Section 301 Analysis of Effects of CWB on U.S. HRS/HAD

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INTRODUCTION

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

The case has been resolved and now the STR is seeking appropriate remedies. Not all the papers and evidence from the case are available and the resolution process is currently proceeding. These reasons affect the scope of this paper. The purpose of this paper is to describe the evolution and findings of the case. In the first section below we describe the evolution and findings of previous related cases. Then, we identify the details of the Section 301 case. The major claims and responses by the parties are presented. Results of the ITC investigation and interpretation of the STR are then presented. The following section provides a broader discussion of the likely next steps and issues that economists and policy analysts will have to be considering 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 U.S. and Canada. Several investigations and negotiations have been conducted concerning behavior of the CWB and its' impacts on U.S. farmers since 1989. These investigations/negotiations have been undertaken under different auspices ranging from the Canada-United States Free Trade Agreement (CUSTA); the U.S. International Trade Commission (ITC) sections 332 and 22; Government Accounting Office (GAO); North American Free Trade Agreement (NAFTA); the Canada-United States Joint Commission on Grains, the U.S. Department of Commerce, and it remains a point of contention within the WTO. Investigations have focused primarily on trade in durum wheat and within North America. These are summarized by Schmitz and Furtan (Table 1.)

The issues between the U.S. and Canada were first addressed during the period from 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 could sell agricultural products at a price below the acquisition price of goods plus storage, handling nor other costs. This agreement did not define the acquisition price so it failed to resolve concerns of the U.S.

Table 1. U.S. - Canada Grain Border Disputes

Investigation	Conducted by	Completed	Outcome
Durum: Conditions of competition	U.S. ITC, under section 332 of Tariff Act of 1930	1990	CWB deemed clean No evidence of price cutting by CWB in U.S. market
Review of CWB/AWB	U.S. GAO	1992	No evidence of unfair trade practices
CUSTA	Bi-National Panel under CUSTA	1993	Ruled in favor of Canada Received audit of durum sales First audit covered 3.5 years
Wheat/Products: harm to U.S. farm programs?	U.S. ITC, under section 22 of Agricultural Adjustment Act of 1930	1994	1994-95 cap on exports to the U.S. negotiated that precluded 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 STEs to distort trade	U.S. GAO	1996	USDA officials acknowledged that they did not have 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
CVD live cattle from Canada - petitioner alleged CWB is a subsidy to cattle producers	U.S. Department of Commerce	1999	Final ruling confirmed that the CWB did not provide a subsidy to cattle producers in the POI (April 1997 to July 1998)

Source: CWB/Schmitz and Furtan

The U.S. 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 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 USITC has conducted several investigations into conditions of competition between the U.S. and Canada. In 1990, the USITC 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 USITC 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 U.S. for wheat, the USITC focused its analysis on Canada. The USITC found that Canadian imports were interfering with U.S. wheat. This was resolved with a Memorandum of Understanding negotiated between the U.S. and Canada which implemented tariff rate quotas on Canadian imports to the U.S. for one year.

The GAO investigated issues involving the ongoing dispute between the U.S. 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 context of GATT and 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 U.S. with regard to STE activities of the CWB. They reiterate that the CWB is a 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. They have repeatedly indicated that they have withstood the eight trade challenges initiated by the U.S. since 1989.

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 Canadian Wheat Board. This case differs from prior cases in that it extends areas of competition examined beyond direct comparisons within the North American Market to offshore markets and includes the Hard Red Spring wheat (HRS) market as well as the durum wheat market.

U.S. Claims

The U.S. advanced several claims against the CWB. They argued that the CWB had special privileges and protections that gave the CWB unfair advantages that could not be replicated or would incur additional costs/risks if implemented by commercial firms in the U.S. Specifically, they argue the CWB, as a government monopoly benefits from:

- 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 them 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, they argue that CWB has no mandate to maximize producer profits. Their only mandate is to avoid the undue accumulation of Canadian wheat stocks.

As evidence the NDSWC indicated an 8% advantage for CWB offers in third country markets. They indicate that traders in third countries report a longstanding pattern of the CWB offering wheat at average selling prices 5% under U.S. bids. In addition, the practices of overdelivery of protein and over cleaning of Canadian wheat amounts to an additional 2%, and 1%, advantage respectively. Further, they indicate other transportation (rail) benefits.

The North Dakota Wheat commission proposed several changes to induce more competitive practices.

1. Elimination of CWB supply and export monopolies.
2. Definition of CWB acquisition costs under U.S.-Canada Free Trade Agreement must be changed to include all payments to producers.
3. Full transparency of CWB operations including acquisition costs, export pricing, and other sales information unique to single desk exporters.
4. National treatment for any U.S. wheat entering Canada including full and equal access to Canada's marketing and transportation system.
5. Tariff rate quotas on imports of Canadian durum and non-durum wheat into the United States.
    1. Durum - TRQ $50/ton for imports exceeding 300,000 tons
    2. Non-durum - TRQ $50/ton for imports exceeding 500,000 tons

Responses by CWB

Responses by the CWB to the complaint and requests of the ITC were generally limited and non-forthcoming. Most are contained in the paper by Sumner and Boltuck which is summarized below.

Sumner and Boltuck evaluated arguments in the Section 301 case for wheat for the CWB. Their responses were in three areas (Structure of global wheat market, relationship between the global market and regional/local purchasing and role/influence of CWB, and they comment on certain aspects of competition and trade between the U.S. and Canada). Their major conclusion is that the complaints were from a simplistic view of cause and effects in regard to U.S.- Canada wheat trade. Specific arguments included:

S The analysis does not take into account the world global market including national producers as well as competing exporters.
S The focus on eight exporting countries ignores losses in market share that are offset by gains in other markets.
S Analysis ignores performance of competing exporters, and
S Study does not consider that efforts of CWB may actually increase U.S. exports.

Structure of Global Wheat Market. They indicate several aspects of the structure of the global wheat market that must be considered when analyzing competition between Canada and the U.S. First, while the U.S. and Canada are the largest exporters, they are not the largest producers of wheat. Second, they argue the U.S. is a special case in that the U.S. exports wheat, yet also imports from other countries to supplement different class/quality needs. Third, that U.S.-Canadian wheat trade is also affected geographically. They indicate that production areas in Canada are closer to demand sources in the U.S. than are some U.S. production areas. In turn, the U.S. production areas are closer to export locations than U.S. demand areas. Fourth, the marketing performance of U.S. farmers is affected by actions of multinational traders who contract with importers and can source from multiple origins (Canada, U.S., etc.).

In response the experts for the US case indicated that Canada incorrectly combines the durum and wheat market in their presentation. The U.S. experts argue that durum does not have close substitutes and should be evaluated separately. If durum is examined separately, then Canada is the second largest producer, behind the EU and accounts for 59% 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.

Price Discrimination. NDSWC argued that the CWB practices price discrimination. Sumner and Boltuck argue that NCSWC's 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 claimed that price discrimination present in international markets is classic third degree discrimination. Further, the ability to price discriminate is limited by the integration of importing markets into the global market; prevalence of alternative sources of wheat including domestic and international supplies; contestability of the market by potential entrants; downstream competition in flour, semolina, and pasta; and competition among wheat classes. In addition, 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 is the CWB restricting exports to U.S.

In response the U.S. experts indicated that Sumner and Boltuck argued 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 was to maximize profits for Canadian farmers. However, they argue the CWB has neither a statutory requirement nor actual incentive to maximize profits. Further, they indicate that Sumner and Boltuck later argue the objective of the CWB is to maximize revenues. The U.S. experts argue that maximizing revenues from sales of wheat bought from Canadian farmers is not consistent with maximizing profits for Canadian farmers.

CWB as Farmer Cooperative in Procurement. The NDSWC 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. cooperatives. In addition, the CWB cannot have a monopsony in procurement because it does not retain profits. They indicated that while the CWB is more successful in forward sales than U.S. firms, U.S. firms are free to do so, but profits are not there. They argue their success in offering long-term contracts is primarily due to scale of sales and not due to a supply monopsony.

In response the US experts indicated that while the CWB cannot earn monopsony profits from Canadian farmers, they 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 CWB Act provides for jail sentences for farmers who attempt to market wheat to anyone other than the board. 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 as risks of unexpected price changes is borne by Canadian farmers.

ITC Interpretation

The ITC examined aspects of competition between Canada and the U.S. on a number of dimensions.

Structural Differences between Durum Markets. The ITC indicates a number of differences are important between the U.S. and Canada for durum wheat. First, Canada's durum production is three times larger than that for the U.S. Meanwhile, the U.S. durum market is a narrow market that is more heavily dominated by Canada than is the market for HRS. Second, there are no close substitutes for durum wheat unlike the HRS market where HRS and HRW typically compete for the same products. Third, the market for durum is dominated by a few large sellers and a few large buyers. This has resulted in durum price discovery being more opaque due to limited observed trades and the demise of the MGE durum futures contract. In fact, the demise of the MGE durum contract was suggested to be fostered by the presence of the CWB. Finally, Canada can forward contract durum sales, while the U.S. typically sells on spot transactions.

Structural Differences Between U.S. and Canadian Industries. There are several structural differences between the U.S. and Canada in wheat. First, the CWB has both monopsony and monopoly powers in marketing of western Canadian wheat. Second, 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 NDSWC 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 to either increase final payments to producers or used to lower bids to U.S. The CWB disputes this.

CWB as Cooperative. The CWB has been argued to be a State Trading Enterprise (STE) and an entity of the Canadian Government. The CWB argued that it resembles a producers' cooperative and should not be treated differently.

The ITC found three significant differences between the CWB and producers cooperatives. First, the CWB has financial security from government backing of its borrowing and lending. Second, all western wheat producers must use the CWB to market all of their product, however producer participation in a cooperative is voluntary. Thus, the CWB has no "free riders' adding to Canadian supply, nor under cutting the CWB's pricing structure. Finally, the CWB does not have to accept all saleable western wheat offered to it. A cooperative has to accept all saleable wheat it is offered. This gives CWB power over quantities as well as prices.

Pricing in U.S. Market. The ITC surveyed market participants for pricing terms in the U.S. Respondents indicated that many purchases of Canadian wheat are quoted/contracted relative to U.S. prices (Most often cited reference price was the MGE HRS futures price). 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 USITC indicated that the premium for No. 1 over No. 2 CWRS was 3 c/b 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 and where more likely to have longer delivery terms.

Product Quality Issues in the U.S. Market. The ITC examined overdelivery of protein for U.S. and Canadian sales in the U.S. market by surveying market participants. They found 65% of U.S. HRS and Durum shipments examined over delivered on protein, while 54% of Canadian contracts over delivered on protein. Most of the overdeliveries were small with all deliveries within 1.5% of the protein level specified in the contract. None of the respondents indicated adjustments in price due to overdelivery on protein. However, the Commission's analysis indicated that when a delivery exceeded the contract protein specification, the delivered price exceeded the contract price in about 1/5th of reported purchase contracts.

Price comparison of U.S. and Canadian Wheat. 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, and timing etc.). Two analyses were conducted. The first examined contracted (largely gateway) prices for comparable wheats (No. 1 CWAD - No. 1 HAD; No. 1 CWRS - No. 1 HRS; and No. 2 CWRS - No. 2 HRS). The second examined delivered prices, basis Minneapolis.

Results indicated that prices basis Minneapolis for CWAD were higher than HAD for all months except one from 1996/97 to 2000/01. 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.

Third country export market practices. 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. Most overdelivery for protein was within .2%. However, Canada was more likely to over deliver in excess of .8% higher than specifications versus experts from the U.S. 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 non-responsiveness and due to the unavailability of prices. Some countries only bought from either Canada or the U.S. so prices were available from only one of the exporters. Others received exports directly through the CWB where no price data was supplied. Direct comparisons were made for the Venezuelan market (a market served by 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.

Rail Transportation. There are several important features of rail transportation important for wheat trade between the U.S. and Canada. Canada has regulated rates to eastern and western ports for export of wheat (these are below comparable commercial rates and significantly lower than U.S. rates). Shipments of Canadian wheat to the U.S. are not covered by regulated rates. The CWB is the shipper of record and rates are negotiated between shipper and railways. The CWB also provides railcars without charge to railroads.

The CWB argues higher U.S. rail rates are due to greater railway monopoly concentration in U.S. However, the ITC saw no difference in Class 1 railroads servicing areas or layout of shortlines between U.S. and Canada. They indicate that when alternative modes of transportation included (barge, truck), transportation concentration is lower in U.S. than Canada.

Effects of Canadian Trade Programs and CWB pricing on U.S. exports to Canada. The ITC examined effects of Canadian trade/market regulations on U.S. exports to Canada. They found participants in the U.S. industry indicated Canadian Regulations and laws as well as CWB operations have virtually precluded marketing of U.S. milling grade wheat or milled flour to Canadian mills and buyers.[1] Specifically, they identified varietal registration and end-use certifications as hindering U.S. movements into Canada. Further, U.S. interests argued 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.

STR Response

The U.S. Trade Representative found in favor of the NDWC that the CWB's monopolistic system disadvantaged U.S. farmers and undermines 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."

The USTR committed to undertaking several strong initiatives to address problems with the CWB. Specific steps include:

- USTR will examine possible dispute settlement case against CWB in WTO.
- Work with NDWC and U.S. wheat industry to examine possibilities of filing U.S. countervailing duty and anti-dumping petitions with U.S. Dept. of Commerce and International Trade Commission.
- Work with industry to identify specific impediments to U.S. wheat entering Canada and present these to Canadians.
- Ongoing effort to vigorously pursue comprehensive and meaningful reform of monopoly state trading enterprises within the WTO agriculture negotiations.

The USTR decided not to apply tariff rate quotas (TRQs) at this time as this would violate NAFTA[2] and WTO commitments, could result in retaliation by Canada, and 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.

CWB: The CWB released an initial statement indicated that because "the U.S. did not impose tariffs, we have successfully come through our ninth trade challenge (Canadian Wheat Board, 2002)."

Other Canadian Interests: Other respondents from Canada were less optimistic. Art Erns, president of the Western Canadian Wheat Growers Association indicated that the ruling

[1] Though not reported, this included that shipments of grains grown in the United States are not allowed access to the lower statutoary rates available in Canadian for "grain grown on the prairies."

[2] However, since then there has been disagreement on this interpretation of NAFTA.

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." Further, the fact that the focus is only on the practices of the CWB and not non-board grain markets, poses a major challenge for western farmers (U.S. Wheat Associates). The president of the Western Barley Growers Association (Canadian) indicated "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 (U.S. Wheat Associates)."

US Responses: Responses from U.S. parties included the Secretary of Agriculture, Ann Veneman, who applauded the decision. She indicated that the investigation "clearly established 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 Associates)." North Dakota's congressional delegation and Governor supported the ruling, yet had wanted a stronger, more immediate action. Senator Byron Dorgan (D-ND) indicated that "we should welcome an opportunity to watch Canada defend the maintenance of a state-run monopoly in the middle of a free-trade zone." 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)."

ASSESSMENT/DISCUSSION

Given that this remains an ongoing case and that the papers and evidence are not all publically accessible, the discussion below is somewhat limited. The ruling is being discounted to some as just another finding without teeth and solid evidence. It is important that the findings were affirmative and that the CWB as an arm of Government. These differ from previous proceedings. These findings also further illustrate problems of market integration with disparately organized marketing systems and the resulting difficulties of harmonization of policies and business practices.

There are several potential paths that could ensue. These would include a negotiated agreement, the STR pursuing remedies inclusive of WTO resolution or letting it pass-away with an undignified death. It is also claimed that the NAFTA precludes imposition of TRQ's but, this interpretation is apparently debatable. Nevertheless, for 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 the presentation is intended to coincide with what appears to be the case logic. That logic appears something as follows. First, there are special rights and privileges enjoyed by the CWB that are not easily replicated in a competitive situation. Second, these facilitate greater discretion in pricing and competitive strategy and positioning than could be enjoyed by commercial rivals. While this is a general claim, it is normally reflected in the claim that the CWB uses extensive price discrimination in off-shore marketing. 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. Finally, these powers result in an unfair competitive advantage relative to rival suppliers. These are discussed in the remainder of this paper.

Special (Exclusive) Rights and Privileges

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, etc., to name a few. For these reasons, anything that undermines the powers of STEs (both import and export) would reduce disadvantages of competitive rivals. The reason for this is that it is extremely difficult (costly and/or risky) to replicate these advantages within a commercial marketing system.

The WTO defines a 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).[3] The CWB conforms to every definition of a STE, and is acknowledged as a STE through past submissions. Most important is that there are numerous exclusive rights and privileges bestowed on the CWB that are not available to rivals.[4]

In the case of the CWB there are likely numerous rights and privileges. Those of greatest importance, as examples only, include:

- 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
- Monopoly on selling of 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. These include:

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[3] It is also this definition drawn on by the recent ITP study on STEs which indicated that the goal should be to dismantle STEs or change rules so that STEs do not distort trade. As long as these STEs "enjoy exclusive powers or advantages not shared by their competitors, these monopolies will not behave like "at risk" enterprises." (p. 16). They conclude indicating these monopolies should be eliminated.

[4] Canada's position is that Canada should maintain the ability to choose how to market its products. Minister Vanclief indicated 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." Finally, 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).

The CWB's stance is to reinforce STE's 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 AWB, AWB Limited Chairman Trevor Flugge indicated "We also expect that the issue of State Trading Enterprises will be considered during the course of negotiations. The issue should be not STE's 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." (AWB, May 31, 1999.)

- Rail car ownership by governments and allocation authority for CWB grains[5];
- special legislated rates on rail grains (i.e., for grains grown in western Canada there are separate regulations)[6] and
- non-reporting of prices (facilitating being non-transparent)[7]

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

Guaranteed Initial Payments

One of the important features of the operations of some STEs is the guarantee by the federal government of initial payments paid to producers which is a fundamental tool of the CWB.[8] This mechanism, along with the purchasing monopoly provides advantages to these selling organizations. While there are numerous issues about these mechanisms, two are particularly apparent in competition with competitive rivals.

One is that the initial payment is typically a sharp discount relative to market prices. In fact, in recent years, this spread appears to have widened and does not accurately reflect price differentials associated with quality differences. For an exporter STE this represents an element of marginal cost for transactions and in fact is the lower bound. This would be in contrast to a competitive rivals 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 second impact of these mechanisms in competition with competitive rival 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 first described this relationship. While in concept large export firms could provide similar terms, they would be more costly to execute. They indicated that this policy regime (IP along with a procurement

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[5] Car allocation authority is granted the CWB for specified movements and provides several benefits, including, making adjustments to grain tranrportaiotn plans, ensures farmer access, fosters (foists) competition amongst handlers via tendering systems etc.

[6] In 1996 the CTA repalced the NTA with competitive providions. Concurrently it created Div VI rates with continues the maximum rates on grains which by now were based on 1992 frozen costs, indexed upwards. These were for statutory movements defined as grain and grain proudcts with origins in prairies, to specific export ports. Exclusions were made for grains not grown in the prairies (eg US) and grains exported to the US. This resulted in 2 regimes of rates, one subj to normal regulatory processes and one for statutory grain movements. Those for the latter were more favorable and have since been assigned a revenue cap.

[7]Elsewhere in Canada and US, government entities are active in price reporting for purposes of faciliating more symmetric information amongst rivals.

[8]The Guaranteed Minimum Price (GMP) concept in Australia was abandoned in June of 1999 when government backing of AWB loans was discontinued. While initial payment guarantees remain an issue, Australia has moved away from this practice and some Canadian authors are now indicating that this will be a topic that will have to be dealt with at the next round of negotiations.

monopoly) is fundamentally similar to the Government providing a free put option.[9] Using typical values at that time, the value of that advantage was about 8c/b. 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 presumes there are perfectly efficient futures and options markets for these grains and grades; which of course is not the case even though this 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 hedgable nor cost-free to assume.

These claims have been challenged by several authors. Veeman et al. 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 U.S., traders do not face significant problems of grain acquisition. Further, they argue that because initial prices are known, U.S. traders know the CWBs acquisition cost whereas, the CWB does not know this for U.S. firms. Finally, they argue that the practice of initial pricing results in less flexibility in procurement pricing for the CWB.

Schmitz, Furtan and Baylis have indicated that government guaranteed initial prices are a soft-price discrimination policy that "may" violate WTO rules when payments are made because tax payer 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 when "the same commodity is sold to different customers for different prices" (Phlips, 1985 p. 5.) Price discrimination may also occur when/if different quality products are sold to different customers for the same price or, when terms of trade are not reflected in prices. Technically, price discrimination is said to exist if

$$P_i / MC_i \neq P_j / MC_j$$

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. It is a very common practice, particularly among industries with high fixed costs. Examples abound and include pricing by railroads, airlines, universities, movie theaters, etc. Generally, price discrimination is optimal for any selling organization if they have 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) and virtually impossible to

[9] Gray and Gardner (Joint Commission) indicate deficits in initial payments can occur when market prices fall after initial payments are announced. However, deficits have been uncommon. Over the period of 1980/81 to 1993/94 total deficits in initial payments amounted to $1.05 billion for sales of 300 MMT (an average of $3.50 per ton).

prevent, or 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 the case about whether price discrimination occurs or not, how bad is it, is it good or bad and its impact prospectively on US 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 without transaction prices.

Despite this, there are numerous observations by US Wheat suggest that the CWB (and the AWB) actively pursue discriminatory pricing practices. Some of these examples would technically conform to the definitions of price discrimination as above. Irrespective of these anecdotal observations, it is common knowledge that this is a common practice and the CWB readily admits an advantage they enjoy is the ability to "differentially price," particularly among importing countries and in some cases between companies in the same markets.

Kraft et. al. illustrated that the CWB have been able to price discriminate and as such increase 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 EEP period. The EEP provided greater incentives for STEs to exploit price discriminating strategies--the EEP simply exacerbated the demand heterogeneity confronting STE sellers. 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 exacerbated.[10]

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

For purposes of this case there are a number of important questions. First, some of the evidence/claims are that the CWB offers at a fixed differential relative to US offers in specific markets. This is the rub that irritates many US parties. However, this doesn't necessarily imply price discrimination as defined above, nor, is it a case of non-transparency (as discussed below). This may simply be more symptomatic of brutal competition (i.e. reducing prices for market entry). Second, given the definition of price discrimination 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. Third, certainly, the claims of over providing quality (if overt, which is questionable), would be examples of price discrimination, as would providing preferred terms for deferred shipments.

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[10] Goodwin and Smith indicated that price discrimination was analogous to an implicit subsidy on exports if the seller is able to limit imports into the higher priced markets. Skully indicated that the CCC uses its export policies (the combination of EEP, PL480 and credit guarantees) to price discriminate. Paddock 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 indicated that it was a common practice among private trading organizations and would continue to be even without STEs.

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) have the impact of effectively making 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 have been a range of definitions for price transparency. Sosland indicated that a lack of price transparency was "a lack of price disclosure." Furtan describes it as "the extent that details of transactions made by purchasing or selling agents are available to the public." Glickman defined it as "people knowing the market prices and volumes and producers know on a fairly instantaneous basis what's happening, who's getting what for what dollars." Wilson et al. defined it as where firms in bidding competition have 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.

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 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. summarized earlier works on transparency, indicating an earlier study by Schmitz and Furtan found 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 $1-2/mt.

There is a fundamental difference between price transparency versus 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 their pooled transactions 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 do their predecessors of the 1970s. As examples, the largest exporters today include Cargill which has to report their financial performance routinely due to being an ESOP; ConAgra and ADM, among others, whom are publicly held stock companies and report their financials routinely; and the larger cooperatives who also report to the public and their shareholders. Thus, notwithstanding the irrelevancy of any of these to the real issues of transparency (i.e., price transparency), the CWB is no more or less transparent than other exporters in their financial reporting.

Traditionally, marketing boards and STEs have not released information on export sales and yet some of these sales are subsidized. As such, it is difficult to monitor given transactions. This matter is further complicated by compliance issues with notification. The current questionnaire for STE notification does not require information that would allow for verification of circumvention of reduction commitments. This would require information on volumes of individual transactions, their level of subsidies and sales prices (Incgo and Ng). Nevertheless, under current WTO rules, countries are required to report their STEs. In the past, few countries reported their STEs. 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, as policy analysts, it is important that it is generally thought that greater transparency about prices is desirable. Certainly, individual rivals will strive very hard to be non-transparent to yield some asymmetric advantages. Nevertheless, a hallmark about market efficiency and policy is that greater transparency is good and indeed provides motivations for price and export sales reporting. Given the non-synchronous treatment of this issue regarding CWB marketing versus that elsewhere in Canada and throughout the US, there is no doubt that this will be a continual challenge to reconcile.

FUTURE CHALLENGING ISSUES

The affirmative findings requires that the STR seek resolution. How that will ensue and its likely alternatives are not at all clear. It is not clear the Government of Canada has left room for a negotiable solution. And, it is not clear of the will of the current administration to push for a resolution with great zeal. No doubt, each party would likely prefer that the problem would just go away, as opposed to reaching mutually acceptable resolution to the problem.

In light of these proceedings however, there are a number of issues that policy analysts will have to deal with in coming years. Some of these are mentioned just briefly. One relates to price discrimination and the extent that marketing policies (due to special rights and privaledges) are the enabling mechanism. 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. Second, to what extent is/can non-transparency of one rival versus others be compatible.

Third, operationally, NAFTA has relied on a loosely defined concept of an acquisition cost to facilitate interpreting the prospect of anti-competitive behavior within North America. This will pose a continued challenge for policy analysts.

Finally, independent of the specific claims in this case, 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 the gnawing differences would include: policies in the US reducing acres (e.g., CRP) in an open border market; US policies favoring storing (i.e., non-selling) versus Canadian pooling mechanisms favoring selling within a marketing year; salesmanship for Canadian grains, in an environment where there has been reduced marketing efforts by multinational trading firms; the more recent changes in Canadian grain marketing likely entails even more micro-scopic rights and privileges. These again are just examples of the fodder for research on these issues in the coming years.

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