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Mr John Ralph AO
Chair
Wheat Export Marketing Consultation Committee
GPO Box 858
Canberra ACT 2600

Dear Mr Ralph

Re: Future Wheat Export Marketing Arrangements

I would like to thank you and your committee members for the diligence and tolerance with which you have approached the task of listening to wheat grower views about future export marketing arrangements.

Having attended the meeting at Wagga Wagga on 12 February, and having made comments to the committee (copy attached) which were seen as hostile by I suspect the majority of those present, I have reflected at some length on what I heard that day.

I still find it perplexing that so many fellow wheat growers, who generally have common sense in abundance, remain so wedded to a marketing structure that to me is clearly outdated and hasn't performed adequately, and to an organisation whose recent conduct is, to me, utterly unacceptable and a product of the structure and internal conflicts that underpin it.

I do not, for example, agree with an AWB grower shareholder quoted in the media who, at AWB's AGM last week, apparently called for some directors to resign, because "it is not the single desk or the company that has been at fault, only some directors". In my opinion this is a fundamental misreading of the problem. While directors ultimately must (and hopefully will) take responsibility under our corporate governance system, AWB's failings stem from, and are driven by, a culture that reflects its monopoly status. Until and unless that structure is changed, similar examples of poor performance will recur one way or another.

As to the question of non transparency, the shipping example I mentioned in Wagga is a telling, but I suspect not widely understood, example: chartering profits being booked to the company, hence shareholders, while demurrage costs (net of dispatch credits) are charged to the pool, hence growers. The basic information appears in successive AWB annual reports but, sadly, this is one of the many areas where growers have been let down by the inadequate analysis of the WEA.

I cannot avoid concluding that the frequent comments you heard are, as I said in Wagga, a combination of grower ignorance, AWB's lack of transparency, and the effectiveness of its spin doctors, along with an understandable fear of the unknown. On the latter point, it should be recalled that growers were equally apprehensive about the possibility of life after domestic deregulation of wheat, the export single desk for barley in NSW and Victoria, and other coarse grains in NSW and Queensland, or the floor price for wool. But they quickly learnt how to operate in the new environment, to the point that there has been absolutely no call for a return to the old forms of regulation (or elsewhere where deregulation has occurred, such as sugar and dairy).

I commend to you the article in this week's Land newspaper by Malcolm Bartholomaeus, the newspaper's regular grain trading analyst. His credentials and experience are widely recognised by wheat growers across Australia, and his commercial recommendations regarding hedging and forward selling widely followed. After noting that final wheat prices to Australian growers are made up of US wheat futures prices, the exchange rate and the basis (the difference between our prices and US futures prices), and that the current debate focuses on factors influencing the basis, he made the following comments:

> "Growers need maximised secure returns. We need a full range of pool products and cash prices to choose from, and cash prices that are truly competitive with pooling alternatives. We need truth in pricing to stop the current practice of overstating pool estimates. We need competition in the provision of marketing products and marketing and payment functions to drive down costs and margins, and to provide growers with full choice. We need full and independent information on wheat stocks, production and export sales and shipments to prevent poor information from distorting the domestic market. We need a system that costs less to run than the current system, and one funded by a levy on all wheat, so that all growers pay for the industry good functions... Because the current single desk system can record costs of between $5.85 a tonne in a normal year, to more than $20 a tonne in a drought year, the basis moves by $15 a tonne just because of the single desk system and the current remuneration system. Eliminating basis risk in a new export system will benefit all growers greatly."

He then went on to say that the required outcomes can be delivered by a (different) single desk system, or full deregulation, but that the WA grain licensing system or the current interim (Ministerial) arrangements are likely to provide the worst result because not all growers will be treated equitably and basis levels will remain unstable.

I doubt that the necessary improvements can be delivered by a reformed single desk - and Malcolm did not explain how - but I do agree that there are grave dangers in a half-way house, unless on the clear understanding that it is for a short transition period towards full deregulation.

I am sure that the sensible people within AWB understand this too and are already preparing the organisation for transition to a normal competitive model. In this respect, I would urge the committee to draw an important distinction between those associated with AWB who are continuing to whip up fear among growers of the impact of any change (aided by leaflets, head office briefings and the like) and those who are going about forward-looking duties in a less public way.

The emotional side of the fear mongers' arguments is fairly easily mounted, with recourse variously to the evils of "large" growers (since when has the single desk been an adjunct of welfare policy?), multinational corporations (who ripped off growers, so it is asserted, during the 30s - as if that experience retains the slightest relevance to today's circumstances), "the Government" (despite, as you noted in Wagga, the fact that AWB and the single desk is a product of government legislation), Americans, corrupt markets, threats to the fabric of rural communities, possible closure of branch lines, and so on.

Notwithstanding the passion with which these arguments are held by many growers, they are not the central issue. The central issue is: does the single desk system produce the best net returns for all growers all of the time, and is an alternative system better capable of doing so?

The quantitative and rigorous analysis that has been conducted in recent years gives an unambiguous answer to this question: deregulation will result in a lower cost, more competitive marketing system within Australia, at least equivalent prices being obtained in world markets (and the possibility of additional markets being identified that AWB misses - the durum wheat story is instructive here), and a deeper array of associated marketing and financial services, as outlined by Malcolm Bartholomaeus above, and advocated by one thoughtful grower at the Wagga meeting.

Among many reports, I would draw your attention in particular to:

- the in principle arguments in the Productivity Commission's 2000 report, *Single Desk Marketing: Assessing the Economic Arguments;*
- GrainCorp's recent submission to you, *A Contestable Export Wheat Market: Maximising Returns to Growers*;
- two reports written by colleagues of mine at ACIL Tasman, *Marketing Western Australian Wheat* (July 2005) for the Pastoralists and Graziers Association, and *Marketing Australian Wheat: Competition and Choice in the Australian Wheat Market - Increasing Growers' Net Returns* (November 2006) for the Australian Grain Exporters Association; and
- the 2006 WEA Growers Report which, rather belatedly, has concluded that AWB does not extract significant market premiums for Australian wheat <u>because</u> of the single desk, which defeats the main rationale for having it (see p 10); in addition the report concludes that AWB did not affect country storage and handling costs (p8), incurred a net cost from hedging and foreign

exchange operations when assessed against a passive hypothetical hedger (p10), while non-AWBI export permit holders (containerised or bagged wheat) gained better prices for most of these exports than AWB (p22).

I would like to respond briefly to some of the pro single desk arguments that have appeared in the recent debate, at Wagga and elsewhere:

- "**the national pool outperforms the world market by $20 per tonne**"; I do not know where this assertion comes from; if it has any basis it will presumably have been identified by the WEA, but this does not appear to be the case; it is important to be comparing like with like here, especially given that much of Australia's wheat market price advantages derive from intrinsically better quality and freight, not the single desk *per se*; GrainCorp can provide data on the performance of its wheat pools relative to the national pool over recent years;
- "**because the US hates the single desk it must be good**"; this is a plausible assertion on the surface but it is wrong; the underlying point that is made by US wheat export interests is that AWB over delivers in quality against specification and hence is acting like a weak seller, the very opposite of what it is meant to do;
- "**the single desk gives us market power in a corrupt world market**"; if markets are corrupt (by which I take to mean are distorted by export subsidies) no single desk will be able to redress them unless matching Australian Government subsidies are provided; it is another assertion that rolls easily off the tongue but has no basis in fact; on previous occasions AWB has publicly acknowledged that (US or EU) export subsidies have prevented or made export sales difficult (for example, to Egypt); despite what it often says, or is said on its behalf, AWB understands that it is powerless in the face of such distortions;
- "**only AWB can operate a national pool**"; if other companies (such as GrainCorp) were given the chance to operate a national pool, and there was sufficient demand relative to other marketing products, they would be more than capable of doing so; other companies do offer (regional) pool products now, and some growers utilise them; again GrainCorp can provide details of its pools experience;
- "**the national pool is the buyer of last resort**"; it is difficult to know what this frequently asserted statement really means; if it means that growers are assured that someone will purchase their wheat at the appropriate grade/price for its quality, then so can other companies; if it means that growers of poorer quality wheat should be subsidised by others, then the question is why?;
- "**AWB provides outstanding technical support to overseas customers**"; this used to be a major attribute of the former Australian Wheat Board, but according to AWB's export customers it is not longer the case; criticism of AWB's declining after sales service performance was repeatedly made to the GrainCorp chairman when he made an extensive tour of customers last year, especially in Asia;

- "**only AWB can sell a big crop**"; it is hard to test this assertion as no one else has been given the chance; the implied point is that if there is a big crop, then only AWB can make the storage and marketing decisions to place it onto the market strategically / gradually without depressing the market, both export and domestic; in fact other companies - as they do in other industries or commodities - have every incentive to maximise their net returns (ie after storage and finance costs have been taken into account) just as AWB does; an important point is that if AWB makes a wrong decision for whatever reason, the costs are borne by all growers and the accountability for performance is weak, which is not the way that normal markets work; in the end, it is another red herring; finally if "a big crop" is a factor in the global supply and demand balance, it will inevitably exert an influence on prices, just as "a small crop" will do so in the opposite direction; growers can't have it both ways;
- "**without AWB, regional monopolies will harm growers**"; this argument is a direct jibe at the main bulk handlers, such as GrainCorp, ABB and CBH; as a director of GrainCorp I have no difficulty in saying that competition in recent years (from on farm storage, direct consignment from farm to domestic customers, and strategically located investments made by AWB and ABB), have helped to sharpen GrainCorp's performance and customer focus – this is what competition always does; having said that, I understand that AWB has consistently made losses on its up country storage investments – which the committee might probe; however, the main point is that, especially in Eastern Australia, but also in WA (via the offering of cash and pool options at local silos), there are alternatives competing to receive, handle and market a grower's wheat, and they must offer a sufficiently attractive price in order to do so; with more competition there will be more such alternatives (eg a recent announcement that Namoi Cotton intends to enter the grain storage and handling business);
- **"when Wheat Australia sold to Iraq last year, it did so at prices $15 a tonne below the price/pool"**; the role of Wheat Australia was as a facilitator to a market from which AWB was then excluded; Wheat Australia's prices were approved by AWB and there was a simultaneous back-to-back supply/price agreement between it and Wheat Australia; if the Iraq prices were below the market/pool, this was because AWB sanctioned them; the fact that contracts took a long time to negotiate (in part because of delays at the AWB end) and market prices may have moved in the interim, is irrelevant; it is generally believed that this argument has been put about by AWB staff;
- **"lets not have change for change sake"**; this is a major observation from a recent report conducted for AWB by trade consultant, Alan Oxley; his report has been widely criticised as non analytical (for example, the respected weekly newsletter Pro Farmer said of the report on 30 November 2006: "unfortunately Oxley has been 'got at' by the AWB spin doctors. The paper is yet another example of AWB scaremongering which wheels out the old chestnuts but presents scant analysis to support these propositions... the case

for change is compelling and to suggest otherwise is counter-productive."); I understand that ABARE has undertaken a comprehensive critique of this report that the committee might like to peruse;

- **"without the single desk, growers will be screwed by multinationals just as they were in the 30s"**; there are two problems with this assertion, which is still trotted out at nearly every meeting; first, the prices paid in the depths of the depression were just that – depression prices – I think I am correct in saying that considered assessment of what happened does not bear out the more dramatic interpretation of events, although I cannot bring to mind the specifics; more importantly, the array of expertise, marketing and communication tools available to today's farmers, not to mention their own skills, makes this argument particularly patronising; and
- **"nothing should be done to the single desk without the guarantee of reciprocity benefits from trade negotiations"**; the problems here are that a multilateral trade agreement is highly unlikely to turn on a single desk negotiation, that reciprocity is never a good basis for trade negotiations despite its popularity (we should do what is right for us, whether or not others follow suit – ie unilateral reform is most in Australia's interests), and that the argument is disingenuous in that it really amounts to a call to defer a decision, perhaps indefinitely.

For all these reasons, I adhere to the view I expressed in Wagga that wheat growers will be best served by complete deregulation of the single desk, the sooner the better.

I note that you are not asked to make explicit recommendations to the Government. However, I am confident that you will draw attention to the practical arguments against a no change outcome - whether "no change" entails the Minister continuing to administer the single desk or a return to the pre November situation.

You might be aware that in terms of the export applications made to the Minister by GrainCorp just prior to Christmas - applications that in every case were accompanied by a letter of endorsement from the customer (one of which was in the UK, a market not presently serviced by AWB) - no reasons for the Minister's rejection have been provided. This is despite there being a national interest test for the exercise of his power. Nor have any reasons been provided by WEA or AWB. Is this the type of transparency that we should aspire to in an export wheat regulation environment where the objective is maximising growers' net returns? I don't think so.

If the *status quo* is not an option, the question comes down to how much change and how quickly. I would hope that you would point out the deficiencies of the proposed AWB demerger plan, and the inadequacies of the half-way houses of WA or SA licensing other than as a step towards full deregulation.

Finally, I can recall the period in the 1960s when Australia had margarine quotas to protect the butter markets of dairy farmers. A highly successful television campaign was run against this policy on freedom of choice grounds, featuring "Mrs Jones", the housewife who wanted to use margarine. That history seems ludicrous now and yet wheat growers who want the freedom of choice to select alternative wheat export marketing options - or in some cases even export their own wheat - are prohibited from doing so. This seems iron curtain stuff, and it is long overdue that it was brought to an end, like the iron curtain itself.

I wish you well as you prepare your report to the Government. I have confidence in what it will contain and I again thank you for devoting your time to this important task.

Yours sincerely

David Trebeck

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