Discussion

SPARKS COMPANIES INC.

Ron Gibson

The focus of my comments is primarily on the U.S. paper, but I will have some comments on the Canadian paper as well. At Sparks Companies, Inc., we project acreage and production. Our direction of expectations in terms of acreage fits very well with both papers. Looking at acreage in terms of world trends, we see a continuing dietary trend toward increased wheat, protein and vegetable oil consumption.

Our Canadian and U.S. acreage allocation projections indicate increased acreage of coarse grain production—corn in the United States and barley in Canada. Sparks also projects increased acreage of oilseeds—particularly, soybeans in the United States and canola in Canada.

Ten years of subsidy wars have distorted the quantity of wheat consumed in the world. Wheat priced at $90 per tonne results in buyers like the former Soviet Union and China consuming more than when prices are at $150 or $200. As a result, wheat coarse grains and oilseed complexes could lag over the next 10 or 15 years.

I was really interested in the impact of less government on the amount of price volatility. There is a school of thought that with less government involvement in managing prices, less volatility results. The argument against that point of view is that the market does a better job of managing stocks that the government does. I do not usually agree with that. In past years, the government was holding 8 billion bushels of wheat, oilseeds and feed grains. It is hard to imagine that we are going to have less price volatility with the stock levels which we have now. Presently, the market is not willing to pay for large stock levels.

A relatively small percentage increase in trade between Canada, the United States and Mexico is attributable to the North American Free Trade Agreement (NAFTA). One of the major events which caused the increased wheat trade was the Export Enhancement Program (EEP). It sucked Canadian grain into the United States.[1] There has been a legacy to that. Many U.S. millers got used to using a particular kind of Canadian wheat. They liked it and continued to use it even though the EEP, at least for the time being, has disappeared. Also, with the Canada-United States Trade Agreement (CUSTA), the Canadian Wheat Board believed that there was more political palatability to selling wheat to the United States.

[1]This was all happening when I worked for the Canadian Wheat Board.

On another point, the Anderson paper mentioned that there have been increased exports of oats and barley into the United States. That has occurred because of a shift in the United States away from oats and barley and into corn and soybeans. Those have been the two major growth areas for exports into the United States. These exports simply represent a filling of a void caused by the attractive returns in the United States on corn and soybeans.

Comments were made that CUSTA and NAFTA had created a more favorable investment environment for U.S. companies into the Canadian grain sector. I think that is probably true, but it has had very little impact on the decisions by ConAgra and ADM to come into Canada. The big reason is a global and definitely North American trend toward companies trying to get more integrated with their complete downstream operations. Companies like ConAgra, ADM and others are more interested in handling grain as a function of their downstream processing. They are not handling grain just for the sake of handling grain. While this explains why ConAgra and ADM came into Canada, it does not explain why Dreyfus came in—for which I am still perplexed. Dreyfus does not have domestic processing in either Canada or the United States. Perhaps this is a "follow the leader" phenomenon—everybody is investing in Western Canada so maybe we should as well.

The regulatory phenomena which has attracted U.S. companies to Canada is the rail incentive rates. For those of you who are unfamiliar with incentive rates, which started in the late-1980s, they are just lower rates if you can load more cars. That has a surprising impact. With incentive rates, a big company like ConAgra would have an advantage over a smaller company. That fits extremely well with their style of doing business in the United States. Incentive rates have attracted U.S. companies into Canada. Also, with the general impression that Canada is deregulating, there is an opportunity to enter.

I would like to address the notion of the impact of removing the Canadian Wheat Board and its impact on the flow of grain into the United States. I was happy to see recognition that pressure periodically develops for Canadian farmers to want to sell into the United States as a result of the difference between the spot versus pool price. In Canada, the farmers are looking at the pool returns for milling and durum wheat. In the United States, they are looking at spot market prices which go all over. It is when those prices get out of line that we see considerable pressure develop to sell in the United States. That situation is so often overlooked when trying to explain trade flows. It is appropriate that this point be made.

I was really intrigued with the argument that with the new volatility that we expected and have seen in the last couple of years, combined with reduced government involvement (less stock holding and subsidies), there is a fear of a backlash against free trade policies. I think that there are three flaws in that logic:

- As an economist, I do not think government has really demonstrated its ability to execute safety net programs very effectively.

- Even if we have decoupled programs, for which we assume the existence of safety nets, there are still trade-distorting impacts. For example, Europe, with its massive decoupled payments for cereal grain production have had production stimulating effects. We have seen major increases in European cereal production since the WTO.
- Agricultural production is not as large a percentage of the overall economy as it used to be. The traditional economic logic for safety nets does not exist anymore. As long as farmers believe we are going to bail them out, they will not use risk management tools and will not plan for their future capital needs.

I have a few quick comments on the Canadian paper. One of the major trade shifts which was mentioned was the loss of China as a huge wheat market for Canada. Sparks did a study that projected out ten years and we do not think that the loss of China is a short-term phenomenon. China has a national priority to be self-sufficient in wheat. We project that they will only be importing high-quality wheat, maybe 2 to 4 million tons per year, with the exception of the occasional drought.

The Canadian paper did not extensively cover what I believe to be the most impressive structural change in Western Canada—the rationalization of our elevator system. In Western Canada, there is a massive building program of new grain elevators. In addition to the elevators which have already been built, there are 60 new elevators which have yet to be constructed. These are all $10 to $20 million investments which represents about 25 percent more capacity than exists now. In terms of through-put, it is much more.

Right now, there are over 1,100 elevators in Western Canada. At Sparks, we project that there will soon be less than 500. I do not think that this is a direct result of CUSTA but, rather, it is a result of other factors such as incentive rates, Canada Transportation Act, low cost of money and the domino effect of investing.