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UNDERSTANDING THE CANADA/UNITED STATES GRAINS DISPUTE: FACTORS AND IMPACTS

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INTRODUCTION

> *Issues of economic policy are necessarily issues of politics. Even in theory it is difficult to distinguish between the economic and political aspects of the problem. ... Even if the economist tries to distinguish between the economic and political elements in his argument, the public is unlikely to recognize the distinction. To the public an economist is an economist, and most people are not usually able, even if they were willing, to distinguish the political from the economic. ... The need to distinguish between the economic and political element in any prescription is emphasized in academic economics, but when economists debate in public they frequently ignore this distinction* (E. Devons, 1961, p.34, p.43).

Recent trade agreements involving Canada and the United States have led to greater north-south trade flows of agricultural products and increased competition in the North American grain markets. The Canada-United States free trade agreement (CUSTA) was an important step towards a more integrated North American market for agricultural products and the multilateral Uruguay agreement was a move in the same direction. However, with this expanded trade has come additional North American agricultural policy conflicts and many of these conflicts have been with respect to grains, mainly barley and wheat. In Canada, the government and the grains industry (farmers, handlers, and processors), cannot agree on whether more or less grain should be sold into the United States. On the other hand, in the United States, farmers, processors, and the government, have argued over whether or not more Canadian grain imports are preferred to less. Economists have also been actively involved in these public policy debates and they cannot agree either. They have (unavoidably) mixed in economic and political aspects of the problem.

Special interest groups in agriculture are politically very powerful in both countries, influencing all aspects of grains policy. Although some subsidies are difficult to measure

with precision[1], it appears that in general, grain farmers and agribusiness are more successful at lobbying in the United States, compared to their counterparts in Canada. Grain farmers in the United States have stronger political support than do Canadian farmers. One possible explanation is that the private sector in the United States is more efficient at lobbying, than are the cooperatives and state trading agency in Canada. This view is supported by the observation that the Australian grain marketing system has many similarities to Canada's and farmers in Australia do not enjoy strong political support, less than in either the United States or Canada. However, the lobbying process with respect to grains policy is not very well understood and thus it is difficult to say which groups are more successful at lobbying and why.

To better understand the grains policy process, it is necessary to understand the role of special interest groups, the dynamics of the coalitions they form, and why they are influential. It is also worth considering why economists are so unsuccessful in the policy process. Perhaps academic economists have little incentive to get involved in debates over grains policy and thus their influence is minimal because they are disinterested in the politics of grains policy. Alternatively, the rhetorical gap between economists and policy makers may be too large, rendering economists ineffective. Of course, this is also true outside of agriculture as economists involved in non-agricultural policy issues are no more successful than agricultural economists in terms of influencing policy makers. Galbraith provides an interesting anecdote on the ineffectiveness of academic economists:

> *Council of Economic Advisors Chairman Murray Weidenbaum, when asked directly what weight of influence, on a scale of one to ten, economists had enjoyed in drafting the original tax program of the [Reagan] administration, replied, "Zero"* (quoted in Cordes, et al., 1994, p.224).

Both the Canadian and United States governments have endorsed freer trade in grains with the signing of CUSTA and then, subsequently, the Uruguay Round agreement. Implicitly, these two agreements introduce more uniform international laws implicitly designed to limit the political power of domestic lobby groups. The agreements can essentially be viewed as an international pact not to "give in" to domestic special interests (Esty, 1993). Unfortunately, both the United States and Canadian governments have broken this pact by resorting to unilateral policy choices in response to domestic political pressure in grains. For instance, the credibility and good faith of the United States government's commitment to free trade has been questioned by recent unilateral actions taken with respect to placing a limit on imports of Canadian wheat, and by threats to impose permanent import barriers against Canadian grains.

In the United States the expanded north-south trade has been interpreted as the consequence of two "unfair" trade practices which are pursued by Canada, namely, transportation subsidies on grain shipments and the so-called "secretive" pricing policies

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[1] Canadian grain subsidies are slightly less than in the U.S., on average, according to PSEs published by the OECD. However, the PSEs overstate the level of subsidy to western Canadian grain farmers because they do not account for the negative effects of excessive regulation in the Canadian grain handling and transport system. For example, in the province of Alberta, the combination of exorbitant (regulated) elevation fees and the cost of pooling transportation across the prairies, has negated any benefit due to rail freight subsidies under the Western Grain Transportation Act.

of the CWB. Ironically, removal of the transportation subsidies and elimination of the CWB's monopoly over exports, would probably lead to additional imports of grain from Canada (Carter, 1993a). The United States has claimed that Canada is an "unfair" trader because it grants a state trading organization (the Canadian Wheat Board—CWB) exclusive rights to export wheat and barley. In fact, the standard approach of the United States government has been to view any state trading agency, in any country, as having an inequitable trading advantage due to "secretive" pricing. For instance, the United States government's objection to China's entry into the World Trade Organization (WTO) is partially based on the fact that China imports grain through a state trading agency (Hafemeister, 1994). In contrast, economic theory would predict that state trading agencies are inefficient, and thus would be inferior traders, unless they had sufficient market power to make up for the inherent inefficiencies due to lack of competitive discipline within the organization. The reasons for the United States government's blanket opposition to any state trader in grains are not immediately obvious, as it is doubtful that all the state traders in all grains have market power. In fact, state trading agencies like the CWB or the Australian Wheat Board (AWB) sell a large percentage of their grain for export to private trading companies and thus do not deal directly with the final importer, suggesting an absence of market power. As part of the 1994 United States International Trade Commission (USITC) hearings on Canadian wheat exports to the United States, the CWB argued that it typically sells wheat to the United States through accredited agents (e.g., private trading companies) and therefore the CWB may not know the final landed price of a shipment. The same is true for CWB sales of barley to the United States. If the final landed price or final customer is unknown to the state trader, then market power is most likely absent.

The United States sense of injury due to "unfair" Canadian grain policies is heightened by the unwillingness of Canada to reduce by any appreciable degree the protectionist effects of its supply management programs and, thereby, permit the expansion of United States exports to that market for dairy and poultry products. Perhaps grain disputes should not be viewed in isolation from these other commodity disputes in dairy, chickens, or sugar.

Canada has responded to the United States criticisms by pointing out that the CWB is infrequently subsidized by the government[2], that United States grain subsidies have historically been higher than in Canada, and that United States export subsidies raise the domestic United States price above world levels and natural arbitrage pressures result in more Canadian grains flowing into the United States. The recent debates over wheat have been summarized by Alston, Gray and Sumner (1994), while those in barley have been discussed by Veeman (1993), and by Johnson and Wilson (1994). The purpose of this

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[2] The CWB pools all sales within a crop year (August to July) and advances to farmers an initial payment when farmers deliver their grain. Government budgetary transfers to the CWB are infrequent, and only occur when final returns amount to less than the initial payment. In the case of barley, the "pool losses" have been insignificant, except in 1985/86 when they were $35 ($C) per mt. and in 1986/87 when losses were $17 per mt. In the case of wheat, losses have been less common, with a small loss of $1.05 per mt in 1985/86. In 1990/91, wheat losses were rather large, however, with a $20 per mt. loss on the durum wheat pool and a $30 per mt. loss in the wheat pool. These large pool deficits occurred at a time when significant changes occurred in U.S. exports as a consequence of the Farm Bill.

paper is to outline some of the forces and factors that have produced the disputes between Canada and the United States, and to discuss the role of economists in the debate, with the overall aim of better understanding the policy process.

DESCRIPTION OF THE DISPUTES

Durum Wheat

The recent grain disagreements center primarily around additional southbound Canadian exports to the U.S and it all began with durum wheat (Alston, Carter, Gray and Sumner, 1994) after the signing of CUSTA. The CWB was never precluded from selling grain into the United States market but CUSTA provided a more formal means of legitimizing sales. With CUSTA, there was less threat of imposition of Section 22 of the Agricultural Adjustment Act of 1933, which allowed the United States government to impose quotas on imports if it was determined that such imports were threatening United States price support programs. Prior to CUSTA, Canadian import barriers were high for grain, while those in the United States were relatively small. As a result of CUSTA, Canadian import licenses were to be removed and the United States tariff was to be lowered, and this has happened in the case of wheat. CUSTA also eliminated Canadian subsidized freight rates on grains exported to the United States through the west coast of Canada.

In the late 1980s, the United States began importing significant amounts of durum wheat from Canada and these shipments soon became a major trade irritant to the United States. The United States government position was that increased Canadian durum sales were inconsistent with the 1989 CUSTA and the Canadian government strongly disagreed. In response to the imports, in December 1989, the United States Congress instructed the United States International Trade Commission (USITC) to examine the "conditions of competition" between the United States and Canadian durum industries[3]. The USITC report in 1990 concluded that the drought of 1987-89 was the main reason for increased durum imports from Canada and price differences were not found to be a factor.

However, the issue was not put to rest by the USITC ruling and the case of Canadian durum wheat sales was then heard before the CUSTA binational panel in 1992. The United States alleged that the growth in Canadian exports was due to the CWB selling into the United States at less than acquisition cost and that, in addition, the Canadian transportation subsidy led directly to increased Canadian exports to the United States. Under CUSTA, public entities cannot export agricultural goods to the other country at less than the acquisition price:

> *Neither party, including any public entity that it establishes or maintains, shall sell agricultural goods for export to the territory of the other Party at*

[3] This was USITC Investigation No. 332-285 "Durum Wheat: Conditions of Competition Between the U.S. and Canadian Industries".

a price below the acquisition price of the goods plus any storage, handling or other costs incurred by it with respect to those goods. (CUSTA Article 701.3)

The charge that the CWB was selling into the United States below acquisition price was akin to the notion that the CWB was "dumping" into the United States market. The binational panel did not agree with the United States claim and the panel made its final ruling in favor of Canada in January 1993. The panel found there was no compelling evidence that the CWB was selling below its acquisition cost. In arriving at its decision on acquisition costs, the panel noted that Ms. Ann Veneman, Deputy Secretary of the USDA, and United States Trade Representative Clayton Yeutter, on separate occasions, had both defined the term "acquisition cost" to be the CWB's initial payment[4]. In the final report, the panel stated that the United States government had tried to avoid the Veneman and Yeutter statements, however the binational panel viewed the Veneman and Yeutter statements as being important. Unfamiliarity with the Canadian system could have led to these statements by Veneman and Yeutter on CWB acquisition costs and, ironically, these official government statements helped Canada win the case in front of the binational panel.

The accuracy of the statements by Veneman and Yeutter may be debatable but if the statements are inaccurate, this does not mean the CWB was dumping into the United States market. The CWB initial payment is a type of "down-payment" and is not the full acquisition price. The initial price is established each year by the CWB, based on expected market prices over the course of the crop-year, and the initial payment is set low enough to avoid a deficit in the pool. Thus, the initial CWB price is always set below the expected average price for the year. The CWB's true acquisition price is the crop-year average price paid for grain purchased in the pool and thus about one-half of the sales during the year are typically below the acquisition price. The very nature of price pooling is designed to smooth price fluctuations over the crop-year by returning the average price. All sales cannot be made above the average, and thus it may be impossible for the CWB to meet the terms of CUSTA's section 701.3, strictly interpreted.

Milling Wheat

The dispute in durum then spread into regular milling wheat shortly after the binational panel ruled against the United States on durum. In response to political pressure in the northern wheat-growing regions of the United States, President Clinton requested the International Trade Commission (ITC) investigate the effects of wheat imports from Canada in 1994. In July 1994, the ITC reported with a split decision. Three Commissioners found that imports from Canada had materially affected the costs of the wheat program through lowering prices and increasing the value of deficiency payments, thereby potentially triggering the use of import quotas to protect the program.

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[4] See the Final Report of CUSTA's binational panel in the matter of "The Interpretation of and Canada's Compliance With Article 701.3 With Respect to Durum Wheat Sales" CDA-92-1807-01, February 8, 1993, pp. 39-41.

The other three Commissioners found these imports had not materially affected the cost of the wheat program but that they did have some effects on particular regions and classes of wheat. All six supported the recommendation that higher import barriers should be introduced.

However, even before the ITC had reported, in April of 1994 the United States government notified the GATT under Article XXVIII that it intended to amend its tariff rates on wheat and barley imports from Canada (Simone, 1994). It can be inferred from this preemptive action that the United States was not seeking temporary protection from perceived injury, otherwise alternative measures could have been used, such as Section 22 legislation. It may be concluded that in the absence of a negotiated settlement with Canada, Article XXVIII offered the best alternative for the United States, despite the risk that Canada would use the provisions of the Article to seek compensation or to retaliate (Carter and MacLaren, 1995).

In August 1994 after protracted negotiations, an agreement between the two countries was reached. There are three elements to this agreement which include: schedules of tariff rate quotas on durum and non-durum wheat imports by the United States from Canada; the establishment of a Joint Commission to examine each country's price support systems for grains and their effects on third country trade; and a peace clause which limits for one year actions on grains and grain products which are not consistent with either the NAFTA or the GATT. While the United States withdrew its proposed actions under GATT's Article XXVIII, Canada maintained the right to challenge United States actions under both the NAFTA and the GATT, although agreeing for one year from September 1994 not to use the dispute settlements procedures of either Agreement.

Why did Canada agree to this outcome which, at the export levels prevailing during 1993/94, would lead to a loss of export earnings? Could Canada have forced the United States to use Article XXVIII of the GATT and then, legitimately, have imposed its own import restrictions on, or sought compensation from, the United States? As Canada had maintained that GATT obligations took precedence over obligations under the NAFTA, it was infeasible to claim as a negotiating ploy that the United States was violating Article 401 of the CUSTA by raising tariffs. At the same time, it can hardly be claimed that Canada had entered into the spirit of the Uruguay Round Agreement on Agriculture with respect to the tariffication process of non-tariff barriers for the supply managed products; these out-of-quota rates being established at prohibitive levels.

Carter and MacLaren (1995) evaluated the 1994 wheat trade Agreement between the United States and Canada in the context of a potential trade war that could have erupted given the determination of both sides. Using a CGE (Computable General Equilibrium) model, we concluded that the 1994 Agreement appears to have been a success, from the viewpoint of the Canadian government and its desire for an outcome that minimized losses in the face of United States threats to impose permanent import barriers on Canadian grains. Even though the Agreement resulted in economic costs for both countries, it was successful in the sense that it averted a potentially damaging agricultural trade war.

Barley

The dispute in barley has not reached either the USITC or the binational panel, because the CWB has not aggressively marketed barley in the United States, partly for fear of retaliation on the part of the United States (Brooks, 1993). However, within the Canadian public policy arena, the barley debate has been vigorous (Veeman, 1993; Johnson and Wilson, 1993). The CWB (1992) has argued that in the case of barley it has market power in the United States, and thus it is optimal to restrict sales into that market. Accordingly, the CWB has argued the United States barley market is not highly important for Canadian farmers. This claim has been challenged by Carter (Carter, 1994), and by Johnson and Wilson (Johnson and Wilson, 1994), who find no evidence of CWB market power and, instead, argue there is good potential for additional feed and malting barley sales from Canada to the United States. The feed grain demand would be in the western part of the United States, the Pacific North West (PNW) (including Oregon, Idaho, and Washington) and California.

Farm groups in Canada are split over this issue of whether or not to aggressively pursue the United States barley market, as is the Canadian grain handling and processing industry. For instance, the brewing industry in Canada would prefer free trade in North American malting barley and malt, whereas the Canadian maltsters prefer the status quo whereby the CWB controls sales. It might seem paradoxical that the Canadian maltsters prefer to buy from a monopoly but they are obviously willing to trade-off any cost of doing so against returns through other disguised forms of beneficial government regulation and beneficial treatment by the CWB with regard to availability and pricing of malting barley processed for export.

Historically, the Canadian and United States barley markets were essentially two separate markets until the CUSTA agreement. There was relatively little north-south trade, and price differentials across the border frequently exceeded transport and handling costs. There were two primary reasons for this market separation. First, the Canadian rail freight subsidy encouraged east-west movement of grain within Canada, and second, the CWB controlled export permits for barley and limited export to the United States.

It has been argued earlier by the author (Carter, 1993a; 1993b; 1994) that a single desk seller is unwarranted in the case of Canadian barley sales to the United States because Canada is a price taker in the United States market. The inefficiencies associated with having a government single desk seller in barley far outweigh the relatively small benefit from domestic price discrimination in malting barley within Canada.

Alternatively, Brooks (1993) claims the CWB has market power in the United States market and that single desk selling is important from an economic efficiency standpoint, because he reasons the system is most efficient when Canadian farmers do not know the United States price of barley. He argues that inefficient resource allocation will take place if prairie farmers are in a position to compare the spot United States price with the CWB pooled price. Theory would predict that inefficiencies arising from a lack of market signals under the status quo adversely affect the allocation of resources in Canada and distorts the amount of feed and malting barley produced.

On August 1, 1993 the Canadian government implemented a continental barley market by removing the CWB's control over exports to the United States. However, on September 10th, 1993, a federal court judge ruled the government decision to introduce a continental barley market was illegal. Thus the continental market was only effective for forty days, but during this relatively short time period it was estimated that between 0.5 and 1.0 mmt of barley was sold to the United States (Johnson and Wilson, 1994). Prior to the 40-day record level of exports, the most the CWB ever previously sold in one entire year was 0.47 mmt. and Johnson and Wilson have estimated that a continental barley market could result in Canadian exports to the United States reaching 3.5 mmt per year. This reinforces the point that reform of the CWB's control over exports would most likely lead to a higher level of Canadian sales into the United States market. The future role of the CWB in the barley market remains an unsettled issue in Canada.

ECONOMIC ANALYSIS VERSUS POLICY REALITY

In describing the role of economists in influencing policy, Paul Krugman (Krugman, 1994) divided economists into two groups: *policy entrepreneurs* and *professors*. The former describes economists who play up to the preconceptions of politicians and special interest groups, while the latter describes academic economists who stick to academic arguments. Krugman's rule is that if you see an economic expert on television quite often, then he or she probably is not much of an expert, but rather, a *policy entrepreneur*. Robert Nelson (Nelson, 1987) would describe Krugman's group of professors as *neutral experts*.

Many economists have an idealized view of their role in policy making and are often puzzled as to why their ideas are typically crowded out by political considerations. Economists are constantly frustrated with policy makers who do not place much weight on economic efficiency. Rivlin has explained that there exists a large rhetorical gap between economists and policy makers and largely for this reason, economists have limited influence over policy. Economists do not speak the same language as politicians. There is good reason to believe these generalizations by Rivlin apply in the case of North American grains policy. In describing why politicians and economists rarely understand one another, Alice Rivlin noted that "economists and political leaders not only miscommunicate, but each accuses the other of incompetence, obfuscation, self-serving motives, and anti-social behavior" (Rivlin, 1987, p.1).

However, it is also possible that even if economists are ineffective in the short run, their ideas may slowly percolate into the future shaping of policies. John Maynard Keynes argued that the *professors* do have an influence:

> *The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slave of some defunct economist. Madmen in authority, who hear voices*

> *in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of the vested interests is vastly exaggerated compared with the gradual encroachment of ideas* (Keynes, 1936, pp. 383-384).

Economists have been partly involved in these recent grain disputes but to what extent have they had any influence over the policy process? Most policy makers would probably say that economists have had very little influence. Is the problem due to the fact that economists and policy makers do not understand one another, as Rivlin suggests? Economists working as advocates for special interest groups have perhaps played a larger role than that of the so-called *neutral* economists. Academic economists have a tendency to implicitly support established agricultural policies by remaining silent on the issue and not challenging the social desirability of policies. Challenges on economic efficiency grounds run the risk of offending funding agencies (such as the ERS or Agriculture Canada) or other politically powerful institutions (such as grower organizations, the Canadian Wheat Board or private grain companies). Agricultural economists are often careful not to condemn established policies for fear of getting involved in a political debate, as there is a fine line between economic policy analysis and politics.

It is unavoidable that any comprehensive economic analysis of policy issues in grains involves an investigation of the role of established institutions. Several years ago, Hendrik Houthakker observed that "the economic analysis of institutions is not highly regarded or widely practiced among contemporary economists" (Houthakker, 1959, p.133). Houthakker's observation remains valid today in North American grains policy and it partially explains why economists have been less than effective.

Alternatively, some of the in-house economists working for institutions such as the CWB, or the United States Department of Agriculture's Economic Research Service often have to take partisan positions and stand clearly on one side of the line between academic policy analysis and politics. These institutions have a certain demand for economists who are willing to argue a partisan position, much like a lawyer who tries to get the most for his or her client. This is not to say these institutions do not employ both types of economists, including those who are expected to be *neutral* analysts and provide policy advice based on economic criteria alone.

The economic arguments put forth during the 1994 USITC hearings on Canadian wheat imports brought out both the *policy entrepreneurs* and the *professors*. The arguments made during the hearings are summarized by Alston, Gray and Sumner (Alston, et al, 1994). Three groups of economists presented results to the hearings, representing the United States Department of Agriculture, the CWB, and the USITC staff economists. The USDA testimony (Collins, 1994) argued that Canadian imports of wheat had a significant impact on the United States wheat program because the imports lowered United States domestic prices by about 9¢ per bushel. An import quota on Canadian imports set at 22.4 percent of 1993/94 imports would have "saved" the United States government about $230 million, according to the USDA economists. Alston, Gray and Sumner found a much smaller impact on the cost of the United States wheat program and they estimated program costs would only fall by about $16 million if Canadian imports were limited to 22.4 percent of the 1993/94 level. There is a tremendous gap between the two sets of estimates. The USITC commissioners were not impressed with the intellectual depth of

the USDA testimony and suggested the USDA analysis was "essentially political statements, devoid of any analysis" and this opinion was widely circulated in the press. Ironically, after the USITC hearings, another USDA economist (Haley, 1995) contradicted the USDA analysis that was prepared for the USITC hearings. Haley concludes that an import quota on Canadian wheat imports would increase the cost of the United States wheat program, rather than lower it, as argued by Collins. The Haley result is confusing however, as he essentially argues that an import quota will lower domestic prices, which is at odds with economic theory. Elsewhere in the Haley paper there are serious gaps in the depth of understanding of the Canadian grain marketing system, which suggests there are also significant rhetorical gaps amongst economists. For example, he writes that "the CWB goal is to price the grain sufficiently low so that proceeds from CWB sales will cover the sum of the initial payments to producers" (Haley, 1995, p.4). Haley also assumes the CWB would respond to a United States import quota by using "export subsidies more aggressively" (Haley, 1995, p.10). What export subsidies?

Rivlin has noted that "economists tend to be uncomfortable in the role of partisans or advocates, preferring to be seen as neutral experts whether we are or not" (Rivlin, 1987, p.10). Her observation suggests that *policy entrepreneurs* might ideally prefer to be seen as *neutral experts* but sometimes the *policy entrepreneurs* have trouble hiding their stripes. This is an alternative way of saying that even though economists portray others as rent-seekers, they do not want to see themselves as rent seekers (Cordes et al., 1993).

CONCLUSION

It appears as though the making of grains policy in Canada and the United States is ninety percent politics and ten percent economics, and this might be an optimistic view of the role of economics. Policy makers and economists do not seem to understand one another and this may explain why economists do not appear to be very effective when it comes to influencing policy makers. For instance, economists are constantly puzzled as to why the United States government wastes so much money subsidizing grain exports under the export enhancement program, or why the Canadian government believes farmers are better off not knowing the true price of their grain. Policy makers often have simple answers as to why these policies are popular, and the answers have nothing to do with economics. However, maybe all is not lost, as Keynes has argued that economist's ideas, whether they are good or bad ideas, gradually have an important influence on policy. Perhaps Keynes was not referring to grains policy, or even agricultural policy, or perhaps economists are just too impatient with the policy process and Keynes was right that economists are more influential than is commonly believed. It just takes time for their ideas to sink in.

Economists involved in the grains policy process have operated as both *policy entrepreneurs* and *neutral experts*. However, *neutral experts* have a tendency to avoid criticizing important institutions and established policies, partly because these institutions tend to be important funding agencies. The quote by Devons at the beginning of the paper highlights the fact that it is often difficult for even so-called *neutral experts* to

separate out the economic versus political aspects of the problem. Thus, there may be a tendency on behalf of the *neutral experts* to avoid working on issues that are potentially politically charged, such as North American grains policy. They are not only neutral, but smart enough to avoid researching issues that could become politically contentious.

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