

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

(WT/DS103)

May 6, 2002

COMMENTS OF THE UNITED STATES ON CANADA'S RESPONSES TO THE PANEL'S QUESTIONS

General Comment

1. Because many of Canada's responses have been addressed by the United States in its answers to the questions from the Panel or in its written submissions and oral statement, the United States has endeavored to limit its comments on Canada's responses. Thus, the absence of a comment by the United States should not be construed as agreement or acquiescence with Canada's answer.

Question 4(a)

2. As explained in our written submissions and during the panel meeting, Canada's claim that 77 percent of its producers fall within the range of CEM returns is without foundation as Canada has admitted that there is no correlation between the producers and the CEM returns.

3. More importantly, Canada's response to Question 4 constitutes an admission that it cannot satisfy its burden of proof under Article 10.3 of the *Agreement on Agriculture* with respect to the "payment" element under Article 9.1(c). Even under Canada's restricted calculation of the cost of production and misleading "decile" approach, Canada admits that 23 percent of its producers do not fall within the range of CEM returns *and* that it cannot demonstrate that those producers are not participating in CEM transactions. Thus, Canada cannot show that those producers are not making a "payment" to processors.

4. Canada's response that it is "reasonable to conclude that a producer would not participate in commercial export transactions unless he or she could recoup the amount spent on variable and fixed costs over time" assumes away the test set forth by the Appellate Body. If it could be considered reasonable to assume that only producers who can cover their average total cost of production will participate in CEM transactions, there is no reason to actually calculate the total cost of production in order to compare it to CEM prices.

Question 5

5. Contrary to Canada's argument, the CDC guidelines include the costs of family labor,

management services and capital in the cost of production calculation because these are actual costs incurred by the producer. As previously explained, these items are labelled as costs by the CDC and, more importantly, calculated as costs. If a producer does not recoup these costs, it will incur losses over the long term.

Question 6

6. The fact that Canada may choose to set its administered price near the average total cost of production does not change the reliability or relevance of the underlying cost data. Even Canada admits in response to Question 6 that “the setting of price is a separate exercise to the calculation of cost of production by the CDC.”

Question 9(e)

7. Again, Canada's admission that Exhibits CDA-9, CDA-11 and CDA-13 “do not link commercial export milk returns with the individual producer's average total cost of production” and that Canada has “no legal authority” to access data that would demonstrate any such linkages means that those exhibits provide no foundation for any conclusions regarding the percentage of producers covering their total cost of production.

Question 14

8. The United States notes that Canada finally admits in paragraph 83 that “[a]n ‘exemption’ from the requirement to pay the administered domestic price is not necessary to the protection of entitlement to the domestic administered price.” As previously explained, Canada has now confirmed that there is no reason other than the transfer of economic resources from producers to processors for this price exemption.

Question 17

9. Contrary to Canada's assertion, the Appellate Body report in *United States - FSC*¹ does not state that an export subsidy under Article 10.1 of the *Agreement on Agriculture* must fulfill the general definition of a subsidy in Article 1 of the *Agreement on Subsidies and Countervailing Measures* (“SCM Agreement”). In paragraphs 136-140, the Appellate Body drew on Article 1 as “context” but conducted a separate “transfer of economic resources” legal analysis under the provisions of Article 10.1. The Appellate Body did not state that the requirements of Article 1 must be considered and satisfied in order to find a violation of Article 10.1.

¹ *United States - Tax Treatment for “Foreign Sales Corporations”* (AB-1999-9) WT/DS108/AB/R.

Question 32

10. As Canada's answer to Question 32 inadvertently points out, the calculation of "normal value" under the Anti-dumping Agreement coincides with the calculation of "proper value" contemplated by the Appellate Body. In both cases, all economic costs must be taken into account. As the Appellate Body explained in paragraph 87:

"For any economic operator, the production of goods or services involves an investment of economic resources. In the case of a milk producer, production requires an investment in fixed assets, such as land, cattle and milking facilities, and an outlay to meet variable costs, such as labour, animal feed, health care, power and administration. These fixed and variable costs are the total amount which the producer must spend in order to produce the milk and the total amount it must recoup, in the long term, to avoid making losses."

11. Just because administrative, selling and general costs are placed under separate headings for purposes of the Anti-dumping Agreement does not change the fact that they are economic costs to the producer. Likewise, the family labor cost and the cost of capital would be included as part of the "normal value" cost construction. For example, Canada's Customs and Revenue Agency's November 9, 2001 cost estimate in the antidumping investigation into "Fresh Tomatoes" included a "cost schedule to account for all non-cash overhead costs, including depreciation and return on investment in equipment and buildings." Just as these costs are included in the "normal value" calculation under the Anti-dumping Agreement, they should be included in the "proper value" calculation. They constitute costs which the producer must recoup in order to avoid incurring losses in the long-term.

12. As explained in the United States' answer to Question 32, the reference to "generally accepted accounting principles" (GAAP) in Article 2.2.1.1 of the Anti-dumping Agreement is a reference to the reliability of the producer's records, and not a definition of the items to be included in the cost of production calculation.

Question 38

13. The United States still disagrees with the conversion factors proposed by Canada. Recent contracts on the Ontario Bulletin Board have been based on milk with 3.9 % fat, 3.3 % protein and 5.7 % other solids which means drying one hectoliter of milk will give 12.9 kilograms of whole milk powder. Or, inverting the process, one kilo of whole milk powder will give 7.75 liters of milk. Since those percentages are the basis for CEM prices, we do not understand the justification for using a different factor for imported product.

Paragraph 134 & Table 2, Footnote 27

14. On a technical basis, only whole milk powder (WMP) can be re-hydrated to give a product roughly comparable to export milk. Skim milk powder can be re-hydrated but it is not useful for applications needing a fat component. Similarly pure butter is not useful for applications needing protein. For example, to truly compare IREP with CEM prices in table 2, the skim milk powder price of \$27.23 would need to be combined with either the value of butter at \$10.48 or for butteroil at \$9.52 giving a value near or above \$37/hl. Of course it is still a dry product and still in port, so re-hydration and transportation costs would still apply.

Paragraph 145 & Tables 4-5

15. This section largely confirms the U.S. contention that most IREP imports are not applicable to the products of concern in this dispute. Table 5 indicates that confectionary products (none of which are relevant here) account for over two-thirds (on a milk-equivalent basis) of IREP imports. In contrast, yogurt accounts for an insignificant 15,000 hectoliters. In the yogurt table, the most directly competitive import, liquid whole milk, is priced at \$87/hl -- a level that is not even competitive in the domestic market much less the CEM market.

16. Table 4 showing IREP imports for cheese manufacture is confusing since it nearly all imports are butter and butter oil. Butter and butter oil would be used in cheese manufacture to boost the fat content of cheese. However, typical cheese making operations in North America involve using milk either as it comes from the farm or with some fat removed before the milk goes into the cheese vat. The latter reflects modern dietary concerns that most 'full-fat' cheeses have too much fat. With the exception of a very few high-fat cheese types, it is seldom necessary to boost the fat content of normal milk. Thus, rather than presenting a picture of IREP imports that are competitive with contract export milk, as claimed by Canada, Table 4 seems to indicate a pattern where these imports are complementary or supplementary to some aspect of cheese making in the domestic economy. The butterfat imports shown by Table 4 are many times too large to be viewed as a possible supplement to cheese manufactured for export under the CEM system. Of course, if the economics of cheese production in the domestic system are involved, particularly if the IREP imports are complementary products, then price comparisons between the CEM system and IREP are not worthwhile.