

GLENCORE GRAIN PTY LTD

ABN 29 106 378 885

29 Queen Victoria Street, Fremantle, Western Australia



ECONOMIC REGULATORY AUTHORITY SUBMISSION for
GLENCORE GRAIN PTY LTD

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EXECUTIVE SUMMARY	PAGE 3
PRICING AND TRANSPARANCY	PAGE 4
Effectiveness of operations of GLA	PAGE 4
The need for continuation of GLA	PAGE 5
International Pricing	PAGE 5
ACCOUNTABILITY & LIQUIDITY	PAGE 7
Net Public benefit of restrictions	PAGE 7
PREVIOUS REVIEWS OF MARKETING SYSTEMS	PAGE 9
REPORTS ON WA GRAIN INDUSTRY	PAGE 10
Extracts from Acil Tasman Review	PAGE 11
Extracts from Bird Cameron Review	PAGE 12
Extracts from NCP Review	PAGE 12
Extracts from GLA report to Minister	PAGE 13
AUSTRALIAN GRAINS INDUSTRY	PAGE 14
Licensing Requirements	PAGE 14
Fees/Charges	PAGE 14
Alternative Regulatory Models	PAGE 14
CONCLUSION	PAGE 16

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EXECUTIVE SUMMARY

The Grains and Licensing Authority was set up to test whether or not allowing private trader's access to the West Australian market, would improve price transparency, hold established pools to account, and improve liquidity in the highly monopolized West Australian coarse grain market.

Since its establishment, the public accusations by the main license holder and certain growers that Special Export License holders were undercutting "Grainpool Markets" have become considerably less vocal.

The GLA has been a completely successful interim system to allow everyone involved in the WA Grain industry to effectively put its 'toe in the water' of how things would operate in a free market. Not even spokespeople of the Grainpool – who were initially vehemently opposed to the GLA system - can criticize the effectiveness of this quasi free market system.

However the greatest evidence of the success of this system is the groundswell of grower support that the Special Export License holders have felt. The existence of Special Export License holders has also forced increased transparency of the Grainpool managed pools with growers now given revised estimated pool returns almost weekly during the harvest time.

The grains industry environment has changed significantly since the GLA was set up.

- Since GLA being set up, South Australia has joined the other east coast states of Victoria, NSW and QLD and deregulated its coarse grain market, making WA's more regulated system the least attractive Australian origin to purchase grain in.
- Wheat is almost certainly going to be deregulated by the 08/09 harvest
- Record high world grain prices have meant that the transmission of international prices directly to the western Australian grower (through Special Export License holders) has become far more important.

Against the backdrop of the above relevant macroeconomic factors, the GLA now needs to progress to an almost fully deregulated system. There are very real costs of operating a GLA. There is very real dislocation between attempted government administration, and the faster moving marketing companies.

The "value" of the GLA has now been exhausted, as the significant benefits of an open market system have now been proven beyond question. Even the original critics of the GLA system (GPPL) are now actively campaigning for open access to wheat. The fact that GPPL are trying to retain their main license over coarse grains, whilst being the most active campaigner for open access to wheat is laughable & the majority of growers find this to be totally hypocritical.

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GRAIN PTY LTD

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PRICING AND TRANSPARANCY

The Australian grain industry has been littered with examples of where statutory backed monopolies have collapsed. The very nature of monopolies (in ANY market) lends itself to inefficiencies, market abuse and the participants in that market ultimately bearing the cost.

The most glaringly obvious example of this today is the AWB / Iraq scandal. But perhaps a more relevant example to Western Australia is the collapse of the New South Wales Grains Board. NSWGB had an almost identical marketing arrangement as the Grainpool currently has in Western Australia. They had a state backed monopoly over prescribed grains such as barley, canola, oats and lupins. The arguments the NSWGB used to justify this arrangement were identical to the arguments pushed by Grainpool.

-To protect “their” markets.

-That new participants would “undercut” the price

-That the same origin grain would be competing against itself on the world market

(All of these myths will be dealt with in more detail later in the submission.)

But in actual practice these established marketing bodies were trying to insulate themselves from being held to account. The most glaringly obvious way these marketing bodies are held to account is through price. If a non-GPPL marketer can offer a more competitive price, then the inevitable questions must be asked. Why?

West Australian farmers are a very practical and pragmatic people, and most do not consider it the sole right of any single entity to market their grain. The Western Australian government recognized this attitude through the introduction of the GLA licensing system to allow new market participants into the Western Australian grains market. This forever changed the market dynamic for the WA grains market because there was now alternative prices which growers could hold the main license holder to account.

Effectiveness of operations of GLA

The GLA has shown the WA grains industry how a quasi-open grain market can operate in Western Australia. How the administration of the GLA was handled was always going to be difficult. The significant gap between when applications are written/requested by special export licenses hopefuls, and when the grain is actually shipped is significant. The agricultural commodity markets are extremely volatile markets, comprising multiple worldwide buyers and sellers. While marketers can do their very best to predict where their purchased grain will be destined – factors such as drought, changes in government policies, variations in buyers needs and continuing dietary changes in nearby developing markets means it is extremely difficult to always be accurate. It is for this reason that some Special Export License Holders do not execute on their licenses.

There is also significant direct cost to running the GLA. Marketers can now look to South Australia as a significant alternative to Western Australian barley and not pay any GLA export license fee. This can surely be to the detriment of the people the GLA was set up to protect – WA growers.

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It is our belief that the GLA operated as effectively as government can administer a free market. However the system is far from ideal and our submission would claim the cost, and administration, time and effort required is now unnecessary.

The need for continuation of the functions of the GLA

The GLA now offers no value to any in the Grain industry. At the time of conception many growers were nervous about change to a fully deregulated free market for their coarse grains. This window of uncertainty has now passed, and growers now routinely do significant business with these (previously demonized) special export license holders as part of their marketing program. There could not be a clearer example of growers voting with their feet. If growers are comfortable selling to special export license holders, then who is the government now trying to protect through the GLA system??

International pricing of coarse grains

Prior to the GLA being set up, Western Australian growers could look at the Grainpool's estimated pool return to see what their barley or canola was worth. That was the industry wide yardstick with which the industry ran. The problem with this system is that this estimated pool return was not necessarily a true reflection of the international price.

Where our company has been able to offer value to Western Australian growers is the daily price transmission of international prices of their grain/oilseed to the local market. The idea of excluding the strength of global connection that multi national companies can bring to Western Australia is extraordinarily backward. Our company alone has over 50 offices worldwide across some 40 countries. We bring the strength of that information to Western Australian growers in the form of price. Every day our prices will reflect the international price for their grain. The main license holder can now behave just like any other competitor, in any other market: compete and attract business, or not be competitive and lose the business of customers.

What has this new dynamic meant for growers? The benefits have been numerous, but primarily include:

- 1) Price Transparency: as noted above, the main license holder is now held to account on a daily basis. Most growers are now extremely comfortable with multiple buyers competing for cash for their crops. This not only has implications for cash pricing on a daily basis, but also puts the main license holders' estimated pool return into context.
- 2) Pool Transparency: before the introduction of SEL's the Grainpool would issue extremely infrequent estimated pool returns. However against the backdrop of daily cash prices being offered by other marketers, the Grainpool now advises growers of EPR's almost weekly during the marketing months.
- 3) Greater product pricing: the introduction of a wider variety of price products. For example no discount on colour, protein or screenings for malting barley, flexible spreads for multigrade barley contracts (allowing growers to lock in feed barley prices at today's bid & lock the malting barley price later in the year) as well as new crop

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wheat / barley and canola contracts for growers wishing to lock in higher prices early for their crops.

Even Grainpool has offered ‘premium pools’ for barley which encourage growers to lock in barley earlier in the season usually at a \$15-\$20 premium to their normal No 1 pool price.

No more evident is the benefit of alternative pricing and transparency more clearer than when we look at the one zone in Western Australia where (due to liquidity reasons) SEL holders do not operate – and the main license holder is still the exclusive buyer in that zone.

Here when we compare the Agracorp (Grainpool’s cash marketing arm) Kwinana cash price vs the Geraldton cash price the cost to Geraldton growers is alarming. The selected days were days where significant volumes of grain were being marketed (hence price determination should be sharpest).

AGRACORP	Nov 15th			Nov 26th			Dec 05th		
	Malt	Feed	Canola	Malt	Feed	Canola	Malt	Feed	Canola
GERALDTON	\$340.0	\$270.0	\$517.0	\$340.0	\$280.0	\$527.5	\$350.0	\$280.0	\$528.0
KWINANA	\$365.0	\$300.0	\$550.0	\$371.0	\$310.0	\$575.0	\$385.0	\$325.0	\$565.0
Difference	-\$25.0	-\$30.0	-\$33.0	-\$31.0	-\$30.0	-\$47.5	-\$35.0	-\$45.0	-\$37.0

When displayed like this, we can place a dollar cost on having no liquidity in the Geraldton zone; this cost, being worn by Geraldton growers. This discount should be put in the context of other zones where there was largely equal prices between Kwinana / Albany and Esperance zones for malt and feed and canola¹. It is not a separate coincidence that other marketers were active buyers in these zones also. It is our clear intention to highlight that other marketers in these zones, almost completely eliminated any inter-zone discount which previously existed.

GLENCORE GRAIN PTY LTD

ABN 29 106 378 885

29 Queen Victoria Street, Fremantle, Western Australia

ACCOUNTABILITY & LIQUIDITY

As touched on above, the introduction of SEL's into the Western Australian grain market has dramatically improved the accountability with which the main license holder has been kept. Their cash pricing as well as their pools can now be consistently compared with the pricing products offered by other market participants. Not only does this keep the main license holder honest, but it also forces the new market participants to compete. Just as a market should operate, if the new entrants have value to offer growers (through global information flows, or more efficient marketing execution, or greater product expertise) then this will flow through in the form of higher prices.

An important dimension in the marketing of grain is the liquidity of the market. Prior to the GLA setting up in Western Australia there was absolutely no liquidity within the WA grains market. The AWB handled all of the wheat and the Grainpool handled the coarse grains and oilseeds. By having only 2 players for different commodities is an effective duopoly. Liquidity only exists when there are multiple parties, and institutional power is limited².

The risk of operating in a market which is highly illiquid may be difficult for someone of a non-grain marketing background to understand. However this is not just a perceived risk, it is real and costs serious money if mismanaged.

For example: we start buying Feed Barley in Geraldton, and decide to deliver the same prices to Geraldton growers as in other zones. Since this is an area where production is more volatile than in other areas – at best we only accumulate some 25,000mts. This tonnage is not enough to execute on a vessel to normal bulk barley buying markets. If there were multiple players in this market, we could sell this tonnage at the prevailing market price; effectively liquidating our position – but having still delivered equivalent prices to Geraldton growers as we did other zones. However there is no liquidity in Geraldton. In practice what we are forced to do is turn to the only other buyer of barley in the zone – Grainpool – and “ask” them to purchase our grain or allow us to indeed buy their grain to make up a bulk vessel (50, 000mt & above). However, in practice this is done at prices significantly below or above the market price and our business incurs significant losses from this exercise.

As a private company all we ask for is for government to allow a business environment where commercial common sense prevails and where liquid markets are “allowed” to operate. It is a fact that the \$\$ consequences of operating in the illiquid Western Australian grains market is perceived by many international grain marketing company as being a risk too high to operate from.

Net public benefit of restrictions on the export of ‘prescribed grains’.

Using the above example it is not difficult for a reasonable person to make the link between a restriction on exports for prescribed grains, and the resulting increased risk to marketers as a result of reduced liquidity. Using the above example still, the losers are ultimately the growers

² The institutional power that the Grainpool/CBH can and do exert is another discussion entirely, however will not be explored as it deviates from the focus of the report: GLA.

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because marketers will not operate in an environment where they are exposed to such non-commercial behaviour. Therefore we have a situation like the Geraldton zone where the main license holder is still the only volume buyer of coarse grains and oilseeds in this zone. And the “discount” we have already shown is how the growers pay that cost. Again we have growers wearing the cost of a system which was set up to protect them. Most rational people would consider this untenable, unjustifiable and unsustainable.

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IMPACT OF RECENT CHANGES IN AUSTRALIAN COARSE GRAINS

Prior to coarse grain deregulation in Victoria, NSW & SA & the issuing of Special Licenses in WA, the single desks (and Agri politicians who support the single desks) argued that competition would lead to lower farm gate returns, a reduction in services and doom and gloom for the grain industry. Having used this fear argument for decades, many farmers actually believed the Agri politicians and single desk holders as there was no major deregulated grain market in Australia for growers to compare regulation versus deregulation.

However, we now have real life examples of deregulated markets and their effect on growers returns versus the regulation. Following deregulation in Victoria, cash prices in Geelong increased relative to Adelaide and Kwinana. With the introduction of Special Licenses in Western Australia in December 2003, we saw substantial increases in Kwinana relative to Adelaide and Geelong. In fact in the first harvest with a GLA, Kwinana was at a premium to Geelong, which it should be due port cost differentials and freight advantage. Not only did we see Kwinana zone growers benefit with competition, Albany and Esperance growers also were getting the same price as Fremantle when these zones previously traded at a discount under the Grainpool's monopoly.

Growers achieve higher farm gate returns for wheat in WA versus Victorian due to the natural freight advantage and port efficiencies that WA enjoys. However Grainpool has failed to capture these advantages and growers in WA have been getting substantially lower prices for years until a GLA was introduced and competition led to a \$17.00 advantage (RSM Bird Cameron report) for those growers that sold for cash versus delivering to pools.

A GLA has given WA growers a taste of competition, but as stated previously from a trading point of view it is very difficult to plan under the current system to know exactly who your customers will be & to estimate prices to be achieved. As we saw last year market dynamics can change markedly on a daily level & new opportunities to trade can also change accordingly.

Applying for a license early in the year requires the SEL to nominate customers on licenses, this is both restrictive & inflexible since better pricing premiums may present themselves later in the year from other customers.

Part of a permit consideration is granted on the basis of whether a market is an existing premium customer of the Grainpool. They state that all of their customers are premium markets. However the RSM Bird Cameron report could **not** identify **one** premium market that the Grainpool has. Not one!!!!. So if they are not achieving any premiums why do they still have the main export license?

How much market power Grainpool has on the world market is also questionable. According to the RSM Bird Cameron report, Grainpool sells on average about 190,000mts of feed barley a year to Saudi Arabia. This is a 6.0 million tonne market for feed barley with multiple buyers. We have regular buyers that will take hundreds of thousand of tonnes from us and we could significantly increase WA market share into Saudi with a more open market.

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REPORTS ON WA GRAIN INDUSTRY

In the following we wish to address recent reports into the coarse grain industry both here in WA & within Australia. Evidence of benefits of open markets & the GLA have been clearly assessed:

- *A Review of the NCP Grain Market Reforms*, Acil Tasman, November 2004;
- *Independent Ministerial Review of the Benefits and Costs of the Operations of the Grain Marketing Act 2002 And the Grain Licensing Authority*, Bird Cameron, January 2005;
- Grain Licensing Authority, *Report to Minister on Operation and Effectiveness for the 2003/04 Season*, June 2004 (supported with evidence from 'Farm Horizons report to GLA, Independent Assessment, of the Existence and Extent of Price Premiums which result from Market Power Available to the Main Export License Holder', Lloyd George, June 2004);
- Productivity Commission 2004, *Review of National Competition Policy Reforms*, Discussion Draft, Canberra, October.

Extracts from Acil Tasman Grain Market Reform Review

'A Review of the NCP Grain Market Reforms', Acil Tasman, November 2004;

GPPL's evidence on costs of GLA not convincing

Another of our major observations is that there is no evidence of any general or sustained effect of deregulation on prices for grain at port.... We found the case put forward by the Grain Pool of Western Australia for the opposite position to be unconvincing.

WAFF's arguments of damage of GLA not backed up with evidence

One of the most interesting observations made by the consultants during consultations with industry has been the small quantity of empirical evidence provided to support claims made by those opposed and those who support deregulation. Despite recent media activity and claims of a complete collapse of the Western Australian barley market the Western Australian Farmers' Federation told the consultants that they have no evidence to support these claims.

WAFF believes that total deregulation of the barley market in Western Australia will force at least 50% of barley producers out of business in 4-5 years. This assertion is based on a belief

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that deregulation will make pooling completely unviable... WAFF representatives said that they have no data or analysis or anecdotal evidence to support these claims.

This absurd claim highlights the level of scaremongering promoted by Grainpool to farm groups & in the public arena. Obviously this has been proven false & in fact we have seen prices for barley hitting record price levels for three of the past 4 years, and those prices being properly reflected back to growers by Special Export License Holders.

Observations of the effects of grain market deregulation - Pooling

Pooling is possible in a deregulated market. In every state in Australia which has undergone full or partial deregulation, the traditional pools have endured the transition to deregulation. These pools have undergone some changes but the central elements of pooling remains.

Benefits

The most significant change to a grain market when either fully or partially deregulated, that we have observed is the development of a 'deeper' or higher volume cash market for grain.

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ABN 29 106 378 885

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Extracts from Bird Cameron's Review

Review of the Benefits and Costs of the Operations of the Grain Marketing Act 2002 And the Grain Licensing Authority, Bird Cameron, January 2005

The Agricultural Minister Kim Chance himself commissioned his own independent review of the GLA conducted by RSM Bird Cameron. Yet again the Grainpool's claims of lost markets, costs to pool etc because of the existence of other marketers were refuted when the RSM Bird Cameron panel concluded '*...it is our opinion that we have not been provided with any conclusive evidence of any significant damage inflicted on the GPPL by the issue of licenses*'. Other positive outcomes listed in this independent report of GLA (other than increased returns to growers and more choice and options of product) was that WA growers were becoming better informed. Other comments include:

We do not believe that we have been provided with any evidence to show that the issue of special licenses reduced prices available to the GPPL in any key markets other than price changes attributable to world market trends.

In summary, it is our opinion that we have not been provided with any conclusive evidence of any significant damage inflicted on the GPPL by the issue of licenses in 2003/04.

Benefits

We have made an indicative assessment of the increase in returns to growers who delivered grain to the grain traders including an estimate of the financial benefit they received through receiving full payment in cash rather than part of the payment on deferred terms as occurs for pool participants. We have assessed that increased return to growers to be approximately \$5.8 million.

Extracts from Review of National Competition Policy Reforms

Productivity Commission 2004, ***Review of National Competition Policy Reforms***, Discussion Draft, Canberra, October.

In the Productivity Commission review of National Competition Policy (NCP) reforms they singled out that farmers and local rural communities had benefited under grain industry reform made under the auspices of NCP. The Victorian Government deregulated their barley marketing system in 2001 and said in their submission to the Productivity Commission that:

"...the reforms to barley marketing had resulted in considerable innovation and structural change in the sector, including:

- *entry of new competitors and innovation in related services such as financing for growers;*

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- *considerable rationalisation and vertical integration across the grains industry to achieve benefits of scale and scope; and*
- *increased investment by growers in on-farm storage and segmentation, to take advantage of niche market opportunities.”*

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ABN 29 106 378 885

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Extracts from GLA Report to Minister

Grain Licensing Authority, *Report to Minister on Operation and Effectiveness for the 2003/04 Season*, June 2004

NB: This report was supported with evidence from ‘*Farm Horizons report to GLA, Independent Assessment, of the Existence and Extent of Price Premiums which result from Market Power Available to the Main Export License Holder*’, Lloyd George, June 2004.

Deregulation of the coarse grains in WA will continue to put GPPL under the microscope as they continue to compete against other marketers to accumulate stock and their performance was benchmarked by the GLA. The GLA report to the Minister in June 2004 indicated that the GPPL’s performance had areas for improvement and the claims they had been making regarding premium markets (over a number of years) were unsubstantiated. Growers have more than satisfied with the new market opportunities offered by other marketers.

The partial deregulation in WA has had a very positive impact on the cash market for prescribed grains in WA. There was a noticeable lift in cash prices offered for both feed barley and canola following the issuing of special export licences, while at the same time estimated pool returns for prescribed grain increased over the harvest period. The GLA was frank in its review which found the special licenses had lifted cash prices and made recommendations to the GPPL about improving their performance.

The Grainpools claims of “cherry picking” in markets by their new competitors were clearly refuted in the report and the Grainpool was warned that it needed to be more forthcoming in the future with information on their long term relationships and “market power” premiums, or face licenses being issued into their core markets.

Grainpool withholding evidence from GLA

(pg6) *If the GLA issues significant quantities of export licenses prior to seeding this could have a significant adverse impact on the operations of the Grainpool in meeting the requirements of long-term customers and the States reputation as a grain exporter. The GLA has requested to see substantive evidence of long-term selling relationships held by the Grainpool but none has been forthcoming.*

... the GLA was prepared in the first season to err on the side of caution, however if there is ongoing lack of evidence of price premiums due to market power this will result in the GLA having to reassess which markets it will consider the GPPL may be attaining a price premium due to market power.(pg16)

Impact of Special Licenses on Pooling

The issue of cherry picking is raised by Grainpool but the GLA refutes this argument saying the

GPPL is not locked out of any market and can compete either through pooling or cash trading operations (pg 8).

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ABN 29 106 378 885

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AUSTRALIAN GRAINS INDUSTRY

The continuing existence of the GLA can not be looked at in isolation from the dramatic changes unraveling within the Australian Grain Industry. Australia's largest export crop – wheat – is going to be deregulated for the coming harvest. The question remains as to what marketing arrangements will exist for coarse grains and oilseeds in Western Australia.

To answer this question properly, one only need ask the question: how will growers be best served, and under what system? We believe that the GLA has served its purpose in weaning the industry from the effective duopoly which did exist to an environment where growers are now voting with their feet and actively embracing and encouraging new market participants. Most growers are quite astute in understanding the market dynamics which need to exist for a market to operate effectively.

As the largest grain exporting state in Australia, Western Australian growers have the most to gain in a properly managed export system. It would be a detrimental scenario for WA growers if wheat was deregulated in all states but coarse grains and oilseeds remained regulated – ESPECIALLY given that all other major Australian states have these markets deregulated.

Licensing requirements governing the accumulation and trade of prescribed grains

It is our belief that a limited system of licensing still be administered through the GLA. This body would issue open export licenses to marketers who passed certain criteria set out by the GLA. Basically marketers who held export licenses could export any grade, at any shipment time, to any country and to any buyer. However the GLA would need to ensure that those licensed exporters had experience in the marketing of export quantities of grain, had sufficient capital to be able to withstand any market movement of grain and not leave growers out of pocket. Marketers must have a sound reputation within the industry and be proven performers. This is important to ensure that growers who sell to these licensed exporters are NEVER left unpaid for whatever reason. It is of paramount importance that growers can sell with confidence to licensed exporters. This level of administration is a sensible level of government involvement to ensure the best possible outcome for WA growers.

Fees/Charges

If the GLA were to take up a new role as suggested above, the cost of running the GLA would be minimal. We would expect that no longer would Special Export License holders be asked to pay approximately \$10k or more for applying for license.

Alternative Regulatory models

The model we have suggested above is workable, it makes sense and it allows for the marketing companies to do what they do best without a costly, and unnecessary regulatory framework imposed on it. South Australia recently deregulated its export barley market and administered a license system under the body ESCOSA (Essential Services Commission of

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South Australia). ESCOSA issued licenses to 8 reputable grain trading companies (of which we were one) to operate openly in the South Australian market for the export of barley from that state. There was an initial application fee of \$12.5k to cover all costs. The primary concern for South Australian government was to ensure that participants in that market were reputable companies with the capacity to handle export volumes of grain. This system is certainly a system that WA should consider implementing, where the right balance between regulation and free market operation is met.

It is an important investment note to make that our company is not only adequately resourced, but also has intentions to invest heavily in the Western Australian Grains industry so far as storage in strategic areas. However not a cent can be spent until the level of deregulation suggested above is adopted by government. The GLA's issuance of multi-year licenses does not offer anywhere near enough investment certainty to spend several million dollars on storages across the state.

CONCLUSION

The arguments for greater level of deregulation are now beyond refute. The facts are irrefutable and arguments for the new system; justifiable. The GLA has proven this for all in the Western Australian Industry. It is now time for the industry to move past the tired debates of deregulation and get on with the job of growing, storing, transporting and marketing grain to customers around the world. Those companies who do this job the best, will deliver greater returns to growers and be best equipped to compete in this industry. Anything less is a travesty for the West Australian grower.

If you have any queries do not hesitate to contact our Fremantle office.

Regards,

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