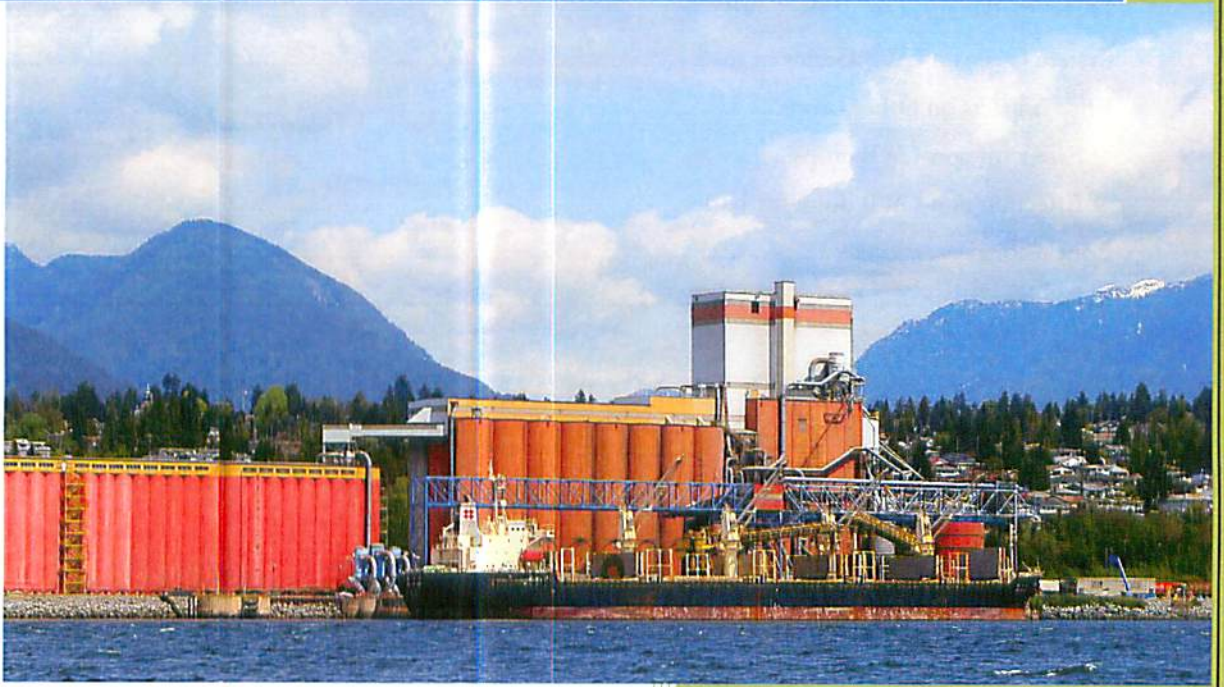


CWB Costs



GoA

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CWB Costs

Often we talk about the overhead costs of the CWB but in reality there is much more that needs to be included as “CWB costs” from a farmer’s perspective. CWB overhead is just one cost factor in the whole CWB system; other costs include direct marketing costs that are not included as overhead or “administration” and the impact of the CWB system on farm decisions such as storage or marketing of other crops. It must also include the impact on the value of other crops. This report is intended to provide an overview of these costs.

CWB Administration

The CWB is a large organization, employing 441 people (as of July 31, 2010). With its head office in Winnipeg, MB, it has offices in Vancouver, BC, Tokyo, Japan and Beijing, China. It gets involved in much more than marketing grain; it’s main non-marketing activity is as farmer advocate.

It’s most recent financial report shows the following:

Statement of administrative expenses				
For the year ended July 31 (dollar amounts in 000s)				
	2010		2009	
Human resources	\$	38,981	\$	39,635
Employee future benefit expense		4,553		3,681
Office services		3,363		3,471
Professional fees		6,483		5,853
Computer services		11,870		11,632
Facilities		1,778		1,989
Travel		1,717		1,819
Advertising and promotion		2,518		2,128
Other		1,648		1,410
Training		402		398
Recoveries		(2,771)		(3,099)
Total administrative expenses (Note 26)	\$	70,542	\$	68,917

From a farmer’s perspective, the per-tonne costs are probably more applicable: in 2010 the administration expenses were equal to \$3.45/tonne of grain handled; in 2009 they equaled \$3.04/tonne.

Direct marketing costs of the CWB

The federal Grain Monitor has the task of compiling all relevant grain handling and shipping data from the various participants in the Western Canadian grain industry and providing the information in meaningful and useful format. Although the Annual Reports of the CWB include all organization’s costs, it is not in a format that can easily be allocated to marketing alone. Therefore, the CWB provides to the federal Grain Monitor, specific data covering all of its marketing costs specific to the grains in question. The following tables show the average Western Canadian marketing costs for spring wheat and durum for the last few years:

Spring Wheat	02-03	03-04	04-05	05-06	06-07	07-08	08-09
CWB Costs (gross)	\$7.72	\$7.79	\$6.50	\$9.16	\$8.14	\$11.64	\$10.14
CWB Transportation Savings	\$2.70	\$3.14	\$1.49	\$1.32	\$1.79	\$1.76	\$1.70
CWB Costs (net)	\$5.02	\$4.65	\$5.01	\$7.84	\$6.35	\$9.88	\$8.44

Durum Wheat	02-03	03-04	04-05	05-06	06-07	07-08	08-09
CWB Costs (gross)	\$27.83	\$20.46	\$22.79	\$23.52	\$24.55	\$31.43	\$30.09
CWB Transportation Savings	\$2.70	\$3.14	\$1.49	\$1.32	\$1.79	\$1.76	\$1.70
CWB Costs (net)	\$25.13	\$17.32	\$21.30	\$22.20	\$22.76	\$29.67	\$28.39

The Grain Monitor describes “CWB Costs” as: “CWB Costs (gross) represent the per-tonne operating costs of each pool account at an in-store export port position, plus the apportioned value of its overall transportation savings.”

CWB Transportation Savings is described as: “The CWB Transportation Savings is an apportioned per-tonne amount representing the total financial returns to the pool accounts as a result of grain-company tendering, freight and terminal rebates, and any penalties for non-performance.”

CWB Costs (net) is simply the gross costs minus the transportation savings.

All these CWB costs are in addition to conventional elevation and handling costs.

System Costs on CWB Grains

System costs are the costs paid by farmers, either directly or through the CWB, for elevation and cleaning.

Grain companies handle both non-CWB grains such as canola, flax and peas, as well as CWB grains (wheat and durum). However, the way these companies charge for their services differs quite dramatically between the two systems – CWB and non-CWB.

Grain companies earn revenue on non-CWB grains through merchandising the grain – buying and selling – with a margin in between to cover all their costs. These system costs are a function of market conditions, competition and marketing decisions made by the company. In addition, some companies are active in the prairies with primary elevators but do not own or operate terminal facilities, reducing their ability to extract profits from the whole pipeline.

Grain companies handle CWB grains for a set fee, or tariff. Each company reports to the Canadian Grain Commission (CGC) its maximum tariffs for handling (elevation and cleaning) for primary, transfer and terminal elevators. As a rule, these companies charge the maximum posted tariffs for wheat; however, for canola the process is quite different. The posted primary elevator tariffs for elevation and cleaning canola are effectively meaningless in the process of determining the charges the companies charge. This is because the companies do not simply deduct these tariffs – rather, they merchandise their space through buying and selling at the market. For this reason, elevator margins at the primary elevators will vary due to market conditions.

Terminal elevations are somewhat different as terminal operators will charge other firms their posted tariff for handling canola.

A good analysis of total CWB system costs is to compare system costs; CWB elevation and handling costs to canola costs. All the relevant information to perform this comparison is found with the CGC and the Federal Grain Monitor. The table below summarizes the results since 2002-03.

	02-03	03-04	04-05	05-06	06-07	07-08	08-09
Spring wheat	\$18.97	\$19.52	\$20.63	\$20.61	\$20.78	\$21.28	\$21.51
Durum	\$19.04	\$19.08	\$20.01	\$20.36	\$20.53	\$20.58	\$21.21
Canola	\$17.24	\$11.90	\$9.72	\$10.28	\$11.41	\$17.78	\$11.06

This table shows the total system costs of spring wheat, durum, and canola. For CWB grains (spring wheat and durum), the figures include the annual averages of: primary elevation, cleaning, CGC weighing and inspection, trucking premiums (paid by the elevator company) and terminal elevation. It is also assumed that this figure includes all related marketing costs such as storage, interest, and demurrage paid by the CWB.

For canola, the data is collected differently since the companies do not charge tariffs. Since they earn a margin through merchandising – the system cost is the difference between the price they pay farmers at a primary elevator and the price they sell the canola, basis instore a terminal. The difference, minus the freight, is a good estimation of the costs farmers pay to have canola handled to export position. This difference will include all costs such as elevation, cleaning, storage, interest, demurrage, etc.

In addition, terminal elevations are considered since grain companies earn margins through the whole export process, including terminal handling.

Trucking premiums, increased payments to farmers to entice them to deliver are also factored in; these are reductions in the net system costs and are relevant to this analysis.

System costs of CWB grains have been increasing slightly over the review period and are in the \$20-22 range. Canola system costs are more variable and show no real trend up or down. More significantly is the fact that canola system costs are substantially below CWB costs, by as much as \$10.00/tonne (49%).

Price Impacts on Other Crops

Effect on non-CWB crops

The CWB process of limiting the amount of grain farmers can deliver at any given time has a negative impact on non-CWB crops. Because farmers need cash flow at harvest to pay bills, and because they are limited to the amount they can deliver and they only receive the Initial Payment, they are often forced to sell non-CWB crops for cash flow.

The CWB organizes deliveries into the grain handling system through a “contract call” system. Most farmers sign up 100% of their production for acceptance into the grain handling system, but the CWB decides how much you get to deliver and when.

A good example is the 09-10 crop year, where durum producers saw the following:

- The Initial Payment was roughly \$3.50/bu in Alberta and Saskatchewan
- The first Contract Call (Series A) was for 25% of contracted tonnage (this means farmers could deliver no more than 25% of the amount they contracted with the CWB, until another call is issued)
- The second call of Series A (Dec 17) was for 15% (for a total of 40% of the crop by this point)

Using a typical yield of 40 bu/acre, this means that up to the end of December durum farmers could only deliver 16 bu/acre and receive the equivalent of about \$56/acre. With cost of production around \$140/acre, the typical durum farmer was about \$84/acre short against his durum expenses. That's more than a \$13,000 deficit on a quarter section.

The next Contract Call (in Series B) was on April 20 for 20%. Since only 40% was taken in Series A, the balance is rolled into Series B and included in this call – the net effect is that this call is for 12% of the original contract. This allowed delivery of 4.8 bu/acre and netted about \$18/acre. Total payment at this point was about \$74/acre.

And that was it: the CWB accepted only 52% of the crop. This means the typical durum producer received a total of about \$74/acre for a crop that cost him \$140 to produce. Durum farmers were left with a deficit of about \$66/acre, or about \$10,500 per quarter of durum.

To make up this deficit, farmers are forced to sell other crops or sell into other markets. Many farmers are forced to sell other crops such as non-CWB crops like canola and peas in the fall when prices are cyclically low. The added selling pressure also tends to push the harvest value of these crops lower, so farmers end up having to sell more than otherwise simply to earn enough revenue to pay their bills.

In this example, some durum farmers sold their high quality durum that was not moving through the CWB, to the local feed market. It has been argued that although the prices they received were higher than the Initial Payment, the export market would have been paying more in the end. This creates a diversion of wealth away from Western Canadian farmers.

Effect on non-CWB domestic barley

The CWB's activities in export feed barley are quite small in relation to the domestic feed market. In recent years, whenever the CWB becomes active in feed barley exports, it has used various strategies to originate the grain. For example, in 2007-08, the CWB sold a large amount of feed barley and originated it all from grain companies (who bought the barley from farmers as non-CWB barley); farmers were unaware of the export program or the value of barley offshore. In 2010, the CWB began an export program using Guaranteed Price Contracts (outside of the pool) and then changed to Guaranteed Delivery Contracts with 100% Early Payment Option (inside the pool).

Experience has shown that the prices transmitted to farmers are typically much lower than the sale price. For example, in 2007-08, the CWB made about 50 per tonne on its export barley trade (this amount did not go to barley farmers; rather it went into the CWB's Contingency Fund).

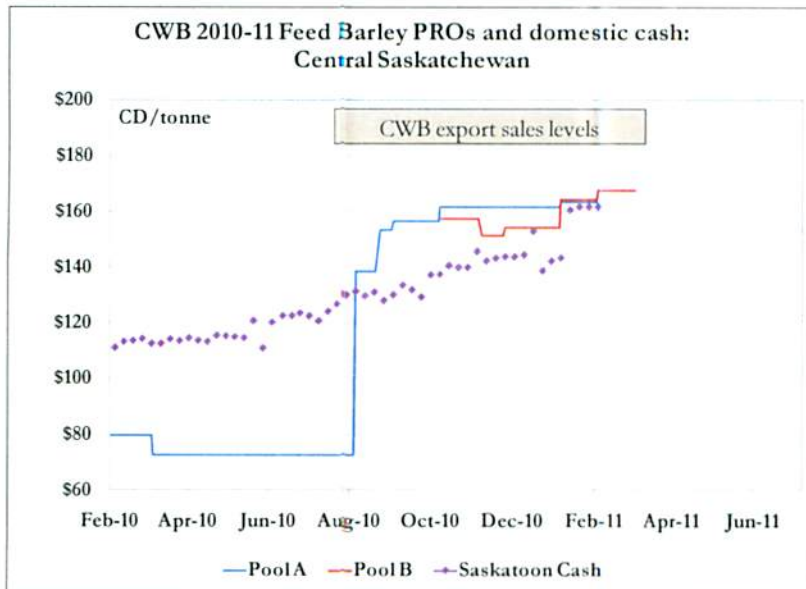
In August 2010, the CWB sold feed barley for the equivalent of \$263 per tonne; the price farmers saw was about \$208 per tonne, a \$55 per tonne difference. This is because of the way the CWB has chosen to manage the risk on these sales.

Because the higher sale price is not transmitted back to farmers in Western Canada, the local domestic market does not need to compete with those higher values; in an efficiently operating market, the higher export values would be transmitted back to the domestic market, pulling up the whole market in order to compete. This lack of arbitrage represents a cost to barley farmers that can be measured in the hundreds of millions.

The chart below shows the domestic prices in Saskatchewan, along with the CWB's feed barley pool prices (in Saskatchewan). It also shows the band of higher export values (converted to a Saskatchewan price) at which the CWB was selling.

In addition, the way the CWB operates in the export feed barley market may actually limit how much volume it does. The CWB first tenders to grain companies for supply (in the example above, at \$208 per tonne); only

when the barley is “in the showcase” does it sell the barley (here, at \$263 per tonne). In the time lag between originating the barley and offering it for sale, the market price can drop and that’s why the CWB goes to the farmer with a discounted price



The CWB may have missed sales because of this approach. By the time the tenders go out, the grain companies respond, and the CWB tries to sell, the buying interest may have been satisfied from other sources.

Conclusions

The discussion around the cost of the CWB often focuses only on the overhead of the CWB. However, this review demonstrates that the CWB and its marketing activities come at a much higher cost than the simple administration of the CWB. The true costs include CWB administration, other direct marketing costs, opportunity costs and market losses due to lack of arbitrage. The true cost of the CWB borne by farmers is in the hundreds of millions of dollars each year.

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