United States – Continued Dumping and Subsidy Offset Act of 2000 **(WT/DS217, WT/DS234)**
Recourses by the United States to Article 22.6 of the DSU

Comments of the United States
on the Replies of the Requesting Parties
to the Additional Questions of the Arbitrators

June 14, 2004

1. Brazil, Canada, Chile, the European Communities ("EC"), India, Japan, Korea, and Mexico (the "Requesting Parties") agree with the United States in many of their replies to the Arbitrators' additional questions. For example, all of the parties agree that any model based on data from the three-digit North American Industry Classification ("NAIC") or from the Global Trade Analysis Project ("GTAP") would result in a relatively imprecise estimate of the effect the CDSOA (as a non-permissible specific action against dumping or a subsidy) has on the trade of the Requesting Parties. The parties also agree that substitution elasticities are generally not "time sensitive." And the parties agree that there is no way to predict the changes from year to year in the amount of CDSOA offset payments for any given product (which, in the view of the United States, makes it quite difficult for affected domestic producers to plan any business activity that could affect dumped or subsidized competition based on these payments).

2. Where the United States and the requesting parties differ is in their proposed response to the problems inherent in aggregate data and modeling. The Requesting Parties invite the Arbitrators to abandon legitimate techniques of data analysis and modeling and – in effect – throw their hands up in frustration. By contrast, we present solid analysis and the data to back it up. If the Arbitrators apply that analysis, they will find that the CDSOA (a non-permissible specific action against dumping and subsidization) has no effect on the trade of the Requesting Parties. Or, failing that, the Arbitrators will implement the product- and country-specific model

provided by the United States[1], and determine "the level"– rather than developing a formula for calculating multiple levels – of nullification or impairment, consistent with the practice of Article 22.6 arbitrators in the past.

Question 1

3. The United States agrees with the Requesting Parties that "[t]he 3 digit NAIC level is not at a sufficiently disaggregated level and covers too broad a range of products"[2] to serve as a model in this case, when product-specific data are readily available from the antidumping and countervailing duty investigations of the U.S. International Trade Commission ("USITC"). We also agree that similar difficulties are inherent in a model based on the GTAP.[3] And, as the Requesting Parties recognize[4], the level of aggregation in the NAIC and GTAP models is problematic not only with respect to substitution elasticities, but also with respect to data on imports and domestic shipments.

4. The Requesting Parties, for example, lend support to the substitution elasticities we used with respect to ball bearings and pasta. In the case of ball bearings, they note that the GTAP elasticity for a broader category of bearings that includes ball bearings is 2.8, but they argue the

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[1] If the Arbitrators disagree with the United States that the CDSOA has no, or no more than a *de minimis*, effect on production and trade.

[2] Replies of Brazil, Canada, Chile, the European Communities, India, Japan, Korea and Mexico to the Additional Questions of the Arbitrator, June 7, 2004 ("Requesting Parties' Second Set of Replies"), para. 1.

[3] *See* Requesting Parties' Second Set of Replies, para. 5 and note 4; *see also* para. 26 (stating that the GTAP model only provides "an approximate order of magnitude" for the domestic trade effect). The United States also notes that, although the Requesting Parties state that the 57-sector breakdown of the GTAP is "approximately equivalent" to the NAIC breakdown for goods industries, the Requesting Parties apparently did not perform a thorough concordance between the NAIC and GTAP systems.

[4] *See* Requesting Parties' Second Set of Replies, para. 15.

ball-bearing specific elasticity should be higher. We used an elasticity of 4 in our model. (Japanese ball bearing producers in the USITC investigation argued that an elasticity estimate of 3 to 5 was "too high." They asserted that an elasticity of 1 to 2 was more appropriate.)[5] In these circumstances, an estimate of 4 is reasonable, if it is not too generous to the Requesting Parties.

5. In the case of pasta, the Requesting Parties note that the GTAP elasticity for a broader category of foods that includes pasta is 2.2, but they argue that the pasta-specific elasticity should be higher. We used an elasticity of 3 in our model. (Italian pasta producers in the USITC investigation argued that an elasticity estimate of 2-4 "is too high.")[6] Again, an estimate of 3 is reasonable under these circumstances.

6. We part company with the Requesting Parties, however, in their assertions that (1) there are worldwide trade effects associated with the CDSOA that should be included in an economic model, and (2) product-specific production data are not publicly available and are out of date.

The Requesting Parties' Unsupported Allegation of a "Worldwide" Trade Effect

7. The Requesting Parties argue that the CDSOA affects trade in markets outside the United States. The United States addressed this argument more than a month ago. We pointed out that the Requesting Parties offer *no* evidence to support this assertion.[7] More than one month later,

[5] *See* Exhibit US-15.

[6] *See* Exhibit US-15.

[7] U.S. Comments on Answers of Requesting Parties, May 4, 2004, n. 32.

they still have provided the Arbitrators with no legal or evidentiary support for this assertion.[8] Instead, it appears the Requesting Parties offer this criticism in the hopes of avoiding a traditional analysis under Article 22.6 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU").

8. Indeed, the Requesting Parties admit that, in *EC – Hormones* and *EC – Bananas*, "the level of nullification or impairment was limited to the lost exports into the territory of the Member maintaining the measure". But they attempt to distinguish those arbitrations based on their self-serving invented taxonomy of WTO-inconsistent measures, which includes at least two species: "measures that affect market access conditions" (by which they mean the measures at issue in *EC – Hormones* and *EC – Bananas*) and "rules-related measures" (by which they mean the CDSOA and measures relating to prohibited subsidies).[9]

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[8] The Requesting Parties cannot simply speculate about the worldwide trade effects of the CDSOA. *See* Arbitration Award in *United States – Anti-Dumping Act of 1916 Act (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, para. 5.54 (Arbitrators "cannot base [trade-effects] estimates on speculation."). In estimating the trade effects of a WTO-inconsistent measure, the arbitrators "need to guard against claims of lost opportunities where the causal link with the inconsistent [measure] is less than apparent, i.e., where exports are allegedly foregone not because of the [WTO-inconsistent measure] but due to other circumstances." Arbitration Award in *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 ("*EC – Hormones*"), para. 41.

[9] *See, e.g.,* Written Submission of Chile, paras. 11 and 12; *see also* Requesting Parties' Second Set of Replies, paras. 13 and 14; *and* Written Submission of Brazil, the European Communities, India, Japan, Korea and Mexico, para. 48. The United States has commented on some aspects of this argument before; *see, e.g.,* U.S. Comments on Answers of Requesting Parties, May 4, 2004, n. 8.

The United States also wishes to note that the Requesting Parties acknowledge the import ban in *EC – Hormones* and the import regimes in *EC – Bananas* could also have effects on other countries' markets, but argue this effect "could only be indirect and therefore too uncertain and remote to qualify as nullification or impairment." Requesting Parties' Second Set of Replies, para. 13. It is not clear why the Requesting Parties consider the third-country effects in *EC – Bananas* and *EC – Hormones* as "indirect" but claim that the CDSOA has "direct" effects in these markets.

9. Contrary to the approach taken by the Requesting Parties, one should determine the level of nullification or impairment not by developing an artificial classification of various types of measures, but by examining the WTO provision with which the measure was found to be inconsistent. As we explained in our Written Submission:

> It is the WTO-inconsistency of the measure, rather than the measure itself, that forms the basis for a claim of nullification or impairment. In determining the trade that would flow were the measure to be brought into compliance with the WTO ruling, it is necessary to focus on the provisions with which that measure was found to be inconsistent. Only benefits that can reasonably be expected to accrue to the requesting party under the provision violated may serve as a basis for authorization to suspend concessions.[10]

10. The CDSOA was found to be a non-permissible specific action against dumped or subsidized imports into the United States. The level of nullification or impairment must be based on that finding, not on a self-serving classification of measures that in no way relates to the underlying obligation or breach.[11]

11. The Requesting Parties apparently are attempting to draw the Arbitrators away from this fundamental point by looking, oddly enough, at provisions that either (in the case of prohibited subsidies) no one has ever claimed were involved in these disputes or that (in the case of actionable subsidies) the DSB concluded were not infringed by this measure. This was particularly clear when Chile, after identifying the CDSOA as a measure on "rules," stated that Article 4.10 of the *Agreement on Subsidies and Countervailing Measures* ("*SCM Agreement*") –

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[10] U.S. Written Submission at para. 39 (emphasis added). The Requesting Parties have not contested this fact at any stage in these proceedings.

[11] We made this point more than a month ago, after the Requesting Parties first argued that the CDSOA affects trade "worldwide". *See* U.S. Comments on Answers of Requesting Parties, May 4, 2004, para. 32. Unfortunately, however, the Requesting Parties ignored the point in their latest submission.

which applies exclusively to prohibited subsidies – "relate[s] to rules measures".[12] But the intent is also clear in their recent replies, when they argue that "CDSOA payments provide an undue competitive advantage to US products wherever they are sold and has direct trade effects *in all markets in which they compete*."[13]

12. As the United States has repeatedly noted, the CDSOA is neither a prohibited nor even an actionable subsidy. Indeed, no WTO Member has ever claimed that the CDSOA is a prohibited subsidy, and the DSB found that the CDSOA is not an actionable subsidy either. The desires of the requesting parties should not replace the findings of the DSB. The Arbitrators should determine the level of nullification or impairment based on the findings of the DSB that the CDSOA is a non-permissible specific action against the dumping or subsidization of imports into the United States.

Production Data from USITC Investigations Provide a Reliable Estimate of Trade Effects

13. As we have stated before, there is no need to use an economic model to calculate the trade effect of the CDSOA because there is no reason to believe that offset payments have any effect on production or trade. However, if the Arbitrators believe it is necessary to rely on an economic model, we have provided the Arbitrators with a product- and country-specific model. And, contrary to the views of the Requesting Parties, the production data that is included in that

[12] *See* Written Submission of Chile, paras. 11 and 12.

[13] Requesting Parties' Second Set of Replies, para. 14 (emphasis in original).

model is not "too old" to employ with confidence for estimation of the trade effects of CDSOA payments.[14]

14. In most cases, the United States based its estimates of U.S. production (or U.S. shipments) of each product on data from 2002, the most recent year for which data are available. While production may have varied slightly from that figure in 2001 and in 2003, the difference is unlikely to have a significant effect on the estimate of trade effects. Consider, for example, the estimated trade effects under the model associated with ball bearings from Japan in 2001. In that year, U.S. shipments totaled $1,691.1 million and U.S. exports were $161.8 million. In 2002, U.S. shipments increased to $1,725.3 million, while U.S. exports dropped to $148.8 million. If one were to replace the 2001 production figures with 2002 figures (while holding all other variables in the 2001 model constant), one would find that a $34.2 million increase in U.S. shipments results in just a $13,137 decline in the estimate of the effect on trade for 2001.[15]

15. The Arbitrators have product-specific, publicly available, and current data on (1) the amount of CDSOA offset payments that affect production for each year of the 2001-2003 period, (2) the amount of imports for each year of the 2001-2003 period; (3) elasticities of demand,

[14] There appears to be no dispute that the other data used in the model (relating to the amount of the disbursements affecting production, the amount of imports, and the various elasticities) are publicly available and either current (through 2003) or not time-sensitive (in the case of elasticities, as the Requesting Parties have explained in response to Question 3).

[15] Moreover, as the United States recovers from an economic downturn, U.S. production for the various products subject to antidumping and countervailing duty orders is likely to increase, lowering the impact on each Requesting Party. This means that the use of 2002 production data in the model is likely to exaggerate each Requesting Party's level of nullification or impairment. U.S. real GDP increased by 3.1 percent in 2003, and increased at an annual rate of 4.4 percent in the first quarter of 2004.

supply, and substitution; and (4) fairly precise estimates of annual production, generally based on 2002 data.

Question 2

16. In Question 2, the Arbitrators asked the parties to "[a]ssume that, instead of using all of the CDSOA benefits to finance price reductions (as per the Requesting Parties' assumption of 100 per cent pass-through) ..., the recipients used the funds in a variety of ways with differing effects on price." The Requesting Parties ignore the question and simply and repeatedly state that "the only appropriate assumption is that all CDSOA benefits are used to finance price reductions".[16]

17. The Requesting Parties also misinterpret the findings of the Panel in these disputes. In support of its "assumption of 100% pass-through", the Requesting Parties recall that the Panel found that "most or many" of the affected domestic producers will use the payments to address the injury caused by dumped imports "in one way or another."[17] The United States does not believe a use of payments by "most or many" producers "in one way or another" is in any way consistent with an assumption of "100% pass-through."[18]

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[16] Requesting Parties' Second Set of Replies, para. 22 (emphasis added).

[17] Requesting Parties' Second Set of Replies, para. 21 (quoting Panel Report in *United States – CDSOA*, para. 7.37) and 23.

[18] We also note that, even if one were to (incorrectly) assume 100 percent pass-through, that assumption could not be applied to payments received by Ingersoll-Rand and Green Tree Chemical Technologies because neither of those companies produces the products for which it received CDSOA offset payments. *See* U.S. Written Submission, paras. 71-72. In other words, an assumption of 100 percent pass-through cannot withstand the fact that no offset payments affected production of the relevant products in these cases.

18. Finally, the Requesting Parties state that, "[i]f CDSOA payment[s] were not used for the benefit of the subject products, the CDSOA could not achieve its stated purpose: to offset continued dumping and subsidization."[19] The point of this statement is rather opaque; among other things, the issue before the Arbitrators is what are the actual trade effects of the measure in question, not whether the measure has been effective in achieving whatever its stated objectives were. In any case, however, there is in fact no reason to believe the CDSOA is effective. As we explained in our first set of replies, if the purpose of the CDSOA were to ensure that prices "return to fair levels," as the Requesting Parties argued in the underlying disputes, that objective has not been fulfilled.[20] Foreign producers and exporters continue both to dump their products and to sell subsidized products in the U.S. market.

Question 3

19. The United States and the Requesting Parties agree that there is no reason to believe that substitution elasticities are "time variant".[21] Thus, based on the replies to Questions 1 and 3, the parties agree that substitution elasticities need to be product-specific and that elasticities calculated several years ago are still relevant today. As a result, USITC investigations provide the most reliable source for those elasticities.

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[19] Requesting Parties' Second Set of Replies, para. 18.

[20] *See* U.S. Replies to Arbitrators' Questions, April 28, 2004, para. 32.

[21] Requesting Parties' Second Set of Replies, para. 24.

Question 4

20. When asked whether the Arbitrators could use the economic model previously submitted by seven of the Requesting Parties to calculate the trade effects of the CDSOA, the Requesting Parties can claim nothing more than that the model they submitted "provides an approximate order of magnitude" for the domestic trade effect.[22] And even that modest claim is questionable, as it is premised on the unproven assumption that "various omitted factors tend to be offsetting".[23] Moreover, the model does not even produce an individual level of nullification or impairment for each Requesting Party. This hardly provides the Arbitrators with what they need to apply the exacting standard of "equivalence" under Article 22.6 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes*.[24]

21. After providing a lukewarm defense of their model, the Requesting Parties repeat their well-worn argument that the appropriate calculation of the level of nullification or impairment "is one based on the level of disbursements paid under the Act".[25] They contend, yet again, that these disbursements represent "credible, factual and verifiable information".

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[22] Requesting Parties' Second Set of Replies, para. 26.

[23] Requesting Parties' Second Set of Replies, para. 26.

[24] *See* Arbitration Award in *European Communities – Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU (United States)*, WT/DS27/ARB, April 9, 1999, para. 4.1 ("[T]he ordinary meaning of the word "*equivalence*" is "equal in value, significance or meaning", "having the same effect", "Having the same relative position or function", "corresponding to", "something equal in value or worth", also "something tantamount or virtually identical.").

[25] Requesting Parties' Second Set of Replies, para. 27.

22. That the amount of the payments is a verifiable fact does not mean that this amount is equivalent to the level of nullification or impairment. By such logic, the level of nullification or impairment could just as easily be the price of a single cup of coffee in the WTO coffee shop.

Question 5

23. The United States wishes to reply to statements made by the Requesting Parties regarding (1) a three-year period of investigation for the CDSOA, (2) the unpredictability of CDSOA offset payments, (3) the unpredictability of the economy, (4) the likelihood of significant variations in future CDSOA offset payments, and (5) the cash deposits that have been collected on softwood lumber from Canada.

The Three-Year Period of Investigation

24. According to the Requesting Parties, the Arbitrators could not use the data on CDSOA disbursements for 2001-2003 to predict the future value and industrial distribution of such disbursements because data for 2001 – 2003 are "far too limited a sample to provide the basis for any time series analysis". In fact, however, the arbitrator expressed no reservation in using a three-year investigation period in *United States – Section 110(5) of the Copyright Act.*[26] Indeed, that arbitrator noted "that under GATT practice the most recent three-year period not distorted by restrictions has been used in assessing the consistency of a measure."[27]

[26] Arbitration Award in *United States – Section 110(5) of the U.S. Copyright Act – Recourse to Arbitration under Article 25 of the DSU*, WT/DS160/ARB25/1, 9 November 2001, para. 4.45.

[27] Arbitration Award in *United States – Section 110(5) of the U.S. Copyright Act – Recourse to Arbitration under Article 25 of the DSU*, WT/DS160/ARB25/1, 9 November 2001, para. 4.45.

The Unpredictability of CDSOA Offset Payments

25. The Requesting Parties admit that "[t]here is no way to predict the relative size of payments to new entrants into the [CDSOA] program versus those exiting. Nor is there any general way to predict the changes from year to year in the volume of duties collected and disbursed due to normal fluctuations in trade flows and changing behaviour of companies subject to duty who may price up to avoid paying, etc."[28]

26. As we stated in our written submission, this unpredictability makes it exceedingly difficult for affected domestic producers to plan their business activities.[29] As a result, the offset payments cannot be expected to have any significant impact on their investment or production decisions. This is similar to a zero pass-through situation the Requesting Parties described: "a one-time lump sum payment (or tax) expands (reduces) the wealth of the firm but does not change the relationship between the marginal cost of producing the next item and the marginal revenue from selling that unit. Accordingly, its profit maximizing quantity of production is not affected."[30]

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[28] Requesting Parties' Second Set of Replies, para. 29.

[29] U.S. Written Submission, paras. 69-70.

[30] Answers of Brazil, Canada, the European Communities, India, Japan, Korea and Mexico to the Questions of the Arbitrator, April 28, 2004, para. 22.

The Unpredictability of the Economy

27. The Requesting Parties argue that "[t]he cyclical nature of demand of many of the affected products and ... a host of internal and external economic variables rule out the use of prior years' payments to forecast future payments."[31] But, of course, these facts are present in all Article 22.6 arbitrations, and have never prevented an arbitrator from basing its determination on historical data. The demand for many products – including bananas, beef, and music – is cyclical in nature, and imports of these products are always affected by "internal and external economic variables" that cannot be attributed to the WTO-inconsistency of the measure.

Variations in CDSOA Offset Payments

28. The Requesting Parties state that "[f]orecasts by US authorities confirm that huge variations [in the total annual value of CDSOA offset payments] will continue to occur in the future."[32] In support of this statement, the Parties cite a report by the Congressional Budget Office ("CBO"). In fact, however, the CBO estimates that the amount of total offset payments will remain perfectly constant from 2004 to 2014, with the exception of just one year.[33]

[31] Requesting Parties' Second Set of Replies, paras. 28 and 30.

[32] Requesting Parties' Second Set of Replies, para. 31.

[33] *See* Exhibit RP-4, p. 4.

Cash Deposits on Softwood Lumber from Canada

29. The Requesting Parties[34] mistakenly equate the amount of cash deposits collected in connection with softwood lumber from Canada with the amount of monies that are likely to be distributed in future years. There is simply no basis upon which to assume that all or even most of the cash deposits collected in connection with these orders will ultimately be liquidated and distributed to the domestic industry. No definite relationship exists between amounts deposited and any antidumping or countervailing duties ultimately assessed. The first administrative reviews of these orders have not been completed and will likely result in a determination that the rate of dumping or subsidization decreased after the conclusion of the investigation. Indeed, the preliminary determinations, released on June 3, 2004, reflect this likelihood. The preliminary result of the first countervailing duty administrative review is a country-wide rate of 9.24% – less than half the 18.79% rate determined during the investigation.[35] Likewise, the preliminary determination in the first administrative review of the antidumping duty order shows margins of 1.08% to 10.21%, with an all-others rate of 3.98%.[36] The original investigation resulted in rates ranging from 2.18% to 12.44%, with an all-others rate of 8.43%.[37] If these rates are indicative of the rates that will prevail in the final determination, a substantial amount of the cash deposits that have been collected will not be distributed to domestic producers through the CDSOA, but will

[34] The United States notes that a discussion of the treatment of cash deposits on softwood lumber from Canada should only be held within the arbitration between Canada and the United States. The issue is not relevant to the other Requesting Parties.

[35] *See* 69 Fed. Reg. 33204 (June 14, 2004); *and* 67 Fed. Reg. 36070 (May 22, 2002).

[36] *See* 69 Fed. Reg. 33235 (June 14, 2004).

[37] *See* 67 Fed. Reg. 36068 (May 22, 2002).

instead be returned to the importers that posted them, with interest. Thus, basing estimates of the amount of money that may potentially flow to domestic producers through CDSOA on the cash deposits collected by Customs would be too speculative, and the Arbitrator should avoid such speculation.

30. It must also be recalled that the amounts of duty calculated in these administrative reviews are subject to challenge under the North American Free Trade Agreement ("NAFTA"). Any such challenge could take several years and may result in further decreases in the amount of duty owed.

31. As the above considerations make clear, actual evidence based on recent experience – rather than predictions and speculation about what the future may hold – provides a better approach for measuring the effect of the WTO-inconsistency of the CDSOA as such.