

The Role of the State in Agricultural Trade in North America: Issues for Domestic Policy, WTO and NAFTA

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Introduction.

The role of the state in the trading of agricultural goods is rapidly changing in North America, as in many parts of the world. In place of the presumption that state involvement was necessary to provide profitable outlets for farm goods and an equitable distribution of the revenue generated, the counter proposition has emerged that the state has a more limited function, largely to set up the structure within which private firms can operate. This shift of fundamental political philosophy makes it appropriate to reconsider the place of government in agricultural marketing, and in particular the functions of the parastatal marketing organizations that now exist in North American agriculture.

There are three major interdependent manifestations of the changing role of the state in this area. *First*, the adoption of more liberal domestic economic policies has led to the privatization of many former state trading enterprises, thus reducing the scope for the state engaging in agricultural trade. The most dramatic change in this regard has been in Mexico, where the state has withdrawn largely from its role as the sole marketer of many of the most important agricultural goods. In the US, with less overt involvement by the state in agricultural marketing, the shift has been more subtle. The changes have come about mainly through the modification of the tasks which the existing agencies are obliged to perform. The reduced role of the Commodity Credit Corporation in storing grain is a clear example of this

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functional adaptation. In Canada, the process appears on the surface to have proceeded less far, as the major institutions are still intact, both at the Provincial and the Federal level. However some significant shifts are visible in the relation between these parastatals and the private sector, and in their role in marketing.

The second influence on the role of the state in trading agricultural products has been the growing integration of the region assisted by the liberalization, under the North American Free Trade Agreement (NAFTA), of the North American market. The removal of the ability of parastatals to control trade flows within NAFTA limits their role in marketing. Moreover the conditions of competition within NAFTA becomes a larger issue with increasing integration. This has brought to the fore the activities of the Provincial Marketing Boards in Canada which still regulate milk and poultry product trade, and the Canadian Wheat Board (CWB) which has perceived problems of compatibility with the marketing systems used in other parts of the North American market.

The Canada-US Trade Agreement, and later the NAFTA agreement, allowed relatively free access to the US grain markets for Canadian products. Canadian cereals have found a market in the US in increasing quantities, to the consternation of US grain farmers. As all the grain from the Canadian Prairies is handled by the Canadian Wheat Board, a monopoly seller, the issue of the “fairness” of the competition has been raised. US producers have complained that the CWB subsidizes grain through its pricing policies, as well as providing stiff competition in overseas markets. Canadian farmers have also been made aware of the higher prices on US markets and have sought to market their grain directly to their southern neighbor. The Wheat Board denies any element of subsidy and claims that its market discrimination policies are merely “pricing to market” to the benefit of the Canadian producer. This *contretemps* led to the establishment of a bi-national committee which at least kept talking long enough for higher world prices to remove the element of crisis.¹

¹ The report of the Committee is to be found in Canada-US Joint Commission (1995).

The third influence on state trading is the reform of the multilateral trade rules. The Agreement on Agriculture of the Uruguay Round, in the process of removing non-tariff barriers, has highlighted the problem of state trading as a possible means of protecting domestic markets and avoiding the negotiated improvement in market access. Similarly there is concern that state export agencies can avoid the constraints on export subsidies.

Moreover, many are asking whether there needs to be some sort of agreement at the multilateral level to maintain or enhance competition in national and international markets. This immediately raises the issue of whether agricultural markets should be obliged to become more contestable or whether state (and private) monopolies will be allowed to persist. Accordingly the WTO is more closely monitoring the activities of state trading enterprises and could soon begin negotiations to limit further their scope.

For each of these three reasons the time is right to explore these changes, re-examine the arguments for and against the involvement of the state in trading agricultural products, and analyze the impact of selected institutions on the performance of agricultural markets. In addition, it is an appropriate moment to look at changes in the operation of these enterprises that would be both beneficial domestically and be consistent with deeper regional integration and emerging multilateral trade rules.

The North American Forum Project on State Trading

The North American Forum research project on State Trading in North American Agriculture was carried out as a collaborative enterprise among economists from Mexico, Canada and the United States. Six individuals formed the core of a “State Trading Study

Group” which coordinated the work, each taking responsibility for particular parts of the study, as detailed below.²

The Study Group first met in March 1997 to discuss the issues and procedures. The focus of the project was to be a series of papers drafted by the participants that dealt with specific state trading institutions found in North America. These case studies included a detailed look at the activities of the institutions chosen; an assessment of the main impacts of these activities on trade patterns and on farmers, consumers and taxpayers; a discussion of the implications for efficiency and competitiveness; and speculation about the ways in which the institutions might evolve in the light of national, regional and international pressures.

The identification of the case studies involved a discussion of the differences among commodities in the three North American countries and the issues that were of most significance for policy. This led to the following nine “cases” being identified as particularly worthy of consideration. The table below shows the cases.

Research Issues

Three main questions are addressed in the papers comprising the study. The first is *the compatibility of state involvement in the marketing of agricultural products with developing a competitive agriculture and an efficient marketing system*. This issue is particularly relevant with respect to the changes in the role of CONASUPO in marketing basic agricultural goods in Mexico. This parastatal no longer holds the monopoly position on the domestic and import market, with the partial exception of the import of milk powder. Has the performance of the Mexican market been fundamentally improved by introducing private

² The individuals constituting the core of the Workshop were Rich Barichello, University of British Columbia, Canada; Dan Sumner, University of California, Davis; Antonio Yunez, El Colegio de Mexico; Colin Carter, University of California, Davis; Al Loyns, University of Manitoba, Canada; Luis Arturo Garcia, Mexico City; and Tim Josling, Stanford University. The overall direction of the project resided at Stanford University under the responsibility of Professor Josling.

<u>Table 1: Institutions by Commodity Group and Country</u>			
	<u>Milk and Dairy Products</u>	<u>Grains and Oilseeds</u>	<u>Other Products</u>
<u>US</u>	Federal and California Milk Marketing Orders	Commodity Credit Corporation	Federal and California Fruit and Vegetable Marketing Orders
<u>Mexico</u>	CONASUPO/LICONSA (dried milk imports)	CONASUPO (grains and oils)	
<u>Canada</u>	Provincial Marketing Orders	Canadian Wheat Board and Ontario Wheat Board	Provincial Marketing Boards for Fruits and Vegetables and Provincial Poultry Marketing Boards

trading in basic foodstuffs? Does the removal of state trading have an impact on market stability? What is the new role of CONASUPO in the context of the Mexican agricultural and trade liberalization program? How does the Mexican experience of privatization relate to other countries that have reduced the role of the state in grain marketing (e.g., other Latin American countries and Portugal)?

The Provincial Marketing Boards in Canada pose similar problems with respect to their efficiency and their contribution to the development of a competitive agricultural sector in

North America. Have these boards been effective market regulators for their members? Can their functions be made compatible with more competitive markets? Should they still be able to fragment the market for farm products by controlling inter-provincial movements?

Similar questions arise with respect to the Canadian grain system. There is currently controversy about the economic performance of the CWB as a monopoly buyer of Western grains. Has the CWB benefited Canadian producers? Is the domestic monopsony position of the CWB a problem for grain market efficiency? Could the CWB become a competitive marketing institution with no exclusive market privileges? Do the recent changes in the Australian Wheat Board have implications for changes in the CWB? Will the recently announced changes in the governance of the CWB make such a transition easier?

The US in general has less state intervention in trading, but the dairy sector is dominated by a series of Federal and State marketing orders for milk which act in ways similar to the decisions of a parastatal body. Are these marketing orders interfering with the efficient development of a competitive dairy sector? Or is the advantage of market organization and segmentation great enough to outweigh the costs of regulation and control? The US fruit and vegetable trade is also regulated by Federal and State Marketing Orders. Do these have an economic justification? How do they differ in operation? The US has a state trading agency for grain and other commodities, the Commodity Credit Corporation, which operates in both the domestic and foreign market. To what extent is this agency distorting the performance of the market for grains in North America?

The second question is *the compatibility of different marketing systems with the provisions of NAFTA, and with the realities of market integration following from regional trade liberalization*. This has already emerged as a political issue with respect to the consistency of different grain marketing policies in North America. Should the grain trading systems within the three countries be “harmonized” in order to resolve conflicts? How can the dispute between the US and Canada over the CWB operations be resolved? Could the CWB retain an export monopoly and relinquish control over internal (or within NAFTA) sales?

The US agencies also pose potential problems for competition within North America. Do, for instance, the sales to Mexico from CCC stocks of agricultural products constitute a “state trading” problem for NAFTA? Does the existence of state-sponsored Cooperatives in the marketing of various products in the US constitute a problem for the integration of the North American market? Could the Fruit and Vegetable Marketing Orders expand their operations to include Mexican producers as well? Do they still, as once feared in Mexico, enable US producers to avoid direct competition in these markets?

The issue of compatibility with NAFTA also arises in the case of the Provincial Marketing Boards for dairy and poultry products in Canada. Can the Canadian provincial boards survive both internal liberalization and domestic policy reform and the challenge of NAFTA from outside? Does domestic market control necessarily imply border controls, or can supply management coexist with tariff-only protection?

The third research question is the *compatibility of state trading entities in North America with the current GATT/WTO rules and the likely development of those rules in future trade negotiations*. The treatment of STEs in the WTO was modified somewhat in the Uruguay Round, with tighter monitoring and reporting requirements. The major challenges are still ahead, as countries get ready to define the agenda for the next phase of negotiations. What are the likely suggestions for improving the consistency of the international treatment of STEs? This will also require some way of monitoring the trade impacts of STEs. Can one estimate the international trade impact of exclusive domestic collection systems and of single-desk sellers? How might these new rules impact on North American parastatals, such as the CWB and the CCC? Will there be any attempt to curb the use of market power in international transactions? If so, how might this affect the marketing institutions in North America?

A Typology of STEs

One problem that is immediately apparent when exploring the issue of state trading is the fact that the institutions involved differ so much from each other. Generalizations are likely to be wide of the mark. Case-by-case consideration of STEs would be unwieldy and impracticable. Some sort of typology is therefore necessary to be able to compare these institutions to each other. This typology needs to be based on meaningful characteristics or dimensions. The General Accounting Office (GAO) discusses the three “relationships” that STEs have, with the producers, with foreign buyers and with the host government (GAO, 1997). The first relationship is defined by whether the STE purchases all domestic supply (for domestic and/or foreign markets. The second relationship is whether the STE is the sole seller of the good in question to foreign buyers. The third relationship, between the STE and the government, revolves around whether subsidies are paid when the STE makes a loss. Though useful in emphasizing the key relationships, the GAO scheme does not take this to the level of taxonomy. The relationships have to be further defined to be useful as classification criteria.

Ackerman (1997) has suggested a number of the dimensions which help to pigeon-hole the STEs, including ownership, product range, market regime and policy objectives. Of these the dimension most closely tied to performance is that of market regime. This element can be thought of as the extent of market power exerted by the STE. The extent of market controls actually exhibited by the STEs depends on a number of factors, such as the monopoly rights granted to them, their domestic and international market shares, their missions and objectives, special legal privileges, and degree of managerial independence. But the potential for such market power is ultimately based in their control over the domestic and trade markets.

Dixit and Josling (1997) point out that such potential market power, and hence the possibility of influencing trade patterns, depends on the *combination* of domestic and trade market control.³ This would suggest four relevant cases that are likely to have different

³ The term “control” is used to imply direct influence over the quantities that flow through a market. All market actors are likely to influence market flows, but that does not constitute control. The terms monopoly

characteristics. STEs that have neither domestic nor trade monopolies are clearly distinct from those that have both. In the absence of any monopoly power, the main role of the STE will tend to be market promotion and quality control. Those that have monopoly power in both domestic and trade decisions will be able to use one to reinforce the other. But those that enjoy a trade monopoly may not always control the domestic market. This clearly limits their ability to differentiate prices and cross-subsidize. And those STEs that control the domestic market but not the trade decisions will tend to be weakened by liberalization of trade. Table 2 summarizes this fourfold typology of STEs.

Table 2: Typology of State Trading Enterprises

	Quantitative Trade Controls?	Domestic Market Controls?	Potential for Trade Distortion	Characterization
Type I	None	None	Negligible	Market Promotion Board
Type II	None	Yes	Low	Domestic Control Board
Type III	Yes	None	Moderate to High	Trade Control Board
Type IV	Yes	Yes	High	Total Control Board

Source: Adapted from Dixit and Josling (1997).

The first STE category (Type I) might be called a Market Promotion Board. This type of STEs does not control either the domestic market or the export or import market. Usually, its major objectives are to promote the sale of particular commodities in the export markets

and monopsony are used to describe this market control attribute. If an actor in the market has a monopoly in,

and to control the qualities of the commodities. Therefore its distorting effects in the international market tend to be smaller than other three types. Only by using quality control instruments aggressively or in a discriminatory fashion could such a board have a significant effect on trade patterns.

The second type of state trading board could be called a Domestic Control Board, having market power not in the international market but in the domestic market. Such boards often had a key role, when set up, in preventing over-supply on the domestic market, or in ensuring equitable distribution of scarce supplies. This category could also include sub-national parastatals, which have market controls only in the state where they exist. In this case, however, the dominance of that region in the production of the country as a whole and the conditions of trade among regions become important in determining the likely trade impact of the STE.

The third type of STE can be called the International Trade Control Board. These boards control the export and/or import market but not the domestic market. Importantly, they can use the market power over trade to achieve an internal (price) objective. They can have an indirect influence on the domestic market by monopolizing exports and/or imports of the commodities they handle. Export monopolists can limit exports to keep down domestic prices, but such activity is rarely challenged in international trade relations. Their competitive activities with respect to other sellers does however raise trade conflicts. On the other hand they cannot use domestic market control to influence external trade.

The last type of STEs is one that controls both domestic and international markets. This category could be labeled a Total Market Control Board. The potential trade-distorting effects of the STEs falling in this category are usually larger than other three types, depending upon how they use the market power in both the trade and the domestic market.

say, the import market, that actor is deemed to have control over the level of imports (and *vice versa*).

The Interface between Domestic and Trade Market Power

The typology as described above has two potential uses. The first is to provide some categories that allow analysts to compare and contrast individual STEs. Clearly the label STE covers a wide number of institutions. The dimension of market power is not a bad first step towards grouping like with like and assisting in a discussion of their characteristics and problems. Consider the first group, the Market Promotion Boards, with no exclusive or monopoly rights in the markets in which they operate. The influence that these STEs have on the market is circumscribed by their inability to control imports. When governments could use non-tariff barriers, such as import licenses, to control the volume of trade, the role of such boards was less constrained. Even if they did not themselves regulate trade, they operated in a system where the size of the market was subject to control. It is these boards that have generally been affected the most by privatization, economic liberalization and by tariffification. In turn they cause little if any controversy in international trade.

At the other extreme are the Total Control Boards, the STEs that maintain both domestic and trade monopoly powers. The ability of these Boards to influence trade is not in doubt: that is why they were set up. In many respects these institutions are anomalous in a modern economy, relics of a by-gone era, and are also being changed by current notions of increased competition and privatization. But there are two situations where these dinosaurs may persist. The first is in the markets for those products where the public would rather the state retain control of the trading decisions, so as to protect moral or physical health. Liquor monopolies presumably fall under this category: they seem to have survived “liberalization” by adapting to be more “commercial”. The other situation is where the control of the market for a particular good is an integral part of economic management of the country. This applies presumably to energy supplies in some countries. It may apply to basic foodstuffs in some instances, though these STEs are vulnerable to changes in the economic paradigm.

The typology also throws up two interesting questions about the “mixed” monopolies defined above. A chartered monopoly in the domestic market (Domestic Control Board) is clearly vulnerable to the decontrol of trade. Not that the monopoly cannot survive: one can

still be the only buyer (or seller) on a market even with free trade. The problem comes that the ability to extract rents from the other side of the market is limited. The monopolist cannot get a scarcity premium when any consumer can buy on the world market. Similarly a monopsonist has to compete with export opportunities and pay world prices for domestic goods. Tariffs offer some rents, of course, but to a limited extent. In general this type of Board, where it still exists, is not likely to cause major trade frictions.

What about the public or private agency that is granted exclusive trading privileges on the international market but asked to compete with other firms on the domestic market? These Trade Control Boards can exist and flourish even with privatization and economic deregulation if they are allowed to control trade. But their success is tied to their operation of what is in effect a non-tariff trade barrier. Thus one important task in regulating STEs may lie in persuading countries that monopoly rights in trade are in effect non-tariff barriers. With domestic market control as well, the STE can regulate and control markets for specific purposes which may be considered in the national interest. But an STE that only has a trade monopoly must be presumed to be acting in the commercial interest of domestic producers and hence should be regulated just as much as tariffs and overt trade barriers.⁴

In addition to the usefulness of the classification of STEs by market power for comparing like with like, the same typology is also useful for designing regulations. Those STEs that have no monopoly powers can make little impact on other countries. They may or may not have a constructive role in domestic marketing, but it is difficult to imagine spending the scarce resource of international oversight and regulation on agencies which are so limited in their ability to affect trade volumes or prices. Those that have domestic but not trade exclusive rights are similarly so constrained in their actions that it is difficult to conceive of many cases where trading partners are harmed. Those STEs with trade monopolies should by contrast be monitored not because the existence of the monopoly is in itself undesirable

⁴ A trade monopoly could of course deliberately flood the domestic market with imports, to the advantage of consumers. Though equally distorting, this behavior is less likely to be objectionable to trade partners.

but because trading partners need to be assured that the monopoly power is not being abused for commercial purposes. If the monopoly does not extend to control over domestic production then there is a strong presumption that the monopoly power is being used to benefit producers in a non-transparent way. If the monopoly is complete, covering domestic and trade decisions, then the country should be required to explain the rationale and observe the usual non-discrimination and national treatment principles embedded in regional and multilateral treaties.

The theme of looking at STEs as having different degrees of market power on both domestic and international markets recurs throughout the papers in the North American Forum project. The differences among the three North American countries are apparent. The complexity of the market institutions in Canada reflect a long period of reliance on parastatals and a strong relationship between trade and domestic market controls. By contrast, the US has tended to emphasize the role of private firms in the marketing of agricultural goods even when strong policy motivations existed to control the outcome, both price and quantity, in the market. The state has manipulated levers unnecessary in Canada where control has been more direct. But the levers are also a form of state trading, even if not manifest through monopoly rights given to quasi-public agencies.⁵ Mexico, shifting economic policies dramatically in the mid 1980s, demonstrates the way in which the role of the government in agricultural trade is a political decision rather than an immutable fact of nature.

Finally, it should be emphasized that the issue of state trading cannot be taken in isolation with the more general issue of market institutions, public and private. A growing “Canadian critique” of what is usually taken as a US-inspired challenge to the marketing boards north of the border is to point to high concentration in the market for grains and oilseeds. A relatively

⁵ Further along the same spectrum is the EU, which has chosen to disband most state trading enterprises as posing threats to intra-European trade. The exceptions are those agencies which have retained a role in intervention buying. But the main instruments of farm policy have been administered through the private trade rather than through agencies such as the CCC. At the other extreme, Japanese policy uses state trading much more completely than does Canadian policy to control markets.

small number of private firms handle much of the production, whether for domestic or foreign use. It would seem appropriate to treat public and private market power with some semblance of symmetry. On the other hand, competition policies already exist to control private monopolies. Moreover, international (and regional) trade rules have rarely attempted to regulate the behavior of private firms, with the obvious exception of anti-dumping agreements.⁶ So while it is entirely appropriate to ask the question as to the relationship between public and private market power, the solutions themselves are likely to remain distinct.

Summary: The Behavior of STEs

The above typology emphasizes the structural aspects of STEs, namely their market power. At its root the STE issue is concerned with the behavior of such entities. Market power is a proxy for that behavior. The activities of the Boards that attract the most attention are the exclusive export provision (single-desk selling); the payment to producers of a price based on an average revenue from different markets (price pooling); the extension of the board into other commercial activities (revenue pooling); and the ability of the Board to borrow from the government or finance deficits at a favorable rate relative to the private sector (preferential financing).

Proponents of the single-seller approach argue that the producer and the country gain from the ability of a Board to control both the quality and quantity of exports into overseas markets. It is probably true that in the highly-distorted world markets for agricultural products, a single seller able to set differential prices will be able to generate higher revenues and to pass these on to producers. This may in particular be the case for a single seller exporting a product into a market protected by a tariff-rate quota. A monopolistic exporter could probably sell at a higher price; economic rents could then be mainly collected by the exporting country rather than by the importing country. However, much of the argument

⁶ Anti-dumping agreements within the WTO and NAFTA can be seen as tentative attempts to regulate competition. Many economists would argue that they have in effect been captured as protectionist instruments, and that a fresh approach to international competition policy is needed.

about single-desk sellers emphasizes their ability to grant export subsidies rather than use monopoly power. Price differentiation could be thought of as the shorting of one market in order to subsidize another. But this may be unhelpful as a guide to policy. One would have to know whether the high priced market were really yielding monopoly rents or just benefiting from high demand in the presence of trade restrictions and transactions costs. The low priced market may be either depressed by subsidies or be the “world” price as set by competitors. Thus the existence of price differentiation may say little about monopolistic exploitation or export subsidization.

If the single-desk seller is able to exploit a country’s position in world markets, this potentially benefits the exporting country. No such claim is advanced with respect to the habit of price pooling. This system will tend to lead to allocative inefficiency. Producer returns may be based on a bundle of products rather than just those products sold by the producer to the marketing board. This bundle could consist of several different farm-level products, or of a mix of farm-level products and elements of marketing, packaging, processing and other services engaged in by the board. In either instance, a farmer receives a price based on some average of the components of the bundle, rather than a price equal to the additional revenue that his production would bring. These distorted market price signals can lead farmers to allocate their resources inefficiently. Similarly, revenue pooling from unrelated activities, if it influences the returns of the producer, is potentially distorting. The marginal returns to the producer may depend on the success of some unrelated business activity of the Board.

The ability of state traders to draw on government financial support for commercial activity, both trading deficits and investment needs, is more difficult to criticize. On the one hand it would seem to lead to inefficient behavior, with producers receiving a subsidy relative to the returns a private agent would pay. On the other hand the board by its legal charter carries less commercial risk and therefore should be able to borrow more cheaply than a private sector agent. Given the fungibility of financial resources, and different internal accounting practices, it may be impossible to sort out the negative subsidy component from the

legitimate lower cost of doing business with the backing of the financial power of a government.

A different type of disadvantage of state trading, from the domestic point of view, is that statutory monopolies face, by assumption, no competition in their market which might drive them to innovate. This may reduce incentives to contain costs of preparing and processing products for export. The influence of competition on efficiency has been an important motivation behind reforms in marketing of agricultural and horticultural products. It has been suggested that monopolistic marketing boards, by preventing or restricting entry into export marketing, may suppress the use of other marketing strategies and thus reduce product innovation.

In the long run this impact on the dynamism of the sector may be the most important drawback to the involvement of the state in agricultural marketing. Where the board has to compete in the marketplace, the inefficiencies of bureaucratic control are severely limited. But whether trade rules, at the regional or multilateral level can find a way to promote competition in areas where governments like to keep control is still an open question.

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