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When we talk about CWB premiums achieved on sales, we need to know how they are defined and measured. This includes a full accounting of premiums plus the costs associated with achieving them.

In addition, detail concerning what aspects of the sale that contributed to the premium will be valuable in assessing the CWB's position that the single desk market power is what generates the premiums.

CWB Measurement and Reporting

- The CWB indicates that it measures a set of key indicators which includes "sales price comparisons". These comparisons are described as "Net per-tonne price spread realized by the CWB compared to competitors' values"; it is understood that a positive price above competitors' prices is what the CWB calls a premium.

- The CWB indicates that the price spread is "calculated based on the CWB's best knowledge of the relevant competition on every sale it makes. Maximizing the net price spread does not drive the overall CWB sales strategy. Focus is placed on achieving the highest possible returns to farmers over the entire sales volume, not necessarily by individual sales."[1]

- In the last four years, the CWB reported achieved premiums as follows ($/tonne):

	05-06	**06-07**	**07-08**	**08-09**
Wheat	8.66	6.00	13.81	6.65
Durum	5.98	7.77	48.84	15.37
Designated barley	7.77	13.45	29.47	14.65

This is saying that, for instance, in 08-09 the CWB is reporting that it achieved an average of $6.65/tonne premium over the closest competitor on every sale.

[1] 2008-09 CWB Annual Report, page 45.

How does the CWB get these premiums?

The CWB presents that it achieves these premiums because it is the sole seller of Canadian grain. If a buyer wants Canadian wheat or barley, the CWB argues that it must deal with the CWB. According to the CWB, this allows the CWB to keep the price higher. It further argues that the alternative, multiple sellers, will pressure the price lower.

Why the single desk vs multi-seller argument isn't convincing

According to the CWB, as multiple sellers compete for sales, they offer the price lower in high priced markets until they equate to the prices in the lower priced markets. The CWB refers to this as the Law of One Price. It argues that if there were multiple sellers of Canadian wheat and barley, the prices in "premium markets" would be eroded down to the same level as non-premium markets.

But the CWB competes in the global market which is a "multiple seller" market. So, according to the CWB's theory of the Law of One Price, the various markets within the global market should be all at one price. And yet, they are not. The CWB mentions premium markets in the 2008-09 CWB Annual Report:

> *The global market for wheat, durum and barley is highly competitive. For more than 70 years, the CWB has sustained and built Western Canada's market presence and strong reputation through branding and customer service. As a result, we have become the largest producer-controlled wheat and barley marketer in the world. However, all competitors are seeking ways to sustain and expand their share of the global market, particularly in premium markets*[2].

In a competitive market, the CWB has three choices; it can sell "at the market" (at a competitive price), below the market (at a lower price than the competition) or not at all. In a competitive global market, there is no evidence to indicate that buyers will pay more for Canadian wheat and barley over other sources unless there is a value proposition involved, regardless of whether there is a single desk or multiple sellers. In other words, there is no evidence to support the idea that simply because the CWB is the only seller of wheat and barley from Western Canada, it can get higher prices than its competitors.

Why have "premium markets" kept their premiums, even with multiple sellers competing?

There are many reasons why different buyers will pay different prices on the same day. In fact, the same buyer may pay two different prices on the same day from two different suppliers. Mostly it comes down to

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[2] 2008-09 CWB Annual Report, page 33.

buyers have different needs (quality, risk diversification, political or strategic needs) and sellers have different offerings (quality, consistency, timing, available freight).

Premium markets have shown that they are willing to pay for something extra, while more "price sensitive" markets are not. It's much like how some are willing to buy a Cadillac while others will only buy a Chevy. Car manufacturers deal in both markets by providing different products. The same can be said for grain companies, including the CWB.

Other factors that could generate premiums on the day of the sale

There should be no doubt that there are times when a higher priced offer is accepted over a lower priced offer. This happens in all markets, and not just on CWB grains. The potential reasons are manifold:

- **Quality**: Canadian grain often receives higher prices than other origins due to its quality. (However, there are also examples of other origins getting premiums over Canadian grain due to their consistency).

- **Quality assurance:** Provided by the Canadian Grain Commission, this is as true of all Canadian grains and oilseeds, not just CWB grains.

- **Quality applications**: The CWB will at times apply a higher quality of wheat on a cargo than what was originally sold. Some buyers will pay a small premium for the lower grade knowing there is a chance to get higher quality.

- **Specifications**: The CWB could sell low quality wheat that has a specification that is attractive to a buyer, like high protein. The CWB may compare this low quality wheat with other low quality wheat without considering individual specifications.

- **Terms**: Payment terms including credit availability. Moreover, CWB offers may include favourable financial terms which the CWB could offer given its government-rated interest rates.

- **Deferred sales**: The CWB has indicated that it can sell large quantities in deferred positions when the private trade cannot or will not. In theory, the CWB could demand a premium. However, in these situations, the CWB may not have any relevant sellers to compare to so they would need to compare its sale to competitors' sales in nearby positions and estimate what those sellers would sell for in the deferred positions.

- **Timing**: In volatile markets, offers that are even a couple of hours apart could have dramatically different prices or terms (which impact prices).

- **Market impact**: The CWB will often sell large amounts without hedging. In these situations, the market place will not react to a large amount of business occurring; a private trader in the same situation will hedge the transaction, therefore having a net impact on the price. Knowing this, buyers will be willing to pay a slightly higher price to be able to cover their needs without moving the market higher.

- **Large sale size**: Sellers like the CWB may be able to achieve a higher price than a single spot deal by selling a number of cargoes at one time, but in doing so they are taking some price risk and providing the customer with price security that has value and needs to be rewarded.

- **Small sale size**: Smaller amounts – less than full vessel amounts – called parcel lots will often demand a higher price. Often, buyers will prefer small shipments (even on large sales).

- **Grade breakdowns**: Often sales are made of numerous grades. At times, buyers will pay more for the higher grades because they are getting the lower grades at a lower price than other sources.

Concerns around the CWB comparisons

- When the CWB sells grain, it records what it believes to be the competition's price for similar grain and similar terms; often competitive prices are not available and the CWB estimates the competitive prices.

- Since these comparisons are on a transaction-by-transaction basis, this process does not assess the CWB's performance over a crop year; the true measure of performance on behalf of farmers is the net pool return achieved compared to the average market price over the crop year. A $10 premium is no real achievement if the CWB's pool return (weighted average sales) is well below the average for the crop year.

- Premiums over competitive prices are part of the calculation of sales staff bonuses. These calculations are based on information provided by the sales staff themselves and are not provided or vetted by an independent body. For comparative analysis and bonuses, competitive prices should come from an independent 3rd party.

The Malt Premium

In 2005, the CWB commissioned a study on the barley market, "The Canadian Wheat Board and Barley Marketing" by Dr. Andrew Schmitz, Dr. Troy G. Schmitz and Dr. Richard Gray (SSG). This study had two basic conclusions:

- "The annual average price increase earned by the CWB for 6-row malting barley relative to what a multiple-seller marketing structure would have had from 1995/96 to 2003/04 was $35.25/mt. This number was computed as the simple average of the difference in the weighted-average price of 6-row malting barley under the CWB versus what the equilibrium price of 6-row malting barley would have generated under the multiple-seller model."

- "The calculated annual average price difference between what the CWB received and what a multiple-seller structure would have received on sales of 2-row malting barley for the 1995/96 to 2003/04 crop years is $40.29/mt.

The study further indicates that these price "increases" are on malt barley only and that the study does not show any similar impact on feed barley[3].

Simply put, SSG is saying that, without the CWB single desk, the average malt premium (over feed) would drop $35.25/t on 6-row barley and $40.29/t on 2-row barley.

A review of domestic feed barley prices in Saskatchewan (basis Saskatoon) provides a comparison of CWB final pool returns for 2-row and 6-row malt barley to annual average domestic feed barley prices in what is typically the region with the lowest domestic prices.

For the period covered in the SSG analysis of CWB barley marketing performance, the annual average 2-row spread to domestic feed ranged from a high of $30.23/t <u>over</u> feed (in 96-97) to a low of $13.43/t <u>under</u> feed (in 01-02). The average covering the whole period was $5.71/t <u>over</u> feed.

SSG identified 02-03 as the year where the malt premium over feed was highest at $61.82/t. However, comparing the malt pool return that year to the domestic feed prices in Saskatchewan, the 2-row malt pool return was only $2.84/t <u>over</u> the annual average feed barley price.

SSG's assertion of an average 2-row malt premium of $40.29/t is unreasonable given these actual price comparisons. The SSG results demand an ancillary conclusion that, without the CWB single desk, the price of 2-row malt barley would, on average, be below the domestic feed barley price.

[3] Dr. Richard Gray confirmed this in a conversation with the author.

The average 6-row pool price ranged from a high of $1.71/mt over domestic feed (96-97) to a low of $33.12/t under domestic feed (01-02). The average covering the whole period was $8.65/t under feed.

This means that, on average, the CWB didn't get a premium for 6-row malt barley at all. Rather, on average, the price of 6-row malt barley was below feed price. Moreover, the CWB's 6-row price was below the average feed price in five out of the nine crop years assessed.

The Domestic Market

Canadian value added processors buy from the CWB as they have no meaningful alternative supplies of grain. The CWB can – and does – extract premium prices from these customers. This may sound great for farmers, but these premiums come at a high price.

Think like a processor for a minute. Why would you build in Canada when you have no alternative but to deal with one seller, who can change the rules whenever it wants? Most have determined that it's better to build in other locations so they can buy from a number of sources, including Canada if they need to. When that happens, the CWB is forced to compete and does not get premiums. These companies need to compete in the global market so they need a reliable supply at a globally competitive price – something they don't always get in Canada.

Look at the malting industry. There have been no investments in Canadian capacity for years. In fact, we may see a decrease in capacity as one plant could soon close. Not that many years ago, a number of firms considered Canada to either build or expand in. All three companies built new capacity in the US. The reason for all this: the CWB's single desk.

Now think like a farmer. Why should you care if a processor is available to you as a customer, just around the corner? Some think that the only reason a processor will build close to you is because he thinks he can buy grain from you cheaper. If that were the case, companies would be lining up to build in the Peace – and they're not.

When a processor locates in Western Canada, the local economy gains. They pay taxes, employ local people, add to the infrastructure and local creation of wealth. Farmers gain in other ways as well. They have options. They have a local buyer ready to compete with the other markets they serve. They have a buyer even when the local elevator is plugged, or can't get rail cars.

But none of this works if the processor can't make a go of it. And that means selling globally. Farmers and processors enjoy a good relationship when price and service are world class. Just ask farmers close to Yorkton, SK where two world class canola processors have been built, just how good it is having local competition for their canola.

Premiums for Quality or Value

You can't really talk about price discrimination – or differential pricing – without talking about why some buyers will pay premiums for some sources and not others.

Often it just comes down to consistency and quality.

A good example is the Japanese feed barley market where we've seen different prices paid for grain from different origins – the buyers are the ones doing the price discriminating. Over the years, Japan has paid a premium for Australian feed barley over Canadian or US feed barley. In Japan, it's referred to as the "Australian Premium". The reason for the premium is mostly quality.

Barley from Australia comes from different regions, mainly Western Australia, New South Wales and Victoria. Barley from each of these regions gets shipped out of regional ports, keeping the barley from these different regions separate which keeps the quality consistent and identifiable. Growing conditions can be quite different between these regions but within each region, the conditions are much more consistent. Japanese buyers don't just buy Australian barley, they buy New South Wales barley, or Victoria barley, or Western Australian barley and will know upfront that the quality they get is quite consistent – and often quite different between the regions.

On the other hand, barley from Canada is originated from many regions within Western Canada and is commingled in the process of moving it from various origination points to Vancouver. Therefore, the barley that Canada sends to Japan does not have as consistent a quality as Australia.

Another factor plays into the quality of the feed barley we send to Japan. Because the dominant market in Western Canada is the domestic feed market, the CWB must compete for barley for export. And as we all know, most often the PRO is below the domestic price which makes originating feed barley problematic most years. (The fact that the PRO doesn't respond effectively to changes in market values also makes it difficult to attract barley. The CWB will be the first to admit this.)

With no realistic competition from the CWB, domestic buyers will buy the best quality barley available to them first. Feed barley is bought on the basis of bushel weight – if 52 to 56 pound barley is available, it will be snapped up by buyers, leaving the 44 to 48 lb barley. This leaves the lesser barley looking for a home. Often farmers will have barley that technically grades a 1CW feed but is comparatively lightweight. This is the barley that gets sold to the CWB. And so this is the barley that gets sent to the quality conscious buyers of Japan. It's no wonder Australia gets a premium over Canadian barley.

A friend recently told me a story of when he had Japanese buyers visit his farm. When his guests saw a pail of barley that my friend had kept for samples, they asked what it was. They did not believe it was Canadian barley – it was nothing like they had ever seen in Japan from Canada.

We could match or exceed Australian quality in export markets. Over the years, the CWB has been approached various times to allow "selected" feed barley to be handled from the farm right through to the buyer. So far it has failed to capitalize on these opportunities to market high quality feed barley which would provide barley producers with another outlet for their barley.

When some director candidates talk about meaningful changes to the CWB, becoming more responsive to farmers needs, this is the kind of thing that they're talking about.

The CWB remains mostly impotent when it comes to feed barley. We need a CWB that is responsive to market opportunities that will benefit farmers. We need directors that will pursue these opportunities – not be threatened by new ideas just because it doesn't fit with the prime directive of keeping the single desk model. If the single desk is in the way, then perhaps the single desk needs to be moved into another room.

One more thing to think about: when the CWB says it discriminates on price, is it really? Or is the buyer just paying for Canadian quality?

Conclusions

There is no evidence that the CWB gets premium prices through the employment of the single desk. There is however, ample evidence that premiums are possible (and likely) due to a variety of other factors, many of which are evident in all grain markets- CWB and non-CWB.