
THE SECTION 301 ACTION AND EFFECTS OF THE CANADIAN WHEAT BOARD ON U.S. HARD RED SPRING AND AMBER DURUM WHEAT

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INTRODUCTION

Another trade dispute was initiated in 2001 involving parties in the United States against the Canadian Wheat Board (CWB). This trade dispute was initiated by concerns raised by the North Dakota Wheat Commission, and represented through their council and experts. Compared to previous trade disputes, this one differs in that it focused on trade practices both within North America and in third countries and it included both hard red spring (HRS) and durum wheat. Ultimately these concerns were deemed legitimate by the U.S. International Trade Commission (ITC), and the Special Trade Representative (STR) concurred. Most important was that an affirmative decision was reached in the early stages of the action, as well as a determination that the CWB acts as an arm of the Government of Canada.

The case has been resolved (as of early 2002) and the Trade Representative is now seeking appropriate remedies. Not all the papers and evidence from the case are available and the resolution process is currently proceeding. These factors affect the scope of this paper. The purpose of this paper is to describe the evolution and findings of the case. In

the next section we describe the evolution and findings of previous related cases. Then, we identify the details of the Section 301 case and present the major claims and responses by the parties. We provide the results of the ITC investigation and the interpretation of the Trade Representative. In the last section, we discuss the likely next steps and issues that economists and policy analysts may consider in future deliberations.

EVOLUTION OF TRADE DISPUTES

The trade practices of the Canadian Wheat Board (CWB) have been a long-standing area of contention between the United States and Canada. Several investigations and negotiations have been conducted concerning the behavior of the CWB and its impacts on U.S. farmers since 1989. These investigations/negotiations have been undertaken under different auspices, which remain a point of contention within the WTO. The range includes the Canada/United States Free Trade Agreement (CUSTA); the U.S. International Trade Commission (ITC), Sections 22 and 332; General Accounting Office (GAO); North American Free Trade Agreement (NAFTA); Canada/United States Joint Commission on Grains; and the U.S. Department of Commerce. Investigations have focused primarily on trade in durum wheat and within North America. These are summarized by Schmitz and Furtan in Table 1.

The issues between Canada and the United States were first addressed during the period 1989–2000 within the Canada/United States Free Trade Agreement (CUSTA). Under CUSTA, concerns over pricing, Canadian transportation subsidies, market access and import restrictions for wheat were addressed. Under this agreement, both sides agreed that neither country could sell agricultural products at a price below the “acquisition price” of goods plus storage, handling and other costs. CUSTA did not define the acquisition price so it failed to resolve concerns of the United States.

The United States requested a dispute resolution panel under CUSTA in 1992 to address their belief that Canada was selling exports at below acquisition costs. The panel in this dispute ruled in favor of Canada and defined the acquisition price in Canada as the initial price paid to

Table 1: Canada/United States Grain Border Disputes.

<i>Investigation</i>	<i>Conducted by</i>	<i>Completed</i>	<i>Outcomes</i>
Durum: conditions of competition	U.S. ITC, under Section 332 of the <i>Tariff Act</i> of 1930	1990	CWB deemed clean. No evidence of price cutting by CWB in U.S. market
Review of CWB and Australian Wheat Board	U.S. GAO	1992	No evidence of unfair trade practices
CUSTA	Bi-National Panel under CUSTA	1993	Ruled in favor of Canada. Received 3.5 year audit of durum sales.
Wheat and products: harm to U.S. farm programs?	U.S. ITC, under Section 22 of the <i>Agricultural Adjustment Act</i> of 1930	1994	1994/1995 cap on exports to the US precluding more severe trade restrictions
Canada/U.S. grain market and policy environment	Joint Commission on Grains	1995	Many recommendations were made to improve trade in both directions.
Ability of state trading enterprises to distort trade	U.S. GAO	1996	Acknowledged that there was no evidence that the CWB was violating existing trade agreements.
U.S. agricultural trade; Canadian wheat issues	U.S. GAO	1998	No solid conclusions, but focused on areas of U.S. concern
Countervailing duty on live cattle from Canada alleging CWB results in barley subsidy.	U.S. Department of Commerce	1999	Final ruling confirmed that the CWB did not provide a subsidy to cattle producers April 1997 to July 1998.

Sources: CWB and Schmitz and Furtan (2002)

farmers. Canadian sales into the U.S. market were again brought up in the negotiations for NAFTA. However, under NAFTA, the same commitments and definition of acquisition price contained in CUSTA were maintained despite appeals from U.S. wheat farmers for changes.

The ITC has conducted several investigations into conditions of competition between the United States and Canada. In 1990, the ITC investigated the durum wheat market from 1986 to 1989 and found no significant difference in prices paid by U.S. processors for Canadian or similar quality U.S. durum. In 1992, the ITC within Section 22, was asked to examine if imports of wheat, flour or semolina affected wheat support programs. Since Canada is the largest exporter to the United States for wheat, the ITC focused its analysis on Canada and found that Canadian imports were interfering with U.S. wheat. This was resolved with a Memorandum of Understanding negotiated between the United States and Canada which implemented tariff rate quotas on Canadian imports to the United States for one year.

The GAO investigated issues involving the ongoing dispute between the United States and Canada over wheat on several occasions, focusing on several specific issues. In 1992, the GAO confirmed that the CWB had received payments from the Canadian government for shortfalls in their pool account in 1990 and 1991. In 1995, the GAO examined the CWB as a state trading enterprise (STE) in the context of GATT and the WTO. In 1996, the GAO again examined STEs including the CWB. They found that the CWB benefitted from government subsidies covering occasional operational deficits, monopoly over domestic consumption and export markets, and pricing flexibility obtained through delayed producer payments. In 1998, the GAO again examined Canadian wheat imports into the United States with regard to STE activities of the CWB. They reiterated that the CWB is an STE, but indicated that available information was insufficient to determine whether the CWB was operating within existing laws.

In all cases, the CWB's response to these investigations has been to claim vindication as a fair trader. The CWB repeatedly states that it has withstood the eight trade challenges initiated by the United States since 1989.

THE SECTION 301 CASE

In October 2000 the U.S. Trade Representative, at the request of the North Dakota Wheat Commission, initiated an investigation under Section 301 of the *Trade Act* of 1974 examining the wheat marketing practices of the CWB. This case differs from prior cases in that it extends the areas of competition examined beyond direct comparisons within the North American market to offshore markets and includes the Hard Red Spring (HRS) wheat market as well as the durum wheat market. In the first subsections below, we summarize the claims, counter-claims and interpretations by the parties and government agencies. This is done without critique. Then, in the following section we provide our economic interpretation of the claims and interpretations.

U.S. Claims

The United States advanced several claims against the CWB in this action. It was argued that the CWB had special privileges and protections by virtue of its relationship with government that gave the CWB unfair advantages that could not be replicated or would incur additional costs/risks if implemented by commercial firms in the United States. Specifically, it was argued the CWB, as a government monopoly, has six benefits:

- government borrowing for operations and export credit extensions at reduced rates;
- government-guaranteed initial payment to producers;
- price pooling;
- lack of price transparency;
- preferential transportation legislation and regulations; and
- non-tariff import barriers.

In addition, the CWB benefits due to its supply monopoly, which allows it to enter into long-term contracts risk free. Due to the supply monopoly, the CWB can call supplies at any time without regard for prices or market signals. Extension of longer-term commercial contracts would incur higher costs/risks that would have to be accounted for. Finally, it was argued that the CWB has no mandate to maximize producer profits; that its only mandate is to avoid the undue accumulation of Canadian wheat stocks.

As evidence, the North Dakota Wheat Commission (NDWC) indicated an eight-percent price advantage on CWB offers in third country markets. The NDWC indicates that traders in third countries report a long-standing pattern of the CWB offering wheat at average selling prices five percent under U.S. bids. In addition, the practices of over-delivery of protein and over-cleaning of Canadian wheat amounts to an additional advantage of two percent and one percent, respectively. Further, the NDSWC indicates other transportation (rail) benefits.

The NDWC proposed five changes to induce more competitive practices:

- elimination of the CWB supply and export monopolies;
- definition of CWB “acquisition costs” under CUSTA must be changed to include all payments to producers;
- full transparency of CWB operations including acquisition costs, export pricing and other sales information unique to single desk exporters;
- national treatment (i.e., treating US and Canadian wheat similarly in each others’ market system) for any U.S. wheat entering Canada including full and equal access to Canada’s marketing and transportation system; and
- tariff rate quotas on imports of Canadian durum wheat (\$50/ton for imports exceeding 300,000 tons) and non-durum wheat (\$50/ton for imports exceeding 500,000 tons) into the United States.

Responses by the CWB

The responses by the CWB to the complaint and the requests of the ITC were generally limited, non-forthcoming and predictable. Most of their arguments are contained in the paper by Sumner and Boltuck (2001) summarized below.

Sumner and Boltuck evaluated the arguments in the Section 301 case for wheat for the CWB. Their responses were in three areas: the structure of the global wheat market, price discrimination, and the CWB as a farmer co-operative in procurement. They also commented on certain as-

pects of competition and trade between the United States and Canada. Their major conclusion is that the complaints leveled against the CWB were a simplistic view of cause and effect with regard to U.S./Canadian wheat trade. They included four specific arguments:

- the analysis does not take into account the world global market, national producers, and competing exporters;
- the focus on sales to eight specific countries ignores the losses in market share that are offset by gains in other markets;
- the analysis ignores the performance of competing exporters;
- the analysis does not consider that the efforts of the CWB may actually increase U.S. exports.

Further, Sumner and Boltuck indicated four aspects of the structure of the global wheat market that must be considered when analyzing competition between Canada and the United States:

- while the United States and Canada are large exporters (Canada is the third largest exporter), they are not the largest producers of wheat;
- the United States is a special case in that it exports wheat, yet it also imports wheat from other countries to supplement different class/quality needs;
- U.S./Canadian wheat trade is affected geographically; production areas in Canada are closer to demand sources in the United States than some U.S. production. In turn, U.S. production areas are closer to export locations than U.S. demand areas; and
- marketing performance of U.S. farmers is affected by actions of multinational traders who contract with importers and can source from multiple origins (Canada, the United States, and other countries).

In response to these arguments, the experts for the U.S. case indicated that Canada incorrectly combined the durum market and the wheat market in its presentation. The U.S. experts argued that durum does not have close substitutes and should be evaluated separately. If durum is examined separately, Canada is the second largest producer, behind the European Union and accounts for 59 percent of world durum exports. These

large market shares suggest that the CWB may be able to exercise unilateral market power in the world durum market.

The NDWC said that the CWB practices price discrimination (as has Kraft Furtan and Tyrchniewicz, Schmitz and the Canadian Wheat Board). Sumner and Boltuck argue that NDWC allegation of predatory pricing as related to price discrimination is simply not credible because the CWB could not expect to recover profits lost by engaging in predatory pricing. They claim that the price discrimination present in international markets is classic third degree discrimination (Phlips). Further, the ability to price discriminate is limited by the integration of importing markets into the global market; the prevalence of alternative sources of wheat including domestic and international supplies; the contestability of the market by potential entrants; downstream competition in flour, semolina and pasta; and the competition among wheat classes. Finally, the presence of third degree price discrimination may not necessarily be harmful to U.S. producers and may in fact benefit them. The prime example of this benefit is the CWB restricting exports to the United States.

In response, the U.S. experts argued that Sumner and Boltuck indicated the CWB would have no incentive to engage in predatory pricing because they would not be able to recover profits lost. The U.S. experts argue this would have some relevance if the CWB's overriding objective were to maximize profits for Canadian farmers. However, they argue the CWB has neither a statutory requirement nor actual incentive to maximize profits. Further, they argue that Sumner and Boltuck later indicate the objective of the CWB is to maximize revenues. The U.S. experts argue that maximizing revenues from the sales of wheat bought from Canadian farmers is not consistent with maximizing profits for Canadian farmers.

The NDWC argued that the CWB has a government monopsony for supply. Sumner and Boltuck indicate that while not technically the same, the CWB operates much like U.S. co-operatives. In addition, the CWB cannot have a monopsony in procurement because it does not retain profits.

Sumner and Boltuck indicated that while the CWB is more successful in forward sales than U.S. firms, U.S. firms are free to conduct business that way. They also argued that the Board success in offering long-term contracts is primarily due to scale of sales and not due to a supply monopsony.

In response the U.S. experts indicated that while the CWB cannot earn monopsony profits from Canadian farmers, it can benefit from running up excessive administration costs at the expense of Canadian farmers. Further, the CWB can enter into long-term contracts because it faces no market determined acquisition risks as the *Canadian Wheat Board Act* provides for jail sentences for farmers who attempt to market wheat to anyone other than the CWB. U.S. grain firms have no such assured supply and would need to purchase futures contracts to reduce risks to acceptable levels. The CWB does not have to hedge long-term contracts because the Canadian farmers (collectively through the pools) bear the risks of unexpected price changes.

ITC Interpretation

The ITC examined aspects of competition between Canada and the United States and made statements on nine dimensions.

The ITC indicated four structural differences between the Canadian and U.S. durum markets:

- Canada's durum production is three times larger than in the United States, and the U.S. durum market is more heavily dominated by Canada than the HRS market;
- there are no close substitutes for durum wheat, unlike the HRS wheat market where HRS and Hard Red Winter (HRW) typically compete for the same products;
- the market for durum is dominated by a few large sellers and a few large buyers. This domination has resulted in durum price discovery being more opaque due to limited observed trades and the demise of the Minneapolis Grain Exchange durum futures

contract. The demise of the MGE durum contract has been attributed to the presence of the CWB.

- Canada can forward contract durum sales while the United States typically sells on the spot transactions. The ITC argues that because the few trades occur for durum futures and cash sales are spotty and thin, the process of price discovery is more opaque. Thus, the CWB can make forward sales which no U.S. firm could due to the high level of risk and price volatility facing traders in a thinly traded market.

The ITC also identified several structural differences between the United States and Canada in ordinary wheat. First, The CWB has both monopsony and monopoly powers in marketing of western Canadian wheat. Also, the ITC claimed the CWB has several deductions applied to prices paid to farmers which they control and dictate (cleaning, transportation, handling charges). These deductions have been argued to be phantom charges which can be manipulated to Canada's advantage when pricing. The NDWC indicates that charges are deducted from all producer deliveries and that these do not reflect actual costs for all shipments. The excess can be used either to increase final payments to producers or to lower bids to the United States. The CWB disputes these allegations.

The ITC found three significant differences between the CWB and producers co-operatives:

- the CWB has financial security from government and backing of its borrowing and lending;
- all western wheat producers must use the CWB to market, however producer participation in a co-operative is voluntary. Thus, the CWB has no "free riders" adding to Canadian supply, nor under-cutting the CWB's pricing structure.
- the CWB does not have to accept all saleable western wheat offered to it (but it is contractually obliged to request delivery of 100% of the amount it does accept), whereas a cooperative does. This control gives the CWB power over quantities as well as prices.

The ITC surveyed market participants for terms and conditions of pricing in the United States. Respondents indicated that many purchases of Canadian wheat are quoted and contracted relative to U.S. prices, often using the Minneapolis HRS prices. Prices for U.S. grain typically included premiums and discounts for grade factors not meeting specifications while Canadian sales contained only premiums for grade differences. The ITC indicated that the premium for No. 1 over No. 2 CWRS was three cents per bushel which is consistent with U.S. price differentials for grades. Other differences in pricing centered around delivery terms, where Canadian sales were more likely to be forward sales than spot sales and were more likely to have longer delivery terms.

The ITC also examined the issue of over-delivery of protein for U.S. and Canadian sales in the U.S. market by surveying market participants. They found that 65 percent of U.S. HRS and durum shipments examined were over-delivered on protein, while 54 percent of the Canadian contracts were over-delivered on protein. Most of the over-deliveries were small with all deliveries within 1.5 percent of the protein level specified in the contract. None of the respondents indicated adjustments in price due to over-delivery on protein. However, the ITC's analysis indicated that when a delivery exceeded the contract protein specification, the delivered price exceeded the contract price in about one fifth of the reported purchase contracts.

The ITC examined prices of U.S. and Canadian wheat. Direct comparison of contracted and delivered prices were not possible due to differences in reporting contract terms (grade, protein, timing, and other factors). Two analyses were conducted. The first examined contracted (largely gateway) prices for comparable wheats (No. 1 CWAD and No. 1 HAD; No. 1 CWRS and No. 1 HRS; and No. 2 CWRS and No. 2 HRS). The second analysis examined delivered prices, basis Minneapolis. Results indicated that prices basis Minneapolis for CWAD were higher than HAD for all months except one over the period 1996/1997 to 2000/2001. Comparisons for No. 1 CWRS versus HRS were mixed. Some CWB prices were higher and some lower than U.S. prices. For No. 2 CWRS, prices at Minneapolis were generally higher than No. 2 HRS.

The ITC sought to examine market practices and prices for exports from Canada and the U.S. to selected countries. Issues examined included quality differences including overdelivery on specifications and export price comparisons. Foreign and U.S. buyers indicated that Canada was more likely to over-deliver on quality than U.S. shippers. Most over-delivery for protein was within 0.2 percent. However, Canada was more likely to over-deliver in excess of 0.8 percent higher than specifications versus exports from the United States. Prices were often not adjusted for over-delivering on protein.

The Commission asked survey respondents for information on monthly export prices for HRS/CWRS and HAD/CWAD for the eight exporting countries examined. Direct comparisons of export prices were limited due to non-response and the unavailability of prices. Some countries bought only from either Canada or from the United States so prices were available from only one of the exporters. Others received exports directly through the CWB where no price data were supplied. Direct comparisons were made for the Venezuelan market (a market served by CWB accredited exporters). They indicated that prices for No. 2 HAD and No. 2 CWAD offered to importers in Venezuela generally moved in the same pattern. Otherwise, the ability to verify claims about price discrimination and marketing were extremely limited.

There are several important features of rail transportation that are important for wheat trade between Canada and the United States. Canada has regulated rates (now regulated for maximum revenue) to eastern and western ports for export of wheat. These rates are below comparable commercial rates and significantly below U.S. rates. Shipments of Canadian wheat to the United States are not covered by regulated rates. The CWB is the shipper of record (in other words, is presumed to pay the bill) and rates are negotiated between the shipper and the railways. The CWB also provides some rail cars without charge to the railroads. The CWB argues that higher U.S. rail rates are due to a greater railway monopoly concentration in the United States. However, the ITC saw no difference in Class 1 railroad servicing areas or the layout of shortlines between the United States and Canada. They indicate that when alternative modes of transportation

included (barge, truck), transportation concentration is lower in the United States than in Canada.

Finally, the ITC examined effects of Canadian trade and market regulation on U.S. exports to Canada. They found participants in the U.S. industry indicated Canadian regulation and laws, as well as the CWB operations, have virtually precluded the marketing of U.S. milling grade wheat or milled flour to Canadian mills and buyers. Specifically, they identified varietal registration and end-use certificates as hindering U.S. movements into Canada. Further, U.S. interests argued that the CWB lowers prices to Canadian mills to eliminate any possibility of U.S. wheat or flour coming into Canada. The Wheat Access Facilitation Program which was designed to allow U.S. wheat access to Canadian rail is no longer in use.

Response by the Special Trade Representative

The U.S. Trade Representative found in favor of the NDWC that the CWB's monopolistic system disadvantaged U.S. farmers and undermined the integrity of the U.S. trading system (USTR, 2002). Specifically, the USTR indicated that "the monopoly CWB has taken sales from U.S. farmers, and is able to do so because it is insulated from commercial risks, benefits from subsidies, has a protected domestic market and special privileges, and has competitive advantages due to its monopoly control over a guaranteed supply of wheat" (p. 8).

The USTR committed to undertaking several strong initiatives to address problems with the CWB and specified four steps:

- examine prospects for a dispute settlement case against the CWB in the WTO;
- work with the NDWC and the U.S. wheat industry to examine the possibilities of filing U.S. countervailing duty and anti-dumping petitions with the U.S. Dept. of Commerce and the ITC;
- work with the industry to identify specific impediments to U.S. wheat entering Canada and present these to Canadians;
- provide ongoing effort to vigorously pursue comprehensive and meaningful reform of monopolistic STEs within the WTO agriculture negotiations.

The USTR decided not to apply tariff rate quotas at this time as this application would violate NAFTA¹ and WTO commitments, it could result in retaliation by Canada, and it would not achieve a longer-term solution to market distortions caused by the CWB.

Post-Announcement Positioning and Spin-Doctoring

As has become usual in these types of proceedings, all affected players began spin-doctoring their positions. Following is a synopsis of what has been said.

Canadian Wheat Board and Other Canadian Interests. The CWB released an initial statement indicating that because “the U.S. did not impose tariffs, we have successfully come through our ninth trade challenge” (Canadian Wheat Board, 2002; p. 1). Other respondents from Canada were less optimistic. Art Enns, president of the Western Canadian Wheat Growers Association indicated that the ruling was a serious threat to western grain producers. He also indicated that “it was interesting that the main targets of the investigation are the very same things that the CWB claims as its strengths” (Western Canadian Wheat Growers, p. 1). Further, the fact that the focus is only on the practices of the CWB and not on non-board grain markets, poses a major challenge for western farmers (Western Canadian Wheat Growers). The president of the (Canadian) Western Barley Growers Association said, “The CWB’s lack of transparency continues to be an irritant to our trading partners, which results in continual action against Canadian farmers. It is time that the CWB and the Canadian government took action to make participation in the Canadian Wheat Board voluntary, thereby removing the basis of complaints and trade investigations” (Western Barley Growers Association, p. 1).

U.S. Responses. Responses from U.S. parties included the Secretary of Agriculture Ann Veneman, who supported the decision. She indicated that the investigation “clearly establish that the trade-distorting practices of the Canadian Wheat Board and the country’s restrictions on imports of wheat are detrimental to the U.S. wheat Industry” (U.S. Wheat

¹ However, since then there has been disagreement on this interpretation of NAFTA.

Associates, 2002 p. 1). North Dakota's congressional delegation and Governor supported the ruling, yet they had wanted a stronger, more immediate action. Senator Byron Dorgan (D-ND) said, "We should welcome an opportunity to watch Canada defend the maintenance of a state-run monopoly in the middle of a free-trade zone" U.S. Wheat Associates, 2002, p. 1). Other players including the North American Millers Association chairman Bernard J. Rothwell III, indicated that "they would look forward to working with the Administration and growers toward the mutual goal of eliminating monopoly powers of STEs" (U.S. Wheat Associates, 2002, p. 1).

ASSESSMENT AND DISCUSSION OF POSITIONS IN THE ACTION

Given that this case is ongoing at the time of preparing this paper and that documents and evidence are not all publicly accessible, the discussion below is somewhat limited. The ruling is being discounted by some as just another finding without teeth or solid evidence. It is important that the findings were affirmative in terms of the allegations and that the CWB is an arm of the government. These findings differ from previous proceedings. They further illustrate the problems of market integration with separately organized marketing systems and the resulting difficulties of harmonization of policies and business practices.

There are several potential paths that could ensue, such as a negotiated agreement, the Trade Representative pursuing remedies inclusive of the WTO resolution, or simply allowing the issues to pass away with an undignified death. The claims that NAFTA precludes the imposition of tariff rate quotas are apparently debatable. Nevertheless, for our purposes there are a number of major issues that will no doubt be revisited by economists, industry and policy analysis.

The major theme or logic to this paper is intended to coincide with what appears to be the economic logic of the case. There are three points to that logic:

- there are special rights and privileges enjoyed by the CWB that are not easily replicated by competitive rivals;

- these special rights and privileges facilitate greater discretion in pricing, strategy and positioning than could be enjoyed by commercial rivals;
- these powers result in an unfair competitive advantage relative to rival suppliers..

While these comprise a general proposition, it is normally reflected in the claim that the CWB uses extensive price discrimination in off-shore marketing. The CWB and its proponents are on record many times making this very point (see on p15). The notion is that these special rights and privileges facilitate a greater extent of price discrimination than would evolve in a more competitive marketing system.

These aspects of CWB operation are discussed in the remainder of this paper.

Special (Exclusive) Rights and Privileges of the CWB

STEs can influence numerous regulations and policies to their advantage which are much more difficult to implement in a competitive commercial marketing system. Exporter STEs have advantages in sales arrangements, quality regulations, to name two. For these reasons, anything that undermines the powers of STEs (both import and export) would reduce disadvantages of competitive rivals because it is extremely difficult (costly and/or risky) to replicate these advantages within a commercial marketing system.

The WTO defines an STE as, “Government and non-government 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 purchases or sales the level or direction of imports or exports” (U.S. GAO, 1995; p. 16). The CWB conforms to every definition of an STE and is acknowledged as an STE through past submissions to the GATT/WTO. Most important are the

numerous exclusive rights and privileges bestowed on the CWB that are not available to rivals.²

In the case of the CWB there appear to be numerous rights and privileges. We include three of greatest importance, as examples only:

- guarantees on initial payments made to producers- -the Government of Canada guarantees the CWB (as a selling organization) for these payments, not individual producers;
- monopoly on procurement; and
- monopoly on selling wheat and barley from Canada to domestic and off-shore buyers.

In addition to these, the CWB maintains other exclusive rights and privileges, not normally acknowledged, but which could likely be interpreted similarly:

² Canada's position is that Canada should maintain the ability to choose how to market its products. Agriculture Minister Vanclief has said that, "If other countries have concerns regarding alleged trade effects of orderly marketing systems, Canada is prepared to discuss factual concerns. But Canada will not engage in sterile debates over alternative marketing philosophies." Also, it is Canada's position that it was willing to discuss practical trade concerns. However, "Canada will seek to ensure that any new disciplines proposed to deal with the perceived market power of such enterprises apply equally to all entities, public or private, with similar market power" (Agriculture and Agri-Food Canada 1999).

The CWB's stance is to reinforce STEs as legitimate commercial enterprises. They have been advocates for further reductions in support programs, and "future agreements must continue to ensure that Canada has the right to establish its own approach to marketing, including the CWB." (CWB, July 1999). In the case of the Australian Wheat Board, Chairman Trevor Flugge said, "We also expect that the issue of state trading enterprises will be considered during the course of negotiations. The issue should not be STEs per se, but rather whether the entity concerned contravenes any established world trade rules. In light of this, we believe each STE should be examined on a case by case basis and we would strongly refute the claims made by the United State in relation to so-called trade distorting practices of AWB Limited as an STE" (Australian Wheat Board, May 31, 1999).

- rail car ownership by governments and allocation authority for CWB grains;³
- special legislated rates on rail grains (i.e. for grains grown in western Canada there are separate regulations);⁴ and
- non-reporting of prices (facilitating non-transparency).⁵

While there are many issues related to the integration of STE types of functions into more commercially competitive industries, there are three areas of particular importance in grain trading which warrant special attention: the competitive effects of guaranteed initial payments and procurement monopoly, price discrimination and price transparency.

Guaranteed Initial Payments

One of the important features of some STEs is the guarantee by government of initial payments paid to producers. This is a fundamental tool of the CWB. This mechanism, along with the purchasing monopoly provides advantages to these selling organizations. While there are numerous impacts of these mechanisms, two are particularly apparent in a reasonably competitive market place. One impact is that the initial payment is typically a sharp discount relative to market prices. In recent years, the spread between initials and market price appears to have widened and does not accurately reflect

³ Rail car allocation authority is granted to the CWB for specified movements and provides several benefits, including making adjustments to grain transportation plans, ensuring farmer access, fostering (foisting) competition among handlers via tendering systems, etc.

⁴ In 1996 the Canada Transportation Act replaced the National Transportation Act with competitive provisions. Concurrently, it created Div VI rates with the maximum rates on grains, which by now were based on 1992 frozen costs, indexed upward. These were for statutory movements defined as grain and grain products with origins in the Prairies, to specific export ports. Exclusions were made for grains not grown in the Prairies (e.g. the United States) and grains exported to the United States. This resulted in two regimes of rates—one subject to normal regulatory processes and the other for statutory grain movements. The latter regime of rates was more favorable and has since been assigned a revenue cap.

⁵ Elsewhere in Canada and the United States, government entities are active in price reporting for purposes of facilitating more symmetric information among rivals.

price differentials associated with quality differences. For an exporter STE the initial represents an element of marginal cost for transactions, which could be argued to be the lower bound of marginal cost. This situation contrasts to a private-firm rival for whom a major component of the marginal cost of selling is the current market value. The effect of this differential provides greater pricing flexibility to the extent it can be pursued by the STE.

The other impact of these mechanisms in competitive selling is that it provides a greater ability for making fixed price deferred delivery contracts, an important issue in competition among selling organizations and firms. Wilson et al. (1999) first described this relationship. In concept, large export firms could provide similar terms but they would be more costly to execute. Wilson et al. indicated that the policy regime in Canada (identity preservation along with a procurement monopoly) is fundamentally similar to the Canadian government providing a free put option to the CWB. Using typical values at the time of their analysis, the value of the free put option was about 8 cents per bushel.

This interpretation is important. If a competitive firm were to provide similar sales terms (i.e. fixed price for distant deferred delivery), that firm would have to assume a position of long-cash/long option (put). Of course, that position presumes there are perfectly efficient futures and options markets for these grains and grades, which of course is not the case even though it is commonly alleged. Hedging costs (i.e. execution costs) and transaction costs are non-zero, basis risks would still be assumed by the seller, and for most of the grains and grain types in questions, futures and options do not exist. Thus, these risks are not easily hedgeable, nor cost-free to assume.

These claims have been challenged by several authors. Veeman et al. (1999) argue that risks in procurement costs can be hedged and costs for search of supplies can be offset by contracting between producers and traders. They indicate that since contracting for supplies is not a widespread practice in the United States, traders do not face significant problems of grain acquisition. Further, they argue that because initial prices are known, U.S. traders know the CWB's acquisition cost whereas, the CWB does not know what those prices are for U.S. firms. Finally, they argue that

the practice of initial pricing results in less flexibility in the procurement pricing for the CWB.

Schmitz, Furtan and Baylis (1999, p. 31) indicate that government guaranteed initial prices are a soft-price discrimination policy that “may” violate WTO rules when payments are made because taxpayer revenue is transferred directly to producers. This is one of the core arguments of the ITC which indicates there is a tendency for the CWB to have greater pricing flexibility and advantages in deferred transactions versus competitive rivals.

Price Discrimination

Price discrimination is defined as “the same commodity being sold to different customers for different prices” (Phlips 1985, p. 5). Price discrimination may also occur when or if different quality products are sold to different customers for the same price, or if terms of trade are not reflected in prices. In economic terms, price discrimination is said to exist if:

$$P_i / MC_i \dots P_j / MC_j$$

where P is price, MC is marginal cost and i and j represent two different customers.

Price discrimination is generally considered an acceptable trade practice and in some cases, a desirable business practice, subject to limits (Phlips) It is a very common practice, particularly among industries with high fixed costs but requires market power to effectuate and ability to separate markets. Examples abound including pricing by railroads, airlines, universities, movie theaters, etc. Generally, price discrimination is optimal for any selling organization if it has some monopoly power, if there are differences in demand elasticities among different customer groups, and/or if there are cost differences in serving different customers. Because of its appeal, and irrespective of its innocuous effects, it is frequently difficult to detect (according to the definition above). It is virtually impossible to prevent or to regulate selling firms/organizations from practicing price discrimination. This is generally true in domestic economies,

and no doubt would be excessively difficult or impossible in international trade. Indeed, that is what confronted investigators and consultants in this case.

There is much debate in this action about whether price discrimination occurs or not, how extensive is it, is it good or bad, and its impact prospectively on U.S. prices. However, both parties probably missed the important points. These arguments get bogged down in terms of market definition, class substitutability, elasticities and the inevitable problem of market

elasticities for products versus purchase probabilities for individual suppliers, all of which are elusive considerations without transaction prices. Despite these problems, there are numerous observations by U.S. Wheat Associates that suggest that the CWB (and the Australian Wheat Board) actively pursue discriminatory pricing practices (USTR 2002). Some of their examples would technically conform to the definitions of price discrimination as above. Irrespective of these anecdotal observations, it is common knowledge that price discrimination is a commonly practiced and the CWB admits an advantage they enjoy is the ability "to price differentially," particularly among importing countries and in some cases between companies in the same markets.

Kraft et al. (1996) purport to illustrate that the CWB has been able to price discriminate and as such to increase the revenue paid to their producers. Wilson and Dahl however qualify some of these observations. Many of the blatant examples of price discrimination generally coincided with the Export Enhancement Program (EEP) period in the United States. The EEP provided greater incentives for STEs to exploit price discriminating strategies- -the EEP simply exacerbated the demand heterogeneity confronting STE sellers and, itself, separated some markets. It is likely that price discrimination has been practiced for many years prior to and since

EEP, but during the period in which EEP was active, its use was likely facilitated.⁶

The WTO has specific provisions about price discrimination. STE's are subject to the WTO constraints that export subsidies do not exceed the allowable subsidies in the WTO Schedules, and a general constraint that they must behave commercially. Therefore, STEs can price discriminate as long as it is for "commercial" (as opposed to subsidization) reasons. Targeted price discrimination is allowed for STEs only as long as the amount of subsidy is less than the limits established in their respective country's WTO commitments.

For purposes of this action there are three important issues in relation to price discrimination:

- some of the claims and evidence are that the CWB offers wheat at a fixed differential relative to U.S. offers in specific markets. This belief irritates many U.S. parties. However, this does not necessarily imply price discrimination (as defined above), nor is it a case of non-transparency (as discussed below). It may simply be more symptomatic of brutal competition (i.e. reducing prices for market entry).
- under the definition provided above, it is virtually impossible to make credible claims about price discrimination without concurrent and detailed information about marginal costs inclusive of handling, shipping, as well as price adjustments for different grades, classes and specifications; notwithstanding the interpretation of what marginal cost means to the CWB.

⁶ Goodwin and Smith (1995) indicate that price discrimination is analogous to an implicit subsidy on exports if the seller is able to limit imports into the higher priced markets. Skully (1992) indicates that the CCC uses its export policies (the combination of EEP, PL480 and credit guarantees) to price discriminate. Paddock (1998) indicates that while the practice of price discrimination by STEs is a concern, he argues that alleged premiums could be extracted from any market with an inelastic demand without arbitrage opportunities. In contrast to Paddock, who suggested that price discrimination may be limited, Veeman et al. (1999) indicate that it was a common practice among private trading organizations and would continue to be even without STEs.

- certainly, the claims of over-delivering quality (if overt, which is questionable), would qualify as price discrimination, as would providing preferred terms for deferred shipments.

Taken together, the effect of several of the marketing policies in Canada (notably pooled pricing commensurate with lower initial prices, rail rate differentials, and others) is to make a larger component of costs as fixed, thereby lowering the relevant marginal cost of marketing. The effect of this is to facilitate a greater latitude in pricing than would be the case if the marginal cost represented a larger share of the total cost. Hence, these marketing policies likely have the impact of facilitating price discrimination to a greater extent than otherwise would be the case.

Price Transparency

There is a range of definitions for price transparency. Klassen indicates that a lack of price transparency is “a lack of full price disclosure” (Sosland, 1994 p. 29). Furtan describes it as “the extent that details of transactions made by purchasing or selling agents are available to the public” (Furtan, p. 4). Glickman defines it as “people knowing the market prices and volumes, and producers know on a fairly instantaneous basis what is happening and who’s getting what for what dollars” Wilson, 1999 (p. 4). Wilson et al. define it as firms in bidding competition having symmetric information about each other, thus no bidders have a strategic advantage. If information is asymmetric, then bidders with superior information would have a strategic advantage (Wilson et al.).

Many of the aspects of the U.S. marketing system are highly transparent to competitors. These include public reporting of prices, export tenders, sales and inspections (weekly), and public tariffs for transportation and handling. In addition, results of all sales made under export assistance including PL480 and EEP are publicly reported. These mechanisms do not have counterparts (e.g., price reporting, reporting or export sales/shipments in a timely manner) in either Canada or Australia.

Factors affecting price transparency include a lack of futures markets and/or highly decentralized cash markets that may be subject to large

premiums and discounts for quality and the cessation of EEP activity has reduced the transparency of U.S. firms. Further, there are aspects of the Canadian marketing systems that both exacerbate and mitigate the transparency problem. These include price pooling, disclosure of daily CWB offers in the North American market, and the initial payment guarantee. Schmitz et al. (1999) summarize earlier works on transparency, and argue that price transparency was not trade distorting. They argue that if the CWB were replaced by multinationals, transparency would not increase. They argue that, in the world grain market, price discovery occurs in U.S. futures markets that are linked to cash markets throughout the world and these relationships are followed and known by both STEs and traders. As such, the bidding/asking prices of multinationals are as confidential as the CWB's offer prices.

Wilson et al. (1999) examined transparency and bidding competition in the international wheat trade. Stylized cases were developed to estimate the advantage of less transparent players in bidding games. Results indicate that as the number of bidders increase, informational advantages of less transparent bidders decline with most of advantages being lost when there are six or more bidders. Further, firms that both act as agents in some auctions and compete with STEs in others can defeat informational advantages of STEs. Finally, in their stylized game, the value of the likely informational advantages of STEs were estimated to be within the range one to two dollars per metric ton.

There is a fundamental difference between price transparency and transparency of operations. The CWB (as described by Paddock) alleges they are transparent due to the fact that they publish an annual report. However, this does not negate the issues associated with non-transparency in transactions. The annual report simply is an average of all pooled transactions over the crop year, available a year after the fact, and is virtually meaningless in mitigating the adverse impacts of transparency. Further, it is important now that the vast majority of the international grain traders have much greater public transparency than their predecessors of the 1970s. As examples, the largest exporters today include Cargill which has to report their financial performance routinely due to having an Em-

ployee Stock Option Program (ESOP); ConAgra and ADM, among others, which are publicly held stock companies and report their financials routinely; and the larger co-operatives which also report to the public and their shareholders. Thus, notwithstanding the irrelevancy of any of these to the real issues of price transparency, the CWB is no more or less transparent than other exporting firms in their public reporting of financial returns and operations.

Traditionally, marketing boards and STEs have not released information on export sales. As such, it is difficult to monitor transactions. This matter is further complicated by compliance issues with notification. The current questionnaire for STE notification to the WTO does not require information that would allow for verification of circumvention of commitments. That would require information on volumes of individual transactions, their level of subsidies and sales prices (Incgo and Ng, 1998). Nevertheless, under current WTO rules, countries are required to report their STEs. In the past, few countries reported them. For those that have reported their STEs, reports have been sporadic and the amount of information reported has been limited. This occurred due to STEs largely trading agricultural goods which were generally not controlled by trade rules. Potential changes in WTO rules have been advanced in prior negotiations to increase transparency. However, those countries with STEs have argued that transparency issues are covered in the notification system.

The issue of lack of transparency is highlighted in the ITC case. However, it is not clear whether the concern is lack of price transparency (or similarly, transparency about export sales, credit terms or other terms of transactions), or transparency of operations. Irrespective, it is important that greater transparency about prices is desirable. Certainly, individual rivals will strive very hard to be non-transparent to gain some asymmetric advantages. Nevertheless, hallmarks of market efficiency and effective economic policy is that greater transparency is desirable, which requires price and export sales reporting. Given the non-synchronous treatment of this issue regarding CWB marketing versus marketing elsewhere in Canada and throughout the United States, there is no doubt that this will be a continual challenge to reconcile.

FUTURE CHALLENGING ISSUES

The affirmative findings of the ITC on the NDWC claims regarding the CWB require that the Trade Representative seek resolution. How that resolution will ensue and its likely alternatives are not at all clear. It is not clear that the Government of Canada has left any room for a negotiated solution. And, it is not clear if the will of the current U.S. administration is to push for a resolution with any great zeal. Each party would likely prefer that the problem would just go away, as opposed to reaching, or forcing, a mutually acceptable resolution to the problem.

In light of these proceedings, policy analysts will have to deal with several issues in the coming years. Four of these are mentioned briefly. First is the issue of price discrimination and the extent that marketing policies (due to special rights and privileges) are the enabling mechanism is important. The WTO does not preclude price discrimination, probably due to the difficulty of monitoring, measuring and interpreting the results. Nevertheless, extensive price discrimination is likely not a favorable outcome for competition in the trading and vertically aligned industries.

Second, is the extent that non-transparency of prices affects rival's behavior and conduct in an industry. Third, operationally, NAFTA has relied on a loosely defined concept of "acquisition cost" to facilitate interpreting the prospect of anti-competitive behavior within North America. This should almost certainly be revisited looking for a more defensible definition.

Finally, independent of the specific claims in this action, some of the results are again a reminder of difficulties of integrating competitive rivals with entities subject to lesser competitive pressures, as well as inconsistent policy mechanisms. A few of these differences would include: 1) policies in the United States reducing acres (e.g. Conservation Reserve Program) in an open border market and income subsidies; 2) U.S. policies favoring storing (i.e. non-selling) versus Canadian pooling mechanisms favoring selling within a marketing year; 3) the salesmanship for Canadian grains in an environment where there has been reduced marketing efforts

by multinational trading firms; and 4) recent consolidations in Canadian grain marketing has likely allowed even more microscopic rights and privileges to be exploited by the CWB. These issues are all examples of the fodder for research and probably more trade actions in the coming years.

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