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Transformative Change in Agriculture: The Canadian Wheat Board

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National policies must be in the interest of all Canadians. Between the 1920s and 1940s when the Canadian Wheat Board (CWB) was first being constructed, the export of wheat from the prairies was an essential component of national policy. In the twenty-first century the CWB has no important role in the development policy of western Canada. Its objectives are totally aimed at earning premiums in the market for prairie farmers. The CWB controls a smaller volume of the prairie crop in 2005 than it did in 1948. Given this diminished role for the CWB, does it need to exist at all? How might it be changed in a transformative way, given the present day realities of trade agreements and domestic pressures, so that it operates in the national interest while still maximizing returns for prairie wheat and barley farmers?

Keywords: Canadian Wheat Board, single-desk selling, trade agreements, transformative change

Introduction

National policies must be in the interest of all Canadians. Between the 1920s and 1940s when the Canadian Wheat Board (CWB) was first being constructed, the export of wheat from the prairies was an essential component of national policy (Fowke, 1957). Another important piece of national policy that affected the prairie wheat economy was the Crowsnest Freight Rate, which gave farmers protection from increasing freight rates for export grains. In this context the CWB made sense. By the 1990s, the export of wheat and barley was not an essential part of national policy in Canada. In 1995, the Government of Canada removed the transportation subsidy for export grains. Following the Canada–United States Trade Agreement (1989) and the Uruguay Round Agreement on Agriculture (1995), Canada has promoted free trade in all agricultural commodities with the exceptions of supply-managed commodities and the export of wheat and barley through the state trader (i.e., the CWB). Some argue that the continued existence of the CWB in its present form is a hindrance to achieving national policy objectives because it is a trade irritant for our largest trading partners.

In the twenty-first century the CWB has no important role in the development policy of western Canada. Its objectives are totally aimed at earning premiums in the market for prairie farmers. Canadian consumers are not affected by the continued existence of the CWB (for example through higher bread prices) because Canada allows for the import of both wheat and barley by millers, malt houses, and feed users. Given this diminished role for the CWB, does it need to exist at all? How might it be changed, given the present day realities of trade agreements and domestic pressures, so that it operates in the national interest while still maximizing returns for prairie wheat and barley farmers? The purpose of this article is to examine these questions.

Part I: The Current Situation

The perceived problem

There are at least two perceived problems with the current structure of the CWB. The first concern is associated with the historical development of the CWB, specifically, why does the single-desk authority apply only to wheat and barley? The second concern is with how the CWB fits into Canada's future trade strategy. This section of the article gives a thumbnail sketch of the roots of these two concerns.

When the CWB was first put together, wheat, oats, and barley were the primary grains grown by prairie farmers. When canola (originally rapeseed) and pulse crops (e.g., peas and lentils) were introduced in the 1960s and 1970s respectively, farmers chose to leave the marketing of these crops outside the CWB. The result is a mixed marketing system, and while it is an irritant to some prairie producers it is not a trade concern.

The second concern is more serious because it relates to Canada's trade options. The CWB is a state trading enterprise with some special powers granted to it by the federal government. Two such special powers of the CWB are 1) single-desk selling authority for wheat, durum, and barley produced in the CWB "area" and sold for domestic human consumption or into the export market and 2) the "pool account" guarantee. The region over which the CWB has regulatory power consists of the three Canadian Prairie provinces and the Peace River region of British Columbia. There are producer benefits from the CWB, some of which are price premiums earned in some markets, simplicity of pricing, no issue over receiving payments for delivered grain (the CWB always pays farmers for grain at time of delivery), and some transportation benefits.[1]

An initial payment is paid to farmers by the CWB when they deliver their grain to the elevator (Schmitz and Furtan, 1999). The initial payment is the first installment of the final price received by the grain farmer. The final price is determined after all sales for the marketing year have been made. The funds to make the initial payment are drawn from one of the four "pool accounts" which the CWB creates for each marketing year.[2]

The single-desk selling powers are required to make the pool accounts sustainable.[3] The CWB makes annual forecasts for wheat and barley sales and prices. Once the CWB can approximate how much grain it has to sell for the year (i.e., once the crop is planted), it can make a reasonable estimate of what farmers will receive for their grain at the elevator. The initial payment is usually set at approximately 70–75 percent of what the CWB forecasts will be the final price for grain. Farmers receive a pooled price for their grain that depends upon the class, grade, and protein of the grain delivered, and the farmer's location, less CWB marketing and administration costs.[4] The fact that it has single-desk selling authority guarantees the CWB management all of the wheat, durum, and barley produced in the CWB area that is sold into the domestic human-consumption or the export market. (Barley and wheat can be sold by farmers into the domestic animal-feed market outside the CWB.) This restriction on marketing grain serves two purposes: 1) it ensures that if an importer wants Canadian wheat, durum, or barley they must buy it from a single seller (i.e., the CWB), which may charge a higher price than if the market were competitive and 2) it allows the CWB to enter long-term sales contracts without having to use the futures market.[5]

For certain, not all farmers see the current CWB price pooling scheme as a benefit. Some farmers would choose to operate outside the existing system but have not been allowed to do so by the federal government.[6] In fact some prairie farmers were willing to go to prison for marketing their own grain into U.S. markets as a demonstration of their opposition to the single-desk selling authority of the CWB.

The CWB is under pressure from some members of the World Trade Organization to change some of its operational procedures. The WTO framework agreement cited at least two issues its members have with the current operations of the CWB.[7] First, the WTO has some concern around the operation of the CWB pool account guarantee and the role of government financing.[8] When the pool account goes into deficit, the federal government must pay the CWB an amount equal to the deficit. The "initial price", or pool account guarantee, is set by the federal government following a recommendation by the CWB. The pool account for wheat has incurred deficits four times since 1950, in crop years 1968-69, 1985-86, 1990-91, and 2002-03.[9] It is this guarantee that that the WTO wants removed. The proposal to remove the pool account guarantee is now on the negotiating table and may be accepted by the Canadian government. Second, the WTO framework agreement suggested that the single-desk selling authority of the CWB needs to be examined. Some member countries of the WTO are seeking changes to the powers of exporting state trading enterprises such as the CWB. The Canadian government is resisting the pressure to place this issue on the negotiating table.

In addition, the CWB has been challenged with unfair trade practices by the United States a total of 12 times (14 if you count the CVD/AD on hard red spring/durum wheat as 4) for different reasons and through different channels. In 2003, the United States brought a formal complaint to the WTO against Canada. One element of the complaint challenged the CWB, claiming it was not operating in accordance with Article XVII of the GATT 1994. In April of 2004, the WTO panel established to hear the U.S. complaint rejected the U.S. argument that the CWB violated its obligations set out in Article XVII. The United States appealed the panel's findings with respect to the CWB.

In 2002, the United States Department of Commerce initiated countervailing and antidumping investigations on imports of Canadian hard red spring and durum wheat. In most of the previous U.S. challenges the CWB was found not to be in violation; however, the 2003 result was different. As a result of the 2003 challenge, the United States government imposed a countervailing duty of 5.29 percent and an antidumping duty of 8.87 percent on hard red spring wheat imports from Canada (CWB, 2005).[10] As no injury was found on durum imports from Canada, no tariff was placed on durum imports. The countervailing duty, particularly the 4.94 percent tariff attributable to the government guarantees, is being appealed by the Canadian government, along with the CWB and the provinces of Alberta and Saskatchewan, to a NAFTA panel. In addition, the CWB is appealing the U.S. International Trade Commission's ruling of injury on hard red spring to a NAFTA panel.

Just how important is the CWB to prairie farmers?

A number of studies have demonstrated that the CWB does earn a premium in some world markets, such as the Japanese wheat market and the domestic malt barley market (Furtan et al., 1999; Schmitz et al.,1997; Wilson and Gallagher, 1990). These premiums are a direct result of the single-desk selling authority of the CWB. The Australian Wheat Board (AWB) makes the same claim for Australian wheat in some markets and for the same reason. The AWB has single-desk selling authority for the export of wheat from Australia into foreign markets but has no single-desk authority in the domestic market.

Farmers have a direct say on the board of directors of the CWB. With ten of the fifteen board members elected by farmers, the senior management is responsive to the demands of farmers. As the number of co-operative grain companies has declined on the prairies, farmer control of the CWB has become more important. This influence over the CWB is one part of the grain handling system where the farmer's voice has increased over the past ten years.

Wheat as a crop has declined in economic importance to prairie farmers. Wheat revenue as a percentage of total farm income has declined from 78 percent in 1950 to just under 40 percent in 2002 (figure 1). Over the past 30 years the crops that have increased in economic importance to farmers are canola, feed barley, and pulse crops. Interestingly, all these crops are outside the CWB. The malt barley market, which has increased from 1.216 million tonnes over the period 1987–92 to 2.244 million tonnes in 1997–2002, is under the CWB; however, the majority of the growth in barley sales has been in the animal-feed market. The feed barley market operates largely outside of the CWB. The increased reliance of the CWB on wheat revenues is shown in figure 2. The result of these trends is that the CWB is not as economically important to prairie farmers as it once was.

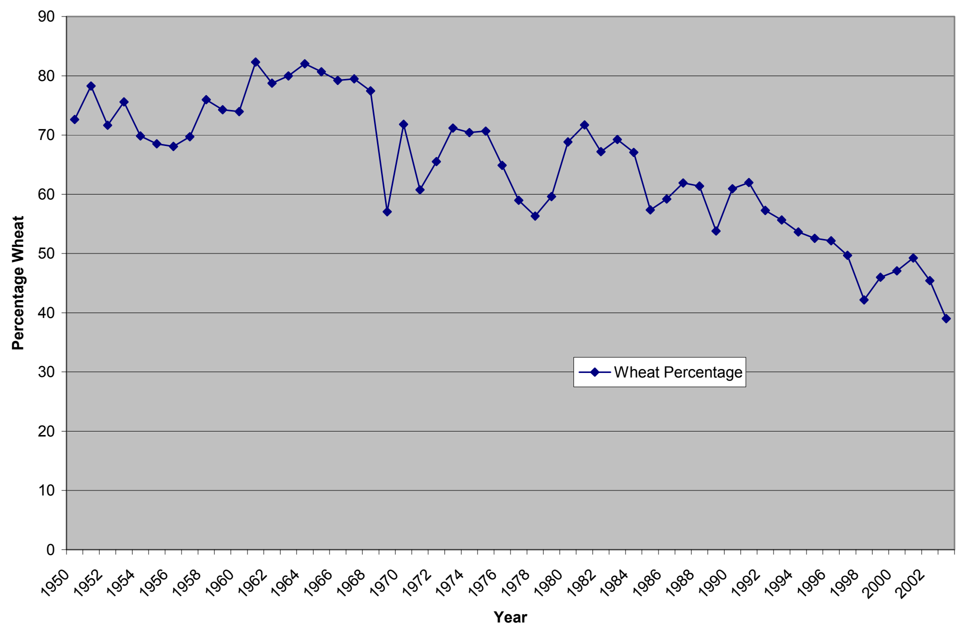

Figure 1: Percentage of prairie grain income made up of wheat, 1950-2003
Source: Statistics Canada

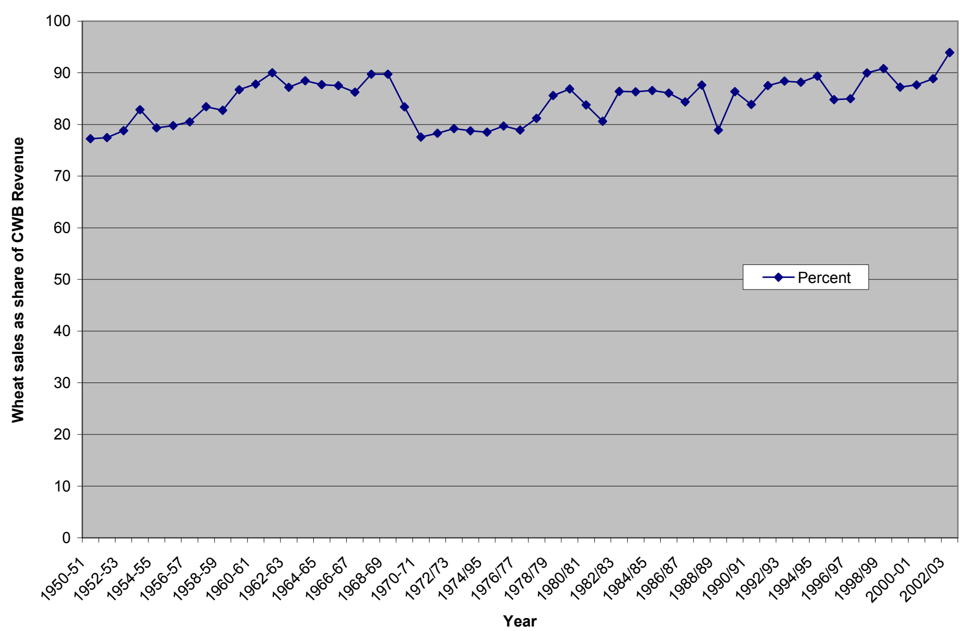

Figure 2: Wheat sales as share of CWB revenue: 1950 to 2003
Source: Canadian Wheat Board

Part II: An Alternative Situation

If demands by members of the WTO and/or U.S. or domestic pressures result in a change to the pool account guarantee and a relaxing of the single-desk selling authority, what options does the CWB have to continue in the grain business? (A host of other issues that merit investigation would arise with any change to the CWB, for example, the implications for the grain transportation sector; however, these issues are well beyond the scope of this article.)

A farmer-funded guarantee

The most obvious alternative to the government guarantee is for farmers to purchase insurance or to self-insure. Given the infrequent occurrence of the pool account deficit, the cost of insurance would be very low. Large insurance companies would supply this service for a fee. Alternatively, farmers could build up an account from a grain check-off to cover any deficit that occurred, i.e., they could self-insure.

This option would be most attractive to the federal government, because it would be rid of a contingent liability for no cost. However, farmers are most likely to lobby for an alternative policy that provides some economic protection at government expense. If the guarantee on the pool account is to be removed it could be replaced with a loan rate scheme that mirrors the support for U.S. farmers.[11]

A loan rate scheme for Canadian wheat farmers

The American loan rate is set in the U.S. Farm Bill and is fixed over the life of the bill. It puts a floor on the price of the commodity in question. There are loan rates for a long list of commodities, including, among others, wheat, barley, corn, and soybeans. If the price of the commodity falls below the loan rate a deficiency payment is made to the farmer. This is not substantially different in purpose from the guaranteed pool account; however, the U.S. loan rate on wheat is binding more often than the pool account guarantee and thus has paid out much more to U.S. wheat producers.[12]

With a loan rate scheme the Canadian government would make a payment to wheat farmers whenever the price the farmer receives is below the loan rate. The price at which the loan rate is set will determine the magnitude of the government expense. If the Canadian government set the loan rate to exactly mirror the U.S. loan rate, Canadian wheat farmers would have exactly the same floor price as American farmers.[13]

The cost to government of a loan program for Canadian wheat farmers would not be as large as it first appears because program substitution economies would occur. Any support money paid to Canadian wheat farmers under the loan rate policy would be counted as farm income and would reduce other farm income support payouts required.[14] The current federal-provincial agreement on farm income support is called the Canadian Agriculture Income Support program (CAIS). This program is designed to stabilize the five-year moving average of the "eligible net margin" of farms.[15] This program has some similarity to the additional U.S. farm programs, such as disaster relief programs.

Removal of all CWB single-desk selling authority

Any WTO-negotiated removal of the single-desk selling authority from the CWB will occur a long way in the future, if ever. The more likely case is that the single-desk selling authority will be removed through a change to the Canadian Wheat Board Act undertaken by the Government of Canada for some domestic reason. For example, the Conservative Party clearly identified removal of the single-desk authority of the CWB as part of its farm policy platform in the 2004 general election.

The most drastic response to the pressure for change to the CWB would be the removal of its single-desk selling authority in all markets and for all commodities. This would make Canada a free trader in all grains. However, it would also mean the CWB would disappear, and with it any ability of producers to have a farmer-controlled marketing agency that could price discriminate in the world grain market.

With a complete loss of the single-desk selling authority the CWB would not be able to operate a pool account as it does currently because it would have no control over the farm marketing of Canadian wheat and barley supplies. If grain prices were to start to increase within the marketing year, farmers would have an incentive not to sell their grain through the CWB. This would lower the average pooled price because only the lower-valued sales would be in the pool account. If prices were to fall over the marketing year, farmers would have the incentive to sell into the pool account. Thus, farmers would be in the position of having to decide whether to market their grain through the CWB or on their own, depending upon which way they anticipate prices will move over the crop year.

The CWB would be limited in its ability to enter into long-term contracts with foreign buyers, because farmers might deliver their grain to other marketers who operate outside the pool account. The CWB would be forced to operate like a grain company and sell on a margin, i.e., the difference between the export price and the price paid to farmers. It would have little choice but to become another grain company offering marketing services to farmers. Even this outcome is highly unlikely because currently the CWB does not own assets like terminals and inland delivery points.

The Canadian government could choose to make a payout to existing wheat farmers as compensation for the loss of the single-desk selling authority. A similar policy option was used by the Government of Canada in 1996 when a portion of the Crow Benefit[16] was paid to farmers in the CWB region in the form of a one-time acreage payment, and by the Government of the United States when U.S. peanut and tobacco farmers lost their production quotas. It has also been raised as a possible option with respect to the removal of Canadian supply-management production quotas.

One option in the event of complete removal of the single-desk selling authority is to transform the CWB from a marketing board for farmers into a co-operative grain company. The personnel of the CWB understand the world market; given a transition period and some financial assistance, the organization may be positioned to compete very successfully in world grain markets – as it has been doing for the past 60 years.

The new grain company would require some grain assets, which could be purchased with a loan from the federal government. Rather than pay out farmers for the loss of the CWB single desk, the government could make such a loan to assist in the transition. If farmers are to give up a price premium, the federal government could make funds in lieu of the forgone premium available to the CWB for the transition.

This option is not with out risk. How does one know if the new company would be able to pay back the loan? Recently, co-operative grain companies have not done well in Canada. Both the Alberta and Manitoba co-operative grain companies have been amalgamated with United Grain Growers to form Agricore United Inc. In 2005 the Saskatchewan Wheat Pool completely removed its co-operative structure in favor of a traditional business structure. Stiff competition from large multinational grain companies with deep pockets would occur.

Removal of some CWB single-desk selling authority

At least two options for the partial removal of the single-desk selling authority are worthy of consideration. The first option would be to re-create the continental barley market while maintaining the single-desk authority for hard red spring and durum wheat. In the run-up to the 1993 general election the federal government created a continental barley market by allowing for the export of Canadian barley to the United States through agencies other than the CWB. A court challenge lead by the Saskatchewan Wheat Pool got the policy overturned. Before the government could further amend the CWB legislation they were defeated in a general election. The new Liberal government did not re-introduce the amendments to the Canadian Wheat Board Act so the continental barley market did not become permanent.

The continental barley market option still exists. However, barley exports into the United States are low and have not created any trade tension since 1993. Removing the designation of the CWB as the sole seller of Canadian barley to the United States would appease only those domestic farmers who want out from under the CWB mandate.[17]

The major problem with a continental market is the transshipment problem. For example, a grain company could purchase malting barley in Canada, export it to the United States as feed barley, and re-export it into the international market in competition with the CWB. A similar problem exists with the creation of a continental wheat market. Some will see such competition as a good outcome; however, it does reduce the ability of the CWB to earn a price premium.

A second option is to free up the domestic market for all commodities and let the single desk remain only with respect to exports. This option would transform the CWB into a marketing agency similar to the Australian model. The AWB has gone further and purchased grain assets both in Australia and in some importing countries. It has raised capital on the Australian stock market through a share offering.[18] Some say the AWB is preparing itself for the day it loses all single-desk selling authority.

This second option has a number of attractive characteristics. First, the CWB, like the AWB, could purchase grain-handling assets. This may give it more leverage to capture price premiums from foreign consumers. Second, the CWB could be allowed to market other grain products for farmers, for example, canola and pulse crops, but without any single-desk selling authority. There are scope economies in the international grain trade, and the CWB (with a change to its act) could capture some new marketing opportunities. This arrangement would allow the CWB to become more engaged in the marketing of grains produced on the prairies if farmers found the agency's performance to be competitive.

Canada allows for the importation of milling wheat and malting barley. Given that milling wheat in Canada is priced off the Minneapolis exchange and malting barley is priced off the Pacific Northwest market, Canadian consumers are already paying U.S. prices. This means there would be no new arbitrage between the two markets if the domestic Canadian market were freed up.

The Australian option would do little to appease the United States. The AWB is less of an annoyance to the Americans because it does not export into the U.S. market in the volumes the CWB does because of location and the types of products they produce. Canadian durum is one product which is in strong demand in the United States. The U.S. pasta makers purchase large quantities of Canadian durum wheat, in part because of the quality, and in the process these firms maintain good commercial relationships with the CWB.

Recommendations

While this article is not at all exhaustive, I make three recommendations that the Government of Canada and the CWB may consider.

Recommendation 1

The CWB move away from its reliance on the federal government guarantee for the pool account by self-insuring the pool account. All pricing decisions would then be the sole responsibility of the CWB management and board of directors.

Recommendation 2

The CWB give up its single-desk selling powers in the domestic market in exchange for the ability to market all types of grains produced on the prairies. The single-desk selling powers would remain only for export wheat, durum and barley.

Recommendation 3

The CWB purchase grain-handling assets at an advantageous time that facilitates the maximizing of market returns to prairie grain farmers. This would move the CWB in the direction taken by the AWB.

Conclusion

The CWB is a complex entity. As the policies that govern the CWB are interrelated, it is difficult to change just one aspect, such as removing some of the selling powers. Such difficulties must not hinder the process of looking for alternatives and determining how they would affect prairie farmers and whether they would be more consistent with Canada's national policy on free trade. Changes to some of the long-standing institutional structures are likely to be thrust upon farmers from a number of sources. It is time to have an open and constructive dialogue about possible changes to the CWB and their implications.

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Endnotes

1. Price premiums are earned by the CWB's ability to price discriminate in some international markets.
2. A marketing year goes from August 1st of one year to July 31st of the following year. Each year the CWB has pool accounts for wheat, durum, feed barley, and malting barley.
3. Without the single desk, farmers will potentially behave opportunistically in getting "in" and "out" of the price pool. See the section "Removal of all CWB single-desk selling authority" later in this article for a more detailed discussion.
4. The cost of CWB services varies from year to year depending upon the volume handled. The actual costs are reported each year in the annual report. Comparable marketing costs for large private grain trading firms are not publicly available.
5. Some reviewers question why the CWB could not enter into long-term marketing contracts (i.e., five-year contracts) with farmers and in such a manner guarantee the supply of grain. The major problem with this option is that it is difficult to take farmers to court if they break the contract.
6. Given that the pooled final price is an annual average, farmers can always identify days when they could market grain at a price above the seasonal average. Of course this is after the fact, but as the end of the marketing year approaches it does become easy to forecast the final pooled price.

7. The report is the *Decision Adopted by the General Council on August 1, 2004 (Ref: WT/L/579)*, which contains an Annex A – *Framework for Establishing Modalities in Agriculture.*
8. The government financing benefits received by the CWB are not discussed here in any detail. While they affect the cost structure of the CWB, they do not affect how the CWB interacts with farmers.
9. It is worth mentioning that at least two of the four wheat pool deficits were extraordinary events. The deficit in the 1980s was a direct result of the action by the U.S. government to challenge other wheat exporters through the Export Enhancement Program. The 1991 deficit resulted from what is considered a political decision by the Canadian government to set the initial payments at a level above the expected pool return.
10. In terms of lost revenues, the wheat tariff cost approximately 40 million dollars per year and has effectively stopped the U.S. importation of Canadian wheat. Rulings on the appeals are expected in the spring of 2005 (CWB, 2005).
11. It may be possible to shorten the pooling period, as is the case for barley, thus reducing the risk of a pool account deficit.
12. Since 1988 the U.S. loan program has paid out over $3.8 billion for wheat, whereas the CWB initial payment guarantee has paid out $85 million (CWB, 2005).
13. This would not result in countervailing duties disappearing, but may convince U.S. farmers they are on an even footing with Canadian wheat producers.
14. The same effect occurred when the Federal Government made the BSE payment to farmers in 2004. The BSE payments were added to the farmer's revenue, reducing the probability of a CAIS payment.
15. For details on what revenues and costs go into the "eligible net margin" and the government's contribution to maintaining this revenue see the Agriculture and Agri-Food Canada website.
16. The Crow Benefit was a transportation subsidy paid by the federal government to prairie farmers on export grains.
17. The CWB does make a substantial premium for producers on the sale of malting barley (Schmitz et al., 1999). The malt market is separate from the feed market; the barley is fungible between the two end uses, thus making the opening up of the feed market problematic.
18. A full discussion of the transformation of the AWB is beyond the space limitation of this article. The Government of Australia has stated it will not make further changes to the mandate and structure of the AWB until after 2010. This appears to indicate support for the direction in which the AWB has moved.