UNITED STATES – CERTAIN COUNTRY OF ORIGIN
LABELLING (COOL) REQUIREMENTS

Recourse to Article 22.6 of the DSU by the United States

(WT/DS386/ARB)

Methodology Paper of the United Mexican States

10 July 2015

1. In 2008, Mexico initiated the dispute settlement procedure in relation to the original country of origin labeling (COOL) measure that has imposed extra and discriminatory burdens on imported cattle, thereby favouring the use of domestic cattle. The United States' cattle industry has benefited from the competitive advantages granted by this measure for well over six years, while the Mexican industry has suffered competitive disadvantages and economic loss during that time, and continues to do so.

2. Following from compliance procedure initiated by Mexico in *United States – Certain Country of Origin Labelling (COOL) Requirements* in accordance with article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), the Dispute Settlement Body (DSB) adopted last 29 May 2015 the Article 21.5 Appellate Body Report and the Compliance Panel Report, as amended by the Appellate Body Report.

3. Resulting from the United States' failure to bring its measure in compliance or otherwise comply with the recommendations and rulings of the DSB in this dispute[1], Mexico has requested authorization to suspend concessions to the United States equivalent on an annual basis to the nullification or impairment of benefits accruing to Mexico. This request was made in accordance with Article 22.2 of the DSU, and in light of paragraph 6 of the understanding reached between the Parties on agreed procedures under Article 21 and 22 of the DSU.[2]

4. The United States objected to the amount of Mexico's proposed suspension of benefits and the matter was referred to an Arbitrator pursuant to DSU Article 22.6.[3]

5. Consistent with the schedule established by the Arbitrator, Mexico is submitting this Methodology Paper (Paper) to explain how Mexico has calculated the nullification and impairment of benefits experienced by Mexico on an annual basis caused by this inconsistent WTO measure.

I. PROCEDURAL BACKGROUND

6. On 23 July 2012, the DSB adopted the Appellate Body Report and the Panel Report as modified by the Appellate Body report. In these reports, it was found that the original COOL measure of the United States was inconsistent with the obligations of Article 2.1 of the Agreement on Technical Barriers to Trade (TBT Agreement).[4] The DSB recommended

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[1] *United States – Certain Country of Origin Labelling (COOL) Requirements – Recourse by Mexico to Article 22.2 of the DSU*, WT/DS386/35, 19 June 2015.

[2] WT/DS386/24.

[3] *United States – Certain Country of Origin Labelling (COOL) Requirements – Recourse to Article 22.6 of the DSU by the United States*, WT/DS386/36, 23 June 2015.

[4] The current COOL measure comprises: (a) the Agricultural Marketing Act of 1946 (7 U.S.C. 1621 et seq.), as amended by the Farm Security and Rural Investment Act of 2002 and the Food, Conservation, and Energy Act of 2008; (b) the Mandatory Country of Origin Labeling of Beef, Pork, Lamb, Chicken, Goat Meat, Wild and Farm-Raised Fish and Shellfish, Perishable Agricultural Commodities, Peanuts, Pecans, Ginseng, and Macadamia Nuts (7 CFR Parts 60 and 65), 74 Fed. Reg. 2658-2707; and (c) the Mandatory Country of Origin Labeling of Beef, Pork, Lamb, Chicken, Goat Meat, Wild and Farm-Raised Fish and Shellfish, Perishable Agricultural Commodities, Peanuts, Pecans, Ginseng, and Macadamia Nuts (7 CFR Parts 60 and 65), 78 Fed. Reg. 31367-31385. See Panel Report, *US – COOL (Article 21.5 – Mexico)*, para. 7.9.

that the United States bring the COOL measure into conformity with its obligations under the TBT Agreement.

7. The United States informed the DSB that it intended to implement the DSB recommendations and rulings for which it required a reasonable period of time (RPT). Mexico requested that the RPT be determined through binding arbitration under Article 21.3(c) of the DSU. On 4 December 2012 the Arbitrator issued an award determining that the RPT for the United States to implement the recommendations and rulings of the DSB would expire on 23 May 2013.[5]

8. On 23 May 2013, the United States Department of Agriculture adopted an amended COOL measure, but the amended measure did not bring the United States into compliance with the recommendations and rulings of the DSB.

9. Mexico requested the establishment of a compliance panel, which was established on 25 September 2013. The compliance panel found that the amended COOL measure is inconsistent with Article 2.1 of the TBT Agreement and Article III:4 of the General Agreement on Tariffs and Trade 1994 (GATT 1994).[6] The Appellate Body Report circulated to WTO Members on 18 May 2015 upheld the Panel's conclusions on Article 2.1 of the TBT Agreement and Article III:4 of the GATT 1994.[7] On 29 May 2015, the DSB adopted the Article 21.5 Appellate Body Report and the compliance panel report, as amended by the Appellate Body Report.

II. SUMMARY OF METHODOLOGY

10. Under Article 22.4 of the DSU, the level of suspension must be "equivalent to the level of nullification or impairment".

11. As explained above, the amended COOL measure was found to be inconsistent with both Article 2.1 of the TBT Agreement and Article III:4 of the GATT 1994. The amended COOL measure has not been modified in any manner since the Appellate Body issued its report on 18 May 2015 or the adoption of the report by the DSB on 29 May 2015. Accordingly, the nullification and impairment continues.

12. In fact, as established in the Article 21.5 compliance panel proceedings, the amended COOL measure "increases the practical necessity for private actors to choose domestic over imported livestock, and has an increased negative effect on the competitive conditions of imported livestock in the US market."[8] Further, although the amended COOL measure was published on 23 May 2013, by its own terms it was not made mandatory and not enforced for six months, until 23 November 2013. For these reasons, in order to determine the level of nullification or impairment caused by the measure, the appropriate period for assessing the counterfactual is the first full calendar year following 23 November 2013 during which the COOL measure was fully in force.

13. To determine the level of benefits to suspend, Mexico has compared the actual circumstances of the market for Mexican feeder cattle during that year to a counterfactual in which neither the original nor amended COOL measures would exist. The difference between those circumstances is the amount of nullification or impairment.

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[5] WT/DS386/23, para. 123.

[6] WT/DS386/RW.

[7] WT/DS386/AB/RW.

[8] Panel Report, *US – COOL (Mexico – Article 21.5*), para. 7.167.

14. Mexico commissioned a qualified economic expert to perform the calculations. His resume is included as Exhibit MEX-1.

15. As shown in the report presented in Exhibit MEX-2, the calculations include two categories of economic harm: (i) losses resulting from the impact of the measure on exports of Mexican feeder cattle to the United States and (ii) losses resulting from price suppression in the Mexican feeder cattle market resulting from the measure.

A. Losses on Exports to the United States

16. The calculation of losses on exports to the United States has two components: the reduction of prices for Mexican feeder cattle when sold into the United States and losses of sales. The calculation of these losses involves comparing the export revenues realized with the COOL measure in place to the export revenue that would have been observed if the COOL measure had never been implemented.

17. For these purposes, the relevant period for the counterfactual is the first full calendar year following implementation of the amended COOL measure at the end of November 2013. The counterfactual is based on a regression analysis and a simulation, which rely on data from both before and after the adoption of the COOL measures.

1. Suppression of Prices of Mexican Cattle Exported to the United States

18. Before COOL, Mexican feeder cattle exported to the United States were close substitutes to U.S.-born feeder cattle. This meant that the "basis" – i.e., the difference in value between two commodities – between Mexican feeder cattle exported to the United States and U.S. domestic feeder cattle was essentially zero.[9] Compliance with the COOL measure requires the segregation of cattle to ensure the proper labeling of meat according to the cattle country of origin. This caused Mexican feeder cattle to become less valuable than U.S.-born feeder to U.S. cattle farms. The additional costs of handling cattle from a second origin were passed on the price of Mexican feeder cattle exported to the United States. The pass-through of the COOL measure on the price paid for feeder cattle from Mexico means a widening of the difference in value between Mexican feeder cattle exported to the United States and U.S. domestic feeder cattle.

19. The price of exported feeder cattle is measured in U.S. dollars in Texas and New Mexico, which are states bordering Mexico. The U.S. price of feeder cattle is also measured in U.S. dollars in Texas and New Mexico. Thus, the exchange rate and transportation costs do not affect the basis because prices are measured in the same currency at the same location. The analysis includes monthly dummy variables to control for seasonal effects, as well as a variable for the drought because abnormally dry conditions can impact feeder cattle weights. Dummy variables for the COOL measure are also included.

20. The price of the feeder cattle is based on its weight. The impact of the COOL measure on the price of feeder cattle of all weights is estimated at negative USD 0.118/lb for the original COOL measure and an additional effect of the amended COOL measure of negative USD 0.069/lb, for a total of negative USD 0.187/lb. The total impact of the COOL measures on the price of a 350lb feeder cattle is larger at negative USD 0.199/lb, while the total impact of the COOL measures on the price of 550lb feeder cattle is smaller at negative USD 0.175/lb. The average of the estimates for the two weight categories exactly equals the estimates found in the regression for all feeder cattle of negative USD 0.187/lb.

[9] This is the case when measuring the basis in U.S. dollars in Texas and New Mexico, where there are no material differences in transportation costs and no exchange rate effects.

21. Using data published by the U.S. government on the quantity of Mexican feeder cattle exported to the United States in 2014 – the first full year after implementation of the amended COOL measure – the loss is USD 96,968,515.

2. Lost Sales of Mexican Cattle to the United States

22. The denial of equal competitive opportunities for Mexican cattle not only had price effects, but also discouraged exports. Therefore, the calculation includes the estimated impact of losses of exports to the United States resulting from the COOL measure.

23. Using a conservative estimate of the export supply elasticity of 4, the economic model shows that Mexico would have exported an additional 342,476 head of feeder cattle in 2014 if the COOL measure did not exist. With feeder cattle weighing on average of 468/lb, the total export quantity loss caused by the COOL measure is 160,278,538lbs. Taking into account that prices would have been an average of USD 0.175/lb higher than they were, the economic impact of lost sales is USD 417,846,148.

B. Losses on Price Suppression in the Mexican Market

24. Reflecting the close integration between the markets, the COOL measure directly impacts the Mexican feeder cattle market by suppressing the domestic price of feeder cattle in Mexico. Indeed there was a decline in the domestic price of Mexican feeder cattle coincidental to when the COOL measure was adopted in 2008.

25. The Mexican and U.S. markets for cattle are not perfectly seamless, and therefore the price effects are not completely transferable. Using data from a pre-COOL period it was estimated that the long-run price transmission effect is USD 0.678 lb, in other words, USD 0.678/lb of a USD 1/lb increase in the price of feeder cattle exported to the United States is transmitted to Mexican domestic price of feeder cattle.

26. Scaling the impact of the COOL measure on the price of exported feeder cattle measured at negative USD 0.187/lb to find the impact of COOL on the Mexican domestic price of feeder cattle yields negative USD 0.127/lb (-0.187*0.678).

27. The annual number of feeder cattle marketed domestically in Mexico is calculated at 3.69 million head, and the average weight of feeder cattle when marketed is 468lb., giving a total of 1,726,920,000 lbs. To avoid double counting economic loss, it is appropriate to subtract the weight of cattle that are not being exported to the United States because of the COOL measure (160,278,538 lbs.). This gives a total number of pounds of cattle affected by the price suppression domestically as 1,566,641,462 lbs.

28. The product of 1,566,641,462 lbs. and USD 0.127 is USD 198,628,204, which is the economic impact of the price suppression in the Mexican domestic market caused by the COOL measure.

III. TOTAL LOSSES RESULTING FROM COOL MEASURE

29. To calculate the total nullification and impairment, it is necessary to sum the above elements:

Price suppression effect on exports to U.S. market:	96,968,515
Lost exports to U.S. market:	417,846,148
Price suppression effect in Mexican domestic market:	198,628,204
Total:	USD 713,442,869

30. This analysis presents a conservative approach. There are a number of reasons why it might underestimate the losses to Mexico:

- The U.S. price average includes discounted Mexican cattle. This would have the effect of lowering the U.S. price used in the basis computation, thus understating the estimated negative impact of the COOL measure.
- The calculations are limited to feeder cattle because that is the relevant category of livestock that Mexico exports to the United States. However, the impact of the COOL measure also extends to other categories of cattle. Dual purpose cattle, dairy cattle, cows and bulls are substitutes to feeder cattle raised specifically for their meat. Thus, the suppression of the price of feeder cattle also caused a decline in the price of other cattle.
- The calculations assume that Mexican production of cattle was not affected by the COOL measure. However, the COOL measure has been suppressing prices since 2008. The Mexican cattle industry would have been of a greater size but for the COOL measure, which has reduced the profitability of Mexican cattle operations.

IV. CONCLUSION

31. For the reasons explained in this document, and based on a detailed econometric analysis in Exhibit MEX-1, Mexico has requested authorization to suspend concessions equal to USD 713,442,869, which is the level of nullification or impairment resulting from the failure of the United States to comply with the recommendations and rulings of the DSB and bring its measure into consistency with the covered agreements.