



**The Canadian Wheat Board's
comments on a report prepared by
the George Morris Centre entitled:**

*Benefits and Costs of a Voluntary
Wheat Board for the Province of Alberta*

Canadian Wheat Board Comments on: Benefits and Costs of a Voluntary Wheat Board for the Province of Alberta

Executive Summary

The report entitled *Benefits and Costs of a Voluntary Wheat Board for the Province of Alberta* prepared by the George Morris Centre (GMC) surprisingly suffers from significant deficiencies. This is surprising because the Centre has developed a reasonably good reputation. However, its admitted reliance on other studies for this paper results in the absence of some easily available facts.

The authors attempt to develop the case for creating a voluntary Canadian Wheat Board (CWB) by trying to argue that:

1. A majority of producers support the creation of a voluntary CWB.
2. Wheat and barley based value-added in Western Canada lags the U.S. and Ontario and that CWB pricing policies hinder its development.
3. Removing alleged impediments such as the CWB, would result in huge growth in wheat and barley based value-added processing on the prairies.
4. Removing farmers single-desk selling status would result in a net benefit for producers.

The GMC study alleges that several polls, surveys and plebiscites indicate that a majority of producers support a voluntary CWB. With the change in CWB's governance structure effective December 31, 1998, farmers were handed control of their marketing organization. Farmers elect 10 of the 15 members of the CWB Board of Directors. If the direction and policies are to change at the CWB, they should be driven by farmers, in the interest of farmers. The authors seem to imply that the current democratic system of electing farmer directors is not adequate and that unilateral change is necessary.

The GMC study also incorrectly contends that the CWB's pricing policies remove western Canadian processors' advantage of having access to the lowest cost raw material. The authors are incorrect when they state that the CWB charges western Canadian mills the Minneapolis price plus freight to the mill location. In fact, western Canadian mills are charged the Thunder Bay or Vancouver price less full commercial freight back to their prairie location. The authors contend that the CWB charges domestic processors at the "import ceiling price" and that this has a huge dampening effect on value-added in Western Canada. The fact is that the CWB does not charge the "import ceiling price" to domestic customers. Applying the study's logic, we can only conclude that the CWB does not have a dampening effect on value-added in Western Canada. The authors also imply that it is the absolute value of the raw product that is important to domestic customers. However, domestic customers are more concerned with the competitive value of the raw product, or the individual processor's price relative to its competitors, than the absolute value of the raw product. The authors also incorrectly state that the Canadian product market is closed to imports. It seems as though the authors base their arguments that the CWB hinders value-added on these incorrect assessments of CWB pricing policies and trade in wheat products. CWB pricing policies do not disadvantage western Canadian value-added enterprises. These critical errors seriously question the authors' logic and conclusions that removing the CWB's single-desk selling would increase the amount of value-added processing in wheat and barley in Western Canada.

The study attempts to oversimplify the complex issue of value-added processing on the prairies to argue that if farmers' single-desk selling status is removed, there would be huge growth in value-added in Western Canada. This oversimplification is evidenced by the fact that numerous important factors which influence value-added investment such as the economics of plant location (source vs. destination), the type of commodity being processed and other fundamentals of processing industries are not discussed. The study focuses on the supply side of the industry without recognizing the fact that opportunities in value-added processing are largely driven by market demand. They do not indicate that there is market demand for wheat and based barley products that is currently going unmet which could drive an increase in value-added processing. Since CWB pricing policies do not adversely influence value-added processing in

western Canada, it is unclear how simply removing farmers' single-desk marketing power will create more value-added processing in Western Canada. The authors do not establish that the scenarios they use as a basis for their value-added projections are reasonable scenarios.

By using value data, the authors attempt to portray that wheat and barley based value-added processing in Western Canada lags behind the U.S and Ontario. In fact, the performance of wheat and durum processors has been exceptional. The authors do not mention that:

- Thirty-two per cent of the Canadian milling capacity is located in Western Canada compared to 16 per cent of U.S. milling capacity in the U.S. Northern Tier states.
- Milling capacity in Canada has increased 34 per cent since 1991, compared to 17 per cent in the U.S.
- The export volume of Canadian wheat and durum products has increased 127 per cent since 1991, while the value of those exports has increased by 381 per cent. By comparison exports of canola oil and canola meal have increased by 89 per cent in volume and by 142 per cent in value over the same time period.
- Canadian malting capacity has grown by 75 per cent in the last decade. Most of this growth has been in the West.
- Seventy-seven per cent of Canadian malting capacity is located in Western Canada.
- Malt exports from Canada have increased 114 per cent since 1991.

The authors dismiss the results of any previous studies that show single-desk selling provides benefits to western Canadian farmers. They attempt to justify this by simply stating that the arguments traditionally made in favour of single-desk selling such as exerting market power in the export market and providing benefits to farmers through price pooling do not hold up in the "real world of grain marketing". However, findings reported in the December 2001 U.S International Trade Commission (ITC) report suggest that these concepts do hold up in the real world of grain marketing. The ITC found that in all but one month examined, Canadian durum moving into the U.S. market was priced higher than U.S. values.

The authors also create a list of inefficiencies allegedly created by the CWB, most of which are taken directly from an academic study done by Drs. C. Carter and R.M.A. Loyns in 1996. These alleged inefficiencies either do not exist or are not unique to the existence of the single-desk.

In the end, the authors do not convincingly establish that value-added in Western Canada lags the U.S. and Ontario nor do they establish the conceptual basis for the argument that CWB pricing policies hinder value-added. This reality throws into question the authors' main conclusion that huge growth in wheat and barley based value-added in Western Canada would be witnessed if the CWB's single-desk status was removed. They also do not establish that removing the single-desk will result in higher returns for farmers.

A. Introduction

The George Morris Centre (GMC) study, authored by L. Martin, H Mayer and J. Bouma, attempts to develop the case for creating a voluntary Canadian Wheat Board (CWB). The study states that it has two objectives. They are:

- To examine the costs and the benefits of the mandatory board that has existed in the past; and
- To develop a picture of what the grains-based value-added industry in Western Canada could look like in the future.

The authors present a significant amount of commentary on the evolution of the wheat marketing system in Canada and identify changes that have occurred in the Australian wheat marketing system. Their views on producer attitudes toward the CWB are largely based on results of surveys and plebiscites available to them. The authors also report on feedback from the in-person and telephone interviews they conducted with unnamed “market participants “.

This analysis does not attempt to address every inaccuracy in the study. Rather, it addresses the major concerns. Our analysis of the study reveals the authors have made critical conceptual errors and have relied on incorrect analysis to draw their conclusions.

B. Critical conceptual errors

There are several areas in the paper where the authors demonstrate a fundamental lack of understanding of key concepts needed in order to effectively analyze the issue of value-added processing in Canada. Critical errors made in discussing the pricing and trade of grain and grain-based products brings into question the study's key conclusions.

1. Pricing to Canadian wheat and durum processors

The comments in the report on pricing to Canadian processors are inaccurate and demonstrate a fundamental misunderstanding of how pricing of wheat and durum to Canadian processors works.

Examining a key point in the study;

“...all domestic end users of wheat, durum and malting barley are charged a price based on Minneapolis plus freight and handling to Canadian points. This is opposite to what one would expect in a market characterized as surplus of product. In an efficient market, prices are usually less than at destination by the cost of freight and handling. Hence, the pricing policy removes the advantage for Canadian end users of Western Canada's ability to be a low cost producer of grain.”

All domestic end users **are not** “charged a price based on Minneapolis plus freight and handling to Canadian points”. Western mills are charged Thunder Bay or Vancouver price **less** full commercial freight to their prairie location. In addition, mills do not pay handling charges. Therefore, according to the authors' own definition above, it is an efficient market. The price **is always** (not usually) less inland than it is at port destination. Therefore, we can conclude that we must have an efficient market by the authors' own definition. The CWB pricing policy **does not** remove the advantage for Canadian end users and processors located in the prairies nor does it remove their access to the lowest cost raw material.

For a processor, it must be understood that the absolute value of the raw material is not the primary issue. It is the competitive value of the raw material that is most important. The worst option is a market that sends confusing, chaotic price signals to the processor, customer, and competitor. There must be either a single-desk seller or complete and open arbitrage, there can be no in between that benefits value-added processing. A dual market has exactly the wrong impact and sends incorrect signals. This has happened in Ontario, where transition has created confusion.

2. Processors are not charged the import ceiling price and investment is not hampered

The authors are correct in saying that the CWB could potentially charge Canadian processors at or near the “import ceiling” relative to the U.S. market. This would certainly increase revenue for producers in the short run, and indeed some producers have argued in favour of doing this. However, the CWB does not charge at or near the “import ceiling”. As explained in the preceding section, western mills are charged Thunder Bay or Vancouver price **less** full commercial freight to their Prairie location. The “import ceiling” the authors speak of would be a price for wheat or durum at an inland point in the U.S. northern tier, plus the cost of trucking that wheat/durum to the mill in Western Canada. While this has the potential for generating more immediate revenue for producers, it would be a deterrent to value-added processing and the interests of western Canadian wheat producers in the long run.

The authors conclude that charging processors at the “*import ceiling price has a huge dampening effect on investment in value adding activities in Western Canada*”. The preceding discussion clearly shows that this “import ceiling” is not the price processors are charged, and therefore that the CWB does not have a dampening effect on investment in value adding activities in Western Canada. This invalidates the study’s conclusion #7.

3. The Canadian product market is not closed

The authors reference the Canada-U.S. Free Trade Agreement in their text, but then state “...*because the domestic product market is closed, they [processors] can pass the higher cost on.*” This is absolutely incorrect, as the Canada/U.S. border is completely open to two-way trade in wheat, durum, flour, semolina and products thereof. There are no tariffs or duties on wheat or wheat products from the U.S. This key error demonstrates a lack of fundamental research in this critical area. A thorough understanding of the trade environment in which the sector operates is necessary to be able to assess of the potential for the grains-based value-added sector.

C. Concerns with the analysis

The authors’ forecasts of what the grains-based value-added sector could potentially look like are developed from two scenarios that appear to be based on overly optimistic assumptions. The authors provide little detailed justification as to why they think that these scenarios are reasonable. Also, the authors’ estimates of inefficiencies created by the CWB are mostly taken directly from the Carter and Loyns (1996) study. Shortly after the release of this study in 1996, the CWB pointed out the many problems with these estimates and the fact that many of these “costs” would not disappear in the absence of the single-desk. These and other problems with the analysis are outlined below.

1. Grains system becoming more focused on differentiation

The authors spend a significant amount of time explaining changes that are occurring in the grains sector. They point out that each year grain markets have less and less of a commodity focus and are becoming more oriented to differentiated products with specific quality characteristics. The authors also share their views on the future of identity preservation systems. The authors’ implication is that the CWB is not positioned to perform well in a system focused on delivering differentiated products to a large number of customers.

The CWB’s marketing focus has been to differentiate its products from the competition in the eyes of its customers by focusing on delivering highly consistent products for which quality conscious customers are willing to pay more. The CWB expends a significant amount of money and effort, not only to assure development of the right products by the industry, but also to convince buyers of the value of Canadian wheat and barley to their operations. These activities are geared towards developing “brand” loyalty among customers for CWB products. The CWB single-desk is the tool that allows farmers to capture, in the form of single-desk selling (SDS) price premiums, the incremental value these customers place on western Canadian wheat and barley. The CWB is currently well positioned to continue to capture benefits for farmers as customers’ requirements continue to evolve.

2. Scenarios examined

On page 29, the authors outline two “what if” scenarios where they examine what the level of value adding and value-added employment in Western Canada would have been under each of these scenarios. The two scenarios they examine are:

- If value-added grew by the same absolute amount per year as it did in Ontario from 1989 to 1997 (an average of \$74.72 million per year); and
- If value-added grew at the same percentage rate per year as oilseed processing in Canada from 1989 to 1997 (12.36 per cent per year).

It is interesting that the authors choose to use a different measure of growth for each scenario – absolute values (dollars) in the first and percentage values in the second. The authors recognize that on a percentage basis, cereal-based value-added in Western Canada actually grew faster than in Ontario, but state that this was because the base was so low. In their second scenario, the authors use the percentage growth rate achieved in the oilseed value-added sector in Western Canada. It could also be argued, particularly in the case of a less mature industry like oilseed processing, that the base period in this case was low as well. However, the authors do not explain why they feel the use of the percentage growth rate is appropriate in this case.

The paper mentions that there is no way of knowing what the situation would have been like without ‘impediments’ in the grain marketing system. In fact, the authors state that they “...can speculate about the possibilities”. These two scenarios are absolutely fundamental to the authors’ projections as to what the grain-based value-added industry in Western Canada could look like by 2010. Since their choice of scenarios is so critical to their results, it is interesting that the authors do not explain why they think that these two possibilities are reasonable ones to consider. For the first scenario, the authors state “... *there is no obvious reason why Western Canada should not or could not participate at the same growth rate as Ontario*”. For the second scenario, the authors state “*This rate is used because it has clearly been achieved with that sector, and because it would not be a stretch, in our view, to achieve the same rate for grain based products if the system were changed to encourage value adding*”. The authors do not expand on these statements and do not discuss the key factors that drive investment in value-added processing, the differences in the expected growth rates in mature and developing sectors and the differences in the economics of plant location between different grain- and oilseed-based products. We discuss some of these factors below. In the end, the authors do not establish that the scenarios they examine are reasonable, which leave the accuracy of their projections in question.

(a) Some key factors influencing value-added investment

An **origin** plant is located in close proximity to where the agricultural commodity is grown and transports its output over long distances to its customers. This is the type of plant that is located on the Prairies. Advantages of an origin plant include: lowest possible wheat cost; first hand knowledge and access to the local wheat crop; flexibility in targeting customers; and reduced shipping weights. Disadvantages of this type of plant include: difficult customer service; vulnerability to local crop and agronomic conditions; lower by-product values; limited freight flexibility and transportation complexities.

A **destination** plant is located in close proximity to its customer base and generally transports its raw material over long distances. It is generally located in or near large urban centers. Some of the advantages of destination plants are: easier customer service; lower inventory risk; flexibility in wheat origination; and higher by-product values. Examples of the disadvantages of this type of plant are: the cost of raw material handling; transportation and storage; greater risk of raw material supply disruption (weather); and the fact that the loss of one key customer can be devastating.

It is generally acknowledged throughout the wheat/durum processing industry that, at this time, a destination plant is a more favourable option than an origin plant.

Also, the type of commodity being processed is important. When one considers where to process a particular commodity, the make-up of the raw material is critically important. For example, oats is a light bulky commodity, and as a result, shipping the raw material over long distances is very expensive. A destination in Eastern Canada which costs \$3000 per car has a cost of \$50 per tonne for oats, but only C\$33

per tonne for wheat. A dramatic difference exists when considering the per-tonne cost of these raw materials. Some 35 per cent of the oat consists of the hull which is a low value waste by-product, therefore it makes economic sense from a freight perspective alone to process the oat on the Prairies and remove the waste hull. Oats, when processed, also produce a very limited product line - some table oat groats, oat flour and flakes. There can be over 40 different kinds of wheat flour. Oats is, by its very nature, a good candidate for origin milling and is suited nicely to being processed in Western Canada where it is produced.

The authors refer to oat processing as having achieved great success since its removal from the CWB. However, they omit some key information that would bring the proper perspective to oat and wheat comparisons. They do not mention that one major plant (Ogilvie Winnipeg) closed in 1991. Further, the Can Oat Plant in Portage la Prairie, MB was built with significant contribution from the federal and provincial governments and changed hands (at lower capitalization value each time) before it became successful. The Quaker oat plant in Peterborough, ON has closed, as has the ADM Midland, ON plant, which was built in 1995.

Other key fundamentals of processing industries, which are not mentioned include:

- The high level of investment. Grain processing is highly capital intensive and requires a significant level of start-up investment;
- Processing is also a relatively low-margin business and puts early stress on the return on investment and to investors;
- Processing technology is fairly standard and there is little that is unique to distinguish one processor from another;
- A high degree of risk in raw material ownership;
- Processing is dominated by large international players; and
- Processing is extremely sensitive to supply and demand fluctuations.

Key elements to success in a processing venture are continuity and predictability in pricing of raw material, a reliable year-round supply of quality raw material with full risk management capability, and investors with deep pockets and access to substantial capital to facilitate cash flow.

Contrary to what the authors imply on page 19 of their report, it is precisely the disciplined price relationship to Minneapolis that provides price transparency and risk management capability for value adding in Western Canada. It is in fact an incentive for value adding in Western Canada not a disincentive as the authors contend. The CNMA, which represents approximately 90 per cent of total Canadian wheat flour milling industry capacity and production, including capacity and production in Alberta, clearly stated the importance of this in a letter to Alberta MLA Mark Hlady on May 3, 2002.

3. Inaccurate portrayal of grains based value-added in Western Canada

(a) Using value data

The authors make comparisons based on the dollar value of the different industries and when comparing the U.S. and Canada. This is not an appropriate way to compare commodity based industries. The “value” of the industry will always be subject to the value of the underlying commodity. So if the underlying commodity is a higher value commodity, the dollar value will obviously be greater. Further, the changes in value are dramatically influenced by the price changes in the value of the underlying commodity. Using value data for this type of analysis captures more than just changes in the level of processing activity and can lead to incorrect conclusions.

(b) Capacity

The Canadian milling industry consolidated in the mid-1990s as old, excess capacity was wrung out. Since that time, medium and smaller millers have successfully targeted niche markets in Canada, and more specifically in the U.S., which has allowed them to incrementally expand their capacity utilization and reduce their cost base.

Thirty-two per cent of Canadian milling capacity is located in Western Canada compared with 16 per cent in the U.S. northern tier states. The capacity in Western Canada is utilized to near total capacity. As well, milling capacity in Canada has increased 34 per cent since 1991, while U.S. capacity has only increased 17 per cent over the same period.

Seventy-seven per cent of Canadian malting capacity is located in Western Canada. In the last decade, Canadian malting capacity has grown by about 490 000 tonnes (bulk barley equivalent), or about 75 per cent, and growth has mainly occurred on the Prairies. During the same time, four facilities - two in Alberta, one each in Saskatchewan and Manitoba - have either been built or have undergone major upgrades and expansions.

(c) Performance of the wheat- and barley- based value-added sector

The performance of Canadian wheat and durum processors has been exceptional. The key time frame here is the initiation of the Canada-U.S. Free Trade Agreement. The authors use 1989 as a starting point in one of their calculations and reference it as “the first year of the Canada-U.S. Trade Agreement”. While this is the year the agreement was signed and completed, it is important to know that the Canada/U.S. border opened to trade in wheat and products thereof in June of 1991 when the producer support estimates (PSE’s) equalized. In fact, tariffs and duties remained in place and were gradually phased out over a period of five years, and were completely eliminated only on January 1, 1998. Effectively, the Canada-U.S. border was completely and freely open to two-way trade in wheat products on January 1, 1998. This is contrary to the authors’ assertion on page 18 that the domestic products market is closed.

Between 1991 and 2001, the export volume of Canadian wheat and durum primary products (flour, mixes, dough, pasta, etc.) increased 127 per cent (747 527 tonnes from 329,468 tonnes) and the value of those shipments increased 381 per cent (\$1.519 billion from \$315.7 million)¹. This can be contrasted with canola oil and meal which itself experienced outstanding growth in volume of 89 per cent and value of 142 per cent. However, this growth was not as strong as it was for wheat processors. The statistics support the fact that Canadian value-added processors of wheat and durum are benefiting from market opportunities in the U.S. brought about by the Canada/U.S. Free Trade Agreement. This also clearly demonstrates that CWB pricing is not a deterrent to value-added processing opportunities. Even the U.S. International Trade Commission (ITC) recognized this fact in its December 2001 report².

“Additionally, the CWB sells wheat to domestic Canadian millers using a North American pricing policy that ensures that its selling prices to Canadian millers are competitive with U.S. prices.”

“There has been a sharp increase in the number of mills located in the Prairie provinces as well as some increase in traditional milling centers in eastern Canada.”

“The CWB also has policies that facilitate or encourage flour milling in Canada.”

Referencing an International Grains Council Report, the *Milling & Baking News* reported in its September 24, 2002 edition:

“Among the major flour-producing nations, ranked as those making two million tonnes or more per year, the sharpest increase in output – 94.9 per cent - occurred in Canada.”

Increased exports of malting barley and market diversification by the CWB and its Accredited Exporters have been an ongoing trend. The CWB share of the total export market has grown from 19 per cent in 1991-92 to approximately 25 per cent in 2000-2001.

¹ The volume and value of wheat flour, wheat product and malt exports were taken from Agriculture and Agri-Food Canada, Grains and Oilseeds Statistics – September 2002.

² United States International Trade Commission. December 2001. Wheat Trading Practices: Competitive Conditions Between U.S. and Canadian Wheat.

The area of greatest success for the Canadian malting barley industry is the growth and development of the value-added malting industry in Western Canada. Malt exports from Canada (barley equivalent) have increased steadily from 320 284 tonnes in 1991 (262 633 tonnes in 1989) to exports of 685 368 tonnes in 2001. Per capita, Canada produces three times more malt than the U.S does. Canada's position in world malt markets has strengthened, and Canadian malt export growth occurred, in a period of intense global competition from malting overcapacity.

The malt industry in Canada has increased its capacity to produce malt, moving from 810 000 tonnes in 1985 to 1 220 000 tonnes (barley equivalent) in 1999. The increase in malting capacity requires an additional 410 000 tonnes of malting barley per year to supply malt houses. Throughout the 1990's, the cooperative marketing between the CWB and Canadian maltsters has expanded the volume of malting barley selected in Western Canada and increased revenue from malting barley. This in turn has led to an expansion of plant capacity, virtually all of which took place in Western Canada. The industry accomplished all of this in the face of aggressive subsidized competition, particularly from the European Union (EU).

(d) Presentation of data

The authors were selective in how they chose to present their data. For example, in comparing Western Canada and the U.S. northern tier, they chose to include Washington State, but omitted British Columbia. This allows them to include the Pendleton Mill in Seattle, which is not an origin mill. Interestingly, this mill has 43 per cent of the state's capacity and it closed permanently in January 2002, a fact which the authors fail to mention. By omitting B.C. from their analysis, the authors leave out Rogers Foods in Armstrong, B.C., which trucks all its wheat from Alberta and acts just like an origin mill. This is a questionable methodology for comparison.

Further, the authors assume that the mills are operating at maximum capacity. It is a well-known fact that the U.S. milling industry is operating at below 85 per cent capacity and Canada exceeds 90 per cent of capacity. Secondly, it is also general industry knowledge that some of the most constrained plants are in the U. S. northern tier (Seattle, Washington now closed, and Blackfoot, Idaho sold, are a few examples).

(e) Depiction of the oilseed processing sector

The authors chose not to present some of the difficulties currently facing the oilseed processing industry in Western Canada. They do not mention that poor crushing margins and limited supplies during the past couple of years has resulted in about a 50-per-cent capacity utilization rate for oilseed processing in Canada. Some facilities have gone through temporary shut downs. The CWB has supply assurance in place for Canadian wheat and durum processors to prevent this kind of occurrence. Additionally, the facility constructed at Ste. Agathe, MB in 1997 has never operated commercially. The *Manitoba Co-operator* quoted Bob Broeska, with the Canola Oilseed Processors Association (COPA), in its June 7, 2001 issue:

"The industry in the last 30 years has already gone bankrupt twice, once in the 1980's and then again in the early 1990's, he [Broeska] said, indicating that the recapitalization of the market the last time has basically left the sector in the control of the biggest players that exist in the crush industry internationally."

In that same edition of the *Co-operator*, Mr. Broeska was quoted as saying:

"These hardships faced by the oilseed processing industry are nothing new and are part of an ongoing cycle of ups and downs in any marketplace. But he was fearful for the health of the industry amid the threat of a new round of shutdowns and possibly closures."

It is not clear whether the authors of the GMC report are suggesting that the cereal-based processing sector be modeled after the oilseed processing industry. By almost any standard, the wheat and durum processing industry has performed better.

(f) Potential For growth in value-added

The authors quote at some length from a speech by Morton Sosland, editor of *Milling and Baking News*, from November 1997. The authors state that “*Sosland forecasts a rise of 26 per cent in flour consumption for Canada from 1996 to 2010, about the same as his forecast for the U.S. in percentage terms.*” The authors then use this forecast growth as a basis for making projections for potential value-added growth. It does seem odd, however, that in a 2002 report, the authors choose to cite projections that were made based on a data set from 1996.

While Sosland’s forecast was reasonable at the time it was made, at the present time, one has the benefit of having five more years of information to consider. Since 1996, U.S. flour consumption has grown only 1.9 per cent, so to increase by 26 per cent by 2010 will take incredible growth over the next seven years. The growth of Canadian flour consumption is closer to the forecast, having grown 16.3 per cent since 1996.

Canada has only 31 million people versus the U.S. population of 286 million. Put in absolute terms, the small U.S. percentage growth rate amounted to 348 000 tonnes while the much larger percentage growth rate in Canada amounted to 269 000 tonnes. It is clear that for Canadian value-added processing to even consider expanding at the rate the authors contend, there must be a vibrant, healthy, expanding U.S. demand for flour. That condition does not exist today. The authors also do not mention that at the current time, the U.S. market is the only significant export market for Canadian wheat flour that is not subject to government-subsidized competition from other flour exporting nations.

The U.S flour milling industry, which is referenced frequently by the authors, has a current surplus of capacity which has led to downsizing and rationalization. This is a normal business cycle and is the result of declining flour consumption. Therefore it is somewhat strange that despite the fact Canadian processors of wheat and durum have continued to invest and expand, flour production has continued to increase and that exports have grown dramatically, the authors find the CWB system to be flawed and lacking. Considering the downturn in both the U.S. flour milling industry and the canola crushing industry it seems as though the opposite may be true.

(g) Influence of government policy on value-added processing

On page 40, the authors recognize that government policy of the past (e.g. the Crow Rate) could have significantly influenced the level of investment in value-added activities in Western Canada. This transportation subsidy was in effect for almost the entire period that they examine (1989 to 1997), until the Western Grain Transportation Act (WGTA) was repealed on August 1, 1995. Even though the authors recognize this as a potentially important factor driving the level of value-added activity, they do not attempt to account for it in their analysis.

(h) Investment and expansion must be demand driven

Much of the report is premised on the notion that lowering the price to domestic users will generate significant growth in demand for wheat and barley. What is never discussed in the report is the market demand for wheat-based products. Putting all else aside, opportunities in value-added processing are derived from market demand. The introduction of new products with a longer shelf life in bakeries in the U.S. is having a negative effect on flour demand. The authors present no evidence that suggests there is unmet market demand for wheat-based products that would drive the level of investment and expansion the authors contend should occur. The CNMA reiterates the importance of this point in its May 3, 2002 letter to Mr. Mark Hlady.

4. Assumption regarding the price sensitivity of domestic customers

On page 19 and 20, the authors assert that if the CWB was to lower the domestic market price, more domestic sales would be made, thereby displacing some lower-priced offshore sales and having a positive impact on the CWB pool accounts. Firstly, the CWB could not reduce its price to only domestic customers without negative market access implications for Canadian value-added processors exporting products to the U.S. – i.e. likely trade action. The CWB would have to reduce its entire North American pricing structure, including to U.S. customers, which would not result in any competitive advantage for Canadian value-added processors. Secondly, the effect on the pool of increased sales into the domestic market depends critically on how sensitive the quantity demanded by the market is to price. For lower domestic prices to

have a positive effect on pool returns, the authors would need to assume that the quantity of wheat demanded in Canada is relatively sensitive to price (price elastic). That is, the authors would need to assume that reducing the domestic price by a certain percentage would result in a correspondingly larger percentage increase in the quantity of wheat demanded domestically. For example, if reducing the domestic price by 10 per cent would result in an increase in the quantity of wheat demanded by 30 per cent, then the authors' logic would be correct. However, it is generally acknowledged that the demand for wheat in North America is extremely price inelastic – price fluctuations do not significantly change the quantity of wheat demanded by North American customers. A good example of this is the current market situation. The domestic millers have not indicated that they want to significantly cut back on wheat purchases due to the high prices. Domestic customers also do not significantly increase purchases in relatively low price periods. This concept is consistent with the point made previously that it is the competitive value of the raw product, not the absolute value that is most important to processors. Due to the nature of domestic demand for wheat, it is clear that forcing additional volumes into the domestic market would have negative implications for pool returns, not positive impacts as the authors state.

5. Authors dismiss studies which find CWB provides benefits

The paper reviews previous academic work done on the value of the single-desk wheat marketing system in Canada, and dismisses any studies that show that farmers, through the single-desk power given to them, receive higher returns than would be achieved in a multiple seller environment. They contend that any higher prices achieved by Canadian producers are mainly due to quality differences between Canadian grain and its competition, rather than due to the marketing power of the single-desk. The authors state that the arguments in favor of a mandatory board such as exerting market power in the export market and providing benefits to farmers through price pooling “*do not hold up in the real world of grain marketing*”. However, findings reported in the December 2001 ITC report suggest that these concepts do hold up in the real world of grain marketing. For example, the ITC stated:

“...Canadian durum prices were above U.S. prices for all comparable months except one.”

6. Alleged costs of the CWB

The study also tries to estimate the cost of inefficiencies allegedly caused by the CWB. The authors' estimation of these costs relies heavily on the costs estimated in a 1996 study by Carter and Loyns³, most of which either do not exist or are not unique to the existence of the CWB's single desk status. The costs presented in the GMC study, allegedly due to the CWB, are presented in the following table.

³ Carter Colin, A. and R.M.A. Loyns. 1996. The Economics of Single-desk Selling of Canadian Grain. March.

Producer Cost Item	Wheat (\$/mt)	Barley (\$/mt)	GMC Estimate From Carter and Loyns (1996) Study (Y/N)
Varietal Development	\$3 to \$5	\$3 to \$5	Y
CWB Admin Costs	\$0.70	\$0.70	N
Protein Giveaway	\$1.60		Y
Grade Giveaway	\$1.25		Y
Opportunity Interest Cost	\$0.60 to \$1.60	\$0.10 to \$0.60	Y
Delivery Patterns	(\$2.60) to \$2.60	(\$1.80) to \$1.80	Y
Production Inefficiency	\$4	\$4	Y
Excess Malting Barley	n.a.	\$1 to \$3	Y
<i>GHTS (Cost Reductions)</i>			
Handling Charges	\$1.25 to \$5	\$1.25 to \$5	N
Country carrying charges and Terminal storage	\$2.35 \$2.39 (durum)	\$3.63 (feed) \$0.29 (malt)	N
Demurrage	\$0 to \$0.95	\$0 to \$1.67	N
Freight Rates	\$0.47	\$0.47	N
TOTAL	\$15.22 to \$22.96	\$10.81 to \$24.07	

Source: Benefits and Costs of a Voluntary Wheat Board for the Province of Alberta. George Morris Centre. March 2002.

(i) Varietal development

The authors estimate that the CWB causes a \$3 to \$5 per tonne cost due to its involvement in the Canadian grain industry's variety development/registration process. They draw this estimated cost directly from the Carter and Loyns study. The accuracy of Carter and Loyns' estimates, which are based on studies performed 15 and 20 years ago, remains questionable. Carter and Loyns assume that if the CWB was not in place, the development of higher yielding, lower quality varieties would be fast-tracked and would increase returns for farmers.

The varietal registration system is a key component of Canada's quality control system. Customers of Canadian wheat and barley value the consistency within grade classifications that the Canadian system is able to provide. The rigorous standards for variety registration in Canada contributes to the product consistency that farmers are able to provide to their domestic and international customers. This has resulted in some buyers paying a premium due to brand loyalty. The lack of a focus on quality in the U.S. and the EU has resulted in decreased competitiveness. This is especially important considering the fact that there has been a dramatic increase in wheat production from what used to be "minor exporters". Their presence has increased competition in medium- and lower-quality markets. The market reality is that there are currently many low-cost producers, who compete aggressively on price, willing to supply medium- and lower-quality wheats. The CWB's strategy of focusing on the provision of high quality products and on differentiating its products from this portion of the market is particularly beneficial for Western Canadian producers in the current market environment.

It must, once again, be stressed that the CWB is a participant in the variety registration process and reflects customer requirements to plant breeders and to the industry. There are many factors that influence the development of higher yielding varieties and farmers do have the option of growing higher yielding medium-quality varieties such as Canada Prairie Spring (CPS) wheats. In addition, due to successful breeding programs, the relative yield of Canada Western Red Spring (CWRS) varieties has vastly improved over the past 10 years.

(j) CWB administrative costs

The authors assume, with little solid justification, that CWB administration costs “*should at a minimum, be 25 per cent lower than current levels.*” The authors’ logic appears to be that since CWB administration costs have increased more than grain company costs and administration costs at the Australian Wheat Board over the same time period, then CWB administration costs must be higher than they should be. The authors ignore the fact the CWB has, and continues to, greatly expand its services provided to farmers (expanded marketing flexibilities, more effective communication and business interaction with farmers, etc). The CWB has also had to expend a significant amount of money over the past 10 years defending Western farmers’ market access interests in trade disputes with the U.S. The CWB is a much different organization than it was 10 years ago. The authors’ suggestion that the CWB could provide at least the same level of service to farmers at a 25 per cent lower cost seems to be a “feeling” as opposed to being a well-substantiated argument.

(k) Protein/grade giveaway

For their estimate on protein and grade giveaway, the authors take their estimate (\$1.60 on protein and \$1.25 on grade) directly from the Carter and Loyns study. The Carter and Loyns study did not recognize that most CWB contracts contain grade options, which allow the CWB to load alternative grades at, agreed upon premiums or discounts. Therefore, although the CWB may have shipped a higher grade than the base grade on such contracts, it does not imply a cost to producers. The Carter and Loyns study also incorrectly compares Canadian 1 CWRS 13.5 per cent protein with U.S. Hard Red Winter (HRW) 13.0 per cent protein for sales to Japan. The Japanese market would not consider these grains to be of equivalent value. Also, there were inconsistencies and inaccuracies in the way the data on protein exports were presented by Drs. Carter and Loyns. Additionally, since the measurement for protein is only accurate within 2/10 of one per cent, shipments are routinely loaded with an excess of 2/10 of one per cent protein to ensure minimum contract requirements are met.

Slight overdelivery on protein occurs in all commercial systems. In fact, in its December 2001 report, the ITC reinforces this concept. It found that protein overdelivery occurs in both the Canadian and American systems. It found that overdelivery on protein actually occurred less on shipments of Canadian wheat to the U.S. market (54 per cent) than for shipments of U.S. wheat to its own domestic market (65 per cent). It also found that the level of overdelivery of protein was small in shipments to export markets for both Canadian and U.S. wheat and was similar in magnitude in both systems. The ITC stated that this overdelivery was likely due to the fact that most contracts have penalties for underdelivery of protein and that any overdelivery action was likely taken by exporters to ensure that minimum contract specifications are met.

The authors attempt to justify their inclusion of this “cost” with statements such as “Anecdotal evidence from the grain trade points to the CWB forwarding No. 1 or No. 2 wheat to customers who ordered lower grades.” The assertion that overdelivery of grade and protein would be reduced in the absence of the CWB is not well founded in fact.

(l) Opportunity interest cost/delivery patterns

The authors’ estimates of increased interest costs due to delayed CWB payments come directly from the Carter and Loyns study. The Carter and Loyns study assumes that the producer would have delivered his or her crop by December 31 of the crop year.

Western Canadian grain producers are faced with the prospect of moving their product through the most constrained handling and transport system of any major grain exporter. It is unrealistic to assume that their entire crop could be moved in the first four months of the shipping period (September to December) due to the limited capacity of the system, both at country and at port. Deliveries must be spaced out over the crop year, so that customer demand is satisfied and that the efficient use of the logistical resources available allows for maximum exports through premium ports. In the absence of significant investment, limited system capacity will continue to be the case regardless of whether the CWB is a single-desk seller of wheat and barley.

The CWB administers the federal government's cash advance program, which is aimed at improving farmers' cash flow situation by providing interest-free loans using grain inventories as collateral. The CWB has developed and continues to develop payment options designed to get a larger portion of the expected return in farmers' hands sooner. These programs are entirely optional and can be used at the sole discretion of each farmer based on his or her individual cash flow situation.

Carter and Loyns do not show that producer interest and storage costs would decrease in aggregate with the removal of a single-desk marketer. These costs might change for specific individuals, but on aggregate, producers' interest and storage costs would continue to be logistically determined and Western Canada's constrained handling and transportation system will dictate that deliveries and shipment occur throughout the crop year with producers receiving revenue as sales are completed. This alleged cost should not be included.

(m) Production inefficiency

The GMC study uses the Carter and Loyns' estimate of production inefficiency due to "poor" price signals provided by the CWB. In their 1996 study, after some complex economic modeling, Carter and Loyns simply assume the production inefficiency created by the CWB is equal to one per cent of total farm cash receipts in Western Canada. Many of Carter and Loyns' arguments were based on the expected returns and price information available to farmers prior to the introduction of the CWB's Pool Return Outlook (PRO) in 1993 and certainly before the portfolio of CWB payment options which are currently available to farmers were developed. In fact, the authors of the GMC study state on page 43 "*The introduction of the Pool Return Outlooks (PROs) was a significant step towards alleviating this problem*". This statement and the authors' choice to include this production inefficiency "cost" seem inconsistent.

(n) Excess malting barley production

The authors include Carter and Loyns' estimate of \$2 per tonne due to "excess malting barley production". The authors argue that the premium on malt barley encourages the production of these varieties at the expense of higher-yielding feed varieties and results in lost revenue for producers. Carter and Loyns do not specify how they estimate the \$2 per tonne cost. It seems inconsistent that the authors of the GMC study choose to include this "cost" after they conclude on page 39 that "*...there is no proof that the Canadian Wheat Board's monopoly benefits producers by exercising market power to generate higher prices.*" If the single-desk cannot increase returns to producers, then the malting barley overproduction argument, including a "cost" due to excess malting barley production does not hold up.

(o) Grain handling and transportation system inefficiencies

The authors also estimate several inefficiencies in the grain handling and transportation system, namely excessive country carrying charges, terminal storage charges, demurrage and freight rates allegedly created by the CWB.

The authors state that if grain companies were competing to provide the CWB with grain under a tendering process, there would be increased competition between grain companies for farmers' grain. The authors cite estimates by Agricore and the Prairie Farm Commodity Coalition, which claim that this would reduce primary elevator handling charges by five per cent and 15 per cent respectively. The authors' use an estimated savings of \$1.25 to \$5 per tonne based on these estimates.

The authors also state that a good tendering process would be a "just-in-time" system where grain would be sourced from farmer bins as needed, moved out from the elevator quickly and would spend little time, if any, in port terminals. They argue that this would allow grain companies to generate additional premiums due to more blending opportunities in a less congested elevator system, and the savings would be passed back to producers. The Canadian grain system does, in fact operate in a "just-in-time" system. Through contract calls, the CWB already sources grain from farmers, as the grain is needed to meet sales commitments. However, it is overly simplistic to think that sales opportunities could be perfectly predicted, terminal inventories reduced to zero and terminal storage costs could be eliminated. This does not exist in non-board crops and is unreasonable to assume that this would be the case for cereals if the CWB only tendered for grain at port position. Some terminal inventories are needed to be able to take advantage of commercial opportunities as they arise. Therefore, the assumption that port congestion would

be reduced, and that blending premiums passed back to farmers from grain companies would increase in the absence of the CWB's role in transportation are overly optimistic.

The authors state that if the CWB's role in transportation was eliminated, demurrage costs would be reduced (by up to \$0.95 per tonne) due to increased accountability and competition and that lower freight rates (by \$0.47 per tonne) would result due to increased use of multi-car blocks. The authors provide no solid rationale to support these contentions, nor do they explain how they calculate their empirical estimates for these "costs".

What the authors do not account for is that the CWB has been operating a tendering system, where it tendered for at least 25 per cent of its movement in both the 2000-01 and the 2001-02 crop years. The CWB will tender for 50 per cent of its movement for the 2002-03 crop year. The authors' estimates of inefficiencies due to the lack of a commercial tendering process clearly do not hold up.

D. Summary of analysis

In the study, the authors convey a lack of understanding of some critical components of the Canadian grain industry, which lead one to question their entire analysis. Their flawed description of domestic pricing and their assertion that the domestic product market is closed are examples that are particularly troubling and clearly incorrect.

The authors' portrayal of the western Canadian wheat- and barley-based value-added sector is neither complete nor accurate. The Canadian wheat- and barley-based value-added sector is actually performing quite well compared to the U.S industry. It has also been shown that Western Canada has performed well compared to the rest of Canada in value-added processing of these products.

The study attempts to oversimplify a complex issue by implying that removing farmers' single-desk marketing power will result in huge growth in value-added processing in Western Canada. This oversimplification is evidenced by the fact that the study fails to address some critical factors that affect profitability and investment in the industry. Without addressing these components, the authors cannot justify the scenarios upon which they base their projections. The CWB is not attempting to imply that expansion of value-added processing is not feasible. We are simply indicating that there are many factors that drive investment in value-added and that CWB pricing policies do not hinder investment in value-added in Western Canada.

It has also been shown that the estimated costs of inefficiencies allegedly created by the CWB are highly questionable. Many of the "costs" are taken directly from a 1996 study by Carter and Loyns which have been refuted as inaccurate and/or cannot be attributed to the existence of the CWB's single-desk status.

This study does not establish that the CWB limits the level of value-adding in Western Canada, nor does it provide any convincing arguments or analysis to indicate that removing the single-desk will result in higher returns for farmers or more value-added processing from wheat and barley.