

**Submission from The Australian Grain Exporters Association (AGEA) to
the Economic Regulation Authority of Western Australia.**

Review of Grain Marketing Act 2002

February 2008

1 Introduction

1.1 This submission has been prepared by The Australian Grain Exporters Association (AGEA) in response to the review of the Grain Marketing Act 2002 (WA) by the Economic Regulation Authority. The AGEA represents several grain marketing companies in Australia. The members of the AGEA are:

- A C Toepfer international Pty Ltd.
- Glencore Grain Pty Ltd.
- Bunge Agribusiness Australia Pty Ltd.
- Cargill Australia Limited.
- Louis Dreyfus Australia Pty Ltd.
- Noble Resources Australia Pty Ltd.

Central to AGEA members is the philosophy that open and contestable markets are the most effective and efficient means of maximizing returns to the grains industry and the wider community. Members of the AGEA and their associates market a diversity of grains throughout the world. In significant grain producing countries, which feature open and contestable grain markets, AGEA members have often made substantial investments in infrastructure and grower services. Yet in most instances, most AGEA members have maintained only a limited presence in Australia, since market access to the most important grains has been subject to various forms of regulation by state and federal government. However, in some instances and where permitted, AGEA members have been marketing Australian grain, both on behalf of growers, and also on behalf of current and former statutory marketing authorities, who have utilized the members' extensive global grain marketing networks.

1.2 The AGEA welcomes the review of the Grain Marketing Act (2002) and in particular the appraisal of The Grains and Licensing Authority (GLA) in Western Australia. The GLA was initially created under the Grain Marketing Act (2002), to administer the grain licensing scheme for the bulk export of barley, narrow leafed lupins and canola from Western Australia (W.A). The grain licensing scheme intended to test whether or not allowing private trader's access to the W.A market, would improve price transparency, hold

established grain pools to account and improve liquidity in the highly monopolized WA coarse grain market. Indeed, as an interim system, the GLA has been largely successful. The presence of the GLA has essentially allowed individuals involved in the W.A grain industry to experience free market competition that exists in a de-regulated market, whilst gradually transitioning out of a fully regulated grain market that completely lacked any competition prior to the establishment of the GLA. Nonetheless, since the GLA's establishment, the surrounding environment in which the WA grain industry operates has changed significantly. In July 2007, South Australia joined Victoria, New South Wales and Queensland and fully de-regulated the bulk export of barley. Further, the new Labor government Minister for Agriculture Tony Burke has plans to fully deregulate bulk wheat exports by July 1 2008, in time for the commencement of the next harvest. Such events have rendered WA as the least attractive Australian state in which to purchase grain.

- 1.3 Today, the GLA system is no longer compatible with the current and predicted environment in which the WA grain industry operates. The costs of utilising the GLA system are significant and are ultimately worn by the growers. The WA grain industry requires a competitive, fair and efficient system, which will ensure that all W.A growers, like the growers in neighboring states, also benefit from the highest world grain prices currently on record. The benefits of a fully deregulated grain market are clearly evident. The present enquiry into the GLA provides the perfect opportunity to fully deregulate the W.A prescribed grain industry and the GLA system. Retaining the GLA in its current capacity would fail to withstand the test of reason.

2 The effectiveness of the operations of the GLA

- 2.1 While members of the AGEA have carried out their operations competently and in strict adherence to the relevant legislation and guidelines, the GLA licensing system still imposes many unwanted restrictions relative to an open and competitive market. Of serious concern is the time delay experienced by license applicants when making an application for an export license. The entire licensing process is simply not geared towards the activities of grain

exporters. Agricultural commodity markets can be very volatile comprising of many different players worldwide reacting differently to any given situation. Grain exporters will generally attempt to predict which specific markets they intend to sell grain into, yet things often don't go to plan. As each license currently issued by the GLA is receiver specific, the grain exporter would currently have to reapply for a new license should a shipment be cancelled and the exporter wish to resell to another buyer. The current GLA licensing system restricts grains marketers from implementing a contingency plan should their situation change. These unwarranted restrictions add costs and risks to license holders and reduce the quality, quantity and variety of services provided to participants in the W.A grain industry, especially growers.

- 2.2 In the current contestable marketing environment operating in most of Australia, grain exporters clearly identify a more efficient pathway to obtain the supply of grain for bulk exports, by purchasing from de-regulated states rather than from W.A. Exporters seeking to purchase coarse grain in W.A, specifically because of W.A's closer proximity to the Middle East and subsequent lower freight costs, can now look to neighboring South Australia as a suitable alternative. While South Australian coarse grains often need to be freighted longer distances to export markets, an exporter does not need to go through the longwinded and costly process of obtaining an export license such as those issued by the GLA, thus making South Australia a more attractive grain market than the market that lies across it's western boarder.

3.0 The Need for the continuation of the functions of the GLA.

- 3.1 Previous justifications for the continuation of the GLA are today no longer valid. The GLA remains a cost to the primary license holder and to W.A growers. Prior to the transitory-deregulation and the implementation of the interim GLA, reform anxiety was great among individuals in the W.A grain industry. However, this air of doubt and uncertainty has now passed. W.A growers now regularly come into business contact with export license holders, who through competitive forces can offer better price, terms and conditions, than has been the case in the past. Surely if W.A farmers are now willing to deal with export license holders, they would be willing to deal with the very

same entity in a fully deregulated market environment free of costly administration fees.

4.0 Net Public benefit of the restrictions on the export of prescribed grain.

- 4.1 The current regulatory environment in W.A has limited the participation of many service companies in the grain industry. Restricted as exporters, grain marketers have to apply for a license to each destination market, to which they may intend to export. This limits an exporters capacity to pay the full world market price as they may be unable to obtain a license for the highest paying market, or they may face the cost of applying for multiple licenses to many markets in order to be able to access the best prices. No matter what the scenario, the losers are ultimately the growers, because grain is mostly homogeneous and grain exporters are therefore going to take their business to the easiest origin in which they can access grain.

5.0 Assessment of the operations of pools and cash acquisition by Grain Pool Limited.

- 5.1 Prior to the establishment of the GLA, growers of prescribed grains in W.A had few selling options- most growers sold to the pool. In a pool, the grower carries the price and freight risk as well as the risk of payment default by overseas buyers. With the implementation of the GLA system, some growers have been able to transfer this risk by contracting with exporters. The presence of the GLA over recent years, has given growers the opportunity to be able to decide whether the risk and reward tradeoff in a pool suits them better than a fixed contract.
- 5.2 The National Farmer's Federation submission on the review of the National Competition Policy Arrangements (2005) highlights that the GLA has 'greatly expanded the choices available to WA growers' and has provided farmers with other opportunities like 'being able to sell at harvest time... when actual production is known so no production risk is involved.' Further the submission states that the implementation of the GLA system has provided growers with

'deeper liquidity in the market from forward competition, many types of contracts...that address farmers production and pricing risk needs.' Notwithstanding, there is not much evidence that the GLA/Grain Pool Pty Ltd framework created any premiums or benefits except that by introducing competition via the GLA, Grain Pool Pty Ltd, the primary licence holder, has been forced to compete in some markets for prescribed, while some growers have enjoyed higher prices and better choice in comparison with the previous monopoly marketing system, in existence prior to the establishment of the GLA. It is the AGEA's opinion that fully deregulating the W.A prescribed grain market and introducing competition will further force Grain Pool Pty Ltd to 'sharpen their pencil,' thus ultimately providing greater benefits to all W.A growers.

6.0 Licensing requirements governing the accumulation and trade of prescribed grains for exports.

6.1 The AGEA believes that the effectiveness of restrictions, imposed by licensing requirements, can only be measured against the objectives that these restrictions are supposed to achieve. Since its establishment, the GLA has simultaneously needed to satisfy the primary licence holder's wishes, whilst at the same time attempt to maximise returns to growers. In this respect, the role of the GLA can only be seen as counter productive and pending licensing applications are bound to reflect whether the GLA is today protecting the primary licence holder or the growers. This situation is unjustifiable, unsustainable and is viewed in the grains industry as an unnecessary impediment to trade. The AGEA holds the view that any form of licensing in W,A greatly limits the scope for a liquid and competitive market and thus the AGEA seeks the disbandment of the GLA.

7.0 Alternative regulatory models that could be applied in WA.

7.1 The introduction of competition to market WA prescribed grains in W.A will provide significant benefits to all WA growers. This has been amply demonstrated following the implementation of fully deregulated reform models in Victoria, NSW and Queensland. The AGEA calls for the complete

removal of the bulk export licensing system for prescribed grains and recommends the following:

- Open competition to be introduced to the W.A bulk export market for prescribed grains from July 1st 2008.
- The Economic Regulation Authority (ERA) establish a system for certifying the accreditation of exporters of prescribed grains in bulk, that meet minimum financial security and ethical trading standards.
- The Economic Regulation Authority establish and secure a regime to guarantee access to designated grain storage, handling facilities, and the provision of services for the satisfactory and competitive export of commodities from WA.

7.2 In making these recommendations above, the AGEA envisages the role of the ERA as being similar to that of the Essential Services Commission of South Australia (ESCOSA) and, in part, similar to that of the Essential Services Commission (ESC) Victoria, in requiring exporters to meet specified standards, thereby offering security to growers.

7.3 The AGEA believes that implementing the alternative model proposed above will result in several positive outcomes, some of which include:

- A range of new selling options for growers will be made available due to the newly increased presence of grain exporting companies in W.A.
- A wider range of grower services will be made available in W.A including a year round price competitive cash markets for (prescribed) grains.
- The introduction of new pricing options will increase and improve market signals received by growers that will in turn lead to better production decisions and an improvement in the use of the state's resources.
- Net returns to growers will improve as supply chain costs, including trading margins, are reduced through competition.

7.3 The AGEA believes that these benefits mentioned above can be achieved without any negative effects on prices received by WA growers.

8.0 Conclusion

8.1 The AGEA believes that the GLA system should be regarded as a transitory stage to a completely open market and maintains that there is now no compelling case for the continuation of the bulk export licensing system for prescribed grains, in its present form. A major feature of the GLA is its association with the export wheat monopoly. Section 49, 'Expiry of the Act of the Grain Marketing Act 2002,' (Western Australia), states that:

- The minister may, by order published in the *Gazette*, specify as the expiry day a day that is –
 - Not before the order is published in the *Gazette* and not before the Commonwealth has passed legislation to make a relevant Commonwealth legislative change; and
 - As soon as practicable after the 30th of April next following the day on which is relevant Commonwealth legislative change comes into effect.

8.2 The Commonwealth legislative change referred to in the Act means a change to the Wheat Marketing Act 1989 when restrictions on the export of wheat are removed.

8.2 The inclusion of this clause in the Grain Marketing Act 2002 (WA) clearly establishes that the future of the GLA is based on factors independent of its operational performance. It strongly suggests that the establishment of the GLA is not solely based on the merits of the system or the effectiveness of the GLA's role.

8.3 The AGEA submits that the GLA no longer performs the role it was originally intended to fulfil and is not maximising returns for W.A growers.



SA Barley Marketing

A submission by the
Australian Grain Exporters Association
to the
SA Barley Marketing Working Group

Submission prepared for the Australian Grain
Exporters Association by ACIL Tasman

August 2006



ACIL Tasman

Economics Policy Strategy

© ACIL Tasman Pty Ltd

This work is copyright. The *Copyright Act 1968* permits fair dealing for study, research, news reporting, criticism or review. Selected passages, tables or diagrams may be reproduced for such purposes provided acknowledgment of the source is included. Permission for any more extensive reproduction must be obtained from ACIL Tasman on (03) 9600 3144.

Reliance and Disclaimer

The professional analysis and advice in this report has been prepared by ACIL Tasman for the exclusive use of the party or parties to whom it is addressed (the addressee) and for the purposes specified in it. This report is supplied in good faith and reflects the knowledge, expertise and experience of the consultants involved. The report must not be published, quoted or disseminated to any other party without ACIL Tasman's prior written consent. ACIL Tasman accepts no responsibility whatsoever for any loss occasioned by any person acting or refraining from action as a result of reliance on the report, other than the addressee.

In conducting the analysis in this report ACIL Tasman has endeavoured to use what it considers is the best information available at the date of publication, including information supplied by the addressee. Unless stated otherwise, ACIL Tasman does not warrant the accuracy of any forecast or prediction in the report. Although ACIL Tasman exercises reasonable care when making forecasts or predictions, factors in the process, such as future market behaviour, are inherently uncertain and cannot be forecast or predicted reliably.

ACIL Tasman shall not be liable in respect of any claim arising out of the failure of a client investment to perform to the advantage of the client or to the advantage of the client to the degree suggested or assumed in any advice or forecast given by ACIL Tasman.

ACIL Tasman Pty Ltd

ABN 68 102 652 148

Internet www.aciltasman.com.au

Melbourne

Level 6, 224-236 Queen Street
Melbourne VIC 3000

Telephone (+61 3) 9600 3144
Facsimile (+61 3) 9600 3155
Email melbourne@aciltasman.com.au

Canberra

103-105 Northbourne Avenue
Turner ACT 2612
GPO Box 1322
Canberra ACT 2601

Telephone (+61 2) 6249 8055
Facsimile (+61 2) 6249 7455
Email canberra@aciltasman.com.au

Brisbane

Level 15, 127 Creek Street
Brisbane QLD 4000
GPO Box 32
Brisbane QLD 4001

Telephone (+61 7) 3236 3966
Facsimile (+61 7) 3236 3499
Email brisbane@aciltasman.com.au

Sydney

PO Box 170
Northbridge NSW 1560

Telephone (+61 2) 9958 6644
Facsimile (+61 2) 8080 8142
Email sydney@aciltasman.com.au

Perth

Level 12, 191 St Georges Terrace
Perth WA 6000
PO Box 7035
Cloisters Square
Perth WA 6850

Telephone (+61 8) 9485 0300
Facsimile (+61 8) 9485 0500
Email perth@aciltasman.com.au

Darwin

Telephone (+61 8) 8927 8237
Email darwin@aciltasman.com.au

For information on this report

Please contact:

Mark Barber

Telephone (02) 6249 8055

Mobile 0427 604 433

Email m.barberb@aciltasman.com.au

Contents

Executive summary	v
1 Introduction	1
2 How the SA barley export market would operate when opened to competition	2
2.1 Grower adjustment	2
2.2 Key institutions	3
2.2.1 NACMA	3
2.2.2 ESCOSA	4
2.2.3 Technical and marketing support for SA barley	6
2.2.4 How incumbent grain marketers would adjust	6
3 Rationale for a competitive export barley market in SA	7
3.1 International barley marketing	7
3.2 Objectives of regulation	8
3.2.1 Pools and Pooling	9
3.3 Current oversight of the ABB export barley monopoly	10
3.4 Current barley marketing alternatives in Australia	11
3.4.1 The GLA	12
3.4.2 Deregulation in Victoria	14
3.5 Price differences attributed to competitive status of various markets	15
3.5.1 Japan	16
3.6 What can SA learn from WA and Vic?	17
A Key aspects of the global barley market	A-1
B The ability to price discriminate in international barley markets	B-1
C Compulsory Pools and Pooling	C-1
D Price comparisons between SA, WA and Vic	1
E Competition policy	3

Boxes, charts, figures and tables

Box 1	How the AGEA model addresses popular concerns	vi
Box 2	Sparks Inc Review of the Chinese malt barley market	B-3
Box 3	Discussions with the ABB on how pools have accommodated change	C-2
Chart 1	Japanese feed barley market (USD tonne)	17
Chart 2	International production of coarse grains 1986-2006	A-1
Chart 3	Malting barley sales to China made by Grain Australia from the 2001-02 crop	B-2
Table 1	GLA approved barley licences	14

Executive summary

Key points of the AGEA model for the SA barley industry

- Open competition to be introduced to the SA export barley market for both feed and malting grades from 1 July 2007
- If required, a strengthening of the National Agricultural Commodity Marketing Association's (NACMA) role in the grain market including:
 - the development of national export barley quality standards; and
 - the development of an industry self-regulated system for certifying the accreditation of barley exporters that meet minimum financial security and ethical trading standards.
- An extension of the access commitments made to the ACCC by ABB at the time of the ABB Ausbulk merger should be investigated. If an extension of the ABB undertakings are not possible then ESCOSA to establish, and secure a regime to guarantee, access to designated grain storage, handling facilities, and the provision of services, for the export of commodities.
- An SA barley promotional body, independent of commercial trading activities could be established if required, and modelled on a number of other grains industries such as pulses and oilseeds.

The Australian Grain Exporters Association (AGEA) has prepared this submission for the South Australian Barley Marketing Working Group, to consider changes to the Barley Marketing Act 1993 (SA). This submission provides evidence that the continued restriction of choice and competition in the SA export barley market is not warranted, and that there are existing industry organisations capable of ensuring that the best interests of SA barley growers and the SA community, are not only protected, but enhanced.

The AGEA calls for the complete removal of the export barley monopoly in South Australia from 1 July 2007, for the 2007-08 season. There is no clear evidence that supports the continuation of the current export barley restrictions, either for the benefit of South Australian barley growers or the South Australian community.

The introduction of competition to market South Australia's malt and feed barley will provide significant benefits to South Australian barley growers as has been amply demonstrated following reform in Victoria, NSW, and Queensland. In an open and competitive export barley market:

- a range of new selling options for growers will be offered, including a year round price competitive cash market;
- barley pools would continue to be offered so long as there was demand from growers and would be improved through competition;

SA Barley Marketing

- the introduction of new pricing options will increase and improve market signals received by growers, that will in turn lead to better production decisions and an improvement in the use of the state's resources;
- net returns to growers will improve as supply chain costs, including trading margins are reduced through competition; and
- costly, and ultimately arbitrary, restrictions on competition in the commercial activities of SA barley growers, will no longer be required.

All of these benefits will be introduced without any negative price effects.

The AGEA believes that there is no compelling case for the introduction of an export barley licensing system modelled on the Grain Licensing Authority (GLA) currently operating in WA. The GLA – which is the outcome of a political compromise – is not a system introduced to maximise returns to WA growers, as its on-going justification is not dependant on its operational performance, but rather on the continuation of the national export wheat marketing monopoly.

The introduction of a barley licensing system would not provide any additional benefits to SA growers, or to the South Australian community, than those that have been enjoyed by Victorian growers since reform of the barley market in 2001. Indeed, the deadweight of another bureaucratic institution would be another net cost and should be avoided.

Box 1 **How the AGEA model addresses popular concerns**

Multiple sellers of SA barley:

- multiple sellers mean multiple buyers, competing to accumulate grain from farmers. In a competitive cash market with multiple buyers, the market price at which a buyer can buy will usually determine the sale price. However, a short seller, that undercuts other sellers, to make a sale will then have to compete with other buyers when the sale is covered; and
- multiple sellers will look for new markets, and new buyers as well as developing innovative grain marketing products.

Buyer of last resort:

- In most sizeable barley markets there are always buyers for a range of different malting and feed barley qualities. Growers that depend on a buyer of last resort and are not producing barley suitable to buyers' needs, should not be cross subsidised by those that take trouble to produce the right quality for a buyer.

Fly by night traders:

- Growers will need to take responsibility for managing their credit exposure and selling only to reliable buyers. A good starting point would be to deal only with NACMA Members. If necessary NACMA could be called upon to provide a form of accreditation for exporters. Growers will always have the option of trading with the ABB and other grain companies, if they are concerned about the financial security of any one particular buyer.

SA Barley Marketing

Quality standards:

- SA barley quality standards will be maintained in at least two ways. Competition to export grain will force exporters to meet or exceed the standards that overseas buyers require to maintain market share. Buyers will also be developing new, often niche, markets that will lead to increased differentiation. The AGEA model recognises the role of NACMA in establishing industry-wide grain standards and contract terms and conditions. Buyers and sellers can agree to use these standards or develop other standards to suit their own particular needs. ABB will still handle the majority of the barley crop through their storage and bulk handling network and will therefore be able to ensure that minimum receival standards are met.

Promoting SA barley to world markets:

- In virtually every other agricultural export market there is a separation of generic and industry-wide promotion and commercial trading activity. The AGEA believes that this principle is fundamental to any future SA barley marketing arrangements. The AGEA model proposes that SA barley will be promoted by private grain companies as it will be in their interests to do so, once they have made investments in barley marketing services and infrastructure in SA. There are also a number of government agencies that can fulfil this role, as they do for a range of other SA primary products. Alternatively, a separate SA (or Australian) barley promotional body could be established, if required, based on other industry models such as Pulse Australia, and the Australian Oilseed Federation (AOF).
- The formation of a separate barley marketing organisation should also be considered in the context of potential changes to the national wheat export market.

1 Introduction

This report was commissioned by the AGEA, as their submission to the S A Barley Marketing Working Group. The AGEA represents several grain marketing companies in Australia. The members of the AGEA are:

- A C Toepfer International (Australia) Pty Ltd.
- Glencore Grain Pty Ltd.
- Bunge Global Markets Australia Pty Ltd.
- Cargill Australia Limited.
- Louis Dreyfus Australia Pty Ltd.
- Noble Grain Australia Pty Ltd.

The AGEA was formed in 1980 by a group of private grain exporters to promote their philosophy that open and contestable markets are the most effective and efficient means of maximising returns to the grains industry and the wider community.

Members of the AGEA and their associates market a diversity of grains throughout the world.

In most instances, the AGEA members have a limited presence in Australia since market access to the most important grains has been the subject of various forms of regulation by State and Federal Governments. However, in many instances, and where permitted, these companies have been marketing Australian grain, both on behalf of growers, and also on behalf of current, and former statutory marketing authorities, who have utilised their global grain marketing services.

Where AGEA members do have significant access to the grain market in a particular country, the investments they have been prepared to make in infrastructure and grower services have at times been substantial.

There have been at least 25 major studies on the impact of grain market regulation in Australia over the past 10 years. In almost all cases the reports have been ex-ante to reform; few reviews are conducted ex-post. The main reason for this is that prior to reform anxiety is greatest, prompting a desire for detailed studies to be carried out and various views to be canvassed. Before this reform, commentary, inspired by vested interests whose main concern is self-preservation, has at times approached an almost hysterical pitch, but tended to quickly disappear after the event. An important objective of this submission is to show that the angst that typically precedes reform is not warranted.

A consistent finding of virtually all of the analyses conducted to date suggests that any price effects attributable to a change in grain market regulation are difficult to ascertain and any price differences are likely to be small. This suggests that any market power held by the incumbents is likely to be small or non-existent. All of the anecdotal information, particularly when SA and Victorian prices are compared is that there is a significant price difference of between \$10 and \$20 per tonne.

The interests of the AGEA and SA barley growers are well aligned – AGEA members depend on profitable grain growers for a continued and expanding supply of high quality grain to market.

2 How the SA barley export market would operate when opened to competition

The AGEA proposes that the SA export barley market be opened for competition from 1 July 2007. The following sections outline;

- how growers have adjusted to competition where markets have been reformed and reorganized;
- the key institutions that operate in competitive markets to protect growers and the wider industry interests;
- how new market entrants access storage and handling infrastructure; and
- how the incumbent marketer has managed the adjustment.

2.1 Grower adjustment

Experience in Victoria, NSW, Queensland and Western Australia suggests that barley growers will quickly adjust to a competitive market environment and take advantage of new marketing opportunities with little or no disruption to their business operations.

The main reasons behind these successful transitions are covered in section 3 where experiences of partial and full reform in WA and Victoria are examined in more detail. However, the main reasons for these efficient transitions are summarised as:

- the incumbent marketer, in each instance, has maintained significant market share through their previous long-standing presence as a single buyer for some time after the introduction of competition;
- familiar pooling options continue to be offered to growers;
- prices have remained at least at pre-competition levels and there is considerable anecdotal evidence that higher net returns to growers

eventuate as costs, particularly pool managers' commissions and grain company margins, decline as competition increases; and

- a number of commercial and publicly funded market information services are introduced and utilized by growers.

In the case of WA, NSW, Vic and Queensland the intention to introduce additional competition into export grain markets was clearly signalled to growers and the industry, well in advance, to allow necessary adjustments to be made.

2.2 Key institutions

There are two institutions that the AGEA believes could play a key role in a competitive SA export barley market, if required. These organizations are:

- the National Agricultural Commodity Marketing Association (NACMA); and
- the Essential Services Commission of SA (ESCOSA).

In addition to these organisations a SA barley market promotion and technical support organisation may be required. However, this organisation will need to be developed in the context of a national approach to grain market promotion that may be required after the Federal Government responds to the findings of the Cole inquiry.

2.2.1 NACMA

The AGEA believes that an industry self regulation approach to would provide the most efficient method of ensuring that the interests of growers and the wider SA barley industry are protected. This is because industry and growers can together develop a system of oversight for certifying export marketing of South Australian barley that is responsive to their needs now and in the future.

An organisation upon which an export industry accreditation body could be modelled or adapted to provide these services is the National Agricultural Commodity Marketing Association (NACMA).

All of the members of the AGEA are members of NACMA, so is ABB Grain and the Grains Council of Australia (GCA). A number of barley and wheat growers are also members of NACMA and most growers are familiar with the grain standards and contract forms that NACMA has developed for most broad acre crops in Australia.

NACMA is the Australian industry's self-regulatory body representing and servicing the commercial interests of the Australian grains industry. NACMA

is an independent and non-commercial body that operates to ensure the smooth facilitation of trade and commerce within the grains sector¹.

NACMA's main core functions at present are:

- standardising grain quality specifications, contracts and trade rules enabling smooth facilitation of trade;
- the provision of a cost effective mediation and dispute resolution service for the entire industry, not just NACMA members; and
- trade information services that include the latest trading tools, education programs, etc.

The AGEA believes that the Working Group should carefully assess the need for an independent body to provide some form of export market accreditation for grain marketing companies wishing to export South Australian barley. If such a body were deemed necessary the Working Group could consult with NACMA as to its capacity to provide this service. If required, a certification system could be developed to provide the following assurances to growers, industry participants, and government alike, that the grain marketing company holding the certificate:

- is reputable and trades in an ethical manner;
- is experienced and has the financial capacity to export Australian barley;
- invests in education and training programs for staff;
- will enhance the reputation of the South Australian barley industry in export markets;
- uses a uniform pricing system for delivery to country silo or port elevator, as approved by NACMA;
- uses NACMA trading contracts; and
- discloses all contracts terms and conditions to growers (and ensures that growers understand and accept them) and, in the event of a dispute, will enter into a dispute resolution process, such as that provided by NACMA.

AGEA believes that an industry self-regulation system such as NACMA could provide, if necessary, a transparent and secure trading environment that will gain the confidence of growers who are already enjoying the benefits of NACMA, when they trade a range of other grains, both in SA and throughout Australia.

2.2.2 ESCOSA

At the time of the ABB Grain Ltd/Ausbulk Ltd/United Grower Holdings merger, ABB Grain Ltd made certain undertakings to the ACCC in relation to

¹ *Providing commercial rules and standards for the Australian Grains Industry*, NACMA 2006. More information on NACMA can be found at www.nacma.com.au

access to the SA storage and bulk handling system and the provision of services.

The AGEA considers that those undertakings should be extended and modified to cover access for new entrants as this would avoid the need for an administratively expensive new access regime. However, in the event that the undertaking given by ABB Grain Ltd to the ACCC cannot be extended, then the AGEA supports a system to be established and administered by ESCOSA.

ESCOSA is the Essential Services Commission of South Australia. Generally, its role is to protect the long term interests of South Australian users of utilities with respect to the price, quality and reliability of essential services whilst also:

- promoting competitive and fair market conduct;
- preventing misuse of monopoly or market power;
- facilitating entry into relevant markets;
- promoting economic efficiency;
- ensuring consumers benefit from competition and efficiency;
- facilitating maintenance of the financial viability of regulated industries and the incentive for long term investment; and
- promoting consistency in regulation with other jurisdictions.

In both South Australia and Victoria access to railways and bulk grain loading facilities at ports is assured by their respective Essential Services Commissions. Whilst there is no specific legislation covering terminal silos in South Australia, ABB Grain Ltd is a Regulated Operator and Regulated Service Provider in respect of the Port of Ardrossan and a Regulated Operator in respect of the other six grain loading ports, so it is subject to ESCOSA monitoring and direction, if necessary.

In the event that barley could be exported from South Australia by several marketers in competition with each other, ESCOSA would have an important role to play in ensuring that new entrants to the market could obtain access to country and port storage and loading facilities owned/operated by a competitor (in this case ABB Grain). Use of those shared facilities would have to be on the basis of ESCOSA's role in protecting the interests of users of the essential services outlined above.

Sharing of bulk storage and loading facilities is already practised in Victoria. For example, Graincorp owns and operates the regulated terminals at Geelong and Portland, at which it is obliged to provide access to its facilities on 'fair and reasonable terms'. The Essential Services Commission of Victoria has the power to arbitrate any disputes over the conditions of access that cannot be resolved through commercial negotiation.

2.2.3 Technical and marketing support for SA barley

The AGEA is not immediately convinced of the merits of a separate barley promotion body for Australia or South Australia. The AGEA is of the view that private traders have an incentive to promote Australian barley to maximise prices, find new buyers and increase market share, as do voluntary groups of barley growers.

Having said that, the AGEA acknowledges that there are a number of such promotional organisations operating in several other agricultural industries that are popular with growers

There are several organisations upon which a barley promotional organisation could be based, including:

- the Australian Oilseed Federation;
- the Wine and Brandy Corporation; and
- Pulse Australia.

The AGEA does not object to such a body being formed and, in the event that a clear need were to be established, the AGEA would actively support its creation.

The overarching principle of the creation of a barley industry promotional body would be to separate it from commercial trading interests. This would allow the organisation to act in the interests of all SA barley growers and allow the funding of the organisation to be transparent.

2.2.4 How incumbent grain marketers would adjust

As outlined in section 3.4.2, the export barley market was opened to competition in Victoria on 1 July 2001. Since that time, the incumbent marketer has maintained significant market share through its previous long-standing presence as a single buyer. Moreover, in response to competitors it has improved its services to growers with cash bids, forward contracting options into cash markets, deferred payment options, and greater disclosure of pricing structures.

Through its historical and close relationship with barley growers, ABB Grain Ltd is in a prime position to secure its role on a competitive basis. In addition to selling export barley, ABB Grain Ltd's commercial activities extend to storage and handling services, a freight service, on-line market information service, grain processing and cleaning, testing for quality attributes, a malting operation, containerisation, engineering, maritime services and fertilizer distribution. Its track record stands it in good stead not only to survive, but to prosper in response to the opportunities opened up by market reform.

3 Rationale for a competitive export barley market in SA

3.1 International barley marketing

The international barley market has some unique features that provide the context for any discussion of changes to the South Australian barley export monopoly. The most important aspects of the international barley market are:

- the Saudi Arabian Government has fixed the level of subsidies on feed barley imports which means that domestic prices will now track international prices and not be fixed;
- the Japanese Food Agency has introduced a simultaneous buy/sell system allowing a number of new entrants into this market;
- the regulatory changes in Saudi Arabia and Japan are reshaping the nature of the international barley market. Elasticity of demand in these markets is likely to increase, which may reduce any capacity, assuming there was any, that there may have been for the ABB to price discriminate;
- with a reduction in the influence of the Saudi subsidies and changes to Japanese buying, an international barley futures market may emerge;
- China may become a more important market for Australian malting barley, but it is a highly competitive market, demonstrating a willingness to regularly substitute Australian malting barley with cheaper, lower quality barley from the EU (see box 1 below);
- the way barley is marketed is different from wheat. Grain marketing companies buying and selling barley do not have a dominant international barley futures market to benchmark price and provide price discovery. To successfully buy and sell barley, as with other grains, it is necessary at all times to be fully aware of the supply and demand balances of a number of key exporting and importing countries; and
- the barley market is continuously created on the views of individual companies which can and do vary from one another from time to time, but generally the market appears to be reasonably efficient.

Given the volatility of international barley markets and the lack of an internationally recognised derivatives market the ability to trade a number of ‘origins’ (sources of supply) of barley is an important risk management tool for grain marketing companies. Multiple origin trading means that a marketer can source grain from a number of origins around the globe for different markets. However, buyers can, and regularly do, specify the origin of the barley they wish to purchase. The advantages of being able to trade grain in this manner are:

- a marketer is not dependant on a single supply of grain and consequently subject to variations in production from this source;
- a marketer trading multiple origin has the incentive to invest in supply and demand information for a wide range of producers and consumers;
- scale economies can be developed as the marketer can spread the costs of the business over a much larger potential source of grain; and
- shareholders of a company trading a single origin will need to be compensated for the increased risk of trading in this manner which will be reflected in the margin charged by the marketer.

The ability to trade a number of sources or origins of grain does not lead to a marketer ‘cherry picking’ markets or playing one source off against another. In a competitive market a marketer that tries to extract ‘rents’ will find that other marketer will quickly identify the variation in price and bid it back to world price levels. The term for this type of trading activity is ‘arbitraging’, by which competition ensures markets remains in relative equilibrium.

3.2 Objectives of regulation

In the AGEA’s view the objectives of the current barley market regulation are no longer being achieved, and are unlikely to have been fulfilled for some time. It follows that the legislation restricting competition in the SA export barley market should be repealed as soon as possible.

The aim of regulation of the SA barley export market was to increase growers’ returns by:

- capturing monopoly rents from the rest of the world (by price discriminating between markets of different elasticities of demand) and transferring them to South Australia barley growers;
- providing a mechanism to counter asymmetry of information between a small number of large-scale buyers and a large number of small-scale barley growers; and
- capturing economies of scale and scope that are not otherwise available to grain marketing companies.

Many independent studies commissioned for various reviews of grain market regulation over several years, and the AGEA’s analysis and members’ experience of the international barley market, clearly show that the objectives of regulation are either no longer relevant or can be achieved by means other than a restriction of competition.

- Modern international grain markets, particularly feed and malt barley markets, preclude the ability of any marketer, either state backed or private, to price discriminate (see appendices A and B). There is no independent or clear evidence to suggest that any statutory backed marketer has been able to exercise market power for any of Australia’s major grains. Where an

enhanced price has existed it has been due to other factors such as quality differences, timing of delivery, financial arrangements or special needs of the purchaser which are already built into the price. Evidence of the ability to set a price – due solely to the statutory status of the seller – that has been presented by monopoly marketers to previous studies is unconvincing (see appendix B section B.1).

- To the extent that asymmetry of information existed decades ago between major marketers and small growers, it has been overcome by:
 - advances in technology – such as the internet – which provide low cost, easily and promptly obtainable, high quality and up to date domestic and international barley price information;
 - a proliferation of private and public market information service providers; and
 - a rising awareness of markets and marketing options by growers.
- Similar scale economies to that of the ABB are achieved and exceeded by a number of international barley marketers. The ABB pool service charges of between \$AUD6.00 and \$AUD7.00 per tonne, which is higher than a number of comparatively sized pools, and that of the AWB national pools as reported by the WEA, in a normal wheat production year suggest that either scale economies are not achieved by ABB or are not being passed on to growers².

3.2.1 Pools and Pooling

Another of the problems of regulation that restricts competition in grain markets is that any benefits, if there are any, need to be equitably distributed to barley growers.

The benefits or costs that may flow from regulating a grain market can only be efficiently distributed to all grain growers through compulsory pooling. However, pools are grain marketing products that are also offered in competitive markets. Thus regulated markets are dependant on pools, but pools can be offered as a grain marketing product in regulated, partially competitive and fully competitive markets.

Pools smooth prices over time and between growers, creating a degree of cross subsidisation that is not present in most other grain marketing products. This cross subsidisation leads to:

- distorted grain prices, leading to inaccurate production decisions by farmers; and

² ACIL Tasman, 2005, Marketing Western Australian Wheat, an analysis of the effects of export wheat monopoly on the Western Australian wheat industry, July.

- inefficient resource allocation by farmers, which diverts resources from higher value uses.

Inefficient resource allocation impacts on all South Australians as barley growers may use resources that could be better utilised in other enterprises or by other sectors of the economy. Moreover, all South Australians are denied the full benefits of competition policy reform in addition to the \$AUD3.0 million in competition payment already lost (see Appendix E).

3.3 Current oversight of the ABB export barley monopoly

Originally, the state government in SA was considering its future marketing arrangements for barley given the prospect of continuing to lose National Competition Policy (NCP) payments of the order of \$3 million each year. Potentially, the reforms could have been to introduce a fully competitive market or, in transition, a WA style Grain Licensing Authority (GLA).

However, to pacify critics and supposedly to accommodate the SA Government's wish for some reform, the ABB has opted for several transparency measures instead. These are explained from the ABB website.

In August 2005 ABB, together with the South Australian Farmers Federation (SAFF) Grains Council, developed a three-pronged strategy to enhance the transparency of ABB's management of the growers' single desk. The strategy involves producing a concise ABB Pool Performance Report; providing third-party access to ABB's export barley pool; and allowing an independent auditor to examine the operations of the pool. The audit process will be overseen by the recently established South Australian Barley Single Desk Transparency Committee.

While the introduction of the transparency measures appears to be a genuine attempt to increase the accountability of ABB Grain's management of the pool it appears to be governance rather than performance oriented. While monitoring the governance of the pool is important to ensure growers' interests are being looked after, it does not provide any assessment of the benefits that the export barley monopoly produces for South Australian growers.

Even if the Transparency Committee were established to measure the performance of the ABB Grain there are considerable questions about how this would be accomplished. To assess the performance of ABB Grain a suitable benchmark needs to be established. This has proven to be an almost impossible task when the experience of attempts to benchmark AWB Ltd and CWB are considered.

In 2001 the CWB commissioned Dr Richard Grey from the University of Saskatchewan to develop a benchmarking methodology to measure the

performance of the CWB. The task given to Dr Grey was to develop “meaningful benchmarks that will measure the performance of the CWB relative to a market where multiple sellers exist.” In his final report, he defined “performance” as “net farm gate prices received by Canadian farmers under single desk selling versus the net farm gate prices Canadian farmers would have received under identical conditions if the CWB did not exist.”

A Sparks Inc (Sparks 2003) review of the methodology developed by Dr Grey and his colleagues commissioned by the Alberta Grains Commission concluded that the methodology developed by Dr Grey was flawed, mainly due to the use of inappropriate prices, costs and a failure to adjust for distortions caused by the export monopoly. What Sparks was referring to was a lack of understanding by Dr Gray of what the ‘other wise’ (the absence of the CWB monopoly) would be.

In Australia, the Wheat Industry Benchmark (WIB) is used to measure the performance of the AWB. The basis of the benchmark is what a passive manager of the pool would do. A passive manager is loosely defined by the WEA as a manager that does not establish any price risk management, currency or trading strategies. This appears to be an even worse attempt than the CWB as the ‘otherwise case’ chosen by the WEA; a passive manager is clearly not what would arise if multiple traders were competing to market Australian grain. Thus the WEA’s approach is not a credible measure of the performance of the AWB Ltd.

The difficulty of benchmarking a monopoly trader raises the same issues that confront a licensing system but on a sale by sale basis. A credible licensing authority must answer the same question that benchmarking AWB Ltd and CWB have failed to answer, that is, “what would the ‘otherwise’ be?”

Sparks Inc also concludes that measuring marketing performance for any organisation should include a measure of total returns, not isolated to unit price. In other words, volumes sold relative the tonnage available should also be benchmarked.

3.4 Current barley marketing alternatives in Australia

The SA Barley Marketing Working Group has two approaches to reform of the barley market from which to draw when considering its recommendations. They are the partially competitive model adopted in Western Australia, and the fully competitive model in Victoria. While a great deal of information has been produced on the GLA, little has been written on the introduction of a fully competitive market in Victoria. This suggests that the GLA model requires

repeated investigation and raises considerable debate, while in Victoria the system works smoothly and efficiently, so there are no calls for re-regulation.

3.4.1 The GLA

The Grain Licensing Authority was created by the Grain Marketing Act 2002 to administer the grain licensing scheme which allows the issuing of Special Export Licences for prescribed grain exports, in bulk, from Western Australia. Licences are not required for prescribed grains exported in bags, and containers, or for the bulk export of certain value added grains.

The key roles of the Authority are to:

- manage the licensing scheme, which includes the ability to issue Special Export Licences, and administer the activities of the Main Export Licence Holder. (Part 3)
- exercise power of entry for ascertaining whether there has been a contravention of the Act. (Section 22).
- cancel a licence when a contravention of its conditions occurs. (Section 37)
- grant a Special Export Licence authorising its holder to –
 - buy any prescribed grain specified in the licence for the purpose of its export in bulk and in accordance with the Act; and
 - export in bulk any prescribed grain specified in the licence to any market specified in the licence. (section 29)
- place conditions on the licence that the Authority thinks are appropriate.(Section 33)
- seek additional information on licence applications necessary for proper consideration of the licence. (Section 35(2))

For the purposes of this submission the key aspects of the GLA that the SA Barley Marketing Working Group should consider are:

- it has been well utilised by growers;
- the barley pools have continued to operate in WA and have had to improve the services they provide to match the limited competition they now face;
- there is now a substantive body of information that has been generated which indicates that the market power of the Grain Pool of Western Australia was substantially less than popularly believed prior to the introduction of the GLA;
- growers now have a genuine cash marketing option, particularly early in the season;
- additional marketing options have been introduced for growers; and
- the GLA is costly to administer; if a similar situation applied in SA the cost would be approximately \$350,000 per years or 22 cents per tonne of barley exported.

SA Barley Marketing

While the GLA system does provide access for grain companies to the WA market there are serious problems these companies face when dealing with a licensing system. They are:

- risk of not getting a licence;
- political risk, which on the whole is not well understood, and cannot be well managed by grain marketers which will be factored into the margins required to operate in partially competitive markets;
- costs and risks are reflected in the price a grain marketer is willing to pay for the grain; and
- the licensee is required to nominate the intended destination and identity of the buyer for each sale in the application. This is a major constraint for a marketer, particularly when making sales on a forward basis. If the sale is not executed the marketer cannot divert the cargo to another buyer or another destination. This situation is likely to explain why a number of licences are not shipped against.

A major feature of the GLA is its association with the export wheat monopoly. Section 49, Expiry of the Act of the Grain Marketing Act 2002 (Western Australia), states that:

- the Minister may, by an order published in the *Gazette*, specify as the expiry day a day that is –
 - not before the order is published in the *Gazette* and not before the Commonwealth has passed legislation to make a relevant Commonwealth legislative change; and
 - as soon as practicable after the 30 April next following the day on which a relevant Commonwealth legislative change comes into effect.

The Commonwealth legislative change referred to in the Act means a change to the Wheat Marketing Act 1989 where restrictions on the export of wheat are removed.

The inclusion of this clause in the Grain Marketing Act 2002 (WA) clearly establishes that the future of the GLA is based on factors independent of its operational performance. It strongly suggests that the establishment of the GLA is not solely based on the merits of the system or the effectiveness of GLA's role.

The Working Group should take into account that the GLA was established for reason other than maximising returns for WA growers.

Table 1 **GLA approved barley licences**

Grain	Region	Tonnage Approved						Total
		03/04	04/05	05/06	06/07	07/08	08/09	
Feed	Middle East	433,000	401,000	580,000	280,000	110,000	110,000	1,914,000
	China			35,000				35,000
	Asia	35,000						
Malting barley	China			145,000	85,000	50,000	95,000	375,000
	Asia							
Total barley		468,000	401,000	760,000	365,000	160,000	205,000	2,324,000
WA barley production		3,170,000	2,080,000	2,598,000	2,039,000	1,829,000	1,829,000	
		14.7%	19.3%	29.3%	17.9%			

Data source: GLA

3.4.2 Deregulation in Victoria

The export barley market was opened up to competition in Victoria on 1 July 2001 and should provide ample evidence for the SA Barley Marketing Working Group that the concerns expressed prior to reform were not warranted as few, if any, growers in Victoria have called for the reforms to be reversed.

Key features of marketing reform in Victoria that the review committee should consider are:

- genuine cash bids, particularly for malt barley are available all year;
- there are now forward contracting options into cash markets which were not previously available when ABB was the only buyer;
- prices are now transparent, as FOB values are available to all growers on a daily basis, so that when charges, freight and other costs are deducted farmers can accurately compare prices on offer;
- most of the cash-sellers of barley have enjoyed very prompt payment terms from competing business;
- buyers have developed selling options and terms in response to growers' demands; for example deferred payment options are still available to growers from these cash buyers to spread tax across income years, and cash advances have been made by many of these cash buyers to growers requiring some additional funds prior to harvesting their contracted crop;
- there are now value-adding options for farmers (although they are small and often relate to the terms of the trade if opportunities are emerging). For example some farmers are storing grain on-farm and charging for the

service, which provides limited but important marginal competition for the dominant bulk handling companies; and

- a substantial container market was developed to better service many smaller Asian markets almost on a just-in-time (JIT) service, in which ships leave Victorian ports every week to make consistent supply possible without requiring enormous stockpiles or funding.

3.5 Price differences attributed to competitive status of various markets

There has been a great deal of analysis conducted on the price differences in the WA, SA and Victorian markets since 2001. The general consensus of all of the independent reviews is that while there are price differences from time to time, there is no conclusive evidence of a sustained price advantage for any market. A summary of some of the more widely quoted price comparisons can be found in appendix D.

Having said that there is no conclusive proof of price differences attributed to the regulatory status of a particular market, anecdotal evidence of a significant price difference between SA and Victoria is substantial. Even some of the most respected industry analysts concede that for extended periods of time, usually around harvest, the Victorian barley prices can often be \$AUD10 to \$AUD15 per tonne higher than comparable South Australian grades and zones.

Malcolm Bartholomaeus, a long standing grains industry analyst and South Australian grain grower, commented on the difference between South Australian and Victorian barley prices at the ABARE Regional Outlook Conference in 2004 ³:

The real issue surrounding the barley single desk is the inability for growers to protect themselves against a year on year drop in barley prices. The same futures based tools available to wheat growers are not available to barley growers. There is no mechanism to ensure that true market values are offered for barley in the forward market other than via a free market...

The free market in Victoria has helped. No longer can cash prices for feed barley or malting barley be set too low in the Adelaide division relative to Victorian prices. However, the influence of the Victorian market does get watered down as we move north and west of Adelaide. As well, South Australian prices have to trade slightly lower than Victoria prices for the price signals to be set up that allow feed barley to move from South Australia into Victoria. Also, because of limitations on exporting South Australian barley,

³ Bartholomaeu, M, Current Issues for Single Desk Arrangements for Wheat and Barley, ABARE Regional Outlook Conference, Murray Bridge, September, 2004.

but not on exporting Victorian barley, we can still see large price differentials at the border during harvest.

Malcolm Bartholomaeus concluded his presentation by saying that:

For barley, the changes are lagging those of wheat, with no third party access to ABB pools, and distortions being created in the cash market by the pooling system. We are also seeing the domestic market being distorted in Victoria because of exports of feed barley when often there is not an exportable surplus. The single desk on barley will come under increasing pressure from a range of parties, because the system is no longer as compatible with current business.

3.5.1 Japan

Japan is often cited as an example of where the ABB is able to exercise market power. However, the conclusions of several independent analyses suggest that the enhanced prices paid by the Japanese are due to factors other than a restriction of competition in export markets in Australia.

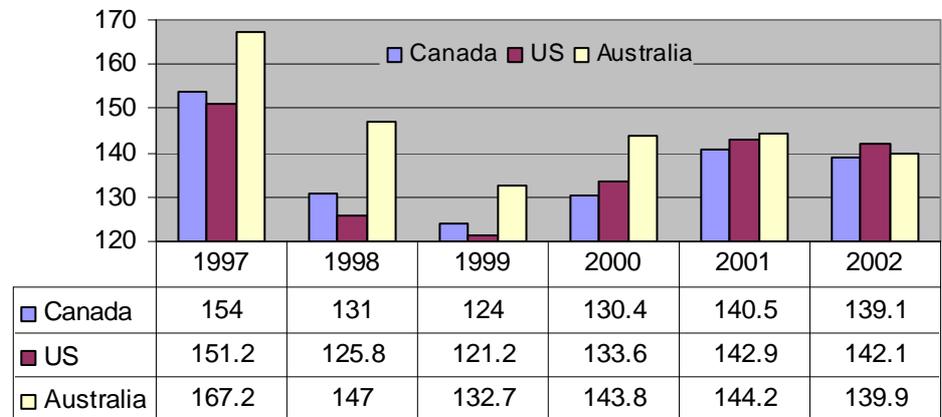
Story 2005⁴, suggests that the enhanced prices that are paid by Japanese buyers, after adjusting for inherent quality differences, for feed barley are likely to be due to:

- a desire by Japanese buyers to secure supplies of high quality feed barley;
- the cost of extended payment terms; and
- the reservation of a year-round supply of grain provided by some Australian statutory marketers

An important question raised by Storey is whether the enhanced prices paid by the Japanese are sufficient to cover the costs of supplying the additional services. Over-servicing of customers is a common characteristic of statutory backed trading enterprises.

⁴ Story Marketing Services, Grain Marketing in Western Australia, *An assessment of the existence and extent of price premiums which result from market power available to the main export licence holder*. August, 2005.

Chart 1 **Japanese feed barley market (USD tonne)**



Sparks 2004

Data source: Japanese Ministry of Finance

Australian barley has enjoyed an enhanced price in the Japanese market, due to its bright colour and consistency (see Chart 1). This enhanced price is referred to by the Japanese as the 'Australian premium'. As can be seen in Chart 1 the 'Australian premium' declined between 1997 and 1999. This decline occurred before any of Australia's export markets were reformed.

3.6 What can SA learn from WA and Vic?

This paper has presented a number of arguments for the introduction of a competitive export barley market in South Australia. The main arguments presented are:

- price differences for malt and feed barley, as experienced in Western Australia and Victoria, are extremely difficult to attribute to changes in regulation. However all of the analysis carried out suggests that there is no negative impact, with the debate largely centred on the size of the increase in price in competitive markets;
- in partially and fully competitive markets growers are offered a wider variety of marketing options. Victorian growers now enjoy liquid cash selling opportunities for both malt and feed barley all year;
- the GLA model, while creating a number of new marketing opportunities for growers (including improved pool and cash products from the incumbent marketer), creates a level of uncertainty as to the issuing of licences that is difficult for applicants to manage and is ultimately reflected in the application price and the level of investment marketers are willing to make in WA;
- the GLA model is not based on the benefits it generates for WA growers as its continuation is reliant on factors independent to its operational performance, that is, changes to the national wheat export monopoly;

SA Barley Marketing

- the GLA model also retains a significant government involvement that creates additional cost to administer. This government involvement attracts considerable lobbying activity and appears to generate continuous reviews and performance reports tying up public resources; and
- continuation of the current SA barley marketing arrangements is not likely to be consistent with future COAG NCP agreements and therefore may deny the SA community the benefit of future competition payments in addition to the \$3.0 million per annum lost to date.

There is no compelling argument for the introduction of a licensing system where marketers, other than the incumbent, are restricted from operating in particular markets. The preferred model for the AGEA is a free, open and competitive market with an objective and transparent system for licensing exporters, overseen by NACMA.

The introduction of a barley licensing system in SA should only be considered by the SA Barley Marketing Working Group if all of the following circumstances can be established:

- SA growers require a period of transition to a fully competitive market;
- that there are features of the current barley export arrangements in SA that do deliver net benefits to SA growers that cannot be achieved other than by legislation to restrict competition and that those features can be preserved by a barley export licensing system;
- there are demonstrated benefits to the general community in South Australia;
- that the costs of running a barley licensing system (direct operating costs and wider industry compliance costs) are less than the benefits created;
- the main licence holder can demonstrate unambiguously the ability to price discriminate where it claims to have market power (see Appendix B); and
- the Authority be wound up at a specified time or, if before that time, one or more of the circumstances above no longer applies

A Key aspects of the global barley market

A.1 Key aspects of the global barley market

The global barley market has some unique features that need to be taken into account when considering the options for reform in South Australia.

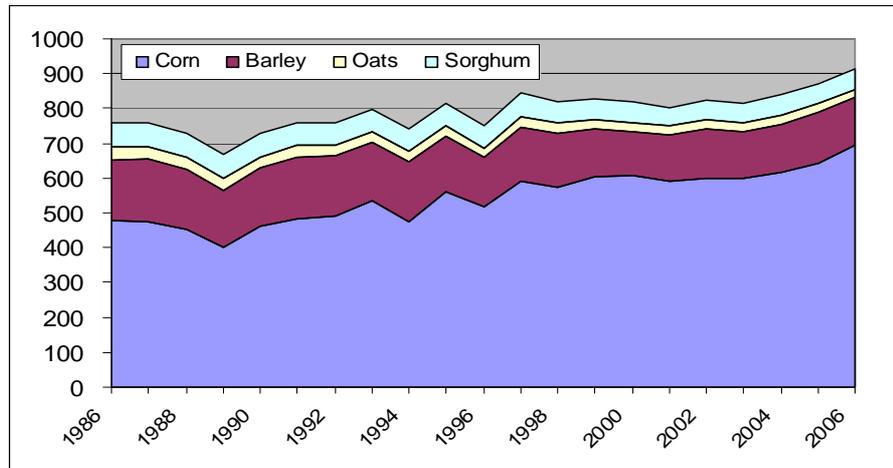
Key aspects of the global barley market:

- Total international barley trade has averaged 14.6 million tonnes over the past 5 years (Sparks 2004), which is approximately 10-12 percent of total barley production.
- Total Australian exports of barley have averaged 3.988 million tonnes (ABARE 2004) which is 66% of total Australian production and 27% of total world trade.
- On average South Australia exports 2.1 million tonnes of barley per annum this is 45 percent of total Australian barley exports.
- On average South Australia exports 75 percent of the barley produced in the State each year.
- Australian feed barley exports have averaged 2.64 million tonnes, which is 66% of total Australian exports and 20% of total world feed barley trade. Australian feed barley exports are 2.6% of total world coarse grain trade.
- Australian malting barley exports have averaged 1.35 million tonnes per annum which is 33% of Australian exports and 32% of world trade. Almost all of Australia malting barley exports is purchased by China which imports close to 50% of its total malting barley requirements from Australia.
- The dominant markets for South Australian barley are Saudi Arabia, China and Japan.
- In 2001 ABB Ltd formed a joint barley marketing company with the Grain Pool of Western Australia (owned by CBH). This joint venture is a strategic marketing arrangement where ABB and the GPWA jointly negotiate prices but do not pool grain. This joint venture exports grain from all of the major Australian barley producing states including Victoria.

When considering the international barley market the dominance of feed barley substitutes such as corn and sorghum need to be taken into consideration as outlined in the chart below

Chart 2 **International production of coarse grains 1986-2006**

SA Barley Marketing



Data source: USDA

While South Australia enjoys a significant share of the world malt and to a lesser extent the feed barley market, feed barley needs to be seen in the context of the total coarse grain market, as much of it is readily substituted for barley.

B The ability to price discriminate in international barley markets

Market power is defined in the Victorian Government Review of the Victorian and South Australian Barley Market Act 1993 (1997) as the ability to:

- identify buyers with different elasticity of demand;
- increase the price of the low demand elasticity market by withholding grain; and
- sell the surplus grain to the high elasticity markets who will purchase more at the same price to that paid at lower quantities.

The increased value of the total grain sold is the quantity of grain sold at the higher price multiplied by that price assuming that the elastic market buys all of the additional grain with no effect on price.

To be able to obtain market power a barley marketer needs to:

- have a detailed and highly accurate understanding of the elasticity of demand for a range of buyers all of the time;
- have a comprehensive knowledge of all of the relevant supply and demand factors for the grain being traded and substitute grains;
- acquire sufficient quantities of the grain to be able to restrict supply to target markets;
- have a full knowledge of rival suppliers' behaviour; and
- be able to apply the knowledge in the above points not only at the point of sale but over time as well. In the case of the ABB this knowledge must be able to be applied over the life of the entire pool.

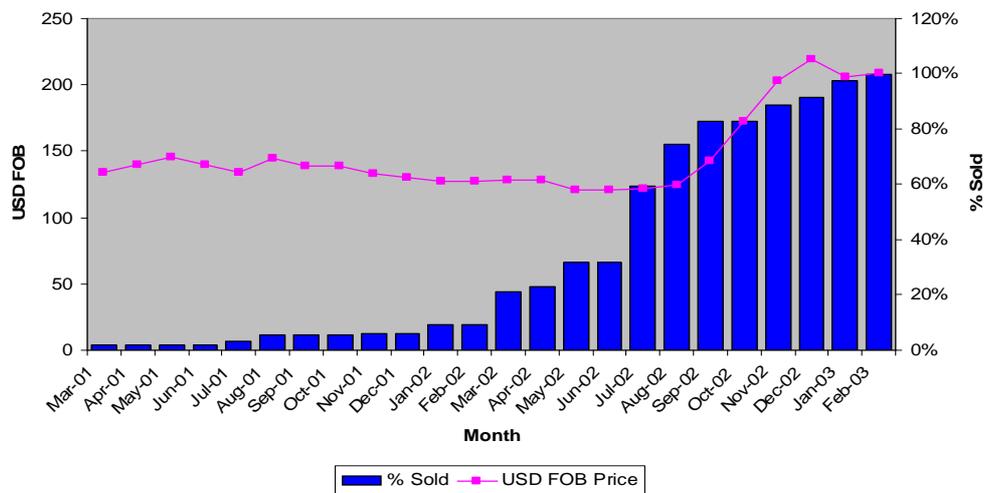
If the barley marketer does not meet all of these criteria then the strategy can produce at best a return no different from general market returns but additional cost will have been incurred in storage and financing, or worse the total value of the grain could diminish. At worst, if this strategy fails the average price achieved will be significantly lower if the elasticity of the lower price market is misjudged and the increased supply to this market causes a price fall.

B.1 A Grain Australia example of price discrimination

The following chart was provided by the Grain Australia to ACIL Tasman in 2004 as an example of the market power that it believes it had been able to exert as a result of the regulation of the barley market in Western Australia and

South Australia up until 2003. Grain Australia believes that the chart illustrates how it withheld malting barley from sale to the Chinese market with the result that the price was forced up in late 2002 through to early 2003. ACIL Tasman believes that this chart was used extensively by Grain Australia to advance its cause during grower meetings conducted in 2004.

Chart 3 Malting barley sales to China made by Grain Australia from the 2001-02 crop



© GPPL 2004

Note: Provided to consultants by the GPPL

Grain Australia representatives explained that grain, that would normally be offered for sale from the 2001-02 pool, was purposefully held back until July 2002. This created a situation where Grain Australia held the only significant quantity of malting barley in the world from July 2002 to February 2003, making it a strong seller. The Chinese, unable to buy from another source, were forced to pay prices set by Grain Australia. Grain Australia describes this as a clear demonstration of their market power that stemmed from the single desk. Grain Australia claimed that this market power would diminish if multiple sellers of Western Australian and South Australian malting barley were allowed to compete with the GPPL in certain markets.

While market power may have been held by Grain Australia at this time it is difficult, if not impossible, to prove based solely on the information presented in the chart. There were a number of factors impacting on the barley market at this time that could provide alternative explanations of the outcome.

In June and July 2002, dry conditions were affecting cereal and oilseed crops in both North America and Australia. At the time, the USDA was making significant downward revisions to international barley crop forecasts each month during 2002. In July, the USDA estimated that Canadian barley

production was likely to be 3.0-4.0 million tonnes less than expected. By August 2002, the USDA estimated total world barley production would be well over 4.0 million tonnes, lower than initially forecast. In a world trade situation of 15 million tonnes this represented a decline of 20-30 per cent. With demand estimated to remain stable, the projected reduction could only mean that prices would rise, especially when production declines in other grains were predicted.

Another aspect of the chart that Grain Australia failed to point out to ACIL Tasman was that by August 2002, 80 percent of the sales to this market had already been made prior to an increase in the price. In addition to this, between June 2002 and July 2003, approximately 40 percent of total volume of grain sold was traded at the lowest point of the market.

Box 2 **Sparks Inc Review of the Chinese malt barley market**

Sparks Inc review of the Chinese barley market:

“China is known to exploit its position as a major malt barley importer, leveraging the considerable competition between Australia and the EU and Canada. China is well aware of the perishable nature of malting barley which loses germination capacity over time reducing quality. Exporters need to ship within a certain time after harvest to avoid a drop in quality. For these reasons the Chinese market is considered to be amongst the most competitive and, therefore, lowest returning destinations in the world. In times of surpluses among the major exporters, competition become fierce into China with Chinese buyers responding well to price, a scenario that tends to depress values into China relative to other destinations.

“Chinese buyers are very sensitive to price [reducing any possibility of market power] and so do not refuse competitive price offerings from any of the major suppliers. With a proportionately smaller growing region, Australian quality and yield variability are proportionately higher in a given year than Canada. However, Australian exports in the range of 90% of its production, which makes it a very aggressive seller into China.

“China is also well known for importing good quality cheap EU feed barley (graded as ‘Fair Average Quality’) for use as malt. This is fully dependent on price but underscores China’s sensitivity to price over quality.”

C Compulsory Pools and Pooling

The confounding of price signals to producers and the cross subsidisation that occurs as a result is described in the following comment on barley marketing in Australia, reproduced from a paper written by Professor Gordon MacAulay and Rosemary Richards in 1997.

‘The marginal return, which is the appropriate return to consider in economic decisions by a producer, and reflects the price signal to a grower, is confounded in a complex way by the actions of all the other growers contributing to the pool.² In simple terms, a grower who produces a high-priced component as a contribution to the pool receives a lower per unit average return than might otherwise be the case while the grower contributing the lower-valued component to the pool receives a higher price than would otherwise be the case. Thus, the high value producer is in effect subsidising the low value producer.’ (MacAulay and Richards, 1997).

This cross subsidisation, particularly where there are no or few grain marketing alternatives creates production distortions as growers respond to distorted prices signals. For the producer, distorted price signals lead to inappropriate production decisions than can lead to inefficient resource allocation at the farm level. Inefficient resource use has implication for the entire state economy as resources are diverted from higher value uses.

Inaccurate or inefficient production decisions create problems for the pool manager, adding to problems due to the pool manager having limited control over the amount of grain that may be grown. For instance, as indicated by MacAulay and Richards in the quotation above, if too much of the variety is grown, a pool manager has three options:

- try and clear the surplus at a discounted price;
- blend the grain with other varieties; and/or
- hold the grain until demand increases or into the next season.

² Under a system of pooling, the basic marginal rule for a producer changes from marginal cost equals the product price to the marginal product multiplied by a weighted average price for the product plus the average return from all growers weighted by the share of output.

Let the revenue for a single producer be indicated as R1 and written as:

$$R_1 = y_1 AR$$

$$= y_1 (p_1 y_1 + p_2 y_2) / (y_1 + y_2)$$

The marginal revenue can be derived by differentiating with respect to y1 and equating to marginal cost and rearranging, then:

$$MC = MP (p_1 y_1 + AR y_2) / (y_1 + y_2)$$

where MC = marginal cost, MP = marginal product for the producer, AR = average return from all growers, p₁ = product price and y₁ = sales by the individual producer, y₂ = sales by all other producers. Without pooling and under standard conditions

$$MC = MP p = VMP$$

where VMP is the value of the marginal product.

All of this indicates that the pools are not efficient in managing an increasing differentiated grain supply. This problem was raised in a report prepared by ACIL Tasman for the Pastoralists and Graziers Association (PGA) on the effects of the wheat export monopoly on the Western Australian wheat industry. This report found that compulsory pools were not well placed to deal with specialty wheat varieties for the reasons cited above. The report also raised some additional problems that may arise from the introduction of specialty grain varieties under a compulsory pool. They are:

- there are limited price risk management options using traditional pool strategies as the basis risk (the price variation between the specialty variety and the futures market) is likely to be high; and
- pool performance assessments become difficult due to the same problems that arise in price risk management – that is, the price of the specialty grains diverge from the price of benchmark grains.

Another important feature of pools is that the growers are the residual claimants to the revenue that flows from them. This means that the growers bear all of the risks associated with the pool including pricing, hedging and financial risks and receive a return after all of the costs of managing the pool are deducted. The risk borne by growers is clearly pointed out to ABB shareholders in the company's 2005 annual report:

The consolidated entity operates grain pools on behalf of growers and has legal title over the pool stocks however, the majority of the risks and benefits associated with pools, principally price risk and benefit, together with credit risk, are attributable to growers.⁵

The regulation of the grains industry also exposes pool participants to other risks, which has been highlighted by the recent revelations in the Cole Inquiry into the activities of AWB. South Australian barley growers, as export grain growers are dependant on the strategic marketing decisions of one company; and the consequences of those decisions are borne by all export barley growers.

Box 3 Discussions with the ABB on how pools have accommodated change

There is still demand for pools from growers due to several factors apart from price which includes:

- loyalty to the organisation running it and the principles of collective marketing;
- growers view the organisation as having a high credit worthiness and offering high security of payment; and
- a preference for the risk management function of the pools.

In discussions with ABB, while not providing any substantive evidence, they assert that

⁵ ABB Grain Ltd Annual Report 2005 Notes to the Financial Statements Page 62

SA Barley Marketing

there has been a return by growers to the pools this year.

They also point out that if a GLA-type system is introduced into the SA pool they will no longer be able to run the pool as they currently do. They believe that they will have to break the pool up into a series of smaller pools to secure returns at different levels. This has been their experience in Victoria where a number of pools have been developed for various grades and for various marketing opportunities.

An example of this is the Victorian Number 1 feed barley pool in 2003. The ABB indicated that they opened this pool as a direct result of the deregulation of Victorian barley exports. The Victorian No 1 pool opens during the growing season and closes before harvest. This type of pool management gets growers to commit to pools during the season rather than wait until harvest.

D Price comparisons between SA, WA and Vic

There is a substantial body of work that has been commissioned to analyse the price differences between the regulated, partially competitive and fully competitive barley markets in Australia. A summary of the major reports is listed below.

Feed Barley Price Assessment, 2003. Produced by Farm Horizons for the Australian Grain Exporters' Association

A price comparison report of feed barley prices between different states between 2000-03. The report makes the following observations:

- an increase in cash prices offered for feed barley was discovered in Geelong relative to other states after deregulation in Victoria (2001) despite the drought conditions in 2002; and
- WA export bids can be higher due to freight and fobbing advantages in the west.

...and concludes that:

- despite these two countering factors the differences in marketing arrangements between states have contributed to price variations;
- in particular the introduction of special Export Licences in WA has been the major factor contribution to a increase in Fremantle feed barley prices in December 2003; and
- it was too early to conclude whether the GLA had affected pool prices.

Feed Barley Price Assessment, 2004. Produced by Farm Horizons for the Australian Grain Exporters Association

A follow up price comparison report of feed barley prices between different states between 2003-04 and 2004-05 that seeks to compare cash prices estimate actual and estimated pool returns. The report makes the following conclusions:

- Grain Pool of WA final 2003-04 feed barley pool return was equivalent to the average cash bids on the same basis and location but a farmer that sold at harvest time would be \$2.25 per tonne better off;

SA Barley Marketing

- ABB No 1. SA feed barley pool was \$12.79 per tonne below the average cash prices for Port Adelaide;
- both pools were lower than the average cash price in Geelong for the same period;
- estimated pool returns for 2004-05 appear to be giving similar trends to the 2003-04 price results.

Grain Marketing in Western Australia. “An assessment of the existence and extent of price premiums which result from market power available to the main export license holder”, August 2005. Prepared for the GLA by Storey marketing Services.

The report’s Term of Reference are reflected in the title of the report and in summary it concludes that; the exertion of market power to raise prices in very competitive global grain markets is highly unlikely. It comments that there is an opportunity to capture freight premiums through withholding grain but little supporting evidence is available mainly due to the secretive nature of single desks and commercial-in-confidence data. It qualifies this statement further by saying the core question of the report “.....an assessment of the existence and extent of price premiums which result from market power....” is unable to be assessed against ‘hard’ sales contract data

Of interest, the report investigates premiums being paid by buyers of grain to a WA single desk and states that these premiums are non-existent, except for feed barley into Japan. It also concludes that a reality check is needed in relation to the beneficial operation of the single desk in WA in respect to barley as other eastern states have deregulated and the GPPL faces competition from Australian grain exporters, e.g. feed barley into Saudi Arabia/Japan and malt barley into China/Korea/Japan.

Analysis on the impact of special export licences on prescribed grain cash prices in Western Australia, June 2006. Department of Agriculture and Food. Government of Western Australia.

This report assesses the affect on the introduction of the GLA (Commissioned Nov 2002, commenced operations August 2003) on WA barley prices (malt and feed). The methodology looks at weekly port barley prices at various locations and attempts to take out seasonal and extraneous factors (Ausbulk-

ABB merger Sept 2004 and merger of Vicgrain and Graincorp Oct 2004 etc) to make a like-with-like comparison.

The results are inconclusive for both feed and malt barley - the analysis states that WA barley prices have fallen the least compared to other states but when taking into account annual production figures all markets have shown similar price fluctuations.

The price impact of partial deregulation in the Western Australian grain export market, 2005 Bruce Layman, Assistant Director, Economic Policy Division, Department of Treasury and Finance.

This report uses the same price data set as used in the above study but uses specific time series statistical techniques to analysis the affect of the GLA on barley prices. It concludes that there is evidence to state that a relative price premium has emerged after the introduction of a partially competitive market in WA , particularly for feed barley. It also states there is some evidence of a malting barley premium, but this can not be confirmed with any certainty. The report comments that a premium for WA barley would come from two sources: 1. private marketers finding new high priced opportunities for WA barley, 2. a compression of barley marketers' margins due to increased competition (12 traders compared to the original) which are then passed on to the farmer through improved cash prices.

E Competition policy

Why do we have national competition policy?

In 1995 COAG (the Council of Australian Governments) agreed that economic reform was essential to ensure that Australia remained globally competitive in order to deliver sustainable improvements in living standards. Since the benefits would be shared by the community as a whole, the reforms required a national approach. Hence NCP (National Competition Policy) was introduced. Every state government signed up.

The central feature of National Competition Policy is the public good, as distinct from private interests. The focus is on making changes that benefit the broad community rather than allow special treatment for certain groups at the expense of consumers generally.

The success of NCP is seen in community gains from:

SA Barley Marketing

- high and sustained economic growth;
- substantial increases in personal wealth;
- some 2 million more jobs created and a correspondingly low unemployment rate;
- cheaper airfares;
- a wider range of financial services; and
- removal of the legal profession's monopoly on conveyancing.

After only five years of reforms the Productivity Commission conservatively estimated that progress to the year 2000 had seen 2.5 per cent added to Australia's GDP growth, or some \$20 billion.

Ten years after the NCP reforms began, COAG endorsed the need to maintain momentum and to lock in the substantial benefits achieved. In June 2005 it stated that:

It is important not to be complacent about the continued performance of the Australian economy. Resting on the achievements of the past decade will cost the Australian community opportunities for greater prosperity

Australia's productivity performance is under threat, with further reform essential if the economic expansion of the last (sic) 14 years is to continue.

The Australian economy is operating in an intensely competitive international environment. As a small trading nation, Australia will drive its economic growth by minimising barriers to trade and maximising its business flexibility. The case for continuing reforms on a collaborative basis is clear.⁶

National Competition Payments ...

A key feature driving reforms in Australia has been the principle that jurisdictions which remove impediments to greater competition and choice receive immediate benefit in the form of National Competition Payments (NCPs). For example, in 2005-06 \$800 million was available to the states provided they met their competition reform obligations. It is important to note that the NCC does not place commitment on governments to which they do not agree. It simply assesses a government's performance against its (the government's) undertaking.

⁶ Source: NCC, Assessment of government progress in implementing the national Competition Policy and related reforms: 2005.

... depend on reform progress

In its 2005 Assessment Report (October 2005) the National Competition Council found that two reviews of the South Australian Barley Marketing Act had failed to produce credible public interest evidence to support the monopoly marketing arrangement

Following the 2003 NCP assessment, the Australian Government imposed a suspension of 5 per cent of 2003-04 competition payments until South Australia provided details of a complying reform implementation program.

After the imposition of the suspended penalty, the South Australian Government made a concerted effort to introduce a reform package in the public interest. However, the legislation did not have sufficient support to pass through Parliament. Accordingly, the Australian Government permanently deducted the suspended competition payments and imposed a suspension of 5 per cent of 2004-05 competition payments until South Australia instituted a complying reform implementation program.

There has been no further progress, so the NCC recommended a permanent deduction of 5 per cent of 2005-06 competition payments for continued non-compliance. The NCC noted that the lack of progress in this area was disappointing, given the demonstrable benefits afforded the Western Australian community (particularly grain growers) from that state's reforms.

The government commissioned a new review of the barley export monopoly in November 2002. The review was conducted by a three-member panel, led by Professor David Round of the University of South Australia, and included a former senior State Government official and the deputy chair of the S A F F Grains Council.. It was charged with determining whether the barley single desk was clearly and credibly in the public interest. In June 2003 the review panel reported that:

...it has not demonstrated to the Panel's satisfaction in any convincingly rigorous way that the single desk delivers benefits to the Australian community as a whole that outweighs the costs, and that the objectives of the legislation in granting single desk powers to ABB can only be achieved by restricting competition. (Round et al. 2003, p. 73)

The panel recommended 'controlled deregulation' in which the single desk is exposed to competitive challenge through reform – along the lines of Western Australia's Grain Marketing Act – whereby ABB Grain Ltd would retain a principal barley export licence and, a year after the passage of reform legislation, an independent authority would license barley exports by other

marketers that the authority determined would not threaten the price premiums that ABB Grain Ltd claimed it could achieve as a result of its market power.

In June 2004, the government introduced into the South Australian Parliament a Bill to deregulate barley exported in bags and containers while licensing bulk exports. The Main Export Licence would be held by ABB Grain Export Limited while other exporters could apply to an authority for Special Export Licences. However the bill lapsed and, notwithstanding some discussions between the government and grower representatives about reform proposals, has not been re-introduced.

\$3 million NCP payment withheld

The failure of South Australia to meet its commitment to reform barley marketing has resulted in South Australians, as a community, forgoing the National Competition Payments which would have been made if the system had been reformed.

In 2005-06, \$60 million in total was available as NCP payments to South Australia but, because of failure to comply with its barley marketing reforms, 5 per cent has been permanently withheld. That is, lack of barley marketing reform has cost South Australians \$3 million in forgone NCP payments.

The latest tranche of NCP payments concluded in June 2006 and, at this stage, future reforms and related payments have not been decided. This is presently being considered by a Committee within the Department of the Prime Minister & Cabinet. On the basis of COAG's acknowledgement of the benefits of competition policy reform and its commitment to continuing the process, it is to be hoped that future reforms will be accompanied with NCP payments or something similar. Since the lack of barley marketing reform has cost South Australia a 5 per cent permanent deduction from its NCP payments, the loss of approximately \$3 million per year is likely to continue until the market is opened up to competitors.