

13 October 1987

CANADA - IMPOSITION OF COUNTERVAILING DUTIES ON
IMPORTS OF MANUFACTURING BEEF FROM THE EEC

*Report by the Panel
(SCM/85)*

I. Introduction

1.1 In a communication dated 10 October 1986, which was circulated in document SCM/77, the EEC requested the Committee on Subsidies and Countervailing Measures ("the Committee") to establish a panel to examine a dispute between the EEC and Canada regarding the standing of the petitioners and the definition of industry in the countervailing duty proceedings brought against EEC exports of boneless manufacturing beef to Canada. This matter had previously been referred by the EEC to the Committee (SCM/75) under the consultation and conciliation provisions of the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade ("the Code") but it had not been possible for the Committee to resolve the matter.

1.2 At its meeting of 29 October 1986, the Committee agreed to establish a panel and authorized the Chairman to decide, in consultation with the parties to the dispute on the final wording of the terms of reference of the Panel. The Committee also authorized the Chairman to decide, after securing the agreement of the signatories concerned, on the composition of the Panel (SCM/M/32, paragraphs 183-185).

1.3 At the meeting of the Committee on 3 June 1987 the Chairman informed the Committee that the terms of reference of the Panel were as follows (SCM/M/34, paragraph 104):

"To review the matter referred to the committee by the European Community in SCM/75 relating to the standing of the petitioners and the definition of industry employed by the Canadian authorities in the recently concluded countervailing duty case against Community exports of boneless manufacturing beef to Canada and, in the light of the facts of the matter, present to the Committee its findings concerning the rights and obligations of the signatories party to the dispute under the General Agreement as interpreted and applied by the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade."

At the same meeting the Chairman informed the Committee that, after securing the agreement of the parties concerned, he had decided on the following composition of the Panel (SCM/M/34, paragraph 125):

Chairman:	Mr. Carl Henrik von Platen
Members:	Mr. Robert E. Hudec
	Mr. Adin Talbar

1.4 The Panel met with the two parties on 15 May and 29 June 1987. In addition, the Panel met on 14 May, 30 June, 15, 16 and 17 July 1987 and 21 and 22 September 1987. On 22 September 1987 the Panel submitted its conclusions to the parties.

II. Factual aspects

2.1 On 18 October 1985, the Deputy Minister of Revenue Canada (Customs and Excise), following consultations with the EEC as provided for in the Code, initiated an investigation under Section 31 of the Special Import Measures Act (SIMA) based on a complaint received from the Canadian Meat Processors Association (CCA) regarding the alleged injurious subsidization of boneless manufacturing beef exported

investigation

to Canada from the EEC. On 26 February 1986 the Deputy Minister accepted an undertaking from the EEC to limit the annual quantity of the subject goods exported to Canada to 10,668 tonnes, and the investigation was suspended. The undertaking was subsequently terminated as a result of an objection by the complainant, and the investigation was resumed on 27 March 1986. On that day a preliminary determination of subsidization was made and the complaint was then referred to the Canadian Import Tribunal (CIT) for a determination on the issue of material injury.

2.2 In the course of its enquiry the CIT considered the legal issue of whether the petitioners, who are producers and feeders of live cattle, can be considered part of the domestic industry producing boneless manufacturing beef and thus have standing to complain and to advance a case of material injury to that industry. The CIT concluded that the CCA could be considered part of the relevant domestic industry. In its Statement of Reasons, the CIT indicated that the production of manufacturing beef in Canada was a continuous sequential process commencing with the live cattle and ending with the boxed grinding beef; that there was a high degree of functional dedication and economic dependence in this sequential process; that no one disputed that the primary purpose of raising beef cattle was to produce beef, and that grinding beef was merely one of the product forms produced by the cattlemen. It also noted that others engaged in the production of manufacturing beef, i.e. the slaughterers and boners, the dairy industry and the packing houses contributed in varying degree to the goods in question, but said it was not persuaded that the various elements in the chain should be

2.5 According to the figures presented by Canada, when cows and bulls culled by cow-calf operators and dairy farmers are slaughtered for manufacturing beef, approximately 85 per cent of the usable carcass is manufacturing grade beef and 15 per cent is high grade beef. In the case of feedlot operators, 17 to 20 per cent of the usable carcass of feedlot steers and heifers enter into the production of manufacturing beef. The sale of cows and bulls for manufacturing beef accounts for approximately 20-25 per cent of income earned by cow-calf operators, and for the dairy farmer it accounts for 10-15 per cent of income. There are no precise data as to what part of income of a feedlot operator is derived from sales of manufacturing beef. The Canadian delegation estimated that the return was less than the weight percentage going into this production (i.e. less than 17-20 per cent). At the wholesale level, the value of the live animal used to produce manufacturing beef constitutes 66 per cent of the total value of manufacturing beef sold.

2.6 In Canada there is little vertical integration between suppliers of cattle and the firms which perform slaughterhouse and boning operations. Processing operations are sometimes performed by integrated firms while in other cases the slaughtering and boning operations are performed by separate firms. The Canadian firms engaged in processing operations were not parties to the countervailing duty proceeding and took no position on the question of material injury.

2.7 The Canadian delegation supplied the following information pertaining to the relationship between imports of boneless manufacturing beef and prices in the cattle-raising sector: According to a staff report prepared for the CIT in the present case, during the years 1983-1986 there was an 85 per cent correlation between the spot price of boneless manufacturing beef in Toronto and the price of manufacturing-grade cows in Toronto. In general, the supply of manufacturing-grade animals tends to be price inelastic. The number of culls removed from herds is determined in part by the need to remove unproductive animals in order to maintain an efficient production system. There are over 100,000 cow/calf producers in Canada, and there is no government regulation of supply. Historically,

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manufacturing beef because it could not be said to have physical characteristics identical to those of boneless manufacturing beef. At least two further stages of industrial processing were required.

3.4 The EEC noted that Article 6:5 of the Code defined domestic industry as domestic producers of the like product. The EEC argued that the use of the word "shall" made this definition mandatory. The term "producer" clearly referred only to the industry which produced the like product itself - not the industry which produced an input product. The concept of "domestic industry", as defined in Article 6:5 also

3.9. The Panel noted that the central issue for the Panel to establish was the meaning of the term "industry" as domestic producers of the product in question. In this regard Canada's interpretation of Article 6:5 of the Code did not clarify the definition of "producers". Article 6:6 did not provide guidance for identifying producers, but rather, provide guidance for identifying the like product. The Panel noted that the Code does not provide any flexibility to take account of market realities. For example, the Code does not allow for certain circumstances, the components so as to identify producers in specific regions, even though a market exists in a customs union, by

of industry for while Article 6:5 there was no strict as to the EEC'S rather stated that product, in this case, the "producers" of where production tacts. Canada also market realities. For industry into regional sign subsidization, Article 6:7). The n of industry

3.10 Canada argued that the concept of industry of industry regarding horizontal terms based on the product in question. While Canada argued that the dumping of electrical transistors (14)

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industries characterized by the following: (i) a continuous sequential process of production involving the use of only one raw material input which, by undergoing relatively little processing prior to becoming an end-product, accounted for a substantial proportion of the value of the end-product; (ii) an input which was functionally dedicated to the manufacture of only one end-product and which had no economically viable alternative uses; (iii) a situation of economic interdependence in which end-product producers were able to pass back to input producers a decrease in the price of the end-product resulting from competition from subsidized imports.

3.13 In the Canadian opinion the production process in the boneless manufacturing beef industry in Canada satisfied these three conditions. There was a single continuous line of production which started with one raw material (the live animal or parts thereof) and yielded only one significant end product (boneless manufacturing beef) . Furthermore, there was no other economically viable use for culled cattle from the cow-calf and dairy sector or for the manufacturing beef derived from the feedlot sector. Moreover, at the wholesale level, the value of the input, i.e. the live animal used to produce manufacturing beef constituted 66 per cent of the value of the end product. Finally, most of the injury associated with the importation of boneless manufacturing beef was not felt by the slaughterhouses, but was passed backward to the producers of the livestock in the form of lower bid prices. The primary factor affecting a slaughterhouse's bid price for cows destined for the production of boneless manufacturing beef was the price for said beef. According to a staff report prepared for the CIT, there was an 85 per cent correlation between the price of manufacturing beef and the price of manufacturing grade cows.

3.14 Canada considered that, cast in terms of economic theory, a cattle producer's supply curve was effectively inelastic. In the short run, he was unable to control the supply of cattle going to market. The supply of cattle was determined by factors unrelated to the price of beef or cattle, including grade, weight, age and condition of the animal,

than that of live animals entering the production process, the contribution of wine grapes to the value of wine was considerably lower (an estimate of a comparable figure for Canadian production was 14 per cent); and (3) while beef processors had the ability to pass back injurious effects of imports of subsidized beef to cattle producers, wine producers had limited ability to do so as wine grape producers have significant alternative markets for their output.

3.17 Regarding the question of whether the CCA represented "the domestic producers as a whole of the like products or those of them whose collective output of the products constitutes a major proportion of the total domestic production" as required by Article 6:5, Canada argued that the CCA represented some 55 per cent (0.83 x 0.66) of the relevant industry. Some 83 per cent of the manufacturing beef produced in Canada was sourced from cow-calf and feedlot operators represented by the CCA. Live animals constituted some 66 per cent of the wholesale value of the beef sold.

3.18 The EEC held the view that the three special factors identified in Canada's argument did not affect the definition of industry in Article 6:5 of the Code. The fact that boneless manufacturing beef emerged from a "continuous sequential" process of production was irrelevant to the question of whether the CCA produced the like product. No such test was incorporated in the Code. The only criterion for judging if a certain producer was part of the domestic industry was whether he produced the like product.

3.19 Regarding the test of "functional dedication" in general the EEC view was that such a test likewise had no basis in the Code. Many inputs - industrial as well as agricultural - were functionally dedicated to produce an output product (e.g. circuit boards for electronic products, mecadecks for video tape recorders, photoconductors for photocopiers). This did not, however, confer on the input product producers the right to complain about allegedly subsidized or dumped end products, nor for any injury to them to be taken into account when assessing injury to the producers of the end product.

3.20 The EEC considered that "economic interdependence" of the kind alleged by the Canadian authorities existed in many sectors, agricultural as well as industrial. Referring to the examples cited earlier, the EEC said that circuit board manufacturers supplying subassemblies to TV or office equipment manufacturers might be as much injured by subsidized imports of the end product as by subsidized imports of their own products. However, the Code did not rely on such arguments but instead restricted the definition of industry to producers of goods having the same characteristics as the imports concerned.

3.21 The EEC was of the view that the Panel decision in the Electrical Transformers case did not support the Canadian position with regard to the claimed flexibility of the definition of industry in the Code. The EEC considered that the Transformers Panel had defined the relevant industry to include all product lines of transformers made by the manufacturer because it had concluded that all the transformers in question were "like products". Moreover the Transformers Panel had in effect dealt with a case of "horizontal" integration of lines of production not, as in the case of dispute here, with a situation where the issue was whether producers of the raw agricultural products might be considered as part of the industry producing the end product ("vertical integration"). As the Tm/F8 11 Tf(a) TjETT1 0 0 1 178

opposite to those desired by most if not all negotiators of the Code. In any case such broadening of the actual definitions was not a matter for unilateral interpretation but would require a rewriting of the Code provisions. Irrespective of whether the

4.5 To illustrate its point Australia made the following observations on the definition of industry in the dispute between the USA and EEC over wine imports. Given that grape growing can be dedicated to production for the dried vine fruit industry, for table grapes or for wine production and that these three functions may be undertaken by the same person, not involved in wine making, it is difficult to argue conclusively that grape growing as such is part of the wine industry. However, if the only type of grape is a wine producing grape, then it would be difficult to argue that the grape grower is not part of the wine industry as he received no return for his produce unless it is converted into wine and that return must reflect the value of wine and the cost of processing. A parallel exists between this latter example and the breed cattle industry,

of Article 6:5 of the Code. The elements of that issue were also not in dispute. Article 6:5 defines the relevant "domestic industry" as "the domestic producers ... of the like products". The term "like product" is defined in footnote 18 to Article 6:1 as:

a product which is identical, i.e. alike in all respects to the product under consideration or in the absence of such a product another product which although not alike in all respects, has characteristics closely resembling those of the product under consideration,

The Panel agreed with the parties that the "like product" in this case was manufacturing beef, fresh or frozen, and that live cattle produced by cattlemen and feedlot operators were a different product not within that definition. Consequently, the question whether cattlemen and feedlot operators could be considered part of the "domestic industry" turned on whether they could be considered "producers" of manufacturing beef.

5.2 The Panel began by examining the text of the applicable provisions. It noted that Article 6:5 did not contain a definition of the term "producers". It observed that, in common usage, one is normally considered the "producer" of only those goods one actually makes and sells; one who produces a new material is not normally regarded as a "producer" of the end-product.

5.3 The Panel noted that Article 6:6 expressed a principle that would support interpreting the term "producer" in accordance with its normal meaning. Article 6:6 defines more exactly the production process that is to be considered when assessing the effect of subsidized imports on "domestic producers ... of the like products." It states that the assessment shall be limited to the production process devoted to making the like product itself, except that, if the production process for that specific product cannot be separately analyzed, the assessment shall be made in terms of the production process for the narrowest group of products including the like product for which data are available. Article 6:6 thus indicates a preference for narrowing the analysis of injury to those production resources directly engaged in making the like product itself. Applied to a vertical production process involving several stages, this principle would indicate that the analysis should likewise be focused on the stage of production devoted to actually making the like product in question, as opposed to earlier stages devoted to producing inputs.

5.4 Under the normal meaning of "producer" indicated by the text of Article 6:5 and 6:6, the cattlemen represented by CCA could not be considered producers of manufacturing beef. The good they actually produced (cattle) was not itself the "like product", and their cattle-raising operations were clearly separate from the subsequent processing operations where cattle were made into manufacturing beef, virtually all of which were under different ownership.

5.5 The Panel then addressed the main argument made by Canada, supported by Australia and the United States, in favour of interpreting the term "producer" to include certain suppliers of inputs. As noted in paragraph 3.12 above, Canada proposed that input suppliers be considered "producers" of the end-product if their economic relationship to the end-product satisfied three criteria:

- (i) the end-product is produced by a continuous sequential process of production involving only one raw material input which undergoes relatively little processing and Which accounts for a substantial proportion of the value of the end-product;
- (ii) the raw material input is "functionally dedicated" to the production of only one end-product and has no economically viable alternative uses;
- (iii) the relationship involves a situation of economic interdependence in which the price impact of subsidized imports will generally be passed back to the input suppliers.

As the Panel understood the Canadian position, the three criteria were meant to identify situations in which all or most of the adverse economic impact from subsidized imports would be concentrated on the raw material supplier. Canada argued that signatory governments had intended the Code to be interpreted in a sufficiently flexible manner to permit governments to grant protection to such suppliers.

5.6 In evaluating Canada's argument, the Panel examined the various legal sources which in its view had a bearing on the principles of interpretation embodied in the Code. The Panel first considered Canada's reference to the paragraph in the preamble to the Code stating that signatory governments desired "to ensure that ... relief is made available to producers adversely affected by the use of subsidies". The Panel appreciated the force of this objective, which would be implicit in any event. It noted, however, that the same paragraph of the preamble stated that governments also desired to ensure that "countervailing measures ... not unjustifiably impede international trade" and that relief to producers be made "within an agreed international framework of rights and obligations". These objectives express a recognition that the remedies provided by countervailing duty laws also impose burdens of expense and uncertainty that can impede legitimate international trade. In the Panel's judgement, the overall objective of the Code must be viewed as one of striking a balance between the injuries to be remedied and the injuries caused by providing such remedies. Thus, the fact that subsidies may be causing a particular injury does not by itself establish that the Code meant to provide a remedy for it.

5.7 The Panel then considered whether the express exception to the Code's definition of "domestic industry" in Article 6:7 indicated a policy of flexible interpretation in this area. Article 6:7 provided that, under certain conditions where separate regional markets could be said to exist, the relevant "domestic industry" might be limited to the producers in that region alone. Canada argued that Article 6:7 could be viewed as evidence of an intention on the part of signatory governments to accept a flexible definition of industry when out-of-the-ordinary conditions caused injuries to occur otherwise than as normally anticipated. The Panel considered, however, that the existence of Article 6:7 could also be interpreted to mean the opposite, i.e. that governments preferred to deal with out-of-the-ordinary situations by means of express exceptions in the text, and that the presence of an exception for regional industries but none for input suppliers meant that none was intended for input suppliers.

5.8 In weighing the evidence relating to the intent of signatory governments, the Panel attached particular importance to the negotiating history of the applicable Code provisions. In the Panel's view, this history reveals

¹ from which the text of the current Article 2:1 provisions was drawn, governments agreed after considerable debate to require that complaints must normally be filed on behalf of the relevant industry as a whole, and not, as advocated by the

¹Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade (hereinafter referred to as Anti-Dumping Code of 1967) BISD 15S/24. Article 5:1 of the 1967 Code contains the text which now appears in Article 2:1 of the Code.

United States¹ and Canada², by any party which considered itself injured. The US and Canadian view

that governments did not appreciate the rigorous character of the legal standard they were adopting, or that they intended it to be interpreted flexibly.

~~Proposed~~ Under the Panel's judgement, the interpretation proposed by Canada would introduce an element of open-endedness into the Code's definition of "domestic industry" of just the kind the code drafters had been concerned to avoid. The principle underlying the Canadian interpretation was that relief ought to be made available to input suppliers when they suffered injuries from subsidized imports equivalent to the injuries normally suffered by those who produce end-products. ~~Canada was~~ asserting that this principle applied only to the situation described

product", the separate production stages will all be part of the same "domestic industry". The second criterion - whether the production process for the "like product" can be separately identified - is likewise independent of vertical integration. If the process of production for one "like product" can be separately identified, it will be treated as a separate industry whether or not it is owned in common with parallel, earlier or subsequent production lines. The only case in which the fact of common ownership will affect the definition of industry will be the case in which common ownership results in such a complete integration of production processes that it is impossible to analyze each one separately.

5.15 The Panel did not consider that the definition of "domestic industry" outlined in the previous paragraph was in conflict with the Panel Report in "New Zealand - Imports of Electrical Transformers from Finland".¹ The statements in that report which appear to be at odds with this definition were not written with direct reference to Articles 6:5 and 6:6.² The actual conclusion in the case - that all product lines of the transformer manufacturer had to be considered when assessing material injury - was not in itself inconsistent with the definition of "domestic industry" adopted in this report, because whenever there are parallel product lines within a single firm, there will always be an issue as to the true separability of those production lines depending on the interchangeability of production resources.

5.16 Finally, the Panel did not agree with the argument that the definition of "domestic industry" in Article 6:5 should be interpreted to be congruent with the definition of "primary product" in Ad Article XVI(B)2 of the General Agreement.³ Essentially the same argument had been considered by an earlier panel, in "United States - Definition of Industry Concerning Wine and Grape Products".⁴ Recognizing that the Committee has so far neither approved nor disapproved the conclusions of that earlier report, the Panel was nonetheless in agreement with the conclusion stated in paragraph 4.5 of that report, notably the view that the two provisions had entirely separate origins and served separate purposes.

5.17 On the basis of the findings reached above, the Panel concluded:

- (i) the term "producer" in Article 6:5 of the Code could not be interpreted to include the cattle producers represented by CCA as "producers" of manufacturing beef;
- (ii) the cattle producers represented by CCA could not therefore be considered as part of the "domestic industry" for the purpose of the Article 2:1 requirements defining standing to complain and the Article 6 requirements governing the determination of material injury; and
- (iii) accordingly, the imposition of countervailing duties based on a petition of the CCA, and also based on a determination of threat of injury to the cattle producers represented by the CCA, was not in conformity with Canada's obligations under