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e-brief

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A Bushel Half Full: Reforming the Canadian Wheat Board

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- The Canadian Wheat Board (CWB) has been earning poor financial returns for farmers over the last three years, based on our benchmarking analysis.
- Reforms are required, including more transparency in reporting financial returns to farmers, and greater accountability on the part of CWB management to the farmer-elected board of directors.

INDEPENDENT • REASONED • RELEVANT

The Canadian Wheat Board (CWB) is, by law, the sole buyer of Western Canadian wheat and barley that is destined for human consumption or export markets. With a total of 21 million tonnes of grain marketed from August 2006 to July 2007 (Canadian Wheat Board 2007a), it ranks as the largest wheat and barley marketer in the world.[1] Since 1935, the CWB has been collecting and pooling grains from farmers in the Prairies – a practice made compulsory in 1943 – and disseminating market data. A central mandate of the CWB is to improve the financial returns to producers by leveraging the power of marketing through a "single desk."[2] But does it?

In this *e-brief* we examine available evidence on whether the CWB's programs and management practices deliver farmers the best possible return in the international grain market. We benchmark the performance of one specific program, the Daily Price Contract (DPC) program, which serves as a window on the CWB's overall performance, and conclude that it does not deliver on its mandate. Benchmarking, however imperfect, could be a useful exercise for the CWB. In this study, for example, we use the US market as the main point of comparison, because we believe that comparing DPC prices against US prices is an appropriate way to benchmark CWB performance, given that the explicit goal of the DPC was to give Canadian farmers a price based on US markets (Canadian Wheat Board 2006).

We find that the CWB's performance in delivering good prices for farmers is not strong, and recommend that the CWB enact reforms to provide: (i) greater transparency for farmers on its performance; and (ii) greater accountability on the part of CWB management to the farmer-elected board of directors.

Background: What the Canadian Wheat Board Does

Western grain farmers sell their grain to the CWB, which sells the wheat on international markets on their behalf. Farmers are first given a pre-determined initial payment per tonne on delivery, then a final payment after the CWB sells all their pooled wheat. This is known as price pooling.

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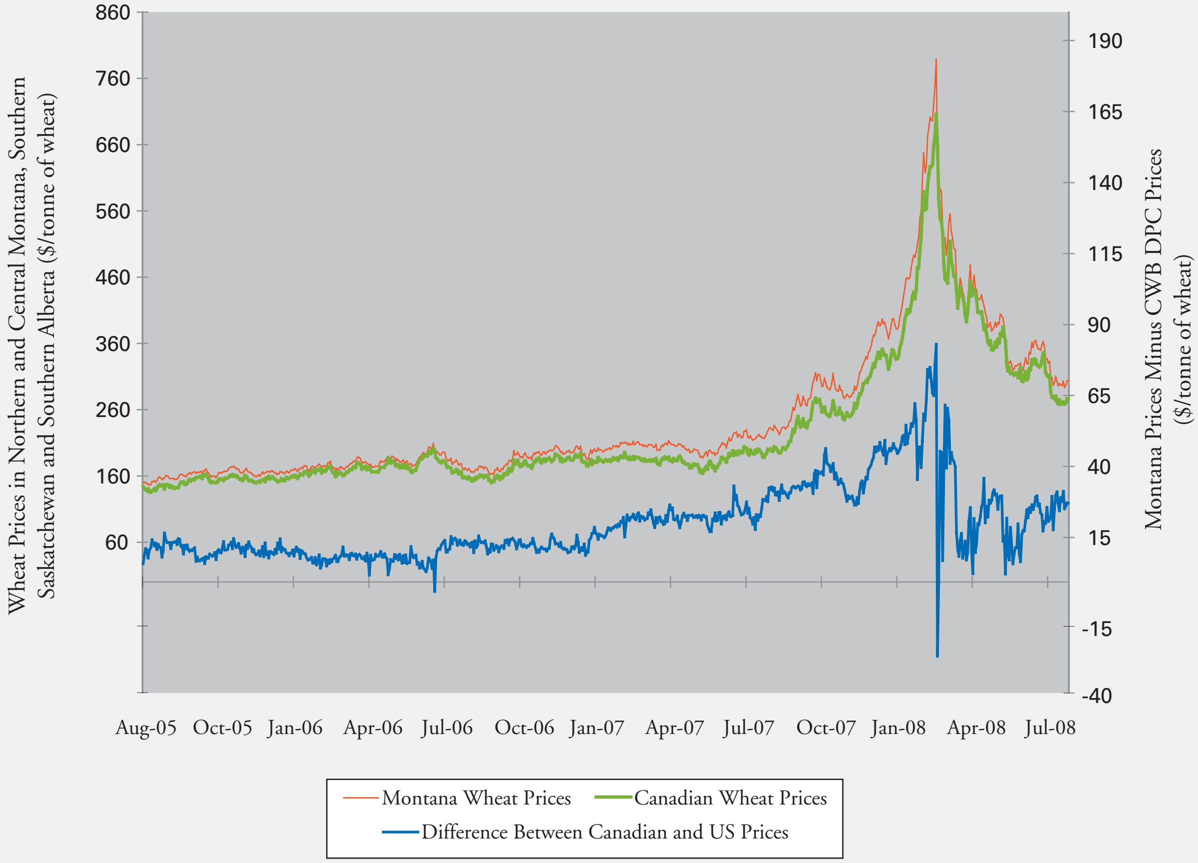
1 Farmers in Eastern Canada (east of Manitoba) and British Columbia (except for the Peace River District in British Columbia) are exempt from the monopoly control of non-feed wheat and barley. Pooling is a resource management term that refers to the grouping together of resources for the purposes of maximizing advantage and/or minimizing risk to the users (Coughlan et al. 2001).

2 One of the stated goals of the CWB is "To extract the highest possible returns for farmers by effectively leveraging the powers of the single-desk." See http://www.cwb.ca/public/en/about/vision/

Figure 1. CWB Price Gap Based on Wheat Prices in Northern and Central Montana versus Southern Saskatchewan and Southern Alberta from Daily Price Contract Data



Note: See online appendix.

Sources: Grain prices from Canadian Wheat Board; transportation costs from Canadian Grain Commission (CGC) and Alberta Agriculture and Rural Development; US grain price data from United States Department of Agriculture (USDA) Agricultural Market Services Department; exchange rate from Bank of Canada noon daily exchange rates.

In 2005, the CWB introduced the Daily Price Contract (DPC) program as a producer payment option to offer farmers more price flexibility and increased ability to manage cash flow. The DPC was a significant departure from the CWB's price-pooling philosophy, under which all producers received the same price for any given grain. The DPC allowed producers flexibility to choose a pricing time, and receive quick payment for their wheat based on a daily cash price, calculated according to a basket of US elevator prices just south of the Canadian border (Canadian Wheat Board 2005). Take-up under the DPC was limited to 650,000 tonnes, approximately 4 percent of the total wheat that the CWB expected to market in 2007/08.[3]

3 This program was replaced in July 2008 by a similar program known as FlexPro. It differs from the DPC by not explicitly claiming to track US grain prices, but the intent of daily price setting is similar.

An Evaluation of the DPC Program

To determine how the CWB performed on the international market relative to US prices, we use a benchmarking system. Our methodology is based closely on the Gray Benchmarking scheme developed by the CWB to compare prices received by Canadian and North Dakota/Montana producers averaged over a year. The Gray Benchmarking scheme is a comparative approach that was used briefly by the CWB in 2001 (Gray 2001; Pedde 2007a).

Comparing southern Alberta and Saskatchewan price results with those from an average of locations in northern and central Montana (the left axis of Figure 1) reveals that from 2005 through 2008 Canadian growers received a significantly lower price per tonne (the right axis) in comparison to Montana-based producers, for the same type of high-quality wheat.[4] We use reported US prices, which are the prices US farmers receive after deductions for freight and handling. We calculate a comparable price, what Canadian farmers receive, by applying the equivalent deductions to the reported DPC price.[5]

Early in the life of the DPC program, the CWB price was lower than Montana prices by, on average, $9.23 per tonne; but later the differential widened dramatically. The price differential expanded to over $12 per tonne in the first half of the 2006/07 crop year and then to an average of almost $40 per tonne at a time when the CWB had told producers that it expected only a $5/tonne price differential relative to US prices (Canadian Wheat Board 2007b).

In addition to obtaining lower prices for Canadian producers, the DPC incurred hedging losses. In 2005/06, the hedging losses were $12.58/tonne and in 2006/07, $14.36/tonne, (Canadian Wheat Board 2007a). Combining these losses with the shortfalls relative to American prices makes the returns to the DPC look even less attractive.[6]

What These Results Mean for all Western Grain Farmers

The DPC results for the 2007/08 crop year will be made public when the Board's Annual Report is released; our analysis, however, indicates an even poorer performance than in previous years. During the period, Canadian farmers were paid an average $32.81 per tonne less than US farmers.[7] We estimate that hedging losses were another $75/tonne.[8] These hedging losses constituted a drain on the contingency fund used by the rest of the alternative price programs in the CWB (Canadian Wheat Board 2007a).

What does this mean for all Western grain farmers? Suppose farmers not using the DPC experienced the same percentage losses relative to US farmers as those in the DPC. If this were true, the returns reported to the 4 percent of tonnage in the DPC would provide a window into the daily trading success of CWB. If the 2005 through 2007 hedging loss and US price shortfall were applied across the board, an average farmer who delivered approximately 700 tonnes annually to the CWB pool accounts would face an opportunity cost – relative to selling at US prices – of at least $18,000 per year.

4 These locations were chosen due to their comparable proximity to port facilities. The US Department of Agriculture (USDA) publishes a daily survey of grain prices for Montana, but not North Dakota (which is excluded in this benchmarking). That survey is deemed consistent with those used in the USDA loan deficiency payment (LDP) program, one of the chief US agricultural income support programs. Thus, our comparative analysis is based on these prices. The Canadian Western Red Spring (CWRS) 14 percent protein class of wheat – used in the production of bread – is the most widely grown wheat class in Western Canada and is considered by many to be the Canadian equivalent of the Dark Northern Spring (DNS) wheat class in the US (Petry and Anderson 1974).

5 We use the following deductions to calculate a comparable Canadian elevator price: freight, elevation, cleaning, and Canadian Grain Commission inspection. See online appendix for details.

6 The CWB reported DPC hedging losses of $935,000 in 2005/06 over 73,904 tonnes and $7,231,000 in 2006/07 over 501,366 tonnes.

7 Rail freight prices to ports in the US were an average, $9.90 per tonne, higher than in Canada during the period under study – Canadian producers should have been seeing a $9.90 premium over US producers at the elevator, not a discount. See http://wbc.agr.mt.gov/Producers/surcharges.html, http://wbc.agr.mt.gov/Producers/transportation.html and Alberta Agriculture and Rural Development.

8 The analysis of the DPC Winter Wheat Program shows similar results. The estimate of hedging losses for 2007/08 is calculated based on hedging losses from 2005 to 2007 of approximately $50,000 per percentage point of international wheat price market variance.

Reform is Needed

The CWB could better help Western grain farmers who need it to market their grains. When analyzing complex global markets, knowledge is a precious commodity and the CWB can be useful in providing structure and information to grain producers. But the CWB's recent track record in providing information to its producers is questionable at best and tactically mismanaged (Pedde 2007b). To serve a valuable economic purpose, the CWB could be retained, but its business model needs to be carefully reformed, in particular with respect to its reporting practices.

Transparent and consistent performance benchmarking is key to reform. Rather than extrapolating results from one program to estimate the losses in the CWB as whole, there should be a more transparent way for all CWB farmers to know how much better (or worse) off they would be if they could sell on a daily basis at comparable US prices. One such improvement would be to re-enact the Gray Benchmarking system (Pedde 2007a). With proper benchmarking, the CWB's value to farmers could become more clear.

Greater transparency would also enable trading functions to be conducted by outside marketing experts, if they show that they earn better returns for farmers than current CWB traders (Pedde and Mirus 2008). At the Board level, greater transparency would also permit farmer-elected directors of the CWB to better hold management to account for the returns it earns for farmers (Auditor General 2002). Better, documented performance would help the CWB establish that it delivers on its mandate.

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