**WORLD TRADE ORGANIZATION**

**WT/DS234/ARB/CAN**
31 August 2004

(04-3516)

Original: English

# UNITED STATES – CONTINUED DUMPING AND SUBSIDY OFFSET ACT OF 2000

# (ORIGINAL COMPLAINT BY CANADA)

## 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 Canada) – 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).

**TABLE OF CONTENTS**

## TABLE OF CASES CITED IN THIS REPORT

| SHORT TITLE | FULL TITLE |
|---|---|
| ***Brazil – Aircraft (Article 22.6 – Brazil)*** | Decision by the Arbitrators, *Brazil – Export Financing Programme for Aircraft – Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WT/DS46/ARB, 28 August 2000. |
| ***Canada – Aircraft Credits and Guarantees (Article 22.6 – Canada)*** | Decision by the Arbitrator, *Canada – Export Credits and Loan Guarantees for Regional Aircraft – Recourse to Arbitration by Canada under Article 22.6 of the DSU and Article 411 of the SCM Agreement*, WT/DS222/ARB, 17 February 2003 |
| ***EC – Bananas III (Ecuador) (Article 22.6 – EC)*** | Decision by the Arbitrators, *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, WT/DS27/ARB/ECU, 24 March 2000, DSR 2000:V, 2243 |
| ***EC – Bananas III (US) (Article 22.6 – EC)*** | Decision by the Arbitrators, *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, WT/DS27/ARB, 9 April 1999, DSR 1999:II, 725. |
| ***EC – Hormones (Canada) (Article 22.6 – EC)*** | Decision by the Arbitrators, *European Communities – Measures Concerning Meat and Meat Products (Hormones) – Original Complaint by Canada – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, WT/DS48/ARB, 12 July 1999, DSR 1999:III, 1105. |
| ***EC – Hormones (US) (Article 22.6 – EC)*** | Decision by the Arbitrators, *European Communities – Measures Concerning Meat and Meat Products (Hormones) – Original Complaint by the United States– Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, WT/DS26/ARB, 12 July 1999, DSR 1999:III, 1135. |
| ***Korea –Dairy*** | Appellate Body Report, *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R, adopted 12 January 2000, DSR 2000:I, 3 |
| ***US – 1916 Act (EC) (Article 22.6 – US)*** | Decision by the Arbitrators, *United States – Anti-Dumping Act of 1916, Original Complaint by the European Communities – Recourse to Arbitration by the United States under Article 22.6 of the DSU*, WT/DS136/ARB, 24 February 2004 |
| ***US – Certain EC Products*** | Panel Report, *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/R and Add.1, adopted 10 January 2001, as modified by the Appellate Body Report, WT/DS165/AB/R, DSR 2001:II, 413 |
| ***US – Certain EC Products*** | Appellate Body Report, *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/AB/R, adopted 10 January 2001, DSR 2001:I, 373 |
| ***US – FSC (Article 22.6 – US)*** | Decision by the Arbitrator, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WT/DS108/ARB, 30 August 2002 |
| ***US – Section 110(5) Copyright Act (Article 25.3)*** | Award of the Arbitrators, *United States – Section 110(5) of the US Copyright Act – Recourse to Arbitration under Article 25 of the DSU*, WT/DS160/ARB25/1, 9 November 2001, DSR 2001:II, 667 |

# I. INTRODUCTION

## A. INITIAL PROCEEDINGS

1.1 On 27 January 2003, the Dispute Settlement Body (DSB) adopted the report of the Panel in this dispute, as modified by the report of the Appellate Body.[1]

1.2 The findings adopted by the DSB were that the measure at issue in this case – the Continued Dumping and Subsidies Offset Act of 2000 (hereafter "CDSOA"):[2]

(a) is a non-permissible specific action against dumping or a subsidy, contrary to Articles VI:2 and VI:3 of the GATT 1994, Article 18.1 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (hereafter the "Anti-Dumping Agreement") and Article 32.1 of the Agreement on Subsidies and Countervailing Measures (hereafter the "SCM Agreement");

(b) is inconsistent with certain provisions of the Anti-Dumping Agreement and SCM Agreement, so that the United States has failed to comply with Article 18.4 of the Anti-Dumping Agreement, Article 32.5 of the SCM Agreement and Article XVI:4 of the Marrakesh Agreement Establishing the World Trade Organization (hereafter the "WTO Agreement");

(c) pursuant to Article 3.8 of the DSU, to the extent that it is inconsistent with provisions of the Anti-Dumping Agreement and the SCM Agreement, nullifies or impairs benefits accruing to the complaining parties[3] under those Agreements;

1.3 On 13 June 2003, an arbitrator established under Article 21.3(c) of the DSU ruled that the "reasonable period of time" for the United States to implement the recommendations and rulings of the DSB in this case was 11 months from the date of adoption of the Panel and Appellate Body Reports by the DSB. The United States was consequently awarded until 27 December 2003 to bring the CDSOA into conformity with its obligations under GATT 1994, the Anti-Dumping Agreement, the SCM Agreement and the WTO Agreement.[4]

1.4 On 16 January 2004, Canada requested authorization from the DSB[5], under Article 22.2 of the DSU, to suspend the application to the United States of its concessions or other obligations in an amount to be determined every year by reference to the amount of the offset payments made to affected domestic producers in the latest annual distribution under the CDSOA.

---

[1] Report of the Appellate Body on *United States – Continued Dumping and Subsidy Offset Act of 2000* (WT/DS217; WT/DS234/AB/R), (hereafter the "Appellate Body Report") and Report of the Panel on *United States – Continued Dumping and Subsidy Offset Act of 2000* (WT/DS217; WT/DS234/R) (hereafter the "Panel Report". Throughout this Decision, the original panel in this case will be referred to as the "Panel". Tc 1.70 ej 371.25"0 Tc 0.187

--Report".F

1.5 The amount would be established by adding:

(a) the amount of offset payments attributed to duties collected on products from Canada; and

(b) a proportionate amount of the balance of total offset payments less the offset payments attributed to duties collected on products of other Members that are authorized by the DSB to suspend concessions or other obligations in this dispute.

1.6 The annual amount of offset payments would be based on information published by the US Bureau of Customs and Border Protection or any successor entity.

1.7 Canada intended to implement the above through one or both of the following types of measures:

(a) the imposition of additional import duties above bound custom duties on products originating in the United States. Each year, prior to the imposition of the additional duties, Canada would notify to the DSB a final list indicating the level of the duties to be imposed on selected products in the light of the latest annual distribution of offset payments under the CDSOA;

(b) the suspension of the application of the obligations under Article VI of GATT 1994, Articles 3, 5, 7, 8, 9, 10, 11 and 12 of the Anti-Dumping Agreement, and Articles 11, 12, 15, 17, 18, 19, 20, 21 and 22 of the SCM Agreement to determine that the effect of dumping or subsidization of pro

1.11 On 13 February 2004, the Arbitrator held a joint organization meeting with the Uniutbw2ptates

1.19 Pursuant to Article 22.7 of the DSU, our mandate is to "determine whether the level of suspension [of concessions or other obligations] is equivalent to the level of nullification or impairment." To this end, the Decision first determines, in Section III, what may be considered to be the correct level of nullification or impairment caused by the CDSOA. This course of action is in conformity with previous arbitrations.[13] Also in line with previous arbitrations, the decision first addresses the approach advocated by Canada for the assessment of the level of nullification or impairment.

1.20 Then, in Section IV, the Decision addresses the level of suspension of concessions or other obligations proposed by Canada, and considers the compatibility with Article 22 of the DSU of: (a) a level of suspension of obligations expressed as a duty rather than as a total value of trade; (b) an annual adjustment to the level of suspension; and (c) the suspension of obligations by one WTO Member in relation to a measure also affecting other Members or non-Members.

1.21 Section V of the Decision contains the award of the Arbitrator. It is followed by some concluding remarks in relation to certain wider issues raised in the course of the arbitration.

## II. PRELIMINARY ISSUES

### A. REQUEST OF THE UNITED STATES FOR A PRELIMINARY RULING

#### 1. Summary of the United States' request

2.1 As mentioned in the previous section, on 19 February 2004, the United States filed a request for a preliminary ruling from the Arbitrator that:

(a) a Requesting Party cannot suspend concessions or other obligations based on the nullification or impairment suffered by other WTO Members; and consequently offset payments for products other than the Requesting Parties' products that are subject to anti-dumping or countervailing duty orders are outside the scope of the arbitration proceeding with respect to that Requesting Party;

(b) the Requesting Parties failed to specify the level of suspension and the level of nullification or impairment in such a way that allows the Arbitrator to determine equivalence; and consequently each party must provide the information necessary to enable the Arbitrator to make the determinations called for under the DSU in relation to that party; and

(c) the proposition that a Requesting Party may establish a new level of suspension each year is inconsistent with Article 22 of the DSU; and is consequently outside the scope of the arbitration proceeding for any party requesting to proceed in that manner.

#### 2. Analysis of the Arbitrator

2.2 On 23 February 2004, we informed the parties that, having regard to the issues raised in the United States' request for a preliminary ruling, they would more appropriately be addressed together with all the issues and arguments that might be raised throughout the proceedings. We added that

[13] See *EC – Bananas III (US) (Article 22.6 – EC)*, para. 4.2:

"… as a prerequisite for ensuring equivalence between the two levels at issue we have to determine the level of nullification or impairment."

parties should feel free to include comments on the United States' request in their submissions, as they saw fit.

2.3 The United States has reiterated the claims made in its request for a preliminary ruling in its subsequent submissions. As a result, we deem it necessary for the clarity of our findings to describe how we dealt with these claims.

2.4 First, we note that neither paragraph 6 nor paragraph 7 of Article 22 of the DSU provide for the possibility of a preliminary ruling and there is, strictly speaking, no practice of a preliminary ruling at the request of a party in past arbitrations.

2.5 Second, some of the issues we were asked to rule upon by the United States were intimately linked to questions central to this dispute. We concluded that the relatively expeditious process of a 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 suffered by the Requesting Parties can be determined on the basis of the total disbursements made by the United States under the provisions of the CDSOA. We address this question as part of our review of the substantive issue, in Section IV.B.2 below.

2.7 Similarly, we concluded that consideration of whether the ability to set a new level of

2.10 This said, we note that our decision not to issue a preliminary ruling on the particular issues raised by the United States does not preclude us from ruling on procedural issues in the Decision.

## B. SUFFICIENT SPECIFICITY OF CANADA'

Parties decline to provide any information on the level of suspension requested or to base their request on trade effect.[20]

2.16 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.[21]

2.17 The United States also contests Canada's intention to suspend the application of some of its obligations under Article VI of GATT 1994, the Anti-Dumping Agreement and the SCM Agreement. The United States notes that, while arbitrators may not review the "nature" of the obligations to be suspended, they nonetheless need to evaluate the impact that a suspension proposal will have. This requires a certain degree of specificity from requesting parties in the description of the measures that they plan to adopt to suspend obligations.[22]

(b) Canada

2.18 With respect to the quantification of the level of nullification or impairment and the level of suspension, Canada replies that the Requesting Parties have directly linked those levels to the level, or quantity, of disbursements made by the United States each year under the CDSOA. The requested level of suspension has been stated in quantitative terms. Not only is the level quantified each year, but the quantity is derived from figures reported by the United States itself.[23]

2.19

2.33 Having regard to the above, we nonetheless urge Canada, as occurred in two arbitrations where similar suspensions of obligations were proposed[33], to take appropriate steps to ensure, if it decides to proceed with the suspension of certain of its obligations *vis-à-vis* the United States referred to in document WT/DS234/25, that

> "11. The duty that rests on *all* parties to produce evidence and to collaborate in presenting evidence to the arbitrators – an issue to be distinguished from the question of who bears the burden of proof – is crucial in Article 22 arbitration proceedings. The EC is required to submit evidence showing that the proposal is *not* equivalent. 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."[37]

2.38 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)*[38] and *in Canada – Export Credit and Guarantees (Article 22.6 – Canada)*[39], 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.[40] 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.[41] 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".[42] 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.[43] 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.

---

[37] See, e.g., *EC – Hormones (Canada) (Article 22.6 – EC)*, paras. 9-11.
[38] Paras. 2.9-2.11.
[39] Para. 3.76.
[40] United States oral statement, paras. 7-13.
[41] United States written submission, para. 40.
[42] 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).
[43] United States written submission, para. 47.

**2. Canada**

3.7 Canada claims that the level of nullification or impairment in this case corresponds, at a minimum, to the total amount of disbursements made by the United States' authorities under the CDSOA.

3.8 According to Canada, Article 22.4 of the DSU does not itself elaborate on the concept of "nullification or impairment". However, the meaning of these terms can be understood by considering how nullification or impairment relates to a violation of obligations. Article 3.8 of the DSU provides for a presumption that a violation of rights will lead to nullification or impairment because the covered agreements confer "benefits" on Members in the form of "rights". A violation by a Member of its obligations adversely affects – nullifies or impairs – the rights of other Members. Indeed, Articles 22.3(a) and 23.1 deem a violation of obligations to be a form of nullification or impairment of benefits. It follows that the extent of a violation will determine the extent of the

expect that the United States will take no measure other than those authorized under the WTO Agreement to respond to dumping, and the corresponding obligation of the United States not to take such measures. Canada refers to the arbitration in *US – FSC (Article 22.6 – US)*, where the arbitrator rejected the United States' argument that the remedies for non-compliance under Article 4 of the SCM Agreement had to be linked or limited to "trade effect". Likewise, the obligation being breached by the United States is an *erga omnes* obligation, owed to each of the Requesting Parties. Each of the Requesting Parties might therefore have requested a level of suspension equivalent to the total amount of the disbursement.[53]

## B. ANALYSIS OF THE ARBITRATOR

### 1. Introduction

3.12 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 Canada is, if one excludes the arbitrations carried out under Article 4.10/4.11 of the SCM Agreement, novel in the context of Article 22.6 of the DSU.

3.13 Consistent with the practice of previous arbitrators[54], we proceed with the review of the approach advocated by Canada. If we find it to be compatible with the DSU, we will proceed with a determination of the level of nullification or impairment on that basis. If we do not find it compatible with the DSU, we will determine the level of nullification or impairment by applying a methodology appropriate in this case.[55]

3.14 Canada's contention that the level of nullification or impairment corresponds, at the minimum, to the total amount disbursed by the United States under the CDSOA seems, in our understanding, to be based essentially on the following premises:

(a) a violation is a form of nullification or impairment;

(b) the notion of "benefit" under Article XXIII of GATT 1994 and the DSU encompasses rights under the WTO Agreement;

(c) Canada has a right under the WTO Agreement to expect that the CDSOA should not exist. As a result, Canada, together with the other Requesting Parties in this case, has a right to suspend concessions or other obligations up to the full amount of disbursements under the CDSOA.

3.15 We will hereafter address these elements. We will also subsequently address a core issue for our determination of the level of nullification or impairment, i.e. whether we can consider disbursements under the CDSOA in our calculation.

### 2. Review of the approach proposed by Canada

#### (a) Article XXIII of GATT 1994 and the DSU

3.16 After careful consideration we are not persuaded that the position of Canada is supported by Article XXIII of GATT 1994 or the DSU, for the reasons stated below.

---

[53] Canada's written submission, para. 46.
[54] See, e.g., *Brazil – Aircraft (Article 22.6 – Brazil)*, paras. 1.5 and 3.18.
[55] *EC – Hormones (Canada) (Article 22.6 – EC)*, para. 12.

3.17 First, in order to assess Canada's arguments, it seems appropriate to revisit the source of the concept of nullification or impairment, i.e., Article

3.22 Even if we were to follow Canada's interpretation of Article 3.8, the end result would be the same as that from our interpretation: a nullification or impairment is deemed to exist, which implies that the Member found in breach of its obligations has to bring its legislation into conformity with its obligations under the WTO Agreement. However, this does not imply that the level of such nullification or impairment is equal to the "value" of the violation. 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.

3.23 Canada argues that the presumption under Article 3.8, if not rebutted, implies that nullification or impairment exists and cannot be "zero". Canada cites the *US – 1916 Act (EC)*

3.32 Again, we consider that this argument fails to recognize the distinction between the violation of a right and the consequence thereof, i.e., nullification or impairment within the meaning of Article XXIII:1 of GATT 1994. We therefore consider that, while a violation of an obligation may affect all Members, this does not *ipso facto* result in a nullification or impairment of a given Member's benefits up to the "value" of the violation.

(b) Previous arbitrations

*(i) Introduction*

3.33 We note that previous arbitrations (a) support our approach regarding the interpretation to be given to the provisions relating to nullification or impairment and (b) more specifically, have concluded that the nullification or impairment of benefits resulting from a violation should be expressed in terms of trade or, in two instances, economic effects.[58]

*(ii) Interpretation of the provisions relating to nullification or impairment by previous arbitrators*

3.34 Previous Article 22.6 arbitrators concluded, as we have, that violation and nullification or impairment are two different concepts. The arbitrator in *EC – Bananas III (US) (Article 22.6 – EC)* stated that the presumption of nullification or impairment contained in Article 3.8 of the DSU could not, in and of itself, be taken simultaneously as evidence proving a particular level of nullification or impairment allegedly suffered by a Member requesting authorization to suspend concessions or other 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

> Thus, exclusive rights such as those set forth in Articles 11*bis*(1)(iii) and 11(1)(ii) will normally translate into economic benefits for copyright holders.
>
> In their submissions to the Arbitrators, the parties have focused on this type of benefit accruing to copyright holders. The Arbitrators concur with the parties that, for purposes of these arbitration proceedings, the relevant benefits are those which are economic in nature.[60] This is consistent with previous decisions of arbitrators acting under Article 22.6 of the DSU.[61] Moreover, like the parties to this dispute, the 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)."

3.37 We further note that, with the exception of the arbitrations carried out under Article 4.11 of the SCM Agreement, previous arbitrators have relied on an approach based on the economic or trade effect of the violation.[62] While most arbitrations have relied on the narrower concept of trade effect, we note that both the *US – Section 110(5) Copyright Act (Article 25.3)* arbitrator and the *US – 1916 Act (EC) (Article 22.6 – US)* arbitrators referred to economic effects.[63] The use of direct trade effect in most case reflects the fact that trade loss is generally more directly identifiable and quantifiable and that, in such a context, arbitrators preferred to rely on verifiable figures.

3.38 In both *US – Section 110(5) Copyright Act (Article 25.3)* and *US – 1916 Act (EC) (Article 22.6 – US)*, reliance on the broader concept of economic impact was dictated by the nature of the measures at issue. In *US – Section 110(5) Copyright Act (Article 25.3)*, no actual trade took place,

---

[60] *(footnote original)* This view is based on the object of the present proceedings, which is to quantify the economic harm suffered by the European Communities as a consequence of the continued application of Section 110(5)(B). It does not necessarily follow that Members having recourse to Article 64 of the TRIPS Agreement need to establish nullification or impairment of *economic* benefits accruing to them under the TRIPS Agreement. The Arbitrators find support for their view in the following statement by the arbitrators in *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*: "[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." See the Decision of the Arbitrators on *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU* (hereafter "*EC – Bananas III (22.6) (US)*", WT/DS27/ARB, 9 April 1999, para. 6.10.

[61] *(footnote original)* See, e.g., the Decisions of the Arbitrators on *EC – Bananas III (22.6) (US), supra*, para. 6.12 (benefits nullified or impaired: losses in US exports of goods and losses by US service suppliers in services supply); *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, WT/DS27/ARB/ECU, 24 March 2000, footnote 52 (benefits nullified or impaired: losses by Ecuador of actual trade and of potential trade opportunities in bananas and the loss of actual and potential distribution service supply); *European Communities - Measures Concerning Meat and Meat Products* (*Hormones*) *- Original Complaint by the United States - Recourse to Arbitration by the European Communities under Article 22.6 of the DSU* (hereafter "*EC - Hormones (22.6) (US)*[illegible]

> 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."[66]

3.46 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 be reduced to a requirement that constrains countermeasures to trade effects, for the reasons we have set out above."

3.47 While the arbitrator in *US – FSC (Article 22.6 – US)* did not exclude the application of a trade effect test under Article 4.11, it would be difficult, in situations other than those relating to prohibited subsidies, to conclude that any disbursement pursuant to an illegal measure automatically causes nullification or impairment at least equivalent to the total amount disbursed.

3.48 Canada also relies on the arbitrator's decision in *US – 1916 Act (EC) (Article 22.6 – US)* in support of its position.[67] We do not agree with Canada that the passages it relies upon support the position that the violation resulting of the existence of an inconsistent measure itself nullified or impaired benefits accruing to the European Communities. We note that the arbitrator in *US – 1916 Act (EC) (Article 22.6 – US)* agreed with the arbitrators in *EC – Bananas III (US) (Article 22.6 – EC)* that:

---

[66] *US – FSC (Article 22.6 –US)*, paras. 5.45-5.47.
[67] *US – 1916 Act (EC) (Article 22.6 – US)*, paras. 6.14 and 7.8.

> "[T]he *presumption* of nullification or impairment, as provided in Article 3.8 of the DSU, by no means provides evidence of the *level* of nullification or impairment sustained by the Member requesting authorization to suspend obligations."[68]

3.49 We further note that, in that case, the arbitrator relied on the economic impact of the measure. The arbitrator refused to consider the "chilling effect" of the law as such, and it was determined that the costs attached to any settlement or judgement under the 1916 Act – i.e., instances of application – could be considered to correspond to the economic effect of the 1916 Act on EC companies.

3.50 Overall therefore, we conclude that the reasoning of previous arbitrators under Article 22.6 of the DSU does not seem to support the approach proposed by Canada.

(c) Conclusion

3.51 We conclude from the above that Article XXIII of GATT 1994 and the DSU clearly differentiate between two stages in WTO dispute settlement:

(a) one is the establishment of the *existence* of nullification or impairment by panels and the Appellate Body. This is where Article 3.8 of the DSU plays its role by providing that the existence of a violation creates a presumption of nullification or impairment of a benefit; and

(b) a separate and subsequent process where a Member requests the [illegible]

Arbitrator to make an award for alleged nullification or impairment supposedly caused by measures not even in existence.[70]

3.56 Canada argues that where a measure as such has been found to violate the WTO Agreement, every application of the WTO-inconsistent measure by that Member further nullifies or impairs benefits to other WTO Members. If the successful challenge of the application of a measure does not impugn the whole measure (because there may be other ways to apply that measure consistent with that Member's obligations), where a measure as such violates the WTO Agreement, each and every application of that measure is by definition also a violation. If one were to follow the United States' logic, Canada argues, a complaining party seeking appropriate retaliation rights would have to challenge a law each and every time it is applied, which could only be done after the damage has been done. Any application of the measure not addressed in the challenge would be unaffected by the DSB recommendations and rulings. This would make the prompt settlement of disputes impossible.[71]

(b) Analysis of the Arbitrator

3.57 First, we recall that the requesting parties have not identified nullification or impairment beyond that resulting from the instances of application of the CDSOA.

3.58 Second, we note that the United States raised two separate questions regarding this issue: one is whether disbursements already made under the CDSOA can be considered by the Arbitrator, the other one is whether future disbursements may be considered.

3.59 At this stage, the question before us is whether we may take into account the economic or trade effects resulting from the instances of application of the CDSOA, given the United States claim that the CDSOA was challenged as such, and, had not been applied when it was first challenged.

3.60 We agree with the United States that the DSB never issued recommendations or rulings with respect to the application of the CDSOA. We also note the arguments of the requesting parties that once a measure has been found illegal, any instance of application of this measure is *ipso facto* illegal.

3.61 We take the view that the CDSOA *mandates* disbursements whenever certain conditions are met; that these disbursements have been found by the Panel and the Appellate Body to be a core element in their conclusion that the CDSOA violates the WTO Agreement[72], and that there is no reason, *for the purpose of assessing nullification or impairment*, to exclude instances of the application of the CDSOA from our consideration.

3.62 This approach is in line with the practice of other arbitrators. For instance, the arbitrator in *US – 1916 Act (EC) (Article 22.6 – US)* considered that instances of application could be taken into account in assessing nullification or impairment by a law as such.[73]

3.63 We also recall that, in reply to one of our questions[74], the United States referred to two cases, *US – Section 110(5) Copyright Act (Article 25.3)* and *EC – Hormones (US) (Article 22.6 – EC).* In

[70] United States oral statement, paras. 39-40.
[71] Canada's written submission, paras. 42-46.
[72] See Panel Report, paras. 7.35-7.39 and 8.1; Appellate Body Report, para. 256.
[73] *US – 1916 Act (EC) (Article 22.6 – US)*, para. 7.8.
[74] Reply of the United States of 28 April 2004 (paras. 11 and 12) to question 12 of the Arbitrator of 21 April 2004, which reads as follows:

"Considering its reasoning in paragraphs 15 to 19 of its written submission and more generally its position on nullification or impairment, could the United States give an example of a situation where a law *as such* would cause more than "zero" nullification or impairment?"

those two cases, a law had been challenged as such. Nevertheless, the arbitrators determined the level of nullification or impairment on the basis of an analysis of lost royalties in the first case and lost trade in the second case.

3.64 We fail to see any meaningful difference between the *US – Section 110(5) Copyright Act (Article 25.3)*, the *EC – Hormones (US) (Article 22.6 – EC)* arbitrations and this arbitration. In these two cases, the arbitrators relied, for all practical purposes, on the economic result of the *application* of the law. In this case, Canada requests us to rely on disbursements made under the CDSOA to assess the level of nullification or impairment it suffered. The only difference which may exist is that, under the CDSOA, the United States' authorities are expected to implement the law through the application of a number of administrative steps. The United States seems to claim that, as a result, these are "measures" separate from the CDSOA on which no finding was ever made. The difference, in our view, is a matter of degree, not of nature.

3.65 As a result, we conclude that we are entitled, for the purpose of assessing the trade effect and, thus, the level of nullification caused by the CDSOA to Canada, to take into account instances of application of the CDSOA.

3.66 The second question raised by the United States is addressed in Section

expressly referred to in any part of the DSU and we are not persuaded that the object and purpose of the DSU – or of the WTO Agreement – would support an approach where the purpose of suspension of concessions or other obligations pursuant to Article 22 would be exclusively to induce compliance. Having regard to Articles 3.7 and 22.1 and 22.2 of the DSU as part of the context of Articles 22.4 and 22.7, we cannot exclude that inducing compliance is part of the objectives behind suspension of concessions or other obligations, but at most it can be only one of a number of purposes in authorizing the suspension of concessions or other obligations. By r

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.[83] The United States added that even if the firms concerned did use the funds to

- "An estimate of changes in foreign trade partner exports to the United States, specifically

- offset payments reflect a small fraction of production, hence they cannot have a discernable impact on trade.

3.91 However, in response to the Arbitrator's query on the validity of a zero pass-through value,

Table 1: Estimated Level of N

3.95 The formal specification of the model proposed by the Requesting Parties, as submitted to the Arbitrator, is:[98]

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

where,
M = volume of imports
$\Delta$ M = change in the volume of imports
$P_m$ = the price of imports

commodities and commoditised manufactured goods that compete under conditions much closer to perfect competition".[100] They further argue that:

> "elasticities of substitution specific to the products benefiting from the CDSOA payments would be higher than the aggregated average GTAP or NAIC data because CDSOA disbursements typically relate to commodities and commoditised manufactured products, for which preference of buyers is largely determined by price. Moreover, it is generally acknowledged in the economic literature that the more disaggregate the sample the higher the estimated substitution elasticity. Therefore the Requesting Parties consider that an elasticity drawn from the upper end of the GTAP range (5.2) is justified as typical degree of price sensitivity".[101]

3.99 In addition to the homogeneity of products as implied by the assumption of commoditized manufactured products, the Requesting Parties submit that elasticity values should be taken from long-run estimates and not short-run estimates. They note that these estimates are "on average, twice as large as short-run elasticities".[102]

3.100 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.

3.101 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.

3.102 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 CDSOA would be put towards reducing the price of domestic products (i.e. pass-through effect). The United States also notes that an aggregate measure of import penetration is used as opposed to a measure specific to those industries where there is an incidence of CDSOA payments. In addition to these criticisms, the United States notes that

taken into account, such as the industry distribution of the payments and the fact that one variable in their computation, the import penetration ratio, can vary significantly across industries.

3.105 We also note that the Requesting Parties have not explained the basis on which they chose the highest value for the elasticity of substitution.

3.106 The model proposed by the United States, while qualitatively similar to that of the Requesting Parties, is slightly more sophisticated. The effect of a CDSOA disbursement depends upon a number of parameters beyond the elasticity of substitution between domestic and imported products. In particular, the response of domestic and foreign firms to any change in the domestic price plays a role in determining the overall trade effect.

3.107 The level of sophistication and the heavy data requirements of this model prevented the United States from applying it at the desired level of detail. We note that of the 66 country-product-year data points, the United States applied its model to 21 such points.[103] This indicates, roughly, that 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.

3.108 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.

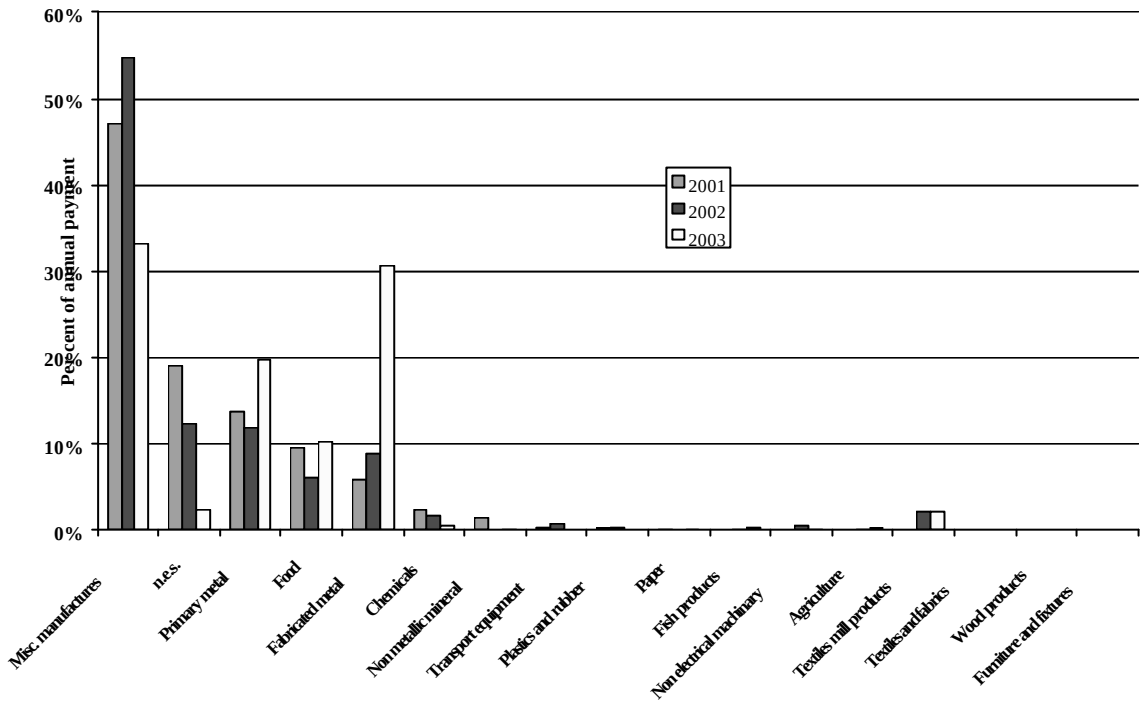
3.109 Table 2 illustrates that, with product-specific data, the aggregate trade effect coefficient could exceed 1. At the same time, it also highlights the different effects that one could obtain at different levels of disaggregation.

[103] An estimate for a given product, in a given year for a given exporter is considered to be one observation. There are considerably more periods of observations, however, the United States chose not to submit the data for those observations that did not meet its assumption of *de minimis* effect.

United States' model in its entirety. Our decision is to reject the United States' model in favour of a

companies in the electronics, machinery and primary and fabricated metals industries. In addition, the United States identifies a further 21 per cent of 2002 disbursements as going to the primary and fabricated metal industries. The comparable figures for 2001 are 66 per cent for "miscellaneous manufacturing and not elsewhere specified" (with a similar distribution to that in 2002) and 20 per cent classified as primary and fabricated metal. Chart 1 also highlights the fact that the inter-industry distribution of payments can also vary over time.

Chart 1: Distribution of CDSOA Disbursements by 3-Digit North American Industry Classification, 2001-2003




3.119 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 product categories out of 71 that met their criteria for a *de minimis* trade effect. Of these

requirements. Instead of using the detailed product level data, we adopt the 3-digit North American Industry Classification for our model. Therefore, each of the parameters of the model requires data at that level and both parties were able to submit all the data necessary to run the model. The trade effect expression is, therefore, applied at each industry level for each year to estimate the trade effect of each industry. The sum of these trade effects is then divided by the total annual disbursements for the year to arrive at a trade effect coefficient for that year. This coefficient, by definition, is a weighted average of the CDSOA payments.

3.122 We have also taken into account the reservations of the United States in adopting this approach. The United States underlines four reservations towards this approach: (i) the total payments should not be used; (ii) the total price reduction should not be equivalent to the size of the payments; (iii) industry-specific data should be used; and (iv) greater care should be taken in choosing appropriate elasticity values instead of arbitrarily choosing the highest value. The manner in which these are taken into account is explained later in this section. At this point, we wish simply to recall that the United States' reservations are with how the model is implemented, not with the specification of the model *per se*.

3.123 Our approach is not immune from data difficulties. We are in agreement with the views of the arbitrators in *US – FSC (Article 22.6 – US)* regarding the reliability of economic modelling when they stated that they were "mindful that the task of evaluating the trade effects of the scheme cannot be accomplishe

the payments, the pass-through effect and the elasticity of substitution. It does not discuss import penetration, since there is only one source for this data, the United States' Government. We therefore used the figures provided by the United States regarding import penetration.

3.126 Another issue tha

orders. We consider that we should, as a matter of transparency, rely on figures published by the United States' authorities when it comes to assess the value of CDSOA disbursements. As a result, we will disregard administrative errors that have not been corrected at the time of the publication of the relevant figures.[111] Likewise, we see no reason to adjust the figures published by the United States' authorities because reimbursements have been requested but the requests have not yet been finally settled.[112]

3.132 With respect to the United States' argument that disbursements relating to revoked orders should be deducted, we note that, under the CDSOA, payments made in, say, 2004, actually correspond to revenue collected in 2003. If an order was revoked on imports from a given Requesting Party in 2004, this has no influence on the fact that offset payments in 2003 corresponded to duties collected at the time when the order was in place. Under these circumstances, we see no reason to exclude payments made in a given year, even though in that year no duty may have been collected due to the revocation of an existing order, if the payments are based on duties collected while the order was in place. We believe this interpretation to be consistent with the Panel and Appellate Body findings in this case.

3.133 As a result, we decide to use the amount of disbursements published by the United States, without any adjustment.

3.134 The United States has also raised the issue of *de minimis* deductions. We do not have any legal guidance as to why such deductions should be made in these proceedings. In making the deductions, the United States referred to two provisions of the Anti-Dumping Agreement and the SCM Agreement that we do not consider relevant in an arbitration pursuant to Article 22.6 of the DSU. Furthermore, we do not see any rationale for making the deductions on economic grounds. The purpose of an economic model is to estimate the trade effect rounds.6Fasour. UAntyresult,dedrvendfrom a Tj -26485 -

(d) Pass-through

3.137 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* –

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 bett

Table 3: Summary of Trade Effect C

B. THE LEVEL OF SUSPENSION OF CONCESSIONS OR OTHER OBLIGATIONS DETERMINED BY THE ARBITRATOR TO BE EQUIVALENT TO THE LEVEL OF NULLIFICATION OR IMPAIRMENT

**1. Suspension of concessions or other obligations expressed as a duty on an undetermined quantity of trade rather than as a suspension of concessions on a determined value of trade**

(a) Arguments of the parties

*(i) United States*

4.5 The United States contests the Requesting Parties' intention to impose additional import duties on US products which rate will be set so as to collect, over one year, additional duties equivalent to certain offset payments under the CDSOA. The United States contends that the Requesting Parties set no limits on the amount of trade that would be covered by their request. Depending on the amount of duty, the impact on United States exports could exceed by many multiples any impact that the CDSOA may have on exports from the Requesting Parties. The Requesting Parties' suspension proposal stands in stark contr94he 136 .Nf T2d076bitartoral duti2 Tc

*(ii) Canada*

4.13 According to Canada, the approach pursuant to which all the disbursements under the CDSOA are WTO-inconsistent, constitute in their totality t

with respect to the trade effect caused by disbursements under the CDSOA relating to its own exports.[127]

### 3. Determination of a variable level of suspension of concessions or other obligations

(a) Main arguments of the parties

*(i) United States*

4.17 The United States considers that the Arbitrator should establish a single level of suspension for each Requesting Party, and that the DSU does not permit a requesting party to alter the level of suspension in the future. It is of the view that, in this case, it would be impossible to create a formula that would equate allowable levels of suspension in the futur

United States' rights are protected. It needs only reduce or eliminate its illegal disbursements to correspondingly reduce or eliminate the level of retaliation against it.[130]

(b) Analysis of the Arbitrator

4.20 We first address the textual arguments. While we note that Article 22.4 refers to "the level" (singular) of nullification or impairment and to "the level" (singular) of suspension of concessions or other obligations, we are not persuaded that these terms impose an obligation to identify a single and enduring level of nullification or impairment. The requirement of Article 22.4 is simply that the two levels be equivalent. As long as the two levels are equivalent, we do not see any reason why these levels may not be adjusted from time to time, provided such adjustments are justified and unpredictability is not increased as a result. In fact, we see no limitation in the DSU to the possibility of providing for a variable level of suspension if the level of nullification or impairment also varies.

4.21 Most previous arbitrators have established one single level of nullification or impairment at the level that existed at the end of the reasonable period of time granted to the responding party to bring its legislation into conformity.[131] We do not disagree that this approach is, in the large majority of cases, the most appropriate. However, we do not read anything in Article 22 of the DSU that would preclude us from following a different path if the circumstances of this case clearly required it.

4.22 The economic analysis carried out above suggests that the value and industry distribution of the trade impact of the CDSOA could vary widely from one year to the next, because of the numerous factors affecting the amounts that may be disbursed, the nature of the recipients and how each category of recipient is likely to use the monetary amounts awarded to them under the CDSOA. This variability is, in our opinion, very different in nature and degree from the more steady evolution of exports recorded in other cases where counterfactuals[132] were applied, such as *EC – Bananas III (US) (Article 22.6 – EC)* or *EC – Hormones (US) (Article 22.6 – EC)*. In those cases, the trade loss identified on the basis of a counterfactual was artificially fixed once for all. In the present case, there is an economic justification for allowing a variable level of nullification or impairment and, correlatively, a variable level of suspension of concessions or other obligations.

4.23 We are mindful of the United States' arguments that the ability to vary the level of suspensions could make the level of countermeasures applied unpredictable from one year to the next, and that no formula could be developed to introduce sufficient predictability. We do not find these arguments compelling. Indeed, the level of nullification or impairment in terms of the trade effect that we have calculated above is based on the CDSOA, a law designed and adopted by the United States' authorities, which disbursements are also determined by the United States' authorities. It should be straightforward for the United States' authorities to apply the formula developed in this Decision to find the amount of United States trade that may be subject to the suspension of concessions or other obligations in each following year. Any unpredictability ought correspondingly to be minimal.

4.24 Moreover, in this case, the United States would control the levers to make the actual level of suspension of concessions or other obligations go down. Indeed, in other arbitrations where the level of nullification or impairment was set once and for all, the responding party could not influence the level of countermeasures applied to its trade, unless the requesting party agreed to modify it. In this case, the level of suspension of concessions will automatically depend on the amount of

[130] Canada's written submission, paras. 56-59.

[131] See, e.g., *EC – Hormones (Canada) (Article 22.6 – EC)*, para. 37; *Brazil – Aircraft (Article 22.6 – Brazil)*, paras. 3.63-3.65; *US – FSC (Article 22.6 – US)*, paras. 2.12-2.15; *Canada – Aircraft Credits and Guarantees (Article 22.6 – Canada)*, paras. 3.67-3.73.

[132] For a definition of "counterfactual", see footnote 42 above.

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 impact 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

## 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

- R is the ratio of the value of imports to the value of domestic shipments in the markets in question and can be expressed as $R = \left( \frac{P_m M}{P_q Q} \right)$

9. Turning first to the specification of the model and concerns about its robustness. In the first instance, we share the view of the United States that one cannot be 100 per cent certain that the entire disbursement given to a firm will be expended to reduce imports. While the economic rationale behind a 100 per cent pass-through is strong, the model specification needs to be adjusted to account for cases where the pass-through effect will be less than 100 per cent. Accordingly, we can include a fourth multiplicative term to equation A1 to account for less than 100 per cent pass through and re-specify equation A1 as equation A2 (equation (6) in the main text):

$$\text{Reduction in imports} = a * h * S * R \qquad \text{(A2)}$$

Where, $\alpha$ is the pass-through factor and takes on a values: $0 < \alpha < 1$.

10. A value of zero for $\alpha$ implies no expenditure is used to reduce price, therefore the estimated trade effect would be zero. This is the case presented by the United States. The opposite case, presented by the Requesting Parties is that $\alpha$ takes on a value of 1, which represents a 100 per cent pass-through.

11. The principal focus of our approach to analysing trade effect is the determination of a trade effect coefficient, which is defined as a number that can be multiplied by the applicable level of disbursements to estimate the total trade effect. By focussing on the coefficient as the basis of our award, it is easier to simplify and bridge the differences in the models that have been proposed by the Requesting Parties. In expression A2 above, the coefficient can be defined as the product of $\alpha$, $\eta$ and R. Accordingly, equation A2 can be reduced to A3:

Reduction in imports =

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.[146] 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."[147]

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.[148] 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".[149]

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.[150] 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.

---

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

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

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

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

[150] 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".[151] 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.[152] This total trade effect is subsequently divided by the level of disbursements to obtain the trade effect coefficient ($\beta$ 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.[153]

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 3.142 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

---

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

[152] 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.

[153] 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 considerably (Annex Table 1). The standard GTAP range has a lower mean (2.7) than the USITC estimates (3.1), smaller range (4 compared to 3.4), but both have the same median (2.8). The USITC has higher values in 22 of the categories and the same value in eight of the categories.

27. In an attempt to develop a workable framework for modelling, the parties were requested to submit elasticities of substitution at the 3-digit NAIC level.[154] The Requesting Parties, while expressies,h -0.1 (o3)T -12.75 TD -0.1013 Tc 0has a lower mean (2.7) than the USITC esti--0.06le 1). The standard GTAP range has a lower mean 7 Tc 1.42.8241 4n attemp415 Tw (digit NAIC t (Urd GTA

perfect in o270 6.75 TD -0228s a le"parti4 Parties, w0974ean 73 284

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 r2igu TD -0.1F2Tj tas art v.1r.

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 |

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.

Annex Table 4: Counterfactual Trade Effect of CDSOA Disbursements

Assuming 100 per cent Pass-

Annex Table 5: Counterfactual Trade Effect of CDSOA Disbursements

Annex Table 6: Summary of Results for Various Values for Substitution Elasticity and Pass-through, 2001-2003

| **2001** | | | |
|---|---|---|---|
| | Low | Medium | High |
| 25 per cent | 0.22 | 0.27 | 0.33 |
| 50 per cent | 0.43 | 0.54 | 0.65 |
| 75 per cent | 0.65 | 0.81 | 0.98 |
| 100 per cent | 0.87 | 1.09 | 1.30 |
| | | | |
| **2002** | | | |
| | Low | Medium | High |
| 25 per cent | 0.25 | 0.31 | 0.37 |
| 50 per cent | 0.50 | 0.62 | 0.74 |
| 75 per cent | 0.74 | 0.93 | 1.12 |
| 100 per cent | 0.99 | 1.24 | 1.49 |
| | | | |
| **2003** | | | |