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MAY 23 1974

The Honorable Charles A. Vanik
House of Representatives

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Dear Mr. Vanik:

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Your January 29, 1974, letter requested information on the Canadian system of regulating wheat stocks and the role of domestic international sales corporations (DISCs) in exporting agricultural products. Other information you requested will be addressed in separate correspondence. In discussions between our staffs, it was agreed that the limited information thus far developed would constitute our response.

FEATURES OF CANADIAN EXPORT REGULATION

You expressed the view that perhaps some of the operating features of the Canadian system could be adopted by the United States to better manage its wheat stocks. Essentially, you asked whether the Canadian system provided stable supplies at stable prices to the consumer.

Comparison of systems

The Canadians manage their wheat supplies through Government policies and with a quasi-governmental trading organization known as the Canadian Wheat Board. The Board is responsible for many aspects of wheat handling, including

- development of markets and export sales,
- delivery in domestic and export markets, and
- prices, and their stability, that the producers receive for wheat.

Because the Board handles the marketing functions and has access to other Government agencies involved in establishing grain policies, it has readily available information on such diverse activities as production, storage at the elevators, shipments in transit, inventory at the ports, export sales, and sales commitments. As discussed later, the Canadian Government has recently taken steps to stabilize the cost of bread and cereal-based foods in Canada by establishing a two-price system that insulates the domestic wheat price from the uncertainties of the export market. However, the increasing costs of labor and of ingredients other than wheat recently caused the price of bread to increase 2 to 3 cents a loaf.

Wheat in the United States is managed by private producers and exporters using a free-market approach. Inherent in such a system is

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the problem of obtaining from private exporters adequate and current information which bears on the domestic availability and which is necessary to determine the effects of foreign and domestic demand on wheat prices and related products. The Department of Agriculture in October 1973 instituted new reporting requirements on export commitments, to obtain a more complete and timely picture of the wheat supply and demand situation; but problems persist over the accuracy, reliability, and timeliness of the data generated.

The United States has no wheat reserve policy or price stabilizing program to insure adequate domestic supplies at stable prices to U. S. consumers.

Subsidies and costs

In September 1973 the Canadian Government announced new minimum price guarantees and maximum prices to be paid to producers for wheat going into domestic food use, in lieu of payments to producers on an acreage basis. The policy guarantees producers a minimum in Canadian dollars (C) ^{1/} of C \$3.25 a bushel, less transportation and handling costs, for the next 7 years for wheat used for domestic food. Maximum prices to be paid to producers are set at C \$5 a bushel for wheat for bread and C \$7.50 for durum wheat.

The objective of the new two-price program is to prevent further domestic price increases of bread and other cereal-based foods. Payments made under the program by the Canadian Government are a subsidy to the Canadian consumer. The Government pays the Canadian Wheat Board and the Board, in turn, pays the farmer the difference, if any, between the export price, up to C \$5.00 a bushel, and the C \$3.25 paid by the millers.

The Wheat Board estimates the annual cost of the new price program to the Canadian Federal Treasury will be in excess of C \$100 million, compared with C \$64 million to C \$66 million for the past 2 years under the previous program. The Canadians domestically consume, for food purposes, about 87 million bushels of wheat and export about 500 million bushels.

In contrast, the United States consumes about 530 million bushels and exports about 1 billion bushels of wheat. Using the Canadian estimates, the cost to the U. S. Government for a similar two-price system would be in excess of \$600 million.

^{1/} Late in March 1974 one Canadian dollar was equivalent to about \$1.03 in U. S. dollars.

Canadian producers will continue to be paid actual world market prices, less the cost of the operation of the Canadian Wheat Board, for most of their output, which is exported.

As of early March 1974, smaller quantities of Canadian grain have been transported to the elevators and ports this crop year than in the same period last year, because of a railcar shortage, railway labor problems, and smaller amounts of wheat marketed by farmers.

Grain moves at subsidized rates to export points from scattered elevators, many of which have a low handling capacity in comparison to those in the United States. Railcars are allocated to move grain at unusually low Government rail rates established in 1925, which remain in effect. The Government subsidizes feeder lines which tie into the main rail lines for shipping grain to the ports. These subsidy payments reduce the railroads' losses but not to the extent that hopper cars are willingly allocated to move grain. The rail subsidies represent a benefit to the producers because the costs have not been offset against their returns. To ease the grain transportation problem, the Government purchased 2,000 giant hopper cars in the past year.

2 With respect to U.S. subsidies, the Department of Agriculture maintains a program of domestic price supports with guaranteed or "target" prices to wheat producers. These support payments are intended to insure a certain level of return for farmers rather than to stabilize prices to consumers. Payments under the price-support program depend on market prices which currently exceed the price-support level; therefore, no subsidies are necessary at the present time. 42

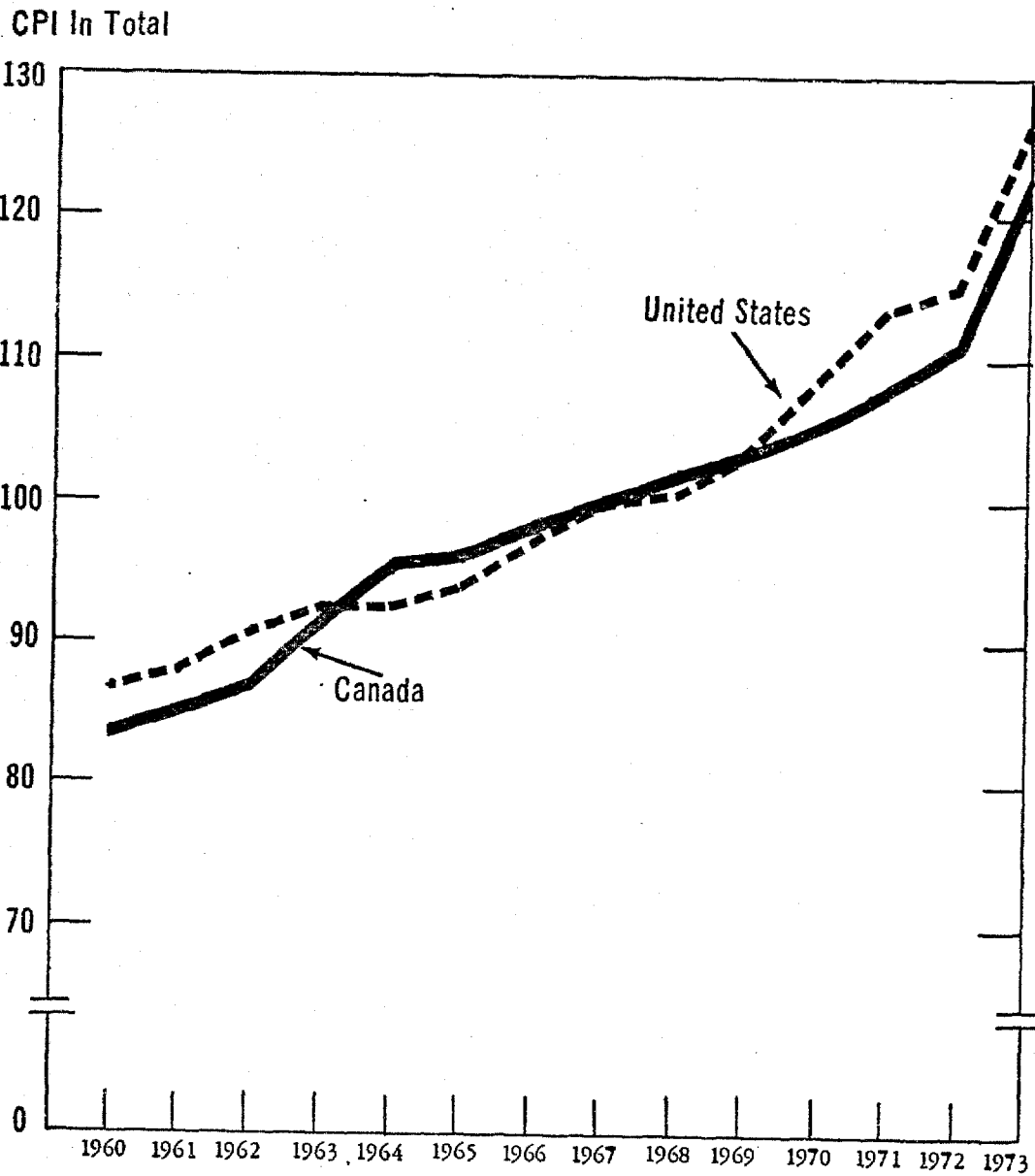
Export subsidy payments were formerly made by Agriculture to exporters to make up the differences between higher domestic wheat prices and lower world market prices. The payments generally resulted in sales at lower prices to foreign buyers than to domestic purchasers. Because of changed market conditions, the subsidies were eliminated in September 1972. In addition, when the United States had wheat which was surplus to its needs, Agriculture paid the storage costs for its wheat inventories.

Supply and prices of Canadian wheat

Enclosures I and II show that over the years Canadian wheat supplies have been ample for domestic consumption and for export. Prices for cereals and bakery products increased gradually through 1972 but in 1973 rose sharply. As shown in the following chart, the Canadian consumer price index for cereal and bakery products (with 1967 as the base year of 100) has risen from 83.7 in 1960 to 122.6 in 1973, a 38.9-percent increase.

Enclosure III provides U.S. consumer price indexes for these products over the same period. The enclosure and the following chart

**CANADIAN AND U. S. CONSUMER PRICE INDEXES (CPI)
OF CEREAL AND BAKERY PRODUCTS
FOR 1960 TO 1973 (1967=100)**



Source: Enclosures I and III

show that the U. S. index for the group (with 1967 as the base year of 100) has risen from 87.1 in 1960 to 127.7 in 1973, a 40.6-percent increase.

Canadian Wheat Board and export control

You pointed out that the export regulation features of the Canadian system might help the United States avoid some of the pitfalls of recent years and asked about the feasibility of establishing a national export licensing and control agency. On the basis of discussions with Canadian and U. S. officials and the written material obtained on the subject, we are presenting below some of the pros and cons of such a proposal. These should not be considered as all encompassing or as favoring such a proposal.

Pros

1. Controls and coordinates production, delivery (transport and storage), and marketing.
2. Regulates the flow of supplies to domestic and export markets according to demands and stabilizes domestic prices at a level lower than export prices (two-price system).
3. Controls and sets export prices and generally promotes optimal and equal returns per unit of sale to producers from all sales through markets and price differentiation (two-price system).
4. Eliminates market fluctuation and speculation.
5. Facilitates long-term, large-scale, trade arrangements with domestic and foreign buyers, particularly advantageous in dealing with State trading countries (for example China, Russia, and Eastern Europe).
6. Facilitates orderly product research and development and market promotion and development.

Cons

1. May discourage individual producers' initiative to produce quantities for export markets because of ability to obtain only an average price or sell only a certain quantity.

2. Prevents direct contracting by individual producers to insure aggressive marketing.
3. Provides little incentive for competitive and efficient merchandising and promotion with fixed pricing structure imposed on industry.
4. Permits possible misinterpretation of world supply and demand situation and pricing which could severely injure the industry.
5. Produces a potential for inflexibility and inertia because of bureaucracy and political pressures.

A bibliography of reference material is included as enclosure IV.

DISC IMPACT

The DISC legislation was designed to provide a significant incentive to expand export operations and place U.S. domestic firms on an equal and competitive tax footing with the U.S. firms marketing through foreign subsidiaries by enabling qualifying domestic corporations to defer tax payments on approximately 50 percent of their foreign earnings from export sales. Congressional conferees, in their review of the Revenue Act of 1971, estimated that tax receipt deferrals of \$100 million for fiscal year 1973 and \$170 million for fiscal year 1974 would provide U.S. firms with capital and incentive so that additional sales could be obtained abroad through DISC but not at the expense of investments in foreign plants or equipment.

You mentioned the tax loss from the DISC provisions was estimated to be \$240 million in fiscal year 1975. A Treasury official advised us late in March 1974 that preliminary estimates of the revenue loss ranged from about \$250 million to \$300 million for fiscal year 1973. We understand that these underestimates of the revenue loss are due to greater than anticipated profit margins.

The Revenue Act of 1971 requires the Secretary of the Treasury to submit each April 15 to the Congress an analysis of the operation and effect of the DISC provisions. In its April 1974 report, Treasury indicated that it attempted to evaluate the export effect of DISC legislation, recognizing the difficulty of separating the influences of various changing economic factors on U.S. exports. Treasury stated that, although its estimates are tentative, they suggest that the DISC program had a positive impact on U.S. exports.

Agricultural products

Treasury officials did not have complete or readily available data to analyze the value of DISC legislation in helping to increase agricultural exports, including wheat. We were informed that the DISC tax

returns vary in their reporting periods from 2 months to 1 year ending June 30, 1973, and not all returns have been received. We were told that only rough comparisons could be made using the normal reporting returns received from the industry for calendar year 1972 and that the companies were only required to report on their export receipts of grain mill products rather than wheat per se.

For 75 firms reporting for periods through June 30, 1973, Treasury officials stated that raw agricultural products and services exported through DISC totaled about \$1.1 billion. Total raw agricultural products and services exported for 1972 were \$5.7 billion. DISC-reported exports, therefore, approximated 20 percent of the 1972 total agricultural exports. Based on 18 of 20 reporting companies dealing in grain, Treasury officials also stated that grain exports under DISC amounted to about \$600 million of the \$1.1 billion.

Taxable income for exporters was estimated to be \$30 million for all agricultural commodities and \$5 million for grain only and the deferred taxable income would be about 50 percent of the taxable income. The income deferred to Treasury and the advantage to the companies would approximate \$7.5 million and \$1.25 million, respectively, plus the cost of the money over the deferred period.

Treasury officials had no firm supporting figures for increased exports resulting from DISC; however, using the concept of value elasticity and assuming that income earned would be passed on to the foreign purchasers in the form of lower prices, it was estimated that the DISC legislation resulted, at most, in additional sales of about \$22 million for all agricultural products and about \$3.75 million for grain only.

Because the DISC income tax returns were not made available to us for review, we were not in a position to independently analyze and assess the tax impact of the DISC legislation or reach a conclusion on the effectiveness of the legislation in increasing exports.

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We shall be pleased to discuss these matters further with you if you wish. We do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,



Acting

Comptroller General
of the United States

CANADIAN CONSUMER PRICE INDEXES OF
CEREAL AND BAKERY PRODUCTS
For 1960 to 1973 (1967 = 100)

<u>Year</u>	<u>All-purpose white flour</u>	<u>Corn flakes</u>	<u>Plain white bread</u>	<u>Total</u>
1960	74.0	82.2	81.8	83.7
1961	75.9	82.6	83.5	85.2
1962	83.1	87.3	85.9	87.1
1963	86.9	88.7	90.2	91.2
1964	91.9	91.2	94.7	95.5
1965	92.6	95.2	94.8	96.0
1966	96.7	96.5	99.7	98.6
1967	100.0	100.0	100.0	100.0
1968	101.4	100.2	102.9	102.2
1969	102.0	103.1	103.3	103.5
1970	101.4	104.1	104.8	105.7
1971	99.7	106.1	108.9	108.1
1972	102.4	109.5	113.0	111.8
1973	114.3	(a)	127.0	122.6

a/
Not available at time of review.

Source: Statistics Canada--converted by GAO to a base year
of 1967

CANADIAN WHEAT SUPPLIES AND DISPOSITION
Crop years 1960-61 to 1972-73

Crop year	Supplies				Disposition			Balance
	Inward carryover August 1 (note a)		Production (note a)	Total supplies	Domestic disappearance (note b)		Exports wheat and flour (note a)	Total outward carryover July 31 (note a)
	Farm	Commercial			Farm	Commercial		
(thousands of bushels)								
1960-61	143,700	455,888	518,379	1,117,967	92,078	64,299	353,249	608,341
1961-62	170,950	437,391	283,394	891,735	83,431	59,224	358,022	391,058
1962-63	59,170	331,888	565,585	956,643	82,619	55,410	331,367	487,247
1963-64	64,706	422,547	723,500	1,210,747	91,046	65,713	594,548	459,440
1964-65	120,640	338,800	600,726	1,060,166	80,607	66,941	399,594	513,024
1965-66	109,100	403,924	649,412	1,162,436	84,985	72,423	584,906	420,122
1966-67	100,000	320,122	827,338	1,247,460	84,093	71,309	515,307	576,751
1967-68	205,000	371,751	592,920	1,169,671	98,908	69,243	336,010	665,510
1968-69	236,000	429,510	649,844	1,315,354	83,964	73,724	305,838	851,828
1969-70	372,200	479,628	884,276	1,536,104	92,660	88,256	346,498	1,008,690
1970-71	542,700	465,990	331,519	1,340,209	76,474	84,368	435,213	744,154
1971-72 (c)	404,820	339,334	529,552	1,273,706	93,439	86,715	503,890	589,662
1972-73 (c)	317,500	272,162	533,288	1,122,950	-	-	576,594	366,060
1973-74 (c)	-	-	628,738	994,798	-	-	-	-

a/
Source: Statistics Canada

b/
A residual item. Farm disappearance is computed by adding inward farm carryover and production and deducting therefrom marketings and outward farm carryover. Commercial disappearance is computed by adding inward commercial carryover and marketings and deducting therefrom outward commercial carryover and exports.

c/
Subject to revision

Source--The Canadian Wheat Board

BEST DOCUMENT AVAILABLE

UNITED STATES
CONSUMER PRICE INDEXES OF
CEREAL AND BAKERY PRODUCTS
For 1960 to 1973 (1967 = 100)

<u>Year</u>	<u>Flour</u>	<u>Corn flakes</u>	<u>White bread</u>	<u>Whole wheat bread</u>	<u>Total</u>
1960	88.4	81.4	85.2	-	87.1
1961	89.4	83.5	87.8	-	88.9
1962	90.9	86.4	89.1	-	90.8
1963	91.0	89.4	91.0	-	92.1
1964	93.3	91.6	91.5	88.1	92.5
1965	95.7	92.3	92.6	90.7	93.8
1966	97.9	94.6	98.3	96.7	97.7
1967	100.0	100.0	100.0	100.0	100.0
1968	98.3	99.9	100.5	101.1	100.4
1969	97.5	100.3	103.5	105.7	103.3
1970	99.0	103.2	109.1	111.4	108.9
1971	101.0	107.3	112.3	117.5	113.9
1972	100.4	100.6	113.0	120.1	114.7
1973	127.1	104.4	126.7	132.3	127.7

Source: Bureau of Labor Statistics, Department of Labor

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