Canada – Measures Relating to
Exports of Wheat and Treatment of Imported Grain
(WT/DS276)

Answers of the United States of America
to Written Questions of the Panel
in Connection with the First Substantive Meeting

September 24, 2003

Questions Posed to the United States

Q1. *The United States claims that the "CWB Export Regime" is inconsistent with Article XVII:1 of the GATT 1994 (US first written submission, para. 105). The term "CWB Export Regime" is defined at para. 15 of the US first submission as comprising (i) the legal framework of the CWB, (ii) Canada's provision to the CWB of exclusive and special privileges, and (iii) the actions of Canada and the CWB with respect to the CWB's purchases and sales involving wheat exports. In this regard, please provide further clarification as follows:*

(a) *Is the United States claiming that the "legal framework of the CWB" as such (*per se*) is inconsistent with Article XVII:1?*

1. The U.S. claim is that the CWB's legal structure and its incentives to act in a non-commercial manner necessarily result in the CWB making sales not in accordance with Article XVII standards. This legal framework, when taken together with other aspects of the CWB export regime, is inconsistent with Article XVII.

(b) *What is the United States' claim with respect to "the* provision *to the CWB of exclusive and special privileges"? Paras. 3 and 50 of the US first written submission appear to recognize that Members may provide exclusive or special privileges to enterprises.*

2. Article XVII is premised on the fact that Members can grant exclusive and special privileges to STEs. However, in recognition of the fact that these benefits and privileges may enable STEs to engage in trade-distorting practices to the detriment of other Members, Article XVII imposes specific obligations on Members that establish STEs. The United States alleges that the CWB export regime as a whole, including the actions of the CWB resulting from the unchecked exercise of its exclusive and special privileges, violates Canada's obligations by necessarily resulting in the CWB making sales that are not in accordance with the standards set forth in Article XVII:1.

(c) *What "actions" of Canada with respect to the CWB's purchases and sales involving wheat exports are inconsistent with Article XVII:1?*

3. The "actions" of the Government of Canada that affect the purchases and sales of wheat are: (1) Canada's failure to exercise its authority to oversee the CWB, (2) Canada's approval of the CWB's borrowing plan and guarantees of all borrowings as well as credit sales, and (3) Canada's approval and guarantee of the initial payment price. These actions, when taken together with other aspects of the CWB export regime, are inconsistent with Article XVII.

(d) *What "actions" of the CWB with respect to the CWB's purchases and sales involving wheat exports are inconsistent with Article XVII:1?*

4. The "actions" of the CWB are the CWB's purchases and sales of wheat on discriminatory and non-commercial terms.

Q2. *In connection with the US argument that Canada is required under Article XVII:1 to "ensure" that the CWB meets the Article XVII:1 standards, please provide clarification as follows:*

(a) *Is the United States arguing that Canada's legislation must require, or mandate, the CWB to meet the Article XVII:1 standards? (US first written submission, paras. 65-66)?*

5. No, the United States is not arguing that statutory language requiring the CWB to meet Article XVII:1 standards would be sufficient to meet Canada's obligations under Article XVII. In any case, it is undisputed that Canada has no such statutory provision in place. We understand that, as a general matter, Members may choose the mechanism that they wish to use to meet their WTO obligations. In this case, because the CWB's legal structure and incentives, absent any countervailing supervision or incentives, necessarily results in the CWB making sales not in accordance with the Article XVII standards, Canada is not meeting its WTO obligations.

(b) *Is the United States arguing that in addition to imposing a statutory requirement on the CWB that it meet the Article XVII:1 standards, Canada would need to supervise CWB operations? (US first written submission, para. 69 and footnote 59) Or is the supervision requirement an alternative to a statutory requirement?*

6. While this question sets forth possible means for Canada to bring itself into compliance with Article XVII, it is undisputed that Canada is not now undertaking such supervision, in accordance with a statute or otherwise. This absence of supervision, taken together with the legal structure of the CWB and the incentives created by the CWB export regime, is not consistent with the Canada's obligations under Article XVII.

(c) *Regarding the supervision requirement, what level and what kind of government supervision would be required to "ensure" compliance with the Article XVII:1 standards?*

7. It would not be appropriate for us to speculate as to whether any particular measures

adopted by Canada would bring the CWB export regime into compliance. Whether any particular, hypothetical level of supervision by Canada would actually lead to a conclusion that Canada was in compliance with its obligations under Article XVII would depend on all of the facts and circumstances of the CWB export regime as a whole. The fact that Canada is undertaking *no* such supervision at present, in combination with other aspects of the CWB export regime, is sufficient to conclude that the regime is inconsistent with Article XVII.

(d) *Is Article 18 of the CWB Act insufficient to meet the supervision requirement argued for by the United States?*

8. Yes. In this case, Canada has explained that while it could supervise the CWB under Article 18, it chooses not to do so. That fact of non-supervision, in combination with the other aspects of the CWB export regime established by Canada, means that Canada has failed to meet its obligations under Article XVII.

(e) *Is the United States arguing that as long as an STE has the ability to engage in conduct proscribed by Article XVII:1, the Member maintaining or establishing it is in breach of Article XVII:1, or is the United States arguing that as long as an STE has this ability, the Member concerned is under an obligation to supervise the STE's operations? (US first written submission, paras. 67, 77-78)*

9. Neither one of these statements captures the U.S. position. It is not the mere fact that the CWB has the ability to engage in conduct proscribed by Article XVII:1 that results in a breach of Article XVII. Rather, the CWB's unique legal structure and incentives, and the lack of any countervailing supervision or incentives, necessarily result in the CWB making sales not in accordance with Article XVII standards. A lack of government supervision is but one element of the CWB regime. If this element, or any other element, were to be modified, the WTO-consistency of the CWB regime would need to be reevaluated.

(f) *With reference to para. 50 of the US first written submission, why cannot the balance of rights and obligations be preserved by an interpretation of Article XVII:1 according to which, under Article XVII:1, Members have the right to establish and maintain trading enterprises with special or exclusive privileges, but in exchange must do nothing more than assume responsibility under international law for any conduct by such enterprises which has been found not to be in accordance with certain prescribed standards?*

10. It is not entirely clear to us what it would mean, in the context of the WTO Agreement, for Canada to "assume responsibility under international law" if Canada did not, as suggested in paragraph 50 of the first U.S. submission, "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." As described before, in the absence of supervision by the

Government of Canada and given its unique structure, the CWB export regime necessarily results in the CWB making sales not in accordance with Article XVII standards. The CWB regime is therefore inconsistent with Article XVII. In these circumstances, Canada cannot be said to have assumed its responsibility under the WTO Agreement.

> Q3. *Is the United States arguing that if the CWB used its privileges to make sales on terms which could not or would not normally be offered by privately-held marketing agencies, such sales necessarily would not be in accordance with "commercial considerations"?*

11. Yes. This is supported by the provision in Article XVII:1(b) concerning allowing enterprises of other Members an adequate opportunity to compete.

Questions Posed to Both Parties

> Q6. *Do the "commercial considerations" referred to in Article XVII:1(b) vary depending on what type of entity (e.g., co-operatives, share-capital corporations, etc.) is conducting the purchase or sales operations?*

12. No. Commercial entities, whether cooperatives or share-capital corporations, make decisions in an environment that is constrained by market forces. These market forces discipline commercial entities regardless of their corporate structure. The CWB is not disciplined by market forces in the same way that commercial enterprises are. For example, a commercial cooperative enterprise has to compete for farmer members, and farmers are free to leave a cooperative and sell their wheat elsewhere if the commercial cooperative does not provide favorable returns. A share-capital corporation must also compete in the marketplace for sales of wheat and must balance commercial risks when making a decision regarding how much the corporation can pay for wheat. Unlike any commercial enterprise disciplined by market forces, the CWB has a guaranteed supply of wheat because farmers have no viable alternative but to sell their wheat for domestic human consumption and export to the CWB. This guaranteed supply of wheat gives the CWB a different risk and pricing structure than a commercial actor.

> Q7. *Please indicate whether, in your view, the CWB is a "State enterprise" or an "enterprise" which has been granted "exclusive or special privileges", as these terms are used in Article XVII:1(a), and why.*

13. We consider the CWB to be a state trading enterprise, as Canada acknowledges in its STE notification.[1]

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[1] *See* Working Party on State Trading Enterprises, New and Full Notification [by Canada] Pursuant to Article XVII:4(a) of the GATT and Paragraph 1 of the Understanding on the Interpretation of Article XVII, G/STR/N/4/CAN, 5 November 2002 (Exhibit US-1).

Questions Posed to the United States

Q8. *Could the United States confirm that, in respect of receipt of foreign grain into Canadian elevators, the United States' claim is that the provisions of section 57 of the Canada Grain Act, as such, are inconsistent with Article III:4 of the GATT 1994?*

14. Yes, section 57 of the Canada Grain Act, as such, is inconsistent with Article III:4.

Q9. *Could the United States confirm that, in respect of the mixing of grain, the United States claim is that the amended provisions of section 56(1) of the Canada Grain Regulations (Exhibit CDA-23), as such, are inconsistent with Article III:4 of the GATT 1994?*

15. Our first submission addresses the measure in effect at the establishment of the March Panel and the July Panel, which is section 56(1) prior to amendment. This measure, as such, is inconsistent with Article III:4. The amended provision, although not within the terms of reference of the Panel, also appears to do exactly the same thing, since, as we understand, U.S. grain cannot qualify as eastern Canadian grain. Accordingly, the amended measure, as such, also appears to be inconsistent with Article III:4.

Q10. *Could the United States indicate whether, in respect of the revenue cap, the United States claim is that the provisions of section 150(1) of the Canada Transportation Act, as such, are inconsistent with Article III:4 of the GATT 1994?*

16. The U.S. claim is that section 150(1) and section 150(2) of the Canada Transportation Act, as such, are inconsistent with Article III:4.[2]

Q11. *Could the United States confirm that, in respect of rail car allocation, the United States claim is that the provisions of section 87 of the Canada Grain Act, as such, are inconsistent with Article III:4 of the GATT 1994?*

17. Section 87 of the Canada Grain Act is inconsistent with Article III:4. Canada's claim that foreign producers may use producer rail cars under section 87 is a hollow one. Only Canadian producers can take advantage of producer rail cars under section 87 because all producer car loading stations are in Alberta, British Columbia, Manitoba, or Saskatchewan.

Questions Posed to Both Parties

Q20. *Once a panel has determined that, in making certain export sale(s), an STE did not act in conformity with the standards set forth in Article XVII:1(b), can the panel find*

[2] *See* First Written Submission of the United States, para. 45.

a violation of Article XVII:1 on that basis alone, or is it necessary for the panel to make a separate and additional determination whether, in making the export sale(s) in question, the relevant STE did not act in a manner consistent with the general principles of non-discriminatory treatment

18. Article XVII:1(b) states that the obligations under Article XVII:1(a) "shall be understood to require" that STEs make purchases and sales in accordance with commercial considerations and afford the enterprises of other Members adequate opportunity to compete in accordance with customary business practice. Thus, Article XVII:1(b) sets forth examples of conduct that Article XVII:1(a) requires. To fail to engage in the required conduct under Article XVII:1(b) constitutes a violation of XVII:1. As the *Korea Beef* panel found, "[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."[3]

19. Moreover, on the facts of this case, a finding that the CWB makes sales not in accordance with commercial considerations under Article XVII:1(b) necessarily leads to the conclusion the CWB is not acting in accordance with the general principles of non-discriminatory treatment. Under the CWB's statutory structure and incentives, it uses its pricing flexibility to make sales on non-commercial terms in order to target particular export markets, resulting in a violation of general principles of non-discriminatory treatment.

Q21. *The second clause of Article XVII:1(b) requires STEs to afford enterprises of other Members adequate opportunity "to compete for participation in such purchases or sales".*

(a) *Is the expression "such purchases or sales" a reference to a given STE's "purchases or sales involving either imports or exports", i.e., the expression used in Article XVII:1(a)? In other words, is "such purchases" a reference to a given STE's purchases abroad (imports) and "such sales" a reference to a given STE's sales abroad (exports)?*

20. In the context of this case, the expression "such purchases or sales" in the second clause of Article XVII:1(b) refers to the opportunity to participate in the CWB's sales of wheat. This is more fully explained in the answer to question 21(b), below.

(b) *Taking the case of an export STE like the CWB, are the relevant "enterprises" of other Members (i) the enterprises which are interested in buying wheat from the CWB (i.e., wheat buyers); (ii) those enterprises competing with the CWB for sales to the same*

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[3] *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, (WT/DS161/R WT/DS169/R) (31 July 2000) (hereinafter *Korea Beef),* para. 757.

wheat buyers (i.e., wheat sellers) or (iii) other enterprises?

21. Under Article XVII, an STE has an obligation to afford all enterprises an adequate opportunity to compete for *participation* in its purchases or sales involving either imports or exports. This, in addition to the first obligation under Article XVII:1(b) to act in accordance with commercial considerations, obliges a Member to ensure that its STEs with special and exclusive benefits and privileges act as commercial actors. Here, the enterprises at issue would include any enterprise that is competing for participation in CWB wheat sales, including enterprises competing to purchase wheat from the CWB (*i.e.*, wheat buyers), as well as those enterprises selling wheat in the same market as the CWB (*i.e.*, wheat sellers).

Q22. *Assume a Member has an export STE which has the exclusive right to sell a particular agricultural product for export and domestic consumption. Please indicate whether in the following situations the STE would be making its export sales in accordance with "commercial considerations" within the meaning of Article XVII:1(b):*

(a) *The STE charges a lower price in export market 2 than in export market 1 because market 2 is contested by a supplier who benefits from an export subsidy, while market 1 is not.*

22. We assume for this question that the STE and the subsidized supplier are offering wheat for sale on the same terms, with the exception of price. We also assume that to meet the subsidized price, the STE would be offering wheat for sale at a price that is less than the replacement value for the wheat. Although in the short run both a private supplier and an STE could sell below cost in this manner to meet the subsidized price in export market 2, in the long run a private actor could not sustain this behavior. If an STE uses its special and exclusive privileges to engage in sustained, long-run price discrimination between export market 2 and export market 1 in these circumstances, the STE is not acting in accordance with commercial considerations.

23. A Member is not permitted to violate its obligations under Article XVII of the GATT 1994 merely because that Member's STE sells in a market where its competitor has received export subsidies. No such exception exists under Article XVII. Price discrimination by an STE using its exclusive and special privileges in a non-commercial, non-transparent manner is not permitted under Article XVII.

(b) *The STE charges a lower price in export market 2 than in export market 1 because market 2 is a priority market for the STE (e.g., due to expected growth in import demand) and the lower price is intended to deter other exporters from contesting export market 2. The price charged by the STE in export market 2 would not or could not have been charged in the absence of the special or exclusive privileges enjoyed by the STE.*

24. In this case, the STE would not be making its sales in accordance with commercial

considerations because it could not price discriminate in export market 2 in the absence of its special and exclusive privileges.

> (c) *The STE charges a higher price in export market 1 than in export market 2 because the price-elasticity of import demand is lower in export market 1 than in export market 2.*

25. In this case, assuming that both the STE and a private seller without any special and exclusive privileges could both sell at a higher price in export market 1 due to the price-elasticity of import demand, the STE would be acting in accordance with commercial considerations. However, if the STE alone was able to engage in price discrimination in this manner due to its exercise of special and exclusive privileges, the STE would not be acting in accordance with commercial considerations.

> (d) *Same as (c), but the STE in addition extracts monopoly rents (price premiums) in both markets, which it could not do but for its exclusive right to export the product concerned (assume the STE's product is perceived as superior in quality for instance, such that there is no significant competition from other products).*

26. An STE that extracts monopoly rents in both markets, which it could not do but for its special and exclusive benefits and privileges, is not acting according to commercial considerations. Although a commercial actor may be able to extract some monopoly rents if it faces little competition in the marketplace, the fact that an STE is able to use its special and exclusive benefits and privileges to extract monopoly rents in markets regardless of the price elasticity of demand means that the STE is not acting in accordance with commercial considerations.

> Q23. *Is the "commercial considerations" requirement in Article XVII:1(b) essentially intended to make sure that STEs use their special or exclusive privileges in such a way that their purchases or sales involving imports or exports are made on terms which are no more advantageous for the STE than they would have been if the STE did not have any special or exclusive privileges? Or is the "commercial considerations" requirement essentially intended to make sure that STEs act like rational economic operators, i.e., that, in their purchase or sale decisions, they are guided only by the consideration of their own economic interest?*

27. Article XVII:1(b) requires STEs to act *commercially*, not merely rationally. Therefore the "commercial considerations" requirement in Article XVII:1(b) is intended to ensure that STEs do not use their special privileges to the disadvantage of commercial actors. A Member could not meet the second obligation under Article XVII:1(b) – to afford enterprises of other Members adequate opportunity to compete – if an STE's special privileges could be used to gain special advantages in the marketplace. Article XVII:1(b) must be read in its entirety, and the first obligation under XVII:1(b) cannot render moot the second obligation under Article XVII:1(b).

These two obligations must be read together. Therefore, the "commercial considerations" requirement in Article XVII:1(b) must be intended to ensure that commercial enterprises without special and exclusive privileges are able to adequately compete for participation in the STE's purchases and sales involving imports and exports.

> Q24. *Pursuant to Article XVII:1(a), each Member undertakes that its STEs "shall" act in a specified manner. Please explain the meaning and usage of the term "shall" in Article XVII:1(a). In particular, what, if any, difference in meaning would there be if Article XVII:1(a) had said that each Member "undertakes" that its STEs "will" act in the specified manner?*

28. Here the term "shall" should be given its ordinary meaning. "Shall" implies an obligation. According to the New Shorter Oxford Dictionary, in relation to statutes, regulations, etc., "shall" is "equivalent to an imperative."[4] Similarly, according to the Merriam-Webster Dictionary, "shall" is "used in laws, regulations, or directives to express what is mandatory."[5] Simply put, the obligation of each Member under Article XVII:1(a) is a mandatory requirement that STEs granted special or exclusive privileges act according to the general principles of non-discriminatory treatment prescribed in the GATT 1994.

29. The language of Article XVII, as with many articles in the GATT 1994, sets forth obligations using the term "shall." The United States cannot address how different language not found in Article XVII might or might not change the nature of the obligations at issue in this case.

Questions Posed to the United States

> Q25. *With reference to para. 58 of the US first written submission, please elaborate on how the Note to Articles XI, XII, XIII, XIV and XVIII supports the view that Article XVII:1(a) requires non-discrimination as between sales in the domestic market and sales in export markets.*

30. The scope of the obligation under Article XVII:1(a) to "act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement" is a broad one. It does not refer to a specific article or specific obligation, but, rather, refers to the general principles of non-discrimination reflected in the obligations of the GATT 1994. This broad reference to non-discriminatory treatment would encompass discrimination between sales in the domestic market and sales in export markets.

31. Previous panels have concluded that the purpose of the Note to Articles XI, XII, XIII,

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[4] New Shorter Oxford English Dictionary (1993), at 2808.

[5] Merriam-Webster's Collegiate Dictionary: Tenth Edition (2001), at 1072.

XIV and XVIII of the GATT 1994 "is to extend to state-trading the rules of the General Agreement governing private trade and to ensure that the contracting parties cannot escape their obligations with respect to private trade by establishing state-trading operations."[6] Indeed, the *Korea Beef* panel found that the Ad Note's broad purpose – to ensure that Members cannot escape their WTO obligations by establishing state-trading enterprises – led to the conclusion that the "general principles of non-discriminatory treatment" under Article XVII:1(a) must include national treatment, *i.e.*, discrimination between imported and domestic products.

32. The same logic can be extended to export restrictions and the behavior of a state export monopoly. Article XI generally states that no prohibitions or restrictions may be placed on exports. In other words, a Member may not withhold goods from export markets. The Ad Note makes clear that a Member cannot circumvent its obligations under Article XI by acting through a state-trading enterprise, thus establishing that the obligations of Article XVII:1(a) include non-discrimination between sales in the domestic market and sales in the export market.

> Q26. *With reference to paras. 17 and 65 of the US first written submission, is there anything in the CWB Act, or any other statute or regulation, which legally precludes the CWB from making its sales involving wheat exports in accordance with Article XVII:1?*

33. The CWB is required by law to promote the sale of Canadian wheat in world markets. This statutory mandate and the actions of Canada and the CWB with respect to purchases and sales of wheat, along with the special and exclusive privileges granted to the CWB through laws and regulations, necessarily preclude the CWB from making sales in a non-discriminatory manner, according to commercial considerations, and in a manner that provides enterprises from other Members an adequate opportunity to compete. If the CWB were to act otherwise, it would violate its statutory mandate. Furthermore, Canada has not taken any steps to ensure that the CWB adheres to the Article XVII requirements.

> Q27. *Could the United States comment on the description of CWB export sale operations provided by Canada at paras. 54-58 of Canada's first written submission?*

34. Paragraphs 54 through 58 do not provide any evidence that the CWB is acting in a non-discriminatory manner, is acting according to commercial considerations, or is allowing enterprises of other Members an opportunity to compete.

35. The CWB states that it forecasts "target returns" for each export market in order to maximize overall return to the pool, but fails to explain what considerations are used when setting this target return. Similarly, while Canada states that managers are required to obtain a certain "acceptable return" on each sale, Canada does not provide any information on how this

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[6] *Korea Beef*, para. 749 (quoting *Japan - Restrictions on Certain Agricultural Products* (L/6253-35S/163) (2 February 1988), para. 5.2.2.2).

acceptable return is calculated. The CWB has an incentive to use its special and exclusive privileges to discriminate between foreign markets and make some sales in a non-commercial manner.

36. Finally, under paragraph 58, Canada states that "most," but not all, sales prices are linked to U.S. futures exchange prices and that the CWB "often," but not always, looks to U.S. exchanges to guide pricing decisions. The CWB also implicitly acknowledges that while differences in prices are "primarily" based on considerations such as grade and protein of grain and transportation costs, other, presumably non-commercial factors also come into play.

37. Indeed, paragraph 58 only tells part of the story, by focusing on Hard Red Spring wheat. Noticeably absent is any discussion of the Durum wheat market, even though the CWB accounts for over fifty percent of world Durum exports. There is no futures market for Durum wheat, and commercial actors in the Durum wheat market have no basis upon which to judge the CWB's Durum wheat prices.

> Q28. *With reference to para. 80 of the US first written submission, if the CWB tries to sell all wheat it has bought and in doing so seeks out the best markets and tries to obtain the best possible prices, are the sales made in this way in accordance with commercial considerations?*

38. No. The CWB's mandate under the CWB Act is to obtain "reasonable" prices, considering the objective of promoting sales of wheat. Accordingly, the CWB is driven to maximize sales quantity. In contrast, a commercial actor is only able to take advantage of a "best" price in a given market if that price covers the commercial actor's replacement value for the wheat sold. The CWB's special and exclusive privileges, including a government guarantee of all initial payments for wheat (which translates into a fixed, guaranteed, and known acquisition cost), means that the CWB does not need to obtain a price that covers its costs in every market. In addition, the CWB's special and exclusive privileges allow the CWB to sell wheat at lower prices than commercial actors could ever offer.

> Q29. *With reference to section 7(1) of the CWB Act, is the "object of promoting the sales of grain produced in Canada in world markets" an objective which is commercial in nature? (US first written submission, para. 65)*

39. Sales promotion is not *per se* inconsistent with commercial objectives. However, the objective of sales promotion is just one of many objectives a commercial enterprise would need to balance when acting in accordance with the realities and disciplines of the commercial marketplace. Canada has given the CWB special and exclusive privileges that can be used to promote sales without regard for other commercial considerations. With the Government of Canada guaranteeing CWB's cost of acquisition of wheat (*i.e.*, the initial payments made to farmers), the CWB can promote sales without being restrained by commercial considerations, thereby violating the obligations under Article XVII:1.

Q30. *With reference to footnote 12 of the US first written submission, please provide support for the assertion that the CWB sets the "buy-back" price sufficiently high so as to make the "buy-back" program commercially insignificant.*

40. Under the CWB's "buy-back" program, wheat farmers who wish to export their wheat independently must both buy back their wheat from the CWB at a premium and receive an export license from the CWB to sell that wheat abroad. The premium price is set by the CWB and is the price the CWB determines the wheat farmer would get if selling in the foreign market for which the export license is issued. This means that the wheat farmer must pay the CWB not only for the cost of the wheat, but also for the expected return that wheat will earn when sold in a foreign market. The CWB sets this artificial price, and it is not based on any publically available rate.

41. Section 46(d) of the CWB Act provides for the "buy-back" program. That provision states, in relevant part, that the "buy-back" program requires:

> recovery from the [farmer] by the [CWB] . . . of a sum that, in the opinion of the [CWB], represents the pecuniary benefit enuring to the [farmer] pursuant to the granting of a licence, arising solely by reason of the prohibition of exports of wheat and wheat products and then existing differences between prices of wheat and wheat products inside and outside of Canada.

42. The only farmers who participate in the buy-back program are those who think they can sell their wheat for an artificial price above the price the CWB determines that farmers should earn abroad. It is not surprising that few, if any farmers, choose to accept this risk. Effectively, the CWB has used its special and exclusive privileges to negate any benefit a farmer might be able to receive through the independent sale of his wheat in foreign markets. A similar buy-back program is available for independent wheat sales to the domestic market for human consumption.

Q31. *The United States asserts that on average the CWB's initial payment to farmers has been between 65 and 75 percent of the expected final value of the wheat sold (US first written submission, para. 25). Does the United States argue that any marketing arrangement which involves an initial payment plus a revenue-sharing arrangement is necessarily inconsistent with commercial behaviour? If not, please indicate what would be a "commercial" initial payment (as a percentage of the expected final value of the wheat sold), taking account of the marketing and other services provided under such a marketing arrangement.*

43. Marketing arrangements that involve an initial payment are not *per se* inconsistent with commercial behavior. However, the CWB is afforded the special and exclusive privileges that enable the CWB to use pooling in a manner that is inconsistent with commercial considerations. The Government of Canada guarantees the CWB's initial payment price and effectively requires

farmers to sell their wheat to the CWB, giving the CWB greater pricing flexibility than a commercial actor would have. The CWB's decision to set its initial payment price is not governed by commercial considerations since the Government of Canada's guarantee of those payments ensures that any potential pool deficits are covered and farmers cannot opt out of the CWB regime without facing significant costs. In other words, the CWB is not governed by the commercial reality of facing an actual economic loss on sales or of losing its source of supply. No commercial actor can determine its purchase price for wheat knowing that the purchase price will not affect the commercial entity's bottom line. The Government of Canada removes market risk from the CWB's decision to procure wheat.

> Q32. *With reference to para. 25 of the US first written submission, please explain further how the fact that the initial price is set by the CWB and the Government of Canada, as distinct from possible government guarantees of the initial payments, gives the CWB greater pricing flexibility than other grain trading companies.*

44. A commercial actor does not face a guaranteed supply of wheat at a known, fixed price of acquisition throughout the marketing year. The only way for a commercial actor to obtain such a price guarantee is to purchase futures or options to ensure against price fluctuations. Price certainty gives the CWB greater pricing flexibility than other grain trading companies because the CWB faces a completely different price risk structure that is not driven by commercial considerations. A private grain company would have to pay a tangible cost to obtain the same certainty under commercial conditions.

> Q33. *Please provide evidence supporting the existence of the two alleged pool deficits (US first written submission, para. 26). Were these two deficits paid for by the Canadian government?*

45. Exhibit US-16 includes relevant pages of CWB Annual Reports which document two pool deficits.[7] These two pool deficits were paid for by the Government of Canada.[8]

> Q34. *The United States has stated that when the CWB makes a sale on credit, the credit is extended at a commercial rate (US first written submission, para. 36). At the same time, the United States has stated that government guarantees of CWB borrowings allow the CWB to provide more favourable credit terms than those provided by commercial grain traders (US first written submission, para. 75). Please explain how these statements can be reconciled.*

46. The CWB, benefitting from its special and exclusive privileges, has an opportunity to

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[7] *See* Canada Wheat Board, Annual Report: 1985-86, pp. 46-47; Canada Wheat Board, Annual Report: 1990-91, Table A. (Exhibit US-16.)

[8] *Id.*

offer credit terms that are far more favorable than those offered by commercial grain sellers who do not benefit from guaranteed government borrowing at below-market rates. The CWB can take greater risks in extending credit than a commercial grain trader because the CWB is getting *its* financing at below commercial rates. In paragraph 75, the United States observes that all other terms being equal, as a direct result of the CWB's special and exclusive borrowing privileges, the CWB will be able to capture a sale by taking a greater credit risk than would be warranted if the CWB was acting under the commercial considerations of a private grain trader. When the CWB extends credit at commercial interest rates, it can take additional credit risks, such as offering a longer term for the loan than would be offered by a commercial actor. This has the effect of denying enterprises of other Members an adequate opportunity to compete, since a private grain trader acting according to commercial considerations and without the special and exclusive privileges of the CWB would not be able to make the sale on the same terms.

47. It should be noted that the CWB also has an arbitrage opportunity as a direct result of its government-guaranteed borrowing privileges. We do not mean to imply that the CWB never seizes upon this opportunity. Indeed, if the CWB lends at commercial rates and borrows at below commercial rates, it profits from interest rate arbitrage in a way that a commercial enterprise of another Member, acting according to customary business practice, could not.

> Q35. *The United States argues that because the CWB is required to sell all Western Canadian wheat which is produced, it will tend to export larger quantities of wheat at a lower price than would a competitive marketing structure. But if Canadian wheat production were to decrease because the CWB returns a lower price to Canadian farmers than would a competitive marketing structure, can the United States produce any evidence, in theory or otherwise, and in addition to Exhibit US-15, that CWB export supplies over time would be higher with the current marketing structure?*

48. In accordance with its legislative mandate, the CWB attempts to maximize all sales of Western Canadian wheat produced in a current marketing year. Through its special privileges the CWB has more pricing flexibility than a commercial entity and can reduce prices in order to export larger quantities of wheat.

49. Since farmers cannot, in practice, privately sell their wheat for domestic human consumption or export without going through the CWB, the fact that some may believe they could receive a higher return through a more competitive marketing structure does not factor heavily into the determination to produce wheat. There is effectively no exit option, as demonstrated by the Western Canadian wheat farmers that have gone to jail for attempting to market their wheat on their own, outside of the costly buy-back program that effectively precludes farmers from operating outside of the CWB's marketing structure.

50. If some farmers did reduce their wheat production, the CWB would still continue to have access to practically all wheat produced in Western Canada because of the CWB's monopsony privilege and thus would always have a relatively stable supply of high quality wheat for sale.

Indeed, the CWB has paid farmers a premium for high quality wheat even when such a premium is not justified by demand, giving Western Canadian farmers an incentive to over-produce high quality wheat. A CWB and Manitoba Rural Adaptation Council Inc. study (Exhibit US-15) found that during the base period (1992-1997), on average, the production of high quality Canadian Red Spring Wheat exceeded the market demand that has been willing to pay a commercial price premium for wheat of that quality. In particular, the analysis suggests that Canadian high-quality wheat production exceeded demand by 32 percent over 1992-1997. Western Canadian wheat farmers respond to the realities of the CWB-dominated wheat market and, with no alternative marketing structure available, 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.

Questions Posed to Both Parties

> Q42. *As a supplement to Exhibit CDA-24, could the parties provide an estimate of the volume and proportion of US grain imported into Canada for domestic consumption as compared to that imported for re-export?*

51. Attached as Exhibit US-17 is information on total U.S. grain shipments to Canada. The United States does not collect data on Canadian use of U.S. grain and therefore is unable to provide an estimate of the proportion of U.S. grain imported for domestic consumption or re-export.

> Q43. *Are the findings at para. 11.169 of the panel report on* Argentina - Hides and Leather mutatis mutandis *and at paras. 8.133-8.134 of the panel report on* US - FSC (Article 21.5 - EC) *relevant to this Panel's assessment of whether the grain segregation and rail transportation measures give rise to differential treatment as between "like" products within the meaning of Article III:4 of the GATT 1994?*

52. The reasoning in both reports is relevant. The panel in *US – FSC (Article 21.5 - EC)* explicitly found that a good is not "unlike" merely because of its origin. The panel went on to find that for measures of general application, "there is no need to demonstrate the existence of actually traded like products in order to establish a violation of Article III:4." U.S. origin grain, even when of the exact same type as domestic Canadian grain, is subject to differential treatment as "foreign grain" under Canada's grain segregation and transportation measures. Because origin alone cannot serve as a basis for a determination that two commodities are not like products, Canada's challenge that U.S. grain is not "like" Canada origin grain fails.

53. Regarding the reasoning in *Argentina - Hides and Leather*, that panel found that where the structure and design of the measure at issue differentiates among products based not on physical characteristics or end-uses but, instead, based on factors which are not relevant to the definition of likeness, the evidence required for a party to discharge its burden of establishing that a measure applies to products is minimal. And, as the *FSC* panel noted, product origin

cannot serve as a basis for a determination that two products are not "like." Here, because Canada's grain segregation and rail transportation measures discriminate on the basis of origin – even when all other product characteristics are exactly the same – one must reach the conclusion that the measure at issue applies to like domestic and foreign products. Thus, the structure and design of the Canadian measures alone make clear that like products are subject to the Canadian measures at issue.

> Q44. *Are all imported and domestic products falling within each of the categories of "grains" as defined in section 5(1) of the Canada Grain Regulations "like products" for the purposes of Article III:4 of the GATT 1994, or are there different "like" products within each of the categories of grain? Are all imported and domestic products falling within each of the categories of "grains" or "crops" as defined in section 147 of the Canada Transportation Act "like products" for the purposes of Article III:4 of the GATT 1994, or are there different "like" products within each of the grain or crop categories?*

54. All imported and domestic products falling within each of the categories of "grains" as defined in section 5(1) of the Canada Grain Regulations are "like products" for the purposes of Article III:4 (*i.e.*, foreign durum wheat and Canadian durum wheat, foreign canola and Canadian canola, foreign barley and Canadian barley).

55. The same holds true for like products falling within each of the categories of "grains" or "crops" as defined in section 147 of the Canada Transportation Act.

> Q45. *Could the parties respond to the EC's assertion in paragraph 43 of its third party written submission that a bulk grain handling system, such as that covered by the Canada Grain Act, "offers cost advantages compared to other ad hoc distribution possibilities."*

56. The EC's assertion that a bulk grain handling system, such as that covered by the Canada Grain Act "offers cost advantages compared to other ad hoc distribution possibilities" must be viewed in the context of the entire paragraph of the EC submission, paragraph 43, which states:

> In contrast, the fact evoked by Canada that foreign producers are not obligated to use Canadian grain elevators, and may for instance deliver directly to Canadian end users does not remove the unfavourable effects of the entry into grain elevators. It must be presumed that an efficient bulk grain handling system offers cost advantages compared to other ad hoc distribution possibilities. Equally, the fact that an exceptional authorization for using the elevators is a "well known and used" process does not remove the less favorable treatment of foreign grain.

57. We believe that the key phrase in this paragraph is that the possibility of alternative distribution channels or exceptional authorizations "does not remove the less favorable treatment of foreign grain." Canadian grain can move in and out of the bulk grain handling system subject to far less burdensome regulatory requirements than foreign grain. If foreign grain was treated as

favorably as like Canadian grain in the bulk handling system, foreign grain could be transported at far less cost.

58. There is a reason that the vast majority of grain in Canada travels through the bulk grain handling system – there is no efficient alternative for most grain producers. The majority of grain in the market is sold to large-quantity purchasers whose demands cannot be met by individual farmers shipping small lots of grain directly to end users outside of the bulk grain handling system. The bulk grain handling system allows numerous grain farmers to consolidate smaller quantities of grain at elevators into the large bulk shipments that purchasers demand. Farmers who cannot take advantage of the bulk grain handling system face prohibitive handling and transportation costs. For example, trucking rates are significantly higher than rail rates and are not a viable economic alternative for most producers. It is difficult and costly to access the rail system as an individual producer, rather than through the bulk handling system.

Questions Posed to the United States

> Q46. *With reference to paras. 207, 217 and 279 of Canada's first written submission, is it correct that Article III:4 of the GATT 1994 does not apply to laws affecting the transportation of goods in-transit?*

59. There is 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 in transit shipments are no relevant to this dispute. The laws and regulations at issue in this case – the Canada Grain Act and the Canada Grain Regulations – are measures affecting the internal transportation and distribution of grain. These measures affect all foreign and domestic grain that arrives at a bulk handling facility. Any foreign grain or domestic grain entering Canada's bulk grain handling system is subject to Canada's internal grain regulation from the moment that grain arrives at an elevator in Canada, regardless of the final destination of the product.

60. There is a limited scenario in which 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.

> Q47. *With reference to para. 91 of the US first written submission, please explain how section 57 of the Canada Grain Act and section 56 of the Canada Grain Regulations affect the "transportation" of grain.*

61. Canada's bulk grain handling system is the internal distribution and transport network for grain in Canada. The Canada Grain Act and the Canada Grain Regulations comprise the regulatory structure for the bulk grain handling system, including the receipt and treatment of

grains by elevators throughout Canada. Most grain transported internally in Canada will, at some point, be received and/or stored in a Canadian grain elevator. The language in the two passages referenced in the Canada Grain Act and Canada Grain Regulations state that Canadian elevators must not receive foreign grain, except as authorized, and must not mix foreign grain with Canadian grain. Since elevators comprise the main transport and distribution network for grains, these regulations necessarily affect both the transportation and distribution of grain.

Q48. *What is the United States' reaction to the assertion by Canada in its first written submission (para. 238) that "since the entry into force of the WTO Agreement, the CGC has never refused entry of foreign grain into Canadian elevators"?*

62. The issue in this dispute is not whether the CGC has refused entry of foreign grain into Canadian grain elevators. The regulations administered by the CGC result in less favorable treatment for foreign grain than for like domestic grain. The CGC may grant licenses, but these licenses are conditionally granted and require elevators to satisfy additional onerous regulatory requirements that are not imposed on like domestic grain.

Q49. *Could the United States submit a complete version of the Canada Transportation Act (Exhibit US-9)?*

63. A complete version is attached as Exhibit US-18.

Q50. *Does the United States agree with Canada's assertion, at para. 282 of its first written submission, that the only rail movements subject to the revenue cap which affect transportation of imported grain for internal sale are the movements of imported grain to Thunder Bay or Armstrong for domestic use in Canada?*

64. The United States fundamentally disagrees with Canada's assertion that the only relevant rail movements are movements of U.S.-origin grain to Thunder Bay or Armstrong for domestic use in Canada. As stated in Canada's own submission, the revenue cap applies to all grain movements that "originate in Western Canada."[9] Thus, the revenue cap applies to the internal transport of all grain within Canada from points in Western Canada to other Canadian ports. All of these movements are covered by Article III:4.

Q51. *With reference to para. 100 of the US first written submission:*

(a) *Could the United States explain how the revenue cap translates into a competitive advantage for Western Canadian grain over imported grain in respect of the internal transportation of grain?*

[9] Canada First Submission, para. 269.

65. Because railroads must pay a significant penalty for exceeding the rail revenue cap, railroads price transport for Western Canadian grain subject to the cap at rates below the level that could trigger the railroad to exceed the cap. Rail rates charged for imported grain can be set at a level that exceeds the rail rates charged for domestic grain because the revenue cap does not apply to shipments of foreign grain.

(b) *Why does the revenue cap necessarily constrain the rate-setting of the prescribed railways rather than the volume of grain shipped?*

66. Revenue received per mile is likely far more predictable than volume hauled. Because of the CWB's secrecy, railroads are faced with a great deal of uncertainty regarding the volume of commodities to be moved, as well as the timing and demand for rail equipment during the marketing year. We understand that the railroads have never denied transport of Board grain. As the railroads have little control over volume, rates are set at a low enough level so that adjustments can be made if concerns arise about annual revenues, and there is ample opportunity to raise rates without exceeding the revenue cap.

(c) *Could the United States explain how a system which appears to mandate a maximum average rate translates into a competitive advantage for Western Canadian grain?*

67. For an explanation of how the rail revenue cap translates into a competitive advantage for Western Canadian grain, please see the U.S. answer to question 51(a).

Q52. *Could the United States comment on paras. 290 and 291 of Canada's first written submission?*

68. Paragraphs 290 and 291 discuss grain movements that contain a transportation segment that is not subject to the revenue cap for domestic movements of grain. However, Canada ignores cases where the revenue cap applies for the full route, *i.e.* shipments westward for export or shipments eastward that stop at Thunderbay. Whether the rail revenue cap applies to part of the route or the full route, railroads provide lower rates to Western Canadian grain shipments subject to the cap so that the railroads do not pay the penalty for exceeding the cap. As a practical matter, therefore, the rail revenue caps keep prices lower for the transport of Western Canadian grain. Shipments of Western Canadian grain that are subject to the rail revenue cap pay lower transportation costs than those shipments would pay without the revenue cap. These lower transportation costs accord domestic grain more favorable treatment than like foreign grain.

69. Further, there is no support for Canada's argument in paragraphs 290 and 291 of its written submission that railroads can charge as high a rate for a non-regulated transportation segment and a low rate on the regulated transportation segment so that the average rate reflects a "market" rate.

Q53. *Could the United States confirm that, in respect of rail car allocation, the United States claim is that the provisions of section 87 of the Canada Grain Act, as such, are inconsistent with Article III:4 of the GATT 1994?*

70. Yes, the United States claims that section 87 of the Canada Grain Act is inconsistent with Article III:4 of the GATT 1994.

Q54. *With reference to para. 101 of its first written submission, could the United States explain how "[m]aking government rail cars available for the transport of domestic grain reduces transportation costs for any grain that receives this benefit."*

71. The provision of railcars from the Government of Canada relieves the railroads of the costs of ownership associated with these rail cars. Therefore, the railroads can charge lower rates than would be the case if the railroads had to lease or purchase the railcars themselves and factor these additional costs into the freight rates. This cost savings is passed on to those transporting domestic grain under the producer car program.

Q55. *Could the United States explain further and provide further evidence for its assertion in paragraph 101 of its first written submission that the producer car program "excludes all imported grain."*

72. Despite Canada's statement to the contrary, foreign producers cannot take advantage of the producer rail car program, as all of the loading sites are in Canada.[10] In addition, the relevant regulations do not state that foreign grain is eligible for the producer rail car program.

Q56. *With respect to the United States' claims under the TRIMs Agreement, what specifically does the United States mean when it asserts in its first written submission (para. 103) that:*

(a) *The grain segregation requirements require elevator operators to "use" domestic Canadian grain; that the rail revenue cap requirements require shippers to "use" domestic Canadian grain; and that the producer car program requirements require shippers to "use" domestic Canadian grain?*

(b) *What precisely are the "requirements" the United States is challenging for each of the measures being challenged?*

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[10] *See* Canadian Pacific Railway, "CPR Producer Car Loading Sites," *available at* http://www8.cpr.ca/cms/English/Customers/New+Customers/What+We+Ship/Grain/Producer+Cars.htm (last visited Sept. 23, 2003) (Exhibit US-19)*; see also* CN, "Producer Car Loader Station List," *available at* http://www.cn.ca/productsservices/grain/Canadaorigin/en_KFGrainCNProducerCarLoaderStationList.shtml (last visited Sept. 23, 2003) (Exhibit US-20).

(c) *What "advantage" is the United States asserting the foreign shippers are seeking to obtain?*

73. Answers to (a), (b) and (c) are discussed below for both elevator operators and shippers.

74. "Use" by elevator operators refers to handling of grain in the normal course of business, *i.e.*, handling, storage and transport. The requirements challenged are the Canada Grain Act's prohibition on the receipt of foreign grain into grain elevators under section 57 and the Canada Grain Regulations prohibition on mixing foreign grains under section 56(1). Local content requirements can be facilitated through a variety of regulatory mechanisms, some of which are more transparent than others. 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 also 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. These matters are described in more detail in paragraphs 100 of the First Written Submission of the United States.

75. "Use" by shippers refers to the shipment of grain by rail. The requirements being challenged here are the requirement that only Canadian grain can be shipped in order to qualify for the rail revenue cap, and the requirement to ship Canadian grain in order to qualify for the producer car program. Both requirements provide cost advantages in the form of lower rail transport rates to those shippers that choose to ship Canadian grain rather than foreign grain. Again, these matters are described in more detail in paragraph 101 of the First Written Submission of the United States.

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

WT/DS276

Answers of the United States of America
to Written Questions of the Panel
in Connection with the First Substantive Meeting

September 24, 2003

LIST OF EXHIBITS

US - 16. Canada Wheat Board, Annual Report: 1985-86, pp. 46-47; Canada Wheat Board, Annual Report: 1990-91, Table A.

US - 17. USDA, Foreign Trade Statistics: Foreign Agricultural Service Export Commodity Aggregations for Canada: 1999-2003.

US - 18. Canada Transportation Act, R.S.C., ch. 10 (1996).

US - 19. Canadian Pacific Railway, "CPR Producer Car Loading Sites," *available at* http://www8.cpr.ca/cms/English/Customers/New+Customers/What+We+Ship/Grain/Producer+Cars.htm.

US - 20. CN, "Producer Car Loader Station List," *available at* http://www.cn.ca/productsservices/grain/Canadaorigin/en_KFGrainCNProducerCarLoaderStationList.shtml.