

Summary Report

Marketing Choice For Wheat and Barley Produced in Alberta

A Proposal for a Test Open Market

*A Summary¹ Prepared by
Alberta Agriculture, Food and Rural Development
and Alberta Grain Commission*

April 2004

¹ This paper is a summary of “Technical Report: Marketing Choice for Wheat and Barley Produced in Alberta: A Test Open Market Analysis”

Additional copies of this document are available from:

Alberta Grain Commission

305, 7000 - 113 Street

Edmonton AB T6H 5T6

Phone: 780-427-7329

Fax: 780-422-9690

©2004. All rights reserved by her Majesty the Queen in Right of Alberta

No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, or otherwise without permission in writing from Alberta Agriculture, Food and Rural Development.

Printed in Canada

Contents

| | |
|---|-----------|
| Summary | 1 |
| Introduction | 2 |
| Background | 2 |
| Current Situation..... | 2 |
| Issue | 3 |
| Industry Direction | 3 |
| Alberta Government’s Position | 4 |
| Proposed Test Open Market | 4 |
| Approach..... | 4 |
| Operation | 6 |
| Contracts as Basis for Transactions | 6 |
| Export Licensing..... | 7 |
| Monitoring and Audits..... | 7 |
| Related Service Areas | 8 |
| Other Aspects..... | 8 |
| Evaluation | 9 |
| Conclusions | 10 |

Summary

Currently, Western Canadian farmers must market their wheat and barley (that is destined for export and domestic human consumption) through the Canadian Wheat Board (CWB). Alberta farmers would prefer to have marketing choice so they can market their wheat and barley to any buyer, including the CWB. Moving forward on marketing choice is also supported by a variety of agricultural and business agencies across Canada.

The Alberta Government has passed legislation calling for a 10-year trial of an open market for Alberta wheat and barley. During the trial period, the test market would be evaluated to determine if it meets criteria for a healthy open market with the CWB as a voluntary agency.

The test market would likely require some regulatory and institutional changes, operational changes to various parts of the system, and some training and education. The details of the test market's operation could be developed through discussions with farmers, the CWB, grain companies and processors.

Under the proposed system, commercial contracts would be the basis for both CWB and open market transactions. Alberta farmers would be able to sell to any buyer. The CWB would compete as a buyer and a seller with private companies.. Processors would be able to buy grain directly from farmers, grain companies or other suppliers on the open market, or from the CWB. Various methods could be used to monitor and reduce "leakage" of out-of-province CWB grain onto the test open market.

The proposed system is not designed to be risk-free or to sharply increase farm gate prices. Its aim is to allow Alberta farmers and processors the opportunity to take full advantage of market potential to maximize their returns.

Monitoring and evaluation of the test market could be done by a third-party agency. This agency might also act as an arbitrator, hear complaints, and examine options for correcting any problems, so the test market's operation could be improved during the 10-year period.

There are no fundamental barriers to the successful operation of the 10-year test open market. The grain trade in Alberta already has the knowledge and expertise to move swiftly and easily into the test market. However, this proposal hinges on the CWB and the federal government cooperating, in developing and implementing the test market.

Introduction

This summary document outlines a proposal for a test open market for Alberta wheat and barley, with the Canadian Wheat Board (CWB) as a voluntary marketing agent. The proposed approach is intended to capture the benefits of an open market system while retaining some aspects and services of the CWB, for those who choose to use it.

This document briefly describes some key elements of the current system, outlines some of the recent calls for change to the system, and summarizes the Alberta Government's position on the issue. Then it outlines the proposed approach for the test open market, and describes how the proposed system might be implemented and evaluated.

Background

Current Situation

Under current federal legislation, the CWB is the sole marketing agency for wheat and barley grown in the Prairies and British Columbia's Peace River Region destined for export or domestic food consumption. The CWB is not involved in marketing of other grains, and it does not market wheat and barley grown in central and eastern Canada.

The CWB pools the revenues from its sales to ensure that all farmers delivering the same grade of wheat or barley receive the same return at the end of the crop year (minus elevator and terminal handling fees and transportation). However, pooling also means that no individual farmer can capture benefits from the timing and coordination of sales².

The international marketplace is rapidly changing, with increasing competition, changing demands from consumers and users of grain, and changing trade flows. The current marketing system for wheat and barley does not give Alberta farmers and processors the flexibility to respond to these changing conditions, for example by catering to the needs of alternative and niche markets.

The CWB is losing market share on world markets. Currently, Canada's share of the global wheat market is about 17 percent. This is not large enough to obtain premium prices based on market power alone. Where Canadian grain does command premium prices, these prices may result from a combination of factors such as service, reliability and quality.

The grain trade in Alberta already has the knowledge and expertise to function in an open market. Alberta farmers currently participate in open markets for canola, feed grain, oats, pulses and special crops. At one time, feed grains and oats were also under the CWB; there have been no substantive calls for returning those grains to the CWB.

² The CWB has introduced programs to provide farmers with alternatives to pooling. However these programs are designed to protect pooling over other alternatives and are programs within the mandatory single desk.

Many of the grain companies operating in Alberta have extensive international experience and direct exposure to customers for Canadian grain. Many of the major grain companies already handle all the functions of moving wheat and barley from the elevator system through to unloading the grain at a customer's location.

Issue

Plebiscites, surveys, producer organizations representing wheat and barley producers, and Alberta's Ag Summit consultation process have all demonstrated the strong support in Alberta for "marketing choice" for wheat and barley. Marketing choice is the ability of farmers to market their wheat and barley at any time, to any buyer, including the CWB, without impediment.

Alberta farmers want marketing choice because the viability of their farms depends on exploring every possible opportunity appropriate for their own unique situation. Marketing choice would also increase opportunities for growth and development of Alberta's agricultural processing sector.

Industry Direction

A number of industry groups and initiatives are contributing to the push for change to Alberta's current marketing system for wheat and barley:

- The Ag Summit process and the Ag Summit's Alberta Farmers Have Marketing Choice Action Team have called for marketing choice for Alberta farmers.
- The Grain Growers of Canada, representing over 80,000 farmers, presented a proposal for marketing choice to the directors of the CWB.
- The Ontario Wheat Producers Marketing Board is taking steps to ensure Ontario farmers have choice and flexibility to make their own business decisions.
- The agricultural members of the Canadian Federation of Independent Business, who primarily produce field crops, voted 85 percent in favor of a less restricted marketing system. Eighty-three percent recommended that the CWB operate under a dual marketing mandate (allowing farmers to choose whether or not they sell to the CWB).
- The Alberta Economic Development Authority has called for change to the CWB marketing system in order to improve the value-adding prospects in this province.
- A study by the George Morris Centre indicated that the cost to producers and to the grains-based value-added industry outweighs any benefits of the CWB's monopoly.
- The House of Commons Standing Committee on Agriculture and Agri-food acknowledged "a lack of uniformity" in the regulation of wheat and barley marketing across Canada. It said, "*When visiting Ontario and Quebec, the Committee observed that the grain producers of those two provinces enjoy increasing flexibility in the marketing of their wheat and barley. Although it must be acknowledged that the volumes produced by those provinces bear no relation to those in Western Canada, there is nevertheless a lack of uniformity, which does nothing to resolve the debate on the CWB's future role.*" The Standing Committee recommended (Recommendation Number 14) that the CWB Board of Directors authorize, on a trial basis, a free market for the sale of wheat and barley.

- The Canadian Chamber of Commerce passed a resolution recommending that the federal government implement the Standing Committee's recommendation for a trial open market.
- The Winnipeg Commodity Exchange supports the Standing Committee's recommendation and in particular supports a voluntary market for barley.
- Through the Agricultural Policy Framework, the federal government has acknowledged that the industry must be innovative and adaptive to meet the challenges of the global marketplace.

Alberta Government's Position

The Alberta Government responded to industry recommendations for marketing choice by passing the *Alberta Wheat and Barley Test Market Act* in December 2002. This Act calls for Alberta's Minister of Agriculture, Food and Rural Development to enter into an agreement with the federal minister(s) responsible for the CWB, the CWB itself, or both, to allow Alberta producers of wheat and barley to sell their product to any buyer, including the CWB. This test market would be in place for a minimum of 10 years.

In an open market, buyers and sellers are free to make all decisions involved in producing and marketing their product. The Alberta Government believes an open market would enable Alberta's agriculture and food industry to be more competitive and flexible on a global scale. An open market would facilitate product identification and traceability, provide better price signals, foster value chain relationships, and provide opportunities to discover greater efficiencies.

The debate over the effectiveness of Canada's grain marketing system has gone on for many years. The proposed test market could help provide the information needed to resolve this debate.

Proposed Test Open Market

Approach

The Alberta Government is proposing a test open market for Alberta wheat and barley, with the CWB as a voluntary marketing agent. This approach is intended to capture the benefits of an open market system while retaining some aspects and services of the CWB, for those who choose to use it. This proposal hinges on successful negotiations with the CWB and the federal government, and their cooperation in developing and implementing the test open market.

The test open market will likely require some regulatory and institutional changes, operational changes in various components of the system where the CWB is currently involved, and some training and education.

The details of how the test market would be set up, operate and be evaluated are open to discussion and input from agencies and individuals involved in the grain marketing

system. The Alberta Government envisions the following roles for the various participants in the test market system:

- **Farmers:** Most farmers, especially those who want to participate in the test open market, are already experienced in selling, pricing and delivering their products. Under the proposed approach, Alberta farmers would be able to sell to any buyer, which could include:
 - < the CWB
 - < grain companies
 - < processors in Canada
 - < U.S. buyers
 - < livestock feeders and feed mills in Canada and the U.S.
 - < farm cooperatives or companies
 - < direct offshore exports

Farmers would decide how much of their grain would be marketed to the CWB and how much they would market independently. Most farmers would likely choose to sell some amount into each channel.

Alberta wheat and barley currently account for about 25 percent of the CWB's total volume. Thus, under the proposed approach, the CWB would still have full control of at least 75 percent of all Western grain and likely more, depending on how much grain Alberta farmers choose to sell to the CWB.

- **CWB:** In the proposed test open market, the CWB would compete as a buyer and a seller with private companies. The CWB would retain control over all wheat and barley not sold in the open market, and it would be able to source grain from grain companies, as necessary, to fulfill its sales plan. Out-of-province wheat and barley would still be sold through the CWB system into Alberta. Various methods could be used to reduce "leakage" of out-of-province CWB grain onto the test open market.
- **Winnipeg Commodity Exchange:** The Winnipeg Commodity Exchange would need to play an important role in all aspects of the test open market, so farmers will be comfortable in taking responsibility for marketing their crop.
- **Grain Companies:** Many grain companies in Alberta already have the knowledge and experience needed to merchandise grain on domestic and international markets. They already operate in an open market for crops like canola, oats and feed grains.

Processors: Processors would be able to buy grain directly from farmers, grain companies or other suppliers on the open market, or from the CWB. Processors would continue to have access to out-of-province supplies through the CWB. Processors who buy supplies on the open market would undertake functions such as planning of deliveries, contracting with farmers and pricing in cooperation with the open market merchandisers (much as they do now with the CWB). The CWB would determine which services it might wish to provide to grain processors.

This proposed system is not designed to be risk-free or to sharply increase farm gate prices. Its aim is to allow Alberta farmers and processors the opportunity to take full advantage of market potential to maximize their returns.

Operation

Contracts as Basis for Transactions

Under the proposed system, commercial contracts would be the basis for both CWB and open market transactions. This approach builds on the CWB's current approach with farmers.

In recent years, the CWB has almost completely moved to a contracting system. Currently, farmers offer grain to the CWB through a delivery contract, and the CWB determines what portion of the offer it will accept. Occasionally the CWB closes access to the pool accounts by not accepting all the contracts. So the CWB is essentially limiting access to the pool account already (although proportionately among all farmers opting for the pool). Thus there is a precedent for the CWB to work with farmers on a contract basis and to control the amount of grain it accepts.

Farmer-to-Company Transactions (CWB or Open Market)

The CWB and open market buyers would determine their own transaction terms with farmers and would enforce their own contracts.

CWB Considerations

- The CWB would contract periodically from farmers, as it does today.
- The CWB would continue to contract for deliveries in other provinces. The CWB's enforcement of contracts in other provinces would help control "leakage" of out-of-province grain into the test open market.
- Contracts between Alberta farmers and the CWB could include an affidavit to be signed by farmers, declaring that the grain being delivered was produced in Alberta.
- The CWB would make its own decisions on such considerations as: whether to offer farmers the option of opting in and out of pooling; whether there should be deadlines for entering the pooling system and the timing of those deadlines; whether to close one pool and open another during the crop year; and whether to offer daily prices.

Farmer Considerations

- Farmers would contract to the CWB the amount of wheat or barley they plan to sell to the CWB on a regular basis (e.g. annually or quarterly, as decided by the CWB).
- The spirit of the contract with the CWB would be truly commercial in nature, committing the farmer to deliver the amount contracted.
- By default, farmers would be choosing the amount they plan to sell into the open market.
- When a farmer delivers his grain, he would declare whether it is a CWB delivery or an open market delivery (as is currently the case for CPS wheat).
- Contracting before harvest would involve some risk around the ability to deliver the specified quality and quantity. The farmers would determine whether they are prepared to enter into such a contract, depending on the terms of the contract.

- On the open market, farmers could sell only grain that is not contracted to the CWB. Clearly, farmers would have to be careful not to over-commit. However, they have experience with this risk through the open markets for other crops.

Grain Company Considerations

Grain companies would still record CWB transactions in permit books, and commitments to the CWB would be noted in the permit book. The system would need to ensure that contracted volumes are sold first (as is done with canola deliveries or cash advance repayments).

Processor Considerations

The contracting system would also apply to processors. Processors would be able to purchase directly from farmers, grain companies or the CWB. Farmers could also process their own grain.

Company-to-CWB Transactions

Companies would continue to handle grain for the CWB. Currently this is done under contractual arrangements with grain companies, through the signing of handling agreements or accredited exporter agreements. Those agreements would likely need some modification and negotiation. The CWB would continue to have the ability to buy directly from grain companies, as it deems necessary to fulfill its contracts.

Export Licensing

At present, the CWB is responsible for issuing export licenses for wheat and barley exported from any region of Canada. Under the proposed system, the CWB would give up control over export licenses, so it would not have the ability to use export licenses as leverage to interfere in open market sales.

All wheat, barley, wheat products and barley products would continue to need an export license before exporting. Any entity (a farmer, CWB, grain company, broker, processor) wanting to export would obtain export certification from a third-party agency such as the federal Department of Foreign Affairs and International Trade or Agriculture and Agri-Food Canada.

The third-party agency would track grain movements out of Canada through the export licenses. It would also collect information on those movements and make the aggregated data publicly available, perhaps in conjunction with Canadian Grain Commission statistics. Exporters would need to provide customer name, volume and value (similar to any other export) to the agency, but this private contractual information would not be available to other market participants.

Monitoring and Audits

All companies and the CWB would be required to maintain books for open market and CWB purchases and sales. An annual audit, by an independent third-party auditor, may be required to gather information for assessing the test market system, in particular to ensure that large leakages from other provinces are not occurring. The Canadian Grain

Commission could take on the role of controlling leakage, similar to its role in monitoring other contract terms such as grading.

Related Service Areas

- Sellers (farmers, grain companies, CWB or others) would be responsible for customer follow-up and satisfaction.
- Processors would purchase the most cost-effective package of grain and services that meets their specifications.
- The Canadian International Grains Institute could continue as a market development and customer education arm for all Canadian grain producers. Funding for these activities of the institute could perhaps be through a check-off.
- Currently, CWB-accredited exporters have a significant role in marketing CWB grains. These exporters would probably take up market development activities for open market wheat and barley.

Other Aspects

Cash Advances: At present, farmers who meet certain criteria can apply for cash advances at harvest. The cash advances are provided through a federal government program; in the case of wheat and barley, this program is administered by the CWB. A number of other producer organizations, such as the Canadian Canola Growers Association, administer the program for specific commodities through an agreement with the federal government. Under the proposed test market, the CWB would continue to administer these advances for deliveries to the CWB. Possibly some other body could administer these advances for open market wheat and barley.

Initial Payments: Currently, the federal government guarantees the CWB's initial payments to farmers. If returns to the pool exceed the sum of these total payments, then farmers receive a final payment, after the end of the crop year. If returns fall short, then the federal government makes up the difference to the CWB. It may be possible for guarantees to be available in the test market system, since the federal government provides guarantees for pooling systems for other Canadian commodities.

Transportation: To implement marketing choice, the CWB's legislated authority over transportation would have to be modified, relaxed or held in abeyance until the end of the trial period. The best alternative may be for the CWB to take possession of the grain "at spout" (vessel loading) instead of at origin in the country; this would allow grain companies control over their own facilities and logistics.

Freight Cost Deductions: No change would be needed in freight procedures or rates for open market grains. The only difference would be that the negotiating power of the grain companies with the railways would presumably increase because they would represent more tonnage.

Multi-Car Incentives: For open market grains, grain companies could use the anticipated revenues from multi-car incentives to bid higher prices to those farmers

providing the grain to load these large blocks of cars. In this way, farmers would share directly in the financial benefits of these incentives.

Terminal Commingling: Whether CWB and open market grain would be mixed or remain segregated at terminals would be a matter for negotiation with the CWB and the terminal operators.

For more details on how potential issues related to implementing the test open market could be addressed, refer to the technical report *Marketing Choice for Wheat and Barley Produced in Alberta: A Test Open Market Analysis*, available from the Alberta Grain Commission.

Evaluation

A key aspect of any experiment is to evaluate the results. The test market would be monitored on an ongoing basis to determine if it meets criteria for a healthy open market with the CWB as a voluntary agency.

Ideally, monitoring and evaluation could be done by a third-party agency. This agency might also act as an arbitrator, hear complaints, and examine options to correct any problems, so the test market's operation could be improved during the 10-year period.

The evaluation criteria could be developed in consultation with the groups involved in the grain marketing system, including farmers, the CWB, grain companies, processors and exporters. Some of the criteria that could be used are:

- Are farmers able to market their wheat and barley to whomever they want, at prices reflecting current supply and demand conditions, as well as capacity, need and value?
- Are farmers unconstrained, and able to add value to their crops by further processing or finding new markets?
- Are there multiple sellers and buyers in both cash and futures markets?
- Are public and transparent market prices, reflecting market volume and liquidity, available?
- Is there a healthy marketplace with such features as price variability, user-defined quality characteristics, alternative delivery periods, and changes in freight deductions?
- Do individuals accept both the risks and benefits of marketing decisions? Do farmers and agribusinesses have maximum flexibility to make their own business decisions?
- Have administered or artificial price policies ended?
- Are unrestricted delivery options (subject to contractual arrangements and market needs) available for open market grains?
- Have there been impacts on customers during the trial period? Have these impacts been positive or negative?
- Can Alberta wheat, barley and their products able to flow to any domestic or export markets without impediment?
- Does marketing through the CWB continue to be an option? Is the CWB still able to source supplies from other provinces and from Alberta farmers choosing to sell to it?

- Are out-of-province wheat and barley still sold through the CWB system in Alberta? Do Alberta grain processors continue to have access to grain from other provinces on reasonable commercial terms?
- Are consequences of pooling (i.e. equity and wealth redistribution) imposed on farmers using open markets?

Conclusions

The proposed approach for a test open market for Alberta wheat and barley is intended to capture the benefits of an open market system while retaining some aspects and services of the CWB. This proposal hinges on successful negotiations with the CWB and the federal government, and their cooperation in developing and implementing the test open market.

There are no fundamental barriers to the successful operation of the 10-year test open market. The grain trade in Alberta has the knowledge and expertise to move swiftly and easily into the proposed test open market. The details of exactly how to implement the test open market could be developed through discussions with farmers, the CWB, grain companies and processors.

The test open market could be evaluated and refined on an ongoing basis during the 10-year period. This proposal puts forward a solution to addressing the need to resolve the long-standing debate over the effectiveness of Canada's current grain marketing system.