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State Trading Enterprises: A Canadian Perspective

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This paper provides a Canadian perspective on the debate about state trading enterprises in the World Trade Organization. STEs carry out important economic functions as part of national policies. STEs can do this without distorting competitive equilibrium in trade. From an economic and legal standpoint, STEs can properly function within the WTO system. The paper comments on why WTO rules on STEs may be practically meaningless, given the lack of application of the STE rules in WTO dispute resolution. The suggestion is made that the direction of legal inquiry into STEs should focus on the question of trade influence, rather than on the political question of government control of STEs. The real economic trade effects of STEs are the important aspects of STE study, not the ideological aspects of STE governance.

Keywords: ideology; state trading; subsidies; unfair trade; WTO

Introduction

The topic of state trading enterprises (STEs) has attracted much attention lately in trade law circles. There are two main reasons for this. First, the United States focused much attention on STEs leading up to the World Trade Organization (WTO) negotiations in December 1999. Second, many of the former or current centrally planned economies (e.g., China) have applied for WTO membership and maintain STEs. These applications for WTO membership raise questions about how STEs fit in with WTO principles and rules. As a result, interest in STEs is currently very high.

This paper will provide a Canadian perspective on the STE debate. The majority Canadian view is that STEs have a legitimate place in world trade. They carry out important economic functions for the benefit of Canadian citizens. They can do this without distorting competitive equilibrium in trade. From an economic and legal standpoint, Canada's view is that STEs can properly function within the WTO system.

This paper provides a perspective on two further issues. First, the WTO rules on STEs may be practically meaningless. Second, the debate on STEs has been wrongly focused by the United States on the political question of government control of STEs instead of on the real economic issue of the trade influence of STEs. The paper suggests a redirection of the legal inquiry in the direction of trade influence.

Why Are STE Rules Such a Hot Topic?

Why Are There WTO Rules on STEs?

The introductory question to the topic of STEs is: What is it about STEs that the WTO is trying to regulate? This question is answered by recognizing that the original GATT contracting parties wanted to prevent governments from doing indirectly what they were agreeing not to do directly. They wanted to stop each other from circumventing the rules that they had adopted. Governments were willing to agree, in GATT 1947,[1] to a certain extent at least, not to use STEs to avoid commitments on trade measures like tariffs, subsidies, and quantitative restrictions. This agreement limiting the use of STEs to activities that comply with GATT rules remains part of WTO rules today.

STEs in Trade Generally

The rules in GATT 1947 regarding state trading applied to all types of trade in both primary and processed products. At that time, tariffs and market access were the main concerns. Export subsidies were not a primary concern. In fact, GATT permitted the continued use of export subsidies for primary products, even after it restricted their use for manufactured or processed products in 1955. The STE rules continued to apply to all products, but against this backdrop of other GATT rules.

Trade in agricultural and food products dominates international trade by STEs, but other products have their trade conducted by STEs as well. State trading in general is widely practised throughout the world with respect to a variety of products. At one time trade by STEs included at least one quarter of total world trade.[2] This has led to numerous examinations of the international treatment of state trading.[3] For example, trade in minerals has a significant STE component. The issue of subsidized mineral production by STEs and compliance with GATT rules has been examined in the past.[4] The issue of GATT rule compliance by STEs is relevant to industrial products as well as agricultural products.

STEs in International Agricultural Trade

State trading enterprises play a significant role in international agricultural trade. The international trade operations of STEs made up 10 percent to 15 percent of the total trade of GATT member countries in 1962,[5] and the percentage has likely grown since then. Exact statistical analysis is difficult to do considering the confidential nature of this type of information. A study of State Trading Notifications to the GATT Secretariat for the period 1980 to 1994 showed that 68 percent of the reporting countries had an STE involved in grain and cereal trade, and 60 percent had one involved in dairy products trade.[6] Since the WTO was created in 1995, these Notifications show 121 STEs in countries trading in agricultural products.[7] STEs have a prominent place in international agricultural trade, and therefore have an influence on Canada's export trade.

In 1995, Canada's exports of agricultural products were valued at just over $20 billion.[8] This represented about one-third of Canada's agricultural output.[9]

Canadian exports of agricultural products involve state trading enterprises such as the Canadian Wheat Board, the Canadian Dairy Commission, and the Ontario Bean Producers' Marketing Board.[10] These Canadian agencies had combined export sales in 1995 of over $6.2 billion. This amounted to over 30 percent of Canada's agricultural export sales.

The world wheat trade is an example of the extensive role of STEs in world trade. STEs have long played an important role in the world trade of this important strategic commodity. The extent of the involvement of state traders in this commodity was first analyzed by McCalla and Schmitz in 1982.[11] Their statistics on the share of the world wheat trade handled by state trading exporters were recently updated.[12] The statistics show that in the period 1990 to 1994, exports by STEs made up 94 percent of the world wheat trade. These statistics are an indication of the potential effects of STEs on the terms of world trade, especially in agricultural products.

Prior to the Uruguay Round Agreement on Agriculture[13] in 1994, many GATT 1947 provisions did not apply to trade in primary agricultural products. Since many STEs dealt with such products, they were not subject to GATT rules. But the Agreement on Agriculture has brought GATT disciplines to this area of trade. How will these rules now be applied to STEs that trade or influence trade in agricultural products? The Agreement on Agriculture is the most important reason that STEs are a contentious issue at this time.

A further WTO negotiating round was set to begin with a Ministerial Conference in December 1999 in Seattle, Washington. Despite the fact that the ministers could not agree on a negotiating agenda at that time, the WTO will attempt to continue the negotiating process. It is expected that discussions regarding STEs will arise in these negotiations because of the extensive role STEs play in agricultural trade.

Accession Negotiations

The applications by China and others for membership in the WTO raise the question of the application of STE rules to the centrally planned economies now in transition. Can the rules be applied as they are? Will they be amended just for these new members, or for all members? How will WTO rules on STEs deal with the problem of market access in formerly centrally planned economies?[14] A good understanding of STE law and economics will help deal with these applications for membership in the WTO, as these countries still depend heavily on state trading enterprises to complete international transactions.

Formerly Centrally Planned Economies

The expansion of exports from formerly centrally planned economies has also been a reason to reconsider the STE rules. These economies still conduct much of their trade through agencies controlled by the state even though they are members of the WTO. There has been a similar growth in export trade from developing countries, which often use state trading agencies to manage trade. The increase in exports from these economies encourages an examination of how STE rules apply to them.

STE Rules as Part of the WTO Institution

As illustrated, trade by STEs has a major impact on the Canadian economy. Until 1994, GATT did not regulate the subsidized trade of agricultural products by STEs. An example of this absence of regulation is the recent wheat subsidy war between the United States and the European Union. Both governments arguably used STEs to administer subsidies. Neither the main protagonists, nor the other WTO members who were hurt by the subsidies, attempted to use GATT rules to control the subsidy war. Neither government had the political will to stop the subsidy battle, even when it beggared their treasuries and wreaked havoc on third countries, including Canada. This provided the impetus to try to improve the GATT rules in the Uruguay Round. Progress was made in the Agreement on Agriculture. The subsidy battle is, however, heating up again. Is there any hope that WTO rules regulating STE activities in the area of agricultural trade will prevent such subsidy battles and their disastrous effect on Canadian agriculture?

The Unfair Trade Complaint

The main U.S. complaint about export-oriented STEs is that they engage in unfair trade. The unfair trade complaint is a serious challenge to liberalized rules of trade. The basic argument is that trade is fair only if all trading states have similar kinds of domestic policies. The debate becomes heated when some countries, such as the United States, allege that they do not use STEs and argue that their policies are undermined by those countries, for example, Canada, that do use them as part of their domestic policy.[15]

The unfair trade complaint usually amounts to the complaint that STEs engage in excessive price cutting.[16] The question then becomes: What is "excessive" price cutting? Is it selling below the world price established by others? Is it selling below cost of production and marketing for the STE? Is it selling below the costs of other competitors? An examination of STE economics would help to address these questions about the meaning of unfair trade.

Domestic Policy Implications

It is especially important to consider some of the terms of GATT 1994[17] because of the potential impact that they have on domestic policy. For example, the GATT rules that apply to STEs will have an impact on organizations such as the Canadian Wheat Board and the Canadian Dairy Commission. These rules affect the Canadian Wheat Board monopoly with regard to the purchase of wheat and barley from Canadian producers and with regard to its selling practices. The United States has just succeeded in a WTO complaint about certain practices of the Canadian Dairy Commission.[18] Thus, STE rules have an impact in all areas of domestic and trade policy.

What Are the WTO Rules?

GATT Article XVII

The heart of WTO rules on STEs is:

Article XVII: State Trading Enterprises[19]

1. (a) Each contracting party undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges, such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.

   (b) The provisions of sub-paragraph (a) of this paragraph shall be understood to require that such enterprises shall, having due regard to the other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.

   (c) No contracting party shall prevent any enterprises (whether or not an enterprise

described in sub-paragraph (a) of this paragraph) under its jurisdiction from acting in accordance with the principles of sub-paragraphs (a) and (b) of this paragraph.

2. The provisions of paragraph 1 of this Article shall not apply to imports of products for immediate or ultimate consumption in governmental use and not otherwise for resale or use in the production of goods for sale. With respect to such imports, each contracting party shall accord to the trade of the other contracting parties fair and equitable treatment.

3. The contracting parties recognize that enterprises of the kind described in paragraph 1 (a) of this Article might be operated so as to create serious obstacles to trade; thus negotiations on a reciprocal and mutually advantageous basis designed to limit or reduce such obstacles are of importance to the expansion of international trade.

4. (a) Contracting parties shall notify the CONTRACTING PARTIES of the products which are imported into or exported from their territories by enterprises of the kind described in paragraph 1(a) of this Article.

   (b) A contracting party establishing, maintaining or authorizing an import monopoly of a product, which is not the subject of a concession under Article II, shall, on the request of another contracting party having a substantial trade in the product concerned, inform the CONTRACTING PARTIES of the import mark-up on the product during a recent representative period, or, when it is not possible to do so, of the price charged on the resale of the product.

   (c) The CONTRACTING PARTIES may, at the request of a contracting party which has reason to believe that its interests under this Agreement are being adversely affected by the operations of an enterprise of the kind described in paragraph 1 (a), request the contracting party establishing, maintaining or authorizing such enterprise to supply information about its operations related to the carrying out of the provisions of this Agreement.

   (d) The provisions of this paragraph shall not require any contracting party to disclose confidential information which would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises.

The legal rules in Article XVII are supplemented by further provisions in an Interpretive Note[20] and an "Understanding on the Interpretation of Article XVII."[21]

A Working Definition for GATT 1994

The ongoing discussions about the definition of "state enterprises" appear to have culminated in a "working definition" of the term in the Uruguay Round "Understanding on the Interpretation of Article XVII" of GATT 1994. The working definition is:

> 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.

This definition appears to be a functional definition which focuses on the exercise of special rights or privileges that have an influence on the level or direction of imports or exports. This represents a shift from the early U.S. Suggested Charter institutional approach which focused on the control of the enterprise exercised by government. The working definition is the definition that will likely be used by GATT panels if necessary.

Despite this working definition of STEs from the WTO, the United States seems to maintain a different view of what an STE is. In a report by the Congress in 1996,[22] the United States General Accounting Office stated:

> STEs are generally considered to be enterprises that are authorized to engage in trade and are owned, sanctioned, or otherwise supported by the government.

This different description of STEs may yet lead to disputes about what an STE is. Tinkering with the definition will not mean much in legal circles until some WTO members are challenged on their STE practices in the dispute resolution process.

Notification Requirements

In addition to the substantive obligation of non-discriminatory treatment set out in Article XVII (1) a, WTO members have an obligation to notify the WTO about the trade activities of their STEs. The purpose of this obligation is to provide information that will give transparency to the activities of the STE so that compliance with the substantive obligations can be addressed. For example, how can it be determined if an STE exporter is subsidizing sales, if information is not publicly available to determine prices or other transaction information? This has been a vexing legal problem since GATT 1947 first attempted to prevent rule circumvention by STEs.

The transparency issue has gained new significance with the Agreement on Agriculture. Now that more STEs are the subject of scrutiny in the area of agricultural products, there are new demands for information from these STEs. These demands arise from the needs of WTO members to have economic data to assess the issues of subsidies and trade influence. It is important, however, to assess what the real legal obligations of WTO members are regarding disclosure about STEs. The obligations are contained in the

mandatory questionnaire about STE activities that each WTO member must complete as part of the notification process.

Notification Deficiencies

The notification requirement has four key deficiencies:

1. The lack of definition of an STE in Article XVII. This leads to confusion and disagreement about what enterprises have to be reported.
2. The lack of an enforcement or review mechanism for the notifications.
3. The provisions of Paragraph 4 (d) provide:

   (d) The provisions of this paragraph shall not require any contracting party to disclose confidential information which would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises.

   This provision again raises the question of the meaning of commercial interest and allows members to claim an exemption from the provision of full economic details of their enterprises' operations.
4. The notification provisions are unclear about what is required from WTO members with respect to enterprises that hold special rights or privileges from sub-national governments. It is not apparent from the questionnaire on STEs that these enterprises have to be reported, even though they may have significant trade effects.

Attempts to address the deficiencies of the notification process were made in the 1994 "Understanding on the Interpretation of Article XVII." A working definition of STEs was supplied. A counter-notification process was set up, using the Council for Trade in Goods and a working party to consider the adequacy of notifications.[23] The working party, working on a new questionnaire and on an illustrative list of state trading relationships, has reported once and is continuing its work. In addition the WTO Secretariat has provided a background paper containing a review and analysis of STE notifications.[24] There is also a Handbook on Notification Requirements available to WTO members.[25]

The provisions of Paragraph 2 of the Understanding are relevant to the transparency obligation. Paragraph 2 provides:

2. Each Member shall conduct a review of its policy with regard to the submission of notifications on state trading enterprises to the Council for Trade in Goods, taking account of the provisions of this Understanding. In carrying out such a review, each Member should have regard to the need to ensure the maximum transparency possible in its notification so as to permit a clear appreciation of the manner of operation of the enterprises notified and the effect of their operations on international trade.

This obligation is still subject to the "commercial interests" criteria of Paragraph 4 (d) of Article XVII. The tension between "maximum transparency" and "commercial interests" will continue to be a main feature of the debate on STE regulation. There is recognition that private firms do not always provide public information about their businesses and that STEs should not be held to a higher standard when they are in competition with these private firms. The balancing of the transparency and commercial interests will continue to demand consideration by WTO members.

The key legal point to note in the deficiencies in the notification process is that the obligation to provide information is always subject to the protection of the commercial interests of the STE. Thus the legal obligation is largely meaningless. So Paragraph 4 of Article XVII is not an effective way of policing rule circumvention by STEs. Other methods will have to be used to ensure STEs are subject to WTO rules.

Canada's Notifications

The WTO requires each WTO member to file a notification identifying its STEs. Canada has identified the Canadian Wheat Board, the Canadian Dairy Commission (CDC) and the Ontario Bean Marketing Board.[26] The notification identifies the special rights and privileges of each agency, and their volumes of business activity.

U.S. Notification

The WTO and the Commodity Credit Corporation

The United States is a frequent critic of state trading enterprises. The United States, however, may be guilty of throwing stones while living in a glass house. It can be argued that the United States Commodity Credit Corporation (CCC) is a state trading enterprise with the potential for trade influence in the area of agricultural products.[27]

The CCC administers an export subsidy program called the Export Enhancement Program (EEP). The program purports to help products produced by U.S. farmers meet competition from other subsidizing countries, especially the European Union. Under the EEP, the CCC pays cash to exporters as bonuses, allowing them to sell U.S. agricultural products in targeted countries at prices below the exporters' costs of acquiring the products.

The CCC is clearly a state enterprise that has special rights or privileges that result in the subsidization of exports. On the classic Article XVII description of an STE, the CCC will be caught by the WTO rules. Classifying the CCC as a state trader makes sense because it has substituted political for economic objectives in its operations.

The United States has officially recognized the CCC as a state trader in the past, in its Notifications regarding state trading to GATT and the WTO. However, the most recent State Trading Notification by the United States does not include the CCC. The United

States now takes the position that the CCC is not encompassed by the state trading definition since it does not actually make purchases or sales of product.

If the CCC is not a state trader because it does not make purchases or sales, do the actual exporters become state traders? On the working definition set out above, they likely are state traders. They have the special privilege of receiving a cash bonus or subsidy on the export of a product. Their sales directly influence the level or direction of trade in a product. Perhaps Cargill is the real state trader when it benefits from the EEP. In any event, the real issue in international law is whether the export subsidies that do exist contravene WTO subsidy rules. As long as existing subsidies fit within the WTO caps on product volumes and budget outlays, it does not matter whether they are made directly by the U.S. government or indirectly through the CCC.

Subsidies Through STE Exporters

For STE exporters, the real trade issue is whether or not the STE is being used to subsidize exports. This is the allegation made by the United States against Canada's CWB. It has been suggested that either the government or the producers are subsidizing exports of wheat and barley, and that this is unfair competition that distorts trade. What are the facts?

A recent study by the Organization for Economic Co-operation and Development (OECD) detailed the producer subsidy equivalents (PSEs) for wheat and barley. The results, in $ US per tonne, in 1998 were:

	Europe	**U.S.**	**Canada**
Wheat	$ 141	$ 61	$ 8
Barley	$ 171	$ 49	$ 5

Which system creates unfair trade competition? Is it really important to world trade that Canada conducts its wheat and barley trade through an STE? The Canadian view is that we are the trade innocents in this area. The CWB is being unfairly targeted by U.S. trade officials for ideological reasons, not economic ones.

Why is this happening? In my view it is happening because U.S.-based multinational grain corporations would like to see the CWB out of business. This would leave our grain producers at the mercy of the oligopoly of a few large grain buyers. The market quality premiums and marketing profits, which are now returned to producers by the CWB, would be available for capture by the grain companies.[28] The domestic benefit of an STE would be sacrificed to multinational corporate power.

Do STEs Really Affect World Trade?

The U.S. General Accounting Office (GAO) has recently examined the operations of the CWB and found that it did not contravene WTO rules. In a special report to Congress,[29] the GAO studied the CWB in detail and concluded that the CWB did not violate any existing trade agreements. Further, in a December 1998 report from USDA Economics Research Service (ERS) titled *Agriculture In The WTO*,[30] ERS researchers found that "only a few of the major agricultural STEs examined have the potential to significantly affect world trade … ." They found potential only, and no effect in fact. So the facts found by the United States government in its own studies do not support the political allegations levied against the CWB.

The Canadian Dairy Commission (CDC) is another important STE to Canadians. It controls milk pricing in Canada through a supply management and import control system. It was recently challenged by the United States through the WTO. A complaint was made that Canada was subsidizing some milk product exports (e.g., cheese) through subsidized pricing by the CDC.[31] The U.S. complaint was upheld by a WTO panel decision and an appeal.[32] The important thing to note about this case is that in a 200-page panel judgement, there is absolutely no mention of STEs! None!

If STEs are such an important issue to U.S. politicians and trade representatives, why were the STE provisions not invoked in the WTO battle over the CDC? In my view, the case shows that the U.S. government believes that the WTO subsidy rules can be applied against an STE without relying on Article XVII.

This viewpoint leads to the question of why the United States feels it must focus attention on STEs in WTO trade negotiations. In fifty years of GATT history, from 1949 to 1999, there has never been a case that relied on Article XVII to regulate an STE exporter. In fact there have only been a handful of cases involving STEs at all. So if there is no history of the United States using the STE rules, and if the United States recently passed up the chance to use Article XVII in the Canadian Dairy Commission case, is the U.S. negotiating position on STEs just empty rhetoric?

How Should STEs Be Assessed?

It appears the U.S. view of STEs is that they are inherently bad for trade and must be regulated out of existence. At least the rhetoric used by U.S. elected officials leaves this impression. This U.S. view appears rooted in laissez-faire economic ideology that suggests any government involvement will distort a free trade competitive equilibrium. Should this ideological view of STEs be used to assess their effect on trade?

Canada's view is that the real question that international law makers should ask about STEs is what effect they have on trade prices, quantities and directions. If we accept that

world trade rules are designed to foster free trade competition, then the real objective of the rules is a competitive equilibrium of price and quantity in the free trade market. If the question is "what trade effect does an STE have?" the answer depends on the market in which the STE operates.

Another way to state this view of STEs is to say that they are not inherently good or bad from an economic or trade perspective. They may produce good or bad results when compared to a competitive market result, depending on the type of market the STE operates in. If the STE has little market power to influence price or quantity traded when it is compared to the other players in the market, then it will have little market result and need not be of much regulatory concern. Hence, examining the market is as important as examining the STE.

A proposal for the market-oriented approach to STEs is contained in *The WTO Regulation of State Trading Exporters.*[33] The author outlines the need for both law and economics to be considered in dealing with STEs through the WTO. The thesis suggests that an economic methodology focused on the market in which an STE operates would be helpful in assessing WTO rule compliance by STEs.

The Canadian government recently released a research paper, "International Trade in Agricultural and Food Products: The Role of State Trading Enterprises."[34] This paper presents an economic methodology for examining the trade effects of STEs in different types of markets. It also presents a classification scheme for STEs depending on the type of market they operate in. In our view this is much more useful than the USDA Economics Research Service type classification based on the types of government control over STEs. The Canadian classification system would allow identification of which STEs would have a distorting effect.

Hence, the assessment of STE activity through international trade rules needs to be refocused. The 1994 working definition points in the new direction with its words:

> in the exercise of which they influence through their purchases and sales the level or direction of imports or exports.

The Canadian view is that STEs should be assessed by examining their real trade effects from an economic methodology, not by criticizing their imagined influence from a political or ideological perspective.

Conclusion

This paper outlines why there is currently such a high degree of interest in STEs. It concludes that STE rules in the WTO are not being used to resolve disputes. The rules may be practically meaningless since disputes are being resolved using other parts of the WTO. If STE rules are to be effectively used, the focus should be on the real economic trade effects of STE activity, and not on ideological aspects of STEs.

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