

*Canada – Measures Relating to
Exports of Wheat and Treatment of Imported Grain*

(WT/DS276)

**Executive Summary of the Second Written Submission
of the United States of America**

October 10, 2003

I. INTRODUCTION

1. In its submissions to date, Canada has come forward with a series of misleading factual assertions and unsupported legal conclusions. The United States would like to take this opportunity to once again highlight the principal issues in this dispute and to further clarify the ways in which Canada is violating its obligations under Articles XVII and III:4 of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") and Article 2 of the *Agreement on Trade-Related Investment Measures* ("TRIMs Agreement").

II. CANADA HAS BREACHED ITS OBLIGATIONS UNDER GATT ARTICLE XVII

2. Article XVII sets forth clear obligations for any Member, including Canada, that chooses to establish a State Trading Enterprises ("STE") and provide that STE with special and exclusive privileges. Under Article XVII, Canada undertakes that if it chooses to establish or maintain an STE, that STE shall "act in a manner consistent with the general principles of non-discriminatory treatment" prescribed in the GATT 1994. As Article XVII goes on to state, it is understood that this obligation requires that the STE make purchases and sales "solely in accordance with commercial considerations." Furthermore, this obligation requires that the STE "afford the enterprises of the other [Members] adequate opportunity . . . to compete."

3. The Canadian Wheat Board's ("CWB") unique legal structure, its unchecked exercise of its exclusive and special privileges, its incentives to act in a non-commercial and discriminatory manner, and the lack of any countervailing government supervision necessarily results in sales that are not in accordance with Article XVII standards. Yet Canada takes no action to ensure that the CWB adheres to the behavior required by Canada's Article XVII obligations. Under these circumstances, the only possible conclusion is that Canada has breached its obligations under Article XVII.

4. Article XVII contains several distinct obligations, and a violation of any of these would sufficiently result in a violation of Article XVII. As stated unequivocally by the *Korea Beef* panel, "[a] conclusion that the principle of non-discrimination was violated would suffice to prove a violation of Article XVII; similarly, a conclusion that a decision to purchase or buy was not based on 'commercial considerations,' would also suffice to show a violation of Article XVII."

5. In this case, the CWB acts inconsistently with all of the standards set forth in Article XVII:1. The CWB takes actions that violate principles of non-discriminatory treatment found in the GATT 1994, fails to act in accordance with commercial considerations, and denies the enterprises of other Members an adequate opportunity to compete for participation in the CWB's purchases and sales.

6. Article XVII:1(a)'s obligation to act "according to the general principles of non-discriminatory treatment," goes beyond most-favored-nation principles to include behavior that would run afoul of the general principles of non-discriminatory treatment in the GATT 1994. This includes discrimination between third country markets, as well as discrimination between

domestic and third country markets. The CWB engages in both types of prohibited, discriminatory conduct.

7. Moreover, the very structure of the CWB export regime leads the CWB to make sales not in accordance with commercial considerations under Article XVII:1(b), which also violates the principles of non-discriminatory treatment set forth in Article XVII:1(a).

8. As the CWB itself observes, “The link between farmers and the federal government offers three distinct economic advantages. Firstly, the federal government guarantees initial payments to farmers when they deliver their grain. Secondly, the CWB is able to compete in higher risk markets and make sales on credit because of federal government backing. Finally, the government guarantees our borrowing enabling us to finance our operations at much lower rates of interest than any comparably-sized, private-sector company. These financial savings more than cover the CWB’s administrative costs.” These special and exclusive privileges, combined with the CWB’s structure and lack of government oversight, necessarily lead to non-competitive and discriminatory practices.

9. In addition, the special and exclusive privileges of the CWB give it more pricing flexibility and less exposure to market risk than a commercial actor. For example, while a commercial grain trader has to pay the market price – a price that fluctuates and cannot be taken as fixed or guaranteed for a given marketing year – for grain, the CWB, through its special and exclusive privileges, has a fixed, guaranteed and known acquisition cost of wheat along with guaranteed supply. Similarly, according to the CWB’s own analysis, the CWB “manages risk to an extent not available in the open market[.]” Indeed, “[t]he average risk management costs for [non-Board grains] flax and canola were found to be at least \$5.53 per tonne higher than the cost of managing a wheat transaction through the CWB.” Such a risk structure, by artificially lowering CWB costs, clearly gives the CWB greater pricing flexibility than a commercial actor, because a commercial actor would have to pay to manage risk in a way that the CWB does not.

10. Canada appears to admit that some discipline over the CWB is required if the CWB is to act in accordance with commercial considerations, noting that “the discipline over the CWB is not from the top but from the bottom. The farmers will ensure that the CWB acts in accordance with commercial considerations.” However, as we emphasized in our responses to the Panel’s questions, wheat farmers in Canada cannot discipline the CWB because the farmers are required, by law, to sell all of their grain for human consumption and export to the CWB. Canadian wheat farmers have no real choice. They sell to the CWB at a fixed initial payment price that is set by the Government of Canada and the CWB, and that is guaranteed by the Government of Canada. Due to the disadvantageous terms of the buy back program, a farmer who wants to sell wheat for domestic human consumption or export has no real alternative but to sell his wheat to the CWB.

11. The Canadian Government’s guarantee of all initial payments for wheat, which translates into a fixed, guaranteed, and known acquisition cost, combined with other aspects of the CWB export regime, clearly enable the CWB to act non-commercially. As the CWB itself has

observed and we noted in our first submission, Canada's guarantee of initial payments "is like a revenue insurance policy for farmers with no premiums." There is no risk to the CWB for running pool deficits because "the federal government makes up the difference." The CWB uses its pricing flexibility and its reduced risk exposure to make sales on non-commercial terms in order to target particular export markets. This results in a violation of the general principles of non-discriminatory treatment and deprives the enterprises of other Members an adequate opportunity to compete according to customary business practice.

12. One example of this behavior is the CWB's decision to pay premiums to Canadian farmers for high quality wheat even when this acquisition behavior is not justified by demand for high quality wheat in third-country markets. This behavior gets to the heart of the CWB's non-commercial practices. The CWB gives Western Canadian farmers an incentive to over-produce high quality wheat and the CWB uses this over-production to act non-commercially and make sales that a commercial actor would not be able to consummate.

13. Specifically, and as mentioned in our first submission, Canadian high-quality wheat production exceeded demand by 32 percent over 1992-1997. This occurred because the CWB was willing to pay a premium for high quality wheat to give it flexibility when it consummates export sales. Western Canadian wheat farmers respond to the realities of the CWB-dominated wheat market and, with only the lower-valued feed market as an alternative marketing option, continue to produce and sell wheat to the CWB of a quality and in a quantity that is responsive to the CWB rather than to market demand.

14. This excess of high quality wheat means that for certain transactions, the CWB provides a price discount for high quality wheat to meet the price competition for lower quality wheat in a given market. This behavior results in a protein or quality giveaway, because the CWB provides wheat at a greater protein level or at a higher grade or quality level than the commercial terms of the contract require. At the same time, in a second market, the CWB charges a premium price for its high quality wheat. When combined with the CWB's other incentives and privileges, the ability to price discriminate in this fashion over the long run is behavior that runs contrary to commercial considerations, does not afford commercial enterprises from other Members an adequate opportunity to compete according to customary business practices, and results in a violation of the non-discriminatory treatment principles of the GATT 1994.

15. Canada keeps its pricing data secret, making specific examples difficult to come by. However, the CWB itself states that "[t]he CWB monopoly captures premiums because it allows price differentiation[.]" The CWB observes that in the 1994-95 crop year, the CWB set a price for No. 2 Canada Western Red Spring (13.5% protein) wheat – a wheat of a higher quality than No. 3 Canada Western Red Spring wheat – at prices *below* the price for No. 3 Canada Western Red Spring. Again, such pricing flexibility, the result of the CWB's structure and incentives and its exclusive privileges, could not be exercised by a commercial enterprise acting according to customary business practice.

16. One of several elements of the CWB export regime that allows the CWB to engage in price discrimination is its ability to benefit from borrowing at below-market rates. Government-guaranteed borrowing at below-market rates enables the CWB to derive extra interest income from its credit sales by extending credit at rates that are higher than the government-guaranteed rate extended to the CWB. The spread in the two rates results in additional revenue for the CWB. In the words of the CWB, “With the CWB’s borrowing power, it is able to borrow money at a lower rate of interest than the rate extended to the credit customer. As a result, the CWB benefits from the ‘spread’ in interest rates in the form of excess interest revenues over interest expenses.”

17. These “net interest earnings” go directly into the pool accounts, even though these earnings are a benefit of the preferential borrowing rates extended to the CWB, not revenues from wheat and barley sales. This extra income is significant and “virtually covers the total annual administrative costs of operating the CWB.” The CWB’s exercise of its government-guaranteed borrowing privileges, combined with the incentives of the CWB export regime more generally, give the CWB pricing flexibility that a commercial actor would not possess, thus enabling the CWB to act in a discriminatory manner by not providing other enterprises a adequate opportunity to compete in the sales of the CWB.

18. Canada tries to argue that the CWB should only be held to the standard of affording an adequate opportunity to compete only to enterprises with similar exclusive and special privileges like those enjoyed by the CWB. This defies logic and is unsupported by the text of Article XVII. The obligation under Article XVII is not to protect the non-commercial behavior of an STE with special and exclusive privileges in one country from the non-commercial behavior of an STE with special and exclusive privileges in another. The obligation under Article XVII, stated in Article XVII:1(b), focuses on the protection of commercial actors, and affording those commercial actors an adequate opportunity to compete in the marketplace.

19. As stated in our response to the Panel’s questions, Article XVII:1(b) requires that the CWB act commercially, not merely as a rational economic actor. Unless the CWB acts in accordance with commercial considerations, it cannot give the enterprises of other Members an adequate opportunity to compete. Canada’s argument that mere “rational” behavior is required under Article XVII:1(b) directly contradicts the plain language of the provision, which requires the CWB to act both according to commercial considerations *and* afford enterprises from other Members an adequate opportunity to compete, according to customary business practice.

III. CANADA PROVIDES LESS FAVORABLE TREATMENT TO IMPORTED LIKE GRAIN, IN VIOLATION OF GATT ARTICLE III:4

A. U.S. Grain and Canadian Grain Are Like Products.

20. Each category of grain is a like product for purposes of the Panel’s analysis under GATT Article III:4 (*i.e.*, wheat, whether domestic or foreign, or soybeans, whether domestic or foreign).

As explained in detail in our responses to the Panel’s questions, origin cannot serve as a basis for distinguishing like products. The Canada grain segregation and rail transportation measures at issue here differentiate among grains based not on physical characteristics or end-uses, but based on factors not relevant to the definition of likeness, such as whether or not the grain is “foreign.” Given the nature of Canada’s grain segregation and transportation measures, the United States has met its burden of establishing that like products are at issue.

21. Even if Canada contends that the like product analysis should focus on specific varieties of grain – an argument that is not supported by the measures at issue and that the United States does not concede – the fact remains that U.S. growers in the northern United States plant wheat varieties that are identical to wheat varieties planted in Canada. Canada, in its answers to the Panel’s questions, notes that “[t]here are many different classes of wheat produced in Canada that have different inherent characteristics and are grown for different uses, such as hard red spring wheat (for bread) as opposed to soft white winter wheat (for cookies).” U.S. wheat farmers also grow hard red spring wheat, and it is this same product that is subject to less favorable treatment under the Canadian grain segregation and transportation measures.

B. Canada’s Regulations Are Measures Affecting the Internal Sale, Offering for Sale, Purchase, Transportation, Distribution or Use of Like Products.

22. Although Canada suggests otherwise in its first submission, there is no question that the measures at issue here affect the distribution and transportation of like products. As explained in our responses to the Panel’s questions, Section 57 of the Canada Grain Act and Section 56 of the Canada Grain Regulations are measures that affect the entry of grain into Canada’s bulk grain handling system. This bulk grain handling system is part of the internal transportation and distribution network for grain in Canada. The rail revenue cap and producer rail car measures directly affect the transportation of grain.

23. There is therefore no question that Article III applies to the measures at issue in this case. Canada’s references to Article V of the GATT 1994 and to in transit shipments are irrelevant. The measures at issue in this case are measures affecting the internal transportation and distribution of grain. Any imported grain or domestic grain entering Canada’s bulk grain handling system is subject to Canada’s internal grain regulation when that grain arrives at an elevator in Canada, regardless of the final destination of the product.

24. As explained in our responses to the Panel’s questions, some U.S. grain is truly “in transit” through Canada and is not subject to Canada’s internal regulatory process. U.S. grain shipped from the U.S. State of Montana by rail on sealed rail cars that travel through Canada and do not stop until they reach their final destination in the U.S. State of Washington are not subject to Canada’s internal measures because that grain never enters the Canadian grain handling system. Any Canadian regulations in connection with such traffic in transit are not at issue in this case.

C. Canada’s Grain Segregation Measures Accord Imported Grain Less Favorable Treatment than Domestic Grain.

25. As discussed in our first submission, “the purpose of Article III is to ensure that internal measures not be applied to imported or domestic products so as to afford protection to domestic production.”¹ Canada thus has an obligation under Article III:4 “to provide *equality of competitive conditions* for imported products in relation to domestic products.”²

26. To argue that Section 57 of the Canada Grain Act treats imported grain as favorably as like domestic grain is disingenuous. On its face, Canada’s grain segregation measures discriminate against imported grain. Section 57 of the Canada Grain Act states that foreign grain may not enter grain elevators in Canada, unless special authorization is granted. The default is a prohibition on foreign grain. Canadian grain does not require any special authorization to enter grain elevators. Similarly, Canada’s measures related to mixing treat imported grain less favorably than like domestic grain by permitting mixing only “if neither of the grains is . . . foreign grain.” These regulatory prohibitions have a real, negative impact on the ability of imported U.S. grain to move through the Canadian bulk grain distribution and transport system, thereby affording protection to Canadian grain. The default prohibition impedes commercial opportunities for U.S. grain by making it more costly and burdensome for U.S. grain to move through the bulk grain handling system.

27. Canada argues that even though these measures prohibit the entry of imported grain into grain elevators in Canada, the Canada Grain Commission (“CGC”) is authorized to grant exceptions to these general prohibitions and, thus, treatment is not necessarily “less favorable” for imported grain. Canada provides isolated examples of these CGC authorizations in an attempt to demonstrate that the CGC does provide approvals for the entry of foreign grain into Canadian elevators. However, these authorizations do not remedy what is otherwise an Article III:4 violation. The fact that imported grain needs to obtain these authorizations, while domestic grain does not, means that the imported grain is treated less favorably.

28. Even when a CGC authorization is obtained under the exception to Section 57 prohibiting entry of imported grain into grain elevators, imported grain is subject to additional regulatory requirements that are not placed on like domestic grain. And under the Wheat Access Facilitation Program, storage bins containing U.S. wheat must be sealed by a CGC employee (not simply the elevator manager, who is permitted to take such action for Canadian grain).

29. Despite Canada’s statements to the contrary, these additional regulatory requirements

¹ *Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, WT/DS169/AB/R (December 11, 2000), para. 135 (hereinafter “*Korea Beef AB Report*”) (quoting *Japan - Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R (November 1, 1996), pp. 16-17 (internal citations and quotations omitted)).

² *Id.* (italics in original).

result in real costs to grain elevators and discourage grain elevators from handling U.S. grain. This limits the access that U.S. grain has to the Canadian market.

30. In the same way that restrictions on access to points of sale can be violations of Article III:4, restriction on access to key entry points in the distribution network can deny imported grain competitive opportunities afforded to like domestic grain. For example, the Wheat Access Facilitation Program is a series of cumbersome regulatory requirements that imported wheat must satisfy – but Canadian wheat need not satisfy – in order to enter Canadian grain elevators. These cumbersome and costly additional requirements provide Canadian grain with more favorable treatment and results in U.S. grain being forced to compete on unequal footing.

31. As the CGC’s Memorandum to the Trade explains, “[p]rimary elevator facilities are required to notify the CGC . . . of the upcoming arrival of U.S. wheat at least 24 hours in advance to ensure that a CGC employee/designate is on site when the wheat is unloaded.” This CGC employee must “take a sample for information purposes,” “monitor the flow of U.S. wheat into the bin(s),” and “seal the bin(s).” The primary elevator must pay for these CGC services, thereby making the costs of receiving U.S. wheat higher than the cost of receiving like Canadian wheat. There are also indirect costs such as the time and equipment it takes to comply with the foreign grain requirements, and the additional regulatory uncertainty resulting from the need to contact the CGC in advance and rely upon its inspectors. For Canadian grain, however, the elevator manager does any necessary weighing and sampling without the need for advance notice.

32. Again, when U.S. wheat is discharged, the primary elevator must pay for a CGC employee to return to the elevator. The CGC’s office must be notified 24 hours in advance of the discharge. The CGC employee then must go through the procedure of unsealing the bin(s), sampling, and monitoring the outward flow of the grain. As Canada itself concedes, “[a]dditional requirements apply to U.S. wheat shipped to a processing facility or a terminal elevator.”

33. Finally, despite the fact that the Wheat Access Facilitation Program provides that “[d]uring the initial stages of [the Program], the CGC costs of monitoring U.S. wheat will be covered by Agriculture and Agri-Food Canada (AAFC) and the Canadian Department of Foreign Affairs and International Trade (DFAIT),” this alone does not remedy the inequalities of the system, which to this day discourage Canadian elevator operators from accepting U.S. wheat that is like Canadian wheat. The system puts into effect precisely the type of discrimination that Article III:4 forbids.

D. Canada’s Transportation System Affords Less Favorable Treatment to Imported Grain.

1. Producer Cars.

34. Canada has argued that producer cars are theoretically available to all producers,

regardless of whether those producers produce Canadian or foreign grain. But as discussed in our responses to the Panel’s questions, only Canadian producers can take advantage of producer rail cars under Section 87 of the Canada Grain Act, because all producer car loading stations are in Alberta, British Columbia, Manitoba, or Saskatchewan.

35. Furthermore, Agriculture and Agri-Food Canada itself states that only “Canadian grain producers with an adequate quantity of lawfully deliverable grain may apply to the Commission,” and the only eligible provinces are “Alberta, British Columbia, Manitoba and Saskatchewan.”

36. Access to these producer cars is a competitive opportunity inasmuch as they provide domestic grain producers with increased transportation flexibility and lower costs. Thus, denying imported grain access to these cars results in less favorable treatment for imports.

2. Rail Revenue Cap.

37. The rail revenue cap also violates Article III:4 by treating imported grain less favorably than like domestic grain. The revenue cap, which is only available for shipments of domestic grain, reduces transportation costs and thus provides a tangible benefit to domestic grain. As discussed in detail in our first submission and in our response to the Panel’s questions, because there is a significant penalty for shippers who exceed the rail revenue cap, shippers have an incentive to charge lower fees on Canadian shipments than on like foreign shipments. This denies imported grain the same competitive conditions as accorded like domestic grain.

38. The U.S. Commerce Department analysis mentioned by Canada is not relevant to the legal question before the Panel. The Panel must examine whether the revenue cap results affords domestic grain more favorable treatment than like foreign grain in violation of Article III:4, and to do so does not require that actual trade effects be shown. The Commerce Department analysis focused on the fact that the rail revenue cap has not been reached in the 2001-01 and 2001-02 crop years. The Commerce Department did not address the discriminatory aspect of the revenue cap, that is, that railroads have an incentive to charge higher rail rates for foreign grain than domestic grain on the routes governed by the rail revenue cap.

IV. CANADA HAS FAILED TO MAKE THE REQUISITE SHOWING UNDER ARTICLE XX(d) WITH RESPECT TO ITS GRAIN SEGREGATION MEASURES

39. Recognizing that its arguments under Article III:4 will fail, Canada attempts to justify its grain segregation measures under Article XX(d) of the GATT 1994. This Article XX(d) defense must also fail because Canada has continuously failed to carry its burden of proof with respect to

such an affirmative defense.³

40. As stated by the appellate body in *United States - Gasoline* and affirmed by the appellate body in *Korea Beef*, in examining Canada's grain segregation measures under Article XX, a two-tiered analysis is appropriate.

First, the measure must be one designed to 'secure compliance' with laws or regulations that are not themselves inconsistent with some provision of the GATT 1994. Second, the measure must be 'necessary' to secure such compliance. A Member who invokes Article XX(d) as a justification has the burden of demonstrating that these two requirements are met.⁴

A. Canada Has Not Demonstrated that Its Grain Segregation Measures at Issue Are Necessary to Secure Compliance with Any Provision of Canadian Law.

41. In a single paragraph in its first submission, Canada asserts that its grain segregation requirements are necessary in order to secure compliance with the grading provisions of the Canada Grain Act and to ensure that there is no misrepresentation of grain in the system consistent with the Competition Act. This mere assertion does not satisfy Canada's burden under Article XX(d).

42. Canada has also failed to show how the grain segregation measures are necessary to secure compliance with either the grading requirements of the Canada Grain Act or the Competition Act. Indeed, grain can be and is identified in the marketplace based not on whether the grain is of foreign or domestic origin, but based on the intrinsic characteristics of the grain itself, such as grade and protein.

B. Canada's Grain Segregation Measures Constitute Unjustifiable Discrimination.

43. Not only are Canada's grain segregation measures unnecessary to secure compliance with the Canada Grain Act, they also constitute unjustifiable discrimination within the chapeau of Article XX of the GATT 1994. Concerns about misrepresentation and grading apply to all grain, and therefore all grain – not just imported grain – should be subject to additional regulation and special CGC oversight. To limit these regulatory requirements to foreign grain only thus results in arbitrary and unjustifiable discrimination.

³ Furthermore, it is important to note that Canada fails to explicitly invoke this affirmative defense with respect to its discriminatory rail transportation measures.

⁴ *Korea Beef* AB Report, para. 157.

**V. CANADA’S GRAIN SEGREGATION AND RAIL TRANSPORTATION
MEASURES ARE INCONSISTENT WITH ARTICLE 2 OF THE TRIMS
AGREEMENT**

44. As stated in our response to the Panel’s questions, Canada’s prohibition on the receipt of foreign grain in elevators and prohibition on the mixing of foreign grain are “mandatory” and “enforceable” requirements within the meaning of the TRIMs Agreement Illustrative List. Moreover, they provide direct cost advantages to those elevator operators that accept Canadian grain over foreign grain because the need for special authorization to accept and/or mix foreign grain and the onerous conditions that are often placed on such authorizations creates a regulatory regime that financially rewards those elevators that accept domestic grain over foreign grain.

45. Similarly, the rail revenue cap and producer car programs are “mandatory” and “enforceable” within the meaning of the TRIMs Agreement Illustrative List. These measures provide cost advantages in the form of lower rail transport rates to those shippers that choose to ship Canadian grain rather than foreign grain.

46. Therefore, these TRIMs, which are inconsistent with Article III:4, are necessarily inconsistent with Article 2 of the TRIMs Agreement.

VI. CONCLUSION

47. For all of the reasons set forth above and in our submissions, answers to questions, and statements before the Panel, the United States respectfully requests that the Panel find that: (1) Canada has breached its obligations under Article XVII of the GATT 1994; (2) Canada’s grain segregation requirements are inconsistent with Canada’s obligations under Article III:4 of the GATT 1994 and Article 2 of the TRIMs Agreement; and (3) Canada’s rail revenue cap and producer car program are inconsistent with Canada’s obligations under Article III:4 of the GATT 1994 and Article 2 of the TRIMs Agreement.