

Volume 11 Number 1 2010/p. 46-66

esteyjournal.com



The Estey Centre Journal of **International Law and Trade Policy**

Trade Friction, Dispute Settlement and Structural Adjustment, Or, Why *Canada–Wheat* Doesn't Matter in North American Trade Relations

Marc D. Froese

*Assistant Professor, Department of History and Political Science,
Canadian University College*

This article examines the substance of the WTO panel decision for *Canada–Wheat* as it relates to trade friction in North American agricultural markets. I provide an overview of recent economic literature on state trading enterprises (STEs) and examine the WTO's approach to regulating the behaviour of STEs. The *Canada–Wheat* panel was the first WTO panel to consider Canada's single-desk marketing system for Western Canadian wheat and barley and was the first test of the WTO's regulation of STEs under GATT Article XVII. The panel rejected the American argument, opting for a line of reasoning that highlights the rules of non-discrimination while maintaining some of the ambiguity of Article XVII. I conclude by examining the competitive pressures that exacerbate trade frictions between North American wheat producers. From a legal perspective, this panel decision is significant because it clarifies the WTO's position on STEs, to a certain extent. In the context of continental politics, however, the ruling will likely have little impact on Canada/U.S. trade relations because it must be analyzed in relation to the domestic demands that arise from ongoing structural adjustment in both nations' agricultural sectors.

Keywords: agricultural exports, Canadian Wheat Board, dispute settlement, state trading enterprises, World Trade Organization

*Editorial Office: 410 22nd St. E., Suite 820, Saskatoon, SK, Canada, S7K 5T6
Phone (306) 244-4800; Fax (306) 244-7839; email: kerr.w@esteycentre.com_____46*

Introduction

Agriculture is one of Canada's leading value-added industries (Cross, 2007). Like many agricultural exporters, Canada has a number of programs in place to deal with volatility in global markets for agricultural products. Wheat prices in particular are somewhat cyclical and have a higher variable of growth compared to the total Canadian business sector. In Canada, market volatility has been managed through wheat pooling and the international sale of wheat through a single-desk marketing system. In the United States, price swings are managed by direct payments to exporters through the U.S. Department of Agriculture's Foreign Agriculture Service. The Canadian Wheat Board (CWB) is part of a historically rooted trajectory of national industrial development (Zysman, 1996). Like American farm support programs, it plays an important political role in stabilizing the agricultural sector alongside its commercial function of maximizing wheat sales for farmers.

The main issues for opponents of single-desk marketing in Canada are political – only Western Canadian farmers must sell to the CWB. Farmers in other parts of Canada have separate marketing boards, and participation in these is voluntary. There is also evidence that the current system forces farmers and taxpayers to bear hidden costs; it is these costs, coupled with a lack of marketing choice, that Western farmers take issue with (Carter and Loyns, 1996). The proponents of the CWB argue that farmers are protected to a certain degree from market volatility, and the Canadian Wheat Board brand is known globally for its high-quality product. The main issue for American competitors is structural. There is a perception in the American wheat industry that the Canadian Wheat Board is structured in such a way as to ensure it will not operate in accordance with commercial considerations – that is, in the interests of free market competition.

This article examines the substance of the WTO panel decision for the Canada–Wheat case as it relates to the trade friction in North American agricultural markets.¹ Canada–Wheat was the first WTO panel to consider Canada's single-desk marketing system for Western Canadian wheat and barley. It was also the first test of the WTO's regulation of state trading enterprises (STEs) under GATT Article XVII (Hoekman and Trachtman, 2007). The first section contains an overview of the place of state trading enterprises in international trade and examines the cases for and against this form of producer support. The second portion of this article examines the WTO panel and Appellate Body reports in the 2004 Canada–Wheat case. The WTO panel found that the primary discipline of GATT Article XVII:1 governing STEs was non-discrimination, and operating on the basis of "commercial" considerations, as commerce was defined in the American argument, was not an independent obligation.

In this case, the WTO upheld the legality of Canada's state trading enterprise, suggesting that trade discipline may play less of a role in Canada's structural adjustment process than other factors such as proximity to American markets and other competitive pressures that result from increased exposure to global markets.

The final section remarks upon the convergence of Canadian and American levels of support for agriculture. Both countries are adjusting levels of support downwards overall, and each country responds to the pressures of intrasectoral competition in different ways. I conclude by arguing that the trade friction caused by Canada's single marketing board for Western Canadian wheat and barley may not be the result of the trade-distorting impact of the CWB as much as it is a product of long-term competitive pressures in the market for North American wheat.

Trade Friction in the North American Market for Wheat

A number of kinds of STEs trade in agricultural markets – statutory marketing boards, canalising agencies and foreign trade enterprises are operated by the vast majority of countries that export agricultural goods. The Canadian Wheat Board is a marketing board, and the latter two organizational frames are often used by developing countries to develop markets of scale for trade operations. There is a small body of literature that examines the role of STEs in global agricultural markets. Much of the literature assumes that STE market power stems from their special privileges and relationship with national governments, and that they compete in otherwise perfectly competitive markets.

Recent studies have shown that this is a problematic assumption (Abbott and Kallio, 1996; Pick and Carter, 1994; and Veeman, Fulton and Larue, 1999). A handful of multinational companies have a large influence on world wheat prices. Much of the world grain trade is controlled by five multinationals – including Cargill and Louis Dreyfus – and these international grain traders frequently “price to market”. Wheat Board sales totalled approximately \$2.2 billion in 2003. In comparison, Cargill sales topped \$60 billion and the Louis Dreyfus Group posted sales worth \$20 billion.² Canada's single-desk marketing system is a small player in a very big industry, one that does not meet the standard definition of free market competition.

Since 1995 the United States has been especially keen to curtail the activities of agricultural state trading enterprises or ban them altogether (OECD, 2001). There is a perception on the part of the American wheat industry that state trading enterprises enjoy levels of governmental support that far outstrip the support enjoyed by American farmers. Indeed, in 1995 Canadian wheat transportation legislation was

significantly changed to bring it into line with WTO law. Similarly, American farm support has been retooled over the past decade as well, although the American model of agricultural support still relies almost exclusively on cash payments to farmers. The USDA's Export Enhancement Program, which was developed under the rationale that U.S. agricultural exporters needed government support to compete with Europe's heavily subsidized agricultural sector, has been slowly phased out, replaced by other, industry-specific export subsidies such as the Dairy Export Incentive Program and the Market Access Program.

The Canadian Wheat Board was established by Parliament in 1935 and still retains its headquarters in Winnipeg, the traditional gateway to the West. It is governed by a fifteen-person board of directors, ten of whom are elected farmers; four are appointed by the federal minister of agriculture, and the president of the board is appointed by the prime minister. The CWB acts as a marketing agent for all Western Canadian wheat and barley farmers. It pays out an interim payment for crop and a final payment – the amounts of which are set by the current year's sales volumes and prices. This pooled selling system ensures predictable cash flow for farmers through pooled prices and a government price guarantee if marketing forecasts fall below expectations. Notably, in the case of wheat and barley, it does not allow individual farmers to choose where, when and to whom to market their product. In all other products farmers are not subject to the marketing control of the Canadian Wheat Board.

High levels of farm support are as old as the trade regime itself. In fact, the most glaring compromises made by the original GATT signatories with the post-war economic order were in agriculture. The North American agricultural trade environment today is the result of diverse economic policy choices made by member governments in the process of navigating the post-war trading system. Many of these policy choices were made between 1930 and 1960, and involved what Ruggie (1982) terms a compromise with embedded liberalism. The balance developed by G7 nations during this formative period allowed them to manage the social adjustment costs of increased market openness.³

These different approaches to managing volatile business cycles survived and flourished in the post-war international economic order. Embedded liberalism, as a theoretical tool to analyze different national regulatory approaches to post-war integration, has lost some of its currency. Keohane (1984) successfully argued that America's move away from the gold standard ended American economic hegemony and marked the end of post-war embedded liberalism. Markets are now global and the distinction between national and international business transactions has lost some of

its significance. Nevertheless, trade friction still arises from different public policy strategies having their roots in historical circumstances and political compromises that were unique to the post-war economic order.

Table 1 US Trade Challenges to Canadian Wheat Exports, 1990 – 2006

Investigation	Date completed	Final determination
USITC investigation (under section 332 of the Tariff Act of 1930)	Jun-90	Canadian wheat sold in the US at or above market prices – no evidence of dumping
USGAO review of the CWB/AWB	Jun-92	No evidence of unfair trade practices
Canada-US Trade Agreement	Feb-93	Panel ruling In favour of Canada
USITC investigation (under section 22 of the Agricultural Adjustment Act of 1930)	Jul-94	Negotiated cap on exports to the US for 1994-95
Joint Commission on Grains	Oct-95	Recommendations to improve trade in both directions
USGAO (ability of STEs to distort trade)	Jun-96	No evidence that the CWB violates any existing agreements
USGAO (Canadian wheat issues)	Nov-98	No solid conclusions
USDOC (countervailing duty on live cattle from Canada)	Oct-99	No evidence that the CWB provides a subsidy to cattle producers
USITC investigation (under section 332 of the Tariff Act of 1930)	Nov-01	Canadian wheat sold at or above US prices in all but one of 60 months examined
USTR (section 301 investigation)	Feb-02	No justification for imposing entry barriers to Canadian wheat
USDOC / USITC & NAFTA on appeal	Aug 2003 - June 2005	Duties imposed on Canadian wheat by USDOC – lifted in 2006 after successful NAFTA appeal
USDOC / USITC / USCIT	August 2003 - July 2004	Duties imposed on Canadian wheat by USDOC; duties revoked by USITC; appeal dismissed by USCIT
USDOC / USITC / USCIT & NAFTA on appeal	August 2003 - June 2005	Duties imposed on Canadian wheat by USDOC; USITC split on injury; decision defaults to petitioner – lifted in 2006 after successful NAFTA appeal
WTO panel and appeal (DS276 Canada: Measures relating to exports of wheat and treatment of imported grain)	Aug-04	US argument that the CWB violates GATT Article XVII dismissed at panel and appeal. Finding that three other Canadian measures violate GATT Article III

Prior to the Uruguay Round Final Act, the GATT placed fewer restrictions on agriculture than it did on other sectors. According to Trebilcock and Howse (1999), a number of major states came close to ignoring the GATT altogether, even refusing to implement GATT panel decisions. Special treatment in agriculture was largely a reflection of the influence of the United States after the Second World War (ibid.). Import quotas and export subsidies were an essential part of the American supply management framework for agricultural products.

GATT regulation of trade in agriculture is concerned chiefly with quantitative restrictions and export subsidies. Article XI bans quantitative restrictions on imports, with some significant exceptions – relevant ones include exceptions in order to address critical food shortages such as export restrictions and restrictions for the application of standards and regulation. Export subsidies are also prohibited except in the case of “primary products”, defined as any product of farm, forest or fishery at an early stage of processing.⁴ And in the case of primary products, export subsidies cannot be used to increase a nation’s share of international trade. Domestic subsidies and domestic support measures also fall under the GATT’s oversight, but are much more difficult to police.

GATT Article XVII deals with the regulation of state trading enterprises. The substantive obligations of members under the rules governing state trading are as follows: non-discrimination (MFN, or Most-Favoured Nation, treatment); no quantitative restrictions; preservation of the value of tariff concessions (no domestic price manipulation); and transparency. In defining non-discriminatory treatment, strict MFN treatment is not necessarily required. This allows a state trading enterprise to charge different prices for its products in different markets, provided that this is done for commercial reasons, that is, to meet supply and demand conditions in export markets.⁵

According to WTO notifications, STEs serve a number of purposes – income support, price stabilization, increase in government revenue, protection of public health, continuity of domestic food supply.⁶ Trebilcock and Howse (1999) add that STEs are also linked to arguments having to do with self-sufficiency and national security and preservation of the environment and the rural way of life. Income redistribution is often the primary reason for the use of STEs. In addition to exploiting national market power by aggregating the supplies of many farmers, STEs can act to distribute income towards or away from farmers. In the Canadian case, the CWB acted to distribute income towards farmers. But in developing countries, governments frequently use STEs to transfer resources to consumers of food.

The GATT recognizes STEs as legitimate participants in trade but also recognizes that they have the potential to distort trade if they make decisions based on government instruction rather than market principles. It is difficult to quantify the anticompetitive effects of export STEs, because they do not directly subsidize their exports to world markets. However, because the STE is in place in lieu of a subsidy there is a continually abiding suspicion that their behaviour does not always correspond to that of other, private actors, and ties to national governments give them unfair advantages vis-à-vis private competitors. Hoekman and Trachtman (2007, 4) give five ways that STEs can be used to circumvent WTO commitments. First, they can circumvent the MFN principle enshrined in GATT Article I by discriminating among trade partners regarding purchases and sales. Second, they can circumvent the National Treatment principle of GATT Article III by discriminating among domestic and imported goods (Canada lost on this point in its treatment of foreign wheat at Canadian elevators). Third, if they have import privileges, they can restrict quantities of imports contra GATT article XI. Fourth, they might exercise import rights to sell imported goods at mark-ups that operate like tariffs. Finally, STEs may use their purchases and sales to subsidize sellers and buyers.⁷

A main concern of the United States was that the CWB was using its market power and discriminatory pricing behaviour as a de facto subsidization mechanism for Western Canadian wheat producers by discriminating between foreign and domestic product behind the border. There was a concern that implicit subsidization was occurring in the economic sense, if not in the legal sense. The United States sought a finding of broad discipline on the competitive behaviour of STEs. A case based on this sort of large and sweeping indictment had a certain amount of traction because the CWB does not necessarily maximize export profits, as a private economic actor does; rather, it uses its market power to get the best prices for its different products in many different national markets.⁸

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

Over the past two decades, the American wheat industry has brought more than a dozen challenges against Canada's centralized system for buying and selling wheat. These challenges are summarized in table 1. Beginning in the early 1990s, the U.S. International Trade Commission investigated charges of Canadian wheat being dumped on the American market. In 1993 a case was taken by U.S. regulators to the new dispute settlement process in the Canada-U.S. Free Trade Agreement, and Canada

won. Five more challenges were launched by the ITC, the Department of Commerce, and the Government Accountability Office throughout the 1990s. Canadian wheat exports to the United States were briefly capped in 1994 and 1995. Between 2003 and 2005 duties were twice imposed on Canadian wheat by the Department of Commerce. In both cases the finding of material injury was appealed at NAFTA and subsequently reversed. And then came the most serious charge – a full court press at the WTO to find the Canadian Wheat Board and a number of other support mechanisms in contravention of Canada’s MFN obligations and GATT Article XVII:1, which defines the limits of state trading.

Canada–Wheat concerns two aspects of Canada’s regulatory apparatus for the transport and sale of wheat. The first part of the American challenge concerned Canada’s export regime for wheat, the Canadian Wheat Board. It included the legal framework of the CWB, its special rights and privileges granted by the federal government and its actions with respect to wheat purchasing at home and sales abroad of Canadian wheat. The second part concerned requirements contained in the Canada Grain Act (CGA), the Canada Grain Regulations and the Canada Transportation Act, for the treatment of grain imported into Canada. Section 57c of the CGA governs the receipt of foreign grain into Canadian elevators. Section 56(1) of the Canada Grain Regulations disallowed the mixing of certain types of foreign and domestic grain in Canadian elevators. Section 150 of the Canada Transportation Act imposed a cap on revenues earned by certain railways for the transportation of Western Canadian grain. Finally, section 87 of the CGA allows producers to apply for a railway car to transport their wheat to a grain elevator or a co-signee.

Together, these measures add up to a policy that protects Canadian wheat producers from the vagaries of the international market and from significantly increased transportation costs caused by seasonal demand for railway transportation. The American case claimed that these were trade-distorting measures that gave Canadian wheat producers an unlawful set of trading advantages, both in terms of sale on the international market as well as in terms of the treatment of grain at home, vis-à-vis imported wheat.

The Panel Report

The American claim under GATT Article XVII :1 that the Canadian Wheat Board breached Canada’s obligations was a challenge to the entire CWB export regime (paragraphs 6.18-21, 6.24-25). The American suit alleged that illegality of the CWB export regime proceeded from a combination of three elements – the CWB’s legal structure and mandate, its privileges and the incentives that flowed from those

privileges, and the lack of supervision by the Canadian government. In particular, the United States made three claims:

1. The CWB export regime is not consistent with GATT Article XVII:1;
2. Canadian grain segregation requirements in Section 56 of the Canada Grain Regulations and Section 57 of the Canada Grain Act are inconsistent with GATT Article III:4 (national treatment) and Article 2 (investment) of the Trade Related Investment Measures (TRIMS) Agreement; and
3. The rail revenue cap and the producer railway car program were also inconsistent with the national treatment principle enshrined in Article III of the GATT and Article 2 of the TRIMS Agreement.⁹

Before examining this claim, the panel addressed disagreement over the meaning of the terms of Article XVII:1 (a) and (b):

1. (a) Each contracting party 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.

(b) The provisions of subparagraph (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 contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales (GATT 1947, emphases added).

The panel noted that Canada and the United States disagreed over whether the provisions of paragraphs 1(a) and 1(b) form an obligation on the part of members to ensure that their STEs comply with certain standards or whether, as Canada argued, the provisions only require that STEs act in such a way that a member is responsible for their actions under international law, and if a complaining party is unable to demonstrate that the STE in question is not meeting its legal obligation, then “that Member must be assumed to have honoured its undertaking” (paragraphs 6.34-36, 6.40).

The panel examined three interpretive issues surrounding XVII:1(b) – the most important being the interpretation of the first clause of subparagraph (b), which states 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.” The panel did not accept the U.S. argument that STEs must act like “commercial actors” that “maximize profit [and] do not enjoy government-conferred privileges and are disciplined by market forces” (paragraphs 6.84-88). In the panel’s opinion the clause simply meant that STEs must make decisions based upon commercial rather than political considerations. STEs “should seek to purchase or sell on terms that are economically advantageous for themselves, and/or their owners, members, beneficiaries, etc.” (ibid.). In short, the panel determined that although a state trading enterprise may be granted rights and privileges that have a political goal, such as support for farmers, it must operate based on commercial considerations. For example, an STE would not be acting on commercial considerations if it were to buy or sell on the basis of the nationality of the buyer or the national interest of its member government.

The U.S. claim that the CWB export regime necessarily results in non-conforming sales was based on four broad assertions:

1. Privileges enjoyed by the CWB give it more flexibility than would be enjoyed by a commercial actor;
2. Pricing flexibility allows the CWB to offer “non-commercial” sales terms, thereby robbing “commercial” enterprises of an opportunity to compete;
3. The CWB’s mandate and legal structure create an incentive for it to maximize sales rather than profits, meaning that it can discriminate between markets, selling lower in some markets for example. In this way the CWB encourages the overproduction of high-quality grain; and
4. The Government of Canada does not ensure that the CWB conforms to Article XVII:1 (a) and (b), and in the absence of government safeguards the CWB’s legal structure and mandate result in non-conforming sales of wheat.

The panel decided that these assertions must be taken together in order to demonstrate non-conforming sales, and so the United States had to establish the veracity of all four assertions. It proceeded to examine the first part of the American challenge – that the CWB’s legal structure gives it an incentive to make sales that do not conform to its obligations under GATT Article XVII:1. The panel disagreed, noting that the majority of directors that serve on the CWB are elected by Canadian wheat and barley producers. These directors ensure returns for producers by maximizing sales. It also noted that the CWB Act requires directors and officers to “act honestly and in good faith with a view to the best interests of the [CWB]”

(paragraphs 6.123-134). The CWB's legal structure does not give it an incentive to make wheat sales on a basis other than commercial considerations.

The panel also rejected the U.S. assertion that the CWB's mandate to strive for a "reasonable price" meant that the CWB did not strive for a profit-maximizing price. The panel decided that although the CWB was not striving to make a profit for itself, it was attempting to maximize the returns for its producers. Further, Article XVII:1 does not suggest that STEs only meet the "commercial considerations" requirement if operations are structured to maximize profit. An STE can also be structured to meet other goals that benefit its producers, such as the maximization of returns. The panel concluded that "(a) the United States has not established that the CWB Export Regime necessarily results in non-conforming CWB export sales; and, as a consequence (b) the United States has not established that Canada has breached its obligations under Article XVII:1 of the GATT 1994" (paragraph 6.151).

The panel moved on to examine the other charges brought against Canada's wheat export regime. Section 57(c) of the CGA does not allow elevators to receive foreign grain except when authorized by regulation or the Canada Grain Commission. The panel found that the section is inconsistent with GATT Article III:4 because imported grain is treated less favourably than domestic grain, since an additional regulatory burden must be met by foreign grain before it can enter Canada's grain handling system.

Turning next to an examination of the consistency of Section 57(c) of the Canada Grain Act (Receipt of Foreign Grain) with GATT Article XX (d), Canada's defence of its differential treatment of foreign grain in its domestic grain handling system involved the general exceptions clause of GATT. Canada argued that Section 57(c) was necessary to ensure compliance with wheat grading requirements and to make sure that foreign wheat is not misrepresented as domestic wheat in Canada and elsewhere. The panel found that Canada could put policies into place that would do the same things it was intending to do without placing an extra regulatory burden on foreign wheat, and therefore Section 57(c) of the Canada Grain Act was not justified under GATT Article XX(d).

Likewise, Section 56(1) of the Canada Grain Regulations allows the mixing of any grade of grain coming into or going out of an elevator as long as neither is western grain or foreign grain. The United States argued this is a discrimination in contravention of GATT Article III:4 because it is based on place of origin, not on whether the products are "like products". The panel also found that the section was inconsistent with the GATT. Canada made the same GATT Article XX(d) defence, and the panel struck it down for the same reasons.

In the examination of the consistency of sections 150(1) and 150(2) of the Canada Transportation Act (Rail Revenue Cap) with GATT Article III:4, the United States argued that “the effect of these provisions taken together is that domestic grain is favoured over like imported grain” in that there is an incentive for railways to hold prices down for Western Canadian grain, but no incentive exists for the transportation of foreign grain (paragraph 6.328). Canada responded that “the revenue cap has never been met and is unlikely to be met in the future” and therefore no adverse trade effects have ever been felt by foreign grain (paragraphs 6.357-358). The panel emphasized that it is not necessary to demonstrate adverse trade effects, because Article III protects the conditions of competition; the panel struck down the rail revenue cap.

Table 2 Anatomy of the Panel Decision

<p>Examination of the legality of Canada’s export regime for wheat</p> <ul style="list-style-type: none"> The CWB’s legal structure does not necessarily give it an incentive to make wheat sales on a basis other than commercial considerations. The panel also rejected the US assertion that the CWB’s mandate to strive for a ‘reasonable price’ meant that the CWB did not strive for a profit-maximizing price. The panel decided that although the CWB was not striving to make a profit for itself, it was attempting to maximize the returns for its producers. Further, Article XVII:1 does not suggest that STEs <i>only</i> meet the ‘commercial considerations’ requirement if operations are structured to maximize profits over sales. They can also be structured to meet other goals that benefit their producers, such as the maximization of returns. <p>Examination of the consistency of Section 57(c) of the Canada Grain Act (Receipt of Foreign Grain) with GATT Article III:4</p> <ul style="list-style-type: none"> The panel found that the section was inconsistent because imported grain was treated less favourably than domestic grain. <p>Examination of the consistency of Section 57(c) of the Canada Grain Act (Receipt of Foreign Grain) with GATT Article XX (d)</p> <ul style="list-style-type: none"> The panel found that Canada could put policies into place that would do the same things it was intending to do without placing an extra regulatory burden on foreign wheat, and therefore Section 57(c) of the Canada Grain Act was not justified under GATT Article XX(d). <p>Examination of the consistency of Section 56(1) of the Canada Grain Regulations (Mixing Authorization) with GATT Article III:4</p> <ul style="list-style-type: none"> The panel found that the section was inconsistent with the GATT. <p>Examination of the consistency of Section 56(1) of the Canada Grain Regulations (Mixing Authorization) with GATT Article XX(d)</p> <ul style="list-style-type: none"> The panel found that the section was inconsistent with the GATT. <p>Examination of the consistency of Sections 150(1) and 150(2) of the Canada Transportation Act (Rail Revenue Cap) with GATT Article III:4</p> <ul style="list-style-type: none"> The panel struck down the rail revenue cap. <p>Examination of the consistency of Section 87 of the Canada Grain Act (Producer Railway Cars) with GATT Article III:4</p> <ul style="list-style-type: none"> The panel ruled that there was nothing in the statute that limited access to railway cars to domestic producers and therefore Section 87 of the CGA was consistent with the GATT. <p>Examination of the consistency of Section 87 of the Canada Grain Act (Producer Railway Cars) with TRIMS Agreement Article 2</p> <ul style="list-style-type: none"> The panel ruled that the US had not established that Section 87 excluded foreign producers nor that section 87 was necessarily inconsistent with TRIMS Article 2.1.
--

The panel ruled in Canada's favour in the final two allegations brought by the United States. Section 87 of the Canada Grain Act allows producers of grain who meet certain conditions to apply for a railway car to take their grain to an elevator. The United States argued that this mechanism was discriminatory because it allowed only domestic producers to access the railway car program. The panel disagreed, ruling that there was nothing in the statute that limited access to railway cars to domestic producers. Finally, the United States claimed that Section 87 of the Canada Grain Act is inconsistent with TRIMS Article 2 because it requires shippers to use domestic Canadian grain in order to obtain an advantage. Recalling its finding above, the panel ruled that because the United States had not established that Section 87 excluded foreign producers it could not find that section 87 was necessarily inconsistent with TRIMS Article 2.1.

The Appellate Body Report

The dispute settlement panel in the wheat case took the view that the term "commercial" simply refers to economic action that is actually taking place in the marketplace. The United States had sought to define commercial as referring to an undistorted free market. The panel decided that the term, although it referred to business interaction within the market, did not preclude goals other than profit. The Appellate Body report clarified the relationship between subparagraphs (a) and (b) of Article XVII:1. Subparagraph (a) "sets out an obligation of non-discrimination" and subparagraph (b) "clarifies the scope of that obligation" (paragraph 100). It disagreed with the U.S. interpretation that subparagraph (b) "establishes separate requirements that are independent of subparagraph (a)" (paragraph 100). The significance of this clarification is that it more fully defined the scope of Article XVII:1. The American definition of "commercial" in subparagraph (b) would have established a separate obligation for members and their STEs and would have narrowed the proper scope of STE activity significantly. Any STE that could not prove that its actions were only in the service of profit-maximization and undistorted market competition would have been in contravention of the GATT.

The Appellate Body's definition of the relationship between subparagraphs (a) and (b) is narrower. It does not allow for the expansion of obligations under subparagraph (b) but rather argues that the text provides illustrative examples of discrimination that is prohibited in (a). This interpretation of Article XVII:1 preserved a significant realm of autonomy and scope of action for STEs. This is significant in the Canadian context because the panel ruled that the CWB's approach to grain exports, which maximizes sales for farmers rather than profits from individual transactions, is a perfectly legitimate way for an STE to conduct business in the global marketplace.

The Appellate Body adopted an interpretation of Article XVII:1 that limits its disciplines to non-discrimination. STE action need not conform to free-market expectations, it must only be non-discriminatory. The Appellate Body declined to find a requirement that STEs act like private actors, and in this way it preserved the “possibility that states may use STEs to achieve broader public policy goals” (Hoekman and Trachtman, 2007, 3). The finding suggests that certain government policies, including STEs “may be appropriate responses to the exercise of market power by large multinational corporations in particular fields” (ibid., 18). The fact that this approach has the dual outcome of preserving a significant global market share for Canadian farmers while simultaneously sheltering producers from unstable international wheat prices is of no legal consequence. It is strategic public policy, not anticompetitive behaviour.

Structural Adjustment in North American Wheat Markets

The American response to competitive pressure on the agriculture front has been a multi-pronged attack on the Canadian Wheat Board that includes domestic trade challenges, WTO dispute settlement and continued pressure on Canadian agricultural industries at the WTO. In the larger scheme of things, the panel decision in *Canada–Wheat* may be significant for the global regulation of export STEs, but in the North American context, the ruling will likely have little impact on Canada/U.S. trade relations in the agricultural sector because it must be considered in relation to other, larger forces such as American domestic politics and the regional politics of agriculture in Canada.

The divergence of the trajectories of Canadian and American commercial regulation is underscored by general American attitudes towards state trading. Annand (2000) compares the GATT’s and the U.S. Government Accountability Office’s definitions of STEs. The working definition of STEs from the Understanding on the Interpretation of Article XVII of GATT 1994 states that they are “Governmental and nongovernmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports.” A 1996 Government Accountability Office report defines STEs as “enterprises that are authorized to engage in trade and are owned, sanctioned, or otherwise supported by the government” (USGAO, 1996). The key difference is that the GATT definition focuses on the impact of STEs on trade while the GAO definition focuses on their relationship to government, that is, the fact that they are not private actors.

This definitional difference goes to the heart of the unfair trade complaint. In the American institutional context, STEs are perceived to engage in unfair trade because they are at least marginally dependent upon their governments as the source of monopoly/monopsony rights and therefore not always subject to the discipline of the market. Their buying and selling may be guided by factors other than market discipline. Underlying this argument is the premise that international trade can be fair only if all countries have similar kinds of domestic policies – a level playing field depends upon everyone playing the same game with the same deck of cards.

This cognitive dissonance should be considered in the broader context of North American agricultural trade. On both sides of the border, national support for agricultural producers has been steadily declining over the past 20 years, and farmers in both countries have had to manage that structural adjustment process. It stands to reason that they would respond to the pressures of increased intrasectoral competition in ways that are compatible with historical modes of regulation in their respective national jurisdictions – namely export subsidies and trade litigation. Figure 1 shows the measure most commonly used to compare support to the agricultural sector amongst developed countries.

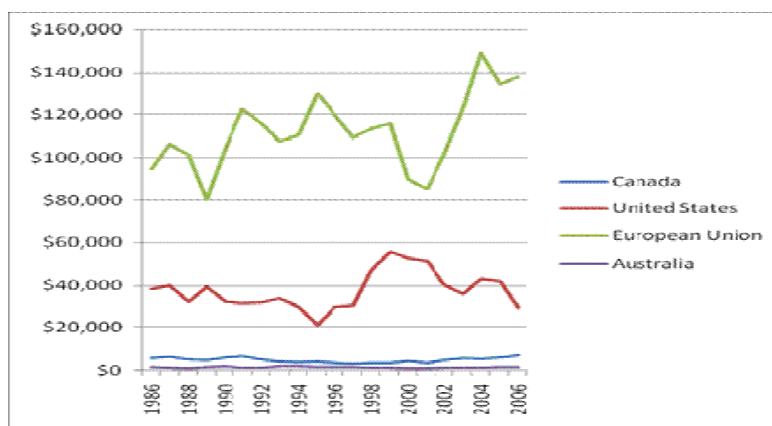


Figure 1 The apparent gap between American and Canadian support for agricultural producers: OECD Producer Support Estimates, 1986 – 2006 (in millions USD).

Source: OECD Statistical Database

The OECD's Producer Support Estimates (PSEs) indicate the annual value of "gross transfers from consumers and taxpayers to support agricultural producers, measured at farm gate level" (OECD, 2007, 6). The PSE measures transfers to farmers from policies designed to maintain domestic prices, provide payments to farmers and support farmers through lower production input costs. In sheer dollar amounts, the United States outspends Canada in supporting agricultural producers, according to the *Estey Centre Journal of International Law and Trade Policy*

OECD. The comparison of Canadian and U.S. producer support obscures a more subtle trend, however. When producer and consumer support are factored together, Canada and the United States exhibit a steady trend towards lower levels of agricultural support as a percentage of GDP (see figure 2). Total Support Estimates measure the “value of all gross transfers from taxpayers and consumers arising from policy measures which support agriculture” (OECD, 2007, 14). Total support for agriculture has declined significantly over the past 20 years. Farmers in both countries are dealing with long-term structural adjustment in their agricultural sectors. Notably, the gap has narrowed considerably from levels of total support offered in the mid 1980s, when Canada’s arrangements offered considerably more support to farmers than did arrangements in the United States.

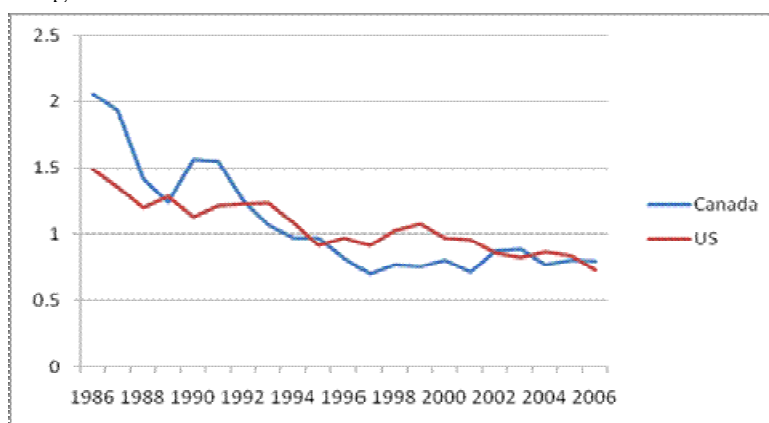


Figure 2 Narrowing the gap in agricultural support in North America: OECD Total Support Estimates, 1986 – 2006, as a percentage of GDP.

Source: OECD Statistical Database

Marketing boards have been very successful in the postwar era and continue to be useful in addressing a number of policy objectives. Given Canada’s historical industrial development trajectory, which has moved from centralized public ownership to decentralization over the past two decades, the CWB may appear to be something of an anachronism. Indeed, it has proven to be politically unpopular with a significant portion of its client base, and concerted legislative efforts have been made to dismantle it, with both the provincial government in Alberta and the current Conservative government in Ottawa stating a strong preference for producer choice over a single-desk marketing system. Nevertheless, moving to an export model that more closely resembles the wheat industry in the United States will not guarantee better relations with American wheat producers. There is certainly some evidence that this WTO challenge, like the many other challenges before it, was at least partly

driven by declining governmental support and an accompanying increase in intrasectoral competition.

Conclusion

This article has not staked out territory in the economic literature on the efficacy of state trading enterprises; rather, I have attempted to provide an overview of WTO panel reasoning as it relates to policy choices faced by both national and subnational governments in Canada's agricultural sector. Policy decisions must consider all the relative merits and demerits of the Canadian competitive model for the export and sale of wheat. The Canadian model is weighted in favour of price security and predictability. As such, it takes final marketing choice from the producer. The American alternative is weighted in favour of freer competition amongst domestic producers and a greater role for corporate agribusiness in the marketing and sale of hard red spring wheat. Disputes in the agricultural sector must be considered in terms of historical regulatory factors, which must be weighed alongside questions of free market competition. In short, trade friction caused by Canada's single marketing board for Western Canadian wheat and barley may not be the result of the trade-distorting impact of the CWB so much as it is a product of long-term competitive pressures in the market for North American wheat.

State trading enterprises are perhaps the most prominent symbols of agricultural protectionism, even as they have proven to be one of the most popular ways to manage the social costs of trade liberalization. After World War II, the GATT's framers were reluctant to disallow the single most important tool for social protection. Annand (2000) estimates that in the decades immediately following the Second World War, STEs accounted for approximately 25 percent of world trade, with about 90 percent of the world's wheat exports coming under the influence of state traders. It may be because of the political expediency of STEs that the text of GATT Article XVII is even today so ambiguous about their definition and so ambivalent about their role in the global economy.

Even so, from a legal perspective this case was fairly clear-cut. It dealt with a state trading enterprise maintained by an industrialized country that operates according to a higher standard of transparency than do most STEs in other parts of the world. It fell to the panel to decide whether to maintain the rules of non-discrimination according to a close reading of Article XVII or to agree with a more expansive reading of commercial considerations. The former option hewed closer to the WTO's formal mandate, while the latter offered a chance to reconsider the benchmark by which STEs may be evaluated, if only to clarify standards of conduct. Given the ambitious nature

of the American case, it is not surprising that the panel decided to maintain both the principle of non-discrimination and some of the textual ambiguity of Article XVII. Any other decision would have been the first step towards a more fundamental reinterpretation of the article, with significant and unforeseen implications for the future regulation of global trade.

References

- Abbott, P. C., and P. K. S. Kallio. 1996. Implications of game theory for international agriculture trade. *American Journal of Agricultural Economics* 78(1996): 738-44.
- Annand, Mel. 2000. State trading enterprises: a Canadian perspective. *The Estey Centre Journal of International Law and Trade Policy* 1(1): 36-50.
- Barnes, Angela. 2007. Grains push commodity index higher. *Globe and Mail*, 25 October.
- Canadian Wheat Board. 2006-2007 statistical tables. Available at www.cwb.ca/public/en/library/publications/
- Canadian Wheat Board. A history of U.S. trade challenges. Available at www.cwb.ca/public/en/hot/trade/popups/trade_history.jsp
- Carter, Colin A., and R. M. A. Loynes. 1996. The economics of single desk selling of Western Canadian grain. Available at [http://www1.agric.gov.ab.ca/\\$department/deptdocs.nsf/all/agc2248](http://www1.agric.gov.ab.ca/$department/deptdocs.nsf/all/agc2248)
- Cross, Philip. 2007. The new underground economy of subsoil resources: no longer hewers of wood and drawers of water. *Canadian Economic Observer*.
- Davey, William J. 2001. Article XVII GATT: an overview. In *State Trading in the Twenty-First Century*, eds. Thomas Cottier and Petros C. Mavroidis. Ann Arbor: University of Michigan Press.
- Dispute Settlement Commentary – WT/DS276/R. 2004. In *Worldtradelaw.net Dispute Settlement Commentary*. Wellington, FL: Worldtradelaw.net LLC.
- Gagne, Gilbert. 2003. The Canada-US softwood lumber dispute: a test case for the development of international rules. *International Journal* 58(3).
- Hoekman, Bernard, and Joel Trachtman. 2007. *Canada–Wheat: discrimination, non-commercial considerations, and state trading enterprises*. The World Bank / Development Research Group / Trade Team.
- Keohane, Robert O. 1984. *After Hegemony: Cooperation and Discord in the World Political Economy*. Princeton, N.J.: Princeton University Press.
- Organization for Economic Cooperation and Development (OECD). 2001. *State Trading Enterprises in Agriculture*. Paris: OECD.
- Petersmann, Ernst-Ulrich. 1998. GATT law and state trading enterprises: critical evaluation of Article XVII and proposals for reform. In *State Trading in the Twenty-First Century*, eds. Thomas Cottier and Petros C. Mavroidis. Ann Arbor: University of Michigan Press.
- Pick, D. H., and C. A. Carter. 1994. Pricing to market with transactions denominated in a common currency. *American Journal of Agricultural Economics* 76(1994): 55-60.
- Ruggie, John Gerard. 1982. International regimes, transactions, and change: embedded liberalism in the postwar economic order. *International Organization* 36(2): 379-415.

- Trebilcock, Michael J., and Robert Howse. 1999. *The Regulation of International Trade*. 2nd ed. London: Routledge.
- United States Government Accountability Office (USGAO). 1996. Canada, Australia and New Zealand: potential ability of state trading enterprises to distort trade. GAO/NSIAD-96-94. Washington D.C.
- Veeman, M., M. Fulton, and B. Larue. 1999. International trade in agricultural and food products: the role of state trading enterprises. Report for Agriculture and Agri-Food Canada. Ottawa: Agriculture Canada.
- World Trade Organization (WTO). 2004. *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain*. WT/DS276/R, WT/DS276/AB/R. Geneva: World Trade Organization.
- World Trade Organization (WTO). 2007. The regulation of state trading under the WTO system. Geneva: World Trade Organization. Available at www.wto.org/english/tratop_e/statra_e/statrad.htm
- Zysman, John. 1994. How institutions create historically rooted trajectories of growth. *Industrial and Corporate Change* 3(1).

Endnotes

1. Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain (DS276). Request for consultations received December 17, 2002. Panel report circulated on April 6, 2004. Appellate Body decision circulated on August 30, 2004. Access all reports and associated documents at www.wto.org/english/tratop_e/dispu_e/cases_e/ds276_e.htm
2. Access statistical data on the activities of the Canadian Wheat Board at www.cwb.ca/public/en/library/publications/
3. Much of the agricultural legislation in the United States dates from the 1930s, and of course Canada's Wheat Board dates from 1935.
4. Access the General Agreement on Tariffs and Trade and all related legal texts at www.wto.org/english/docs_e/legal_e/legal_e.htm
5. Two other articles are pertinent to this discussion. Article XX covers general exceptions, and subparagraph (d) states that nothing in the agreement shall prevent the adoption or enforcement by any member of measures necessary for ensuring compliance with regulations relating to the enforcement of monopolies. Article XXXVII:3 (a) states that in cases where government determines the resale price of products produced in developing countries, members should maintain trade margins at equitable levels.
6. As of October 2007, 71 out of 151 members had notified the WTO that they are now operating, or have in the past seven years, operated a state trading enterprise. The number of members operating STEs is likely to be much higher given the notoriously low reporting rate. Access to annual reports of the WTO's Working Party on State Trading Enterprises is available through the WTO website at http://www.wto.org/english/tratop_e/statra_e/statra_e.htm
7. OECD research has shown that economists need to differentiate between the monopoly aspect of an STE and its objective function. The assumption is frequently made that STEs will act like private firms in a monopoly position. However, "the public nature of the state trading enterprise distinguishes it from a private firm ... although a state trading enterprise may hold a monopoly position, it may not behave in a traditional textbook manner" (OECD 2001, 54).
8. The CWB exploits quality differences in wheat grades in order to leverage higher prices across many national markets. However, its ultimate goal is to sell as much wheat as possible, rather than to sell wheat at the highest possible price. Nevertheless, Canadian wheat commands high prices that are a reflection of the high quality of the Canadian product.
9. For a full case commentary see "Dispute Settlement Commentary – Wt/Ds276/R." In *Worldtradelaw.net Dispute Settlement Commentary*. Wellington, FL: Worldtradelaw.net LLC, 2004.

The views expressed in this article are those of the author(s) and not necessarily those of the Estey Centre Journal of International Law and Trade Policy nor the Estey Centre for Law and Economics in International Trade. © The Estey Centre for Law and Economics in International Trade. ISSN: 1496-5208