Department of **Treasury and Finance**
Government of **Western Australia**

Submission to the Economic Regulation Authority

Review of the Grain Marketing Act 2002

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Contents

Introduction

Grain marketing reforms in Western Australia have already removed single desk powers from prescribed grains that are traded domestically or exported in containers rather than bulk. This submission focuses on the key economic questions of whether single desk powers, the current system of partial deregulation of prescribed grains through licensed competition or full deregulation (removal of the single desk) is the best policy for the bulk export of prescribed grain.

The public interest in the case of the *Grain Marketing Act 2002* (the Act) is largely the interests of Western Australia's grain growers, rather than consumers who are obviously overseas. While there are other relevant concerns (eg private grain traders who would like to compete with the Grain Pool Proprietary Limited (GPPL[1]) on a level playing field), the key purpose of the Act is the welfare of grain growers. The key question would therefore seem to be, do growers benefit most from the market power that the single desk provides as was intended, or is partial or full deregulation more in their interests?

The Department of Treasury and Finance (DTF) has an interest in the Act as it had a coordinating role in the implementation of the National Competition Policy (NCP). The issue of single desk powers for grain export was a high profile NCP issue.

With the creation of the Grain Licensing Authority (GLA), which issues licences allowing private traders to compete with the GPPL, the DTF has had a continuing role through membership of the GLA Board.

Background

The issue of single desk powers being given to State and Commonwealth statutory marketing entities has long been debated. While there has been considerable grower support for these organisations, independent studies have consistently shown that GPPL does not have the market power to benefit growers through single desk selling. Most jurisdictions have now removed single desk powers; with the partially deregulated GPPL and the Australian Wheat Board (AWB), the remaining two organisations that still maintain statutory single desk. The new Commonwealth Government has indicated it will remove the AWB's single desk.

NCP played a substantial role in reforming grain markets, and influencing the arrangements in Western Australia. The NCC did not accept Western Australia's initial reviews of grain marketing in 2000, which supported the status quo. The NCC warned Western Australia that it would have a deduction in its competition payments unless the finding for retention of the single desk was reconsidered. Meetings between the Government and the NCC led to an agreement in which Western Australia agreed to partial deregulation through:

[1] GPPL is the trading arm of Co-operative Bulk Handling (CBH)

- granting licences to private traders so that they could accumulate and export the prescribed single desk grains (barley, canola and lupins);

- establishing the GLA to grant licences to private traders in those markets in which GPPL did not have market power to achieve a price premium; and

- including a representative of the DTF on the GLA Board in addition to two grower representatives and a representative of the Department of Agriculture and Food (DAF).

Changes to the Act were introduced in November 2002 to implement the agreement. Subsequently the GLA was established and commenced operations in August 2003.

One effect of the GLA's operation is that it has provided quantitative information on the market impact of partial deregulation in comparison with the fully regulated single desk. In particular it has provided opportunity to make comparison of cash prices growers received for their grain in the case of the single grain buyer (monopsony) with prices being achieved through the partially competitive grain purchasing market (resulting from the GLA's role).

Single Desk

The economic rationale for the single desk is that a single seller is able to achieve a price premium by virtue of its market power. Market power is exercised by strategically and temporarily withholding supply from a market. This can only be effective if the seller dominates a market such that by withholding it materially increases price. As one of many suppliers to the global market for grains, the GPPL does not have this degree of market power so it would be surprising if it achieved a premium. In addition, substitute products are available in some of the overseas markets for these prescribed grains, further limiting the capacity to achieve a price premium.

- In the case of lupins, they are exported principally as an ingredient for livestock feed rations. This is a very competitive market in which other grains, such as soybeans, can easily replace lupins unless the price is right. That is, price premiums are extremely unlikely.

- Western Australia's total export of barley is only around 10% (in 2005-06 it was 11%) of world trade and by this measure alone would seem unlikely to have market power. Moreover In the case of feed barley there are other feeds such as corn and pasture, which can substitute for barley, and there is also substantial competition from other suppliers such that market power is extremely unlikely.

- Malt barley also involves significant competition, and in the Chinese market, some ability to substitute adjuncts such as broken rice and corn and to a lesser extent, wheat beer. There would seem little opportunity to exercise market power, although GPPL may have had on occasions very brief opportunities when competitors are in short supply.

- Canola produces canola oil, which is substitutable by other oils, such as sunflower, soybeans and palm oils.

Consistent with the above, three reviews commissioned by the GLA have all concluded that GPPL has very little, if any ability to push up grain prices (these reviews are available on the GLA website). The one exception was that two of the reviews (one by Farm Horizons in 2004 and the other by Storey Marketing in 2005) concluded that GPPL exercised market power for malt barley on the Japanese market. While GPPL may achieve a premium on this market, it is not clear that this is a result of GPPL's market power or whether it is the particular relationships in the Japanese market.

In contrast to its impact on world grain markets, the GPPL's single desk powers mean it has had absolute market power in the grain purchase/accumulation market in Western Australia where GPPL buys barley, canola and lupins for export and has retained a partially protected status under the GLA.

Partial Deregulation

The granting of licences by the GLA has resulted in traders exporting barley and canola, leading to a significantly more competitive grain accumulation market, most notably in the case of feed barley. Not surprisingly, higher grain prices were observed following the GLA meetings when licences were granted as the private traders took advantage of their licences to accumulate grain for export.

Subsequently, two econometric studies have estimated the impact on the prices growers receive from the private traders' competition with the grain pool. The first of these, *Analysis on the impact of special export licences on prescribed grain cash prices in Western Australia*, undertaken by the Department of Agriculture and Food (DAFWA), estimated that the impact was to increase payments to farmers for feed barley by just over $10 per tonne and malting barley by $7 per tonne.

The second study, *The price impact of partial deregulation in the Western Australian grain export market*, was by the DTF, who estimated that payments to farmers had increased by $8.50 per tonne for feed barley and by about $3.80 per tonne for malt barley as a result of partial deregulation. (These studies are available at the GLA's website)**.** Even if the lower DTF estimate is used, and it is very conservatively assumed that partial deregulation only benefits those who have sold grain to private traders, the total benefit for feed barley would be $3.7 million in 2004 and $5.2 million in 2006 and for malt barley $130,000 in 2004 and $550,000 in 2006.

An independent review of the impact of partial deregulation by RSM Bird Cameron in 2005 estimated a net benefit of $2.9 million to growers in the first year of GLA operation. With more licences granted in 2007 allowing private traders to purchase substantially more grain for export, and very much higher grain prices, benefits are likely to be higher than shown by these studies based on earlier data.

The GPPL's single desk powers have not appeared to deliver the intended market power in export markets. However, it provided GPPL absolute market power in the accumulation market as prior to the advent of the GLA, as the only buyer of barley, canola and lupins for bulk export. In effect, GPPL has been a monopsony, which economic theory would suggest means lower prices paid to grain growers than if the GPPL had competition. The findings of the above studies show that this is not just theory, with prices to grain growers significantly higher when there is competition between grain accumulators.

The Attachment provides greater detail with a figure representing an analysis of the single desk monopsony versus competition to accumulate grain with the associated benefits to growers. Part of the benefit to growers would represent a loss to GPPL as higher prices are paid for grain. The fact that the growers are shareholders of CBH/GPPL complicates this analysis. A further benefit to growers from competition is that higher prices may encourage increased production, and with this higher profit to growers, although this effect is likely to be small.

It is likely, also, that there will be dynamic efficiency gains from GPPL having to compete with private traders for grain, GPPL will have an imperative to operate efficiently, create and innovate to be a responsive organisation or it will lose market share. An observation of changes to GPPL since partial deregulation is the extent to which it appears to have opened up new marketing services in response to private trader competition**.**

Another benefit of partial deregulation is that instead of one company with its limited networks of grain salesmen and market contacts, partial deregulation has involved another 11 to 12 companies in the selling of Western Australia's grain. These companies are large, in many cases far bigger than GPPL, and have the potential to sell grain into markets in which GPPL does not operate.

In summary, while there is little or no evidence to support claims of the benefits from single desk export marketing, there are benefits from the competition partial deregulation brings:

- benefits through higher prices paid to growers conservatively estimated to be $8.50 per tonne for feed barley in 2005;

- emergence of cash market creates valuable marketing alternative to growers;

- significant gains from 'dynamic efficiency' as competition drives a response from GPPL which may include increased productivity and is evident in the wider range of selling options that are now offered;

- possibly more effective marketing as many companies with their salesmen and network of contacts selling the grain rather then one company; and

- small gains through higher production and profit as a result of the higher price.

Full Deregulation

In a fully deregulated market, the benefit from competition could be greater than for partial deregulation as there would not be any barrier to entry, whereas the GLA can and does refuse to grant some licence applications. Possibly a deregulated market would attract more private traders. Therefore greater benefits to growers could be expected than for partial deregulation.

In addition with full deregulation there would be other benefits over partial deregulation:

- avoiding the cost of the GLA, which although not a major consideration, would save the GPPL and private traders a total of $300,000 to $400,000 per year;

- avoiding the cost to private traders and the GPPL of complying with GLA regulation (eg. meeting the information requirements of the GLA in applying for a licence in the case of the private traders and for the GPPL providing market information to the GLA); and

- avoiding uncertainty and delayed decision making for private traders, who cannot purchase grain for export until they are advised they have a licence and applications may not be successful. Greater certainty would assist their decision making and may also mean they invest more in the industry.

Some grain growers have had a clear preference for a fully regulated grain market for barley, canola and lupins. However four years of partial deregulation would appear to have most growers now comfortable with and better able to cope with partial deregulation. The points above would suggest that partial deregulation could be viewed as a useful transition for growers and GPPL to prepare them for full deregulation.

Conclusion

- There is little evidence to support the view that GPPL is able to achieve higher prices on export markets as a result of the market power the ‘single desk’ gave it.

- There is evidence from two studies that partial deregulation is associated with higher prices to growers than when the GPPL is the only grain purchaser.

- In addition to higher prices to growers, partial deregulation provides other benefits over the single desk:

- o increased productivity through 'dynamic efficiency' as GPPL responds to competition;
- o wider range of selling options to growers;
- o more effective marketing and selling networks; and
- o higher production and profit to growers.

- There is a strong evidence that full deregulation will deliver additional benefits over partial deregulation:
  - o attracting more private traders leading to more competition with and better prices to growers;
  - o enabling savings to GPPL and private traders by avoiding the cost of GLA and its compliance requirements; and
  - o providing predictability of grain purchase arrangements for private traders and growers who would not need to cope with the uncertainty of whether they will or will not be granted a licence;
- On the basis of the above, there is a good case for full deregulation. Partial deregulation, specifically the role of the GLA would seem to have been a useful transition for growers and the GPPL to a fully deregulated market.

References

Advance Trading Australia (2006), *Grain Market Assessment in Western Australia: An Assessment of the Existence and Extent of Price Premiums Resulting from Market Power Available to the Main Export Licence Holder.* Grain Licensing Authority (July 2006), *http://www.gla.wa.gov.au/documents/ Assess Price Premium_Market_Power-Advance%20Trading%202006.pdf*

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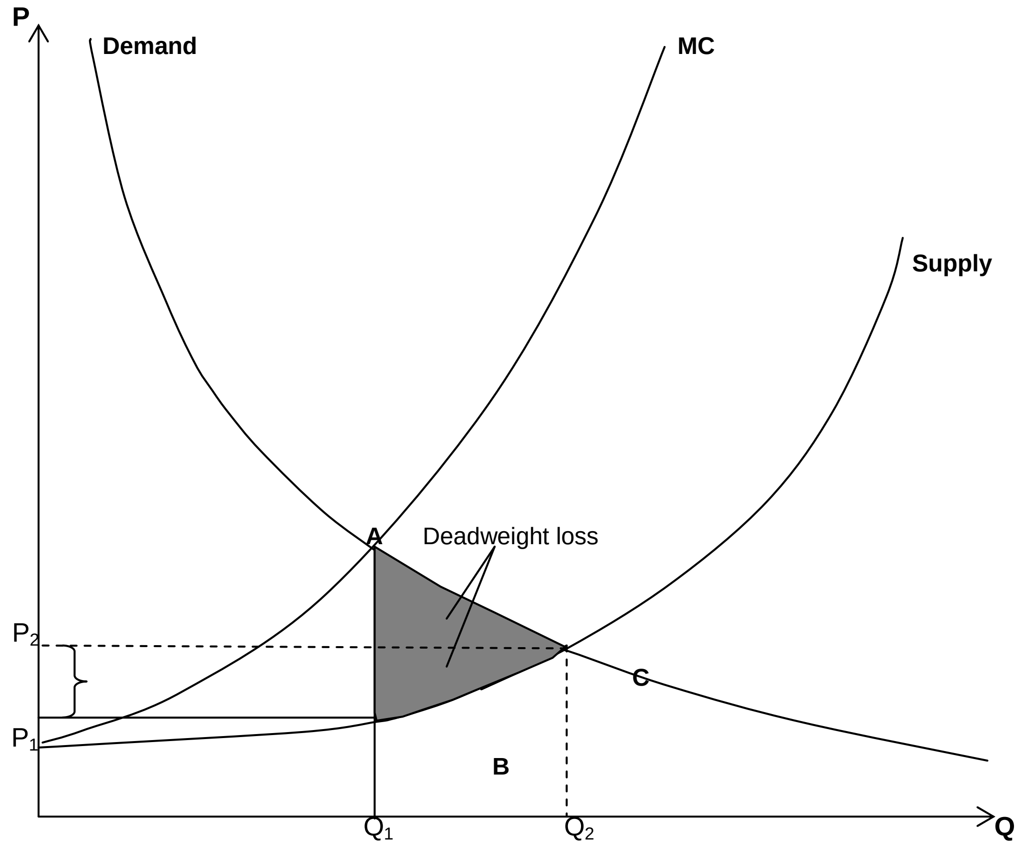
Attachment

Theoretical Outcomes under Monopsony and Contestable Purchasing



In text book theory, the monopsonist will not pay the price, P_2, that equates supply and demand for the product, but will price at P_1, determined by the intersect of the monopsonist's demand and the marginal cost, ***MC***, of the grain. With competition price would be P_2 representing the intersect of supply and demand. While GPPL may not act exactly like a theoretical monopsonist, evidence shows higher price resulting from partial competition (P_2 above) $8.50 more than the monopsony price (P_1 above). .