UNITED STATES - TAX TREATMENT FOR "FOREIGN SALES CORPORATIONS" - RECOURSE BY THE UNITED STATES TO ARTICLE 22.6 OF THE DSU AND ARTICLE 4.11 OF THE SCM AGREEMENT

WT/DS108

COMMENTS OF THE UNITED STATES

ON THE EC'S ANSWERS TO QUESTIONS FROM

THE ARBITRATOR AND THE UNITED STATES

March 25, 2002

1. The United States appreciates this opportunity to comment on the answers of the EC to the questions from the Arbitrator and the United States. Because most of the EC's answers simply repeat arguments that the United States already has rebutted, the United States does not address all of the EC answers or all of the arguments contained in those answers. Accordingly, the absence of a U.S. comment on a particular EC answer or argument should not be construed as signifying that the United States agrees with that answer or comment.

Questions from the Arbitrator

1. Could you please clarify whether, in your view, there is a "difference" between Article 4.10 of the SCM Agreement and Article 22.4 of the DSU within the meaning of Article 1.2 of the DSU (i.e. should Article 4.10 "prevail" over Article 22.4)?

2. In its answer to this question, the EC errs when it states that, with respect to Article 4.10 and Article 22.4, "the standards and mandates conflict".[1] This erroneous assertion simply begs the question before the Arbitrator, which is whether Article 4.10 should be interpreted so as to generate a conflict with Article 22.4.

3. As the United States previously has explained, there is a presumption against conflicts in the interpretation of public international law, and the Appellate Body has cautioned against interpretations of special or additional rules and procedures that generate conflicts with provisions of the DSU. The U.S. interpretation of Article 4.10 as requiring a consideration of the trade impact of a subsidy on the complaining Member avoids generating a conflict between the two provisions. At the same time, the U.S. interpretation respects the difference between the standards of "not disproportionate" – as used in Article 4.10 – and "equivalent" – as used in Article 22.4.[2]

2. Could you please clarify whether, in your view, the mandate of the Arbitrator in this case should be defined pursuant to Article 22.7 of the DSU, Article 4.11 of the SCM Agreement, or both? In answering this question, please indicate whether you consider that there is a "difference" between these two provisions, within the meaning of Article 1.2 of the DSU, such that Article 4.11 of the SCM Agreement should prevail over Article 22.7 of the DSU.

4. While the EC and the United States appear to agree that the Arbitrator's mandate is defined by both Article 4.11 and Article 22.7, they disagree on the manner in which those two provisions are different. *See* comments on Question 1, above.

5. In addition, the United States does not agree with the EC assertion that Article 22.7 is relevant only if "the Arbitrators should decide that the appropriate amount of countermeasures under Article 4.11 of the *SCM Agreement* is less than US$ 4,043 million ... ." As the United

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[1] *Answers of the European Communities to the Questions of the Arbitrator* ("*EC Answers*"), 20 March 2002, para. 8.

[2] *See US Oral Statement*, paras. 28-30; and *Additional Submission of the United States* ("*US Additional Submission*"), 20 March 2002, paras. 16-19.

States has indicated previously, "it is necessary for the Arbitrator to correlate the portion of its award corresponding to each source of authority". Because the EC has not shown the basis for any amount under Article 22.2, then the amount attributable to Article 22.2 should be assigned a value of zero. The EC cannot simply ask the Arbitrator to "fill in" an amount attributable to Article 22.2 in order to make up for any reduction by the Arbitrator to the amount that the EC has requested under Article 4.10.

4. *Since the issuance of the Brazil-Aircraft arbitral Award, the General Assembly of United Nations has adopted a resolution taking note of the International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts with commentaries. The arbitrator in that case cited the relevant part of the 1997 version of the Draft Articles (para. 3.44). Please comment on whether and how these Articles (in particular, Articles 49, 51 and 47) are relevant to our interpretation of "appropriate countermeasures" under Article 4.10 and footnotes 9 and 10 of the SCM Agreement.*

6. The EC's position with respect to the seven Draft Articles on countermeasures can be summarized as follows. Six of the seven Draft Articles are irrelevant because the substantive standards of Article 4.10 constitute a *lex specialis*. However, the substantive standard of the seventh provision should be incorporated into Article 4.10 even though there is absolutely no evidence that the drafters of Article 4.10 or its precursors ever intended to do so. This argument is implausible on its face, and other aspects of the EC's argument are equally erroneous.

7. As an initial matter, the United States notes that the EC errs when it states that the U.N. General Assembly "approved" the Draft Articles.[3] As stated in Question 4 itself, the General Assembly merely "took note" of the Draft Articles. The General Assembly recently issued a decision in which it "reiterate[d] that the terms 'takes note of' and 'notes' are neutral terms that constitute neither approval nor disapproval."[4] Thus, the General Assembly has not adopted, endorsed or approved in any sense the Draft Articles. Indeed, it continues to refer to them as a "draft".[5]

8. The EC acknowledges the relevance of Article 55 of the Draft Articles, but then asserts that notwithstanding Article 55, Article 49 of the Draft Articles does apply and provides the definition of the term "countermeasures" as used in Article 4.10.[6] The EC even goes so far as to now assert that the SCM Agreement has two different regimes for "countermeasures" – one for

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[3] *EC Answers*, para. 18, note 6.

[4] General Assembly Decision 55/488, 15 September 2001 (copy attached as Exhibit US-19).

[5] In any event, even adoption of the Draft Articles by the General Assembly would not have the effect of establishing the customary international law character of any particular provision of the Draft Articles, nor would it have the effect of converting the Draft Articles into a customary rule of interpretation of public international law within the meaning of Article 3.2 of the DSU. *See US Answers*, para. 13.

[6] *See, e.g., EC Answers*, para. 19.

prohibited subsidies and one for actionable subsidies – each presumably with its own definition of that term.[7]

9. There is absolutely no basis for the EC's selective invocation of the Draft Articles. First, as noted, the ILC commentary cites the DSU as an example of a situation where it is "clear from the language of the treaty . . . that only the consequences specified [in the treaty] are to flow."[8] Thus, none of the provisions of the Draft Articles apply, period. Instead, the dispute settlement provisions of the WTO must be interpreted in accordance with customary rules of interpretation of public international law.

10. Second, the EC has yet to offer a valid justification for incorporating Article 49 of the Draft Articles into the SCM Agreement, as opposed to interpreting the text of Article 4.10 in accordance with customary rules of interpretation. The EC's only explanation for its novel approach to treaty interpretation is that the arbitrator in *Brazil Aircraft* did the same thing.[9] However, the arbitrator in *Brazil Aircraft* never justified its decision to bypass customary rules of interpretation, but instead simply asserted that the Draft Articles supplied the definition of a term used in a WTO agreement.[10]

11. Moreover, of the three articles in the SCM Agreement that use the term "countermeasures", Article 49 of the Draft Articles potentially could apply to only one of them: Article 4. Is the EC asserting that the drafters of the SCM Agreement intended that a single term – "countermeasures" – be defined on the basis of Article 49 in one place (*i.e.*, Article 4) and defined according to the customary rules of interpretation in other places (*i.e.*, Articles 7 and 9)? This, indeed, seems to be the EC's position when it says that the SCM Agreement contains "one regime for countermeasures available against prohibited subsidies and one for countermeasures available against actionable subsidies."[11] However, there is not a scintilla of evidence that the drafters of the SCM Agreement intended that the term "countermeasures" be defined one way in Article 4 and another way in Articles 7 and 9. To the contrary, the normal presumption would be that the drafters intended the term to have the same meaning wherever used.

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[7] *Id.*, para. 23.

[8] *Report of the International Law Commission*, U.N. General Assembly, 56th Sess., Supplement No. 10 (A/56/10) (2001), page 357; *see also US Answers*, paras. 15-16.

[9] *EC Answers*, paras. 20-22, discussing *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* ("*Brazil Aircraft*"), WT/DS46/ARB, Decision of the Arbitrators circulated 28 August 2000.

[10] *See US Additional Submission*, para. 9. In fact, Article 49 does not even purport to "define" the term "countermeasures", but instead addresses the "object and limits of countermeasures". Indeed, there does not appear to be a definition of "countermeasures" in the Draft Articles. This means that even if, *arguendo*, one were to treat the Draft Articles as a convention or a treaty, one would have to rely on customary rules of interpretation to interpret the term as used in the Draft Articles.

[11] *EC Answers*, para. 23.

12. Not only has the EC failed to introduce any evidence that the drafters intended a special meaning with respect to the term "countermeasures", but the use of the term by WTO dispute settlement bodies is inconsistent with the type of narrow definition proposed by the EC. As the United States has observed, the ordinary meaning of "countermeasures" is: "An action taken to counteract a danger, threat, etc.", and "counteract" is defined as "hinder or defeat by contrary action; neutralize the action or effect of."[12] Another definition of "countermeasures" is: "A measure or action taken in opposition to another."[13] The EC has never explained why these definitions are inadequate for purposes of interpreting the term "countermeasures." The best it can do is to cite the Appellate Body's statement that dictionary definitions do not always resolve interpretive questions and the U.S. observation that the dictionary definition of "appropriate" did not resolve the interpretive question as to what the standard in Article 4.10 of the SCM Agreement is.[14] However, the Appellate Body did not say that dictionary definitions *never* resolve interpretive questions,[15] and the fact that the dictionary definition of "appropriate" may be of little help says nothing about the dictionary definition of the term "countermeasures." The EC never explains, for example, why "[a] measure or action taken in opposition to another" does not provide a satisfactory definition of the term "countermeasures" as used in Article 4.10.

13. Likewise, the EC has never responded to the U.S. observation that WTO dispute settlement bodies have used the term "countermeasures" interchangeably with other terms relating to WTO-authorized remedies.[16] This is significant because even if, *arguendo*, one accepted Article 49 of the Draft Articles as relevant, Article 49, by its terms, is limited to

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[12] *See US Oral Statement*, para. 15, quoting from *The New Shorter Oxford English Dictionary* (1993).

[13] *See US Oral Statement*, para. 15, quoting from *The American Heritage Dictionary of the English Language* (New College Ed. 1975).

[14] *See Answers of the European Communities to the Questions of the United States* ("*EC Answers (US)*"), 20 March 2002, paras. 6-8.

[15] If it did, then the bulk of the Appellate Body's jurisprudence would become inexplicable, given that body's heavy reliance on literal interpretations of treaty text.

[16] *See US Oral Statement*, para. 19, and cases cited therein. The United States would add to the list of cases previously cited the decision of the arbitrator in *United States - Section 110(5) of the US Copyright Act - Recourse to Arbitration Under Article 25 of the DSU*, WT/DS160/ARB/25/1, Award of the Arbitrators circulated 12 October 2001, para. 4.4, in which the arbitrator stated as follows:

> The Arbitrators were mindful of the fact that, in arbitration proceedings under Article 22.6, a party contests the level of countermeasures which the other intends to take under paragraphs 2, 3 and 4 of Article 22. It is therefore understandable that the burden be on the party that contests the level of countermeasures to make a *prima facie* demonstration that the methodology and the calculations submitted by the party intending to apply countermeasures are inconsistent with the requirements of Article 22 of the DSU.

(Underscoring added).

"countermeasures against a State which is responsible for an international wrongful act ... ."[17] Neither a safeguard measure, an antidumping duty, or a temporary textile safeguard measure – each of which has been characterized by the Appellate Body as a "countermeasure" – is a measure taken against a State which is responsible for an international wrongful act.[18]

14. This analysis remains valid even if one considers only the provisions of the SCM Agreement. As originally drafted, the SCM had three operative articles that included the term "countermeasures": Articles 4, 7 and 9. Of these three, only Article 4 could be considered as applying to an international wrongful act of a State. Article 9 – which applied to non-actionable subsidies – clearly did not deal with an internationally wrongful act of a State. "Non-actionable subsidies" were just that – non-actionable. Notwithstanding their non-actionable status, however, a Member could invoke a process which might ultimately lead to the imposition of "countermeasures" if the Member could demonstrate serious adverse effects. Likewise, Article 7 – which applies to actionable subsidies – does not deal with an internationally wrongful act of a State, given that Article 5 of the SCM Agreement provides that "No Member *should* cause . . . adverse effects" rather than "No Member *shall* cause . . . adverse effects." (Emphasis added). Yet Article 7, too, provides a process which ultimately can lead to the imposition of "countermeasures".

15. It is, of course, true that under customary rules of interpretation, a "special meaning shall be given to a term if it is established that the parties so intended."[19] However, the EC has failed to establish that "the parties so intended" in the case of Article 4, notwithstanding that the burden is on the EC to establish such an intent.[20]

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[17] Draft Articles, Article 49(1). The EC acknowledges this point in *EC Answers*, para. 47.

[18] *See United States - Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea*, WT/DS202/AB/R, Report of the Appellate Body adopted 8 March 2002, para. 257; and *United States - Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan*, WT/DS192/AB/R, Report of the Appellate Body adopted 5 November 2001, para. 120.

[19] *See Vienna Convention on the Law of Treaties* ("*Vienna Convention*"), Article 31(4).

[20] *See Report of the International Law Commission on the work of its eighteenth session*, Yearbook of the International Law Commission, 1966, Vol. II, in which the ILC provided the following commentary regarding Article 27(4) of the draft convention, the predecessor to Article 31(4) of the *Vienna Convention*:

> Other members . . . considered that there was a certain utility in laying down a specific rule on the point, if only to *emphasize that the burden of proof lies on the party invoking the special meaning of the term*. They pointed out that the exception had been referred to more than once by the Court. In the *Legal Status of Eastern Greenland* case, for example, the Permanent Court had said:
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> > The geographical meaning of the world "Greenland", i.e. the name which is habitually used in the maps to denominate the whole island, must be regarded as the ordinary meaning of the word. *If it is alleged by one of the Parties that some unusual or exceptional meaning is to be attributed to it, it lies*

(continued...)

16. The EC attempts to infer an intended special meaning on the part of the drafters by referring to the Swiss proposal during the Uruguay Round negotiations.[21] The problem is that nothing in the Swiss proposal talks about a special meaning for the term "countermeasures." This is understandable, because the term was not new to the GATT legal system.

17. There is no mystery as to where the term "countermeasures" came from. It came directly from the Tokyo Round Subsidies Code. So-called "Track II" of the Code dealt with multilateral remedies against subsidies. Article 13 – which was part of Track II – was entitled "Conciliation, dispute settlement and authorized countermeasures", paragraph 4 of which provided as follows:

> If, as a result of its review, the Committee concludes that an *export subsidy* is being granted in a manner inconsistent with the provisions of this Agreement or that a subsidy is being granted or maintained in such a manner as to cause injury, nullification or impairment, or serious prejudice, it shall make such recommendations to the parties as may be appropriate to resolve the issue and, in the event the recommendations are not followed, it may authorize *such countermeasures as may be appropriate, taking into account the degree and nature of the adverse effects found to exist*, in accordance with the relevant provisions of Part VI.

(Emphasis added; footnote omitted).

18. In addition to Article 13, Article 18, which was entitled "Dispute Settlement", contained a paragraph 9, which provided as follows:

> The Committee shall consider the panel report as soon as possible and, taking into account the findings contained therein, may make recommendations to the parties with a view to resolving the dispute. If the Committee's recommendations are not followed within a reasonable period, the Committee may authorize *appropriate countermeasures (including withdrawal of GATT concessions or obligations) taking into account the nature and degree of the adverse effects found to exist*. Committee recommendations should be presented to the parties within thirty days of the receipt of the panel report.

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[20] (...continued)
on that Party to establish its contention.

(Emphasis added; footnote omitted).

[21] *See EC Answers*, paras. 39-42.

(Emphasis added).

19. Thus, in drafting the SCM Agreement, the Uruguay Round negotiators were not breaking new ground when they used the term "appropriate countermeasures". Instead, as in the case of many other provisions of the SCM Agreement, they started with the existing provisions of the Code and modified them where they considered it appropriate.

20. There are several relevant aspects regarding the use of the term "countermeasures" in the Code. First, as demonstrated by Articles 13:4 and 18:9, a single term applied to all types of subsidies, including subsidies that, under the current SCM Agreement, would be considered actionable subsidies. Thus, when introduced, the term "countermeasures" was not limited to subsidies that could be regarded as an internationally wrongful act of a State. This continued in the SCM Agreement, as the term "countermeasures" applied to each of the three categories of prohibited, actionable and non-actionable subsidies. However, while the remedy standard applicable to each category of subsidies differs, there is no indication that the drafters of the SCM Agreement intended – anymore than did the Code drafters – that the term "countermeasures" have a different meaning in different provisions.

21. Also noteworthy is the fact that the Code contained a single standard – nature and degree of the adverse effects – for all types of subsidies. This standard is inconsistent with the amorphous standard that the EC attempts to fabricate from Article 49 of the Draft Articles. Instead, the standard in the Code accommodated the traditional GATT objective of restoring the balance of concessions. Thus, the language of the Code belies the EC assertion that the term "countermeasures" connotes some special form of remedy that focuses solely on the objective of inducing compliance.

22. Third, the Code was signed in 1979. Given that the provisions of the Draft Articles dealing with countermeasures were in their infancy at that time, and have changed significantly since then, it is inconceivable that the term "countermeasures", as originally used in the Code, was intended to be defined exclusively in light of what is now Article 49 of the Draft Articles.

23. In conclusion, the EC's answer to this question highlights the severe shortcomings in the EC's interpretation of Article 4.10. The EC ignores the text of Article 4.10, and instead incorporates into it a single principle – inducing compliance – that comes from a source that is outside the WTO. The EC then takes this single principle and applies it to the exclusion of everything else, resulting in a benchmark for countermeasures that is unconnected to anything measurable. Because under the EC's approach the higher the amount, the greater the "inducement",[22] there effectively is no ceiling on the amount of countermeasures that can be requested and authorized.

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[22] *See* EC response to Question 1 from the United States.

5. In its report on US – Cotton Yarn (WT/DS192/AB/R, para. 120) the Appellate Body made the following observations:

> *Our view is supported further by the rules of general international law on state responsibility, which require that countermeasures in response to breaches by states of their international obligations be commensurate with the injury suffered. In the same vein, we note that Article 22.4 of the DSU stipulates that the suspension of concessions shall be equivalent to the level of nullification or impairment. This provision of the DSU has been interpreted consistently as not justifying punitive damages.... It would be absurd if the breach of an international obligation were sanctioned by proportionate countermeasures while in the absence of such breach, a WTO member would be subject to a disproportionate and hence, "punitive", attribution of serious damage not wholly caused by its exports. In our view such an exorbitant derogation from the principle of proportionality in respect of the attribution of serious damage could be justified only if the drafters of the ATC had expressly provided for it, which is not the case.*

Could you please comment on this paragraph and on its potential relevance, or lack thereof, to the issues before the Arbitrators in these proceedings?

24. While the United States agrees with the EC that the Draft Articles were inapplicable to the interpretation of the provisions of the *ATC* at issue, the United States disagrees with the EC contention that Article 22.4 of the DSU does not provide relevant context for purposes of interpreting Article 4.10 of the SCM Agreement. Instead, Article 22.4 provides extremely relevant context in support of the proposition that a countermeasure under Article 4.10 is not appropriate if it is disproportionate to the trade impact of a subsidy on the complaining Member.[23]

6. Do you believe that, under Article 4.10 of the SCM Agreement, there is a generally applicable benchmark or standard according to which the Arbitrator can (or should) determine the appropriateness of a proposed countermeasure? Or, do you agree that a case-by-case approach should be employed for Article 4.10 of the SCM Agreement, as under Article III of the GATT? If so, what factors should the Arbitrator take into account in determining an appropriate countermeasure?

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[23] *See, e.g., US Answers*, paras. 17-20.

25. The United States, of course, disagrees with the EC assertion that the standard of Article 4.10 is "what is adequate to induce compliance."[24] However, in its answer to this question, the EC does not add anything new, and the prior submissions of the United States have demonstrated why the EC's assertion is incorrect. Here, the United States simply notes that the EC has yet to address the fact that prior arbitrators have found that a purpose of countermeasures under Article 22 of the DSU is to "induce compliance" and that this purpose is not inconsistent with a standard that considers the trade impact of a measure on the complaining Member.[25]

7. The Arbitrator in Brazil-Aircraft (para. 3.57) stated that "we agree that in practice there maybe situations where countermeasures equivalent to the level of nullification of impairment will be appropriate...." Do you agree with this statement? If so, under what specific circumstances will a countermeasure equivalent to the level of nullification or impairment be appropriate? Can you provide examples? Why would our present case not fall under this category?

26. The EC's assertion that "the appropriateness of countermeasures under Article 4.10 of the *SCM Agreement* must be assessed from the perspective of the Member granting the prohibited subsidy rather than from that of the complaining Member" is just a repackaged version of the EC's erroneous assertion that "inducing compliance" is the sole objective of Article 4.10. As noted in the U.S. comment on the EC's answer to Question 6, prior U.S. submissions have demonstrated why the EC is wrong.

34. Could you please clarify the respective roles of Article 22.2 of the DSU and Article 4 of the SCM Agreement as the legal basis of your request for authorization to suspend concessions contained in document WT/DS108/13?

27. The United States simply will note that the EC has said that the entire amount of the countermeasures it has requested are attributable to Article 4.10. Because the EC has not shown the basis for any amount under Article 22.2, the amount attributable to Article 22.2 should be assigned a value of zero. The EC cannot simply ask the Arbitrator to "fill in" an amount attributable to Article 22.2 in order to make up for any reduction by the Arbitrator to the amount that the EC has requested under Article 4.10.

35. Could you please clarify what role you ascribe in the current proceedings to the violation of GATT Article III:4 of the GATT found in the "compliance" proceedings in this dispute? In particular, could you please clarify:

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[24] *EC Answers*, para. 55.

[25] *See US First Submission*, para. 43; *US Second Submission*, paras. 51-53; and *US Oral Statement*, para. 22.

1. *whether, in your view, your request for authorization to suspend concessions covers measures to be taken in response to this violation?*

2. *Assuming that the rules or procedures of Article 4.10 would not be relevant to any measures to be authorized in relation to that violation, could you please clarify what portion of the measures you propose to take relates to that violation?*

3. *What legal implications you ascribe to the arguments and figures presented in paragraphs 52-57 of your First Submission?*

4. *To the extent that the violation of Article III:4 would be within the scope of this arbitration, could you please clarify on what legal basis and in which circumstances you believe the Arbitrator may be entitled not to assess the level of nullification or impairment caused by this violation (as suggested in paragraph 83 of your Oral Statement)?*

28. The United States fails to see the relevance of the EC statement that at the time when the EC requested suspension of concessions, a violation of Article III:4 had not been established.[26] It is equally true that it had not been established that the ETI Act violated provisions of the SCM Agreement or the *Agreement on Agriculture*.

29. In any event, because the EC has not shown the basis for any amount under Article 22.2, the amount attributable to Article 22.2 should be assigned a value of zero. The EC cannot simply ask the Arbitrator to "fill in" an amount attributable to Article 22.2 in order to make up for any reduction by the Arbitrator to the amount that the EC has requested under Article 4.10.

36. In its Second Submission, the United States has identified a number of issues which it considers not to be in dispute (see US Second Submission, paragraphs 19-26). To the extent that you have not already confirmed them in your Oral Statement, could you please indicate, for each of these issues, whether you agree with the US view that it is not in dispute?

30. The United States disagrees with the EC's suggestion that, in the context of this proceeding, it could increase the requested amount of suspension of concessions. There is no support for this suggestion in either the DSU or the SCM Agreement, and even the arbitrator in *Brazil Aircraft*, on which the EC has blindly relied, expressed doubts – without deciding – as to whether Canada could modify or expand its requested countermeasures in the course of the arbitration proceeding.[27] The EC has yet to justify its position.

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[26] *EC Answers*, para. 65.

[27] *Brazil Aircraft*, paras. 3.13-3.15.

37. In its Second Submission, the US suggests that the EC considers "the trade impact on all Members" to be the relevant benchmark for assessing whether countermeasures are "appropriate" within the meaning of Article 4.10 of the SCM Agreement (See US Second Submission, para. 13). Do you agree with this description of your position? Do you consider the interpretation you propose to be completely independent of the trade impact of the measure (please address in your answer both the relevance of the notion in the context of these proceedings and more generally in the context of Article 4.10 of the SCM Agreement)?

31. The United States notes that the EC again misstates the difference between Article 4.10 and Article 22.4.[28] The difference between the two provisions is found in the difference between the standard of Article 4.10 – "not disproportionate" – and the standard of Article 22.4 – "equivalent". The United States does not dispute the existence of this difference, but maintains that an interpretation of Article 4.10 along the lines of that suggested by the EC would generate an unwarranted conflict between the SCM Agreement and the DSU.

38. In its submissions, the US has identified the total amount of the subsidy as a proxy for the trade impact of the measure. Assuming arguendo that the trade impact of the measure would be of relevance in these proceedings, would you agree that the total amount of the subsidy constitutes, in these proceedings, a relevant proxy for the overall trade impact of the measure?

32. The United States notes that the EC's "belief" that the trade impact of a subsidy must be greater than the amount of the subsidy is just that – a belief.[29] The EC has not proven that the trade impact of the FSC/ETI is greater than the amount of the subsidy, and the United States has demonstrated that an amount of trade impact less than the amount of the subsidy lies well within the reasonable range of estimates of the trade impact.[30]

39. Could you please clarify what is exactly in your view the role of "inducing compliance" in the determination of what constitutes "appropriate countermeasures"? In your view, what criteria should be used, and with what relative weight, in assessing whether countermeasures "induce compliance"? Do you consider this to be the sole benchmark by which the "appropriateness" of countermeasures under Article 4.10 of the SCM Agreement can or should be assessed? If other elements may or should be considered, which are they?

33. With respect to the EC's answer to this question, the United States will not reiterate all of the reasons why the EC's interpretation of Article 4.10 is incorrect. Instead, the United States will limit its comments to some of the new assertions made by the EC.

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[28] *EC Answers*, para. 78.
[29] *EC Answers*, para. 80.
[30] *See, e.g., US Answers*, paras. 101-112 and Exhibit US-17.

34. With respect to the EC assertion that "the benefit conferred by a WTO Member on exporters is 'mirrored' by an equal loss of revenue to the same Member's exporters",[31] the United States would note that the proposed EC countermeasures do not purport to achieve this objective. The EC is not proposing to impose an additional tariff to "mirror" the amount of the subsidy, a tariff which would be *de minimis* in *ad valorem* terms. Instead, the EC is proposing a 100 percent tariff to offset a volume of trade which it claims was measured on the basis of the amount of the subsidy.[32] Thus, the EC's proposed actions are not even consistent with its misguided interpretation of Article 4.10.

35. In paragraph 96 of the *EC Answers*, the EC argues that its interpretation of Article 4.10 is justified by the fact that Article 4 is aimed at removing a measure which is presumed to cause negative trade effects. However, the same presumption operates with respect to any other WTO rules violation, as evidenced by Article 3.8 of the DSU. More generally, the EC has yet to explain why a prohibited subsidy warrants an approach which is so radically different from the remedy for other WTO rules violations.

36. In paragraph 100(1) of the *EC Answers*, the EC asserts that "footnote 9 requires the countermeasure to be proportionate to the *violation* rather than the trade effect." (Emphasis in original). In fact, this is not what footnote 9 says. Instead, footnote 9 precludes "countermeasures that are disproportionate *in light of* the fact that the subsidies dealt with under these provisions are prohibited." (Emphasis added). If the drafters had intended the standard to be "not disproportionate to the violation" they easily could have said so.

37. In paragraph 102 of the *EC Answers*, the EC asserts that a Member challenging a request for authorization under Article 4.10 "must demonstrate that such proposed measure is not aimed at inducing compliance." Given that it is well-established that a purpose of countermeasures under Article 22 of the DSU is also to induce compliance – a point to which the EC has yet to respond – there is no basis for reading into Article 4.10 this unique and amorphous burden of proof standard which would seem to depend solely on the subjective intent of the Member seeking authorization. Whether the amount requested was $1 or $1 trillion, one could always argue that the amount is "aimed at inducing compliance."

38. In an even more incredible assertion, in paragraph 103 of the *EC Answers*, the EC asserts that a Member challenging a request for authorization under Article 4.10 "should demonstrate that the proposed measure is not effective in inducing compliance, or that it is out of proportion to the objective of inducing withdrawal without delay ... ." How would such a subjective standard – which requires the challenging Member to prove a negative – ever operate in practice? As discussed below in connection with the EC's answer to Question 1 from the United States, the

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[31] *EC Answers*, para. 88.

[32] *See EC Methodology Paper*, paras. 7-11 and WT/DS108/13.

EC has asserted that a higher amount always will be more effective than a lower amount in inducing compliance. Therefore, a higher amount always will be more consistent with the EC's purported standard than a lower amount. The fact that this is the outcome that follows from the EC interpretation of Article 4.10 speaks volumes as to the lack of validity of that interpretation.

39. Finally, with respect to paragraph 105 of the *EC Answers*, the U.S. interpretation does not "read out the differences" between the various provisions of the SCM Agreement and the DSU. Instead, the U.S. interpretation harmonizes them. It recognizes the differences between the standard of Article 4.10 – "not disproportionate" – and Article 22.4 – "equivalent". At the same time, it avoids generating an unwarranted conflict between Article 4.10 and Article 22.4 by calling for a benchmark in Article 4.10 – the trade impact of a subsidy on the complaining Member – that is consistent with the dual objectives of the WTO dispute settlement system, which are to induce compliance and restore the balance of concessions.

40. Could you please clarify whether you consider that the amount of the subsidy constitutes the legal benchmark by which the "appropriateness" of countermeasures under Article 4.10 of the SCM Agreement should be assessed? If not, could you please clarify why countermeasures of that amount should be considered "appropriate" in this case and what legal benchmark is relevant in determining the appropriateness of countermeasures?

40. With respect to paragraph 106 of the *EC Answers*, the United States reiterates that the countermeasures the EC has proposed – a 100 percent tariff – do not equate to the amount of the subsidy, however calculated.

41. With respect to paragraph 109 of the *EC Answers* and the EC assertion that "[t]he FSC/ETI subsidy . . . boosts US exports to all WTO Members", this is a mere assertion which the EC has not proved. As noted previously, the United States has demonstrated that an amount of trade impact less than the amount of the subsidy lies well within the reasonable range of estimates of the trade impact.[33]

41. Could you please elaborate on why you consider the amount of countermeasures you have requested is "not ..disproportionate" within the meaning of footnotes 9 and 10 of the SCM Agreement? More generally, could you indicate what criteria you consider relevant in the assessment of the "proportionality" of countermeasures under Article 4.10 of the SCM Agreement?

42. With respect to paragraph 110 of the *EC Answers*, the United States reiterates that the countermeasures the EC has proposed – a 100 percent tariff – do not equate to the amount of the subsidy, however calculated.

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[33] *See, e.g., US Answers*, paras. 101-112 and Exhibit US-17.

42. Assume the following hypothetical scenario: the EC prevailed in this arbitration, and was authorized to take a countermeasure in the amount of the total subsidy. The ETI Act is still in place. Japan later initiated proceedings concerning the same measure and ultimately requested the DSB to authorize taking countermeasures in the amount of the total subsidy again. What should be the Arbitrator's decision in this second arbitration? Should the Arbitrator reject Japan's request because the proposed countermeasure is not appropriate? In answering this question, please indicate how you take account of the objective of inducing compliance.

43. Paragraph 117 of the *EC Answers* provides a rather glib response, ignoring entirely the actual scenario presented in *EC Bananas* where there were simultaneous co-complainants, but one co-complainant sought authorization to impose countermeasures shortly (less than 7 months) after the first co-complainant had already received authorization. If, as the EC posits, the standard under Article 4.10 is merely one of inducing compliance, why should the countermeasures be allocated at all? It should not matter which WTO Member is imposing countermeasures so long as *one* WTO Member is. As for determining which WTO Member is the lucky one authorized to impose countermeasures, under the EC approach, it is simply a matter of which Member wins the race to the WTO "courthouse". It is clear from the EC's response that subsequent Members would be relegated to a marginal role, only being entitled to obtain whatever amount, if any, is "left over" from the award to the first Member.[34] Such a "crumbs from the table" approach finds no basis in Article 4.10.

44. Do you agree with the US that the subsidy rate provided by the ETI is 0.87 per cent as argued by the US? If not, what rate would you propose and why?

44. The United States notes at the outset that, as explained in its response to Question 30 from the Arbitrator, the correct figure is 0.81 percent.[35]

45. As explained in the U.S. answer to Question 30, the 0.81 percent figure represents the "pre-tax" *ad valorem* subsidy rate, and not, as the EC seems to assume, a 2002 estimate of the subsidy share of total U.S. goods exports. The United States finds it remarkable that the EC does not recognize or understand the "pre-tax" concept, given that the EC's consultants relied upon it in their own economic modeling, as set forth in Exhibit EC-8, Annex 7. What this says is that notwithstanding the EC's insistence that the Treasury model (as modified by the EC) is superior to all other models available, the EC actually has a very limited understanding of the model.

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[34] *See* for example paragraph 115 of the EC responses where the EC concedes that under its approach, a second Member would get the difference between what was awarded to the EC and whatever higher amount (if any) might apply in light of changed circumstances. It is not clear anything would be left over for any additional Member.

[35] *US Answers*, para. 115-119.

Given this evidenced lack of understanding, the Arbitrator should be extremely skeptical of any statements made by the EC regarding the model's purported virtues.

46. Putting aside the EC's failure to understand the workings of its own model, the concept of a pre-tax subsidy rate was used by the United States in running the adjusted EC/Treasury model and the Armington model. As shown below, the actual U.S. estimated subsidy rate (calculated by dividing the amount of the subsidy by total goods exports) for 2000 of 0.528 percent is actually much lower (35 percent) than the pre-tax rate of (0.812 percent). If the EC believes that the pre-tax rate should not be used, then the U.S. estimates of the trade effects provided to the Arbitrator from using the adjusted EC/Treasury model and the Armington model would be reduced by roughly one-third. To be clear, however, the United States notes that it is the value of the subsidy – not the "pre-tax" equivalent used to calculate trade effects – that falls in the middle range of trade effects when the "pre-tax" equivalent is used to calculate trade effects.

47. In its answer to the Arbitrator's question, the EC includes a table that contains inaccurate *ad valorem* subsidy rates. The rates for the years 2000 and 2001 are particularly inaccurate, given that they are based upon the EC's incorrect estimates of the subsidy amount for those years. The following table contains corrections to the EC's errors:

Corrected EC Table from EC Answer to Arbitrator's Question 44
(In $US millions)

Year	Total U.S. Exports	FSC Exports	Subsidy	Subsidy/Total Exports	Subsidy/FSC Exports
1987	254,122	84,280	772	0.304%	0.92%
1992	448,164	152,263	1,340	0.299%	0.88%
1996	625,077	285,902	2,974	0.476%	1.04%
2000	781,897		4,125	0.528%	
2001	730,897		3,896	0.533%	
2002	na	na	na	na	na

Note: The subsidy amounts for 2000 and 2001 reflect the U.S. estimates, as set forth in the *US Additional Submission*, para. 42 and Exhibit US-15.

45. Please comment on paragraph 75 of the US Oral Statement about the level of EC exports to the world excluding intra-EC trade.

48. In paragraph 75 of the *U.S. Oral Statement*, the United States identified a clear error by the EC in its calculation of its share of the subsidy based upon trade data. The United States finds it amazing that the EC response is not to correct the error, but instead to provide completely new trade data. Moreover, these trade data do not come from official sources (government or respected international organizations like the WTO or the IMF), but instead come from a private research group that modifies official government data.

49. To make matters worse, the EC withholds from the Arbitrator the fact that these data are flawed because they do not purport to report total world trade. CEPII, the group that publishes the CHELEM database, states quite clearly on its website that it uses "the 52 most important countries (or groups of countries), which account for 92% of world trade and 90% of world output ... ."[36] The absence of complete data can be seen by examining Exhibit EC-13, which reports total world goods exports (excluding intra-EC exports) as being $4,039 billion in 1999.[37] According to the IMF Direction of Trade Statistics, however, total world exports were $4,275 billion in 1999 (6 percent greater than the CHELEM figures). According to the WTO, total world goods exports were $4,241 billion in 1999 (5 percent greater than the CHELEM figures).[38]

50. In addition to the EC's failure to disclose the shortcomings in the CHELEM data, the EC offers no explanation at all for its use of 1999 data. Because data for 2000 is readily available from official sources, the only conclusion one can draw is that the EC found that data for the year 1999 generated a figure more favorable to the EC than data for the year 2000.

51. Finally, in its answer to Question 24 from the Arbitrator, as well as in the *US First Submission*, paras 64-68 and Exhibit US-10, the United States has provided the Arbitrators the economic rationale for using a production-based formula. The EC has not provided any economic theory explaining why the affect of an export subsidy is limited to third country exports (and not third country domestic substitutes), or why an export subsidy would have no impact on trade in the EC (as well as EC domestic production substitutes for U.S. exports to the EC).

52. Accordingly, the United States believes that its production-based method is a superior method of calculating the EC's share of the amount of the subsidy, the amount of the subsidy serving as a proxy for the trade impact of the subsidy on the EC. However, if the Arbitrator were

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[36] *See* <http://www.cepii.fr/anglaisgraph/bdd/chelem.htm>, visited 21 March 2002.

[37] Exhibit EC-13 also reports total world imports.

[38] The discrepancy is even greater with respect to world imports. According to the IMF, world imports (excluding intra-EC trade) totaled $4,528 billion (12 percent greater than what CHELEM reports). According to the WTO, world imports (excluding intra-EC trade) totaled $4,492 billion (11 percent greater than what CHELEM reports).

to use the EC's method, when correct data from official sources is used in applying that method, the EC's share estimate falls below the level derived from the U.S. methodology.[39]

46. Please clarify the use of the term 'volume' in paragraph 69 of your Oral Statement.

53. During this arbitration, the EC has routinely followed an approach of presenting scarcely-supported claims of trade harm at values several times greater than the $4 billion it is claiming in countermeasures. This approach appears intended to create a "climate" in which the $4 billion request might not only seem reasonable, but even beyond questioning. The EC's answer to Question 46 from the Arbitrator appear to be in a similar vein.

54. The attempt by the EC to isolate, within the overall trade impact of the FSC, the quantity effects of the subsidy from its price (or income) effects, serves one purpose: to inflate the measurement of trade harm, which the EC claims to have been nearly $14 billion in 1996. The EC does not actually make a claim for an arbitral award based on such a methodology, but instead purports to be "pointing out that this was another reason to consider the estimates it advanced Exhibit EC-8 (using the US Department of Treasury methodology) to be conservative."[40]

55. The United States believes that the Arbitrator should take no account of a measurement of trade harm based on the isolation of a volume effect from the overall revenue or trade effect. Well-established WTO dispute settlement practice is to conduct a comparative static measurement of the change in relevant export revenues arising from non-compliance. In this case, that would be the difference between: (1) the value (price times quantity) of actual affected EC production in a designated recent year with the FSC/ETI in place, and (2) the estimated value of what EC production would have been in that same year if the United States had been in compliance with its WTO obligation, all long-term economic adjustments assumed to have been made and all other factors held constant. The United States certainly did not make claims for, or even refer to, the higher constant price evaluations of the harm it had suffered in the arbitrations dealing with the level of U.S. suspensions of concessions in *EC Bananas* and *EC Hormones*.

56. Indeed, in *EC Bananas*, the arbitrator stated that in estimating the level of nullification or impairment, the same basis must be used for measuring the level of suspension of concessions.[41] In this proceeding, the EC has not requested a suspension of concessions based on volume.

57. Finally, the United States would make one further point on this issue that is absolutely clear from a technical standpoint. The actual trade impact on the EC from the FSC/ETI is, in

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[39] *See US Oral Statement*, paras. 71-80.
[40] *EC Answers*, para. 133.
[41] *EC Bananas*, para. 7.1.

fact, lower than what is measured by either the United States or the EC modeling exercises. This follows from the fact that if the measurement of the subsidy's impact were being done outside the context of WTO dispute settlement, an economic analysis would *never* ignore the impact of the subsidy on the U.S. dollar exchange rate and the resulting dampening effect on any export growth that might otherwise occur. Thus, if the Arbitrator were to depart from prior dispute settlement practice and accept the EC suggestion to measure the impact of the FSC/ETI on the basis of volume in order to achieve a more economically "pure" result, to be consistent the Arbitrator also would have to take account of the exchange rate effect.

58. Therefore, the United States recommends that the Arbitrator assess the trade impact of the FSC/ETI on EC production free from any coloration that the EC might like to add based on analytical approaches that fall outside the norms of WTO dispute settlement practice.

47. During the meeting with the Arbitrator, you referred to recent comments by Professor Pugel. Could you please provide any relevant supporting documents relating to these comments and any relevant explanation of the conclusions you draw from these comments?

59. In responding to Question 47 from the Arbitrator, the EC provides a written text of Mr. Pugel's oral comments. Mr. Pugel asserts that the pricing power of U.S. firms in foreign markets has declined since 1974 because of increasing global competition. According to Mr. Pugel, as a result of this alleged decline, the percentage of the subsidy passed through to export prices is "presumably higher" than it was in 1974, when Mr. Pugel and Mr. Horst estimated the pass-through of the DISC tax savings to be 75 percent.[42] Mr. Pugel, who was retained by the EC to develop a study of FSC effects (*see* Exhibit EC-8, Annex 7) states that even if the pass-through "is not currently 100 percent, it is very close."[43]

60. The one specific example offered by Mr. Pugel in support of the alleged loss of marketing power by U.S. firms relates to large civil aircraft. According to Mr. Pugel, "[e]ven in civil aircraft, the one remaining U.S. producer faces stiff competition from Airbus, and pricing to gain orders is generally very competitive."[44]

61. The United States finds this assertion extremely puzzling. Part of the problem with this argument is that pricing power is determined less by nationality than by the global structure of production in each industry. Thus, the ability of a U.S. firm to influence price is influenced by the degree of domestic as well as foreign competition. While the Boeing Company may face only Airbus competition today, in 1974 it competed fiercely with planes produced by McDonnell-Douglas, Lockheed, and Airbus, the latter having launched the A-300 wide-body

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[42] *EC Answers*, para. 134.
[43] *Id.*
[44] *Id.*

aircraft in 1970. Thus, the four competitors of 1974 have become two today, and the civil aircraft industry today is more, not less, concentrated then it was in 1974 in terms of the number of competitors. If Pugel and Horst found that Boeing would pass through less than the full DISC subsidy in 1974, why would one simply assume that today, with fewer market participants, Boeing is under greater pressure to pass through the full amount of the FSC/ETI tax benefit?

62. In para 137 of the *EC Answers*, the EC attempts to support Mr. Pugel's unsupported assertion by citing work by Ball and McCulloch showing that between 1959 and 1996 the U.S. share of the largest 10 firms has declined in various industries. This information, in and of itself, is not germane to the issue of pricing power. More to the point would be changes in the total number of firms in each industry, the degree of concentration of production among firms and the place of firms exporting from the United States in the changed industry structure. In this regard, it should be noted that not all exports from the United States are by U.S. capital-owned firms, but sometimes are made by large subsidiaries of foreign capital-owned parents, including European parents, that themselves claim benefits under the FSC/ETI.

63. In para 138 of the *EC Answers*, the EC cites Porter and van Opstal as evidence of the alleged declining pricing power of U.S. firms in foreign markets. The citation, however, also can be viewed as consistent with a world in which globally spreading technological capacity and human capital confer the ability to capture pricing power, at least temporarily, for companies in an increasing number of countries. Such firms identify and develop niche markets or new products for the enjoyment of pricing power. With respect to any specific product, such pricing power usually declines or disappears inevitably over time. With respect to the company's and the country's export bundle, however, constant, sustained innovation and product development sustain ongoing pricing power.

64. In para 135 of the *EC Answers*, the EC cites major trade liberalization as the fundamental reason for increasing global competition in markets. The United States agrees with the EC and applauds the pro-competitive effects of trade liberalization under the GATT/WTO. Nevertheless, it is disingenuous on the part of the EC to omit any reference to the TRIPS Agreement. Even the most pro-competitive societies recognize the importance and public value of temporary restraints on competition (and the resulting pricing power conferred) permitted in order to encourage innovation, research and development. The TRIPS Agreement has, if anything, removed impediments to innovation by extending intellectual property protection to exactly those knowledge-based products, protected by patent or trademark, that figure so prominently in the U.S. export bundle.[45]

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[45] Indeed, notwithstanding Mr. Pugel's undocumented assertions of declining U.S. competitiveness, the Financial Times quite recently carried a story entitled "World's Knowledge Economy Dominated by U.S. Regions" (copy attached as Exhibit US-20). This article reports on the newly released study entitled The World Knowledge

(continued...)

65. In para 136 of the *EC Answers*, the EC cites growing international trade and investment as a source of increasing global competition and, by inference, a loss of pricing power. Again, however, such trends do not necessarily suggest declining pricing power *for firms*. Imports and exports rising as a share of GDP in high-income countries is a statistical fact. But that fact is also compatible with the view that producers in such countries reduce their output of traditional or standardized, price-sensitive products and instead specialize increasingly in those knowledge-based niche markets where their productive endowment confers cost advantages and oftentimes pricing power.

66. The EC reports Mr. Pugel as concluding that, "[a]lthough there is a broad-worded caveat in the text of the Treasury study [concerning the degree of pass-through], the Treasury did not judge it to be important enough to provide alternative estimates using somewhat less than 100 percent pass through."[46] Despite this highly conclusory statement, there are in fact many reasons other than the asserted lack of importance of the overstatement for which the Treasury may not have considered presenting multiple estimates of the FSC's effect on exports in 1996. One reason may well have been the lack of empirical economic literature estimating export supply elasticities. Also, sensitivity analysis is not routinely included in articles aimed at non-technical audiences. Treasury may well have felt, in the context of a study of this type, that a clear statement that the effect of the FSC was overstated was fully sufficient to cover a wide range of degrees of possible overstatement.

67. The Pugel and Horst work of 1977 was a published study in a refereed professional journal. The recent remarks by Mr. Pugel, as reported by the EC, do not rise to the level of a formal examination of the issue in more recent times, nor do they refer to any published literature on the subject. They are mere speculations by an economist retained by the EC for purposes of this dispute. Indeed, the United States finds that Mr. Pugel's speculations raise more questions than they answer.

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[45] (...continued)
Competitiveness Index, 2002, by Robert Huggins Associates, a U.K. private think-tank. The article states, "[t]he US dominates the world's knowledge economy ... . Forty-five of the top 50 regions with the best knowledge bases in the world are in the US-led by Minneapolis-St Paul, home of the high technology manufacturer 3M." Significantly, the report defined knowledge competitiveness as the "ability not just to create new ideas but also to exploit their economic value." The article also states that the report's "findings highlight the gap in competitiveness between the United States and Europe." Products exported by knowledge-based industries are exactly the types most likely to be covered by intellectual property protection or even simply the temporary pricing power conferred by being the first market entrant with a new product or service. This is certainly a view of the U.S. economy that appears inconsistent with the view expressed by the EC's consultant, Mr. Pugel, regarding the near loss of pricing power by U.S. firms in the EC market due to an alleged loss of competitiveness.

[46] *EC Answers*, para. 134.

68. As one example, Mr. Pugel's statements appear to be inconsistent with the positions taken by the EC's Directorate for competition. Indeed, Mr. Pugel's assertions regarding competition in the large civil aircraft industry seem at odds with the EC's highly publicized investigation of the merger between Boeing and McDonnell-Douglas. According to numerous newspaper reports, this investigation was launched due to the EC's concern with Boeing's dominant position in the large civil aircraft industry.[47] Similarly, Mr. Pugel's assertions are at odds with the EC's investigation of Microsoft, a company which is reported to be a major user of the FSC/ETI.[48] For purposes of this arbitration, the United States offers no comment one way or the other on the validity of the EC's charges in these competition proceedings. Instead, the United States' point is simply that the very existence of these investigations is inconsistent with Mr. Pugel's unsubstantiated assertions.

69. Finally, the United States notes that Mr. Pugel's remarks address only one source of less than full pass-through: pricing power on the part of producers. His remarks do not address the other source: an upward slope to the export supply curve (rising marginal costs) in the segments of the supply curve affected by the subsidy. An assumption of constant marginal costs (resulting in full pass-through under conditions of perfect competition) is more easily sustained when the subsidy is furnished to a single product than when made generally available to all U.S. production for export. In the latter case, to the extent that production for export increases, many industries (instead of one) competing for added inputs at the same time are far more likely to raise the cost of inputs and absorb some of the subsidy into added costs of production.[49]

70. In summary, in the absence of more recent formal economic literature on subsidy pass-through in general, or on the FSC/ETI in particular, the speculations of neither Mr. Pugel, the EC nor the U.S. can definitively answer for the Arbitrator the difficult but important question of pass-through. However, this question becomes relevant only if the Arbitrator should decide to measure the trade effects of the FSC/ETI through economic modeling.

Questions from the United States

1. The European Communities ("EC") has asserted that the sole purpose of countermeasures under Article 4.10 of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement") is to induce compliance. Assuming for purposes of argument that this

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[47] *See, e.g., European Panel Objects to Boeing-McDonnel Deal*, The New York Times, July 5, 1997 (copy attached as Exhibit US-21) ("The panel said the planned takeover would strengthen Boeing's '*existing dominant position* and therefore should be prohibited,' the people familiar with the decision said."). (Emphasis added).

[48] *See, e.g., Europeans Unmoved by U.S. Proposal*, The New York Times, November 6, 2001 (copy attached as Exhibit US-22) ("The European authorities said in August that Microsoft might have violated their antitrust rules by using illegal practices to extend *its dominant position in the market for personal computer operating systems* into the market for low-end server operating systems."). (Emphasis added).

[49] *See US Answers*, para. 95.

assertion is correct, what limit does this standard impose on the amount of countermeasures that would be "appropriate"? Would not an amount in excess of the amount of the subsidy or an amount in excess of the trade impact on the complaining Member (or on all Members) be more effective in inducing compliance? Please explain the basis for your answers. In general would it not be true that the higher the amount the more effective it is in inducing compliance?

71. In its answer to this question, the EC states that "[i]t is clear that the higher amount of a countermeasure the more effective it will be in inducing compliance."[50] In the very next sentence, however, the EC says that "a countermeasure may not be disproportionate to its purpose."[51]

72. If, however, a higher amount of countermeasures always will be more effective in inducing compliance, how could an arbitrator ever conclude that a higher amount is disproportionate to its purpose? More than anything, this answer reveals that the EC's purported "standard" under Article 4.10 is not a standard at all.

2. In paragraph 71 of the EC's Oral Statement of March 7, 2000, the EC asserts that the Arbitrator should rely on the 1997 Treasury study (Exhibit EC-1) because this study "has been presented to the US body politic by its own experts". Is it not true that the U.S. Government tax expenditure estimates have been presented to the "US body politic by its own experts"? Please explain the basis for your answer.

73. The United States disputes the EC's assertion that the 1997 Treasury report was "based on real data rather than estimates".[52] One of the most important parameters in the entire report – the parameter concerning the amount of tax pass-through – was based entirely on an "assumption" of full pass-through, an assumption which the EC's own consultant has described as "implausible". Similarly, the other elasticities used in the analysis are simply estimates, and outdated estimates at that.

74. With respect to the EC assertions regarding the Treasury tax expenditure estimates, the EC insinuates that the United States somehow has agreed with the EC assertion that these estimates are always underestimates.[53] To the contrary, the United States believes that the Treasury estimates – which for the period after 1996 assume an export growth rate of 6 percent

[50] *EC Answers (US)*, para. 1.
[51] *Id.*
[52] *EC Answers (US)*, para. 2.
[53] *See id.*

per year and a growth in FSC/ETI usage of 1 percent per year – probably overestimate the amount of the subsidy in recent years.[54]

3. Again referring to paragraph 71 of the EC's Oral Statement and the EC's assertion that the Arbitrator should rely on the 1997 Treasury study, would the EC please explain why the Arbitrator should not also rely on the statement in the 1997 Treasury study that the assumptions made for purposes of that study will "tend to overstate the loss in exports that would accompany the removal of FSC benefits"? Was not the study, in its entirety, "presented to the US body politic by its own experts"?

75. The EC's "reruns" of the adjusted EC/Treasury model with less than full pass-through only further support the argument made by the United States throughout this proceeding: the level of the measured trade effect is highly sensitive to the degree of pass-through and the elasticities selected. Just the change of the export supply elasticity to 10 for industrial sectors reduces the global trade effect by approximately 25 percent. The EC results reported in this EC response are higher than U.S. estimates due to the fact that the EC has chosen to use higher demand elasticities than those found in the more recent literature that the United States has cited and that it has used in its own "reruns" of the adjusted EC/Treasury method.

4. At the meeting with the Arbitrator on March 7, in its oral comments on the U.S. Oral Statement, the EC asserted that the United States has agreed with the EC that the ordinary meaning of the term "countermeasures" is insufficient to for purposes of determining the meaning of that term. Would the EC please identify where, in either the written submissions of the United States or in the U.S. Oral Statement, the United States has expressed this alleged agreement?

76. The EC answer refers solely to the discussion of the term "appropriate" in paragraph 20 of the *US First Submission*.[55] The EC cannot point to anything in the U.S. submissions where the United States has agreed with the EC's assertion that the ordinary meaning of the term "countermeasures" is insufficient for purposes of determining the meaning of that term. To the contrary, the United States has demonstrated that the ordinary meaning of "countermeasures" is sufficient for purposes of determining its meaning, and that there is no need to bypass the customary rules of treaty interpretation in order to rely on a purported "definition" from a source that is external to the WTO Agreement.

5. In document WT/DS108/13 (17 November 2000), the EC has requested the DSB to act under both Article 4.10 of the SCM Agreement and Article 22.2 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"). Would the EC agree that this

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[54] *See, e.g., US Answers*, paras. 121-124.

[55] *EC Answers (US)*, para. 6.

proceeding consists of recourse to both Article 4.11 of the SCM Agreement and Article 22.6 of the DSU? Does the Arbitrator not need to indicate how it is exercising its authority pursuant to Article 4.11 and how it is exercising its authority with respect to Article 22.6? With respect to the $4.043 billion in suspension of concessions which the EC has requested in that document, would the EC please identify the precise portion of that amount for which authority is requested under Article 4.10 and the precise amount for which authority is requested under Article 22.2?

77. The EC's answer to this question indicates that the EC is not requesting any amount under Article 22.2 of the DSU. Because the EC has not shown the basis for any amount under Article 22.2, the amount attributable to Article 22.2 should be assigned a value of zero. The EC cannot simply ask the Arbitrator to "fill in" an amount attributable to Article 22.2 in order to make up for any reduction by the Arbitrator to the amount that the EC has requested under Article 4.10.

6. *Referring to Question 5, above, the United States has indicated its intention to comply with the January 29, 2000 recommendations and rulings of the DSB regarding the ETI Act. However, let us assume that another Member is in a situation identical to that of the United States and that the Arbitrator decides to award the EC suspension of concessions in an amount of $4.043 billion. Let us also assume that this Member promptly eliminates the inconsistency with Article III:4 of the GATT 1994, but takes longer to eliminate the inconsistency with Article 3.1(a) and 3.2 of the SCM Agreement. How would the parties to the dispute know which portion of the $4.043 billion in suspension of concessions should be terminated upon the elimination of the inconsistency with Article III:4 if the Arbitrator had not separately identified the amount attributable to the violation of the SCM Agreement and the amount attributable to the violation of the GATT 1994? Is it the EC's position that the complaining Member may determine unilaterally which portion is attributable to the respective violations? Please explain the basis for your answers.*

78. Because the EC has attributed the entire amount of its requested $4.043 billion amount to Article 4.10, there is no basis for the Arbitrator to simply "fill in" an amount if it should reduce the EC's request under Article 4.10, as the EC suggests. The entire amount – whatever the Arbitrator determines that to be – would have to be attributed to Article 4.10. Thus, if the hypothetical in the question were altered so that the export subsidy violation is eliminated first, there would be no basis to apply countermeasures with respect to the remaining violation of Article III:4. The United States does not understand the EC to be asserting that it has the unilateral power to do so.

8. *As the United States understands it, based on the EC's Oral Statement and its oral comments at the March 7 meeting with the Arbitrator, the EC attaches great significance to the fact that the recommendation under Article 4.7 of the SCM Agreement is to "withdraw" the subsidy, whereas the recommendation under Article 19.1 of the DSU is to "bring the measure*

into conformity". However, the EC previously has asserted that the ETI Act would be consistent with the SCM Agreement if the export contingency were eliminated. See United States - Tax Treatment for "Foreign Sales Corporations" - Recourse to Article 21.5 of the DSU by the European Communities, WT/DS108/RW, Report of the Panel, as modified by the Appellate Body, adopted 29 January 2002, Annex F-1, para. 148. In other words, the EC has indicated that the subsidy can remain in place so long as it is not export contingent. Assuming the EC position is correct, why, then, is the use of the phrase "withdraw the subsidy" so significant? If the EC's position is that the elimination of a prohibited contingency constitutes the "withdrawal" of a prohibited subsidy and its replacement by an actionable or non-actionable subsidy, how is this any different from the situation under Article 19.1 of the DSU? Specifically, if, under Article 19.1, a Member brings a WTO-inconsistent measure into conformity, has it not "withdrawn" the WTO-inconsistent measure and replaced it with a new, WTO-consistent measure?

79. In its answer to this question, the EC asserts that in its prior response to a question from the Article 21.5 Panel, it "was not saying that by making these changes [eliminating the prohibited contingencies] the United States would have withdrawn the subsidy."[56] The United States finds it remarkable that the EC appears to be asserting that a violation of Article 3 of the SCM Agreement cannot be remedied by eliminating the prohibited contingency that gave rise to the violation. The United States understands that the EC needs to take this position in order to justify its peculiar interpretation of Article 4.10.[57] However, it appears to be a position that already has been rejected and that, in any event, is inconsistent with the right of Members to provide non-prohibited subsidies.[58]

[56] *EC Answers (US)*, para. 8.

[57] Namely, the EC needs to argue that the requirement in Article 4.7 of the SCM Agreement that the subsidy be withdrawn is radically different from comparable provisions in the DSU in order to justify its argument that Article 4.10 is also radically different from those provisions.

[58] *See US Additional Submission*, para. 15.

EXHIBIT LIST

Number	Exhibit
US-19	U.N. General Assembly Decision 55/488, 15 September 2001.
US-20	*World's Knowledge Economy Dominated by US Regions*, The Financial Times, March 21, 2002.
US-21	*European Panel Objects to Boeing-McDonnell Deal*, The New York Times, July 5, 1997.
US-22	*Europeans Unmoved by U.S. Proposal*, The New York Times, November 6, 2001.