

Department of Agricultural Economics

Project on Organic Agriculture



Number 13

March 2005

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Organic Grains and the Canadian Wheat Board

This document is partially based on the results of producer, marketer and processor surveys administered as part of the marketing study being conducted by the Project on Organic Agriculture in the Department of Agricultural Economics. The objective of the study is to examine the issues, opportunities and challenges in organic grain marketing and to provide insight to the organic grain industry on what can be done to improve the organic marketing system for the benefit of all participants. These papers are designed to provide industry participants with a brief summary of this information. This document is one of a series that will constitute the complete marketing study.

1. Introduction

The effect of the Canadian Wheat Board (CWB) on the organic wheat market in the prairie region of Canada is fiercely debated among members of the organic sector. Some organic producers and marketers believe that the CWB has a negative effect on organic wheat marketing, while others believe that the CWB does not substantially affect the organic wheat and barley markets. An analysis of the effects of the CWB may help to resolve this debate.

The objective of this paper is to discuss the effect of the CWB on the marketing of organic wheat in the prairie region of Canada. A background of the CWB's activities is provided in section two. A brief description of the effects of the Producer Direct Sale (PDS) on organic wheat marketing is given in section three. The opinions of organic producers, marketers and processors are presented in section four, and the discussion and implications conclude the paper in section five.

2. Background

The CWB is authorized by federal legislation to be the single marketer of wheat and barley in the "CWB designated area", which includes Manitoba, Saskatchewan, Alberta and part of northeastern British Columbia. The revenue of CWB sales for each type of wheat are pooled into accounts and then distributed among wheat producers. Although prices

are dependent on the quality and quantity of the grain, producers receive the same "pooled" price per tonne for each designated grade for their wheat regardless of the date that they deliver during the crop year. A crop year begins August 1st and ends July 31st. The CWB sells into conventional wheat and barley markets, and does not sell any grain as organic.

Price pooling only works when everyone sells through the pool. However, there is a large incentive to sell outside of the pool when the outside price is higher than the pool price. If some producers sell outside of the pool when the outside price is higher, then the pool price would erode and eventually everyone would leave the pool. This is the reason why government legislation requires all wheat and barley to be sold through the CWB.

Organic wheat and barley is not exempt from the CWB legislation, and must also be sold through the CWB. This is the case because it could potentially compete with the conventional grains that are marketed by the CWB. Although the CWB does not market organic grain, it is required that organic wheat and barley producers perform a transaction with the CWB so that CWB marketing efforts are not negatively affected. When delivering organic grain to a Canadian company that is established as a handling agent of the CWB, that company will handle all of the necessary transactions with the CWB. In sales to

companies that are not CWB handling agents, the producer must arrange to do a PDS with the CWB.

The PDS involves two steps. First, the organic wheat producer sells his or her wheat to the CWB and receives the initial payment, followed by interim and final payments later in the year. Second, at the same time as the producer receives the initial payment, the CWB sells the organic wheat back to the producer for the market price on that day in the country that the organic wheat is destined for. The net result of the PDS transaction is that farmers receive the pool return (the same as all other farmers), plus the organic premium and any other premiums they negotiate for their grain.

Consider the case of an organic producer wanting to sell outside the CWB to the U.S. If the CWB asking price for wheat in the U.S. is above the CWB pooled price on that day, the producer ends up making a net payment to the CWB for the difference. Alternatively, if the CWB asking price in the U.S. is below the CWB pooled price on that day, the CWB ends up paying the producer for the net difference. The organic producer then sells his or her organic wheat to the U.S. buyer. In the end, the organic farmer receives the price from the U.S. buyer, plus or minus the net return or net cost of the PDS.

For conventional wheat, the PDS eliminates the incentive for a producer to sell outside of the CWB when the cash price on a given day is above the CWB pooled price. In order for a marketer to make more money selling conventional wheat outside the CWB compared to selling through the CWB, they must “beat” the CWB’s asking price on that day in the country that the wheat is destined for.

3. Effects of the CWB on Organic Wheat Marketing

The impact of the CWB on organic wheat and barley can be summarized into five effects:

- 1) Market Power Spillover
- 2) Added Costs
- 3) Sales Timing
- 4) Price Risk
- 5) Choice

Each effect is described in more detail below.

Market Power Spillover

Several studies have shown that the CWB’s market power gives it the ability to price discriminate (sell at different prices in different markets) in the case of spring wheat (Furtan, Kraft and Tyrchniewicz 1999) and malting barley (Schmitz and Gray 2000). In the case of durum wheat, where the CWB controls over half the world export market, evidence suggests that the CWB can increase the world price by restricting output to the world market (Van Melle 2003). CWB price discrimination increases the price in markets such as the U.S. and Japan that are willing to pay a premium for Canadian wheat, while output restriction increases prices in all countries. Since organic spring wheat, durum wheat and malting barley is predominately sold into these same high-value markets, and assuming conventional grain prices have a positive effect on organic grain prices, CWB market power may have a positive effect on the price of organic spring wheat, durum wheat and malting barley. However, it is difficult to test for the significance of CWB pricing strategies on organic prices in different countries because the relationship between conventional and organic grain prices is not well understood and data are limited.

Added Costs

There is a cost of \$1.50 per tonne that producers pay in order to complete a PDS. This transaction cost increases to \$2.00 per tonne if the producer elects to defer payment to the CWB.

Complications/Sales Timing

Performing the PDS creates extra complications for deciding when to sell organic wheat. Without the PDS, an organic producer would try to sell at the highest price. If the PDS is required, an organic producer must also consider the affect of the PDS on the resulting return from selling on a given day. The producer's goal then becomes maximizing the organic price, net of the PDS net cost or net return. In other words, the producer will want to maximize the difference between the organic price and the CWB asking price on a given day.

The problem of choosing when to sell and perform the PDS is similar to the problem of choosing the right time to sell grain that is hedged on the futures market with a fluctuating basis. In the case of the futures market, the change in basis over the time of the hedge will affect the return to the marketer. However, in the case of organic wheat, producers must also consider the changes in the organic premium over time as well.

The timing considerations of sales requiring a PDS are only important if the organic wheat price does not go up and down with the CWB asking price. If the CWB asking price and the organic price are perfectly correlated, then the producer will simply try to sell when the organic price is highest. However, if the CWB asking price always moves earlier than the organic price, there will be more incentive to sell organic wheat when the CWB asking price is falling and less incentive to sell when the CWB asking price is rising.

In addition to not being sure if organic and conventional wheat prices are correlated, there is also the issue that the CWB asking price for conventional wheat may not represent the market price for wheat in foreign markets. This can further complicate the process of determining the appropriate time to sell organic wheat. Specifically, the CWB might be pricing

above the market price in some countries, while pricing below the market price in other countries.

It is not possible at this time to measure the relationship between organic and conventional (CWB) wheat prices. Weekly organic wheat price data are not published, and the CWB does not share its historical asking prices. This makes it difficult to detect if the PDS would have an effect on the timing of sales.

Price Risk

The effect of the PDS on the variability of organic wheat prices must also be considered. The PDS eliminates day-to-day price variability for sellers of conventional wheat within a given crop year. It is not known if the PDS also eliminates day-to-day price variability for sellers of organic wheat. On the one hand, the PDS may increase price variability for organic wheat marketers within a given crop year if the prices of organic wheat and conventional wheat are not correlated. On the other hand, organic and conventional wheat prices may be sufficiently correlated so that the PDS decreases the day-to-day price variability of organic wheat.

A decrease in price variability is good for producers. It is important to note, however, that grain companies that buy organic wheat from producers may already absorb some of the price variability in the organic market. There is not enough data on organic and CWB wheat prices to measure the effect of the PDS on price variability that organic wheat producers experience.

Choice

The ability to market with or without the CWB is a concern for many organic producers and marketers. The effect of the CWB on marketing choice is a matter of opinion. On the one hand, many people want the freedom to market their organic wheat and barley without any intervention by the CWB. On the other hand, some people want the choice to use the CWB

to market their organic wheat and barley so that they have the benefit of marketing as a group and do not have to use their own time to market.

4. Opinions on the CWB

The organic producer survey asked producers to state whether or not they wanted the CWB to become more involved in organic wheat marketing. In the sample of 58 organic producers, 26 percent of organic producers answered "yes", while 74 percent answered "no".

The survey also asked producers to explain their answer. Some producers favored CWB involvement in organic wheat because they liked the idea of collective marketing and didn't like to market on their own. Many farmers did not want CWB involvement because they wanted less government intervention and more freedom to market. Several producers were also concerned that the CWB could not market organic wheat very efficiently or effectively because the transportation and customers were so different from conventional wheat. In addition, many organic wheat marketers are not pleased with the CWB's presence in the organic wheat and barley supply chain.

5. Discussion and Implications

It is clear that the CWB has several potential effects on the marketing of organic wheat. The \$1.50/tonne cost of the PDS is the most definitive effect of the CWB, while the effect of sales timing, price risk and market power is less clear. The CWB contends that the PDS has a "profit neutral" effect on the organic market, but it is difficult to test this statement. The profit neutrality of the PDS depends on the assumption that organic and conventional wheat prices move up and down together. Since organic and conventional wheat are similar products, one would expect the organic prices and the CWB asking prices to be related. However, the degree of this relationship is not well understood. In addition, it is difficult to test if CWB market power has a spillover effect on organic prices. There is not enough data on

organic prices and CWB asking prices to test whether the PDS has a significant effect on the average price that organic producers receive. The lack of data also makes it difficult to test whether price risk is higher or lower when using the PDS. Overall, the lack of understanding of the relationship between organic and conventional grain prices is a limitation that merits further investigation.

The results of the producer survey suggest that most producers do not want the CWB to become more involved in marketing organic grains. This result is mirrored by comments made by marketers and processors.

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Note: The authors would like to acknowledge the financial support of Saskatchewan Agriculture Food and Rural Revitalization (SAFRR) for this project.

The authors would also like to thank everyone who filled out questionnaires or agreed to be interviewed. Their participation is very much appreciated.

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