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Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products - Second Recourse by the United States to Article 21.5 of the DSU
(WT/DS103)

ORAL STATEMENT OF THE UNITED STATES

April 22, 2002

1. Thank you Mr. Chairman. First, I would like to say that the United States very much appreciates the willingness of the members to serve once again as panelists in this dispute.

2. As the Panel is quite familiar with this case, I will not belabor all of the points made in our written submissions but will focus on a few key issues.

3. In its latest report in this case, the Appellate Body concluded that the benchmark for determining whether a "payment" exists under Article 9.1(c) should be based upon the producers' average total cost of production. While the United States did not advocate this benchmark, it has been adopted by the Dispute Settlement Body for purposes of this dispute and thus applies to this proceeding.

4. Although this type of private cost data might be difficult to obtain in many instances, here we are fortunate that the Canadian government annually collects such information. As explained in our written submissions, a comparison of the average total cost of production as reported by the Canadian Dairy Commission for the dairy year 2000 (which is the most recent data that is complete) to the average CEM price for the same period shows that the producers are without question making a "payment" to the processors. Indeed, we demonstrated that the CDC's cost figure is actually understated due to the sample population used, the exclusion of quota costs and the valuation of capital at its book value rather than market value.

5. In response, Canada does not dispute the accuracy of the underlying CDC data, but argues as a conceptual matter that certain items should be excluded from the cost calculation. Canada argues that four items should be excluded. These include the costs of family labor, management services, capital and marketing. With regard to the first three items, Canada argues that these do not involve "actual outlays" and therefore are properly excluded under the Appellate Body's new standard. With regard to market expenses, Canada argues that, although this is an actual outlay, it is not properly included because it is a cost of *selling*, not a cost of *production*.

6. As explained in our written submission, Canada's proposed calculation is inconsistent with the Dispute Settlement Body's recommendations and rulings and fails to measure the producers' true economic cost of production. Canada is proposing a cash-basis accounting approach to measure the cost of production. Yet, it is plain from its report that the Appellate Body contemplated that the new benchmark would measure economic costs. As noted in our second submission, for example, the Appellate Body repeatedly refers to the producer as an economic operator that makes an investment of economic resources.

7. Again, it is important to note that Canada does not claim that the CDC has measured those costs incorrectly. Rather, Canada argues that these costs should be ignored because they are collected by the CDC for a different purpose and because the Appellate Body allegedly called for the inclusion of only "actual outlays." As I just mentioned, it is impossible, however, to reconcile Canada's argument for the inclusion of only "actual outlays" with the language of the Appellate Body report. Furthermore, as explained in our second submission, the purpose for which the CDC collects this information is irrelevant. The ultimate use of the information does not change the accuracy of the underlying data.

8. Canada also argues that, under accounting standards, the first three cost items should be excluded because they are "essentially" the profits of the enterprise and not a cost of production.

Canada cites an excerpt from an accounting handbook describing the basic elements of financial statements in support of this argument.

9. First, the general excerpt from the accounting handbook cited by Canada in exhibit CDA-4 does not say that these types of costs are properly considered "profits" and not a cost of production. Rather, it simply describes in very general terms the notion of "net income" for the purpose of financial statements.

10. More importantly, however, even if these items are considered "profits" for accounting purposes, as a matter of economics, they are properly included as costs. As previously explained, the Appellate Body report sets forth a benchmark based upon economic costs, not accounting standards as Canada argues. The Appellate Body explained that its standard is based upon the costs that a producer must recoup in order to avoid incurring losses over the long term.

11. In addition to economic principles, basic common sense holds that a producer must recoup its economic costs, not just its actual cash outlays, to avoid incurring losses over the long run.

12. Likewise, a producer must recoup its marketing expenses to avoid losses in the long run. The revenue from the sale of milk is the only revenue stream from which to recoup this cost. Canada's argument regarding marketing expenses is a facile attempt to artificially reduce the cost of production figure and should be rejected.

13. Finally, in addition to improperly excluding certain actual costs, Canada's proposed calculation and the conclusions it draws from that calculation should be rejected as it is based upon a "range" of costs and not an average total cost as stated by the Appellate Body. As explained in our second submission, Canada's exhibits, especially exhibit 14, are misleading. This is because, although Canada is careful not to make the claim explicitly, exhibit 14 insinuates

that the low-cost producers are those participating in the CEM scheme. Although Canada matches a range of CEM prices (from lowest to highest) with a range of costs (from lowest to highest), Canada presents no evidence that the producers with a low cost of production are selling CEM milk. Thus, contrary to Canada's assertion, exhibit 14 does not demonstrate that any of the 77 percent of producers could cover their costs in the CEM market or that even any of those 77 percent are those involved in CEM transactions.

14. Moreover, Canada's exhibits and conclusions are based upon an analysis that bears no resemblance to the Appellate Body's specific instructions. The Appellate Body specifically stated in paragraph 96 of its report that the benchmark should be calculated by "dividing the fixed and variable costs of producing *all* milk, whether destined for the domestic or export markets, by the *total* number of units of milk produced for *both* of these markets." It said nothing about comparing the costs of a range of producers to the CEM prices obtained by a possibly different range of producers, as Canada has done.

15. Indeed, to adopt an approach which holds that there is no subsidization if an individual or decile is shown to be covering their costs would effectively eliminate the disciplines under Article 9.1(c) as there would undoubtedly be some producers covering their costs and some that are not. The Appellate Body's approach was that the existence of a "payment" cannot depend upon whether individual producers are or are not recouping their costs but, rather, must be based upon an industry-wide standard. As explained in our written submissions, when the average total cost of production for all producers is compared to the average CEM price for the same period, as required by the Appellate Body, it shows a substantial "payment" to processors.

16. In sum, Canada has failed to sustain its burden of proof. Canada's proposed cash-basis accounting approach is inconsistent with the Appellate Body's mandate to measure the economic cost of production. Furthermore, by focusing on a "range" of prices and costs, Canada's

presentation of information contradicts the method set forth by the Appellate Body for calculating the "average total cost of production"and is otherwise misleading and distortive.

17. The second requirement under Article 9.1(c) is that the payment is financed "by virtue of governmental action." In our written submissions, the United States has shown that there is a demonstrable link between governmental action and the financing of the payment to processors.

18. As explained in our written submissions, the primary indicia of the governmental action in financing the payments to processors is the exemption of processors for export from the requirement to purchase milk at the high domestic price and the prohibition on producers selling non-quota milk into the domestic market, with appropriate sanctions to support this prohibition.

19. Canada's response is that the governmental action cited by the United States and New Zealand "protect[s] a producer's entitlement to the higher domestic price" and has "no relation or link to any alleged sale by a producer of milk to a processor at below his or her cost of production."

20. Yet, Canada never explains how banning export milk from receiving the higher domestic price protects the producer's entitlement to that price. The reality is that the price ban protects the processors' ability to export. It is no secret that Canadian dairy processors cannot compete on the world market at the higher, regulated price for milk.

21. Indeed, Canada emphatically maintains that a "producer enters into a commercial export contract on his or her own volition." It would be inconsistent for Canada to argue *both* that producers themselves choose whether to produce milk for export *and* that selling milk for export is necessary to protect the domestic supply management system. There is no reason to ban export milk from the high regulated price except to subsidize the processors in order that they may export.

22. In Canada's words, the government "mechanism or process" that makes "unprofitable sales on behalf of producers" is the ban of export milk from the higher, regulated price and the enforced artificial segregation of the two "markets" for milk. As explained in our written submissions, even accepting that governmental action does not oblige or drive producers to produce additional milk for export sale, does not change the fact that, once non-quota milk is produced, the producers have no real choice but to sell the milk at a price below their average total cost of production into the CEM market.

23. Canada never really answers this point. After recounting the complainants' arguments in this regard in paragraph 70 of its first submission, Canada's only response is to assert that the complaining parties are asking the Panel to overturn the findings of the Appellate Body. Yet, other than its statement regarding whether producers are driven or obliged to produce additional milk for export, the Appellate Body made no findings on the second prong of Article 9.1(c).

24. In sum, it is undeniable that without the enforced segregation of the market by the government and the ban of export milk from the higher administered price, there would be no lower-priced milk available for processors to purchase for export. The ban on export milk from the higher administered price has nothing to do with the domestic supply management system. It is a deliberate choice on the part of the Canadian government to assure a transfer of economic resources to processors whenever product is sold for export. Thus, there is clearly a demonstrable link between "governmental action" and the financing of the payments to processors. Indeed, it is undeniable that governmental action is indispensable to the transfer of resources from the producers to the processors. Accordingly, the requirement under Article 9.1(c) that payments on export of agricultural products are financed "by virtue of government action" is also satisfied in this case.

25. The United States has also included an alternative claim under Article 10.1 of the *Agreement on Agriculture* and a separate claim under Article 3 of the *SCM Agreement*. We consider that our written submissions have set forth the requirements of each of those claims and have demonstrated that those requirements are met in each instance. Consequently, we do not believe it is necessary to revisit those points today during our oral statement. Of course, the United States stands ready to answer any questions relating to those claims or to anything else.

26. For the reasons we have stated today and those stated in our written submissions, the United States respectfully requests that the Panel conclude that Canada has failed to implement the recommendations and rulings of the DSB, and that the Panel recommend that Canada bring its measures into conformity with its obligations under the *Agreement on Agriculture* and the *SCM Agreement*.

27. That concludes our oral statement today. Thank you, Mr. Chairman.