

**UNITED STATES – TAX TREATMENT FOR "FOREIGN SALES
CORPORATIONS"**

**Recourse to Arbitration by the United States
under Article 22.6 of the *DSU*
and Article 4.11 of the *SCM Agreement***

DECISION OF THE ARBITRATOR

The decision of the Arbitrator on *United States – Tax Treatment for "Foreign Sales Corporations"* is being circulated to all Members, pursuant to the *DSU*. The report is being circulated as an unrestricted document from 30 August 2002 pursuant to the Procedures for the Circulation and Derestriction of WTO Documents (WT/L/452).

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I. INTRODUCTION

A. INITIAL PROCEEDINGS

1.1 On 20 March 2000, the Dispute Settlement Body (DSB) adopted the Panel and Appellate Body reports in this dispute. The DSB recommended, in particular, that the United States bring into conformity the measures found to be inconsistent with its obligations under the *Agreement on Subsidies and Countervailing Measures (SCM Agreement)* and the *Agreement on Agriculture* and that the United States withdraw the FSC subsidies "at the latest with effect from 1 October 2000".¹ On 12 October 2000, the DSB agreed² to accede to a request by the United States that the DSB modify the time-period in this dispute so as to expire on 1 November 2000.³ On 15 November 2000, the President of the United States signed into law an Act of the United States Congress entitled the "*FSC Repeal and Extraterritorial Income Exclusion Act of 2000*"⁴ (the "ETI Act"). With the enactment of this legislation, the United States considered that it had implemented the DSB's recommendations and rulings in the dispute and that the legislation was consistent with the United States' WTO obligations.⁵

1.2 On 17 November 2000 the European Communities had recourse to Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "*DSU*"), considering that the United States had failed to withdraw the subsidies as required by Article 4.7 of the *SCM Agreement* and had thus failed to comply with the DSB recommendations and rulings. The Panel established under Article 21.5 of the *DSU* (the "Compliance Panel") found the ETI Act to be in violation of United States obligations under the *SCM Agreement*, the *Agreement on Agriculture* and Article III:4 of the *GATT 1994*. The Appellate Body upheld these conclusions. The reports of the Compliance Panel and the Appellate Body were adopted by the DSB on 29 January 2002.

B. REQUEST FOR ARBITRATION AND SELECTION OF THE ARBITRATOR

1.3 On 2 October 2000, the parties informed the DSB of their Understanding on "Agreed Procedures under Articles 21 and 22 of the Dispute Settlement Understanding (*DSU*) and Article 4 of the *SCM Agreement* applicable in the follow-up to the *United States – Tax Treatment for 'Foreign Sales Corporations'* dispute", concluded between the parties on 29 September 2000.⁶ The agreed procedures in this Understanding foresaw that, if the European Communities considered that the situation described in Article 21.5 of the *DSU* existed and initiated consultations under that provision, it could request authorization to suspend concessions or other obligations pursuant to Article 22.2 of the *DSU* and to adopt countermeasures pursuant to Article 4.10 of the *SCM Agreement*.⁷ It was also agreed that, "[u]nder Article 22.6 of the *DSU* including Article 4.11 of the *SCM Agreement* [(sic)]", the United States would object to the appropriateness of the countermeasures and/or the level of suspension of concessions or other obligations and/or make an Article 22.3 claim, before the date of the DSB meeting considering the European Communities request, and that the matter would be referred to arbitration pursuant to Article 22.6 of the *DSU*.⁸ It was also agreed that where the European Communities requested the establishment of a compliance panel, both parties would request

¹ Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations"* ("US – FSC") WT/DS108/R, adopted 20 March 2000 as modified by original Appellate Body Report, WT/DS108/AB/R, DSR 2000:IV, 1677, para. 8.8

² See Minutes of the DSB meeting held on 12 October 2000, WT/DSB/M/90, paras. 6-7.

³ WT/DS108/11, 2 October 2000.

⁴ United States Public Law 106-519, 114 Stat. 2423 (2000), submitted as Exhibit EC-5; Exhibit US-1. in the Article 21.5 Compliance Panel proceedings.

⁵ Minutes of the DSB meeting held on 17 November 2000, WT/DSB/M/92, para. 143.

⁶ Circulated as document WT/DS108/12, 5 October 2000.

⁷ *Ibid.*, para. 8.

⁸ *Ibid.*, para. 10.

the arbitrator to suspend his work until either: (a) adoption of the Article 21.5 compliance panel report or, (b) if there was an appeal, adoption of the Appellate Body report.⁹

1.4 On 17 November 2000, the European Communities requested authorization from the DSB to take appropriate countermeasures and to suspend concessions pursuant to Article 4.10 of the *SCM Agreement* and Article 22.2 of the *DSU* in the amount of US\$4,043 million per year. On 27 November 2000, the United States objected to the appropriateness of the countermeasures proposed by the European Communities and the level of suspension of concessions proposed by the European Communities and requested that, "as required by Article 22.6 of the *DSU* (and consequently Article 4.11 of the *SCM Agreement*), 'the matter be referred to arbitration'".¹⁰

1.5 At the meeting of the DSB on 28 November 2000, it was agreed that the matter raised by the United States in document WT/DS108/15 be referred to arbitration as required by Article 22.6 of the *DSU* and Article 4.11 of the *SCM Agreement*.¹¹ In the light of the establishment of a compliance panel under Article 21.5 and in accordance with the Procedures agreed between the European Communities and the United States, the European Communities and the United States requested the Arbitrator to suspend the arbitration proceeding until adoption of the Panel Report or, if there was an appeal, adoption of the Appellate Body Report.¹²

1.6 The panel and Appellate Body reports under Article 21.5 of the *DSU* were adopted by the DSB on 29 January 2002 and, in accordance with the parties' understanding referred to in paragraph 1.3 above, the Arbitrator then resumed its work.

1.7 The Arbitration was carried out by the original panel, namely:

Chairman: Mr. Crawford Falconer
Members: Mr. Didier Chambovey
Prof. Seung Wha Chang.

II. PRELIMINARY ISSUES

A. MANDATE OF THE ARBITRATOR

2.1 The United States has initiated these proceedings pursuant to Article 22.6 of the *DSU* and Article 4.11 of the *SCM Agreement*. Article 22.6 of the *DSU* provides in relevant part:

"When the situation described in paragraph 2 occurs, the DSB, upon request, shall grant authorization to suspend concessions or other obligations within 30 days of the expiry of the reasonable period of time unless the DSB decides by consensus to reject the request. However, if the Member concerned objects to the level of suspension proposed, (...) the matter shall be referred to arbitration. (...)"

2.2 With regard to countermeasures taken in response to violations of Article 3.1 of the *SCM Agreement* on prohibited subsidies, however, Article 4.11 of that Agreement provides the following mandate for arbitrators:

⁹ WT/DS108/12, para. 11.

¹⁰ See WT/DS108/15.

¹¹ See WT/DS108/17.

¹² See WT/DS108/18.

"In the event a party to the dispute requests arbitration under paragraph 6 of Article 22 of the Dispute Settlement Understanding (*DSU*), the arbitrator shall determine whether the countermeasures are appropriate."¹⁰

(*original footnote*)¹⁰ This expression is not meant to allow countermeasures that would be disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited.

2.3 With regard to any amount of suspension of concessions that would be requested in relation to a violation of Article III:4 of the *GATT 1994* or of the *Agreement on Agriculture*, our mandate is defined by Article 22.7 of the *DSU*, which provides in relevant part that:

"The arbitrator acting pursuant to paragraph 6 shall not examine the nature of the concessions or other obligations to be suspended but shall determine whether the level of such suspension is equivalent to the level of nullification or impairment ..."

2.4 The United States argues both that the amount of suspension of concessions requested by the European Communities is inconsistent with Article 4.10 of the *SCM Agreement* in that the countermeasures proposed are not "appropriate" within the meaning of that provision, and that the level of suspension of concessions requested by the European Communities is inconsistent with the provisions of Article 22.4 in that it is not "equivalent to the level of nullification or impairment" suffered by the European Communities.

2.5 The European Communities clarified, in the course of the proceedings, that it based its request for authorization for countermeasures in the amount of US\$4,043 million on both the *SCM Agreement* and *DSU* provisions. If we should decide that the appropriate amount of compensation under Article 4.11 of the *SCM Agreement* is less than the requested amount, then the European Communities is of the view that it will be necessary for us to consider whether an additional amount of suspension of concessions needs to be awarded under Article 22.7 of the *DSU*, in particular with regard to the violation of Article III:4 of *GATT 1994*.¹³ Therefore, we decide to first examine whether the European Communities's proposed countermeasures are appropriate within the meaning of Article 4.10 of the *SCM Agreement*. Then, if necessary, we shall proceed to examine whether the level of the European Communities requested suspension of concessions is inconsistent with Article 22.4 of the *DSU*.

2.6 We also recall the terms of Article 30 of the *SCM Agreement*, which clarifies that the provisions of the *DSU* are applicable to proceedings concerning measures covered by the *SCM Agreement*. Article 22.6 of the *DSU* therefore remains relevant to arbitral proceedings under Article 4.11 of the *SCM Agreement*, as illustrated by the textual reference made to Article 22.6 of the *DSU* in that provision. However, the special or additional rules and procedures of the *SCM Agreement*, including Articles 4.10 and 4.11, would prevail to the extent of any difference between them.¹⁴

2.7 Finally, we note that there is no dispute on the *type* of measure proposed in this case. Our mandate under Article 4.11 of the *SCM Agreement* in relation to the violation of Article 3 of that Agreement is therefore only to determine whether the *level* of countermeasures proposed is appropriate.

¹³ EC response to question 2 of the Arbitrator.

¹⁴ On the notion of "difference", see Report of the Appellate Body on *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico* ("*Guatemala – Cement I*"), WT/DS60/AB/R, adopted 25 November 1998, DSR 1998:IX, paras. 65 and 66.

B. BURDEN OF PROOF

2.8 Both parties agree that the United States, as the applicant in this case, bears the burden of proving its assertions that the requested level of suspension of concessions is not an appropriate countermeasure within the meaning of Article 4.11 of the *SCM Agreement* and is not equivalent to the level of nullification or impairment to the European Communities within the meaning of Article 22.4 of the *DSU*.¹⁵

2.9 The United States, however, disputes the European Communities' description of the duties of the United States in these proceedings, to the extent that it suggests that the United States bears the burden of disproving every factual assertion made by the European Communities.¹⁶

2.10 We recall that the general principles applicable to burden of proof, as stated by the Appellate Body, require that a party claiming a violation of a provision of the *WTO Agreement* by another Member must assert and prove its claim.¹⁷ We find these principles to be also of relevance to arbitration proceedings under Article 22.6 of the *DSU* and Article 4.10 of the *SCM Agreement*.¹⁸ In this procedure, we thus agree that it is for the United States, which has challenged the consistency of the European Communities proposed amount of suspension of concessions under Articles 4.10 of the *SCM Agreement* and 22.4 of the *DSU*, to bear the burden of proving that the proposed amount is not consistent with these provisions.

2.11 We also note, however, that it is generally for each party asserting a fact, whether complainant or respondent, to provide proof thereof.¹⁹ In this respect, therefore, it is also for the European Communities to provide evidence for the facts which it asserts. In addition, we consider that both parties generally have a duty to cooperate in the proceedings in order to assist us in fulfilling our mandate, through the provision of relevant information.²⁰

C. RELEVANT MEASURE AND DATE FOR CALCULATIONS

2.12 We note that the time-period within which the United States was to have withdrawn the prohibited FSC subsidy in this dispute originally terminated on 1 October 2000.²¹ We also recall that the DSB acceded to the United States request that the DSB modify the time-period in this dispute so as to expire on 1 November 2000.²² We further note that the United States enacted the ETI Act on 15 November 2000. It was the ETI Act which was reviewed by the Compliance Panel and, on appeal, by the Appellate Body, under Article 21.5 of the *DSU*.

¹⁵ EC first submission, para. 6 and US first submission para. 27.

¹⁶ US first submission, para. 27.

¹⁷ Report of the Appellate Body, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India* ("US – Wool Shirts and Blouses"), WT/DS33/AB/R, adopted 23 May 1997, DSR 1997:I, 323, at 337.

¹⁸ For previous application of these rules in arbitration proceedings under Article 22.6 of the *DSU*, see Decision by the Arbitrators, *European Communities – Measures Concerning Meat and Meat Products (Hormones) – Original Complaint by Canada – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU* ("EC – Hormones (Canada) (Article 22.6 – EC)", WT/DS48/ARB, 12 July 1998 DSR 1999:III, 1135, paras. 8 ff. For an application in the context of Article 4.10 of the *SCM Agreement*, see Decision by the Arbitrators, *Brazil – Export Financing Programme for Aircraft – Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, (*Brazil – Aircraft*, (Article 22.6 –Brazil)) WT/46/ARB, 28 August 2000, paras. 2.8 ff.

¹⁹ Report of the Appellate Body, *US – Wool Shirts and Blouses*, p. 14.

²⁰ Report of the Appellate Body, *Canada – Measures Affecting the Export of Civilian Aircraft* ("*Canada – Aircraft*"), WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, para. 190.

²¹ WT/DS108/11.

²² *Ibid.*

2.13 The parties to this dispute agree that the ETI Act, as the implementing measure found to be inconsistent with the United States' obligations under the *WTO Agreement*, is the relevant measure to consider. We agree that this should be the relevant measure to take into account for the purposes of our examination.²³

2.14 However, in using the ETI Act as the relevant measure, we have to address two main questions:

- (a) The first one is the date on which we should assess the appropriateness of the countermeasures proposed by the European Communities. We note that the United States was required to withdraw the subsidy by 1 November 2000, and that the ETI was enacted on 15 November 2000. We also recall: (i) that the European Communities had recourse to Article 4.10 of the *SCM Agreement* and Article 22.2 of the *DSU* on 17 November 2000²⁴; (ii) that the DSB agreed that the matter was referred to arbitration on the basis of the United States' request pursuant to Article 22.6 of the *DSU* and 4.11 of the *SCM Agreement* on 28 November 2000; and (iii) that this arbitration was *suspended* on 21 December 2000, pending the conclusion of the proceedings initiated under Article 21.5 of the *DSU*.

We recall that in past arbitrations, arbitrators have referred to the date on which the implementation period expired, as the date on which to assess whether the proposed suspensions of concessions or other obligations were equivalent to the level of nullification or impairment or constituted appropriate countermeasures.²⁵ Since this arbitration was *suspended* pending the completion of the Article 21.5 *DSU* proceedings, we should give the term "suspension" its full legal meaning and consider that the European Communities proposed countermeasures should be assessed as of the date of expiry of the implementation period.²⁶

- (b) Secondly, we must take into account certain considerations in our assessment of the data before us, in particular, the extent to which we may rely on estimates of economic figures based on the pre-ETI FSC scheme. We considered whether we needed to adjust such figures to account for the entry into force and application of the ETI Act.²⁷ We took into account the following factors:
 - (i) First, we note that the actual application of the ETI Act to date has been limited. It was enacted in November 2000 and, pursuant to its own terms, in the case of FSCs already in existence on 30 September 2000, the ETI Act did

²³ We recall that, in *EC – Bananas III*, the arbitrators considered that the level of proposed suspension of concessions had to be assessed in relation to the measure taken in order to comply with the recommendations and rulings of the DSB, rather than the original measure. See WT/DS27/ARB, para. 4.3: "In the original *Bananas III* dispute, the findings of nullification and impairment were based on the conclusion that several parts of the EC measures at issue were inconsistent with its WTO obligations. Therefore, any assessment of the level of nullification or impairment presupposes an evaluation of consistency or inconsistency with WTO rules of the implementation measures taken by the European Communities, i.e. the revised banana regime, in relation to the panel and Appellate Body findings concerning the previous regime."

²⁴ WT/DS108/13.

²⁵ Decision by the Arbitrator, *EC – Hormones*, WT/DS48/ARB, paras. 38 to 42 and Decision of the Arbitrator, *Brazil – Aircraft*, WT/DS46/ARB, para. 3.66.

²⁶ We note that the arbitrator in *Brazil – Aircraft* based its calculations on the number of deliveries and sales that took place between the end of the period of implementation and the latest period for which figures were available (18 November 1999-30 June 2000). However, this solution was based on the particular circumstances of the case, where the amount of subsidy granted was specifically related to the delivery of aircraft after the end of the reasonable period of time.

²⁷ See Annex 1, "shift to the ETI Act".

not apply to transactions occurring before 1 January 2002. Furthermore, for FSCs already in existence on 30 September 2000, the FSC subsidies continued in operation for one year and, with respect to FSCs that entered into long-term binding contracts with unrelated parties before 30 September 2000, the ETI Act did not alter the tax treatment of those contracts for an indefinite period of time. Some aspects of the FSC regime are actually "grandfathered", in some cases indefinitely.²⁸

- (ii) Second, we noted that the United States suggested that the transitional provisions of the ETI Act mentioned above could be ignored for purposes of estimating the amount of the subsidy and the trade effect or trade impact. Both parties agreed that the amount of benefit to the taxpayer was the same under both the ETI and the FSC regimes.²⁹
- (iii) The United States agreed with the European Communities that an upward adjustment should be made to the amount of the subsidy to account for the additional product coverage in the ETI Act, as compared to the initial FSC scheme.³⁰

2.15 We therefore decided to assess the proposed suspension of concessions at the time the United States should have withdrawn the prohibited subsidy at issue, in 2000. We consider it relevant, in light of the nature of the countermeasures proposed by the European Communities, to calculate the appropriate countermeasures on a yearly basis. We thus decided to include the whole of the year 2000 in our assessment, taking into account an adjustment for the shift to the ETI Act.

III. SUMMARY OF MAIN ARGUMENTS

3.1 The **United States** has argued that the amount of countermeasures proposed by the European Communities is not appropriate because it is disproportionate to the trade impact of the inconsistent measure on the European Communities.³¹ It interprets Article 4.10 of the *SCM Agreement* as requiring countermeasures not to be disproportionate to the trade impact of the violating measure on the complaining Member.³² It also considers that, in this instance, the amount of the subsidy can and should be used as a "proxy" for the trade impact of the measure.³³ The United States estimated the total value of the subsidy at US\$4,125 million for the year 2000³⁴, and suggested that, allocating to the European Communities its share of that amount, countermeasures in a maximum amount of US\$1,110 million would be appropriate.³⁵ It further encouraged the arbitrators to refrain from using economic modelling in the circumstances of this case, because of the range of uncertainties of the measurements and the range of possible "reasonable" outcomes under economic modelling. However, in response to questioning, the United States has also indicated that, were we to pursue economic modelling, certain considerations would have to be taken into account.

²⁸ We recall, in particular, that the ETI act's provisions "grandfathering" the FSC subsidies were part of the subject of examination in the compliance proceedings.

²⁹ EC answers to additional questions from the arbitrator, para. 4 and US answers to additional questions, para. 2.

³⁰ US second submission.

³¹ US first submission, para. 15.

³² US first submission, paras. 16 to 57.

³³ US first submission, para. 62.

³⁴ US Exhibit 17.

³⁵ US second submission, para. 4. In its first submission, the United States had initially estimated the actual value of the subsidy at a lower figure. However, it subsequently re-evaluated that amount to take account of certain EC arguments concerning the relevant elements for the calculation. The amount cited here is the US figure for the amount of the subsidy as adjusted to take account of the coverage of the subsidy and the shift to the ETI Act. A more detailed analysis of the relevant factors and figures can be found in Annex 1.

3.2 The **European Communities** has argued that the amount of countermeasures it has proposed corresponds to the value of the subsidy, and that this amount is "appropriate" within the meaning of Article 4.10 of the *SCM Agreement*. In the European Communities view, Article 4.10 of the *SCM Agreement* sets out a unique benchmark for countermeasures in response to violations of a particular provision of the *SCM Agreement* – namely Article 3.³⁶ In the European Communities view, Article 4.10 of the *SCM Agreement* allows for countermeasures which will induce compliance, and in this instance, countermeasures in the amount of the value of the subsidy to be withdrawn are appropriate, although they reflect a conservative approach.

IV. APPROACH OF THE ARBITRATOR

4.1 We recall that Article 4.10 of the *SCM Agreement* provides as follows:

"In the event the recommendation of the DSB is not followed within the time-period specified by the panel, which shall commence from the date of adoption of the panel's report or the Appellate Body's report, the DSB shall grant authorization to the complaining Member to take appropriate⁹ countermeasures, unless the DSB decides by consensus to reject the request."

(*footnote original*) ⁹ This expression is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited.

4.2 In addition, Article 4.11 of the *SCM Agreement* defines our mandate as follows:

"In the event a party to the dispute requests arbitration under paragraph 6 of Article 22 of the Dispute Settlement Understanding ("*DSU*"), the arbitrator shall determine whether the countermeasures are appropriate.¹⁰"

(*footnote original*) ¹⁰ This expression is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited.

4.3 These two provisions complement each other: the arbitrator's mandate in relation to countermeasures concerning prohibited subsidies under Article 4 of the *SCM Agreement* is defined, quite logically, with reference to the notion embodied in the underlying provision in Article 4.10. The expression "appropriate countermeasures" defines what measures can be authorized in case of non-compliance, and our mandate requires us to review whether, in proposing certain measures to take in application of that provision, the prevailing Member has respected the parameters of what is permissible under that provision.

4.4 In doing this, we must aim at determining whether, in this particular case, the countermeasures proposed by the European Communities are "appropriate".

4.5 We recall, in this regard, that the European Communities has proposed a certain amount of countermeasures and explained the rationale for that proposal. The United States, as noted above, is challenging that amount as being disproportionate to the trade impact of the violating measure on the European Communities. We understand the United States argument to be essentially two-fold. The United States seems to argue to the effect that the fundamental test for assessing whether countermeasures are appropriate or not is an "adverse effects" test and that, moreover, this is to be assessed in a manner broadly comparable to that which would occur pursuant to a case of nullification or impairment under Article 22.4 of the *DSU*. This is tantamount to a two-pronged argument: (a) that the European Communities entitlement to respond to the illegal subsidy is limited to the trade effect

³⁶ EC second submission para 22.

on it; and (b) that the mode of calculation is comparable, although not identical in its precision, to an assessment under Article 22.4 of the *DSU*.

4.6 In order to examine the United States challenge, we therefore need to consider first whether indeed, as argued by the United States, countermeasures under Article 4.10 are required to be proportionate, or at least not disproportionate, to the trade impact of the violating measure on the complaining Member. We will then be in a position to assess, in light of our conclusion on that point, whether in the circumstances of this case, the proposed countermeasures are "appropriate" or not.

4.7 We will consider first the expression "appropriate countermeasures" contained in Articles 4.10 and 4.11 of the *SCM Agreement*. In this regard, we note that the scope of application of Article 3.2 of the *DSU* is not limited to panel and Appellate Body proceedings. Accordingly, in assessing the matter before us, we must clarify the relevant provisions, to the extent necessary, in accordance with the customary rules of interpretation of public international law. These rules are reflected in Articles 31, 32 and 33 of the Vienna Convention on the Law of Treaties ("Vienna Convention"). We recall in particular that Article 31.1 requires a treaty to be

"interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."³⁷

4.8 We will therefore consider the terms of Article 4.10 of the *SCM Agreement* in accordance with these rules.

V. THE NOTION OF "APPROPRIATE COUNTERMEASURES" UNDER ARTICLE 4.10 OF THE *SCM AGREEMENT*

5.1 In assessing the validity of the US proposition that countermeasures under Article 4.10 of the *SCM Agreement* should not be disproportionate to the trade impact of the measure on the complaining Member, in this instance the European Communities, we find it useful to consider first the terms of

³⁷ The full text of Article 31 of the Vienna Convention reads as follows:

Article 31

General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

2. The context, for the purpose of the interpretation of a treaty shall comprise, addition to the text, including its preamble and annexes:

- (a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
- (b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account together with the context:

- (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
- (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
- (c) any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.

Article 4.10 in themselves.³⁸ This initial textual analysis will inform the rest of our analysis, where we will address the detail of the US interpretation and, more generally, our understanding of the expression "appropriate countermeasures" in Article 4.10 of the *SCM Agreement*, taken in its context and in light of its object and purpose.

A. TEXT OF THE PROVISION

5.2 We recall again that Article 4.10 of the *SCM Agreement* provides as follows:

"In the event the recommendation of the DSB is not followed within the time-period specified by the Panel, which shall commence from the date of adoption of the panel's report or the Appellate Body's report, the DSB shall grant authorization to the complaining Member to take appropriate⁹ countermeasures, unless the DSB decides by consensus to reject the request".

(*Original footnote*)⁹ This expression is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited.

5.3 This provision thus foresees the authorization of "appropriate countermeasures". We shall consider these terms in turn.

1. "Countermeasures"

5.4 Dictionary definitions of "countermeasure" suggest that a countermeasure is essentially defined by reference to the wrongful action to which it is intended to respond. The New Oxford Dictionary defines "countermeasure" as "an action taken to counteract a danger, threat, etc".³⁹ The meaning of "counteract" is to "hinder or defeat by contrary action; neutralize the action or effect of"⁴⁰. Likewise, the term "counter" used as a prefix is defined *inter alia* as: "opposing, retaliatory"⁴¹. The ordinary meaning of the term thus suggests that a countermeasure bears a relationship with the action to be counteracted, or with its effects (cf. "hinder or defeat by contrary action; neutralize the action or effect of"⁴²).

5.5 In the context of Article 4 of the *SCM Agreement*, the term "countermeasures" is used to define temporary measures which a prevailing Member may be authorized to take in response to a persisting violation of Article 3 of the *SCM Agreement*, pending full compliance with the DSB's recommendations. This use of the term is in line with its ordinary dictionary meaning as described above: these measures are authorized to counteract, in this context, a wrongful action in the form of an export subsidy that is prohibited *per se*, or the effects thereof.

5.6 It would be consistent with a reading of the plain meaning of the concept of countermeasure to say that it can be directed either at countering the measure at issue (in this case, at effectively neutralizing the export subsidy) or at counteracting its effects on the affected party, or both.

5.7 We need, however, to broaden our textual analysis in order to see whether we can find more precision in how countermeasures are to be construed in this context. We thus turn to an examination

³⁸ Our analysis, in this section, of the terms "appropriate countermeasures" as contained in Article 4.10 of the *SCM Agreement* (as informed by footnote 9), should be understood to apply also the same terms as they are contained in Article 4.11 (as informed by footnote 10).

³⁹ The New Shorter Oxford English Dictionary (1993).

⁴⁰ *Ibid.*

⁴¹ Webster's New Encyclopaedic Dictionary (1994).

⁴² The New Shorter Oxford English Dictionary (1993).

of the expression "*appropriate*" countermeasures with a view to clarifying what level of countermeasures may be legitimately authorized.

2. "*Appropriate countermeasures*"

5.8 The term "appropriate" countermeasures in Article 4.10 is informed by footnote 9, which provides guidance as to what the expression "appropriate" should be understood to mean. For the sake of clarity, we will first consider the term "appropriate", and then the terms of the footnote. However, this is with the understanding that these two elements are part of a single assessment and that the meaning of the expression "appropriate countermeasures" should result from a combined examination of these terms of the text in light of its footnote.

5.9 The ordinary dictionary meaning of the term "appropriate" refers to something which is "especially suitable or fitting".⁴³ "Suitable", in turn, can be defined as "fitted for or appropriate to a purpose, occasion ..."⁴⁴ or "adapted to a use or purpose".⁴⁵ "Fitting" can be defined as "of a kind appropriate to the situation".⁴⁶

5.10 As far as the amount or level of countermeasures is concerned, the expression "appropriate" does not in and of itself predefine, much less does it do so in some mathematically exact manner, the precise and exhaustive conditions for the application of countermeasures. That is, in itself, surely significant. There would have been no *a priori* reason why some defined and/or formulaic approach could not have been set down in advance for the application of countermeasures. The terms of the *SCM Agreement* on this point manifestly eschew any such approach. But the provisions actually used do not become any the less meaningful or of lower legal status by reason of that fact. Much less can there be some kind of inherent presumption that they must be contorted to fit some kind of procrustean bed in the proportions of a formula when it is manifestly not present in the text itself.

5.11 It is, after all, scarcely a matter for debate that not all situations can be imagined in advance. But even if one takes the view that, as a consequence, there can be no manual which offers a precise course of action for a given situation, that does not mean that one is completely bereft of guidance or, as the case may be, that there are no bounds set to permissible action. This is clearly enough the situation we are dealing with here, where a Member might find itself resorting to countermeasures. The relevant provisions are not designed to lay down a precise formula or otherwise quantified benchmark or amount of countermeasures which might be legitimately authorized in each and every instance. Rather, the notion of "appropriateness" is used.

5.12 Based on the plain meaning of the word, this means that countermeasures should be adapted to the particular case at hand. The term is consistent with an intent not to prejudge what the circumstances might be in the specific context of dispute settlement in a given case. To that extent, there is an element of flexibility, in the sense that there is thereby an eschewal of any rigid *a priori* quantitative formula. But it is also clear that there is, nevertheless, an objective relationship which must be absolutely respected: the countermeasures must be suitable or fitting by way of response to the case at hand.

5.13 We would underline that the adjective "appropriate" does not, in and of itself, make it clear whether the "countermeasures" at issue become so by reason of whether they are aimed at neutralizing the original wrongful action, its effects, or both. To that extent, we only say, at this point, that the test is in principle permissive of a range of possibilities.

⁴³ Webster's New Encyclopaedic Dictionary (1994).

⁴⁴ The New Shorter Oxford English Dictionary (1993).

⁴⁵ Webster's New Encyclopaedic Dictionary (1994).

⁴⁶ Webster's New Encyclopaedic Dictionary (1994).

5.14 We must turn, therefore, to footnote 9 of the *SCM Agreement* to see whether this is capable of shedding any further light on this matter.

3. Footnote 9 to the *SCM Agreement*

5.15 Footnote 9 of the *SCM Agreement*, which provides the only express indication of what the expression "appropriate countermeasures" encompasses, reads as follows:

"This expression [appropriate] is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited."

5.16 This footnote effectively clarifies further how the term "appropriate" is to be interpreted. We understand it to mean that countermeasures that would be "disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited" could not be considered "appropriate" within the meaning of Article 4.10 of the *SCM Agreement*. We turn to a further examination of these terms.

5.17 The term "disproportionate" can be defined as "lacking proportion, poorly proportioned, out of proportion".⁴⁷ The term "proportion" refers, *inter alia*, to a "comparative relation or ratio between things in size, quantity, numbers" or a "relation between things in nature. etc".⁴⁸ The term "disproportionate" thus suggests a lack of proper or due relationship between two elements.

5.18 Based on the ordinary meaning of the terms, the concept involved is understood well enough in everyday experience. It is a manner of describing relationships adapted to the circumstances, where the instrument of measurement is perception by the naked eye rather than scrutiny under the microscope. It is not meant to entail a mathematically exact equation but soundly enough to respect the relative proportions at issue so that there is no manifest imbalance or incongruity.⁴⁹ In short, there is a requirement to avoid a response that is disproportionate to the initial offence - to maintain a congruent relationship in countering the measure at issue so that the reaction is not excessive in light of the situation to which there is to be a response. But this does not require exact equivalence – the relationship to be respected is precisely that of "proportion" rather than "equivalence".

5.19 We consider therefore that footnote 9 further confirms that, while the notion of "appropriate countermeasures" is intended to ensure sufficient flexibility of response to a particular case, it is a flexibility that is distinctly bounded. Those bounds are set by the relationship of appropriateness. That appropriateness, in turn, entails an avoidance of disproportion between the proposed countermeasures and, as our analysis to this point has brought us, either the actual violating measure itself, the effects thereof on the affected Member, or both.

5.20 We receive, however, rather more specific guidance on these elements in the final part of the footnote, which reads:

"... disproportionate *in light of the fact that the subsidies dealt with under these provisions are prohibited.*" (emphasis added)

5.21 The use of the terms "in light of" directs that the final part of the footnote is a matter that must enter into consideration at all times. It seems reasonable also to conclude that it is not seen to be a

⁴⁷ The New Shorter Oxford English Dictionary (1993). Vol. I, p. 700.

⁴⁸ *Ibid.*

⁴⁹ See, on that issue, the *Case Concerning the Air Services Agreement of 27 March 1946 (United States of America v. France)* (1978) International Law Reports, Vol. 54 (1979), p. 304 (hereafter "*Air Services arbitration*"): "It has been observed, generally, that judging the proportionality of countermeasures is not an easy task and can at best be accomplished by approximation" (at para. 83, p- 338).

minor or insignificant consideration. On the contrary, it is rather to be an element that is to pervade or colour the whole assessment. That, at least, is the only reasonable way to construe viewing something "in light of" something else.

5.22 As we read it, the text refers us unambiguously to the provisions of Part II of the *SCM Agreement* and requires us to ensure that our perspective on countermeasures is invested with and coloured by consideration of the nature and legal status of the particular underlying measure in respect of which the countermeasures are applied. In short, this provides that, when assessing countermeasures under Article 4.10, account must be taken of the fact that the export subsidy at issue is prohibited and has to be withdrawn.

5.23 This emphasis on the unlawful character of export subsidies invites, in our view, a consideration of the impact which this unlawful character may have, in itself. We note in this respect that the maintenance of the unlawful measure by the Member concerned – in violation of its obligations – has, in itself, the effect of upsetting the balance of rights and obligations between the parties, irrespective of what might be, as a matter of fact, the actual trade effects on the complainant. We recall, in this regard, that the prohibition on export subsidies is a *per se* obligation, not itself conditioned on a trade effects test. Members are entitled to trade without other Members resorting to export subsidies. In our view, the second part of the footnote directs that this is in itself a required consideration when it comes to assessing whether countermeasures are not disproportionate within the meaning of Article 4.10. Such consideration can only be reasonably construed to be aggravating rather than a mitigating factor, to be duly reflected in our assessment of whether countermeasures are appropriate.⁵⁰ Indeed, it directs us to consider the "appropriateness" of countermeasures under Article 4.10 from this perspective of countering a wrongful act and taking into account its essential nature as an upsetting of the rights and obligations as between Members. This, we conclude, is the manner in which we are directed to assess the matter. We are not, by comparison, actually directed to, e.g., consider demonstrated trade effects of the measure on the complaining Member.

5.24 On the latter point, we would simply note that there has been – and remains – nothing in the text which precludes a Member from applying countermeasures in the sense of measures that are aimed at countering the injury, more narrowly conceived, that it has suffered as a consequence of the wrongful act.⁵¹ However, what this footnote makes clear is that the text cannot be construed to *confine* the appropriateness test to the element of countering the injurious effects on a party, but also, and more importantly, that the entitlement to countermeasures is to be assessed taking into account the legal status of the wrongful act and the manner in which the breach of that obligation has upset the balance of rights and obligations as between Members. It is from that perspective that the judgement as to whether countermeasures are disproportionate is to be made.

5.25 Having considered the express terms of Article 4.10 of the *SCM Agreement*, we therefore note, at this stage of our analysis, that they do not suggest a specific quantum to be respected in each and every case in the determination of an amount of countermeasures which can be authorized under this provision. On the contrary, they direct us to consider whether the countermeasure proposed are in an adequate relation to the situation to be countered, instructing us specifically to consider that the subsidies under Part II of the *SCM Agreement* are prohibited in assessing whether the countermeasures proposed are disproportionate.

⁵⁰ On this point, see WT/DS46/ARB, para. 3.51.

⁵¹ We would only add on this point that, as regards countering any demonstrated effects, the standard of judgement is still that of appropriateness, in the sense of being not disproportionate, by which we take it to mean a judgement that does not require mathematical exactness of equivalence but that of proportionality in the sense of not being manifestly excessive. We see this as consistent with the view of the arbitrator in *Brazil – Aircraft* (footnote 55) to the effect that " 'appropriate' should not be given the same meaning as 'equivalent', but should be understood as giving more discretion in the appraisal of the level of countermeasures against prohibited subsidies".

5.26 It should also be noted that the negative formulation of the requirement under footnote 9 is consistent with a greater degree of latitude than a positive requirement may have entailed: footnote 9 clarifies that Article 4.10 is not intended to allow countermeasures that would be "disproportionate". It does not require strict proportionality.⁵²

5.27 With these observations in mind, we will consider further whether, when reading these terms in their context and in light of their object and purpose, this interpretative approach is confirmed and whether further clarification can be ascertained as to how the "appropriateness" of countermeasures under Article 4.10 should be assessed.

B. CONTEXTUAL ANALYSIS OF ARTICLE 4.10

5.28 We thus turn to an examination of the terms of Article 4.10 of the *SCM Agreement* taken in their context, in order to ascertain further how the notion of "appropriate countermeasures" should be understood. In that regard, we will address the US arguments relating to the role of the trade impact of the measure in assessing whether countermeasures are appropriate under Article 4.10 of the *SCM Agreement*.

5.29 In the view of the United States, "appropriate" countermeasures under Article 4.10 of the *SCM Agreement* must not be disproportionate to the "trade impact" of the measure on the complaining Member. The United States acknowledges that the standard under Article 4.10 – "not ... disproportionate" – is not identical to the standard under Article 22.4 of the *DSU* – equivalence – . However, in its view, the standard under Article 4.10 of the *SCM Agreement* cannot be applied as if it existed in clinical isolation from the *DSU*, and in a manner which is inconsistent with the object and purpose of the *DSU*. The United States argues in particular that in light of Article 22.4 of the *DSU* and Articles 7.9 and 9.4 of the *SCM Agreement*, it would be untenable to interpret Article 4.10 of the *SCM Agreement* as permitting countermeasures that are disproportionate to the trade impact on the

⁵² We note in this regard the view of the commentator, Sir James Crawford, on the relevant Article of the ILC text on State Responsibility, reflected in a resolution adopted on 12 December 2001 by the UN General Assembly (A/RES/56/83), which expresses – but only in positive terms – a requirement of proportionality for countermeasures:

"the positive formulation of the proportionality requirement is adopted in Article 51. A negative formulation might allow too much latitude." (J. Crawford, *The ILC's Articles on State Responsibility, Introduction, Text and Commentaries 2002*, CUP, para. 5 on Article 51).

Article 51 of the ILC Articles on State responsibility (entitled "*Proportionality*") reads as follows:

"countermeasures must be commensurate with the injury suffered, taking into account the gravity of the internationally wrongful act and the rights in question". (emphasis added)

We also note in this respect that, while that provision expressly refers - contrary to footnote 9 of the *SCM Agreement* - to the injury suffered, it also requires the gravity of the wrongful act and the right in question to be taken into account. This has been understood to entail a qualitative element to the assessment, even where commensurateness with the injury suffered is at stake. We note the view of Sir James Crawford on this point in his Commentaries to the ILC Articles :

"Considering the need to ensure that the adoption of countermeasures does not lead to inequitable results, proportionality must be assessed taking into account not only the purely "quantitative" element of the injury suffered, but also "qualitative" factors such as the importance of the interest protected by the rule infringed and the seriousness of the breach. Article 51 relates proportionality primarily to the injury suffered but "taking into account" two further criteria: the gravity of the internationally wrongful act, and the rights in question. The reference to "the rights in question" has a broad meaning, and includes not only the effect of a wrongful act on the injured State but also on the rights of the responsible State. Furthermore, the position of other States which may be affected may also be taken into consideration." (*op. cit.*, para. 6 of the commentaries on Article 51).

complaining Member.⁵³ In the US view, the term "countermeasures" as used in the *SCM Agreement* does not have a special meaning and these countermeasures do not have a unique objective in inducing compliance. Rather, Article 4 of the *SCM Agreement* should be interpreted in light of the objectives of the WTO dispute settlement, including the objective of maintaining a proper balance between the rights of obligations of Members, as foreseen in Article 3.3 of the *DSU*. An assessment of the appropriateness of countermeasures under Article 4.10 by reference to the trade impact of the violating measure on the complaining Member is, in the US view, the only approach that is consistent with the object and purpose of Article 4.10.⁵⁴

5.30 To begin with, we recall that first, we have found not only that, *via* footnote 9, there is an entitlement to take account of the unlawful nature of the initial act which gives rise to the countermeasures, but also that this is the perspective for assessment specifically required for under the *SCM Agreement*. While we do not see the plain language of Article 4.10 as in any way precluding the application of countermeasures aimed at countering the effects of the wrongful act on a Member provided they otherwise satisfy the terms of the *SCM Agreement*, we do not find this to be the necessary standard of assessment laid down in Article 4.10 of the *SCM Agreement*. We saw nothing in the plain language of this text which, on its face, dictates that the term "appropriate countermeasures" must be *limited* in its meaning to "equivalence" or correspondence (or some synonym) with the "trade impact" on the complaining Member.⁵⁵

5.31 We therefore must address the question of whether there is otherwise, in reading the provision in context, some overriding requirement to assess the appropriateness of countermeasures under Article 4.10 from the perspective of demonstrated trade effects on the complaining Member.

1. Article 4.10 in the context of the *SCM Agreement*

5.32 Recourse to countermeasures is foreseen in three provisions of the *SCM Agreement*: Article 4.10, which we are concerned with here, Article 7.9 and Article 9.⁵⁶ As regards actionable subsidies, Article 7.9 provides for authorization of countermeasures "commensurate with the degree and nature of the adverse effects determined to exist...". In a similar vein, Article 9.4 provides, in relation to non-actionable subsidies, for the authorization of countermeasures "commensurate with the nature and degree of the effects determined to exist". The explicit precision of these indications clearly highlights the lack of any analogous explicit textual indication in Article 4.10 and contrasts with the broader and more general test of "appropriateness" found in Articles 4.10 and 4.11.

5.33 In short, as far as prohibited subsidies are concerned, there is no reference whatsoever in remedies foreseen under Article 4 to such concepts as "trade effects", "adverse effects" or "trade impact". Yet, by contrast, such a concept is to be found very clearly in the context of remedies under Article 7, through the notion of "adverse effects".

5.34 We believe that this difference must be given a meaning and that we should give due consideration to the fact that the drafters – who obviously could have used other terms in order to quantify precisely the permissible amount of countermeasures in the context of Article 4.10 – chose

⁵³ See US first submission, paras. 32 ff.

⁵⁴ See US first submission, para. 44.

⁵⁵ The United States acknowledges that Article 4.10 does not require the strict equivalence imposed under Article 22.4 of the *DSU*. Nonetheless, it construes the "appropriateness" of countermeasures under Article 4.10 fundamentally as a "trade effects" test of a nature comparable to that foreseen under Article 22.4. See US answers to questions by the Arbitrator, paras. 4 and 5.

⁵⁶ We are aware of the provisions of Article 31 of the *SCM Agreement* and that Members took no action to extend the application of the provisions of Articles 8 and 9 of the Agreement concerning non-actionable subsidies beyond the period of five years from the date of entry into force of the *WTO Agreement*. However, these provisions can nevertheless be helpful, in our view, in understanding the overall architecture of the Agreement with respect to the different types of subsidies it sought and seeks to address.

not to do so. It is not our task to read into the treaty text words that are not there.⁵⁷ We are also cognizant that the terms that do appear in the text of the treaty must be presumed to have meaning and must be read effectively.⁵⁸ The implications of the use of the term "appropriate" must therefore be acknowledged and we must give this expression in Article 4.10 its full meaning.⁵⁹

5.35 This cannot be viewed as a matter of simple difference in terminology in abstraction from any other consideration. Export subsidies do, after all, have "adverse effects" on third parties. Systemically speaking they are, as a category of subsidy, more inherently prone to do so than any other. Thus, there would have been no inherent reason why the drafters could not have, in relation to export subsidies, provided for disciplines of the type foreseen in Articles 5 and 7 in terms of "adverse effects" and made provision for countermeasures based on the same concept as is applied, e.g., in Article 7. On the contrary, there would have been every reason to treat this category of subsidies in the same way if the guiding intent had been to apply an "adverse effects" test. Yet it was decided not to do so. This, in our view, underlines all the more that this is meaningful and reflective of a rationale. In other words, the distinction cannot be presumed to be arbitrary or casual, much less effectively read out of the text in its entirety.

5.36 We consider that the rationale is not difficult to discern. These different wordings reflect, in our view, the distinct legal nature and treatment under the *SCM Agreement* of various types of subsidies. The fundamental distinction between actionable and prohibited subsidies which underlies the whole structure and logic of the *SCM Agreement* finds expression generally in the differences in the elements defining the applicable obligations and the differences of treatment given to these measures with regard to the remedies available to challenge them.⁶⁰

5.37 The distinction in the terminology relating to countermeasures is, in turn, a corresponding reflection of the distinction when it comes to substantive disciplines for export subsidies: i.e. a clear and unambiguous intent to apply different and more exacting disciplines when it comes to export subsidies viz. a prohibition.

5.38 The underlying rationale for the distinction made is clear enough. The provisions regarding remedies pursuant to Articles 5 and 7 relate to subsidies that are accepted, in themselves, not to be illegal. But, while they are acceptable in themselves, other Members are, nevertheless, entitled to protection from their possible adverse effects. So the basis for actionability of such measures is their

⁵⁷ See for example the reports of the Appellate Body in *India – Quantitative Restrictions*, WT/DS90/AB/R, DSR 1999:IV, 1763, para 94; *EC – Hormones*, WT/DS26/AB/R, and WT/DS48/AB/R, DSR 1998:I, 135, para. 181; *India – Patents (US)*, WT/DS50/AB/R, DSR, 1998:I, 9, para. 45.

⁵⁸ See for example the reports of the Appellate Body on *US – Gasoline*, WT/DS2/AB/R, DSR 1996:I, 3, at 21 and *Korea – Dairy*, WT/DS98/AB/R, DSR 2000:I, 3, para. 81.

⁵⁹ See paras. 4.24-4.26 above.

⁶⁰ With respect to the differences in the elements defining the applicable obligations, we recall that Article 3.1(a) of the *SCM Agreement* – containing the defining elements of prohibited export subsidies -- provides:

"3.1 Except as provided in the *Agreement on Agriculture*, the following subsidies, within the meaning of Article 1, shall be prohibited:

(a) subsidies contingent, in law or in fact⁴, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I⁵;"

(original footnote)⁴This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.

adverse effect on other Members.⁶¹ In the case of a nullification or impairment claim, this adverse effect is defined as that which is "caused to the interests of the Member requesting consultations".⁶²

5.39 This is, of course, quite different from the situation with export subsidies. We see in Article 4 of the *SCM Agreement* that the prohibited nature of export-contingent subsidies has justified more stringent (faster) dispute settlement procedures⁶³ and a clear requirement to withdraw them *without delay*.⁶⁴ More importantly, they are prohibited *per se*. Other Members are not obliged to make a case regarding any adverse effects to successfully challenge such measures. They are required simply to establish the existence of a measure that is, as a matter of principle, expressly prohibited. As an empirical matter they undoubtedly do have adverse effects. But that is not the legal basis upon which action may be taken to challenge them under the *SCM Agreement*.

5.40 This is, in turn, reflected consistently in the provisions addressing remedies. Pursuant to the relevant provisions in Articles 5 and 7, a Member found to be in breach - having granted a subsidy which was not prohibited but has produced demonstrated adverse effects on another Member - has the alternative of withdrawing the measure or removing these adverse effects.⁶⁵ What is important for present purposes is that, by contrast, there is, under Article 4 relating to prohibited export subsidies, no option for an infringing party to simply remove the adverse effects and retain the measure. A Member found to be in breach must withdraw the measure without delay. This contrasts with the remedies in Article 7 of the same Agreement that are available in relation to actionable subsidies. In all provisions relating to prohibited subsidies in Part II of the *SCM Agreement*, the remedies available are stronger and more rapid than those available in Part III of the *SCM Agreement* for actionable subsidies. This is clearly not just a random distinction. It reflects the legal status of a prohibition: if the measure is *per se* prohibited, irrespective of its effects, the only consistent remedy is to withdraw it.⁶⁶

5.41 This reading of the text in its context confirms us in our view that, rather than there being any requirement to confine "appropriate countermeasures" to offsetting the effects of the measure on the relevant Member, there is a clear rationale exhibited that reinforces our textual interpretation that the Member concerned is entitled to take countermeasures that are tailored to neutralizing the offending measure *qua* measure as a wrongful act. The expression "appropriate countermeasures", in our view, would entitle the complaining Member to countermeasures which would at least counter the injurious

⁶¹ Thus, the concept of "adverse effect" is indeed to be found in the *SCM Agreement*, but only in relation to provisions that contrast with the prohibition on export subsidies in Article 4. Article 7 makes it clear that when a member considers that the granting or maintaining of a subsidy results in, *inter alia*, nullification or impairment, the provisions on remedies pursuant to that Article will apply. It should be emphasized that a positive finding of nullification and impairment is, by definition, also a finding of "adverse effects" (this ultimately deriving from the use of i.e. in Article 5 which makes it plain that nullification and impairment is one category of the overarching concept of "adverse effects" under the *SCM Agreement*). It is also to be noted that where a positive finding is made, the party concerned may either "remove the adverse effects of the subsidy" (Article 7.9) or "withdraw the subsidy" (*ibid.*). In a situation where there is non-compliance by the party against whom a finding has been made, the complaining Member is entitled "to take countermeasures, commensurate with the degree and nature of the adverse effects determined to exist".

⁶² *SCM Agreement*, Article 7.2.

⁶³ *SCM Agreement*, Article 4, including Article 4.12.

⁶⁴ *SCM Agreement*, Article 4.7.

⁶⁵ One might note, in passing, that there is no provision for compensation in a nullification and impairment case under these provisions of the *SCM agreement* as there is provided for under Article XXIII GATT 1994 and the Article 22 of the *DSU*, although that is not important for present purposes.

⁶⁶ Of course, as a logical matter, removal of the measure would certainly encompass a suppression of effects. One might underline here that is a matter of removal of *all* effects: the practical effect of the remedy provided for under Article 4 is clearly to eliminate a measure in its entirety-including its effects. That is clearly distinct from the practical effect of the Article 5 and 7 disciplines under which it is envisaged that a remedy can be applied which would ensure elimination of the effect on a complaining party but where the possibility of effects on other parties remains.

effect of the persisting illegal measure on it. However, it does not *require* trade effects to be the effective standard by which the appropriateness of countermeasures should be ascertained. Nor can the relevant provisions be interpreted to *limit* the assessment to this standard. Members may take countermeasures that are not disproportionate in light of the gravity of the initial wrongful act and the objective of securing the withdrawal of a prohibited export subsidy, so as to restore the balance of rights and obligations upset by that wrongful act.

5.42 To conclude otherwise would effectively erode the fundamental distinction in the *SCM Agreement* between those provisions regarding purely "effects-oriented" remedies and those distinctly provided for pursuant to Article 4. Under the former provisions, it is clear that the premise is that the Member is to retain the entitlement to persist with certain subsidies, as they are not prohibited *per se*. The obligation of such a Member goes to attenuating their demonstrated trade *effect*. Accordingly, the remedy to which an affected Member is entitled goes only as far as countering those effects. In such a situation, there is an effective "rebalancing", but only a rebalancing on the level of reciprocal actual trade effects. In such a case, the legal status of the original measure is not itself affected.

5.43 This contrasts with the situation *vis-à-vis* a prohibited export subsidy. To insist on a remedy limited to such effects would be precisely to entertain "rebalancing" at that level, which would neither specifically take into account the obligation to withdraw the original measure nor aim to restore the balance of rights and obligations that has been upset by the original wrongful action. It would be effectively to read away the fundamental distinction between the relevant provisions as well as to undermine the essential rationale of that distinction. In our view, footnotes 9 and 10, in their final part, require us specifically to account for, and give due force to, that distinction in our determination of whether countermeasures are "appropriate".

2. Article 4.10 and Article 22.4 of the DSU

5.44 While the aforementioned provisions appear to us to be the most direct and relevant context, we examine also whether there is anything which, taking Article 22.4 of the *DSU* into account, would in any way lead us to modify our interpretation. We do so in particular bearing in mind the fact that the United States considers that the *DSU* is relevant on the matter of the role of trade effects pursuant to Article 4.10.

5.45 We recall that Article 22.4 of the *DSU* provides as follows:

"The level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification or impairment."

5.46 The drafters have explicitly set a quantitative benchmark to the level of suspension of concessions or other obligations that might be authorized. This is similarly reflected in Article 22.7, which defines the arbitrators' mandate in such proceedings as follows:

"The arbitrator acting pursuant to paragraph 6 ... shall determine whether the level of such suspension is equivalent to the level of nullification or impairment..."
(footnote omitted)

5.47 As we have already noted in our analysis of the text of Article 4.10 of the *SCM Agreement* above, there is, by contrast, no such indication of an explicit quantitative benchmark in that provision. It should be recalled here that Articles 4.10 and 4.11 of the *SCM Agreement* are "special or additional rules" under Appendix 2 of the *DSU*, and that in accordance with Article 1.2 of the *DSU*, it is possible for such rules or procedures to prevail over those of the *DSU*. There can be no presumption, therefore, that the drafters intended the standard under Article 4.10 to be necessarily coextensive with that under Article 22.4 so that the notion of "appropriate countermeasures" under Article 4.10 would limit such countermeasures to an amount "equivalent to the level of nullification or impairment"

suffered by the complaining Member. Rather, Articles 4.10 and 4.11 of the *SCM Agreement* use distinct language and that difference must be given meaning.

5.48 Indeed, reading the text of Article 4.10 in its context, one might reasonably observe that if the drafters had intended the provision to be construed in this way, they could certainly have made it clear. Indeed, relevant provisions both elsewhere in the *SCM Agreement* and in the *DSU* use distinct terms to convey precisely such a standard as described by the United States, in so many words. Yet the drafters chose terms for this provision in the *SCM Agreement* different from those found in Article 22.4 of the *DSU*. It would not be consistent with effective treaty interpretation to simply read away such differences in terminology.

5.49 We therefore find no basis in the language itself or in the context of Article 4.10 of the *SCM Agreement* to conclude that it can or should be read as amounting to a "trade effect-oriented" provision where explicitly alternative language is to be read away in order to conform it to a different wording to be found in Article 22.4 of the *DSU*.

5.50 We would simply add that, while we consider that the precise difference in language must be given proper meaning, this goes no further than that. Our interpretation of Article 4.10 of the *SCM Agreement* as embodying a different rule from Article 22.4 of the *DSU* does not make the *DSU* otherwise inapplicable or redundant.

C. OBJECT AND PURPOSE

5.51 Our understanding of the terms of Article 4.10, including footnote 9, based on an analysis of the relevant terms taken in their context is, in our view, also consistent with the object and purpose of the *SCM Agreement* in relation to Article 4.10, and of the *WTO Agreement*, as they relate to the dispute settlement remedies.

5.52 In our view, the object and purpose of the DSB's mandate to authorize countermeasures under Article 4.10 can first be drawn from the very language of Article 4.10. Article 4.10 requires that the DSB authorize the complaining Member to take appropriate countermeasures in case of non-compliance with the recommendation of the DSB. In other words, countermeasures are taken against non-compliance, and thus its authorization by the DSB is aimed at inducing or securing compliance with the DSB's recommendation. In this context, pursuant to Article 4.7, the DSB may *only* recommend that the subsidizing Member withdraw the subsidy without delay. We therefore consider that the objective of the *SCM Agreement* in relation to Article 4.10 in particular is to secure compliance with the DSB's recommendation to withdraw the subsidy without delay.

5.53 Article 4.10, by allowing for the imposition of countermeasures in case of non-compliance, provides a specific temporary instrument to WTO Members, in the context of disputes concerning prohibited subsidies. This instrument contributes to the ultimate achievement of the objectives of dispute settlement.

5.54 We note in this respect that Article 3.7 of the *DSU* also provides that "[i]n the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures" found to be inconsistent with WTO obligations.

5.55 We also note that the *DSU* Article 3.2 provides that the WTO dispute settlement system (of which this type of arbitration is an integral part) is "a central element in providing security and predictability to the multilateral trading system", and "[t]he Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements."

5.56 In the case of prohibited subsidies, we are of the view that the fact that a panel determining that a subsidy found to be prohibited can *only* recommend its withdrawal without delay is significant

and must be given some meaning when determining the appropriateness of proposed countermeasures. Furthermore, in our view, the legal means prescribed to ultimately restore the "balance of rights and obligations" of Members in relation to prohibited subsidies are specifically provided for under Article 4.7 of the *SCM Agreement*. In a situation where the balance of rights and obligations has been upset through the granting of a prohibited subsidy, panels may only recommend that the subsidizing Member withdraw the subsidy "without delay" in order to restore such balance.

5.57 In light of the above, we believe that countermeasures authorized under Article 4.10 contribute to the purpose of inducing compliance with the DSB's recommendations, consistently with restoring the balance of rights and obligations between the Members. In our view, the terms of Article 4.10 of the *SCM Agreement*, including footnote 9, confirm that, when assessing the scope of what may be deemed "appropriate" countermeasures, we should keep in mind the fact that the subsidy at issue has to be withdrawn and that a countermeasure should contribute to the ultimate objective of withdrawal of the prohibited subsidy without delay.

5.58 Finally, we note that the term "countermeasures" has acquired a meaning in general international law⁶⁷, which is reflected in the work of the International Law Commission (ILC) on State Responsibility. While the term "countermeasures" has a specific meaning in the *SCM Agreement* as regards their nature and application, we find that our interpretation of the relevant texts appear to be consistent with the object and purpose of countermeasures as reflected in the work of the ILC.

5.59 Article 49 of the text resulting from the ILC's work on State Responsibility (of which the General Assembly of the UN has taken note in a recent resolution) provides, in respect of the object and limits of countermeasures in international law, *inter alia*, that:

"An injured State may only take countermeasures against a State which is responsible for an internationally wrongful act in order to induce that State to comply with its obligations in Part Two."⁶⁸

5.60 We note that Article 49.1 of the ILC text does not, *per se*, determine the amount of countermeasures that can be authorized. Rather, it defines the only object and purpose for which countermeasures can legitimately be imposed: i.e., to induce the State which has committed an internationally wrongful act to comply with its obligations.⁶⁹ That is not incompatible, in our view, with the notion of countermeasures within the WTO dispute settlement system, where such measures are imposed as a temporary response to an absence of compliance. We note in this respect the observation by the arbitrator in the *EC - Bananas* case, in the context of Article 22.4 of the *DSU*, that "this temporary nature [of suspension of concessions or other obligations] indicates that it is the purpose of countermeasures to induce compliance".⁷⁰

5.61 Thus, as we interpret Article 4.10 of the *SCM Agreement*, a Member is entitled to act with countermeasures that properly take into account the gravity of the breach and the nature of the upset in the balance of rights and obligations in question. This cannot be reduced to a requirement that constrains countermeasures to trade effects, for the reasons we have set out above.

⁶⁷ See, e.g., the *Naulilaa* arbitral award (1928), UN Reports of International Arbitral Awards, Vol. II, p. 1028 and the *Air Services* arbitration, *op. cit.*

⁶⁸ Resolution of the General Assembly of the UN, A/RES/56/83, Responsibility of States for internationally wrongful Acts, adopted on 12 December 2001. We note that the ILC's work is based on relevant State practice as well as on judicial decisions and doctrinal writings, which constitute recognized sources of international law under Article 38 of the Statute of the International Court of Justice.

⁶⁹ See J. Crawford, *op. cit.*, p. 286. This author notes in particular that "countermeasures are taken as a form of inducement, not punishment" (para. 7 of the Commentaries on Article 49).

⁷⁰ Decision by the Arbitrators, *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU* ("*EC – Bananas III (US) (Article 22.6 – EC)*"), WT/DS27/ARB, 9 April 1999, DSR 1999:II, 725, para. 6.3.

5.62 At the same time, Article 4.10 of the *SCM Agreement* does not amount to a blank cheque. There is nothing in the text or in its context which suggests an entitlement to manifestly punitive measures. On the contrary, footnote 9 specifically guards us against such an unbounded interpretation by clarifying that the expression "appropriate" cannot be understood to allow "disproportionate" countermeasures. However, to read this indication as effectively reintroducing into that provision a quantitative limit equivalent to that found in other provisions of the *SCM Agreement* or Article 22.4 of the DSU would effectively read the specific language of Article 4.10 of the *SCM Agreement* out of the text. Countermeasures under Article 4.10 of the *SCM Agreement* are not even, strictly speaking, obliged to be "proportionate" but not to be "disproportionate". Not only is a Member entitled to take countermeasures that are tailored to offset the original wrongful act and the upset of the balancing of rights and obligations which that wrongful act entails, but in assessing the "appropriateness" of such countermeasures – in light of the gravity of the breach – , a margin of appreciation is to be granted, due to the severity of that breach.

VI. ASSESSMENT OF THE COUNTERMEASURES PROPOSED BY THE EUROPEAN COMMUNITIES

6.1 As noted above, the parties agree that, in qualitative terms, the *type* of measure envisaged by the European Communities in this case is appropriate. Their disagreement is over whether the quantitative *amount* of the countermeasure is appropriate.

6.2 The European Communities has requested an authorization to suspend concessions in an amount of US\$4,043 million. It has argued, as a general matter, that Article 4.10 of the *SCM Agreement* would allow for an amount of countermeasures such as to effectively induce compliance, and that it could have, on that basis, requested a higher amount of countermeasures. However, it has explained that the amount which it has actually requested in this instance is based on the amount expended by the United States in granting the subsidy.

6.3 We will therefore consider whether countermeasures in this amount can be considered "appropriate" within the meaning of Article 4.10, bearing in mind our analysis in the previous section.

6.4 We recall that we are required, in our analysis, to apply the terms of footnote 9 and, in that regard, need to take into account its second part. We therefore need to consider whether the European Communities proposed countermeasures are not disproportionate "in light of the fact that the subsidies dealt with under these provisions are prohibited".

6.5 In approaching this, we first wish to underline exactly what our responsibility is in making this determination. We are required, under Article 4.11 of the *SCM Agreement*, to ascertain whether the countermeasures proposed by the European Communities are "appropriate". In this assessment, we are guided in particular by the terms of footnote 10, which directs us to consider whether we are persuaded that the EC countermeasures are "disproportionate" in light of the fact that the subsidies at issue are prohibited. As we noted above, this is not exactly the same as being persuaded that they are "proportionate". In the absence of being effectively persuaded that they are disproportionate, we would conclude that the European Communities' proposed countermeasures are within the bounds of what they are entitled to apply pursuant to Article 4.10 of the *SCM Agreement*.

6.6 As noted above, in assessing whether the proposed countermeasures are "disproportionate" in light of the fact that the subsidies dealt with in this provision are prohibited, "our perspective on countermeasures is invested with and coloured by consideration of the nature and legal status of the particular underlying measure in respect of which the countermeasures are applied".⁷¹ As we have outlined in paragraph 5.61 above, we consider that the European Communities is entitled to act with

⁷¹ *Supra*, para. 5.22.

countermeasures that properly take into account the gravity of the breach and the nature of the upset in the balance of rights and obligations in question. In the case at hand, we consider what this entails.

6.7 As regards the matter of the balance of rights and obligations between Members that is being upset through the granting of the subsidy, the European Communities has had the "right" to expect that there will be no export subsidies applied to those goods covered by the *SCM Agreement*. The United States, for its part, has had a corresponding obligation to refrain from applying such export subsidies. The persistence by the United States with this breach of its obligations upsets the "balance of rights and obligations" that we have referred to in the previous section of this report.

6.8 As far as a trading partner is concerned, the matter does not become problematic, as a legal matter, contingent on any other factor such as, e.g. the actual effects of the measure itself. It is problematic in the form of an upset in the reciprocal balance of rights and obligations in and through the measure itself and, in this case, it is intrinsic to that measure as a wrongful act that the United States is incurring costs in granting and maintaining the export subsidy. Once such a measure is in operation, its real world effects cannot be separated from the inherent uncertainty that is created by the very existence of such an export subsidy. The measure is, by its very nature, inherently destabilizing. This is its essential character and it is reflected in the fact that the measure is *per se* prohibited. In this particular case, moreover, the subsidy at issue, the FSC/ETI scheme, is a measure which is extensive in its application and, indeed, is potentially available to a very wide range of goods for export. It is not at all like a product- or even a sector-specific measure with, e.g., a set rate or quantum of funds. It is a highly complex and comprehensive export subsidy being applied to a multiplicity of firms.

6.9 The FSC/ETI scheme is available systemically and very widely. If anything, this can only intensify the degree to which, in this case, the measure concerned creates systematic uncertainty and instability of expectations as to trading conditions, as opposed to security and stability of such conditions based on the understanding – grounded in an express obligation – that export subsidies are prohibited. We consider that this is a matter that is relevant to the issue of the "gravity" of the initial wrongful act. The European Communities cannot, of course, itself counter the export subsidy at its source, i.e. effect its cessation. But, as regards the balance of rights and obligations between Members, it is entitled to "redress" the upsetting of that balance *via* countermeasures.⁷²

6.10 The quantitative element of the breach in this case is, in fact, that the United States has spent approximately US\$4,000 million yearly in breach of its obligations.⁷³ To our mind, each dollar is, as it were, as much a breach of the obligations of the United States as any other. Certain dollars do not become any less so – or effectively "quarantined" from their legal status of breach of an obligation – by virtue of some other criteria (such as trade effects). To put it another way, the United States' breach of obligation is not objectively dismissed because some of the products benefiting from the subsidy are, e.g., exported to another trading partner. It is an *erga omnes* obligation owed in its entirety to each and every Member. It cannot be considered to be "allocatable" across the Membership. Otherwise, the Member concerned would be only partially obliged in respect of each and every Member, which is manifestly inconsistent with an *erga omnes per se* obligation. Thus, the United States has breached its obligation to the European Communities in respect of all the money

⁷² Of course, the balance of rights and obligations between Members will only ultimately be properly redressed through full compliance with the DSB's recommendations, i.e., in this case, withdrawal of the unlawful subsidy. Countermeasures merely offer a *temporary* and imperfect redress to the persisting violation, which in no way reduces the need to comply or substitutes for such compliance.

⁷³ For a detailed analysis of the value of the subsidy, see Annex A below.

that it has expended, because such expenditure in breach – the expense incurred – is the very essence of the wrongful act.⁷⁴

6.11 Thus, legally speaking, in terms of redressing the balance of rights and obligations, this is a significant consideration in our assessment of the European Communities' proposed countermeasures. In this respect, we recall our earlier conclusion that countermeasures under Article 4.10 may be tailored to the initial wrongful act they are to counter. In this instance, the European Communities has proposed to take countermeasures which would precisely tailor the response to the amount of this initial wrongful act. In light of our interpretation, in the previous section, of the terms of Article 4.10 of the *SCM Agreement*, we find such an approach, which aims to challenge the wrongful act itself – the breach of the obligation – to be permissible in principle. Indeed, it is in our view entirely compatible with the essence of the notion of countermeasures, in that it seeks to respond exactly to the violation, the persistence of which generates the entitlement to countermeasures.

6.12 We thus turn to a consideration of the proposed countermeasures in relation to the initial wrongful act which they are to counter, the prohibited subsidy.

A. THE PROPOSED COUNTERMEASURES IN RELATION TO THE PROHIBITED SUBSIDY

6.13 In order to proceed with an analysis of the proposed countermeasures in relation to the wrongful act they are to counter, we must first define the elements of that wrongful act. It seems to us that the relevant factors that can be used when it comes to defining the prohibited subsidy itself cannot be artificially constructed. They should be discerned from and grounded in the *SCM Agreement* itself. We recall in this respect the guidance provided in particular by footnote 9, which directs us to take into consideration that the underlying subsidy is prohibited under Part II of the *SCM Agreement*.

6.14 We turn first to what we consider to be fundamental when it comes to characterizing the measure *qua* measure, namely the "financial contribution", given that it is a core element of the definition of a subsidy within the meaning of Article 1 of the *SCM Agreement*.

6.15 In this regard, we first note that the amount of the countermeasures proposed certainly exhibits a manifest relationship of proportionality, as we understand the term⁷⁵, in regard to the amount of the export subsidy granted. In this instance, the parties effectively do not fundamentally disagree on the actual value of the export subsidy in respect of which the United States has been found to be in persistent violation.⁷⁶ Their disagreement rests only on the issue of whether that amount of countermeasures is "appropriate" within the meaning of Article 4.10.

6.16 As noted above, the quantitative element of the breach in this case is, in fact, that the United States has spent approximately US\$4,000 million in breach of its obligations.⁷⁷ The European Communities, for its part, is requesting an authorization to take countermeasures in an amount of US\$4,043 million.

6.17 The values concerned are not disproportionate. In purely numerical terms, they are in fact in virtual correspondence.⁷⁸

6.18 But this is not just a matter of merely arithmetic proportionality in the abstract. There is an underlying more "structural" element of proportionality that is exhibited in the countermeasures

⁷⁴ One of the arbitrators wishes to stress that this and the following paragraph should not be read to mean that, without regard to the particular circumstances of individual cases, the total amount of the subsidy would be a universally and generally applicable standard at all times.

⁷⁵ See *supra* para. 5.18.

⁷⁶ For a detailed analysis of calculations of the amount of the subsidy, see Annex A below.

⁷⁷ For a detailed analysis of the value of the subsidy, see Annex A below.

⁷⁸ See WT/DS46/ARB, para. 3.60.

proposed which provides a legally relevant relationship between measure and countermeasure. Firstly, the granting of a subsidy involves a financial contribution, thus an expense incurred by the government. That is, *stricto sensu*, the "measure" at issue as the wrongful act of the responsible State party. In this instance, an amount of approximately US\$4,000 million has been granted in the year 2000, in a manner found to be inconsistent with the *SCM Agreement*, by the US government to its exporters. That is the expense incurred by the United States Government in granting that measure, through the FSC/ETI scheme. As a wrongful act – as breach of an obligation owed to the European Communities in this case – this is the essential act of the government itself.

6.19 Thus, following our reasoning above, this is a central perspective from which to view the "appropriateness" of the countermeasures at issue. The United States has effectively incurred an expense which can be valued at around US\$4,000 million for the year 2000, as an act of Government in breach of its obligations under the *SCM Agreement*. In the instant case the European Communities cannot, of course, directly thwart that expenditure at source. As we see it, the European Communities is proposing to respond by suspending a numerically equivalent obligation which it owes to the United States. Absent those countermeasures, the United States would enjoy those rights, just as, absent the expenditure by the United States, the European Communities would enjoy its rights. It appears to us that this is a proper manner from which to judge the congruence of the countermeasure to the measure at issue, i.e. to view it under its legal category: on the one hand an expense to government of a certain value constituting an upsetting of the balance of rights and obligations; and therefore, on the other hand, a congruent duty imposed by a responding government as a mirror withdrawal of an obligation.

6.20 We have evidently assigned fundamental importance to the role of the financial contribution as the act in respect of which countermeasures should be evaluated. That reflects the fact that it is the element reflecting most accurately the act of the Member itself, over which it exerts direct control.⁷⁹

6.21 Of course, the second element that is central to the subsidy as defined by Article 1 of the *SCM Agreement* itself is the benefit to the recipient. In this case, there is manifestly a benefit conveyed through the FSC/ETI scheme. It is conveyed to US firms. At the broadest level, the EC countermeasures would be viewed as aiming to deprive such firms of an advantage they would otherwise receive in relation to access to the EC market. There is no doubt that the character of the EC response, in addition to being an act of response to a quantifiable breach of an obligation with a congruent response, also has the consequence of effecting that *via* US firms. Yet it is also a fact that US firms are benefiting from the prohibited subsidy. To that extent, a certain basic proportionality is respected. In this case, the European Communities' powers are limited to its own jurisdiction. One way of countering an absolute benefit to firms is to impose an equivalent absolute expense. Certainly, the overall effects will vary as will the impact on firms. There will not be pure equivalence in terms of economic impact. But within the realistic constraints that states operate in, and in dealing with an all-pervasive regime such as the FSC/ETI scheme, the principle being effectively followed here is the imposition on firms of the Member concerned of expenses at least equivalent to those initially incurred by the treasury of the Member concerned in granting benefits to its firms. In that sense, there is a certain correlation between the benefits initially conferred to US firms and the European Communities' proposed response.

6.22 It is certainly true that the European Communities' proposed countermeasures would not in a literal sense amount to (nor are they claimed to be) an exact counter to the benefits to recipients of the FSC/ETI subsidy. This does not, in our view, represent a fundamental problem in this case. It is almost inevitable that it will, in many situations, be impracticable to devise a countermeasure that would exactly counter the benefits conferred, nor is there, in our view, a requirement to do so, precisely because the terms justifying countermeasures are, for the reasons we have given, entitled to

⁷⁹ This is not necessarily the case, e.g., for the effects of the measure, it being understood, of course, that as regards responsibility, this extends also to the consequences as well as the act.

be viewed essentially from the perspective of countering the legal breach as a wrongful act. Be that as it may, in the case of a programme such as this, which applies to firms across a considerable range of industries and products, it is clearly impossible for a foreign government to counter precisely the specific benefits to specific firms. The task of calculation alone would be near impossible, let alone tailoring responses to particular firms.

6.23 In this instance, the European Communities has based its proposed amount of countermeasures on the face value of the subsidy, rather than directly on the benefits conferred by it.⁸⁰ The United States has not sought to object to the level of countermeasures on these grounds. Taking all of this into account, we, for our part, have certainly found no reason to consider that, to the extent that this aspect is relevant in the first place, it provides any reason to depart from our judgement that the entitlement to the level of countermeasures stemming from the wrongful act as measured by the expense to government is not disproportionate.

6.24 Thus, it is our view, in light of these considerations, that the countermeasures proposed are not disproportionate to the initial wrongful act to which they are intended to respond.

6.25 Our analysis above and the fact that we have concluded that the countermeasures proposed in this case are not disproportionate to the initial wrongful act – the maintenance by the United States of an unlawful export subsidy in violation of its obligations under Article 3 of the *SCM Agreement* – , would in themselves, in our view, be sufficient to allow us to consider that, in the circumstances of this case, the proposed amount of countermeasures would be "appropriate" within the meaning of Article 4.10 of the *SCM Agreement*. We recall in this respect our conclusion in Section V above regarding the entitlement to take countermeasures tailored to restore the balance of rights and obligations upset by the original wrongful act, and taking into account its gravity. In this instance, this is the approach followed by the European Communities, and we find it to be consistent with the terms of Article 4.10 of the *SCM Agreement*.⁸¹

6.26 This is an appropriate point at which to underline that there is one matter that is particular to the circumstances of this case and is material to this conclusion, yet has not – up to this point – been expressly dealt with.

6.27 In the circumstances of this case, the European Communities is the sole complainant seeking to take countermeasures in relation to this particular violating measure. That is also, in our view, a relevant consideration in our analysis. Had there been multiple complainants each seeking to take countermeasures in an amount equal to the value of the subsidy, this would certainly have been a consideration to take into account in evaluating whether such countermeasures might be considered to be not "appropriate" in the circumstances. That is not, however, the situation before us.

⁸⁰ The European Communities has referred, in the course of the proceedings, to the notion of benefits to the United States of the scheme in the context of proposing alternative methodological approaches to calculate an amount of "appropriate countermeasures" and suggests that "since the benefits the US derives from the FSC/ETI scheme are higher than the value of the subsidy, the imposition of countermeasures equivalent to the value of the subsidy can be seen to be a modest and conservative estimate of what is required to induce compliance" (First submission, para. 69). It has also argued that it had proposed "countermeasures based on the - and proportionate to - the benefit provided by the FSC-ETI scheme to United States exporters" (Second submission para. 55). However, the European Communities has not sought to directly quantify these benefits to demonstrate an exact correspondence between these benefits and the amount it is suggesting in this instance. Rather, it argues that these benefits would be *higher* than the amount of the subsidy.

⁸¹ We would only observe that our judgement is, in any case, simply that the countermeasures sought by the European Communities are not disproportionate, based on our reasoning and the facts of this case. In determining that, we have not necessarily defined this quantum of countermeasures as being *the* definitive limit. We have not made – and do not make – any judgement on that matter. The only question before us is whether the amount sought by the European Communities is not disproportionate.

6.28 The reasoning we have followed above could be construed – in a purely abstract manner – to be as inherently applicable to any other Member as to the complainant in this case viz. the European Communities.⁸² We would simply underline, in this regard, that in this case, we were not presented with a multiple complaint but a complaint by one Member. Thus we have not been obliged to consider whether or how the entitlement to countermeasures based on our reasoning above should be allocated across more than one complainant. Thus to the extent that there would be an issue of allocation, as it were, it need not – and did not – enter into consideration as an element to otherwise "discount" the European Communities' entitlement to countermeasures in this particular case.

6.29 Understandably, it would be our expectation that this determination will have the practical effect of facilitating prompt compliance by the United States. On any hypothesis that there would be a future complainant, we can only observe that this would give rise inevitably to a different situation for assessment. To the extent that the basis sought for countermeasures was purely and simply that of countering the initial measure (as opposed to, e.g., the trade effects on the Member concerned) it is conceivable that the allocation issue would arise (although due regard should be given to the point made in footnote 84 above). We take note, on this point, of the statement by the European Communities:

"...it may well be that the European Communities would be happy to share the task of applying countermeasures against the United States with another member and voluntarily agree to remove some of its countermeasures so as to provide more scope for another WTO Member to be authorized to do the same. This will be another fact that future arbitrators could take into consideration."⁸³

6.30 It must be stressed, however, that there is no mechanical automaticity to this. The essence of such assessments is that it is a matter of judging what is appropriate in the case at hand. There could well be other factors to take into account in their own right, e.g., if for instance the matter of bilateral trade effects were essentially at issue.

6.31 At this point of our analysis, we therefore have, in our view, elements sufficient to allow us to find that the countermeasures proposed could be considered "appropriate" within the meaning of Article 4.10, on the basis of their relation to the initial violating measure.

6.32 In doing so, we are conscious that we have not precisely considered the contention that the matter should be determined by means of reference to the adverse trade effects of the subsidy on the European Communities. We recall, moreover, that the United States has argued that the basis for assessing the "appropriateness" of countermeasures should precisely be these adverse trade effects (or "trade impact"). We address this issue further below.

B. THE TRADE EFFECTS OF THE SUBSIDY ON THE EUROPEAN COMMUNITIES

6.33 As discussed in the previous section, we have not interpreted Article 4.10 to preclude a Member from taking countermeasures that are tailored to counter the adverse effects it has suffered as a result of the illegal measure. We therefore do not rule out *a priori* that trade effects of the measure on the affected Member can enter into consideration in a particular case, as a relevant factor, in determining the "appropriate" amount of countermeasures within the meaning of Article 4.10 of the *SCM Agreement*. Indeed, as we have previously noted, the expression "appropriate countermeasures",

⁸² One of the arbitrators wishes to stress that under different circumstances in a particular case, this consideration alone may not automatically lead to the conclusion that the countermeasures are "appropriate" within the meaning of Article 4.10 of the *SCM Agreement*.

⁸³ EC response to question 42 from the Arbitrator, para. 116.

in our view, would entitle the complaining Member to countermeasures which would at least counter the injurious effect of the persisting illegal measure on it.⁸⁴

6.34 However, we have also determined that Article 4.10 of the *SCM Agreement* does not *require* trade effects to be the effective standard by which the appropriateness of countermeasures should be ascertained. Nor can the relevant provisions be interpreted to *limit* the assessment to this standard.

6.35 Bearing in mind, however, our view that trade effects are not *a priori* to be ruled out as relevant in a particular case, we see merit in examining whether, *even if* one addressed the matter of trade effects in this case, there would be any reason to reach a different conclusion. In this case, in fact, we find no reason to reach a different conclusion after examining the arguments presented by the United States in respect of the trade effects of the FSC/ETI scheme on the European Communities.

6.36 We recall in that regard that the United States presented essentially two lines of argument in relation to the assessment of the trade effects of the FSC/ETI scheme on the European Communities. Firstly, the United States principally suggested that in this case, the face value of the subsidy should be taken as a "proxy" for the trade impact of the measure and that this sum then should be apportioned on a percentage basis to the EC share of world trade as a proxy for the trade effect of the subsidy on the European Communities. Secondly, in the event that we would nonetheless decide to examine the economic data pertaining to the trade effects of the measure, the United States has presented a range of possible estimates of the trade impact of this measure using methodologies other than the "proxy" approach. The United States nonetheless argued in the first instance that these should not be used to estimate the trade effects of the measure in this case, by reason of their unreliability and the excessively broad range of the results of calculations. We will consider these two arguments in turn.

6.37 Turning first to the proposed "proxy" approach, under that approach, if the US\$4,125 million⁸⁵ figure suggested by the United States is used as the starting-point, representing the value of the subsidy, and retaining 26.8 per cent of that figure as the European Communities' share of the global trade effects of the subsidy, as suggested by the United States⁸⁶, the appropriate amount of countermeasures would be in a range of approximately US\$1,110 million.⁸⁷

6.38 We have stated that we see nothing in the text that directs a trade effects test and that it cannot be construed to be limited to this. There is furthermore nothing in the text which would expressly direct *how* trade effects are to be estimated in a case relating to countermeasures in response to export subsidies. The "proxy" approach proposed by the United States, however, does not appear to have any sound support in the provisions at issue or in the facts of the case.

6.39 To begin with, the proxy approach proposed by the United States is based on no particular economic rationale. It simply presumes a one to one correspondence of dollar of subsidy to dollar of trade impact. This is manifestly arbitrary. Indeed one could even argue that it is a fundamentally self-contradictory concept: if a dollar of subsidy can always and everywhere only lead to a dollar of

⁸⁴ See para. 5.41 above. For instance, it is conceivable that some adverse effects on a Member could be manifestly greater than the amount of the subsidy that is expended. In such cases, the Agreement can hardly be construed to preclude a Member from taking countermeasures to deal with that situation precisely on the basis of adverse trade effects or that Member – especially when that would otherwise mean that they had recourse thereby only to countermeasures that would be *less* effective than those available to a Member under Article 5 of the *SCM Agreement* (or for that matter under the countervailing provisions of the Agreement, where the other conditions for application would also be present). That is not, of course, the situation we are dealing with here. The European Communities is not seeking entitlement to countermeasures greater than the face value of the subsidy.

⁸⁵ Amount of the subsidy for the year 2000 as calculated by the United States, including relevant adjustments.

⁸⁶ See US First submission, para. 69.

⁸⁷ See US Second Submission, para. 4.

trade effect, this is manifestly to determine in advance what the trade effect is. Yet the very concept of trade *effect* is precisely to assess what has occurred in the real world as the distinct *effect* of that dollar expended. One is, it seems to us, actually precluded from determining such effect if it is already determined that it *is* the actual expenditure. This renders the whole concept of "effect" redundant or meaningless. Under this approach, no such assessment would ever be required: the conclusion is predetermined once the amount of government expenditure is known.

6.40 Indeed, the approach suggested by the United States is hardly reconcilable with a coherent reading of the Agreement. Where trade effects are specifically dealt with under the *SCM Agreement*, in provisions other than Article 4, the criteria for assessment are not at all arbitrary or artificial in this way. This is evident in those provisions of the *SCM Agreement* where a demonstration of trade effects is relevant, and the provisions relating to such assessments (e.g. in relation to injury to the domestic industry or serious prejudice – Article 6 on actionable subsidies – and application of countervailing duties – Part V –). In such cases, the relevant concepts (such as price undercutting, price depression and suppression, etc) are manifestly aimed at objectively determining certain effects. There is not the slightest suggestion in these provisions that this can be ascertained by means of an arbitrary "proxy" such as that proposed by the United States in this case.

6.41 Indeed, were it a matter of merely determining the expenditure, this would completely obviate the need for any such precise concepts to be applied when ascertaining the effects. Bearing that in mind, it would scarcely be coherent to consider that, when it comes to the manifestly more stringent requirements relating to export subsidies, there should be any presumption of an implicit methodology which is *less* likely to bear an objective relationship to the facts of the case.

6.42 Nor has the United States convinced us of why this particular predetermination would be any more inherently plausible than any other. The arbitrator in the *Brazil – Aircraft* case suggests in fact that, if anything, a more likely presumption would be that the relationship of expenditure to effect is to be multiplied rather than static.⁸⁸ We take no position on that point in this case. We note, however, that the United States approach in fact amounts to assigning implicit values to the economic variables which the United States otherwise argues are too uncertain to devise, in the context of economic modelling.⁸⁹ It is not at all clear to us why these implicit values would be inherently more plausible than any of those that can be assigned in the context of economic modelling, which at least represents analytical estimates rather than an unreasoned assumption. This underlines, in our view, the inherently arbitrary nature of the US proposed approach.

6.43 We turn now to the alternative methodologies presented by the parties for estimating the trade effects of the measure on the European Communities. These methodologies are similar in nature. Nevertheless, different estimations were obtained, both below and above the amount of countermeasures proposed by the European Communities, due to differing assumptions about the values to be assigned to the relevant parameters in the calculations.⁹⁰

⁸⁸ See the Decision of the Arbitrator, *Brazil – Aircraft (Article 22.6 – Brazil)* WT/DS46/ARB, para. 3.54 ("given that export subsidies usually operate with a multiplying effect (a given amount allows a company to make a number of sales, thus gaining a foothold in a given market with the possibility to expand and gain market shares), we are of the view that a calculation based on the level of nullification or impairment would, as suggested by the calculation of Canada based on the harm caused to its industry, produce higher figures than one based exclusively on the amount of the subsidy").

⁸⁹ Assuming full pass through of the subsidy, a value of -1.65 for the price elasticity of the aggregate US export demand curve will result in the value of the trade effect equalling the value of the subsidy (see exhibit US-17).

⁹⁰ The quantitative estimate of the impact of an export subsidy on trade depends upon the relationship between the mode of delivery of the subsidy and various economic parameters. In this case the subsidy is allocated on the basis of export income. Eligible export income is used to reduce the overall tax burden of a firm. The overall impact depends upon four factors: the value of the subsidy; the reduction in the price of the

6.44 The European Communities suggested that the Arbitrators should consider the methodology used by the US Treasury Department in 1997 in its report to the United States Congress on the trade impact of the FSC Scheme.⁹¹ The United States objected to this methodology on the following grounds: (1) the price elasticity of export demand is estimated to be too high; (2) the price elasticities of export supply are also estimated to be too high and (3) the pass through of the subsidy to prices is overstated.

6.45 The methodology of the US Treasury is more sophisticated than the proposal by the United States to simply use the value of the subsidy as a proxy. In recognition of this fact, the United States made two further proposals for our consideration. The first was an alternative methodology that the United States claimed was more suitable for an estimation of trade effects on the European Communities.⁹² The second was to resort to a different set of parameters for the US Treasury model.⁹³

6.46 The United States itself subsequently questioned its own alternative proposed methodology due to the fact that it contained incomplete data.⁹⁴ Hence, the options before us for evaluating the trade effects would be limited to the US Treasury model, as proposed by the European Communities, and amendments to this model as suggested by the United States.

6.47 To the extent that we might consider it appropriate in this case to assess the trade effects of the measure on the European Communities, our task would not be to judge, with absolute precision,

good benefiting from the subsidy; the export response of producers benefiting from the subsidy; and the price elasticity of demand for US exports.

⁹¹ EC First Submission, paragraph 62. For example, using the US Treasury model as proposed by the European Communities and the estimated subsidy values of both the European Communities and the United States for industrial products as set out in Annex A, the range of the estimated trade effects can be estimated between \$3,253 million and \$4,294 million.

⁹² The United States proposed the Armington model, which assigns elasticities to products based on their country of origin. Therefore, the model, according to the United States, has the advantage of isolating the EC specific trade impact of the subsidy (US Second submission, para 122).

⁹³ The United States took the position that "imputed" elasticity estimates from estimated substitution elasticities are more robust than the estimates provided by the European Communities. The calculations provided by the United States were justified on the grounds that they were more recent and could be calculated at a disaggregate level.

⁹⁴ While we acknowledge the general contribution that the Armington approach to modelling differentiated products models of trade can make, the United States did not, in the case before us, satisfactorily explain why we would be obliged to find the particular approach suggested by it to be more reasonable than that generated by the proposed EC approach. On the contrary, the United States' approach had demonstrable flaws as it sought to apply it in this case. We note that, in this case, the estimation of the trade impact of the subsidy generated by the United States using the Armington model does not *in fact* employ EC-specific cross price elasticities nor does it use specific elasticities of US export demand (US Second submission, footnote 97). Furthermore, in response to a question from the Arbitrator relating to the use of the alternative methodology, the United States underlined the lack of reliable basis to use this approach. Its response was that "Although the United States *could not find the information necessary* to distinguish between the EC and the rest of the world, the Armington model runs, nevertheless, at least furnish the Arbitrator with an independent assessment of the trade impact of the US subsidy on the EC based on a different set of parameter estimates" (emphasis added) (Para. 30, US Response to Additional Questions by the Arbitrator). The United States also stated that it lacks information, which if available would have allowed them to calculate the trade effects with more precision. "With this additional information, the Armington model *may have possibly* provided better guidance than the Treasury model, because it *would have* incorporated more information (i.e. the degree of substitutability between US exports and EC goods) and *would have* avoided the need to determine how to calculate the EC share" (US Answers to Additional Questions from the Arbitrator, paragraph 30) (emphasis added). Thus, at most, the United States hypothesizes that there *could* be a more reliable and robust approach. It however has been itself unable to give us a reliable alternative basis to make a judgement that would definitively prevail over any based on the Treasury model.

which is the single correct model or which are the correct parameters, but to examine the results of these models to see if they provide an insight into the range of trade effects caused by the FSC/ETI scheme carrying sufficient weight to materially affect our judgement on whether the countermeasures proposed are disproportionate.

6.48 In this regard, the very fact that the US Treasury report was submitted to Congress is, in our view, of considerable weight. That report did suggest that it may have somewhat overstated the results. Indeed, it may not be absolutely exact. Nonetheless, the US Treasury obviously made the judgement that, in the context of presenting the effects of the FSC scheme to US Congress (the authors, we note, of the legislation concerned), this report, including the modelling assumptions on which it is based, had sufficient credibility to represent a reliable reflection of the impact of the scheme when it came to the matter of informing the US Congress on its operation and effects. That was presumably not undertaken lightly and, at the very least, it was presumably considered to be not manifestly misleading. That perspective, it seems to us, is akin to the kind of judgement that is to be properly applied when an assessment is to be made of whether something is disproportionate. One is not expecting, or looking for, mathematical exactitude, but whether or not (to a reasonable eye) something is out of proportion. In these circumstances, it is not a matter of whether or not the US Treasury study might not be certain as to its conclusions. It is a matter of whether there is, available to us, a more fundamental reason to reliably reject the Treasury study. In this sense, we see that there is, in practical terms, a burden on the United States in this case, in our view, to successfully challenge the model that its own Treasury Department had developed to evaluate the scheme before the US Congress.

6.49 Of course, we have to take due note of the reservations now expressed by the United States about its own study. One can always debate all estimates, but the real issue is not whether some alternatives are possible, but whether there is something reliable that would oblige us to see the broad parameters of that study's outcome as being unreasonable. In that context, we are mindful that the task of evaluating the trade effects of the scheme cannot be accomplished with mathematical precision. Nevertheless, economic science does allow us to consider a range of possible trade effects with a certain degree of confidence.

6.50 In our view, however, the United States has, in any event, failed to demonstrate that alternative assumptions leading to lower estimates would be more plausible than those used in the US Treasury study and relied on by the European Communities in this case. First, the United States has argued that different elasticities of export demand should be used⁹⁵ and that the pass through rates should be lower. The basis upon which these should be preferred to those which their own Administration actually applied in the study were not, however, persuasively explained. The United States submitted re-estimated parameters for the Treasury model using more recent data, but these were imputed from estimates of US *imports*, instead of US exports, which are our concern in this case.⁹⁶

⁹⁵ The United States submitted that the range of estimates of the point price elasticity of the aggregate US export demand is between -1.13 and -2.53, whereas the simple average of the estimates of the price elasticities used in the US Treasury study is -3.0. The difference between these estimates, the United States argues, is one reason why the US Treasury model would lead to overestimates of the actual trade impact. The United States, however, did not submit evidence to support the use of these alternative aggregate estimates. More to the point, it did not deal with the fact that four sectors alone in the US Treasury study account for 66 per cent of the total FSC exempt income and pursuant to the US Treasury study, these have estimates at the sectoral level of -1.7, -3.8, -4.1, -3.8 respectively. Given the weight of these sectors in the overall trade effect of the subsidy, the value of the price elasticity of these sectors should be the focus of analysis. This is consistent with the view that simple aggregate elasticities would be more inherently likely to underestimate elasticities for the purposes of an analysis of the FSC/ETI scheme.

⁹⁶ The United States took the position that 'imputed' elasticity estimates from estimated substitution elasticities are more robust than the estimates provided by the European Communities. The calculations

6.51 Secondly, with respect to the issue of pass through, the economic reasoning provided by the United States for adjusting the rate to a lower figure was no more inherently compelling than that which was used for its own study (US Treasury). The EC estimate of the trade impact assumes a full pass through effect of the subsidy onto the price of US products.⁹⁷ The United States argues that such an assumption is not necessarily supported by the empirical facts and hence would bias the results upward.⁹⁸ It argues that two factors could act in concert to result in a less than 100 per cent pass through of the subsidy onto the price of world products.⁹⁹ First, if firms are operating on the positively sloped segment of their average cost curve, an increase in production could result in an increase in costs that may not be compensated by the subsidy.¹⁰⁰ Second, if firms in an industry have market power, they would not necessarily have an incentive to lower prices.¹⁰¹

6.52 However, empirical evidence shows that the pass through effect of a similar programme was 75 per cent in the 1970s.¹⁰² Today, more than 25 years later it is not unreasonable to suggest that the

provided by the United States were justified on the grounds that they were more recent and could be calculated at a disaggregate level. The process by which the elasticities are imputed, however, was never clearly specified by the United States. The original estimates from which the imputed estimates are done were sourced from two academic studies (Gallaway et al. (2001); Shiells and Reinert (1993)). Both studies relate to the United States. We note that these estimates are derived from demand functions for US consumers. Therefore, these estimates relate to the degree of substitution between imported products into the United States and domestically produced products for US consumers. The United States did not establish why measures of elasticities of imports into the United States could be used as estimates of elasticities of exports. In our view, the United States failed to effectively respond to three reasons identified by the EC as a cause for concern about the procedure used by the United States:

"The Armington elasticity estimates used by the United States are for substitution between imports into the United States and domestically produced US products. These are not the same as substitution elasticities between US exports and domestically produced products in foreign countries. First, the foreign countries will have different policies towards imports. Second, foreign consumers will have tastes and preferences that are different from US consumers. Third, it is likely that the set of trade goods in an industry is not the same as the set of domestically produced goods offered for local sale. Therefore, the set of US exported goods is not the same as the set of domestically produced goods offered for sale in the United States, and the set of goods imported into the United States is not the same as the set of foreign produced goods offered for sale in foreign countries." (EC comments on US Responses to Additional Questions from the Arbitrator, para 5).

⁹⁷ The issue of pass through relates to the degree to which a company uses a subsidy it receives to lower the price of the product that it exports. At one extreme the company may choose to apply the full amount of the subsidy to the price of its products, thereby lowering its price. At the other, it may choose not to lower the price of the product. The concept of pass through is further explained in paragraph 89 of US Answers to Questions from the Arbitrator:

"An exporter presented with the FSC/ETI tax savings can do one of two things. One the one hand, it can lower the price of its exports by the amount of the tax savings. If it does this, its net profit per transaction will remain the same, although its overall profits may increase because – other factors being held constant – the volume of its exports will increase. This is the "full pass through" scenario.

Alternatively, the exporter can leave the price of its exports unchanged. If it does this, the volume of its exports will remain unchanged – other factors being held constant – but its net profit per transaction will increase by the amount of the tax savings. This is the "no pass-through scenario".

⁹⁸ The United States asserts that "pass-through is so critical that if it were determined that firms completely absorbed the tax subsidy rather than reflecting it in export prices, the subsidy would have no effect on US exports and the quantification of the trade impact would be zero." (US Oral Statement, para. 56).

⁹⁹ US Answers to Questions from the Arbitrator, para 94.

¹⁰⁰ US Answers to Questions from the Arbitrator, paras 95-97.

¹⁰¹ US Answers to Questions from the Arbitrator, para 98-99.

¹⁰² EC Answers to Questions from the Arbitrator, para 134.

world market is now more competitive, thereby increasing the pass through effect.¹⁰³ We certainly found no plausible reason to give credence to a view that it was reasonable to assume that pass through was in the lower rather than the higher end. Again, we cannot say with mathematical precision the exact figure for the pass through, but we can put a lower and upper limit to the range of possible effects.¹⁰⁴

6.53 We recognise the existence of a genuine debate on the values of parameters in economic models. Furthermore, we recognise that the parameters employed in the US Treasury model are in the upper range of estimates. Nonetheless, they fall within an acceptable range, underlined in particular by the fact that the US Treasury itself used them to report to Congress. The United States has suggested various possibilities based on different assumptions and variables, which could yield an estimate of the trade effects of the FSC/ETI scheme on the European Communities that is lower than the amount of countermeasures the European Communities proposes to take. On balance, however, we would consider them not to be persuasive, and certainly not inherently more persuasive than the figures proposed by the European Communities.

6.54 Even if one were to assume equal plausibility of the various variables and outcomes, an examination of them would at most lead to the conclusion that the trade effects of the measure on the European Communities were not *proven* to be either higher or lower than the proposed amount of countermeasures. That would evidently not be sufficient to lead us to conclude that the countermeasures proposed are disproportionate. Absence of proof on a point that is objected is not enough to undermine a judgement that is otherwise substantiated. In these circumstances, one would certainly not be entitled to conclude that the benefit of the doubt in the face of competing figures must always go to the Member challenging the proposed amount of countermeasures, in this instance the United States. Such an assessment – based on the trade effects of the measure on the European Communities as suggested by the United States – would actually lead, in this instance, to the conclusion that the proposed countermeasures could not be considered to be "disproportionate" to these effects.

6.55 Not that, in this case, it is the situation we would in fact find ourselves in. It appears to us that, on balance, the European Communities figures are at least as plausible as the low estimates put forward by the United States. The wording of footnote 9 makes it clear that we must make our assessment in light of the fact that the subsidy concerned is prohibited. Here we recall that the last part of footnote 9 suggests that this is an aggravating rather than mitigating consideration, and that in assessing the "appropriateness" of such countermeasures – in light of the gravity of the breach – a margin of appreciation is to be granted.¹⁰⁵ That can only reasonably be construed to entail that, in a situation where there is no more inherently plausible reason to opt for a lower rather than higher number, it would be inconsistent with the direction of the footnote to automatically default to the lower option. That would be effectively to go in the opposite direction from that laid down in footnote 9.

6.56 Moreover, to the extent that there is an even chance of error, any presumption for a lower number would systematically bias the risk in favour of creating a disincentive to conforming with

¹⁰³ The market access landscape for industrial products as a result of the Uruguay Round was a reduction in average tariffs of 40 per cent from 6.3 per cent to 3.8 per cent. Furthermore, the proportion of products entering duty-free in the developed country markets would increase from 20 to 44 per cent, while the proportion of products facing tariffs above 15 per cent declined from 7 to 5 per cent (GATT Secretariat (1994), *The Results of the Uruguay Round of Multilateral Trade Negotiations*, Geneva, GATT). In addition, the United States did not successfully rebut arguments presented by the European Communities as to the increasing global competition in markets for industrial goods. In particular, the European Communities cited relevant economic literature suggesting rising global competition to US firms (see EC Answer to Question 47 by the Arbitrator).

¹⁰⁴ An upper limit would be 100 per cent, whereas a lower limit could be the estimate for the similar programme in the 1970s of 75 per cent (see EC Answers to Questions from the Arbitrator, para. 134).

¹⁰⁵ See paragraph 5.62 above.

withdrawal of the subsidy. That would be entirely contrary to the direction of footnote 9. Thus, the objective of the requirement must be to ensure that the incentive is more likely to ensure respect for the objective of withdrawal of a prohibited export subsidy as the sole way to restore the preexisting balance of rights and obligations.¹⁰⁶ For these additional reasons, we are all the more comfortable in our judgement in this case.

6.57 Consequently, even if consideration is given to the adverse trade effects of the measure on the European Communities in this case, we would not have any reliable basis to conclude that, based on the trade effects of the measure on the European Communities (and taking account of the manner in which these are to be judged), the amount of countermeasures proposed by the European Communities would be out of proportion with these effects.¹⁰⁷

6.58 Moreover, we recall that beyond the reasonable margin of appreciation that might exist in assessing the actual trade effects of the measure on the European Communities, Article 4.10 would in any event not only allow for, but indeed directs that, in our assessment, we provide for a consideration of the prohibited nature of the subsidy. As we have noted above, this entails, in our view, a consideration of the gravity of the initial breach, and of the fact that, in itself, the maintenance of the measure in violation of the United States' obligations under the *SCM Agreement* upsets the balance of rights and obligations between Members, and more specifically, between the United States and the European Communities. As we have seen, in this case, the prohibited measure is a scheme that is available systemically and on a very wide scale. It thus has the potential of creating instability in the trading conditions across a broad range of sectors. This is in itself an appropriate consideration in an assessment of whether the proposed countermeasures are relevant, even if an assessment were to be made on the basis of actual trade effects of the measure on the complaining Member.

6.59 Such an element can only be conceived, in quantitative terms, as ensuring an entitlement to a Member taking countermeasures that it is at a level somewhat higher than what a very precisely constructed estimate of trade effects (should such a calculation be feasible) would lead to. For the reasons outlined elsewhere above, to conclude otherwise would effectively reduce the terms of Article 4.10 and footnote 9 thereto to a pure "trade effects" standard, thereby undermining the whole object and purpose of ensuring that such a distinction be made, respected and enforced effectively in the *SCM Agreement*.

6.60 We therefore do not find any reason to reach a different conclusion from that already reached on the basis of the European Communities proposed approach, having now also examined the proposed level of countermeasures from the perspective of the measure's trade effects on the European Communities.

C. CONCLUDING REMARKS

6.61 Finally, although we are satisfied that the countermeasures are not disproportionate, we wish to address any possible residual concern that the European Communities cannot be entitled to *de facto* act *erga omnes* on behalf of the WTO membership, as it were.

¹⁰⁶ As a practical application, one could relate this to pass through. Even if one took the view that there was no decisive evidence for 100 per cent pass through, in a situation where plausibility was at stake, say, as between 75, 90 or 100 per cent, it would need to be borne in mind that the prohibition of export subsidies is not inherently conditioned on whether or not the export subsidy is entirely passed through into prices. A dollar of export subsidy is a dollar of export subsidy. That being so, in circumstances where there is no decisive element to opt for one particular alternative, the direction in footnote 9 comes into play, to the effect that there is no presumption that a lower option should prevail.

¹⁰⁷ We recall that the United States itself considered that they did not provide a reliable tool, in this case, to estimate these effects, in light of the number of uncertain variables that would need to be accounted for.

6.62 That is not how we see the matter before us. First, to the extent that there was any suggestion that entitlement to countermeasures to the level we have determined was reflecting "trade effects" on parties other than the European Communities, this would have no foundation. To repeat, we consider that our finding is warranted, based on the equivalence in the breach of the original rights and obligations taking into account the gravity of the breach. Where we addressed the issue of trade effects, we have in any case done so only in respect of those relating to the European Communities.

6.63 Second, the conclusion we have reached is not in any sense, a matter of "entitling" the European Communities to act "on behalf" of Members other than itself. As we have underlined in our reasoning above, it is proposing countermeasures relating to the redress of rights and obligations as between those two Members. In the facts of this case, we are dealing with the precise situation at hand. That precise situation at hand is that it is the European Communities that has sought the entitlement to take countermeasures. In doing so, the fact that this is a matter between two Members is a relevant factor which we have taken into account. Should the matter ever arise, our finding does not affect the ability of other complainants to subsequently request, and, if warranted, obtain an authorization to take appropriate countermeasures in accordance with Article 4.10 of the *SCM Agreement*. By definition, in the event that any such case could arise hypothetically, it need only be stated that there is, in our view, no reason to presume that an arbitrator who might be required to address such a complaint in future would not take into account all the relevant factors in determining what might, at the time it is ruling, constitute "appropriate countermeasures" in such future case.¹⁰⁸

6.64 In light of the above, we find that the amount of countermeasures proposed by the European Communities in this case is "appropriate" within the meaning of Article 4.10 of the *SCM Agreement*.

VII. EC REQUEST IN RESPECT OF THE VIOLATION OF ARTICLE III:4 OF THE GATT 1994

7.1 We note that the European Communities has requested a specific amount of countermeasures, and has clearly limited its request to this amount. The European Communities made clear its view that it would be necessary for us to consider whether an additional amount of suspension of concessions needs to be awarded under Article 22.7 of the *DSU*, in particular with regard to the violation of Article III:4 of the *GATT 1994*¹⁰⁹ in the event that we were to decide that the appropriate amount of countermeasures under Article 4.11 of the *SCM Agreement* is less than the requested amount. We have concluded that countermeasures in the amount of \$4,043 million, as proposed by the European Communities, would constitute "appropriate countermeasures" in the circumstances of this case. We therefore do not need to address the issue of suspension of concessions or other obligations in relation to the violation of Article III:4 of the *GATT 1994*.

VIII. AWARD OF THE ARBITRATOR

8.1 For the reasons set out above, the Arbitrator determines that, in the matter *United States – Tax Treatment for "Foreign Sales Corporations"*, the suspension by the European Communities of concessions under the *GATT 1994* in the form of the imposition of a 100 per cent *ad valorem* charge on imports of certain goods from the United States in a maximum amount of \$4,043 million per year, as described in the European Communities' request for authorization to take countermeasures and suspend concessions, would constitute appropriate countermeasures within the meaning of Article 4.10 of the *SCM Agreement*.

¹⁰⁸ We refer to paragraph 6.29 above and the European Communities' statement in this respect.

¹⁰⁹ EC response to Question 2 of the Arbitrator.

ANNEX A - CALCULATION OF THE AMOUNT OF THE SUBSIDY

A.1 The purpose of this annex is to present the arguments and methodologies for the estimation of the value of the subsidy for the year 2000.

A.2 There is no actual data available for the year 2000.¹¹⁰ The starting-point for the analysis is, therefore, the revenue cost of the FSC scheme for 1996, the latest year for which data is available.¹¹¹ The parties differ in their views about the methodology to be used to project the 1996 figure forward to the year 2000.¹¹²

A. ARGUMENTS OF THE PARTIES

1. Calculation of the unadjusted value

A.3 The first submission of **the European Communities** states that the actual revenue cost of the programme (subsidy) is known only for 1996. In this year the cost of the programme was \$2,972 million.¹¹³ They propose two alternative methodologies in order to estimate the value for later years. First, one based on a US Treasury approach that assumes a growth rate of 8 per cent. In this scenario the value of the subsidy is \$4,043 million in the year 2000. Second, actual exempt income under the FSC programme grew at an average annual rate of 16.7 per cent from 1987 to 1996.¹¹⁴ If this growth rate were applied the value of the subsidy in 2000 would be \$5,512 million.¹¹⁵

A.4 In its comments on the European Communities Methodology, **the United States** proposed the use of the US Dept. of Treasury published tax expenditure estimate of the subsidy for that year.¹¹⁶ This figure is stated in the United States first submission as the figure used in the Budget of the United States government as \$3,890 million for 2000.¹¹⁷ Since the programme is applied across the board an adjustment is required to take services trade into account. The United States argues that this adjustment should be 8.3 per cent to deduct agricultural, computer, motion picture, engineering and architectural services.¹¹⁸ The value of the subsidy in 2000 according to the United States is, therefore, \$3,567 million.¹¹⁹

A.5 Section V of the United States second submission addresses the methodology issue directly and makes some amendments to the above figure. It argues that there are two elements to be considered in the growth of the subsidy. The first is the revenue cost per dollar of FSC exports, or the value of the subsidy divided by FSC exports. The second is the ratio of FSC exports to total exports. By separating the value of the subsidy from total exports, actual data on United States exports can be

¹¹⁰ We note in this respect that the European Communities argued in the course of the proceedings that more recent actual data should be available through a report to be presented to Congress for the period 1997-2000. In response to a question by the Arbitrator, the United States indicated that the US Department of the Treasury has been collecting and processing data on the operation of the FSC programme every four years since 1992, and that the most recent year for which data have been collected and analyzed in 1996. While data has been collected for the year 2000, the "finished data" for tax year 2000 should be available by the end of 2002. Publication of the analyzed data is not expected before 2004. The United States also indicates that the production of tax returns would not be permissible under US law, and that the use of selected data would produce an unreliable and potentially very misleading picture of the programme's operation in the year 2000 (see US answers to Questions, paras. 75 to 83).

¹¹¹ Exhibits EC 11 and US 15.

¹¹² These are summarized in exhibits EC 11 and US 15.

¹¹³ Para. 34.

¹¹⁴ EC first submission para 41.

¹¹⁵ EC-3.

¹¹⁶ Para. 7.

¹¹⁷ Page 28.

¹¹⁸ Page 29.

¹¹⁹ US first submission para 74 .

used for estimation purposes. As a result, the only component of the subsidy that needs to be estimated is the revenue cost per dollar. The United States estimate of the growth rate of this component is 1 percent based on economic data for the period from 1997 to 2000.¹²⁰

A.6 In order to better understand how this estimate is calculated, the United States breaks down the overall revenue cost of the FSC/ETI programme into its three determinants: the revenue cost per dollar of eligible exports, the ratio of FSC exports to total United States exports, and total United States exports.¹²¹

A.7 The relevant information on these components is:

- In 1987 the revenue cost per dollar of FSC exports was 0.092 per cent, 0.091 per cent in 1992 and 1.04 per cent in 1996. The average rate of growth from 1992 to 1996 was 3.3 per cent;
- The share of total United States exports was 33.7 per cent in 1987, 34.6 per cent in 1992 and then 46.7 per cent in 1996. The average rate of growth of this component was 7.5 per cent from 1992 to 1996. The United States argues that the growth rate forecast of these two components (combined) to be 1 per cent¹²²; and
- The usage of FSC (the ratio of exempted revenues to the value of total exports) was 1.36 per cent in 1996. At a one per cent annual average growth rate, this figure would reach 1.414 per cent in 2000 and 1.429 in 2001.

A.8 The total global unadjusted subsidy, according to the United States would be \$3,869 million in 2000, which differs from its original estimate.¹²³

A.9 The European Communities agreed to the revised United States methodology which takes into account actual data, subject to two provisions.¹²⁴ The first was the year to be calculated. The second is that the growth rate of the usage of the FSC provision should be the 1992 to 1996 growth rate. The European Communities does not consider that the utilisation of the scheme between 1987 and 1996 is appropriate since the United States corporate income tax rate declined from fiscal year 1987 to fiscal year 1992.¹²⁵ It argues that the decrease in the corporate tax rate would have a negative impact on the usage of the FSC scheme. Accordingly, it argues, the growth rate should be 1992 to 1996 during which tax variables were constant.¹²⁶

A.10 The United States has identified three factors, which it considers to underpin the US Treasury estimate for the period 1996 to 1999. These are: the ratio of taxable profits to sales of manufacturing corporations with positive tax liabilities, the ratio of FSC exports to total exports, and the overall United States tax rates.¹²⁷ The United States goes on to say that the key aspect of these three points is that they rely on data from the actual period to be estimated, as opposed to extrapolating forward from

¹²⁰ US Second submission para. 84.

¹²¹ US Second Submission paragraphs 77-78.

¹²² US Second Submission para. 84.

¹²³ US Second Submission para. 86.

¹²⁴ EC Oral Statement para. 47.

¹²⁵ EC Oral Statement, para. 50.

¹²⁶ EC Oral Statement, para. 50.

¹²⁷ US Answers to questions from the Arbitrator, para. 122.

past rates.¹²⁸ The United States further amplified on these points in a response to a specific question on this issue from the Arbitrator.¹²⁹

A.11 The European Communities has maintained its position that they view the approach of the Treasury as arbitrary and that the US Treasury has consistently underestimated the value.¹³⁰ It argues that, based on the new methodology proposed by the United States, the growth rate from 1996 to 2000 should be based on the 1992 to 1996 growth rate¹³¹, since the United States approach "lacks any solid basis".¹³²

A.12 The European Communities also criticises the use of unreferenced data by the United States. They cite tabulations 1 and 2 from the United States Answers to additional questions from the Arbitrator that are "done by the Office of Tax analysis, US Department of Treasury".¹³³ They also specifically address the determinants proposed by the United States. For example, they argue that there is a difference between the profitability of the overall manufacturing industry and the profitability that can be attributed to export sales.¹³⁴ With respect to the figures on profits, the European Communities produced data from the Economic Report of the President that challenge the United States data on profitability, and cited a study that showed that the major FSC beneficiaries has increased their FSC benefits in absolute amounts during the period 1996-2000.¹³⁵

A.13 Taken together, if the 1992-1996 usage rate is applied, the European Communities estimate of the unadjusted subsidy for 2000 is \$5,577 million (table A.1).¹³⁶ In contrast, the estimate of the unadjusted subsidy using the United States methodology is \$3,869 million.

2. Adjustments to the estimated total

A.14 We note that the parties differed slightly in their approaches to this aspect of the calculation. While the European Communities contended that "if it were appropriate to reduce [its] estimates of revenue foregone by an amount corresponding to sales of services, the reduction would be very small and well within the overall margin of underestimation built into the European Communities' conservative request"¹³⁷, the United States initially proposed a one per cent downward adjustment to the total subsidy amount¹³⁸, and subsequently endorsed a methodology involving a 0.57 per cent reduction of the amount calculated for the subsidy.¹³⁹ The European Communities accepted that any possible reduction for services could only be 0.57 per cent. However, it also contested that any deduction was necessary because, in its view, the obligation of the United States is to withdraw the FSC/ETI scheme, and there is no indication that the United States would have introduced this scheme for engineering and architectural services only or that it would remove it for all exports except for engineering and architectural services.¹⁴⁰ In the view of the European Communities, to reduce the countermeasures in respect of these services would reduce the amount of the appropriate countermeasures to less than the benefit and therefore to below the level needed to induce compliance.

¹²⁸ US Answers to questions from the Arbitrator, para. 122.

¹²⁹ Question 10 of Additional Questions from the Arbitrator and the response of the United States to that question.

¹³⁰ EC Second submission paras 40-45.

¹³¹ EC Oral Statement, para 52 and Exhibit EC-11.

¹³² EC Comments on US Responses to Additional Questions from the Arbitrator, para 16.

¹³³ EC Comments on US Answers to Additional Questions from the Arbitrator, para 17.

¹³⁴ EC Comments on US responses to Additional Questions from the Arbitrator, para 19.

¹³⁵ The data is produced in exhibit EC 17 and the study was submitted as Exhibit EC 15.

¹³⁶ EC Response to questions from Arbitrator, para. 52.

¹³⁷ EC first submission, para. 93.

¹³⁸ US Second Submission, para. 23.

¹³⁹ This amount was based on 2000 SOI data: i.e. the proportion.

¹⁴⁰ EC second submission, para. 86.

B. ASSESSMENT BY THE ARBITRATORS

1. **Projection of the value of the subsidy**

A.15 Like previous arbitrators, we consider that we are not bound by the amounts and calculations presented by the parties. If necessary, i.e. if we consider that the amount or calculations of the parties are not appropriate, we may perform our own calculations.¹⁴¹

A.16 We have addressed *supra* the issue of the relevant year to be taken into account, hence we shall proceed with our calculation of the subsidy value for the year 2000.¹⁴²

A.17 Both parties agree that the ratio of net exempt income to United States exports was 0.91 per cent in 1992 and 1.36 per cent in 1996.¹⁴³ Using the standard formula to calculate the average annual growth rate with a period of compounding assumed to be four periods gives the result of 10.69 per cent for the year 2000.¹⁴⁴ The United States has estimated the growth rate to be 1 per cent.¹⁴⁵

A.18 When the 2000 ratio of net exempt income, calculated using the 10.69 per cent per annum, is applied to total United States exports of \$781,918 million, the amount of total exempt income for that year is \$15,940 million. The corresponding amount of the unadjusted subsidy is \$5,577 million for that year. In contrast, using the United States figure of 1 per cent growth rate results in an unadjusted subsidy value of \$3,869 million.

2. **Adjustments to the subsidy**

A.19 Some adjustments to the total amount of the subsidy should be considered in order to reach a figure representing the total value of the subsidy which the United States is required to withdraw as a result of the DSB's rulings and recommendations.

Accounting for services

A.20 The United States initially considered that the amount of the subsidy should be adjusted by deducting amounts which, in its view, were attributable to exports concerning four categories of services. The European Communities objected that of these four categories, only one, architectural and engineering services, did not involve the export of goods. The United States, upon further review, agreed that this was the only statistical category in respect of which an adjustment should be made.¹⁴⁶

A.21 Under the ETI Act, the only way to earn qualifying foreign trade income that does not involve qualifying foreign trade property is through certain engineering or architectural services.¹⁴⁷ We

¹⁴¹ See *Hormones* and *Aircraft* arbitrations, *op. cit.*

¹⁴² See above paras. 2.14 and 2.15.

¹⁴³ Exhibit EC 11 and paragraph 73 of US Second submission.

¹⁴⁴ The formula is $V=A(1+g)^t$. Where V is the final value, A is the initial value, t is the number of time periods, and g is the annual average growth rate.

¹⁴⁵ US Answers to Additional questions, response to question 10.

¹⁴⁶ US Second Submission para 23.

¹⁴⁷ We recall that under the ETI Act, certain income of a United States taxpayer may be excluded from taxation. Such income - "extraterritorial income" that is "qualifying foreign trade income" - may be earned with respect to goods only in transactions involving qualifying foreign trade property. Outside the goods area, such income may be earned in relation to services which are: related and subsidiary to (i) any sale, exchange, or other disposition of qualifying foreign trade property, or (ii) any lease or rental of certain qualifying foreign trade property; for engineering or architectural services for construction projects located (or proposed for location) outside the United States; or for the performance of managerial services for a person other than a related person in furtherance of the production of certain foreign trading gross receipts. ETI Act, section 3; section 942 IRC, as described in Compliance Panel Report, para. 2.3 and note 23.

therefore agree that, for the purposes of fulfilling our mandate concerning the level of countermeasures in relation to the violation of Article 3.1(a) of the *SCM Agreement*, the adjustment to the subsidy amount for exports of services should account for this category of engineering and architectural services.¹⁴⁸

A.22 Since there are differences of view between the parties regarding the growth of the FSC usage rate and adjustments to the gross estimate of the subsidy, there are necessarily differences in the estimates. Nevertheless, if the subsidy is adjusted downwards by 0.57 per cent and upwards by 7.2 per cent, the overall adjustment would be upwards by 6.63 per cent, which is the difference between the two adjustment values. In this case, the estimate of the adjusted subsidy provided by the United States is \$4,125 million, while that of the European Communities is \$5,988 million.

3. Allocating agriculture

(a) Introduction

A.23 The United States initially considered that the amount of subsidies attributable to exports of agricultural products should be deducted for the purposes of determining the amount of "appropriate countermeasures" under Article 4.10 of the *SCM Agreement*. Upon further reflection, it considered that such adjustment was not necessary, because the same proxy approach is necessary. The European Communities argues that the obligation of the United States is to withdraw the whole subsidy, and that the amount of exports of agricultural products under the FSC/ETI scheme is in any case very small.¹⁴⁹ The European Communities has also argued that the existence of a separate violation under the Agriculture Agreement cannot lead to a reduction of the amount of countermeasures below the amount of the subsidy.

A.24 We turn to an examination of the amount of the subsidy for the purposes of the SCM Agreement.¹⁵⁰ In order to identify the agricultural component of the FSC subsidy, we will refer to the product coverage of the *WTO Agreement on Agriculture*. The principal technical challenge involved is that the WTO definition is commodity-based, whereas the industry definitions are a mix of manufacturing and services industries. For example, in the USSIC fishing is included in 090, but so is the operation of fish hatcheries and preserves (table A.2).

(b) Coverage of the *Agreement on Agriculture*

A.25 The *Agreement on Agriculture* covers HS Chapters 1-24, less fish and fish products, plus a number of headings in chapters, 33, 35, 38, 41, 43, and 51-53.¹⁵¹ Fish and fish products are defined as chapter 03, 0509, 1504, 1603-05, 2301.¹⁵²

(c) US Standard Industrial Categories

A.26 The 13 sectors that are used in the European Communities study are aggregated using United States SIC classification. Since these are industry categories they are a mix of both service and

¹⁴⁸ See US first submission, para. 73; US Second Submission, para. 88; EC first submission, para. 93.

¹⁴⁹ First Submission para. 88.

¹⁵⁰ We recall that the 21.5 panel in this case made a separate ruling that the FSC/ETI scheme was in violation of the *Agreement on Agriculture*, in addition to the *SCM Agreement*. The Appellate Body upheld this finding (Article 21.5 Appellate Body Report, para. 256(d)). We also note, in respect of the deduction for agricultural products discussed here, that if a separate assessment were made to evaluate the level of nullification or impairment resulting from the violation of the *Agreement on Agriculture*, this could provide a separate basis for suspension of concessions which would in any event not lower the entitlement to countermeasures under the *SCM Agreement*.

¹⁵¹ See *Agreement on Agriculture, Annex 1*.

¹⁵² From WTO, *Unfinished Business*.

manufacturing industries. The sectors where agriculture products are included are: agriculture, other non-manufactured, food and tobacco.

A.27 The non-manufactured industry in the United States SIC classification includes mining, forestry and fishing, none of which are part of the WTO definition of agriculture. Fish, and fish products are included in the United States SIC other food products (209). Therefore, the exempt income related to that category must be deducted in order to calculate the overall subsidy.

A.28 Isolating exempt income for United States SIC category 209 is problematic, since the only degree of disaggregation of exempt income available to the Arbitrator is the 13 sector level used in the European Communities model. In our view there are only two options to estimate the WTO agriculture consistent definition of agriculture. Either, deduct food from the overall calculation so that the estimate is an underestimate of the true value. Or, include food so that the overall calculation would be an overestimate.

A.29 The second approach has been chosen for the calculation, since fish and fish products are classified in the other food sectors. This classification would imply that such products are, by definition, not core products in the classification. The assumption is that had it been of sufficient importance in terms of production in that category a specific classification number would have been allocated. We recognise that this approach is not perfect, especially since these categories were not structured with respect to key sectors that use FSC programme. It is entirely possible for a significant amount of the exempt income in the food category to be concentrated in the fish and fish product category, but it is impossible to quantify that figure without the relevant data.

(d) Conclusion

A.30 In the absence of any information that would allow fish and fish products to be separated from the food category, the non-agricultural component of the subsidy can be calculated by subtracting exempt income from agriculture, food and tobacco industries.

4. Recalculating the value of the subsidy

A.31 Following from the previous section, the sectoral distribution of the exempt income is given in table A.3. Subtracting the exempt income from agriculture, food and tobacco gives a total value of \$5,843.2 million. This amount can now be used to calculate the estimated value of the subsidy in 2000 using the methodologies proposed by the European Communities and the United States, which is obtained by multiplying the amount of exempt income by 0.65.

A.32 The estimated subsidy using the United States methodology is, therefore, \$3,798 million (table A.1). Using the same procedure for the European Communities yields \$7,860 million for exempt income and a corresponding estimate for the overall subsidy using their methodology of \$5,332 million.

C. CONCLUSION

A.33 Having regard to the figures reached on the basis of the calculation, we note that the final amount of subsidy following the United States approach is \$3,739 million, whereas the final amount following the European Communities approach is \$5,332 million.

A.34 We see merits and shortcomings in both calculations. We also recall that we are not expected to calculate an exact amount but to determine whether the amount of countermeasures proposed by the European Communities, in the amount of \$4,043 million, is appropriate. In these circumstances, we find that the amount of \$4,043 million, which falls within the range of reasonable values

calculated on the basis of the parties' respective methodologies, can be considered to be a reasonable approximation of the actual value of the subsidy for the year 2000.

Table A.1 - Calculating the value of the subsidy for the year 2000

	United States	European Communities
FSC Usage growth rate	.01 per annum	.106886 per annum
FSC Exempt Income in 2000		
Total US Exports*	\$781,918 million	\$781,918 million
Unadjusted subsidy value in 2000	\$3,869 million	\$5,577 million
Adjustment		
Services (-0.57 %)	\$22 million	
ETI Adjustment (+7.2%)	\$278 million	\$401 million
Estimated value with agriculture	\$4,125 million	\$5,988 million
Estimated value without agriculture	\$3,739 million	\$ 5,332million

* Source: WTO (2002), www.wto.org

Table A.2 – United States Standard Industrial Classification

Agriculture	
010	Agricultural production – crops
020	Agricultural production – livestock and animal specialties
070	Agricultural services
Forestry, and Fishing	
080	Forestry
090	Fishing, hunting and trapping
Food and Kindred Products	
201	Meat products
202	Dairy products
203	Preserved fruit and vegetables
204	Grain mill products
205	Bakery products
208	Beverages
209	Other food and kindred products
210	Tobacco

Table A.3 - Pre-tax exempt income (millions of dollars)

	1996	US 2000	EC 2000
Agriculture	118.7	165.3	222.9
Other non-manufactured	435.6	644.8	818.3
Food	153.3	214.2	287.9
Tobacco	153.6	214.2	288.5
Lumber	30.3	42.1	56.9
Paper	74.5	103.7	139.9
Chemical	729.8	1018.2	1370.9
Rubber	24.4	33.8	45.8
Primary metal	44.2	61.6	83.0
Fabricated metal	59.9	83.4	112.5
Non-electrical machinery	742.5	1036.3	1394.8
Electrical machinery	911.7	1272.2	1712.6
Transport equipment	644.3	898.8	1210.3
Scientific instruments	254.4	355.4	478.0
Other manufactured	137.0	202.1	257.3
TOTAL	4513.9	6346.1	8479.5
Total non –agriculture	4088.4	5752.4	7680.2

Source: WTO, based on submissions by the parties.
