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THE LAST STRAW

By Rose Olfert, Murray Fulton and Grace Skogstad

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Background

By Rose Olfert

Beyond the daunting challenges to producing grains in western Canada for the early European settlers, the marketing of their products presented additional trials. Prior to World War I (WWI), individual farmers found themselves at the mercy of the grain companies, the railways, and the Winnipeg Grain Exchange in the weighing, grading, and marketing of their crops.

To address their concerns, farmers sought assistance from the federal government and initiated cooperative ventures. They formed the Grain Grower's Grain Company in 1905 and successfully exerted pressure on the Canadian Government to standardize the weighing, grading, and inspection of grains. This was accomplished through the establishment of the Canadian Grain Commission in 1912. Farmer lobbying for direct government involvement in marketing grains was pre-empted by the imperatives of WWI. The government established a Board of Grain Supervisors with complete control over the purchase, sale, and pricing of wheat for export.

Following the war, the first Canadian Wheat Board (CWB) was established to market the 1919 wheat crop. The CWB's mandate was to sell wheat in domestic and export markets at

prices consistent with world levels. The crop was essentially "pooled" for the entire crop year for all farmers, and after all was sold the farmers' entitlements could be discerned. An initial payment was awarded at the time of delivery, acting as a "floor price". A final payment was made when all receipts were in.

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This first CWB was, however, seen as an extraordinary measure by the federal government, and following WWI it was disbanded in 1920. However, during its short term the CWB, perhaps partially attributable to high wartime prices, had gained widespread support, leading to farmer lobbying to re-establish the CWB. Failing in this bid, farmers in each of the three Prairie provinces formed "Wheat Pools" in 1923 with a system of pooling and payments similar to that of the CWB.

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putting its own representative in charge of the Central Selling Agency operating for the Wheat Pools. By 1935, the federal government conceded its involvement was no longer a temporary measure, signaling its commitment in the enactment of the *Canada Wheat Board Act (CWB Act)*. The system of pooling receipts over a crop year, with government-guaranteed initial payment followed by final (and later also interim) payments was essentially retained.

While deliveries to the CWB were initially voluntary, they became compulsory during World War II with the CWB becoming the monopoly marketer of western Canadian wheat in 1943. This was part of Canada's commitment to the war effort. To a large extent farmers supported the monopoly position of the CWB in marketing western Canadian grains.

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Since the initial *CWB Act* of 1935, the Board has undergone a number of changes and has increasingly come under scrutiny, domestically as well as internationally. Once again questions relating to the form and function of the CWB that are of fundamental importance to western Canadian farmers are being raised.

The core of the current debate relates to the single-desk selling powers of the CWB, that is, its monopoly position in the export marketing of some western Canadian grains. ➤

BIO

Rose Olfert is a professor in the Department of Agricultural Economics at the University of Saskatchewan and has primary responsibility for the SIPP presence at the University of Saskatchewan. Rose has a B.A. (Economics) and M.Sc. (Agricultural Economics) from the University of Saskatchewan and has been on faculty since 1988. She teaches at the diploma, undergraduate and graduate levels. She has published widely in rural economic development, rural-urban linkages, off-farm employment, and community restructuring. She is also active at the Canada Rural Economy Research Lab at the University, undertaking spatial analysis and producing presentations and policy papers on Saskatchewan and Canadian public policy issues.

The Canadian Wheat Board in an Open Market: The Impact of Removing the Single-Desk Selling Powers

By Murray Fulton

INTRODUCTION

Over the last year the Government of Canada has indicated its desire to remove the single-desk selling powers of the Canadian Wheat Board (CWB). To this end, the government has, among other things, created a task force to recommend options for how the CWB can deal with such a transition and has held a farmer plebiscite on whether the single-desk selling powers for barley should be removed.

A key issue that has arisen in the discussion and debate around the removal of the CWB's single-desk selling powers is whether the CWB would be able to operate if these powers were removed. The government has repeatedly called for the CWB to bring forward a plan for how it would function without its single-desk selling powers; the most recent request came after the plebiscite in which nearly 50 per cent of respondents indicated a preference for the choice to market either to the CWB or another buyer. For its part, the CWB has indicated that it would not be able to operate in a marketing choice environment—i.e., a dual market—in a way that would be effective.

The purpose of this brief is to explore the impact of removing the single-desk selling powers of the CWB. The focus of the analysis is on wheat, since wheat makes up the greatest percentage of the grain handled by the CWB. The main conclusion of the paper is that it would be very difficult, if not impossible, for the CWB to operate as a grain marketing organization without its single-desk selling powers for wheat.

There are two potential options that can be considered for how the CWB would operate if its single-desk selling powers were removed. One option would be to operate as a marketing agency—contracting grain from farmers and selling to end-use customers, and doing so without any grain handling facilities of its own. The other option would be to become a full-fledged grain company that would purchase grain from farmers, move it through a grain handling system that the CWB owned and controlled, and sell it to end-use customers.

The next sections of the brief examine these two options. In each case, a number of barriers are identified that make the option unachievable.

THE CWB AS MARKETING AGENCY

Operation as a marketing agency without single-desk selling powers is almost certainly not sustainable. There are at least three reasons: (1) the CWB does not own elevator facilities, particularly at port position; (2) the CWB would be unable to retain key personnel; and (3) the CWB would be unable to offer any unique marketing opportunities. Each of these reasons will be examined in turn.

Lack of grain handling facilities

Without its own grain handling system, a marketing agency would be able to source grain only at the pleasure of the existing companies that own the grain handling system (while some grain could be sourced through producer cars, this would not be sufficient to achieve the economies of scale required for a marketing agency to operate efficiently). In most cases the grain companies would benefit from supplying the grain directly to the same customers that the CWB was attempting to serve, rather than providing grain handling opportunities to the CWB. Thus, a new CWB structured as a marketing agency would find it difficult, if not impossible, to source grain from the farmers in a predictable and sustainable way, and hence would be unable to set up long-term contracts with major buyers. The situation that the CWB would be in is similar to what would happen if Ford, for instance, were to rely on General Motors dealerships to sell its line of automobiles.

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It may be argued that the CWB might be able to obtain access to grain handling facilities owned by the grain companies if excess country elevator capacity existed on the Prairies. With excess capacity, the grain companies could be expected to compete aggressively for grain; one way of competing for tonnage would be to allow the CWB to move grain through their facilities. However, excess capacity is unlikely to exist in the Prairie grain handling industry in the foreseeable future. Last year the Dominion Bond Rating Service (DBRS) indicated that the period of large-scale

elevator abandonment is over and that there is little excess capacity in the industry. DBRS also indicated that the one factor that would prompt further consolidation would be deregulation of the grain marketing system—the implication is that grain companies would be particularly concerned about extra capacity if the CWB were removed and would take steps to make sure that it did not exist. The Saskatchewan Wheat Pool's recent acquisition of Agricore United needs to be seen in this light; one of the key outcomes will be an elimination of any excess capacity that exists in the industry.

It is instructive to note that farmer-owned marketing agencies without grain handling facilities do not exist in the U.S. grain marketing system; this is a further indication that a farmer-owned marketing agency is not a sustainable option.

Lack of key personnel

It is often argued that the CWB would be able to use the marketing expertise that currently exists in the organization to line up long-term contracts with domestic and international buyers, and that the CWB has an advantage over other companies because of this marketing expertise. While the CWB does indeed currently have a great deal of marketing expertise, the argument, however, is faulty. The reason is that a restructured CWB would be unlikely to have access to the people and expertise that exist in the current CWB. Once it was clear that the current form of the CWB was going to be dissolved, CWB employees would immediately start looking for other jobs (if they had not already done so). They would be especially sensitive to the uncertainty and high risk of the CWB being able to continue operations without its single-desk selling powers. Other players in the grain industry would very quickly hire the most talented of the CWB staff as these players prepare for a system where they now require domestic and international marketing and logistics expertise. A new CWB would have to compete directly for the former CWB personnel; by virtue of their size and presence, the other industry players would be in a position to bid aggressively to ensure that key personnel were enticed to join their companies.

Lack of unique marketing opportunities

It has also been suggested that the CWB could survive without its single-desk selling powers by providing farmers with unique marketing options such as pooling deliveries and receipts across clients and over a period of time. One obvious problem with this argument is that if farmers really

desire these services, then the CWB competitors could use the same strategies—the CWB would hardly be able to offer a unique marketing opportunity.

A more fundamental problem, however, is that an effective pooling system is virtually impossible to operate without single-desk selling powers—i.e., in an open market. This is why there are no pools in the grain sector in the U.S. and why we do not see pooled contracts in canola. And although the Ontario Wheat Producers' Marketing Board (OWPMB) operates wheat pools, these pools account for less than 5 per cent of total grain sales.

Operating pooling accounts is not viable because of the incentives that are created as a consequence of pooling. With pooling, high and low prices—prices received at different times of the crop year and in different markets—are weighted according to the quantity of sales to give a pooled price. The consequence of the averaging process is that when market prices are rising, the pool price will lag behind. Under a voluntary pooling arrangement, the lower price for the pool will result in farmers opting out of the pool and delivering to the cash market. In contrast, when prices are falling, the pool price will generally be above the cash price. This will provide an incentive for producers to deliver to the pool. The consequence of this behaviour is that the voluntary pool experiences either relatively small volumes being pooled during rising prices or substantial losses in the pool during falling prices if guaranteed initial payments are present.

Contractual pools theoretically do not suffer from the problem of producers moving in and out of the pool. However, contractual pools experience problems with delivery enforcement as delivery contracts are not ironclad and cannot be made so. The experience of the OWPMB indicates that farmers often renege on contracts when the price outside the pool is better. The result is a substantial contract default under conditions of rapidly rising prices.

Pools may also be subject to the strategic behaviour of the other grain companies in the industry, who may set prices in such a fashion that the pool suffers large losses. While such a strategy may temporarily lower the profits of the grain companies, it may return long-term benefits if the pool is unsuccessful, as the competitors then gain market share.

THE CWB AS GRAIN COMPANY

Given that the CWB would not be able to operate as a marketing agency without its own grain handling facilities, could it be successful without its single-desk powers if it were

a full-fledged grain company with grain handling facilities? Ownership of grain handling facilities would allow the CWB to be able to compete directly with the other grain companies for farmers' grain. It is important to note that such a CWB would have to own port facilities to be involved in the export trade, since most of the export grain moves through one of the three main ports (Thunder Bay, Prince Rupert, and Vancouver). Without terminal facilities, a new CWB would be in much the same position in international trade as if it owned no country elevators.

Given the importance of the ownership of grain handling facilities, a key question is whether the CWB would be able to actually acquire them. The current economic environment in the Western Canadian grain industry would make the acquisition of facilities very difficult. There are at least three reasons: lack of capital; lack of merger or acquisition targets; and the costliness of building new facilities. Each of these reasons will be examined in turn.

Lack of capital

The most obvious problem is a lack of capital. Unlike the Australian Wheat Board, which was allowed to build up a significant investment fund over a substantial period of time, a restructured CWB would have no capital. Without capital, acquiring grain handling facilities is simply not possible. For instance, the government's task force envisaged the CWB selling shares to farmers; this share offering would provide the CWB with \$110 million in assets. This amount, however, would be wholly inadequate to purchase grain handling facilities. As a case in point, the Saskatchewan Wheat Pool's bid for Agricore United is valued at \$1.8 billion; as part of that deal, JRI purchased 15 grain elevators (13 of which are high-throughput facilities) and 9 input sales facilities for \$255 million. It is also interesting to note that as part of the deal, JRI will be provided with a throughput agreement at the Cascadia Terminal on the west coast, an indication that access to terminal services is something that is valuable and cannot be assumed to exist.

Lack of merger partners

Even with a large capital fund, acquiring grain handling facilities would be difficult today. One obvious way for a new farmer-owned entity to acquire facilities would be to merge with existing farmer-owned entities that already own grain handling facilities. With the conversion of the three Prairie Pools to standard business corporations over the last ten years, the option to merge with co-operatively-owned grain handling firms is no longer available. A number of farmer-

owned inland terminals do exist; however, many are not independent since they are partially owned by existing grain handling firms. Thus, even if one or two of the independent producer terminals were willing to merge (which itself is highly questionable), this would not result in sufficient market presence to operate across all of Western Canada.

Another option for acquiring grain handling facilities would be to purchase them from existing industry players. While some of the grain companies might be willing to off-load some of their more poorly situated elevators to a new competitor, in general the existing players will not want to see a new competitor come into the market and thus will not be willing to sell their elevators. This is particularly the case at port position, where ownership of terminal capacity provides grain companies with significant market influence. Thus, a situation where one or more of the existing companies sell off a significant portion of their grain handling system is very unlikely, except at a very high price. This is particularly the case given the acquisition of Agricore United by Saskatchewan Wheat Pool. As a result of that agreement and the side deals that were negotiated, the industry now consists of three relatively large players (Saskatchewan Wheat Pool, Cargill, and JRI), plus a number of smaller players. The opportunity for any major merger or acquisition no longer exists.

Costliness of building new facilities

A third option for acquiring elevator and terminal facilities would be to build new ones. While this would have been a viable option at the country level a decade ago when much of the elevator capacity needed rebuilding, this option is not viable today given the overcapacity that would result from such a move. Bringing on new capacity today would likely trigger very intense price competition by the existing firms in the industry as they try to retain market share and drive out the new player. As well, the construction cost alone is very high. The cost of Saskatchewan Wheat Pool's Project Horizon (construction of 22 high-throughput terminals) was \$270 million at the end of the last decade—the cost of building new facilities today would be much larger, particularly given the rapid rise in construction costs that has occurred during the last two or three years.

The bottom line

While ownership of grain handling facilities would be highly beneficial to the successful operation of the CWB, the likelihood of the CWB acquiring these facilities is virtually zero. And even as a full-fledged grain company, the

CWB would still face the other problems outlined in the previous section. Specifically, there is no reason to believe the CWB would have any advantage in marketing personnel and expertise. Nor should it be expected that the CWB would offer any unique marketing options. Thus, while ownership of grain handling facilities is a condition that must exist for the CWB to be successful, such ownership by itself is not sufficient.

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CONCLUDING REMARKS

The removal of the CWB's single-desk selling powers will almost inevitably result in the disappearance of the CWB. Although farmers have indicated that they would like the option of marketing to either the CWB or to other buyers, in reality this choice is highly unlikely to ever exist. Once its single-desk selling powers are removed, the CWB will be unable to operate effectively and will cease operations. This inability to operate is not a function of insufficient desire or poor management. Rather, the inability for the CWB to operate in a so-called "marketing choice" environment is a direct consequence of the nature of pooling and of the structural realities of the grain industry at this point in time. What may be billed as a "marketing choice" option is equivalent to removing the CWB entirely from the choice set. ∞

This brief is based on the author's paper "The Canadian Wheat Board in an Open Market: The Impact of Removing the Single-Desk Selling Powers". The paper can be found at http://www.kis.usask.ca/CWB_Open_Mkt_Fulton.pdf.

BIO

Murray Fulton is a professor in the department of agricultural economics at the University of Saskatchewan. His research interests include the industrial structure of the agricultural sector and the transformation of agricultural organizations. He is currently the principal investigator for a Knowledge Impact in Society project "Adapting to New Environments: Agriculture and Rural Economies in the 21st Century".

Agricultural Policy in a Minority Government

By Grace Skogstad

Three factors guide the making of agricultural policy: they are interest, ideas, and institutions. I will speak to these factors as they affect the Harper minority government. The primary interest of any government is re-election and that means maintaining your electoral base and ideally expanding it. I don't want to be too cynical here in suggesting that re-election is the over-riding preoccupation of any government, but it is obviously something that any political party or government has to worry about. Beyond that interest of getting re-elected, there are clearly other interests and substantive preoccupations that governments have. And one that any government looking at agriculture has to keep firmly in mind, regardless of what its partisan stripe is, is the overall Canadian interest in maintaining trade across international borders.

The second thing that shapes agricultural policy formation in this country is the dominant ideas in play. What are the appropriate goals for the sector? What are the appropriate ways—or policy instruments—for going about realizing those goals? In many ways there are big ideas in play here, including ideas that a lot of people disagree about. Should governments regulate markets? Should individual freedom prevail over the well-being of the community? Answers to these questions tell us what the major ideas at play are in terms of agricultural policy. Now, for big ideas like these to be influential, you clearly need to have champions in positions of political power or with substantial political followings. Ideas that are going to impact also on policy making have to be financially feasible and they have to be consistent with the rules and principles of international trade institutions and the global trade regime. They are not going to get taken up if they are not feasible in those ways.

Now if I look back at the broad set of ideas that have been shaping agricultural policy in recent decades, the ideas that become apparent to me are that governments must work very hard to try to make the agri-food sector competitive. But there are a host of ideas out there about how you go about making an agri-food sector competitive. Take, for example, the case of the Wheat Board. Is the wheat board an example of competitiveness? That was a debate that we already had once in this country. But we probably will have it again.

Another idea that is at work here relates to the following. Given that any Canadian government has to work very hard to maintain open borders or maintain trade relationships,

how do you go about doing that? Do you go about abandoning any policy instruments that are causing you trade frictions, causing borders to close? Or do you rather say, “No, there are legitimate reasons to keep those regulatory instruments, those marketing institutions, because they can give us a leg up when it comes to getting our produce into the international markets at competitive prices.” So there are a whole host of ideas at play. Some are about the big issues—about the relationship between markets and states and individuals—and others are ideas about how you go about realizing those bigger goals of trying to create a more competitive economy.

When you have a matter like wheat board marketing, where Ottawa alone exercises jurisdiction, provincial governments don't have any veto over what the Government of Canada is going to do. So they don't begin to exercise the same kind of influence as when it comes to income safety nets or supply management.

In addition to the ideas and interests of the decision makers, the third factor that clearly affects policy developments is political institutions. The important institutions are those within which policies are made and those in which some policies are indeed embedded. When we look at the Canadian political system, the institutional framework for policy making differs quite a bit as we look across agri-food policy issues. There are some matters that fall exclusively in the jurisdiction of the Government of Canada and then there are some matters where the provinces and the Government of Canada share jurisdiction. When you have a matter like wheat board marketing, where Ottawa alone exercises jurisdiction, provincial governments don't have any veto over what the Government of Canada is going to do. So they don't begin to exercise the same kind of influence as when it comes to income safety nets or supply management. That's not to say that provincial governments are without influence over federal policy matters that lie exclusively within the domain of the Government of Canada. Usually the federal government will be sensitive because what the federal government does clearly has huge ramifications for the rural economies. But it is to say that if a federal agricultural minister or the federal government is determined to proceed with a particular course of action, then the federal system is not necessarily going to be the obstacle point. It's not going to be a veto point.

Far more important, when you are in a minority government situation, as we are now, is the parliamentary system. The

parliamentary system is a hugely important vehicle for those who want to bring pressure to bear on the government, particularly if they can get a sympathetic hearing with the opposition parties. All opposition parties are clamoring to turn their opposition status into government status.

Now those are the formal institutions within agricultural policy. But underlying, and complimentary to these organizations, are certain norms about how you make policy. And one of the most important norms that has developed in Canada over the decades is the norm that the farm community has the right to have input into agricultural policy. I would say that it is an established practice in this country that no decision that is vitally important to the farm community can be taken without prior consultations with it and without its input. Ministers break norms to their political peril even if norms rarely stand up in the court of law. They are not rules, they are norms.

Now when we come to the case of the Wheat Board, if we look back at the first great debate in the 1990s, it seems to me that Ralph Goodale established some important precedents about what you do when a community, an agriculture community, is deeply divided over an issue. Most of you lived through that experience and you will recall the process that he went through trying to resolve the deep fractures that occurred over grain marketing. The process Mr. Goodale struck included hearings by the western grain marketing panel, a plebiscite on the Wheat Board's barley monopoly, and then, of course, there were extensive hearings by both the House of Commons and the Senate Standing Committees as the legislation to change the Wheat Board was making its way through parliament. So my point here, to repeat, is that there is this right for the farming community to be consulted on significant issues. And indeed, in the *Canadian Wheat Board Act*, there is a provision that farmers have to be consulted through a plebiscite if there is to be a major change in the mandate of the Wheat Board.

So here we have coming together a situation in which we have the substance of Canadian agricultural policy being shaped in important ways by the interests and ideas of the responsible minister and governing party. They are sensitive to the broader context in which they are making that policy. They are sensitive to international trade rules, and to negotiations in the Doha Round (which has been suspended but probably will be reconvened at some point). But the capacity of any agriculture minister and government to act on its preferred interests and ideas is importantly shaped and limited by the institutional context within which these debates unfurl and take place. Just to reiterate, the

parliamentary and federal systems are both building in checks here with the parliamentary system having the greatest capacity to limit the government's ability to carry out its own agenda in this minority government situation.

I will comment very briefly on two things about the Harper government and the context in which it is proceeding. One, I think, is that it is a more ideologically driven government than we have seen in some time. It certainly is much more ideologically driven than the Liberal government and the minister in charge of the Wheat Board in the mid 1990s. The Chretien Liberals and Minister Ralph Goodale were both pragmatists. I don't think they had any ideological aversion to state involvement in the market. I think the Harper Conservatives are different. They are driven by ideas. They are an ideological party. They will have to be persuaded that sticking with their ideas about the Wheat Board, for example, is not in their electoral interest. I think that is going to be hard to do in some respects because this is a government that also believes that the way to translate its minority status into a majority government status is to keep its electoral promises. So having made certain promises with respect to the Wheat Board and dual marketing, they are likely to think that their electoral chances will be undermined if they don't keep those promises. At the same time, if this minority Conservative government is to be re-elected and translate its minority status into a majority status, it will have to extend its base of support in Ontario and Quebec. Significant in this regard is that during the current debate in the House of Commons and in the Standing Committee on Agriculture, the Quebec farm organization, UPA, and Bloc Quebecois MPs have come out strongly against tampering with the Wheat Board's mandate. So if you are the Conservatives, and you have your eye on your electoral calculus, you better be a little cautious about proceeding on a course of action that looks to be a vote loser.

I conclude by observing that there is a lot of uncertainty here and by no means would I want to make a prediction on how the Conservative government's overtures with respect to the Wheat Board's monopoly status will turn out. ∞

BIO

Grace Skogstad is a professor of political science at the University of Toronto. Her research interests include policy making in a context of multi-level governance and internationalization, with a particular focus on agricultural and food policy making. She is currently conducting research on a SSHRC-sponsored project entitled "Embedding Social Concerns in Plant Biotechnology Regulation and Trade".

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