

**STATE TRADING ENTERPRISES
UNDER ARTICLE XVII OF THE GATT
FOLLOWING *CANADA -WHEAT***

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ABSTRACT

This paper examines Article XVII of the GATT, and the recent reports of the WTO Disputes Panel and the Appellate Body, in relation to the complaint brought by the US, in Canada – Measures relating to exports of wheat and treatment of imported grain. The US sought to limit the ability of STEs to use their exclusive and special privileges by arguing that STEs must behave like private trading actors, or risk being in breach of the non-discriminatory treatment obligations in Article XVII. This paper examines Article XVII, and looks at the findings of the Panel and Appellate Body. The view of the Panel and the Appellate Body is that Article XVII is an anti-avoidance provision, rather than a code to restrict trade distorting conduct in agriculture. The appropriate place for the US to advance its ideological concerns is through progressing the liberalisation of trade in agriculture in the Doha round of negotiations, and not through straining the interpretation of Article XVII.

**STATE TRADING ENTERPRISES UNDER
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FOLLOWING *CANADA –WHEAT***

JG WALTON

The matter of wheat trade between Canada and the United States has been an extremely contentious issue ever since the signing in 1989 of the Canada – United States Free Trade Agreement. Canadian wheat which the United States farmers, my clients, consider unfairly priced, has poured into the United States market.

To make matters worse, Canada – despite its free trade commitments under the 1989 agreement and now NAFTA – has retained series of non-tariff barriers which essentially eliminates the possibility of US wheat exports into Canada. Not satisfied with its increasing United States market share, the Canadians have been targeting certain third-country markets where, again, we contend with unfair prices, as they under-price United States wheat bids in order to capture the market. As a result, United States wheat farmers are reeling.

The United States government has attempted on numerous occasions over the past decade to resolve this matter, but the Canadians are insistent that they have every right to maintain a single desk procurement and selling monopoly by way of a state trading enterprise known as the Canadian Wheat Board.¹

1 INTRODUCTION

Single desk marketing boards have long been a source of contention for the US as can be seen from the quote above by the former US Assistant Secretary of Transportation and International Affairs, Charles A Hunnicutt.

Mr Hunnicutt's strategy, on behalf of his clients, has been to file countervailing duty and dumping cases against Canada, under existing US domestic trade laws, and to file a complaint with the World Trade Organisation (WTO) through the US Trade Representative.

¹ Charles A Hunnicutt, *Speech delivered on 9 April 2003 at the Annual Spring Banquet for the Georgia Journal of International and Comparative Law*, reported in 32 Ga. J. Int'l & Comp. L. 99 at pp 104-105

This paper is concerned with the second of Mr Hunnicutt's two strategies, and to review the impact on state trading enterprises under Article XVII of the General Agreement of Trade and Tariffs 1947 (*the GATT*) following the reports of the Panel and the Appellate Body in the dispute of *Canada – Measures relating to exports of wheat and treatment of imported grain*² (*Canada – Wheat*).

Somewhat surprisingly for the controversy surrounding the use of producer marketing boards, *Canada – Wheat* is the first dispute directly on the export activities of state trading enterprises (STEs) under Article XVII.

2 ARTICLE XVII OF THE GATT

There has been considerable academic discussion about the purpose and intent of Article XVII, some of which is discussed or referred to later in this paper. It is a helpful starting point to look at the wording of Article XVII:1 and to consider its meaning on its face, rather than in the context of a particular trade sector or ideological perspective.

1 Article XVII:1(a)

Article XVII:1(a) of the GATT contains the primary obligation in relation to STEs, and provides as follows:

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.*

The core of the obligation is for STEs to act in a manner *consistent with the general principles of non-discriminatory treatment* under the GATT. The reference to *non-discriminatory treatment* includes the most favoured nation obligations in Article I of the GATT, and arguably the national treatment obligations under Article III:4.

(a) Nature of the obligation on governments

Paragraph 1(a) is unusual in that it imposes on contracting parties, governments, an obligation in relation to the trading activities of third parties; STEs they may have formally or effectively created through ownership or the grant of privileges. That obligation is expressed as an *undertaking*. The extent of that undertaking on

² Ref WT/DS276/R delivered on 6 April 2004 and WT/DS276/AB/R delivered on 30 August 2004.

governments, as opposed to the STEs themselves, is not entirely clear from the text of the Article.

(b) Enterprises defined

The definition of STE is the subject of *Ad Note* to paragraph 1 and of the Understanding on the Interpretation of Art XVII 1994.

The former expressly extends the phrase *state trading enterprise* to include marketing boards.

The latter, adds the concept of the grant of privileges *in the exercise of which* [STEs] *influence through their purchases or sales the level or direction of imports or exports*³. The ability to influence the level or direction of imports or exports implies a certain level of market dominance within a trade sector. This extended definition would tend to support the US aversion to *trade-distorting conduct*. The converse, however, is also true; that the concept of market dominance here relates only to the definition of state trading enterprises, and serves to exclude smaller enterprises with little market influence.

(c) Non-discriminatory Treatment

The constraint applies to all market activities of STEs, including all *purchases or sales involving either imports or exports*, which would suggest that the paragraph is referring not only to GATT obligations of most favoured nation treatment under Article I, but also to national treatment under Article III:4.

The *Ad Note* to paragraph 1 also provides that *charging by a state enterprise of different prices for its sales of a product in different markets* is not caught by the non-discrimination provisions of paragraph 1(a), *provided that such different prices are charged for **commercial reasons**, to meet conditions of supply and demand in export markets*. There is no guidance in either the *Ad Note* or in the Understanding on what *commercial reasons* may be in this context. It is interesting to note that the proviso in the *Ad Note* only applies charging different prices in *export markets*.

On the basis that different prices cannot be charged to meet the conditions of supply and demand in imports also seems to suggest that the national treatment provisions in Article III:4 are intended to apply to STEs.

³ See clause 1 of the Understand on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade 1994

2 Article XVII:1(b)

Article XVII:1(b) provides:

(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.*

The impact of paragraph 1(b) is twofold, providing a gloss on the obligations in paragraph 1(a) in both respects.

(a) *Commercial considerations*

First, STEs are to make *purchases or sales solely in accordance with commercial considerations*. Again, there is no guidance in either the *Ad Note* or the Understanding to the meaning of *commercial considerations*. In the context, however, of STEs being either established or maintained by governments or being the holders of exclusive or special privileges granted by governments, it would be fair to expect *commercial* to be interpreted by reference to trade, commerce or other business activity, rather than national, political, social, environmental or other considerations which would be the natural objective of government.

The inclusive words reinforce this interpretation, referring to *price, quality, availability, marketability, transportation and other conditions of purchase or sale*. The use of STEs by governments, either through the power of ownership or through conditioning the exercise of the exclusive or special privileges, to achieve a purpose unrelated to commerce, however valid, would not excuse treatment which would otherwise be *discriminatory* under paragraph 1(a).

(b) *Opportunity to participate*

Second, paragraph 1(b) also requires the principles of non-discriminatory treatment in paragraph 1(a) to be understood to require STEs to afford the enterprises of other countries adequate opportunity to compete for participation in such purchases and sales, in accordance with customary business practice.

The reference to *such purchases and sales* is to the purchases and sales in which the STE is to make *solely in accordance with commercial considerations* in terms of the

earlier part of paragraph 1(b), and also to the *purchases or sales involving either imports or exports* for which STEs are not to be discriminatory under paragraph 1(a).

The circumstances in which STEs have the strongest opportunity to deny such adequate opportunity is in relation to imports and home market access, which also suggests that the national treatment obligations in Article III:4 are intended to apply to paragraph 1(a).

The extent of the participation obligation in paragraph 1(b) is also unclear, though it is to be in accordance with customary business practice. In providing opportunity, therefore, the STE is not required to act in a way which is contrary to its commercial interests, though whether that is in the context of holding exclusive or special privileges and a position of market dominance, or in some implied condition of privilege-free, purely private trading capacity, is not at all clear.

When referring to purchases and sales, the paragraph also provides no guidance on whether those are purchases or sales generally in a market, in the context of competition law concepts, or the STEs' own purchases or sales, which would militate the recognition of the special position of STEs under Article XVII. From a *customary business* perspective, the second interpretation would tend to put STEs in a less advantageous position than the first.

3 *Interrelationship of Article XVII:1(a) & (b)*

Reading the two paragraphs together, we are left with a lingering uncertainty of what is required to establish non-compliance with Article XVII:1.

From a plain reading of the two paragraphs, the requirement in paragraph 1(a) is that the government *undertakes* that STEs will act in a manner that is consistent with the principles in the GATT of *non-discriminatory treatment*. Paragraph 1(b) contains no direct obligations. By its opening words, paragraph 1(b) provides only a gloss on the interpretation of paragraph 1(a).

It is tempting to read Article XVII:1 as providing three elements so that, if an STE does not make its purchases or sales in accordance with *commercial considerations*, or does not afford foreign competitors *adequate opportunity to compete for participation* in its purchases and sales in terms of paragraph 1(b), the STE is behaving in a discriminatory fashion in terms of paragraph 1(a). The Panel in *Korea –Measures*

affecting imports of fresh, chilled and frozen beef⁴ (Korea – Beef) appeared to adopt this reasoning when it commented:

In other words the terms "general principle of non-discrimination treatment prescribed in this Agreement" (Art. XVII:1(a)) should be equated with "make any such purchases or sales solely in accordance with commercial considerations" (Art. XVII:1(b)). The list of variables that can be used to assess whether a state-trading action is based on commercial consideration (prices, availability etc...) are to be used to facilitate the assessment whether the state-trading enterprise has acted in respect of the general principles of non-discrimination. A conclusion that the principle of non-discrimination was violated would suffice to prove a violation of Article XVII; similarly, a conclusion that a decision to purchase or buy was not based on "commercial considerations", would also suffice to show a violation of Article XVII.⁵

Conversely, it can also be said that an STE can act in a way which is on its face discriminatory, apparently in breach of paragraph 1(a), but be saved from being in breach if it can establish that its buying and selling behaviour is in accordance with commercial considerations. Similarly, it could be argued that any constraints on market participation are not in breach of paragraph 1(a) if adequate opportunity to compete is provided.

For the sake of symmetry, an STE can theoretically not act in accordance with commercial considerations, or not allow adequate opportunity to compete, but not offend Article XVII:1 if the overall threshold of *non-discriminatory treatment* has not been breached. It is quite possible that an STE might not act commercially, but not be discriminatory.

Finally, it is worth reinforcing the context in which Article XVII:1 is to be considered. The purpose of Article XVII:1 is to avoid STEs being used as non-tariff barriers to trade; to ensure that STEs are not used to circumvent Member states' obligations under the GATT. It is not a code for all activities of STEs. There are explicit references to STEs

⁴ See *Korea – Measures affecting imports of Chilled and Frozen Beef*, Report of the Panel delivered on 31 July 2003, ref WT/DS161/R. While *Canada – Wheat* is the first consideration of the export activities of STEs under Article XVII, *Korea – Beef* concerned the measures attaching to imported beef by Korea's Livestock Products Marketing Organization.

⁵ *Ibid* at para 757

throughout the GATT⁶, and in *The Agreement on Agriculture*, which will catch non-complying activities independently of Article XVII.

3 CONTEXT OF STES

There is an unhappy relationship between the overall purposes of the GATT, *directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce*⁷, and the continuation of recognition of STEs in Article XVII. As observed by McKenzie, *the GATT is about the evolution of an international economy disciplined by the operation of comparative advantage*⁸, which is at odds with government involvement in trade.

The difficulty with government participation or influence in trade for free market proponents is that governments are viewed as political actors, rather than commercial, and as such are driven by political objectives, rather than the economic dogma of efficiency. The assumption is that STEs provide an irresistible temptation to governments to further their potential objectives. Ianni identifies two fundamental advantages for the state trader over its private competitor: *greater economic bargaining power and greater transnational power* which translates into size, and the power to translate *acquired economic power into other kinds of influence*.⁹ How, and if, that influence is exercised is a matter for some debate.

In the former British colonies, the concept of state granted concessions and other privileges in trade is not uncommon.¹⁰ In Ianni's view, the antagonism of the US to state trading, as evidenced by the comments of Mr Hunnicutt which preface this paper, is based in the *traditional association of communism with state trading*, bolstered by liberal economic theory, and its convergence with foreign policy.¹¹ This translates into

⁶ See *Ad Note* Articles XI (*Quantitative Restrictions*), XII (*Balance of Payments*), XIII (*Non-discriminatory Administration of Quantitative Restrictions*), XIV (*Exceptions to the Rule of Non-discrimination*) and XVIII (*Governmental Assistance to Economic Development*).

⁷ See the Preamble to the GATT 1947, third paragraph, also reflected in the third paragraph of the Preamble to the GATT 1994.

⁸ Paul D McKenzie, *China's Application to the GATT: State Trading and the Problem of Market Access* (1990) 24 J.W.T. 5 133, at 135.

⁹ Edmond M Ianni, *The International Treatment of State Trading* (1982) 16 JWTL 480, at 485.

¹⁰ For an interesting, but not entirely relevant discussion of the history of Crown Charters and transnational corporations, see Janet McLean's George P Smith II Distinguished Visiting Professorship Lecture, *The Transnational Corporation in History: Lessons for Today?* 79 Ind. L.J. 363.

¹¹ *Ibid* at p 492.

concerns about trade-distorting conduct, anti-competitive effects, non-tariff barriers to trade, and lack of transparency.¹²

Interestingly, for all its rhetoric, the US is not itself shy about protecting its agricultural sector, having previously notified its Commodity Credit Corporation (CCC) as an STE in 1995 and 1996¹³. It has not since, presumably on the basis that as the CCC provides agricultural commodity price support, but does not now directly engage in purchases or sales, it does not strictly fall within the definition of enterprise in Article XVII:1(a).

The use of STEs remains popular on a global scale. The most recent report of the WTO Working Party on State Trading Enterprises¹⁴, lists 59 notifications (either updating or new and full) of STEs since 2000. Of these, 14 are former communist countries (including China), 15 or so are developed (including the EU) and the rest are either developing or least developed countries in central and south America, Africa and Asia.

From the perspective of market economies, the use of STEs is commonly justified to ensure quality and to protect market access, usually by pooling produce under a single desk marketing board. The volumes traded through such producer boards has been significant. For example, averaged for the 1994-1997 marketing years, the Canadian Wheat Board (CWB) and its Australian counterpart accounted for a third of world wheat exports.¹⁵ Over a similar period, the NZ Dairy Board handled about 30% of world dairy product exports.¹⁶

The CWB exports about 70% of its wheat, and alone accounts for 20% of world exports of wheat; second only to the US, which accounts for about 30%. Interestingly, Canadian exports of wheat to the US amounts to only 6% of the US market¹⁷, which, while growing, hardly represents the flood Mr Hunnicutt's clients complain of.

Since the US and Canada entered into their free trade agreement in 1989, the US has taken numerous actions against the Canadian wheat trade. It has launched a federal

¹² See McKenzie, *supra* and Steve McCorriston and Donald MacLaren, *State Trading, the WOT and GATT Article XVII* (2002) 25:1 *World Economy* 107, at 108.

¹³ For a full discussion of the CCC, see Karen Z Ackerman and Praveen M Dixit *An Introduction to State Trading in Agriculture* USDA Economic Research Service, AER 783 (October 1999).

¹⁴ 4 November 2003, G/STR/W/41

¹⁵ Ackerman & Dixit, *supra*, at p 4.

¹⁶ *Ibid* at p 6.

¹⁷ See Brian Mayes, *Blame Canada: American Trade Complaints Against the Canadian Wheat Board* 2 *Asper Rev Int'l Bus & Trade* L 135

government investigation through the US International Trade Commission (*USITC*) in 1990, made a complaint under the Free Trade Agreement (*FTA*) in May 1992, instituted a further investigation by the *USITC* under the Agricultural Adjustment Act in January 1994, requested a dispute settlement panel under the North American Free Trade Agreement (*NAFTA*) in July 1995, carried out studies through the General Accounting Office (*GAO*) in 1995 and made a complaint under s 301 of the Trade Act in September 2000¹⁸. In each case, the investigations largely concluded that there was no evidence of significantly different prices between Canadian and US wheat, little evidence of wrongdoing, but a potential to distort trade. The s301 complaint resulted in a finding of unfair transportation subsidies and unfair price-advantage in sales to third party market. However, no tariffs or retaliatory action was imposed.

The complaints by the US which lead to *Canada – Wheat* are the latest broadside in the bitter, ongoing battle between the US Government and the CWB.

4 PANEL REPORT IN *CANADA – WHEAT*

A Factual Background

1 Canada Wheat Board

The Canadian Government established the CWB under the Canadian Wheat Board Act (*CWB Act*).

The CWB is a producer board, or single desk marketer, with all the monopolistic/monopsonistic powers which are normally associated with that status. Under the *CWB Act*, all wheat produced in Western Canada for human consumption, whether in Canada or for export, is to be sold to the CWB.

The primary objective of the CWB under the *CWB Act* is the *marketing in an orderly manner, in inter-provincial and export trade, of grain grown in Canada*. Under section 7(1) of the *CWB Act*, the CWB is to *sell and dispose of grain acquired by it pursuant to its operations under this Act for such prices as it considers reasonable with the object of promoting the sale of grain produced in Canada in world markets*.

The CWB pays producers an initial purchase price representing 65 – 70 % of the estimated price for the grain. All revenue is then pooled and distributed to all Western Canadian wheat growers at the end of the year.

¹⁸ For detailed analyses of these complaints, see Mayes, *supra*.

The initial payments are guaranteed by the Canadian government, as are the CWB's borrowings and any future sales contracts to foreign buyers.

2 *US Complaints*

The US alleges Canada has implemented measures which are:

- inconsistent with Article XVII:1 of the GATT, in relation to the export of wheat; and
- inconsistent with Article III:4 of the GATT and Article 2 of the *TRIMs* Agreement, in relation to the treatment of imported grain, generally.

This paper focuses on the first complaint.

The measures challenged by the US under Art XVII are (collectively, *the CWB Export Regime*):

- (i) the legal framework of the CWB under the CWB Act;
- (ii) Canada's provision to the CWB of exclusive and special privileges, which comprise:
 - (1) The exclusive right to purchase Western Canadian wheat for export and domestic human consumption;
 - (2) The right to set the initial purchase price for such wheat, subject to government approval;
 - (3) The government guarantee of the initial payment;
 - (4) The government guarantee of CWB's borrowing; and
 - (5) Government guarantees of certain of CWB's credit sales to foreign buyers; and
- (iii) The actions of Canada and the CWB in purchases and sales of wheat for export:
 - (1) The actions of Canada comprise the failure of Canada to oversee the CWB, Canada's approval of CWB's borrowing plan and its guarantees of CWB's sales and borrowings, and Canada's approval and guarantee of the initial payment to producers; and
 - (2) The actions of the CWB concerns the purchases and sales of wheat for export on discriminatory or non-commercial terms.

B Arguments of the Parties

1 US Submissions

The US view, overall, is that the CWB Export Regime necessarily results in the CWB making export sales which are discriminatory, are not in accordance with commercial considerations and are anti-competitive, in terms of paragraphs 1(a) & (b). The government of Canada, by granting the exclusive and special privileges and not implementing measures which *ensure* compliance by the CWB is therefore in breach of Article XVII.

The US complaint was not based on any particular measure, nor on any suggestion that Canada was not supervising the CWB's activities, but was aimed more at the CWB Export Regime *per se* viewed in its entirety¹⁹, and its trade-distorting effects. In this respect, the US could be seen to be mounting a challenge on STEs generally. The US was seeking a ruling that, while they may have exclusive and special privileges, STEs cannot use those privileges if they result in trade-distorting conduct, which would otherwise be in breach of the GATT.

The US arguments therefore, usefully, centre squarely on the interpretation and application of Article XVII:1.

(a) Article XVII:1(a)

Two points were at issue in relation to paragraph 1(a): the nature of the obligation on Members, and the meaning of the phrase *non-discriminatory treatment* prescribed in the GATT.

(i) Obligation on Members

In the US view, *undertaking* in paragraph 1(a) is to *ensure* that STEs comply with the non-discriminatory obligations.

In support of this contention, the US referred to paragraph 1(c), under which Members are not to *prevent* any enterprise, regardless of whether or not it is an STE, from acting in accordance with the non-discriminatory undertakings in paragraph 1(a). As the obligations in paragraph 1(a) are of a higher level, then in the US view, Members must do more to *ensure* that STEs meet the requirements of paragraph 1(a).

¹⁹ Ibid para 6.28

In its later submissions, the US clarified that they were not seeking to impose a higher standard than in already contained that provision. The US was simply seeking to clarify the intent of the *undertaking*, as requiring Canada to have constraints in place which avoided the potential for breach by the CWB. It is not that the CWB does breach the standard of conduct, but that it could.

(ii) *Non-discriminatory treatment*

The reference to non-discriminatory treatment, in the US view, relates to more than just *most favoured nation treatment* in terms of Article I of the GATT. It also extends to *national treatment* in Article III:4.

The US made a distinction between two types of conduct: discrimination in sales between different export markets and between export markets and the domestic market of the Member establishing the STE²⁰, but did not allege that the conduct was actually taking place; just that it was possible.

(b) *Article XVII:1(b)*

On the relationship between paragraphs 1(a) & (b), the US argues that they contain distinct legal obligations. The examples of conduct in paragraph (b), are simply illustrative, in the US view, of what is required under paragraph (a).

The US argued, citing *Korea – Beef*²¹, that Article XVII:1 contains three distinct legal obligations: (1) Members undertake that their STEs will comply with the *non-discriminatory treatment* obligations in the GATT, (2) Members undertake that their STEs will make purchases and sales solely in accordance with *commercial considerations*, and (3) Members undertake that their STEs will afford their foreign competitors *adequate opportunity* to compete. A breach of any of these obligations, in the US view, will constitute a breach of Article XVII:1.

The first obligation in paragraph 1(b), in the US view, is to act commercially, as opposed to rationally, which means maximising profit rather than revenue. The requirement to make sales having regard to *commercial considerations* therefore generally precludes STEs from actually using their exclusive and special privileges to the disadvantage of their commercial competitors.

The second obligation in paragraph 1(b), dealing with *adequate opportunity*, the US argued that an STE is to allow all enterprises to compete for participation in the STE's

²⁰ To support this view, the US drew a comparison between Article XI and XVII, see para 6.46

²¹ See quote on page 6 above

export sales, and to do that STEs must make their own sales on commercial terms and not use their exclusive or special privileges to their advantage in this respect.

Taken together, in the US view, the obligation to be commercial, the opportunity to compete and the implications of accepting the Canadian view would be to allow STEs to use their exclusive and special privileges in a way which could not be matched by private traders, and which would therefore distort free trade²².

(c) CWB Export Regime

Looking at the CWB Export Regime, the US claim was not aimed at any particular element of the regime, but that it *necessarily* resulted in non-conformance because of the structure which the Government of Canada had put in place. Non-conforming sales are an inescapable consequence, in the US view²³.

The US case rested on four broad assertions:

- (1) The privileges enjoyed by the CWB give it more flexibility for pricing, as it acquires its wheat for well below cost, it holds a monopoly/monopsony position on wheat purchases and it has favourable credit as a result of the government guarantee²⁴.
- (2) The flexibility enables the CWB to offer *non-commercial* sales terms, thereby denying commercial operators the opportunity to compete and to discriminate between export markets and its home market²⁵.
- (3) The CWB's obligation to promote the sale of its wheat in world markets, combined with its privileges, create an incentive to discriminate between markets by making non-commercial sales²⁶.
- (4) Canada is taking no steps to ensure that the CWB conforms to Article XVII:1²⁷.

2 Canada Submissions

In response, Canada argues that the US complaint is wrong in law, and in fact.

²² Ibid at paras 6.90 – 6.91

²³ Ibid at para 6.109

²⁴ Ibid at para 6.110

²⁵ Ibid at para 6.111

²⁶ Ibid paras 6.112 – 6.113

²⁷ Ibid at para 6.114

(a) Article XVII:1(a)

In Canada's view, the systemic argument of the US and the requirement for *ensuring* compliance is not supported by the wording of paragraph 1(a). If non-compliance cannot be demonstrated, then the Member must be taken to have honoured its undertaking. Members, it argued, have a choice in how STEs achieve the desired outcome.

In this respect a distinction must be drawn between *results*, which Article XVII:1(a) is concerned with, and *means*, which it is not. The US argument is concerned with *means* as it has not been able to establish actual discriminatory conduct.

(b) Article XVII:1(b)

In Canada's view, paragraph 1(b) does not create an independent obligation. By its express terms, paragraph 1(b) is only relevant once the discriminatory treatment under paragraph 1(a) has been established.

Canada also observed that the US interpretation would put STEs at a commercial disadvantage to private traders as: (1) discriminatory behaviour which would otherwise be justified on the grounds of commercial considerations would be caught by paragraph 1(a); and (2) STEs would not be able to make distinctions based on commercial considerations in the same way that private traders can. In this respect, the statement in *Korea – Beef* relied upon by the US should not be followed, as the statement was unnecessary for the purposes of that dispute.

For Article XVII:1 to be properly applied, a complainant must first establish discriminatory treatment in terms of paragraph 1(a), then consider if this treatment can be justified on the grounds of acting on *commercial considerations* and providing *adequate opportunity* under paragraph 1(b).

In response to the US arguments on the first part of paragraph 1(b), Canada argued that *commercial considerations* are less concerned with profit than with normal business practices of private enterprises in similar circumstances. This would extend to the use of the privileges conferred by government.

In relation to the second obligation in paragraph (b), Canada argued that the enterprises to be afforded adequate opportunity are those interested in purchasing the products offered by the STE. In Canada's view, customary business practice is to win sales, not to participate in the sales of competitors.

(c) *CWB Export Regime*

In response to the four assertions of US, Canada pointed out:

- (1) US produced no evidence of CWB's greater flexibility.²⁸
- (2) The mere possibility that CWB might not act in accordance with commercial considerations is insufficient.²⁹
- (3) Use by CWB of its privileges does not necessarily mean that it would be in breach of Article XVII:1³⁰.
- (4) Canada does not interfere with the CWB's day to day management and operation, making it more, rather than less, commercial. Further, if the government found that the CWB was not acting in accordance with Canada's obligations, it has the power to rectify the situation under statute³¹.

C Arguments of Third Parties

Canada and the US were joined by the following third parties:

1 Australia

As an exporter of wheat of some note³², Australia reinforced the fundamental premise that as the GATT allows for STEs, Art XVII must be applied in such a way as to give that premise meaning.³³

2 People's Republic of China

The PRC is a centrally planned economy, however, its use of STEs have been steadily increasing since the liberalisations of the 1980s. China's submission broadly mirrored the arguments of Canada on the application of Article XVII:1.

²⁸ Ibid at para 6.115

²⁹ Ibid at para 6.116

³⁰ Ibid at para 6.117

³¹ Ibid at para 6.119

³² Averaged for the 1994-97 marketing years, the Australian Wheat Board accounted for 13.1% of world wheat exports – source, Ackerman and Dixit, *An Introduction to State Trading in Agriculture*, USDA Economic Research Service, AER 783 (October 1999), at p 4

³³ Panel Report in *Canada – Wheat*, paras 4.505 – 4.526

3 *European Communities (EC)*

Perhaps reflecting the fact that the EU does not generally use STEs for its exports, the EC submitted that Canada appeared not to have met its obligations under Art XVII:1(a) & (b), by failing to ensure compliance by the CWB.³⁴

4 *People's Republic of China (Taiwan & Territories)*

Taiwan's particular interest was in the application of Art XVII to STEs, and confined itself to agreeing with Canada that the meaning of the word *undertakes* in the first sentence of paragraph 1(a) contains no requirement to ensure compliance, and that actual measures need to be established for there to be violation.

D Report of the Panel

1 *Meaning of Article XVII:1(a)*

(a) *Nature of the obligation on Members*

The Panel noted that the obligation on Members under paragraph 1(a) is primarily to close the door on Members using STEs to avoid their obligations under the GATT³⁵. By requiring an undertaking from Members, STEs therefore cannot be used as an artifice to circumvent obligations, and the undertaking is the only mechanism used to achieve this.

Comparing paragraphs 1(a) and (c), the Panel observed that paragraph 1(a) goes further by imposing a positive obligation on Members when an STE behaves contrary to the requirements of paragraph 1(a)³⁶. While the Panel avoids Canada's distinctions between means and results, it appears to concede the contention that there must be discriminatory behaviour before the obligation on Members comes into effect.

(b) *Non-discriminatory treatment*

The Panel noted that the phrase includes most favoured nation treatment, and that the *Ad Note* allows the charging of different prices for products in different export markets, provided they did so for commercial reasons.

³⁴ *Ibid*, see conclusion in para 4.619

³⁵ *Ibid* at para 6.39

³⁶ *Ibid* at para 6.43

The Panel declined to express a view on whether or not the obligation extended to discrimination between export markets and home markets, as requested by the US, as it was not necessary to resolve the dispute at issue.³⁷

2 *Meaning of Article XVII:1(b)*

After reviewing the divergent interpretations of the parties, the Panel took the view it was not necessary for it to form a view on the interrelationship of paragraphs 1(a) & (b).

However, the Panel did observe that it was not persuaded that the CWB Export Regime necessarily resulted in an inconsistency with paragraph 1(b), but then commented that *for the sake of argument, the Panel will proceed on the assumption that inconsistency with Article XVII:1 can be established merely by demonstrating that an STE is acting contrary to the principles of subparagraph (b)*.³⁸

On the second obligation in paragraph 1(b), the Panel did not accept the arguments of the US, but did not offer further analysis of the meaning of the second obligation in paragraph 1(b).³⁹

Reverting to the first part of paragraph 1(b), the Panel was of the view that *commercial considerations* should be considered in the context of commerce and trade, as opposed to the national interest of the STE⁴⁰. What is required is that STEs should make sales and purchases *on terms which are economically advantageous for themselves and/or their owners, members, beneficiaries, etc*.⁴¹

In relation to the US objections to the use by STEs of their special privileges, the Panel observed that the first part of paragraph 1(b) does not require STEs to behave like *commercial actors*⁴². The reference to *commercial considerations* is simply to stop STEs from adopting *political* considerations⁴³. The Panel recognised that STEs may legitimately be used for purposes other than commercial purposes.

³⁷ Ibid at para 6.50

³⁸ Ibid at para 6.59

³⁹ Ibid at para 6.73

⁴⁰ Ibid at para 6.88

⁴¹ Ibid at para 6.87

⁴² Ibid at para 6.92

⁴³ Ibid at para 6.94

The Panel also accepted that the exclusive and/or special privileges may be granted and used for legitimate purposes, without offending Article XVII:1:

Another concern we have with the United States' interpretation of the first clause of subparagraph (b) is that for STEs to be able to act like "commercial actors", in many cases, they effectively would need to be "commercial actors", at least with respect to their purchase or sale operations. In order to subject themselves to the same sort of market constraints as those faced by "commercial actors", they might, for instance, need to refrain from using certain of their privileges when making purchases or sales, or isolate their purchase or sale operations from other operations in respect of which privileges may have been granted (e.g., financial operations). We believe that if the intent behind the "commercial considerations" requirement had been to produce such far-reaching consequences, this intent would have been expressed both with greater clarity and in more detail.⁴⁴

While exclusive and special privileges granted to an STE might be used in a way which would put purely commercial actors at a disadvantage, the Panel felt that it was neither required nor authorised to interpret the clause *so as to prevent export STEs from using their exclusive or special privileges to gain a competitive advantage in the marketplace*⁴⁵. STEs do need to make sale and purchase decisions using commercial considerations, but this does not mean in isolation of the opportunities they may have by reason of their ownership or the privileges they may have been granted.

3 CWB Export Regime and Article XVII:1

The Panel took the view that, to succeed, the US must prove all four of its assertions⁴⁶. Perhaps somewhat confusingly, the Panel did not appear to express a view on the appropriateness of those assertions, but decided that the US case needed to satisfy these assertions if it was to succeed at all. This appeared to be a case of judicial economy.⁴⁷

The Panel then focussed on the third assertion, namely that the CWB's mandate, structure and privileges create an incentive for discrimination in a non-commercial

⁴⁴ Ibid at para 6.95

⁴⁵ Ibid at para 6.99

⁴⁶ See above, on page 13

⁴⁷ As was argued by Canada before the Appellate Body. The Appellate Body was more sympathetic to the Panel, finding that it has perhaps over used its assumptions (see page 25 below)

manner. Following its consideration of the meaning of *commercial considerations*⁴⁸, the Panel found that there was no such incentive⁴⁹, and therefore the US case failed on its own terms.

On the issue of supervision by the government, the Panel was of the view that this reinforced, rather than reduced the use of commercial considerations in its decisions making⁵⁰.

In response to the US arguments about maximising trade rather than profit, the Panel noted that the CWB does not have the objective of making profit for itself, but for wheat producers:

*In our view, the mere fact that the CWB does not make a profit for itself does not support the conclusion that the CWB has an incentive not to make sales solely in accordance with commercial considerations.*⁵¹

Similarly, the Panel saw no support in Article XVII:1 for the contention that the CWB can only use commercial considerations if it was seeking to maximise profit, nor that the CWB should conduct itself in the market place like a privately held corporation.

In conclusion, the Panel found that the US had not established that the CWB Export Regime necessarily results in non-conforming export sales and as a consequence Canada had not breached its obligations under Article XVII:1.⁵²

⁴⁸ See above, on page 17

⁴⁹ Ibid at paras 6.136 to 6.146

⁵⁰ Ibid at para 6.124

⁵¹ Ibid at para 6.133

⁵² Ibid at para 6.151. It should be noted in passing that the Panel did find that sections of the *Canada Grain Act*, the *Canada Transportation Act* and the *Canada Grain Regulations* were inconsistent with Article III:4 of the GATT, and with Article 2 of the *TRIMS Agreement*.

5 REPORT OF THE APPELLATE BODY IN CANADA – WHEAT

A Arguments on Appeal

Both the US and Canada appealed the Panel Report on procedural and substantive aspects of the Panel's findings in relation to Article XVII:1 of the GATT.

1 Canada's appeal

(a) Relationship between Article XVII:1(a) & (b)

Canada requested the Appellate Body to find that:

- (i) A violation of Article XVII:1 requires a violation of the non-discriminatory treatment provision in paragraph 1(a);
- (ii) Actions that are not discriminatory in terms of paragraph 1(a) should not be considered under paragraph 1(b); and
- (iii) The Panel erred in not dismissing the US case for failing to establish that the CWB Export Regime necessarily results in a breach of Article XVII:1(a).⁵³

The core of Canada's case on appeal is that paragraph 1(b) provides a gloss, only, on paragraph 1(a) of Article XVII:1, and on that basis a breach of the *non-discriminatory treatment* obligation in paragraph 1(a) must first be established before the justification of *commercial consideration* under paragraph 1(b) is considered.

Conversely, the Panel went directly to a consideration of whether or not the measures complained of could have commercial justification, rather than whether or not they were discriminatory, in the first instance.

In applying Article XVII:1 to the CWB Export Regime, Canada argued that the Panel proceeded on the incorrect *assumption* that paragraphs 1(a) & (b) create separate obligations, a breach of any of which will establish a breach of Article XVII:1. Whereas, Canada argued, the US claim should have been dismissed for failing to establish discriminatory treatment under paragraph 1(a).

(b) Interpretation of paragraph 1(b)

Canada argued that the Panel correctly interpreted paragraph 1(b). In Canada's view, there is nothing in Article XVII:1(b) which prevents STEs from using their special privileges, so long as they do so like a *rational market actor*⁵⁴.

⁵³ Report of the Appellate Body in *Canada – Measures relating to exports of wheat and treatment of imported grain* AB-2004-3 delivered on 30 August 2004 (WT/DS276/AB/R) at para 14

In relation to the second provision in paragraph 1(b), Canada also supported the findings of the Panel⁵⁵.

2 *US appeal*

(a) *Relationship between Article XVII:1(a) & (b)*

Not surprisingly, in response to Canada's argument on appeal, the US argued that the Panel correctly viewed the requirements in the two paragraphs as being separate, and the obligation on Canada was to *ensure* compliance by the CWB⁵⁶.

In the US view, Article XVII:1 *creates a coherent regime designed to discipline STEs that might otherwise engage in trade distorting conduct*⁵⁷.

(b) *Interpretation of paragraph 1(b)*

The US requested the Appellate Body to reverse the Panel's interpretation of the first and second provisions of paragraph 1(b), and to find that the CWB Export Regime necessarily results in sales not based solely on commercial considerations⁵⁸.

In relation to the first provision, the US argued that *commercial considerations* should not be viewed in the context of wider issues like political objectives, as this has the effect of allowing STEs to use their special privileges *even if this causes discrimination or serious obstacles to trade*⁵⁹.

On the second, the US argued that the Panel misinterpreted the term *enterprises* in paragraph 1(b) and focussed solely on the term *participation*, which led the Panel to an incorrect interpretation of the provision⁶⁰.

⁵⁴ Ibid at paras 44 to 47

⁵⁵ Ibid at para 48

⁵⁶ In support for this contention, the US raised the use of *obligation* in the French and Spanish versions of Article XVII:1, and also noted the consistency of approach in Articles III:3 and XVII:1(c) – Ibid at paras 23 & 24.

⁵⁷ Ibid at para 25

⁵⁸ Ibid at para 28

⁵⁹ Ibid at paras 29 to 30

⁶⁰ Ibid at paras 31 to 33

3 *Third party claims and arguments*

Australia supported Canada's interpretation of paragraph 1(b), pointing out that the purpose of Article XVII:1 was to prevent the use of STEs to circumvent the non-discriminatory treatment obligations of the GATT⁶¹.

China also argued in support of Canada, observing that if a STE is found to have acted in accordance with commercial considerations and to have afforded adequate opportunity to compete to the enterprises of other members, then the non-discriminatory requirement of paragraph 1(a) would be met. In relation to paragraph 1(b), China also argued that Article XVII allows Members to establish STEs and for those STEs to enjoy and privileges confirmed upon them by their governments⁶². To then restrict the ability of them to use their privileges would defeat the purpose of Article XVII:1.

The EU agreed with the Panel's application of paragraphs 1(a) and (b)⁶³.

B Findings of the Appellate Body

1 *Interrelationship between paragraphs 1(a) & (b)*⁶⁴

The Appellate Body noted that the purpose of paragraph 1(a) is:

*... to ensure that a Member cannot, through the creation or maintenance of a State enterprise or the grant of exclusive or special privileges to any enterprise, engage in or facilitate conduct that would be condemned as discriminatory under the GATT 1994 if such conduct were undertaken directly by the Member itself. In other words, subparagraph (a) is an "anti-circumvention" provision.*⁶⁵

On the interrelationship of paragraphs 1(a) and (b), the Appellate Body was influenced by the opening words of paragraph (b), and the clear dependence of paragraph (b) on paragraph (a), and accepted Canada's view *that the principle source of the relevant*

⁶¹ Ibid at paras 59 to 61

⁶² Ibid at paras 64 to 69

⁶³ Ibid at paras 70 to 72

⁶⁴ Ibid, Part IV of the Appellate Body Report

⁶⁵ Ibid at para 85

obligations are found in paragraph 1(a)⁶⁶, and paragraph 1(b) is dependent upon it. The Appellate Body reviewed the previous panel reports⁶⁷ and went on to provide:

*Our conclusions regarding the relationship between subparagraphs (a) and (b) imply that a panel confronted with a claim that an STE has acted inconsistently with Article XVII:1 will need to begin its analysis of that claim under subparagraph (a), because it is that provision which contains the principal obligation of Article XVII:1, namely the requirement not to act in a manner contrary to the "general principles of non-discriminatory treatment prescribed in [the GATT 1994] for governmental measures affecting imports or exports by private traders." At the same time, because both subparagraphs (a) and (b) define the scope of that non-discrimination obligation, we would expect that panels, in most if not all cases, would not be in a position to make any finding of violation of Article XVII:1 until they have properly interpreted and applied both provisions.*⁶⁸

In relation to the quote from the Panel in *Korea – Beef*⁶⁹ relied upon by the US, the Appellate Body expressed the opinion that this quote was taken out of context, and that the Panel in that dispute could not have intended the interpretation relied upon by the US.⁷⁰

Turning to the Panel's analysis, the Appellate Body took the view that discriminatory or differential treatment must be established under paragraph 1(a) before any analysis is undertaken in terms of paragraph 1(b)⁷¹. They were not convinced, however, that this is what the Panel did in this case, proceeding as it did on an assumption that discriminatory conduct had been established⁷².

⁶⁶ Ibid at paras 89 to 106

⁶⁷ *Canada – Administration of the Foreign Investment Review Act*, adopted 7 February 1984, BISD 30S/140 and *Korea – Beef* supra. In relation to *Korea – Beef*, the Appellate Body noted the section quoted by the US and formed the view that this passage had been taken out of context, and that *Korea – Beef* actually favoured the approach taken by the Appellate Body in *Canada – Wheat*, see paras 102 to 105.

⁶⁸ Ibid at para 106 – footnote references removed.

⁶⁹ See page on page 5

⁷⁰ Ibid at paras 103 - 105

⁷¹ Ibid at para 111.

⁷² Ibid paras 113 to 130.

Having found that the Panel did not err in law, the Appellate Body did, however, express concern with the way in which the Panel ordered its analysis and the assumptions it made in doing so⁷³.

2 *Interpretation of commercial considerations, and the adequate opportunity to compete in paragraph 1(b)*⁷⁴

The Appellate Body accepted the Panel's wider view of commerce, rather than the US narrow view requiring a return on capital, or profit. The Appellate Body went on to say that this must be determined on a case by case basis, having regard to the STE and to the market:

*In other words, a panel inquiring whether an STE has acted solely in accordance with commercial considerations must undertake this inquiry with respect to the market(s) in which the STE is alleged to be engaging in discriminatory conduct. Subparagraph (b) does not give panels a mandate to engage in a broader inquiry into whether, in the abstract, STEs are acting "commercially". The disciplines of Article XVII:1 are aimed at preventing certain types of discriminatory behaviour. We see no basis for interpreting that provision as imposing comprehensive competition-law-type obligations on STEs, as the United States would have us do.*⁷⁵

On the issue of the extent to which STEs can use their exclusive or special privileges, the Appellate Body agreed with the Panel, noting that this did not leave STEs unconstrained in their activities. To the extent that STEs are not engaging in discriminatory conduct, or to the extent that they are, they are acting in accordance with commercial considerations, STEs are free to use their privileges⁷⁶. Any abuse of those privileges would result in sanctions elsewhere in the GATT and other agreements⁷⁷.

On the second obligation in paragraph 1(b), the Appellate Body agreed with the Panel that *the requirement to afford an adequate opportunity to compete for participation (i.e., taking part with others) in "such" purchases and sales (import or export transactions involving an STE) must refer to the opportunity to become the STE's counterpart in the*

⁷³ Ibid at para 130.

⁷⁴ Ibid, Part V of the Appellate Body Report.

⁷⁵ Ibid at para 145.

⁷⁶ Ibid at para 149.

⁷⁷ In this respect, the Appellate Body noted that the *SCM Agreement*, Article VI of the GATT and the *Agreement on Implementation of Article VI of the GATT 1994*, and the *Agreement on Agriculture* imposed some discipline (see para 150 of the Appellate Body Report) and also noted that it was not going to enter into an analysis of the provisions in the GATT which deal with STEs (ibid at para 98).

*transaction, not to an opportunity to replace the STE as a participant in the transaction*⁷⁸.

3 Findings in summary

In summary, the Appellate Body found, among other things:

- (a) The Panel had not erred in its consideration of paragraphs 1(a) and (b) of Article XVII:1,
- (b) The Panel did not err in its interpretation of commercial considerations and enterprises in paragraph 1(b) of Article XVII:1, and
- (c) The Panel did not fail to examine the CWB Export Regime in its entirety.

In doing so, however, the Appellate Body reinforced the interpretation of Article XVII:1 favoured by Canada.

6 CONCLUSION

The report of the Panel in *Canada-Wheat*, and more particularly the gloss which the Appellate Body applied to the report, is a rational and logical application of the express terms of Article XVII:1.

The report establishes that the purpose of Article XVII:1 is to avoid the circumvention by Member states of the anti-discriminatory provisions of the GATT through the use of STEs, rather than a code to emasculate STEs of the privileges which have at this stage been legitimately bestowed on them by their respective governments.

The rejection of the US approach to the establishment of breach, and the interrelationship of paragraphs 1(a) and (b) of Article XVII:1 is supported by the direct language of Article XVII. Regrettably, however, the reports do not examine in any detail how *discriminatory treatment* is to be established under Article XVII:1(a), and the issue of the applicability of national treatment under Article III:4 raised in *Korea-Beef* is almost studiously ignored. We are left with a case by case analysis of these issues.

Similarly, the refusal by both the Panel and the Appellate Body to follow the almost doctrinaire approach of the US to stamping out *trade distorting conduct* through the use of state granted and monopolistic privilege is also welcome. The US protestations are somewhat disingenuous, engaging in their own ways in protecting their primary producers from open competition and giving them what advantage they can through the CCC.

⁷⁸ Ibid at para 157.

It may well be that agricultural trade is ripe for reform, and the days of primary producer boards, single desk marketing boards and other state trading organs has passed as is reflected by the General Council's *July Package*.⁷⁹

But the forum for that change is in trade negotiations. Until that happens, the matters probably quite legitimately complained of by the US are perhaps better dealt with under the *Agreement on Agriculture* and other residual, protectionist provisions relating to all measures which protect agriculture as a whole. Dam's observation in 1970 remains apposite:

*... progress in the GATT, if it is to take place at all, must be based on special procedures designed to deal with the differential character of the various state-trading practices of the contracting parties. The GATT rules alone do not provide an adequate framework for an attack on protectionism in the guise of state trading.*⁸⁰

That framework should properly cover all protectionist mechanisms, particularly in agricultural trade, and not just the narrower practice of state trade. Not surprisingly, this is a view shared by the Government of Canada.⁸¹

⁷⁹ See para 18 of the General Council's post-Cancún decision of 31 July 2004, WT/L/59.

⁸⁰ Kenneth W Dam, *The GATT Law and International Economic Organisation* (Chicago: University of Chicago Press, 1970) at p 332

⁸¹ See Mel Annand, *State Trading Enterprises: A Canadian Perspective* (2000) *The Estey Centre Journal of International Law and Trade Policy* Vol 1, No1 36-50