

The Impact of Removing Single Desk Marketing on your Farm

Q and A for Farmers

Background Information

The federal government plans to transform the CWB to a voluntary marketing entity operating in an open market. In order to do this, the single desk function of the CWB must be removed. This change would be irreversible and will impact the entire industry – from grain handling, transportation and marketing to trade, risk management and farmer returns.

In all likelihood, you as a farmer have many questions about what these changes could mean for you. This document has been prepared to provide farmers with some of the questions we must ask ourselves during this time and to encourage everyone to get involved in the debate. While individual farmers determine what's best for their farm, all farmers together must decide the future of our industry.

Because of the way the single desk has been structured; all profits by the CWB are returned back to the farm. A unique feature of Canada's system is the way it aligns the interests of farmers and grain companies in promoting value and equity in the system. This maintains the system's focus on farm-level interests. It is important that we make the right decisions in terms of the systems that should be maintained and determine what changes, if any, should be made.

While Canada produces only 3% of global wheat supplies, Canadian farmers represent 16% of global trade in wheat, second only to the U.S. In the West, of the 20 million tonnes of wheat produced, about 80% of this exported to more than 70 countries around the world. Canada is a significant global trader in durum, with 55% of global market share. In the barley and malt markets, the Canadian farmers have approximately 30% of global market share. The single desk provides western farmers with a structure to compete head-on with large, international grain companies.

The loss of the single desk will change the structure of the Canadian Wheat Board significantly. For clarification, the future CWB will be referred to as "the new marketing entity" in this paper.

Questions on Farmer Returns

Price Premiums

When you market your crops throughout the crop year, will you be able to obtain premium prices from an open market?

- The single desk provides the ability to price discriminate – an indicator of market power and performance in negotiations with buyers.

- Several independent audits of the CWB¹ concluded that single desk market power extracts premiums from the market. On the conservative side, these premiums are estimated to be in excess of \$10 to \$13 per tonne. Based on wheat and barley volumes, this could increase grain producer returns by about \$300 million every year.
- Premiums obtained by a single desk will differ from year to year and across crops. Of those studies conducted, premiums have been estimated to range from \$25-\$40/tonne for malt barley and \$8-\$20/tonne for spring wheat. While durum returns have not been studied as extensively, Canada maintains a market share in this crop of about half the world's trade. This large volume provides farmers with a single desk power to influence prices.
- In an open market, farmers will have no ability to influence markets and would compete against each other for market access.
- Implementing an open market would require the new marketing entity to sell in direct competition with established, international grain companies.
- Competition among sellers is good for buyers because it reduces prices.
- In commodity markets, without a single desk, farmers are price takers at the international market price.

Price Pool Viability

***Has price pooling been an important risk management tool for your farm?
Without a single desk, is price pooling still viable?***

- Pooling is an effective and equitable risk management tool and a common feature in Canadian agriculture.
- Pooling is a system where high and low prices, received from a variety of buyers and at different times throughout the crop year, are averaged to provide a common, pooled price for all producers. Because of this averaging feature, individual producers can avoid the volatility and risk associated with trying to time the market.
- A voluntary pool without controls in place would be unsustainable in an open market.² This is because market forces would encourage producers to jump in and out, depending on the direction prices were heading. To manage this, multi-year contracts would be necessary to commit farmers to deliver grain. In some years, enforcing these contracts could be difficult.
- Without the prospect of market premiums, fewer farmers will divert grain to the pool, making pooled volumes and price levels smaller overall.
- In an open market where there is no pooling, studies show that risk management costs are higher. The CWB's ability to self-hedge has been estimated to save farmers \$5.53 per tonne when compared to the risk management costs of buying and selling flax and canola³.

¹ Kraft, Furtan, Tyrchniewicz (1996); Schmitz, Gray, Schmitz, Storey (1997); Gray (2001); Schmitz, Schmitz and Gray (2005)

² Hartley Furtan, University of Saskatchewan, (2002).

³ Kraft, Furtan and Tyrchniewicz, (1996).

Marketing Options

Does the CWB currently provide enough marketing options to meet the needs of your farm?

- The CWB provides choices for farmers who wish to operate outside of the pool. These programs allow producers to lock in a basis, fix prices to a basket of prices at U.S. elevators and increase control of delivery opportunities, while ensuring the benefits of single desk selling continues to flow to all producers. These pricing options include:
 - *Basis Payment Contract*
 - *Fixed Price Contract*
 - *Delivery Exchange Contract*
 - *Early Payment Option*
 - *Daily Price Contract*

Customer-Focused Relationships

In a multiple seller environment, who will receive the benefits from farmers' previous investments in market development and branding?

- For many years, farmers have been investing in market development and branding activities through the CWB. Methods of assuring wheat quality and consistency and activities around pre/post-sales services and research have developed a positive reputation for Canadian wheat, durum and barley, ultimately obtaining premium sales. The single desk ensures that the benefits from these investments flow back to the farm community.
- A key differentiator of the single desk has been the ability to offer long-term supply contracts to buyers. This provides buyers with valuable, guaranteed access to the Western wheat crop. Without a single desk, it would be difficult to guarantee this access.
- Combined with branding and market development, the CWB's ability to offer long-term supply contracts drives the premiums farmers have been able to achieve.

Branding Canada

In an open market, would there be an incentive for any company to continue the Brand Canada activities that have provided so many benefits for farmers?

- The CWB's efforts on behalf of western Canadian farmers through various entities like the Canadian International Grains Institute (CIGI) and the Malt Barley Technical Centre have made great strides in branding Canada in global markets. The single desk has enabled producers to capture the brand's value.

Research and Innovation

Who will continually invest in research and innovation over the long term, while maintaining a focus on the interests of farmers?

- Staying on the leading edge of a commodity-based industry requires continuous investments in innovative research.
- The CWB has focused farmers' research dollars through entities that would make Canada a strong competitor in global wheat and barley markets. Some examples of innovative research include the Western Grains Research Fund, the Richardson Centre for Functional Foods and Nutraceuticals and the Food Development Centre, to name a few.

Farmers' Market Power and Share of the Food Dollar

As an individual marketer, does your farm have enough market power to get a fair share of grain industry profits?

- Companies with market power retain more of the profits in a value chain relative to those who have little or no market power. Through the single desk, farmers maintain the market power and profits in grain supply from the field to the customer, whether it be domestic mills or overseas buyers.
- While farmers can obtain market power through alternate channels, for example, through identity preserved systems, success with these schemes is not widespread.
- In a world where bigger is better, smaller companies have a difficult time competing. The grain trade sector is no exception. Only four firms control three quarters of the global grain trade. Without the single desk, international, integrated grain companies would likely also dominate western Canada's wheat and barley exports.
- These companies have tremendous market power and most profits earned beyond the farm gate are retained by them.
- In an open market, farmers' share of supply chain profits would be reduced.

Questions on Transportation

Transportation Advocacy

In an open market, who will be the advocate for all Western farmers on transportation issues?

- There exists little competition among terminals at the Port of Vancouver and in the grain transportation system. Port of Vancouver terminal services are currently controlled by only two commercial groups and there exists extremely high barriers for new commercial operators. There are two national railways on the Prairies and the lack of competition between them has always been a concern for all shippers. The CWB's role in car allocation and advocacy provides farmers with some balance in the system. The CWB has always been a vocal advocate for farmers on transportation issues.
- The CWB has been the only shipper to challenge the railways for poor service through the Canadian Transportation Agency and the courts. Due to their efforts on behalf of farmers, Canadian Pacific Railway reimbursed farmers \$15 million in

the late 90's. Canadian National opted to settle its claim with farmers outside the courts.

- Vancouver is becoming increasingly important as an export gateway. On two occasions the CWB intervened at Competition Tribunal hearings on terminal ownership at the Port of Vancouver.
- Any savings in transportation and handling costs that farmers are able to collectively achieve have been passed back to the farm community in a transparent manner.

Linkages Between Port Terminals and Inland Elevators

Many groups, including producer-owned inland terminals, producer-car groups and the proposed new marketing entity, do not own port facilities. In an open market, will the grain companies provide competitors with cost-competitive access to their port facilities?

- Port terminals are significant profit centres for grain companies. By receiving grain from the Prairies, terminals earn fees for storage, elevation, blending and cleaning. The more grain that is shipped through a terminal, the higher the profits earned by their owners. These profits can be used to subsidize inland operations in order to acquire greater volumes of grain.
- Not all grain handlers on the Prairies own terminals at the ports, particularly the independent inland terminals. These companies must negotiate for access to the port terminals, increasing their cost structures and reducing their competitiveness.
- Board grains represent more than half the volume shipped through Vancouver. Because working with the single desk is the only means to receive handling revenues on Board grains, grain companies provide cost-competitive access to their terminals.

Port of Churchill and OmniTrax

Given that 75% of Churchill's business is in shipping Board grains, could Churchill survive without the single desk?

What impact will the loss of Churchill have on farmers in Northwest Manitoba and Northeast Saskatchewan?

- The Port of Churchill provides a cost advantage to farmers of roughly \$15 - \$20 per tonne versus positioning grain into the St. Lawrence ports system. Farmers within Churchill's catchment area save, on average, \$1.4 million per crop year in freight costs.
- Because the focus of the CWB is to maximize returns to producers, grain is directed to the port that provides the highest return. For farmers in Northwest Manitoba and Northeast Saskatchewan, this is Churchill. Churchill's main competitor is Thunder Bay, where major grain companies own the terminals, the dominant companies being Agricore-United and Saskatchewan Wheat Pool.
- If the CWB were to disappear, grain companies will direct grain to their own terminals at Thunder Bay as they have no incentive to move grain through Churchill.

- Despite the competitive movement of canola and peas through Churchill, 75% or more of the port's annual business is in shipping Board grain.

Producer Cars and Shortlines

Board grains accounted for 99% of producer car shipments in 2004/05. How confident are you that you will continue to be able to use producer cars as effectively in an open market?

Given that most traffic generated on short lines comes from producer cars, what will be the future of the network of short line railways in an open market?

- Producer cars have proven to be an important mechanism for farmers to exercise control over handling costs and they provide some farmers with greater value than the commercial elevator network. However, Board grains account for a disproportionate share of shipments - 99% in 2004/2005.
- In order to receive a producer car for either Board or non-Board grains two conditions must be met: an entity must provide the administrative services for producers and an export terminal must agree to accept delivery of the producer car. Producer cars are in direct competition with the grain companies and there is little incentive to provide administrative services or access to their terminals, therefore making it very difficult to access producer cars for non-Board grains.
- The CWBs role in car allocation ensures that these conditions are met and that farmers continue to obtain benefits from producer cars. In an open market, it is very likely that producer car use would decline.
- Finally, most traffic generated on many short lines come from producer cars, the future of producer cars will ultimately determine the future of short line railways.

Tendering and Despatch/Demurrage

Revenues from tendering and despatch are currently shared by all farmers. In an open market, how will farmers ensure they are receiving their fair share of supply chain efficiencies?

- The CWB tenders out a portion of their marketings to the private trade in order to extract a portion of any supply chain efficiencies individual companies could achieve. These savings are comprised of terminal agreements, financial penalties and rebates. The total of these net transportation activities saved farmers approximately \$23 million in 2005/06.
- Despatch is revenue earned by the CWB and grain companies when ships are loaded ahead of contractually specified schedules. The reverse of despatch is demurrage. In the CWB's case, net despatch is a revenue stream for the CWB and these revenues are deposited directly into the pool accounts and become revenue for all farmers. From the 2000-01 to the 2005-06 crop year, the net of despatch earned by the CWB and returned to the pool accounts was \$17 million.
- In the case of non-Board grains, however, the private trade must build into the basis a risk premium to insure them from potential losses from demurrage payments. Whatever the outcome at the port, the grain company retains all revenues.
- Under the CWB system, farmers are assured that they are getting a share of supply chain efficiencies. In the private sector, this transparency does not exist.

Questions on Grain Handling

Access to the Commercial Elevator System

***Given that the commercial elevator system can only hold 10% of the crop at any one time, what would your delivery opportunities be in an open market?
How would basis levels be affected if the CWB were no longer using contract calls to allocate access to the handling system?***

- In the grain handling system, elevators can only hold 10% of the crop at any one time. For non-board grains, basis levels are used to allocate grain into the handling system. The basis will rise or fall depending on farmer demand for access to the system. In contrast, the CWB provides farmers with orderly and equal access to it through contract calls. Once the single desk is eliminated, the basis would allocate access to the handling system for all grains

Independent Grain Elevators and Inland Terminals

Given that elevators will have to finance all inventory at commercial rates, will smaller companies be able to remain viable?

- Farmers across the Prairies have spent significant amounts of money investing in handling facilities and inland terminals. These strategic investments help farmers obtain a fairer share of the grain value chain.
- However, because many of these companies do not themselves own port terminal infrastructure in which to earn additional revenues, they are at a competitive disadvantage compared to integrated companies when bidding for grain inland.
- Buying and selling grain requires access to more financing than handling alone, increasing the cost structures for grain companies who would choose to market Board grains in the new environment.

Questions on Value Added

How will current value-added activities and growth be impacted by a move to the open market?

Growth of Value-Added

- There is a perception among some that the single desk system is a deterrent to growth in value-added activities. While this claim is difficult to measure, data indicates that value-added activity is growing on the Prairies.
- Through the 1990's, malting capacity has increased by 75%, or almost a half million tonnes, the majority of this growth has occurred on the Prairies. In the 10-year period ending in 2001, malt exports have doubled.
- Wheat milling capacity has increased by 28%, compared to only 14% in the U.S. A third of our nation's milling capacity is on the Prairies. Only 17% of U.S. milling capacity is located in comparable U.S. locations.

- Under CWB pricing policy, Canadian processors pay prices that are competitive with those paid by their U.S. competitors.

Stock-Switching Program

- The CWB has implemented a stock switching program to encourage prairie-wide, farm-level buy-in to regional value-adding opportunities. The program assists those farmers that produce wheat and barley to participate in any venture in the CWB region, regardless of the location of their own farm.

Questions on International Trade

Are you aware that Canada's trade agreements would make eliminating the single desk effectively irreversible?

- Access to international markets is crucial to the Prairie grain industry. Our country relies heavily on various trade agreements to provide this access.
- However, because of these agreements, large changes to the CWB would be irreversible in the longer term. This is because under our various trade agreements, private companies have a right to challenge the government in the courts if they become disadvantaged if the single desk is ever reinstated.

Trade with the U.S.

In an open market, who will be an effective advocate on behalf of farmers in trade disputes?

If Canadian grain truck movements to the U.S. increase in an open market, will there be more trade disputes with the U.S.?

- When selling to the U.S. market, the CWB ships grain directly to end users, bypassing the U.S. elevator system.
- In an open market, Canadian grain farmers will ship grain directly to U.S. elevators, making Canadian grain exports more visible to American producers. This could make Canadian grain more vulnerable to trade challenges, particularly if there is a large increase in truck traffic.
- Anti-dump trade action is a common tool for protectionists because it is easy to prove and difficult to defend. The cost and responsibility of defending anti-dump charges are always left to industry, not governments. The CWB, on behalf of western grain farmers, has been a very strong and successful opponent to U.S. protectionists in the past.

Questions on the Open Market

What's the difference between the proposed new marketing entity and a commercial grain company?

Why would competitors move the proposed new marketing entity's grain if they could move their own?

- The “dual market” is really an open market. It has often been described as retaining the benefits of the single desk without the single desk - in effect, requiring the new marketing entity to “compete” with private, multinational trading firms.
- Without the single desk, the new marketing entity becomes another grain company, but without any facilities or capital.
- In an open market, the new marketing entity will be required to negotiate with their competitors to continue accessing existing handling facilities. Even if this entity were successful in negotiating an access agreement, their cost structures would increase and this would be reflected in their offer to farmers.
- Because the CWB does not have any assets, they would have trouble acquiring affordable financing for grain marketing activities.

Questions about Choice / Freedom in Marketing

CWB Act: Democratic Process

Who should decide how the grain industry operates?

- A farmer-elected Board of Directors provides the CWB with direction, providing farmers with direct control of their marketing system.
- A democratic process for making changes to the CWB is already in place. Section 47.1 of the Canadian Wheat Board Act requires that a plebiscite be held among farmers prior to making any significant changes to the CWB's mandate.
- It has been suggested by some that farmers should be able to vote on the future of the CWB with their grain. If this were the case, the option of having a single desk would already be decided and precluded. All of the features that are unique to the single desk would disappear.

Questions about Marketing Institutions in Other Jurisdictions

Often, there are comparisons made with the marketing systems in Ontario and Australia. Is this a relevant comparison?

Ontario Wheat Producers' Marketing Board

- Direct comparisons between Ontario and the Prairies are not easily made
- Ontario primarily produces soft wheat and is a net importer of hard wheat
- Most wheat produced in Ontario is consumed domestically. Less than 1 million tonnes is exported and the majority of this is shipped to Michigan and Ohio.

- Transportation costs do not play as significant a role in Ontario's marketing decisions as they do on the Prairies
- Most of Ontario's producers seed less than 50 acres of wheat
- About 80% of the crop is sold right off the combine.
- Changes to the OWPMB were made by farmers through their elected Board of Directors, not by government instruction

Australian Wheat Board

- The Australian Wheat Board has a monopoly on export sales.
- The AWB was provided with time to adjust to the loss of the domestic market. They were also given the right to retain earnings and reinvest these funds into supply chain assets, like handling and processing infrastructure. To do this, they were transformed into a share-capital corporation, with all farmers being its owners.