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Curbing the Unfair Advantage of the Canadian Wheat Board -
A Suggestion for a U.S. Negotiating Proposal

by

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One of the top trade objectives of the U.S. wheat industry is to abolish the Canadian and Australian Wheat Boards. If that is not possible, the wheat industry insists that the U.S. government negotiate disciplines at the WTO that will stop the unfair practices of the Wheat Boards.[1] So far, the U.S. wheat industry has been unable to develop a concrete WTO proposal to stop these unfair practices or even to make a convincing case that the Wheat Boards are engaging in trade-distorting practices. The purpose of this note is twofold: (1) to identify the unfair advantage of the Wheat Boards and (2) to suggest a U.S. negotiating proposal to curb this unfair advantage.

<u>What are the Wheat Boards doing that is unfair?</u>

The literature on State Trading Enterprises (STEs) identifies two ways that exporting STEs, such as the Wheat Boards, could distort trade.[2] First, they could act as monopolists usually do and use their monopoly powers to raise prices by restricting their exports. Second, the Wheat Boards could be the vehicles through which governments provide export subsidies. Unfortunately, neither argument is very helpful in developing a WTO proposal to address the concerns of U.S. wheat growers. The U.S. wheat growers charge that the Wheat Boards are acting opposite to the way monopolists usually act and are using their monopoly power to expand exports by selling their wheat at discounted prices. Further, neither the Canadian nor the Australian government is providing significant subsidies to its Wheat Board.

U.S. Wheat Associates (USW) has long argued that the Wheat Boards distort trade by using their monopoly powers to engage in “price undercutting to win markets.”[3] If USW could document that the existence of the Canadian Wheat Board (CWB) increased Canadian wheat exports or depressed wheat prices, it would have a good case to take to the WTO. However, there are three problems with translating the USW argument into a WTO proposal. First, in spite of what USW alleges, it is not unfair to undercut U.S. price offers in order to make a wheat sale. How else is the CWB going to make a sale? It is hard to believe that the CWB is deliberately selling Canadian wheat for less than it thinks is necessary to make the sale. Second, if the CWB were abolished, Canadian wheat production and total exports are unlikely to change very much. Since only a small part of the Canadian crop can be sold in the Canadian domestic market, Canadian farmers would still have to sell the same proportion of their crop into the export markets.[4] In years of low prices, Canadian farmers might carryover more of their wheat, but this wheat would eventually be exported. To sell the same quantity of wheat as is now being sold through the CWB, Canadian farmers would likely have to offer it at prices similar to CWB offers. Third, at least over a period of several years, it is contradictory to argue that the CWB is both increasing Canadian wheat exports and undercutting prices. If USW is correct and the CWB is selling Canadian wheat at a lower price than is necessary to make the sale, Canadian wheat production should be less profitable and Canadian exports should be less than they would be if the CWB were abolished.

If the CWB does not significantly affect total Canadian wheat exports, what is its unfair advantage? The CWB does have a major advantage over the exporters of U.S. wheat. Exporters of U.S. wheat must purchase their wheat from U.S. farmers at publicly reported prices or at prices that are closely tied to prices on the major commodity exchanges. The CWB can observe these purchase prices and form a good estimate of the price at which U.S. wheat will be offered in the export market. Since the CWB can sell and export wheat before it has made full payment to Canadian wheat farmers, U.S. exporters have much less knowledge of what CWB offers will be. One recent study has estimated that the CWB can use its better knowledge of the "reservation price" of U.S. exporters to gain an average $1 - 2 per metric ton price advantage.[5]

A U.S. Negotiating Proposal to Eliminate the CWB's Unfair Advantage

The CWB has an unfair advantage because it is vertically integrated and, consequently, does not need to purchase the wheat that it sells. This advantage could be corrected by eliminating the CWB. However, it may be possible to eliminate this unfair advantage while still maintaining the unique features of the Canadian system – a price pool for farmers and a monopoly exporter of Canadian grain. The U.S. should propose that the CWB be split into two independent parts – a price pool controlled by Canadian wheat farmers (The Pool) and a monopoly exporter of Canadian wheat (the New CWB). The New CWB would purchase its wheat from The Pool at **publicly announced prices and would be required to make full payment at the time that it purchases the wheat.** [6]

Much of the U.S. complaint against the CWB can be traced to the fact that currently a key price does not exist – the CWB's acquisition price.[7] If the New CWB were required to purchase wheat from The Pool at publicly announced prices, U.S. exporters and the CWB would have similar knowledge of each other's acquisition prices and would be on a more equal footing when selling their wheat on competitive tenders. Also, this change would put the CWB "at risk." Like the exporters of U.S. wheat, the CWB could not discount its wheat sales price below its full acquisition costs without showing a loss.

Endnotes:

[1] Policy statements by the U.S. wheat industry usually refer to State Trading Enterprises (STEs) rather than explicitly to the Wheat Boards. This is unfortunate since it creates confusion. Except among U.S. grain producers, almost all the concern about STEs focuses on **importing** STEs. The issues relating to the importing STEs are very different from those of exporting STEs, such as the Wheat Boards. Importing STEs can distort trade since they can raise their import prices and restrict imports in a way that causes the same effects as a tariff.

[2] See, for example, Tim Josling, "State Trading and the WTO: Agricultural Trade Policy Aspects," pages 18-19. The paper is part of a conference on the "Role of the State in Agricultural Trade" that took place at Stanford University on November of 1998. This paper and others on STEs are available at http://www-iis.stanford.edu/stateagr/.

[3] See Alan Tracy's speech to the CWB on January 19, 2000. A copy of the speech is available on the U.S. Wheat Associates' web site – www.uswheat.org.

[4] See my earlier paper, "Wheat Growers are Focusing on the Wrong Trade Issue."

[5] See William W. Wilson, Bruce L. Dahl, and D. Demcey Johnson, "Transparency and Bidding Competition in International Wheat Trade," Agricultural Economics Report No. 414, North Dakota State University, May 1999. The paper is available at http://agecon.lib.umn.edu/ndsu.html.

[6] The New CWB acquisition price would not be a market price and would be set unilaterally by the New CWB. However, I believe that the New CWB would be forced to match the prices on U.S grain exchanges. Since the New CWB's acquisition price would be publicly announced and would be the full payment that Canadian farmers receive for their wheat, Canadian farmers would rebel if the acquisition price was consistently below the market prices on U.S. exchanges.

[7] U.S. wheat grower policy statements demand that the CWB operate with more "transparency." This demand is confusing since it often seems to imply that the CWB should reveal its selling price and the exporters of U.S. wheat don't publish their sales prices. If the argument made here is correct, what the U.S. needs to know is the CWB acquisition price and this price does not currently exist. Creating a publicly announced acquisition price would make the CWB "transparent" in that the exporters of U.S. wheat would have the same knowledge about the CWB's acquisition costs as the CWB now has of U.S. grain exporters' costs.