

05 June 2007

Mike Woods
Commissioner
Productivity Commission
Regulatory Burdens – Primary Sector
PO Box 80
Belconnen ACT 2616

Dear Mr Woods

AWB welcomes the opportunity to support the annual Productivity Commission review of regulatory burdens on business in the primary sector.

This review is a timely consideration of wider compliance burdens in the wheat industry, particularly in the grains industry supply chain.

AWB believes that these considerations will complement the Australian Government's recent consultations on wheat marketing and also assist the scheduled 2010 National Competition Policy review of wheat marketing arrangements.

To assist the Productivity Commission, AWB has provided a copy of the ITS Global report prepared by Alan Oxley, on the impact of international trade reforms and regulatory changes on Australia's wheat marketing arrangements.

The key conclusions of the ITS Global Report are that:

- Further changes to Single Desk arrangements for marketing Australian wheat overseas are warranted, but they should be gradual and linked to the global trade reform timetable and structural adjustment within the domestic grains industry, to ensure wheat growers are globally competitive and financially viable.
- Change for change's sake is likely to be counter-productive and rapid change of the Single Desk arrangements would incur high unintended costs for wheat growers, especially those 12,500 small to medium wheat growers in the eastern wheat belt of Western Australian, the Eyre Peninsula of South Australia and western New South Wales, who rely on collective marketing to sell their crop.
- Deregulation of the current Single Desk arrangements will not produce a contestable market for the sale of Australian wheat unless regional monopolies in grain handling and storage in Western Australia, South Australia and New South Wales are comprehensively over-hauled as part of a structural adjustment process.
- The Single Desk should be maintained under current arrangements long enough to give wheat growers time to adjust and the grains industry time to establish alternative marketing arrangements.
- The National Pool should therefore be allowed to manage through the current harvest (2006-2007) and the next harvest (2007-2008) and sell all the Pool wheat on international markets through the normal 18 month cycle (until 2010). This would avoid undue financial uncertainty and stress during the current drought and maintain critical high value markets in Asia and the Middle East, which

would be targeted opportunistically by international competitors such as Cargill (which is a shareholder in Grain Corp), Archer Daniels, Louis Dreyfus, and Bunge.

AWB has also included a copy of the Western Australian Chamber of Commerce and Industry (CCIWA) Report "Implications of Wheat Marketing Deregulation".

The CCIWA report serves as a case study of grain industry supply chain and marketing issues in Western Australia, which was chosen because it is the major wheat exporting State. However the issues raised by the report arise in all States where grain is produced and exported.

The key regulatory findings of the report are:

- On the basis of the *Competition and Infrastructure Reform Agreement* signed by COAG in February 2006 as part of the New National Reform Agenda, it is imperative that the port facilities controlled by bulk handlers are reviewed by the WA Government to determine whether regulation is warranted in order to promote competition in the wheat industry.
- In Western Australia, the ERA exists to promote competition and fair market conduct, and prevent the abuse of monopoly or market power. If it is deemed that the main bulk handling company is abusing its market power in relation to its storage and handling infrastructure, the WA Treasurer could refer this issue to the ERA to be investigated. Such a referral would be consistent with the WA Government's obligations under the New National Reform Agenda.
- Seeking to have the infrastructure owned by bulk handlers declared an essential service for the purposes of Part IIIA of the TPA represents a legal avenue for access, if it is deemed that access cannot be obtained on "reasonable" terms and conditions at "fair" prices.

The ITS Global and the CCIWA reports provide the Productivity Commission's Annual Review of Regulatory Burdens on Business with independent analysis of regulatory issues confronting the Australian grains industry. These reports highlight the need for a whole of industry approach to measured reform that alleviates the regulatory burden on wheat growers at all levels of government.

AWB is committed to the development of more efficient wheat marketing arrangements and to the removal of regulatory and compliance burdens in the grains industry. We will continue to work with all parties to find a way forward, and to ensure that Australia has the best possible wheat marketing arrangements and regulatory environment for growers and the industry.

Yours sincerely,



Robert Hadler
General Manager, Corporate Affairs
AWB Limited



ITS Global

Consultants on Global Issues

Sustaining Australia's wheat export markets

Report for AWB by ITS Global

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Executive Summary

Key findings

The Single Desk arrangement carries very significant implications for the position of Australian grains in world markets and the welfare of Australian growers.

ITS Global has concluded that any action to deregulate the Single Desk should be guided by the following:

- **Further changes to Single Desk arrangements for marketing Australian wheat overseas are warranted, but they should be gradual and linked to the global trade reform timetable and structural adjustment within the domestic grains industry, to ensure wheat growers are globally competitive and financially viable.**
- **Change for change's sake is likely to be counter-productive and rapid change of the Single Desk arrangements would incur high unintended costs for wheat growers, especially those 12,500 small to medium wheat growers in the eastern wheat belt of Western Australia, the Eyre Peninsula of South Australia and western New South Wales, who rely on collective marketing to sell their crop.**
- **Deregulation of the current Single Desk arrangements will not produce a contestable market for the sale of Australian wheat unless regional monopolies in grain handling and storage in Western Australia, South Australia and New South Wales are comprehensively over-hauled as part of a structural adjustment process.**
- **The Single Desk should be maintained under current arrangements long enough to give wheat growers time to adjust and the grains industry time to establish alternative marketing arrangements.**
- **The National Pool should therefore be allowed to manage through the current harvest (2006-2007) and the next harvest (2007-2008) and sell all the Pool wheat on international markets through the normal 18 month cycle (until 2010). This would avoid undue financial uncertainty and stress during the current drought and maintain critical high value markets in Asia and the Middle East, which would be targeted opportunistically by international competitors such as Cargill (which is a shareholder in Grain Corp), Archer Daniels, Louis Dreyfus, and Bunge.**

The production of wheat is a vital part of Australian agriculture and the Australian economy. It generates 0.72 percent of Australia's GDP and provides employment to around 30,000 wheat growers, as well as harvest contractors, transport operators, storage handlers, marketers and millers. The multiplier effect is considerable, particularly in rural and regional communities.

Australian wheat producers rely heavily on export markets, with an average of 75 percent of production, by volume, heading overseas each year.¹ Australia is one of the world's largest wheat exporters, accounting for over 15 percent of global wheat exports. Important export markets are located predominantly in developing countries in Asia and Middle East/Africa, with valuable markets in some developed countries, such as Japan.

These are very difficult markets in which to trade. They are highly distorted by the wealthiest governments in the world economy. They are also highly competitive and volatile, subject to political and economic insecurity, the vagaries of weather, the impact of new technologies and year-by-year fluctuations in production. Trade reform is unlikely to deliver any significantly increased access to markets for Australian growers for at least 15 years.

Despite this difficult environment, Australian grain exporters have, over time, built an important share in the world market, through a very significant investment in a long-term marketing system that focuses on securing end-user demand. This system is clearly different from the margin trading approach adopted by major multinational commodity trading competitors based in the EU and US.

The Single Desk is the foundation of a system which seeks to deliver premiums to Australian growers, while building market share and reducing risk.² Most importantly for this study, the Single Desk helps to maintain positions in markets, by allowing for the concentration of available supplies on highest value markets, and shelters growers from market volatility, by averaging of returns to growers over time and through providing a buyer of last resort for all Australian wheat. The system has been steadily reformed over the last decade to improve the marketing of Australian grains and strengthen the capacity of the industry to be globally competitive.

It is not clear when the Doha Round will conclude, but it seems clear that when it does, new rules on export competition will be established in WTO agreements, and they will include restrictions on the activities of business enterprises which trade with some form of state sanction. The restrictions on these enterprises will be aimed at the grain trading bodies in Canada and Australia.

While Canada has lagged behind Australia in reform of its grain trading arrangements, it has recently adopted 2013 as a target date to have implemented deregulation. 2013 has equally been identified as the deadline for new WTO rules on export competition to come into effect,³ and the year the EU will review subsidy payments to its farmers. It would be practicable to assume that Australian Government arrangements that govern the marketing of grains will need to be consistent with these global rules by 2013 or face challenge under international trade rules. It would be prudent planning for Australian authorities to set a timetable for orderly reform of the Single Desk system, to ensure Australian arrangements will also be compliant by that time.

The Australian grains industry will only hold its place in this more de-regulated market in the future if Australian growers are globally competitive and financially viable. This requires an

¹ Australian Bureau of Agricultural and Resource Economics (ABARE), "ABARE Commodity Statistics, 2005", Canberra, 2005, p213. The figure relates to exports as a percentage of total production, from 1990-91 to 2004-05.

² The extent to which market premiums are captured is contested. See Appendix I to this document for a full discussion.

³ Export competition refers to export subsidies and "all export measures with equivalent effect".

enabling environment and supply chain that supports and does not detract from global competitiveness. For reform of the Single Desk to be effective, it should be part of a broad and comprehensive strategy of structural adjustment in the Australian grains industry.

A number of scenarios are currently being floated in political and industry circles to reform the Single Desk arrangement in Australia. These include transferring the right to approve wheat exports to the regulatory body, the Wheat Export Authority; transferring this right to a consortium of private operators; fully separating the Single Desk mandate from service provision, and finally, full deregulation.

Any sudden change in the arrangements for the marketing of Australian wheat carries significant risk to market security and the interests of Australian wheat growers. The primary risk is to the approximately 12,500 small to medium size grain growers that make up three quarters of the industry.⁴

Market share in valuable markets could be easily lost and would be difficult to regain once lost. Sudden removal of the Single Desk would expose growers to greater volatility in prices than they currently face and they would effectively be competing at the same level as major international competitors whose trading terms are strongly supported by significant government assistance. Unless changes to the market system are carefully managed, some Australian wheat producers may be exposed to some degree of market failure.

History has shown that change for change's sake is frequently counterproductive. Australia has more stored experience than most countries in managing the public policy of deregulation. A key lesson learned is that phased adjustment is more effective, less damaging to commercial and economic interests and less costly than sudden change.

Any strategy to reform the arrangements for marketing Australian wheat should be guided by two considerations – one, that any of the changes outlined above as being currently under consideration will result in effective deregulation, not just a shifting of one part of the system to another export-monopsony, be it a government agency or an oligopsony; and two, that any change should be carefully phased and staged as part of a deliberate and strategic plan to improve the efficiency of the whole industry, including reforms to the management of storage, transport and port infrastructure.

The existence of regional monopolies in grain storage and handling in particular means that unless the entire industry—rather than just the marketing entity—is comprehensively overhauled, then deregulation will not create a truly contestable market with the correct competitive tensions to drive future efficiencies.

Rapid change is also likely to incur high avoidable costs. Shifting the Single Desk to another entity, such as the Wheat Export Authority, would require establishment of new marketing capacity. There would also be political pressure for a significant farmer structural adjustment package, which could be expected to be greater than the \$1.76 billion cost of restructuring the dairy industry. These costs would be lower with orderly and planned change.

To mitigate the risks identified above and protect Australia's competitive position on global markets, we conclude that any removal of the Single Desk should only be contemplated as part of a long term, deliberate and progressive process of regulatory change, which allows complete reform of the entire grain handling and marketing systems, and provides time for the capability of

⁴ Approximately 12,500 grain-only farms grossing less than \$500,000 out of a total of 16,300 grain-only farms.

the marketers, regulators and a new statutory marketing and promotion corporation to be sufficiently developed.

The Single Desk should be maintained under current arrangements for long enough to give growers time to make medium-term investment decisions that reflect future conditions, and to allow sufficient time to develop the institutional capacity required to properly regulate, market and promote Australia's wheat internationally.

Finally, in light of the current drought, any considered reform should provide the National Pool with sufficient scope and opportunity to insulate Australian grain growers from adverse effects in global markets. The current Pool should be completed and the rationing of exports necessitated by current drought conditions should be followed through, and existing pooling arrangements maintained at least to the completion of the 2008 Pool in 2010. This would protect Australian exporters and help them to maintain market share in high-value markets. This would also obviate the risk of targeted predatory action by international competitors, which would be expected in the volatile environment likely to follow sudden and piecemeal de-regulation.

Introduction

ITS Global was commissioned by AWB to analyse the Australian wheat industry's situation in key export markets, the impact of regulatory changes (globally) on the Australian wheat industry's competitive position and other elements that have impacts on the competitive position of Australian wheat in export markets, with a view to drawing independent conclusions about the impact of either publicly mooted changes to Single Desk marketing, or deregulation, on the competitive position of Australian wheat—through comparison with existing arrangements.

ITS Global

ITS Global is a leading Australian consultancy on strategic policy issues relating to international trade. ITS Global consultants have wide experience in trade law and policy, advising on tariffs, subsidies, technical barriers to trade, services, dumping, quarantine and dispute settlement. ITS Global has experience analysing trade policy for Australian business, private clients, governments and international organisations.

ITS Global has particular expertise in strategic analyses of trade policy for agricultural industries, including for the beef, dairy, pork, poultry, processed foods, wheat and wool industries.

Alan Oxley, Managing Director, is an expert on international governmental and multilateral activities, particularly those with a direct bearing on business. He is a former Ambassador of Australia to the GATT (predecessor to the WTO) and a former Chairman of the GATT, with extensive experience providing strategic trade advice to the Australian agri-business sector.

The structure of the report

This report is divided into three parts. They are:

Part 1. Wheat Marketing: Structure & Key Impacts.

Part 2. The Competitive Environment for Australian Wheat Growers.

Part 3. Exploring Changes to the Marketing System.

A range of appendices cover the factual background to these questions in more detail:

Appendix I. Single Desk: History, Structure, Value Components;

Appendix II. The Competitive Environment for Australian Wheat Growers, analyses the global commercial environment for wheat trade in greater detail than in the body of the report;

Appendix III. Scenarios for Changing Wheat Marketing Assessed, analyses current proposals for changing wheat marketing in greater detail than in the body of the report.

Appendix IV. Australia's Role in Global Grain Markets, analyses Australia's global market share;

Appendix V. Traditional Threats to Australia's Wheat Growers, analyses in detail why global wheat markets are traditionally at the more volatile end of agricultural trade, and

Appendix VI. Emerging volatility in Wheat Markets, examines newer sources of volatility in global wheat market

Part 1. Wheat Marketing: Structure and Key Impacts

AWB is the exclusive manager and marketer of all Australian bulk wheat exports through the Single Desk system. It markets and trades a range of other grains including barley, sorghum and oilseeds. The operation of the AWB “National Pool” and the monopoly position for Australia’s export of bulk wheat are commonly referred to as the Single Desk system. “AWB International” is a subsidiary of AWB Ltd; it holds a statutory veto over wheat exports by other parties and in effect operates the Single Desk. AWB Ltd provides services to AWB International supporting the operation of the National Pool.

The Single Desk allows wheat farmers to sell through supply relationships that are time intensive to build.

The notional level of “premiums” earned is much debated. However, more important to this analysis is the fact that—in the face of price volatility year to year—the Single Desk has served as the foundation of a system to support the wheat industry, principally by managing price volatility, maintaining access to markets for growers, competing successfully with companies that spread the risk of marketing over a much wider revenue base and diversified range of commercial activities.

1.1 Importance of industry

Wheat is Australia’s largest crop, accounting for around 15 percent of the total value of Australian farm production. In 2004/05 this was in excess of 22.6 million tonnes, valued at AU\$ 5.6 billion.⁵ Wheat production, sale and distribution provided jobs for almost 30,000 Australian wheat growers in 2004, along with harvest contractors, transport operators, storage handlers, marketers and millers.⁶

As domestic consumption is small and relatively stable, about 75 percent of Australian grain production is exported.⁷ In 2004/05, grains exports were worth over AU\$ 4 billion and comprised almost 20 percent of Australia’s exports of rural goods. Wheat comprises the majority of this 20 percent, with overseas sales in excess of AU\$ 3.4 billion. (More detail on Australia’s role in global wheat markets is provided in Appendix IV.)

1.2 Key impacts of marketing arrangement

The Single Desk has created a general system of marketing for wheat which provides a degree of price stabilisation for lower income Australian grain growers. This has usually not been acknowledged in public policy discussion of the arrangement, because of the sensitivity of the subject in international trade policy circles. However, it is important consideration in the policy debate regarding possible changes to the wheat marketing arrangements.

The impacts of the Single Desk that are most relevant to this study are:

⁵ Australian Bureau of Statistics (ABS), “1301.0 – Year Book Australia 2006”, The Australian Wheat Industry, 2006, at www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/1301.0Feature%20Article212006?opendocument&tabname=Summary&prodno=1301.0&issue=2006&num=&view at 11 October 2006.

⁶ *Ibid.*

⁷ ABARE, 2005, p213. The figure relates to exports as a percentage of total production, from 1990-91 to 2004-05.

- How it maintains a substantial share of premium world markets for Australian growers, and
- How it delivers a more stable price to Australian growers.

These benefits flow from size, access to capital to support foreign exchange and commodity hedging, long-term investments in marketing, and from being able to plan sales across the entire Australian crop. The full range of the value components of the Single Desk are analysed in Appendix I to this document. In assessing the impact of the Single Desk it is important to realise that it has underpinned a broad system to protect Australia's lower income farmers. Any reform of the Single Desk must take into account the impact of change on that broad system.

Building substantial shares of global markets for Australian growers

Building market share relies on long-term investments in marketing. Because demand for wheat fluctuates depending on a wide array of factors, the Single Desk has spread the risk of fluctuating demand across a wide range of customers.

Marketing relationships are time-intensive to build but can be easily lost, because although wheat is a vital commodity, it is largely a bulk commodity, so in many cases purchasers can switch customers relatively easily.

The Australian marketing arrangement reflects a significant long term investment focused on securing end-user demand.

In times of scarce production, such as now, the Single Desk concentrates production on the most valuable markets, helping to preserve market share in these markets over market share in others.

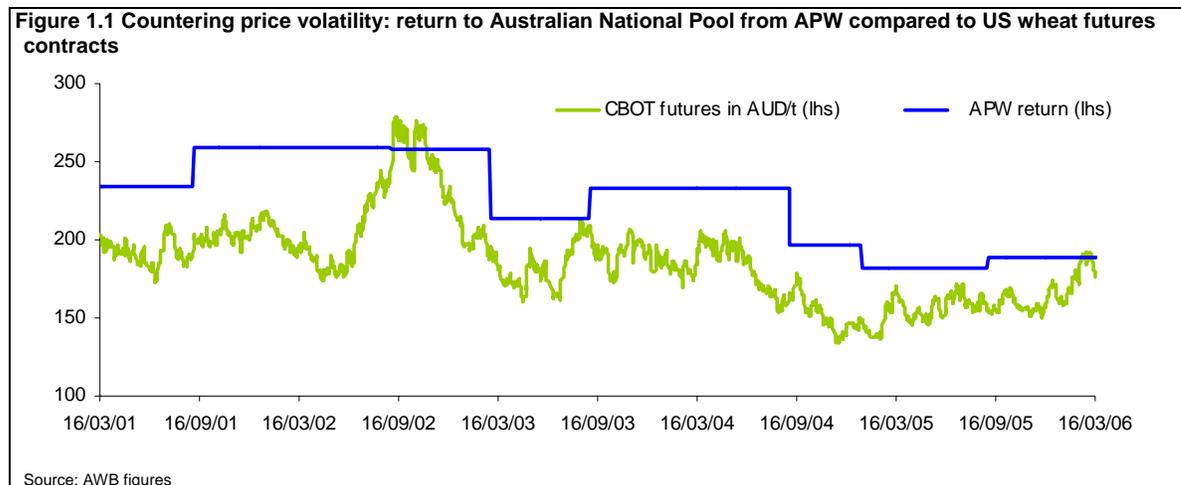
Countering price volatility

The Single Desk allows growers to counter the volatility in prices for particular wheat grades. This is principally done through:

- averaging returns across the length of the selling period;
- spreading a range of risks, including risks of contract failure, credit risk, quality risk and counter-party risk, across a large base of sales;
- using the strength of the National Pool's balance sheet to take positions in commodity markets, which means purchasing derivatives that grant the right to sell or buy wheat at a particular price, which offsets the risk of sudden changes in prices;
- using the strength of the National Pool's balance sheet to take positions in foreign currency markets, which means purchasing derivatives that grant the right to sell or buy US currency at a particular price in Australian dollars, since wheat is traded in US dollars and the rates between US and Australian dollars are subject to volatility.

All these functions of the Single Desk are activities that individual growers or smaller traders could undertake on their own behalf, but not to the degree possible through the National Pool, which benefits from scale.

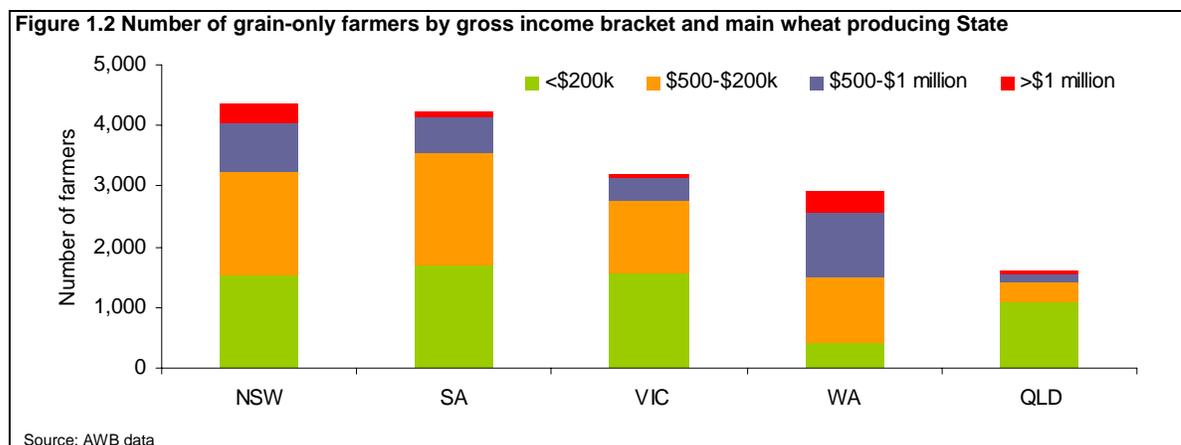
Evidence of the impact of price stability provided by the Single Desk can be seen in Figure 1.1 (over), which compares the return to the pool on one wheat grade, APW, to the prices for derivative contracts for a comparable wheat grade, for the period from 2001 to 2006. APW returns are far more stable and usually at higher levels.



1.3 Significance of small to medium farms

Of 16,300 grain-only growing operations in Australia, around 12,500 have gross revenues of less than A\$ 500,000 per annum (see Figure 1.2).⁸

While the data outlined in Figure 1.2 reflects gross income, the profitability of smaller farms varies considerably from year to year. Margins tend downwards during drought periods and tend also to be lower on smaller farms, with margins on farm cash income (earnings before interest, tax and depreciation) in the wheat and other crops sector of around 20 percent representing the average for 2004/05.⁹ Thirty-one percent of crop farms in 2004/05 had negative cash farm income.¹⁰



⁸ Grain-only farm data presented.

⁹ ABARE, "Farm Financial Performance", 2006, at www.abareconomics.com/australiancommodities/flash/finiinceperf.swf, at 30 October 2006.

¹⁰ *Ibid.*

Smaller growers have adjusted their farm business plans to the expectation of continued backing from the Government through the Wheat Marketing Act for price stabilisation over time.

It is important to recall that many wheat-producing areas have little access to domestic markets. Domestic demand is forecast to increase, but this increase is forecast to occur on the eastern seaboard.¹¹ A considerable number of small to medium farms remain that are removed from sources of domestic demand and would be significantly exposed in a deregulated environment. The structural adjustment pressures on these farms and rural communities would be considerable. Farms in the eastern wheat belt of Western Australia, Eyre Peninsula in South Australia, and the western central area of New South Wales are likely to face negative exposures, and the case for protecting them in any process of change is strong.

Due to the lack of viable agronomic alternatives, the structural adjustment consequences for the wheat industry as a result of deregulation would be significantly greater than was the case for the dairy industry, which was supported with a package of \$1.76 billion funded by an on-going 11 cents per litre levy on all retail milk sales.

The production and business systems of small to medium sized farms have been built on the expectations of the price stabilisation arrangement on all facets of grain production. Any change to the Single Desk system will change the system of protection of those farmers. This is not a justification for rejecting reform, but it does mean the approach to reform should be assessed for its social impact.

¹¹ ACIL Tasman "Marketing Western Australian Wheat" prepared for the Western Graingrowers of the Pastoralist and Graziers Association of Western Australia, July 2005.

Part 2. The Competitive Environment for Australian Wheat Growers

2.1 The general competitive environment

The competitive environment for Australian wheat is shaped by vigorous distortions in competition, regulatory interference in global markets and efforts to change the regulation of trade through negotiations and trade policy reform.

While the global policy trend is towards deregulating statutory marketing arrangements for agricultural commodities, there is no concomitant move to reduce subsidies in the US and the EU, or to temper the move towards greater regulatory discretion in food trade more broadly.

Commercially, Australian wheat exporters exist in a highly competitive and largely oligopolistic trading environment. The commercial environment is highly concentrated with four major competitors that are vertically integrated conglomerates. These companies have extensive sourcing, production and transportation capabilities and total revenues far exceeding those of the Single Desk or any other domestic operators within the Australian wheat growing industry. More detail on the commercial competitive environment is provided in Appendix II.

Volatility in global wheat markets is due to a range of factors, including shifting supply, changing technologies in food production, increasing regulatory discretion in food safety and changing preferences in food trade. These are analysed in greater detail in Appendices V and VI.

This section focuses primarily on the impact of the global policy environment on Australian growers.

2.2 The global policy environment

The competitive environment for Australian wheat is to a large degree dependent on the domestic agricultural policies of major importing and exporting countries (principally the EU and the US), which have commercially significant impacts on trade and production decisions. Policies have traditionally been (and remain) characterised by high levels of domestic support, combined with the aggressive use of export credit programs, food aid and government-funded promotion and marketing activities, and direct government diplomatic intervention at the commercial level.

There are current moves in the WTO agriculture negotiations to curb the operation of single desk marketing enterprises like the National Pool, pushed largely by the US and the EU. Some have suggested that interest of the US and EU in the Australian marketing arrangement suggests the Australian Single Desk is a significant competitive threat. However, another key dynamic is that the US frequently groups AWB with CWB when discussing single desk entities, even though the two differ in key respects. Pressure to deregulate these entities aside, it is our assessment that no significant increases in access to protected wheat markets are on offer as matters stand in the WTO negotiations. Free Trade Agreements negotiated between competing wheat exporting nations and wheat importing nations also carry risk for Australian wheat exporters.

For this reason, any reform of the Single Desk should result in a strengthening of the capacity of the industry to manage and succeed in the face of existing and emerging distortions.

2.2.1 Pressure from EU and US policy

a. Subsidisation of wheat in the EU and US

Subsidies for wheat in export competitors, such as the EU and the US, adversely affect the competitiveness of farmers in low cost wheat producing nations such as Australia. They tend to distort production decisions that, in turn, impact on world markets. In exporting countries wheat subsidisation can lead to over supply and stock piles, which encourages the export of excess stock to the international market, reducing demand for efficient producers. In importing countries subsidisation can lead to continued production when it may no longer be economically efficient to do so, thereby reducing demand for wheat from efficient wheat producing countries such as Australia.

US support

Although there has been some incremental movement in policy reform to reduce levels of support for agriculture in the US, the sector remains highly protected.¹² Despite a shift away from payments based on output towards direct payments in recent years (where the latter are not linked to production requirements and are potentially less trade distorting), counter-cyclical payments together with marketing loans that also offset lower prices continue to be significant and limit market signals.

Support for wheat, measured by estimated support provided to farmers as a proportion of value produced, through the Producer Support Estimate (PSE),¹³ is high, at 30 percent, compared to average levels of 17 percent for agriculture overall.¹⁴ In 2004, this amounted to US\$ 3.3 billion¹⁵ in producer support for wheat. Support is provided principally through the *Farm Act 2002* ("The Farm Bill") in the form of:¹⁶

- direct payments (income payments fixed for each crop independent of current production or by current market prices, with limits on direct payment supply);
- countercyclical payments (price-dependent benefits for covered commodities including wheat, when the effective price for the commodity is less than the targeted price minus the direct payment rate); and,
- commodity loan programs with marketing loan provisions (under which farmers can choose to receive marketing loan benefits through direct loan deficiency payments (LDPs) when market prices are lower than commodity loan rates).

US Farm Bills are revamped every five years. The current bill is due to expire in July 2007. The status of WTO negotiations and recent disputes cases affecting US subsidy programs will have an impact on changes made to the structure and level of support in the next Bill. The US is expected to be reluctant to dismantle unilaterally its farm programs, in the absence of the pressure for

¹² OECD, "Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005, Highlights, p 73-74.

¹³ PSE measures the annual monetary value of gross transfers from consumers and taxpayers to agricultural producers, measured at the farm gate level, arising from policy measures that support agriculture, regardless of their nature, objectives or impacts on farm production or income. *Ibid*, p 76.

¹⁴ PSE measurement, 2006. *Ibid*, p 73.

¹⁵ OECD, PSE/CSE database 2005 (provisional data).

¹⁶ Vocke, G., Allen, E. W. & Ali, M., "Wheat Backgrounder", United States Department of Agriculture, Electronic Outlook Report from the Economic Research Service, December 2005, pp16-17 at www.ers.usda.gov/publications/whs/dec05/whs05K01/whs05K01.pdf at 20 October 2006.

agricultural reform from ongoing WTO negotiations. Recent disputes cases, which have ruled some elements of US programs illegal under WTO rules, will also affect the next Farm Bill. In any event, the Bill is likely to be restructured to shield it from further WTO challenge. Whether this will reduce or merely restructure levels of support and the implications for wheat are not yet clear, however respected industry commentators are suggesting that despite the desire for the administration to undertake significant reform, the domestic political dynamics will result in little change in funding or structure for a number of years.

EU support

The EU also maintains significant price support for wheat, totalling US\$ 13.6 billion¹⁷ in producer supports in 2004. Although overall support to farmers has declined significantly since the late 1980s (as measured by the PSE)¹⁸, it remains above the OECD average of 20 percent. Support for wheat is much higher at over 40 percent.¹⁹

The main policy instrument through which support is provided is the Common Agricultural Policy (CAP).²⁰ Most payments for wheat are based on historical entitlements, as well as on output of production use and on inputs constraints and income.²¹ Income support is gradually becoming more important in EU programs. The 2003/04 CAP reforms are designed to move away from commodity support to income support by means of direct payments based on average historical commodity based payments beginning in 2000/01.²²

Although changes to the CAP are likely to result in less trade distorting production decisions (with farmers more responsive to markets signals than policy interventions), it can be expected that member states will take advantage of the latitude allowed them regarding the timing of implementation (2005-2007) and the degree of linking of payments to production.²³ Some member states (France in particular) are resistant to further cuts, with the result that significant changes look unlikely for some time. Further reforms are not envisaged until 2008/09 and with WTO negotiations currently at a standstill, there will be less pressure from trading competitors.

The addition of new EU members is not expected to affect significantly the average levels of support provided to farmers across the board. The OECD has estimated that because the agricultural sectors of the new members are relatively small, support to the new members will mean only a marginal decrease in average support relative to farm receipts across the newly enlarged EU.²⁴

b. Impacts of US export credits and food aid

Use of export credits, export credit guarantee programs and food aid, principally by the US, negatively impact on Australian wheat exports when, operating as a type of subsidy, they are used

¹⁷ OECD, PSE/CSE database 2005 (provisional data).

¹⁸ From 41 percent in 1986-88 to 34 percent by 2004. OECD, "Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005, Highlights", 2006, p 45.

¹⁹ *Ibid.*, p 46.

²⁰ Carter, A., 2001.

²¹ OECD, "Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005, Highlights, 2006, p 45.

²² USDA, "Briefing Rooms: European Union: Policy – Common Agriculture Policy" Economic Research Service, 2004 at www.ers.usda.gov/briefing/EuropeanUnion/PolicyCommon.htm at 20 October 2006.

²³ *Ibid.*, 2004.

²⁴ OECD, "Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005, Highlights, 2006, p 45.

aggressively to gain predatory market share in export markets. These subsidies can have significant commercial impacts by distorting trade and production decisions.²⁵

Export credits

Principally it is the US that uses export credits to subsidise the grain industry.²⁶ Although the subsidy element of US credit programs is small in comparison to other forms of export subsidy,²⁷ it is disproportionately focused on wheat. Bulk cereals receive half of the total subsidies from only a third of total credits.

The main US agricultural credit guarantee programs are the General Sales Manager (GSM) program and the Supplier Credit Guarantee (SCG) program, a variant of the GSM program. Both these programs provide advantages to US wheat exporters through long-term credit on terms more favourable than the market would normally offer. The GSM programs guarantee repayment when US banks extend credit to foreign banks to finance sales of US agricultural goods for between 3 and 10 years. The SCG program guarantees repayment from the importer when the US exporter extends credit for 180 days or less directly to the importer.²⁸

The continued operation of these schemes is threatened by WTO dispute cases, and to a degree, ongoing negotiations in the Doha Round. A recent WTO case ruled that the GSM and SCG programs were export subsidies in the case of cotton and certain other commodities under WTO rules. Although the full impact of these rulings is not yet known, it is likely the GSM programs will be eliminated and the SCG program is slated to be restricted when the WTO Doha Round negotiations end.²⁹ US Department of Trade is aware of possible inconsistencies between US schemes and WTO rules and the possible implications for the next Farm Bill.

The United States Department of Agriculture (USDA) recently announced it was making available USD\$ 300 million in credit guarantees for US sales to Indonesia, Malaysia, Papua New Guinea, the Philippines, Singapore, Thailand, Vanuatu and Vietnam under the GSM-102 program for the 2006-07 fiscal year. In addition, USDA will make US\$ 50 million in credit guarantees to Russia for all agricultural commodities, including wheat.

The EU does not offer official support for export credit guarantees at the level of the EU. Individual EU members run credit guarantee programs but do not provide specific information on

²⁵ AWB Limited, "The Australian Government's Approach to Upcoming Multilateral Trade Negotiations", Submission to the Department of Foreign Affairs and Trade, May 2002.

²⁶ The US accounts for 90 percent of all agriculture export credits and has the highest estimated average subsidy elements of credits. See OECD, "Analysis of Officially Supported Export Credits in Agriculture", 2000, pp15-16 at www.oecd.org/dataoecd/48/45/1911035.pdf at 20 October 2006.

²⁷ Calculated by the OECD to be US\$216 million in 1988. See *Ibid*, 2000, p 15.

²⁸ Stevenson, P., "Supplier Credit Guarantee Program", United States Department of Agriculture: Foreign Agricultural Service at www.fas.usda.gov/info/agexporter/1996/December%201996/supplier.html at 20 October 2006.

²⁹ In relation to payment of interest, minimum interest rates, minimum premium requirements, and other elements which can constitute subsidies or otherwise distort trade. The negotiating mandate in the WTO as it stands will not lead to the elimination of all export credits, with only those of 180 days or more to be eliminated, and those of less than 180 days subject to further "disciplines." Paragraph 18 of the Hong Kong Ministerial Declaration states: "*The following will be eliminated by the end date to be agreed: Export subsidies as scheduled; Export credits, export credit guarantees or insurance programmes with repayment periods beyond 180 days; Terms and conditions relating to export credits, export credit guarantees or insurance programmes with repayment periods of 180 days and below which are not in accordance with disciplines to be agreed. These disciplines will cover, inter alia, payment of interest, minimum interest rates, minimum premium requirements, and other elements which can constitute subsidies or otherwise distort trade.*"

credits related to the food and agriculture sector, which are provided in a variety of ways by different EU member states.³⁰

Food aid

More subtle forms of export subsidies, in the form of commercially targeted food aid donations and government sponsored market promotion programs, also impact on the commercial markets of Australian exporters. Food aid programs are of concern where aid donations are not quarantined from the commercial market in the country they are provided to, often deliberately displacing commercial sales and demand. Purchases for programs also prevent normal production responses to low prices and generate additional uncertainty in an already difficult market. Often US wheat is consciously donated to a market dominated by Australia wheat exports, and the recipient government monetises the donation by selling on the local market, thereby upsetting market signals and displacing Australian wheat. Generally, food aid donations undermine development of commercial trade in recipient countries where they are in excess of humanitarian requirements.³¹

Food aid is generally administered as one of three types; emergency aid, project food aid and programme food aid, with the majority delivered in the form of emergency food aid, rather than commercially-tied food aid.³² The annual value of food aid in the 1990s was approximately US\$ 2.5 billion, making it smaller than direct transfers of export subsidies, valued at about US\$ 6 billion in 2000.

The US is the country that most strongly links concessional export credits to commercial policy goals, although overall expenditure on food aid programs has generally fallen since the 1990s, reflecting cuts in the programs with the greatest direct link to markets.³³ Food aid is provided through three main channels administered by USDA; the Section 416 Program,³⁴ the Food for Progress Program,³⁵ and the Public Law 480 Program³⁶ (which is almost twice the size of other food programs).

Conditions for granting food aid and the terms of its use are managed in the FAO and the WTO. Current WTO agriculture rules and negotiations provide very limited scope for constraining the use of food aid as subsidies. Currently members have agreed to eliminate the provision of food aid that is not in conformity with operationally effective disciplines *to be agreed*, with the objective of

³⁰ United States General Accounting Office, "Export Finance: Comparative Analysis on U.S. and European Union Export Credit Agencies", Washington, October 1995, p11. "The U.K. uses a single government agency to deliver an entire range of export-financing assistance. Italy uses a government agency to deliver government-supported export cover (guarantees and insurance) but also uses a state-owned bank to provide interest rate subsidies for export loans. France, Germany, and the Netherlands use commercial insurance companies to deliver government-supported export cover and use other entities to provide interest rate subsidies for export loans."

³¹ AWB Limited, "The Australian Government's Approach to Upcoming Multilateral Trade Negotiations", Submission to the Department of Foreign Affairs and Trade, May 2002.

³² Shapouri, S. & Rosen S., "Global Food Security: Prospects and the Role of Food Aid", United States Department of Agriculture: Economic Research Service, May 2004, at www.ers.usda.gov/publications/GFA15/GFA15b.pdf at 20 October 2006, pp5&6.

³³ *Ibid*, 2006, p6.

³⁴ Provides for overseas donations of surplus commodities owned by the US government in order to carry out assistance programs in developing countries, with no requirement for recipient countries to repay donations. Donations often go to countries in need but also to those with a demonstrated capacity to import commercially grain needed to cover demand.

³⁵ Provides sale on credit terms or donations of commodities to developing countries and/or emerging democracies.

³⁶ Provides for US government financing of sales of US agricultural commodities to developing countries and private entities on concessional credit terms, with interest free credit for up to 30 years.

preventing commercial displacement. At the Doha level, this could be further limited by many proposed concessions and loopholes, as well as by likely special and differential provisions for net food importing developing countries and least developed countries in wheat export markets such as Egypt, Cambodia and Sudan.

2.2.2 Threats from the WTO and FTAs

Major threats to the operating environment of Australian growers arise from current moves in the WTO agriculture negotiations to restrict the monopoly powers of exporting STEs and to provide damaging exemptions for developing countries to avoid obligations to reduce barriers to market access. Bilateral and regional FTAs, particularly negotiated by the US, also carry commercial risks if they accord preferential market access to competitors.

a. Pressure on the Single Desk

The negotiating mandate

Although over the past few years the principal focus of the negotiations on exporting STEs has been overwhelmingly on their subsidy-like effects, there is now an official mandate in the WTO to impose disciplines on the use of monopoly powers which result in trade distorting practices.

Negotiations are tied to the agreement by WTO members, as of the Hong Kong Ministerial Meeting in December 2005, to “ensure the *parallel* (emphasis added) elimination of all forms of export subsidies and disciplines on all export measures with equivalent effect by the end of 2013.”

As a result of the Framework Agreement of July 2004, members agreed to eliminate, by an end date to be agreed, “trade distorting practices with respect to exporting STEs including eliminating export subsidies provided to or by them, government financing, and the underwriting of losses.”³⁷ It also stated that “effective transparency provisions (for the above) will be established [...] consistent with commercial and confidentiality considerations.”³⁸

The Agreement noted that the issue of future use of monopoly powers would be “subject to further negotiation.”³⁹ This language was substantially weaker than previously proposed (but not adopted) text, which would have made export monopolies illegal in the WTO.⁴⁰

Following the Ministerial Meeting in Hong Kong in December 2005, the mandate to address the practices of exporting STEs was expanded and expressly linked with progress in eliminating other

³⁷ Paragraph 18 states: “Trade distorting practices with respect to exporting STEs including eliminating export subsidies provided to or by them, government financing, and the underwriting of losses. The issue of the future use of monopoly powers will be subject to further negotiation.” WTO Document WT/L/579 (Doha Work Programme, Decision Adopted by the General Council on 1 August 2004) 2 August 2004.

³⁸ *Ibid.* Paragraph 19 states “Effective transparency provisions for paragraph 18 will be established. Such provisions, in accordance with standard WTO practice, will be consistent with commercial confidentiality”.

³⁹ *Ibid.*

⁴⁰ Paragraph 5(b) of Attachment 7 of the “Harbinson Text” states that: “Members shall ensure that governmental export enterprises are not operated in such a way as to circumvent export subsidy commitments under this Agreement nor in such a manner that would nullify or impair the conditions of competition in world export markets that would prevail in the absence of such special rights, privileges or advantages. To this end Members undertake: (i) to ensure that exports of a product by a governmental export enterprise do not take place at a price less than the price paid by such an enterprise to the domestic producers of the product concerned; (ii) not to restrict the right of any interested entity to export, or to purchase for export, agricultural products; (iii) not to grant special financing privileges, including government grants, loans, loan guarantees, or underwriting of operational costs, to governmental export enterprises that export for sale, directly or indirectly, a significant share of the respective Member's total exports of an agricultural product”. WTO Document TN/AG/W/1/Rev.1 (Negotiations on Agriculture First Draft of Modalities for the Further Commitments, Revision), Committee on Agriculture Special Session, 18 March 2003.

forms of export subsidies. Although the mandate noted in the July Framework Agreement was affirmed, the reference to “further negotiations” on monopoly powers was replaced with language that expressly called for disciplines relating to the future use of monopoly powers that circumvent measures to eliminate subsidies.

Paragraph 6 of the Ministerial Declaration Hong Kong⁴¹ states that:

As a means of ensuring that trade-distorting practices of STEs are eliminated, disciplines relating to exporting STEs will extend to the future use of monopoly powers so that such powers cannot be exercised in any way that would circumvent the direct disciplines on STEs on export subsidies, government financing and the underwriting of losses [...] the date above for the elimination of all forms of export subsidies, together with the agreed progressivity and of parallelism, will be confirmed only upon completion of the modalities.

As a result of the negotiations agreed to date therefore, disciplines imposed on STEs are likely to be negotiated for:

- provision of transparency;
- prohibition of export subsidies;
- prohibition on government underwriting of losses;
- prohibition on export credit guarantees; and
- prohibition on other privileges (e.g.: lower bank debt rates).

In addition, as a result of the Hong Kong Declarations, monopoly powers of STEs may be subject to disciplines by reason of their trade distorting effects.

Sources of pressure

Principal critics of STEs in the WTO negotiations and proponents of disciplines to address them are the EU, the US, Japan and other net food importing countries.⁴² Australia, Canada and New Zealand have defensive interests, as does China which has a large number of importing STEs.

The EU and the US have targeted exporting STEs in the negotiations for a number of reasons. They argue that STEs are not comparable to private sector entities and that complementary activities that characterise STEs (such as getting a fair price for producers) are not compatible with product minimising prices for customers. Furthermore, they contend that STEs enjoy a range of rights and privileges that help them stay in business, and that the existence of the monopoly means that the entity does not have to behave in a competitive fashion.⁴³ It should be noted that these allegations could be successfully aimed at US cooperatives, which enjoy a range of rights and

⁴¹ WTO Document WT/MIN(05)/W/3/Rev.2 (*Doha Work Programme, Draft Ministerial Declaration, Revision*) Ministerial Conference, Sixth Session, Hong Kong, 13 - 18 December 2005) 18 December 2005.

⁴² Such as Netherlands and Switzerland.

⁴³ Ackerman, K., “State Trading Enterprises in World Agricultural Trade”, Agriculture in the WTO, USDA: Economic Research Service, 1998, pp43-47 at www.ers.usda.gov/publications/wrs984/wrs984h.pdf at 20 October 2006.

privileges (including anti-trust exemptions under the Capper-Volstead Act⁴⁴ and favourable tax treatment⁴⁵).

The US position is closely linked with the idea that STE activities reflect a form of export subsidisation. The US has pushed strongly in the negotiations for the elimination of STEs and for increased transparency obligations of STEs,⁴⁶ including reporting on operations, price, customer and data per transaction. This position is targeted mainly at opposition to the Canadian Wheat Board (CWB), which can be differentiated from the Australian Single Desk and National Pool in respect of several key economic characteristics.⁴⁷ It is also driven by pressure from the US wheat industry (Wheat Export Trade Education Committee, National Association of Wheat Growers and US Wheat Associates) and a relatively small number of northern US states and their political allies.⁴⁸ The CWB is currently undertaking a major reform to be commercially focused and to eliminate trade distorting practices. The proposed model has many similarities with the current arrangements in Australia.

The EU has pushed for new rules on STEs and has linked new rules on export credits and food aid with stand-alone disciplines on STEs to ensure “parallelism” of treatment as required in the Framework Agreement text.⁴⁹ The linkage of treatment of STEs with elimination of export subsidies in general was a feature of the Hong Kong text agreed.

Australia has challenged the US and EU to demonstrate how the Single Desk engages in practices that differ from those pursued by a whole range of bodies in the US and EU, on the basis that new rules for STEs could only be justified following evidence of distortions in the marketplace.⁵⁰

CWB has been a subject of a number of unsuccessful challenges in the World Trade Organisation, particularly from the United States. Until 2006, the Canadian Government had insisted on the continuation of the Single Desk system.⁵¹ Canada's newly-elected Conservative Party has proposed revoking CWB's monopoly powers by giving wheat growers a choice about whether to market their products through the agency.⁵² Citing that current (suspended) WTO agriculture talks are likely to result in elimination of government financing of state trading institutions, CWB laid out its own reform proposals, which include full privatisation of the organisation, and removal of government guarantees on its loans. The Canadian Government has recently adopted 2013 as a

⁴⁴ USDA, “Understanding Capper-Volstead”, Rural Business and Cooperative Development Service, June 1985.

⁴⁵ United Nations Secretary-General, “Status and role of cooperatives in the light of new economic and social trends”, report to the General Assembly, December 1998, at www.copacgva.org/a-54-57.htm on 26 October 2006.

⁴⁶ United States Trade Representative (USTR), “U.S. Proposal for Bold Reform in Global Agriculture Trade”, Doha Development Agenda Policy Brief – October 2005, at http://bridgetown.usembassy.gov/uploads/images/CqvgsLgF8nMR57MUzwpNbA/Doha_fact_sheet4.pdf at 10 October 2006.

⁴⁷ For example, the CWB has government guarantees for some portion of loans to selected importers. The Government also guarantees advance payments to wheat growers in CWB pools. ERS/USDA “State Trading Enterprises: Their Role in World Markets” Ag Outlook/ June 1997.

⁴⁸ US Wheat Associates, “AWB Scandal Impacts on US Wheat Farmers. President's Report to the USW Board of Directors”, Trade Policy Statement, February 4, 2006 at www.uswheat.org at 9 October 2006.

⁴⁹ ..., “The Commission Proposal and the Doha Round: What Impact on EU agriculture”, Presentation by the DG for Agriculture and Rural Development, European Commission, November 1995 at <http://ec.europa.eu/agriculture/external/wto/hongkong/pres1.pdf> at 20 October 2006.

⁵⁰ ..., “World Trade Organization: WTO Doha Round Bulletin – Update”, Trade Policy Section, Department of Foreign Affairs and Trade, Canberra, 24 January 2006 at www.dfat.gov.au/trade/negotiations/wto_bulletin/2006/wto_bulletin_060124.html at 20 October 2006.

⁵¹ CWB, “Harvesting Opportunity”, ppi-ii.

⁵² Agriculture and Agri-Food Canada (AAFC), “Ministerial statement following a meeting with farmers on marketing choice for wheat and barley”, at www.agr.gc.ca/cb/index_e.php?s1=n&s2=2006&page=n60727 at 28 September 2006.

target date by which to implement reforms of its grain trading arrangements. This links to the year in which Europe has agreed to phase out the use of export subsidies.

Scope of the threat

As things stand now, new disciplines on STEs will be negotiated whenever the Doha Round concludes. The language of the Hong Kong Declaration suggests that the focus on exporting STEs is now no longer just on their subsidy-like effects, but also their trade distorting effects through use of monopoly powers, for which disciplines are now also to be negotiated. These are now clearly linked with concessions in other areas related to export subsidies, such as disciplines on export credits and food aid.

There will be pressure for greater transparency. Impacts would be great if full disclosure of details of transactions were required. Competitors would be aware of National Pool pricing strategies in all markets and be better placed to undertake targeted predatory attacks on key customers. The scope and extent of such disciplines likely to be negotiated in the Doha round is not clear. Nevertheless, the monopoly status of wheat exporting enterprises like the Single Desk is now a political bargaining chip in the broader context of negotiations for further disciplines for export competition. The strength of the push by the US to discipline STEs, or eliminate them altogether, should not be underestimated. Pressure to reform export credits and food aid will heighten opposition to STEs.

The focus of attention on the monopoly powers of single desk marketing also increase the likelihood WTO members will seek to challenge monopoly powers under WTO Dispute Settlement procedures.

b. Negligible gains on market access on offer in WTO

WTO negotiations

If current efforts in the WTO to secure agreement to the set of proposals on the table in the Doha Round negotiations succeed, very little additional gain is likely for Australian grain exporters. As discussed earlier, even the most optimistic outcome would lead to barely detectable reductions in applied tariffs in just three wheat importing countries.

Not only that, there is evidence of a distinct trend in the negotiations to create new rights for developing countries to exempt themselves from obligations to accept full commitments to reduce trade barriers in future.

WTO members to date have provisionally agreed in the agriculture negotiations that developing countries will be able to designate some products as special products, which will be subject to lesser tariff reductions or exempt from tariff reductions for reasons related to food security and rural development. Under these same provisionally agreed rules, developing countries would be able to impose special safeguards against imports. This is likely to be in addition to right to exempt "sensitive products" from obligations.

Although the exact scope of these special provisions is not yet agreed, there is likelihood that they will weaken whatever package of commitments to reduce market access is agreed, including in wheat import markets.

Bilateral and regional free trade agreements

Free trade agreements negotiated between major wheat trading nations that are Australia's major competitors and wheat importing nations also prospectively threaten the business of Australian wheat exporters in some markets.

The US has negotiated free trade agreements with Morocco, and is currently pursuing free trade agreements with South Korea, Malaysia, and Thailand. Long-term goals are to forge agreements with trading partners in the Middle East and Africa, notably Egypt, as part of a broader US-Middle East FTA.

These FTAs have the potential to create opportunities for competitors to secure greater access to export markets at the expense of Australian exporters. The US Morocco FTA, for example, eliminates tariffs on US common wheat and durum exports to Morocco over an 11 year period, with an initial preferential advantage of 20 percent over Australian durum imports. This advantage will continue to grow each year under the terms agreed. AWB has in the past exported up to 50,000 MT of durum annually to Morocco.⁵³

Given the institutional capacity and resources of the US to negotiate more FTAs than Australia, examples such as this demonstrate the likely introduction of further marketing disadvantages for Australian wheat in the future.

2.3 The trend towards de-regulation

It is not clear when the Doha Round will conclude, but it seems clear that when it does, new rules on export competition will be established in WTO agreements, and they will include restrictions on the activities of business enterprises which trade with some form of state sanction. As noted in the foregoing, the restrictions on these enterprises will be aimed at the grain trading bodies in Canada and Australia.

2013 has been identified as the date at the latest on which these new rules will come into effect. This is also the date at which there is agreement in the EU that payments of subsidies to farmers will be reviewed. This is a date by which it would be practicable to assume that Australian Government arrangements to govern the marketing of grains will need to be consistent with such global rules or face challenge under international trade rules to change them.

The Canadian Government which was elected in January 2006 has adopted 2013 as a target date by which to implement reforms of its grain trading arrangements.

It would be prudent planning for Australian authorities to set a timetable for orderly reform of the Single Desk system to ensure Australian arrangements will also be compliant by that time.

⁵³ AWB figures.

Part 3. Exploring Changes to the Marketing System

According to media, four broad options for altering the Single Desk arrangement are being discussed. In this section we review the general principles underpinning those options, draw some conclusions about the impacts those arrangements are likely to have and propose principles which should inform consideration of how to deregulate wheat marketing.

This discussion must necessarily be general since there is no detailed model of deregulation to assess. (A somewhat more in-depth analysis of these options is, however, undertaken in Appendix III.)

The four models are:

- Transfer the bulk veto to the grain export regulator, the Wheat Export Authority;
- Transfer the bulk veto to a grouping of wheat trading and grain storage companies;
- Separate the Single Desk holder from the National Pool service provider;
- Complete deregulation of the industry, either now or in the future.

These scenarios need to be evaluated against the critical goal of maintaining Australian's grain export industry. Will they achieve effective deregulation? Will they enable Australian growers to maintain the valuable position they have achieved in global grain markets? Will they enable growers to manage market and price volatility? Will they enable the 12,500-odd grain growing businesses—which are in the lower earning segment of the industry and who constitute a measurable portion of the industry—to effect an orderly adjustment to a regime where price stabilisation will no longer reduce risk in their businesses? Most importantly, will they mitigate or heighten the risks to Australia's position in global markets that will attend changes to the marketing system?

The key problem facing all scenarios is that removing the price stabilisation function of the Single Desk during a period of drought or recovery from drought is going to create significant financial volatility for farmers. Secondly, unless the purchase of last resort obligation was transferred to a new party, the security of a guaranteed buyer would be removed, introducing further risk for growers. A related problem is that the Single Desk relies on existing long term marketing relationships in key markets, relationships which cannot be transferred without application of time and resources. In the interim, it is unlikely sales would be concentrated on the most valuable markets and the door would be left open for targeted and opportunistic predatory actions by competitors. This puts market share at risk in key markets and implies lower returns to growers, not just in the short term but in the long term as well.

On the surface, some of the scenarios appear to be change for change's sake, which by definition, has no intrinsic merit, and also carries substantive risk. Figure 3.1 (over) assesses the current options under the criteria listed above.

Figure 3.1 Scenarios for deregulation assessed

Policy scenario	Effective deregulation?	Allow growers to maintain market share?	Allows vulnerable growers to manage change?
Transfer Bulk Veto to Wheat Export Authority	No. A step backwards (re-regulation) to a larger Government role in commercial decision making. Bureaucratic and costly, with higher levies, creates inefficiency and introduces delays for exporters awaiting price approvals before being able to confirm tender offers.	No. WEA is not equipped to concentrate scarce production in the most valuable markets, and does not provide any exporter with the security required to invest in long term market development in any particular country.	Not if WEA cannot maintain effective export flow to highest value markets.
Transfer Single Desk to a consortium of grain companies.	No. As these companies already have effective regional monopolies, the removal of competitive tensions in the domestic supply chain would be detrimental to the interests of producers. This would necessitate a full national Productivity Commission review of the complete grain supply chain and a comprehensive competition policy reform.	Possibly, but with ambiguous impact on growers, because of lack of contestability in the provision of all services in the domestic supply chain. There would also be a period of 2-3 years where the consortium needed to develop its offshore offices, sales and marketing capability, as well as the corporate structures to manage the financial risks of such an enterprise.	Unlikely, due to inherent disincentive to reduce supply chain costs or to maximise grower margins.
Fully separate the Single Desk from the National Pool service provider	No. Unless it is a transitional measure as part of a managed strategy to move to full deregulation.	Yes, provided sufficient time was given to build the capacity of new entity prior to separation.	Yes, provided it allows time for growers to recover from the drought and to make medium term investment decisions that reflect the likelihood of future deregulated conditions.
Rapid and full deregulation	Yes. Achieves goal of full contestability.	No, since maintaining market share relies on the relationships of the Single Desk. Would require costly establishment of marketing and promotion corporation.	No, would bring abrupt change, cutting off farmers from foreign markets. Would require significant structural adjustment.

Need for structural adjustment

Any reform of the Single Desk that entailed making wheat exports immediately contestable would remove price stabilisation provided by the Single Desk. This would mean the operations of a portion of smaller Australian wheat growers—particularly those who do not have ready access to the domestic market—would become uneconomical, since they would be unable to counter year-to-year volatility.

Those hardest hit would be in areas where switching activities is least feasible. There are a number of small farms who lack the economies of scale necessary to counter volatility through their own independent hedging activities. A number are also at a natural disadvantage being further from the domestic wheat markets, while others do not have the soil types or climatic profiles to permit alternative enterprises.

To avoid significant dislocation in rural communities, there would be strong political pressure for structural adjustment to support these farmers. The costs of this would be likely to be greater than the \$1.76 billion adjustment package provided to the dairy industry a few years ago. The adjustment to the dairy industry was significantly mitigated by the ability of dairy farmers to switch enterprises given their higher rainfall zones, their inherently fertile land types and access to irrigation supplies in many cases.

In addition, the impact on many rural communities in the wheat belt would be high, given the lack of agronomic options for the farmers upon which these towns are overwhelmingly reliant. Structural adjustment would also be significantly more costly if it was needed to take farmers from their current positions off the land immediately, than if it was provided after farmers had undertaken several years of planning in view of future change.

The need to establish a statutory wheat marketing authority

The international sales of all Australian export commodities requires a significant investment in marketing and promotion activities, with industry bodies like Dairy Australia, the Australian Wine and Brandy Corporation, Meat and Livestock Australia and Australian Wool Innovation all providing essential services to develop and maintain market share.

Currently, AWB Ltd provides these services as an embedded function of the marketing structure, which has the benefit of integrating marketing fully with commercial activities. Equally, wheat product research and development functions are embedded in AWB(I). As a result, any move towards deregulation (even the option of transferring the export veto to the Wheat Export Authority) would require the immediate establishment of a statutory marketing and promotion corporation.

This would require a lead time to develop the infrastructure and resources, offshore capability, market intelligence and financial resources required. This would be most likely provided by government in the first instance and later through an industry levy. It is difficult to determine the cost of this operation, however the US Wheat Associates 2006 Annual Report indicates an annual budget (majority funded by government, partially through industry levies) of USD\$ 15.38 million. Therefore, it is reasonable to suggest that after initial establishment and infrastructure costs the annual budget for an Australian operation would be in the order of AUD\$18-20 million per annum, presumably provided by a new industry levy.

Achieving effective deregulation

To mitigate these risks and protect Australia's competitive position on global markets, we see that any removal of the Single Desk should only be contemplated as part of a long term and gradual process of regulatory change. Key principles should attend this reform to ensure that Australia does not risk its competitive position. Reform should:

- be gradual. AWB(I) should retain the Single Desk mandate over wheat exports for 3-5 years (ideally until 2010). This would allow farmers to conclude the 2008 pool, make some recovery from the current drought at least likely, allow a marketing and promotion corporation to be properly established, allow potential exporters to develop their resources and capability both onshore and offshore, and would allow time to assess any impacts of Doha reforms. Importantly, it would allow for sensible medium-term investment decisions to be made by farmers and for them

to develop their necessary capability with the financial and derivative markets.

- create the best feasible defence for growers against existing distortions in global markets. This means permitting them time to assess the outcome from the current impasse in WTO negotiations and to have a clear picture of the inequities in the trading environment they are entering.
- reduce to some degree the need for costly structural adjustment packages by allowing farmers to plan a change in production if necessary.
- not involve a return to a more regulated environment whereby the Government takes control of operating the Single Desk. Any move should reduce bureaucracy and costs, and involve greater rather than lesser distance between the regulatory function and the commercial function.
- consider the anti-competitive effects of the highly concentrated supply chain for Australian wheat, which impacts on storage, rail transport and ports.

Any move towards deregulation needs to be undertaken through a phased approach to avoid unintended consequences. Comprehensive reform of every sector of the industry would be required, and changes to Single Desk marketing without reform and restructure of all other sectors is unlikely to lead to any industry benefits.

Competing in the emerging environment

It is clear from Part 2 of this report that the international environment for global grain trading will get tougher as time passes. Australia's success as a global trader in agricultural products has been based on the assumption that Australian farmers need to be competitive on whatever terms are dictated in global markets, regardless of whether or not the actions of those shaping those markets are "fair".

It is also clear that Australia will need to continue its reform of the Single Desk arrangement in order to be consistent with international trade rules as they evolve.

The only effective strategy which will enable Australian grain growers to hold their hard won position in global grain markets into the future is to ensure individual grain growers are globally competitive and financially viable. This requires an enabling environment and supply chain that supports and does not detract from global competitiveness.

For reform of Single Desk to be effective, it should be part of a broader and comprehensive strategy of structural adjustment of the Australian grains industry.

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Abbreviations

\$CAN	Canadian Dollar
ABARE	Australian Bureau of Agricultural and Resource Economics
ABB	Australian Barley Board
ABS	Australian Bureau of Statistics
ADM	Arthur Daniels Midland
AGP	Australian General Purpose
AH	Australian Hard
APEC	Asia-Pacific Economic Cooperation
APH	Australian Prime Hard
APW	Australian Premium White
ARG	Australian Railroad Group
ASW	Australian Standard White
ASX	Australian Stock Exchange
AU\$ / AUD	Australian Dollar
AWB	Australian Wheat Board
AWB(I)	Australian Wheat Board International
AWB(L)	Australian Wheat Board Limited
BHA	Bulk Handling Authorities
CAP	Common Agricultural Policy
CBD	Convention on Biological Diversity
CBH	Co-operative Bulk Handling
CIS	Commonwealth of Independent States (including Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan)
CRC	Co-operative Research Centre
CWB	Canadian Wheat Board
ERS	Economic Research Service (US Department of Agriculture)

EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FDA	Food and Drug Administration (US)
FTA	Free Trade Agreement
GAIN	Global Agricultural Information Network.
GCA	Grains Council of Australia
GEB	Grain Elevators Board (Australia)
GHA	Grains Handling Authority (Australia)
GM	Genetically Modified
GMO	Genetically Modified Organism
GSM	General Sales Manager
IIBE&L	Institute for International Business, Economics and Law (Adelaide University)
KT/t	Kilo (Thousand) Ton/Tonnes
LMO	Living Modified Organism
LTD / Ltd	Limited
MNE	Multinational Enterprise
MRA	Mutual Recognition Agreements
MRL	Maximum Residue Limits
MT/t	Million Ton/Tonnes
N/A	Not Available
NAWG	National Association of Wheat Growers
NCP	National Competition Policy
NSW	New South Wales
OECD	Organisation for Economic Cooperation and Development
PTY / Pty	Proprietary
PNW	Pacific Northwest Wheat

QLD	Queensland
QR	Queensland Rail
SA	South Australia
SCG	Supplier Credit Guarantee
SPS	Sanitary and Phytosanitary
STE	State Trading Enterprise
SWW	Soft White Winter
TBT	Technical Barriers to Trade
US	United States
USA	United States of America
USDA	United States Department of Agriculture
USTR	United States Trade Representative
US\$ / USD	United States Dollar
VIC	Victoria
WA	Western Australia
WEA	Wheat Export Authority
WETEC	Wheat Export Trade Education Committee
WIF	Wheat Industry Fund
WMA 1989	Wheat Marketing Act 1989
WTO	World Trade Organisation

Appendix I. Single Desk: History, Structure, Value Components

I.1 Brief History

a. 1970s-80s: The first wave of reform

AWB is the exclusive manager and marketer of all Australian bulk wheat exports through what is known as the Single Desk system. It also markets and trades a range of other grains including barley, sorghum and oilseeds.

From when the first wheat marketing board was set up in World War I until the 1970s, the wheat industry was heavily regulated. From the 1970s onwards there was a gradual change in economic philosophy in the Australian economy, away from Keynesian economics towards a greater reliance on market forces. Protection for the Australian economy was being wound back and markets became both more open and more flexible. The Government began to question the policies that required them to underwrite wheat sales. Financial deregulation followed the floating of the dollar in 1983 and new financial tools were developed to manage financial risk. At the same time, global wheat markets were affected by a subsidy war between the US and the EU that led to a rapid decline in the price of some grades of wheat.⁵⁴

At the AWB, a new grading system was introduced in 1974 which distinguished between wheat types. Previously, most wheat was marketed on the same standard. In 1979 the minimum price was made to reflect actual returns on world markets. In 1984, AWB began offering different rates for different grades of wheat and permitting some domestic trades outside the AWB.

In 1984, the domestic feed market was effectively deregulated, allowing growers to sell feed wheat freely domestically.

The most important legislative development was the *Wheat Marketing Act 1989* (WMA 1989).⁵⁵ The WMA 1989 deregulated the domestic wheat market and turned the AWB into a producer-controlled organisation. The Government was acting to limit its financial liability to wheat growers. To replace the capital base, the WMA 1989 set up the Wheat Industry Fund, to be capitalised by a 2 percent compulsory levy on earnings from sales to the pool. The fund provided each grower a certificate of equity each year that indicated the size of their contributions to the fund (recognised as “units”) and their share of earnings.

The WMA 1989 retained the Single Desk due to grower support.

Until the 1980s, governments also exercised control over the supply chain for wheat, with control over bulk handling authorities (BHAs) and the railways. Costs of bulk handling and delivery were pooled (or averaged) across growers. The McColl Royal Commission into Grain Storage, Handling and Transport was established in 1986 to review the legislative arrangements for grain handling and transportation. The impetus for the review was growing costs of centralised systems for grain storage in each State. The most important recommendations of the inquiry were to charge growers for the actual cost of delivery of their grain and to restructure the BHAs as commercial entities.

⁵⁴ Ryan, T. “The Australian Wheat Board: An Engine of Change or a Caboose?” in Gray, R., Becker, T. and Schmitz, A. (eds.) “World Agriculture in a Post-GATT Environment: New Rules, New Strategies”, University of Saskatchewan, 1995.

⁵⁵ JRG Consulting Group, CIGI, “Grains & Oilseeds: Handling, Marketing, Processing” (5th ed, 2003), 2005; Ryan, 1995.

Figure I.1 Other important changes ushered by the WMA 1989 were:⁵⁶

- Total liberalisation of selling on domestic market;
- Elimination of guaranteed minimum prices to growers that had been based on historical average prices with a partial payment based on the average expected net pool return;
- Replacement of Government guarantee with a declining government guarantee of AWB borrowings which would end by 1994 (this was extended in 1992 to 1999);
- Division of wheat pool was divided into 10 sub pools, allowing for greater commercialisation and greater specialisation;
- Specification of the AWB's objectives as maximisation of grower returns by the minimization of storage, handling and transport costs;
- AWB permitted to trade in other grains;
- AWB permitted to have more than one receiver of grain per state;
- AWB permitted to buy or build handling facilities, and
- Elimination of AWB's approval for non-bulk exports.

b. 1990s – the second wave of reform

Following the adoption of the Wheat Marketing Act 1989 the industry undertook strategic planning, led by the Grains Council of Australia. The process of strategic planning was begun in 1990 and took place over five years. It included a range of studies and extensive consultation with growers, government and other stakeholders. This process generated a number of key outcomes:

- That AWB would not survive further deregulation since it was small on a global scale and not vertically integrated;
- That AWB needed further capital and to further reflect market signals and that the best way to achieve this would be to corporatise the organisation.⁵⁷

A number of models for corporatisation were examined, including a capital trust, an ordinary equity model and a dual class share model. The last option was adopted, whereby one class of shares would be issued to growers, which would confer effective control over the board of the organisation, and another class of shares would be formed from the conversion of the WIF. These shares would have only limited voting rights but would be eligible to receive dividends.

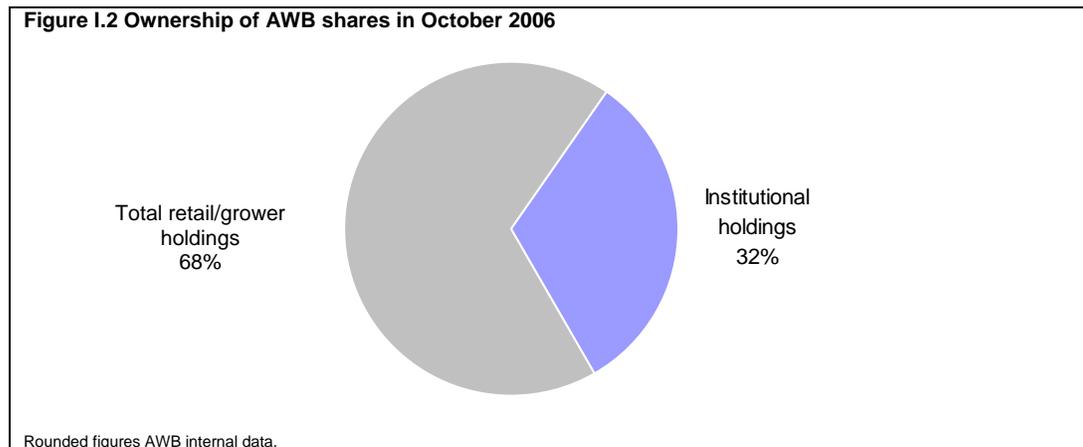
In 1997 the Government announced its broad agreement to the terms proposed by the GCA. Legislation was first tabled to give effect to the GCA model in 1997 and AWB was privatised on July 1, 1999. The regulatory function of AWB was transferred to the Wheat Export Authority, except that the legislation granted the Single Desk export rights of bulk wheat to AWB International, a wholly owned subsidiary of AWB. Australia's 30,000 wheat growers became the new shareholders based on the equity they had contributed to the Wheat Industry Fund of the new company over the preceding decade. This created a capitalisation of around A\$ 600 million. In August 2001, AWB listed on the Australian Stock Exchange, with the listing contributing around another A\$ 100 million to the capital base.

⁵⁶ *Ibid*, 2003.

⁵⁷ CIGI, 1995.

In 2004, an Independent Panel conducted a review of Australia's wheat export arrangements, under WMA 1989. The overall finding was that "AWBI has performed well in meeting its responsibilities... as the commercial manager of the wheat export single desk".⁵⁸ In 2005, the Federal Government accepted all of the Panel's recommendations.⁵⁹

WMA 1989 is scheduled for review under the National Competition Policy (NCP) principles in 2010.



I.2 Legislative and administrative arrangements

a. The Single Desk and the "pool"

A "pool" is a system by which grain is acquired, managed, marketed and aggregated with similar wheat for the purpose of marketing in bulk. Wheat pools allow growers to aggregate their production with that of other growers, to provide a more consistent quality supply to customers, to facilitate consistent market access and to manage price volatility. Using the Single Desk system, established under the WMA 1989, AWB Ltd has a formal obligation to maximise returns to wheat growers from the National Pool. The Single Desk system aims to capture value through price premiums, reducing supply chain costs, providing risk management services and give growers access to buyers in over 40 countries. Operating the National Pool requires managing the grain supply chain from over 700 receival points across the Australian wheat-belt through to international consumers.

AWB Ltd manages the AWB National Pool on behalf of AWB International ("AWB(I)"), which formally holds the Single Desk rights. The Single Desk is the only entity in Australia that may export bulk wheat overseas without the approval of the Wheat Export Authority, under the terms of the Wheat Marketing Act 1989. Through a subsidiary company, AWB (International), AWB Ltd is the sole exporter of bulk wheat from Australia.

As the contracted service provider to the Single Desk, AWB Ltd manages relevant marketing operations, export customer relationships, wheat purchasing, storage and logistics, research and development, quality and hygiene specifications, management of pools and associated financial arrangements, management of currency and other risk management activities. The provision of these services is covered by a Service Agreement that details the nature of the services and sets out

⁵⁸ Hon. Warren Truss MP, "Australian Government response to the 2004 Wheat Marketing Review", media release, 5 April 2005.

⁵⁹ *Ibid*, 2005.

the manner in which AWB is to be paid for providing them. A management fee is paid to the National Pool for specific and integrated services provided to the Single Desk that are needed to operate the Desk.

Following the recommendation of the 2004 Wheat Marketing Review, an independent review of the National Pool's remuneration model was conducted in 2004. After this review, several adjustments were made to the structure and operation of the WIB for the 2004-05 Pool. Changes related to the method for calculating the base fee and the calculation of the Out performance incentive. Remuneration to the Pool is now based on a benchmark model, the Wheat Industry Benchmark, or WIB. The Single Desk pays the National Pool an incentive if it achieves a Pool Value which outperforms the WIB. The incentive is earned in two tiers, one representing 0.375% for exceeding the WIB, and the second for exceeding the WIB plus a hurdle. The first tier is designed to provide a small element of return-on-capital that is linked to the performance of the National Pool. To share in the second tier the National Pool must achieve a set premium dollar amount per tonne above the WIB.

The WMA places explicit controls on competition in the Australian wheat industry, in particular:⁶⁰

- Export controls: Firstly, exports of wheat from Australia require the consent of the Wheat Export Authority, the statutory authority that oversees the operation of the WMA. AWB(I) has a general exemption from the requirement for consent of WEA in order to export wheat.
- AWB(I) has a veto over any consent that might be given to a person or firm that may wish to export wheat in 'bulk' quantities given by the WEA;
- Standards for wheat received: the WMA 1989 gives the Single Desk the right to establish standards for wheat it receives.

The WMA 1989 also has other key elements that define and constrict the activities of AWB, which are:⁶¹

- A section obliging AWB(I) to purchase all wheat offered to it that meets receipt standards, offer cashflow finance against the pool and operate a pooling arrangement for calculating the price of that wheat,
- A section that requires WEA to provide regulatory review of the performance of the AWB Group.

AWB Ltd is a publicly listed company and governed by a Constitution. Article 2.3 of AWB Ltd's Constitution stipulates the primary objective of the company as:

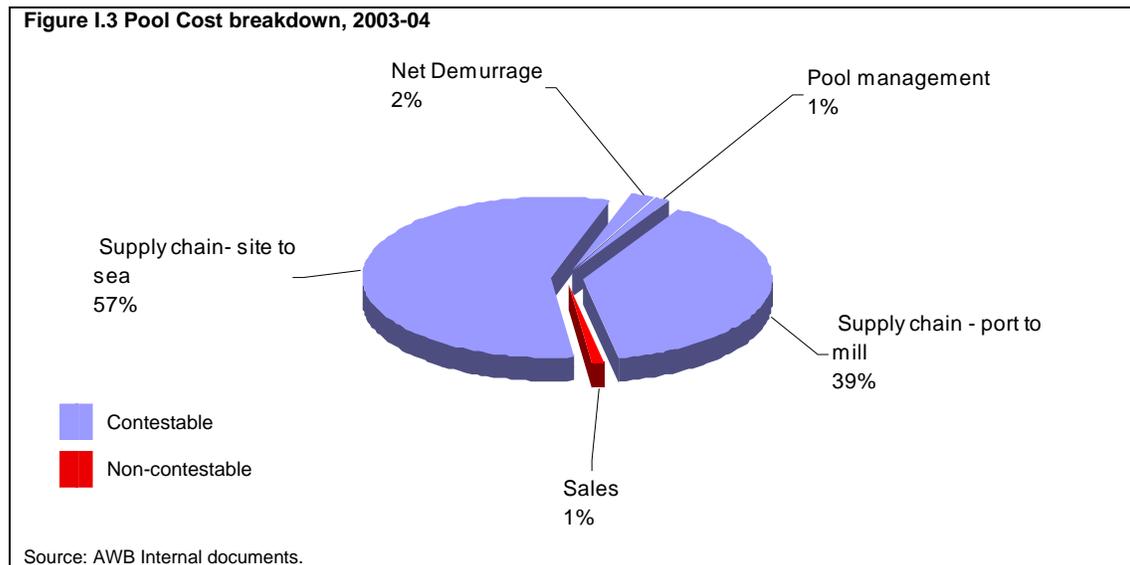
in relation to wheat growers who sell pool return wheat to the company or its subsidiaries, to maximise their net returns from the pools by securing, developing and maintaining markets for wheat and wheat products and by minimising costs as far as practicable.

⁶⁰ Gans, J., "Grower Returns and Single Desk Selling of Australian Wheat", Melbourne Business School, 2004 at www.mbs.edu/index.cfm?objectid=951E3D88-123F-A0D8-427DDA28490AF1FE at 1 October 2006.

⁶¹ *Ibid*, 2004.

In this way, AWB Ltd is the only publicly listed company in the world constitutionally obliged to ensure purchase for its suppliers, to ensure the highest return for its suppliers (rather than its shareholders) and to guarantee its suppliers timely cash-flow finance.

As a result of its monopoly AWB(I) has considerable market power in the domestic market, but its ability to exercise this power (by restricting its purchasing to drive down prices, for example) is limited by its statutory obligation to accept all wheat delivered and the obligation in the AWB Constitution to provide the best possible return to growers. While AWB(I) is obliged to market all grain it receives, it has no control over production decisions of individual growers. While AWB Ltd manages the core services of managing marketing flows, the bulk of services required to fulfil AWB(I)'s marketing commitments (in value terms) are outsourced to commercial operators through the National Pool. In fact, AWB estimates that over 90 percent of National Pool services are sourced competitively from the market (Figure I.3).



The role of the WEA

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

- To control the export of wheat from Australia; and
- To monitor AWBI's performance in relation to the export of wheat and examine and report on the benefits to growers that result from that performance.

As noted by AWB:⁶²

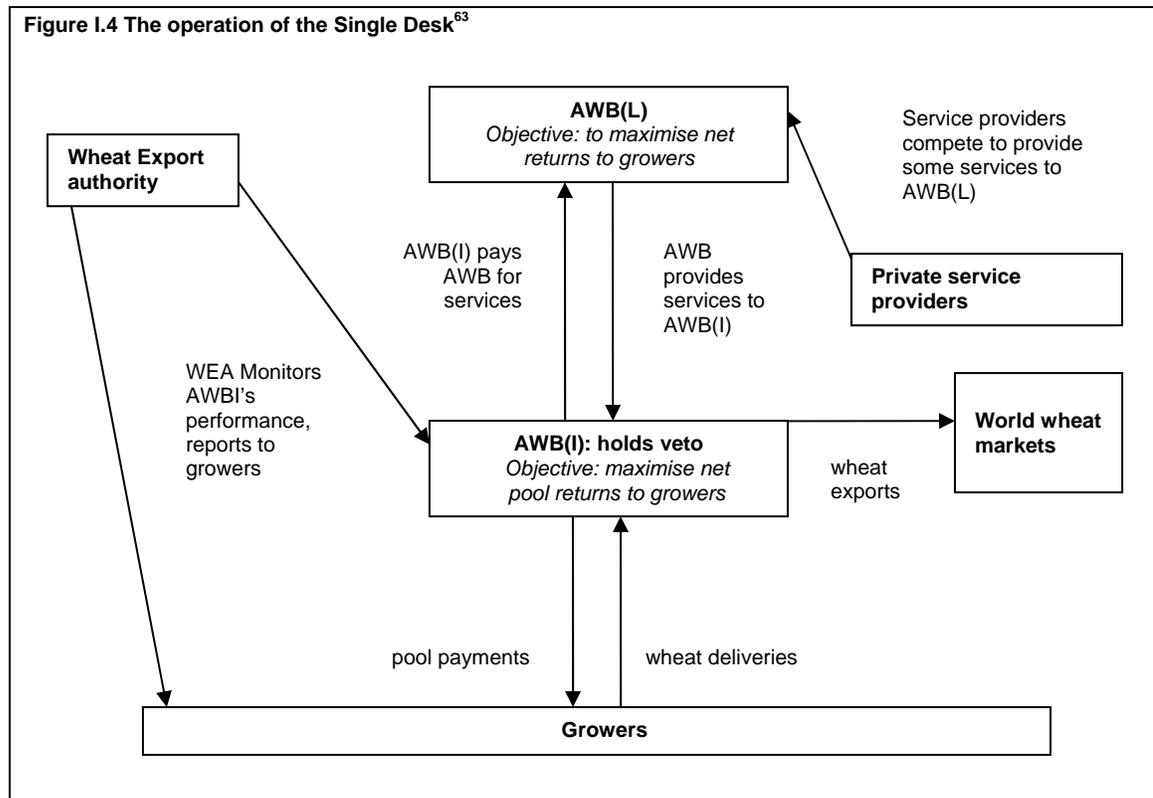
The Government's clear objective when it privatised the then Australian Wheat Board was to ensure that the Single Desk was held in a separate, wholly owned subsidiary of AWB Ltd with constitutional obligations to maximise net pool return. It was recognised at the time that AWB was privatised that the WEA cannot have complete responsibility for exports of wheat, since this would require expert knowledge and considerable resources to actually judge the commercial "soundness" of particular traders or sales. This would

⁶² AWB, "Industry Structure AWB & the Wheat Export Authority" at www.awb.com.au/aboutawb/factsandindustryinformation/publicpositionpapers/industrystructure/ at 2 October 2006.

require the establishment of a large, expensive Statutory Authority similar to the old Australian Wheat Board which the Government sought to do away with in the privatisation process.

Instead, the WEA has a statutory role to control the export of wheat through its role as monitor of AWB(I)'s performance. Figure I.4 below outlines in simple terms the interaction of AWB Ltd AWB(I) and the WEA.

Growers get charged their individual costs for receipt, storage, freight and port costs.



The structure of ownership

The AWB Ltd Constitution creates the ownership structure and puts limits on the capacity of different types of members of AWB to influence management. When AWB was corporatised in 1999, a dual share structure was adopted. This included two types of shares, which were:⁶⁴

- “A class” shares: can only be owned by current wheat growers and specifically exclude dividends. They confer on A class shareholders a number of rights, including the right to elect 7 out of the 12 AWB Directors. The Chairman must be an A class Director. To be eligible for an A class share, growers must produce at least 100 tonnes of wheat on a three year rolling basis. Only one A class share is issued to each qualified grower; however, voting entitlements are proportionate to wheat tonnage delivered to the National Pool.

⁶³ Adapted from: AWB “Your Single Desk”, Report prepared by AWB, Melbourne, 2004.

⁶⁴ *Ibid.*, 2004.

- “B class” shares: In contrast, B class shares can be owned by either wheat growers or non-growers. B class shares carry rights to receive dividends and the right to elect a minority of the AWB Ltd’s Board of Directors. It is AWB’s B class shares that are quoted on the ASX. In 1999, growers were issued with B class shares on the basis of their equity in the Wheat Industry Fund (WIF) monies collected from wheat growers over the preceding decade under a compulsory levy.

Unlike a traditional public company, where the goal is maximising shareholder value, as a cooperative, AWB Ltd operates to maximise the net returns to growers. This objective is written into the AWB Ltd Constitution. However, the Constitution also recognises the need to provide a “reasonable return” to B Class shareholders, in view of that fact that AWB Ltd may need to raise capital in the future.

Figure I.5 Ownership structure of AWB Ltd

Class of share	How allocated	Transferable	Voting rights	Eligible for dividends
A	1 share per grower (but voting entitlements are proportionate to wheat tonnage delivered to the National Pool.)	No	Yes. Voting power relates on tonnage. ¹ Majority voting rights: right to elect 7 directors of 12 on the board.	No
B	Issued on basis of equity in WIF (which was based on compulsory levy of 2 percent on wheat sales to the AWB)	Traded on ASX, 10 percent cap on ownership.	Yes. Minority voting rights. Elects 2 directors of the 12 on the board.	Yes

1. At any meeting of Members or of A Class Shareholders, an A Class Shareholder has: (i) one vote; plus (ii) one additional vote if the average annual tonnage of wheat delivered by the A Class Shareholder to the AWB Group is more than 33 1/3 tonnes per year; plus (iii) an additional vote for each 500 tonnes or part thereof per year of average annual tonnage of wheat delivered by the A Class Shareholder to the AWB Group above 500 tonnes per year.

AWB Ltd earns the bulk of its returns in global grain markets, which are oligopolistic and volatile. The marketing arrangements of the Single Desk have permitted long-term specialisation in the marketing of Australian wheat.

AWB advances the argument that the Single Desk structure is allowing Australia to “punch above its weight” in trade terms. There is some disagreement over the extent to which the Single Desk arrangement permits the Single Desk to capture price premiums in foreign markets, with debate generally turning on the question of whether the Single Desk can exercise sufficient market power to engage in price discrimination.⁶⁵

However, more pertinent to this analysis is how the Single Desk has allowed for long-term market access and price stability to Australian growers.

⁶⁵ See Ryan, T. J., “Marketing Australia’s crop: The way ahead. Review of Marketing and Agricultural Economics”, Review of Marketing and Agricultural Economics, n62, 1994, pp107–21; Gropp, L., Hallam, T. & Manion, V., “Single-desk Marketing: Assessing the Economic Arguments.” Productivity Staff Research Paper, Canberra, 2000; Carter, C. A. & Smith, V. H., “The Potential Impacts of State Trading Enterprises on World Markets: The Exporting Country Case”, Canadian Journal of Agricultural Economics, 49, 2001, pp429-439; Piggot, R. R., “Some old truths revisited”, Australian Journal of Agricultural Economics, v36, n2, 1992, pp117-140; Booz Allen & Hamilton, “Milling Wheat Project”, consultant’s report to Grains Council of Australia’s National Grain Marketing Strategic Planning Unit, Grains Council of Australia, 1995.

I.3 Impacts

a. Broad benefits of the Single Desk

In simple terms, the Single Desk allows the National Pool to generate valuable intangible assets and protect returns flowing from these assets. AWB's intangible assets include sophisticated marketing capacity, long-term trading relationships, and research and development in grain technology. These assets require specialisation.

The National Pool spreads the costs of specialisation across a wide revenue base. Control (or the ability to enforce exclusivity over returns) is provided by features of the pool, and is reflected in the ability to organise and plan marketing across a diverse range of wheat producing regions.

Empirical evidence and theory both suggest that the international grain trading market is oligopolistic and likely to remain so. This is empirically evident, since four very large firms dominate trading in the global grain market. But economic theory suggests MNEs are large in part as a result of their competitive environment.⁶⁶

All grain trading companies must invest in costly intangible proprietary assets⁶⁷—such as specialised technical skills, long term trading relationships and marketing skills. However, companies also typically find it a challenge to maintain exclusivity over intangible assets like these. Theoretical work done by Richard Caves suggests that firms that expand geographically tend to do so in part because they find it difficult to enforce ownership over their proprietary assets any other way than through expanding “control” and internalising transactions.⁶⁸

Industries that require investments in long term and costly intangible assets tend to favour large firms not only because of economies of scale, but also because expansion makes it easier to protect returns.

Academics Drs. Veeman, Fulton and Larue note that attempts to generate a return by making intangible assets available to other firms on a piecemeal basis, through such means as licensing agreements, “are often prone to market failures, arising from opportunistic behaviour.”⁶⁹ This is because the marginal cost of adding new users to an intangible asset such as an information network is minimal, but there are high incentives and returns for an external player exploiting information to undermine margins.⁷⁰

Grain traders also tend to be large because the markets they operate in are volatile, being highly dependent on unpredictable factors like weather. Size helps traders to counter risk and to maintain stability in supply. Stability of supply in wheat trade is valued highly because wheat is a vital commodity in most societies and is bought in large quantities.

The Single Desk allows Australian wheat growers to invest in building intangible assets and thereby to build and maintain market share.

The question of premiums

⁶⁶ Veeman, M., Fulton, M. & Larue, B., “International Trade in Agricultural and Food Products: The Role of State Trading Enterprises”, Report prepared for Agriculture and Agri-Food Canada, Ontario, 1999.

⁶⁷ Caves, 1996.

⁶⁸ *Ibid.*

⁶⁹ *Ibid.*

⁷⁰ Sewell, T., “The World Grain Trade”, New York, 1992.

As outlined at the beginning of this section, there is disagreement among academics and industry representatives over the extent to which the Single Desk can earn premiums on exports of Australian wheat.⁷¹ Without carrying out fresh econometric analysis, we cannot provide fresh insight on this question. However, price discrimination is only one element of the arguments advanced in favour of the Single Desk arrangement (commonly focused on, because it provides opportunities for econometric quantification).⁷²

Since it is clear Australia cannot influence prices in the market for wheat overall, arguments generally turn on whether there is perfect or imperfect competition in global grain markets, whether value is derived from wheat being produced in niche varieties, and to what extent a Single Desk arrangement is necessary to support creation of niche wheat varieties made fit for specific purposes.⁷³

Australian wheat products are somewhat more differentiated now than ten years ago. This being the case, in markets where the Single Desk provides differentiated product, the company should, all things being equal, be able to exploit imperfect competition to earn premiums, by withholding supply (this is particularly the case with Australia's noodle wheat and durum). The Single Desk competes with large conglomerates that spread the costs of marketing across larger general revenues and spread their risk over a diversified range of commercial activities. Anecdotal evidence suggests that Australia rarely withholds supply, but, in times of scarcity, sales are concentrated on valuable markets.

It is sometimes argued that it is the ability of the Single Desk to capture premiums that allows it to compete with larger companies that can mitigate market risk more easily. It is unclear to what extent the Single Desk's performance permits it to offset any disadvantages it faces vis-à-vis the major traders. Some argue that what explains the competitiveness of the Single Desk—in the absence of market premiums—is that it is the largest purchaser of wheat in the domestic Australian market (which allows it to earn greater rents on domestic wheat traded). However, the latter explanation seems unlikely. The Single Desk cannot drive down the price it pays its suppliers domestically (by holding off buying) or drive up the prices it gives to domestic buyers (which is a small market in comparison to the export market), because the Single Desk carries statutory obligations to purchase all wheat as a buyer of last resort and to maximise grower returns.

In any case, the question of whether the Single Desk arrangement is providing price premiums for Australian growers is not as pertinent to this analysis as the question of how the Single Desk has permitted the National Pool to secure valuable market share over a long period, and why maintaining these benefits relies, in the short term, on a business strategy built around the rights and obligations of the Single Desk arrangement. These benefits are—as Single Desk critics Carter and Smith acknowledge—“independent of whether or not world markets for the commodity itself are competitive,”⁷⁴ and flow from the benefits of long-term supply arrangements, scope, internal organisation and, as noted by the Industry Commission, “in market differentiation in key markets, backed up by services targeted on those markets.”⁷⁵

⁷¹ See Ryan, 1994; Gropp et al., 2000, Carter et al. 2001.

⁷² The extent to which any premiums created are actually passed on is equally contested, see Irving, M., Arney, J. & Lindner, B., “National Competition Policy Review of the Wheat Marketing Act 1989”, December 2000, report of the independent committee appointed to review the Act under the National Competition Policy agreement, p33.

⁷³ For background in the broader argument on the capacity of STEs like CWB and AWB to generate premiums see Carter, C.A. et al, 2001, pp429-439.

⁷⁴ *Ibid.*, 2001, p429-439.

⁷⁵ Industry Commission, “Statutory Marketing Arrangements for Primary Products”, Report no.10, Australian Government Publishing Service, Canberra, 1991.

The impacts of the Single Desk that are most relevant to this study are:

- How it maintains a substantial share of premium world markets for Australian growers
- How it delivers a more stable price to Australian growers.

Together, these benefits flow from long term investments in marketing and the capacity to earn returns from these investments through the Single Desk.

The individual elements of the current business strategy are outlined in below.

b. Specific benefits: local

On the Australian side, the Single Desk allows the National Pool to:

- Promote income and price stabilisation by minimising price and credit risk (through foreign exchange hedging and derivative products) and by ensuring margins are not competed away as would occur with multiple sellers;
- Engage in geographic diversification of risk, allowing for reduction in production risk for growers;
- Guarantee a buyer of last resort for all Australian wheat;
- Engage in research and development tied directly to trading outcomes and shifting market dynamics.

Income and price stabilisation for growers

The National Pool minimises price and credit risk through markets for foreign exchange and commodity derivatives. It uses AWB Ltd's large capital base to offset its exposure and smooth the volatility of international wheat prices. AWB Ltd provides a committed capital base to fund positions, allowing the National Pool to spread downside price and market risk on behalf of growers.

Buyer of last resort

The Buyer of Last Resort obligation is key when there is high stock-to-use ratio (not currently the case), and in markets that are not well served by infrastructure for transporting grain. The requirement in the WMA that the Single Desk act as a buyer of last resort is a key competitive element of the Single Desk arrangement, ensuring that the National Pool does not exploit its monopsonist position. The requirement to accept all grain that is produced in the market is "pro-competitive because it prevents AWB from exercising monopsony power when purchasing from Australian growers."⁷⁶ This ensures that the Single Desk operates in the interests of all growers, since it is required to underwrite all cashflow to growers for wheat produced, while it does not have any control of production decisions.

Enhanced bargaining position along domestic supply chain, contestability in the procurement of services

⁷⁶ Gans, J., "Grower Returns and Single Desk Selling of Australian Wheat", Melbourne Business School, 2004 at www.mbs.edu/index.cfm?objectid=951E3D88-123F-A0D8-427DDA28490AF1FE at 1 October 2006.

In Australia, the markets for inland freight, bulk handling and ports are dominated by virtual monopoly positions. (See Figure I.6 below, which outlines consolidation in the rail and storage sectors).⁷⁷

Figure I.6 Primary Logistics Providers to the Grains Industry 1989, 2006

RAIL					
	NSW	VIC	QLD	WA	SA
1989	State Rail Authority	V/Line	Queensland Rail	West Rail	Australia National Rail
2006	Pacific National		QR/ARG		

STORAGE					
	NSW	VIC	QLD	WA	SA
1989	GHA	GEB	Bulk Grains Qld	CBH WA	SA CBH
2006	GrainCorp			CBH WA	ABB

 Government owned	 Co-ops controlled by government legislation	 Public company	 Corporatised cooperative
--	---	--	--

GHA	Grain Handling Authority	CBH	Co-operative Bulk Handling	QR	Queensland Rail
GEB	Grain Elevators Board	ARG	Australia Railroad Group		

Source: adapted from Kronos Corporate "A Review of Structural Issues in the Australian Grain Market", September 2002.

The majority of services provided by the National Pool are sourced on a contestable basis, i.e., AWB Ltd selects providers competitively and attempts to secure the lowest possible prices through negotiation.⁷⁸ A range of these services are outlined in Figure I.7 (over).

The size of the National Pool in the Australian freight market also has other positive effects. In particular, larger loads allow for network optimisation. The National Pool's large coordinated shipments provide the base load required to support freighting by rail, where smaller loads would be likely to travel economically only by road.⁷⁹ In March 2006, WEA reported that the National Pool has been able to drive down supply chain costs in most states over the past 10 years.⁸⁰

⁷⁷ AWB, "Your Single Desk", 2004.

⁷⁸ Accenture produced a report in 2004 that found that removing AWB(I) from the supply chain will bring additional competition and unlock \$100 million in savings. Logistics specialists Tim Hoffman, Paul Stanley and Neil Matthews completed a report for AWB that same year which rejected this finding. It is worth noting that most evidence provided on this issue does not come from objective sources, see Irving, M. et al, December 2000: "AWB(I) claim that economies of scale and scope provided by the 'single desk' enable it to negotiate with principal service providers to lower supply chain logistics costs and charges. Much of the evidence to the contrary was provided on a confidential basis by organisations directly involved in grain trading".

⁷⁹ Hoffman, T., Stanley, P. & Matthews, N., "Single Desk and the Grain Supply Chain", Paper prepared by Strategic design + Development for AWB(I), March 2004.

⁸⁰ Wheat Export Authority, "AWB(I)'s Performance in the 2003-04 National Pool (Supply Chain, WEA Monitoring of Pool Operations, International Offices)", Fact Sheet 3, March 2006.

Figure I.7 Discipline of competition in the supply chain

Activities	Type of organisation engaged in service provision	Nature of relationship
Storing wheat Receiving wheat Testing wheat Storing wheat	Bulk Handling Companies (BHCs) e.g. CBH, GrainCorp, ABB, ABA, GrainFlow	Outsourced Service selected by grower through selection of local sites for delivery (where competition exists)
Price risk management	Banks	Competitively outsourced
Financing	Banks, finance companies	Competitively outsourced
Transporting wheat to local silo	Provided by local trucking companies and BHCs	Competitively outsourced
Trade Finance	Banks, insurance companies	Competitively outsourced.
Insurance, ocean freight	Provided by AWB Ltd, but in competition with other providers	-

Engages in research and development tied to changes in consumer preferences

The National Pool collects and coordinates detailed information on changing market dynamics. This is as used the basis for research and development. Through the Single Desk, the National Pool has access to consolidated supply and demand information, crop profiling, sales and distribution data.

The National Pool uses information on consumer preferences to blend grains, with a view to raising the average price of the crop and can create product to specification that meets the needs of particular customers. Differentiation of this type appears important in supporting higher prices for Australian wheat. Economists from the Economic Research Service at the United States Department of Agriculture⁸¹ suggest that Australian and Canadian exports of wheat exhibit higher physical and intrinsic quality than wheat from the United States. Their findings suggest that the main concern with US bread wheat is “the variability in protein quality within and between shipments.”⁸²

The Single Desk also has a system for transmitting price signals to growers, called “Golden Rewards”, which has become increasingly sophisticated in recent years. The system creates “pay grades” which are based on the variety of wheat grown and the quality attributes of the wheat and thereby provides an important incentive system to align growers’ production decisions with the needs of the market. The loss of this system through any process of deregulation would have a clearly detrimental affect on the health of the wheat export industry.

⁸¹ See Mercier, S., “The Role of Quality in Wheat Import Decision making” Agriculture Economic Report No. 670. U.S. Department of Agriculture, Economic Research Service, 1993; Mercier, S., Lyford, C. & Oliveira, V., “The Effect of Quality on Corn Export Price Determination”, Review of Agricultural Economics, n16, 1994, pp234-47.

⁸² Cited in Lavoie, N., “Price Discrimination in the Context of Vertical Integration: An Application to Canadian Wheat Exports”, American Journal of Agricultural Economics, v87, n4, November 2005.

Furthermore, the Single Desk has a process which transmits market quality and price signals to plant breeders and the R&D community. Premium Choice Varieties payments provide an incentive for breeders to meet market quality targets, which are communicated by the Single Desk through a variety of forums.

c. Specific benefits: international

Internationally, the Single Desk allows the National Pool to:

- Play international buyers off against each other and strategically ration supply in drought years to target higher value markets;
- Provide value-added services tied to Australian wheat-exports;
- Create capacity to counter the effect of market distortions such as food aid.

This section examines the mechanics behind the premiums, while the following section examines evidence for premiums.

Price discrimination, collective bargaining

AWB argues that it can use its size, its access to diverse types of wheat and its control of the export and information flows between consumers and producers to extract returns from premium buyers. Premiums come in various varieties. Firstly, some premium relate to niche varieties or markets. Through the Single Desk, the National Pool seeks to place varieties in markets where demand for them is highest.

Secondly, some premiums relate to Australia leveraging off lower freight costs than competitors in key markets. This occurs where the import parity price in the overseas country is higher than the export parity price from Australia—due to ocean freight differentials from alternative supplying countries. Through collective bargaining, the National Pool seeks to maintain prices in these markets at the competitors' rate, where price competition between Australian producers would bid away this advantage.

Figure I.8 Benefits of the Single Desk: freight premiums

Australia sells Australian Soft Wheat (ASW) to markets in South East Asia at a pre-shipping price that is on par with the US. The competing grade of wheat is Soft White Winter (SWW), which comes out of the Pacific North West.

Variety	Price excl. shipping	Freight price to South East Asia	Market price received	Freight premium
ASW	137.5	24	173.50	12
SWW	137.5	36	173.50	-

Assuming the pre-shipping price for ASW and SWW to be US\$ 137.50, the US wheat ocean freight rates are quoted at US\$ 36/MT to South East Asia, giving a total price of US\$ 173.50. The Australia ocean market freight rate is US\$ 24/MT. This delivers a premium to Australian producers of US\$ 12/MT.

The benefit of the Single Desk is demonstrated not in the existence of the premium but in the Single Desk's capacity to capture the premium almost intact, because the Single Desk controls the supply of Australian wheat exports.

Value added services

The National Pool offers a range of value-added services to final consumers of Australian wheat.

These services revolve around AWB's specialisation in a number of areas and include:

- **Global Grains** – an expanded service for customers to optimise their grain procurement from a variety of origins to complement the National Pool. Global business network gives customers access to a full range of wheat, feed grains, and oilseeds.
- **Chartering** – chartering services for over six million tonnes per year of grains and other cargoes worldwide through a fleet of handymax and panamax vessels.
- **RiskAssist** – a price risk management service which tailors hedging strategies for specific customers.
- **Other technical services** – The Global Technical Services unit offers a range of other technical service before and after purchase.

The National Pool is also involved in delivering an array of customer focused training programs in flour milling, grain quality, baking, end product assessment, grain storage and hygiene and other grain industry related subjects—all designed to reinforce preferences for Australian wheat. Flour milling is expensive and utilises complex machinery to achieve the optimum flour output.⁸³ Often the machinery has to be tailored to the type of wheat entering the mill. Mills structured to handle Australian wheat cannot be easily switched to other origins, therefore achieving customer buy-in through joint training and development, which strengthens end mill-use demand.

Capacity to counter subsidies

Global wheat markets are heavily distorted. Of the major developed-country wheat producers, Australia provides the least support to wheat production.

Export subsidies are examined in *Part 2* in the main body of this report. In short, however, subsidies can improve the competitiveness of competitor growers (through lowering their cost of production), without necessarily requiring them to sell at a lower cost or produce more product (in fact, it is not in their interests to produce more product unless forced to through the dynamics of the subsidy in question). In this context, any premiums the Single Desk is able to generate through scale and trading strategically would act as a competitive counter weight.

d. Estimates of the value of the Single Desk in earning premiums

Debate about the extent to which the Single Desk captures premiums generally turns on the question of whether it can exercise sufficient market power to engage in price discrimination.⁸⁴ As outlined in the section above, price discrimination is only one element of the value created by the Single Desk arrangement. However, it is commonly focused on, because it provides opportunities for quantification.

The Single Desk is clearly not in a position to manipulate or trade globally in a general sense by controlling supply of Australian wheat. However, there is reasonable evidence that the Single Desk

⁸³ USDA, "Quality Traits of Hrs Wheat Flour Mill Streams". Agricultural Research Service, October 2006.

⁸⁴ See Ryan, T. J., "Marketing Australia's crop: The way ahead. Review of Marketing and Agricultural Economics", n62, 1994, pp107–21, Gropp, L. et al, 2000; Carter, C. A. et al, 2001, pp429-439.

can exercise market power for some commodities in some markets, on the basis of imperfect competition in those markets.

Figure I.9 provides estimates of the premiums from a number of sources, as presented by Boston Consulting Group for AWB.

Figure I.9 Estimates of the value of premiums deriving from the Single Desk

Source of estimate	US\$/tonne	Type of measurement	Comments
Allen Consulting Group	4.20	Premium measured above competitors in market	Historical premiums above fob prices for comparable PNW wheat grades
Gans & Hirschberg	9.00	Premium measured above competitors in market	Econometric price premium estimate under perfect competition including transport cost differential
Econtech	8.13	Premium above price in a base market	Econometric price premium estimation using premium above the price achieved in a base country (Egypt)

Source: Adapted from Boston Consulting Report to AWB, 2004.

Separate work done by Econtech, for AWB, adapted three econometric models to measure premiums available to the National Pool as a result of Single Desk marketing.⁸⁵ The models differ somewhat in their assumptions,⁸⁶ but econometricians at Econtech adapted the findings of these models for comparative purposes. Econtech found that all three models showed the National Pool earning premiums on 9 different types of wheat, with only one exception.

Figure I.10 Average Export Price Premiums (A\$ per tonne), by model

Variety of wheat	Hedonic		Carter-Knetter		Price Discrimination	
	\$/tonne	percent	\$/tonne	percent	\$/tonne	percent
APH	16	6	11	4	4	2
AH	14	6	4	2	19	8
APW	30	14	16	7	15	7
ASW	6	3	8	4	5	2
AGP	17	8	11	5	61	29
Feed	-2	-1	15	10	24	15
Noodle	49	24	54	26	41	20
Soft	24	12	31	16	44	23
Durum	44	17	27	10	9	3

Source: Econtech, cited in AWB "Your Single Desk", 2003

⁸⁵ The models adapted by Econtech are: the "Carter Knetter" model, based on work by Michael Knetter (Knetter, M.M., "Price discrimination by U.S. and German exporters," *American Economic Review*, n79, 1989, pp198-210) and Colin Carter (Carter, C.A., "The Economics of a Continental Barley Market," *Canadian Journal of Agricultural Economics*, n41, 1993, pp243-255), the "Price Discrimination" model, based on work completed by Centre for International Economics and Econtech themselves, and the Hedonic model, based on work completed by Joshua Gans, an academic from the University of Melbourne/Melbourne Business School.

⁸⁶ For a discussion of how the models differ, see Econtech, "Single Desk Marketing of Wheat, Report 1: AWB's Single Export Desk and Achievement of Price Premiums" prepared by Econtech for AWB Ltd, April, 2004.

Figure I.10 show that for most wheat varieties, the three models produce comparable estimates of price premiums. The table also shows that the National Pool attracts the highest wheat export premiums for Noodle wheat and Durum wheat. Econtech's findings suggest that Single Desk achieves average premiums of A\$ 13 per tonne.

Appendix II. The Competitive Environment for Australian Wheat Growers

II.1 Competition from global grain conglomerates

Australian wheat exports compete in a highly concentrated global wheat market. Its primary competitors are vertically integrated conglomerates such as Cargill, Louis Dreyfus, Archer Daniels Midland and Bunge, as well as the Canadian Wheat Board (CWB), some of which have operations in Australia.

AWB and CWB represent wheat growers of their respective nations.⁸⁷ Both bodies control export sales, and negotiate with overseas buyers on behalf of their constituencies. They are known as “source of origin” traders.

For conglomerates such as Cargill, wheat trade makes up only a proportion of their operations. These companies are vertically integrated, with extensive sourcing, production and transportation capabilities (e.g. being involved in grain production, processing of grain into livestock feed, and final sale of packaged meat products to consumers). Some of them (Glencore, for example) have stakes in other industries, such as minerals and pharmaceuticals. In contrast to “source of origin” players such as AWB and CWB, these multinational companies are able to access multiple wheat markets and are hence less vulnerable to climatic variations. By investing in supply chain assets in multiple countries, they “have both the incentive and the ability to provide customers with wheat from multiple countries of origin.”⁸⁸ With interests in milling, crushing and livestock operations, they can often keep grain prices down. They also have significant financial arms permitting them to benefit from price volatility by speculating in foreign exchange.⁸⁹

Total revenues of these conglomerates far exceed those of AWB and CWB. It is often difficult to separate the wheat trading operations of major conglomerates from the rest of their activities. However, one estimate suggests that four major traders (Cargill, Louis Dreyfus, Archer Daniels Midland and Bunge) increased their share of world grain trade from 62 percent to 73 percent from 1998 to 2003.⁹⁰

II.2 Recent structural change in the industry

Since the 1980s global food trade in general (and the grain industry in particular) has been characterised by rapid consolidation. Numerous mergers and acquisitions have resulted in the emerging dominance of the conglomerates (outlined above), with farm input, food processing, wholesaling, service and retailing industries being concentrated in the hands of fewer, larger firms.⁹¹ Another important development has been the emergence of contract relationships between wheat growers and processors, replacing the traditional “spot market”⁹² transactions.⁹³

⁸⁷ Although CWB only represents farmers from Canada's western states of Manitoba, Saskatchewan, Alberta and parts of British Columbia. See Canadian Wheat Board (CWB), “Canada begins effort to end Wheat Board monopoly (WR)”, Hot Topic at www.cwb.ca/public/en/topics/article/index.jsp at 28 September 2006.

⁸⁸ The Boston Consulting Group, 2004, p9.

⁸⁹ FAO, “Trade reforms and food security – conceptualizing the linkages”, 2003, p123.

⁹⁰ The Boston Consulting Group, 2004, p9.

⁹¹ Marvin Hayenga & Robert Wisner, “Cargill's acquisition of Continental Grain's grain merchandising business”, *Review of Agricultural Economics*, 1999, v22, n1, 1999, p253.

⁹² A spot market is where a purchase is made on the current price and not long term contracts.

⁹³ Young, L. M. & Hobbs, J. E., “Vertical linkages in agri-food supply chains: changing roles for producers, commodity groups and government policy”, *Review of Agricultural Economics*, v24, n2, 2002, p432. Caswell, J.

These developments can be attributed to increased competition in the grain trade from Argentina, Brazil and Western Europe in the late 1980s, resulting in excess capacity and squeezing of profit margins for grain traders which are primarily US-based,⁹⁴ combined with improvements in communications technology, leading to general disappearance of “pure traders,”⁹⁵ which have either sold out to conglomerates, or started operating their own mills or silos.⁹⁶ Increased levels of competition in grain trade also provided incentives for larger companies to diversify their activities and engage in value-added processing.⁹⁷

Increase in consumer demand for differentiated food products has also been an important driver for structural change. This can be attributed to the general growth in world income leading to more selective consumption (often based on intangible features, such as food safety and process attributes), and the increase in competition in grain trade. These developments have encouraged

...a movement away from commodity production towards the production of food products with diverse characteristics for niche markets. As a result, traditional spot market transactions impose higher search and monitoring costs on transacting parties relative to contracting, strategic alliances, and other forms of closer vertical coordination.⁹⁸

Market power considerations and the emergence of economies of scale have also been cited as reasons for rapid consolidation in the industry. In a highly competitive industry characterised by tight profit margins, mergers and acquisitions are to be expected, as elimination of competitors (and subsequent growth in market power) can lead to higher profitability. Presence of economies of scale means that higher volume output can be achieved without an equivalent increase in cost. Both considerations were evident in Cargill's acquisition of its competitor Continental Grain's grain merchandising business.⁹⁹

Figure II.1 (over), provides a brief description of the size and scope of major players in the global wheat industry.

A., “Rethinking the role of government in agri-food markets”, *American Journal of Agricultural Economics*, v79, 1997, pp651-656.

⁹⁴ Hayenga & Wisner, 1999, p254.

⁹⁵ Companies involved solely in grain speculation, relying on information to do so at a profit.

⁹⁶ The Boston Consulting Group, 2004, p5.

⁹⁷ Hayenga & Wisner, 1999, p255.

⁹⁸ Young & Hobbs, 2002, p429.

⁹⁹ Hayenga & Wisner, 1999, pp255-256.

Figure II.1 International wheat industry – major players

Name	Venture type	Headquarters	Primary activities	Total revenue, \$US million, 2005 financial year (unless stated)*	Net earnings, \$US million, 2005 financial year (unless stated)	Key markets, 2005
<i>Glencore International</i>	Private company	Baar, Switzerland	Production and trade of metals, minerals, crude oil, oil products, coal, grain, oilseeds	\$91,000 (calendar year)	N/A	North Africa, Middle East, Asia
<i>Cargill Incorporated</i>	Private company	Minnesota, USA	Production and trade of agricultural commodities, livestock feed, ingredients for processed foods, pharmaceuticals	\$71,066	\$2,103	N/A
<i>Archer Daniels Midland Co. (ADM)</i>	Public company	Illinois, USA	Processing of soybeans, corn, wheat and cocoa	\$35,944	\$1,044	N/A
<i>Bunge Limited</i>	Public company	New York, USA	Agribusiness, production of fertiliser and food products	\$24,275 (calendar year)	\$530 (calendar year)	Europe, United States, Brazil
<i>Louis Dreyfus Group</i>	Private company	Paris, France	Processing and trade of agriculture and energy commodities, ownership and management of ocean vessels	\$20,000+ ^a	N/A	N/A
<i>ConAgra Foods, Inc</i>	Public company	Nebraska, USA	Production of packaged foods, trade in agricultural commodities	\$11,504 (year ended 28 May 2005)	\$642 (year ended 28 May 2005)	N/A
<i>AWB Limited</i>	Public company	Melbourne, Australia	Export of Australian wheat, barley, sorghum, canola and pulses	\$3,931 ^b	\$146	Indonesia, China, Iraq
<i>Canadian Wheat Board (CWB)</i>	Shared governance corporation	Manitoba, Canada	International and domestic marketing of wheat, durum and barley from Canada's western states	\$2,996 (total) ^c \$2,030 (wheat)	[\$2,786 (total)] ^d [\$1,897 (wheat)]	China, South Korea, Japan

*Please note that whilst 2006 data was available for some organisations, 2005 data was used for the purpose of comparison.

Sources:

Glencore, "Financial overview" at <www.glencore.com/pages/financial_overview.htm> at 21 September 2006.

Cargill, "2006 Summary Annual Report", 2006, p15.

ADM, "Annual report 2005", 2005, p1.

Bunge Limited, "2005 Annual report", 2005, p27.

Louis Dreyfus, "Worldwide business of Louis Dreyfus" at www.louisdreyfus.com/content.cfm?page=index.cfm&qbus=8 at 23 September 2006.

ConAgra, "ConAgra Foods Inc. 2006 Annual Report", 2006, pi.

AWB, "Annual report 2005", 2005, p4.

CWB, "2004-05 annual report", 2005, pp52-53.

Notes:

- Louis Dreyfus does not publish any financial information. However, on its website it states 'Aggregate average annual gross sales in recent years have exceeded \$20 billion' www.louisdreyfus.com/content.cfm?page=index.cfm&qbus=8.
- The original data was expressed in Australian dollars. In order to obtain US dollar equivalents, an average exchange rate for the 2004-2005 financial year was used (\$CAN 1 = \$US 0.7609). www.oanda.com.
- The original data was expressed in Canadian dollars. In order to obtain US dollar equivalents, an average exchange rate for the 2004-2005 financial year was used (\$CAN 1 = \$US 0.8011). www.oanda.com.
- Being a non-profit organisation, all CWB revenue is returned to growers minus the administration fees. In its annual reports, the figure is referred to as 'earning for distribution'.

Cargill

Cargill Incorporated (Cargill) is an international provider of food, agricultural and risk management products and services. According to its latest figures, Cargill's revenue reached \$US 75 billion in 2006.¹⁰⁰ It employs 149,000 people in 63 countries,¹⁰¹ and is, according to *Forbes*, the largest private company operating in United States.¹⁰² Cargill is the largest grain exporter in the United States, which is the world's biggest wheat producer.¹⁰³ A recent FAO report reveals Cargill's heavy involvement in various aspects of agribusiness:

[In United States] 60 percent of terminal grain handling facilities are owned by four companies: Cargill, Cenex Harvest States, ADM and General Mills. 82 percent of corn exporting is concentrated in three companies: Cargill, ADM and Zen Noh. Beef packing is dominated by an 81 percent share among four companies: Tyson, ConAgra, Cargill and Farmland Nation. 61 percent of flour milling capacity is owned by four companies: ADM, ConAgra, Cargill and General Mills... (Cargill) it is dominant in wheat, soybeans, corn and cotton. It is also ranked seventh in the world as a food and beverage company. Cargill is also a major player in beef packing, ethanol, steel, fertiliser production and financial services.¹⁰⁴

In 1999, Cargill acquired Continental Grain, the third-largest US grain exporter and one of Cargill's competitors. Concerns were expressed regarding the effect of the merger on the level of competition in US grain trade, with suggestions that increased concentration in the market would suppress grain acquisition prices,¹⁰⁵ resulting in lower returns for US farmers.

Archer Daniels Midland (ADM)

ADM is one of the world's largest processors of soybeans, corn, wheat and cocoa. Its revenue comes primarily from sale of protein meals, oils, sweeteners, ethanol and flour to global customers. A public company based in Illinois, USA, it employs more than 25,000 employees at over 500 agricultural processing and distribution facilities.¹⁰⁶ In 2005, its Agricultural Services segment alone (the use of company's 'grain elevator and transportation network to buy, store, clean, and transport agricultural commodities, such as oilseeds, corn, wheat, milo, oats, and barley, and resells these commodities primarily as feed ingredients and as raw materials for the agricultural processing industry'¹⁰⁷) resulted in net sales of over \$US 15 billion.¹⁰⁸

ADM's Grain Trading Group operates a network of more than 350 grain elevators (buildings used for storage and shipment of grain) worldwide.¹⁰⁹ It also has strong commercial links to the Brazilian grains and oilseeds sector, employing almost 2000 people in Brazil.¹¹⁰

Louis Dreyfus Group

¹⁰⁰ Cargill, *About Us*, www.cargill.com/about/index.htm at 22 September 2006.

¹⁰¹ *Ibid.*

¹⁰² *Forbes*, *The Largest Private Companies*, <http://images.forbes.com/lists/2005/21/htm/filter.html?sort=0>, at 26 September 2006.

¹⁰³ FAO, 2003, p.121.

¹⁰⁴ *Ibid.*, 120-122.

¹⁰⁵ USDA, "Cargill's acquisition of Continental Grain: anatomy of a merger" (1999) *Agricultural Outlook / September 1999*, 21-24.

¹⁰⁶ ADM, "Annual report 2005", 2005, p.i.

¹⁰⁷ *Ibid.*, p23.

¹⁰⁸ *Ibid.*, p48.

¹⁰⁹ ADM, "Grain trading", at www.admworld.com/naen/services/graintrading.asp at 25 September 2006.

¹¹⁰ Verdock, R., "Sizing Up Brazil's Demanding Market" (2003) *AGE exporter / September 2003*, pp14-16.

This Paris-based conglomerate engages primarily in 'processing, trading and merchandising of various agricultural and energy commodities'.¹¹¹ It also has stakes in ownership and management of ocean vessels, telecommunications, and real estate. Its grains and oilseeds sector includes offices in 29 countries, including Australia, Argentina, Canada, Europe and United States (all major wheat producers).¹¹² On its website, Louis Dreyfus reports trading and merchandising in all principal international grain markets, and of representing 'approximately 15 percent of total world trade' in grains and oilseeds.¹¹³ It operates a number of large grain elevators in United States and Canada, and owns SACEIF (one of the Argentina's largest exporters of cereals and oilseeds). Louis Dreyfus has 67 listed subsidiaries,¹¹⁴ over 10,000 employees, and operates in 53 countries.

Louis Dreyfus goes to great lengths to keep its operations private. As a private company, it does not publish any financial information regarding its activities. However, according to its website, 'aggregate average annual gross sales in recent years have exceeded US\$ 20 billion'.¹¹⁵ Its Australian subsidiary (Louis Dreyfus Australia Pty Ltd) alone has generated total revenue of almost A\$ 200 million in 04-05.¹¹⁶

Bunge Limited

Bunge is a global agribusiness and food company, based in New York. Its operations range from sales of raw materials (grains and fertilisers) to retail food products, such as margarine and mayonnaise.¹¹⁷ Its grains and oilseeds operations involve a network of approximately 275 country elevators in North America, South America and Europe, and 50 oilseed processing plants. Bunge has 25 international marketing offices throughout the world, and conducts sales of commodities to over 90 countries.¹¹⁸ Its Argentine subsidiary (Bunge Argentina) claims to be 'the largest wheat exporter, the second largest corn exporter, and one of the biggest soybeans exporters'¹¹⁹ in the country.

Bunge Limited employs over 23,000 people, with the majority working in South America. It claims to be 'the world's leading oilseed processing company, based on processing capacity; the largest producer and supplier of fertiliser to farmers in South America, based on volume; and a leading seller of bottled vegetable oils worldwide, based on sales'.¹²⁰ According to its annual report, 72 percent of Bunge's revenue in 2005 came from its agribusiness sector. Its primary markets are Europe, United States and Brazil, accounting for 82 percent of total revenue.¹²¹

The Canadian Wheat Board

¹¹¹ Louis Dreyfus, "Worldwide business of Louis Dreyfus", at www.louisdreyfus.com/content.cfm?page=index.cfm&gbus=8 at 23 September 2006.

¹¹² *Ibid.*

¹¹³ Louis Dreyfus, "Commodities – Grains and oilseeds", at www.louisdreyfus.com/content.cfm?page=grains.cfm&gbus=3&sgrp=1&rightmenu=default at 23 September 2006.

¹¹⁴ Louis Dreyfus, "Company Directory", at www.louisdreyfus.com/content.cfm?page=companydir.cfm&gbus=8, at 23 September 2006.

¹¹⁵ *Ibid.*

¹¹⁶ CPA Australia, "Louis Dreyfus Australia Pty Ltd", at www.cpaaustralia.com.au/apps/ibisworld/company.aspx?c=19210, at 23 September 2006.

¹¹⁷ NYSE Group, "Bunge Limited", at www.nyse.com/about/listed/bg.html, at 25 September 2006.

¹¹⁸ Bunge Limited, "Grains and oilseeds", at www.bunge.com/products-services/grain.html, at 25 September 2006.

¹¹⁹ *Ibid.*

¹²⁰ Bunge Limited, "2005 Annual report", 2005, p4.

¹²¹ *Ibid.*, p8.

CWB is a marketing agency for grain growers in western Canadian states. Characterised as a “shared-governance corporation”, its 15-member Board of Directors consists of 10 directors elected by western Canadian farmers, and 5 appointed by the federal government. It represents roughly 85 thousand farmers.

Under the Canadian Wheat Board Act, grain producers in Saskatchewan, Manitoba, Alberta and parts of British Columbia are obliged to sell their wheat to the CWB. Whilst technically speaking wheat growers can obtain export permits for independent exporting, these can only be purchased through CWB.¹²² Consequently, CWB is the main supplier of Canadian wheat, durum and barley and both domestically and in foreign markets.

Upon delivery of grain to CWB, farmers receive a partial payment which ‘is equal to about 75 percent of the CWB’s best estimate of the average market price for wheat and barley to be sold over the course of the crop year’.¹²³ The pooled grain is then sold domestically and overseas. If a surplus occurs after the deduction of marketing costs from total sales revenue, it is distributed as a final payment to the producers. All deficits are covered by the Canadian government.¹²⁴ CWB is also able to borrow funds at government interest rates, and has its loans guaranteed by the government.¹²⁵

In Canada (unlike Australia), a large proportion of wheat is consumed domestically. However, CWB and AWB do compete in a number of markets, including China, South Korea, Japan and Indonesia. Their total revenue figures are also somewhat similar.¹²⁶

The Canadian Government elected in January 2006 has adopted 2013 as a target date by which to implement reforms of its grain trading arrangements. The motivations behind this are analysed in more detail in Part 2 of this report, 2.2.2 a) *Pressure on the Single Desk*.

ConAgra Foods

ConAgra’s primary activity is production of packaged food. Based in Nebraska, USA, it is the owner of many household American brands, such as Egg Beaters, Healthy Choice and Hunt’s. Grain trade comes under its Trading and Merchandising segment, which netted US\$ 1.224 billion in sales in 2005 fiscal year (roughly 10 percent of ConAgra’s total sales).¹²⁷ ConAgra’s trading activities also include gas and crude oil. It claims to have the ‘No. 3 grain-handling and storage system in America’, and reports being world’s largest source of fertiliser components.¹²⁸ The Trading and Merchandising segment includes international general and merchandising offices in Canada, Mexico, Italy, Brazil, United Kingdom, Switzerland, Hong Kong and Australia.¹²⁹

Glencore International

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- ¹²² Canadian Wheat Board (CWB), “Canada begins effort to end Wheat Board monopoly (WR)”, Hot Topic at www.cwb.ca/public/en/topics/article/index.jsp at 28 September 2006.
- ¹²³ CWB, “About us”, at www.cwb.ca/public/en/about/, at 28 September 2006.
- ¹²⁴ Dakers, S., & Fr chet te, J., “The Canadian Wheat Board”, Depository Services Program, Government of Canada, at <http://dsp-psd.pwgsc.gc.ca/Collection-R/LoPBdP/modules/prb98-2-grain/wheatboard-e.htm> at 28 September 2006.
- ¹²⁵ Canadian Wheat Board (CWB), “Canada begins effort to end Wheat Board monopoly (WR)”, Hot Topic at www.cwb.ca/public/en/topics/article/index.jsp at 28 September 2006.
- ¹²⁶ CWB, “2004-05 annual report”, 2005, pp30-31.
- ¹²⁷ ConAgra, “ConAgra Foods Inc 2006 Annual Report”, 2006, p10.
- ¹²⁸ *Ibid* p12.
- ¹²⁹ *Ibid* p9.

Glencore is a Swiss-based conglomerate involved in production and trade of metals, minerals, crude oil, oil products, coal, and agricultural products. As a privately owned company, Glencore restricts access to its detailed financial information, but it has reported US\$ 91.0 billion in revenue for the 2005 fiscal year.¹³⁰ It is impossible to determine what share of this revenue comes from Glencore's grain trading activities.

In terms of grain trade, Glencore reports that its subsidiaries 'own or operate processing, storage and handling infrastructure in the UK, Hungary, Romania, the CIS, Argentina and Australia'.¹³¹ Commodities traded include wheat, corn, barley, oilseeds, meals, edible oils and rice. Glencore's subsidiary is owner of the Moreno Group in Argentina, a large producer and exporter of sunflower oil and meal.¹³²

¹³⁰ Glencore, "Financial overview", at www.glencore.com/pages/financial_overview.htm at 21 September 2006.

¹³² Glencore, "Agriculture", at www.glencore.com/pages/agriculture.htm at 21 September 2006.
Ibid.

Appendix III. Scenarios for Changing Wheat Marketing Assessed

III.1 The scenarios under consideration

According to media reports, four broad options for altering the Single Desk arrangement are currently being discussed in political and industry circles. In this section we review the principles underpinning these options and draw some conclusions about the impacts these arrangements are likely to have and raise principles which need to be considered if any path towards deregulation of the wheat marketing is to be undertaken.

This discussion must necessarily be general, since there is no detailed model of deregulation to assess.

a. The scenarios apparently under consideration:

1. Transfer the right to approve requests for bulk wheat exports to the regulator, the Wheat Export Authority;
2. Transfer the right to approve requests for bulk wheat sales to a consortium of grain and bulk storage companies;
3. Separate the Single Desk holder from the service provider;
4. Fully deregulate the marketing of wheat.

b. Assessing the scenarios

Each scenario will be assessed against the following questions:

- a. Does it achieve deregulation?

This question is pertinent because the case for altering the Single Desk is to deregulate the marketing of Australian grains.

- b. Does it preserve the global marketing position of Australian grain?
- c. Does it counter price volatility?
- d. What is the impact on lower income growers?

Scenario One: Transfer the right to approve requests for bulk wheat exports to the regulator, the Wheat Export Authority

This outcome does not achieve deregulation, but effectively is a return to arrangements similar to those in place before the privatisation of the Australian Wheat Board.

To ensure that the position of Australian grain in world markets was protected, effectively the body of marketing expertise currently found in AWB would need to be transferred to the Wheat Authority. If this did not occur, the Wheat Export Authority would not have the capability to protect complex market positions built over time. This would be a serious risk when supplies are

scarce because of the drought: the traditional position of the Single Desk when supplies are short is to protect markets which have long term value rather than seeking opportunistic offerings. In addition, the WEA currently relies on market sensitive information provided from AWB Ltd's market intelligence. Under the proposed model, WEA would not have access to this information, unless it established its own staff, and was able to secure cutting-edge information from the trading community. It is clear that this increase in resources would have to be met through a significant increase in grower levies.

If the WEA assumed a decision-making role for commercial transactions this would also raise some confusion of roles. The WEA would no longer be a regulator, but acquire a mix of functions more like the old Wheat Board from which the creation of the privatised AWB Ltd was supposed to be a step away.¹³³

There is also a question about how quickly that transfer of capabilities could be achieved. Such developments normally take a considerable period of time. Supply could be disrupted, as well as the capacity to minimise price volatility for growers.

Volatility would mean the capacity to protect the interests of lower income growers would be weakened.

In addition, prospective Australian wheat exporters would be hampered in meeting the realities of the global commercial wheat trading system. For instance, prospective suppliers make an offer to an international tender from a particular market often with only a 24-hour validity due to international price volatility. Each interested supplier would need to gain prospective approval for each offer from the WEA to ensure that if they were successful they could close the deal. Suppliers would need to have the WEA in a position to give very rapid in-principle approvals for price and quality and volume within the commercial cycle.

The WEA would need to build a much more extensive and more costly staff base, including full marketing support for international transactions.

In addition, if the WEA granted exports to multiple sellers, then there would be downward pressure on price in Australia's export markets, lowering the value of Australia's wheat exports.

If the WEA were to assume this new role in the short term, it is likely the current Pool would not be completed to its optimal value, since the process of selling runs for approximately 15 months post-harvest on average. The 2006 harvest concludes in early 2007 and the selling process can extend to early 2008. This would mean an interruption in returns to Australian wheat growers during a period of significant hardship brought on by drought.

Scenario Two: Transfer the right to approve requests for bulk wheat sales to a consortium

This would deliver few of the gains which deregulation seeks to achieve. The domestic supply chain would not be contestable, since these operators have regional monopolies on bulk handling assets in all markets.

The domestic supply chain for export wheat has a number of distortions and conflicts of interest. The primary holders of storage assets are highly concentrated. The most important distortions

¹³³ AWB, "Industry Structure AWB & the Wheat Export Authority" at www.awb.com.au/aboutawb/factsandindustryinformation/publicpositionpapers/industrystructure/ at 2 October 2006.

arise from the concentration of bulk storage assets in the hands of three companies, GrainCorp, ABB and CBH, as outlined in Figure III.1. These organisations have differing structures.

The effect of this concentration is that these operators have significant market power. This market power would allow the bulk handlers to drive down returns to farmers through tighter margins and unfavourable terms of trade, cutting returns to growers dramatically, unless these organisations were, as a consortium, required to put the interests of growers as whole ahead of their shareholders.

In addition, it would remove the incentive for supply chain costs to be reduced. Under the existing arrangements, the National Pool is required to drive down supply chain costs through negotiation or competition, and the WEA Annual reports have declared significant progress achieved in this area of recent years.

Any reform of the Single Desk arrangement that does not act on the inherently anti-competitive effects of the highly concentrated supply chain for Australian wheat is likely to cut returns to growers abruptly, unless legislative arrangements were contemplated that could promote competition in this market.

Figure III.1 Primary Logistics Providers to the Grains Industry 1989, 2006

<i>RAIL</i>					
	NSW	VIC	QLD	WA	SA
1989	State Rail Authority	V/Line	Queensland Rail	West Rail	Australia National Rail
2006	Pacific National		QR/ARG		

<i>STORAGE</i>					
	NSW	VIC	QLD	WA	SA
1989	GHA	GEB	Bulk Grains Qld	CBH WA	SA CBH
2006	GrainCorp			CBH WA	ABB

	Government owned		Co-ops controlled by government legislation		Public company		Corporatised cooperative
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GHA	Grain Handling Authority	CBH	Co-operative Bulk Handling	QR	Queensland Rail
GEB	Grain Elevators Board	CBH	Co-operative Bulk Handling	ARG	Australia Railroad Group

Source: adapted from Kronos Corporate "A Review of Structural Issues in the Australian Grain Market", September 2002.

The relationships, contacts and knowledge of the markets held by the National Pool would not be transferred, nor would the benefit of the integrated marketing relationships established by the current Single Desk. Unless the consortium was able to build their capacity and capability there would be a risk that optimal outcomes would not be achieved on behalf of growers, and failing to sell in the most valuable markets would risk Australia's market share in those markets.

Scenario 3: Separate the Single Desk from the National Pool service provider

This would separate the Single Desk from National Pool service provider. The goal would be to make all services provided to the Single Desk by the National Pool or other service providers contestable, and clearly to establish AWB(I) as a stand alone entity.

If this process did not ultimately result in full deregulation, then the result might not be a great deal different to Scenario Two, except that the process of change is likely to be handled more effectively, the risk of loss of markets and price volatility could be minimised and the critically important intellectual property and market relationships would be maintained.

If adopted through a phased approach, this appears the most feasible of the options currently suggested. AWB Ltd would be in a better position to pass on its knowledge to the newly separate entity, since it could dedicate resources to transferring capacity internally in the lead up to the split. Most importantly, this option might help to manage the risks to Australia's position in global markets that attend changes to the marketing system.

Scenario 4: Full deregulation

This scenario would be the “big bang” model of change.

It would achieve full deregulation and the introduction of many new prospective exporting companies to the market place. It would be expected that the main entrants would be the large multinational grain trading companies who would soon dominate the market.

This strategy carries a high risk of obstructing access to foreign markets for a significant number of Australian farmers, who would not be competitive without the Single Desk to stabilise their returns.

The farmers hardest hit would be those on smaller farms (with gross income of less than A\$ 500,000 per year). Of Australia's 16,300 grain-only growers, 12,500 gross less than A\$ 500,000 per annum and 6,500 have revenues of less than A\$ 200,000 per annum. Crop growers had average farm cash income margins (income after all farm cash costs but before interests, tax and depreciation) of around 20 percent in 2004-05.

To avoid significant dislocation in rural communities, structural adjustment would be required immediately to support these farmers. Structural adjustment would evidently be significantly more costly if it was needed to take farmers from their current positions off the land immediately, than if it were provided after farmers had undertaken several years of planning in view of future change.

The costs of this would be very large, many times higher than the A\$ 1.76 billion adjustment package provided to the dairy industry a few years ago.

In addition, a move towards deregulation which does not act upon the inherently anti-competitive effects of the highly concentrated supply chain for Australian wheat is likely to cut returns to growers abruptly, unless legislative arrangements were contemplated that could promote and regulate competition in this market. There is a significant risk that without strong regulation and the support of both State and Federal governments that an impasse similar to the one that eventuated recently at Dalrymple Bay could eventuate either in the storage, transport or port sectors.

Furthermore, a statutory wheat marketing and promotion authority would need to be established. This would require the imposition of industry levies, and as a comparison, using the funding benchmark of US Wheat Associates including usage of US government-provided Market Access Program (MAP) and the Foreign Market Development (FMD) grants, it would be expected that a

minimum of A\$ 20 million per annum would be required to fulfill the on-going needs of the Australian wheat industry, in addition to the initial establishment costs.

III.2 Effective Structural Adjustment

A clear message can be drawn from the foregoing analysis. Change for change's sake is frequently counterproductive, particularly when the change impacts on only one feature of a larger system and the other components are not exposed to change.

The clearest illustration would be the potential effects on many marginal farmers and rural communities of immediate deregulation. This would disrupt a system upon which over 10,000 farm businesses have adjusted business risk on the basis of price stabilisation provided by the system. The economic and social disruption would be considerable.

The sudden change would also jeopardise the strong position and loyal commercial relationships in global markets built up over a long period on behalf of Australian grain growers.

Transferring the Single Desk function to an oligopsonist group, which has strong control over the supply chain, such as under Scenario Two, would carry strong risks. Such a reform should be accompanied by a strategy to improve competitiveness in the supply chain, which would ideally be the subject of a prior analysis by the Productivity Commission on how best to achieve that.

III.3 De-regulating during drought

The key problem facing all scenarios is that removing the price stabilisation function of the Single Desk during a period of drought is likely to create significant price volatility for farmers.

This is not a time to make changes the full consequences of which may not be clear when the bulk of the industry is buckling down to cope with the effects of prolonged drought.

Periods of shortage of supply are also critical periods for managing marketing to preserve positions in premium markets. This would be a particularly inopportune time to change Single Desk arrangements with the attendant risk of loss of marketing experience which is likely to follow in the scenarios being mooted.

Any immediate change carries risk that the current Pool would not be optimised. The 2006 harvest concludes in early 2007 and the selling process can extend to early 2008. This would mean an interruption in returns to Australian wheat growers during a period of significant hardship brought on by drought. Figure III.2 assesses the options under the criteria above.

III.4 Principles to govern reform which preserves market positions

When considering the cost of changing the incumbent Single Desk arrangement, the current arrangements should be compared, in their totality, to policy scenarios likely to succeed them. The question of whether rapid removal of the Single Desk is likely to damage the competitive position of Australian wheat is central.

To reproduce all the functions of the Single Desk in either the WEA or with a consortium and to maintain the level of specialisation in marketing of Australian wheat would require an entirely new structure. The analysis in this report suggests that this structure cannot be produced or adopted immediately—or even in the short term—without risking the position of Australian wheat on global markets.

Figure III.2 Scenarios for deregulation assessed

Policy scenario	Effective deregulation?	Allow growers to maintain market share?	Allows vulnerable growers to manage change?
Transfer Bulk Veto to Wheat Export Authority	No. A step backwards (re-regulation) to a larger Government role in commercial decision making. Bureaucratic and costly, with higher levies, creates inefficiency and introduces delays for exporters awaiting price approvals before being able to confirm tender offers.	No. WEA is not equipped to concentrate scarce production in the most valuable markets, and does not provide any exporter with the security required to invest in long term market development in any particular country.	Not if WEA cannot maintain effective export flow to highest value markets.
Transfer Single Desk to a consortium of grain companies.	No. As these companies already have effective regional monopolies, the removal of competitive tensions in the domestic supply chain would be detrimental to the interests of producers. This would necessitate a full national Productivity Commission review of the complete grain supply chain and a comprehensive competition policy reform.	Possibly, but with ambiguous impact on growers, because of lack of contestability in the provision of all services in the domestic supply chain. There would also be a period of 2-3 years where the consortium needed to develop its offshore offices, sales and marketing capability, as well as the corporate structures to manage the financial risks of such an enterprise.	Unlikely, due to inherent disincentive to reduce supply chain costs or to maximise grower margins.
Fully separate the Single Desk from the National Pool service provider	No. Unless it is a transitional measure as part of a managed strategy to move to full deregulation.	Yes, provided sufficient time was given to build the capacity of new entity prior to separation.	Yes, provided it allows time for growers to recover from the drought and to make medium term investment decisions that reflect the likelihood of future deregulated conditions.
Rapid full deregulation	Yes. Achieves goal of full contestability.	No, since maintaining market share relies on the relationships of the Single Desk. Would require costly establishment of marketing and promotion corporation.	No, would bring abrupt change, cutting off farmers from foreign markets. Would require significant structural adjustment.

To mitigate the risks identified above and protect Australia's competitive position on global markets, we conclude that any removal of the Single Desk should only be contemplated as part of a long term, deliberate and progressive process of regulatory change, which allows complete reform of the entire grain handling and marketing systems, and provides time for the capability of the marketers, regulators and statutory marketing and promotion corporation to be sufficiently developed.

Key principles should attend this reform to ensure that Australia does not risk its competitive position. Reform should:

- be gradual. AWB(I) should be given a mandate over wheat exports for at least 3-5 years (ideally to 2010). This would make some recovery from the current drought at least likely, it would allow a marketing and promotion corporation to be properly established, it would allow potential exporters

to develop their resources and capability both on-shore and off-shore, and it would allow for sensible medium-term investment decisions to be made by farmers and for them to develop their necessary capability with the financial and derivative markets.

- create the best feasible defence for growers against existing distortions in global markets. This means permitting them time to assess the outcome from the current impasse in WTO negotiations and to have a clear picture of the inequities in the trading environment they are entering.
- Reduce to some degree the need for costly structural adjustment packages by allowing farmers to plan a change in production if necessary.
- not involve a return to a more regulated environment whereby the Government takes control of operating the Single Desk. Any move should reduce bureaucracy and costs, and involve greater rather than lesser distance between the regulatory function and the commercial function.
- Consider the anti-competitive effects of the highly concentrated supply chain for Australian wheat, which impacts on storage, rail transport and ports.

Any move towards deregulation needs to be undertaken through a phased approach to avoid unintended consequences. Comprehensive reform of every sector of the industry would be required, and changes to Single Desk marketing without reform and re-structure of related sectors is unlikely to create a net benefit from change.

Appendix IV. Australia's Role in Global Wheat Markets

IV.1 The Australian grains industry

The Australian grains industry has long been an important part of the Australian economy in terms of both production and trade. Of the four distinct grains product groups—wheat; coarse grains (barely, sorghum, oats, triticale and maize), oilseeds (canola, cottonseeds, sunflower seeds and soybeans) and pulses (lupins and field peas)—wheat is the most important.

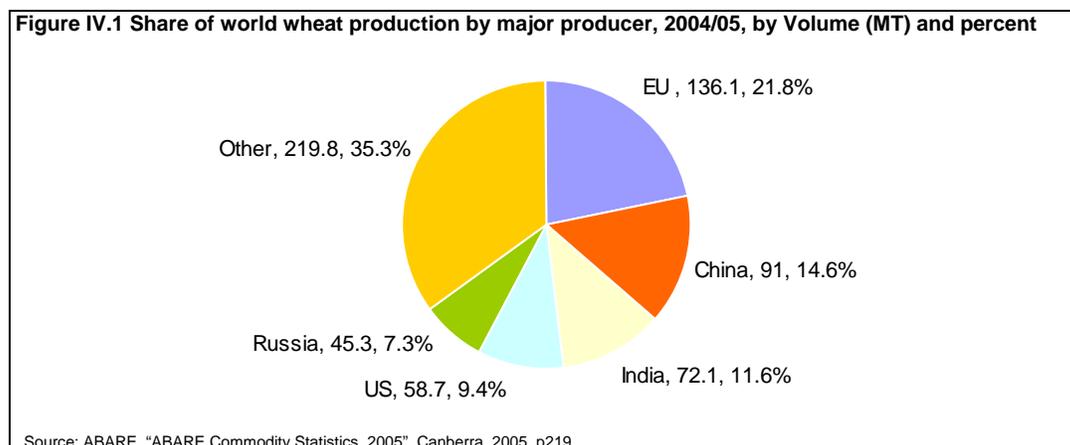
Grains production accounts for around 20 percent of the value of agricultural production in Australia.¹³⁴ Wheat is the largest crop, accounting for around 15 percent of the total value of Australian farm production. In 2004/05 this was in excess of 22.6 million tonnes, valued at AU\$4.3 billion.¹³⁵ Wheat production, sale and distribution provided jobs for almost 30,000 Australian wheat growers in 2004, along with harvest contractors, transport operators, storage handlers, marketers and millers.¹³⁶

As domestic consumption is small and relatively stable, about 75 percent of Australian grain production is exported.¹³⁷ In 2004/05, grains exports were worth over AU\$ 4 billion and comprised almost 20 percent of Australia's exports of rural goods. Wheat comprises the majority of these exports, with overseas sales in excess of AU\$ 3.4 billion.

IV.2 Global wheat production and trade

a. Global production

Global wheat production has been increasing steadily since the 1960s, exceeding 600 million tonnes (MT) in 2004/05. In 2004/05 major producers were the EU-25, China, India, the US and Russia. These countries accounted for 64 percent of global wheat production.¹³⁸ Australia is a relatively minor producer of wheat, contributing around 3 percent to world production.¹³⁹



b. Global wheat trade

¹³⁴ ABARE, "ABARE Commodity Statistics, 2005", 2005, p219.

¹³⁵ ABARE, "Australian Commodities 06.2", June Quarter, 2006, pp436-439.

¹³⁶ Australian Bureau of Statistics (ABS), "1301.0 – Year Book Australia 2006", The Australian Wheat Industry, 2006 at www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/1301.0Feature%20Article212006?opendocument&tabname=Summary&prodno=1301.0&issue=2006&num=&view at 11 October 2006.

¹³⁷ ABARE, 2005, p213. The figure relates to exports as a percentage of total production, from 1990-91 to 2004-05.

¹³⁸ *Ibid*, 2005, p219.

¹³⁹ *Ibid*, 2005, p213. ABARE, "Australian Commodities 06.2", June Quarter, 2006

Just under 20 percent of global wheat production by volume is traded internationally.¹⁴⁰ In absolute terms, trade has increased in volume terms from the 1960s, rising from just 62 MT in 1965/66 to 109 MT in 2004/05. Since the 1990s, total trade has averaged 105 million tonnes, rising to 110 MT in 2005/06.

Global wheat exporters

Unlike wheat production, global wheat trade is characterised by developed country exporters and developing country importers.

Wheat exports are dominated by five countries. These are the US, Australia, Canada, Argentina and the EU (25). Together these five account for over 78 percent of global wheat exports.¹⁴¹

Although Australia is a minor producer of wheat, it is (along with Canada) the world's second largest exporter following the United States. In 2004/05, Australian exports accounted for about 15 percent of global wheat exports.

Australia's dominant export position relative to production is partly explained by low domestic consumption, due to the relatively small population.

The Russian Federation, Kazakhstan and Turkey are smaller exporters.¹⁴² China and India have large domestic markets which consume a substantial amount of what is produced and are both generally net importers.¹⁴³



Wheat import markets

While wheat exports are dominated by a few countries, many countries import large amounts of wheat. Although the EU, Japan and South Korea are large importers, the majority of wheat imports are in developing countries. Together developing countries now account for almost 80 percent of imports.¹⁴⁴ These include countries with limited production potential, such as Egypt, Algeria, Indonesia, Iraq, Mexico and Nigeria.

¹⁴⁰ In 2004/05 wheat trade was just under 18 percent of production, totaling 109 MT. ABARE, 2005, pp219-220.

¹⁴¹ ABARE, 2005, p219.

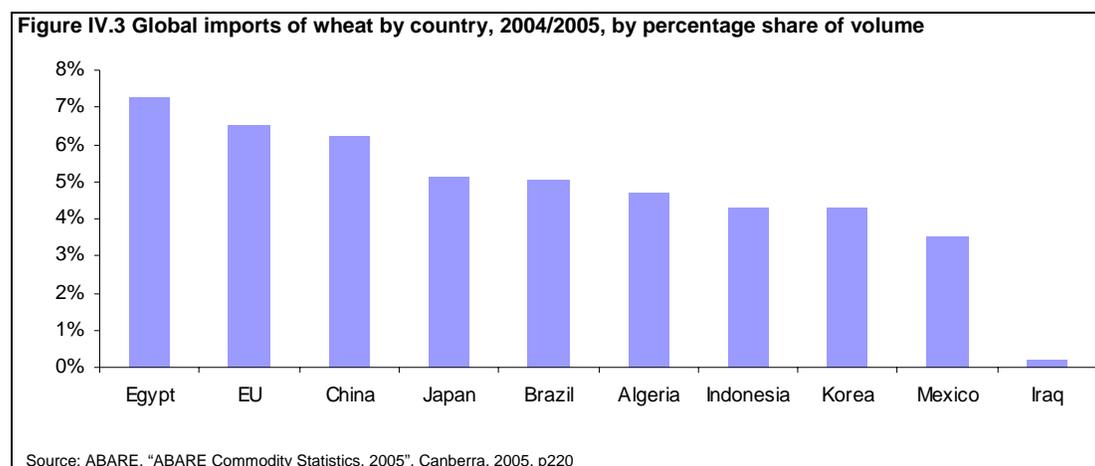
¹⁴² *Ibid*, 2005, p220.

¹⁴³ Although China was a net exporter for the years 2000/2001.

¹⁴⁴ ITS Global calculations based on ABARE, 2005, p220.

Major global importers in 2004/2005 were Egypt, the EU, China, Japan, Brazil and Indonesia, South Korea, Algeria, Mexico and Iraq.¹⁴⁵ No one country accounted for more than 7 percent of global wheat imports.

Import markets can be divided into two types; milling wheat and durum markets. Milling markets are large, accounting for about 95 percent of world wheat trade. They can generally be classified according to prescriptive demand in premium niche markets and less prescriptive demand in lower price markets where specifications are more flexible.¹⁴⁶ The bulk of wheat traded is not a niche product. Niche markets often require wheat that meets precise specifications with regard to protein, hardness, moisture, colour and dough properties. The main markets with demand for highly specified product are Japan, South Korea, the EU and the US.



Lower-priced markets where specifications are broader and more flexible are much larger. They mainly include developing countries in North Africa, South East Asia and the Middle East (such as Egypt, Iraq, and the Philippines). Much of the wheat imported into North Africa and the Middle East is used for flat rather than fully-leavened breads. This bread is only partially leavened requires different specifications from wheat typically used for bread making in the western world. This is also the case for South East Asia, where wheat is imported for consumption as noodles and steam breads. World durum markets are much smaller than milling markets, accounting for less than 5 percent of total world wheat production.¹⁴⁷ Major markets for durum wheat include the US, the EU (Italy) and Algeria (where it is used to produce couscous rather than pasta).

Australia's export markets

Australia exports wheat to more than 40 countries, but is a dominant exporter to the Middle East and Asia. Major markets include Indonesia, Sudan, South Korea, Japan, Malaysia, and Egypt. Vietnam and Yemen are important but growing markets, and are expected to turn into major importers of Australian wheat in the future.¹⁴⁸

Figure IV.4 Share of Australian Wheat Imports, by importer, 2004/05, volume (MT) and percent

¹⁴⁵ ABARE, 2005, p220.

¹⁴⁶ Carter, A., "Current and Future Trends in the Global Wheat Market", in World Wheat Overview and Outlook 2000-2001: Developing No-Till Packages for Small-Scale Farmers, International Maize and Wheat Improvement Centre, Mexico, 2001.

¹⁴⁷ *Ibid*, 2001.

¹⁴⁸ AWB, internal document.

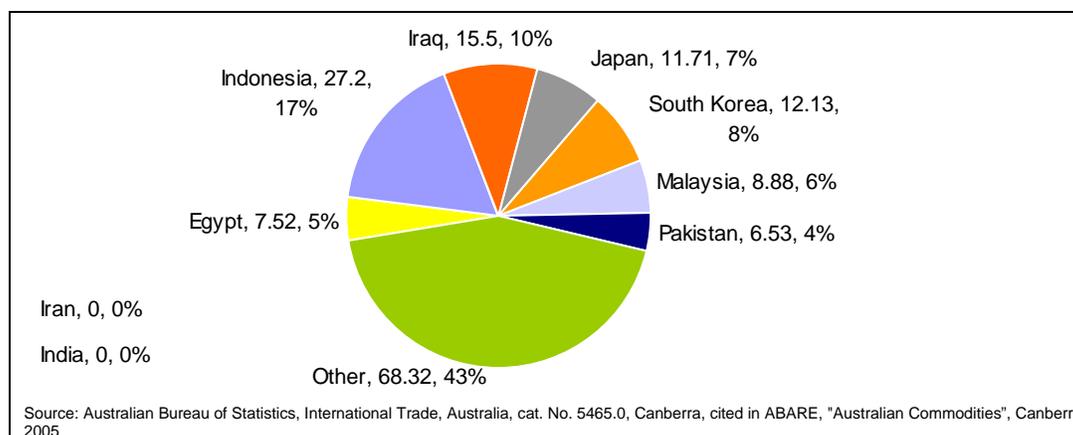


Figure IV.5 Australia's Share of Global Export Markets, 2002-2005, percentage share based on volume.

Importing Country	2002/03	2003/04	2004/05
Bangladesh	9.7	7.3	8.1
Egypt	9.5	34.7	9.2
India	0.0	50	0.0
Indonesia	42.3	58.4	58.4
Japan	20.3	21.7	20.4
South Korea	25.0	31	33.8
Malaysia	31	55.5	62.9
United Arab Emirates	14.1	17.3	19.9
Yemen	23.3	12.1	17

Sources: ABARE, "Volume of Australian Exports of Wheat and Flour, by destination", Australian Commodity Statistics 2005, Canberra, p215, 2005 & US Department of Agriculture, "World Wheat, Flour and Products Trade", Foreign Agriculture Service, Washington, USA, 2006
Notes: July - June Year, Country Imports include Wheat and Flour Products, Exports include Wheat and Flour

Australia's most important export markets are Indonesia, Japan, South Korea, Sudan, Yemen, Malaysia and China. India, China and Pakistan are considered "opportunistic" markets, as exports to these countries depend on their year-to-year domestic production levels.

Figure IV.6 Major destinations of Australian wheat volume (MT) and gross revenue, 2004-05

Market	MT	Gross revenue (US\$ million)
Egypt	0.7	119
Indonesia	2.7	379
Japan	1.2	201
South Korea	1.2	157
Malaysia	0.8	138
Pakistan	0.6	45

Source: Australian Wheat Board calculations

The type of wheat supplied by Australia is well suited to the consumption and end-use needs in major markets. The majority of Australian wheat produced today is milling wheat, which is used to make noodles and flatbreads. The production of durum wheat, used for pasta and couscous, is only suited to certain geographic regions in Australia and accounts for only 3 percent of the Australian crop. It is mainly exported to Italy.

The major volume wheat produced in Australia is Australian Standard White (ASW). ASW meets the demands of Australia's Middle East and Asian markets due to their requirement for free

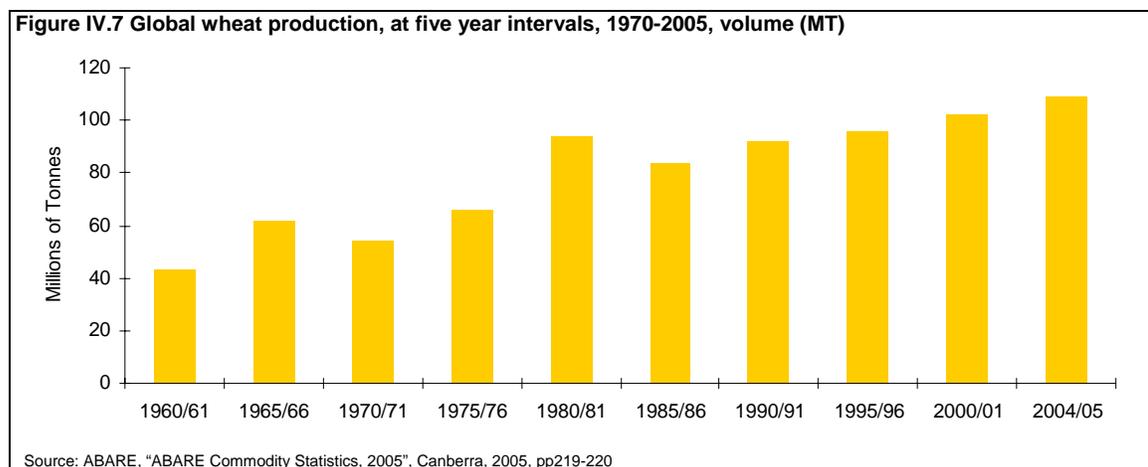
milling white wheat. ASW is primarily used in the Middle East to produce Arabic unleavened flatbreads.

Australia also has a clear competitive advantage for exporting to countries in Asia and the Middle East due to geographic proximity. As one of the few major suppliers of wheat in the Southern Hemisphere, along with Argentina, it is also capable of supplying during the Northern Hemisphere's off-season.

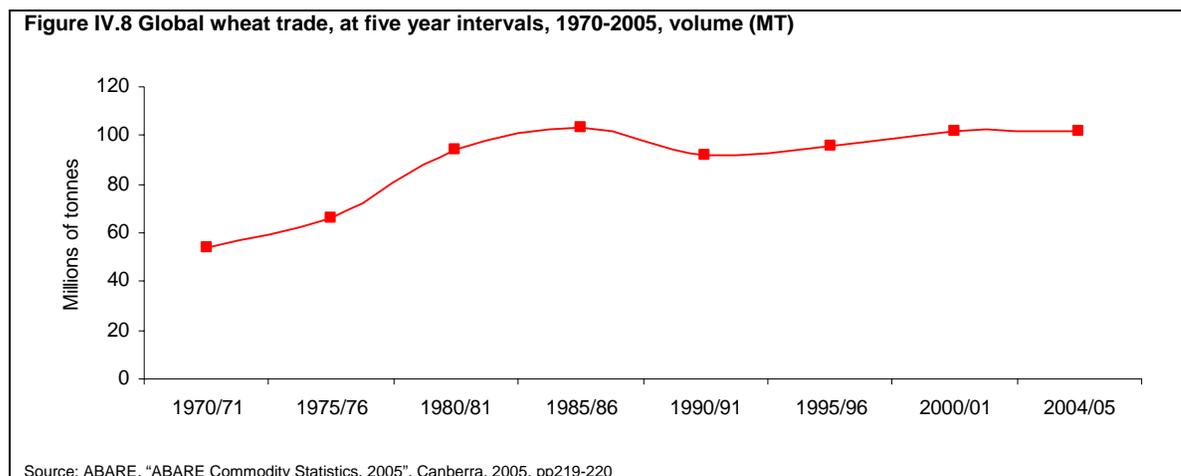
IV.3 Trends in global wheat trade and production

a. Overall trade and production

Although world production of wheat has increased in absolute terms,¹⁴⁹ growth has been relatively stable. Production grew rapidly in the 1970s and 1980s, but has not shown significant growth since then (Figure IV.7).¹⁵⁰



Global wheat trade grew rapidly in the 1970s, but slowed during the 1980s. It has been relatively stable since the 1990s, improving slightly from 2000 (Figure IV.8)¹⁵¹



¹⁴⁹ Rising from 265 MT in 1965/66 to 623 MT in 2004/05. ABARE, 2005, p219.

¹⁵⁰ By 33.6 MT or 5.7 percent. ABARE, 2005, pp219-220.

¹⁵¹ ABARE, 2005, p220.

Global wheat trade has expanded relatively steadily over the last 30 years (Figure IV.8).¹⁵²

b. Major exporters and importers

Although traditional global wheat exporters have dominated trade since the 1970s, the last 10 years have seen the emergence of non-traditional exporters¹⁵³ such as Kazakhstan, Russia, Ukraine and India. In aggregate these countries have increased their global market share of from just 2 percent in 1997/98 to nearly 17 percent in 2004/05.¹⁵⁴ East Asian imports doubled in the 1990s and East Asia now represents the largest importing region. Import markets that have shown growth since the 1990s include Egypt, South Korea, Mexico and Indonesia.

The last ten years have also seen the importance of Russia in world import markets decline while Chinese demand has fluctuated and demand in East Asia ex-China, Latin America and North Africa has increased.¹⁵⁵

During the early 1980s China and the Russia were both large wheat importers. In the late 1980s and early 1990s China's imports accounted for about 15 percent of global trade volume. In the late 1990s imports plummeted, accounting for only 2 percent of imports from major import markets.¹⁵⁶ In 2000/01 China was a net exporter of wheat.¹⁵⁷ Since 2001, Chinese imports have increased again, rising to around 13 percent of imports of major importing countries in 2004/05.¹⁵⁸ Russian imports have steadily declined from levels in the 1990s while exports have increased.

This can partially be explained by improvements in infrastructure and distribution systems for wheat, which have led to less domestic production being wasted, particularly in the former communist countries, as infrastructure and distribution systems have improved.

¹⁵² USDA ERS, "Briefing Rooms: Wheat: Trade", 2005 at www.ers.usda.gov/Briefing/Wheat/trade.htm at 18 October 2006.

¹⁵³ Carter, A., 2001.

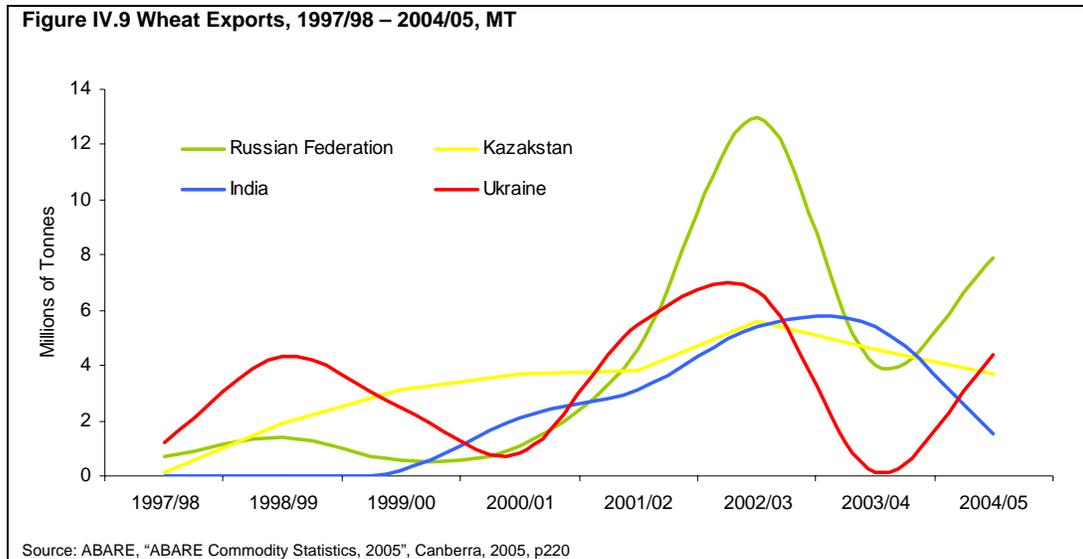
¹⁵⁴ For example, exports from Russia increased from 1.4 MT in 1998/99 to 4.6 MT by 2001/02 and 7.9 MT by 2004/05. Exports from Kazakhstan increased from 1.9 MT to 3.8 to 3.7 in the same years. ABARE, 2005, p219.

¹⁵⁵ Carter, A., 2001.

¹⁵⁶ In 1999/2000.

¹⁵⁷ Imports 0.2 MT.

¹⁵⁸ 3.7 million MT in 2003/04, rising to 6.8 MT in 2004/05.



Iran, India and Malaysia are projected by the OECD and FAO to be important growth markets for Australian exports. The increase is projected to be driven by shortfalls in production in domestic economies as demand increases.¹⁵⁹

Figure IV.10 Projected growth of Australia's key wheat export markets (MT)

Country	Average 2003-2005 estimated	2015 projected	Change %
Egypt	7.4	8.4	13.09
India	0.4	1.3	321.86
Indonesia	4.7	5.4	16.12
Iran	0.3	2.1	826.64
Japan	5.5	5.4	-1.97
South Korea	3.7	4.5	21.14
Malaysia	1.4	1.7	23.63
Pakistan	0.7	0.6	-6.84

Source: OECD-FAO Agricultural Outlook 2006-2015, p122

¹⁵⁹ *Ibid*, 2006, pp36 & 39.

Appendix V. Traditional Threats to Australia's Wheat Producers

Global wheat production and trade has traditionally been subject to considerable volatility. Australian wheat exports face a number of established threats. These include (among others) exposure to weather patterns, freight costs, significant exposure to currency fluctuations, and the emergence of former command economies as major wheat exporters.

a. Climatic variation

Global supply of wheat is highly volatile primarily due to the significant impact of climatic variations on production. For example, the drought of 2002/3 reduced Australia's wheat production from 24.3 MT in 2001/02 to 10.1 MT (a decrease of 58 percent); more favourable conditions in 2003/4 brought the production back to 26.1 MT (an increase of 158 percent).¹⁶⁰ Such variation makes it difficult to develop and sustain long-term customer relationships in wheat trade. Wheat has to be "rationed" to maintain important customer relationships when supply is low; when supply is high, new customers must be found.¹⁶¹

Whilst Australia is not the only wheat exporter subject to climate variations, wheat producing regions have recently experienced particularly dry weather. For 2006/7, area planted to wheat is estimated to be down by 14 percent to 11.1 million hectares. Production is forecast to decline to 9 to 11 million tonnes (a decrease of at least 56 percent from 2005/2006).¹⁶² If Australia fulfils its forecasted export commitments, its wheat stocks will experience an 11.3 MT reduction during 2006/7.¹⁶³

However, because of its sheer size, Australia's States experience different climatic conditions in the same season, influencing production. Crop growth in Western Australia is almost entirely dependent upon winter rains, whilst other states usually experience considerable spring rainfall.¹⁶⁴ The geographic diversification allowed by the use of a national pool means that the reliability of Australia's wheat supply is less exposed to climatic fluctuations.

b. Freight cost

Land freight cost makes up a large proportion of expenditure associated with wheat trade. In 2005, AWB estimated transactional costs (transport, storage and bulk handling) consumed 13.7 percent of total revenue, but this excludes sea freight.¹⁶⁵ Sea freight costs account for a significant share of the value of international trade in wheat and coarse grains. Although nominal freight rates of grains have tended to decline, the FAO estimates that for many countries, freight charges can add one-fifth to the cost of grain importing. In the competitive grain market that has existed since the mid-1990s, freight costs can also play a pivotal role in the volume and direction of grain trade.¹⁶⁶

Physical proximity to markets is crucial: the United States Department of Agriculture has argued that, despite being the world largest exporter of wheat, US market share in Indonesia's wheat

¹⁶⁰ ABS, 2006.

¹⁶¹ The Boston Consulting Group, 2004, p7.

¹⁶² AWB, "Reduction in the 2006/07 wheat production forecast", public announcement, 25 October 2006.

¹⁶³ ABARE, "Australian Crop Report", no.139, 2006, p19.

¹⁶⁴ Simmonds, D., "Wheat and wheat quality in Australia", William Brooks, Queensland, 1989, p2.

¹⁶⁵ AWB, "Submission to the House of Representatives Standing Committee on Transport and Regional Services", 2005, p7.

¹⁶⁶ FAO, "FAO/GIEWS - Food Outlook No.1", February 2000, p8.

imports is insignificant 'due to a significant freight cost disadvantage'.¹⁶⁷ Recent high fuel prices, combined with shortages in capacity for ships (driven by the resource boom) have further exacerbated comparative freight advantages.

Compared to other major wheat exporters (USA, Argentina, and Canada), Australia's geographic location means it is well-placed to serve the Asian markets (Indonesia, Japan, South Korea, Philippines, China). This advantage, however, is currently being eroded:

The substantial freight cost advantage Australian growers have traditionally enjoyed over their North American peers, especially in Asian markets, is eroding as ports are constructed in Asia to receive Panamax and larger vessels. Vietnam recently opened a deep water port that can accommodate these very large vessels, and several similar ports are under construction in Malaysia, while mills are locating nearby. The majority of US corn exports to South Korea are already via Panamax vessels, and wheat may soon follow. Customers with deep water access are bundling North American wheat and other grain into these larger shipments, accessing freight savings and putting additional pressure on Australian returns.¹⁶⁸

In addition, the emergence of a number of former command economies (Russia, Ukraine and Kazakhstan) as major wheat exporters is decreasing Australia's comparative freight advantage in Asia. This threat is discussed in more detail below.

c. Emergence of former command economies

A number of former Soviet Union republics (Russia, Kazakhstan and Ukraine) have emerged as major wheat exporters over the recent years. This has been primarily due to their increased openness to global markets, and higher levels of investment in agricultural sectors (which are characterised by low costs of production).¹⁶⁹ In the last 6 years, the combined wheat exports of these nations have increased from 9 MT to 20 MT, accounting for 17.6 percent of world exports in 2005/6.¹⁷⁰ USDA has predicted that Ukraine and Kazakhstan will continue gaining market share.¹⁷¹

Due to the region's weather extremes, production and export figures of these countries tend to be volatile even by the standards of commodity markets.¹⁷² However, their presence in the wheat market 'is expected to remain a factor over the longer term, as consistent quality and reliability continue to improve'.¹⁷³ An advantageous geographic location means they are well-placed to serve the Asian, Middle-Eastern and North African markets, and are less dependent on sea shipping (which is less efficient than road or rail transport).

d. Cost of inputs

Compared to most other agricultural activity, wheat production is energy-intensive. USDA has estimated that energy input costs for US wheat production accounted for 52 percent of total operating costs in 2004.¹⁷⁴ Energy use includes direct energy consumption (the use of petroleum,

¹⁶⁷ USDA, "Indonesia Grain and Feed Annual 2006", GAIN Report Number: ID6003, 2006, p3.

¹⁶⁸ The Boston Consulting Group, 2004, p9.

¹⁶⁹ USDA, "Agricultural Baseline Projections: Global Agricultural Trade, 2006-2015", 2006.

¹⁷⁰ USDA, "Grain: World Markets and Trade – May 2006".

¹⁷¹ USDA, "Agricultural Baseline Projections: Global Agricultural Trade, 2006-2015", 2006.

¹⁷² Russia, Ukraine and Kazakhstan accounted for 23 percent of world exports in 2002/3, 7 percent in 2003/4, 13.3 percent in 2004/5, and 17.6 percent in 2005/6. USDA, "Grain: World Markets and Trade – May 2006", p5.

¹⁷³ AWB, "Investor Fact Book 2004", 2004, pp101-102.

¹⁷⁴ Shoemaker, R., McGranahan, D. & McBride, W., "Agriculture and Rural Communities Are Resilient to High Energy Costs", Amber Waves, v4, n2, 2006, p18.

natural gas, and electricity) and indirect energy use through agricultural inputs (such as nitrogen fertiliser) which have a significant energy component associated with their production.¹⁷⁵ Because energy input costs make up a large proportion of total operating costs, wheat producers are highly exposed to changes in energy prices. Recent rises in fuel costs are making alternative agricultural activities (e.g. livestock) more attractive, and make it harder for wheat to compete against other crops on global markets.

e. Currency fluctuations

Australia exports a large share of its wheat (in 2005/6, 62 percent of wheat output was exported).¹⁷⁶ In global markets, wheat is priced in USD. Australian growers are therefore highly exposed to fluctuation in exchange rates. This, in turn, can lead to instability in sales volume and income. Australia's reliance on commodity exports (minerals and farm produce) means that the value of the Australian dollar is volatile.

f. Land degradation

Land degradation is an ongoing problem for Australian farmers. In a 2005 survey conducted by the Australian Bureau of Agricultural and Resource Economics (ABARE), 53 percent of cropping specialists stated that land degradation 'had a significant impact on their farming business'.¹⁷⁷ Major sources of concern reported were the effects of weeds and pest animals (cited by 31 percent of farmers surveyed), poor soil quality (22 percent), water and wind erosion (19 percent), and dryland salinity (10 percent). Furthermore, the problem seems to be worsening—a 2000 ABARE survey showed that only 38 percent of the farmers had significant land degradation problems on their property.¹⁷⁸

Dryland salinity is emerging as a major threat to the grain industry. It is caused by rising groundwater levels, primarily as a result of agricultural activity. A 2002 Australian Bureau of Statistics (ABS) Land Management and Salinity Survey showed that 17.9 percent of irrigated grain farms showed signs of salinity, with the figure rising to 33.5 percent for non-irrigated farms. Overall, over 640,000 hectares of grain farm land was salinated, 63 percent of which was subsequently unsuitable for production.¹⁷⁹ ABS estimated that the annual cost of salinity to agricultural industries through lost production was AU\$ 187 million in 2000.¹⁸⁰ It also predicted that the impact will increase in the coming years.

AWB's partnership with a research body CRC Salinity—"Promoting Salinity Solutions through Agribusiness"—aims to find practical solutions to dryland salinity, and encourages sustainable farming practices.¹⁸¹

¹⁷⁵ *Ibid.*, 2006.

¹⁷⁶ USDA, "Grain: World Markets and Trade – May 2006", p5.

¹⁷⁷ ABARE, "Australian farms - natural resource management in 2004-05", Research Report 06.12, 11, 2006. The survey split farms into production groups ("crop specialists", "mixed livestock-crops", "sheep specialists", "beef specialists", "sheep-beef" and "dairy").

¹⁷⁸ ABARE, "Landcare and farm forestry – providing a basis for better resource management on Australian farms", 2000, p30. The survey split farms into agricultural zones ("pastoral", "wheat-sheep" and "high-rainfall". The 38% figure refers to the wheat-sheep zone.)

¹⁷⁹ ABS, "1301.0 - Year Book Australia, 2004", Salinity and land management, 2004 at www.abs.gov.au/ausstats/abs@.nsf/94713ad445ff1425ca25682000192af2/c6aff66c68ced997ca256dea000539d6!OpenDocument# at 12 October 2006.

¹⁸⁰ *Ibid.*, 2004.

¹⁸¹ AWB, "Annual report 2005", 2005, p34.

Appendix VI. Emerging Volatility in Markets

Volatility in global wheat markets is growing. This is caused by new technologies, changes in consumer tastes and preferences, and shifting regulatory barriers. The Australian wheat industry is particularly exposed to changes in global markets, as a high percentage of Australia's overall wheat production is exported.

VI.1 Impact of technologies

Of the various factors leading to increased volatility in wheat markets, changes in technology are likely to have the single largest impact. Technological advances can increase yields, decrease costs and improve margins. Key technologies are genetically modified crops, no-till farming and precision agriculture. The genetic modification of crops is the most significant of these. While GM technology is still in its infancy—and there is controversy surrounding its implementation—several of Australia's competitors have adopted it (notably, Argentina, Canada and the United States of America).

a. What are the new technologies?

There are three major technological advances in wheat and grains: genetically modified crops, no-till farming and precision agriculture.

The use of GM organisms or transgenic crops is the most significant emerging technology in wheat production. GM wheat refers to crops that have had naturally occurring or synthetic genes introduced into crops. It is the most rapidly adapted crop technology occupying 5 percent of total output for cropland globally.¹⁸² GM crops are genetically modified for a range of purposes, including increasing yields, breeding insect or disease resistance, an increased tolerance to soil types and other conditions.¹⁸³ They can also be modified for purposes beyond food production, including for pharmaceutical purposes. GM wheat is not approved to be grown in Australia.¹⁸⁴

b. Impact on trade

The goal of all three technologies is to increase yields by increasing productivity. The effect would be to increase global production of wheat with little or no additional cost input. Currently there is equilibrium in global supply and demand for wheat. The recent OECD-FAO Agricultural Outlook 2006-2015 shows global demand increasing in line with current predictions of yields.¹⁸⁵ This is consistent with the downward trend for the price of wheat since the 1960s. As Australia's wheat is predominantly exported, a reduction in the world price would decrease the economic sustainability of wheat production.¹⁸⁶

¹⁸² Larkin, P., "Risks, Benefits and the Adoption of GM Technology", Paper to the ABARE Outlook Conference 05, Canberra, 2005, p1.

¹⁸³ *Ibid.*, 2005, pp1-2.

¹⁸⁴ Hoisington, D., Bohorova, N., Fennell, S., Khairallah, M., Pellegrineschi, A. and Ribaut, J., "The application of biotechnology to wheat improvement", FAO, at www.fao.org/DOCREP/006/Y4011E/y4011e0d.htm at 18 October 2006.

¹⁸⁵ OECD-FAO, "OECD-FAO Agricultural Outlook, 2006-2015 – Working Party on Agricultural Policies and Markets", Paris, 2006, p36.

¹⁸⁶ Wisner, R., "Market Risks of Genetically Modified Wheat", Western Organization of Resource Councils, 2003, p1.

Of the three technologies, GM wheat is the only technology that will further impact trade. It would have a direct contribution to wheat yields; this can be seen in the United States where GM crop producers have increased production volume by 41 percent.¹⁸⁷

However, the introduction of GM crops in Australia could also come at a cost to competitiveness of GM and non-GM wheat through market access restrictions and regulatory hurdles. Some markets impose labelling requirements for GM crops as well as certification requirements for the GM-free status of non-GM crops. This also includes certification for supply chain status of wheat to avoid contamination between GM and non-GM crops. To ensure that market access can be maintained additional supply chain processes and marketing may need to be established for GM and non-GM wheat. A survey by the US Department of Agriculture estimated that the cost of a dual marketing system for GM and non-GM wheat could add up to an additional US\$ 0.70 per bushel.¹⁸⁸ This could have a direct effect on the competitiveness of countries that approve the production of GM wheat.

c. Regulatory threats

Of the three technologies, the only technology that faces regulatory hurdles is GM wheat. In consumer markets, regulations can include requirements for GM-free status of products, strict labelling requirements or outright bans on importing GM crops. At least 37 countries already have mandatory labelling requirements for food products including GM ingredients.¹⁸⁹

The campaign against GM products is most significant in Europe. It is also setting the standard for other markets. It is EU policy to apply the 'precautionary principle' on environment regulation. This means products are not introduced until any potential risks have proven to be safe beyond doubt. As it is difficult to prove the safety of a product beyond doubt, doubts about GM crops can be exploited for protectionist purposes.

A recent study by the Australian APEC Study Centre demonstrated the rising threat from 'environmental' regulation for GM products and products with GM ingredients. These included market access restrictions, marketing approval, and traceability and labelling requirements.¹⁹⁰ Regulation on crops used for animal feed use is less strict.

The EU also supports increasing the flexibility of environmental regulations in WTO agreements, including regulations that would accommodate restrictions on GM crops. To date, the EU lacks support from WTO members, but has stated it will pursue this agenda through 'political' means in bilateral and regional trade agreements.¹⁹¹

Europe is not alone. China requires safety certificates for GM crops and labelling of food containing GMOs. Japan and Thailand require labelling of products with GM ingredients above 5 percent. Indonesia and South Korea require all products containing GM inputs to be labelled.^{192;193} India requires additional approval from a Government committee for marketing and imports of

¹⁸⁷ Larkin, 2005, p1.

¹⁸⁸ Wisner, 2003, p1.

¹⁸⁹ *Ibid*, 2003, p1.

¹⁹⁰ Oxley, A., Osborne, K. & Marty, L., "European Unilateralism – Environmental Trade Barriers and the Rising Threat to Prosperity through Trade", Australian APEC Study Centre, Melbourne, 2003.

¹⁹¹ ITS Global and Centre for Food and Agribusiness, University of Asia and the Pacific, "A Background Paper for the Strategic Plan of Action on ASEAN Cooperation in Food and Agriculture (2005-2010)", Melbourne, 2004, pp18-19.

¹⁹² Foster, M., Berry, P. & Hogan, J., "Market Access Issues for GM Products – Implications for Australia", ABARE eReport, 03.13, Canberra, 2003, pp4-5.

¹⁹³ Foster et al, 2003, p40.

GM product.¹⁹⁴ Labelling attracts additional cost, but can also reflect consumer choice in countries where there is a strong resistance to GM products.

At this time the only multilateral restrictions to trade in GM crops is in the Cartagena Protocol to the UN's Convention on Biological Diversity. The agreement creates the rights to restrict the importation of living GM organisms. This does not affect processed foods or harvested crops. The Convention focuses on the use of trade instruments to regulate trade in GM goods and can diminish the rights of WTO members to take action against countries that restrict trade in GM products.¹⁹⁵

The primary producers of GM wheat are Canada, the United States and Argentina. Australia does not currently allow production of GM wheat. The major investor and producer of GM wheat technology is Monsanto. It has suspended the release of Roundup Ready® Wheat due to a lack of producer interest.

d. The nature of the threats to grain trade

The threat to markets of the introduction of GM grains remains unclear. Despite the regulatory barriers and perceived consumer preference for non-GM products, GM wheat producing nations have maintained their global market shares.¹⁹⁶ If GM products gain widespread acceptance as safe, Australia's largest competitors for wheat will have a competitive advantage in adoption of the technology and its application.¹⁹⁷ If resistance continues, Australian wheat may be one of the world's largest wheat exporters to maintain GM-free status.

GM crops other than wheat have been approved in Australia and other GM crops may approved be in the future. There is also a risk of cross contamination. Currently GM canola is not approved due to bans at State Government level. These bans are reviewed and renewed on short-term cycles. GM canola is one of the crops that appears most likely to receive approval for production.¹⁹⁸ Silos and supply chains used for canola are also used for wheat opening ample opportunity for cross contamination. This could result in Australian wheat facing additional regulatory barriers and costs in key export markets.

Consumers, wholesalers and retailers are also campaigning against GM products. Retailers in Europe are also lobbying for labelling requirements for animal products that consume GM animal feed, though there seem to be no market access conditions set at this time.¹⁹⁹ Some importers have been sent clear signals from wholesalers that they do not want GM product. In Asia the attitude is mixed. Of the key markets for Australian wheat, Japan strongly opposes GM Wheat, whereas South Koreans²⁰⁰ and Indonesians²⁰¹ are more comfortable. This could have a positive or negative affect on Australia's grain trade, depending on whether Australia remains GM-free.

e. Competitive threats and new products

¹⁹⁴ *Ibid*, 2003, p.38.

¹⁹⁵ ITS Global et al, 2004, p30.

¹⁹⁶ Larkin, 2006, p5.

¹⁹⁷ United States, Argentina and Canada.

¹⁹⁸ Foster, M., "GM Canola – What are its economics under Australian conditions?", Australian Grains Industry 2003, Grain Research and Development Corporation, Canberra, 2003.

¹⁹⁹ *Ibid*, 2003, pp7 & 16.

²⁰⁰ Forsythe, D., "GM Wheat, Customer Acceptability Survey – Results from Asia", US Wheat Associates, 2002, pp3-4.

²⁰¹ Reuters, "GM Wheat see getting mixed reception in Asia trade", 2003.

If Australia approves the production of GM wheat, it faces a mix of competitive advantage through increased productivity, higher yields and new wheat products, coupled with market access restrictions, additional labelling costs and threats to market access for non-GM wheat. As many of Australia's key wheat export competitors have already introduced GM wheat, Australian farmers already face these challenges. They have managed to maintain their market share despite the introduction of GM wheat, this being in part due to preferences in their export markets.

The competitive threat to Australia's export markets is hard to predict. It is difficult to prove that Australia gains from its GM-free status.²⁰² It may lose by not adopting technology early, particularly as the industry is heavily reliant on exports, and new products may emerge.

VI.2 Impact of consumer preference

Trends in consumer preferences will have a significant impact on the international grain trade and the opportunities for the Single Desk. The National Pool has strong established relationships in markets set for growth. The reasons are numerous, but clear trends exist due to rising income levels, urbanisation of populations and Australia's proximity to growth markets. This is despite consumers in some markets reducing or stabilising their consumption of wheat products.

a. Consumption and Consumer Preference Trends

Wheat production is primarily driven by human consumption which accounts for 72 percent of its total end use.²⁰³ Wheat consumption is only expected to grow 1 percent from 2005-2016.²⁰⁴ The 2006-2015 OECD-FAO Agricultural Outlook projects wheat consumption will grow with population growth in industrialised countries, with little or no expectation of per capita consumption growth.

Both the OECD-FAO and International Food Policy Research Institute project increased demand from developing countries. This is because they have growing populations, rising income levels and spend a large component of their incomes on food products.

There is a strong link between the consumption of wheat and economic development. Global trends show that as incomes rise the share of staple products, such as wheat, declines. This is coupled with rising consumption of meat, fish and dairy products and processed foods.²⁰⁵

Wheat for animal feed currently represents 19 percent of total use. The FAO has projected that consumption of meat will double from 1997 levels by 2020.²⁰⁶ This will affect demand for animal feed, and subsequently wheat.

b. Consumer preferences in key AWB markets

The OECD and FAO project that of Australia's key export wheat markets, India, Iran, Malaysia and South Korea will increase their imports most. Egypt and China are also expected to increase their demand.²⁰⁷ These increases are projected to be driven by shortfalls in production in domestic economies as demand increases.

²⁰² Foster et al, 2003, p18.

²⁰³ OECD-FAO, 2006, p39.

²⁰⁴ *Ibid*, 2006, p39.

²⁰⁵ ITS Global, 2004, pp4-11.

²⁰⁶ OECD-FAO, 2006, p40.

²⁰⁷ *Ibid*, 2006, pp36-42.

Figure VI.1 Projected growth of Australia's key wheat export markets (MT)

Country	Average 2003-2005 estimated	2015 projected	Change %
Egypt	7.5	8.4	13
India	0.4	1.3	222
Indonesia	4.7	5.4	16
Iran	0.3	2.1	727
Japan	5.5	5.4	-2
South Korea	3.7	4.5	21
Malaysia	1.4	1.7	24
Pakistan	0.7	0.7	-7

Source: OECD-FAO Agricultural Outlook 2006-2015, p122 Figures rounded

c. Key factors affecting consumption in these markets

There is no universal drive affecting consumption in Australia's key wheat export markets.

In Egypt buyers are primarily price sensitive as one of the largest per capita consumers of wheat in the world. As a result, foreign exchange fluctuations also have a significant impact on the markets Egypt imports from.²⁰⁸ Australia has doubled its market share in Egypt, from 7.4 percent in 2004/05 to 15.8 percent in 2005/06.²⁰⁹

Strong growth in India results from increased consumer power, population growth and urbanisation of the population. The growth in higher end processed foods and fast food (i.e. pizza) is also driving demand for wheat imports. This is despite a negative trend of per capita consumption. India's wheat imports are also highly dependent on its domestic production capacity and variable weather conditions that can require large-scale imports.²¹⁰

The driving factor behind Japan's wheat consumption is the transfer of consumer preference from rice to processed foods with wheat ingredients. Demand stagnated when Japan's economy slowed in the late 1990s, but has begun to grow again in line with the economy. However, demand is expected to decrease as Japan's population ages and traditional consumption, notably rice, increases.²¹¹

In South Korea the increase in consumer demand is being driven by consumer expectations for consistency in noodle products. The National Pool considers South Korea to be a niche market for Australian noodle wheat.²¹²

Malaysia's demand is also being driven by consumer preference for wheat based products, including breads and noodles for domestic consumption and for export, including to Australia.²¹³ Indonesia is following a similar trend, particularly as noodles makes up 50 percent of wheat use.²¹⁴

²⁰⁸ Giles, F., Seifarth, K. & Ibrahim, S., "GAIN Report: Egypt – Grain and Feed Annual, 2006", USDA Foreign Agricultural Service, US Embassy (Cairo), 2006, p4.

²⁰⁹ Giles, F. & Ibrahim, S., "GAIN Report: Egypt – Grain and Feed Wheat Update, 2006", USDA Foreign Agricultural Service, US Embassy (Cairo), 2006, p2.

²¹⁰ Govindan, A., "GAIN Report: India – Grain and Feed Annual, 2006", USDA Foreign Agricultural Service, US Embassy (Dehli), 2006, pp1, 4 & 5-6.

²¹¹ Fukuda, H., "GAIN Report: Japan – Grain and Feed Annual Report, 2006", USDA Foreign Agricultural Service, US Embassy (Tokyo), 2006, pp 12-13.

²¹² AWB, Internal document.

In the Middle East, Australian wheat is preferred due to its colour, high extraction rate, and high gluten strength. These properties make Australian Hard wheat particularly suited to flat breads which are widely consumed in the region.²¹⁵

d. Impact of these factors for Australian wheat

The international demand for wheat provides ample opportunity for export growth. While export demand is expected to grow in line with Australian domestic production, the demand for consistent wheat quality in noodles and premium wheat products provides on-going opportunities to maintain exports to these economies because of the consistency of Australia Standard White.

Geographic proximity to key growing wheat importing nations in Asia and the Middle East also places Australia at a competitive advantage if the export program is managed in a holistic manner.

VI.3 Increasing regulation of trade in food and grains

Recent years have seen a trend toward increasing government regulation of trade in food which affects grains. These include standards and technical regulations as well as certification and inspection requirements directed toward plant and animal health and safety, food hygiene, the environment and consumer protection.

Regulatory trends are being driven by major developed countries, principally the EU, where there has been a tendency to apply increasingly stringent rules on the basis of the precautionary principle. Domestic policy moves have been mirrored at the international level which has also seen greater regulation of trade in food through international conventions.

Increasing regulation has begun to alter the commercial and operating environment in which trade is conducted, affecting the competitiveness of global traders and exporters. The rise of regulation is particularly problematic for food products like grain, which is traded as a bulk commodity and which is exposed to regulation at many different points in the food chain.

Increasingly specific and complex regulations can act as barriers to trade and impose costs throughout the supply chain, including shipping, handling and distribution.

For business, regulation has both heightened the importance of regulatory arrangements which ease these costs (such mutual recognition agreements (MRAs) and equivalency agreements), and facilitated the development of private food safety and hygiene standards at the industry level.

a. Increasing regulation of trade in food

In the past few years regulation of trade in food related to health, safety and environmental concerns of food production has been increasing. It has been driven both by consumer demand in developed markets and a desire in some countries to address these through government regulation rather than market based approaches.

Regulations have included:

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- 213 Hoh, R., "GAIN Report: Malaysia – Grain and Feed Annual Report, 2006", USDA Foreign Agricultural Service, US Embassy (Kuala Lumpur), 2006, pp8-9.
 - 214 Rittgers, C. & Meylinah, S., "GAIN Report: Indonesia – Grain and Feed Annual Report, 2006", USDA Foreign Agricultural Service, US Embassy (Jakarta), 2006, pp3-4.
 - 215 AWB, Internal document

- general food hygiene and safety requirements, including certification, inspection and testing requirements;
- labelling and traceability obligations throughout the food chain;
- tolerance levels (MRLs) for hazardous substances and contaminants in food products, and;
- bans or limits on use of certain food products, such as GMO and biotech foods.

The EU has been the main proponent and driver of increased regulation for food safety. It has recently implemented new Community-wide regulations which apply an integrated approach to food health and safety “from farm to table,” covering all sectors of the food chain.²¹⁶ This year new food hygiene laws came into effect which place responsibility on food operators, including in third countries, to ensure food safety from the point of primary production through to point of sale. Current laws already impose obligations on food operators to ensure the traceability of food at all stages of the production, processing and distribution and to conduct requisite monitoring, testing and certification to ensure food safety. Existing laws governing the labelling of foodstuffs require producers to provide information about their product throughout the product life cycle including on composition, manufacturer, methods of storage and preparation. Recent amendments to these laws made these conditions more onerous.²¹⁷

Many countries, including Australia and Japan as well as developing countries such as India, now have in place labelling requirements for biotech food. Since 2003 the EU has applied mandatory labelling and traceability requirements for products containing and derived from genetically modified food and feed, which require operators to provide information about the product such that it can be traced through the production and distribution line.²¹⁸

Recent moves have also been made to set maximum residue limits (MRLs) or tolerances for pesticide and chemical residues in food products. The EU is harmonising its current legislation governing MRLs. New legal limits for levels of mycotoxins (a toxic crop contaminant caused by some species of fungi) in unprocessed cereals, including wheat, as well as finished products such as bread and breakfast cereals, were implemented as part of new legislation this year. Japan is also in the process of implementing new regulations on residues of agricultural chemicals and feed additives in food, including new MRLs for fungicides (metconazole and cyazofamid) affecting wheat and other food products.²¹⁹ India this year likewise proposes pesticide tolerance levels on several crops and established MRLs for an additional 16 pesticides. It is currently revising tolerance levels for various pesticides on imported wheat, which will remain valid until March 2007.²²⁰

²¹⁶ Including feed production, primary production, food processing, storage, transport and retail sale.

²¹⁷ For example, by requiring all ingredients in foodstuffs to be indicated on the label, abolishing the previous rule which exempted components of compound ingredients comprising less than 25 percent of the final food product.

²¹⁸ Moves are underway to update the entire EU food labeling system by 2008.

²¹⁹ USDA, “Japan Sanitary/Phytosanitary/Food Safety Proposed Changes to Standards on Metconazole; Cyazofamid; Enrofloxacin; and Regulations on e.coli levels in certain wheat products”, USDA GAIN Report, USDA Foreign Agricultural Service, 20 June 2006.

²²⁰ USDA, “India Food and Agricultural Import Regulations and Standards Country Report, 2006”, USDA Foreign Agricultural Services, GAIN Report July 31 2006.

Regulatory developments affecting grains trade at domestic level have been followed in the international sphere. The last five years have seen the implementation of international conventions that seek to regulate trade in food products and which seek legitimise domestic measures based on standards in such agreements. The Cartagena Protocol, for example, which regulates trade in living modified organisms (LMOs), gives importers rights to restrict imports of products containing LMOs. There are also moves to address environmental concerns related to “Alien Invasive Species”²²¹ through international instruments which use controls on trade.²²²

b. Increasingly stringent, specific and complex standards and technical regulations

Food safety standards, particularly those in the EU, exhibit several characteristics. They are geared toward issues of quality control, process verification, traceability and labelling. They tend to be increasingly stringent, in some cases mandating standards that exceed those set internationally by CODEX and other international bodies. Many are based on precaution, rather than an assessment of health and safety risks supported by science, and are therefore potentially contrary to WTO rules. Some mandate the use of trade bans as means of enforcement.

The EU is currently in the process of updating and implementing Community-wide initiatives for the regulation of food products and chemical substances.²²³ New Harmonised MRLs for toxic substances in food will come into effect within the next few years, in some cases set at levels which are more stringent than international standards.

It has been EU policy in its approval and authorisation of genetically modified food and feed products to apply a de-facto moratorium on the placing of GM products on the market, based on precautionary grounds.²²⁴ Recently, imports of rice from the US were banned in both the EU and Japan on the grounds that commercial rice supplies had been contaminated by trace amounts of a genetically engineered variety of rice not approved for human consumption, despite USDA and FDA assurances that there are no known human health, food safety or environmental concerns associated with the rice. Japan also maintains a zero tolerance policy for genetically modified rice.

Since the late 1990s the EU has also taken an active decision to maintain an import ban on beef fed with certain growth hormones, despite a WTO ruling that this was illegal under trade rules on the grounds that it could not be supported by science.

c. Commercial impacts and effects on competitiveness, including in grains trade

Although exact impacts are hard to measure, increased regulation has altered the operating environment in which trade of wheat is conducted.

²²¹ Invasive alien species are non-native species that are introduced deliberately or unintentionally outside their natural habitats where they become established, proliferate and spread in ways that cause damage to human interests. See www.biodiv.org/programmes/cross-cutting/alien/default.shtml.

²²² A set of principles governing ‘Alien Invasive Species’ and for the possible development of a new international instruments to manage this, was adopted by the meeting of parties to the CBD in April 2002. There was opposition from several countries including Australia and Brazil to the articulation of the precautionary principle and general advocacy of using trade and quarantine barriers to control these products. Since then, an ad hoc technical expert group has been established to address gaps in international regulatory frameworks, and to develop recommendations and indicators for consideration at the next meetings of the parties in 2005 and 2006.

²²³ It has recognized and incorporated the precautionary principle as an integral part of Community health, safety and environmental protection. For example, see *Regulation 178/2002* of basic food law.

²²⁴ Approval processes for marketing of biotech products between 1996 and 2004 were recently found to by the WTO disputes settlement body to be in violation of several WTO rules.

Standards and regulations are becoming increasingly difficult to comply with. This is particularly the case with food safety in bulk commodity marketing, where compliance is required along the entire supply chain. For example, are detecting trace amounts of material for pesticides and pesticide residues in wheat shipments that is non-uniformly distributed among individual kernels is problematic.

Standards and regulations can also act as barriers to trade in export markets due to threats of trade bans in the event of non compliance. For example, any product found to contain a substance in violation of MRL regulations in Japan, or crops not meeting the specifications of the Food Sanitation Law will not be allowed entry into Japan, and can be discarded, re-exported, reconditioned or otherwise disposed of.²²⁵

Regulations have also had the effect of shifting food safety risks from government to food businesses, which are now responsible for monitoring and ensuring food safety throughout the entire food chain. This has imposed additional costs on conducting trade throughout the supply chain including shipping, handling, and distribution, both in complying with a given regulation and in implementing specific changes and procedures in order to do so. For grains trade, there are costs involved in maintaining the integrity of shipment from port to point of sale—shipping, handling and transportation— which are multiplied in different markets with differentiated requirements.

d. Results for business

In order to prevent the multiplication of TBT and SPS requirements from seriously hindering trade, efforts are being made to foster their harmonisation across member countries, in particular through the development and adoption of international standards, the promotion of acceptance of equivalency of requirements and the forging of MRAs. Several such initiatives have been conducted successfully in recent years. However, the instances of accepting of equivalency of requirements or of mutual recognition agreements have mainly involved developed countries.²²⁶

Increased regulation has also encouraged the development of voluntary private food safety standards to help business control risks associated with food safety and to satisfy consumer demand. These standards have mainly been developed at retail level for processed foods rather than bulk commodities and are “enforced” through cooperative structures which manage and audit them.

²²⁵ USDA, “Japan Food and Agricultural Import Regulations and Standards”, Annual FAIRS Report 2006, USDA Foreign Agricultural Service GAIN Report, 15 September 2006.

²²⁶ “European Union Food Regulations and Emergence of Private Standards: Implications for International Trade” Conference held Nov 3, 2005, Washington DC, Farm Foundation at www.farmfoundation.org/projects/06-19EUFoodRegs.htm at 11 October 2006.



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A Report Commissioned by
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About CCI

The Chamber of Commerce and Industry of Western Australia (CCI) is the leading business association in Western Australia.

It is the second largest organisation of its kind in Australia, with a membership of 5,000 organisations in all sectors including manufacturing, resources, agriculture, transport, communications, retailing, hospitality, building and construction, community services and finance.

Most members are private businesses, but CCI also has representation in the not-for-profit sector and the government sector. About 80 per cent of members are small businesses, and members are located in all geographical regions of WA.

CCI exists to serve its members and the broader business community as the State's leading representative for commerce and industry, dedicated to the pursuit of a competitive and responsible free enterprise economy for the benefit of all individuals in our society.

Introduction

The Federal Government is currently undertaking an inquiry into the future wheat marketing arrangements for the 2007 crop and beyond.

It is not the purpose of this report to examine the single desk marketing arrangements or the possible reform options that are currently being considered by the Wheat Export Marketing Consultation Committee. Rather, the report's purpose is to examine the competitive environment that exists across the wheat industry supply chain, and analyse the impact of the possible reform options on the competitive environment.

This analysis will be undertaken with reference to Western Australia, as the largest producer of wheat in Australia, and from where the majority of Australia's wheat exports originate.

Executive Summary

Western Australia's wheat industry is the largest in Australia, and is recognised as one of the most efficient and competitive not only in Australia but across the world. However, by virtue of its relatively small population base, the majority of the wheat that is produced in WA is exported overseas rather than consumed domestically.



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This has therefore made Western Australia a critical part of the AWB's national wheat pool which it markets overseas as part of the Government-mandated single desk arrangements. While AWB currently maintains an exclusive right to market wheat overseas without a permit, it does not own or control any storage, handling and transportation infrastructure in Western Australia. The storage and handling system, including port terminals, is owned by CBH, and land transport is coordinated through rail and road operators.

The CBH Group has evolved into a strong and diverse organisation over many years in Western Australia, with the foundations of this growth built around protection originally provided under the *Bulk Handling Act 1967*. This allowed it to invest in a substantial storage and handling infrastructure network, establishing CBH in a very strong position of supply chain control, where there are high barriers for entry by potential competitors. Through its subsidiary, the Grain Pool, the CBH Group has also developed a strong marketing focus as the main licence holder to export barley, canola and lupins from the State, and more recently its wheat marketing products through AgraCorp. More recently, it also obtained a special licence to export 500,000 tonnes of wheat to its Asian flour milling investment in Indonesia.

In a similar manner, AWB has grown into a strong and diverse organisation with the assistance of the protection afforded under the single desk. This has allowed AWB to undertake strategic investments around the world, as well as establish a presence in other related businesses.

In the context of the WA market, however, the size and scale of AWB is moderated to some extent on the grounds that it does not control key grain storage, handling and transportation infrastructure networks. This has been confirmed by its regulator – the Wheat Export Authority – which found that AWB appears unable to use its market power to significantly influence country storage and handling costs in WA.

Given the nature of the wheat market in Western Australia (and similarly in other States), the discussion over future deregulation of the wheat export marketing arrangements must be cognisant of the implications that this would have on the competitive dynamics within the wheat industry.

This report has found that reform to wheat marketing arrangements – either through partial or full deregulation – could have anti-competitive implications for the wheat industry overall. These concerns need to be investigated by Government when making its decision on reform to wheat marketing arrangements.

While the objective of reforming wheat marketing arrangements is founded on National Competition Policy (NCP) principles, which have been committed to by



all Australian governments, the potential for such reforms to lessen or restrict competition across the supply chain would be inconsistent with such principles.

The overall outcome of any changes to the wheat industry should be that there is a truly competitive environment in all aspects of the industry – not just in relation to one specific part of the supply chain (that is, wheat marketing).

The report has found that if the single desk is removed and wheat exporting is deregulated, this would mean that AWB would become one of a number of grain accumulators seeking to purchase grain for export. It could be argued that the familiarity of growers with the AWB, and the fact that many growers are shareholders in the privatised entity, would mean that AWB would continue to remain a competitive force in relation to the marketing of wheat for export.

However, given the extent of CBH's operations in the wheat supply chain, and in relation to other grains, this represents a competitive threat to AWB's core business of marketing wheat, and an opportunity for CBH to further grow its business.

Deregulation of wheat marketing could, however, trigger other reforms to the grain market more generally. In this regard, a review of the current arrangements under the Western Australian *Grain Marketing Act 2002* can be triggered if the national wheat single desk is removed. This in turn could present an opportunity for AWB to compete in the coarse grain market.

Notwithstanding the control that CBH has over the key storage and handling infrastructure in Western Australia, there are a number of key issues which require further consideration in order to help facilitate competition in the wheat industry.

An important aspect in facilitating competition will be to review the ways in which CBH can control the supply chain, such as through the standard service agreements that CBH requires its customers to accept. Through their control over the supply chain, and because of the structure of the standard service agreements, CBH is provided with both informational and operational advantages, which are not available to other market participants.

CBH has also recently introduced a differential pricing structure which provides a cheaper price to traders for port outloading provided that CBH controls the supply chain (that is, accumulates the grain and controls the transport).

While such a pricing structure makes sound business sense for CBH, there is a concern that such a pricing structure will provide CBH with further competitive advantages in a deregulated market that allows it to also become a marketer of wheat. It will mean that CBH will have the opportunity to control their own stocks



and effectively charge their marketing division a cheaper price on account that the stock will be fed through the CBH supply chain.

In a deregulated environment, it is expected that CBH will become a more vertically integrated business and, by expanding into wheat marketing, this will provide it the opportunity to complete its supply chain link from the grower right through to its overseas flour mills.

Concerns with vertical integration across the supply chain stem from the power it provides the infrastructure owner to offer preferential pricing to its affiliates at the expense of independent competitors. At worst, such power can lead to the denial of access to external parties. This may result in higher prices and/or inefficient restrictions on output.

While it is important that the implications of the current wheat marketing arrangements on the wheat industry more generally need to be understood, there are also ways in which competition could be facilitated – both in the context of the current environment and, more importantly, in a partially or fully deregulated wheat marketing environment.

In Western Australia, the Economic Regulation Authority (ERA) exists to promote competition and fair market conduct, and prevent the abuse of monopoly or market power. If it is deemed that CBH is abusing its market power in relation to its storage and handling infrastructure, the WA Treasurer could refer this issue to the ERA to be investigated. Such a referral would be consistent with the WA Government's obligations under the New National Reform Agenda agreed to by the Council of Australian Governments (COAG) in February 2006.

This becomes especially important given that the *Bulk Handling Act 1967* does not contain any provisions for review of the legislation.

As part of the New National Reform Agenda, COAG signed a *Competition and Infrastructure Reform Agreement* to provide for a simpler and consistent national system of economic regulation for nationally-significant infrastructure.

A key aspect of this agreement was in relation to port competition and regulation. Essentially, the agreement notes that ports should only be subject to economic regulation where a clear need exists in the promotion of competition in upstream or downstream markets or to prevent the misuse of market power. The agreement also stipulated that each jurisdiction would review the regulation of ports and port authorities, and the handling and storage facility operations at significant ports within its jurisdiction to ensure they are consistent with National Competition Policy.



On the basis of the COAG agreement, it is imperative that the port facilities controlled by CBH are reviewed by the WA Government to determine whether regulation is warranted in order to promote competition in the wheat industry.

Given the monopoly aspects of CBH's facilities, another avenue that could be pursued to ensure fair market access to such facilities is to have them "declared" under Part IIIA of the *Trade Practices Act 1974* (TPA). The resulting development of an access regime would provide certainty on the terms and conditions on which CBH would provide access. Importantly, this would require the development of transparent costing and pricing policies, and would ensure that prices are set by an independent arbitrator.

However, the Part IIIA process is time consuming and costly, and it is not clear whether all the infrastructure owned by CBH would satisfy the criteria for it to be declared an essential service. However, this has never been tested.

Key Findings

The key findings from the report are detailed below.

1. Because reforms to wheat marketing arrangements could have anti-competitive implications for the wheat industry overall, it is important that this is investigated by Government prior to making any decision on reform to wheat marketing arrangements.
2. The lack of transparency across the supply chain has provided bulk handling companies like CBH with both informational and operational advantages, which will be exacerbated upon deregulation of the wheat marketing arrangements.
3. The application of differential pricing to traders for port outloading will be likely to provide CBH with further competitive advantages in a deregulated environment. While it is unclear whether such a pricing structure breaches the TPA, this should be investigated.
4. As CBH becomes more vertically integrated and therefore increases its market power, this will have implications for other competitors that utilise its services.
5. In Western Australia, the ERA exists to promote competition and fair market conduct, and prevent the abuse of monopoly or market power. If it is deemed that CBH is abusing its market power in relation to its storage and handling infrastructure, the WA Treasurer could refer this issue to the ERA to be investigated. Such a referral would be consistent with the WA Government's obligations under the New National Reform Agenda.



6. On the basis of the *Competition and Infrastructure Reform Agreement* signed by COAG in February 2006 as part of the New National Reform Agenda, it is imperative that the port facilities controlled by CBH are reviewed by the WA Government to determine whether regulation is warranted in order to promote competition in the wheat industry.

7. Seeking to have the infrastructure owned by CBH declared an essential service for the purposes of Part IIIA of the TPA represents a legal avenue for access, if it is deemed that access cannot be obtained on “reasonable” terms and conditions at “fair” prices.

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Overview of the Wheat Industry

A Brief History¹

The industry had its beginnings over 200 years ago when Governor Phillip, realising the need to make the colony self sufficient in food, established a 40 acre government farm at Parramatta.

By the end of 1790, 200 bushels (approximately 5.4 tonnes) of wheat had been harvested, all of which was saved for seed. With the opening up of Liberty Plains (now two of Sydney's western suburbs, Homebush and Strathfield) by free settlers, the colony had 6,000 acres under wheat by 1799.

With the settlement of Victoria, South Australia and Western Australia during the 1830s and 1840s, cultivation of wheat expanded rapidly.

Assisting the expansion of the wheat industry into large scale operations were the inventions of the scrub roller, the “stump jump” plough and the header harvester. Between them, these machines allowed for the clearing and preparation of large tracts of land and harvesting of the bigger crop. The opening up of the inland country railway network in the 1880s greatly improved the efficiency of crop transportation.

Complementing these mechanical advancements was research into new wheat varieties more suitable to the Australian environment and mechanical harvesting, and more resistant to disease. In later stages, growth of the Australian wheat industry was supported by changes in many farm management activities, including the introduction of mixed farming, crop rotation, application of fertilisers, improvements in cultivation techniques, and, since the 1940s, the use of tractors.

The improvement of bulk grain handling systems, development of chemicals to combat diseases, pests and weeds, and the further development of higher yielding disease resistant wheat strains are some of the off-farm activities that continue to make important contributions to the industry.

Since the loss of the United Kingdom market in the 1960s, researchers have sought to create wheat varieties which meet the end-use requirements of Middle Eastern and Asian customers. Australian wheat enjoys an excellent reputation for quality in international markets and the hard white varieties are particularly suited to the production of food products in East Asia, such as instant and fresh noodles.

While tailoring these products for the Australian and international end-markets, researchers had to also ensure that the wheat was high yielding and suitable for the differing environmental conditions experienced across the wheat belt from Queensland to Western Australia.



Initially, wheat breeding and research was limited by the available genetic material. However, from the early-1970s to mid-1980s there was a rapid increase in the availability of new, high yielding varieties to Australian growers.

Wheat growing areas are determined by soil type, soil fertility, topography and rainfall. Rain should predominantly fall during the winter and spring months and needs to be of an annual average between 400 and 600 millimetres per year at a minimum. Suitable conditions prevail on mainland Australia in an area west of the Great Dividing Range known as the wheat belt which stretches from Central Queensland through New South Wales and Victoria and on to South Australia in the form of a narrow crescent, continuing into the south west of Western Australia. In addition, a small area of land in Tasmania is used for growing wheat.

Over time, Western Australia's wheat industry has evolved considerably, and today it has the most area under wheat and the biggest crop of any State in Australia.

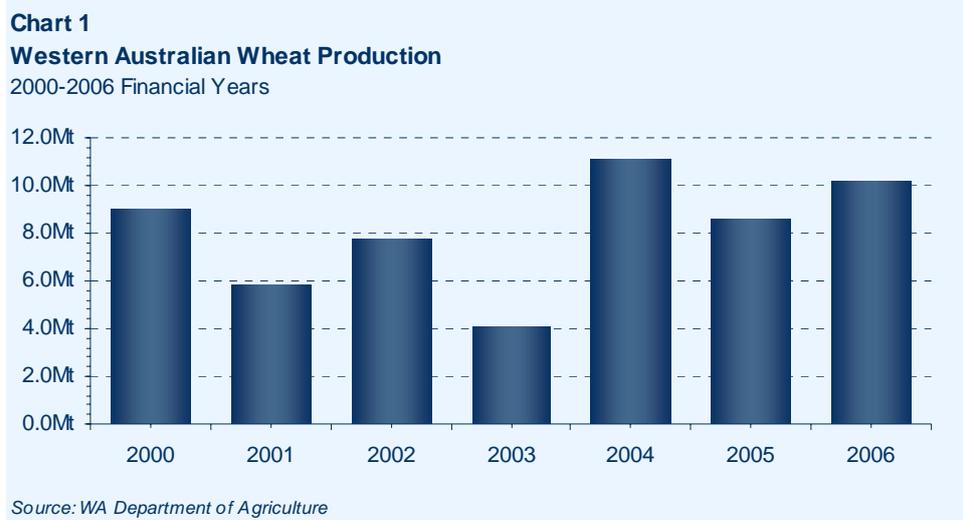
Economic Profile

Wheat Production

Wheat production is Western Australia's largest agricultural crop, with wheat production averaging 8.2 million tonnes per annum over the five years to 2005-06, with an average value of \$1.8 billion. In 2005-06, 9.5 million tonnes of wheat were produced, representing an increase of 10 per cent from the previous year (Chart 1).

Overall, wheat production accounts for almost 30 per cent of the total value of agricultural production, and around 60 per cent of total grain production in Western Australia.

The major wheat growing areas in Western Australia were the central (Kwinana)



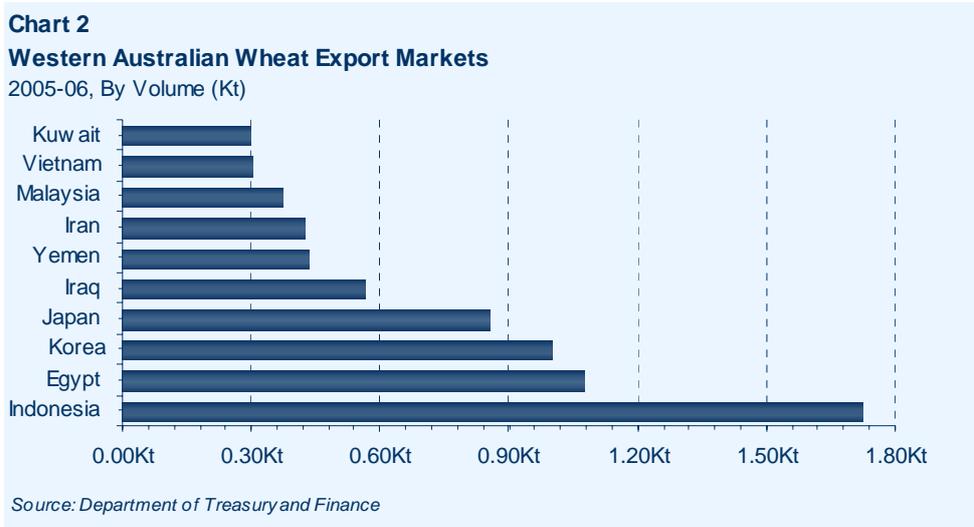
region, which produced approximately 50 per cent of the total wheat production, the northern (Geraldton) region, which produced 27 per cent of total production, the southern (Albany) region, which produced 14 per cent of total production, and the Esperance region, which produced nine per cent of total production.

Wheat Markets

There are two flour mills in Western Australia, with the majority of the production of flour used for domestic purposes. Overall, domestic demand is relatively small in Western Australia, with the majority of wheat produced exported overseas. The Department of Agriculture and Food estimates that approximately 87 per cent of all wheat produced in Western Australia is exported².

In 2005-06, the total value of wheat exported was \$1.6 billion. Wheat exports represent an important export for WA, accounting for 40 per cent of total agricultural exports, and 4.4 per cent of total exports.

Western Australia’s top 10 wheat export markets in 2005-06 are detailed in Chart 2 below. Indonesia was the State’s largest wheat export market in 2005-06, followed by Egypt, and South Korea. These three markets accounted for almost half of all Western Australia’s exports in 2005-06.



Industry Profile

Production

Western Australian wheat producers are some of the most efficient in the world. As with most areas across Australia, there has been significant consolidation of farms in Western Australia, with the total number of grain growing farms falling by 50 per cent since the late 1970s³.



This was highlighted in a recent report by ACIL Tasman, which found that Western Australian growers are:

“becoming larger, reaping scale economies, becoming more specialised, more reliant on wheat income, experience less variation in yield and total production, and are increasing total factor productivity more rapidly”⁴.

Transportation, Storage & Handling

The wheat supply chain in Western Australia is integrated across transport modes and involves a range of storage and handling facilities. The network extends seamlessly from farm gate to port, ensuring Western Australia’s wheat market is one of the most efficient and competitive in the world.

The rail system serving the grains industry comprises both narrow and standard gauge track, with the majority of grain handled on the narrow gauge network. On 16 February 2006, the above rail operations of Western Australia’s rail network owned by the Australian Railroad Group were sold to Queensland Rail, and Babcock and Brown acquired the WestNet Rail below rail business and assume responsibility for the standard gauge and narrow gauge rail infrastructure leases in WA.

The rail network plays a critical role in the transportation of wheat to port facilities for export. In Western Australia, freight rates for the use of the rail network are established under an industry contract negotiated with CBH, AWB, the Grain Pool, the Western Australian Farmers Federation, and the Pastoralists and Graziers Association.

Grain is also transported via the road network, with the Department of Agriculture and Food estimating that about 40 per cent of all grains delivered to ports for export transported by road⁵.

There are four major grain ports located strategically around Western Australia. These port facilities are used for storing, loading and unloading grain. These facilities are all owned by CBH. The facilities are considered to be world class, and have the lowest storage and handling charges of all other ports in Australia.

There are almost 200 strategically located storage facilities across the southern part of Western Australia, with CBH estimated to receive 85-90 per cent of the State’s grain crop per annum (with the rest stored on farm either for domestic use or kept for seed). Around half of grain produced is directed through Fremantle Port, although the regional ports of Albany, Geraldton and Esperance also play an important role in the export of grain from Western Australia and their transport links are also significant.



CBH Group

The CBH Group is a vertically integrated group of companies which stores, handles and markets grain. However, its primary function continues to be the storing and handling of grains.

The company comprises of CBH Grain Operations, Grain Pool Pty Ltd, AgraCorp Pty Ltd and Bulkwest Engineering Pty Ltd.

- **CBH Grain Operations** manages the grain supply chain from farm to ship.
- **Grain Pool** holds the main licence to export barley, canola and lupins in bulk out of Western Australia.
- **AgraCorp** markets and trades a range of other grains including wheat, triticale and oats.
- **Bulkwest Engineering** services a range of rural, Australian and international customers providing innovative design, manufacturing and turn-key storage and handling construction solutions.

The CBH Group also invested strategically further down the supply chain. In 2004, the CBH Group established a joint venture company, **Pacific Agrifoods**, with partners The Salim Group, to invest in the Asian value chain and to grow value for the Western Australian grains industry. Through Pacific Agrifoods, the CBH Group holds a stake in five flour mills in Indonesia and Malaysia and a grain terminal and flour mill in Vietnam.

CBH has also directly invested in the **Eastern Pearl Flour Mill** in Indonesia, which is the fourth largest flour mill in the world, with an annual production capacity of 840,000 tonnes.

It should also be noted that on 22 December 2006, the CBH Group was granted a **wheat export licence** from the Wheat Export Authority and the Federal Minister for Agriculture, Hon Peter McGauran MP, to export 500,000 tonnes of wheat to its Asian flour milling investment in Indonesia. This application followed the transfer of the power of veto that originally was held by AWB Limited to the Federal Minister for Agriculture. This decision has effectively expanded CBH's operations to now include the export of wheat.

To store and handle grain, the CBH Group has developed almost 200 strategically located terminal and country receival points across the south-western part of the state, with a total storage capacity of over 19 million tonnes.



The main grain types stored and handled across the state include wheat, barley, lupins, oats, field peas, canola, chick peas and faba beans. Other grains handled in smaller quantities include triticale, rye and albus lupins.

Western Australian grain is transported by rail or road from country receival points into four port facilities located at Geraldton, Kwinana, Albany and Esperance. Each country receival point is located within a zone. There are six zones – Geraldton, Kwinana South, Kwinana North, Kwinana East, Albany and Esperance. Each zone is further divided into areas, with offices located at Avon, Corrigin, Katanning, Koorda, Lake Grace, Merredin, Morawa and Wongan Hills.

The **Geraldton grain terminal** port facility was established by the CBH Group in 1937, and the most recent upgrade was completed in 1994 where construction of fourteen 10,000 tonne steel silos with separate road/rail discharge hoppers and the installation of computerised equipment created a modern and highly efficient facility.

Grain is delivered by road and rail from 23 receival points within the Geraldton zone. During the annual harvest, the Geraldton grain terminal becomes one of the busiest receival points in the world, with growers delivering between 20,000 and 30,000 tonnes of grain per day. The terminal currently has a grain storage capacity of just over one million tonnes and a ship loading speed of 2,000 tonnes per hour.

The **Kwinana grain terminal** is Western Australia's primary grain export facility, shipping more than half of the state's export grain and with a total storage capacity of more than one million tonnes. The terminal was opened in 1976 and receives grain from nearly 120 country receival points throughout the Kwinana zones. Grain is transported by rail to the terminal at Kwinana, which has a current storage capacity of more than one million tonnes.

The **Albany grain terminal** was built in 1956 and has been upgraded and extended several times to provide for increasing volumes of export grain. In 1984, a major upgrade added ten 10,000 tonne concrete silos and a 120,000 tonne horizontal storage structure. In 1995, an 113,000 tonne capacity horizontal annexe was added.

In 2006, the Albany grain terminal received a further \$130 million upgrade to increase operating efficiencies and create greater storage capacity. The latest upgrade has resulted in the full integration of all storages and transformed the terminal into a state of the art, world class facility with the construction of ten 6,000 tonne storage cells for grain. The current storage capacity is over 470,000 tonnes. Grain is received by road and rail from the 41 receival points in the Albany zone.



The **Esperance grain terminal** was built in 1962 to cater for increasing volumes of grain produced in the Esperance region. Steady growth in production for the region led to a \$68 million upgrade in 2000. The current storage capacity of the terminal is now more than 240,000 tonnes. The majority of grain is received by road from the CBH Group's 15 receival points in the Esperance zone. Only two receival points, Grass Patch and Salmon Gums, are connected by rail to the terminal.

The CBH Group parent entity is exempt from income tax by virtue of Section 50-40 of the *Income Tax Assessment Act 1997*. This exemption comes by virtue of its establishment "for the purpose of promoting agricultural production", but this is "provided that it is not carried on for the profit or gain of its individual members".

Under the *Bulk Handling Act 1967* (see page 20 for further details), CBH is permitted to build up reserves and does not make distributions of these reserves to shareholders.

Sales & Marketing

In Australia, the sales and marketing of wheat for export overseas is undertaken by AWB (International) Limited (AWBI), a subsidiary company of AWB Limited (AWB).

AWBI is the Government-mandated exclusive exporter of Australian bulk wheat under the Single Desk marketing system. This Single Desk allows AWB to offer the National Pool, which is open to all of Australia's 30,000 wheat growers. Both AWBI and AWB Limited have a constitutional mandate to maximise net returns to those who deliver wheat to the AWB National Pool. The AWB National Pool markets, on average, \$4 billion worth of Australian wheat annually to around 100 customers in more than 40 countries worldwide⁶.

Operating the AWB National Pool requires managing the wheat supply chain from over 700 receival sites across the Australian wheat-belt right through to international customers.

AWB Limited

AWB, AWBI and AWB (Australia) Limited (AWBA) were established under amendments to the *Wheat Marketing Act 1989* which effected the privatisation of the Australian Wheat Board. On 1 October 2003, AWB was restructured to separate AWB's wheat export related operations from its commercial activities for credit rating purposes and the acquisition of Landmark. As a result, AWB now has a number of operating subsidiaries.

In general terms, the roles of the major companies in the group are set out below⁷:



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WESTERN AUSTRALIA

- **AWB**, as the holding company, is responsible for joint venture investments and projects and earning a return on shareholders' funds. It is also the vehicle for the voting interest of growers in the conduct of the AWB National Pool and the services provided to it.
- **AWBI** is responsible under the *Wheat Marketing Act 1989* for operating the AWB National Pool with the objective of maximising and distributing net returns to growers who sell grain to the pools, and manages the export of bulk wheat through the Single Desk system as well as exercising the statutory power of approval of other bulk wheat exports.
- **AWBA** is responsible for domestic wheat and other grain trading as well as the export of other grains. Its activities also extend to other commercial ventures such as chartering and AWB Seeds.
- **AWB Services Limited** provides, on a fee for service basis, the management and business infrastructure required to support AWB Group operations, including asset management and staff.
- **AWB Harvest Finance Limited** provides growers delivering to the AWB National Pool with a suite of financing alternatives. It also manages foreign currency and interest rate exposures for AWBI's pooling activities.
- **AWB Commercial Funding Limited** provides working capital finance and manages foreign currency and interest rate exposures for the commercial subsidiaries of AWB.
- **AWB Riskassist Limited** provides risk management services to growers participating in the Basis Pool, in particular, providing a service to manage foreign currency and commodity risk.
- **AWB GrainFlow Pty Ltd** operates AWB's supply chain and logistical services and provides modern bulk grain handling facilities to growers. AWB GrainFlow Pty Ltd owns 21 grain centres throughout Victoria, New South Wales, South Australia and Queensland.
- **Agrifood Technology Pty Ltd** provides analytical services to assist AWB's marketing program. Agrifood Technology Pty Ltd generates a commercial return by providing world class analytical and laboratory services to external clients in the food and feed related industries.
- **Landmark Operations Limited** is the principal operating entity for Landmark in Australia (excluding Queensland).

AWB's corporate structure consists of two classes of shares:



- *A Class shares* – which are shares that can only be issued to current wheat growers (that meet the definition of a grower in the AWB constitution), cannot be transferred and are automatically redeemed when the A Class shareholder ceases being a wheat grower. A Class shares are not entitled to receive any dividends, however, they do carry other important rights giving A Class shareholders control of AWB, including giving A Class shareholders the ability to elect a majority of the Board of directors of AWB.
- *B Class shares* – these are the shares which are quoted on the Australian Stock Exchange (ASX). B Class shares carry rights to receive dividends and the right to elect a minority of the Board of directors of AWB. They can be freely traded between wheat growers and non-growers, subject to no shareholder owning more than 10 per cent of the B Class shares on issue. B Class shares commenced trading on the ASX on 22 August 2001.

AWB's evolution from a marketer of wheat to a conglomerate under which a number of subsidiaries operate, has meant that today AWB is one of Australia's top 200 companies (as listed on the ASX).

Regulatory Environment

History

In 1915 the Commonwealth Government set up a wheat pooling scheme to assist wheat growers and to ensure appropriate management of this vital foodstuff during World War I. It was administered by an Australian Wheat Board, comprising the Prime Minister and a Minister from each wheat growing state. Under the scheme, returns from each season's wheat crop were pooled (over time and across markets) and shared fairly among all growers for the duration of the World War I.

After the first Australian Wheat Board ceased operations in 1921, regional wheat pools continued, often managed by farmer cooperatives.

At the beginning of World War II, the Australian Wheat Board was established as a statutory authority under National Security (Wheat Acquisition) Regulations to handle all matters connected with wheat disposal during World War II. Following the war, legislation was passed to establish the peacetime Wheat Board in 1948. The purpose of the board was to ensure that the wheat industry operated in an environment of price stability and orderly marketing and was responsible for the receipt and sale of virtually all wheat produced in Australia.

In 1984 the domestic feed market for wheat was effectively deregulated and growers could sell, under a permit system, to anyone they chose. This was the first step in the deregulation of the Australian domestic wheat market and was designed to benefit the industry by injecting greater flexibility and competition.



In 1989, the domestic wheat market was completely deregulated and since that time has operated without any specific government regulation. At the same time, the Commonwealth government established the Wheat Industry Fund, a compulsory levy on wheat sales, to create a sufficient capital base for the privatisation of the Australian Wheat Board.

In July 1999, the Wheat Board ceased to operate as a government controlled statutory authority and became AWB Limited, a grower-owned and controlled corporation with a dual-class share structure. At this time, all government financial assistance for the Wheat Board, such as underwriting its borrowings, ended. AWB Limited became a public company in 2001, when B-class shares (issued to holders of the units in the Wheat Industry Fund) were listed on the Australian Stock Exchange and today it is one of Australia's top-100 largest public companies.

Through a subsidiary company, AWBI, AWB Limited continues to be the sole exporter of bulk wheat from Australia (under the Single Desk system). Using the Single Desk system – established under the *Wheat Marketing Act 1989* – AWB Limited has a formal obligation to maximise returns to wheat growers from the national pool through being the only exporter of Australian wheat. The Single Desk system aims to capture value through price premiums, reducing supply chain costs, risk management and giving growers access to buyers in over 40 countries.

A government regulator, the Wheat Export Authority (WEA), was established by the Commonwealth Government to monitor and report on AWBI and to manage the system that allows exports of wheat in containers and bags outside the Single Desk.

Commonwealth Wheat Marketing Act 1989

Until 1998 the Wheat Marketing Act prohibited the export of wheat by anyone other than the Australian Wheat Board without the board's consent. In addition, the Act guaranteed the board's borrowings until July 1999 and provided for the accumulation of the Wheat Industry Fund to eventually replace the statutory guarantee.

In 1998 the Act was amended to facilitate the establishment of a grower owned and controlled company, AWB Limited, and its export pool subsidiary, AWBI, to assume responsibility for wheat marketing and financing from July 1999. The amendments also:

- established the WEA to control the export of wheat and to report to the Australian Government minister for Agriculture before the end of 2004 on the performance and conduct of the AWBI;



- conferred on the AWBI the power to export wheat without the WEA's consent; and
- exempted anything done by the AWBI in exporting wheat from Part IV of the *Trade Practices Act 1974*.

The power of the WEA to control the export of wheat is constrained. The amended Act requires the WEA to consult the AWBI before consenting to the export of wheat; for proposed exports in bulk, the WEA cannot consent without the AWBI's approval.

In early 2000, the government commissioned a three-member committee to review the Act against the Competition Principles Agreement (CPA) under National Competition Policy (NCP). The committee recommended that:

- the government retain the single desk until the 2004 review required by the Act;
- the 2004 review incorporate NCP principles and be the final opportunity to show a net community benefit from the arrangements; and
- the government convene a joint industry–government forum to develop performance indicators for the 2004 review.

The committee also recommended that the WEA trial for three years a simplified system of consents for the export of wheat in bags and containers by other exporters.

The government responded on 4 April 2001, stating that it would retain the single desk but would not conduct the 2004 review under NCP principles. The Minister argued that the latter decision is necessary to avoid further uncertainty in the industry and for wheat growers. The government agreed to the development of rigorous and transparent performance indicators to ensure the 2004 review accurately measures the benefits to industry and the community.

In June 2002, the National Competition Council (NCC) assessed that the government had not met its obligations under the CPA arising from the *Wheat Marketing Act*, because the review did not show that retaining the wheat export single desk is in the public interest. Rather, the review found that allowing competition is more likely to be of net benefit to the community.

This position was reiterated in subsequent NCP assessments in 2003, 2004 and 2005.



On 7 December 2006, Federal Parliament passed legislation to remove AWB of its wheat export veto, handing it to the Federal Agriculture Minister for six months. Following this decision, Agriculture Minister Peter McGauran approved two applications for export permits, allowing Wheat Australia to export 300,000 tonnes to Iraq, and CBH to send 500,000 tonnes to its Indonesian flour mills.

Bulk Handling Act 1967

The *Bulk Handling Act* was enacted in 1967 to regulate the bulk handling of grain by Cooperative Bulk Handling Ltd (CBH).

The passage of the *Bulk Handling Amendment Act 2002* repealed major restrictions on competition in the *Bulk Handling Act 1967*. CBH no longer has the sole right to receive grain in bulk and to handle, transport and deliver bulk grain in Western Australia. Ministerial approval is no longer required for installation and alteration of grain handling and storage facilities, and the Treasurer will no longer issue government guarantees in respect of moneys borrowed by the Grain Pool Pty Ltd, the Company formed out of the merger of Cooperative Bulk Handling Ltd and the Grain Pool of Western Australia.

CBH is still controlled in part by statute under the *Bulk Handling Act 1967*. The Act is administered through the Western Australian Department of Agriculture and Food.

Under this Act, CBH must allow any person to utilise any bulk handling facilities it owns at ports, but is free to determine the appropriate fee for using these facilities.

Following these changes, the NCC assessed that the Act was deemed to comply with the obligations under the CPA. In its 2003 Assessment, the NCC stated that:

“The Council assesses that Western Australia has met its CPA clause 5 obligations arising from the Bulk Handling Act. The continued requirement that CBH accept all grain tendered to it is most unlikely to restrict competition as it does not prevent new entry into the bulk handling and storage services market and, as CBH is free to determine its charges and the location and standard of facilities, it does not in practice prevent CBH from responding to new entry, actual or threatened, through, for example, changes to its service prices or its receival site network.

In relation to port facilities it is open to anyone not satisfied with CBH’s voluntary terms of access to invest in alternative facilities or to seek to have CBH’s facilities declared under Part IIIA of the TPA.”



Supply Chain Analysis

Industry Dynamics

Prior to examining potential reform options to the wheat industry, it is important that an assessment be undertaken on the wheat industry supply chain. By examining the supply chain, this can assist in determining the competitive environment, and the implications of any reform options on the competitive environment.

At its broadest level, the wheat industry supply chain can be broken down into wheat growers (production), transport, storage and handling (distribution), sales and marketing, and final consumers.

These sectors (other than final consumers) will be examined separately, by looking at the external environmental and industry factors which impact on the dynamics of the wheat industry.

Broadly speaking the wheat industry is subject to similar external environmental factors, which have a significant influence on the profitability of the industry.

In relation to the *natural environment*, wheat producers are clearly influenced by climatic and weather conditions, as well as other factors such as soil quality. These factors directly impact on wheat producers, but also indirectly impact on the rest of the supply chain to the extent that the amount that is required to be transported and stored, and marketed is reduced.

Economic factors also influence the production of wheat, although the demand for wheat globally is seen to be a relatively inelastic commodity, and therefore have relatively stable levels of demand.

Technological advances have played a significant role in relation to wheat production, through the introduction of more efficient harvesting techniques and other varieties of wheat which are more suitable to WA conditions, as well as advanced transportation and storage techniques, which have more efficiently brought supply to market.

In relation to *government influences*, these are generally minimal at the production stage of the supply chain, although government assistance is sometimes provided in times of stress (such as drought). Government also provides indirect assistance to wheat producers through its taxation environment. Government, however, has played a more significant role in the other key elements of the supply chain.



- In relation to the distribution sector, CBH has benefited from the initial protection it was afforded under the *Bulk Handling Act 1967*, as it enabled CBH to invest in a substantial storage and handling infrastructure network.
- In relation to sales and marketing, government policy in relation to the marketing of wheat through a single desk has obviously benefited AWB.

The influence of government in relation to the market power gained by CBH and AWB will be explored further on page 24.

It is also important to examine the industry-related factors that impact on each sector. A common approach to assessing the industry environment is Porter's Five Forces Model⁸. This model focuses on the five forces that shape competition within an industry: (1) the risk of entry by potential competitors; (2) the degree of rivalry amongst established companies within an industry; (3) the bargaining power of buyers; (4) the bargaining power of suppliers; (5) the closeness of substitutes to an industry's products.

Overall, it can be said that the stronger each of these forces, the more limited the ability of established companies to raise prices and earn greater profits.

Production

Analysing the production industry with reference to these five forces, it can be concluded that there are competitive elements with producers (growers), although competition is constrained by certain characteristics to the extent that:

- *barriers to entry exist* with respect to the production of wheat due to the land and capital investment requirements;
- there is a *high degree of market power* amongst WA wheat producers collectively when compared to wheat producers in other states and in other countries, due to more efficient production techniques and scale advantages;
- there is a *moderate degree of bargaining power on the part of customers*, on account that while WA producers compete on a global stage, they represent a large share of the total market, and their product is marketed through a single desk, which also increases market power;
- as the first step in the supply chain, it can be seen that the *degree of bargaining power of suppliers is high*, to the extent that wheat producers require the services of CBH (and the rail operators and AWB) to get their product to market (which is primarily export markets); and
- the *threat of substitutes is considered to be low*, due to the fact that wheat is a staple and therefore essential commodity for most countries around the world.



Based on the above analysis, it can be concluded that while wheat producers have a strong position in a globally competitive environment, the degree to which they can raise prices and earn greater profits is influenced to a large extent by CBH (as the supplier of storage and handling infrastructure) and AWB (as the single desk operator).

Distribution

With reference to the five forces framework, it can be concluded that there currently exists a high degree of market power with CBH, although this is mitigated to some extent by virtue of the fact that AWB maintains a government-mandated monopoly position with respect to the marketing of wheat overseas. In this regard:

- there are *high barriers to entry*, with CBH having developed a significant storage and handling infrastructure network substantially under the protection of the *Bulk Handling Act 1967*, which is unlikely to be easily replicated;
- there is a *high degree of market power* to the extent that CBH is a monopoly provider of storage handling services in Western Australia;
- there is a *moderate degree of bargaining power on the part of customers*, on account that while there are limited alternatives to using CBH's services, AWB is also a monopoly provider through the government controlled single desk arrangements;
- the *degree of bargaining power of suppliers is high*, to the extent that CBH requires the use of Western Australia's rail network, with the above rail owned by Queensland Rail and the below rail network controlled by Babcock and Brown; and
- the *threat of substitutes is considered to be low*, due to the fact that CBH is an integrated transportation and service provider.

Sales and Marketing

With reference to the five forces framework, it can be concluded AWB is afforded a high degree of market power, although this market power is mitigated to some extent by the monopoly power that exists with CBH in the transportation and handling of wheat prior to export (in the Western Australian context). In this regard:

- there are *high barriers to entry*, given that the government-mandated single desk arrangements preclude anyone else marketing wheat overseas. This has allowed AWB to build up strong relationships and networks across Australia and around the world;



- there is a *high degree of market power* to the extent that AWB has the legislated single desk monopoly in the marketing of wheat for export in Western Australia (and nationally);
- there is a *low degree of bargaining power on the part of customers*, on account that all wheat has to be marketed through AWB;
- the *degree of bargaining power of suppliers is relatively high*, to the extent that CBH maintains a monopoly through its storage and handling infrastructure in Western Australia. In relation to growers, their degree of bargaining power is also relatively high, on account that all current wheat growers, as A Class shareholders, maintain a degree of control over AWB; and
- the *threat of substitutes is considered to be low*, on the grounds that the only alternative to using AWB's service is to market wheat to the domestic market, which is very small in comparison to total wheat production in WA.

Key Issues

What the previous section highlights is a wheat industry that is heavily influenced by the market power on the part of CBH (as the monopoly provider of storage and handling infrastructure), AWB (as the single desk marketer in Australia), and to a lesser extent the rail operators in Western Australia.

Such an industry structure has evolved on the back of a high degree of government involvement. Therefore, if there were to be changes made in the context of wheat marketing arrangements (which is currently being considered by the Wheat Export Marketing Consultation Committee), then this could have significant flow-on effects to the current competitive balance in the wheat market.

The market power of both CBH and AWB are explored further below.

Market Power of CBH

Under the protection originally provided under the *Bulk Handling Act 1967*, CBH has been able to invest in a substantial storage and handling infrastructure network with a storage capacity of greater than 19 million tonnes, comprising of just under 200 receival points with four port terminals strategically located at Kwinana, Geraldton, Albany and Esperance which is strongly linked with the rail network. This has placed CBH in a very strong position of supply chain control, where there are high barriers for entry by potential competitors.

The major issue with the Act is that pricing of access and services are completely discretionary, and CBH have used this to their advantage.



Although CBH have not increased grower receival charges (i.e. charges direct to growers), storage and handling charges paid by AWB have increased significantly over the last four years.

AWB analysis of CBH charges highlights a significant increase in storage and handling costs, especially in relation to Time Based Storage (TBS) charges. Analysis indicates that over the four year period from 2003-04 to 2006-07, storage and handling charges in WA increased by 52 per cent, while TBS costs increased by 84 per cent. According to AWB, attempts to have CBH review their charges have been unsuccessful.

While it is recognised that CBH provides the cheapest storage and handling charges on a per tonne basis in Australia, it is the rate of increase in CBH charges over recent years (which far exceeds increases by other bulk handlers) that has been of concern to AWB in that it does not appear to be linked to normal inflationary pressures.

It could also be argued that CBH should have lower costs relative to other bulk handlers due to the benefits from being exempt from income tax, the fact that it does not have an obligation to provide dividends to shareholders, and its scale advantages relative to other bulk handlers.

The extent to which CBH controls the supply chain is reinforced through the standard service agreements that CBH requires its customers to accept⁹. While further details are provided in the Appendix A, the following points are worth noting regarding the supply chain control bulk handling companies like CBH are afforded:

1. **Stock Information** – Such information is not available to others, and allows CBH to determine the relevant stock holdings of competing traders, knowledge of what growers are delivering to warehousing, and what supplies of critical grades are available prior to market knowledge.
2. **Site Level Information** – Having access to the quality profiles of the individual bins and bunkers at a storage site allows CBH to be able to arbitrage stock within grades. This superior knowledge (combined with the ability to control the supply chain) allows CBH a greater capability than other traders to blend different grades to a customer specification.
3. **Ability to Move Client and Competitor Stock** – CBH is authorised to move stock, and can do so without notifying the grower. Because the value of the grain to a trader is in its position in the supply chain, this means that if it is moved by CBH, the trader could lose value either through position or through the cost of the freight rate that CBH chooses to charge.



4. **Differential Pricing** – CBH recently introduced differential pricing, which essentially provides a cheaper price to traders for port outloading provided that CBH controls the supply chain (that is, accumulates the grain and controls the transport). Under this pricing structure CBH, as a marketer, will have the opportunity to control their own stocks and effectively charge their marketing division the cheapest price.
5. **Operational Advantages** – CBH will be able to move its stock to port in preference to competitors, therefore gaining priority in vessel loading.

Concerns over CBH's market power are not confined to the wheat market and AWB.

Box 1 below represents an extract from the Grain Licensing Authority 2005-06 Annual Report, noting the market power that CBH has in relation to its charges it sets for the Grain Pool (GPPL) and Special Export Licence Holders (exporting grains other than wheat).

Box 1: Extract from Grain Licensing Authority 2005-06 Annual Report

CBH introduced a number of policies, fees and charges that appear to be different for the Main Export Licence Holder (GPPL) in comparison to Special Export Licence Holders (SEL) for prescribed grains.

While CBH is a grower owned company it is still controlled in part by statute under the *Bulk Handling Act 1967*. It would appear that CBH are required to allow any person to utilise any bulk handling facilities it owns at ports, but it is free to charge whatever fee(s) it determines.

The uneven application of charges by CBH on GPPL Ltd and SEL's may be justified in some instances. For example where there are clearly greater costs involved in dealing with the requirements of the SEL's. However in a number of instances there does not appear to be justification for some of the policies, fees and charges that CBH has put in place.

A number of SEL's have been in contact with the GLA stating that they believe that they are being unfairly treated by CBH in comparison to the GPPL, a wholly owned subsidiary of CBH. If this is the case, then it is hindering the intended operation of the Act and limiting the competition for prescribed grain on the cash market and lowering prices available to growers.

There is little doubt that the first two years of operation of the GLA have resulted in a significant lift in the cash prices for barley and canola in Western Australia (WA), resulting in better returns for growers who chose to sell for cash.



What is currently not clear is the difference in cost of dealing with an external exporter compared to the GPPL. While it is understandable that costs would be lower for a subsidiary there is no transparency as to how the costs differ and if they are justifiable.

Given that CBH currently holds a natural monopoly on storage and handling in WA, principally through its control of facilities at the four ports, this matter has been referred to the Treasurer, to determine whether the matter warrants intervention under the provisions of the Part IIIA of the *Trade Practices Act 1974*. This matter has been noted by the Department of Agriculture and Food and Treasury, and a Working Group has been formed to look at the issue.

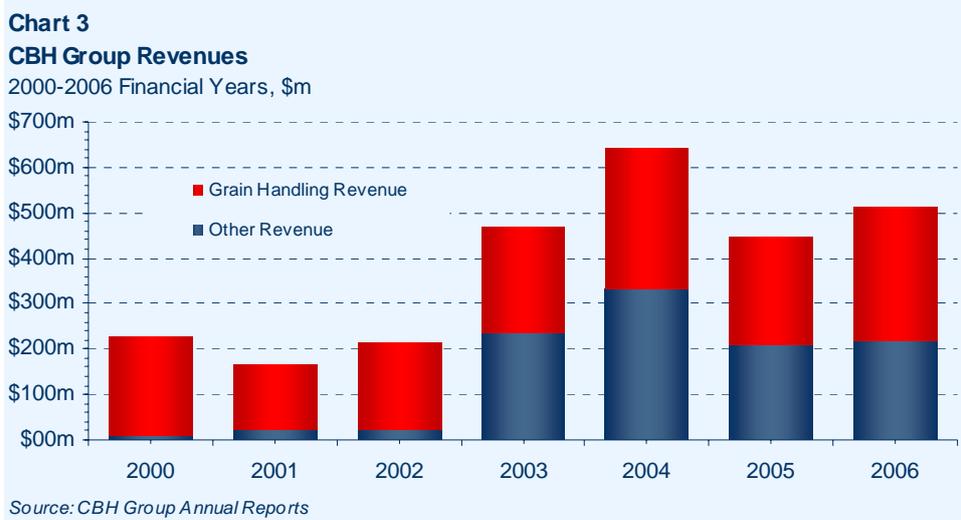
Source: Grain Licensing Authority 2005-06 Annual Report

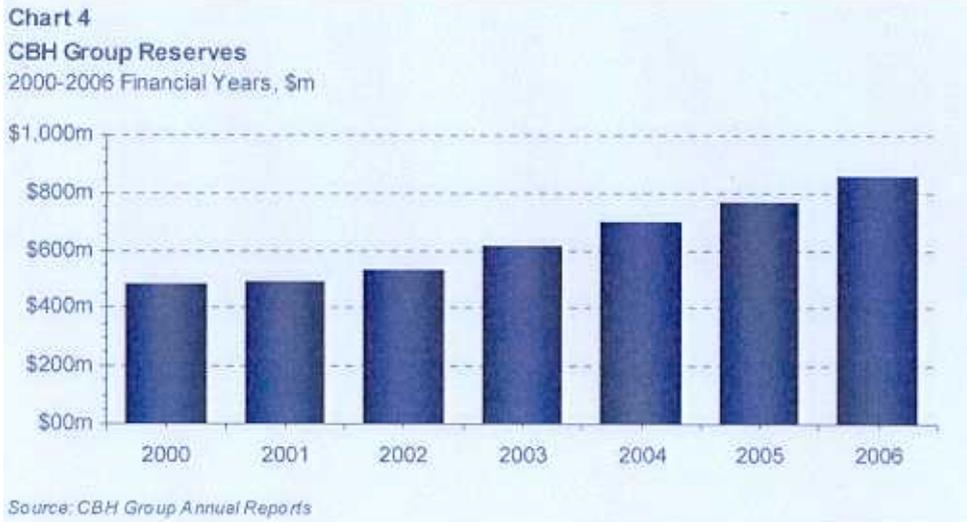
The extent of CBH's market power is clearly reflected in its strong financial position. While the profitability of CBH is to a large extent dependant on the grain harvest in any one year, it has still managed to generate strong results.

In relation to profitability, CBH Group reported a net profit after tax of \$87.3 million for 2005-06, an increase of 42.8 per cent from the previous year. While profitability levels are dependent on the grain harvest, on average since 2001, profits have increased by 56 per cent per annum.

Revenue growth has been similarly strong, with reported total revenues of \$512.9 million in 2005-06, an increase of 14.9 per cent from the previous year. Since 2001, total revenues have increased on average by 23.5 per cent (Chart 3).

CBH Group reported net assets of \$915.8 million in 2005-06, an increase of 11.8 per cent from the previous year. On average, net assets have grown by 11.3 per cent per annum since 2001.





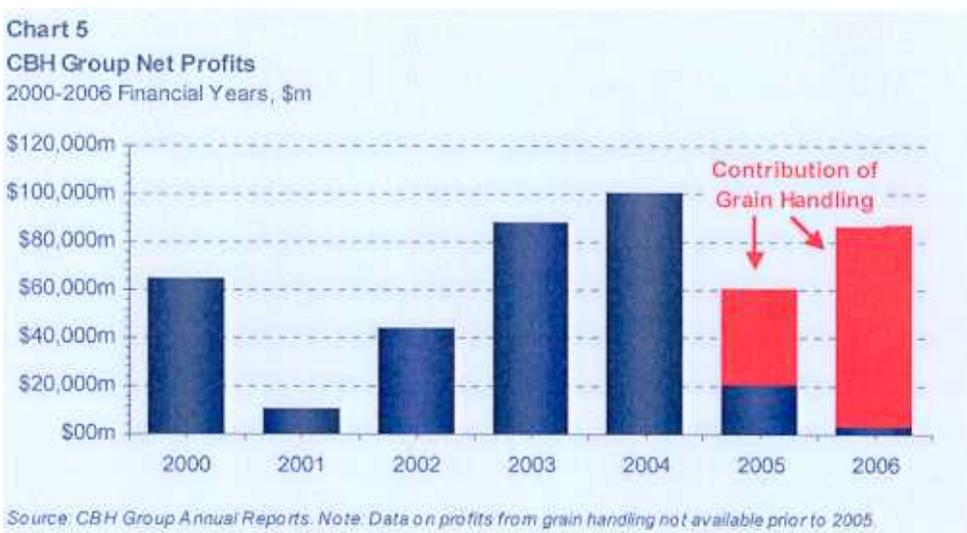
Because the *Bulk Handling Act 1967* allows CBH to build up reserves, but at the same time prevents these reserves from being distributed to shareholders, this has meant that it has built up \$860 million in reserves (see Chart 4).

While CBH Group has a number of business operations, their core business continues to be grain storage and handling. The strong financial performance of CBH Group, by and large, is a reflection of the strong performance of its grain handling business operations.

While diversification has reduced its reliance on grain handling for revenue, in 2005-06 grain handling revenues still contributed 57.3 per cent of total Group revenue, and made up almost all of the Group's net assets. In 2005-06, the grain handling business net profits represented 95.9 per cent of total Group net profits.

Market Power of AWB

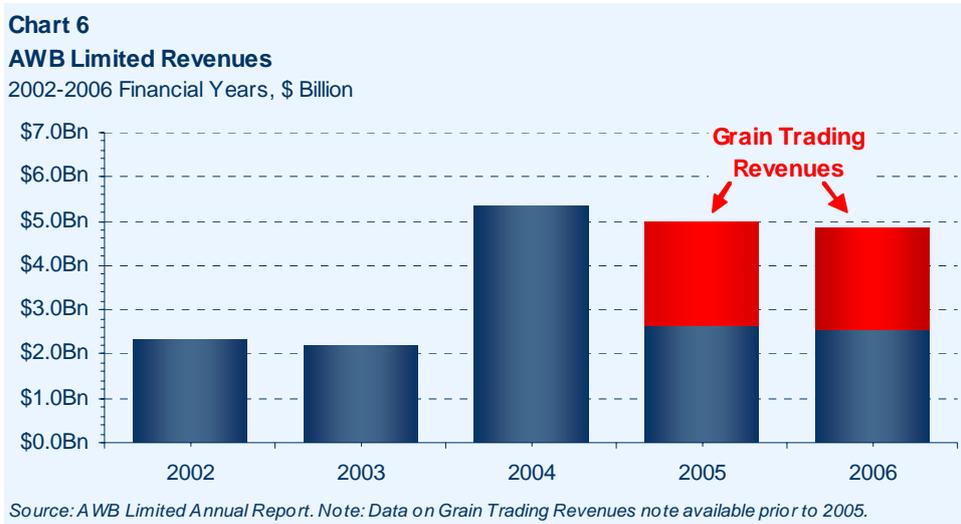
AWB has a number of subsidiaries under its group structure. Its segment performance detailed in its annual reports highlights a diversified organisation,



with its finance and risk management, pool management services, rural services (Landmark), grain acquisition and trading segments in particular making a significant contribution to the overall performance of AWB.

In its 2006 Annual Report, AWB reported total revenues of \$4.9 billion, which helped generate a net profit of \$58.1 million in 2005-06. Both financial measures were down from the previous year, as a result of the effects of drought on the grain harvest.

The most significant segment of AWB is its grain acquisition and trading segment (primarily the international trading business operated by AWBI), which accounted for 47.1 per cent of total revenues (amounting to \$2.3 billion) and 38.5 per cent of net profits (amounting to \$22.4 million) in 2005-06 (Chart 6).



The single desk provides AWBI with a high degree of market power in relation to the marketing of wheat overseas. This has allowed AWB to undertake strategic investments around the world to boost its performance in this area, such as through the opening of offices in new cities (e.g. Sao Paulo), and strategic investments in grain storage and handling infrastructure in India¹⁰.

While this positions AWB well in relation to its export marketing role, its overall market power in Australia (and more specifically Western Australia) is diluted to some extent on the grounds that it does not control key grain storage, handling and transportation infrastructure networks.

In this regard, the 2006 Annual Report highlights that of AWB's \$5.5 billion in assets, only two per cent represent supply chain assets. The majority of its assets are instead tied up primarily in rural services (Landmark), finance and risk management, pool management services, and grain acquisition and trading segments.



The extent of AWB's market power was highlighted in the Wheat Export Authority's (WEA) performance monitoring of AWB which is required under the *Wheat Marketing Act 1989*.

The 2006 report¹¹ analysed the prices paid by AWB for storing and out-turning grain with the major bulk handling companies as well as with one private grain handling organisation.

The WEA compared the cost of receiving, segregating and storing grain for 12 months and out-turning to rail (for country bulk storage sites). The analysis found that AWBI pays more per tonne to AWB Grainflow and GrainCorp than other storage and handling providers. Of note is that AWBI pays the same as any non-AWBI traders to GrainCorp, more than the non-AWBI traders to CBH and less than non-AWBI traders to ABB Grain.

Based on this analysis, the WEA found that AWBI appears unable to use its market power to significantly influence country storage and handling costs¹².



Implications of Reform

Reform Options

The Wheat Export Marketing Consultation Committee is currently investigating three broad approaches to wheat marketing arrangements. These are discussed briefly below.

Deregulation

Deregulation of wheat exports is akin to arrangements for most other commodities. Growers wishing to export would choose, based on price and service, whether to sell to AWB or another bulk exporter.

Supporters of deregulation argue that increased competition would provide benefits to growers through, for example, improved efficiency in the supply chain, greater contestability of marketing and transport services, better transmission of market signals, more options for growers, product and market development improvements, and elimination of regulatory costs¹³. On the other hand, opponents of deregulation argue that it may increase short-term price volatility, resulting in benefits for some growers and reduced returns for others, and the elimination of the possibility of obtaining price premiums for Australian wheat and end grower control of marketing¹⁴.

Partial Deregulation – Licensing Systems

There are numerous variations of licensing models which would result in varying numbers of additional exporters. A multiple licensing system requires the development of a pre-determined, specific criteria against which additional licences would be issued. Proponents of a licensing system argue that they provide some competition benefits and increased choices for growers without jeopardising all of the benefits of a single desk. Opponents of a licensing system argue that they are a halfway house delivering neither the benefits of a single desk nor deregulation while adding regulatory complexity¹⁵.

Licensing arrangements can be structured to give varying levels of market access and competition – with criteria potentially developed to issue licences to particular markets, quantities, and/or wheat types. Additional licences could be limited and restrictions gradually lifted over time to provide for increased competition. Alternatively, criteria could be developed based solely on the characteristics of the potential exporter. The buyer of last resort obligation could also be reviewed.

This type of market structure exists in Western Australia's grains market (other than wheat), with the establishment of the Grains Licensing Authority provided with the powers to issue special export licences, and to monitor the performance of the Grain Pool Pty Ltd as the main export licence holder.



Single Desk

Under the single desk model, a single company would have the right to export wheat in bulk without consent from the WEA and the right to veto other bulk exports. The WEA would issue wheat export consents to parties other than the company managing the single desk and monitor and report on the single desk manager's export performance.

Proponents of the single desk argue that it minimises uncertainty, enables price premiums to be obtained, shares risk across the industry and allows economies of scale to be achieved. Opponents of the single desk argue that price premiums realised for Australian exports are the result of higher quality wheat rather than the single desk. They also argue that it does not deliver the most efficient services or the range of services growers desire and that it exposes growers to risks associated with a single seller¹⁶.

Currently the *Wheat Marketing Act 1989* stipulates that AWB is the manager of the single desk.

It is not the purpose of this report to analyse the single desk arrangements, which has been subject to numerous reviews over the years, with varying results. In the context of the current inquiry, however, opinion remains divided as to whether the single desk arrangements should continue.

In the context of this report, it should be noted that purely from a competition policy standpoint, in its 2002, 2003, 2004 and 2005 assessments of the *Wheat Marketing Act 1989* as part of National Competition Policy, the NCC noted that the Australian Government had failed to demonstrate that restricting competition in the export of wheat was in the public interest¹⁷.

Supply Chain Implications of Reform

Much of the discussion surrounding the wheat export marketing arrangements has focussed on the perceived benefits that would likely be achieved if the single desk marketing arrangements were deregulated.

This section briefly explores the possible implications of deregulation in relation to the competitive dynamics within the wheat industry in Western Australia.

Overall, it is likely that the removal of the single desk marketing arrangements will result in a major shift in chain power relationships. According to a study of the power relationships in the grain supply chain undertaken by Strategic Design and Development (SDD)¹⁸, such a change will result in the migration of chain "control" further away from the grower and in the direction of the monopoly-holding port terminal, which in Western Australia is CBH. With control over the storage and handling of wheat to ship, this will mean that CBH will



become an even more powerful player with respect to other parties in the supply chain (such as marketers).

While marketers like AWB will retain a privileged position in the supply chain due to grower loyalty and their international marketing expertise, this advantage will be reduced as transnational marketers and bulk handling companies such as CBH which already have a well resourced trading function and close operational ties to the grower, enter the marketing space.

The SDD study found that because the trading and storage functions of the bulk handling companies are not separated, this will provide internal pricing advantages, and ensure that the bulk handling company becomes the dominant player in a multi-operator environment.

In a deregulated wheat marketing environment, the grower will have access to a greater range of export buyers for their grain, and therefore a broader choice of marketing options and services. In this way, it is argued that efficiencies would flow through supply chain, by allowing bulk handlers to compete with AWB in the contracting of storage, transport and port terminal services for the movement of export wheat.

However, because the storage and handling infrastructure will remain at the control of CBH, this will increase their market power. While the CBH Group would certainly benefit from such supply chain control, this will come at the expense of other players in the supply chain – particularly growers and marketers.

According to the research conducted by SDD:

“The natural tendency for such a powerful organisation would be to ‘cherry pick’ the tonnage it handled from ‘farm gate to port’, depending on its access to reasonable freight services (i.e. a single dedicated train). This would leave the remaining business to be transferred to port by AWB, ABB and other traders at far higher costs, as these smaller freight customers would have minimal buying power. Eventually a majority of business would be handled by this single integrated organisation, but by no means all. Some growers would benefit from this arrangement, but inequity among growers (even between neighbours) would be greatly increased, and average chain costs would increase.

BHCs [Bulk Handling Companies] acting as traders or marketers will have strong operational cost drivers dictating how grain products are blended and binned, both up-country and at port. Marketers argue that BHCs would favour a reduction in segregations and the range of quality products currently being marketed. Any blending profits available in the cargo assembly process (i.e. where lower quality grains are mixed with high quality products to meet a customer’s specification) would be delivered to the BHC, rather than to the growers via the current pooling mechanisms.



The section, Issues for Review on page 37 looks at this issue further in the context of CBH's recent service agreement for the 2006-07 season.

Deregulation

If wheat marketing arrangements are completely deregulated, this will mean that AWB would become one of a number of grain accumulators seeking to purchase grain for export.

It could be argued that the familiarity of growers with the AWB, its extensive networks both within Australia and overseas, and the fact that many growers are shareholders in the privatised entity, would mean that AWB would continue to remain a competitive force in relation to the marketing of wheat for export.

While there are incumbent and scale advantages that are likely to provide AWB will an advantage in a deregulated market, given the extent of CBH's operations in the wheat supply chain, and in relation to other grains, this represents a competitive threat to AWB's core business of marketing wheat.

To the extent that CBH controls the wheat supply chain from the grower to the port, and has recently commenced exporting wheat, this will place AWB and other traders at a competitive disadvantage against CBH. This form of market power could therefore act to inhibit the development of competition in wheat marketing.

For CBH, complete deregulation of the wheat marketing arrangements would represent an opportunity for it to grow its business. CBH has articulated and demonstrated a strategy of moving from a pure cooperative storage and handling company towards a vertically integrated grain business.

For example, in November 2002 CBH merged with Grain Pool Pty Ltd and in 2004 invested in Asian flour Mills through a joint venture with Pacific Agrifoods. In addition, CBH recently commenced exporting wheat under a licence granted by the Federal Minister for Agriculture.

CBH has the capacity to expand into marketing of wheat on the basis that the Grain Pool already performs such a function as the main licence to export barley, canola and lupins in bulk out of Western Australia. This trading function performed by the Grain Pool is well resourced and has close operational ties to growers of these other grains.

Concerns over supply chain control not confined to the wheat industry, but also downstream with flour millers both within Australia and overseas concerned over the supply chain control that will result to bulk handlers like CBH as a result from deregulation.



For example, the Flour Millers Council of Australia has not supported deregulation. In a recent article to the Weekly Times, it said:

“...deregulation would play into the hands of the bulk handlers, with the three regional monopolies exerting influence over the market.”¹⁹

As a consequence of CBH being granted a special licence to export wheat to its flour mills across South East Asia, a number of competing flour mills overseas²⁰ have also detailed their concerns to both the Wheat Export Authority and the Prime Minister. These concerns centre on the ability for CBH to potentially cross-subsidise or provide its own flour mills with preferential access, thereby limiting the ability of other flour mills to compete.

Reforms to Coarse Grains Marketing

Under the *Grain Marketing Act 2002*, the Grain Pool is granted the main export licence for barley, canola and lupins. However, it should be noted that following reforms to the Act, a provision was inserted into the Act to require the Minister to carry out a review of the operation and effectiveness of this Act. This review is to be carried out as soon as is practicable after the expiration of five years from the commencement of this Act, which would be 31 October 2007. A review of the Act may commence earlier, however, if the national wheat single desk is removed (Clause 49).

It should be noted that the possible deregulation of the wheat market does not automatically infer that the coarse grain industry will also be deregulated, as this will be a decision for the relevant Western Australian Minister following the review.

The possible deregulation of the grains market in Western Australia could potentially present an opportunity for AWB to compete in the coarse grain market – which incidentally was identified as a risk when the partial deregulation of the grains market in WA was implemented with the introduction of the *Grain Marketing Act 2002*.

Partial Deregulation

The implications of partial deregulation on the wheat industry will largely depend on what system is implemented.

For example, if a similar system is adopted to that which exists in the Western Australian coarse grains market, the competitive implications will depend on which party is provided with the main export licence. If, however, AWB is granted to main export licence, it is foreseeable that this would help to ensure that the market power of the bulk handlers like CBH is controlled to some degree.



However, in a partially deregulated environment bulk handling companies such as CBH could still “cherry pick” the tonnage it handled from farm gate to port. If AWB, as the main export licence holder, is encumbered with a requirement to be the buyer of last resort, bulk handling companies will have the opportunity acquire wheat and deliver to the AWB grades/quality they do not want and and/or grain that has a freight disadvantage.

It is not the purpose of this report to investigate the competitive implications of all possible systems, because of the questions as to the number of export licences that would be issued, and whom they would be issued to.

That said, the analysis undertaken under the complete deregulation option helps to highlight the possible implications of deregulation across the wheat industry, if market power on the part of CBH remains unfettered.

Summary

What this section highlights is the need for any decision regarding the reform to wheat marketing arrangements to consider the supply chain implications.

This section has found that reform to wheat marketing arrangements – either through partial or full deregulation – could have anti-competitive implications for the wheat industry overall.

These concerns need to be investigated by Government when making its decision on reform to wheat marketing arrangements.

While the objective of reforming wheat marketing arrangements is founded on National Competition Policy (NCP) principles, which have been committed to by all Australian governments, the potential for such reforms to lessen or restrict competition across the supply chain would be inconsistent with such principles. The background to NCP is provided in Appendix B.

It is important to understand that the purpose of NCP is to undertake reforms which help to promote competition in business activities undertaken by government and other sectors of the economy.

The overall outcome of any changes to the wheat industry should be that there is a truly competitive environment in all aspects of the industry – not just in relation to one specific part of the supply chain (that is, wheat marketing).

Finding: *Because reforms to wheat marketing arrangements could have anti-competitive implications for the wheat industry overall, it is important that this is investigated by Government prior to making any decision on reform to wheat marketing arrangements.*



Facilitating Competition

The purpose of this report has been to analyse the competitive environment that currently exists in the wheat industry and, in particular, examine the competitive dynamics that exist across the supply chain.

This report has found that prior to any decision over possible changes to the wheat marketing arrangements, it is important that the Government understand the likely competitive implications on the wheat industry supply chain.

Notwithstanding the control that CBH has over the key storage and handling infrastructure in Western Australia, there are a number of key issues which require further consideration in order to help facilitate competition in the wheat industry.

Issues for Review

Supply Chain Transparency

An important aspect in facilitating competition will be to review the ways in which bulk handling companies can control the supply chain, such as through the standard service agreements that CBH currently requires its customers to accept. Through their control over the supply chain, and because of the structure of the standard service agreements, CBH is provided with both informational and operational advantages, which are not available to other market participants.

- *Information advantages* take the form of stock holdings, what is being delivered to warehouses, what supplies of critical grades are being delivered, and the quality profiles at storage sites. Such information is not available to traders, meaning that if CBH is able to start marketing wheat, this will provide a significant advantage over traders such as AWB.
- *Operational advantages* exist by virtue of the fact that CBH is able to move stock at their discretion down the supply chain, reducing the benefits that can be obtained by traders if they have to pay additional freight rates. In addition, CBH is able to move its stock to port in preference to other customers, on account of its control over the facilities.

The issue of supply chain transparency is a common concern that has been expressed in relation to grain market reforms. For example, in the SA Barley Marketing Working Group Report, it found that (in the context of the South Australian barley industry):

“it is important to have a clear and transparent booking system, where the owner of the ship loader cannot disadvantage the other party simply because they own the infrastructure.”²¹



Finding: *The lack of transparency across the supply chain has provided bulk handling companies like CBH with both informational and operational advantages, which will be exacerbated upon deregulation of the wheat marketing arrangements.*

Pricing Structures

In addition, in the case of CBH, they have recently introduced a differential pricing structure which provides a cheaper price to traders for port outloading provided that CBH controls the supply chain (that is, accumulates the grain and controls the transport). Three different charges are imposed, depending on the services that are utilised by the traders, namely:

- (i) *Export Assist* – This is charged when CBH accumulates the cargo (site selects) and controls the transport component. This product is charged at \$6.85/tonne.
- (ii) *Export Select* – This is charged when CBH controls the transport component and the customer nominates the site selections for cargo accumulation. This product is charged at \$7.35/tonne.
- (iii) *Export Standard* – This is charged when the customer controls both the transport and accumulation of the cargo (select sites). This product is charged at \$8.35/tonne²².

Under this pricing structure CBH, as a marketer, will have the opportunity to control their own stocks and effectively charge their marketing division the cheapest price. If traders wish to have some control over their stocks (i.e. arrange transport or select cargoes), they will have to pay higher costs for port outloading. The alternative is to accept handing complete supply control to CBH in order to compete on supply chain costs.

While such a pricing structure makes sound business sense for CBH, there is a concern that such a pricing structure will provide CBH with further competitive advantages in a deregulated market that allows it to also become a marketer of wheat. It will mean that CBH will have the opportunity to control their own stocks and effectively charge their marketing division a cheaper price on account that the stock will be fed through the CBH supply chain.

Although it is unclear whether such a pricing structure breaches the *Trade Practices Act 1974* (TPA), this will need to be investigated further.



Finding: *The application of differential pricing to traders for port outloading will be likely to provide CBH with further competitive advantages in a deregulated environment. While it is unclear whether such a pricing structure breaches the TPA, this should be investigated.*

Vertical Integration

In a deregulated environment, it is expected that CBH will become a more vertically integrated business, and by expanding into wheat marketing, this will provide it the opportunity to complete its supply chain link from the grower right through to its overseas flour mills.

These concerns over the impact of CBH as a vertically integrated entity on the Australian wheat industry have been discussed in detail on page 31.

However, there are also international implications because of CBH's strategic investments in flour mills in South East Asia. As a consequence of CBH being granted a special licence to export wheat to its flour mills in South East Asia, a number of competing flour mills have detailed their concerns to both the Wheat Export Authority and the Prime Minister.

These concerns centre on the ability for CBH to potentially cross-subsidise or provide its own flour mills with preferential access, thereby limiting the ability of other flour mills to compete.

It is important to ensure that competition is protected and promoted in the wheat industry as the industry becomes more vertically integrated. Whether this can be achieved in the current environment, backed up by the provisions preventing the abuse of market power in the TPA, is a question that will require further analysis.

Concerns with vertical integration across the supply chain stem from the power it provides the infrastructure owner to offer preferential pricing to its affiliates at the expense of independent competitors. At worst, such power can lead to the denial of access to external parties. This may result in higher prices and/or inefficient restrictions on output.

In order to address such issues, this may necessitate the introduction of some form of access arrangement for the infrastructure services, or may also require some form of price monitoring.

Finding: *As CBH becomes more vertically integrated and therefore increases its market power, this will have implications for other competitors that utilise its services.*



Avenues for Review

While it is important that the implications of the current wheat marketing arrangements on the wheat industry more generally need to be understood, there are also ways in which competition could be facilitated – both in the context of the current environment and, more importantly, in a partially or fully deregulated wheat marketing environment.

There are a number of ways by which competition could be facilitated, including:

- through the Economic Regulation Authority (ERA); or
- pursuing the review of CBH’s port and infrastructure facilities under the new COAG *Competition and Infrastructure Reform Agreement*; or
- seeking CBH’s facilities to be declared “essential infrastructure” under Part IIIA of the *Trade Practices Act 1974* (TPA).

Each of these issues is examined further below.

There are also a number of policy reform opportunities for Government to pursue during any amendment to the current wheat marketing arrangements and as part of any transitional arrangements to partial and/or eventual deregulation. These issues, however, are not explored in this report.

Economic Regulation Authority

If AWB believe that CBH are taking advantage of their significant market power, then one avenue by which this could be investigated is to refer the issue to the ERA.

This becomes more important given that the *Bulk Handling Act 1967* does not contain any provisions for review of the legislation.

In WA, there is a need for an independent body to review anti-competitive legislation and market structures. These responsibilities would sit ideally with the ERA, as the independent economic regulator for the state. The ERA currently oversees regulation and licensing for the gas, electricity, water and rail industries.

Synergies already exist between the functions of the ERA and the objectives of competition policy. The *Economic Regulation Authority Act 2003* allows for the State Treasurer to refer any matter related to a regulated industry to the Authority for the purposes of an inquiry²³. The Act goes on to state the matters that can be referred to the Authority include, but are not limited to:

- prices and pricing policy in respect of goods and services provided in the



industry concerned;

- quality and reliability of goods and services provided in the industry concerned;
- investment and business practices in the industry concerned; and
- costs of compliance with written laws that apply to the industry concerned.

The Act specifically directs the ERA to have regard for the need to promote competitive and fair market conduct, as well as to prevent abuse of monopoly or market power in performing its functions.

***Finding:** In Western Australia, the ERA exists to promote competition and fair market conduct, and prevent the abuse of monopoly or market power. If it is deemed that CBH is abusing its market power in relation to its storage and handling infrastructure, the WA Treasurer could refer this issue to the ERA to be investigated. Such a referral would be consistent with the WA Government's obligations under the New National Reform Agenda.*

COAG Competition and Infrastructure Reform Agreement

As part of the new national reform agenda, COAG signed a *Competition and Infrastructure Reform Agreement* to provide for a simpler and consistent national system of economic regulation for nationally-significant infrastructure.

The agreed reforms aim to reduce regulatory uncertainty and compliance costs for owners, users and investors in significant infrastructure and to support the efficient use of national infrastructure.

A key aspect of this agreement was in relation to port competition and regulation. The relevant section from the agreement is detailed in Appendix B.

Essentially, the agreement notes that ports should only be subject to economic regulation where a clear need for it exists in the promotion of competition in upstream or downstream markets or to prevent the misuse of market power. The agreement also stipulated that each jurisdiction would review the regulation of ports and port authority, handling and storage facility operations at significant ports within its jurisdiction to ensure they are consistent with the principles set out in clauses 4.1 and 4.2. Significant ports include:

- major capital city ports and port facilities at these ports;
- major bulk commodity export ports and port facilities, except those considered part of integrated production processes; and
- major regional ports catering to agricultural and other exports.



Finding: *On the basis of the COAG agreement, it is imperative that the port facilities controlled by CBH are reviewed by the WA Government to determine whether regulation is warranted in order to promote competition in the wheat industry.*

Access Arrangements

As part of National Competition Policy, the Commonwealth Government introduced a national access regime for infrastructure services in 1995. Background information on ncp is provided in Appendix B.

Part IIIA of the TPA establishes the legal rights for third parties to share the use of certain infrastructure services of national significance on reasonable terms and conditions. In essence, the Part IIIA framework covers nationally significant infrastructure services where such infrastructure has natural monopoly characteristics, and where it is deemed that access to such infrastructure is necessary to promote competition in an upstream and downstream market.

Part IIIA also requires that access be economically feasible and not be allowed to compromise the system integrity of infrastructure, and the benefits of access regulation must not outweigh the costs.

The National Competition Council (NCC) is responsible for administering the Part IIIA framework, and there are essentially three avenues for a party to seek access to an infrastructure service – through declaration; by using an effective access regime; or under the terms and conditions set out in a voluntary undertaking approved by the Australian Competition and Consumer Commission.

The declaration pathway is the common way in which a business will try to gain access to a particular infrastructure service, with the NCC in making its deliberation taking into consideration a number of criteria to establish whether the relevant service is provided by a nationally significant facility that has natural monopoly characteristics and that occupies a bottleneck position in an industry. In addition, a public interest assessment is undertaken to weigh the costs and benefits of imposing access regulation.

If an infrastructure service is declared, it does not provide the access seeker with an automatic right to use that service; rather, it establishes a right for any party to negotiate terms and conditions of access with the service provider.

The NCC cannot recommend that a service be declared unless it is satisfied that all of the following criteria (set out in section 44G(2) of the TPA) are met:



- (a) that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service
- (b) that it would be uneconomical for anyone to develop another facility to provide the service
- (c) that the facility is of national significance, having regard to:
 - (i) the size of the facility or
 - (ii) the importance of the facility to constitutional trade or commerce or
 - (iii) the importance of the facility to the national economy
- (d) that access to the service can be provided without undue risk to human health or safety
- (e) that access to the service is not already the subject of an effective access regime and
- (f) that access (or increased access) to the service would not be contrary to the public interest.

The Council must also consider whether it would be economical for anyone to develop another facility that could provide part of the service (section 44F(4)).

The Council must be affirmatively satisfied that all of the declaration criteria in section 44G(2) are met before it can recommend declaration. If the Council is not satisfied that one or more of the criteria are met, then it must recommend that the service not be declared.

Part IIIA therefore provides a regime by which businesses can obtain access to major infrastructure provided that the application is made in good faith (section 44F(3)), and whether it would be economical for anyone to develop another facility that could provide part of the service (section 44F(4)).

In the case of major infrastructure, businesses should have legal avenues to pursue the use of nationally significant infrastructure services owned and operated by others on commercially negotiated terms.

Where commercially negotiated terms and conditions are not possible, implementing authorities must be sensitive to the implications of their decisions including possible disincentives to future investment that may result from mandated access and it is important that where access is given it is on 'reasonable' terms and conditions and at "fair" prices.



By seeking to have CBH's facilities "declared" under Part IIIA, the resulting development of an access regime would provide certainty on the terms and conditions on which CBH would provide access. Importantly, this would require the development of transparent costing and pricing policies, and would ensure that prices are set by an independent arbitrator.

However, the Part IIIA process is time consuming, and it is not clear whether all the infrastructure owned by CBH would satisfy the criteria for it to be declared an essential service. In this regard, it should be noted that in their discussions with the SA Barley Marketing Group over the SA barley market, the NCC remain of the view that up-country storage and handling facilities would not be seen as a natural monopoly as there is already some competition²⁴. However, in the case of port infrastructure, this may not be the case.

Finding: Seeking to have the infrastructure owned by CBH declared an essential service for the purposes of Part IIIA of the TPA represents a legal avenue for access, if it is deemed that access cannot be obtained on "reasonable" terms and conditions at "fair" prices.

Victorian Grain Access Regime

In the context of the previous discussion, it should be noted that a grain access regime was developed by the Victorian Government in 2003 to cover the export grain handling and storage facilities at the ports of Geelong and Portland.

Rather than direct price regulation, the regime establishes a "negotiate-arbitrate access regime". Under the new framework, GrainCorp Operations Limited, the owner/operator of the regulated terminals, must provide access to its on "fair and reasonable terms". The Essential Services Commission in Victoria will arbitrate any disputes over the conditions of access that cannot be resolved through commercial negotiation.

The regulatory framework applying to GrainCorp's export grain handling terminals at the ports of Geelong and Portland is specified in the *Grain Handling and Storage Act 1995* (GHSA) and in the Guidelines for the Grain Handling and Storage Access Regime (Guidelines) published by the Essential Services Commission. The regulatory objectives of the Commission in relation to export grain handling services are specified in section 14 of the GHSA as follows:

- to promote competition in the storage and handling of grain;
- to protect the interests of users of the grain handling and storage facilities in terms of price by ensuring that charges across users and classes of services are fair and reasonable; and



- to ensure users and classes of users have fair and reasonable access for grain to the port facilities whilst having regard to the competitiveness and efficiency of the regulated industry.

Under the negotiate/arbitrate regulatory framework that is now in place under the GHSA, the Commission will only make a determination concerning prices if notified that parties cannot agree on terms and conditions of access to the prescribed services. A determination can be made under sections 18 or 21 of the GHSA depending on the nature of the dispute.

As required under Section 23(1) of the GHSA, in 2006 the Commission completed an inquiry as to whether or not Victorian export grain terminals are “significant infrastructure facilities”.

Overall, the Commission found that there is “a significant degree of actual and potential competitive substitution”²⁵. However, it accepted views within the industry of the importance of the existing access regime for the development of competition in grain marketing – particularly in an industry that may be further deregulated in the future.

While the Commission did not believe that the risk of misuse of market power directed towards the minor marketers is sufficient to warrant the continuation of access regulation over a five year term, it was persuaded for the regime to be reviewed again in two years time (by no later than 30 June 2008) in light of the significant degree of change in the industry.

Instead, the Commission recommended that in the interim it would have a monitoring role, to determine whether the port terminals provide access on fair and reasonable terms. Under this monitoring role the Commission would require each of the terminals to prepare an undertaking, which would be as light handed as possible, and contain a binding dispute resolution process. The Commission’s regulatory role would be confined to a last resort, if the undertaking is not adhered to.



Appendix A – Standard Service Agreements

A review of the standard service agreement for Bulk Handling Companies (BHC) helps to highlight the ways in which supply chain control can be exerted. The service agreements have been sourced from the National Agricultural Commodities Marketing Association.²⁶

Stock information

A BHC can determine the relevant stock holdings of competing traders. This stock information provides them information on ownership levels by grade. This advantages the BHC in knowing who to approach for trades, swaps and other opportunities.

With a deregulated market, growers may wish to warehouse their grain until they are ready to make a selling decision. For BHCs that also act as a trader (e.g. CBH), this will mean that they have access to who has delivered to warehousing, their tonnages and quality. This allows BHCs to target growers who have delivered to warehousing. No other trader has access to this information.

Site level Information

Under the CBH Standard Services Agreement, Clause 5.4(d) states:

“CBH warrants the accuracy of Customers Grain Entitlement in respect of a Port Zone Entitlement Stock only and does not warrant the correctness of Site Stock data supplied to the Customer”

The value of grain for a trader is in its position. If a CBH can only provide accuracy of data at a port zone level, particularly when CBH have the right to move the grain at their discretion (see below), then this value can be eroded for other traders.

Having access to the quality profiles of the individual bins and bunkers at a storage site allows the BHC to be able to arbitrage stock within grades. For example, at a large site the BHC can internally reserve all their ownership against bins that contain better quality grain (e.g. pre-rain product).

In the CBH Standard Services Agreement, Clause 5.3 states:

“Subject to Clauses 22 and 25, any Grain stored in Common Stack Segregation will be Outturned by CBH to a quality no less than the minimum Receival Standard which applies to Common Stack Segregation in which the Customer's Grain is stored.”

and Clause 5.2 states:



"All Grain will be stored by CBH in Common Stack Segregations"

Currently AWB pays growers premiums for superior quality above the base grade. Under the Standard Services Agreement, CBH is only obliged to outturn grain to the minimum receival standard.

Quality arbitrage can be managed by BHCs in numerous ways. This is available by having access to superior information on the quality profile of grain at, and within, each storage site. This superior knowledge combined with the ability to control the supply chain allows the BHC a greater capability than other traders to blend different grades to a customer specification.

These agreements also provide the ability for BHCs to cherry pick stocks to gain freight/quality advantages. If there is partial deregulation and AWB is the buyer of last resort CBH can deliver to the AWB national pool grades/quality they do not want and and/or grain that has a freight disadvantage.

Ability to move clients/competitors stock to erode value of competitor

Under Clause 11.1 (b):

The customer expressly and irrevocably authorises CBH to:

(i) move at it discretion, grain held at any site; and

(ii) incur transportation costs, either in CBH's name or the Customer's name (as the case requires)

Under Clause 11.1 (e):

CBH is not obliged to notify customers prior to the movement of any Grain.

Because the value of grain to a trader is in its position, if it is moved by CBH, the trader could lose value either through position or through the cost of a freight rate that CBH chooses to charge.

Differential pricing

In its 2006-07 Season Grain Services Agreement, CBH has introduced three new Port Outloading Charges for Export Grain.

(i) Export Assist – This is charged when CBH accumulates the cargo (site selects) and controls the transport component. This product is charged at \$6.85/tonne.



(ii) Export Select – This is charged when CBH controls the transport component and the customer nominates the site selections for cargo accumulation. This product is charged at \$7.35/tonne.

(iii) Export Standard – This is charged when the customer controls both the transport and accumulation of the cargo (select sites). This product is charged at \$8.35/tonne.

Under this pricing structure CBH, as a marketer, will have the opportunity to control their own stocks and effectively charge their marketing division the cheapest Export Product (i.e. \$6.85/tonne).

However, most other grain traders who wish to have some control over their stocks (i.e. arrange transport or select cargoes) will have to pay higher costs for port outloading. The alternative is to accept handing complete supply control to CBH in order to compete on supply chain costs.

Similar charges were introduced by CBH in 2004-05 for domestic outloading products.

Operational Advantages

BHCs can restrict access to stock owned by clients through claiming a mechanical fault or insect infestation. This can damage a trader's relationship with a customer and/or force a trader into a swap that will benefit the BHC.

CBH is also able to move its stock to port in preference to competitors, and therefore gaining priority in vessel loading. By having control of the supply chain, CBH can preferentially move their stock to port and therefore gain priority loading on vessels.



Appendix B – Competition Policy

National Competition Policy

The formal push towards a national competition framework in Australia commenced in 1992, when the Commonwealth and State governments established an Independent Committee of Inquiry into a National Competition Policy for Australia.

The committee's recommendations, known as the Hilmer Report, made a vital contribution to the evolution of competition policy in Australia. Its key contributions were to propose a co-ordinated, systematic and uniform approach to competition policy across all government jurisdictions, and to recommend mechanisms designed to address the institutional and political factors that can lead governments and regulators to adopt anti-competitive measures that are not in the public interest. In particular, it proposed:

- the establishment of a clear principle that anti-competitive regulation and legislation should be permitted only when it can be demonstrated to be in the interest of the community, and cannot be achieved by other means; and
- the establishment of 'arms-length' bodies to oversee and advise on the general implementation of competition policy (the National Competition Council) and regulate its detailed application (the Australian Competition and Consumer Commission).

On 11 April 1995, the Council of Australian Governments (COAG) agreed to a national competition policy package providing for uniform legislation on the protection of consumer and business rights and increased competition in all jurisdictions. The Prime Minister, Premiers and Chief Ministers signed two inter-governmental agreements to implement the package. COAG reaffirmed its commitment to continuing micro-economic reforms in key industries and this was reflected in a third agreement which provided for financial arrangements, including a series of competition payments to be paid to the State Governments in return for implementing competition policy reforms.

In summary, the three key measures provided:

- a *Conduct Code Agreement* along with *The Competition Policy Reform Act* and various State and Territory legislation, which extended coverage of Part IV of the *Trade Practices Act* to all businesses irrespective of their legal form or ownership;
- a *Competition Principles Agreement*, which set standards on structural reform



of public monopolies, reviews of anti-competitive legislation and regulation, prices oversight, access to essential infrastructure, competitive neutrality, and local government; and

- an *Agreement to Implement the National Competition Policy and Related Reforms*, which set out conditions for financial transfers to the States and local government in return for implementing competition reforms.

The co-ordination and structure of Australia's NCP program (and prior reforms) has been recognised as being exceptional among the international community. According to the OECD:

"In the last decade of the 20th century, Australia became a model for other OECD countries in two respects: first, the tenacity and thoroughness with which deep structural reforms were proposed, discussed, legislated, implemented and followed-up in virtually all markets, creating a deep-seated 'competition culture'..."²⁷

The specific program of reform established under NCP ended in 2005. However, the initial NCP agreements provided for a review and consideration of another agenda towards the end of the initial agreement period.

That review process commenced in April 2004, with the Commonwealth Treasurer requesting that the Productivity Commission undertake a Review of National Competition Policy Reforms. Drawing on that study, as well as recommendations from COAG senior officials, the COAG agreed in February 2006 to a new national reform agenda.

National Reform Agenda

The COAG agreed to a *National Reform Agenda* on 10 February 2006. The agenda includes a new wave of collaborative reforms which build on the success of the NCP and previous economic and social policy reforms.

The COAG agenda is split into three streams - human capital, competition and regulatory reform. The latter two are the focus of this paper.

The competition stream of the new agenda aims to further boost competition, productivity and the efficient functioning of markets through further reform and initiatives in the areas of transport, energy, infrastructure regulation and planning and climate change. This agenda follows the formula of national competition policy reforms, with governments working together to identify reform opportunities, and agreeing on a process for delivering them.

Importantly, all governments have recommitted to the principles contained in the National Competition Principles Agreement, which was established under the



NCP. Jurisdictions have also agreed to continue and strengthen gate-keeping arrangements established under the NCP to prevent the introduction of unwarranted restrictions on competition in new and amended regulations and all outstanding priority legislation reviews from the NCP review program also need to be completed.

The specific competition reform objectives of the new agenda and how they relate to Western Australia are discussed in section titled *The Reform Agenda for Western Australia*.

The regulatory reform stream of the new agenda focuses on reducing the regulatory burden imposed by the three levels of government. The measures proposed in the agenda aims to ensure that markets operate efficiently and fairly, in balance with other social and economic objectives (that is, that consumers and the environment are suitably protected and that the benefits from regulation do not outweigh their compliance and implementation costs).

It is expected that further action to address burdensome regulation and red tape will be taken as the Commonwealth considers and responds to the report of the *Taskforce on Reducing the Regulatory Burden on Business*, and as State, Territory and local governments undertake their own regulation review processes. In its initial report in response to the recommendations of the Regulation Taskforce, the Federal Government indicated support for only 86 of the 178 recommendations. It is hoped that more of the recommendations will be embraced in the second part of the Government's report which is due for release in July 2006.

COAG has agreed in principle to establish new intergovernmental arrangements for the governance of the *National Reform Agenda*. Like NCP, it is envisaged that Governments at all levels will have a central role in elaborating and implementing the agenda.

Several steps still need to be taken to advance the new agenda, particularly as to who will administer the new process. COAG has agreed in principle to establish a COAG Reform Council (CRC) to report to COAG annually on progress in implementing the National Reform Agenda. It is envisaged that the CRC will be an independent body that will replace the National Competition Council which currently oversees the NCP process.

The primary role of the CRC would be to report to COAG annually on progress towards the achievement of agreed reform milestones and progress measures across the broad National Reform Agenda.



Competition and Infrastructure Reform Agreement

As part of the new national reform agenda, COAG signed a *Competition and Infrastructure Reform Agreement* to provide for a simpler and consistent national system of economic regulation for nationally-significant infrastructure. CCI supports the proposed agenda.

The agreed reforms aim to reduce regulatory uncertainty and compliance costs for owners, users and investors in significant infrastructure and to support the efficient use of national infrastructure.

A key aspect of this agreement was in relation to port competition and regulation. The relevant section from the agreement is detailed below.

4.1. The Parties agree that:

- a. ports should only be subject to economic regulation where a clear need for it exists in the promotion of competition in upstream or downstream markets or to prevent the misuse of market power; and*
- b. where a Party decides that economic regulation of significant ports is warranted, it should conform to a consistent national approach based on the following principles:*
 - i. wherever possible, third party access to services provided by means of ports and related infrastructure facilities should be on the basis of terms and conditions agreed between the operator of the facility and the person seeking access;*
 - ii. where possible, commercial outcomes should be promoted by establishing competitive market frameworks that allow competition in and entry to port and related infrastructure services, including stevedoring, in preference to economic regulation;*
 - iii. where regulatory oversight of prices is warranted pursuant to clause 2.3, this should be undertaken by an independent body which publishes relevant information; and*
 - iv. where access regimes are required, and to maximise consistency, those regimes should be certified in accordance with the Trade Practices Act 1974 and the Competition Principles Agreement.*



4.2 *The Parties agree to allow for competition in the provision of port and related infrastructure facility services, unless a transparent public review by the relevant Party indicates that the benefits of restricting competition outweigh the costs to the community, including through the implementation of the following:*

- a. *port planning should, consistent with the efficient use of port infrastructure, facilitate the entry of new suppliers of port and related infrastructure services;*
- b. *where third party access to port facilities is provided, that access should be provided on a competitively neutral basis;*
- c. *Commercial charters for port authorities should include guidance to seek a commercial return while not exploiting monopoly powers; and*
- d. *any conflicts of interest between port owners, operators or service providers as a result of vertically integrated structures should be addressed by the relevant Party on a case by case basis with a view to facilitating competition.*

4.3 *Each Party will review the regulation of ports and port authority, handling and storage facility operations at significant ports within its jurisdiction to ensure they are consistent with the principles set out in clauses 4.1 and 4.2.*

- a. *Significant ports include:*
 - i. *Major capital city ports and port facilities at these ports;*
 - ii. *Major bulk commodity export ports and port facilities, except those considered part of integrated production processes; and*
 - iii. *Major regional ports catering to agricultural and other exports.*



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