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

(WT/DS276)

Executive Summary of the First Written Submission of the United States of America

August 11, 2003

I. INTRODUCTION

1. The Canadian Wheat Board ("CWB") sells more wheat on world markets than any other single enterprise. The CWB is also a State Trading Enterprise ("STE") under Article XVII of the General Agreement on Tariffs and Trade 1994 ("GATT 1994"). Canada provides its STE with lavish exclusive and special privileges, including the exclusive right to purchase wheat for human consumption produced in all of Western Canada, the exclusive right to sell such wheat in domestic and foreign markets, and the right to require Canadian farmers to sell their wheat to the CWB at an initial payment price well below full market value. Canada has adopted no processes or procedures to ensure that the CWB complies with Article XVII standards. In these circumstances, the United States submits that the Panel must find that Canada is not in compliance with its obligations under Article XVII of the GATT 1994.

2. This dispute also addresses a series of Canadian measures that serve as a major impediment to the sale of imported grain, including wheat, in the domestic Canadian market. One set of measures serves to exclude imported grain from the entire Canadian grain handling system. A second set of measures favors domestic grain over imported grain in the Canadian rail transportation system. These measures accord to imported grain less favorable treatment than that accorded to like domestic grain. Accordingly, the United States submits that the Panel should find that Canada's treatment of imported grain is inconsistent with Canada's obligations under Article III:4 of the GATT 1994 and Article 2 of the *Agreement on Trade-Related Investment Measures* ("TRIMs Agreement").

II. STATEMENT OF FACTS

A. The CWB Export Regime

3. Canada has notified the CWB as a State Trading Enterprise within the scope of Article XVII of the GATT 1994. As described in the STE Notification, "The statutory objective of the CWB is the marketing in an orderly manner, in inter-provincial and export trade, of grain grown in Canada." The basic goal of the CWB is to sell all wheat produced in Western Canada. As Canada itself explains, "The volume of grain exported is primarily a function of the available supply less domestic use and inventory adjustments." Under its governing statute, the CWB must sell Western Canadian wheat "for such prices as it considers reasonable with the object of promoting the sale of grain produced in Canada in world markets." Nothing in the statute requires the Canadian Wheat Board to make its sales in accordance with commercial considerations.

4. The CWB does not make publicly available any information indicating that its sales are made in accordance with commercial considerations. In particular, the CWB maintains the secrecy of specific information concerning its export sales, such as price, quality, length of contract, and credit terms. On December 23, 2002, the United States submitted a request to Canada under Article XVII:4(c) of the GATT 1994 for more detailed information concerning CWB sales. Canada has not responded to that request.

5. Canada has provided to the CWB three related exclusive and special privileges that make the CWB unlike any private grain trader: (a) monopoly rights of purchase and sale; (b) the right to set the initial purchase price paid to producers, with any remaining income distributed in "pool" payments; and (c) a government guarantee of the initial payment.

6. Another exclusive or special privilege that Canada provides to the CWB is a government guarantee on CWB borrowings. The government guarantee allows the CWB to borrow funds at a favorable noncommercial rate. The CWB can use the borrowed funds to make credit sales on terms not practicable for commercial sellers. The CWB also borrows to make export sales under government-guaranteed credit programs.

B. Canadian Treatment of Imported Grain

7. Canadian measures discriminate against imported grain, including grain that is the product of the United States. Under the Canada Grain Act and Canadian Grain Regulations, imported grain must be segregated from Canadian domestic grain throughout the Canadian grain handling system; imported grain may not be received into grain elevators; and imported grain may not be mixed with Canadian domestic grain being received into, or being discharged out of, grain elevators.

8. In addition, Canadian law favors domestic grain over imported grain in the rail transportation system. Canadian law caps the maximum revenues that railroads may receive on the shipment of Canadian domestic grain, but not revenues that railroads may receive on the shipment of imported grain. Under these rules, a railroad must refund, with penalties, any revenues received in excess of the cap. Thus, Canadian railroads have a great incentive to hold their rates on Western Canadian grain at a level that will ensure that the railroads do not exceed the revenue cap. No comparable incentive, however, exists for setting the rates charged for the transport of imported grain.

9. Canadian law also favors Canadian grain over imported grain in the allocation of government railcars. The Canada Grain Act establishes a program known as "producer railway cars." On its face, the program appears only to apply to grain grown by a producer, meaning that no imported grain is eligible for the producer car program. The Canadian Grain Commission summarizes this program as follows: "Producers can order rail cars from the CGC to ship their grain to market." Canada has no comparable program that provides rail cars for the transport of imported grain.

III. LEGAL ARGUMENTS

A. Canada is Not in Compliance with its Obligations under GATT Article XVII

1. GATT Article XVII Imposes an Obligation on Canada to Ensure that the CWB Makes Purchases or Sales in Accordance with the Article XVII

Standards

10. Based on the plain text and the context of the GATT 1994, Article XVII imposes an obligation on Canada to ensure that the CWB makes purchases or sales in accordance with the Article XVII standards. The pertinent provisions of Article XVII provide that:

> 1.* (a) Each [Member] undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges,* such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.
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> (b) The provisions of sub-paragraph (a) of this paragraph shall be understood to require that such enterprises shall, having due regard to the other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations,* including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other [Members] adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.
>
> *Ad Article XVII*
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> The charging by a state enterprise of different prices for its sales of a product in different markets is not precluded by the provisions of this Article, provided that such different prices are charged for commercial reasons, to meet conditions of supply and demand in export markets.

11. This obligation on Members establishes the GATT's basic balance with regard to STEs. Members may establish STEs that enjoy special benefits and privileges not available to free-market enterprises. These benefits and privileges may enable the STE to engage in trade-distorting practices, to the detriment of other Members. But Article XVII restores the balance, by imposing an obligation on the Member establishing the STE to ensure that the STE acts in a manner consistent with the general principles of non-discriminatory treatment, to make purchases or sales solely in accordance with commercial considerations, and to allow the enterprises of other Members an adequate opportunity to compete.

12. The context of Article XVII confirms that the obligation on Canada is to ensure that the STE it has established meets the Article XVII requirements. With respect to STEs, a Member has an obligation to ensure that the STE does not engage in trade-distorting conduct. Whether or not the Member has control over the STE, Article XVII imposes an obligation on the Member to

ensure that the STE complies with the standards set out in Article XVII:1(a) and (b).

2. The Standards in Article XVII Apply to the Wheat Exports of the CWB

13. The standards in both paragraphs 1(a) and 1(b) of Article XVII:1 apply to the wheat exports of the CWB.

14. Article XVII:1(a) requires that Canada ensure that the CWB "act[s] in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders." The conduct prohibited by this provision includes the CWB's use of its special benefits and privileges to target particular export markets. This provision also prohibits the CWB from harming other Members' wheat sellers by, in effect, shutting them out of markets, or portions of markets, that are subject to the CWB's targeting. Such conduct by an STE would amount to discrimination in the terms of sale between export markets, and thus would run afoul of "a general principle of non-discriminatory treatment prescribed in this Agreement," as reflected in the most-favored-nation obligation.[1]

15. Article XVII:1(a) also prohibits the CWB from making use of its exclusive privileges to discriminate in its terms of sale between export markets and the Canadian domestic market. In this category of conduct, "the general principles of non-discriminatory treatment" are those reflected in the national treatment obligation.

16. Subparagraph (b) of Article XVII:1 establishes two different, but related, obligations. First, Canada must ensure that the CWB makes any purchases or sales involving wheat exports solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale. Second, and relatedly, Canada must ensure that the CWB affords the enterprises of other Members adequate opportunity, in accordance with customary business practice, to compete for participation in purchases or sales involving wheat exports.

17. The separate obligations in subparagraphs XVII:1(a) and (b) are related, and each must be read in the context of the other. In particular, the note to Article XVII:1 provides that an STE does not violate general principles of non-discrimination if it charges different prices for its sales of a product in different markets if "such different prices are charged for commercial reasons, to meet conditions of supply and demand in export markets." This ad note provision ties into subparagraph (b)'s requirement for STEs to make sales solely in accordance with commercial considerations. In addition, subparagraph (b) has an introductory clause tying back to subparagraph (a): namely, "the provisions of sub-paragraph (a) of this paragraph shall be understood to require" that STEs make their sales in accordance with commercial considerations

[1] See GATT 1994, Article I:1.

and allow enterprises of other members an adequate opportunity to compete.

18. The *Korea Beef* panel explained how these separate but related obligations should be applied:

> The list of variables that can be used to assess whether a state-trading action is based on commercial consideration (prices, availability etc…) are to be used to facilitate the assessment whether the state-trading enterprise has acted in respect of the general principles of non-discrimination. 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.

Whether looked at as a question of non-discrimination, or as a question of sales in accordance with commercial considerations and allowing the enterprises of other Members to compete, Canada has failed to comply with its obligations under GATT Article XVII to ensure that the CWB does not abuse its exclusive benefits and privileges.

3. Canada Has Not Met its Obligation to Ensure that the CWB Makes Purchases or Sales in Accordance with the Article XVII Standards

19. Article XVII imposes an obligation on Members establishing STEs to ensure that those STEs comply with the Article XVII standards. The Article XVII standards require that the CWB make its purchases and sales involving wheat exports in accordance with general principles of non-discrimination, in accordance with commercial considerations, and in a manner allowing the enterprises of other Members to compete. Canada, however, has completely failed to meet its obligation of ensuring that the CWB meets these standards.

20. Canada has already acknowledged in this proceeding that it takes no measures to enforce the Article XVII standards on the CWB. If, as Canada asserts, Canada has no control or influence over the CWB, than Canada has not complied – and, under its current regulatory structure, cannot comply – with its obligation to ensure that the CWB meets the standards in Article XVII regarding wheat exports. Similarly, if, as Canada asserts, it does not even collect information on the CWB's "contracts with . . . customers on terms and other conditions of wheat sales," Canada cannot *even begin* to meet its obligation to ensure that the CWB's purchases and sales involving wheat exports are made "solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale."

21. The provision in the CWB Act governing CWB pricing provides only that:

> Subject to the regulations, the [CWB] shall sell and dispose of grain acquired by it

> pursuant to its operations under this Act for such prices as it considers reasonable with the object of promoting the sales of grain produced in Canada in world markets.

Thus, under its organic statute, the CWB need only sell wheat at any price it considers "reasonable." In addition, the term "reasonable" is to be construed in the context of "the object of promoting the sales of" Canadian grain in foreign markets. The object of "sales promotion" is not the same as, or even consistent with, the requirements that CWB's wheat exports are in accordance with general principles of non-discrimination, in accordance with commercial considerations, and are made in a manner allowing the enterprises of other Members to compete.

4. Canada's Policy of Non-Supervision Cannot Meet Canada's Obligation to Ensure that the CWB Complies with the Article XVII Standards

22. In light of the extensive, market-distorting privileges that Canada provides to the CWB, Canada's acknowledgment that it takes no affirmative steps to ensure that the CWB's wheat exports meet the Article XVII standards is sufficient to establish that Canada has failed to comply with its international obligations under Article XVII.

23. There is no basis to presume that the CWB, without the adoption of any measures to ensure compliance with Article XVII standards, will nonetheless make its wheat exports in accordance with those standards. Enterprises make sales in accordance with commercial considerations because they are governed by commercial considerations. The CWB, however, is not. To the contrary, the extensive special privileges that Canada provides to the CWB detach the CWB from the commercial considerations that govern the conduct of free-market enterprises.

24. First, the monopoly power over Western Canadian wheat gives the CWB greater pricing flexibility than any private actor. The CWB, unlike any commercial actor, has a guaranteed supply of wheat at a cost of acquisition well below the market value, as well as a reduced interest costs and an extra income stream from investment earnings. As a result, the CWB has greater flexibility in setting the price of its wheat. Moreover, the CWB is not even required to recoup the amount of the initial payment. Under the initial payment guarantee, the Canadian Parliament will make up the difference if the actual amount received in a marketing year falls below the CWB's initial payments to producers.

25. Second, the exclusive and special privileges enjoyed by the CWB allow the CWB – as compared to a commercial grain trader – much greater freedom to engage in forward contracts or long-term contracts. In entering into a long-term or forward contract, a commercial actor has to account for the risks associated with the possible changes in the market price of wheat. The CWB, in contrast, has guaranteed access to supplies at a known price. This privilege enhances the CWB's ability to forward contract wheat for future delivery at a fixed price in a manner that a private company could not without incurring additional costs.

26. Third, government guarantees of the CWB's borrowings allow the CWB to provide more favorable credit terms than those provided by commercial grain traders, and government guarantees of credit sales allow the CWB to offer credit to high-risk buyers.

27. These special benefits enable the CWB, if it so chooses, to make its sales not in accordance with commercial considerations, and on such noncommercial terms that do not allow the enterprises of other WTO Members an adequate opportunity to compete. In other words, the special benefits provided by Canada pricing enable the CWB to engage in conduct proscribed in GATT Article XVII:1(b).

28. The special benefits also enable the CWB, if it so chooses, to provide such noncommercial terms of sale in some markets and not others. Such conduct amounts to discrimination between markets, and thus is likewise inconsistent with the discipline set forth in GATT Article XVII:1(a).

29. Finally, the CWB has fundamentally different incentives and motivations than those of a private grain trading company. The goal of commercial entities is to maximize profit, which is revenue minus expenses (including the cost of purchasing wheat). The CWB, on the other hand, was created for the purpose of maximizing only revenue.

30. That the CWB is a revenue maximizer, rather than a profit maximizer, is established by the CWB's governing statute. The prime objective of the CWB, as set forth in its statute, is the "marketing in an orderly manner, in inter-provincial and export trade, of grain grown in Canada." The objective of the CWB is to market Western Canadian wheat, it does not have an objective, like a private trader, of maximizing profit. Similarly, the governing statute provides that the CWB must sell Western Canadian wheat "for such prices as it considers reasonable with the object of promoting the sale of grain produced in Canada in world markets." Again, the prime objective is to sell the wheat produced in Western Canada, not to maximize profit.

31. A revenue-maximizing firm will act differently in the market than will a profit-maximizing firm. In particular, revenue-maximizing firms will tend to produce greater volumes, and sell at lower prices, than would profit-maximizing firms. This distinction illustrates the fundamental fallacy of any claim that the "CWB tries to get the best prices" is equivalent to an assertion that the CWB will conduct itself like a private grain trader. Instead, where a firm is a revenue maximizer like the CWB, the firm will tend to make sales in greater volumes, and at lower prices, than a normal, profit-maximizing firm.

B. Canada's Treatment of Imported Grain is Inconsistent with its Obligations under Article III:4 of the GATT 1994 and Article 2 of the TRIMs Agreement

1. Canadian Grain Segregation Requirements

32. Canada's grain segregation requirements provide more favorable treatment to domestic

grain than to like imported grain, and are thus inconsistent with Canada's obligations under Article III:4 of the GATT 1994 and Article 2 of the TRIMs Agreement. As the Appellate Body explained in *Korea Beef*, three elements must be satisfied to establish a violation of Article III:4:

> [1] that the imported and domestic products at issue are "like products"; [2] that the measure at issue is a "law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use"; and [3] that the imported products are accorded "less favourable" treatment than that accorded to like domestic products.

Each of these three elements apply to the Canadian grain segregation requirements.

33. First, the imported and domestic products at issue – the types of grain covered by the Canada Grain Act and Regulations – are identical, and are thus "like products" for the purpose of GATT Article III.

34. Second, the measures at issue are laws and regulations affecting the transportation and distribution of grain. Section 57 of the Canada Grain Act and Section 56 of the Canadian Grain Regulations apply to the receipt of grain into, or discharge of grain from, "elevators". The Canadian grain act broadly defines "elevators" to cover all Canadian facilities used for handling and storing grain. Thus, by placing strict limitations on foreign grain received into or removed from "elevators," the Canadian measures concern the treatment of foreign grain throughout the entire Canadian system.

35. Third, the treatment accorded to imported grain is less favorable than that accorded to like domestic grain. As the Appellate Body explained in *Korea Beef*, this factor may be analyzed as follows:

> Article III obliges Members of the WTO to provide <u>equality of competitive conditions</u> for imported products in relation to domestic products. [T]he intention of the drafters of the Agreement was clearly to treat the imported products in the same way as the like domestic products once they had been cleared through customs. Otherwise indirect protection could be given.

36. Under Section 57 of the Canada Grain Act, imported grain, just like "infested or contaminated grain," may not be received into any grain-handling facility without special approval of the Canadian Grain Commission. In addition, Section 57 provides no indications of the criteria that the Commission might use in deciding whether to grant such approval. In stark contrast, Canadian domestic grain is automatically approved for receipt into any grain-handling facility in Canada. In these circumstances, the conditions of competition established by the Canadian measure strongly favor domestic grain over imported grain. Canadian grain is provided with a special status that assures its eligibility to be received into grain-handling facilities throughout Canada. Imported grain, however, enjoys no such assurances. Any person

wishing to make use of imported grain must seek special approval, based on unstated, nontransparent criteria.

37. Section 56(1) of the Canadian Grain Regulations prohibits the mixing of imported grain and domestic grain in transfer elevators. In *Korea Beef*, the Appellate Body examined under Article III:4 a comparable Korean measure that required the segregation in all retail stores of imported and domestic beef: "The central consequence of the dual retail system can only be reasonably construed, in our view, as the imposition of a drastic reduction of commercial opportunity to reach, and hence to generate sales to, the same consumers served by the traditional retail channels for domestic beef." The effect of the Canadian anti-mixing requirement is to cut off imported grain from existing Canadian distribution channels, with the effect of reducing the commercial opportunity of imported grain to reach Canadian end-users.

2. Differential Treatment in Canadian Transportation System

38. The rail revenue cap and the producer car program both favor domestic grain over imported grain, and are thus inconsistent with Canada's obligations under Article III:4 of the GATT 1994. Both programs satisfy the three elements required to establish a violation of Article III:4.

39. First, the imported and domestic products at issue are identical, and are thus "like products" for the purpose of GATT Article III. Second, both of these measures directly relate to the transportation of grain, and are thus "laws, regulations and requirements affecting . . . transportation" under Article III:4. Third, both of these measures accord treatment to imported grain that is less favorable than that accorded to like products of national origin. The rail revenue cap applies to Western Canadian grain, and no imported grain is eligible for receiving the benefits of the program. This discriminatory treatment provides more favorable conditions of competition for Canadian domestic grain than for imported grain.

40. Similarly, the producer car program only applies to grain grown by Canadian producers, and thus excludes all imported grain. Making government rail cars available for the transport of domestic grain reduces transportation costs for any grain that receives this benefit. In contrast, imported grain, which is not eligible for the program, receives no such benefits. Again, the result is a system which mandates a competitive advantage for domestic grain over imported grain.

3. The Canadian Grain Segregation Requirements and Discriminatory Rail Transportation Measures are also Inconsistent with Article 2 of the TRIMs Agreement

41. The Canadian grain segregation requirements and discriminatory rail transportation measures are also inconsistent with Article 2 of the TRIMs Agreement. First, these measures fall within the types of measures covered in the Illustrative List in the Annex to the TRIMs Agreement. Illustrative List 1(a) provides:

> 1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require:
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> > (a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production.

42. The grain segregation measures require elevator operators to use domestic Canadian grain. The discriminatory rail transportation requirements require shippers to use domestic Canadian grain in order to obtain the advantages of the rail revenue cap or government rail cars. Thus, both types of measures fall squarely within the Illustrative List of measures covered by the TRIMs Agreement.

43. Second, under Article 2 of the TRIMs Agreement, a TRIM that is inconsistent with Article III of the GATT 1994 is also inconsistent with the TRIMs Agreement. Thus, for the same reasons that the grain segregation requirements and discriminatory rail transportation measures are inconsistent with Canada's obligations under Article III:4 of the GATT 1994, these measures are also inconsistent with Article 2 of the TRIMs Agreement.

IV. CONCLUSION

44. For all of the reasons set forth above, the United States respectfully requests that the Panel find that: (1) the CWB export regime is inconsistent with the obligations of Canada under Article XVII:1 of the GATT 1994; (2) the Canadian grain segregation requirements are inconsistent with the obligations of Canada under Article III:4 of the GATT 1994 and Article 2 of the TRIMs Agreement; and (3) the rail revenue cap and the producer car program are inconsistent with the obligations of Canada under Article III:4 of the GATT 1994 and Article 2 of the TRIMs Agreement**.**