

# Deregulation of Wheat and Barley Marketing in Australia and Potential Application to Western Canada

*Prepared for*

**Alberta Agriculture, Food and Rural Development**

**Contract # 235-05**

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**March 2005**

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## Table of Contents

<b>ACRONYMS AND DEFINITIONS USED .....</b>	<b>IV</b>
<b>EXECUTIVE SUMMARY .....</b>	<b>VI</b>
<b>1.0 INTRODUCTION .....</b>	<b>1</b>
1.1 AUSTRALIA'S GRAIN INDUSTRY HAS BEEN DEREGULATING .....	1
1.2 AUSTRALIAN EXPERIENCES MAY ASSIST REGULATORY CHANGE IN CANADA .....	2
1.3 PROJECT OBJECTIVES AND SCOPE .....	3
1.4 METHODOLOGY .....	4
1.5 REPORT ORGANIZATION .....	4
<b>2.0 PROVIDING CONTEXT FOR AUSTRALIA'S DEREGULATION ..</b>	<b>5</b>
2.1 SIGNIFICANCE OF AUSTRALIAN WHEAT AND BARLEY PRODUCTION AND EXPORTS .....	5
2.2 PRIMARY INDUSTRIES IN AUSTRALIA WERE HIGHLY REGULATED .....	7
2.3 THE AUSTRALIAN WHEAT BOARD – A SIMILAR GENESIS AS THE CWB .....	7
2.4 BARLEY WAS ALSO HIGHLY REGULATED .....	9
2.5 THE GRAIN INDUSTRY SUPPLY CHAIN WAS GOVERNMENT CONTROLLED .....	10
2.6 REGULATORY SUMMARY 1914-1989 .....	10
2.7 THE CASE FOR REGULATORY REFORM IN WHEAT BEGAN IN THE 1980'S .....	12
2.8 MAJOR DRIVERS OF CHANGE AFFECTING THE GRAIN ECONOMY .....	13
2.9 ECONOMY WIDE DEREGULATION TO DELIVER BENEFITS OF COMPETITION .....	13
2.10 HIGH LEVEL VIEW OF DEREGULATORY OUTCOMES .....	15
2.11 POSITIONING DEREGULATION IN THE AUSTRALIAN ECONOMY .....	17
<b>3.0 GETTING GOVERNMENT OUT OF THE GRAINS INDUSTRY .....</b>	<b>18</b>
3.1 DRIVERS OF CHANGE .....	18
National Competition Policy .....	19
3.2 CHANGE IN WHEAT MARKETING AND THE AWB .....	21
Wheat Marketing Act 1989 .....	21
Industry Strategic Planning .....	22
Corporatization of the AWB .....	24
WEA .....	31
Durum Wheat .....	31
3.3 RECENT REVIEWS OF WHEAT MARKETING AND ASSOCIATED CHANGES .....	32
2000 Wheat Marketing Review .....	32
2003 Senate Inquiry .....	35
2004 Wheat Marketing Review .....	35
3.4 CHANGES IN BARLEY MARKETING IN AUSTRALIA .....	37
Corporatization of ABB .....	39
3.5 RECENT REVIEWS OF BARLEY MARKETING AND ASSOCIATED CHANGES .....	42
1997 Barley Marketing Review in Victoria and South Australia .....	42
WA's 2002 Marketing Review .....	44
2002 Barley Marketing Review in South Australia .....	46
2004 Report of WA's Grain Licensing Authority .....	47
Review of WA's Grain Marketing Act 2002 and the Grain Licensing Authority .....	49
3.6 CHANGES WITH BULK HANDLERS OF GRAIN .....	50
Queensland .....	50
New South Wales .....	51
Victoria .....	52
South Australia .....	52
Western Australia .....	53

3.7	<i>CHANGES WITH RAILWAYS</i> .....	55
	<i>Queensland</i> .....	55
	<i>New South Wales</i> .....	55
	<i>Victoria</i> .....	56
	<i>South Australia</i> .....	56
	<i>Western Australia</i> .....	56
3.8	<i>CHANGES IN INDUSTRY STRUCTURE</i> .....	56
3.9	<i>REGULATORY SUMMARY</i> .....	59
<b>4.0</b>	<b><i>IMPACT OF THE DEREGULATORY THRUST IN THE GRAIN INDUSTRY</i>.....</b>	<b>60</b>
4.1	<i>OVERALL IMPACT</i> .....	60
4.2	<i>IMPACT OF DEREGULATION ON THE SUPPLY CHAIN</i> .....	61
4.3	<i>IMPACT OF AWB ON THE SUPPLY CHAIN AND DEREGULATION IN WHEAT</i> .....	63
4.4	<i>IMPACT OF DEREGULATION IN BARLEY AND CANOLA</i> .....	66
4.5	<i>EFFECTIVENESS OF NEW STRUCTURE FOR AWB</i> .....	68
4.6	<i>OTHER ISSUES - WEA</i> .....	73
4.7	<i>IMPACT OF DEREGULATION ON DOMESTIC VALUE-ADDED INDUSTRY</i> .....	74
4.8	<i>IMPACT OF DEREGULATION ON THE ENVIRONMENT AND RURAL COMMUNITIES</i> .....	74
<b>5.0</b>	<b><i>CURRENTLY FINDING THE RIGHT REGULATORY BALANCE ...</i></b>	<b>75</b>
5.1	<i>NATIONAL COMPETITION POLICY</i> .....	75
5.2	<i>SINGLE DESK JUSTIFICATION</i> .....	76
5.3	<i>CONTESTABILITY WITH SINGLE DESK SELLING BY ABB AND AWB</i> .....	79
5.4	<i>OTHER ISSUES – POOLING BY AWB</i> .....	80
5.5	<i>OTHER ISSUES - US AUSTRALIA FREE TRADE AGREEMENT</i> .....	81
5.6	<i>OTHER ISSUES - WTO</i> .....	81
<b>6.0</b>	<b><i>COMPARISONS TO WESTERN CANADA</i>.....</b>	<b>82</b>
6.1	<i>GENERAL COMPARISONS TO CANADA</i> .....	82
6.2	<i>AUSTRALIAN APPROACHES AS OPTIONS FOR WESTERN CANADA</i> .....	85
6.3	<i>REGULATOR ASSESSES CWB SINGLE DESK PERFORMANCE</i> .....	87
6.4	<i>CONTESTABILITY IN NON-PREMIUM MARKETS</i> .....	88
6.5	<i>DEREGULATION OF DOMESTIC MARKET</i> .....	91
6.6	<i>DOMESTIC DEREGULATION AND CONTESTABILITY IN NON-PREMIUM EXPORT MARKETS</i> .....	93
6.7	<i>PROVINCIAL CHOICE ON SINGLE DESK SELLING FOR BARLEY</i> .....	94
6.8	<i>NO SINGLE DESK FOR BARLEY</i> .....	96
6.9	<i>NO SINGLE DESK FOR BARLEY AND CONTESTABILITY IN NON-PREMIUM MARKETS</i> .....	97
6.10	<i>HIGH LEVEL ASSESSMENT OF OPTIONS</i> .....	98
6.11	<i>SOME IMPLICATIONS FOR THE CWB WITH LESS REGULATION</i> .....	100
<b>7.0</b>	<b><i>SUMMARY OF FINDINGS</i>.....</b>	<b>103</b>
7.1	<i>SUMMARY OF DEREGULATION IN AUSTRALIAN WHEAT AND BARLEY</i> .....	103
7.2	<i>APPLICABILITY OF AUSTRALIAN EXPERIENCE TO WESTERN CANADA</i> .....	103
7.3	<i>SOME LESSONS LEARNED FROM THE AUSTRALIAN EXPERIENCE</i> .....	104
<b>ANNEX</b> .....	<b>108</b>	
	<i>ANNEX I - PROJECT SCOPE CONSIDERATION</i> .....	108
	<i>ANNEX II – ORGANIZATIONS CONSULTED AND RESULTS</i> .....	110
	<i>ANNEX III – OVERVIEW OF AGRICULTURE IN AUSTRALIA</i> .....	114
	<i>ANNEX IV - 2000 WHEAT MARKETING REVIEW</i> .....	130
	<i>ANNEX V – STUDIES CONDUCTED ON WHEAT AND BARLEY DEREGULATION IN AUSTRALIA</i> .....	135
	<i>ANNEX VI – COMPARISON OF GRAIN MARKETING IN AUSTRALIA AND CANADA</i> .....	137

## **Acronyms and Definitions Used**

<b>ABA</b>	Australian Bulk Alliance
<b>ABB</b>	Australian Barley Board
<b>AWB</b>	Australian Wheat Board
<b>BHA</b>	Bulk Handling Authorities
<b>CBH</b>	Cooperative Bulk Handling Ltd
<b>C&amp;F</b>	Cost and Freight
<b>FOB</b>	Free on Board
<b>GBE</b>	Government Business Enterprises
<b>GCA</b>	Grains Council of Australia
<b>GGA</b>	Grain Growers Association
<b>GLA</b>	Grain Licensing Authority
<b>GPPL</b>	Grain Pool Pty Ltd (previously GPWA)
<b>GPWA</b>	Grain Pool of Western Australia
<b>NCC</b>	National Competition Council
<b>NCP</b>	National Competition Policy
<b>NSW</b>	New South Wales
<b>QLD</b>	Queensland
<b>SA</b>	South Australia
<b>SACBH</b>	SA Co-Operative Bulk Handling Ltd
<b>SMA</b>	Statutory Marketing Authorities
<b>STE</b>	State Trading Enterprise
<b>VIC</b>	Victoria
<b>WA</b>	Western Australia
<b>WEA</b>	Wheat Export Authority
<b>WIF</b>	Wheat Industry Fund
<b>WMA</b>	Wheat Marketing Act

**Corporatization**, structural change from a statutory marketing or handling organization to a shareholder owned and controlled corporation

**Contestable markets**, where there are minimal barriers to entry and/or there is competition between firms providing a service

**Market Power** refers to the ability to increase prices by restricting the amount of grain into a market where demand is relatively unresponsive to changes in price and redirecting the grain into markets that can absorb it without lowering prices.

**Monopoly**, a market where there is only one supplier (seller) of a good or service, which provides market power in determining the selling price received.

**Monopsony**, a market where there is only one buyer for a product (or service), which provides market power in determining the purchase price ultimately paid

**Oligopoly**, a market where there are few suppliers (sellers) of a good or service, which can provide some market power in determining the selling price received.

**Oligopsony**, a market where there are few buyers for a product (or service), which can provide some market power in determining the purchase price ultimately paid

**Single Desk Seller**, a term used to describe a market structure where there is a grower owned (or grower controlled) entity based on domestic regulations which is the sole seller into specific markets and this entity is also obliged to purchase all product delivered to its facilities (or its agents). As a result, as single desk seller can encompass roles of a monopsonist (or oligopsonist if buyers for other markets) on services purchased (e.g., rail, storage and handling), a regulated monopsonist due to its obligation to purchase all grain delivered, and a monopolist into markets as the sole supplier of origin specific grain (or an oligopolist if buyers do not differentiate between origin, aside from quality/functional attributes).

**State Trading Enterprise**, a term used in the Uruguay Round of the WTO negotiations and defined as “governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports.”

## **Executive Summary**

The regulatory changes that have occurred in the Australian wheat and barley sector over the last 15 years provide insightful parallels for the marketing of wheat and barley in western Canada.

### ***Australian wheat and barley marketing is less regulated than in western Canada***

The Australian wheat and barley sector was highly regulated as in Canada, with single desk selling applying to domestic and export sales. Today, however, the Australian wheat and barley sector is less regulated than in Canada. The domestic market for wheat is fully deregulated (no longer mandatory single desk selling in the domestic market). The domestic market for barley has been effectively deregulated for barley and single desk selling into export markets for barley has been eliminated in most Australian States. Single desk export sales continue for wheat through AWB Ltd (formerly the Australian Wheat Board). Barley single desk export sales only exist through ABB Grain Ltd (formerly the Australian Barley Board) in South Australia and the Grain Pool in Western Australia.

### ***Drivers of change***

The major drivers for change in grain industry regulation were rising storage, handling and transport costs in the early 1980s, the desire for the Commonwealth Government to extract itself from the obligations of underwriting prices and finances for the wheat crop, and more recently the National Competition Policy (NCP) initiatives implemented in 1995. The NCP objective agreed by all State and Commonwealth Governments is to increase Australia's economic performance and benefits through greater competition throughout the economy. This policy has affected many industries in Australia, not just agriculture and has provided ongoing incentives and political motivation to enact reforms. The guiding principle of the NCP is that legislation and regulations restricting competition were only to be retained if the benefits to the community outweighed the cost (public benefits test) and if the objectives of the legislation could only be met by restricting competition.

### ***Current regulatory structure on wheat marketing***

The current structure of the wheat industry is a deregulated domestic market, with the AWB the single desk seller in export markets. The Wheat Export Authority (WEA) is a regulator that monitors and reports on the performance of the single desk activities of the AWB. This feature has increased the accountability of the AWB. The WEA also issues export permits to applicants for exporting wheat in containers and bags. The AWB is the holder of export license for bulk exports of wheat and can veto any application by other parties to export wheat in bulk, and must be informed, and has the right to object, on export permits for containers and bags.

### ***Current regulatory structure on barley marketing***

The current structure of the barley industry is more deregulated than wheat. The domestic market is effectively deregulated across Australia and only single desk selling for export sales occurs in South Australia (through ABB) and in Western Australia (through the Grain Pool). These entities have a joint venture, Grain Australia, to collectively manage their barley sales into export markets. As of October 1, 2005 the single desk selling authority for barley in New South Wales will be terminated – it is currently held by GrainCorp.

The State Governments provide single desk selling legislation for barley and if they did not comply with NCP, the Commonwealth Government would withhold or suspend “competition payments” (a form of transfer payment deemed to arise from the benefits of implementing

NCP). This provided a financial and political justification for the changes. Wheat export legislation however is under Commonwealth control and, as such, the competition payments could not be a driving force on wheat marketing.

In Western Australia a regulator, the Grain Licensing Authority (GLA) has been established to provide contestability in specific export markets for barley, canola, and lupins. The GLA grants export licenses when certain conditions prevail. In the last crop year almost 20% of feed barley was licensed to be exported by other marketers, and not the single desk (the Grain Pool). The export license system is designed to preserve the single desk price premium and add competitive elements to improve grower returns. South Australia is considering whether to implement a comparable export licensing system for barley.

### ***Deregulation in the grain supply chain***

It should be noted that the grain handling and transportation systems were also highly regulated until the mid 1990s. A single grain handling entity operated in each State, which was State owned or operated by a State wide grower co-operative. Railways were state owned. Today as a result of reforms and driven by NCP, there is private ownership of the rail system except in Queensland and of grain handling companies with all operations open to competition. A few grain companies have emerged with country receiving positions and port facilities. These include the AWB Ltd, ABB Grain Ltd , GrainCorp Ltd and CBH, with most having assets in a number of States for better positioning and lowering of per unit costs. As well, there are fewer railway companies and they now have a focus beyond their old State boundaries. A result of deregulation there has been a reduction in supply chain costs.

### ***Future deregulation in wheat and barley marketing***

Many argue that the deregulatory thrust that started has not stopped, particularly in the case of barley. After September 2005, only Western Australia and South Australia will still have single desk selling authority on barley exports. Many argue that the concept of the GLA is not an end state, but a transition to full deregulation and no single desk selling. Proponents of more change argue that premiums on Australian barley can be captured by grain companies and do not require a single desk. Others argue that any premium, such as location advantage, will be bid away in a multiple seller environment. Interestingly, Western Australia has tied, through legislation, any further deregulation to the Commonwealth removing restrictions on the export marketing of wheat.

While many studies have been commissioned that suggest the single desk does capture a premium, other studies suggest this not the case. Indisputable facts on single desk premiums and benefits have not been provided by the proponents of either side. The majority of growers opposed, and continue to oppose, further change in wheat and barley marketing arrangements, implying a continuation of support for the single desk concept. Paradoxically however there is no desire to unwind the changes and go back to the old system. Perhaps this natural conservatism allows changes to be tested because once the market is deregulated it is not possible to bring the old system back. The most recent 2004 review of wheat marketing arrangements did not include the single desk in its terms of reference and wheat is not being reviewed again until 2010. The main focus on wheat will likely continue to be on improving the new regulatory structures that have been created, and on improving accountability and performance of the AWB.

### **Some lessons learned from the Australian experience**

A number of lessons learned from the Australian experience are applicable to the western Canadian grain economy; some of these include:

- ❑ The National Competition Policy created a country wide imperative for deregulation;
- ❑ Financial incentives at the State level helped drive change in barley and in most other sectors;
- ❑ Domestic deregulation created a number of marketing and pricing options for producers;
- ❑ Deregulation allowed for an improvement in efficiency and for the growth of valued added industries, which increased output of malt, flour, and livestock products in response to Asian demand;
- ❑ The domestic market share of single desk authorities will generally decrease over time;
- ❑ Transition periods are important to assist in the process of change;
- ❑ A clear definition of the desired end-state can help in the transition process;
- ❑ New organizations and regulatory structures were created as part of the deregulatory process;
- ❑ Single desk sellers can become competitive agri-business companies;
- ❑ A single desk seller that becomes a share capital corporation will have a clear focus;
- ❑ Excessive regulatory oversight can create significant regulatory cost to the single desk;
- ❑ Being stuck in the middle of the deregulatory process can result in significant inefficiencies:
- ❑ Performance reporting increases accountability and transparency;
- ❑ The debate and supporting facts on nature of the single desk price premium in relation to other market premiums continues:
- ❑ It is argued that the single desk seller allows Australia to capture locational advantage;
- ❑ Australia has attempted to retain market specific single desk premiums through granting of export licenses;
- ❑ An important question that needs to be addressed is whether efficiency gains more than offset the loss of any single desk premium; and
- ❑ Indisputable facts are helpful in the argument and resolution on the trade-off between efficiency gains associated with deregulation and the benefits of single desk sellers.

### **Application of Australian experiences to Canada**

The Australian experience has considerable applicability to the wheat and barley industries in western Canada. Based on the Australian experience potential options for western Canada were developed and included dimensions of:

- ❑ An new regulatory body that examines and reports on single desk seller performance;
- ❑ A new regulatory body that also grants export permits into non-premium markets to provide contestability;
- ❑ Single desk selling continuing in export markets for wheat and barley and domestic deregulation (no domestic single desk);
- ❑ Provinces having choice on whether to have a single desk seller for barley into export markets;
- ❑ No single desk selling in barley, either export or domestic.

The potential options considered in this report included:

- ❑ A regulator assesses CWB single desk performance for wheat and barley sold into domestic and export markets.
- ❑ A regulator assesses CWB single desk performance, and grants export permits for wheat and barley for contestability in non-premium markets.
- ❑ Deregulation of the domestic market, and a regulator assesses CWB single desk performance for wheat and barley on export sales.

- ❑ Deregulation of the domestic market, a regulator assesses CWB single desk activities, and grants export permits to allow for contestability in non-premium markets in export markets.
- ❑ Provincial choice on single desk selling for barley, deregulation of the domestic market and a regulator assesses CWB single desk performance on export.
- ❑ No single desk for barley across the prairies, deregulation of the domestic market, and a regulator assesses CWB single desk activities for wheat in export markets.
- ❑ No single desk for barley across the designated region, deregulation of the domestic market, single desk seller for wheat exports, and a regulator assesses CWB single desk performance, and grants export permits to allow for contestability in non-premium markets.

The resulting options can provide a context for advocates of change concerning the regulatory structure on the western Canadian wheat and barley sectors. These options create opportunity for the grain industry in western Canada. For example, improvements in accountability of the single desk can be made through the establishment of a regulatory body that monitors and assesses the performance of the CWB. Supply chain and marketing efficiencies and greater value adding activities can result from the deregulation of the domestic market. Producers have more marketing options and choice with deregulation of domestic markets and introducing contestability into export markets. The introduction of contestability in export markets should lower export supply chain costs. Issuing export permits for non-premium markets should, in principle, retain suggested single desk premiums.

#### ***Implications for the CWB operating in a less regulated environment***

There are a number of significant implications for the CWB operating in a less regulated environment. The CWB may evolve into an entity that is similar in nature to the AWB. In order for the CWB to continue to serve the Canadian producer in a less regulated environment, the following implications should be considered:

- ❑ The CWB will focus on a single objective – delivering superior net returns;
- ❑ The CWB will operate more as a grain company;
- ❑ There will be an increase in cash trading in the western grain market;
- ❑ The CWB will require a financial base for cash trading;
- ❑ The CWB will have a strong focus on further reducing supply chain costs;
- ❑ The CWB will likely enter into more “c&f” (landed cost) export sales;
- ❑ There will be increased pressure on pool performance;
- ❑ There will likely be an increase in frequency of pool closures;
- ❑ There will be an increase in the number and variety of pricing, risk management, and financing options available;
- ❑ The CWB’s “buyer of last resort” status will likely change;
- ❑ There will be an increase in transparency and accountability of CWB performance;
- ❑ The issue of CWB ownership may be forced;
- ❑ There will be renewed support by some growers as the CWB as the growers company;
- ❑ The CWB will operate with fewer, if any, government guarantees;
- ❑ The issue of whether the CWB continues as the organization that positions Canadian grain in the export market will need to be addressed;
- ❑ The CWB will likely develop a number of alliances with service providers;
- ❑ The issue of whether the CWB becomes an asset based grain company (such as AWB) or an alliance based entity will need to be addressed; and
- ❑ There will likely be greater acceptability of the CWB to the United States.

***The net gain from deregulation – efficiency gain and single desk premiums***

Moving from the current situation to the option of deregulating the domestic market may result in some loss in the single desk premium, if the domestic market is a premium market for the CWB. However, producers can be better off due to the efficiencies and market place dynamics that flow from deregulation. All of the impacts associated with deregulation are difficult to predict, whether in the grain industry or in other industries. The Australian experience with domestic deregulation created many improvements, and efficiencies in the supply chain, as well as opportunities. The extent of value added opportunities will likely be greater for western Canada than for Australia since markets are located next door to western Canada, which is not the case in Australia.

More generally, producers are better off if any loss of any existing single desk premium is more than offset by efficiency gains, such as better pricing and financing alternatives from improved market liquidity, reduction in supply chain costs, greater valued added opportunities, and benefits created by more producer choices. Selected contestability in export markets potentially generates more efficiency and choice gains, but at the possible expense of some of the hypothesized single desk price premiums.

If a single desk premium does not exist, or is not captured by producers, then all options are an improvement for producers, some more than others.

The central questions that were not designed to be answered by this study remain. They are; what are the benefits (e.g., a single desk premium) arising from the current Canadian system, what are the costs associated with that system, and can the system be improved by altering all or certain of its aspects. The comparison to Australia is informative because it offers insights for Canadian policy makers into likely benefits, costs and implications from altering the current system in various ways. The options chosen for Canada will depend on market context and the policy environment faced by Canada; the Australian experiences can assist in defining feasible paths to follow and allow for an understanding of the likely consequences of those paths.

## **1.0 Introduction**

This chapter provides a high-level over-view of the project, beginning with a synopsis of regulatory change in Australia's grain industry. The objectives, scope and methodology are discussed as well as the organization of the report.

### **1.1 Australia's Grain Industry Has Been Deregulating**

Australia is an example of a country that is transforming from a highly regulated grain industry to one that is less regulated. This process has been driven by a larger deregulatory process that has occurred throughout the Australian economy. In particular, the Council of Australian Governments implemented the National Competition Policy (NCP) in 1995 with the objective of increasing economic performance and benefits through greater competition.

Anti-competitive legislation was to be reviewed by the end of 2000. The guiding principle was that legislation and regulations restricting competition were only to be retained if the benefits to the community outweighed the cost (public benefits test) and if the objectives of the legislation could only be met by restricting competition.<sup>1</sup> The 2000 Wheat Marketing Review found that greater competition would produce more benefits for growers and the wider community than the continuation of export controls but because of uncertainty recommended that the single desk be retained and reviewed again in the 2004 review. It also made recommendations regarding the Wheat Export Authority (WEA).<sup>2</sup> The 2004 Wheat Marketing Review has just been completed. The scope explicitly excluded a review of single desk exporting.<sup>3</sup>

Prior to the 2000 review, there was a continuing push from within the Commonwealth Government for reforms to enhance competition in the economy as well as the grain industry. This push was enhanced in grains by a triggering of the underwriting provisions for the 1986-87 wheat pool on the Government. The Wheat Marketing Act of 1989 (WMA) ushered in significant changes to wheat marketing, and deregulated the domestic wheat market. The WMA established a Wheat Industry Fund (WIF) to collect a mandatory levy on wheat sales by producers. By 1999 the fund was worth \$607 M (A\$465 M collected from growers over ten years).<sup>4</sup> The Act also immediately reduced the government's guarantee to 85% with provision to reduce it to 0%. The Wheat Industry Fund was used to allow AWB to develop a capital base and diversify into value-added activities. The Act also replaced guaranteed minimum prices to growers that had been based on historical average prices with a partial payment based on the average expected net pool return. The wheat pool was subdivided into 10 sub pools. The AWB, which is subject to periodic review, sells bulk wheat directly or indirectly through grain companies. Container and bag sales of wheat to offshore markets were subject to its approval, prior to the establishment of the Wheat Export Authority (WEA).

On July 1, 1999, the commercial functions of the Australian Wheat Board were transferred to AWB Ltd, a grower owned and controlled corporation. The regulation of the single desk exporter was transferred to the Wheat Export Authority (WEA). AWB Ltd has a number of wholly owned subsidiaries directly related to grain, and include:

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<sup>1</sup> "Issues Paper for the National Competition Policy Review of the Wheat Marketing Act of 1989", May 2000.

<sup>2</sup> 2002 NCP Assessment: Chapter 4 - Primary Industries.

<sup>3</sup> "2004 Wheat Marketing Review – Report to Growers", October 2004.

<sup>4</sup> Kronos, "A Review of Structural Issues in the Australian Grain Market", September 2002.

- ❑ AWB (International) Ltd – manages the export single desk through international wheat marketing and pooling services;
- ❑ AWB Finance Ltd – provides financial services such as underwriting and advance payments to growers;
- ❑ AWB (Australia) – trades wheat in Australia, trades in other grains and performs other commercial operations.

AWB Ltd provides commercial and business services to its subsidiaries.<sup>5</sup> AWB Ltd has a dual class structure with its “B” shares traded on the ASX. The structure of the board maintains grower control. The Wheat Export Authority controls wheat exports and monitors the performance of AWB International (AWBI) in exporting wheat and examines and reports on the benefits accruing to growers from AWBI’s performance.<sup>6</sup>

Barley marketing entities such as the Australian Barley Board (ABB) have also seen changes to their governance, ownership, and responsibilities. The ABB was established under the National Security Act in 1939 to coordinate the acquisition and marketing of all barley produced in Australia. In 1942 the ABB’s jurisdiction was reduced to only Victoria and South Australia where state acts gave it the sole authority to acquire barley. The Barley Marketing Acts of 1993 in these states had a sunset clause of 2001.

After a review under the National Competition Policy guidelines in which the existence of export premiums could not be proven, the state of Victoria completely deregulated the marketing of barley in 2001. ABB’s authority was extended indefinitely by South Australia and reviewed in 2002.<sup>7</sup> The ABB was transformed into a private grower owned corporation, ABB Grain Ltd in 1999. ABB Grain Ltd has a dual class structure with “B” Shares traded on the ASX. Grower control is primarily maintained through Board structure and governance.

ABB Grain Ltd operates in all grain growing regions, can trade barley and other grain domestically, and is responsible for its own quality control, financial services, and logistics. ABB Grain Export Ltd, is a wholly owned subsidiary, which has the monopoly export rights for exporting bulk barley from South Australia. It operates in all grain growing regions of Australia and New Zealand. ABB has vertically integrated into malt, grain containerization, grain cleaning, storage facilities, etc. ABB recently merged with AusBulk (previously SACBH) and United Grower Holdings and it has a joint venture, Grain Australia with the Grain Pool of WA. Grain Australia provides a single face to all overseas customers of ABB Grain Ltd and GPPL and manages their export sales.

## **1.2 Australian Experiences May Assist Regulatory Change in Canada**

The evolutionary pathways for wheat marketing in Australia and western Canada were very similar in their early histories. However, in the last 15 years the AWB and ABB have undergone a significant transformation with respect to power, governance, and activities<sup>8</sup>.

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<sup>5</sup> AWB

<sup>6</sup> “Issues Paper for the National Competition Policy Review of the Wheat Marketing Act of 1989”, May 2000.

<sup>7</sup> Kronos, “A Review of Structural Issues in the Australian Grain Market”, September 2002.

<sup>8</sup> Australia and Canada have both experienced recent changes in their overall grain handling, marketing, and transportation systems. Changes that have occurred in the Canadian industry such as the transformation of producer cooperatives into publicly traded companies have been used as models for the privatization of the AWB, the ABB, and other government entities.

In the context of continued deregulation of the grain industry in western Canada, the current approach used for wheat and barley marketing in Australia could provide a potential model to adapt for use in Western Canada. Moreover, many insights and lessons learned through the Australian experience can assist the western Canadian grain industry and government as change is contemplated.

### **1.3 Project Objectives and Scope**

In this context, AAFRD commissioned this consortium lead by JRG Consulting Group and SJT Solutions<sup>9</sup> to review the wheat and barley industry and marketing system in Australia and make relevant comparisons to the wheat and barley industry in western Canada and the roles, responsibilities, and marketing performance of the Canadian Wheat Board. The *objective guiding this study is to use Australia's experiences in wheat and barley deregulation to advocate improvements to the western Canadian wheat and barley marketing systems.*

Scope issues guiding this project are highlighted in Annex II, which are in the areas of:

- ❑ Describing Australia's wheat and barley marketing systems,
- ❑ Indicating the impact of deregulation in Australia,
- ❑ Outlining future prospects for the Australian system, and
- ❑ Providing a comparison to wheat and barley marketing in western Canada.

Accordingly, the primary focus of this report is to highlight the facts and context surrounding deregulation of the grain industry in Australia. This includes where the Australian wheat and barley industry has come from, where it is today, and where it will likely head, with a particular focus on regulatory structures. With this fact base, an assessment can be made of how Australia's experiences and lessons learned could be applied to the provinces in western Canada, including the implications on the CWB if recent AWB and ABB transformations were part of a new CWB structure.

In addressing the project objectives and scope issues, our approach included;

- ❑ Reviewing existing documents and reports on structure and changes in the Australian grain industry.
- ❑ Using Australian based consultants, who have experience working and consulting in the Australian grain industry, as part of the study team to ensure that proper insight is provided,
- ❑ Addressing specific questions on rationale for change, impact of change and potential future changes in the regulatory structure in Australia,
- ❑ Comparing the regulatory changes that occurred in Australia with the major regulatory change that happened in western Canada, the changes in western grain transportation regulations,
- ❑ In-person interviews with selected representatives of the grain industry in Australia and western Canada (see Annex III for a listing of organizations consulted),
- ❑ Developing high level options on changes to CWB regulatory powers based on recent Australian experiences
- ❑ Providing an assessment of impact associated with these options if employed in western Canada

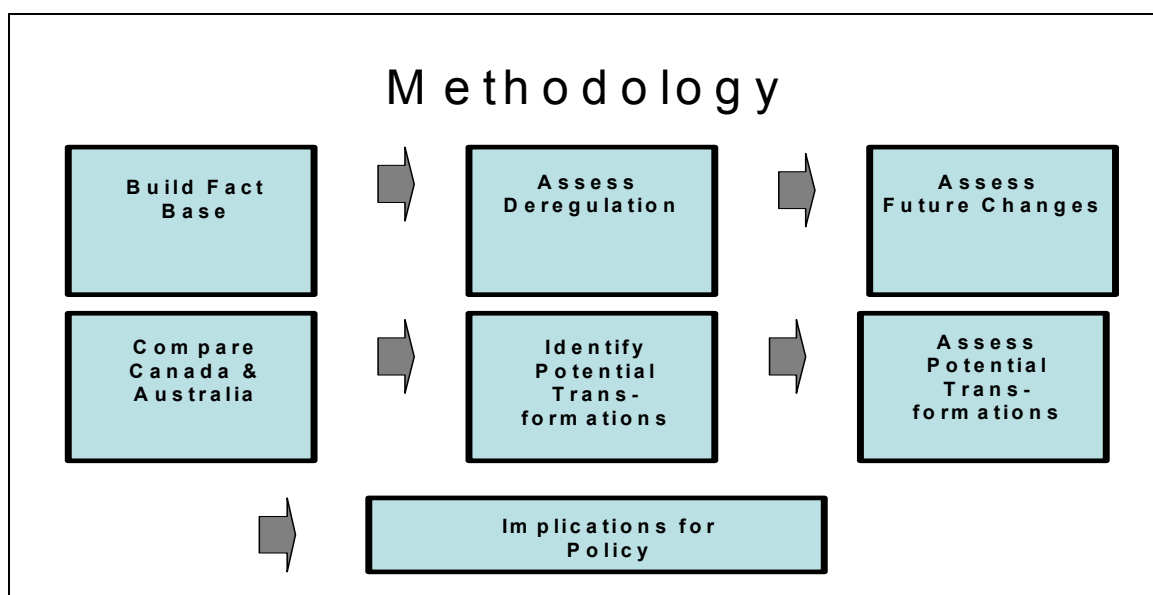
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<sup>9</sup> The project was led by Dr. John Groenewegen of the JRG Consulting Group and Dr. Shelley Thompson of SJT Solutions. Other team members included Bruce Johnson of Windrow Consulting, Dave Spearin of LMS Marketing and Dr. Timothy Ryan of Timothy J Ryan and Associates Pty Ltd in Australia.

## 1.4 Methodology

Our project methodology is shown below, with seven major activities:

1. **build the fact base**;
2. **assess deregulation** in wheat and barley marketing in Australia;
3. assess **future changes** that could affect wheat and barley marketing in Australia;
4. **compare** the marketing systems for wheat and barley in **Australia and Canada**;
5. using the knowledge gained from examining the evolution of the system in Australia **identify potential transformations** that could be made to western Canada's system;
6. **assess the potential transformations**; and
7. identify any resulting **policy implications**.



## 1.5 Report Organization

Our report is organized in the following manner. The next section (2.0) provides a brief overview of the regulatory structures present in the Australian grain industry prior to 1989 – when major deregulation initiatives were implemented. This section also provides the background for the larger deregulation thrust that occurred in the Australian economy and the deregulation that occurred in most agricultural sectors in Australia.

Section 3.0 highlights the regulatory changes that occurred in the Australian wheat and barley industries, as government was starting to get out of the grain industry. The impact of those regulatory changes on the many dimensions of grain industry is part of the fact base described in section 4.0. Possible future changes in regulations and structure of the Australian grain industry are discussed in section 5.0, as Australia attempts to find the right balance between producer choice and maximizing returns to growers.

Comparisons to western Canada are provided in section 6.0, with a focus on lessons learned that could be applied to Canada and a comparison of CWB operations based on transformations that have occurred at the AWB and the CWB. A high level summary of findings is provided in the last section, section 7.0.

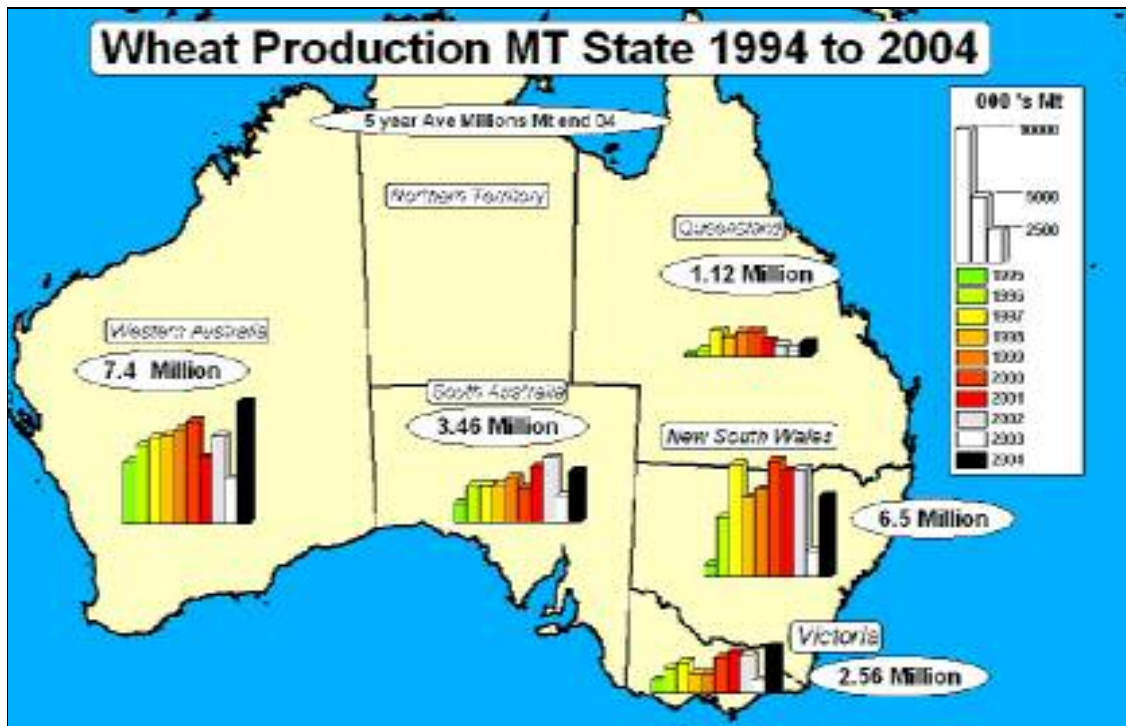
## 2.0 Providing Context For Australia's Deregulation

In this section of the report we provide some context to consider the deregulation that has occurred in the Australian grain economy. This begins with an overview of wheat and barley production for the major grain growing States<sup>10</sup>. We then provide some context for the deregulatory thrust that has occurred in Australia, including those in agriculture.

### 2.1 Significance of Australian Wheat and Barley Production and Exports

Western Australia is the largest wheat-producing region in Australia with an average of 7.4 M tonnes of production over the last 5 years. Wheat production is weather dependent and production can fall well below trend in a drought year, as occurred in 2003 (see Figure 2.1). New South Wales is the second largest wheat growing region in Australia, with an average of 6.5 M tonnes of production over the last 5 years.

Figure 2.1 Wheat Production by State, 1994 to 2005



Over the last 5 years approximately 70% of Australian wheat (including durum) production was exported and 55% of barley production. Australian exports were an average of 14.9 M tonnes for wheat and 3.4 M tonnes for barley over the 1999 to 2004 period. Table 2.1 indicates that for some Australian states exports are significant; for example, 86% of wheat production in Western Australia is exported and 75% of barley production in South Australia is exported.

<sup>10</sup> Additional information on the agriculture sector in Australia can be found in Annex III.

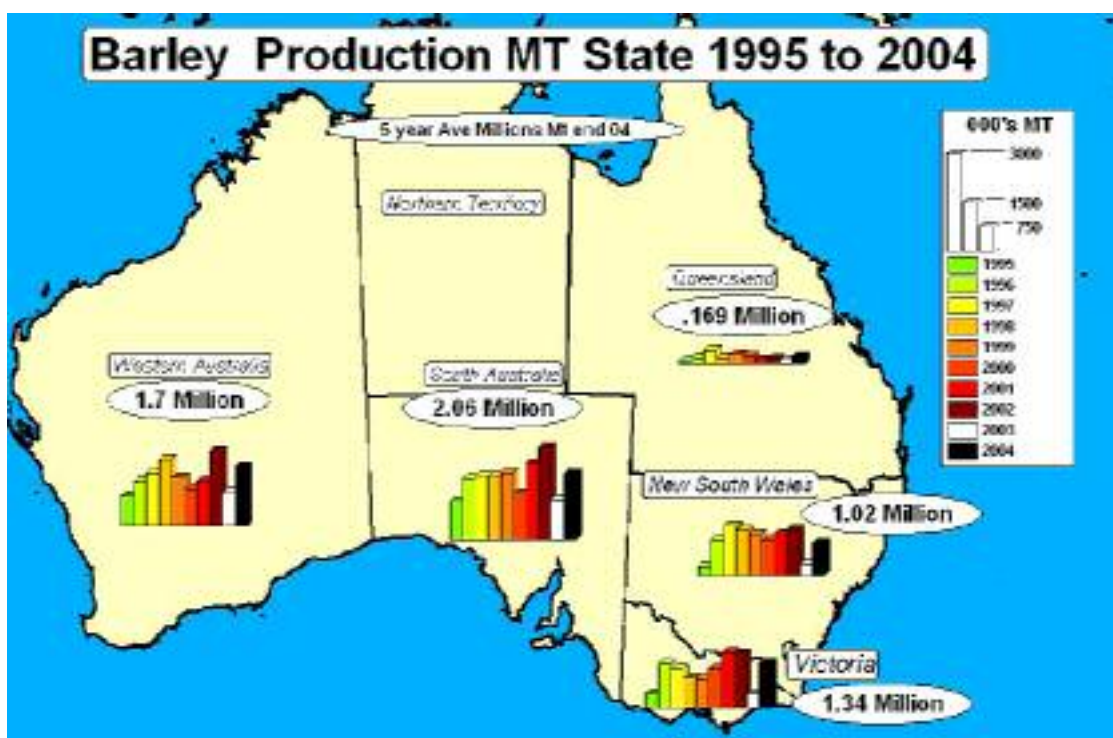
**Table 2.1 Wheat and Barley Production and Exports by State; 1999 - 2004 average**

State	Wheat			Barley		
	Production tonnes	Port Exports Tonnes	Export % of Production %	Production tonnes	Port Exports Tonnes	Export % of Production %
Western Australia	7,425,600	6,362,982	86%	1,742,600	1,329,301	76%
South Australia	3,465,200	2,816,972	81%	2,062,200	1,542,429	75%
Victoria	2,562,600	2,448,198	96%	1,341,000	309,620	23%
New South Wales	6,502,400	2,611,705	40%	1,025,000	195,000	19%
Queensland	1,112,400	633,273	57%	169,000	22,000	13%
<b>Total</b>	<b>21,068,200</b>	<b>14,873,130</b>	<b>71%</b>	<b>6,339,800</b>	<b>3,398,350</b>	<b>54%</b>

Source: Calculated by consultants

South Australia is the largest barley-producing region, with 2.1 M tonnes of production as an annual average over the last 5 years. Western Australia exported 75% of its 1.7 M tonne crop over the last 5 years, on average.

**Figure 2.2 Barley Production by State, 1995 to 2005**



In terms of exports, Australia has a larger share than does Canada of world exports for barley and a similar share for wheat (including durum). For example, in the case of wheat Australia's 5-year export volume of 14.9 M tonnes is slightly less than Canada's 5-year average of 15.2 M tonnes. For barley, Australia's 5 year average of 3.4 M tonnes is almost double Canada's volume of 1.9 M tonnes, which has been declining over time.

## **2.2 Primary Industries in Australia were Highly Regulated**

Starting in the 1920's, the processing and marketing of primary produce were increasingly controlled by statute and compulsory cooperatives in Australia. The statutory marketing arrangements typically involved demand/supply management using market entry barriers, production control mechanisms, such as quotas and licenses, along with various pricing and vesting powers.

Agricultural marketing was heavily regulated in Australia from the 1920's to the 1990's, with over 50 state and 10 federal statutory marketing entities<sup>11</sup>. As in Canada, a major rationale for government intervention in Australia was to protect growers from excessive marketing costs, exploitation, and lack of market power. The marketing entities were essentially compulsory cooperatives; growers had a deep connection to them, believing that they operated on behalf of growers. Compulsory cooperation is based on orderly marketing, which eliminates competition between growers selling their production. Producers pool their production and behave as if they are a single seller. Grower equality, risk sharing, and price stabilization are the principles underlying orderly marketing. As well, the railroads were state owned operations<sup>12</sup>.

## **2.3 The Australian Wheat Board – A Similar Genesis as the CWB**

The Australian Wheat Board originated during World War I. In 1914 the federal government established compulsory wheat pools administered by the AWB. As promised to private grain traders, compulsory pooling was discontinued after the 1920-21 crop and a mixed ownership system of grain marketing (private companies and grower cooperatives) existed until World War II. During the 1930's depression, the Australian government encouraged wheat production in order to generate foreign exchange through exports. However, a global excess supply of wheat made this strategy unsuccessful, as well as undermining government efforts to provide a guaranteed price to growers. The 1930's were a time of financial difficulty for Australian growers.

Historically, Australia, just like Canada and the US, exported wheat in bags. While Canada and the US quickly moved to more efficient bulk handling systems, Australia was very slow to adopt bulk handling because of concerns about the cost of required infrastructure. Beginning in 1915, Australian governments began helping to finance bulk-handling facilities. However the debt proved difficult to repay because the facilities were under-utilized. To assist with debt repayment, States passed regulations making delivery of grain to bulk handling facilities mandatory. Some Bulk Handling Authorities (BHA) had social objectives such as non-

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<sup>11</sup> While both Canadian and Australian grain economies were heavily regulated, an argument can be made that overall agriculture in Australia was more regulated than in Canada

<sup>12</sup> The information in this section is based on a number of sources including (1) Productivity Commission 1999, *Impact of Competition Policy Reforms on Rural and Regional Australia*, Report no. 8, AusInfo, Canberra. (2) Bielak M, "Organizational Change in the Australian Grain Industry: A Cooperative Life Cycle Approach", Unpublished MS Thesis, Department of Agribusiness and Agricultural Economics, University of Manitoba, October 2004. (3) NCP Wheat Review, "Issues Paper for the National Competition Policy Review of the Wheat Marketing Act 1989", May 2000. (4) Kronos, "A Review of Structural Issues in the Australian Grain Market", September 2002. (5) Ryan T, "The Australian Wheat Board: An Engine of Change or a Caboose?" in *World Agriculture in a Post-GATT Environment: New Rules, New Strategies*. Edited by R Gray, T Becker and A Schmitz. University of Saskatchewan, University Extension Press. 1994. (6) Productivity Commission, "Review of National Competition Policy Reforms", 2004. (7) "Issues Paper for the National Competition Policy Review of the Wheat Marketing Act of 1989", May 2000.

discrimination between growers. Private companies were only allowed to store and handle small volume grains.

With the beginning of WWII, the government re-established the AWB in 1939 to market wheat domestically and internationally. The AWB also provided financing to producers through advance pool payments, which were made when wheat was delivered. Further payments were made throughout the year as wheat sales were made by AWB. The government underwrote the financing activities of the AWB. At the end of the war because growers did not want to abandon the AWB, it was operated on a temporary basis until 1948 when the Wheat Industry Stabilization Act was passed. The objective of the single desk, in conjunction with pooling, was to capture the net profits from all sales including the price premiums from export sales for the benefit of all growers delivering to the pool.

The AWB moved from being a temporary entity in 1948 with the passage of the Wheat Industry Stabilization Act to a permanent organization. In Australia because national grain marketing legislation must be enacted by State legislation, the States passed legislation complementary to the Wheat Industry Stabilization Act 1948.

The Act had a sunset clause requiring review and re-negotiation by government and the Australian Wheatgrowers Federation (AWF), which became the Grains Council of Australia (GCA). The Act was renewed in 1954, 1958, 1963, 1968, 1974, 1979, and 1984. The Act was renamed the Wheat Marketing Act in 1979. The sunset clause was discontinued in 1989.

The main features of the Acts governing wheat marketing from 1948 to 1989 were administered pricing, a stabilization fund, compulsory pooling, and granting of AWB sole domestic and international marketing rights for wheat. The AWB did not have the authority to accumulate funds.

During much of the 1948 to 1989 period the Australian economy was heavily protected from foreign competition by high import tariffs and there was a widespread belief that growers should also be protected. In order to provide growers with a fair return, for many years administered prices were based on the cost of production. The determination of the administered price was very political with both the government and the AWF having to be satisfied. The political nature of price determination was no doubt responsible for the stabilization fund requiring government funds in 14 of 31 years. In 1979, the formula for the guaranteed minimum price was changed to be 95% of the average of the current estimated pool return and the estimated pool return for the previous two years.

The objective of the stabilization fund was to provide price stability. If the average export price earned by AWB was greater than the guaranteed price then the difference was taxed (export stabilization tax) and went into the stabilization fund. If, however, the average export price was less than the guaranteed price the revenue shortfall was covered by the fund. Because of the political nature of the guaranteed price, the fund was empty by 1959 and the government began directly subsidizing the fund. When the government changed the guaranteed minimum price in 1979 the fund was discontinued.

In AWB's compulsory pooling system, each grower received the same average net pool return regardless of location or timing of delivery. All sales revenue and all costs (administration, transport, storage, and handling) were pooled. Producers had to deliver in order to get the advance payment creating an incentive to deliver immediately after harvest and consequently the development of a system with one turn. The principle of grower equality underlying the pooling system also permeated the wheat grading system. The AWB was responsible for

setting the receiving standards. Until 1974 almost all wheat was marketed as Fair Average Quality (FAQ) and there were very few separate pools for different wheat types. Consequently growers received the same price regardless of the type or quality of the wheat delivered. In such a system, growers have an incentive to grow large volumes of wheat rather than high quality or higher valued wheat. A new grading system was introduced in 1974 with the following classifications: Australian Standard White (replacing FAQ), Prime Hard, Hard, Soft, and Durum. It was not until 1984 that AWB began offering different advance payments for different wheat types.

From the 1970's these arrangements were increasingly subject to scrutiny and review. The focus was driven partly by competition principles and by other environmental changes: For example, better and cheaper communications, the development of new financial tools to manage risk, and the adoption of a flexible exchange rate, substantially reduced the need for statutory arrangements to smooth out the effects of fluctuations.

## **2.4 Barley Was Also Highly Regulated**

Barley was also highly regulated in Australia. However, rather than being controlled at the national level, it has generally been controlled at the state level.

The Australian Barley Board (ABB) was established under the National Security Act in 1939 to coordinate the acquisition and marketing of all barley produced in Australia. In 1942 the ABB's jurisdiction changed to only Victoria and South Australia when the federal government transferred responsibility to these states. The State Acts gave the ABB the sole authority to acquire barley in these States.<sup>13</sup>

New South Wales established statutory marketing entities for barley, sorghum, oats and oilseeds (canola, safflower, sunflower, linseed and soybeans) in 1927 under the Marketing of Primary Products Act. Under the legislation, a majority of growers had to support the establishment of a marketing board for a crop. The Act was replaced in 1983 with the Marketing of Primary Products Act 1983. In the late 1980's when the marketing boards for oats and oilseeds became insolvent, new legislation was enacted, the NSW Grains Marketing Act 1991. The 1991 legislation created a single entity, NSW Grains Board, to handle marketing for all the listed commodities. The NSW Grains Board had single desk marketing powers in the domestic and export markets for barley, sorghum, oats, canola, safflower, sunflower, linseed, and soybeans.<sup>14</sup>

In Western Australia, the Grain Marketing Act (1975) gave the Grain Pool of Western Australia (GPWA) single desk selling rights in the domestic and export markets for barley, lupins, and canola. The act mandated an elected board of directors. The Grain Pool originated in 1922 as the Wheat Pool. It acted as an agent of the AWB during WWII. The Grain Pool took over the marketing and administration functions of the Western Australian Barley Marketing Board in 1952. In 1962 it became known as the Grain Pool of Western Australia (GPWA).

Queensland established the Barley Marketing Board Queensland (BMBQ) in 1930. During WWII it acted as an agent for the Australian Barley Board. From 1942 to 1991 the BMBQ was

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<sup>13</sup> Kronos, "A Review of Structural Issues in the Australian Grain Market", September 2002.

<sup>14</sup> Government of New South Wales, "Review of the NSW Grain Marketing Act 1991, Final Report", July 1999.

the compulsory buyer of barley in Queensland. In 1991 it became part of Grainco Australia Ltd.<sup>15</sup>

## **2.5 The Grain Industry Supply Chain Was Government Controlled**

While the marketing of wheat and barley was government controlled or through agencies based on government linkages, the rest of the supply chain (bulk handling companies, railroads, etc.) was also government controlled or owned.

Bulk handling authorities (BHA) stored and handled grain in the country and at port. In the 1980's it was estimated that these entities handled over 75% of Australia's grain production. Prior to de-regulation in 1989 there were five BHAs one in each State:

- ❑ Bulk Grain Queensland (Queensland),
- ❑ Grain Handling Authority (NSW),
- ❑ Grain Elevator Board (Victoria),
- ❑ South Australian Co-operative Bulk Handling (SA) and
- ❑ Co-operative Bulk Handling of Western Australia (WA).

These bulk-handling facilities were either state authorities or grower cooperatives and the majority of board seats of most bulk handling authorities (BHA) were filled by growers. Each BHA had exclusive rights to receive wheat in the state on AWB's behalf. The relationships were governed by agreements made by AWB with each BHA. The price for storage and handling was primarily determined by each BHA's cost, which meant that rates varied by state.

In Australia the railways were State owned entities. Grain primarily moved within a State rather than between States and certainly did not move in an optimal mode or direction. This was because the rail networks, with different rail gauges had been developed on a State basis, freight was heavily regulated and movement by truck was limited by legislation.

## **2.6 Regulatory Summary 1914-1989**

A summary of regulations that existed prior to 1989 is provided in this section for the pre-1948 period and the 1948-1989 period.

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<sup>15</sup> Kronos, "A Review of Structural Issues in the Australian Grain Market", September 2002.

**Pre 1948**

<b>Pre 1948 Highlights</b>			
<b>Beginning Industry Structure</b>	<b>Drivers of Change</b>	<b>Strategic Responses</b>	<b>Ending Industry Structure</b>
Concerns about producer exploitation by grain companies and railways	WWI	Federal government establishes mandatory AWB to market wheat domestically and off-shore in 1914. Discontinues after 1921.	AWB operated on a temporary basis.
	WWII	Federal government re-establishes AWB in 1939 as single desk and underwrites advance payments to producers made by AWB. Federal government establishes ABB as single desk in 1939. ABB made mandatory in only 2 states (Vic & SA) in 1942	
Australia exporting in bags. State government financing of bulk handling facilities	Difficulties repaying bulk facilities' debt	State government made deliveries to state owned/grower controlled BHA mandatory	Compulsory delivery to BHA for wheat & most other grain. Private handling facilities allowed for very minor grains
		Producers want AWB to exist on a permanent basis	
	1930's depression	Federal government encourages wheat production during depression to gain foreign exchange	

**1948 – 1989**

<b>1948 -1989 Highlights</b>			
<b>Beginning Industry Structure</b>	<b>Drivers of Change</b>	<b>Strategic Responses</b>	<b>Ending Industry Structure</b>
AWB operated on a temporary basis.	Growers want a permanent AWB		AWB permanent entity with five year reviews - Wheat Industry Stabilization Act 1948 AWB single desk for domestic and export wheat
	Rest of economy highly protected – growers should be also		Administered pricing – cost of production pricing until 1979 when moved to 95% of past and expected prices
	Gradual shift to a more market orientated economy – reduced manufacturing tariffs, floated dollar, deregulated financial sector	Industries Assistance Commission which recommended changes such as deregulating domestic and export markets began in 1974	
	Grower equity and price stability		Compulsorily pooling – each grower receive same price regardless of location, type or quality of wheat or timing of delivery for most of period
Compulsory delivery to BHA for wheat & most other grain. Private handling facilities allowed for very minor grains	1986 Royal Commission on Storage, Handling etc	Recommended changes to make system more efficient, restructure BHA as commercial structures, change pooling so that actual costs attributed to individual growers	
	Growers wanted price stability		Stabilization fund – political nature of guaranteed prices depleted fund and government began guaranteeing prices

## **2.7 The Case for Regulatory Reform in Wheat Began in the 1980's**

After WWII, the government used a Keynesian approach featuring full employment goals and the protection of infant industries. However, during the 1970s and early 1980's the performance of the Australian economy faltered. Unemployment rates rose and the economy contracted in real terms. This resulted in a major shift in economic philosophy. The new goal was to increase efficiency by increasing competition and relying on market forces. The government reduced import tariffs on manufactured goods in 1973 which reduced one of the justifications for government support of agriculture. The Australian dollar was allowed to float beginning in 1983 and was followed by deregulation of the financial system.

In 1974, Australia established the Industries Assistance Commission (IAC) to advocate economic reform. The IAC reviewed wheat marketing prior to the Commonwealth Government and AWF renegotiating the arrangements every five years. The 1978, 1983 and 1988 IAC reports recommended increasing competition and flexibility in wheat market and deregulating the domestic market. The 1988 report also recommended removing AWB's export monopoly.

The McColl Royal Commission into Grain Storage, Handling and Transport, established in 1986, was driven by the ever-increasing costs of the centralized storage systems in each State and associated logistical systems. The McColl Commission was the first comprehensive review of grain handling and transportation in 50 years. Many industry experts have argued that this royal commission was the turning point in the grain marketing debate. The Royal Commission looked at the impact of institutional arrangements on efficiency and cost effectiveness and made the following conclusions:

- ❑ The Australian grain storage, handling and transport system was not efficient, cost effective or integrated,
- ❑ Grain did not flow in the least cost manner, and
- ❑ Cost pooling masked signals about the actual cost of facilities resulting in over-utilization of inefficient facilities.

The Royal Commission made the following recommendations:

- ❑ Eliminate BHA's exclusive right of receiving grain in the country,
- ❑ Require BHA's to minimize storage, handling and transportation costs,
- ❑ Charge each grower their actual cost for delivery, handling and transport rather than a pooled cost, and.
- ❑ Restructure BHA as commercial entities.

Farmers were not supportive of deregulation in the 1980's. Although the President of the AWF, Trevor Flugge, publicly indicated that the current structure was inefficient thereby lowering returns to producers, the majority of AWF members did not share these views. During this time the AWF experienced a significant amount of internal conflict.

The first wave of deregulation in the Australian grain industry began in 1989 when the Wheat Marketing Act 1989 (WMA 1989) was enacted. This act deregulated the domestic wheat market and initiated the transformation of the AWB to a producer-financed organization. The major impetus for change was the financial losses incurred by the AWB, which the government had to absorb. For a variety of reasons, including minimizing government financial obligations, the government wanted to shift the financial risk to the grower.

Changes to grain marketing had been instigated prior to 1989 with the introduction in 1984 of a permit system for feed wheat (i.e., trade outside AWB) and different prices for wheat for human consumption and industrial/feed usages.

## **2.8 Major Drivers of Change Affecting the Grain Economy**

Prior to 1989, the major factor driving change in the Australian grain industry was a shift in government policy from being interventionist to more market oriented.

There were two external factors encouraging deregulation prior to 1989. The first was that the US and the EU were engaged in an export subsidy war which resulted in a 40% drop in price for ASW in 1986. The price drop resulted in a deficit for AWB's 1986-87 pool. The Australian government said that because it could not compete with the treasuries of the U.S. and the EU. Australia's only choice was to increase the efficiency of grain handling and marketing.

The second external factor was the very long Uruguay round on trade negotiation that began in the late 1980's. Australia believed that if export subsidies were disciplined, growers with efficient production and marketing would have a competitive advantage.<sup>16</sup>

The major driver for recent and on-going changes in grain industry regulation is the National Competition Policy (NCP) which was implemented by the Council of Australian Governments in 1995. The objective of the policy is to increase Australia's economic performance and benefits through greater competition. This policy extended well beyond agriculture and affected many industries in Australia as it:

- ❑ extended the anti-competitive conduct provisions of the Trade Protection Act to unincorporated and government businesses;
- ❑ instituted structural reforms and required competitive neutrality for public monopolies and government businesses;
- ❑ created independent authorities for the oversight of monopoly service providers;
- ❑ established a national regime to provide third party access to essential infrastructure services with monopoly characteristics;
- ❑ introduced a legislative review program to review and access anti-competitive regulations; and
- ❑ implemented reform programs that had been agreed to for gas, water, road transport and electricity sectors.

The guiding principle of the NCP was that legislation and regulation restricting competition was only be to retained;

- ❑ if the benefits to the community outweighed the cost (public benefits test), and
- ❑ if the objectives of the legislation could only be met by restricting competition.

The NCP is highlighted in more detail in the following section (3.0).

## **2.9 Economy Wide Deregulation to Deliver Benefits of Competition**

In response to ongoing evidence of inefficiencies in service delivery associated with Government business enterprises (GBEs), governments began to introduce reforms in many of these areas more than a decade ago. Reform was seen by governments as important for a range of reasons including:

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<sup>16</sup> Ryan T, "The Australian Wheat Board: An Engine of Change or a Caboose?" in World Agriculture in a Post-GATT Environment: New Rules, New Strategies. Edited by R Gray, T Becker and A Schmitz. University of Saskatchewan, University Extension Press. 1994.

- ❑ to address the poor performance of GBEs, which imposes a dead-weight 'tax' on users and the economy generally — GBEs are significant suppliers of inputs to the rest of the economy and there are often few (if any) other suppliers;
- ❑ to ensure that resources are directed to areas of greatest need — there is always an alternative use for scarce public funds (e.g., funding of rail authorities versus funding for hospitals and schools); and
- ❑ to promote better investment decisions — governments are increasingly concerned with achieving a satisfactory return on the substantial public funds invested in the assets of government businesses.

Initially, State and Territory governments embarked on their respective reform agendas separately. However, in 1992, in an attempt to address problems which can arise from a fragmented State-by-State approach to reform (such as the different gauges and standards in Australia's rail system), the Council of Australian Governments (CoAG) commissioned an independent committee of inquiry into a national competition policy (Hilmer 1993). In response to the Hilmer Committee's report, the Commonwealth and all State and Territory governments agreed, in April 1995, on the need for a more coordinated and systematic approach to reform.

The Council of Australian Governments implemented the National Competition Policy (NCP) in 1995 with the objective of increasing economic performance and benefits through greater competition. *"In essence, most NCP reforms are measures designed to reap the benefits that competition, properly harnessed, can bring. The objective is not to pursue competition as an end in itself, but, where appropriate, to inject competition into previously sheltered areas of the economy to boost economic performance and provide benefits to Australian consumers and households".*<sup>17</sup>

The NCP is a cross-government approach to deliver the benefits of competition through a national approach to competition policy reform. National Competition Policy is the set of reforms agreed to by the Commonwealth, State and Territory governments of Australia under intergovernmental agreements signed in April 1995. These are:

- ❑ The *Competition Principles Agreement (CPA)*, which sets out principles for:
  - oversight of certain government businesses;
  - putting government businesses on a 'competitively neutral' basis with private sector competitors;
  - reform of government monopolies;
  - reviews of legislation which restrict competition;
  - allowing businesses (third parties) to gain access to some 'essential' infrastructure facilities; and
  - application of the CPA to local governments
- ❑ The *Conduct Code Agreement*, which establishes the basis for extending the competitive conduct rules of the *Trade Practices Act 1974 (TPA)* to all businesses and professions in Australia, and
- ❑ The *Implementation Agreement*, which specifies a program of financial grants by the Commonwealth to State and Territory governments — so-called competition payments — contingent on implementation of the agreed reforms. In recognition of the economic benefits expected to flow from the reforms, and that the Commonwealth stands to gain increased tax revenue, the NCP specifies a program of financial grants by the

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<sup>17</sup> Irving M, J Arney, and B Lindner, "National Competition Policy Review of the Wheat Marketing Act 1989", 2000.

Commonwealth to State and Territory governments contingent on implementation of the agreed reforms. These payments were estimated to be valued at \$1.6 billion payable to the states from the Commonwealth, contingent upon following through on commitments<sup>18</sup>.

In addition to the three intergovernmental agreements, the *Competition Policy Reform Act 1995* established two institutions — the Australian Competition and Consumer Commission (ACCC) and the National Competition Council (NCC).

- ❑ The ACCC is involved principally with enforcement of the TPA.
- ❑ *The NCC has the key role of monitoring and advising the Commonwealth Government on the progress of NCP reforms.*

NCP is a package of measures which, broadly speaking, aims to encourage competition. The underlying premise is that greater competition will usually create incentives for improved economic performance. To the extent that this can be achieved, incomes, employment and living standards are likely to rise. However, NCP permits restrictions on competition where such arrangements can be shown to be in the “public interest”.

Under the Competition Principles Agreement (CPA) of the National Competition Policy (NCP), the Commonwealth, State and Territory governments agreed to:

- ❑ develop a timetable for legislative reviews, by June 1996<sup>19</sup>;
- ❑ review, and where appropriate reform, legislation that restricts competition by the end of 2000; and
- ❑ ensure that new legislation which restricts competition passes the competition test — that is, the benefits to the community as a whole must outweigh the costs, and the objectives of the legislation can only be achieved by restricting competition.

A major focus of the National Competition Council (NCC) has been on statutory marketing legislation for agricultural commodities, such as operate in the wheat and barley industries. Typically, statutory marketing legislation is anti-competitive as it grants these statutory marketing authorities (SMAs) monopoly powers to:

- ❑ compulsorily acquire (vest) an entire crop;
- ❑ regulate the quality or price of the commodity; or
- ❑ act as the single seller on either or both the export and domestic markets.

The NCC has stated that “arrangements underpinning SMAs are *prima facie* anti-competitive<sup>20</sup>”

## **2.10 High Level View of Deregulatory Outcomes**

As a result of the initiatives highlighted above, the level and extent of government support offered to the Australian grain industry has been decreasing. Using wheat as an example, the absolute value of government support has decreased from over \$(AUS) 325 million in 1986 to \$(AUS) 107 million in 2003, as measured by the Producer Support Estimate (PSE) estimated

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<sup>18</sup> For example, in 2003-04, \$AUS 765 million was available for distribution to the states. New South Wales had 5% (\$12.9 million of \$257 million) in payments deducted since the State government was not able to show that restrictions are in the public interest. Western Australia had 5% of payments suspended pending implementing an appropriate reform program for egg marketing. In South Australia, 5% of the payment (\$2.9 million) was suspended pending implementation of a program for barley marketing reform. (NCC Press Release – “2003 NCP assessment outcomes”).

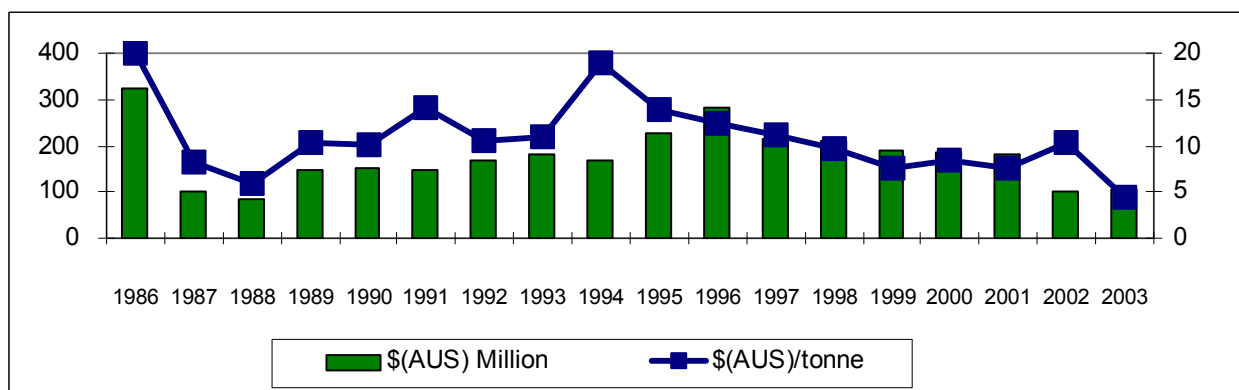
<sup>19</sup> Some 1800 pieces of legislation were identified for review.

<sup>20</sup> (NCC 1998b, p.103).

by the OECD. This decline is reflective of the many dynamics at play in Australia, including the desire to reduce government's financial obligations and to get government out of many parts of the economy.

This trend is shown in Figure 2.3 for the aggregate PSE and the per tonne PSE. The per tonne value has decreased from \$(AUS) 20/tonne in 1986 to \$(AUS) 4/tonne in 2003<sup>21</sup>.

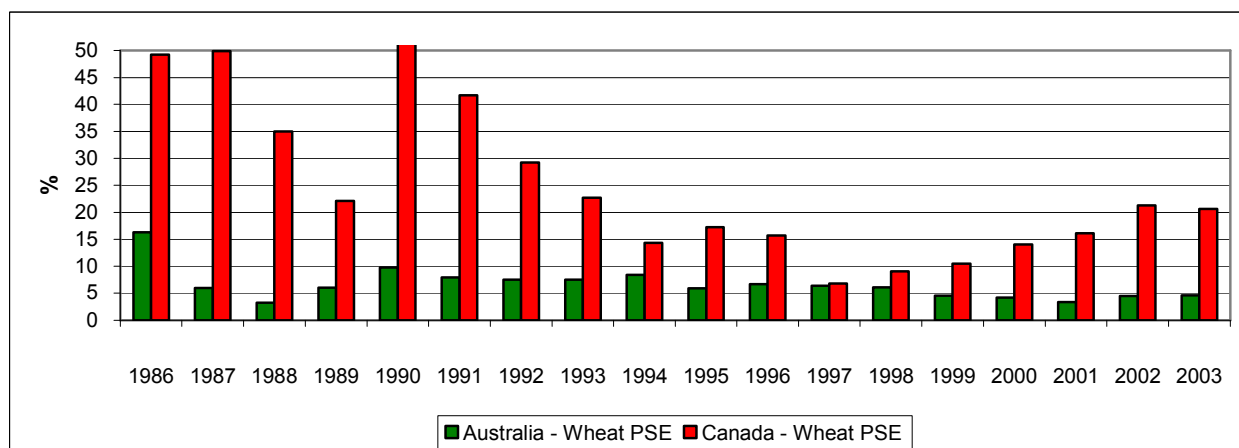
**Figure 2.3 Government Support Provided to Australian Wheat Producers – PSE**



Source: OECD

On a comparative basis to Canada, Figure 2.4 shows the percentage PSE<sup>22</sup> for Australian wheat producers compared to Canadian wheat producers. This shows that support provided to growers in Australia has been, and continues to be, much lower than support provided by the government of Canada. For example, in 1986 the percentage PSE was 49% in Canada and 16% in Australia, compared to 21% and 5% for the respective countries in 2003<sup>23</sup>.

**Figure 2.4 Support Provided to Australian and Canadian Wheat Producers - % PSE**



Source: OECD

<sup>21</sup> It should be noted that the per tonne value in 1994 and 2002 was due to a much smaller drought-induced wheat crop.

<sup>22</sup> Percentage PSE is the estimated level of support (PSE) divided by the farm gate value of production.

<sup>23</sup> Comparable data for U.S. wheat is 56% (\$99US/tonne) in 1986 and 25% (or \$US42/tonne) in 2003.

## **2.11 Positioning Deregulation in the Australian Economy**

Australia has gone through a period of deregulation and getting government and/or government run agencies out of many parts of the economy. This deregulatory thrust has been driven by a few key drivers and has not been exclusive to agriculture.

In this regard we are labeling the deregulatory change that was precipitated over the 1985 to 1995 time frame as the period of; *Reducing government expenditures and obligations and deregulating to capture efficiency gains in the economy, or in short - "Getting government out of the grains industry"*.

Australia has had at least a decade of experience since the changes began. As a result, we are labeling the position the grain industry is in today as: *Finding the right regulatory balance to enable producer choice and maximize grower return, or in short - "Finding the right regulatory balance"*.

We will use these two positioning statements as a way to summarize and position the deregulation in the Australian grain economy.

In the next section we highlight how government started getting out of the grains industry in Australia.

### 3.0 Getting Government Out of the Grains Industry

In this section we indicate the changes that have occurred in the Australia grain economy starting in the late 1980's and early 1990's. The impact of the deregulation and the new structures is discussed in section 4.0.

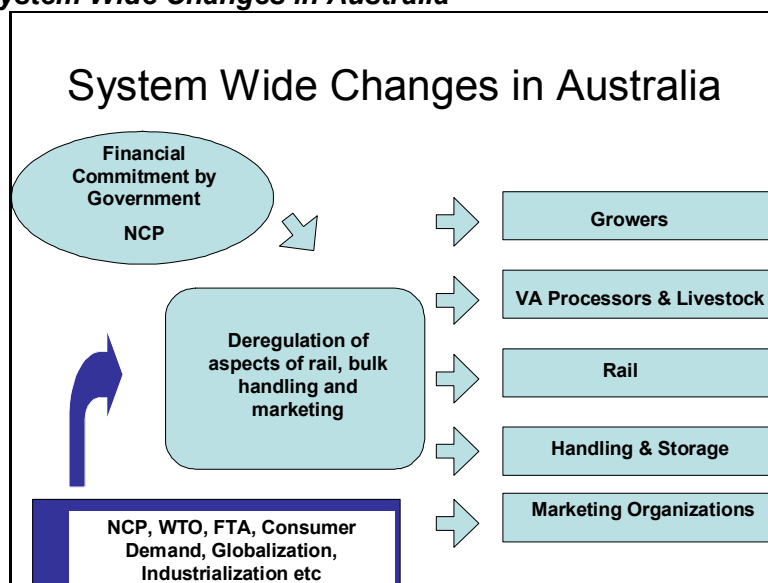
#### 3.1 Drivers of Change

System wide changes are shown in the following chart. Change in the Australian wheat and barley sector has been driven by two major factors: the desire by the federal government to eliminate its financial obligations to the Australian Wheat Board, and implementation of the National Competition Policy.

The ensuing deregulation (or at least partial deregulation) of rail, bulk handling and marketing affected growers and the value added sector (processors and livestock producers) and resulted in further changes in rail, bulk handling, and marketing. According to a report by Kronos (for a number of private interests in the grain trade) the current state of the Australian grain sector can be characterized by:

- ❑ inefficiency arising from no change in export powers of AWB;
- ❑ limited options for growers;
- ❑ conflict of interest in terms of investment in value added by AWB and ABB;
- ❑ duplication of assets (storage); and
- ❑ lack of competition for services provided by one arm of a STE to another arm.<sup>24</sup>

Figure 3.1 System Wide Changes in Australia



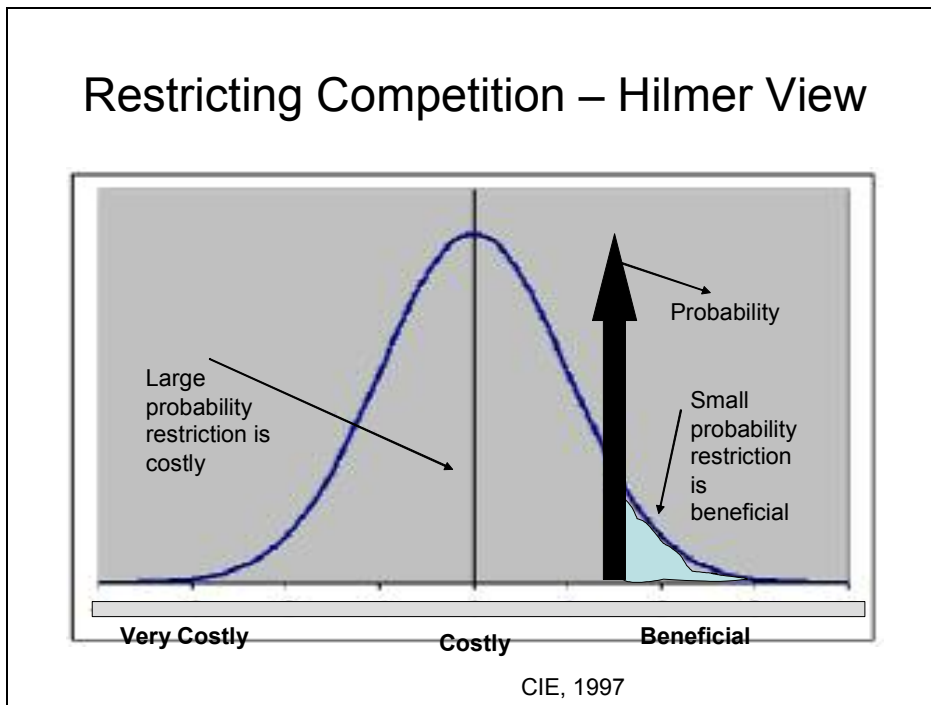
<sup>24</sup>The information in this section is based on the following sources: 1) Kronos, "A Review of Structural Issues in the Australian Grain Market", September 2002 2) Irving M, J Arney, and B Lindner, "National Competition Policy Review of the Wheat Marketing Act 1989", 2000 3) Productivity Commission, "Review of National Competition Policy Reforms", 2004 4) "Issues Paper for the National Competition Policy Review of the Wheat Marketing Act of 1989", May 2000 5) CIE, "Review of the Victorian and South Australian Barley Market Act 1993", 1997 and 6) National Competition Council, "Securing the Future of Australian Agriculture, Community Information", 2000.



considerations (environmentally sustainable development, social welfare and equity, consumer interests and policy issues such as health and safety, access and equity, and industrial relations). Anti-competitive legislation was to be reviewed by the end of 2000. In 1995, Australia had single desk marketing arrangements in coarse grains and oilseeds, dairy, eggs, horticulture, poultry meat, potatoes, rice, sugar, and wheat.

The National Competition Policy assumes that restricting competition imposes costs on the community because they remove the incentive for companies to adjust to changes, improve performance and develop new products. However, the author of these principles, Hilmer, also noted that in some situations restrictions on competition may achieve a more efficient outcome for the community. The Centre for international Economics (CIE) view of the situation is shown below in Figure 3.3 where there is a large probability of the restriction being costly and a small probability that it is beneficial.

**Figure 3.3** *Impact of Restricting Competition*



A report from the National Competition Council in 2000 stressed the need to manage any change resulting from NCP reviews. Suggested options include;

- ❑ consultations with those affected about the implementation of the reform;
- ❑ phasing of reform;
- ❑ providing information and education;
- ❑ exit programs for producers wishing to leave the industry;
- ❑ direct support to producers; and
- ❑ support programs for affected communities.

Reform of the dairy industry used direct support to producers, exit programs, and assistance to communities. The deregulation of the barley market in Victoria and South Australia was designed to proceed in stages.

### 3.2 Change in Wheat Marketing and the AWB

Since 1989, there have been many changes in wheat marketing in Australia. The following table provides an overview of significant events regarding wheat market that have occurred.

**Table 3.1 Overview of Significant Events in Wheat Marketing**

Overview of Significant Events in Wheat Marketing	
1989	Wheat Marketing Act 1989 – deregulated domestic market, established Wheat Industry Fund, changed government guarantee
1989 to Mid 1990's	Industry Strategic Planning – recognized need to make changes to AWB to ensure its survival
1999	Corporatization of AWB and creation of Wheat Export Authority
2000	Review of Wheat Marketing Act 1989
2003	Senate inquiry
2004	Wheat Marketing Review

#### Wheat Marketing Act 1989

The *Wheat Marketing Act of 1989* (WMA) ushered in significant changes to wheat marketing.<sup>26</sup> The changes were as follows:

- ❑ Deregulation of the domestic market by ending AWB's compulsory acquisition power and the administered domestic price (no single desk selling authority in the domestic market),
- ❑ Elimination of the guaranteed minimum prices to growers that had been based on historical average prices with a partial payment based on the average expected net pool return,
- ❑ Replacement of the Government guarantee with a declining government guarantee on AWB borrowings which would end by 1994,
- ❑ Establishment of the Wheat Industry Fund (WIF) with a mandatory 2% levy on wheat sales by growers was established,
- ❑ Specification of the AWB's objective as the maximization of grower returns by the minimization of storage, handling and transport costs. Where ever possible, costs were not to be pooled,
- ❑ Allow the AWB to trade in other grains,
- ❑ Allow the AWB to have more than one receiver of grain per state,
- ❑ Allow the AWB to buy or build handling facilities for wheat and other grains,
- ❑ Removal of the sunset clause mandating five year reviews, and
- ❑ Elimination of AWB's approval for container and bag exports.

<sup>26</sup> The information sources for this section are 1) CIGI. *Grains & Oilseeds: Handling, Marketing, Processing*. Fifth edition. 2003 2) Ryan T, "The Australian Wheat Board: An Engine of Change or a Caboose?" in *World Agriculture in a Post-GATT Environment: New Rules, New Strategies*. Edited by R Gray, T Becker and A Schmitz. University of Saskatchewan, University Extension Press. 1994 3) Bielik M, "Organizational Change in the Australian Grain Industry: A Cooperative Life Cycle Approach", Unpublished MS Thesis, Department of Agribusiness and Agricultural Economics, University of Manitoba, October 2004.

In 1992 the *Wheat Market Act 1989* was amended to **allow the AWB to engage in value added activities and to continue the government guarantee** on AWB borrowing until June 30, 1999.

The objectives of the Wheat Marketing Act 1989 were to remove AWB's domestic monopoly; improve price signals to growers by eliminating the price guarantee formula; and enable AWB to compete in a deregulated market by extending its commercial powers and increasing its flexibility. The Act retained the single desk for wheat exports because of grower concern.

The WMA 1989 established a Wheat Industry Fund to create a grower funded capital base. The AWB and the GCA lobbied to have the WIF included in the Act because they believed that the AWB would need a capital base to be successful in the new environment.

*"Quite simply, without a capital base the [AWB] could not continue to function effectively and would undoubtedly lose the confidence of the growers whom it was established to serve, and the Federal Parliament, which grants the AWB its statutory powers. The GCA decided that it was preferable to establish a capital base for the AWB which would provide a clear and unequivocal line of equity to grower equity holders and a facility to returns on monies invested."*  
27

The objectives of the WIF were to;

- a) underwrite AWB's domestic trading.
- b) provide a capital base to allow AWB to diversify, and
- c) to provide a capital base that would allow AWB to continue making advance payments.

In 1992/93 industry agreed to build the WIF to AU\$450 M to AU\$500 M by 2000.

At the grower level the WIF operated in the following manner:

- ❑ Each grower received a certificate of equity each year which indicated their contributions and share of earnings.
- ❑ The certificates were transferable but it was very difficult to redeem equity as the AWB restricted the amount that could be redeemed.
- ❑ Growers exiting the industry received full cash out.

## **Industry Strategic Planning**

After the WMA of 1989 partially deregulated wheat marketing in Australia, the Grains Council of Australia (GCA) recognized that further deregulation would occur and initiated a strategic planning process (Grains 2000) in 1989 to determine an optimal course of action. A study by Booze, Allen, and Hamilton was commissioned by the GCA in 1995 to examine the Australian situation. This report **concluded that the AWB was not sustainable if further deregulation occurred because the AWB could not compete with multinational grain companies because it was too small and not vertically integrated.** The report also recommended that the **AWB be corporatized** to give it the financial focus necessary for long term success.

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<sup>27</sup> Bielik M, "Organizational Change in the Australian Grain Industry: A Cooperative Life Cycle Approach", Unpublished MS Thesis, Department of Agribusiness and Agricultural Economics, University of Manitoba, October 2004.

At a series of meetings with growers, the GCA identified the following key objectives for transforming the AWB:<sup>28</sup>

- ❑ Retain single export desk
- ❑ Growers must have control and/or ownership and be able to access their equity.
- ❑ Provide an adequate capital base to maintain the advance payment system.
- ❑ Have a commercial structure which maximizes grower returns, provides flexibility and reflects market signals.
- ❑ Allows for industry self determination and provides certainty and efficiency in structural arrangements.

Working with consultants, the GCA determined that the new structure would also have to be acceptable to international capital markets because of AWB's large borrowing needs, have favorable tax implications, take into account AWB's need to establish a credit rating after the government guarantee on borrowings ended, and provide an acceptable return on investment. There was a lot of discussion about whether grower voting rights should be on the 1 grower 1 vote basis or be based on business volume. One of the agricultural cooperative models examined by the consultants was the newly corporatized Saskatchewan Wheat Pool (SWP).

Although consideration had been given to only allowing growers to contribute equity via a revolving WIF capital base; this was considered unworkable. Grower investment would be ill liquid because of the length of time required for fund revolvment. This model would also limit AWB's ability to access and manage capital. The issues with capital would reduce AWB's credit rating and reduce the level of advance payments it could make.

**The three organizational structures that were evaluated were: capital trust, ordinary equity model, and dual class share model.** In a capital trust model, the WIF would guarantee borrowing of AWB subsidiaries that perform AWB's functions. The control of capital would be separated from the control of operations. The equity model consisted of a single class of fully transferable shares with ownership and control rights. The WIF would be converted into ordinary shares. Restrictions on share ownership by non-growers could be used to maintain grower control. In the dual class share model, one class of shares is issued to growers. These shares have nominal value and are ineligible for dividends but carry voting rights to elect the majority of board directors. The other class of shares formed from the conversion of the WIF, have limited voting rights, elect a minority of board directors and are eligible to receive dividends. The performance of each model against grower and other objectives is shown in the Table 3.2 below.

The consultants viewed the dual class share model as being the preferred option. The State affiliates of the GCA, however, had difficulty in agreeing on an option. For example, Western Australia with larger farms did not want 1 grower 1 share. A compromise was reached in which voting rights partially reflect individual grower business volumes.

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<sup>28</sup> The information in this section is from Bielik M, "Organizational Change in the Australian Grain Industry: A Cooperative Life Cycle Approach", Unpublished MS Thesis, Department of Agribusiness and Agricultural Economics, University of Manitoba, October 2004.

**Table 3.2 Evaluation of Selected Structures for AWB Transformation**

<b>Evaluation Matrix for Organizational Structures for AWB Transformation</b>			
	Capital Trust Model	Ordinary Equity Model	Dual Class Share Model
Retain single desk	Yes	Yes	Yes
Maintain grower control	Yes	No Restriction on ownership by non-growers would reduce liquidity	Yes
Adequate capital base	No	Yes	Yes
Maximize grower return & provide market signals & flexibility	Yes	Yes	Yes
Allow industry self determination	Yes	No	Yes
Favorable reception by capital markets	No	Yes	More favorably than capital trust
Other	Burdensome structure		

### **Corporatization of the AWB**

The legislative process began in 1997 and ended with AWB's privatization on July 1, 1999 when the government guarantee of borrowing ceased. **Privatization separated AWB's commercial and regulatory functions.** The regulatory functions were transferred to the Wheat Export Authority (WEA), which legally is a continuation of the former Australian Wheat Board. The legislation granted the single desk export rights of bulk wheat to AWB International a wholly owned subsidiary of AWB Ltd. The commercial functions of the former Australian Wheat Board were transferred to AWB Ltd, a grower owned and controlled corporation.<sup>29</sup>

The share structure of AWB Ltd is as follows:

- ❑ Class A shareholders: one share for each of the approximately 37,000 growers. The shares have variable voting rights based on deliveries. The "A" shares are non-transferable and are not eligible for dividends etc.
- ❑ Class B shareholders: shares were issued to growers on the basis of equity in the Wheat Industry Fund. The shares which are traded on the ASX are subject to a 10% cap on individual or entity ownership.

<sup>29</sup> This section is based on material from 1) AWB, 2) Bielik M, "Organizational Change in the Australian Grain Industry: A Cooperative Life Cycle Approach", Unpublished MS Thesis, Department of Agribusiness and Agricultural Economics, University of Manitoba, October 2004. 3) AWB, "AWB Harvest Finance – National Pool Options for 2004-05" and 4) AWB, Investor Presentation, November 2004.

Control remains in the hands of growers because the 12 member Board of Directors has seven directors elected from the Class A shareholders (the growers), two elected by “B” shareholders, two additional outside directors and the Managing Director of AWB. Some other governance restrictions also exist to maintain grower control. Class B shares have minority voting rights because without some degree of control over the company and the risk capital they provide, the shares would be severely discounted by the market. AWB Ltd and subsidiaries operate under laws governing corporations while the WEA operates under the WMA 1989. When AWB Ltd publicly listed Class B shares on ASX on August 1, 2001 it issued AU\$ 100 M of new equity to increase share liquidity and raise capital.

There is a hierarchy of objectives with the maximization of net pool returns to growers being more important than the maximization of shareholder value. The corporate constitutions of AWB Ltd and AWBI both stipulate that activity is to maximize net pool returns to growers. AWBI’s constitution also requires the net pool returns are distributed to growers. Regarding the B shares, “directors may have regard to providing Class B with a reasonable return and that future capital may need to be raised”.<sup>30</sup>

The vision, mission and business objectives of the corporatized AWB are shown below.

<b>AWB’s Vision, Mission and Business Objective</b>	
Vision	To be Australia’s leading agribusiness
Mission	To be both the primary producers’ and end-use consumers’ business partner of choice
Business Objective	Maximize value for primary producers, customers, and shareholders

Source: AWB

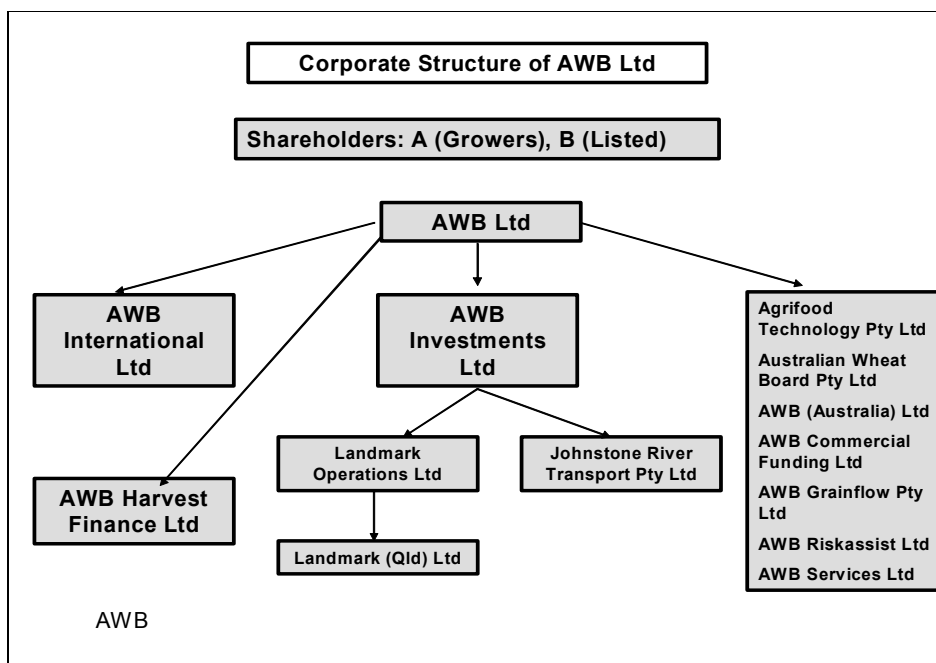
The corporate structure of AWB Ltd is shown below.

- ❑ **AWB (International) Ltd** – manages the export single desk through international wheat marketing and pooling services;
- ❑ **AWB Harvest Finance Ltd** – provides financial services such as underwriting and advance payments to growers;
- ❑ **AWB Investments Ltd** which has investments in Landmark and Johnson River Transport;
- ❑ **a diverse set of companies** that trade domestic wheat and other grains, and perform other commercial services. AWB Ltd provides commercial and business services to its subsidiaries.

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<sup>30</sup> Bielik M, “Organizational Change in the Australian Grain Industry: A Cooperative Life Cycle Approach”, Unpublished MS Thesis, Department of Agribusiness and Agricultural Economics, University of Manitoba, October 2004.

**Figure 3.4 Overview of AWB Corporate Structure**



AWB has **six business segments**: pool management, financial and risk management products and services, grain acquisition and trading, supply chain and other investments, grain technology and Landmark. The before tax profits of the business segments are shown below (the grain technology segment is now reported with the pool management services segment).

**Table 3.3 Profits Before Tax by Segment of the AWB, 2003 and 2004**

Profits Before Tax, By Segment, M of AU \$		
	2004	2003
Pool Management Services	27.5	18.9
Grain Acquisition & Trading	81	24.7
Supply Chain & Other Investments	-9.9	-20.4
Finance & Risk Management	30	36.1
Landmark	72.6	3.6

Source: AWB, Investor Presentation, December 2004

**Pool Management Services** “primarily involves the aggregation, management and global marketing and distribution of Australian export wheat.” AWBI has no assets or employees and contracts with AWB Ltd for 77 services. AWBI compensates AWBL using a base fee and a performance incentive.<sup>31</sup> The pool management costs are shown below in Table 3.4.

<sup>31</sup> AWBI pays AWBL a base fee (1.5% of gross pool value) of between \$45M and \$60 M and a performance incentive paid for pool returns greater than the Wheat Industry Benchmark plus hurdle. The total management fee is capped at 3% of the gross pool value. The Wheat Industry Benchmark consists of three components: \$US Wheat Price Benchmark (85%), Foreign Exchange Benchmark (10%) and a Supply Chain Benchmark (5%). The hurdle rate was set at \$5/tonne supposedly to reflect Australia’s price premium. (Accenture, “Appendix: 2002 Submission to the Wheat Export Authority”, 2002.) This arrangement has now changed for the 04-05 pool following the 2004 WMA Review. The base fee has been removed from concept of pool value and is set to reflect the costs & risks of running the pool. A

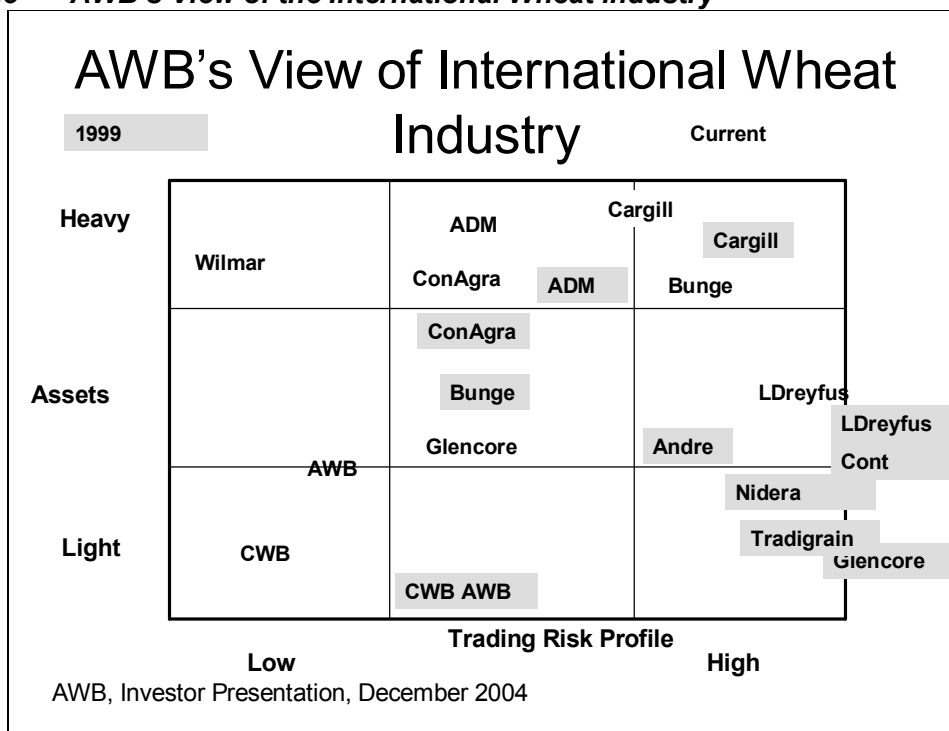
**Table 3.4 Pool Management Costs of the AWB**

Pool Management Services M of AU \$						
	Sept 30 2003 - Sept 30 2004			Sept 30 2002 - Sept 30 2003		
	2002/03	2003/04	Total	2001/02	2002/03	Total
	Pool	Pool		Pool	Pool	
Base Fee	4.6	57.2	61.8	6.0	41.8	47.8
Out Performance	4.1	29.4	33.5	14.0	15.3	29.3
Administration Costs		-62.6	-62.6		-53.8	-53.8
Profit Before Tax	8.7	24.0	32.7	20.0	3.3	23.3

Source: AWB, Investor Presentation, December 2004

The **Grain Acquisition and Trading** component, “consists of trading, as principal, of grains and grain related trading flow.” In 2003-04, AWB traded 3.2 M tonnes of wheat and 0.953 M tonnes of other grains domestically. AWB has a trading operation in Geneva that trades non-Australian grain (2 M tonnes in 2003-04). A chartering business is also part of this business segment. In 2003-04, AWB had 16% of world wheat exports, 1.3% of world oilseed exports, and 1.4% of world corn exports. The players in the world wheat industry have changed strategies over the last five years as shown in Figure 3.5. According to AWB this has allowed it to adopt a “global niche market position.”

**Figure 3.5 AWB’s View of the International Wheat Industry**



fixed base fee of \$A65.1m has been negotiated between the respective Boards for 04-05. The out performance incentives (20% of OPI) have been separated into 2 tiers, the first set between the Wheat Industry Benchmark and Hurdle is capped at 0.375% of pool value, the second is capped at 1.125% of pool value.

The **Finance and Risk Management** component provides finance and risk management products to growers and end-users (see Table 3.5). AWB charges interest and underwriting fees on financial products. In the pre-corporatized AWB, it had the advantage of being backed by the Government through the various underwriting schemes and was able to obtain funds at preferred rates and charged growers on a cost recovery basis. Banks and other grain companies such as ABB Grain Ltd and CBH also offer financial products.

**Table 3.5 AWB's Finance and Risk Management Products, 2004**

<b>AWB's Finance and Risk Management Products</b>	
<i>Category</i>	<i>Products Offered</i>
Harvest Finance (\$1.5 B Book)	Harvest Loan, Flexible Drawdown Loan, Advanced Payment, Deferred Payment
Lending (\$1.1 B Book)	Term Loans, Seasonal Finance, Line of Credit, Fastrak Finance
Deposits (\$303 M Book)	Call Investment Account, Rural Cheque Account, Rural Card, Term Deposit
Insurance (\$120 M Book)	General Insurance, Crop Insurance, Stud Livestock Insurance, Transit Insurance
Net Access (2,800 Clients)	Landmark Finance Online Plus, Transfer Funds, Views Statements, Pay Bills
Wealth Management (New Business)	Financial Advice, Master Trust Platform, Investment Products

Source: AWB, Investor Presentation, December 2004

The Australian wheat grower can receive their money from AWBI in five ways. AWB National Loan Distributions are periodic payments made to growers as the National Pool sells wheat and receive payment for it. If the producer chooses to take only the National Loan Distribution they receive those payments when and as pool equity is available. The distributions are not underwritten and the timing of the payments and the amount of payment is uncertain. The grower may also chose from two types of loans and two types of deferred payments.

The loans are non-recourse, meaning that if the distributions from the National Pool are insufficient to pay off the loan growers are not required to make up the difference. The product options are:

- ❑ Harvest Loan: A loan, based on 90% of the Nominated Estimated Pool Return less estimated costs, provides growers with the majority of their cash flow at harvest. Repayment occurs automatically from AWB National Pool Distributions (plus GST).
- ❑ Advanced Payment: A grower receives 80% of the Nominated EPR less estimated costs as a non recourse payment at harvest. Two more payments may be made (in May and at pool finalization).
- ❑ Deferred Payment: In July, a grower receives 90% of the July EPR less estimated costs. The final payment is made when the national pool is finalized.
- ❑ Flexible Drawdown Loan: A line of credit with total available credit based on 90% of the Nominated EPR less estimated costs. Repayment occurs as distributions of the National Pool are made. This is a non-recourse loan.

The **Supply Chain and Other Investments** component consists of AWB's handling facilities (1.8 M tonnes in 2003-04), the Melbourne Port Terminal which is a joint venture with Australian Bulk Alliance (ABA), and various overseas investments. The supply chain and investment

segment built a storage and handling facility in Victoria in 1999. AWB entered the handling business in order to increase competition and cost efficiency and gain a strategic share of production. AWB's entry into this area created tension with bulk handlers, especially in WA. Using a different strategy, AWB and CBH announced a Joint Venture (JV) to unify logistics in WA in December 2003 but this has not been implemented. AWB does have a JV logistics venture (EGL Pty Ltd established in 2004) with GrainCorp on the East Coast to handle export logistics. AWB unsuccessfully attempted to merge with GrainCo but that company was subsequently acquired by GrainCorp in 2003. AWB also attempted to acquire the assets of Australia's largest miller but the Australian Competition and Consumer Commission did not allow the deal to go through and again GrainCorp became ultimately the majority owner with Cargill. This AWB Ltd's business segment is also responsible for off-shore investments which include a 30% share in Egypt's largest private mill, interests in Vietnamese and Chinese mills, and a JV with Japan's largest cooperative.

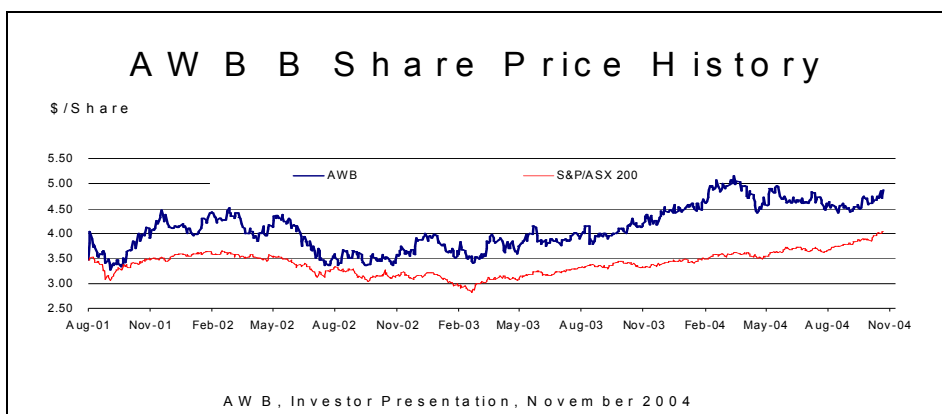
The **grain technology** segment is responsible for establishing receival standards in the country and approving and classifying new wheat varieties. AWB has a JV with Syngenta to develop new varieties as well having a wholly owned subsidiary that commercializes new varieties.

The **Landmark** component "provides customers with rural merchandise, fertilizer, livestock, wool, agronomy, insurance, real estate and financial services." In 2003 AWB Ltd purchased Wesfarmers' Landmark Ltd, the largest supplier of agricultural inputs in Australia, for AU\$825 M. The largest contributors to Landmark's gross profit in 2003-04 were fertilizer/merchandise, livestock, finance, and real estate.

In November 2004:

- ❑ AWBL's market capitalization was \$1.6 B
- ❑ AWBL had 342 M shares (B)
- ❑ Shareholder equity was \$1B
- ❑ There were 26,161 Class A shareholders and 64,383 Class B shareholders. Institutional investors held 25.89% of Class B shares. Growers represented 73.2% of retail shareholders.
- ❑ The following share price history

**Figure 3.6 AWB "B" Share Price History**



The history of dividends for AWB is shown in Table 3.6, and AWB's financial history is shown in Table 3.7.

**Table 3.6 AWB Ltd's Dividend History**

<b>AWB Ltd's Dividend History</b>					
<b>Payment Date</b>	<b>Record Date</b>	<b>Financial Year</b>	<b>Type</b>	<b>Amount per share</b>	
17-Dec-04	03-Dec-04	2003-04	Final	11 cents	
02-Jul-04	18-Jun-04	2003-04	Interim	14 cents	
19-Dec-03	05-Dec-03	2002-03	Final	11 cents	
04-Jul-03	23-Jun-03	2002-03	Interim	14 cents	
20-Dec-02	06-Dec-02	2001-02	Final	11 cents	
05-Jul-02	24-Jun-02	2001-02	Interim	14 cents	
04-Jan-02	14-Dec-01	2000-01	Final	8 cents	
04-Jul-01		2000-01	Interim	14 cents	
14-Dec-00		1999-00	Final	22 cents	

Source: AWB

**Table 3.7 AWB Ltd's Financial History, 2000 to 2004**

	<b>AWB's Five Year Financial History</b>				
	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
<b>(\$A million)</b>					
Revenue from ordinary activities	5,344.6	2,211.9	2,319.6	1,956.8	1,758.7
Cost of sales	-4,612.1	-1,889.2	-1,926.3	-1,608.1	-1,474.6
Depreciation and amortization	-83.3	-29.9	-14.5	-8.0	-5.6
Borrowing costs	-113.9	-70.5	-98.6	-95.9	-89.9
Other	-388.2	-163.4	-127.0	-122.2	-90.1
Operating profit before tax	<b>147.1</b>	<b>58.9</b>	<b>153.2</b>	<b>122.6</b>	<b>98.5</b>
Income tax expense		-14.7	-45.4	-38.4	-34.8
Operating profit after tax		44.2	107.8	84.2	63.7
Outside equity interests		-0.3	-0.6	-0.5	-0.4

Source: AWB

## **WEA**

The **role of the Wheat Export Authority**, established under the WMA, is to **control wheat exports and to monitor the performance of AWB International** in exporting wheat and examine and report on the benefits accruing to growers from AWBI's performance. With respect to wheat exports, the WEA can issue export permits for wheat exports in containers or bags; however the WEA must obtain permission from AWBI to issue an export permit for bulk wheat (AWB has veto power on other entities being able to export wheat in bulk). The WEA is accountable to the Parliament and the Grains Council of Australia.<sup>32</sup>

The WEA **monitors the performance of AWBI** in the following areas:

- ❑ Wheat export arrangements: AWBI export rights, AWBI role in export consent arrangements, niche and complementary market facilitation, impact on National Pool returns and non AWBI exporter compliance
- ❑ Pooling operations: market characteristics and customer analysis, pool management and pool returns
- ❑ Pricing performance: gross sales revenue, price discrimination, pricing, commodity hedging, and foreign exchange
- ❑ Supply chain: port costs, storage and handling, and freight
- ❑ Operating environment: corporate governance, service agreements, delivery and cost
- ❑ Grower Services, products and benefits: grower perceptions and satisfaction

## **Durum Wheat**

The export of durum wheat falls under the WMA 1989. Prior to the 1990's, durum was grown for domestic use. When exportable surpluses emerged in the 1990's at first AWB issued permits for its bulk export by private traders. In 1996/97 the AWB established a pool for durum. Durum wheat is now marketed in the following ways:<sup>33</sup>

- ❑ Contract between grower and domestic user
- ❑ Producer cooperatives that organize domestic or export sales
- ❑ AWB Ltd via pool or cash sale
- ❑ Private traders

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<sup>32</sup> "Issues Paper for the National Competition Policy Review of the Wheat Marketing Act of 1989", May 2000.

<sup>33</sup> Irving M, J Arney, and B Lindner, "National Competition Policy Review of the Wheat Marketing Act 1989", 2000.

### **3.3 Recent Reviews of Wheat Marketing and Associated Changes**

#### **2000 Wheat Marketing Review**

**The WMA 1989 was reviewed in 2000 under the National Competition Policy.** Under the terms of reference the independent review panel was to assess the appropriate regulations for the export of wheat taking into account: the public benefits test and alternative approaches; sustainable development, welfare and equity, occupational health and safety; economic and regional development; consumer interests, competitiveness of Australian business, and efficient resource allocation; and compliance costs and administrative burdens for small business.<sup>34</sup> Characteristics of the Australian wheat industry and implications associated with change highlighted by the review are noted in Annex IV.

**The committee examined alternatives to the WMA 1989.** It was determined that full repeal of single desk selling authority would provide growers with greater choice, have a greater emphasis on cash sales for growers, increase competition, and possibly result in industry consolidation. Even without its single desk, it was thought likely that AWBI would remain the dominant player in the export market because of customer and grower loyalty.

The committee examined five modifications of the WMA 1989. These modifications were (with high level assessment noted after each modification):

- ❑ Increasing competition in export market by issuing or auctioning export licenses.
  - The auction was considered to not be cost efficient because of administration and compliance costs
- ❑ Increasing competition in export markets by allowing multiple exporters for specialty wheat
  - Would work for durum; however because of distinguishability problems would not work for noodle and soft wheat
- ❑ Increasing competition in export markets by allowing multiple exporters for non-premium markets
  - Would increase competition
  - Because AWB would be able to offer a higher price (cross subsidization from premium markets), competitors would have to find cost savings to compete
- ❑ Increasing competition in export markets by auctioning off single desk
  - Auction not cost efficient because of associated administration and compliance costs
- ❑ Changing domestic arrangements
  - Look at contestability of service AWB's service arrangements in 2004 review

The committee noted that there were **some major obstacles that would have to be overcome prior to instituting competitive marketing.** The following issues would have to be addressed:

- ❑ Improvements in communication technology (mobile access, high speed internet) available to growers
- ❑ Grower access to education on risk management and financing
- ❑ A system to ensure Australia continues to produce and market high quality wheat
- ❑ Demonstration and communication of the benefits of deregulation to Australia

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<sup>34</sup> This section is based on material from 1) Irving M, J Arney, and B Lindner, "National Competition Policy Review of the Wheat Marketing Act 1989", 2000 and 2) Bielik M, "Organizational Change in the Australian Grain Industry: A Cooperative Life Cycle Approach", Unpublished MS Thesis, Department of Agribusiness and Agricultural Economics, University of Manitoba, October 2004.

- Industry and government planning process to manage a smooth transition

**The Committee made the following recommendations:**

1. **Amend the WMA so that the objectives of the legislation are clearly stated.** This would provide future reviews a common reference point. Because the act is silent on its objectives, the Committee used the following objective in its work: *“for the Australian Government to use its control of wheat exports to ensure direct grower access to marketing services and export markets, and to ensure that growers receive the highest net return from sales of wheat in export markets”*.<sup>35</sup>
2. **Amend the WMA to ensure that the Wheat Export Authority carries out its functions completely independently from AWBI** and recommends that the process for administering non-AWBI wheat exports be simplified and WEA board members be chosen with business skills such as management, marketing, and finance.

The WMA 1989 affects competition directly in two ways. It restricts the entry of firms by allowing one firm an export monopoly and it restricts grower choice, discriminating against growers who do not wish to export through the single desk. The WMA grants a monopoly to a private firm. The government and growers should consider some of the implications of this such as WTO. The committee observed that the service agreements between AWBL and AWBI should be clarified in order to ensure consistency with the WMA.

3. The WEA should test a **simplified export control process** for a three year period. Under the simplified process the WEA would issue annual licenses for a fixed fee to exporters who can meet criteria such as integrity, competency, financial standing, and commitment to providing required information. There would be penalties for non-compliance and an appeal process for rejected or withdrawn licenses.

The current process gives AWBI more control over exports than intended. One way to remedy this would be to modify or remove the requirement for the WEA to consult with AWBI prior to approving exports in containers or bag or to obtain written consent prior to approving bulk exports. This option would, however, require changes to the WMA. The recommended option, simplifying the export control process, can be implemented immediately.

4. The **2004 review should incorporate the NCP principles** into its assessment and that the process to be used for the 2004 Review is clarified and communicated within 90 days after the government responding to the 2000 review recommendations.
5. The government should establish a **joint industry-government forum** funded by government and industry and without regulatory power to discuss policy issues and processes such as performance indicators for the 2004 review.
6. **Retain the export single desk until the 2004 review of AWBI’s operation of the single desk by the WEA.** The objective of this review should be changed in order to examine the public benefit of the single desk for a final time. This approach would allow further information about single desk price premiums and the ability of AWBI to reduce supply chain costs for growers. If no public benefit is found, then the single desk should be discontinued. If a net

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<sup>35</sup> Irving M, J Arney, and B Lindner, “National Competition Policy Review of the Wheat Marketing Act 1989”, 2000.

public benefit is found, then the single desk should continue with regular reviews by WEA and perhaps a NCP review in 2010.

*“Regarding the public benefits test, the Committee was not presented with, nor could it find, clear, credible, and unambiguous evidence that the current arrangements for the marketing of export wheat are of net benefit to the Australian community. As the NCP guidelines place the burden of proving that the current system delivers demonstrable net benefits to the Australian community on those arguing for the retention of the legislation, this suggests that the WMA should now be modified, or repealed.”<sup>36</sup>*

Estimating the impact of deregulation on net returns is complex and involves uncertainty. Conflicting evidence was received about AWBI’s single desk price premium. Evidence that single desk exports inhibited innovation in marketing (niche markets, specialty wheat, etc) was convincing. Conflicting evidence was also heard regarding the impact of the single desk on supply chain costs. AWBI’s evidence that its scale and scope gave it negotiating power with service providers thus lowering costs was directly contradicted by service firms and by evidence from other countries. *“On balance, the Committee came to the view that the introduction of more competition into export wheat marketing in the future would more likely deliver net benefits to growers and to the wider community than continuation of the current arrangements without modification.”<sup>37</sup>* Continuing the single desk with some modifications would provide more evidence about the impact of the newly privatized AWB on supply chain costs, price premiums, and marketing innovation. Because of the recognition of the complexity of single desk analysis and the limited time period between the privatization of AWB and the review, the Committee concluded that it would be premature to recommend the appeal of the WMA at this time.

7. Amend the WMA so that the **WEA does not have to consult with AWBI about applications for bag and containerized wheat exports** except for markets where the transport cost differential between bag, container, and bulk movement is small. This would allow for the three year trial of a simplified process for non-AWBI wheat exports.

Continuous marketing innovation and market development is necessary for long term success. Multiple sellers may be able to service small, niche market better than a single large seller. Opening up exports in bag or containers to markets with a high freight rate difference between bulk and container or bag shipments would stimulate innovation without reducing the protection offered to AWBI.

8. Amend the WMA so that the **WEA does not have to obtain written approval from AWBI before allowing exporters to export bulk durum and so that AWBI does not have to purchase all the durum offered it.** This would allow for a three year trial of more competitive durum exports.

Durum is distinguishable from wheat and has a different end use which eliminates separability issues. There was also no evidence that AWBI obtained price premiums for durum. Consequently, changes in durum exporting should occur. However, separability problems with noodle wheat and soft wheat preclude changes at this time. Many stakeholders suggested that other exporters should be allowed into non-core markets. However, it may be difficult to

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<sup>36</sup> Irving M, J Arney, and B Lindner, “National Competition Policy Review of the Wheat Marketing Act 1989”, 2000.

<sup>37</sup> Irving M, J Arney, and B Lindner, “National Competition Policy Review of the Wheat Marketing Act 1989”, 2000.

identify non-core markets and it would be difficult to ensure that exports to non-core markets were not diverted to core markets.

**The federal government retained the single desk for export wheat and declined to have the 2004 Review comply with NCP principles.** The rationale used for the government's decisions was to avoid further uncertainty about the future of single desk exporting and to not interfere or harm AWB's IPO. Political reasons appear to be the primary reasons for the government's behaviour. The review coincided with a Federal election where rural seats were important. The government did, however, improve the WEA's export approval system.

### **2003 Senate Inquiry**

In 2003, the Federal Senate launched an inquiry into the WEA's ability to monitor AWB's single desk activities and its effectiveness as a regulator. A broad range of concerns were raised, most of them beyond the scope of the inquiry. Significant concerns that were raised about the AWB included:<sup>38</sup>

- Conflicts between grower and shareholder interests
- AWB's unfair advantage in storage, handling, and other activities because of AWB's control over the export supply chain.
- Lack of transparency and accountability to growers

The government agreed to strengthen the powers of the WEA but again refused to have the 2004 review use NCP principles.

### **2004 Wheat Marketing Review**

The **2004 Wheat Marketing Review** conducted by the NCC has just been completed. The scope, which explicitly excluded a review of single desk exporting, was as follows:<sup>39</sup>

- Review AWB International's performance as the commercial manager of the export single desk
- Review the operation of the export consent arrangements
- Review the performance of the Wheat Export Authority in monitoring and reporting AWBI's performance and controlling non-AWBI exports.

### **AWBI's Performance**

The review found many positive aspects such as improvements to corporate governance, implementation of a sound risk management system, development of key performance indicators and the Wheat Industry Benchmark, increasing the amount of transparency and communication, and maintaining grower returns.

Suggestions for improvements were as follows:

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<sup>38</sup> Bielik M, "Organizational Change in the Australian Grain Industry: A Cooperative Life Cycle Approach", Unpublished MS Thesis, Department of Agribusiness and Agricultural Economics, University of Manitoba, October 2004.

<sup>39</sup> This section is based on information from "2004 Wheat Marketing Review – Report to Growers", October 2004.

- Increase AWBI's independence from AWBL both corporately and operationally through the following:
  - Appoint an independent board chair and a majority of independent directors and establish its own board committees
  - Have its own staff to manage the national pool (sourced from AWBL) and create incentives to align their performance with the objective of maximizing pool returns
  - Make the manager of the national pool only accountable to the board of AWBI
  - Develop quality assurance processes for the management of the national pool
  - Develop criteria to determine the appropriateness of service providers for the national pool

AWBI's performance in the management of the national pool is measured by the Wheat Industry Benchmarks and WEA's performance monitoring framework. The Wheat Industry Benchmarks should be reviewed to ensure they are measuring and aligning AWBL's performance with the objective of maximizing grower benefits. The WEA should enhance the performance framework in the areas of grower relations, innovation, financial management, process and risk management, market development and customer relationships.

Remuneration to AWBL should provide it with the incentive to maximize net pool returns. The base fee has not been unfair to growers. However, the model should be changed to include costs. Penalty provisions need to be refined and then utilized.

Supply chain costs for the national pool have been falling because of AWBL's actions in implementing logistic systems, obtaining favourable freight rates and using least cost paths. *"AWBI should continue to control the negotiation of storage, handling and freight for the National Pool and retain an "at silo" model, to maintain Australian wheat quality and decision-making control right along the supply chain. AWBI should develop strategies to improve supply chain transparency – e.g. classifying supply chain information according to sensitivity and allowing greater access to industry members, as appropriate, to test contestability of supply chain services."*<sup>40</sup> A move to the port, according to the review panel, might prove costly to AWBI if it involves the loss of quality and negotiating power.

Other areas requiring improvement were risk management, information sharing and communication.

### Export Consent Arrangements

The review did not find evidence that AWBI's veto over bulk exports resulted in the loss of viable commercial sales that would have benefited producer returns. WEA and AWBI should still consult on bulk exports but should provide greater transparency by making public the approval criteria and providing feedback for unsuccessful applications.

The export consent system, in its current form, is unlikely to maximize grower returns and provide an environment appropriate for the development of markets. The panel suggested a longer term consent system that would issue export consents for bags and containers for 12 months (non-niche markets, volume limits) and 24 months (niche markets, no volume limits). This would provide non-AWBI exporters with greater certainty, timeliness and incentive. The new system would be trialed for three years. The system would include mechanisms to safeguard pool returns. Improvements would be made with respect to the application process, consultation arrangements, business rule, compliance, and fee structure.

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<sup>40</sup> "2004 Wheat Marketing Review – Report to Growers", October 2004.

### **3.4 Changes in Barley Marketing in Australia**

The Australian Barley Board (ABB) was established under the National Security Act in 1939 to coordinate the acquisition and marketing of all barley produced in Australia. In 1942 the ABB's jurisdiction changed to only Victoria and South Australia when the federal government transferred responsibility to these States. The State acts gave it the sole authority to acquire barley.<sup>41</sup> It ultimately has ended as ABB Grain Ltd with export powers only in barley from South Australia.

New South Wales established statutory marketing entities for barley, sorghum, oats and oilseeds (canola, safflower, sunflower, linseed and soybeans) in 1927 under the Marketing of Primary Products Act. Under the legislation, a majority of growers had to support the establishment of a marketing board for a crop. The Act was replaced in 1983 with the Marketing of Primary Products Act 1983. In the late 1980's when the marketing boards for oats and oilseeds became insolvent, new legislation was enacted, NSW Grains Marketing Act 1991. The 1991 legislation created a single entity, NSW Grains Board, to handle marketing for all the listed commodities. The NSW Grains Board had single desk marketing powers in the domestic and export markets for barley, sorghum, oats, canola, safflower, sunflower, linseed, and soybeans. It became insolvent in 2000 and was acquired by Grainco.

In 1975 the Grain Marketing Act gave the Grain Pool of Western Australia single desk selling rights in the domestic and export markets for barley, lupins, and canola. The act mandated an elected board of directors. The Grain Pool originated in 1922 as the Wheat Pool. It acted as an agent of the AWB during WWII. The organization took over the marketing and administration functions of the Western Australian Barley Marketing Board in 1952. In 1962 it became known as the Grain Pool of Western Australia and in 2002 after merging with CBH trades as GPPL.

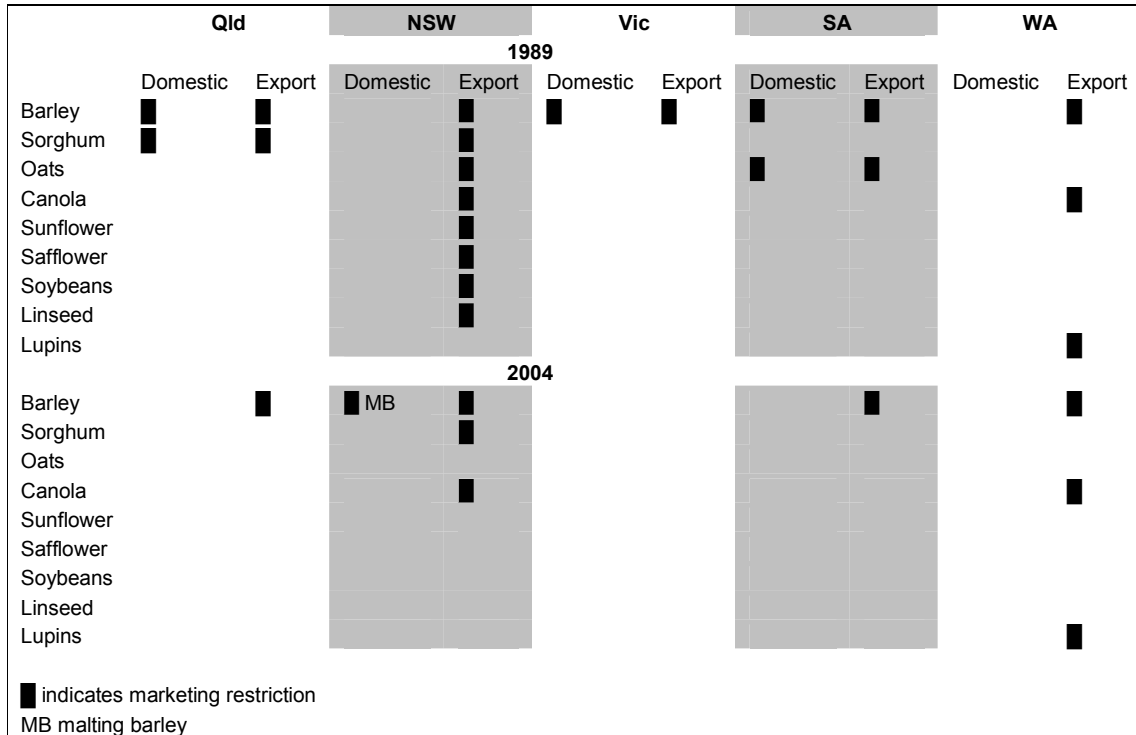
Queensland established the Barley Marketing Board Queensland (BMBQ) in 1930. During WWII it acted as an agent for the Australian Barley Board. From 1942 to 1991 the BMBQ was the compulsory buyer of barley in Queensland. In 1991 it became part of Grainco Australia Ltd that in 2003 was acquired by GrainCorp Ltd.

Figure 3.7 provides a snapshot of changes in marketing arrangements for non-wheat crops that have occurred since 1989. The marketing of non-wheat crops like barley and canola is controlled by the States. In 1989 Queensland had restrictions on domestic and export marketing of barley and sorghum. NSW had restrictions on the export of eight commodities. Victoria had marketing restrictions in the domestic and export marketing of barley. South Australia restricted the domestic and export marketing of barley and oats while WA had export marketing restrictions for barley, canola, and lupins. By December 2004, Queensland and Victoria had completely removed their marketing restrictions. NSW currently has restrictions on domestic sales of malting barley and on exports of barley, sorghum and canola, but these will end October 1, 2005. South Australia still retains a restriction on barley exports and this single desk authority is entrusted to the ABB. West Australia retains a marketing restriction on barley, canola, and lupins and is entrusted to the GWPA.

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<sup>41</sup> This section is based on information from 1) Kronos, "A Review of Structural Issues in the Australian Grain Market", September 2002 2) Government of New South Wales, "Review of the NSW Grain Marketing Act 1991, Final Report", July 1999 3) Grain Pool of Western Australia 4) National Competition Council, "NCC Occasional Series: A Review of the NCP Grain Market Reforms", 2004 and 5) NCP Wheat Review 2000.

**Figure 3.7 Changes in Marketing Restrictions**



Source: Kronos, National Competition Council 2004, NCP Wheat Review 2000

Grainco Australia was formed in **Queensland** 1991 through the merger of a number of marketing authorities and obtained single desk responsibilities for barley and sorghum along with the provision of Queensland’s storage and handling services. The domestic markets were deregulated and export barley was deregulated in 2002. (sorghum deregulated prior to 2002).

The State of **Victoria** ended the barley export monopoly of ABB in 2001 and ABB’s domestic monopoly in 1999. Oats was completely deregulated in SA in 1999. ABB’s export monopoly for bulk barley in SA was extended indefinitely even though a review under the National Competition Principles found it did not extract price premiums for barley exports.

The Government of South Australia faced a \$2.9 M penalty for not complying with its NCP obligations. The **Grain Pool of Western Australia (GPWA)** was established in 1923 with responsibility for the sole exporting of feed grains since 1952. In 1975 the GPWA received exclusive export power over exports of barley, lupins, and canola. In 2001, Western Australia began the process of privatizing the GPWA. In 2001, GPWA and ABB established a joint venture, Grain Australia. Grain Australia is the single export face for ABB and GPWA (barley from WA and SA). The GPWA merged with the Co-operative Bulk Handling (CBH) in 2002 and trades as GPPL.

Table 3.8 summarizes the regulatory changes that have been made by states regarding non-wheat marketing since 1989.

**Table 3.8 Summary of Regulatory Changes Applicable to Barley**

<b>Grain Legislation by State</b>				
State	Legislation	Restrictions	Reviews	Reforms
Qld	Grain Industry (Restructuring) Act 1993	Monopoly to Grainco for domestic and export marketing of barley	1997 review recommended removing domestic monopoly and extending export monopoly until at least mid-2002	Legislation amended accordingly Export monopoly sunsetted June 30, 2002
NSW	Grain Marketing Act 1991	Monopoly to NSW Grains Board over domestic and export marketing of barley, sorghum, oats, canola, safflower, sunflowers, linseed and soybeans	1999 review recommended removing domestic restrictions for malting barley by Aug 31, 2001 and for all other grains by Aug 31, 2000, removing export restrictions for canola by Aug 31, 2001 and for sorghum, oats, safflowers, linseed and soybeans by Aug 31, 2000, and retaining export restrictions for barley exports for markets where have market power or access premiums	In 2000 announced restrictions retained until 2005 for domestic malting barley, export barley, sorghum and canola
Vic	Barley Marketing Act 1993	Monopoly to ABB for domestic and export of barley	1998 review recommended removing domestic monopoly, retain export monopoly for a short transition period, and restructure ABB as private grower-owned company	1999 amendments removed domestic monopoly July 1, 1999, removed export monopoly July 1, 2001, and privatized ABB
SA	Barley Marketing Act 1993	Monopoly to ABB for domestic and export of barley	1998 review – same recommendations as in Vic Gov't removed sunseting of export monopoly 2003 review recommended controlled deregulation using a licensing authority	1999 deregulated domestic barley market, single desk for exports retained
WA	Grain Marketing Act 1975	Monopoly to GPWA for export marketing of barley, canola and lupins	2002 review recommended establishing a licensing authority for bulk grain exports and allowing unrestricted export of grain in bags and containers	Grain Marketing Act 2002 establishes a bulk grain licensing authority (for exports) which expires when Commonwealth removes restrictions on wheat marketing

Source: National Competition Council, "NCC Occasional Series: A Review of the NCP Grain Market Reforms", 2004.

Significant events in barley marketing are shown in the following chart. These events are discussed in the remainder of this section and in the next section of this report.

<b>Overview of Significant Events in Barley Marketing</b>	
1997	Review of barley marketing in Victoria and South Australia
1999	Corporatization of ABB
2002	Review of marketing in West Australia
2002	Review of barley marketing in South Australia
2004	Report of WA's Grain Licensing Authority

### **Corporatization of ABB**

The governments of Victoria and South Australia decided that the ABB would be corporatized and established a working group to examine options in 1998.<sup>42</sup> The working group had representatives from ABB, grower organizations, the two state governments and consultants. A dual class structure model similar to AWB's new structure was chosen because it was

<sup>42</sup> This section is based on information from 1) ABB (various annual reports and merger information) and Bielik M, "Organizational Change in the Australian Grain Industry: A Cooperative Life Cycle Approach", and 2) Unpublished MS Thesis, Department of Agribusiness and Agricultural Economics, University of Manitoba, October 2004.

viewed as being able to “unlock the value embedded in the organization and attribute it to individuals, while at the same time ensuring that growers would retain control of the new company.” (Day)<sup>43</sup>

The Australian Barley Board was transformed into a private grower owned corporation, ABB Grain Ltd, in 1999. ABB Grain Ltd is responsible for domestic and export grain trading, quality control, financial services, and logistics. ABB Grain Export Ltd, a wholly owned subsidiary has the single desk rights for exporting bulk barley from South Australia which operationally is conducted by ABB Grain Ltd.

There is a service agreement between ABB Grain and ABB Grain Export. The objective of ABB Grain Export is to maximize the net export pool returns to growers. ABB Grain’s strategy is to expand its activities along the east coast of Australia in order to grow its business and decrease its risk exposure from crop failure.

ABB Grain Ltd has the following **dual class share structure**:

- Class A Shareholders: one share for each active barley grower. The “A” shares are non-transferable and are not eligible to dividends etc.
- Class B shareholders: shares were issued to growers (15,000). The shares which are traded on the ASX have very few voting rights. Their ownership is subject to a 15% cap.

Each grower has one Class A share which gives the right to one vote for each 25 tonnes of grain delivered. The Class B shares were created from the AU\$35 M in ABB reserves and distributed to growers on the basis of their average individual deliveries from 1995-99 to 1998-99. When these shares were listed on the ASX in 2002, another AU\$22 M equity was raised. Grower control is maintained via seats at the board table. Class A shareholders elect 5 directors (as per merger agreement) while Class B shareholders elect 2 directors. The Managing Director and an external director complete the nine member board. Following the merger with Ausbulk in 2004, an interim Board of 12 (still a majority of A Class Directors) was appointed from the two companies. By 2006, the Board will revert to 9 with 5 A Class, 3 B Class Directors and an MD.

ABB had three business segments prior to the merger with AusBulk: grain marketing (which includes management of the export pool), finance and risk management products, and other business such as grain containerization and cleaning business and a fertilizer business. The financial performance of ABB is shown below.

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<sup>43</sup> Bielik M, “Organizational Change in the Australian Grain Industry: A Cooperative Life Cycle Approach”, Unpublished MS Thesis, Department of Agribusiness and Agricultural Economics, University of Manitoba, October 2004. thesis

**Table 3.8 ABB's Financial Performance, 2001 to 2004**

<b>ABB's Financial Performance (Prior to Merger)</b>				
	2001	2002	2003	2004 - 6 months
Grain Volumes				
For Pools, M tonnes	3	3	0.7	3.4
Grain Trading	0.7	1	1	1.9
	000 \$ (AU)			
Revenue	233,107	296,430	433,091	433,413
Grain Marketing	216,456	282,677	424,261	421,702
Finance & Other Products	16,609	13,606	6,550	11,623
Other	42	147	2,280	88
EBITDA	34,100	31,964	26,191	24,522
Net Profit After Tax	33,500	14,423	15,038	12,439
Earnings/Share	94	38	32	26

Source: ABB & AusBulk Merger Information

In September 2004, ABB, AusBulk and United Grower Holding Ltd (holder of majority of shares of AusBulk) merged to create one of Australia's largest agribusinesses with a market capitalization of about AU\$ 850 M. The merger combines the agricultural commodity marketing and logistics capability of ABB with the grain storage, handling and processing businesses of AusBulk. The new ABB has the capacity to store 10 M tonnes of grain and to produce 400,000 tonnes of malt annually. The ABB - AusBulk merger means that ABB Grain Ltd is the major storage & handler (by far) in South Australia, and also through ABA has receival and storage sites in Victoria, New South Wales and a share in the Port of Melbourne terminal.

ABB operates in all grain growing regions of Australia and New Zealand. Its operations involve accumulation and logistics. In 2003-04 ABB accumulated 5.6 M tonnes of grain of which 4 M tonnes was barley. ABB Grain expanded into the trading of other grains like domestic wheat. In 2003 it purchased Jossco, a grain trading company that is active in the domestic market, exports peas and sorghum and trade grain from other countries. Jossco has a significant presence in New Zealand.

ABB is Australia's largest supplier of malting barley for the domestic market and together with Grain Australia accounts for about 50% of global malting barley trade. ABB Grain uses the services of bulk handlers as well as negotiates logistics and offers chartering services for exports. It has a very minor investment in a flour and feed mill in Egypt and has a share in Grain Trust. Grain Trust was established in 2000 by members of the grain industry to commercialize new varieties.

ABB offers growers a variety of pricing options for barley, wheat, canola, lentils, etc. These options include basis pools, multi-grade contracts, forward contracts, pools, cash, and trigger prices.

ABB's involvement along the supply chain prior to its 2004 merger is summarized below.

**Table 3.9 ABB in the Supply Chain**

<b>ABB Grain's Supply Chain Activities (prior to 2004 merger with AusBulk)</b> <b>Vision: Shaping the Global Future of Australia's Agribusiness through our unique grain relationships</b>			
Seed	Producer	Handling & Storage	Logistics
Share of Grain Trust	Underwrites pool payments	Via merger with AusBulk	Export chartering service
Marketing	Domestic Value Added	Off-Shore Value Added/Investment	
Single export desk in SA Export marketing alliance, Grain Australia, with CBH's Grain Pool Trades barley & wheat domestically Exports other grain (Jossco)		Jossco in NZ Investment in feed and flour mill in Egypt	

### **3.5 Recent Reviews of Barley Marketing and Associated Changes**

#### **1997 Barley Marketing Review in Victoria and South Australia**

In 1997 the government of Victoria and South Australia held a joint NCP review of barley marketing. Barley marketing in both states and oats in South Australia were controlled under the Barley Marketing Act 1993. Both States had almost identical acts. The objectives of the Australian Barley Board were as follows:<sup>44</sup>

- To supply effective and efficient marketing service to growers of barley in Victoria and SA, oats in SA and other grains as prescribed.
- To maximize net returns to these growers delivering to an ABB pool by minimizing costs where practicable and by developing and maintaining markets.

ABB had the right to compulsory acquisition – barley couldn't be sold or delivered to anyone other than the ABB and it could not be transported after it was sold or delivered in contravention of the act. Exemptions included barley (and oats in SA) used on the grower's farm; barley purchased from ABB; barley sold under a permit by ABB; and barley not meeting ABB's standards. No one could purchase barley (or oats) from a grower unless ABB had issued a permit. Although interstate deliveries by growers were not exempt from regulations, ABB did not enforce its compulsory acquisition authority under this circumstance. The Act restricted where barley could be stored before it was considered to have been delivered to ABB. Once the barley was delivered to an authorized receiver (VicGrain and CBH) it was deemed to have been acquired by ABB.

<sup>44</sup> The information in this section is based on 1) CIE, "Review of the Victorian and South Australian Barley Market Act 1993", 1997 and 2) Joint Industry Submission Group, "Australian Wheat: It's Time for Choice", A Submission to the Independent Review Committee Reviewing the WMA 1989 under NCP", 2000.

**Compulsory acquisition is different in theory from vesting.** A marketing agency with vesting power theoretically has the crop after it germinates and growers could be required to deliver it directly after harvest. In practice, however, there is little difference between vesting and compulsory acquisition. It is compulsory acquisition power that provides ABB with its single desk export powers. Although it is difficult for States to directly prohibit exports under the Australian Constitution, the compulsory acquisition power gives it the exclusive right to export barley produced in Victoria and SA.

The ABB did not have complete control over the domestic barley market. It was required to issue permits within 21 days to any one wishing to buy barley for feed use in Australia. ABB was allowed to charge an application fee. Since 1994, no fees were charged and only very large buyers sought a permit. Domestic maltsters could apply to ABB for a permit to purchase malting barley directly from growers if they had entered into a deed of arrangement with ABB. ABB would have to issue a license within 21 days for a reasonable fee. However the condition of the deed of arrangement was used to limit the amount of barley that could be purchased directly from growers. The ABB would provide a payment service to growers and then be reimbursed by the maltster. These arrangements provided market information to ABB regarding the domestic market for malting barley. The ABB was also required to sell all barley that met its standards as well as being required to ensure maltsters in Victoria and SA received the amount of malting barley they required.

**ABB also determined the receival standards** for barley delivered to it. ABB also had the power to require anyone to provide information about barley or barley products and it had the right of search and seizure to ensure the Act was complied with. ABB also had the right to engage in activities that some commentators alleged were contrary to the Hilmer principle of competitive neutrality (no activities that create a competitive advantage in a regulated market) such as making deductions from pool funds to defray marketing costs in the domestic market in competition with others.<sup>45</sup>

The Centre for International Economics (CIE) analysis of the affect of restricting competition through the ABB used the following guidelines:

- Restricting competition may provide the community with net benefits if anyone of the following occurs:
  - An industry has enough market power to influence world prices to its advantage
  - Growers face unreasonable buying or selling power which can only be countered by interventions allowing the growers to collude
  - Economies of scale in marketing can only be achieved through government intervention
- If any of the above conditions exist then the following two conditions must also be met:
  - The cost of restricting competition is demonstrated to be less than the benefit from a community or national perspective
  - Only legislated restrictions on competition are able to achieve the net benefits.

An empirical model used in the CIE study of the ABB's export monopoly in barley found that under the assumption of perfect information the single desk would increase average net returns for feed barley by \$2.50/tonne and for malting barley by \$2.75/tonne. The price premium increased domestic grain prices which resulted in a cost of \$4.1 M for feed barley and \$1.5 M for malting barley. When the assumption of perfect information was dropped, it was estimated

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<sup>45</sup> CIE, "Review of the Victorian and South Australian Barley Market Act 1993", 1997.

that the ABB had only a 15% chance of achieving a price premium for malting barley and a 3% chance for feed barley. The estimated cost of the single desk rose in this case.

CIE's model also showed that every \$5/tonne increase in the price of domestic feed barley caused by ABB cost hog and grain feed cattle \$10 M per year. These results were consistent with submissions made by feed users that argued the ABB's export single desk imposed costs on them. Identified costs included poor liquidity in the domestic market and ABB's ability to raise domestic prices above international prices when supply is low (imports are not allowed). The distribution of feed was argued to be poor because of the existence of statutory marketing, bulk handling and transport authorities.

The CIE concluded that ABB has been able to use market power in the domestic market to obtain premiums for feed and malting barley but has not been able to use market power in the export market. The premium for Australian feed barley in the UAE occurs because of lower freight and quality characteristics. The premium for Australian feed barley in Japan occurs because of Japan's trade and food security policy.

CIE also examined the arguments that ABB was required to provide countervailing power against central buying agencies or the use of export subsidies by other exporters and that restricting competition was necessary to provide ABB with economies of scale in marketing. CIE did not find evidence supporting these arguments for single desk selling.

The report concluded that restricting competition imposes costs on the Australian community and on some growers (entrepreneurs) and that there is no net benefit to the community from ABB's market power in the domestic market. The premiums obtained in the UAE and Japan for feed barley could be obtained using other marketing arrangements.

The review examined oat marketing in SA and concluded that the restrictions on competition in the marketing of oats did not impose significant costs or benefits and are not necessary for environmental purposes in the Eyre Peninsula. Growers in the Eyre Peninsula could form a cooperative to market their oats.

The review made the following **recommendations**:

- Deregulate the domestic malting and feed barley market
- Retain the export single desk for barley for only a short transition period
- Restructure ABB as a corporation

Both Victoria and South Australia deregulated the domestic barley market in 1999. Both states were to remove ABB's export monopoly in 2001. Victoria carried out the deregulation. The government of South Australia extended the single desk export powers for ABB indefinitely in 2000 but agreed that it would review the situation after two years under the NCP.

### **WA's 2002 Marketing Review**

Western Australia's Grain Marketing Act 1975 established the Grain Pool of WA to market certain grains. The objectives of the GPWA are to maximize net returns to growers and to provide growers with marketing options by participating in export and domestic markets. Its functions are as follows:<sup>46</sup>

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<sup>46</sup> The information in this section is based on Department of Agriculture, WA, "The Need for Changes to Grain Marketing Legislation in Western Australia – a Discussion Paper for Public Consultation", April 2002.

- ❑ Control marketing of prescribed grain that is to be exported
- ❑ Promote and sell domestically and off-shore grain delivered to it
- ❑ Consult and reach agreements with licensed receivers and carriers
- ❑ Determine receival standards
- ❑ Facilitate or participate in value added processes and the development and commercialization of grain varieties

At the time of its 2002 review, numerous changes had occurred in Australia's grain industry and indications that change would continue were evident. The GPWA wanted to corporatize and merge with CBH. The scope of the review covered the need to retain GPWA's single desk powers, which grains should be covered by a single desk; means to encourage the development of value added processing; and the maintenance of grain quality. There was a significant amount of concern that in a deregulated Western Australia grain market the AWB would capture a significant share of GPWA's business. This concern would vanish if both AWB and GPWA lost their single desk powers at the same time. Although deregulation in WA was not viewed to be in the best interests of WA's grain industry it was believed that the creation of a flexible transitional framework would allow both grain companies and growers to adjust to ongoing change. The framework would have to separate the regulatory and commercial operations of the single desk in order to comply with NCP principles. The Government of Western Australia proposed the following model for grain marketing in WA:

- ❑ New Act would create Grain Licensing Authority (GLA),
- ❑ Grain Licensing Authority would initially grant GPWA a single desk export license for prescribed grain,
- ❑ GPWA would restructure as a grower owned company,
- ❑ Prescribed grains would be barley, lupins, and canola,
- ❑ The GLA would issue licenses for value added processed grain,
- ❑ The GLA would issue special export licenses in extraordinary circumstances, and
- ❑ There would be no restrictions on bag or container exports.

This approach to grain marketing was viewed as;

- ❑ providing appropriate control by the government;
- ❑ having an independent body to approve exports;
- ❑ separating the regulatory and marketing functions of the single desk (as per NCP);
- ❑ maintaining single desk for bulk exports; and
- ❑ allowing GPWA to restructure, merge etc.

It was viewed as having a positive impact on value added processing because domestic prices were artificially high under the current marketing arrangements. The GLA would have the authority to issue downstream value added processed licenses for bulk grain.<sup>47</sup> The GLA would be able to issue export licenses for bulk grain in extraordinary circumstances.

Extraordinary circumstances would include the following situations:

- ❑ Single desk license holder is not interested in a unique marketing opportunity because it has no impact on the single desk, and
- ❑ Emergencies such as natural disasters or war.

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<sup>47</sup> Value added processed grain is defined as "barley that has been malted, steamed and rolled, pearled and flaked, milled into flour or incorporated into a compound feed mix or feed product; lupins that have been de-hulled, steamed and rolled and flaked, milled into flour, or incorporated into a compound feed mix or feed product; and canola that has been crushed, converted into oil or meal, or incorporated into a compound feed mix or feed product."

The government recognized that grower education and market information would have to accompany the changes in marketing arrangements. The costs could be recouped using an industry levy.

## **2002 Barley Marketing Review in South Australia**

**The State Government of South Australia initiated a review of export barley marketing in 2002 and the report was released in 2004.** The Barley Marketing Act 1993 gave ABB the exclusive right to export barley from South Australia except for barley not meeting standards, exports in bag or containers (less than 50 tonnes), and export of propagating material. The task of the review panel was to examine if the restrictions on barley marketing resulted in a net benefit to the community and if so determine if restricting competition is the only way to achieve the net benefits.<sup>48</sup>

One of the tasks of the panel was to update the analysis of single desk barley marketing previously done by the CIE in 1997 and Econtech in 2000.<sup>49</sup> The Econtech report (as cited in the report by Professor Pound) indicated that single desk operations generated about \$9 M in price premiums. The panel had the Econtech model and results examined by an independent expert and concluded that there was a lot of uncertainty attached to the results and that continuation of the single desk would likely result in small but uncertain net benefits. The panel also reviewed confidential data provided to it regarding price premiums concluding that price premiums likely exist in the Japanese market and some other small markets. However, the panel does not believe that the premiums occur because of the existence of single desk exporting. The premiums might occur because of ABB's marketing skills and relationships with customers. Also, other unregulated exporters are able to obtain premiums in the feed barley market in Japan and international competition will lessen these premiums over time. ABB's operations do benefit growers in terms of finance, risk management and insurance.

Based on these facts, *"The Panel is prepared to accept, at least in some ordinal measure, that benefits exist from the single desk. But it is not prepared to accept assertions that these net public benefits could not be achieved in any other way."* The Panel accepted that some form of deregulation was necessary. Full deregulation was not viewed as being desirable because it would be "socially costly and divisive" and "difficult to sell" to growers and grower organizations. A more socially efficient solution was determined to be reliance on emerging market forces. The panel recommended that *"ABB's single desk for barley exports should be deregulated, so that it is exposed to a greater degree of market forces. This deregulatory reform should proceed by means of a streamlined process in which ABB retains its single desk, but is opened to competitive challenge through a contestability process."*

The panel examined three options for change:

- retaining single desk for feed barley exports to Japan only;
- allowing growers to choose who to deal with (opt in/opt out); and
- making the market contestable (Western Australia approach).

The option of retaining the single desk only for Japan was not viewed favorably by industry. The industry believed that equity issues would arise because not all barley could be sold to the

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<sup>48</sup> The information contained in this section is based on 1) Professor Round, Adelaide University, "Report to Parliament on the Review of the Barley Marketing Act 1993", July 2004 and 2) AWB, "Your Single Desk: Value for Wheat Growers, Rural Communities and the Australian Economy", 2004.

<sup>49</sup> As noted elsewhere, many studies have been commissioned by different parties regarding the marketing of wheat and barley. These studies are listed in Annex VI, indicating the study sponsor, author and a brief comment on high-level findings.

high valued Japanese market. The panel did not accept that this would create an unsolvable problem. However, the panel believed that this option could prove to be commercially infeasible for ABB. The panel determined that the opt in/ opt out approach was a disguised form of deregulation that would make ABB's single desk unworkable.

The third option was to utilize the WA approach which introduces contestability in the process of buying grain for export. *"In the face of legislation supporting a single desk, unfettered potential competition for the market can be as effective as competition within the market, and with less likelihood of lasting damage being done to any net public benefits that may in fact be achievable only through a single desk"*.

The panel recommended that *"Careful consideration be given to the principles of the Western Australian Grain Marketing Act 2002 as a model to form the basis of introducing contestability into the South Australian export barley market."* In this approach, ABB would be deemed to hold the principle export license and growers would be allowed to return to ABB in subsequent seasons if they wished after selling to another company. Under a licensing authority approach potential exporters must demonstrate that they can perform as well as ABB has without causing long term damage in the market and ABB has an incentive to perform by obtaining premiums or risk losing all or part of the market. Issues that will need to be resolved about the licensing authority include the lead time, composition and operating rules, funding method, use of sunset clauses, appeal process, conditions of the license, and evidence required from ABB and potential exporters. The panel recommended that the licensing authority be composed of five members (three not associated with barley or grain industry) and that it be reviewed one year after its establishment and then at three years periods. The panel also recommended allowing non-growers to access the export pool.

ABB does not agree that the introduction of an export licensing system in South Australia would benefit growers. Econtech, on ABB's behalf, estimated that introducing such a system would reduce the net benefit of ABB's single desk by 30% and reduce the price for export barley by \$2/tonne across Australia.

AWBI also believes that using an export licensing approach for wheat exports would be detrimental to growers and be an inefficient use of resources. It also suggests that a grain licensing approach would violate Article 11 of GATT which prohibits the use of measures other than tariffs to regulate imports and exports by entities other than single desk marketers commercially importing and exporting commodities. Some argue that grain licensing authorities are not acting as marketers but exist to implement political objectives.

### **2004 Report of WA's Grain Licensing Authority**

The Grain Licensing Authority (GLA) reported to the government of WA after its first year of operation and argued that it had met the intent of the act as stated during the second reading of the Grain Marketing Act 2002.<sup>50</sup>

*"The provision for special export licenses is not intended to undermine the benefits of the single desk and the market power that it creates. The intention is that special export licenses will provide a mechanism for industry to capture opportunities outside the single-desk system while maintaining the benefits for grain growers that flow from it."*

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<sup>50</sup> The information in this section is based on Grain Licensing Authority, "Report to Minister on Operation and Effectiveness for the 2003/04 Season", June 2004.

The GLA used three key principles for determining whether special export licenses should be issued. It considers the impact of the special license on:

- the GPPL's marketing strategies and price premiums,
- on the state's reputation as a grain exporter or on the state's industry in general, and
- if it would capture opportunities outside the single desk.

More attention is paid to the first two principles. During the 2003/04 season 19 applications were received for special export licenses, of which 12 were granted. Data on the applications is shown below in Table 3.9.

**Table 3.9 GLA and Issuance of Special Export Licenses, 2003/04**

GLA and Disposition of Special Export Licenses, 2003/04							
Grain	# Applications	Successful				Unsuccessful	
		#	Region	Tonnes	Shipped	Region	Tonnes
Malting Barley	1	1	Asia	35,000	Nil		
Feed Barley	14	9	Middle East	433,000	339,791	Middle East	318,000
Canola	3	1	Subcontinent	48,000	Nil	Asia Subcontinent	40,000 45,000
Lupins	1	1	East Asia	20,000	Nil		

Source: Grain Licensing Authority

The report found that the operation of the GLA had a positive affect on the WA industry. In particular;

- Over 700 growers (10% of total) delivered for cash to holders of special export licensees. No problems with non-payment were reported.
- **Cash prices for feed barley offered to growers increased.** The GPPL's pool price for feed barley rose. A consultant's report to the GLA regarding the effect of the changes in marketing arrangements found that:
  - When barley exports in Victoria were deregulated in 2001, cash prices for feed barley in Geelong Victoria increased relative to prices in Adelaide SA and Fremantle WA and remained higher until the partial deregulation of barley exports in WA in 2003. The price differences can not be completely accounted for by differences in domestic demand and export costs. The differences in marketing arrangements are likely to have contributed to the differences. The introduction of special export licenses in WA is likely to be the major reason for the increase in feed prices in Fremantle.
- **The issuing of special export licenses had no affect on the operations of the GPPL and its pool.** The GLA issued export licenses for some markets that the GPPL considered to be core. After analysis, the GLA determined that Saudi Arabia is a residual market for feed barley and does not offer a price premium. The Pakistan market for canola was also found to be a non-premium market. The GLA did not issue licenses for markets where there could be a price premium; special license holders did not "cherry pick" markets. With respect to the volumes of grain that are core to the GPPL, analysis indicated the following volumes: feed barley 0.5 M tonnes, malting barley 0.165 M tonnes, canola 0.2 M tonnes, and lupins 0.25 M tonnes. Except in severe drought years, the amount of grain available

surpasses these amounts by a substantial margin. The volume of special license applications related to small share of production.

Applications for feed barley represented 22% of production, malting barley and lupins applications both represented 4% and canola applications represented 8%. The share of the grain actually shipped under the special export license was much smaller. Needless to say the GPPL did not agree with this assessment.

*“A second season following the same procedures as applied to the 2003/04 crop will significantly damage pool returns and destroy more value for growers than it creates. It is proposed that the single desk itself is also truly at risk if policies and procedures are not adapted prior to the issuing of licenses for the next crop. It is essential that a clause is introduced into the Ministerial Guidelines that requires the GLA to take into consideration the volume of licenses granted. Special export licenses should not be issued for quantities beyond a set percentage of the respective season’s crop and percentage of the State’s pooled barley, canola and lupins.”*

The GLA report noted that changes to the timing of the granting of special export licenses would benefit growers. If licenses could be issued prior to seeding growers would have access to pre-planting bundles of services (i.e. finance, inputs, fixed price) and it would allow growers to manage their finances better (price certainty). Another issue noted was that domestic processors’ still do not have access to the export channel to dispose of surplus grain. For example, the use of multi-grade contracts by maltsters (separate prices for malting and feed) prior to season to secure enough malting barley requires access to additional markets for feed barley.

**One of the responsibilities of the GLA is to report annually on the existence and extent of price premiums arising from the GPPL’s market power.** A consultant reported that *“The existence of premiums and their extent in specific markets varies considerably amongst analyses. Most analyses considered premiums were likely to be small, but some found larger premiums. Premiums were consistently observed into the Japanese barley market although the extent of the premium varied considerably. Premiums for other commodities, including malting barley, canola and lupins into other markets were considered to be small or non-existent.”* Premiums can also occur because of freight advantages, higher quality, and service, however, these are not due to single desk selling.

### **Review of WA’s Grain Marketing Act 2002 and the Grain Licensing Authority**

WA recently completed a review of its Grain Marketing Act and the Grain Licensing Authority. The benefits and costs of the new act and authority were estimated by RSM Bird Cameron to be \$5.8 M and \$2.9 M, respectively. The estimated net benefit to growers was \$2.9 M. Highlights of the report are as follows:<sup>51</sup>

- The issuance of special export licenses reduced volumes and increased operating and administration costs for the GPPL, the main export license holder. Almost 340,000 tonnes were sold via special export licenses. Direct costs to the GPPL from the GLA approach were estimated to be \$2.9 M. The estimated costs do not include the \$8.5 M that the GPPL estimates the approach cost in lost foreign exchange opportunities.

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<sup>51</sup> RSM Bird Cameron, “Review of the Benefits and Costs of the Operations of the Grain marketing Act 2002 and the Grain Licensing Authority”, January 2005.

- There was no evidence that indicated the issuance of special licenses reduced price premiums received by the GPPL in key markets. Price premiums from market power require a dominant supply position, few substitutes, many small volume buyers, and asymmetric information about stock levels and substitutes. A review did not find that the GPPL had any market power. The study noted that quality perceptions, customer support, supply consistency, and temporary supply reductions by competitors can also result in price premiums.
- Growers who delivered to grain traders (who exported under the special license provisions) received a cash price for barley of about \$14/tonne more than the estimated GPPL pool price. The total benefit of the higher price was \$4.8 M. Growers selling on the cash market do not have to wait to receive full payment. The value of this was estimated to be \$1.1 M.
- The GLA approach has resulted in a small increase in jobs and investment by grain trading firms in WA.
- The GLA approach is in accordance with National Competition Policy. WA received additional federal funding because of this.

### **3.6 Changes with Bulk Handlers of Grain**

As previously mentioned States established State owned bulk handling authorities to provide storage and handling authorities or allowed grower cooperatives to have monopolies. During the last 15 years these agencies have undergone significant change in terms of their structure. As of 2002 the only remaining legislative restrictions on grain handling were the Essential Services Commission in Victoria, which provides oversight to GrainCorp ports, and the Western Australia Bulk Handling Act which prevents entry into the handling sector. In 2002, 100% of up country storage and 90% of export port facilities were free of restraining legislation.<sup>52</sup> An overview of structural changes is shown below.

**Table 3.9 Changes in Bulk Handlers, 1989 to 2004**

	Qld	NSW	Vic	SA	WA
	<b>1989</b>				
Storage	Bulk Grains QLD	GHA	GEB	SACBH	CBHWA
	<b>2004</b>				
Storage	GrainCorp	GrainCorp ABA	GrainCorp ABA	ABB Grain Ltd	CBH
	AWB	AWB	AWB	AWB	
	Gov't Owned				
	Coop under Gov't Leg				
	Public Co				

Based on: Kronos, "Directory of Linkages in The Australian Grains Industry", 2004

#### **Queensland**

<sup>52</sup> This section is based on information from 1) Kronos, "A Review of Structural Issues in the Australian Grain Market", 2002 and 2) Bielik M, "Organizational Change in the Australian Grain Industry: A Cooperative Life Cycle Approach", Unpublished MS Thesis, Department of Agribusiness and Agricultural Economics, University of Manitoba, October 2004. thesis 3) GrainCorp and 4) CBH

Bulk Grains Queensland was Queensland's state owned storage company. In 1991 it was merged with Central Queensland Sorghum Board, State Wheat Board, BMBQ and two grower cooperatives. The new entity, Grainco Australia Ltd, was completely owned by growers. Grainco expanded its base of operations to include Victoria and NSW.<sup>53</sup> Grainco was acquired by GrainCorp in 2003.

AWB Ltd entered the storage and handling business in 1999 when it built a facility in Victoria. It now has facilities in Queensland, NSW, Victoria and South Australia. AWB entered the handling business in order to increase competition and cost efficiency and gain a strategic share of production.

### **New South Wales**

New South Wales established the state owned Grain Elevators Board (GEB) in 1917 to provide grain handling and storage. The authority was renamed the Grain Handling Authority of NSW (GHA) in 1981. The GHA was the first of the handling and marketing companies to privatize. In 1989, the government of NSW announced that there was no longer a reason for state involvement in bulk handling, particularly after the domestic wheat market was deregulated. The privatization was supported by growers, the GHA, and industry. In 1992, the GHA was acquired by Prime Wheat Association (PWA), a grower owned organization and renamed **GrainCorp**. Its shares were listed on the ASX in 1998.

GrainCorp's strategy has been to diversify horizontally and vertically in the supply chain. In 1995 when Victoria privatized its BHA, GrainCorp was part of a consortium purchasing the company now known as Vicgrain. The other consortium members were ABB and Victorian Grain Services, an unlisted company owned by Victorian grain growers. GrainCorp also became active in grain marketing in 1995.

In 1999, GrainCorp and Vic Grain Services merged Vicgrain and GrainCorp, with the resulting company known as GrainCorp. This was the first major consolidation in the Australian grain industry. The holding companies of GrainCorp and Vic Grain Services also merged to form Grain Growers Association (GGA) which maintains grower control of the merged holding company, GrainCorp.

In 2002, GrainCorp and Cargill jointly purchased the flour mills of Goodman Fielder which was Australia's largest miller. The enterprise, of which GrainCorp owns 60%, is known as Allied Mills. In 2003 Cargill and GrainCorp combined their grain purchasing businesses into a joint venture.

GrainCorp merged with Grainco, Queensland bulk handler in 2003. According to GrainCorp the merger allowed it to expand its geographic base and diversify its earnings. Grainco's rationale for the merger was that it was too small and undercapitalized to be an effective competitor in an increasingly competitive environment. Grainco brought to the merger its exclusive export marketing rights in NSW for sorghum, barley and canola.

Grainco, privatized in 1995, had acquired these rights from the NSWGB when it became bankrupt in 2000. GrainCorp also sells farm inputs, leases rail cars, and has a presence in the seed development and commercialization sector. GrainCorp has positioned itself as a significant competitor to AWB Ltd.

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<sup>53</sup> Kronos, "A Review of Structural Issues in the Australian Grain Market", 2002.

GrainCorp's activities through out the supply chain are summarized in the following table.

**Table 3.10 GrainCorp and the Grain Supply Chain**

<b>GrainCorp's Supply Chain Activities</b>			
<b>Vision: Diversify horizontally and vertically in the supply chain</b>			
Seed	Producer	Handling & Storage	Logistics
Development	Ag Plus sells farm inputs and finance products	350 country facilities, 9 ports, and 2 containerization facilities in NSW, Queensland and Victoria Merger with Vicgrain & Grainco	Provides rail and road transport
Marketing	Domestic Value Added	Off-Shore Value Added/Investment	
In 1995 began marketing Gained single desk export of sorghum, barley and canola in NSW from merger with Grainco	Largest miller (JV with Cargill)		

**Victoria**

The Grain Elevators Board was the state owned bulk handler. Victoria sold it to a consortium, Vicgrain, in 1995. Vicgrain was owned by GrainCorp, ABB and Victorian Grain Services, an unlisted company owned by Victorian grain growers. In 1999, GrainCorp and Vic Grain Services merged Vicgrain and GrainCorp, with the resulting company known as GrainCorp.<sup>54</sup>

**South Australia**

The SA Co-operative Bulk Handling Ltd (SACBH) was formed by the South Australian Wheat and Woolgrowers Association in 1954 to establish a grower owned and controlled grain handling and storage system in SA. The co-operative's structure was such that it couldn't issue shares or pay dividends to members. By 1999, it had AU\$320 M in assets. By the late 1990's members realized SACBH needed to diversify its geographic base and vertically integrate. Its business structure was unable to support these initiatives so SACBH examined alternative structures. The major evaluation criteria were maintain grower control; pass direct ownership to growers via shares; and ensure individual shareholders could not exert undue influence via votes.

In 2000, SACBH renamed itself **AusBulk** and corporatized using a holding company structure. The holding company, United Grower Holdings (UGH), is owned by active growers and is the controlling shareholder in AusBulk, the share corporation. Grower control is maintained

<sup>54</sup> Kronos, "A Review of Structural Issues in the Australian Grain Market", 2002.

through UGH's election of six of the eleven directors of AusBulk. The strategy of AusBulk is to become an integrated service provider in the value chain. It established a grain marketing division in 1999 which was Australia's largest independent wheat trader on the domestic market and the largest originator of pulses. It acquired two malting companies in 2002. Joe White Maltings, one of the acquired companies, was Australia's largest maltster. AusBulk is now one of the largest maltsters in the world. AusBulk's activities along the supply chain are summarized in the following table.

**Table 3.11 AusBulk and the Grain Supply Chain**

<b>AusBulk's Supply Chain Activities (prior to 2004 merger with ABB Grain)</b> <b>Vision: To become an integrated service provider in the value chain</b>			
Seed	Producer	Handling & Storage	Logistics
		Facilities in SA, NSW and Victoria JV in Melbourne Port Terminal	
Marketing	Domestic Value Added	Off-Shore Value Added/Investment	
Largest independent trader of domestic wheat Largest originator of pulses	One of world's largest maltster		

AusBulk and Grainco established the Australian Bulk Alliance (ABA) as a joint venture in 1999. ABA has ten up-country storage and handling sites in NSW and Victoria and also owns 50% of Melbourne Port Terminal. GrainCorp acquired Grainco in 2003 but on orders from the ACCC GrainCorp must sell its 50% share in ABA. Sumitomo has recently purchased GrainCorp's 50% share in ABA. ABB Grain Ltd (through its AusBulk merger) is now involved in ABA.

ABB, AusBulk and United Grower Holdings (majority shareholder of AusBulk) merged in September 2004 to create a significant Australian based agribusiness.

### **Western Australia**

The Co-operative Bulk Handling Ltd (CBH) was established in 1933 by Westralian Farmers' Cooperative and Western Australia Wheat Pool in order to develop Western Australia's storage and handling system. The CBH did not diversify its operations and in 2000 was the only BHA still only present in the storage and handling component of the supply chain. Regulations actually restricted it from marketing grain.<sup>55</sup> In 1990's the board and management knew that the cooperative was in need of major changes because of changes that were occurring in the industry. However, an attempt to transform CBH into a dual class share corporation failed in 2000 because of insufficient member support.

<sup>55</sup> Department of Agriculture, WA, "The Need for Changes to Grain Marketing Legislation in Western Australia – a Discussion Paper for Public Consultation", April 2002.

In 2001, **CBH merged with the Grain Pool of WA**, the statutory export marketer of barley, lupins, and canola. This time members voted in support of change because of their desire to strengthen the Western Australian industry and because the merger retained member control and the cooperative structure. Western Australia changed its legislation in 2002 to allow the merger.

CBH has an engineering and construction company subsidiary that is active in grain facility planning and building. In 2003, CBH and George Weston Foods created a JV lupin de-hulling plant in Western Australia. The Grain Pool has a subsidiary that trades chickpeas, oats and wheat. As the AWB Ltd diversified its operations, CBH became concerned that AWB would enter the bulk handling service in Western Australia. CBH estimated that the loss in company value that could occur under this scenario at AU\$252 M. AWB Ltd and CBH have had several negotiations concerning a joint venture in their grain logistics activities in Western Australia; however none have been successful to date.

CBH Group has signed an agreement (Nov 2004) to take a direct interest in grain processing via a \$A72 million investment in two of Asia's leading flour millers. Pacific Agrifoods, The CBH Group's joint venture with The Salim Group established in April 2004 of this year will acquire a 66.7% stake in Interflour, one of Asia's largest flour milling operations with four flour mills in Malaysia along with a plant and a grain terminal in Vietnam. As part of this transaction, The CBH Group has taken a one third interest in the Berdikari Flour Mills of Indonesia, the world's fourth largest flour miller which when combined with the Interflour assets, represents around 1.5 million tonnes of productive capacity.

CBH is also moving into South Australia (as of September 2004) and is working together with rural supplier Elders to provide marketing options to growers. Its activities along the supply chain are summarized below.

**Table 3.12 CBH and the Grain Supply Chain**

<b>CBH's Supply Chain Activities</b>			
<b>Vision: To be an innovative, commercially successful and diversified company</b>			
Seed	Producer	Handling & Storage	Logistics
	Finance and risk management options	200 country facilities, 1 consolidation center and 4 port terminals in WA	Bulkwest Logistics
Marketing	Domestic Value Added	Off-Shore Value Added/Investment	
Gained single desk export of lupins, barley and canola in WA from merger with Grain Pool of WA Grain Pool marketing of wheat, oats, and chickpeas	Lupin de-hulling JV with George Weston Construction and engineering of grain facilities Australian Grain Centre – R&D on grain quality	JV with Salim Group resulting in interest in flour mills in Malaysia, Vietnam, and Indonesia and a grain terminal in Vietnam	

### 3.7 Changes with Railways

The following table indicates the changes that have occurred in rail transportation over the last 15 years. Australia's rail network has several interesting characteristics: separation of ownership/management of above and below rail, public access rights (known as joint running rights in Canada), fragmentation by State, and the existence of three different gauges of track (3 ft. 6 in.; 4 ft. 8 1/2 in.; and 5 ft. 3 in.).

**Table 3.13 Changes with Rail Providers, 1989 to 2004**

	Qld	NSW	Vic	SA	WA
	1989				
Rail	Queensland Rail	State Rail Authority	V/Line Freight	Aust National Rail	West Rail
	2004				
Rail	QR	Pacific National	Pacific National	Aust S Rail ARG	Aust W Rail ARG
	Gov't Owned				
	Public Co				

Based on Kronos, "Directory of Linkages in The Australian Grains Industry", 2004

#### Queensland

Queensland Rail, founded in 1865, is still owned by the government of Queensland. It is funded by commercial operations and community service agreements with the state government. Queensland rail has both the above and below rights. Queensland has narrow gauge track. Traditionally, Queensland Rail's role in grain transportation was to move grain to port for export but it now also moves grain to domestic millers and feed manufacturers in Queensland. It handles all of AWB's exports from Queensland.<sup>56</sup>

#### New South Wales

The NSW rail network consists of about 8,700 km of track. Prior to 1999, the state owned company had both the above and below rights. In 1999, however, these rights were separated in a restructuring that created Freight Corp (above rail services, owned by state), Rail Access Corp (below rail, state owned), and the Public Transport Authority (passenger trains). In 2001, the Rail Infrastructure Corporation was created as a state owned company from the Rail Access Corp and the Rail Services Australia (maintainers of the network).

In 2002, the National Rail Consortium purchased Freight Corp from the NSW government and National Rail from the Commonwealth and called the organization Pacific National. It operates the interstate network and the intrastate network. The government of NSW also committed to supporting rural and regional rail via direct payments to freight operators and investment in grain branch lines. Service on grain branch lines was also guaranteed until 2005/06.

<sup>56</sup> The information in this section is drawn from Kronos, "A Review of Structural Issues in the Australian Marketplace", September 2002.

### **Victoria**

In 1999, the government of Victoria sold V/Line Freight (above rail rights) to Freight Australia (owned by Rail America). Freight Australia operates in Victoria and in parts of NSW. It contracts with trucking companies to consolidate grain and move grain from closed lines. About 70% of its total freight of 7 M tonnes is grain. Freight Australia has long term contracts with customers such as AWB. Freight Australia was sold in late 2004 to Pacific National that owned the NSW freight rail. The below rail portion of the network is owned and operated by Victorian Rail Track Corporation, a state owned corporation. Victorian Rail Track leases track infrastructure within Victoria (to Freight Australia) and interstate (some to Australian Rail Track Corp). Although there are public access rights, it is difficult to access this track. In order to improve rail efficiency, the government of Australia is spending \$96 M over five years to increase the amount of standard gauge track to 70% from its 2002 level of 27 percent.

### **South Australia**

The combination of the railways systems of South Australia, Tasmania and commonwealth created the Australian National Railway in 1975. In 1997 the Australia Southern Railway acquired the SA portion of the Australian National Railway. The Australia Southern Railway is now part of the Australia Railroad Group which operates in South Australia and Western Australia. In South Australia, the Australia Railroad Group negotiates freight rates jointly with AusBulk, AWB, and ABB. The Eyre Peninsula rail system has particular challenges facing it. Its track is in urgent need of rehabilitation, it is a separate system (i.e., it does not connect with any other rail system) servicing the grain areas and leading to Port Lincoln, and as well it has a narrow (3ft 6in) rail gauge.

### **Western Australia**

The Australia Railroad Group is owned by Wesfarmers and GWI, two WA organizations. The ARG was formed in 2000 to acquire Westrail from the WA government. The ARG operates more than 10,000 km of track. It owns WestNet Rail which has a 49 year lease on track in Western Australia.

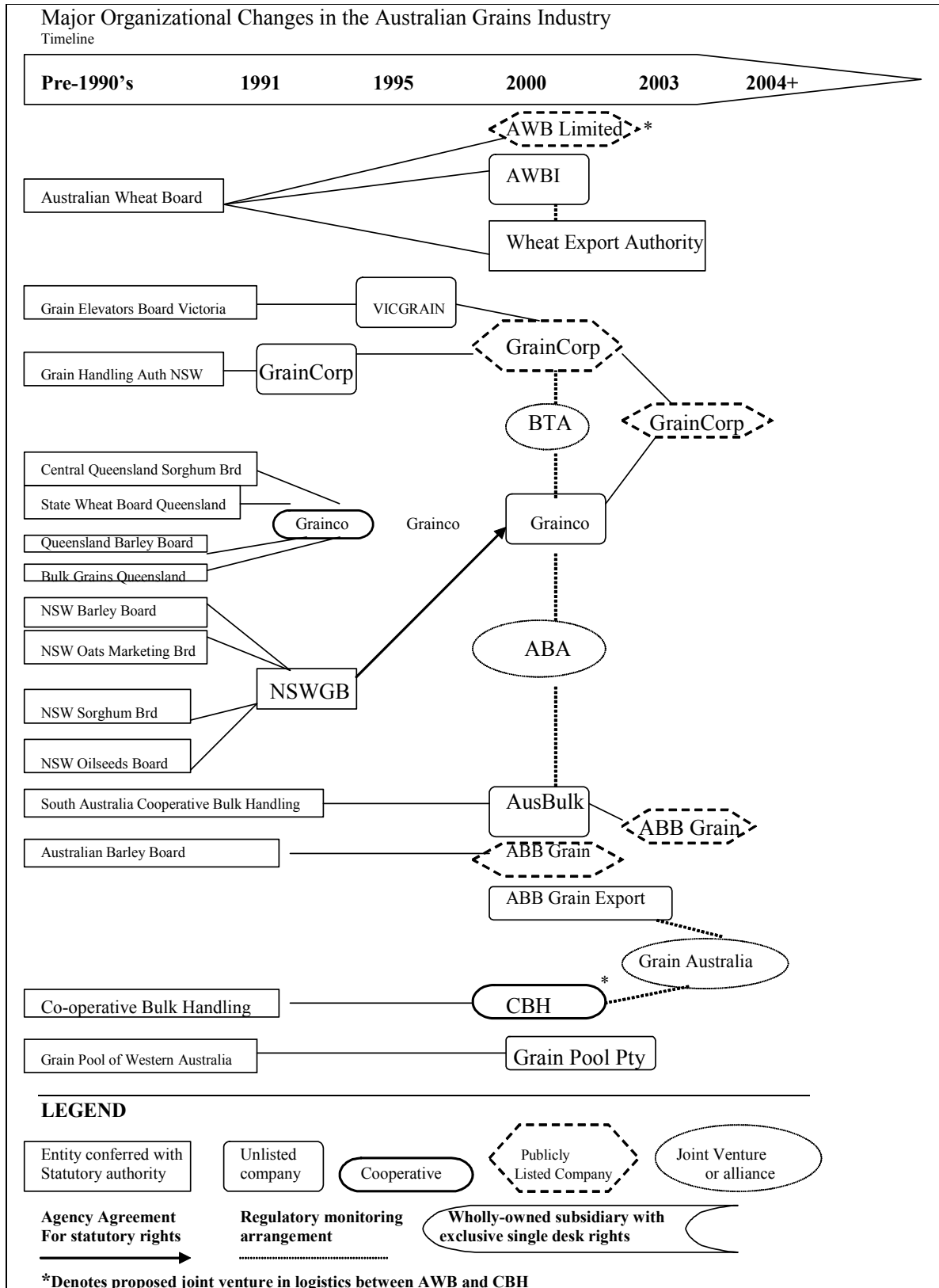
## **3.8 Changes in Industry Structure**

The major organizational changes that occurred during the last 15 years are shown below. Deregulation has transformed 15 statutory marketing and handling organizations into four private agri-businesses:

- AWB Ltd,
- GrainCorp,
- ABB Grain, and
- CBH.

In Australia, the government has granted some private companies single desk export marketing rights: AWB for wheat, GPWA for barley, lupins, and canola in Western Australia, and ABB Grain for barley in South Australia. These companies are moving beyond their traditional geographic boundaries and position in the supply chain and some are strategically positioning themselves for the removal of single desk exporting of wheat. The private companies have kept some cooperative characteristics. In particular, they have maintained grower control through board structure and voting rights. One non-cooperative characteristic of these hybrid firms is that they may allow non-growers to own shares.

**Figure 3.8 Major Organizational Changes in the Australian Grains Industry**



The changes that have occurred in marketing restrictions over the last 15 years are shown below in Table 3.13, and changes in rail and storage providers are summarized in Table 3.14.

**Table 3.13 Changes in Marketing Restrictions – Single Desk Selling**

	Qld		NSW		Vic		SA		WA	
	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export
<b>1989</b>										
Wheat	■	■	■	■	■	■	■	■	■	■
Barley	■	■			■	■	■	■		■
Sorghum	■	■								
Oats							■	■		
Canola										■
Sunflower										
Safflower										
Soybeans										
Linseed				■						
Lupins										■
<b>2004</b>										
Wheat		■		■		■		■		■
Barley		■	■ MB	■				■		■
Sorghum				■						
Oats										
Canola				■						■
Sunflower										
Safflower										
Soybeans										
Linseed										
Lupins										■

■ indicates marketing restriction  
MB malting barley

Based on: Kronos, National Competition Council 2004, NCP Wheat Review 2000

**Table 3.14 Changes in Rail and Storage Providers, 1989 to 2004**

	Qld	NSW	Vic	SA	WA
<b>1989</b>					
Rail	Queensland Rail	State Rail Authority	V/Line Freight	Aust National Rail	West Rail
Storage	Bulk Grains QLD	GHA	GEB	SACBH	CBHWA
<b>2004</b>					
Rail	QR	Pacific National	Pacific National	Aust S Rail ARG	Aust W Rail ARG
storage	GrainCorp	GrainCorp ABA	GrainCorp ABA	Ausbulk	CBH
	AWB	AWB	AWB	AWB	
Gov't Owned					
Coop under Gov't Leg					
Public Co					

Based on: Kronos, "Directory of Linkages in The Australian Grains Industry", 2004

### 3.9 Regulatory Summary

In this section a number of regulatory changes affecting wheat and barley marketing in Australia were reviewed. These changes are highlighted in the following Table.

**Table 3.15 Highlights of Regulatory Change Over the 1989 to 2004 Period**

1989-2004 Highlights			
Beginning Industry Structure	Drivers of Change	Strategic Responses	Ending Industry Structure
AWB permanent entity with single desk for domestic and export wheat Administered pricing for wheat Compulsory pooling Stabilization fund	AWB Pool Losses US & EU export subsidies Beginning of Uruguay round	Wheat Marketing Act, 1989: -deregulated domestic market -created a Wheat Industry Fund -reduced and then eliminated government guarantee of AWB borrowing -AWB allowed to engage in value added activities	Extent of Single Desk Powers: Wheat: export single desk (5 states), domestic market deregulated Structure of Single Desk: AWB controls export supply chain Separation of regulation and marketing for single desk
	AWB requires financial focus for long term success and needs to accumulate capital for value added investment	Corporatization of AWB completed in 1999, publicly listed in 2001	AWB: corporate, dual class shareholders, publicly traded Separation of Regulation and Marketing
	National Competition Policy	2000 Wheat Marketing Review	Contestability for Market:
	National Competition Policy	2004 Wheat Marketing Review	Next review of single desk powers in 2010
Queensland: export and domestic single desk for barley and sorghum	National Competition Policy	1997 review	Queensland: export and domestic markets for sorghum and domestic barley deregulated, export barley as of Sep 05
NSW: export single desk for barley, sorghum, oats, canola, sunflower, safflower, soybeans, and linseed	National Competition Policy	1999 review	NSW: until September 2005 single desk for domestic malting barley, and export barley, sorghum and canola
Victoria: domestic and export single desk for barley (ABB)	National Competition Policy	1998 review	Victoria: domestic and export barley markets deregulated
SA: domestic and export single desk for barley and oats (ABB)	National Competition Policy	1998 review	SA: export single desk for barley ABB restructured as dual share company
WA: export single desk for barley, canola and lupins (GPWA)	National Competition Policy	2002	WA: export single desk for barley, canola, and lupins Separated regulatory and marketing functions

## 4.0 Impact of the Deregulatory Thrust in the Grain Industry

In the last section the changes in the regulations and structures affecting grain marketing were highlighted. In this section of the report, the impact of the deregulatory thrust on the grain industry, particularly the marketing of wheat and barley is discussed.

### 4.1 Overall Impact

The Australian grain industry has undergone a significant transformation in the last 10 to 15 years as the following table indicates. However, not all parts of the industry have changed at the same pace. Statutory marketing arrangements have slowly become more deregulated while privatization and deregulation has occurred very quickly in the rail and bulk handling components of the supply chain, although the bulk handlers have natural geographic monopolies and high cost of entry barriers. The difference in the rate of transformation has created tension within the industry. Tension has also been created by the advantages that companies with legislated single desks have as the structure of the industry changes.<sup>57</sup>

**Table 4.1 Overview of Transformations in Australia**

Overall Transformations in Australia	Impact
Deregulation of domestic market	In 1989 for wheat, later for non-wheat commodities
Deregulation of storage and handling	Except for WA Bulk Handling Act & Oversight Leg in Vic
Restructuring of storage capacity	3.3 M tonnes of new capacity Rationalization of old capacity
Changes to grain transportation	Privatization of freight companies except for QR
Transformation to corporation and then privatization	AWB, ABB, creation of Grainco Australia Ltd, Grain Corp, AusBulk Ltd
Changes in export arrangements	Barley in Vic Oats, sunflower, safflower, soybeans, and linseed (canola, sorghum & barley from 1 Oct 2005) in NSW Oats in SA Barley (from 1 Oct 05) & sorghum in Qld
Consolidation of grower companies	From 15 to 5
Vertical integration by former Gov't entities/grower cooperatives through investment or JV's	Grainco & ConAgra create Marketlink (now owned by GrainCorp) Grain Corp & Cargill purchase flour mills AWB & Syngenta, AWB and Landmark ABB and Ausbulk form ABB Grain Ltd CBH and GPWA merge.

Many studies have been commissioned to assess the impact of change on the Australia wheat and barley industries. Some of these studies have been commissioned by the NCC under the auspices of the NCP, others by State governments, and others by industry players to advocate further change or demonstrate the benefit of the current system. As a result, the reader should be aware of the study sponsor when reviewing study findings, etc. Over 25 of these studies are listed in Annex V.

<sup>57</sup> The information in this section is drawn from Kronos, "A Review of Structural Issues in the Australian Marketplace", September 2002.

According to the Kronos report, prepared for an industry group, the current Australian industry is very inefficient, services and assets are being duplicated, and tension is high. This environment they argue is caused by the following factors:

- ❑ Although single desk sellers have been privatized there have been no major changes in their powers. About 72% of Australian grain exports are controlled by these companies.
- ❑ Most of the holders of the single desk marketing rights are corporations with an obligation to maximize shareholder returns.
- ❑ Marketing options for growers have changed very little since 1989 when the domestic wheat market was deregulated.
- ❑ Conflicts of interest and lower levels of competition are occurring as the privatized single desks move into value added activities and other investments.
- ❑ There is concern that grower returns are not being maximized because of the lack of contestability for services, and a lack of transparency and accountability on the part of the single desk to growers.
- ❑ There may be a lack of proper oversight of the exercise of single desk powers. Agencies regulating the export monopolies may not have enough independence or expertise to be effective regulators.

According to the Kronos report some single desk entities in this environment with little transparency and contestability may be earning excessive profits in the provision of services to export pools. As well, infrastructure is being rationalized in a distorted environment. Overall changes could reduce the long term viability of the Australian industry and grower net returns.

## **4.2 Impact of Deregulation on the Supply Chain**

According to a report by Accenture, prepared for the Grain Growers Association, there are distinct regional differences in the supply chain.<sup>58</sup>

- ❑ The east coast, which accounts for 42% of wheat exports on average, historically had two bulk handling companies. GrainCorp operated the NSW and Victoria facilities, which were high cost small facilities. Grainco operated the Queensland facilities, which is now part of GrainCorp. Rail deregulation, the introduction of unit trains, and the construction of new export facilities on main lines have created rapid changes. Currently, some growers are benefiting from AWB Ltd and ABA new export facilities. The facility network is being duplicated but without increasing the level of competition. The need for greater segregations and other customer needs are adding cost and complexity to bulk handling operations.
- ❑ South Australia, which accounts for about 18% of total wheat exports, has a strong export focus. There are three geographic sub-regions (Eyre and Yorke Peninsulas and Adelaide Region) which involve a large number of ports. About 40% of wheat is delivered directly to port. South Australia experienced a facility investment boom in the 1990's. AusBulk's strategic selection of locations for new facilities contributed to a 20% decrease in rail rates. ABB Grain Ltd (formerly AusBulk) faces some competition from AWB Ltd through its Grainflow upcountry facilities and from GrainCorp near the border with Victoria. ABB Grain Ltd is set to develop the Outer Harbour complex at Port Adelaide and provide deep-water port access.
- ❑ West Australia has a strong export focus. It accounts for 40% of wheat exports on average. Grower owned bulk handlers have invested in fast and efficient facilities in the country and

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<sup>58</sup> Accenture, "Appendix: 2002 Submission to the Wheat Export Authority", 2002.

port over a long period of time. Historically, a Grain Logistics Committee coordinated actions by BHC, road, rail, etc. Currently, CBH is the only bulk handler in the state. AWB may build a port facility. The merger of CBH and Grain Pool WA is expected to create supply chain efficiencies.

Kronos, in their report commissioned by grain marketers not affiliated with single desk operations, argue that the following general changes in the supply chain have occurred:<sup>59</sup>

- Loyalty Rebates: Prior to its merger with Grainco, Grain Corp, a traditional bulk handler had been relegated to the position of residual receiver in the country and at port. In an effort to compete with AWB and others, Grain Corp introduced rebates to growers delivering to their facilities. Grain Corp believes that the lack of transparency in AWB's country prices would prevent growers from seeing that it had reduced storage or handling charges.
- Storage Rationalization: Older, smaller and less efficient facilities are being closed.
- Increasing Freight Competition: Greater competition is occurring as new rail companies move outside of their traditional boundaries. Competition will increase again as long term contracts between marketers and freight companies expire.
- Branch Lines: Greater competition in storage and handling resulting from the construction of new facilities by AWB and others has shifted grain from branch lines in NSW and may accelerate line closures.
- Impact on Grain Flow Patterns: The investment in new port facilities is changing the flow of grain in south eastern Australia. Grain from NSW is being attracted to Melbourne Port terminal, the new facility in Victoria and away from facilities in Port Kembla and Geelong. Grain from south eastern SA is being attracted east to Portland. Grain from western Victoria is being sourced by AusBulk for movement west. This will increase when a new deep water port at Adelaide is built and as rail gauge is standardized in Victoria. Some parts of the industry dispute AWB's claim that it uses the least cost path to move grain from the country to an export position, arguing that AWB's actions tend to be in its corporate interest. Concerns have also been raised about the ability of single desks with grain in both their own and competitor facilities to disadvantage competitors by leaving grain in the competitor's facilities.
- Impact on Storage Charges: Analysis of storage charges for ten years after 1989 indicated that storage charges were increasing because of the need for greater segregations and a lack of competition in marketing. Storage charges are still not falling despite the construction of new capacity because the growth in capacity is not accompanied by greater competition. Traditional bulk handlers cannot compete with the new facilities being built by AWB and ABA because they have no synergy from freight savings or marketing gains to use to attract grain. They are attempting to replace revenue by increasing charges.

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<sup>59</sup> Kronos, "A Review of Structural Issues in the Australian Marketplace", September 2002.

### **4.3 Impact of AWB on the Supply Chain and Deregulation in Wheat**

In the late 1990's government officials knew reform could result in rationalization of the former State marketing and handling authorities and that AWB's export monopoly would give it an unfair advantage over other players. The former BHAs were particularly critical arguing that AWB's export monopoly was indeed providing it with an unfair advantage because of its control over the export supply chain for wheat. The AWB has statutory authority to set grain receival standards, negotiate freight, and capture blending revenues. The AWB is simultaneously the BHA's largest single customer and a competitor in storage, handling and finance activities. In 2003, GrainCorp and Aus Bulk publicly questioned the AWB's role in the export supply chain arguing that **moving AWB to a FOB position would increase competition and reduce supply chain costs**. CBH has offered similar views.<sup>60</sup>

Many groups have examined the impact of changes in AWB's structure and operations and how they have affected the supply chain for grain in Australia. Kronos in their report for the private grain trade raised the following issues:

- Grain Flows: According to a recent review of export grain handling in Victoria, "*AWB does have a potential capacity to influence transport patterns by using its market power derived from its single desk seller status to obtain favourable rail rates for its terminals relative to other handlers' terminals*".<sup>61</sup> AWB is offering very favorable pool deductions at some of its new sites. Although AWB claims the lower deductions arise from efficiency and lower logistics costs, experts argue that freight deductions have been artificially lowered by the AWB. Freight rates at older sites not owned by AWB have increased as traditional bulk handlers with no marketing operations can not reduce rates via negotiation. Grain flows are changing as a result which is concerning if it is occurring because of artificial rather than market incentives.
- AWB Freight Contracts: Because of the volume involved AWB negotiates more favourable freight rates than other companies. The contracts provide a fixed rate for a given volume and a lower rate for subsequent volumes. AWB can return these savings to growers in the national pool or retain them. It appears that the pool pays the higher rate and that AWB's cash sales pay the lower rate. This practice also provides AWB an unfair advantage against other players in the cash market.

According to the Joint Industry Group, the **single desk in wheat has "fossilized" the grain handling and transportation system**. Current problems in the system include:

- Too many inland silos – modern trucks can move grain efficiently 150 Km. If the system had evolved more grain would have been picked up on the farm and moved to large strategically located receiving centers with high intake and outturn rates. Then large trains with quick turnaround times would take the grain to port. However in the current reality there are too many local depots that are inefficient.

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<sup>60</sup> This section is based on information from 1) Bielik M, "Organizational Change in the Australian Grain Industry: A Cooperative Life Cycle Approach", Unpublished MS Thesis, Department of Agribusiness and Agricultural Economics, University of Manitoba, October 2004, 2) Kronos, "A Review of Structural Issues in the Australian Marketplace", September 2002, 3) Joint Industry Submission Group, "Australian Wheat: It's Time for Choice", A Submission to the Independent Review Committee Reviewing the WMA 1989 under NCP", 2000, 4) Accenture, "Appendix: 2002 Submission to the Wheat Export Authority", 2002 and 5) AWB, "Your Single Desk: Value for Wheat Growers, Rural Communities and the Australian Economy", 2004.

<sup>61</sup> Kronos, ESC Review of Export Grain Handling, 2002. Note however that AWB only has a half share in one small terminal at the Port of Melbourne

- ❑ Inefficient rail transportation - Moving grain by rail is inefficient because of low traffic density, poor cycle times, excessive rolling stock, and poor industrial relations. There is no incentive to make investments to improve these issues.
- ❑ Inefficient port terminals – Inefficiency occurs because of excess capacity (poor planning of shipments) and poor industrial relations. There is also no incentive for investment in efficient port terminals.

A 1995 study (Booze, Allen et al) found that Australian growers paid at least US\$5/tonne more for grain handling and transportation than U.S. growers. Another study found that grain flows in the current system deviated significantly from least cost grain paths. The Joint Industry Group argues that changes to the pricing practice and increasing transparency could save \$12.5 M to \$23 M annually.

The fossilization of the grain handling and transportation system, it is argued, occurs because the AWB (and ABB etc) control the export supply chain which inhibits competition, investment and innovation. For example, AWB and bulk handlers negotiate fees for handling grain with the AWB being dissatisfied with high charges and the handlers dissatisfied with AWB's behaviour which precludes new investment or competition.

Other reasons for a higher cost system are that many of the bulk handlers have a conflict of interest between maximizing returns to shareholders and returns to growers just as the AWB has and that many charges are pooled so growers do not have an incentive to deliver to a more efficient facility. In 2000, typical supply chain costs, as shown below, averaged \$45 to \$55 per tonne. These costs represent up to one-third of gross pool returns to growers. Research by grain handlers indicates that allowing competing supply chains would reduce costs by \$5 to \$15 per tonne. This would increase revenue by \$120 M to \$360 M and average farm business profit by 27%.

**Table 4.2 Supply Chain Costs for Wheat, 2000 - Joint Industry Submission**

<b>Charge</b>	<b>\$/tonne</b>	<b>Comments</b>
Local truck	5 to 10	Varies greatly
Receival	6 to 8	Vicgrain's higher at \$7.70 to \$11.70/tonne
Storage	3 to 8	Based on fee of \$1/t. for 3 months. Shrink could add \$1/t.
Freight	21 to 28	Varies greatly
Fobbing	7 to 13	
<b>Total</b>	<b>45 to 55</b>	

Source: Joint Industry Submission Group, "Australian Wheat: It's Time for Choice", A Submission to the Independent Review Committee Reviewing the WMA 1989 under NCP", 2000

Cost savings, according to the Joint Industry Group, could be found in the following areas:

- ❑ Accurately forecasting of supply programs and shipping programs
- ❑ Providing monetary incentives for growers to use on-farm storage
- ❑ Reducing the number of local receival points
- ❑ Improving coordination between bulk handlers and railways
- ❑ Building state of the art facilities
- ❑ Rationalizing entire supply chain in the long run

Average export supply chain costs for wheat growers are shown in Table 4.3 and reflect the supply chains previously described.

**Table 4.3 Average Export Supply Chain Costs for Wheat Growers by Region, 2002**

Region	Storage & Handling	Transport & Distribution	FOB & Port	Average
East Coast	\$15/tonne	\$22/tonne	\$8/tonne PCD=-\$.40/tonne	\$45/tonne with range from \$35 to \$60/tonne
SA	\$11/tonne	\$6/tonne	\$7/tonne PCD = \$4.50/tonne	\$29/tonne with range from \$22* to \$40/tonne
WA	\$10/tonne	\$12/tonne	\$7/tonne PCD= -\$2.30/tonne	\$27/tonne with range from \$15* to \$40/tonne
PCD= Port Cost Differentials reflect ship selection and scheduling constraints and added loading costs that arise in some ports * indicates direct delivery to port				

Source: Joint Industry Submission Group, "Australian Wheat: It's Time for Choice", A Submission to the Independent Review Committee Reviewing the WMA 1989 under NCP", 2000

Furthermore, a report by Accenture prepared for the Grain Growers Association, argues that changes in four areas could benefit wheat growers by \$6/tonne immediately. Table 4.4 shows what Accenture proposed to increase supply chain efficiency.

**Table 4.4 Proposed Increases in Supply Chain Efficiency**

<b>Accenture's Supply Chain Solutions</b>		
<i>Supply Chain Efficiency</i>	<i>Issues:</i> Conflicts and misalignments along the supply chain Non-transparent charges limiting investment	<i>Recommendations:</i> Make changes to allow more effective and efficient, management of storage and handling networks, Encourage more competitive investment in these networks, These changes would create \$60M annually in efficiency benefits for wheat and \$91 M for all grains

The Accenture report argues that one of the current issues with respect to the supply chain is that AWBL's supply chain is becoming more misaligned and more conflicted. For example, the report notes that AWB's directive operational control of its export supply chain prevents storage and handling companies from optimizing their operations. Barriers created by vertical contractual relationships prevent horizontal coordination between supply chain components. AWB's directives such as Stock Transport Orders (used to direct wheat movements) can increase freight and labour costs and AWB's control over binning strategies can result in lost capacity.

Although efficiencies in rail freight can create significant cost savings, it is difficult to capitalize on such opportunities because of the lack of transparency in grower freight costs, misalignments at rail – handling interfaces which only AWB is allowed to correct, and conflicts of interest between AWB's responsibility for the export supply chain and the operation of facilities it owns.

Another area of concern in the supply chain is AWB Ltd can discourage others from making investments by using non-transparent charges. AWB Ltd can change grain flows to benefit its facilities using these charges. The non-transparent charges also prevent other bulk handlers from capturing a return on investment in fast rail loading facilities and at the port non-transparent Port Cost Differentials can impact investment decisions.

Not surprisingly the AWB does not share the view that it has a negative impact on the supply chain. The AWB points out that for wheat, total supply chain costs (in 2002-03 dollars) which comprise bulk handling and storage costs, rail freight and port charges have fallen by \$1.89 AU per tonne from 1999-2000 to 2002-03, about a 4% reduction in total supply chain costs. A study by Hoffman and Matthews commissioned by the AWB argues that the single desk offers the best option to reduce costs in a supply chain dominated by entrenched monopoly service providers. *“Thus, with the onset of deregulation, the only protection provided to the individual grower from companies involved in storage, handling, transport and port services is the bargaining power of the Single Desk.”*<sup>62</sup>

According to work done for the AWB by Gans and Hirschberg<sup>63</sup> the degree of contestability for the export market is an important factor determining the impact of complete or partial deregulation of the single desk for wheat. **Entry barriers and issues along the supply chain, according to this study, would limit the contestability of the market.** The main barriers to entry are the sizeable volume required to gain economies of scale in logistics, research and development of new varieties, provision of information to growers, and underwriting and the need for strict regulations to maintain Australia’s “brand” in the international wheat market. It is also argued that supply chain issues would reduce the contestability of the export market. Gans and Hirschberg **view the industry from country site to port and beyond as a series of monopolies** and single out bulk handlers and port facilities as being virtual monopolies. The analysis suggests that without the single desk these entities would reduce grower returns by \$134 M.

#### **4.4 Impact of Deregulation in Barley and Canola**

A report by Kronos suggests that the following impacts have occurred as a result of deregulation in barley marketing:<sup>64</sup>

State Comparisons: The difference in regulations for barley exports that exists between states provides information on the impact of deregulation.

- Comparing Victoria (deregulated) and SA (regulated): Deregulation occurred smoothly in Victoria and growers received \$20/tonne more for their barley than SA growers during the last 2 years. Victoria produces the highest proportion of malting barley relative to total barley production. Deregulation has not affected malting barley quality.<sup>65</sup>

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<sup>62</sup> AWB, “Your Single Desk: Value for Wheat Growers, Rural Communities and the Australian Economy”, 2004.

<sup>63</sup> See reference in Annex V.

<sup>64</sup> This section is based on information contained in 1) Kronos, “A Review of Structural Issues in the Australian Marketplace”, September 2002, 2) ACIL Talsman, “NCC Occasional Series: A Review of NCP Grain Market Reforms”, November 2000 and 3) Farm Horizons, “Price Premiums from Market Power”, May 2004.

<sup>65</sup> This may be incorrect. Victoria is where the domestic demand lies (end users) not in SA, particularly on the major producing areas of the Yorke & Eyre Peninsulas. Barley in SA is generally at export parity, whereas in Vic it is often above export parity (little feed barley exported from Vic). In years of short supply (eg 2003-04) the difference in price may reach levels which cover transportation costs from SA to

- ❑ Comparing Victoria (deregulated) and NSW (regulated): Growers in NSW appear to be receiving lower prices for their barley than growers in Victoria.
- ❑ SA (regulated): Problems are occurring because while ABB can buy barley domestically and then place it in the export pool, other marketers can not. This distorts prices.<sup>66</sup>
- ❑ WA (regulated): Prices seem to be lower than in eastern Australia. Canola prices were \$20/tonne below prices in SA or Victoria.
- ❑ ABB: ABB has adapted to changes in its environment and handles about 85% of all barley marketed in Victoria despite Victoria being a totally deregulated barley market.

Buying Monopoly Vs Export Monopoly: Export marketing for grain other than wheat varies by State. Many suggest that this means Australia does not have a single desk exporter for commodities like barley and that States with restrictions really have legislated buying monopolies. Buying monopolies result in less marketing and risk management options for growers and reliance on the ability of one organization to maximize net grower returns.

Pooling and Grower Risk: Growers bear all of the price risk associated with single desk export pools. Growers require access to more risk management options.

Restrictive Business Practices: ABB restricts access to its export pool to growers. This reduces liquidity in the cash market which reduces risk management options available to growers.

In 2004 the National Competition Council commissioned an analysis of the **impacts of competition reform in barley** and canola markets. The key findings of the study prepared by ACIL Tasman for the NCC are as follows:

- ❑ According to interviews with international grain traders restrictions on destinations for offshore barley by ABB and the GPWA result in a \$3 US to \$5 US per tonne discount. Also, the current level of deregulated barley trading is not large enough to attract investment in handling, storage and market infrastructure from international players. **Even if barley were completely deregulated international investment might not be profitable until the wheat market is completely deregulated.**
- ❑ Barley does not have a significant international futures market which complicates price discovery. The lack of an international futures market limits the pricing and risk management choices offered to growers and makes pooling (which transfers the risk to the grower) attractive to companies. Canola, on the other hand, is priced on an export parity basis with Canadian canola (the Winnipeg Commodity Exchange's canola futures provide price discovery).
- ❑ Deregulation has resulted in a higher volume cash market. Pooling still exists in a deregulated market. In the deregulated barley market of Victoria 80% of barley is pooled. Under deregulation pool managers now have to compete to acquire the grain. When the barley market was partially deregulated in WA, 12% of the barley exported was purchased using cash contracts between growers and licensed exporters. The partial deregulation of the Australian barley market has helped the feed barley futures contract on the Australian Stock Exchange grow in volume.

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Vic. In other years SA price will lie at export parity & Vic at the level set by domestic demand, many 'studies' simply look at the difference and do not consider where the markets (demand) lie.

<sup>66</sup> Also other marketers can sell into the ABB Pool in SA, **but not deliver** (i.e. need to negotiate a price as does ABB Trading with the Pool Manager).

- ❑ Deregulation had no significant or sustained impact on prices.<sup>67</sup> Market power attributable to the export single desks for barley and canola could not be substantiated.
- ❑ Deregulation has increased the number of pricing products and services offered to growers. In a deregulated market, pools termed “commercial pools” are opened and closed more frequently to protect prices and they may involve more pools for different grades. Deregulation has increased the number of firms offering price risk management advice to growers.
- ❑ There is no indication that deregulation has reduced industry research and development.

Consultations revealed distinct views on the effect of deregulation as Table 4.5 indicates.

**Table 4.5 Effect of Deregulation on Barley**

<b>Negative</b>	<b>Positive</b>
Market power of statutory marketing bodies is eroded	Grower prices rise because gross prices received by traders increase and competition reduces marketing costs and margins
Inability to countervail buyer and supplier power	Increase in the number of options for grower to sell grain
Loss of economies of scale in marketing	Increased transparency in prices
Reduction in research and development	Increase in investment in infrastructure

#### **4.5 Effectiveness of New Structure for AWB**

Many groups have commented about the effectiveness of the new structure for AWB.<sup>68</sup> As an example, the Joint Industry Group submission identified several issues with respect to;

- ❑ the separation of regulatory and commercial functions,
- ❑ granting a monopoly to a private company, and
- ❑ the operations of the WEA.

There is an apparent conflict of interest with the AWB Ltd trying to maximize shareholder and net pool returns simultaneously. Both AWB Finance and AWB Australia also have conflicts of interests because their returns depend on both AWBI and AWB Ltd. Commercial and regulatory conflicts also arise in wheat breeding, registration, and variety commercialization. AWB’s involvement in these functions can result in lost opportunities. Varieties that could benefit other sellers or that don’t fit AWB’s receival standards may not be developed or commercialized.

Growers are unable to effectively monitor the performance of the privatized AWB because much information is deemed to be commercially sensitive. The WEA must rely on AWBI to provide information so that WEA can monitor it. Although this is a typical problem faced by

<sup>67</sup> Farm Horizons examined the existence and extent of price premiums resulting from the Grain Pool of WA’s market power in **canola, lupins, and barley**. Price premiums for malting barley, canola and lupins were small or non-existent. Price premiums for feed barley in the Japanese market were found. Premiums do not have to result from single desk selling and can also occur because of freight advantages, higher quality, and service.

<sup>68</sup> This section is based on information from 1) Joint Industry Submission Group, “Australian Wheat: It’s Time for Choice”, A Submission to the Independent Review Committee Reviewing the WMA 1989 under NCP”, 2000, 2) Kronos, “A Review of Structural Issues in the Australian Marketplace”, September 2002, 3) Accenture, “Appendix: 2002 Submission to the Wheat Export Authority”, 2002, 4) Grain Growers Association, “2002 Submission to the Wheat Export Authority”, 2002 and 5) Grain Growers Association, “No Tenders: No Transparency”, Submission to the Wheat Marketing Review Panel, March 2004.

regulators, it may be more severe in this case. Generally, regulators are accountable to Parliament; however, the WEA is accountable to both Parliament and the GCA. This may change WEA's independence. Also there is no effective mechanism for appeals.

Kronos, in their report on behalf of interests in the private grain trade, raised the following issues about the AWB's marketing arrangements:

- ❑ **Control:** When AWB was privatized, the WEA was given responsibility to manage wheat exports. However, the legislation gives power over bulk exports to AWBI and limits WEA's power over bag and container exports. To improve WEA's effectiveness, it must be more independent, receive more funds, and have better resources.
- ❑ **Divergent Objectives:** The objective of AWB Ltd is to maximize shareholder returns. The objective of AWBI is to maximize net pool return to growers. If Class A and B shares were held by the same people there would be no conflict. However, this is not the case which creates the potential for conflict. The conflict will increase as AWB Ltd's involvement in logistics and finance services on a for-profit basis increases. The boards of AWB Ltd and AWBI share many of the same directors. Both organizations require separate and independent boards.
- ❑ **Transparency:** In order for pool returns to be maximized and evidence presented of their maximization, oversight and transparency is required. Transparency, however, is lacking. The AWB appears to continually cite the need for commercial confidentiality when denying grower requests for more disaggregated data on expected returns and costs associated with the national pool.
- ❑ **Comparable Prices:** AWB posts prices that are not comparable with prices offered for other marketing options. For example, AWB may include GST in its price (not an industry standard practice), may or may not include the receival fee, and might not provide an estimate of the harvest pool price<sup>69</sup>. Bulk handlers also differ in their presentation of prices. This confuses and frustrates growers. An industry body should develop a standard methodology for quoting prices in the country.
- ❑ **Contestability:** AWB Ltd provides services such as underwriting, funding, logistics and marketing to AWBI and earns most of its income from doing this. However, AWB Ltd determines the cost and the quality standards of these non-contestable services which implies there is now way to determine value for money. Some of the services could be supplied in a competitive manner by others in the industry.
- ❑ **Restrictive Business Practices:** The AWB has introduced rules to reduce access to some products citing the need to protect pool returns and ensure AWB captures all margins in the supply chain. Others in the industry view these restrictions as unfair business practices. For example, the 2000 tonne restriction per group of related entities per year for basis contracts, deferred delivery contracts, and multi-grade contracts is viewed as reducing liquidity in the cash market which negatively affects grower risk management options.
- ❑ **Export Monopoly Status:** Tension is growing within the industry because of changes in traditional roles and the inherent dysfunctional nature of the industry. Legal action by participants against others has become more common. Calls for a review of the single desk for wheat are occurring.

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<sup>69</sup> AWB now posts prices net of GST.

- Government Granted Monopoly and Commercial Interests: The Commonwealth government has reminded AWB to keep its focus on its export desk and to operate in a transparent manner if it wants the government to defend the single desk domestically and internationally. AWB has invested in domestic grain handling infrastructure which is duplicating infrastructure and hurting returns of others. AWB believes that its investments are necessary to improve the efficiency of the supply chain. AWB's activities in trading third country wheat have the potential to create conflicts of interest. This should be corrected.

Kronos also raised concerns about AWB's cost structure:

- According to Kronos, growers delivering to AWB pools pay at least an additional \$9.33 per tonne since 1999 when AWB was privatized. The incremental costs arise in the following manner:
  - \$4/tonne: from fees paid to manage the national pool
  - \$0.40/tonne: fees paid for chartering services
  - \$4.93/tonne: finance and risk management fees
- Pool management fees have two components. The first is based on 1.5% of the gross pool value, with minimums and maximums in place. The second is an out performance incentive based on the Wheat Industry Benchmark and capped at 3% of the gross pool value. The benchmark is based on the historical price premium for Australian wheat which was set at \$5/tonne by the boards of AWBL and AWBI.
- AWB Chartering charges a fee to arrange ocean freight for the pool and other customers. Prior to privatization, the pool was not charged this fee. Before privatization, net interest costs and underwriting costs were not paid by the pool. Under the current structure the pool does pay these costs.
- Kronos suggests that the apparent margins received by the Grain Acquisition and Trading Group appear very high. Questions have been raised about the margins on stock swaps, the allocation of freight costs, and information access.

Accenture, on behalf of Grain Growers Association, argues that the following changes to AWB's competitive services would create \$90 M annually in benefits for wheat growers.

**Table 4.6      *Accenture's Solutions for Competitive Services***

<i>Competitive Services</i>	<i>Issues:</i> Single desk operations costly, Full benefits of trading, risk management and financial services not reaching growers	<i>Recommendation:</i> Make provision of single desk services transparent and contestable, Encourage provision of competitive risk management, financial and trading services to growers, These changes would create \$90M in benefits annually for wheat
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Accenture's specific concerns about AWB and competitive services are as follows:

- AWBL currently provides non-contestable services to AWBI. This creates concerns about the cost of such services. In addition, the structure of the remuneration for single desk services is not transparent and could reduce returns for growers delivering to the pool. AWBI pays AWBL a base fee (1.5% of gross pool value) of between \$45M and \$60 M and a performance incentive is paid for pool returns greater than the Wheat Industry Benchmark plus hurdle. The total management fee is capped at 3% of the gross pool value. The Wheat Industry Benchmark consists of three components: \$US Wheat Price Benchmark (85%), Foreign Exchange Benchmark (10%) and a Supply Chain Benchmark (5%). The hurdle rate was set at \$5/tonne supposedly to reflect Australia's price premium. There is a lack of transparency regarding how the components of the Wheat Industry Benchmark are estimated.<sup>70</sup>
- Competition to provide growers with financial services has resulted in lower costs for these services. Prior to 2000/01 only the AWB provided harvest loans to growers. Since then the National Australia Bank and others have entered this market. Greater competition has reduced the underwriting fee from over \$2/tonne to \$1.60/tonne. In 2002, it was estimated that AWBL had 80% of the grower finance market, followed by the National Australia Bank with 15%.
- It is argued that AWB's single desk impacts competition in the cash market which ultimately reduces grower options to manage risk. There is also concern that the profits from AWB Ltd's trading arrangements do not accrue to growers even though a significant amount of wheat purchased for cash by AWB Ltd ends up in the national pool.

The Grain Growers Association received legal advice about specific aspects of the governance of AWBI and AWB Ltd. Specifically,

- With respect to **maximizing grower net returns**, the constitution of AWBI states that its directors must endeavor to ensure that AWBI is "managed with the objective of maximizing the net return for growers who sell wheat into the pools run by AWBI", which over-rides obligations to act in the interest of AWBI as a whole and to have regard to the interests of AWB Ltd. The constitution of AWB Ltd states that its directors must endeavor to ensure that "the business of AWBI is managed with the objective of maximizing a net return for growers who sell wheat into the pools run by AWBI", which over-rides obligations to act in the interest of AWB Ltd as a whole.
- With respect to **tendering for services**, if AWBI obtains all or most of its services from AWB Ltd without putting the services out for tender, AWBI directors have not ensured that costs are being minimized as far as practical. Under Australian corporation law, without a tendering process the AWBI directors can not ensure the provision of services is at arm's length. Good corporate governance would at least require external data to support the pricing of services obtained from AWB Ltd. According to AWB Ltd's constitution, it has a priority objective of "providing funding and other services (including administrative, human resources, marketing, risk management and treasury services) to AWBI efficiently at competitive prices". This does not mean that services are to be provided without a competitive tendering process or without independent verification of the costs.

In a 2004 submission to the wheat marketing review (No Tenders: No Transparency: Submission to the Wheat Marketing Review Panel) (the Grain Growers Association argues that the best model to correct current deficiencies is to **introduce competition into the provision of services for the national pool and to make governance independent**. Other options

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<sup>70</sup> See footnote 31 for a description of how the fee is now set.

include the status quo, removal of the single desk, moving the single desk to the port, and tendering all services (domestic and international).

The removal of the single desk is not supported by a majority of growers. Although moving the single desk to the port is the best and preferred option, it does not have wide industry support according to this report by GGA. Tendering all services would likely harm the single desk. Services such as marketing, sales, relationship management, final grain acquisition and some risk management functions should remain with the single desk. The remainder of the services should be tendered. AWB Ltd would be allowed to compete to provide them. Tendering would reduce costs and allow for transparency. The tendering process would require independent management (such as an accounting firm) and would require oversight by WEA.

Other views put forward by the GGA are as follows:

- ❑ The GGA supports the continuation of the single desk for wheat export. It will continue to do so until the majority of members feel otherwise.
- ❑ The single desk is currently operating a domestic supply chain monopoly for the national pool. The single desk is supposed to be an export monopoly.
- ❑ Management expenses in the national pool are not made up for by dividends from AWB Ltd because non-growers own shares of AWB Ltd.
- ❑ Under the Companies Act, the Directors of AWB Ltd are required to act in the interests of all shareholders. Grower interests can not be put ahead B class shareholders.
- ❑ The single desk should be operated as a public trust on behalf of Australian wheat growers. The single desk should not benefit AWB Ltd.
- ❑ The single desk actually resides with the WEA. When AWB was privatized, the name of the Australian Wheat Board was changed to the WEA. The WEA is accountable to the Commonwealth Government. AWBI is only the manager of the national pool.
- ❑ AWBI is not independent from AWB Ltd which results in misallocations of income from export wheat sales.
- ❑ AWBI and AWB Ltd share some directors in common. AWBI has no staff or assets. All employees of the national pool are employed by AWB Ltd. AWBI purchases 77 services from AWB Ltd and pays a lump sum for them. This is not in the best interests of growers because the transaction lacks transparency and is unlikely to minimize the cost of managing the pool.
- ❑ The performance incentive component of AWBI's payment to AWB Ltd for pool management should be based on net grower income.
- ❑ The WEA has only recently realized that basing AWB Ltd's compensation on net rather than gross pool returns would provide AWB Ltd to reduce supply chain costs.
- ❑ Public policy on competitive supply and cost minimization is inconsistent with the arrangements between AWBI and AWB Ltd.
- ❑ Expenditures should be based on the concept of "value for money".
- ❑ The single desk provides benefits to growers. However, it is costing growers in terms of innovation and new market development.
- ❑ AWBI has told potential niche exporters that it will veto an application before it has even seen the full case. It has also blocked the development of complementary markets and used grower returns to assist its actions.

## **4.6 Other Issues - WEA**

The GGA believes that under the WMA the WEA has the obligation and power to examine and report on the performance of AWBI that may affect net pool returns to growers. Specific legislation is as follows:<sup>71</sup>

- ❑ Section 5(1): the WEA is “to monitor nominated company B’s performance in relation to the export of wheat and examine and report on the benefits to growers that result from that performance” (AWBI is nominated company B)
- ❑ Section 5(2): the WEA “has power to do all things that are necessary or convenient to be one in connection with the performance of its functions”.

The Grain Growers Association believes that the WEA has the following problems:

- ❑ The WEA is not fulfilling its responsibility to ensure growers are the primary beneficiaries of the management of the national pool.
- ❑ The WEA takes a very narrow view of its responsibilities and fails to examine the governance of AWBI and to protect growers’ interests. The WEA did not protect growers when AWBI voted to increase the fee paid to AWB Ltd by \$13M during a severe drought.
- ❑ The WEA does not carefully examine the costs associated with the management of the national pool.
- ❑ The WEA has until recently simply accepted AWB Ltd’s benchmarked costs for the pool.

The Grains Council of Australia (GCA) made the following comments about the WEA in a recent submission<sup>72</sup>:

- ❑ The CGA supports the current consultation process between WEA and AWBI used to ensure AWBI is fulfilling its obligations under the WMA. Over time the flow of information between the two has improved and CGA supports continued efforts to improve transparency and disclosure.
- ❑ Currently AWBI must consent in writing to WEA’s approval of any bulk wheat exports and WEA must inform AWBI of its intention to approve bag or container exports. GCA supports this process. Only 5% of the movement approved by WEA was actually shipped in 2002-03. A full or partial cost recovery policy should be instituted for export applications.
- ❑ The GCA is satisfied with how the WEA performs its monitoring of AWBI. It is supportive of the WEA holding regional consultation meetings with growers. The cost effectiveness, however, of the service arrangements between AWBI and AWBL should be measured against a global competitive benchmark. The penalty provisions of the arrangement should be reviewed and changed to enhance performance. The WEA and AWBI should set a timetable to resolve their differences about the Wheat Industry Benchmark. The GCA agrees with many in the industry that the hurdle rate in AWB Ltd’s performance incentive has been set too low (should be US\$9/tonne rather than US\$5/tonne.)
- ❑ The WEA is supported by a levy on export wheat sales of \$0.22/tonne. Because this amount will be insufficient after 2005-06 the WEA funding mechanism should be revised to provide funds until the 2010 NCP review.
- ❑ The GCA recommends the creation of an Independent Review Tribunal to monitor the activities of WEA and the relationship between AWBI and AWBL. The tribunal would report twice over the period 2005 to 2010.

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<sup>71</sup> This section uses information from 1) Grain Growers Association, “2002 Submission to the Wheat Export Authority”, 2002, 2) Grain Growers Association, “No Tenders: No Transparency”, Submission to the Wheat Marketing Review Panel, March 2004 and 3) Grains Council of Australia, “2004 Wheat Marketing Review Submission”, 2004.

<sup>72</sup> Grains Council of Australia, “2004 Wheat Marketing Review Submission”, 2004.

#### **4.7 Impact of Deregulation on Domestic Value-Added Industry**

The 2000 Wheat Market Review committee examined the impact of deregulation on the domestic wheat market. Domestic utilization increased from 3.2 M tonnes in 1991/92 to 5.8 M tonnes in 1999/00. In 1999/00, about 2.25 M tonnes of wheat was used for food, 2.8 M tonnes were used for feed, and the remainder was used for seed and on-farm. The Committee concluded that *“While it has not been conclusively demonstrated that the market growth resulted from the increased opportunities for direct wheat producer and domestic wheat user interaction following the deregulation of the domestic wheat market in 1989, this deregulation is now generally acknowledged to have had a positive effect on the industry.”*<sup>73</sup>

According to a Joint Industry Group Submission, the single desk affects the **domestic value-added industry**. Intensive livestock operations are affected through the inability to import grain unless it is denatured; difficulty of locking in prices; lack of risk management services (single desk removes ability of private firms to provide these); and higher domestic prices when domestic users must compete against international buyers when supply is short. A 1997 study examining the competitiveness of the Australian broiler industry relative to the US found that Australian producers had a 27% cost disadvantage of which 40% was due to higher feed costs. The import restrictions were estimated to add \$7.50 per tonne to the cost of barley in Australia in 1997.<sup>74 75</sup>

#### **4.8 Impact of Deregulation on the Environment and Rural Communities**

The Joint Industry Group submission commented on the **impact of single desk selling on the environment, rural communities, and community breakdown**. In terms of the environment, the submission argued that the single desk and compulsory pooling reduces growers' financial returns which prevent the adoption of environmentally sound farming practices. The Productivity Commission attributes concern in the regions about NCP 1) confusion between competitiveness and forces driving change and the trend to larger and fewer farms; 2) contraction of smaller centers being more publicized and noticed than benefits of the growth of regional centers; 3) use of NCP as a scapegoat for unpopular local decisions; and 4) lack of awareness and understanding of broader impacts of deregulation. The submission argued that eliminating the single desk would shift power to areas closer to producers, enhance financial risk management that would increase grower returns, and allow new players to enter the supply chain, increasing competition and innovation. Rather than increasing community tension, the submission argues that removing the single desk would enhance social and economic cooperation. Growers would be provided marketing options and political influences on AWB decisions would be eliminated.<sup>76</sup>

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<sup>73</sup> Irving M, J Arney, and B Lindner, “National Competition Policy Review of the Wheat Marketing Act 1989”, 2000.

<sup>74</sup> Joint Industry Submission Group, “Australian Wheat: It’s Time for Choice”, A Submission to the Independent Review Committee Reviewing the WMA 1989 under NCP”, 2000.

<sup>75</sup> Unlike its competitors, Australia is very dependent on barley as a source of feed. It does not have another widely available feed grain like corn.

<sup>76</sup> Joint Industry Submission Group, “Australian Wheat: It’s Time for Choice”, A Submission to the Independent Review Committee Reviewing the WMA 1989 under NCP”, 2000.

## **5.0 Currently Finding The Right Regulatory Balance**

The current deregulatory thrust in Australia is finding the right regulatory balance for the wheat and barley industry. For example, will all States eliminate single desk selling for barley, or will the two remaining States of South Australia and Western Australia have as an end-state the retention of a single desk for specific markets and support market contestability in other non-premium markets (for the single desk seller)? As well, is the end-point for wheat as it is today, with a single desk seller for wheat on export sales, or will the system evolve to a lessening of single desk selling powers after the next official review in 2010? This is discussed in this section. This discussion can assist in understanding the dynamics and some of the potential issues that may also arise in western Canada.

### **5.1 National Competition Policy**

The National Competition Council found that the Commonwealth has not met its obligations under the NCP to review the appropriateness of granting a private company a monopoly and of the effectiveness of the separation of the regulatory and commercial functions of the monopoly in 1999. This is in reference to the AWB and WEA. After the 2000 review the Commonwealth still did not clearly separate the regulatory and commercial functions. It refused to amend the export consent process because of a potential negative impact on AWB Ltd's initial public offering. The 2000 review did not show that retaining the single desk provided a net benefit to the community.<sup>77</sup>

The National Competition Council does not consider the 1999 review in **New South Wales** adequate with respect to the net benefit of single desk marketing of barley, canola, and sorghum. It is also unclear about why the New South Wales Government chose to retain single desk even when the NSW Grains Board went bankrupt as other marketers could have stepped in. The NCC considers that the governments of **Victoria** and **Queensland** have met their NCP obligations.

The Government of **Western Australia** remains committed to the removal of export restrictions on barley, canola, and lupins and will do so when the AWB is deregulated. That is elimination of export licenses for barley in Western Australia is tied to the Commonwealth eliminating the single desk powers of the AWB. The Council is unconvinced that the Grain Pool would be unable to compete with AWB in a deregulated market as experience has shown that the former state single desk remains a major player after deregulation. The council is also concerned about the use of the "lack of knowledge" argument being used to rationalize maintaining the export monopoly. The Council accepts the WA government's actions as fulfilling the NCP requirements.

The government of **South Australia** reviewed its Barley Marketing Act 1993 (in conjunction with Victoria's review) in 1997. At that time there were domestic and export restrictions on oats and barley. The government accepted the recommendations to remove domestic barley restrictions in 1999 and to end ABB's export monopoly over barley June 30, 2001. However, the Government subsequently decided to extend the export monopoly indefinitely because of grower concerns and an analysis indicating ABB extracted monopoly premiums in Japan. The barley export monopoly was to be reviewed in 2002. The Council does not accept the analysis of ABB's export monopoly as being valid.

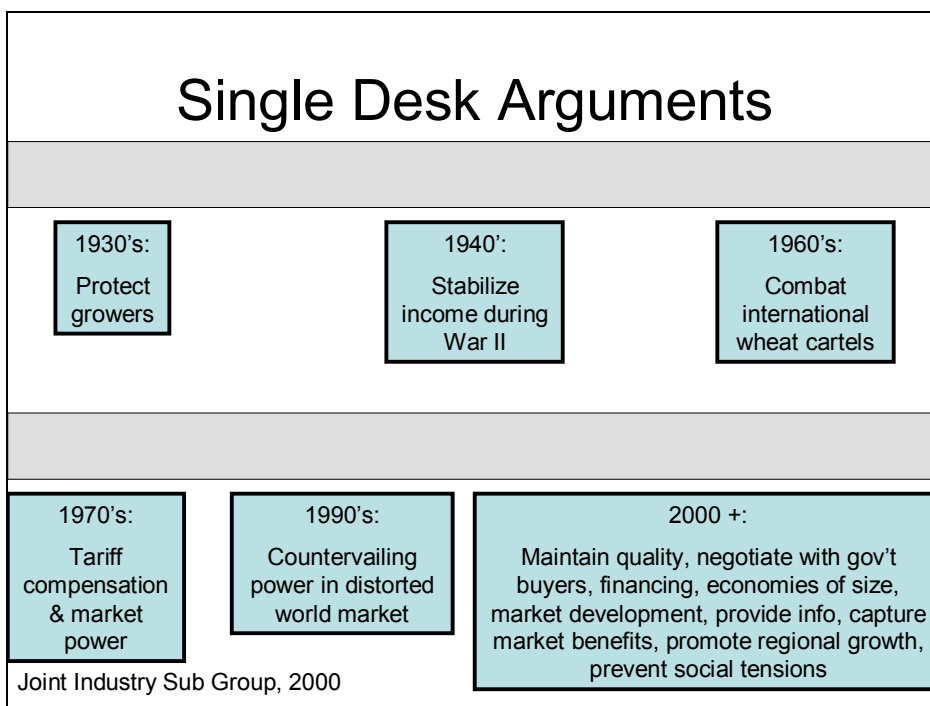
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<sup>77</sup> This section is based on 2002 NCP Assessment, "Chapter 4 Primary Industries", 2002.

## 5.2 Single Desk Justification

Over time the rationale for single desk selling has evolved as the following chart indicates. However, the Joint Industry Submission Group (a group of grain company and related interests) notes that **the only valid rationale is that a single desk seller can exert market power in order to obtain a higher average net price from exports.**<sup>78</sup>

Figure 5.1 Evolution of Arguments Supporting the Single Desk



According to the Joint Industry Group, based on a study conducted for them by CIE, the prerequisites for Australia having market power in international wheat markets are 1) having a significant share of world market, 2) being in a situation where competitors can not undermine its ability to control supply, 3) be faced with inelastic demand (price responsive) in several markets where reducing supply increases price, and 4) have full and complete information on market demand curves and competitor responses. The submission argues that some of the price premium for Australian wheat occurs because of its high quality and that this would occur regardless of the type of export arrangement.

Australia also enjoys a location premium in several markets and according to the submission the benefits of lower freight would be captured by other marketing arrangements. The submission counters the argument that single desk selling into the Japanese wheat market creates price premiums; by arguing that the sole buying agent's objective is to obtain a secure supply and that it is willing to pay a premium to obtain it. Multiple sellers that could guarantee a

<sup>78</sup> This section uses information from 1) Joint Industry Submission Group, "Australian Wheat: It's Time for Choice", A Submission to the Independent Review Committee Reviewing the WMA 1989 under NCP", 2000, 2) Accenture, "Appendix: 2002 Submission to the Wheat Export Authority", 2002, 3) Grains Council of Australia, "2004 Wheat Marketing Review Submission", 2004 and 4) AWB, "Your Single Desk: Value for Wheat Growers, Rural Communities and the Australian Economy", 2004.

secure supply would also receive a price premium. According to this industry led submission, there is little economic evidence that the AWB is able to price discriminate between markets. However, this argument is counter to economic theory, where multiple sellers would bid the price down to the next best alternative market (not the Japanese price). This is starting to be observed as the market is open to more suppliers and smaller Japanese companies with access to JFA tenders are now able to source supplies from non single desk suppliers.

The Joint Industry Submission Group (CIE report) also argues there is also no need for a single desk in order to follow a strategy of product differentiation. With respect to the argument that a single desk seller is necessary in a distorted world market rife with export subsidies, the submission argues that any competitive seller would avoid markets severely distorted by export subsidies and that Australia's lobby efforts for trade liberalization are weakened by its use of single desk selling.

Accenture, in their report for the Grain Growers Association, argues that there are two areas of concern with respect to revenue preservation and growth for wheat marketing. The first is that there is a risk involved with having only one wheat exporter. The single desk may misjudge the market which will cause significant costs for the industry. It could also misalign its sales and marketing efforts with customer requirements, for example over servicing some market segments which could be more effectively serviced by complementary sales channels. Complementary channels which do not undermine pool net returns should be encouraged. Historically, container exports of wheat served to either discover new markets or displace bulk wheat exports. The former should be encouraged. The second issue is the paucity of information available to the industry for decision making and planning purposes. Information about wheat exports is seen as creating power and tightly controlled.

**The Grains Council of Australia is very supportive of single desk exports for wheat.** A 2004 study by Gans and Hirschberg (for Econtech) found that the average price premium from single desk exports was \$13/tonne. GCA believes that much of this premium occurs because of AWBI's relationship and support of its customers. Pooling also benefits growers. The WEA estimated that pooling by AWBI in 2001-02 provided a \$14.60/tonne benefit to growers. The GCA argues that single desk exports should not be reviewed until the 2010 NCP review.

The AWB uses studies by Econtech and Gans to argue that the benefits from single desk selling are as follows:

- ❑ Delivers an annual average premium of \$13 per tonne or \$200 M AU to growers
- ❑ Increases private consumption in Australia by \$50 M
- ❑ Contributes \$79 M AU annually to rural Australia's GDP
- ❑ Increases the value of production in agriculture, forestry and fisheries by \$73 M AU, wholesale trade by \$12 M, retail trade by \$5 M, and finance and insurance by \$4 M, as well as contributing \$3 M to the value of house ownership

Highlights of empirical analysis of single desk selling are shown on the following page.

### **Summary of Empirical Analysis of Single Desk Premiums**

**AWBI, 2000** – using the results of an analysis by **Gans and Hirschberg**, the AWBI attributes a premium of \$8.72 AU per tonne of wheat to the ability of the single desk to extract premium prices. (The study actually found that 60% of the variation in price premium for FOB prices obtained by AWBI and PNW prices were due to Australia's distance advantage and the grade of wheat. The report did not attribute the remaining 40% of the variation to single desk selling by the AWBI – it only said that single desk selling could be responsible for it, along with other factors.)

**Allen Consulting Group, 2000** – using a price discriminating monopolist model it found the AWB's price discrimination increased the price of wheat by \$0.79 US to \$2.56 US per tonne.

**Burton, 2000** – found average premiums of up to \$2.14 US per tonne in wheat using the AWBI data.

**Booze Allen Hamilton, 1995** – used two different approaches and found premiums between \$1.75 US to \$7.10 SU per tonne.

**Econtech, 2004** – analysis for AWB found that average price premium from single desk wheat exports was \$13/tonne.

**WEA** – examines AWBI's ability to price discriminate between wheat markets over time. Found that AWBI price discriminated across markets within each national pool and between national pools in 2002-03 but does not provide a dollar estimate.

**CIE, 1997** - An empirical model of the ABB's export monopoly by the CIE in barley found that under the assumption of perfect information the single desk would increase average net returns for feed barley by \$2.50/tonne and for malting barley by \$2.75/tonne. The price premium increased domestic grain prices which resulted in a cost of \$4.1 M for feed barley and \$1.5 M for malting barley. When the assumption of perfect information was dropped, it was estimated that the ABB had only a 15% chance of achieving a price premium for malting barley and a 3% chance for feed barley. The estimated cost of the single desk rose in this case. The CIE concluded that ABB has been able to use market power in the domestic market to obtain premiums for feed and malting barley but has not been able to use market power in the export market. The premium for Australian feed barley in the UAE occurs because of lower freight and quality characteristics. The premium for Australian feed barley in Japan occurs because of Japan's trade and food security policy.

**Update of 1997 CIE analysis and Econtech 2000 analysis** - An independent expert concluded that there was a lot of uncertainty attached to the results and that continuation of the single desk would likely result in small but uncertain net benefits. The SA Barley Review Panel also reviewed confidential data provided to it regarding price premiums and concluded that price premiums likely exist in the Japanese market and some other small markets. The panel did not believe that the premiums occurred because of the existence of single desk exporting. The premiums might occur because of ABB's marketing skills and relationships with customers.

**Farm Horizons, 2004** - examined the existence and extent of price premiums resulting from the Grain Pool of WA's market power in canola, lupins, and barley. Price premiums for malting barley, canola and lupins were small or non-existent. Price premiums for feed barley in the Japanese market were found. Premiums do not have to result from single desk selling and can also occur because of freight advantages, higher quality, and service.

The current arguments supporting single desk selling and the positive impacts on growers are noted as follows:

- ❑ Price discrimination and better marketing results in price premiums
- ❑ Allows growers to compete in distorted international markets
- ❑ Allows for the capture of economies of scale and scope
- ❑ Shapes crop production and quality to meet customer needs
- ❑ Manages price and currency risk
- ❑ Secures premiums from selling Australian wheat as a branded and differentiated product in some markets
- ❑ Keeping the freight advantage which can be lost with multiple sellers,
- ❑ Based on market information and ability to control supply of particular types and classes of grain, offering aggressively at some time and not aggressively at other times – use of pricing power to obtain an average higher price,
- ❑ Provides social benefits to rural areas, and
- ❑ Reduces supply chain costs, including the use of countervailing market powers due to monopolistic suppliers of rail transportation and grain handling services in most States.

### **5.3 Contestability with Single Desk Selling by ABB and AWB**

Another regulatory issue being discussed in Australia is the concept of market contestability while retaining single desk selling. In theory separation of the WEA from the AWB for the issuance of export licenses allows some other interests to access export markets. This concept was further developed in Western Australia through the Grain Licensing Authority, where other exporters are eligible to make the case for receiving an export license based on doing as good as or better than the Grain Pool – the Grain Pool has a special exemption and does not have to make the case for being issued a license. By separating the regulatory function of export permit issuance from the marketing function of selling grain to specific customers, it can be argued that the single desk selling authority rests with the holder of the export licenses – e.g., WEA and the Grain Licensing Authority.

This same concept is being contemplated in South Australia, where the 2004 Report to Parliament on the Barley Marketing Act of 1993 was reviewed. Creating a separate authority to issue export licenses is designed to ensure some markets are contestable by other exporters showing to the export license granting agency that they are able to obtain equal to or better returns on specific sales. This may result in contestability in certain export markets, where private exporters are able to better than the existing ABB, AWB, Grain Pool, etc.

On the contestability theme, some interests want to ensure that there is contestability on service provision to authorities such as the AWB. Contestability of services is viewed by some as an alternative to greater transparency between the AWB and some of its service providers (AWB Limited).

## **5.4 Other Issues – Pooling by AWB**

According to the Joint Industry Group representing private grain companies and other interested parties:<sup>79</sup>

- Pooling is a “best endeavors, cost plus system” in which growers bear all the price risk and not AWB which simply passes the consequences of actions back to the growers through the pool. The AWB does not effectively hedge forward prices for the entire crop which exposes growers to price and currency volatility. Pools are not an effective risk management tool for growers wishing to make specific investments that would benefit from greater price certainty.
- Basis pools, which allow growers to lock in a higher price than the expected pool return using CBOT futures and exchange rates, have increased in popularity. However, the AWB introduced restrictions on private company participation which reduced the amount of potential competition it faced from these private merchandisers.
- The existence of the pool affects the entire domestic grain market through the impact on feed wheat, the pricing benchmark. When the AWB estimated pool price return is below international prices (because of need to cover price risk) the cash prices in the Australian market will be below international prices. If supplies are short or it is late in the season, cash prices may be above international prices. The deviation of domestic and international prices increases the risk of using basis contracts.
- Mandatory price pooling inhibits the existence of a wheat futures market in Australia. A successful wheat futures market requires multiple buyers and sellers, price volatility, price transparency, enforceable contracts, substantial cash market, reliable information and minimum government intervention. Most of these characteristics do not exist in Australia because of the single desk. Sorghum, an unregulated grain, had 25% of its annual production in futures contracts while wheat had about 1%.
- The privatization of AWB has increased marketing costs. Providing growers with financing is profitable. The margin between the growers’ interest rate and the commercial interest rate is profit for AWB which in turn flows out via dividends. Operating costs, about \$3/tonne, are also high.
- Some growers like pooling because it is a trouble free way of marketing. However, a single desk is not necessary for pooling to occur. Cotton, for example, is sold using voluntary pools.

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<sup>79</sup> Joint Industry Submission Group, “Australian Wheat: It’s Time for Choice”, A Submission to the Independent Review Committee Reviewing the WMA 1989 under NCP”, 2000.

## **5.5 Other Issues - US Australia Free Trade Agreement**

The US and Australia Free Trade Agreement came into effect January 1, 2005. Under the agricultural section of the agreement:<sup>80</sup>

- ❑ Australia immediately eliminates all agricultural tariffs
- ❑ The US will liberalize agricultural products by reducing some tariffs and establishing tariff rate quotas for some products. Some safeguard measures will be available.
- ❑ The US and Australia will work together to resolve issues involving sanitary and phytosanitary measures.

Both parties agreed to work together in the WTO negotiations to 1) improve market access for agricultural goods, 2) reduce with a view to phasing out export subsidies in agriculture, 3) develop disciplines to eliminate restriction on a growers' or traders' right to export and 4) reduce trade distorting domestic support.

## **5.6 Other Issues - WTO**

The current draft guiding WTO negotiations contains the following language regarding export competition:

- ❑ By an agreed upon end point export subsidies will be eliminated; export credits, export credit programs or insurance programs with repayment periods exceeding 180 days will be eliminated and those with repayment periods less than 180 days will be reformed; **activities of state trading enterprises that distort trade (such as export subsidies, government financing, and underwriting losses) will be eliminated; the monopoly powers of state trading enterprises will be subject to further negotiations;** and food aid programs that displace commercial trade will be eliminated.
- ❑ Developing countries will have a longer time frame to implement reforms.
- ❑ Developing countries with state trading enterprises that provide price stability and food security will receive special consideration for maintaining monopoly status.

Because the AWB is not financed or underwritten by the government it is more trade acceptable than the CWB. Further negotiations of monopoly powers of state trading enterprises is of concern to both the CWB and AWB

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<sup>80</sup> USDA, "United States and Australia Free Trade Agreement", 2004.

## 6.0 Comparisons to Western Canada

In this section of the report we focus on highlighting on the implications for western Canada if some of the major approaches taken by Australia become part of the grain marketing landscape in western Canada. Before these Australian-experience-based options are presented, a general comparison of single desk selling for wheat and barley in Canada and Australia is provided.

### 6.1 General Comparisons to Canada

This section provides some comparisons between grain marketing in Australia and Canada. A more complete comparison is contained in Annex VI.

#### Establishment of the Single Desk

##### **Australia**

- AWB by Commonwealth government
  - Producers wanted price stability, pooling and ability to exercise market power.
  - Wheat Marketing Act provides authority for AWBI to export wheat & established Wheat Export Authority (WEA) that controls non AWB International (AWBI) exports & oversees export performance of AWBI.
- ABB and GPWA by state governments.
- Grains Marketing Act 2002 (WA) establishes Grain licensing Authority & issues main export licenses to GPWA & special licenses to others for export of barley, lupins & canola.

##### **CWB**

- By federal government action reflecting desires of producers and government, but for different reasons
- Producers wanted a countervailing market power and government wanted the CWB as a means for public policy.

#### Legal Authority

##### **Australia**

AWB Ltd – publicly traded corporation (Class B shares)  
accountable to shareholders  
Two types of shares (Class A Growers & Class B financial)  
AWBI, wholly owned subsidiary of AWB Ltd operates the National Pool & has a services agreement with AWB Ltd to provide all needed services.  
Under WMA (1989) pool operations (AWBI) accountable to Wheat Export Authority (WEA)  
WEA controls the export of wheat.  
ABB Grain Ltd– publicly traded corporation (Class B shares)  
Accountable to shareholders  
Two types of shares (Class A growers & class B (financial))

##### **CWB**

Through federal legislation, the Canadian Wheat Board Act,  
15 member board with 10 seats filled by elected growers  
Requires permission by Department of Finance to borrow money  
Must report regularly and file annual reports with Minister Responsible for CWB

### **Extent of Marketing Powers**

#### ***Australia***

##### Wheat – AWB

- AWB has single desk selling authority on all bulk wheat exports.
- WEA may issue permits for export (bulk only with AWBI approval) of wheat under guidelines.

##### Other

- ABB has single desk selling authority for barley exports from SA
- GPWA is main license holder from GLA for the bulk export of barley, canola and lupins from WA, special licenses may be issued to others.
- Arrangements (permit) in NSW (export feed barley, sorghum, canola & all malt barley single desk) will be finishing Sep. 2005.

#### ***CWB***

- Applicable to wheat and extended (by Order-In-Council) to barley grown in the designated area,
- Single desk seller of all designated area wheat (and barley) in export markets and in domestic (human consumption) markets,
- By CWB Act regulation, producers can market un-graded wheat into off-Board market for feed use,
- The CWB controls the transportation and marketing of all Canadian wheat (and barley) for human consumption and export markets in designated area and between designated area and the rest of Canada
- Controls import permits and any exporter must have CWB permission to export

### **Span of Supply Chain Involvement**

#### ***Australia***

- AWB involved in farm inputs (through Landmark purchase), storage and handling in country and at Melbourne Port, marketing of crops other than wheat, chartering, and export sales of non-Australian wheat
- AWB leases 2 freight trains.
- ABB Grain also heavily involved in S&H following Ausbulk merger and 50% ownership in ABA (Aus Bulk Alliance), in Melbourne Port, in chartering and in malting.
- ABB Grain acquires and markets all grains, imports & distributes, fertilizer and has a small chemicals business & a container packing business.
- Grain Pool is similarly involved in S&H through CBH & in marketing other grains.

#### ***CWB***

- The span of control by the CWB is from the farm gate through to export fob on vessel – the CWB is starting to sell C&F the customer.

### **Exports by Producers**

#### ***Australia***

- WEA can issue export permits to growers and trade for exports of wheat in bags and containers (must inform AWBI).
- WEA can issue export permits to growers and trade for bulk wheat exports but must receive written consent of AWBI.
- GLA (in WA) can issue export permits to growers and trade for exports of barley, canola, and lupins
- ABB allows export of barley from SA in containers without hindrance.
- In Victoria producers can export barley directly or through grain companies, in NSW a permit (feed only) is required (restrictions end Sep. 2005)

#### ***CWB***

- Producers in the designated area can buy back wheat from the CWB (at a buy-back price related to the Minneapolis wheat price), and be issued a license to export wheat or sell it domestically for human consumption

### **Use of Accredited Exporters**

#### ***Australia***

- ❑ Grain from Australia can go through any channel either directly to end-users or through the trade. Only limitations are the commercial ones of ensuring payment from the buyer.
- ❑ Both AWB & ABB prominent in selling directly and in selling c&f.
- ❑ Japanese market has restrictions imposed by JFA regarding who can sell into JFA tenders or into SBS system.

#### ***CWB***

- ❑ Up to 50% of wheat and durum sales made by accredited exporters
- ❑ Up to 80% of malting barley exports made by accredited exporters

### **Initial Payment Guarantees**

#### ***Australia***

- ❑ The WMA (1989) gradually eliminated government guarantee of initial payments.
- ❑ AWB has Credit Agency ratings and operates an extensive funding operation (\$US3 bill & \$A2.5 bill facilities) in the domestic and global capital markets in its own right (no Government guarantees).
- ❑ AWB charges growers a compulsory underwriting fee.
- ❑ ABB and GPWA also operate without government guarantees.
- ❑ ABB has an extensive funding operation managed through its Banks to raise monies. It offers growers the choice of paying an underwriting fee.

#### ***CWB***

- ❑ Federal government guarantees the initial payment, based on the *Canadian Wheat Board Act*
- ❑ This provision may be lost through the next round of WTO negotiations

## 6.2 Australian Approaches as Options for Western Canada

Prior sections indicate that the Australian grain marketing system has evolved and has taken approaches in grain marketing that could be considered in western Canada. The major characteristics of the current systems for wheat and barley marketing in Australia are as follows:

1. Deregulation of the domestic market for wheat and barley and State choice in export barley – some regulated and some not, likely end state is complete deregulation in barley
2. Separation of regulatory and marketing functions of STE (state trading entity) (AWB and WEA)
  - Regulator monitors and assesses performance of the STE (WEA and GLA)
  - As well as monitoring the performance of the STE, the regulator grants export permits to others which introduces contestability into export markets (WEA and GLA)

To highlight the potential for western Canada, these characteristics are mapped onto western Canada to create options that can potentially transform wheat and barley marketing in western Canada. Based on the extent of deregulation and the functions of the regulator possible options for wheat and barley marketing in western Canada can be defined in the following way.

**Table 6.1 Options for Western Canada**

Market Regulation ↓	Regulatory Activity ↗	
	Monitor and Assess STE	Monitor and Assess STE Grants Export Permits
<ul style="list-style-type: none"> <li>□ Single Desk for Export of Wheat and Barley</li> <li>□ Domestic Regulation</li> </ul>	Option 1	Option 2
<ul style="list-style-type: none"> <li>□ Single Desk for Export of Wheat and Barley</li> <li>□ Domestic Deregulation</li> </ul>	Option 3	Option 4
<ul style="list-style-type: none"> <li>□ Single Desk for Export of Wheat</li> <li>□ Domestic Deregulation</li> <li>□ Provincial Choice in Export Barley</li> </ul>	Option 5	**
<ul style="list-style-type: none"> <li>□ Single Desk for Export of Wheat</li> <li>□ Domestic Deregulation</li> <li>□ Export Barley Deregulated</li> </ul>	Option 6	Option 7
** Although this cell is a potential option, it is not considered because of the implications of option 5.		

These options are highlighted in this section, with implications of each option provided in following sections.

**Option # 1 - Regulator assesses CWB single desk performance** for wheat and barley sold into domestic and export markets. This option is based on the Australian approach of having the single desk seller accountable to a regulator, the WEA. The regulator examines and reports on the benefits accruing to growers from single desk activities. The regulator itself would be accountable to growers and to Parliament (or the Auditor General of Canada).

**Option # 2 - Regulator assesses CWB single desk performance, and grants export permits for wheat and barley for contestability in non-premium markets<sup>81</sup>.** This option separates specific regulatory and marketing powers to introduce contestability<sup>82</sup> in the market, implying that instead of the CWB another body would be created to have the power to grant export licenses. For export markets, this approach is used in Australia today where firms are able to access export markets outside of the single desk seller. Exporting of wheat has less contestability than barley exports in Western Australia. For example, in Western Australia with the creation of the Grain Licensing Authority, other exporters are able to request an export license to export canola, barley and lupins outside of the single desk into markets that are considered non-premium markets. Premium markets must be retained for the single desk seller. This concept of introducing contestability into the supply chain is being considered for barley in South Australia. The WEA (Wheat Export Authority) has the power to grant export licenses for bagged and containerized wheat (the WEA must only inform AWBI of its decisions) but must gain written approval from AWBI to grant export permits for the bulk export of wheat. The grain licensing approach used by Western Australia is less restrictive because the grain pool cannot block the issuance of export permits to other players.

**Option # 3 - Deregulation of the domestic market, and regulator assesses CWB single desk performance** for wheat and barley on export sales. With domestic deregulation there is no single desk selling authority for the CWB on domestic sales of wheat and barley. This is based on Australia's deregulation of the domestic markets for both wheat and barley.

**Option # 4 - Deregulation of the domestic market, regulator assesses CWB single desk activities, and grants export permits to allow for contestability in non-premium markets** in export markets. Contestability is introduced into the export markets through the regulator's issuance of export permits for non-premium markets. This option is based on Australia's deregulation of the domestic markets for wheat and barley and the use of the WEA and GLA to introduce contestability into export markets for wheat and barley.

**Option # 5 - Provincial choice on single desk selling for barley, deregulation of the domestic market and regulator assesses CWB single desk performance** on export. This option implies deregulation of the domestic market, a regulator assessing CWB single desk performance, and provinces can choose to retain single desk selling authority for barley in the export market. This option is based on the Australian situation where the marketing of barley varies by state. South Australia and West Australia have retained single desk entities responsible for the export of barley. Other States like Victoria, New South Wales (from 1 October 2005), and Queensland have completely deregulated barley marketing. This option also reflects the Alberta Open Market Test Case.

**Option # 6 - No single desk for barley across the prairies, deregulation of the domestic market, and regulator assesses CWB single desk activities** for wheat in export markets. This option would remove the single desk selling authority for barley from the CWB and would have a regulator assess and report on the performance of the single desk on wheat in export markets. This option characterizes the situation in Australia, in the eastern States of Queensland, New South Wales (from 1 October 2005) and Victoria, where there is no single desk for barley, while the AWB has single desk selling authority in export markets for wheat.

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<sup>81</sup> Introducing contestability into the domestic market could create a sub-option. The regulator would grant firms the right to sell wheat and barley in non-premium domestic markets.

<sup>82</sup> Contestability implies that there are minimal barriers to entry and/or there is competition between firms providing a service.

**Option # 7 - No single desk for barley across the designated region, deregulation of the domestic market, single desk seller for wheat exports, and regulator assesses CWB single desk performance, and grants export permits to allow for contestability in non-premium markets.** This option characterizes the situation in barley in Queensland, New South Wales (from 1 October 2005) and Victoria and the marketing arrangements for wheat across Australia. It also reflects Australia's use of the WEA and GLA to introduce contestability into the export markets for wheat and barley.

### **6.3 Regulator Assesses CWB Single Desk Performance**

**Option # 1 Regulator assesses CWB single desk performance for wheat and barley sold into domestic and export markets.**

#### **Description of the Option**

This option is based on the Australian approach of having the single desk seller accountable to a regulator. The regulator would examine and report on the benefits accruing to growers from single desk activities. The regulator itself would be accountable to growers and to Parliament (or the Auditor General of Canada).

#### **Features of the Option**

Features of this option include:

- ❑ A new independent regulatory body would be established, which would be accountable to Parliament or to the Minister of Agriculture,
- ❑ Regulator would examine and annually report on performance of the single desk in domestic and export markets, and assess impact on growers compelled to market through the single desk,
- ❑ Public versions of report on performance would provide transparency on single desk operations, but not divulge trade secrets or CWB tactics in specific markets,
- ❑ Performance measures developed by an independent third party with grain trade knowledge, with input provided by the CWB,
- ❑ Performance assessment by an independent body would be relative to international benchmarks on a 'C&F' and "FOB" basis to determine capture of any premiums on export sales. The assessment would separate our premiums due to quality, product uniqueness, country specific premiums, location advantage, and price discrimination between markets,
- ❑ Performance assessment would also include net impact on growers and impact of single desk selling on supply chain costs and net returns back to the farm gate.

#### **Implications and impact of the Option**

Some of the implications and impacts of this option can include:

- ❑ Transparency of single desk operations increases, with more accountability of the CWB to growers and to society,
- ❑ Grain marketing system has another cost center that will either be funded by taxpayers or by producers delivering to the single desk seller,
- ❑ CWB operating procedures and systems improve to ensure performance measures are met,
- ❑ Clarity regarding objective of CWB – explicitly to maximize net returns to producers
- ❑ CWB focuses on both reducing costs in the grain supply chain, and on capturing single desk premiums,
- ❑ Growers should have more assurance that their farm gate returns are maximized by the single desk seller in the existing market structure,

- Any premiums in the export market due to the single desk seller should continue to be captured by the single desk seller,
- With increased transparency and reporting of performance, pressure for change in areas where single desk seller is not adequately performing.

#### **Key issues associated with Option #1**

The key issue associated with this option is that accountability of the single desk seller increases. This increase in accountability can lead to improved performance of the single desk seller and returns realized by growers compelled to deliver wheat and barley to the CWB. Examination of results by the regulator should help address the question of single desk premium capture by the CWB.

## **6.4 Contestability in Non-Premium Markets**

### **Option # 2 *Regulator assesses CWB single desk performance for wheat and barley sold into domestic and export markets and grants export permits for wheat and barley.***

#### **Description of the Option**

In this option the CWB is accountable to a regulator that would monitor and assess its performance and grant export permits for non-premium markets. This option builds on Option #1 by introducing contestability into the export market for wheat and barley.

As a result, specific regulatory and marketing powers currently held by the CWB as the single desk seller are separated. An agency grants export permits to applicants based on pre-established criteria and the CWB retains its single desk selling status in specific markets (whether geographic or by class, such as durum wheat).

This approach is used in Australia today where firms are able to access export markets outside of the single desk seller. There is a continuum of contestability in export markets. Exporting of wheat has less contestability than barley exports in Western Australia. For example, in Western Australia with the creation of the Grain Licensing Authority, other exporters are able to request an export license to export canola, barley and lupins outside of the single desk into markets that are considered non-premium markets. Premium markets are retained for the single desk seller. This concept of introducing contestability into the supply chain is being considered for barley in South Australia.

In the case of wheat in Australia, the WEA (Wheat Export Authority) has the power to grant export licenses for bagged and containerized wheat (the WEA must only inform AWBI of its decisions) but must gain written approval from AWBI to grant export permits for the bulk export of wheat. The grain licensing approach used by Western Australia is less restrictive because the grain pool cannot block the issuance of export permits to other players.

With a new regulatory body granting the export licenses, the single desk selling authority, which has been granted by Parliament, essentially sits with the new regulator/issuer of export permits. However, the CWB would be considered the main export permit (license) holder. This regulator can be the same regulatory body that examines and reports on the performance of the single desk exporter such as is the case in Australia. All other potential exporters must apply to the regulator for an export permit. The CWB could be granted a special exemption from this requirement. The agency would issue export permits for other exporters on a case-by-case basis. As previously discussed there is a continuum of contestability in the export market. In the approach used by the Grain Licensing Authority (most contestability) the regulator would

consider the impact of the sale on price premiums, Canada's reputation in the international grain market, and if the sale would capture opportunities not captured by the CWB. If the model used in wheat was used, the regulator could issue export permits for bagged or containerized exports but would require the CWB's permission for bulk exports. In Australia, the WEA must receive written permission from AWBI to allow the bulk exports of wheat. The AWBI has veto rights on bulk export licenses.

In our option, we are suggesting a model that is closer in design to the GLA, where the incumbent, the CWB, does not have veto power on applications, but rather where the regulator only entertains applications for pre-established non-premium markets and uses a set of criteria for granting export permits to entities other than the CWB.

This approach introduces contestability into the marketplace. The Western Australia approach introduces contestability in the process of buying grain for export. *"In the face of legislation supporting a single desk, unfettered potential competition for the market can be as effective as competition within the market, and with less likelihood of lasting damage being done to any net public benefits that may in fact be achievable only through a single desk".*<sup>83</sup>

### **Features of the Option**

Features of this option include:

- ❑ Features as described in Option #1,
- ❑ The new regulatory body that assesses CWB single desk performance would also be the body that grants export permits,
- ❑ CWB would be the main export license holder for bulk exports of wheat and barley,
- ❑ The domestic market for wheat and barley continues to be subject to the current regulations
- ❑ Container exports, while subject to export permits, would be freely provided, unless regulator determined that these shipments destroyed a single desk market premium,
- ❑ Guidelines support issuing of export permits to other exporters. These guidelines should be flexible, and include considerations such as markets where CWB captures single desk premiums<sup>84</sup>, percentage of a class of grain that are retained for the single desk seller, etc,
- ❑ Predetermination of single desk premium markets required by the regulator and/or an independent body, with input from the CWB and other parties on which markets are premium markets due to the single desk status of the CWB, versus premiums due to quality, product differentiation, etc.
- ❑ Decisions required on administrative issues, such as lead time allowable to apply for a export permit, can permits be issued in the pre-harvest or pre-plant period, the amount of confidentiality associated with applications and decisions,
- ❑ The CWB would not have a monopoly on sourcing producer wheat and barley for export,
- ❑ Grain companies can sell grain to the CWB pool at export position or to other grain companies,
- ❑ Change in Canadian Wheat Board Act required,
- ❑ Allowing other grain companies to export grain and purchase grain directly from farmers for export, is designed to introduce market contestability, which would benefit growers through the bid price and the pool returns. It would maximize returns to producers on

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<sup>83</sup> Professor Round, Adelaide University, "Report to Parliament on the Review of the Barley Marketing Act 1993", July 2004.

<sup>84</sup> These markets could be labeled as "preferred CWB markets".

sales into selected export markets and increase competition into the grain handling and transportation supply chain between grain companies and the CWB.

### **Implications and Impact of the Option**

- ❑ More delivery and marketing opportunities and choice for producers,
- ❑ Pressure on pool returns to be at least as good as prices received by growers for non-CWB deliveries, Pressure on pool returns to be at least as good as prices received by growers for non-CWB deliveries,<sup>85</sup>
- ❑ Liquidity of markets should increase, both cash markets and futures markets,
- ❑ CWB may increase the frequency of pool closures,
- ❑ CWB will offer more pricing and risk management options to growers,
- ❑ CWB will not be required to be a buyer of last resort,
- ❑ This option can be used to reduce CWB trade pressures and challenges from US growers, particularly if the US is not designated as a single desk premium market. It could also lead to more exports from Canada into the U.S,
- ❑ What will be the buyer reaction if they are aware of their market being designated as CWB premium market,
- ❑ CWB volumes into export markets will decline as multi-national grain companies compete with Canadian grain in non-CWB preferred markets,
- ❑ For CWB to be a long term player in the market it may have to have capital reserves to offer attractive pricing options to producers and/or participate in pricing options, etc.
- ❑ The CWB may need to develop alliances with selected grain companies, owners of grain handling assets, and transportation assets to develop supply chain efficiencies,
- ❑ Impact of this option to growers and to the CWB depends on the capability of the regulator and the information it has to make decisions,
- ❑ Regulator is acting as market coordinating mechanism through its granting of export permits,
- ❑ This option will force the debate on the nature of premiums achieved by Canadian grain exports, and the attribution of any premium to factors such as location and freight advantage, quality, ability to price discriminate, etc.
- ❑ Pressure to deregulate the domestic market, as the grain trade services some overseas accounts through export permits,
- ❑ Pressure on the single desk concept and need to demonstrate providing a superior return to producers in the export market,

### **Key Issues Associated with Option #2**

It can be argued that variants of this model have been used by the CWB, where the CWB relies on accredited exporters to develop certain export markets<sup>86</sup>. In the case of accredited exporters and the CWB, this relationship can be viewed as lying on the far left of a continuum with the GLA providing export permits based on pre-established criteria on the far right of the continuum.

A key to success is effective operation of the export permit application process. Too restrictive a process, or providing blanket veto powers to the incumbent single desk seller, will not allow market and supply chain services contestability to occur. A process that is rather open can

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<sup>85</sup> Note this actually puts pressure on pools per se because a spot cash price is being compared with returns averaged over time & markets (pools) that not only has to contend with possible lower prices, but the storage charges out into the future.

<sup>86</sup> Accredited exports are of two types, one where the buyer wants the grain company to be the intermediary with the CWB and arrange all of the logistics, etc, and the other is where the grain company has identified new markets and negotiates with the CWB on the best terms for both parties.

lead to the evaporation of any single desk premiums currently captured by the single desk based on competing with other suppliers of Canadian grain in designated premium markets.

In Western Australia many of the associated operational issues are still being fine-tuned. The South Australia review<sup>87</sup> noted that issues such as lead time, composition and operating rules, funding method, use of sunset clauses, appeal process, conditions of the license, and evidence required from the primary export license holder and potential exporters need to be resolved. The panel in SA recommended that the licensing authority be composed of five members (three not associated with barley or grain industry) and that it be reviewed one year after its establishment and then at three year periods. The panel also recommended allowing non-growers to access/deliver to the export pool.<sup>88</sup>

## **6.5 Deregulation of Domestic Market**

### **Option # 3 Deregulation of the domestic market and regulator assesses CWB single desk performance for wheat and barley on export sales**

#### **Description of the Option**

In this option the CWB retains single desk selling authority in the export market for wheat and barley. However, with domestic deregulation there is no single desk selling authority in the domestic market, meaning that in human consumption markets (wheat for flour, barley for malt, etc.) domestic processors of wheat and barley can buy directly from growers, from grain companies, or the CWB. As in option # 1, with this option the performance of the CWB is examined and reported on by the independent regulator.

Within western Canada growers have the right to sell wheat and barley directly to domestic processors and to add value to their own grain without “buying it back” from the CWB. Domestic processors can buy directly from growers or through grain companies etc. In other words the domestic market for wheat and barley would operate in a similar fashion as in eastern Canada and as with canola, flax, oats in the domestic market.

#### **Features of the Option**

Features of this option include:

- ❑ Features as described in option # 1.
- ❑ Upon delivery to the elevator, a producer has the option of delivering grain to the CWB for export, delivery to the grain company for domestic sales, and/or storage at the elevator for future delivery,
- ❑ Domestic users and their agents can buy directly from growers, grain companies, or the CWB
- ❑ Producers will be able to compare expected CWB export pool returns, with cash values in the domestic market, with cash prices and other pricing options for CWB export grains
- ❑ Producers are free to use food grade wheat and barley for any processing and value added activity on the prairies,
- ❑ CWB and grain companies can swap grain,
- ❑ Change in the Canadian Wheat Board Act required

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<sup>87</sup> Professor Round, Adelaide University, “Report to Parliament on the Review of the Barley Marketing Act 1993”, July 2004.

<sup>88</sup> Note this provides a ‘free’ put option to these entities who if prices are falling can dump into the pool & capture previously earned higher prices.

### **Implications and impact of the Option**

Some of the implications and impacts of this option can include:

- ❑ Implications and impacts as noted in option #1,
- ❑ More delivery and marketing opportunities and choice for producers,
- ❑ Primary focus of the CWB will be on the export market,
- ❑ Over time the CWB will have a smaller share of the domestic market,
- ❑ Producers with a locational advantage to markets will likely deliver proportionately more into these markets,
- ❑ Some value added processing by producers, second generation co-ops, and private companies emerge to service market opportunities,
- ❑ Value added industry may be stimulated if buyers have sense of more than one supplier,
- ❑ Exports of grain based value added products should increase, particularly to the U.S. market,
- ❑ Pressure on export pool performance as growers can track returns available from the domestic market,
- ❑ CWB may have to change its pricing formula into the domestic market to retain market share,
- ❑ Any domestic market price premium due to single desk sales will not be available to the CWB pools,
- ❑ The cash advance program could continue to operate as today, with the CWB administering the program for wheat, durum, feed barley and malting barley
- ❑ Grain companies should be able to buy lower grade food wheat for use in livestock feed markets, when required,
- ❑ Trading rules and contract specification may need to be developed for the domestic market,
- ❑ Cash markets will develop for food grade wheat and barley, which should be relatively liquid through-out the year,
- ❑ More pricing in the market based on U.S. cash and futures markets for wheat,
- ❑ More pricing options developed for growers with more participants providing price and financial options,
- ❑ Futures markets may develop for malt barley, or more trade in feed barley with established premiums for malt (WCE currently has contracts for both feed wheat and feed barley),
- ❑ End-users who used to purchase from the CWB will develop needed expertise (or outsource) in pricing, sourcing grain, logistics, securing supplies, etc.
- ❑ An increase in advisory services to grain buyers and grain producers expected,
- ❑ Grain companies may be in conflict with the CWB on access to transportation services to move grains into domestic markets that utilize rail transportation<sup>89</sup>,
- ❑ There will be no change in how wheat and barley varieties are registered with this option, or on the KVD (kernel visual distinguishability) requirement,
- ❑ Border monitoring to ensure that wheat and barley are not exported to the U.S. except by the CWB and its agents under the provisions of an export permit,
- ❑ Pressure to extend market deregulation to include the U.S. market,
- ❑ Over time new pressure points will emerge requiring change/solutions

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<sup>89</sup> The majority could use truck as backup if rail became an issue. Contracts would have a freight clause to cover this contingency.

### **Key issues associated with Option #3**

The key issue associated with this option is the opening up of the domestic market and allowing market forces to allocate resources. This option should see the development of markets and more pricing options available to grain producers, with more choice available to producers and more value added activity. With this domestic deregulation, any single desk premiums captured in the export market are maintained, while allowing for market efficiency gains to occur within western Canada. This option also provides producers with greater choice and may increase value-adding activities.

## **6.6 Domestic Deregulation and Contestability in Non-Premium Export Markets**

***Option # 4 Export licenses are granted to allow for contestability in non-premium markets, deregulation of the domestic market, and regulator assesses CWB single desk activities in export markets.***

### **Description of the Option**

This option includes the specifics of option # 3 where a regulator assesses the performance of the single desk seller in export markets for both wheat and barley and the domestic market for wheat and barley is deregulated. In addition, this option introduces contestability in a set of export markets by having another body, rather than the CWB, grant export permits for wheat and barley. As a result, specific regulatory and marketing powers currently held by the CWB as the single desk seller are separated. An agency grants export permits to applicants based on pre-established criteria and the CWB retains its single desk selling status in specific markets (whether geographic or by class, such as durum wheat).

This option builds on Option #2 where the regulator monitors and assesses the CWB's performance by the addition of a deregulated domestic market.

This approach is used in Australia today where there is no single desk selling in the domestic market and firms are able to access export markets outside of the single desk seller through applying for export permits.

### **Features of the Option**

Features of this option include:

- Features as described in Option # 3 and Option # 2.

### **Implications and impact of the Option**

Some of the implications and impacts of this option can include:

- Many of the implications and impacts as noted in Options # 2 and # 3,
- More delivery and marketing opportunities and choice for producers,
- Producers are free to use food grade wheat and barley for any processing and value added activity on the prairies
- Increase in cash sales by growers and increase in marketing and pricing options available to growers,

#### **Key issues associated with Option #4**

This approach is designed to bring about improvement by allowing the single desk to continue to capture single desk export premiums, while at the same time increasing the efficiency of grain handling and marketing and encouraging value-added activities in western Canada. This should decrease supply chain costs and increase net returns to growers.

A key issue of this option is that this change will likely require the CWB to become a full service grain company, either through acquisition of assets, or through alliances with selected grain handling and transportation companies. With both strategies, the CWB will need to develop an equity base; at issue is how the CWB will build up such equity. The AWB and ABB did it through a mandatory levy.

### **6.7 Provincial Choice on Single Desk Selling for Barley**

***Option #5 Provincial choice on single desk selling for barley, deregulation of the domestic market and regulator assesses CWB single desk performance on export.***

#### **Description of the Option**

This option provides provincial choice to retain single desk selling authority for barley in the export market; would deregulate the domestic market for wheat and barley; and establishes a regulator to monitor and assess the performance of the CWB. This option expands Option #3 by allowing provinces to determine if the CWB should continue to be the single desk exporter of barley.

This option is based on the Australian situation where the marketing of barley varies by state. South Australia and West Australia have retained single desk entities responsible for the export of barley (i.e., ABB and GPWA and marketed under Grain Australia). Other States like Victoria, New South Wales (from 1 October 2005), and Queensland have completely deregulated barley marketing.

#### **Features of the Option**

As with Option #3, operations of the grain market would require change with this option. Some work has already been completed on this issue<sup>90</sup>, and we use this as a starting point for the operational changes required in a province choosing this option. Features of this option include:

- ❑ Features as described in option # 3 for domestic deregulation for wheat and barley and regulator assessing single desk export performance, except for;
- ❑ Provinces are free to choose whether, in the case of barley, they want to retain the single desk seller concept – it is assumed for analysis purposes that only Alberta initially chooses the option of no single desk for barley in export market channels.
- ❑ This option opens up the U.S. market to Alberta barley producers, for exports of both feed barley and malting barley.
- ❑ The CWB would be a voluntary marketing agent for domestic barley and for export barley from Alberta.
- ❑ Barley growers could sell to any buyer.
- ❑ Processors could buy directly from growers, from grain companies, or from the CWB.

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<sup>90</sup> AAFRD and AGC, "Summary Report – Marketing Choice for Wheat and Barley Produced in Alberta: A Proposal for a Test Open Market", April 2004.

- ❑ The CWB gives up its right to restrict the issuance of an export permit to grain companies and grain producers based in Alberta – issuance of export licenses may have to be by the Export and Import Controls Bureau of DFAIT.

### **Implications and impact of the Option**

Some of the implications and impacts of this option can include:

- ❑ Many of the implications and impacts as noted in option #3,
- ❑ Free flow of barley between Alberta and U.S. states, with barley flowing into the US in some years, and when feed barley is short in Alberta, grain flows north,
- ❑ Saskatchewan can back-fill Alberta when Alberta is short of barley as it does now plus backdoor exports through Alberta will occur depending on pricing in various markets,
- ❑ Some grain companies in Alberta would attempt to source barley directly from Saskatchewan to serve feed and malt barley market opportunities,
- ❑ Alberta based grain companies may capture the majority of malting barley sales into export markets, which may cause the CWB to respond through pricing options (to end-users and to growers),
- ❑ Increase in cash purchase by the CWB for specific grades of malt to secure supplies,
- ❑ Further development of markets and market liquidity for feed barley and malt barley, including increased liquidity on the futures market in Winnipeg,
- ❑ Pressure on barley pool performance given the cash market prices that will emerge, and the CWB may have different pool and pricing options to attract supplies,
- ❑ Any price premium available to the CWB due to single desk status in export markets may be lost due to competing suppliers of Canadian barley in export markets,
- ❑ Grain companies will purchase barley based on a number of pricing options, including cash market purchases, basis contracts, forward contract sales, price pools, etc.
- ❑ CWB has less certainty on the barley supplies available for export contracts, particularly in the pre-harvest season,
- ❑ The allocation of grain cars and rail capacity to the CWB and to the private grain companies in Alberta would likely occur as it does today for canola and other non-CWB grains,
- ❑ The role of the CWB in grain handling and transportation system, and how the CWB gets its grain to port position would need to be addressed in a manner that is fair and equitable to all grain exporters and shippers,
- ❑ Costs in the supply chain to move barley into domestic and export markets can decrease due to the increase in sellers wanting to access continental and export markets,
- ❑ Will segregation of CWB and non-CWB barley be required in the system?,
- ❑ The CWB will not be required to be a receiver of last resort for barley in Alberta,
- ❑ The CWB may exit certain segments of the feed barley export market,
- ❑ CWB may price more barley on a “C&F” basis to capture any freight market advantages,
- ❑ CWB share in barley export markets likely will decrease, as a high percentage of contracts are now through accredited exporters,
- ❑ Any value adding opportunity suitable to western Canada in barley will likely locate in Alberta,
- ❑ Pressure to have neighboring provinces provide provincial choice for barley due to the flow of barley into Alberta – eventual loss of single desk status for the CWB on barley,
- ❑ This option leads to a continental market for barley,
- ❑ Pressure to extend provincial choice concept to wheat after a few years of operation,

### **Key issues associated with Option #5**

This option has all of the beneficial features of Option # 3 for wheat, and as well creates a true open market for barley in Alberta. This will generate benefits to Alberta. However, since a regulated system cannot effectively operate beside an open market system, this option is a temporary option. Either the CWB would regain its single desk selling status for barley into export markets, or the CWB would lose its single desk status for barley in all markets and would compete along side the grain companies for barley to supply export markets.

## **6.8 No Single Desk for Barley**

***Option # 6 No single desk for barley across the prairies, deregulation of the domestic market, and regulator assesses CWB single desk activities for wheat in export markets.***

### **Description of the Option**

This option eliminates single desk selling authority for barley from the CWB and has a regulator assess and report on the performance of the single desk on wheat in export markets. This option characterizes the situation in Australia, in the eastern States of Queensland, New South Wales and Victoria, where there is no single desk for barley, while the AWB has single desk selling authority in export markets for wheat.

This option builds on Option #5 (provincial choice in barley marketing, deregulated domestic market, and regulator assessing CWB performance) by eliminating the CWB's single desk for barley exports throughout the designated area.

### **Features of the Option**

Features of this option include:

- ❑ Features as described in Option #5 for domestic deregulation for wheat and regulator assessing single desk export performance, and domestic and export market deregulation for barley,
- ❑ This option opens up the export market to grain companies and barley producers, for exports of feed barley and malting barley.
- ❑ The CWB would be a voluntary marketing agent for both export and domestic barley,
- ❑ Barley growers could sell to any buyer.
- ❑ Processors could buy directly from growers, from grain companies, or from the CWB.
- ❑ Export permits are not required to export barley into any market,
- ❑ Change in the Canadian Wheat Board Act required

### **Implications and impact of the Option**

Many of the implications and impacts as noted in option #5. Option #5 leads to a continental market in barley and the CWB losing share in barley export markets. In Option # 5 the CWB may conclude that barley is not a core business area due to the highly mixed system it is operating in.

With this option, the CWB would become one of many suppliers of Canadian barley. Since any single desk premium that the CWB could be capturing for barley will be eliminated with this option, the CWB has a strategic choice to make. Will it only be opportunistic on barley export market sales, and focus on wheat and maximizing the value of the single desk to wheat growers, or will the CWB decide to aggressively compete with other grain companies for barley supplies and export barley.

- Many of the issues such as allocation of cars to the CWB, the role of the CWB in the grain handling and transportation system and CWB financial reserves and alliances identified in the prior options will also require resolution in this option.

#### **Key issues associated with Option #6**

In this open market model for barley, the key issues that will surface is how a single desk seller/monopoly buyer operates along with grain companies. This will likely force further change in the supply chain from the farm through to the export vessel. Issues such as allocation of cars, the requirement of grain companies to act as agents of the Board for wheat, and the desire to use IP programs will force the industry to reach agreement on how CWB grain is delivered to port. It may also result in the CWB owning and operating assets in the supply chain.

### **6.9 No Single Desk for Barley and Contestability in Non-Premium Markets**

***Option #7 No single desk for barley across the designated region, deregulation of the domestic market, single desk for wheat exports, and regulator assesses and monitors performance as well as grants export permits.***

#### **Description of the Option**

This option builds on Option #6 by introducing contestability in the export market for wheat. In this option the barley market is completely deregulated and the domestic market for wheat is deregulated. A regulator would monitor and assess the CWB's performance in exporting wheat as well as grant export permits for wheat. This would separate the regulatory and marketing functions of the single desk.

This option expands on Option #4 (single desk for wheat and barley exports, domestic market deregulated, and regulator assess CWB performance and grants exports permits) by removing the CWB's single desk for barley exports.

This option mirrors the situation in Australia in states that have deregulated barley marketing and the WEA's role across Australia to assess the performance of the AWBI and issue export licenses for wheat.

#### **Features of the Option**

- Features as described for Option #6
- Introduces contestability into the export market for wheat by establishing a regulator that issues export permits to firms for sales into non-premium export markets

#### **Implications and Impact of the Option**

The majority of the implications and impacts were identified in Option #6. Because this option adds contestability to the export market for wheat, it intensifies the need to address grain handling and transportation issues.

#### **Key Issues Associated with Option #7**

As with Option #6, the key issue that will surface is how a single desk seller/monopoly buyer operates along with grain companies. The introduction of contestability into the export market for wheat will increase the importance of this issue. This option would likely force further change in the supply chain from the farm through to the export vessel. Issues such as allocation of cars, the requirement of grain companies to act as agents of the Board for wheat,

and the desire to use IP programs will force the industry to reach agreement on how CWB grain is delivered to port. It may also result in the CWB owning and operating assets in the supply chain.

### 6.10 High Level Assessment of Options

A high level assessment of the seven options is presented in Table 6.2. This assessment is based on the following set of criteria:

**Criteria for assessing options**

- ❑ Accountability of single desk to producers
- ❑ Increase producer choice of marketing options
- ❑ Enable supply chain and market efficiency gains
- ❑ Decrease export supply chain costs
- ❑ Increase in value added activities
- ❑ Preserve single desk premium on bulk exports

Our assessment suggests that implementation of these options can deliver on selected important criteria. For example, improvements in accountability of the single desk can be made through the establishment of a regulatory body that monitors and assess the performance of the CWB. Deregulating domestic markets and introducing contestability into export markets both provide producers with more marketing options. Supply chain and marketing efficiencies and greater value adding activities can result from the deregulation of the domestic market. The introduction of contestability in export markets would lower export supply chain costs. Finally, the issuance of export permits for non-premium markets would retain single desk premiums.

**Table 6.2 Assessments of Australian-Experience-Based Options**

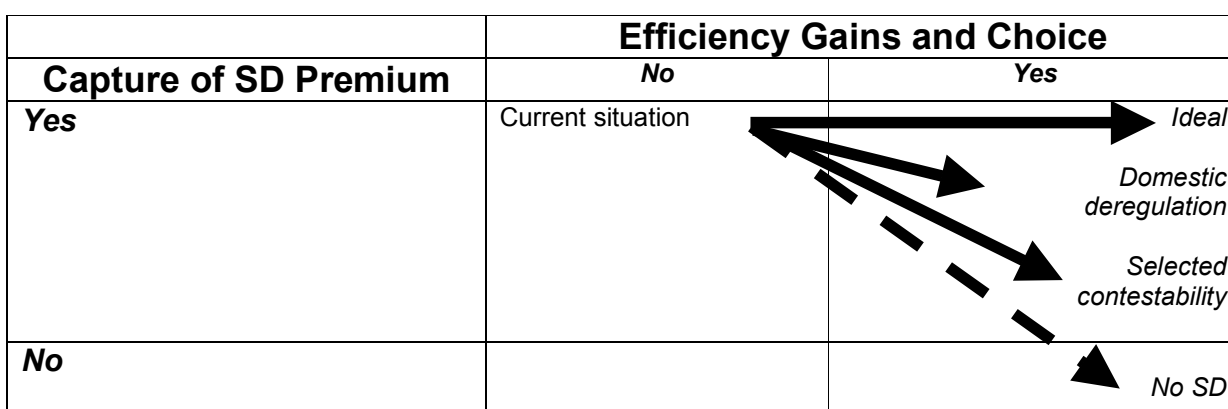
Criteria	Options						
	#1 Regulator Assesses SD Performance	#2 Regulator Assesses SD Performance and Issues Export Permits	#3 Domestic Deregulation and Option #1's Regulator	#4 Domestic Deregulation and Option #2's Regulator	#5 Domestic Deregulation, Provincial Choice in Barley, and Option #1's Regulator	#6 Domestic Deregulation, Only Single Desk Exports for Wheat, and Option #1's Regulator	#7 Domestic Deregulation, Only Single Desk Exports for Wheat, and Option #2's Regulator
Accountability of CWB	↑ +	↑ +	↑ +	↑ +	↑	↑	↑
Producer Choice		↑ +	↑ +	↑ +	↑ +	↑ +	↑ +
Market Efficiency			↑ +	↑ +	↑ +	↑ +	↑ +
Decrease Export SC Costs		↑ +		↑ +	+	+	↑ +
Increase Value Added			↑ +	↑ +	↑ +	↑ +	↑ +
Preserve Single Desk Premiums	↑ +	↑ +	↑ (Exports) +	↑ + (Exports)	↑ (Exports)	↑ (Exports)	↑ (Exports)
↑ for wheat + for barley							

These options can be viewed as involving a trade-off between the capture of single desk price premiums and the creation of efficiency gains and producer choice. This is shown in Figure 6.1, where the ideal situation would be to move from the current situation of single desk premium capture to retaining the entire premium and generating significant efficiency gains and increases in producer choice. However, there may be some trade offs.

Moving from the current situation to the option of deregulating the domestic market, results in some loss in single desk premiums (which exists only if the CWB is capturing price premiums in the domestic market) and a gain in market and supply chain efficiency and producer choice.

Selected contestability generates more efficiency and choice gains, but at the possible expense of the capture of single desk price premiums.

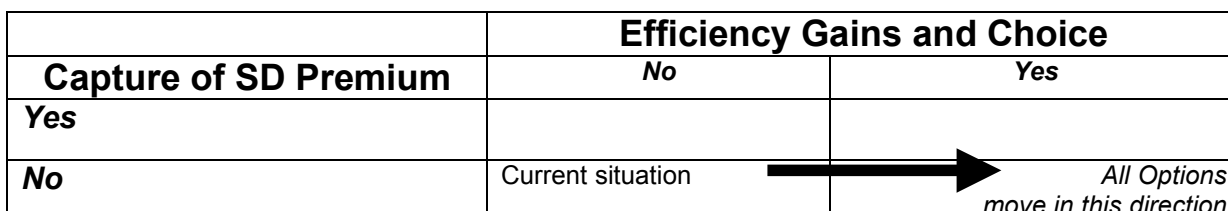
**Figure 6.1 View of Options – Capture of A Single Desk Premium Currently Exists**



In summary, producers are better off if any loss of a single desk premium is more than offset by efficiency gains (market liquidity, reduction in supply chain costs, greater valued added) and producer choice.

The above view is predicated on the belief, or demonstration, that single desk premiums are captured by the CWB. If a single desk premium does not exist, then all options are an improvement for producers, some more than others. For example, the elimination of the single desk for barley would provide significant gain, while a regulator that only assesses performance of the single desk would provide minimal gain.

**Figure 6.2 View of Options – No Single Desk Premium**



## **6.11 Some Implications for the CWB with Less Regulation**

In this section we highlight some of general implications for the CWB operating in an environment of less regulation. A number of these implications are based on our observations of the impact of change in Australia.

### ***CWB will focus on a single objective – delivering superior net returns***

With competition for farmers' grain and with other marketers being able to export grain into selected markets, the CWB will focus on delivering superior value to growers. We argue that for long run CWB sustainability this focus will be on providing superior net returns.

### ***CWB will operate more as a grain company***

Many of the options will have the CWB competing with grain companies for farmers' grain, and without the monopoly right to this grain. To be successful, the CWB will be forced to operate more like a grain company on both grain buying and selling grain, and on the pricing options and risk management products it offers to growers who choose to use the CWB.

### ***Increase in cash trading***

There will be a general increase in cash trading, with the CWB having more cash purchases, and pricing options linked to markets where it can offset price risk.

### ***CWB requires a financial base for cash trading***

The CWB will need to develop a financial base for its procurement operations. This financial base can come through a variety of mechanisms. One would be to access commercial funds to finance grain purchases based on the inventory of grain it has and will be purchasing from farmers, and through its sales contracts. Another is to build reserves based on a share of proceeds, before closing the pools. Another is to explicitly assess a levy, as in Australia to build up a capital base outside of the pools.

### ***CWB will have a strong focus on reducing supply chain costs***

In an attempt to offer the best price and value to farmers, when competing against other grain companies to access grain, the CWB will continue its attempts to reduce the handling and freight costs in the supply chain between the farm and the overseas customer.

### ***CWB will likely enter into more "c&f" sales***

As part of this focus on reducing supply chain costs and as the CWB attempts to capture as much "C&F value as possible, the CWB will enter into more "C&F sales, and have fewer "FOB" sales. Ocean freight will increasingly become a traded commodity for the CWB.

### ***Pressure on pool performance***

Pressure on pool returns and performance will increase, as farmers have more options and the CWB will need to demonstrate its value in offering superior returns to producer based on being the monopoly single desk seller. This will focus CWB activities in marketing and cost management.

### ***Increases in frequency of pool closures***

The pressure on pool performance and producers having access to more pricing options can lead to an increase in frequency of pool closures. For example, for producers choosing the pooling options, they could have a choice of a delivering into a crop year pool, or depending on the time of delivery into a harvest delivery pool or a post-harvest pool.

### ***Increase in the number and variety of pricing, risk management, and financing options***

When the CWB is obliged to compete with other grain companies to access producers' grain, the CWB will need to use a variety of pricing, risk management, and financing options. These will be in addition to the operation of pool accounts. This is starting to occur today, however the variety of options available to producers will increase significantly with the development of associated markets.

***Impact on CWB's "buyer of last resort" status***

When growers are compelled to deliver export and food grade wheat and barley to the CWB, the CWB as well is required to accept all grain delivered, subject to grading standards, and sometimes over more than one crop-year. The CWB will not be obliged to be the "buyer of last resort" when other grain companies can also ship into export markets, for example. As a result, in some crop years, the CWB may not be in the market and not wanting to access producers' grain based on market place strategy and delivery contracts.

***Increase in transparency and accountability of CWB performance***

All of the options result in more transparency and accountability of CWB performance, whether through the regulator that examines and reports on performance, or through the alternatives to delivering to the CWB.

***Issue of CWB ownership may be forced***

With the CWB operating in a less regulated environment, the issue of CWB ownership will likely be dealt with. The CWB could be transformed into a share capital corporation if the CWB builds up a financial reserve and does not operate as a non-profit corporation. Based on the history of the CWB, the most logical ownership response is the CWB will be owned by producers in proportion to their recent deliveries<sup>91</sup> to the CWB.

***Renewed support by some growers as the CWB as the growers company***

As the CWB shows that it is generating acceptable net returns in the export market relative to the other prices and returns available to producers, there can be renewed support of the CWB by growers, and growers seeing this as their grain marketing company.

***The CWB will operate with fewer, if any, government guarantees***

In a less regulated environment, other grain companies will rightly argue that the CWB cannot have an unfair advantage of operating with government guarantees that are not available to them. This plus the current WTO negotiating thrust of eliminating government guarantees with STEs (state trading enterprises, such as the CWB) will result in the CWB operating with fewer, if any, government guarantees. As noted above, the CWB will respond by developing a capital base to help finance operations. However, the CWB can purchase and sell grain with a relatively small capital reserve due to the ability to access commercial credit based on the hedged value of grain in possession of the CWB. Credit can likely be accessed for somewhere between 75% and 90% of inventory value.

***Will the CWB still be the organization that positions Canadian grain in the export market?***

Due to its monopoly position in the export market, the CWB has been the organization that has championed and positioned western Canadian wheat and barley with overseas buyers. In an environment where the CWB does not have this exclusivity, an interesting issue is whether the CWB will retain this role as ambassador for Canadian wheat, particularly when it can be argued that other grain companies are able to take advantage of these efforts. In a less regulated

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<sup>91</sup> This can be viewed in a five-year context, with the same outcome if a levy as assessed on all grain shipped to the CWB over a period of time.

environment where the private grain companies have a share of wheat exports, the industry may evolve to a structure where a separate organization promotes Canadian wheat on behalf of all growers and exporters. If and when this occurs, the CWB will be positioned as another grain company, possibly grower owned.

***Alliances of the CWB with service providers***

With more grain buyers competing with the CWB for grain on the prairies, there will likely be new approaches developed to allocate grain handling and transportation capacity between grain buyers. One approach can be for the CWB to develop alliances with other service providers (e.g., freight, storage and handling companies in the country and at port) to ensure that the CWB has access to sufficient capacity to move the right grain to the port at the right time. Unless the CWB is specifically relieved of its transportation powers there will be few issues around the CWB getting sufficient car allocation. In this event there is a long history of the industry developing formulae to get product to port.

***CWB becomes an asset based grain company (such as AWB) or an alliance based entity***

In a less regulated environment, the CWB will evolve to become either an asset based grain company, such as the AWB and ABB in Australia, or the CWB will use its core competency of marketing and develop alliances with grain companies with assets in the country side, grain companies with assets at port positions, and with freight companies (land and water).

***Greater acceptability of the CWB to the United States***

With the CWB operating in a less regulated environment, and not having access to government guarantees, it can be argued that the CWB will be more acceptable to the U.S. The level of acceptability will depend on which deregulatory route, if any, is chosen. Having a regulator assess CWB performance will likely not change US attitudes to any significant degree, nor would domestic deregulation. However, a model where there are contestable markets (of which the US is one) and the CWB does not have access to government guarantees may alter US attitudes. This will not prevent trade action, if US growers believe that U.S. imports of Canadian wheat are hurting US growers.

## **7.0 Summary of Findings**

In this last section of the report, we provide a brief summary of findings and highlight some lessons learned from the Australian experience that could apply to Canada.

### **7.1 Summary of Deregulation in Australian Wheat and Barley**

Australia has gone through a period of deregulation in its grain and oilseed sector over the last 15 years. While the wheat and barley sector were highly regulated as in Canada, today the wheat and barley sector is less regulated than in Canada. Evidence to support this statement includes the elimination of single desk selling in domestic markets for wheat and barley, and the elimination of single desk selling into export markets for barley in some Australian States.

As well, Australia has moved towards ensuring that markets are contestable while preserving single desk advantages. This has been accomplished through the establishment of the WEA for wheat and the GLA for barley (in Western Australia), and the granting of export licenses when certain conditions prevail. The export license system is designed to preserve the single desk price premium and add competitive elements to improve grower returns.

In addition, the regulated entities in Australia are more accountable than in Canada. This is through independent regulators that are accountable to Government and examine and report on the performance of the single desk seller. These regulatory bodies are relatively new and are subject to some criticism as their procedures evolve and as they gain experience in carrying out their roles.

### **7.2 Applicability of Australian Experience to Western Canada**

The Australian experience has considerable applicability to the wheat and barley industry in western Canada. Based on the Australian experience potential options for western Canada were developed and included dimensions of:

- ❑ A new regulatory body examines and reports on single desk seller performance,
- ❑ A new regulatory body also grants export permits into non-premium markets to provide contestability,
- ❑ Single desk selling continues in export markets for wheat and barley and domestic deregulation (no domestic single desk),
- ❑ Provinces having choice on whether to have a single desk seller for barley into export markets,
- ❑ There is no single desk selling in barley, either export or domestic.

Options associated with these dimensions of change were discussed in section 6.0, with implications highlighted. These options can provide a context for advocates of change concerning the regulatory structure impacting on the western Canadian wheat and barley sectors.

### **7.3 Some Lessons Learned from the Australian Experience**

A number of lessons learned from the Australian experience are applicable to the western Canadian grain economy; particularly those lessons and observations associated with an environment where the grain industry has been shaped by the presence of a single desk seller, and the industry has moved to an environment where the single desk seller has a reduced scope of powers. These are noted below.

#### ***National Competition Policy created a country wide imperative for deregulation***

The NCP was a catalyst for change. The NCP was economy wide and not specific to agriculture. This created an environment of deregulation and the agriculture sector, or a sub-sector of agriculture, could not argue that it was the only sector that was the focus of deregulation.

#### ***Financial incentives helped drive change in barley and in most other sectors***

Withholding competition payments by the Commonwealth Government to State Governments created incentives for changes to the regulatory structure in agricultural commodities under State control. Those incentives drove State governments to support and deliver deregulation in barley, and other commodities such as eggs, chicken meat, potatoes, and dairy. It also provided a political justification for the changes; the States would miss out on monies. Wheat export legislation however is under Commonwealth control and, as such, the competition payments could not be a driving force on wheat marketing.

#### ***Domestic deregulation created marketing and pricing options for producers***

With domestic deregulation many marketing and pricing options were created leading to development of liquid cash markets, particularly at harvest in areas where domestic markets existed. (Some illiquidity may occur later in the season as grain has been committed to export paths). Because of the dominance of the AWB pool due to the relative proportions of export wheat (in normal years) the expected pool returns play a major role in price discovery. Also local Futures contracts for wheat, barley and canola have been developed, but the volume is not very large (Winnipeg is the main hedging market used for canola). Domestic deregulation and the resulting marketing options gave producers choice.

#### ***Deregulation and growth of valued added industries***

Domestic deregulation of the wheat and barley sectors coincided with a rapid increase in feed grain usage by the livestock and poultry industry. While domestic deregulation supported the development of value added industries, the primary driver was the growth in export demand for the value added products particularly into Asia along with domestic demand (e.g., chicken meat). Domestic deregulation did not result in any significant increase in export of flour or malt, however, the efficiencies in the domestic flour and malt industries increased as a result of domestic deregulation.

#### ***Domestic market share of single desk authorities will decrease over time***

Immediately following the change in the AWB's single desk selling status in the domestic market, the AWB held a rather large market share. Over time as other grain companies better understood the market and were able to service the market more efficiently, the AWB's share of domestic sales has declined to 15% to 30% of domestic food wheat demand. In some cases millers buy directly from farmers, from grain companies and from the AWB.

***Transition periods are important***

A sector cannot move instantaneously from a highly regulated environment to a deregulated environment overnight. A transition period is important to allow the necessary infrastructure to develop and for participants to develop the needed skills and processes (contracts, dispute resolution procedures, standards) that allow markets to function in a deregulated environment. Structures to facilitate transition to a non-single desk selling environment can include entities such as the GLA in Western Australia along with the development of industry associations.

***Clear definition of the desired end-state***

Deregulation is more successful when there is a clearly defined end-state. This clear definition allows for the establishment of the appropriate supporting mechanisms and necessary infrastructure. In the case of barley in Western Australia an issue for some is whether the GLA is a part of the transition process to complete deregulation or the desired end state for the barley sector.

***Creation of new organizations and regulatory structures***

In Australia, significant industry effort has gone into modifying the institutions that were created as their roles and responsibilities were better understood. This is an evolutionary process to improve their effectiveness. For example the accountability and independence of the AWB International from AWB Ltd has been increasingly identified as a major corporate governance issue. A number of industry commentators argued that the benchmarking system and the associated performance payments to AWB Ltd from AWBI for managing the wheat pools is benefiting shareholders at the expense of growers (pool returns). Also there have been strong claims that many of the services provided by AWB Ltd should be opened for others to offer to AWBI, that is they should be contestable. Another area of contention is that AWB Ltd has the right of veto over WEA granting bulk export licenses, and the WEA need to advise AWB Ltd of applications for bagged and container licenses provides AWB Ltd with the opportunity to obstruct or even prevent their issuance. The lesson is that considerable attention should be placed on developing the appropriate structure and rules for the new regulatory entities to maximize the efficiencies to be gained and to ensure that inefficiencies are not created.

***Single desk sellers become competitive agri-business companies***

In a deregulated environment, single desk sellers do not vanish. The Australian experience has shown that the former entities build on their core competencies in grain marketing and develop to meet and capture the opportunities available after the single desk status is removed. ABB Grain Ltd (while still with some barley single desk status) has evolved into a strong marketer across many commodities and has merged with a major bulk handling company to become a major integrated agribusiness including being the largest maltster in Australia and in the top ten in the world in malting. The AWB again while still with the export wheat desk is now the largest agri-business company in Australia having expanded heavily into rural merchandising as well as developing its grain marketing and financing activities. GrainCorp which evolved from a regulated storage and handling entity has expanded interstate, taken over former single desk marketing activities, developed strong commercial marketing activities and is heavily involved in flour milling. Similarly CBH in Western Australia and the Grain Pool (now merged) are moving to establish investment relationships with major overseas flour milling companies.

***A share capital corporation will have a clear focus***

Corporatized entities have a clear responsibility to maximize returns to shareholders but those with single desk responsibilities also have an obligation to maximize pool returns to growers. This apparent conundrum can be managed to the benefit of both groups. First, the Board structure of the companies was purposefully constructed so that growers have the majority of

director positions and therefore control over the company's activities. Second, growers are the suppliers of grain and it is in the interests of shareholders to ensure that the growers continue to produce grain and to provide it to the company. Therefore the pool returns have to be competitive to alternative marketing channels. Third, in cases where alternatives are not available clear, transparent business rules need to be established and implemented and performance criteria developed that encourage desired behaviour. Taken together the companies will have incentives to preserve single desk status, where there are clear advantages to growers, because both will benefit. In addition, the disciplines that corporatization imposes causes companies to consider their whole operations including capital management, on harsh commercial criteria which drives efficiencies. Costs can no longer be simply pooled.

***Excessive regulatory oversight can create significant regulatory cost to the single desk***

In cases however where the regulatory oversight becomes too onerous or where commercial advantages are being exposed for all to see, the company may make a commercial decision that it is not in the company's interest to bear the regulatory costs. That is the cost of regulation combined with the removal of what previously were benefits that a full single desk operator could achieve, outweighs the remaining benefits of the single desk.

***Being stuck in the middle***

Providing that the companies are properly structured, have clear business rules and are not encumbered with transparency, single desk or regulatory requirements that place them at a competitive disadvantage to other competitors, there is no reason why they cannot operate in so called "dual" markets. A dual market is however effectively a deregulated market and some or all of any single desk benefits will be lost. Difficulties may prevail where there is a requirement for the pools to be the receivers of last resort (or to accept deliveries into pools from all including trading companies so that when prices fall they dump grain into the pool) or for commercial transaction details to be disclosed. It is also difficult to operate a pool price (which is an average over time and over markets and necessarily includes carrying costs of grain) against a spot cash price.

***Performance reporting increases accountability and transparency***

Deregulation in the domestic market, regulatory oversight, and assessment of performance of the single desk seller has most certainly increased accountability, transparency and performance.

***The nature of the single desk price premium in relation to other market premiums***

Deregulation has sharpened the debate on the nature and size of the single desk premium for wheat and barley, and which premiums are due to factors beyond the single desk. In Australia, it has been argued that premium returns in the export markets can be due to:

- ❑ Location advantage of Australia over the next alternative supplier,
- ❑ Quality advantage of Australian grain,
- ❑ Differentiable products (e.g., dry, hard white wheat),
- ❑ Market specific such as buying patterns of JFA,
- ❑ Ability to price discriminate between markets and increase the average price received,
- ❑ Ability to manage and shape the qualities of Australian grain to suit particular market needs, and
- ❑ Ability to use marketing knowledge to control the timing of sales of grain to coincide with higher prices.

Many argue that a single desk sales agency is not required to capture premiums due to quality, differentiated products and market specific premiums due to buying patterns.

### ***Single desk seller allows Australia to capture locational advantage***

There are suggestions that the single desk premium for Australia may only reflect the capture of Australia's locational advantage. For example, in markets in some parts of Asia, where Australia has lower freight costs than the next available supplier, the single desk seller can capture the freight advantages from a series of markets and return a higher "FOB" price (to growers). With multiple sellers, the FOB price freight advantage can be bid away to the FOB price of the next alternative to supply the specific market, or to the FOB price of the next country where Australia has a freight advantage<sup>92</sup>. An interesting issue is whether the CWB has a freight advantage<sup>93</sup> to exploit given the proximity of the U.S. as a competitor and its east coast, west coast, and Gulf export positions.

### ***Retain market specific single desk premiums through granting of export licenses***

Australia has attempted to use the process of granting export permits as a way to ensure that any single desk premium is retained from specific premium markets while allowing contestability in other markets. The GLA for barley is expected to preserve premiums that arise from the single desk for the incumbent single desk holder and allow for other (non-premium) markets to be contested. The debate continues over what is a premium market and is any market consistently a premium from one year to the next given variation in crop production and the likelihood that in larger production years more distant markets are needed, but not in smaller production years. If premiums largely are derived from freight advantages, then a marginal market one year may be a premium market in a year of high production when even further markets (higher freight costs) are needed to clear the crop.

### ***Do efficiency gains more than offset loss of any single desk premium?***

Another issue with deregulation is that there may be a trade off between losing single desk premiums and efficiency gains through such factors as lowering of supply chain costs. For example, a loss of a \$5 premium, but an efficiency gain of \$10, would result in net returns to growers that would be \$5 higher in a deregulated system.

### ***Indisputable facts are helpful***

In Australia, there are arguments and reports that support the continuation of single desk selling into export markets, and there are reports and arguments that indicate that the costs of operating a single desk outweigh any potential benefits. As a result of not having indisputable facts for either side of the argument, the politically safe option is to continue with the status quo. This is occurring in the case of wheat, where the single desk per se was not part of the 2004 wheat review and will not be addressed until 2010. Once the market is deregulated it is not possible to bring the old system back<sup>94</sup>. The issue of whether there is a single desk price benefit that is realized by growers is debated in Australia, just as in Canada.

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<sup>92</sup> With multiple sellers the FOB price freight advantage to any particular market will be bid away to the lowest FOB price needed to clear the market. Irrespective of where each market is located, the freight advantage is passed to the buyers as multiple sellers cut their price to ensure that they get the sale. The clearing price falls until it just equals the price to the buyer on a C&F basis in the most marginal Australian market, which is a market that can be supplied at that same C&F cost from an alternative origin. Competition forces this to happen. In other words on any particular day, for any given quality wheat, one FOB price prevails and any buyer can access that FOB price irrespective of that buyer's location.

<sup>93</sup> Arguably, the CWB has used price discrimination to obtain price premiums by moving part of the crop to a non-premium market coast to ensure some price discrimination premiums are captured in the premium coast market. In this example, the extra logistics costs need to be considered to determine the net benefit to growers.

<sup>94</sup> The majority of growers strongly support maintaining the status quo. There is no strong push to actually unwind any of the changes that have been made. The thrust continues to be one of no further change in structure, but there are increased calls for improved accountability.

## Annex

### Annex I - Project Scope Consideration

The purpose of the project is to examine the evolution of wheat and barley marketing in Australia; assess the impact of the deregulation on producers and other stakeholders; examine the factors that may compel future changes; and compare wheat and barley marketing in Canada and Australia. **The specific elements to be examined in the review of the evolution of wheat and barley marketing in Australia are shown below.**

	Wheat	Barley
Historical Development	Describe process leading up to the <i>Wheat Marketing Act</i> of 1989 National Competition Policy Key drivers of the reform process, farmer involvement in the process, support for and opposition to deregulation, economic arguments for deregulation Development and purpose of the Wheat Industry Fund Describe evolution of the Australian Wheat Board Ongoing role of government in the wheat industry	Describe the evolution of the state barley marketing authorities Describe the function and powers of the Grain Licensing Authority Key drivers for change, farmer involvement, support for and opposition to deregulation Ongoing role of government in the barley industry
Structure and Governance	For AWB Ltd. and AWBI: Legislative authority, shareholder system, election process, board of directors composition (elected versus appointed), terms of office, voting privileges on the Board, management and corporate structure and financing arrangements, performance measures Describe the functions and powers of the Wheat Export Authority and relationship to AWB Ltd.	For state level barley marketing entities including ABB Grain Ltd., AusBulk, Graincorp Operations Ltd. and Grain Pool Pty Ltd.: Legislative authority, shareholder system, election process, Board of Directors composition (elected versus appointed), terms of office, voting privileges on the Board, management and corporate structure and financing arrangements Other grains marketed by state agencies and grain companies
	<i>Regulatory agencies: Roles and responsibilities</i>	<i>Regulatory agencies: Roles and responsibilities</i>
	Grain companies: Market share versus AWB Ltd. How has deregulation affected industry structure in terms of mergers, new entrants into the market, changes in grain handling infrastructure – current structure of the wheat industry.	
	Policy environment: Describe the policy development process, competitiveness factors affecting deregulation, and domestic and external policy pressures.	Policy environment: Describe the policy development process, competitiveness factors affecting deregulation and domestic and external policy pressures.
	Assessment of value adding industry: Key industry participants, grain companies, millers Size of industry – value to Australian economy Growth since deregulation, industry restructuring, investments Australia's value added investment abroad	Assessment of value adding industry: Identify key industry participants, grain companies, malsters, brewers Value and volumes of barley processed Growth since deregulation, industry restructuring, investments Australia's value added investment abroad

With respect to **deregulation**, the study is to:

- 1) Analyse, assess and describe the impacts on farmers from deregulation and the elimination of the guaranteed minimum price.
- 2) Analyse, assess and describe the impacts of deregulation on grain companies, processors and other stakeholders (e.g. livestock industry).
- 3) Assess and describe the transition mechanisms that may have been put into place during the deregulation process.

The study is to examine **how Australia's system may change in the future**. Specific items are:

- 1) Assess, analyse and describe Australia's policy positions regarding State Trading Enterprises in current WTO negotiations and how the Australian Wheat Board and the federal and state governments are approaching the monopoly issue.
- 2) Evaluate the recent Australia/U.S. trade agreement with particular reference to impacts on the wheat and barley marketing requirements/restrictions.
- 3) Describe further industry reviews and other forces for change.

**The comparison between marketing in Canada and Australia** has the following tasks:

- 1) Compare Australian national and state level marketing systems and regulatory authorities to western Canadian wheat and barley marketing systems.
- 2) Assess how Australia's experiences and lessons learned could be applied to Canadian provinces.
- 3) Compare Canadian government involvement in the CWB with Australian system.
  - What are the financial arrangements/backstops between the government and the CWB as compared to Australia?
  - What is their value on an annual basis?
  - Describe the capital requirements needed to enable the AWB system to move towards a corporate model.

## **Annex II – Organizations Consulted and Results**

The following organizations were consulted:

<b>Australia</b>	<b>Canada</b>
<p><b><u>Grain Companies</u></b>                      Australian Barley Board                      Australian Wheat Board                      Cargill                      GrainCorp Limited                      Louis Dreyfus</p> <p><b><u>Grain Users</u></b>                      Allied Mills                      Australian Flour Millers Council                      Joe White Maltings</p> <p><b><u>Other</u></b>                      Advance Trading Australia                      Grain Licensing Authority (WA)                      Pacific National Railroads                      Storey Marketing</p> <p><b><u>Associations</u></b>                      Australian Dairy Farmers                      Australian Grain Exporters Association                      Australian Lot Feeders' Association                      Australian Oilseed Federation                      Grain Growers Association                      NSW Farmers Association                      National Agricultural Commodities Marketing Association</p>	<p><b><u>Grain Companies</u></b>                      Agricore United                      CWB</p> <p><b><u>Other</u></b>                      Alberta Agriculture, Food and Rural Development                      Alberta Grain Commission                      Consultant to Brewers                      Canadian Grain Commission                      Government of Canada</p> <p><b><u>Associations</u></b>                      Brewers of Canada                      Alberta Agricultural Products Marketing Council                      Western Barley Growers Association                      Western Canadian Wheat Growers Association</p>

The following table summarizes the results of the consultations in Western Canada.

<b>Western Canadian Consultation Summary</b>	
<b>Question</b>	<b>Responses</b>
Major changes in the GHTS since end of the WGTA	Led to revenue cap; producer paying full freight; elimination of car allocation policy group; consolidation of facilities; facilitated investment; increased entrepreneurship; increase in exports to south; increase of imports of corn and soy meal; increase in non-board production; increase in CWB power over car allocation
Who benefited and who was harmed by changes?	Benefited: cattle and hog production; federal government (decreased dollars); railways; end-users; special crops; handlers; railways; western Canadian economy; only CWB; growers Harmed: handlers; growers; dehy; no one; increase cost of road maintenance; local communities; CWB; CGC; canola (because of transportation problems); and all (because change was incomplete)
Have changes occurred in the structure of the industry?	Entry by LD and ConAgra; growth of inland terminals; elevator rationalization; creation of high throughputs; abandonment of branch lines; increased hauling distance; increase on farm storage; more non-boards and livestock; consolidation of grain companies; change in cooperative grain handlers
What changes did you expect to occur or should have occurred?	Should have moved CWB to port as recommended by Estey and Kroeger; significant crop diversification; increase in value added; increased concentration; greater rail line rationalization; greater economic efficiencies; didn't expect large increase in producer car loading; resolution of CWB's role in transportation; increase in car block size;
What changes have occurred in the amount and type of value added in Western Canada?	Increase in value added in oats; greater oil crushing capacity; more small food processors; increase in malt and flour mill capacity; increase in beef and pork; increase in exports of wheat based production; increase in processing on non-boards;
Where are the greatest opportunities for value added processing in Western Canada?	Bio-fuels, varietal tailoring; hard white wheat; nutraceuticals; livestock; grain processing
What are the greatest obstacles to the growth of value added in Western Canada?	Getting projects off the ground; distance from market and small population base; high taxes except in Alberta; access to patient capital; poor coordination of R&D, business development and grants; industry doesn't think strategically; cost to produce primary crops too high; CWB – investors don't like risk of only one source of supply; too many roadblocks; government attitudes; lack of labour
What is your perception of wheat and barley marketing in Australia? Is it very regulated or deregulated? What changes have been made to the AWB and what has been the impact?	Highly deregulated but with single desk in wheat; AWB and ABB have export monopoly; deregulated domestic market; no government guarantee on borrowings; deregulation of exports in bags or containers; producers have freedom in barley marketing; recent study (RSM

	<p>Bird Cameron) shows grower gained from open market; better vision and governance; AWB privatized; AWB and ABB have invested in handling and farm supplies; Australia more open to change; have lost price premium on barley into Japan; Australian government won't go the wall to defend single desk</p>
<p>Does Canada have an influence on world markets for wheat and barley?</p>	<p>Canada mainly a price taker with any influence from product quality; durum – has 55% of world market so does influence price but because no control over supply growers overproduce; wheat – not as much benefit so can't influence world prices but can extract price premiums; can influence malting barley price; no influence on feed barley price; Canada does influence price in malt barley and durum and can price discriminate in some markets like Japan and the UK; like Australia Canada has little market power; Canadian influence falling because of declining exports; technical change and the ability to substitute lower quality reduces influence and power</p>
<p>What are the benefits and costs of the CWB's single desk selling?</p>	<p>Benefits: good tool for those producers not wishing to do own marketing; segment and differentiate markets to maximize returns; one stop shopping for buyers; domestic malsters get best quality; CWB good at maintaining relationships; \$150 M to \$200 M benefit for non-durum wheat, \$60 M benefit for barley                  Costs: huge issue with US, Japan and EU; CWB can put private companies at a disadvantage; investors don't like having only one supplier; CWB over delivers on quality; inefficiency; limits price signals; lack of transparency; lack of accountability to growers; lower farm gate returns; decreased market access; liability in WTO negotiations; impediment to value added; higher transportation costs; impediment to entrepreneurship</p>
<p>What are some potential changes that could be made and what would be the impacts?</p>	<p>Voluntary CWB: increased producer choice; increased returns; and greater value added; would remove CWB from transportation; other stakeholders would adapt; enhance Canadian competitiveness; help with trade disputes; CWB could raise capital and make investment; CWB would have to earn grower's business (like in Ontario), increased efficiency; more R&amp;D (remove KVD requirement); increase transparency and accountability of CWB; lower handling and transportation costs; decrease risk to growers; more focus on IP;                  Changes for malting barley: split pool into domestic and export; negotiate five year contracts with malsters; increase price spreads; old varieties should receive a lower price and only go to discount markets like Brazil; contract system with growers; establish a dispute settlement mechanism; move to a feed plus price system; make CWB more commercially oriented                  CWB governance changes: increase amount of producer</p>

	control; eliminate government appointments to board of directors; allow off-shore investments; allow CWB to market other commodities (voluntary) – these changes would increase producer control and allow capture of value from investment in consumption channels; neutral to trade situation and other stakeholders; reduce supply chain costs
Impact of specific changes: loss of single desk in domestic market and loss of single desk in export market	<p>Loss of single desk in barley in domestic market: little or no change; would lose price premium; would get rid of KVD and some of CGC; increase producer choices; increase in value added; increase in direct sales to end-users; allow development of relationships between malsters, grain companies, and brewers; big brewers would become vertically integrated</p> <p>Loss of single desk in wheat in domestic market: no change; greater impact; would lose price premium; get rid of KVD and some of CGC; lower costs; increase quality control, increase niche markets; increase value added; increase producer choice; increase in direct sales to end-users</p> <p>Loss of single desk in export in barley: not much impact; barley is following a different path than wheat; lower prices; increase power of multinationals; feed barley no change because Canada is a price taker; in malt relationships would develop and big brewers would become vertically integrated</p> <p>Loss of single desk in export in wheat: no change; CWB not likely to survive; lower prices; increase power of multinationals; end of KVD, would hurt in durum</p>
Does Canada's proximity to the US suggest that the impact of domestic deregulation would be different in Canada than Australia?	Yes, we aren't an island; US market is a huge opportunity and should be able to access it; would have to be careful about flooding market; no geographic impact; under US Bio-terrorism Act are stricter border controls
What would be the impact of the Alberta Test Open market on the barley market and on the Wheat market?	<p>Barley: very upsetting on market; change in how stage malting barley; wouldn't work; CWB wouldn't know supply; grower gets money immediately</p> <p>Wheat: wouldn't work; not sustainable; CWB wouldn't know supply; grower gets money immediately</p> <p>General: AB Test Open Market is a bargaining chip – it acts as a credible threat to force changes in CWB</p>

### **Annex III – Overview of Agriculture in Australia**

#### **State Map**



The above map shows the mainland states of Australia. Tasmania is not shown. Every state except the Northern Territory is involved in cereal grain and oilseed production. Livestock is produced in all states.

There are two cropping seasons in Australia, winter and summer. The typical winter cropping is the dominant season for crops such as wheat, barley, and canola. Typical planting occurs between April and June with harvest in October through December.

The summer season is for crops planted in states of New South Wales and Queensland. Crops include cottonseed, sunflower, sorghum and rice. Planting occurs later in summer months of November and December with harvest in February to March.

The most important agriculture region in Australia is the Murray - Darling River basin. This region spans the four states of South Australia, Victoria, New South Wales and Queensland. The following image map shows the extent of the basin and the white circles represent the areas of wheat production.

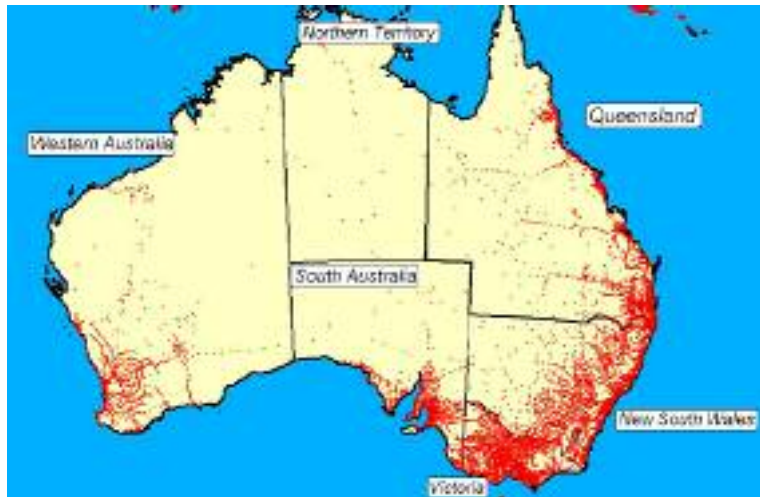
#### **Murray Darling River Basins**



Source: <http://www.mdbc.gov.au/education/encyclopedia/agriculture/agriculture.htm>

This region produces a lot of Australia's total agricultural production. It accounts for 35% of wheat production, 42% of barley production and 73% of oilseed production.

### Population Map



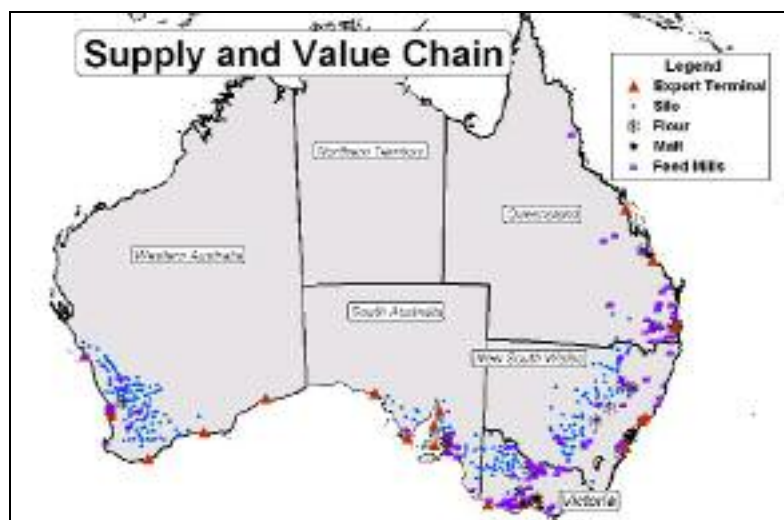
Population is concentrated in the southern and eastern states of South Australia, Victoria and New South Wales. These areas also have the highest domestic demand for processing of cereals for human consumption as the manufacturing sector mirrors population.

### Grain Company Evolution



During the 1990's Australian grower organizations for pooling and handling of grains evolved from the various state base organizations to either private or new public based companies. In 1990 there were 15 organizations as compared to four in 2004. The above map shows which state companies have merged since 1995 to form the present day grain industry. The most recent merger was in September 2004 between Ausbulk and ABB.

**Supply and Value Chain Map**



The cereal supply and value chain in Australia is illustrated by showing the locations of Inland silos (elevators), export terminals and processing sites for malt, flour and feed., As the grain industry amalgamated, companies either rationalized their distribution systems by locating new silos and investing in export terminals. Companies expanded storage capacity at silos and terminals and upgrading ports to accommodate larger vessels. The milling and malt industry is concentrated in Victoria and New South Wales. Some of the export terminals in these states also service the local domestic market as they are situated adjacent to processing facilities. The greatest impact from the deregulation of the wheat market has occurred within the states of New South Wales and Victoria. AWB has developed and located both new inland silos and export terminals. In response to AWB entering these states, GrainCorp has rationalized some sites and expanded other silos and port terminals. CBH, which operates in Western Australia, has also made similar supply chain changes by either expanding port capacity or inland terminal sites. Most companies have identified key collection sites and expanded their capacity. However this has led to losses for other facilities situated on grain dependent rail lines. The Australian Inland infrastructure has not been fully rationalized and is still in transition.

**Comparison Storage Capacity Canada - Australia 2000-2001, Million Tonnes**

Area	Canada 2001	Australia 2000
On Farm	30	9
Primary Elevator	6.1	21
Process	0.5	0
Port Terminals	2.7	6
Transfer Elevators	2.3	0
<b>Total</b>	<b>41.6</b>	<b>36</b>

Source: Grains and Oilseeds Test book, 5th Edition; CIGI, 2003

The major differences between Canada’s and Australia’s storage capacity in the supply chain include:

- Greater on farm storage within Canada,
- Less reliance for inland and port storage in Canada
- Greater reliance for primary elevator-silo and export storage in Australia (represents three times the capacity of Canada’s)

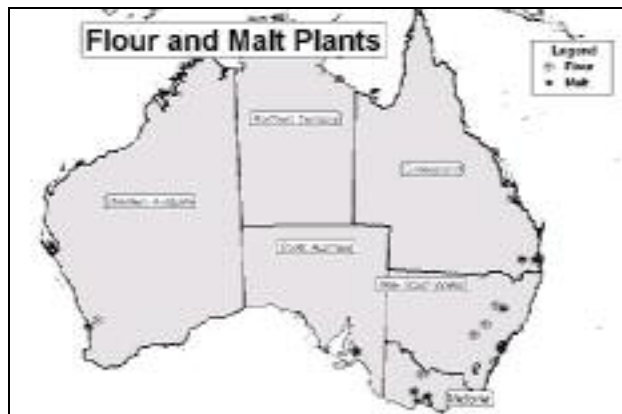
**Australia Agriculture Investment Expenditure by Selected Companies 1998 to 2004**

<b>Investment Type</b>	<b>A\$ Millions</b>	<b>%</b>
Silo	\$476.85	27%
Terminals	\$151.13	9%
Processing	\$146.19	8%
Seed Development	\$14.00	1%
Acquisitions	\$860.00	48%
JV Projects	\$126.30	7%
<b>Total Investments</b>	<b>\$1,774.47</b>	

Sources: Individual Annual Reports

The above table shows the investments by type by selected grain companies operating in Australia from 1998 to 2004. The companies include AWB, ABB, Ausbulk, CBH, GrainCorp and Grainco. Investment data was from company’s’ annual reports and press releases. The investment type was classified as silo (primary inland storage), terminals (export), processing (malt and flour), seed development, acquisitions and joint ventures. The data represents the major companies operating in Australia. From the table acquisitions were the greatest investment type as companies merged and consolidated. The second largest expenditures were for inland silo storage at AU\$476 M. Investment in export terminals ranked third, processing fourth. Excluding acquisitions, the greatest investment dollars was associated with new infrastructure development for storage-terminals.

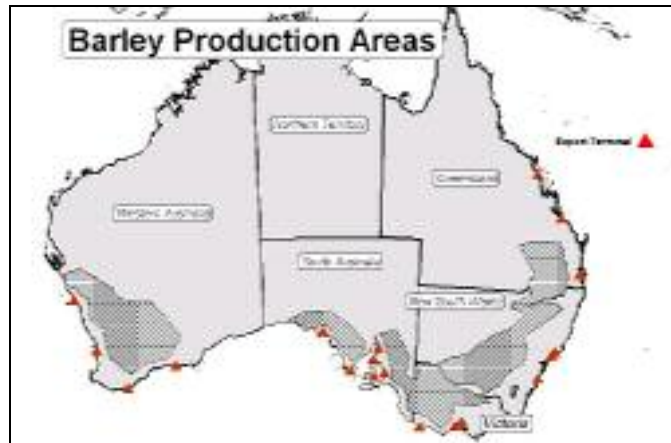
**Australian Flour and Malt Plants**



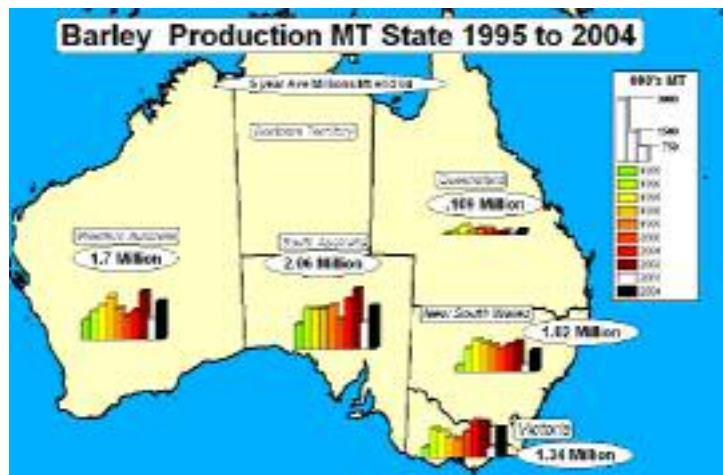
The states of New South Wales and Victoria have the greatest concentration of flour mills and malting plants because of the concentration of population. Malting sites are predominantly situated at port cities. Victoria has the greatest demand for malt, as the production capacity is the greatest of all states. New South Wales has the greatest production capacity for flour milling.

### **Barley Production Area Map**

Barley production is concentrated in the southern areas of Australia. The principal export terminals are shown as a triangle.



### **Barley Production by State**



This map illustrates barley production by state in metric tonnes from 1995 to 2004. The map also indicates the five-year average production by state ending in 2004 (in circles). The most barley is produced in South Australia (2 M T) and Western Australia (1.7 M T). Production in both Victoria and New South Wales ranges from 1.3 to 1 M T. In 2003 production fell because of a severe drought.

**Supply and Disposition of Australian Barley 1982 - 2004**

Crop Year	Harvested		Production	Total			Export Malt	Domestic	Domestic	Domestic	Total	
	Area	Yield		Exports	Export Intensity	Exports Feed	Exports Malt	Barley Eq	Feed Use	Malt Food	Seed	Domestic
	000 ha	t/ha	000 mt	000 mt	%	000 mt	000 mt	000 mt	000 mt	000 mt	000 mt	000 mt
1994-1995	3,111	0.94	2,913	1,486	51%	875	1,155	386	1,900	155	140	2,195
1995-1996	3,409	1.71	5,823	4,042	69%	1,451	1,579	411	1,709	122	152	1,970
1996-1997	3,367	1.99	6,696	4,331	65%	1,957	1,928	447	1,910	144	158	2,202
1997-1998	3,521	1.84	6,482	3,463	53%	2,025	982	457	1,800	148	143	2,091
1998-1999	3,167	1.89	5,987	4,765	80%	2,607	1,635	525	1,890	151	117	2,158
1999-2000	2,596	1.94	5,032	3,325	66%	1,524	1,234	569	1,700	154	157	2,009
2000-2001	3,454	1.95	6,743	4,567	68%	2,143	1,824	602	2,000	158	168	2,325
2001-2002	3,707	2.23	8,280	5,274	64%	2,971	1,705	600	2,200	161	174	2,535
2002-2003	3,062	1.07	3,268	2,534	78%	885	1,099	624	1,650	165	171	1,986
2003-2004	3,800	2.27	8,625	6,968	81%	4,235	2,093	637	2,100	168	161	2,429
2004-2005 f	3,572	2.04	6,223	3,974	64%	1,948	1,465	560	2,200	172	152	2,524
<b>Five Year Average (05)</b>	<b>3,519</b>	<b>1.8</b>	<b>6,628</b>	<b>4,663</b>	<b>70%</b>	<b>2,436</b>	<b>1,637</b>	<b>605</b>	<b>2,030</b>	<b>165</b>	<b>165</b>	<b>2,360</b>
<b>% of Production(5year)</b>				<b>70%</b>		<b>37%</b>	<b>25%</b>	<b>9%</b>	<b>31%</b>	<b>2%</b>	<b>2%</b>	<b>36%</b>
<b>% of Exports</b>						<b>49%</b>	<b>37%</b>	<b>14%</b>				

Source: ABARE Australian Commodity Statistics 2003, 1996, 1997

Australia Crop Report November 2004, December 2002

Review of NSW Grain Marketing Act 1991, NSW Government Review Group

The five-year average production ending in 2005 is 6.6 M tonnes. Domestic demand represents 31% of production while exports represent 70 % of production. Feed barley, malting barley and malt barley equivalents represent 37%, 25%, and 9% of total production, respectively. Traditional malt export tonnes are to Japan, Philippines, Thailand and Korea. In 2000 exports of malt were 205,000 tonnes to Japan; 65,000 tonnes to Philippines; 58,000 tonnes to Thailand and 57,000 tonnes to Korea. Other new markets include Vietnam at 82,000 tonnes in 2000.<sup>95</sup> The Japanese market in the 1990's represented one third of malt exports and now this has declined to 22% of total malt exports. Exports of malting barley are to China and some South American countries. Major exports markets for feed barley include Japan, Taiwan and Middle East.

**Barley 5 Year Average Production and Exports by State (5 Year Average)**

State	Port			Notes	ABB Mt 5yr End 2002
	Production mt	Exports Mt	% Exports		
Western Australia	1,742,600	1,329,301	76%	<b>5 Yr Ave 1999-2004</b>	1,436,623
South Australia	2,062,200	1,542,429	75%	<b>5 Yr Ave 1999-2003</b>	
Victoria	1,341,000	309,620	23%	<b>2000 3 Yr</b>	
New South Wales	1,025,000	195,000	19%	<b>5 Yr Ave 1999-2004</b>	
Queensland	169,000	22,000	13%	<b>One Port No data</b>	
<b>Total</b>	<b>6,339,800</b>	<b>3,398,350</b>	<b>54%</b>		

Exports Based upon Port Data

**ABARE Stats**

ABARE Ave Exports Barley 5 years(2004)	4,548,200
ABARE Ave Prod 5 years(2004)	6,339,800
ABARE % Exp to Prod	72%

Sources: ABARE Crop Report November, 2004; Individual Port Statistics

Total Australian Barley exports represented 72% of the five-year average production.

<sup>95</sup> "Servicing the Asian Brewing Market" L. MacLeod, Barrett Burston Malting; Proceedings of the 10<sup>th</sup> Annual Australian Barley Technical Symposium, 2001.

State export data is confidential and is not obtainable or easily compiled. However we compared the port statistics that were available to identify and evaluate the percentage of exports to production by state. Data pertaining to Victoria and New South Wales has not been obtained. We have contacted the various ports for information but there has been no response. The data that was obtained showed that the states of Western and Southern Australia exported over 75% of their barley production, which mirrors the total country percentage of over 70 % of production. The majority of barley crop in Queensland is used for domestic feed because of the large concentration of feedlots located there.

**Australian Malting Barley Production and Use, Tonnes  
(Average 1992 - 1999\*)**

State	Production*	Malting	Malt	Barley	Excess	% Exports
		Barley*	Capacity	Required	Malting Barley	
Western Australia	1,366,000	716,000	135,000	162,000	554,000	41%
South Australia	1,801,000	562,000	140,000	168,000	394,000	22%
Victoria	1,058,000	571,000	325,000	390,000	181,000	17%
New South Wales	1,109,000	346,000	85,000	102,000	244,000	22%
Queensland	254,000	21,000	45,000	54,000	-33,000	-13%
Total	5,588,000	2,216,000	730,000	876,000	1,340,000	24%

Source: Proceedings of the 10th Australian Barley Technical Symposium 2001  
"Servicing the Asia Brewing Market -an Export Maltsters Perspective" L. MacLeod,  
Barrett - Burston Malting Co

Total barley production was 5.5 M tonnes with malting barley representing 40% of total production. The demand for malting barley was 876,000 tonnes. The excess supply of malting barley, 1.3 M tonnes, can be exported. The greatest domestic demand for malting barley is in the southeastern states of Victoria and South Australia. Western Australia has the greatest excess of malting barley, representing 41% of Barley production.

In November 2004, ABB-AusMalt announced an increase of its plant in Western Australia by 110,000 tonnes. The company is capitalizing on increased exports of Malt to SE Asia.

**Australia Malt Barley Comparison Capacity 1992 to 2004 (tonnes)**

<b>Australia Malt Industry Capacity 1992</b>							
<b>Name</b>	<b>Queensland</b>	<b>NSW</b>	<b>Victoria</b>	<b>South Aus</b>	<b>West Aus</b>	<b>Tasmania</b>	<b>Total</b>
Joe White	25,000	43,000	63,000	70,000	40,000	6,000	247,000
Barrett Burston	30,000	36,000	160,000	0	0	0	226,000
Adelaide	0	0	0	45,000	0	0	45,000
Kirin	0	0	0	0	45,000	0	45,000
Maltco	0	0	30,000	0	0	0	30,000
Cascade	0	0	0	0	0	5,000	5,000
<b>Total</b>	<b>55,000</b>	<b>79,000</b>	<b>253,000</b>	<b>115,000</b>	<b>85,000</b>	<b>11,000</b>	<b>598,000</b>

<b>Australia Malt Industry Capacity 2004</b>							
<b>Name</b>	<b>Queensland</b>	<b>NSW</b>	<b>Victoria</b>	<b>South Aus</b>	<b>West Aus</b>	<b>Tasmania</b>	<b>Total</b>
Joe White Malting	25,000	43,000	70,000	150,000	200,000	6,000	494,000
Barrett Burston	30,000	40,000	160,000	0	0	0	250,000
Kirin	0	0	0	0	45,000	0	45,000
IMC(Int Mat Co)	0	0	65,000	0	0	0	65,000
Cascade	0	0	0	0	0	5,000	5,000
<b>Total</b>	<b>55,000</b>	<b>83,000</b>	<b>295,000</b>	<b>150,000</b>	<b>245,000</b>	<b>11,000</b>	<b>859,000</b>

Malting capacity has increased by 13% from 1992 to reach 811,000 tonnes in 2004. The greatest change in capacity has been in plants in Western Australia. AusMalt now ABB, recently announced an 110,000 tonne expansion at its Perth plant.

**World Commercial Malting Companies (Production Capacity 000's tonne)**

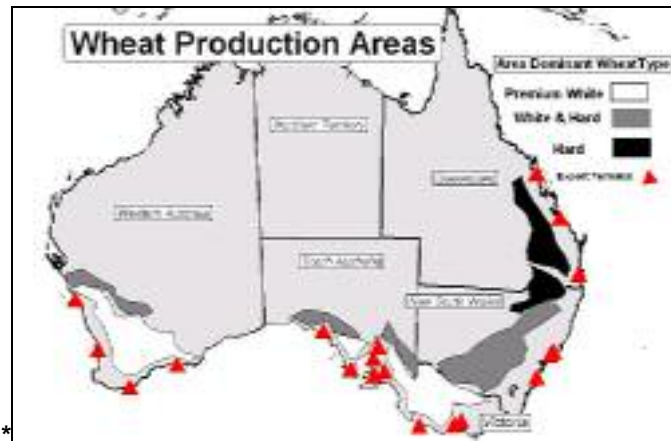
Rank	Company	Canada	USA	Oceania	Asia	Europe	South America	East EU/ Russia	Total	World Capacity Company %
1	Cargill	245	592		65	425	90		1,417	11%
2	Groupe Soufflet					686		637	1,323	10%
3	ConAgra / Tiger Oats	470	300	221		261			1,252	10%
4	Groupe Malteurop				56	963	23	100	1,142	9%
5	Lesaffre / ADM	95	772	96		105			1,068	8%
6	Greencor Group					605			605	5%
7	Anheuser Busch		603						603	5%
8	Rahr Malting	140	385						525	4%
9	Weissheimer Malt					395		125	520	4%
10	ABB (AusMalt)			500					500	4%
11	Boortmalt				40	348		50	438	3%
12	Guongdong Enterprises				400				400	3%
13	Schill / Global Malt					330			330	3%
14	Viking Malt Companies					328			328	3%
15	COFC - Dalian				300				300	2%
16	Coors Brewing Company		251						251	2%
17	Durst Malt					236			236	2%
18	IREKS Worldwide					221			221	2%
19	JP simpson					220			220	2%
20	Muntons					191			191	1%
21	Crisp Malting Group					186			186	1%
22	Franco Suisse					160			160	1%
23	Bavaria Maltings					120			120	1%
24	Grupo Moodela SA		107						107	1%
25	Raisio Group					105			105	1%
26	Rhein - Main - Malt					101			101	1%
27	Agromalte						90		90	1%
28	C Thywissen					90			90	1%
29	Malteria Do Vale						70		70	1%
30	Briss Malting Company	0	54	0	0	0	0	0	54	0%
	<b>Total</b>	<b>950</b>	<b>3,064</b>	<b>817</b>	<b>861</b>	<b>6,076</b>	<b>273</b>	<b>912</b>	<b>12,953</b>	
	<b>Country %</b>	<b>7%</b>	<b>24%</b>	<b>6%</b>	<b>7%</b>	<b>47%</b>	<b>2%</b>	<b>7%</b>	<b>100%</b>	

Source: AFRD 2004, Sparks, "The Canadian Barley Industry in Transition"

ABB press release Nov 30, 2004; [www.theage.com.au/news/Business/ABB-grain-reports-profit-rises/2004/11/30](http://www.theage.com.au/news/Business/ABB-grain-reports-profit-rises/2004/11/30)

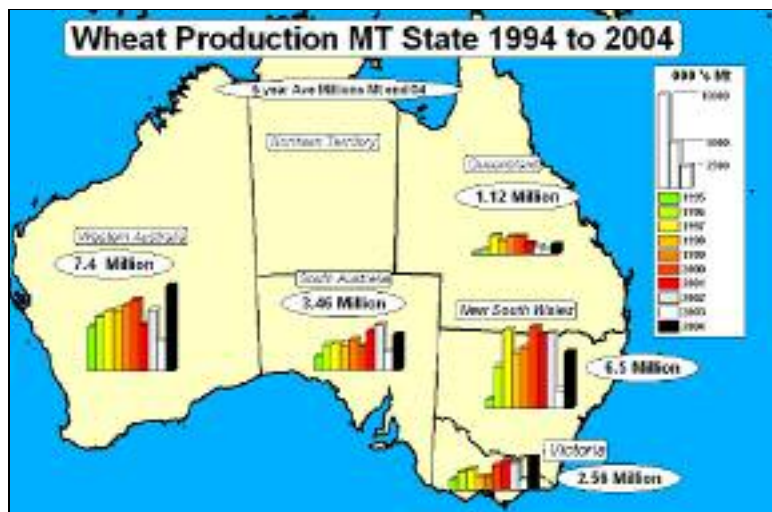
The above table compares world malting capacity by company and Region. The greatest capacity is in the EU with 47% of global capacity. The US accounts for 24% of world capacity while Canada and Australia account for 7% and 6% respectively. Cargill, Groupe Soufflet and Conagra-Tiger Oat rank as the top three producers in the world representing 30% of world capacity. Conagra is the only company in the top three that has capacity in Australia. The majority of malting capacity in Australia is now controlled by ABB which recently merged with AusMalt which had the most producing sites in the country. In the last 10 years, the Australian Barley industry has seen a series of takeovers and mergers which has resulted in two major producers and a series of smaller micro sites.

### Australia Wheat Production State Growing Regions



The wheat growing areas are shown by shaded area to the dominant wheat type grown. There are three distinctive areas. The white area represents the Australian Premium White. The grey shaded areas are where White and Hard varieties are grown and the black area shows areas of Hard production. The largest wheat growing areas are in Western Australia and New South Wales. The key export terminals are shown as a Triangle.

### Wheat Production Map 1995 to 2004



The map illustrates the last 10 years of production in metric tonnes by state as shown in the bar graph for each state. The five-year average production ending in 2004 is shown in M of tonnes in the circle for each state.

The map shows that there has been growth in production in Western Australia and Victoria. The other states have had stable production levels over the period. A severe drought in 2003 significantly reduced production. Western Australia and New South Wales are the two principal production states. The majority of production in Western Australia is exported whereas in New South Wales the production is also used for domestic feed and flour milling.

## Supply and Disposal of Australia Wheat 1982 - 2004

Crop Year	Harvested		Production 000 mt	Exports 000 mt	Export Intensity %	Total		Human 000 mt	Feed 000 mt
	Area 000 ha	Yield t/ha				Domestic Use 000 mt			
1982-1983	11,520	0.77	8,876	7,280	82%	4,190			
1983-1984	12,930	1.70	22,016	14,159	64%	2,641			
1984-1985	12,079	1.55	18,665	14,659	79%	3,081			
1985-1986	11,737	1.39	16,259	16,331	100%	2,526			
1986-1987	11,261	1.45	16,308	15,596	96%	2,825			
1987-1988	9,062	1.36	12,368	9,864	80%	3,479			
1988-1989	8,903	1.58	14,061	11,404	81%	2,888			
1989-1990	9,003	1.58	14,214	10,980	77%	2,415			
1990-1991	9,218	1.63	15,066	11,990	80%	3,239			
1991-1992	7,183	1.47	10,557	7,122	67%	4,095			
1992-1993	9,101	1.78	16,184	10,345	64%	4,186			
1993-1994	8,383	1.97	16,479	13,805	84%	3,900			
1994-1995	7,891	1.14	8,972	6,342	71%	3,916			
1995-1996	9,221	1.79	16,504	13,298	81%	4,109			
1996-1997	10,936	2.10	22,924	19,189	84%	3,512			
1997-1998	10,439	1.84	19,224	15,679	82%	5,079	2,174		2,385
1998-1999	11,543	1.86	21,464	16,391	76%	4,306	2,117		2,341
1999-2000	12,168	2.03	24,758	17,784	72%	4,636	2,159		1,930
2000-2001	12,141	1.82	22,108	16,085	73%	4,703	2,185		2,000
2001-2002	11,529	2.11	24,299	16,304	67%	4,796	2,208		2,100
2002-2003	10,831	0.87	9,385	9,068	97%	5,279	2,418		2,700
2003-2004	12,401	2.01	24,920	17,986	72%	5,169	2,443		2,185
2004-2005 f			20,154	17,300	86%	5,233	2,457		2,239
<b>Five Year Average(04)</b>	<b>11,814</b>	<b>2</b>	<b>21,094</b>	<b>15,445</b>	<b>73%</b>	<b>4,917</b>	<b>2,283</b>		<b>2,183</b>
<b>% of Production</b>				<b>75%</b>		<b>23%</b>	<b>12%</b>		<b>11%</b>
<b>% Domestic</b>							<b>46%</b>		<b>44%</b>

Source: ABARE Australian Commodity Statistics 2003  
Australia Crop Report November 2004, December 2002

The five-year annual average of wheat production is 20.5 M tonnes. Domestic demand accounts for 25% of average production while exports accounts for 75%. Feed represents 44 % of domestic demand with human consumption at 46%. Seed demand was not shown and would represent the difference in domestic demand.

**Australian Wheat and Flour Exports by Region and Country (Wheat Equivalents) 1996-97 to 2002-03, 000's of tonnes**

Region	Country	1995 -96	1996 -97	1997 -98	1998 -99	1999 -00	2000 -01	2001 -02	2002 -03	5 yr 2002	5 Yr Ave	% 5 Years
Africa	Egypt	739	1,665	735	1,503	1,012	955	1,680	602	5,885	1,177	
	Ethiopia	35	6	41	33	20	35	10	24	139	28	
	S Africa	412	349	161	234	239	141	98	48	873	175	
	Subtotal	1,186	2,020	937	1,770	1,271	1,131	1,788	674	6,897	1,379	8%
Asia	Bangladesh	174	231	254	372	343	252	133	130	1,354	271	
	China	2,229	156	204	165	107	60	46	38	582	116	
	India	0	1,632	2,189	296	173	7	0	0	2,665	533	
	Indonesia	1,959	2,369	2,424	1,414	1,850	2,174	2,073	1,662	9,935	1,987	
	Japan	1,148	1,256	1,108	1,147	1,189	1,160	1,193	1,132	5,797	1,159	
	Korea	709	687	768	1,212	1,181	1,139	953	1,014	5,253	1,051	
	Malaysia	798	631	671	874	800	775	681	370	3,801	760	
	Pakistan	233	1,308	1,039	1,102	1,187	0	0	9	3,328	666	
	Singapore	88	59	86	107	92	96	94	64	475	95	
	Sri Lanka	326	263	80	189	155	262	209	117	895	179	
	Thailand	243	255	315	308	251	269	282	290	1,425	285	
	Subtotal	7,907	8,847	9,138	7,186	7,328	6,194	5,664	4,826	35,510	7,102	43%
Middle East	Bahrain	27	67	37	21	23	44	0	0	125	25	
	Iran	1,879	3,349	579	1,663	1,520	2,352	2,418	1,064	8,532	1,706	
	Iraq	50	815	1,388	1,269	2,265	2,587	2,245	1,037	9,754	1,951	
	Kuwait	144	202	177	219	132	180	230	175	938	188	
	Oman	193	287	282	248	300	136	114	27	1,080	216	
	Qatar	40	64	36	61	22	28	0	0	147	29	
	UAE	226	457	289	519	462	399	226	142	1,895	379	
	Yemen	254	633	527	644	544	507	450	412	2,672	534	
Subtotal	2,813	5,874	3,315	4,644	5,268	6,233	5,683	2,857	25,143	5,029	31%	
Oceania	Fiji	55	67	66	73	88	93	102	119	422	84	
	Nea Zealand	158	146	84	94	182	189	335	306	884	177	
	New Guineaaa	95	119	109	131	137	136	110	130	623	125	
	Subtotal	308	332	259	298	407	418	547	555	1,929	386	2%
Other		0	1,275	1,596	2,486	3,000	2,594	2,724	1,894	12,400	2,480	15%
Total		12,214	18,348	15,245	16,384	17,274	16,570	16,406	10,806	81,879	16,376	100%

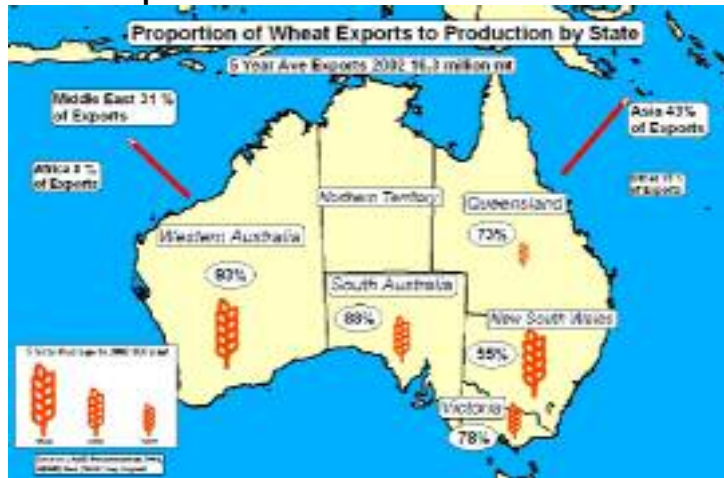
Notes: Crop Year Ending June to July  
Exports are of Wheat (including Spelt, Groats, Meal, Pellets,) Meslin (Mixed grains)

Plain white flour, self- raising flour in wheat equivalent.

Source: ABARE, Australia Commodity Statistics 2003

The dominant export market for Australia wheat exports is Asia representing 43% of the total five-year average ending in 2002. Within the Asian market, countries receiving over 1 M tonnes were Japan, Korea and Indonesia. The Middle Eastern market region is the second most important market, representing 31% of total exports. Countries receiving over 1 M tonnes per year include Iraq and Iran. Africa represented 8% of the total exports with Egypt receiving over 1 M tonnes. AWB has invested in Flour Mills in Egypt and Yemen and has negotiated key supplier agreements to mills in Indonesia and Japan.

**Map of AWB % of Wheat Exports to State Production 2001**



Western Australia has the greatest percentage of production being exported at 93%, followed by South Australia at 88%, Victoria 78%, Queensland 73%, and New South Wales at 55%. New South Wales has the greatest domestic demand because of a high concentration of population and wheat milling capacity. Victoria, Queensland and New South Wales also have significant concentrations of animal populations.

**Wheat Volume by Flour Mill and State 2004**

Company	Milling Sites	State	Demand Volume Wheat Mt per Year	Subtotal State Capacity	% Total
ALLIED	Summer Hill	New South Wales	200,000		
ALLIED	Tamworth	New South Wales	70,000		
ALLIED	Kensington	New South Wales	250,000		
MANILDRA	Manildra	New South Wales	650,000		
MANILDRA	Gunnedah	New South Wales	350,000		
MANILDRA	Narrandera	New South Wales	50,000		
WESTON	Gulgong	New South Wales	50,000		
WESTON	Enfield	New South Wales	220,000		
Subtotal				1,840,000	73%
ALLIED	Toowoomba	Queensland	50,000		
WESTON	Brisbane	Queensland	50,000		
Subtotal				100,000	4%
ALLIED	Mile End	South Australia	70,000		
WESTON	Port Adelaide	South Australia	50,000		
Subtotal				120,000	5%
ALLIED	Tennyson	Victoria	150,000		
ALLIED	Ballarat	Victoria	100,000		
ALLIED	Bridgewater	Victoria	10,000		
WESTON	North Melbourne	Victoria	85,000		
Subtotal				345,000	14%
ALLIED	North Fremantle	Western	70,000		
WESTON	Northam	Western	50,000		
Subtotal				120,000	5%
<b>Total</b>			<b>2,525,000</b>		

To evaluate flour-milling capacity the annual demand for wheat to was used to provide a proxy of the size of the industry by state. Australia has 18 major flourmills and these mills demand 2.5 M tonnes of wheat per year. There are another 12 smaller regional and specialty mills. New South Wales, with eight major mills, has the greatest milling capacity, with 73% of the total capacity, (1.8 M tonnes) Victoria has 14% of the flour milling capacity. The other states are very similar in their capacity, with each having about 5% of the total. Allied has announced it will build a greenfield site at Picton south of Sydney and close the Summer Hill plant when the new build is commissioned. The new facility will be a large site with potential capacity of 400,000 tonnes per year.

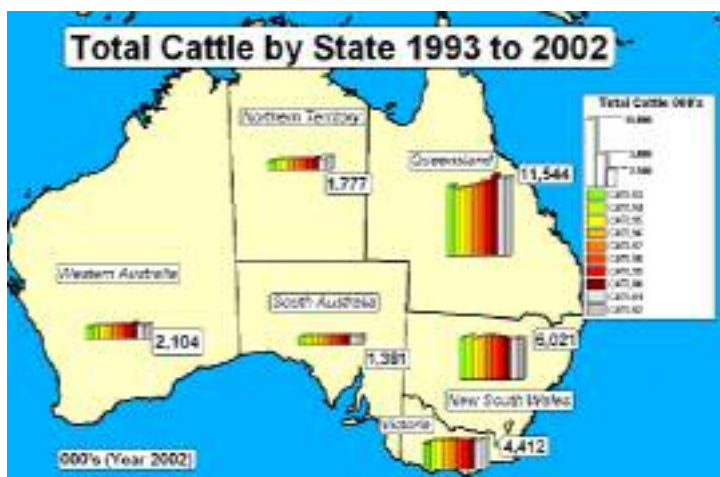
### Domestic Wheat Market Share by Company, 2001

<u>Company</u>	<u>%</u>
AWB	50
AusBulk	12
GrainCo	12
Graincorp	15
Other Australia	2
Other Global	9

Source: AWB Presentation Results 2001

AWB is the most dominant firm in the domestic wheat market with a market share of 50%. Three regional grain companies handle 12 to 15% of domestic traded wheat.

### Cattle Production by State 1993 to 2002 <sup>96</sup>

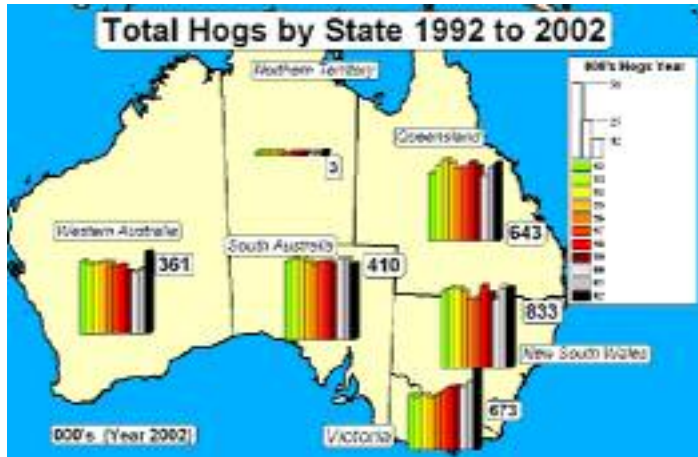


The map shows the total cattle population from 1993 to 2002 measured in number of head. The numbers for 2002 are shown in circles. In 2002 there were 27.87 M cattle and calves, an increase of 11% increase since 1993. Queensland has the greatest number cattle at 11.5 M, which represents 46% of total numbers. It has the greatest concentration of feedlots in the

<sup>96</sup> Livestock production data is collected annual through a survey of establishments. The date for enumeration for 1997 to 1999 was 31 March. Since 1999 the reference date is June 30. The number of animals is used to measure livestock production at that point in time.

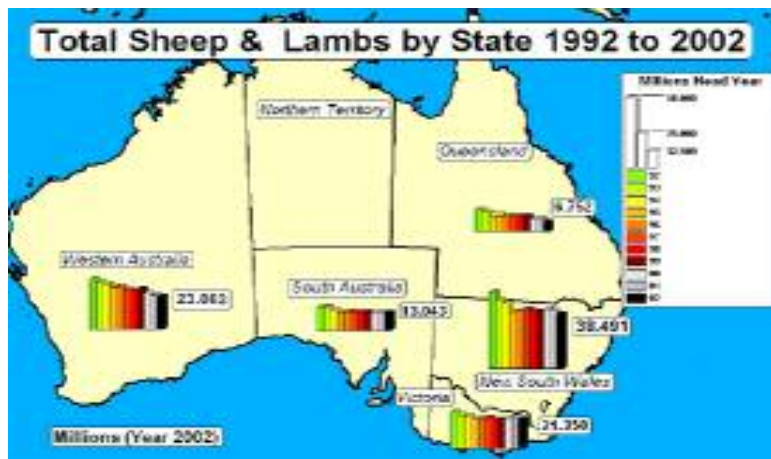
southern area adjacent to the border with New South Wales. New South Wales is the second most important state for cattle with 6 million head or 24% of total production. The feedlots in NSW are situated in the Northern area of the state bordering with Queensland.

**Hogs by State 1992 to 2002**



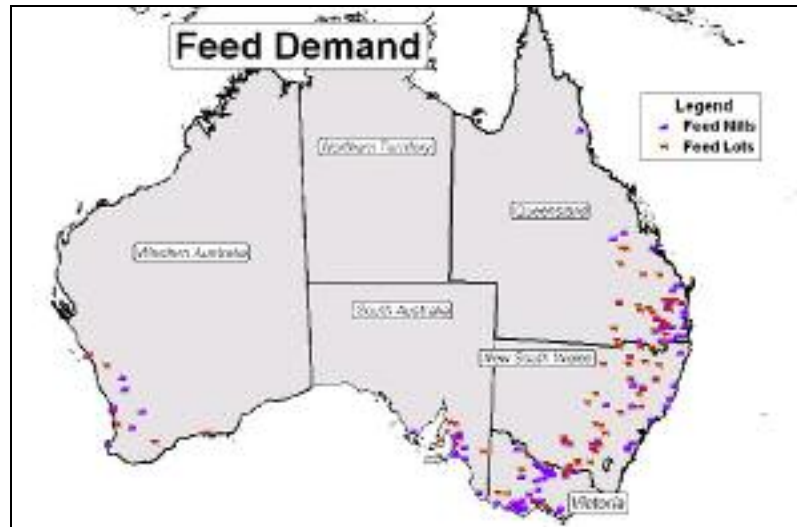
The hog industry is concentrated in the southern area of NSW, the southern area of Queensland adjacent to NSW and in the northern area of Victoria. Recent growth has occurred in Victoria and Western Australia. New South Wales has the greatest production of hogs per year with over 800,000. In 2001 NSW accounted for 30% of total Australian production, while Queensland and Victoria each accounted for around 22%.

**Sheep Production by State 1992 to 2002**



Sheep production has been declining since the 1990's because producers have switched to other production due to low wool prices. New South Wales has the largest production followed by Western Australia and Victoria Both NSW and Western Australia represent 60% of total production.

## Feed Demand Areas



The greatest concentrations of feed mills and feed lots are in the States of Victoria, Queensland and New South Wales. Feed demand is greatest in southern area of Queensland because of the concentration of feedlots in Queensland. The feed industry in northern Victoria namely services the hog sector and in southern Victoria for poultry. Not all locations are shown. The feedlots and mills shown represent the largest firms and capacity representing an estimate of 80%. The dairy industry is a major feed grain user in Victoria. Pigs and poultry are also significant feed users in Victoria.

## Annex IV - 2000 Wheat Marketing Review

The WMA 1989 was reviewed in 2000 under the National Competition Policy. Under the terms of reference the independent review panel was to assess the appropriate regulations for the export of wheat taking into account: the public benefits test and alternative approaches; sustainable development, welfare and equity, occupational health and safety; economic and regional development; consumer interests, competitiveness of Australian business, and efficient resource allocation; and compliance costs and administrative burdens for small business.<sup>97</sup>

When evaluating change, the committee considered certain characteristics of the Australian wheat industry. The characteristics and their implications are shown below.

2000 Review Considerations of Characteristics	
<i>Key Characteristics</i>	<i>Implications for Change</i>
Wheat is widely grown in five states	Changes to WMA will affect all regions
Area and production are variable	Wheat marketing system must be able to handle small and large crops
Financial performance of broad acre crops similar across Australia (scale and skill more important than location in financial success)	Wheat marketing system does not require regional modifications
Bulk of production (60%) from small number of crop specialist operations (14,000 farms)	Wheat marketing system must not inhibit innovation by crop specialist farms
1989 deregulation improved domestic wheat market	Would greater interaction between grower and foreign end-user be beneficial?
Australia has < 15% share of world wheat market	Australia has little effect on policies of other exporters
Majority of Australian wheat sold in Asia and Africa	US, EU, and Canada are strong competitors in Asian and African markets
Average unit export return for wheat for Australia not significantly different than return for Canada and the US	Australia's wheat export strategy is to operate as a stock disposer – any premiums in some markets offset by need to discount wheat to clear the stocks
Little Australian presence in some large importing countries	Wheat marketing system must be flexible enough to allow access to a wide range of markets
Durum is now being exported by Australia	Should there be a separate marketing system for durum?

<sup>97</sup> This section is based on material from 1) Irving M, J Arney, and B Lindner, "National Competition Policy Review of the Wheat Marketing Act 1989", 2000 and 2) Bielik M, "Organizational Change in the Australian Grain Industry: A Cooperative Life Cycle Approach", Unpublished MS Thesis, Department of Agribusiness and Agricultural Economics, University of Manitoba, October 2004.

The WMA 1989 was reviewed in 2000 using a consultative approach in which over 3000 submissions were received. The following table indicates the major views of stakeholders providing submissions.

<b>2000 WMA Review – Stakeholder Views</b>	
Retain single desk	AWBI, GCA, NSW Farmers' Assoc, Vic Farmers Federation Grains Group, SA Farmers Federation, WA Farmers Federation, AgForce Grains, many individual growers
Retain but make changes	GGA (major shareholder in GrainCorp), Durum Wheat Growers Assoc, Netco Grain Cooperative, Shepards Producers Co-operative, Goodman Fielder, Flour Millers' Council of Australia, Grain Pool of WA, Australian Bulk Alliance, Grainco, Vicgrain
Remove single desk	PGA Western Graingrowers, Capgrains Cooperative Assoc Grains, WA Noodle-Wheat Growers Assoc, GrainCorp, Joint Industry Submission Group, Cargill
Problems with single desk	Pea Growers Co-Operative, Walgett Special One Co-Operative, Pork Council of Australia, Chicken Meat Industry, Confederation of Australian Pork Exporters

The following tables summarize the input made in 2000 on the issues of the single desk, price pooling, supply chain costs, domestic market, value added activities, communities, and other areas.

<b>Single Desk Export</b>	
<i>Provides Benefits</i>	<i>Does Damage/Other Comments</i>
Branded wheat earns a premium	No evidence of any price premiums – single desk doesn't necessarily result in market power
Superior negotiating position	Denies producer choice in marketing
Increases return for National Pool by AU\$8.72/tonne	WEA should be able to issue export permits for durum independently of AWB
Enhances export performance in a grossly distorted world market	Deregulation should start with the Japanese noodle-wheat market
Has critical mass necessary to compete effectively internationally	Single desk should be retained only in premium markets, WEA should issue permits for remainder of markets
Ensures grower profit not captured by multinationals or middlemen	AWB should not be able to veto bulk exports to non-strategic markets
	Should have unrestricted access to NA, PNG and Pacific Islands
	In some markets with lower levels of competition and where higher returns occur regularly could auction right to export
	Argument that single desk creates countervailing power only works if buyer can't switch suppliers
	In distorted world market, any savvy marketer would divert supply to highest price market
	Some of observed premium may be due to special services such as guaranteed supply – but at what cost
	Allow unrestricted wheat exports in containers

<b>Price Pooling by Single Desk</b>	
<i>Provides Benefits</i>	<i>Does Damage</i>
Guarantees grower access to international markets	Destroys opportunity for hedging and pricing
Ensures all growers can market their wheat (last resort provisions)	AWB's risk management ability is limited – can't hedge all wheat
Provides grower with efficient risk management	Basis pool doesn't allow growers a satisfactory means of forward pricing
Manages exchange rate risk	AWB restricted in ability to forward price using CBOT
	If AWB has no pool for a particular grade, growers may have to deliver to a lower valued pool
	Prevents the development of effective risk management markets in Australia
	AWB has incentive to maximize tonnage to National Pool because bulk of its income earned by providing non-contestable services to National Pool
	Basis pool has unnecessary limitations and lacks transparency

<b>Supply Chain Costs &amp; Single Desk</b>	
<i>Provides Benefits</i>	<i>Does Harm/Other Comments</i>
Generates cost efficiencies in freight, handling and storage	Results in higher supply chain costs between farm and port (by AU\$5/tonne or more)
Coordinates logistics of wheat handling year round	AWB's use of ticket by ticket marketing is beyond scope of WMA (prevents companies from earning \$ from blending)
	AWB manipulates supply chain charges and prices and uses National Pool to subsidize other grain handling – move AWB to port position
	Make WEA independent from AWB intervention – exporting in containers creates inefficient supply chain
	Remove AWB to port to reduce supply chain costs

<b>Domestic Market &amp; Single Desk Export</b>	
<i>Provides Benefits</i>	<i>Does Harm</i>
Has no impact on domestic market	Distorts domestic durum market
Removal of single desk would increase price volatility in domestic market	Millers should be able to accumulate wheat and export it in bulk to their mills in NZ and Papua New Guinea
Feed wheat price more affected by feed grain demand and supply	Pool tender system must become more flexible
No correlation between domestic wheat price and value of product manufactured	AWB exerts undue market pressure in pool tender system
Domestic buyers can access AWBI's stocks	Domestic wheat customers should receive consideration in quality and logistics issues
National Pools may stabilize domestic price	Feed costs must be reduced to international levels – want access to feed wheat at export parity prices
Results in higher quality wheat	Higher feed costs reduce hog and pork competitiveness
Market is very competitive	Domestic price spikes increase price risk which reduces hog production
Processors also buy wheat domestically	Encourages production of marginal wheat and deters investment in domestic livestock
Small traders successful export wheat in containers	
Millers want export single desk retained	

<b>Value Added Activities &amp; Single Desk Export</b>	
<i>Provides Benefits</i>	<i>Does Harm/Other Comments</i>
Allows for investment in off shore VA with growing markets and also acts as a type of market development	Discourages innovation and entrepreneurial activity
	Should not allow AWB to invest in domestic cereal food processing

<b>Other Issues &amp; Single Desk Export</b>	
<i>Provides Benefits</i>	<i>Does Harm/Other Comments</i>
Capacity to provide a quality and consistent product	Reduces opportunity for innovation
Because is customer driven stocks don't accumulate	Does not allow growers to develop skills
Responsible for growth in Australian exports from 13 M tonnes to 18 M tonnes over the last decade while total wheat trade static	Cooperatives can't expand markets that they have developed
Maximizes final returns to growers in National Pool as required by AWB Ltd	No competitive pressure on AWBL costs
Increases the quality of wheat by industry initiatives and payment incentives	Gives AWB a major advantage in trading other grain
R&D is focused on customer needs	Potential conflict between maximizing grower and shareholder returns
Reflects price signals for quality which raises quality over time	Higher domestic prices and lower competition in export supply chain could hurt wheat industry in long-term
Provides market information, crop financing and other services to growers	Need independent process to determine grain quality and varietal standards
Does promotional activities	Need third party review of export market development
Assists other exporters to sell into niche markets	Increase transparency and accountability of AWBI and WEA
Most customers prefer dealing with a grower owned marketing organization	
Enforces contract compliance by buyers	
Acts as a buyer of last resort	
Efficiently collects and uses world market information	
Develops long term relationship with customers	

<b>Community &amp; Single Desk Export</b>	
<i>Provides Benefits</i>	<i>Does Harm</i>
Cash flows from wheat are economic foundation of many communities	
National Pools create cash flow prior to wheat selling	
Because is grower owned the benefits accrue to them	
Results in regional employment to service wheat growers	

## **Annex V – Studies Conducted on Wheat and Barley Deregulation in Australia**

Title	Author	Year	Study Sponsor	Study Purpose/High Level Findings
<b>Wheat Studies</b>				
<u>National Competition Policy</u>				
2002 NCP Assessment, Chapter 4 Primary Industries	Productivity Commission	2003	National Competition Council	Progress on compliance with NCP
National Competition Policy Review of the Wheat Marketing Act, 1989	Malcolm Irving, Jeff Arney and Bob Lindmer	2000	National Competition Council	Assess the appropriate regulations for the export of wheat
2004 Wheat Marketing Review, Grower's Report	Alice Williams, Martine Pop and Barry Watts	2004	National Competition Council	Review performance of AWBI and WEA and operation of export consent arrangements
A Review of the NCP Grain Market Reforms	ACIL Tasman	2004	National Competition Council	Ex-post evaluation of deregulation under the NCP in selected sectors. Australia appears to be a price taker for barley.
<u>Regulators</u>				
The Grower's Report 2004	Wheat Export Authority	2004	Wheat Export Authority	Performance monitoring of AWB (International) Limited under the Wheat marketing Act 1989
Report to Minister on Operation and Effectiveness for the 2003/04 Season	Grain Licensing Authority	2004	Grain Licensing Authority	Report on operations of GLA and makes recommendations to the Minister
<u>Regulator Commissioned Reports</u>				
Price Premiums from Market Power	Farm Horizons	2004	Grain Licensing Authority	Input to GLA Report to Ministers on GLA performance. Premiums due to quality, freight advantage and other services do occur, but they can not be attributed to market power
<u>Industry Commissioned Reports</u>				
Australian Wheat: It's time for Choice	Centre for International Economics (CIE)	2000	Joint Industry Submission Group (included NACMA, Australian Grain Exporters Association, some private grain companies, and some grain user groups)	Submission to the independent Review Committee reviewing the Wheat marketing Act 1989 under the NCP
A Review of Structural Issues in the Australian Grain Market	Kronos Corporate	2002	NETCO Co-operative Ltd., United Grower Holdings (UGH) now GrainCorp, and National Agricultural Commodities Marketing Association (NACMA)	Review changes in the industry and offers many recommendations for further change in the industry
Appendix - 2002 Submission to the Wheat Export Authority	Accenture	2002	Grain Growers Association	Provide a submission to the Wheat Export Authority on current wheat marketing arrangements and exploration of alternatives
Submission to the 2004 Wheat Marketing Review		2004	Grains Council of Australia	Provides views of GCA with respect to performance of WEA and AWBI
No Tenders: No Transparency: Submission to the Wheat Marketing Review Panel		2004	Grain Growers Association	Provides views on export wheat marketing arrangements
What the World Wants from Australian Wheat Growers	Bowman Richards and Associates and Bread Research Institute	2004	Grain Growers Association	Study of wheat markets and opportunities for Australian wheat growers in export markets.
<u>AWB Commissioned Reports</u>				
Maximizing Returns to Growers Supplying The National Wheat Export Pool	The Boston Consulting Group	2004	AWB (International) Limited	Provide a comprehensive review of AWBI activities and to recommend a strategic direction to maximize wheat grower returns

Deregulation of wheat and barley marketing in Australia and potential application to western Canada

Competition and Single Desk Selling of Wheat from Australia: An Economic Analysis	Joshua S. Gans, University of Melbourne, and Joseph Hirschberg	2000	AWB (International) Limited	AWBI input into the 2000 NCP review of the Wheat Marketing Act 1989. Study shows economic argument for a single desk and measures premiums received for Australian wheat
Grower Returns and Single Desk Selling of Australian Wheat	Joshua S. Gans, University of Melbourne	2004	AWB (International) Limited	To show the potential benefits and costs of removing the single desk powers of AWBI
Single Desk Marketing of Wheat – Three Price Premium Models: Report to AWB	Econtech (done by Gans and Hirschberg)	2004	AWB (International) Limited	Measured the benefits of single desk exports using three models
Single Desk and the Grain Supply Chain – A Study of Power Relationships	T Hoffman and N Matthews	2004	AWB (International) Limited	Examined the impact of removing AWBI from the export supply chain for wheat based on deregulation of barley in Victoria
Your Single Desk	AWB (International) Limited	2004	AWB (International) Limited	Highlight the value of the Single Desk marketing system for wheat in Australia
<b>Barley Studies</b>				
<b>ABB Commissioned Reports</b>				
Submission on Behalf of ABB to the 2003 National Competition Policy Review of ABB's Barley Single Desk in South Australia	Econtech	2003	ABB	Estimation of price premiums associated with single desk exports of barley by ABB
<b>State Government Commissioned Reports</b>				
Review of the Victorian and South Australian Barley Marketing Act 1993	Centre for International Economics (CIE)	1997	Governments of Victoria and South Australia	Review of barley marketing (ABB) under the competition principles
Review of the NSW Grain Marketing Act 1991, Final Report	NSW Government Review Group	1999	Government of New South Wales	Review of NSW Grain Marketing Act under the competition principles
The Need for Changes to Grain Marketing Legislation in Western Australia – A Discussion Paper for Public Consultation	Department of Agriculture, Government of Western Australia	2002	Government of Western Australia	Examination of needs for grain exporting and presentation of proposal to change grain marketing in WA
Report to Parliament on the Review of the Barley Marketing Act 1993	Professor Round, I Kowalick and G Schulz	2004	Government of South Australia	Review of single desk export barley marketing
Review of the Benefits and Costs of the Operations of the Grain Marketing Act 2002 and the Grain Licensing Authority	RSM Bird Cameron	2004	Government of West Australia	Review of Grain Marketing Act 2002 and Grain Licensing Authority

## **Annex VI – Comparison of Grain Marketing in Australia and Canada**

### **Production and Exports**

#### **Size of the Wheat and Barley Crop**

##### ***Australia***

the Australian wheat crop averages around 18 million tonnes, and the barley crop around 7 million tonnes

##### ***CWB - designated area***

the prairie (designated area) wheat crop averages around 20 million tonnes, and the barley crop around 11 million tonnes

#### **Wheat Utilization - % of production**

##### ***Australia***

Domestic processing	12%
Exports	75%
Feed and seed	11%

##### ***CWB - designated area***

Domestic processing	15%
Exports	63%
Feed and seed	19%

#### **Barley Utilization- % of production**

##### ***Australia***

Domestic processing	3%
Exports	69%
Feed and seed	29%

Doesn't add to 100%, try 4%, 64% & 32%?

##### ***CWB - designated area***

Domestic processing	3%
Exports	16%
Feed and seed	80%

### **Size, Authorities, and Accountabilities of the Single Desk-Sellers**

#### **Size of the Boards**

##### ***Australia***

AWB Ltd and its subsidiaries have 2,700 employees (approx 600 pre Landmark acquisition in 2003) and costs for pool services (fees paid in 02-03, a drought year) of \$A65.8 million (fees in 01-02 were \$A88.3m). WEA states costs averaged \$A47.9m over 1994-00 period. AWB Ltd has a market capitalization of \$A1.6 bill.

The ABB pre merger with Ausbulk had 140 full time & many seasonal (post merger numbers not released), it has a market capitalization of \$A1 bill.

The GPWA merged with CBH so any comparisons very messy as are those with AWB & ABB given Landmark & AusBulk acquisitions & merger.

GrainCorp Ltd (In NSW) also has statutory (until Sep 2005) powers through NSW Grains Board (now defunct)

##### ***CWB***

the Board has 450 employees, with administrative expenses of \$50 M to \$54 M

#### **Establishment of the Board Single Desk Selling Authority**

##### ***Australia***

##### ***CWB***

AWB by Commonwealth government  
Producers wanted price stability, pooling and ability to exercise market power.  
Wheat Marketing Act provides authority for AWBI to export wheat & established Wheat Export Authority (WEA) that controls non AWB International (AWBI) exports & oversees export performance of AWBI.  
ABB and GPWA by state governments.  
Grain Marketing Act 2002 (WA) establishes Grain licensing Authority & issues main export licenses to GPWA & special licenses to others for export of barley, lupins & canola.

### **Legal Authority and Accountability**

#### **Australia**

AWB Ltd – publicly traded corporation (Class B shares)  
accountable to shareholders  
Two types of shares (Class A Growers & Class B financial)  
AWBI, wholly owned subsidiary of AWB Ltd operates the National Pool & has a services agreement with AWB Ltd to provide all needed services.  
Under WMA (1989) pool operations (AWBI) accountable to Wheat Export Authority (WEA)  
WEA controls the export of wheat.  
ABB Grain Ltd– publicly traded corporation (Class B shares)  
Accountable to shareholders  
Two types of shares (Class A growers & class B (financial))

### **Shareholders**

#### **Australia**

AWB Ltd– 12 member board, 7 from Class A (growers) and 2 from Class B, 2 additional and Managing Director  
AWB (International) Ltd wholly owned subsidiary 7 Directors  
3 A class Directors elected, AWB Ltd Chairman, MD, 1 A Class from AWB Ltd & one other AWB Ltd Director.  
ABB Grain Ltd, currently 12 Directors (merged AusBulk & ABB Boards)  
From 2006, – 9 member board, 5 Class A 3 Class B, elected & MD (appointed)  
Grain Pool Pty Ltd wholly owned subsidiary of CBH Ltd with a common Board of 12 Directors

By federal government action reflecting desires of producers and government, but for different reasons  
Producers wanted a countervailing market power and government wanted the CWB as a means for public policy.

#### **CWB**

Through federal legislation, the Canadian Wheat Board Act,  
15 member board with 10 seats filled by elected growers  
Requires permission by Department of Finance to borrow money  
Must report regularly and file annual reports with Minister Responsible for CWB

#### **CWB**

The CWB is not structured as share capital corporation  
Is a hybrid – neither a crown corporation or a producer owned cooperative

inc Chairman

**Producers delivering to the single desk seller**

***Australia***

AWB for wheat  
ABB for barley (SA)  
GPWA for barley, canola and lupins (WA)  
GrainCorp (NSW Grains Board) for all malt barley & export feed, sorghum & canola, but a permit system now operates.

***CWB***

Wheat  
Barley

**Extent of Marketing Powers**

***Australia***

Wheat – AWB  
AWB has single desk selling authority on all bulk wheat exports.  
WEA may issue permits for export (bulk only with AWBI approval) of wheat under guidelines.  
Other  
ABB has single desk selling authority for barley exports from SA  
GPWA is main license holder from GLA for the bulk export of barley, canola and lupins from WA, special licenses may be issued to others.  
Arrangements (permit) in NSW (export feed barley, sorghum, canola & all malt barley single desk) will be finishing Sep. 2005.

***CWB***

Applicable to wheat and extended (by Order-In-Council) to barley grown in the designated area,  
Single desk seller of all designated area wheat (and barley) in export markets and in domestic (human consumption) markets,  
By CWB Act regulation, producers can market un-graded wheat into off-Board market for feed use,  
The CWB controls the transportation and marketing of all Canadian wheat (and barley) for human consumption and export markets in designated area and between designated area and the rest of Canada  
Controls import permits and OWMB must have CWB permission to export

**Statutory Obligations**

***Australia***

AWB required to accept and market all wheat delivered to elevators that meets receival standards.  
ABB required to accept all barley of acceptable quality in SA.  
GrainCorp (NSW Grains Board) required to accept delivery of all vested commodities that meet delivery standards but not relevant with permit system in place.

***CWB***

Accept and market all wheat delivered to its agents (the country elevators) by producers as CWB destined grain  
Inward flow of grain controlled by contract and de facto quota system

### **Oversight – Supervisory bodies**

#### ***Australia***

WEA monitors the performance of AWBI

#### ***CWB***

There are no supervisory bodies to which the CWB must report and no benchmarks or oversight by independent entity

The CWB Act allowed for one special audit, which was completed by the Office of the Auditor General a few years ago.

### **Extent of Powers over Inter-Provincial (State) and Export Trade**

#### ***Australia***

Deregulated domestic market for wheat and barley (except malting barley in NSW)

AWB single desk seller of bulk wheat exports.

ABB single desk seller of barley exports from SA  
GPWA main license holder for exports of barley, lupins, and canola exports from WA, others may obtain special licenses.

GrainCorp (thru NSW Grains Board) controls until Sep 2005 feed barley, sorghum, canola exports & all malt barley, but issues permits).

#### ***CWB***

Single desk seller of all designated area wheat (and barley) in export markets and in domestic (human consumption) markets

### **Market Related Considerations**

#### **Market Orientation**

##### ***Australia***

AWB markets pool wheat internationally.

AWB offers wheat from pool onto domestic market through regular tenders.

AWB acquires & trades wheat domestically & acquires & trades internationally through AWB Geneva.

ABB markets barley internationally and trades barley domestically

ABB Trading Division trades in all grains domestically & in New Zealand & operates internationally inc purchasing soymeal, chemicals.

##### ***CWB***

Orderly marketing into domestic and export markets, through the use of delivery quotas and delivery calls, and railcar allocations.

#### **KVD (kernel visual distinguishability) and variety registration**

##### ***Australia***

Growers provide a declaration as to variety (for all grains) backed by random testing.

AWB has a list of accepted varieties and a preferred list with additional premiums.

ABB has a list of varieties acceptable & will also use premiums to encourage particular varieties.

Other marketers essentially use same receival standards, but at times have special grades.

##### ***CWB***

Wheat and barley that is visually distinguishable can only be grown on the prairies for export and domestic human consumption markets.

### **Freedom to Delivery**

#### ***Australia***

Producers are free (encouraged) to deliver wheat and barley at harvest to country elevators  
Can deliver to port if road receival facilities available.

### **Delivery Options**

#### ***Australia***

Growers free to deliver (sell) domestic wheat & barley to whomever & whenever they choose, but many silos close down once harvest is finished.

AWB & ABB deliveries are to approved receival agents (Bulk handling companies, own sites & some private storages).

AWB accepts grain into Pool from traders (ticket by ticket basis).

ABB pools only available to growers.

### **Influence over the Supply Chain**

#### ***Australia***

AWB has significant control over export supply chain for wheat through agreements with railways and directive operational control

ABB has significant control over export supply chain (reinforced by owning SA Storage system) & agreements with Bulk Handlers & Rail authorities.

### **Span of Supply Chain Involvement**

#### ***Australia***

AWB involved in farm inputs (through Landmark purchase), storage and handling in country and at Melbourne Port, marketing of crops other than wheat, chartering, and export sales of non-Australian wheat

AWB leases 2 freight trains.

ABB Grain also heavily involved in S&H following Ausbulk merger and 50% ownership in ABA (Aus Bulk Alliance), in Melbourne Port, in chartering and in malting.

ABB Grain acquires and markets all grains, imports & distributes fertilizer and has a small chemicals business & a container packing business.

Grain Pool is similarly involved in S&H through CBH & in marketing other grains.

#### ***CWB***

Prairie wheat producers can not freely deliver all of their wheat to a Board agent at any time, deliveries occur when the Board calls wheat through delivery contracts

#### ***CWB***

Prairie wheat producers can deliver their wheat to a Board agent, when the Board calls wheat through delivery contracts, or delivery can be made to the off-Board market as feed wheat

#### ***CWB***

The CWB, as the largest single customer of the system, can use its position to influence supply chain costs

The CWB has use a tendering program to exercise control over costs between the farm gate and the ex-spout fob grain

The CWB has a significant amount of control over wheat movements through rail car allocation programs

#### ***CWB***

The span of control by the CWB is from the farm gate through to ex-spout fob on vessel – the CWB is starting to sell C&F the customer.

### **Direct Deliveries to Terminal Market Positions**

#### ***Australia***

Producers can deliver to terminal position where road receival facilities are available. They are charged the same receival fee as for upcountry, but the EPR is higher reflecting freight differentials.

Deliveries into Port from other storage suppliers incur a throughput charge.

Storage providers offer on farm pick up (OFFP) to provide lower costs to growers and more efficient accumulation.

Direct sales terms to end users are set between the parties involved.

#### ***CWB***

Producers can deliver directly to terminal positions through producers cars to avoid paying the country elevator handling charge (approximately \$13/t),

Producers can also directly deliver to processors located on the prairies and pay a lower handling charge than with a country elevator delivery.

### **Direct Delivery to Processors**

#### ***Australia***

wheat and barley domestic markets are deregulated except malting barley in NSW. no restrictions on sales to domestic processors (except malting barley in NSW).

#### ***CWB***

On deliveries to prairie processors, producers receive the initial payment (net of transportation charges to the nearest terminal market),

The processor usually charges a lower handling (administration) fee than at primary elevators as an allowance to offset trucking costs to the processor.

### **Exports by Producers**

#### ***Australia***

WEA can issue export permits to growers and trade for exports of wheat in bags and containers (must inform AWBI).

WEA can issue export permits to growers and trade for bulk wheat exports but must receive written consent of AWBI.

GLA can issue export permits to growers and trade for exports of barley, canola, and lupins

ABB allows export of barley from SA in containers without hindrance.

#### ***CWB***

Producers in the designated area can buy back wheat from the CWB (at a buy-back price related to the Minneapolis wheat price), and be issued a license to export wheat or sell it domestically for human consumption

### **Use of Accredited Exporters**

#### ***Australia***

Grain from Australia can go through any channel either directly to end-users or through the trade. Only limitations are the commercial ones of ensuring payment from the buyer.

Both AWB & ABB prominent in selling directly and in selling c&f.

Japanese market has restrictions imposed by JFA regarding who can sell into JFA tenders or into SBS system.

#### ***CWB***

Up to 50% of wheat and durum sales made by accredited exporters

Up to 80% of malting barley exports made by accredited exporters

### **Export Credit**

#### **Australia**

Export Finance Insurance Corporation (EFIC) provides credit insurance on commercial terms if required. (EFIC is open to any (not only grain) exporter from Australia.

National interest cover may be provided by Australian Government in certain instances.

There are no WTO concerns.

ABB does not sell internationally on credit.

#### **CWB**

The CWB can access credit guarantees on sales to sovereign governments through the Credit Grain Sales Program (CGSP), as well export credit insurance through the EDC can be used to facilitate commercial transactions

These arrangements are expected to be discontinued due to current WTO negotiations

## **Returns from the Market**

### **Establishment of Domestic Sales Prices**

#### ***Australia***

AWB sets Estimated Pool Returns (EPR) by pool grade as does ABB for barley to growers. These estimates are based on likely export returns and domestic returns where relevant.

Domestic market prices off these EPRs adjusted for location, but in drought areas local prices will disengage from EPRs.

ABB similarly sets EPRs.

AWB & ABB also offer cash prices.

Sales prices are set according to what the domestic market will bear & are determined by EPRs and cash market levels, service provided etc.

AWB sets its tender reserve prices at levels that it argues are consistent with returns it expects if that pool wheat goes into export channels.

In drought times (02-03) AWB can price up to or above import parity, but end users now more sophisticated and in 02-03 arranged early imports of grain that caused AWB to drop its prices.

#### **CWB**

Processor purchase prices are initially linked to the Minneapolis futures market, Thunder Bay is deemed equivalent to Minneapolis, administrative adjustments (based on freight costs and other factors) are made for points further west.

### **Establishment of Export Sales Prices**

#### ***Australia***

AWB negotiates with individual buyers based on comparable international values adjusted for quality and freight spreads.

AWB has international benchmarks against which its sales performance is measured and it can earn a performance fee if it betters the benchmark overall.

ABB similarly negotiates with buyers against international values and freight spreads.

#### **CWB**

Prices are negotiated by the CWB (or its agent) with individual buyers, or the CWB prices wheat to be competitive in the markets it serves.

### **Linkage Between Pooling and Single Desk Selling**

#### ***Australia***

All wheat deliveries to AWB as opposed to cash sales are into pools. Pool grain goes to export or through a tender system to domestic market.

Traders can swap stock with pool

All ABB deliveries are into pools, but growers may sell for cash to ABB.

#### ***CWB***

All deliveries to the CWB are to the pool.

### **Number of Pools, Pools by Class and Variety Segregation**

#### ***Australia***

AWB runs a national pool with a number of pay grades based on variety.

Returns are calculated into pay grades depending on spreads achieved.

A golden reward system operates for preferred varieties (fixed), protein, moisture and admixtures. These are adjusted as the season progresses.

ABB operates malt and feed pools and pays set rates on grade qualities delivered as well as on protein scales (malt).

Special varieties may receive a fixed premium and special segregations may be established, particularly if it is an unusual year to capture as much value as possible for growers.

#### ***CWB***

Has two pool accounts for wheat; one for all wheat classes (except durum) , with administrative adjustments for class and grade, and a separate durum wheat pool account,

Aside from durum, all wheat is in one pool account reflecting the value of grade differences

For barley, there are two pools, one for feed barley and one for malting barley premiums and discounts between wheat classes and grades are established within the pool account based on administrative adjustments

Protein premiums for wheat and barley

### **Producer Returns Additional to Harvest Period Initial Payment**

#### ***Australia***

AWB provides a number of payment options. They may involve a payment at delivery as either a loan (fully flexible drawn down options available) or an advanced payment or it may involve deferred payments that come in periodically or in July as pool returns are received.

As wheat is marketed the returns are paid as national Loan Distributions to repay loans or to fund deferred payments.

ABB offers similar facilities for barley and its wheat pools.

#### ***CWB***

Possibility of interim and final payments

### **Initial Payment Guarantees**

#### ***Australia***

The WMA (1989) gradually eliminated government guarantee of initial payments. AWB has Credit Agency ratings and operates an extensive funding operation (\$US3 bill & \$A2.5 bill facilities) in the domestic and global

#### ***CWB***

Federal government guarantees the initial payment, based on the Canadian Wheat Board Act

this provision may be lost through the next round of WTO negotiations

capital markets in its own right (no Government guarantees).  
AWB charges growers a compulsory underwriting fee.  
ABB and GPWA also operate without government guarantees.  
ABB has an extensive funding operation managed through its Banks to raise monies. It offers growers the choice of paying an underwriting fee.

### **Pricing Options Available to Producers**

#### ***Australia***

AWB  
basis contract, flexible payment schemes out of pools, trigger price contracts  
ABB – for wheat, barley, canola, lentils, etc  
Basis pools, multi-grade contracts, forward contracts, pools, cash, trigger price etc  
GPWA – pools for barley, wheat, canola and lupins & cash prices

#### ***CWB***

Fixed price contract (for barley and wheat) and basis payment contract (for wheat) provide producers with entire payment within 10 days of delivery  
Early payment option for wheat and barley  
Traditional pool payment

### **Protecting Value of Un-priced Wheat**

#### ***Australia***

AWB is very active on & is one of the largest users of the Nth American Boards of Trade (inc Winnipeg) to hedge wheat & offer basis across a range of commodities.  
It also uses Australian facilities, freight markets, US & European premium and paper markets to hedge & in OTC products.  
AWB is a major operator in the forex & interest rate markets using a range of FEC, FRAs, swaps & options.  
Growers can price their wheat in the basis pool using commodity & forex instruments.  
ABB similarly uses a wide range of hedging options in commodities in which it operates including freight and in forex and interest rate markets.

#### ***CWB***

The CWB sometimes uses futures and options markets to protect the value of some un-priced wheat

### **Cash Advances on Stored Wheat**

#### ***Australia***

Growers can warehouse grain in the central system but normally do not receive a payment unless they commit it to a buyer.

#### ***CWB***

Participates in the federal cash advance program to allow growers to access cash prior to delivery

### **Cash Payment for Delivered Wheat**

#### ***Australia***

On delivery growers have available the full range of pricing options for receiving monies.

#### ***CWB***

Producer receives initial payment at time of delivery unless deferred

### **Responsiveness and Innovations**

#### ***Australia***

AWB, ABB and other buyers of grain (others will deliver into AWB pools & essentially offer financing products at lower costs) have introduced numerous pricing & funding options for growers.

The structure of AWB & ABB payment options has provided the opportunity for third parties to offer financial products (compete on interest rates, fees & structure) and banks have taken this up.

Banks will also provide risk management facilities out to 2 years.

A number of entities including AWB will price wheat (& canola) up to 2 years forward.

AWB (& other buyers) have established risk management areas to assist growers in managing price/currency risks.

A number of private advisers have set up to advise growers on the best marketing alternative.

#### ***CWB***

The CWB has introduced many pricing options for growers

## **Costs of Operation**

### **Board Administrative Expenses**

#### ***Australia***

AWBI has a very detailed service agreement to pay AWB Ltd to manage national pool that contains incentives, penalties and a range of KPIs.

The basis of the fee has been refined, but essentially a base fee plus an out-performance fee (OPI) against WIB (Wheat Industry Benchmark).

The base fee used to be set as a percentage (1.5%) of the gross pool value with a cap & floor, the OPI returning 20% of returns above WIB net of a hurdle & was also capped at 1.5% of GPV.

2002-03 pool distorted by severe drought (4.5 m tonnes in pool).

2001-02 pool (19.6 mt) had a base fee of \$60m & OPI of \$28.3 for total of \$A88.3 m or \$A4.51/t.

WEA continually assess the arrangements and

#### ***CWB***

CWB administrative expenses charged to the pools are \$50 to \$54 million, ranging from \$2.68/tonne in 2002 and \$4.03/tonne in 2003

advises on improvements.

For 2005-06 pool base fee is fixed at \$65.1 m & OPI a 20% incentive operative, but capped in two tiers at a percentage of GPV.

### **Pricing and Marketing Cost Transparency**

#### ***Australia***

A number of parties (particularly opponents of SD) have raised significant concerns about non-transparency and contestability of services provided to AWBI by AWB

Also raised issue of possible conflict of maximizing return to pool vs. max profit of AWB Ltd.

AWBI has a Board (with some non AWB Ltd Directors) that is responsible for pool.

A very detailed Service Agreement with service levels and KPIs has been negotiated and is continually being refined.

WEA examines and comments on the pool performance and prepares a confidential Report to the Minister and a Report to Growers (most recent 2004).

AWBI also prepares a very detailed Report on Pool performance (most recent on 2002-03 Pool).

Push is for services provided to AWBI by AWB Ltd to be opened for others to provide.

### **Actual Marketing Costs**

#### ***Australia***

supply chain costs (storage & handling, transport & distribution of FOB & port) for wheat in 2002:

east coast= average \$45 AU/tonne

SA= average \$29 AU/tonne

WA= average \$27/tonne

AWBI 2002-03 National Pool Report shows that average real cost of supply chain has fallen each of 6 years from 1997-98 to 2002-03 from \$48.32 to \$41.83 per tonne.

#### ***CWB***

Minimal transparency exists since all wheat classes are in one pool account, with average marketing costs charged to each class of wheat,

Some pool marketing costs are deducted from revenue, and not reported as a pool operating cost (e.g., vessel transport costs, Great Lake shipping costs, option market contract costs)

#### ***CWB***

Very few marketing costs (\$5.85/tonne) are shown in the pool accounts, with another \$10/t (western area) to \$20/t (eastern area) buried in the gross income line of the pool account, Export basis for wheat in 2002-03 in Alberta from \$70 to \$79/tonne