BEFORE THE
WORLD TRADE ORGANIZATION
APPELLATE BODY

Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products Recourse to Article 21.5 of the DSU by New Zealand and the United States

(AB-2001-6)

EXECUTIVE SUMMARY OF THE APPELLEE SUBMISSION OF THE UNITED STATES

October 1, 2001

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1. In response to the DSB's recommendations and rulings in this case, Canada made certain regulatory changes regarding its dairy exports. Although the new provincial export programs differ in some regards from the Special Milk Class 5(e) that they replace, the objective is exactly the same: the provision of low priced milk to processors/exporters to make dairy exports commercially viable. The provincial programs vary from each other to some extent but possess several common elements that enable the new programs to accomplish this goal. First, by law, any milk produced above the level of the domestic quota must be sold for export-only processing (or relegated to marginal uses like animal feed that carry a low price mandated by the government). The government mandates that milk that is committed to export may not be introduced into the domestic market; such milk and all components of it (or the resulting dairy products) must be exported by law. Second, exporters of dairy products are provided access to milk at significantly lower prices; they are not required to pay the much higher, regulated price for milk produced within the domestic quota, for which prices are specifically established by provincial authorities, and they are not required to turn to the noncompetitive Import for Re-Export Program ("IREP"). Third, producers are required to aid processors by "pre-committing" to sell in the export market, and export milk must be delivered "first out of the tank." This benefits processors by providing them with a predictable supply of milk. Fourth, the federal and provincial governments monitor and enforce (through financial penalties) the requirement that milk contracted for export may not be redirected into the domestic market.

2. Convened at the request of the United States and New Zealand, the Article 21.5 Panel (hereinafter "the Panel") concluded that Canada's revised export schemes continue to provide export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture,* and that Canada continues to exceed its reduction commitments on export subsidies and, therefore, Canada has breached its obligations under Articles 3.3 and 8 of the *Agreement on Agriculture.*

3. The United States demonstrates that the Panel correctly concluded that Canada's revised export schemes continue to provide illegal export subsidies. The Panel properly found that all of the substantive elements of the WTO-inconsistent SMC export subsidies are encompassed in the revised measures. Under both the SMC system and the revised measures, milk at discounted prices is still provided only to exporters. Indeed, prohibitive penalties exist to ensure that any discounted milk or products made from such milk is in fact exported and not diverted into the domestic market. Most importantly, the provision of discounted milk to exporters is accomplished through the indispensable intervention of the federal and provincial governments. Thus, only the form, not the substance, of Canada's export subsidies has changed.

4. The United States first recalls that Article 10.3 of the *Agreement on Agriculture* specifies that Canada continues to bear the burden of establishing that its dairy management measures, including those putatively taken to comply with the DSB's recommendations and rulings, have not subsidized dairy exports in excess of its commitment levels under that *Agreement*. The Panel properly concluded that Canada failed to carry its burden.

5. Under Article 9.1(c), two conditions must be met to find an export subsidy under that paragraph. There must be: (1) payments on the export of an agricultural product and (2) those "payments" must be "financed by virtue of governmental action."

6. Here, the Panel correctly concluded that the processors/exporters receive a "payment on the export of an agriculture product" within the meaning of Article 9.1(c). Canada's argument that a "payment" has not been made should be rejected as it advocates an erroneous approach to analyzing the "payment" element and ignores the true nature of the commercial export milk market as found by the Panel. The Panel in this proceeding properly concluded that a "payment" within the meaning of Article 9.1(c) is conferred upon the exporter/processor through the provision of discounted milk for export. As the Panel explained, such a discount exists whether the price of export milk is compared to the price of domestic milk or to the terms of imported milk under the Import for Re-export Program ("IREP"), which are the only other sources of milk available to exporters in Canada.

7. Canada's approach is inconsistent with the Appellate Body's previous report in this case and ignores that the so-called "commercial export milk market" is a market contrived and controlled by the Canadian government. Consistent with the Appellate Body's previous report in this case, the Panel applied a benchmark analysis and concluded that processors are receiving milk priced lower than any other source of milk available to them. The degree of government intervention does not affect the benchmark analysis. The Panel properly concluded that government intervention is relevant to the second element of Article 9.1(c), the government action element, but not the first element.

8. Canada does not and, indeed, cannot dispute that the payment (i.e., the provision of lower priced milk) is only available in the case of milk purchased for the manufacture of dairy products destined for the export market. Consequently, the payment constitutes a payment "on the export of an agricultural product" under Article 9.1(c).

9. The Panel also correctly concluded that the payments are "financed by virtue of government action" within the meaning of Article 9.1(c). Adopting the Appellate Body's analysis, the Panel in this proceeding applied the "indispensability" test to determine whether the payments under the new export schemes are 'financed by virtue of governmental action." Given that the Panel applied the same legal standard adopted by the Appellate Body in its previous report in this case, the Panel's choice of legal standard should be upheld.

10. Once the Panel concluded that the "indispensability" test was the appropriate legal standard in this dispute, it then applied that standard to the facts. The Panel identified two facts which it considered would satisfy the indispensability test if established. These include: 1) that governmental action "prevents Canadian milk producers from selling more milk on the regulated domestic market at the higher price than to the extent of the quota allocated to them;" and 2) that governmental action "obliges Canadian milk processors to export all milk contracted as lower-priced commercial export milk, and accordingly penalizes the diversion by processors of milk contracted as commercial export milk to the domestic market."

11. Having properly found these two facts (which Canada cannot challenge before the Appellate Body), the Panel correctly concluded that the governmental action was indispensable to the transfer of resources from the producers to the processors. The Panel explained that, in the absence of either of these governmental measures, lower-priced milk would not be provided to the processor/exporters. Without the limitation (*i.e.* quota) on the amount of milk that a producer can sell in the higher-priced domestic market, an economically rational producer would not choose to sell in a lower-priced export market. Without the government requirement that milk contracted for export products must be exported and the government enforcement of that requirement, export milk would be diverted into the domestic market thereby undermining the low export price as well as the high domestic price.

12. Canada's response to the Panel's finding on this point is to re-argue the facts. However, this is outside the mandate of the Appellate Body. The Panel correctly concluded that Canada did not satisfy its burden of establishing that the measures in question do not constitute export subsidies under Article 9.1(c). A review of the factual record establishes that it is only through governmental action that processors are provided with milk at discounted prices, contingent on export. Thus, the Panel's conclusion that processors are receiving payments "financed by virtue of government action" should be upheld.

13. Finally, although the Panel exercised judicial economy and did not opine upon the Article 10.1 claim under the *Agreement on Agriculture* or the Article 3 claim under the *Agreement on Subsidies and Countervailing Measures*, Canada has included arguments on these claims. Accordingly, should the Appellate Body decide to complete the legal analysis of the Panel, the United States submits that, in the alternative, Canada's revised export schemes constitute export subsidies under Article 10.1 of the *Agreement on Agriculture*. Further, should the Appellate Body deem it necessary to complete the analysis, the United States submits that Canada's revised export schemes are prohibited export subsidies within Article 3 of the *Agreement on Subsidies and Countervailing Measures*.