SUBMISSION TO THE

PRODUCTIVITY COMMISSION INQUIRY

Into

THE AUSTRALIAN PIGMEAT INDUSTRY

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PASTORALISTS AND GRAZIERS ASSOCIATION OF WA INC.

The Pastoralists and Graziers Assn of WA Inc (PGA) is a non-profit industry organisation established in 1907 which represents primary producers in pastoral and agricultural regions of Western Australia (WA). The PGA is the only Western Australian State Farmer Member of the National Farmers' Federation and participates in key industry and commodity groups. The PGA has a state-wide District Committee structure which enables grass-root input on all policy matters.

The PGA philosophy is to promote the welfare and profitability of the interests of it's members through the encouragement of private enterprise. The PGA is proud of its achievements and history as a leading advocate for removal of statutory interference in Australian agricultural commodity markets.

PGA OPPOSES CURRENT WHEAT MARKETING ARRANGEMENTS

The PGA have taken an interest in the Pigmeat Industry Inquiry due to our fundamental opposition to the current wheat marketing arrangements. The PGA has long lobbied for the dismantling of single desk arrangements believing that they are not of benefit to wheat growers or our customers, in particular our domestic customers which seem to get ignored at the expense of export marketing, which makes up the biggest percentage of total wheat sales.

The PGA believe Single Desk system is not an advantage to domestic users (or indeed Australian growers) for the following reasons:

1. In times of grain shortage (e.g. drought) domestic prices have not been at export parity prices

In the PGA submission to the Productivity Commission Inquiry into National Competition Policy in June 2004 we raised the issue of feed industries suffering at the expense of the single desk system due to lack of export parity.

> *This issue came to a head during the drought of 2002/03 where shortages of grain caused extreme prices and it is claimed the AWB Ltd. used their export power to restrict domestic supply and inflated the price for domestic grain buyers.*
>
> *Dairy Australia adviser John O'Connor [1]said the AWB had set its domestic feed grain prices during the 2002-03 drought at levels well above export parity and, for a significant period, above import parity. He said those prices could not have been sustained without the AWB's monopoly export power and had only moderated after feed-grains users moved to import their own grain. As well as charging excessive prices during the drought it is believed, the AWB had restricted the volumes available to feed-grain users and failed to provide customers with information about quantities of wheat in store.*
>
> *Other industries who rely on feed grains have supported the dairy farmers in their claim. The Livestock Feed Grain Users Group recently said the AWB had used its position to generate windfall profits during drought at the expense of livestock producers. The Dairy and Chicken meat industry consume 5 million tonnes of various grains per annum. All grain feed buyers should be afforded a fair and open market system…*

[1] Formed part of the submission made by Livestock Feed Grain Users Group as reported in the Stock and Land on 9/6/04

2. Lack of Risk Management Services for Domestic Feed users who have surplus feed are forced to sell to AWB to quit stocks

Domestic Feed users cannot afford to be 'long' in the market (i.e. hold more stocks than they need) as there is not competition for who will buy excess stock (AWB Ltd have monopoly so they are only option). This means they are forced to buy 'hand-to-mouth' and are at the mercy of AWB if there is a shortage in the market.

3. AWB under current system have no obligation to domestic feed users despite them being a major customer of growers

AWB's main concern is to the export pool and they have long term supply contracts with customers which they will fill first and domestic customer come a poor second. In times of shortage (drought, end of season etc.) the AWB can take advantage of domestic buyers and inflate the price of grain which often doesn't even flow back to growers (as they sell to the pool).

4. Wheat Marketing Arrangements do not meet National Competition Policy (NCP) principles yet domestic feed users have been forced to comply with NCP (e.g. dairy industry)

Background to National Competition Policy and Wheat Marketing Arrangements

Under the guiding principle set out in the Government's Competition Policy Agreements, legislation should not restrict competition unless it can be demonstrated that the benefits of the restriction to the community as a whole outweigh the costs, The current president of the NCC, Wendy Craik said "*A public interest test in NCP allows restrictions in legislation to be retained where they are in the public interest...The case needs to be made robustly, but the provision is there.*"[2]

In 2000 the Minister for Agriculture announced a National Competition Review into the Wheat Marketing Act 1989. The review was conducted by a three-person panel as part of the NCP review process. The review was to determine whether the single desk arrangements for wheat provide an overall net benefit for Australia, including to rural and regional communities.

[2] Source: Speech given by Dr Wendy Craik at the WA Farmers Federation Annual conference in Perth ,March 2004

The 2000 Review Committee sought tangible evidence on the magnitudes of such benefits, costs and overall effects. The 2000 Review concluded that:

> *Based on the assessments examined by, and undertaken for, the Committee in its consideration of the 'public benefit' test, the Committee concludes it has not been presented with, nor could it find, clear, credible, and unambiguous evidence that, on balance, the current arrangements for the marketing of export wheat are of net benefit to Australian wheat growers or to the Australian community. The NCP guidelines place the burden of proof of net benefit on those arguing for the retention of anti-competitive legislation*[3].

While the Committee recommended that the 'single desk' be retained until the scheduled review in 2004 by the Wheat Export Authority (WEA) of AWB International's operation of the 'single desk'. They recommended the main purpose and implementation of the 2004 review should be changed so that it provides one final opportunity for a compelling case to be compiled that the 'single desk' delivers a net benefit to the Australian community. In this conclusion the committee also said *"if no compelling case can be made by the time of the 2004 review, that there is a net public benefit, then the 'single desk' should be discontinued"*. The Committee has also made several recommendations on the introduction of competition into the current system.

Government Response to 2000 NCP Review

The Government baulked on implementing all the recommended changes by declaring in April 2001 that they would retain the single desk and that it would not conduct the 2004 Review under NCP Principles. Mr Truss, the Minister for Agriculture, confirmed this when he released the Terms of Reference for the 2004 Wheat Review Panel (see Appendix 4). In a media release dated 23rd Dec 2003, Mr Truss said *"the Reviews Terms of References clearly indicate that the review is not an investigation of Australia's single desk arrangements, nor will it seek to duplicate the National Competition Policy Review held in 2000."*

Federal Government has failed to apply National Competition Principles to Wheat Marketing Arrangements

The government are avoiding the issues of the net benefits of the wheat single desk in the current 2004 review. The NCC confirmed the Commonwealth had not met its CPA clause 5 obligation relating to the regulation of wheat export marketing in their 2003 Annual Assessment. The PGA believes the current NCP Inquiry needs to

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[3] Pg 142, National Competition Policy Review of the Wheat Marketing Act 1989, M.Irving AM, J. Arney & Prof B.Linder, Dec 2000

investigate this and demand that the recommendations Irving *et al.* gave after the 2000 Review should be implemented immediately. There is no conclusive evidence that the single desk delivers net benefits to the Australian grain growers or the Australian economy. Unless net benefit can be proved the public benefit test set down by the NCP cannot be used as a reason to retain our current wheat marketing arrangements.

ADDITIONAL INFORMATION

Verbal Submission to Productivity Commission in Perth on 28th January, 2005 – other relevant comments are made in this submission which add further weight to our argument that the current monopoly wheat and prescribed grains marketing systems are detrimental to intensive livestock feed industries and of no benefit to grain growers either.

Please find attached another relevant document to the inquiry

Australian Wheat It's Time for Choice, A submission to the Independent Review Committee reviewing the Wheat Marketing Act 1989 under National Competition Policy, August 2000, Joint Industry Submission Group. The names of all the participants of the Joint Industry Submission Group is listed on *page iv* in the introduction of the submission.

The Commission will find Chapter 6 (pg 62-70) most relevant to this inquiry as if refers to the intensive livestock feed industries and the implications of the single desk system for these industries.

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Australian Wheat

It's time for choice

A submission to the Independent Review Committee reviewing the *Wheat Marketing Act 1989* under National Competition Policy

Joint Industry Submission Group

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August 2000

Joint Industry Submission Group

This submission was prepared by the Centre for International Economics on behalf of the Joint Industry Submission Group.

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Foreword

THIS PUBLICATION IS AN EDITED VERSION of a submission by the Joint Industry Submission Group to the Independent Review Committee undertaking the National Competition Policy review of the *Wheat Marketing Act 1989*.

This group has an annual turnover of $12 billion in rural industries in Australia and directly employs some 15 000 people. The activities of the group members create substantial flow-on effects that enhance employment and investment throughout rural and regional Australia and the economy generally.

The members of the Joint Industry Submission Group cover a wide array of industries, businesses and organisations that have been influenced by this legislation, which grants a monopoly on Australia's bulk wheat exports. All members of the group have one thing in common — they are keen to see substantial reforms to wheat marketing arrangements in Australia.

This publication and the submission were produced to raise awareness of the significant costs incurred by growers and wheat consumers as a result of the restrictions imposed through the Wheat Marketing Act and highlight the negative impact this has on further investment in regional Australia. Consequently, all in the group have contributed to the production of this comprehensive study of the impacts of the Act on the wheat industry and on the many other industries that are influenced by the anticompetitive restrictions imposed by this legislation.

The study and the preparation of this report were undertaken by the Centre for International Economics on behalf of the Joint Industry Submission Group.

The Secretariat to the group is provided by BFT Pty Ltd.

Lloyd George
Chairman
Joint Industry Submission Group

Joint Industry Submission Group

Members

PGA of WA Inc — Western Grain Growers

Pork Council of Australia Ltd

Australian Lot Feeders Association

Elders Limited

National Agricultural Commodities Marketing Association Inc.

Australian Grain Exporters Association

Cargill Australia Limited

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Grainco Australia Limited

Marubeni Australia Limited

Sydney Futures Exchange Limited

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MANY PEOPLE CONTRIBUTED in different ways to the production of this report. Members of the Joint Industry Submission Group gave freely of their time to contribute data, information and ideas. Many other people, too numerous to list, were consulted during the course of the study and their contribution is gratefully acknowledged.

Ms Vanessa Eccles (Centre for International Economics), who produced the manuscript, deserves special praise.

Contents

Boxes, charts and tables

Abbreviations

ABB	Australian Barley Board
AH	Australian Hard (wheat)
APW	Australian Premium White (wheat)
ASW	Australian Standard White (wheat)
AusAID	Australian Agency for International Development
AWB	Australian Wheat Board
c&f	costs and freight
CIE	Centre for International Economics
EU	European Union
fob	free on board
GCA	Grains Council of Australia Inc.
NEAT	New England Agricultural Traders
WEA	Wheat Export Authority
WMA	Wheat Marketing Act

Defining the AWB

In 1998 the previous statutory marketing authority called the Australian Wheat Board (AWB) was privatised and became a conglomerate of companies, the parent company being AWB Limited. It has a number of subsidiary companies, the most relevant for this submission being AWB (International) Limited, AWB (Australia) Limited and AWB (Finance) Limited. In this report the term 'the AWB' is used to refer generally to the new parent company and its subsidiaries as well as the previous AWB unless otherwise specified. In general, where reference is made to the pooling operations of the AWB and its international marketing activities the term AWB (International) is used.

Submission at a glance

- The *Wheat Marketing Act 1989* restricts competition. It confers extraordinary powers on a private company. The mechanisms for independent review and control are not sufficient.
- The impacts of the restriction spread across all levels of the wheat industry, resulting in anticompetitive and inefficient outcomes.
- The intended beneficiaries, wheat growers, are in fact penalised. The evidence that total revenues are enhanced through a 'single desk' is ambiguous and any advantage is small at best. Costs to the wheat industry, particularly growers, are increased substantially and this is certain.
- A competitive and contestable market, operating in a framework of appropriate regulation, could deliver the intended benefits of the Wheat Marketing Act, as well as additional benefits for the Australian community.

The Joint Industry Submission Group submits the following.

1. If the Independent Review Committee concurs with these findings it recommends the removal of the restrictions on wheat exports that are contained in the Wheat Marketing Act.
2. The committee should examine the regulatory framework in the context of principles of good public administration and recommend:
   - the removal of any regulatory powers from the consolidated AWB that may be a carryover from the previous statutory authority;
   - the setting up of an independent body to oversee appropriate regulatory functions pertaining to the wheat industry (this body would oversee the appropriate *framework* but the provision of services throughout the supply chain, including export services, would be contestable); and
   - the establishment of an appropriate appeals mechanism for aggrieved parties.
3. In all considerations of regulation pertaining to the wheat industry, the definition of the wheat industry should be broadened to include all sectors — end users, service providers, potential entrants, as well as growers.

The hurdles	To clear them requires proving a lot …
1 Market power	Proving that the AWB has market power and is using it to raise the average export price (chapter 3)
2 Domestic supply chain costs	Proving that the AWB's monopoly is not adversely affecting domestic supply chain costs (chapter 4)
3 Growers' costs	Proving that pooling and 'single desk' selling are not raising costs to growers or restricting their ability to manage their risk (chapter 5)
4 Costs to other industries	Proving that there are no, or minimal, adverse effects on other industries (chapter 6)
5 Environmental, regional & social issues	Proving that the 'single desk' favourably addresses environmental, regional and social issues (chapter 7)
6 The net public benefit test	Proving that the net public benefit of 'single desk' selling is positive and significant by providing quantitative evidence (chapter 8)
7 Alternatives	Proving that there are no alternative marketing arrangements, including partial deregulation, that would achieve the implicit objectives of the Wheat Marketing Act (chapter 9)

… which will be difficult because …

- The international wheat market is highly competitive.
- Restricting supplies in a market invites competitors to fill the gap, and is inconsistent with long-term market development.
- Prices differ between markets for many reasons and do not indicate market power.
- No studies have demonstrated a higher average export return from 'single desk' selling.

- The Grains Council of Australia has already shown that these costs in Australia are US$5 a tonne higher than in the United States.
- Monopolies invariably mean higher costs.
- The combination of AWB's monopoly and that of bulk handlers stifles innovation and investment in the supply chain.
- Introducing competition could reduce these costs by A$5–15 a tonne.

- Growers have no choice but to deliver export bulk wheat to the pool.
- They share the risk of price falls but cannot adequately manage their individual risk.
- Most growers cannot lock in peak international prices.
- 'Single desk' selling is very costly for growers. They pay very high interest charges.

- Pooling means that end users of wheat have difficulty in managing their risk.
- A futures market is prevented from functioning well because of the monopoly.
- End users are prevented from quitting surplus stocks except to the AWB.
- Other players are virtually locked out of providing export marketing services.

- Growers' inability to lock in prices impedes their ability to invest in environmentally sound practices.
- Half of Australia's wheat growers are not making a farm business profit.
- Divergence between AWB shareholders and pool suppliers will increase divisions among growers as will farmers' lack of choice in marketing.

- It must be demonstrated that the average return to growers is significantly higher under 'single desk' selling than under competitive marketing and that these benefits significantly outweigh any costs to other sectors.
- The methodology proposed for this review will not be able to demonstrate this.

- Claimed benefits of the 'single desk' such as product differentiation and niche marketing can more appropriately be achieved by competitive marketing.
- Within a framework of appropriate regulation there are several alternatives to the export monopoly but, in all cases, the AWB would remain a major marketer of Australian wheat.

Summary

This is a story about a big restriction on competition

The monopoly on the bulk exporting of Australian wheat granted by legislation to AWB (International) — the so-called 'single desk' — is a major restriction on competition. Farmers and anyone else except AWB (International) are prohibited by law from exporting bulk wheat unless they have consent from the Wheat Export Authority (WEA). That consent requires the approval of AWB (International). Under National Competition Policy (NCP) rules, if this monopoly power — now assigned to a private company with no sunset clause — is to continue, the Independent Review Committee will have to conclude on the basis of evidence presented to it and from its own investigations that this restriction decisively passes the net public benefit test *and* that there are no other less restrictive ways of achieving the objectives underlying the Wheat Marketing Act.

The 'single desk' is longstanding and there is considerable attachment to it. But as this report shows, the impact on total export returns is ambiguous and small at best while the increase in costs is significant and certain.

Such a restriction must pass NCP hurdles beyond doubt

To pass the net public benefit test, proponents of the existing restriction will need to jump some formidable hurdles. They will need to demonstrate that:

- AWB (International) has significant market power in major markets and is using this market power as a price discriminating monopolist or other means to achieve a higher average export return from all pool wheat sales compared with the return from a competitive market system;
- the storage, handling and transport costs from farm gate to vessel are not adversely affected or are only marginally higher than under competitive marketing;
- net returns to growers are demonstrably higher under 'single desk' marketing and growers are not disadvantaged in their endeavours to manage their risk;
- other sectors of the community, especially end users and service providers in the domestic market, are not unduly disadvantaged;

- overall, the benefits to the whole community — not just growers — from retaining the 'single desk' demonstrably outweigh the costs; and
- there are *no* other alternative, less restrictive ways of achieving the implicit objectives underlying the legislation.

The committee will conduct its own analysis but the evidence presented in this submission points overwhelmingly to there being no demonstrable net public benefit and several alternative ways of achieving apparent objectives.

Should the committee concur with these conclusions it has only one alternative. It must, under NCP, recommend the removal of the restriction. The federal government is then obliged under the Competition Principles Agreement to enact corresponding changes to the *Wheat Marketing Act 1989* as amended in 1998, putting an end to 'single desk' marketing arrangements.

Appropriate regulation is the answer — not no regulation

Removing the restriction on wheat exports does not mean having no regulation. What is needed is appropriate regulation consistent with competitive marketing of Australian wheat overseas and competitive neutrality among firms engaging in trade. The strong points of the current system would be maintained by appropriate regulation. The AWB would remain a formidable competitor in the market and pooling arrangements would, undoubtedly, continue. The big difference would be that growers would be free to choose to market their wheat as they saw fit. Indeed, they would have the choice of several buyers and pools rather than just the national pool for export wheat.

Objectives of the 'single desk' are many and moving

The objectives set for compulsory collective marketing have shifted considerably over the years. Fifty years ago an objective was to control middlemen. Contemporary objectives include combating corrupt world markets, retaining freight rate premiums and promoting regional stability and community harmony. Many of these shifting objectives appear to be ways of rationalising the arrangements to fit around prevailing issues.

Market power is the only objective with any credibility

The only robust objective relates to the enhanced capacity of a single seller of Australian wheat to secure a higher average price from export sales than would happen if there were many sellers — the so-called market power objective.

But to use market power ...

For an organisation to have market power in one or more markets it must:

- have a substantial share of the market;
- command a market position whereby competing suppliers cannot undermine its attempts to control supply;
- be facing several markets that are price responsive to supply changes so that cutting back supply would raise prices in those markets; and
- have full knowledge of all markets' price responses (demand elasticities) as well as full knowledge of competitors' responses.

... you need to have it ...

International wheat markets are highly competitive, with constant dynamic adjustment as buyers and sellers seek to discover market information. Assume that demand elasticities do differ across markets. To export under these circumstances, a single seller would need to know how much the price would increase if supplies were withheld on some markets and how much prices would fall on those markets where the displaced product was sold. This information would be needed for all markets and wheat types. The information demands would be huge and the risks of getting it wrong would be high. If supply were withheld, some markets might be lost completely and, in markets where the displaced product was sold, there would always be the chance that price would fall by more than just a little (chart 1). That a 'single seller' — no matter how competent — could have all this information is beyond belief.

... and it seems Australia does not

The Grains Council of Australia (GCA) recognises 'the Australian wheat industry's inherent market power deficiencies' (Hooke 1992, p. iii). Thus it is highly unlikely that Australia has the core conditions for exerting market power. The first hurdle already seems too high to clear.

Previous studies (GCA 1995) have demonstrated that for all but a small proportion of Australia's wheat exports — the high quality wheats — Australia does not consistently get a premium. An examination of Australia's top 10 wheat markets reveals that they are all contestable and any attempts by Australia to cut back supplies to raise prices would be quickly met with other suppliers moving in to fill the gap.

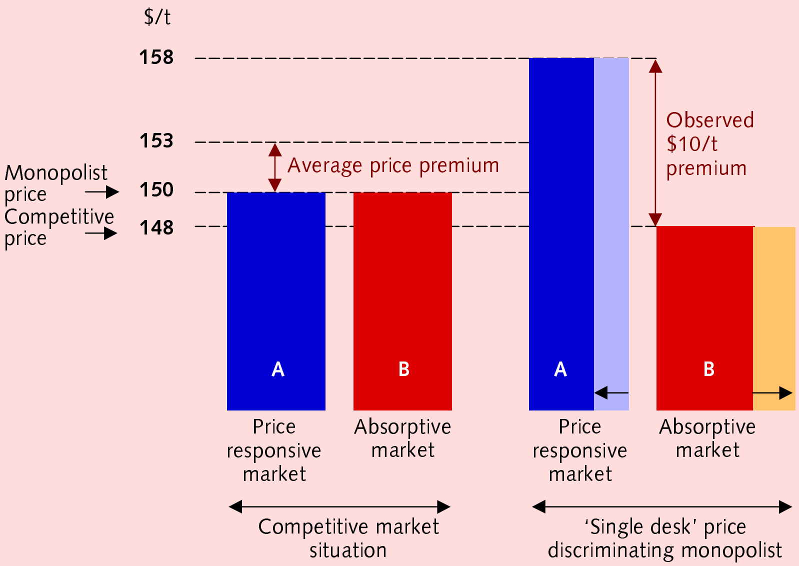
The Independent Review Committee will need to be careful to distinguish between any price premiums that are due solely to the advent of the 'single desk' and those that are inherent in the quality of Australian wheats or other factors such as geography, which have nothing or very little to do with 'single desk' selling.

Good prices do not mean market power

Australian wheat has some inherently good qualities and international buyers in several markets pay premium prices for the wheat because of these qualities. These premiums would be paid irrespective of the marketing system, so long as an appropriate regulatory framework existed. Many studies have failed to find any conclusive evidence that the AWB, through the 'single desk', has significant and consistent market power. Even the GCA notes the slim chance of the AWB exerting market power.

1 A 'single desk' seller can show an apparent premium but be actually reducing revenues

Case 1: Seller has perfect information



The competitive market price is $150 a tonne. The single seller takes product off market A (pushing the price to $158 a tonne) and sells it in market B ($148 a tonne). The gain in market A outweighs the loss in market B so that the average export return is $3 a tonne higher than under competitive marketing.

(Continued on next page)

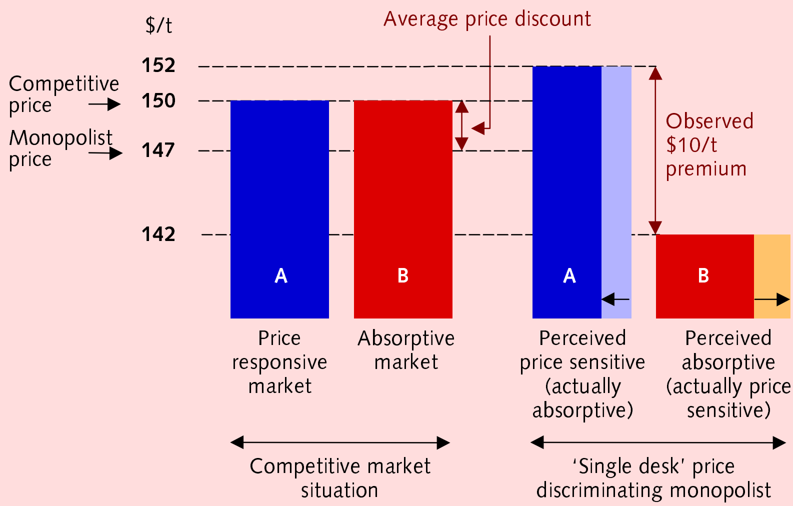
… By virtue of the Australian wheat industry's inherent market power deficiencies (Australia cannot possibly supply the entire market, even in any particular type of wheat) Australia will remain at a competitive disadvantage if it relies on statutory arrangements alone to give effect to what little market power it can exercise. (Hooke 1992, p. iii)

Freight 'premiums' or the benefits of being close …

In several markets Australia has a freight advantage over its competitors, simply because it is close to these markets. It will probably be argued to the Independent Review Committee that freight differentials are freight 'premiums' that can be captured by only 'single desk' marketing

1 A 'single desk' seller can show an apparent premium but be actually reducing revenues (continued)

Case 2: Seller has imperfect information — the monopolist gets it wrong



The monopolist thinks market A is price responsive but actually it is an 'absorptive' market. Taking product off this market raises the price only a little — to $152 a tonne. When the extra product is sold in market B, which is actually price responsive, there is a substantial price fall — to $142 a tonne. The average price for the monopolist is $147 a tonne, $3 a tonne less than under competitive marketing.

The result

With imperfect information, the monopolist can unknowingly be achieving a lower average price but still be observing a price premium ($10 a tonne).

arrangements. It may also be argued that multiple exporters would bid away these freight differentials.

But for a single seller to be able to extract all the advantages of being close, it would need to have the same high level of information as it would need to be able to price discriminate effectively. It would need to know exactly what would happen to price and revenue if it were to shift product from one (close) market to another less close one.

… are shared by both sellers and buyers …

The more likely outcome is that the benefits of being close are shared between the close countries whether there is a single seller or there are many sellers. The c&f prices struck between buyers and a single seller reflect, among other things, the buying and selling opportunities available to each. The same would apply if there were many sellers.

… whether there is one or there are many sellers

In short, Australia's freight advantage over its competitors in some markets is primarily a fact of geography and confers benefits to both Australia and its customers, regardless of the type of marketing system.

Good prices in Japan reflect good service

Wheat supplied to the Japanese market generally receives good prices. The Japanese Food Agency, the sole buying agency, has a special requirement — security of supply — and is prepared to pay extra for it. There is no reason to believe that in a competitive market Australian exporters would get a lower price than other suppliers, provided they met that customer's needs of food security and were prepared to keep grain in reserve. The costs of keeping grain in reserve need to be considered in an assessment of both marketing systems.

It is risky to behave as a monopolist …

The Independent Review Committee will need to understand the mechanism AWB (International) uses to exert any market power it claims to have. The only credible mechanism is price discrimination. This means that it would limit supplies to the relatively more price-responsive (price-inelastic) markets and sell more on other markets where increased Australian supplies may have little dampening effect on prices (elastic markets). The GCA believes that the 'AWB's single desk seller status enables it to control, supply and price discriminate between markets' (Hooke 1992, p. v).

… especially if you are not one

This proposition will need to be thoroughly tested by appropriate economic analysis as part of this review. This analysis would need to show that the average export price received under 'single desk' selling is significantly and consistently greater than the average export price under competitive marketing, taking into account decisions made by AWB (International) under uncertainty and the chances of 'getting it wrong' (see chart 1). As already noted, an incredible amount of detailed information would be required to discriminate effectively. A review of the literature reveals that in practice there is little evidence from such economic analyses to support the proposition that the 'single desk' is able to control supply and price discriminate between markets.

Product differentiation is a good idea …

A major consultancy report on the wheat industry (GCA 1995) justified the 'single desk' in the context of it being an integral part of a product differentiation strategy. It argued that the 'single desk' was needed to maintain and develop differentiated or 'branded' Australian wheat products and to market those products in quality discerning markets. But there are many industries in Australia that have a wide range of differentiated products and have successfully developed markets for their products without 'single desk' marketing. Less than a quarter of Australia's wheat exports are high quality and sold into quality discerning markets for specific end uses (GCA 1995).

The stories behind the noodle wheat market in Japan and the development of the durum wheat industry in Australia demonstrate that a 'single desk' is not necessary for such marketing strategies and may be a hindrance in some cases.

… but it does not need a 'single desk' to do it

In short, a 'single desk' system is not necessary to maintain and develop a product differentiation strategy. Indeed, it could be more forcefully argued that the qualities of creativity and flexibility needed to develop markets for differentiated products are more likely to be found in private firms or cooperative groups. Also, there is a logical inconsistency between restricting supplies to a market as a price discriminating monopolist, and market development that aims to expand the market.

The 'single desk' is no help against export subsidies …

It might be argued to the Independent Review Committee that the 'single desk' marketing of wheat is needed to counteract the export subsidies and the 'unlevel playing field', which characterise the international wheat market. But the mechanisms used for any such counteraction remain to be explained. When trade interventions such as export subsidies occur the only immediate strategy is to take them as a 'fact of life' and avoid the affected markets where possible. Such a strategy could be followed just as well, if not better, by competitive sellers. In the long run the best answer to these subsidies is international trade liberalisation. The United States has not granted export subsidies on wheat under its Export Enhancement Program since 1995 and, under the Uruguay Round Agreement, countries have agreed to wind back export subsidies.

… instead it probably weakens Australia's position

Australia's position in pressing for trade liberalisation is weakened — not strengthened — by the continuing attachment to restrictive 'single desk' selling arrangements.

The market mix argument is also empty

A variant of the product differentiation argument is what the Milling Wheat Project report (GCA 1995) called the 'market mix'. According to this argument the AWB's 'single desk' enabled it to avoid low price markets affected by export subsidies and concentrate on the higher price markets to an 'unusual' degree. Most of the estimated benefits from 'single desk' selling were attributed to this strategy.

But the analysis on which these conclusions were based was flawed and self-fulfilling. It compared Australian markets with those of the subsidising exporters — the United States and the European Union — as well as Canada, also a 'single desk' marketer. So the finding might well have been predicted. The proper counterfactual should have compared the degree of Australia's favourable 'market mix' with competitive marketing arrangements. Under the latter, traders would obviously seek out the higher paying markets.

The basis of international trade agreements is that all countries stand to gain if each of them has open trading systems. Thus the tendency in Australia to conclude that 'if the Americans say it's bad for them then it must be good for us' is to misunderstand the sources of gains from trade. Just as the trade interventions of the United States are 'bad for them and bad for us' so are Australia's own trade interventions.

So, overall, there is little substance in the market power argument

Government intervention is appropriate only where that intervention successfully addresses market failure. In this case, it is difficult to see where there is any market failure. Any claims that Australia is able to successfully use its market power to extract a higher average price from the international market appear to be unfounded. If there is to be any case for retaining the 'single desk', conclusive evidence will need to be presented of the AWB (International)'s ability to raise average export prices by using market power.

While market revenues from 'single desk' selling are unsubstantiated, additional costs are certainly large

Benchmarking studies of Australia's storage, handling and transport costs against equivalent costs in the United States reveal that Australian wheat growers pay at least US$5 a tonne more than US growers pay (GCA 1995). Several other studies have demonstrated the potential for significant savings from reforms in this area.

Cost savings of at least A$5 a tonne could easily be achieved with greater competition in the supply chain from farm gate to vessel (fob). Savings of this magnitude would amount to at least A$120 million across the industry and would mean, on average, an increase of at least 27 per cent in growers' farm business profit.

AWB (International) could choose to manage its monopoly on bulk wheat exports from the vessel (fob) stage, leaving competitive market forces to deliver vessels loaded to specific requirements at specific times. However, it has chosen a different path and spread its monopoly influence through to the silo delivery stage, thus having a firm control over the whole supply chain. This, combined with the virtual regional monopolies of the bulk handling organisations, has denied any incentive through competition to improve the system and reduce costs. Bulk handling charges per tonne have significantly increased over the past decade, reflecting the lack of any effective competition. In contrast, rail freight charges have decreased somewhat as competition has increased, especially from road freight.

There is ample scope to increase efficiencies and reduce costs to growers. A prerequisite for this is the introduction of greater competition into this part of the marketing chain.

Forced pooling is like a 'lucky dip'

The current wheat marketing arrangements force growers to deliver their bulk export wheat to the national pool. This places severe restrictions on their options for managing their risk.

Sharing risk is not managing risk

Sharing risk is one thing; managing it is quite another. Collectively, growers take all the price risk — they lose ownership of their wheat on delivery but cannot fully price the wheat for, at least, 12 months. This leaves them individually exposed to falls in the pool price even though the pool is hedged to a degree.

For many growers this is not good enough. Their capacity to manage their own risk according to their individual circumstances is restricted because of the pooling system.

Furthermore, growers cannot take advantage of price spikes in the international market. Very often estimated pool returns are set conservatively and are below international parity prices.

One size does not fit all

Pooling does not suit all growers. This is why the recently introduced basis pool has become so popular for some growers seeking to lock in a better price for their wheat, based on international parity. But there are limits on the basis pool. Access by growers is restricted to those who deliver nearly 1000 tonnes of wheat, and access by traders is limited to 20 000 tonnes. Growers delivering smaller amounts are discriminated against and are denied opportunities to lock in prices that are at times up to $40 a tonne above the estimated pool return. Recently, the basis pool was closed.

The pool prices tend to hurt domestic prices …

The conservative prices set by pool managers early in the season and at around harvest set the benchmark for domestic prices so that they are invariably below international parity prices. Thus, at harvest or before, any grower selling for cash or forward into the domestic market will get a lower price than a competitive marketing system would yield.

… and the development of an Australian wheat futures market

The Sydney Futures Exchange operates a wheat futures market but it is thinly traded and not a reliable means of hedging against adverse pool price movements. There is little doubt that, in the absence of the 'single desk' and the compulsory pooling of bulk export wheat, a well-functioning futures market could develop in Australia and provide growers and other players with a convenient and reliable mechanism for managing their risk.

The pool is very expensive to run

Pooling is an expensive way of marketing wheat. Financing costs are at the top or even above commercial rates, with AWB (Finance) making profits from an interest rate margin of around 2.5 percentage points (around $6.00 a tonne) on all loans under the harvest payment. Even to lock in the harvest payment costs growers an extra $1.95 a tonne. The AWB operating costs of $68 million or $3 a tonne are further costs, and so on. Why are growers not questioning these cost imposts?

The wheat industry is not just about growing wheat

Australia's wheat marketing arrangements impact on firms that, for example, use wheat, supply or could offer value adding marketing services and export wheat in containers.

Domestic prices at a discount to international prices …

In the case of firms that use wheat, such as the intensive livestock industries, it appears that, if anything, they might initially be able to source their wheat at a lower price than would apply in a competitive marketing system. This is because of the benchmarking effect of the conservatively estimated pool return.

… do not always translate into low grain input costs …

However, those initial low prices received by growers selling in the domestic market frequently do not translate into low grain costs for users. This is because the latter have difficulty in locking in the prices of grain inputs, largely because of the lack of risk management services. For such services to emerge, firms need to have unrestricted access to the export market and a well-functioning futures market in Australia.

… especially when supplies are tight

During drought periods or at the end of the season when supplies are tight it is often the case that the AWB, because of its dominance, is the only player in the domestic market with grain supplies. It can then use its price discriminating monopoly strategies to raise domestic prices above export parity, thus adding to the input costs of end users.

Costs to end users are high for other reasons as well …

Firms that might be prepared to physically carry wheat are inhibited from doing so because, if they need to quit inventory on the export market, they have to do it through AWB (International). This situation severely limits the positions that risk management providers can take and offer.

… and activities that could add value are discouraged

Just as growers and their domestic clients are disadvantaged by not having access to risk management services so also are the firms that could supply them. Firms, small or large, that offer services covering storage, accumulation, elevation, grading, blending to specification, transport, finance, insurance certification, inspection, breeding, risk management, advice and so forth are all inhibited from offering growers a full range of such services. Instead, growers must export through a monopoly service provider that:

- takes ownership but pays the growers after the product is sold
- deducts selling costs that are resolved on a cost-plus nontransparent basis
- requires growers to share risk but does not enable them to manage risk.

The mystery that the Independent Review Committee has to solve is why Australian wheat producers who, as much as anyone else, shop around for good prices and good service when they purchase their headers, tractors, fertilisers and the like are said to be so keen on restricting their own choice and that of their fellow producers when it comes to wheat marketing services.

While intensive livestock industries and firms offering to buy, hold, accumulate, store and grade wheat and firms offering to export wheat in containers would benefit in a competitive market, the overwhelming beneficiaries would be wheat growers themselves.

It is difficult to invest in sustainable environmental practices when you cannot lock in prices

People interviewed in the course of preparing this submission say that their inability to lock in prices impedes their ability to invest in long run, environmentally sound practices. There are environmental concerns right across Australian agriculture but no one is seriously proposing a monopoly as a solution to these concerns. If anything, it would be a hindrance to addressing these issues for the reason just mentioned.

A centralised monopoly does nothing for…

… regional development …

Competition among providers of value adding marketing and trading services would see a shift from a city-based (Melbourne) centralised supplier to decentralised providers ranging from pastoral houses, fertiliser companies and finance firms to small grain accumulators, graders, blenders and seed cleaners.

… or social cohesion

Allowing growers to choose among many providers, by taking the politics out of a commercial activity, would be less likely to cause rivalry, mistrust and community breakdown than having control exercised by a monopoly private firm.

Half of Australia's wheat growers are not making a farm business profit. Over time, those at the bottom of the income distribution will tend to sell their B-class shares in AWB Limited to those larger growers at the top, and this will cause increased divisions among growers. This will put further strains on the already apparent conflicts of interest AWB faces between looking after shareholders and looking after those delivering to the pool.

The 'single desk' has reached its 'use by' date

To have government restrictions in the marketing of any product there needs to be identified market failure and an appropriate policy to address that market failure. In this case, no market failure can be identified. And it seems impossible that anyone can conclusively demonstrate a net public benefit from retaining the 'single desk'. Under NCP, a clear conclusion emerges — the 'single desk' has reached its use-by date and it is a matter of when, not whether, growers should have a choice in how they sell their export wheat.

This raises two issues — the need for an appropriate regulatory framework and possible alternative arrangements.

But a regulatory framework is still needed …

An appropriate regulatory framework must include independence and empowerment of the regulator, separation of commercial and regulatory powers and competition in service delivery. It also requires independent review.

These framework principles should be applied immediately. While the AWB was a statutory authority, answerable to the Parliament, it appropriately undertook certain regulatory functions. Now that it is a private company many of these are no longer appropriate or even ethical. An independent body or mechanism is now required in areas such as:

- setting wheat breeding directions and registration of new wheat varieties;
- classifying wheat types and assigning new varieties to particular categories (for example, ASW and APW);
- setting receival standards and tolerance limits;
- testing and certifying quality specifications for export wheat;
- controlling market information; and
- establishing an appropriate appeal process.

… as is regular independent review and evaluation

A principle of good government is that restrictive policies should be monitored and regularly evaluated. But the WEA's evaluation role — the requirement that it report to the Minister for Agriculture, Forestry and Fisheries by June 2004 — is unclear. One interpretation is that its review is just to evaluate AWB's performance without questioning 'single desk' policy. It must be made crystal clear that the 2004 WEA review is to measure performance against the competitive market model and, if found wanting, the recommendation should be to remove the 'single desk'. But the 2004 review may not be necessary — depending on the outcome of this NCP review.

Alternative marketing arrangements need to be considered

Against a background of appropriate regulation, alternative marketing arrangements should be considered. These include:

- allocating specific markets to AWB (International) and allowing private traders and their wheat grower clients access to the rest;
- establishing an independent licensing authority (such as the WEA) to sell permits (by tender or auction) to export to preferred markets to competing export marketers and thereby test the extent and value of any market power; or
- introducing a fully competitive marketing system, allowing any party to export wheat subject to the appropriate regulatory environment.

In any case, immediate steps should be taken to introduce competition into the supply chain from farm gate to vessel (fob).

No alternative to the current wheat marketing arrangements would involve dismantling the AWB. Growers pleased with the services it delivers would be free to continue trading with it. But other growers would be free to choose how they want to export their wheat and who they want to do it.

1 Wheat marketing at the crossroads

WHEAT MARKETING ARRANGEMENTS in Australia have long been controversial. The *Wheat Marketing Act 1989* (Cwlth) was preceded by vigorous debate about whether the domestic market should be deregulated. The subsequent deregulation of the market has ultimately led to a 75 per cent increase in domestic wheat sales.

The early 1990s saw a renewed debate about wheat marketing reform and in 1995 the Milling Wheat Project under the GCA's Grains 2000 Project reviewed Australia's wheat industry and its marketing arrangements (GCA 1995). The consultants, Booz Allen & Hamilton (Australia) who undertook the Milling Wheat Project, gave a 'rather luke warm and less than conclusive endorsement of the single desk' (GCA 1995, p. 46).

After almost a decade of debate, the AWB is now fully privatised under Australian Corporations Law and the original *Wheat Marketing Act 1989* is all but scrapped except for the AWB's export monopoly. It and its subsidiaries, especially AWB (International) Limited and AWB (Australia) Limited, are now much like any other large Australian conglomerate of companies. But there is one stark difference. Under the 1998 amendments to the Act, AWB (International) was granted a monopoly on the bulk exporting of Australian wheat that is to apply indefinitely. The term 'export monopoly' does not refer to AWB (International)'s situation relative to international buyers of Australian wheat. These buyers have a wide range of choices as to where they source their wheat. The monopoly starts and finishes in Australia. Producers of Australian wheat have no choice as to how they sell their bulk export wheat. No one can export bulk wheat unless they have the written consent of the Wheat Export Authority, a statutory body set up under the amendments. In the case of bulk export wheat, the WEA can grant an export permit only if it has the written consent of AWB (International). For exports other than bulk exports, AWB (International) must be consulted.

These are strong restrictions on competition. For a private company to have such a privileged position protected absolutely by legislation with no sunset clause is unprecedented — not just in Australia, but in most other countries. People making the case for liberalising export wheat marketing cannot understand how the process leading up to the 1998 amendments of the Act delivered what appears to be a tightening of restrictions. The legislative amendments appear to have been introduced without proper analysis of their benefits and costs. A privatised AWB would make sense in a competitive environment. Indeed the question should be raised as to why such an environment was not established before privatisation.

This National Competition Policy (NCP) review of the *Wheat Marketing Act 1989* provides a unique and timely opportunity to thoroughly examine these highly restrictive marketing arrangements. It is not necessary to show that there are benefits from removing the restrictions. Rather, under the NCP rules, the onus is on those wishing to retain them to demonstrate that there is a net public benefit from doing so. This is net of any benefits that may accrue to growers and include the effects on other sectors of the economy. Proponents must also show that there are no alternative, less restrictive arrangements that can achieve the same objectives. If they cannot show this then the monopoly on bulk wheat exports held by AWB (International) must be removed.

Wheat marketing and the international environment now are dramatically different from what they were even two decades ago. Today, information technology means that any grower can access essentially the same type of market information as any grain trader or buyer. And grain importing through 'single desks' is diminishing — Japan and its Japanese Food Agency being an exception. Large importers such as Egypt and China have recognised the high costs of maintaining monopoly buying agencies and have moved to deregulate imports. Also, as an outcome of the Uruguay Round of multilateral trade negotiations, there is now less scope for other countries to subsidise their wheat exports. The United States under its Export Enhancement Program has not granted any export subsidies on shipments of wheat since 1995.

Thus, whatever merits the argument for monopoly marketing may have once had — to counter alleged imbalances in information between buyers and sellers or to deal with government monopoly buying agencies in importing countries — the supporting circumstances no longer apply.

2 National Competition Policy — a reality check

THIS IS A SUBMISSION to an NCP review. The 'rules of engagement' for such a review are simple. Australian governments have agreed to review all legislative restrictions on competition with a view to keeping those restrictions that are in the public interest and removing those that are not.

The strengths of NCP

The NCP process has several strengths.

- It is comprehensive, involving all Australian governments and open independent reviews focusing on those directly and indirectly affected.
- Virtually all regulation across the economy is covered in this process, which is both fair and efficient.
- Competition is presumed to be the first port of call in organising economic activity on the grounds that:

> Competition provides the spur for businesses to improve their performance, develop new products and respond to changing circumstances. Competition offers the promise of lower prices, improved choice for consumers and greater efficiency, higher economic growth and increased employment opportunities for the economy as a whole. (Independent Committee of Inquiry 1993, p. 1)

The burden of proof lies with the proponents of the export marketing monopoly

In the case of wheat marketing, the NCP process puts the spotlight squarely on the supporters of the monopoly granted to AWB (International) in the exporting of growers' wheat. They must conclusively *prove* that maintaining this monopoly generates benefits for the entire community in excess of costs, and that there are no other less restrictive ways to achieve those benefits.

This is unlike any other review or debate in wheat marketing. In the past those who have sought change have had to demonstrate the payoffs from reform. Indeed, the end of the monopoly is the review starting point. The test for the NCP Independent Review Committee is to imagine that Australia currently has an open competitive marketing system for wheat as it does for beef, wool, cotton and nearly all other commodities. From this starting point, the committee needs to answer the following questions.

- Would it recommend introducing the current arrangements and why?
- Can it decisively demonstrate a net public benefit from such a change that could not possibly be achieved under open competition?

The restrictions being reviewed here are really quite extraordinary. They fly in the face of all of the tenets of Australian competition policy. This means that the net public benefit must be established beyond doubt. This appears to be an impossible task. No study done to date has conclusively demonstrated the benefits of the so-called 'single desk' and, on all major issues surrounding the 'single desk' debate, the 'for' arguments either cannot be proved right or can easily be proved wrong.

The counterfactual or 'without restriction' situation does not exist and must be established artificially. This is complicated because prices of Australian wheat on international markets might vary for an infinite number of reasons that have nothing to do with the alleged market power of a single seller. The AWB has been reluctant to provide information on pricing performance for what it says are 'commercial reasons'. But, even if the Independent Review Committee had unrestricted access to the AWB's pricing and sales data, the task would be formidable. As the GCA has observed:

> It is virtually impossible to generate conclusive empirical evidence on the relative efficiencies of 'single desk' and multiple selling of Australia's wheat exports since they are obviously mutually exclusive. (Hooke 1992, p. v)

In this review exaggerated unsubstantiated claims about the benefits of a 'single desk' will not be acceptable. If a *factual* case based on the net public benefit of the 'single desk' cannot be made, then AWB (International)'s monopoly must be removed.

Steps for an NCP review

The process for an NCP review examining anticompetitive legislation involves five main steps:

- clarifying objectives of the legislation
- identifying the nature of the restrictions
- identifying effects
- assessing benefits and costs
- examining alternatives.

Clarify objectives of the legislation

The favoured contemporary objective of the Wheat Marketing Act appears to be to obtain the benefits of market power in certain international markets. However, as box 2.1 shows, monopoly seller arrangements have been rationalised on a host of shifting grounds over many years.

The usual starting place for identifying the objectives for any legislation is its Second Reading Speech. In the case of the amended Wheat Marketing Act, the Second Reading Speech (House of Representatives 1998) refers to a structure based on the objectives of grower ownership and control, self-reliance and a full commercial approach to marketing. However, there is no mention of the objective set for such a marketing arrangement. Neither does the amended Wheat Marketing Act mention its objective.

The Issues Paper prepared for the review suggests that the objective of the Wheat Marketing Act could be read as:

> … to maximise the net benefits to the Australian wheat industry, and in particular growers, from the export marketing of wheat through single desk selling and related control arrangements. (NCP Wheat Review Secretariat 2000, p. 4)

It is worth noting the difference between this interpretation, with a focus on growers in general, and the primary objective of the AWB, with a focus on maximising returns to those delivering to the national pool:

> … to maximise net returns from the pools by securing, developing and maintaining markets for wheat and wheat products and minimising costs as far as practicable. (NCP Wheat Review Secretariat 2000, p. 3)

In these terms the objective is about market power and its exploitation on behalf of those delivering to the pool. Of course, under NCP, and as noted in the Issues Paper, this review has a much broader remit and must consider the implications of any such exploitation across the Australian economy.

Identify the nature of the restrictions

The main legislative restriction is of course the prohibition of exports of bulk wheat by any person or firm other than AWB (International) and the requirement for a permit to export container and bagged wheat. These restrictions and their effects are assessed in detail in later chapters.

Two other aspects of the 1998 amendments to the Wheat Marketing Act need to be examined in the context of Clause 4 of the Competition Policy Agreement, which requires review where public monopolies are reformed or privatised. The Issues Paper refers specifically to the most effective means of separating regulatory and commercial functions, the appropriateness of a

2.1 Changing fashions in rationalising a wheat export marketing monopoly

- In the 1930s collective wheat marketing arrangements were advocated on the grounds that unscrupulous middlemen were taking innocent farmers for a ride.
- Then in the 1940s wartime emergency circumstances saw the establishment of national wheat marketing and stabilisation arrangements. These arrangements were locked in after the war, apparently with a view to stabilising incomes. Realisation that such arrangements actually de-stabilised incomes was to dawn some 20 years later.
- In the 1960s the need to combat international trading cartels came to be the main explanation of perpetuating the monopoly.
- Then in the early 1970s tariff compensation or a deliberate policy of assisting industries to compensate them for the cost burden of tariffs was given a run, as was the current favourite — the establishment of a means to apply market power.
- In the 1990s the arrangements were seen as absolutely vital to reflect the reality of the international market.

  > In an international wheat market so distorted and concentrated, Australia must exercise some form of countervailing power if it is to avoid foreign government treasuries dictating the pattern of resource allocation within Australia contrary to the national interest. (Hooke 1992, p. 7)

- Over the years, other possible rationalisations have drifted in and out of fashion. These include:
  - maintain grain quality standards
  - finance the crop
  - negotiate with government buyers
  - achieve economies of size
  - provide market development and promotion
  - ensure growers had full information
  - return profits to the growers
  - capture the benefits of being closer to some markets than others.
- The most recent suggestions capitalise on the concerns and fears of people in country areas facing real pressures for change from a wide range of sources. Thus AWB (International)'s monopoly is alleged to:
  - promote regional growth
  - prevent social tensions.

private company and the structure and functions of the WEA. These matters raise the following issues.

- Conflicts of interest are looming between the AWB's obligation to shareholders and its obligation to growers delivering to the pool.
- Substantial conflicts of interest have arisen since privatisation as in several areas the AWB is simultaneously 'goal umpire and full forward' (see chapter 9). These areas include:
  - the possession of, and commercial interest in, information that should be in the public domain;
  - commercial interest in, and major influence over, plant breeding, seed certification and the release of new wheat varieties and effective control over their classification and commercialisation; and
  - controls over quality standards on receivals and the way they are enforced and over quality certification of all exports.
- There is an apparent lack of effective regulation of the export monopolist.

Conflicts of interest

The apparently innocuous objective of the AWB, mentioned earlier, raises serious concern about the scope for conflicts in the structure of the consolidated AWB.

- To maximise returns for shareholders, the AWB would have an incentive to raise marketing and financing fees charged to the national pool. But growers supplying the pool want low fees and charges. Thus the conflict for AWB Limited is whether it should please shareholders by raising marketing fees or whether it should please wheat producers by having low costs, low fees and low profits.
- AWB (Australia) Ltd and AWB (Finance) Ltd have conflicts of interest in that their fortunes — particularly those of AWB (Finance) Ltd — are tied to AWB (International) and to AWB Limited.

So long as producers and shareholders are one and the same it might be argued that this will not be a problem but differences in how people would like their income — as profits on wheat or as shareholder returns — are likely to emerge as some growers take on larger shareholdings and as growers with different farm areas and serving different markets demand a wider range of marketing services.

The ability of growers, whether as shareholders or as clients, to monitor and evaluate the AWB's performance is a major source of concern. Not only is information pooled and therefore lost, but also much of the information that is available on performance is held to be 'commercial-in-confidence'. As Watson (1999, p. 449) has observed:

> … AWB Limited could suffer an acute version of the 'principal and agent' problem. Costs for farmers (principals) of monitoring salary management (agents) will be prohibitive.

The capacity of the regulator

The Wheat Export Authority, established under the 1998 amendments to the Wheat Marketing Act, is responsible for controlling the export of wheat from Australia and monitoring AWB (International)'s performance in relation to the export of wheat.

These tasks of the WEA are formidable for several reasons.

- While the corporations law provides regulatory cover, the effective mechanisms for monitoring AWB (International) seem weak.
- Most regulators face, to some degree, what is referred to as 'information asymmetry'. This happens when the regulator must rely on the firm it is regulating for performance information. This problem appears to be a particularly weighty problem in this case.
- In normal circumstances the regulator of a monopoly would be accountable to the Parliament. In this case the WEA is accountable to both the Parliament and the GCA. Such accountability arrangements are an unusual representation of independence.
- There is no effective appeal mechanism.
- The WEA's authority over AWB (Australia) and AWB (Finance) does not seem to be well-specified. Yet, in both cases AWB Limited's responsibility to shareholders would require it to manage the operation of the entire conglomerate with a view to satisfying shareholders and not necessarily growers.

While the WEA is required to conduct a review of 'these matters before the end of 2004' (NCP Wheat Review Secretariat 2000, p. 4), the scope of that review is unclear. There is a question about whether it will cover:

- the performance of AWB (International) in discharging its 'single desk' role; and
- the appropriateness of a 'single desk'.

The legislation is consistent with a review that focuses on only the first task but the corresponding Explanatory Memorandum suggests a focus on the second. The Issues Paper (p. 5) reports that the WEA sees its activities as including 'to understand and report on the impact of the "single desk" arrangements on the wheat industry and, in particular, growers'. However, it suggests that a function of the review will be to test 'whether there is broader industry support for this interpretation' (NCP Wheat Review Secretariat 2000, p. 5).

It seems that there has been a move from a situation where, for many years (up to 1989), the statutory authority with 'single desk' power faced a public review every five years (that is, a sunset clause), to a situation where, with the 1998 legislative amendments, a private monopoly has no sunset clause and an ambiguous review of performance in 2004 but nothing beyond that. The stakes involved in this NCP review, therefore, are raised considerably.

Benefits and costs — the crux of the issue

If the export marketing monopoly is to provide a significant real net benefit to Australia and, in particular, to enhance growers' incomes, the 'single desk' must be managed in such a way that:

- the *average export return* from wheat exports is maximised through the use of monopoly power;
- the costs of marketing, including all AWB costs and all other costs in the supply chain, are minimised;
- any adverse effects on other sectors are minimised; and
- the overall net public benefit is maximised.

The *average export return* is maximised if it is not possible for the 'single desk' seller to take one tonne off one market and sell it into another market and get a better price for it. It is not sufficient that the single marketer achieves 'premiums' in some markets. 'Discounts' on other markets must also be considered. The 'single desk' marketer must be using its monopoly power so that the *average export price* is significantly greater than it would be under a competitive marketing system.

Costs under monopolies are invariably higher than under competition. This underlies the very basis of NCP. A reasonable presumption, therefore, is that all marketing costs under the current monopoly arrangements are higher than they would be under a competitive marketing system. Either this must be proved wrong or it must be proved that the costs of the current monopoly arrangements are only slightly higher and less than the benefits.

The *adverse effects on other sectors* can rise if the 'single desk' marketer is successful in raising the average export price because this will raise domestic wheat prices. This means higher input costs to domestic users. But there are other factors to consider as well.

Finally, the *net effect* of all these factors must be higher incomes for wheat growers and a positive net public benefit compared with the situation under a competitive marketing system.

Working through each of the components of the net effect and appropriately quantifying their magnitudes raises some very significant hurdles. (Subsequent chapters in this report are devoted to describing the burden of proof needed to clear them.)

From the above, it follows that if the monopoly power argument does not stand up there would be no possible basis for concluding that the monopoly arrangements provide a net public benefit and, hence, no justification for continuing the monopoly.

Hurdle 1:
Prove that the AWB has market power and is using it to raise the average export price

A single seller would have market power if it could withhold supply (or threaten to withhold supply) so as to obtain a higher price from particular buyers. It is said, for example, that in the Japanese market, because the AWB provides Australian wheat producers with a united front, it obtains a higher price than several or many growers and traders would get after being played off against each other by the Japanese Food Agency. As explained in chapter 3 these preconditions do not appear to apply.

To demonstrate market power it would be necessary to show that, through price discrimination between markets or by other means, the average unit return from exports is higher under the 'single desk' than without the 'single desk'. Two matters complicate this task.

- Prices vary for a lot of reasons so that it would need to be shown that a higher price in a particular market truly reflected the application of market power and was not the result of marketing margins reflecting such things as guaranteed delivery of supply even in shortfall seasons, preferential finance and inherent quality advantages.
- The confidentiality of AWB price performance across markets creates a substantial practical barrier to demonstrating the existence of market power.

To get over this hurdle the proponents of continuing the monopoly seller arrangements would have to demonstrate that the AWB is delivering a higher average export return (fob) than a competitive marketing system would achieve. In this context they would need to refute claims by suppliers of specialty niche markets that the AWB has reluctantly developed new markets in several cases (see chapter 3). They would also need to show that, if Australia can exert market power, it is not detrimental to its longer term position in the market — that is, buyers do not turn to other suppliers or wheat types.

Wool is a good analogy. If any Australian industry has the potential to exert market power it is the wool industry because of Australia's dominance in the international market for wool. But this industry tried and failed — to the point where it practically devastated the industry.

The mechanism by which the 'single desk' is said to counteract the 'unlevel playing field' would need to be explained, as well as how successful this strategy has been.

Hurdle 2:
Prove that the AWB's monopoly is not adversely affecting domestic supply chain costs

It has been well documented that Australia has higher storage, handling and transport costs than other major wheat exporters (GCA 1995). The main reason for this is that the export monopoly is entrenched throughout the supply chain back to the local silo, resulting in the fossilisation of existing structures and a lack of innovation in grain handling, transport and storage. Proponents of the 'single desk' cannot deny that greater competition would significantly reduce costs in this case.

Hurdle 3:
Prove that pooling and 'single desk' selling are not raising costs to growers or restricting their ability to manage their risk

The review will need to test whether mechanisms such as the mandatory pooling of export wheat do more good than harm. For example, such pooling precludes growers from effectively managing their own risks. Also, the costs of running the pool and financing harvest payments appear unduly large.

Hurdle 4:
Prove that there are no, or minimal, adverse effects on other industries

This NCP hurdle has seldom been tackled in other reviews of wheat marketing. Yet it is obvious that many other industries are affected by the wheat marketing arrangements. The review will need to weigh up and demonstrate that these industry effects are either benign or outweighed by benefits.

Hurdle 5:
Prove that the 'single desk' favourably addresses environmental, regional and social issues

Proponents of the 'single desk' will need to explain why a 'single desk' is better for the environment than a competitive marketing system and why it is more favourably disposed to assisting regional development and rural communities and to addressing social problems.

Hurdle 6:
Prove that the net public benefit of 'single desk' selling is positive and significant by providing quantitative evidence

To estimate the net public benefit of 'single desk' selling requires the construction of a comprehensive economic model of wheat trading that incorporates all of the essential elements of the 'single desk' issue. This model would be used to estimate the net economic gain or loss from 'single desk' selling, which would be compared with the results of a competitive marketing system.

Hurdle 7:
Prove that there are no alternative marketing arrangements, including partial deregulation, that would achieve the implicit objectives of the Wheat Marketing Act

This hurdle is probably the most difficult to clear. Even if all other hurdles are cleared, it needs to be demonstrated that market power could not be achieved in a less restrictive way. No one seriously argues that the AWB has market power in all markets. Would it be possible, for example, to allow export competition in those markets where the AWB does not have market power and/or to sell permits by auction or tender to marketers wishing to supply wheat to markets where Australia may have some market power? The prices paid for the permits would quickly reveal the extent of market power.

3 Market power and price premiums

THE ONLY CREDIBLE JUSTIFICATION for a country with a competitive marketing system to introduce a 'single desk' for export marketing would be that the 'single desk' seller could use its market power to price discriminate between markets and achieve a significantly higher average export return. But it would be very difficult to demonstrate this in the case of Australian wheat, as this chapter will show.

Two other ways in which a higher average export return might be achieved by a monopoly exporter of wheat follow.

- The 'single desk' exporting agency adopts a product differentiation strategy. But this begs the question of why the competitive marketing system needed to be changed to a 'single desk' system to achieve this.
- Some importing countries have 'single desk' government buying agencies that prefer to deal on a government-to-government basis. But this raises questions such as why exports to all markets need to come under a 'single desk' and whether the sole buying agencies in these importing countries consistently pay above world prices for comparable wheat grades and why.

Each of these cases is examined later in this chapter. But, first, an overview of international and Australian wheat markets is provided. This demonstrates the highly competitive nature of the international market and the difficulties any 'single desk' exporter has in attempting to exert market power. The meaning of terms commonly used in discussions of the 'single desk' are clarified in box 3.1.

Sketch of the world wheat market

World wheat production has grown to be nearly 600 million tonnes a year but for well over a decade the amount traded has been steady at around 100 million tonnes a year — 17 per cent of production. Australia is one of five major exporters but accounts for only 16 per cent of total wheat traded (chart 3.2) and 3 per cent of world wheat production.

3.1 Clarifying terms used

Single desk

This commonly used term simply means that one organisation — in this case, AWB (International) — is, by law, given sole right to export bulk wheat from Australia.

Monopoly

An organisation is said to be a monopolist if it is the sole seller of a particular commodity. (A monopsonist is the only buyer of a commodity.) AWB (International) has a monopoly on the sale of Australian bulk export wheat. While growers can sell their wheat to anyone in Australia, they are forced to deliver wheat destined for export — nearly three-quarters of wheat produced — to AWB (International)'s national pool. It is not a monopoly seller of wheat as international buyers can choose to purchase wheat from a wide range of sources.

Market power

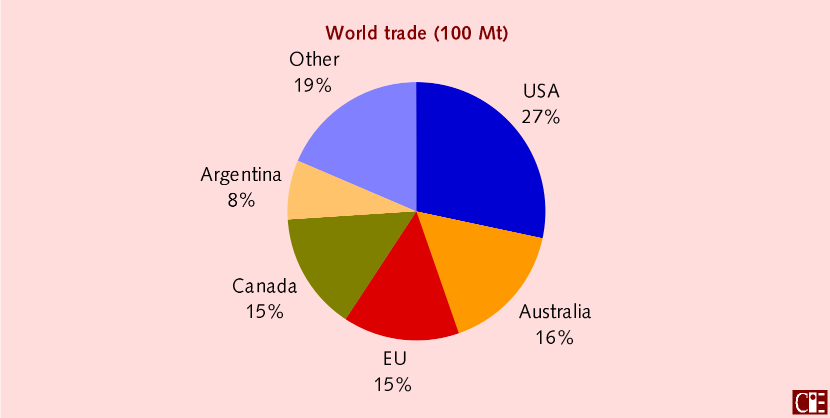
A seller is said to have market power if it is able to extract a nontrivial, nontransitory increase in price in a particular market by reducing supplies to it or threatening to withhold supply.

Price premiums

In context of this review a 'single desk' price premium should refer to any price increase received purely as a result of AWB (International)'s 'single desk' seller status. It is the difference between the price received with AWB (International) having 'single desk' status and the price that would have been received for the same wheat in the absence of the 'single desk'. Of course, the latter is not observable and must be estimated through economic modelling or other means. 'Single desk' premiums can be obtained from a particular market or through price discrimination across a number of markets, in which case the premium is the margin above the average export price obtained under competitive marketing.

There may be other types of premium such as 'quality premiums', which refer to increased margins received for quality, but these have nothing to do with 'single desk' selling. It is not valid to talk of the 'single desk' price premium as the difference between the higher prices received by AWB (International) from particular markets and the average world wheat price. There could be any number of reasons for such observed differences that have nothing to do with 'single desk' selling. Neither is it valid to consider the 'single desk' premium in a particular market as being the margin that AWB (International) might get above the price a competitor would get. The competitor may be supplying a less preferred type of wheat or offering fewer services.

3.2 Major exporters' shares of world trade in wheat, 1998-99



Data source: ABARE (1999).

Australia faces enormous competition in world wheat trade (GCA 1995). It competes against large producers that export a much lower proportion of their total wheat production and are therefore less vulnerable to the intense international competition. These considerations alone cast doubt on Australia being in a position to exert any significant market power in international markets.

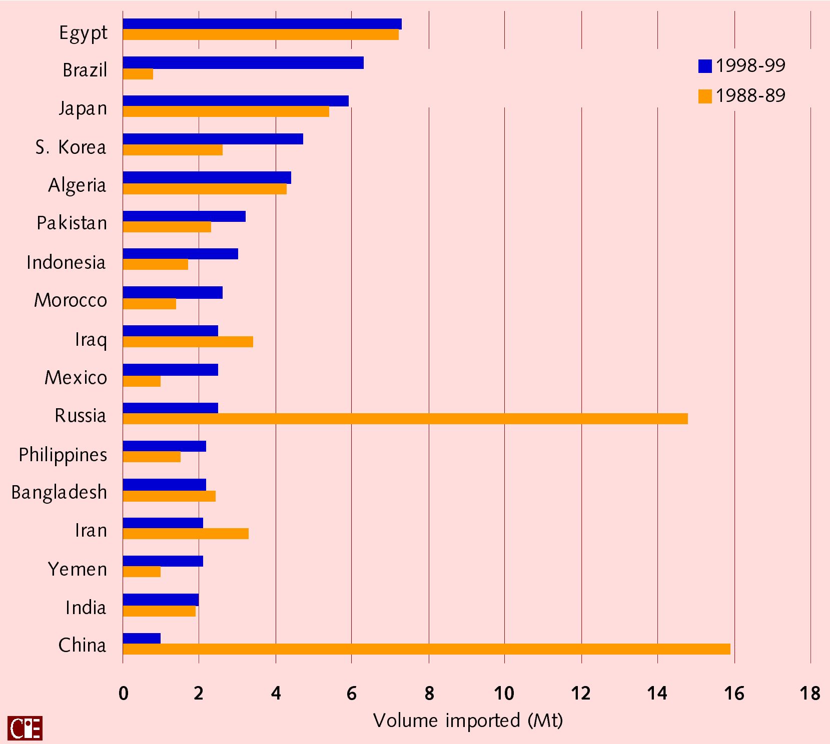
The major importing countries shown in chart 3.3 account for over 60 per cent of total wheat imports.

Several importers such as Egypt and Japan have maintained relatively steady levels of imports over the past decade, but otherwise there have been major changes in import patterns. After 1990, Brazil emerged as a major market but the former USSR and China have substantially reduced imports. India is a sporadic importer and is sometimes an exporter.

The world wheat market is frequently divided geographically. South American markets are serviced primarily by Argentina, the United States and Canada, and north African markets by the European Union. Australia tends to concentrate its exports in Asia, the Middle East and the Gulf.

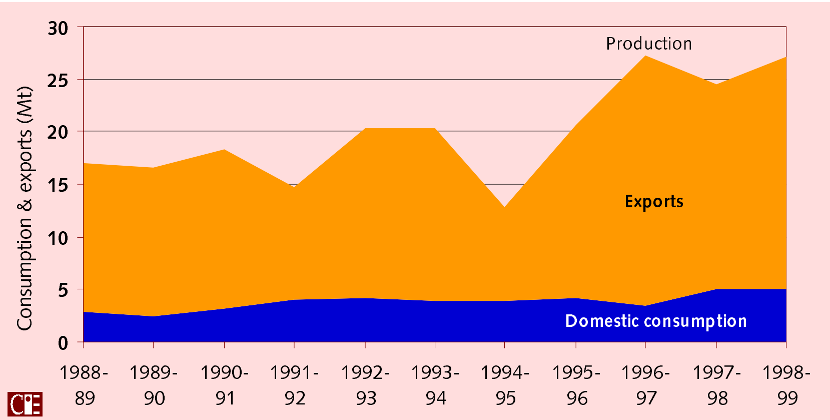
Politics too plays a role in the division of the world wheat market. The United States is currently not selling wheat to Iraq and Iran but dominates the Philippine and South Korean markets. Also, when the United States battled the European Union over export subsidies, Australia and Canada tended to reduce exports to those markets where returns were depressed by the subsidies. But since 1995 no US wheat exports have attracted subsidies under its Export Enhancement Program.

3.3 Major wheat importers



Data source: ABARE (1999).

3.4 Exports dominate the disposal of Australian wheat



Data source: ABARE (1999).

Of the importers listed in chart 3.3, Japan and South Korea are two of the few high price or quality-conscious markets. Some Middle East markets buy special ASW or APW wheats while countries such as Malaysia, Thailand and Singapore may buy some special grades for noodles, fish feed and other end uses. Buyers in other markets typically purchase the most competitively priced wheat to suit their general requirements.

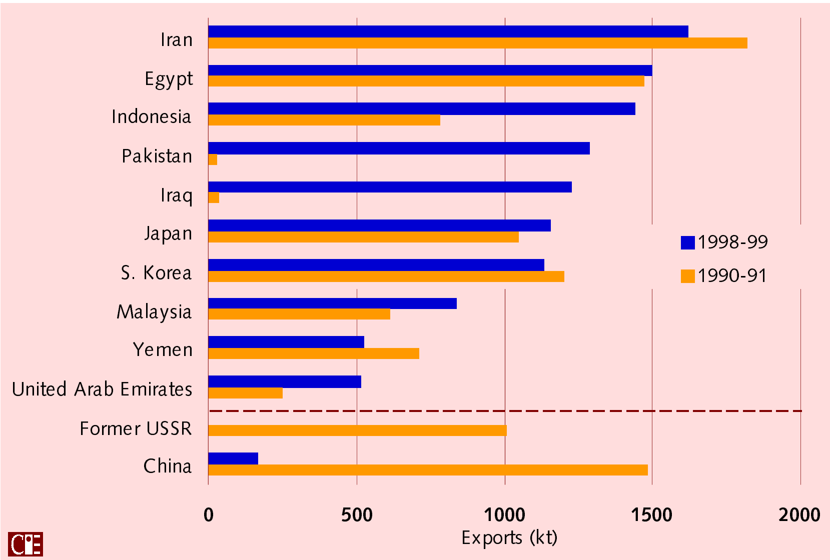
Australia's export markets

Most wheat produced in Australia is destined to be exported (chart 3.4). AWB (International) is obliged to take delivery of all the wheat that is for export. As the sole seller of Australian export wheat, its aim is to get the highest average price (fob equivalent basis) from the sale of pool wheat.

Australia exports wheat to nearly 90 markets but its top 10 markets account for over 70 per cent of Australia's total wheat exports (chart 3.5). Pakistan has only recently come to prominence as a market for Australian wheat. The Gulf War severely curtailed Iraq's ability to buy Australian wheat but it is once again a large market for Australian wheat.

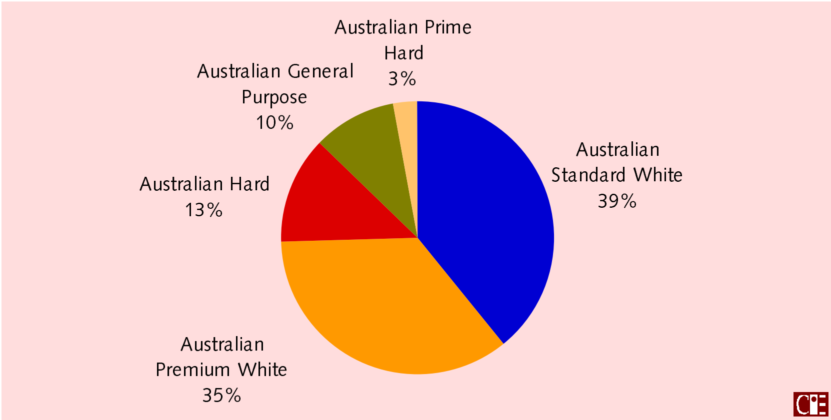
Compared with the exporting countries in the northern hemisphere, Australia is able to supply dry white wheats that are preferred in several

3.5 Australia's major markets for wheat exports



Data source: ABARE (1999).

3.6 Wheat receivals by the AWB, by grade, 1998-99



Data source: AWB Limited (1999).

markets. ASW and APW wheats are suitable for noodles and/or varieties of cakes, biscuits, pastry and other similar end uses. But protein levels are generally less than in US Hard Red Winter and Hard Red Spring wheats and Canadian Winter Red Spring wheats. These higher protein wheats tend to be more suited to bread and pasta.

Chart 3.6 gives the proportion of AWB receivals of various grades of Australian wheat. Nearly three-quarters of Australian wheat is ASW or APW grades (these were lumped together as ASW prior to 1995-96). It is these grades of wheat for which the Milling Wheat Project report concluded that 'ASW does not appear to consistently get a premium, even in quality markets' (GCA 1995, p. 45).

AWB (International) as a price discriminating monopolist

The only credible justification for a monopoly seller of Australian pool wheat is that the seller is able to achieve a higher average fob equivalent return across all pool wheat sales than a competitive marketing system could achieve. To do this, the monopoly seller would need to price discriminate between its markets while equating marginal revenues across all markets, including the domestic market. The Australian Barley Board stated that it acts in this way:

> In essence, the ABB uses different pricing strategies in different markets depending on their elasticities of demand in order to maximise the total return. (CIE 1997b, p. 64)

And the GCA believes that the 'single desk' operates in this way:

> The AWB's single desk seller status enables it to control supply and price discriminate between markets. (Hooke 1992, p. v)

Assuming for the moment that AWB (International) does operate in this way, to successfully price discriminate it would need to equalise marginal returns on an fob basis across all markets. For this to be the case certain preconditions need to apply.

- The 'single desk' seller must have the power to redirect supplies between markets.
- The demand characteristics of markets (elasticities) must vary. Some markets must be significantly more price responsive to variations in supply than others are.
- The 'single desk' seller must know the differences in demand characteristics with a high degree of accuracy — across markets, across wheat grades and across time.
- The 'single desk' seller must know the supply reactions of its competitors to any price increases it creates and be sure that its competitors do not increase supplies to the market where it has restricted supplies.
- The 'single desk' seller must be able to use its market demand and supply information to analyse complex interactions between all markets to optimise its allocation of export sales to markets to achieve the net gains.

Case A in chart 3.7 is a simple representation of how a monopolist can maximise profits by price discriminating between markets if all the conditions specified above apply. Compared with a competitive market situation, the monopolist will sell less in the less elastic market and more in the more elastic market, given that it has a certain quantity to sell. In each market, the relevant demand curve incorporates not only the influence of wheat buyers in the importing country, but also the characteristics of other supplies of wheat and close substitutes in that market. It assumes that, despite the countervailing actions of other suppliers, the monopolist has some market power in each of the markets or at least the most price responsive market.

This strategy, however, means that a successful monopolist must have access to immense amounts of reliable information about the demand characteristics of buyers in the importing country and the supply characteristics of competitors.

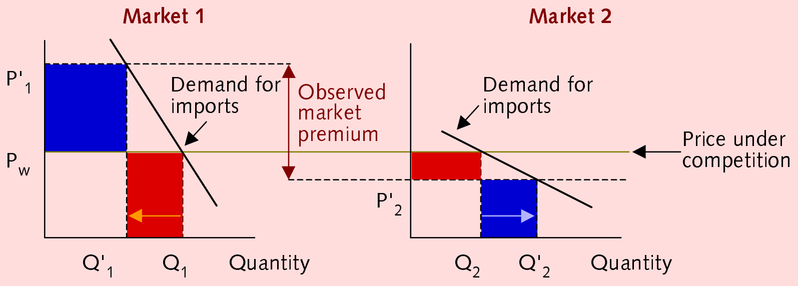
With AWB (International) selling scores of different wheat types to nearly 90 different markets, with other suppliers holding different competitive positions and with constantly changing economic and political environments, the information demands for an effective price discrimination strategy are enormous. Most would say that the task is impossible.

3.7 An observed price premium does not necessarily mean an increase in market revenue

Case A and case B illustrate a number of important points.

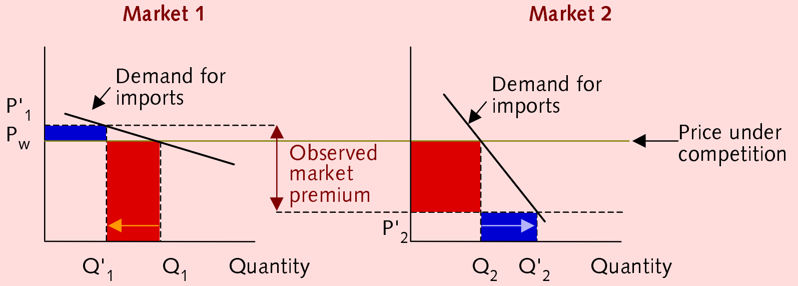
- In each case, a market 'premium' is observed, but this bears no relationship to whether returns are being maximised.
- The marketer must restrict supplies to market 1 in order to capture a premium and raise total export revenue (case A), but if supplies are restricted in the wrong market (case B), overall revenue will fall and the average export price will be at a discount to the average world price.
- The 'premium' observed is inflated if it is judged against prices received by a price discriminating marketer ($P'_1 - P'_2$). It should be judged against the world price under competition ($P'_1 - P_w$). The 'discounts' in the other market or markets must be considered.
- Other things being equal, restricting supplies to a key market is the only way of exercising market power, but this runs the risk of letting other suppliers move in.

Case A: Optimistic — inelastic market 1, elastic market 2



Results: Restricting supplies to market 1 raises revenue from both markets. (Blue areas (gains) in each case are greater than red areas (losses).)

Case B: Pessimistic — elastic market 1, inelastic market 2



Results: Overall revenue and the average price are decreased even though a premium is observed in market 1. (Red areas (losses) are greater than blue areas (gains).)

Source: Derived from CIE (1997b, p. 32).

The risks of such a strategy are high. If an aspiring monopolist misjudges the relative characteristics of each market (relative elasticities) it can significantly reduce total revenue from export sales and the average export price will be at a discount to the average that would prevail under competitive marketing. But there would still be a price 'premium' or price difference between markets, which the 'single desk' seller would proudly announce to growers.

Case B in chart 3.7 shows the case where the aspiring monopolist completely misjudges the characteristics of each market. It thinks market 1 is a relatively inelastic or highly price-responsive market when it is not. And it thinks market 2 is relatively price unresponsive to supply increases, but the opposite is the case. Restricting supplies to market 1 does not raise prices by much and reduces revenue (represented by the difference between the two shaded areas). Increasing exports to market 2 by a corresponding amount substantially reduces prices and reduces export revenue from this market. The net result is a lower average price to growers compared with a competitive market outcome. The drop in price from market 2 is much greater than the rise in price from market 1 so the average export price is less. But there is still an observed market premium.

Even if the monopolist is successful in extracting a premium price out of some markets, it runs the risk of those markets eventually turning to alternatives — other sources of wheat and other wheat types.

Model results for barley

The CIE (1997b), as part of its review of the *Barley Marketing Act 1993* in Victoria and South Australia, constructed a simple model of the barley market to test the effects of the Australian Barley Board's 'single desk', assuming it behaved — as it claimed — as a price discriminating monopolist. The model was based on the diagram in chart 3.7, but incorporated actual price and sales data averaged over five years.

The model results showed that, assuming that the Australian Barley Board had perfect information (unrealistic) and acted as a 'text book' price discriminating monopolist, it could receive a maximum average premium on feed barley of $2.50 a tonne and on malting barley of $2.70 a tonne. However, the resulting higher domestic prices for feed and malting barley meant net community costs of $4.1 million for feed barley and $1.5 million for malting barley.

But when the model was run assuming that the Australian Barley Board did not have perfect information, the results indicated that it had only a 15 per cent chance of achieving a premium for malting barley and a 3 per cent chance of achieving a premium for feed barley. Overall, it was estimated that the net cost to the community of the board acting as a price discriminating monopolist under uncertainty was around $8.5 million (CIE 1997b).

This approach to analysing the effects of 'single desk' selling by statutory marketing authorities was described by Graeme Samuel, the President of the National Competition Council, as a 'benchmark' (Samuel 1998). It should form the basis for analysing 'single desk' selling by AWB (International) as part of the NCP review.

Product differentiation

AWB (International) might be able to achieve a higher average return from pool wheat sales through a product differentiation strategy. This involves appropriate levels of segregation, development of particular branded products and targeting higher price markets.

The Milling Wheat Project report (GCA 1995) suggested that the main reason for the 'single desk' was to support the execution of a product differentiation strategy. But it highlighted the following.

- Over half of the wheat sold by Australia is shipped to price-conscious markets that traditionally are willing to trade off quality for a lower price. There are only a 'few markets to be targeted with differentiated products'.
- Australia, like Canada (which also has a 'single desk' seller for wheat), has mostly overdelivered on quality specifications, thereby incurring a cost because buyers pay for only what they specify.
- Significant costs are associated with such a strategy, including marketing and promotion costs 'complete with overseas offices and technical assistance programs', and higher storage and handling costs to support the greater number of segregations of wheat into different quality types in the centralised bulk handling system.

On the last point, the additional number of segregations demanded of the bulk handlers by the AWB has been a significant factor in raising bulk handling charges but information on the extra costs of segregations and any extra benefits of additional segregations has not been communicated to growers and may not even have been evaluated.

There are also substantial risks associated with centralised decision making when decisions that can affect the whole industry in a major way are concentrated among a few people in the AWB. They cannot hope to stay abreast of all developments in an increasingly sophisticated and changing world wheat market. The pricing decision on the day is a matter of judgment, taking into account a multitude of factors. Mistakes by them or opportunities lost could impose high costs on the whole industry, costs that could be hidden by the pooling payment system. Hidden mistakes are likely to be repeated mistakes. These could be avoided in a competitive market where multiple buyers compete for farmers' wheat and, on sale, the risk is transferred to the buyer.

In addition, with the AWB having such a dominant influence over wheat breeding, registration and commercialisation of new varieties, any misjudgments by it can be very costly to many growers. These can arise from not only decisions made about what varieties to register and commercialise (which the AWB insists must fit in with its grading system), but also decisions made about varieties that are not approved and that could potentially represent lost opportunities. For example, as discussed later, in the past some big mistakes have been made with regard to noodle and durum wheats, which have cost some growers dearly. Also, the AWB might refuse to register a particular feed wheat variety because it does not fit into its marketing strategy, but in many areas this variety might be very high yielding. This would impose a significant cost on those growers who could have grown the particular variety.

In contrast, under a competitive system, mistakes in judgment by an individual firm would be costly to that firm, but the whole industry would not be affected and the costs would be transparent.

In evaluating the benefits of the 'single desk' in the context of product differentiation, the Milling Wheat Project report examined three components:

- premium pricing — the extent to which Australian wheat achieves a better price than comparable products of competitors in specific markets (this is taken as a proxy for the 'single desk' price premium);
- market mix — the extent to which Australia has a high share of good markets and is able to avoid poorer returning markets; and
- pricing discipline — the extent to which the 'single desk' prevents the bidding away of freight advantages.

Scope for premium pricing is very small

Looking at Australia's top ten export markets (see the appendix for an assessment of Australia's position in these markets), the key question is: in how many of these major markets can the AWB realistically expect to hold some market power and achieve a 'single desk' price premium? Also, how many are high price or quality-conscious markets?

In the course of this review, the Independent Review Committee will need answers to the following questions.

- In which markets is AWB (International) consistently getting a 'single desk' price premium (c&f, fob)? (See box 3.1 for definitions.)

- What is the magnitude of any premiums and on what basis are any premiums estimated?
- In which markets is it receiving price discounts and what sizes are those discounts?

On the method of estimation, the Independent Review Committee will need to be satisfied that, where premiums have been claimed, they are indeed 'single desk' price premiums and not due to other factors. Also, where spreads between the c&f price received in the importing country and the fob price in Australia are estimated, it will need to take into account *all* marketing and freight costs and all relevant factors.

As already noted, a precondition for any supplier to have any chance of exerting market power is that the supplier holds a substantial market share or has a specific type of wheat demanded by the importer that no other supplier has. The importing market must also have a low elasticity of demand so that restricting supplies to that market will raise the price without other suppliers filling the gap. That is, the degree of contestability by other suppliers is important even if Australia has a large market share.

Because the international wheat market is highly competitive, even in markets where Australia has a reasonably high market share, competition from other suppliers means that Australia is not able to exert market power to any significant degree. The Milling Wheat Project report concluded that Australia may get some premiums in some markets for the higher quality wheats but ASW wheat (now split into ASW and APW) did not appear to consistently get a premium, even in quality-conscious markets and, overall, any premiums Australia got were small. An examination of Australia's top 10 markets (see the appendix) confirms that the chances of AWB (International) being able to exert any real market power are very slim. These conclusions are supported by the quick literature review reported in box 3.8.

As a final word, there is an obvious contradiction between a 'single desk' marketer limiting supplies to a market to exercise market power and raise prices, and the same marketer aiming to develop markets and expand sales under a product differentiation strategy. What is AWB (International) really doing?

'Market mix' is not a valid benefit of the 'single desk'

The Milling Wheat Project report suggested that Australia has more than its fair share of the better price markets because of the 'single desk' and estimated the value of this to growers to be between US$10 million and US$80 million. But this argument is totally invalid for two reasons.

3.8 A quick literature review

Carter, CA and Wilson, WW 1997, 'Emerging differences in state grain trading: Australia and Canada', *Agricultural Economies*, vol. 16, pp. 87–98.

Advantages associated with 'single desk' selling owing to market power have to be weighed against the costs of a 'single desk'. The lack of competitive disciplines within Australia and Canada may mean that the costs of marketing grain are raised. Additional competition between sellers could result in a decrease in marketing costs and increased overall demand for Australian wheat. Both countries have relatively high marketing costs compared with the costs in countries with greater competitive pressures.

Piggott, R 1992, 'Some truths revisited', *Australian Journal of Agricultural Economics*, vol. 36, no. 2, pp. 117–40.

Reasons are given why the price obtained in a particular market might be higher than prices secured in other markets. Do reported price premiums reflect the application of market power or additional marketing services such as certainty of supply, finance, storage and subsidised insurance? Taking these complications into account, Piggott concludes that gains from any market power in the world wheat market are likely to be very small.

Watson, AS 1999, 'Grain marketing and National Competition Policy: reform or reaction', *Australian Journal of Agricultural and Resource Economics*, vol. 43, no. 4, pp. 429–55.

The original benefits (rents) from a natural monopoly are often dissipated by favoured employment conditions and deals for preferred customers. The capacity of markets to organise trade in Australian grain has increased over time because of the falling costs of providing marketing services, especially marketing information. Centralised marketing with the pooling of marketing costs does not allow systems to evolve as technology and markets change.

Carter, CA 1993, 'An economic analysis of a single North American barley market: a reply', *Canadian Journal of Agricultural Economics*, vol. 41, no. 3, pp. 243–56.

Carter argues that the Canadian Wheat Board's pricing strategies are sub-optimal and that the board cannot affect the prices that farmers receive.

Clark, JS 1995, 'Single desk selling by the Canadian Wheat Board: does it have an impact?', *Canadian Journal of Agricultural Economics*, vol. 43, pp. 225–36.

The Canadian Wheat Board argues that its 'single desk' selling raises the pooled price of barley above the prices under competitive marketing. The board's conclusions and Carter's (1993) conclusions are tested using feed grain prices. The results indicate that the board's 'single desk' selling has no impact on prices and that Carter's analysis is more consistent with the data than is the board's analysis.

First, Australia is closer to many of the higher price markets in East Asia and so has a slight freight advantage over competitors. This is a natural advantage to Australia. Second, under a competitive marketing system, sellers of Australian wheat would also seek out the higher price markets but, in the analysis, this comparison with the appropriate counterfactual — the competitive system — was not considered. As MacAulay and Richards (1997, p. 6) point out, the market mix, as the cornerstone of the Milling Wheat Project report assessment of the 'single desk', 'has no specific connection to market power or price discrimination'.

Export subsidies change the market mix, with or without a single seller

A variant of the 'market mix' argument is that the 'single desk' is needed because Australia is 'pitted against US and EU subsidies'. It is seldom explained how a 'single desk' helps but the argument appears to be that, with 'single desk' selling, Australia can avoid the most heavily subsidised markets.

Export subsidies have been a 'fact of life' irrespective of Australia's wheat marketing arrangements. Following the Uruguay Round Agreement, the European Union has significantly changed the nature of its support arrangements to direct income support, and export restitutions have been at considerably reduced rates and have fluctuated between export taxes and export subsidies. As already noted, there have been no subsidised US wheat exports under the Export Enhancement Program since July 1995.

The key point is that sellers in a competitive marketing system would avoid low price subsidised markets just as a 'single desk' seller would. If proponents of a 'single desk' seller persist with this argument they must explain *how* a 'single desk' is any better than a competitive marketing system in 'combating' export subsidies.

Agricultural policies such as the US Export Enhancement Program are, of course, bad for Australia. However, they are also bad for the United States and bad for the international trading system. And Australia argues this strongly in bilateral and multilateral trade negotiations. However, Australia's credibility in making these arguments is weakened by such arrangements at home.

Freight advantages are natural advantages

The Milling Wheat Project report also attributes as a benefit of the 'single desk' the freight advantages Australia has in several markets compared with other major exporters (table 3.9). But the authors considered only first-round effects. They argued, for example, that under a competitive marketing system any freight advantage would be bid away by the many sellers of Australian

3.9 Freight margins over Australia's east coast[a]

	Pakistan	Iran	Iraq	Egypt
	US$/t	US$/t	US$/t	US$/t
West coast Australia	-1.72	-1.71	-1.17	-1.36
Pacific North West (US)	2.06	na	na	1.03
Gulf (US)	na	na	6.78	-1.50
Canada	na	3.61	4.11	na
Europe	na	1.39	2.41	-6.33

[a] All rates are based on 60 000 tonne cargoes. The figures are the additional freight costs from a particular source to a particular market above the freight rate from Australia's east coast. For example, the freight rate from the Pacific North West to Pakistan is US$2.06 a tonne more than from Australia's east coast to Pakistan. na Not applicable.

Source: Consultations with grain traders and shipping companies.

wheat. But this fails to take into account the simultaneous nature of the international market and the adjustments that would occur to ensure that Australia's natural geographical advantage provided benefits that would be shared by buyers and sellers irrespective of the marketing system.

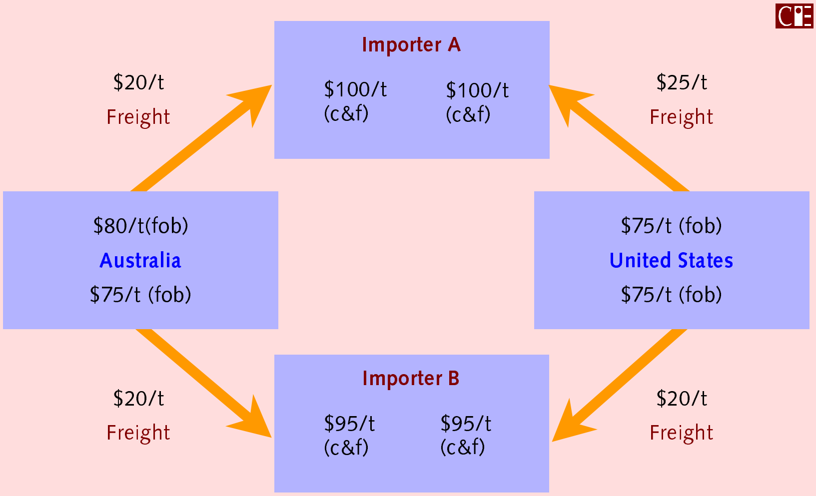
The situation described in chart 3.10 is where some markets (importer A) are more price sensitive and pay a higher price than others (importer B). In this example the freight 'premium' between Australia and importer A would be shared by the importer and Australia's 'single desk' marketer, depending on the relative bargaining strategies between them. But, if there were several marketers in Australia, there would be simultaneous market adjustments that would mean Australia would get a greater share of the higher price market. In such situations there would be no need for private traders to lower their offer price below the world price. There would be no eroding of the freight advantage.

The key point is that freight rate differences are an integral part of a simultaneous system and it is not possible to make any credible statements about a 'single desk' marketer capturing freight rate differentials in isolation of all simultaneous adjustments that would occur if Australia's marketing system were changed to a competitive system.

The bottom line on product differentiation

Running a product differentiation strategy really means tailoring products to meet the specific requirements of discerning customers. It implies nothing about market power, and a 'single desk' is not necessary to achieve it. Indeed, there are instances where some growers allege that Australia's 'single desk' has been a hindrance to niche marketing and efforts by them to develop their own specific products to meet the needs of specialty buyers. The cases of noodle wheat growers in Western Australia and durum wheat growers in northern New South Wales are outlined in box 3.11.

3.10 Geographical freight advantage will benefit the advantaged country



Consider the situation where Australia, with a ‘single desk’, has a freight advantage of $5 a tonne over the United States in the importing country A. This means that Australia gets $5 a tonne more on a fob basis from this market than the United States does. Neither country has an advantage in country B. Australia, with a ‘single desk’, price discriminates (fob basis) between the two markets but US exporters are indifferent between the two.

The argument put forward in the Milling Wheat Project report (GCA 1995) is that, if Australia were to change to a competitive marketing structure, competition would bid away the $5 a tonne freight advantage until Australian sellers were indifferent about selling to markets A and B. But this is only a first-round effect and totally ignores subsequent market adjustments.

With the change, Australia would be significantly undercutting the United States in the high price market A and would gain market share. To do this, it would divert product from market B to market A. The United States would then sell less to market A and take up the slack in market B. The net result would be that Australia would capture a higher share of the high price market and sell less to the low price market and, overall, total revenue (on a fob basis) would not be much different from that under the ‘single desk’.

The price discriminating model described earlier could be used to quantify any changes.

Government-to-government trading

Is there a case for having a 'single desk' to facilitate government-to-government wheat trading? In years gone by Egypt, for example, maintained a sole government buying agency that preferred to deal on a government-to-government basis with Australia. But this was largely because Australia was the only country that would offer Egypt credit — and this was provided under National Interest cover (where any default risk was guaranteed by the federal government). Whether this meant a higher price for Australia farmers is a moot point. Moreover, even if Australia had been receiving prices above the world price for exports to such markets, the markets would have woken up to the higher prices they were paying and the high costs of maintaining inefficient monopoly importing systems. Egypt now allows the private sector to import. So does China, where negotiations with suppliers often come down to how keen the AWB and the Canadian Wheat Board are to sell and the strength of China's need for wheat. Often, the boards will give away some, if not all, their freight or quality advantage to secure the business. But prices are hidden and there are no benchmarks to judge whether the sellers are obtaining a premium or discount. Also, it does not seem credible that both the AWB and the Canadian Wheat Board simultaneously get price premiums from the same market.

Pakistan also allows some private wheat imports but maintains a government tender buying system. It purchases wheat through a transparent tender system where there is no scope for any one supplier to consistently receive prices above the world price for a particular wheat type purchased.

The logic behind arguments that a 'single desk' exporter is needed to trade with a government-owned buying agency is curious. If the buying agency prefers to deal with a 'single desk' seller and pay prices above the world price, this is a customer requirement that does not reflect market power on the part of the 'single desk' seller. Alternatively, the government buyer could attempt to use its monopsony power to buy at below the world market price. In this case, it is difficult to see how the 'single desk' seller could achieve a 'single desk' premium and, like all other sellers, it has the option of selling to other markets at the world price. Even if the sole government buyer were willing to pay extra to deal with a 'government' agency seller, this could easily be done without requiring the agency to be a 'single desk' seller of all exports. In any case, the AWB is now a conglomerate of private companies.

Is Japan a special case?

The Japanese Food Agency, in effect, administers a virtual quota system on wheat imports. It consistently imports about 6 million tonnes of wheat a year and allocates country quotas to the major Japanese trading houses and some international grain traders, which in turn deal with the selling agents in the supplying countries. Effectively, Australia is allocated an import quota of about

3.11 The 'single desk' — a help or a hindrance to niche marketing?

Typical claims made in support of the 'single desk' are:

> the effectiveness of adopting niche marketing strategies is a product of the single desk … Australia is best served by [the 'single desk' AWB] continuing to selectively target, develop and secure markets for specialised and differentiated products and control supply into each niche market … (Hooke 1992, p. 5).

But stories about the development of the noodle market in Japan and the durum wheat industry cast considerable doubt on these claims.

Noodles in Japan

The Western Australian Noodle Wheat Growers' Association has about 500 grower members who produce about 80 per cent of the noodle wheat sold in Japan and South Korea.

Western Australian plant breeders modified the variety Gamenya to suite local conditions and in the process accidentally developed a strain with unique characteristics ideally suited for the Japan udon noodle wheat markets. The Japanese market began to acknowledge the superior quality of Gamenya from about the mid-1970s. At the time the AWB did not pass this information onto growers and subsequently there was a decline in the production of Gamenya.

In the 1980s Western Australian noodle wheat growers asked the AWB to introduce a separate noodle wheat pool but this apparently went against the pooling philosophy for ASW wheat. In the late 1980s the growers began lobbying for a separate pool. So unconvinced was the AWB of the need for a separate pool that it said in a position paper presented to the noodle growers in 1991 that there was nothing unique in Gamenya. It said it had poor milling quality and would normally attract a varietal discount.

It was not until 1992-93, when the AWB finally introduced a separate pool, that the Japanese market could feel secure that its quality and quantity requirements for noodle wheat would be met by Australia.

Growers receive a premium for noodle wheat of around $20–35 a tonne over ASW wheat and since 1992-93 the extra return to growers has been estimated at $150–200 million.

(Continued on next page)

1.1 million tonnes a year. To meet the agency's focus on food security, the AWB virtually guarantees to supply this amount, which is shipped evenly throughout the year. The Canadian Wheat Board does likewise and, as a result, probably gets a higher price for wheat sold in Japan than does the United States, which does not guarantee supplies. So in a sense Japan is a special market that purchases wheat and simultaneously purchases guaranteed supply so that the higher price reflects the cost of delivering this guarantee.

3.11 (continued)

The durum wheat story

Throughout the 1970s and 1980s a small, but growing, durum wheat industry developed in northern New South Wales. In 1993-94 wheat protein content was down, with a significant proportion of DR3 wheat below 11 per cent protein. Local millers were reluctant to use this wheat for domestic milling purposes. The AWB advised durum growers in writing that there was no international market for this type of output and their best course of action would be to sell the product locally as feed. Deliveries to AWB attracted feed wheat values only. New England Agricultural Traders (NEAT) stepped in on behalf of growers and negotiated and developed new markets for this wheat in Turkey and Morocco, returning participating growers between $60 and $80 a tonne above feed wheat values. The wheat was sold under an arrangement with the AWB to these new overseas markets, whereby NEAT was forced to sell the wheat to the AWB and buy it back at the export terminal (fob). NEAT continued to develop new markets, obtaining a number of bulk export permits until the AWB became privatised on 1 July 1999. Production expanded from an estimated exportable surplus of 64 kilotonnes in 1993-94 to an estimated 600 kilotonnes in 1999-2000.

In 1996-97 the AWB formed an exclusive agency relationship with the Italian trading house Pagnan. In 1997-98 NEAT was able to obtain much higher bids from Italian millers than those Pagnan was offering the AWB. NEAT was forced to sell durum wheat to the lower paying markets of Morocco and Tunisia in 1997-98 because the AWB would not allow NEAT to deal directly with Italian millers. This cost NEAT and growers in excess of A$4 million in the 1997-98 season. In 1998-99, under pressure from growers and NEAT, the AWB dropped the Pagnan relationship.

Since April 1999 the AWB has refused to grant or agree to any bulk export permits for traders such as NEAT. Here is a case of a small group of wheat growers working with a trader to develop a specialty market, only to have the AWB apparently become keen when the market reached a reasonable size and cut-off the opportunities for such growers.

Sources: J Hawkins, Western Australian Noodle Wheat Growers' Association, pers. comm., 12 July 2000; P Sneakers, New England Agricultural Traders, pers. comm., 13 July 2000.

If the AWB's 'single desk' were removed Japan would remain a high price market because of its security requirements. Whether prices would rise or fall would depend on the extent to which grain traders were prepared to hold wheat in store to guarantee the Japanese Food Agency's yearly requirements.

To sum up

The only substantial analysis of the benefits of Australia's 'single desk' marketing system for wheat — that presented in the Milling Wheat Project report — gave a luke warm and less than conclusive endorsement of the 'single desk' at that time. It estimated net benefits of between minus A$3.35 and plus A$8.72 a tonne. But the logic of the arguments and the method of analysis were seriously flawed. Disallowing the estimated benefits from 'market mix' and allowing for second-round effects in the estimation of benefits from freight premiums would tip the scales decisively in favour of allowing a competitive marketing system.

4 Storage, handling and transport

POOLING AS A COOPERATIVE MARKETING SYSTEM is deeply ingrained in the Australian grains industry. It took the Royal Commission on Grain Storage, Handling and Transport (1988) to expose the inequities and inefficiencies of a 'cooperative' pooling system whereby all wheat growers who delivered to the AWB pool paid the same storage, handling and transport costs irrespective of their individual circumstances. Since then, rail freight services have been deregulated, bulk handling authorities have been privatised and some amalgamations of these are taking place.

Despite these changes Australia still has an inefficient and costly grain handling and transport system, and significant elements of pooling in handling charges remain. The 'single desk' marketing systems for wheat and barley, which prevent any effective competition, are the main reason for these handling inefficiencies, as this chapter testifies.

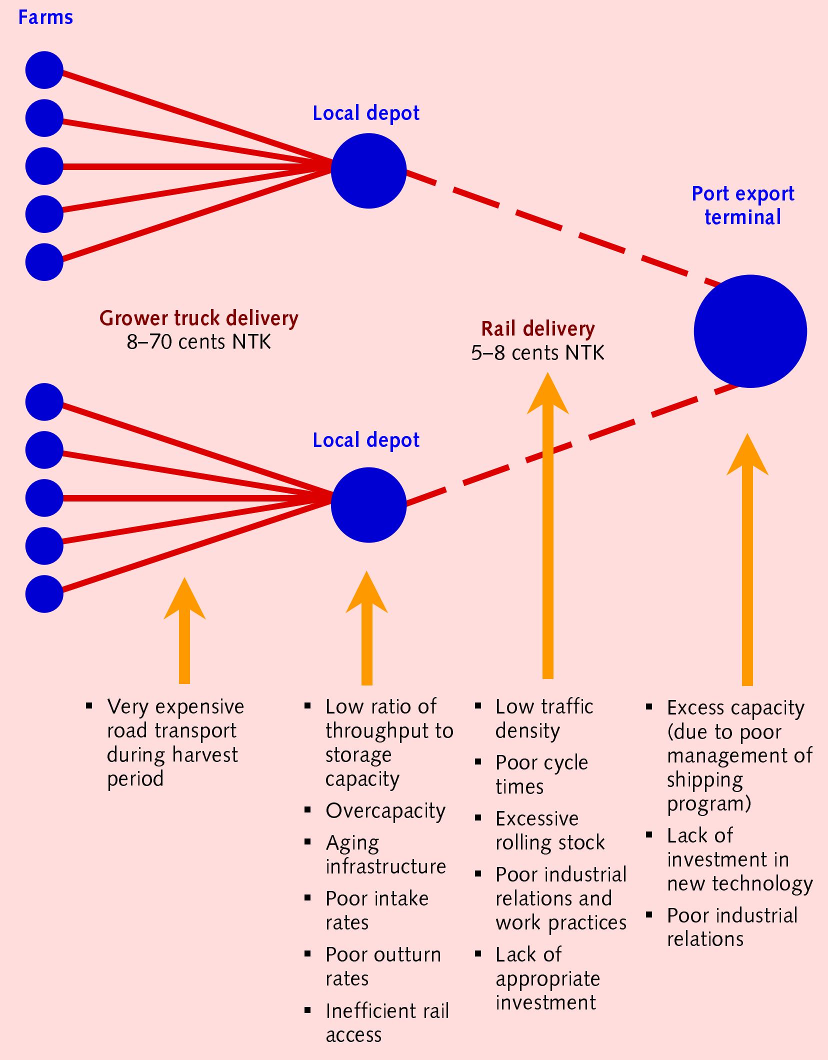
Grain handling system is costly and antiquated

Following the Royal Commission, one would have expected significant innovations, increased competition and lower charges in grain handling. This has not occurred. On closer inspection, essentially the same organisations exist today as before the Royal Commission. While they have changed from statutory organisations to grower-owned private companies or cooperatives, they are still basically state-based with effective regional monopolies on grain handling services for export grain. If the amalgamation of Vicgrain and Graincorp goes ahead, the minor competition at the edges between the organisations in the eastern states will be virtually eliminated.

There have been some changes in the grain handling system but its basic structure remains much the same as it was four decades ago. At harvest, farmers generally use their own trucks to deliver their grain to hundreds of local silos scattered along railway lines throughout the wheat growing areas. Rail wagons are gradually accumulated until a train of sufficient size takes the grain to the port where it is finally elevated onto a ship. The system and the problems it encounters are illustrated in chart 4.1.

Such a system may have suited the conditions four decades ago but, since then, developments such as substantial increases in farm size, modern machinery to quickly remove the crop and trucks such as B-doubles to efficiently move grain up to around 150 kilometres mean that the structures of hundreds of local silos are relics. As technology changed, obvious developments would have been more onfarm pick-ups, strategically located large

4.1 Australia's typical grain export supply chain has problems



NTK = net tonne kilometre

receival centres with economies of size and state-of-the-art elevating, and large trains taking grain to ports with fast turnaround times. Developments along these lines have been rare.

No significant entrants have been prepared to invest in new grain handling facilities or introduce expertise and innovations to compete with the existing grain handling organisations. With some exceptions, the existing organisations have persisted with aging facilities and have undertaken only limited investment in state-of-the-art handling facilities.

All of this has cost Australian grain growers dearly. The Milling Wheat Project report found that, net of all subsidies, Australian grain growers paid at least US$5 a tonne more for storage, handling and transport services than their US counterparts did.

In a study of least cost grain paths in the Western Australian grain handling system, Lindner and McLeod (1996) found that moving to a system of grain handling where charges reflected resource costs and were disaggregated and transparent could ultimately generate potential savings in annual net revenue costs of between $12.5 million and $23 million. They found that the simple change from the current pricing practice with a high degree of aggregated non-transparent charges to a disaggregated pricing system would significantly change least cost grain paths, resulting in potential significant cost savings to growers. These study results are important in that they indicated gains from reducing the aggregation of charges. But in a competitive system the appropriate degree of aggregating charges would be settled in the marketplace.

Why has there been so little progress in reforming the system and reducing grain handling charges?

'Single desks' fossilise grain handling systems

The AWB's 'single desk' and the states' 'single desks' for barley could choose to manage their 'single desks' from vessel (fob) onwards in the marketing chain. They could, for example, contract suppliers in a competitive environment to transport grain of a particular specification from farms to vessels (fob) by a specified time but still maintain the concept of 'single desk' selling.

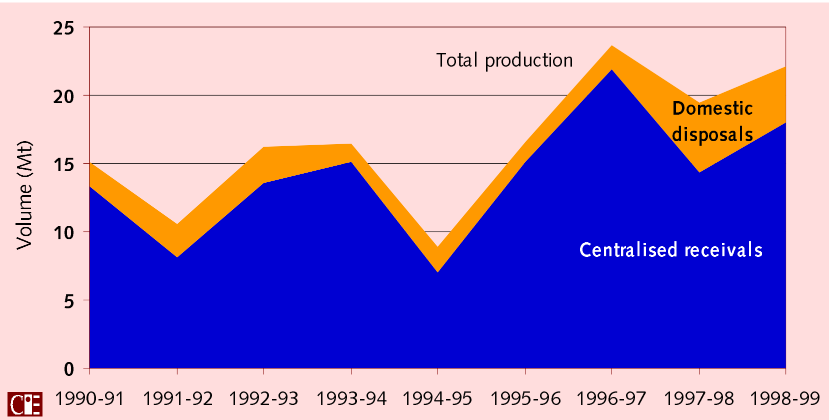
Instead they have chosen to spread their monopoly influence back down the supply chain to local silos so that they have total control over the supply chain. Farmers have no choice but to use the centralised grain handling system in each state if they wish to export wheat or barley. As shown in chart 4.2, most wheat is delivered into the centralised handling system.

The AWB, as the monopoly export marketer of Australian wheat, orchestrates the entire supply chain and directs bulk handlers and rail companies on all facets of grain storage, handling and transport. This environment discourages competition, innovation and change in grain handling systems. For example, there is little incentive for bulk handling companies to make investments in fast train loading or rail sidings that would reduce train cycle times and hence freight rates. In effect, one monopolist tells another monopolist what to do and they negotiate a price for the services to be undertaken. The bulk handlers and rail companies are agents of, and service providers to, the AWB and do not have the flexibility to do other than what they are told to do.

There is also little incentive for rail companies to undertake reforms that reduce the operational costs of bulk handlers. Nevertheless, rail companies have come under somewhat more competition from road freight and other reforms. These aspects are reflected in the trends in freight rates and bulk handling charges (chart 4.3). Whereas freight rates have declined somewhat, bulk handling charges have generally risen, reflecting the lack of competition but also the greater number of wheat segregations demanded by the AWB (see the discussion in chapter 3 on this). This is further emphasised by considering the general increase in wheat receivals (chart 4.2). One would expect bulk handling charges per tonne to decrease as throughput increases.

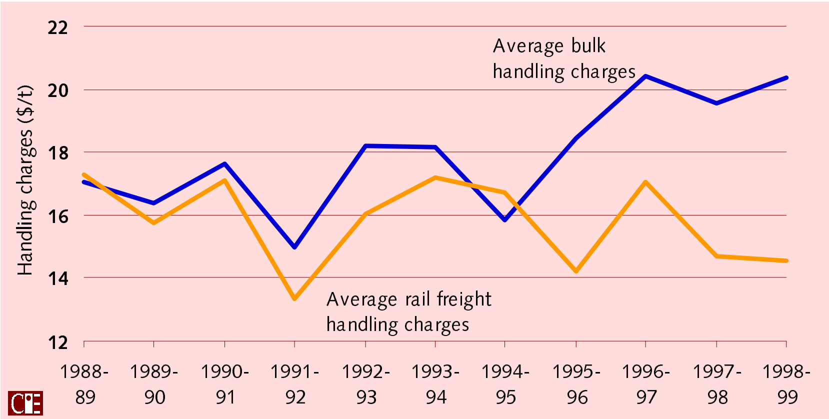
The AWB negotiates on prices of services provided by the grain handling organisations. The former complains that charges are too high while the latter makes the valid point that the prescriptive, controlling behaviour of the AWB provides no room for competition or for bulk handlers to innovate and invest. This stalemate has persisted for many years. In its submission to the recent determination on grain handling services in Victoria, the AWB noted that its 'frustration with high terminal usage charges levied by Vicgrain was a primary driver in AWB's investment in an alternative export port' (Office of

4.2 Most Australian wheat goes into the centralised handling system



Data source: ABARE (1999).

4.3 Bulk handling charges in Australia have generally increased



Data source: ABARE (1999).

the Regulator General, Victoria 2000). The AWB will have access to lower charges because of the introduction of some competition — in this case the new Australian Bulk Alliance terminal at Port Melbourne where the AWB has a commercial interest. Largely as a result of this change, Vicgrain's charge for loading export grain declined from $10.75 a tonne in 1997-98 to $6.50 a tonne in 1999-2000 (AWB Limited 2000) — demonstrating the power of even a little competition.

Two other factors are relevant in understanding the lack of incentives to reform the system.

- The AWB and the grain handling companies have conflicts of interest — between minimising costs to grain growers and maximising returns to shareholders.
- The concept of pooling charges is still prevalent in bulk handling companies. For example, Vicgrain maintains a common receival charge for wheat delivered to primary sites irrespective of whether growers deliver to these sites in country areas or to ports. But the services provided in each case are significantly different. Such bundling of charges would not occur under a competitive system (Office of the Regulator General, Victoria 2000).

For growers, if handling charges were more disaggregated they would be able to make better choices about their least cost delivery paths. But for pooled wheat, once delivered to the silo, the AWB pays the bill for delivering the wheat to ports and loading it onto vessels and deducts this from growers' gross returns. There are limited commercial incentives for the AWB to reduce costs and find greater efficiencies — only a 'best endeavours' aim. And the only real accountability is occasional reports to grower organisations that are not independently assessed.

For the AWB, disaggregation of costs is less of an issue since it pays (on behalf of growers) the whole bill from silo to vessel. The key point is that the AWB's control over the supply chain limits the system to one buyer and one seller in nearly all regions, with virtually no competition and hence no incentives to innovate or invest.

There is ample scope for greater efficiencies

In the United States, where monopolies or public utilities have been opened up to competition, prices to consumers have fallen (Wilson and Wilson 1999). In Australia, wherever competition has been introduced into markets previously controlled by monopolists, such as telecommunications and electricity, the reductions in costs have been substantial. It would be the same for the grain handling system.

Some grain handling companies have conducted extensive research over the past two years and are convinced that, across the board, there are supply chain savings of the order of $5–15 a tonne available through the creation of competing supply chains. (Details can be made available on a commercial-in-confidence basis to the Independent Review Committee if it requests them.) Savings of this magnitude across the whole wheat crop would amount to between $120 million and $360 million. Importantly, it would raise the average farm business profit of wheat producers by at least 27 per cent (ABARE 2000). This would substantially reduce the number of farmers with zero or negative farm business profits.

Typical supply chain costs are shown in table 4.4. They represent up to a third of gross pool returns to growers. But bulk handlers would need 'a piece of the action' in a competitive environment to give them the incentives to invest in new technology and pathways. This also applies to potential new entrants. Savings could be achieved by:

- more accurately forecasting shipping programs and supply movements;
- making better use of onfarm storage over the season by having pricing incentives for storage;
- rationalising the number of local silos;
- improving the coordination between rail and bulk handling services;
- increasing investment in state-of-the-art facilities; and
- in the long run, rationalising the entire structure of the supply chain.

4.4 Typical supply chain costs for wheat

Type of charge	Wheat	Comment
	$/t	
Local cartage	5–10	Highly variable, depending on the location of the wheat farm in relation to the local silo.
Receival charge	6–8	Vicgrain's charges for 1999-2000 ranged from $7.70 to $11.70 a tonne.
Storage charge	3–8	Conservative — based on an average storage charge of $1.00 a tonne per month for three months. Shrinkage could add another $1.00 a tonne.
Freight charge	21–28	Variable, depending on distance from silo to port.
'Fobbing' cost	7–13	All-inclusive costs from rail wagon to vessel, stowed and trimmed (fob).
Total	**45–55**	**Not valid to add highs and lows.**

Source: Interviews with bulk handlers and traders.

To sum up

There is no effective competition in the provision of grain handling services, except 'at the edges' in the eastern states. With no competitive pressures, bulk handling charges have generally risen over the past decade when the opposite should have occurred, given the substantial increase in wheat receivals.

The 'single desk' is the dominant factor underlying this lack of competition and the increasing trend in bulk handling charges. AWB Limited chooses to manage its 'single desk' by commanding complete control over the whole domestic supply chain for export wheat. It need not do this.

There are ample opportunities to reform the system and reduce grain handling and freight charges to growers. A necessary step in that reform is to remove the monopolistic influence of the AWB and the state grain marketing monopolies and introduce competition into the supply chain from farm gate to vessel.

5 Effects of pooling on grower returns

THE MONOPOLY ON BULK WHEAT EXPORTING, in conjunction with pooling, places severe restrictions on the ability of growers to manage their risk. Growers are exposed and unable to effectively plan their operations or to receive the best price for their wheat.

What is pooling?

When growers deliver their bulk wheat to the silo it enters the national pool and legal ownership is transferred to AWB (International). Most growers elect to receive a harvest payment equal to 80 per cent of the estimated pool return less all marketing costs. The harvest payment is a short term loan at rates of interest that in July 2000 were around 8.75 per cent. For an additional $1.95 a tonne underwriting fee, growers can insure against any shortfall call. As the wheat is sold overseas, the loan is automatically repaid. Once the loan has been repaid, the grower receives subsequent payments and a final payment up to 15 months after delivery.

Pooling is a 'best endeavours, cost-plus' system in which growers jointly bear all the price risks. If AWB (International) makes a marketing mistake or loses on hedging transactions, growers wear the cost of that mistake. If world wheat prices fall after delivery, growers take whatever price the wheat is sold for less marketing costs. AWB (International) aims to minimise costs but there are few commercial disciplines on it, or benchmarks against which to judge its performance. Unlike commercial trading companies, the AWB takes no principal risk. Furthermore, with the privatisation of the AWB, the conflict of interest between shareholders and wheat producers means that the latter are no longer assured that the AWB is attempting to minimise marketing costs.

For many growers, this pooling system appears to have some psychological appeal.

- A common perception is that pools assure growers that they all receive the same price for the type of wheat delivered. This may provide some growers with some comfort. But the introduction of a wider range of payment options over the past two years means that the chances of growers receiving the same pool price as their neighbours do for identical wheat delivered to the same silo are quickly diminishing.

- Growers can abdicate the pricing decision — they deliver their wheat at harvest time and wait for the result over the ensuing 12–15 months.
- Pools are a trouble-free means of off-loading grain quickly at harvest time.

Pooling is not an effective risk management tool for all

The final gross pool return for a particular pool reflects several things, including:

- the returns from wheat sales to many markets spread out over the life of the pool — at least 12 months;
- currency hedging activities of the AWB Treasury;
- the grain hedging activities of the pool managers using US futures/options as well as more exotic tools such as swaps; and
- management of the basis, which is the difference between Chicago Board of Trade prices and Australian prices.

For growers who are content to deliver their wheat to the pool and take their chances on the final price they will get, the pooling system is an easy way for them to market their wheat. For such growers pooling is fine and, under a competitive marketing system, the AWB along with commercial companies would continue to run pools to accumulate these growers' grain. In the cotton industry, for example, over half of all cotton marketed is by way of voluntary seasonal pools run by private trading companies. What is at issue here is the *compulsory* requirement that any wheat grower wishing to export bulk wheat must go through the AWB's national pool. Also at issue is the impact this has on the choice of risk management options available to growers and the price distortions that pooling causes.

Successful modern farming requires not only good management of physical resources and technical operations, but also good marketing skills and business management. The latter depends on the abilities of growers, each with individual circumstances, to effectively manage their risk according to their own risk preferences. This means being able to effectively lock in prices for one or even two years ahead so that decisions on investments can be made with greater certainty about outcomes. With wheat prices locked in through hedging, farmers can budget properly and have a much greater chance of obtaining loans for investment and greater confidence that the loans can be repaid.

It is worth noting that in 1998-99 over half of Australia's wheat growers failed to earn a farm business profit (ABARE 2000). In part, this reflects the fact that many growers using the pool face uncertain returns both before and after delivering their wheat and this can adversely affect management decisions.

Wheat pools are not an effective risk management tool for farmers wishing to hedge for specific purposes, such as buying or leasing a new property or undertaking specific management practices where greater certainty of outcomes is important.

Unless wheat is priced through either an actual sale or a derivative mechanism, Australian growers collectively bear price risks through pools. Although the information is confidential, it is generally known that the AWB is unable to effectively hedge forward prices for the entire Australian crop. By definition this means that Australian growers are collectively exposed to fluctuations in international wheat prices and international currency movements to some extent even when pools are hedged.

Indeed, once pool managers undertake any hedging activity the growers' capacity to hedge against falls in the pool price is diminished. To hedge effectively there needs to be a relatively stable basis. That is, the relationship between what is being hedged and the instrument that is being used to hedge must be relatively stable. Once a pool manager starts hedging the pool the relationship between the price that the pool will obtain and the relevant futures market becomes opaque. A farmer cannot assume that a loss on his or her hedge will be offset by a higher than expected pool price because the hedging activities of the pool operators may result in a loss in the pool price also. Indeed, one of the most important pieces of information — the profitability of AWB hedges — is unknown to the grower wishing to hedge against pool price falls. Furthermore, wheat futures are thinly traded on the Sydney Futures Exchange largely because of the dominance of pooling.

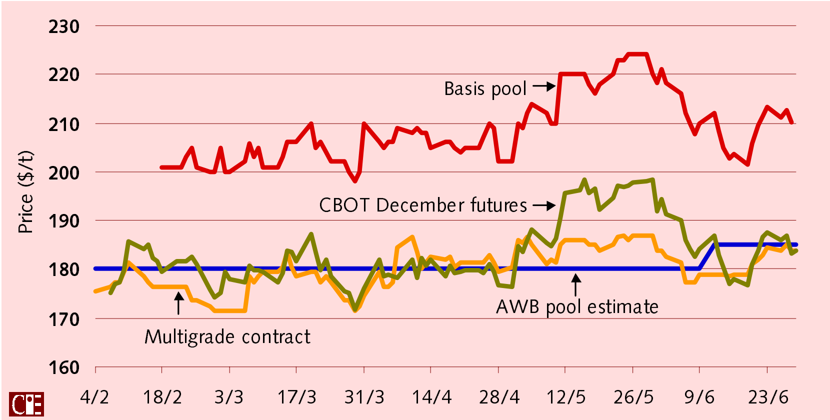
These factors in part underlie the rise in popularity of the AWB's basis pool.

The basis pool — better but limited and not the full answer

As growers have realised the extent of price exposure inherent in pooling and the opportunities available to get much better forward prices for their wheat by locking in peaks in international price movements, there has been a surge of interest in the AWB's basis pool, which was introduced in 1998.

Under basis pool contracts, growers undertake to deliver a minimum of 952 tonnes (formerly 1000 tonnes) of wheat to the AWB's pool, but independently price their pooled wheat by fixing their own US futures and exchange rates for three separate tranches. The AWB remains responsible for the basis between its pool price and Chicago Board of Trade futures for each payment tranche. As an illustration of how growers can use the basis pool to get a better price for their wheat, consider chart 5.1. The return from the basis pool, which better reflects international daily prices, was as much as A$40 a tonne higher than the AWB's estimated pool return over the period shown.

5.1 Standard pool returns were well below international prices and the returns from the basis pool in the first half of 2000



Data source: Dennis Wise, Profarmer, pers. comm., 9 July 2000.

By appropriately covering their own currency and Chicago Board of Trade futures, growers are able to 'lock in' a much higher price for their wheat using this basis pool rather than the standard pool. Similarly, by using the multigrade contracts, growers can capitalise on opportunities when there are peaks in world prices by 'locking in' higher prices.

In the initial year, 1998, the AWB expected to contract a few early innovators and expected about 30 000 to 40 000 tonnes. In fact 420 000 tonnes entered the basis pool. It is believed that since 1998 the AWB has contracted somewhere around 500 000 tonnes of wheat in the basis pool each year.

The basis pool has proved to be so popular that in 2000 the AWB restricted merchandiser participation by limiting any contracting party to 20 000 tonnes. The limit on commercial merchandiser activity could be possible only in an uncompetitive environment where one entity is allowed to monopolise wheat exports.

This has had an undesirable side effect on the trade and Australian farmers. Trade merchandisers, including some former statutory marketing authorities, had been performing a valuable marketing function by acting as market intermediaries — that is, offering growers forward contracts and laying off risk against the AWB's basis pool contract (and assuming a risk on the basis). This was a particularly valuable function for individual growers who were unable to enter AWB basis pools because of the minimum delivery of 952 tonnes or production risks. It might even be seen as discrimination against smaller growers and the trade. By limiting traders' participation to 20 000 tonnes, the AWB has effectively limited potential competitors from offering a range of farmer-friendly pricing instruments. In July 2000 the basis pool for the season was closed.

Growers are penalised by selling in the domestic market

Growers who sell in the domestic market can be penalised by receiving prices that are below export parity.

The AWB mostly sets a conservative estimated pool return early in the season. This is not unreasonable given the complex factors that pool managers must take into account in deriving the estimate. But it has undesirable consequences for many growers.

Under normal circumstances the AWB's estimated pool return becomes a de-facto benchmark price against which all other buyers and traders in the domestic market take their pricing cue. Buyers have no choice. Buyers need to at least match the pool estimate otherwise growers will sell to the pool. Cash sales may be at a discount to the pool estimate, reflecting the risks taken by the buyer who has to subsequently sell the grain and the preference by the grower for certain payment now at a somewhat lower price rather than uncertain payment later at a somewhat higher price.

Furthermore, since feed wheat tends to be the benchmark against which other feed grains are priced, other feed grains are also sold domestically at a discount to international prices. It is only in times of short supply during drought or late in the season, when the AWB holds practically all the stocks and can 'call the shots' from its monopoly position, that domestic prices are above international parity prices. This occurred during the drought in the mid-1990s when domestic feed wheat prices rose well above import parity prices, reflecting the combination of AWB's monopoly and the restrictions on imports.

In short, when the AWB holds its estimated pool return below international price parity, all Australian cash prices are likely to be below international parity prices. In effect, the AWB is manipulating the basis and thereby adding to the risk of those using basis contracts. This also adversely influences the performance of several new generation forward pricing contracts available through Grainco, South Australian Cooperative Bulk Handlers, Farmarco, Goodman Fielder and others. These contracts offer growers the opportunity to use forward prices for wheat by separately booking currency, futures and basis against Chicago futures. It is the last of these that is adversely affected by the AWB's effective manipulation of domestic prices.

In the absence of the 'single desk', Australian growers would stand a far better chance of a reliable basis against Chicago and, hence, international parity wheat prices.

The management of the different pools can also distort prices to growers in less obvious ways. Under current arrangements it is possible for growers of ASW wheat to get a better net return than that received by growers of the superior grade APW wheat because of differences in the timing of sales and in interest rate charges. If, for example, ASW wheat were sold quickly and paid for in the first half of the year when interest rates were low the net return to growers might be better than for APW wheat sold mostly in the second half of the year when extra storage and finance charges were incurred.

The 'single desk' inhibits an Australian wheat futures market

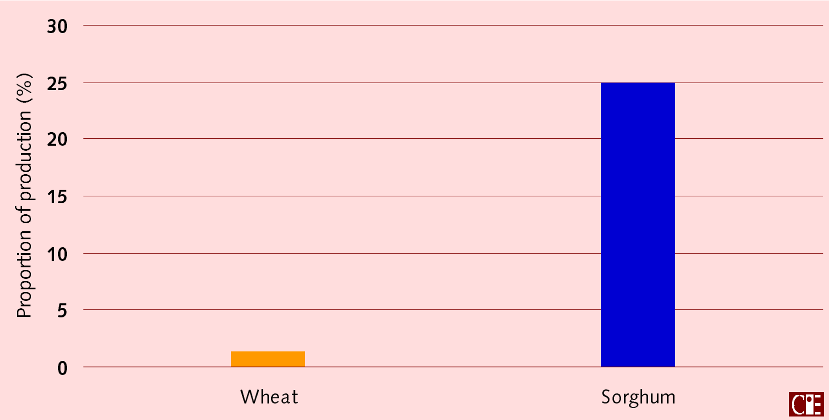
A successful wheat futures market in Australia would greatly assist growers to better manage their risk more conveniently. Successful futures markets have several prerequisite conditions. These include:

- multiple buyers and sellers, including players interested in hedging, arbitrage and speculation — a balance of these players being essential and the more participants, the greater the liquidity of the futures market;
- price volatility, which attracts speculators and arbitrage players;
- price transparency;
- enforceable trade contracts;
- a significant underlying physical or cash market;
- a minimum of government intervention; and
- access to reliable information.

Nearly all of these conditions are violated in Australia, largely because of the existence of the 'single desk'. For example, the domination of prices by the pool estimates has tended to dampen price movements. And the wheat futures contract on the Sydney Futures Exchange has relatively low liquidity and is likely to always be limited while the 'single desk' is in place.

Chart 5.2 shows dramatically the influence of a monopoly in dampening activity in futures trading. For the regulated wheat market the volume of wheat in futures contracts traded in the past 12 months represented only 1.3 per cent of total production. In the deregulated sorghum market the volume traded in the recently introduced sorghum futures contracts, if extrapolated over 12 months, would be equivalent to 25 per cent of production.

5.2 Tonnage in futures contracts as a proportion of total annual production



Data source: M Willett, Sydney Futures Exchange, pers. comm., 13 July 2000.

Growers pay higher costs

Many wheat growers delivering to the national pool may not realise the extent to which they are now paying higher marketing costs following privatisation of the AWB. Take financing costs, for example. Previously growers received the benefits of the AWB's high credit rating in the form of relatively low financing costs for first advance payments. But now growers appear to pay more than the commercial interest rate for their financing loans on harvest payments. As already noted, they are currently (July 2000) charged 8.75 per cent whereas AWB Treasury is probably borrowing the money on its high credit rating at around 6.5 per cent. The margin ends up as profit for the AWB and dividends to shareholders, again emphasising the conflict of interest between shareholders and those delivering to the pools.

Over time there will be a growing divergence between growers as deliverers to the pool and growers as shareholders. Based on the experiences with privatisations of statutory authorities, larger growers will tend to accumulate proportionately larger numbers of B-class shares, and small growers with limited liquidity will tend to sell their shares. Ironically, the main support base of the AWB — growers with small to medium sized properties — are the group most likely to be adversely affected by these trends, as B-class shares become concentrated among fewer, but larger, growers. The former group will increasingly lose out in higher costs but increasingly these costs will not be offset by dividends on shares.

Financing costs are only one example of the high costs faced by growers. AWB operating costs are also unusually high, as the GCA (1995) study discovered. In the year ended 30 September 1999 the AWB's consolidated operating expenses were $68.2 million, equivalent to $3 a tonne. The underwriting fee is also significant, although voluntary.

The Independent Review Committee will need to investigate the marketing costs of growers delivering to the national wheat pool and relate them to what would apply under a competitive marketing system.

6 The wheat 'industry' — much more than growing

AUSTRALIA'S WHEAT MARKETING ARRANGEMENTS have effects that extend well beyond wheat growing — a rather obvious point but a point that needs to be made, particularly in the context of an NCP review. Past assessments and even the terms of reference for a major consultancy advertised in connection with this review focused on only the effects on the wheat industry. For example, the Milling Wheat Project report made scant reference to domestic activities using wheat.

While the list of activities indirectly involved is very long and would include producers of other grains and other users of land, for the purposes of discussion here the following activities are considered:

- firms that purchase wheat, such as:
  - intensive livestock producers of lot-fed beef, pigs, eggs, broilers and dairy products
  - flour millers, food processors, and livestock feed compounders
  - aid agencies purchasing wheat for foreign aid.
- firms that provide or could provide marketing and production support services to wheat producers and consumers of wheat:
  - commodity traders, commission agents and brokers
  - cleaners, graders and accumulators including container trade services
  - transport firms and storage and handling firms
  - providers of financial services
  - providers of risk management services
  - seed breeders
  - fertiliser companies.
- firms exporting wheat in containers.

Intensive livestock industries

For users of wheat in the intensive livestock industries two kinds of impact may be identified — direct purchase price effects and second-round risk management effects.

Price effects

When a single seller attempts to differentiate prices between markets, domestic users face three possible outcomes relative to the outcome of a competitive market.

- If imports are controlled and the domestic market is regulated, prices in the domestic market are set relatively high, thereby discriminating against domestic consumers.
- If the domestic market is deregulated and the price of wheat sold in export markets is raised through the use of market power, domestic buyers must pay a higher price to bid grain away from the export markets.
- If the single seller has no real market power in either the domestic market or international markets, the price paid by domestic users would depend on seasons and interactions in the market.

The NCP review will need to assess the domestic price effects of the last two of these possible outcomes. If the proponents of 'single desk' marketing claim that market power raises pool prices they will need to justify the equivalent price raising impacts on domestic users.

However, as discussed in earlier chapters it is unlikely that it will be possible to demonstrate the existence of market power. Therefore, to assess the price effects on domestic users it is necessary to look at what happens in the interaction between the international and domestic markets.

As already noted in chapter 5, domestic prices tend to be benchmarked against the estimated pool return, which at harvest or before is typically below the world price. This means that, to secure wheat, domestic users need to match a conservatively estimated pool price adjusted to the farm gate. In normal seasons, therefore, domestic users buying grain around harvest time may pay a lower price for wheat than they would in a deregulated system where growers would have a greater choice of buyers for all their wheat.

However, users say that any advantage to them is more apparent than real. This is because it is difficult for them to lock in a price and manage risks, so that initially lower prices in these circumstances translate into higher grain costs for them.

To understand how low prices for growers end up as high costs for domestic users it is necessary to consider risk management effects.

Second-round risk management effects

Intensive livestock industries face strong international competition as they compete with overseas suppliers who have year-round access to grain at international prices.

Even if they are able to secure an initial benefit of accessing wheat at less than international prices at harvest time any such advantage is lost as a result of the following factors.

- Australian intensive livestock producers do not have access to grain imports unless they are denatured — which is costly.
- Locking in prices through the year is made more difficult by the influences of the 'single desk'.
- The provision of risk management services including the purchase and storage of grain is inhibited partly because, to provide full services, traders and people willing to assume risk would need unrestricted access to the international market. For example, people holding grain need to have options for quitting inventory. But under current circumstances they have to sell into the national pool. The AWB has a competitive advantage over private traders because it can export wheat whereas other traders cannot.
- Part of the services AWB (International) offers in the Japanese market involves guarantee of supply so that, in times of production shortfall, domestic users need to compete with such international markets. The statutory obligation to meet domestic users' needs no longer applies. And at such times the pool is virtually the only source of supply. This is when the 'single desk' monopoly comes into play in raising prices on the domestic market.

Some estimated impacts on intensive livestock industries

Studies of the chicken meat industry show that despite a high level of technical efficiency the industry is at a significant competitive disadvantage (INSTATE Pty Ltd and S G Heilbron Pty Ltd 1997). Benchmarked against the US industry, Australian producers have a cost disability of 27 per cent of total production costs. Nearly 40 per cent of the difference between US and Australian production costs is attributed to higher feed costs. Part of this was attributed to the effects of 'single desk' selling, especially late in the season and in times of short supply. The Australian cooked chicken meat market, for example, now faces competition from the United States and Thailand. The Australian Chicken Meat Federation has estimated that Australian chicken meat producers will initially lose some 5 per cent of the domestic market because their costs of production are higher than the costs of these competitors.

In a study of the impact of grain import restrictions through the drought in 1994-95 in the context of a 'single desk' the CIE (1997a) study concluded the following.

- Higher feed costs over the period dramatically reduced the profitability of lot feeding, causing lot feeders to curtail their production. Between June 1994 and February 1995 the number of cattle on feed in Queensland fell by 65 per cent.
- Estimates suggest a reduction in value added from the lot fed beef industry of $27 million between October 1994 and May 1995, which can be directly attributed to the ban on imports under protocol 3.

It was shown that domestic prices for part of the period went well above import parity prices due to the combination of 'single desk' monopoly behaviour on the domestic market and the restrictions on grain imports.

In normal years, prices in export markets and the domestic market are largely in tune, as shown in the top half of chart 6.1. But in a year of short supply, satisfying long term arrangements comes at a cost to users in the domestic market, as shown in the lower half of chart 6.1. Ironically, buyers in the key competitor markets would have other options for sourcing their grain as they can import from a wide range of sources, whereas Australian users cannot.

These results refer to the cost of the restrictions on grain imports. For purposes of the NCP review the import restrictions are given and the question needing an answer is: what are the costs of restricting the risk management practices of beef producers and lot feeders, including their management of storage and hedging? As a guide the Stockfeed Manufacturers' Association of Australia (pers. comm., 18 July 1997) has estimated that:

> … the inability in Australia to tap into world price movements combined with carry costs imposed by the need for major harvest buying in November and December, add an estimated $7.50 a tonne to the cost of barley procurement versus overseas competition.

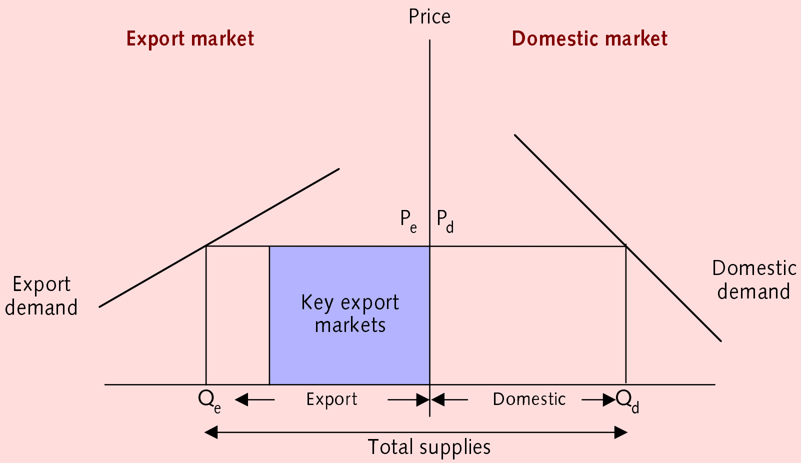
Pig meat production is highly sensitive to grain prices. For example, it has been estimated using the AUSPIG model that a 40 per cent increase in domestic wheat prices would have a proportionately greater impact on profitability — reducing it by half (Black 2000). Such a price rise occurred in the 1994-95 drought and, in the seven months to July 1995, 1100 producers left the industry.

Millers and stockfeed mixers

Manufacturing processors of wheat can sometimes source their wheat at a good price. But as noted earlier, when firms do not face international prices, they make inefficient decisions. When wheat growers' prices are held down (because growers are effectively taxed by existing arrangements), wheat growing is discouraged and, if processors are paying too little (because they are effectively subsidised), processing is encouraged.

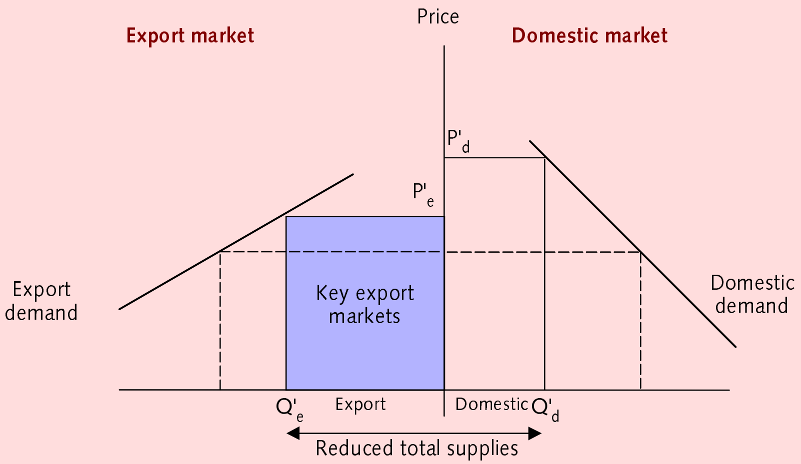
6.1 A simple illustration of how domestic grain prices move when export sales to key markets are maintained in a dry season

Case A: A normal year



In a normal year, other things being equal, the domestic price will be similar to the export price.

Case B: A drought year



In a drought year, export unit returns rise but domestic prices can be substantially increased by diverting supplies from the domestic market to maintain export supplies to key markets. This is the monopolist at work.

Source: CIE (1997b, p. 58).

Aid agencies

Other domestic buyers of wheat include the Australian government through the Australian Agency for International Development (AusAID). Box 6.2 contains a discussion of how AusAID fares with the 'single desk'.

6.2 Wheat sales for foreign aid — a possible case of market power

AusAID currently uses a pricing mechanism based on the AWB's daily card prices for a given month when purchasing its wheat requirements. This mechanism enables AusAID to price its wheat purchases after examining the market trends for a given month, with the added advantage of being able to select 'the lowest daily price card' in that given month rather than the monthly average. The AWB also continues to provide AusAID with a rebate of A$10.00 for each tonne of wheat purchased above 200 000 tonnes in a given financial year.

Card prices are publicly quoted offer prices of the AWB and are equivalent to Chicago futures prices in US dollars adjusted for quality, freight differences and exchange rates. Like any offer prices, card prices are usually higher than the prices at which the AWB makes export sales. The AWB receives card prices for sales to only a few overseas markets. All other sales involve a discount from the quoted card prices and in several cases the discount is substantial.

If AusAID were free to purchase from other suppliers of wheat it would probably be able to source its requirements at a lower price. And if the AWB had to sell its wheat in some other market those sales would be at a lower price.

Does this mean that judicious use is being made of market power for wheat growers at the expense of Australian taxpayers and aid recipients? The answer is that it is not clear. Just as is the case with other claims of market power, it is difficult to sort out the extent to which any price premium reflects a 'hidden' subsidy to Australian farmers or the extent to which the premium is a payment for extra quality and services, including low purchase transaction costs, which AusAID may require.

Industries servicing producers and consumers

The wheat marketing arrangements also affect firms that do or could supply trading services. Such firms might be trading houses, pastoral houses, or agri-businesses able to deliver various combinations of services to wheat producers and their customers.

Although the domestic market is now deregulated, the firms undertaking these activities remain stifled because the AWB's monopoly denies them access to international trading. No one can say whether removing this barrier would see the emergence of many small niche firms or the evolution of large world-class Australian businesses. Equally, no one can say what synergies in marketing would be discovered — for example, combining fertiliser distribution with grain transport, or machinery purchase with banking services and crop financing. What seems certain though is that, with wheat out of the agribusiness chain of services, efficiencies derived from supplying a wide range of services covering a wide range of farming activities are artificially retarded.

What can also be said though is that a search for the best way of delivering marketing services, which is driven by competition among many existing and potential providers of those services, is more likely to deliver both growers and users a better set of services than that emerging from a monopoly provider that:

- pays only after selling the product
- pays only after deducting its costs
- settles those costs on a cost-plus basis
- denies transparency of costs on 'commercial-in-confidence grounds'
- assumes ownership of growers' wheat without committing to a price level.

The Independent Review Committee is likely to receive submissions that argue that farmers are better off having a monopoly provider of marketing services to take their wheat and deliver it to international customers. These submissions will portray the people and firms who might offer producers and consumers choice in marketing services in pejorative terms as 'middlemen who subtract value at the expense of grower returns'. Such views do not seem to fit the facts. In virtually all other parts of the economy, choice and competition in the delivery of such services opens the 'arteries' between producers and consumers. The reason is simple — if service providers do not deliver they do not get hired.

That people who enjoy and benefit from such competition and freedom of choice in almost every other aspect of their lives apparently want to close it off when it comes to marketing their wheat is a real policy puzzle.

One of the challenges for the Independent Review Committee will be to determine if such views are correct. Box 6.3 canvasses some explanations of this puzzle.

6.3 Competition and choice in marketing services

Why is it that Australian wheat producers, who as much as anyone else shop around for a good price when they purchase their headers, tractors, fertilisers and the like, are reported to be so keen on restricting their own choice and that of their fellow growers when it comes to purchasing wheat marketing services?

Several explanations come to mind. One is that marketing wheat is a simple process that involves the marketer or trader taking a cut of grower profits and doing not much else. This contrasts with an appreciation of the infinite number of things that can be done to enhance the value of the product. Identifying what consumers want, matching that with what wheat breeders can produce and transmitting that information to growers is an economic activity that requires resources, skills, time and risk taking. So do all the stages of marketing from elevation at the silo through to transport, storage, processing and exchange of title.

Just as competition provides an effective, silent, comprehensive information processing system that gets our homes built and our grocery stores stocked competition would do the same for discovering the best possible way of taking wheat from grower to the end market. People identifying niche markets for, say, noodle or durum wheat would be free to explore these markets — bearing the risks and earning the returns.

Another explanation is that the growers' attachment to the monopoly provider of marketing services is overstated. While it is true that some surveys of growers indicate that the majority of them say they are attached to the monopoly seller, when given a chance the same people opt for choice quickly enough. For example, the deregulation of domestic wheat marketing happened smoothly and people now like it very much. Similarly the basis pool now offered by the AWB, which allows both growers and traders to take some of their own risk management decisions, has been taken up so readily that limits now apply.

Another explanation is that growers like a system where, if they are to be hamstrung in how they do their marketing, at least they are all hamstrung in the same way. If this explanation were sensible, growers would press for a monopoly seller of one tonne utes, headers and farm silos, for example. But with deregulation they could still choose to go though the AWB. So why should they be concerned if their neighbours choose not to?

A final explanation is that the restriction improves profits. But, as this report shows, the impact on total returns is ambiguous at best while the impact on those costs that can be measured is definitely negative. Given that a large certain increase in costs is bound to outweigh any small, uncertain increase in revenue, this explanation makes no sense either.

The container wheat trade — market discovery and innovation

In the early 1990s traders identified opportunities for an export trade in wheat in containers. At the time the AWB took a benign view of the activity. Volumes being traded then were small and it was not interested in undertaking the trade itself but saw no reason to interfere with the people that were. The trade required detailed management and supervision by the firms doing it. The AWB released facilitative guidelines. Japan was not allowed as a destination and, while a permit from the AWB was technically required, in practice permits were granted automatically. A rapid increase in the container business occurred, encouraged by a drop in container freight rates during the Asian financial crisis. It turns out that, in some markets with shallow ports and undeveloped handling and storage facilities, containers are an efficient and a just-in-time way of doing business. Specialists in the container trade emerged and they invested in regional accumulation, cleaning and grading facilities — adding to the economic activities in some regions.

People in the container wheat trade say that, when the AWB was privatised and the WEA was charged with supervising the container trade, the facilitative business environment seemed to turned into an obstructive one blocked by red tape and export permits. Before the WEA issues permits it must now consult with AWB (International). The demands for information have escalated and made it difficult for traders to close off on deals as in many cases by the time a permit is granted the buyer has turned to a competing supplier.

The Issues Paper contends that the difficulties surrounding container trade permits have escalated significantly since the WEA was formed. However, a comparison of permit issue rates before and after the WEA became involved needs to be carefully qualified as the issue of permits used to be taken for granted to the point that exports quite often happened without a formal permit.

It is difficult to see how this turn of events has improved the lot of wheat growers and the rural centres where investment in this value adding activity was occurring.

7 Environmental, regional and social issues

IF THE COMMERCIAL ARGUMENTS for a 'single desk' do not stand up, the question arises as to whether there are any other social or strategic reasons for continuing the current wheat marketing arrangements. The Issues Paper invited comment on the following questions.

- Does having a 'single desk' help the rural environment?
- Does the grower-owned 'single desk' seller provide support for rural communities?
- Without the 'single desk' would there be increased competition between growers that would lead to social problems such as rivalry, mistrust and community breakdown?

Environmental considerations

Would dismantling the private monopoly marketer of Australian bulk export wheat threaten the environment? Or, to put it another way, would its retention help the environment? On the evidence available, the answer to both questions appears to be 'no'.

Indeed, as explained in the preceding chapters, the evidence is that the arrangements are inhibiting investment in environmentally sound farming practices. Because growers are unable to lock in prices for at least one or two years, they have difficulty in borrowing to invest in, for example, drainage systems, tree planting and crop rotations needed to support environmentally sustainable, long term farming systems.

Cotton production is a case where the potential for environmental damage is inherently much greater than in the case of wheat, if for no other reasons than the intensive use of water and chemicals in its production. Yet no one would suggest that centralised monopoly export arrangements for cotton would be a way of overcoming such concerns. Instead the problems are being tackled at the source by way of improved water allocation systems, education, direct regulation of chemical use, the use of genetically engineered insect-resistant cotton varieties and, above all, a marketing system that lets farmers lock in product and input prices.

Thus dismantling the current wheat marketing arrangements would arm wheat growers — and the people they deal with — with information and power to more efficiently tackle environmental problems and invest in remedial measures. Certainly if the arrangements did not exist, it is difficult to think of an argument that could be mounted for introducing them on environmental grounds.

Rural community considerations

Would rural communities be hurt if wheat producers were allowed to decide for themselves how to sell their export wheat?

The answer is that moving to a decentralised marketing system can only enhance regional development and hence rural communities. Such a system would:

– shift power and responsibility from the city centre closer to producers;
– give wheat users access to trading options that allow them to lock in prices;
– allow growers to lock in prices and improve their returns; and
– allow new players such as pastoral houses, finance companies, agri-businesses and fertiliser companies to take advantage of synergies in service delivery.

While concerns have been raised in relation to NCP in general, a review of the impact of competition policy on regional Australia by the Productivity Commission (1999) attributed these concerns to four factors.

- Rural Australia and regional Australia are facing pressures for change from several sources, including technological change and the trend to larger farms, and commentators have confused these pressures with NCP outcomes.
- The positive effects of the growth of larger regional centres tend to be noticed less than the negative effects of closures and contractions in smaller centres.
- There is a tendency for some local governments to make NCP a scapegoat for unpopular local decisions.
- People tend to focus on identifiable and proximate effects and to not appreciate the broader benefits across the economy.

While it is difficult to say exactly what would happen to rural communities if growers were able to choose how they exported their wheat, there is every reason to presume that regions would benefit. Other providers of the services that wheat growers require would emerge. Pastoral houses would be able to achieve economies in banking and marketing services, as would fertiliser and seed suppliers. Wheat growers and the regions they come from are being artificially kept out of a full agribusiness circle and the efficiencies it offers. For example, a fertiliser company is more likely to be stuck with an empty truck after delivering fertiliser. And a pastoral house providing seasonal finance is discouraged by its inability to take a lien on the crop and by the fact that the AWB offers financial services backed by the 'single desk' monopoly. This is not competitive neutrality. In such examples and thousands like them the range of services such firms can offer is unnecessarily reduced so that their presence in rural towns is smaller than need be.

The success of smaller cooperative marketing groups that draw together growers with similar needs and interest indicates that local firms do succeed. Walgett Special One Coop is an example of a regional grower organisation. It directly employs six people. It has seen a growth in services in the town as a result of the growth in cropping activities. The growth in cropping has occurred partly as a result of the increased confidence of growers in dealing with a regional organisation. Such regional groups are users of professional services in their local areas.

Rural people in Australia are going through a period of considerable change and adjustment. They deserve facts and analysis, not scare tactics. The existing wheat marketing arrangements are impeding investment by farmers, financial service providers and users of wheat, which could provide a boost for rural communities. While the above arguments have not been proved, there is no evidence at all that maintaining the arrangements helps rural communities.

Implications for social problems

The Issues Paper (p. 8) asks whether there is 'evidence to suggest or can it be demonstrated that increased competition between wheat growers to market wheat without a single desk could lead to social problems such as rivalry, mistrust and community breakdown'. To the extent that there is evidence on such matters it is that liberating people so they have greater choice and freedom enhances social and economic cooperation.

- Existing arrangements that mandate identical treatment of people who are not identical necessarily means unequal and unfair outcomes.
- With competition in the supply of export marketing services the people who want to pool still could but a source of tension would be removed in that those who do not want to be part of the pool would not have to be.

- Traders and larger growers now have limited access to the basis pool, which lets them manage their own risks. This access is denied to smaller growers on arbitrary grounds. This seems unfair.
- Decisions such as the size of the harvest payment, the number of wheat segregations, and when to close the pool have the capacity to influence returns in different ways for different growers in different regions and these decisions are determined as much by political as commercial considerations.

Unlike in most other industries — for example, wine, cotton, wool, beef and horticulture — where competition and freedom quickly and without favour sort matters out, in the wheat industry, policies and the associated transfer of commercial power from individual farmers to elected officials seem more likely to engender mistrust and unproductive rivalry than to reduce it.

The best way to nurture wheat growers, their families and their communities would be to have an environment in which they can make a reasonably good income. In this respect, what would be good financially would also be good socially.

8 The net public benefit test

THE BENEFITS AND COSTS imposed on the *community* by the restrictions on competition in the Wheat Marketing Act need to be evaluated and brought together in a *net public benefit test*. For the restrictions to remain, this test must produce a significant positive result.

Around the time of the closing date for submissions to the NCP review, a paper titled *Methodology to be Employed in Evaluating Economic Impacts of the WMA* (Piggott and Edwards 2000) was released by the Independent Review Committee. The status of this paper is unclear. Is it a discussion paper or does it bind the contracted consultants assisting the committee to the particular methodology suggested?

The authors of the paper suggest that, as a starting point, the contracted consultants should become familiar with the literature on Australian wheat marketing and 'single desk' selling, and a 'starting list' of references is provided. The Milling Wheat Project report (GCA 1995), which was the outcome of a consultancy valued at over $1 million and which reviewed in detail Australia's milling wheat industry, should be added to the reference list.

The paper suggests four approaches to evaluating the impacts of the Act.

- a 'first principles' approach
- an 'interviewing of market participants' approach
- a case study approach
- an empirical approach.

First principles approach

The methodology paper says:

> Economic theory can be drawn upon in a 'first principles' approach to evaluating a number of potential economic impacts of the WMA. (Piggott and Edwards 2000, p. 4)

This is commendable, but the discussion fails to come to grips with the crux of what must be demonstrated in a public benefit test and with several important issues that have been discussed in this submission.

For the Wheat Marketing Act to pass the net public benefit test, it must be demonstrated that the benefits of maintaining the monopoly on bulk wheat exports outweigh the costs from a community viewpoint. The 'base line' must always be an assessment of what would prevail under a competitive marketing system.

On the benefits side, it must at least be shown that the *average export price and total export revenue* are consistently higher under 'single desk' selling than under competitive marketing. The only credible way for a 'single desk' seller to achieve this is to price discriminate between its markets. This is *not* the same as 'pricing to market' whereby price differences between some markets are observed in some statistical tests. As demonstrated in chapter 3 (chart 3.7), under 'single desk' selling it is possible to observe different prices in different markets ('price premiums' relative to the low price market) but for the monopoly export marketer of Australian wheat to earn a lower average export price relative to the price that could be achieved in a competitive market. This result is net of any differences due to quality, distance, timing of sale, credit and other factors.

From first principles it must also be recognised that the 'single desk' seller will not have perfect information about market characteristics and this must be taken into account in any analysis. If the single desk seller does not have perfect information it will sometimes make wrong decisions, the outcomes of which need to be considered.

Any higher prices on the domestic market as a result of price discrimination will not be counted as a benefit to growers. Such a benefit is no more than a transfer payment to growers from domestic wheat buyers — there is no net public benefit. Indeed there is more likely to be a net community cost because of distortions in how resources are allocated — caused by domestic market participants, including growers, not being able to respond to the world price (see also Houck 1986, p. 115).

On the costs side, the following factors will need to be taken into account, all of which have been discussed in depth in this submission:

- the additional storage, handling and transport costs (see chapter 4) associated with 'single desk' selling;
- the additional costs to growers (chapter 5); and
- the additional costs imposed on other players in the domestic market (chapter 6).

The methodology paper is silent on how most of these can be evaluated.

Even if a 'single desk' seller is successful in raising the average export return, the *margin* above the average return under competitive marketing must be very substantial if a net public benefit is to be demonstrated because of the cost factors noted above. This margin has to be substantial to demonstrate even a net benefit to growers.

Interviewing market participants

The contracted consultants would be expected to adopt this approach as a matter of course. The methodology paper lists overseas buyers of wheat, grain traders in Australia and wheat using industries as stakeholders. But other groups should be added to this list, such as those discussed in chapter 6. Obvious omissions are:

- grower groups, such as the PGA of WA Inc, which do not support the 'single desk' — the PGA accounts for about a third of all wheat produced in Western Australia;
- bulk handling and transport organisations and other service providers;
- value adders and niche marketing groups who are frustrated by the current arrangements, such as noodle wheat growers and durum wheat growers, small seed cleaners and exporters; and
- those providing other services, particularly risk management services, to the wheat industry, including the Sydney Futures Exchange.

Case study approach

The methodology paper suggests that some importing countries in which it is claimed that a price premium is earned by virtue of the 'single desk' be studied intensively so that the 'nitty gritty' of how any premium is achieved can be explained. Japan is suggested as a useful case study.

This approach, if done properly, may provide some interesting information but it does not address the core issue noted earlier — whether 'single desk' selling raises the *average export return* above what competitive marketing would achieve. It also raises other important questions.

- How will the price premium be measured? Will it be measured on the basis of landed prices (c&f) in the importing country? Will it be measured relative to other exporters' landed prices or relative to c&f prices in other Australian markets? Which markets will be chosen and on what basis will they be chosen? Or will the price premium be measured on a fob basis — relative to what?
- What methodology will be used to assess the effects of quality differences and extra costs involved in servicing the particular markets chosen, such as extra storage costs and credit provision?

- How will exchange rate effects and differential freight rates be taken into account in the case studies?
- What will the case studies really show?

As noted on several occasions in this submission, even if a 'single desk' price premium could be demonstrated in one or two case study markets, this does *not* mean that the monopoly marketing system is achieving a higher *average* export return than a competitive marketing system would realise.

Empirical approach

The methodology paper notes the difficulties involved in undertaking empirical work on the issue of 'single desk' selling but advocates an approach based on the so-called 'pricing to market' methodology (Carter 1993; Knetter 1989; Krugman 1987).

This methodology, used by Carter to examine the price discriminating possibilities for the Canadian Wheat Board in selling barley internationally, assumes that, in a competitive market, export prices (fob) received from all markets should be the same and there should be no exchange rate effects. In contrast, if a 'single desk' seller was practicing price discrimination, the statistical analysis should show positive country effects (different prices received from different markets) and/or positive exchange rate effects (the single seller captures beneficial exchange rate changes).

This approach, of course, assumes a homogeneous commodity. But the methodology paper is silent on how the raw sales data from the AWB could be adjusted for quality differences (there are numerous grades of wheat), differences in credit provision or other services, and changes in freight rates. It is important that, whatever methodology is used, it is capable of distinguishing between 'single desk' price premiums and those due to other factors.

Again, the results from 'pricing to market' tests may be interesting but they will not throw light on the fundamental question: 'by maintaining a monopoly on exports of bulk wheat, is Australia achieving a higher *average* export return, compared with a competitive market given uncertain information'? At best, the Carter methodology can be used to examine the extent of price differences between markets. But differences alone give no confirmation about the costs and benefits of 'single desk' selling.

An empirical methodology for testing for net benefits, given price differences between markets (including the domestic market), was developed in the NCP review of the Victorian and South Australian 1993 Barley Marketing Acts (CIE 1997b). As already mentioned, the President of the National

Competition Council commented that this approach 'represents a benchmark for the conduct of SMA reviews' (Samuel 1998). The methodology used in that study could be applied to Australian wheat, in addition to the other suggested approaches.

From the many studies that have examined the potential for 'single desk' sellers to earn higher export returns than generated in a competitive marketing system, the overall message is that the results have been inconclusive. At best, some empirical results have shown small positive 'price premiums' (GCA 1995; MacAulay and Richards 1997), but most studies have produced results that have shown either no impact (Carter 1993) or a lower average export return from 'single desk' selling (CIE 1997b).

Very few studies have examined in detail the additional costs associated with 'single desk' selling that are borne by growers and other groups within Australia. From the discussion in chapters 4, 5 and 6, the additional costs — particularly for moving grain from paddock to vessel — are large.

The Independent Review Committee will need to carefully consider the methodologies to be used in this NCP wheat review to ensure that those chosen are capable of addressing *all* elements of the net public benefit test.

9 Alternative arrangements

AN NCP REVIEW REQUIRES consideration and reporting on alternative arrangements. In this case the arrangements are those that would achieve the objective of an efficient wheat marketing system. The central restriction of the existing arrangements is the monopoly on how growers can export their wheat. Less restrictive arrangements might serve as a means of testing the need for the restriction and as a transition to growers choosing their own arrangements. But just as important are the regulatory arrangements that need to be in place for a competitive trading system to operate effectively.

Appropriate regulatory arrangements

Until now, this submission has focused on the restriction applying to growers' choice about how they export their wheat. But underpinning this restriction is a web of regulation that would be untenable in an environment where growers had the freedom to manage their own affairs.

As the Issues Paper prepared for the review points out, NCP is not just about removal of unnecessary or harmful restrictions on competition. It is as much about establishing appropriate regulatory frameworks.

The regulatory environment is a determinant of success, as is climate, technology and hard work. It appears that Australia's major competitors, the United States and Canada, have an advantage in that the regulatory environments in these countries exhibit many desirable characteristics.

For example, Canada's Grains Commission is separate from the Canadian Wheat Board. The commission is an independent regulator for such things as the approval of varieties, the licensing of elevators, the licensing of traders, the issue of quality certificates and the training of wheat testers. In the United States various levels of government are independently responsible for such matters as the licensing of elevators, the accreditation of grain testers, the provision of mechanisms of dispute settlement, the inspection of ship's holds and weighing certificates.

In Australia, regulatory functions and the information and powers associated with those functions, which formerly belonged with a statutory body, have been changed. In some cases they have been assigned in principle to the

WEA; in other cases they appear to remain with the AWB; and in yet other cases there is a question as to where responsibility lies.

According to the amended Act, the WEA has the power to do all things necessary or convenient to be done for the performance of its functions. However, some sections of the old Wheat Marketing Act — such as section 58, classification, and section 59, quality control — have been repealed. If the legislation is now silent on such matters, is it intended that the AWB administer these functions? Or will WEA assume responsibility? In what circumstances would that happen? Where does the process of appeal lie? Clarification of such matters would seem to be a very important task for the Independent Review Committee.

Commercial and regulatory functions need to be clear and separate

Apart from the conflicts of interest between growers supplying to the pool and AWB shareholders (discussed in chapter 4), there are conflicts of interest between the commercial and regulatory functions of the AWB.

Wheat breeding and the associated registration and commercialisation of varieties are important examples where current commercial and regulatory functions appear to be in conflict.

The increasing demand for wheat types that deliver highly specific processing, colour and taste attributes, as well as technological developments enabling plant breeders to produce varieties with these attributes, has placed a premium on the regulation of these matters. An efficient system would:

- channel information from consumers to both plant breeders and seed companies; and
- allow competition in the testing and development of varieties subject to independent supervision to protect the consumers, the breeders and the holders of plant variety rights.

The AWB's involvement in wheat breeding activity and the commercial development of varieties runs the risk of locking in particular varieties and excluding others that may have commercial value to some.

Because the AWB can endorse varieties and set receival standards for bulk handlers it could give rise to incentives to breed only wheat varieties that fit in with the AWB's receival standards and could discourage the breeding of any other varieties.

Another example of where there is conflict between information that belongs in the public domain and commercial information. It is now increasingly difficult for the AWB to provide full transparency of inherited regulatory activities because to do so would compromise its commercial obligation to shareholders. Thus, whereas the former statutory AWB put a considerable amount of information into the public domain there are inherent difficulties for the privatised consolidated AWB to do that.

Currently Agri Food Technology, a subsidiary of AWB Limited, must test all shipments of wheat and, if an exporter operating as an agent of the AWB chooses to go to an independent tester, an extra cost is incurred. For the supply of export marketing services to work effectively, export inspection services including certification of product for quality standards would need to be made independent and effective.

Regulation should be in terms of a much broader view of the 'wheat industry'

In an appropriate regulatory environment the definition of the 'wheat industry' would be much broader than it is now. It would encompass, for example, all end users, value-adders, service providers, other marketers and exporters, potential entrants as well as growers.

The make-up of the regulator need not be representative and to the extent that it is representative it would have a much broader base. The regulator would be accountable to only the Parliament.

A regulatory body should be independent

There should be no requirement for the regulator to secure AWB (International)'s approval of bulk exports or even to consult on other exports.

As noted in chapter 2, the WEA is required to monitor AWB (International)'s performance in relation to the export of wheat and report on the benefits to growers that result from that performance. This leads to several questions.

- In a situation where so much information previously made public is held to be 'commercial-in-confidence' and there are no benchmarks, how will the WEA assess this performance?
- What sanctions would apply if performance were judged to be unsatisfactory and against what baseline would performance be judged? Is the baseline to be the estimated competitive marketing model? How will this be estimated? If AWB (International)'s performance is judged to provide fewer benefits to growers than the competitive model would, what then? Is it only the performance of AWB (International) that is judged, or are all aspects of the consolidated AWB performance that relate to the 'single desk' in the equation?

- If AWB (International), as the holder of the monopoly right, were judged to deliver a poor performance, what would be the grounds for expecting another private firm to perform any better as the holder of the monopoly?

These questions will need to be answered by the Independent Review Committee. The Wheat Marking Act is ambiguous on these questions although a supplementary explanatory memorandum seems to imply that the WEA review in 2004 should address the question of whether AWB (International) should continue to have special export rights.

Findings

The following statements of principle emerge from this examination of appropriate regulatory arrangements.

- Regulation should be in terms of a much broader view of the 'wheat industry'.
- Regulatory powers need to be kept separate from commercial powers.
- Firms marketing wheat should not face conflicts of interest between their clients and their shareholders.
- A regulatory body should be independent. There should be no requirements for the regulator to secure the consent of AWB (International) to approve bulk exports or even to consult on other exports.

Alternative marketing arrangements

Alternatives to the current wheat marketing arrangements include:

- allocating some markets to AWB (International) and allowing private traders and their wheat grower clients access to the rest;
- establishing an independent licensing authority (perhaps the WEA) to sell (by auction or tender) permits to export specific quantities to specific markets where Australia may have a special position;
- maintaining the export monopoly from vessel (fob) to the international market but allowing competition from farm to vessel (fob); or
- establishing a competitive market for the export of Australian wheat.

Allocate some markets to the AWB

Under this alternative AWB (International) would maintain control of, say, those markets where its marketing position is strongest and where the 'single desk' has some market power. Arguments that might be raised in favour of these arrangements follow.

- It would satisfy concerns that competitive selling would erode prices on markets where the AWB has market power.
- It would allow growers and traders access to other markets.
- It would allow international buyers in those standard markets direct access to Australian sellers.
- A benchmark for evaluating marketing performance and costs would be established.

Arguments that might be raised against these arrangements follow.

- AWB (International) would have difficulty in guaranteeing supply at existing prices as it would no longer have captive suppliers. But if it were extracting a market power premium from those markets its ability to pay higher prices to growers would assure it of supplies.
- Wheat allegedly destined for another market could find its way into the designated preferred market. The question arises as to why that does not happen now. One explanation in the case of Japan is that Japanese buyers consider that, allowing for security of supply, size of shipments and so forth, they get a good deal from AWB (International).

Establish an independent licensing authority

Under this alternative an independent agency would sell permits to export to those markets that it considers to warrant controlled supply. The permits could be sold by auction or by tender to competing marketers including traders, the AWB and independent grower groups, with the revenue from permit sales going to the growers.

Arguments that might be raised in favour of these arrangements follow.

- It would maintain any benefits of market power for particular markets.
- Competition in export marketing services would ensure lowest cost structures and provide a benchmark for evaluating performance of the permit system.
- Innovation and the search for niche markets would be encouraged.
- Information would be discovered through the level of bids for different markets.
- Sales to markets where Australia has no market power could proceed freely.
- The true commercial values of the permits (and with that the extent of any market power) would quickly be made transparent.

Arguments that might be raised against these arrangements follow.

- It would be bureaucratic and would require the independent agency to possess a degree of knowledge about markets that is unrealistic. (The same might be said of existing arrangements.)
- Any advantages of pooling would be lost. (Voluntary pools could still operate, as in the cotton industry.)
- Any mechanism to channel revenue back to growers would be extremely complicated. (The revenues could be channelled to the Grains Research and Development Corporation, which could correspondingly reduce the research levy.)

Allow competition from farm to vessel (fob)

Under this alternative, AWB (International)'s control over export wheat would not begin at the silo but at the loaded vessel (fob). Arguments that might be raised in favour of this option follow.

- Some of the bigger gains from improved efficiency in storage, handling and transport (see chapter 4) would be achieved.
- The processes involved from vessel (fob) to international markets are already subject to extensive competition.
- Growers who wished to stay with AWB (International) could but others could choose to test the market.

Arguments that might be raised against this alternative follow.

- It would be the 'thin edge of the wedge' in breaking down the 'single desk'.
- AWB (International) needs to know what wheat will be forthcoming and when to be able to manage supply to markets (but only a small proportion of markets are quality discerning markets.)
- Domestic market service providers would be reluctant to invest unless they could access the international market.

Establish a competitive market for the export of Australian wheat

This alternative would allow any party to export wheat. It does not mean dismantling the AWB conglomerate. There seems little dispute that, in the international market where it faces intensive competition, it disposes of wheat quite well. So those growers who saw advantages in the pool and the existing system could stay with that system.

Some people might elect to form cooperatives with growers with similar interests, wheat and cost structures. Others might export through agents and yet others might choose to sell to traders who assume ownership and risk. These outcomes would need to occur in an appropriately regulated environment (identified earlier).

9.1 Characteristics of an efficient wheat marketing system and appropriate regulatory system compared with the existing system

Characteristics of ideal marketing system & regulatory system	Rating of existing system	Rating of competitive marketing system & appropriate regulatory system
Regulation would be effective, transparent and at arms length.	There is limited regulation of the monopolist, which as a private company takes on the role of regulation in several high conflict areas.	An efficient, independent regulatory system would encourage fair and efficient competition from wheat breeding to customer.
Decisions would be made on commercial, not political, grounds.	Commercial decisions affecting the returns of growers are influenced by elected office bearers.	Providers of marketing services would be clear and upfront about their objectives to please *their* wheat grower clients.
Product would be delivered from producer to consumer at least possible cost.	The cost-plus nature of the current Australian system leads to higher costs than elsewhere.	Efficient marketing would be best achieved through competition and choice by growers.
Producers and domestic consumers would be responding to international prices at all times.	The pooling system hides international price movements.	Competition in marketing would discover the best prices and quickly and efficiently feed them to growers and consumers.
Producers and consumers would be able to manage risk or shift risk.	The pool manager carries no risk — returns to growers are simply prices received less costs.	Providers of risk management services would compete to provide the best products at the best prices.
Price signals and information discovery would be quickly transmitted through the market to all players.	Pool prices do not reflect all market developments or international price movements.	Through prices and information flows, players would adjust quickly to market developments and technological changes.
Enabling legislation would include effective monitoring and evaluation procedures.	WEA is monitoring the AWB's performance and will evaluate it by 2004. What then? Against what will performance be assessed?	The competitive market would be the most effective and efficient form of performance evaluation. No performance means no trading.
Appropriate appeal procedures would be available.	The only recourse is to the AWB — the problems for aggrieved growers or traders in competition with the AWB are obvious.	Normal commercial procedures would apply.

Arguments that might be raised in favour of these arrangements follow.

- Growers would have choice in how they marketed their wheat.
- The costs of getting wheat to markets would be subject to competition and be unambiguously lower and transparent.
- Returns from the domestic market would be enhanced as farmers, traders, storage companies and users were better able to take positions on the market, secure in the knowledge that they could always quit their wheat.
- All market players, particularly growers, would have complete flexibility to manage their risk and take advantage of periods of high prices in international markets.
- Returns from international markets would be enhanced as consumers would be able to quickly transmit their demands to producers and marketers.
- Returns from international markets would not be put at risk by expecting the single seller to possess unattainable amounts of complex information on demand elasticities across all wheat types and markets at all times.
- With costs down and returns up, incomes would rise.

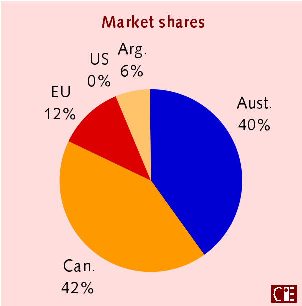
Table 9.1 sets out a stylised, ideal, alternative marketing system and regulatory system, and compares them with the existing system. Arguments against this alternative will, of course, form the basis of submissions to the Independent Review Committee by the proponents of 'single desk' exporting of Australian wheat.

Appendix

Australia's top 10 wheat export markets

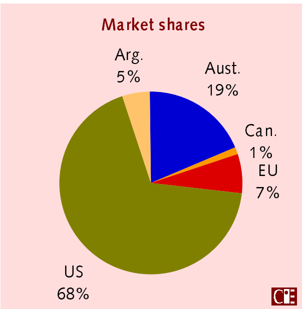
BRIEF ASSESSMENTS of Australia's top ten export markets follow. In these markets, Australia's main competitors are usually the United States, Canada, the European Union and Argentina. Their market shares are five-year averages to 1998-99.

Iran



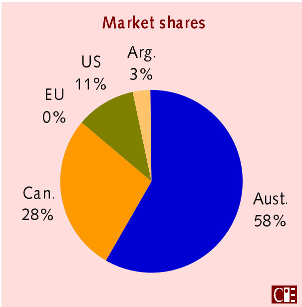
Iran has a central buying agency, the Government Trading Corporation. Iran is a bulk market for standard wheat. It is not a quality-conscious market and is highly competitive. Australia faces strong competition from Canada in this market. Because of politics, the United States is not a supplier but as political tensions ease it could be in the future. Iran has recently bought corn from the United States. In short, Iran looks for the cheapest wheat of standard quality. Australia has some freight advantage to this and other wheat markets in the Middle East and the Gulf.

Egypt



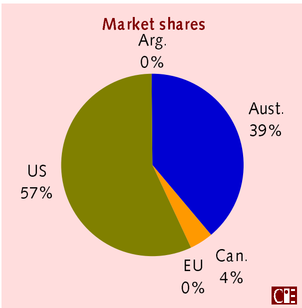
For many years Australia has maintained good relationships with the central buying agency, the General Authority for Supply Commodities, but the market is now partly deregulated and, as this has happened, Australia's share of the authority's total requirements has declined. Egypt has realised that there is a high price to pay for preferable relationships and now sources its wheat more widely and at the cheapest price. It was a credit market under National Interest cover but Egypt now mostly pays cash and Australia's market share has been eroded. The AWB is part owner of the Five Star flour mill, which is used as a conduit to promote the private sector trade. The AWB also trades with the General Authority for Supply Commodities, where it competes with US and EU exporters. Australian wheat (APW and AH) is highly regarded by the private sector but private mills can access this through only the Five Star flour mill. Government wheat purchases are of a somewhat lower grade white wheat and are by tender. Any premiums Australia may get are for quality.

Indonesia



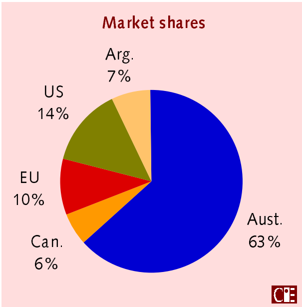
The Indonesian market is rapidly changing. Previously the government procurement agency, BULOG, imported all the wheat and the government-owned flour mill, Bogasari, held about an 80 per cent share of the internal flour market. BULOG, under United Nations direction, has lost its monopoly on imports and the AWB now deals directly with Bogasari. Australia's main competition comes from Canada but Australia has a distinct freight advantage. Competition is increasing and the market is slowly becoming more transparent. Australia ships mainly ASW wheat for noodles and higher quality wheats for a variety of end uses. While Australia does have some competitive edge in this market because of freight and wheat type, any exercise of market power would be quickly countered by Canada or the United States.

Pakistan



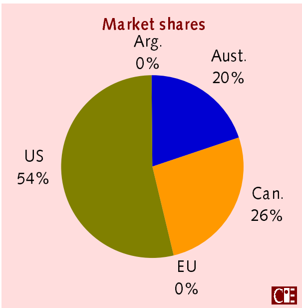
Pakistan imports wheat mainly through the government agency, which purchases in a transparent and open tender system. Private imports have generally been small. These factors negate any possibility of market power. The two major suppliers are Australia and the United States and both supply white wheats — ASW wheat from Australia and soft white wheat from Pacific North West USA. Sales are mostly financed. The United States uses its GSM102 financing program, while the AWB relies on National Interest cover. This is a risky market where in Australia's case the risk is borne by the taxpayer. Previously, the AWB did not offer wheat directly to Pakistan — the wheat was sold (fob) to the trade for this destination. It is only since National Interest cover has been offered that the AWB has traded directly and significant shipments started in only 1996-97.

Iraq



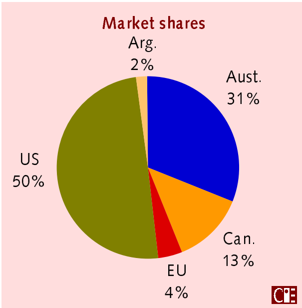
Iraq buys wheat on humanitarian grounds under 'oil for food' sanctions of the United Nations. In some years the United States does not ship any wheat to Iraq. Australia has over a 60 per cent share of this market but, under the circumstances, it is in no position to extract 'single desk' premium prices. Any premiums (c&f) Australia receives would be for the harder type of wheat shipped and for the higher risks involved in doing business with Iraq. Australia's wheat exports to Iraq receive National Interest cover so any risks are borne by Australian taxpayers.

Japan



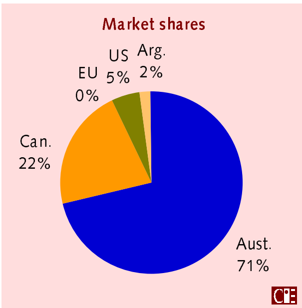
In Japan wheat imports are tightly controlled by the Japanese Food Agency, which has a strong focus on food security. Japan is a high price wheat market because the Japanese Food Agency is prepared to pay high prices to ensure security of supply. Imports have been very stable (at around 6 million tonnes a year), as have the market shares of the major suppliers. Import allocations are not devoid of political influence. All grades of wheat are shipped but, broadly, they are evenly divided between the end uses of noodles and bread flour. There have been some moves by the Japanese Food Agency to introduce greater flexibility in grain purchases. Australia receives high prices but so do all other suppliers. Any premiums received by Australia over US suppliers mainly reflect better quality wheats and Australia's willingness to ship evenly throughout the year and guarantee supply — which incurs additional storage costs in Australia.

South Korea



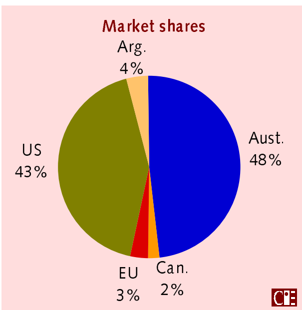
The United States is the dominate supplier of wheat to this market in which there are about 11 independent firms that are regional procurement cooperatives. A range of wheat types are imported and most milling wheat ends up as noodles. US imports set the benchmark for prices against which other suppliers compete. Australia's gain in market share over the years appears to have been achieved by discounting against US wheat. There is also a large feed wheat component in South Korea's imports and Australia sometimes supplies this market segment if it has sufficient supplies.

Malaysia



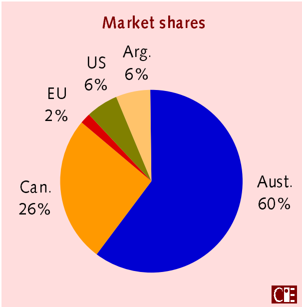
Australia is the dominate supplier of wheat to Malaysia, which is mainly a noodle wheat market. Canada has been increasing its market share by pricing aggressively. Some higher protein wheat is also being imported to support fish aquaculture enterprises. In the noodle sector of the market there is a preference for Australian wheats because their characteristics are better suited to noodles. Australia has less advantage in the bread making sector. Several mills are aiming to increase flour exports to China and Vietnam and to remain competitive they require grain priced competitively.

Yemen



Australia competes with the United States in the Yemen wheat market, which requires white wheats. The milling industry is very unsophisticated and is price-conscious but not quality-conscious. Given the political instabilities in Yemen, it is also a high risk market and some private traders have suffered payment defaults. Any premiums paid in this market would be needed to compensate for the additional costs associated with the higher risk.

United Arab Emirates



The United Arab Emirates consist of Abu Dhabi, Dubai and Sharjah. There is a government-owned flour mill in Abu Dhabi (Abu Dhabi Flour and Feed Factory), one in Dubai, one in the free trade zone of Jebel Ali, and one in Sharjah. The mills in Dubai and Jebel Ali are owned by the Al Ghurair Group under the name of National Flour Mills. Their combined milling capacity is around 1.5 million tonnes, but total imports are around 400 000 tonnes. Australia has a 60 per cent share of the market and supplies mainly APW wheat or AH wheat. In Dubai the National Flour Mills are tending to switch to ASW-type wheats, with Canada supplying increased qualities as the mills focus more on flour exports.

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Joint Industry Submission Group

This group of companies and organisations has a common goal of opening up to competition Australia's restrictive wheat marketing arrangements. The group directly employs some 15 000 people and generates a turnover of $12 billion in rural industries throughout Australia. The multiplier effects from this further contribute substantially to employment, investment and wealth creation throughout rural and regional Australia.

This publication and the submission were produced to raise awareness of the significant costs incurred by growers and wheat consumers as a result of the restrictions imposed through the WMA and highlight the negative impact this has on further investment in regional Australia.

Members of the group are:

PGA of WA Inc — Western Grain Growers

Pork Council of Australia Ltd

Australian Lot Feeders Association

Elders Limited

National Agricultural Commodities Marketing Association Inc.

Australian Grain Exporters Association

Cargill Australia Limited

Louis Dreyfus Australia Pty Ltd

Jossco Australia Pty Ltd

Oceania Australia Pty Ltd

Grainco Australia Limited

Marubeni Australia Limited

Sydney Futures Exchange Limited

BFT Pty Ltd (Secretariat)