly depart from the rationale of the Requesting Parties' approach.

3.76 We are also mindful that other arbitrators have taken a prudent approach by avoiding claims that were "too remote", "too speculative" or "not meaningfully quantified".[69] We recall that parties have also cautioned us against the risk of relying on overly speculative data.[70]

3.77 For this reason, we considered it inappropriate to try to apply a counterfactual based on a relatively simple equation and simple parameters, as in *EC – Hormones (US) (Article 22.6 – EC)*, *EC – Hormones (Canada) (Article 22.6 – EC)* or *EC – Bananas III (US) (Article 22.6 – EC)*. Rather, given the number of factors potentially influencing the eventual trade effect of the CDSOA disbursements, it would be more appropriate to identify and apply an economic model reflecting those factors and allowing us, on the basis of a clearly identifiable amount – the disbursements made under the CDSOA – to assess the extent to which those payments could nullify or impair benefits accruing to the Requesting Parties.

3.78 To this end, we requested the parties to submit data and relevant economic literature so as to assess the feasibility of an economic model that would measure the extent to which disbursements under the CDSOA affect exports from the Requesting Parties to the United States.[71] On the basis of the elements available, we concluded that such a model was feasible and produced more credible results than if we applied the total disbursement as a proxy for the level of nullification or impairment. Indeed, while the model we have chosen to apply is based on a number of assumptions, we also note that the evidence before us does not demonstrate that using the total disbursement as a proxy for the level of nullification or impairment would produce a more credible result. Our analysis is described in Section III.C below.

3.79 We recognize that, in relying on an economic model in this arbitration, we may be breaking new grounds. This impression may be correct to the extent that we base our determinations on the results of this model. However, we note that economic modelling has already been applied in the *US – FSC (Article 22.6 – US)* arbitration. We are also mindful that applying economic models in arbitrations under Article 22.6 of the DSU may make such proceedings more complex and costlier. We acknowledge that economic analysis requires expertise that may not be readily available to all WTO Members. We do not believe, however, that this should be a reason to deprive ourselves of a means to reach a credible result through a transparent process in complex cases such as this one. Rather, we see the option of using economic models in Article 22.6 arbitrations as creating an opportunity to ensure full cooperation from the parties and, hence, more precise and credible results where the alternative may be to choose between simplistic and perhaps irreconcilable approaches.

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[69] See, e.g., *EC – Hormones (US) (Article 22.6 – EC)*, para. 77; *US – 1916 Act (EC) (Article 22.6 – US)*, paras. 5.54 -5.57.

[70] See, e.g. United States written submission, para. 40; written submission of Brazil, the European Communities, India, Japan, Korea and Mexico, para. 61.

[71] See paras. 3.128-3.129 below.

C. CALCULATION OF THE LEVEL OF NULLIFICATION OR IMPAIRMENT THROUGH AN ECONOMIC MODEL

1. Introduction

3.80 As mentioned above, we consider that an appropriate way to assess the trade effect of a law operating, in economic terms, like a domestic subsidy[72] was to endeavour to establish an economic model. This model, when applied to the facts of this case, would identify a coefficient which, when multiplied by the amount of disbursements over a given period, would produce a figure corresponding to a trade effect which could reasonably be deemed to correspond to the level of nullification or impairment for that period.

3.81 We also noted that when establishing an economic model, we would need to address a number of arguments made by the United States in relation, *inter alia*, to the calculation proposed by the Requesting Parties: its own view that the level of nullification or impairment would, in fact, be "zero"; the combined effect of offset payments and an anti-dumping or countervailing duty order; and the effect of CDSOA payments vis-à-vis the United States or foreign competitors not subject to anti-dumping or countervailing duties.[73] These arguments are addressed in the relevant parts of this section in relation to the determination of the amount of disbursements to be used in the application of the model, together with the United States' arguments regarding the fact that the figures published by the United States' authorities may either not be accurate or not definitive.[74]

2. Review of the approaches of the parties regarding economic models

(a) United States

3.82 The United States originally took the view that the trade effect of the CDSOA disbursements can be estimated to be zero.[75] This position is grounded in the view that benefiting firms would not expend the CDSOA disbursements to enhance their commercial position. Instead, the funds would be used elsewhere. The United States did not disagree that modelling was appropriate in this case, but because the input to the model would be zero, the output, or conclusion about trade effects would also necessarily be zero.[76] The United States added that even if the firms concerned did use the funds to enhance their competitive position, there would be a *de minimis* effect on output and hence on trade. In other words, the United States considered that the pass-through effect of the government transfers, i.e. the *ad valorem* effect of the transfers on the recipients' prices, would be zero or close to zero.

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[72] We are mindful of the United States' views that the CDSOA is a subsidy not found to cause any adverse trade effect (United States written submission, paras. 62-65). We nonetheless note that the United States does not object to a model which would rely on the price effect of CDSOA disbursements (see, e.g., Exhibit US-18, p. 2).

[73] See United States written submission, para. 52.

[74] See United States written submission, paras. 13, 14, 26 and 27.

[75] The Arbitrator asked the United States to submit a model that would justify its claim that nullification and impairment is "zero". The United States did not submit a model in response to this question, but outlined the basic parameters of the Armington model, which was submitted at a later stage in the proceedings. Instead, the United States argued that a formal model was not required, since in its view the facts are such that the CDSOA payments would not result in any increase in production. (United States replies to the Arbitrator's questions of 21 April 2004, paras. 16-26).

[76] United States replies to the Arbitrator's questions of 21 April 2004, para. 26.

3.83 However, the United States ultimately acknowledged that modelling could actually be done with some precision and volunteered a possible model.[77]

3.84 The model proposed by the United States adopts a disaggregated approach to estimating trade effects. Instead of treating the United States' economy as a whole and estimating a single trade effect number, it estimates the trade effect at the product level for each importer. These individual values are then summed to obtain the total trade effect. The model proposed by the United States also divides the countries in the world into three groups: the United States, WTO Members affected by the CDSOA disbursements and other exporters to the United States, thereby isolating the effects of the CDSOA payments only on the WTO Members subject to active anti-dumping or countervailing duty orders. The inputs required to run the model include:[78]

- A current market value share for each source of the products;
- An *ad valorem* measure of the CDSOA distribution that actually affected production;
- An estimate of the elasticity of substitutability as between products produced in the United States and imports (the elasticity of substitution);
- An estimate of the price sensitivity of supply for each product (the elasticity of the United States' supply, complaining party import supply, and rest-of-the-world import supply); and
- An estimate of the market demand elasticity.

3.85 Estimates of the supply, demand and substitution elasticities were taken from various US International Trade Commission reports. Supply elasticities for WTO Members with dumped or subsidized exports into the United States were arbitrarily set at 100 to reflect that they would not be able to adjust the price of their product downwards.[79] Trade and production data for the model is sourced from the Bureau of the Census, US Department of Commerce, and USITC investigations.[80]

3.86 The output of the model for each WTO Member affected by the CDSOA payments and each industry is as follows:[81]

- "An estimate of the decrease in US domestic shipments"; and
- "An estimate of changes in foreign trade partner exports to the United States, specifically breaking out the gain to the individual complaining party, the exemption of whose duty payments from CDSOA served as the basis for the particular counter factual estimation."

3.87 While the model is straightforward and based on the standard literature in applied international economics, implementation of the model by the United States in this case was not. The United States made a number of assumptions, which in its view were specific to the current case. These assumptions affect the input of the model, the values of the elasticities and the treatment of unavailable data.

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[77] In commenting on the view of the Requesting Parties that modelling would be "complex and burdensome" and Chile's comment that modelling would be "tedious", the United States stated that:

> "The fact that an exercise is complex, tedious, or even burdensome does not mean it can be dispensed with."

Comments of the United States of 4 May 2004 on answers of the Requesting Parties to the questions of the Arbitrator, para. 3.

[78] Exhibit US-18.

[79] Exhibit US-18.

[80] Exhibit US-18.

[81] Exhibit US-18.

3.88 These are:

- ignoring cases that do not exceed the *de minimis* threshold advocated by the United States in this arbitration;
- making certain assumptions about which payments affect production;
- making certain assumptions about the pass-through effect of payments.

3.89 The United States considers that only those payments that are above a *de minimis* level should be analysed. Citing Article 6.1(a) of the SCM Agreement and Article 6.4(a) of the Agreement on Agriculture, the United States argues that a 5 per cent *de minimis* threshold is appropriate.[82] In implementing the model, however, the United States assumes a 1 per cent *de minimis* level.

3.90 The United States also deducts certain payments, which it assumed did not affect production.[83]

3.91 The United States further deducts payments made in respect of products for which the anti-dumping or countervailing duty was revoked on the ground that the "nullification or impairment should be measured in terms of the effect the CDSOA has on producers/exporters subject to antidumping or countervailing duty orders".[84] This point is further clarified in the United States' statement that "a Member cannot suffer nullification or impairment as a result of a non-permissible specific action against dumping (or against a subsidy) if no order is in place and no duties can be collected on that Member's products."[85]

3.92 Only once the industries that meet the United States' definition of *de minimis* are identified and the various deductions are calculated does the United States apply its assumption of the proportion of disbursements that affect production. Its initial argument is that the pass-through figure should be "zero", which implies that none of the CDSOA disbursements would have an affect on trade. The United States provides four reasons for this assumption:

- the disbursements are untied, hence there is no requirement to expand production with these payments[86];
- there is no link between "qualifying expenditures" under the CDSOA and the expansion of production;
- the unpredictability of the disbursements makes it difficult for beneficiary firms to rely on the expenditures in a commercially meaningful way;
- offset payments reflect a small fraction of production, hence they cannot have a discernable impact on trade.

3.93 However, in response to the Arbitrator's query on the validity of a zero pass-through value, the United States indicated that a pass-through level of 25 per cent would be "reasonable".[87] It qualified this response by indicating that the economic literature did not point towards any specific value. However, the United States cited a value of 75 per cent for a United States policy contingent on export (the Domestic International Sales Corporation programme), which was reported in an

[82] United States replies to the Arbitrator's second set of questions, para. 27.
[83] Citing the example of a company called Torrington, which was sold to another company (Timken) without the payments, the United States argues that these payments should be deducted, since they do not affect production.
[84] United States replies to the Arbitrator's second set of questions, para. 23.
[85] United States replies to the Arbitrator's second set of questions, para. 24.
[86] United States replies to the Arbitrator's second set of questions, paras. 5-7.
[87] United States replies to the Arbitrator's second set of questions, para. 13.

academic study.[88] The United States also cites a study that concludes that 60 per cent of an investment tax incentive was received by the recipients.[89]

3.94 The results of the United States' model as applied according to its assumptions are outlined in Table 1.

(b) Requesting Parties

3.95 The original position of the Requesting parties was that modelling need not be considered by the Arbitrator to determine the award. Instead, they argued that the value of the CDSOA disbursements was a proxy for the minimum level of nullification or impairment caused by the measure found to be illegal. The position of the Requesting Parties is that the level of nullification or impairment can be quantified on the basis of the value of the CDSOA payments; since their view is that economic modelling of the trade effects in this case would be too difficult.[90]

3.96 However, in response to a question posed by the Arbitrator regarding whether or not a model for estimating the trade effects that meets their criteria exists, the Requesting Parties submitted such a model. Their model is based on the level of CDSOA payments, a gross measure of the elasticity of substitution between domestic and imported products and the ratio of US manufacturing imports to domestic shipments of US manufacturing industries.

3.97 The formal specification of the model proposed by the Requesting Parties, as submitted to the Arbitrator, is:[91]

$$\text{Reduction in imports} = \left(\frac{\Delta M / M}{\Delta P_q / \Delta P_q} \right) * \left(\Delta P_q * Q \right) * \left(\frac{P_m M}{P_q Q} \right) \qquad (1)$$

where,
M = volume of imports
ΔM = change in the volume of imports
P_m

Table 1: Estimated Level of Nullification or Impairment Revised Pursuant to the Model Proposed by the United States

2001	2002	2003

3.98 The Requesting Parties further simplify this expression by reducing it to the following three components:

- the elasticity of substitution (η), which is the first term and can be expressed as:

$$h = \left(\frac{\Delta M / M}{\Delta P_q / \Delta P_q} \right) \qquad (2)$$

-

long-run estimates and not short-run estimates. They note that these estimates are "on average, twice as large as short-run elasticities".[95]

3.102 Data on domestic shipments are sourced from public sources. The Requesting Parties estimate that in the year 2002 the ratio of imports to domestic production was 0.295.

3.103 Using total payments for 2002 of US$329 million, the Requesting Parties, therefore, conclude that the total trade effect of the CDSOA programme is US$505 million. In simple terms, they conclude that for the year 2002 the trade effect coefficient would be 1.54 times the level of disbursements. At this point we should note that this coefficient is independent of the value of disbursements. It depends only on the assumed value of the elasticity of substitution and the import penetration ratio. Changes in either one of these values will change the overall value of the coefficient.

3.104 We also recall that, in commenting on the model submitted by the Requesting Parties, the United States observed that the Requesting Parties include the amount of all CDSOA offset payments. This is equivalent to assuming that every CDSOA dollar disbursed by the United States under the

estimation of the CDSOA disbursements could only be done for around a third of the cases. The rest of the cases would require the use of proxy data. In our view, such a heavy reliance on proxy data would cast doubt on the reliability of that model. Furthermore, it would seem to us that the use of proxy data is open to the same criticisms as those made by the United States with respect to the Requesting Parties' model in terms of its degree of aggregation.

3.110 Despite the differences between the parties as to the appropriate model to be used, the two models submitted have qualitatively similar characteristics. Both multiply an assumed level of disbursements by a factor, or coefficient, to arrive at the total trade effect. In the case of the Requesting Parties, this factor is 1.54. In the case of the United States, this factor would appear to be on a product and importer basis for each year as illustrated in Table 2. The range of coefficients as estimated by the United States for the seven products for which they have data is 0.27 to 1.41.

3.111 Table 2 illustrates that, with product-specific data, the aggregate trade effect coefficient could exceed 1. At the same time, it also highlights the different effects that one could obtain at different levels of disaggregation.

Table 2: Aggregate Trade Effect Coefficient for Products Estimated by the United States

Product	Exporter	Year	Aggregate trade effect coefficient
			e effect coefficient

assumption that only 50 per cent of a given CDSOA disbursement will have an impact on output, will necessarily reduce any estimate of the trade effect by 50 per cent.

(b) Choosing an appropriate model

3.114 The previous sections presented the approaches to economic modelling submitted by the parties and a number of shortcomings we identified with both approaches. In general, we considered the approach of the Requesting Parties to be too aggregated, hence not specific enough to this case. While the model specification proposed by the United States is disaggregated and well specified, we concluded that there is insufficient data to run that model with any degree of accuracy.

3.115 Our preference would have been to employ a model endorsed by all parties, and we gave ample opportunity to the parties to try and find common ground on this question. Failing this, our preference would have been for the disaggregated model proposed by the United States. However, as mentioned above, the United States failed to provide sufficient data to employ such a model, despite it being in the United States' interest to do so. Moreover, the United States decided to apply a *de minimis* threshold for assessed trade impacts. The result was that the United States' model could not be implemented independently. This left us with the option of either accepting or rejecting the United States' model in its entirety. Our decision is to reject the United States' model in favour of a modified version of the model proposed by the Requesting Parties.

3.116 We have two principal reasons for taking this decision. The first is the lack of available data to implement the United States' model. As we have noted before, relevant data was available for only a third of the samples proposed by the United States and the United States did not provide any indication as to whether or not additional data would be made available. Our second reason is that the only objections the United States had about the Requesting Parties' model concerned the value of the parameters used in the model and the level of aggregation. We agree with the Requesting Parties in their assessment of the United States' view on their submitted model that the United States "does not critique the economic theory supporting the model, but argues that the parameter values used in the model are inappropriate".[97] This implies that if due account is taken of the legitimate concern of both sides regarding the variance in the values of the parameters, then the model of the Requesting Parties could be used to estimate the trade effect of the measure in question.

3.117 A basic economic model to derive a coefficient for the trade effects of disbursements operating as subsidies can be described as the product of four variables: the value of the subsidy, a measure of the *ad valorem* price reduction caused by the CDSOA disbursements (i.e., "pass-through"), a substitution elasticity of imports, and import penetration. The basic relationship of the trade effect can be expressed as follows:

Trade effect = (value of disbursements)*[(pass-through)*(import penetration)*(elasticity of substitution)]

3.118 The term in the square brackets can be defined as a trade effect coefficient. For a given 77.25 0 TD k

the pass-through effect of the disbursements on production. In the Requesting Parties' model, this term was implicitly assigned a value of one. It can be rewritten as:

$$\text{Reduction in imports} = a * h * S * R$$

3.121 We account for the industry distribution variation of the CDSOA payments by calculating the trade effects at the industry level and then aggregating the result. This approach is broadly similar to the approach of the United States, which is to calculate the trade effects at the detailed product level. Even though this approach is a practical way to proceed, we did not use the United States approach due to some shortcomings in the implementation of the model. The United States identified only 18

difficulties should not be confused with those resulting from the failure of the parties to supply data, where those parties are generally the source of the relevant information. While the first type of difficulty (the intrinsic difficulties attached to the use of an economic model) is one of the elements arbitrators must consider in deciding whether to apply an economic model, the second type of difficulty (that resulting from the failure of the parties to supply data) should not be part of that consideration. We therefore remain convinced that it is appropriate to rely on the information available when the arbitrator is of the view that an economic model would be the most effective way of calculating the level of nullification or impairment and one or more parties do not fully cooperate with the arbitrator in providing data and do not submit convincing reasons for not doing so. In other

disbursement, then we do not see any grounds, legal or economic, to round that value down to zero and issue an award of "zero".

(c) Elasticity of substitution

3.137 The views of the parties also differ on the appropriate value of the elasticity of substitution to be used in modelling, although they are all in agreement that it is possible to calculate values at the 3-digit NAIC level.[106] The Requesting Parties submitted a set of elasticities at that level. The United States did not submit these elasticities when requested, and failed to convincingly contest the validity of the values submitted by the Requesting Parties. As a result, we used in our model the values submitted by the Requesting Parties.

3.138 In recognition of the fact that different aggregation methodologies exist, we decided to vary the elasticity values submitted by the Requesting Parties by 20 per cent. Therefore, three different sets of simulations are performed; one using the submitted elasticities and one each for values that are 20 per cent lower and 20 per cent higher than these elasticities.

(d) Pass-through

3.139 While the concept of pass-through is generally referred to in the economic literature as the extent to which exchange rate changes affect domestic prices, in this case we use the concept in a similar fashion to that used by the arbitrator in the *US – FSC (Article 22.6 – US)* case. The arbitrator in that case noted, in the context of an export subsidy that:

> "[P]ass through relates to the degree to which a company uses a subsidy it receives to lower the price of the product that it exports. At one extreme the company may choose to apply the full amount of the subsidy to the price of its products, thereby lowering its price. At the other, it may choose not to lower the price of the product."[107]

3.140 Therefore, pass-through, in the context of the case before us, is the extent to which a CDSOA disbursement will be applied to reducing the price of a beneficiary firm's products lowe20Pan thw

payments to train their workers, to upgrade their technology or machinery, or to expand their capacity and/or production. While using the funds in these sorts of ways clearly will have supply side effects that may have eventual consequential effects on prices, these price effects will be inter-temporal. Finally, some firms may, as the United States argues, not use the funds in any way that would have price effects.

3.143 In order to identify a suitable value for the pass-through coefficient we sought supplemental submissions and guidance from the parties.[108] On the one hand, the United States responded that a study of their Domestic International Sales Corporation programme had identified a pass-through of that export subsidy of 75 per cent of the payment, but expressed the belief that "a pass-through of 25 per cent is reasonable".[109] This statement was not supported by any methodology or based on any factual evidence. On the other hand, the Requesting Parties did not alter their position that the only reliable pass-through is 100 per cent.

3.144 In the absence of precise information on the value of the pass-through, we adopt the same approach as we adopted for the value of the elasticity of substitution; instead of using one specific value we have used the range of 25 per cent to 100 per cent derived from the comments of the parties. The lower point of the range is provided by the United States, whereas the 100 per cent assumption is based, as we stated above, on the assumption that a firm has every incentive to use the funds in a commercially meaningful way. We acknowledge that 100 per cent pass-through is, in practice, not realistic for the reasons mentioned above, and we do not wish to give any credit to the Requesting Parties for not having justified their position that the pass-through is 100 per cent. However, we were not provided with any better information allowing us to apply another percentage as the upper end of our range and we are intuitively of the view that, if the upper end of the range is not 100 per cent, it is probably very close to that percentage.

5. Application of the model

3.145 We now proceed to apply the model. Table 3 summarizes our results for the range of assumed elasticities of substitution and for a range of assumed pass-through values for 2001, 2002 and 2003. For each year we have 12 values, giving us 36 values in all. At the outset we note that the range for 2003 differs from the ranges for the other two years. This arises due to the change in the industry distributions for that year (see Chart 1 above). The yearly change in the industry distribution is also one of the reasons why we use an average based on 2001-2003, even though the United States was not required to bring its legislation into conformity with its WTO obligations until 27 December 2003.

3.146 Since our approach is based on assigning a single value of a trade effect coefficient we need a methodology to reduce the 36 estimates to a single value. Since we have no guidance from the literature or from the submissions of the parties, we have decided to take for each year, the average of the middle two rows and the middle column and average these three values. In doing so, we obtain a value of 0.68 for 2001, 0.78 for 2002 and 0.70 for 2003 and an overall value of 0.72.

3.147 The United States contests the right of the Requesting Parties to "retaliate on behalf of other Members" and we now proceed to address how this point is taken into account in our modelling. Our core rationale is that the trade effect of the CDSOA measure can be estimated to be the nullification or impairment that the Requesting Parties have suffered as a result of the measure having not been withdrawn. Based on our analysis, we have estimated that the trade effect coefficient of the disbursements can be estimated to be 0.72. Therefore, . The y66 55ehiTw (disbursements c,akeng a snverage

based on total disbursements on Requesting Parties products of US$190,199,701.02. Our remaining task is to allocate this total trade effect amongst the Requesting Parties. One possibility is to use the aggregate share of total imports for each Requesting Party. This, however, has an obvious bias, especially due to the industry concentration of the disbursements as discussed earlier. More detailed trade data could circumvent the problem of industry concentration, but, in our view, this is also problematic, due to the fact that the trade data would be biased since they reflect import values when the anti-dumping and countervailing duties were in place.

3.148 In our view, a better measure is based on the distribution of CDSOA payments, which is in turn based on aggregate duty collections on imports of products subject to anti-dumping duty or countervailing duty orders, but which can be analysed to determine the distribution of those imports amongst the various exporting countries. From this we may conclude that a WTO Member's share of the total disbursements is a better indicator of the share of their exports that will be lost in consequence of the disbursement than the aggregate share of imports. Therefore, we decide to allocate the total trade effect amongst the Requesting Parties on the basis of the share of CDSOA disbursements attributable to duties collected on their respective exports. In doing so, we note that the level of nullification or impairment will not exceed, for each Requesting Party, the level of nullification or impairment that results from the disbursements relating to that party's exports subject to anti-dumping or countervailing duty orders.

Table 3: Summary of Trade Effect Coefficient Values by Elasticity and Pass-Through, 2001-2003

2001			
	Elasticity values		
Pass through	Low	Medium	High
25	0.22	0.27	0.33
50	0.43	0.54	0.65
75	0.65	0.81	0.98
100	0.87	1.09	1.30
2002			
	Elasticity values		
Pass through	Low	Medium	High
25	0.25	0.31	0.37
50	0.50	0.62	0.74
75	0.74	0.93	1.12
100	0.99	1.24	1.49
2003			
	Elasticity values		
Pass through	Low	Medium	High
25	0.22	0.28	0.34
50	0.45	0.56	0.67
75	0.67	0.84	1.01
100	0.89	1.12	1.34

D. CONCLUSION: LEVEL OF NULLIFICATION OR IMPAIRMENT

3.149 As mentioned above, the purpose of the development of an economic model in this case was to define a coefficient by which future disbursements under the CDSOA would be multiplied to reach a value of trade effect. In line with past arbitrations, we consider this trade effect to represent the level of nullification or impairment suffered by Japan.

3.150 We note that this solution is hybrid to the extent that it combines a fixed coefficient calculated on the basis of actual disbursement patterns over a particular period of time – in this case 3 years[110], with variable amounts of future disbursements. We also acknowledge that this coefficient is based on past disbursements (2001-2003) which may reflect neither the amount nor the categories of products which will be subject to anti-dumping or countervailing duty orders and lead to CDSOA disbursements in the future. We nevertheless note that this approach is consistent with past arbitrations where representative periods where used to determine volumes and prices of exports[111] in order to calculate levels of nullification or impairment and levels of suspension fixed once and for all. It is also consistent with the practice under Article XIII of GATT 1947 and 1994 for allocation of quotas or tariff quotas.

3.151 As a result we conclude that: the level of nullification or impairment in this case may be deemed to correspond, for Japan and for a given year, to the following:

> Amount of disbursements under CDSOA for the most recent year[112] for which data are available relating to anti-dumping or countervailing duties paid on imports from Japan at that time, as published by the United States' authorities.
>
> *multiplied by*

impairment as we have decided to determine it (i.e., in terms of trade effect). This issue is addressed in relation to the following features of Japan's request, which are challenged by the United States:

(a) Suspension of concessions or other obligations expressed as a duty on an undetermined quantity of trade rather than as a suspension of concessions and tariff surcharges on a determined value of trade;

(b) Suspension of concessions or other obligations by some of the Requesting Parties so as to cover the total amount of disbursements under the CDSOA; and

(c) Determination of a variable level of suspension of concessions or other obligations.

4.4 In doing so, we are mindful that, pursuant to Article 22.7 of the DSU, we should not examine the nature of the concessions to be suspended.

B. THE LEVEL OF SUSPENS

considered the amount of additional duty as related to the *nature* of the envisaged suspension, which falls outside the mandate of arbitrators under Article 22.7 of the DSU.[116]

(b) Analysis of the Arbitrator

4.7 In the approach we decided to follow in order to determine the level of nullification or impairment, disbursements made under the CDSOA were only a starting point in assessing the *trade effect*

2. Suspension of concessions or other obligations by Japan and other Requesting Parties so as to cover the total amount of disbursements made under the CDSOA

(a) Main arguments of the parties

(i) United States

4.12 The United States notes that all the Requesting Parties, except Chile, include in their requests, authorization to impose countermeasures in an amount that corresponds to duties collected on dumped

(b) Position of the Arbitrator

4.14

the CDSOA in the future. It is not even possible to specify the level of payments under the CDSOA given the uncertainties attached to its calculation. The United States concludes that if requesting parties were permitted to refigure and revise their own level of suspension on an annual basis, these arbitrations would generate, rather than resolve, disputes between parties.[122]

(ii) Japan

4.19 Japan argues that the purpose of Article 22.4 of the DSU is to ensure equivalence between the level of suspension and the level of nullification or impairment so as to ensure that no punitive measures are taken against a Member found in violation of its WTO obligations. This does not mean, however, that a level may not vary depending on the variations of the level of nullification or impairment. The Requesting Parties fixed one single level of suspension which is identifiable at each point in time during the application of the suspension. Japan refers to the decision in *US – 1916 Act (EC) (Article 22.6 – US)*, where the arbitrator took into account the objective of Article 22.4, which is to ensure equivalence between two levels in the course of the application of retaliatory measures. Japan considers that it would be speculative to extrapolate a fixed level of nullification or impairment and suspension for the future, given the wide variance among the annual CDSOA offset payments so

variability is, in our opinion, very different in nature and degree from the more steady evolution of exports recorded in other cases where counterfactuals[125] were applied, such as *EC – Bananas III (US) (Article 22.6 –*

Japan exceeds, for a given period, the level of nullification or impairment that Japan has sustained as a result of the violation of the United States' obligations by the CDSOA, as calculated using the formula developed above.[129]

V. AWARD OF THE ARBITRATOR

5.1 For the reasons set out above, we determine that, in the matter *United States – Continued Dumping and Subsidy Offset Act of 2000 (Original Complaint by Japan)*, the level of nullification or impairment suffered by Japan in a particular year can be deemed to be equal to the total of disbursements made under the CDSOA for the preceding year relating to anti-dumping or countervailing duties paid on imports from Japan, multiplied by the coefficient identified in Section III.D above.

5.2 Accordingly, we decide that the suspension by Japan of concessions or other obligations in the form of the imposition of additional import duties above bound custom duties on a final list of products originating in the United States covering, on a yearly basis, a *total value of trade* not exceeding, in US dollars, the amount resulting from the following equation:

> Amount of disbursements under CDSOA for the most recent year for which data are available relating to anti-dumping or countervailing duties paid on imports from Japan at that time, as published by the United States' authorities.

multiplied by:

> 0.72

would be consistent with Article 22.4 of the DSU.

5.3 In this respect, we note that Japan will notify the DSB every year, prior to the adjustment of the duties, a detailed list indicating the level of the additional duties on the selected products in the light of the latest annual distribution of offset payments under the CDSOA.

5.4 In that context, we suggest that Japan also notify to the DSB, every year, the amount of trade that will be subject to the above-mentioned measure.

5.5 Finally, we remind that Article 22.8 of the DSU provides that:

> "The suspension of concessions or other obligations shall be temporary and shall only be applied until such time as the measure found to be inconsistent with a covered agreement has been removed, or the Member that must implement recommendations or rulings provides a solution to the nullification or impairment of benefits, or a mutually satisfactory solution is reached. …"

VI. CONCLUDING REMARKS

6.1 Some of the issues raised in these proceedings lead us to make the following remarks for wider consideration.

6.2 As mentioned above, the DSU does not expressly explain the purpose behind the authorization of the suspension of concessions or other obligations. On the one hand, the general obligation to comply with DSB recommendations and rulings seems to imply that suspension of

[129] See also Panel and Appellate Body Reports on *US – Certain EC Products*.

concessions or other obligations is intended to induce compliance, as has been acknowledged by previous arbitrators.[130] However, exactly what may induce compliance is likely to vary in each case, in the light of a number of factors including, but not limited to, the level of suspension of obligations authorized.[131]

6.3 On the other hand, the requirement that the level of such suspensions remain equivalent to the level of nullification or impairment suffered by the complaining party seems to imply that suspension of concessions or other obligations is only a means of obtaining some form of temporary compensation, even when the negotiation of compensations has failed.

6.4 In other words, it is not completely clear what role is to be played by the suspension of obligations in the DSU and a large part of the conceptual debate that took place in these proceedings could have been avoided if a clear "object and purpose" were identified.

6.5 The WTO dispute settlement system authorizes Members to challenge a law as such, i.e. irrespective of whether it has been applied or not. The "classical" approach based on an assessment of the trade effect of a given measure may not always contribute to the identification of the actual level of nullification or impairment, in particular if no instances of application had arisen at the time. This may be because the trade effect of a measure may be difficult to assess due to the lack of verifiable figures. We are of the view that, while parties share a duty to cooperate with the Arbitrator in the establishment of the facts, there is no reason *a priori* to sanction the requesting party or the respondent if supporting figures are difficult or impossible to find. We believe that this is a situation that has to be addressed in order to reach a decision on what may be achievable through recourse to suspension of obligations in such cases.

6.6 In this arbitration, we have interp Tfp8/F0 11.B1s

ANNEX A

WORKING PROCEDURES OF THE ARBITRATOR

The Arbitrator will follow the normal working procedures of the DSU where relevant and as adapted to the circumstances of the present proceedings, in accordance with the timetable it has adopted. In this regard,--

(a) the Arbitrator will meet in closed session;

(b) the deliberations of the Arbitrator and the documents submitted to it shall be kept confidential. However, this is without prejudice to the parties' disclosure of statements of their own positions to the public, in accordance with Article 18.2 of the DSU;

(c) at any substantive meeting with the parties, the Arbitrator will ask the United States to present orally its views first, followed by the party(ies) having requested authorization to suspend concessions or other obligations;

(d) each party shall submit all factual evidence to the Arbitrator no later than in its written submission to the Arbitrator, except with respect to evidence necessary during the hearing or for answers to questions. Derogations to this procedure will be granted upon a showing of good cause, in which case the other party(ies) shall be accorded a period of time for comments, as appropriate;

(e) the parties shall provide an electronic copy (on a computer format compatible with the Secretariat's programmes) together with the printed version (6 copies) of their submissions, including the methodology paper, on the due date. All these copies must be filed with the Dispute Settlement Registrar, [...]. Electronic copies may be sent by e-mail to [...]. Parties shall provide 6 copies and an electronic version of their oral statements during any meeting with the Arbitrator or no later than noon on the day following any such meeting.

(f) except as otherwise indicated in the timetable, submissions should be provided at the latest by 5.00 p.m. on the due date so that there is a possibility to send them to the Arbitrator on that date. As is customary, distribution of submissions to the other party(ies) shall be made by the parties themselves;

(g) if necessary, and at any time during the proceedings, the Arbitrator may put questions to any party to clarify any point that is unclear. Whenever appropriate, a right to comment on the responses will be granted to the other party(ies);

(h) any material submitted shall be concise and limited to questions of relevance in this particular procedure.

(i) Parties have the right to determine the composition of their own delegations. Delegations may include, as representatives of the government concerned, private counsel and advisers. Parties shall have responsibility for all members of their delegations and shall ensure that all members of their delegations act in accordance with the rules of the DSU and these Working Procedures, particularly in regard to confidentiality of the proceedings. Parties shall provide a list of the participants of their delegation prior to, or at the beginning of, any meeting with the Arbitrator.

(j) to facilitate the maintenance of the record of the arbitration, and to maximize the clarity of submissions and other documents, in particular the references to exhibits submitted by parties, parties shall sequentially number their exhibits throughout the course of the arbitration.

ANNEX B

METHODOLOGY FOR CALCULATING THE TRADE EFFECT OF CDSOA DISBURSEMENTS

A. INTRODUCTION

1. Section III.C.2 of this Decision outlines the proposed approaches of the parties to estimating the decline in imports arising from the disbursement of funds as part of the United States Continued Dumping and Subsidy Offset Act. The purpose of this Annex is to explain the methodology used to calculate the values in Table 3 in the main text. Section B outlines this methodology. This is followed, in Section C, by an explanation of the changes made to the Requesting Parties' model by the Arbitrator in its application of this model. Section D discusses the issue of the values to be assigned to the various parameters. The last section presents the overall results.

B. METHODOLOGY

2. The role of economic modelling of trade effects is discussed at length in the *US – FSC (Article 22.6 – US)* Arbitration decision.[132] The arbitrator in that case faced an issue similar to that faced by us, which is the selection of an appropriate model. Its approach, however, differs from the one we have taken, since the arbitrator decided to use, in its entirety, the model proposed by one of the parties. In support of its decision, the arbitrator in that case pointed to the fact that the model it used, although proposed by the European Communities, had actually been developed by the United States Government to explain the trade effects of the FSC programme to the United States Congress. Hence, the arbitrator concluded that, if the model was suitable for the United States Congress, it would be suitable for the arbitration.[133]

3. In this case, we received two models in response to our request to all parties to submit what they viewed as suitable models to simulate the trade impact of the CDSOA disbursements. However, as explained in Section III.C.2, the models proposed by the Requesting Parties and the United States, although broadly similar, differed in their level of aggregation and, to some extent, in the variety of parameters that estimate the counterfactual decline in the value of imports arising from CDSOA payments.

affected WTO Member. The aggregate estimate using this approach was obtained by summing the individual estimates for each product.

4. Despite the relative merits of the proposed models, as presented in these proceedings, each possessed fundamental flaws that made them unworkable for this case. The model of the Requesting Parties required economy wide values. Hence, a single elasticity parameter was used to capture the substitutability between domestic and imported goods. Similarly, the import penetration value in this

Standard Industrial Classification, the United States provided the necessary data at the 3-digit level of the North American Industrial Classification ("NAIC"), which is more appropriate.

15. In a subsequent set of questions, we requested each of the parties to submit the additional data required to run an economic model at the 3-digit level of the NAIC system.[139] In responding to these questions, both the Requesting Parties and the United States expressed concern about conducting a counterfactual trade effects analysis at the 3-digit NAIC level. Consequently, before proceeding we should state and address these concerns.

16. The Requesting Parties' view was that:

> "3-digit NAIC levels cannot accurately represent substitution elasticities for products receiving CDSOA payments. The 3-digit NAIC level is not at a sufficiently disaggregated level and covers too broad a range of products. In fact, most products under dumping orders are specified at a highly disaggregated level. The use of aggregate estimates of substitution elasticities for disaggregated products would result in biased results for the calculated trade effects."[140]

17. They further submitted that this bias is likely to be downward, since the product specific elasticities are likely to be higher than the aggregate elasticities.[141] This assertion is substantiated through the example of pasta. This product would be included with breakfast cereals and candy bars, which tend to be branded products. The Requesting Parties also highlighted a similar problem associated with various categories of bearings by distinguishing between high-precision bearings used in aircraft and those used in the automotive industries and home appliances.

18. The United States shared the same view as the Requesting Parties that a 3-digit analysis would necessarily be biased. They stated, "all of the parties agree that any model based on data from the three-digit North American Industry Classification or from the Global Trade Analysis Project (GTAP) would result in a relatively imprecise estimate of the effect the CDSOA has on the trade of the Requesting Parties".[142]

19. The parties have placed us in a difficult position with respect to choosing an appropriate level of aggregation. We agree with the United States that a more product specific methodology is preferable to an aggregate methodology. However, given that if the product-specific methodology lacks the appropriate data, we do not see how a disaggregated methodology would be more accurate than an aggregate methodology. Furthermore, we note that the solution of the United States for cases where necessary data was missing was to assume the results of their analysis with available data applied to those products for which data was not available.[143] The United States, in effect, assumes that the analysis for one set of products could automatically be applied to another set of products, which must implicitly introduce the very same sorts of biases and inaccuracies that the United States argued against.

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[139] Question 1 of the second set of questions of the Arbitrator.

[140] Replies of the Requesting Parties to the second set of questions of the Arbitrator.

[141] Replies of the Requesting Parties to the second set of questions of the Arbitrator, para. 6.

[142] Comments of the United States to replies of the Requesting Parties to the second set of questions of the Arbitrator, para. 1.

[143] See footnote 6 of US Exhibit 18. The United States adopts the same approach that we adopt, which is to assume a trade effect coefficient. It defines the level for these products for which information is not available by the product of the offset payments and the ratio of the modelled trade impact for all complaining parties in the given year and the total modelled offset payments for all complaining parties in the given year.

20. While reiterating that economic modelling is not always precise, we consider that the issue is whether or not the broad parameters of an outcome derived through a trade-effects analysis is "unreasonable".[144] In this context, our assessment is that an analysis at the 3-digit level effectively bridges the problems of a too highly aggregated model that assumes single values for each variable and a disaggregated analysis, which does not have all the required data.

21. Therefore, the adopted approach is to estimate the trade effect, for a given year, at the 3-digit level and then sum these values to obtain a total trade effect.[145] This total trade effect is subsequently divided by the level of disbursements to obtain the trade effect coefficient (β in equation A3). This is done for each of the years 2001 through to 2003. The final value of the coefficient is then calculated as the simple average of these three numbers. The results arising from the implementation of this approach are explained and presented in the last section of this Annex.

C. VALUES ASSIGNED TO PARAMETERS

1. Pass-through

22. The positions of the parties with respect to pass-through are completely opposite. The United States asserts that the value is zero, whereas the Requesting Parties assert that it is 100 per cent. Section III.4(d) presents the rationale of the parties' positions and our views on the appropriate values. In summary, we have opted for a range of pass-through values of between 25 and 100 per cent. We were not persuaded by the US argument that the value should be zero. Although they identified certain cases where firms that benefited from CDSOA disbursements did not utilize the funds, the United States was not convincing in establishing that this would arise for every single dollar disbursed under the CDSOA programme.[146]

23. Similarly, the fact that the United States was able to identify at least one firm that did not use the funds to divert imports suggests that an absolute 100 per cent pass-through would be unrealistic. The problem we face, however, is that there is no evidence to suggest what the upper-bound value might be if it is not 100 per cent. The weight of economic theory and commercial pressures point to 100 per cent, but not any other specific number. As we state in paragraph 3.144 we are intuitively of the view that the upper end of the range would be close to 100 per cent.

2. Elasticities

24. As the parties have pointed out, the debate over the appropriate values to assign to the various elasticities used in modelling is intense. Not only are there differences at the specific product level, but, as the United States has pointed out, there would be differences about the relevant aggregation methodology to be employed if calculations are not done at the product level.

25. The model of the Requesting Parties relies on a single elasticity value – the elasticity of substitution. In contrast, the model of the United States employs three elasticity values in addition to the elasticity of substitution. We agree with the Requesting Parties that any avenue to minimize the

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[144] See *US – FSC (Article 22.6 – US)* para. 6.49.

[145] Aggregating the individual industries to get the total value should not be confused with analysing the effects in the United States market using general equilibrium analysis. Each estimate at the individual level is done assuming no changes in any other industry.

[146] The United States provided anecdotal evidence of a few firms that did not use the funds to expand output on pages 30-34 of its written submission. When asked (Question 13 of the Arbitrator) to provide additional evidence, the United States responded that it has "been unable to determine how affected domestic producers use CDSOA payments, beyond the information provided on pages 30-34 of [its] written submission".

variance in values should be explored. In this regard, the model of the Requesting Parties narrows the debate over relevant elasticity values to only the elasticity of substitution.

26. The Requesting Parties themselves acknowledge the difficulties in obtaining precise estimates. They submitted two sets of elasticities as evidence of possible values that could be used to model the trade effect. One set was sourced from the Global Trade Analysis Project ("GTAP") based on the sectors within their basic model. The second submitted set for the same sectors was sourced from United States International Trade Commission ("USITC") researchers. The two sets differed

that, despite asking specifically for values that we could use, we only have one set of values for the 3-digit NAIC level. In order to account for measurement error and, of course, aggregation bias, we propose to use the Requesting Parties' set of elasticity estimates, but vary them by 20 per cent in order to have a range of effects. That is, the calculations will be done using elasticity values that are both 20 per cent above the submitted elasticities and 20 per cent below. The figure of 20 per cent was chosen as a conservative adjustment, given that the differences between the means of the US low and medium and US medium and high values is approximately 25 per cent.

3. Import penetration

30. The import penetration values were calculated using data provided by the United States. They are defined by the Requesting Parties as the "ratio of imports to domestic shipments". The latter is defined as total shipments less exports.

31. The figures reported in the table correspond to what might intuitively be expected, with the exception of the very high figure for fish and fish products. The reported production figures for the years 2000 through to 2002 are respectively: US$3.55 billion, US$3.23 billion and US$3.09 billion. The respective export figures were: US$2.66 billion, US$2.85 billion and US$2.8 billion. When these figures are combined with the import figures of US$8.12 billion, US$7.71 billion, and US$7.8 billion for the respective years, the resulting import penetration figures are very high relative to those calculated for the other industries.[149]

[149] Imports divided by the residual of production minus exports.

Annex Table 2: Import Penetration Ratios by 3-digit NAIC Industry, 2001-2003

Industry	NAIC Code	2001	2002	2003
Agricultural products	111	0.16	0.16	0.17
Livestock and livestock products	112	0.03	0.04	0.03
Fish, fresh, chilled, or frozen and other marine products	114	20.60	26.89	23.79*
Food manufacturing	311	0.05	0.05	0.05
Beverages and tobacco products	312	0.08	0.09	0.11
Textiles and fabrics	313	0.16	0.19	0.21
Textile mill products	314	0.25	0.27	0.30
Apparel and accessories	315	1.30	1.29	1.38
Leather and allied products	316	3.34	2.64	2.55
Wood products	321	0.18	0.19	0.19
[redacted]	[redacted]	[redacted]	0.13	0.13

values for each of the years are not too dissimilar from the overall value of 0.295 presented by the Requesting Parties, which could also be used as a proxy.

D. IMPLEMENTING THE MODEL

34. Having dealt with the specification and various parameters of the model, we turn now to its implementation. The adopted aggregation methodology for the results at the 3

Annex Table 3: Counterfactual Trade Effect of CDSOA Disbursements
Assuming 100 per cent Pass

Annex Table 4: Counterfactual Trade Effect of CDSOA Disbursements
Assuming 100 per cent Pass-through by 3-digit NAIC, 2002

					Reduction in imports (US dollars)		
NAIC Code	Industry	Disbursements (US dollars)	Elasticity	Market Penetration	Low	Mid-point	High
111	Agriculture	535685.42	2.2	0.16	150849	188561	226274
114	Fish products	261675.49	2.8	26.89	15761657	19702071	23642485
311	Food	18886033.44	2.2	0.05	1661971	2077464	2492956
313	Textiles and fabrics	0	2.2	0.19	0	0	0
314	Textiles mill products	6734180.07	2.2	0.27	3200082	4000103	4800124
321	Wood products	0	2.8	0.19	0	0	0
322	Paper	128975.29	1.8	0.13	24144	30180	36216
325	Chemicals	5463401.14	1.9	0.25	2076092	2595116	

Annex Table 5: Counterfactual Trade Effect of CDSOA Disbursements
Assuming 100 per cent Pass-through by 3-digit NAIC, 2003

					Estimated Reduction in Imports (US dollars)		
NAIC Code		Disbursements (US dollars)	Elasticity	Market Penetration	Low	Mid-point	High
111 114	Agriculture	417142.63	2.2	0.17	124809.1	156011	187214

Annex Table 6: