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

WT/DS108

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I. INTRODUCTION

1. In this submission, the United States will respond to arguments made by the European Communities ("EC") at the meeting with the Arbitrator on March 7, 2002. Before addressing those arguments, however, it is useful first to take stock of where we are in this proceeding.

2. There are two basic approaches one can take to arbitration proceedings regarding the amount of countermeasures. One approach is to treat the proceeding as essentially nothing more than a negotiation. Under this approach, the party seeking to impose countermeasures comes in with an unrealistically high figure and the party which is the target of the countermeasures comes in with an unrealistically low figure. Both parties pay little heed to the law or the facts, but instead count on the arbitrator to pick a number somewhere in the middle.

3. This appears to be the approach that the EC has taken. It has justified its figure of $4.043 billion as "conservative and moderate" by asserting that the amount to which it would be entitled is actually $13.5 billion.[1] Presumably, the EC hopes that merely by repeating this figure, the Arbitrator will be persuaded that the $4.043 billion figure is reasonable.

4. As the United States has demonstrated, however, the $4.043 billion figure is not reasonable. Among the more glaring errors in the EC's "methodology" that purports to justify this figure are the following:

- The EC's estimate of the total amount of the subsidy was based on projected exports that vastly exceeded the amount of actual U.S. exports.

[1] *See EC First Submission*, para. 59.

- The EC's estimate of the projected FSC usage rate was based on experience during a narrow time period in which the United States experienced unprecedented economic growth.

- The EC's estimate of the trade effect of the subsidy relied on the EC's inaccurate calculations of the amount of the subsidy.

- The EC's estimate of the trade effect of the subsidy relied on the methodology used for purposes of the 1997 Treasury study even though that study expressly stated that the methodology used therein overstated the effects of the subsidy.

- The EC simultaneously argues that: (1) the subsidy is fully passed through in the form of lower export prices; and (2) none of the subsidy is passed through because companies pocket the tax savings in the form of higher profits.

- The EC even has gone so far as to dispute the necessity of an adjustment to the amount of the subsidy for engineering and architectural services, notwithstanding the fact that exports of services are not subject to the SCM Agreement.

5. The other approach to an arbitration proceeding is to treat it like any other WTO dispute settlement proceeding in which the outcome will depend on an objective assessment of the law and the facts. This is the approach that the United States has attempted to take. To the extent actual data exists, the United States has relied on it to calculate the amount of countermeasures to which the EC should be entitled. In addition, in the legal positions it has advanced, the United States has taken principled positions, even where those positions work against its interests in this case. Thus, for example, the United States has urged the Arbitrator to rely on data for the year 2000, notwithstanding that reliance on data for the year 2001 would generate a lower amount of countermeasures. Similarly, the United States has argued that the EC's share of the total amount of the subsidy should be determined on the basis of production data, notwithstanding that the EC's trade flows approach – when correctly calculated – would generate a lower figure. The net result is that the United States has not tried to "low ball" the number, but instead has presented a

figure – $1.106 billion for 2000[2] – that is supported by the law and the facts and that satisfies the dual objectives of inducing compliance and restoring the balance of concessions.

II. THE EC INTERPRETATION OF ARTICLE 4.10 OF THE SCM AGREEMENT IS UNTENABLE

6. As noted above, the EC has attempted to justify its $4.043 billion figure by claiming that the amount to which it would be entitled is $13.5 billion. Because the United States has demonstrated that the $13.5 billion figure is a fiction that is unsupported by the facts, the final refuge of the EC is in its assertion that Article 4.10 of the SCM Agreement permits countermeasures to be determined without regard to the trade impact of a subsidy on the complaining Member. The United States believes that it has demonstrated that the opposite is the case, and that Article 4.10 requires that countermeasures not be disproportionate to the trade impact of a subsidy on the complaining Member. Nevertheless, it is useful to recount the arguments made by the EC in support of its position in order to demonstrate how untenable that position is.

A. The EC's Interpretation of Article 4.10 Is Inconsistent with Customary Rules of Interpretation of Public International Law

7. One of the most remarkable aspects of the EC's interpretation of Article 4.10 is that it completely ignores customary rules of interpretation of public international law as reflected in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties* ("*Vienna Convention*"). The EC never once attempts to identify the ordinary meaning of the term "countermeasures" in

[2] As explained below, the United States has discovered some computational errors in the calculations presented in the *US Second Submission*. The correct figure of $1.106 billion is slightly lower than the figure of $1.1 billion originally proposed by the United States.

Article 4.10, which, as the United States has explained, is "An action taken to counteract a danger, threat, etc." or "A measure or action taken in opposition to another".[3] The EC stated in an oral comment at the meeting with the Arbitrator that the ordinary meaning of "countermeasures" is not helpful, but it never has explained why this is so.[4]

8. Instead, the EC bypasses the *Vienna Convention* and asserts that the term "countermeasures" in Article 4.10 has a special meaning.[5] The EC's *sole* justification for this assertion is the decision of the arbitrator in *Brazil Aircraft*.[6] There are several problems with this approach.

9. First, customary rules of interpretation, as reflected in Article 31(4) of the *Vienna Convention*, do provide that "[a] special meaning shall be given to a term *if it is established that the parties so intended*." (Emphasis added). However, the EC offers no evidence that the drafters intended that the term "countermeasures" have a special meaning, and the EC does not even refer to Article 31(4). Instead, the EC merely cites to *Brazil Aircraft*, a case in which the arbitrator itself did not provide any justification as to why the term "countermeasures" should be accorded a special meaning under Article 31(4) of the *Vienna Convention*, nor an explanation as to why it chose to ignore the other rules of interpretation reflected in Articles 31 and 32 of the *Vienna Convention*. In the view of the United States, the arbitrator's decision to simply borrow a

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[3] *See US Oral Statement*, para. 15 and materials cited therein.

[4] At the meeting, the EC also asserted that the United States agreed with the EC on this point. This assertion is erroneous, and in its questions to the EC the United States has asked the EC to identify precisely where in the U.S. written submissions this agreement allegedly is reflected.

[5] *EC Second Submission*, para. 17.

[6] *Id.*, citing to *Brazil - Export Financing Programme for Aircraft - Recourse to Arbitration by Brazil Under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement* ("*Brazil Aircraft*"), WT/DS46/ARB, Decision of the Arbitrators circulated 28 August 2000.

definition from outside the WTO agreements constituted legal error and would have been so found had the decision been subject to review by the Appellate Body.

10. To make matters worse, the EC's unique interpretation of "countermeasures" is inconsistent with its position regarding the relevance of the Draft Articles. At the March 7 meeting, the Arbitrator asked both parties about the relevance of the Draft Articles to the instant proceeding.[7] The EC appeared to agree with the United States that the Draft Articles have no relevance. However, if the Draft Articles have no relevance, how can they supply the definition of a term used in the SCM Agreement?

11. Of course, there is no secret as to why the EC is engaging in such an unconventional, internally inconsistent method of treaty interpretation. If the term "countermeasures" were interpreted in accordance with the customary rules reflected in Articles 31 and 32 of the *Vienna Convention*, an interpreter would have to take into account the object and purpose of the WTO Agreement and its dispute settlement provisions. That purpose, which the EC does not dispute, is twofold: (1) to induce compliance; and (2) to restore the balance of concessions. In order to justify its unique interpretation of Article 4.10, the EC needs to get rid of the second purpose. Its method of doing so is to go outside of the WTO agreements in order to find a definition of "countermeasures" that suits its purposes in this case.

12. Unfortunately for the EC, the path to its unique interpretation is securely blocked by Article 3.2 of the DSU. Article 3.2 establishes that the WTO dispute settlement system serves "to clarify the existing provisions of [covered] agreements in accordance with customary rules of

[7] This question was reduced to writing as Question 4 in the written questions from the Arbitrator.

interpretation of public international law." These rules cannot be cast aside on a case-by-case basis because one party considers it convenient to do so.

B. The Fact that Article 4.7 of the SCM Agreement Calls for the Withdrawal of the Subsidy Provides No Support for the EC Interpretation

13. The second argument used by the EC to justify its interpretation is the fact that Article 4.7 of the SCM Agreement calls for the "withdrawal" of the subsidy.[8] However, this purpose is not so different from the standard remedy under Article 19.1 of the DSU as to justify the EC's radical interpretation of Article 4.10.[9]

14. First, although Article 19.1 uses different words – "bring the measure into conformity" – in reality it requires the withdrawal of a measure found to be WTO-inconsistent. To bring a measure into conformity within the meaning of Article 19.1, a Member either has to withdraw the measure altogether – as would be the case with respect to a simple import quota that violates Article XI of GATT 1994 – or it would have to amend the measure to render it WTO-consistent. By amending the measure, however, the Member effectively "withdraws" the measure found to be WTO-inconsistent and replaces it with a new measure that is supposed to be WTO-consistent.

15. Second, it is questionable whether Article 4.7 of the SCM Agreement requires "withdrawal" in the literal manner suggested by the EC argument. A better reading of Article 4.7 is that it permits a Member to either eliminate the subsidy altogether or eliminate the contingency that caused the subsidy to be prohibited. The EC itself appears to have recognized this when it informed the Article 21.5 panel that the ETI Act would be consistent with the SCM Agreement if

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[8] *See, e.g., EC Second Submission*, para. 59.

[9] As the United States previously has noted, Article 3.7 of the DSU calls for the "withdrawal of the measures concerned". *See, e.g., US Second Submission*, para. 55.

the requirement for "use outside the United States" were eliminated.[10] This also appears to be the position taken in *Canada Aircraft*, where there was no dispute that Canada had withdrawn the subsidy found to be prohibited by restructuring the TPC program; the only question was whether the revised TPC program was WTO-consistent.[11] Any other result would be nonsensical, because it would conflict with the right of Members to provide non-prohibited subsidies.

C. The Fact That Article 4.10 Is a Special or Additional Rule and Procedure Provides No Support for the EC Interpretation

16. The final argument used by the EC to justify its interpretation of Article 4.10 is that Article 4 contains special or additional rules and procedures within the meaning of Article 1.2 of the DSU.[12] It is unquestionably correct that Article 4 contains special or additional rules and procedures within the meaning of Article 1.2 of the DSU. However, that fact does not support the EC's radical interpretation of Article 4.10.

17. In this very dispute, the Appellate Body stated that "'the rules and procedures of the DSU apply *together with* the special or additional provisions of the covered agreement' except that, 'in the case of a *conflict* between them', the special or additional provision prevails."[13] Rather than

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[10] *See United States - Tax Treatment for "Foreign Sales Corporations" - Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW, Report of the Panel, as modified by the Appellate Body, adopted 29 January 2002, Annex F-1, para. 148.

[11] *Canada - Measures Affecting the Export of Civilian Aircraft - Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, Report of the Appellate Body adopted 4 August 2000, para. 33-34.

[12] A fourth EC argument is really nothing more than blind adherence to *Brazil Aircraft*. The United States believes that it already has demonstrated that *Brazil Aircraft* is distinguishable on its facts, and that, to the extent the EC is trying to apply *Brazil Aircraft* to a dramatically different set of facts, the arbitrator's decision in that case was seriously flawed. *See US Second Submission*, paras. 34-63; and *US Oral Statement*, paras. 26-27.

[13] *United States - Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R, Report of the Appellate Body adopted 20 March 2000, para. 159, quoting from *Guatemala - Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, Report of the Appellate Body adopted 25 November 1998, para. 65 (emphasis in original).

trying to read these provisions together, which would comport with the presumption against conflicts in the interpretation of public international law,[14] the EC instead urges an approach that would manufacture a non-existent conflict between Article 4.10 and the provisions of the DSU, particularly Article 22.4 of the DSU.

18. The EC tries to confuse things by asserting that Article 4.10 "would be reduced to redundancy and inutility" if the U.S. interpretation were accepted.[15] Here, the EC confuses the issues. There is no dispute that the standard under Article 4.10 – "not disproportionate" – is different from the standard under Article 22.4 of the DSU – "equivalence". In this sense, Article 4.10 prevails over Article 22.4. Instead, the real issue in dispute is the "thing" to which the standard of Article 4.10 is to be applied; *i.e.*, disproportionate with respect to what?

19. Thus, interpreting Article 4.10 so as to require a consideration of the trade impact of a subsidy on the complaining Member in no way renders Article 4.10 redundant, because the standard of "disproportionality" is preserved. At the same time, such an interpretation avoids creating an unwarranted conflict between Article 4.10 and the DSU by requiring that disproportionality be measured in terms of the trade impact of a subsidy on the complaining Member, as opposed to the EC's nebulous standard of inducing compliance.

III. THE EC'S CALCULATION OF THE AMOUNT OF THE SUBSIDY CONTINUES TO BE INCORRECT

20. While the United States is pleased that the EC has tacitly acknowledged that its original methodology for calculating the amount of the subsidy had FSC/ETI exports exceeding total U.S.

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[14] *See Indonesia - Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, Report of the Panel adopted 23 July 1998, para. 14.28 and materials cited therein.

[15] *EC Oral Statement*, para. 43.

exports, the United States does not agree with the recalculation of the subsidy amount reflected in Exhibit EC-11. The United States continues to believe that it is inappropriate to rely on the growth rate for FSC usage between 1992 and 1996, and that the Arbitrator instead should rely on the growth rate of 1 percent as used by the U.S. Department of the Treasury for purposes of its tax expenditure estimates. Because this issue is addressed in the U.S. response to Question 31 from the Arbitrator, we will not repeat that discussion here.

21. The United States also disagrees with the EC's suggestion that the Arbitrator rely on data for the year 2002. The United States previously has explained why it would be inappropriate to determine the amount of countermeasures on years beyond 2001.[16] Instead of responding to the U.S. arguments, however, the EC merely has opined that it "does not see any reason to base estimates of the subsidy amount on US fiscal years 2000 or 2001."[17] The United States addresses this issue in response to Question 31 from the Arbitrator.

IV. THE EC'S ARGUMENTS REGARDING THE MEASUREMENT OF THE TRADE EFFECT OF THE FSC/ETI SUBSIDY ARE INCORRECT

22. In its oral statement, the EC made a number of points regarding the measurement of the trade effect of the FSC/ETI subsidy that are incorrect. The U.S. answers to the questions from the Arbitrator respond to many of these points, and we will not repeat those responses here. Instead, in this section the United States responds only to those points that are not addressed in the U.S. answers.

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[16] *Id.*, paras. 98-100.
[17] *EC Oral Statement*, para. 52.

A. The Fact That the 1997 Treasury Study Was Submitted to the U.S. Congress Does Not Require the Use of the Methodology Reflected in That Report

23. In paragraph 69 of the *EC Oral Statement*, the EC asserts that the Arbitrator should use the methodology used by Treasury in its 1997 report to the U.S. Congress because "this methodology is the one that has been presented to the US body politic by its own experts acting under a legal mandate as the best way to estimate the trade effect of the FSC scheme." The EC argument is specious for several reasons.

24. First, the fact that this report was submitted to the U.S. Congress does not mean that the methodology reflected therein is appropriate for use by a WTO dispute settlement body. Like other reports of this type that Congress requires from the Executive Branch of the U.S. Government, no legal consequences are attached to the report or to any conclusions made or assumptions used therein.

25. Second, the report itself states that the effect of the subsidy described therein is overstated.[18] The EC never addresses this point, but essentially argues that the Arbitrator should use the Treasury methodology only in part; *i.e.*, use the formula but ignore the fact that the formula overstates the effect.[19]

26. Finally, the EC argument is inconsistent with its position concerning the Treasury tax expenditure estimates. The EC claims that those tax expenditure estimates should not be used

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[18] Exhibit EC-1, page 12.

[19] In its answers to the questions from the Arbitrator – particularly in the answers to Questions 21 and 25 – , the United States discusses in greater detail the methodological problems inherent in the EC's use of the Treasury model.

because they allegedly underestimate the amount of the subsidy.[20] However, these tax expenditure estimates, like the 1997 Treasury report, are submitted to the "US body politic". Thus, under the EC's theory, those estimates should be used to determine the amount of the subsidy.

B. The EC's Criticisms of the Armington Trade Model Are Without Merit

27. In its oral statement, the EC criticized the United States' use of the Armington trade model.[21] For the following reasons, the United States believes that the EC's criticisms are without merit.

28. In its second submission, the United States used the Armington imperfect substitutes model because the objective in this proceeding is to measure the trade effect on U.S. trading partners of the FSC/ETI measure. The Treasury methodology is not explicitly designed to measure the trade effect on specific trading partners. Instead, it was designed to measure the effect on U.S. exports. Whatever the assertions as to its shortcomings, the Armington imperfect substitutes model is one of the most widely-used empirical trade tools in economics for purposes of measuring the trade effects on trading partners of trade and tax policies.

29. The EC commented that the Armington trade substitution elasticities chosen by the United States were too low, thereby producing small trade effects. The EC asserts that trade economists suspect that Armington elasticities are too low. In support of this assertion, the EC

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[20] The Treasury tax expenditure estimates actually may overstate the amount of the subsidy to the extent that they are based on an annual export growth rate of 6 percent. As explained in the *US Second Submission*, para. 69, U.S. exports grew at only a 3.2 percent annual rate from 1996 to 2001.

[21] *EC Oral Statement*, paras. 63-65.

cited Exhibit EC-12, an article downloaded from the U.S. International Trade Commission website regarding this issue.

30. That econometric estimates of trade substitution elasticities are downward biased is, to date, an unfounded assertion. In fact, this is an empirical question and the existing empirical international trade literature has not established that these estimates are higher or lower than the econometric estimates that are in the professional economics literature. With each new econometric study, the trade substitution elasticity estimates are not as high as some might suspect. Thus, the United States has proceeded with the professional economics literature as the only reasonable, defensible approach.

31. Finally, the EC raises the point that the model results are sensitive to the choice of the trade substitution elasticity, and that there are no econometric estimates of the substitutability between U.S. and EC goods and services. The EC point is correct, but the fact remains that substitutability has to be estimated, and the EC appears to have no problem in assuming full pass-through using the Treasury model even though Treasury itself recognizes that such an approach overstates the effects. The United States has relied on the elasticities in the literature, which reflect the trade substitutability between U.S. domestic and imported products. The fact is, U.S. and EC products could be more or less substitutable than U.S. and other-country products. Again, this is an empirical question, and the United States is unaware of any research that has addressed it. Indeed, this is exactly the reason why the United States has cautioned against using a modeling approach. Whether one uses the Treasury or the Armington model, empirical data is lacking for certain key parameter values.

C. The EC's Assumption of a Multiplier Effect Is Not Supported by Evidence

32. Throughout its submissions, the EC relies on the assumption that the effect of the FSC "must be" greater than the amount of the subsidy itself. However, the EC assumption is just that; an assumption. The EC offers no evidence in support of this assumption. Moreover, as noted above, the EC simultaneously argues that FSC users pocket the tax savings, in which case there would be little if any effect, let alone a multiplier effect.

V. THE ARBITRATOR SHOULD FIND THAT THE LEVEL OF NULLIFICATION OR IMPAIRMENT ATTRIBUTABLE TO THE VIOLATION OF ARTICLE III:4 IS ZERO

33. In its second submission, the United States demonstrated, based on the EC's own data, that the 50 percent rule does not have any discernible impact on EC exports of inputs to the United States. In its oral statement, the EC did not even try to counter the U.S. analysis, but instead essentially asked the United States and/or the Arbitrator to do the EC's work for it.[22] The EC even went so far as to ask the Arbitrator to simply assume that the amount of nullification or impairment is $1.5 billion. Such a request is flatly inconsistent with a result grounded in the facts and the law.

34. The EC even goes so far as to admit that its methodology does not give an estimate of the actual impact of the 50 percent rule, but instead only gives an estimate of the *potential* trade impact of that rule.[23] The United States does not believe that the EC methodology even measures

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[22] The EC's assertion that the United States is in possession of information that would allow for a "more sophisticated analysis" is false. *EC Oral Statement*, para. 81. The only relevant information of which the United States is aware is the same input-output table relied on by both the EC and the United States.

[23] *EC Oral Statement*, para. 77.

the potential trade impact, but even assuming *arguendo* that it does, this type of approach was rejected by the arbitrator in the *Section 110(5)* case.[24]

35. In the *Section 110(5)* case, the United States and the EC requested arbitration under Article 25 of the DSU to determine the amount of compensation which the United States should provide to the EC due to the U.S. violation of Article 13 of the TRIPS Agreement. Specifically, Section 110(5) of the U.S. Copyright Act exempted certain small establishments from having to pay licensing fees on the performance of copyrighted music, and this had been found to be a violation of Article 13. The question for the arbitrator was the level of nullification or impairment this violation caused with respect to the EC. Although the arbitration took place under Article 25, the mandate of the arbitrator was the same as it would have been under Article 22 of the DSU; *i.e.*, to determine the level of EC benefits which were being nullified or impaired.[25]

36. The EC argued that the arbitrator should proceed on the assumption that all establishments using copyrighted works of EC rights holders are licensed. This would have required the arbitrator to find that the "economic value of the copyrights at issue . . . corresponds to the licensing revenue *potentially* foregone by EC right holders as a result of Section 110(5)(B)."[26]

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[24] *United States - Section 110(5) of the US Copyright Act - Recourse to Arbitration Under Article 25 of the DSU*, WT/DS160/ARB/25/1, Award of the Arbitrators circulated 12 October 2001 ("*Section 110(5)*").

[25] *Id.*, para. 2.7.

[26] *Id.*, para. 3.4 (italics in original).

37. The arbitrator rejected the EC approach because the evidence showed that for practical, commercial reasons, EC right holders did not attempt to license all users of copyrighted works.[27] Thus, the arbitrator found, it would be inappropriate to assume that in the absence of Section 110(5), EC rights holders would be obtaining licensing revenue from all potential users of copyrighted works. The arbitrator stated as follows:

> In the light of the foregoing, the Arbitrators consider that the European Communities could not reasonably expect that, in the United States, all users of copyright works of EC right holders would be licensed and would pay licensing royalties. As a result, the level of royalty income which the European Communities could reasonably expect EC right holders to receive is, in the view of the Arbitrators, limited to licensing revenue from the numbers of users that *would* be licensed.
>
> The Arbitrators are unable to accept the European Communities' view that the level of benefits which the European Communities could reasonably expect to accrue to it under Articles 11*bis*(1)(iii) and 11(1)(ii) equals the royalty income potentially realisable by EC right holders. Indeed, were the Arbitrators to adopt the European Communities' view, the level of EC benefits *nullified or impaired* as a result of Section 110(5)(B) would be *higher* than the level of benefits which would *actually accrue* to the European Communities if Section 110(5)(B) were brought into conformity with the TRIPS Agreement. The Arbitrators consider that such an outcome would be both inconsistent and unwarranted. It would be quite inappropriate for the Arbitrators to award the European Communities benefits which it is not actually losing as a result of the continued application of Section 110(5)(B).[28]

38. The relevance of the *Section 110(5)* case to the instant dispute could not be more clear. In this case, as in the *Section 110(5)* case, the EC is urging the Arbitrator to based its decision on potential effects, not actual effects. However, the actual data demonstrate that the 50 percent rule has had no discernible impact on EC exports of inputs to the United States, because the

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[27] *See, e.g.*, paras. 3.29-3.31.
[28] *Id.*, paras. 3.33-3.34 (italics in original; footnotes omitted).

percentage of imported goods inputs actually used in producing finished goods in the United States comes nowhere close to the 50 percent threshold or even the EC's arbitrary 40 percent threshold. In the words of the *Section 110(5)* arbitrator, "it would be quite inappropriate to award the EC benefits which it is not actually losing as a result of the continued application of the 50 percent rule."

VI. ANY TRADE IMPACT OF THE 50 PERCENT RULE REDUCES THE TRADE IMPACT OF THE EXPORT SUBSIDY

39. In its second submission, the United States demonstrated that even assuming *arguendo* that the 50 percent rule has some positive impact on EC exports of goods inputs to the United States, the amount of any nullification or impairment attributable to the 50 percent rule would have to be subtracted from the amount of any trade impact attributable to the export subsidy.[29] The EC makes two responses to this argument, neither of which has merit and neither of which disputes the economic logic of the U.S. position.[30]

40. First, the EC claims there is no double counting because an exporter would not claim the subsidy if its costs increased.[31] While it is true that a rational exporter would not claim the subsidy if the total cost increase exceeded the amount of the tax savings, it is equally true that a rational exporter would claim the subsidy so long as there was a net tax savings. For example, if use of the FSC/ETI generated a $10 tax savings and increased costs by only $9, the exporter

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[29] *US Second Submission*, paras. 131-139.

[30] The EC's third response – which is that the EC's claim for suspension of concessions under Article 4.10 of the SCM Agreement is based on the amount of the subsidy – is irrelevant, because, as the United States has demonstrated, that claim must be based on the trade impact of the subsidy. *See EC Oral Statement*, para. 74.

[31] *EC Oral Statement*, para. 73.

would still be $1 better off than if it had not claimed the subsidy. Thus, there is, indeed, double counting in the EC approach.

41. Second, there is no "induced effect" as the EC would have the Arbitrator believe.[32] Here, there is a single measure which both confers a benefit and (assuming *arguendo* that it actually alters firms' behavior) imposes a cost. It would ignore economic reality to fail to take both of these aspects of the single measure into account.

VII. RECALCULATION OF THE AMOUNT OF THE SUBSIDY AND THE EC'S PROPORTIONATE SHARE

42. The United States has uncovered certain computational errors in the figures provided in the *US Second Submission* concerning the total amounts of the subsidy in 2000 and 2001 and the EC's proportionate share thereof. The corrected amount of the total subsidy is $4.125 billion for 2000 and $3.896 billion for 2001. The EC's proportionate share of this amount – continuing to use the percentage of 26.8 percent – is $1.106 billion for 2000 and 1.044 billion for 2001. The details of the corrected calculations are set forth in Exhibit US-15.

[32] *Id.*, para. 75.

VIII. CONCLUSION

43. For the foregoing reasons, the United States respectfully requests that the Arbitrator:

(a) find pursuant to Article 4.11 of the SCM Agreement that the countermeasures requested by the EC are not appropriate;

(b) find pursuant to Article 22.7 of the DSU that the level of suspension of concessions or other obligations requested by the EC is not equivalent to the level of nullification or impairment; and

(c) find that the amount of countermeasures or suspension of concessions or other obligations to which the EC is entitled is no more than $1.106 billion (based on data for the year 2000) or $1.044 billion (if the Arbitrator should decide to rely on data for the year 2001).[33]

[33] The United States recalls that it has suggested that a 1 percent downward adjustment to these figures to account for exports of services would be appropriate and conservative. *See, e.g., US Second Submission*, para. 153.