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State Trading and the Upcoming WTO Discussions

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While state-trading enterprises (STEs) handle many agricultural and nonagricultural commodities, the focus here is on the world wheat and barley trade. Major state-trading exporters include the European Union (EU), the United States, Canada, and Australia. State-trading importers include the Japanese Food Agency (JFA), Bulog (of Indonesia), and the China National Cereals, Oils and Foodstuffs Import and Export Corporation (COFCO). From 1990 through 1994, countries involved in state trading accounted for more than 70 percent of total wheat exports. The same percentage applied to state-trading importers (Simontot). The percentage of state traders in the world wheat market, however, varies from year to year. In 1997, for example, countries with some state trading accounted for less than 50 percent of the market share. The United States, which had high commodity prices in 1997, changed its farm subsidy policies in 1996 and was no longer a state trader.

Members of the World Trade Organization (WTO) are raising many questions about the effects of state-trading activities on world trade. What activities fall within the legal definition of state trading and STEs? Does the WTO currently allow any trade-distorting activities that cause world prices and quantities to differ from those of a perfectly competitive market? Does the WTO clearly define its criteria governing STEs? Does the WTO differentiate between STE trade distortions caused by hard-price discrimination (charging different buy-

ers different prices without the use of government subsidies) versus those caused by soft-price discrimination (using direct government subsidies)? Do STE activities significantly distort trade? The WTO negotiations in 1999 will focus on state-trading activities, and concerned parties need answers to these questions. We use the Canadian Wheat Board (CWB), a single-desk exporter of Canadian prairie wheat and barley with annual sales of over \$4 billion (Canadian dollars), to focus on these questions. The CWB is one of the world's largest wheat exporters with roughly 20 percent of the world's wheat export market.

What activities make importers and exporters qualify as state traders?

The Uruguay Round 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 (GAO 1996, p. 16).

It is clear that the CWB is an STE, but the STE status of the United States seems less certain. In its 1979 notification to GATT, under Article XVII, the United States designated the Commodity Credit Corporation (CCC) as a state trader (Dixit and



Josling). In carrying out U.S. agricultural policy, the CCC gave the United States its state-trading status—even though multinational businesses handled most U.S. wheat and barley exports (Rossmiller and Sorenson). CCC operations, which determine the STE status of the United States, include commodity support activities, inventory and disposal operations, and domestic and export programs. Furthermore, with the introduction of the Export Enhancement Program (EEP), the ability of the United States to price discriminate increased. Under EEP, the government awards to exporters bonuses in generic certificates that they can redeem for CCC-owned surplus commodities. The bonuses, or so-called export subsidies, cover the differences between the sale price of wheat in the targeted market and the price paid for wheat in the U.S. market. As Langley notes, “Although the CCC does not engage in physical export activities, its export assistance programs affect exports, private inventories, and the terms of international transactions including prices and quantities” (p. 122).

The WTO’s definition of STEs affects global trade as well as trade negotiations. Under its definition, in 1997 the United States did not qualify as an STE because it no longer used export credits or the CCC. Thus the United States could be critical of STEs that supposedly distort trade. Such criticism, perhaps, indicates a desire to eliminate STEs and improve the competitive position of U.S. firms.

WTO and trading-distorting activities

WTO criteria and rules that govern STE activities cause problems for policy makers. STEs must meet three criteria to avoid violating WTO rules: (1) price discrimination can be used, but only for commercial reasons (to take advantage of customers who are willing to pay higher prices) and not for political reasons (such as foreign or military policy considerations); (2) the use of quantitative restrictions is to be limited; and (3) states must notify the WTO of state-trading activities (Baban). In addition, the WTO only allows STEs limited use of soft-price discrimination to distort trade (Annand and Buckingham). The Member’s Schedule of Commitments, issued by the WTO Agreement on Agriculture, specifies these limitations. As long as an STE operates within these guidelines, the WTO finds it acceptable. We illustrate that the CWB meets the first criterion because it price discriminates only for commercial reasons, and it meets the third criterion because Canada reports CWB activities to the WTO. The second criterion is vague and may contradict the first. To price discriminate, the CWB must restrict supply in certain markets.

Canada, through its STE single-desk statutory-marketing authority, practices hard-price discrimi-

nation for commercial purposes. Schmitz et al. (1997b) cite this example: In 1991–92, the CWB earned a price of Can\$135.74 per tonne for feed barley in the Japanese market, compared to Can\$106.73 per tonne in the U.S. market and Can\$104.21 per tonne in the rest of the world. In order to do this, the CWB restricted quantities in certain markets. For example, the CWB significantly restricted the exports of barley to the United States relative to a multiple-seller situation (Johnson and Wilson). The United States practiced soft-price discrimination through EEP subsidies. Simultaneously the CWB, in order to maximize export-sales revenue in the presence of the EEP, price discriminated by selling less grain into the markets that were supported by EEP and more into the markets that did not receive EEP. The key difference between Canadian and American state-trading practices was that Canada, through the CWB, did not use taxpayers’ dollars to subsidize exports. However, there were exceptions. On rare occasions, the CWB also practiced soft-price discrimination. For example, in 1985, the Canadian government subsidized producers by paying the deficit (caused by high initial prices relative to final returns) in the pool account. At that time, the CWB may have been in violation of WTO since it practiced soft-price discrimination.

The WTO must address other possible trade-distorting issues. For the CWB, these include price transparency, government guaranteed initial prices, technical barriers, and government credit guarantees. Schmitz and Furtan find that these are generally not trade distorting. Contrary to Schmitz and Furtan, some allege that the lack of price transparency by STEs may distort trade. If multinational grain companies were to replace state-trading monopolies, however, would prices become more transparent? Several researchers, including Paddock, note that they would not. In world-grain markets, price discovery occurs in the U.S. futures markets that are linked to various cash markets located throughout the world. The major players in the market—state traders and multinationals included—follow and understand these price relationships. In this context, the bidding/asking prices of the multinationals are as confidential as the CWB’s offer prices. Hence, there is no reason to expect an increase in transparency if multinationals were to replace state-trading monopolies.

State-trader impacts on trade

In this article, we make calculations that show that the CWB does not significantly distort trade or world prices. The GAO (1998) in its evaluation of the CWB did not attempt such calculations. Furtan, Kraft, and Tyrchniewicz find that, through price discrimination, the CWB obtains price premiums

Table 1. Impacts of the CWB on Canadian production, world price, and trade

Scenario	Crop	Supply Change in Canada (mmt)	Change in World Price (Can\$)	Change in Canadian Exports: Percentage of World Trade (%)	Change in Canadian Production: Percentage of World Production (%)
CWB premiums	Wheat	1.45	(0.04)	1.1	0.30
	Malt barley	0.10	(0.29)	2.5	0.06
	Feed barley	0.12	(0.23)	0.2	0.07
CWB costs	Wheat	(3.29)	0.38	(2.5)	(0.60)
	Malt barley	(0.11)	0.31	(2.7)	(0.07)
	Feed barley	(1.24)	0.52	(2.7)	(0.70)

Source: Authors' calculations.

Note: Supply elasticities for Western Canadian wheat and barley are 0.46 and 0.304 respectively (Yildirim). Demand elasticities for Canadian wheat and barley in the rest of the world are -10 and -20 respectively (Spriggs, and Schmitz et al. 1997b).

on wheat above those that would exist under a multiple-seller environment. The price premiums for wheat range from Can\$13 to Can\$20 per tonne. Schmitz et al. (1997b) find that the CWB earns a premium of Can\$5.80 per tonne on feed barley and a premium between Can\$30 to Can\$35 per tonne on malting barley.

Carter and Loyns contend that although the CWB may be able to price discriminate, the CWB lowers farmgate prices because of higher marketing costs. They argue that the CWB costs farmers an additional Can\$31.65 and Can\$37.50 per tonne on wheat and barley, respectively. If their argument holds, it is as if the CWB imposes an implicit export tax on Canadian wheat and barley growers. Such a trade-distorting tax, however, could reduce Canada's export-market share and increase world prices. Such an advantage to Canada's major competitors would mean support for the CWB from U.S. producers (Schmitz et al. 1997a).

Table 1 illustrates the impact of the CWB on the world price and on quantity traded compared to multiple-seller prices and quantities. We calculated the results for Canadian wheat and barley using the CWB price premium model (Furtan, Kraft, and Tyrchniewicz; Schmitz et al. 1997b) and the CWB costs framework (Carter and Loyns). Using the Furtan et al. results, Canadian wheat production increases by 1.5 million metric tons (mmt) because of the premiums earned through price discrimination, and Canadian exports increase by 1.1 percent of world trade. Placing this increased production in international markets lowers world wheat prices by only \$0.04 per tonne. In the higher-cost world of Carter and Loyns, on the other hand, Canadian production decreases by 3.3 mmt and Canadian exports drop by 2.5 percent of world trade. This increases world prices by \$0.38 per tonne. For feed and malting barley, Canadian production increases by 0.1 mmt and 0.12 mmt, respectively (Schmitz et al. 1997b). The increased

exports from Canada comprise 2.4 percent of the world malt-barley trade and 0.2 percent of the world feed-barley trade, which results in a price drop of \$0.29 and \$0.28 per tonne respectively. According to Carter and Loyns (in which the CWB taxes farmers by Can\$37.50 per tonne), Canadian malt- and feed-barley production drops by 2.8 mmt and 1.2 mmt, respectively. The resulting decrease in exports represents 2.7 percent of the world malt- and feed-barley trade and a price rise of \$0.31 and \$0.52 per tonne respectively.

The results, presented in table 1, do not include the effects of non-CWB STEs. Considering the trade impact of all single-desk buyers and sellers, the price distortions caused by single-desk sellers could offset the price-distorting effects caused by single-desk buyers. Thus, the results of CWB actions could be smaller than those suggested in table 1.

Not only is the CWB's trade-distorting impact small, it is not significant in comparison to the impact of the EEP. In the case of barley, Haley et al. note that EEP increased the U.S. domestic feed-barley price by U.S.\$6 to U.S.\$11 per tonne in 1986-87 and simultaneously lowered Australian, Canadian, and EU export-barley prices by 5, 3, and 2 percent, respectively. The result is similar for 1987-88.

Clear definitions needed

While the United States has always been critical of STEs (Schmitz et al. 1997a), now that it is no longer a significant state trader in grains it seems even less friendly toward them. However, the WTO rules appear to support those STEs that practice hard-price discrimination.

Here we demonstrate that the trade-distorting effects of the CWB were small indeed. This is the case whether the CWB earns a price premium for producers or taxes producers. In the first case, the CWB practices hard-price discrimination, which is

legal under current WTO rules. In the second case, when the CWB is inefficient and lowers producer returns, its activities are still acceptable under WTO. The tax scenario makes the CWB highly favorable to its competitors. Importantly, even if the distorting effects were much larger than those reported, CWB activities would still be allowable because the WTO places no limit on the magnitude of price discrimination by STEs. This strong conclusion should cast doubt on the ability of the WTO to discipline STEs. A problem arises because the WTO does not adequately qualify its limit on quantitative restrictions. For example, since the CWB does not set Canadian grain-trade policy, to price discriminate (which the WTO permits) the CWB must use quantitative restrictions (which the WTO limits). Thus, there appears to be a contradiction between the first and second requirements of the WTO. Upcoming WTO discussions must focus on more careful definitions of the criteria that limit STEs and their activities. ■

■ For more information

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