

GAO

Report to the Honorable  
Byron Dorgan, U.S. Senate

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October 1998

# U.S. AGRICULTURAL TRADE

## Canadian Wheat Issues



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**United States  
General Accounting Office  
Washington, D.C. 20548**

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**National Security and  
International Affairs Division**

B-280949

October 16, 1998

The Honorable Byron Dorgan  
United States Senate

Dear Senator Dorgan:

As you requested, we have reviewed issues involving Canadian grain exports to the United States. Our review focused on the operations of the Canadian Wheat Board and the trade remedies applicable to the activities of state trading enterprises.

As you requested, we plan no further distribution of this report until 30 days after its issue date, unless you publicly announce its contents earlier. At that time, we will send copies of this report to the Secretary of Agriculture, the U.S. Trade Representative, the Commissioner of Customs, the U.S. Attorney General, the Secretary of Commerce, the Chairman of the International Trade Commission, Canadian government officials, and other interested parties. We will also make copies available to others on request.

This report was done under the direction of JayEtta Z. Hecker, Associate Director. If you have any questions concerning this report, please contact her on (202) 512-8984. The major contributors to this report are listed in appendix VIII.

Sincerely yours,

A handwritten signature in black ink that reads "Benjamin F. Nelson".

Benjamin F. Nelson  
Director, International Relations  
and Trade Issues

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# Executive Summary

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## Purpose

U.S.-Canadian grain trade has been a source of contentious debate between the two countries over the past dozen years as Canadian wheat exports to the United States have increased. Some U.S. grain industry participants and observers have been concerned about this development, partially because grain sales are handled differently in the two countries. In the United States, private grain companies compete to buy and sell grain. These grain companies typically transact their own overseas sales on an individual basis. In Canada, the majority of the grain trade is handled by the Canadian Wheat Board (CWB), a government-backed entity referred to as a state trading enterprise (STE), to which western Canadian farmers must sell their wheat and barley for domestic human consumption or export.

Some critics and U.S. officials are concerned about the CWB's unique status as a quasi-governmental entity and its possible effects on U.S. grain farmers and sellers in international markets. Some grain industry observers say that the CWB engages in unfair trade practices. There is also some concern about data limitations and legal remedies available to the United States to counteract these practices.

In response to concerns about the CWB's impact in the international grain market, Senator Byron Dorgan asked GAO to review some key issues relative to the CWB. In response, this report discusses the following: (1) CWB operations, government assistance to the CWB and the Canadian farmer, and ongoing changes to the environment in which the CWB operates; (2) the availability of data to ascertain CWB pricing practices, and efforts to increase the amount of data available; and (3) the nature of trade remedies available to address the operations of STEs, and the frequency with which these remedies have been applied to STEs. In addition, GAO is providing information on the CWB's role in commodities and futures markets, a summary of studies on the CWB's effect on the Canadian farmer, and the applicability of U.S. antitrust laws to the CWB (see apps. II, III, and VII).

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## Background

STEs, such as the CWB, are enterprises that are authorized to engage in trade and are owned, sanctioned, or otherwise supported by the government. STEs are legitimate trading entities under the World Trade Organization (WTO) and are subject to rules established by the General Agreement on Tariffs and Trade (GATT).<sup>1</sup> The WTO Agreement requires that

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<sup>1</sup>The WTO was created in 1994 by the WTO Agreement to be the formal organization that encompasses all disciplines (practices) established by the GATT. As an organization, GATT officially ended on December 31, 1995.

STES purchase and sell their goods solely on the basis of “commercial considerations,” including factors such as quality, price, market, and transportation. In addition, countries must report certain types of information on the operations of their STES to the WTO annually to provide members with information to help assure that STES operate in accordance with WTO disciplines.<sup>2</sup>

The CWB, Canada’s fifth largest export earner, was established in 1935 to regulate Canada’s grain trade. It is currently the largest grain marketing board in the world, handling about 20 percent of the world wheat and barley trade. The CWB has a monopoly on certain Canadian grain sales. It has statutory authority to acquire all western Canadian wheat and barley sold for domestic human consumption or export. Western Canadian farmers are required to sell their wheat and barley for domestic human consumption or export to the CWB, which then markets the commodity in domestic and foreign markets. Generally, the CWB pays the farmers an initial payment for their wheat, sells the wheat, and then may pay the farmers an interim and a final payment by the end of the marketing year.<sup>3</sup> The Canadian government backs the CWB operations through the CWB’s status as a crown corporation.<sup>4</sup>

Changing rules under trade agreements and increases in Canadian grain imports into the United States have contributed to concerns about U.S.-Canadian grain trade over the past 10 years. The 1989 U.S.-Canada Free Trade Agreement (CFTA), the 1994 North American Free Trade Agreement (NAFTA), and the WTO agreements modified the rules regarding U.S.-Canadian grain trade and provided additional dispute resolution mechanisms to address concerns. Between 1990 and 1997, U.S. imports of Canadian red spring wheat increased by more than 2,000 percent to 1,449,600 tons, and imports of Canadian durum wheat increased by 57 percent to 427,600 tons.

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<sup>2</sup>The 1994 Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade defines STEs as “governmental and non-governmental 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.” STEs are also defined in U.S. law at 19 U.S.C. 2906(6).

<sup>3</sup>If the net value of the grain is greater than the initial payment to the farmers, the farmers receive the difference in interim and/or final payments.

<sup>4</sup>A crown corporation, or a semiautonomous government organization, is used to administer and manage public services in which enterprise and public accountability are combined.

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## Results in Brief

The CWB is a state trading enterprise with a monopoly on certain Canadian grain sales and receives Canadian government subsidies in a number of direct and indirect ways. The Canadian government also provides other assistance to its wheat and barley farmers. The CWB's operating environment is undergoing changes, some of which are expected to make the United States a more attractive market for Canadian grain. At the same time, there is a greater presence of U.S. grain companies operating in Canada, and the CWB is dealing more frequently with private companies in the sale of Canadian grain.

Little information on actual CWB contracts is publicly available. Although U.S. Customs and the U.S. Department of Agriculture (USDA) collect a great deal of information on imports of Canadian grain into the United States, these data cannot be used to ascertain CWB export prices. The format that countries use to report on their state trading enterprises' activities to the WTO has recently been revised. However, U.S. officials are concerned that it does not go far enough to increase the openness of the pricing practices of certain state trading enterprises, such as the CWB.

Trade remedies to combat disruptive or trade-distorting imports under U.S. trade laws do not treat STEs any differently from other entities involved in international trade. These U.S. trade laws can address trade issues such as dumping,<sup>5</sup> actionable subsidies,<sup>6</sup> and surges in imports.

In addition, STE activities may be subject to dispute settlement provisions under international trade agreements if the activities are inconsistent with an obligation agreed to by the government of the STE. Relatively few trade remedy actions have been taken involving STEs—15 since 1980—with 8 actions involving an export STE and 7 actions involving an import STE.

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<sup>5</sup>"Dumping" is generally defined as the sale of an exported product at a price lower than that charged for a like product in the "home" market of the exporters or at a price below cost.

<sup>6</sup>As used in this report, an "actionable" subsidy is a subsidy for which U.S. law provides a remedy in the form of an increased or "countervailing" duty. Not all benefits that governments confer on their products are actionable or countervailable subsidies. Rather, in general, subsidies must be limited to a specific group of firms or industries or to a firm's export activities in order to be covered under the countervailing duty law.

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## Principal Findings

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### CWB Operations and Government Assistance

Besides operating as a state-sanctioned monopoly, the CWB receives Canadian government subsidies in a number of direct and indirect ways. The government guarantees the CWB's initial payments to farmers, finances overseas credit sales, and provides research and development funding and marketing assistance through the Canadian International Grains Institute. Also, the CWB's government backing allows it to borrow money at favorable interest rates. In addition, rail shipment costs for CWB grains are reduced by the government's provision of hopper cars to the sector.

Through its status as an STE, the CWB has a system of reimbursing farmers in multiple payments, rather than in a lump sum at the time of delivery. According to the government of Canada, the CWB pays farmers an initial payment of 70-75 percent of the expected final return for their grain. This payment system gives the CWB flexibility in setting its export prices and protects it from operating losses due to decreases in market prices.

The Canadian government also provides other assistance to its wheat and barley farmers, including payment of the costs associated with insurance programs and one-time payments that compensate agricultural landowners for the removal of a long-standing subsidy on railroad shipments. In 1996, the combined subsidies for wheat and barley farmers amounted to \$922 million, or 19 percent of production valued at \$4.8 billion.<sup>7</sup>

The CWB's operating environment is undergoing change. Canadian Parliament Bill C-4, which passed on June 11, 1998, will make a number of structural changes to the CWB's mandate, including the establishment of a producer-majority Board of Directors. Other changes to the CWB's operating environment include (1) the removal of a transportation subsidy in 1995, changes to freight charges, and the privatization of the railcar fleet in 2002, all of which are expected to make the United States a more attractive market for Canadian grain; and (2) a reduction in import-oriented STEs to conduct business with the CWB, compelling the CWB to deal with private companies more frequently.

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<sup>7</sup>Unless otherwise noted, all Canadian dollars have been converted to constant 1997 U.S. dollars using a market exchange rate and the U.S. gross domestic product deflator.

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## CWB Export Pricing Information Is Limited

Little information is available on CWB sales transactions. The CWB discloses limited details about its prices for the wheat and barley that it sells to its trading partners. USDA officials believe that the lack of transparency (openness) in the CWB's pricing methods provides the CWB with a greater ability to distort trade than is found among private grain traders. The CWB states that it reveals as much about its prices as its competitors in the private sector. Some U.S. government officials and U.S. farmers believe that nontransparent CWB prices make it difficult to assess whether the CWB's practices are consistent with its international obligations under trade agreements. The data collected by Customs and USDA, which include origin, volume, and value of the grain, cannot be used as part of such an assessment. This is because the data lack certain details on the quality of the grain and other specifics of the transaction.

Officials from USDA and U.S. Customs Service are discussing the possibility of gathering more details on Canadian wheat when it comes into the United States. However, USDA acknowledges that it would be difficult for Customs to collect at the border the detailed information that would be useful in determining whether the CWB is engaging in improper pricing, i.e. pricing that would justify the use of a trade remedy based on U.S. law or through the dispute settlement process available under international agreements. For example, the international tariff classification system would have to be expanded to take into account variation in wheat protein levels. The United States is also working through the WTO to increase the amount of information STEs, such as the CWB, must report on pricing and other activities. Thus far, the United States and other countries' efforts to expand STE reporting requirements on pricing have had limited success. The WTO has recently updated its format for STE reporting to require more information on STE pricing practices. However, U.S. officials believe that the newer format does not require the level of detail necessary to determine if the CWB and other STEs are engaging in improper pricing.

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## Trade Remedies Have Been Applied to STE Activities

Some U.S. grain industry observers have questioned whether trade remedies under U.S. law and international trade agreements are applicable to STEs, such as the CWB. In fact, a wide range of trade remedies are available and have been used to address trade issues involving STEs. Trade remedies available under U.S. law to combat the effects of disruptive or trade-distorting imports do not accord STEs special treatment or recognition. Regardless of whether events or actions giving rise to a trade remedy were caused by STEs, these remedies may be applied to address trade issues such as dumping of goods in the U.S. market, actionable



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subsidies, or import levels that injure U.S. industry. In addition, because of the quasi-governmental nature of STEs, their activities may be subject to dispute settlement procedures under international trade agreements, if those activities are inconsistent with an obligation agreed to by the government of the STE.

GAO found that 15 trade remedy actions have been taken since 1980 involving an STE. Three of the actions involving an export STE, including one dumping investigation and two investigations regarding actionable subsidies, resulted in the United States imposing additional duties as a remedy. The United States prevailed in all four of the GATT dispute settlement procedures it invoked challenging an import STE's restrictive trade practices. The United States believed that these practices had impeded U.S. exporters' ability to sell in the foreign market; the GATT dispute panels found that they violated GATT prohibitions against quantitative restrictions. The panel rulings prompted the countries in which the import STEs in question operated to either remove the restrictions in question or sign an agreement with the United States to work toward resolving the problem.

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## Recommendations

GAO is not making recommendations in this report.

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## Agency and Country Comments

GAO requested comments on a draft of this product from USDA, the U.S. Trade Representative (USTR), the U.S. Department of Commerce, the U.S. Customs Service, the U.S. Department of Justice, and the U.S. International Trade Commission. USDA, USTR, and Commerce found the report to be accurate, fair, and balanced. In addition, USDA noted that the calculations in the report on Canadian rail subsidies and the value of the CWB's lower interest rates constituted new and useful information. However, USDA emphasized that the CWB, as the sole buyer of Canadian wheat for domestic human consumption and for export, is able to engage in trade-distorting actions. USDA believes that GAO did not sufficiently emphasize the CWB's pricing flexibility due to its practice of making initial payments to its farmers of only 70-75 percent of the expected value of their grain. GAO believes that point was sufficiently established in the draft. However, GAO did not attempt to quantify the impact of CWB activities on grain trade.

GAO received technical comments from USDA, USTR, the U.S. Department of Commerce, the U.S. Customs Service, the U.S. Department of Justice, and

the U.S. International Trade Commission. These technical comments were incorporated into the report where appropriate.

GAO also discussed portions of the draft report with embassy representatives from Canada and the CWB. The CWB did not agree with GAO's observation regarding the CWB's pricing flexibility as compared to private firms. Rather, the CWB stated that it has a competitive disadvantage in obtaining grain because private grain traders know the CWB's acquisition cost. GAO has included the CWB's statement in its discussion of this issue.

Canada and the CWB also provided technical comments that were incorporated into the report where appropriate.

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**Abbreviations**

ABI	Automated Broker Interface
AE	accredited exporter
AWB	Australian Wheat Board
CBOT	Chicago Board of Trade
CFTA	U.S.-Canadian Free Trade Agreement
CFTC	Commodity Futures Trading Commission
CWB	Canadian Wheat Board
EC	European Community
EEP	Export Enhancement Program
FAS	Foreign Agricultural Service
GATT	General Agreement on Tariffs and Trade
HTS	Harmonized Tariff System
ITC	International Trade Commission
KCBOT	Kansas City Board of Trade
MGE	Minneapolis Grain Exchange
MOU	memorandum of understanding
NAFTA	North American Free Trade Agreement
OECD	Organization for Economic Cooperation and Development
PSE	producer subsidy equivalent
STE	State trading enterprise
USDA	U.S. Department of Agriculture
USTR	U.S. Trade Representative
WTO	World Trade Organization

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# Introduction

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State trading enterprises (STE)<sup>1</sup> have existed for some time and have been considered legitimate trading entities by the General Agreement on Tariffs and Trade (GATT) since 1947. STEs<sup>2</sup> have developed in various countries for various reasons at different points in history. The current Canadian Wheat Board (CWB) was formally established in 1935, after other cooperative-like organizations disbanded. It is one of the largest grain traders in the world, and the largest exporter of wheat and barley to the United States.

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## STEs Are Established for a Variety of Reasons

STEs have been formed for various reasons. For example, the Australian Wheat Board (AWB) was created in 1939 to help Australian farmers manage difficulties in marketing wheat during wartime conditions, while Cyprus' Carrot and Beetroot Marketing Board was established in 1966 because competition among producers was depressing the domestic and export prices of carrots and beetroot. Generally, a goal of export-oriented STEs is to maximize financial returns through the regulation of commodity sales from a particular country or region. The level of government involvement and overall size of the STEs' operations vary widely; thus, it is difficult to generalize about STE operations or motivations on a global basis.

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## Previous GAO Reports on STEs

We have already published a number of reports on state trading issues, including (1) a July 1995 report that provides a brief summary of trade remedy laws available to investigate and respond to activities of entities trading with the United States, including STEs;<sup>3</sup> (2) an August 1995 report on the General Agreement on Tariffs and Trade/World Trade Organization (WTO) practices that apply to STEs and the effectiveness of those disciplines to date;<sup>4</sup> and (3) a June 1996 report that focuses on the activities of three

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<sup>1</sup>STEs are generally considered to be governmental or nongovernmental enterprises that are authorized to engage in trade and are owned, sanctioned, or otherwise supported by the government. The 1994 Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade defines STEs as "governmental and non-governmental 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." STEs are also defined in U.S. law at 19 U.S.C. 2906(6).

<sup>2</sup>Two different types of STEs exist in world markets—those that regulate exports and those that regulate imports of commodities. In this report, any references to STEs allude to export STEs unless specifically stated otherwise.

<sup>3</sup>Summary of Trade Remedy Laws Available to Investigate State Trading Enterprises and Encourage Behavior Consistent With Fair Trade ([GAO/OGC-95-24](#), July 28, 1995).

<sup>4</sup>State Trading Enterprises: Compliance With the General Agreement on Tariffs and Trade ([GAO/GGD-95-208](#), Aug. 30, 1995).



STES, including the CWB, and their potential capabilities to distort trade in their respective commodity markets.<sup>5</sup>

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## CWB History

In Canada, prairie provincial wheat pools were formed in 1924 but went into temporary receivership after the stock market crash of 1929. Following the financial hardship faced by farmers during the Depression, the Canadian government passed the Canadian Wheat Board Act of 1935, establishing the CWB. The CWB was also given control of marketing oats and barley, although oats were removed from the CWB's purview in 1989.

The CWB is currently managed by three commissioners, who are appointed by the government of Canada. A producer advisory committee, composed of 11 farmer-elected representatives from the prairie provinces, provides the CWB with advice on operational matters.<sup>6</sup> The CWB employs over 500 people and has annual revenues of over \$4.4 billion.<sup>7</sup>

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## CWB Is a Major Grain Trader in the World Market

Although Canada produced only 5 percent of the world's wheat and 10 percent of the world's barley in 1996, it held a 20-percent share of the world's wheat export market and about 20 percent of the world's barley export market in that year (see figs. 1.1 and 1.2.) In 1996, the United States ranked fourth in the world in both wheat and barley production, while Canada ranked fifth in wheat and third in barley production.

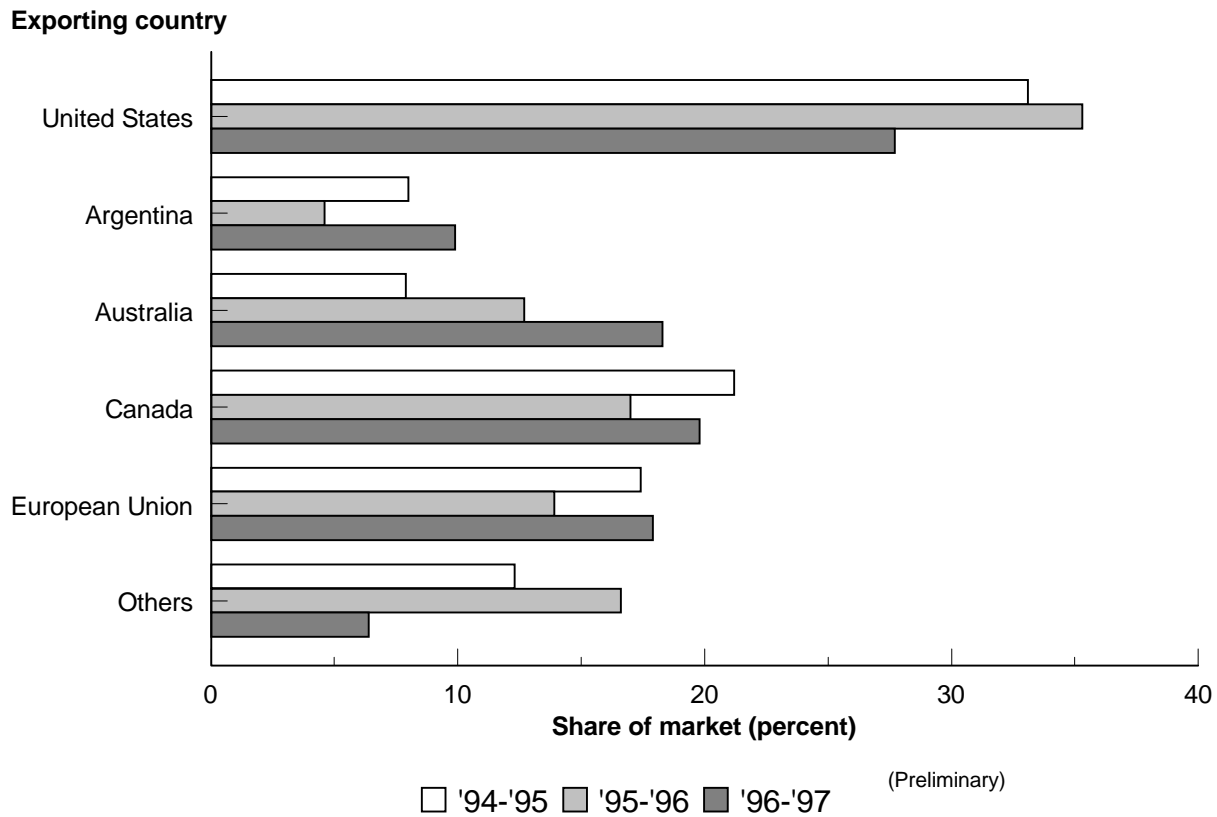
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<sup>5</sup>Canada, Australia, and New Zealand: Potential Ability of Agricultural State Trading Enterprises to Distort Trade (GAO/NSIAD-96-94, June 24, 1996).

<sup>6</sup>On June 11, 1998, the Canadian Parliament passed legislation that will lead to changes in the CWB's corporate structure and operations. For more details, see our discussion on changes in the Canadian grain system, in chapter 2.

<sup>7</sup>Unless otherwise noted, all Canadian dollars have been converted to constant 1997 U.S. dollars using a market exchange rate and the U.S. gross domestic product deflator.

Figure 1.1: Share of World Exports of Wheat by Country, 1994-97

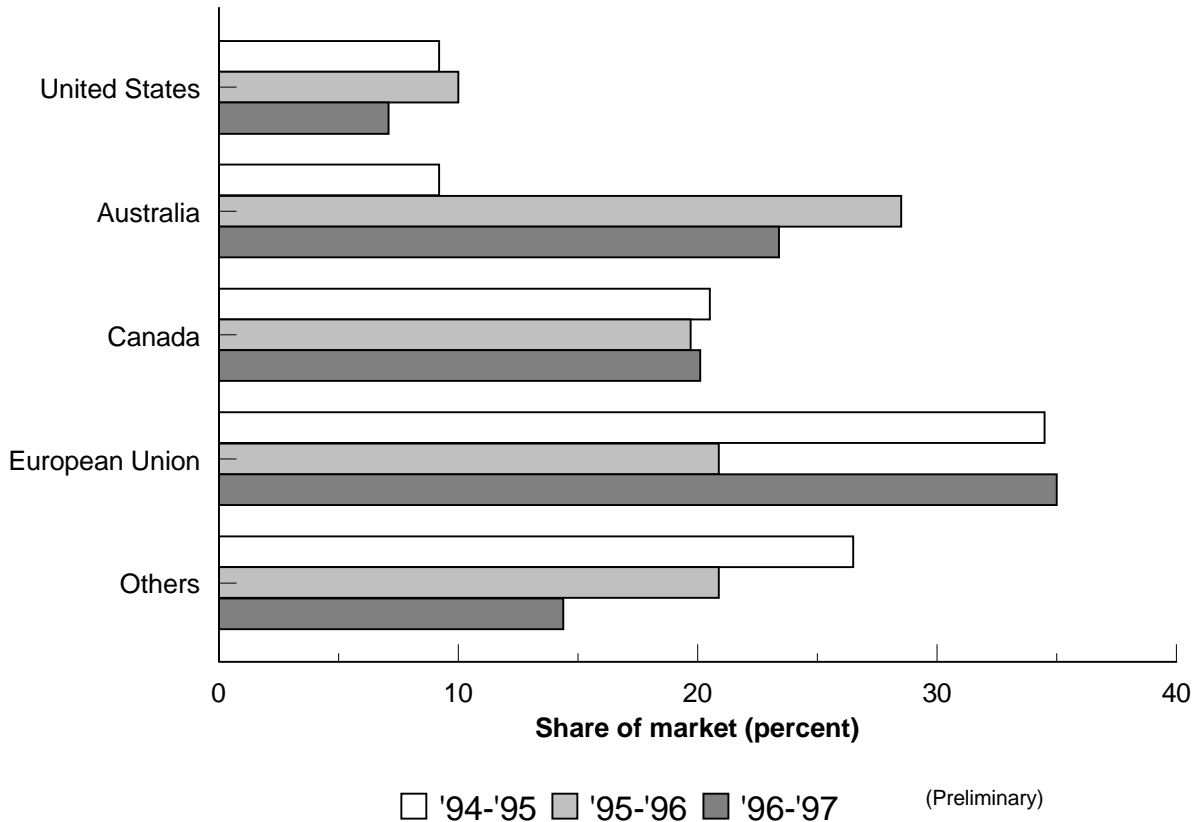


Note: Wheat includes wheat flour; shares based on volume.

Sources: Statistics Canada and the U.S. Department of Agriculture (USDA).

Figure 1.2: Share of World Exports of Barley by Country, 1994-97

Exporting country



Note: Shares based on volume.

Sources: Statistics Canada and USDA.

The United States imports more red spring wheat, durum wheat, and barley from Canada than from any other country. These imports constitute a significant share of the U.S. market. In crop year 1996-97, about 14 percent of the durum wheat and 7 percent of the red spring wheat supply in the United States came from Canada. The United States imported this wheat in part because of problems with disease, adverse weather conditions, and a shortfall in domestic supply. Also, U.S. food use of

durum has risen 125 percent over the past 2 decades; thus, as the demand for durum wheat has increased, so too have U.S. imports of this wheat from Canada. The vast majority of durum wheat, red spring wheat, and barley arrives in the United States from Canada by rail direct from Thunder Bay, Ontario, and the Canadian western prairie provinces of Manitoba, Saskatchewan, Alberta, and the Peace River district of British Columbia. In 1997, 70 percent of these Canadian grains were shipped by rail, 18 percent by vessel, and 13 percent by truck.

For some export sales, the CWB relies on “accredited exporters” (AE), who are national and multinational companies authorized to purchase grain from the CWB for resale to customers. Some of the AEs are subsidiaries of U.S.-based multinational firms; some of the transactions that the AEs facilitate involve selling grain to other subsidiaries of the same company. Although the majority of the CWB’s sales are made directly to an end user, CWB officials told us that AEs facilitate all wheat sales to buyers in the United States.

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## **U.S.-Canadian Relations—Grain Trade and the CWB**

With the rise in U.S. imports of Canadian wheat beginning in the mid-1980s, U.S. wheat farmers became increasingly concerned about what they perceived as Canadian wheat export subsidies and unfair barriers to U.S. wheat exports. U.S. wheat farmers thought that Canadian transportation subsidies gave Canadian wheat farmers an unfair advantage in foreign markets. Canadian wheat and barley producers have historically received transportation subsidies that reduced shipping costs. U.S. wheat farmers’ market access concerns centered on Canadian import permits, or license requirements, which essentially prevented U.S. farmers from selling their grain to Canada without a permit. In addition, the U.S. government was concerned that the CWB might be selling its grain in an unfair manner.

Specific provisions of the U.S.-Canada Free Trade Agreement (CFTA), effective January 1, 1989, dealt with several of these aspects of U.S.-Canadian grain trade. For example, under the CFTA, Canada agreed to eliminate Canadian transportation subsidies for agricultural goods originating in Canada and shipped via West Coast ports for consumption in the United States. CFTA called for ending Canadian import permits for grain pending changes in the comparative level of U.S. and Canadian support for producers. CFTA also dealt with the pricing of agricultural products, including wheat, providing that neither the United States nor Canada could export agricultural goods to the other at a price below the acquisition

price of the goods plus any storage, handling, and other costs. Differences in U.S. and Canadian interpretations of this provision eventually led the United States to invoke CFTA dispute settlement procedures in May 1992. The subsequent 1993 CFTA dispute panel decision called for an audit of CWB pricing. An audit was conducted and its findings were reported in December 1993 (see ch. 4 for a discussion of the CFTA dispute panel decision).

The Canada-United States Joint Commission on Grains, mandated by a 1994 U.S.-Canadian memorandum of understanding (MOU), released its final report in October 1995. Comprised of 10 nongovernment U.S. and Canadian officials with equal representation, it was formed to assist the two governments in reaching long-term solutions to existing problems in the grains sector. The report addressed policy coordination, cross-border trade, grain grading and regulatory issues, infrastructure, and domestic and export programs and institutions (see app. I for a chronology of U.S.-Canadian grain trade relations).

While some areas of debate have been resolved, recent events have shown that difficulties remain in U.S.-Canadian relations regarding the grains trade. Neither CFTA nor the use of trade remedies has resolved U.S. producer concerns about U.S. access to the Canadian wheat market, CWB practices, and increasing Canadian wheat imports into the United States. Despite CFTA's gradual elimination of all duties between Canada and the United States by January 1, 1998, and the removal of Canadian import license requirements in 1995, some barriers continue to impede trade. Canada still requires an end-use certificate and subsidizes grain transportation through its ownership of railcars, and reciprocal access to grain handling and transportation systems in the two countries is yet to be achieved. In addition, the U.S. Trade Representative (USTR) remains concerned that the CWB may be using its monopoly to undercut U.S. wheat prices and that U.S. farmers continue to be hurt by increased Canadian wheat imports.

Regarding market access, Canada removed its import license requirement in 1991 but still requires that U.S. wheat be accompanied by an end-use certificate to maintain Canada's varietal controls and quality standards. The U.S. requirement that imports be accompanied by an end-use certificate is a direct response to Canada's requirement and will remain in effect until Canada removes its end-use requirement. It also serves as a method to prevent imports from being used in U.S. foreign aid, export, and

credit guarantee programs. The Canada-United States Joint Commission on Grains recommended that both countries remove these requirements.

Another long-standing issue involves U.S. wheat exporters' access to Canada's primary grain elevator system. Canadian access to U.S. elevators, on the other hand, is relatively less impeded. In addition, Canada provides its wheat farmers with government railcars to transport their wheat. The Canada-United States Joint Commission on Grains recommended that both countries pursue the long-term goal of providing reciprocal access to each other's grain infrastructure. In January 1998, the United States and Canada announced plans to implement a pilot program to facilitate U.S. wheat exports to Canada that would enable the United States to ship its grain directly to Canadian grain elevators.<sup>8</sup> The United States is negotiating with Canada over Canada's current requirement that U.S. grain be accompanied by a phytosanitary certificate—an assurance that the grain is disease free.<sup>9</sup> The United States is also concerned about the costs of the pilot program and how it will be applied to imports.

The United States continues to disagree with Canada's interpretation of CFTA provisions defining the acquisition price of grains and the decision of the CFTA durum panel. In her May 1998 testimony before the Senate Agriculture Committee, the U.S. Trade Representative stated that there was a problem with CFTA in this regard and that the United States may try to revisit this issue in the upcoming 1999 WTO multilateral trade negotiations involving agriculture. In March 1998, the United States requested a new audit of the CWB's grain pricing related to the acquisition price. Canada agreed to the new audit but disagreed with the United States on its terms. Canada wants to maintain the audit terms both countries agreed to after the 1993 CFTA dispute settlement panel decision. The United States wants to (1) deviate from the panel decision by applying a broader definition of "acquisition price"; (2) expand the audit to cover not only durum but also spring wheat and barley; and (3) include in the audit Canadian grain export prices to countries other than the United States.

Wheat imports from Canada into the United States have risen since 1990, as shown in figure 1.3. Since the early 1990s, durum and red spring wheat imports have increased. Between 1990 and 1997, Canadian red spring

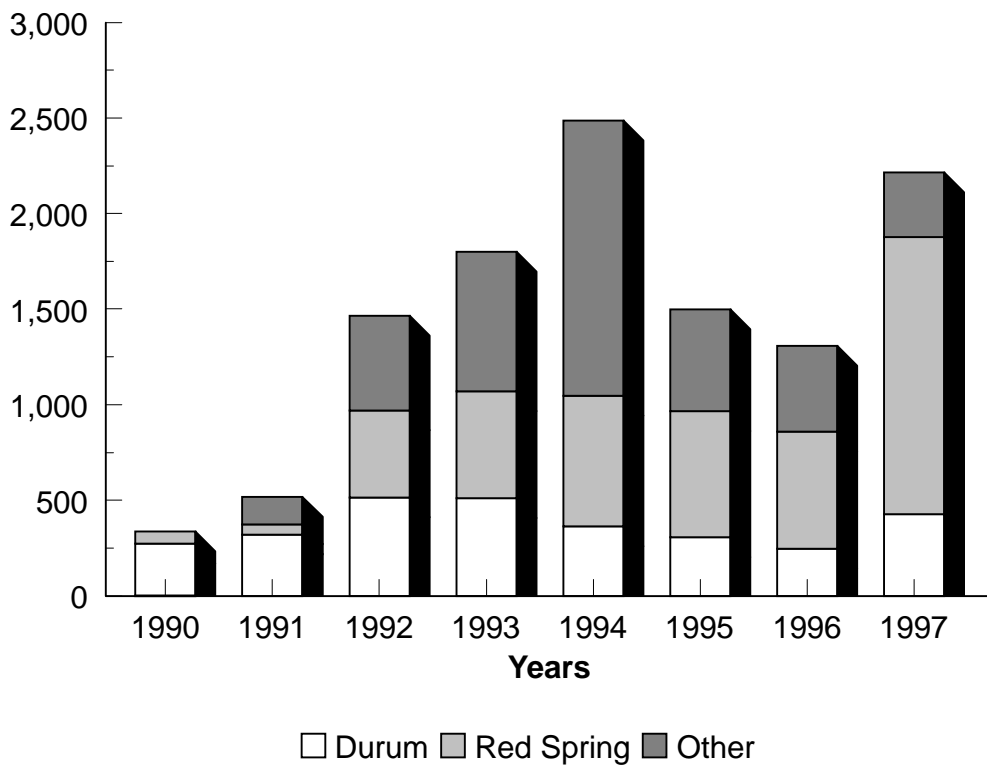
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<sup>8</sup>Currently U.S. wheat can only enter Canadian elevators on a case-by-case basis requiring approval from the Canadian Grain Commission.

<sup>9</sup>Sanitary and phytosanitary measures are regulations or other measures taken to protect human, animal, or plant life or health. The Agreement on the Application of Sanitary and Phytosanitary Measures in the 1989-95 Uruguay Round of GATT contains disciplines (practices) in the use of such measures. NAFTA contains similar disciplines.

wheat imports grew by more than 2,106 percent to 1,449,600 tons, while Canadian durum wheat imports have risen by 57 percent to 427,600 tons.

Figure 1.3: U.S. Imports of Canadian Wheat, 1990-97  
Thousands of metric tons



Note: "Other" wheat category includes seed (durum and other wheat) and all wheat other than durum and red spring wheat.

Source: U.S. Census Bureau, imports for consumption.

## Objectives, Scope, and Methodology

In our 1996 report on STES, we developed an economic framework to assess the capabilities of three STES, given their relationships to domestic producers, governments, and foreign buyers. In this report, at the request of Senator Byron Dorgan, we look more closely at one of those three STES—the CWB—and review a number of issues regarding its exports to the United States. We reviewed the following: (1) CWB operations, government

assistance to the CWB and the Canadian farmer, and ongoing changes to the environment in which the CWB operates; (2) the availability of data to ascertain CWB pricing practices, and efforts to increase the amount of data available; and (3) the nature of trade remedies available to address the operations of STES, and the frequency with which these remedies have been applied to STES. In addition, we are providing information on the CWB's role in commodities and futures markets, a summary of studies on the CWB's effect on the Canadian farmer, and the applicability of U.S. antitrust laws to the CWB.

To explore the operations of the CWB and the government assistance available to the CWB and Canadian farmers, and ongoing changes to the environment in which CWB operates, we reviewed background documents on the CWB and the North American grain trade provided by officials in the Canadian embassy in Washington, D.C., the CWB, the USDA's Foreign Agricultural Service (FAS), the Department of Commerce, and USTR. We also traveled to Canada to gather documents and interview officials from various agencies within the Canadian government who are involved with the Canadian grain trade, including Agriculture Canada, the Department of Foreign Affairs and International Trade, the Canadian Grain Commission, Finance Canada, the Canadian International Grains Institute, and Transport Canada. In addition, we interviewed officials from the CWB, representatives from the Canadian railroad industry, and private sector representatives in the grain trade.

To learn about the CWB from the U.S. government perspective, we interviewed officials from FAS and USTR. We also travelled to North Dakota to speak with state government officials, local farmers' groups, private grain traders, and academics about the impact of Canadian grain imports on the U.S. grain industry.

To learn about the availability of data on CWB pricing practices and determine the efforts to increase the amount of data available, we built upon the information we gathered by reviewing the data collected by the U.S. Customs Service, the U.S. Bureau of the Census, and USDA on Canadian wheat imports. Specifically, we obtained Customs' detailed data base on all wheat and barley shipments from Canada entered from 1992 through 1996. From Census, we obtained aggregate import data for 1992 through 1997.<sup>10</sup> We also obtained information collected and compiled by USDA on the end use of wheat imported from Canada for the most recent 3 marketing years. We then reviewed all of the data to determine what they

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<sup>10</sup>The Census import data are the official import data of the U.S. government.



revealed about Canadian wheat imports. We requested a variety of data from the CWB, including transactional data, but were denied access.

We also interviewed officials from Customs, Census, and USDA about their import data. Our discussions included what procedures they use for collecting and compiling the data and for ensuring quality control, how the data are used by government agencies and private industry, and what the strengths and limitations of the data are. We also reviewed the agencies' written procedures and regulations governing the collection and compilation of the data as well as internal evaluations of their data programs. In addition, we relied on previous GAO evaluations of the systems and processes for measuring U.S. trade with other countries.

To identify efforts to increase the amount of data available we evaluated whether the WTO has made progress in increasing the amount of information available on the CWB and other STES as well as WTO members' compliance with STE reporting requirements. We reviewed the annual reports and minutes of formal meetings of the WTO Working Party on STES, and WTO members' STE reporting submissions for 1995-97, as well as USDA and USTR documents. We also interviewed WTO Secretariat officials, individual members of the Working Party on STES, and USDA and USTR officials. In addition, we reviewed relevant documents, including the 1994 Understanding on the Interpretation of GATT article XVII, which deals with STES.

To identify the nature of trade remedies available to address the operations of STES, we reviewed relevant U.S. statutes and documents published by the International Trade Commission (ITC), the Congressional Research Service, and GAO. We also reviewed the dispute settlement mechanisms within the CFTA, the 1994 North American Free Trade Agreement (NAFTA), and the WTO. We reviewed appropriate provisions of international trade agreements.

To determine the frequency with which dispute settlement procedures have been used for matters involving the CWB and other STES, we reviewed appropriate provisions of international trade agreements. We identified WTO member country STES; the type of information available about STES; and STES' compliance with the WTO's article XVII, by reviewing article XVII STE notifications<sup>11</sup> submitted to the WTO Secretariat from 1995 to 1997. We also reviewed past GAO work. We requested that USTR identify all disputes

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<sup>11</sup>WTO members are expected to provide responses, called "notifications," to questionnaires collecting information about their STES. Ideally, the notifications should provide enough transparency (openness) about STES to determine whether or not they are adhering to GATT disciplines.

under international agreements that involved an STE that had been notified to the WTO.

To determine the frequency with which U.S. trade remedy laws have been applied to matters involving the CWB and other STEs, we reviewed those laws and spoke with officials at USTR, the ITC, the Department of Commerce, USDA, the Department of Justice, and the NAFTA Secretariat. We obtained a list of STEs that provided notifications to the WTO Secretariat. We then asked USTR, the ITC, and Commerce to search their trade remedy enforcement records for any actions involving those STEs, going back to 1980. We asked the agencies to provide us with a description of the actions and their outcomes. All of the agencies responded to our request by identifying trade remedy actions that, according to their records, had involved STEs. The agencies stated, however, that it was difficult to determine conclusively whether the cases the agencies had identified represented the entire universe of such matters involving STEs. The agencies provided several reasons for this difficulty: (1) the voluminous amount of documentation on some types of cases coupled with an absence of electronic records to facilitate searches; (2) the possibility that an STE's foreign name translation in a case file would differ from the translation on our STE list; (3) the fact that under U.S. law, STEs as institutions would not be the primary subject of a trade remedy action; and (4) the fact that the trade remedy action may not be country or foreign exporter specific; that is, it may involve imports of a particular product from all sources. We also examined Federal Register notices and reports issued by the agencies on their findings.

To review CWB participation in U.S. futures and commodity markets/exchanges, we met with CWB officials and reviewed CWB documents concerning CWB objectives in participating in U.S. markets. We also discussed the participation of STEs in these markets with the U.S. Commodity Futures Trading Commission (CFTC) and officials representing the Minneapolis Grain Exchange (MGE), the Chicago Board of Trade (CBOT), and the Kansas City Board of Trade (KCBOT).

To gather information on the CWB's impact on the Canadian farmer, we reviewed Canadian and U.S. studies that measured the economic impact of the CWB and spoke with some of the authors of those studies. We also spoke with private grain traders and Canadian farm groups that represented both general farmers' interests and specific commodity interests.

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To determine the applicability of U.S. antitrust law to the CWB, we interviewed officials at the Department of Justice's Antitrust Division and the Federal Trade Commission and reviewed the Antitrust Enforcement Guidelines for International Operations, issued by those agencies in 1995. We also reviewed statutes and case law relevant to the extraterritorial applicability of U.S. antitrust law.

We conducted our review from September 1997 to June 1998 in accordance with generally accepted government auditing standards.

We requested comments on a draft of this report from the Secretary of Agriculture, the U.S. Trade Representative, the Secretary of Commerce, the Commissioner of Customs, the U.S. Attorney General, and the Chairman of the ITC. We received technical comments from all six agencies, and incorporated them into the report where appropriate. USDA, USTR, and Commerce found the report to be accurate, fair, and balanced.

We also discussed the factual content of the report as it related to the CWB and the Canadian government with embassy representatives from Canada and with representatives from the CWB. Canada and the CWB provided technical comments, which were incorporated into the report where appropriate.

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# CWB Operations and Government Support for the Grain Sector

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As an STE, the CWB has certain marketing characteristics and government support. These include a monopoly over most sales of Canadian wheat and barley and pricing flexibility through guaranteed supply and delayed payments to farmers. It also enjoys government guarantees of its financial operations and favorable interest rates on loans. Through other programs, the Canadian government provides additional subsidies to wheat and barley producers. However, the CWB faces changes in its structure and operations due to recently completed legislative reforms. These alter its corporate governance and relations to the government. Additionally, other changes in the Canadian grain marketing system are underway, including potential changes in rail regulation, U.S. investment in the industry, and the decline of import STES in other countries.

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## Operational Characteristics Offer CWB Unique Status

The CWB has the sole authority to market for export and for domestic human consumption wheat and barley grown in the western prairie provinces of Manitoba, Saskatchewan, Alberta, and the Peace River district of British Columbia.<sup>1</sup> The CWB controls all exports of wheat and barley products through an export licensing process and directly markets most of its exports, including those made to import STES. The operating costs of the CWB are deducted from payments made to producers. It enjoys pricing flexibility due to its assured supply of grain and ability to price discriminate. This assurance of supply is not absolute, however, as producers are free to plant non-CWB crops. In addition, the CFTA established that CWB sales into the United States could not fall below the acquisition price.

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## CWB Monopoly Status

The CWB reports that its monopoly status as a “single-desk seller” of western Canadian wheat allows it to extract more money from the world market on behalf of farmers than would be the case without this government-mandated status.<sup>2</sup> This status allows the CWB to capture premiums through price differentiation, a practice in which the CWB sells grain at differing prices into different markets and to different customers. CWB-contracted economic studies have concluded that the single-desk status of the CWB gives it market power in the world wheat and barley trade and increases farmer revenue through price discrimination. One

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<sup>1</sup>The small quantities of wheat and barley grown outside of this area are not handled by the CWB. For example, white winter wheat grown in Ontario is marketed by the Ontario Wheat Producers Marketing Board under provincial legislation. In addition, feed wheat and feed barley grown throughout Canada can be sold by the producer domestically. However, wheat and barley produced in eastern Canada requires permission of the CWB for interprovincial or export sales.

<sup>2</sup>See appendix III for details concerning the costs and benefits of the CWB for the Canadian farmer.

study<sup>3</sup> found that for 1981-94, the CWB on average increased wheat revenues by \$14.56 per ton, or \$289 million per year when compared to a system of multiple sellers offering wheat in competition with each other.<sup>4</sup> These premiums represent about 8 percent of CWB wheat revenues for those years. A second study found that the CWB increased barley producer revenues on average by \$70.5 million per year (1986 to 1995) when compared to what they would have received in a system of multiple sellers.<sup>5</sup> These premiums represent about 15 percent of the CWB barley revenues for those years.

In contrast, a study financed by the provincial government of Alberta concludes that the CWB lacks market power and finds that the Canadian grain system is more costly than the comparable U.S. system.<sup>6</sup> The study concluded that Japan is the only market where a single-desk premium may exist, and that, based on Japan's share of CWB sales, the single-desk seller premium is small.

As a single-desk seller, the CWB has market power and can price discriminate, according to officials at six grain companies located in the United States and in Canada. "Price discrimination" is the practice of charging a higher price to some buyers and a lower price to others in order to maximize profits. CWB contracts include a provision that stipulates that the grain is for shipment to and consumption in a specific country. Grain companies reported that this stipulation prevents the AES from competing against each other on price. One grain company characterized this as being good for Canadian and foreign producers but bad for consumers.

As a single-desk seller, the CWB may also choose to sell quantities to a certain market that differ from what would be supplied by the private trade. Several grain industry officials representing grain companies, grain consumers, and industry organizations reported that they believe the CWB withholds grain sales to the United States, with some citing the sales' political sensitivity. An implication of withheld sales is that exports to the United States would increase in the absence of the CWB. Representatives of

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<sup>3</sup>Daryl F. Kraft, W. Hartley Furtan, and Edward W. Tyrchniewicz, "Performance Evaluation of the Canadian Wheat Board" (Winnipeg, Canada: Canadian Wheat Board, Jan. 1996) covers CWB sales of Canadian hard red spring wheat.

<sup>4</sup>Unless otherwise noted, all Canadian dollars have been converted to constant 1997 U.S. dollars using a market exchange rate and the U.S. gross domestic product deflator.

<sup>5</sup>CWB sales of feed and malting barley are analyzed by Drs. Andrew Schmitz, Richard Gray, Troy Schmitz, and Gary Storey in "The CWB and Barley Marketing: Price Pooling and Single-Desk Selling" (Winnipeg, Canada: Canadian Wheat Board, Jan. 1997).

<sup>6</sup>Colin A. Carter and R.M.A. Loyns, "The Economics of Single Desk Selling of Western Canadian Grain" (Edmonton, Canada: Alberta Agriculture, Food and Rural Development, Mar. 1996).

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wheat farmers in Canada and the United States, as well as Canadian government officials, also believe that grain exports to the United States would be greater if the CWB ceased to exist.

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## CWB Pricing Flexibility

As the sole buyer of most Canadian wheat, the CWB has pricing flexibility and can deal in long-term contracts. The CWB has an assured supply of grain that it does not compete for and, according to a Canadian government official, acquires the grain from farmers at about 70-75 percent of the expected final return.<sup>7</sup> This provides the CWB with a large margin within which to set prices and absorb any risk from changes in market conditions.<sup>8</sup> The Canadian government confirms that, within its mandate to maximize returns to producers, the CWB has a certain latitude in pricing grain to customers. In contrast, private grain companies compete to acquire farmer-held stocks of grains and then compete to market it to buyers. Their profits and operations are funded from this margin between the two, and they encounter considerable risk from changes in market conditions.<sup>9</sup>

CWB officials note that the CWB engages in price discrimination to benefit from differing market conditions around the world. Certain customers may be willing to pay more for CWB grain than other customers, so the CWB could charge them a higher price. In turn, the CWB may be able to lower its price to certain importing countries without affecting its sales to premium customers.<sup>10</sup> We were not able to analyze the conditions under which this occurred, since we did not have access to CWB transactions, which the CWB considers commercially sensitive.

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<sup>7</sup>Testimony of Mike Gifford, Director General, International Trade Policy Directorate, Market and Industry Services Branch, Agriculture and Agri-Food Canada, before the Standing Committee of the Canadian Senate on Agriculture and Forestry (Dec. 4, 1997). According to Canadian government officials, producers will grow other crops if they are not satisfied with the performance of the CWB. Oilseed and specialty crop areas have expanded in recent years.

<sup>8</sup>Producers receive an initial payment based on grade and quality when they deliver grain to a primary elevator and a final payment at the end of the marketing year after marketing and CWB administrative costs are deducted. During the crop year, the CWB may increase the initial payment if forecasted revenues rise. The CWB may also make an interim payment to producers following the end of a crop year but prior to closing the accounts on the marketing year.

<sup>9</sup>In addition, with assured supply, the CWB is able to market some of its grain under long-term contracts. Canadian government officials report that the CWB markets very little grain under long-term agreements at this time.

<sup>10</sup>USDA has charged the CWB with engaging in noncommercial activities such as dumping wheat on world markets and undercutting exporting countries' prices. See "Non-Commercial CWB Pricing Activities: Some Examples of Unfair CWB Practices," Staff Paper prepared for the Canada-United States Joint Commission on Grains by the USDA Support Staff (Washington, D.C.: USDA, Mar. 29, 1995). This is reprinted in volume II of the Commission's 1995 Final Report.

CWB pricing flexibility into the U.S. market was restricted as part of the CFTA, which went into effect in 1989. According to the agreement, sales into the United States could not be for less than the acquisition price plus the cost of transportation and handling of the grain. The United States and Canada disagreed on what constituted the Canadian acquisition price. A CFTA dispute resolution panel determined that the acquisition price is the initial payment the CWB gives farmers when they deliver their grain (see ch. 4). The initial payment is set by the government of Canada in consultation with the CWB. However, changes in how the government establishes the initial payment since the CFTA went into effect may have increased CWB flexibility in pricing grain headed into the United States.

A USTR negotiator of the CFTA recalls that during the 1980s the initial payment was established close to 90 percent of the expected final payment to producers. During the early 1990s, the CWB initial payments were set at 80 percent while, according to an official of the government of Canada, the initial payment is now set at between 70 and 75 percent. We requested data on the expected final payment to producers from the government of Canada to confirm this trend, but the request was declined. According to a Canadian government official, the decisions on the amount of the initial payment are considered to be “Advice to Ministers” and thus confidential. A USTR official believes that the reduction in the initial payment gives Canada more latitude in lowering its prices to the U.S. market. This effectively lowers the pricing floor established by the CFTA. The government of Canada interprets these changes differently. According to government officials, while the events during the 1980s and early 1990s may well have influenced the subsequent judgments of those involved in making decisions concerning initial payment levels, to attribute any trend in government decision making in this area to the CFTA or the relationship to acquisition prices would be misleading.

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## Canadian Government Assistance to the CWB

The Canadian government provides important financial assistance to the CWB. The government has covered CWB wheat and barley pool deficits on seven occasions over the course of its 63 year history. The government of Canada guarantees certain export credit sales of the CWB and compensates the CWB in case of losses or defaults. As a crown corporation,<sup>11</sup> the CWB’s financing activities are guaranteed by the government. Thus the CWB is able to show net profits on its financing activities.

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<sup>11</sup>A crown corporation, or a semiautonomous government organization, is used to administer and manage public services in which enterprise and public accountability are combined.

**Direct Canadian  
Government Support of the  
CWB**

The Canadian government offers direct financial support to the CWB under certain conditions. The Canadian government guarantees CWB initial payments and adjustments to initial payments as paid to farmers. In any year that sales revenue is insufficient to cover the initial payments, including any adjustments to the initial payment, the government pays the shortfall. Since the first CWB deficit in 1969, the government has provided monies in 6 other years for deficits in the wheat and barley pools.<sup>12</sup> The total value of these transfers for losses in wheat and/or barley marketing operations is \$1.3 billion.<sup>13</sup> See table 2.1 for more details on these deficit payments.

**Table 2.1: Occurrences of CWB Wheat and Barley Price Pooling Deficits Covered by Government Assistance, 1943-97**

U.S. dollars in millions (1997 constant dollars)			
<b>Crop year</b>	<b>Wheat deficit</b>	<b>Barley deficit</b>	<b>Total deficit</b>
1968-69	\$142.9	\$35.3	<b>\$178.3</b>
1970-71	0	38.0	<b>38.0</b>
1971-72	0	12.9	<b>12.9</b>
1982-83	0	6.9	<b>6.9</b>
1985-86	23.1	172.0	<b>195.1</b>
1986-87	0	112.8	<b>112.8</b>
1990-91 <sup>a</sup>	749.0	1.0	<b>750.0</b>
<b>Total</b>	<b>\$915.0</b>	<b>\$378.9</b>	<b>\$1,293.9<sup>b</sup></b>

Note: The CWB maintains separate pool accounts for wheat, durum wheat, barley, and malting barley. However, in order to simplify the presentation, we have combined the two wheat accounts and the two barley accounts.

<sup>a</sup>No pooling deficits have occurred since 1990-91.

<sup>b</sup>Totals may not add due to rounding.

Source: Canada's Department of Foreign Affairs and International Trade.

**Indirect Canadian  
Government Support of the  
CWB**

In addition to direct government support in cases of operational deficits, the government provides indirect support through guarantees of CWB borrowings. These guarantees allow the CWB to borrow in commercial markets at favorable interest rates. In parliamentary testimony, a CWB

<sup>12</sup>The CWB experienced deficits that were covered by government payments in 12 of its 63 years when deficits in the oats pool are also considered. Oats are no longer controlled by the CWB and those payments are not included in our calculations.

<sup>13</sup>In October 1995, the Canada-United States Joint Commission on Grains reported that the pool deficits have accounted for 1.1 percent of the total sales of wheat, durum, feed barley, malting barley, and oats made by the CWB over the approximately 50 year period when initial payment guarantees have been in effect.



official estimated that in 1995, CWB borrowing costs were \$30 million lower than if the CWB had borrowed at the rate faced by a large multinational grain company and \$46 million lower when compared to the normal commercial business rate of borrowing.<sup>14</sup> The effect of this difference varies over time. In order to update the estimated interest savings, we recomputed the savings based on data provided by the CWB on the interest difference between rates the CWB posts to investors on its commercial paper and market rates of commercial paper from highly rated, nongovernment-guaranteed issuers. As of December 1997, the annual interest savings on CWB borrowing were between \$9.4 million and \$14 million, substantially lower than the 1995 value.

The CWB is in a position to profit from the interest rate differential between government borrowing costs and commercial rates on behalf of producers. In addition to enjoying reduced borrowing costs, the CWB can also earn interest on funds held following a grain sale but before making final payment to the producers. During the interim, the CWB can invest the funds at market rates and earn interest. The CWB does not distinguish in its public reporting between its earnings related to the indirect government support of below market rates of interest and its earnings from the reinvestment of sales revenues on behalf of producers. The latter earnings do not represent a benefit of the CWB since individual producers could also have invested the revenues at market rates if the CWB paid them at the time of sale. In 1997, the net interest from both of these sources was reported by the CWB to be about \$61 million, nearly double the CWB's \$34 million in administration costs.<sup>15</sup>

In addition to the contributions of the government to the CWB's operational borrowing, the government also provides guarantees for export credit sales. The government of Canada provides export credit guarantees for government buyers of CWB wheat through the Credit Grain Sales Program. As of March 1998, the CWB had outstanding loans to foreign countries of \$4.7 billion. At the end of the 1997 marketing year, the CWB accounts receivable from foreign customers was \$4.6 billion. Of those loans, only 3.6 percent were classified as current, with 83 percent rescheduled,

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<sup>14</sup>Testimony of Lorne Hehn, Chief Commissioner of the CWB, before the Standing Committee of the Canadian House of Commons on Agriculture and Agri-Food (Dec. 12, 1995).

<sup>15</sup>The CWB declined to provide us with any information on the composition or values of the components of "net interest" beyond what is available in the CWB's annual report, due to its confidentiality.

9.1 percent overdue, and 4.5 percent subject to a Paris Club rescheduling.<sup>16</sup>

In certain cases, the government of Canada negotiates debt relief agreements with nations as do other exporting countries under the Paris Club process. Where there has been a rescheduling, this occurred for reasons of national policy, including reasons related to humanitarian concerns. In cases where a country with outstanding CWB exposure under the Credit Grain Sales Program receives concessional (favorable) treatment, the government of Canada makes up the difference owed to the CWB by the debtor country. For the CWB, both the principal and the interest are guaranteed by the government. Over the last 6 years, the government has reimbursed the CWB \$918 million for lost principal and interest under Paris Club debt relief.

The Export Development Corporation, another Canadian crown corporation, provides export insurance and financing services for export sales; for example, providing insurance against the risk of nonpayment by a foreign bank in export transactions involving a letter of credit.<sup>17</sup> The Export Development Corporation does not release information by commodity for reasons of commercial confidentiality; thus, we are unable to report on what share of its business involves CWB exports. Public reporting of government export finance subsidies is limited to the aggregate costs of the negotiated debt relief that is published in Canada's Main Estimates. The structure of Canadian credit guarantees by commodity or by nation is not released by the government to the public or to GAO for reasons of commercial confidentiality.

The government's support of the CWB is supplemented by the fact that the CWB is not taxed on its activities. The CWB is exempt from tax on its income and capital because it is a crown corporation. The returns paid to the farmers are taxed as regular income.

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<sup>16</sup>The Paris Club is an informal group of creditor countries that meets, as needed, to negotiate debt rescheduling and relief efforts for public or publicly guaranteed loans. In addition to the 18 countries that regularly participate in the Paris Club, other countries are invited to the negotiations on an ad hoc basis if they hold a significant share of the debt being discussed.

<sup>17</sup>A letter of credit is a financial document issued by a bank at the request of the consignee guaranteeing payment to the shipper for cargo if certain terms and conditions are fulfilled.

## Canadian Government Assistance to the Wheat and Barley Producers

The Canadian government also provides other subsidies to the grain sector through income support policies, income and crop insurance, and provision of railroad hopper cars. While Canadian government support for wheat and barley is substantial, it has fallen significantly in the last several years.

Many nations, including Canada and the United States, support their agricultural producers through direct and indirect assistance and subsidies. The government of Canada provides an annual estimate of this support for wheat and barley.<sup>18</sup> The reported Canadian subsidies include costs associated with insurance programs<sup>19</sup> for farmers; one-time payments that compensate agricultural landowners for the removal of the long-standing subsidy of railroad shipments of western agricultural products; other federal government expenditures on research and development, marketing, and promotion; and subsidies provided by provincial governments. In 1996, the combined subsidies for wheat and barley amounted to \$922 million, or 19 percent of production valued at \$4.8 billion. (See table 2.2 for the breakout by category.) This reflects a substantial reduction from 1990, when the combined subsidies for wheat and barley amounted to \$3.2 billion, or 68 percent of production valued at \$4.7 billion.

**Table 2.2: Canadian Wheat and Barley Subsidies in 1996**

<b>Government sectoral subsidies</b>	<b>U.S. dollars in millions (1997 constant dollars)</b>
Insurance	\$162.9
Payments for end of rail subsidies	470.3
Other federal subsidies	117.0
Provincial government subsidies	172.0
<b>Total</b>	<b>\$922.2</b>

Source: OECD.

<sup>18</sup>Canada submits data on its agricultural policies to the Organization for Economic Cooperation and Development (OECD). These are included in the OECD's computation of the "producer subsidy equivalent" (PSE). The PSE is an indicator of the value of monetary transfers to agricultural production from consumers of agricultural products and from taxpayers resulting from a given set of agricultural policies in a given year.

<sup>19</sup>For example, the Canadian government established a program to stabilize farmers' net income under the Net Income Stabilization Act. The program allows farmers to make contributions to individual accounts, which are matched by the federal and provincial governments. Producer deposits earn a 3-percent interest bonus over and above the competitive rates. When income is low, the program triggers farmer withdrawals from their accounts.

Moreover, the payments to landowners for the end of Canada's subsidy for the transport of western grain ended with the 1996 payments. Thus, according to a Canadian official, for 1997 Canada projects that the reported subsidies will be about half of the 1996 rate and will be 10 percent of the farmgate value of production.

The subsidy data provided by Canada are, however, incomplete, as several government subsidies are not included.<sup>20</sup> These consist of the previously discussed lower interest loans of the CWB and government reimbursements for losses on credit sales, as well as government support of the Canadian International Grains Institute. In addition to these excluded CWB subsidies, Canadian government data also exclude the value of government-provided hopper railcars that are supplied to transport prairie grains.

The government of Canada acquired 13,120 hopper cars during the 1970s and early 1980s, with 12,780 now in service. According to a Transport Canada official, these cars are an indirect subsidy to western grain producers, because producers are not charged for their services. This subsidy applies to all prairie grains, including the CWB grains. In addition to the federal government-owned hopper cars, the government leases another 1,982 hopper cars, and two provincial governments contribute another 1,973 cars. In total, government-provided cars constitute about two-thirds of the 25,000 grain cars in Canada.<sup>21</sup> The government of Canada does not have an estimate of the subsidy value of the government-owned and -leased cars that it provides to the western grain industry. We estimate that the government grain car fleet, if procured through private sector leases, would cost between \$61 million and \$68 million per year. This subsidy benefits all western grain producers, including barley and wheat producers. The proportion of this subsidy accruing to wheat and barley producers is about 64 percent, so the subsidy to wheat and barley producers is between \$39 million and \$44 million.<sup>22</sup>

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<sup>20</sup>The OECD data submissions do not include indirect subsidies related to the issuance of credit.

<sup>21</sup>Hopper cars purchased and owned by the CWB are not included in the subsidy calculations.

<sup>22</sup>The annual rental value of the railcars was based on recent, long-term (2 to 5 years) lease rates available in the North American railcar rental market. Three leasing companies were contacted for estimates of the rental value of grain hopper cars of the same size, age, condition, and terms of maintenance as those in the CWB fleet. Railcar maintenance is not provided by the government. The proportion of the estimated subsidy attributed to wheat and barley is based on Agriculture Canada apportionment of other government subsidies among different western grains.

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## **Canadian Grain System Is Undergoing Changes**

Changes to the Canadian grain system are ongoing, and several events have the potential to alter the U.S.-Canadian grain trading environment. The Canadian government has recently enacted legislation that alters the operational structure of the CWB. Also, recent changes in government subsidies for the transportation system and proposed further deregulation may have an impact on grain flows to the United States. Meanwhile, increasing foreign investment and consolidation of the grain distribution and handling system in Canada, as well as privatization of grain import functions by many of the CWB's customers, are changing the CWB's operating environment.

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## **Legislative Change to the CWB's Mandate**

A law to amend the Canadian Wheat Board Act of 1935 was passed by the Canadian parliament on June 11, 1998. This law, known as Bill C-4,<sup>23</sup> provides for a number of changes to the CWB in the areas of corporate governance and operational flexibility (see table 2.3), although it is too early to speculate about the legislation's effects on Canadian farmers and the Canadian grain system as a whole.<sup>24</sup> Bill C-4 was first put before the Canadian House of Commons on September 25, 1997, after more than 2 years of consultation with farmers and the Canadian grain industry. The bill builds on the principle of increasing direct producer input into the priorities and operations of the CWB while retaining the reporting mechanisms that allow the Canadian government to provide the CWB with financial guarantees and monopoly exporter status.

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<sup>23</sup>Now known as "Statutes of Canada 1998, Chapter 17."

<sup>24</sup>See appendix III for a summary of studies on the effect of the CWB on Canadian farmers and comments from some farmers' groups on this effect.

**Chapter 2  
CWB Operations and Government Support  
for the Grain Sector**

**Table 2.3: Comparison Between the 1935 Canadian Wheat Board Act and the 1998 C-4 Bill**

<b>Provision</b>	<b>Canadian Wheat Board Act</b>	<b>Bill C-4</b>
Status	CWB qualifies as an agent of Her Majesty and a crown corporation	CWB ceases to be an agent of Her Majesty or a crown corporation
Governance structure and operations	Consists of three to five commissioners appointed by the government	Consists of a part-time, 15-member board of directors (10 producer-elected representatives and 5 government appointees, including a full-time President; the board also designates a chairperson)  The board may authorize cash purchasing, expedited adjustment payments, early pool cash-outs, negotiable producer certificates, and use of modern risk management tools
Monopoly	Holds monopoly on wheat and barley marketed for export and domestic human consumption	No change
Contingency fund	None	Establishes a producer-funded contingency fund to provide financial support for certain operations
Initial payments	Adjustments to initial payments guaranteed by the government	Eliminates government guarantee on adjustments to initial payments; the contingency fund may be used to guarantee adjustments
Borrowing	Repayment with interest of loans and advances guaranteed by the government	No change
Pool period	Is defined as a crop year	Is defined as any period(s) not exceeding 1 year in total

Note: The inclusion and exclusion clauses that would allow the board to add or remove crops from the CWB's jurisdiction did not pass. Under Bill C-4, no changes to the CWB's marketing jurisdiction can be made without first gaining approval from producers.

Source: GAO analysis of Canadian legislation.

A key provision in the new law replaces the CWB's commissioner structure of management with a President and board of directors. Ten representatives on the 15-member board will be directly elected by producers; 5 board members, including the President, will be government appointees. Since the directors will not be elected until later this year, the new management structure of the CWB is unlikely to be in place in time to affect this year's sales policy. Under Bill C-4, the board has numerous administrative powers, including the authority to designate its own chairperson; determine the salaries of the directors, chairperson, and President; and review the performance of the President. Furthermore, all directors will have full access to information about CWB operations, including audited financial statements; they will also be able to review the

efficiency of the CWB with respect to grain sale prices, price premiums achieved, and operating costs.

Bill C-4 also grants the CWB the ability to buy grain and reimburse producers for grain on more flexible terms. The CWB can now offer new payment options for farmers and enhance producers' cash flows.<sup>25</sup> For instance, the CWB will be able to close pool accounts before January 1 and thereby make final payments to producers before the beginning of the calendar year. These actions will be at the discretion of the new board.

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## Changes in Canadian Transportation System

Canadian wheat and barley producers have historically received transportation subsidies that reduced shipping costs. The direct subsidies paid to the railroads under the 1983 Western Grain Transportation Act peaked at \$925 million in 1986-87 and declined to \$445 million in 1994-95, their last year. The subsidy, since the CFTA in 1989, did not apply to shipments to the United States from Canadian west coast ports, but to shipments traveling overseas and to the United States through Thunder Bay, Ontario. The cash subsidy ended in 1995 with its elimination due to internal budget constraints and Canada's need to meet its obligations under the WTO agreements. With the removal of the subsidy in 1995, freight rates were capped until at least the year 2000.<sup>26</sup> Owners of prairie land received a \$1.2-billion payment paid out in 1995-96 to compensate them for the removal of the subsidy.<sup>27</sup>

The CWB expects the end of the grain transportation subsidies to make the United States a more attractive export market.<sup>28</sup> According to a CWB official, the shipping costs of moving grain to Canadian coastal ports more

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<sup>25</sup>Currently, the CWB is a participant in the U.S. futures exchanges for grain and currency. See appendix II for a discussion of this participation.

<sup>26</sup>The rates can be adjusted for inflation and a partial reduction in cost due to branch line abandonment.

<sup>27</sup>The \$1.2 billion payment was treated as capital rather than income for tax purposes, so the effective value of the subsidy was about \$1.7 billion, according to a Canadian official. An additional one-time adjustment assistance fund of \$224 million was established to partially offset other changes in the transportation system.

<sup>28</sup>This view is shared by academic researchers. See Demcey Johnson and William W. Wilson, "Canadian Rail Subsidies and Continental Barley Flows: A Spatial Analysis," *Logistics and Transportation Review* (Mar. 1995). The Western Grain Transportation Act elimination may also affect livestock production and trade; the ITC calculated that the maximum effect of a drop in feed grain prices in the Canadian prairies due to the elimination of the Western Grain Transportation Act would result in a 1 to 2 percent increase in beef supply and an equivalent 3 percent increase in Canadian beef exports to the United States. See *Cattle and Beef: Impact of NAFTA and URA on U.S. Trade*, ITC publication 3048 (July 1997).

than doubled when the subsidy ended, while costs to ship to the United States were left unchanged. The observed impact of the removal of the subsidies has been obscured by concurrent factors that have influenced export volumes and destinations. The CWB official in charge of U.S. marketing explained that at the same time the end of the rail subsidies made the United States a more attractive market, the decline of U.S. usage of the USDA's Export Enhancement Program was working in an offsetting fashion, making the United States a less attractive market.<sup>29</sup> According to a Canadian transportation official, it is too soon after the changes in the rail subsidy to see the effect, but Transport Canada anticipates the changes will lead to greater shipments to the United States or increased Canadian grain processing.

During the same period in which the government rail subsidies ended, the CWB changed the way it computes the freight charges that it deducted from the payments it made to individual producers when they delivered their grain. This change in the pooling points for computing freight rate changes raised the shipping costs of grain for producers in the eastern prairies, making the United States a more attractive market. The impact of the subsidy elimination and of the CWB changes in freight charges is estimated to have a significant impact on the Canadian exports to the United States. The Producer Payment Panel, a Canadian government-appointed group representing industry, government, and academics, used an economic model of Canadian agriculture to estimate the impact. The panel estimated that the two changes would increase export shipments of wheat to the United States by 46 percent and barley by 44 percent.<sup>30</sup> This assumed that commodity flows are allowed to respond to market signals and do not face U.S. border restrictions or diversion by the CWB.

The government of Canada gave notice in 1997 that by 2002, the fleet of government-owned rail hopper cars would be privatized. The privatization of these hoppers is expected to change the attractiveness of shipment to the U.S. market relative to shipments to Canadian ports in a way reminiscent of the impact of ending the direct transportation subsidies.

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<sup>29</sup>The Export Enhancement Program raised U.S. domestic prices for grain above world prices, which made the United States an attractive destination for Canadian grain. For discussions of this relationship, see Kenneth Hanson, Stephen Vogel, and Sherman Robinson, "Sectoral and Economywide Impacts of Eliminating the Export Enhancement Program" (Washington D.C.: USDA, Economic Research Service, Nov. 1995); and Richard Gray and Bruce Gardner, "The Impact of Canadian and U.S. Farm Policies on Grain Production and Trade," in Canada-United States Joint Commission on Grains, Final Report, Vol. II (Winnipeg, Canada, and Washington D.C.: Oct. 1995).

<sup>30</sup>"Delivering the Western Grain Transportation Act Benefit to Producers: Technical Appendix," Producer Payment Panel (government of Canada: June 1994).



Currently, railcars are provided to the industry without cost<sup>31</sup> for rail movements east, north, or west, but charges are levied if the cars are used for shipments to the United States. According to a Canadian rail manager, the application to rail shipments of full costs for the railcars will make it relatively cheaper to move grain to the United States than to port positions once privatization takes place.

Recently, the Canadian government began a review of the grain handling and transportation system, with completion scheduled by the end of 1998. The grain review secretariat describes its scope as comprehensive, covering all handling and transportation actions between the farm bin and the loading of vessels for export. The objectives of the review are to ensure that the Canadian system meets expectations of customers; maximizes system efficiency, competitiveness, and capacity utilization; provides cost-effectiveness; promotes necessary investment; and establishes roles, responsibilities, and accountability for each system participant. A Montana State University study reviewed changes underway in the Canadian grain handling and transportation system and concluded that any reduction in freight costs due to system improvements is unlikely to fully offset the large increase in shipping costs due to the end of the direct subsidies and change in pooling costs.<sup>32</sup> This suggests that changes in the transportation system will provide increased economic incentives for Canada to ship to the U.S. market.<sup>33</sup>

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## Other Changes to the CWB's Operating Environment

U.S. companies have been investing more heavily in the Canadian grain system, both in new infrastructure and the commercial operations of the system, in recent years. This shift in ownership reflects U.S. business' interest in the Canadian grain system. For example, officials at ConAgra, Inc., told us that their company has invested in terminal operations in western Canada; and Archer-Daniels-Midland purchased a 43-percent share of a Canadian grain company, United Grain Growers. This change means the CWB interacts on more levels with U.S.-based companies within Canada.

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<sup>31</sup>The government does not pay for maintenance of the railcar fleet.

<sup>32</sup>Linda M. Young, "Changing Canadian Grain Policies: Implications for Montana's Grain Industry," Northern Plains and Rockies Center for the Study of Western Hemisphere Trade, Policy Issues Paper No. 1 (Bozeman, Montana: Montana State University, undated).

<sup>33</sup>Recent rail mergers are improving the links of the Canadian rail system to ports on the U.S. Gulf Coast. This may facilitate exports of Canadian grain through U.S. ports.

Historically, the CWB completed a lot of business on a state-to-state basis, especially with nonmarket economies, such as China; this trade involved working with other STEs. The decline of import-oriented STEs in other countries has changed the way the CWB does business with these countries, however. While some countries, such as China, still conduct business with the CWB through an STE, the majority of the CWB's sales involves private companies. According to CWB officials, sales to other STEs now only comprise 10 to 15 percent of their entire business; at one time, this figure was as high as 35 percent. A Canadian farmers' organization noted that private entities tend to prefer trading with other private entities as opposed to STEs; so the CWB increasingly uses its AES to facilitate transactions with these private companies.

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## Conclusions

As an STE, the CWB receives direct and indirect government support, and it has some flexibility in setting its export prices. Moreover, wheat and barley producers also enjoy other government subsidies. The CWB faces structural changes due to recently completed legislative reforms, and other changes in the Canadian grain marketing system are underway; however, it is unclear how these changes will affect the way that the CWB conducts its business.

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## Agency and Country Comments

We received technical comments from USDA, USTR, ITC, the government of Canada, and the CWB on a draft of this chapter. We incorporated their suggestions where appropriate.

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# CWB Export Prices Have Limited Transparency

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The United States collects extensive information on imports of Canadian grain, including the value of each shipment entering the United States, but because this information lacks important details on such grain aspects as quality, it reveals little about the CWB's prices. The CWB discloses only limited information about its prices for the wheat and barley that it sells to its trading partners. U.S. officials believe that the lack of transparency in the CWB's prices may provide it with more flexibility than is found among private grain traders. The CWB states that it reveals as much about its prices as its competitors in the private sector. U.S. government officials and U.S. farmers believe that nontransparent CWB prices make it difficult to assess whether the CWB's practices are consistent with its international obligations under trade agreements. Officials from USDA and Customs—agencies that gather import data—are discussing the possibility of collecting more details on Canadian grain prices; however, they acknowledge that much of the information necessary to determine pricing practices would be difficult for Customs to readily collect at the border. The United States is also working through the WTO to increase the amount of information STEs, such as the CWB, must report on pricing and other activities. Thus far, the United States' and other countries' efforts to expand STE reporting requirements on pricing have had limited success. For example, while the WTO has recently introduced a new format for STE reporting that requires more information on STE pricing practices, that format does not go as far as the United States would like in increasing the pricing transparency of STEs such as the CWB.

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## CWB Provides Limited Information on Its Export Prices

The United States and other grain trading nations, and members of the U.S. grain industry, are concerned that without greater transparency, the CWB may be able to price its grain exports unfairly. The CWB makes public some aspects of its pricing methods, such as its use of prices on U.S. grain markets as the basis for sales into the United States. However, the CWB declines to reveal other important information, such as the actual contract prices for its sales to foreign grain buyers. The nontransparency makes it difficult for farmers to review CWB operations or to identify contract prices for individual sales. These contract prices could be useful in determining whether the CWB is engaging in pricing practices for which a trade remedy would be available, either through dispute settlement procedures under international agreements or through U.S. trade law. The CWB has recently made its contract records available to economists performing reviews of the CWB's marketing performance under contracts with the CWB.

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The CWB and the government of Canada defend the lack of full price transparency by noting that the CWB behaves like other private sector grain companies that also do not reveal their sales prices. The CWB believes that it should not be held to higher pricing disclosure standards than its competitors in the private sector. The CWB reports that revealing transactional data violates its confidentiality agreement with its customers.

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## CWB Pricing

Some aspects of CWB pricing are better known than others. The CWB allocates sales between Canada, the United States, the Caribbean and Latin America, Europe, the Middle East, the former Soviet Union, and the Asia-Pacific area based on expected returns, using different pricing strategies in different markets. According to CWB officials, prices for sales into the Canadian and U.S. markets are based on the trading values of grain on the MGE, adjusted for commercial freight. During hours when the MGE is closed, the price is based on the prior day's closing price. The CWB sends its daily mill closing price to all mill customers, and it is published in several publications. According to the CWB, the objective of this strategy is to assure that Canadian domestic millers have grain prices that are consistent with what the wheat price would be in an open market. A Canadian grain company confirmed that sales to Canadian consumers are based on the MGE prices. The CWB's domestic sales practices have created substantial domestic price transparency, although quantity information is only provided on an aggregate annual basis.

The CWB established a program that provides daily price quotes based on the MGE's futures and cash markets for Canadian farmers wishing to market directly to the United States. These prices are posted daily for CWB producers. Without access to CWB transactional data, we were not able to confirm that sales into the United States were at the published prices. Several U.S. companies we spoke with reported that the CWB appeared to use prices based on the MGE.

CWB sales to other markets are less transparent, with the CWB reporting that sales reflect conditions of supply and demand in the various export markets. The CWB publishes daily export prices for its grains that are available at various port locations along the St. Lawrence Seaway and in-store at Vancouver, British Columbia. According to CWB officials, these "card" prices represent the prices paid by the top-paying customers for top grain and represent 10-12 percent of CWB sales volume. Of the 1.7 million-1.9 million tons sold at "card" prices, about 1.4 million tons

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were sold to Japan. In other cases where grain purchases are done through public tender, similar transparency is achieved. Remaining CWB sales are nontransparent.

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## Views of Interested Parties on CWB Transparency

There are mixed views on CWB price transparency. Some U.S. government officials and U.S. farmers believe that nontransparent CWB prices make it difficult to assess whether the CWB's practices are consistent with its international obligations under trade agreements. Representatives of the Western Canadian Wheat Growers Association reported that the lack of transparency hampers their ability to evaluate the performance of the CWB as their grain marketer. Moreover, critics of the CWB believe that it is erroneous to compare a government-sponsored monopoly with a private company. In parliamentary hearings, some farmers testified that they do not trust the CWB, which they believe lacks transparency and accountability, and advocate that the Auditor General of Canada be the auditor of the CWB.<sup>1</sup>

Officials at USDA emphasize that U.S. export prices are more readily available than those of Canada and other exporters. As an example, they cite an analysis of reported sales and export prices published by the International Grains Council that they prepared for the Canada-United States Joint Commission on Grains. They found that for a study period during the early 1990s, there were over 1,000 entries for the United States, 220 for the European Union, 71 for Canada, 44 for Argentina, and 11 for Australia on reported sales of grain and products.

Several grain industry experts believe that differences in price transparency between the U.S. and Canadian systems may give the CWB strategic advantages when compared to private grain traders. Studies prepared for the Canada-United States Joint Commission on Grains highlighted differences in price transparency between the grain systems of the two countries. According to one analysis, private export and domestic grain pricing in the United States is done in a transparent manner, with government-subsidized export sales also open to public view, while in Canada the prices of export sales by the CWB are closely held, though the price of grain in the domestic Canadian market is transparent.<sup>2</sup> This

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<sup>1</sup>Report on Bill C-4, Standing Committee of the Canadian Senate on Agriculture and Forestry (May 14, 1998). Recent Canadian legislation permits the Auditor General to conduct an audit of the accounts and financial transactions of the CWB.

<sup>2</sup>Martin Abel, "A Comparison of the U.S. and Canadian Marketing Systems for Wheat and Barley: Transparency, Differential Pricing, and Monopolistic Behavior," Canada-United States Joint Commission on Grains, Final Report, Vol. II (Winnipeg, Canada, and Washington, D.C.: Oct. 1995).

difference in transparency between the U.S. and Canadian pricing practices places U.S. firms at a strategic disadvantage when competing with the CWB. Another Commission analysis concluded that the single-desk seller, with more knowledge of pricing behavior by U.S. firms, can win more bids and can expect to earn a higher profit.<sup>3</sup>

In comparing the CWB with private firms, the CWB is further benefited by its monopoly sourcing requirement. Because it does not compete in procuring grain, it has the ability to undertake longer contracts and has a larger margin between the price at which it acquires its product and the price it asks for its grain. This advantage in sourcing gives the CWB considerable flexibility and latitude in pricing in comparison with private firms. The CWB, however, disputes this and believes that it may have a competitive disadvantage in grain procurement since private traders know the CWB acquisition cost and can use this information as a competitive advantage over the CWB.

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## Efforts to Increase CWB Pricing Transparency

U.S. concerns that the CWB has an unfair pricing advantage have led to efforts to increase the transparency of CWB pricing practices. USDA and Customs officials are discussing the possibility of collecting more detailed price information on Canadian wheat imports. The data that Customs currently collects on Canadian grain, as well as on all other imports, lack the transactional detail necessary to be useful in determining whether the CWB engages in pricing practices for which a trade remedy may be available. For example, this information could be important to the United States in determining whether the CWB's exports to the United States are priced below the acquisition price, and thus, not consistent with Canada's obligations under CFTA and NAFTA. However, given the limited availability of detailed contract information, USDA officials acknowledge that expanded data collection at the Canadian border would be of only limited benefit in revealing CWB pricing practices, because much of the information necessary to determine these practices cannot be readily collected by Customs. The United States is also working through the WTO to increase the amount of pricing information the CWB and other STEs are required to submit in notifications to the WTO on their activities. So far, the United States has had limited success in achieving this objective. The WTO has changed its STE reporting format to include more information on pricing, but the United States does not believe that the changes are

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<sup>3</sup>William W. Wilson, Demcey Johnson, and Bruce Dahl, "Pricing to Value: U.S. Analysis and Issues," Canada-United States Joint Commission on Grains, Final Report, Vol. II (Winnipeg, Canada, and Washington, D.C.: Oct. 1995).

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sufficient to determine if the CWB and other STES are engaging in improper pricing.

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**Grain Import Data Are**  
**Insufficient to Determine**  
**CWB Pricing Practices**

In general, the information on the value of imported merchandise collected by Customs on the entry forms submitted by importers is used to calculate duties<sup>4</sup> as well as to compile U.S. trade statistics (see app. IV for a detailed discussion of processes for collecting and compiling import data). However, most imports from Canada, including wheat and barley, are duty free under NAFTA. Therefore, the value information collected by Customs on Canadian wheat and barley shipments is used only for statistical purposes. Census aggregates this value information to show the total value of wheat and barley entering the United States from Canada. Further aggregations allow Census to determine the U.S. trade balance with Canada as well as the overall U.S. trade balance.

While the value information collected by Customs is used for calculating duties and compiling trade data, there are several reasons why this information lacks the detail that would be useful to determine whether the CWB is engaging in pricing practices for which a remedy may be available, either through use of dispute settlement procedures or through U.S. law. The entered value data currently collected by Customs do not provide specific detail on all of the elements affecting the price of a shipment, for example, protein content and payment terms. According to the Department of Commerce, additional information regarding imports may be useful in assessing whether foreign exporters are engaging in unfair pricing practices. However, Commerce officials state that the lack of additional information should not prevent a domestic industry from seeking relief under U.S. trade laws since petitions filed under those laws, in most cases, need not provide specific price information. Commerce states that while pricing information is an important element of a dumping petition, such information has been compiled from a variety of alternative sources by the petitioning industry. Moreover, Customs' aggregate data have often been used by domestic industries when filing an antidumping petition.

In addition, the value information collected by Customs is of only limited use in determining the competitiveness of the price of Canadian grain in the U.S. market. In order to make an accurate determination of the price of Canadian grain, detailed information about the nature of the grain is

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<sup>4</sup>It is important to note that the duty rate for some merchandise, such as wheat from countries not covered by trade preference programs such as NAFTA, is based on quantity rather than value; for example, the duty rate for durum wheat is \$0.71 per kilogram.

required. For example, wheat's protein and moisture content as well as the amount of foreign material it contains are important pricing determinants in the wheat market. The price of durum wheat, for instance, can vary significantly depending on its protein level. In the 1996-97 marketing year, the CWB paid Canadian farmers \$198 for a metric ton of a particular grade of durum wheat at a 14-percent protein level as compared to \$188 for a metric ton of the same grade of wheat at a 12.5-percent protein level. Customs' import entry form does not require this level of detail. The form only requires that wheat be classified according to the Harmonized Tariff Schedule (HTS), which provides separate classifications for varieties of wheat such as durum and red spring. The HTS also divides some wheat varieties, such as red spring, into broad grade categories.

Customs' entry information, therefore, can only be used to estimate the border price per metric ton of varieties of Canadian wheat, such as durum. Without the detailed quality information, Canadian wheat import prices are not comparable to U.S. market prices.

Customs' entry information also does not reflect important information about the contract between the exporter and importer, which is necessary for determining the competitiveness of the price of Canadian grain entering the U.S. market. For example, the value of a shipment of durum wheat entering the United States from Canada in October could be based on a contract that was signed in February. The contract price is usually based on the current price of durum on the Minneapolis grain market. The market price of durum wheat can vary considerably from month to month. Therefore, a direct comparison of Canadian durum import prices and market prices on the date of importation is often inappropriate. Moreover, Customs' entry form does not require information on payment terms, such as credit.

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### **Customs and USDA Discussing Expanding Amount of Data Collected on Canadian Wheat Shipments**

Customs and USDA recently began discussions on increasing the amount of information Customs collects on wheat shipments. USDA has asked Customs to consider the feasibility of collecting more detail on wheat protein levels on Customs' entry forms. According to Customs, some invoices for wheat presented to Customs at entry contain quality and protein information. Customs can also obtain such information by sending a "request for information" (form CF28) to the importer, although the information is not part of Customs' automated reporting system, and, thus, not publicly available.



USDA wants the HTS classifications for wheat to be expanded to take into account variations in protein levels.<sup>5</sup> Customs told us that the HTS classifies durum and some other types of wheat merely by the name of the wheat, with no consideration of various quality levels being imported. Currently, the HTS only allows for reporting varying grades for red spring wheat. USDA hopes that expanding the HTS classification for wheat would allow it to better estimate the price of Canadian wheat entering the U.S. market. However, USDA acknowledges that even if such an expansion of the HTS occurs, estimates of Canadian wheat prices entering the United States would still be limited. USDA notes that these estimates would still lack important wheat pricing information such as moisture and foreign substance content, as well as contract details such as the prevailing market price at the time of the contract. In addition, USDA does not believe it is feasible for Customs to collect such detailed information on the automated import entry form. Customs officials expect opposition to such changes from some importers and Customs brokers who would consider the additional information requirements to be burdensome.

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**New STE Notification  
Questionnaire May Not  
Sufficiently Increase CWB  
Pricing Transparency**

The issue of the potential trade-distorting practices and lack of transparency of STEs, such as the CWB, is being discussed multilaterally through the WTO.<sup>6</sup> The WTO will soon implement a new questionnaire for collecting information on STE activities, including their pricing practices. In negotiations on the format of the new questionnaire, the United States argued strongly for adding questions that would help bring greater transparency to the pricing activities of STEs and therefore be of use in determining whether STEs such as the CWB are engaging in improper pricing.<sup>7</sup> U.S. officials believe that the new questionnaire does not go far enough in increasing the pricing transparency of the CWB and other STEs. The United States plans to continue pursuing the issue of STE transparency in the WTO.

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<sup>5</sup>To expand the HTS to take into account wheat protein levels, USDA must petition the ITC. Administrative changes to the HTS are carried out through an interagency committee, the Committee for the Statistical Annotation of the Tariff Schedule, composed of the ITC, Census, and Customs.

<sup>6</sup>Regional forums, including ongoing negotiations under the Free Trade Area of the Americas and the OECD, are discussing STE activities, but their endeavors are mostly in support of WTO efforts. Discussions in these forums are focused on various issues that can relate to STE activities, including anticompetitive business conduct; price pooling, export subsidies, and other export practices; and export credit guarantees.

<sup>7</sup>While U.S. concerns regarding the CWB relate to the pricing activities of export STEs, the United States also sought to obtain greater pricing transparency for import STEs through a revised questionnaire.

The WTO agreement provided for the creation of a Working Party on STES tasked with ensuring and, in the long run, improving the transparency of STE activities. The agreement also established a formal STE definition.<sup>8</sup> The Working Party has allowed the WTO to better track the activities of STES but has had mixed success in increasing their transparency. One of the tasks of the Working Party has been to revise the WTO's questionnaire on STES.

After over 2 years of negotiation, in April 1998 the Working Party reached agreement on a revised questionnaire that will now be used as the basis for WTO members' STE notifications (for more information on WTO members' recent STE notifications, see app. V.) While the new questionnaire requests more descriptive information about the functioning of WTO members' STES and additional quantitative information on STE import and export activities, it may not increase the transparency of the CWB.

Obtaining detailed information on STE pricing activities has been a major U.S. objective for revising the questionnaire because U.S. officials think that such data may assist the United States in determining whether certain STES use their special status to operate unfairly. To this end, the United States forwarded several proposals to the Working Party. One proposal requested that members be asked to provide transaction-level pricing data on an ad hoc basis; that is, at the request of another member. Another proposal asked that members provide, on a quarterly basis, information on average prices for STE imports and exports, broken down by country of origin or destination. However, while supported by some Working Party members, the United States faced significant opposition from other Working Party members, including Canada, to these proposals. Opposing WTO members were concerned about providing commercially confidential information and about the possible administrative burden this would impose on countries. Ultimately the Working Party could not agree that this more detailed pricing data should be provided; instead, the new questionnaire asks for information on STES' average annual prices for individual commodities.

U.S. government and WTO officials believe that the new questionnaire represents an improvement over the 1960 questionnaire. According to USDA and USTR officials, the new version provides greater "organizational clarity" for WTO members to make their notifications. Specifically, the new questionnaire sets forth detailed guidelines and a structure for presenting

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<sup>8</sup>These provisions were included in the Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade 1994, which was annexed to the WTO agreement.

descriptive and statistical information on members' STE practices. In addition, the questionnaire now asks members to submit information on their STEs' domestic pricing practices, something that was not previously required. The new questionnaire may be particularly useful in obtaining more information on the STE practices of prospective WTO members with market transition economies. In these countries, such as China or Russia, public information on their STEs is not always readily available. According to a WTO Secretariat official, the new questionnaire asks for information on STE practices in a much clearer way; the more precise language in the new questionnaire will "discourage one-line answers" and may result in less variation in the level of detail members provide on their STEs. Other Working Party members we spoke with echoed this view.

According to USDA officials, whether the new questionnaire is able to bring greater transparency specifically to the CWB's activities will largely depend on how Canada responds to the questionnaire. USDA officials told us that if Canada acts in the spirit of the new questionnaire, Canada could use its new notification to provide new information on the CWB's activities. However, one USDA official also told us that the new questionnaire may provide virtually no new information about CWB pricing. This official told us that the CWB has provided much more information and transparency on domestic prices in recent years; Canada now publishes prices daily in various publications, and these data are essentially the same kind of price data that are available in the United States for U.S. grain prices. Therefore, according to this official, the new questionnaire does not necessarily provide for new information on Canada's domestic grain prices. In addition, this official could not identify any sections of the new questionnaire that would definitely constitute new information that is not in the public domain with respect to the CWB. Canadian officials did not respond to our request to identify areas where the new questionnaire will require them to provide additional information on the CWB.

In addition to the questionnaire, the Working Party has been developing an illustrative list of state trading activities. This list will be used in conjunction with the new questionnaire to help WTO members identify what entities in their trading regimes should be reported in the notification questionnaire.

Working Party members have agreed to continue work defining possible further information needed to enhance the transparency of STEs. According to one WTO member we spoke with, it may be appropriate for the Working Party to review the adequacy of the new questionnaire and

the list after a few years, because countries may initially “report the bare minimum” in the first trial run of the questionnaire. However, the working party has only met twice since the questionnaire was approved and, according to the WTO Secretariat,<sup>9</sup> the Working Party has not begun discussing any future work program beyond continuing the review of notifications and finalizing the illustrative list. USDA and USTR officials told us they intend to pursue obtaining greater transparency of STES through the Working Party, but they have not yet outlined their strategy for doing so. These officials stated that the United States is beginning to “think beyond transparency” about the need to develop disciplines on STES in agriculture; they anticipate that STES will be a significant focus in the WTO negotiations on agriculture set to begin at the end of 1999 or shortly thereafter.

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## Conclusions

While the United States collects extensive Canadian grain import data, it has been unable to shed light on the CWB’s grain export prices. Although the existing grain import data are insufficient to determine CWB export prices, expanding the amount of data collected on Canadian wheat import shipments would be difficult and may not provide the desired pricing information. The United States has worked closely with the STE Working Party at the WTO but has had limited success in increasing STE pricing transparency in that forum, as well.

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## Agency and Country Comments

In comments on our draft report, USDA emphasized that, in its view, the CWB, as the sole buyer of Canadian wheat for domestic human consumption and for export, is able to engage in trade-distorting actions. USDA also said that we did not sufficiently emphasize the CWB’s pricing flexibility that comes from its practice of making initial payments to its farmers of only 70-75 percent of the expected value of their grain. We believe that point was sufficiently established in the draft. However, we did not attempt to quantify the impact of CWB activities on grain trade.

The CWB did not agree with GAO’s assertion that the CWB has flexibility in pricing compared to private firms because it does not compete to procure grain. Rather, the CWB believes that it has a competitive disadvantage in obtaining grain because private grain traders know the CWB’s acquisition cost. GAO included the CWB’s statement in its discussion of this issue.

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<sup>9</sup>The WTO Secretariat is responsible for servicing WTO delegate bodies, including individual working parties within WTO.

# Trade Remedy Enforcement Affecting STEs

The CWB and other STEs are allowable under the WTO Agreements and NAFTA. They operate throughout the world in various forms and for various purposes. Trade remedies have not been fashioned specifically to deal with imports from STEs. However, products imported into the United States that are manufactured, produced, or marketed by STEs are subject to the same laws regulating imports as any other product, including laws that restrict imports or provide remedies to U.S. industry competing with unfairly traded goods. We asked the U.S. government entities charged with enforcing international trade agreements and U.S. trade laws, including USTR, Commerce, and the ITC, to search their records from 1980 to the present to determine how trade laws have been applied to STEs. We found a total of 15 trade remedy actions involving an STE, the most recent taken in 1995. Some of the trade remedy actions resulted in increased duties, while others prompted the country in which the import STE was operating to remove import restrictions that limited U.S. exports.

## Trade Remedies Under U.S. Law and International Trade Agreements

Trade remedies under U.S. law allow government and private parties to seek redress for disruptive, trade-distorting, or unfair trade practices.<sup>1</sup> The United States has various trade remedy laws at its disposal to deal with trade issues, dumping,<sup>2</sup> actionable subsidies,<sup>3</sup> or increased imports causing domestic injury. Dispute settlement provisions under international trade agreements, including the WTO<sup>4</sup> and NAFTA, provide a means of seeking relief from measures or actions taken by other governments, which could include actions by STEs. The following is a brief summary of the relevant U.S. laws (for a more detailed description of each trade remedy, see app. VI).

<sup>1</sup>For a catalog of available trade sanctions or other remedies that may be used to ensure that other countries' STEs operate fairly, see the Related GAO Products list at the end of this report.

<sup>2</sup>"Dumping" is generally defined as the sale of an exported product at a price lower than that charged for a like product in the "home" market of the exporters or at a price below cost.

<sup>3</sup>As used in this report, an "actionable" subsidy is a subsidy for which U.S. law provides a remedy in the form of an increased or "countervailing" duty. Not all benefits that governments confer on their products are actionable or countervailable subsidies. Rather, in general, subsidies must be limited to a specific group of firms or industries or to a firm's export activities in order to be covered under the countervailing duty law. Subsidies provided by a government or public body may confer benefits on the recipient that provide an unfair advantage in international trade, such as allowing a producer to sell its products at a lower price than that of the competition.

<sup>4</sup>With the establishment of the WTO in 1995, the GATT dispute settlement mechanism was strengthened.

- Title VII of the Tariff Act of 1930, as amended,<sup>5</sup> provides the most common means of dealing with antidumping issues. Under title VII, private parties can petition the Department of Commerce and the ITC on behalf of a U.S. industry to determine whether a class or kind of merchandise is being sold in the United States at “dumped” prices and whether a U.S. industry is materially injured or threatened with material injury by reason of such dumped imports. If the agencies find that both dumping and injury or threat of injury exist, Commerce then calculates the amount of duties imposed on each importer to offset the price difference between the U.S. price and the normal value of the imported merchandise.
- Title VII of the Tariff Act of 1930, as amended,<sup>6</sup> also provides for the imposition of countervailing (or equalizing) duties whenever a government or public entity provides certain subsidies for the manufacture, production, or export of articles subsequently imported into the United States and a U.S. industry is materially injured or threatened with material injury by reason of such subsidized imports. As in the case of antidumping law, petitions are filed with Commerce and the ITC, and countervailing duties are imposed if Commerce finds a subsidy and the ITC finds that a U.S. industry is materially injured or threatened with material injury by reason of imports of such subsidized imports.
- Under section 332 of the Tariff Act of 1930, as amended,<sup>7</sup> the ITC has broad authority to investigate matters pertaining to U.S. customs laws, foreign competition with domestic industry, and international trade relations. Most ITC investigations under section 332 are conducted at the request of USTR or the House Committee on Ways and Means or the Senate Committee on Finance.
- Section 22 of the Agricultural Adjustment Act of 1933, as amended,<sup>8</sup> authorizes the President to impose fees or quotas on imported products that undermine any USDA domestic commodity support or stabilization program. Since 1995, such actions may be applied only against imports from non-WTO countries.
- Sections 201 to 204 of the Trade Act of 1974, as amended,<sup>9</sup> authorize the ITC to conduct investigations concerning whether an article is being imported into the United States in such increased quantities as to be a substantial cause of serious injury, or the threat thereof, to the domestic

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<sup>5</sup>19 U.S.C. 1673 *et seq.*

<sup>6</sup>19 U.S.C. 1671 *et seq.*

<sup>7</sup>19 U.S.C. 1332.

<sup>8</sup>7 U.S.C. 624.

<sup>9</sup>19 U.S.C. 2251-54.

industry producing a like or directly competitive article. If the ITC makes an affirmative determination, it recommends a remedy to the President, who makes the final decision as to whether to impose a remedy and, if so, in what form and amount. Remedies generally take the form of increased tariffs and import quotas.

- Sections 301-309 of the Trade Act of 1974, as amended,<sup>10</sup> commonly referred to as “Section 301,” give the President broad discretion to enforce U.S. trade rights granted by trade agreements and to attempt to eliminate acts, policies, or practices of a foreign government that violate a trade agreement or are unjustifiable, discriminatory, or unreasonable and burdensome or restrict U.S. commerce.

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## **CWB and Other STE Involvement in Trade Remedy Actions**

The CWB and other STEs have been involved in investigations under U.S. trade law, and their activities have been the subject of formal disputes under international trade agreements. As shown in table 4.1, the CWB has been involved in three different trade remedy actions since 1980. The ITC conducted two investigations involving U.S. imports of Canadian grain, and USTR reported one CFTA dispute settlement action about CWB export pricing. As for other STEs, the Department of Commerce found that five STEs had been involved in antidumping or countervailing duty investigations or reviews. The ITC reported no actions involving STEs under sections 201 to 204. USTR identified three Section 301 investigations involving STEs,<sup>11</sup> which led to three GATT dispute settlement procedures. USTR found one additional dispute settlement procedure involving an STE, not preceded by a Section 301 investigation. USTR found no WTO or NAFTA disputes involving STEs. All of the GATT dispute settlement cases involved restrictive practices of import STEs, whose actions impeded U.S. exporters’ access to foreign markets.

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<sup>10</sup>19 U.S.C. 2411 et seq.

<sup>11</sup>USTR identified four additional section 301 cases and two GATT dispute cases that we did not include in our analysis. Given the products and countries involved, these cases could have involved an STE, but either no STE was identified by name or the STE mentioned in the case was not one notified to GATT. In addition, one of the four countries was not a GATT member.

**Table 4.1: Number of Trade Remedy Actions Involving STEs Since 1980**

Trade remedy type	Number of actions	U.S. agency overseeing	Type of STE involved
U.S. antidumping law	1	Commerce/ ITC	Export
U.S. countervailing duty law	4	Commerce/ ITC	Export
Section 332	1 <sup>a</sup>	ITC	Export
Section 22	1 <sup>a</sup>	ITC/USDA	Export
Sections 201 to 204	0	ITC	
Section 301	3	USTR	Import
Dispute settlement - GATT	4	USTR	Import
Dispute settlement - CFTA	1 <sup>a</sup>	USTR	Export

Note: There were no WTO or NAFTA dispute settlement cases involving STEs.

<sup>a</sup>The STE involved was the CWB.

Sources: USTR, Department of Commerce, and the ITC.

## Use of Trade Remedies Involving the CWB

The CWB was involved in three trade remedy actions, including two ITC investigations and one CFTA formal dispute. The ITC investigations both involved Canadian wheat imports into the United States—one looking at the competitiveness of the two markets, and the other examining the effect of those imports on U.S. farm sector support programs. The CFTA dispute involved the interpretation of provisions in the agreement on export prices of agricultural goods.

## ITC Investigations of U.S. Grain Imports

The increase in imports of Canadian grain to the United States prompted two ITC investigations. In 1990, the ITC began a section 332 investigation on the conditions of competition between the U.S. and Canadian durum wheat industries. The ITC found that it was not apparent that prices paid by U.S. processors during 1986-89 for Canadian durum wheat were significantly different than prices paid for similar quality U.S. durum.

At the President’s request, the ITC launched an investigation in January 1994 under section 22 of the Agricultural Adjustment Act to determine whether wheat, wheat flour, and semolina were being imported into the United States under such conditions and such quantities as to “render or tend to render ineffective, or materially interfere with, the price support, payment and production adjustment program conducted by. . .” USDA for wheat. Canada was the principal source of wheat imports into the



United States, Canadian production and U.S. production being the two most important sources of supply.

The ITC completed its section 22 review in July 1994. The six commissioners rendered a split decision: three commissioners found that wheat was not being imported under such conditions and in such quantities as to materially interfere with USDA wheat programs; three Commissioners found that wheat was being imported under such conditions and in such quantities as to materially interfere with USDA wheat programs. The commissioners had differing recommendations. Previous negotiations and the ITC investigation resulted in a 1-year MOU between the two countries (see app. I).

**CFTA Dispute Panel Ruling on  
Canadian Durum Wheat  
Exports**

In May 1992, the United States requested that a binational dispute panel under CFTA consider pricing policies for Canadian durum wheat exports. The United States believed that Canada was acting contrary to the CFTA requirement that neither country export agricultural goods to the other country at a price below the acquisition price. Among other things, the panel was asked to determine whether the acquisition price included solely the initial payments made to farmers by the CWB—the Canadian position—or all payments made to farmers with respect to a durum wheat crop (initial plus interim and final payments, if any)—the U.S. position. The United States was concerned that the Canadians' more narrow definition would allow Canada to undercut U.S. grain prices and still meet the terms of CFTA.

The panel's final report<sup>12</sup> supported Canada's definition of the term but stated that it was not possible or desirable for the panel to determine whether the CWB had violated the CFTA provision. However, the panel recommended that a bilateral working group should be established for the general purpose of overseeing an audit of the CWB. An initial audit was conducted, which found that out of the 105 contracts or durum wheat sales to the United States CWB signed and completed from January 1, 1989, to July 31, 1992, 3 contracts were not in compliance with the CFTA prohibition against selling below acquisition price. By volume, the 3 contracts represented 13,985 metric tons in durum wheat sales, or 1.34 percent of the 1.04 million metric tons in total sales for the 105 contracts.

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<sup>12</sup>In the Matter of the Interpretation of and Canada's Compliance With Article 701.3 With Respect to Durum Wheat Sales, Final Report, Before the Panel Convened Pursuant to Chapter 18 of the Canada-United States Free Trade Agreement, CDA-92-1807-01 (Washington, DC: NAFTA Secretariat, Feb. 8, 1993).

**Use of Trade Remedies Under U.S. Law**

STEs have been involved in trade remedy actions under U.S. law. These actions included products exported to the United States through STEs, and actions addressing STEs' alleged unfair trade practices restricting U.S. exporters' access to foreign markets.

**Antidumping and Countervailing Duty Investigations**

Commerce reported that it had conducted one antidumping investigation and four countervailing duty investigations involving STEs (see table 4.2). The 1990-91 antidumping investigation was prompted by a petition from the Ad Hoc Committee for Fair Trade of the California Kiwifruit Commission. Commerce found that fresh kiwifruit was being dumped at less than fair value by a New Zealand STE, the New Zealand Kiwifruit Marketing Board, through which all New Zealand kiwifruit for export must pass, except for such exports to Australia. The ITC then found that U.S. industry was injured/threatened by the imports. As a result, the United States imposed a dumping duty of 98.6 percent on those imports, effective November 1991. In two out of the four countervailing duty investigations, Commerce concluded that the STEs in the case, the New Zealand Meat Producers Board in one case and the Turkish Grain Board in the other case, were providing actionable subsidies. Commerce subsequently required Customs to levy a countervailing duty on imports from these two STEs.<sup>13</sup> In the two remaining countervailing duty investigations, the petitioners terminated one, and the ITC found no injury on the other, and therefore no countervailing duties were levied.

**Table 4.2: U.S. Antidumping and Countervailing Duty Investigations Involving STEs Notified to the WTO, 1980 to the Present**

<b>STE</b>	<b>Case type (initiated)</b>	<b>Commerce and ITC determinations</b>	<b>Outcome</b>
New Zealand Kiwifruit Marketing Board (NZKMB)	AD (1991)	Commerce: fresh kiwifruit from New Zealand is being, or is likely to be, sold in the United States at less than fair value  ITC: made affirmative determination on injury	Customs initially charged NZKMB a weighted-average dumping margin of 98.6 percent <sup>a</sup>

(continued)

<sup>13</sup>The ITC found injury in the countervailing duty case on pasta from Turkey. However, the ITC was not required to find injury in the second countervailing duty case—lamb meat from New Zealand. This is because, at the time, New Zealand was not a “country under the Agreement” with respect to the GATT countervailing duty code and thus was not entitled to an injury finding.

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**Trade Remedy Enforcement Affecting STEs**

<b>STE</b>	<b>Case type (initiated)</b>	<b>Commerce and ITC determinations</b>	<b>Outcome</b>
(Israeli) Production and Marketing Board of Ornamental Plants (PMBOP); and Flower Board	CVD (1980)	In a 1980 countervailing duty investigation, Commerce found no government support of PMBOP  In a 1986 countervailing duty investigation, Commerce found the Flower Board <sup>b</sup> had received funds from the Ministry of Agriculture and that this financial support was countervailable  ITC: made negative determination on injury	No CVD order issued due to Commerce finding no improper subsidy (1980)  No CVD order issued due to ITC negative determination on injury (1986)
Australian Meat and Live-stock Corporation (AMLC)	CVD (1981)	Commerce: preliminarily determined that funds from AMLC to Australian producers, processors, and exporters of lamb meat qualify as subsidies  ITC: no ruling due to termination of case	Investigation was terminated at petitioners' request <sup>c</sup>
New Zealand Meat Producers Board	CVD (1985)	Commerce: certain benefits that constitute subsidies within the meaning of countervailing duty law are being provided to producers The net subsidy amount is NZ\$0.3602/lb  ITC: not required to rule	Customs charged a CVD duty on subject products entering the United States, equal to the net subsidy
Turkish Soil Product Office (Turkish Grain Board)	CVD (1995)	Commerce: one company, Filiz, received free wheat from the Turkish Grain Board in exchange for exporting a certain amount of its product. This was found to be a countervailable subsidy  ITC: made affirmative determination on injury	Customs initially charged a CVD duty of 3.87 percent ad valorem from Filiz <sup>d</sup>

Legend

AD= Antidumping  
CVD= Countervailing duty

<sup>a</sup> The "dumping margin" is the fair market value minus the U.S. price divided by the U.S. price. The fair market value can have one of three meanings: (1) the price of a like product in the home market, (2) the cost of production in the home market, or (3) the price of a like product in a surrogate market. In this case, the fair market value is the price in a surrogate market—Japan. Once Commerce issues an antidumping order, Customs requires that the importer post a cash deposit in an amount equal to the previously found margin of dumping. The amount of these deposits is periodically adjusted as a result of administrative reviews of antidumping orders conducted by Commerce. Any extra deposits are refunded.

<sup>b</sup>Commerce stated that the Flower Board was an entity established by the Ornamental Plants Production and Marketing Board Law of 1976 and that the record of its investigation did not indicate what relationship, if any, existed between the Flower Board and the PMBOP.

<sup>c</sup>By the withdrawal of the petition and termination of the investigation, this determination is without legal force or effect.

<sup>d</sup>Percent ad valorem means percent of value of the subject merchandise entering the United States.

Source: U.S. Department of Commerce, International Trade Administration.

A Commerce official reiterated that Commerce does not make a determination regarding STE status and that STEs are not accorded special treatment or recognition under U.S. antidumping and countervailing duty law. However, Commerce said that to the extent that an STE sells goods into the United States that are dumped or unfairly subsidized, U.S. antidumping and countervailing duty laws could provide a potential remedy. The official cautioned that it was difficult to determine conclusively which STEs had been the subject of antidumping or countervailing duty investigations or reviews, due to the length and complexity of the cases, the possible involvement of an STE in a case in an indirect or insubstantial way, and potential difficulties in translating foreign STE names.

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## Section 301 Cases Leading to a GATT Dispute Settlement

### Canada - Restrictions on Beer Imports

USTR initiated a Section 301 investigation in June 1990 related to alleged discriminatory distribution and pricing practices of the provincial liquor boards of Ontario, including an STE, the Ontario Liquor Control Board. The USTR investigation was prompted by petitions filed by two U.S. brewing companies. These practices included listing requirements, discriminatory mark-ups, and restrictions upon distribution. After negotiations between Canada and the United States failed to resolve the issue, USTR requested that a GATT dispute settlement panel examine Canadian practices. In October 1991, the GATT panel reported that many of the Canadian practices were inconsistent with GATT prohibitions on quantitative restrictions and recommended they be removed. Because Canada did not discontinue the practices, in December of that year USTR determined that, consistent with the GATT panel finding, duties should be increased on beer and malt beverages from Canada. After resuming negotiations with Canada and again failing to reach agreement, the United States did increase duties by 50 percent ad valorem.<sup>14</sup> Canada responded in kind by raising duties on beer imports from the two U.S. brewing companies that had originally submitted the Section 301 petitions. USTR initiated new negotiations with Canada in 1993, and the two countries ultimately signed an MOU in August of 1993. The MOU, among other things, increased U.S. brewers' access to Canadian stores and reduced the Ontario Liquor Board's fees for handling U.S. beer and removed the duties imposed earlier.

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<sup>14</sup>Percent ad valorem means percent of value of the subject merchandise entering the United States.

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**Thailand - Restrictions on  
Cigarette Imports**

The U.S. Cigarette Export Association filed a Section 301 petition in 1989 alleging that the Royal Thai Government and its state-controlled import monopoly and STE, the Thailand Tobacco Monopoly, engaged in taxing and licensing practices that effectively prohibited the importation and sale of cigarettes into Thailand. USTR initiated a Section 301 investigation and, on February 5, 1990, requested that a GATT panel be formed to consider the issue. The GATT panel issued a report in September 1990 concluding that Thai cigarette import restrictions violated GATT prohibitions on quantitative restrictions. The panel recommended that Thailand bring its practices into conformity with its obligations under GATT. In October 1990, the Thai government said that it would remove its import restrictions and, in response, USTR terminated the Section 301 investigation.

**Korea - Restrictions on Beef  
Imports**

The United States challenged quantitative import restrictions imposed by Korea's STE, the Livestock Products Marketing Organization, arguing that they violated GATT prohibitions against quantitative restrictions. The United States also argued that the very existence of an import monopoly controlled by domestic producers constituted a prohibited import restriction. The GATT panel concluded that the existence of a producer-controlled monopoly was not a GATT violation but found that the Livestock Products Marketing Organization import restrictions did violate GATT prohibitions against import restrictions. In 1989, a GATT panel report was adopted recommending that the two countries consult and that Korea conform to GATT. Pursuant to the panel recommendation, the United States and Korea signed a bilateral agreement. Two subsequent agreements, one in 1993 and one under the Uruguay Round, were entered into force to achieve free market conditions for the importation and distribution of U.S. beef in Korea. Each year, both countries meet quarterly to ensure full implementation of the beef agreement provisions.

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**Use of GATT Dispute  
Settlement Provisions  
Under International  
Agreements**

**Japan - Restrictions on Certain  
Agricultural Products**

In 1988, a GATT dispute settlement panel's report was adopted on a GATT dispute case. The United States alleged that a variety of quantitative restrictions maintained by Japan on 11 agricultural categories were inconsistent with Japan's GATT obligations. Some of these restrictions were imposed by an STE - the Livestock Industry Promotion Corporation. The

Livestock Industry Promotion Corporation is an import monopoly that regulates imports of beef and certain dairy products, including condensed skim milk, whole milk powder, skimmed milk powder, whey powder, and buttermilk powder, into Japan. Japan acknowledged that the Livestock Industry Promotion Corporation maintained import restrictions but argued that the GATT prohibition on quantitative restrictions did not apply to state-trading monopolies. The dispute settlement panel concluded that GATT provisions, including those prohibiting quantitative restrictions, apply to all import restrictions, whether or not they are instituted through quotas or by STES. The panel further ruled that while GATT permits measures such as those limiting private imports necessary to enforce the exclusive trading rights of import monopolies, it does not permit quantitative restrictions otherwise inconsistent with GATT obligations.

On August 2, 1988, the United States and Japan signed an agreement to resolve the GATT dispute. Japan partially lifted its quotas and provided increased access as compensation. Japan eliminated quotas on 7 of the 11 product categories by April 1, 1990.

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## Conclusions

While relatively few trade remedy actions have been taken involving STES—15 since 1980—some of these actions have resulted in increased duties on imports found to be injurious to U.S. industry. In addition, the United States prevailed in all of the GATT dispute settlement cases involving STES. In every case, the GATT dispute panel found that the import STE's restrictions that limited U.S. exports had violated GATT rules. A wide range of trade remedies can be applied to STES, such as those seeking redress for dumping, actionable subsidies, and sufficiently injurious imports, and those seeking relief, through dispute settlement, from actions taken by other governments as well as by STES.

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## Agency Comments

We received technical comments from USDA, USTR, the U.S. Department of Commerce, the U.S. Department of Justice, and the ITC on a draft of this chapter. We incorporated their suggestions, where appropriate.

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# Chronology of U.S.-Canadian Grain Trade

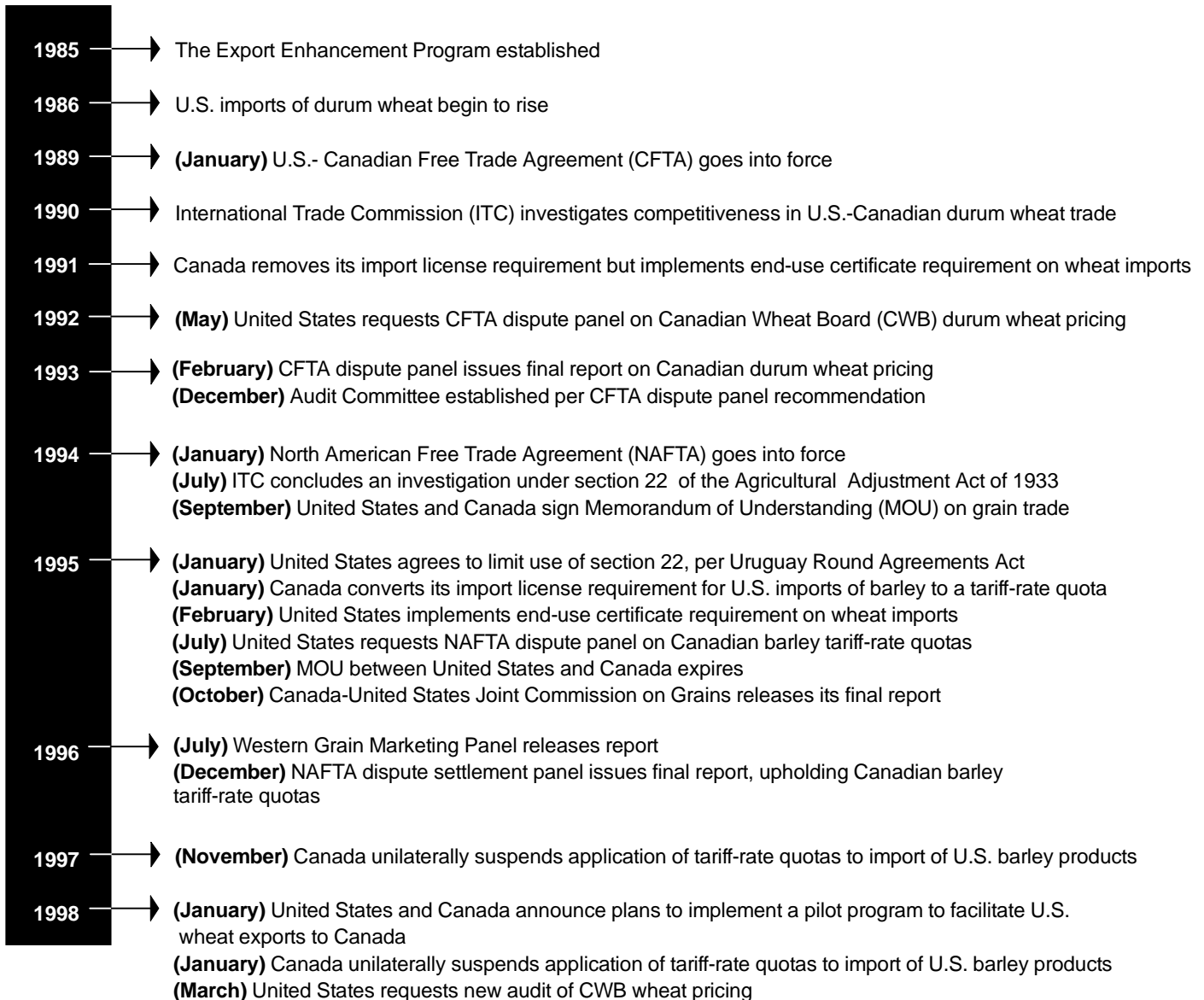
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The United States and Canada have addressed many issues related to grain trade between the two countries, through bilateral and multilateral trade agreements, including dispute resolution procedures, domestic trade laws, and other venues. The following is a chronology of the major events affecting U.S.-Canadian grain trade over the past dozen years. Figure I.1 is a time line of those major events.



**Appendix I**  
**Chronology of U.S.-Canadian Grain Trade**

**Figure I.1: Time Line of U.S.-Canadian Grain Trade Related Events**



Source: GAO.

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## 1985—The Export Enhancement Program

By 1985, the prices of many U.S. commodities, including wheat, had become significantly higher than those of foreign commodities, particularly from the European Community (EC), and were no longer competitive in the international marketplace. In May 1985, the U.S. Secretary of Agriculture announced the establishment of the targeted Export Enhancement Program (EEP), providing subsidies in kind to U.S. exporters to enable them to lower prices of their commodities to be competitive with subsidized foreign agricultural exports. Although EEP did not specifically target U.S. exports to Canada, Canadians contended that EEP sales artificially raised the supply of wheat on world markets, thereby causing lower world prices. They also said that EEP displaced Canadian exports.

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## 1986—U.S. Imports of Canadian Wheat Rise

In 1986, U.S. imports of Canadian wheat began to rise from previously very low levels. American farmers blamed these higher imports on the grain selling practices of the CWB and on Canadian transportation subsidies. Canadian agricultural officials attributed the rise to U.S. commodity programs, including U.S. Department of Agriculture (USDA) supply management programs and EEP.

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## 1989—U.S.-Canada Free Trade Agreement

The U.S.-Canada Free Trade Agreement, implemented on January 1, 1989, addressed the pricing of agricultural products, including wheat, Canadian transportation subsidies, market access, and the imposition of import restrictions. To allay U.S. concerns that the CWB might be selling its wheat to the United States at below Canadian farmers' cost of production, CFTA stated that neither country could sell agricultural goods to the other at a price "below the acquisition price of the goods plus any storage, handling or other costs incurred by it with respect to those goods." However, this provision did not ultimately resolve U.S. concerns on the matter, primarily because CFTA did not define "acquisition price." The United States believed that the CWB was continuing to offer wheat export prices below the cost of acquisition. The United States eventually requested a dispute resolution panel under CFTA in May 1992. The subsequent 1993 panel decision recommended an audit of CWB pricing of durum wheat sales to the United States. The panel ruled in favor of the Canadian interpretation of acquisition price. An audit was concluded, and its findings were reported in December 1992 (for a discussion of the CFTA dispute, see ch. 4).

In its Statement of Administrative Action accompanying the CFTA implementing legislation, the United States called for consultations with

Canada directed toward establishing a method to determine the price at which the CWB was selling agricultural goods to the United States. The Statement of Administrative Action said that the United States would review agricultural commodities sales for export to the United States by the Canadian government and public entities, including necessary price, quantity, and quality information, to ensure compliance with CFTA. To assist in this review, the U.S. Customs Service was to provide information in its possession as necessary (for a discussion of U.S. data collection efforts, see ch. 3).

Regarding transportation subsidies, CFTA eliminated those established under the 1984 Western Grain Transportation Act for agricultural goods originating in Canada and shipped via west coast ports for consumption in the United States. CFTA did not remove the so-called “Canadian Crow’s Nest” subsidies at eastern Canadian ports, such as Thunder Bay, Ontario. A U.S. Department of Agriculture official at the time stated that this subsidy was not removed because it was generally available and not conditioned upon exports.

As for market access, CFTA called for a staged elimination of all U.S. and Canadian tariffs, with a phase-out for most grains, and duty-free status by January 1, 1998. Canada agreed to eliminate any import permit requirements when the level of government support for any of the grains—wheat, oats, or barley—in the United States became equal to or less than the level of government support for that grain in Canada. However, Canada could require that the grain be accompanied by an end-use certificate completed by the importer, declaring that it is to be imported for consumption in Canada.<sup>1</sup>

Finally, CFTA restricted both countries’ ability to impose import restrictions for grain products, such as under section 22 of the U.S. Agricultural Adjustment Act of 1933. CFTA provided that each country could reintroduce import restrictions or import fees on grains only if “imports increase significantly as a result of a substantial change in either Party’s support programs for that grain (includes wheat, oats, barley, rye, corn, triticale and sorghum).” The Uruguay Round of the General Agreement on Tariffs and Trade (GATT) further restricted U.S. use of section 22 in 1995 (see later discussion in this app.).

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<sup>1</sup>Canada removed its import license requirement in 1991, under the terms of CFTA—when U.S. government support programs for wheat declined below the Canadian support program levels. To date, however, Canada has retained its end-use certificate requirement for wheat. The United States implemented its own end-use certificate requirement in February 1995.

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**1990—International  
Trade Commission  
Section 332  
Investigation**

In 1990, the ITC conducted a section 332 investigation on the competitiveness between the U.S. and Canadian durum wheat businesses. The ITC found that it was not apparent that prices paid by U.S. processors for Canadian durum were significantly different than prices paid for U.S. durum (see ch. 4).

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**1994—North  
American Free Trade  
Agreement**

The North American Free Trade Agreement, effective on January 1, 1994, retained the previously negotiated CFTA market access provisions affecting Canada and the United States, while adding new bilateral commitments on agriculture between the two countries and Mexico. NAFTA provisions applicable to trade among all three countries included dispute settlement provisions based on those contained in CFTA.

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**1994—U.S.-Canadian  
Memorandum of  
Understanding**

Following the July 1994 ITC section 22 decision on wheat, wheat flour, and semolina imports (see ch. 4), the United States and Canada signed an MOU in September 1994. The United States stated that it would apply a new schedule of tariffs on the importation of wheat, for a 12-month period. The two countries also agreed to establish a joint commission on grains to further examine their mutual grain problems and to set a 12-month hold on all countermeasures under either NAFTA or GATT.

The MOU set an overall limit on Canadian wheat exports to the United States of 1.5 million metric tons, with separate limits on durum wheat and all other wheat, excluding eastern soft wheat. Up to 300,000 metric tons of durum wheat could enter the United States with a preferential tariff, with an additional 150,000 metric tons allowed into the United States at a higher tariff level. Imports of other wheat would be limited to 1.05 million metric tons.

Upon the expiration of the MOU in September 1995, the United States ended import restrictions and continued monitoring Canadian grain exports, stating that it would apply its trade remedy laws should Canadian wheat imports cause market disruption.

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## 1995—United States Agrees to Limit Use of Section 22, Per Uruguay Round Agreements

In January 1995, WTO members agreed, as part of the Uruguay Round Agreement on Agriculture, to convert quotas, such as those maintained by the United States under section 22 of the Agricultural Adjustment Act, to tariff-rate equivalents such as tariff-rate quotas.<sup>2</sup> These tariff equivalents would initially offer the same level of protection as quotas but would be reduced over time. In addition, the Agreement on Agriculture prohibited WTO members from imposing quantitative restrictions on products whose non-tariff barriers had to be converted to tariffs. The U.S. implementing legislation, the Uruguay Round Agreements Act, amended section 22 to prohibit the use of section 22 for products of WTO members.

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## 1995—Canada’s Imposition of Duties on Barley Prompts Dispute

In January 1995, Canada increased duties on imports of certain agricultural goods, including barley. Canada converted its quotas and import license requirements to tariff-rate quotas as part of its implementation of the WTO agreements. In 1995, the United States requested a dispute settlement panel under NAFTA claiming that these new duties violated NAFTA.

In December 1996, the NAFTA dispute panel issued its final report, concluding that Canadian tariffs of up to 350 percent on such goods qualified under an exception to NAFTA’s general prohibition against raising or imposing import tariffs on other member countries’ products.

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## 1995—Canada-United States Joint Commission on Grains

The Canada-United States Joint Commission on Grains released its final report in October 1995. Comprised of 10 nongovernment U.S. and Canadian officials with equal representation, it was formed to assist the two governments in reaching long-term solutions to existing problems in the grains sector. The report addressed policy coordination, cross-border trade, grain grading and regulatory issues, infrastructure, and domestic and export programs and institutions. The report noted that “the use of discretionary pricing by governments, directly through their programs or entities, had led to trade distortions.” The report recommended that both countries “eliminate the excessive discretionary pricing practices of their institutions; and . . . modify their domestic agricultural policies to remove trade distorting effects . . .” To do so, the report recommended that both countries consult regularly and create a bilateral producer/industry-based consultative committee for cross-border issues.

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<sup>2</sup>A tariff-rate quota is the application of a lower tariff rate for a specified quantity of imported goods. Imports above this specified quantity face a higher tariff rate.

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## **1996—Western Grain Marketing Panel**

In 1995, the Canadian Minister of Agriculture and Agri-Food appointed the Western Grain Marketing Panel to lead a comprehensive examination of western Canadian grain marketing issues. The panel released its report in July 1996 and concluded that (1) a growing number of farmers were asking for more options and flexibility in marketing grains and (2) common concerns about the CWB by farmers were the lack of accountability to farmers for its performance and the inflexibility of its operating policies. The panel proposed amending the 1935 Canadian Wheat Board Act to allow changes in CWB governance and to increase the flexibility of its operations and the services it provides to farmers (for a discussion of CWB operations, see ch. 2).

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## **1998—Plan for Pilot Program to Facilitate Wheat Exports**

In January 1998, the United States and Canada announced plans to implement a pilot program to facilitate U.S. wheat exports to Canada that would enable the United States to ship its grain directly to Canadian grain elevators.<sup>3</sup> The United States is negotiating with Canada over Canada's current requirement that U.S. grain be accompanied by a phytosanitary certificate—an assurance that the grain is disease-free.<sup>4</sup> The United States is also concerned about how the cost of the pilot program will be applied to imports.

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## **1998—United States Requests New Audit of CWB Wheat Pricing**

In March 1998, the United States requested a new audit of the CWB's grain pricing related to the acquisition price. Canada agreed to the new audit but disagreed on its terms. Canada wants to maintain the audit terms both countries agreed to after the 1993 CFTA dispute settlement panel decision. According to a USTR official, the United States wants to (1) deviate from the panel decision by applying for a broader definition of "acquisition price"; (2) expand the audit to cover not only durum but also spring wheat and barley; and (3) include third country pricing, that is, Canadian grain exports to countries other than the United States.

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<sup>3</sup>Currently U.S. wheat can only enter Canadian elevators on a case-by-case basis requiring approval from the Canadian Grain Commission.

<sup>4</sup>Sanitary and phytosanitary measures are those taken to protect human, animal, or plant life or health. The Agreement on the Application of Sanitary and Phytosanitary Measures in the Uruguay Round of GATT contains disciplines in their use. NAFTA contains similar disciplines.

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# CWB Usage of the U.S. Futures Markets and Commodity Exchanges

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The CWB is a participant in the U.S. futures exchanges for grain and for currency. It enters into wheat futures and options contracts to price a portion of anticipated sales. It also enters into foreign exchange forward and option contracts in order to manage the foreign exchange risk of a portion of anticipated sales. The CWB reported that it conducts its operations in order to reduce risk. Under certain conditions, the CWB can face restrictions in its participation in futures markets at the Chicago Board of Trade (CBOT) and the Kansas City Board of Trade (KCBOT) that prevent Canadian grain from being delivered against a futures contract. Both exchanges allow the entity that takes physical delivery of wheat against a futures contract to specify that the wheat be of U.S. origin. According to officials at both exchanges, this option helps ensure that wheat exported under a U.S. government export program is of U.S. origin.

Officials at the U.S. Commodity Futures Trading Commission (CFTC), the Minneapolis Grain Exchange (MGE), the CBOT, and the KCBOT confirmed that there are no specific restrictions placed on state trading enterprises such as the CWB. Rather, these entities must face the same market rules that all other traders face. As with all traders, those who want to take an unusually large position in the cash or futures markets must file an application with the relevant exchange and the CFTC (if applicable). In addition, those traders must file periodic reports with the exchanges and the CFTC (if applicable) detailing their cash positions.

Some markets allow U.S.-origin requirements for wheat, which officials at those markets told us were implemented in order to ensure that delivered wheat that was benefiting from any U.S. food aid, export promotion, or credit guarantee programs was of U.S. origin only, as required by law. Since the importance of U.S. export promotion programs has diminished in recent years, some traders have relaxed their U.S.-origin requirements. For example, officials at the CBOT told us that Canadian wheat had been delivered against futures contracts at their exchange.

We were not able to ascertain the level of involvement of the CWB in U.S. commodity and futures trading due to the confidentiality accorded trading activity. At the MGE, for example, trading in the cash market takes place on a trading floor, and no records are kept by the exchanges recording specific information about the identity of traders. Although the CFTC does monitor the activities of traders in the futures market, confidentiality restrictions contained in the Commodity Exchange Act<sup>1</sup> prohibit it from revealing such data to the public.

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<sup>1</sup>7 U.S.C. 1.

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# Effect of the CWB on the Canadian Farmer

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The costs and benefits of the CWB's operations to Canadian farmers are subject to considerable dispute among academics and farmers. Two CWB-contracted economic studies suggest the single-desk selling status of the CWB gives it market power in the world wheat and barley trade and increases farmer revenue through price discrimination. Further, the studies conclude that the CWB marketing system does not result in a more costly grain system for the farmers. In contrast, a study financed by the provincial government of Alberta concludes that the CWB lacks market power and finds that the Canadian grain system is more costly than the comparable U.S. system.

Canadian farmers are divided in their views of the CWB. Some believe that the CWB provides farmers with countervailing power relative to multinational grain companies. Other farmers believe that the CWB reduces their freedom and limits their incomes. Some believe that the CWB is withholding exports to the United States and thus reducing the potential returns to Canadian wheat and barley producers. A recent livestock study provides some evidence in support of this view.

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## CWB Price Discrimination and Producer Revenue

The CWB has contracted with academic authors for studies that investigate whether the CWB delivers higher returns to wheat and barley producers than would be the case in a multiple-seller environment.<sup>1</sup> Two studies were completed, one in 1996 on CWB wheat operations and one in 1997 on CWB barley operations. The CWB provided its authors with unique access to each CWB contract over an extensive period of time.<sup>2</sup> This enabled the authors to compare CWB sales of Canadian western spring wheat and western Canadian feed and malting barley to customers in Canada, the United States, and other nations. Additionally, Alberta Agriculture sponsored an assessment of the CWB.<sup>3</sup>

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<sup>1</sup>Daryl F. Kraft, W. Hartley Furtan, and Edward W. Tyrczniewicz, "Performance Evaluation of the Canadian Wheat Board" (Winnipeg, Canada: Canadian Wheat Board, Jan. 1996) covers CWB sales of Canadian hard red spring wheat. CWB sales of feed and malting barley are analyzed by Drs. Andrew Schmitz, Richard Gray, Troy Schmitz, and Gary Storey in "The CWB and Barley Marketing: Price Pooling and Single-Desk Selling" (Winnipeg, Canada: Canadian Wheat Board, Jan. 1997). The CWB has contracted for, but not yet received, a study of its durum wheat market operations.

<sup>2</sup>The CWB declined to grant us access to these same contract records. This included a GAO request restricted to a 5 percent sample of contracts. CWB officials also reported that they would not make their records available to non-CWB-affiliated scholars.

<sup>3</sup>Colin A. Carter and R.M.A. Loyns, "The Economics of Single Desk Selling of Western Canadian Grain" (Edmonton, Canada: Alberta Agriculture, Food and Rural Development, Mar. 1996).



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**CWB Wheat Study**

The CWB-sponsored wheat study compared the prices of individual CWB wheat contracts with a price purported to correspond to a multiseller competitive price. This was accomplished by matching the export price of a Canadian wheat sale of a specific grade, on a specific day, from a specific Canadian port with the competitive price of a similar wheat from a competitor nation's port. For example, a contract for Canadian western red spring wheat graded 1 or 2 with a 14.5-percent protein content originating from a St. Lawrence or Atlantic port was compared to U.S. dark northern spring wheat with 15-percent protein content originating from U.S. Gulf of Mexico ports.

The study concluded that for 1981-94, the CWB on average increased wheat revenues by \$14.56 per ton, or \$289 million per year when compared to multiple sellers offering wheat in competition with each other.<sup>4</sup> These premiums represented about 8 percent of the CWB wheat revenues for those years. The export market on average accounted for 74 percent of this price premium, while the remainder reflected higher prices faced by Canadian consumers and by foreign aid wheat donors. For 1994, the last year covered in the study, the CWB premium was \$6.38 per ton, which represented 5.4 percent of that year's sales value of \$117.72 per ton. The study reported that European buyers offered the highest price for wheat, while in certain years sales to the United States earned low or no premiums. An important consideration of the study was how the single-desk system performed when the United States was intervening in the world market with its EEP. The study found that the CWB premium over revenue generated by multiple sellers was highest during the years of U.S. export subsidies. The additional premiums in the EEP period reflected the higher prices the CWB realized from sales to nonsubsidized EEP markets in comparison with multiple sellers that are assumed to receive subsidy-reduced prices on all sales.

The reliability of the study's conclusions is subject to serious methodological constraints that make it difficult to interpret the estimated premiums. First, the matching of a Canadian grain contract with a U.S. or another nation's competitive grain price was an incomplete match. While grade and protein content were accounted for, in no comparisons were the grain varieties identical, and other quality attributes, including moisture level, cleanliness, water absorption, test weight, consistency, percentage of hard vitreous kernels, and protein quality were not controlled for in the comparisons. Observed price differences due to these other attributes or

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<sup>4</sup>Unless otherwise noted, all Canadian dollars have been converted to constant 1997 U.S. dollars using a market exchange rate and the U.S. gross domestic product deflator.

differences in trade servicing should not be attributed to the operations of the CWB. In addition, CWB contract prices may reflect the provision of credit and other payment terms so that they are not comparable to competitive port prices. Second, for certain geographic markets, grain originating from Canada can have an ocean freight cost advantage (or disadvantage) when compared to U.S. export prices. Third, a significant problem with the study is that its methodology cannot distinguish between premiums that arise from CWB marketing operations and those that arise from regulatory activities of the Canadian Grain Commission that establishes and maintains standards for grain quality and regulates grain handling.

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## CWB Barley Study

The CWB-sponsored barley study used a different methodological approach to evaluate whether the CWB creates revenue benefits for barley producers greater than they would receive from multiple sellers. The study concluded that the CWB successfully discriminates in the prices it charges consumers in different markets and estimated that the CWB extracts from barley consumers greater revenues for producers than would occur in a competitive market.

As a demonstration of the CWB's market power to price discriminate, an analysis was conducted of CWB feed barley export contracts from west coast Canadian ports. Price differences between sales to the United States, Japan, and the rest of the world were established on a monthly basis. For those months between 1986 and 1995 where comparable sales to all three destinations took place, CWB prices per ton for sales to Japan were \$28.33 (Canadian dollars) higher than they were for the rest of the world, and CWB U.S. sales were \$4.47 (Canadian dollars) higher per ton than the rest of the world.<sup>5</sup> Price discrimination not only existed between export destinations but also between the Canadian domestic market and the U.S. market. For example, the study estimates that in 1991/92, the CWB's Canadian customers paid 29.6 percent more than did U.S. customers for six-row malting barley and 14.1 percent more for two-row malting barley.<sup>6</sup>

In order to estimate the differences between CWB operations and that of multiple sellers, the study used an economic model to simulate the prices and revenues that multiple sellers would generate and compare them with those generated by the CWB. This exercise required that a series of assumptions be made about market conditions, which were subjected to a

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<sup>5</sup>Due to the confidential nature of the data, the study's authors were unwilling to share sufficient data with us to allow its conversion to 1997 U.S. dollars.

<sup>6</sup>The study did not show a price breakout between the domestic and U.S. market for any other year.

sensitivity analysis. For 1986 to 1995, the study found that the CWB increased producer barley revenues on average by \$70.5 million per year when compared to multiple sellers. These premiums represent about 15 percent of the CWB barley revenues for those years. However, in 1995, the last year of the study, producer revenues would have been \$5.3 million greater without the CWB, or 1.4 percent of that year's barley revenue. This loss occurred because the CWB made its sales early in the crop year, while a tightening feed barley market resulted in non-CWB feed barley prices exceeding CWB prices late in the crop year. Consistent with the wheat study, the benefits of the CWB were greater during years with heavy EEP usage.

The economic model used in the analysis required numerous assumptions to conduct the study, some of which may limit the reliability of its conclusions. Even though the study breaks the barley market into three components: feed barley, six-row malting barley varieties, and two-row malting barley varieties, this degree of product differentiation may not be sufficient for purposes of analysis. For example, there are significant differences between the barley varieties demanded by U.S. brewers and those in Canada and other nations.<sup>7</sup> Thus, price comparisons between CWB sales to Canada, the United States, and the rest of the world may be comparisons of unlike products. Additionally, malting barley contracts can include terms beyond variety and grade specifications, including plumpness, protein, germination, varietal purity, and credit terms, which render comparisons difficult.

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## Alberta Agriculture Study

The Alberta study did not have access to the actual contracts of the CWB and thus used other, more indirect evidence to evaluate whether the CWB has market power to earn premiums for Canadian farmers. This study reviewed the destination of most CWB sales and found that about 80 percent of the sales were to price-sensitive markets where prices were consistent with a competitive market. Only sales to Japan, the United Kingdom, and the United States were deemed to be to markets that were more sensitive to quality than to price. With respect to the United States, the findings of an ITC investigation were cited that found no premiums were paid for Canadian wheat by U.S. flour millers. The study concluded that Japan is the only market where a single-desk premium may exist, although it is difficult to disentangle it from payments for other

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<sup>7</sup>U.S. brewers primarily use malt produced from six-row white aleurone barley, while Canadian beers use six-row blue aleurone and two-rowed barley. See Demcey Johnson and William W. Wilson, "North American Malting Barley Trade: Impacts of Differences in Quality and Marketing Costs," Canadian Journal of Agricultural Economics (1995), pp. 335-53.

characteristics such as cleanliness and uniformity. Based on Japan's share of CWB sales, the study concluded that the single-desk premium is small. Further, a comparison of farmgate returns between the United States and Canada fails to show any evidence of price premiums.

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## Marketing Costs of the CWB

In order to reach a bottom-line conclusion with respect to the costs and benefits of the CWB for Canadian producers, the two CWB-contracted studies and the Alberta study reviewed whether operating costs are higher or lower under the CWB than would be the case with multiple sellers. The CWB studies found that costs are lower, in part due to the government's financial guarantee of CWB operations, while the Alberta study concluded that the CWB imposes net costs on the grain sector, especially in restricting its flexibility to adjust to changes in market conditions.

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## CWB Wheat Study

The approach taken in this study was to compare the risk management costs of wheat to that of two non-CWB-marketed Canadian grains: flax and canola. The wheat study estimated the differences in private sector risk management and that of the CWB from 1981 to 1994. Private operations were shown to have a risk management cost of about \$21.50 per ton for canola and on average \$18 per ton for flax. The study estimated that the risk management cost of CWB wheat was on average \$3.91 per ton, including taxpayer subsidies to cover deficits in several marketing years. This difference suggests a risk management cost advantage for the CWB.

For more recent years, however, the record is less decisive. For the canola market, the study further refined its estimates of risk management costs. It reported that from 1991 to 1994 the adjusted risk cost per ton was \$7.70 per ton of canola which, when compared to the prior estimate for CWB risk costs of \$3.91 per ton (1981-94), reduces the CWB's risk management advantage to \$3.79 per ton.

This final basis of comparison does not, however, rely on the same time period. Comparing the performance of wheat, canola, and flax for the most recent 4 years of the study (1991-94) shows the risk management cost per ton of wheat as \$8.94,<sup>8</sup> for canola as \$7.70, and for flax as \$14. This suggests that CWB wheat operations are at a disadvantage in comparison to canola but retain an advantage in comparison to flax.

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<sup>8</sup>This estimate is higher due to the large government deficit payment to the CWB made in 1991.

The use of the canola and flax markets as a basis of comparison to CWB wheat risk management operations may be misleading. First, flax and canola represented a small proportion of total grain production in western Canada. During the period covered by the wheat study, flax and canola tonnage averaged only 10 percent of total western grain production. Therefore, part of the cost advantage for wheat marketing could reflect economy of scale rather than the operation advantage of the CWB. Second, the financial risk should be expressed with respect to value and not with respect to weight or volume. Canola and flax are more valuable per ton than wheat. During 1983-94, farmgate prices per ton for canola in western Canada were 96 percent greater than wheat prices, and flax prices were 76 percent greater. Therefore, the risk management cost per ton would be expected to be greater than for wheat. Hence, part of the risk management cost disadvantage for these crops can reflect higher crop values rather than the absence of a government marketing board.

The study did note that taxpayer monies and guarantees available to the CWB gave it an advantage over private sector firms. The study reported that the government guarantee allowed the CWB to borrow at the government borrowing rate, which lowered borrowing costs between \$26 million and \$45 million for the 1995-96 crop year or between about \$1 and \$2 per ton. Additionally, the CWB profited from being able to raise money at the government borrowing rate and then lending to borrowers at commercially competitive rates. From 1981 to 1994, the CWB showed net interest earnings in 10 years. Not mentioned in the study are the tax advantages the CWB has relative to private companies.

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### CWB Barley Study

This study focused on cost issues specific to barley. The study found that the pooling system created economic efficiency losses due to the inability of barley export deliverers to adjust to differences between Canadian domestic prices and U.S. prices. On average for 1989-96, the losses were about \$4 million per year, although the losses in 1996, the last year of the study, were estimated to be about \$15 million. In addition, the study reported that direct taxpayer transfers to barley producers occurred three times during 1986-95 and noted that rather than being costs, these transfers are benefits to producers. The study did not estimate the subsidy value of the government guarantees that allow the CWB to borrow at the government borrowing rate and to earn interest during the marketing year.

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**Alberta Study**

This study included in its estimation of CWB costs the costs of institutional and regulatory factors that are part of the Canadian grain system but not part of the CWB. It justified its approach by asserting that the CWB is responsible for much of the lack of flexibility in the Canadian system and the limited competition in the grain handling and transportation areas. According to the study, the CWB does not have the economic or political incentive to reduce system costs and functions instead as a follower, not a leader. In computing these system costs, the study reported that for wheat farmers, direct costs and revenue losses are between \$16.94 and \$22.18 per ton, while taxpayer costs are another \$4.10 per ton. For barley farmers, direct costs and revenue losses are between \$18.14 and \$24.50 per ton, and taxpayer costs are \$6.70 per ton.

Many of the components of the estimated costs to farmers in this study are probably independent of whether the CWB exists or not. For example, the direct cost of CWB administration includes marketing and logistical activities that would occur in the private sector. The relevant analysis would require a demonstration that CWB costs are greater (or smaller) than those of private sector grain companies. Similarly, storage costs attributed to CWB operations would also occur in a multiseller environment. In computing costs of the grain handling system, the study compared shipping and handling costs with those of operations in the United States without considering whether the geography and infrastructure are comparable. In any event, for many of the identified costs to change, changes in other government regulations would be required beyond the elimination or reform of the CWB. There are, however, several examples in the study of cases where the CWB has responded slowly to changes in market conditions and to the needs of farmers. In addition, the report showed clearly that Canadian farmers benefit from taxpayer support of the CWB.

In summary, while the CWB economic studies provide evidence of successful price discrimination and single-seller market power, there are methodological issues that reduce the reliability of the measured revenue benefits. Over the time period investigated (1981-94), the CWB studies' estimated average contribution of the CWB to wheat and barley revenues were about 8 percent and 15 percent of total revenue, respectively. With respect to cost, there is agreement among the studies that the government guarantee of wheat board operations and other financial benefits are a significant subsidy to Canadian farmers. Otherwise, the evidence presented on the costs of CWB operations is mixed.

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## Grain Company and Canadian Farmer Views on the CWB

Grain companies located in the United States and in Canada have mixed views concerning the operations and future of the CWB. With respect to pricing practices, six grain companies reported that as a single-desk seller, the CWB had market power and did price discriminate. CWB contracts include a provision that stipulates that the grain is for shipment to and consumption in a specified country. Grain companies reported that it is through these contracts that the CWB controls the ultimate destination and use of its exports. This prevents the accredited exporters (AE) from competing against each other on price and arbitrating between the markets of different countries. This restriction was characterized as being good for grain producers but bad for grain consumers.

The Canadian National Farmers Union sees the CWB as part of its defense against domination by foreign grain traders and the railroads. It believes that the CWB provides farmers with market leverage when dealing with corporations. The Western Canadian Wheat Growers Association, a voluntary group representing some western grain farmers, wants to end the mandatory nature of the CWB and allow farmers to participate in a dual market where the group could market through the CWB or for themselves. The Western Canadian Wheat Growers Association criticizes the secrecy of the CWB and the association's inability to examine the CWB's financial books. While the association recognizes that the government financial support is valuable, it believes that the CWB fails to get the highest price for farmers.

One issue of interest to Canadian farmers and their U.S. counterparts is whether the CWB restricts or encourages grain sales to the United States. The CWB wheat study concluded that a multiple-seller system would so expand exports to the United States that the U.S. government would restrict Canadian access to the U.S. market. The CWB barley study found that Canadian prices were lower than U.S. prices in 5 of 8 years analyzed, suggesting that multiple sellers would increase their shipments to the United States. The Alberta study pointed to the dramatic increase in barley exports to the United States when the CWB briefly lost its authority to regulate sales to the United States for a 40-day period in 1993. Interviews with Canadian grain industry participants support the notion that the CWB withholds grain from the U.S. market. Some said the CWB did this in order to reduce trade conflicts. Many industry participants believe Canadian exports to the United States would increase in the absence of the CWB. For example, the Western Canadian Wheat Growers Association notes that exports of oats to the United States increased when the CWB lost control of

that commodity, as did barley exports, during the brief time period in which the CWB lost control of barley sales.

Withholding of Canadian grain from the U.S. market can have effects on other agricultural industries, both in Canada and the United States. Canadian livestock production in western Canada has increased since the elimination of rail subsidies for grain exports. A recent Canadian government-sponsored study found that western Canada was the lowest-cost producer mainly due to the low cost of feed in the western provinces.<sup>9</sup> U.S. feed costs were 41 percent greater than they were in the Canadian prairies. The study concluded that the price difference was incompatible with an “efficient market.” The CWB controls all barley exports from Canada, including feed barley exports to the United States and, according to one analysis, does not maximize farmer returns from higher prices in the U.S. market.<sup>10</sup> According to a director of the Canadian Cattlemens’ Association, the CWB exercises a national feed grains policy that ensures a minimum supply of barley is available for the domestic livestock industry which, at times, has been detrimental to Canadian grain farmers.<sup>11</sup> Canadian government officials report that there is no federal government or CWB policy to ensure that a minimum supply of barley is available for the domestic livestock industry. However, Canada’s livestock has expanded, and exports to the United States are increasing. Legislation has been introduced in the U.S. Senate to establish a joint U.S.-Canada Commission on Cattle and Beef.<sup>12</sup>

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<sup>9</sup>Dr. Larry Martin, Dr. Zana Kruja, and John Alexiou, “Prospects for Hog Production and Processing in Canada” (Guelph, Ontario: George Morris Centre, Mar. 3, 1998).

<sup>10</sup>Submission to the Canada-United States Joint Commission on Grains by the Alberta Barley Commission and Western Barley Growers Association, Final Report, Vol. II (Winnipeg, Canada, and Washington D.C.: Oct. 1995).

<sup>11</sup>Testimony of John Prentice, Canadian Cattlemen’s Association, Before the Standing Committee of the Canadian Senate on Agriculture and Forestry, Edmonton, Alberta (Apr. 1, 1998).

<sup>12</sup>S. 617 (105th Cong. [1998]).



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# How U.S. Data on Canadian Grain Are Collected

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The U.S. government collects extensive data on imports of Canadian grain and on how one of these grains, Canadian wheat, is eventually used in this country. Grain import data, along with similar data for all U.S. imports, are used by government and business for such purposes as monitoring trade balances with other countries and developing government trade policies and corporate marketing strategies. Import data are collected by the U.S. Customs Service and compiled by the U.S. Census Bureau. In preparing this summary of U.S. data on Canadian grain, we found that the accuracy of data on Canadian grain imports may be affected by a relaxation of Customs' regulatory controls because of NAFTA. Data on the use of Canadian wheat, known as "end-use data," are collected and compiled by USDA to prevent Canadian grain shipments from benefiting from U.S. agricultural assistance programs.

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## Uses of Grain Import and Wheat End-Use Data

Grain imports from Canada are an important component of U.S. trade with Canada. As noted in chapter 1, U.S. imports of grains, such as durum wheat, red spring wheat, and barley from Canada, through the CWB, have increased significantly in recent years. Therefore, data on U.S. grain imports from Canada have several important uses. For example, USDA monitors the data to determine the effect of these imports on the supply and price of similar commodities in the United States because these imports can affect U.S. farmers. U.S. Customs uses the data to administer U.S. trade laws pertaining to Canadian grain imports. For example, the data help Customs determine whether grain shipped from Canada is in compliance with NAFTA. However, it should be noted that because Canadian grain is duty and quota free under NAFTA, Customs does not need to examine Canadian grain import data as closely as it does data for imports not covered by NAFTA or other trade access programs.

Census and other U.S. statistical agencies, such as the Bureau of Economic Analysis, also use Canadian grain import data in compiling the overall accounting of U.S. trade with other countries. Canadian grain imports are included in the U.S. merchandise trade data produced by Census that account for all commodities imported by the United States or exported to other nations. Merchandise trade data, in turn, are used by the Bureau of Economic Analysis in compiling information on the overall economic performance of the United States.

Unlike grain import data, which are collected for numerous administrative and statistical purposes, data on the end use of Canadian wheat are collected for the sole purpose of assuring that such wheat is not mingled

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with U.S. wheat. As we discuss in the next section, the end-use certificate was instituted by the Congress to prevent Canadian wheat from benefiting from certain U.S. assistance programs, including EEP.

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## How Data on Canadian Grain Shipments Are Produced

The production of data on Canadian grain shipments is a large undertaking, involving staff from three federal agencies—Census, Customs, and USDA—as well as the U.S. buyers of these shipments. The strengths and limitations of data on Canadian grain imports and data on the end use of Canadian wheat in determining CWB pricing practices are related to how these data are collected and compiled.

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## Grain Import Data Are Collected by Customs and Compiled by Census

Producing U.S. data on merchandise imports involves both the U.S. Customs Service and the U.S. Bureau of the Census. The production process is essentially the same for all commodities entering the United States. However, the following discussion focuses on the collection and compilation of data on grain imports from Canada.

The process begins at the ports where goods enter the United States. Grain imports from Canada mainly enter the country through the northern land border ports, particularly those located in North Dakota, Montana, and Minnesota. For grain and other merchandise to enter the country, importers (or brokers representing them) are required to present information on the nature, origin, value, and other aspects of the goods<sup>1</sup> on a form known as an “entry summary.” This entry information is used by Customs to determine the duties and fees owed and also whether the goods are under quota or other import restrictions. However, under NAFTA, most imports from Canada are not subject to duties, quotas, or other import restrictions. According to Census and Customs officials, about 99 percent of the information is transmitted through an electronic data exchange known as the Automated Broker Interface (ABI). ABI is part of Customs’ overall computerized merchandise processing system, the Automated Commercial System. If entry information is not transmitted through ABI, it must be presented on paper at the port of entry.

The entry information submitted to Customs by importers forms the basis for the nation’s data on merchandise imports. Each entry lists the country of origin, the international Harmonized Tariff Schedule (HTS) number that indicates the type of good being imported, the value of the merchandise,

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<sup>1</sup>Customs does not require formal documentation for nontextile import transactions valued at less than \$2,000 nor for textiles valued at less than \$250.

the quantity, its weight, and several other items describing the shipment. Customs' ABI has built in statistical edits designed by Census that reject entries that do not meet statistical parameters developed by Customs and Census. For example, a shipment of durum wheat from Canada with an unusually high price per metric ton would fail the edit program. Rejected entries are transmitted back over ABI to be corrected by the filer. ABI entries accepted by Customs are transmitted to Census headquarters in Suitland, Maryland.

If Customs discovers an error in an entry after it is transmitted to Census, it is supposed to send a corrected version to Census, usually through an on-line system. Statistical errors sometimes are found by Customs import specialists. These staff, at offices associated with ports of entry, review selected entries to ensure that the proper amount of duties and fees are paid on imported merchandise and to verify that imports comply with various quotas, other restrictions, and statistical reporting requirements. Since most Canadian shipments are exempt from duties and other import restrictions, when Customs import specialists review Canadian shipments such as wheat, they are mainly concerned with statistical accuracy and verifying that the shipments originated in Canada. Import specialists do not review all entries. Rather, a component of the Automated Commercial System, the Entry Summary Selectivity System, selects entry summaries for review based on risk criteria.

After Customs transmits the entry information to Census, Census subjects all the data to a further array of statistical edits. Like the edits done by Customs' ABI program, these edits check whether import entries fit within established parameters for value, quantity, country of origin, classification, and other data elements. Import entries that fail any of the edits are examined by Census commodity specialists, who may then contact the importer, broker, or U.S. Customs to obtain the information needed to resolve the problem. After Census finishes processing the data, they are summarized monthly and released to the public. The first monthly release usually occurs about 45 days after the close of the month and contains the overall import, export, and trade balance data. Soon thereafter, Census releases more detailed reports by commodity and trading partner and other breakouts.

Since 1988, the United States and Canada have been exchanging administrative records on imports and in 1990 started using this information to determine each country's exports to the other. The United States and Canada began this arrangement because of the large

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discrepancies that Census and its Canadian counterpart, Statistics Canada, had identified between U.S. export and Canadian import data. A 1986 reconciliation of U.S.-Canadian merchandise trade data indicated that reported U.S. exports were 20 percent lower than Canada's reported imports from the United States. Census and Statistics Canada believe that by exchanging their more accurate administrative records on imports, they have significantly improved U.S. and Canadian export data. This information exchange between the United States and Canada is unique.

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**Wheat End-Use Data Are**  
**Collected and Compiled by**  
**USDA**

The 1994 North American Free Trade Agreement Implementation Act that approved U.S. participation in NAFTA authorized the wheat end-use certification program.<sup>2</sup> As noted in the previous section, this program, which has been in place since April 1996, is intended to ensure that Canadian wheat does not benefit from U.S. export programs such as EEP. The Canadian government maintains a similar program for U.S. wheat imported into Canada.

The wheat end-use certification program is administered by USDA's Farm Service Agency. Under the program, imported Canadian wheat must be stored separately and may not be commingled or blended with wheat produced in the United States until the Canadian wheat is delivered to an end user or is loaded onto a conveyance, such as a train, for direct delivery to an end user.

To assure compliance with the requirements of the program, the Farm Service Agency requires that all importers and subsequent buyers of Canadian wheat file information relating to their purchases. The importer must file a certificate that notes the importer's name, the class and quantity of wheat imported, the storage location, and the mode of transportation used to bring the wheat to the United States from Canada. The importer and all subsequent purchasers of the wheat must also submit a wheat consumption and resale report that specifies the quantity and class of wheat received, the quantity resold, the identity of the buyers, and the end use. The wheat consumption and resale report identifies seven broad categories of end use, including milling for human consumption, milling for animal feed, manufacturing, brewing or malting, distilling, re-export to another country, and other.

According to statistics compiled by the Farm Service Agency, over 92 percent of imported Canadian wheat is used for milling for human

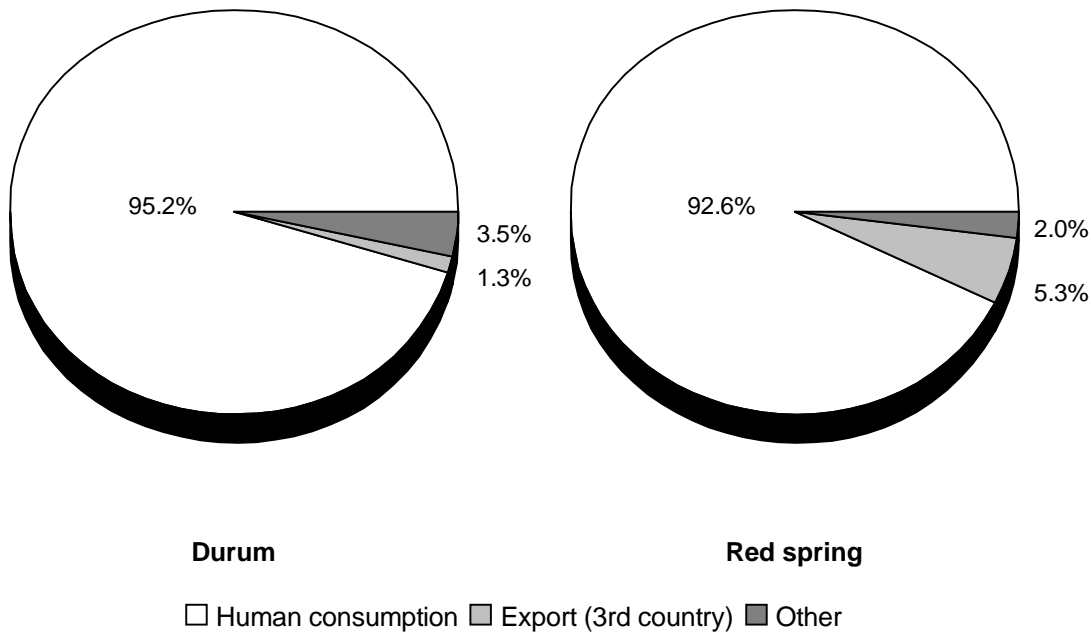
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<sup>2</sup>Public law 103-182, December 8, 1993, section 321(f), 19 U.S.C. 3391(f).

**Appendix IV  
How U.S. Data on Canadian Grain Are  
Collected**

consumption. The wheat end-use certificate program does not require more detailed information concerning the milling of Canadian wheat, such as the food products (for example, bread or pasta) made from the milled wheat. Figure IV.1 shows the end use of Canadian wheat for March 1995, when the end-use certificate program began, to December 1997.

**Figure IV.1: End Use of Canadian Wheat, March 1995-December 1997**



Note: "Other" includes animal feed and manufacturing.

Source: USDA.

**Reliability Issues  
Could Also Affect  
Import Data's  
Usefulness in  
Determining CWBs  
Prices**

In preparing this summary, we became aware of two potential problems with the reliability of Customs data. The statistical edits employed by Customs and Census in combination with the entry summary reviews performed by Customs field personnel are extremely useful for maintaining the quality of U.S. import data. However, in two instances, these procedures failed to detect errors in the filings made by importers of Canadian wheat. In the first instance, USDA end-use data revealed that a significant number of shipments of Canadian wheat bound for other

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countries were incorrectly entered as U.S. imports, thus inflating the recorded amount of wheat entering the country from Canada. In the second instance, an audit by Customs revealed that some importers had overstated the value of the wheat on their Customs entry forms. These problems are consistent with concerns raised by some U.S. officials in a previous GAO report,<sup>3</sup> where they noted that the reduction in duties brought about by NAFTA may cause the accuracy of U.S.-Canadian trade data to decline. The degree to which these errors affect the accuracy of data on Canadian wheat imports is unclear, and Customs and Census report that they have taken some steps to improve their quality control procedures.

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### Re-Exports of Canadian Wheat Can Affect Import Data Accuracy

For several years, Census officials have been concerned that statistical edits and Customs entry reviews are unable to detect instances in which exports from Canada are entered as U.S. imports even though they are to be exported from the United States without ever entering the U.S. market. Census officials noted that if such Canadian exports, referred to as “in-transit shipments,” are often filed as U.S. imports, U.S. data on Canadian imports are overstated. The officials said that the initial purchasers of the re-exported good should have instead filed an in-transit form with Customs, which indicates that the shipment will only be traveling through the United States en route to another country. Customs does not try to determine whether filers of Canadian import entries are submitting the correct form, because Customs law permits purchasers of foreign goods to file them as imports even if they are to be re-exported from the country.

According to Census and Customs officials, some U.S. purchasers of Canadian goods, such as wheat, find it easier to file an import entry than an in-transit document. In-transit documents require detailed transportation information that Customs needs to assure that goods bound for another country are not illegally diverted into the U.S. market. Also, because of NAFTA, there are most likely no duties associated with filing an import entry for Canadian goods. However, buyers of Canadian goods must pay brokers’ fees regardless of whether they file import entry or in-transit documents.

Data collected by USDA on wheat end-use and consumption certificates reveal that some Canadian wheat shipments transiting through the United

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<sup>3</sup>See *Measuring U.S.-Canada Trade: Shifting Trade Winds May Threaten Recent Progress* (GAO/GGD-94-4, Jan. 19, 1994).

States on the way to other countries have been incorrectly entered with Customs as U.S. imports. As noted earlier, these certificates must be filed for all Canadian wheat imported into the United States. Filers of wheat consumption certificates must indicate either that the wheat will be used in the United States for such purposes as human consumption or that the wheat will be re-exported from the United States. According to USDA officials, wheat designated for re-export on the wheat consumption form was probably incorrectly entered as an import with Customs.

Data from the wheat consumption and resale reports show that a significant percentage of wheat shipments from Canada was designated by purchasers as being for re-export. For the 1995-96 wheat marketing year (June 1 through May 31), about 1.5 percent of Canadian wheat entering the United States was designated for re-export. This figure rose dramatically in the 1996-97 marketing year to almost 12 percent. USDA officials believe that this large increase was attributable to severe weather in Canada, which prohibited many wheat shippers from using Canadian ports. The officials explained that the shippers decided to move their shipments through available U.S. ports and felt it was more expeditious to enter the wheat as a U.S. import than to file in-transit documents. In the 1997-98 marketing year, wheat re-exports represented about 2 percent of U.S. imports of wheat from Canada.

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### **Recent Customs Review Revealed Errors in Canadian Wheat Values**

A recent review of a small sample of Canadian wheat entries by Customs and the Department of Commerce revealed that Customs' and Census' quality control procedures failed to detect mistakes in the reported value for some entries. Customs initiated the review in early 1998 in order to assess the accuracy of value data it collects on Canadian wheat imports. Customs was particularly concerned that the entered value accurately reflected the transaction price between the CWB and the U.S. purchaser of the wheat.

Customs staff at the ports of Pembina, North Dakota, and Duluth, Minnesota, reviewed recent entries of wheat made under several large contracts between the CWB-accredited exporters and buyers in the United States. By comparing the entered values to information contained on invoices and contracts, the staff determined that for all the entries they reviewed, the entered value was based on the prices used in the transaction between the CWB's accredited exporter and the purchaser in the United States. This determination was important because it indicated that the values submitted by Canadian wheat importers represented actual

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**Appendix IV**  
**How U.S. Data on Canadian Grain Are**  
**Collected**

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transaction prices rather than estimated prices based on spot prices on the MGE.<sup>4</sup>

However, during the course of the review, the Customs staff found that in some of the entries, some freight charges, which should have been reported separately, were included in the entered value. By including these freight charges, the importer inflated the value of the shipment. Customs reported this finding to the Commerce Department's International Trade Administration, whose staff then reviewed a sample of Canadian wheat entries. Of the 19 entries they examined, 6 included freight in the entered value. Because of the small number of entries reviewed by Customs and Commerce, the agencies were unable to determine the extent to which such errors affected the accuracy of reported Canadian wheat import data. However, Customs officials noted that none of the errors in value resulting from the inclusion of freight charges exceeded \$10,000. Census does not require corrections to the import database for value errors lower than this threshold because it believes that they will not significantly affect the accuracy of the overall official import statistics.

Customs staff interviewed the Customs brokers that filed the entries in the reviewed sample to determine why freight charges were included in some of the entered values. The staff found that in some instances wheat importers did not separate the freight charges from the transaction price in the information they provided their broker because brokers charge more to file entries with freight charges than entries with no such charges. Importers that included freight charges in the entered value did not incur any Customs fees for doing so because Canadian wheat imports are duty free under NAFTA.

Although they only reviewed a small sample of Canadian wheat entries, Customs officials believe that the inclusion of freight charges in the entered value was a widespread problem on the northern border. They note that most Canadian wheat enters the U.S. through a few Customs ports, such as Pembina and Duluth, connected to U.S. rail lines. Most of the wheat entries arriving at these ports are filed by the same few large Customs brokers interviewed by Customs.

Since the entry review, Customs has informed brokers that file Canadian wheat entries that they should not include freight charges in the entered

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<sup>4</sup>Customs did not compile the results of its entry reviews and was unable to tell us how many entries were involved.



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value. Customs is currently reviewing a sample of Canadian wheat entries filed in early 1998 to verify that the entered value is correct.

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### **Trade Liberalization May Affect Data Quality**

Both the reporting of Canadian wheat for re-export and the inclusion of freight charges in the entered value for Canadian wheat shipments appear to confirm concerns expressed by U.S. officials and others in our 1994 report on the processes for measuring trade between the United States and Canada. In that report, we noted that Census officials and others in the statistical community had concerns that the implementation of NAFTA, including the elimination of duties, would diminish the accuracy of Customs' statistical information. We said that these officials believed that Customs would not be inclined to scrutinize entry documents solely for the purpose of detecting statistical errors or to reject entries for what it might consider to be minor statistical inaccuracies.

Census officials told us that they are concerned about discrepancies in Canadian wheat import data such as those uncovered in the two reviews. However, they remain confident that the data are sufficiently accurate for their intended uses such as determining U.S. trade balances. Commerce officials, on the other hand, note that errors in the reported value of Canadian wheat entries present a major impediment to using import data to analyze trends in Canadian wheat prices.

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# STE Notifications to the WTO for 1995-97

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Every 3 years all members of the WTO are required to submit information, in the form of a “new and full notification,” on the nature and extent of their country’s state trading enterprise activities. WTO members traditionally have been required to list products covered by STES, report reasons for introducing and maintaining STES, provide some description of their STES’ functions, and include statistics on the extent of trade accounted for by STES. Since 1995, all STE notifications have been reviewed by the Working Party on STES, which has allowed the WTO to better track the activities of STES. According to the WTO, 58 countries, or about half of all WTO members, complied with the full notification requirement when last due in 1995. However, compliance problems remain, including a lack of understanding of what trading entities should be listed on the notification and the timeliness of members’ notification submissions. Members’ notifications reveal a wide variety of products covered and reasons for maintaining state trading enterprises.

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## STE Notification Compliance Has Increased, but Some Problems Remain

In 1995, we reported on the compliance with STE reporting requirements from 1980 to 1994 and found that compliance was generally poor.<sup>1</sup> The lack of compliance with notification requirements was attributed to (1) the problem of what constitutes an STE, (2) the lack of a systematic review of notifications received, (3) the low priority some member countries assigned to STE reporting, and (4) the overall burden of reporting. Since the creation of the Working Party on STES in 1995, compliance has improved. Fifty percent of all WTO members submitted a new and full STE notification for 1995, compared to the previous high of 21.2 percent of members in 1981, another full notification year. In addition, WTO members are required to submit “updating notifications” in intervening years, and the response rate for updating notifications in 1996 and 1997, though lower than that for 1995, represented an improvement over the response rates recorded for updating notifications between 1980 and 1994. During that period, the highest response rate was 15.3 percent of members, and the lowest was 6.7 percent of members; this compares to a low of 26 percent of members responding in 1997, shown in table V.1.

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<sup>1</sup>See State Trading Enterprises: Compliance With the General Agreement on Tariffs and Trade (GAO/GGD-95-208, Aug. 30, 1995).

**Appendix V**  
**STE Notifications to the WTO for 1995-97**

**Table V.1: STE Notifications, 1995-97**

<b>Notification type</b>	<b>Number of notifications<sup>a</sup> received</b>	<b>Response rate (percent)<sup>b</sup></b>
New and full (1995)	58 <sup>c</sup>	50
Updating <sup>d</sup> (1996)	48	41
Updating (1997)	30	26

<sup>a</sup>The number of notifications reflects the fact that the EC submits a single notification that covers all 15 of its member states.

<sup>b</sup>The response rate has been calculated on a base WTO membership of 117, which counts the EC as a single member. The official total membership of the WTO (132) includes the EC's 15 member states counted individually as well as the EC itself.

<sup>c</sup>According to WTO documents, 23 of the 58 new and full notifications were also counted as updating notifications, due to their late submission (see discussion to follow).

<sup>d</sup>In updating notifications, members are supposed to indicate if any changes to their state trading regimes have taken place since their last notification.

Source: STE notifications to the WTO Secretariat.

WTO provisions allow countries to question the completeness of other members' STE notifications.<sup>2</sup> Through the Working Party on STES, members submit written questions regarding other countries' notifications and receive written responses.<sup>3</sup> According to the WTO Secretariat, this process itself has brought greater transparency to the notification process. U.S. officials told us that the Working Party provides a good forum to apply pressure on members that are not in full compliance with the reporting requirements, either for the lateness or the incompleteness of their submissions. According to WTO Secretariat officials, in at least one case, a member that originally notified that it did not have STES amended its notification and reported several STES, following pressure from the United States and other Working Party members.

**Continuing Problems**

Despite progress in the Working Party, some problems remain, including a lack of understanding of what trading entities fall under the WTO's definition for state trading enterprises and the timeliness of member countries' responses to STE questionnaires. WTO Secretariat officials we

<sup>2</sup>Specifically, these provisions were included in the 1994 Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade, which is found in annex 1 of the WTO agreement.

<sup>3</sup>If a WTO member is still not satisfied with another members' notification after questioning and discussion in the Working Party, the member can submit a "counternotification" to the WTO Council for Trade in Goods raising its concerns. As of June 1998, no member has yet submitted a counternotification against another member. Although the provision remains untested, U.S. officials we spoke with believe the ability to do so remains important.

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spoke with said that the STE definition under article XVII is “still very vague.” Differing interpretations of what constitutes state trading enterprises may have resulted in inconsistencies in members’ notifications. For example, three Central European countries submitted notifications claiming that they had no STEs under article XVII, while three other countries with similarly structured economies from the same region claimed that they had them. (For more information on whether individual countries reported maintaining state trading enterprises, see table V.2.)

Members’ timeliness in submitting STE notifications has been one of the principal areas of concern among Working Party members. According to a WTO Secretariat official, “virtually all countries” have missed the deadlines for submitting notifications. For example, WTO documents indicate that 23 out of the 58 new and full notifications submitted for 1995 were so late that the Secretariat considered them updating notifications as well.<sup>4</sup>

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<sup>4</sup>According to USDA officials, WTO members’ timely submission of notifications is a pervasive problem in the WTO, affecting many other issues besides STE monitoring.

**Appendix V**  
**STE Notifications to the WTO for 1995-97**

**Table V.2: WTO State Trading Enterprise Notifications by Country, 1995-97**

<b>Country</b>	<b>New and full notification (1995)</b>	<b>Updating notification (1996)</b>	<b>Updating notification (1997)</b>	<b>State trading reported<sup>a</sup></b>
Argentina	X	X	X	
Australia	X	X	X	X
Barbados	X			X
Botswana	X	X		
Brazil	X	X	X	X
Bulgaria	X	X		
Canada	X	X	X	X
Chile	X	X	X	X
Colombia	X	X		X
Costa Rica	X			X
Côte d'Ivoire	X	X		X
Cyprus	X			X
Czech Republic	X			X
El Salvador	X	X		
EC	X	X		X
Gambia	X	X	X	
Guinea, Republic	X			
Haiti	X	X	X	
Honduras	X			
Hong Kong, China	X	X	X	
Hungary	X	X	X	
Iceland	X	X		X
India	X			X
Indonesia	X	X		X
Israel	X	X		X
Jamaica	X	X	X	X
Japan	X	X	X	X
Korea	X	X		X
Liechtenstein	X	X	X	X
Macau	X	X	X	
Malaysia	X			X
Malta	X	X		X
Mauritius	X	X	X	X
Mexico	X	X		
Morocco	X			X
Namibia	X	X		X

(continued)

**Appendix V**  
**STE Notifications to the WTO for 1995-97**

<b>Country</b>	<b>New and full notification (1995)</b>	<b>Updating notification (1996)</b>	<b>Updating notification (1997)</b>	<b>State trading reported<sup>a</sup></b>
New Zealand	X	X	X	X
Nigeria	X	X	X	
Norway	X	X	X	X
Pakistan	X	X	X	
Peru	X	X	X	X
Philippines	X	X		X
Poland	X			X
Qatar	X	X	X	
Romania	X	X	X	
Singapore	X	X	X	
Slovak Republic	X	X		X
Slovenia	X	X		X
South Africa	X	X	X	X
Switzerland	X	X	X	X
Thailand	X	X	X	X
Tunisia	X	X		X
Turkey	X	X	X	X
United Arab Emirates	X	X		
United States	X	X	X	X
Uruguay	X	X	X	X
Venezuela	X	X	X	X
Zambia	X	X	X	
<b>Total</b>	<b>58</b>	<b>48</b>	<b>30</b>	<b>39</b>

Note: The WTO Secretariat considered 23 of the "new and full" notifications as also updating notifications due to the lateness of their submission.

<sup>a</sup>As reported in the country's latest notification.

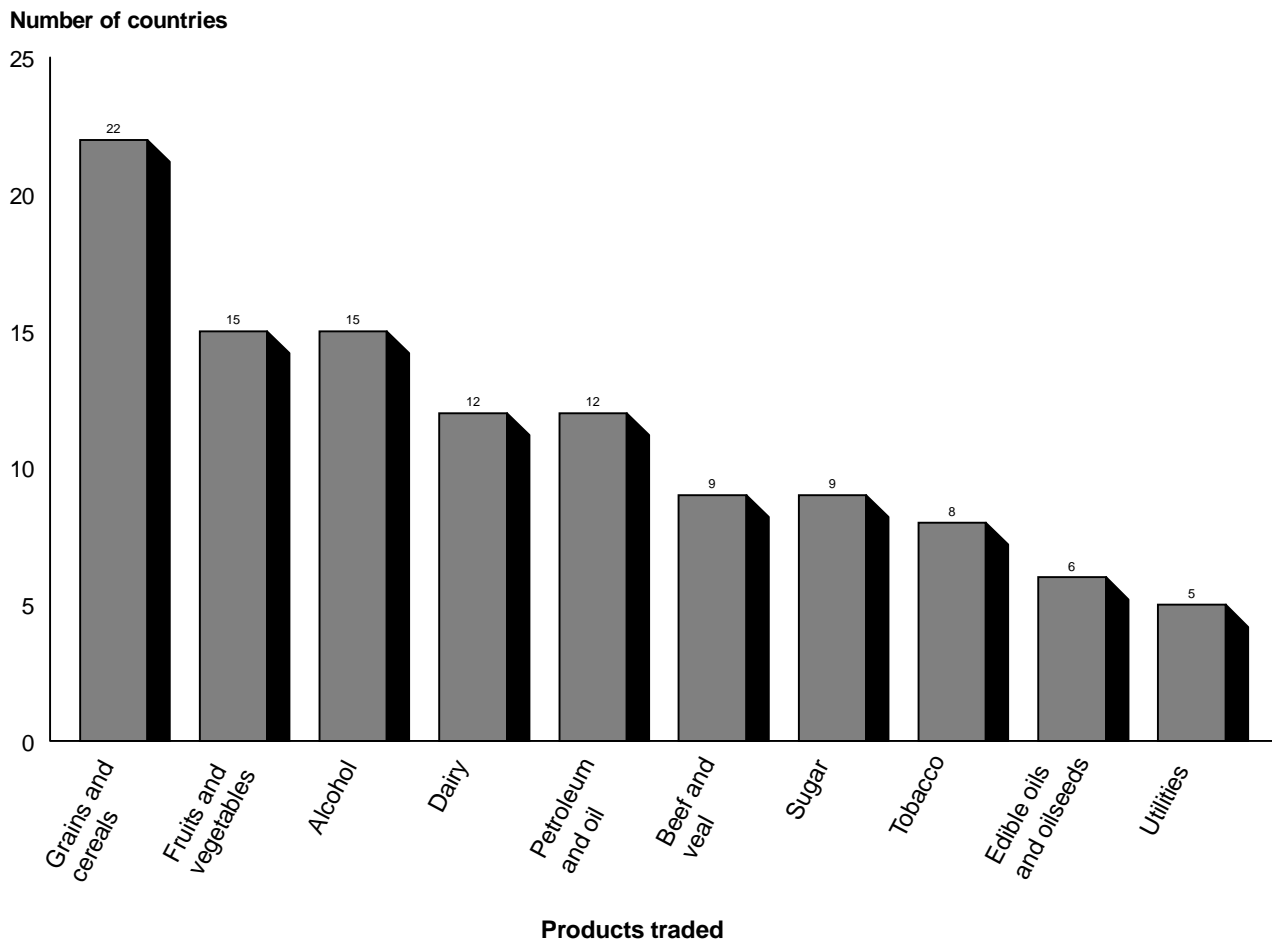
Source: Article XVII notifications provided to the WTO Secretariat.

## Notifications Show Wide Range of Products Covered and Reasons for Maintaining STEs

WTO notifications provided some insight into the activities of STEs in the 39 member countries that reported maintaining some STEs between 1995 and 1997. As required by the WTO, these member countries listed the products or groups of products for which they maintain STEs in their notifications. Figure V.1 shows which commodities were most frequently reported by countries as being subject to state trading. While members maintained STEs for a wide variety of products, the majority of STEs described in members' notifications operated in the agricultural sector. In addition to

the products listed in figure V.1, some member countries also reported maintaining STES for tea, pork, poultry and eggs, and wool, among other products. A few member countries reported maintaining STES in nonagricultural products such as chemicals and minerals and ore.

Figure V.1: State Trading Notifications by Product Sector, 1995-97



Note: Data are for products for which at least five WTO members reported maintaining state trading.

Source: GAO analysis of STE notifications.

WTO members also reported a number of reasons for introducing and maintaining STES in their notifications. For example, many WTO members reported using STES to regulate prices in their domestic market. Some countries sought to maintain market stability by limiting excessive price movements and by guaranteeing minimum or maximum prices for selected products. Other members reported that government intervention through STES made staple foods available to the general population at an affordable price or to consumers in the economically weaker sectors at the lowest possible price. Numerous member countries also reported using STES to prevent disruptions in their domestic food supply. Additionally, some member countries reported using STES to provide producers with “the opportunity to obtain a fair return for their labor and investment” or to help “maximize the income” of farmers.

The notifications also included a description of the operations of STES in WTO member countries. For example, many countries reported that their STES held exclusive rights to import and/or export covered products. In addition, in some cases STES acted as the sole agent in the processing, marketing, distribution, and purchasing of controlled products. STES in some member countries were authorized to issue licenses or permits to import or export products and to process controlled products. Furthermore, some members reported that STES were involved in ensuring the quality of covered products and supporting research and development in those product sectors.



# Legal Remedies

Various trade remedies are available to the United States under international agreements and U.S. law. These include dispute settlement mechanisms for resolving government-to-government disputes, as well as U.S. laws that authorize U.S. agencies to conduct investigations and, where warranted, provide relief to U.S. industry. The following section provides an overview of these remedies.

## Dispute Settlement—GATT/WTO

The WTO dispute settlement rules are incorporated in the Uruguay Round's Understanding on Rules and Procedures Governing the Settlement of Disputes (Dispute Settlement Understanding), which is annex 2 to the WTO agreement. These rules apply to disputes under all the WTO agreements. The dispute settlement mechanism is intended to be a central element in providing security and predictability to the multilateral trading system. The dispute settlement mechanism is available for government-to-government disputes in which a WTO member believes that another has failed to meet an obligation agreed to in the WTO agreements. A panel report under the WTO Dispute Settlement Understanding must be adopted by the Dispute Settlement Body, unless there is a consensus not to adopt it. Prior to the establishment of the WTO in 1995, disputes were settled by GATT panels, whose decisions could be blocked by any party, including the country that did not prevail in the dispute.

## Dispute Settlement—CFTA/NAFTA

Three separate dispute settlement provisions of NAFTA are set forth in chapters 19, 20, and 11. They provide mechanisms for dealing with the three primary areas in which disputes can arise; they include, respectively, antidumping and countervailing duty matters, the interpretation and application of NAFTA, and the protection of investor rights. Chapter 19 lays out the system for the review of antidumping and countervailing duty final determinations made by the domestic agency of the importing country in the dispute. Chapter 19 contains a mechanism for replacing judicial review of final antidumping and countervailing duty determinations involving imports from Canada, Mexico, and the United States with review by independent, five-member, binational panels of experts drawn from an agreed roster developed by the signatories. Chapter 20 provides for five-member panels of experts to render decisions and recommendations. Chapter 20 establishes NAFTA's procedures for settling disputes between signatory governments regarding NAFTA's interpretation and application. NAFTA is unique among trade agreements because, under chapter 11, it contains a comprehensive regime for settling disputes between foreign investors and host governments.

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## Section 301 Investigations

Sections 301-309 of the Trade Act of 1974, as amended,<sup>1</sup> commonly referred to as “Section 301,” gives the President broad discretion to enforce U.S. trade rights granted by trade agreements and to attempt to eliminate acts, policies, or practices of a foreign government that violate a trade agreement or are unjustifiable, discriminatory, or unreasonable and burden or restrict U.S. commerce. Section 301 provides a domestic procedure under which affected enterprises or individuals may petition the U.S. Trade Representative to initiate actions to enforce U.S. rights under bilateral and multilateral trade agreements. USTR also may initiate Section 301 investigations at its own discretion.

Once an investigation is undertaken, USTR must consult with the foreign country alleged to have engaged in the unfair trade practices. If a mutually acceptable solution is not reached, and the complaint concerns a breach of an international agreement that has a dispute settlement mechanism, USTR is obligated to commence dispute settlement procedures as provided for in that agreement.<sup>2</sup>

If the determination at the end of the investigation is affirmative and involves a trade agreement or an alleged unjustifiable practice that burdens or restricts U.S. commerce, USTR must take action. If the determination is affirmative and involves an unreasonable or discriminatory practice that burdens or restricts U.S. commerce, USTR may decide which actions, if any, are appropriate. Section 301 permits USTR to decide to forgo trade action if a dispute settlement panel finds no violation of a trade agreement or that the offending action does not deny U.S. legal rights or nullify benefits under an agreement.<sup>3</sup> Remedies available include suspending trade agreement concessions; imposing duties, fees, or various import restraints; and denying service licenses.<sup>4</sup>

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## U.S. Antidumping Law

The antidumping law is set forth in title VII of the Tariff Act of 1930, as amended.<sup>5</sup> The law allows U.S. industry, including agricultural goods producers, to petition the government to impose additional duties on imports that the government determines are dumped and where the

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<sup>1</sup>19 U.S.C. 2411.

<sup>2</sup>19 U.S.C. 2413(a)(2).

<sup>3</sup>19 U.S.C. 2411(a)(2).

<sup>4</sup>19 U.S.C. 2411(c).

<sup>5</sup>19 U.S.C. 1673 *et seq.*

government determines that there is material injury to a U.S. industry producing a like product by reason of the dumped imports.

Dumping is generally defined as the sale of an exported product at a price lower than that charged for the like product in the “home” market of the exporters or at a price below cost. U.S. antidumping laws seek to redress this practice as a form of unfair price discrimination if an industry in the United States is materially injured or threatened with material injury by reason of the dumped imports. The U.S. antidumping law is applied in the context of internationally negotiated rules on antidumping proceedings and measures under the WTO antidumping agreement.<sup>6</sup>

Under the law, private parties petition the Department of Commerce and the ITC on behalf of a U.S. industry to determine whether a class or kind of merchandise is being sold in the United States at dumped prices and whether those imports are sufficiently injurious. Commerce is to determine whether sales are at “less than fair value” by calculating the difference between the normal value of the product (for example, the price in the home market) and the export price (for example, the price in the United States). In a parallel investigation, the ITC determines whether a U.S. industry is materially injured or threatened with material injury or whether the establishment of an industry in the United States is materially retarded by reason of the imports determined by Commerce to have been dumped, using criteria specified in the act.<sup>7</sup> If the agencies find that both dumping and the requisite injury exist, Commerce then calculates the amount of duties imposed on each importer to offset the price difference between the U.S. price and the normal value of the imported merchandise.

The information that must be provided in an antidumping petition is set forth in federal regulations.<sup>8</sup> The Commerce Department determines whether the petition “alleges the elements necessary for the importation of a duty,” based on “information reasonably available to the petitioner supporting the allegation.”<sup>9</sup> The party alleged to be dumping must respond to Department of Commerce questionnaires on sales volumes and prices that the Department creates and later verifies through on-the-spot

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<sup>6</sup>Section 1317 of the Omnibus Trade and Competitiveness Act of 1988 (19 U.S.C. 1677k) establishes procedures for the U.S. Trade Representative to request a foreign government to take action against third-country dumping that is injuring a U.S. industry.

<sup>7</sup>19 U.S.C. 1677.

<sup>8</sup>19 C.F.R. 353.12.

<sup>9</sup>19 U.S.C. 1673a(c)(1).

investigations. A failure to respond to the questionnaire or to permit verification may lead to a dumping determination supported by the “best information available,” that is, most likely the petitioner’s or other respondent’s written submissions.<sup>10</sup> Because this result may be undesirable to the party alleged to be dumping, the best information available rule has the effect of a subpoena, and most respondents answer the Commerce Department’s questionnaires. According to the Department of Commerce, aggregate values entered on U.S. Customs forms have often been used by domestic industries to establish U.S. sales prices in an allegation of dumping when filing an antidumping petition. Commerce officials further stated that although information regarding the prices, terms, and physical characteristics of the merchandise entering the United States is an important element of a dumping allegation in an antidumping petition, such information has been compiled from a variety of alternative sources.

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## U.S. Countervailing Duty Law

Subsidies provided by a government or public body may confer benefits on the recipient that provide an unfair advantage in international trade, such as allowing a producer to sell its products at a lower price than that of the competition. U.S. countervailing duty laws attempt to redress the adverse effects to a U.S. industry that seeks such relief.

The Tariff Act of 1930, as amended, provides for the imposition of countervailing duties whenever certain actionable subsidies are bestowed by a foreign government or public entity within a foreign country upon the manufacture, production, or export of any article that is subsequently imported into the United States causing injury.<sup>11</sup>

The process for countervailing duty investigations is similar to that for dumping. Commerce must determine whether a country is providing certain actionable subsidies to its industry or group of industries, either directly or indirectly. If Commerce finds that an actionable subsidy exists and the ITC determines that a U.S. industry is materially injured or threatened with material injury or that the establishment of an industry in the United States is materially retarded by reason of imports of the subsidized product, Commerce then calculates the amount of duties to be imposed on each importer to offset the subsidies provided for the manufacture, production, or export of that product. While governments can take many actions that could be said to confer benefits on their

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<sup>10</sup>19 U.S.C. 1677e(b).

<sup>11</sup>19 U.S.C. 1671 et seq.

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producers, not all of these actions are viewed as countervailable subsidies. Generally, the benefit must be limited to a specific group of firms or industries, or to a firm's export activities, in order to be covered under this law.<sup>12</sup>

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## **Section 332** **Investigations of** **Trade and Tariff** **Matters**

Under section 332 of the Tariff Act of 1930, as amended,<sup>13</sup> the ITC conducts investigations into trade and tariff matters upon request of the President,<sup>14</sup> the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, either House of the Congress, or upon the ITC's own initiative. Unlike other investigations by the ITC, the statute does not provide for initiating section 332 investigations by public petition. The ITC does, however, seek written submissions and participation in public hearings during most section 332 investigations.

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## **Investigations Under** **the Agricultural** **Adjustment Act**

Under the provisions of section 22 of the Agricultural Adjustment Act of 1933, as amended,<sup>15</sup> the President can impose fees or quotas on imported agricultural commodities that undermine any USDA domestic commodity support program. The act directs the Secretary of Agriculture to advise the President when the Secretary believes that an article is being imported in such quantities as to interfere with or affect any USDA support program or other agricultural program. If the President agrees, he or she must order an investigation by the ITC. Based upon the ITC investigation, the President can make an affirmative determination and impose import fees or import quotas on the product in question.

These provisions are no longer applicable to products of countries or entities that are WTO members. Title IV of the Uruguay Round implementing legislation eliminates the use of quantitative restrictions on agricultural goods under section 22 for products of WTO members.

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<sup>12</sup>19 U.S.C. 1677(5A).

<sup>13</sup>19 U.S.C. 1332.

<sup>14</sup>The President has delegated authority to request investigations to the USTR.

<sup>15</sup>7 U.S.C. 624.

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## Safeguards—ITC Investigations of Serious Injury to U.S. Industries From Increased Imports

A safeguard is a temporary import control or other trade restriction a country imposes to assist domestic industry seriously injured by increased imports that are fairly traded. Generally they must be applied to merchandise from all sources without discriminating against any particular country. The safeguard clause in article XIX of GATT allows WTO members to obtain emergency relief from increased imports.<sup>16</sup> Sections 201-204 of the Trade Act of 1974, as amended,<sup>17</sup> authorize the ITC to conduct investigations concerning whether an article is being imported into the United States in such increased quantities as to be a substantial cause of serious injury, or the threat thereof, to the domestic industry producing a like or directly competitive article.<sup>18</sup>

In making its determination, the ITC is required to take into account all relevant economic factors.<sup>19</sup> For example, in determining serious injury, the ITC must consider whether (1) productive facilities in the industry have been significantly idled, (2) a significant number of firms have been able to operate at a reasonable level of profit, and (3) significant unemployment or underemployment has occurred within the industry. In determining the threat of serious injury, the ITC must consider, among other factors, a decline in sales or market share; a higher and growing inventory; and a downward trend in production, profits, wages, productivity, or employment in the industry. The ITC is required to consider the condition of the domestic industry over the relevant business cycle and examine factors other than imports that may be the cause of serious injury, or threat of serious injury, to the domestic industry.

If the ITC makes an affirmative injury determination, it is required to recommend the action that would most effectively address the serious injury or threat to the domestic industry.<sup>20</sup> The ITC may recommend to the President relief in the form of new or increased tariffs, quotas, trade

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<sup>16</sup>Additionally, the WTO Agreement on Agriculture provides for the imposition of special agricultural safeguards for designated agricultural products that have been subject to tariffication, such as beef, cheese, and peanuts. There are two types of special safeguards, each of which allows for additional duties to be imposed: a “volume-based” safeguard may be applied whenever imports exceed a certain quantity, and a “price-based” safeguard may be applied to products whose price is below a price threshold. These special agricultural safeguards, however, do not apply to products from Canada or Mexico.

<sup>17</sup>19 U.S.C. 2251-54.

<sup>18</sup>The ITC may initiate an investigation on its own motion; at the request of the President, USTR, the House Committee on Ways and Means, or the Senate Committee on Finance; or upon petition of an entity representative of an industry.

<sup>19</sup>19 U.S.C. 2252(c).

<sup>20</sup>19 U.S.C. 2252(e).

adjustment assistance to workers, or a combination of these measures. The President may then take action consistent with the ITC recommendation or other action deemed appropriate.<sup>21</sup> The President must report to the Congress on the action that he or she is taking. If he or she takes action that differs from that recommended by the ITC or takes no action at all, the Congress may, through a joint resolution, direct the President to proclaim the relief recommended by the ITC.<sup>22</sup>

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## **Safeguard—Bilateral Emergency Action Safeguard Procedures**

NAFTA provides for a separate bilateral safeguard action in a case of injury due to the reduction or elimination of duties under NAFTA.<sup>23</sup> Under U.S. NAFTA implementing legislation,<sup>24</sup> the process for seeking relief is similar procedurally to that for global safeguard investigations.<sup>25</sup> If the ITC finds that, as a result of the reduction or elimination of a duty provided for under NAFTA, a product from Canada or Mexico is being imported in such increased quantities and under such conditions that imports of the product, alone, constitute a substantial cause of serious injury, or the threat of serious injury, to the domestic industry producing a like or directly comparable product, it makes a recommendation to the President. The President is responsible for making the final decision on whether to grant relief; available relief is limited to an increase in duty to the lesser of the pre-NAFTA rate or the current most-favored-nation rate. Unlike the general safeguard provision under GATT, NAFTA requires that a party taking such action provide mutually agreed compensation in the form of concessions having substantially equivalent trade effects or the equivalent value of the additional duties expected to result from the relief action.<sup>26</sup> Provisional relief is available under these bilateral emergency action procedures.

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<sup>21</sup>In addition to these recommendations, the ITC may also recommend that the President initiate international negotiations to address the underlying cause of the increase in imports of the article or otherwise to alleviate the injury or threat. The ITC may, in addition, recommend that the President implement any other action authorized under law that is likely to facilitate positive adjustment to import competition (19 U.S.C. 2252(e)(4)).

<sup>22</sup>19 U.S.C. 2253(c).

<sup>23</sup>As a general rule, these bilateral actions may be taken only during NAFTA's transitional period (that is, the 10- to 15-year period during which duties are being phased out).

<sup>24</sup>19 U.S.C. 3352.

<sup>25</sup>NAFTA countries retain their rights to use general safeguards, although NAFTA limits the ability of a NAFTA country to apply a general safeguard to another NAFTA country. A NAFTA party wishing to apply a general safeguard to another NAFTA country must find that imports from the NAFTA country account for a substantial share of total imports and contribute importantly to the serious injury or threat caused by the imports in question.

<sup>26</sup>NAFTA article 801.4.

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# Application of U.S. Antitrust Laws and the CWB

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It is well established through statute<sup>1</sup> and case law that U.S. antitrust law can reach beyond our borders to address foreign activity if that activity has the required effect in the United States. Antitrust enforcement, whether initiated (1) by the U.S. government through the Department of Justice or the Federal Trade Commission,<sup>2</sup> (2) by private parties,<sup>3</sup> or (3) by state attorneys general,<sup>4</sup> is carried out through legal proceedings in U.S. courts, or in the case of the Federal Trade Commission, through administrative proceedings. When a court applies our antitrust laws, whether domestically or internationally, it must determine whether particular conduct constitutes a practice covered by a provision within those laws. Analyzing the applicability of antitrust law to the CWB, however, is further complicated by the nature of the CWB as a quasi-governmental entity, certain acts of which could be covered by sovereign immunity and related doctrines. Thus, any potential applicability of U.S. antitrust law to the CWB will depend on the specific conduct or activities of the CWB.

Department of Justice officials in the Antitrust Division told us that the division has not, at least within the last 20 years, initiated any action against the CWB, nor were they aware of any deliberations contemplating such action. These officials, as well as an official at the Federal Trade Commission, stated that they could not provide a definitive answer to the question of the applicability of U.S. antitrust laws to the CWB, emphasizing the fact-specific nature of such cases. A general principle that emerges from a review of applicable case law and discussion with government officials, however, is that courts would be more likely to apply U.S. antitrust law to CWB activities where those activities are not compelled under Canadian law and where the CWB is acting as a participant in the wheat market and not as a regulator. On the other hand, courts are unlikely to accept a challenge against CWB conduct that is required under Canadian law governing the marketing and export of wheat even where that conduct conflicts with U.S. antitrust law. Courts are also unlikely to find jurisdiction over activities of the CWB that could be considered sovereign activity of the Canadian government.

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<sup>1</sup>15 U.S.C. 6a.

<sup>2</sup>The Department of Justice and the Federal Trade Commission share responsibility for enforcing the antitrust laws at the federal level.

<sup>3</sup>It is reported that private actions accounted for approximately 95 percent of all antitrust litigation in the U.S. District Courts in 1997. See *Judicial Business of the United States Courts*, Table C-2 (Washington D.C.: Administrative Office of the U.S. Courts, 1998).

<sup>4</sup>State Attorneys General enforce U.S. antitrust laws pursuant to section 4c of the Clayton Act of 1914, as amended. 15 U.S.C. 15c. State Attorneys General also enforce state antitrust laws.



While other U.S. laws may possibly be relevant to potential antitrust theories,<sup>5</sup> a broad prohibition on anticompetitive behavior is contained in the Sherman Act of 1890.<sup>6</sup> Section 1 makes illegal “[e]very contract, combination . . . or conspiracy, in restraint of commerce or trade among the several States, or with foreign nations.”<sup>7</sup> Section 2 of the Sherman Act prohibits monopolization of, attempts to monopolize, and conspiracies to monopolize any part of trade or commerce among the several states or with foreign nations. Under U.S. law, however, U.S. producers of agricultural products are permitted to act together in, among other things, processing and marketing their products and, thus, enjoy a qualified immunity from antitrust laws.<sup>8</sup>

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## **Extraterritorial Reach of U.S. Antitrust Laws**

A number of issues have an effect on the extraterritorial application of U.S. antitrust laws. These issues include subject matter jurisdiction, personal jurisdiction, international comity, the act of state doctrine, and foreign sovereign compulsion.

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## **Subject Matter Jurisdiction**

U.S. courts have held that the Sherman Act applies to foreign conduct that was meant to produce and did in fact produce some substantial effect in the United States.<sup>9</sup> Thus, for example, where foreign companies organize a cartel for the purpose of raising the price of a product in the United States, it will have met the intent element of the test. Whether the imports have a substantial effect in the United States, of course, will depend on the particular facts present.

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## **Personal Jurisdiction**

In order to bring a suit in a U.S. court, the court must have personal jurisdiction over the defendant. Courts have required that the defendant have “minimum contacts” with the United States such that an exercise of

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<sup>5</sup>For example, the Clayton Act of 1914 (15 U.S.C. 12-27), prohibits a variety of business practices whose effect may be to substantially lessen competition or tend to create a monopoly. According to the “Antitrust Enforcement Guidelines for International Operations” (April 1995) (Antitrust Guidelines), the Clayton Act expands on the general prohibitions of the Sherman Act of 1890 and addresses anticompetitive problems in their incipiency.

<sup>6</sup>15 U.S.C. 1-7.

<sup>7</sup>15 U.S.C. 1.

<sup>8</sup>Capper-Volstead Act, 7 U.S.C. 291.

<sup>9</sup>Hartford Fire Insurance Co. v. California, 509 U.S. 764 (1993).

jurisdiction comports with “fair play and substantial justice.”<sup>10</sup> The antitrust guidelines state that the Department of Justice and the Federal Trade Commission interpret the concept of transacting business pragmatically. For example, jurisdiction over a foreign entity may be established through a related company in the United States acting as its agent or alter ego.

The 1976 Foreign Sovereign Immunities Act provides immunity from suit in U.S. courts for the sovereign acts of foreign states and agencies or instrumentalities owned by a foreign state.<sup>11</sup> Under the act, a key question for establishing personal jurisdiction over the CWB would be whether the alleged anticompetitive activities are sovereign or commercial as defined in the act. A foreign government is not immune from suit in any case “in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.”<sup>12</sup>

The antitrust guidelines state that in attempting to distinguish commercial from sovereign activity, courts have considered whether the conduct being challenged is customarily performed for profit and whether the conduct is of a type only a sovereign can perform. The guidelines conclude that most activities of government-owned corporations operating in the commercial marketplace will be subject to U.S. antitrust laws to the same extent as the activities of foreign, privately owned firms.

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## International Comity

Where two governments prescribe inconsistent conduct of the same person, the U.S. courts have held that they must “consider, in good faith, moderating the exercise of [their] enforcement jurisdiction.”<sup>13</sup> Potential or actual conflicts among national legal systems are often avoided or moderated by deference shown by one nation’s courts to the courts and laws of another state, a deference referred to as “comity.” Although the application of comity is discretionary, courts have enumerated specific

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<sup>10</sup>International Shoe Co. v. Washington, 326 U.S. 310 (1945).

<sup>11</sup>28 U.S.C. 1602, 1603(a),(b).

<sup>12</sup>28 U.S.C. 1605(a)(2).

<sup>13</sup>Timberlane Lumber Co. v. Bank of America, 549 F.2d 597 (9th Cir. 1976).

factors to be considered, including the degree of conflict with foreign law or policy.

In 1993, the Supreme Court had an opportunity to clarify the law concerning the degree of conflict factor for purposes of comity analysis.<sup>14</sup> In that case, 19 states and numerous private plaintiffs had brought cases against domestic insurers and domestic and foreign reinsurers of general commercial liability. The plaintiffs alleged that the insurance companies had conspired to restrict the terms of coverage of commercial general liability insurance available in the United States. The district court dismissed the case on the grounds of comity, finding that a “significant” conflict with English law and policy would result from application of U.S. antitrust law to the British reinsurers’ conduct and operations in the United Kingdom and that the interference and harm caused by the conflict was not outweighed by other factors. The Court of Appeals for the Ninth Circuit reweighed the factors that figured in the comity balance and reversed the decision.

The Supreme Court held that comity did not justify dismissal. The Court found that subject matter jurisdiction existed since there had been foreign conduct that “was meant to produce and did in fact produce some substantial effect in the United States.” The Court rejected the claim that conflict with foreign law existed, holding that no conflict exists for purposes of an international comity analysis if the person subject to the regulation by two states can comply with both. The Court determined that conflict did not exist because the defendants could have complied with the law of both nations at the same time. Thus, in a proceeding against the CWB, in considering whether comity would weigh against review, one factor a court might look to would be whether the activities that form the basis of the alleged antitrust violation were required by Canadian legislation governing the CWB’s activities.

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## The Act of State Doctrine

According to Department of Justice and Federal Trade Commission officials, a key defense the CWB may raise against the application of U.S. antitrust law to activities of the CWB is the act of state doctrine. As described in the antitrust guidelines, the act of state doctrine is a judge-made rule of federal common law.<sup>15</sup> It applies only if the specific conduct complained of is a public act of the foreign sovereign within its territorial jurisdiction on matters pertaining to its governmental

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<sup>14</sup>Hartford Fire Insurance Co. v. California, 509 U.S. 764 (1993).

<sup>15</sup>Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964).

sovereignty. The guidelines explain further that while the act of state doctrine does not compel dismissal as a matter of course, judicial abstention is appropriate in a case where the court must “declare invalid, and thus ineffective as a rule of decision in the U.S. courts . . . the official act of a foreign sovereign.”<sup>16</sup>

The act of state doctrine, however, has been held to be inapplicable to the commercial activities of a foreign state.<sup>17</sup> In this regard, the antitrust guidelines state that the U.S. government would not challenge foreign acts of state if the fact and circumstances indicate that (1) the specific conduct complained of is a public act of the sovereign; (2) the act was taken within the territorial jurisdiction of the sovereign; and (3) the matter is governmental, rather than commercial. Determining whether a particular action is a commercial activity rather than an act of state is a fact-specific question. According to an Federal Trade Commission official, if the CWB were viewed as a regulator of wheat rather than a participant in the wheat market, that is, if the CWB were considered by a U.S. court as a regulating arm of government, then its activity could be immune from the reach of U.S. antitrust law.<sup>18</sup> On the other hand, if a court considered the CWB to be, in effect, a government-chartered entity engaged in a commercial endeavor, the act of state doctrine may not provide immunity to the CWB.

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## Foreign Sovereign Compulsion

Under circumstances where the foreign sovereign has compelled the very conduct that the U.S. antitrust law prohibits, the Department of Justice and the Federal Trade Commission will recognize a foreign sovereign compulsion defense.<sup>19</sup> The scope of this defense is considered limited,<sup>20</sup> and the Department of Justice and the Federal Trade Commission will refrain from enforcement actions on the grounds of foreign sovereign compulsion only when three criteria are satisfied: (1) the foreign government must have compelled the anticompetitive conduct under circumstances in which a refusal to comply with the foreign government’s command would give rise to the imposition of penal or severe sanctions; (2) the compelled conduct can be accomplished entirely within its own

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<sup>16</sup>W.S. Kirkpatrick & Co. v. Environmental Tectonics Corp., 493 U.S. 400 (1990).

<sup>17</sup>Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682 (1976).

<sup>18</sup>See International Assoc’n of Machinists and Aerospace Workers v. OPEC, 477 F. Supp. 553 (1979), aff’d. 649 F.2d 1354 (1981), cert. denied 454 U.S. 1163 (1982).

<sup>19</sup>See Antitrust Guidelines; Interamerican Refining Corp. v. Texaco Maracaibo, Inc., 307 F. Supp. 1291 (1970) (antitrust immunity if illegal acts were compelled by foreign sovereign).

<sup>20</sup>See In re Japanese Electronic Products Antitrust Litigation, 723 F.2d 238 (1983).

territory; and (3) the order must come from the foreign government acting in its governmental capacity.

The foreign sovereign compulsion defense, as well as the act of state and comity doctrines, were invoked to dismiss a recent antitrust challenge to an STE. In that case in which a private plaintiff alleged that the New Zealand Dairy Board violated the Sherman Act, the District Court dismissed the action, finding that there was an actual and material conflict between U.S. antitrust law and New Zealand law regarding the export of dairy products.<sup>21</sup> The court looked to the underlying statutory scheme empowering the Board and essentially determined that the Board's conduct was required by its statute. The court declined jurisdiction on the grounds of foreign sovereign compulsion, act of state, and international comity. While not specifically explained in the decision, to the extent the Board is a participant in the market engaging in activities compelled by New Zealand law, the foreign sovereign compulsion doctrine would appear to apply. According to the Department of Justice and Federal Trade Commission officials, however, the foreign sovereign compulsion doctrine is usually limited to private parties. The decision of the court demonstrates the interrelationship of these doctrines, each of which could be significant in analyzing the potential applicability of U.S. antitrust law to a quasi-governmental entity like the CWB.

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<sup>21</sup>Trugman-Nash, Inc. v. New Zealand Dairy Board, 954 F. Supp. 733 (1997).

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