



**Australian Government**  
**Productivity Commission**

# Wheat Export Marketing Arrangements

Productivity Commission  
Inquiry Report

No. 51, 1 July 2010

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***The Productivity Commission***

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

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1 July 2010

The Honourable Nick Sherry  
Assistant Treasurer  
Parliament House  
CANBERRA ACT 2600

Dear Assistant Treasurer

In accordance with Section 11 of the *Productivity Commission Act 1998*, we have pleasure in submitting to you the Commission's final report into Wheat Export Marketing Arrangements.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Wendy Craik'.

Wendy Craik AM  
Presiding Commissioner

A handwritten signature in black ink, appearing to read 'Angela MacRae'.

Angela MacRae  
Commissioner

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## Terms of reference

### Productivity Commission Inquiry into Wheat Export Marketing Arrangements

I, Nick Sherry, Assistant Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998* hereby request that the Productivity Commission undertake an inquiry into wheat export marketing arrangements and report before 1 July 2010.

#### *Context*

This inquiry will assess the operation of the current wheat export marketing arrangements, including the costs and benefits, and inform the Australian Government on the effectiveness of the arrangements.

#### *Background*

The *Wheat Export Marketing Act 2008* (the Act) came into effect on 1 July 2008. The Act established a new regulator, Wheat Exports Australia (WEA), to formulate and administer an accreditation scheme for bulk wheat exports. The *Wheat Export Accreditation Scheme 2008* (the Scheme) also came into effect on 1 July 2008.

The Scheme requires exporters to meet strict probity and performance tests to satisfy WEA that they are fit and proper entities to hold accreditation. In addition, to be accredited exporters that own or operate port terminal services need to meet an access test under the Act, which requires them to have access undertakings approved by the Australian Competition and Consumer Commission (ACCC) in place by 1 October 2009.

Compliance of accredited exporters with the conditions of their accreditations is monitored by WEA which has the power to vary, suspend or cancel accreditations in certain circumstances.

Section 89 of the Act requires the Productivity Commission (the Commission) to conduct an inquiry into the operation of the Act and the Scheme.

#### *Scope of the inquiry*

Under the Act, the Commission must review:

- the operation of the Act, including the costs and benefits; and
- the operation of the Scheme, including the costs and benefits.

In conducting the inquiry, the Commission will assess the effectiveness of the arrangements in meeting the objectives of the Act and will consider the operation of the Act and the Scheme, including the role of WEA, as a whole. The Commission will also consider how individual components of the Act and the Scheme affect relevant stakeholders and the costs and benefits they deliver. The Commission

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should provide comment on those aspects that are working effectively and identify those that require change. The Commission will take into consideration recent reports and studies into Australia's grain supply chains.

The Commission will give consideration to issues that may or do affect the effective operation of the Scheme including, but not limited to:

- the suitability of the eligibility criteria required for, and conditions imposed upon accreditation;
- the appropriate level of assessment of each applicant for accreditation by WEA against these eligibility criteria;
- the appropriateness and effectiveness of the access test requirements that apply both before and after 1 October 2009;
- the effectiveness of, and level of competition existing under current arrangements for the transport, storage and distribution of wheat in contributing to a sustainable supply chain from farm gate to export load port;
- the availability and transparency of relevant market information to participants in the export supply chain; and
- any other factors that may affect the performance of WEA.

If considering changes to the operation of the Act or Scheme, the Commission will examine how such changes would affect arrangements to fund WEA and the use of cost-recovery mechanisms.

In conducting its inquiry, the Commission will consult widely with interested parties including WEA, growers, grains industry representatives, accredited exporters, bag and container exporters, potential bulk exporters, bulk handling companies, the ACCC and relevant government departments.

Consultation with interested parties can occur at any time but there must be an opportunity for stakeholders to comment on the operation of the arrangements for the export of the 2009-10 crop. This will allow consideration to be given to the export of wheat through peak shipping periods for two harvests.

This will be done in an open and transparent manner and include release of a draft report for public comment. It may also include public hearings in major wheat growing areas, if deemed necessary by the Commission.

The Commission is required by the Act to commence its review by 1 January 2010 and report to the Government before 1 July 2010.

NICK SHERRY

[received 29 September 2009]

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## Disclosure of interests

The Productivity Commission Act 1998 specifies that where Commissioners have or acquire interests, pecuniary or otherwise, that could conflict with the proper performance of their functions during an inquiry they must disclose the interests.

Presiding Commissioner Wendy Craik has advised the Chairman of the Commission that she holds or has interest in the following organisations:

- Dairy Australia
- Elders Ltd

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# Abbreviations

ABA	Australian Bulk Alliance
ABARE	Australian Bureau of Agricultural and Resource Economics
ABB	ABB Grain Limited
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACG	Allen Consulting Group
ACIP	Advisory Council on Intellectual Property
ADR	Australian Durum
AGEA	Australian Grain Exporters Association
AGP	Australian General Purpose
AH	Australian Hard
AOF	Australian Oilseeds Foundation
AOP	Annual Operating Plan
APH	Australian Prime Hard
APW	Australian Premium White
APWT	Australian Premium White T
ASFT	Australian Soft
ASIC	Australian Securities and Investments Commission
ASW	Australian Standard White
ASWN	Australian Noodle
ASX	Australian Securities Exchange
AUD	Australian dollar
AWB	AWB Limited
AWBC	Australian Wine and Brandy Corporation
AWBI	AWB (International) Limited

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AWI	Australian Wool Innovation
AWM	Australian Milling Wheat
BAS	Business Activity Statement
BHC	Bulk handling company
CBH	Co-operative Bulk Handling Limited
CBOT	Chicago Board of Trade
CGC	Canadian Grains Commission
CIF	Cost, insurance and freight
CIGI	Canadian International Grains Institute
COAG	Council of Australian Governments
COGGO	Council of Grain Grower Organisations
CRP	Commodity reference price
CWB	Canadian Wheat Board
DAFF	Department of Agriculture, Fisheries and Forestry
DFAT	Department of Foreign Affairs and Trade
DITRDLG	Department of Infrastructure, Transport, Regional Development and Local Government
EPR	End Point Royalty
ERS	Economic Research Service (United States)
ESC	Essential Services Commission (Victoria)
ESCOSA	Essential Services Commission of South Australia
ETG	Elders Toepfer Grain
EVAO	Estimated Value of Agricultural Operations
EWC	Export Wheat Commission
FAS	Foreign Agricultural Service (United States)
FOB	Free on board
GCA	Grains Council of Australia
GE	Grain Express
GGA	Grain Growers Association
GIWA	Grain Industry Association of Western Australia
GLA	Grain Licensing Authority (Western Australia)

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GRDC	Grains Research and Development Corporation
GTA	Grain Trade Australia
GWRDC	Grape and Wine Research and Development Council
HRW	Hard Red Winter
IEG	Industry Expert Group
IPA	Institute of Public Affairs
MLA	Meat and Livestock Australia
MPT	Melbourne Port Terminal
Mt	Million tonnes
NACMA	National Agricultural Commodities Marketing Association Limited
NASS	National Agricultural Statistics Service (United States)
NCC	National Competition Council
NGR	National Growers Register
NRS	National Residue Survey
NSWGB	New South Wales Grains Board
ODF	Oilseeds Development Fund
PBR	Plant Breeders Rights
PC	Productivity Commission
PHA	Plant Health Australia
PIERD Act	<i>Primary Industries and Energy Research and Development Act 1989 (Cwlth)</i>
PIRSA	Department of Primary Industries and Resources of South Australia
SACBH	South Australian Co-operative Bulk Handling Limited
SDD	Strategic Design and Development
SEC	Synergies Economic Consulting
SGIA	Summit Grain Investment (Australia) Pty Ltd
SGNC	Strategic Grain Network Committee
SPFM	Statistically Passive Forward Marketing
SRW	Soft Red Winter

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SSCRRAT	Senate Standing Committee on Rural and Regional Affairs and Transport
SVGA	Single Vision Grains Australia
TPA	<i>Trade Practices Act 1974 (Cwlth)</i>
UN	United Nations
USD	US dollar
USDA	US Department of Agriculture
USW	US Wheat Associates
VFF	Victorian Farmers Federation
WAW	Western Australia Wheat
WCC	Wheat Classification Council
WIB	Wheat Industry Benchmark
WEA	Wheat Exports Australia
WEC	Wheat Export Charge
WEMA	<i>Wheat Export Marketing Act 2008 (Cwlth)</i>
WQOG	Wheat Quality Objectives Group



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# OVERVIEW

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## Key points

- The transition to competition in the exporting of bulk wheat has progressed relatively smoothly, particularly given difficult international trading conditions — a pronounced commodity price cycle, the global financial crisis, and exchange rate appreciation.
- The regulatory arrangements for marketing bulk wheat exports have been beneficial during the transitional phase since deregulation. They have given growers confidence in adjusting to deregulation and facilitated the rapid entry of 28 accredited traders, with 12 million tonnes exported to 41 countries in the first year after deregulation.
- A range of marketing options have become available since deregulation. However, some growers prefer the previous single desk arrangements.
- The benefits of accreditation of traders will rapidly diminish in the post-transitional phase, leaving only the costs. The accreditation scheme, Wheat Exports Australia and the Wheat Export Charge should be abolished on 30 September 2011.
- The port terminal access test has provided greater certainty for traders and made access easier, more timely and less costly than it could have been by relying on potential declaration under Part IIIA of the Trade Practices Act.
- However, there are still some transitional issues associated with port access and contestability in the logistics supply chain. The access test accordingly should remain a condition for port operators to export bulk wheat until 30 September 2014.
- The benefits of the access test will diminish and could become costly in the long term without the checks and balances of Part IIIA of the Trade Practices Act. From 1 October 2014, regulated access should rely on Part IIIA, with continuation of mandatory disclosure, supplemented by a voluntary code of conduct by all port terminal services operators.
- There is evidence that increasing on-farm storage, and competition between road and rail, are leading to improvements in supply chain efficiency. However, it is important that the regulatory arrangements enhance efficiency in the transport and storage market by facilitating contestability.
  - The Commission supports the decision by the ACCC to review the exclusive dealing notification in relation to Grain Express in Western Australia.
- The level and allocation of investment in road and rail infrastructure by governments should be based on rigorous cost-benefit analysis, with a focus on developing economically and socially efficient logistics chains.
- Monthly information by state on stocks, exports and domestic uses facilitates an efficient wheat market. Industry should consider funding its continuation.
- The provision of most other 'industry good' functions is best left to the industry.

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# Overview

In 2008, the Australian Government deregulated the marketing of bulk wheat exports by removing the ‘single desk’ operated by AWB (International) Limited (box 1). Wheat Exports Australia (WEA) was established under the *Wheat Export Marketing Act 2008* (WEMA) to administer an accreditation scheme for bulk wheat exporters. The *Wheat Export Accreditation Scheme 2008* (Scheme) also came into effect on 1 July 2008, making it possible for any trader, once accredited, to export bulk wheat from that date. Port terminal operators wishing to export were required to satisfy an additional ‘access test’ to gain accreditation.

The legislation also required the Productivity Commission to conduct a review of the arrangements, commencing no later than 1 January 2010 and reporting to the Australian Government by 1 July 2010.

The Commission has been asked to examine the operation and effectiveness of the current bulk wheat export marketing arrangements and to comment on:

- the effectiveness of the arrangements in meeting the objectives of the WEMA, including the role of WEA
- the suitability of the eligibility criteria for accreditation of exporters
- the appropriate level of assessment of each applicant for accreditation by WEA against these eligibility criteria
- the appropriateness of the access test requirements for accreditation of port terminal operators as exporters
- the effectiveness of, and level of competition in, the transport and storage supply chain for wheat
- the availability and transparency of market information.

In considering any changes to the operation of the WEMA or the Scheme, the Commission has also been asked to examine how such changes would affect the arrangements to fund WEA, and the use of cost-recovery mechanisms. The Australian Government has described the inquiry as ‘one of a number of checks and transparency measures incorporated to assist wheat growers and industry *with the transition*’. The Commission’s approach, therefore, has been to consider possible improvements to the arrangements that have been put in place and not to compare

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the current arrangements for wheat exports with those that previously existed under the single desk (box 1). However, some growers wanting a return to single desk arrangements would have preferred that the deregulated arrangements be assessed against the single desk environment.

### **Box 1      Single desk**

‘Single desk’ is a term used to describe the monopoly marketing of wheat by the Australian Wheat Board (1939–1999), and its privatised successor, AWB (International) Limited (1999–2008).

A key characteristic of the single desk was the national pooling of returns to growers, whereby the price received by growers (apart from adjustments for quality and transport costs), was the average from sales minus the costs incurred by the Board.

The scope of the single desk varied over time, encompassing both domestic and export sales of wheat until 1989, then only export sales, and finally from 27 August 2007 to 30 June 2008, only bulk wheat export sales. Momentum for change to the export marketing arrangements built up over time, following:

- the *National Competition Policy Review of the Wheat Marketing Act 1989* (2000), which found there was no clear, credible, and unambiguous evidence that the current arrangements for the marketing of export wheat were of net benefit to the Australian community
- the successful deregulation of the export of other grains
- increasing grower dissatisfaction with the performance of the single desk, notably in Western Australia
- the *Inquiry into Certain Australian Companies in Relation to the UN Oil-For-Food Programme* (2006).

## **Australia’s wheat export industry in transition**

The current wheat export marketing arrangements have been operating for two years, and only one full marketing year has been completed under the arrangements. The 2008-09 marketing season (October to September) was the first full season under which the new arrangements operated and the 2009-10 marketing season is nearing completion.

Participants have expressed a range of views on the current arrangements and some examples are presented in box 2.

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## Box 2 Participants' views on the export arrangements

R & L Guest stated:

We are 4<sup>th</sup> generation grain farmers on this property. We grow 4000 acres of crops each year and directly because of the deregulation of the single desk market we see no future in farming. Not one of the 'good' things the new marketing system was meant to provide has happened and we have slipped back to the 1930's before the wheat board was established. (sub. 1, p. 1)

L L & S J Mattingly said:

In just the short time that the Single Desk was scrapped the wheat has gone from profit to loss this year and next year it will be a lot lower in price. Don't just blame the world recession for this, we the farmer knew this would happen and that is why the Single Desk was brought in the first place to stabilize the industry. (sub. 2, p. 1)

Trevor Badger noted:

Deregulation has given me more options but I don't believe the net result is measurable. (sub. 14, p. 5)

Ronland Nominees stated:

I welcome a deregulated wheat export market, as last season Australian wheat was sold into several new markets it had not been sold into for many years and growers had the choice of several marketers to know the true World price for their wheat. (sub. 15, p. 1)

A D & S E Duncan said:

Broadly I have major concerns in regard to the current Wheat Export Marketing Arrangements and basically believe that the post deregulation phase relating to Australia's wheat exports has reached a point where regulation should be kept at an absolute minimum. Why do we have relatively onerous regulations relating to wheat exports which are not imposed on other grains (barley/canola) or other industries (coal/iron ore)? (sub. 8, p. 1)

Pastoralists and Graziers Association of Western Australia stated:

The PGA believes that a sunset clause for WEA should be put in place and that the accreditation of bulk wheat exporters is not required beyond this. However the PGA believes that the Port Access Test within the Act is necessary and should be maintained even beyond the sunset of WEA if the ACCC finds that [bulk handling company] behaviour has not changed as a result of the Port Access Undertakings. (sub. DR81, p. 4)

The South Australian Farmers Federation noted:

SAFF Grains support deregulation. [However] SAFF Grains has found that deregulation to date has not given the benefits of competition that were expected, particularly for South Australia. (sub. DR64, pp. 1–2)

The Australian Grain Exporters Association said:

While, in general, AGEA supports the recommendation to reduce regulation, it does not believe that the Productivity Commission has recognised the substantial issues that still remain in relation to port access and the likely impact of taking the industry backwards if its recommendations are implemented in full. The grains industry is still in a transition period and the supply chain is not yet of a structure that provides for an efficient and effective model in a commercial environment. (sub. DR79, p. 1)

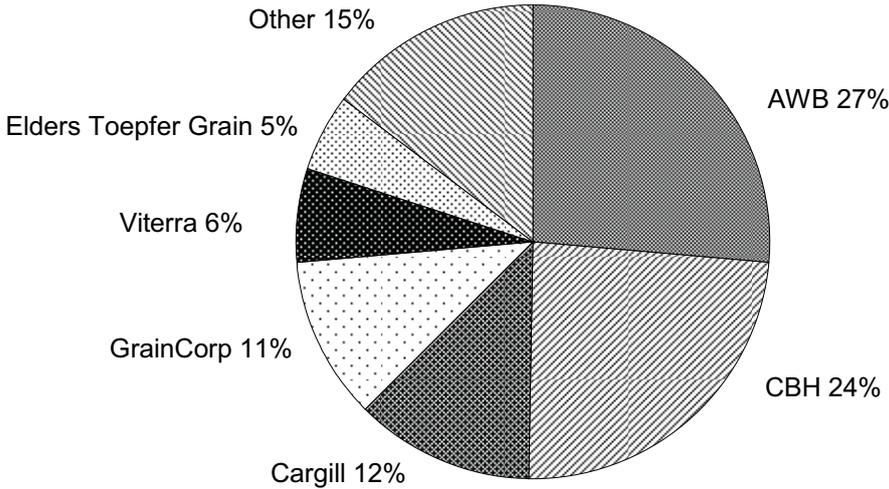
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The Commission’s view is that the transition to competition in the marketing of bulk wheat exports has progressed remarkably smoothly and the industry has performed well under the new arrangements, notwithstanding the concerns expressed by some growers. This is particularly so when the difficult international trading conditions (a pronounced commodity price cycle for wheat and other grains, the global financial crisis, and appreciation of the Australian dollar) are taken into account. A number of considerations have contributed to this assessment.

First, 28 organisations are now accredited to export bulk wheat from Australia (as at May 2010) and competing exporters have successfully gained market share from AWB (figure 1). Some growers have reported that there is a liquid market for wheat with a multitude of offers available.

**Figure 1 Estimated export shares of bulk wheat exporters in 2009**

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Second, in the first marketing year of the current arrangements (2008-09), a relatively large volume of wheat was successfully exported to a diverse range of international markets in 41 countries (12.2 million tonnes). The number of destination countries is larger than for the previous four marketing years (2004-05 to 2007-08) in which Australia exported to 36, 34, 20 and 17 countries, respectively.

Third, none of the accredited exporters has experienced bankruptcy or had its accreditation revoked, notwithstanding the challenging international trading conditions. Growers have a high level of confidence in payment security.

Finally, deregulation of bulk wheat export marketing has also revealed cross-subsidies and inefficiencies that were embedded and hidden in the previous

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compulsory national pool. Growers are now observing prices that are closer to the actual costs of transporting, storing and handling, and marketing their grain.

However, the industry is still working through some significant transitional issues related to port access such as:

- shifting peak period congestion at some ports and the associated supply chains
- the access test and contestability in the logistics supply chain
- the impact of the access test on wheat prices and trading across regions.

There are large variations in the size of wheat farms across Australia, and between and within states (box 3). The wheat marketing arrangements have introduced marketing that is more sophisticated, making the business environment more complex. Some industry participants have faced challenges adapting to this complexity. The challenges have been exacerbated by the recent decrease in the world price of wheat and the appreciation of the Australian dollar (panel A, box 4).

### **Box 3 Concentration of production**

Wheat production in Australia (by tonnes) is highly concentrated. Almost half of the industry's production is grown by 10 per cent of growers, and less than 10 per cent of production is grown by 50 per cent of growers.

Production of wheat also varies across states:

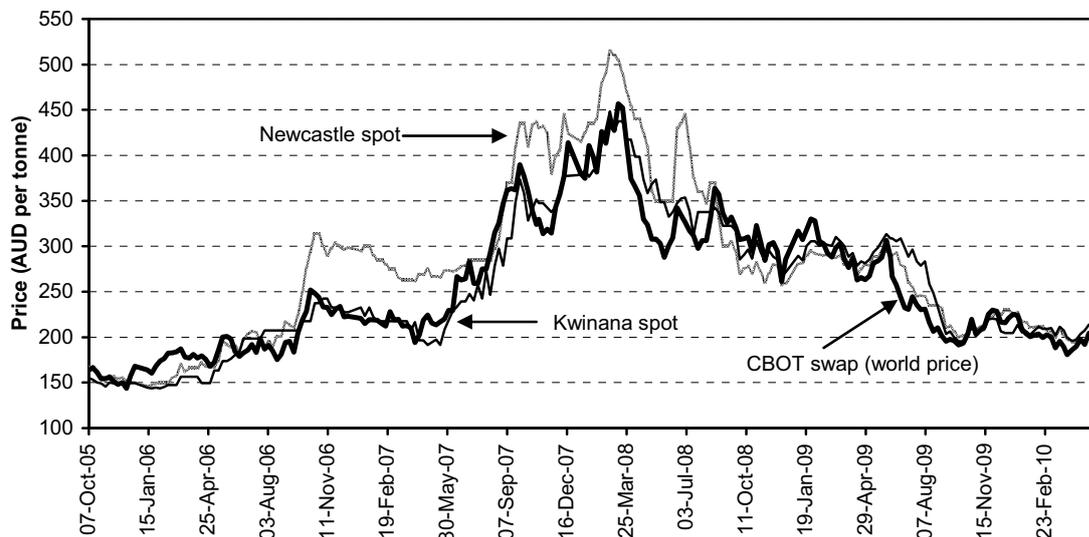
- wheat growers in Western Australia are the largest in Australia with over 75 per cent of them among the largest 50 per cent of wheat growers nationally
- wheat growers in New South Wales and South Australia are evenly split between the smallest and largest 50 per cent of wheat growers nationally
- wheat growers in Victoria and Queensland tend to be smaller, with 63 and 66 per cent of them respectively among the smallest 50 per cent of growers nationally.

Within each state, a large proportion of total production is produced by a small proportion of growers. For example, in Western Australia, 66 per cent of wheat is produced by the largest 30 per cent of growers. In Queensland, 65 per cent of wheat is produced by the largest 15 per cent of growers.

## Box 4 Recent trends in prices

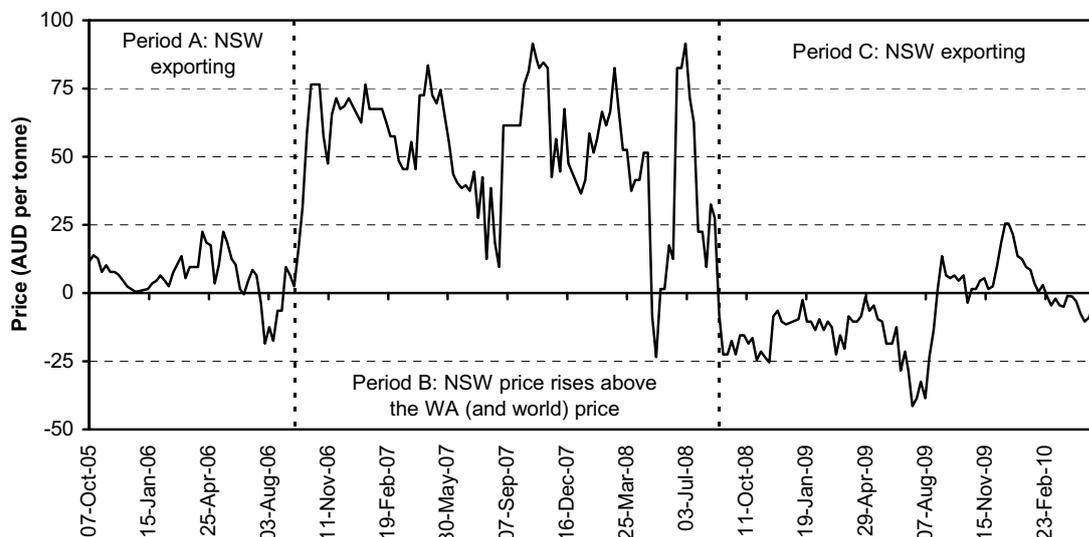
Panel A illustrates the link between the Australian and world price of wheat and the recent price cycle.

Panel A: Spot prices of Australian Premium White in NSW and WA



Panel B illustrates that in times of reduced supply in the eastern states (particularly NSW) the price in NSW rises relative to WA (and the world price).

Panel B: Spot price in NSW minus the spot price in WA



Wheat marketing, including managing price risk using hedging instruments, in the eastern states (particularly in New South Wales) is more complicated because of the impact on prices of variations in production and exports. In drought years, almost

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all of the production in New South Wales is used in the domestic market and almost no exporting of bulk wheat takes place. The domestic price rises as local users compete to secure local supplies, and incur higher transport costs if wheat is imported from other states, such as Victoria, South Australia, and possibly Western Australia. In high production years, production in excess of domestic demand is exported and the price in the domestic market reflects the lower export price.

By contrast, even in low production years, Western Australia exports most of its wheat and the local price reflects the export price. Consequently, when there is low production in New South Wales, the local price of wheat in New South Wales rises above that in Western Australia — and the world price (panel B, box 4) — by up to as much as the transport cost of getting wheat to New South Wales from other exporting states.

All of the above factors have been creating pressures for structural change for growers and others in the wheat industry. Traders and marketers, financial service providers, futures brokers, bulk handlers and growers are still adapting to the new trading environment. The marketing and risk management products on offer are still evolving. Some adjustments will require investment. It will take time for traders, port operators, transport and storage providers, and growers to adapt fully and develop innovative solutions to the new demands and opportunities from competition in the exporting of wheat.

## **Accreditation of bulk exporters**

The objective of the WEMA and the Scheme is to promote competition and choice in marketing for growers. The purpose of accrediting exporters was to give growers confidence that new exporters were ‘fit and proper’ to export wheat from Australia and would bring little business risk to growers. However, neither the WEMA nor the Scheme provide any financial guarantee or underwriting of accredited exporters.

The WEMA and Scheme were also designed to facilitate access by traders to port terminal facilities. To be accredited to export bulk wheat, port terminal operators are currently subject to the access test, consisting of continuous disclosure requirements and an Australian Competition and Consumer Commission (ACCC) approved access undertaking.

Accreditation is subject to a number of mandatory conditions including the preparation of annual export and compliance reports and a requirement to report to WEA on notifiable matters. In addition, WEA has the discretion to impose other conditions.

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## **Benefits of accreditation**

Accreditation has provided comfort to growers and international buyers in a period of rapid and substantial policy change. There had been a long history of a highly regulated market prior to deregulation, and strong resistance to change by some growers. In addition, deregulation has coincided with the down side of a pronounced commodity price cycle (a temporary increase in the export price of wheat of about 150 per cent just prior to deregulation), the global financial crisis and significant movements in the exchange rate. As accreditation was in place from 1 July 2008, it has facilitated a smooth transition as the exporting of bulk wheat was opened up to competition. However, these benefits only accrue during the transitional phase and are rapidly diminishing over time.

Accreditation has also facilitated access for traders to port terminal facilities. The condition that port terminal operators pass the access test to be allowed to export has ensured that access undertakings approved by the ACCC were in place by 1 October 2009 and that continuous disclosure rules were complied with. However, these matters can be dealt with outside of an accreditation system, as outlined below.

## **Costs of accreditation**

The cost of running WEA in 2008-09 was \$4.2 million, funded by:

- \$1.1 million from the Australian Government as part of its transitional assistance package of about \$8.3 million over three years (box 5)
- \$2.7 million from exporters through the Wheat Export Charge on all wheat exported, including wheat in containers and bags
- \$0.4 million from application fees charged to exporters seeking accreditation.

WEA considers that the recurrent costs of continuing to administer the scheme will be about \$4 million per year. The Australian Government has stated that in future these costs should be fully funded through application fees and the Wheat Export Charge.

Compliance with accreditation has not been a significant cost for most accredited exporters. The exception has been for the trading arms of port terminal operators, as well as AWB, which have had additional compliance requirements. These companies estimate compliance costs to have been between \$200 000 and \$600 000 in the initial year. There is general consensus that the ongoing costs of accreditation will be lower than in the first year.

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### **Box 5 Transitional assistance package**

The Australian Government committed about \$8.3 million over three years to assist the wheat industry with its transition to the deregulated exporting arrangements. The following projects were funded.

- The development and promotion of a grain industry code of conduct by Grain Trade Australia (\$0.069 million).
- Development and approval by the Australian Competition and Consumer Commission of the access undertakings by providers of port terminal services that sought accreditation to be exporters (\$1.5 million).
- Facilitation of information sessions for growers, by the Department of Agriculture, Fisheries and Forestry (DAFF), about the wheat marketing arrangements and how to manage their businesses in this environment (\$0.523 million).
- The provision of monthly statistics by the ABS and ABARE on wheat production, exports and stocks (ABS \$3.38 million and ABARE \$0.45 million).
- Wheat Export Technical Market Support Grants Program, administered by DAFF, to assist new and small scale exporters to develop innovative export ideas (\$0.536 million).
- Assistance to Wheat Exports Australia to ensure that it could operate effectively during the introduction of the accreditation scheme (\$1.1 million).
- Administrative and legal costs incurred by DAFF during the implementation phase to 30 June 2008 (\$0.8 million).

Assessment processes have lacked transparency. In addition, there are other potential costs of accreditation arising from market distortions and reduced economic efficiency. These include a disincentive for entry by new exporters, a loss of trading flexibility for accredited exporters, and increased incentives to export wheat in bags and containers (which are unregulated). Such costs are more difficult to measure and may not be particularly large. However, if accreditation remains in place on an ongoing basis, these costs would be expected to increase as they become more entrenched and harder to unwind, especially in light of the significant risk of regulatory creep.

### **Future for accreditation**

There is no evidence to indicate that there is a special need for the Australian Government to intervene to accredit bulk exporters of wheat beyond the transitional period, notwithstanding that some growers considered the size of the wheat export industry made it a special case. The Australian Government does not accredit exporters of other grains or most other agricultural commodities, and the export of

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those commodities operates smoothly. Ultimately, it is the responsibility of wheat growers to exercise due diligence in their business dealings with traders, just as they do for other grains or in other commercial relationships. Diversification across a number of traders can be used to help manage the risk of an individual trader defaulting on payment.

The transitional period as it relates to accreditation is approaching its end. An ongoing accreditation scheme would have virtually no benefits and would continue to impose costs. Therefore, the Commission is proposing that the Scheme be abolished on 30 September 2011. This timing would allow the Scheme to run to the end of the marketing year and provide the Australian Government with enough time to implement the necessary legislative changes.

Providers of port terminal services would still be required to pass the access test in order to export. However, the matter of access regulation to port terminal services would be addressed separately, as outlined below.

If the industry considered that it needed an accreditation framework (for example, to manage quality, international reputation and branding) then it could develop, administer and fund its own arrangements.

Should the Australian Government choose to retain an accreditation scheme, the Commission has provided some guidance on how such a scheme should be streamlined.

## **Future role and funding of Wheat Exports Australia**

The Commission is proposing that WEA be wound-up on 30 September 2011. Consequently, the Wheat Export Charge of 22 cents per tonne on all wheat exports should be abolished from that date.

## **Access arrangements for port terminal services**

The ‘access test’ was included in the WEMA because of concerns that wheat exporters with port terminal operations (three of the dominant incumbent bulk handling companies) could use their control of those terminals to advantage their own wheat export operations at the expense of potential new entrants (rivals).

The entities operating grain port terminals must satisfy the access test to be accredited to export bulk wheat. To satisfy the access test, they must:

- publish their daily shipping schedule and protocols for port access, including vessel nomination and acceptance rules, schedule of vessels, amount of wheat to be loaded and anticipated date of loading
- between 1 July 2008 and 30 September 2009, publish a statement on their website outlining terms and conditions for port access
- from 1 October 2009, have in place a voluntary access undertaking approved by the ACCC.

At the time the WEMA came into effect there were no voluntary undertakings by port terminal operators approved by the ACCC. Without the access test, regulated access would have relied on the declaration provisions in Part IIIA of the Trade Practices Act (TPA) (box 6). Declaration decisions under the general access provisions (Part IIIA) are made on a case-by-case basis for individual port facilities. However, under the WEMA access test, each port terminal operator must have a ‘voluntary’ access undertaking as a condition of accreditation (from 1 October 2009), should it wish to export bulk wheat.

#### **Box 6 Part IIIA of the Trade Practices Act**

Part IIIA of the TPA provides three ways for a third party to gain access to the service of an essential facility.

- Seeking declaration of a facility by the relevant Minister, following a recommendation by the National Competition Council (NCC). Declaration provides access seekers with a legal right to negotiate access and with a mandatory dispute resolution mechanism. In making a recommendation to declare a facility, the NCC is required to apply strict criteria. The NCC, and the relevant Minister, can only recommend that the service be declared if all of the criteria are met.
- Using an existing state access regime that the NCC has determined is effective. Once an effective regime is in place, declaration is foreclosed.
- Using a voluntary undertaking by the service provider that the ACCC has approved. Once a voluntary undertaking is approved, declaration is foreclosed.

### **Benefits of the access test**

The benefits of the access test are mostly concentrated in the transitional phase of managing deregulation. Having the access test in place from 1 July 2008 has facilitated the rapid entry of traders able to compete to export wheat by:

- reducing uncertainty for traders entering the market for the first time

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- making access easier, quicker, and less expensive than it could have been by relying on declaration or voluntary undertakings under Part IIIA.

The access test provided for a smooth transition that might otherwise have been difficult given the overnight change on 1 July 2008, from a single exporter of bulk wheat, to many exporters. The access test is also likely to reduce the length of the transitional period by facilitating commercial decisions and limiting transaction costs which may otherwise have arisen under sole reliance on the declaration pathway for access in Part IIIA.

A single marketing year is yet to be completed since undertakings came into effect on 1 October 2009. A number of traders and growers have raised concerns about the possible distortionary impact of the current access arrangements on wheat trading and wheat prices, particularly in the South Australian and Western Australian markets. However, these are likely to have been exacerbated by one-off transitional factors as market participants adjusted to the new arrangements. Other factors such as trader behaviour and changing conditions in the international wheat market, with significantly reduced demand for Australian wheat, are also likely to have had an impact.

The focus of the access test in the WEMA was on promoting competition in the exporting of Australian wheat, and this has been successfully achieved. However, during this inquiry, issues have been raised by traders and rival logistics providers about the use of terms and conditions of access to port as a possible means of dominant bulk handling companies that own ports inhibiting contestability in the upstream market for storage and transport.

In light of the short period of time that traders and bulk handling companies with port terminals have had to adjust to the new trading environment and develop port access arrangements, the Commission sees merit in continuing with the access test requirement for bulk handling companies with port terminals that wish to export bulk wheat, for a few more years.

Once a competitive environment has become institutionalised among the market participants, including port operators, traders and logistics services providers, the benefits of the access test will diminish.

### **Costs of the access test**

The Australian Government provided the ACCC with \$1.5 million over two years to cover the administrative costs of assessing the undertakings of the three bulk

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handling companies that sought accreditation. WEA will have also incurred expenditure on access test related matters.

Collectively, the three bulk handling companies that also export, have incurred compliance costs of about \$2.8 million to date in getting their undertakings approved. They anticipate costs of about \$0.5 million per annum each, in complying with the access test.

Although the administrative and compliance costs are important, the major concern in relation to the cost of access regulation in the long term is its potential impact on investment arising from changing the property rights of the owners of the facilities. In the short term, the impact on investment is unlikely to be large. However, the long-term costs of a specific access test could be considerable without the checks and balances of Part IIIA of the TPA. Long term application of the access test has the potential to:

- create incentives for wasteful strategic behaviour by both port terminal operators and traders, and potential rival transport and storage providers, seeking access
- constrain the scope for port terminal operators to deliver and price their services efficiently
- reduce incentives to invest in port terminal facilities to expand capacity for third party use, to provide new services, or to maintain existing facilities — particularly if port operators perceive that the regulated terms and conditions are favourable to port users.

In addition, third parties are also likely to have reduced incentives to invest themselves, further locking in existing supply chains if:

- they consider regulatory arrangements will ensure they can access services provided by infrastructure facilities on favourable terms (rather than investing in rival facilities)
- they consider other exporters would be able to access any new facilities on terms and conditions determined by a regulator.

Although general access regulation also has the potential to create the problems identified with the WEMA access test, the negative impact is likely to be much less because the declaration criteria require assessment of the costs and benefits of long-term regulation for each individual facility.

In addition, the application of industry specific access regulation, such as the WEMA access test, has the potential to impact on infrastructure investment in the economy more generally. Especially if ‘ad hoc’ industry specific declaration for access came to be seen as the norm by potential infrastructure providers rather than

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relying on the consistent criteria and transparent framework for declaration under Part IIIA of the TPA.

### **Future of access regulation**

The Commission recommends that the specific access test (including the continuous disclosure requirements) remain in place until 30 September 2014. From that time, the access test should be abolished and grain port terminals should be subject to the declaration provisions of Part IIIA of the TPA.

The access test has had net benefits as a temporary measure to facilitate the entry of exporters into the market. There is a case for continuation of the access test arrangements until 2014, given:

- the long history of the development of the bulk handling systems in each region prior to deregulation
- the specific circumstances of the bulk wheat export industry with respect to deregulation, and the limited time (less than one complete marketing year) to assess the impacts of the initial undertakings
- concerns of traders and rival logistics providers about the use of terms and conditions of access to port (including charges for direct delivery to port) as a possible means to inhibit contestability in the upstream market for storage and transport
- concerns of traders and growers about the possible distortionary impacts of the current access arrangements on wheat trading and relative prices across regions.

The transitional period as it relates to port terminal access is distinct from the transitional period as it relates to accreditation. The Commission considers the latter is coming to an end. In the absence of an accreditation mechanism for exporters, port operators that wish to export should continue to be required by law to pass the access test (continuous disclosure plus undertakings) until 30 September 2014. The ACCC should have sole responsibility for the implementation of the access test. The Commission considers the ACCC to be the appropriate regulator to deal with access related issues, and that shared jurisdiction with WEA in relation to competition matters is inappropriate.

The Commission considers that the interests of all parties can be effectively addressed as part of the ACCC's review of the undertakings to be completed by the end of September 2011. Parties also have further opportunity to have any concerns considered through the negotiation and arbitration processes, as provided for by the

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publish-negotiate-arbitrate framework embedded in the undertaking provisions of the TPA.

The Commission sees merit in the use of auctions to facilitate access by exporters to the services of port terminals in situations where shifting peak load congestion arises. However, it is important that the auction design and rules facilitate a competitive and efficient allocation of port services and encourage efficiency in upstream storage and transport services by ensuring the access arrangements are not used to inhibit contestability in upstream markets. The condition that a transport provider be nominated early as part of the Co-operative Bulk Handling (CBH) auction process has the potential to:

- impede contestability in the upstream storage and transport market and reduce pressure for efficiency improvements in the logistics supply chain
- inhibit the development of an effective secondary market for shipping slots (which is important in the context of a shifting peak load for use of ports in some regions).

To facilitate contestability in the upstream storage and transport market, it is important that the port capacity being auctioned is independent (unbundled) from upstream storage and transport capacity.

From 1 October 2014, port terminal operators should still be required to publish daily shipping stems and port access protocols on their websites, but it would no longer be a condition of exporting bulk wheat. In addition to these mandatory requirements, the Commission sees merit in port terminal operators developing a voluntary code of conduct to govern port access.

Moving to rely primarily on Part IIIA of the TPA from 1 October 2014 will bring the wheat industry into line with most other industries. The application of Part IIIA will allow the long-run benefits of ongoing regulation to be assessed against the costs, should a trader seek declaration.

## **Competitiveness of transport, storage and handling**

Following deregulation, growers are now observing prices that more closely reflect the costs of marketing, transporting, storing and handling export wheat. There are also pressures for efficiency improvements in the rail and road components of the transport system stemming from reform to the road and rail sectors.

The logistics supply chain for wheat export is shared with other grains, and with other export commodities on road and rail networks. Moreover, characteristics of

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the supply chain vary across three separate markets in Australia (box 7). It is in the efficiency of the supply chain that real benefits to the industry can emerge, and this relies on effective contestability, brought about by the opportunities to by-pass the transport and storage systems of the dominant, incumbent bulk handlers in each region, particularly in Western Australia and South Australia. By-pass is the ability for traders or rival bulk handlers to accumulate grain (from growers) and deliver to port for shipment without having to use the transport and storage services offered by the dominant, incumbent bulk handling company.

### **Box 7      Regional variations in wheat supply chain characteristics**

There are three distinct regions with respect to supply chain characteristics.

*East Coast (New South Wales, Victoria, Queensland and the easternmost part of South Australia)*

- Wheat is exported and consumed domestically. The bulk supply chain competes with exports in containers and bags and the storage and transport of grain for sale in the domestic market.
- The market for bulk storage and transport services is dominated by GrainCorp in New South Wales, Victoria and Queensland and Viterra in South Australia. Competition is provided by on-farm storage, a number of independent bulk handlers and some overlap of GrainCorp and Viterra storage networks.
- Bulk grain export terminals in New South Wales, Victoria and South Australia operated by GrainCorp, Melbourne Terminal Operations and Viterra are in relatively close proximity and might compete for some grain throughput.

*Western Australia*

- Almost all wheat is exported in bulk. Some competition is provided by exports in containers and bags.
- CBH is the dominant supplier of bulk storage and transport services. There is some competition from on-farm storage, but none from independent bulk handlers. CBH's Grain Express service requires utilisation of CBH services throughout the entire length of the supply chain, once grain has entered it.
- CBH operates all bulk grain export terminals.

*Eyre Peninsula (South Australia)*

- Almost all wheat on the Eyre Peninsula is exported in bulk. Some competition is provided by exports in containers and bags.
- Viterra is the dominant supplier of bulk storage services. There is some competition from on-farm storage and independent bulk handlers.
- Viterra operates all bulk grain export terminals.

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Clearer price signals and reforms in the transport sector are creating pressure for structural change in the bulk transport, storage and handling of wheat and other grains. The trends include:

- greater use of on-farm storage by growers
  - giving rise to trials of on-farm grading and blending and development of quality assurance systems to facilitate delivery of stored grain to bulk receival sites or direct to port
  - giving growers greater flexibility about where and when to deliver wheat
- greater use of large trucks to deliver grain from farms to more distant receival sites or direct to ports. The lower marginal cost of using larger trucks means growers have more choices about where to deliver grain
- consolidation and rationalisation of receival sites and the development of super-receival sites, typically located close to main rail lines
- consolidation and rationalisation of rail branch lines, particularly low volume lines linking small remote receival sites
- bulk handling receival sites being developed by rivals to the three incumbent bulk handling companies offering port terminal facilities, particularly on the east coast
- rationalisation of the use of rail rolling stock (grain wagons) and greater use of trucks by bulk handlers to move grain from bulk receival sites to ports
  - this is particularly efficient for handling the peak load associated with larger harvests in good seasons, or to temporarily increase peak load capacity to assemble large shipments of grain
- an increase in the export of premium quality wheat (and other grains) in containers.

There is scope for structural adjustment and efficiency improvement in the storage and transport of bulk wheat, centred around a reduction in bulk storage sites (table 1) and associated changes in the mix of rail and road transportation.

**Table 1 Bulk grain storage and capacity, by state**

		<i>NSW</i>	<i>Vic</i>	<i>Qld</i>	<i>SA</i>	<i>WA</i>
Average annual production (2003–08)	Mt	9.0	4.2	3.1	5.4	11.9
On-farm storage (2009)	Mt	6.4	3.5	1.9	1.2	2.6
GTA registered bulk handlers (2010-11)	no.	8	8	3	8	1
Major bulk handler		GrainCorp	GrainCorp	GrainCorp	Viterra	CBH
Market share of grain receivals (2002–06)	%	82	76	79	95	100
Up-country storage capacity (2010)	Mt	12.2	5.2	2.5	9.5	20.0
Up-country storage sites						
1998	no.	265	257	87	116	200
2006	no.	145	92	42	111	196
2015 (an industry estimate)	no.	43	25	10	39	101

In light of the competition between rail and road and the pressures for change in the transport, storage and handling of grain, the Commission has concluded that there is no case for regulated access of the bulk handlers' logistics chains.

The bulk handling companies are moving from network-based pricing to site-based pricing. It is likely that the costs of transport in the outer reaches of port catchment zones will rise relative to those closer to port because they were previously under-recovering their costs.

To facilitate the structural adjustment and efficiency improvements in transport and storage, it is important that terms and conditions of access to port grain terminals do not act as an impediment to contestability in the transport and storage of wheat.

In Western Australia, CBH lodged an exclusive dealing notification with the ACCC to implement Grain Express. Under Grain Express, grain storage and handling services are provided on the condition that growers and marketers of grain acquire grain supply coordination services from CBH while the grain remains in its custody. The ACCC did not revoke the notification because it did not consider that Grain Express would substantially lessen competition. The ACCC considered that Grain Express could also provide significant efficiency benefits arising from the central coordination of grain storage, handling and transportation.

Although it might be the case that the costs of running the existing supply chain can be minimised, the existing supply chain might be inefficient. Ensuring that there are no regulatory impediments to contestability in the transport and storage market could drive efficiency in the supply chain more quickly than otherwise. Efficiency might arise by traders and potential rival transport providers using a tangible threat of entry to negotiate better terms and conditions for transport and storage, rather than actually proceeding to develop rival supply chains.

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The key to making by-pass contestable is access to port grain terminals by road and rail other than that provided by Grain Express (CBH) in Western Australia. The terms and conditions of access to port grain terminals play an important role here. Given market developments over the past 18 months, the Commission supports the recent decision by the ACCC to review the exclusive dealing notification.

Another issue in Western Australia is the extent to which the cooperative ownership structure of the regional bulk handler is impeding structural change. The costs of inefficiency in the transport, storage and handling system are ultimately passed back to growers as higher costs and lower farm gate prices. It is therefore a matter for the grower members of the cooperative to resolve. As long as contestable by-pass is possible, growers, traders or other service providers have the potential to develop more cost-effective options, if economically feasible, or to use the threat of entry to negotiate with CBH and thereby drive efficiency improvements.

Improved contestability and structural adjustment in transport and storage also bring with them risks for traders, port operators and transport service providers in terms of managing transport logistics, particularly in an environment where there is shifting peak demand for exports. These risks could be higher in the early stages of any structural changes to the supply chains.

An issue for governments is the level of investment in rail and road infrastructure, particularly in light of the commercial pressures for structural change in transport, storage and handling. Investment decisions by governments and industry should be directed at improving efficiency throughout the supply chain and be based on rigorous cost-benefit analysis, incorporating social and economic costs and benefits. Inappropriate investment decisions can be wasteful of scarce financial resources and impede the development of an efficient supply chain, at the expense of growers (or possibly taxpayers).

## **Availability and transparency of market information**

Timely and accurate information is important for supporting efficient bulk wheat exports and domestic markets. Prior to deregulation, AWB managed and provided the majority of market information. In a post-deregulation environment it is necessary to determine what information should be provided and who should fund its provision.

Historical information (published with some lag) is useful for long-term policy development, and investment and planning decisions by all sectors of the wheat

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industry. Therefore, the current arrangements to provide core wheat market information are appropriate, including the funding for the ABS and ABARE.

Provision of more detailed, frequent, and up-to-date information could further facilitate the operation of the market. However, what information is provided, how often and by whom are more contentious.

A transitional funding package was provided by the Australian Government to produce information on stocks by state (with a three to six week lag), until 30 June 2011. Beyond this date, the Commission considers that there is merit in continuing to provide this stocks information monthly, by state. It facilitates the efficient operation of the wheat market and the price discovery process in both the domestic and export markets.

However, this information has public good characteristics (box 8) which leads to no one wanting to pay for it. As a result, there will be inadequate provision of the information without some kind of intervention. Because the information on wheat stocks by state is of benefit primarily to the wheat industry itself, the information should be funded by the industry through a compulsory payment mechanism, such as an industry levy. Funding through an organisation such as the Grains Research and Development Corporation would appear to be an efficient option, given it already has a collection mechanism in place.

The ABS is best placed to provide stocks information by state and territory. The existing stocks publications, *Stocks of Grain Held by Bulk Handling Companies and Grain Traders, Australia* and *Wheat Stocks and Use, Australia*, provide a good example of the type of stocks information the industry may choose to commission from the ABS. The cost of the ABS producing this information is estimated to be around \$1 million annually.

Many in the industry thought further detailed information on stocks (such as by grade and port zone) should also be made available. In particular, industry participants were concerned about unequal access to this information. Such asymmetries are common in supply chains, and it is not considered to lead to significant market inefficiencies. The Commission is not proposing that this information be compulsorily made available to the market. However, the Commission recognises the value of this information for the efficient operation of the domestic and export wheat markets, and encourages the bulk handling companies to voluntarily disclose greater levels of detailed stocks information.

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## ‘Industry good’ functions

The grains industry uses the term ‘industry good’ functions to describe services provided to the industry that support trade and industry development and affect the performance of the entire industry. One of the functions, research and development, is not reported on here as it is the subject of a separate Commission inquiry.

The framework used to assess the responsibility for providing (and funding) industry good functions is outlined in box 8.

### **Box 8      Framework for assessing ‘industry good’ functions**

A pure public good is non-excludable (individuals cannot be excluded from benefiting from the good) and non-rivalrous (consumption by one person does not diminish consumption by others). Public good characteristics lead to free rider problems because if an entity pays for a public good, others might be able to access the good free of charge. This can lead to market failure, resulting in the under provision of the good, and justify some kind of intervention in the market.

Some industry public goods might have ‘spillover’ effects outside of the industry. That is, the market failure extends beyond the industry itself to other industries in the economy (inter-industry public goods).

Private goods do not exhibit strong public good characteristics and should be provided by the market without any intervention.

In practice, industry good functions usually include a combination of public good and private good characteristics.

There might be benefit in the government intervening in the provision of industry good functions that exhibit strong public good characteristics. This will depend on the costs and benefits associated with such intervention. Where the benefits are confined to the industry (intra-industry public goods), the industry itself should pay for provision of the good — for example, by using a compulsory industry levy.

Evidence of significant inter-industry spillover benefits might justify a level of co-funding by government or by other industries that receive the spillover benefits.

A small number of industry goods exhibit ‘public good’ characteristics. These goods may have value to the industry, and even be important to its efficient operation, but will be underprovided if left to the industry to fund on a voluntary basis. That is, market failure in the provision of such goods can occur due to free rider problems. It is important to determine the scope of benefits of such industry goods — whether they are confined to the wheat industry (intra-industry public goods), or potentially apply to the wider economy (inter-industry public goods) — as this will inform how they are most appropriately delivered and funded (table 2).

In principle, the cost of providing an industry good function should be borne by those who benefit from it.

**Table 2 Industry good functions — scope of benefits**

<i>Industry good function</i>	<i>Mostly benefits the wheat industry</i>		<i>Some inter-industry public good characteristics</i>
	<i>Predominantly commercial/private in nature</i>	<i>Predominantly intra-industry public good characteristics</i>	
Crop shaping activities	●		
Industry strategic planning	●		
Information			
Core long-term		●	●
Stocks monthly by state and national		●	
Stocks by port zone, receival site	●		
Receival standards	●		
Regulatory advocacy	●		
Technical market support	●		
Trade policy advocacy		●	●
Wheat branding	●		
Wheat classification	●		
Wheat promotion	●		

Most of the industry good functions in table 2 have predominantly ‘private good’ characteristics, even though there may be some spillovers and free rider problems associated with their provision. The costs of any market failure are relatively small because the goods are predominantly commercial in nature. Such goods can be provided by the industry to the extent they have value for the industry (though the industry may wish to act collectively to provide such goods efficiently). An industry-led body could handle the provision of these industry good functions, such as quality and brand reputation in export markets, through industry self-accreditation mechanisms and the use of logos by accredited members.

If the industry sees merit in the coordinated provision of a range of industry goods, it may wish to consider establishing an industry-led body. Several participants to this inquiry have proposed such a body, and there is evidence the industry is already working toward this.

Where an industry good has predominantly intra-industry public good characteristics, such as the provision of monthly stocks information (table 2), there may be a case for implementing a compulsory levy, supported by legislation. Such a mechanism can be used to ensure that the industry good is provided and paid for by industry participants.

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Where an industry good has inter-industry public good characteristics, such as core long-term information and trade policy advocacy, there may be a case for government provision and funding. Trade policy advocacy should be provided by government, with industry input. Not only is government the only player that can feasibly perform this role, its actions in the international arena impact on the economy more generally and exhibit inter-industry public good characteristics.



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# Recommendations and findings

## Chapter 3 — Marketing and pricing

FINDING 3.1

*The key drivers of the export price of wheat (and the recent commodity price cycle) are:*

- *the global demand for, and supply and stocks of, wheat*
- *the exchange rate*
- *relative transport costs from Australia (and other exporting countries) to export markets.*

FINDING 3.2

*The transitional period of the current wheat export marketing arrangements has coincided with:*

- *a pronounced commodity price cycle associated with a short-term increase in the price of wheat of at least 150 per cent just prior to deregulation*
- *the global financial crisis*
- *large movements in the exchange rate.*

FINDING 3.3

*The local wheat price in New South Wales rises above the export price in periods of low production. When local demand absorbs almost all local production, almost no wheat is exported and wheat is imported into New South Wales from other states.*

FINDING 3.4

*Improving pool transparency is best undertaken by the industry and can be achieved through a more detailed code of conduct. The Commission has not identified any further role for government in this process.*

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## Chapter 4 — Accreditation of exporters

### FINDING 4.1

*The Australian Government followed good regulatory processes in establishing the Wheat Export Marketing Act 2008, which helped smooth the transition of the bulk wheat export industry away from the single desk.*

### FINDING 4.2

*The Wheat Export Accreditation Scheme 2008 has been effective and appropriate as a transitional measure, providing net benefits to the bulk wheat export industry in the short term.*

### FINDING 4.3

*There is likely to be a net cost to keeping accreditation beyond a transitional period. The transitional period as it relates to accreditation is approaching its end.*

### RECOMMENDATION 4.1

***The Wheat Export Accreditation Scheme 2008 should be abolished on 30 September 2011. This timing would coincide with the end of the 2010-11 marketing year and give the Australian Government sufficient time to put the required legislative changes in place.***

### RECOMMENDATION 4.2

***Regulation 9AAA of the Customs (Prohibited Exports) Regulations 1958, which prohibits bulk exports of wheat unless exported by an accredited wheat exporter, should be repealed effective 30 September 2011.***

### RECOMMENDATION 4.3

***Wheat Exports Australia should be abolished on 30 September 2011.***

### RECOMMENDATION 4.4

***The Wheat Export Charge should be abolished on 30 September 2011.***

### RECOMMENDATION 4.5

***If the Australian Government decided not to abolish accreditation, a system similar to that administered by ESCOSA for bulk exports of barley in South Australia would be the next best alternative.***

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- *A less attractive alternative would be to amend the Wheat Export Accreditation Scheme 2008. As outlined in this report, this would include streamlining the level of assessment employed by Wheat Exports Australia and more clearly defining its role to ensure that its powers do not extend into matters of competition policy.*

*If the Australian Government decided not to abolish accreditation, the application fees and the Wheat Export Charge would need to be reviewed. A Cost Recovery Impact Statement should be formulated, in line with the Australian Government Cost Recovery Guidelines. The Wheat Export Charge should no longer be levied on exports of wheat in bags and containers, as they are not covered by the accreditation scheme.*

*Any new or amended arrangements put in place by the Australian Government should be reviewed after no more than five years.*

## **Chapter 5 — Access to port terminal facilities**

FINDING 5.1

*Access to ports is the most critical issue in ensuring the success of deregulation.*

FINDING 5.2

*The access test has been effective and appropriate as a transitional measure, providing significant short-term benefits. Any offsetting short-term costs are likely to have been relatively small.*

FINDING 5.3

*If maintained in the long run, the costs of the access test would significantly exceed its benefits. However, given the industry is still in a transitional phase relating to port access, there are likely to be net benefits of maintaining the test until 30 September 2014.*

FINDING 5.4

*Overlapping regulatory responsibility for access matters increases the potential for regulatory uncertainty and inconsistency, as well as higher compliance and administration costs. The ACCC is the most appropriate body to deal with access related matters.*

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RECOMMENDATION 5.1

*The Australian Government should proceed with the scheduled independent review of the National Access Regime. This review should commence no later than 31 December 2011.*

RECOMMENDATION 5.2

*The requirement for grain port terminal operators to pass the access test contained in the Wheat Export Marketing Act 2008 (continuous disclosure requirements and an ACCC accepted port access undertaking) as a condition for exporting bulk wheat should remain in place until 30 September 2014. Responsibility for determining if the access test is met (including the continuous disclosure requirements component) should rest solely with the ACCC beyond 30 September 2011, whether or not accreditation continues past that date.*

*Ideally, grain port terminal operators not subject to the access test between 30 September 2011 and 30 September 2014 would voluntarily publish their shipping stem and port access protocols.*

*The requirement for port terminal operators to pass the access test as a condition for exporting bulk wheat should be abolished on 30 September 2014.*

*The requirement for continuous disclosure should continue after 30 September 2014, although this should no longer be a condition for exporting bulk wheat. From this date, the continuous disclosure rules should be applied to all grain port terminals, regardless of ownership. Responsibility for monitoring compliance with continuous disclosure rules should remain with the ACCC after 30 September 2014.*

*From 1 October 2014, access disputes (other than those relating to the continuous disclosure requirements) should be dealt with by the National Access Regime under Part IIIA of the Trade Practices Act.*

*Ideally, port terminal operators would supplement these arrangements with a voluntary code of conduct from 1 October 2014.*

*Should the access test continue beyond 30 September 2014, it should be reviewed after no more than five years.*

FINDING 5.5

*Price monitoring of port terminals is not an appropriate mechanism to deal with matters relating to port access.*

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FINDING 5.6

*Section 46 of the Trade Practices Act is unlikely to deal adequately with matters relating to port access.*

## **Chapter 6 — Transport, storage and handling**

FINDING 6.1

*Greater competition can improve the efficiency of the grain supply chain. These efficiency improvements lower the costs of the supply chain, providing benefits to the industry, and particularly to growers.*

FINDING 6.2

*Up-country storage facilities do not exhibit natural monopoly characteristics. There is no case for specific third party access regulation. Specific access regulation is likely to hinder the development of efficient supply chains.*

FINDING 6.3

*Competition in the grain supply chain requires that participants have the ability to by-pass the bulk handling system.*

RECOMMENDATION 6.1

***The ACCC has announced that it will review the exclusive dealing notification granted to CBH, regarding the use of Grain Express. In light of market developments and concerns over the contestability of CBH's supply chain, the Commission endorses the decision by the ACCC to review Grain Express. The Commission recommends that the ACCC makes its determination as soon as practicable.***

RECOMMENDATION 6.2

***When considering investment in road and rail infrastructure for the transportation of grain, decisions should be based on thorough cost-benefit analysis, including both economic and social costs and benefits. Where possible, the analysis should consider the benefits that can be obtained throughout other parts of the grain supply chain.***

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FINDING 6.4

*Investment in transport infrastructure should be funded by those who benefit from the investment, which in many cases is likely to be both the community and industry. Where governments make investment in rail infrastructure based on perceived social benefits, payments should be made in the form of clearly specified community service obligations.*

## **Chapter 7 — Information provision**

FINDING 7.1

*The ABS and ABARE should continue to provide core, long-term wheat market information, in line with what is currently provided by these agencies for other Australian grains and agricultural commodities. Government funding for this purpose is appropriate.*

FINDING 7.2

*The cessation of government funding provided to the ABS and ABARE for additional wheat data collections and publications on 30 June 2011 is appropriate.*

RECOMMENDATION 7.1

***The Commission sees value in the provision of stocks information by state to support the effective operation of the domestic and export wheat markets. However, if the industry wants this information, it should pay for it. The most efficient approach to funding this information would be via an existing compulsory industry levy. Specifically, the GRDC levy collection framework appears to be the most practical and cost-effective option for funding stocks information by state.***

FINDING 7.3

*The ABS is well placed to continue providing stocks information by state.*

## **Chapter 8 — Wheat quality standards and market segmentation**

FINDING 8.1

*The design, delivery and funding of a wheat classification function is most appropriately undertaken by the industry. The Commission has not identified a role for government.*

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FINDING 8.2

*The benefits of varietal classification can potentially be captured by individual plant breeders. Assessment and classification of candidate varieties by the Wheat Variety Classification Panel could be undertaken on a fee for service basis, with fees paid by plant breeders for the lines they submit. This matter is being considered as part of the Wheat Classification Council's review of operations.*

RECOMMENDATION 8.1

***Reforms and initiatives to improve the collection and enforcement of End Point Royalties, such as those recommended by the Advisory Council on Intellectual Property's Review of Enforcement of Plant Breeders Rights, should be implemented expeditiously.***

## **Chapter 9 — Other industry good functions**

FINDING 9.1

*It is appropriate for the Australian Government to be involved in trade policy advocacy activities, with support from industry. Arrangements for the provision of activities ('industry good' functions that are predominantly private in nature) such as technical market support, crop shaping, regulatory and policy advocacy, industry strategic planning, wheat promotion and wheat branding, are matters for the industry to determine.*

*Research and development is the subject of an ongoing Productivity Commission inquiry.*

FINDING 9.2

*The Australian Government currently collects compulsory levy payments from producers in the wine, meat and livestock, dairy and wool industries. Some of this levy revenue is used for market promotion and development activities, as well as information collection and dissemination.*



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# 1 Introduction

The current wheat export marketing arrangements commenced on 1 July 2008, requiring that exporters of wheat in bulk be accredited. Wheat Exports Australia (WEA), a new regulator, was established under the *Wheat Export Marketing Act 2008* (Cwlth) (WEMA). WEA administers the *Wheat Export Accreditation Scheme 2008* (Cwlth) (Scheme), which also came into effect on 1 July 2008.

In effect, the current arrangements deregulated bulk wheat export marketing, removing the requirement that individual proposals to export bulk wheat be approved by:

- the Minister for Agriculture, Fisheries and Forestry, from December 2006 until 30 June 2008 (an interim arrangement)
- the operator of the wheat single desk prior to December 2006
  - AWB (International) Limited (AWBI) and its predecessor, the Australian Wheat Board.

The export of non-bulk wheat (in bags and containers) was deregulated in August 2007.

The industry is currently in transition. The new arrangements have been in place for two years, and only one full marketing year has been completed. The move to a deregulated export market environment has had implications for participants in all sectors of the wheat export industry — including growers, plant breeders, bulk handling companies, rail and road transport service providers, port operators, and wheat marketers and buyers. It has also had flow on effects to the domestic wheat industry. The wheat marketing arrangements have introduced marketing that is more sophisticated, making the business environment more complex. Some industry participants have faced challenges adapting to this complexity. The challenges have been exacerbated by the recent decrease in the world price of wheat and the appreciation of the Australian dollar.

At the time the new legislation was enacted, provisions were made for the Productivity Commission to conduct a review of the arrangements, commencing no later than 1 January 2010, and reporting to the Australian Government by 1 July 2010. This inquiry is that review.

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## 1.1 What was the Commission asked to do?

The Australian Government asked the Commission to examine the operation and effectiveness of the current wheat export marketing arrangements.

Under the terms of reference, the Commission was asked to consider how individual components of the WEMA and the Scheme affect relevant stakeholders, and the costs and benefits they deliver. The Commission is also required to provide comment on those aspects that are working effectively and identify those that require change.

The inquiry covers the operation of the WEMA and of the Scheme, including:

- the effectiveness of the arrangements in meeting the objectives of the WEMA, including the role of WEA
- the suitability of the eligibility criteria for accreditation of exporters
- the appropriate level of assessment of each applicant for accreditation by WEA against these eligibility criteria
- the appropriateness of the access test requirements for accreditation of port terminal operators as exporters
- the effectiveness of, and level of competition in, the transport and storage supply chain for wheat
- the availability and transparency of market information.

In considering any changes to the operation of the WEMA or the Scheme, the Commission was also asked to examine how such changes would affect arrangements to fund WEA, and the use of cost-recovery mechanisms.

## 1.2 The Commission's approach

In responding to the terms of reference, the Commission has considered the effectiveness of arrangements for the bulk wheat export industry's transition to a competitive marketing environment.

The existence of three distinct regional wheat markets, each with the legacy of a single dominant bulk handler–exporter has resulted in port access, and related supply chain issues, being the major areas of concern in this inquiry. The Commission has taken account of the fact that the supply chain is shared with other grains, but has been constrained by the terms of reference to consider it in the context of wheat.

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In assessing the effectiveness of the transitional arrangements, the Commission has been mindful of the long history of regulation, and the costs and difficulties faced by all parties during the transitional period.

In response to the Commission’s draft report, the Victorian Farmers Federation expressed concern that the Commission had ‘focused on broader regulatory issues of service providers within the industry’, and not given sufficient attention to the impact of regulatory reduction ‘on growers as members of “regional communities”, “consumers” of the industry services in question, and members of the “Australian Community” in general’ (sub. DR65, p. 1).

The NSW Farmers Association expressed similar concern:

The effective contraction of the growing of grains as a direct result of deregulation will have a dramatic effect on farmers, regional communities and infrastructure. (sub. DR91, p. 17)

The Association further noted that decisions relating to wheat export marketing should have the support of the majority of growers, and advocated that a democratic survey of all registered wheat growers in Australia be undertaken as part of the inquiry to assess their experience of deregulation (sub. 49; sub. DR91).

The Productivity Commission’s terms of reference required it to consider improvements to the new structure of the industry, and the Commission’s charter further requires it to consider the issues from the perspective of maximising benefit to the community as a whole, not to one single sector of the community. The benefits and costs associated with a change to regulatory arrangements will vary across sectors of an industry and the community generally. For some groups the benefits are direct and identifiable. However, for other groups the impacts may be quite diffuse and less tangible. The Commission’s recommendations are based on its assessment of the issues put before it as part of the inquiry process, rather than the level of support for a particular position.

There are difficult tradeoffs to be made in deciding the best path forward. In making its recommendations, the Commission has had concern for immediate impacts, but has also recognised the need to focus on how the industry can best position itself for the future in a highly competitive world market.

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## Some issues relating to the timing and scope of the inquiry

Some stakeholders considered that the timing of the inquiry was premature because the arrangements are being assessed after only one full cycle of marketing, as noted by M I & H I Gooding:

Firstly it is a bit too early to be making any definitive statements as to how the new wheat marketing regime is going. It needs at least five years before a true picture emerges. (sub. 31, p. 1)

The Department of Agriculture and Food (Western Australia) also stated that ‘it will clearly take a number of years before the industry adjusts to this new environment’ (sub. 34, p. 9).

In addition, a number of stakeholders expressed disappointment that the scope of the inquiry did not include consideration of the single desk arrangements:

- In my opinion I find it difficult to comprehend how the Commission can fully meet their stated aim of independence by discarding the ‘Single Desk’ option even if it is used as a base case. It is hoped that the methodology to support the Commission’s findings will clearly identify and quantify as to whom, how and what benefits and losses are being incurred in the current system. (Sunridge, sub. 20, p. 1)
- We are very disappointed the terms of reference for this inquiry do not include an examination of what might have been had any attempt been made by government to seriously look at the best possible marketing system for our export wheat. The current act is not a marketing system — it is merely deregulation with a legislative program to support it. (R H & M J Billing, sub. 30, p. 1)
- It is my belief that it is unfortunate this inquiry will not compare the current arrangements against the former arrangements, when the objectives of the *Act* are to ‘promote the development of a bulk wheat industry that is efficient, competitive and responsive to the needs of wheat growers’. (Kay Hull MP, sub. 36, p. 1)

The timing and scope of the inquiry were defined by both the review provisions contained in the WEMA, and the terms of reference.

Moreover, advice from the Department of Foreign Affairs and Trade (DFAT) (sub. 22) indicated that a return to the previous arrangements does not appear to be a viable option, at least in the context of the current trade environment. DFAT advised that under proposed World Trade Organisation rules to come out of the Doha Round of trade negotiations, changes to the single desk marketing arrangements would have likely been required had the WEMA not been introduced. It further advised that under the provisions of the Australia–United States Free Trade Agreement, the single desk arrangements could not be reintroduced with respect to the United States.

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DFAT also noted that Australia's removal of the single desk marketing arrangements had enabled it to 'strengthen its advocacy in favour of agricultural trade reform, in both the WTO [World Trade Organisation] and FTA [Free Trade Agreement] negotiations' (sub. 22, p. 2).

The Commission's approach, therefore, has been to work within the given policy settings to consider possible improvements to the arrangements that have been put in place.

### **1.3 Conduct of the inquiry**

The terms of reference for this inquiry were received from the Assistant Treasurer on 30 September 2009. Under the terms of reference, and according to provisions in s. 89 of the WEMA, the Commission was required to report by 1 July 2010.

In addition, the Productivity Commission is required under its own Act, and by the terms of reference, to provide an opportunity for participants to respond to a draft report. This meant that the initial hearings, forums and due dates for submissions coincided with peak harvesting times in the major wheat growing states. Hearings on the draft report also coincided with the crop sowing period.

Concerns about the inquiry schedule were expressed by growers and industry representative bodies:

- At the outset it is important to note that WA Farmers is extremely disappointed with the timing of the submission as well as the dates provided for the Public Hearings and Forums in Western Australia which are set for the busiest and most important time for grain growers, being in peak harvest times. This has meant that many grain growers have not been able to play as active a part in the debate as they would have liked. (The Western Australian Farmers Federation, sub. 29, p. 5)
- It must be recorded the dates of public hearings and public forums on the Wheat Export Marketing Arrangements organised by the Productivity Commission shows a complete disregard or/and knowledge for the industry in Western Australia with the dates scheduled to be during peak harvest time. (Pike Family Trust, sub. 18, p. 1)
- We have considerable concerns about the timing of the public hearings and roundtables being in the middle of harvest this year and then further consultation following the draft report in the middle of sowing next year. Whilst the VFF understands the timelines the Productivity Commission is working towards, the timing will raise questions amongst growers as to the willingness of the Productivity Commission to truly consult with farmers. (Victorian Farmers Federation, sub. 40, p. 1)

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Similar sentiments were expressed in a number of other submissions (for example, R & L Guest, sub. 6; M B Scott, sub. 10; R H & M J Billing, sub. 30; Grain Growers Association, sub. 41).

In response to these concerns, the Commission made efforts to facilitate the involvement of growers, given their constraints, throughout the consultation process. The Commission consulted and invited feedback in the following ways.

The Commissioners and team undertook informal industry visits prior to the receipt of the terms of reference in order to be able to release an issues paper as soon as possible after the inquiry was announced.

The issues paper and a circular announcing public hearings and public forums were sent to all Senators in the five wheat growing states and to House of Representative members whose electorates include wheat growing areas.

The inquiry was advertised nationally, including in regional areas (table 1.1), and the Commission promoted the inquiry on its website.

**Table 1.1 Print advertising for the new inquiry, and all public hearings and forums**

<i>State</i>	<i>Publication</i>
New South Wales	The Sydney Morning Herald The Land
Victoria	The Age Weekly Times
Queensland	The Courier-Mail Queensland Country Life
South Australia	Adelaide Advertiser Stock Journal
Western Australia	The West Australian Farm Weekly

A media alert was issued, and advertisements also placed in each of the relevant metropolitan and regional papers regarding the hearings and forums (table 1.1). The Commissioners also undertook radio interviews on the ABC to draw growers' attention to the public forums in regional areas. The hearings and forums were held in a major wheat growing area in each wheat growing state, in addition to metropolitan areas (table 1.2).

The purpose of the due dates for submissions is to encourage participants to get their submissions in prior to public hearings. However, the usual practice of the Commission is to accept submissions for the duration of the inquiry, with the caveat

that the later they are received, the less scope the Commission has to consider them in preparing the draft or final report respectively.

**Table 1.2 Schedule of public hearings and forums**

<i>Location</i>	<i>Date</i>
<b>Initial round</b>	
Horsham forum	Monday, 23 November 2009
Melbourne hearing	Tuesday, 24 November 2009
Geraldton forum	Tuesday, 1 December 2009
Cunderdin forum	Wednesday, 2 December 2009
Perth hearing	Thursday, 3 December and Friday, 4 December 2009
Brisbane hearing	Monday, 7 December 2009
Dalby forum	Tuesday, 8 December 2009
Dubbo forum	Wednesday, 9 December 2009
Sydney hearing	Friday, 11 December 2009
Adelaide hearing	Monday, 14 December 2009
Port Lincoln forum	Tuesday, 15 December 2009
<b>Draft Report</b>	
Melbourne hearing	Wednesday, 28 April 2010
Perth hearing	Monday, 3 May 2010
Sydney hearing	Tuesday, 11 May 2010
Adelaide hearing	Monday, 17 May 2010

The Commission advised growers at the hearings and forums, and in correspondence to peak bodies, that their submissions would continue to be accepted and taken into consideration after the due date.

In conducting its inquiry, the Commission consulted widely, including through discussions with interested parties such as WEA, growers, grains industry representatives, accredited exporters, bag and container exporters, potential bulk exporters, bulk handling companies, the Australian Competition and Consumer Commission and relevant government departments (appendix A).

Fifty-six submissions were received prior to releasing the draft report. An additional 44 submissions were received between the draft and final reports.

The Commission thanks all inquiry participants for meeting with Commissioners and staff, facilitating visits to many industry sites and making submissions to the inquiry.

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## 1.4 Guide to the report

Chapter 2 of this report provides an overview of the industry, putting the current wheat export marketing arrangements in context. Chapter 3 examines marketing and pricing in the post-deregulation environment. Chapter 4 assesses the export accreditation scheme. Chapter 5 addresses issues relating to the ‘access test’ for the use of port terminal facilities. Chapter 6 examines the competitiveness and effectiveness of transport, storage and handling. The availability and transparency of information provision are discussed in chapter 7. In chapter 8, issues relating to the quality standards system, including plant breeding and the collection of End Point Royalties, are discussed. The remaining industry good functions are covered in chapter 9.

Appendix A lists the participants that made submissions to the inquiry and the consultations conducted by the Commission, including public hearings and forums. Appendix B provides a brief description of the methods used by growers to market and price their wheat. Appendix C provides an overview of the experiences in other Australian and international grains and agricultural industries in relation to the administration of export accreditation schemes, and arrangements for the provision of industry good functions.

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## 2 The Australian bulk wheat export industry

### Key points

- Wheat is the most significant grain crop grown in Australia in terms of area sown, volume of grain produced and value of the crop. The majority of wheat produced is destined for export in bulk.
  - Australia competes with other larger suppliers in a competitive global market.
  - The industry's competitiveness relies on an efficient bulk grain supply chain.
- Production of wheat in Australia is highly concentrated. In 2005-06, 50 per cent of wheat growers accounted for less than 10 per cent of production, and 10 per cent of growers accounted for almost half of the industry's production.
- Western Australia is the largest producer of wheat (40 per cent) and exports 90 per cent of its crop.
  - Other states export between 35 per cent and 70 per cent of their production on average and in poor production years, some states export very little wheat.
- The bulk wheat export market was regulated continuously for over 60 years prior to deregulation. The industry has transitioned to the new arrangements remarkably smoothly.
  - Twenty-eight organisations are now accredited to export wheat in bulk from Australia and have gained considerable market share from the former single desk operator.
  - There is a high level of confidence in payment security and no accredited exporter has experienced bankruptcy, or had its accreditation revoked.
  - A relatively large volume of wheat was successfully exported in the first marketing year following deregulation and this looks set to continue in 2009-10.
  - Growers are now observing prices that are closer to the actual costs of transporting, storing and handling, and marketing their grain.
- However, some transitional issues are still being worked through.
  - Port access and supply chain efficiency has been a topic of contention.
  - There have been challenges in adjusting to the new industry arrangements, particularly for some growers that saw benefits under the single desk.
  - The industry's challenges have been compounded by a decline in the world wheat price, the onset of the global financial crisis, and a rising exchange rate.

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Fundamental to assessing the operation of Australia's wheat export marketing arrangements is an understanding of the context in which the marketing arrangements apply, how these arrangements have changed and the developments that have occurred since the introduction of those changes.

In section 2.1, a brief introduction to the current marketing arrangements and their evolution is provided. This is followed by an overview of the bulk wheat export industry in section 2.2 and a high level assessment of the industry's performance since deregulation in section 2.3.

## 2.1 Evolution of the marketing arrangements

The current wheat export marketing arrangements commenced on 1 July 2008 and require that exporters of wheat in bulk from Australia be accredited by an Australian Government agency, Wheat Exports Australia (WEA). Accreditation of bulk wheat exporters by WEA is intended to promote competition and choice in marketing for growers while providing them with some level of assurance that a bulk wheat exporter will not default on its liabilities (Burke 2008a).

The introduction of the new arrangements deregulated bulk wheat export marketing, removing the requirement that individual proposals to export bulk wheat be approved by:

- the Minister for Agriculture, Fisheries and Forestry, from December 2006 until 30 June 2008 (an interim arrangement)
- the operator of the wheat single desk prior to December 2006
  - AWB (International) Limited (AWBI) and its predecessor, the Australian Wheat Board (box 2.1).

The non-bulk export of wheat (in bags and containers) was deregulated in August 2007.

This section discusses the new wheat export marketing arrangements and traces the history of wheat marketing regulation in Australia.

### The current arrangements

The *Wheat Export Marketing Act 2008* (Cwlth) (WEMA) is the principal legislation governing the bulk export of wheat from Australia from 1 July 2008. The WEMA established WEA to formulate and administer the *Wheat Exports Accreditation Scheme 2008* (the Scheme) and requires that an exporter of wheat in bulk from

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Australia be accredited under the Scheme. In addition to the WEMA, the *Customs Act 1901* (Cwlth) prohibits exports of wheat in bulk except by an accredited exporter.

### **Box 2.1 The wheat single desk**

'Single desk' is a term used to describe the monopoly marketing of wheat by the Australian Wheat Board (1939–1999), and its privatised successor, AWB (International) Limited (1999–2008).

A key characteristic of the single desk was the national pooling of returns to growers, whereby the price received by growers (apart from adjustments for quality and transport costs), was the average from sales minus the costs incurred by the Board.

The scope of the single desk varied over time, encompassing both domestic and export sales of wheat until 1989, then only export sales, and finally from 27 August 2007 to 30 June 2008, only bulk wheat export sales. Momentum for change to the export marketing arrangements built up over time, following:

- the *National Competition Policy Review of the Wheat Marketing Act 1989* in 2000, which found there was no clear, credible, and unambiguous evidence that the current arrangements for the marketing of export wheat were of net benefit to the Australian community
- the successful deregulation of the export of other grains
- increasing grower dissatisfaction about the performance of the single desk, notably in Western Australia
- the *Inquiry into Certain Australian Companies in Relation to the UN Oil-For-Food Programme* (2006).

In order to be accredited, a prospective bulk wheat exporter must satisfy WEA that it is fit and proper against a broad range of probity and performance criteria. Although intended to provide payment security for growers, neither the WEMA nor the Scheme provide any financial guarantee or underwriting of accredited exporters.

WEA was formed through the reconstitution of the former regulator, the Export Wheat Commission, and commenced operation as a statutory agency on 1 July 2008. WEA consists of a chairperson and five members appointed by the Minister for Agriculture, Fisheries and Forestry; and is assisted by a secretariat of approximately 15 staff (WEA 2010e).

Funding for WEA is primarily sourced through the Wheat Export Charge levied under the *Primary Industries (Customs) Charges Act 1999* (Cwlth) and collected by the Levies Revenue Service within the Department of Agriculture, Fisheries and Forestry. The Wheat Export Charge is currently levied on the export of all wheat

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from Australia (including exports in bags, containers and bulk) at a rate of \$0.22 per tonne. Under the WEMA, WEA is also able to charge application fees on a cost-recovery basis and currently imposes fees for accreditation applications, renewals and variations, and to reconsider a decision. The accreditation of bulk wheat exporters is discussed in chapter 4.

## **A brief history of wheat marketing**

Prior to deregulation, the bulk export of wheat was regulated continuously under a single desk marketing system of some form for over 60 years.

### *The Australian Wheat Board*

The origins of the former wheat single desk lay in the compulsory wheat pooling schemes introduced by the Commonwealth Government as war time measures during the first and second world wars.

Peacetime single desk legislation designed to shelter growers from volatile wheat prices was introduced by the *Wheat Industry Stabilisation Act 1948* (Cwlth). This Act, together with complementary state legislation, established a wheat stabilisation scheme comprising:

- the Australian Wheat Board with the power to acquire all wheat produced in Australia, and to market that wheat in Australia and overseas
- guaranteed prices, underwritten by the Commonwealth Government and a grower financed stabilisation fund
- a single authorised receiver of wheat in each state of Australia (almost exclusively state-based bulk handling companies).

The single desk legislation had an initial lifespan of five years but a series of subsequent Acts extended the life of the Australian Wheat Board until 1999, when it was privatised. In the intervening years, a number of major milestones saw the scope of the single desk narrow and wheat marketing in Australia become more liberalised:

- 1979: The Board was empowered to issue permits for growers to deliver wheat directly to a domestic customer rather than into the bulk handling system, in recognition that this was cheaper for growers in some cases.
- 1984: The Board was empowered to issue permits allowing the purchase of wheat for use as stock feed directly from growers.

- 
- 1988: The Board was permitted to use handling and storage facilities of its choice.
  - 1989: The *Wheat Marketing Act 1989* (Cwlth) removed the Board's compulsory acquisition powers for wheat and deregulated the domestic market, replaced the regime of guaranteed prices with a government guarantee on the Boards' borrowings and permitted the Board to trade in grains other than wheat.

Following deregulation of the domestic market, the Australian Wheat Board continued to operate the single desk for export wheat.

### *Privatisation*

In 1999 the Australian Wheat Board was privatised. Its subsidiary, AWB, received the majority of the assets and liabilities of the Board and became a grower owned and controlled company. The legal entity of the Australian Wheat Board was renamed the Wheat Export Authority and assumed the role of regulating the export of wheat from Australia.

At the same time, the single desk export privilege for bulk wheat was transferred to an AWB subsidiary, AWBI which was granted the power to veto bulk wheat exports by other exporters. However, non-AWBI exporters were permitted to export non-bulk wheat subject to approval by the Wheat Export Authority (box 2.2).

With the transition to a grower owned and controlled bulk export single desk, the Commonwealth's underwriting of the liabilities of the single desk ceased. AWB was publicly listed on the stock exchange in August 2001.

In 2003, the Wheat Export Authority exhausted the funds it retained after the privatisation of the Australian Wheat Board and the Wheat Export Charge of \$0.22 per tonne was introduced to fund its operations.

In 2006 the *Inquiry into certain Australian companies in relation to the UN Oil-For-Food Programme* found that AWB and AWBI might have breached Australian law in relation to its dealings with Iraq. Amendments to the arrangements that took effect in December 2006 transferred AWBI's power to veto bulk wheat exports by non-AWBI exporters to the Minister for Agriculture, Fisheries and Forestry (box 2.3).

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## Box 2.2 Non-bulk exports by consent

From 1999 to 2007, the export of wheat in bags and containers by non-AWBI exporters required the approval of the Wheat Export Authority. During this time, the Wheat Export Authority's guidelines for non-AWBI export consents (and the *Wheat Marketing Act 1989*) were revised periodically, however the principal requirement remained the same — that exports by non-AWBI exporters complement rather than compete with AWBI's single desk marketing strategy.

Each year the Wheat Export Authority typically received export applications from non-AWBI exporters totalling 2–3 million tonnes and approved 30–60 per cent of these or about 4–8 per cent of total wheat exports. However, actual exports by non-AWBI exporters made up only about 1–5 per cent of total wheat exports<sup>1</sup>. In the final two years of non-bulk export regulation, the total tonnages sought by non-AWBI exporters increased to 7 million and 17 million tonnes (including bulk and non-bulk export proposals), however total consents for exports by non-AWBI exporters and actual amounts exported in terms of tonnage did not rise significantly.

Sources: WEA (2009e; 2010b).

Further amendments to the Wheat Marketing Act in 2007 prepared for the removal of AWB's involvement in the bulk single desk from 1 March 2008 by permitting the Minister to appoint another entity as the operator of the single desk. In the Second Reading Speech to the Wheat Marketing Amendment Bill 2007 (Cwlth), the Minister for Justice and Customs stated that the new operator of the single desk was to be 'either a completely new, grower owned and operated body, or a completely de-merged AWB (International) Ltd' (Johnston 2007, p. 115).

In addition, the export of wheat in bags and containers was deregulated from 27 August 2007. As a condition, exporters were required to comply with a *Non-bulk Wheat Quality Assurance Scheme* designed to protect the reputation of the industry by ensuring exports in bags and containers met contract specifications. At the same time, the governance arrangements of the Wheat Export Authority were reformed and it was renamed as the Export Wheat Commission.

Prior to the scheduled termination of AWB's involvement in the single desk, a new Australian Government that was elected in December 2007 repealed the Wheat Marketing Act and replaced it with the WEMA effective from 1 July 2008.

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<sup>1</sup> Actual non-bulk exports by non-AWBI exporters were only a fraction of approved tonnages. The Wheat Export Authority (2007a) stated that this was due to either business not eventuating, exports that were not shipped, or multiple exporters seeking export consents to the same buyer.

---

### **Box 2.3 Bulk exports by consent**

Between 9 December 2006 and deregulation on 1 July 2008, the export of wheat in bulk by non-AWBI exporters required the approval of the Minister for Agriculture, Fisheries and Forestry. During this time a total of 130 applications were made by non-AWBI exporters to export wheat in bulk from Australia. The Minister<sup>2</sup> directed the regulator to issue nine non-AWBI bulk wheat export consents totalling 1.8 million tonnes (1.4 million tonnes were actually exported), 120 applications were rejected and 1 lapsed. Prior to the transfer of the veto to the Minister, AWBI had approved bulk exports by non-AWBI exporters on only two occasions since 1999, one of which was to Iraq in May 2006 after Iraq refused to deal with AWBI.

*Sources:* Wheat Export Authority (2006); EWC (2008a); WEA (2009e).

## **Marketing of grains other than wheat, consolidation in the grains industry and deregulation**

In the past, statutory marketing boards have maintained single desk marketing arrangements in the domestic and/or export markets for barley, sorghum, maize, oats, oilseeds, lupins and rice (Royal Commission into Grain Storage, Handling and Transport 1988).

Prior to the 1990s, the grain industry was highly regulated with grain handling, marketing and transport governed by legislation. The specific regulations and grains covered varied between states, however, the principal arrangements involved:

- statutory marketing boards vested with an exclusive right to acquire certain grains
- a single state-based bulk handling authority in each state with an exclusive right to receive those grains
- legislation or government policy governing the mode of grain transport.

During the 1990s and early 2000s, the industry experienced a period of consolidation in which a number of bulk handling companies and statutory marketing boards were privatised<sup>3</sup> and merged together (figure 2.1). These developments coincided with a period of deregulation, in which controls on bulk

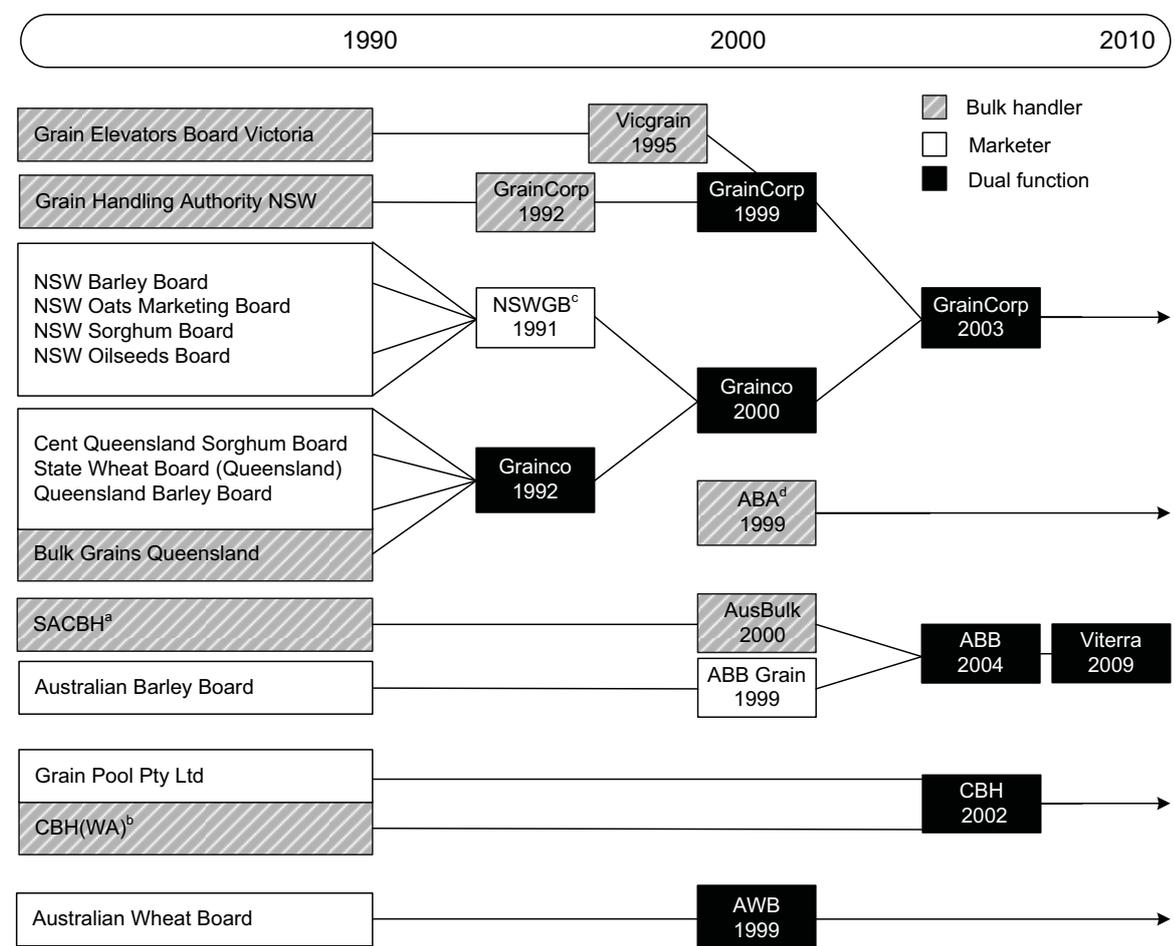
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<sup>2</sup> Consents/rejections for the 2006-07 export consent period were by the then Minister, the Hon. Peter McGauran MP, and for the 2007-08 export consent period by the Minister, the Hon. Tony Burke MP.

<sup>3</sup> The bulk handling companies were established during the period 1910–60 as state government owned authorities in New South Wales, Victoria and Queensland and grower cooperatives in Western Australia and South Australia (Sydenham and Whitwell 1991).

handlers, transport, and marketing arrangements for grains other than wheat, were largely dismantled.

**Figure 2.1 Grain industry consolidation**



<sup>a</sup> SACBH (South Australian Co-operative Bulk Handling). <sup>b</sup> CBH(WA) (Co-operative Bulk Handling (Western Australia)). <sup>c</sup> NSWGB (New South Wales Grains Board). <sup>d</sup> ABA (Australian Bulk Alliance) was formed in 1999 as a joint venture between AusBulk and Grainco, but was fully acquired by Sumitomo in 2010. ABA and AWB each own 50 per cent of the Melbourne Port Terminal in a joint venture arrangement.

Sources: ESC (2006); ABB (2006).

At present, the major bulk handling companies (GrainCorp, Viterra (formerly ABB) and Co-operative Bulk Handling (CBH)) and AWB have both bulk handling and marketing functions. AWB, GrainCorp and Viterra<sup>4</sup> are public companies listed on the Australian stock exchange, and together with the private company Australian Bulk Alliance (ABA), do not have specific legislation governing their activities

<sup>4</sup> Viterra is listed on both the Australian and Toronto stock exchanges.

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(other than the WEMA)<sup>5</sup>. CBH continues to operate as a grower owned and controlled cooperative and in addition to the WEMA, is governed by the *Bulk Handling Act 1967* (WA), that among other things, requires it to accept all grain tendered to it, but does not grant it any exclusive receival rights.

In Western Australia, the *Grain Marketing Act 2002* (WA) provides for the Grain Licensing Authority to issue licenses for the bulk export of prescribed grains. In 2009, all the remaining prescribed grains (barley, lupins and canola) were de-prescribed, effectively deregulating the bulk export market for grain in that State. A Bill to repeal the Grain Marketing Act was before the Western Australian Parliament in May 2010.

Other than the current wheat marketing arrangements, the only remaining statutory grain marketing arrangements in Australia are a transitional exporter licensing scheme for barley exports in South Australia (scheduled for expiry on 1 July 2010), and a licensing scheme for authorised buyers of rice in New South Wales, including a sole and exclusive export licence.

## 2.2 Industry overview

Wheat is the most significant grain crop grown in Australia in terms of area sown, volume of grain produced and value of the crop. The majority of wheat produced is destined for export in bulk.

Over the ten year period to 2008-09, the average annual gross value of wheat produced was \$4.8 billion and accounted for 56 per cent of the gross value of all grains and oilseeds produced and 13 per cent of total farm production in Australia. During the same period, the value of wheat exports averaged \$3.6 billion per annum (61 per cent of the value of all grain and oilseed exports), making wheat Australia's second most valuable agricultural export after beef and veal (\$4.1 billion) (ABARE 2010a).

This section provides an overview of the bulk wheat export industry in Australia including the production of wheat, the supply chain and other key sectors.

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<sup>5</sup> GrainCorp and ABA as operators of port terminals in Victoria, were previously subject to regulation under the *Grain Handling and Storage Act 1995* (Vic). From 1 October 2009, all ports in Victoria were declassified as 'significant infrastructure facilities' and are not subject to regulation under that Act. ABA and AWB each own 50 per cent of the Melbourne Port Terminal, however it is managed by an ABA subsidiary, Melbourne Terminal Operations which is not considered by WEA to be an associated entity of an accredited exporter and as such, is not subject to the access requirements of the WEMA (WEA 2009c). Sumitomo, the owner of ABA was previously an accredited wheat exporter but surrendered its accreditation in May 2010.

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## Production

Wheat is produced in Australia on farms, typically in conjunction with other grains and/or the grazing of livestock such as sheep and cattle. The ABS (2010d) estimates that approximately 26 000 businesses grew wheat in Australia during 2008-09<sup>6</sup>.

Australia's aggregate level of wheat production is highly variable from year to year, and is primarily dependent on prevailing weather conditions. In addition, wheat competes with other crops and agricultural activities for limited arable land. Consequently, prices of wheat relative to other agricultural commodities, as well as relative production costs, contribute to variations in area sown and production.

Over the ten years to 2008-09, Australian wheat production averaged 20 million tonnes, however, production varied significantly during this period, from a low of 10 million tonnes in 2002-03 when drought affected production, to a high of 26 million tonnes the following year (figure 2.2). On average, wheat makes up about half the total volume of grain and oilseeds produced (ABARE 2010a).

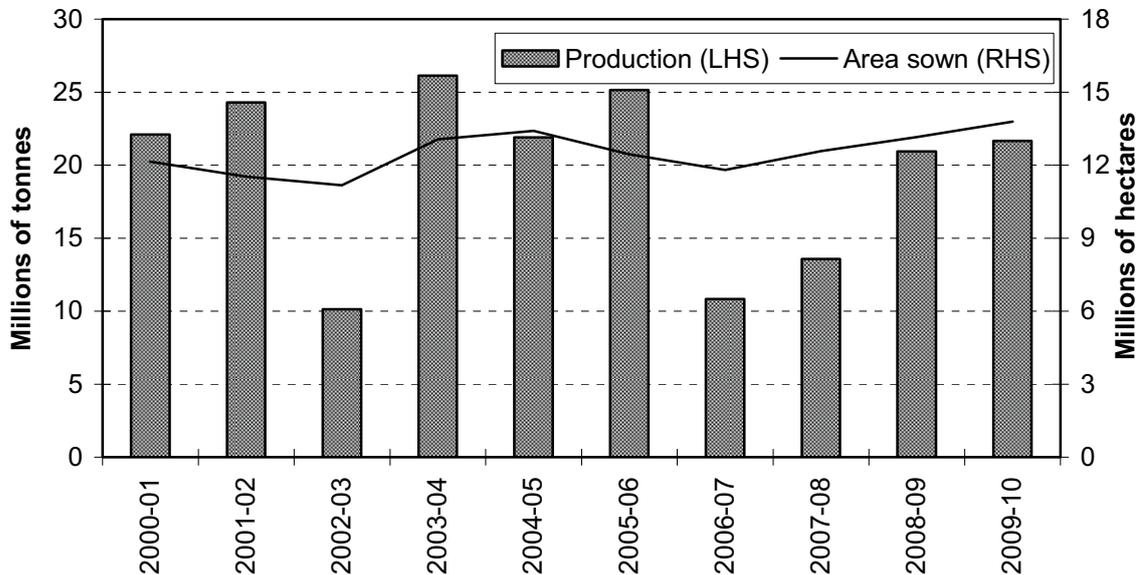
In terms of world production, Australia is a small producer of wheat, contributing on average only 3 per cent of the world total. However, due to its relatively small level of domestic demand, Australia exports 70 per cent of its crop and contributes a relatively greater share (12 per cent) to the world trade in wheat (figure 2.3).

The 2008-09 and 2009-10 growing seasons are the first under the new marketing arrangements and have been characterised by variable conditions across Australia, though on a whole, were much improved from the drought years of 2006-08. Total production in 2008-09 was 21 million tonnes, considerably larger than 2007-08 and above the ten year average. ABARE (2010b) estimates that total wheat production in 2009-10 is 22 million tonnes, 3 per cent higher than 2008-09. However, some regions have had a below average season, particularly in New South Wales. In addition, the quality of wheat in some regions of Victoria and South Australia was adversely affected by extreme heat and heavy rainfall.

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<sup>6</sup> This number includes all businesses that produce wheat and have an Estimated Value of Agricultural Operations (EVAO) of \$5000 or more, regardless of their level of specialisation and as a consequence, is likely to overstate the number of commercial wheat growers.

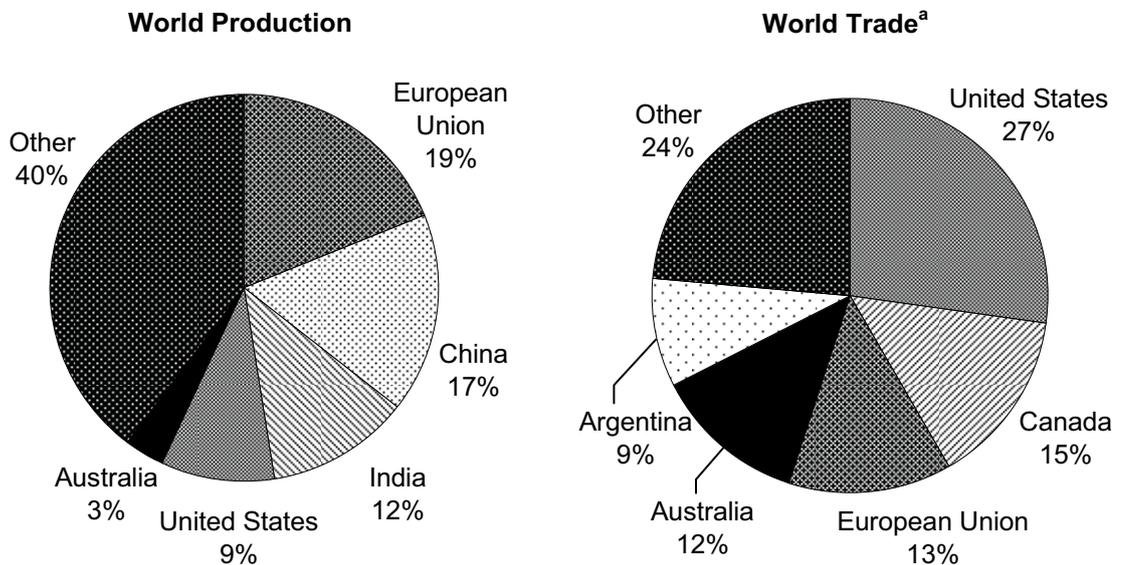
Figure 2.2 Australian wheat production and area sown



Sources: ABARE Australian Crop Report no. 153; ABS (*Historical Selected Agricultural Commodities, by state (1861 – present)*, Cat. no. 7124.0).

Figure 2.3 World wheat production and trade

Ten year average, 1999-00 to 2008-09



<sup>a</sup> Share of world trade calculated as share of total world exports.

Sources: ABARE (2007; 2009a).

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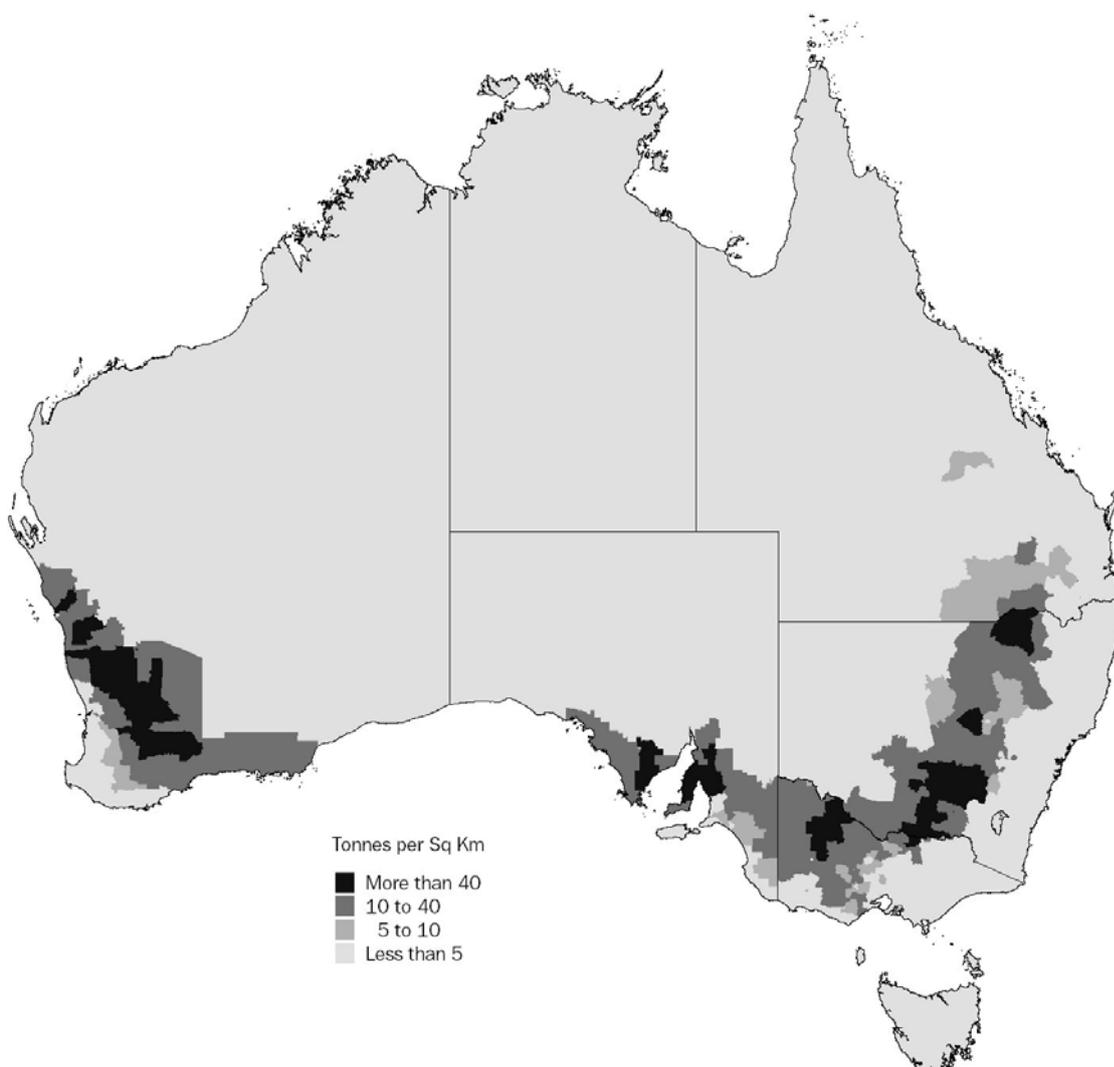
### Wheat growing areas

Wheat is primarily grown in regions with rainfall averaging between 400mm and 1000mm per annum (Sims 1990). Australia's principal wheat growing areas cover a crescent shaped area of southern Australia stretching from the southwest corner of Western Australia across South Australia, Victoria, central New South Wales and into southern Queensland. This area is colloquially known as the 'wheat belt'. Figure 2.4 shows the areas producing wheat and the intensity of production.

**Figure 2.4 The wheat belt, 2006**

Intensity of wheat production in Australia, tonnes produced per square kilometre<sup>a</sup>

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<sup>a</sup> Shaded areas reflect tonnes of wheat produced per square kilometre of a statistical local area in the year ended 30 June 2006.

Source: ABS (Unpublished 2006 Agricultural Census data).

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Wheat is a winter crop and the main portion of the Australian crop is sown between May and June and harvested during the summer months commencing in October and extending as late as February. Sowing and harvest times vary depending on variety sown, region and prevailing weather conditions (Sims 1990). The wheat ‘marketing year’ begins at the start of harvest in October and ends in September the following year.

Although wheat is often referred to generically, different wheat varieties, grown in different regions of Australia, have a range of end use characteristics that make them suitable for different uses (box 2.4 and more detail in chapter 8).

#### **Box 2.4 Australian wheat grades**

Under Australia’s wheat classification system, wheat varieties grown in specific geographic zones of Australia are classified into wheat grades based on their processing and end use characteristics. Hundreds of varieties of wheat grown in seven geographical zones of Australia, have been classified into eight different grades:

- *Australian Prime Hard (APH)* (Queensland and Northern, Central and Southern New South Wales)
- *Australian Hard (AH)* (All zones)
- *Australian Premium White (APW)* (All zones)
- *Australian Standard White (ASW)* (All zones)
- *Australian Soft (ASFT)* (All zones)
- *Australian Noodle (ASWN)* (Western Australia, Victoria and Northern, Central and Southern New South Wales)
- *Australian Durum (ADR)* (All zones)
- *Australian Premium White T (APWT)* (Western Australia)

Each of the grades has different end use characteristics, that make the flour milled from them suitable for making different products.

- Grades with hard grains and high protein levels (APH, AH) are suitable for use in yellow alkaline noodles, straight dough baking and sponge and dough baking.
- Grades with hard or intermediate grains and a lower protein level (APW, ASW) are suitable for yellow alkaline noodles, straight dough baking and rapid dough baking.
- Grades with soft grains and lower levels of protein (ASFT) can be used to make steamed buns and cookies or biscuits.
- ADR is used specifically to make pasta and the two noodle grades (ASWN, APWT) are suitable for making udon and white salted noodles respectively.

Sources: AWBI (2008); Wheat Classification Council (2009a).

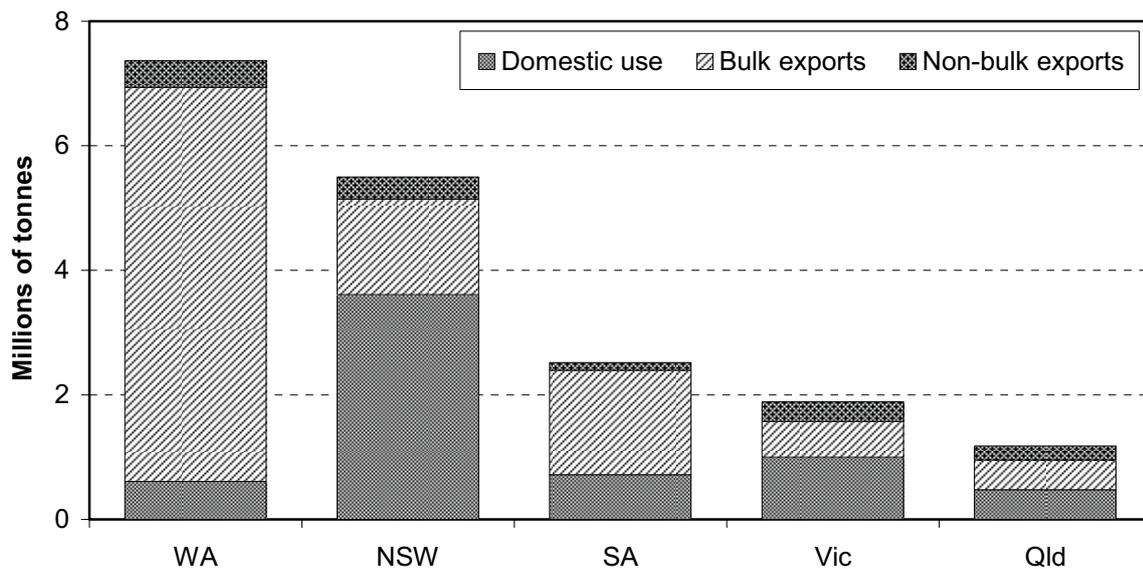
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### Export wheat supply and disposal

Western Australia and New South Wales are the largest producers of wheat in Australia, producing on average about 40 per cent and 30 per cent of the total respectively followed by South Australia (15 per cent), Victoria (10 per cent) and Queensland (5 per cent).

Due to their relatively small populations and level of domestic demand, Western Australia and South Australia are the most reliant on the export market for disposal of their production, exporting about 90 per cent and 70 per cent respectively. Queensland exports 60 per cent and Victoria 45 per cent. Despite on average producing the second largest volume of wheat, New South Wales' large population and high level of domestic demand result in it exporting only 35 per cent of its production. Figure 2.5 disaggregates the average production of wheat by state into exports (bulk and non-bulk) and domestic use over the five year period to 2008-09.

**Figure 2.5 Average wheat supply and disposal, 2004-05 to 2008-09<sup>a</sup>**



<sup>a</sup> Domestic use calculated as the average of production in a state less exports from that state over the marketing years 2004-05 to 2008-09. Estimates might vary from actual values due to estimation errors, changes in stocks and the interstate trade of wheat.

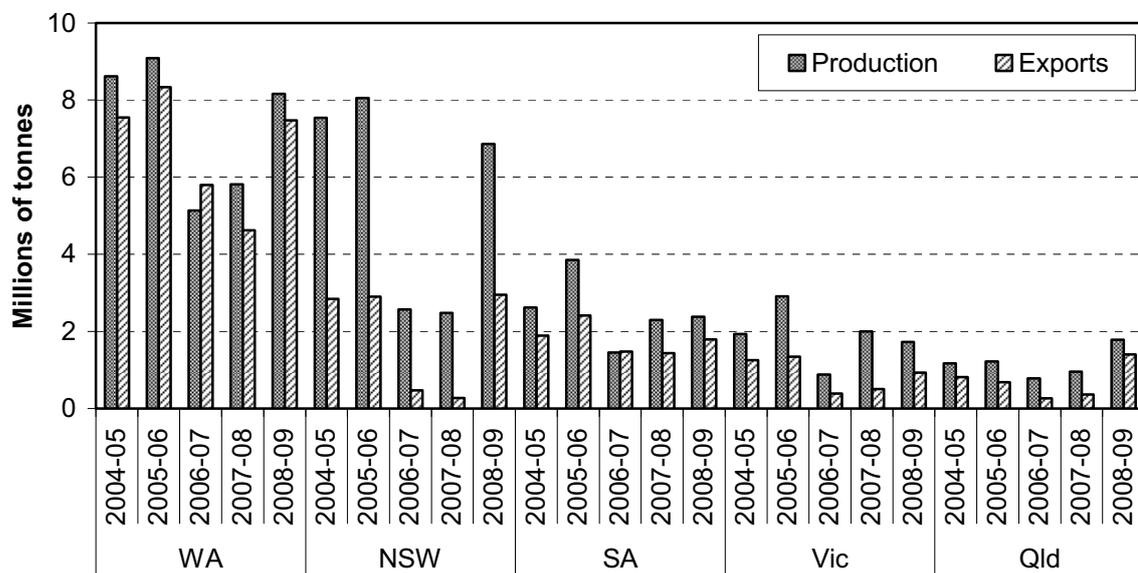
Sources: ABS (*Historical Selected Agricultural Commodities, by state (1861 – present)*, Cat. no. 7124.0); ABS (Unpublished International Merchandise Trade data).

Export wheat volumes from Australia's relatively highly populated eastern states (New South Wales, Victoria and Queensland) also exhibit greater volatility than those from the less populated states of Western Australia and South Australia. This is because production in the eastern states must exceed the level of domestic

consumption for a surplus to be exported. In years when production is high, as in 2005-06, these states contribute significantly to Australia's total wheat exports. However in years of poor harvest, such as 2006-07 and 2007-08 when drought affected production, exports from the eastern states reduce dramatically (figure 2.6).

This volatility was particularly evident in 2007-08 when, after two consecutive years of drought, there were no bulk wheat exports from New South Wales and only a small volume of non-bulk exports (273 000 tonnes) (ABS 2010c).

Figure 2.6 **Wheat production and exports<sup>a</sup>**



<sup>a</sup> Exports exceed production in some years due to changes in carryover stocks.

Sources: ABS (*Historical Selected Agricultural Commodities, by state (1861 – present)*, Cat. no. 7124.0); ABS (*Unpublished International Merchandise Trade data*).

The 2009-10 marketing year, the second since deregulation, is now partially complete. ABS statistics show that in the marketing year to April 2010 total Australian wheat exports were marginally below those during the same period in 2008-09 (table 2.1). However, there were large variations in export volumes by state, with Victoria recording a large increase in export volume while South Australia experienced a large decrease. New South Wales, Queensland and Western Australia experienced relatively minor decreases.

Although year to year changes in production, stocks on hand and world market conditions are likely to contribute to variations in wheat exports, some participants to the inquiry have stated that the divergent export performance of some states in 2008-09 and 2009-10 (particularly South Australia and Western Australia) is

symptomatic of distortions created by different port booking arrangements across states. This is discussed in chapters 3 and 5.

**Table 2.1 Wheat production, stocks and exports**

		<i>NSW</i>	<i>Vic</i>	<i>Qld</i>	<i>SA</i>	<i>WA</i>	<i>Aust</i>
2008-09 marketing year <sup>a</sup>							
Production	'000 t	6 861	1 724	1 781	2 376	8 161	20 939
Stocks held by bulk handlers (April)	'000 t	3 412	447	1 286	879	4 084	10 108
Year to April exports	'000 t	1 334	553	564	1 210	4 700	8 361
2009-10 marketing year							
Production	'000 t	5 050	3 177	1 200	3 951	8 248	21 657
Stocks held by bulk handlers (April)	'000 t	2 667	1 301	821	3 178	4 803	12 770
Year to April exports	'000 t	1 251	844	536	943	4 076	7 651
Year on year percentage change							
Production	%	-26	84	-33	66	1	3
Stocks held by bulk handlers (April)	%	-22	191	-36	262	18	26
Year to April exports	%	-6	53	-5	-22	-13	-8

<sup>a</sup> The wheat marketing year runs from October to September.

Sources: ABARE Australian Crop Report no. 153; ABS (*Wheat Use and Stocks*, Cat. no. 7307.0).

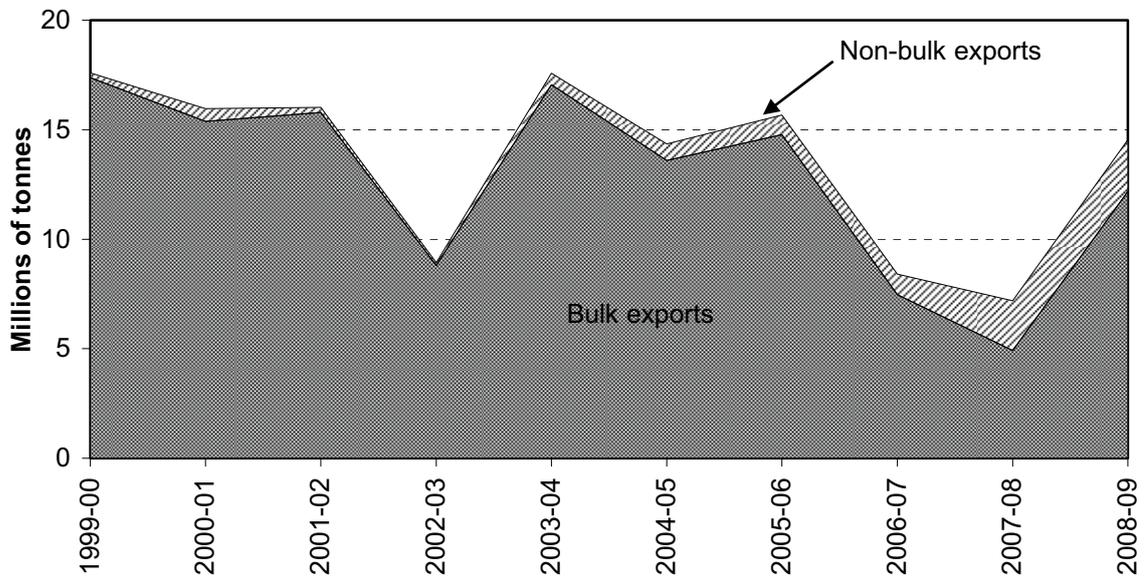
The two broad modes of export of wheat from Australia are bulk and non-bulk (containers and bags). The bulk export of wheat generally has lower per tonne handling and transport costs than non-bulk exports. However, non-bulk exports allow specialty or niche grains to be marketed in smaller quantities, permits access to ports that do not have infrastructure capable of receiving bulk grain and can also be more convenient for end-users to store and transport their grain. In addition, the export of non-bulk wheat does not require accreditation.

The majority of Australia's wheat exports are in bulk, however, the composition of total exports by mode varies across states. Over the five year period to 2008-09, non-bulk exports accounted for about 35 per cent of Victoria's exports, 30 per cent of Queensland's and 20 per cent of New South Wales'. In the same period, non-bulk exports accounted for only 6–7 per cent of exports from Western Australia and South Australia (figure 2.5).

The volume of non-bulk wheat exports has also increased in recent years. Between 1999-00 and 2006-07, wheat exports in bags and containers grew from 1 per cent to 11 per cent of the total. Following deregulation of non-bulk wheat exports in August 2007, these exports more than doubled in volume from almost 1 million tonnes in 2006-07 to 2.3 million tonnes in 2007-08, or 32 per cent of the total. In 2008-09, the volume of non-bulk exports increased marginally (2.4 million tonnes),

but an increase in bulk exports on higher production volumes coincided with the non-bulk share of total wheat exports declining to 16 per cent (figure 2.7).

Figure 2.7 **Australian bulk and non-bulk wheat exports<sup>a</sup>**



<sup>a</sup> Years are marketing years, October to September.

Sources: 1999-00 to 2003-04 WEA 2010b; 2004-05 to 2008-09 ABS (Unpublished International Merchandise Trade data).

GrainCorp, when explaining the increase in non-bulk wheat exports, stated:

The tonnage of grain exported in containers has increased in recent years, driven partly by the excess supply of empty containers that needed to be returned to Asia, and increases in bulk freight rates.

In GrainCorp's experience the trend in share of wheat exported in containers vs. bulk has had more to do with the deregulation of wheat in containers since August 2007. This coupled with excellent summer and winter crops in central and southern Queensland, and competitive container freight rates, grew the market rapidly to August 2008. After this time, bulk freight rates came down, making it more economical to ship in bulk. (sub. 43, p. 39)

Similarly, AWB submitted:

The trend to an increased volume of containers was initiated by relative value of bulk ocean freight prices (inflated by substantial demand for bulk minerals from China and India) relative to container ocean freight values and the fact that Australia is a net importer of packed containers and was a net exporter of empty containers.

Deregulation of the export wheat sector in Australia has coincided with this development and facilitated a rapid increase in grain containerisation capacity.

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It is likely that with the continuing increase in demand from South East Asian markets, (from both existing and new entrants), the current capacity is maintainable but in future periods the economics of bulk delivery of grain will substantially out compete the economics of container supply and this is most likely to be driven by the availability of supply of dry bulk vessels globally and supply of packed containers entering Australia. (sub. 24, p. 28)

### *Markets and prices*

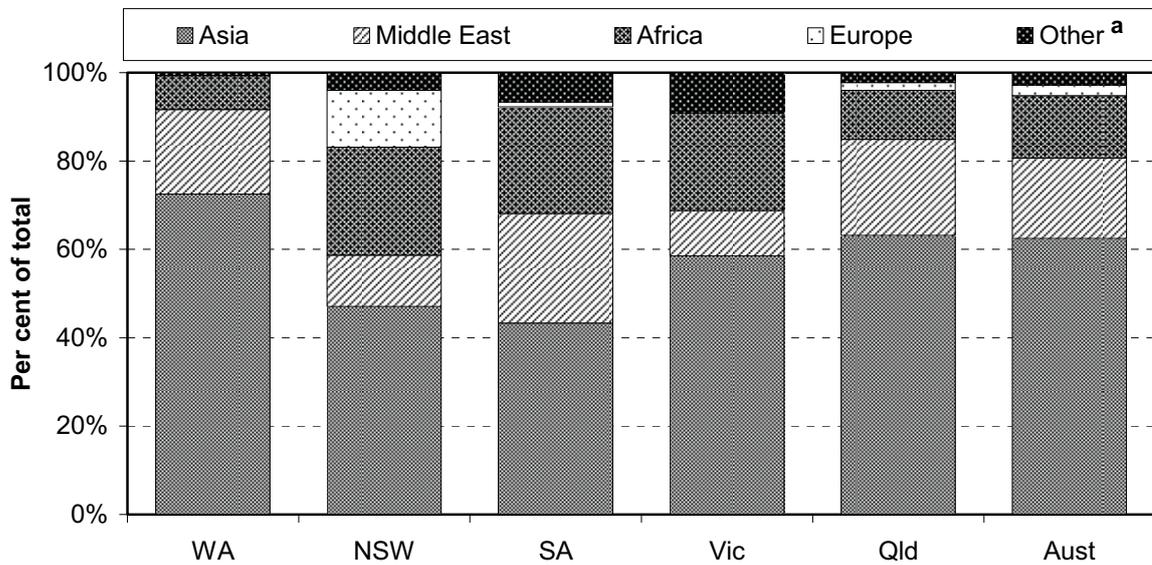
Asia is the principal export market for Australian wheat, receiving 63 per cent of Australia's exports over the five years to 2008-09. Two other major markets, the Middle East and Africa received 18 per cent and 13 per cent respectively. Together, Europe, Oceania and the Americas account for less than 6 per cent of total wheat exports (figure 2.8).

The relative importance of different export markets varies somewhat from state to state reflecting transport cost advantages and market demand for wheat grades grown in particular regions of Australia. For example, durum wheat is primarily grown in New South Wales and exported to Europe. Also, since over 90 per cent of Australia's exports are to regions north and west of Australia, it is generally accepted that Western Australia has favourable transport costs to Australia's largest wheat export markets.

In the first marketing year following deregulation (2008-09), Australia exported wheat in bulk to 41 countries. This is a greater number than the previous four marketing years, 2004-05 to 2007-08, in which Australia exported wheat in bulk to 36, 34, 20 and 17 countries, respectively (ABS 2010c). In the 2009-10 marketing year to April, Australia exported wheat in bulk to 29 countries (ABARE 2010d), however there are 5 months remaining in the marketing year and a significant proportion of the crop is yet to be exported, as demonstrated in table 2.1.

Wheat prices are subject to significant volatility over time, particularly over the past three years (figure 2.9). The world price of wheat in Australian dollars (as measured by the indicator price of US Hard Red Winter wheat) fell from a record high of AUD530 per tonne in March 2008 to AUD218 per tonne at the end of May 2010. The key drivers of world and Australian wheat prices are discussed in chapter 3.

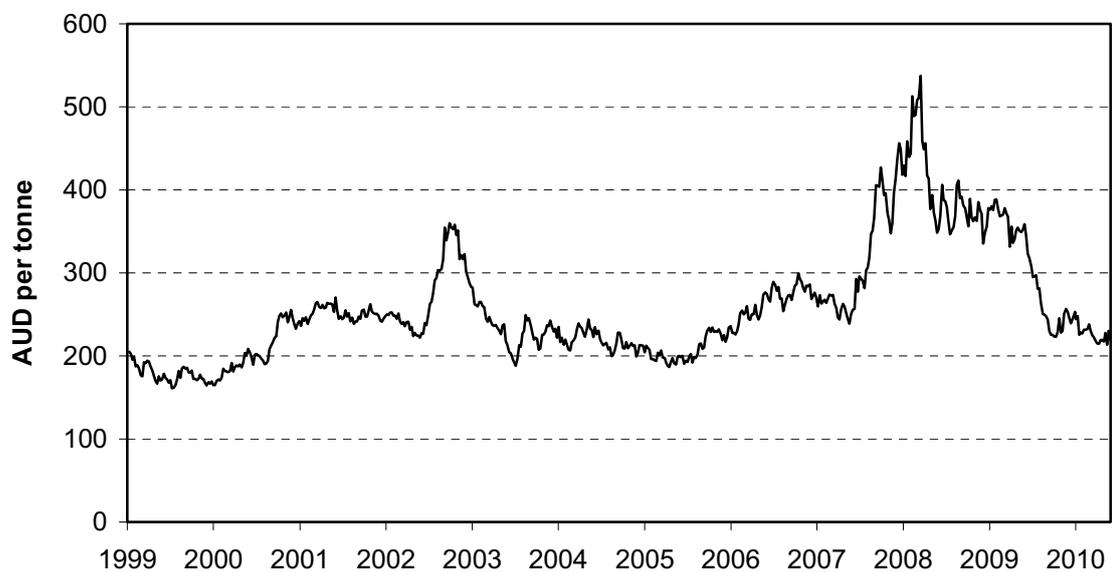
Figure 2.8 **Wheat export destinations, 2004-05 to 2008-09**



<sup>a</sup> Other includes Oceania and the Americas.

Source: ABS (Unpublished International Merchandise Trade data).

Figure 2.9 **World wheat price<sup>a</sup>**



<sup>a</sup> Price of US Hard Red Winter wheat 11.5 per cent protein fob US Gulf ports, converted to AUD.

Source: International Grains Council (*Weekly Wheat Export Quotations*) (accessed 4 June 2010).

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### *Size, concentration and specialisation*

Researchers have reported a trend towards fewer and larger farms in Australia (PC 2005) and more specifically the grains industry. Alexander and Kokic (2005) observed that the number of grain farms in Australia declined by over 40 per cent between 1977-78 and 2003-04 and the average area operated per farm increased by 50 per cent.

The size of grain growing farms in general varies considerably between states. Analysis of ABARE Farm Survey data shows that grain farms in Western Australia, the largest in the country, are approximately 3 times the size and sow 3–4 times as much area to cropping and wheat than those in Victoria, which has the smallest grain farms in terms of area operated (table 2.2).

**Table 2.2 Australian grain farms**

Selected physical estimates per farm, five year average, 2004-05 to 2008-09<sup>a</sup>

	<i>Units</i>	<i>NSW</i>	<i>Vic</i>	<i>Qld</i>	<i>SA</i>	<i>WA</i>	<i>Aust</i>
Farms	no.	8 250	4 935	2 606	4 342	4 559	24 770
Wheat produced	t	498	321	361	489	1 476	625
Wheat area sown	ha	370	237	225	420	940	440
Total area cropped	ha	624	577	486	821	1 502	794
Area operated	ha	2 328	1 046	2263	1660	3 358	2 126

<sup>a</sup> Comprises a weighted average of per farm estimates from ABARE farm surveys for farms classified into the broadacre industries, wheat and other crops industry and mixed-livestock-crops industry. ABARE farm surveys have targeted farms with an EVAO of \$40 000 or more since 2004-05.

Source: AGsurf database (accessed 22 April 2010).

Among wheat growers specifically, wheat production in Australia is highly concentrated. Information from the 2006 ABS Agricultural Census<sup>7</sup> indicates that in 2005-06, 50 per cent of wheat growers accounted for less than 10 per cent of production, and 10 per cent of growers accounted for almost half the industry's production (table 2.3).

Production of wheat also varies across states (table 2.4):

- wheat growers in Western Australia are the largest in Australia with over 75 per cent among the largest 50 per cent of wheat growers nationally

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<sup>7</sup> Estimates of 2005-06 farm production are based on information from the Agricultural Census at 30 June 2006. The scope for the 2005-06 Agricultural Census was all agricultural businesses recorded on the Australian Business Register maintained by the Australian Taxation Office. The measure of size was the ABS' EVAO or Business Activity Statement (BAS) turnover. A minimum size cut-off of \$5000, based on either EVAO or BAS turnover was used to determine whether a unit was in-scope for the Census.

- wheat growers in New South Wales and South Australia are evenly split between the smallest and largest 50 per cent of wheat growers nationally
- wheat growers in Victoria and Queensland tend to be smaller, with 63 and 66 per cent of their growers respectively among the smallest 50 per cent of growers nationally.

Within each state, a small proportion of growers produce a large proportion of total crop production. For example, the largest 30 per cent of growers in Western Australia produce 66 per cent of that State's wheat. In Queensland, the largest 15 per cent of growers produce 65 per cent of that State's wheat.

**Table 2.3 Decile of wheat production per business, 2006**

<i>Decile<sup>a</sup></i>	<i>Average production per business</i>	<i>Range in production per business</i>	<i>Total production of all businesses</i>	<i>Proportion of total production</i>	<i>Cumulative proportion of total production</i>
	tonnes	tonnes	tonnes	%	%
Lowest	31	0–58	75 000	0.3	0.3
2nd	90	58–120	257 000	1.0	1.3
3rd	162	120–200	456 000	1.8	3.1
4th	252	200–300	671 000	2.7	5.8
5th	365	300–440	945 000	3.8	9.6
6th	521	440–625	1 420 000	5.6	15.2
7th	750	625–910	2 072 000	8.2	23.4
8th	1 083	910–1 355	2 964 000	11.8	35.2
9th	1 716	1 355–2 300	4 836 000	19.2	54.5
Highest	3 903	>2300	11 453 000	45.5	100.0
<b>Total<sup>b</sup></b>	<b>919</b>		<b>25 150 000</b>	<b>100.0</b>	

<sup>a</sup> Deciles of production per business are estimated by ranking all wheat producing businesses in Australia (27 367) from lowest to highest according to total wheat production per business, and then dividing the businesses into ten equal or nearly equal sized groups. <sup>b</sup> Totals might not add as a result of rounding.

Source: ABS (Unpublished 2006 Agricultural Census data).

The activities of wheat growers are also somewhat diversified. Wheat in Australia is typically grown in combination with the cultivation of other crops and/or the grazing of livestock.

The diversification of farming activities can reduce production and price risks associated with a single crop. Crop and livestock rotation also forms an important part of modern sustainable farming practices and can have positive effects on disease control and soil fertility, improving yield and reducing production costs. In addition, diversification can result in more efficient use of resources, by increasing the number of crops that can be grown (summer and winter crops for example) and by spreading the workload more evenly over the year (Alexander and Kokic 2005).

**Table 2.4 Decile of wheat production per business, by state, 2006**

Decile <sup>a</sup>	Range in production per business	Share of production					Share of businesses				
		NSW	Vic	Qld	SA	WA	NSW	Vic	Qld	SA	WA
	tonnes	%	%	%	%	%	%	%	%	%	%
Lowest	0–58	0.3	0.6	0.9	0.3	0.0	8.7	10.2	21.1	7.4	2.9
2nd	58–120	1.1	2.4	1.8	1.4	0.2	10.5	14.6	14.8	10.6	4.2
3rd	120–200	2.1	4.2	2.8	2.4	0.4	11.1	13.7	12.2	10.4	4.2
4th	200–300	3.1	6.1	3.2	3.8	0.6	10.3	13.0	9.1	10.8	4.4
5th	300–440	4.1	7.6	4.4	5.6	1.3	9.5	11.3	8.6	10.7	6.5
6th	440–625	6.8	10.4	4.3	8.1	2.2	11.1	10.7	6.0	11.0	7.7
7th	625–910	9.5	13.0	7.8	12.6	3.8	10.8	9.3	7.3	11.9	9.2
8th	910–1 355	12.3	15.7	9.2	17.7	7.9	9.8	7.7	6.1	11.6	12.9
9th	1 355–2 300	18.7	19.4	17.6	25.1	17.4	9.4	6.2	7.2	10.2	17.9
Highest	>2300	41.9	20.5	48.0	23.1	66.1	8.7	3.3	7.7	5.2	30.0
<b>Total<sup>b</sup></b>		<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

<sup>a</sup> For a definition of decile, refer to table 2.3, note a. <sup>b</sup> Totals might not add as a result of rounding.

Source: ABS (Unpublished 2006 Agricultural Census data).

A significant majority of wheat growers of all sizes, in terms of wheat area sown, engage in activities other than growing wheat. Data from the 2006 ABS Agricultural Census indicate the most common non-wheat agricultural activity undertaken by Australian wheat growers was the raising of livestock, with 82 per cent devoting some area to grazing land, 68 per cent to raising sheep and 34 per cent to beef.

Barley was the most common other grain crop grown by wheat growers (59 per cent) followed by oats (33 per cent) and canola (20 per cent). Lupins, field peas and sorghum were grown by less than 20 per cent of wheat producers in 2005-06.

Small to medium wheat growers are less dependent on wheat growing activities than larger wheat growers which are more specialised. For example, the smallest 5 deciles of producers (in terms of area sown to wheat) devoted 4–15 times as much land to grazing and 1–2.5 times as much land to growing other grains, than was sown to wheat. This contrasts with the largest 5 deciles of growers, which devoted only 1–3.5 times as much land to grazing and only 0.3–1 times as much land to growing other grains (table 2.5).

**Table 2.5 Agricultural activities undertaken by wheat businesses, by decile of wheat area sown, 2006**

Decile <sup>a</sup>	Wheat	Grazing land	Sheep	Barley	Cut Hay	Cattle (beef)	Oats	Canola	Lupins	Field Peas	Sorghum
Share of businesses undertaking activity											
	%	%	%	%	%	%	%	%	%	%	%
Lowest	100	82	64	40	56	47	36	9	5	5	7
2nd	100	82	66	48	50	43	35	15	7	7	7
3rd	100	95	78	64	55	43	42	23	11	12	7
4th	100	69	57	48	40	28	28	18	9	11	5
5th	100	82	69	62	46	35	36	24	11	14	7
6th	100	79	66	63	43	29	33	23	13	16	7
7th	100	80	68	66	42	30	34	23	15	17	6
8th	100	83	69	67	39	31	31	23	18	16	7
9th	100	83	70	67	37	30	31	22	25	16	7
Highest	100	82	68	64	29	26	29	19	36	15	6
<b>Total</b>	<b>100</b>	<b>82</b>	<b>68</b>	<b>59</b>	<b>44</b>	<b>34</b>	<b>33</b>	<b>20</b>	<b>15</b>	<b>13</b>	<b>7</b>
Measure of activity undertaken											
	'000 ha	'000 ha	'000 no.	'000 ha	'000 ha	'000 no.	'000 ha				
Lowest	52	821	2 402	67	53	196	32	12	6	4	11
2nd	129	1 246	3 053	120	63	216	43	26	7	7	22
3rd	262	1 500	3 687	197	71	233	58	43	14	17	29
4th	279	1 314	2 713	184	56	172	43	42	14	18	27
5th	482	2 038	3 803	287	75	226	57	70	21	28	45
6th	637	2 133	3 758	337	76	220	62	82	27	38	56
7th	934	2 391	4 283	444	77	236	76	107	44	46	50
8th	1 387	2 928	4 830	553	84	268	76	136	73	54	77
9th	2 329	4 998	5 675	691	82	348	86	165	150	61	101
Highest	5 951	6 969	7 343	974	84	431	113	223	421	81	138
<b>Total<sup>b</sup></b>	<b>12 443</b>	<b>26 337</b>	<b>41 548</b>	<b>3 853</b>	<b>723</b>	<b>2 545</b>	<b>646</b>	<b>905</b>	<b>777</b>	<b>353</b>	<b>557</b>

<sup>a</sup> Deciles of wheat area sown per business are estimated by ranking all wheat growing businesses in Australia from lowest to highest according to total wheat area sown, and then dividing the total number of businesses into ten equal or nearly equal sized groups. <sup>b</sup> Totals might not add as a result of rounding.

Source: ABS (Unpublished 2006 Agricultural Census data).

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## The supply chain

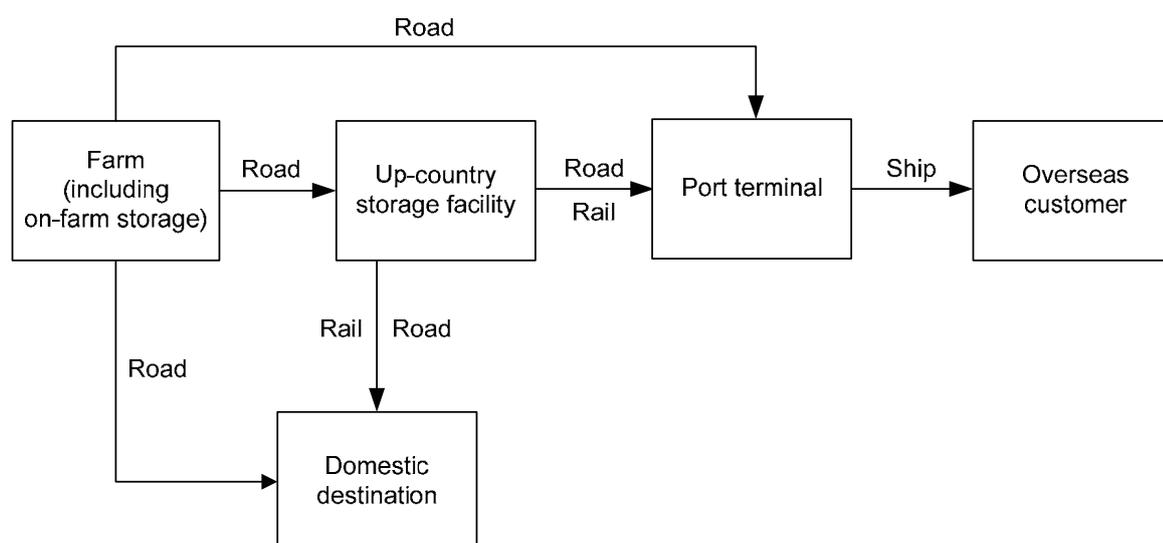
The majority of Australia's wheat is supplied through the bulk grain handling system. The system comprises a network of up-country receival facilities connected by road and rail transport links to population centres and port facilities. The bulk grain handling system also serves other grains produced in large quantities in Australia, including barley, canola, oats, lupins, field peas and sorghum. Figure 2.10 provides an overview of the bulk grain supply chain.

In addition to wheat supplied into the bulk handling system, a portion of Australia's wheat will be stored on-farm or transported directly from the farm gate to a domestic customer (for example, a flour miller) or a non-bulk grain handler for packing and sale or export in containers and bags.

The transport and storage of wheat is discussed in chapter 6.

**Figure 2.10 Bulk grain supply chain**

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### *The bulk handling companies*

Australia's bulk grain handling system is dominated by three major regionally based bulk handling companies: GrainCorp in New South Wales, Victoria and Queensland; Viterra in South Australia, and CBH in Western Australia.

In addition to the major bulk handlers, there are two large independent bulk handling companies: AWB with operations in South Australia, Victoria, New South Wales and Queensland; and, ABA, with operations in New South Wales and

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Victoria. A number of smaller independent storage and handling facilities also complement the major bulk handlers. Box 2.5 summarises the regional variations in wheat supply chain characteristics.

The services provided by bulk handlers at each step in the supply chain can form an integrated service connecting the farm gate to the domestic customer or export market. Generally however, these services are available separately, allowing a bulk handler's client to gain physical control of its grain at any point in the supply chain. An exception is in Western Australia where CBH introduced a bundled service called Grain Express in 2008. Grain Express requires utilisation of CBH services throughout the length of the supply chain once grain has entered it, from receipt site to destination point — typically a port but there are also domestic outturn sites.

### *Storage and handling*

Once wheat has been harvested, it will typically be stored on farm or delivered by road to one of over 550 up-country storage facilities operated by bulk handlers in Australia. Alternately, in some cases, wheat might be delivered directly to port (figure 2.10).

The storage capacity of the bulk grain handling system is approximately 50 million tonnes (table 6.1) and is complemented by on-farm storage of about 16 million tonnes (ABS 2010d). In addition, users of grain (for example, millers) and temporary storage options such as bags are likely to contribute several million tonnes capacity. Australia's total grain storage capacity is about twice Australia's average annual grain production over the ten years to 2008-09 of about 36 million tonnes and well in excess of the highest production year on record, 47 million tonnes in 2003-04 (ABARE 2009a).

There is currently a wider choice of storage service providers in the eastern states and sections of South Australia than in Western Australia, as the major bulk handlers storage facility networks overlap to some extent and compete with a number of independent storage providers. This is reflected in the greater number of Grain Trade Australia Registered Bulk Handlers operating in New South Wales, Victoria and South Australia (table 2.6).<sup>8</sup>

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<sup>8</sup> A bulk handler may apply to Grain Trade Australia (GTA) to be registered as a GTA Registered Bulk Handler. For 2010-11, 18 bulk handlers have been provisionally registered by GTA. In each of New South Wales, Victoria and South Australia, eight provisionally registered bulk handlers operate. In Queensland, three operate and in Western Australia, only CBH has been provisionally registered. It should be noted that not all bulk handlers seek registration or are eligible (GTA 2010).

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## Box 2.5 Regional variations in wheat supply chain characteristics

There are three distinct regions with respect to supply chain characteristics.

*East Coast (New South Wales, Victoria, Queensland and the easternmost part of South Australia)*

- Wheat is exported and consumed domestically. The bulk supply chain competes with exports in containers and bags and the storage and transport of grain for sale in the domestic market.
- The market for bulk storage and transport services is dominated by GrainCorp in New South Wales, Victoria and Queensland and Viterra in South Australia. Competition is provided by on-farm storage, a number of independent bulk handlers and some overlap of GrainCorp and Viterra storage networks.
- Bulk grain export terminals in New South Wales, Victoria and South Australia operated by GrainCorp, Melbourne Terminal Operations and Viterra are in relatively close proximity and might compete for some grain throughput.

*Western Australia*

- Almost all wheat is exported in bulk. Some competition is provided by exports in containers and bags.
- CBH is the dominant supplier of bulk storage and transport services. There is some competition from on-farm storage, but none from independent bulk handlers. CBH's Grain Express service requires utilisation of CBH services throughout the entire length of the supply chain, once grain has entered it.
- CBH operates all bulk grain export terminals.

*Eyre Peninsula (South Australia)*

- Almost all wheat on the Eyre Peninsula is exported in bulk. Some competition is provided by exports in containers and bags.
- Viterra is the dominant supplier of bulk storage services. There is some competition from on-farm storage and independent bulk handlers.
- Viterra operates all bulk grain export terminals.

On-farm storage capacity also makes up a relatively greater proportion of the total storage in the eastern states than in Western Australia and South Australia which rely more heavily on bulk handlers for grain storage. A number of participants to the inquiry have noted that deregulation has prompted many growers to invest in on-farm storage to increase their marketing options post-harvest. The larger stock of on-farm storage in the eastern states might be attributable to the relative importance of the domestic market and longer history of choice in domestic marketing.

**Table 2.6 Grain storage task and capacity**

		NSW	Vic	Qld	SA	WA
Average annual production <sup>a</sup>	Mt	9.0	4.2	3.1	5.4	11.9
Major bulk handler <sup>b</sup> storage capacity <sup>c</sup>	Mt	12.2	5.2	2.5	9.5	20.0
On-farm storage <sup>d</sup>	Mt	6.4	3.5	2.0	1.2	2.6

<sup>a</sup> Average annual production of grains and oilseeds in the period 2003—08. <sup>b</sup> GrainCorp in NSW, Vic and Qld; CBH in WA and Viterro in SA. <sup>c</sup> Denotes potential capacity. Due to segregations, actual capacity is likely to be less than potential capacity. <sup>d</sup> As at 30 June 2009.

Sources: ABARE Crop Report no. 153; ABS (*Principal Agricultural Commodities, Australia*, Cat. no. 7121.0); Productivity Commission estimates.

### Transport

From an up-country receival facility, wheat is either sold into the domestic market or transported to port for export (figure 2.10). Modes of transport vary depending on the location of the up-country receival facility and distance to customer or port. Approximately 75 per cent of Australia's export grain is transported via rail with the remainder delivered by road (table 6.3).

Although road haulage is provided by a number of companies in each state there is only one, or at most a few, rail freight providers for grain in each state. Bulk handlers typically enter long-term contracts for dedicated trains serving their export terminals and on-sell excess capacity to other grain exporters (ESC 2009). Refer to chapter 6 for a discussion of grain transport.

### Ports

Once the grain arrives at port it might be fumigated (particularly if it has arrived from outside the bulk grain handling system), and stored awaiting loading onto a ship. Wheat can also be blended at the port facility to meet specific client requirements.

The *Export Control Act 1982* (Cwlth) requires that grain and the ship that it is to be transported in must be inspected by the Australian Quarantine and Inspection Service prior to export to ensure it is free from vermin or insects and meets the phytosanitary requirements of the destination country.

In addition, the National Residue Survey (NRS) tests all shipments of bulk wheat (and 20 other grains) during loading for chemical residues. The NRS also randomly tests container and bag exports at the point of packing. In 2008-09, the NRS

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reported 100 per cent compliance with standards for bulk grain exports and over 98 per cent compliance amongst bag and container grain exports (DAFF 2009b).

There are 20 bulk grain export terminals around the Australian coast, four CBH terminals in Western Australia, eight Viterro terminals in South Australia (six of which export wheat) and two GrainCorp terminals in Victoria, two in New South Wales and three in Queensland. In addition, the Melbourne Port Terminal (MPT) in Victoria is jointly owned by ABA and AWB and operated by Melbourne Terminal Operations. Figure 2.11 shows the location, operator and average annual throughput of the 18 bulk grain terminals in Australia that export wheat.

Except for Victoria, where the MPT has about a third of the total market and GrainCorp terminals two thirds (ACG 2008a), there is only a single provider of bulk grain port terminals in each state. However, some ports in New South Wales, Victoria and South Australia are in relatively close proximity and might compete for some grain throughput.

There is also some prospect that greater competition will develop between port facilities in the future. In August 2009, Wilmar Gavilon purchased the Brisbane Sugar Terminal at Fisherman Islands near Brisbane and has stated its intention to expand the facility to service grain and other bulk and liquid commodities (Wilmar Gavilon 2009). In addition, a multi-purpose port facility has been proposed at James Point near Kwinana in Western Australia (Whitaker 2009; Barnett 2009).

During the 2008-09 marketing year, about 12 million tonnes of wheat were exported in bulk from Australia and over 7 million tonnes of this was from Western Australia. In March 2009, exports of wheat in bulk from the CBH grain terminal at Kwinana in Western Australia exceeded half a million tonnes and were higher than in any month in at least the previous five years (ABS 2010c). Despite the record throughput, delays were experienced loading ships at ports operated by CBH in Western Australia in the first year following deregulation.

The Department of Agriculture and Food (Western Australia) explained:

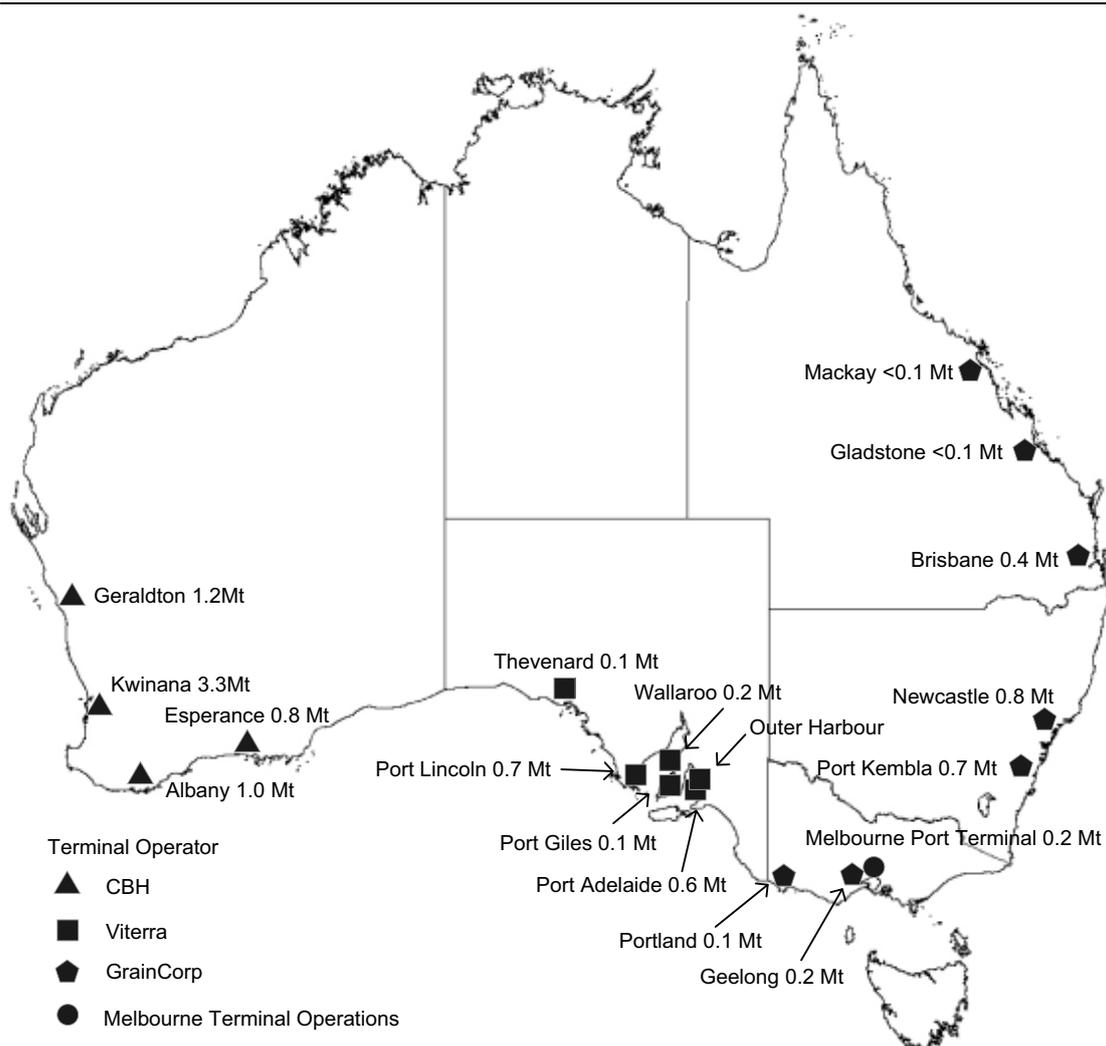
In the 2008-09 season, there were constraints for the grains industry in transferring the harvest from upcountry receival sites to port facilities. The delays were predominantly due to the shipping stem and road/rail infrastructure, however, there were additional problems including:

- a large and delayed harvest along the WA coast
- exporters wanting early shipments based on an increase in cash sales
- multiple exporters (increased from one to 23)
- moving large volumes from farm to port

- the timing of receipt point fumigation.

There is evidence that the delays had an impact on wheat sales and that potential buyers were considering using other Australian ports or alternate overseas suppliers. If these delays occur in future seasons, this will affect Western Australia's reputation as a reliable supplier. (sub. 34, pp. 3–4)

**Figure 2.11 Australian bulk wheat terminals**  
Location, operator and average annual throughput<sup>a</sup>



<sup>a</sup> Average per annum tonnage of bulk wheat grain throughput over the five years to the 2008-09 marketing year in millions of tonnes (Mt). Outer Harbour commenced operation in 2010 and did not export wheat during the period measured.

Sources: ABS (Unpublished International Merchandise Trade data); WEA (2010c).

ACIL Tasman, in a report prepared for CBH, stated:

In early 2009 demand to export wheat from WA rose dramatically and a 'bottleneck' in the export supply chain emerged, particularly at Kwinana. The result was that some shipments that some exporters had expected to be made over this period experienced

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considerable delays. These delays occurred despite record throughput at the ports over this period.

The spike in demand and subsequent bottleneck appeared to be the result of [a] number of factors including:

- a rain delayed harvest
- demand for early deliveries of wheat by a number of end users
- a lack of communication between the port operator and the exporters
- volatility in the export wheat price and bulk sea freight rates in early 2009
- limited rail network capacity due to a number of load and speed restrictions on many branch lines. (ACIL Tasman 2009, pp. 14–15)

On the congestion experienced at ports, Viterra submitted:

When AWB managed the single desk, it was able [to] spread the shipping over the whole year and therefore avoid peak capacity issues. Bulk handlers have now been required to consider the management of the dynamic capacity of their port terminals and through experience will be better able to predict and manage capacity. (sub. 23, p. 8)

In response to the issues experienced at its ports in Western Australia in the first year of deregulation, CBH introduced an auction system to allocate port capacity and alleviate congestion at peak periods for the 2009-10 harvest. The 2009-10 marketing year is now partially complete and the port congestion problems experienced in 2008-09 have not reoccurred, however, in response to the Commission's draft report, wheat exporters have expressed concern regarding their ability to access port facilities on fair terms throughout Australia and this remains an area of contention amongst stakeholders. The CBH auction system and port access in general is discussed in chapter 5.

## **Other key sectors**

### *Marketing and trade*

Marketers provide the link between the participants in the supply chain. They purchase grain from growers and each other, find buyers and coordinate transport of grain between the two. Marketers typically take control of grain at the up-country receival facility where they might post daily prices, or take delivery of grain they have already agreed to purchase, or have contracted to be delivered into a pool.

There have been a number of wheat marketers operating in the domestic market since 1989, the non-bulk export market since 1999 and, as a result of the new bulk

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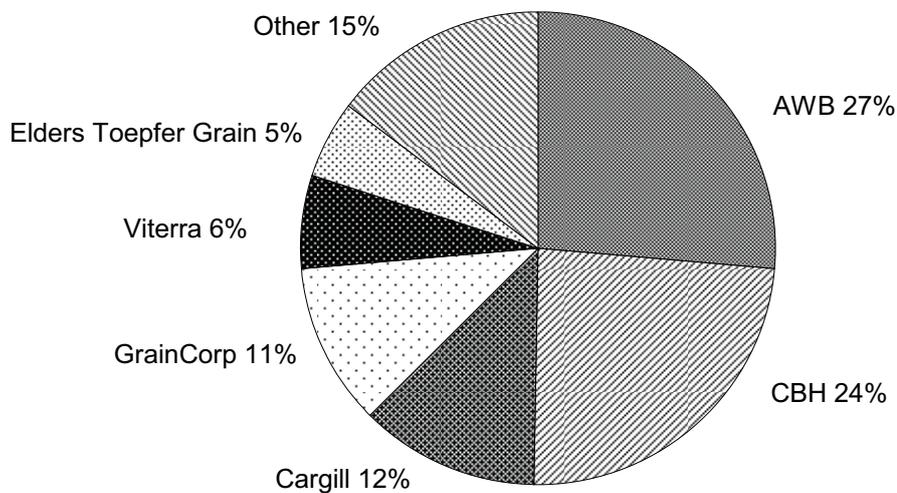
wheat export marketing arrangements, there were 28 accredited exporters in the bulk wheat export market at May 2010 (WEA 2010d).

Since deregulation, accredited bulk exporters have been successful in gaining significant market share from AWB. During the 2008-09 marketing year, 17 accredited exporters exported 12 million tonnes of wheat in bulk. WEA has stated that 60 per cent of bulk wheat exported during this period was by the top three exporters and 90 per cent by the top nine exporters (WEA 2009d).

The Commission has been provided with industry estimates, based on the monitoring of port shipping stems, that indicate that AWB and CBH each hold approximately a quarter of the bulk wheat export market, followed by Cargill (12 per cent), GrainCorp (11 per cent), Viterra (6 per cent) and Elders Toepfer Grain (5 per cent). A number of smaller exporters exporting less than 5 per cent each make up the remainder (figure 2.12).

**Figure 2.12 Estimated export shares of bulk wheat exporters in 2009<sup>a</sup>**

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<sup>a</sup> Industry estimate based on monitoring of port shipping stems from January to December 2009.

Source: Lloyd George (AgIntel, pers. comm., 28 January 2010).

The increased number of marketers has resulted in a greater range of marketing options, terms and conditions for growers. This has increased liquidity and flexibility for growers. However, some growers have commented that increasing choice has itself resulted in increased costs:

The challenge is being embraced but at a cost — one must follow the markets, purchase new mobile phone systems, computer hardware/software, attend courses, employ

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consultants, all of which has a dollar value as well as time which impinges on other areas of the business or rest. (Pike Family Trust, sub. 18, p. 1)

Wheat marketing, including the increased choices that have emerged for growers to market their wheat, is discussed in chapter 3.

The 2008 wheat export marketing arrangements were implemented in part to reassure growers that they would not be subject to high levels of credit risk when dealing with marketers of bulk export wheat.

Since implementation of the new arrangements, none of the accredited exporters has experienced bankruptcy or had its accreditation revoked. There also appears to be a high level of confidence in payment security among growers. The WA Grains Group (sub. 46, p. 1) has stated ‘WEA gives farmers the security of knowing that the companies have the ability to pay. This is important in the interim period of moving from regulation to deregulation’.

However, some participants raised doubt about the level of security accreditation actually provides. GrainCorp submitted:

... the regulator provides no financial guarantees or warranties to any party transacting business with an accredited bulk wheat exporter, and ... the scheme thus provides an ‘appearance’ of security where none actually exists ... (sub. 43, p. 3)

The value of ongoing accreditation is discussed in chapter 4.

Payment security is particularly relevant in the context of recent economic conditions and the adverse impact the global financial crisis had on the ability of companies to gain access to finance in 2008 and 2009. As trading companies, finance is important for bulk wheat exporters as credit is used to finance the accumulation of grain for export. Without credit, exporters would be required to finance grain accumulation with equity (at greater cost) or would not be able to accumulate grain.

However, inquiry participants were of the view that the global financial crisis did not significantly affect the ability of marketers to accumulate grain. GrainCorp (sub. 43, p. 38) stated that it ‘had no problems securing grain inventory finance for the 2008-09 grain harvest. The company has not experienced any problems securing finance for the 2009-10 harvest’.

Further, the Pastoralists and Graziers Association of Western Australia noted:

We have had the big test of the global financial crisis and farmers were able to trade in a very liquid market at good values. The best cash trading opportunities I would say they’ve ever had at a time of liquidity crisis in global markets and that’s continuing today. (trans., p. 55)

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In support of the financial soundness of bulk wheat exporters, WEA has stated:

In 2008-09, proposed export volumes from 24 accredited companies totalled approximately 27 million tonnes, which is considerably greater than the 12.3 million tonnes of wheat actually exported. This indicates that accredited exporters had the combined capacity and financial resources available to export more than twice the size of the Australian crop available for export in 2008-09, despite the difficult economic circumstances of the global financial crisis. (sub. 55, p. 29)

In addition to marketers, there are a number of private and public sector organisations and grain brokers providing information and services to growers and other market participants.

Industry bodies also play a role in facilitating the trade of grain, such as Grain Trade Australia, which publishes commodity standards, standardised contracts and trade rules and provides a dispute resolution service; and the Wheat Classification Council, which manages the classification system under which the majority of Australia's wheat is traded.

#### *Research and development*

Research and development also contributes to Australia's competitiveness in the international wheat market.

In addition to four commercial wheat breeding companies operating in Australia, the Grains Research and Development Corporation (GRDC) — a statutory corporation under the *Primary Industries and Energy Research and Development Act 1989* (Cwlth) — is responsible for allocating and managing investments in grain research and development. The GRDC provides funding to universities, farming groups and private companies to conduct research in three main areas:

- pre-breeding research to identify, isolate and enhance genetic traits and for the development of new varieties
- improving growing practices
- developing new products for use by growers.

The GRDC is funded by a grower levy and the Australian Government. The grower levy is currently 0.99 per cent of the value of grain produced, and is collected on 25 crops including wheat. Taxpayers contribute on a sliding scale up to a maximum of 0.5 per cent of the gross value of Australian grain production.

Industry good functions are discussed in subsequent chapters including information (chapter 7), wheat quality and classification (chapter 8) and other industry good

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functions (chapter 9). Research and development is the subject of a separate Productivity Commission inquiry.

## 2.3 Industry performance

Deregulation on 1 July 2008 represented a significant transition for the bulk export wheat industry which had been regulated under single desk marketing arrangements for over 60 years. The 2008-09 marketing season (October to September) was the first full season under which the new wheat export marketing arrangements operated and the 2009-10 marketing season is now partially complete.

The transition to deregulation has coincided with a period of turbulence in the world economy due to the global financial crisis and a significant decline in world wheat prices. However, despite the dramatic change that deregulation brought to the industry and adverse economic and price conditions, the transition to competition in bulk wheat export marketing has progressed remarkably smoothly and the industry is performing well under the new arrangements.

A number of considerations have contributed to this assessment:

- Twenty-eight organisations are now accredited to export wheat in bulk from Australia (as at May 2010) and competing exporters have successfully gained significant market share from AWB. Growers have reported that there is a liquid market for wheat with a multitude of marketing options available.
- A relatively large volume of wheat was successfully exported in bulk to a diverse range of international markets in the first marketing year following deregulation and this looks set to continue in 2009-10.
- None of the accredited exporters has experienced bankruptcy or had its accreditation revoked. There is a high level of confidence in payment security among growers.
- Deregulation has revealed cross-subsidies and inefficiencies that were embedded and hidden in the previous compulsory national pool. Growers are now observing prices that are closer to the actual costs of transporting, storing handling, and marketing their grain. This is discussed in chapters 3 and 6.

However, it is clear that the industry is still working through some transitional issues related to deregulation, such as port access and supply chain efficiency.

In addition, it is also apparent that all industry participants, particularly some growers that saw benefits under the single desk, have faced challenges in coming to terms with the new industry arrangements, including operating in a more complex

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marketing environment. These difficulties have been exacerbated by the recent decline in the world price of wheat and the rising value of the Australian dollar.

Looking forward, the prospects for the Australian bulk wheat export industry look bright if it continues to be flexible to market signals and strives to be intensely competitive, a sentiment shared by BRI Australia in a report prepared for the Grain Growers Association:

Overall, Australia is in a fortunate geographic location to compete in the growing Asian market, however, the industry will need to continue to innovate and improve quality so as to ensure Australian wheat continues to meet the high standards expected of it in a market subject to intense international competition. Having the diversity of product and the flexibility to take advantage of opportunities in other markets will also be increasingly important. (BRI Australia 2010, p. 23)

The following chapters look more closely at industry performance in respect of particular aspects of the wheat industry and consider changes that might be required to make the marketing of bulk export wheat more competitive.



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## 3 Marketing and pricing

### Key points

- The wheat industry is still in transition under the current export arrangements.
  - Only one marketing cycle has been completed to date, with the second nearing completion.
- Some growers have raised concerns with the new marketing arrangements.
- The transitional period has coincided with unusual volatility in world wheat prices.
  - Extremely high prices have been followed by low prices.
  - Some industry participants have found marketing and managing production and risk challenging. The volatility in price since deregulation has certainly made the environment more difficult.
  - The global financial crisis and exchange rate appreciation have added to the challenge.
- The main factors affecting the export price of wheat are unrelated to the dismantling of the single desk and include the:
  - global demand for, and supply and stocks of, wheat
  - exchange rate
  - transport costs from Australia to export markets.
- Growers now have many choices available to them to market grain and manage production and price risk.
  - The plethora of products and options available undermine the sense of security and stability some growers felt characterised the single desk arrangements.
  - Some growers expressed a particular preference to return to a single national pool. Although not directly comparable, regional pools operated with involvement from private companies owned by growers or grower cooperatives are now widely available.
- Marketing wheat and managing production and price risk in New South Wales can be different from other states.
  - In years of low production in New South Wales, local demand exceeds local supply and the local price rises above the export price, reflecting the cost of importing wheat from other states.
  - This makes managing price volatility and production risk more challenging without a suitable and liquid futures market.

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The current wheat export arrangements have been operating for two years. The 2008-09 marketing year was the first full season under which the new wheat export marketing arrangements operated and the 2009-10 marketing year is nearing completion. It is early days in terms of experience and adjustment to the changes being brought about by a more competitive export marketing system. This is particularly so after about 60 years of having a single exporter marketing Australia's wheat using a compulsory national pool. Under the current arrangements there has been an increase in the marketing choices available to growers, resulting in a more complex decision making environment. The Commission is aware of a range of views on the current wheat exporting arrangements (section 3.1).

In this chapter, the transitional environment is briefly described (section 3.1), and the trends in the price of export wheat and the key factors affecting it are reviewed (section 3.2). The risks associated with growing and marketing wheat are discussed, as well as the increased choices that have emerged for growers to market their wheat and manage price risk (section 3.3). Finally, issues arising in the marketing of wheat are discussed (section 3.4).

### **3.1 An industry in transition**

All sections of the wheat export industry (including growers, bulk handling companies, rail and road transport service providers, port operators, and wheat marketers and traders) are still learning, experimenting and adapting to the new business environment.

Some growers have raised concerns about the transition to the new wheat export marketing arrangements (box 3.1). These issues will each be addressed throughout this chapter.

The transition has coincided with a pronounced commodity price cycle for wheat and many other grains traded on international markets. Further, in some parts of Australia, particularly in east Australia, there has been prolonged drought. This has further complicated wheat marketing because of the rise and fall of wheat prices relative to the export price in the eastern states (particularly New South Wales) depending on the level of production in the eastern states — discussed further in section 3.2.

Deregulation of wheat export marketing has revealed cross-subsidies and inefficiencies that were embedded and hidden in the previous compulsory national pool. Growers are now seeing costs that are closer to the actual costs of transporting, storing, handling (chapter 6) and marketing their grain.

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### **Box 3.1 Grower concerns**

Growers have expressed a range of views on the current wheat export marketing arrangements. Those growers concerned with the removal of the single desk generally see marketing and pricing issues as paramount. The main issues raised by these growers are summarised below.

- Low prices and increased price volatility.
- Loss of Golden Rewards and a return to 'cliff-face pricing'.
- Cost and complexity of selling in a competitive market.
- Increased risk to growers associated with pricing and marketing.
- Loss of forward hedging, resulting in lower returns to growers.
- Loss of efficiencies by having more than one entity to control supply and throughput of wheat, resulting in higher storage and transport costs.
- No buyer of last resort.
- No payment security.
- No real competition between traders, and in some cases a reduction in the number of buyers at harvest.
- Growers are best served by a national pool managed as a grower-owned cooperative.

The issues relating to pricing and marketing are addressed in this chapter. Supply chain issues are discussed in chapter 5 (ports) and chapter 6 (transport, storage and handling).

All of the above factors are leading to pressures for structural change, both for growers and other sectors of the wheat industry, as they adapt to the change in their individual business circumstances. The marketing products on offer are still evolving. Some adjustments require investment and it will take time for growers and the logistics supply chains to adapt and develop innovative solutions to take advantage of the new demands and opportunities arising from increased competition in the marketing of wheat exports.

The coincidence of the global financial crisis and the strong Australian dollar for much of the 2009-10 marketing season have added to the challenge of adjustment. A low world price for wheat might have in some cases exacerbated rural adjustment pressures. Some industry participants ascribe these challenges to deregulation.

Participants to the inquiry have expressed a range of views about prices and marketing under the current wheat export marketing arrangements, as indicated below.

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## Participants' views

A number of growers have expressed dissatisfaction with the current wheat export arrangements:

We were and still are very strong supporters of the single desk system of marketing Australia's bulk wheat exports and believe the decision to deregulate has not been in the best interests of 'family farmers' like us who make up the majority of Australian growers, or our rural communities which are vital for Australia's future, or for our national economy as Australia fights for survival in a world market economy dominated by much bigger players supported by government subsidies and more and more influenced by speculators completely out of our control. (R H & M J Billing, sub. 30, p. 1)

One grower considered that Australian wheat exports are in jeopardy:

We are 4<sup>th</sup> generation grain farmers on this property. We grow 4000 acres of crops each year and directly because of the deregulation of the single desk market we see no future in farming. Not one of the 'good' things the new marketing system was meant to provide has happened and we have slipped back to the 1930's before the wheat board was established.

Farmers have been sacrificed as pawns (single desk) for the governments suicidal Free Trade Agreements. Politicians did what the USA told them. Unless there is immediate action taken to rectify the damage you have done [to] the Australian Grain Industry it is doomed to only supply a small domestic market. (R & L Guest, sub. 1, p. 1)

A stronger view was expressed by Senator Fiona Nash at the public forum in Dubbo, New South Wales. In her view, wheat production in Australia could decrease to such an extent that it would become a food security issue of national significance.

A number of growers blamed the recent decrease in the price of wheat on the current arrangements:

- In just the short time that the Single Desk was scrapped the wheat has gone from profit to loss this year and next year it will be a lot lower in price. Don't just blame the world recession for this, we the farmer knew this would happen [and] that is why the Single Desk was brought in in the first place to stabilize the industry. When something was so good why interfere with it. (L L & S J Mattingly & Son, sub. 2, p. 1)
- How can the de-regulated system work, when you have 20 plus grain companies trying to secure markets for their wheat before they have actually purchased it? At this moment, most wheat harvested in Northern New South Wales has been warehoused or stored on farm. Most grain trading companies have offered a ridiculously low price at silos for this year's harvest, hoping to take advantage of growers needing early cash flow and also know that everyone will eventually have to sell. (Dalkeith Warialda, sub. 4, p. 1)

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- I disagree that we have benefited from deregulation. It appears that at least fifty dollars per ton went directly from our pockets to the pockets of grain traders immediately this occurred due to there being no floor in the market. (David Fox, sub. DR71, p. 1)
  - The light, or to many nil harvests, of the last two seasons with marketing and delivery incomplete have not been a true test of the deregulated marketing system. Even with this limited amount of wheat, growers have experienced large falls in price, some of which can be attributed to logistical problems experienced by both growers and exporters; eventually the total cost of these things will all be passed back to growers. (Rod Hatty, sub. DR72, p. 1)

Other growers are concerned about the pressures for structural change arising from a more competitive export marketing environment:

- We were among the farmers who felt strongly about the need to retain the single desk, orderly marketing system. Although this ‘brave new world’ is welcomed by some it puts pressure on our business and families as there is not enough time to attend to all that one must, is required to and would like to within the farm let alone a life ‘after hours’. (Pike Family Trust, sub. 18, p. 1)
- I am a mixed farmer from southern NSW. I was and still am a supporter of a single desk system. I’ve stored a lot of my grain this year only to find prices going down. How am I supposed to find the time to market my grain and run my farming business successfully. I’m not big enough to spend too much time on computers doing research etc. This was done for me by AWB as a single desk organiser. (J & C Lloyd, sub. 56, p. 1)

Grower concerns about the impact of the new arrangements were particularly concentrated in New South Wales, as indicated by the NSW Farmers Association’s call for a return to a national pool run as a grower cooperative (sub. 49). Growers at the Dubbo Forum also supported a return to a national wheat marketing system, suggesting that true competition does not exist under deregulation.

This was also a sentiment supported by a member of the Parliament of Australia from the Riverina region:

It is the view of the majority of growers I represent that the current operation of the [*Wheat Export Marketing*] Act and the new marketing system is seriously flawed, and it is ineffective in achieving higher returns for growers. (Kay Hull MP, sub. 36, p. 1)

Other participants were more equivocal and considered it too soon to make a judgment. The Western Australia Farmers Federation stated:

WAFarmers believes that if the national single desk had evolved to meet changing conditions and operated regional pools, it was the preferred option for the majority of Western Australian wheat producers and that there is insufficient data to evaluate any potential benefits of deregulation at this point in time. (sub. 29, p. 16)

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Trevor Badger, from Western Australia, also noted:

Deregulation has given me more options but I don't believe the net result is measurable. (sub. 14, p. 5)

On the other hand, others have accepted the changes and are getting on with business, as noted by J & M Hassell:

While some still hanker for the single desk the fact is we have to move on. (sub. 13, p. 3)

A number of market participants, including growers and traders, are positive about the removal of the single desk:

- I welcome a deregulated wheat export market, as last season Australian wheat was sold into several new markets it had not been sold into for many years and growers had the choice of several marketers to know the true World price for their wheat. (Ronland Nominees, sub. 15, p. 1)
- In spite of having some wins and losses since deregulation I am significantly ahead of where I would be with a continuation of the regulated market. It is just unfortunate that deregulation coincided with a world over supply of wheat, and increased production in Australia causing significant falls in prices, which some would try to infer were as a result of deregulation. (Angus Macneil, sub. DR58, p. 2)
- All market participants, apart from AWB Limited, have benefited from the removal of the bulk wheat export monopoly 'single desk'. Removal of the single desk has allowed up to 20 organisations to participate in the bulk wheat export market. This in turn has precipitated a more active and robust market for the purchase of wheat from grain growers in all regions. (GrainCorp, sub. 43, p. 4)
- The Australian Grain Exporters Association (AGEA) welcomed the new wheat export marketing arrangements (WEMA) that came into force in July 2008 and enabled the introduction of competition into the Australian wheat market. ... The Australian wheat market has matured and grower skills and understanding of markets have developed so that the vast majority are now comfortable operating in a competitive market. ... In the first year of deregulated export wheat marketing, the Australian grains industry has shown its ability to respond to change and embrace the opportunities of a contestable market environment. The new marketing era has been a success and has enabled large volumes of Australian wheat to continue to be shipped in both bulk and containers. (Australian Grain Exporters Association, sub. 28, p. 1)

Furthermore, a number of growers support complete deregulation of the market:

- Broadly I have major concerns in regard to the current Wheat Export Marketing Arrangements and basically believe that the post deregulation phase relating to Australia's wheat exports has reached a point where regulation should be kept at an absolute minimum. Why do we have relatively onerous regulations relating to

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wheat exports which are not imposed on other grains (barley/canola) or other industries (coal/iron ore)? (A D & S E Duncan, sub. 8, p. 1)

- We are pleased that now there is many avenues to export our grain but are concerned that due to over regulation the cost of the accreditation process to exporters for wheat are being directly past on to growers who are operating on marginal returns and are focused on minimizing cost where possible. (P D Lynch & Co, sub. 37, p. 1)
- I am a wheat grower from Barmedman, cropping 10 000 ac each year, about 60% of it wheat. I am opposed to the single desk and support complete deregulation, the quicker the better. (David Trebeck, sub. 50, attachment A, p. 1)

Other participants were concerned that the benefits of deregulation are not being fully realised. The South Australian Farmers Federation noted:

SAFF Grains support deregulation. However the benefits of deregulation are not happening in South Australia because of the control of the supply chain by Viterra. Other participants are not willing to buy grain in South Australia because of the increased risks such as the high penalties for cancelling shipping, restrictions within the shipping stem, and high storage and handling charges. (sub. DR64, p. 2)

Kim Halbert also noted:

The deregulation of the export wheat market has given growers many new opportunities to market their grain. However, these opportunities and future industry innovations could be substantially compromised by the three major Australian bulk handlers (and port operators). This was also a concern of the Federal Government as the Minister for Agriculture Fisheries and Forests, Tony Burke in his second reading speech to the *Wheat Export Marketing Act 2008* said ‘One of the concerns identified during consultation was the risk of a single wheat export monopoly being replaced by three regional monopolies.’ (sub. DR88, p. 1)

The Pastoralists and Graziers Association of Western Australia stated:

The path of deregulating and rationalising the wheat industry in Australia is progressing, and in general, PGA is pleased with the progress. We as an industry are still working through the remnants of the regulated wheat export markets of our past, and hopefully, within the next three years, we will easily arrive at a fully de-regulated and competitive market. Until then, we must be vigilant that those remnants of the past do not cause us to be pulled backwards instead of moving strongly and competitively into the future. (sub. DR81, p. 6)

In a number of submissions, concerns were raised that the export price was not a true reflection of the value of wheat, as foreign governments subsidise their farmers:

- Grain trading is now done wholly off the world market, which is not unfair, but the world market does not reflect the cost of wheat or its value as most of it is produced by farmers in heavily subsidised countries so this wheat does not reflect the true cost of production. (Ilestyle, sub. 9, p. 2)

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- The poor prices cannot be blamed on export parity as that is not a true price as the grain from other countries are subsidised by governments who care about their farmers. NOT LIKE OUR GOVERNMENTS (Liberal and Labour). (R & L Guest, sub. 6, p. 1)

Many countries subsidise their wheat growers and this makes it more difficult for Australian farmers to compete. Although Australia is a medium sized player in the world export market, it is not sufficiently large to alter the world price for wheat, with or without a single desk. Australia contributes on average only 3 per cent of world wheat production, or 12 per cent of world trade in wheat (chapter 2, figure 2.3). Any attempt to raise the price of Australian wheat is likely to lead to our international customers switching to other lower priced imports.

The Australian Government takes up issues relating to policies distorting international trade in agricultural commodities. The Department of Foreign Affairs and Trade recognises these distortions:

Globally, agricultural trade is the most distorted sector of trade in goods. It is characterised by very high tariffs and high levels of government support to primary producers. ... Export subsidies, the most trade-distorting form of subsidies, are tolerated in the agricultural sector – in contrast to other sectors, such as manufacturing, where they have long since been prohibited. ... The Australian Government is working hard through the WTO to make global agricultural trade fairer. (DFAT 2010)

Australian farmers, particularly grain growers, are resilient and resourceful and have a proven track record of adjusting to international market developments and domestic cost pressures (so-called declining terms of trade) by improving their productivity. This can mean short-term pain for some, but will deliver long-term gains in the form of a competitive and efficient wheat export industry.

The changes taking place in the wheat industry as a consequence of the current export marketing arrangements are likely to lead to productivity improvements in wheat growing, marketing, and transport and storage, allowing the Australian wheat industry to thrive in a highly competitive international market. However, along with this will come structural change within the industry (box 3.2), as has been happening over many years, even with the single desk in place. For example, Alexander and Kokic (2005) observed that the number of grain farms in Australia declined by over 40 per cent between 1977-78 and 2003-04 and average area operated per farm increased by 50 per cent.

The cycles and the level of the price of export wheat are attributable to international factors beyond Australia's control and to movements in the Australian exchange rate, and as illustrated in the next section, not the introduction of the current export marketing arrangements.

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### **Box 3.2 Structural adjustment in the wheat export industry**

As China and India continue to develop in the future, demand for minerals and energy will increase. This will put pressure on the wheat export industry, and indeed other Australian export industries.

Henry (2010) discussed the opportunities and challenges associated with a mining sector boom and described the net outcome as a ‘three speed economy’:

1. The mining and mining-related sectors grow strongly.
2. Other trade exposed sectors (including the wheat export industry) grow more slowly.
3. Non-traded sectors grow at a rate somewhere between those two.

As demand for minerals and energy increases and the world price of those commodities rises, those sectors will expand production capacity, thereby using more labour, capital and intermediate inputs. This will increase the price of Australia’s (largely) fixed factor, namely labour. At the same time the exchange rate will appreciate.

For export industries that do not experience a similar increase in demand (including wheat), input prices are going to rise more than the export prices (a deterioration of their terms of trade). This will create pressure for structural change and productivity improvement.

Having a productive and efficient wheat industry that can adapt to the economic environment is paramount for the performance of the industry. Preserving inefficiencies in the logistics supply chain will impede structural change in the industry.

The pressure will be on all exported agricultural commodities, not just wheat. Manipulating wheat export marketing arrangements to try to ease the adjustments that farmers must inevitably face will be unsuccessful in fostering the long term success of the industry.

## **3.2 Key drivers of the price of export wheat and its variability over time**

There is variability over time in the price of Australia’s export wheat, principally reflecting three factors:

- variability in the international market price of wheat over time, which in turn is affected by global demand, production and stocks
- variations over time in the Australian exchange rate
- variations over time, and geographically, in international shipping rates, which changes the relative costs of Australia and its competitors in delivering wheat into regional markets supplied by Australia.

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Typically, the international or world price of wheat is examined by reference to the futures contracts traded on the Chicago Board of Trade (CBOT) and the spot prices of US Soft Red Winter (SRW) and Hard Red Winter (HRW) wheats at the Gulf. For Australia, the CBOT December (and sometimes March) futures price is considered relevant because it is an indication of the world price of wheat at the time of the Australian harvest (and close to the principal selling period). In Australia, the Australian Securities Exchange (ASX) operates futures markets for Australian Milling Wheat (AWM) and Western Australia Wheat (WAW).<sup>1</sup> For a description of futures markets see appendix B.

In the following examples the world price is sometimes based on information for CBOT futures prices, and other times is based on information for US spot prices at the Gulf, depending on the data source.

### **International price of wheat**

Wheat is a readily tradeable and storable commodity and can easily be blended. These attributes mean that the world price (and consequently the price of Australian wheat) reflects the overall situation in the international market place with respect to demand, supply and stocks in storage. As the World Bank recently noted:

To interpret the asymmetric and episodic behaviour of grain market prices, and identify the causes of high volatility, it is crucial to understand the relation between prices, consumption and stocks. Accumulation of stocks when price is low can prevent steep price slumps. Disposal of these stocks when price is higher can smooth price spikes, but only so long as stocks are available. In a competitive market, short hedgers perform these functions, holding carryover stocks when the expected price covers the cost of storage and interest. Futures markets encourage storage by short hedgers by facilitating the transfer of price risk to long hedgers (such as grain users) or long speculators, and protecting all participants from counterparty risk. (Wright 2009, p. iv)

The recent spike (2007-08) in the price of Australian wheat (a short-term increase in the price of wheat of at least 150 per cent) (figure 3.1) was a direct result of shocks to the global demand and supply situation, which led to a rundown in global wheat stocks. The World Bank (Wright 2009) has identified a number of factors contributing to the high price of wheat in 2007 and 2008, outlined below:

- sustained rapid increase in income in many countries, including China and India, which increased the demand for wheat (and other grains)

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<sup>1</sup> ASX code AWM (GTA standard APW2, NSW track Newcastle and Port Kembla) and ASX code WAW (GTA standard APW2, track Kwinana).

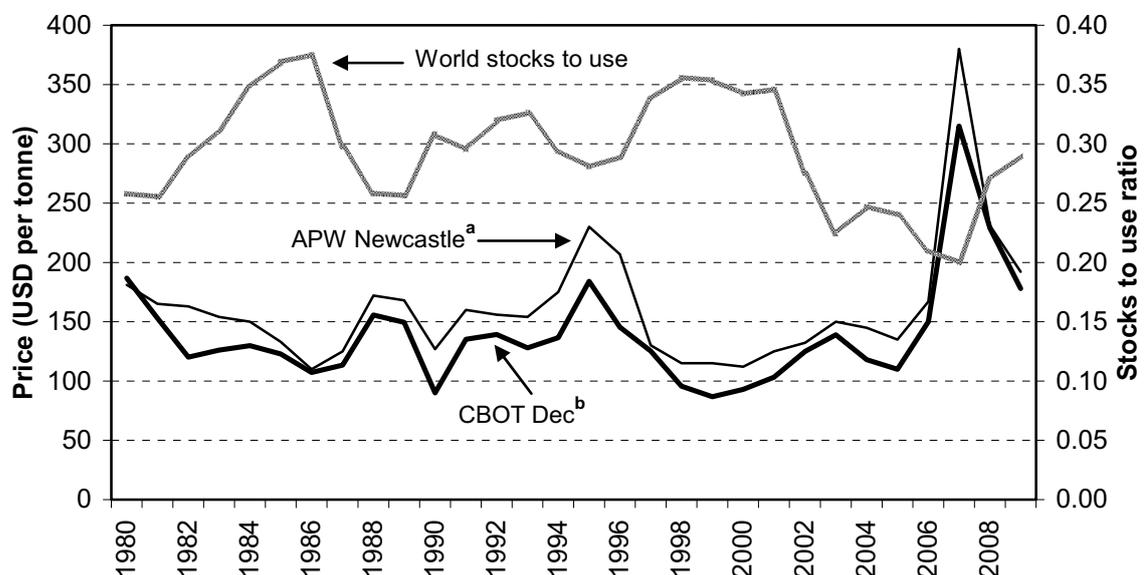
- an unexpected increase in biofuel production, induced by a spike in oil prices and government policies (subsidies) for biofuel production
- reduction in supply attributable to the prolonged drought in Australia and supply problems in other countries
- increases in international shipping rates
- exchange rate movements.

The net effect of these factors was a progressive tightening of the aggregate supply-demand balance, reduced stocks and higher prices.

A combination of the global financial crisis, reduced global demand, increased supply from Australia and other producing countries, lower transport costs and the accumulation of world wheat stocks has returned world wheat prices back to their long-term trend.

Wheat price cycles over time are common, as indicated in figure 3.1, and these can be expected to occur in the future.

Figure 3.1 **Wheat prices and the ratio of world stocks to use**



<sup>a</sup> Price of wheat futures contracts for AWM traded on the ASX, converted to US dollars. <sup>b</sup> Price of December wheat futures contracts traded on the CBOT.

Source: WEA (2009f).

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## Exchange rate

Another major factor influencing the price of Australian wheat (fob<sup>2</sup>) in Australian dollars is the exchange rate. The impact of movements in both the world price of wheat and the exchange rate are illustrated in figure 3.2.

In US dollar (USD) terms, the prices of Australian Premium White (APW) and US HRW wheat are highly correlated (the correlation coefficient between them is 0.95). The movement in the USD price of APW is closely linked to movements in the world price of wheat (figure 3.2, panel A).

However, movement in Australia's exchange rate impacts on the price received in Australian dollars (AUD), which is evident by examining the wheat price in figure 3.2, after about mid-2008. In the second half of 2008, the world price of wheat (and the export price of Australian wheat in USD) decreased markedly from its peak (panel A). At the same time, the Australian dollar depreciated against the US dollar, which helped to cushion the decrease in the AUD price of exported wheat (panel B). Since the beginning of 2009, the world wheat price has remained relatively stable, albeit at a lower price. However, the Australian dollar has appreciated, leading to a fall in the price of wheat in AUD. The strength of the Australian dollar for much of the 2009-10 marketing season has been particularly hurting farmers, at a time when world wheat prices have returned to lower levels.

### FINDING 3.1

*The key drivers of the export price of wheat (and the recent commodity price cycle) are:*

- *the global demand for, and supply and stocks of, wheat*
- *the exchange rate*
- *relative transport costs from Australia (and other exporting countries) to export markets.*

### FINDING 3.2

*The transitional period of the current wheat export marketing arrangements has coincided with:*

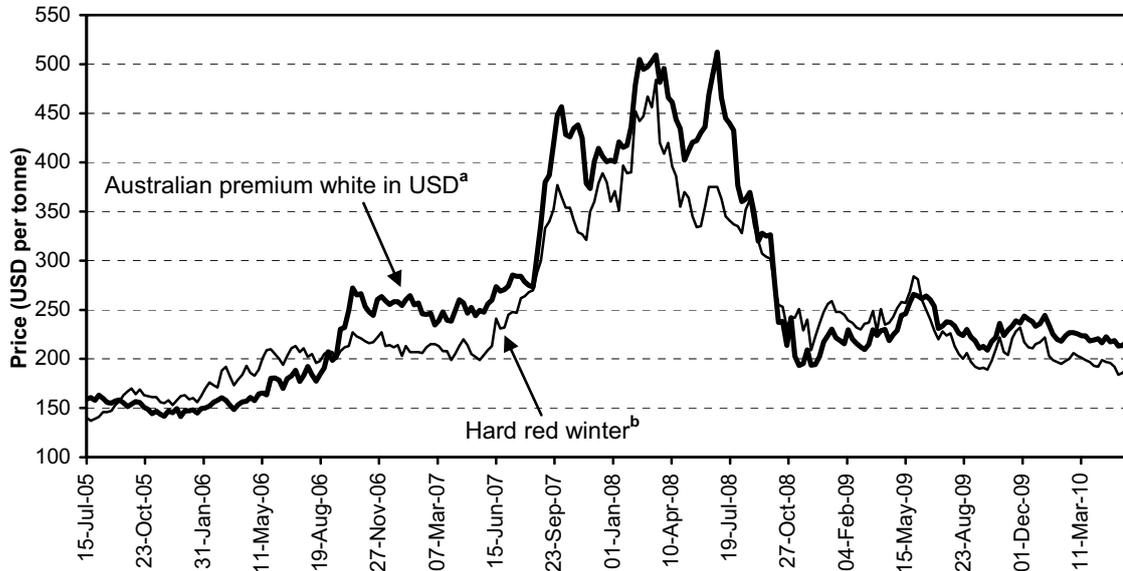
- *a pronounced commodity price cycle associated with a short-term increase in the price of wheat of at least 150 per cent just prior to deregulation*
- *the global financial crisis*
- *large movements in the exchange rate.*

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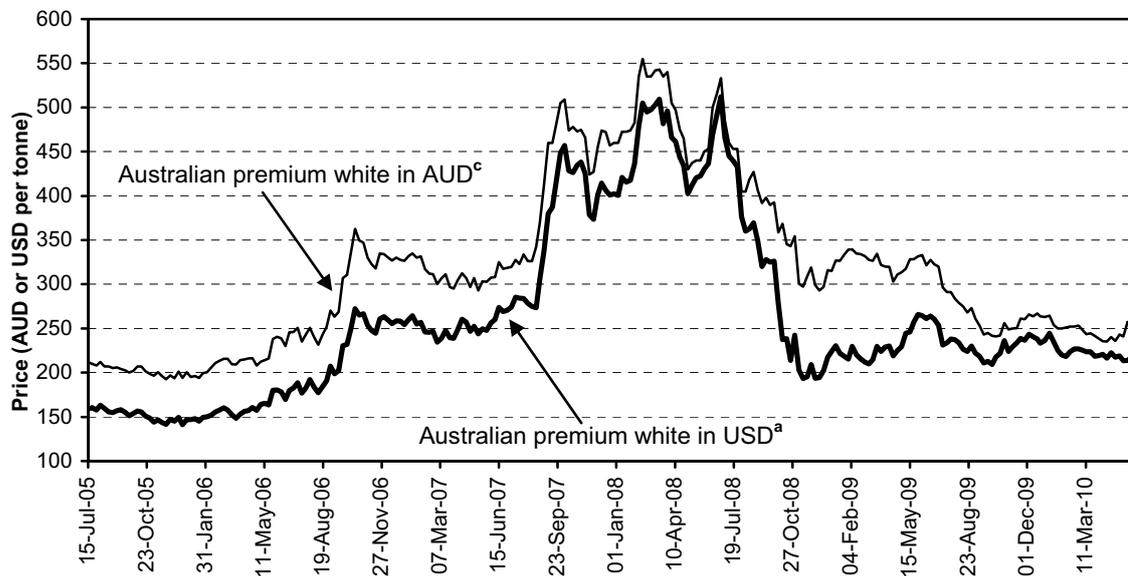
<sup>2</sup> Fob price is the world price less shipping costs in AUD.

Figure 3.2 **Effects of world prices and exchange rate on Australian wheat prices (eastern states)**

Panel A: Australian and US wheat prices in USD



Panel B: Australian wheat price in AUD and USD



**a** Price of wheat futures contracts for AWM traded on the ASX converted to fob and USD. **b** Price of HRW wheat in the United States, fob in the Gulf. The price of this wheat exported fob from the Gulf is considered a good benchmark for Australian APW. **c** Price of AWM contracts in Australian dollars converted to fob.

Source: Lloyd George, AgIntel, pers. comm., 28 May 2010.

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## Local factors affecting prices to growers

As discussed above, the export price of Australian wheat predominantly reflects the international wheat market and shipping costs. However, other factors also have an impact. One factor is the quality characteristics of the wheat harvested. There are differences in prices between grades of wheat, for example, by bin grade. Although the prices of these grades are different, the direction of movement is highly correlated with the world price. However, the average price received for wheat exports can vary because of variation in the composition (or relative volumes) of the grades of wheat.

Another factor that can impact on the price of wheat at the farm gate is the cost of transport, handling and storage from the farm gate to the ship for export. In addition, the ability of, and cost of, being able to sell and physically export wheat at times when the world price for wheat is favourable can also impact on the price received. On-farm storage is playing an increasingly important role here. These issues are considered in chapters 5 (ports) and 6 (transport, storage and handling).

AWB Limited (AWB) recognised regional differences in its submission to the inquiry:

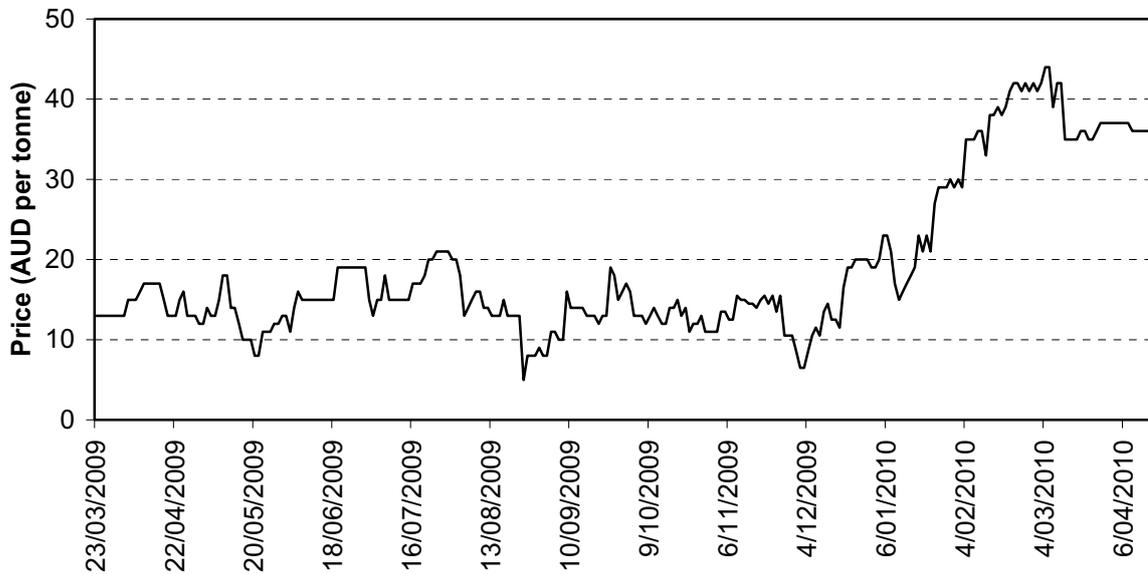
Wheat marketing in the East Coast has been more complex due to the more frequent occurrence of drought in recent years. This has led to greater price volatility and supply constraints for local and international buyers. However East Coast participants have the benefit of more local marketing options due to domestic demand, a greater number of intermediary participants (traders) and greater competition in the up country supply chain in many locations, existence of competition between road and rail, and in some areas, greater competition at port (Melbourne/Geelong/Port Kembla/Port Adelaide). Western Australia has benefited from more reliable 'in-season' rainfall over the last decade than the eastern states and closer proximity to most markets for Australian grain by sailing time. (sub. DR63, p. 2)

A comparison of wheat prices in South Australia and Western Australia for the 2009-10 season illustrates that variations in transport conditions can create differences in regional markets and prices. Figure 3.3 shows the difference between prices at Port Lincoln and Kwinana, as submitted by Elders Toepfer Grain.

The spread between Port Lincoln and Kwinana prices has increased recently. Although it is expected that Western Australian prices will be higher to reflect the shipping cost advantage over South Australia (discussed further below), other factors seem to be contributing to the price differences. The Australian Grain Exporters Association submitted that 'the spread is being caused by an "artificial" factor such as the [CBH] auction system [in Western Australia] and risk of losing

the non refundable fees (approximately AUD25.00 per tonne) associated with this' (sub. DR79, p. 14). This issue is discussed further in chapter 5, section 5.6.

Figure 3.3 **Difference between WA and SA prices<sup>a</sup>**



<sup>a</sup> The difference is ASW1 grower bids (average of multi grade and cash) at Fremantle less ASW1 grower bids at Port Lincoln.

Source: Elders Toepfer Grain, sub. DR94.

In the future, prices will continue to vary across states due to variations in supply (harvest), supply chain congestion and differences in transport conditions.

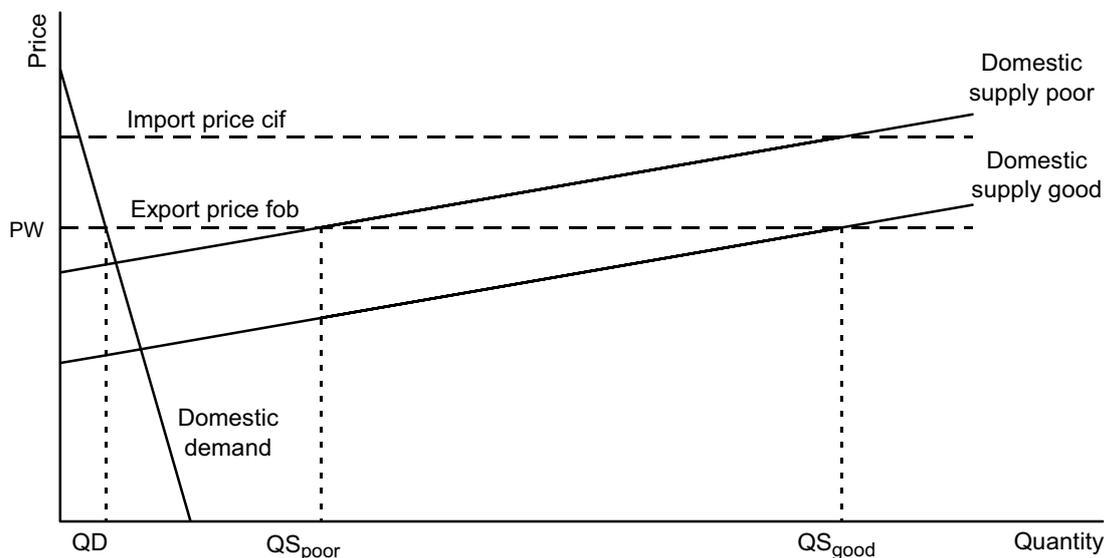
Differences in regional production and shipping costs are examined in the next section.

### **Some regional differences in the links between world and Australian export prices**

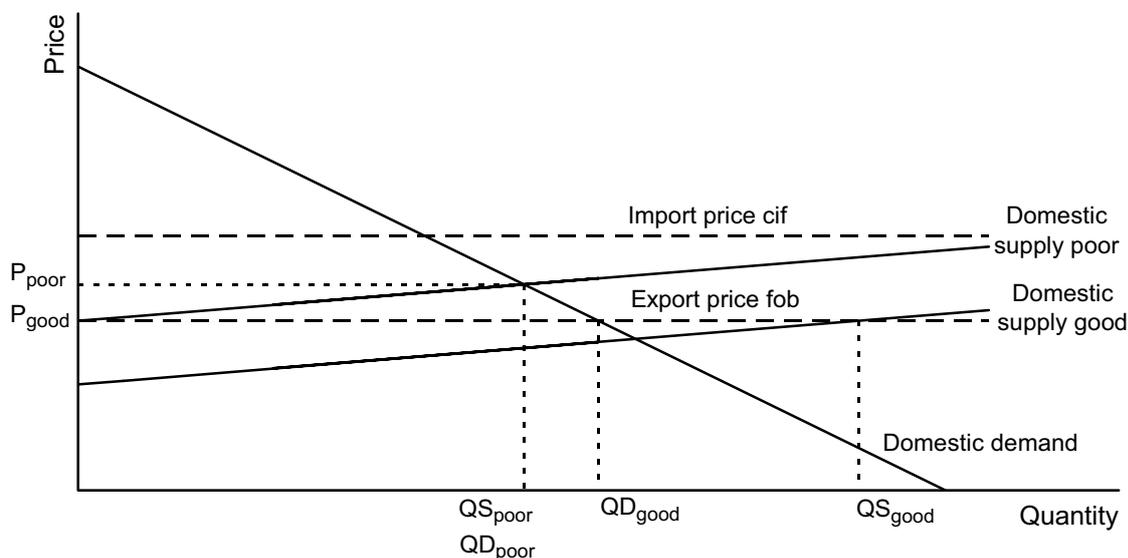
The links between domestic wheat prices in Australia and the world price vary regionally (essentially by state), reflecting differences in domestic regional wheat markets. In some regions, these relationships change over time, depending on the seasonal level of regional production. This is illustrated stylistically in figure 3.4, based on market attributes of Western Australia and New South Wales.

Figure 3.4 Links between domestic and international wheat prices

Panel A: Illustration of supply and demand conditions in WA



Panel B: Illustration of supply and demand conditions in NSW



In the case of Western Australia, the price received by growers is essentially driven by the price of export wheat (PW: export price fob). In that State, 90 per cent of wheat is exported. Even in a low production year (for example, due to drought) supply ( $QS_{poor}$ ) exceeds domestic demand (QD), and exports are  $QS_{poor}$  minus QD (panel A, figure 3.4). The price of wheat is determined by the international price (PW: export price fob). Changes in Western Australian supply, all else equal, have no impact on the price growers receive (such as moving from domestic supply poor

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to domestic supply good). It is simply the export volume that changes ( $QS_{\text{good}}$  minus  $QD$ ) because the price is determined by the world price ( $PW$ ) which is assumed to be unaffected by the change in the volume of exports from Western Australia.

The situation is different in other states, particularly New South Wales, Victoria and parts of South Australia (panel B). These states have much larger domestic markets relative to their production. In high production seasons, excess supply ( $QS_{\text{good}}$  minus  $QD_{\text{good}}$ ) is exported and the price of wheat (both for domestic use and export) is determined by the price of wheat for export ( $P_{\text{good}}$  equals export price fob).

In a low production season, it is possible that domestic supply is insufficient to meet domestic demand. In this situation, the price at which traders are willing to export wheat ( $P_{\text{poor}}$ ) rises above the world price (export price fob) and therefore no exports are made. In this situation, domestic demand ( $QD_{\text{poor}}$ ) equals domestic supply ( $QS_{\text{poor}}$ ) and no exports take place. The price rises above the export price because local users bid up the price to procure limited local supplies and import wheat from other nearby regions (Victoria or South Australia) at higher cost because of transport, but at a lower price than importing from other countries.

The rise and fall of the price of wheat in New South Wales relative to the export price is evident in figure 3.5. Focusing on panel A of figure 3.5, there is a gap between the price of APW (Newcastle) (in USD) and the world price for the 2006-07 harvest. This occurred because New South Wales had a drought and domestic supply was allocated fully to the domestic market (aside from a small volume of container trade) (figure 2.6 in chapter 2). The price of wheat in Western Australia continued to track the world price. The increase in the price of wheat in New South Wales relative to Western Australia (and indirectly the export price) is particularly evident in panel B of figure 3.5.

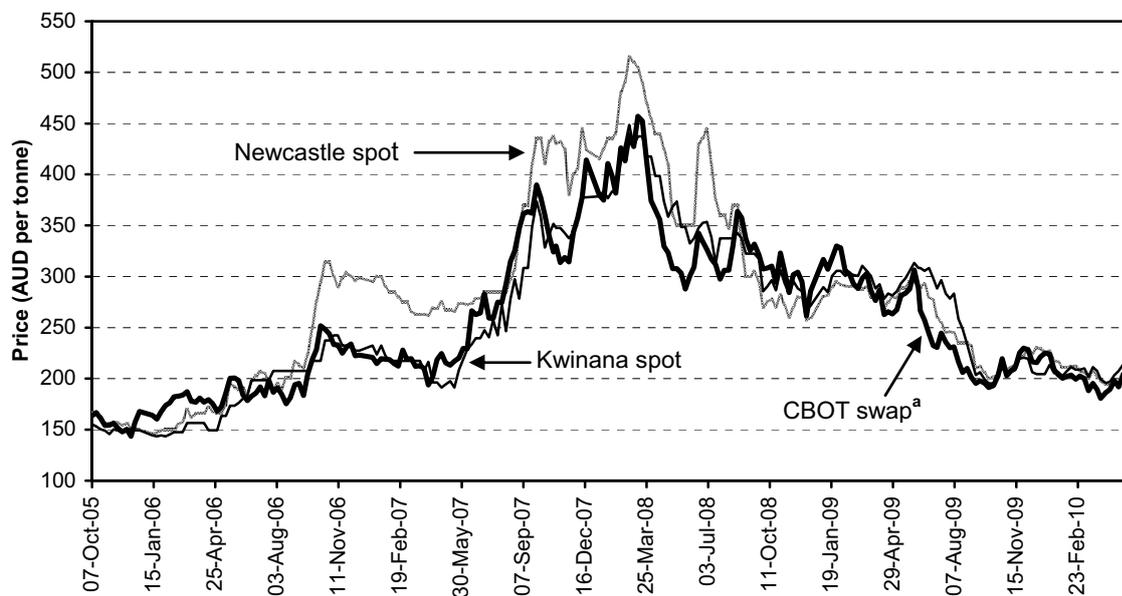
This can make managing risk associated with price volatility and production variability more complex in New South Wales, particularly early in the season when the status of the crop is unclear. Using risk management tools is more challenging without a suitable and liquid futures price market. Nevertheless, the fact that there is potential upside on the world export price for those in New South Wales could be considered a relative advantage over other states, where domestic demand is never a big enough factor to drive prices above the world export price.

FINDING 3.3

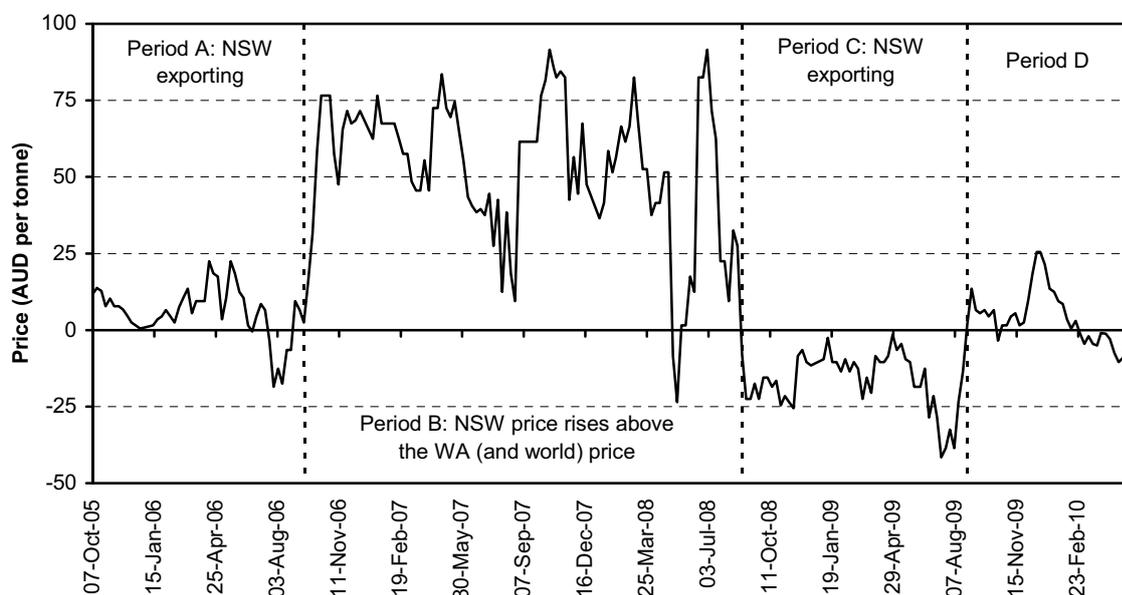
*The local wheat price in New South Wales rises above the export price in periods of low production. When local demand absorbs almost all local production, almost no wheat is exported and wheat is imported into New South Wales from other states.*

**Figure 3.5 Regional variations in the link between domestic prices and the world price**

**Panel A: Spot prices of APW in NSW and WA**



**Panel B: Difference between NSW and WA spot prices<sup>b</sup>**



<sup>a</sup> CBOT swap is the nearby futures price and is taken to be an indication of the spot price. <sup>b</sup> The difference is the spot price at Newcastle minus the spot price at Kwinana.

Source: Tom Basnett, AgRisk Management, pers. comm., 28 May 2010.

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Another factor that can differentially impact on the export price of wheat (fob) around Australia is the cost of freight to deliver wheat to international customers. The majority of Australia's wheat exports (94 per cent) go to Indonesia, other Asian countries, the Middle East and Africa (figure 2.8 in chapter 2), even bulk exports from New South Wales. Western Australia has a shipping cost advantage over the eastern states (New South Wales, Victoria and Queensland) because of its proximity to these export markets.

One consequence of removing the single desk operated by AWB (International) Limited (AWBI) has been to make these transport cost differentials between the east and west coasts more transparent and reflective of the actual transport cost. Although AWBI had a system of adjusting pool returns by port zone to reflect differences in port terminal and shipping costs, it was unclear whether these differentials reflected accurately the actual differences in costs (ACIL Tasman 2005). Western Australian growers have suspected that there was some cross-subsidisation in the compulsory national pool returns that shared the freight advantage of Western Australian growers with growers in the eastern states.

The WEA (2009b), some market analysts and some participants to the inquiry consider that these differentials have been revealed in changes to the relative prices of export wheat between Western Australia and the eastern states. The Pastoralists and Graziers Association of Western Australia stated:

Richard Koch has done a lot of work on this and his ProFarmer analysis regularly tracks the basis and it's quite a stunning chart actually. From the day that the applicants actually got licensed as to export, the basis in Western Australia improved dramatically. (trans., p. 57)

There is some limited evidence to support this outcome, drawing on the information in figure 3.5, panel B. The difficulty is that comparisons of Kwinana and Newcastle export prices to determine if prices in Western Australia reflect the freight advantage are only valid when wheat is being exported in the eastern states and the Newcastle price reflects the world price of wheat, as discussed above.

For the 2008-09 crop year (period C), there were exports of wheat from New South Wales. During the 2008-09 crop year, the Newcastle price was consistently below the Kwinana price. This is a change of the relativities from previous times when wheat was being exported from New South Wales, for example, for the harvest and marketing year of 2005-06 (period A). The difference in relative prices between period A and period C suggests that the price of export wheat (fob) in Western Australia improved relative to Newcastle. This could be an indication that transport cross-subsidies embedded in the single desk have been dismantled.

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For the 2009-10 crop year (period D), the expected trend, had the freight differential been evident, would have been for Western Australia to continue to have higher prices than New South Wales (as New South Wales was expected to export in that year). This did not occur early in the crop year. However, this could be because of concerns about wheat production in New South Wales, as noted by ABARE:

Expectations for winter crop production have fallen dramatically across most of the cropping regions of southern and central New South Wales as below average spring rainfall, warm temperatures and frosts in some areas reduced yields and caused crop losses. Rainfall in late November also raised concerns over grain quality for crops remaining to be harvested. Harvest has been completed in northern New South Wales and yields are expected to be higher than in other regions of the state. Although average September rainfall provided some relief to moisture stressed crops in southern New South Wales, lack of follow-up rain has ended in another disappointing season. Spring rainfall in the central-west was patchy, ranging from below average to very much below average, resulting in many later sown crops dependent on spring rainfall failing or producing lower than expected yields. (ABARE 2009b, p. 9)

These concerns about possible short supply of wheat in New South Wales led to a rise in the spot price in New South Wales relative to Western Australia as domestic users in New South Wales tried to secure suppliers. Most recently, post-harvest, there have been some exports of wheat out of New South Wales, and the price of wheat exported from Newcastle has eased relative to that from Kwinana.

### **Using the basis to interpret prices**

The concept of the basis is used widely to analyse wheat prices. A definition of the basis is provided in box 3.3. Caution is needed when using the basis to compare Australian wheat prices with those in the United States, using futures prices to calculate the basis.

Australian wheat most closely resembles US HRW wheat, which is traded on the Kansas City Board of Trade futures market. However, due to the higher volumes traded on the CBOT exchange, most Australian hedging occurs using contracts that are traded on the CBOT exchange. Although the CBOT wheat contract is technically designed to allow for delivery of SRW, HRW, Dark Northern Spring and Northern Spring wheat, the higher cash prices for the other classes of wheat relative to SRW make the delivery against the CBOT contract impractical for other classes (Aulerich, Hoffman and Plato 2009, p. 25). If the price of Australian wheat does not follow the CBOT futures price, volatility in the Australian basis will occur (for example, the situation in New South Wales described above). Furthermore, if there are problems occurring in the CBOT futures market, this too can distort the basis (discussed in section 3.4).

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### Box 3.3 What is the 'basis'?

The three components of the Australian price of wheat when using US futures prices are the spot price of Australian wheat being traded, the exchange rate and the basis of the relevant US futures contract. These can be analysed in terms of the futures price, exchange rate and the basis.

#### *Futures price*

Chicago Board of Trade futures are used as an important indicator for Australian wheat prices. The futures price will reflect a range of international factors such as global supply, demand and stocks.

#### *Exchange rate*

Australian wheat sold on the international market is commonly priced in USD. As a result, the exchange rate will influence the price received in AUD.

#### *Basis*

The basis is the difference between the spot market price of the grade of wheat being traded from Australia and the nearby futures contract price at any point in time prior to maturity of the wheat futures contract (for example, Soft Red Winter wheat on the Chicago Board of Trade). For example, if the futures price is \$220 and the spot price is \$200, then basis is \$20 under (-\$20). If the futures price is \$220 and the spot price is \$240, basis is \$20 over (+\$20). Basis also represents the portion of price risk that cannot be mitigated by hedging.

Generally, a futures contract is expected to trade at a premium to the spot price, reflecting the carrying-charge (cash and carry) theory of futures contracts. Over time, as the expiry date of the futures contract approaches, this gap is expected to diminish as the spot price and the futures contract price converge (carrying costs diminish). Fair value for a wheat futures contract is the current value of the commodity (current spot market price) plus the cost of carry. However, there are many factors that cause the actual price of a futures contract to vary from the theoretical fair value price.

The basis is also affected by a range of other factors, such as:

- differences between the characteristics (class and quality) of the wheat being hedged (grown by the farmer) and the characteristics of wheat specified in the futures contract
- local supply and demand conditions such as quality of wheat, availability and local weather, which impact differentially on the price of Australian wheat
- differences in, and changes in, domestic and international interest and storage costs and transport and handling costs.

The strengthening or weakening of the basis refers to a change in the relationship between the spot market price and the futures market. *It does not indicate the nature of the change in the price of wheat (spot market or futures market).*

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### 3.3 Growing and marketing wheat is a risky business

Growing and marketing wheat is a risky business and deregulation is making these risks more transparent to growers, traders and those in the transport, storage and handling supply chain. The sources of risk include:

- costs of production and yield at harvest risk
- price risk for wheat sold
- counterparty risk of dealing with parties in the supply chain and marketing.

#### Yield at harvest

Production risks relate to the variability that occurs with respect to the volume of grain produced (a function of yield and area sown), its quality (protein content, moisture content, screenings and foreign seeds), and the timing of the harvest.

Factors affecting production risk include:

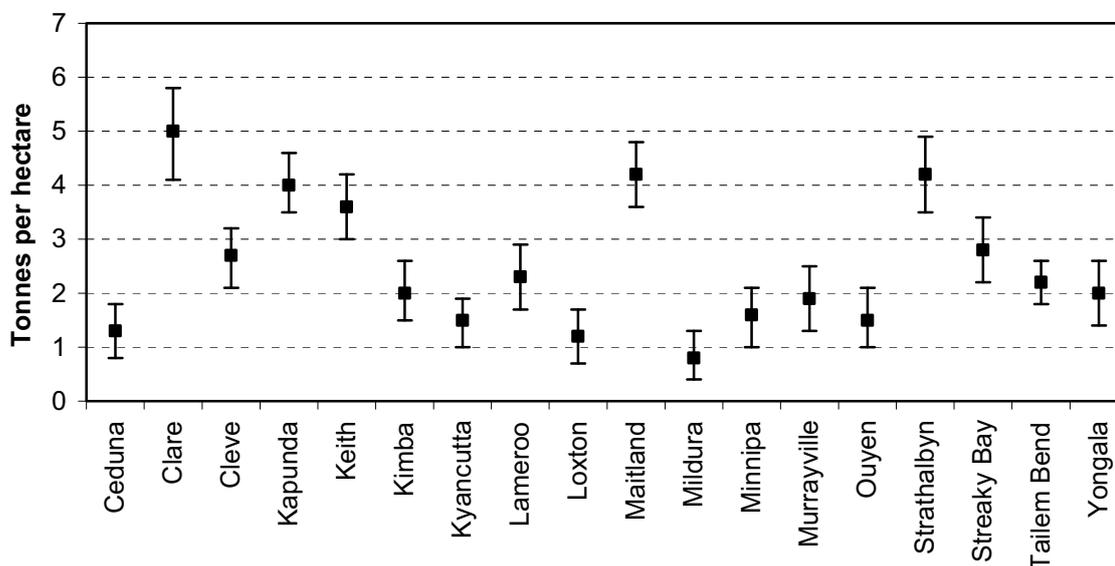
- variations in weather (rainfall, temperature, hail)
- pests, diseases and fire
- costs of key inputs such as fuel and fertiliser, and interest rates.

Figure 3.6 illustrates that expected yield and yield variability differ by region. This will have implications for decision making and risk management strategies across regions, as the underlying profitability of wheat growing varies for individual growers.

In Australia, production risk is a major source of risk for growers and this heavily influences the marketing decisions made by growers. Production risk can have important implications for the choice of strategies (and their financial consequences) used by growers to manage price risk. These are discussed in appendix B.

Crop insurance is available to help manage production risk. For example, insurance is available for fire and hail (peril insurance) and water stress (yield insurance).

Figure 3.6 **Theoretical yield variation<sup>a</sup> for sites in Victoria and South Australia**



<sup>a</sup> Derived from experimental field trials. Average yield and one standard deviation depicted.

Source: Darren Arney, pers. comm., 2010.

## Price risk

As illustrated in section 3.2, there is variability in the price growers receive for wheat.

Growers can manage production and price risk by diversifying across a number of crops or livestock activities, as illustrated in table 2.5 of chapter 2.

The current marketing arrangements have made the price risks associated with growing and marketing wheat more transparent to growers than they were under the compulsory national pool. In addition, there are many risk management products available to growers to manage their risks according to their personal preferences, as noted by GrainCorp:

... growers have access to more information about domestic and international grain markets than they have ever had. New products and services are also being made available that allows growers to better manage price risk and market volatility. In short, growers have a more diverse range of marketing options, price risk management tools and buyers from which to choose. Grower marketing alternatives are no longer constrained as they were under the export monopoly. This is particularly the case in regions where export grain dominates, such as South Australia and Western Australia. (sub. 43, p. 37)

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## Counterparty risk

This refers to the risk the grower faces from dealings with traders and transport and storage service providers. The main sources of risk here are related to:

- a trader defaulting on payment or going into liquidation after the grower has delivered grain to the trader
- transport and storage service providers being unable to deliver grain, either warehoused in bulk storage or stored on farm, for export at the time and location desired by the grower.

Although the wheat export accreditation scheme has afforded growers some comfort in dealing with accredited exporters (chapter 4), growers remain responsible and liable for managing their business dealings and need to undertake the appropriate due diligence. This is just as they would do for the other commercial transactions they enter into as part of operating a business.

## Marketing, pricing and managing risk

There are eight main methods growers can use to market and price their wheat (table 3.1). In practice, growers are likely to use a mix of these methods, reflecting:

- their risk preferences
- their production risk (expected yield and variation in yield) and exposure to crop failure
- their own assessment of current and future prices
- their need for cash flow and their level of debt
- the taxation implications of the timing of cash flow.

Growers might also decide to store grain at the time of harvest and defer marketing and pricing decisions until a later time.

To further manage price risk and counterparty risk, growers can diversify their choice of trader or financial institution in applying these methods. For example, a grower might place more business with a trader considered to be more reputable and financially secure.

These methods, and examples of how they are used to manage price risk, are described in appendix B. The next section will focus on issues raised in relation to these marketing tools.

**Table 3.1 Main methods used by growers to market and price wheat**

<i>Pricing strategies</i>	<i>Decision maker<sup>a</sup></i>	<i>Requires physical delivery of wheat</i>	<i>Pre-harvest</i>	<i>Harvest and post-harvest</i>
Spot market	Grower	Yes	No	Yes
Forward contract	Grower	Yes	Yes	Yes
Pools (commitment)	Pool manager	Yes	Yes	Yes
Pools (harvest)	Pool manager	Yes	No	Yes
Futures contract	Grower	No	Yes	Yes
Options (put)	Grower	No	Yes	Yes
Swaps	Grower	No	Yes	Yes
Basis contracts	Grower	Yes and no <sup>b</sup>	Yes	Yes

<sup>a</sup> Growers might use marketing advisers and futures advisers and brokers to assist them in their decision making. <sup>b</sup> Basis contracts essentially become forward contracts requiring delivery once the basis component is locked in.

Sources: Based on Stevenson and Sims (2008) and GRDC (2008a).

### **3.4 Issues raised about marketing, pricing and managing risk**

There are more choices and more complexity in marketing and pricing wheat than ever before. The market is still adjusting, and new products are emerging in response to market demands.

#### **Costs and complexity of marketing and pricing tools**

Some participants have expressed concern about the costs and complexity of these risk management tools:

- With deregulation the AWB stopped forward selling of grain. The Banks and Marketers flooded the market with a plethora of ‘Risk Management Tools’. The volatility that ensued in the grain markets defied understanding. Exposure to these markets has had a devastating effect on many farm operations. Australian farmers are purportedly the most efficient in the world, they are good at growing product, for many having to enter the marketing side has been difficult. (M B Scott, sub. 10, p. 1)
- These [costs of transition] have been considerable both financial and in time. I know I spend time every day studying the markets and prices. I have had consultants offer to perform the service for me but all offers have been at more than \$1 per tonne and with no guarantee that they could outperform me. These costs are hard to justify on a year like this where the enterprise will run at a loss. (Trevor Badger, sub. 14, p. 5)
- Smaller growers often don’t have the resources to invest in marketing strategies and certainly don’t have the same economy of scale. Having said that, there is no reason

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why a small grower can't achieve a similar price to a large grower via a trader. In terms of being able to export direct, obviously larger production is required. (AgForce Grains, sub. 16, p. 16)

It needs to be acknowledged that there are transaction costs associated with managing marketing and price risk, and fees (or price discounts) if the price risk is being transferred to another party. As illustrated in chapter 2 (table 2.3), there are a large number of growers that produce small quantities of wheat. For some growers, the time, effort and cost of using some of the more sophisticated marketing tools might be large relative to the value of the wheat they are selling.

If the transaction costs associated with the more sophisticated methods are too high for growers, then they may choose other options such as the spot market or pools. In pools the grower lets the pool manager decide how to market the wheat and manage price risk for the wheat sold through the pool.

Additionally, small growers tend to be diversified across a number of crops or livestock activities (chapter 2, table 2.5). This diversification is a way of managing production and price risk, and hence the need for sophisticated marketing tools is reduced.

In contrast, growers who produce large quantities of wheat (and account for most wheat exports) tend to be more specialised than smaller growers and hence more reliant on income from wheat.

Although pools are convenient, care is needed in assessing whether they are likely to return the grower the best return for the crop compared with the other marketing and risk management tools available. The grower is still indirectly incurring costs for marketing and price risk management through the management fees and charges deducted from the pool return by the pool manager (as was the case under the compulsory national pool).

## **Issues regarding pools**

Pools embody a range of services such as marketing wheat, managing price and exchange rate risk, as well as transport. Pools provide a mix of what are essentially marketing and financial services and they vary in terms of risk management strategies, accuracy of estimated returns, cash flow and tax implications, supply chain costs, management fees and payment systems (table B.1 in appendix B) and costs of administration.

An issue with pools is an understanding by growers of the performance of pools in marketing (finding buyers) and price risk management through hedging. A key to

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this is the transparency and information disclosure by pool managers. During the Adelaide hearing, the South Australian Farmers Federation expressed concern about the risk of pools:

The other position that we see that may have a place for ASIC or the Productivity Commission or someone is the financial services in regard to pools, because I think there is a very large degree of risk. Unfortunately, I don't believe a lot of growers understand how much risk is attached to pools. (trans., p. 299)

Pools do have commercial risks. Under the current wheat export arrangements there have been no export wheat pools that have failed commercially. However, in the past, there have been a number of domestic wheat pools that have failed, including Shepherds Producers Cooperative, Creasy's Grain Enterprises and Barry Smith Grains.

A range of issues relating to the performance of pools are described below.

These areas for performance evaluation were also relevant when considering the national pool run by AWBI. However, if AWBI underperformed, there were few other export options for growers. Under the current arrangements, growers can choose other pools, or use other marketing methods.

#### *Hedging on wheat prices and forward contracting*

Pool operators will generally undertake some hedging and forward contracting in order to manage price risk.

In the days of AWBI having the single desk, the pool was operated as a harvest pool. Growers delivered their wheat at harvest time. AWBI was able to undertake pre-harvest selling or hedging because it knew from crop production forecasts approximately how much wheat it could expect to sell, as growers had to deliver their wheat for export to AWBI.

Harvest pools are still being operated in 2010. They differ significantly from the traditional harvest pool under the single desk in that they do little pre-harvest hedging. Operators of harvest pools have no way of knowing how much production will go into the pool and are therefore limited in their ability to hedge.

To overcome the pre-harvest hedging limitation of harvest pools, pool managers are also offering commitment pools. In these pools, growers contract prior to harvest (several months) to deliver a specified amount of wheat of a specified quality to the pool. In most cases, the contracted quantity can be exceeded by up to 50 per cent. These pre-harvest contracts might pay a premium to the grower over the average pool price, to reward the grower for that commitment. Contracting pre-harvest

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enables the pool manager to estimate the minimum amount of wheat that is likely to be delivered into the pool, allowing it to start pre-selling grain and hedging prior to harvest.

The scope for hedging will differ significantly across pools, as will the performance of different pool managers over time.

AWBI's mixed performance on commodity hedging illustrates this issue. For example, WEA considered that hedging for the 2006-07 national pool was unfavourable when compared to benchmarks:

AWBI's commodity hedging performance for the 2006/07 Pool resulted in a reduction of AUD145 million or AUD46.03 per tonne in Pool returns. This loss compares unfavourably with both the SPFM benchmark and the WIB commodity hedging sub-benchmark.<sup>3</sup> (WEA 2009e, p. 10)

But WEA considered AWBI's hedging performance to be favourable in 2007-08:

AWBI's commodity hedging performance for the 2007/08 Pool resulted in a reduction of AUD40.36 million or AUD9.25 per tonne in Pool returns. This compares favourably to the SPFM benchmark's loss of AUD38.16 per tonne. (WEA 2009e, p. 10)

### *Hedging on the exchange rate*

As described above, the exchange rate is a major factor influencing the price of Australian wheat in Australian dollars. As the exchange rate is volatile, pool operators will hedge on the exchange rate in order to reduce price risk. Once again, growers selling wheat through pools need to be cognisant of this risk exposure.

### *Provision of pool services*

Another issue about pools is the scope for pool managers to make profits through their provision of services to the pool by contracting out services (for example,

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<sup>3</sup> The SPFM benchmark assumes that the wheat marketer commences hedging the crop prior to harvest on a gradual and consistent basis until harvest, when 50 per cent of the crop is hedged. Once 50 per cent of the crop is hedged, the marketer is assumed to buy back its hedging positions on a gradual basis as physical wheat sales are made, regardless of any movement in wheat prices and crop size during the pool period (WEA 2009e). The WIB commodity hedging sub-benchmark compares actual USD prices achieved for the pool with an average price achievable using a basket of comparable international wheat grades. The benchmark incorporates an assessment of actual commodity hedge returns from participation on the US futures markets relative to a benchmark commodity hedge program in those same markets (Wheat Export Authority 2007c).

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transport, marketing, hedging, shipping) to related entities. This might disadvantage the pool due to a lack of competition in the provision of these services.

For example, under the single desk arrangement, AWB Chartering provided chartering services to AWBI, despite the existence of an external market for such services. WEA reported on these arrangements and found:

AWBC [AWB Chartering] rates were consistently higher than industry spot rates. Of the 45 cargoes [in the period July 2007 to December 2008], AWBI was better off using AWBC in one case and achieved the same rate in another. ... AWBI and the Pool have been commercially disadvantaged by AWBC exclusively providing chartering services to the Pool. (WEA, 2009e, pp. 13–14)

### *Transparency of pools*

Understanding the performance of pools is not straightforward. Comparing pool returns is further complicated by the different payment options available (table B.1, appendix B).

Under current legislation, companies offering pools are granted general relief by the Australian Securities and Investments Commission (ASIC) from the managed investment scheme provisions of the *Corporations Act 2001* (Cwlth), including product disclosure and licensing provisions, subject to conditions. This is a general class order for managed investment schemes not for money, and it would therefore apply to all agricultural commodity pools.

ASIC has previously granted relief for a small number of intermediaries involved in commodity pools. ASIC considered that in these cases the general class order did not apply ‘because they did not produce the goods involved in the transaction’ (ASIC 2007). As ASIC (2007) noted this relief was granted because:

- compliance was disproportionately burdensome taking into account:
  - other persons involved in the transaction having the benefit of relief
  - the short duration of the transaction
- the likelihood and extent of potential consumer detriment was minimal.

AWB was granted specific exemption from sections of the Corporations Act in 2003. Other pool managers have also been granted specific exemption since then.

The issue of transparency was previously raised in submissions to the Wheat Industry Expert Group in 2008. For example, the Victorian Farmers Federation (2008) suggested an industry initiative be introduced to improve pricing transparency by using standard information sheets.

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Bartholomaeus noted:

... in the absence of broad industry agreement and self regulation on this issue, that the existing FSR [Financial Services Reform] Act, and the government's proposed truth in pricing legislation should be used in full to tighten up the grain industry and the way it quotes pools. (Bartholomaeus 2008, p. 6)

Koch suggested the following areas where pool managers could improve their performance and transparency:

- better articulate their strategy
- co-ordinate release of estimates
- industry standards for the calculation of estimates/costs
- make it easier to assess performance (statements on pool entry/exit, quarterly updates)
- state pool size
- adopt an industry auditor (someone who understands how grain pools work and can spread best practice across the industry). (Koch 2009)

AWB (sub. DR63, p. 3) noted '[t]he Australian grains industry would benefit from pool operator guidelines to enhance and promote further transparency in the industry.' AWB identified the following key areas for improving transparency:

- clearly defined strategy and objectives
- regular and timely pool reporting
- segregation and separation of pool assets
- independent scrutiny of pool accounts. (sub. DR63, p. 3)

Glencore Grain submitted there is a need 'for unit or consistent pricing, both for pool prices and prices offered by traders, so that growers can fairly compare prices' (sub. DR89, p. 13), and suggested this be included in the *Wheat Export Marketing Act 2008* (Cwlth) or the *Wheat Export Accreditation Scheme 2008* (Cwlth). Further, Glencore Grain considered 'that Wheat Exports Australia should be retained to continue to monitor wheat pools and pool prices' (sub. DR89, p. 14). WEA currently has the capacity to monitor pools under its general information gathering powers, and has exercised this power on one occasion.

Co-operative Bulk Handling (CBH) agreed with the sentiment that pool transparency could be improved, but suggested that regulatory oversight is not needed to achieve this:

... increased transparency need not be mandated solely by formal regulatory oversight of pools. Rather 'industry experts' such as marketing consultants, with skill in comparing pool performance are growing in number and can be utilised by growers for

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this purpose. ... Growers will readily work out who they can 'trust' and who they can't. This is no different to any other market where credibility and reputation become important. Regulation on its own will not protect growers or enhance their returns in a responsible manner ... If pool providers act contrary to the interests of the pool participants the use of pools by growers is destined to shrink as they will lose credibility as an alternative to taking a fixed cash price on the day. (sub. DR75, p. 2)

Market based solutions have emerged to help inform growers on pools. For example, in Western Australia the Kondinin Group publishes an industry report to help growers make informed marketing decisions in relation to pools titled *Western Australian Wheat Pools Performance Comparison*.

Given the concerns about pool transparency, there might be a role for an industry governing body to set guidelines for product disclosure of pools. This might be achieved by adopting a code of conduct for the industry. (For a broader discussion on a governing industry body see chapter 9.) Grain Trade Australia has developed an industry code of conduct that 'aims to improve transparency and to encourage clear disclosure with regard to prices including the basis of pricing, what is included, what is excluded and what charges apply' (GTA 2009b, p. 21). However, there is scope to further improve pool transparency with more detailed guidelines.

Alternatively, the industry could adopt an auditor to advise on best practice, or publish comparative reports such as that provided by the Kondinin Group more widely.

FINDING 3.4

*Improving pool transparency is best undertaken by the industry and can be achieved through a more detailed code of conduct. The Commission has not identified any further role for government in this process.*

#### *Ownership structure of pool managers*

One of the issues raised at the public forum in Dubbo and in Western Australia is the perception by growers that their interests are best served by marketing their wheat through a pool managed as a grower-owned cooperative. This sentiment was expressed by the NSW Farmers Association:

The Association supports a return to a National Pool run by a grower owned and controlled not for profit company which allows multiple exporters as under the Australia Wheat Limited ('AusWheat') plan ... (sub. 49, p. 2)

Under the current arrangements there is no barrier to grower-owned cooperatives operating pools. However, the Commission has argued against a compulsory

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national pool in its submission to the *National Competition Policy Review of the Wheat Marketing Act 1989*.

Furthermore, evidence presented in chapter 2, chapter 6 and above in this chapter demonstrates the regional differences in wheat markets around Australia. A national pool is unlikely to be an efficient outcome due to regional differences in the wheat industry, and is likely to disadvantage some regions that are more dependent on the export market and represent the largest share of the Australian wheat export industry (Western Australia and some parts of South Australia).

A number of joint venture cooperatives have emerged that offer a full range of wheat marketing options. Growers can choose to market their grain through a cooperative. If the cooperative ownership structure outperforms in terms of returns to growers, then it is possible that cooperatives could achieve large market shares.

#### *Grower-owned cooperatives*

The CBH Group is based in Western Australia and is owned and controlled by about 4800 grain growers. In Western Australia, CBH Grain offers a wide range of marketing options including four pool options (Harvest Pool, Benchmark Pool, Managed Pool and ProtectionPlus Pool). The Managed Pool and ProtectionPlus Pool are jointly managed by CBH Grain and Plum Grove.

In eastern Australia CBH Grain operates a harvest pool in Victoria and South Australia. CBH Grain also has operations in New South Wales, but this does not include a pool for the 2009-10 harvest.

#### *Joint venture cooperatives*

Emerald Group Australia has joint ventures with a number of grower-owned private companies or cooperatives:

- EP Grain is a joint venture with the grower based company FREE Eyre. EP Grain has headquarters in Port Lincoln and services the specific needs of Eyre Peninsula grain farmers. The Eyre Peninsula is an export focused grain production region and EP Grain offers an extensive range of grain marketing solutions for wheat, barley and canola farmers.
- Southern Quality Produce is a joint venture with Southern Quality Produce Co-operative Ltd. Southern Quality Produce is 45 per cent grower-owned and offers a range of marketing options including wheat pools across Victoria.

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- Southern Ag Grain is a joint venture with grower run unlisted public company Southern Agventure. Southern Ag Grain is based in Wagga Wagga and services the needs of southern New South Wales grain growers. Their services include a harvest pool for wheat.

In addition, Emerald Group Australia has a partnership with The Western Australian Farmers Federation whereby Emerald manages the WAFarmers WheatPool.

### *Independent traders*

In addition to the grower-based organisations listed above, a number of independent traders offer pools including GrainCorp, AWB, Plum Grove and Viterra.

## **Loss of Golden Rewards**

One of the major issues raised by growers in submissions and at hearings is the loss of Golden Rewards:

Due to our crop rotation (wheat and pulses) and dry finishes to seasons, we have been producing hard wheat with protein levels of 14 to 16%. Yet with the return of flat grade pricing under a deregulated market, the prices on offer often reflect that of a base protein of 11.5%. I estimate that we should be capturing an additional \$15 per tonne based solely on protein, without taking moisture, screenings, or preferred milling performance of varieties into account. ... I have been frustrated and felt demeaned trying to sell quality wheat in the deregulated market as we are not being paid incrementally for quality. ... What happened to the Golden Rewards system of returning premiums to growers for quality wheat? (Cannon Partners, sub. DR60, p. 2)

Kay Hull MP noted:

One of the key issues raised has been the future grading of Australian wheat. The Golden Rewards scheme introduced by the AWB, encouraged growers to produce, incrementally, better wheat. Before the season began, growers could confidently justify the application of larger volumes of fertiliser or chemical, knowing there is an incremental reward at the end of the season. This has now been lost. (sub. 36, p. 1)

The NSW Farmers Association estimated the reduction of income due to the loss of golden rewards is \$16.75 per tonne:

In the case study the particular grower has 944.62 tonnes, binned as APH1, APH2, APW1, ASW1, AUH2 and H2, all delivered to Condobolin GrainCorp during November 2009. Based upon applying the protein and screenings increments and moisture increments which were applied during the 2007-08 season, the most recent year of the Golden Rewards scheme's operation, to the grower's 2009 crop enables a comparison of the different programs. This comparison reveals that the removal of the

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Golden Rewards program and the reinstatement of cliff face pricing has led to a reduction in income to the grower of \$15 820.20. This equates to an average loss of \$16.75 per tonne. (sub. 49, p. 25)

Golden Rewards was a varietal based payment system that was operated by the AWBI national pool. Payments were based on the broader class of wheat delivered, rather than the narrower bin grade quality (figure 8.1 in chapter 8). Different qualities of wheat were then paid according to the payment matrices for protein, screenings and moisture over the broad class of wheat.

One of the main changes arising from the current marketing arrangements has been the move from varietal payment systems to payment based on bin grade. A varietal payment system pays growers based on broad definitions of wheat classes (for example, wheat grade defined by the Wheat Classification Council). Payments based on bin grade reflect more narrowly defined grades of wheat (for example, as defined by receival standards set by Grain Trade Australia).

AWBI used to offer increments within the broad wheat grade classes. To some extent, the move to bin grade prices has encapsulated some of the payment increments under the varietal or wheat grade system offered by AWBI in the national pool.

However, the increments under the old AWBI payment system were finer than those of bin grade. For example, increments were offered for protein, moisture and screening levels within a bin grade.

For the 2009-10 harvest, many pools are offering some quality increments within grades. It seems that in response to demand by growers, the pool managers have brought back increments as a marketing strategy. However, the increment system in today's pools is less finely differentiated than in the past. Although there has been some recovery of the quality increments within bin grades, the rewards to growers are no longer the same.

Although it is difficult to make direct comparisons, the transition might have reduced returns to some growers who no longer receive payment increments for quality. However, comparing the overall return to growers is complex and it depends on the actual pool return or price received, not only the increments.

Payment of quality increments, whether under the AWBI varietal payment system or the new pools, is a complex matter. The relative prices offered for quality increments within bin grades might not match the value of the commingled grain when it is traded. To the extent that the value of the commingled grain is lower than the sum of the quality increments paid to growers for grain delivered, the pool

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return is lower. Hence, there can be tradeoffs between a grower chasing quality increments and the overall lower return achieved by the pool.

It is difficult to get quality increments for non-pool products. GrainCorp noted that international customers do not pay for quality increments:

When you look at how grain is marketed, pools have the capacity ... to run a Golden Rewards where ... you're pooling a known quantity of grain and you get a return. But when you actually go to sell it, you sell it at [a] cliff-face price through national marketers. International markets or customers don't give you increments for protein et cetera et cetera above the specific standard you're selling against. ... [I]t would be difficult to see that a lot of export traders would actually move to ... [pay] increments on a cash basis because it's not how the market works at the other end. (trans., pp. 487–8)

AWB suggested that there is now an increased risk in offering Golden Rewards, as bulk handlers only guarantee a minimum out-turn quality:

Obviously when you introduce, say, 30-plus competitors, and rules in which the bulk handlers will only guarantee a minimum quality which is equivalent to receival standard, it means that as the grain now comes into the system, it all gets commingled. So a particular farmer may have very good quality, but ... that hard wheat may get mixed into a stack with a whole heap of other farmers' hard wheat. Under the minimum guarantee rules set out in the storage and handling agreement set out by the bulk handlers, they [the bulk handlers] will only guarantee, through out-turn, 11 and a half per cent protein. So the individual specifications of that particular farmer's grain get lost ... It's very hard then as a buyer to essentially pay the 13 per cent when the bulk handler is saying, 'We're only going to guarantee you 11 and a half per cent.' (trans., p. 342)

Growers have more choices now to manage this matter; they can store high quality grain on farm, warehouse it in the bulk system, or blend the grain on farm to achieve a desired marketing grade, or sell high quality grain in containers or bags.

Additionally, CBH will trial a load averaging system during the upcoming harvest. The system is 'designed to provide more flexibility and control over grain quality by allowing growers to virtually blend loads of wheat to form optimised lots of better grades' (CBH 2010a). A grower would be able to blend higher quality grain that sits above the standard with lower quality grain, in order to sell the low quality grain for a higher price. Under the terms of the trial, CBH guarantees out-turn quality, rather than the minimum standard.

Similarly, traders can seek to have bulk handlers separate high quality grain into a special bin (for a fee), or store in a non-bulk handler receival site. The decisions depend upon the price of wheat of different qualities and the cost of storage, handling and transport to deliver wheat of various standards.

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AWB and GrainCorp both offered an APH1 bin grade with a minimum of 14 per cent protein for the 2009-10 season in New South Wales. This indicates that there is flexibility to introduce a high quality segregation when the demand exists and there is sufficient supply available.

AWB considered that competition would continue to create systems that paid quality increments:

I think competition will create, as it already has done, people who are prepared to offer a Golden Rewards system. ... I think the evolution will be essentially through new supply chains where the quality can be preserved and not lost in commingling, where you're likely to see more and more of that payment for quality capacity being preserved. ... [T]here are certainly endeavours, and we are aware of one bulk handler at least who is now starting to talk about ... guaranteeing the quality going in and coming out. (trans., p. 343)

For the 2009-10 season, a number of market participants offered quality payment systems, and this is likely to continue as the market matures and supply chains and port procedures evolve.

### **Receiver of last resort**

Without AWBI acting as a receiver of last resort, some growers have expressed concern that they cannot sell poor quality wheat. For example, the NSW Farmers Association noted:

We've seen examples last year where we've had a lot of weather damaged grain up north still in store because there was no receiver of last resort to soak that up. Now we have in Victoria this year a chance of some weather-damaged wheat coming in, and once again, with the dairy industry the way it is, they may not be able to soak up all that excess feed [grain]. So you need that buyer of last resort to soak up that off grade wheat, to put grades for it and do the blending to bring it up to a standard and pass those profits back to the growers. (trans., p. 257)

The notion is that AWBI was a receiver of last resort that binned the wheat in an appropriate receival standard and then sold it and paid a pool return based on the price received for the 'stack average'. Growers delivering poor quality wheat might have received a higher price (through cross-subsidy with other growers) in the pool. As ACIL Tasman noted:

... the 'buyer of last resort' culture in the wheat industry creates a situation in which growers who produce good quality grain are subsidising producers of lower quality grain. ... growers who rely on a mandated receiver of last resort are being supported by those that do not. Also the industry more broadly is disadvantaged because growers are being encouraged to grow lower quality / higher yielding wheat than they would have if

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they had received accurate price signals about what the market wanted. (ACIL Tasman 2006, p. 8)

Furthermore, AWBI did not always accept grain of any quality at all receival sites. They sometimes required the grower to deliver to a receival site further away, and the grower had to incur the transport costs, or decide not to deliver.

These cross-subsidies are unwinding. The grower can probably find a buyer, but the price will reflect the market value of the grain.

### **Comparing prices pre- and post-deregulation**

Several participants to the inquiry (NSW Farmers Association, sub. 49; Kay Hull MP, sub. 36) cited in their submissions a newspaper article in the *Land* on 12 November 2009 by Malcolm Bartholomaeus, ‘Learning from Pools’:

As we enter the peak harvest period this year, basis levels are running at about \$0/t to +\$5/t, or still up to \$20/t lower than what we would have expected from the old single desk. ... If changes are not made, most growers will be worse off, the industry will be worse off, and the country will have lost valuable export income. ... we need to begin replicating what AWB used to do. (Bartholomaeus 2009, p. 89)

The inference being drawn by the reference to the article in the *Land* is that prices are lower under the current arrangements compared with the previous single desk arrangement. This inference hinges on the estimated value of the basis in 2008-09 and 2009-10. However, movements in the basis can be due to changes in the spot price and/or changes in the futures price.

It is still too early to be able to make comparisons about returns to growers, and Australia, under the current arrangements with those under the single desk for a number of reasons. This is particularly the case for comparisons based on the levels of the basis (for a description of the basis see box 3.3).

First, the industry (growers, traders and providers of risk management products) is still adapting to the new business environment. There has only been one completed production and marketing cycle under the current arrangements.

Second, the introduction of the current arrangements has coincided with a pronounced commodity price cycle for wheat and other grains on international markets (a short term increase in the price of wheat of at least 150 per cent just prior to deregulation). Interpreting the basis can be particularly problematic during a commodity price cycle.

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Third, there have been concerns raised in the United States about the performance of the US futures markets for grain (corn, soybeans and particularly wheat). Since 2005, market participants have been concerned that the futures prices have been artificially high, leading to the basis for US wheat futures (CBOT) being negative at various points in time. The US Department of Agriculture recently stated:

... evidence shows that the link between futures and the underlying cash price has weakened, resulting in unpredictable and erratic basis levels and lack of normal convergence of cash and futures prices. (Aulerich, Hoffman and Plato 2009, p. 28)

Similarly, Irwin et al. noted:

Performance has been consistently weakest in wheat, with delivery location basis at times exceeding one dollar per bushel, a level of disconnect between cash and futures not previously experienced in grain markets. (Irwin et al. 2009, p. 2)

There appear to have been periods of non-convergence (between the spot price and futures price) in 2008-09 and volatility in the basis. Figure 3.7 shows the US SRW wheat basis (the spot price at the Gulf less US nearby CBOT futures prices). As figure 3.7 illustrates, the US basis was negative in 2008-09.

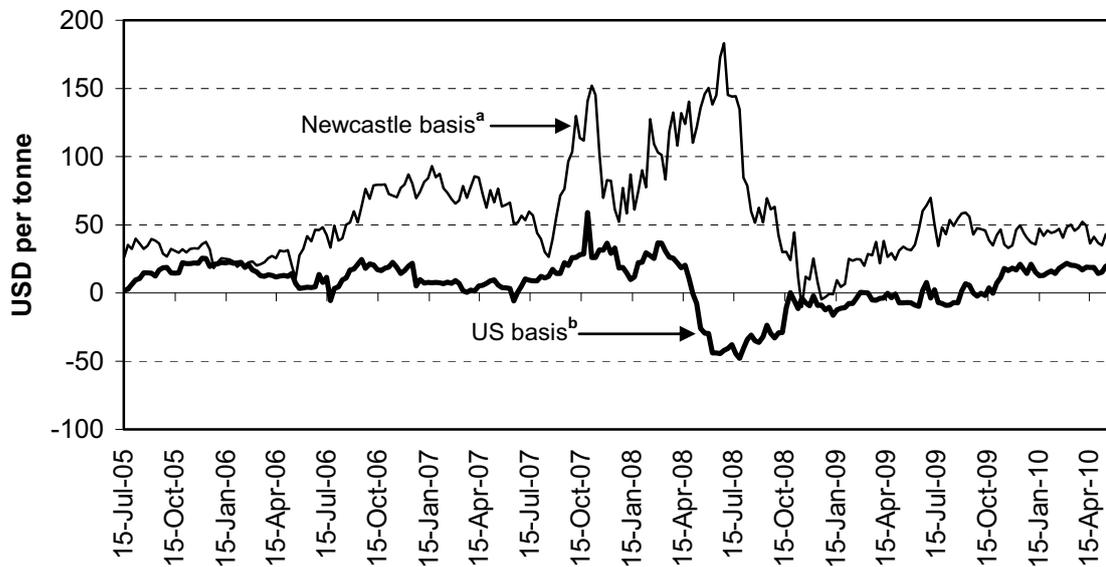
This disconnect between cash and futures prices has a number of consequences:

First, the failure to converge leads to bias in the price discovery process as futures do not represent subsequent cash prices. Second, uncertainty in basis behaviour increases as markets bounce unpredictably between converging and not converging and this leads to marked declines in hedging effectiveness. (Irwin et al. 2009, p. 2)

As Australia's spot prices tend to track those in the United States (apart from the eastern states in non-exporting years), when the US basis (spot price less the futures price) is negative, it would be expected that the Australian basis would also be negative. The poor basis levels in 2008-09 and 2009-10 cited in the submissions and the article coincide with a poor basis in the United States. So, it is possible that it is not reflecting a decrease in the Australian spot price relative to the world price of wheat, but rather that the futures price is artificially high relative to the world spot price of wheat.

When the spot price in New South Wales rises above the world price in periods of low production, the Newcastle basis will be relatively strong. This can be seen in figure 3.7. For example, in 2006-07 and 2007-08, the prices in New South Wales were above world spot prices and, as a result, a gap emerges between the Newcastle basis and the US basis. However, in 2008-09, the gap between the Newcastle basis and the US basis decreased markedly, reflecting the decrease in the wheat price in New South Wales to reflect the export price as local supply increased. This relationship makes using hedging instruments to manage price risk more complicated.

Figure 3.7 Australian and US wheat basis



<sup>a</sup> Price of AWM contracts converted to fob and USD less nearby CBOT futures prices. <sup>b</sup> Spot price at the Gulf less nearby CBOT futures prices.

Source: Lloyd George, AgIntel, pers. comm., 28 May 2010.

## Issues in the spot market

The Commission is aware of cases where the price has fallen in the time between a grower calling a trader and making delivery to the receival site. For example:

Last harvest I rang up for a price. I sent the truck straight away to the buyer only to find the price drop by \$10. (R & L Guest, sub. 1, p. 2)

For price certainty, a short-term contract can be entered into. Of course, if the grower locks in the price and the spot price rises, the grower is only paid the contracted price.

Another issue raised by growers is that the spot market prices on offer by traders are similar and so they claim there is not competition between traders. However, in competitive markets for a homogenous commodity, like a specific grade of wheat, the law of one price tends to prevail. This is a consequence of competitive pressure and the ease with which arbitraging can take place. Consider two traders offering to purchase grain at two different prices. There is nothing to stop an arbitrageur (grower or a trader) from buying grain from the low priced trader and on-selling it to the high priced trader. Alternatively, the trader offering a higher price could buy grain from the trader offering the lower price.



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## 4 Accreditation of exporters

### Key points

- The Wheat Export Accreditation Scheme 2008 (the Scheme) has been appropriate as a transitional arrangement and provided a net benefit to the industry.
  - It has provided comfort to growers and international buyers in a period of change and financial instability, and facilitated a smooth transition to the deregulated environment.
  - The condition that port terminal operators pass the access test to be accredited to export has facilitated access for traders to port terminal facilities.
- Beyond a transitional period the benefits of accreditation are limited, leaving only the costs. These costs include:
  - direct costs of administering and complying with accreditation
  - indirect costs in the form of market distortions and losses in economic efficiency which, although difficult to measure, would be expected to increase over time as the distortions become more entrenched.
- While the benefit derived from the condition that port terminal operators pass the access test might remain for a further period, this can be achieved without accreditation (chapter 5).
- There is no persistent market failure that requires government intervention in the bulk wheat export industry beyond a transitional period, and nothing particular about wheat that requires a system of accreditation without which other grains and most agricultural commodities operate smoothly.
- The transitional period as it relates to accreditation is nearing its end. Weighing up the costs and benefits, the Commission does not see an ongoing role for accreditation. It is recommended that the Scheme be terminated, the WEA abolished and the Wheat Export Charge removed. This should occur on 30 September 2011.
  - If the Australian Government decided to retain accreditation beyond 30 September 2011, a system similar to that administered by ESCOSA for barley would be more appropriate than trying to amend the existing arrangements.
  - If the Australian Government decided to retain the current Scheme, considerable change would be required, including streamlining the level of assessment employed by WEA and more clearly defining its role to ensure that its powers do not extend into matters of competition policy.

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Under the *Wheat Export Marketing Act 2008* (Cwlth) (WEMA), those companies seeking to export bulk wheat from Australia must be accredited. The system of accreditation is set out in the *Wheat Export Accreditation Scheme 2008* (Cwlth) (Scheme), which came into effect at the same time as the WEMA, on 1 July 2008.

The stated purpose of the Scheme is ‘to establish a system of accreditation for exporters of wheat (other than wheat in bags or containers) in order to attest that an exporter is a fit and proper company to export wheat from Australia’ (s. 3). In essence, while not offering a financial guarantee, the Scheme was intended to give a degree of comfort that players in the newly deregulated bulk export market for wheat were reputable and likely to be able to pay growers.

The Scheme is also designed to facilitate access for traders to port terminal facilities, by requiring that port terminal operators that also wish to export bulk wheat have an Australian Competition and Consumer Commission (ACCC) approved access undertaking in place before accreditation can be granted.

The Scheme was formulated by the Export Wheat Commission (EWC), the predecessor of Wheat Exports Australia (WEA) and the regulator at the time the Scheme was formulated. The Scheme was established as a legislative instrument to give its administrator, WEA, the flexibility to easily and quickly amend the Scheme without the need to change the WEMA itself (Burke 2008b). This is reflective of the high level of discretion conferred to WEA by the WEMA legislation.

In section 4.1 of this chapter, the eligibility criteria for obtaining accreditation are outlined, including the access test. This is followed by a summary of the accreditation application process in section 4.2, and the ways in which WEA monitors compliance with the Scheme in section 4.3. The direct costs of accreditation are set out in section 4.4. The effectiveness of the overall arrangements is evaluated in section 4.5, including a discussion of whether accreditation should be ongoing. The chapter concludes with an assessment of some of the more specific aspects of accreditation, and outlines what would need to change if accreditation were to continue (section 4.6).

## **4.1 Eligibility criteria**

To operate as an accredited bulk wheat exporter, an applicant must satisfy the eligibility criteria set out in the Scheme (s. 5) (box 4.1). These criteria are identical to those specified in the WEMA (s. 13), and fall into three categories:

1. Those which must be strictly fulfilled by an applicant.

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2. Those which WEA must consider, but which individually may not lead to an application for accreditation being rejected.
  3. Those which must be fulfilled to the satisfaction of WEA.

Those criteria falling under categories two and three provide WEA with discretion about whether or not to grant accreditation.

The overarching set of criteria for assessing applicants, and the area where the greatest level of judgement is required of WEA, is whether a company is deemed to be 'fit and proper' to export bulk wheat from Australia. There are 17 points outlined in the Scheme that WEA must consider in making such an assessment.

**Box 4.1 Eligibility criteria**

1. A company is not eligible for accreditation unless:
  - (a) the company is:
    - (i) registered as a company under Part 2A.2 of the *Corporations Act 2001*, or
    - (ii) a co-operative, and
  - (b) the company is a trading corporation to which paragraph 51(xx) of the Constitution applies, and
  - (c) WEA is satisfied that the company is a fit and proper company, having regard to the following:
    - (i) the financial resources available to the company
    - (ii) the company's risk management arrangements
    - (iii) the company's business record
    - (iv) the company's record in situations requiring trust and candour
    - (v) the business record of each executive officer of the company
    - (vi) the experience and ability of each executive officer of the company
    - (vii) the record in situations requiring trust and candour of each executive officer of the company
    - (viii) whether the company, or an executive officer of the company, has been convicted of an offence against an Australian law or a foreign law, where the offence relates to dishonest conduct
    - (ix) whether the company, or an executive officer of the company, has been convicted of an offence against an Australian law or a foreign law, where the offence relates to the conduct of a business
    - (x) whether an order for a pecuniary penalty has been made against the company, or an executive officer of the company, under section 1317G of the *Corporations Act 2001* or section 76 of the *Trade Practices Act 1974*

(Continued next page)

**Box 4.1** (continued)

- (xi) if the company is or has been accredited under the Scheme — whether the company has contravened a condition of the company's accreditation under the Scheme
  - (xii) whether an executive officer of the company has been involved in a contravention of a condition of an accreditation under the Scheme
  - (xiii) whether the company, or an executive officer of the company, has been convicted of an offence against section 136.1, 137.1 or 137.2 of the *Criminal Code*
  - (xiv) whether the company, or an executive officer of the company, has committed or been involved in repeated contraventions, or a serious contravention, of a designated sanitary or phytosanitary measure
  - (xv) whether the company, or an executive officer of the company, has committed or been involved in a contravention of a United Nations sanctions provision
  - (xvi) whether the company, or an executive officer of the company, has committed or been involved in a contravention of an Australian law or a foreign law, where the contravention relates to trade in barley, canola, lupins, oats or wheat
  - (xvii) such other matters (if any) as WEA considers relevant, and
- (d) WEA is satisfied the company is not an externally-administered body corporate, and
- (e) if the company, or an associated entity, is the provider of one or more port terminal services — WEA is satisfied that the company or associated entity, as the case may be, passes the access test in relation to each of those services.
2. Subparagraphs (1)(c)(i) to (xvii) do not apply to an act, omission, matter or thing that occurred:
- (a) if the company is not, and has never been, accredited under this Scheme — before the start of the five-year period that ended when the company made its application for accreditation, or
  - (b) if the company is or has been accredited under this Scheme — before the start of the five-year period that ended when the company first became accredited under this Scheme.<sup>a</sup>

<sup>a</sup> There are other ancillary provisions outlined in the Scheme.

Source: Wheat Export Accreditation Scheme 2008 (s. 5).

## The access test

One of the eligibility criteria outlined in box 4.1 states that, to gain accreditation, the following condition must be satisfied:

If the company, or an associated entity, is the provider of one or more port terminal services — WEA is satisfied that the company or associated entity, as the case may be, passes the access test in relation to each of those services. (Scheme, s. 5(1)(e))

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The access test is set out in the WEMA (s. 24) and summarised in box 4.2. The appropriateness and effectiveness of the access test provisions are the subject of chapter 5. Discussion in this chapter is confined to the role of WEA in monitoring compliance with the access test as it stands, and the interaction between the access test and accreditation.

**Box 4.2 The access test**

**Before 1 October 2009**

A person passes the access test in relation to a port terminal service at a particular time if the person complies with the continuous disclosure rules in relation to the port terminal service (see below), and either:

- at that time, there is available on the person's Internet site a current statement to the effect that the person is willing to:
  - provide accredited wheat exporters with access to the port terminal service for purposes relating to the export of wheat, and
  - do so on such terms and conditions as are set out in the statement, or
- at that time:
  - there is in force a decision under Division 2A of Part IIIA of the *Trade Practices Act 1974* that a regime established by a State or Territory for access to the port terminal service is an effective access regime, and
  - under that regime, accredited wheat exporters have access to the port terminal service for purposes relating to the export of wheat.

**On or after 1 October 2009**

A person passes the access test in relation to a port terminal service at a particular time if the person complies with the continuous disclosure rules in relation to the port terminal service (see below), and either:

- at that time, there is in operation, under Division 6 of Part IIIA of the *Trade Practices Act 1974*, an access undertaking relating to the provision to accredited wheat exporters of access to the port terminal service for purposes relating to the export of wheat,<sup>a</sup> or
- at that time:
  - there is in force a decision under Division 2A of Part IIIA of the *Trade Practices Act 1974* that a regime established by a State or Territory for access to the port terminal service is an effective access regime, and
  - under that regime, accredited wheat exporters have access to the port terminal service for purposes relating to the export of wheat.

<sup>a</sup> For the purposes of this provision it is assumed that subsection 44ZZBA(1) of the *Trade Practices Act 1974* had never been enacted, and that an access undertaking comes into operation at the time when the ACCC publishes its decision to accept the undertaking.

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Box 4.2 (continued)

**Continuous disclosure rules — before and after 1 October 2009**

A person complies with the continuous disclosure rules in relation to a port terminal service at a particular time if:

- there is available on the person's internet site a current statement setting out the person's policies and procedures for managing demand for the port terminal service (including the person's policies and procedures relating to the nomination and acceptance of ships to be loaded using the port terminal service), and
- at that time, there is available on the person's internet site a current statement setting out:
  - the name of each ship scheduled to load grain using the port terminal service, and
  - for each ship — the time when the ship was nominated to load grain using the port terminal service, and
  - for each ship — the time when the ship was accepted as a ship scheduled to load grain using the port terminal service, and
  - for each ship — the quantity of grain to be loaded by the ship using the port terminal service, and
  - for each ship — the estimated date on which grain is to be loaded by the ship using the port terminal service, and
- at that time, the person had a policy of updating the statement each business day.

*Source:* WEMA (s. 24).

## 4.2 The application process

To apply for accreditation to export bulk wheat, an application form must be lodged with WEA, with supporting documentation. The application form is available on the WEA's website. The form has 56 pages and seeks information on an applicant's:

- organisational profile
- corporate structure and governance
- risk management
- export proposal
- financial systems and resources
- company and executive officer record
- port terminal services (where applicable).

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The export proposal must describe the nature and scope of proposed bulk wheat exporting operations, including details of expected tonnage, markets, sources of wheat and peak funding requirements.

The process for renewing an exporter's accreditation is set out in the Scheme and is similar to that for a new application. Applicants are required to provide an updated export proposal and new or updated information on the same matters set out in the new application.

### **Assessment processes**

WEA makes judgements about whether an applicant is 'fit and proper' to be accredited, taking into account the performance and behaviour of the applicant in the preceding five years, as set out in the application form (WEA 2009d). WEA can exercise discretion in making decisions based on the applicant's particular circumstances and specific export proposal (Burke 2008a).

The emphasis of WEA in reviewing and making decisions on an application (be it new or renewal) was set out in its submission to the inquiry:

The assessment process adopted by WEA has placed primary emphasis on an applicant's financial resources and risk management capability. Ultimately, WEA must be satisfied that the applicant meets these criteria to a standard appropriate for the purposes of its specific export proposal. (sub. 55, p. 15)

In assessing export applications, WEA Secretariat staff undertake a variety of searches and evaluations to verify the accuracy and completeness of the information provided in the application form, and engage external experts where appropriate (box 4.3). These procedures seek to ensure that a considered recommendation can be made to the WEA members.<sup>1</sup>

At any time during the application process, WEA can request additional information to satisfy itself that an applicant is eligible for accreditation. If, once accreditation has been granted, WEA is satisfied that one or more of the eligibility criteria are no longer being met, WEA must cancel the accreditation of an exporter.<sup>2</sup>

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<sup>1</sup> WEA is a body corporate consisting of a Chair and five other members. Members are appointed by the Federal Minister for Agriculture, Fisheries and Forestry. The staff of WEA are employed under the *Public Service Act 1999* (Cwlth).

<sup>2</sup> WEA has discretion about whether or not it cancels the accreditation of a company that enters administration after accreditation is granted, depending on what would be in the best interest of growers (Wheat Export Accreditation Scheme 2008, s. 31).

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## Box 4.3 Phases in the assessment and decision process

### Phase 1: Receipt of application

- An application form with supporting documentation is received in hard copy, filed as hard copy, scanned and entered in WEA's electronic system.
- Clearance of the application fee is confirmed before further processing.
- Staff e-mail acknowledgment of application and receipt for application fee to the applicant.

### Phase 2: Initiate checks and searches

- Staff read and check that the application is complete.
- Staff initiate searches, including:
  - media and other general information
  - financial and risk reports on applicant; parent company; relevant associated companies
  - identify and check executive officer nominations: company and director extracts
  - WEA database for exporter history in shipping bulk/ non-bulk wheat
  - legal database by jurisdiction
  - internet — general information
  - Australian Securities and Investments Commission (company registration etc)
  - Australian Federal Police national police checks (for Executive Officers)
  - Australian Quarantine and Inspection Service (Incident reports).
- Staff analyse all reports for issues of concern.
- Staff request any incomplete or additional information from the applicant, and query issues raised in searches not previously covered.
- Staff log actions and new information received in database and on files.

### Phase 3: Review and evaluate applicant's financial, risk and price risk management

- Commission a financial evaluation from appropriate WEA consultant.
- Staff evaluate consultant's report against financial assessment guidance tree (internal benchmarking tool) and score applicant.
- Commission a broad risk management report from appropriate consultant.
- Commission a price risk management report from appropriate consultant.
- Commission legal advice as required.
- Staff review each of the above reports as appropriate with senior managers.

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Box 4.3 (continued)

**Phase 4: Recommendation to WEA members**

- Staff prepare Executive Summary.
- Staff identify potential external audits and any weaknesses of the application.
- Staff discuss potential conditions of accreditation with applicant.
- CEO provides recommendation and supporting documentation to members for decision.

**Phase 5: WEA members consideration and decision**

- Members consider recommendation and supporting documentation.
- Members decide to accredit or refuse (Phase 6) or request further information.
- Staff respond to requests by members for additional information.
- When additional information is received, application is re-submitted for consideration (where relevant).
- Staff discuss proposed conditions of accreditation with applicant.
- If applicant objects to proposed conditions they may submit further information. Either way, the application must be reconsidered before a final decision is made.

**Phase 6: Implement decision**

- If successful, prepare and forward Instrument of Accreditation to the exporter.
- Notify the Australian Customs and Border Protection Service.
- Publish decision on WEA register of accredited exporters.

*Source: WEA (sub. 55, pp. 15–16).*

WEA must consult an applicant or accredited exporter (as the case may be) before deciding to refuse an application for accreditation, or before cancelling or suspending accreditation. WEA can determine the duration of accreditation to be granted, taking into account the export proposal and the level of export experience of each applicant. However, the period of accreditation cannot exceed three years and, once set, cannot be varied by WEA until it expires and is renewed (or in the event that accreditation is suspended or cancelled).

## Conditions of accreditation

All accreditations are subject to a set of mandatory conditions (box 4.4). However, WEA may impose additional conditions if it considers this appropriate at the time of the initial or renewal application. These additional conditions are imposed on a

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case-by-case basis and are specific to the particular accreditation being granted. They are made available on WEA's website, together with explanatory notes that outline the nature of the condition. The reasons as to why the conditions are imposed are not made public (for example, for confidentiality reasons).

WEA can vary or revoke conditions, or impose further conditions, at any time during accreditation. Before WEA makes a decision to impose, vary or revoke a specific condition, WEA must consult with the applicant or accredited exporter (as the case may be). During its period of accreditation, an exporter can apply to WEA to vary or revoke a condition of accreditation. Any such application attracts a fee (see below).

The Explanatory Memorandum to the Wheat Export Marketing Bill prohibits WEA from imposing limits on tonnage or market destinations, unless explicitly proposed by the applicant. The 'export proposal' section of the application form states that:

WEA will not impose conditions on an accreditation limiting tonnage or market destinations unless an applicant proposes those arrangements. Applicants can choose to propose such conditions as they relate to the export proposal outlined in this section of the form. For example, if the applicant has limited financial resources and experience, it may wish to propose conditions limiting its operations to a certain tonnage. (WEA 2010a, p. 25)

In 2008-09, additional conditions were attached to the accreditations of ten exporters. These related to tonnage limits (requested by four exporters), the port terminal access test (six exporters), and miscellaneous conditions (two exporters) (WEA 2009a). Examples of the conditions imposed are outlined in box 4.4.

In the 2009-10 marketing year to date, additional conditions have been attached to the accreditations of 13 exporters (WEA, pers. comm., 11 June 2010). These related to tonnage limits (requested by eight exporters), the port terminal access test (three exporters) and miscellaneous conditions (four exporters).

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## Box 4.4 Conditions imposed by WEA, 2008-09

### Compulsory conditions<sup>a</sup>

An accredited exporter must comply with the following conditions:

- provide information as requested by WEA
- arrange for an external audit upon request from WEA
- comply with notifiable matter requirements
- notify WEA of a new executive officer appointment.

In addition, at the end of each marketing year, accredited bulk wheat exporters must provide WEA with:

- an Annual Export Report outlining:
  - the quantity of wheat exported during that year, disaggregated by wheat grade and country of destination
  - the terms and conditions on which the accredited exporter acquired wheat from growers during that year for export by the accredited wheat exporter
- an Annual Compliance Report outlining the accredited exporters compliance with:
  - the conditions of the exporter's accreditation
  - Australian and foreign laws that are applicable to the accredited wheat exporter's export trade in wheat
  - the United Nation's sanctions provisions.

### Additional conditions

- Payment of the Wheat Export Charge (WEC) of \$A0.22 per tonne on wheat exported from Australia.<sup>b</sup>
- Compliance with a tonnage limit of accreditation imposed for the 2008-09 marketing year.
- Compliance with a market restriction (buyer) imposed for the 2008-09 marketing year.
- Compliance with the submission of an interim Annual Export Report and Annual Compliance Report (period ending 28 February 2009).
- Commodity hedging undertaken in compliance with the terms of the condition imposed by WEA for any wheat export pools operated by AWB for the 2008-09 marketing year.
- Chartering undertaken in compliance with the terms of the condition imposed by WEA for any wheat export pools operated by AWB for the 2008-09 marketing year.

<sup>a</sup> Many of these are discussed further in section 4.3. <sup>b</sup> While all accredited exporters must pay the WEC, it is categorised as a specific condition by WEA as the condition is not defined in the Scheme. The additional condition also includes penalties for late payment.

(Continued next page)

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**Box 4.4** (continued)

- Maintenance of files and documents in compliance with the terms of the condition imposed by WEA relating to commodity hedging and chartering activities of AWB for the 2008-09 marketing year.
- Compliance with the condition limiting bulk wheat exports to wheat produced on the properties of the accredited wheat exporter.

**Additional conditions – bulk handling companies**

- Compliance with the continuous disclosure rules in relation to each port terminal service operated, requiring the publication of a 'shipping stem' to be updated each business day.
- Compliance with the requirement to publish the terms and conditions of access to each port terminal service operated by an accredited exporter or 'associated entity' prior to 1 October 2009.

Source: WEA (2009d).

## **Timing of decisions**

The WEA Corporate Plan outlines non-legislated targets regarding the time taken to process applications. These include:

- making requests for further information within two weeks of receiving an application
- consulting on issues of concern, possible additional conditions of accreditation or denial of accreditation within four weeks of receiving an application (and any further information)
- making decisions within six weeks of receiving a complete application (and any further information).

These targets are in addition to the legislated requirement that WEA notify an applicant within 14 days of a decision being made in relation to its application.

In 2008-09, the target of six weeks from receipt of a complete application to notification of a decision was achieved in all cases (WEA, sub. 55). However, there were sometimes lengthy delays in receiving a complete application or responding to WEA requests for further information. These delays can be the result of incomplete or incorrect application forms being submitted, or additional information being required by WEA to make its assessment of the eligibility of an applicant.

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## Accreditations granted to date

The first accreditations were issued in August 2008. In the first year of operation of the Scheme, a total of 23 exporters were accredited and the period of accreditation was limited to one year, with all initial accreditations expiring on 30 September 2009.<sup>3</sup> According to WEA, the one-year period:

... enabled WEA to reassess each accredited exporter against the Act's eligibility criteria at the time of renewal and verify that there were no events or circumstances requiring suspension or cancellation of the accreditation. Also, the expiry aligned with the date when providers of export terminal services were required to obtain an access undertaking to remain eligible for accreditation. (sub. 55, p. 11)

All accredited exporters that required renewal of their accreditation applied to WEA and were successful. The majority of accreditations were renewed for three years, except for those issued to the exporting arms of port terminal operators, which were renewed for two years to coincide with the period of their port access undertakings.

Following the start of the 2009-10 marketing year, a further six applicants were granted accreditation, bringing the total to 29.

In May 2010, Sumitomo Australia Pty Ltd surrendered its accreditation.

Sumitomo Australia Pty Ltd owns 30 per cent of Summit Grain Investment (Australia) Pty Ltd (SGIA) (Sumitomo Corporation owns the other 70 per cent). Prior to 21 April 2010, SGIA held a 50 percent share in Australian Bulk Alliance (ABA). On 21 April 2010, SGIA purchased the other 50 per cent share of ABA from Viterro Operations Ltd, making SGIA the sole shareholder and owner of ABA.

WEA has confirmed that it considers the provider of the port terminal service at the Melbourne Port Terminal to be Melbourne Terminal Operations Pty Ltd (refer to WEA 2009c), which is a 100 per cent owned subsidiary of ABA (chapter 5). Prior to the acquisition of ABA, Sumitomo Australia Pty Ltd was an accredited bulk wheat exporter and not considered by WEA to be an associated entity of Melbourne Terminal Operations Pty Ltd.

Sumitomo Australia surrendered its accreditation on 19 May 2010, bringing the total number of accredited exporters to 28 as of May 2010.

To date, no application for accreditation has been rejected (WEA, pers. comm., 11 June 2010). However, it is apparent from discussion with WEA members that

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<sup>3</sup> One accredited exporter, GrainCorp Limited, subsequently surrendered its accreditation in May 2009, leaving 22 exporters at the end of 2008-09 (WEA 2009a).

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some applications could have failed in the absence of specific conditions being negotiated with applicants (such as tonnage limits).

### **4.3 Monitoring compliance with the Scheme**

Having granted accreditation, it is the role of WEA to monitor compliance with the Scheme, including conditions of accreditation, and deal with non-compliance.

#### **Information**

As noted above, WEA can request information and documents from accredited wheat exporters where it believes such information is relevant to its functions or powers. It can also request information and documents from any other person if it believes the information is relevant to its functions and powers (WEA, sub. 55).

WEA must request information in writing, and allow at least 14 days for the exporter to deliver the information. An accredited exporter can seek compensation from WEA for reasonable costs associated with complying with such requests.

WEA required further information from 22 accredited exporters on 31 occasions in 2008-09 in accordance with section 25 of the WEMA (WEA 2009a). Five requests for information were also made to third parties, under section 29 of the WEMA (WEA, pers. comm., 4 March 2010).

#### **Notifiable matters**

An accredited exporter must notify WEA of any event occurring or circumstances arising that might lead to its accreditation being cancelled, or lead to the conclusion that the accredited exporter is no longer 'fit and proper'. Notification must be made within 14 days of the event taking place. Guidelines for notifiable matters are made available on WEA's website to assist accredited exporters.

In 2008-09, WEA received 20 notifiable matter reports from seven accredited exporters (WEA 2009a). In assessing these reports, WEA determined that there was no further action required under the Scheme.

#### **Audit**

To monitor the 'fit and proper' status of each accredited exporter, WEA has the power to appoint an external auditor, or have the exporter appoint one itself. WEA

can also conduct random audits of accredited exporters. The scope of an external audit can include:

- compliance with the conditions of accreditation
- accuracy of information given to WEA
- accuracy of statements made in the accreditation application.

WEA must meet the cost of all audits, and reimburse reasonable expenses incurred by accredited exporters in complying with audit requirements. To facilitate reimbursement, exporters are required to submit an itemised tax invoice to WEA outlining the costs incurred by that exporter in complying with WEA's requirements. To date, there has been only one request for reimbursement and no payment has yet been made (WEA, pers. comm., 11 June 2010).

WEA aims to conduct external audits on at least 50 per cent of accredited exporters annually (WEA 2008). In the 2008-09 marketing year, WEA conducted 26 audits of 16 exporters, the majority of which related to financial and risk management information (table 4.1) (WEA 2009d).

**Table 4.1 Audits completed in 2008-09 marketing year**

<i>Type of audit</i>	<i>Number of audits</i>	<i>Areas of findings or improvement</i>
Financial	7	<ul style="list-style-type: none"> <li>• Information provided during accreditation confirmed as accurate.</li> </ul>
Risk management	10	<ul style="list-style-type: none"> <li>• Continuous improvement required towards whole-of-enterprise risk management and monitoring systems including the development of effective risk mitigation and risk treatment plans.</li> </ul>
Policies, systems and procedures	4	<ul style="list-style-type: none"> <li>• Increased awareness of End Point Royalties collection and National Residue Survey participation.</li> <li>• Improved budgeting processes to reflect the requirements necessary to execute the export proposal.</li> </ul>
Compliance with conditions of accreditation	5	<ul style="list-style-type: none"> <li>• Improved disclosure of daily shipping stem information and transparent management of vessel nominations.</li> <li>• Improved policies and procedures and recommendations on their implementation and regular review.</li> <li>• Management of pools to ensure transparent and equitable outcomes for the benefit of pool participants (audits proved compliance).</li> <li>• Execution of shipping and chartering to minimise risks and costs (audits proved compliance).</li> </ul>
<b>Total audits completed</b>	<b>26</b>	

Source: WEA (2009d).

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## **Annual compliance and export reports**

Under the WEMA, accredited exporters are required to submit Annual Export and Compliance Reports. The Annual Export Report is designed to provide transparency to growers and WEA regarding the specifications and quantities of bulk wheat exported, and the price, terms and conditions offered to growers (Burke 2008b). In the Annual Compliance Report, the accredited exporter must set out its compliance with conditions of accreditation for the previous marketing year.

According to WEA, these reports are integral to the ongoing monitoring regime as a way of confirming that exporters are complying with their accreditation conditions (WEA, sub. DR90).

## **Shipping schedule and data**

To ensure compliance with the continuous disclosure rules (outlined in box 4.2 above), WEA downloads and analyses, on a daily basis, the shipping schedules of the grain ports operated by the three bulk handlers currently subject to access undertakings. Any anomaly on the shipping stem, such as unexplained changes in the order of shipping, is identified, and the bulk handlers might be consulted on reasons for the change (WEA, sub. 55).

WEA also monitors export data from the Australian Customs and Border Protection Service on a weekly basis to ensure that only those that are accredited to do so export bulk wheat from Australia, and that tonnage and market restrictions are adhered to (WEA 2009d).

## **Dealing with non-compliance**

If, through its monitoring activities, WEA determines that an accredited exporter has not complied with the requirements of its accreditation, WEA has the power to:

- cancel accreditation. Before doing so, WEA must consult with the accredited exporter. In some cases of non-compliance it is mandatory for WEA to cancel accreditation (WEMA, s. 19(1)) and in other cases it may use its discretion (WEMA, s. 19(2))
- suspend an accreditation for up to three months, a mechanism intended to provide WEA with flexibility compared with immediate cancellation. Before doing so, WEA must consult with the accredited exporter
- impose further conditions on an exporter's accreditation at any time throughout the period of accreditation

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- apply for a civil penalty order with respect to particular breaches of the WEMA or the Scheme.

To date, no accreditation has been cancelled or suspended (WEA, pers. comm., 11 June 2010).

## **4.4 Direct costs of accreditation**

This section outlines the cost to WEA of administering accreditation, the costs to accredited exporters of complying with accreditation, and the wider industry costs.

### **WEA costs of administering accreditation**

The cost of running WEA in 2008-09, and those forecast for 2009-10, are shown in figure 4.1. Total expenditure in 2008-09 was \$4.2 million.<sup>4</sup> This exceeded the budgeted amount by around \$0.5 million dollars (WEA 2009a). The reason for this is explained in the Annual Report of WEA:

At the time of preparation of the 2008-09 Portfolio Budget Statements (PBS), new legislation to establish WEA and regulations to establish the Scheme that WEA would administer was pending and only nominal budget amounts were provided to the PBS. WEA undertook significant monitoring and enforcement responsibilities during its first year of operation to protect the interests of growers and other industry participants. As a result, actual expenditure in excess of the nominal budget amounts was incurred. (WEA 2009a, p. 97)

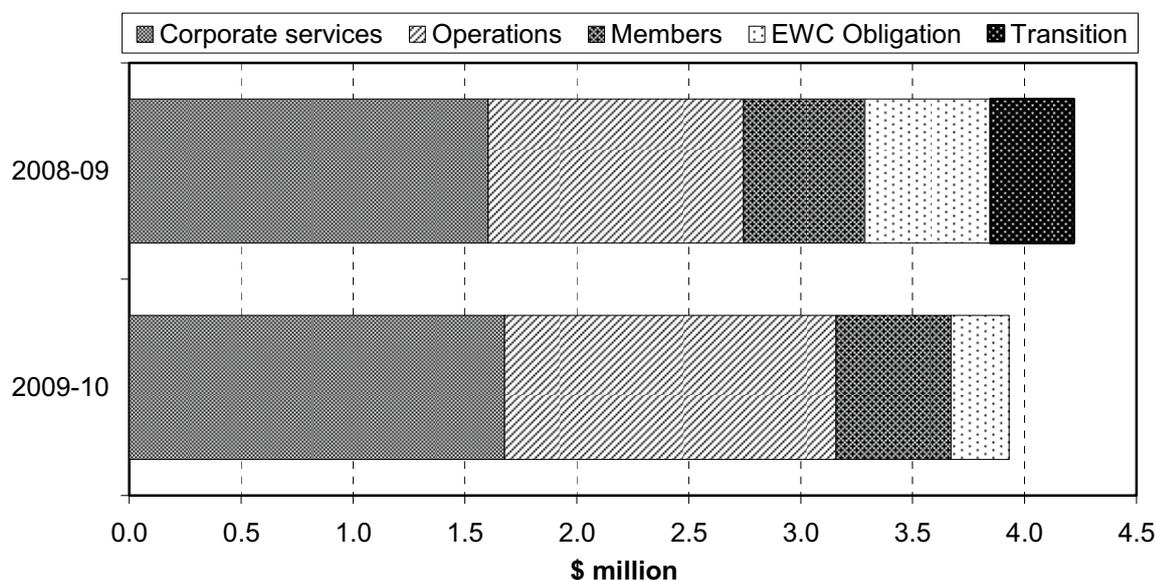
In 2009-10, total expenditure is expected to fall to \$3.9 million. This reflects the fact that the transitional costs incurred in the first year are not incurred again in 2009-10, and that the EWC reporting task ended in the first half of 2009-10 such that associated costs are halved compared with 2008-09. The cost of administering the scheme (that is, the sum of staff, members, corporate services and operational costs) is expected to rise from \$3.3 million in 2008-09 to \$3.7 million in 2009-10.

The Minister for Agriculture, Fisheries and Forestry said, in the Second Reading Speech of the Wheat Export Marketing Bill, that the ongoing costs of running WEA are expected to be around \$4 million per annum (Burke 2008a).

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<sup>4</sup> This included the cost of WEA completing the EWC reporting task, as part of the transitional arrangements, on the performance of AWB (International) Ltd in exporting wheat during the 2006-07 and 2007-08 pool periods, and the benefits to growers that resulted from that performance. This report was released in November 2009 (WEA 2009e).

Figure 4.1 **WEA expenditure 2008-09 (actual) and 2009-10 (forecast)**



Source: WEA (sub. 55, p. 7).

### Sources of WEA revenue

WEA was set up to be entirely industry funded through:

- the Wheat Export Charge (WEC) of \$0.22 per tonne, imposed on all wheat exports (including bulk, bag and container exports)
- application fees (table 4.2), which were determined on a cost-recovery basis by EWC at the time the Scheme was formulated, payable for new and renewal applications, applications to vary conditions of accreditation and applications for a reconsideration of a decision made by WEA.

Table 4.2 **Application fees**

Type of application	Fee (\$) including GST
New accreditation	13 299
Renewal of accreditation	7 084
Varying accreditation	6 248
Reconsideration of a decision made by WEA	3 344

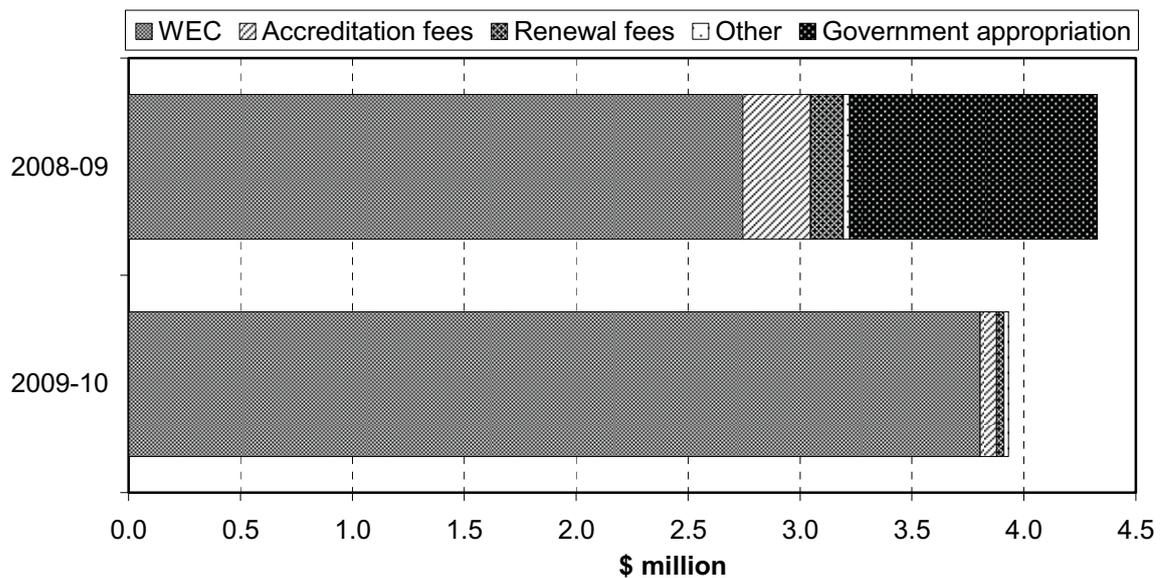
Source: Wheat Export Accreditation Scheme 2008.

In 2008-09, WEC revenue totalled \$2.7 million, and revenue from accreditation fees (including renewals) amounted to \$0.45 million (figure 4.2). The shortfall was made up for by the Australian Government as part of its transitional package (chapter 9).

In establishing WEA, the Australian Government provided \$1.1 million of supplementary funding. This was to account for the limited cash reserves available for transfer from the EWC to WEA resulting from lower WEC revenue in recent years due to drought, as well as to assist WEA in its first year of operation (including reporting on the performance of AWB (International) Ltd (WEA 2008)).

WEA is expected to be fully industry funded from 2009-10, mainly via the WEC.

Figure 4.2 **WEA revenue by source 2008-09 (actual) and 2009-10 (forecast)**



Source: WEA (sub. 55, p. 6).

#### *Under-recovery of application fees*

In its submission to the draft report, WEA provided updated, audited estimates of the cost of processing accreditation applications (table 4.3). The cost of processing a new application is estimated to be about \$27 000. When compared with the fee of \$13 299 charged to process a new application, it is clear that costs are not being recovered, despite the Australian Government’s policy intent that accreditation fees be set on a cost-recovery basis. In its submission, WEA noted that the EWC costing model at the time of formulating the Scheme was based on:

... a range of assumptions relating to the assessment of applications, which WEA has since developed through the operation of the Scheme and in accordance with the level of information it requires as a decision making body. (sub. 55, p. 17)

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The updated cost of processing renewal applications in WEA's post-draft submission shows that renewals, at about \$19 000, are less costly to process than new applications, but are also under-recovered by the renewal fee of \$7084.<sup>5</sup>

**Table 4.3 Estimated cost of assessing applications<sup>a</sup>**

<i>Type of application</i>	<i>Fee (\$) including GST</i>
New accreditation	27 038
Renewal of accreditation	18 821

<sup>a</sup> Estimates have been audited. They are based on actual applications received during 2009, including five new applications, 22 renewals, one variation and one reconsideration.

Source: WEA (sub. DR90, p. 4).

## **Industry costs**

Industry costs include the cost to exporters of complying with WEA processes for accreditation, as well as payment of the WEC.

### *Compliance costs of exporters*

Compliance costs are defined as the costs that accredited exporters face in complying with the Scheme. These include the costs of:

- preparing new and renewal applications
- responding to information requests
- complying with audit requirements
- prescribed application fees payable.

In its draft report the Commission sought additional feedback on compliance costs from accredited exporters. The Commission now has feedback from a wider range of accredited exporters, which suggests that accreditation has not been a significant cost for most exporters (Glencore Grain, trans., pp. 529-30; Elders Toepfer Grain, trans., p. 563). The biggest costs have been reported by the bulk handling companies that have trading arms, and AWB Limited (AWB). The bulk handling companies have incurred additional compliance requirements associated with WEA's monitoring of the access test. AWB has reported significant costs due to the additional conditions imposed on its initial accreditation (sub. DR63). The range of

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<sup>5</sup> Estimates were also provided for the cost of processing applications for variation (\$19 811) and reconsideration of a decision (\$33 451). However, they are each based on a sample size of one, and therefore are not reliable indicators of ongoing processing costs.

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estimates of compliance costs for these companies was between \$200 000 and \$600 000 in the first year of accreditation. There is general consensus that the ongoing costs of accreditation will be lower than in the first year.

In addition to these compliance costs, WEA application fees totalled about \$450 000 across all accredited exporters in 2008-09, and are expected to be about \$100 000 in 2009-10.

#### *Other industry costs*

The industry has also incurred the cost of paying the WEC that funds WEA operations (\$2.7 million in 2008-09, and forecast to be \$3.8 million in 2009-10). While this charge is paid by exporters (of both bulk and container wheat), it is likely to be borne ultimately by wheat growers.

## **4.5 Evaluating the arrangements as a whole — should accreditation continue?**

The terms of reference for this inquiry ask the Commission to assess the effectiveness of the current arrangements in meeting the objectives of the WEMA, and to consider the operation of the WEMA and the Scheme (including the role of WEA) as a whole.

In this section, an evaluation of how the WEMA was formulated by the Australian Government and how WEA was established is provided. The benefits of accreditation in transition are then outlined, followed by an assessment of whether or not accreditation should continue.

In the subsequent section, more specific aspects of accreditation are evaluated, including the eligibility criteria, conditions and level of assessment.

### **Formulating the Wheat Export Marketing Act**

The process by which any regulatory scheme is put in place is crucial to its relevance and effectiveness in achieving the intended policy objectives. Deciding whether or not to introduce regulation requires careful assessment of the risks arising from no regulation, compared with the payoffs from some form of regulation.

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This was emphasised in the Commission’s Annual Review of Regulatory Burdens on Business:

... while it is appropriate to attempt to reduce risks through regulation, it must be recognised that this risk reduction may come with added costs and unintended consequences. It must also be recognised that risk can never be entirely eliminated. Attempting to eliminate all risk is likely to lead to perverse outcomes because it can produce unwarranted expectations by service users and compliance burdens that are so heavy that they impede achievement of the broader policy intent.

Excessive minimisation or avoidance of risk through regulation can also lead to overly prescriptive regulations, ‘black letter law’ interpretation of regulations by regulators and excessive reporting requirements. Additional regulation can also be seen as a visible and public solution to unfortunate but isolated problems that may arise in a particular sector. (PC 2009, pp. xxiii–iv)

The design of regulation is also crucial. Poorly designed regulation can be unnecessarily complex and burdensome, and might duplicate regulations of other jurisdictions or regulatory bodies. The report of the Australian Government’s Regulation Taskforce (2006), *Rethinking Regulation*, sets out principles of good regulatory process.

In formulating the WEMA, the Australian Government complied with good regulatory practices. For example, the Australian Government completed a Regulatory Impact Statement, which outlined:

- an assessment of the problem being considered
- a statement of the objectives of Government action
- a cost-benefit analysis of three regulatory options — the status quo, and an accreditation scheme with, and without, an access test
- an impact analysis of regulation on the key stakeholders
- a summary of the consultation process and stakeholder views
- a justification for the preferred option
- how the regulation will be implemented and when it will be reviewed.

While the case for movement away from the single desk arrangement was made clear in the Regulatory Impact Statement, the Australian Government could have better established the case for some, rather than no, regulation (that is, a system of accreditation rather than no regulation at all). However, given the long-standing historical reliance on the single desk arrangement, and the extent of change in the trading environment that was expected to take place, the Commission considers some form of regulation was justified. Furthermore, provision for an early

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post-implementation review was included in the WEMA so that the effectiveness and efficiency of the arrangements could be reviewed. If the Government decides to continue with an accreditation scheme, a further review after five years would be prudent.

In developing the legislation, the Government also undertook extensive consultation, including:

- release of an exposure draft for public comment, to which it received 35 submissions
- a Senate Rural and Regional Affairs and Transport Committee inquiry into the Bill, which held four public hearings and received 48 submissions
- establishing an industry expert group to consult with industry on the provision of ‘industry good’ functions (Burke 2008a).

The draft legislation was amended to include feedback from the consultation process — for example, making cooperative structures eligible for accreditation — and where feedback was not acted upon, an explanation was provided as to why (Burke 2008b).

The legislation was also enacted in a very timely manner, allowing sufficient time for consultation and for the exposure of draft legislation for feedback. It also allowed for the Scheme to be formulated in advance (by the prevailing regulator, EWC) so that it was ready to be in place at the inception of the new arrangements on 1 July 2008. This is likely to have contributed greatly to the smooth transition away from the single desk.

The policy intent of the legislation was made clear, with the objectives of the regulation clearly outlined in the WEMA. Further policy guidance was provided in the Second Reading Speech and the Explanatory Memorandum.

The WEMA was specific regarding the guidelines and minimum requirements that were to be followed by the EWC in formulating the Scheme, and the Scheme closely mirrors the requirements of the WEMA — it does not add anything material to the minimum requirements set out in the WEMA.

FINDING 4.1

*The Australian Government followed good regulatory processes in establishing the Wheat Export Marketing Act 2008, which helped smooth the transition of the bulk wheat export industry away from the single desk.*

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## Establishing Wheat Exports Australia

Good regulatory practice was also followed in establishing WEA. A selection committee was set up by the Minister to provide advice on suitable candidates (Burke 2008a). The WEA members chosen by the Australian Government all have prior and varied industry experience and knowledge, a requirement of membership that was outlined in the WEMA.

The accountability of WEA is upheld in several ways in the legislation. The obligation for WEA to report on its operations every financial year is an important way of monitoring its performance. The deadlines for decisions made by WEA set out in the WEMA also ensure timeliness of decision making. The additional performance targets set by WEA itself in the Corporate Plan, that must be submitted to the Minister every three years (outlining the objectives of WEA and the strategies and policies to be followed to achieve those objectives), are also useful indicators of regulatory performance (WEA 2008).

Requirements for WEA to consult with exporters are clearly set out in the WEMA. WEA must consult with exporters before refusing an application, suspending or cancelling accreditation, and imposing, changing or revoking a condition. This promotes interaction between the regulator and regulated entities, and the sharing of information for effective decision making.

Right of review of decisions made by WEA were also put in place by the Australian Government. It is a legislated requirement that parties be allowed to apply for internal review of decisions made by WEA by applying for a ‘reconsideration’ of a decision. In addition, the legislation provides for merits review of WEA decisions by the Administrative Appeals Tribunal. Affected parties might also have the right to seek judicial review under the *Administrative Decision (Judicial Review) Act 1977* (Cwlth) if they believe a decision made by WEA has not been made in accordance with law.

If the current arrangements were to continue, it would be prudent that any new or amended legislation provide for reconsideration fees to be refunded if a decision is made in the applicant’s favour. There are currently provisions for WEA to refund fees in exceptional circumstances, and WEA has exercised this power for the benefit of an applicant in the past (sub. DR90). Providing for this explicitly in legislation would strengthen the certainty of such a refund, and strengthen recourse for review of WEA decisions.

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### *Powers conferred to WEA*

The WEMA clearly outlines the powers of WEA, but it also confers a high level of discretion and flexibility to WEA both in formulating and implementing the Scheme. It allows for:

- the Scheme to be a legislative instrument to give WEA the flexibility to manage the Scheme without requiring changes to the legislation
- flexibility for WEA in its assessment of certain eligibility criteria so that the criteria can be considered in relation to an applicant's particular circumstances and proposed export arrangements
- WEA to consider 'such matters (if any) as WEA considers relevant' (s. 13(1)(c)(xvii)), in addition to specific eligibility criteria set out in the WEMA
- WEA to make accreditation subject to any specific conditions it deems necessary, in addition to mandatory conditions set out in the WEMA.

The level of discretion and flexibility given to WEA is a core feature of the current arrangements and a key focus of feedback received from participants. It is touched on throughout the remainder of this chapter.

## **Benefits of accreditation in transition**

There was a widely held view from participants that accreditation was of benefit in the transition away from the single desk, and that it has been successful in meeting the objective of the WEMA to protect the needs of growers.

The Commission agrees with this overall view. The benefits that have ensued from accreditation include providing comfort to growers, facilitating access for traders to port terminal facilities, protecting Australia's reputation and facilitating a smooth transition. However, it is the Commission's view that most of the benefits of accreditation are small and will diminish over time, and that any ongoing benefits can be better achieved in ways other than accreditation.

### **Comfort to growers**

There was widespread recognition from participants that accreditation has provided comfort to growers in the transition to deregulation. This view was put forward most strongly by grower groups, including the following:

- From a grower's perspective, having accreditation for bulk wheat exporters, wheat growers are reassured that the companies are credible. As a result growers have

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been able to trade with greater confidence. Had this accreditation not been in place prior to the impacts of the Global Financial Crisis, the outcomes may have been quite different. Just by having the system in place provides an automatic filter of assurance. (AgForce, sub. 16, p. 2)

- Market participants have benefited from ... accreditation, particularly when there are now 24 accredited companies under the Wheat Export Accreditation Scheme. The Association believes that the accreditation process gives growers some confidence which, under the present wheat export marketing arrangements, could not be obtained through any other process. (NSW Farmers Association, sub. 49, p. 6)
- Criteria such as the financial resources available to the company, the company's risk management arrangements, business records and any offences related to dishonest conduct and whether a company has contravened a condition of the company's accreditation are important. (The Western Australian Farmers Federation, sub. 29, p. 5)

Some participants emphasised, however, that while accreditation might provide comfort, no actual guarantee of payment is provided to growers and, therefore, accreditation is of little tangible benefit. The comment from the Australian Grain Exporters Association (AGEA) was representative of this view:

The accreditation process does not provide growers with any guarantees in regard to security of payment or marketer performance and thus, can be said to provide little tangible additional benefit. (sub. 28, p. 6)

Viterra pointed out that accreditation can in fact provide false hope:

There is no guarantee that bulk wheat exporters will not default; to the contrary the WEA's review of the financial condition of exporters may give some growers a false sense of confidence. (sub. 23, p. 2)

While many accepted that accreditation had provided comfort to growers, there were a variety of views about whether this comfort can and should be ongoing. Some participants asserted that there is already enough comfort afforded growers from existing legislation (for example, the Corporations and Trade Practices Acts, discussed below) as well as from experience dealing with the same exporters in trading other grain. They therefore believe that the extra layer of comfort derived from accreditation is unnecessary. As an example of such a view, the AGEA pointed out:

While the accreditation process may have provided growers and others with comfort in regard to the capacity and capability of the exporters, in the main, growers were already dealing with the accredited exporters in relation to other grains and other services and were therefore, already known to growers. Similarly many of the accredited exporters already have global operations and established customer relationships. (sub. 28, p. 6)

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Other participants noted that it should be the responsibility of growers to exercise due diligence and make prudential decisions in their marketing deals, and that there are enough services and sources of information available to assist them, without the need for accreditation. For example, wheat producer J & M Hassell stated:

WEA cannot provide any guarantee that any business can or cannot pay for grain. Growers can rely on their own market information and judgement about who can and cannot pay and trade with whomever they think is the best fit for their business: those that can't pay will not be in the game for long. Underwriting can be purchased for a fee to guarantee income from the sale of grain. This is of course the choice of the grower. (sub. 13, p. 1)

ACIL Tasman, in the report prepared for Co-operative Bulk Handling (CBH), said:

All parties trading in the grain supply chain have strong incentives to actively and constantly scrutinize those with whom they are dealing. Commercial or counterparty risk assessment is made on a case by case basis for many producers. This assessment relies on an assessment of the risks of each transaction taking into account the terms of the contract and the reputation of the counterparty. ... In many instances buyers and sellers will rely on the performance of the counter party in previous transactions. Over time each party establishes a commercial history. (ACIL Tasman 2009, pp. 31–2)

### *The Commission's view*

The Commission agrees with the widely held notion that the Scheme has provided some comfort for growers in the movement away from a single desk arrangement towards a deregulated environment. Having WEA rigorously assess the financial viability and risk management practices of potential exporters of bulk wheat has reduced fears held by growers that payment would not be received for wheat under the new arrangements. This has been important given both the extent of change in the market within such a short period of time, and the fact that deregulation coincided with the global financial crisis where growers might have felt an even greater level of unease about not being paid.

However, it is the Commission's view that, while the comfort provided by accreditation has been of benefit, this benefit is:

- limited in scope — accreditation does not provide financial security or guarantee of payment to growers. An accredited exporter can still default on payment and, therefore, growers still need to exercise judgment when entering into commercial transactions with accredited exporters. This is made explicit by WEA. It notes that 'accreditation does not indemnify any persons dealing with accredited exporters and provides no guarantees that an exporter will remain financially viable throughout its accreditation period' (WEA 2009a, p. 4)

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- short-term only — as market forces promote greater competition, the incentives for exporters to establish a solid reputation with growers increase. Once this reputation becomes better established, the need for accreditation is eliminated. Any potential risk from unknown new entrants is also reduced as growers and buyers may choose to deal exclusively with exporters that they know to be better established.

In addition, most growers are already dealing with many of the accredited wheat exporters in marketing other grains, or domestic wheat, and have long-standing relationships with them. The Commission has not received any evidence to suggest that growers selling into other grain markets, including domestic wheat and wheat exported in containers and bags, are not being paid, and there is no evidence to suggest that traders of bulk export wheat are any less reputable than traders in other markets. As with other markets, wheat growers must exercise judgment over who to sell to.

### **Facilitating access**

The access test provision set out in the eligibility criteria for accreditation establishes a link between access to port terminal facilities, and the ability of operators of those facilities to export wheat in bulk. It has been a condition for port terminal operators to comply with the access test in order to be accredited, thereby ensuring that access undertakings were in place with the ACCC and that continuous disclosure rules are complied with. Many participants see this link as crucial to ensuring that a credible threat is in place for bulk handling companies that do not comply (see examples of such views provided in chapter 5).

#### *The Commission's view*

The Commission agrees that the link between accreditation and access has been of benefit in transition. The threat of losing the ability to export has ensured that the port terminal operators had undertakings in place with the ACCC and complied with continuous disclosure rules.

However, beyond a transitional period, it is the Commission's view that an accreditation scheme is not required to maintain a link between the access test and a port terminal operator's ability to export. The WEMA could be amended to provide that port terminal operators that wish to export pass the WEMA access test — that is, have an ACCC accepted undertaking in place, and adhere to continuous disclosure rules — without accreditation. The ACCC could monitor compliance with these provisions. This would avoid the possibility of regulatory overlap from

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having two regulators —WEA and ACCC — overseeing matters related to access. This issue is discussed in more detail in chapter 5.

## **Reputational benefits**

Some participants see accreditation as a way of maintaining the reputation of Australian wheat. The threat of being deemed by WEA as no longer fit and proper to export and thereby having accreditation cancelled is believed to discipline exporters to ensure quality control of export shipments.

Quality control problems emerging in the now fully deregulated container market have been used as evidence to support this view. For example, the Wheat Quality Objectives Group said:

The Group believes that accreditation is a prerequisite in a deregulated export market in order to protect Australia's reputation as a reliable supplier of quality wheat. ... On quality grounds alone, one could argue that there is an equal need for accreditation of non-bulk wheat exporters and domestic suppliers, given the damage that can be done to Australia's 'brand' image by the supply of poor quality grain that fails to meet customer's expectations. That said the domestic market is in a somewhat better situation in that buyers can deal directly with the grower, seller or grain handler and ensure that their precise needs are accommodated. (sub. 27, pp. 2–3)

Similarly, Hart Krtschil said:

Given that the evidence available points to an increase in outturn problems since deregulation, the recommendation in the draft report to remove accreditation of wheat exporters must surely amplify such risks even further due to more exporters entering the market with little or no knowledge of wheat quality parameters or chemical residue issues. (sub. DR80, p. 1)

### *The Commission's view*

The Commission believes that the accreditation scheme is likely to have increased the confidence of international customers buying Australian bulk wheat in the transition away from the single desk and, in doing so, maintained Australia's reputation as a reliable and high quality exporter of bulk wheat. The Commission also acknowledges the concerns of some industry participants that even one shipment of sub-par quality wheat is enough to damage the entire industry's reputation.

However, the imperatives of a competitive environment should be sufficient to protect Australia's reputation on an ongoing basis (chapter 8). Such an environment is characterised by international buyers having unprecedented choice in who they

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trade with, requiring exporters to offer competitive terms, deliver to contract specifications, and ensure quality control. This point is made explicit by WEA in its 2008-09 Report for Growers:

WEA plays no role in controlling the quality of Australian bulk wheat exports. ... Commercial realities in a competitive environment mean that exporters must meet contract specifications if they wish to secure and maintain long-term relationships with overseas customers. (WEA 2009d, p. 18)

In addition to these commercial imperatives, the reputation of Australian wheat is already protected in a number of ways (chapter 8). The Australian Government, in reference to the full deregulation of bag and container wheat exports:

There are ... measures in place through other legislation, such as Export Control (Plant and Plant Product) Orders 2005, that require an exporter to obtain an export permit from the Australian Quarantine and Inspection Service for the export of grain (including wheat). This provides a mandatory control on trade description and practical freedom from insects, pests and noxious weeds. (Burke 2008b, p. 11)

The fully deregulated environment in which the domestic wheat market and other grain industries are operating (appendix C) is also testament to the ability of competitive industries to manage quality control without an accreditation system — no verified quality control issues in these industries have been drawn to the attention of the Commission.

In any case, if the industry thinks that there is a systemic problem with quality control (in container or bulk exports or both) and that widespread damage to the industry's reputation is possible, the Commission supports industry self-management as the most efficient solution to such a problem, rather than the retention of an accreditation system for this purpose (chapters 8 and 9).

## **Facilitating a smooth transition**

Feedback from submissions indicated that the activities undertaken by WEA have had the benefit of ensuring a smooth transition away from the single desk. This has occurred in the following ways:

- through accreditation, which provided comfort to growers, traders and buyers of wheat at a time of immense change and uncertainty (as outlined above)
- enhancing governance and risk management processes of accredited exporters through the audit process (box 4.5)

- having WEA undertake certain so-called ‘industry good’ activities on behalf of the industry. Some of the activities cited by participants as providing a benefit to the industry include:
  - promoting awareness of the End Point Royalty and National Residue Schemes by including compliance with the schemes in the accreditation application form (Australian Seed Federation, sub. DR68; Grains Research and Development Council, sub. DR69; WEA, sub. 55) (chapter 8)
  - monitoring pool performance (Glencore Grain, sub. DR89) (chapter 3)
  - facilitating engagement of key stakeholders (WEA, sub. 55)
  - disseminating information to industry, including newsletters, fact sheets, media releases, presentations and the annual Report for Growers which summarises the operation of the wheat export accreditation scheme in that year and provides industry statistics (NSW Farmers Association, sub. 49; Grain Growers Association (GGA), sub. 41; WEA, sub. 55).

**Box 4.5      Comments from accredited exporters to WEA about the accreditation process**

- ‘... it has been a very rewarding process and one that I believe has added a lot of value to (our) business, not just from an export customer point of view, but just as important, internal procedures and processes.’
- ‘... we found the (external) audit constructive and useful especially with respect to risk management and how it would apply to our business strategy as we move from a primarily containerised grain shipper to bulk shipper.’
- ‘... (the external) audit report has also assisted us in now redefining risk management processes and we would be willing to implement the report recommendations.’
- ‘... (the external) audit report forms a strong policy base to enhance to a level recommended by the risk management standard.’
- ‘... (the external) audit was difficult although it has identified a number of issues that we had not thought of, this has been of benefit to our business.’

*Source: WEA (sub. 55, p. 32).*

Some participants argue that these benefits justify an expanded role for WEA over and above accreditation:

- The Wheat Export Marketing Act 2008 should in fact go further to include the extension of powers for WEA to require it to benchmark the performance of all accredited exporters and publish export information in the interest of market transparency. (NSW Farmers Association, sub. DR91, p. 5)

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- The provisions for Wheat Exports Australia to proactively monitor the conduct of the bulk handlers, both to actually provide access and to fairly conduct their wheat pools ... need to be retained and strengthened. This can be done at the same time as removing the requirement for export accreditation under the Act. (Glencore Grain, sub. DR89, p. 2)

### *The Commission's view*

The presence of a single body, WEA, to facilitate the industry's transition from a single desk to one with many exporters has been of considerable benefit. The role of WEA has been pivotal in ensuring that the transition has been smooth in light of the degree of change to take place in a short period of time, and the additional uncertainty brought about by the global financial crisis that coincided with deregulation. This benefit, however, diminishes once the transitional period ends.

Having WEA perform activities other than accreditation on behalf of the industry has also been of benefit in transition. It has given the industry time to adjust to the deregulated environment. In the longer term, however, it is best left up to the industry to self-manage any gaps in the provision of 'industry good' type activities that might emerge in such an environment, rather than have a government body such as WEA perform these functions on an ongoing basis. Keeping such a body beyond a transitional period may risk preventing the industry from making a coordinated effort to find efficient, self-directed solutions (this issue is dealt with in detail in chapters 7, 8 and 9).

In addition, the improvements to the governance and risk management practices of exporters are largely one-off benefits only.

## **Should accreditation continue?**

Whether or not accreditation should remain in place is essentially a question of weighing up the costs and benefits. This section examines this first from the perspective of inquiry participants, and secondly from the perspective of the Commission.

### **Views of participants**

Looking beyond a transitional period, participants were split as to whether or not there was an ongoing role for accreditation.

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Some participants, mainly grower organisations, advocate ongoing accreditation for the sake of assessing the fit and proper standing of exporters, and therefore did not agree with the Commission's draft recommendation that accreditation be abolished in September 2011.

The Victorian Farmers Federation put forward this view:

Wheat Exports Australia should continue as industry umpires to ensure marketers are fit and proper companies to export. They provide much needed checks, balances and security during the transitional period, a role that is still required as the industry is by no means prepared for total deregulation. (sub. 40, p. 2)

In presenting a similar view, other organisations argued that bulk wheat exports should be treated differently from other export grain industries that do not have accreditation:

- The main reason why the accreditation process is so important for exporters of bulk wheat and not for exporters of other grains, or exporters in the bag and container trade, is due to the simple fact that bulk export wheat is by far the largest export of Australian grain and as the benchmark grain, affects the most growers. (NSW Farmers Association, sub. 49, p. 6)
- It was raised by other groups that other grains do not need this regulation and the market weeds out bad exporters. However given that wheat is the most important grain exported in Australia AgForce Grains do not believe that the industry can afford to let market forces expose the bad exporters, at this early stage. ... Wheat should not be compared to other grains, as most other grains are ... exported as feed grain. Wheat has many different grades with many quality parameters. ... While it is not being suggested that the regulation/accreditation be in place indefinitely, AgForce grains believe it is vitally important that there be some form of accreditation process for the near future. This would help provide some checks and balances to assist the industry through the transition period. (AgForce Grains, sub. DR73, p. 2)
- This organisation asserts that some form of accreditation is required when it comes to bulk exporters of wheat, and that this accreditation or licensing should be on-going. While opponents to on-going accreditation would say that this is not occurring for barley and other coarse grains, our answer would be that wheat is the most significant crop grown in Australia, and indeed Western Australia, and any losses obtained through growers not dealing with a 'fit for purpose' exporter would bring about significant financial losses to growers. (The Western Australian Farmers Federation, sub. DR92, p. 3)

In its submission to the draft report, the NSW Farmers Association went further, suggesting that accreditation should also include domestic traders (sub. DR91).

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Several growers also strongly supported ongoing accreditation:

- I believe that WEA should continue its role until at least 2014 as it has a role to play in the accreditation of exporters and does give some security that growers will be paid for their grain. (Marion Billing, sub. DR61, p. 1)
- At this stage I have to support continuation of the accreditation scheme beyond [September] 2011 because we have nothing better to give growers any security on their wheat. (Rod Hatty, sub. DR72, p. 3)
- I disagree with removing all accreditation to exporters. Growers will have no confidence in buyers' abilities to pay because of the lack of accreditation or background checks. (David Fox, sub. DR71, p. 1)
- We believe September 2011 is too early to remove the need for exporters to be accredited, and too early to disband the WEA. We are very concerned the marketing of Australian wheat should be by Australian companies/cooperatives registered in, and paying taxes to Australia. (Ralph Billing, sub. DR62, p. 2)

On the other hand, many participants felt that accreditation was no longer necessary. For example, grower Trevor Badger stated:

I believe there is no need for accreditation of bulk exports as the rest of the world operates efficiently without such bureaucracy and it simply places Australian growers at a disadvantage. This layer of bureaucracy is paid for by the Australian grower and brings no benefits. ... Accreditation should be stopped now as there are adequate levels of protection in existence such as the Trades Practice Act and Bulk Handling Act 1967. (sub. 14, p. 1)

The Department of Agriculture and Food (Western Australia) stated:

As outlined in the original submission, the department is comfortable with the removal of the requirement for accreditation of exporters and, therefore, supports draft recommendations 4.1, 4.2, and 4.4. The department is of the view that the benefits of maintaining [Wheat Exports Australia] and the accreditation of wheat exporters cannot be justified on the basis of cost. (sub. DR84, p. 1)

AWB said:

... AWB retains the view that the compliance regime applied is unnecessary given the lack of demonstrable benefit to the wheat export industry beyond assisting with the facilitation of the bulk export market deregulation. (sub. DR63, p. 7)

To support the view that accreditation is no longer necessary, many participants raised the idea that wheat is no different from other grains and therefore should be treated as such. CBH's comment was typical of this view:

All other grains are exported successfully without any form of regulation. There is no precedent of other bulk commodity export industries (e.g. coal and iron ore) requiring regulation of this kind. (sub. 39, p. 3)

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ACIL Tasman, in a report prepared for CBH, expanded on this point:

Given that there does not appear to be any clearly differentiating feature of export wheat buyers with other wheat buyers for domestic purposes and that licensing export wheat buyers only covers a proportion of wheat buyers, it is difficult to see how licensing could deliver benefits to the community (and farmers) other than as a short term transitional arrangement to encourage broader economic reforms in the wheat industry. (ACIL Tasman 2009, p. 36)

As the WEMA covers only the bulk export of wheat, while exports of wheat using bags and containers are now fully deregulated (appendix C), some participants also argued that this different treatment of bulk exports and container exports creates distortions and makes accreditation inappropriate. For example, the GGA said:

The accreditation process adds an additional administrative burden to the industry which doesn't exist for either exporters of wheat in containers or other grains/commodities in bulk, nor the domestic market ... Our view is that the current system is not sustainable due to the regulatory arbitrage that can occur between exports in containers and in bulk. (sub. 41, p. 5 and p. 6)

ACIL Tasman, in the report prepared for CBH, added to the debate:

The establishment and continuation of the WEMA establishes an artificial delineation between merchants exporting or intending to export wheat to all other grain merchants operating in Australia. This delineation of exporters is not based on the services they provide to growers but on whether some or all of the wheat they purchase is exported in bulk. The destination of the wheat and in what form it is exported in bears almost no relationship with the potential or actual transaction that these companies have with growers who are the intended beneficiaries of the legislation. (ACIL Tasman 2009, p. 36)

Other participants argued that accreditation is a costly duplication of existing regulation. They contend that sufficient legislation already exists to protect industry players and that accreditation is therefore wasteful, and places the bulk wheat export industry at a 'regulatory and commercial disadvantage when compared to other grain and non-grain export industries and ... bulk wheat industries in other countries' (Viterra, sub. DR70, p. 4). GrainCorp went into detail on this issue in its submission:

The accreditation system also fails to take into account the existing multiple levels of regulation that apply to the action of financing and purchasing grain from growers or other traders. ... GrainCorp believes there is significant overlap between the *Wheat Export Marketing Act 2008* and the Corporations Act, Trade Practices Act and a range of other Acts and Regulations that bind accredited exporters of wheat to act in a lawful manner. The above mentioned Acts and Regulations apply to all business dealings that relate to the trading of wheat in the domestic Australian market, and to the trading of non-regulated grains in both the domestic and export markets. In many instances, these Acts and Regulations have primacy over the *Wheat Export Marketing Act 2008*. All of

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the matters that Wheat Exports Australia require for both their ‘fit and proper’ test, and for the ‘notifiable matters’, are matters that duplicate provisions under the *Corporations Act 2001*, and for listed companies, ASX listing rules. Other criteria contained within the scheme, including the financial disclosures, duplicate requirements under a range of Acts and Regulations that apply to accredited companies. (sub. 43, p. 6 and pp. 11–12)

ACIL Tasman, in the report prepared for CBH, held a similar view:

There also appears to be considerable regulatory overlap with the licensing provisions of the WEMA and sections of corporate law as administered by the Australian Investment and Securities Commission. In particular the *Financial Services Reform Act 2001* (Cth) requires grain marketing companies selling derivative based products (futures and options) to maintain a Financial Services License. (ACIL Tasman 2009, p. 33)

ACIL Tasman (2009) also suggested that WEA could be crowding out commercial providers of information by duplicating a role that such providers would normally offer for a fee that the industry is willing to pay.

WEA (sub. DR90), on the other hand, expressed reservations about the claims of duplication, noting that most of the information it relies on is not required to be disclosed by the *Corporations Act 2001* or the Australian Securities Exchange, and that most exporters are not listed.

There was some feedback from participants that the accreditation requirements create an unnecessary barrier to entry into the bulk wheat export market. Several participants pointed out that it is mainly the smaller players that face such a barrier. This view is summarised by the GGA:

A substantial portion of the industry is not covered by this scheme as it is either domestic consumption or exports in containers which don’t require accreditation. In this way the presence of the accreditation scheme may have been a barrier to entry for some players to engage in the bulk export of wheat. ... The presence or absence of accreditation is probably not a major consideration for many larger exporters when taken in the context of other matters for consideration such as client demands, comparative shipping rates, etc. However there may be smaller companies who would like to export in bulk but are perhaps more inclined at present to export in containers and avoid the accreditation process. (sub. 41, p. 4 and p. 5)

While many participants thought that accreditation on the basis of a fit and proper assessment is not required, the Commission received feedback on its draft report calling for accreditation to be retained so that the link with the access test for bulk handling companies can remain in place. For example, the AGEA stated:

AGEA agrees with the Productivity Commission finding that export accreditation does not deliver a net benefit in terms of improving security for growers. The major benefit

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of the accreditation process has been to provide a level of confidence to growers in relation to the capacity and capability of the parties participating in the wheat export market to meet their obligations. However, the link with port access has provided considerable value and exporters and growers with a safeguard against the development of an uncompetitive industry structure. AGEA believes that the existing legislation requiring those companies seeking accreditation, and with port facilities, to submit access undertakings to the ACCC should be maintained. (sub. DR79, p. 6)

Similarly, the Pastoralists and Graziers Association of Western Australia said:

PGA deems it necessary for WEA to continue for another round of accreditation, so as to lend additional teeth to the continued ACCC oversight of port access arrangements in the mean time. (sub. DR81, p. 5)

### **The Commission's view**

It is the Commission's view that accreditation has been a very useful tool to facilitate the industry's transition toward a deregulated environment.

Given the historical context in which the legislation was formulated, where there was a long-standing reliance on a single desk system, and the concerns of some participants in the wheat industry regarding deregulation, the Commission understands the need to retain some layer of oversight of the bulk wheat export industry in the transition. The degree of change that would have occurred in moving straight to full deregulation without some form of accreditation is justification for this level of specific regulation during a period of transition.

The Commission has identified several benefits from accreditation, including comfort to growers, facilitating access for traders to port terminal facilities, upholding the reputation of Australian wheat, and facilitating a smooth transition in the face of rapid change. This rapid change coincided with the global financial crisis and accreditation provided reassurance to growers during that period. Weighing these benefits against the direct costs of accreditation to date outlined in section 4.4 above — which can be characterised as relatively small — the Commission sees accreditation as having been of net benefit to the industry in the transitional period.

FINDING 4.2

*The Wheat Export Accreditation Scheme 2008 has been effective and appropriate as a transitional measure, providing net benefits to the bulk wheat export industry in the short term.*

However, beyond the transitional period, there is likely to be a net cost to keeping accreditation. While the ongoing regulatory and compliance costs are not expected

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to be very large, the benefits of accreditation diminish over time, and other, indirect costs can be expected to emerge.

As noted above, the comfort to growers is short term and limited in scope. Ongoing accreditation will only delay growers' adjustment to a competitive environment, and this delay will become costly to them. Ultimately, it is growers' responsibility to exercise prudence in their dealings with bulk wheat exporters, as they are required to do in marketing their other grains. If accreditation remains in place to provide growers comfort without any actual financial security beyond a transitional period, it could be costly to growers by preventing them from exercising due diligence and from adapting to the changed marketing environment they now face.

It is also most efficient for industry to devise a system of quality control that protects the reputation of Australian wheat if required (chapter 8), and deal with any under provision of 'industry good' functions, outside of accreditation (chapter 9). Government intervention in these areas is not justified, except as regards some information provision (chapter 7) and trade policy advocacy (chapter 9).

Retaining accreditation on an ongoing basis could entrench other market distortions, including: barriers to entry into the market for some potential entrants, especially smaller players or those new to the industry; a lack of transparency in decision making which can distort market signals; rigidities and uncertainties that inhibit the industry's ability to respond to market conditions; and, regulatory by-pass in response to inconsistent regulation of the bulk and container export markets. While such costs are more difficult to measure and may not be particularly large, they can be expected to increase over time as the distortions become more entrenched and harder to unwind, especially in light of the significant risk of regulatory creep.

On a broader level, the Commission sees no inherent reason why, beyond a transitional period, bulk wheat should be treated any differently from the container export industry and, indeed, exports of other grains and the majority of other agricultural commodities. Whether or not accreditation is seen as a duplication of existing legislation, the Commission sees nothing particular about wheat that requires an ongoing set of specific regulations related to an accreditation system that other grains and agricultural commodities markets do not have, notwithstanding that some participants considered the size of the wheat export industry made it a special case. The deregulation of the domestic wheat industry, as well as other grain and agricultural industries, has been successful and these industries are effectively operating without accreditation schemes. There is no evidence to suggest that this will not also be the case for the bulk wheat export industry. Retaining accreditation will only add an unnecessary layer of regulation to an existing body of legislation that serves other markets sufficiently.

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Weighing up the costs and benefits of the Scheme, and accounting for the smooth operation of those grain industries without accreditation, the Commission does not see an ongoing role for accreditation. To the extent that the industry believes there are ongoing benefits resulting from aspects of the current accreditation system, these can be dealt with in ways other than accreditation. For example, for concerns over quality control, the industry could self-manage with a code of conduct, or a logo or branding system (chapters 8 and 9). For concerns related to access, the ACCC can administer and monitor compliance with the access test (chapter 5).

It is the Commission's view that the transitional period as it relates to accreditation is approaching its end. The Commission considers that by the end of the next marketing year, the industry will have had three years of adjustment to trading in a deregulated environment with the support of the accreditation system, and that it will be ready to operate without accreditation. This is indicated by:

- the high level of entry of traders exporting bulk wheat and gaining market share from AWB
- a levelling out in the number of accredited bulk exporters
- no bankruptcies of accredited exporters in the first two years
- an increase in choice for growers in marketing wheat
- no traders defaulting on payments to growers
- a high level of bulk exports to a diverse range of international markets being successfully executed.

FINDING 4.3

*There is likely to be a net cost to keeping accreditation beyond a transitional period. The transitional period as it relates to accreditation is approaching its end.*

This is not to say that transitional issues do not remain in other areas of the industry, namely in relation to ports and the related supply chain. These issues are discussed in the following two chapters. However, accreditation is not required to support the industry with these remaining transitional issues.

RECOMMENDATION 4.1

***The Wheat Export Accreditation Scheme 2008 should be abolished on 30 September 2011. This timing would coincide with the end of the 2010-11 marketing year and give the Australian Government sufficient time to put the required legislative changes in place.***

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Under regulation 9AAA of the *Customs (Prohibited Exports) Regulations 1958* (Cwlth), bulk wheat is a prohibited export unless exported by an accredited wheat exporter. Regulation 9AAA becomes irrelevant under the Commission's recommendations to abolish accreditation and should therefore be repealed.

RECOMMENDATION 4.2

***Regulation 9AAA of the Customs (Prohibited Exports) Regulations 1958, which prohibits bulk exports of wheat unless exported by an accredited wheat exporter, should be repealed effective 30 September 2011.***

Without accreditation, the Commission sees no ongoing role for WEA. As noted above, the industry is best placed to fill any gaps that might emerge in a deregulated environment without accreditation (this is discussed further in chapters 7, 8 and 9). It is also possible to keep the condition that to export, port terminal operators must pass the access test, without retaining an accreditation scheme administered by WEA (this is outlined in chapter 5).

RECOMMENDATION 4.3

***Wheat Exports Australia should be abolished on 30 September 2011.***

The terms of reference for this inquiry ask the Commission to examine how changes to the operation of the WEMA or the Scheme would affect arrangements to fund WEA and the use of cost-recovery mechanisms. As noted above, WEA is funded by application fees and the WEC. The WEC is levied on both bulk and non-bulk exports.

The consequence of the Commission's recommendations to abolish accreditation and WEA is that it is no longer appropriate or necessary for the Australian Government to collect the WEC.

If the industry wishes to establish a body to administer an accreditation or licensing system, or to provide 'industry good' functions, it could choose to fund this through a voluntary levy. This would be the responsibility of the industry to coordinate and administer (chapter 9).

RECOMMENDATION 4.4

***The Wheat Export Charge should be abolished on 30 September 2011.***

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## 4.6 Evaluating the criteria, conditions and level of assessment of accreditation

In evaluating the effectiveness of the overall arrangements, the Commission has concluded that accreditation should be abolished. However, the terms of reference for this inquiry also ask the Commission to consider, more specifically:

- the suitability of the eligibility criteria required for, and conditions imposed upon, accreditation
- the appropriate level of assessment of each applicant for accreditation by WEA against the eligibility criteria.

This is relevant in the case that the Australian Government decides to retain some form of accreditation. In this section, the effectiveness of the eligibility criteria, conditions of accreditation and level of assessment employed by WEA is analysed. Those aspects that have worked well are identified, as are the changes that would be required if accreditation were to continue beyond 30 September 2011.

### Eligibility criteria

As outlined in section 4.1, the eligibility criteria for accreditation set out in the WEMA and the Scheme essentially fall into three broad categories:

- company requirements
- the fit and proper standing of a company
- the access test requirements for port terminal operators that also wish to export.

#### *Company requirement*

The WEMA states that, to be eligible for accreditation, a company must be registered as a company under part 2A.2 of the *Corporations Act 2001* (Cwlth) or a cooperative, and the company must be a trading corporation to which paragraph 51(xx) of the Constitution applies.

Some participants thought that the company requirement created a barrier to entry for growers wishing to directly export their wheat in bulk. For example, grower Trevor Badger said:

Assessment costs are unnecessary and simply prevent the normal grower from having a go at exporting his own wheat. To develop new markets or varieties growers or groups of growers must be able to easily access the world markets. ... The accreditation for me was too costly for a deal that may have fallen through at any stage. The whole process

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was counter to the passion I had to provide wheat to a new high value end user. (sub. 14, p. 1)

The Department of Agriculture and Food (Western Australia) echoed this view:

Accreditation appears to be an unnecessary barrier to entry for potential exporters. This is particularly relevant in WA where some larger growers have expressed a desire to export their own wheat but are required to set up a company and gain accreditation. (sub. 34, p. 3)

In his second reading speech, Minister Burke noted that the Government did not think it was necessary ‘to extend accreditation rights to individuals, as prudent managers would operate as a company to reduce their exposure to risks associated with shipping what are expected to be high-value tonnages’ (Burke 2008a, p. 3859).

The company requirement is unlikely to be prohibiting the entry of many potential farm-based exporters, as most large farms are already registered companies. However, if accreditation is to continue in its current form beyond 30 September 2011, it is the Commission’s view that the eligibility requirement could be relaxed to allow other business structures such as partnerships and sole proprietors to commence exporting in bulk. This would lower the barrier to entry for farmers wishing to export their own wheat. Any increase in risk associated with a non-company structure could be limited by imposing specific conditions on these exporters, such as the condition that exports be restricted to wheat produced on the properties of the accredited wheat exporter (as is applied to Greentree Farming Export Pty Ltd).

#### *Fit and proper company*

The eligibility criteria for assessing the fit and proper standing of an applicant include 17 points for consideration by WEA and represent the most substantive aspect of the accreditation scheme (outlined in box 4.1 above). These can be broadly categorised as criteria relating to:

- financial resources and risk management practices
- the business and legal record of the company and its executive officers
- any other matters WEA considers relevant.

The second reading speech makes it clear that applicants do not have to meet each of the 17 criteria to be accredited. It also states that WEA can use its judgment as to whether a company is fit and proper even though it might not fulfil all the criteria.

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While there have been some calls for the Australian Government to guarantee payments to growers (for example, Rod Hatty, sub. DR72), in the Commission’s opinion, it is appropriate that the Scheme does not provide a financial guarantee. Any such guarantee would inhibit the objective of the WEMA to promote a competitive environment by stifling competitive forces, and could create moral hazard problems.

The Commission believes that the fit and proper criteria themselves have been appropriate for the transition. It is in the level of assessment employed by WEA when considering these criteria that change would need to occur should accreditation continue, so that processes could be more streamlined (see below).

In addition, the Commission suggests that section 13(1)(c)(xii) of the WEMA, which states that WEA can consider any other matters as relevant in assessing whether a company is fit and proper to export, might create ambiguity as to the powers of WEA in matters related to access — this is discussed next.

#### *Access test*

The WEMA charges WEA with responsibility for ensuring that port terminal operators comply with the access test provisions of having an ACCC approved undertaking in place and of complying with continuous disclosure rules. However, following discussion with a range of stakeholders, it appears to the Commission that there is confusion over how far the powers of WEA extend in matters of access and competition policy as it relates to wheat terminals. The respective roles of WEA and ACCC over such matters is generally not well understood by industry participants and this is not surprising as, in the Commission’s view, the legislation as it stands is not clear on this issue.

For example, regarding the access undertaking component of the access test, it is not clear whether WEA could conclude that a bulk handler had failed the access test if the bulk handler had either entered into arbitration with the ACCC and/or been found by the ACCC to be in breach of its undertaking. It is the Commission’s understanding that as long as an undertaking is technically still in place, accreditation could not be revoked under section 13(1)(d) of the WEMA. However, WEA could retain power to investigate, at its discretion, issues relating to the behaviour of port terminal operators as part of its assessment of whether its trading arm remains fit and proper to export. This could fall under section 13(1)(c)(xii) of the WEMA which allows WEA to consider any matters it sees as relevant to assessing whether a company is fit and proper.

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Regarding the continuous disclosure rules component of the access test, the WEMA states that policies and procedures documents, as well as various details about the shipping stem, should be made *available* on the bulk handling company's internet site. However, the WEMA does not comment on whether these need to be *appropriate*. Therefore, it is not clear to the Commission what role WEA has in monitoring cases of unfair or inappropriate use of the shipping stem, and whether any such behaviour would constitute a breach of the access test and therefore justify a cancellation of accreditation, or whether it would fall under an assessment of fit and proper.

A second issue is, irrespective of what power WEA *does* have over these matters, what powers *should* WEA have? It is the Commission's view that any overlap in regulatory powers as they relate to competition policy is not appropriate (chapter 5). Regulatory overlap creates confusion and uncertainty which can be costly to industry participants, and can also encourage gaming of the regulatory system.

The Commission therefore sees the ACCC as the appropriate regulator to deal with access related issues and believes that WEA should not have any jurisdiction in such matters (chapter 5).

If accreditation and WEA were to continue, any new or amended legislation would need to more clearly define the role of WEA and, in doing so, make it clear that WEA's powers do not extend to ruling on matters of competition policy. It should be made clear that in assessing whether or not a company is fit and proper to export, the assessment should be confined to the operations of the trading arms of vertically integrated companies, and not the conduct of the port terminal operators in relation to the competition matters.

## **Level of assessment**

The Commission takes 'level of assessment' to cover both the processes undertaken by WEA to assess an applicant against the eligibility criteria, and those undertaken to monitor compliance with the Scheme. In this sense, the level of assessment is linked to the costs of administering and complying with the Scheme — the more involved the level of assessment, the higher the costs are likely to be.

According to the Minister in his Second Reading Speech, the Wheat Export Marketing Bill contained 'an appropriate balance between the need to apply strict probity and performance tests to protect the interests of growers while not applying an excessive regulatory burden on accredited exporters' (Burke 2008a, p. 3859). Furthermore, the Explanatory Memorandum makes it clear that the breadth of the

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17 fit and proper criteria is not intended to place an excessive burden on WEA, and that WEA does not need to exhaustively examine each criterion.

There has been concern expressed from port terminal operators that the level of assessment employed by WEA has been excessive, and is adding unnecessarily to compliance costs. For example, GrainCorp stated:

The current level of assessment and auditing has increased the cost of running the accreditation scheme and the cost of complying with the scheme. As a result, the scheme is burdening the wheat export sector with additional costs and imposing significant inefficiencies, in the form of needless compliance activities. GrainCorp believe that no benefits are provided by the current level of assessment and audits. ... Wheat Exports Australia requires a range of reporting that is onerous and disproportionate and its powers are broad and somewhat arbitrary. (sub. 43, p. 13 and p. 14)

GrainCorp called for WEA to ‘of its own volition, implement reforms to the manner in which the current scheme is applied to achieve a more “light handed” outcome, rather than the current *process* focused regulatory regime’ (sub. DR82, p. 5).

In detailing the extent to which the compliance burden is excessive, ACIL Tasman (2009) outlines the steps taken by CBH in complying with the Scheme (box 4.6).

Other accredited exporters, however, have not experienced the same compliance burden from the level of assessment. They note that the level of assessment has not been very intrusive or costly. For example, Elders Toepfer Grain stated at a public hearing:

All our costs were internal costs, so we didn’t actually find that very onerous ourselves, because we have certain reporting requirements internally as well, so it was just a matter of attaching that to our current requirements. We haven’t had to employ any external resources. After the initial accreditation, as far as the ongoing notifications are required, we’re able to accommodate that within our current structure as well, so we don’t find it a great burden at all. (trans., p. 563)

Some submissions raised the idea that the level of assessment leads to lengthy and complicated processes that make it difficult to seize market opportunities, and can create a barrier to new entrants. David Falconer of the Grain Industry Association of Western Australia said at a public hearing:

[The accreditation process] seems a very long process if you have an inquiry from someone who wants to get grain from Australia and you say, ‘Well, I can’t do it for at least three months’ because that’s how long it will take to get a licence. (trans., p. 139)

ACIL Tasman, in the report prepared for CBH, noted:

The specifications of the application place considerable restrictions on the flexibility of a company to adapt to market conditions and most importantly respond to the demands

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of growers should they change through the marketing year. For example, a company intending to offer pools may find that growers in a particular year have a preference for using cash based products. (ACIL Tasman 2009, p. 32)

In addition, Viterra stated:

The accreditation process is time consuming. Combined with the expense of obtaining and maintaining accreditation, the requirements to obtain accreditation are likely to act as a significant deterrent to new entrants wishing to export bulk wheat. (sub. DR70, p. 3)

#### **Box 4.6 CBH's compliance with the Scheme**

To comply with its obligations under the WEMA, the CBH Group had to meet the following requirements in 2008 and 2009:

- Preparation and submission of original application for accreditation which was accompanied by extensive and highly detailed documents in response to multiple information requests.
- Undergo an external audit, in accordance with s. 31(1) of the WEMA.
- Meet three requests for information from the WEA, under s. 25(2) of the WEMA.
- Preparation and submission of Annual Export and Annual Compliance Reports.
- Preparation and submission of four notifiable matter reports.
- Preparation and submission of four Executive Officer appointment reports.
- Preparation and submission of a response to a draft Performance Monitoring Report.
- Preparation and submission of an application for re-accreditation and submission of hundreds of pages of documents in support.
- Preparation and submission of two draft access undertakings to the Australian Competition and Consumer Commission.
- Daily update and maintenance of the Daily Ship Roster on the CBH website.
- Upload of relevant information to the CBH website.
- Regular monitoring of compliance by Risk and Assurance.

*Source:* ACIL Tasman (2009).

Participants have also reported a lack of transparency in the level of assessment, noting that WEA does not provide an explanation for some of its information requests associated with assessing applications and monitoring compliance. This led to some calls from participants for WEA's role to be more clearly defined, with participants providing evidence of instances where they viewed WEA to have over-stepped its charter. For example, GrainCorp made the following comment:

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GrainCorp was also concerned that at times Wheat Exports Australia sought information that GrainCorp believed was of no relevance to the conduct of the accreditation scheme, and that ‘regulatory over-reach’ added cost and complexity to what should be a relatively simple regulatory task. ... The requirement to supply the regulator with correspondence relating to notifiable matters is a good example. No explanation has been provided as to why the range of matters that are seen by Wheat Exports Australia as being ‘of relevance’, when in fact most of the matters that fall within their broad requirements have little or no relevance to the conduct of normal business, in particular the buying of wheat from growers or the provision of grain elevation services. (sub. 43, p. 13 and p. 14)

In its submission, Viterra expressed concern that ‘WEA misconceives its current role’ (sub. 23, p. 3) and provided examples of instances where it believes WEA had overstepped its charter, particularly in relation to access related matters.

There was also concern expressed over the consistency with which the eligibility criteria are applied by WEA. For example, the GGA stated:

The accreditation criteria are appropriate but we understand that there is a need to ensure that these criteria are applied evenly and equally by WEA if accreditation is to continue. The current system provides discretion to WEA as to the level of evidence required to satisfy the accreditation process. It would be more helpful if the required standard were agreed and published by WEA so that companies seeking accreditation were fully aware of the standard they needed to meet for accreditation. Such an approach may have a number of tiers that could be applied depending on the size of the company or level of shipment volume, etc. (sub. 41, p. 7)

Viterra said:

Viterra understands that WEA’s ‘fit and proper’ benchmarks are not applied uniformly, with smaller exporters examined less rigorously, with the aim to avoid raising barriers to entry for smaller traders. Such apparent inconsistencies may create greater risk for growers. (sub. DR70, p. 3)

Some participants supported a more streamlined approach to accreditation, such as that conducted by the Essential Services Commission of South Australia (ESCOSA) for barley in South Australia (for example, Department of Agriculture and Food (Western Australia), sub. DR84; The Western Australian Farmers Federation, sub. DR92; Viterra, sub. 23). This is seen as more light handed and less costly. Comments from the Victorian Farmers Federation and grain producer Ronland Nominees summed up this view:

- While VFF supports the role of WEA, VFF consider that efficiency gains could be garnered to the benefit of the industry, exporters and growers alike, by adopting a more streamlined system of accreditation (similar to those criteria of ESCOSA). However, that such powers and criteria should still be administered by an independent Grains Industry body (WEA or like body). This would reduce the regulatory burden & cost to exporters; reduce costs to growers (export fees); reduce

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potential barriers to entry for exporters; remove potential rigidities and duplication; and yet such a system would still provide for an ‘independent umpire’. (Victorian Farmers Federation, sub. DR65, p. 2)

- If the Government feels that some form of oversight is required, a model similar to the Essential Services Commission of South Australia for barley exports could be considered, whereby companies pay a licensing fee and attest to a number of statements being true and correct. If any of this information is found to be not absolutely correct, the company loses its licence to export grain. The Marketers are relatively free to conduct their business provided they do not contravene any conditions. There is no need for an onerous monitoring body that costs growers money at the end of the day. (Ronland Nominees, sub. 15, p. 1)

### *The Commission’s view*

Although the Government had a clear intent not to make the regulatory and compliance processes overly burdensome, it seems appropriate to the Commission that, in the transitional period, WEA should err on the side of risk aversion and employ a level of assessment that is detailed and rigorous. This is particularly so given the key objective to protect the needs of growers, while being unable to provide an actual guarantee of payment.

On the one hand, allowing the regulator some flexibility and discretion is effective in preventing the legislation from being overly prescriptive and rigid. For example, it is important that WEA may exercise discretion as to which criteria are relevant across different types of applicants — a company that is new to the market might not be able to demonstrate its expertise as fully as a multinational, well established company. It is appropriate that they be treated differently. Furthermore, when the applicant is a small subsidiary of a global parent company, it is appropriate that WEA has the discretion to assess the applicant in the context of the parent company, rather than assess it in isolation.

On the other hand, such flexibility can create the opportunity for ‘regulatory creep’, where the coverage of the regulation expands progressively over time (Regulation Taskforce 2006), and for compliance costs to increase unnecessarily. It can also create uncertainty and reduce transparency as rules change over time.

On balance, it is the Commission’s view that flexibility and discretion have enabled the successful functioning of the Scheme in transition. They have allowed WEA to exercise rigour in assessing the fit and proper standing of exporters in a period of uncertainty, while also promoting competition by ensuring that applicants are not rejected on the basis of overly-prescriptive rules. The Commission also recognises that the application of the accreditation scheme has been a work in progress that has

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developed over time as WEA has become more familiar with the processes required to best fulfil its role.

However, if accreditation were to continue, it would be important to ensure that regulatory and compliance costs are contained by streamlining accreditation processes. This would ensure that the costs associated with accreditation are commensurate with the benefits of ongoing accreditation, which the Commission see as being negligible. A more streamlined accreditation scheme could resemble the licensing system administered by ESCOSA for barley in South Australia (this system is outlined in appendix C). This approach is considered to be light-handed in the sense that it is based on outcomes rather than processes. In explaining its approach, ESCOSA states:

... the [Essential Services] Commission [of SA] has been careful to ensure that its regulatory approach is focussed on outcomes rather than processes. For example, licences issued by the Commission require barley export contracts to deal with certain specified matters, but that requirement does not extend to the form in which those matters are expressed or dealt with in the contracts. It is the Commission's understanding and expectation that the matters will be dealt with in the manner most appropriate to the parties as necessary in the circumstances. This approach may be described as a more 'light-handed' approach to regulation of the barley export industry. (ESCOSA 2007, p. 3)

The recent *Review of the Barley Exporting Act 2007* (Baldock and Brown 2009) indicates that stakeholders have been pleased with the administration of the licensing regime by ESCOSA, and that ESCOSA was not approached with any formal complaint about any of the exporters, and no reviews or appeals of decision by ESCOSA were made. The review also highlights that most submissions indicated that the licensing system had served its purpose and was no longer necessary. (Outstanding concerns centred around the behaviour of bulk handling companies.) As a result, the review recommended that the Barley Exporting Act expire on 30 June 2010 and the licensing system be removed to permit full deregulation.

If accreditation remains it would also be important to strengthen the transparency of the processes in place. The level of assessment could be made more transparent by introducing measures to clarify the processes employed in assessing applicants and how these differ across applicants, as well as making public the results of research conducted during the process, such as audit reports and risk assessment reports — excluding that which is commercially sensitive.

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## Conditions

As noted above, the mandatory conditions imposed on accredited exporters include:

- responding to WEA requests for information and audits
- submitting an Annual Compliance Report and Annual Export Report
- providing Notifiable Matters and new executive officer documentation.

Those conditions requiring exporters to comply with information and audit requests are designed to ensure that the powers of WEA set out in the WEMA to gather information and conduct audits can be upheld. To the extent that the powers conferred are appropriate, having conditions that allow those powers to be properly utilised do not add a level of unnecessary compliance.

On the reporting conditions required under the WEMA, WEA notes that these are integral to its monitoring task, and that such information is not available from other sources (WEA, sub. DR90).

It is the Commission's view that if accreditation remains in place and is streamlined as recommended above, the Australian Government should reconsider the need for annual reporting requirements. An assessment should be made on the importance of the additional information gained from these reports that cannot be obtained elsewhere, especially if a more streamlined accreditation system is adopted.

In relation to the additional conditions imposed by WEA on some accredited exporters, the discretion afforded WEA is again relevant. While the mandatory conditions are uniformly applied, the additional conditions are not — they are applied by WEA as a matter of judgment. On this topic, AWB stated:

In relation to conditions imposed, if conditions must be applied they should be applied consistently across the accredited exporters (with the exception of tonnage restrictions) and should not restrict the exporter from participating in the market on a level playing field with their competitors. Conditions can impact on the participation of the business, resulting in potentially anticompetitive arrangements, reducing the efficiency and competition of the export market. (sub. 24, p. 3)

On the other hand, WEA said in its submission:

This discretionary power [to impose additional conditions] enables WEA to consider the individual applicant's circumstances and export proposal when undertaking the fit and proper assessment. This has meant in practice that a number of exporters have been granted accreditation through tailoring specific conditions of accreditation that ensure WEA is satisfied that the applicant is fit and proper to undertake its export proposal. Rather than impose 'rigidities' upon exporters, the flexibility to impose additional conditions has enabled a wider range of companies to be accredited than would

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otherwise have been the case, ultimately enhancing marketing choice for growers and delivering upon the policy mandate established by the Act. (sub. DR90, p. 3)

While the discretion given to WEA to impose conditions can give rise to the risk of inconsistency across time and across applicants, it also avoids having a set of criteria that is too prescriptive. In addition, that discretion has been a useful tool in providing an additional layer of comfort for growers, and has ensured that applicants that might not have otherwise been accredited were successful, subject to certain conditions. This is preferable to a more prescriptive set of regulations that would restrict the number of eligible players in the market.

Nonetheless, some additional conditions, such as tonnage and market restrictions, could limit an exporter's flexibility to take advantage of market opportunities in a timely manner. For example, by restricting tonnages or market destinations so that accreditation will be approved, exporters might not have the flexibility to respond to changing market conditions quickly enough to exploit opportunities. Rather, an accredited exporter must pay a fee to have WEA consider a variation to a condition of accreditation, and wait up to 14 days to be notified of WEA's decision. This could restrict an exporter's ability to respond to market signals in a timely manner and represent an impediment to an effectively functioning competitive market.

In its submission to the draft report, WEA said:

Should any exporter wish to vary a condition then WEA will quickly process such an application. This has occurred on ... one occasion ... without any loss of a market opportunity. (sub. DR90, p. 7)

The Commission understands that WEA processes requests quickly to avoid unnecessary delay. Nonetheless, there is no legislated timeframe within which WEA must make a decision (just that it must notify the exporter within 14 days of making a decision), and this can create uncertainty for exporters over how quickly a decision will be made.

If accreditation were to continue, the timeliness with which an exporter can have an application to vary a condition of accreditation considered should be outlined in the legislation, and kept to a minimum.

Furthermore, the fact that no justification is provided to the market as to why additional conditions are imposed on some exporters can risk sending distorted signals to the market. For example, knowing that an accredited exporter is restricted to selling into certain markets with no knowledge of why this is so could send an incorrect signal that the exporter is riskier than others that have no such condition.

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If accreditation continues, greater transparency of the reasons for imposing conditions on a new application or renewal should be introduced, with the exception of those which are commercially sensitive.

The provision contained in the Explanatory Memorandum that WEA is restricted from imposing tonnage limits should also be lifted. The Explanatory Memorandum is not legally binding and, in any case, the negotiations regarding tonnage limits that take place between applicants and WEA effectively give WEA the power to impose such restrictions.

## **Summary of changes required if accreditation continues**

If the Australian Government does not accept the Commission's recommendation to abolish accreditation, and instead decides to retain some form of accreditation beyond 30 September 2011, the Commission supports the least intrusive system possible. The Commission recommends adopting a system resembling that administered by ESCOSA for barley in South Australia. The key difference between this and the Wheat Export Accreditation Scheme is in the level of assessment employed by the regulator. The cost for ESCOSA of running the barley accreditation scheme has been a little over \$100 000 a year (ESCOSA 2009).

While the benefits of such a system are no greater than those generated by the current bulk wheat export scheme, and might in fact be lower, the regulatory and compliance costs would be significantly less. The costs would therefore be more in line with the benefits — if any — of ongoing regulation, and more commensurate with the low level of risk involved in trading in the bulk wheat export market.

If, instead of adopting a new system, the Australian Government decides to retain the current scheme, considerable amendment is required. The Commission suggests that as a minimum the following changes should be considered by the Australian Government:

- All port access related matters should be conferred to the ACCC. The powers of WEA should be confined to assessing the fit and proper standing of the trading arms, without regard to the conduct of the port terminal operating businesses.
- The level of assessment employed by WEA should be streamlined to better reflect the risks involved in operating in the bulk wheat export market.
- As far as practicable, areas of unnecessary overlap with existing legislation should be removed from the fit and proper assessment of applicants.
- The processes employed by WEA in assessing applicants should be publicly documented. Reasons for imposing additional conditions on accreditation and

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the results of research conducted during the accreditation process — excluding those which are commercially sensitive — should be made public.

- The timeliness with which an exporter can have an application to vary a condition of accreditation considered should be outlined in the legislation, and kept to a minimum.
- Fees for reconsideration of decisions made by WEA should be refunded if a decision is made in the applicant's favour.
- The costs and benefits associated with having exporters prepare annual compliance and export reports should be reviewed by the Australian Government, especially in light of adopting a more streamlined approach.
- Non-company business structures such as partnerships and sole proprietors should be eligible for accreditation. Any increase in risk associated with a non-company structure could be limited by imposing additional conditions on these exporters.

At the heart of these suggested changes is a desire to make the overall accreditation system more commensurate with the real risks associated with operating in the bulk wheat export market in Australia, which the Commission considers are little different from other grain and agricultural commodities markets.

Retaining some form of accreditation would have funding implications. If the Australian Government decides not to abolish accreditation, and instead:

- adopts an ESCOSA-style system — there could be scope to reduce application fees and the WEC
- retains the current system with some streamlining — application fees would need to be aligned with the expected costs of processing applications under the new arrangements and the WEC would need to be reassessed
- retains the current system without change — new and renewal application fees would need to be more than doubled to recover processing costs; the WEC might need to increase, especially if the base of the charge is narrowed to include bulk exports only (see below).

Ultimately, any additional cost would be most likely borne by growers.

In the Commission's opinion, it is not appropriate for the WEC to be levied on non-bulk exports. Exports of wheat in bags and containers are exempt from the Scheme and, therefore, participants in that industry do not experience the benefits (however small) associated with accreditation.

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If any kind of accreditation scheme is retained, a Cost Recovery Impact Statement should be formulated to review the WEC and application fees, in line with the *Australian Government Cost Recovery Guidelines* (Commonwealth of Australia 2005).

RECOMMENDATION 4.5

*If the Australian Government decided not to abolish accreditation, a system similar to that administered by ESCOSA for bulk exports of barley in South Australia would be the next best alternative.*

- *A less attractive alternative would be to amend the Wheat Export Accreditation Scheme 2008. As outlined in this report, this would include streamlining the level of assessment employed by Wheat Exports Australia and more clearly defining its role to ensure that its powers do not extend into matters of competition policy.*

*If the Australian Government decided not to abolish accreditation, the application fees and the Wheat Export Charge would need to be reviewed. A Cost Recovery Impact Statement should be formulated, in line with the Australian Government Cost Recovery Guidelines. The Wheat Export Charge should no longer be levied on exports of wheat in bags and containers, as they are not covered by the accreditation scheme.*

*Any new or amended arrangements put in place by the Australian Government should be reviewed after no more than five years.*

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## 5 Access to port terminal facilities

### Key points

- Access to port terminal facilities represented the most significant issue in this inquiry.
- The ability of wheat exporters to access port terminal facilities is critical to the success of the deregulated arrangements for wheat export marketing. In response to concerns that wheat exporters with port terminal operations could use their control of those terminals to advantage their wheat export operations at the expense of rivals, an 'access test' was introduced for such parties. The access test must be passed to obtain accreditation to export.
- The access test has been effective in ensuring a relatively smooth transition to the new marketing arrangements for bulk wheat exports. The test facilitated the entry of new players into the industry by providing certainty about port access in the face of a dramatic overnight change, reducing transaction costs in establishing a competitive market, and facilitating commercial decision making. The access test is also likely to reduce the length of the transitional period. The link between the access test and the bulk handlers' ability to export (hitherto via accreditation) is seen as providing an important incentive for meeting the test.
- In recognition of the transitional benefits of the access test that have accrued because of the specific history and circumstances of the bulk export wheat industry, and in view of the desirability of allowing time for the new, still evolving, marketing arrangements to be institutionalised, the Commission considers the access test should stay in place until 1 October 2014. However, the access test should be administered solely by the ACCC from 1 October 2011. Port operators not passing the test should be prohibited from exporting wheat in bulk under new powers to be conferred on the ACCC that would run until 1 October 2014.
- While the access test has provided benefits (particularly in the short term), it has also imposed costs. The costs are not likely to be large in the short term, but over time, the benefits are likely to diminish and the associated costs (particularly related to reduced incentives to invest) are likely to become much more significant.

(Continued next page)

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**Key points** (continued)

- From a longer term perspective, therefore, the Commission is of the view that Part IIIA of the Trade Practices Act is better placed to balance these costs and benefits. Using Part IIIA to regulate access will bring the wheat industry into line with the general competition law applying to other industries. Therefore from 1 October 2014, the access test should be abolished and grain port terminals should then be subject to the generic provisions of Part IIIA.
- The Commission sees merit in port terminal operators developing a voluntary code of conduct to govern port access after 1 October 2014. In addition, wheat port terminal operators should still be required to publish daily shipping stems and port access protocols on their websites indefinitely.
- The Commission sees auctions as potentially an effective way to allocate limited port capacity to its most highly valued use where capacity constraints are an issue.

As discussed in chapter 4, the *Wheat Export Marketing Act 2008* (Cwlth) (WEMA) provides that, where parties seeking bulk wheat export accreditation also provide port terminal services, they must satisfy an ‘access test’ in respect of their port facilities to obtain wheat export accreditation. In this chapter, issues surrounding the regulation of port terminal access are discussed. Although the WEMA links port access to accreditation through the access test, the Commission does not see port access as inherently linked to accreditation and has accordingly dealt with access issues separately. Therefore, the Commission’s recommendations about the effectiveness of the access test have been made independently of the recommendations in chapter 4 regarding accreditation. The Commission concurs with the view put by many participants that issues raised relating to port terminal access are the most important to be addressed in ensuring the deregulated market operates successfully.

## FINDING 5.1

*Access to ports is the most critical issue in ensuring the success of deregulation.*

The terms of reference for this inquiry asked the Commission to consider ‘the appropriateness and effectiveness of the access test requirements that apply both before and after 1 October 2009’. The Commission was also asked to consider how individual components of the WEMA affect relevant stakeholders and to assess the costs and benefits they deliver. The Commission was asked to provide comment on those aspects that are working effectively and identify those that require change.

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In assessing the appropriateness and effectiveness of the access test, the Commission has considered the merits of other regulatory options for guaranteeing access to port terminals.

## 5.1 Background to port terminal access regulation

Access to port terminal facilities and services under reasonable terms and conditions is essential to promoting competition among bulk wheat exporters (box 5.1).

### Box 5.1 Nature of grain port terminals

The key functions of export grain port terminal facilities are:

- *Receival* — grain received via road or rail grid. All grain received at an export terminal is weighed. The grain is typically quality tested and checked for insect infestation. It will then be unloaded and transported to grain silos or sheds containing grain of a similar type and quality. It might be fumigated if necessary.
- *Storage (long and short term)* — accumulating grain in silos before shipment, and employing elevator towers and conveyor belts to blend grain and move it between silos.
- *Outloading* — using conveyor belts to transport grain from the storage facilities to the ship weigher and to the ship loader (located on a pier or berth) which pours grain into the holds of bulk grain vessels.

The grain export terminal facilities can also be used for loading other dry bulk products such as woodchips, and for storing grain for delivery to domestic consumers.

*Source:* ESC (2009).

The port terminal facilities used for bulk wheat exporting are perceived by many policy makers and industry participants as having ‘natural monopoly’ characteristics (box 5.2). Access regulation is typically used when infrastructure facilities exhibit such natural monopoly characteristics. In the absence of regulation or competition from substitute services, the facility owner is likely to obtain substantial and enduring market power.

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**Box 5.2 What is a natural monopoly?**

A natural monopoly is said to exist if, at the foreseeable level of demand for a good or service, one facility can supply the required service at a lower cost than two or more facilities.

Natural monopoly characteristics generally relate to the presence of significant economies of scale and/or scope in the production of a good or service, the existence of substantial capital costs relative to variable (or operating) costs, and large and 'lumpy' investment.

*Sources:* PC (2006b) and NCC (2009).

The infrastructure owner could seek to exercise this market power in two main ways:

- charging access prices significantly above costs
- denying access to the service, or making conditions of access to the service onerous (PC 2001b).

In the case of port terminal facilities for grain, denial of access could be a significant problem given the major bulk handlers are also involved in grain exporting (as well as generally being the dominant providers of up-country transport and storage services). This led to concern about the potential emergence of 'regional monopolies', with some stakeholders believing the bulk handlers could dominate grain exports by denying access to port facilities for other exporters (or by charging high prices for access, or making conditions of access onerous). There have also been concerns they could structure their integrated port and transport and storage charges to 'lock in' use of their transport and storage infrastructure.

For example, in a March 2008 report for AWB Limited (AWB), the Allen Consulting Group suggested:

Although the changes [to wheat marketing arrangements] will in principle exert downwards pressure on supply chain costs, in practice the potential gains may be undermined by regional monopolies over vital elements of the supply chain infrastructure. (ACG 2008b, p. 1)

Similar concerns were noted by the Senate Standing Committee on Rural and Regional Affairs and Transport (SSCRRAT):

A number of witnesses before the committee expressed concern about the role and potential market power of bulk handling companies under the proposed changes. It was argued that bulk handling and storage facilities throughout Australia are owned and controlled by a limited number of companies. Concerns were raised that, in the event that some or all of these companies became accredited exporters under the proposed

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legislation, they may be in a position to limit access to these facilities by other exporters. (SSCRRAT 2008, para. 3.93)

If any market power were exercised in this way, the benefits of introducing competition to wheat exporting would not be maximised. There could also be wasteful investment in, and operation of, supply chains by other parties to by-pass port terminals (or other parts of the supply chain) seen as overpriced or inaccessible (although existing operators would have a strong incentive to avoid this).

In response to these concerns, an access test was incorporated into the WEMA for parties seeking bulk wheat export accreditation that also provide port terminal services (although no such test was applied to other elements of the supply chain, as is discussed in chapter 6). The access test applies only to wheat and not to other grains or commodities. Port terminal operators must ‘pass’ the access test to attain bulk wheat export accreditation.

## 5.2 The current arrangements

The access test is outlined in section 24 of the WEMA and provides that, to be accredited, exporters must comply with ‘continuous disclosure rules’ requiring them to publish their daily shipping stem and protocols for port access. The requirements include information relating to vessel nomination and acceptance rules, the schedule of vessels using the port terminal facility, the amount of wheat to be loaded into each vessel and the estimated date of loading into each vessel. The information must be published on the internet and updated daily (Burke 2008b).

The access test further provides that:

- *Between 1 July 2008 and 30 September 2009:* to gain accreditation, exporters that operate bulk wheat terminals at ports are required to publish a statement on their website outlining the terms and conditions on which they will allow other accredited exporters access to their port terminal facilities.
- *From 1 October 2009:* to gain accreditation, exporters that provide port terminal services must have a formal access undertaking pursuant to Part IIIA of the *Trade Practices Act 1974* (Cwlth) (TPA) accepted by the Australian Competition and Consumer Commission (ACCC) (ACCC 2009b).

Alternatively, the WEMA provides that the access test would be met if there were in force a decision under Part IIIA of the TPA that a relevant state or territory regime was an ‘effective access regime’ and that regime provided for access to the port terminal service for purposes relating to the export of wheat. However, as no state or territory port terminal access regime deemed to be effective is currently in place,

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the only way the access test can be met currently is to have an access undertaking approved by the ACCC. Once the ACCC accepts the undertakings, they are then binding on the service providers.

In explaining the rationale for the access test, the explanatory memorandum to the WEMA stated:

This clause is intended to ensure that accredited exporters that own, operate or control port terminal facilities provide fair and transparent access to their facilities to other accredited exporters. The test aims to avoid regional monopolies unfairly controlling infrastructure necessary to export wheat in bulk quantities, to the detriment of other accredited exporters. All accredited exporters should have access to these facilities while allowing the operators of the facility to function in a commercial environment. (Burke 2008b, p. 29)

The three major grain bulk handling companies, Co-operative Bulk Handling (CBH), Viterra (formerly ABB Grain) and GrainCorp, currently have undertakings approved by the ACCC for two years. The undertakings are of a ‘publish-negotiate-arbitrate’ nature. The ACCC had previously made draft decisions to not accept the initial undertakings of the three companies, but accepted revised undertakings provided in September 2009. Subsequently, Wheat Exports Australia (WEA) has renewed the accreditation for the bulk handlers for two years (with other accredited exporters generally renewed for three years).

The ACCC noted that, in deciding whether or not to accept the bulk handlers’ undertakings, it did not consider that its role was to assess whether the requirement for bulk wheat exporters to have access undertakings was justified:

The ACCC ... does not consider that its role in the current context is to thoroughly assess the state of competition in the bulk wheat export industry and evaluate whether access undertakings are justified (such as by reason of the port terminal facilities being uneconomical to duplicate). Instead, the ACCC considers that Parliament has expressed a clear intention to require port terminal operators to provide access undertakings to mitigate the potential for anti-competitive harm, and it is in that context that the ACCC must consider the appropriateness of those undertakings as provided. (ACCC 2009b, p. 31)

The access undertakings for CBH, Viterra and GrainCorp apply to 17 port terminals across 5 states (table 5.1). The Melbourne Port Terminal (MPT) has been exempted from the WEMA access test as it is deemed by WEA not to be an associated entity of an accredited wheat exporter (section 5.7). Despite the exemption from the access test, the operators of the MPT have provided WEA with written assurance that they will continue to publish on their website the shipping stem and standard storage and handling agreement relating to MPT (WEA 2009c).

**Table 5.1 Grain port terminals subject to the WEMA access test**

<i>Operator</i>	<i>Port</i>	<i>State</i>
CBH	Geraldton	Western Australia
	Kwinana	Western Australia
	Albany	Western Australia
	Esperance	Western Australia
Viterrra	Port Adelaide	South Australia
	Outer Harbour	South Australia
	Port Giles	South Australia
	Wallaroo	South Australia
	Port Lincoln	South Australia
	Thevenard	South Australia
GrainCorp	Carrington	New South Wales
	Port Kembla	New South Wales
	Geelong	Victoria
	Portland	Victoria
	Fisherman Island	Queensland
	Gladstone	Queensland
	Mackay	Queensland

Source: ACCC (2009a).

### **5.3 The effectiveness and appropriateness of the WEMA access test**

Under the terms of reference the Commission was asked to look at the effectiveness and appropriateness of the WEMA access test in meeting the objectives of the WEMA, namely:

- (a) to promote the development of a bulk wheat export marketing industry that is efficient, competitive and advances the needs of wheat growers
- (b) to provide a regulatory framework in relation to participants in the bulk wheat export marketing industry (WEMA 2008).

#### **Participants' views**

Participants had differing views on the merits of the access test (box 5.3). Grower representatives, and exporters that did not own terminals, tended to strongly support the access test. These groups typically argued that the bulk handlers faced little competition for their services and had strong incentives to favour their trading divisions. However, they generally did not consider that the access test should continue indefinitely.

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### Box 5.3 Participants' views on the need for the WEMA access test

AWB said:

The access test is necessary ... [bulk handling companies] are monopoly providers of port terminal services within geographical areas. There are either very limited or no alternative providers of port terminal services within a distance that make them commercially viable competitors. (sub. 24, p. 6)

The Australian Grain Exporters Association stated:

Bulk handling companies are monopoly providers of port terminal services within geographical areas, with [the] exception of Melbourne Port Terminal. There is either very limited, or no, alternative providers of port terminal services within a distance that make them commercially viable competitors. Access to port terminal services is essential to export bulk wheat from Australia. Australian wheat exporters have no option but to use [bulk handling company] services where they wish to export wheat from [bulk handling company] terminals. There is limited ability to physically move wheat from one port to another owned by another terminal service provider. The cost of interstate movement of grain is prohibitive. (sub. DR79, p. 9)

AgForce Grains suggested:

The access test is necessary as there is only one company (in Queensland) who own[s] port facilities. Therefore all exporters need fair access to the port/export facilities, and without regulation, there is no guarantee that the current owner would continue to grant fair access. (sub. 16, p. 6)

The Department of Agriculture and Food (Western Australia) said:

The large cost imposed on the bulk handlers in meeting port access requirements does not appear to be justified particularly as part IIIA of the Trade Practices Act can be used against owners of port facilities that are also grain exporters and who unfairly exploit their monopoly position. There is evidence in WA that alternate operators and larger growers are looking at alternate storage, handling and port facilities. This will create competition with CBH. Over time, there will be developments in the sector that will result in greater competition but this is likely to take a few years as development of new infrastructure requires planning and capital. (sub. DR84, p. 2)

Viterra said:

Viterra acknowledges that the access test has provided certain benefits which have facilitated the rapid and orderly transition from one bulk wheat exporter to more than 29 exporters. However, the benefits have also come at a significant and continuing cost. Given the rapid transition which has already taken place, Viterra considers any benefits ... associated with requiring terminal operators to submit 'voluntarily' to an additional regulatory regime ... in respect of one commodity in bulk form are very rapidly diminishing, leaving only significant costs. (sub. DR70, p.1)

CBH stated:

The CBH Group contends the requirement for port terminal operators who also wish to be accredited wheat exporters to have a formal access undertaking accepted by the ACCC pursuant to Part IIIA of the TPA in place is unnecessary and inappropriate. The WEMA imposed a 'compulsory voluntary undertaking' process that, in practice is a defacto access declaration regime without the appropriate protections of that regime under the TPA. (sub. 39, p. 2)

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However, other participants — particularly the bulk handlers — saw little merit in the access test, typically arguing that competition concerns were overstated, and that the need to maximise throughput to get a reasonable return on their sunk capital meant they had no incentive to discriminate against rival exporters.

Viterra did note that some aspects of the port access arrangements had been beneficial, such as publication of the shipping stem and the port operating protocols, and had formalised access procedures. However, they believe these mechanisms could be incorporated within an industry code of conduct (sub. 23). CBH and GrainCorp have also expressed support for a voluntary code of conduct to replace the existing access test (sub. DR75; sub. DR82).

The National Competition Council (NCC) expressed strong reservations about the access test:

In the Council's view, to date little if any evidence has been provided to establish that it is necessary to regulate port terminal services for bulk wheat export ... In such circumstances, the Council considers it is undesirable and risky to continue imposing access regulation to port terminal services ... In the absence of clear evidence of a need for regulated access, unnecessary costs and regulatory burdens are likely to be imposed on wheat export marketers and other participants in wheat markets. (sub. 7, p. 4)

Many participants expressed the view that the access undertakings have provided benefits. For example, the Australian Grain Exporters Association (AGEA) said:

The Undertakings approved by ACCC have delivered a number of outcomes for the Australian wheat exporters including that the ACCC has required more reasonable terms from the [bulk handling companies] and laid down benchmarks against which [bulk handling companies] are to be accountable. [Bulk handling companies] are now obliged to negotiate rather than impose terms, are more restricted in the information they can require from port terminal users and are accountable to the ACCC in respect of services. ACCC has also limited the ability of [bulk handling companies] to change prices and withdraw services and [bulk handling companies] will be required to publish regular reports on their performance. (sub. 28, p. 9)

Glencore Grain saw the undertakings as important in its dealings with one port terminal operator in particular:

Glencore Grain [was] effectively eliminated from participating in the 2009-2010 harvest accumulation for shipping wheat off the east coast in any way shape or form because we did not agree to the Port Terminal Services Agreement proposed to us by GrainCorp under its access undertaking. In our view the terms were uncommercial. GrainCorp refused to negotiate with us in any form until we initiated the dispute resolution provisions of the access undertaking, after which GrainCorp immediately negotiated a realistic agreement with us. (sub. DR89, p.12)

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Although this was contested by GrainCorp:

It is quite disingenuous of Glencore Grain to claim that the matters under negotiation related to ‘access’, and thus required the presence of an Undertaking regulated by the ACCC, or the possible intervention of the NCC, when they actually related to matters *not* covered by the Undertaking. The matters did not relate to access to port elevators, but to the *prices charged* for particular services and the insistence by Glencore Grain that a ‘*dispatch – demurrage*’ clause be inserted into the service provision contract. This is a not a matter of access [to] port elevator services, but one that relates to the management of commercial risk associated with exporting grain in bulk. (sub. DR96, p. 2)

(The Commission understands GrainCorp has also negotiated port terminal services agreements with its other bulk wheat exporter customers, in addition to Glencore Grain. To the Commission’s knowledge they are currently the only major bulk handler that has achieved this.)

Others believed there was a need for even stronger regulation. For example, the South Australian Farmers Federation stated:

The legislation needs to be strengthened so that the ACCC has a greater chance of achieving a better policing role. Without open competition, there is a need for a regulated supply chain. (sub. 51, p. 4)

Bulk handlers were very much aware of the costs involved and have told the Commission the compliance costs associated with the access test collectively run into millions of dollars:

- The negotiation of the access undertakings was very significant from a cost perspective. ABB’s [now Viterra] establishment costs were in the order of \$0.8 million and we estimate ongoing annual costs in the order of \$0.5m. We estimate that our costs, and the costs of WEA (\$0.22 per tonne) and ACCC would equate to approximately \$0.50 to \$1.00 per tonne of wheat for an average SA harvest. Inevitably the grower bears this cost. (Viterra, sub. 23, p. 5)
- In 2008/09, the CBH Group has incurred external costs of over \$1.0 million to put in place its ACCC negotiated Access Undertaking. This is money that could have been spent on improving the supply chain. (CBH, sub. 39, p. 2)
- The access process imposes significant additional regulatory cost on GrainCorp. To date, approximately \$1 million additional compliance cost has been imposed upon the company. The commencement of the ‘publish – negotiate – arbitrate’ process is likely to impose up to an additional \$500 000 in legal costs related to the requirement to negotiate with up to 20 parties over the terms and conditions with the Bulk Wheat Port Terminal Services Agreement. (GrainCorp, sub. 43, pp. 18–19)

Although the MPT has hitherto been exempt from the requirements for an access undertaking, Australian Bulk Alliance stated that were it subject to such a requirement it would be significantly disadvantaged relative to larger volume ports,

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as costs per tonne exported would be much higher for its lower volume operation (sub. 48).

Some saw the costs incurred by the bulk handlers as small relative to the benefits of the access test. Kim Halbert stated:

CBH have indicated ... that the cost of completing an ACCC port access undertaking was around a million dollars. Even if this claim is correct, this cost can be amortized over the number of years of the undertaking, and is probably a valid tax deduction anyway. If you relate this cost to grain received by CBH in one year it is approximately 20 cents per tonne. It is likely that future undertakings will be for five years or so, thereby reducing the annualised cost to just a few cents a tonne. At the Grain Logistics Conference in Perth in March 2010, Tim Collins from CBH revealed that CBH are holding in excess of \$60 million in auction premiums. The cost of the withdrawal of this capital from the grains industry as a whole is considerable and far outweighs the cost to CBH of the port access undertakings. (sub. DR88, p. 3)

Some participants considered the additional costs associated with the access test were unjustified. C and J Michael suggested:

Existing laws are already in place to enforce port operators to have open commercial and fair access to ports such as [the] Trade Practices Act and Bulk Handling Act [WA]. Anti-competitive legislation prohibiting companies abusing monopoly powers already exist in current legislation. Why place another layer of compliance criteria when restrictive trade practices legislative powers already exist? This extra layer only increases the costs of the port operators who wish to export in comparison to other accredited export licence holders therefore not achieving the intent of the access undertaking in making it a level playing field for all. (sub. 11, p. 1)

GrainCorp expressed a similar view:

Part IIIA of the Trade Practices Act contains within it sufficient provisions and significant enough penalties to discourage or eliminate anti-competitive behaviour on the part of infrastructure owners such as GrainCorp. The current access undertaking has significantly increased the cost of providing port terminal services, and reduced the flexibility with which these services can be provided. GrainCorp believes that the cost of complying with the new port terminal protocols will increase exporters' costs, and as such there is no significant benefit to any party, from growers to export customer, from the new level of regulation. (sub. 43, p. 18)

The NCC highlighted investment concerns:

In particular, inappropriate access regulation could restrict investment and innovation, and impede desirable change. In a period where the wheat industry is emerging from a period of regulated monopoly, it is important that the processes and structures which arose in that period are not cemented by unnecessary regulation that introduces rigidities and barriers to change. (sub. 7, p. 4)

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Concerns about investment were also raised by the bulk handlers. GrainCorp suggested:

Regulatory intervention in the Australian grain industry continues to hamper investment and diversification, and continues to encourage non-commercial behaviour on the part of industry participants. Removal of regulatory imposts, including those newly imposed by the Wheat Export Marketing Act 2008, will allow the wheat sector, and thus the whole of the Australian grains industry, to commercially, and economically, normalise. This will encourage investment, industry diversification and growth. (sub. 43, p. 17)

Similarly, ACIL Tasman, in a paper prepared for CBH, suggested:

In relation to Western Australia, regulatory failure could be manifesting itself through a lack of investment in port terminal facilities. Parties able to ‘free ride’ on CBH’s port terminal facility services through the imposition of inappropriate access regulation have reduced incentive to invest in their own alternative port terminal facilities. Furthermore, the application of inappropriate access regulation may act as a disincentive for CBH to maintain and upgrade its existing port terminal facilities. (ACIL Tasman 2009, p. 60)

## **The Commission’s view**

In assessing the effectiveness and appropriateness of the WEMA access test, the Commission was careful to differentiate between the short term (when a major transition was being undertaken) and the long term.

### *Short-term benefits*

In essence, the Commission is of the view that the access test is relatively effective in the short term in ensuring a smooth transition to the new marketing arrangements for bulk wheat exports. The test facilitated entry of new grain exporters to the industry. There has not been any change in the number of port terminal providers (although there has been speculation about new players emerging, such as at James Point in Western Australia).

The access test provided certainty in the face of a dramatic overnight change — with the (almost total) AWB monopoly in place one day, and traders being allowed in the next (1 July 2008). The test gave potential exporters increased assurance that — from day one of the new export arrangements — they would have access to port terminal facilities. As noted in chapter 2, by May 2010 there were 28 organisations accredited to export wheat in bulk from Australia. Many of these new exporters have been successful in gaining significant market share. The number of countries receiving Australian wheat exports has increased relative to recent years. The

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increased number of exporters has also led to a greater range of marketing options, terms and conditions for growers (section 2.3).

In addition, the access test is likely to have reduced the transaction costs in establishing a competitive market by encouraging discussion between the parties and facilitating commercial decision making. That is, the access test is likely to have helped to facilitate timely negotiations between the port terminal operators and rival exporters. As noted above, even some bulk handlers agree that publishing of the shipping stem and port access protocols — that is, the continuous disclosure provisions of the access test — has had net benefits.

As a result of these short-term benefits, the access test is also likely to reduce the length of the transitional period to a competitive marketing environment.

#### *Short-term costs*

There have been compliance and administrative costs that need to be taken into account. These include compliance costs for infrastructure owners (possibly about \$3 million so far, as outlined in the participant views above), lobbying costs and administrative costs to regulatory agencies. To cover administrative costs associated with assessment of the bulk handlers' access undertakings, the ACCC was provided with \$1.5 million over two years (Commonwealth of Australia 2009) (box 9.3). WEA will have also incurred some relatively small costs.

Linking the access test to accreditation might have seen market opportunities lost by the port operators, due to the greater level of uncertainty surrounding their accreditation. There are also different accreditation periods for the bulk handlers and other exporters (section 5.7).

The main concerns about current access arrangements, however, are that they can lock in existing supply chains and discourage investment (as discussed with the long-term costs below). These concerns are likely to be low in the transitional period as investments in infrastructure such as port terminal facilities are generally 'lumpy' and long-term in nature. It would appear that, as long as the test is not applied for too long, investments — whether by incumbent operators or potential rivals — might at worst be somewhat delayed rather than curtailed.

A further short-term issue — related to deregulation rather than the access test specifically — stems from the 'overnight' increase in the number of exporters. Whereas previously AWB co-ordinated its export activities giving major consideration to supply chain and port terminal capacity constraints, in the deregulated environment there will be times when multiple exporters all wish to

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export simultaneously. In the first year of deregulation there were, at times, significant delays at port terminals in Western Australia. In response, CBH has introduced an auction model for port capacity, which is discussed in section 5.6. Although the Commission acknowledges there were significant problems in the first year of the model's operation, and that some changes are required (including in the way capacity is tied to other aspects of the supply chain), it is of the view that in the long run auctions are potentially a highly effective way of dealing with capacity constraints while also ensuring the interests of both asset owners and access seekers are met.

### *Long-term benefits*

Were the access test to continue in the long term, it would continue to provide exporters with assurance regarding access to port terminals. However, once competitive settings are institutionalised and the market has had a chance to adapt to the new arrangements, there is no reason to suggest that the wheat industry should be treated differently from other parts of the economy. It is only the specific history and circumstances of the bulk wheat industry that led to the short-term benefits of specific access regulation. The benefits of the access test will therefore diminish over time.

### *Long-term costs*

The long-term costs of an industry-specific access test could be considerable, not just for the export wheat industry but for the economy more generally, because of the potential impact on investment in essential infrastructure, especially if ad hoc access arrangements came to be seen as the norm (box 5.4).

The potential for reduced investment stems not only from the potentially diminished returns from regulation, but also from the prospect that companies could deliberately build smaller facilities to limit potential use by third parties.

Moreover, third parties are likely to have reduced investment incentives if they believe regulatory arrangements will ensure they can access services provided by infrastructure facilities on favourable terms (rather than investing in rival facilities) — effectively locking in existing supply chains.

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#### **Box 5.4 Access regulation and investment**

There has been considerable debate about the impact of access regulation on investment in essential infrastructure. This is unsurprising as once access regulation is applied it is impossible to know the counterfactual — that is, how would investment levels and the nature of that investment have differed in the absence of access regulation?

However, it is widely acknowledged that potential exposure to access regulation can impede investment in essential facilities in two ways:

- It will increase the risk and thereby the cost of investments. Such risk attaches to investment in any regulated activity. However, the scale of investment in essential infrastructure, and the fact that, once in place, assets are sunk, mean that regulatory risk is likely to be a more pervasive influence on decisions to invest than in many other areas.
- Investments in essential infrastructure will also be deterred if prospective terms and conditions under regulated access are not seen as providing a sufficient return to infrastructure owners. A particular issue here is that the possibility of earning higher than normal returns on successful projects might be required to balance the possibility that some projects will fail. If regulatory pricing arrangements inadvertently remove the prospect of upside returns on successful projects (so-called 'regulatory truncation'), they potentially reduce the 'expected return' on investments and overall investment levels are therefore likely to be reduced.

Some such investment impacts are unavoidable if efficient access to essential infrastructure services is to be provided. But if access regulation is overly stringent, those impacts will have greater potential to outweigh the benefits that appropriately configured access regulation can deliver.

*Source: PC (2006a).*

### **Overall assessment**

The Commission acknowledges that the access test was implemented in the context of the export wheat industry making a substantial transition from monopoly export arrangements that had been in place for over 60 years. Given that many in the wheat industry wanted the entire supply chain to be subject to a similar access test to that implemented for port terminals, and/or that bulk handlers should be denied the opportunity to export wheat, the port terminal access test was a more measured response.

In addition, the undertakings in place currently are relatively 'light handed', with no mandatory ring fencing, and the use of the publish-negotiate-arbitrate model

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without the more prescriptive ‘building blocks’<sup>1</sup> approach used in other sectors. In essence, the access undertakings gave precedence to one of the usual criteria applied under Part IIIA, namely the promotion of a material increase in competition in at least one market — in this case being the export of bulk wheat (see section 5.4 below on the Part IIIA criteria).

The Commission considers that the access test has been effective and appropriate as a transitional measure given the considerable benefits it has provided and the likelihood that any short-term costs are likely to have been relatively small.

However, were the test to be maintained in the long term, the Commission considers the costs associated with it would outweigh the benefits. Therefore, the Commission is of the view that the test should be abolished after a transitional period.

#### FINDING 5.2

*The access test has been effective and appropriate as a transitional measure, providing significant short-term benefits. Any offsetting short-term costs are likely to have been relatively small.*

Setting a precise date for abolition of the access test involves difficult judgments. It is important that any change in regulatory arrangements not be ‘rushed’ in case the transitional benefits are lost and competitive markets fail to develop (including for up-country transport and storage). It is the Commission’s view that allowing the access undertakings to run until 2014 (five years since inception of the test) will give the industry sufficient time, and appropriate incentives, to adjust to the new trading environment and institutionalise some new features of the competitive environment (for example, the new CBH auction system will have been tested and very likely modified — section 5.6), while at the same time minimising the chances of damaging future investments or undermining the reasonable returns to existing asset holders.

### **Participant views on the Commission’s draft report recommendations**

Following the Commission’s release of the draft report, the bulk handler’s argued that there was no justification for the access test to remain until 2014. For example, CBH said:

[CBH] notes that no disputes have been lodged to date and that there was no precedent for any disputes prior to the access test. The CBH Group notes that the Productivity

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<sup>1</sup> The ‘building blocks’ approach to regulation involves implementation of price or revenue caps based on an activity’s underlying cost-base.

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Commission did not acknowledge that access to port terminal facilities had been provided to other shippers without incident both prior to the deregulation of wheat and during the period of deregulation where no access undertaking was in place. The CBH Group considers that the access test costs were incurred to avoid an entirely theoretical risk without any real evidence that the risk would or could come to pass. (sub. DR75, p. 3)

GrainCorp said:

GrainCorp rejects the recommendation that regulation of grain export elevator access should continue up to or beyond 2014 on the grounds that:

- The only reason export elevators are regulated is the existence of the access test within the Act.
- Had the access test not been included in the Act, the export elevators would not be regulated, as no need for regulation has been independently and credibly established.
- The review of access regulation and pricing conducted by the Essential Services Commission of Victoria found that access and pricing regulation was not needed, as grain export elevators are not ‘essential infrastructure’. No evidence of anti-competitive behaviour on the part of the relevant elevator operator (GrainCorp) was found.
- In its submission to the Commission, the NCC ... stated that no evidence had been provided to establish the need to regulate port elevator access and that the access regimes imposed ‘... *unnecessary costs and regulatory burdens (that are) likely to be imposed on wheat export marketers and other participants in wheat markets*’.
- The NCC also states ... that, under the current access Undertakings, the *effective declaration* of all grain export elevators (excepting Melbourne Port Terminal) is counter to what is contemplated by Part IIIA of the TPA.
- As the current Undertakings apply to the total elevator capacity, not just excess capacity, the NCC states ‘... *That’s not contemplated by Part IIIA. It shouldn’t be permissible under the access undertakings*’. (sub. DR82, pp. 9–10)

Many other inquiry participants considered 2014 as too soon for the access test to be removed. The AGEA said:

AGEA does not believe that the industry has settled into a sustainable post deregulation model and that the access arrangements need to be continued with no decoupling of accreditation and access. These provisions were included in the 2008 Act in order to ensure a competitive market developed and avoid the creation of regional monopolies. AGEA believes that any new arrangements should not cause the industry to inadvertently revert to a position that was not supported at the time of deregulation. (sub. DR79, p. 4)

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Glencore Grain suggested the access undertakings should be kept in place until supply chains were more competitive:

It may be expected that there will be new port terminal facilities in the future competitive with the existing port terminal facilities of CBH, Viterra and GrainCorp. When that occurs there will be a case for reviewing the need for access undertakings for either the existing terminal facility or the new facility or both ... But there is no case for winding back access obligations before there is any competition. (sub. DR89, p. 15)

The Pastoralists and Graziers Association of Western Australia also said undertakings should remain for now:

Issues ... remain in relation to the efficiency of the supply chain and specifically in relation to port access for Australian wheat exporters. The PGA strongly believes that a regulatory oversight role in relation to the Port Access Undertakings must be maintained and believes that further monitoring of the [bulk handling companies] by WEA for at least another round of accreditation is warranted. (sub. DR81, p. 4)

### **The Commission's view**

The Commission is still of the view, after weighing up the costs and benefits associated with various actions, that 30 September 2014 is an appropriate time for the abolition of the access test. Although the transition to the deregulated wheat market has gone relatively smoothly, the period of transition has not yet been completed.

Access arrangements for ports can be seen to impact most directly on three separate, closely related, markets:

- the export wheat market
- the market for port terminal services
- the market for wheat transport and storage facilities.

These markets are still in transition. In the port terminal services market, access arrangements are still evolving. The CBH auction system is still subject to change and GrainCorp is, as the Commission understands it, the only major bulk handler to have completed negotiating port access protocols with exporters. The degree to which access issues appear 'settled' varies across different markets. On the east coast, exporters seem to be relatively comfortable with current arrangements, although they are less sanguine elsewhere.

The market for wheat transport and storage facilities appears to be very much in transition, particularly in Western Australia. For example, the Grain Express

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arrangements are relatively recent (and the notification allowing the Grain Express arrangements is under review by the ACCC)<sup>2</sup> and competitive pressures are yet to fully emerge in the Western Australian supply chain. Throughout Australia, the lack of competition in wheat exporting and grain transport historically means that supply chains have typically been sub-optimal. Network pricing, with accompanying cross subsidies, has muted price signals and promoted inefficiencies (chapter 6). These arrangements are changing, largely in response to deregulation and competitive pressures, but it is important that port access arrangements do not act as a barrier to structural adjustment that will improve the competitiveness of the Australian wheat industry and provide real benefits to the majority of Australian wheat growers.

In the draft report, the Commission expressed the view that the access undertakings should be unchanged between now and 30 September 2014, unless all parties agree proposed changes are beneficial. However, the Commission now considers such a condition could unnecessarily limit the ability of parties to improve the current undertakings, or the ACCC's capacity to act where necessary to promote competition (box 5.5). Rather, changes should be made where there are strong reasons for doing so. (For example, to allow the use of auctions to allocate capacity where this is seen as desirable, or to improve an existing auction system). It is still important to avoid 'unnecessary' changes to the undertakings to prevent parties incurring additional future compliance and administrative costs in relation to the undertakings. Should the ACCC wish to make significant changes to the undertakings, it should provide stakeholders with plenty of advance notice.

FINDING 5.3

*If maintained in the long run, the costs of the access test would significantly exceed its benefits. However, given the industry is still in a transitional phase relating to port access, there are likely to be net benefits of maintaining the test until 30 September 2014.*

### **The link between accreditation and the access test**

In chapter 4, the Commission recommended the abolition of accreditation from 1 October 2011. The WEMA links the access test to accreditation. Therefore, if the Commission's recommendations on both accreditation and the access test are adopted, the WEMA would need to be amended (or a new legislative measure

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<sup>2</sup> In 2008 the ACCC decided not to revoke an exclusive dealing notification from CBH relating to Grain Express, allowing CBH to implement Grain Express without the threat of legal action under section 47 of the TPA relating to exclusive dealing. The ACCC is now reviewing the notification.

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would be required) to ensure port terminal owners and operators had an incentive to meet the access test requirements until 2014, and to ensure they continued to publish the daily shipping stem and port access protocols after 2014.

**Box 5.5      How should the ACCC approach the next round of undertakings?**

The current port access undertakings do allow for a greater degree of regulatory intervention than has been used to this point, particularly through the arbitration mechanism. For example, as noted by the ACCC (sub. DR95), access seekers could challenge charges levied at port if they considered them to be unjustified. To date this has not happened, although Glencore Grain has suggested the threat of such a challenge was a catalyst for reaching agreement with GrainCorp over access (sub. DR89) — a suggestion strongly disputed by GrainCorp (sub. DR96).

The Commission would anticipate that, for the next round of undertakings, the ACCC could be more proactive in ensuring up-front that port fees and charges were based only on expenses related to port operations (as distinct from the up-country transport and storage elements of the supply chain). The Commission would also expect, and encourage, the ACCC to ensure future port access arrangements do not inadvertently 'lock in' the use of the bulk handler's up-country supply chains or inhibit structural adjustment that would lead to more efficient supply of services by incumbent providers or rivals. (The current non-discrimination clauses are intended to do this, although there are exceptions such as, in the Commission's view, the requirement to nominate whether Grain Express is to be used in Western Australia months before grain is shipped. The Commission notes CBH already proposes changing this. Further, non-discriminatory charges could also 'lock in' existing supply chains if they were used to cross-subsidise other elements of the bulk handler's operations.)

The Commission would also support changes to the undertakings that would improve the way the current CBH auction system is functioning (such as unbundling port access from up-country transport and storage), or enable other port terminal operators to adopt an auction system should they see fit. Changes to 'first in, first served' arrangements designed to discourage 'booking out the stem' would also be supported. These issues are discussed later in the chapter.

In those locations where exporters seem relatively comfortable with current arrangements, such as on the east coast, the Commission would expect negotiations to be less contentious than elsewhere.

The Commission also expressed the view in the draft report that, even if accreditation were to continue, the link between accreditation and the access test should still be broken. The Commission proposed the WEMA should be amended, or another legislative instrument used, to ensure that port terminal operators continued to meet the obligations of the WEMA access test.

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After the release of the draft report, many participants queried the wisdom of breaking the link between accreditation and the access test. Many exporters saw the threatened loss of accreditation as the most effective sanction to influence the behaviour of bulk handlers and to ensure undertakings remained in place. They expressed concern about the efficacy of an unspecified sanction in ensuring provisions of the access test were met. Some bulk handlers were concerned about potentially being subjected to unspecified sanctions that would not apply to infrastructure providers elsewhere in the economy.

The AGEA said:

The link with port access has provided considerable value and exporters and growers with a safeguard against the development of an uncompetitive industry structure. AGEA believes that the existing legislation requiring those companies seeking accreditation, and with port facilities, to submit access undertakings to the ACCC should be maintained. (sub. DR79, p. 6)

The Pastoralists and Graziers Association of Western Australia said whether the access test should continue after accreditation is abolished should depend on the behaviour of the bulk handlers:

The PGA believes that a sunset clause for WEA should be put in place and that the accreditation of bulk wheat exporters is not required beyond this. However the PGA believes that the Port Access Test within the Act is necessary and should be maintained even beyond the sunset of WEA if the ACCC finds that [bulk handling company] behaviour has not changed as a result of the Port Access Undertakings. (sub. DR81, p. 4)

Viterra expressed concerns from a bulk handler's perspective:

In addition to its concerns relating to the proposed continuation of the access test until 30 September 2014, Viterra has significant concerns with any proposal to introduce unclear and unspecified sanctions for failing to enter into a 'voluntary' access undertaking. This proposal significantly heightens the level of investment uncertainty for infrastructure providers. (sub. DR70, p. 2)

The ACCC also suggested breaking the link with accreditation could be problematic:

The development of the current robust access regimes by each of CBH, Viterra and GrainCorp appeared to be strongly aided by the requirement for these Port Operators to have a Part IIIA access undertaking in place by 1 October 2009 in order for their affiliated trading businesses to retain accreditation to export wheat in bulk. The ACCC therefore submits that if the current mechanism were no longer in place, there would need to be an equally strong alternative mechanism and incentive in place for the Port Operators to develop appropriate access arrangements beyond 1 October 2011. (sub. DR95, p. 3)

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In light of the evidence supplied by all parties on this matter, the Commission has come to the conclusion that meeting the access test (an ACCC accepted access undertaking, and meeting the disclosure rules), should continue to be a condition for export of bulk wheat for port terminal operators. Compared to other possible sanctions, continuing with this condition has the advantage of being known and certain. However, this does not justify an ongoing role for WEA.

Currently, WEA monitors the performance of exporters against the continuous disclosure requirements. However, it has no discretion regarding the access undertakings. The WEMA effectively requires WEA to remove accreditation where no ACCC access undertaking is in place, and to monitor compliance with the continuous disclosure rules (and act if they are being breached).

The Commission considers that, in future, the ACCC should monitor the continuous disclosure rules. In addition, the WEMA should be amended to make an ACCC accepted undertaking for port terminal operators a precondition for exporting without the need for an accreditation process. In effect, port operators would be unable to export wheat in bulk unless they met the continuous disclosure rules and had an ACCC accepted undertaking in place. To further strengthen the regulatory process, port operators without an ACCC accepted undertaking should be required to provide a statutory declaration to the ACCC (or possibly the Department of Agriculture, Fisheries and Forestry) to the effect that they had not exported wheat in bulk. The Australian Customs and Border Protection Service would likely have a role in monitoring compliance with this aspect of the access test.

The Commission notes the current arrangements potentially involve the access responsibilities of the ACCC and WEA overlapping to some degree. For example, a port terminal operator with an undertaking accepted by the ACCC will have met the access test (subject to also meeting the continuous disclosure rules). However, were the port operator viewed by the WEA to be operating outside of the spirit of the undertaking, it appears WEA could remove accreditation if it considered this to be evidence the port operator did not meet the ‘fit and proper’ criteria required for accreditation. The Commission considers this possibility undesirable, from a number of perspectives, including:

- lack of clarity about the boundaries of responsibilities for different regulators increases regulatory uncertainty, inconsistency and potentially compliance and administration costs
- the Commission considers the ACCC is the more appropriate body to deal with access related matters, with suitable frameworks and guidelines in place and greater relevant experience

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- the merits review processes of the TPA (under which the ACCC would operate) are more thoroughly established in dealing with access related disputes than the merits review processes under the WEMA.

FINDING 5.4

*Overlapping regulatory responsibility for access matters increases the potential for regulatory uncertainty and inconsistency, as well as higher compliance and administration costs. The ACCC is the most appropriate body to deal with access related matters.*

## **5.4 Access to port terminals after the transition**

As noted earlier, the Commission considers that 30 September 2014 is an appropriate time for the abolition of the access test. If the WEMA access test is abolished at this time, the question remains of what, if any, regulation should apply to grain terminals after that date.

In considering the options, Part IIIA of the TPA was the logical starting point, as it is the regime that applies generally to access arrangements in Australia. A number of participants have also suggested that Part IIIA should be relied on to regulate port terminals into the future.

### **Part IIIA of the TPA**

Part IIIA provides three ways for a third party to gain access to a service:

- declaration of an asset by a minister, following a recommendation by the NCC (Declaration provides access seekers with a legal right to negotiate and a mandatory dispute resolution mechanism.)
- use of an existing access regime established by a state or territory and deemed to be ‘effective’
- seeking access under terms and conditions specified in a voluntary undertaking given by the service provider and accepted by the ACCC.

The undertaking option is an alternative to declaration. It is designed to give infrastructure owners and operators greater certainty about the access conditions applying to their infrastructure.

Presumably, an infrastructure owner or operator would normally only provide a voluntary undertaking to the ACCC if it believed a piece of infrastructure was likely

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to be declared (or that the costs associated with a potential declaration were very large). When making a recommendation on whether to declare an asset for which access has been sought, the NCC is required to apply strict criteria. The NCC can recommend that the service be declared and the relevant Minister can act on that recommendation only if all of the following criteria are met:

- access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service
- it would be uneconomical for anyone to develop another facility to provide the service
- the facility is of national significance, having regard to:
  - the size of the facility, or
  - the importance of the facility to constitutional trade or commerce, or
  - the importance of the facility to the national economy
- access to the service can be provided without undue risk to human health or safety
- access to the service is not already the subject of an effective access regime
- access (or increased access) to the service would not be contrary to the public interest (TPA, s. 44G(2)).

The applicant or the infrastructure owner/operator can subsequently appeal against the Minister's decision to the Australian Competition Tribunal, which, for the purposes of the appeal, has the same powers as the designated Minister and is required to reconsider the matter in its entirety.

The Productivity Commission notes that proposals to streamline the Part IIIA process are currently before Parliament. The Trade Practices Amendment (Infrastructure Access) Bill 2009 was introduced to Parliament in October 2009, based on recommendations of bodies including the Productivity Commission, the Council of Australian Governments, the ACCC and the NCC.

The bill seeks to implement a number of changes designed to streamline procedures including:

- implementing binding time limits for NCC recommendations and decisions by the ACCC and Australian Competition Tribunal (with 'stop the clock' provisions)
- allowing the ACCC and NCC to make decisions by the circulation of papers, without the requirement for meetings

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- allowing deemed decisions in some circumstances where time limits for decisions by the ACCC are exceeded
  - ensuring ministers make decisions on whether to declare assets within 60 days of the NCC's recommendations
  - amending deeming provisions such that if ministers do not make decisions on declaration, they will be deemed to agree with the NCC's recommendations
  - giving the Australian Competition Tribunal the power to determine whether a declaration decision should be stayed following an appeal, rather than having such decisions automatically stayed
  - limiting merits review by the Australian Competition Tribunal to material placed before the original decision maker
  - allowing the Australian Competition Tribunal to order parties to pay costs in reviews of declaration decisions (NCC, sub. 7; Bowen 2009; Emerson 2009).

### **Participants' views on reliance on Part IIIA**

Many participants saw reliance on Part IIIA as being inadequate for providing access to port terminal facilities, largely due to the costs involved and the potential for delays. AWB said:

Access to port terminal services should not be regulated using only Part IIIA of the TPA. That regime is too slow and very expensive. It will be impractical if not financially impossible for most accredited exporters to pursue fair access through Part IIIA of the TPA. (sub. 24, p.7)

However, other participants saw reliance on Part IIIA as appropriate. For example, the Department of Agriculture and Food (Western Australia) said:

Part IIIA of the Trade Practices Act provides sufficient legislative protection for grain exporters against exploitation by monopoly owners of port facilities. It is predicted that the issue of monopoly ownership is likely to reduce over time as it is highly likely that alternate storage, handling and port facilities will emerge and compete with CBH. (sub. 34, p. 3)

Others saw regulation under Part IIIA as appropriate, but, to quote the Grain Growers Association, 'the process for dispute resolutions may need to be streamlined as we understand that the current process may be lengthy and costly' (sub. 41, p. 12).

The NCC also saw delays and costs associated with the declaration process as one of two major barriers to the effective application of Part IIIA regulation to grain

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port terminals (the other potentially being the application of the national significance test, at least for some facilities) (sub. 7).

Nevertheless, the NCC saw the declaration process under Part IIIA as the best way of determining access rules:

In the Council's view it is critically important that regulation of access is predicated on the declaration criteria being met. If not, there is no basis for confidence that such regulation is likely to enhance competition or efficiency. (sub. 7, p. 6)

The ACCC has expressed a preference for use of the declaration criteria in determining whether a service should be declared. In a 2000 submission to the Commission's inquiry into the National Access Regime, the ACCC stated:

The [ACCC] would not support any move to a generic access regime applying to an administratively determined list of services. The [ACCC's] experience is that such a process could lead to making decisions on the application of access to services based on reasons other than sound and consistent economic principles. For instance, a service that is politically sensitive may be inappropriately 'declared' on the grounds that regulation of the service may 'take the political heat out of the issue' or pass the buck to someone else. Part IIIA currently minimises the risk of this happening by requiring that statutory, and economically based, criteria are satisfied before declaration and by involving an independent third party in the process; the NCC has expertise in the areas of competition policy and economics. (ACCC 2000, p. 91)

The AGEA suggested that the impact of regulating based solely on the Part IIIA measures might be different now (or in 2014) than if Part IIIA had been relied on at the time of deregulation.

At the time of deregulation all exporters were new entrants (excepting AWB) and thus, no player had any established market share. Thus, none of the [bulk handling companies] had established their own existing use in relation to wheat, but there have now been two marketing seasons post deregulation which has allowed players to establish a market presence and this will be further established by 2014. The [bulk handling companies] could claim that its current and foreseeable use for wheat and other grains is significant and consequently substantially lessen the capacity available to other exporters. (sub. DR79, p. 10)

### **The Commission's view**

Once the WEMA access test is abolished, grain port terminals should be subject to the generic provisions of Part IIIA so that port terminals would only be declared if they are assessed by the NCC to have met the declaration criteria (and this assessment is subsequently agreed with by the relevant minister).

The Commission is of the view that Part IIIA of the TPA, combined with the transitional path outlined by the Commission (that is, use of undertakings for 5

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years), is better placed than ad hoc industry specific regulation to balance the costs and benefits of access regulation in the long run. Application of Part IIIA will bring the wheat industry into line with the general competition law applying to other industries in Australia.

The Commission also sees merit in a full review of the National Access Regime to ensure it is working as effectively as possible. The Commission itself has previously raised concerns about delays in decisions associated with the Part IIIA process, and expressed concern that the current interpretation of the declaration criteria could result in inappropriate declarations, and has called for legislative amendments to address this issue (PC 2006a).

An independent review of the National Access Regime is due in 2011. The Commission considers it is important that an independent review takes place at this time, particularly to provide a further opportunity to improve Part IIIA procedures, and to consider the appropriateness of the declaration criteria.

RECOMMENDATION 5.1

*The Australian Government should proceed with the scheduled independent review of the National Access Regime. This review should commence no later than 31 December 2011.*

## **5.5 Regulatory requirements in addition to Part IIIA**

While the Commission considers that Part IIIA will play a vital role in ensuring access to port terminal facilities beyond the transitional period, there remains a question of whether any further regulation is required.

### **Participants' views on going beyond Part IIIA**

The bulk handlers felt there were sufficient constraints on their market power to make any regulation beyond Part IIIA unnecessary (box 5.6).

The bulk handlers also suggested in their initial submissions that a voluntary code of conduct could provide exporters with the necessary assurance they require that they would not face discrimination.

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**Box 5.6 Port terminal operator views about constraints on their market power**

Bulk handlers suggest competition concerns about port operations have been overstated. For example, CBH said:

Competition concerns relating to port access are exaggerated and unfounded for a number of reasons:

- CBH is bound by Western Australian legislation, specifically section 19 of the *Bulk Handling Act 1967 (WA)* to provide access to its port facilities to third parties.
- CBH is also subject to section 46 of the *Trade Practices Act 1974 (Cth) (TPA)*
- CBH is a volume based business and must maximise volume throughput at its facilities. The sunk costs of port facilities and the nature of CBH's business is such that maintaining volume throughput is essential to ensure the ports are economically viable.
- CBH is a grower owned and controlled co-operative who would be acting against its own charter should it engage in activities that were detrimental to its shareholder members.

It must also be acknowledged that there is no historical behaviour to support the claims that CBH would deny access to its facilities. (sub. 39, p. 1)

GrainCorp made similar statements:

No credible evidence has ever been presented to indicate the company has ever sought to extract monopoly rents or to form a 'regional monopoly'. The structure of the grains industry in eastern Australia militates against the formation of a regional monopoly, and as such there is no requirement for regulation to prevent the formation of what the market will never allow to form.

- Grain growers enjoy a competitive market where only 30% of grain produced in the eastern states is exported from GrainCorp port terminals. Over 50% of grain produced is consumed by the domestic market.
- A significant portion (up to 25%) of grain is exported from competing facilities, including the containerisation of grain.
- GrainCorp has no incentive to hinder access given that its terminals average shipping utilisation is only 15% and only 24% usage in a maximum year. Our business model requires us to maximise throughput as demonstrated by GrainCorp's track record of providing public access rates to others without the need for regulation.
- GrainCorp's business model is based on open access. GrainCorp has no history of refusing access or of acting in an anti-competitive manner in respect of grain export terminals. For example, GrainCorp voluntarily engaged with the NSW Government to allow multiple licences for export barley and canola when it acquired the NSW Grain Board export rights in 2003. (sub. 43, p. 16)

Viterra said:

The model favoured by ABB [now Viterra] is a Code of Practice from ABB, CBH and Graincorp incorporating the best aspects of the port access undertaking and continuous disclosure rules. Each party would commit to comply with the Code. Any party which wished to withdraw from the Code would be required to provide 1 years notice. Any

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disputes regarding a party's compliance with the Code would be subject to adjudication by an independent arbitrator and the decision of the arbitrator would be legally binding. ABB believes that the very real threat of declaration of port terminal services under Part IIIA of the Trade Practices Act would serve to ensure that the bulk handlers observed their obligations under the Code. (sub. 23, pp. 3–4)

CBH said:

If considered necessary, a voluntary access arrangement would be acceptable. This could be developed through a voluntary industry code of conduct, making provision for a dispute resolution process to be overseen by an appropriate grain industry body. (sub. 39, pp. 2–3)

GrainCorp proposed a multi-stage process, with a voluntary code of conduct to be implemented until mid-2011:

Competition or 'access' related concerns that led to the imposition of new competition regulation through the ACCC could be dealt with under a revised bulk wheat export scheme, by requiring an 'access code of conduct' as part of a revised accreditation scheme until 30<sup>th</sup> June 2011. From that date, a regime consistent with that proposed by the National Competition Council's 'National Access Regime', provided for under a revised Part IIIA of the Trade Practices Act, should be put in place. Such a code of conduct would replicate key elements of the current port access undertakings, but would not require the involvement of the ACCC and the associated costs. (sub. 43, p. 13)

### **The Commission's view**

The Commission considers that, in view of ongoing concerns about the ability of the bulk handlers to discriminate against rival exporters, or for structural change in supply chains to be impeded, there are arguments for continuing with some level of light handed regulation beyond Part IIIA alone. The Commission also notes it is unclear whether at least some of the port terminals would be declared under Part IIIA.

It is not the role of the Commission to try to predict whether the port terminals would be declared under Part IIIA. Certainly, as discussed earlier, there appears to be only a weak case for declaring port terminals in Victoria, where there is potentially more competition between facilities, and some smaller ports might be unlikely to meet the 'national significance' criterion.

Importantly, as noted by the bulk handlers themselves, there are a number of factors that, although not eliminating any market power the port operators might have, certainly limit the extent of such market power or the ability of the operators to take advantage of it (box 5.6). Many of these factors are not of themselves overly

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significant. However, taken *together*, they suggest to the Commission that light handed regulation — particularly combined with the possibility of declaration under Part IIIA — would in the long term be preferable to the current regulatory arrangements (or, importantly, to a total absence of regulation).

These factors, broadly summarised, include:

- the global wheat market is highly competitive. Any market power the bulk handlers might enjoy at home could not be effectively passed on in global markets where they are price takers. Lifting costs for rival exporters would potentially lead to reductions in Australian wheat exports and in throughput at port terminals
- legislative requirements under state legislation, such as the *Bulk Handling Act 1967* (WA) which, for example, limits CBH's ability to deny access to facilities
- benefits to bulk handlers from maximising throughput at port terminals. The capacity of many terminals is greater than the entire annual grain crop for their respective jurisdictions, meaning throughput is critical to the financial viability of the enterprises (especially in drought years)
- consumption of grain by the domestic market. This is likely to represent a significant constraint, particularly on the behaviour of port terminals in the eastern states. If the costs of exporting grain are too high, selling it at home will be more attractive to growers
- competition from the container export market
- competition from port terminals in other states. This is not a constraint in Western Australia but is potentially a factor on the east coast and nearby parts of South Australia. (Competition between ports tends to be manifested through differences in wheat prices across regions. If one region has higher transport costs, wheat prices in that region are likely to be lower to maintain competitiveness. This is discussed in chapter 3.)
- countervailing power on the part of other major Australian exporters. This was obviously a major constraint in the days of the single desk arrangements, but is still relevant
- the threat of declaration under Part IIIA
- the threat of new port terminal entrants. Although barriers to entry are fairly high, other smaller ports could certainly be built to 'cherry pick' customers away. There is also the threat that major exporters, particularly large global exporters, might build rival facilities even if it is uneconomic (in the short term, at least) to do so. Further, although full replication of port terminals is unlikely, smaller players might have capacity to provide some competition, and it would

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be unfortunate if access regulation led to such opportunities being ‘strangled’ before they began. Currently there is talk of rival port facilities being built (for example, at Gladstone in Queensland, and at James Point in Western Australia). There is also the threat of competition from non-grain port terminals, which could potentially be used to export grain.

As a result the Commission is not attracted to heavy handed regulation for port terminals, particularly because of the potentially large costs involved. If infrastructure owners and operators are not adequately protected they will have a diminished incentive to invest in facilities. Therefore, to ensure infrastructure is adequately provided and maintained, the Commission considers it is better to err on the side of infrastructure owners/operators.

Ultimately, when regulating access to monopoly infrastructure, there are predominately two types of error that will potentially diminish community welfare. One is that the regulator might allow an infrastructure owner/operator an element of ‘monopoly rent’ (or over-compensation) beyond that required for an investment to proceed, meaning the price of access will be higher than otherwise and infrastructure services will be ‘under-consumed’ relative to their efficient level.

However, the second type of error is that regulators will ‘under-compensate’ infrastructure owners, potentially leading to the non-provision of some services entirely. The Commission considers this latter prospect to represent a worse outcome involving greater efficiency losses (PC 2001b). Therefore, the Commission is of the view that governments and regulators should be circumspect in applying access regulation to infrastructure projects.

The Commission agrees that a voluntary code of conduct could have benefits for exporters (assuming it included features such as minimal service offerings, publication of reference prices and a binding arbitration process). Even so, it is of the view that considerations such as domestic competition, the need to maximise throughput and the threat of declaration under Part IIIA would be more significant in preventing bulk handlers from discriminating against rival exporters. In view of these additional constraints on the market behaviour of the bulk handlers, the adoption of a voluntary code of conduct (post-October 2014) could provide exporters with some degree of assurance about port access.

It would be in the interests of the bulk handlers themselves that such a code of conduct remained credible, as this would discourage more ‘heavy handed’ regulatory interventions or attempts by other exporters to have port terminals declared under Part IIIA.

The Commission also considers it would be beneficial to require port terminals to continue to publish the daily shipping stem and port access protocols as they are currently required to do under the WEMA (that is, to keep the continuous disclosure rules component of the access test). However, rather than including them in a voluntary code, the Commission considers these requirements should be legislated (for all bulk wheat port terminals, including the MPT, which is currently exempt from the existing access test). The costs of publishing these are relatively low, and there seems widespread agreement that these have helped significantly in providing confidence for exporters regarding their ability to access port terminals. Compliance with the continuous disclosure provisions after 30 September 2014 should not be a condition of exporting wheat in bulk.

**Table 5.2 Summary of Commission’s preferred arrangements for exporters that provide port terminal access**

<i>Date</i>	<i>Regime</i>	<i>Responsible regulatory agency</i>
Now until 30 September 2011	Meeting access test as a condition for export accreditation	ACCC, WEA
1 October 2011 to 30 September 2014	Meeting access test as a condition for exporting	ACCC, Customs
1 October 2014 onwards	Access subject to Part IIIA TPA provisions. Requirements for publishing of the daily shipping stem and port access protocols. Voluntary code of conduct	NCC, ACCC

RECOMMENDATION 5.2

*The requirement for grain port terminal operators to pass the access test contained in the Wheat Export Marketing Act 2008 (continuous disclosure requirements and an ACCC accepted port access undertaking) as a condition for exporting bulk wheat should remain in place until 30 September 2014. Responsibility for determining if the access test is met (including the continuous disclosure requirements component) should rest solely with the ACCC beyond 30 September 2011, whether or not accreditation continues past that date.*

*Ideally, grain port terminal operators not subject to the access test between 30 September 2011 and 30 September 2014 would voluntarily publish their shipping stem and port access protocols.*

*The requirement for port terminal operators to pass the access test as a condition for exporting bulk wheat should be abolished on 30 September 2014.*

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*The requirement for continuous disclosure should continue after 30 September 2014, although this should no longer be a condition for exporting bulk wheat. From this date, the continuous disclosure rules should be applied to all grain port terminals, regardless of ownership. Responsibility for monitoring compliance with continuous disclosure rules should remain with the ACCC after 30 September 2014.*

*From 1 October 2014, access disputes (other than those relating to the continuous disclosure requirements) should be dealt with by the National Access Regime under Part IIIA of the Trade Practices Act.*

*Ideally, port terminal operators would supplement these arrangements with a voluntary code of conduct from 1 October 2014.*

*Should the access test continue beyond 30 September 2014, it should be reviewed after no more than five years.*

## **5.6 Auctions as a mechanism for allocating limited capacity**

As noted earlier in the chapter, the Commission considers auctions can play a significant role in efficiently allocating limited port capacity. CBH introduced an auction system for the most recent harvest in response to delays at Western Australian ports during the previous year. Although the Commission considers aspects of the system can be improved upon, it supports its continuation (subject to modifications) and thinks that other port operators might also consider adopting a similar system where there is a likelihood of excess demand for port capacity at certain points in time (effectively, a shifting peak demand problem driven by movements in the supply and demand for wheat).

### **The CBH auction system**

The current CBH auction system will run until November 2010, and allocates port capacity separately for the ‘harvest period’, between 1 November and 15 January, and the ‘annual shipping period’ between 16 January and 31 October. (Capacity auctioned via the auctions is not based purely on capacity at port. The amount of capacity to be auctioned is based on the ability to load ships, the storage capacity at port and the ability to receive grain at port. Significantly, it also factors in the capacity of CBH’s Grain Express network to bring grain to port.)

During the harvest period, demand for port terminal services is less likely to exceed supply as grain is generally not available in significant quantities for delivery to

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exporters. Therefore, during the harvest period capacity is currently allocated based on expressions of interest rather than via the auction process.

For the annual shipping period, capacity is allocated via auction. The Phase One auctions held in September-October 2009 offered 70 per cent of ‘core capacity’ for the annual shipping period, with remaining ‘core’ capacity and any ‘surge’ capacity to be auctioned in a monthly Phase Two auction process. The core and surge capacity concepts relate predominately to the Grain Express supply chain rather than the port terminals. Core capacity is defined as that capacity ‘available using transport resources which are the least cost option for the export supply chain’ (CBH 2009b, p. 4), whereas surge capacity refers to additional resources that are attainable but only at higher cost. The cost of surge capacity varies with the additional resources required and their availability. The cost of surge capacity is advised before the start of the Phase Two auctions.

As noted by many participants, the auction process put in place by CBH is complex (with training available to marketers, and a mock auction conducted ahead of the ‘real thing’). CBH explains the process ‘in brief’ as follows:

In brief, before the auction CBH will advise the available capacity per port per shipping window. CBH will also set the start or reserve price at the Up Front Marketer Fee (\$3 per tonne or \$0 per tonne auction premium). The auction will proceed through a series of clock increments. When the auction starts, bidders indicate how much capacity they want at the reserve price. At the end of each increment the market demand will be shown for all shipping windows in the auction. Marketers can swap demand for lots between clock increments as long as their total demand doesn’t increase. The first two clock increments will be at 25 minutes followed by a 5 minute activity pause period between rounds and \$0 per tonne premium. Clock increments will be 25 minutes followed by a 5 minute activity pause period between rounds and \$0.50 per tonne thereafter. As the price increases round by round, some bidders will reduce their demand or shift bidding to other lots, closing the gap between demand and supply. Eventually, the rising price lowers demand to a point where demand equals supply. The system then closes the bidding process and capacity can be allocated to bidders at the price of that increment. Where demand does not exceed supply in a given lot, the price will not increase even though the lot remains open. The minimum bid is 1000 tonnes and bids are made in multiples of 1000 tonnes, allowing small and large bidders to compete equally. (CBH 2009b, p. 2)

The \$3 per tonne upfront marketer fee is levied, according to CBH, to ensure only genuine bidders participate in the auction, and to prevent attempts at ‘market cornering’ or speculative acquisition of capacity.

The proceeds of the auction premiums, less the direct cost of developing and running the allocation system, are proportionally rebated to all exporters that used the auction system to ship grain over the entire shipping period.

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The process also involves the use of a secondary market functioning largely independently of CBH. Trades in the secondary market can take place until seven days before the shipping window of the traded slot during the harvest period, and until 30 days before the shipping window of the traded slot during the ‘annual shipping’ period.

### **How effective is the current CBH auction system?**

CBH says the auction system is the best allocation system available:

We believe this system is the best way forward for the industry. It provides fair and equitable access to all market participants, including those seeking direct port access, and aims to ensure a sustainable and efficient grain supply chain. With more than 22 accredited exporters, all of whom have different shipping commitments, meeting all their expectations is a real challenge. However, this revised system provides full operational flexibility for all exporters and creates a more efficient and co-ordinated approach to allocating shipping slots. (CBH 2009a, p. 1)

Viterra has said the main issue in Western Australia is the underlying capacity constraints, and described the auction system as a ‘band aid’ measure:

Viterra considers that CBH’s use of an auction system is an appropriate method of allocating finite capacity between different exporters. However, implementing such an auction cannot, in and of itself, address the underlying issue of capacity constraints in the Western Australian bulk wheat export supply chain. Put another way, an auction system is inherently a ‘band aid’ solution, rather than a solution which enables expansion and investment to remove any capacity constraints. (sub. DR70, p. 8)

Some participants have questioned the complexity of the CBH auction system. For example, AWB said:

The auction model is labour intensive, time consuming and complicated. Loading ships with grain is a relatively straightforward activity. The proposed detail in CBH’s auction system will make the auction model unnecessarily rigid and complex. The auction process needs to match the fluidity of the grain and shipping markets, otherwise it will likely lead to confusion and chaos. (sub. 24, p. 12)

Many participants raised concerns about specific aspects of the CBH auction system. In particular, many were concerned about the interaction between the auction system and Grain Express.

AWB suggested too much capacity was auctioned too early in the season:

Too much capacity was auctioned too early in the season while the crop quality was not known. The default position was that CBH would retain any unpurchased slot for its own trading arm. This forced other exporters to act irrationally, to buy too many shipping slots and to pay too much for most slots. Subsequently there have been

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distortions created in export markets by exporters who paid too much and bought too many slots. (sub. DR63, p. 10)

AWB saw the first auction as not satisfactory from its perspective, with the allocation of capacity being less than optimal from a shipping perspective:

The first auction undertaken since the access test has not been successful. In many cases, AWB and other wheat exporters have only been allocated partial shipments. It is neither efficient nor cost effective to deliver bulk wheat to a discharge port in several ships, instead of one. Failure to load an entire ship will generally result in the charterer incurring ... payment for failing to load the ship to full capacity ... This can make the allocation worthless unless it can be combined in the secondary market. CBH should be providing slots that are sufficient to load whole vessels. (sub. 24, p. 12)

On the other hand, CBH saw the auction system as providing exporters with maximum flexibility:

The CBH Group notes that AWB and all other auction participants have the choice of how much port terminal capacity they buy in a slot at Auction as they are in control of the size of their bid. If an auction participant buys capacity that is only useful for a part cargo then that is the participant's issue to control within the auction process and not a function of auction design or limitation. (sub. DR75, p. 6)

The rebate system was seen by AWB as favouring larger shippers, and discouraging trades in the secondary market:

It should be noted that the CBH 'rebate' unnecessarily complicates the understanding of costs. It is a season average which favours large volume exporters, like CBH over small players. The rebate only applies to the actual shipper, this means the secondary market is unlikely to trade except under duress. (sub. 24, p. 13)

CBH denied the system is likely to favour large shippers:

CBH notes that the rebate will only assist shippers who have acquired capacity in the auction at a premium that is below the Average premium – that could be a small, medium or large shipper. The key determinant as to whether the auction premium rebate provides an exporter with an advantage is when its grain is shipped. If an exporter looks to acquire capacity in the auction and ship grain in off-peak months then it will benefit from the rebate. The CBH Group considers that AWB's misunderstanding of the auction system (as evidenced by its submission) could result in an uninformed bias against the auction process. (sub. DR75, p. 6)

AWB also suggested the auction process should be overseen by an independent body:

The management of the initial allocation and subsequent secondary market for shipping slot allocations needs to be administered by an independent administrator according to rules established by the relevant [bulk handling company] prior to the offer of any shipping allocation process. Rules should not be able to be changed unless caused by an

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instance of force majeure. Exporters need certainty and fairness regarding the application of the rules to create the necessary liquidity to generate the secondary market. (sub. DR63, p. 11)

Concerns have also been raised about inflexibility in allocating shipping slots, and about a perceived inability to trade shipping slots. AWB said:

The secondary market to trade shipping slots has been unnecessarily constrained and rendered ineffective due to the charging of unjustified capacity transfer fees and application of inflexible rules relating to the transfer of shipping slot ownership ... A tolerance on tonnage booked by slot should be applied. This will increase flexibility for both exporter and [bulk handling company] in operating port and related supply chain assets and is in line with practices adopted in the sale of grain ... Shipping slots should be able to be traded within the shipment period to create the most liquid and flexible market to encourage participation, subject to the common rules that should be established prior to a season commencing ... The shipping slot lengths (15 days) are relatively tight and the rules that apply to the implementation of 'grace period' need greater definition. (sub. DR63, p. 11)

Similar concerns were raised by the AGEA:

The effectiveness of the secondary market is also impacted by the unjustified (in the AGEA's view) capacity transfer fee that CBH applies each time a slot is traded on the secondary market. This charge is tonnage based and therefore not reflective of the cost of providing the service. A flat fee would be more appropriate, if in fact, there is any justification for this charge. ... Lack of flexibility in relation to transfer of slots is a major impediment to the efficient operation of a secondary market; and the industry is being made to pay for CBH inefficiency. (sub. DR79, p. 12)

Some participants have raised concerns about the amount of money in the auction premium fund set up by CBH to provide rebates to shippers. For example, the AGEA said:

It is understood that there is in order of \$62 million in the CBH auction premium fund. (This is another incidence to lack of transparency where those paying the fees do not have access to this information). While the intent is that this be distributed back on [the] basis of tonnage shipped through the CBH system ... this is a significant cost impost on the industry and may inhibit the ability for smaller players to participate in the market. Furthermore, it is also inequitable as those who paid the higher premium do not get this back and may result in cross-subsidisation to those participants who shipped the largest tonnage. (sub. DR79, p. 12)

AWB has also questioned the need to charge additionally for 'surge' capacity:

CBH claims that the reason for auctioning shipping slots is that they anticipate that demand exceeds supply after the harvest period and therefore additional capacity, in the form of 'surge' capacity, will be made available at a premium over the base core price. However, the capacity either exists or it does not. Describing it as 'surge' capacity is a

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misnomer – it is the capacity at which CBH charges a premium for the service. (sub. 24, p. 12)

CBH believes such concerns are misplaced:

The CBH Group considers that AWB's statement is incorrect in part and disingenuous in part ... The 'surge capacity' referred to by AWB is a level of capacity above which a user of CBH's up-country supply chain will incur additional freight costs. It is not additional capacity at the port terminal which incurs additional costs. CBH is endeavouring to ensure that users of the CBH supply chain do not incur additional unknown costs. If an exporter acquires 'surge capacity' but does not use CBH's up-country supply chain it will not be charged the surge fee. This is disingenuous in the sense that prior to de-regulation, AWB charged the national wheat pools for 'contestable freight' in circumstances where AWB's contracted freight was unable to meet shipping demand. Contestable freight pre-deregulation and surge freight under Grain Express are exactly one and the same. (sub. DR75, p. 7)

In response to industry feedback, CBH has announced it is considering a number of changes for next year's harvest. These include:

- Shipping slots in the harvest shipping period will now be auctioned.
- Rather than a two phase, multiple auction process, CBH will only conduct four auctions in 2010-11. These auctions will continue to be hosted by Tradeslot.
- Each auction will cover 5 or 6 shipping windows.
- Each auction period will stand alone from an administrative point of view with the auction premium collected for each auction period to be reconciled and rebated to the trade at the conclusion of each auction period.
- A secondary market platform will be developed and provided by Tradeslot. This will essentially be a bulletin board to allow the trade to post and bid on an offer.
- Capacity can be forfeited at late notice. Fees will be payable but these will be lower than in 2009-10.
- Capacity can be repositioned within an auction period if there is spare capacity within the preferred shipping window. The auction premium rebate will still apply to this capacity.
- An increased operational tolerance of 10 per cent will be applied to the reconciliation of lost capacity by port/shipping window.
- Exporters will be asked to nominate Grain Express or direct to port at least 30 calendar days prior to the shipping window. (sub. DR75).

In addition to these proposed changes, the Commission understands CBH will also review its auction related charges (such as the upfront marketer fee).

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## **The Commission's view on possible improvements**

The Commission is of the view that auctions are a useful device for rationing in circumstances where there is a shifting peak demand for capacity, as they are an effective way of ensuring capacity is utilised by those that value it most highly. Auctions can be used in the absence of access regulation or in conjunction with various regulatory structures (including declaration, undertakings or voluntary codes of conduct). However, the process put in place by CBH has some shortcomings, and the Commission recommends some modifications. Some relate to the link with Grain Express, and these will be discussed in the next section.

The Commission acknowledges, of course, that CBH's proposed changes are subject to negotiation and the following comments should be seen as a contribution to this process. The Commission is not seeking to be prescriptive or to 'second guess' mutually agreed changes between parties to the auctions.

The Commission generally supports CBH's proposed changes. In particular, those that provide greater flexibility for shippers and increased tolerance should improve the operation of the auction (although it is important not to introduce too much flexibility with regard to cancelling slots, or else the incentives of the auction participants would be distorted). The decision to auction during the harvest shipping period presumably reflects greater demand during this period last season (or could be due to the likelihood of significant stocks carrying over at the end of this season). The decision to conduct four auctions through the year means exporters will have their capital tied up for shorter time periods, but it potentially means the rebates in future could be smaller. Peak shipping periods and off peak shipping periods will 'stand alone', with rebates no longer occurring between those shipping at the peak time of year and those shipping off peak.

With regard to capacity being sold too early in the season, the Commission notes there appears to be an element of 'winner's curse' at play here where, as often occurs at auctions, the winning bidder later realises they have bid too much. Clearly, wheat prices in 2010 have not reached the heights many exporters might have hoped, meaning with hindsight they have probably paid more than they ideally would have for capacity. However, this is not the fault of CBH or the auction system. This ultimately stems from the exporters own decisions. Risk management is a significant aspect of a wheat exporter's operations, and the auction process involves similar issues to managing price fluctuations and currency risks. That said, however, it still highlights that auctioning capacity well in advance can increase the possibility of sub-optimal outcomes for participants and also potentially distort export markets, as will be discussed later. It also highlights the desirability of an effective secondary market to allow for better risk management.

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The Commission also notes concern about the tonnage based transfer fee charged by CBH for participation in the secondary market. Although this fee is likely to be too small to have any major impact, it nonetheless acts as a disincentive to trade in the secondary market and the Commission agrees with the AGEA that there appears to be little justification for it being tonnage based (given that it relates to an administrative procedure). It would be preferable from an efficiency viewpoint if the charge was a flat fee per transfer.

## **CBH auction process and Grain Express**

Participants have raised concerns about the relationship between the port capacity auction process and Grain Express. To the extent that capacity constraints are based on limitations of the up-country supply chain rather than the ports themselves, what is effectively being auctioned is up-country supply chain capacity. As CBH explains it:

Core Capacity is that capacity available using transport resources which are the least cost option for the export supply chain and which are paid for directly by the growers of Western Australia. The core transport services are those contracted to CBH on long term agreements with set tonnage targets and transport routes. Acquiring an excessive amount of core transport resources would unnecessarily add to export supply chain costs. Core Capacity calculations take into account estimated crop size, domestic use and the requirement to prepare sites to receive growers grain for the next harvest. (CBH 2009b, p. 4)

The AGEA has questioned whether port capacity constraints really exist:

[The AGEA] does not believe that there is a capacity constraint, rather the constraint is related to the CBH supply chain. Removing Grain Express would provide transparency as to where constraints in the system really occur. (sub. DR79, p. 13)

Glencore Grain said:

CBH is able to turn capacity on and off at whim, for the auction is not of capacity generally but tranches of capacity chosen by CBH, including the totally fictitious 'surge capacity' which is based not on additional ship loading speed or spouts but rather the trader paying for additional transport to get grain to port. (sub. DR89, p. 4)

The Commission is of the view that the capacity auctioned through the port capacity auctions process should only relate to actual port capacity, unbundled from the up-country supply chain. The Commission believes it is important that CBH moves towards this.

A change of this nature would be challenging to the industry in the short term. The experience of port delays in 2009 highlights that there are real capacity constraints

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within the current CBH supply chain. When the demands on the system exceed these constraints, one way or another costs will be incurred by industry participants. However, unbundling the auction system from Grain Express will have benefits in the long run.

Links between the port capacity auction and Grain Express reduce incentives for other players to invest in up-country transport and storage, and possibly inhibit the development of rival supply chains. A current failing of the auction system is that up-country capacity is defined only in terms of the CBH up-country supply chain (Grain Express), when there is capacity for other industry participants, including wheat exporters, to augment the supply chain with their own resources. It is important that the auction system does not prevent this. For example, the auction system should not preclude or discourage a rival exporter from using its own transport to take grain to port.

The Commission acknowledges that, in the short term, given Grain Express's dominance, such augmentation of the supply chain is not likely to have a large impact. (Indeed, such is the current dominance of Grain Express arrangements that customers using direct port access might actually 'slow down' CBH's port operations and reduce capacity at port). In the medium to long term, however, it is likely that rival supply chain arrangements will emerge, and CBH will have had time to increase the capacity of its own supply chain. The Commission is therefore of the view that a move towards auctioning purely port capacity at auctions should be a priority and should occur as soon as practicable.

Many participants also questioned whether the requirement under the CBH auction process to nominate well in advance whether Grain Express is to be used, or alternative arrangements made to get grain to port, has the effect of 'locking in' the use of Grain Express. For capacity won in the first phase auction (in late September/early October 2009), exporters had until 1 November to nominate whether they were going to use Grain Express or make their own arrangements for transporting wheat to port. Exporters have seven days from the date of the auction to nominate whether they are using Grain Express for capacity won in the subsequent monthly second phase auctions (CBH 2009b).

The AGEA stated:

In particular, the CBH system is of concern as successful bidders in the auction system have to declare whether they will make use of Grain Express or select Direct Access within seven days of the auction. No change is allowed after that date. It should be sufficient to declare the option of Grain Express or Direct Access when nominating the ship. This is another attempt by CBH to provide 'direct access' on paper, but in reality force exporters to lock themselves into one or the other for the year in advance. (sub. 28, p. 13)

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CBH noted there were benefits of finalising supply chain arrangements early:

CBH requested early feedback on whether an exporter was using Grain Express or not as it was required to obtain transport resources to service the level of demand under Grain Express. It is inefficient to acquire transport resources on a monthly basis. The best rates are achieved using volume and certainty. If an exporter were to switch at the last minute from Grain Express to Direct to Port, then CBH would have transport resources standing around idle. This is inefficient and costs CBH and its grower shareholders, money. (sub. DR75, p. 9)

Although the Commission agrees there are likely to be logistical and financial benefits to CBH in having advance knowledge of exporter's transport requirements, it seems unnecessary for exporters to make decisions about whether to use Grain Express or other arrangements so early. The Commission is particularly concerned that this almost certainly has the effect of making exporters significantly more likely to use Grain Express (given the lack of alternative arrangements), and therefore is likely to impede the development of rival supply chains (or structural adjustment by CBH of its own supply chain). Unless exporters could feel confident, well in advance (indeed, before wheat has actually been purchased), that cost effective alternative arrangements could be put in place to transport wheat from an up-country location to port at a time when the supply chain was likely to be near capacity, they would be likely to nominate use of Grain Express.

The Commission notes CBH has proposed change to the auction system for future years with regard to the time before shipping that transport options must be nominated:

The Commission should note that among the proposed changes to the Auction system for 2010/11, CBH is considering providing exporters with the ability to nominate Grain Express or Direct to port at least 30 calendar days prior to commencement of the relevant shipping window. (sub. DR75, p. 9)

This change will go a long way toward alleviating this problem, and the Commission therefore endorses it.

There is also an issue of whether the link between the auctioning of port slots and the requirement to nominate whether or not an exporter will use Grain Express reduces the efficacy of the secondary market. The AGEA said:

In [the] case of CBH, there is provision for a secondary market, but this is not working effectively, partly because the traded capacity must retain the supply chain option originally nominated. (sub. 35, p. 2)

The link between port slots and the use of Grain Express effectively means both port capacity and the other elements of the supply chain used to transport wheat to port are being bundled and traded in the secondary market. Port capacity that has

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been linked to alternative arrangements for port access might be of limited use to an exporter seeking to use Grain Express, and vice versa should alternatives to Grain Express become more widely available. The link between port slots and the use of Grain Express could reduce the efficacy of the secondary market.

The Commission sees many of the more significant problems associated with the auction system as stemming from the manner in which it is linked to Grain Express. The Commission is of the view that CBH should make greater efforts to ‘unbundle’ port access from the rest of the supply chain where possible, and that between now and 2014 the ACCC should oversee this process when reviewing the next CBH access undertaking (although not in a manner that would undo the efficiency benefits of using an auction model). The Commission notes the ACCC has already foreshadowed that it could potentially play such a role:

Any other deficiencies with the auction system identified by the Productivity Commission in its final report may be able to be addressed in the ACCC’s assessment of revised wheat access undertakings in 2011. (sub. DR95, p. 5)

Specifically, the Commission would like to see:

- a breaking of the link between the port capacity auction system and the Grain Express supply chain such that auction arrangements would not preclude or discourage exporters taking grain to port via means other than Grain Express. Ultimately, it would be preferable if the level of capacity allocated at auction was based purely on capacity at port (that is, *totally* unbundled from the rest of the supply chain)
- the removal of the requirement to nominate so far ahead whether Grain Express or other arrangements are to be used to bring grain to port
- tonnage based transfer fees in the secondary market replaced with a flat fee per transaction.

The Commission also considers it important that feedback from the first year of the auction process be taken into consideration when determining appropriate changes for future years.

### **Auctions versus ‘first come, first served’**

The Commission notes there is disagreement among participants over whether the CBH auction system is preferred over the ‘first come, first served’ approach of other bulk handlers. A major concern expressed regarding the current operation of the ‘first come, first served’ approach is that non-refundable booking fees for shipping slots effectively represent internal company transfers when between arms

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of the same company, while representing a genuine business risk for other exporters.

Michael Schaefer, the chairman of the South Australian Farmers Federation Grain Committee, said:

The other one is the shipping stem. I think that at least CBH has made an attempt. They have talked to the trade and tried to get an outcome that is acceptable. There may be some things that need ironing out in that, but the problem in our state is that the trade have to put up \$5 a tonne to book a ship. ABB or Viterra would argue they have to do the same, but if they are putting up \$5 a tonne it's the left hand paying the right hand. There is no money for their business at risk ... at one point Viterra or ABB ... had about 88 per cent of the shipping stem ... if they had their own money actually up for risk, we may see the shipping stem operating in a different manner. (trans., p. 299)

The Commission notes some participants have highlighted a high rate of cancellations by Viterra in 2009 and 2010 of shipping slots in South Australia, suggesting that Viterra might have tried to initially 'book out the stem' in order to prevent other exporters from exporting from South Australia in large quantities.

Glencore Grain stated:

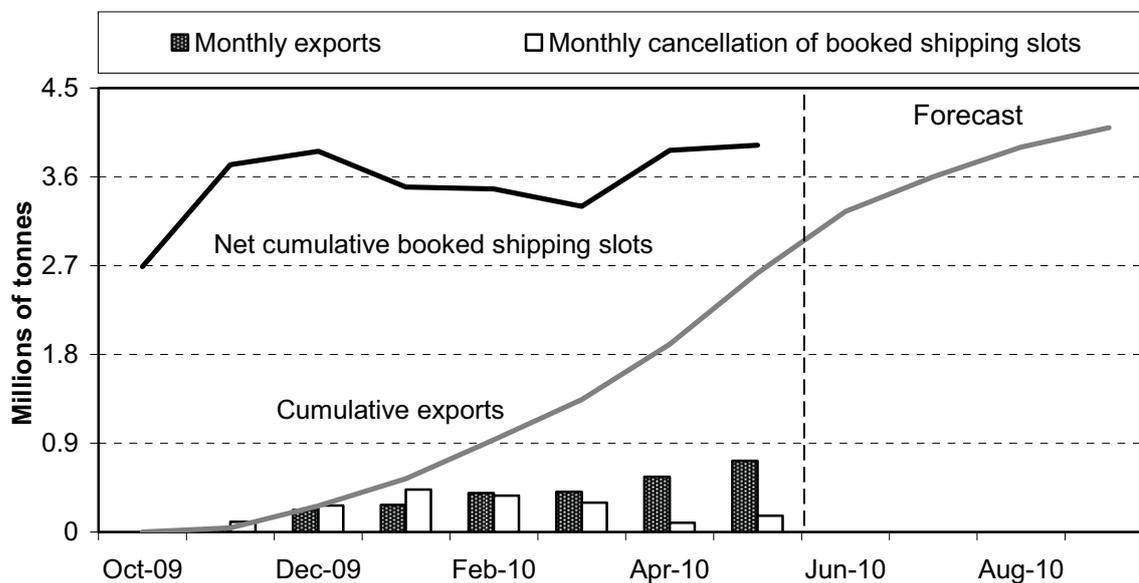
It was not appropriate for ABB Grain [now Viterra] to book 2.6 million tonnes of loading slots at the beginning of the season. They would not have had the anticipated sales to justify this plunge, as confirming by the cancelling of 1 046 000 of the slots, cancelling on average 50 000 tonnes a week and cancelling 3.78 times the level of its competitors. Overbooking by ABB Grain, and the impossibility of transfer of ABB Grain's surplus slots, prevents ... other traders bidding for tenders that would use these slots. (sub. DR89, p. 10)

Elders Toepfer Grain also made reference to the high rate of cancellations in South Australia, and provided a chart showing its estimates of booked capacity for grain terminal access (for all exporters) compared with that which was actually executed (figure 5.1).

Viterra has strongly denied any attempts to prevent rival exporters use of Viterra's ports. General Manager of Transportation and Logistics, Tim Krause said:

Just turning to the key allegations made about Viterra, finally we'd like to highlight to the Commission that we're aware that certain parties have recently used the media to make a number of uninformed and unsubstantiated claims about access issues at Viterra's port terminals. We do not wish to go into great detail addressing those concerns, other than to highlight that they are just that: allegations, without any real evidence. The level of access that non-Viterra parties have had to our port terminal facilities over the season – and, as I mentioned before, 80 per cent bulk wheat exports this season have been by non-Viterra parties – provides clear evidence to the contrary. (trans., p. 584)

Figure 5.1 Elders Toepfer Grain's estimates of booked versus executed capacity for Viterra's grain port terminals in South Australia 2009-10 ('000 tonnes)



Source: Elders Toepfer Grain (sub. DR94).

As the Commission understands it, an attempt by CBH to effectively ‘book out the stem’ via the auction system would see them incur real costs while lowering costs for other exporters (due to the rebate system). However, for Viterra there is currently no penalty for effectively ‘booking out the stem’, as the \$5 per tonne booking fee effectively represents a transfer from the trading arm of the business to the bulk handling arm, there is no ‘premium’ charge for shipments made when demand was highest, and there is no rebate system. This is not to suggest that Viterra sought to do this (and the Commission would regard this as a matter for the ACCC to investigate, should they believe such an investigation is warranted), but rather to note there would be no real financial penalty (at least regarding ‘forgone’ booking fees) if they did so.

The South Australian Farmers Federation has suggested that the booking fees could be put into a similar account to that set up by CBH for auction premia. Michael Schaefer from the South Australian Farmers Federation Grains Industry Committee said:

Everybody needs to be at risk; their \$5 needs to be at risk. We would see the need for an escrow account or something so that everyone puts their tonnes up, the \$5 a tonne goes into an escrow account and then it's divided pro rata for those that have actually shipped the tonnes – and that is the shipping of the tonnes, not just that you might put a slot up and then on-sell it to someone else and they ship them. The people that ship the

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tonnes get the pro rata of the unshipped tonnes. That's how we would view making the slot thing work a lot better. (trans., p. 567)

Glencore Grain made a similar suggestion:

Deposits for loading slots which have been acquired by a company or an associate of a company that operates a port terminal facility to be paid into an independent fund which at the conclusion of the harvest is to be distributed in accordance with the use made of booked slots. (sub. DR89, pp. 15–16)

Viterra has noted the \$5 booking fee is effectively part of the previously existing charge for using port services, while the CBH account is based on 'new' auction premiums. Gavin Cavanagh, the Manager of Planning and Strategic Analysis for Grain at Viterra said:

There are a couple of subtle differences, and I don't pretend to understand the CBH system perhaps the same as Elders Toepfer would or our own marketing division. The first one is that the \$5 booking wasn't a new fee. We effectively split our shipping fee and put a proportion at risk if someone didn't perform by ultimately presenting us a vessel for loading of grain. It wasn't an additional fee whereas, as I understand the WA system a little bit, you're paying premiums in the auction. (trans., p. 590)

The Commission agrees the \$5 booking fees charged by Viterra (and also GrainCorp) are not fully analogous to the auction premiums charged by CBH. However, even if only a proportion of the \$5 went into a common fund to be divided by all that ship wheat over the season, there would be a disincentive for port operators to 'book out the stem'. Alternatively, operators could also charge a somewhat higher fee at times of peak demand, and place the additional payments into a fund to be distributed to all that ship wheat. The latter strategy would also likely lead to a more efficient allocation of slots if capacity constraints were present.

AGEA also noted that bulk handlers other than CBH did not have any form of secondary market, which it saw as being inconsistent with international best practice:

Another key difference between Australian practice and international best practice is that internationally shipping slots can be rolled forward and/or swapped thus, reducing risk and losses for exporters. Under the current [bulk handling company] arrangements, not only is there not the flexibility to move/ swap slots, but there is either not provision for or not an effective secondary market ... In [the] case of GrainCorp and Viterra, there is not provision for a secondary market although, in some instances, there can be more operational flexibility. (sub. 35, p. 2)

The Commission agrees secondary markets have a useful role in allocating port capacity by helping to ensure capacity is utilised by those that value it most highly, either when circumstances have changed from those prevailing at the time of an

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initial allocation of slots (particularly if via auction), or when the initial allocation does not accurately reflect the value placed on capacity by individual exporters.

### **Did the different approaches affect export market behaviour?**

There is prima facie evidence to suggest the differing approaches of CBH and Viterra might have influenced outcomes for growers in Western Australia and South Australia (chapter 3). In Western Australia, after experiencing congestion during the previous season, many auction participants wanted to book slots early and paid relatively high prices for shipping slots at auctions, with the fees largely being non-refundable. A number of participants highlighted that once the auction system started, the spread between grain prices in Western Australia and South Australia increased well above what would typically be expected. The AGEA said:

Analysis of the spread between Fremantle and Port Lincoln ASW and APW prices illustrates the impact of the auction system that has artificially created a market distortion. ... Between February 2009 and 30<sup>th</sup> November 2009, spreads traded in a range of AUD5 - 20.00 per tonne with the average being approximately AUD12.00 per tonne. At AUD12.00 per tonne it is merely a reflection of the execution difference (fobbing and freight) between WA and SA. In other words, the market was trading the estimated cost of execution between the two states as the grain market is efficient. On the 23<sup>rd</sup> October the first official WA auction occurred in which the trade bid for 15 day shipping slots up to 12 months in advance for sales they did not necessarily have. From the 30<sup>th</sup> November 2009 (one week after the auction) the spread went from a low of AUD6.00 per tonne to near AUD45.00 per tonne on ASW and AUD33.00 per tonne on APW. There were adequate supplies in both states, there were no quality issues and no barriers to shipping out of SA and thus, the market should have been pricing grain in line with the most cost effective pathway to the global market. The conclusion drawn, therefore, is that the spread is being caused by an 'artificial' factor such as the auction system and risk of losing the non refundable fees (approximately AUD25.00 per tonne) associated with this. (sub. DR79, p. 14)

Having committed to buying what effectively turned out to be 'overpriced' shipping slots given the depressed state of the global wheat market, it appears exporters did not believe there was any prospect of wheat prices improving enough to justify the cost of 'shifting' shipping slots to another time, and therefore had an incentive to pay 'above market' prices for Western Australian wheat to make up shipments. Having committed well in advance to the Western Australian slots and incurred sunk costs, it appears exporters were less inclined to subsequently ship from South Australia, to the disadvantage of wheat growers in that State.

Of course, having potentially incurred losses on Western Australian shipping slots, this could mean exporters might be more reluctant to behave similarly in future. To the extent to which the auction rules unnecessarily exacerbated this situation, this

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highlights the need for CBH to modify its auction system in future years. In explaining its proposed changes for next year, CBH has said:

CBH believes that the auctioning of Port Capacity is a sound way to fairly allocate the capacity and will be looking to apply this process in 2010/11 for both the Harvest and Annual periods. However, CBH does understand on the basis of feedback received from some exporters, that the current Port Terminal Rules surrounding the allocation and use of Port Terminal capacity may be considered inflexible, costly, and potentially detrimental to the West Australian, and possibly wider Australian grain industry. (CBH 2010c, pp. 1–2)

### **Should auctions be used more broadly?**

There are currently mixed views among participants regarding whether auctions should be used more broadly. AWB is supportive of their use:

AWB supports the adoption of a consistent and independent process for the allocation of shipping capacity. In AWB's view an effective auction process is preferable to a 'first come, first served' basis. AWB does not believe the current CBH system is effective and has resulted in significant market discrepancies which are not in the long term interests of the industry. (sub. DR63, p. 10)

Although the AGEA has a different view:

The auction system is not a model that AGEA would like to see adopted by other bulk handlers. (sub. DR79, p.15)

Where capacity is constrained and excess demand exists, some form of rationing must take place to equate demand and supply. The two mechanisms for achieving this are non-price rationing, or price rationing (PC 2002).

The Commission is of the view that auctions should be the preferred method for allocating port terminal slots in situations where there is likely to be shifting peak load issues (that is, periods of excess demand given capacity constraints).

### **Non-price rationing**

#### *Queuing*

If capacity is allocated based on queuing, as broadly occurred in 2009, real resource costs will be incurred in equating demand and supply. These costs associated with queuing include the value of time spent queuing, staff costs, demurrage, additional costs involved with delays and the potential for lost sales if market opportunities are missed or reputations damaged. The result will be the price paid to the port operator

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at peak times will be lower than under an auction model but a number of additional costs will be incurred associated with queuing. It is also possible, depending on how queuing costs are incurred, that slots might not always go to their most valued uses. An exporter shipping a relatively small amount of grain might consider it worthwhile to join the queue and compete for the most valuable slots. A further problem is that allocation by queuing does not give port terminal owners a strong investment signal, as although willingness to queue can be ascertained, willingness to pay cannot.

### *Non-price administered allocation*

With a non-price administered allocation, or ‘first come, first served’ allocation, with no secondary market trading, there is no guarantee that shipping slots will go to those that value them most highly. Exporters that gain the most lucrative slots are likely to obtain higher prices for their grain (meaning the ‘scarcity premium’ associated with the most lucrative slots is likely to go to the exporter rather than the port terminal operator). However, if exporters wishing to ship relatively small quantities of grain book the most lucrative slots, there is likely to be an inefficient allocation of slots. In the absence of a price mechanism, there is unlikely to be an efficient allocation of shipping slots as there is no mechanism for the port terminal operators to determine the valuations exporters place on each slot.

### **Price rationing**

Allocating scarce resources using the price mechanism is likely to ensure those with the highest valuation obtain the most valued slots. The presence of peak period charging allows port terminal operators to extract ‘capacity (or scarcity) rents’ that might otherwise go to exporters. Whether this would lead to higher profits would depend on the prices obtained for non-peak slots.

One concern under an auction model would be that if port operators retained capacity rents in excess of the cost of providing the additional capacity required at periods of peak demand, this could reduce their incentive to invest to increase port capacity (as the loss of the rents might be more valuable than any extra revenue gained via additional throughput). However, there will still be incentives for port terminal operators to invest to the extent they are still able to charge users higher premiums at peak shipping time, and to prevent encouraging rivals to build additional facilities. The vertically integrated port terminal operators would also have an incentive to invest in port terminal facilities to the extent this could boost their profits from their own trading facilities.

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Moreover, it should not be assumed investment signals would be superior where slots are allocated by means other than price (meaning ‘capacity rents’ will accrue to exporters). Indeed, it is likely port terminal operators would not have an accurate indication about the value of capacity rents or the potential value of new investment (PC 2002). Price rationing also means rents obtained by operators would be more transparent, and potentially more likely to attract a regulatory response where considered warranted.

### **So when are auctions appropriate?**

Auctions are likely to be appropriate only where there is a binding capacity constraint and the presence of excess demand. In the absence of these conditions, they would be likely to impose significant administrative costs relative to other forms of allocation. It is likely, therefore, that there would only be a very limited role for auctions on the east coast. GrainCorp has said it would be unlikely to use auctions to allocate shipping slots. David Ginns, Manager of Corporate Affairs for GrainCorp, said:

The rules under which we nominate for capacity, we run essentially a first in, best dressed system which a lot of people wanted before they got involved in it, and now because some of the exporters have not been first in, so they weren’t best dressed, they’re complaining. You can never please everyone unfortunately. But we would seek to continue to have that process because we believe it’s fair, transparent and it works for the structure of the industry that we have in the eastern states of Australia. We’re not saying that that system would work, for example, in Western Australia or South Australia because the fundamentals of the export supply chain are different over there, and in reverse, we don’t necessarily believe that an auction system such as that used by CBH would be most appropriate for eastern Australia. (trans., p. 478)

Viterra has also stated it is happy with its ‘first come, first served’ arrangement. Tim Krause, Viterra’s General Manager of Transportation and Logistics, said:

First in, first served has probably served us fairly well. We’ve had some pretty bumpy sort of shipping months so far this year. I think it’s been mentioned. I think October might have been under 100 000 tonnes; this month might be 800 000 tonnes. Put that over a year and the issue is about trying to put some smoothness on the task over a whole year rather than trying to ship it out in a short period. As I mentioned before, terminal capacity in terms of loading vessels is not limiting, and if people are providing logistics facilities and things like that, I think the market will find the way to smooth out that demand. (trans., p. 596)

The Commission does not see auctions as a ‘one size fits all’ model, and certainly does not consider they should be imposed on port terminal operators where the operators consider them unnecessary. However, where excess demand applies and

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capacity constraints are binding, they are likely to be the most efficient way of allocating slots.

## 5.7 Other issues

### Port terminal pricing and usage of up-country facilities

A number of participants suggested the pricing arrangements for access to port terminals have been designed to benefit the up-country storage and transport operations of the bulk handlers. This concern stems from charges that would be levied on wheat coming from a supply chain other than that of the port operator, or on wheat that has come directly to port from a farm or rival bulk storage site. These charges might accurately reflect costs incurred by the port operator in ascertaining if the grain is 'safe', or they could be designed to ensure rival supply chains are uneconomic (by removing any commercial incentive to use rival facilities). Such charges could 'lock in' inefficient supply chains by protecting them from competitive pressures.

AWB suggested charges were designed to favour the bulk handlers:

The [bulk handling companies] do charge additional fees to discourage use of [non-bulk handling company] supply chains. Some examples are set out below. AWB has requested how these charges have been quantified. No response has been received.

*Example:* GrainCorp charges a quality management fee of \$1.54/t for wheat received ex-approved storage and \$6.17/t for ex non-approved storage.

*Example:* CBH charges a fee of \$1.10/t additional non-grower receival fee and a fee of \$8.50/t where a customer wishes to have its wheat cleaned and dried by an external company.

*Example:* Viterra charges [wheat exporters] a fee of \$2.15/t more where AWB does not use Viterra's upcountry services, before the wheat is delivered to port. Additionally, Viterra charges a road under-performance fee where the customer does not use Export Select of \$2.00/t.

Quality management fees are not justified given AWB has an incentive as an exporter to maintain quality irrespective of up country origins of the grains. (sub. 24, p. 17)

Similar comments were made by the South Australian Farmers Federation:

For example, ABB [now Viterra] prices third party bulk handler throughput rates through its ports at rates that make the use of any upcountry competing storage options outside of their supply chain untenable. As a sole provider of ship loading services for bulk grain in South Australia, ABB Grain has effectively complete control over the road and rail export logistical task, particularly as 80% of South Australian grain is

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exported. Their storage and handling agreement is structured in a way to ensure that third party storage providers cannot compete with their assets nor provide any competitive logistical services to bring grain to port. (sub. 51, p. 3)

This prompted the following response from Ashley Roff, the Director of Legal, Government Relations and Sustainability for Viterra:

That demonstrates the free-rider approach; that what these people want to do is buy grain at non-Viterra sites and then just take it straight through the port without a cost. The reality of the throughput charge is that there is a cost. There are services that we provide and we are required to provide them because we commingle the grain at port. They include the testing, sampling, weighing, use of rail loaders, use of information systems, profit margin risk. Those things have a cost and our throughput charges have been struck on the basis of what we believe the costs of those services are. We've had an arbitration on that particular subject and the arbitrator has upheld our costing system. (trans., p. 292)

Similar comments were made by Nigel Hart, General Manager of Ports for GrainCorp:

On the pricing side, differential prices are there for a very specific [reason] around how we manage the risk. We actually do segregate them. Particularly with chemical residues, we have numerous examples of growers who'll treat their grain with fenitrothion, which is a product which they won't accept into Japan and other places. So once you actually start segregating ... you start to lose export efficiency and export capacity ... So there's the loss of efficiency, there's the risk inherent with receiving grain which may not have been subjected to the same quality regime that we provide in our system ... There's insect risks as well ... particularly when we receive a lot of ex-farm grain ... that's why we charge a differentiation for that service, because there's inherent risk in it, there's real costs associated with it, to the business. So it's not as a means of discrimination, it's reflecting the risk and the cost of doing that through that pathway. (trans., p. 208)

When detailing the reasons for acceptance of the undertakings provided by the bulk handlers, the ACCC stated:

The ACCC is of the view that appropriate non-discrimination measures should prohibit [the relevant bulk handler] discriminating in favour of itself except to the extent that the cost of providing access to other operators is genuinely and verifiably higher, as per section 44ZZCA of the TPA ... As a transparency measure to support this, appropriate measures would require [the relevant bulk handler] to publish a single set of prices for port terminal services, which may include differentiated prices for different circumstances (i.e. for different processes for testing of grain depending on where it has been stored – but only where these processes are justifiable with regard to hygiene, quality or associated factors), provided those circumstances are transparently stated and the pricing differences are justified on the basis of different costs. (ACCC 2009b, pp. 9–10)

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The Commission agrees with the bulk handlers that there are genuine reasons why additional charges might be placed on grain which has come from alternative supply chains or which has been stored on farm. However, the bulk handlers do arguably have incentives to institute additional charges to ensure growers and exporters use their supply chains. Such behaviour could potentially lead to supply chain inefficiencies and higher than necessary costs for exporters. It is not clear to the Commission how the charges in place have been determined. The Commission is of the view that these issues would be best dealt with in the forthcoming round of access undertaking renewals.

The Commission has concerns about the effectiveness of price monitoring and does not believe the benefits of introducing it would exceed the costs (section 5.8).

The Commission considers that Part IV of the TPA, although not perfect, has the potential to deal with at least the most egregious examples of anti-competitive practices, and reliance on Part IV is likely to represent the best way of dealing with this issue if the access test is abolished. There would also be a strong case for the bulk handlers to maintain the non-discrimination clauses currently included in the access undertakings in any future voluntary code of conduct.

Although CBH charges the same fee for port access regardless of whether the CBH supply chain was used up-country, the AGEA suggested the risk of incurring a domestic outturn fee effectively forced exporters to use Grain Express:

The CBH charging structure also acts as a significant impediment to direct access. Under the current CBH charges using Grain Express incurs a total cost of \$27.10 per tonne comprising the receival fee of \$10.00 per tonne and export outturn charge of \$17.10 per tonne. Direct Access incurs the same cost if drawn from a totally separate supply chain, however, if exporters need to draw supplies from CBH storage sites to 'top up' or complement their direct purchases, then the total cost increases to \$35.60 per tonne comprising the receival fee of \$10.00 per tonne domestic outturn fee of \$8.50 per tonne and export outturn charge of \$17.10 per tonne. In effect, exporters are forced to use Grain Express as they cannot afford the risk of having to 'top up' direct supplies from the CBH system. (sub. DR79, p. 16)

Tamma Grains also suggested the domestic outturn fees made life difficult for CBH's competitors. Owner-manager Kim Packer said:

The people that are interested in equity positions with us to upgrade our storage even further, build other storage in other facilities, is alive and well. They're very, very interested. But one of the major stumbling blocks are these out-turn fees that CBH have out at up-country situations. (trans., p. 397)

Although the Commission does not believe up-country facilities should be subject to either access or price regulation, one area in which the ACCC could examine

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these charges is in the current review of the Grain Express notification. There is further discussion of these pricing issues, and of the Grain Express notification, in chapter 6, in the context of supply chain efficiency.

Tamma Grains also suggested that the \$17.10 per tonne export outloading fee charged by CBH at port was excessive, and prevented smaller industry players from being able to ship grain. Kim Packer said:

If I can give you firstly the present situation and then refer to how it has been in the years leading up to this. At present, anybody that wants to introduce grain to get it onto a vessel needs to go through a CBH loading facility because they monopolise the ports, and we have to introduce that. We have had a charge of \$17.10 per tonne to introduce that grain at the port and have it put onto a vessel. Now, the problem that we have with that is going back the year before Grains Express came in, we had a situation that the fobbing rate or the ability to load that grain onto the vessel was \$8.20. Clearly the increase in charges now is approximately 113 and a half per cent increase over a year. First off, you need to question that, the justification there is in that sort of increase. Infrastructure hasn't changed, the means to load it onto the vessel hasn't changed, so that's my question. I have approached CBH leading up to this coming harvest just gone as to getting a fair and equitable arrangement with them to be able to do this and I was virtually told that that's it, take it or leave it. (trans., pp. 395–6)

In the context of this inquiry, the Commission has not examined individual charges of bulk handlers with a view to determining whether they were justified or not. However, the Commission understands that Tamma Grains has raised its concerns with the ACCC, and the port charge is subject to negotiation and, potentially, arbitration under the current access undertaking. If the ACCC believed there was a problem, it has the capacity to be more 'heavy handed' in its dealings with the bulk handlers with regard to the next undertaking. (For example, *if necessary* it could insist on greater accounting separation between ports and other supply chain assets in order to justify charges at port).

## Legal liability of bulk handlers

Some participants saw caps placed by bulk handlers on their legal liability in the event of contaminated grain as potentially constraining trade. For example, AWB submitted:

Examples of liability caps include:

- GrainCorp limit damages to \$500 000 for wheat outloaded on any shipping vessel and \$10 000 for wheat outloaded onto rail or road trucks.
- CBH limit liability to \$100 000 for any single event and limit maximum aggregate of \$250 000 for the term of the contract.
- Viterra limit liability to \$250 000 per event or per series of related events.

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- ABA limits liability to \$100 000 in total in respect of all events occurring within the term of this agreement and will be limited to \$30 000 per event.

The potential magnitude of a loss for an exporter can [be] very significant. For example a 40,000 mt bulk vessel with contaminated grain at today's average price of USD 250.00/t would result in a multi million dollar loss to AWB. (sub. 24, p. 19)

The NSW Farmers Association made similar comments:

Another example of substantial market power related to the storage and handling terms and conditions of a port operator which limits their liability in relation to a claim, which is recognised by 'the bulk handler' to be valid and 'the bulk handler' agrees to compensate the Client or, in other event, where 'the bulk handler' is liable to compensate or indemnify the Client, then 'the bulk handler's' maximum liability in respect of a claim shall not exceed \$500 000 for grain out loaded onto any shipping vessel, and \$10 000 for grain out loaded onto rail or road truck on any one day for a site. In the situation where a ship haul can be worth in excess of \$25 million and the entire value of its contents can be placed in jeopardy if the ship fails to leave the port, it would seem to the Association that 'the bulk handler's' liability is uncommercial and unusually conservative. (sub. 49, p. 10)

Exporters have argued that the limits on legal liability mean that virtually all of the risks of shipping grain fall on the exporter, and that bulk handlers lack sufficient incentive to ensure receival standards are sufficiently high.

Bulk handlers have highlighted that prices paid by exporters reflect the limited liability. Ashley Roff of Viterra stated:

I think the reality is the services we provide have been priced based on that limitation of risk. Is it possible to increase that limit? Potentially, either at a significantly increased cost or potentially by transferring that risk to an insurer, but it's quite a complicated area and one of the difficulties is that sometimes one gets market claims – ie, claims from a customer of our customer – and the claims are not necessarily based on facts but more political issues like, 'It doesn't actually suit us to receive that cargo, so we're going to make sure that we find a problem with the cargo', and therefore, you know, bad luck, and then our customer seeks to transfer that back to us and it gets quite complicated. (trans., p. 297)

GrainCorp did not see liability claims as a major problem, suggesting grain is tested extensively before being loaded. Nigel Hart said:

But I think you've actually got to look at the evidence in terms of historically, you know, have people made multiple claims against the business. We exported 5 million tonnes last year, and had next to no claims, or very minimal claims; I think it was only one claim for an incident at Fisherman Island, which was a rat on a vessel, or something like that, which is not the find of the century, but we don't believe that it's a significant issue, from our perspective, and we do everything that we can to ensure that prior to that grain going on board it's fully tested in turn, but it's tested whilst it's in store and it's tested as it's going out on the vessel. (trans., p. 209)

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The Commission sees little evidence that the legal liability issue is constraining trade in wheat. Moreover, were the port terminal operators to take on greater risk, presumably this would be reflected in their pricing. Ultimately, if exporters are prepared to pay higher prices for risk sharing, the market is likely to reflect this.

### **Shipping delays and risk sharing**

Another issue raised by some exporters relating to terms and conditions of port access has been a perceived imbalance in risk sharing in the event of shipping delays. International shipping contracts typically include demurrage and despatch clauses. Demurrage is an agreed sum of money payable by shippers to vessel owners in the event of shipping delays. Despatch refers to money payable by ship owners to shippers in the event that the vessel is loaded in less than the agreed time (Wheat Export Authority 2007b).

Shipping delays during the 2008-09 harvest, particularly in Western Australia, saw many exporters incur demurrage expenses. Many exporters would prefer to see the port operators share the risk of making demurrage payments (presumably with the offsetting potential rewards of sharing despatch payments in the event ships were discharged early).

The AGEA said:

Any adjustment in the shipping stem has the potential to expose [wheat exporters] to demurrage. To ensure [bulk handling companies] are accountable for shipping performance and the efficient operation of the facilities, wheat exporters should be compensated for delays caused by [bulk handling companies] including vessel demurrage. Conversely, [bulk handling companies] should be entitled to be rewarded by way of a share in despatch rates if vessels are loaded at a faster than contracted or agreed rate. (sub. 28, p. 11)

On the other hand, CBH suggested exporters have traditionally received despatch payments due to the efficiency of Western Australian ports. CEO Andrew Crane said:

We expended \$137 million just upgrading our new port a few years ago. People try and build ports for less than that. Some of that money was to speed up the loading of vessels. That is value we actually give to the exporter because that vessel is then loaded quicker than their charter party and they earn despatch ... Both the Grain Pool – I can't really speak for AWB but I would be reasonably sure of this, in the years leading up to this have been very happy that they earn despatch far more times than they ever paid demurrage ... in fact CBH, I would believe, actually talking on the growers' behalf, has been leaking value over the years. So those demurrage despatch agreements weren't in place for the last season, as a precedent, and because our ports do perform well and even judging on last year's performance, there were line-ups, but on average, and again

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in comparison to other ports, I still felt probably weren't that bad. But are those people saying, 'Where's my demurrage?' when in fact they didn't sign an agreement that included it on a despatch because invariably you get despatch out of Western Australia. (trans., pp. 128–9)

The Commission understands the frustration of exporters incurring demurrage costs resulting from shipping delays beyond their control. Such delays had not generally been a feature of exporting in previous years, as AWB had taken account of logistical constraints in determining when to ship grain. Exporters are now better able to take advantage of times when grain prices are higher, but consequently are more likely to end up all choosing to export at the same time. Higher demurrage costs for exporters represent the downside of this. An efficient allocation of shipping slots would go a long way towards solving the demurrage problem.

The Commission notes that some exporters are pursuing losses from bulk handlers under current arrangements. Glencore Grain said:

In the first few months of 2009, under Grain Express Glencore Grain incurred 123 laytime days and consequent demurrage claims of over \$1.4 million and 'surge' charges of over \$500 000 (a proportion of which surge charges have belatedly been repaid; but not the demurrage). Generally there were massive delays in transport to the CBH ports. Glencore is pursuing a claim against CBH for these losses. Even in February this year we incurred demurrage costs of \$300 000 due to late transport under Grain Express. (sub. DR89, p. 6)

In any case, the market seems best placed to provide a solution to this dilemma, preferably through an efficient allocation of shipping slots. However, even in the absence of such an efficient allocation, if exporters think they are likely to face large demurrage costs, it will affect their decisions on when they export, and how much they are prepared to pay for port terminal services. Similarly, port terminal operators will be able to charge higher prices if shippers think they are likely to receive despatch payments. One way or another, risks are likely to be shared between exporters and port terminal operators, and port terminal operators are likely to receive signals about the desirability (or otherwise) of additional investment.

If demurrage payments stem from difficulties with up-country supply chains, the 'best' long term solution is to improve the performance of these supply chains. Issues relating to up-country transport and storage are discussed in chapter 6.

### **Improvements if the access test is to apply beyond 1 October 2014**

Although the Commission considers the current access undertakings should not be renewed after 1 October 2014, should a decision be made to continue the access test

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beyond this date, a number of changes should be considered to improve the operation of the test.

### **Equal access or spare capacity**

Under the WEMA provisions, it appears that stakeholders were uncertain about the degree to which bulk handlers should simply ‘join the queue’ to access their facilities, or if access should be provided to other exporters only after the requirements of facility owners have been met.

The ACCC highlighted these dilemmas in comments rejecting provisions of the bulk handlers’ initial undertakings that had, in the opinion of the bulk handlers, sought to balance ‘the Port Operator’s ability to meet its own or its Trading Business’ reasonably anticipated requirements for Port Terminal Services’ (ACCC 2009b, p. 58) with other considerations. In describing such a clause as inappropriate, the ACCC said:

The ACCC considers that the interpretation of [the relevant] clause ... in the context of an access undertaking (rather than in relation to a Part IIIA arbitration) is unclear and that it is likely that difficulties would arise in determining the proper application of this clause. It is noted that the use of the term ‘reasonably anticipated requirements’ in section 44W of the TPA is referring to ‘an existing user’ (i.e. any existing user, not just the access provider). One interpretation of the clause could be that [the bulk handler] intends to reserve and set aside its own or its Trading Division’s ‘reasonably anticipated requirements’ for port capacity and then provide access to third parties for the remaining capacity. This could allow [the bulk handler] to significantly promote the interests of [the bulk handler] above those of potential access seekers in a manner that is neither in the interests of potential access seekers, or in the broader public interest, including the public interest in having competition in markets. This interpretation of the clause runs counter to the objectives of the WEMA and particularly the objective of ensuring ‘fair’ access to port terminal services. This ambiguity raises concerns about the certainty and clarity of the terms of the April Undertaking. (ACCC 2009b, p. 63)

As noted earlier in the chapter, the explanatory memorandum to the WEMA states the access test seeks to ‘provide fair and transparent access to their facilities to other accredited exporters’ and ‘aims to avoid regional monopolies unfairly controlling infrastructure necessary to export wheat in bulk quantities, to the detriment of other accredited exporters’ (Burke 2008b, p.29).

In its decision on whether to accept the undertakings of the bulk handlers, the ACCC said:

The ACCC considers that in the current context, ‘fair access’ ought largely to be equated with non-discriminatory access, reflecting the desirability of ensuring that access to port terminal services is, on the whole, provided on a non-discriminatory

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basis except where there is a legitimate reason for differential treatment. (ACCC 2009b, p. 28)

Part IIIA of the TPA places limitations on the ACCC when it comes to making determinations for declared services. The Act states:

- (1) The Commission must not make a determination that would have any of the following effects:
  - (a) preventing an existing user obtaining a sufficient amount of the service to be able to meet the user's reasonably anticipated requirements, measured at the time when the dispute was notified;
  - (b) preventing a person from obtaining, by the exercise of a pre-notification right, a sufficient amount of the service to be able to meet the person's actual requirements;
  - (c) depriving any person of a protected contractual right;
  - (d) resulting in the third party becoming the owner (or one of the owners) of any part of the facility, or of extensions of the facility, without the consent of the provider;
  - (e) requiring the provider to bear some or all of the costs of extending the facility or maintaining extensions of the facility;
  - (f) requiring the provider to bear some or all of the costs of interconnections to the facility or maintaining interconnections to the facility. (TPA, section 44W)

No such protections are explicitly afforded to asset owners where undertakings are in place, although this is presumably because such arrangements are intended to be voluntary (and such clauses could be written into undertakings). Rather, in determining whether to accept an undertaking, the TPA provides that the ACCC may accept an access undertaking, if it thinks it appropriate to do so, *having regard* to the following matters:

- the objects of Part IIIA of the TPA
- the pricing principles specified in section 44ZZCA of the TPA
- the legitimate business interests of the provider of the service
- the public interest, including the public interest in having competition in markets (whether or not in Australia)
- the interests of persons who might want access to the service
- whether the undertaking is in accordance with an access code that applies to the service
- any other matters that the ACCC thinks are relevant (which includes, for the purposes of the undertakings under discussion, the WEMA).

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That said, however, the Commission understands the dispute resolution procedures in each of the current port terminal undertakings mean that any subsequent arbitration would take place under the Part IIIA arbitration principles. The undertakings also have clauses seeking to prevent arbitrated outcomes contrary to section 44W of the TPA. However, to date there have been no arbitrated outcomes under the undertakings.

John Feil, the Executive Director of the NCC, stated that Part IIIA declarations were about negotiating access to spare capacity:

There are a set of provisions that apply to how the ACCC must conduct its arbitrations. One of the things it cannot do is displace a user's existing or reasonably foreseeable use of the facility itself to make room for others. That's not contemplated by Part IIIA. It shouldn't have been permissible under the access undertaking because those safeguard provisions apply generally. I think it's worth remembering that these parties did invest in these assets. They own them, and this is not about taking them away, it's not about stripping their use. It would be contrary to the operation of Part IIIA to do that. So it is about excess or additional capacity. (trans., pp. 12–13)

Ashley Roff of Viterra, questioned whether the undertaking process under the WEMA provided the same protections to the bulk handlers:

To the contrary, the process that we endured meant that we take our place in the queue with every other exporter and, quite frankly, in terms of whether that is an intrusion on the property rights of our investors and our shareholders I think is a serious question. So we query the basis of imposing those undertakings ... Investors require certainty and under the current regime there is no certainty because there is an ability for access seekers to question and arbitrate on essential terms and prices and, under those conditions, it would be unusual for an investor to commit to, for instance, the \$150 million that Viterra invested in the Outer Harbor grain terminal without the certainty of being able to calculate a reasonable return. (trans., p. 285)

The Commission notes that part of this confusion appears to stem from potential conflict between the objectives described in the explanatory memorandum of the WEMA, regarding 'fair' access to facilities, and the provisions of the TPA designed to ensure access negotiations only take place regarding spare capacity.

In the draft report, the Commission suggested that, were the access test arrangements to be kept past 1 October 2014, the WEMA should be amended to ensure that future access negotiations relate only to spare or excess capacity. This would be the case if Part IIIA was relied on with its 'reasonably anticipated requirements' criteria (at least in principle — in practice, of course, it might be found that no 'reasonably anticipated requirements' exist and all capacity was effectively 'spare'). Many participants suggested the adoption of this recommendation would increase the likelihood of regional monopolies developing.

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The AGEA stated:

This is a fundamental shift in the competitive playing field and will be to the detriment of Australian wheat exporters and consequently Australian wheat growers. There is a real risk that the export wheat industry may result in a scenario where control is with three regional monopolies. The port access regime must apply to total capacity, not spare or excess capacity. (sub. DR79, p. 9)

Kim Halbert said:

The Commission have also stated that after 2014 access to ports should only relate to spare or excess capacity. This will be the death knell for competition. What will stop a port operator from locking up the ports for their own requirements and only making them available to other exporters at other times. The Government has made it very clear on numerous occasions that it supports equal access for all exporters to port facilities. Also, the ACCC stated in their 'Decision to Accept' it *'is of the view that appropriate non-discrimination measures should prohibit CBH from discriminating in favour of itself.'* The privileged position given to the bulk handlers by State governments of rare, prime port land, is irreplaceable and will hold prospective competitors out for many years (if not forever). Limiting the sharing of capacity to excess only, will destroy the incentive for the bulk handlers to improve peak handling capacity of the ports. (sub. DR88, p. 3)

Others saw a need for change. For example, GrainCorp said:

If the current access regulations do not afford an infrastructure owner the same protections that are afforded the owner of infrastructure that is declared 'essential' following a full assessment by the NCC, then surely, the current system regulating export grain elevators is both faulty and iniquitous? The owners of export grain elevators are being regulated in a manner in excess of any other comparable regime in Australia. Continuation of the access test, and therefore the access Undertakings, beyond the date on which the accreditation scheme is abolished, compounds the discrimination against infrastructure owners. (sub. DR82, p. 8)

CBH noted commercial considerations provided a strong incentive to continue to allocate 'total capacity' through the auction system regardless of regulatory requirements. Richard Codling, Group General Counsel for CBH, said:

If we were to have only spare capacity and there [was] uncertainty for other customers as to whether they could obtain capacity or not, we feel that would drive people outside of our system, it would drive them to creating a system in competition to us and that would ultimately be to the detriment of our organisation and, we feel, Western Australian growers as a whole. We need volume for the system and therefore we're keen to retain it. (trans., pp. 439–40)

Viterra and GrainCorp also stated that they intended to allow exporters to bid for the total capacity of their ports for the foreseeable future, with or without the access test.

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In the short term, the Commission agrees that, in practical terms, it is probably beneficial for access negotiations to relate to total capacity of facilities. This conclusion factors in the highly unusual factors in place at the time the market was deregulated, particularly that all but one company had been prohibited from exporting wheat and therefore no market shares had been determined and definitions of ‘reasonably anticipated requirements’ would be so vague as to be almost meaningless (that is, it is unlikely anybody’s property rights would have been eroded). The Commission also agrees with the ACCC that the clauses rejected in the initial undertakings of the bulk handlers considered only the ‘reasonably anticipated requirements’ of the bulk handlers themselves and ignored the rights under Part IIIA of existing users to also have their ‘reasonably anticipated requirements’ protected. As such, it was probably appropriate that the clauses were rejected. It is not, however, the Commission’s role to pre-empt any potential arbitration under the current (or future) undertakings or any subsequent appeal that might stem from such an arbitration.

In the longer term, reasonably anticipated requirements are likely to be established. The Commission is therefore of the view that, should the WEMA access test continue after 1 October 2014, the WEMA objectives should be amended to ensure the balance between the rights of access seekers and protection to infrastructure owners and their existing customers is consistent with that provided under Part IIIA.

Were auctions used to allocate constrained capacity, similarly to the manner currently used by CBH, these considerations would likely be less important as auctions could ensure access is provided to those that value it most highly while also providing an appropriate level of protection to port terminal owners and operators.

## **Historical benefits for bulk handlers**

Some participants highlighted that the three major bulk handlers, CBH, GrainCorp and Viterra, had all benefitted in the past from either government ownership or government regulation ensuring their monopoly status (or both). It was suggested that this should be taken into account when regulating access to these assets. Mitchell Morrison, the general manager of commodities for AWB, said:

Again, in our view the historical development of the industry, largely grower cooperatives of government-owned institutions – who are ... basically privatised, some are still some cooperatives – this is an issue of what’s fair and reasonable in the way those owners and those facilities now should be allowed preference to use those facilities versus how you encourage a competitive environment. (trans., p. 355)

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There is no doubt that, in the past, the bulk handlers received considerable benefits from government regulation that effectively cushioned them from potential competition. However, two of the three bulk handlers are now either listed companies or subsidiaries of listed companies, and owners will have effectively paid for the company based on the value of its existing infrastructure.

Moreover, there would be a strong potential downside of excluding existing assets for regulatory purposes (effectively treating them as sunk costs). This could reduce investment in the economy as other companies in similar circumstances factored sovereign risk into their investment equations. (It would also reduce the attractiveness of purchasing previously government owned assets.) It is likely to be more appropriate, to promote future investment, that regulation take into account the efficient costs of providing services into the future.

### **The MPT exemption**

One issue raised by many participants is the exemption from the access test requirement for the MPT. The facility is jointly owned by Australian Bulk Alliance and accredited wheat exporter AWB. Australian Bulk Alliance was, until recently, a joint venture between Viterra and Sumitomo (in the latter case, via a subsidiary Summit Grain Investment (Australia) Pty Ltd, which is 70 per cent owned by Sumitomo Corporation and 30 per cent owned by Sumitomo Australia Pty Ltd). The MPT is now fully owned by Summit Grain Investment (Australia) Pty Ltd. Subsequently, Sumitomo Australia Pty Ltd has surrendered its previously held export accreditation (although Sumitomo Corporation continues to have a 50 per cent equity interest in the accredited exporter Emerald Group).

WEA has the legislated responsibility to determine whether a company seeking accreditation (or an associated entity) is a provider of a port service. WEA considers Melbourne Terminal Operations Pty Ltd to be the port service provider for the MPT. Melbourne Terminal Operations Pty Ltd is not seeking export accreditation and is not considered by WEA to be an associated entity of an accredited exporter. Therefore the MPT is not required to have an access undertaking.

Some participants have described the exemption as an anomaly, potentially providing MPT with a competitive advantage over other port terminals. AWB said:

In AWB's opinion there are issues raised by the exemption of MPT from access undertakings. The exemption is not appropriate. However competition in the MPT drawing arc occurs due to the existence of the GrainCorp operated port of Geelong, the Viterra Australia port of Outer Harbor and GrainCorp's control of Port Kembla which all compete across the natural export grain drawing arc of MPT. Hence this is the only competitive market for port terminal services in Australia, creating a need for

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efficiency and competitive terms to attract volume into the MPT facility. (sub. 24, p. 10)

The Victorian Farmers Federation said (referring to the MPT's previous ownership arrangements):

Port access test requirements under the Act are not sufficient in our view, to guarantee that other accredited bulk wheat exporters would not be unfairly discriminated against by the joint owners of Melbourne Port Terminal (MPT), being three accredited exporters themselves ... The federal access undertakings allow for fair and equitable treatment of bulk wheat exporters but were also designed to provide consistency of port regulation. VFF Grains Group believes the loophole of the wheat marketing legislation is unfortunate as it allows MPT to be the only exempted grain port terminal, causing inconsistency. (sub. 40, p. 2)

AWB also saw the MPT example as showing that port terminal operators could potentially avoid requirements for access undertakings through the use of 'remote' ownership structures:

In AWB's opinion any existing or potential future bulk wheat exporter seeking to develop new port infrastructure investments or acquire existing port infrastructure will assess the ease and viability of investing through an 'access undertaking' remote structure. The example created by the exemption of the MPT port facility demonstrates the real possibility of this approach. (sub. 24, p. 8)

Australian Bulk Alliance argued, when under its previous ownership arrangements, there was no need for the MPT to be subject to an access undertaking:

ABA and its subsidiary Melbourne Terminal Operations are not controlled by either of its shareholders ... Thus, ABA/MTO is not and should not be subject to Access Undertaking regulation. There has been no evidence presented that ABA/MTO has restricted access to its terminal services. Our shipping stem for 2009-10 shows some 8 wheat exporters planning to use our facilities/services yet we have not entered into an Access Undertaking with the ACCC. To do differently in our competitive market would be commercial suicide. (sub. 48, p. 1)

Viterra, prior to selling its stake in the MPT, expressed similar sentiments:

The exemption for MPT is appropriate ... It relies on maximising throughput through its port terminal. It is not open to ABB [now Viterra] to compel ABA to only export ABB wheat to the commercial detriment of Sumitomo. ABB cannot control ABA for its own commercial ends. The consequences of the ABA exemption are observable for the 2009/10 season: ABA has continued to seek throughput from all wheat exporters and to compete vigorously with the Port of Geelong. (sub. 23, pp. 7-8)

The Commission understands that there would be concern about the use of 'remote' ownership structures to potentially avoid the requirement for an access test. However, there is no concern if there is genuine remoteness of ownership or

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control, as appears to have been the case with the MPT. In any case, the MPT faces competition from GrainCorp owned port terminals within Victoria. Therefore, the case for requiring any of the Victorian ports to have access undertakings might not be as strong as in other jurisdictions (and, by extension, this would apply to other east coast ports, particularly in New South Wales). As the Victorian Essential Services Commission has said:

- several factors highlighted by the [Essential Services] Commission in its 2006 inquiry and in the present review suggest that obtaining access to prescribed services at a particular terminal may not be necessary to permit effective competition in an upstream or downstream market
- the existence of more than one unaffiliated facility and a significant degree of substitutability between services provided by them may constitute an effective duplication of the services. (ESC 2009, p. 64)

The Commission also notes the Victorian Essential Services Commission found port charges at Port Adelaide in 2008-09 were 20 to 40 per cent higher than the average charges at the Victorian bulk terminals (and that Victorian terminals had much lower price differentials between ‘affiliated’ and ‘non-affiliated’ grain compared with Port Adelaide) (ESC 2009). Therefore the Commission is of the view that, even if the access test was to continue beyond 1 October 2014, there might be a weaker argument for access undertakings to apply to Victorian ports than to ports in other jurisdictions.

### **Facility specific assessment**

The issues relating to the MPT exemption highlight that the current access test arrangements fail to recognise that the benefits and costs of regulating access to port terminals varies across facilities. Each facility is likely to have varying degrees of market power, for example, and will differ in terms of its national significance. This point was made by Nigel Hart, General Manager of Ports for GrainCorp:

The argument we’ve always put forward is that there’s a greater commercial imperative for us to enter into commercial arrangements with exporters rather than being driven by regulations, simply because we’ve got an asset there that needs to perform, having been involved in negotiations with our customers. The reason why we have concluded it is that I think the commercial imperative on the east coast is somewhat different to South Australia and Western Australia. I think a lot of the arguments that get put forward may be relevant for Western Australia and may be relevant for South Australia, but certainly I think from an east coast perspective with the competitive dynamic that we have in terms of competing export facilities which aren’t regulated, as well as the significant export container trade, we do need to have our commercial protocols and agreements in place that will attract that business to our facilities. It’s not in our interest to seek to

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exclude anyone from those assets simply because the volumes are so small for the asset capability that we have. (trans., p. 476)

This means the regulatory arrangements under the access test are unlikely to be optimal, and the test would be better targeted if it was based on assessments of individual facilities (as occurs under Part IIIA) rather than ownership structures alone.

### **Length of accreditation periods**

Currently, because the ACCC accepted undertakings are of two years duration, bulk handlers have export accreditation for two years while other exporters have been accredited for three years. CBH, which had initially applied to the ACCC for a three-year undertaking, argued this placed the bulk handlers at a competitive disadvantage relative to other exporters:

The Access Undertaking was granted for a period of two years resulting in a subsequent limitation in Grain Pool's reaccreditation to two years by the WEA. Rival exporters who do not have port terminal interests have been reaccredited for three years, providing them with a distinct competitive advantage. (sub. 39, p. 2)

The ACCC gave a number of reasons for the choice of two years as the time period for undertakings:

The ACCC is of the view that having an undertaking with a short duration is appropriate. In taking this view the ACCC notes the transitional state of the bulk wheat export industry and the desirability of avoiding the imposition of regulation that is not appropriate on a newly deregulated industry, which would not be in the public interest. The ACCC notes that, given the transitional state of the industry, access arrangements that are appropriate now may not be appropriate in several years time. The ACCC considers that three years would be slightly too long a term and that a shorter term of two years would better mitigate these risks. In this regard, the ACCC has also taken into account the desirability of having consistent bulk wheat port access regulation arrangements across Australia (noting that ABB and GrainCorp have proposed two year terms for their Undertakings). (ACCC 2009b, p. 72)

The Commission understands the ACCC's reasons for initially wanting access undertakings in place for only two years, and notes that two of the three major bulk handlers preferred this time period. However, if both accreditation and access undertakings were to continue beyond October 2011, it would be preferable from a 'level playing field' perspective if the periods of accreditation and access undertakings were brought into alignment. (Were it to be determined that both accreditation and access undertakings not continue after 1 October 2014, logic would dictate that they all be renewed to end on 30 September 2014.)

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## Opportunity for merits review

In a paper prepared for CBH, ACIL Tasman suggested the need for an access undertaking by 1 October 2009 gave the ACCC considerable bargaining power and effectively removed the option of merits review for the bulk handlers:

Meeting the deadline set of 1 October 2009 under the WEMA access test gave the ACCC considerable leverage in negotiations and effectively removed an important check on the administrative decision making power of the ACCC. Because wheat exporters who provide port terminal services needed to have an access undertaking in place by 1 October to be accredited to export wheat, their bargaining position to push back on ACCC demands was effectively removed. Furthermore, because of the deadline set of 1 October 2009 for the WEMA access test, wheat exporters who provide port terminal services were effectively denied the opportunity to seek merits review of an ACCC decision to reject an access undertaking before the Australian Competition Tribunal. For all intents and purposes, the operation of the WEMA access test with its imposed deadlines, effectively removed an important check on the administrative decision making power of the ACCC. (ACIL Tasman 2009, p. 62)

The Commission agrees that the imposition of the 1 October deadline did reduce the opportunity for merits review, which it considers undesirable (although also noting that much of the reason for the ‘last minute rush’ for acceptance of the undertakings appears to rest with the bulk handlers). The Commission also notes ACIL Tasman’s suggestion that those appeal rights that do exist could be used mischievously by rival exporters:

In addition, the operation of the WEMA access test leaves open the possibility that other parties could ‘game’ the access undertaking process in an attempt to eliminate wheat exporters who provide port terminal services from wheat export markets ... third parties could ... threaten the accreditation of wheat exporters who provide port terminal services through challenging an ACCC access undertaking decision in the Australian Competition Tribunal in an attempt to have the ACCC decision set aside. A decision by the Australian Competition Tribunal to set aside an ACCC access undertaking in this case would result in the removal of an export accreditation under the WEMA of a wheat exporter for failing the access test. In this manner, parties could try to use Division 6 of the TPA to foreclose wheat export markets on wheat exporters who provide port terminal services. ACIL Tasman is not suggesting that the opportunity for merits review should be removed, but making the point that third parties could exploit the interaction of the access undertaking process with the WEMA for mischievous purposes. (ACIL Tasman 2009, pp. 60–61)

The strict adherence to timelines for what are effectively ‘involuntary’ access undertakings, with the consequent limits on the feasibility of merits review, compounds the risk that the costs of regulation might outweigh the benefits. The possibility of ‘gaming’ by other parties adds to this. Furthermore, the imposition of time limits means the ACCC is also under pressure to accept undertakings late in

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the process as it knows there is the potential for companies to be significantly disadvantaged in the absence of accepted undertakings. The Commission considers these factors represent further reasons for abolition of the WEMA access test in 2014 and greater reliance on the declaration criteria under the Part IIIA access regime.

Ashley Roff from Viterra raised a similar issue:

... there is of course a process under Part IIIA of the Trade Practices Act for declarations of essential facilities. It has a number of protections to the provider of the facilities which we didn't appear to get the benefit of ... (trans., p. 284)

The Commission shares these concerns. The ACCC and the port terminal operators were effectively entering uncharted territory when negotiating the 'involuntary' undertakings under the conditions of the access test. It is not clear that the process adequately provided for the protections that should normally apply to facility owners and operators. This would need to be reviewed were the access test to apply long term, especially if regulation were to become less 'light handed' and issues became more complex and information intensive. It should also be taken into account by the ACCC in the next review of undertakings, which will need to be completed by 1 October 2011.

## **Involvement of the ACCC**

Participants generally considered the ACCC to be the appropriate organisation to consider whether access undertakings should be accepted. For instance, the Grain Growers Association said:

The system appears to have worked well this year with the ACCC demonstrating that it has appropriate powers to ensure a competitive environment. These powers should be retained by the ACCC, irrespective of their continuation within the Wheat Marketing Act. (sub. 41, p. 12)

There were differing views about the appropriateness of the ACCC arbitrating access disputes. Some participants were concerned access seekers would 'invent' access disputes in the hope the ACCC would arbitrate lower access prices. For example, GrainCorp said:

The inevitable arbitration process between GrainCorp and grain exporters, who will claim to the ACCC that prices for port terminal services are too high and should be reduced, is simply a mechanism for these commercial companies to seek to gain a commercial advantage over GrainCorp. (sub. 43, p. 21)

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Others saw conflict between the ACCC's role of regulator and arbitrator. Ashley Roff of Viterra stated:

Certainly one of the issues we have under the existing port access undertaking is the ability of the ACCC to act as arbitrator. We believe that it represents a significant conflict of interest for an organisation that it has to act as regulator and then suddenly to throw off the regulator's hat and put on a hat saying, 'I am an independent arbitrator. I will approach this arbitration with an open mind and without all the dogma of the current government of the day and our personal views about competition.' It's a little bit of a stretch, I would have to say. (trans., pp. 290–91)

The ACCC saw it as important that it was the 'first instance' arbitrator in disputes under the access undertakings:

The ACCC considers it is more likely to be appropriate for the ACCC to have a role as arbitrator. The ACCC considers that clear public interest considerations arise in relation to the ... Undertaking, and which may also arise in relation to certain Disputes between an access seeker and an access provider. In this regard the ACCC notes again the effect of the WEMA in reforming the arrangements for the export of bulk wheat from Australia via the introduction of competition, as well as the transitional state of the industry at present. The ACCC considers it would be better placed than a private arbitrator to have regard to these matters in arbitrating a dispute which raises such matters, particularly due to its experience in economic regulation and in arbitrating matters with public interest considerations. (ACCC 2009b, p. 148)

However, the ACCC agreed that it would be appropriate for some disputes, not involving public interest considerations, to be dealt with by a private arbitrator:

The ACCC notes, however, the likelihood that not every Dispute that may arise in relation to the proposed Undertaking will warrant arbitration by the ACCC. While it is not possible for the ACCC [to] predict, at this stage, the particular Disputes upon which it may or may not choose to arbitrate, it is possible that purely commercial or technical disputes with no public interest considerations may more appropriately be arbitrated by a private arbitrator. (ACCC 2009b, p. 148)

Under the accepted undertakings, the ACCC chooses whether or not to arbitrate in disputes or whether particular disputes are better handled by private arbitrators.

Many participants saw a role for another body to deal with day-to-day disputes. Some suggested Grain Trade Australia (GTA) would be a suitable body, although others saw them as too close to some access seekers.

GTA itself noted it 'remains available to facilitate negotiation and arbitration of day-to-day issues where prompt resolution is important to exporting opportunities' (sub. 19, p. 1). It further argued it had unrivalled industry experience, judicially tested dispute resolution processes and appropriately experienced and qualified mediators.

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The Grain Growers Association supported a role for GTA:

Grain Trade Australia has a disputes resolution process which is often embedded into grain transactions as a first step in dispute resolution. This appears to be an effective process to deal with most claims in an expeditious manner. This process does not exclude a legal dispute resolution in the courts (a point which perhaps should be made more strongly) but provides a low cost first step in the case of a dispute. (sub. 41, p. 13)

The AGEA also supported GTA involvement. Executive Officer Rosemary Richards said:

I think with the ACCC, if I have interpreted it right, really all they're going to arbitrate on is the framework and the process. Some of the other disputes that are going to occur are going to be more operational disputes and we certainly supported GTA as being the body to deal with those operational disputes because often they are things that need to be resolved within a day, maybe even within hours. They're not something that would really fit within an ACCC process and really do need people that understand, have a technical capacity. So our members are very comfortable with the GTA dispute resolution process, certainly recognise they would need to up-skill in some areas in relation to the sorts of disputes that we might get in this but we're more than happy to have GTA there as the dispute body around those operational disputes that need to be sorted out very quickly. (trans., p. 250)

However, Ashley Roff from Viterra expressed reservations about GTA as an arbitrator:

I know that GTA has been suggested as a possible body to do that. We're somewhat concerned because most of the membership of GTA tend to be access seekers, so we'd need some comfort that whoever was going to do the arbitration would have a balanced view about the outcome. GTA is one possible organisation and if that was to be the case, as I said, we'd need to work out how that would work in practice, but primarily our requirement would be for somebody who was independent and came to the dispute with an open mind. (trans., p. 291)

In response, GTA said:

The GTA Dispute Resolution Service operates under the Commercial Arbitration Act and the GTA Dispute Resolution Rules which detail the operation of the Dispute Resolution Service (DRS). An award of a GTA arbitration carries as much weight as an award of the court and if a party wishes to appeal a GTA Award then the appropriate jurisdiction is the relevant State Supreme Court. Rule 17.3 of the GTA Dispute Resolution Rules states

'An Arbitrator shall not be interested in the transaction nor directly interested as a member or financially associated with any party to the arbitration. Where a nominee arbitrator has made a disclosure or where a party independently knows of circumstances likely to give rise to justified doubts as to his or her impartiality or independence, a party shall be at liberty to object to his or her nomination, in which case the party shall nominate a new arbitrator or GTA shall nominate another arbitrator where the arbitrator was nominated by GTA.'

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The GTA DRS is widely used across the grains industry and the impartiality of the GTA Arbitrators has never been questioned. However, all market participants must enjoy a high degree of comfort that, should their dispute come before GTA, it will be handled expeditiously, on the facts presented and the award will be found based on an impartial review of the facts as presented by the parties. GTA therefore would propose:

- That GTA will develop a special set of ‘Dispute Resolution Rules – Access Undertakings’.
- A specialist panel of arbitrators would be formed, i.e. ‘Arbitration Panel – Access Undertakings’.
- The panel would be formed from senior grain industry personnel who are quite independent of the parties. (sub. DR67, p. 1)

The Commission considers the ACCC is well placed to act as arbitrator where disputes involve major public interest considerations and, if undertakings are to continue beyond 1 October 2014, it should continue in this role. However, with regard to day-to-day commercial disputes where no major public interest considerations are present, parties should be able to choose a mutually acceptable mechanism to resolve these. It is also likely that arbitration would not be required for many disputes relating to undertakings.

### **The Commission’s view**

In summary, if (and only if) the access test is to continue beyond 2014 the Commission considers that the following aspects of the test should be altered or reviewed:

- the relationship between the WEMA and the TPA, to clarify the balance between the rights of access seekers and protection to infrastructure owners and their existing customers
- the application of the access test, so that it is based on a facility by facility approach, rather than an ownership test alone
- if both accreditation and access undertakings were to continue post-2014, alignment of periods of accreditation and access undertakings
- the process for developing access undertakings so that it adequately provides for the protections that should normally apply to facility owners and operators
- day-to-day commercial dispute handling so that disputes are handled by a mutually acceptable mechanism
- after 5 years, the appropriateness of the access test itself.

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## 5.8 Alternatives to the suggested future arrangements

The preceding discussion presents the costs and benefits of the arrangements that the Commission considers should ultimately be put into place for access to port terminals used to export bulk wheat. Other alternatives were canvassed, or suggested by participants, and are included here for completeness.

### Price monitoring

A relatively light handed regulatory option is the use of price monitoring. For example, a price monitoring regime is used to regulate stevedoring services, and airport services at major airports that are seen to have market power. The intention of price monitoring is to retain constraints on market power while avoiding unnecessary regulatory intrusion (PC 2006a).

In the case of airports, provisions in Part VIIA of the TPA and the *Airports Act 1996* (Cwlth) stipulate that the ACCC is to monitor the prices, costs and profits relating to aeronautical and related services at a number of major Australian airports. The ACCC does not draw any conclusions about whether the prices and profit levels monitored represent ‘taking advantage’ of monopoly power. The Australian Government, however, uses the information obtained by the ACCC to inform judgments on the effectiveness of the price monitoring regime. Depending on what monitoring indicates, there is the potential for more heavy handed regulation to subsequently be imposed. Monitoring of service quality is also undertaken to complement price monitoring (PC 2006a).

Costs associated with price monitoring would likely be much lower than those associated with access regulation. In its 2006 review of the price monitoring regime for airports, the Commission found that ‘in an overall sense, compliance costs are low, and certainly do not appear to be a major concern for the larger monitored airports’ (PC 2006a, p. 37). The Commission also found that investment levels had been significantly higher under price monitoring than under previous more heavy handed price regulation (although to a large extent this was driven by investment cycles and the need for runway upgrades for the new Airbus A380).

However, the Commission is not persuaded that price monitoring effectively addresses the problems of terms and conditions of access. Price monitoring is likely to be most effective when the major issue relating to access is the price of a service, but it is less effective in dealing with issues relating to the terms and conditions of access.

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*Price monitoring of port terminals is not an appropriate mechanism to deal with matters relating to port access.*

## **Ring fencing**

Many participants asked for greater use of ring fencing regimes (that is, some form of separation of the wheat exporting and bulk handling operations of companies). This is largely due to concern about access to port facilities for exporters competing with the bulk handlers, and concern that the information held by the bulk handling operations could provide an ‘unfair’ competitive advantage to the exporting arms of the bulk handling companies.

Ring fencing regimes are designed to prevent vertically integrated utility owners from pursuing actions to limit competition in upstream or downstream markets. A vertically integrated utility owner might limit competition in these potentially contestable markets by:

- denying potential upstream and downstream competitors access to port (or other essential) facilities
- charging potential competitors higher prices for access to facilities
- using commercially sensitive information gained from its involvement in bulk handling to gain a favourable position in its grain trading activities
- allocating an unreasonable proportion of its total costs to regulated elements of the business to justify charging users higher prices (adapted from PC 2004).

Ring fencing provisions are designed to reduce the incentives and opportunities for infrastructure owners to engage in each of these potentially anticompetitive behaviours by making their behaviour more transparent. Ring fencing can also make the task of applying access regulation more transparent and efficient (PC 2004). Ring fencing can therefore be used as an alternative to access regulation or used in conjunction with it.

The ACCC did not require ring fencing provisions in the access undertakings it accepted from the bulk handlers, although it noted such provisions might be required in the future. The ACCC viewed the proposed ring fencing provisions in the initial rejected undertakings of the bulk handlers as inadequate. However, more significantly, it considered that as the final accepted undertakings contained robust non-discrimination and no hindering access clauses, fair and transparent port terminal protocols and indicative access agreements, as well as measures to deal

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with the potential for information about port terminal services to be used to the advantage of the bulk handler's wheat exporting arms (namely publishing of information in areas such as stocks at port, vessel nominations, tonnage loaded and vessel waiting times), there was no requirement for ring fencing provisions. The ACCC considered it would be an 'undesirable outcome' if ring fencing provisions that were subsequently to be revised imposed unnecessary regulatory costs during a time of industry transition (ACCC 2009b).

One bulk handler, CBH, is already subject to ring fencing arrangements arising from the ACCC's decision not to revoke a 'notification' from CBH relating to a component of its Grain Express product in 2008. CBH's proposed ring-fencing rules in its initial proposed undertaking to the ACCC differed somewhat from the ring-fencing arrangements in CBH's Grain Express exclusive dealing notification. For instance, in the ACCC's view the Grain Express ring fencing policy provides for a more robust complaints handling and resolution process than the process provided for in the initial rejected access undertaking (ACCC 2009b).

Some participants saw ring fencing provisions as important. For example, AWB argued:

The ring-fencing rules are critical to a fair and transparent access regime. The substantial number of failings identified by the ACCC in the [bulk handling companies] proposed Undertakings that require wholesale rectification is telling. The [bulk handling companies] have shown that they will not provide fair and transparent access to port terminal facilities to [wheat exporters] unless required to do so under the risk that their trading arm loses export accreditation. The imbalance in information is exacerbated by the fact that the [bulk handling companies] provide upstream and downstream services. The result is that the [bulk handling companies] possess a great deal of information about the trading activities of the customers who are often their competitors and are consequently in a position to advantage the [bulk handling companies] related entities, or to disadvantage the customers. (sub. 24, p. 9)

The Pastoralists and Graziers Association of Western Australia considered:

The PGA believes that the ring fencing policy may need to change if current measures do not stop [bulk handling companies] from discriminating in favour of their trading arms. As the industry [is] currently in transition, it is essential that robust ring fencing rules are put in place, however short the duration of the Undertakings. (sub. 47, p. 9)

Not surprisingly, bulk handlers were not supportive of ring fencing provisions and pointed to their potential cost. Viterra said:

Normally ring fencing necessitates physical separation of personnel, major adjustments to systems and the introduction of rigorous auditable procedures. This comes at a significant cost. The cost is magnified if the ring fencing relates only to wheat as opposed to all other traded commodities. On the other hand there is no great body of evidence to suggest that ring fencing is effective either in reality or even in

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perception ... The Viterra organisational model in Canada combines grain accumulation and storage and logistics in one business unit. Viterra believes that the understanding by storage and logistics of the grain accumulation task leads to a better understanding of customer needs and a more effective supply chain. Ring fencing would in our opinion stifle innovation and new investment. (sub. 23, p. 7)

GrainCorp stated:

The imposition of 'ring fencing' requirements would place a further cost burden on GrainCorp and similar companies, and further discriminate against companies with heavy infrastructure. If ring-fencing measures were imposed on GrainCorp, it is possible that the trading business could become commercially unviable, due to the costs of duplicating core corporate, back-office, or operational functions. The imposition of such requirements would put at risk GrainCorp ['s] entire business model and would thus negatively affect shareholders. This would have the undesirable outcome of actually reducing competition in the Australian market and thus competition for the purchase of grain from growers would be reduced, as would grower choice, and further entrench the competitive position of multi-national grain traders, which would of course be a desirable outcome for those companies. (sub. 43, p. 24)

GrainCorp further suggested that many of its rival exporters benefitted from vertical integration of their companies globally, meaning that ring fencing for local exporters would put them at a disadvantage:

While much has been said about the competitive position of companies like GrainCorp, no focus has been applied to the competitive position of the global companies that operate in Australia. Companies such as Cargill, Glencore, Louis Dreyfus, Nobel Resources, Marubini, Itochu, Toepfer Grain, (and possibly soon Gavilon, formerly ConAgra Trade Group, should they purchase a stake in AWB Limited), use Australia as a small part of an international grain trading complex. The value of Australian wheat, and other grain exports, is subject to pricing that reflects the vertical integration of the businesses these companies conduct internationally. This weakens Australian companies like GrainCorp through the excessive imposition of domestic regulation. It reduces any advantage from owning or operating infrastructure, or competing in the grain market as a buyer/trader, and ultimately is to the long term strategic disadvantage of the Australian grains industry. (sub. 43, p. 24)

Trevor Badger expressed similar sentiments:

The structure that we have at the moment has a sole beneficiary and that is the grower of Western Australia. As a grower of Western Australia, I need to compete against worldwide vertically integrated businesses. I need to be able to compete against the Cargill family. They own their own farms. They own their own silos. They own their own elevators. They own their own shiploaders. They own their own domestic marketing systems and domestic trading systems. They own their own flour mills and they own their own bakeries. Why aren't I allowed to compete against them? Why is the Australian Government hell-bent on breaking me down but will not lift a finger against companies such as Cargills? I don't mean to individually point Cargills out because all these companies are similar, but apologies to Cargills if I offend them. The

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cooperative in Western Australia performs for me, the grain grower. If anything, the cooperative should be protected and possibly given advantages over these multinational companies. (trans., p. 162)

Although the Commission sees merit in ring fencing in certain circumstances, it does not see convincing arguments to enforce ring fencing provisions in what is very much a market in transition. In seeking to achieve competitive outcomes, ring fencing measures should be considered as more of a ‘last resort’ than a first option for a developing market.

Further, the Commission considers that there are benefits to be gained from vertical integration in the export of bulk wheat — indeed, the fact that all of the major handlers have acquired a trading arm would attest to this fact. Most of Australia’s overseas competitors are also vertically integrated and to deny such benefits in the Australian context could place domestic traders at a disadvantage relative to other global players.

There is further discussion of the merits of ring fencing in chapter 6, in the context of the Grain Express notification, and chapter 7, in the context of information asymmetry.

## **Structural separation**

Some participants have suggested that the best way to deal with the conflicts between the trading and bulk handling arms of the bulk handlers would be through full structural separation (either through forced divestiture or legislative prohibition of bulk handling companies exporting wheat). For example, the Department of Agriculture and Food (Western Australia) said in a submission to the ACCC:

CBH has taken a number of steps to constrain the ability of their Port Operators from favouring its own grain marketing business – most notably the efforts to ‘ring fence’ the two operations. DAFWA is of the view that the best solution for this issue would be for CBH to ‘spin off’ its grain marketing operations (Grain Pool Pty Ltd) as a separate commercial entity and retain CBH purely as a grower owned and operated storage and handling entity. In the event that this occurs the need for a Port Services Access Undertaking would appear to be redundant. (sub. 34, p. 15)

Although the Commission agrees this would virtually eliminate the conflicts between the arms of the bulk handling businesses, and therefore largely preclude the need for access regulation, this would occur at potentially great cost, particularly given the businesses are already vertically integrated (that is, we are not starting from scratch). For example, in addition to losing any efficiency benefits stemming from vertical integration, exclusion of the bulk handlers from the wheat export

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market could see this market deprived of their market knowledge, investment capital and overseas connections.

These costs need to be balanced against the benefits of structural separation, and it is not clear to the Commission that the benefits are greater. (Moreover, structural separation would not ensure competition within the supply chain, and there are still possible competition concerns with a non-vertically integrated bulk handler). The arguments noted above in relation to ring fencing measures — including the observation that Australia’s global competitors are typically vertically integrated — apply even more strongly to suggestions that bulk handlers should be prohibited from trading wheat, or that they should be forced to divest their trading assets.

## **Section 46 of the TPA**

Some participants believed that, even in the absence of the WEMA or Part IIIA provisions of the TPA, or for infrastructure not meeting the declaration criteria, section 46 of the TPA could deal with access issues. The Act states:

- (1) A corporation that has a substantial degree of power in a market shall not take advantage of that power in that or any other market for the purpose of:
  - (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market;
  - (b) preventing the entry of a person into that or any other market; or
  - (c) deterring or preventing a person from engaging in competitive conduct in that or any other market. (TPA, section 46 (1))

ACIL Tasman, in a paper prepared for CBH, argued:

Another means through which the conduct of bulk grain handlers is constrained is through the operation of section 46(1) of the TPA that prohibits the misuse of market power .... Conduct where parties refuse to supply a good or service may constitute a breach of section 46(1). The fact that a refusal to supply can be in breach of section 46(1) was confirmed by the High Court’s decision in the *Queensland Wire* case. (ACIL Tasman 2009, p. 69)

The Commission discussed the possibility of relying on section 46 in its 2001 *Review of the National Access Regime*. At the time, the Commission noted:

Suffice it to say that, as a stand-alone mechanism for providing efficient access to essential infrastructure services, there remain considerable doubts about the efficacy of Section 46 specifically and Part IV more generally. This is particularly the case as Australian trade practices law does not normally provide remedies against firms which are able to earn monopoly rents ... Further, it is significant that no major developed country relies solely on general competitive conduct rules in this area. (PC 2001b, p. 112)

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In a submission to that inquiry, the ACCC expressed significant doubts about the efficacy of section 46 in dealing with access disputes. The ACCC noted:

Three conditions must be satisfied to establish a breach of section 46. First, the firm must have substantial market power. Second, the owner must have taken advantage of its market power by engaging in the conduct in question. Finally, the owner must have done so for one of the three anti-competitive purposes. (ACCC 2000, p. 19)

The ACCC noted the requirement to prove that conduct was motivated by a proscribed purpose limited the usefulness of section 46 in dealing with access disputes. They also noted that the purpose of Part IIIA was to provide access to ensure efficient and competitive markets, meaning the test of seeking to harm competitors contained in section 46 was not an appropriate test for access regulation purposes.

The ACCC also noted the lack of significant relevant case law, raised doubts about courts' ability to balance trade-offs between competition and efficiency where vertical integration might lead to efficiencies, questioned whether the penalties under section 46 lent themselves to setting access prices, and noted the costs involved for access seekers using the court system under section 46 (ACCC 2000).

Although some participants have referred to amendments to section 46 in recent years, the Commission does not believe these have made section 46 any more effective in dealing with access disputes. Further, the ACCC has highlighted the same questions would still apply as in 2001:

In the wheat industry to prove a breach of the misuse of market power provision it would be necessary to establish that any particular fee, charge or logistical arrangements in the supply chain was imposed or implemented for one of the proscribed purposes [in section 46 (1)] and not for a legitimate commercial purpose. (sub. DR95, p. 11)

The Commission considers that section 46 is inadequate for dealing with access disputes in its own right.

FINDING 5.6

*Section 46 of the Trade Practices Act is unlikely to deal adequately with matters relating to port access.*

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## 6 Transport, storage and handling

### Key points

- The export grain supply chain consists of storage and handling facilities up country, transportation of grain (via rail and road), and delivery of export grain at port terminals.
  - Many grains share the use of this common supply chain, but wheat represents the largest share of grains (54 per cent).
- Returns to growers can be increased by improving efficiency of the supply chain.
  - There has been an increase in on-farm storage. Growers might use on-farm storage to exploit a greater range of marketing options under deregulation.
  - The share of wheat transported by road has increased because of privatisation of rail, deregulation and other factors.
- Competition in the supply chain varies across Australia.
  - The east coast typically has more private on-farm storage, more competition in bulk handling facilities and more contestability in the supply chain than the west coast.
- Access to up-country storage facilities should not be regulated, as these facilities do not have natural monopoly characteristics.
  - Rivals need to be able to by-pass the bulk handling system, and have access to port terminals, and freedom to use competing logistics chains. This will provide scope for competition to arise without the need for access regulation up country.
  - Bulk handling companies might charge higher rates for wheat that is not transported to ports via its own supply chain. The proposed port access arrangements (chapter 5) should address this issue.
- In Western Australia, CBH has an exclusive dealing notification requiring that grain stored at CBH facilities be transported using CBH's system, called Grain Express.
  - In light of market developments, the Commission endorses the decision by the ACCC to review CBH's exclusive dealing notification to operate Grain Express.
- Greater investment in transport infrastructure is likely to be required in the future.
  - When making investment decisions, governments and the wheat industry need to examine the effects on the entire supply chain and links with other industries.
  - Thorough cost-benefit analysis, taking into account the economic and social costs and benefits of road and rail use, is required.
  - Long-term investment decisions should avoid 'locking in' supply chains and not restrict the development of other supply chains.

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In chapter 5, access arrangements at port terminals for exporting grain were discussed. In this chapter, the rest of the supply chain — including handling and storage of wheat up country, and transportation — is examined. Section 6.1 contains an overview of how the supply chain operates. The supply chain has undergone much change both prior to and since deregulation. In section 6.2, recent developments in the supply chain are discussed. The efficiency of the supply chain is a critical factor in determining the competitiveness of Australian wheat. Impediments that inhibit the development of competition in, and the efficiency of, the supply chain are discussed in section 6.3. Finally, section 6.4 examines transport infrastructure investment in the future.

## **6.1 How does the wheat supply chain operate?**

Export wheat is delivered to ship via a shared grain supply chain, which has three distinct components:

1. Up-country storage and handling of grain (including wheat), consisting of:
  - (a) up-country storage facilities (operated by the three bulk handling companies and other smaller bulk handlers)
  - (b) on-farm storage (growers).
2. Transportation of grain from up-country to port terminals (or the domestic market), via:
  - (a) rail
  - (b) road.
3. Loading of vessels for shipment to export markets at port terminals.

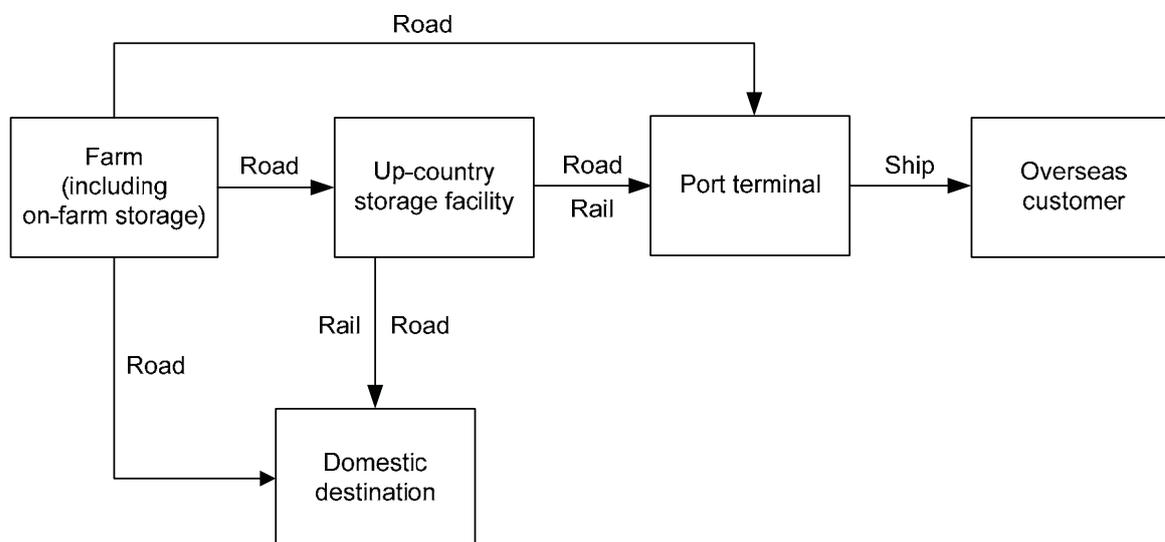
An illustration of how the supply chain operates is presented in figure 6.1.

The majority of wheat destined for export is handled, stored and transported through the bulk grain handling system. This system comprises a network of up-country receival facilities that are connected by road and rail transport links to domestic users (typically feedlots and mills) or to port terminals for export. Although the majority of export grain is transported through the bulk handling system via the rail network, there has been a recent trend towards greater use of road transportation and on-farm storage.

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Figure 6.1 **Bulk grain supply chain**

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The Commission was asked to examine the level, and effectiveness, of competition in the grain supply chain. As will be explained below, the level of competition varies in different regions of Australia. Generally, there are three distinct regions which each have one bulk handling company that provides an integrated supply chain from up country to port (chapter 2). These regions comprise the east coast (New South Wales, Victoria and Queensland), South Australia and Western Australia.

### **Storage and handling**

After harvesting their wheat, growers can choose to store their wheat on farm, move their wheat to an up-country storage facility directly after harvest, or move their wheat direct to port for export or straight to a domestic user. Ports are not generally used as a storage facility, *per se*. Storage at ports is generally used to assemble shipments for export. In contrast, wheat stored up country is held for a much a longer time, and might be carried over to the next harvest.

#### *Up-country storage facilities*

Up-country storage facilities vary in size. Currently there are about 570 up-country facilities that the three major bulk handling companies operate and another 30 facilities owned and operated by other major companies — AWB Limited (AWB) and Australian Bulk Alliance (ABA) (table 6.1).

The bulk handling companies listed in table 6.1 are all registered by Grain Trade Australia. In total, there are 18 registered bulk handlers that have been granted ‘provisional’ status for the 2010-11 marketing season.

To be registered, a bulk handler must publish its storage and handling agreement, and provide a list of fees and charges. This provides growers with information about where they can store grain, although the number of bulk handlers and storage facilities varies across regions. There are eight registered bulk handlers in New South Wales, Victoria and South Australia, three in Queensland, and only one in Western Australia.

In total, there is approximately 50 million tonnes of bulk handling storage capacity (roughly twice the size of the total wheat harvest in a good year). Excess storage capacity is a common feature across Australia.

**Table 6.1 Up-country grain handling storage facilities**

<i>Company</i>	<i>Storage facilities<sup>a</sup></i>		<i>Capacity<sup>a</sup></i>
	No.	Million tonnes	
GrainCorp	270		20.0
CBH	193		20.0
Viterra	108		9.5
ABA	8		0.8
AWB	22		3.7
<b>Total</b>	<b>601</b>		<b>54.0</b>

<sup>a</sup> The number, and capacity of, storage facilities is for all grain types, not just wheat. Number of storage facilities was taken from bulk handling companies websites, and may include sites temporarily closed.

Sources: GrainCorp (2010c); CBH (2010b); Viterra (2010b); ABA (2010b); AWB (pers. comm., 9 June 2010)

In Western Australia, Co-operative Bulk Handling (CBH) has a grain storage capacity of 20 million tonnes. However, CBH submitted that its ‘effective’ capacity is closer to 15 million tonnes because storage capacity is reduced, on average, by:

- 1.6 million tonnes from carryover of stock
- 3.8 million tonnes due to segregation of grain
- nearly 1 million tonnes because some grains (such as barley and oats) take up more room than wheat. (sub. DR75)

CBH’s average receipts at harvest for all types of grain are about 11 million tonnes, and Western Australia’s largest grain harvest was 14.7 million tonnes in 2003-04 (CBH 2010b).

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In South Australia, Viterra (formerly ABB) is the dominant bulk handler, and stated that its total capacity of about 9.5 million tonnes is capable of handling the entire South Australian grain harvest (Viterra 2010b).

GrainCorp operates storage facilities across the eastern states (New South Wales, Victoria and Queensland). GrainCorp has a capacity of about 20 million tonnes of its own storage. This compares with an average annual grain production across the region of about 16 million tonnes (GrainCorp, sub. 43). In addition, most of the New South Wales wheat crop is destined for the domestic market. Generally, about 10 million tonnes of wheat is sold to the domestic market each year. Wheat destined for domestic markets is often delivered directly from farms to end users (see below) implying that GrainCorp has ample storage capacity in its system.

Grain delivered to storage facilities is weighed and tested to determine its grade and quality. It is then stored with other grain of the same bin grade (chapter 8). The total number of bin grades or segregations at each storage site is determined by the tradeoff between the value of segregating grain and its cost. Storage sites also vary considerably in size, and bulk handling companies can use some smaller sites to store narrower product varieties (discussed in section 6.2).

### *On-farm storage*

A report by Francis (2006) presents a useful summary of the various options that growers have to store grain on farm, the costs and benefits of each, and factors likely to influence their use.

First, growers can use grain storage bags to store wheat on farm. Bags typically store between 200 and 220 tonnes of wheat and are filled and emptied using specialised machinery. Bags are sealed, which means, under favourable conditions, they protect grain from insect damage without the use of insecticides. Other benefits include:

- low capital set-up costs
- improved harvest management
- opportunity to segregate and blend grain.

Disadvantages of using bags include the requirement for disposal of used bags and the period of storage before bag deterioration. Bags can be left on farm for up to a year, but are usually held for a much shorter period of time.

Growers that use bags tend not to put their wheat in the bulk handling system. The cost of storage and handling at a bulk handling facility is typically more than from

storing in bags (SDD 2009a). Growers can use their own transport to deliver wheat in bags to a domestic user (for example, flourmill or feedlot) instead of warehousing wheat in a bulk handling facility.

Alternatively, growers can store wheat on farm in sealed grain silos. Compared with bags, silos offer a more permanent storage option. However, they have a higher initial capital outlay. There are also additional on-farm handling and site maintenance requirements (in particular, the prevention of contamination from pests is an issue that many participants noted, and is discussed in section 6.2).

Growers can also use sheds or bunkers for short-term storage requirements (Department of Agriculture and Food (Western Australia) 2008).

The ABS (2010d) estimated that there is about 15 million tonnes of on-farm storage capacity across Australia, located mainly on the east coast (table 6.2).

**Table 6.2 On-farm storage capacity, 2009**

Million tonnes

	<i>NSW</i>	<i>Vic</i>	<i>Qld</i>	<i>SA</i>	<i>WA</i>	<i>Total</i>
On-farm storage capacity	6.4	3.5	1.9	1.2	2.6	15.6

*Source: ABS (Principal Agricultural Commodities, Australia, Cat. no. 7121.0).*

## Transport

After harvesting their wheat, growers have the option to transport their grain from on farm to either a domestic user, direct to a port terminal for shipment, or to a bulk storage facility. For each of these options, wheat is only transported via road (using trucks).

Wheat warehoused at a bulk storage site can be outturned to a domestic end user or transported to a port terminal. Wheat is transported from a bulk storage site (to port terminals or domestic outturn sites) using road or rail. That is, road and rail can directly compete for the transport of wheat from bulk storage sites. Competition does not always exist (for example, if there is no rail line).

The proportion of wheat transported via road and rail depends on factors such as:

- whether it is destined for domestic consumption or export
- distance to port
- seasonal fluctuations (peak-load periods) and size of harvest.

An explanation of how road and rail use varies according to these factors is provided by Single Vision Grains Australia (SVGA):

Rail traditionally dominates in the haulage of grain from the more distant regions to the major ports ... Road transport is used by many domestic consumers, particularly in the milling and stockfeed sectors, and trucks are also heavily used for deliveries to port from coastal growing areas (particularly in WA and SA).

Road transport is also used for export grain when rail is unable to meet short term demands (such as in bumper export seasons, peak shipping demand periods or when silos fill up at harvest time). ... The upshot of this pattern is that rail is used overwhelmingly for the haulage of the more distant volumes, while road transport has a higher proportion of volumes grown closer to the port or the major mills (typically in cities and regional centres) and feedlots. (SVGA 2007a, p. 6)

Current transport shares of road and rail usage are difficult to obtain and vary depending whether measured using volume or adjusted for distance. Industry estimates from 2007 (prior to deregulation) stated that about 75 per cent of Australia's export grain (measured by volume) was transported via rail, with the remainder delivered by road (table 6.3). In New South Wales, Victoria and Queensland, 80–100 per cent of export wheat was transported by rail. These numbers exclude road transport from farm to bulk receival site and the share of grain transported by road is likely to have risen since 2007 (section 6.2).

In states where some growing areas are closer to the coast and port areas, as in Western Australia and South Australia, grain is more likely to be delivered to port by road. However, 65–70 per cent of the volume of export grain was transported by rail in Western Australia and South Australia in 2007.

When volumes of export grain were adjusted for the haulage distance (tonne-kilometres), the share of rail was higher, reflecting the longer distances that grain is transported on rail compared with road.

**Table 6.3 Share of rail and road for export grains, 2007**

<i>State</i>	<i>Share of Rail (per cent)<sup>a</sup></i>	
	<i>Volume</i>	<i>Tonne-kilometres</i>
NSW	95	97
Vic	80	85
Qld	100	100
SA	70	82
WA	65	79
<b>Total</b>	<b>75</b>	<b>86</b>

<sup>a</sup> Figures do not account for the road haul from farm to receival site, which is likely to be significant. Anecdotal evidence suggests that the share of road has increased since 2007 (section 6.2).

Source: Productivity Commission estimates derived from SVGA (2007b).

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Within states, the share of grain transported from bulk receival sites to port terminals by road or rail can vary dramatically. For example, in Western Australia, Esperance received about 90 per cent of its grain via road, while Kwinana received about 90 per cent of its grain via rail in 2007 (SVGA 2007a).

### **Links across the supply chain**

Figure 6.1 illustrates the physical supply chain logistics involved in moving wheat from farm to an end-user. It does not show the ownership of wheat at any point in the supply chain. The major bulk handling companies typically operate services along the supply chain — from bulk receival site to ships. Bulk handlers generally allow users access to any of these services (although grain stored at CBH’s facilities must use CBH’s supply chain to be delivered to its end destination), meaning ownership of wheat can change at any point in the supply chain.

With the advent of deregulation, more competition has emerged in many parts of the supply chain. This competition has led to many different players trying to seek access to, or to develop, alternative supply chains.

Recent changes, and developments to improve the efficiency of the supply chain, are discussed next.

## **6.2 Recent developments in the wheat supply chain**

The wheat supply chain has adjusted to pressures coming from various sources. ‘Privatisation, deregulation and competition in the grain supply chain are contributing to changes in historical patterns of grain transport in NSW’ (NSW Farmers Association 2009, p. 9).

Privatisation of rail networks has seen private operators change their service to minimise costs, while deregulation has seen storage and handling companies move into the marketing of grain and become more active in road and rail transportation, to deliver a more integrated service. In addition, changing customer requirements (by traders and growers) for storage and handling services has led to an increase in these services being provided by rivals to the incumbent major bulk handling companies. Developments and likely trends in the future for storage, handling and transport are discussed below.

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## Competition has emerged in up-country storage and handling facilities

### *On-farm storage has increased*

Although it is difficult to ascertain precisely how much on-farm storage might have increased, a number of sources suggest that there has recently been a large increase in on-farm storage capacity, albeit from a small base:

There is anecdotal evidence of a recent acceleration of the annual growth rate of the take-up of on-farm storage options, including bags ... In the wake of the loss of AWB's single desk, many growers have now apparently reacted against the inevitable sway of chain control to the bulk handlers by building on-farm capability. (SDD 2009a, p. 15)

GrainCorp (sub. 43) estimated that more than 10 million tonnes of permanent storage has been built in the past decade in the eastern states by non-bulk handlers and grain producers.

Similarly, in Western Australia:

The WADAF [Department of Agriculture and Food (Western Australia)] estimates that there are currently around 2 million tonnes of on-farm storage in the state, which does not include the use of temporary storage such as silo bags. They further estimate that on-farm storage will continue to grow over coming years to between 3 and 4 million tonnes. (DITRDLG 2009a, p. 25)

A report produced for the National Transport Commission (SDD 2009a) stated the trend towards more on-farm storage 'initially emerged as growers grew dissatisfied with the lack of choice in bulk handling options and perceptions of their pricing of basic storage services' (SDD 2009a, p. 14).

Although the increase in on-farm storage began prior to deregulation, it is likely that a deregulated environment gives increased incentives for growers to use on-farm storage (in particular, because it provides more marketing options).

The *New South Wales Grain Freight Review* highlighted four reasons explaining the increase in on-farm storage of grain and warehousing since deregulation:

- preserving the identity of individual grain parcels to capture market premiums
- deferring, for as long as possible, the decision on when and to whom the grain will be sold, to maximise price
- reducing the risk of post-harvest weather damage to grain (access to on-farm storage may assist in getting grain into store quickly)
- avoiding the costs of using the centralised handling system unless this is a necessary consequence of the sale decision. (DITRDLG 2009b, p. 29)

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Although the new marketing arrangements provide opportunities to growers, they also add another layer of complexity to the decision making process, and growers might not always make the right decision. For example, one grower stated:

I've stored a lot of my grain this year only to find prices going down. How am I supposed to find the time to market my grain and run my farming business successfully? (J & C Lloyd, sub. 56, p. 1)

Faced with greater uncertainty in a deregulated market, on-farm storage might be used by growers wanting to maintain some control (NSW Farmers Association 2009). That does not mean all growers prefer on-farm storage. 'Growers faced with the uncertainty of wheat marketing are forced to store their own grain' (Ilestyle, sub. 9, p. 1).

The marketing of export wheat is different from that which prevailed under the single desk, requiring a transitional adjustment for growers. Under the new arrangements, the day-to-day decisions growers make to sell export wheat are the same as those for growers marketing other grains (or for wheat that is sold to domestic users).

A number of submissions highlighted issues regarding the costs of building on-farm storage and the control of pests. For example, Kay Hull MP stated:

... there are immense costs involved with on farm storage. Not only is there significant capital development costs, there are a variety of issues to contend with such as weevil infestation and the overall management of running farm storage. (sub. 36, p. 3)

When small volumes of wheat are to be exported, it is probably more cost-effective to store the wheat in a bulk storage facility and pay the associated storage handling fees than to invest in on-farm storage (although growers could use bags when selling small parcels of wheat).

Regarding the testing procedures that are available on farm to protect against pests, the NSW Farmers Association noted:

The breakdown in Insect Pest Chemical Control and the lack of suitable chemical choice has made the Storage of Grain on farm to reduce costs risk laden and expensive if growers have to build suitable on farm storage to stop insect pests. (sub. 49, p. 13)

Ben Mason (NSW Farmers Association) stated that costs of preventing grain contamination are significant and get passed onto growers:

There's a risk with insect – phosphine and chlorpyrifos breakdown. The required aeration of two litres per second per tonne requires about a \$4 per tonne investment. What percentage of growers have got the resources available to implement that now after we've just been talking about 10 years of drought, so it's just forcing these costs back onto growers. (trans., p. 514)

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Export opportunities might be limited if on-farm pest control procedures cannot be developed to the same standard as up-country facilities. Trevor Badger stated:

The biggest impediment to me currently is weevils. I have been storing grain for domestic markets for 14 years and have not been able to stay weevil free 100% of the time. To export I must be weevil free and it is an expensive task when you have to do it yourself. (sub. 14, p. 3)

There is evidence that the industry is responding to these issues. For example:

- Elders Toepfer Grain (ETG) is introducing a national on-farm storage accreditation system. According to ETG the accreditation will ‘set common processes and standards for the storage of grain on-farm, which in turn will stimulate confidence and credibility among supply chain participants.’ (ETG 2009)
- CBH is introducing an on-farm quality assurance program, Better Farm IQ, as part of a wider quality assurance program to assure customers that Western Australian wheat meets food safety standards.

These examples indicate that management of on-farm storage will continue to evolve, as its use becomes more widespread.

*Bulk storage facilities have been replaced with more efficient facilities*

To improve operational efficiencies, bulk handling companies have reduced the number of storage facilities they have open at any point in time.

Prior to deregulation, storing and handling charges tended to be the same across all storage sites, meaning that more efficient sites cross-subsidised those sites that were less efficient. Bulk handlers have since moved towards site-based costing and closed down uneconomic sites.

Table 6.4 shows that, before the *Wheat Export Marketing Act 2008* (Cwlth) (WEMA) took effect, the number of up-country storage facilities in operation reduced by about one-third between 1998 and 2006.

**Table 6.4 Number of storage sites over time**

<i>State</i>	<i>Company</i>	<i>1998</i>	<i>2006</i>	<i>2010<sup>a</sup></i>	<i>2015 (potential)<sup>a</sup></i>
NSW	GrainCorp	265	145	173	43
	AWB	–	10	10	10
	ABA	–	3	4	3
Vic	GrainCorp	257	92	73	25
	AWB	–	4	4	4
	ABA	–	2	4	2
	Viterra	–	–	2	na
Qld	GrainCorp	87	42	36	10
	AWB	–	4	4	4
SA	ABB/Viterra	116	111	114	39
	AWB	–	4	4	4
WA	CBH	200	196	197	101
<b>Total</b>		<b>925</b>	<b>613</b>	<b>625</b>	<b>245</b>

<sup>a</sup> 2010 figures are not directly comparable with 2015 estimates. 2010 includes all sites (including port terminals), while 2015 estimates are only for high capacity sites (not smaller sites). For example, GrainCorp stated it has nearly 200 small sites it opens and closes during the year (GrainCorp 2010c). <sup>na</sup> There was no industry estimate in the report by SVGA (2007a).

Sources: SVGA (2007a, p. 9); GrainCorp (2010c); CBH (2010b); Viterra (2010b); ABA (2010b); AWB (2010).

However, closure of sites has mainly occurred in the eastern states, and mostly by GrainCorp. In Victoria and Queensland, GrainCorp steadily reduced the number of storage sites in operation since 1998. In contrast, GrainCorp expanded the number of facilities it had operating in New South Wales between 2006 and 2010.

Due to the high volatility of grain production and volatility in exports of wheat in the eastern states (chapters 2 and 3), bulk handlers typically close and re-open sites. Timothy Bush explained:

... in the event of a large harvest, either right across the state or in a particular district these sites [which are not currently in operation] are still owned by GrainCorp & can with minimal effort be opened for direct delivery or utilised as overflow storage. (sub. DR77, p. 5)

Therefore, the difference in GrainCorp storage facilities in New South Wales between 2006 and 2010 likely reflects that some sites were re-opened during that period.

In the long term, however, the industry prediction (from 2007) was that closure of bulk receival sites would continue for all bulk handling companies. That the rationalisation of facilities in operation to date has occurred mainly on the east coast suggests that competition and the economic pressures for efficiency (given volatility of production and exports) might be greater there than in South Australia and Western Australia.

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The cooperative structure of CBH might make the transition from network-based to site-based pricing more challenging and impede rationalisation in Western Australia (IPA 2008; GIWA, sub. 38). There might also be limited pressure for CBH to rationalise due to the lack of contestability in bulk storage in Western Australia, which might arise from Grain Express (section 6.3).

Although the total number of bulk storage facilities has generally declined, some sites have been upgraded and more modern facilities, capable of storing greater amounts of wheat, have also been built.

Bulk handling companies have upgraded facilities to generate their own efficiencies and to compete with other rival bulk storage providers. AWB and ABA currently operate 30 storage facilities (table 6.1), whereas previously they did not own any:

GrainCorp, the AWB(L) [AWB] and the ABA (Australian Bulk Alliance) have all invested in upgrading existing grain storage facilities and construction of new storage facilities — ‘super sites’ — with much of this investment driven by competitive and cost reduction strategies. (NSW Farmers Association 2009, p. 10)

The above analysis highlights an increasing trend towards on-farm storage and, that the rationalisation of large, bulk storage facilities is placing competitive pressure on the major incumbent bulk handling companies. The *New South Wales Grain Freight Review* stated:

Increased on-farm storage may well be the early stage of a long-term trend toward providing high quality storage outside of the centralised system — either on farm or in local storage provided by cooperatives or specialist companies. Some grain producers, particularly larger grain producing companies, are investing in substantial storage systems. (DITRDLG 2009b, p. 29)

Sites have also been built in strategic locations that take advantage of cheaper freight rates (discussed below).

## **Share of wheat transported by road has increased and rail decreased**

Rail dominates the transport task of delivering wheat to export terminals (section 6.1). Despite seasonal volatility in the share of grain transported by road or rail, most industry participants agreed that the share of grain transported by road has increased steadily over time. With respect to Western Australia, for example, Strategic Design and Development (SDD) stated:

Rail transports around 60% by volume and 80% by net-tonne-kilometres, but its share is falling, as road transport is being increasingly used in some areas. (SDD 2009b, p. 2)

Road use has increased for a number of reasons.

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The cost efficiency of road compared with rail has improved. Generally, road infrastructure has improved, the capacity of heavy vehicles has increased and heavy vehicles can access more transport routes than before. For example, in New South Wales:

Development of Road trains, B-double and B-triple trucks have lowered the cost of road transport for grain. Roads on which Road trains, B-double and B-triple trucks are permitted to operate now cover a significant part of NSW's grain producing areas. (NSW Farmers Association 2009, p. 14)

While the flexibility and efficiency of road freight has improved, the same cannot be said for rail. For example, AWB stated:

The standard of grain network rail lines in Australia is a problem for the grain industry. Multiple gauge lines, speed restricted lines, equipment class restricted lines and axle load restricted lines are prevalent and all have the impact of reducing the efficiency under which rail can operate across the network. (sub. 24, p. 16)

In addition, deregulation of the wheat market has changed the dynamics of the supply chain, tending to encourage the greater use of road transport:

- Diversified grain requirements have meant that smaller parcels of grain are more likely to be delivered to niche markets using trucks, as trucks are more efficient for moving smaller amounts of wheat.
- A large number of wheat exporters are competing to deliver wheat, which has increased the volatility of demand for wheat, and therefore services across the supply chain. During peak demand periods, trucks might be utilised in conjunction with rail to help meet this demand.
- Developments in up-country storage (rationalisation and a change in location of sites) require trucks to move wheat further distances than before.
- Changes from network-based pricing to site-based pricing have revealed inefficiencies of rail use on outer branch lines, shifting the transport task to road.

The effects of site-based pricing and deregulation on transport are explained in more detail next.

### *Pricing of rail freight has changed because of competitive pressures*

Rail networks consist of main rail lines, which typically run along major corridors. Main rail lines interconnect with smaller, outer branch lines. Sometimes main rail lines and outer branch lines have different gauge widths, requiring that cargo be transferred to a different train at interconnection points.

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Previously, rail freight costs were set at the same rate across the network. However, the cost of provision of rail lines can vary dramatically. For example, an outer branch line with low volume is likely to be more costly to run than a main rail line running the same distance with larger volumes of grain.

With privatisation of rail networks and the deregulation of wheat export marketing, traders and growers can now move their grain using alternative supply chains. These competitive pressures have led to more cost-reflective freight rates being set:

In the pre-privatisation era, freight pricing on these lines [mainline and branchline] did not attempt to reflect the differential in true operating cost between the two line types. Increasingly, as pricing has moved more to a site-specific operating cost basis under more competitive conditions, the differences between mainline and branchline train loading have been reflected more in price. Consequently, freight prices now reflected in grain purchase prices at BHC [bulk handling company] sites on branchlines are now often considerably higher than those on nearby mainlines. Where previously there was a \$5/tonne differential, this might now be \$11/tonne or greater. Previous pricing regimes were influenced by the BHC's interest in maintaining the viability of outlying sites, on behalf of their grower constituencies. Private rail operators have no such concerns and have little interest in maintaining services to poor quality lines. (SDD 2009a, p. 16)

Using Western Australia as an example, SDD highlighted that because some sites now have much higher rail freight rates, there has been a substitution towards road:

Deregulation of grain handling and marketing, has profoundly affected the economics and operation of the grain network. There is competition to transport grain from bins to ports. Due to this competition the traditional grain receiver, CBH, cannot offer a single network-wide price for grain transport, so there is a cost-based price for every bin, exposing some to road transport competition. (SDD 2009b, p. 3)

The upshot of intermodal competition is that bulk handlers and growers will use road and rail to varying degrees, to move wheat in the most cost-effective manner.

### *The impact of transport price changes on growers*

For some growers based in remote areas near outer branch lines, the cost of delivering wheat to ports using rail lines from local sites will be higher than before. This was noted by Ralph Billing, a wheat grower in New South Wales:

Rail freight rates to Port Kembla from our main delivery sites of Junelee (GrainCorp Sub terminal) and Coolamon-Marrar (Australian Bulk Alliance) – both about 30km from Rosemere – have increased from \$22.26/t and \$23.84/t in 07-08 to \$38.75 and \$41.50 in 09-10 respectively. This is a 74% increase over 2 seasons! Over the same period the local silo price of our wheat has declined by 51% (\$388/t to \$190/t). (sub. 30, p. 2)

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At an individual level, an unfortunate consequence of the move to site based pricing is that some transport routes, which might have previously benefited from cross subsidisation, will now have higher freight charges. Offsetting this, however, is that other growers might now benefit from having lower transport costs as they no longer subsidise other routes.

In the long term, growers that are adversely affected by higher rail freight rates at local sites are likely to respond by using alternative transport options.

In coastal areas, growers and traders might use trucks to deliver grain direct to port terminals, located in close proximity. To move grain from more distant locations, trucks can still be used, albeit in a different way from which they were previously used. For example, growers near outer branch lines (who might have experienced higher rail freight rates on those lines) can use trucks to move grain further distances to sites located on major rail lines, rather than to their local sites. SDD stated:

Grain traders' pricing practices in 2008-09 now reflect the fact that rail services on many branchlines are less efficient than road services, and growers now have the incentive to deliver their grain direct to customers by road, or to silos located on more central rail corridors. (SDD 2009a, p. 5)

Based on price differentials, some growers can generate cost savings of \$11 per tonne or more from delivering to a mainline site rather than a local silo (SDD 2009a).

Consolidating grain to travel by major rail corridors means that larger cargoes can be assembled on those lines, therefore increasing the commercial viability of rail wagons (and lowering the costs to users).

Importantly, the effects of deregulation on rail and road transport (changes to the location of storage sites, freight pricing and volatility in demand to move grain), has facilitated the development of alternative, more efficient, transport solutions, particularly on the east coast (there is less competition in storage and transport in Western Australia, as explained below). Although this has made the transport task more expensive for some, it has made it cheaper for others, and the industry as a whole is likely to have benefited from increased competition.

## **Changes in transport and storage are occurring at the same time**

Changes at one point in the supply chain often affect other parts of the supply chain. In addition, growers, traders and bulk handling companies are all simultaneously changing the way they operate.

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Growers face a more complex task for marketing their wheat. They must decide how to store wheat (on farm, in private storage or in the bulk handling system), when and where to deliver (to a local site or further away), while bearing in mind to whom they should sell, and at what time.

Bulk handling companies are coordinating how different parts of their supply chain are developed to minimise costs of transport and storage. For example, ‘super sites’ that have been built can store grain at lower cost, but they are also located at places that minimise transport costs.

In its submission to the *New South Wales Grain Freight Review*, the NSW Farmers Association gave the following example of how modern facilities, with faster rail outloading times and efficient intake from trucks have been built:

Investment in storage facilities includes construction of rapid rail outloading capability which attracts rail freight discounts. Fourteen super sites have been established by the bulk handling companies to accumulate grain at locations where it is economic to transfer it efficiently and quickly from trucks (generally high capacity Road trains or B-doubles) to high capacity trains for direct haulage to ports. (NSW Farmers Association 2009, p. 10)

Behavioural changes of growers and supply chain operators are driving efficiencies throughout the chain:

Increased supply chain competition and integration have reduced transport and storage costs, benefiting grain producers. Growers have taken opportunities to reduce costs by choosing to deliver grain to least cost receival facilities, and grain storage and handling companies have obtained lower prices for rail transport by consolidating loading to gain from economies of scale. (NSW Farmers Association 2009, p. 11)

Increased competition, or contestability, can increase the efficiency of the supply chain. As explained in chapter 3, the world export price typically determines the price for Australian wheat. For growers, overall returns reflect the price paid for Australian wheat less the costs of supplying it (for export at ports or domestic markets). Therefore, lowering supply chain costs will increase the share of overall returns that growers receive.

FINDING 6.1

*Greater competition can improve the efficiency of the grain supply chain. These efficiency improvements lower the costs of the supply chain, providing benefits to the industry, and particularly to growers.*

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## 6.3 Access and competition in the supply chain

The Commission was asked to examine the effectiveness and level of competition in the supply chain.

Access arrangements and competition issues surrounding one part of the supply chain — port terminals — were discussed separately in chapter 5. In this section, the level of competition and access arrangements are first considered separately for up-country storage facilities and transport.

In section 6.2, it was highlighted that export terminal operators now provide a more integrated supply chain and have entered into the marketing and trading of wheat. As a result, the conditions regarding access to their entire supply chains might also need to be considered (and not just port terminals).

This is explained by the Victorian Essential Services Commission (ESC):

... grain handlers now provide a more vertically integrated supply chain service, including up-country receipt and storage, and transportation via long-term rail contracts with dedicated trains serving their export terminals. ... Hence, it is increasingly the case that it is the integrated supply chain services that may be substitutable, rather than the services offered by export terminals. (ESC 2009, p. 50)

Therefore, this section concludes by examining competition and access arrangements for the integrated supply chains of the three bulk handling companies that service the east coast, South Australia and Western Australia. A particular issue in this regard is the use of Grain Express in Western Australia, and is discussed at the end of this section.

### Competition and access to up-country storage facilities

As noted in chapter 5, one reason for having an access arrangement is if a facility is uneconomic to duplicate. The recent increase in on-farm storage (particularly on the east coast) and development of large scale up-country facilities by non-bulk handlers (section 6.2) suggests that storage can be duplicated. Therefore, it is unlikely that up-country receipt sites have natural monopoly characteristics. A similar sentiment was expressed by the Allen Consulting Group (ACG):

While some scale of economies exist in up-country grain receipt sites, it is unlikely that these facilities would meet the principles for access regulation. In particular, it is unlikely that it would be found that such infrastructure represented natural monopoly 'bottle-neck' facilities that were uneconomic to replicate. The emergence of AWB subsidiary AWB Grainflow as a significant provider of storage and handling services in New South Wales and Victoria supports such a conclusion. (ACG 2008a, p. 45)

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Although, as stated above, there is less competition in Western Australia.

The explanatory memorandum for the Wheat Export Marketing Bill 2008 also expressed the view that up-country facilities should not be subject to access regimes:

Up-country facilities do not display natural monopoly characteristics as they have low barriers to entry and there are already a number of competitors in the industry who provide up-country storage services. Nor do they meet the criteria outlined in the *Competition Principles Agreement 1995* for the application of access regimes. (Burke 2008b, p. 13)

As noted above, on-farm storage can sometimes be used as an alternative to the bulk handling system, for example for wheat sold in the domestic market. Being able to sell wheat in the domestic and export markets ensures that, at the margin, growers can substitute between them.

There is no evidence that bulk handlers systematically refuse growers and traders access to their storage sites. The Western Australian Farmers Federation stated that the terms offered to growers regarding storage of grain in Western Australia, and terms and conditions for third parties to purchase that grain, are the same for all traders:

WAFarmers totally rejects any move to impose unnecessary and costly access regimes to upcountry facilities due to the fact that all exporters have equal opportunity to access CBH's upcountry facilities by way of purchasing growers stored grain and/or accessing equal freight arrangements through Grain Express. (sub. 29, p. 3)

Bulk handling companies also emphasised that, because of the large capital costs to set up their facilities, it is in their interests to maximise throughput. For example:

The GrainCorp storage and handling business depends on high volume throughput and therefore has the incentive to attract and retain as much throughput as possible. (GrainCorp, sub. 43, p. 30)

### *Should access to up-country storage facilities be regulated?*

There is no evidence that up-country storage is uneconomic to duplicate or that bulk handling companies have restricted access to allow storage of grain at their up-country facilities. Therefore, there is not a strong case for regulating up-country storage facilities beyond the application of the generic competition law.

Specific regulation would impose many costs. Given the number of up-country storage facilities, these costs would be substantial. Costs of regulation include compliance costs on businesses, costs borne by the regulatory body and risks associated with regulatory error (for example, setting an inappropriate access price).

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Importantly, regulating access can stifle new investment in alternative supply chain options and inhibit the sort of improvements to existing facilities that have occurred since deregulation, which have improved efficiency in the supply chain.

In any case, it would be very difficult to regulate access to up-country storage facilities in practice, if regulations only applied to the wheat export market. Unlike port terminals, which are used exclusively for the export market, up-country storage facilities may be used to store a variety of grain that is sold for both the export and domestic markets. (Domestic wheat marketing is not regulated under the WEMA.) Facilities are also used for other grains — which are not subject to access regulation.

In conclusion, the industry as a whole would not benefit from having access to up-country storage facilities regulated.

#### FINDING 6.2

*Up-country storage facilities do not exhibit natural monopoly characteristics. There is no case for specific third party access regulation. Specific access regulation is likely to hinder the development of efficient supply chains.*

### **Competition and access to road and rail transport**

For wheat stored at up-country storage sites, the availability of trucks provides intermodal competition in transport. However, within each transport mode (road and rail), the degree of competition can vary greatly. ACG stated:

While road haulage is often a very competitive industry, within each State rail transportation services for grain tend to be provided by a single monopoly firm. In some States, a dedicated haulage services provider provides grain haulage services, while in others the same firm may also be the owner of the rail track infrastructure. (ACG 2008a, p. 6)

Rail infrastructure is likely to be uneconomic to duplicate. Recognising the need to promote above-rail competition, third party access regimes for rail infrastructure services were introduced as part of the National Competition Policy reform process (under the National Access Regime), and most states also have their own access regimes for rail infrastructure (PC 2006b). If a state-based regime is certified by the designated federal Minister, access seekers lose the ability to seek access under the National Access Regime.

Under these regimes, a private service operator of trains (above-rail infrastructure) can seek access to below-rail infrastructure, under the prices set for the corresponding access regime.

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Competition in the provision of rail services for grain in Australia varies across regions.

Multiple rail providers exist in New South Wales and Victoria. For example, AWB has contracts in place with El Zorro, and GrainCorp with Asciano to utilise rolling stock.

In Western Australia, CBH stated:

CBH is currently in the process of running a tender for the above rail services with the aim to develop a long term competitive grain supply chain. This is the first time this work has been tendered in the history of the grain business. (sub. DR75, p. 10)

Having various rail operators contesting for the rail services in Western Australia might help to provide effective competition.

The South Australian Farmers Federation (SAFF) argued that access to rail infrastructure in South Australia is problematic:

Recently SAFF Grains were given details of how Genesee & Wyoming Australia Pty Ltd, who have a five-year agreement with Viterra have put unreasonable controls on their rail-lines in South Australia and are charging exorbitant fees. They run trains and control truck access. On their line from Dry Creek to Port Adelaide they require an additional pilot – while only a distance of 10 km, the charge for the pilot is \$2.00 per mt. It has been calculated that for one train carrying 2200 tonnes over 145 km of track, that Genesee & Wyoming Australia would charge \$59 400 compared with VLine \$6224, Australia Rail Track Corporation \$2482 and NSW Rail \$2317. This pricing structure virtually precludes any other company but Viterra from using rail in South Australia easily and cost effectively. There is also an additional rail weighing fee of \$2.75 a tonne (2 to 5 cents would be reasonable). (sub. DR64, p. 2)

In the draft report the Commission made some recommendations regarding the need for access regulation and the vertical separation of rail networks. The Commission has examined these issues extensively in previous reports, most notably in its 2006 inquiry report *Road and Rail Freight Infrastructure Pricing* (PC 2006b). The Commission recommended that governments consider the vertical integration of some grain rail lines, where the benefits outweigh the costs.

Some participants agreed with this recommendation, whereas others did not. The Australian Rail, Tram and Bus Industry Union (RTBU) (sub. DR59) disagreed with calls for vertical integration, noting that the *New South Wales Grain Freight Review* had also questioned the viability of vertical integration, for the following reasons:

- multiple users of many sections of the grain rail network make aligning interests through privatisation problematic – and may raise concerns that control of the infrastructure stifles the development of competing supply chains

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- previous experience with the vertical integration/privatisation of rail infrastructure in Australia and New Zealand has not been encouraging
  - the Task Force discussions revealed substantial doubt as to whether any market participants would have an appetite for acquiring the rail track. (DITRDLG 2009b, p. 49)

Similarly, Asciano stated:

Vertical integration of track and rail operations, for the reasons which led to operations being on a “take or pay” basis, does not transfer the risks for ineffective use of rail maintenance expenditure, since network usage is determined in large part by the grain storage and handling organisations, and not by rail operators. (sub. DR97, p. 4)

The Commission is of the view that there might be some instances where vertical integration is appropriate, but it will depend on many factors, likely to vary across regions.

In each case, governments should consider the benefits and costs of vertical separation. Benefits of separation include the ‘promotion of above-rail competition, encouragement of market diversity and reduced scope for abuse of market power’ (PC 2006b, p. 308). Costs include loss of economies of scope, increased transaction, coordination and information costs, potential complications in pricing efficiently, and potential loss of commercial sustainability (PC 2006b).

In consultations with participants it was highlighted that, in response to the large variability of grain production, rail operators have tended to enter into commercial agreements with grain operators regarding funding, or in some cases ownership of rolling stock. Such deals would make vertical integration problematic.

## **Competition and access throughout the supply chain**

As mentioned in section 6.2, bulk handling companies now provide an integrated supply chain service. Some participants were of the view that regulation should occur at various points (or perhaps all points) of the supply chain, because bulk handling companies could make the conditions to use one of their services so restrictive that it forces participants to use bulk handling companies’ entire, integrated services.

The ESC explained:

... the greater degree of vertical integration of grain handlers from upcountry storage through contracted train services to port may mean that the scope to undertake such differential pricing, or to restrict access, may reside at more than one point on the supply chain — in which case [port] terminal access arrangements may not be fully effective. (ESC 2009, p. 54)

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For example, bulk handling companies might charge higher handling rates at port terminals for users who do not store their wheat at bulk handling companies' up-country storage facilities. Or, they might charge the same rate for all users at port terminals, but set this rate high enough so that they can cross-subsidise their up-country storage facilities. If these port access charges cannot be justified, it not only makes it difficult for growers to use alternative storage systems, but also limits the potential for alternative supply chains — which might use a more direct and efficient transport system — to develop.

Competition to bulk handling companies' integrated supply chains varies across regions. Some participants were concerned that 'regional monopolies' might develop, where one dominant bulk handler has a significant market share for an integrated supply chain (up country to port terminals) in Western Australia, South Australia and the east coast.

On the east coast, ABA and AWB provide alternative supply chains to GrainCorp to deliver wheat from up country to ports.

There is less contestability in South Australia. SAFF highlighted some issues regarding the level of competition in supply chain services in South Australia:

There is very little up-country competition and this is unlikely to change when any company considering building further up-country facilities knows that eventually they will still need to use Viterra's ports, with its control of the shipping stem as well as control of the majority of road and rail logistics in South Australia. (sub. DR64, p. 1)

Such issues could be even more relevant for Western Australia, because that is the only state with no up-country facilities provided in competition with the dominant bulk handling company, CBH (section 6.1). Furthermore, warehousing grain at CBH facilities is contingent on using CBH's transport supply chain (Grain Express). Issues regarding the use of Grain Express are discussed separately below.

Notwithstanding regional differences, overall there is increasing contestability in both transport and storage and handling, allowing growers or traders to deliver wheat to ports using their own transport and storage options. There are no regulatory impediments stopping users from by-passing the up-country supply chains of bulk handlers to deliver grain direct to port (except perhaps in Western Australia because of Grain Express), and the Commission considers that any further regulation is not necessary.

Therefore, provided that wheat delivered to port terminals outside of the bulk handling system is not discriminated against (this requires appropriate port access charges), there will be no impediments to growers and traders using their own supply chains to export wheat.

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At the moment, port terminals do not face strong competition. However, the current and future provisions regarding access at ports (chapter 5) should ensure that participants can gain access to ports or use alternative supply chains to deliver wheat to port. Therefore, provisions regarding access to ports — provided there is competition in other parts of the supply chain — should ensure contestable by-pass throughout the entire grain supply chain.

FINDING 6.3

*Competition in the grain supply chain requires that participants have the ability to by-pass the bulk handling system.*

Regulating access to various parts of the supply chain could also increase the risk of ‘locking in’ existing supply chains. One participant stated:

Alternative supply chains such as on-farm storage and alternative port loading facilities (other than wheat ship loaders) already exist. If market forces are left to prevail these alternative systems will grow if the existing supply chain is uncompetitive over time. Inhibiting these natural supply and demand forces through rules will restrict the industry in moving on in the future. (C & J Michael, sub. 11, p. 2)

Stifling supply and demand signals through regulation would be detrimental to the current evolution of supply chains. For example, the recent consolidation of up-country receival sites could not have occurred if third party access regulation to these sites was imposed on the bulk handlers.

### **Competition concerns under the Grain Express arrangements**

In Western Australia, CBH operates all of the up-country bulk handling facilities. Anyone who stores wheat at these up-country storage facilities is required to use CBH’s transport supply chain — known as ‘Grain Express’ (GE) (box 6.1).

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### Box 6.1      **CBH's exclusive dealing notification to use Grain Express**

Exclusive dealing conduct involves, broadly, 'a trader imposing restrictions on another person's freedom to choose with whom, in what or where it deals' (ACCC 2008b, p. 1). The Trade Practices Act prohibits outright some exclusive dealing conduct (third line forcing). In other cases it is only prohibited if it substantially lessens competition.

Parties may obtain immunity from exclusive dealing (other than third line forcing) by lodging a notification with the Australian Competition and Consumer Commission (ACCC). On 11 June 2008, CBH lodged a notification to use Grain Express (GE). 'In essence, the notified conduct means that while grain is in CBH's custody, its movement will be arranged and coordinated by CBH' (ACCC, sub. DR95, p. 7).

The ACCC can revoke an exclusive dealing notification if:

it is satisfied that the conduct has the purpose, effect or likely effect of substantially lessening competition and the likely benefit to the public will not outweigh the detriment to the public from the lessening of competition. (ACCC 2008b, p. i)

On 8 September 2008, the ACCC decided not to revoke the GE notification. It was not satisfied that GE substantially lessened competition because:

- Grain Express did not appear to foreclose potential competitors to CBH from entering the market for grain receipt, storage and handling
- growers and traders of grain are free to make their own arrangements for the transportation of grain from the farm gate to end user point (including direct to port), or from a "destination site" to end user point
- Grain Express may stimulate competition in the market for the CBH transport contracts by providing greater certainty in respect of transport volumes. Acquirers and marketers of grain will continue to be able to take advantage of niche marketing opportunities
- CBH's amended "Ring Fencing Policy" provides an adequate framework to limit the potential for information obtained by CBH to be transferred to and used anti-competitively by CBH's trading subsidiaries.

The ACCC also considered the central coordination of grain storage, handling and transportation under the Grain Express system was likely to provide significant efficiency benefits. (ACCC, sub. DR95, p. 7)

The ACCC can review and revoke the immunity afforded by a notification at any time. Triggers for a review include 'complaints from persons affected by the exclusive dealing conduct, a change in market conditions or further information coming to light' (ACCC 2007, p. 7).

The ACCC was concerned with the operation of GE in its first year (in particular, congestion problems which might have contributed to shipping delays at ports). CBH claimed that the performance of GE was impacted upon by a range of factors, including the timing and size of the harvest and teething problems in the first year of deregulation. With the completion of a second season, and in light of ongoing concerns regarding GE, the ACCC has stated it is now timely to commence a review of CBH's GE notification.

Sources: ACCC (2007, 2008b); sub. DR95.

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*Grain Express aims to increase efficiency through a more coordinated supply chain*

A report prepared for CBH by Synergies Economic Consulting (SEC 2008), explained the benefits from having CBH operate the Western Australian supply chain through GE. SEC stated ‘Arguably the greatest gain from Grain Express is the benefits it will bring in the utilisation of rail resources’ (SEC 2008, p. 35).

To elaborate further:

The lack of incentive alignment between the participants of a logistics chain creates an environment in which none of the supply chain participants is able to operate in a manner that fully exploits the opportunities presented by network benefits. ... The fragmentation that is inevitable in a decentralised supply chain with multiple marketers will compromise the efficiency of rail operations.

This is because individual marketers will not have the volume to support unit train operation. This in turn may result in a substantial modal leakage of freight from rail to (the less efficient) road system. (SEC 2008, p. 19)

The report also stated that GE is best placed to ensure the future viability of rail lines.

However, since that time, GE appears to have responded by using road where it is more cost-effective and to help with peak loads. The Department of Agriculture and Food (Western Australia) stated in its submission:

Deregulation has clearly had an impact on the grain rail network in WA. This year CBH has announced that it is moving from a Network Pricing system, that has allowed for cross-subsidisation of uneconomic lines to keep the majority of grain on rail, to a Site Cost based pricing system. This will see grain transported by road where rail costs are not competitive. (sub. 34, p. 5)

Nevertheless, given that possibly the greatest benefit of GE cited by SEC (2008) was that it would reduce the leakage of rail freight to road, it would appear that the importance of having GE coordinate the (rail) logistics task might have lessened.

In response to the draft report, CBH stated that it aims to use the most cost-effective transport solution, which is not always rail. CBH emphasised that road usage was higher last year as trucks were required to help meet peak demands, but that rail usage has risen again this year:

Grain Express allows aggregation of volumes that makes rail possible, but it is not a blank cheque for rail transporters to charge whatever they see fit. Whilst the proportion of grain transported by rail during the 2008-09 season may have declined, 2009-10 has seen an increase in the percentage of rail use to port year to date [from 55 per cent in 2008-09 to 64 per cent in 2009-10]. (sub. DR75, p. 12)

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CBH also reiterated that it is best placed to negotiate better freight rates than smaller operators competing against each other, because it can guarantee volume of supply:

Further, the scale of Grain Express, allows CBH to provide road and rail service providers with the volume necessary to invest in efficient plant and equipment required to serve the grain industry supply chain under appropriate commercial terms that allow a balancing of commercial risk in years of poor grain production. (sub. DR75, p. 11)

Essentially, CBH claims that it can use its dominant market position to obtain the cheapest freight rates in Western Australia, because strong intermodal competition exists.

*Grain Express might impede efficiency improvements in the supply chain*

By providing a more bundled service (transport and storage), there is less transparency in the pricing of different services. Some participants considered that GE might impede the efficient rationalisation of storage sites and transport. Furthermore, by bundling the transport and storage services together, there might be an element of cross-subsidisation.

This can lead to inefficiencies across the whole supply chain, as AWB noted:

Generally BHCs have failed to provide transparency in the pricing of services (greater bundling is occurring in WA, but also in SA) and this leads to the risk of inefficient storage facilities being maintained. ... The subsequent impact of this price distortion affects rail infrastructure: subsidised storage attracts greater grain deliveries than should otherwise occur and this historically has required rail providers to service these inefficient sites but on equipment (lines) that have not been maintained, reducing the returns to rail providers and ultimately leading to more expensive rail costs across the whole network. (sub. 24, p. 19)

The Institute of Public Affairs (IPA) argued against GE prior to its commencement. The IPA believed that cross-subsidisation of storage sites was likely to occur, because GE would enable the continuation of flat structured storage fees:

A consequence of flat receivals pricing will be the continuation of smaller, otherwise uneconomic sites thereby placing an additional cost burden on the entire system. Additionally, while the very small or outmoded receivals sites continue via cross subsidies, this hinders the possibility of either rationalisation by CBH, or the entry of new storage and receivals operators. (IPA 2008, p. 20)

CBH has recently moved away from flat pricing of storage and handling across its network. 'CBH's charges vary according to the status of the site that the grower delivers to and commodity and freight varies according to location' (CBH, sub. DR75, p. 13).

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For example, there is now a small differential between storage prices of wheat held at sites classified as being either tier 1 sites (\$10.00) or tier 2 sites (\$11.05).

Similarly, CBH claimed it is moving away from subsidising inefficient freight routes (in line with developments in the transport sector mentioned in section 6.2):

Freight rates in 2009-10 are based on the cheapest mode to port and so have less cross-subsidisation than ever before. Since assuming control of freight of bulk wheat from AWB in 2008 CBH has moved comprehensively to provide growers with transparency on freight costs from its sites in Western Australia. CBH will continue the process of removing freight cross subsidisation in 2010-11.

CBH does not consider that cross subsidisation always makes it difficult for rivals to compete and notes that the opposite is usually the case. CBH is actively moving away from network pricing arrangements in freight because CBH recognises that it is open to competition at any point in its network. If efficient sites are cross-subsidising freight for uneconomic ones; it makes it easier for competition to compete against the efficient freight lines. (sub. DR75, p. 13)

Thus, it does appear that competitive pressures are making the way CBH prices its storage and transport services more transparent (and perhaps more efficient).

Nevertheless, even if CBH can drive efficiencies in transport, it might be transporting grain through an inefficient network of storage sites. That is, GE might minimise the costs of operating an inefficient supply chain.

### *Efficiency of the supply chain and contestability to Grain Express*

The key to driving efficiency in GE (and supply chains in other states) is to ensure that there is competition in the supply chain (finding 6.1) and competition requires the contestable by-pass of supply chains (finding 6.2).

Provided that GE does not impede the potential for rivals to operate supply chains in competition with GE then, if GE fails to minimise costs to growers and traders, alternative supply chains should evolve. Alternatively, the threat of entry by rivals could force CBH to adopt more efficient operations.

In the long term, if contestability exists, there should be pressure for CBH to enhance its supply chain efficiency, for example, by closing inefficient storage sites and adjusting the mix of rail and road transport.

In making its ruling regarding the exclusive dealing of CBH to use GE, the Australian Competition and Consumer Commission (ACCC) concluded that there was sufficient contestability for rivals to use their own logistics chain (box 6.1). Since GE commenced, however, there have been some market developments (discussed below) which might have affected the ability to by-pass GE, and no

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exporters have used direct to port access. In the draft report, the Commission asked participants for their views on using GE, with regards to its efficiency and particularly whether there were impediments to by-passing it.

### *Participants' experiences and views on Grain Express*

CBH stated that there has been limited interest in direct to port access because GE is adequately meeting the needs of the market:

To date CBH has had an extremely limited interest in Direct to Port access (ie access to CBH port terminals through an alternative supply chain). CBH contends that this is because the basic CBH service is addressing the market needs as there is no discrimination between grain delivered from the CBH supply chain versus that from an alternate supply chain. (sub. DR75, p. 9)

In response, Glencore Grain stated that it was locked in to using GE, and that GE was inefficient in transporting grain to port. With regard specifically to CBH's claim above — that GE meets market needs — it stated:

However the plain facts are:

- Traders have to use Grain Express at present. Direct to Port cannot be chosen at the only time allowed for choice, which is within 5 days of buying a [shipping] slot [at auction].
- In the last season we incurred demurrage and surge costs exceeding \$2.3m and this season \$300 000 demurrage costs because Grain Express transport in both seasons has been slow.

It is submitted that CBH's statement is unfounded and cannot be relied on. (sub. DR89, p. 18)

Similarly, the Australian Grain Exporters Association (AGEA) stated:

AGEA believes that Grain Express is anticompetitive and restricts the ability of any party to build any competing infrastructure or transport capability as well as reducing competition in rail and road freight.

Exporters are essentially forced to use Grain Express as the auction rules require exporters to nominate within five days whether or not they are using Grain Express or direct access; and the flat fee charging structure impedes direct access. (sub. DR79, p. 3)

CBH has since announced that it will revise its auction system, which might give traders more choice when nominating their transport.

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Chris Brooks, from Glencore Grain, also said that Glencore Grain had its own trucks available to transport grain, but said that it was refused this under GE:

... we run fleets of our trucks, have done for years. In the massive delay in early 2009 when there was all the problems and all this demurrage [we incurred around] \$2 million [in demurrage in] the first year of Grain Express, we had ships sitting in the port, we had grain that we'd bought up-country and we offered to send a fleet of 50 to a hundred trucks over there to cart our grain to those ports. It was rejected, refused, not allowed, not possible under Grain Express. So we weren't able to move it ourselves but then under this Grain Express monopoly, they turned around and charged us approximately \$5 a tonne extra, over and above the normal freight rate, for a surge charge, because they say in their own submission that the surge capacity was not a restriction of capacity at the ports, it was a restriction of the logistics, which they have a monopoly to deal with and no-one else can get involved which is just unreasonable. (trans., pp. 533–34)

Many traders have withdrawn their support for GE since it commenced, claiming that CBH has not been accountable for service outcomes. ETG stated:

The key driver in supporting this model [Grain Express] from an ETG perspective, was around the concept of shared risk. ETG gave up its right to provide freight alternatives on the basis that CBH could better coordinate and by definition, provide a best cost service with limited risk of execution failure. CBH would therefore take this execution risk ie getting product to the port. Risk was shared.

This has not occurred. ETG are now essentially wearing the risk of non execution through concepts such as core capacities and 'the surge'. Grain Express has become monopolistic with little capacity for its performance to be benchmarked by competition. Companies such as ETG do not have the option to create alternative transport options, which minimizes the use of direct port access and potentially pushes companies to pay surge fees around a non visible base.

ETG no longer support Grain Express in its current state. (sub. DR94, p. 5)

AWB highlighted that the differential pricing for wheat delivered direct to port terminals, rather than through CBH's logistics chain, makes by-pass difficult:

AWB believes that there are elements of the Grain Express system in WA that have created anticompetitive constraints to accessing and utilising CBH's up-country facilities. Under the terms of the 'direct access' alternative path created by CBH, exporters are charged more than Grain Express to reenter CBH's port terminal facilities for Fobbing access. (sub. DR63, p. 12)

In addition to traders' concerns, some growers also raised problems with GE. Kim Halbert stated that GE restricts alternative supply chains from occurring:

People wishing to use their own supply chain or on farm storage are penalised with substantial charges at the point of delivery. This makes gaining a suitable return on investment in alternate storage and supply chain systems difficult. Grain Express has the effect of hand-cuffing growers and traders to the CBH system. (sub. DR88, p. 4)

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Similarly, Leon Bradley of the Pastoralists and Graziers Association of Western Australia said:

In principle it [Grain Express] sounded good when it was introduced but I think what CBH have done is used it to extend their monopoly up country. While they have structured their charges the way they have nobody is going to build storage because they're going to get full ticket anyway, because they're charging \$17 fobbing or \$17.10, whatever it is. I don't think it's an accident they have rearranged their pricing structure. (trans., p. 418)

Some participants provided strong support for GE:

Prior to Grains Express being implemented I was given a presentation and felt that (then as much as now) that Grains Express was essential to growers achieving maximum return with little or no cost to anyone else. (J & M Hassell, sub. 13, p. 2)

Similarly, The Western Australian Farmers Federation stated:

CBH's innovative Grain Express logistics system brought operational efficiencies and lowered the barriers to entry for acquirers in the WA market. It should be acknowledged that Grain Express provided growers with an unprecedented choice of marketers across the wheatbelt in 2008. Through its regular meetings with CBH, WAFarmers is confident that CBH's on-going improvements to the Grain Express system will ensure that the system provides ongoing benefits to growers and marketers. (sub. DR92, p. 6)

Overall, it appears that some growers and most traders no longer support GE (even though many provided initial support). Particular issues with GE identified by participants above are that:

- conditions governing the use of CBH's network (storage and/or port access) potentially have the effect of 'locking in' the use of GE. These include:
  - the shipping allocation system, which required traders to nominate how grain would be transported well before traders had acquired that grain
  - prices charged for going outside of CBH's supply chain to ports, which might be prohibitively expensive for users to by-pass GE
- CBH did not deliver expected efficiency benefits, and that it did not share the risk for non-performance (for example, demurrage and other costs incurred from not delivering grain on schedule).

The ACCC has also announced that it will review the GE notification, in light of market developments and growers continued concerns that have been expressed to the ACCC and to the Productivity Commission via its public consultation process.

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### *The Commission's view*

As mentioned above, the ability to by-pass GE will ensure that the efficiency of the supply chain in Western Australia is maximised.

The Commission is aware of industry speculation regarding the future development of alternative supply chains. For example, a recent news article in *Farm Weekly* reported that at least one company is believed to be organising its own supply chain.

Industry speculation also is suggesting Elders Toepfer Grain is close to announcing a grain handling initiative, that could assist the grower groups with their plans to by-pass the CBH system.

This will seriously impact on CBH's ability to sustain 8.2 million tonnes of grain receipts to maintain its fixed costs structures. (Bettles 2010, p. 3)

Alternative supply chains inevitably will take some time to develop. Any credible threats to entry (and not necessarily entry itself) will drive efficiency improvements by CBH.

The Commission also notes that CBH has addressed some of the shortcomings of GE in its first year of operation. Through continued consultation with industry participants, CBH might continue to adapt the way it operates GE (which should help improve its efficiency).

In weighing up the arguments for and against the use of GE, it is the Commission's view that GE could make it more difficult, in practice, for alternative supply chains to develop or provide a credible threat to entry. There remain widespread concerns by participants, and no grain has yet been transported directly to port by other traders.

Furthermore, in other states, and in other areas of the supply chain, the industry has undergone structural change. In the short term, these changes created challenges for growers, traders and transport and storage providers to adjust, but in the long term these changes should bring about a more efficient supply chain. Thus, delaying or hindering the evolution of alternative supply chains in Western Australia might slow down the types of efficiencies already occurring elsewhere.

Therefore, the Commission endorses the decision made by the ACCC to review the GE notification. The Commission recommends that the ACCC's decision be made as soon as practicable, to ensure that all industry participants (and particularly CBH and other potential storage and transport providers) have certainty. Infrastructure decisions, particularly transport, are made on long-term horizons (section 6.4) and industry players would benefit from having a stable regulatory framework.

*The ACCC has announced that it will review the exclusive dealing notification granted to CBH, regarding the use of Grain Express. In light of market developments and concerns over the contestability of CBH's supply chain, the Commission endorses the decision by the ACCC to review Grain Express. The Commission recommends that the ACCC makes its determination as soon as practicable.*

## 6.4 Transport infrastructure

As section 6.2 showed, there has been a recent trend towards greater road use, which might continue in the future. Local roads (which might not be developed for trucks) are likely to be used more because some outer branch rail lines that have become unviable have closed, and more lines might become unviable in the future.

Some participants stated that rail infrastructure problems and the availability of rail have affected its use. For example, in reference to the Western Australian rail network, WA & LA Newman (sub. 17, p. 3) stated 'Rail is definitely a problem due to its run down state since being privatised by the WA Government'. Commenting on the rail network in Queensland, AgForce stated that 'The availability of rail is a huge problem as most of the network has not been maintained to a satisfactory level' (sub. 16, p. 10).

Some participants stated that rail is better equipped to transport wheat than roads because it can move wheat faster, has less impact on local amenity and is more environmentally friendly than using trucks. For example, Ralph Billing said the bulk rail system 'has traditionally been and should still be the most efficient and environmentally friendly way to transport bulk grain to the ports' (sub. 30, p. 2).

The Western Australian Farmers Federation stated:

It is WAFarmers belief that as much grain as possible be kept on rail for environmental, long term economic and social gains as the rural road system would never be able to cope with the closure of rail lines. (sub. 29, p. 12)

Similarly, the NSW Farmers Association stated:

The Association continues to support the use of rail as the most economically, socially and environmentally friendly means of transporting grain. Rail freight produces less than a third of the emissions of road freight, reduces wear on underfunded rural roads and reduces risk to health and safety on these roads. As such the Association actively endorses investment in rail infrastructure. (sub. 49, p. 12)

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Two issues arise with regard to recent trends in the use of road and rail use — the capability of the transport system to handle large volumes of wheat being moved quickly (including the ability of roads to help meet that task) and what investment might be needed in the future.

### **Efficient use of road and rail to handle peak demands**

The task of getting grain from farm to port will always require a combination of road and rail transport. Although rail might deliver grain to ports faster than roads, this does not mean that an increase in rolling stock capacity is the only way to address peak demands, nor is it always the most economically efficient way.

Investment in rail infrastructure (both track and trains) is usually made on a long-term basis, given the substantial costs involved. Returns from increasing rolling stock must be made over the corresponding period. Increasing the rolling stock could lead to excess capacity for most of the time (that is because peak demand only occurs after harvest, and then only when there are bumper crops). This is not likely to be an economically efficient outcome.

There is also an opportunity cost, for rail providers, from having rolling stock dedicated to grains. It is likely that rolling stock and rail lines can be used more profitably to service the coal industry.

Rather than increasing rolling stock capacity, alternative logistic chain solutions might make it easier to deal with bumper crops.

Trucks can be used to handle the freight task for peak demand periods. The increased use of trucks in 2008-09 is likely to have arisen because rail could not handle the task of moving large amounts of grain during peak periods. In the current marketing year, more orderly movements of grain on the rail network have occurred in Western Australia. CBH reported that the share of road used to transport grain increased to 64 per cent for the year to date, compared with 55 per cent in 2008-09. This highlights that trucks can flexibly be used to help accommodate peak demand periods, but that rail will be the dominant transport method at other times.

The RTBU also highlighted that a number of rail based solutions exist (other than increasing rolling stock) to help handle peak demand periods. These were based on the following findings from the *New South Wales Grain Freight Review*:

- Ensuring that there are no restrictions on 24 hour rail operations into port terminals.
- Improving the rate at which grain can be outloaded from rail at Newcastle.

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- Refining operations to maximise the number of train paths available at critical points in the network.
  - Harmonising technical and safety standards between the states to facilitate the relocation of equipment.

The introduction of peak period pricing on rail could also help to smooth demand within the year. (DITRDLG 2009b, p. 62)

A shift towards greater road use can impact on other parts of the supply chain, and adjustment will sometimes be difficult. For example, many port terminals were not designed to handle wheat delivered from trucks. Therefore, it can be more costly to unload grain from trucks to ports than it is for rail. GrainCorp stated:

For GrainCorp, the cost of unloading trucks is approximately three times that of unloading rail, due to the combination of additional staff required at sample stands and unloading grids, and the tonnes per man hour that results from the lower intake rates. If forced to increase the truck receival capacity at its port terminals, GrainCorp would have to spend up to \$3 million per port terminal (times 7 terminals). This would translate into the need to impose higher service fees. (sub. 43, p. 29)

The RTBU (sub. DR59) questioned whether adapting port terminals to accommodate road was a better outcome than investing in rail infrastructure — for which ports are designed. The Commission does not recommend investing in one mode of transport over another. Provided that there are no impediments to accessing road or rail, then the industry will itself move towards the most efficient mix of road and rail. If there is sufficient pressure to improve the efficiency of port receival facilities by trucks — a need which might arise if an increased use of trucks occurs to handle more frequent peak demand movements of grain — the industry might respond to this by changing the way it operates other parts of its supply chain. AWB stated ‘CBH for example is upgrading road receivals in Kwinana to facilitate this need and reduce reliance on rail movements’ (sub. 24, p. 17).

### **Rail infrastructure reviews are looking at sustainability of branch lines**

A number of reviews have examined the condition of grain transport infrastructure and have made recommendations regarding whether certain rail lines should be closed, retained or upgraded.

- In the early 2000s South Australia reviewed the rail and road transport system on the Eyre Peninsula. Arising from that was an investment package to upgrade rail and road to ensure adequate grain transport infrastructure in the future (box 6.2).
- The Victorian Department of Infrastructure released the *Victorian Rail Freight Network Review* in 2007 (DOI 2007). The review was initiated by the Victorian

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Government after it bought back regional rail networks from private operators in May 2007.

- The *Western Australian Grain Freight Network Review* (GIG 2008), was released by the Grain Infrastructure Group in March 2008.
- An election commitment from the current Australian Government (when it was in opposition) in relation to primary industries, resulted in:
  - a taskforce to review grain freight infrastructure in New South Wales. The taskforce released the *New South Wales Grain Freight Review* (DITRDLG 2009b) in September 2009
  - an independent review of the *Western Australian Grain Freight Network Review*, mentioned above (GIG 2008). That independent review (DITRDLG 2009a) was released in 2009. It questioned many of the assumptions used by the Grain Infrastructure Group in its analysis.
- The Strategic Grain Network Committee was established by the Western Australian Minister for Transport to ‘provide advice to the Minister on emerging transport infrastructure issues in the export grain supply chain’. The committee released its finding in December 2009 (SDD 2009b).
- National reviews of grain freight transport infrastructure include the:
  - *Export Infrastructure Taskforce Review* (EIT 2005), released in May 2005
  - review of grain and livestock transport infrastructure, prepared for the National Transport Commission and Australian Transport Council, released in February 2009 (SDD 2009a).

The Commission has not closely examined the assumptions used in the analysis of these reports, but they do typically apply cost-benefit analysis — an approach the Commission views as being important. For example, most reviews considered economic factors such as:

- operational costs of running trains, and costs of upgrading lines versus the expected grain traffic flows, based on production estimates
- the impact from diverted traffic to roads if lines were to close (including which roads would be used and whether they would be capable of handling increased traffic without increased maintenance).

In addition, some reports considered social costs and benefits, including:

- externalities and crash costs of road and rail
- the possibility that carbon emissions are taxed/priced in the future.

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## Box 6.2 Eyre Peninsula investment package

In 2001, various representatives from the grain transport industry in South Australia approached the state government regarding the competitiveness of rail transport for grain in the Eyre Peninsula, as they thought the future viability of rail was 'at risk'.

The Eyre Peninsula rail network is dedicated entirely to grain, with most grain delivered to Port Lincoln for export. This enabled a resolution to be achieved without the interaction of players in other industries. Crucial to its success was the engagement of local grower groups and community representatives, coordinated at the local government level.

Key features of the package included:

- significant capital contributions from the Australian Railroad Group (ARG) — the integrated rail operator at the time
- AWB, ABB (now Viterro) and ARG agreed to commit their transport requirements to rail as much as possible, and this is reflected in the current freight agreement
- growers signalled their commitment to rail by agreeing to contribute to capital costs through a two year levy on all grain exports
- the state government contributed to rail and road network upgrades, and made a (successful) submission for federal funding
- funding commitments towards one-off capital improvements to rail and supporting roads, in exchange for closing a section of railway parallel to the Eyre Highway.

As a result of the package, the rail system was adequately maintained and continued to transport the majority of bulk wheat for export at Port Lincoln.

Local communities benefitted from the package. There is a limit on traffic in the town centre, which would have otherwise required an expensive by-pass, and small volumes of traffic travel on rural roads (creating safety benefits and savings to local government).

Lessons that this example provide for other governments include:

- a solution aimed at growers interests, and not just grain supply chain providers
- all beneficiaries contributed to the package (including growers)
- recognition that only an integrated road and rail solution can maximise all transport infrastructure in a cost-effective manner. This is likely to include:
  - closure of lightly used rail network sections where good quality roads exist away from built up regions
  - improvements to more heavily used rail sections in areas that are of most benefit to communities (for example, near built up coastal areas)
- commercial agreements that underpin investment by encouraging the maximum use of rail over road.

Sources: DTUP (2002, 2003); SVGA (2007c).

Factors more difficult to quantify, such as amenity loss if more trucks are diverted through communities and the importance of rail lines as part of the entire supply chain (for example, closure might strand nearby storage facilities) were also considered when making decisions.

Each review acknowledged that the increased use of roads is inevitable, and there will be more pressure on outer branch lines to close, as they become (or already are) commercially unviable. However, rail was still anticipated to be the main transport mode into the future.

The relative use of road and rail varies according to many factors, meaning investment in rail lines and closure decisions are likely to vary across each state.

The most recent national review of each grain rail line in Australia showed, after cost-benefit analysis, a positive outcome from closing many branch lines throughout Australia. A summary of the findings from that report (aggregated to the state level) are presented in table 6.5. (As the report was released in February 2009, some of these branch lines might subsequently have been closed or upgraded.)

**Table 6.5 Potential grain rail branch line closures**

<i>State</i>	<i>Upgrade</i>	<i>Retain</i>	<i>Close</i>
NSW	4	1	11
Vic	1	4	8
Qld	0	1	2
SA	0	2	0
WA	0	7	9
<b>Total</b>	<b>5</b>	<b>15</b>	<b>30</b>

*Source:* SDD (2009a).

For rail lines deemed unviable, consideration must be given to where grain will be diverted (site location of silos) and the capability of the road network to handle that task. Alternatively, if rail lines are recommended to be upgraded, there are issues regarding who should pay for the investment. These and other issues are discussed below.

### *Long-term investment decisions*

Grain supply chains are still evolving. Governments and industry need to be careful that any future investment does not 'lock in' supply chains, and prohibit them from adjusting to the new deregulated environment.

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As mentioned in the *New South Wales Grain Freight Review*:

... the full impact of the deregulation of export wheat sales and rail privatisation has yet to be felt. In this extremely dynamic and uncertain environment, there is good reason to be cautious about making changes to long term infrastructure that would be very difficult to reverse, and which may limit the ability of the industry to respond to emerging challenges and opportunities. (DITRDLG 2009b, p. 7)

Having said that, investment in rail infrastructure is usually done on a long-term basis — upgrading/re-sleeping tracks is expensive, and upgrades should be made to keep the system viable for enough time to generate returns:

Without long term contracts in place to ensure return on investment, it is difficult for the rail owner to justify a significant ongoing program of upgrading. (DTUP 2003, p. 4)

Governments need to consider many factors when making long-term investment decisions and appear to have not always done this rigorously. For example:

In many instances, the threat of imminent closure of lines in this [deteriorated] condition, leads to the dedication of emergency or abnormal funding allocations, which are used to bring the line up to a standard where limited services can be reinstated for a short period. These allocations are generally ad hoc, and not the result of any considered long term plan. The targeting of lines for ‘rescue’ is not based on any recognised objective criteria – usually combinations of political and financial factors are involved.

Rarely is a long term decision made, on the orderly transfer of activity from branchline to road, with the requisite investment in road upgrade and improved facilities at transfer points made. The one substantial example in recent times is the Eyre Peninsula investment package. (SDD 2009a, p. 22)

Like all investment decisions, transport infrastructure investment should be based on thorough cost-benefit analysis. This includes, for example, externalities including local amenity, pollution and noise. In many cases, reviews of grain infrastructure have already undertaken cost-benefit analysis.

Investment decisions should be made through consultation between government, and industry players, including growers. Transport infrastructure (particularly rail) investment is made on a long-term basis and if poor decisions are made it runs the risk of ‘locking in’ inefficient supply chains.

### *Investment and efficiency of the whole supply chain*

Although investment to improve rail infrastructure can deliver efficiencies in the transport of wheat (for example, track upgrades to remove speed restrictions will ensure that wheat is moved more quickly), the impacts from improving the efficiency of transport on other parts of the supply chain are also important. For

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example, if storage facilities are not capable of unloading grain quickly, then being able to move grain quickly from up-country sites to ports will not improve supply chain efficiency as a whole — the supply chain is only as strong as its weakest link:

The productivity and competitiveness of rail is as much dependent on the speed of rail loading and discharge facilities as it is on the rail infrastructure and rolling stock. Minor improvements in the speed of rail loading may have a significant effect on the efficiency of rail. (DTUP 2003, p. 1)

Thus, any investments to upgrade rail infrastructure (or road infrastructure) should consider links with other parts of the supply chain. As an example, the *New South Wales Grain Freight Review* (DITRDLG 2009b) stated that GrainCorp had indicated there were a range of initiatives that could be undertaken to improve the efficiency of the branch network (such as installing fast outloading spouts at selected silos). The Review recommended that any funding be contingent on an understanding that private operators of storage facilities also upgrade their capacity or outloading capabilities.

#### RECOMMENDATION 6.2

***When considering investment in road and rail infrastructure for the transportation of grain, decisions should be based on thorough cost-benefit analysis, including both economic and social costs and benefits. Where possible, the analysis should consider the benefits that can be obtained throughout other parts of the grain supply chain.***

#### *Who should fund investment in infrastructure?*

Decisions to invest in rail infrastructure need to consider who should pay for it. The Commission endorses the approach used by the *New South Wales Grain Freight Review*, which recommended that ‘as far as practicable, those likely to gain most from system improvements should shoulder the responsibility for funding such improvements’ (DITRDLG 2009b, p. 4).

For some rail infrastructure investment, the likely result is that governments will share much of the costs of investment. For those rail lines that were deemed viable, the *New South Wales Grain Freight Review* suggested that government invest to maintain the track at a minimum level (Class 5)<sup>1</sup>. If these rail lines, which may also be used by other industries (for example, coal), were to close there could be

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<sup>1</sup> The New South Wales rail network consists of the mainline network (offering freight and passenger services) and the branch line grain network. The branch line network has various classes of track. Class 5 lines have 19 tonne axle loads and a minimum speed of 20km/h. Class 3 have the same axle load, but speed limits of up to 70km/h. Class 2 has a 23 tonne axle load.

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significant costs borne by government to upgrade roads, which would experience greater volumes of traffic from wheat that is diverted to roads.

However, the review also stated that if there was an economic case to upgrade the track further to generate greater efficiencies (for example, to increase speed limits or increase tonnage limits), then that industry should bear those costs, as it is the only beneficiary of them.

Where governments do make non-commercial investments in rail infrastructure, payments should be made as community service obligations payments. Ensuring transparent, explicit budget funding of community service obligations encourages clarification of their intent, and helps ensure the ongoing adequacy of funding (PC 2006b).

FINDING 6.4

*Investment in transport infrastructure should be funded by those who benefit from the investment, which in many cases is likely to be both the community and industry. Where governments make investment in rail infrastructure based on perceived social benefits, payments should be made in the form of clearly specified community service obligations.*

#### *Implications for road transport and investment*

The trend towards greater road use to deliver wheat from locations further from main rail lines might put more pressure on outer branch lines to close, and more pressure on local roads to handle the transport task.

Greater road use can lead to increased congestion, environmental costs and accident costs in the short term (Commonwealth of Australia 2010). In the long term, a strategy to support roads that are affected might need to be developed:

Where rail cannot in future offer road-competitive prices, it is inevitable that a very large proportion of grain will transfer to the road network. In these circumstances, it will not be warranted to support the future provision of track, and a more appropriate strategy will be to concentrate attention on ensuring affected road routes are fit for purpose. (SDD 2009b, p. 9)

Expenditure on roads (building new roads, maintaining or upgrading) can be funded with revenues raised from road use, as it is generally agreed that road recovers its full economic costs of provision in aggregate. However, there is some cross-subsidisation, making the task of matching revenue raised to be spent on those roads that require funding more problematic:

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While overall road provision costs are arguably supported in full by fuel excise charges, the distribution of these funds between different road sections is not directly related to the collection of these costs. (SDD 2009a, p. 5)

For example, heavy vehicles used mainly on urban roads are likely to cross-subsidise those heavy vehicles used on rural roads. This is because many rural roads are not built fit for purpose and require higher costs to upgrade.

Accurate pricing for both road and rail could help address this in the long term:

In the long term true cost-reflective pricing on road and rail would be the best means of ensuring optimally funded transport infrastructure provision to regional communities and industry, and would highlight the true costs of production and transport associated with regional produce. The development of this cost information resource through the COAG Road Reform Agenda process and a parallel rail industry process is essential to sound future infrastructure decision making. (SDD 2009a, p. 11)

Governments should consider the effects of road price reform from a community wide perspective, and not just how it affects the grain industry. However, road price reform could lead to more grain freight on rural roads which might be undesirable, if it does not incorporate externalities such as those mentioned above. Competitive neutrality issues regarding road and rail could also be raised. These issues have recently been considered as part of community wide reforms to road and rail by the Commission (PC 2006b) and by the Treasury (Commonwealth of Australia 2010).

Non-price reforms can also be made. For example, the *New South Wales Grain Freight Review* (DITRDLG 2009b) stated that further efficiency in the supply chain can be made (in New South Wales) by identifying those roads which have higher mass limit restrictions on them, and upgrading them to extend the higher mass limit network. Consultation with the industry will be required to identify roads to upgrade. These decisions should also consider how rail is used. There is generally an industry preference to maximise the use of rail — sometimes to minimise costs, but also because of its effect on local communities. For example:

ABB [now Viterra] relies on its rural workforce and we support important initiatives such as rail that improve the amenity of rural communities. (ABB, sub. 23, p. 9)

The industry and local communities should work together to ensure that decisions to fund the optimisation of road and rail use are made on both economic and social grounds.

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## 7 Information provision

### Key points

- Timely and accurate information is important for supporting an efficient bulk wheat export market:
  - core, long-term wheat information is useful for historical analysis, future policy development and industry investment and planning
  - short-term information facilitates the ‘day-to-day’ operation of the market.
- Prior to deregulation, AWB managed and provided the majority of wheat market information. In a post-deregulation environment it is necessary to determine what information should be provided, who should provide it and who should pay for it.
- The current arrangements for provision of core, long-term wheat information are considered by the industry as appropriate.
  - The Government should continue to fund the ABS and ABARE to provide core, long-term wheat market information.
- The current arrangements for provision of short-term information, particularly in relation to stocks, are more contentious. The Commission considers that provision of regular and timely information on stocks by state is essential to support an efficient wheat market.
  - If the industry wants stocks information by state beyond 30 June 2011, it will need to pay for it. An industry body should be tasked with establishing industry agreement on what stocks information (if any) industry participants are willing to pay for, and the preferred information provider. A similar approach could be used to provide other industry good functions (chapter 9).
  - To manage the free rider problem, a compulsory payment mechanism — such as an industry levy — is the best approach to fund stocks information. This levy would need to be administered by an organisation with the appropriate legislative powers. The GRDC would appear to be an efficient option, given it already has a compulsory levy collection mechanism in place.
  - The existing ABS stocks publications provide a good example of the type of stocks information the industry might choose to commission. The cost to the ABS of producing this information is about \$1 million annually. The ABS is well placed to continue to provide stocks information by state, although some industry participants question its timeliness.

(Continued next page)

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**Key points** (continued)

- Many in the industry thought further detailed information on stocks (for example, by grade and port zone) should also be made available.
  - The Commission acknowledges that unequal access to more disaggregated stocks information confers a marketing advantage on the trading bulk handling companies, and expects that greater disclosure of this information to all participants would improve the operation of the wheat market.
  - However, the cost of imposing a mandatory information disclosure requirement on the bulk handlers is expected to exceed the associated benefits. The Commission encourages the bulk handling companies to disclose more disaggregated stocks information on a voluntary basis.

The terms of reference for this inquiry require that the Commission consider the availability and transparency of relevant market information to participants in the export supply chain. Section 7.1 defines the scope and types of information to be considered in this chapter. This is followed by a summary of the arrangements for provision of market information under the single desk and since the introduction of deregulated wheat export marketing arrangements (section 7.2).

Section 7.3 sets out a framework for identifying the costs and benefits of information provision, and the potential role for government in the provision of information. An assessment of the merits of providing particular types and levels of wheat market information is undertaken in section 7.4, with reference to this economic framework. Issues associated with the role for government in the provision and funding of market information are also discussed. Section 7.5 sets out a proposed approach to industry provision of particular industry good functions — including information.

## 7.1 Market information as an industry good

Wheat market participants regard information provision as an important ‘industry good’ function (box 7.1) for the efficient operation of the bulk wheat export market.

The provision of industry good functions is the focus of chapters 7, 8 and 9 of this report. Chapter 7 considers the provision of market information. Chapter 8 addresses wheat variety classification and wheat receipt standards. Chapter 9 covers the provision of the remaining industry good functions except research and development, which is the subject of a separate, concurrent Commission inquiry into Rural Research and Development Corporations.

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### Box 7.1 Industry good functions

'Industry good' functions can be defined as services that support trade and industry development and affect, at least, a significant subset of the entire industry. Industry good functions can exhibit 'public good' characteristics, 'private good' characteristics, or both (section 7.3).

Relevant industry good functions for the bulk wheat export market might include:

- industry strategic planning
- research and development
- wheat variety classification
- wheat receival standards
- information provision
- crop shaping activities
- technical market support
- wheat promotion
- wheat branding
- trade advocacy
- regulatory advocacy.

Source: IEG (2008).

### What constitutes 'market information'?

All sources and forms of market information currently available to bulk wheat export market participants are relevant for the purpose of this inquiry. This includes data as well as other forms of market information, such as analysis and commentary. The terms of reference do not extend to the domestic wheat market, the containerised or bagged wheat export markets, or other grains. For this reason, information that is entirely specific to these markets has not been included as part of this analysis.

At a broad level, relevant market information is taken to mean information on wheat harvest and yield (actual and forecast), wheat prices, stock levels (including committed and uncommitted wheat) and wheat quality. This is consistent with the scope of market information considered by the Grain Industry Association of Western Australia (GIWA) in its *Review of Market Information* (GIWA 2009a, 2009b). Information that specifically relates to the operation of particular sections

of the industry, such as the shipping stem (port access) or the register of accredited exporters (accreditation) is primarily dealt with in other chapters of this report.

Feedback from participants suggests the industry distinguishes quite explicitly between wheat market information that is primarily useful over the ‘longer term’ — such as annual production and crop forecasts — and more timely, market sensitive information that informs ‘short-term’ marketing and trading decisions, for example, stock levels.

Table 7.1 summarises different types of wheat market information and indicates the timeframe (long term or short term) over which the information is most useful for industry participants.

**Table 7.1 Wheat market information**

<i>Category of information</i>	<i>Description</i>	<i>Timeframe for use</i>
Grower profile	<ul style="list-style-type: none"> <li>• Farm numbers</li> <li>• Average farm size</li> <li>• Average farm production</li> </ul>	Long term
Pre-harvest	<ul style="list-style-type: none"> <li>• Area planted (by variety)</li> <li>• Anticipated yield (by variety)</li> </ul>	Long term
Post-harvest	<ul style="list-style-type: none"> <li>• Total harvest (actual) by variety</li> <li>• Total export by variety, grade, quality and port zone</li> <li>• Total export by destination</li> </ul>	Long term
Forecast harvest	<ul style="list-style-type: none"> <li>• Crop production forecasting by variety and yield</li> <li>• Predicted stock harvest</li> </ul>	Long term
Wheat use	<ul style="list-style-type: none"> <li>• Volume of wheat used, for exports or domestically</li> </ul>	Long term and short term
Stocks	<ul style="list-style-type: none"> <li>• Volumes of wheat in the bulk handling and storage system, held by wheat users, and stored on farm</li> <li>• Volumes of wheat stocks that are committed (for export or domestic use) and uncommitted</li> <li>• Volume of new stock (carry-in) and old stock (carry-out)</li> </ul>	Short term
Prices	<ul style="list-style-type: none"> <li>• Domestic wheat prices</li> <li>• International wheat prices</li> </ul>	Long term and short term
Shipping stem	<ul style="list-style-type: none"> <li>• Capacity at port</li> </ul>	Short term

Participants appear reasonably satisfied with the level of long-term information that is currently available. However, feedback from participants suggests it is short-term information — and stocks information in particular — that is most ‘in demand’. Participants have argued that stocks information is under-supplied, not sufficiently

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timely and not made available to the industry on an equitable basis. These concerns capture the heart of the information ‘issue’ that this chapter seeks to resolve.

### **Getting information provision ‘right’**

The availability of information is critical for the efficient and effective operation of the bulk wheat export market. Information supports and guides grower production and investment decisions, marketing decisions, and the operation and use of transport, storage and port terminal services. Information can also facilitate effective competition.

Many participants explicitly recognised the importance of transparent, timely and accurate market information for the efficient operation of the bulk wheat export market. The benefits of information provision must be weighed against the costs (public and private) associated with collecting, collating and disseminating information.

In looking at possible arrangements for information provision, it is important to balance the commercial interests and rights of individual market participants, with the desire to achieve a well-functioning, competitive and transparent bulk wheat export market. Ownership of information, and the treatment of confidential information must also be dealt with.

## **7.2 Provision of market information**

This section describes the arrangements for provision of market information — and the associated information outputs — under the single desk marketing arrangements, and since deregulation of the Australian bulk wheat export industry.

### **Information provision under the single desk**

Historically, AWB Limited (AWB) controlled all market intelligence acquired through managing the single desk. However, the Australian Bureau of Statistics (ABS) and Australian Bureau of Agricultural and Resource Economics (ABARE) were also involved in provision of wheat market information.

#### **AWB**

The annual *Australian Crop Report* was the principal information product produced by AWB under the single desk. This report provided data and information on the

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quality and functionality of a particular year's wheat crop, including comments on the suitability of each grade for particular end products (for example, noodles) (AWB 2007). This information was published a number of months after the harvest period, and was focused on promoting the merits and uses of Australian wheat to potential or existing customers.

AWB has previously indicated that although the *Australian Crop Report* was not widely available, it was 'effectively in the public domain as AWB has historically not sought to limit its circulation' (AWB 2007, p. 7). For the two years to 2005-06, AWB spent close to \$3 million on production of the *Australian Crop Report* (ACG 2008c).

### *ABS and ABARE*

Under the single desk, government funded wheat market information was confined to ABS export data, two agriculture focused ABARE reports and a number of annual 'general agriculture' publications produced by the ABS:

- ABS, *Principal Agricultural Commodities, Australia, Preliminary* (Cat. no. 7111.0) (annual)
- ABS, *Agricultural Commodities, Australia* (Cat. no. 7121.0) (annual)
- ABS, *Historical Selected Agriculture Commodities, by State* (1861 to present) (Cat. no. 7124.0) (annual)
- ABS, *International Trade in Goods and Services, Australia* (Cat. no. 5368.0) (monthly)
- ABARE, *Australian Crop Report* (quarterly)
- ABARE, *Australian Commodities* (quarterly).

This was in line with the level of government funded information provided for other grains and agricultural commodities at that time. The annual ABS Agricultural Survey (and the five-yearly ABS Census) collects area and production data for a wide range of agricultural commodities, including wheat. The Agricultural Survey contributes to the production of the ABS's general agriculture publications identified above.

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In addition, domestic grain users funded a further ABS collection and the Grains Research and Development Corporation (GRDC) funded<sup>1</sup> an additional ABARE report series:

- ABS, *Stocks of Grain Held by Bulk Handling Companies and Grain Traders, Australia* (Cat. no. 7122.0.55.001).
  - In December 2002, the ABS commenced the collection of information on the volume of grain stored by bulk handling companies and major grain traders in Australia. No state-level stocks information was produced. The national stocks information was funded by domestic users concerned about grain availability during the 2001-02 drought period. These data were published at irregular intervals before ceasing in December 2008.
- ABARE, *Australian Grains Series*.

### **Information provision since deregulation**

The abolition of the single desk saw the cessation of the market information function historically fulfilled by AWB. The ABS and ABARE information outputs have continued to be produced since deregulation.

To advise on the delivery of industry good functions under the proposed deregulated wheat marketing arrangements, the Australian Government announced the formation of an Industry Expert Group (IEG) on 6 February 2008. As part of this review the IEG considered the best way forward for managing the provision of information in a deregulated market environment. IEG recommended:

The lead agency in providing information would be ABARE, which in conjunction with ABS and other agencies as required, would publish monthly base information covering:

- production (forecast and actual) – by tonnes by major classification by state;
- committed and uncommitted wheat (excluding trading stocks) by tonnes by major classification by state; and
- exports – commodity by tonnes by destination by state, both in containers and in bulk.

This information on the amount of wheat available for purchase would be collated and distributed by ABS. If the costs of this data collection are prohibitive the Government may wish to reassess what information is collected. However, the IEG is of the view that with proper use of automated electronic forms and careful assessment of the

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<sup>1</sup> ABARE has indicated that although GRDC funds the Australian Grains Series reports, the survey on which these reports is (partly) based is jointly funded by Meat and Livestock Australia, GRDC and the Australian Government.

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number of participants needed to ensure a high degree of accuracy, the cost should be able to be managed at an acceptable level. ABARE would coordinate the collation of its production data and the information collected by ABS. It would release a report distributing this base information on a monthly basis. (IEG 2008, p. 29)

The IEG did not specify how quickly this information ought to be produced.

Since deregulation, the wheat industry has had access to two ‘additional’ government funded information outputs — one produced by the ABS and one by ABARE. In addition, the user-funded wheat stocks information collected intermittently by the ABS over the period 2002–08 has been improved, and is now funded by the Government.

The additional government assistance afforded to the wheat industry is a direct consequence of the Government’s Industry Assistance Package (box 9.3). For the three-year period to 30 June 2011, the Australian Government has allocated a total of \$3.38 million to the ABS for the provision of market information. A further \$450 000 has been provided to ABARE for the same period. There has been no commensurate increase in the level of government funded information for other grains and major agricultural industries over this period.

The funding allocated to the ABS has been used to produce:

- *Stocks of Grain Held by Bulk Handling Companies and Grain Traders, Australia* (Cat. no. 7122.0.55.001). This collection mirrors the previously produced ABS publication of the same name. However, the ‘new’ version provides monthly wheat stocks information, and is released with a three-week (rather than four-week) lag. It includes:
  - stocks of wheat stored by bulk grain handlers at months’ end for each state
  - stocks of wheat stored by bulk grain handlers at months’ end by grade (either ‘milling’ wheat, which is fit for human consumption, or ‘feed’ wheat which is used for animal consumption), for Australia.
- *Wheat Use and Stocks, Australia* (Cat. no. 7307.0) is released monthly with a five-week lag and builds on the wheat information provided in *Stocks of Grain Held by Bulk Handling Companies and Grain Traders, Australia*, by including:
  - stocks of wheat stored by wheat users, at months’ end for each state
  - volume of wheat used domestically and volume of wheat exported, at months’ end for each state
  - volume of committed wheat (box 7.2) — including:
    - ... wheat contracted for export, at months’ end by state of origin

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... wheat contracted for domestic use, at months' end, nationally.

**Box 7.2 Committed wheat — ABS definitions**

**Committed for export**

For the export sector, 'committed' means there is a contract in place for the export of wheat grain.

**Committed for domestic use**

For the domestic sector, 'committed' means a contract is in place to procure wheat grain for domestic use and/or processing. It does not mean an intention to acquire wheat grain over the remainder of the year. It is acknowledged that this might fluctuate as contracts are cancelled, but is a 'point in time' estimate. It relates to contracts held by end-users of wheat grain, not intermediaries.

*Source:* ABS (2009).

Each quarter the two ABS stocks publications also include estimates for barley and 'selected other grains and pulses' on:

- stocks held by bulk grain handlers, by state
- volumes used — this does not distinguish between grains used for export or domestically.

The Commission understands that this collection represents the output of an agreement between the ABS and a collaborative Feedgrain Partnership project 'involving the GRDC, Dairy Australia, Meat and Livestock Australia, Australian Pork Limited and the Australian Egg Corporation' (GRDC, sub. DR69, p. 4). The GRDC (sub. DR69) has indicated that this arrangement will terminate on 30 June 2011.

ABARE has used the Industry Assistance Package funding to produce a monthly report, *Australian Wheat Supply and Exports Monthly*. This report is published one week after the release of the ABS data (a six-week lag in total) and includes:

- the ABS stocks data
- historical Australian wheat production figures (for the previous three years)
- ABARE's estimate of Australian wheat production for the current marketing year
- wheat exports, split by 'bag and container' and bulk, for each destination country. This information draws on the ABS trade data.

Table 7.2 summarises the wheat industry information outputs produced by the ABS and ABARE before and after deregulation.

**Table 7.2 ABS and ABARE information outputs**

<i>Single desk (pre-2008)</i>	<i>Post-deregulation</i>
ABS, Principal Agricultural Commodities, Australia, Preliminary (annual)	ABS, Principal Agricultural Commodities, Australia, Preliminary (annual)
ABS, Agricultural Commodities, Australia (annual)	ABS, Agricultural Commodities, Australia (annual)
ABS, Historical Selected Agriculture Commodities, by State (1861 to present) (annual)	ABS, Historical Selected Agriculture Commodities, by State (1861 to present) (annual)
ABARE, Australian Crop Report (quarterly)	ABARE, Australian Crop Report (quarterly)
ABARE, Australian Grains Report (GRDC funded, biannual)	ABARE, Australian Grains Report (GRDC funded, biannual)
ABS, International Trade in Goods and Services, Australia (monthly)	ABS, International Trade in Goods and Services, Australia (monthly)
ABARE, Australian Commodities (quarterly)	ABARE, Australian Commodities (quarterly)
ABS, Stocks of Grain Held by Bulk Handling Companies and Grain Traders, Australia (user funded and intermittent)	ABS, Stocks of Grain Held by Bulk Handling Companies and Grain Traders, Australia <sup>a</sup> (monthly)
	ABS, Wheat Use and Stocks, Australia <sup>a</sup> (monthly)
	ABARE, Australian Wheat Supply and Exports Monthly <sup>a</sup>

<sup>a</sup> Funded via the Industry Assistance Package for the three years to 30 June 2011.

Sources: ABARE (2009c, 2010b, 2010c); ABS (2010b).

Other public and private bodies involved in the collection and/or dissemination of information include Wheat Exports Australia (WEA), BRI Australia (formerly The Bread Research Institute of Australia), the port terminal operators (Viterra, Co-operative Bulk Handling (CBH), GrainCorp and Australian Bulk Alliance (ABA)), the Australian Quarantine and Inspection Service (AQIS), the Australian Customs and Border Protection Service and various commercial information providers. BRI Australia recently published the 2008-09 *Australian Crop Quality Report* (box 7.3). The report, which is being piloted for the first time, provides information on the quality of wheat in eastern Australia.

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**Box 7.3 Australian Crop Quality Report, BRI**

The 2008-09 *Australian Crop Quality Report* is the first crop quality report published since the 2005-06 harvest. The report is a pilot for a new version of a national crop quality report to independently benchmark the quality of Australian wheat produced on the east coast. The report is based on major grade samples for each port zone covering the eastern Australian wheat belt.

This report provides the opportunity to compare quality data between seasons and facilitates a measure of Australian wheat quality improvement. The report is designed to provide information for producers, grain handlers, exporters and buyers of Australian wheat. The 2008-09 report was funded by the Grain Growers Association and the Grains Research and Development Corporation.

Source: BRI (2009).

In 2010, Grain Growers Association (GGA) published a report prepared by Professor Gordon MacAulay of BRI Australia, *What the World Wants from Australian Wheat: Update 2010*. This report includes analysis of Australia's domestic and export markets for wheat and end-use products. It is an update of a 2004 report, *What the World Wants from Australian Wheat Growers*. The 2010 update is a preliminary report to a more detailed study commissioned by GGA and funded by the Department of Agriculture, Fisheries and Forestry.

Overall, since deregulation of the bulk wheat export industry, considerably more market information is publicly available than was the case under the single desk. In particular, greater amounts of short-term (stocks) information is provided, and is done so in a more timely manner.

#### *Bulk handling companies*

Viterra, CBH and GrainCorp are vertically integrated businesses that undertake port terminal services, storage, handling and marketing activities. ABA is the other major grain bulk handling company in Australia offering port terminal services, however ABA does not require an access undertaking agreement with the Australian Competition and Consumer Commission (ACCC) (chapter 5). Viterra, CBH, GrainCorp and ABA are all covered by the scope of the ABS's Grain Handlers Stocks Survey.<sup>2</sup>

By virtue of their operational responsibilities, the bulk handling companies collect and manage a variety of wheat market information and data. GIWA notes:

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<sup>2</sup> The Grain Handlers Stocks Survey produces the data used in the two ABS stocks publications.

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BHCs [bulk handling companies] control inventory movements, quality profiles, transportation and capacity at ports and have within their control information relating to logistics of stock into port. Under the current market structure, BHCs know who is transporting stock into port, what stock is coming into port, how much stock is in the port and when and how much stock is due to leave the port. (GIWA 2009a, p. 6)

Each of the bulk handling companies has access to the following wheat stocks information (in their respective facilities) (GIWA 2009b):

- the volume of wheat in its bulk handling and storage system, by grade and quality, for each receival site
- the volume of committed (sold) and warehoused (unsold) wheat
- the volume of carry-in stocks (new stock) and carry-out stocks (old stock).

#### *Publicly available information*

Select pieces of information collected by the three trading bulk handling companies, Viterra, CBH and GrainCorp ('the bulk handling companies') are freely available to the public — some of which is required to be released pursuant to the access undertakings that port terminal service providers have with the ACCC (chapter 5).

Although the precise terms of the access undertakings differ for each of the three trading bulk handling companies, they have all committed to publishing on their websites information on stocks at port (updated monthly) including:

- total stocks of bulk wheat held at each port terminal
- total stocks of 'other grains' held at each port terminal.

This information is usually published within one or two days of months' end. These data differ from the ABS stocks information because only wheat stored in the bulk handlers' facilities at each port terminal is included. It does not capture stocks of wheat held in the bulk handlers' 'up-country' storage and handling facilities (that is, at receival sites away from the port terminal). In addition, these data do not reveal the volume of committed and uncommitted wheat.

The access undertakings also require the bulk handling companies to publish:

- Details of any vessel booking applications for the export of grain (the shipping stem), updated each business day, including:
  - vessel name
  - volume of grain to be exported.

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- A report on key service standards in respect of the provision of port terminal services for bulk wheat at each port terminal, including, for example:
    - tonnage loaded each month
    - number of vessels loaded each month
    - average waiting time for a vessel to complete loading for each month
    - number of vessels that failed survey (do not meet relevant AQIS and safety requirements) each month.

Other publications provided by the bulk handlers on a voluntary basis include:

- CBH Harvest Reports
- CBH forecasts of total grain production in Western Australia
- Viterra ‘market recap’ reports.

The CBH Harvest reports include information on wheat receivals (approximate tonnes) to date by port zone (Geraldton, Kwinana East, Kwinana West, Metro Grain Centre, Albany and Esperance), and are produced on a weekly basis during harvest time. These reports do not provide information on the quality profile or ‘stack averages’ of wheat at receival sites. No comparable publication is currently produced by Viterra or GrainCorp. Viterra publishes a brief daily news bulletin via the ezigrain website, covering developments in international and Australian grain markets.

ABA provides shipping stem information via its website, alongside its *Export Operation Guidelines for the Melbourne Port Terminal*. These guidelines reflect ABA’s commitment to publishing the shipping stem information and updating it ‘regularly with both Intended and Nominated vessels as new information comes to hand’ (ABA 2008, p. 2). Unlike the other bulk handlers, ABA is not required to publish this information but has indicated to WEA that it will continue to do so until further notice (ABA, trans., p. 46).

### *Restricted information*

As a general rule, the majority of information held by the bulk handling companies on stock levels and wheat quality is not publicly available. However, each of the bulk handlers provide restricted access to some of this stocks and quality information, provided the access seeker owns wheat in the storage and handling system (that is, the individual is a grower or buyer using the bulk handler’s facilities). To facilitate this, each of the bulk handling companies operates a restricted website, namely:

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- ezigrain (Viterra)
  - LoadNet (CBH)
  - GrainTransact (GrainCorp).

AWB, an accredited bulk wheat exporter, also provides wheat storage and handling services. Information on wheat held in AWB's facilities is provided to growers and buyers of that wheat via the AWB GrainFlow website. The ABA website provides links to the information available via Viterra's ezigrain website.

The National Growers Register (NGR) (box 7.4) provides a mechanism for 'matching' growers and buyers that use these websites with the grain they own in the respective bulk handling systems.

#### **Box 7.4 National Growers Register**

In 2002 ABB Grain (now Viterra) and GrainCorp led and funded the development of a National Growers Register (NGR). This system is designed to centralise grower information and facilitate more timely trading between growers, marketers and bulk handlers.

The NGR is a national registration system containing growers' contact and payment details. It allows growers to deal with multiple grain handlers and marketers across Australia using a single delivery card. Although Western Australia is not part of the NGR, growers can use their Co-operative Bulk Handling delivery card number to link in with the NGR system and trade with the eastern states. In the past, many growers have been required to register with multiple grain marketers or bulk handlers, depending on who they sell to and where they deliver.

Grower contact and payment details recorded in the NGR database are provided to the marketer or trader purchasing grain, along with the delivery details on the receival ticket. Grower details are only released from the NGR to a marketer, trader, bulk handler or other registered organisation with which growers do business.

*Source:* NGR (2010).

The specific information made available to 'account members' via these websites varies. Broadly speaking, information is limited to:

- the volume and quality of particular loads of wheat in the system that are owned by that individual
- the 'stack average' quality of wheat at those sites where grain is owned.

## Summary

Table 7.3 provides an overview of the wheat market information that is currently provided by various information agencies across Australia.

**Table 7.3 Information provision, by agency, 2010**

<i>Agency</i>	<i>Publication</i>	<i>Timing</i>	<i>Access</i>
ABS	• Stocks of Grain Held by Bulk Handling Companies and Grain Traders <sup>a</sup>	Monthly, 3 week lag	Public
	• Wheat Use and Stocks <sup>a</sup>	Monthly, 5 week lag	Public
	• Agricultural Commodities, Australia	Annually	Public
	• Principal Agricultural Commodities, Australia, Preliminary	Annually	Public
	• Historical Selected Agriculture Commodities, by State (1861 to present)	Annually	Public
	• International Trade in Goods and Services, Australia	Quarterly	Public
ABARE	• Australian Wheat Supply and Exports Monthly <sup>a</sup>	Monthly, 6 week lag	Public
	• Australian Crop Report	Quarterly	Public
	• Australian Grains Report (funded by the GRDC)	Biannual	Public
	• Australian Commodities	Quarterly	Public
<b>Bulk handling companies</b>			
CBH	• Shipping stem	Daily	Public
	• Stock at Port	Monthly, no lag	Public
	• Statement of performance indicators	Quarterly	Public
	• Forecasts of WA grain production	Intermittent	Public
	• Harvest Reports — wheat receivals by port zone	Weekly (during harvest)	Public
	• LoadNet website	Ongoing	Restricted
Viterra	• Shipping stem	Daily	Public
	• Aggregate stock on hand by port terminal	Monthly, no lag	Public
	• Statement of performance indicators	Biannual	Public
	• ezigrain website	Ongoing	Restricted
	• Market recap reports	Daily	Public
GrainCorp	• Shipping stem	Daily	Public
	• Monthly wheat stocks at port by port terminal	Monthly, no lag	Public
	• Available elevation capacity	Monthly	Public
	• Statement of performance indicators	Biannual	Public
	• GrainTransact website	Ongoing	Restricted
ABA	• Shipping stem	Regularly	Public
	• ezigrain website	Ongoing	Restricted

(Continued next page)

Table 7.3 (continued)

<i>Agency</i>	<i>Publication</i>	<i>Timing</i>	<i>Access</i>
<b>Other</b>			
WEA	<ul style="list-style-type: none"> <li>• Register of accredited exporters</li> <li>• Growers Report 2008 (final) and the Report for Growers 2008-09 Marketing Year</li> </ul>	Ongoing Annually	Public Public
BRI	<ul style="list-style-type: none"> <li>• 2008-09 Australian Crop Quality Report (east coast only)</li> </ul>	Pilot only	Public
GGA	<ul style="list-style-type: none"> <li>• What the World Wants from Australian Wheat: Update 2010</li> </ul>	Update on 2004 report	Public
PIRSA	<ul style="list-style-type: none"> <li>• Report on Crops and Pastures in SA</li> </ul>	Every 2 <sup>nd</sup> month	Public
Department of Agriculture and Food (Western Australia)	<ul style="list-style-type: none"> <li>• Crop forecasting</li> <li>• Emerging trends in end product uses and market changes</li> </ul>	Monthly Ongoing	Public Public
Austrade	<ul style="list-style-type: none"> <li>• Policies in importing countries</li> </ul>	Ongoing	Public
AQIS	<ul style="list-style-type: none"> <li>• Exports to date by destination</li> <li>• Exports by grain type, quality and port zone</li> </ul>	Restricted (to WEA) Restricted (to WEA)	
Commercial information providers	<ul style="list-style-type: none"> <li>• Various</li> </ul>	Ongoing	Fee for service

<sup>a</sup> Funded via the Industry Assistance Package for the three years to 30 June 2011.

Sources: ABA (2010a); ABARE (2009c, 2010b, 2010c); ABS (2010b); CBH (2010d); GIWA (2009a, 2009b); GrainCorp (2010a); Viterra (2010a); WEA (2009d, 2009e).

Information that is not generally directly made available to market participants includes:

- Wheat quality information:
  - the ABS and ABARE provide no wheat quality information beyond the split between feed wheat and milling wheat at the national level
  - the bulk handlers provide information on the ‘stack average’ quality of wheat for those sites in which a buyer or grower owns grain, to that buyer or grower.
- The volume of committed and uncommitted wheat by state:
  - the ABS does not provide information on the volume of wheat contracted for domestic use by state — in turn, it is not possible to deduce the total volume of committed and uncommitted wheat by state. The ABS has indicated that it is not possible to collect data on wheat contracted for domestic use by state, as wheat users often do not know the source of the wheat they have contracted to purchase.

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The Commission understands that Vittera (formerly ABB) has, in the past, publicly provided wheat quality information by receival site, via its ezigrain website. Under this arrangement there was no requirement for information seekers to own any grain in the bulk handling and storage system. This information is no longer publicly available, although Vittera has said that its customers can request this information, provided they own in excess of 500 tonnes of grain at the receival site in question.

Various participants have claimed some of this ‘unavailable’ information is shared (either inadvertently or intentionally) with the trading arms of the bulk handling companies, giving rise to an information asymmetry. This issue is discussed later in the chapter. In the case of CBH, there are ring fencing arrangements in place that seek to limit such information flow (box 7.5).

**Box 7.5 Ring fencing provisions — CBH**

As part of the Australian Competition and Consumer Commission’s (ACCC’s) decision not to reject Co-operative Bulk Handling’s (CBH’s) notification for exclusive dealing conduct for Grain Express (Notification N93439) — chapters 5 and 6, the ACCC requested that CBH develop a framework to limit the potential for information obtained by CBH to be transferred to and used anti-competitively by CBH’s trading subsidiaries.

Following discussions between CBH and the ACCC over the precise terms of the ring fencing arrangements, the ACCC accepted an amended version of the CBH Ring Fencing Policy on 22 August 2008. Clause 4 of this policy provides for the management of confidential information between CBH Operations, CBH Senior Management and Grain Pool. In particular, clause 4.5 prohibits CBH from disclosing information to other entities, including its own related bodies corporate, their agents or employees.

*Sources:* ACCC (2008a, 2008b).

For GrainCorp and Vittera, no regulatory restrictions apply — although these companies have indicated that internal policies and procedures to limit information sharing are in place.

### **7.3 Assessing the costs and benefits of information provision**

The objective of providing wheat market information is to facilitate the efficient and effective operation of the Australian wheat industry, while being cognisant of the costs involved. To determine the type and amount of wheat market information consistent with this objective, it is prudent to consider:

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- how the overall efficiency and effectiveness of the Australian wheat industry will be enhanced or impeded by the provision of that information (efficiency impacts)
  - whether any parties stand to benefit (or incur costs) as a result of that information being provided (distributional impacts).

Having identified these costs and benefits, it is important to consider whether the Government should be involved in the provision of information services, or whether this responsibility should lie exclusively with the industry.

The following section sets out a theoretical framework for working through these issues. This framework is relevant for each of the industry good functions set out in box 7.1, and is therefore drawn upon in subsequent analysis undertaken in chapters 8 and 9 of this report.

## **An economic framework**

Identification of the ‘public good’ and ‘private good’ elements of any good or service is critical for understanding the costs and benefits of providing a particular industry good function. Characterising industry good functions in this way is the first step in assessing who should pay for the provision of industry good functions, and the case for government intervention in the provision of that good or service.

### *Public and private goods*

The characteristics that define ‘pure’ public goods and ‘pure’ private goods are well defined. A pure public good is neither excludable nor rival. A definition of what constitutes a public good is provided in the Australian Government’s *Cost Recovery Guidelines*:

Public goods exist where provision for one person means the good or service is available to all people at no additional cost. Public goods are said to have two main economic characteristics: they are non-rivalrous (that is, consumption by one person will not diminish consumption by others); and they are non-excludable (that is, it is difficult to exclude anyone from benefiting from the good). Given that exclusion would be physically impossible or economically unfeasible, these goods are unlikely to be provided to a sufficient extent by the private market. (Commonwealth of Australia 2005, p. 23)

National defence is probably the most commonly cited example of a public good. The public good concept has been applied extensively in the environmental and agricultural sectors, for example, with respect to managing climate change issues. In

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simple terms, Gans et al (2001, p. 216) notes that ‘people cannot be prevented from using a public good, and one person’s enjoyment of a public good does not reduce another person’s enjoyment of it’.

Private goods do not exhibit strong public good characteristics and should be provided by the market, to the most efficient level.

In practice, few goods and services can be classified into these discrete categories (IC 1995). McGinnis (1999, p. 77) notes that ‘[b]oth exclusion and jointness [rivalness] of consumption are characteristics that vary in degree rather than being all or none characteristics’. Groenewegen said:

Although it is relatively easy to define *pure* private goods [and] ... *pure* public goods ... In practice nearly all publicly provided goods have *both* public *and* private good characteristics. (Groenewegen 1979, p. 4)

Likewise, each of the industry good functions considered here are expected to incorporate a combination of public and private good characteristics.

For this reason, it is more appropriate to consider the extent to which each of the industry good functions demonstrates characteristics of a public good and/or a private good, and accordingly, describe industry good functions in terms of where they sit along a ‘continuum’ between a pure public good and a pure private good. This can be used as a basis for identifying those industry good functions which might warrant some level of government intervention.

### *Basis for government intervention*

Market failure might arise in relation to goods and services with public good characteristics. For example:

- Externalities in the consumption or production of a predominantly public good or service might arise because something has a value, but no price is attached to it, or the price does not reflect the full social value of the good or service. For example, external benefits might accrue to parties other than the producer, without adequate compensation being paid to that producer. This could mean that private production and consumption decisions lead to inefficient market outcomes.
  - The non-excludability characteristic can present an incentive for one or more individuals to be ‘free riders’. A free rider is a person that receives the benefit of a good but avoids paying for it. The free rider problem can mean that the private market does not provide the good or service to an efficient level. The

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provision of wheat stocks information by state is a relevant example (section 7.4).

- In some cases it is more efficient and cost-effective to have a single provider of a predominantly public good (that is, a natural monopoly). However, this circumstance can confer market power on the monopolist and might mean that production or consumption of a good or service is restricted below the socially efficient level.

In sum, market failure implies that the level of consumption and/or production of that predominantly public good is not efficient. On this basis, some form of government intervention might be warranted. This intervention could involve direct government provision of a good or service, public (taxpayer) funding for provision of a good or service by another agency, and/or some form of regulatory or legislative intervention.

Previous work by the Productivity Commission (and its predecessor organisation) (IC 1995; PC 2001a, 2007) has extensively considered the rationale for public funding support for specific functions. The 2001 report *Cost Recovery by Government Agencies* draws the following conclusion:

Taxpayer funding may be appropriate where:

- there are significant public good characteristics (that is, the products are non-rivalrous and either non-excludable or, where exclusion is possible, can be provided at such low cost that exclusion is economically undesirable); or
- there are significant positive spillovers.

Some information products that do not meet these tests may nevertheless be funded from general taxation revenue, but only if the government explicitly decides that there are other significant policy reasons for doing so. Where these situations do not arise and information products benefit only particular consumers, there will usually be a case for charging for them. (PC 2001a, p. 24)

‘Spillover’ benefits (or costs) are benefits (or costs) that are not captured (incurred) by the provider of a good or service — the benefit (cost) ‘spills’ over to other groups that have not funded provision of that good or service. The presence of spillover benefits (or positive spillovers) prevent producers from fully appropriating the benefits of their investments.

It is important to distinguish between spillovers that accrue to industry participants only, and spillovers to other groups or individuals outside of the relevant industry. Specifically, ‘intra-industry spillovers’, refer to spillover benefits (or costs) that accrue to (or are borne by) companies within the same or related industry as the company providing the good or service. ‘Inter-industry spillovers’, on the other hand, refer to spillover benefits (or costs) that accrue to (or are borne by) companies

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in completely separate industries. Inter-industry spillovers do not include spillover benefits (or costs) to government, such as allowing government to discharge its functions more effectively, or to the wider community.

The case for any form or level of government intervention ultimately rests on the associated costs and benefits of that intervention. These costs include the direct costs of any public funding provided by the Government (if relevant), the costs of any regulatory or legislative measures that are adopted, any impact public provision has in crowding out private provision and other indirect costs (or ‘side-effects’):

These costs include the efficiency distortions of taxation required to finance the measures, the utilisation of resources on administration and compliance, and the consequences of poor choices when selecting projects to be funded. (PC 2007, p. XIX)

In general terms, evidence of significant spillover benefits to other industries or the wider community might justify a level of co-funding by those industries that receive the spillover benefits, or by the Government. In contrast, where spillover benefits are confined to the industry (intra-industry spillovers), the industry itself should appropriately pay for provision of that good or service. A levy type arrangement might facilitate this (section 7.5).

It is unlikely that any government intervention in the provision of predominantly private goods and services will be justified. Markets work best for these types of goods, and should provide such goods to an efficient level. There might be merit in the industry delivering such services on some sort of collective basis to take advantage of economies of scale. However, this is a matter for the industry itself to consider.

These principles provide an economic framework for assessing industry good functions, which is summarised in box 7.6.

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**Box 7.6 Framework for assessing industry good functions**

A pure public good is non-excludable (individuals cannot be excluded from benefiting from the good) and non-rivalrous (consumption by one person will not diminish consumption by others). Public good characteristics lead to free rider problems because if an entity pays for a public good, others might be able to access the good free of charge. This can lead to market failure, resulting in the under provision of the good, and justify some kind of intervention in the market.

Private goods do not exhibit strong public good characteristics and should be provided by the market without any intervention. In practice, industry good functions usually include a combination of public and private good characteristics.

There might be a net benefit from government intervening in the provision of industry good functions that exhibit strong public good characteristics. This will depend on the costs and benefits associated with such intervention. Where the spillover benefits are confined to the industry (intra-industry public goods), the industry itself should pay for provision of the good — for example, by using a compulsory industry levy (section 7.4).

Evidence of significant spillover benefits to other industries, the wider community and/or to the Government, might justify a level of co-funding by the industries that receive the spillover benefits or by the Government. However, the mere presence of these spillover benefits, does not, in itself, justify public support. Many investments that produce spillovers have sufficient private returns for companies to invest without that support.

## 7.4 The case for provision of wheat market information

This section applies the economic framework set out in section 7.3 to the provision of wheat market information.

### Participants' views

#### *Type and level of market information*

Participants' views on the costs and benefits of providing wheat market information varied considerably.

A number of participants indicated that the current level of wheat market information is comprehensive, superior to other grains and agricultural commodities and represents a marked improvement on the level of information that has been available in the past. Viterra (sub. 23, p. 10) stated 'wheat exporters now enjoy an

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unprecedented amount of timely information’. The Australian Grain Exporters Association (AGEA) supported this position and commented:

The Australian wheat grower today has more information and more services available than ever before. A large number of service providers covering market information news and advisory services have emerged and investment in this area is continuing. (sub. 28, p. 17)

CBH (sub. 39, p. 6) expressed a similar opinion, noting ‘it [CBH] and the wider industry already provides detailed information to aid decision-making on the farm and in the supply chain’. This is consistent with the conclusions of the GIWA Review (GIWA 2009b, p. 5) which found ‘the information needs identified by the participants are predominantly collected and largely publicly available’.

Other respondents considered that the market needs more information than what is currently provided in order to function efficiently. Inadequate stocks information was raised as an issue by several participants. The NSW Farmers Association commented:

The Association would prefer to see stocks on hand per port zone per week or month, and supply and demand figures. (sub. 49, pp. 14–15)

AWB (sub. 24) suggested that monthly stock information at the port zone level should be made available on a user pays basis for all commercially produced grains, oilseeds and pulses. The Department of Agriculture and Food (Western Australia) (sub. 34, p. 6) shared this view, noting ‘there appears to be a case for greater disclosure of market information’ and ‘post-harvest information should be provided on crop type and port zone’.

The Victorian Farmers Federation (VFF) (sub. 40, p. 3) also strongly advocated better stock reporting, noting ‘WEA should carry out this important function so stock levels at least by state, are publicised in a more timely fashion’. The Stock Feed Manufacturers Council of Australia noted:

The Australian grain market is limited in the amount of accurate and timely information that is published relating to grain stocks and demand. ... stocks information is critical to ensure the Australian market operates in a fair and transparent manner. (sub. 21, p. 1)

WEA commented:

Exporters have indicated that this information should be available at an up-country silo level with the data aggregated by grade and warehouse position (thus ensuring that the stocks of individual growers/owners are not identified). ... WEA is broadly supportive of this view. (sub. 55, p. 33)

Requests for greater stocks information were predominantly driven by information access concerns. In particular, it was considered that some market participants have

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greater access to information on the volume and quality of stocks information than others, and that this information asymmetry gives rise to competition concerns — with associated consequences for efficiency.

AWB stated:

There is a significant ability for the current BHCs [bulk handling companies] to access information in a more timely, more detailed and accurate manner than other market participants, creating an asymmetry of information that can generate substantial commercial advantage if this information is transferred to the trading arms of the BHCs. (sub. 24, p. 20)

The Pastoralists and Graziers Association of Western Australia (PGA) took a similar view:

Presently there is no ability to obtain accurate information on the amount and type of stock held at upcountry grain receival facilities, and this may result in creating a significant commercial advantage if the information is transferred to the trading arms of the BHCs [bulk handling companies]. ... Growers require aggregate information of upcountry stock levels to ensure that they have a fair and competitive position in the market place. (sub. 47, p. 11)

The NSW Farmers Association also alluded to the existence of an information asymmetry, and commented:

It is widely known within the industry that Australian grain bulk handling companies have information readily available to them relating to stocks on hand, which can be updated on a real-time or daily basis. (sub. 49, p. 14)

WEA considered the potential for bulk handlers to be ‘advantaged’ by the information at their disposal and commented:

Two bulk handlers indicated to WEA (one during a joint site visit with ACCC) that they did not want stocks data published, as it was considered to be proprietary and as such, is used for the benefit of their marketing arm. (sub. 55, p. 33)

Similarly, CBH indicated that the ring fencing provisions that apply to their business are designed to eliminate any disadvantage that information sharing might imply for their competitors, and noted ‘that is done to give our customers comfort that their own information won’t be misused against them’ (trans., p. 125).

GIWA (2009b, p. 6) found that ‘the sections of industry that did not have comprehensive data were the growers and smaller traders’, as ‘[larger traders] used their [own] data sources to calculate the information that they were seeking’, inferring that the impacts of any information asymmetry are most severe for individual growers and small traders.

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The three bulk handlers contest that these concerns have merit. They have claimed that information on wheat stocks and quality information is not shared with their marketing arms, rendering the information asymmetry argument redundant. One of the bulk handlers described internal processes and practices that are in place to limit information flows. CBH stressed that the ring fencing arrangements are working effectively, and noted:

The policies and procedures are in place to stop the transmission of marketer information across to Grain Pool. ... They're designed to prevent Grain Pool obtaining information which would be market sensitive, and they're audited on a yearly basis. The results of that audit are provided to the ACCC. So we feel that there's very strong controls on that. (trans., p. 125)

Concerns about access to detailed stocks information are addressed later in this section.

#### *Arrangements for provision of market information*

Industry views on the role for government in information provision were firmly divided. Some participants considered that ongoing government involvement is essential to support the provision of rigorous and comprehensive information. The PGA (sub. 47, p. 11) commented 'Government agencies should be given power through amending the Act to compel provision of information'. GIWA proposed that an industry organisation be established — Grains Australia (chapter 9) — and tasked with provision of 'pre competitive market information on crop production, stocks and exports on a timely basis for all grains' (sub. DR78, p. 1).

The VFF also supported ongoing government funding, and proposed that the WEA or an independent grower industry body such as Grain Producers Australia (box 7.7), should be able to take on a role in information provision (sub. 40; sub. DR65). The NSW Farmers Association suggested 'the Government might consider the development of an online information site that would provide all the necessary information a farmer might require in order to market their grain' (sub. 49, p. 15).

In contrast, many participants are of the view that information provision should be managed and funded by the industry itself, either via an industry levy or on a fee-for-service basis. Under this model participants envisaged that the ABS and ABARE would have responsibility for providing core long-term agricultural information only, consistent with the information currently provided for other grains and commodities.

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### Box 7.7 Grain Producers Australia

In 2009, the Grains Council of Australia (GCA) initiated a consultation process with industry to canvass the views of industry participants on the development of a national grower body to succeed GCA. As part of this process, GCA commissioned Alan Umbers to set out an operational and funding plan for national grower representation, and appointed an independent steering committee to develop a working model based on this plan.

In early 2010, the steering committee released a plan for industry consideration — Grain Producers Australia (GPA). Under the proposed model, GPA would operate as a national peak body representing broadacre grain, pulse and oilseed producers — it is not intended to serve as a whole-of-industry structure. Grower membership of GPA — a not for profit company limited by guarantee — would be voluntary. Members would directly elect the board of GPA and participate in polls on issues affecting the industry.

GPA expects to fulfil the current functions of the GCA with respect to oversight of the GRDC, consultation on industry levies and provision of industry views on the Wheat Export Charge. It is proposed by those developing the model, that GPA would be funded by growers through direct voluntary membership subscriptions, calculated using a percentage of the value of production at the first point of sale. The levy amount would initially be determined by the GPA Board, and be subsequently subject to annual review by members. The establishment of GPA would require cash and in kind support from the industry.

Industry support for the GPA concept is not universal, and it is too early to predict whether the proposed model will be successful. The NSW Farmers Association and the Western Australian Farmers Federation do not support GPA, and have proposed an alternative model — National Grains Australia.

*Source:* GPA (2010).

GrainCorp considered that ‘private enterprise should be left to meet the information or market intelligence needs of the industry, not Government’ (sub. 43, p. 32). Similarly, the AGEA noted that ‘collection of this information was only funded by the Government for a period of time and that this may need to move to a fee for service basis in the future’ (sub. 28, p. 18).

GGA agreed and stated that ‘industry is expected to fund this [information] in time in any case’(sub. 41, p. 19). Furthermore, GGA considered that ‘an industry levy is an appropriate way for growers to pay for some of the industry [information] services but that there is also the opportunity for the levy to provide for a wider range of services’ (sub. DR86, p. 4).

Some participants emphasised the importance of the entire industry paying for information provision under an industry-funded model. This supports the conclusion reached by GIWA that ‘it is the view of industry that the cost of market

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information should be borne by the whole industry and not confined to growers or those exporting wheat’(sub. 38, p. 4).

Similarly, the GRDC (sub. DR69, p. 4) considered that ‘the beneficiaries should pay for the information and the key beneficiaries are the traders and marketers, although the entire industry will benefit to a degree’. The GRDC did not support using grower levy contributions to fund this information and proposed that ‘Government consider a user-pays subscription model underwritten by Government funding’.

Previous experiences with levy arrangements suggest that levies are typically ‘passed through’ the supply chain by market participants, and ultimately paid for by the primary producer (grower). In this sense, the administrative arrangements for incidence of an industry levy do not necessarily determine which individual or group actually incurs the cost of a levy. As the final incidence will be with growers — wherever the levy is imposed — the Commission considers that the most cost-effective option administratively, is to levy growers only.

### **Long-term wheat market information**

The ABS and ABARE receive government funding to produce a basic set of information for various Australian grains and agricultural commodities — ‘core, long-term agricultural information’. By way of example, this typically includes information on forecast and actual production levels, farm numbers and size, and agricultural exports by destination. Core, long-term agricultural information does not include stocks information.

This arrangement is well established in Australia, and reflects the Government’s view that provision of this information is of net benefit. With the exception of information on wheat used, the long-term wheat market information currently provided by the ABS and ABARE (table 7.1), is consistent with the concept of core, long-term agricultural information.

The Commission considers that the primary benefits of long-term wheat market information are two-fold:

- Wheat industry (intra-industry) benefits: supports industry planning and guides the investment, production and purchase decisions of growers, traders, and transport and storage operators. In this sense, provision of a basic set of long-term wheat market information facilitates the efficient operation of the wheat industry over time.
- Public benefits: useful for governments in the development of public policy, the achievement of relevant social and equity objectives and as part of broader

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economic management responsibilities. For example, the Government might be interested in tracking industry structural change, such as consolidation of wheat farming businesses.

In addition, there are benefits to other industries outside the wheat industry (inter-industry spillover benefits) that use this information for investment and planning purposes.

The costs incurred by the ABS and ABARE in collecting and producing this information are expected to be modest and outweighed by these benefits. However, the benefits to the wheat industry alone (intra-industry benefits) are unlikely to be sufficient to support a socially optimal level of provision by the private market. It is in this context that government support for provision of core, long-term information by the ABS and ABARE is appropriate.

This view is consistent with the Government's current funding arrangements for provision of core, long-term market information across the economy, and underpins the public support provided to the ABS and ABARE for the provision of that information.

#### FINDING 7.1

*The ABS and ABARE should continue to provide core, long-term wheat market information, in line with what is currently provided by these agencies for other Australian grains and agricultural commodities. Government funding for this purpose is appropriate.*

## **Stocks information**

Stocks information is primarily of use in the 'short-term' and falls outside the scope of core, long-term wheat market information. Stocks information is particularly important for facilitating 'day-to-day' market operation and trading activity. However, stocks information can vary significantly in terms of:

- the extent to which the information is disaggregated
- the type and level of relevant detail provided at that disaggregation
- the frequency and timeliness of its provision.

For example, wheat stocks can be disaggregated at the national, state, port zone, receival site or silo level. The cost and administrative complexity of information provision increases with the extent of disaggregation.

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At each disaggregation, additional information about those stock volumes could also be provided, for example, on the quality or ‘status’ of stocks. Quality information can be as simple as a split between milling and feed wheat, or as detailed as the quality receival standards of individual wheat stacks at each receival site. Status information can imply identification of committed and uncommitted stocks only, or be more specific about wheat sales (for example, committed for export, committed for domestic use).

Precisely how these parameters are set will determine the particular uses of stocks information. For the purposes of our analysis, stocks information can be usefully characterised in terms of three ‘tiers’, where the extent of disaggregation increases as we move from tier 1 to tier 3:

- ‘Tier 1’ information is stocks information in its most aggregated form, namely national wheat stocks information. This information is most useful for international market participants and supports the competitiveness of the Australian wheat market in the global context.
- ‘Tier 2’ information disaggregates the tier 1 information further, to wheat stocks by state. Tier 2 information is useful for facilitating the operation of the Australian export and domestic wheat markets, and the interactions between those markets.
- ‘Tier 3’ information captures all subsequent disaggregations of stocks information. For example, stocks information by port zone or receival site. This information predominantly influences the supply and demand decisions of particular economic agents within the wheat market.

To determine the optimal level of stocks information provision, it is prudent to establish whether there is a net benefit of providing each tier of information. As each tier is simply a disaggregation of the prior tier, the assessment of the costs and benefits of providing an additional tier of information is restricted to the marginal costs and benefits of that disaggregation only.

If a net benefit from provision of a particular tier of information is identified, it is necessary to determine whether this net benefit is preserved when the information is disaggregated further, or whether this tier is in fact the ‘optimal’ level of stocks information provision.

### *Costs and benefits of stocks information*

This section consider the costs and benefits — in efficiency terms — of providing each tier of stocks information, and the case for government intervention to support provision of that information.

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### *Tier 1*

As set out in chapter 2, the Australian wheat industry is heavily export oriented. Maintaining Australia's viability and competitiveness as a wheat exporter in the global market is critical for the overall performance of the Australian wheat industry.

The publication of national wheat stocks information (tier 1) is a basic prerequisite for any competitive wheat exporting region. International customers will consider many variables ahead of deciding where to purchase wheat, including, for example, stocks in each region, freight costs, trade restrictions and reputation. Wheat stocks information is a critical driver of customer and trader purchasing decisions. This information provides two important signals, namely:

- a volume signal — is there a sufficient volume of wheat available to meet the customer's demands?
- a price signal — total wheat availability is a critical driver of wheat prices.

If customers and traders do not have access to information on Australian wheat stocks, they cannot verify whether the Australian market holds sufficient volumes of wheat to meet their demands, or consider what this implies for prices in that region. Withholding this information from the market therefore risks deterring international customers and traders from buying wheat from Australia. This, in turn, has significant consequences for the success of the Australian wheat export market. Indeed, this information is made readily available by competing wheat exporting regions (appendix C).

The Australian Government might also benefit from provision of this information. Governments can use national stocks information for the purpose of meeting food security objectives. In this sense, stocks information can be valuable because of the signal it conveys about domestic wheat supply and any impending shortage (box 7.8).

On balance, the Commission believes that tier 1 (national) stocks information is critical for the success of Australia's wheat export industry, and considers that the total benefits of providing this information justify the associated costs. Furthermore, the significant majority of these benefits accrue to the wheat industry specifically — the benefits for government are small by comparison. It is appropriate then, for the industry to pay for the cost of providing national stocks information, if it wants it made available. Taxpayer funding for this purpose would not be efficient.

The following section considers the costs and benefits of further disaggregating stocks information to the state level.

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**Box 7.8 United States grains shortages — 1972 and 1975**

In 1972, the United States sold an extremely large and unexpected volume of wheat and corn to the Soviet Union. This led to a material increase in domestic food prices and depleted reserve stocks.

At that time, there was no mechanism for the US Government or market participants to obtain accurate information on export volumes until exports were actually shipped. In fact, in 1971 President Nixon had removed a requirement that exporters obtain a license for large grain trade deals, and had eliminated an earlier standing policy that a minimum of 50 per cent of the grain be shipped on American vessels. In addition, US knowledge about what the Soviet Union was buying and the size of Russian crops was inadequate.

In the aftermath of this event, it was determined that timely stocks reporting was necessary to ensure the Government and domestic wheat market participants were made aware of any looming domestic wheat shortage. Accordingly, in 1973 the United States Congress mandated an export sales reporting requirement. Companies had to report to the Government sales of more than 100 000 tonnes of grain within 24 hours of making them. In 1974 this procedure was tightened further, and companies were required to obtain prior approval of sales over 50 000 tonnes in a single day, or over 100 000 tonnes a week.

However, shortly afterwards, in March 1975, the prior approval requirements were abandoned by the US Department of Agriculture (USDA). In July of 1975, the United States once again found itself with inadequate domestic grain supplies, and rising food prices, due to significant grain purchases from the Soviet Union. Many considered that this 'seemed like a painful re-enactment of 1972'.

Today, the USDA Export Sales Reporting Program monitors US agricultural exports on a daily and weekly basis. Reporting under the Export Sales Reporting Program is mandatory. Exporters are required to report sales over 100 000 tonnes within 24 hours. The USDA and the United States Wheat Associates produce weekly reports that draw on this information. It is noted that 'the program also serves as an early alert on the possible effects of foreign sales on US supplies and prices'.

*Sources:* FAS (2010b, 2010c); Morgan (1979).

### *Tier 2*

Stocks information by state is primarily useful for individuals and/or groups within the Australian wheat industry. For this reason, tier 2 information can be regarded as more relevant to the operation of the Australian export and domestic wheat markets, rather than to the performance and competitiveness of the Australian wheat industry in the global market.

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Domestic wheat users, such as flour-millers, stock feed manufacturers and livestock operations purchase wheat from growers and traders in line with their requirements. Competition for Australian wheat from international customers might have consequences for domestically available wheat supplies and, in turn, for the ability of domestic users to secure sufficient supplies of wheat.

In years of below-average wheat production, for example, the total stock of wheat available for purchase will decline. If domestic users are unaware of the tight supply conditions, potentially significant commercial risks arise for domestic wheat users and the operation of the domestic wheat market more broadly (box 7.8). The value of stocks information by state to wheat users is demonstrated by the intermittent, user-funded ABS collection of stocks information over the period 2002–08.

Tier 1 information would not be as effective in helping domestic users manage supply risks, as interstate trade in wheat might not be a cost-effective option due to freight costs. Provision of stocks information is particularly important in the eastern states. In that region domestic users account for a large portion of total wheat sales, wheat supply has been sporadic and below-average in recent years due to drought, and the cost of bringing wheat across from the west coast is significant.

Stocks information by state also benefits the operation of the wheat export market. In the absence of any information on stocks by state, marketers are effectively forced to trade conservatively. Where the decisions and behaviours of wheat marketers are overly restricted, there will be associated impacts for the efficiency with which trading decisions are taken.

In light of the benefits to domestic users and wheat exporters, and the anticipated low marginal cost of producing tier 2 stocks information, the Commission considers there is a net benefit from providing stocks information by state. However, as set out in the following section, it will ultimately be up to the industry to determine whether they see sufficient benefit from provision of stocks information by state to warrant paying for it.

#### *Arrangements for provision of stocks information by state*

The primary benefits of providing stocks information by state accrue to the wheat industry (domestic and export market participants), and can therefore be regarded as intra-industry spillover benefits. Accordingly, the Commission does not consider that there is a strong case for publicly funding the provision of this information.

The Australian Government does derive some value from the provision of stocks information by state. In particular, stocks information might be used by the

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Government to monitor food supply conditions and manage food security issues. Accordingly, this information allows the Government to discharge its responsibilities and functions efficiently.

Despite this, stocks information by state does not generate the same quantum of spillover benefits (to other industries, government, or to the wider community) that core, long-term wheat market information does. For that reason, it would be inappropriate to draw on taxpayer funding to pay for provision of stocks information by state.

The government funding provided to the ABS and ABARE (via the Industry Assistance Package) for additional data collections and publications will cease on 30 June 2011. The Commission does not consider that further government funding should be provided.

The Commission recognises that there were specific policy reasons for funding this information during the transition to deregulation (for example, to establish the collection of data when the industry was not yet in a position to do this). However, market circumstances have now changed and deregulation is well established, eroding any case for ongoing government support.

FINDING 7.2

*The cessation of government funding provided to the ABS and ABARE for additional wheat data collections and publications on 30 June 2011 is appropriate.*

Notwithstanding this, the Commission recognises that provision of stocks information by state is largely non-excludable, and that this could lead to a free rider problem. Government intervention to facilitate the administration of a compulsory payment mechanism for funding stocks information might address this. However, it is important to consider the associated costs and benefits of such intervention. To assist the industry in assessing the merits of pursuing this approach, the Commission has set out a framework for provision of non-excludable goods and services that represent significant value to the industry (section 7.5).

*Tier 3*

Wheat stocks information can potentially be disaggregated beyond the state level to either a 'port zone', receival site or even silo level (tier 3 stocks information).

A number of industry participants considered that the bulk handling companies have superior access to tier 3 information — and that this information is shared with the trading arms of these businesses — giving rise to competition concerns. One

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approach to managing any real or perceived information asymmetry within the bulk wheat export market is to provide all market participants with a greater level of tier 3 stocks information. Indeed, this option has been advocated by many respondents to this inquiry.

The Commission recognises that there might be efficiency benefits associated with providing additional tier 3 information to the wider market. For example, if traders had information on the particular quality characteristics of wheat at each receival site, they might be better positioned to ‘match’ the requirements of international and domestic wheat customers with the available supplies of wheat. This, in turn, might lead to more efficient marketing decisions.

Unequal access to information on the volume and quality of wheat at the receival site level might also provide certain arbitrage opportunities for ‘informed’ traders. In turn, this could give rise to commercial benefits for these traders at the expense of their competitors. Although this circumstance represents a redistribution or transfer of wealth within the industry — rather than a loss of efficiency for the broader market — if it were to become significant, this circumstance could squeeze competitors out of certain markets and lead to wider competition issues. Furthermore, as demand for wheat products becomes more specific, this issue — and any related commercial disadvantage this poses for ‘uninformed’ traders — might be exacerbated.

The AGEA provided an example of how unequal access to tier 3 stocks information can inhibit the trading behaviour of some marketers:

This was highlighted recently by a tender offered by an overseas government buyer which requested in terms that grain be offered with test weight of 80. Data provided by CBH on average stack quality showed that ... the average of the two grades suitable for this tender was less than 79. As such, the risk for exporters to offer basis 80 was too great and thus, a number did not compete. Grain Pool had the confidence to bid for the tender basis test weight of 80. (sub. 35, p. 2)

Despite the wealth of commentary and concern conveyed to the Commission on this issue, the Commission is not convinced that unequal access to this information is imposing sufficiently large efficiency costs on the Australian wheat industry to justify imposing a mandatory information disclosure requirement on the bulk handling companies. In particular, the Commission is mindful of the costs of such a requirement — including managing confidentiality requirements, resolving issues related to ownership of information and protecting the commercial rights and interests of wheat growers and traders.

Under mandatory information provision arrangements, the bulk handling companies would have limited discretion over the type of information disclosed, or the manner

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in which it is made public. However, the complexity and uncertainty associated with quantifying the full costs and benefits of stocks information provision makes it extremely difficult to precisely identify the ‘efficient’ level of stocks information disclosure by the bulk handlers. This combination of circumstances risks introducing mandatory information disclosure arrangements that impose more costs than benefits — this, in turn, could impose costs on market participants in all parts of the supply chain.

The increase in the number of exporters since deregulation suggests that new entrants consider there to be reasonable commercial opportunities for marketers, despite any information asymmetry between the trading arms of the bulk handling companies and other traders.

Notwithstanding this, the inquiry has heard examples of particular bulk handling companies disclosing some detailed stocks information on a voluntary basis. Specifically, industry participants appear to highly value the weekly Harvest Reports produced by CBH during the harvest period (section 7.2).

The Commission considers that such information enhances the effective operation of the wheat market, and the Commission strongly encourages each of the bulk handling companies to voluntarily disclose greater levels of disaggregated stocks information. A voluntary approach to information disclosure provides the bulk handlers with significant flexibility to manage the costs of stocks information provision.

The Commission expects that provision of stocks information will be a cost-effective exercise for the bulk handlers in most circumstances, provided information is not disaggregated to such an extent that management of information ownership and confidentiality issues becomes necessary. In addition, given that detailed stocks information is already collected and maintained by the bulk handling companies for operational reasons, the Commission does not anticipate that these companies will incur any significant additional administrative costs with sharing this information more broadly.

Indeed, the Commission has received evidence that shows more detailed stocks information is made available to particular market participants upon request — it is suggested that whatever stocks information can be provided by the bulk handling companies, is made available to the industry as a whole as a matter of course.

Finally, the Commission understands that some of the bulk handling companies have — in the past — made more wheat quality information publicly available than they do currently. As described earlier in the chapter, prior to the ABB and Ausbulk merger, Viterra (then ABB) provided wheat quality information by receival site via

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its ezigrain website. It is not clear why this information was removed from the public domain. This information is still provided on request — conditional on the customer owning grain in excess of 500 tonnes at that site. Viterra has indicated that it is currently reviewing its information policies, and hopes to provide wheat quality information to its customers more efficiently in the future.

The Commission considers that, at a minimum:

- the level of stocks information — including quality information — available to market participants in previous years be re-instated
- any stocks information that can be — and is currently — provided by the bulk handlers on request, be made available to the industry as a whole as a matter of course
- an equivalent level of stocks information be provided by the three trading bulk handling companies.

To progress this, the Commission encourages growers, traders and industry bodies to pressure the bulk handling companies to disclose this information. Table 7.4 summarises the Commission’s view of the key costs and benefits of providing each tier of stocks information.

Finally, the Commission notes that it is not necessarily inappropriate for the bulk handling companies to be operating with some level of competitive ‘advantage’ as a consequence of any information asymmetry. The bulk handling companies follow a business model that facilitates the achievement of certain synergies and efficiencies between their marketing arms and their operational arms. Sharing information might be necessary in order for the bulk handling companies to capitalise on these efficiencies, and therefore obtain a ‘return’ on their investment in the supply chain.

Indeed, international grain handling companies have adopted a similar business model and are able to benefit from information sharing — and other operational efficiencies — accordingly. A number of these international bulk handling companies operate in Australia. However, the Commission has not heard any evidence of adverse competition impacts arising from the ‘information asymmetry advantage’ these companies have.

**Table 7.4 The case for public provision of stocks information**

<i>Stocks information</i>	<i>Expected costs and benefits</i>	<i>Recommendation</i>
Tier 1	<ul style="list-style-type: none"> <li>• Facilitates Australia’s competitiveness as a wheat exporter</li> <li>• Supports achievement of the Government’s food security objectives</li> <li>• Marginal administrative costs (using existing systems)</li> </ul>	<ul style="list-style-type: none"> <li>• Tier 1 information is of net benefit to the industry</li> </ul>
Tier 2	<ul style="list-style-type: none"> <li>• Provides volume and price signals to domestic wheat users — facilitates efficient purchasing decisions and avoids domestic price volatility</li> <li>• Informs trading decisions of exporters and coordinates the efficient marketing of export wheat</li> <li>• Marginal administrative costs (using existing systems)</li> </ul>	<ul style="list-style-type: none"> <li>• Tier 2 information is also of net benefit to the industry</li> <li>• Industry should pay for this information</li> <li>• Government intervention is warranted to facilitate compulsory industry contributions</li> </ul>
Tier 3	<ul style="list-style-type: none"> <li>• Allows traders to better ‘match’ wheat with customer requirements</li> <li>• Removes any advantage ‘informed’ traders have in trading decisions</li> <li>• Administrative costs are potentially significant and include resolving issues of:               <ul style="list-style-type: none"> <li>- ownership of information</li> <li>- confidentiality requirements</li> <li>- the commercial rights and interests of information owners</li> <li>- managing and coordinating information disclosure</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• The costs of requiring the bulk handling companies to provide a particular level of tier 3 information are potentially significant — it is unlikely that mandatory provision of this information would represent a net benefit to the industry</li> <li>• However, greater disclosure of this information is expected to improve the operation of the wheat market</li> <li>• Voluntarily disclosure of more tier 3 stocks information is strongly encouraged. There is scope for traders and growers to pressure the bulk handlers to voluntarily disclose this information</li> </ul>

Notwithstanding this rationale, many participants considered that the bulk handling companies are not entitled to such a generous return on their investment in the supply chain because these companies did not pay ‘commercial prices’ for these assets to begin with. Other respondents argued that the bulk handling companies only have access to this information because of the storage services they provide, not because they have paid for — or earned — the benefits of the associated stocks information. These concerns should provide industry with further impetus to persuade the bulk handling companies to do more to improve information distribution.

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## Stocks information in other regions

GGA was one of several participants to refer to the information services provided in the United States and Canadian wheat markets, and propose that similar types and levels of information be provided in Australia:

The USDA [United States Department of Agriculture] is the standard, with a range of reports at varying timeframes starting from daily. (sub. 41, p. 19)

The Commission recognises that the level of long-term and short-term wheat market information — including stocks information — provided in the United States and Canada is considerably more sophisticated and timely than the information provided in Australia (appendix C).

For example, the US Department of Agriculture produces a weekly Export Sales Report that provides information on total known outstanding sales and accumulated exports of all classes of wheat, forecasts of future wheat exports and statistics on wheat committed for export (USDA 2010). This report is released with a one week lag. In addition, during the harvest period the US Wheat Associates publish a weekly summary of commercial sales (USW 2010a).

However, participants also acknowledged that the arrangements in the United States and Canada are not particularly realistic in the Australian context. The Wheat Quality Objectives Group pointed out:

The funding of US Wheat Associates needs to be clearly understood. The major financier ... is the US government. Through the USDA the government has funded 73% of the US Wheat Associates annual budget [of] US\$15.4 million for the last few years. (sub. 27, p. 4)

Similarly, the Wheat Classification Council (WCC) commented:

It should be recognised that the wheat associates have an extremely large budget and so are involved in a wider and more extensive suite of activities than any of the grain peak bodies in Australia. It is considered that whilst Australia would not need anything of this order of magnitude the principles of the model are good. (sub. 32, p. 12)

The Commission agrees with this view, and considers that despite the wealth of publicly available and timely information provided in these regions, it is important to be mindful of the different market environments. In particular, the arrangements for information provision in the United States and Canada are characterised by:

- domestic policies and government priorities that guarantee significant public support for the wheat industry
- high levels of government involvement.

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## 7.5 Provision of industry goods and services

The economic and institutional framework set out in this section is not specific to the provision of stocks information by state, or indeed to the provision of market information. The Commission expects that the principles set out in this framework can and should guide the industry's approach to provision of any industry good function that:

- produces significant intra-industry (private) benefits
- does not justify taxpayer funding support
- is characterised by particular public good characteristics (for example, the free rider problem) that compromise the provision of that good or service by the private market.

Ahead of describing the Commission's proposed framework for facilitating provision of such industry good functions, it is important to identify and consider the key steps that must be taken by the industry as part of this process.

### **Achieving industry provision of 'industry good' functions**

To facilitate provision of industry good functions, it is necessary for the wheat industry to:

- reach agreement on the type and level of goods and services to be provided
- implement funding arrangements to support provision of those goods and services
- contract out the provision of those goods and services.

#### *Industry consensus*

The Australian wheat industry, as the primary beneficiary of a particular industry good function, must come to a view on precisely what type and amount of goods and services the industry is willing to pay for, and the preferred service provider. In the Commission's view, a nominated industry-led body (or bodies) would be well placed to canvass the views of industry participants and come to such decisions on behalf of the industry.

As set out in chapter 9, the Commission recognises that various industry groups are currently considering establishing a range of industry bodies. It is not appropriate for the Commission to prescribe which body (or bodies) should assume responsibility for representing the views of industry with regard to the provision of

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industry good functions — this decision is best taken by the industry, in cooperation with government. However, it is important that any body charged with reaching industry agreement is industry-funded, and capable of accurately assessing and representing the views of industry participants.

### *Funding arrangements*

Raising funds from industry participants for the purpose of providing industry good functions involves careful consideration of the public good characteristics of those goods and services. Although the primary beneficiary of an industry good function might be the wheat industry, the public good characteristics of that good or service, and the non-excludability characteristic in particular, could frustrate provision by the private market.

Where such a free rider problem exists, industry participants do not face a strong incentive to contribute to the cost of providing industry good functions. It is theoretically possible to alleviate the free rider problem via arrangements that restrict access to particular goods and services, for example, by creating property rights. However, the regulatory and administrative costs associated with introducing such arrangements could be significant. If this is the case, a compulsory payment mechanism (for example, a compulsory industry levy) might be required to successfully fund the provision of industry goods and services.

Compulsory levy arrangements may only be imposed on industry participants if they are enshrined in relevant legislation. Industry-led bodies do not have the necessary powers to administer any form of compulsory levy. It is in this context that the case for some form of non-funding government involvement to support the provision of industry good functions becomes relevant. Specifically, the only options for facilitating a compulsory contribution from wheat industry participants to fund industry good functions are via:

- an existing, compulsory levy arrangement
- introduction of a new compulsory levy mechanism, legislated by government.

The choice between drawing on a new or existing compulsory levy mechanism to fund industry good functions will ultimately depend on the feasibility and cost-effectiveness of each option (box 7.9).

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**Box 7.9 Administrator of compulsory levy mechanism**

In determining which agency should take on responsibility for administration of a compulsory levy mechanism to fund provision of any industry good function(s), the industry and government will need to consider the feasibility of:

- using an existing mechanism, including whether the legislation allows levy revenue to be used for the intended purpose, and if not, whether the legislation could be changed
- legislating a new compulsory levy mechanism, including whether an existing industry body could administer this, or whether a new body would be required.

Having established the feasibility (or not) of these options, it would then be up to industry and government to assess their cost-effectiveness.

### *Provision of the good or service*

In circumstances where one or more organisation (new or existing), could feasibly provide an industry good function, it will be necessary for the industry to determine which organisation (or organisations) to engage. To facilitate this, it may be desirable for the body charged with representing the views of industry participants regarding provision of industry good functions, to also have responsibility for choosing the relevant service provider. This decision could be determined by a poll of industry participants, or at the discretion of the nominated industry body, possibly guided by certain industry-agreed criteria, principles or objectives.

### **Institutional and economic framework**

The Commission proposes that the following framework (table 7.5) be applied by the wheat industry to facilitate the provision of industry good functions. In setting up the required institutional arrangements, the wheat industry should be guided by the relevant economic principles.

As set out earlier, the Commission considers that it is for government and industry to determine which body should assume responsibility for representing the views of industry participants with regard to provision of industry good functions. The Commission anticipates that one body could potentially fulfil this role for multiple industry good functions. This body would then be tasked with nominating the ‘levy administrator’ and ‘service provider’. The preferred service provider will depend on the particular good or service in question, and the level of competition amongst potential service providers. The levy administrator (and the associated compulsory levy collection framework) might also vary, and will be determined by the

feasibility and cost-effectiveness of relying on any existing levy collection framework, as compared to establishing new arrangements.

**Table 7.5 Institutional and economic framework**

<i>Institutional arrangements</i>	<i>Economic principles</i>
<b>Industry body</b>	
<i>Reach industry consensus</i>	
<ul style="list-style-type: none"> <li>Decide, on behalf of industry, what goods and services (industry good functions) the industry is willing to pay for.</li> </ul>	The nominated industry body should be industry-funded.
<i>Devise funding arrangements</i>	
<ul style="list-style-type: none"> <li>Determine whether the free rider issue can be managed cost-effectively, or a compulsory payment mechanism (such as a levy) is required.</li> <li>Advise the Government or relevant Minister on the preferred amount of the compulsory levy (box 7.10).</li> <li>Advise the Government or relevant Minister on the preferred levy collection framework (new or existing) to be relied upon, and the preferred levy administrator (box 7.10).</li> </ul>	<p>If it is not practical or cost-effective to administer a user-pays system, a compulsory levy mechanism should be used.</p> <p>The levy should be:</p> <ul style="list-style-type: none"> <li>consistent with the ‘beneficiary pays’ principle</li> <li>levied on growers (as opposed to further up the supply chain). This is the simplest and most cost-effective option, given the incidence of any levy will ultimately sit with growers</li> <li>set as a percentage of the farm gate value of production</li> <li>proportional to the cost of service provision</li> <li>subject to annual review by the nominated industry body.</li> </ul> <p>The choice of preferred levy collection framework should be based on the feasibility and cost-effectiveness of alternate options — subject to meeting the above criteria — and made in consultation with the Government.</p>
<i>Select the service provider</i>	
	The choice of service provider should be transparent and based on pre-determined selection criteria, set out by the nominated industry body (and endorsed by the industry).
<b>Levy administrator</b>	
<ul style="list-style-type: none"> <li>Collect compulsory levy amount from industry participants (as provided for in legislation).</li> </ul>	
<b>Service provider</b>	
<ul style="list-style-type: none"> <li>Provide the goods and services commissioned by the nominated industry body (and funded via the compulsory levy).</li> </ul>	

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**Box 7.10 Levy development and administration — the role of the Australian Government**

Under the existing arrangements for imposition of primary industry levies in Australia, an industry body must identify the need to amend or establish a levy to respond to a problem or opportunity requiring collective industry funding. To this end, the industry body must consult with the Department of Agriculture, Fisheries and Forestry (DAFF), and make use of the *Levy Principles and Guidelines*, to prepare a case for a levy to be considered by industry members.

If a majority of industry participants support the levy proposal, the industry body submits the proposal to the relevant minister or the parliamentary secretary for consideration. DAFF assesses the proposal against the *Levy Principles and Guidelines* and provides advice to the minister or parliamentary secretary. Some proposed levy amendments cannot proceed without the approval of the Prime Minister and the Treasurer. If the levy proposal is approved, the Australian Government drafts the legislation to implement the levy.

In some circumstances, the Australian Government may initiate the introduction or change of a levy in the public interest.

The Levies Revenue Service (LRS) is part of DAFF. The LRS administers, collects and disburses levies on a cost-recovery basis. At present, the LRS collects approximately 60 different levies and charges from more than 9 000 levy payers.

*Sources:* DAFF (2009a, 2010).

## **Applying the framework to market information**

Drawing on the framework described in table 7.5, this section sets out the Commission's view on the most efficient approach to industry provision of wheat market information.

### *Scope of market information to be provided*

The Commission anticipates that the industry will see value in the provision of regular and timely information on wheat stocks by state, and notes that the costs involved with providing this information are expected to be modest. The Commission considers that the two wheat stocks publications currently produced by the ABS provide a good example of the level and type of stocks information that the industry should commission from the preferred service provider, if it chooses to fund this information. The Commission understands that the cost of the ABS producing these publications is about \$1 million per year.

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There are likely to be significant economies of scale associated with the collection, management and dissemination of this information. For this reason, if the industry sees value in having this information made available, it would be wise to pursue provision of this information on a collective basis.

More disaggregated stocks information (tier 3 information) might generate marginal efficiencies for the operation of the Australian wheat market in specific circumstances, but is more consistent with localised, commercial benefits for particular industry participants. The precise merits of providing tier 3 information should therefore be considered on a case-by-case basis by the relevant parties, recognising that there will be cases where competition between the holders of information and the information seekers will be a barrier to some information being provided.

Some participants have expressed concerns about the timing and frequency of the information currently provided by the ABS and ABARE. The VFF commented:

Despite a massive increase in funding, by the time information is published by the Australia Bureau of Statistics (ABS) it is already six weeks old. This provides no transparency for the industry and does not assist growers to make effective marketing decisions. (sub. 40, p. 3)

The PGA (sub. 47, p. 11) put forward a similar view, noting ‘the required information from ABS and ABARE is useful; however by the time it reaches the grower is often out of date’. These views reinforce the findings of the GIWA review. GIWA (sub. 38, p. 3) concludes ‘the time delay in publishing ABS information renders it largely ineffectual for making commercial decisions’.

The Commission recognises that the market would prefer to access stocks information in a more timely manner. However, given the logistics associated with conducting the surveys that support the ABS’s publications, it is not clear that the ABS or any other information provider could produce this information more quickly without incurring significant expense, or reducing the reliability, scope and coverage of the surveys. The Commission also notes that the majority of market participants have strongly advocated that the ABS stocks information be continued beyond 30 June 2011 — suggesting that the industry does value this information despite the lags involved. In any case, concerns about timeliness are likely to be more relevant to stocks information that dictates very short-term trading decisions (such as tier 3 information), as compared to stocks information by state.

In summary, although the Commission considers that provision of regular and timely information on stocks by state (tier 2 information) is essential to support an efficient wheat market, the Commission recommends that the industry pay for provision of this information, and considers that the stocks publications currently

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produced by the ABS are a good example of what these information outputs might look like. Notwithstanding this, it will be up to the industry — via the nominated industry body — to reach an agreement with the preferred information provider on the precise content, timing and cost of any stocks information it commissions.

### *Funding arrangements*

The Commission does not anticipate that provision of stocks information by state will impose a material cost on the industry — particularly if the industry elects to commission a similar type and level of stocks information to what is currently provided by the ABS.

It is highly unlikely that a user-pays system for establishing access to this information would be a cost-effective option. The administrative and regulatory costs associated with developing such arrangements would not be trivial, and would likely serve to undermine the case for providing stocks information at all.

Similarly, the relatively modest cost of producing stocks information by state is unlikely to justify the development of a new, compulsory levy mechanism. The Commission considers that if the industry wants to see stocks information produced, an existing compulsory levy contribution framework is the most efficient and practical mechanism for funding the provision of this information.

The Commission notes that under the current arrangements, wheat growers are required to pay a production levy to the GRDC, and wheat exporters are required to pay the Wheat Export Charge (WEC) to the Department of Agriculture, Fisheries and Forestry's Levies Revenue Service (chapter 4). In both cases, these levies are compulsory and are supported by appropriate legislative instruments (the *Primary Industries Levies and Charges Collection Act 1991* (Cwlth), the *Primary Industries (Customs) Charges Act 1999* (Cwlth), the *National Residue Survey (Excise) Levy Act 1998* (Cwlth), and associated legislation) (DAFF 2010).

As set out in chapter 4, the Commission recommends that WEA be abolished in 2011. Under this scenario, the legislation that supports WEA — and imposes the compulsory WEC on exporters — would cease to be effective. The industry could decide to continue collecting the WEC on a voluntary basis, and use this revenue to fund stocks information. However, as described earlier, the free rider issue is expected to undermine private provision of stocks information. In addition, the WEC is only levied on wheat exporters — this is not consistent with the beneficiary pays principle, given the value of stocks information to the domestic wheat market. Given stocks information by state benefits both domestic and export wheat market

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participants, it is important that the entire industry meets the cost of providing this information.

The Commission considers that grower levy contributions to the GRDC provide an appropriate revenue source for funding the provision of stocks information by state, on behalf of the industry. As levies — wherever imposed — would ultimately fall on growers, a grower levy effectively ensures that the entire wheat industry pays for this information, and would remove the costs and challenges associated with legislating and administering any new, compulsory levy mechanism.

The Commission understands that the GRDC is able to use revenue from industry contributions for this purpose (box 7.11). Indeed, the GRDC currently provides funding to both the ABS and ABARE for the purpose of producing grains information. However, the GRDC is an Australian Government statutory corporation and it would be appropriate to seek the views of the Australian Government on this issue.

#### RECOMMENDATION 7.1

*The Commission sees value in the provision of stocks information by state to support the effective operation of the domestic and export wheat markets. However, if the industry wants this information, it should pay for it. The most efficient approach to funding this information would be via an existing compulsory industry levy. Specifically, the GRDC levy collection framework appears to be the most practical and cost-effective option for funding stocks information by state.*

The Commission is aware that the ABS will continue to produce wheat stocks, use and forward commitment information up to, and including, the September 2011 reference period (using the funding provided via the Industry Assistance Package). On this basis, a compulsory levy arrangement should commence from 1 October 2011, if the industry decides to pursue this approach.

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### Box 7.11 GRDC levy

The Grains Research and Development Corporation (GRDC) is a statutory corporation established in 1990 under the *Primary Industries and Energy Research and Development Act 1989* (Cwlth) (the PIERD Act).

GRDC is funded by growers' contributions (the GRDC levy) and a sliding scale of 'matching' contributions paid by the Australian Government. The GRDC levy is collected on 25 crops produced in Australia, including wheat, and is currently set at 0.99 per cent of the farm gate value of grain. The Government typically contributes about 30 to 40 per cent of total levies collected — this contribution is capped at 0.5 per cent of the gross value of Australian grains production.

Section 33 of the PIERD Act specifies that GRDC's money may only be spent on funding research and development activities identified in the Annual Operational Plan (AOP), or for payment or discharge of various expenses and liabilities incurred by the GRDC in its operations. The AOP sets out the GRDC's annual budget, resources and research priorities, including forecast levy revenue. The AOP must be approved by the relevant minister, and the GRDC must consult with the 'representative organisation' in preparing or varying the AOP — the Grains Council of Australia currently fulfils this role.

The 2009-10 AOP sets out four 'output groups' of research and development investment activity — Practices, Varieties, New Products and Community and Capacity Building — with various 'planned outputs' associated with each of these groups. The nature of these planned outputs are quite varied, suggesting the GRDC has some discretion as to how it allocates revenue against its objectives. The Commission expects that using levy revenue to fund provision of stocks information by state would be consistent with the objectives set out in the GRDC's AOP, and therefore allowable under the PIERD Act.

*Sources:* GRDC (2009a, 2009c, 2010a).

### *Service provider*

Provision of regular and timely information on wheat stocks by state could be undertaken by:

- the ABS
- the bulk handling companies
- an existing industry body, such as the GRDC, GGA, BRI, GCA
- a new industry body — chapter 9
- a commercial information provider.

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The Commission considers that the ABS is well placed to provide this information. This view is based on the fact that the ABS:

- is independent
- has the necessary powers to compel provision of information from grain handlers (box 7.12)
- is bound by appropriate confidentiality requirements (box 7.12)
- provides comprehensive stocks information, by virtue of the coverage of the Grain Handlers Stocks Survey
- has well established systems, resources and processes for collection and provision of this information, and has considerable experience and expertise in this area.

**Box 7.12 The ABS legislative framework**

The *Australian Bureau of Statistics Act 1975* (Cwlth) establishes the Australian Bureau of Statistics (ABS) as an independent statutory authority, defines the functions of the ABS, establishes the office of the Australian Statistician and describes the terms under which the Australian Statistician can be appointed to, and removed from, office. The ABS Act also provides for the appointment of the staff of the ABS and establishes the Australian Statistics Advisory Council.

The *Census and Statistics Act 1905* (Cwlth) provides the Australian Statistician with the authority to conduct statistical collections, including the Census of Population and Housing, and, when necessary, to direct a person to provide statistical information. The Census and Statistics Act requires the ABS to publish and disseminate compilations and analyses of statistical information and to maintain the confidentiality of information collected under the Act.

Source: ABS (2010a).

It is unlikely that any alternative information provider could offer these same benefits. Accordingly, using other providers would pose risks for the completeness, accuracy, independence and rigour of any information provided. The costs of establishing the necessary personnel, resources and technical capabilities might also be significant. In addition, there are likely to be challenges and delays associated with developing the required legislative and administrative arrangements, for example, assigning the information agency with powers to direct a person to provide statistical information.

FINDING 7.3

*The ABS is well placed to continue providing stocks information by state.*

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A summary of the Commission's view on the way forward for wheat market information provision is provided in box 7.13.

**Box 7.13 The way forward**

- The funding provided to the ABS and ABARE as part of the Industry Assistance Package will cease on 30 June 2011. No further government funding should be provided.
- Government funding should continue to support the provision by the ABS and ABARE of core, long-term wheat market information.
- The Commission considers that provision of regular and timely information on stocks by state is essential to support an efficient wheat market, but believes that the cost of producing this information should be met by the industry. A compulsory payment mechanism, such as an industry levy, should be used. Funding through an organisation such as the GRDC would appear to be an efficient option, given it already has a levy collection mechanism in place. This is consistent with the GRDC's current funding agreements with the ABS for the collection of barley stocks information,<sup>a</sup> and with ABARE for the *Australian Grains Series*.
- The industry must decide, via a nominated industry body, whether it is willing to pay for the provision of stocks information by state, and if so, which agency it wishes to commission stocks information from. The Commission considers that there is value to the industry in having access to stocks information, and that the information currently produced by the ABS provides a good example of what the industry should request. The cost to the ABS of producing these publications is expected to be about \$1 million annually. The ABS is well placed to continue to produce stocks information by state.
- No changes should be made to any other aspect of the current arrangements for public information provision — it is open to industry to work out alternative arrangements to the existing private provision of information.

<sup>a</sup> The Commission understands that this arrangement is temporary only, and due to expire on 30 June 2011.



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## 8 Wheat quality standards and market segmentation

### Key points

- Management of wheat quality standards, and quality assurance mechanisms, are best left to industry to design and manage.
- There is no evidence, or suggestion, that the current arrangements hinder the development of niche markets, or stifle product innovation and differentiation.
- There is broad support for the ongoing operation of an industry-based national wheat classification function beyond 2010.
- Most participants supported the existing model for wheat classification, although specific features of the model have been questioned. The review by the Wheat Classification Council should be able to deal with these issues. The Commission has not identified a role for government in this area.
- The benefits of varietal classification can potentially be captured by plant breeders. The assessment and classification of new wheat varieties by the Wheat Varietal Classification Panel could be undertaken on a fee-for-service basis.
- Removal of the single desk has meant that the number of collection points for End Point Royalties for wheat has increased, and this has been a concern for plant breeders. However, there are more fundamental concerns regarding the adequacy of the system as it applies to all industries serviced by plant breeders.
- The Australian Council for Intellectual Property has made a number of recommendations for reform of the system, and these are currently being considered by the Australian Government.
- A well functioning system for the collection and enforcement of End Point Royalties to protect plant breeders' rights is important to the continued investment in new wheat varieties. The Commission considers reforms and initiatives to improve the system should be implemented expeditiously.

In Australia, wheat quality standards are managed through wheat classification and receival standards. These mechanisms establish a framework through which wheat can be categorised according to its genetic characteristics, physical qualities and condition when it arrives at a receival point.

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The quality standards system exists to assist the industry as a whole by:

- providing an agreed set of standards such that value from a differentiated product can be captured
- facilitating the delivery of a reliable ‘brand’ of Australian wheat to export customers
- facilitating cost-effective storage and handling of bulk wheat.

The quality standards system is an ‘industry good’ function, which has a combination of private and intra-industry public good characteristics (chapter 7). That is, although the use and benefits of the system are confined to the industry itself, those benefits cannot be captured exclusively by any individual industry participant. There is little or no commercial incentive for participants to independently provide or maintain a system of quality standards, and many of the benefits lie in there being widespread use of the system. Hence, there is every incentive for the industry to act collectively to establish and maintain a quality standards system. In principle, there is no case for government involvement in the design or implementation of such a system, given that the benefits are confined to the industry, and incentives within the industry are such that under-provision of such services is not a risk (though the Commission is aware that the industry is still negotiating an appropriate private funding mechanism to undertake the tasks associated with establishing quality standards).

In this chapter, the system used to establish wheat quality standards, and the importance of those standards, are described in sections 8.1 through to 8.3. Participants in this inquiry supported a nationally agreed system of standards and, by and large, considered the system to be working well. Issues of concern identified by participants are addressed in section 8.4. These relate to the future institutional settings for quality standards management, opportunities for industry participants to capture value from their wheat, quality assurance, and the collection system for End Point Royalties (EPRs).

## **8.1 What are wheat quality standards?**

The term ‘wheat quality’ refers to the quality required by the customer, and may be a combination of wheat, flour, dough and end product attributes, as well as consistency within and between deliveries. Wheat quality broadly derives from the variety grown, the growing conditions and post-harvest handling (Wheat Classification Council, sub. 32, p. 1).

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## **Wheat classification and receival standards**

Wheat classification involves assessment of the inherent characteristics of wheat varieties, using those characteristics to place the varieties into classes or ‘wheat grades’. A wheat class/grade is awarded to a product based on its processing and end-use qualities (table 8.1). Quality requirements of a wheat class/grade may change from time to time in response to market requirements. Classification of a new variety into its respective wheat class/grade is a complex task involving an evaluation of the quality of that variety within a defined geographic area, over several years of production.

**Table 8.1 Australian wheat classes/grades**

<i>Wheat class/grade</i>	<i>Classification zones</i>	<i>Characteristics</i>	<i>Target protein range %</i>	<i>Required end products</i>
Australian Prime Hard (APH)	QLD, all NSW zones	Hard grain, good milling quality, dough strength and extensibility	13-15	Yellow alkaline noodle, straight dough baking, sponge and dough baking
Australian Hard (AH)	All zones	Hard grain, good milling quality, dough strength and extensibility	11.5-13.5	Yellow alkaline noodle, straight dough baking, sponge and dough baking
Australian Premium White (APW)	All zones	Hard grain, good milling quality, medium to strong and extensible dough, moderately high to high-swelling starch	10-12	Yellow alkaline noodle, straight dough baking, sponge and rapid dough baking
Australian Standard White (ASW)	All zones	Mainly hard but some soft grain. Sound, good milling, medium strength and extensibility	..	Yellow alkaline noodle, straight dough baking, sponge and rapid dough baking
Australian Soft (ASFT)	All zones	Soft grain, good milling quality, low strength but adequate extensibility, low flour water absorption	7.5-9.5	Cookie or biscuit, steamed bun
Australian Noodle (ASWN)	All NSW, WA, Vic zones	Soft grain, good milling quality, moderate strength and good extensibility	9.5-11.5	Udon noodle
Australian Premium Durum (ADR)	All zones	Free-milling grain, vitreous, amber-coloured kernels, produces semolina	13-15	Dry long Italian type pasta (spaghetti)
Australian Premium White T (APWT)	WA only	Hard grain, high-swelling starch	10-12	White salted noodle

.. Not applicable.

Sources: AWBI (2008); Department of Agriculture and Food (Western Australia) (2005a, 2005b).

Classification of wheat into wheat classes/grades is distinct from receival standards (or bin grades). Receival standards set the quality criteria for the delivery of wheat to grain buyers and accumulators. Receival standards categorise wheat according first to its wheat class/grade, and then to a range of other physical characteristics on arrival at a receival point. These characteristics include, for example, protein, moisture and the presence of any contaminants, such as unapproved chemical residues, foreign seeds and defective grains (screenings), insects and moulds. These

standards provide the framework for the practical use of the wheat classification system (Wheat Classification Council, sub. 32) (figure 8.1).

**Figure 8.1 Wheat classes/grades and the bin grade matrix**

		Wheat grade (or class)								
		APH	AH	APW	ASW	AGP	ASF1	ASWN	ADR	FEED
H A R D	Bin grade									
	APH2	✂								
	H1	✂	✂							
	H2	✂	✂							
	APW1	✂	✂	✂						
	APW2	✂	✂	✂						
	ASW1	✂	✂	✂	✂					
	AUH2	✂	✂							
	AGP1	✂	✂	✂	✂	✂	✂	✂		
	AUW1	✂	✂	✂	✂	✂	✂	✂		
M I X E D	HPS1	✂	✂	✂	✂	✂	✂			
	SFW1	✂	✂	✂	✂	✂	✂			
	ANW1							✂		
	ANW2							✂		
	SFT1						✂			
S O F T	SFT2						✂			
	DR1							✂		
	DR2							✂		
	DR3							✂		
FED1	✂	✂	✂	✂	✂	✂	✂	✂	✂	

Note: Results for APWT are generally as per APW, so have not been included here separately.

Source: Based on information in *Wheat Trading Standards 2009-10 Season* (GTA 2009c).

Figure 8.1 shows the range of bin grades that may be assigned to a variety, according to which of the wheat classes/grades it belongs, and includes the lower bin grades to which it may also be assigned. For example, only varieties that have been classified as Australian Prime Hard (APH) can be received as APH2, but APH varieties may also be assigned lower bin grades on receipt (right down to feed wheat), according to their various other quality characteristics as set out in the Grain Trade Australia (GTA) wheat trading standards (GTA 2009c).

Use of the system of wheat classification and receipt standards by industry participants is voluntary. There is no impediment to growers and traders trading

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wheat that does not fit within the specifications of the system, so long as it is not represented and marketed as meeting the standards set by the system.

## 8.2 Institutional arrangements

### Wheat classification

Prior to deregulation, AWB (International) Limited (AWBI) undertook wheat classification, and established all wheat classes/grades, described in the Wheat Classification Guidelines (AWBI 2008). Following deregulation the Grains Research and Development Corporation (GRDC) assumed responsibility for the management and operation of wheat classification at the request of the Minister for Agriculture, Fisheries and Forestry.

The GRDC implemented a two-tiered model to provide the functions required for wheat varietal classification. This involves:

- determination of wheat classes/grades based on market requirements (currently undertaken by the Wheat Classification Council (WCC))
- assessment and classification of new wheat varieties into the established grades (undertaken by the Wheat Variety Classification Panel (the Panel)).

#### *The Wheat Classification Council*

The WCC was established on a trial basis in February 2009 to ascertain the industry's ongoing needs for the wheat classification system. It is also responsible for oversight of wheat classification activities.

The WCC presides over a grading framework and criteria that inform wheat variety classification and ultimately wheat breeding and wheat quality research. The WCC operates in accordance with the principles contained in the Wheat Classification Guidelines. The WCC recently completed a revision of the Guidelines.

The administration of classification guidelines is a strategic industry function, and requires input from industry participants. Under the current arrangements, the Chair of the WCC is a grower representative appointed by the GRDC. Selection and appointment of Council members is the responsibility of the Chair. Membership is intended to be representative of industry, and is made up of representatives from wheat producing, marketing, exporting, storage and handling, breeding and domestic processing organisations. The GRDC provides support for the Chair and

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an Executive Officer. Other members, including any grower representatives other than the Chair, fund their own participation on the Council (WCC 2009b).

The WCC was also tasked with developing a model for how it will operate in the longer term, including the future operation of wheat classification in Australia. As part of its review, it was to make recommendations regarding the structure, function and funding options for wheat classification in consultation with key stakeholders before 30 June 2010 for consideration by the GRDC (WCC, sub. 32).

### *The Wheat Variety Classification Panel*

Following deregulation, the GRDC conducted a tender process for an independent service provider to administer the Variety Classification Panel. It appointed BRI Research to manage the varietal classification process for a period of two years from 2009. BRI Research performs a secretariat function, which includes administration, data management and specialist liaison with clients.

The varietal classification process involves assessing new varieties of wheat, and categorising them into one of the Australian wheat classes/grades. Classification decisions for each new, or ‘candidate’, variety of wheat are made on the basis of quality data collected from breeding trials on a seasonal (over a minimum of three seasons) and regional (relating to a defined region of production) basis. Regions of production are referred to as Classification Zones, of which there are currently seven throughout Australia. The classification of a single variety of wheat may vary between different zones, reflecting the impacts of different environments on the quality of that variety.

Members of the Panel are selected based on technical experience and expertise via a selection process overseen by the GRDC.

### *Responsibility for wheat receival standards*

GTA, (formerly NACMA (National Agricultural Commodities Marketing Association)), is an industry body that was formed in 1991 to perform a range of functions, including the standardisation of grain standards, trade rules and grain contracts. It is fully funded by membership fees and provision of services to industry.

GTA plays a role in managing wheat quality through the annual review and publication of wheat receival standards — originally developed by AWBI for bulk storage facilities.

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As part of the annual review process GTA develops an issues paper for distribution to industry, and seeks submissions both from members and the broader grains industry. All submissions are considered by the GTA Standards Committee, which then develops a draft set of Standards. These draft Standards are subject to further review until there is consensus among industry representatives (GTA, sub. 67).

In addition, GTA has developed a grain industry Code of Conduct (funded by the Australian Government's Industry Assistance Package (box 9.3)) to cover both bulk and container trade in order to, among other things, facilitate quality assurance across the industry.

### **8.3 Why are quality standards important?**

An effective quality standards system should facilitate trade by providing opportunities for growers and traders to capture value from their wheat, and to service niche markets through product differentiation. It is particularly important in the context of wheat exporting as it provides benchmarks for trade and quality assurance of Australian wheat in international markets, and facilitates cost-effective storage and handling of bulk wheat.

#### *Benchmarks for quality assurance and trade*

One of the objectives of using a single nationwide quality standards system is to create conditions for which grain of consistent physical quality, processing performance and end product quality can be delivered to overseas (and domestic) markets. The classes/grades of Australian wheat form the basis of the marketing and promotion of wheat internationally (IEG 2008), and in this way assist in establishing and maintaining a reliable 'brand' of Australian wheat.

Receival standards are an important part of the quality assurance process. Wheat is accumulated across Australia in a large number of relatively small consignments at bulk storage and handling facilities. Agreed receival standards provide a basis upon which buyers are able to verify that the wheat they receive matches the description of the wheat they have purchased.

#### *Logistics of storage and handling*

The system of wheat classification allows different varieties within a wheat grade to be mixed, while maintaining the milling and baking properties required by end users (IEG 2008). For example, varieties classified into hard wheat classes/grades, such

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as APH and Australian Hard are suitable for certain types of breads and noodles; varieties classified into soft wheat classes/grades are suitable for confectionary, baked products and some snack foods; and varieties classified as durum are suitable for use in pasta (table 8.1).

Suitability for particular end uses is also influenced by the quality characteristics of the wheat, in addition to its physical or genetic properties. Bin grades, as set out by receival standards, enable market participants to determine the specific quality characteristics of wheat.

Bulk storage facilities have the capacity to make a limited number of segregations of wheat arriving from many different sources. Therefore, the wheat supply chain for bulk export is, by its nature, heavily reliant on shared storage space. When wheat arrives at a receival point it is blended, or commingled, with other wheat that meets standards within a certain bin grade. After it is commingled, an individual farmer's wheat is indistinguishable from other wheat in that segregation. Growers and traders need assurance that they are able to trade grain that meets a standard similar to that which they have delivered to a storage and handling facility. Variety classification and receival standards represent the agreed set of standards for this to occur (WCC, sub. 32).

It is standard practice for bulk handling facilities to guarantee only the minimum receival standard on outturn of wheat that is commingled for bulk storage. Given limited storage capacity, and therefore limited number of segregations that can be made at bulk handling facilities, there are trade-offs between the additional costs of storing wheat separately, and the additional expected return from doing so. That said, segregation decisions at bulk storage facilities are influenced by client (grower and trader) demands, as well as other factors such as wheat on hand and available capacity. For example, AWB Limited (AWB) and GrainCorp both offered an APH1 bin grade with a minimum of 14 per cent protein for the 2009-10 season in New South Wales (chapter 3).

## **8.4 Issues in a deregulated environment**

Although there was broad support for the ongoing role of a nationally agreed set of wheat quality standards for the industry, participants identified issues relating to the future of institutional settings for managing wheat quality standards, opportunities for industry participants to capture value from their wheat, quality assurance mechanisms, and plant breeders rights.

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## Future institutional settings

The current settings and approach to wheat classification and receival standards were broadly considered by participants to be appropriate in assisting the industry to operate more effectively and efficiently. For example, the Australian Grain Exporters Association (AGEA) noted the importance of maintaining and enhancing the key tools for quality, including classification, receival standards and quality assurance practices (monitoring) (sub. 28).

Agforce (sub. 16) commented that the current system of classification was adequate, and did not believe that the market could handle quality issues without a body such as the WCC, based on the experience of other industries. Similar comments, noting the importance of a quality framework to Australia's reputation in international markets, were made by AWB (sub. 24); AGEA (sub. 28); and the Department of Agriculture and Food (Western Australia) (sub. 34). The Wheat Quality Objectives Group (WQOG) also supported a coordinated approach:

[G]iven the highly competitive nature of most aspects of the deregulated wheat market, it is difficult to see a ready means by which the various stakeholders could independently achieve workable solutions to the numerous and often highly technical issues that underpin the production, segregation and marketing of Australian wheat. (sub. 27, p. 5)

Other participants expressed provisional support for the arrangements, such as the Victorian Farmers Federation:

The process of classification of wheat which has been initiated by the Grains Research and Development Corporation looks promising but is still in initial stages and needs to be monitored and supported to ensure its delivery runs smoothly. (sub. 40, p. 3)

However, with regard to the post-deregulation arrangements for wheat classification, views differed regarding whether this role should be undertaken by an existing or new industry body, and specifically how that body should be structured. In relation to receival standards, some participants noted their concerns regarding trends in the setting of standards by GTA.

### *Wheat classification*

The WCC commented that 'the extent to which wheat classification and receival standards are useful depends entirely on the extent to which they reflect market requirements and provide a quality framework for trade' (sub. 32, p. 1). The WCC, or any eventual wheat classification body, must therefore have mechanisms to capture market feedback and translate that into wheat classes/grades, and class requirements.

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For these reasons, it is important that governance arrangements facilitate input to the process that is representative of industry. Appropriate and balanced representation in the wheat classification process will help to ensure that wheat classes/grades are relevant and appropriate to changing market conditions and demands.

The forthcoming review of the WCC role was welcomed by participants, and suggestions were made with regard to possible changes to the current arrangements.

Agfarm (sub. 44) considered that the usefulness of wheat classification is dependent on whether consumers of Australian wheat value the classification process. They suggested that classification continue in the short term until its value to consumers can be determined.

Intergrain similarly commented:

The current wheat classification system has no legal status and operates on inertia and common consent. In the past, this has not been a major issue, but going forward, wheat classification will need to be founded on a clear, transparent, rigorous and objective basis or the process will fail very quickly. (sub. 33, p. 1)

Several participants supported a classification function undertaken by an industry peak body, independent of the GRDC (for example GGA, sub. 41; Department of Agriculture and Food (Western Australia), trans., p. 111).

AWB further advocated an independent, elected chair to ensure a democratic process is in place, and a 'minimum allocated representation for growers, domestic processors, exporters and plant breeders' (sub. 24, p. 22) to ensure a truly representative body.

The WQOG (sub. 27) thought that the basic structure and mode of operation of the WCC was workable, and its composition ensured that the key issues were on the table for debate. However, it noted that the task of making variety classification decisions is a highly technical process and in order to operate effectively the WCC needed strong input from those with the required level of expertise.

The WCC review should be able to address these issues. In general, participants to this inquiry expressed a preference for the responsibility for wheat classification to remain with the industry. Given that the use and benefits of this function are confined to the wheat industry itself, as noted earlier and in chapter 7, the industry is best placed to determine how it should be designed and delivered. On the basis of information available to the inquiry, the Commission has not identified a need for government involvement in, or funding of, wheat classification.

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FINDING 8.1

*The design, delivery and funding of a wheat classification function is most appropriately undertaken by the industry. The Commission has not identified a role for government.*

*Varietal classification*

Breeders develop new lines, or varieties, of wheat and submit these to the Panel for assessment, and eventual classification, if approved. This service is currently provided free to breeders. However, the benefits of variety classification, unlike wheat classification, can potentially be captured by breeders. That is, the gains from developing a new variety can be collected through royalties (box 8.1).

Varietal classification could be undertaken on a ‘fee for service’ basis, with fees paid by individual plant breeders for the lines they submit for assessment and classification. Generally, private goods are most appropriately funded directly by users, whereas goods with non-excludable benefits to members of an industry may appropriately be funded collectively by all industry participants (chapter 7). One of the reasons for this is that inefficiencies are likely to arise in a system where the cost of the service is not reflected in the price paid by the user. For example, according to Intergrain (sub. 33; trans., p. 76), some breeding companies submit large numbers of lines for assessment, utilising the Panel to perform quality review on those lines. If the cost of the service were reflected in user fees, companies would be more likely to submit only those lines that they believe are worthy of classification, to the extent that they are not already doing so.

Intergrain suggested that the cost of the Panel would be low, and could feasibly be funded by fees. It also considered that fees would be more appropriate than funding through the GRDC, as the work of the Panel does not constitute research (sub. 33; trans., p. 76). AWB (sub. DR63) supported the introduction of user fees for variety assessment and classification. Similarly, the GRDC (sub. DR69) stated that this approach could be workable, provided costs are limited to the operation of the technical panel.

The introduction of a user pays system of varietal assessment and classification would need to be complemented by a well functioning system of EPR collection (below).

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*The benefits of varietal classification can potentially be captured by individual plant breeders. Assessment and classification of candidate varieties by the Wheat Variety Classification Panel could be undertaken on a fee for service basis, with fees paid by plant breeders for the lines they submit. This matter is being considered as part of the Wheat Classification Council's review of operations.*

The WQOG (sub. 27) suggested that Panel members be part of the decision making process with regards to wheat classification via consolidation of the Panel and WCC. The Commission considers that it would be appropriate for this suggestion to be addressed by the WCC review.

### *Receival standards*

Generally, participants considered that the receival standards are working well. These were in place and operational prior to deregulation, and participants considered it was appropriate that their management remain in the hands of industry.

Some participants noted concerns in relation to certain aspects of the standards, and the standard-setting process. Grain Growers Association (GGA) (sub. 41) identified areas in which the current receival standards system has not adapted to reflect changing market conditions. These included new end uses for given grains and varieties; novel grains such as red wheat; and evolving relationships with growers, traders and customers following deregulation.

Some participants expressed concerns in relation to a lack of balance in industry input to receival standards. The Western Australian Farmers Federation considered that growers were not adequately represented on GTA, and that votes of growers were ineffective, resulting in 'GTA tending to set standards that benefit marketers to the disadvantage of growers' (sub. 29, p. 15). The NSW Farmers Association expressed a similar concern (trans., p. 277), and suggested instead that:

... receival standards should be set region by region by an independent organisation such as Bread Research Institute which has the access to the appropriate knowledge, expertise, [and] research facilities. In addition any changes to wheat receival standards need to be implemented over a long period to allow wheat breeders adequate time to provide the industry with appropriate varieties. (sub. 49, p. 17)

According to another participant, export requirements, or the quality characteristics specified by export customers, were becoming more tightly specified, and the system needed to be able to deal with such a trend, otherwise skews in stack

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averages could occur that would make it difficult to meet contract specifications. It was thought that receival standards would need to be brought more closely into line with export requirements, with receival standards probably becoming narrower, as a result (Planfarm, pers. comm., Cunderdin, 2 December 2009).

These comments appear to be alluding to two separate issues: the first relates to the specification of standards according to customer demands, which may be more narrowly defined than the GTA receival standards; and the second relates to the way in which market participants influence the development of receival standards through the GTA processes.

Growers may find that narrower specifications are difficult to achieve, allow them less flexibility, and that their grain does not meet standards for segregations at storage facilities, even though it may meet the specifications of the standard bin grades. They may also be concerned that there are gains to be made by traders when wheat is outturned, while the grower has been penalised on delivery as a result of the narrower specification. On the other hand, as exporters attempt to meet customer demands, exporters may wish to influence the way segregations are made at storage sites, and accordingly might also seek to influence the GTA standards.

The way in which export standards influence segregations outside the standard bin grades is largely a function of market demand. Ultimately the market will determine whether sufficient value can be extracted from the additional, or more narrowly specified, segregations in order to make this worthwhile, given storage costs and availability of wheat.

In response to concerns regarding unbalanced representation of industry participants in the standards review process, GTA (sub. DR67) commented that all market sectors were represented on the GTA Standards Committee. It further noted that parties other than growers were sellers in the market — that is, often the primary buyer will on sell the grain and will in turn, become the seller, subject to those same grain standards that applied when they were the buyer. GTA also noted that the standards were not mandatory and could be modified to suit the needs of the parties, although this may involve additional storage and handling costs (section 8.3).

With regards to the GTA receival standards, it is important that industry participants seek to maintain balanced industrywide representation in the standards review process so that it can best meet customer demands given production and logistical constraints.

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## Product differentiation and value capture

There was no evidence, nor in fact, any suggestion from participants that the current arrangements for managing wheat quality hinder the development of niche markets, or stifle product innovation and differentiation.

Participants have indicated that trade in niche products is growing, and that storage (segregation) capacity poses a more relevant constraint on growth in this sector than quality control measures.

A number of participants noted that it is possible to either negotiate a specific set of requirements with one of the bulk handling companies, or accumulate grain privately and market it in bags or containers to satisfy niche markets. Exporting through containers and bags appears to provide a satisfactory way to exploit non-standard marketing opportunities (ABB Grain (now Viterro), sub. 23; AWB, sub. 24; WQOG, sub. 27; The Western Australian Farmers Federation, sub. 29; WCC, sub. 32; Agfarm, sub. 44).

Some issues raised by participants related to the way in which the quality standards were utilised by the industry, and how this may inhibit growers' ability to capture the value of their wheat. In particular, the loss of the Golden Rewards system, and a greater prevalence of cliff-face pricing under deregulation, was raised. This, and the various market mechanisms that are emerging in response, are dealt with in greater detail in chapter 3. In addition, the problem of information asymmetries was identified in the context of commingling and segregation of wheat at receival sites. Specifically, participants expressed concern that traders, particularly those owned by bulk handling companies, can make gains from the use of exclusive information about stocks on hand, and the commingling of lesser quality wheat with that of higher quality (The Western Australian Farmers Federation, sub. 29; South Australian Farmers Federation, sub. 51). The broader issue of information provision is addressed in greater detail in chapter 7.

Governance arrangements in bodies involved in the quality standards process that allow for efficient market feedback will enable the system to accommodate new developments. Ideally, any system of classification and receival standards should be designed such that it is flexible and able to adapt to developments in the industry and markets. Again, the industry itself is best placed to determine the specific arrangements that will best serve its needs.

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## Quality assurance

The quality standards framework plays a role in facilitating quality assurance, although it is not a quality assurance mechanism in itself. The classification process and receival standards provide a framework to facilitate trade of the common grades of wheat differentiated by specific physical characteristics as set out in the receival standards. This is the basis upon which the industry can put in place quality assurance mechanisms.

Use of the quality standards system is optional, and growers and traders are free to trade in wheat that does not comply with the established classes and grades. This in itself is not a problem. Problems can arise if that wheat is misrepresented as being equivalent to a defined industry standard.

### *Quality issues following deregulation*

A number of participants reported that the quality of Australian wheat is deteriorating, or at least international buyers perceive the quality of Australian wheat to be deteriorating. It is difficult to ascertain the extent to which this is occurring, or how widespread this perception is. The export of wheat in containers also poses issues for the management of Australian wheat quality. Trade in (unregulated) container exports has grown significantly in recent years (figure 2.7), and anecdotal evidence suggests the quality of container wheat might not always meet the expectations of customers.

Several participants expressed concerns about potential damage to the reputation of all wheat arising from even a small number of disreputable traders (for example, Agforce, sub. 16; Stockfeed Manufacturers' Council of Australia, sub. 21; AWB, sub. 24; AGEA, sub. 35; Valley Seeds, sub. 45; Angus McNeil, sub. DR58; Hart Krtschil, sub. DR80; GGA, sub. DR86). In response to reliance on market mechanisms for quality control GGA stated:

The problem is that damage caused by one trader can flow on to impact the entire industry as a 'public bad' — something that is overproduced and has collective consequences. While a self regulatory approach is the desirable long term outcome there is currently no process of third party validation across the industry to maintain product integrity. (sub. DR86, p. 4)

AWB commented that it was aware of some 'quite damaging misrepresentations of quality' that have come largely out of the container sector, and was also aware of instances where bulk shipments had been rejected on this basis (trans., p. 346). Specifically, AWB noted instances where vastly different qualities of wheat were being blended to meet the standards of better quality milling wheat. This was an

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issue particularly during drought years where high protein high screenings wheat had been blended aggressively for this purpose. Another example related to west coast noodle wheat varieties being blended into milling wheat varieties — technically the blend will meet minimum specifications, however it will not perform as expected upon processing. In this case, standard testing on the basis of five physical characteristics would not detect the noodle varieties, nor is it evident on visual inspection. According to AWB, there is a need for greater care to be taken in relation to blending practices at ports (trans., p. 347).

Other participants, however, had differing views regarding quality matters. GrainCorp noted that, according to its 2009-10 Harvest Report, quality of wheat being received into its system was meeting the relevant standards and meeting export customer contract specifications:

Despite some recent public commentary alleging a decline in wheat quality, the data in our 2009-10 harvest report indicate that, aside from normal seasonal and regional variations, the milling and baking quality of wheat being received into the GrainCorp system from farm deliveries has not declined. (GrainCorp media release, 2010b)

In its submission, GrainCorp further commented that there had been occasional quality problems with individual shipments under the single desk, and that it did not believe that isolated incidents have the capacity to erode the reputation of Australian wheat (sub. DR82).

In terms of changes in quality management for bulk wheat exports following deregulation, AWB believed quality issues could never be completely eradicated, also noting these had been present under the single desk (trans., p. 345). According to Australian Bulk Alliance, the management process for grain — from receipt at a grain terminal to loading onto a ship — has not changed, and it had not observed any major change in quality since deregulation (trans., p. 318).

### *Quality assurance mechanisms*

There are various quality assurance mechanisms in place along the supply chain. Bulk wheat is tested upon arrival at, and transportation within and out of, the storage facility and at port, to ensure that it meets the minimum contract specifications. In addition, customers can request that exporters provide independent samples from shipments before they leave Australia (although whether or not this occurs is at the discretion of the customer). The Australian Quarantine Inspection Service also provides export inspection and certification services to manage risks from insects, pests and noxious weeds.

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Moreover, many participants believed that market forces could adequately take care of quality assurance, as is the case in other grain industries (for example, Wally Newman, sub. 17; ABB Grain (now Viterra), sub. 23; AGEA, sub. 28; GrainCorp, sub. 43; Pastoralists and Graziers Association of Western Australia, sub. DR81; Australian Bulk Alliance trans., p. 319). Specifically, Viterra stated:

We believe that quality control should be left to market forces, with commercial incentives placing a check on the quality delivered to overseas buyers. This market approach has served the exports of non-regulated commodities such as canola, pulses etc and there is no reason why it should not serve the export of wheat. (sub. 23, p. 10)

The Pastoralists and Graziers Association of Western Australia also commented:

The trade and BHCs [bulk handling companies] should be able to resolve outturn specifications by negotiation. PGA envisions that in a true market environment, this will happen effectively, and additional controls are not necessary to oversee the classification system. (sub. DR81, p. 6)

Nonetheless, considering the concerns that exist amongst industry participants, and given that the export market for wheat has been liberalised for both bulk and containerised/bagged exports, the wheat industry could consider the benefits of encouraging consistent quality assurance processes across the board. The industry has already begun taking steps to achieve this. For example, the GTA grain industry Code of Conduct covers both bulk and container trade, and requires parties to:

... undertake to correctly represent the product as per the grain standards, and where the product is sold outside of the industry standards, it will not be represented as being equivalent to a defined industry standard. (GTA 2009b, p. 15)

Some participants thought the Code could be made more effective. GGA stated:

... it is our view that the current Wheat Industry Code of Conduct (which has been produced with the best of intent) of itself does not provide sufficient rigour and incentives to ensure appropriate market behaviours. (sub. DR86, p. 4)

AWB also commented that, in the context of the quality clauses, ‘the GTA certainly could strengthen that up’, short of putting in place more formal quality control processes that would come at a cost to industry (trans., p. 348).

Although GrainCorp, referring to container quality, considered that the market was working effectively to identify ‘good suppliers and poor suppliers’, it supported industry self-management to address the risks. In response to a reported drop in container quality by customers it stated that ‘this development does however bolster the argument for the development of a program such as the “Grade Certified Australian Wheat” trade mark’ (sub. 43, p. 35).

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A number of participants also advocated government assistance to coordinate and fund quality assurance programs during the transition. The options for the provision of industry good functions are discussed in more detail in chapter 9. In general, the Commission considers that issues relating to quality assurance, to the extent that quality impacts on the branding and reputation of Australian wheat, should be dealt with by the industry as a whole and should be funded by the industry.

## **Plant breeding and collection of End Point Royalties**

Plant breeding, and varietal development and improvement, are important to the wheat industry. They enable growers to increase productivity of their crops, better service new markets, and to address production constraints such as drought, frost, disease and weed competition (GRDC 2009b).

Pre-competitive or pre-commercial research and development activities are undertaken for the industry as a whole by the GRDC. These research and development activities are funded through industry levies, which are matched (capped to 0.5 per cent of the gross value of grains production) by the Australian Government (box 7.11).

Commercial wheat breeding in Australia is now predominantly undertaken by the private sector, and is funded through the collection of royalties (box 8.1). This has not always been the case — in the past, commercial wheat breeding activity was largely publicly funded, with involvement by the GRDC, state government departments and universities. State government departments have more recently reduced their investments in direct breeding, and now focus on pre-breeding research (ACIP 2010).

The costs and risks of investing in commercial plant breeding can be high. According to the Advisory Council on Intellectual Property (ACIP), breeding a new variety typically takes between eight and 14 years (2010). Further, according to the Australian Seed Federation (sub. DR68), a large proportion of breeding lines will be discarded in the process of developing a commercially viable end product, and there is also significant investment along the seed supply chain involved in bringing a product to the market.

### *Collection of End Point Royalties*

In order for investment in commercial wheat breeding to occur, breeders need to be able to obtain an adequate return on their investment. The *Plant Breeders Rights Act 1994* (Cwlth) (PBR Act) provides the legislative framework allowing plant breeders

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to protect their intellectual property and capture commercial gains according to the performance of their varieties via the collection of EPRs (GRDC 2008b).

### **Box 8.1 End Point Royalties**

Owners of Plant Breeders' Rights (PBR) typically obtain a royalty from the purchaser of the initial propagating material and/or an 'End Point Royalty' (EPR) from the grower. EPRs are usually paid under contract and are based on the volume of the harvested product.

EPRs have benefits over royalties on propagating material, which include:

- reducing upfront seed costs for growers
- overcoming loss of collections through farmer's privilege (whereby growers save some of the harvested grain to grow another crop)
- sharing the risk of crop failure between growers and PBR owners.

*Source: ACIP (2010).*

Prior to deregulation, wheat breeders dealt directly with a single exporter. Post-deregulation, however, breeding companies rely on many traders and exporters to pass on EPRs once the end product is traded.

In addition to there being an increased number of collection points for EPRs, according to the Australian Seed Federation, the traditional collection points are changing:

This is because the speed of harvest continues to increase, and growers are seeking greater flexibility to market their grain over longer periods, and the movement of grain into the domestic market increases the amount of delivery points for royalties to be identified and collected. (sub. DR68, p. 3)

Contractual systems can be set up with grain traders whereby they agree to deduct EPRs from payments to the grower, or to provide plant breeders with varietal information, although this is reliant on individual traders undertaking to acquire the necessary systems and software.

Also associated with the EPR system is additional paperwork and complexity for growers. Growers might be harvesting several different varieties concurrently, and subsequently dealing with several traders, some of whom are signed up to collect EPRs and some of whom are not. Recording information about the volumes of those respective varieties before sending the grain off to traders or accumulators, and keeping track of where liabilities have been deducted and where they are outstanding, adds to the administration burden for growers.

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In its submission to the IEG, GRDC (2008b) noted that achieving high levels of EPR collection was a significant issue for the industry. At that time, GRDC advocated industrywide varietal level receipt and export data being made available to PBR owners. Previously this information was collected by AWBI, as were the EPRs, on behalf of the PBR owner on a fee-for-service basis. The GRDC further suggested that reporting obligations would also need to apply to containers.

It was broadly acknowledged that the inclusion of an item relating to EPR collection in the Wheat Exports Australia accreditation process for bulk exporters has been important in grain traders signing up to collect royalties payable by growers. This item requires applicants to demonstrate that they have the systems and processes in place to collect EPRs. According to the Australian Seed Federation, this has been valuable in raising the profile of EPR collection, and bringing about a cultural change, amongst accredited bulk exporters, who might also trade in the domestic and container/bag export sectors (Will Golsby, pers. comm., 5 May 2010). Further, the systems put in place by wheat exporters, are likely to be utilised for any other agricultural commodities traded by that exporter. Intergrain did not consider removal of the accreditation process as being a risk to the arrangements that have now been put in place for the collection of EPRs by exporters (trans., p. 81). However, other participants considered the absence of this requirement would be a downside of any eventual removal of accreditation (GRDC, sub. DR69; Will Golsby, Australian Seed Federation, pers. comm., 5 May 2010).

Participants also identified issues with the level of compliance with the PBR Act, with regards to the payment of EPRs. Valley Seeds advised that compliance was significantly lower than the 60 to 70 per cent factored into its business model. Growers themselves enter an agreement to pay EPRs when buying seed, however concerns were identified regarding the onselling of that seed ('over the fence' trading) (Valley Seeds, trans., p. 35). A number of stakeholders advocated a strengthening of the PBR Act (Valley Seeds, trans., p. 35; Australian Seed Federation, sub. DR69). For example, it is not illegal under the Act to deliberately declare a PBR protected variety to be a non-PBR protected variety (ACIP 2010).

Issues relating to the current EPR collection and enforcement systems apply to all sectors of the wheat industry, and indeed the agricultural and horticultural industries more broadly. Regardless of whether or not the accreditation process for bulk wheat exporters remains in place, it appears that solutions with broad application will be needed to adequately address these issues. ACIP recently conducted *A review of the enforcement of Plant Breeders' Rights* in response to concerns raised in the area (ACIP 2010). The final report, released in January 2010, identified a number of areas for legislative reform and other non-legislative initiatives, which would go

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some way to improving the effectiveness of PBR and EPR enforcement and collection. The review is currently being considered by the Australian Government.

The Commission considers improvement to the system of EPR collection is important, and recommends that implementation of reforms to the system be given high priority. The urgency of reform will be heightened if the recommended abolition of the accreditation system for bulk wheat exporters is adopted (as the accreditation system includes an item relating to EPR compliance).

RECOMMENDATION 8.1

***Reforms and initiatives to improve the collection and enforcement of End Point Royalties, such as those recommended by the Advisory Council on Intellectual Property's Review of Enforcement of Plant Breeders Rights, should be implemented expeditiously.***

Ongoing cooperation amongst industry sectors will be required to embed collection systems and processes and enable the EPR system to operate as intended by the legislation. An example of an industry-based initiative is the National Grower Register's (box 7.4) trial of a tool to streamline the collection, reconciliation and dissemination of EPRs. Such a system would improve compliance and help to alleviate some of the administrative burden for the grains industry in handling EPR information and payments.

Any system of EPR collection will rely to some extent on parties to transactions 'acting in good faith'. Some participants to the inquiry expressed concerns regarding the obligation to pay agreed EPR regardless of the performance of the particular variety. This was expressed by The Western Australian Farmers Federation:

While the majority of our members do not philosophically oppose an End Point Royalty system (which was presented to grain growers as a means of introducing a direct commercial incentive to encourage breeders to develop varieties that meet grower's needs) they are opposed to having to pay EPRs on varieties which are not proving their performance by failing to meet the varietal segregation for which they were designed. (sub. DR92, p. 8)

To the extent that a feature of the EPR system is that it enables the PBR owner and grower to share in the risks and rewards of utilising the new varieties, the flexibility and willingness on the part of plant breeders to adjust or review EPR liabilities to accommodate underperformance of the variety would go some way to building industry relationships that are important to the functioning of the system.

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## 9 Other industry good functions

### Key points

- 'Industry good' functions can be defined as services to the industry that support trade and industry development and affect, at least, a significant subset of the entire industry. Industry good functions can exhibit 'public good' characteristics, 'private good' characteristics, or varying degrees of each.
- Arrangements for provision of two industry good functions have already been dealt with — market information was covered in chapter 7 and wheat classification in chapter 8. Research and development is the subject of a separate Productivity Commission inquiry and is not dealt with in this report.
- The Australian Government provides for trade advocacy activities (via DFAT and Austrade), in consultation with industry. Trade advocacy has a strong public good element, and gives rise to significant spillover benefits to other export industries (inter-industry spillovers) and the broader community. Taxpayer funding for trade advocacy activities is appropriate. Trade advocacy must be provided, in part, by the Australian Government as it is not possible for private industry to do so (for example, sign trade agreements with foreign governments).
- The Commission considers that arrangements for the provision of other industry good functions that are predominantly private in nature, such as technical market support, crop shaping, regulatory and policy advocacy, industry strategic planning, wheat promotion and wheat branding, are matters for the industry to determine.
- An industry-led body has been proposed by several respondents to this inquiry, and there is evidence that groups within the industry are already working toward forming such bodies. An industry-led body is the 'norm' in various other Australian grains and agricultural industries.
- In chapter 7, the Commission set out a framework for the provision of industry good functions that are predominantly private goods and produce significant intra-industry benefits, but are associated with a free rider problem. This framework is used to identify various potential responsibilities for a nominated industry body (or bodies), funded by industry participants.
- To establish an industry-led body, decisions regarding the nature of private funding, governance and the scope of responsibilities (all grains or wheat only) will need to be dealt with.

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A challenge facing the Australian wheat industry since the transition from the single desk arrangements has been the future provision of various ‘industry good’ functions (WEA 2009d). Chapters 7 and 8 of this report have considered the effectiveness of the current arrangements for information provision, wheat varietal classification and wheat receival standards, and how these functions should be carried out in the future.

The focus in this chapter is the provision of the remaining industry good functions, excluding research and development (which is the subject of a separate Productivity Commission inquiry). Specifically, a description of the role and importance of these industry good functions is provided (section 9.1), followed by a review of the arrangements for provision of these services under the single desk wheat marketing arrangements (section 9.2).

Section 9.3 describes how these industry good functions are currently provided in the deregulated market place, and includes an assessment of the appropriateness of the Australian Government having a role in the provision of these services. Issues associated with the institutional and governance arrangements for development of any industry-led body that could undertake particular industry good functions are discussed in section 9.4.

## 9.1 ‘Other’ industry good functions

The ‘other’<sup>1</sup> industry good functions to be considered in this chapter are set out in table 9.1.

### The importance of industry good functions

Each of the services listed in table 9.1 is important for either particular groups of export wheat market participants, or for the bulk wheat export industry more broadly. For example:

- Industry planning is a mechanism for coordinating the activities of all industry sectors to ensure the long-term viability, productivity and sustainability of the industry. Planning is important for dealing with challenges that require a ‘whole-of-industry’ response, such as environmental and infrastructure issues.

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<sup>1</sup> ‘Other’ means those industry good functions listed in box 7.1, not already covered in chapters 7 and 8 (excluding research and development, which is the subject of a separate Productivity Commission inquiry).

**Table 9.1 'Other' industry good functions**

<i>Industry good function</i>	<i>Description</i>
Industry strategic planning	The development of coordinated and strategic business plans for the wheat export industry.
Crop shaping activities	The provision of market signals through grade systems, information sharing and incentives to encourage the production of grades and wheat quality parameters that meet customer demands.
Technical market support	Technical services and training provided by exporters to end-users to assist with the better use of Australian wheat.
Wheat promotion	Representations and activities to international markets and customers to promote the value and benefits of Australian wheat.
Wheat branding	Activities aimed at developing a reputation and market for particular Australian wheat products. Branding seeks to differentiate Australian wheat according to the particular nature and quality of various products. Branding might involve measures or mechanisms to manage the quality of wheat exports.
Policy and regulatory advocacy	Input into development of national and international policy and regulatory arrangements.
Trade advocacy	Actions and representations of the Australian Government, with the support and advice of industry, to international markets and foreign governments.

Sources: ACG (2008c); IEG (2008); WEA (2009d).

- Crop shaping activities provide for the transfer of market signals through the supply chain to breeders and growers. This is important for ensuring that the Australian market is producing the type, volume and quality of wheat that is required by customers and end-users. Technical market support is similar in that it facilitates and secures relationships with customers, thus maintaining sales of wheat.
- Wheat promotion is targeted at highlighting the key advantages of Australian wheat against overseas competitors, and is designed to open up new markets, attract new customers and increase sales of Australian wheat. Establishing and maintaining a 'brand' can also be an effective marketing tool, particularly if customers identify with Australian wheat through the branding process. Wheat branding can also provide opportunities for promoting and protecting the quality reputation of Australian wheat products.
- The performance of the Australian bulk wheat export industry is directly dependent on market access and world trading conditions. Trade advocacy is aimed at increasing sales of Australian wheat through improving international trading conditions and market access opportunities. Advocacy might also be required to initiate or influence policy and regulatory developments, for example, with respect to port access or export licensing requirements.

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## Terminology

Feedback received as part of this inquiry suggests:

- individual industry participants have differing views on:
  - the appropriate definition of the terms ‘industry good’ function, ‘public good’ and ‘private good’
  - the extent to which each industry good function demonstrates public good and/or private good characteristics
- the terminology is often applied loosely
- different terms are used interchangeably, for example, ‘commercial service’ and ‘private good’ or ‘legitimate industry good function’ and ‘public good’.

AgFarm noted:

Industry good functions are essential for the smooth operation of a market. No one participant in the market is incentivised to undertake the functions because there is no direct payback to the individual for providing the function, in fact competitors may gain the benefit of the function being undertaken without having contributed to the cost of the function. (sub. 44, p. 7)

The Wheat Quality Objectives Group (WQOG) suggested that some industry good functions, like crop shaping and technical market support, are commercial issues to be conducted by individual marketers. Others, like industry strategic planning, are the responsibility of the wheat industry itself (WQOG, sub. 27). The Grain Growers Association (GGA) noted that ‘[t]he definition of industry good implies non exclusive goods and services and that there are spillover costs or benefits that apply to a wider group than an individual company or group’ (sub. 41, p. 31).

AWB Limited (AWB) noted:

AWB believes that ‘industry good’ functions are those services that should be undertaken by either government authorities or industry representative bodies to ensure information or services are provided in an independent manner for the benefit of all industry participants. These services should create long term benefits by neutralising the impact of issues that would destroy value for the industry in the long term if they were permitted to be undertaken through commercial channels. (sub. 24, p. 24)

As part of its 2008 review the Industry Expert Group (IEG) considered:

The definition of what constitutes an industry development function, also known as an industry good function or service, has been debated across the Australian wheat industry. For example, many believe services provided by AWB (International) Ltd (AWBI) in managing the single desk, such as branding and wheat promotion, are legitimate industry development functions. However, others consider that these services provided by AWBI are purely commercial activities carried out to maintain strong

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customer relationships and support the penetration of its product in a market. (IEG 2008, p. 9)

The Commission's view is that the term 'industry good' function refers to a service or activity undertaken to support trade and industry development and that affects, at least, a significant subset of the entire industry. It does not imply that the service or activity has a significant public good element, or that the function should attract government funding. Industry good functions can exhibit public good characteristics, private good characteristics, or varying degrees of both (chapter 7). For this reason, it is more appropriate to distinguish between predominantly public goods and predominantly private goods. This process is ultimately a matter of judgment.

## **9.2 Industry good functions under the single desk**

Prior to the privatisation of the Australian Wheat Board in 1999, the single desk incorporated many statutory functions, such as setting wheat breeding direction, registration of new varieties, wheat classification, setting receival standards, and testing and certifying quality specifications of wheat for export. As a statutory body, the Australian Wheat Board was answerable to Parliament in relation to its performance of these regulatory functions (EWC 2008b, p. 19).

### **Role of AWB**

Following privatisation, responsibility for managing and delivering most of these services fell to AWB, as the single desk manager. However, there was no statutory obligation imposed on AWB to invest in industry good functions or to report to, or consult, industry in relation to the provision of industry good functions.

For the three years to 2005-06, AWB spent an average of close to \$10.5 million per year on the provision of industry good functions (table 9.2). Funding for industry good services was derived from the pool management fees charged by AWB, so only those growers who delivered to the national pool contributed financially (despite many benefits flowing to the entire industry) (EWC 2008b, p. 20).

**Table 9.2 AWB expenditure on industry good functions (average of 3 years to 2005-06)**

<i>Industry good function</i>	<i>Average annual expenditure</i>
	\$000
Industry strategic planning and execution	2 925
Wheat receival standards	47
Wheat classification panel	452
Crop shaping	31
Australian wheat crop report	1 493
Technical market support	-
Promotion of Australian wheat	1 678
Policy and regulatory activity	730
Research and development	3 163
<b>Total<sup>a</sup></b>	<b>10 488</b>

<sup>a</sup> Totals might not add as a result of rounding.

Source: ACG (2008c).

## Provision of industry good functions

AWB was not the sole provider of industry good functions under the single desk wheat marketing arrangements — other agencies involved in the delivery of these services included the Grains Research and Development Corporation (GRDC), the Australian Government and industry bodies.

### *Industry strategic planning*

The wheat industry did not have any one ‘industrywide’ strategic plan under the single desk arrangements. However, in 2004 AWB developed and implemented its *Shaping the Future* plan for the wheat export industry. The five key planks of this strategy were:

- enhancing international sales and marketing
- improving crop shaping
- optimising supply chain operations
- strengthening trade advocacy
- improving grower communications.

The Grains Council of Australia (GCA) had a role in whole-of-industry planning under the single desk, and the Australian Grain Exporters Association (AGEA) provided representation for its export members (IEG 2008). The GRDC, through its

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funding of Single Vision Grains Australia (SVGA), also supported industry planning activities over the period 2005–07 (box 9.1).

### Box 9.1 **Single Vision Grains Australia**

In 2003, the Grains Council of Australia invited the industry to contribute to the development of a strategy for the grains industry for the period 2005 to 2025. Input was received from across the industry, including the Grains Research and Development Corporation (GRDC), the Grains Council of Australia, AWB, ABB Grain (now Viterro), GrainCorp, and Co-operative Bulk Handling/Grain Pool. Consultation was undertaken with over 700 growers and industry groups, and workshops and interviews were held with centres of foundation research, input suppliers to growers, grain marketers and handlers, primary and secondary manufacturers, and food and feed users. This culminated in the development of the *Australian Grains Industry Strategy*.

This strategy was published as a report in March 2004, *Towards a Single Vision for the Australian Grains Industry*. This report sets out some of the major challenges facing the grains industry, including: infrastructure, biotechnology and genetically modified crops, communications, and biofuels. This report covered the 25 leviable<sup>a</sup> crops within the GRDC's research portfolio responsibilities, and highlighted the directions that the grains industry could take over the following 20 years.

At this time it was widely recognised that the industry was fragmented and coordination between many segments of the supply chain was poor. In addition, issues such as rising input costs, new competitors and service duplication were considered to be putting pressure on the industry and eroding grower returns. In this context, industry decided it was essential to achieve new efficiencies and reduce costs across the industry.

Accordingly, Single Vision Grains Australia (SVGA) was established on 1 July 2005 as an independent organisation. The purpose of SVGA was to lead and unite the Australian grains industry on critical industry challenges such as infrastructure, biotechnology and communications, as identified in the *Australian Grains Industry Strategy*.

It was envisaged that SVGA would be industry funded in the long term. The GRDC agreed to provide a total of \$2 million seed funding for SVGA for an initial two-year period, with the industry to take on responsibility for funding from 1 July 2007. However, this transition was not successful and SVGA ceased operation on 30 June 2007. The GRDC has indicated that a lack of cooperation among industry participants, coupled with a division caused by the proposed deregulated marketing arrangements, contributed to the demise of SVGA.

<sup>a</sup> Leviable crops are: wheat, barley, oats, sorghum, maize, triticale, millets/panicums, cereal rye, canary seed, lupins, field peas, chickpeas, faba beans, vetch, peanuts, mung beans, navy beans, pigeon peas, cowpeas, lentils, canola, sunflower, soybean, safflower and linseed (GRDC 2010a).

Sources: ABC (2007); GRDC (2004, 2010b).

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### *Crop shaping activities*

Under the single desk, various customers and traders undertook crop shaping activities to provide incentives for the production of wheat of certain grades or quality parameters, in line with customer demands (IEG 2008). However, AWB was undoubtedly the predominant provider of crop shaping services in Australia by virtue of being the monopoly exporter of Australian wheat.

AWB's Golden Rewards and Premium Choice Varieties programs provided direct financial incentives to growers for producing wheat of certain grades and qualities. In particular, the pricing structures of these programs rewarded growers for delivering wheat with higher quality parameters. Other activities undertaken by AWB to influence the shape of the Australia wheat crop included:

- managing the wheat classification system
- providing market signals to the breeding industry through publications, scientific meetings and direct communication — the AWB *Australian Crop Report* set out comprehensive information on the quality characteristics of Australian wheat varieties
- segregation, binning and blending strategies, including 'customising' wheat shipments to meet the particular requirements of markets and customers (ACG 2008c).

### *Technical market support*

AWB was responsible for the large majority of technical market support activities undertaken prior to deregulation. AWB provided technical training to both individual customers and groups of customers, including:

- assistance as to how to assess the quality of different wheat grades and flours
- training on the suitability and advantages of different Australian wheat grades for particular end products
- promotion of the advantages of Australian wheat compared to that offered by other suppliers
- information about how to process Australian wheat to meet customers' product requirements (ACG 2008c; IEG 2008).

Other companies also provided these services for wheat exports to their own customers (IEG 2008).

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### *Wheat promotion and wheat branding*

Historically, AWB was the primary provider of wheat promotion activities that sought to enhance Australia's reputation in international wheat markets. The hosting of 'Grain Industry Orientation' tours for overseas customers, industry groups and government officials was the cornerstone of AWB's wheat promotion campaign.

AWB also sought to develop a 'brand' for Australian wheat and to use this brand as a marketing tool. For example, AWB would brand groups of wheat varieties as distinct products to highlight the quality characteristics and subsequent functionality for different end uses. AWB was successful in establishing brands such as 'AWB Prime Hard' in the international wheat market, despite holding no intellectual property rights over the use of generic terms such as 'Australian Prime Hard' in branding (IEG 2008).

### *Advocacy*

The Australian Government, through the Department of Foreign Affairs and Trade (DFAT), was the chief agency responsible for negotiating improved international trading conditions and better market access for Australian bulk wheat exports under the single desk. This arrangement has not changed since deregulation. Similarly, the Australian Trade Commission (Austrade) — the Australian Government's trade and investment development agency — played a role in assisting industry to create and maintain new trading relationships with international customers, and continues to do so today.

AWB fulfilled an important advocacy role under the single desk through its involvement in industry meetings and forums, its contribution to policy and regulatory processes, and the provision of commentary and advice to the Government on issues that impacted the industry. Examples included AWB's participation in the Australian Quarantine Inspection Services Grain Industry Consultative Council, the DFAT Technical Working Group on multilateral trade reform, and the International Grain Trade Coalition (ACG 2008c).

Representative industry associations, private companies and individuals also engaged in trade, policy and regulatory advocacy under the single desk wheat marketing arrangements. The GCA was particularly active in regulatory and policy advocacy during this period (box 9.2).

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## Box 9.2 Grains Council of Australia

The Grains Council of Australia (GCA) is the national peak industry body for grain growers around Australia.

The GCA was established in 1930 as the Australian Wheat Growers Federation. Its successor — the Grains Council of Australia Incorporated — was established in 1979. In 2006, the structure of the Grains Council of Australia Incorporated was changed from an incorporated association to a company limited by guarantee (Grains Council of Australia Limited).

The GCA is funded via member contributions, where membership is voluntary and subject to approval by the GCA Board. An organisation, association or similar body may apply to become a member of the GCA if 'it fulfils objects similar to those of the GCA in its sphere of activities'. Membership subscription fees are payable by all full or associate members of the GCA, where specific fee amounts are determined by the GCA Board.

Existing full members include AgForce Queensland, Victorian Farmers Federation, South Australian Farmers Federation and the Council of Grain Grower Organisations<sup>a</sup>. The Tasmania Farmers and Graziers Association is the only associate member of the GCA.

The GCA's mission is 'to represent and promote Australia's grain industry, the policies of the GCA and the interests of Australia's grain industry nationally and internationally'. The GCA describes one of its key goals as 'to develop policy from the guidance and direction of its members and to lodge formal submissions to the Federal Government'.

The Commission understands that — due to financial difficulties, and a fall in membership contributions from state based grower bodies in particular — the GCA is set to wind up its operations on 30 June 2010. A successor organisation — Grain Producers Australia (box 7.7) — has been proposed by industry groups and would seek to adopt many of the functions of the GCA. National Grains Australia, an alternative model for a national peak grower organisation, is also being developed. NSW Farmers Association and the Western Australian Farmers Federation signed a Memorandum of Understanding in April 2010 to initiate the establishment of National Grains Australia.

<sup>a</sup> The Council of Grain Grower Organisations (COGGO) — a public company focused on plant breeding and crop improvement activities — was formed in 1997 at the initiative of a group of Western Australian grain growers. COGGO currently has 12 industry members including the Pastoralists and Graziers Association of Western Australia and The Western Australian Farmers Federation.

Sources: GCA (2010); GPA (2010); The Western Australian Farmers Federation (2010).

Table 9.3 sets out a summary of the various agencies involved in the provision of industry good functions prior to the introduction of deregulated market arrangements.

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**Table 9.3 Provision of industry good functions under the single desk**

<i>Industry good function</i>	<i>Agencies involved</i>
Industry strategic planning	AWB, GRDC (SVGA), GCA, AGEA
Wheat promotion and branding	AWB
Technical market support	AWB
Crop shaping activities	AWB, international customers and traders
Advocacy (policy, regulatory, trade)	AWB, GCA, DFAT, Austrade, industry participants

*Sources:* ACG (2008c); IEG (2008).

### **9.3 Industry good functions since deregulation**

The introduction of deregulated marketing arrangements meant AWB no longer had any incentive or responsibility to provide industry good functions.

Under the new marketing arrangements, AWB is only one of a number of companies marketing Australian wheat — continuing to fund services that benefit the wider industry would only serve to disadvantage AWB compared with other businesses in the market. This was recognised by AWB ahead of the introduction of deregulation:

It will not be commercially feasible for AWB to continue to provide industry good services in an environment where the ability to export and market Australian wheat internationally is held by a number of different organisations. (AWB 2008, p. 11)

The Australian Government established the wheat IEG in February 2008 to consider how industry good functions should be provided once the deregulated market arrangements commenced. The conclusions of the IEG are set out later in this chapter.

#### **Provision of industry good functions**

To assist in the shift to deregulation the Australian Government provided a transitional Industry Assistance Package (box 9.3). Some of this funding was directed toward the provision of industry good functions. In particular, the Industry Assistance Package facilitated the establishment of the Wheat Export Technical Market Support Grants Program, and the delivery of a series of information seminars to educate growers about marketing.

### Box 9.3 Industry Assistance Package

The Australian Government has so far committed \$8.3 million of funding over three years to assist with the transition to the new wheat export marketing arrangements. The assistance package includes funding for:

- the Australian Competition and Consumer Commission to administer the access undertakings (chapter 5)
- the Australian Bureau of Statistics and the Australian Bureau of Agricultural and Resource Economics to disseminate market information (chapter 7)
- Grain Trade Australia to formulate a code of conduct for the industry (chapter 8)
- the Department of Agriculture, Fisheries and Forestry to hold information sessions on the new marketing arrangements for growers
- grants to assist new or small wheat exporters in providing technical market support to their customers.

#### Australian Government assistance for the transition to new wheat export marketing arrangements

<i>Transitional initiative</i>	<i>Agency</i>	<i>Expenditure 2008-09 to 2010-11</i>
		\$000
Code of Conduct	GTA	69
Grain port access	ACCC	1 483
Information seminars	DAFF	523
Market information	ABS	3 380
Market information	ABARE	450
Wheat Export Technical Market Support Grants Program <sup>a</sup>	DAFF	536
Wheat Exports Australia <sup>b</sup>	WEA	1 107
Administration and legal costs <sup>c</sup>	DAFF	800
<b>Total</b>		<b>8 348</b>

<sup>a</sup> In addition to this funding, the Australian Government, through the Department of Infrastructure, Transport, Regional Development and Local Government, has also provided funding to the *New South Wales Grain Freight Review* and the *Western Australian Grain Freight Network Review* (chapter 6). Up to \$3 million was provided for each review (Albanese and Burke 2008; Ferguson and Thiel 2007). <sup>b</sup> Higher exports and hence higher revenue from the Wheat Export Charge has meant that WEA has not required the level of funding anticipated. Requirements for 2010-11 are yet to be determined. <sup>c</sup> Incurred during implementation to 30 June 2008.

Source: Department of Agriculture, Fisheries and Forestry.

The Wheat Export Technical Market Support Grants Program provides funding to assist wheat exporters in providing technical market support to their customers. Successful applicants are able to access up to \$60 000 on a matching dollar-for-dollar basis. The objective is to target new and small-scale companies

and/or individuals to deliver innovative export ideas which lead to profitable client relationships over the long term.

Table 9.4 identifies the various individuals and public and private agencies currently providing industry good services for the bulk wheat export market.

**Table 9.4 Provision of industry good functions since deregulation**

<i>Industry good function</i>	<i>Service provider</i>
Industry strategic planning	<ul style="list-style-type: none"> <li>• Industry associations (various)</li> <li>• Individual exporters</li> </ul>
Crop shaping activities	<ul style="list-style-type: none"> <li>• Individual exporters</li> <li>• Individual domestic traders</li> <li>• Exporters and domestic traders draw on the GTA wheat receival standards in undertaking crop shaping activities</li> <li>• Commercial providers (for example, GGA)</li> </ul>
Technical market support	<ul style="list-style-type: none"> <li>• Individual exporters</li> <li>• Commercial providers (consultants)</li> <li>• DAFF via funding (2008–11) for the Wheat Export Technical Market Support Grants Program</li> </ul>
Wheat promotion	<ul style="list-style-type: none"> <li>• Industry associations (various)</li> <li>• Individual exporters</li> <li>• GCA and GRDC<sup>a</sup> (funded the BRI Crop Quality Report)</li> </ul>
Wheat branding	<ul style="list-style-type: none"> <li>• Individual exporters</li> <li>• GCA and GRDC (funded the BRI Crop Quality Report)</li> </ul>
Regulatory and policy advocacy	<ul style="list-style-type: none"> <li>• Various industry associations and interest groups, including the AGEA, GTA, GCA and the GGA</li> </ul>
Trade advocacy	<ul style="list-style-type: none"> <li>• DFAT (Australian Government)</li> <li>• Austrade (Australian Government)</li> <li>• Industry associations and interest groups</li> <li>• Individual exporters</li> </ul>

<sup>a</sup> The GRDC also supports the provision of information services (for example, the BRI Crop Quality Report, and the ABARE Australian grains report — chapter 7) and wheat classification activities (via the funding it has provided to the Wheat Classification Council for 2 years — chapter 8). GRDC is partly funded by grower levy contributions (box 7.11).

Source: WEA (2009d).

## Industry Expert Group

As noted earlier, the IEG was formed to determine how industry good functions should be delivered under the proposed new export marketing arrangements. The IEG's recommendations are summarised in table 9.5.

**Table 9.5 Industry Expert Group recommendations**

<i>Industry good function</i>	<i>IEG recommendation</i>
Industry strategic planning	<ul style="list-style-type: none"> <li>• Organisations and companies continue to undertake strategic planning to meet individual needs.</li> <li>• There is also a substantive view that issues affecting the whole-of-industry could be more effectively dealt with if a body were to coordinate the industry's views. However, the industry will develop this if it considers it will deliver sufficient commercial benefit and value.</li> </ul>
Crop shaping activities	<ul style="list-style-type: none"> <li>• Companies should continue to provide pricing signals to growers that seek to reflect market conditions and customer demands.</li> </ul>
Technical market support	<ul style="list-style-type: none"> <li>• This is essentially after sales support to customers to ensure sales. This is a commercial activity and primarily the responsibility of the marketers.</li> <li>• The Government provides some assistance through Austrade<sup>a</sup> and will continue this service, as required.</li> </ul>
Wheat promotion	<ul style="list-style-type: none"> <li>• Industry as a whole has a role in promoting Australian wheat generically but it will be for key stakeholders to coordinate and lead this promotion if they consider it is necessary.</li> <li>• The production of a publication similar to the Australian Crop Report would need to be at the initiative of the industry, as it would require the cooperation and agreement of all the key industry players.</li> </ul>
Wheat branding	<ul style="list-style-type: none"> <li>• Industry participants should continue to brand their products as they see fit, in the knowledge that the generic Australian wheat brands will be available for their use.</li> </ul>
Trade advocacy	<ul style="list-style-type: none"> <li>• The Government should continue its current role in the negotiation of trade issues, with input from various industry organisations.</li> <li>• The wheat industry could consider whether a single representative body is required to put forward a unified view to the Government.</li> </ul>
Regulatory advocacy	<ul style="list-style-type: none"> <li>• No changes are necessary to the current arrangements.</li> </ul>

<sup>a</sup> Austrade does not undertake technical market support activities directly, but provides assistance to companies that do.

Source: IEG (2008).

Overall, the IEG considered that the provision of industry good functions should be for the industry to sort out, either on an individual or coordinated basis. Specifically, Australian Government involvement should be limited to the funding provided to the GRDC (for research and development activities), and its role in trade policy advocacy. Remaining industry services are considered to be commercial in nature, and should be undertaken at the industry's initiative and discretion. Where services are for the benefit of the entire industry, they might be delivered on a collective basis (IEG 2008).

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This assessment is broadly similar to the findings of the Allen Consulting Group (ACG):

The report suggests that the economic rationale for many of the previously provided industry good services is questionable, particularly in light of proposed new export wheat marketing arrangements. Some of the services ... do have public good characteristics that suggest they may not be provided in the more competitive market envisaged; but many others will continue to be provided through normal price and competition incentives that will apply. (ACG 2008c, p. iv)

## **Participants' views**

### *Are these services being delivered adequately?*

With the removal of AWB as the single desk manager, many industry participants feared particular industry good functions would not be provided in the deregulated environment. The concept of 'gaps' or inadequacies in the delivery of these services has been raised by several respondents. In particular, there is a strong perception among sectors of the industry that activities to promote Australian wheat — and to uphold the Australian 'brand' — have largely disappeared since deregulation.

Assessing the extent to which industry good functions are being adequately provided under the new arrangements necessarily involves monitoring the activities of industry participants. However, the number of exporters currently operating in the market has made it quite challenging to track and measure the various activities being undertaken across the industry — in part because there could be advantages to some players in not revealing the precise activities in which they are involved.

A large number of respondents have suggested that promotion of Australian wheat in international markets has significantly reduced since deregulation. The WQOG pointed out that 'other considerations are needed around generic brand promotion, market development, the branding of the product and the protection of that "brand"' (sub. 27, p. 8).

The Victorian Farmers Federation (VFF) expressed a similar concern about a lack of wheat promotion, and proposed that Australia needs 'a single Australian voice promoting our varieties and product on the world stage' (sub. 40, p. 3). An inequality with respect to promotional activities between the grains industry and the dairy and livestock industries was also raised by the VFF. It commented:

I think it also has to be taken into consideration that other industries, Meat and Livestock Australia, Dairy Australia, they undertake promotional activities that are both funded through compulsory levies on the farmers and on the industry but also are

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taxpayer funded. They undertake promotional activities both domestically and internationally for their industries and yet the GRDC is limited in its ability to do that.

... Even the horticultural industry, the work that is done by groups within some of the more intensive animal industries like the broiler chicken industry, they are all able to use some of that funding towards promotion of their industry and promotion of industry issues on an international market. (trans., p. 23)

The VFF (trans., p. 23) noted that addressing this matter would require changes to the *Primary Industries and Energy Research and Development Act 1989* (the PIERD Act), and this is not easily done. The PIERD Act establishes Research and Development Corporations for relevant primary industries, including the GRDC.

The prescribed functions of the GRDC under the PIERD Act are specific to research and development activities (box 7.11). This means the GRDC is unable to direct revenue toward investment in goods or services — such as wheat (or grains) promotion — that are not related to the GRDC's research and development priorities. The funding agreements that apply to other industry bodies, such as Dairy Australia, are a product of particular historical structures and are specific to the circumstances of that industry. Accordingly, each industry body has its own set of relevant objectives and associated functions (appendix C).

Notwithstanding the limitations on the GRDC's prescribed functions, there might be scope for another industry body to undertake wheat promotion activities on behalf of the industry, or for such services to be provided by a new, industry-led body. Indeed, over the course of this inquiry, a number of groups have put forward separate proposals for the development of some form of wheat industry body (section 9.4). The GCA has been effective in pursuing industry planning and advocacy roles in the past, and in 2009 the GCA hosted the Australian Grains Industry Forum.

AgFarm (sub. 44, p. 7) considered that there are particular industry good functions not being performed, namely technical market support (training and educating export customers), branding and promotion of Australian wheat, and trade advocacy (market access for Australian wheat). Similarly, the NSW Farmers Association noted:

There is no single body promoting Australian wheat, educating millers and bakers and liaising with international Governments on residue issues. As a result the reputation of Australian wheat is suffering. For example, it has been reported in the *Weekly Times* on 18 November 2009 that 500 people attended a millers conference in Turkey. In the past AWB would have been a sponsor and prime speaker however Australia is no longer represented in similar forums. (sub. 49, pp. 19–20)

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The Department of Agriculture and Food (Western Australia) and Co-operative Bulk Handling (CBH) also raised concerns about the level of promotion and branding of Australian wheat. This view was supported by the Grain Industry Association of Western Australia (GIWA):

Now, in deregulation there's not someone there representing Australian [grain]. If you're a trader, you're not representing Australian grain, you're representing, 'How do I make \$4?' So I think that's why we think some of the industry-good functions are very important to be covered by some sort of overarching body. (trans., p. 140)

The Wheat Classification Council (WCC) suggested that several services have been abandoned since deregulation, including crop shaping, wheat promotion, branding, trade advocacy and technical market support. WCC noted:

Some of these issues will be addressed through the recently released 'Australia Grain Industry Code of Conduct'. However in a deregulated market there is a need for a coordinated approach to the management of brand issues across a large number of traders. (sub. 32, p. 7)

In contrast, GrainCorp did not support the view that industry good functions have been neglected since deregulation, and indicated that 'a number of initiatives are already being discussed to ensure that industry good market failure is addressed' (sub. 43, p. 36). GrainCorp noted:

Now that we're exporting bulk wheat in our own right, we have an international sales team, we're sponsoring international conferences. We were at the International Association of Millers in Turkey last year. We're one of the lead sponsors for the same event in South Africa later this year. We put out a crop report a couple of weeks ago. We're doing promotion. We're doing a whole range of things that used to be considered as industry good essentially to support the development and maintenance of our customer relationships in the international market. (trans., p. 489)

Despite concerns from some industry participants about the under-delivery of various industry good functions, few participants explicitly proposed that these issues should be addressed by the Australian Government. In contrast, many respondents advocated an 'industry-driven' approach. Participant views on the extent to which the Australian Government should be involved in the regulation, funding and/or provision of industry good functions are summarised in the following section.

### *Is there a role for the Australian Government?*

Industry participants presented a wide range of views on which of the industry good functions can appropriately be regarded as predominantly public goods (chapter 7). AWB (sub. 24, p. 24) suggested research and development, wheat classification,

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wheat receival standards, information provision and trade advocacy are ‘legitimate industry good functions’ (public goods), whereas Viterra (sub. 23, p. 10) suggested that wheat classification is the only industry good function that can be regarded as a public good.

The WCC considered that there is a role for government in provision of industry good functions:

Some of these issues cannot be left to the market to provide a solution because of conflicting market forces and requirements of individual marketers. Most of these issues are at a higher level than individual trading/marketing operations, making it difficult or unlikely that a national common approach could be developed spontaneously. Government involvement is required to give any industry good function the credibility when dealing with foreign government importing bodies. Government should be asked to partner with the industry to provide some base funding for the industry to build on for the effective continuation of the industry good functions including classification. (sub. 32, p. 7)

Likewise, the Department of Agriculture and Food (Western Australia) (sub. DR84) suggested that government involvement in the provision and funding of industry good functions is important. By way of example, it referred to recent efforts by the Western Australian Government to facilitate the export of Australian wheat by hosting the Grain Silos and Flour Mills Organisation delegation from Saudi Arabia.

In contrast, Viterra did not support a strong role for government in provision or funding of industry good functions:

Apart from the WCC activities ... the industry-good activities can be considered as purely commercial activities carried out by individual firms or, where appropriate, industry bodies such as GTA in order to maintain strong customer relationships for individual firms or self-interested Australian exporters who choose to see commercial benefits out of acting as a group. (sub. 23, p. 10)

Similarly, GrainCorp considered that industry good functions can and are being addressed by the commercial market, and provided a range of examples of their own activities to support this (trans., p. 489). It was noted that although there are some gaps and evidence of market failure, this will be addressed by the industry over time, and ‘it is not appropriate for the Government to seek to impose a “solution” onto the industry’ (sub. 43, p. 36).

CBH also advocated that industry good functions should largely be left to the market and stated, ‘that’s [the provision of industry good functions] a very important line to be drawn, and it’s best drawn by industry’ (trans., p. 134).

Various options for protecting the Australian ‘brand’ and self-regulating the quality of Australian wheat exports are already being canvassed by various participants. For

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example, GrainCorp (sub. 43) suggested the inclusion of a ‘truth in description’ provision in the export licensing arrangements, whereby exporters would gain ‘approval’ to use Australian wheat grade nomenclature. GrainCorp commented ‘adherence would bring with it the right to use an appropriate trade mark (similar to the Australian Heart Foundation ‘Tick’, or the Assured UK Malt program)’ (sub. 43, p. 33).

Similarly, the WCC proposed achieving industry self-management for wheat quality via a wheat branding mechanism ‘similar to the old heart tick of approval’, for use on sales documentation by approved exporters (trans., p. 73). The WCC considered that something like this would be popular with industry, and recalled that ‘a couple of them [the marketers] have even said that, “We’ll pay a membership fee to be part of this”. But it has to be independent’ (trans., p. 73).

### **The Commission’s view**

The Commission acknowledges that it is too early to expect to see evidence of material costs being suffered by the industry from any ‘under-provision’ of industry good functions, since these goods are long-term in nature. Equally, it would be premature to introduce changes to the institutional or governance arrangements that support the provision of industry good functions in anticipation of such costs. Just as any ‘gaps’ will take time to emerge, so it is important that the Government not intervene too quickly and stifle the work of industry to look after these issues.

In any case, it is not clear that particular industry good functions have been ‘totally abandoned’ — on the contrary the inquiry has heard evidence that the industry is already working towards establishing its own arrangements for fulfilling various industry good functions in the deregulated marketplace. This includes several proposals for the development of new industry bodies, as discussed in section 9.4.

The Commission also considers that it is important to distinguish between situations where markets cannot be expected to support an efficient level of provision of industry goods (market failure), and circumstances where there might be some impediments to market provision, but those impediments can be overcome to allow market solutions to emerge (a ‘market adjustment’ issue).

Specifically, the challenges associated with getting industry participants to work cooperatively, as highlighted by the WCC (sub. 32), do not constitute insuperable barriers to effective market operation in the provision of industry goods. Rather, the Commission considers that matters of this nature are typically best resolved by the industry itself, if and where it considers there is value in doing so. Indeed, the

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experiences of other grains and agricultural industries suggest that industry participants are capable of working together to achieve a common interest.

Finally, a number of participants suggested that wheat classification activities exhibit public good characteristics. Although wheat classification does have a public good element, the Commission considers that it is predominantly a private good and, on balance, it is appropriate for the industry to take the lead on this issue (chapter 8).

## **9.4 An industry-led model**

The Commission understands that the wheat industry is currently investigating various approaches for the delivery of industry good functions and that these approaches are broadly similar to the models in place in other Australian grain and agricultural industries (appendix C). It is not for the Government to prescribe what these arrangements should involve, or how an industry body (or bodies) should be established and structured. However, respondents to this inquiry have raised a number of relevant issues that might be useful in informing this debate.

### **Structure and scope of an industry body**

#### *Participant views*

There is considerable support for the development of an ‘industry goods body’ in the bulk wheat export industry. Respondents largely agreed that establishing a single entity on a national basis is the preferred model.

However, comments from industry participants on the precise structure, role and responsibilities of this body were quite varied. Participants were divided on whether a new body should be established, or whether these responsibilities could be allocated to an existing industry agency.

The Department of Agriculture and Food (Western Australia) suggested:

[Wheat Exports Australia] could deliver these functions itself, or it could contract out these services to relevant industry bodies such as the Wheat Classification Council, [t]he Australian Bureau of Statistics or the Australian Bureau of Agriculture Research Economics’. (sub. 34, p. 8)

In contrast, GIWA (sub. 38) and AgFarm (sub. 44) recommended that a new independent body be established to provide various industry good functions.

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The Pastoralists and Graziers Association of Western Australia (PGA) commented:

There is a need for a whole of industry representative body that will represent the interests of growers and other industry participants. However the PGA does not support in any way the retention of the GCA as it was not representative of the industry or growers, nor does it support the NFF [National Farmers Federation] becoming the national industry body as the organisation is [a] State farm group representative and as such does not distinguish between export growers and domestic growers. The structure and development of any national representative body should continue to evolve on market, not political considerations. (sub. 47, p. 13)

The WCC also considered that a new and independent body was crucial, and stipulated that the GRDC was not an appropriate agency to take on these responsibilities. The WCC pointed out:

The overwhelming industry feedback that I've received is that it's impossible to take an existing model and mould it to do what the wheat industry needs, and that's an industry-good body and function. We have even looked at whether the Wheat Exports Australia could be reshaped to actually do these roles. That has been strongly rejected; that it is impossible to take an existing body with its own mindset and executive and try and change it. Everybody is suggesting that it has to be an independent body with a skills-based representative board independent of these other organisations. (trans., p. 72)

In contrast, AWB suggested that 'sufficient industry bodies already exist to undertake the required roles', and indicated that a new industry body is not required (sub. DR63, p. 16).

The decision of whether to establish a 'wheat only' body, as compared to an 'all grains' body was also considered by participants. AWB suggested there are 'limited synergies available in sharing the provision of "industry good" functions outside the Australian grains industry' (sub. 24, p. 24). AgFarm cautioned that shared provision of industry good functions across industries 'would need to be managed very carefully to ensure ... the appropriate focus [is] applied to each industry' (sub. 44, p. 8).

This position was supported by the WQOG:

Wheat is a specialised and highly differentiated product that requires specialist knowledge and facilities in order to demonstrate [its] capabilities. Its closest relative, barley, is used primarily for malting and stock-feed purposes, thus requiring a totally different set of skills and milling/malting/feeding facilities. (sub. 27, p. 9)

By contrast, GIWA suggested there could be merit in establishing a body that covers all grains, and is funded by all grain industries (trans., p. 141). GIWA indicated that this would be a more equitable approach as other grain industry

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participants often benefit from the industry good type services that are provided in the wheat industry.

Specifically, GIWA has proposed the establishment of a not for profit industry organisation, Grains Australia, to provide a range of industry good functions and act as a communication forum for the industry (sub. DR78). A Wheat Australia committee would be formed as a subsidiary of Grains Australia, and 'would replace the current Wheat Variety Classification Council and Wheat Exports Australia [WEA], with GTA and Grower organisation representation' (sub. DR78, p. 5). The WCC has indicated that it supports the Grains Australia proposal, 'with a Wheat Classification Council sitting below that' (trans., p. 390).

The VFF considered that various industry good functions should be undertaken by an independent grains body, such as the proposed industry funded grower model, Grain Producers Australia (sub. DR65) (box 7.7). The VFF noted that such an industry body should be responsible for generic trade advocacy and market promotion, provision of market information, and wheat variety classification. The Department of Agriculture and Food (Western Australia) also supported an all-grains approach, noting 'the funding mechanism should apply to all grain types and all industry participants, not just ... exporters or growers of export grain' (trans., p. 112).

There was considerable optimism among participants that the industry will come together to establish an appropriate industry body and sort out these matters. CBH referred to the example of Grain Trade Australia and noted 'the important thing is the industry players have got together and actually got quite clear about what is in their common interest and what should be left for them to compete on' (trans., p. 134).

GrainCorp (sub. 43) flagged that it and a number of other companies are discussing the feasibility of establishing an organisation that would largely replicate Barley Australia for wheat.

These examples suggest that industry is already thinking about various models that could be adopted by the bulk wheat export industry to facilitate delivery of particular industry good functions.

Notwithstanding this, some participants cautioned against the notion that industry is capable of establishing a body without government assistance. The VFF stated:

There seems to be a general misconception amongst Government decision makers at the Federal level that they can simply leave everything up to industry. Unfortunately, they did not do the hard work prior to removing the single desk to ensure that appropriate bodies were in place to take over established roles such as classification

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and wheat promotion. Rather than simply being able to keep moving forward, the grains industry is now significantly behind. (sub. 40, p. 3)

In summary, there is no industrywide consensus on the appropriate model for an industry-led body responsible for provision of particular industry good functions. Nevertheless, the Commission recognises that various industry participants are currently exploring a range of options including the establishment of:

- a national grower representative body
  - two alternative models (Grain Producers Australia and National Grains Australia) are being developed by separate industry groups
- Grains Australia, a national not-for-profit industry organisation proposed by GIWA.

These developments are encouraging and suggest that the industry sees value in setting up an industry-led body. In particular, the majority of industry participants are optimistic that an industry-led approach is feasible and agree on:

- the need for industry to take responsibility for delivery of certain industry good functions
- adopting a national approach
- establishing a new and entirely independent body (as compared to assigning new responsibilities to an existing body)
- not interfering with other agencies that provide public good functions (that is, the GRDC and the Australian Government (via DFAT and Austrade)).

However, the wheat industry will need to assess whether there is merit in extending the scope of services provided by an industry body to all grains — as is the case under the aforementioned proposals — or restricting this to wheat only. Indeed, industry might find that there are efficiencies in providing particular services across all grains, but keeping other services ‘wheat specific’.

The following section sets out the Commission’s view on the role for government in the future provision of each of the industry good functions considered in this chapter.

### *The Commission’s analysis*

Determining who should appropriately be responsible for industry good services requires identification of those functions that predominantly constitute public goods (and for which some public involvement might be justified), and those that principally represent private goods (which the market can be expected to provide to

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an efficient level). A framework for working through these issues is set out in chapter 7.

### *Trade advocacy*

The Australian wheat industry is heavily export orientated, rendering the provision of trade advocacy services essential to the performance of the industry. Significant intra-industry benefits arise from activities that support and promote the trading activities of Australian wheat exporters.

Regardless of the quantum of private benefits on offer, and specifically how these benefits compare to the costs of trade advocacy activities, the Commission does not anticipate that the industry will undertake sufficient investment in these activities for two reasons:

- Trade advocacy activities exhibit strong public good characteristics. The benefits of improved trading conditions and better market access for Australian industry cannot be easily confined to specific groups, rendering such services largely non-excludable. Likewise, once such improvements have been achieved, there are no additional costs associated with other users capitalising on this progress (non-rival). These public good characteristics are likely to lead to a ‘free rider’ problem (section 7.3).
- The practical realities of trade advocacy activity mean the Australian Government is usually the only entity that can feasibly undertake this industry good function. For example, the World Trade Organisation is the only global international organisation dealing with the rules of trade between nations, and the Australian Government is the only body eligible for membership of the World Trade Organisation, on behalf of the Australian community.

For these reasons, it is appropriate for government to be involved in the provision of trade advocacy activities, in consultation with industry. Furthermore, trade advocacy gives rise to significant spillover benefits to other export industries (inter-industry spillovers) and the boarder community, providing a strong rationale for taxpayer funding of trade advocacy activities — to the extent that the benefits of these government interventions outweigh the costs. The Commission therefore considers that the current arrangements for government support of trade policy advocacy activities on behalf of the bulk wheat export industry are appropriate.

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*Predominantly private industry good functions*

The Commission considers that crop shaping activities, technical market support, regulatory and policy advocacy, industry strategic planning, wheat promotion and wheat branding are most appropriately regarded as predominantly private goods. The benefits of these activities chiefly accrue to individuals and groups throughout the supply chain (intra-industry benefits) and should be undertaken at the initiative of industry participants. There is no compelling evidence of market failure impeding the proper delivery of these services.

The Commission acknowledges that a number of these industry good functions contain a public good element, consistent with the continuum concept described in chapter 7. For example, some of the benefits of industry strategic planning and regulatory and policy advocacy are non-excludable. In addition, advocacy activities might potentially generate some level of spillover benefit for other industries (inter-industry spillover benefits).

However, the Commission is cognisant of the costs of government intervention (chapter 7) and, on balance, does not consider that these limited public good characteristics are sufficient to warrant any form of government intervention in the provision of these predominantly private industry good functions.

Provision of stocks information by state (chapter 7) — by contrast — is expected to generate significant spillover benefits through the role this information has in price discovery and, by consequence, the efficient operation of the bulk wheat export and domestic wheat markets more broadly. The benefits of government intervention to facilitate the collection of a compulsory levy for provision of stocks information are therefore expected to outweigh the associated costs. Although provision of other predominantly private industry good functions might be desirable — and represent considerable value for particular industry groups — the nature and quantum of benefits on offer do not justify a financial or non-financial role for government.

Technical market support and crop shaping activities represent options for exporters and traders to attract and maintain new markets and customers, and to grow wheat sales. The benefits of these activities primarily reside with the exporters and domestic traders that provide these services and, accordingly, are undertaken to whatever extent the exporter determines is commercially desirable. This conclusion is consistent with ACG (2008c).

Regulatory and policy advocacy activities are means for individuals or industry groups to initiate or influence regulatory and policy outcomes for the purpose of furthering their own commercial position, and accordingly should be at the initiative of the affected parties.

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Industry planning endeavours to enhance the compatibility and coordination of industry activities, and provide a strategic direction for the future of the industry. The benefits of industry planning activities are quite tightly linked to the industry itself and it is hard to see how government involvement could assist with such planning.

Industry planning might be a candidate for collective action. Where the beneficiaries of an industry good function are a large group, for example, the entire bulk wheat export industry, there might be merit in providing such services on an industrywide basis. This could allow beneficiaries of that service to take advantage of certain synergies and economies of scale.

The Commission recognises that achieving industry cooperation might be difficult. However, such challenges do not, of themselves, constitute a case for government intervention. Indeed, if the industry itself cannot design a model for an industry body that is supported by the majority of participants, it is not clear how the Government could. Furthermore, although government intervention might be popular in the short term, significant support could weaken the incentive for industry participants themselves to work towards a more sustainable, long-term solution.

Wheat promotion and branding activities are also for the explicit benefit of industry participants. The Commission expects there are both individual and industrywide benefits arising from such activities. For this reason there might be benefit in pursuing a joint industry approach to these issues. The proposals that have been put forward by various participants for managing quality assurance and protecting the Australian brand, suggest that the industry recognises the value of these services, and is willing to invest in them.

In sum, the Commission considers that the industry faces strong commercial incentives to provide these predominantly private goods. For this reason, investment in these services will be undertaken to whatever extent, and in whatever form, is deemed efficient by industry participants, and there is evidence the industry is already working toward this. Equally, it is for the industry to decide whether there is merit in providing these services on any type of collective basis. Some of the key considerations associated with developing a coordinated industry approach are set out in the following section.

*It is appropriate for the Australian Government to be involved in trade policy advocacy activities, with support from industry. Arrangements for the provision of activities ('industry good' functions that are predominantly private in nature) such as technical market support, crop shaping, regulatory and policy advocacy, industry strategic planning, wheat promotion and wheat branding, are matters for the industry to determine.*

*Research and development is the subject of an ongoing Productivity Commission inquiry.*

## **Funding**

### *Participant views*

A further issue that has been canvassed by participants is how an industry body would be funded. Again, views on this matter varied — some participants suggested that the Australian Government will need to provide funding assistance, at least initially, to get this body 'off the ground'. Other parties proposed that the industry body should be self-funding, and that a voluntary levy might be the appropriate mechanism to achieve this.

GIWA broadly supported the concept of developing an industry driven and industry funded body for the provision of services and suggested:

The options available to fund a national industry body include:

- the Wheat Export Charge
- redirection of the Industry Assistance Package
- industry levy
- pay as you use/subscription services. (sub. 38, p. 5)

However, GIWA is of the view that the Australian Government will need to assist during the transitional phase. GIWA commented 'without the government support we [GIWA] wouldn't be getting the traction that we're getting now' (trans., p. 144). Specifically, GIWA has suggested that 'the Australian Government commit as a minimum \$12 million over five years (\$3 million in the first year) to fund the establishment and operation of Grains Australia' (sub. DR78, p. 1).

The Department of Agriculture and Food (Western Australia) also considered that the Government should provide 'seed capital and finite funding' (sub. DR84, p. 3)

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to assist in the setting up of an industry body, and considered that revenue collected via the Wheat Export Charge (WEC) could be drawn on to fund the provision of industry good functions (sub. 34, p. 8). Similarly, the VFF advocated drawing on the ‘existing Wheat Exports levy and government funding, or the existing GRDC levy and matching government funds’ (sub. DR65, p. 6) to support the establishment of an industry body.

AgFarm and WCC also advocated some short-term government support for an industry-led body. AgFarm suggested ‘[t]he first three years of operations should be financially supported by government with a target for self sufficiency after that period’ (sub. 44, p. 8). The WCC commented that if the wheat industry is prosperous, ‘the government will do well out of it as well’ (trans., p. 72). It was suggested that money from the Industry Assistance Package, or money ‘saved’ if WEA is discontinued, could be redirected to establishing an industry body for wheat. The WCC acknowledged that ‘eventually the wheat industry has to stand on its own feet’ (trans., p. 72).

GGA suggested that ‘the Government provide transitional [funding] support for the next 5 years to be directed towards specific industry development projects’ (sub. DR99, p. 5). The GGA proposal follows consultation with other industry bodies (AGEA, GTA and GRDC) regarding the potential future provision of industry goods and services via a ‘virtual industry services model’. GGA expects that the industry will ‘transition to a largely industry funded model, including a Wheat Industry Services Levy’ (sub. DR99, p. 5) after five years, but notes that ‘ongoing Government partnership to develop the appropriate legislative instruments’ will be required (sub. DR99, p. 1).

### *The Commission’s analysis*

As set out in chapter 7, government intervention to support provision of industry good functions is only justified in the presence of a market failure — for example, to capture spillover benefits to the broader community or to manage a free rider problem. In addition, the case for government intervention of any form will ultimately depend on the direct and indirect benefits and costs of that intervention.

The Commission does not consider that industry provision of predominantly private industry good functions is impeded by market failure. Accordingly, government intervention — of any form — to support provision of these goods and services, is not efficient. As the primary benefit of an industry body is the facilitation and provision of these industry good functions, it follows that government intervention to support an industry body would also be inefficient.

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In general terms government intervention might be justified in the short run to facilitate some kind of structural adjustment that would otherwise not occur, or not occur as quickly. Historically, the Australian Government has provided funding assistance to various industries at the time of deregulation to help transition the industry. This funding is typically provided as part of the negotiation process with industry ahead of the shift to deregulation, and is often a consequence of the historical structures and arrangements in place (appendix C). In addition, the establishment of certain industry bodies may have been facilitated by funding inherited from predecessor organisations, for example, Dairy Australia.

However, as outlined earlier, the Australian Government has already provided funding for a number of initiatives to assist with the wheat industry's transition to deregulation, via the Industry Assistance Package (box 9.3). In addition, in 2005 the GRDC provided assistance of about \$2 million over two years for the establishment of SVGA. The Commission does not see a clear case for providing further government funding for this purpose.

### **Lessons from other jurisdictions and industries**

The operation of industry-led bodies in other Australian agricultural (including grains) industries, as well as international wheat exporting regions, can offer valuable insights on the above issues (appendix C). These agencies undertake a range of relevant industry services, and might provide a useful 'template' for the establishment of a similar body in the wheat industry.

Respondents to this inquiry made frequent references to the various industry good type bodies that operate in the Australian dairy, and meat and livestock sectors, as well in the barley, pulses and oilseeds sectors.

The PGA suggested that the Australian wheat industry should move to 'a self regulated model similar to that which operates in other major export industries both domestically ... and in other countries' (sub. 47, p. 12). The WQOG recommended that 'Barley Australia and the Australian Oilseeds Federation are worthy examples [of how industry good functions could be delivered] that warrant close evaluation' (sub. 27, p. 9). GrainCorp (sub. 43) considered that the Australian Oilseed Foundation, Barley Australia and Pulses Australia work well in their respective industries. AgFarm (sub. 44) considered Cotton Australia and Meat and Livestock Australia to be relevant examples.

The United States and Canada were commonly cited as the 'benchmark' for how wheat industry good functions can be provided. The WQOG noted that these programs are extensive, but recognised that 'the government in both countries funds

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a majority proportion of these activities' (sub. 27, p. 9). The WCC made a similar point:

The US Wheat Associates is a good example of how industry promotion and advocacy could be handled ... the wheat associates have an extremely large budget and so are involved in a wider and more extensive suite of activities than any of the grain peak bodies in Australia ... whilst Australia would not need anything of this order of magnitude, the principles of the model are good. (sub. 32, p. 12)

The US Wheat Associates (USW) is funded via a combination of US Federal Government contributions and payments from US wheat producers (appendix C). The 2009 budget for the USW was about USD16.8 million, with total United States Department of Agriculture support accounting for about USD12.5 million (or 74 per cent) of USW's 2009 revenue (USW 2009).

The 19 State Wheat Commissions in the United States are authorised to impose a mandatory levy on growers at first point of sale, and to elect how to spend this money on behalf of growers. Historically, the State Wheat Commissions have chosen to support the activities of USW, and to undertake other direct investments on behalf of growers. Producer contributions to USW totalled USD4.3 million in 2009 (USW 2009).

Although international examples are not directly comparable to the Australian context, the services provided to wheat industry participants in the United States and Canada demonstrate the wealth of information resources available to our 'competitors', and highlight the importance of allocating our own, more modest resources, efficiently and effectively.

In contrast, the experiences of other Australian grains and agricultural industries are relevant to the bulk wheat export industry. In many of these industries a peak body is charged with fulfilling various industry good functions, and is funded by the industry itself (appendix C). The Australian Government provides matching research and development funding to several of these bodies, in the same way government assistance is currently provided to the GRDC for grains industry research and development.

Notwithstanding this similarity, the funding arrangements that apply to the wine, meat and livestock, dairy and wool sectors are subtly different to wheat. In these industries, some of the levy revenue collected by the Australian Government from producers is used for market promotion and development activities, as well as for information collection and dissemination. In the case of wheat, the levy collected by the Government is directed towards research and development activities only (box 7.11).

*The Australian Government currently collects compulsory levy payments from producers in the wine, meat and livestock, dairy and wool industries. Some of this levy revenue is used for market promotion and development activities, as well as information collection and dissemination.*

An industry-led approach to provision of industry good services appears to have worked successfully across a range of industries and commodities in Australia. It would be instructive for the wheat industry to learn from these experiences, as it works toward developing its own industry goods body.



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## A Public consultation

Outlined in this appendix are details relating to consultations through:

- submissions received (table A.1)
- pre- and post-draft visits (table A.2 and table A.3)
- public forums (table A.4)
- public hearings (table A.5).

The Commission received the terms of reference for this inquiry on 29 September 2009. Following receipt of the terms of reference, the Commission placed notices in the press and on its website inviting public participation in the inquiry. Information about the inquiry was also circulated to people and organisations likely to have an interest in it. The Commission released an issues paper on 16 October 2009 to assist inquiry participants with preparing their submissions. The Commission received 56 submissions as input into the draft report.

The Commission also held public forums in regional areas before the draft report. These forums provided an opportunity for participants to present their views in an informal environment. Transcripts were not taken and the formalities of public hearings, such as rules of evidence, did not apply.

An initial round of public hearings was held in Melbourne, Perth, Brisbane, Sydney and Adelaide in November and December 2009, which attracted 23 participants.

The Commission released a draft report for public comment on 22 March 2010. In response to the draft report, a further 44 submissions were received from farmers, grower associations, industry associations, traders, bulk handlers and some members of the public.

To discuss the draft report and draft report submissions, a second round of public hearings was held in Melbourne, Perth, Sydney and Adelaide in April and May 2010, which attracted 20 participants.

Throughout the inquiry, the Commission conducted meetings with a range of organisations and individuals, including wheat growers, bulk handling companies, traders and regulators.

**Table A.1 Submissions received**

<i>Individual or organisation</i>	<i>Submission number</i>
Agfarm Pty Ltd	44
AgForce Grains Ltd	16, DR73
Asciano (Pacific National)	DR97
Australian Bulk Alliance	48
Australian Bureau of Statistics	12
Australian Competition and Consumer Commission	DR95
Australian Grain Exporters Association	28, 35, DR79
Australian Rail Tram & Bus Industry Union	DR59
Australian Seed Federation	DR68
AWB Ltd	24, DR63
Badger, Trevor	14
Billing, Marion	DR61
Billing, Ralph	DR62
Billing, R H & M J	30
Bush, Timothy	DR77
Cannon Partners	DR60
Conlon, S	DR87
Co-operative Bulk Handling Ltd	39, DR75
Crook, Andrew	25
Dalkeith Warialda	4
Department of Agriculture and Food (Western Australia)	34, DR84
Department of Foreign Affairs and Trade	22
Duncan, A D & S E	8
Durham, Ross	DR85
Dwyer, Mark	DR66
Elders Toepfer Grain Pty Ltd	DR94
Feedgrain Partnership	42
Flour Millers Council of Australia	26
Fox, David	DR71
Glencore Grain Pty Ltd	DR89, DR93
Gooding, M I & H I	31
GrainCorp Operations Ltd	43, 54, DR82, DR96, DR98
Grain Growers Association	41, DR86, DR99
Grain Industry Association of Western Australia	38, DR78
Grains Research & Development Cooperation	DR69
Grain Trade Australia	19, DR67
Guest, R & L	1, 6, DR57
Halbert, Kim	DR88

(continued next page)

Table A.1 (continued)

<i>Individual or organisation</i>	<i>Submission number</i>
Hassell, J & M	13
Hatty, Rod	52, DR72
Hull, Kay MP	36
Ilestyle Pty Ltd	9
Intergrain	33
Jones, P & A	5
Krtschil, Hart	DR80
Lloyd, J & C	56
Lynch, P D & Co	37
McKay, Mark	DR74
Macneil, Angus	DR58
Mattingly, L L & S J & Son	2
Michael, C & J	11
National Competition Council	7
Newman, W A & L A	17
NSW Farmers Association	49, 53, DR91
Pastoralists and Graziers Association of Western Australia (Inc)	47, DR81
Pike Family Trust	18, DR83
Rick, D W	3
Ronland Nominees Pty Ltd	15
Scott, M B Pty Ltd	10
South Australian Farmers Federation	51, DR64
Stockfeed Manufacturers Council of Australia (Inc)	21
Sunridge	20
Trebeck, David	50
Valley Seeds Pty Ltd	45
Victorian Farmers Federation	40, DR65
Viterra Ltd (formerly ABB Grain Ltd)	23, DR70, DR100
WA Grains Group	46
Western Australian Farmers Federation (Inc), The	29, DR92
Wheat Classification Council	32, DR76
Wheat Exports Australia	55, DR90
Wheat Quality Objectives Group	27

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Table A.2 **Visits/consultations pre-draft report**

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*Individual or organisation*

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**Adelaide**

Department of Primary Industries and Resources (South Australia)  
Elders Toepfer Grain Pty Ltd  
Grains Industry of South Australia  
South Australian Farmers Federation  
Viterra Ltd (formerly ABB Grain Ltd)

**Canberra**

ABARE  
Australian Competition and Consumer Commission  
Department of Agriculture, Fisheries and Forestry  
The Treasury  
Wheat Exports Australia

**Donald, Victoria**

Harberger Farm Supplies  
Peaco

**Geraldton, Western Australia**

Co-operative Bulk Handling Ltd  
Geraldton Port Authority

**Melbourne**

Australian Competition and Consumer Commission  
Australian Crop Forecasters  
Australian Grain Exporters Association  
AWB Ltd  
Bunge Agribusiness Australia Pty Ltd  
National Competition Council  
Victorian Farmers Federation  
Wheat Classification Council  
Wheat Exports Australia

**Minyip, Victoria**

WIM PAK

**Murtoa, Victoria**

GrainCorp Operations Ltd

**Perth**

Co-operative Bulk Handling Ltd  
Department of Agriculture and Food (Western Australia)  
Pastoralists and Graziers Association of Western Australia (Inc)  
ProFarmer Australia  
Premium Grain Handlers

**Sydney**

Grain Growers Association  
Grain Trade Australia  
GrainCorp Operations Ltd  
NSW Farmers Association

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**Table A.3 Visits/consultations post-draft report**

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*Individual or organisation*

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**Adelaide**

Elders Toepfer Grain Pty Ltd

**Canberra**

Glencore Grain Pty Ltd

Grain Research & Development Council

Viterra Ltd

**Melbourne**

ABARE

ABS

Australian Competition and Consumer Commission

Australian Crop Forecasters

Cargill Australia Ltd

Co-operative Bulk Handling Ltd

Grain Producers Australia

Wheat Exports Australia

**Perth**

Australian Railroad Group

Westnet Rail

**Sydney**

Asciano

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**Table A.4 Public forums**

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*Location*

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**Victoria — 23 November 2009**

Horsham

**Western Australia — 1–2 December 2009**

Geraldton

Cunderdin

**Queensland — 8 December 2009**

Dalby

**New South Wales — 9 December 2009**

Dubbo

**South Australia — 15 December 2009**

Port Lincoln

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**Table A.5 Public hearings**

<i>Individual or organisation</i>	<i>Transcript page numbers</i>
<b>Melbourne — 24 November 2009</b>	
Australian Bulk Alliance	42–51
National Competition Council	2–13
Valley Seeds Pty Ltd	34–41
Victorian Farmers Federation	14–33
<b>Perth — 3 December 2009</b>	
Intergrain	75–82
Pastoralists and Graziers Association of Western Australia (Inc)	54–64
Western Australian Farmers Federation (Inc), The	96–105
WA Grains Group	83–95
Wheat Classification Council	65–74
<b>Perth — 4 December 2009</b>	
Badger, Trevor	159–171
Co-operative Bulk Handling Ltd	121–137
Department of Agriculture and Food (Western Australia)	106–120
Grain Industry Association of Western Australia	138–147
Hassell, John	154–158
Newman, Wally	148–153
<b>Brisbane — 7 December 2009</b>	
AgForce Grains	172–188
<b>Sydney — 11 December 2009</b>	
Australian Grain Exporters Association	237–251
Grain Growers Association	214–228
Grain Trade Australia	229–236
GrainCorp Operations Ltd	191–213
NSW Farmers Association	252–279
<b>Adelaide — 14 December 2009</b>	
South Australian Farmers Federation	298–314
Viterra Ltd	281–297
<b>Melbourne — 28 April 2010</b>	
Australian Bulk Alliance	317–324
Australian Grain Exporters Association	364–383
AWB Ltd	340–363
Victorian Farmers Federation	325–339
<b>Perth — 3 May 2010</b>	
Co-operative Bulk Handling Ltd	437–459
Department of Agriculture and Food (Western Australia)	460–471
Grain Industry Association of Western Australia	424–436
Pastoralists and Graziers Association of Western Australia (Inc)	414–423
Tamma Grains	395–401
Western Australian Farmers Federation (Inc), The	402–413
Wheat Classification Council	385–394

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Table A.5 (continued)

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<i>Individual or organisation</i>	<i>Transcript page numbers</i>
<b>Sydney — 11 May 2010</b>	
Glencore Grain Pty Ltd	528–547
Grain Growers Association	518–527
Grain Trade Australia	491–494
GrainCorp Operations Ltd	472–490
Munro, Jock	495–506 + 548
NSW Farmers Association	507–517
<b>Adelaide — 17 May 2010</b>	
Elders Toepfer Grain Pty Ltd	550–564
South Australian Farmers Federation	565–577
Viterra Ltd	578–597

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## B Marketing and risk management tools

The methods used by growers to market and price their wheat are described briefly in this appendix. The description and illustration focuses on the role of the methods in managing price risk from the point of view of growers that produce and deliver wheat for sale. In particular, the emphasis is on the grower using the methods to hedge against a possible low price or decrease in the price of wheat. Some of the methods are financial instruments that do not require delivery of wheat. As such, these instruments are also used by traders and speculators. In addition, many variations in these methods and combinations of them are offered by financial service providers, pool managers and traders.

### B.1 Contracts

Ultimately, growers sell and deliver most of their wheat under some kind of contract. The five elements to a contract for sale of wheat are:

1. quantity of wheat
2. quality of wheat (such as bin grade or receival standard)
3. time of delivery and payment
4. place of delivery (bulk receival facility or port)
5. price received (fob at a port or at a bulk receival facility).

The wheat traders and Grain Trade Australia (GTA) have developed guidelines and standards for contracting and dispute resolution (GTA 2009a), and these appear to be working well, as noted by AgForce Grains and AWB Limited (AWB):

- Contracts are generally straight forward. The fine print may vary in terms of tonnage variance, freight rates applied, but most are fairly standard. Growers need to know the nett price to them. Most contracts reflect a port price with deductions. (AgForce Grains, sub. 16, p. 15)
- It is extremely easy for a grower to enter a contract with an accredited exporter. Contract terms are available for review before contracts are signed and GTA and major grain companies have sponsored a national effort to increase grower

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awareness to the importance of appreciating terms and conditions of contracts before contracts are signed as well as providing guidance on the best approach to assessing and negotiating contract terms when marketing their produce. (AWB, sub. 24, p. 26)

## **B.2 Spot market (cash sales)**

The spot market is the simplest method of selling grain. The price received is the market price on that day for grain for immediate delivery. Payment is made under normal commercial terms (for example 14–30 days). The spot market is often termed the ‘cash’ market. It provides certainty of price, so there is no price risk for the seller or the buyer, but growers must have grain available for immediate delivery to take advantage of the spot price. In the spot market the five contractual elements of quantity, quality, time, place and price are agreed on the spot. Even when wheat is sold on the spot market, a contract may be used to lock in a price being offered at a particular time of day, otherwise the price might change while the wheat is being delivered from the farm to the port or bulk receival site.

## **B.3 Hedging using forward cash contracts (cash sales)**

A forward contract is a privately negotiated bilateral contract between a grower and a trader. Forward contracts are not traded (unlike futures contracts that are traded in futures markets). Growers and traders use forward contracts as merchandising vehicles, whereby each party expects to make or take delivery, respectively. If they cannot, they must either buy grain, negotiate to change the contract to fit the quality grown or pay compensation (‘washout’ the contract).

Under forward contracting, a grower commits to deliver wheat to a nominated location at a designated time in the future. The price is fixed at the time of contracting. Forward contracts are a way for growers (and traders) to hedge the price they receive (pay) for wheat. From a grower’s perspective, it is a way of avoiding low prices for grain delivered in the future. For the trader, it is a way of avoiding high prices for grain purchased. The main types of forward contracts are outlined below:

- Fixed-grade contracts, where the tonnage, grade, price, time and location of delivery is fixed at the time of contracting.
- Multi-grade contracts that include a schedule of prices according to the bin or receival standard of the wheat at delivery. Some multi-grade contracts might offer price increments for protein, screenings or moisture within the band of

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these quality characteristics for the receival standard (for example, protein (6–16 per cent), screenings (0–10 per cent) and moisture (8–12 per cent)). Price increments are a way of avoiding ‘cliff-face pricing’ by pricing for quality within the range of a receival standard. A multi-grade contract without price increments for quality within the receival standard is termed ‘flat’ and the price reflects the minimum quality characteristics of the grade or receival standard.

- Multi-varietal contracts are similar to multi-grade contracts except that they are based on a varietal payment system rather than payment based on bin or receival standard. A discussion of varietal grade (such as APH) and bin grade (such as APH2, H1, H2) is provided in chapter 8.

Most forward contracts are likely to be flat rather than offer increments within a grade.

Forward contracts can be used to fix the price for wheat either pre-harvest or post-harvest (from wheat the grower has stored on farm or warehoused in a receival site).

Forward contracting eliminates risk from declining prices as well as basis risk (described below) and avoids the costs of paperwork and time associated with hedging in the futures market. As a result, the price is expected to be lower, on average, because the price risks have been transferred to the purchaser and there are fewer transaction costs than hedging (that is, commission costs, margins, interest on margins).

Using forward contracts to sell wheat prior to harvest has one significant disadvantage associated with production risk. If the grower has a poor harvest and cannot deliver the wheat in accordance with the contract, then he has to washout the contract by purchasing wheat at prevailing market prices. There is potential for the grower to make huge losses if the grower cannot deliver, as they not only have no grain to sell, they have to purchase grain at the price prevailing at the time specified in the contract.

## **B.4 Wheat futures markets and other financial hedging instruments**

Wheat futures markets are price discovery and risk management institutions that are designed to establish future prices and manage risk. The futures prices are determined by the interaction of competing expectations of traders (including growers) and reflect a broad range of information about market conditions into the future.

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Examples of wheat futures markets include:

- Australian Securities Exchange (ASX)
  - Western Australia Wheat Future (ASX code WAW) (Wheat Standard APW2 10 per cent protein, contract size 20 metric tonnes, contract months (January, March, May, July, September, November), delivery point Kwinana Track<sup>1</sup>)
  - Australian Milling Wheat Future (ASX code AWM) (Wheat Standard APW2 10 per cent protein, contract size 20 metric tonnes, contract months (January, March, May, July, September, November), delivery point New South Wales track (Newcastle and Port Kembla))
  - Futures contracts and call and put options are available on the ASX wheat futures markets.
- Chicago Board of Trade (CBOT)
  - Soft Red Winter, Hard Red Winter, Dark Northern Spring and Northern Spring Wheat futures.<sup>2</sup>
- Kansas City Board of Trade
  - Hard Red Winter Wheat futures.

Australian growers using US futures markets as hedging instruments do not grow the relevant variety of wheat and cannot make delivery under futures contracts without buying and delivering the appropriate specification of wheat in the United States. They are also exposed to exchange rate risk and differential movements in the spot price of the wheat the grower is producing and selling and the price of wheat traded in the US futures markets. Consequently, hedging decisions for Australian growers using US futures markets are more complex than using Australian futures markets.

Furthermore, as described in chapter 3, the price of wheat in the eastern states of Australia can rise above the export price in years of low production. This complicates managing price risk in the eastern states using international futures markets. Issues regarding the use of US futures for Australia are discussed in Thompson and Bond (1985).

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<sup>1</sup> The Kwinana track price is the price of wheat delivered at Kwinana.

<sup>2</sup> The CBOT wheat contract is technically designed to allow for delivery of Soft Red Winter, Hard Red Winter, Dark Northern Spring and Northern Spring wheat. The CBOT is commonly used by traders for all wheat classes because of its liquidity and volume. However, the higher cash prices for the other classes of wheat relative to Soft Red Winter make the delivery against the CBOT contract impractical for other classes. (Aulerich, Hoffman and Plato 2009, p. 25)

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## **Futures contracts and options**

Wheat futures contracts are a legally enforceable promise to buy or sell a standardised quality and quantity of wheat at a specified time and location at an agreed 'selling price'. Although futures contracts appear similar to forward contracts, they are not the same. There are two essential attributes of futures contracts that distinguish them from forward contracts.

Firstly, futures contracts can be traded (bought and sold) over time (before the expiry date of the contract) on a futures exchange, such as the ASX. This leads to a second distinguishing feature, which is that a futures contract sold by a grower can be extinguished (that is the obligation to physically deliver wheat is extinguished) by buying another equivalent futures contract prior to the expiry date of the contract. In practice, few futures contracts are ever delivered upon (about 2–3 per cent). A financial gain or loss can be made on extinguishing a contract and provides the mechanism by which futures contracts can be used as instruments to hedge wheat prices.

As with forward contracts, futures contracts can be entered into pre- and post-harvest. There is an element of production risk in entering into futures contracts pre-harvest, although the financial consequences from crop failure are significantly lower than for forward contracting. To extinguish the futures contract, the grower needs to pay only the difference between the contracted price and the price of the contract at maturity if the price of wheat at contract maturity is higher than the price paid by the grower.

One note of caution is that during a commodity price spike, like that occurring in 2007-08, it is possible for a grower to make a substantial loss on futures. During the 2007-08 price spike, the spot price was exceptionally high, resulting in a high price to extinguish the futures contract. If a grower also had a crop failure, the financial stress could have led to insolvency of the business because of the coincident timing of the crop failure and the wheat price boom.

An illustrative example of a grower using a futures contract to hedge against a fall in the future price of wheat is given in box B.1.

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### **Box B.1 Illustrative example of a hedge using a futures contract**

In September 2009, a grower with an anticipated harvest of 5000 tonnes wishes to hedge against a drop in the price of wheat (say to below cost of production) by hedging 20 per cent of the expected production (1000 tonnes) using Western Australia Wheat (WAW) futures contracts on the ASX. In September, the grower sells 50 futures contracts for delivery in January 2010 at the prevailing market price of \$200 per tonne. (On the other hand, the trader buying futures contracts from the grower is hedging against a rise in the price of wheat.)

In January, the spot market price for delivery is \$220 per tonne and the grower decides to sell all of his grain at this price. The grower extinguishes his futures contracts by buying futures contracts in January at the market price of \$220 per tonne. In this case, the grower has made a loss on hedging of \$20 per tonne on 1000 tonnes. Total income is \$1.08m (\$1.1m from sale of wheat less a loss on the hedge of \$20 000) or \$216 per tonne. On this occasion, the hedge against a fall in the price of wheat has cost the grower an average of \$4 per tonne on the total crop sold.

If the spot market in January had fallen to \$180 per tonne and futures contracts had fallen to \$180 per tonne, the grower would have made a gain on hedging of \$20 per tonne on 1000 tonnes. Total income would have been \$0.92m (\$0.9m from sale of wheat plus a gain on the hedge of \$20 000) or \$184 per tonne. The hedge against a fall in the price of wheat has gained the grower an average of \$4 per tonne on the total crop sold.

*Sources:* Productivity Commission calculations; GRDC (2008a); Stevenson and Sims (2008).

Futures exchanges often provide ‘options’ (put or call) on futures contracts, which gives the buyer the right, but not the obligation, to buy or sell a futures contract at a specific price at any time on or before the expiry date of the contract.

Options have an expiry date and a specific price at which the buyer or seller may buy or sell the underlying futures contract if the option is exercised. This specific price is referred to as the strike price and the premium payable is dependent on the strike price. Option premiums are determined by interest rates, the length of the insurance period, price trends, price volatility and the value of the strike price. The premium is higher for a more favourable strike price for the hedger.

There are two types of options:

- Put options, which give the buyer the right, but not the obligation, to sell a futures contract at an agreed price on or before a set date. These provide protection from price falls by establishing a floor price.
- Call options, which give the buyer the right, but not the obligation, to buy a futures contract at an agreed price on or before a set date. Call options provide protection from price rises by locking in a price ceiling.

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From a growers perspective, put options can be used to guarantee the sale price of wheat for the life of the option, no matter how low the wheat futures price might go. The purchase of a put option is similar to a form of insurance against a fall in the wheat price.

Put options can also be used by growers to manage production risks. Buying a put option gives a grower the right, but not the obligation, to sell the underlying future at a predetermined price. This can be used by growers that want to take advantage of high prices but are unwilling to enter into forward contracts because of production risk.

As noted above, the ASX offers put and call options on WAW futures contracts. An example of a grower using a put option to ensure a minimum price using WAW futures is outlined in box B.2.

#### **Box B.2 Illustrative example of a hedge using put options<sup>a</sup>**

The grower in box B.1 could have adopted another strategy to hedge against a price fall using put options. In this case, he hedges 1000 tonnes by buying 50 WAW put options to sell wheat in January at the futures price (in September) of \$200 per tonne and pays a premium of \$10 per tonne.

In January, the spot market price for delivery is \$220 per tonne and the grower decides to sell all of his grain at this price. The grower forgoes the option. Total income is \$1.09m (\$1.1m from sale of wheat less the cost of the option of \$10 000) or \$218 per tonne. On this occasion, the hedge against a fall in the price of wheat has cost the grower an average of \$2 per tonne on the total crop sold.

If the spot market in January had fallen to \$180 per tonne and futures contracts fallen to \$180 per tonne, the grower would have had two choices:

- sell the put options at market value ( $\$20$  per tonne =  $200 - 180$ ), and sell all the grain at the spot price ( $\$180$  per tonne)
- exercise the put option and then either:
  - deliver against the futures contract by selling 1000 tonnes at \$200 per tonne
  - or extinguish the futures contracts by buying WAW January at \$180 per tonne.

Total income is \$0.91m (\$0.9m from sale of wheat plus \$20 000 from exercising the option less the option premium of \$10 000) or \$182 per tonne. On this occasion, the hedge against a fall in the price of wheat has rewarded the grower by an average of \$2 per tonne on the total crop sold.

<sup>a</sup> Ignores transaction costs for simplicity.

Sources: Productivity Commission calculations; GRDC (2008a); Stevenson and Sims (2008).

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## Commodity swaps

In finance, a swap is a derivative in which two counterparties exchange certain benefits of one party's financial instrument for certain benefits of the other party's financial instrument. In the case of wheat, (commodity) swaps allow the achievement of an agreed price for a specified quantity of wheat on the maturity date.

A wheat swap is an agreement between the grower and a bank that fixes the price of an agreed quantity of the relevant commodity (fixed swap price) on a future date (maturity date). On the maturity date the fixed swap price is compared with a commodity reference price (CRP) that is determined by reference to a specific futures exchange commodity for the relevant contract month (for example WAW futures on the ASX or a similar reference commodity traded offshore, such as Soft Red Winter wheat traded on the CBOT). If the commodity is traded in currencies other than the Australian dollar (AUD), the grower is exposed to exchange rate risk.

A wheat grower wishing to manage the risk of a price fall using a swap agrees with a bank that if on the maturity date:

- the fixed swap price is greater than the CRP, then the bank will pay the cash settlement to the grower on the settlement date
- the fixed swap price is less than the CRP, then the grower pays the bank the cash settlement amount on the settlement date
- the fixed swap price is equal to the CRP, no amount is payable between the grower and the bank.

A wheat commodity swap is a financial instrument only and does not involve a commitment to actually deliver wheat.

An illustrative example of a grower using wheat (commodity) swaps to hedge against a fall in the future price of wheat is given in box B.3.

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### **Box B.3 Illustrative example of a hedge using wheat swaps**

In September 2009, a grower with an anticipated harvest of 5000 tonnes wishes to hedge against a drop in the price of wheat by hedging 20 per cent of the expected production (1000 tonnes) using wheat swaps offered by banks. In September, the grower enters into a swap with a bank (in AUD) for 1000 tonnes of wheat for a fixed price of \$200 per tonne for APW2 (the reference commodity being WAW futures traded on the ASX).

In January, the spot market price for delivery is \$220 per tonne and the grower decides to sell all of his grain at this price. As the spot market price at the maturity of the wheat swap is higher than the fixed price, the grower pays the bank \$20 per tonne on 1000 tonnes. Total income is \$1.08m (\$1.1m from sale of wheat less a loss on the swaps of \$20 000) or \$216 per tonne. On this occasion, the hedge against a fall in the price of wheat has cost the grower an average of \$4 per tonne on the total crop sold.

If the spot market in January had fallen to \$180 per tonne, the grower would have made a gain on swaps of \$20 per tonne on 1000 tonnes. Total income would have been \$0.92m (\$0.9m from sale of wheat plus a gain on the swap of \$20 000) or \$184 per tonnes. The hedge against a fall in the price of wheat has benefited the grower an average of \$4 per tonne on the total crop sold.

*Sources:* Productivity Commission calculations; GRDC (2008a); Stevenson and Sims (2008).

### **Basis contracts**

A basis contract is a variation of a forward contract, which provides a method of eliminating basis risk without locking in a price. A grower with a basis contract is required to deliver a specified amount of wheat at a specified future time. The grower is guaranteed that the price received will be a fixed amount (called the basis) either above or below the underlying futures contract price.

The basis is equal to the spot price minus the futures price. A more detailed discussion of the basis is provided in chapter 3.

The grower enters into a contract to deliver wheat at a future point in time for a price determined by:

- the commodity futures price locked-in (futures component)
- the foreign exchange rate locked-in (foreign exchange component)
- the basis (basis component).

The grower is paid a price in AUD equivalent to the futures price (based on US wheat futures and exchange rate futures) plus or minus a fixed (basis) margin.

Initially, only the US wheat futures and exchange rate futures need to be locked in. These can be extinguished in the future (albeit for a profit or loss) and the grower can exit without the need to deliver wheat. Once the basis is locked in, the contract becomes a forward contract (with price dependent on futures prices plus or minus a fixed basis margin) to deliver and the grower takes on delivery risk.

Basis contracts do not appear to be popular with growers.

## B.5 Discretionary pools

Wheat pools are popular with growers because they are a relatively simple way for them to market wheat. Growers selling wheat through pools pass all marketing and pricing decisions to the organisation managing the pool. The wheat is typically sold for some time after harvest. All the pool sales are averaged and then a final price is returned to growers. All the marketing and pricing decisions are undertaken by the pool manager, for a fee. The range of pools available to wheat growers has increased, which offers growers access to a range of different risk management strategies, finance options and payment systems.

The current pools fit under two broad categories, harvest pools and managed or commitment pools. A discussion of the hedging activities of different pools is provided in section 3.4 of this report.

### Payment options available from pools

A number of payment options are available from pools (table B.1). Growers choose a payment option based on their need for cash flow and the tax implications.

**Table B.1 Illustrative payment options**

<i>Timing of payment</i>	<i>Harvest payment</i>	<i>Deferred payment</i>	<i>Standard flexi loans</i>	<i>Distribution</i>	<i>Single sum</i>
Harvest	70% less 100% costs		Up to 75% less 100% costs		
Mar 2010				Up to 20% less 20% costs	
Jul 2010		70% less 100% costs		Up to 20% less 20% costs	
Sep 2010	Up to 15%			Up to 20% less 20% costs	
Dec 2010	Final payment	Final payment		Final payment	Final payment

Source: GrainCorp (2009).

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# C Australian and international experiences: accreditation and industry goods

Experiences in other Australian and international grains and agricultural industries can offer valuable insights regarding the administration of export accreditation schemes, and arrangements for the provision of industry good functions.

## C.1 Accreditation

### **Container wheat exports quality assurance scheme — national**

On 27 August 2007, arrangements for exporting wheat in bags and containers began under the *Non-bulk Wheat Quality Assurance Scheme 2007*. The aim of the scheme was to protect Australia's international reputation by ensuring that exports are consistent with sales contract specifications through provisions to sample and quality test wheat exported in bags and containers. This was achieved through an accreditation scheme administered by the Export Wheat Commission (EWC).

Under the Non-bulk Wheat Quality Assurance Scheme, exporters were required to have their wheat tested for protein content, moisture content, falling number (a measure of rain damage at harvest time), screenings and weight before being exported. Wheat had to be packed by an EWC accredited packer, who would take samples of the wheat for quality testing. The samples were sent to a testing laboratory, also accredited by the EWC, who would provide testing results to the exporter and the EWC. At least three samples of 300 grams each from every 25 tonnes of wheat being packed had to be taken. Wheat was deemed fit for export if the description of the wheat in the testing results corresponded with both the notice given by the exporter to the EWC, and with the description in the relevant contract.

The scheme ended on 30 June 2008. In finalising the scheme, Wheat Exports Australia (WEA) performed a review, which showed 99.9 per cent compliance of

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non-bulk wheat shipments (WEA 2009e). Except for a small tonnage, the non-compliant exports were simply administrative errors by exporters.

### **ESCOSA licensing of bulk barley exports — South Australia**

The ABB Grain single desk for exporting barley from South Australia was removed on 1 July 2007. A three-year transitional barley export licensing scheme was established for exports of barley in bulk, under the *Barley Exporting Act 2007* (SA). It was enacted in accordance with the recommendations of the Barley Marketing Working Group, which reported to the South Australian Government in late 2006. Bag and container barley exports of no more than 50 tonnes are exempted from the scheme.

The scheme is administered by the Essential Services Commission of South Australia (ESCOSA). The aim of the scheme is to give growers time to improve their risk management and grain marketing skills, and ensure a proper prudential assessment of barley exporters before the move to full liberalisation (ESCOSA 2007).

The application form is 14 pages long and requests information on:

- the applicant's corporate profile
- the history of commercial dealings of the company, its officers and its shareholders, and the standard of honesty and integrity shown in those dealings
- the nature and scope of barley exporting operations to be undertaken
- the resources available to carry out its operations
- experience in trading and exporting barley
- the risk management systems in place, and whether or not the applicant has sufficient capital to support its operations
- other licences held.

The level of information required is brief, and no substantive supporting documentation is required.

In assessing an application, ESCOSA considers the applicant's experience in trading barley and other grains, its past commercial record, its display of competency, honesty and integrity, and the financial, technical and human resources available to the applicant (ESCOSA 2007). Conditions can be placed on the licence.

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In its assessment of applications, ESCOSA has established and maintained targeted and light-handed regulatory arrangements (ESCOSA, pers. comm., 18 February 2010). The regulatory approach focuses on outcomes rather than processes. It leaves it to the interested parties to determine the most appropriate manner in which these outcomes should be attained given the particular circumstances (ESCOSA 2007).

Under a two week public consultation process, ESCOSA makes licence applications available on its website and anyone can make a submission to ESCOSA regarding the applicant. If that consultation requires the release of confidential information, the Commission will first advise the applicant and seek consent to the release of information (ESCOSA 2007). An application fee of \$2500 is payable by applicants, and there is an annual licence fee of \$12 500 for exporters.

The Barley Exporting Act also established the Barley Exporting Advisory Committee to advise the Minister on the operation of the Act, and any matters arising under the Act. This includes advising the Minister of issues raised by industry stakeholders. It is intended to be a vehicle for growers to provide feedback regarding the deregulated system.

According to the Barley Exporting Advisory Committee, no matters have been raised with it by licensees about ESCOSA's administration of the licensing arrangements (Barley Exporting Advisory Committee, pers. comm., 19 February 2010). In addition, ESCOSA has not dealt with any complaints about the licensing regime, licensee compliance with the Barley Exporting Act, or ESCOSA's regulatory requirements (ESCOSA, pers. comm., 18 February 2010).

The scheme is scheduled to end on 30 June 2010 at which time the industry will move to full deregulation. *A Review of the Barley Exporting Act 2007* (Baldock and Brown 2009), conducted in November 2009, recommended that the Act should be allowed to expire on 30 June 2010 as planned, and that the licensing system should be removed from the industry to permit full deregulation.

### **Grain Licensing Authority — Western Australia**

The role of the Grain Licensing Authority (Western Australia) (GLA) was to administer a grain licensing scheme for prescribed bulk grain exports from Western Australia under the *Grain Marketing Act 2002*. The Grain Marketing Act covered barley, canola and lupins. These licences were issued for exporters other than the main licence holder (Grain Pool).

The original aim of the GLA system was to maximise the benefits of competition in the market whilst protecting the price premiums to Grain Pool, which previously

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held the single desk marketing rights. The aim was also to protect the State's reputation as a grain exporter and the industry more generally. In a review of the Grain Marketing Act in 2008, it was concluded that there was no evidence of price premiums due to market power to the main export licence holder, and therefore that criterion was no longer used as a basis to reject a licence.

The licence specified the type of prescribed grain, the season, quantity, export markets and quality of grain to be shipped. Application fees varied between \$5000 and \$20 000 depending on the total number of tonnes over the licensing period to be shipped out. There was also a \$500 annual licence fee.

The GLA was dismantled on 23 October 2009 and the Western Australian markets for barley, canola and lupins are therefore now fully deregulated. Commenting on the process of deregulation for these grains, the Department of Agriculture and Food (Western Australia) stated that 'there was broad based support across the industry for deregulation of export grain marketing and accreditation was not raised as an issue during the review process' (sub. 34, p. 2).

## **Wine licensing — national**

The Australian Wine and Brandy Corporation (AWBC) requires exporters of grape products to be licensed where shipments exceed 100 litres. The aim of the regulations is to maintain the reputation of Australian wine overseas, and ensure that Australia fulfils its obligations under international wine-trading agreements.

The licensing criteria include the financial standing of the applicant, the place of business of the applicant and whether the applicant or related company has had a licence cancelled (AWBC 2009b). Licences are renewable annually. An export permit is required for each consignment of wine over 100 litres, and wine must be tested by AWBC inspectors for a permit to be issued. A shipping application must be signed for all consignments of wine notifying the AWBC of the intention to export, and must be lodged 10 days before the departure date.

In addition, for bulk wine shipments in containers larger than 20 litres in shipments greater than 100 litres, exporters need special approval by the AWBC (AWBC 2009b). The consignee must be certified in accordance with one of a set number of approved quality management standards. Procedures for the preparation and transportation of bulk wine must also be adhered to. AWBC inspectors have the authority to audit the loading and despatch process to ensure compliance with these procedures. The AWBC may also require commercially dressed samples of the final product. The aim of this process is to reduce the risk of uncontrolled handling, storage and bottling practices carried out by overseas bottlers.

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Wine submitted for export must comply with the Australian wine standards set out by Food Standards Australia New Zealand. It must also comply with the law of the country destination. Random sample checks are conducted to ensure that the wine being exported is consistent with the original samples. These are collected at the last practical point of loading.

A levy is imposed on all exported wine by licensed wine exporters to fund the export promotional activities of the AWBC. Further information on the role of the AWBC, and specifically how it is funded, is provided below in the discussion of industry good functions.

## **C.2 Provision of industry good functions**

The purpose of this section is to ascertain whether the arrangements for provision of industry good functions in other sectors and jurisdictions offer any lessons for the Australian bulk wheat export market.

### **Australia**

#### *Barley*

Barley Australia — a non-profit, independent organisation — is the peak industry body for barley. Barley Australia was established in early 2005 by seven Australian barley industry companies and is wholly funded by these foundation members, namely: ABB Grain (now Viterro), Malteurop Australia, Barrett Burston Malting Co., GrainCorp, Grain Pool, Joe White Maltings and Kirin Australia (Barley Australia 2010).

Barley Australia provides the following industry good functions:

- accreditation of malting barley varieties grown in Australia
- industry leadership and planning
- market focus in barley breeding for future varieties
- management of end use market research and development (R&D) projects — currently Pilot Brewing Australia
- increased recognition and international competitiveness of quality Australian barley through the introduction of trademarking and an assured quality supply chain (Barley Australia 2010).

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The Barley Australia Accredited Variety logo may only be used where a variety of barley has been accredited by Barley Australia as a malting barley. This arrangement does not preclude using non-accredited varieties of barley for malting or brewing purposes.

Pilot Brewing Australia is the body responsible for the pilot brewing of each commercially malted line of barley submitted for evaluation. Pilot Brewing Australia is an industry co-funded project with support from the Grains Research and Development Corporation (GRDC). The GRDC also funds the provision of quarterly barley stocks information from the Australian Bureau of Statistics (ABS). This arrangement is not expected to continue beyond 30 June 2011.

### *Oilseeds*

The Australian Oilseeds Foundation (AOF) is the peak industry body for the Australian oilseeds industry. Oilseeds include canola, cottonseed, soy, sunflower, safflower, peanut and linseed/linola. The AOF was established in 1970 to represent the common interests of all Australian oilseeds industry participants and to promote the development, expansion and improvement of Australian oilseeds production.

Industry good functions provided by the AOF include:

- policy and regulatory advocacy
- trade advocacy
- industry training and education
- implementation of standards and protocols for trading and handling of oilseeds and oilseed products
- identification and implementation of an industry strategic plan and industry goals
- increasing industry awareness of innovations and potential opportunities
- information and communication to/amongst the key interest groups
- promoting Australian grown and Australian made oilseeds and oilseed products
- oilseed related R&D, in conjunction with government, industry and R&D bodies
- promoting environmentally responsible practices within the oilseed industry (AOF 2010).

The AOF is funded by the Oilseeds Development Fund (ODF) and contributions from partner organisations such as the GRDC and Pork Cooperative Research Centre for specific initiatives. The ODF comprises revenue raised through industry

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contributions. The ODF was established in 1992 to provide the base funding for implementation of the AOF's strategic plan. This plan sets out a roadmap for growing the industry from its then value of \$2.5 billion, to \$3.3 billion by 2010. ODF contributors include Cargill Australia, GrainCorp, Grain Pool, Louis Dreyfus, ABB Grain (now Viterro), Meadow Lea Foods and AWB Limited (AOF 2010).

Oilseeds growers contributed about 10 per cent (or \$9.2 million) of GRDC levy revenue in 2008-09. The GRDC invested nearly \$4.8 million in oilseeds-specific R&D activities in 2008-09, equivalent to 5 per cent of total GRDC R&D expenditure (GRDC 2009a).

### *Pulses*

Pulse Australia is the peak industry body for the Australian pulse industry. Pulses include chickpea, faba/broad bean, field pea, lentil, lupin and vetch. A Board of Directors is nominated from across the industry and the GRDC also nominates one director.

Pulse Australia has three distinct streams of activity:

- **Crop Support:** Pulse Australia works in cooperation with the GRDC to develop agronomic management packages and provides training for agronomists and farmers. Pulse Australia has also developed a quality assurance program with whole of industry input.
- **Industry Support:** Pulse Australia works to coordinate activities across all sectors of the industry. This includes information provision to the industry and working with governments, both domestically and internationally, in areas such as market access, tariffs, quarantine and other trade issues. The Pulse Australia Standards Committee develops receival standards for all pulse products within Australia, aimed at meeting the requirements of the export trade.
- **Market Support:** Pulse Australia is actively involved in the promotion of pulses in specific markets and the development of long term secure value chain relationships (Pulse Australia 2010a).

A variety of publications relating to all areas of pulse production, marketing and the end-use of pulses is produced by Pulse Australia, including a Pulse Update Annual, Pulse Tech-notes, and the Pulse Bulletin. Some information is reserved for financial members of Pulse Australia.

Pulse Australia derives its income from a combination of special project funding from the GRDC, fixed income support from major industry players — especially the cereal industry, membership income from independent processors and exporters,

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industry sponsors and other voluntary contributors (Pulse Australia 2010b). Approximately 6 per cent (or \$5 million) of GRDC grain grower levy revenue came from growers of pulses in 2008-09 (GRDC 2009a).

### *Wine*

The AWBC, an Australian Government statutory authority, undertakes a range of industry good functions. The AWBC was established in 1981 as a successor to the Australian Wine Board, which was originally set up in 1929 for the purpose of improving the quality of wine and brandy and promoting the sale of wine and brandy both in Australia and overseas. The AWBC's objectives, functions and powers are set out in the *Australian Wine and Brandy Corporation Act 1980* and its associated Regulations.

The AWBC's mission is to enhance the operating environment for the benefit of the Australian wine industry by providing the leading role in market development, knowledge development, compliance and trade. The core responsibilities of the AWBC include:

- export regulation and compliance
- domestic and international wine promotion
- wine sector information and analysis (box C.1)
- maintaining the integrity of Australia's wine labels and winemaking practices
- defining the boundaries of Australia's wine producing areas
- assisting with negotiations with other countries to reduce trade barriers (AWBC 2009a).

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### Box C.1 Information provision

The Australian Wine and Brandy Corporation (AWBC) provides information to the industry on:

- wine production (vineyard plantings, bearing areas, total grape production, grape crush and prices)
- domestic wine sales
- consumption
- exports by destination country, container type, price points, variety and region.

This information is sourced and collected via a range of information gathering activities pursued by the AWBC including:

- the Australian Regional Winegrape Crush Survey
- the Global Wine Statistical Compendium
- other internal and external data sources relating to wine production, domestic sales, imports and consumption.

The *winefacts* online system is the key mechanism for delivery of market information. *Winefacts* provides access to data reports, publications, fact sheets and industry overviews prepared by the AWBC or sourced from other organisations. Some material available on *winefacts* is free to all users. Wine Grape Levy payers receive free access to a range of AWBC and third party commissioned reports, and licensed wine exporters receive free access to summary export information. Other publications can be purchased on a pay-for-use basis. Account customers have unlimited access to all material.

Sources: AWBC (2009a, 2010).

The AWBC is funded via a combination of:

- levy revenue (box C.2)
- industry contributions (revenue from regulatory fees and export licences, and contributions from industry to overseas marketing programs and promotional events)
- revenue from selling information services (for example, *winefacts* products)
- other promotional funding (AWBC 2009a).

The AWBC's total 2008-09 revenue was \$14.9 million. Industry levies and contributions totalled \$8.3 million, or 56 per cent of the AWBC's 2008-09 revenue (AWBC 2009a). Income from sales of goods and rendering of services (regulatory fees, export licences and sales of *winefacts* products) amounted to \$5.9 million. The Australian Government, via the Department of Foreign Affairs and Trade and the

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Department of Agriculture, Fisheries and Forestry, contributed \$160 000 in special project funding.

### **Box C.2 Levies on grape producers and wine exporters**

Australian Government legislation requires the payment of levies by wine producers and exporters to help fund the activities of the Australian Wine and Brandy Corporation (AWBC), the Grape and Wine Research and Development Council (GWRDC) and Plant Health Australia (PHA). Approximately 41 per cent of the AWBC's 2008-09 revenue came from the Wine Grape Levy and the Wine Export Charge.

#### **Wine Grape Levy**

The Wine Grape Levy is a compulsory levy payable on wine grapes to provide funding for marketing and promotion activities conducted by the AWBC, research and development activities conducted by the GWRDC and plant health activities conducted by PHA. The Levies Revenue Service within the Department of Agriculture, Fisheries and Forestry audits the grape intake of all wineries and accounts for all grapes crushed at each winery. The levy comprises a fixed and variable component — both components vary depending on the volume of grapes produced.

#### **Wine Export Charge**

The Wine Export Charge is a compulsory levy payable on wine exported from Australia and is based on the free on board sales value of the wine exported. The Levies Revenue Service receives the charges and distributes the proceeds to the AWBC. The levy funds international promotional work aimed at increasing demand for Australian wine, and supports the operation of promotional offices in Toronto (Canada), The Hague (the Netherlands), Co Clare (Ireland), Tokyo (Japan), London (United Kingdom) and New York (USA).

#### **Grape Research Levy**

The Grape Research Levy provides funding for research and development programs administered by the GWRDC and plant health programs administered by PHA. The compulsory levy is currently set at \$2.00 per tonne of grapes produced in Australia, with 198.4 cents per tonne forwarded to the GWRDC and 1.6 cents per tonne forwarded to PHA. The GWRDC receives a matching Australian Government contribution for research and development.

*Sources:* AWBC (2010); DAFF (2010).

## *Dairy*

On 1 July 2003, following deregulation of the sector, Dairy Australia, a public company limited by guarantee, was formed from the merger of the Australian Dairy Corporation and the Dairy Research and Development Corporation. At that time,

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the three existing levies (corporation, promotion and research) funding the Australian Dairy Corporation and the Dairy Research and Development Corporation were combined into one levy to fund Dairy Australia — the Dairy Service Levy.

Dairy Australia fulfils a number of industry good functions, and is the primary provider of dairy industry information. The three core objectives of Dairy Australia are to:

- increase farm productivity
- maintain and develop value-added, high margin markets, channels and products
- promote and protect the unique benefits of Australian dairy (Dairy Australia 2010).

Information services provided by Dairy Australia are summarised in box C.3.

**Box C.3 Information provision by Dairy Australia**

Dairy Australia provides market information to its members through a combination of:

- publications and reports including an annual Dairy Situation and Outlook Report (with quarterly updates), weekly and fortnightly industry updates and a weekly Hay and Grain Report
- the Dairy Library, which provides information services to dairy farmers, dairy manufacturers and dairy organisations within Australia. This service is free to dairy farmers and available at low cost to dairy manufacturers
- information sessions, scenario planning workshops, farm consultations and support programs
- *DairyLive*, a national industry conference (online and in person).

Source: Dairy Australia (2010).

Funding for Dairy Australia is sourced from the industry and the Australian Government. Industry contributions primarily consist of revenue raised via the Dairy Service Levy (0.315 cents per litre of milk, or \$3 150 for every million litres of milk produced). The levy is paid monthly to the Australian Government by dairy companies (a manufacturer of, or a person who produces, relevant dairy produce), based on the milk the companies have received from farmers during the previous month.

Membership of Dairy Australia is provided to all Australian dairy farmers who pay the Dairy Service Levy, or who have the levy deducted from the proceeds of their milk sales. As of 30 June 2009, membership of Dairy Australia represented 66 per

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cent of active dairy enterprises (Dairy Australia 2009). Australian Dairy Farmers and the Australian Dairy Products Federation are also members of Dairy Australia.

The rate of the Dairy Service Levy is set by the Australian Government. Under the *Dairy Produce Act 1986*, Dairy Australia is responsible for recommending the industry's preferred level for the Dairy Service Levy to the Minister for Agriculture, Fisheries and Forestry. Before it makes a recommendation, Dairy Australia must conduct a poll of all levy payers so that they can indicate their preferred rate of levy. Voting entitlements are based on allocating one vote per dollar (\$1) of levy paid. About 64 per cent of votes in the 2007 poll were cast in favour of keeping the Dairy Service Levy constant (Dairy Australia 2010).

As the industry services body under the Dairy Produce Act, Dairy Australia is party to a funding deed with the Commonwealth of Australia. Under the Deed, the Australian Government agreed to pay matching R&D funds, up to a ceiling of 0.5 per cent of the gross value of whole milk produced in Australia. The Deed also sets out how those funds may be used.

Total 2008-09 revenue for Dairy Australia was \$53.4 million. Income from the Dairy Service Levy totalled \$29.5 million, with the Australian Government funding contribution accounting for \$19.2 million (Dairy Australia 2009).

### *Meat and livestock*

Meat & Livestock Australia (MLA), a producer-owned company, offers R&D and marketing services, including information services, to the red meat industry. The core activities of MLA include growing demand for Australian red meat, increasing market access, enhancing competitiveness and sustainability and increasing industry capability. Information services provided by MLA are set out in box C.4.

#### **Box C.4 Information provision by Meat & Livestock Australia**

The MLA provides information via its 'information centre' and covers topics such as:

- on-farm issues including pasture management, animal genetics and diseases
- post-farm issues such as technology updates and improved environmental management systems
- market information, including market analysis and forecasting, and multiple industry publications
- consumer and corporate information.

*Source:* MLA (2010).

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MLA is funded by a combination of transaction levies paid by producers, Australian Government funding and other industry contributions. Transaction levies are compulsory levies charged on the sale of livestock (cattle, sheep and goats). Income from transaction levies is shared between Animal Health Australia, Australian National Residue Survey, and MLA. In 2009, levy-paying members of MLA voted to keep the beef levy at \$5/head of cattle (MLA 2010).

The Australian Government provides matching funds for each dollar spent by MLA on R&D, up to a limit of 0.5 per cent of the annual gross value of production for the red meat industry. MLA membership is provided to levy-paying producers of livestock. Members receive free or discounted market information.

MLA's 2008-09 revenue totalled \$163 million, with transaction levies contributing \$98 million and Australian Government R&D funding accounting for \$31 million (MLA 2009).

### *Wool*

Australian Wool Innovation (AWI) is a public company owned by Australian wool levy payers. AWI's chief role is to manage wool innovation, marketing, sales, and R&D. In doing so, AWI provides market information to the industry via the (weekly) publication *Wool Market Review* (AWI 2010).

AWI is funded through a compulsory levy paid by woolgrowers (currently two per cent of the sale price received for their shorn greasy wool) and a matching contribution from the Australian Government for eligible R&D, capped at 0.5 per cent of gross national value of wool production. The levy is imposed on all shorn wool produced in Australia and sold or used in the production of other goods.

The compulsory wool levy is payable by the producer, defined as the person who owns the wool immediately after it is removed from the sheep or lamb. The intermediary, such as a first purchaser, wool broker, or processor, is liable to pay the levy on behalf of the producer (DAFF 2010). Levy revenue represents the majority of AWI funding. The Statutory Funding Agreement between AWI and the Australian Government defines the conditions under which AWI may invest the levy revenue and matching Australian Government funds. The sale of Woolmark licences contributes a further source of income for AWI.

An export charge is imposed on wool that is produced in Australia and exported from Australia. However, the export charge is not payable if a levy has already been paid on the wool to be exported.

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Woolgrowers vote every three years on the percentage of wool proceeds they would like to invest in wool innovation, marketing, sales, off-farm R&D and on-farm R&D. AWI shareholders are entitled to one vote for every \$100 of wool levy paid in the three financial years before any vote. Paying wool levies does not make the levy payer automatically a shareholder of AWI. Levy payers that are engaged in a wool producing business may apply to become an AWI shareholder, however this decision is ultimately made by the AWI Board. AWI had about 30 000 shareholders at 30 June 2009, a decrease of 571 shareholders over the past twelve months (AWI 2010).

Total 2008-09 revenue totalled \$61.7 million, with the wool levy accounting for \$34 million and Australian Government contributions \$11.4 million (AWI 2009).

### *Summary*

Table C.1 provides an overview of the agencies responsible for provision of various industry good functions in other Australian grains and agricultural sectors.

This review of arrangements for the provision of industry good functions in comparable Australian markets suggests:

- an industry-led approach to the management and funding of the provision of industry good functions is common
- industry levies and contributions provide the primary source of funding for these industry bodies. Matching R&D funding is provided by the Australian Government, up to a ceiling of 0.5 per cent of the gross value of production of the industry. This is consistent with the GRDC funding arrangements
- these bodies provide a range of industry good functions, suggesting there may be economies of scale or other efficiencies in consolidating the provision of multiple industry good functions into one body
- this approach appears to work effectively and is well supported by the respective industries. There is strong evidence to suggest that market participants are willing and able to pay for the provision of industry good functions.

**Table C.1 Information provision — other Australian grains and agricultural sectors**

<i>Responsible agency</i>	<i>Structure</i>	<i>Funding</i>
Barley Australia	Peak industry body	<ul style="list-style-type: none"> <li>• Contributions from industry groups (Barley Australia is wholly funded by seven foundation members)</li> </ul>
Australian Oilseeds Foundation	Peak industry body	<ul style="list-style-type: none"> <li>• Oilseeds Development Fund (industry contributions)</li> <li>• GRDC and Pork CRC funding (for specific projects)</li> </ul>
Pulse Australia	Peak industry body	<ul style="list-style-type: none"> <li>• Industry contributions</li> <li>• GRDC funding (for specific projects)</li> </ul>
Australian Wine and Brandy Corporation	Australian Government statutory corporation	<ul style="list-style-type: none"> <li>• Revenue from the compulsory Wine Grape Levy and Wine Export Charge (industry)</li> <li>• Other industry contributions (revenue from export licences)</li> <li>• Information services (selling <i>winefacts</i> products)</li> <li>• Other promotional funds</li> </ul>
Dairy Australia	Public Company (industry owned)	<ul style="list-style-type: none"> <li>• Compulsory Dairy Service Levy (industry)</li> <li>• Australian Government contribution</li> <li>• Other industry contributions</li> </ul>
Meat & Livestock Australia	Public Company (industry owned)	<ul style="list-style-type: none"> <li>• Compulsory livestock transaction levy (industry)</li> <li>• Australian Government contribution</li> <li>• Other industry contributions from individual processors, wholesalers, foodservice operators and retailers.</li> </ul>
Australian Wool Innovation	Public Company (industry owned)	<ul style="list-style-type: none"> <li>• Compulsory levy on woolgrowers, or export charge on exporters (industry)</li> <li>• Sale of Woolmark licences</li> <li>• Australian Government contribution</li> </ul>

*Sources:* AOF (2010); AWBC (2009a, 2010); AWI (2009, 2010); Barley Australia (2010); Dairy Australia (2009, 2010); MLA (2009, 2010); Pulse Australia (2010a, 2010b).

It is worth noting that in some cases, the Australian Government has provided an initial amount of funding at the time of deregulation to help transition the industry. In addition, a number of these industry bodies may have been established using funding inherited from predecessor organisations. For example, Dairy Australia inherited reserves from the Dairy Research and Development Corporation and the Australian Dairy Corporation (Dairy Australia 2010).

As noted in chapter 9, an Industry Assistance Package was established in 2008 to support the bulk wheat export industry's transition to the current arrangements. The Commission does not consider that further government funding is appropriate.

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## International wheat exporting regions

Wheat industry participants commonly regard the United States and Canada as ‘best practice’ examples of how to provide industry good functions. Wheat market information products and services are significantly more elaborate and sophisticated in both the United States and Canada than in Australia.

However, it is not entirely appropriate to directly compare these wheat markets with Australia. The United States and Canadian wheat industries each receive significant levels of government funding and support. In Canada, this reflects domestic policies characterised by high levels of government intervention, regulation and protectionism of the wheat industry. By contrast, the Australian wheat industry operates under much more liberalised, deregulated and competitive settings.

### *United States*

The United States is the world’s largest exporter of wheat, exporting about 50 per cent of its annual production of approximately 60 million tonnes of wheat (GIWA 2009a). US wheat exports totalled 27 million tonnes in 2008-09, accounting for 20 per cent of the global market (USW 2009). Industry good functions for the US wheat industry are provided via multiple public, or publicly funded, agencies and programs (box C.5), namely:

- Economic Research Service (ERS)
- National Agricultural Statistics Service (NASS)
- Foreign Agricultural Service (FAS)
- United States Wheat Associates (USW).

The roles and responsibilities of the ERS and the NASS are broadly similar to ABARE and the ABS respectively. However, the US bodies provide information at a much more disaggregated and detailed level than that provided in Australia. For example, the NASS undertakes a monthly survey of off-farm stocks (that aggregates information from all known commercial grain storage facilities) as well as on-farm stocks across 66 000 operators (GIWA 2009a). The FAS provides similar services as those provided by DFAT and Austrade in Australia, with a specific focus on agricultural export products. The ERS, NASS and FAS are all funded by the United States Department of Agriculture (USDA).

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## Box C.5 United States agencies

### **Economic Research Service**

The Economic Research Service (ERS) is an agency of the US Department of Agriculture (USDA) and a primary source of economic information and research for the department. The ERS conducts a research program to inform public and private decision making on economic and policy issues involving food economics, information services, market and trade economics and resource and rural economics. The ERS disseminates economic information and research results through agency-published research reports, market analysis and outlook reports, economic briefs, and data products.

### **National Agricultural Statistics Service**

The National Agricultural Statistics Service was established in April 1986 to develop and disseminate national and State agricultural statistics, conduct statistical research and coordinate the USDA's statistics programs. The National Agricultural Statistics Service collects, summarises, analyses and publishes agricultural production and marketing data such as the number of farms, land in farms, acreage, yield, production and stocks of grains. The grain stocks estimates are based on surveys conducted during the first two weeks of the month and are released at the end of the month.

### **Foreign Agricultural Service**

The Foreign Agricultural Service operates within the USDA and is tasked with improving foreign market access for US products, building new markets, improving the competitive position of US agriculture in the global marketplace and providing food aid and technical assistance to foreign countries. As part of this role, the Foreign Agricultural Service is responsible for the collection and analysis of statistics and market information on topics such as export sales, agricultural trade data and market access.

The USDA Weekly Export Sales Report requires exporters to report on export sales in excess of 100 000 tonnes within 24 hours of sale, and within the same week's reporting cycle for smaller sales. This information must include the class of wheat sold, the country of export and the marketing year (shipment period).

*Sources:* ERS (2010); FAS (2010a); GIWA (2009a); NASS (2010).

The USW, formed in 1959, is the US wheat industry market development organisation and is the primary provider of industry good functions to the wheat industry. The USW identifies its mission as to 'develop, maintain, and expand international markets to enhance the profitability of US wheat producers', and lists its core objectives as assisting buyers, influencing trade policy and speaking for producers (USW 2009). The USW fulfils a number of significant industry development roles, including the provision of market information (box C.6).

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**Box C.6 Information provision by the United States Wheat Associates**

The United States Wheat Associates provides the wheat industry with information that covers:

- weekly harvest reports on the condition of the US wheat crop (from June)
- crop quality reports (overview of each year's crop including baking quality traits and production estimates)
- weekly price reports (futures prices, free on board values, freight rates, exchange rates, historical price data)
- commercial sales reports (sales breakdown by wheat class and destination)
- US and world supply and demand reports (updated monthly).

Sources: GIWA (2009a); USW (2010b).

The USW receives the majority of its funding from the US Federal Government. The 2009 budget for the USW was about USD16.8 million, with total USDA support accounting for around USD12.5 million (or 74 per cent) of USW's 2008-09 revenue (USW 2009). The USDA committed the equivalent of USD2.89 for every USD1 of producer contributions in that year. This is primarily expended by the USW's overseas offices for foreign market development.

USW is supported by 19 member State Wheat Commissions. These bodies are authorised to impose a mandatory levy on growers at first point of sale, and to elect how to spend this money on behalf of growers. Historically, the State Wheat Commissions have chosen to support the domestic operations of USW, and to undertake other direct investments in market promotion and demand enhancement activities. Producer contributions to USW totalled USD4.3 million in 2009 (USW 2009).

### *Canada*

Canada is the world's second largest wheat exporter, accounting for about 12 per cent of world trade (GIWA 2009a). Over the 10 years to 2007-08, Canada's bulk wheat exports (including durum) averaged 15.4 million tonnes annually. Total production of wheat in Canada totalled over 19 million tonnes (CWB 2008).

Industry good functions are provided via multiple public, or publicly funded, agencies and programs, namely:

- Canada Grains Council (box C.7)
- Canadian International Grains Institute (box C.7)

- 
- Canadian Wheat Board (CWB)
  - Canadian Grain Commission.

#### **Box C.7 Canadian grain agencies**

##### **Canada Grains Council**

The Canada Grains Council (the Council) represents producers, crop input companies, grain companies, processors, end users, government departments, financial institutions and regulatory agencies. It was formed in 1969 to coordinate efforts to increase the sale and use of Canadian grain in domestic and world markets. The Council's primary tool for sharing market information with the industry is via the *Statistical Handbook*. In 2004 the Council built a database containing the 40 years of comprehensive grain industry data compiled in past hard copy issues of the Statistical Handbook. Agriculture and Agri-Food Canada, a department of the Federal Government, provides the core funding for the activities undertaken by the Council.

##### **Canadian International Grains Institute**

Incorporated in 1972 as a non-profit market development organisation, the Canadian International Grains Institute (CIGI) is dedicated to promoting Canada's field crop industries in international and domestic markets through educational programming and technical activities. Representatives from grain, oilseed, pulse and special crops industries worldwide are invited to participate in CIGI programs and seminars. Since its inception, more than 30 000 individuals from 114 countries have attended CIGI programs.

Core funding for CIGI operations is provided by Agriculture and Agri-Food Canada and the Canadian Wheat Board. Additional funds and support are provided by other sectors of the agricultural industry.

*Sources:* Canada Grains Council (2010); CIGI (2010); GIWA (2009a, 2009b).

The CWB is the largest wheat and barley marketer in the world. The *Canadian Wheat Board Act* gives the CWB sole marketing authority for wheat and barley produced by the 75 000 grain farmers of western Canada for export and domestic consumption. All sales revenue, less marketing expenses, is returned to farmers. The CWB is controlled by a board of directors that comprises ten farmer-elected members and five Federal Government appointees. In 2007-08, CWB received 19.8 million tonnes of grain (13.4 million tonnes of wheat) and collected CAD8.42 billion in sales revenue (CWB 2008).

The Canadian Grain Commission is a Federal Government agency responsible for regulating all aspects of grain handling in Canada. It was established by the *Canada Grain Act* which mandates that the Canadian Grain Commission establish and

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maintain standards of quality for Canadian grain, regulate grain handling in Canada and ensure a dependable commodity for domestic and export markets (CGC 2010).

The Canadian Grain Commission carries out its role through a range of grain quality and quantity assurance programs. It also undertakes scientific research. Specifically, the Canadian Grain Commission collects information on grain elevators, grain exports, deliveries and other grain-related subjects. The Canadian Grain Commission has an annual budget of CAD3.94 million to administer the licensing and financial security system and to provide grain quality information to producers (CGC 2010) (box C.8).

**Box C.8 Information provision by the Canadian Grain Commission**

Reports published by the Canadian Grain Commission include:

- Grain Elevators in Canada
- Canadian Grain Exports
- Exports of Canadian Grain and Wheat Flour
- Grain Deliveries at Prairie Points<sup>a</sup>
- Grain Statistics Weekly.

<sup>a</sup> Prairie points refer to the shipping points in respective Canadian prairies (regions).

Sources: CGC (2010); GIWA (2009a, 2009b).

*Lessons for the Australian bulk wheat export sector*

The arrangements for provision of industry good functions in the United States and Canada are characterised by:

- high levels of government involvement
- a significant amount of government funding and support
- sophisticated and comprehensive industry good outputs.

It is difficult to draw direct and meaningful comparisons between these examples and the Australian bulk wheat export market. Domestic policies and government priorities in these regions guarantee significant public support for the wheat industry. Coupled with considerable government involvement and regulatory interventions, the market environment in the United States and Canada is very different to the deregulated Australian market. Most participants acknowledged that Australia could not replicate the scale of information provision that is undertaken in these countries given the cost involved and the relative size of the industry here.

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