

**REVIEW OF NATIONAL COMPETITION
POLICY REFORMS**

**Submission to the
PRODUCTIVITY COMMISSION**

**Provided by the
GRAINS COUNCIL OF AUSTRALIA**

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**Relating to the Discussion Draft Report
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Introduction and Discussion of NCP

A key objective of government macroeconomic management policy is to achieve efficient resource allocation.

It is important to note that this outcome may require intervention to offset market weaknesses caused by the breakdown of competition through monopolistic powers or other externalities, and to improve the equity in distribution of income within society.

National Competition Policy (NCP) should be concerned with maximising economic growth through legislative reform of anti-competitive restrictions within state and federal government jurisdictions.

In many instances, the implementation of reforms under the general heading of 'competition policy' has led to more efficient functioning of the Australian economy. This is particularly the case where jurisdictional issues have been streamlined between states and between states and the federal government. The 'services' sector has benefited greatly from many reforms and the grains industry has benefited in many instances as a consumer of services.

However the imposition of certain policies under the NCP banner have conflicted with the economic and social objectives of the Australian Government's decision to intervene in the grains industry through its retention of and strong support for the *Wheat Marketing Act 1989*.

The *Wheat Marketing Act 1998* established a requirement that the wheat marketing system 'maximises returns to pool participants' and was designed to redress the very real possibility, under a totally deregulated market, of Australian grain growers becoming individual price takers for wheat offered on the world market.

The production and marketing of Australian wheat is clearly an *export focussed* industry, with annual exports worth over \$4 billion and up to 80% of wheat produced in Australia being exported.

The overarching aim of the current marketing arrangement is to maximise the total returns from export sales to the *whole* industry and subsequently to regional communities and the Australian community as a whole.

Background to Australian industry

Australia produces approximately 4.5% of the world's wheat, but our wheat exports account for over 15% of the world wheat trade of approximately 100 million T per annum.

This places Australia as one of the top five exporting nations in the world, competing for market share against other net exporting countries, including the United States, European Union, Canada and Argentina.

As a small producer, but a large exporter, of grain the underlying price levels for the Australian grains industry are set by world supply and demand.

Trade distorting policies of other governments have adversely affected, and continue to adversely affect, the prices received by producers.

Since the development of the export controls on wheat in 1938, there has been a deliberate marketing strategy of building and maintaining a differentiated position for Australian wheat in the international marketplace.

Australia has a sound reputation for the production and supply of high quality, white, low moisture wheat; but it is through the market segmentation strategies to tailor parcels of wheat to meet specific needs of customers, that a competitive advantage has been established by AWB International as the operator of the current wheat export system.

Current Australian Export Wheat Marketing Arrangements

When reform of the former Australian Wheat Board into a privatised agribusiness occurred, the following principles were encompassed;

- The separation of regulatory from commercial function, through establishing contestable elements into smaller independent business units.
- The establishment of an independent authority to monitor the performance of AWB International.
- The adoption of corporate governance structures and commercial obligations to those faced by competing private businesses.

The Grains Council of Australia (GCA) supports the current administrative arrangements provided for under the *Wheat Marketing Act (1989)* where –

- AWB(I) is the commercial manager of the 'single desk' marketing provision / exemption allowed for under the Act;
- AWB(L) is the contracted service provider to AWB(I) – managing relevant marketing operations, export customer relationships, wheat purchasing, storage and logistics, management of pools and associated financial arrangements, management of currency and other risk management activities, etc.; and
- The Wheat Export Authority (WEA) acts as an administrative and operational 'umpire' to ensure that the obligations placed upon AWB(I) under the Act are fulfilled and that continuous efforts are made to maximise benefits to wheat producers (and the community at large) from the export marketing exemption extended to AWB(I).

Accountability Through the Wheat Export Authority

Under Section 5 of the *Wheat Marketing Act 1989* the Wheat Export Authority (WEA) is vested with the following functions:

To control the export of wheat from Australia; and

To monitor nominated company B's performance in relation to the export of wheat and examine and report on the benefits to growers that result from that performance.

Since its inception in 1999, the WEA has taken a strong regulatory approach towards its legislative responsibilities of

- Oversight of the export consent administration
- Monitoring and reporting on the performance of AWB(I) in managing the wheat export controls
- Oversighting the benefits that accrue to growers as a result of this performance, providing accountability and transparency to the Australian Government, the industry and to the wider community.

There is support among producers for the role of the WEA and the duties it has.

The Grains Council currently undertakes regular formal consultations with both AWB and the WEA on behalf and with the involvement of its State Partners. To date the relationships and the consultation processes have been beneficial for all parties.

For example, the WEA has, in consultation with AWB(I), the Grains Council of Australia and industry representatives, developed a comprehensive and rigorous performance monitoring framework for conducting its performance reports on AWB(I)'s management of the single desk.

Similarly the WEA developed and implemented a revised export consent system designed to streamline administration and better align export consents issued with actual export volumes.

It is clear that the intention of the export exemption under the Act allowing AWB(I) to export wheat without having to seek approval, is to capture benefits for the whole of the wheat production sector.

Quantifying the benefits of the Current Wheat Export Marketing System

Over time a considerable body of research has been accumulated that quantifies the benefits of the current wheat export marketing arrangements for producers¹.

The most recent example is the *Econtech - Single Desk Marketing of Wheat – Three Price Premium Models: Report to AWB*, released in March 2004.

The Econtech research, carried out by Professors Gans and Hirschberg, provides the most robust analysis to date of the benefits of the current marketing arrangements, employing as it does, 3 econometric models² to measure the benefits accruing from the current wheat export marketing system.

All three models utilised in the report show that the current wheat export marketing arrangements are delivering a premium to producers of between AUD\$80 million and \$200 million per annum, or an average benefit to pool participants of \$13.00 per tonne.

Pooling allows AWB(I) to service customers with grades and quantities of wheat (including delivery schedules, volumes, etc) in a manner that allows them to build a consistent relationship over time, adding significantly to the value extracted from the market for Australian wheat producers.

The GCA contends that much of the average AUD\$13.00 / tonne³ all grade price premium achieved by AWB(I) can be attributed to the 'relationship' nature of the marketing undertaken on behalf of Australian wheat producers.

Adding further validity to this contention is the estimate by the WEA in its Growers Report 2003, that the pooling activities of AWB(I) in 2001-02 provided a premium to producers of AUD\$14.60 / tonne (AUD\$285 million).

It is important to note that the success of these strategies is dependent on the assurance that AWB(I) can maintain its competitive position in export markets as the sole supplier of Australian wheat in bulk.

A prime example of the benefits of the current system can be found in the long term relationship with Iraq. Australia has just celebrated 56 consecutive years of profitable trade with Iraq, accounting for exports in excess of 30 million T over that period.

¹ In this submission, where benefits or impacts are said to accrue to 'producers', it is clearly implied that the same benefits / impacts will accrue to their families and thus have a flow on effect to their regional communities and the regional economy in general – rationalising that cash generated in farming enterprises is circulated in the local community via consumption and investment.

² Carter-Knetter, Price Discrimination and Hedonic models.

³ Econtech (2004) Single Desk Marketing of Wheat – Three Price Premium Models: Report to AWB.

Calculating the Losses from Removal of the Wheat Export Marketing System

The other side of this coin is the potential cost to wheat producers of the removal of the current wheat export provisions.

Gans and Hirschberg⁴ have modelled the following 3 scenarios (all US\$).

Market Structure	Price received by producer	Reduction in producer returns
Single Desk	\$142	-
Monopoly	\$97.5 to \$115.5	\$563m
Duopoly	\$115.5	\$360m
Fully Contestable	\$133	\$134m

This modelling indicates that any moves to strip away the current wheat marketing arrangements will lead to direct losses on the part of wheat producers and subsequently rural and regional Australia.

International Focus of the Australian Wheat Industry

The Australian grain industry is arguably the most 'internationalised' of our agricultural industries. Production of the main crop, wheat, is highly dependent on access to international markets. The ability of Australian wheat to find buyers reflects both the competitiveness and quality of the Australian product.

Australia as a whole is at a market disadvantage given its relatively small industry and domestic population. Critical mass is required for Australian producers to compete effectively against large scale international sellers / traders.

The *Wheat Marketing Act 1989* allows the Australian industry to address this international market power imbalance by allowing for aggregation of Australian wheat for export under a 'single brand'.

Four major trans-national firms controlled over 73% of global grain trade in 2003⁵. Of the 100 million tonnes of wheat traded globally each year, Australia contributes about 15% (15 million tonnes), from a total global production of about 600 million tonnes.

Cargill, Louis Dreyfus, Archer Daniels Midland and Bunge dominate the transportation, storage, trade and processing of grain and oilseeds around the world. The total revenues of these 4 companies in 2002/03 were approximately US\$150 billion.

AWB International, as the custodian of the export arrangement, must compete in the international market against the trans-national corporations mentioned above.

By controlling around 15% of the global wheat *trade*, Australia is able to positively influence prices to the advantage of wheat export pool participants, as a 15% market share is a critical point at which a seller can influence price movements.

By removing the ability of the current wheat export system to 'bank' on being able to aggregate 97+% of Australian wheat into pools, Australia will be unable to influence global prices to the extent it currently does, leading immediately to the erosion of returns for wheat producers.

The ability of Australian exports to impact on prices makes our export system a 'target' for trans-national grain traders. Removing the Australian influence on the market will allow the major traders to adjust prices to suite their own ends, to the disadvantage of Australian wheat producers.

⁴ 'Your Single Desk' – report prepared by AWB International, 2004.

⁵ Report prepared for AWB Limited by the Boston Consulting Group

International Competitiveness Should be a Key Focus of Policy Deployment

One of the central arguments in favour of implementing national competition policies is that they can usually be expected to increase the competitiveness of Australian firms in the international market. This is due to many of the NCP reforms being directed toward services that are *inputs into exports*, such as public utilities and transport services.

A central *dilemmas* of a national competition policy is that it assumes, to some degree, that the domestic economy is decoupled from the global economy.

In practice this is not the case. Globalisation of the Australian economy means that Australia's *national* competition policy must operate in an *international* environment.

It should be recognised that implementing a national competition policy without due consideration of the realities of international trade could in fact undermine the competitiveness of Australian industry.

Specifically, it should be recognised that domestic *national* competition policy reforms may inhibit the ability of Australian industry to cope with *international* market failure.

A distinction must therefore be drawn between

- An arrangement that allows an Australian industry to become more internationally competitive or is designed to address international market failure and
- An anti-competitive arrangement that has a detrimental effect on the domestic economy.

Here the debate centres on the issue of whether or not Australian companies should be able to become large enough to compete effectively in the international market place, by 'lessening' competition within Australia.

An example of where this pragmatic approach has been applied is in New Zealand.

The New Zealand government and dairy industry recognised that their industry structure was impacting on their international competitiveness. So in 2001 they agreed to combine the New Zealand Dairy Board, The New Zealand Co-operative Dairy Company Limited and Kiwi Co-operative Dairies Limited to form Fonterra Ltd.

By forming Fonterra, New Zealand eliminated 'own country' competition from export sales, concentrating instead on maximising market penetration for New Zealand dairy products and were able to use the subsequent size of the new company to compete with North American and European global dairy companies as 'equals'⁶.

Those who argue against arrangements such as the Australian wheat export marketing system and the formation of organisations like Fonterra for reasons of international competitiveness, are ignoring the realities of an Australian economy that is fully integrated globally.

In particular, they ignore the fact that when competing in most global markets, Australian companies are competing against huge multinationals, with economies of scale and related market power unavailable to local companies.

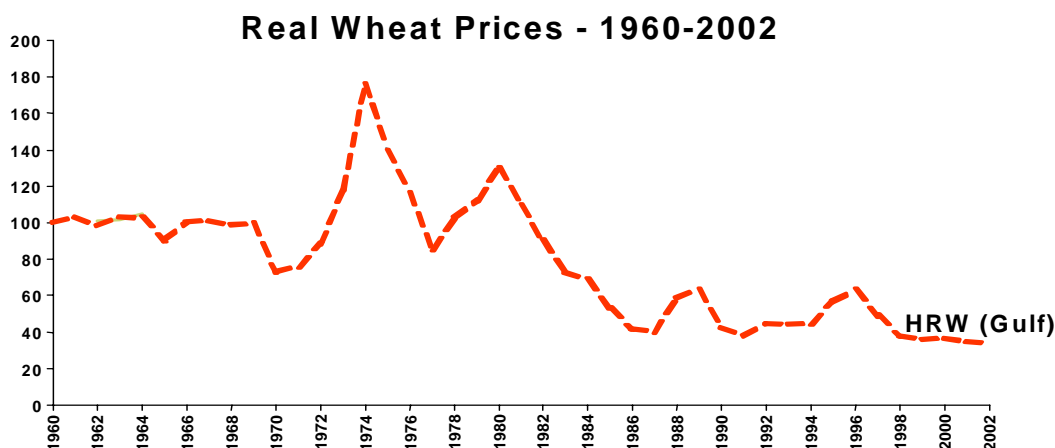
It is necessary that marketing arrangements be viewed in both a global *and* domestic context. The major market in which a company's activity occurs (either domestic or international) should be the focus of consideration.

The nature of the international market in which a firm has to compete, and the openness of the domestic Australian economy, should be taken into account when determining the public benefit of any marketing arrangement.

⁶ Fonterra has assets of (NZ\$ billion) \$4.9, annual turnover of \$11.8, over 19 000 employees and manufactures 1.8 million tonnes of milk PA.

We cannot hope to have a dynamic, export-oriented industry which operates with global best practice, if Australian companies are not allowed to develop a strong domestic base. Without such a base, Australian companies will not have sufficient strength to compete adequately in the world market.

The benefits of competition in terms of economic efficiency, can be derived either from international or domestic competition. The greater the exposure of an industry to international



Source: United Nations Conference on Trade and Development (UNCTAD), Handbook of Statistics, Table 2.2; US Department of Labor, Bureau of Labor Statistics

competition, then the greater the likelihood that competitive pressure is being applied through that competition.

Thus, while an organisation may benefit from a specific arrangement which is *prima facie* anti-competitive in the domestic context, the organisation will still be subject to competitive pressures, due to its exposure to international competition.

Performance of the Current System

Annual growth of around 2.5% in agricultural productivity since 1960 has allowed producers to offset a trend of declining terms of trade. The Australian wheat industry has been at the forefront of this productivity growth.

However research carried out by Pocknee and Associates for the grains industry⁷, indicates that returns for undifferentiated commodity grains could fall over the next two decades by as much as US\$25 / tonne from 2003 values.

The anticipated reduction in returns from export of undifferentiated commodity wheat continues a historical trend shown in the graph below.

The historical trend indicates that the Australian wheat industry has to diversify away from undifferentiated commodities into the production and export of higher value grains. This can be best achieved by leveraging the current export marketing arrangement and undertaking differentiation similar to that available under the AWB Golden Rewards program.

⁷ For the Single Vision industry strategy, launched at Grains Week in March 2004.

During the drought in 2002, AWB International continued to deliver benefits to the Australian community in managing wheat export marketing arrangements and maximising returns to growers who delivered to the National Pool, through the diversion of wheat stocks to the domestic markets experiencing shortened supply and unmet demand.

The prices being paid on the domestic market in the years impacted by drought were higher than the equivalent export prices.

National Pool	Tonnes	
	Export	Domestic
1999-00	18 262 856	2 686
2000-01	15 510 418	8 392
2001-02	16 803 613	1 092 366
2002-03	6 254 219	162 052

This information, taken from the Wheat Export Authority 2004 Growers Report, clearly indicates that in excess of 1 million tonne of wheat was diverted from export sales to the domestic market.

In a scenario where the national pooling facility didn't exist, both wheat producers and domestic market consumers would have been significantly worse off – wheat diverted to the domestic market would have been sold at a lower export price and domestic consumers would have experienced even larger supply shortages.

AWB International has developed sophisticated and transparent, market based price signals, which are incorporated in payments to growers who deliver to the National Pool.

This innovative market based instrument has contributed to the strong performance of the wheat production sector through contributing to the adoption of new technologies and standards, and has improved the responsiveness of Australian wheat growers in meeting changing market needs, who have capitalised on opportunities in new and existing markets for Australian wheat.

The Impact of National Competition Policy on Rural and Regional Communities

The effects of deregulating primary industries impact disproportionately on rural and regional Australians, due mostly to their higher dependence on income derived from primary production.

The wheat export industry involves close to 30 000 producers, directly employs over 150 000 people in regional Australia and close to 45 000 non-farm enterprises rely on a profitable grains industry for survival⁸.

Impacts from further structural reform, such as the removal of the current wheat export marketing provisions, would not only be felt by grain producers and their employees, but also those involved in other aspects of the grains industry, including inputs into grain production, such as chemicals and machinery, research and development, bulk handling, storage and transport, grain marketing, and financial services.

Any loss of employment in regional areas will add to social welfare dependency and add to social dislocation. Evidence of this could be found during the recent drought, where reduced farm incomes (and spending power) impacted on direct employment and on associated enterprises.

Shifting from the current export marketing system, where benefits can be pooled and risks minimised, will precipitate a shift in equity and a reduction in liquidity.

⁸ 'Your Single Desk' – report prepared by AWB International, 2004.

Proponents of alternative 'single desk arrangements' are in fact seeking capital redistribution from producers to shareholders.

For example an organisation such as GrainCorp which has a virtual monopoly on storage and handling on the east coast of Australia, stand to make massive gains in the value of their shares from any move to modify the current wheat export arrangements.

If the current export system were to be changed to become an 'at port' arrangement (a policy promoted by the owners of GrainCorp) the organisation that controls the majority of handling, transportation and storage infrastructure will be able to increase their 'infrastructure rent'.

As this sort of arrangement will have no impact on global trade prices, the margin between returns and costs for producers will be reduced. This will erode the value of export sales being passed back to pool participants, with the 'middleman' capturing a larger share of value than is currently the case.

It is the clear intention of this and other organisations, both domestically and internationally, to capture a large share of the 'premiums' that are currently generated by the pooling system for their own shareholders.

It is true that many wheat producers are shareholders of companies such as ABB, AWB Ltd, GrainCorp &c. However, equity captured as share value rather than as liquidity (cash) will have a different impact on regional communities.

Not only are the livelihoods of most regional communities dependent on the income they derive from agricultural production, they are particularly dependent on export income.

Despite recent WTO trade reforms, international agricultural markets, and in particular the world grain market, are some of the most corrupted in the world. As Australia is a significant exporter of agricultural produce the incomes of rural communities can be considerably depressed because of these international market distortions.

Recent Commentary on Marketing Regulation

The recent *NCC Occasional Series – A Review of the NCP Grain Market Reforms – November 2004*, deals primarily with deregulation in the marketing of barley.

The report actually invalidates a number of arguments put forward in Western Australia over the performance of the Grains Licensing Authority in that state.

Proponents of the new system in WA claimed that the presence of the GLA in its first year caused a major rise in domestic prices. As the report points out, the price variations were due to domestic seasonal and international and domestic supply problems.

The Australian wheat industry cannot be compared to other grain industries, including barley. The dynamics of the respective global markets, the end use of the products and relative size and importance of each in a domestic context make comparisons invalid.

Unfortunately, opponents of the current wheat export marketing system have taken the findings of the NCC report out of context and sought publicly to apply the findings from the barley industry to the wheat industry.

The findings from the NCC report cannot be extrapolated and applied to the wheat industry, the essential differences in the industries preclude such an exercise.

Recommendations

The Reform of National Competition Policy discussed in the Productivity Commission's Final Report should take into consideration the following perspectives -

1. Export marketing arrangements must be viewed not only in a domestic context, but also in relation to the international competitiveness of Australian industry.

In this way a distinction can be made between an arrangement designed to address issues of international competitiveness and an anti-competitive arrangement that only affects the operation of the domestic economy;

2. Grains Council supports the comment made in the 2003/04 Annual Report of the National Competition Council that "...a consideration of a future reform agenda could usefully consider whether a broader resource allocation / efficiency perspective would offer further gains..."⁹.

We agree that the future reform agenda should be expanded beyond the current narrow definition of competition and incorporate efficiency measures when undertaking future NCP assessments. This would be consistent with NCP objectives and provide a greater indication of public benefits in anti-competitive structures that are designed to promote the interests of the Australian community;

3. There is wide recognition that, under certain circumstances, international competition can be an effective substitute for domestic competition;
4. Grains Council concurs with the draft report, that explicit recognition of social, environmental, equity, regional and adjustment objectives is required when assessing particular reform options and agree that it is neither desirable nor practical to promote competition in every activity and circumstance;
5. The NCP public benefit test must be reformed to take into consideration 'real world' comparisons of the likely range of outcomes with and without regulation, in undertaking the assessment of export marketing arrangements.

The assessment must take into consideration the trading environment and the value of countervailing power to agricultural exporters, as well as the likelihood of market failure;

6. Grains Council believes that, in most cases, anti-competitive arrangements are detrimental to the wider community. However, we wish to emphasise that this is a *theory* to be applied and tested and not a given *fact*.

We further believe that the benefits of the competition policy review processes will only be derived when the basis of this theory is made clear and it is matched against the reality of a specific anti-competitive arrangement. This will make the review process both rigorous and transparent.;

7. Grains Council believes the effect of dismantling structures such as the current export marketing system for wheat would have a variable impact across the Australian community and this needs to be taken into consideration when reviewed under NCP.

The adverse effects of removing the current export provisions would fall disproportionately on rural communities in comparison with any benefits which could accrue to other sectors of the Australian community.

8. Pressure on rural communities has been driven by declining terms of trade and population drift from smaller rural communities, as noted in the Draft Report.

⁹ NCC Annual Report 2003-04, page 11

GCA believes it is important to develop a broader discussion and to clearly identify these trends, rather than dismissing them as 'being of a long term nature and unrelated to NCP'.

There is a structural adjustment process related to the imposition of competition policies, and the structural adjustment is felt more keenly in communities where service levels are lower, more costly and the economic base more limited, as is the case in regional Australia.

9. The GCA reaffirms that any changes to arrangements that are in place which assist agricultural producers to deal with the distortion of international agricultural market, should not be dismantled without due consideration to the effect that such a policy would have on Australia's regional communities.

Thus, when an assessment is made during NCP reviews of the net aggregate community benefit accruing from increased competition, NCP reviews should also take into account the geographical distribution of the benefits and costs.

For those communities bearing the costs of any change, an assessment needs to be made of their propensity to adjust, the alternative opportunities available to them and the necessity for relevant governments to provide appropriate adjustment assistance.

10. The benefits from the current export marketing arrangements and the effective manner in which it is being managed have been demonstrated using a range of econometric models over time.

As such, the issue of the appropriateness of the current arrangements should not be brought under review again until the 2010 National Competition Policy review.

This is a perspective supported by both the Federal Government and Federal Opposition and is the position of the Independent panel who conducted the 2004 Review into the Wheat Marketing Act.

11. The continued reference to the wheat export arrangements throughout the draft report, specifically citing the Australian Wheat Board as being '...unfinished business in reforms to public monopolies...', or as '...one of the most prominent areas singled out by the NCC in primary industries...', is inflammatory and without justification.

There is a clear timeline of review enshrined in the *Wheat Marketing Act 1989* and the fulfilment of the legislative requirement to conduct a review in 2004 of the performance of the Wheat Export Authority and of the Pool Manager, AWB International, clearly establishes transparent and robust mechanisms of accountability.

The conduct of any additional reviews would impose unnecessary cost and inefficiency on the operations of AWB International, the industry as a whole and the Australian wheat growers who strongly support the retention of the current arrangements.

This recommendation is clearly supported in the findings of the 2004 Wheat Marketing Review. Time must be provided to the industry to implement the extensive structural and administrative reforms of the operation of the single desk, following the 2004 Review.