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— DISCUSSION —

**PROGRESS WITH HARMONIZATION/CONVERGENCE/COMPATIBILITY:  
U.S. AND CANADIAN GRAIN MARKETING SYSTEMS**

*Don McClatchy*

In the wake of the U.S./Canada Joint Commission on Grains (1994-96) and considerable recent and continuing re-examination in Canada of its Western grains marketing system (1996-97), it may be useful to try to assess what the key bilateral agenda items for H/C/C in grains marketing will be for the next few years.

Many issues have been discussed in this area over recent years but it seems that these issues now fall into three groups. The first of these groups I would characterize as the “chaff”. It includes several different accusations about the effects of the Canadian Wheat Board (CWB) which, despite being argued and analysed at length, have never been demonstrated substantively or conclusively to hold water, and I do not think they ever will. These issues serve to divert attention, energy and resources from the more fundamental problems, in my view.

The second group contains issues which are being addressed and on which steady progress seems to be being made, and can be expected to continue. They might be thought of as the “grist on which the mill is currently grinding”.

Of most concern to me are the issues in the third group. These I foresee as posing the biggest problems for the future. They are key outstanding issues on which little or no progress in resolution has yet been made. To push the analogy further, they are perhaps closest to stones which, if not removed, threaten to break the machinery and bring the whole process to a crisis point.

## **GROUP 1: THE CHAFF**

### **CWB Price Discrimination (spatial)**

The CWB is a monopoly buyer but not a monopoly seller. Furthermore, it has no inherent powers (other than requiring that a cargo be shipped to an indicated destination) to effectively separate the markets into which it is selling, as the successful price-discriminating monopolist must have.<sup>1</sup> Despite its own periodic domestic claims to the contrary, and notwithstanding the results of recent studies commissioned by the Board, I remain persuaded that the opportunities for the CWB to increase total market returns by pricing differentially, in order to take advantage of differences in the slopes of the demand curves for the Canadian product which it faces, are probably quite limited.<sup>2</sup> What seems to be more common and important is that the CWB offers competitive prices in certain separated export markets in order to maintain a presence in those markets (perhaps for longer-term strategic reasons) and in so doing may accept lower-than-opportunity-cost returns in those markets in the current period. In this sense of competitive (though not necessarily profit-maximising) price discrimination, the CWB is effectively doing the same thing as other major grains exporters, — the EU, the United States and Australia. The United States claims to price down in certain targeted markets (using the EEP) in order to allow U.S. suppliers to be competitive with EU exporters subsidised with ‘restitutions’. The CWB follows to remain competitive with the United States and the EU. In the absence of EU and U.S. export subsidies there would be no incentive for the CWB to price lower in such markets, in order to be able to retain a share (the case in the 1995-96 period). The answer to this problem is to get rid of the targeted, discriminatory export subsidy programs, not the CWB.

### **Price Leadership (in time) by the CWB**

Statisticians seem to have run wild in recent years trying to prove this one. Implicit in reported studies and their interpretations seem to be presumptions that there is (or must be) a price leader, that related industrial economic theories have relevance for the world wheat market, that one country has an incentive to lead market prices up or down, and that such price leadership would be necessarily disadvantageous to other exporting countries. Discussion of economic rationale has been largely absent from studies I have seen.

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<sup>1</sup> Such arbitrage-preventing separation on world wheat markets may exist, but not due to the existence of the CWB.

<sup>2</sup> The most obvious exception to this is the Japanese market, where Japan's policy of diversifying its supplies implies much lower elasticity in the Japanese demand for Canadian wheat (at least over a certain range) than that facing the CWB in most other markets. Another example may be a significantly lower demand elasticities for Canadian barley in various malting markets than those in feed markets.

A reasonable empirical statistical case for CWB price leadership seems to be now confined to hard spring and durum wheats. A higher CWB share of total world market supplies for these types lends some plausibility to this, but also suggests a motivation for price leadership lying simply in a better knowledge of current world market supply conditions and a consequent better appreciation of the way prices need to move in order to achieve market clearance. I personally remain sceptical that the CWB can really do this forward price discovery job better than the big U.S. grains exchanges, and that it does in fact lead them for some wheat types. Both types of institution must also anticipate future levels of key policy parameters (e.g., EEP), and I don't believe that the CWB has an advantage in this.

Rather, I remain persuaded that the main price discovery for world grain markets occurs on the Minneapolis, Chicago and Kansas City exchanges, whose participants are as well informed as the CWB about the current state of world market prices, and, in the event of good harvests, about how far prices may have to drop in order to clear the market. I see no incentive for the CWB to lead prices below market-determined levels.

CWB quotes are claimed to follow the daily Minneapolis prices. This claim could, I think, be easily tested. To my knowledge it has not been refuted. The Achilles heel of virtually all statistical analyses to date lies in their use of these quotes, which are not actual sales prices, just as reported fob Gulf or West Coast Ports prices are not actual net sales prices in particular markets. There may be some scope for statistical analysis of price changes over time in particular markets to test the arguments in the previous section. To my knowledge, this has not yet been attempted, and would have to overcome the difficulties of obtaining actual sales prices (adjusted for particular terms and conditions) from both the private sector grain companies and the CWB.

### **Canadian Price Premiums**

It is recognized and accepted that these exist in many markets, have done for a long time, and derive from a reputation for a reliable grading system providing a high degree of consistency in quality. This grading system is provided by the Canadian Grain Commission, which now operates on a full cost recovery basis. Naturally Canada wants to preserve this reputation and the premiums it generates. Apart from the direct costs associated with the grading system, there may have been some indirect costs to Canadian producers over the years because of the limited number of varieties which have been licenced in an effort to ensure purity in the product. There is no evidence, however, that the premiums derive from unfair practices by the CWB. Furthermore, it is erroneous, in my view, to attribute these consistency/reliability premiums to CWB pricing practices or the existence of the single desk seller, rather than to the Canadian grading system. I acknowledge the possibility of a relatively small additional component of the 'Canadian premium' which derives from a superior quality of 'service' provided by the CWB as a seller, but remain sceptical about such claims.

### **Inadequacies of the CWB in Meeting the Needs of Canadian Producers**

Arguments have at times appeared from U.S. academic and other sources suggesting that the CWB pooling system may have some costs as well as benefits for Canadian producers. My impression is that most prairie grain growers understand this quite well, and, as a result, there is a very intense ongoing debate about such questions in Canada. However, as long as the subject is confined to relative costs and benefits for Canadians, then this is a domestic matter, to be resolved in Canada. In my judgement, efforts by outsiders to influence the outcome of this debate could prove counterproductive.

### **Canadian Grain Displacing U.S. Grain From The U.S. Market**

It has now been amply analyzed, demonstrated and explained that such departures from more traditional Canadian grain export patterns happen in response to incentives provided by price differentials when use of the EEP drives a wedge between U.S. domestic prices and world market prices. In other words, they are a product of classical market arbitrage. With no tariffs, the U.S. market automatically becomes more attractive to Canadian exporters than other export markets at such times. The basic problem here lies with the internal inconsistency of the U.S. policy package. Export subsidies don't work unless backed up by some border barrier. The problem is not the existence of the CWB, nor are there hidden Canadian subsidies involved. In fact the problem would have been worse in the absence of the CWB; the single desk seller was able to apply some restraint which may not have resulted from a deregulated marketing situation.

### **Canadian Grains Exports Increased by CWB System**

The job of the CWB is to market all grain which is produced in Western Canada. Exports are the residual after domestic needs are met. Since the elimination of the 'two-price wheat' policy some years ago, the actions of the CWB have not been a factor in Canadian consumption levels. If the claims of the CWB, that it can extract better average prices for growers from the world market than could an unregulated market, are true, then I suspect that the magnitude of the benefit is only marginal.<sup>3</sup> When a small price benefit is applied to a very low price elasticity of supply, then the production impact must be very small. Similarly, such other Canadian subsidy programs as still exist generally apply to all western crops equally, and so do not perceptibly distort the allocation of the fixed land base, or stimulate production of some individual crops relative to others. I conclude that the CWB marketing

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<sup>3</sup> I conclude that the CWB could only affect the quantity of Canadian exports by achieving better market returns (producer prices) and thus stimulating production. Accepting this leads to an inconsistency between the arguments of some CWB critics, who argue that the CWB boosts Canadian exports, and arguments of others that the CWB undercuts and/or drives down market prices, which would imply lower returns for Canadian farmers and hence lower production and exports.

system has very little, if any, impact on the quantities of Canadian grains produced, consumed and exported.

## **GROUP 2: THE GRIST**

### **Grain Grading, Standards and Description Differences**

Both countries' systems have their strong points. The need for progress towards more compatibility, in order that a single North American market might function effectively, is well recognised and steady progress is being made. Superimposed on this is the recognition of the need for flexibility of specifications to meet the special needs of individual customers, and for new, more refined techniques of measuring quality characteristics to be adopted as they are developed and become available. There appears to be good bi-national cooperation on this activity.

### **Equal Access to Each Others' Grain Markets and Marketing Infrastructure**

End use certificates are still in place on both sides of the border, but have little effect in restricting access (with the possible exception of small lots in local border areas). Full two-way access to millers and to feed markets effectively exists now. Canada's main remaining concern is to keep U.S. grain out of the country elevator system, in order to avoid visually-indistinguishable lower-quality (or more variable quality) grain contaminating Canadian export supplies. U.S. grain can and has moved on the Canadian rail system, and through Canadian terminal elevators and ports. Similarly, Canadian grain has begun moving on the Mississippi waterway system and on the U.S. rail system. Such cases will undoubtedly become more frequent and accepted as normal.

### **Lengthening the Arm between the Canadian Government and the CWB**

Clearly this needs to happen, as international opposition will continue as long as the CWB is seen to be to some degree under the control of the Canadian Government. There is also considerable domestic pressure in this direction and some progress is evident. New legislation recently tabled changes the control structure to some extent. Commissioners would be replaced with a more traditional CEO/Board of Directors structure with the policy intent of having a majority of the Board elected by producers and a minority appointed by government.

### **GROUP 3: THE STONES**

These are issues on which little progress is yet evident, and which will probably need to be the main points of focus in future discussions and negotiations, in my view. In some cases (particularly CWB Transparency and Domestic Floor Price Supports which follow) there is need and scope for intellectual input, in the form of good objective analysis, to assist progress.

#### **EEP**

This program will be an irritant as long as it remains. I recognize that its removal will probably have to be in the context of the phasing out of EU export restitutions on grains.

#### **CWB Transparency**

The bulk of evidence suggests that less is generally known about the prices, terms and conditions of CWB sales than about corresponding private sector sales. The CWB argues that, given the nature of the world grain market and the way many importing countries prefer to do business, it can do better for its producers by operating confidentially. This may well be true. The problem is that in the eyes of other countries who wish to change the structure of the international grain market to make it more open and transparent, the CWB facilitates the status quo and is therefore an obstacle to progress. As long the secrecy remains, the perception of a possibility of unfair trade practices will be there and the CWB will remain an international target.

#### **Domestic Floor Price Supports**

It may be argued that both CWB initial prices and U.S. loan rates are equivalent in that they provide a price floor, financed as necessary by taxpayers (CWB pool deficits, and CCC purchases of grain forfeited under the non-recourse loan system), which has been managed at quite low (well below market) levels in recent years. Nevertheless, there is fear on both sides of the border that the other's discipline could be arbitrarily relaxed at any time, turning one or the other instrument into a significant subsidy, and tilting the playing field. Conceptually, there would seem to be a possibility to formally link these two measures. Ideally, it could be jointly agreed to harmonize the levels of the U.S. loan rate and the Canadian initial payment and only to change them by mutual consent. If that would be an unacceptable erosion of U.S. sovereignty, then Canada could still choose to unilaterally follow any U.S. lead in this respect. Then, in deciding to change its loan rate, the U.S. would at least have to presume that Canada would follow suit (and that any down sides to the decision may therefore be exacerbated). There may even be more widespread international

interest in the idea of a coordinated low-slung safety net, where international pressures could be expected to keep it low in all countries.

### **Disciplines on Legislated Monopolies**

It is clear that State Trading Enterprises are going to be a focus of attention in the next round of multilateral trade negotiations. In the eyes of the United States and a few other countries they are an important object of unfinished business left over from the Uruguay Round. One important question will be whether single desk importers and single desk exporters should be treated symmetrically, or whether separate and distinct disciplines are needed for each. My comments are restricted to exporting STEs.

The right of producers to band together to market cooperatively is not at issue; such forms of agricultural marketing exist in most countries and enjoy wide support. When the institution involved is an agency of government or a parastatal, then the potential undesirable effects are relatively clear and it seems likely that some international disciplines will be agreed to curb such effects. The most difficult case may be the intermediate one of legislated monopolies (e.g., marketing cooperatives) which, aside from the underpinning legislation, operate quite independently of government. Whether and why international disciplines would be appropriate in such cases, and, if so, what sorts of disciplines, may become the toughest issue for the STE negotiators to address. The outcome will be crucial to the future of the CWB which can relatively easily be made more independent of the Government, but which regards its purchasing monopoly status as essential to its survival.

### **U.S. Export Credit Guarantees**

As long as the credit guarantees offered under the GSM programs exceed in length of term the norms agreed by virtually all other countries (3 years for grains; more generally, the life of the product), then this is going to remain a source of bilateral and international irritation.

## **CONCLUSIONS**

I conclude from the above that both the United States and Canada have some bullets to bite unilaterally which would further the cause of H/C in grain marketing. There is room for coordinated joint action on at least the issue of floor price support. A cooperative rather than confrontational approach to the STE disciplines issue may also pay dividends for both countries.



