NATIONAL
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NCC Occasional Series

A Review of the NCP Grain Market Reforms

ACIL Tasman

Economics Policy Strategy

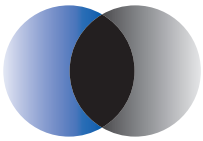
November 2004

Australian Grain Market Reforms

A review of the of National Competition Policy grain market reforms

Prepared for the National Competition Council

August 2004



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Economics Policy Strategy

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The National Competition Council

The National Competition Council was established on 6 November 1995 by the *Competition Policy Reform Act 1995* following agreement by the Commonwealth, State and Territory governments.

It is a federal statutory authority which functions as an independent advisory body for all governments on the implementation of the National Competition Policy reforms. The Council's aim is to 'improve the well being of all Australians through growth, innovation and rising productivity, and by promoting competition that is in the public interest'.

Information on the National Competition Council, its publications and its current work program can be found on the internet at www.ncc.gov.au or by contacting NCC Communications on (03) 9285 7474.

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Foreword

In April 2004 the Australian Government Treasurer referred to the Productivity Commission (PC) a review of National Competition Policy (NCP). The objects of the review are to identify the impacts of NCP on the Australian economy and community and to examine further opportunities for reform that will be likely to produce significant gains for Australia.

Over the last ten years the National Competition Council (Council) has had a central role in promoting NCP reforms and assessing reform activity undertaken by the Federal, State and Territory Governments. As such it has a keen interest in the PC's review.

At an early stage in considering how it could contribute positively to the PC's review, the Council sought to identify areas of research that would complement and inform the PC's analysis. Three research topics emerged from that consideration.

One sought to assist in identifying possible areas of future reform activity by sketching the range of sectoral reforms that had been undertaken in a range of other economies. The aim of this research was to broaden the horizon against which future reform activities might be considered.

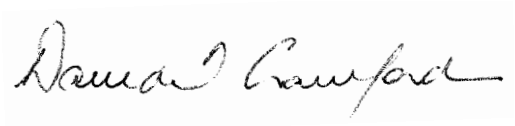
The other two projects sought to undertake an ex post examination of aspects of NCP reform in the dairying and grain production sectors. These were two sectors where claims of adverse results from reform were being made by some groups but where the Council was unable to find any independent or objective analysis to support or reject such views.

In commissioning this research the Council sought to sponsor high quality analysis that would genuinely contribute to the PC's review activity in this area. For each research area identified broad research briefs were prepared and proposals were sought from a number of experienced and professional consultancy organisations.

The commissioned research was conducted between June and September 2004.

This report and two others represent the output of this research activity. The reports present the analysis, judgements and conclusions of the various authors, the details of which may or may not be shared by the Council. Nevertheless the Council is very appreciative of the efforts of each consultancy in undertaking this work and of the contribution these reports can make to understanding of NCP reform activity to date and the scope for gains from similar reform going forward.

These reports have been provided to the PC as part of the Council's response to its draft report on NCP and are being published by the Council as the first three reports in an Occasional Papers series in order to further understanding of NCP and related microeconomic reform issues in Australia.



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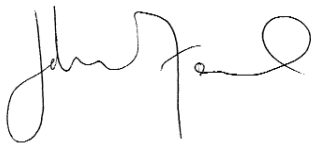
Acting President



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Executive summary

Wheat, barley, canola and coarse grains have been subject to various forms of regulated marketing in Australia since at least the Second World War. Wheat is regulated under national legislation and the others are controlled by the states.

This report focuses on the effects of competition reform as it has been variously enacted by the states from 1995 to 2004 on the malting barley, feed barley and canola markets.

The study of the effects of deregulation of grain markets poses special difficulties for the analyst for a number of reasons. The main one is that the usual problem of knowing what is the 'otherwise case' or 'counterfactual' is especially complicated. Historically grain marketing regulations have mostly been directed at dampening price fluctuations or otherwise altering the variability and time pattern of returns. When this is done with one crop, the composition of farmers' enterprise, investment and insurance portfolios are likely to be affected. Thus the true effects of the regulation in question need to be assessed on a very wide canvass and over a long period of time. The failure to recognize this has marred several earlier studies and submissions to governments on the subject.

In light of these difficulties and the finite resources available for our work, ACIL Tasman presents this report not as a comprehensive statistical analysis of the situation, but rather as a review of the readily observable grain industry facts and as a compilation of grain industry participants' observations. This is an important caveat to what follows.

The most significant effect of partial or complete deregulation of the barley and canola markets in Australia has been the development of cash or 'spot' grain selling alternatives for growers. In particular, a higher proportion of growers now receive payment more or less upon delivery. Before regulation, with barley at least, all growers had to wait until pool sales were complete. The changes are providing (and requiring) new ways for risk to be managed by buyers and sellers.

Another of our major observations is that there is no evidence of any general or sustained effect of deregulation on prices for grain at port. All the indications are that Australian growers receive the world price for barley with variations for local costs of freight and handling to port. Feed and malt barley prices, both pre and post deregulation, in all Australian markets appear to be highly correlated with each other and very similar. That is, Australia appears to be a 'price taker' in these markets, with prices being determined internationally.

We found the case put forward by the Grain Pool of Western Australia for the opposite position to be unpersuasive.

In addition, from the wide-ranging evidence we have obtained, it seems deregulation has affected the timing but not the nominal prices received by farmers - suggesting that the repealed regulations on barley and canola were not adding much if anything to physical handling costs. However, as stated, the terms of payment have changed, indicating that pre-deregulation some financial penalty was being suffered by participants.

Nonetheless, with regard to handling costs, it is still early days. Deregulation of export barley marketing in Victoria did not occur until 2001. Perhaps after a few more years some differences in handling efficiency will emerge. Indeed, the investments required for improved barley productivity may not be made until there is some more deregulation of export wheat marketing. Wheat dominates the grain handling system in this country.

Just as there is no evidence of a rise in prices (or drop in physical handling costs) post-deregulation, there is no evidence of any general grain price decline (or handling cost rise) as a result of deregulation in any of the markets studied. This is contrary to many of the assertions heard from marketing board officials and mainstream state farmers groups before the event.

As the data reveals no consistent price effect from deregulation, it can be reasoned that the price making power derived by the marketing boards from compulsory acquisition cannot have been very great. There is no evidence of any private trader since deregulation having market power either.

With barley in particular, price risk management is considered to be difficult as there is no readily observable derivative contract that can be used by traders for price discovery, hedging or other functions. Whether regulated or not, pooling seems to be the most popular form of trading in barley, at least in Australia. With pools as they are run in Australia, virtually all of the price risk is retained by the grower. (A corollary is that, provided the business of trading is open to competition, traders' margins will be lower than if they were bearing more of the risk.) If the realised price is low, the payments to growers are low. The grower is what may be termed the 'residual claimant'.

Pooling is not as prevalent with canola. Nonetheless, post-deregulation in all of the markets ACIL Tasman has studied while compiling this report, pooling remains a selling option for growers after deregulation. While growers continue to use pools, they have changed substantially from the way they were run in regulated markets. The former monopoly marketing boards have had to change too – they have had to offer different options in order to compete to

accumulate grain in deregulated markets. In regulated markets accumulation is not contested.

Competition to accumulate grain is a major feature of deregulated markets and is overlooked by many when assessing the effects of deregulation. It is clear from the analysis of deregulated grain markets that competition to accumulate grain is strong. Buyers compete not only on price but also terms and services. This has provided growers with a range of new products. Thus, for example, where there was one pool for barley per season in Victoria prior to deregulation, there are a now at least five and most have a range of payment and finance options.

Reform of the financial services sector over the last two decades has made grain market deregulation more effective. There are now numerous financial products from a number of organisations incorporated into pools. These new products have been developed by pool managers in order compete to accumulate grain in deregulated markets. These financial innovations have also spilled into markets that remain regulated.

Having available alternative grain selling options allows grain producers and traders to better match risk, payment timing and financing to their individual business needs. It puts farm firms in a better position to maximize profit, which for most businesses is more important than gross price maximization. Growers are 'voting with their feet' on this and making use of alternatives.

1 Terms of reference

This study was commissioned by the National Competition Council to address the limited availability of ex-post evaluation of the impact of reforms at the sectoral level.

The scope of the study was:

1. Assess the outcomes from the review and reform of statutory marketing arrangements governing the grains industries under the National Competition Policy. The analysis should include, but not necessarily be confined to:

    a) The removal of export marketing arrangements for wheat and barley in Queensland;
    b) The partial de-restriction of grains marketing in New South Wales;
    c) The removal of barley marketing arrangements in Victoria;
    d) New arrangements in Western Australia that provide for a Grains Licensing Authority to approve certain bulk exports outside of the single desk arrangements; and
    e) If relevant to meeting the objectives of this study, any lessons from:
        - reforms to other statutory marketing arrangements in other sectors, such as eggs and dried fruit marketing; and
        - agricultural commodity sectors that have not been subject to statutory marketing intervention

2. In particular, assess

    f) The differential impacts in relation to the deregulated Victorian barley industry and the regulated South Australian barley industry; and
    g) The initial impacts of Western Australia's Grains Licensing Authority

2 Methodology

The broad methodology employed by the consultants to prepare this report has been to:

- analyze price information for feed and malt barley and canola at port;
- analyze what has happened to what would have been the case, which focuses on the effect the emergence of a cash market and the effect this has had on pools and pooling;
- conduct industry consultations with;
    - marketers;
    - government agencies;

  - traders;
  - farmers;
  - service providers; and
  - domestic buyers and users; and
- conduct a literature review and assessment of relevant reports previously done on effects of grain market deregulation, in particular NCP reviews.

The principal areas of research have been in malting and feed barley markets and canola in WA, SA, Vic and NSW. Canvassing views from growers was not deemed necessary. As well as being time consuming and expensive, grain selling patterns and ultilisation of new products provides a sufficient indication of grower reactions and attitudes to the various states regulation changes.

3 Introduction

The report has been prepared for the National Competition Council as an ex-post review of competition reform of certain grain markets in Australia. While a lot is predicted about the effects of reform prior to the event, there is little analysis of what the effects have been. A great deal of angst usually precedes reform in any sector of the economy and agriculture is no exception. Part of the purpose of this report is to see whether the anxiety expressed before hand was warranted.

There has been a range of regulations covering the sale of wheat, barley, oats sorghum, triticale, canola and lupins in Australia. The major focus of this report is on the barley and canola markets as they have been the markets where regulation has been most extensively applied and where deregulation might be expected to have had the largest effect. Lessons from these markets can be equally applied to other coarse grains that have been deregulated also.

Wheat is not considered in this report as it has not been deregulated under National Competition Policy (NCP). The domestic market for wheat was deregulated in 1989 before COAG initiated the NCP and the export market remains regulated.

4 NCC reform process

4.1 National Competition Policy reforms

On the 11th of April 1995 the Commonwealth, State and Territory Governments signed several agreements that formed the basis of NCP. NCP requires each government to review legislation that restricts competition using a guiding principle of:

- the benefits of the restriction to the community as a whole outweigh the costs; and
- the objectives of the legislation can only be achieved by restricting competition.

This means that any restriction to competition must be able to demonstrate a net public benefit to Australia as a whole and that this benefit can only be achieved through restriction of competition.

Importantly for the state and territory governments, the NCP agreements also provide for withholding of competition payments if the process of review and the guiding principles are not applied by the states.

Agricultural competition reform has been an outstanding issue for many states and payments have been withheld from some states as a result. Table 1 outlines the progress each state has made in the grains industries since the initiation of NCP.

Table 1 **State by state review of grain market regulation and reforms**

Jurisdiction	Legislation	Key restrictions	Review activity	Reform activity	Assessment
Commonwealth	Wheat Marketing Act 1989	Prohibits the export of wheat except with consent of the WEA or by AWBI	Review was completed in 2000 by an independent review committee. It found that introducing competition was more likely to deliver net benefits than continuing the export controls. However, it would be premature to repeal the Act before a relatively short evaluation period of new commercial arrangements. It recommended: • retaining the export monopoly until the 2004 review; • incorporating NCP principles into the 2004 review; • developing performance indicators for the 2004 review; • moving from export consents to export licensing; • removing for a three-year trial the requirement that the WEA consult AWBI when consenting to the export of bagged and containerised wheat; and • removing for a three-year trial, the requirement that the WEA obtain written approval from AWBI for the export of durum wheat.	In April 2001, the Government announced it would retain the export monopoly, but it: • declined to incorporate NCP principles in the 2004 review; • retained the requirement that the WEA consult with AWBI when consenting to the export of bagged and containerised wheat; and • retained the requirement for AWBI's written approval of the export of durum wheat.	Does not meet CPA obligations (June 2002)
New South Wales	Grain Marketing Act 1991	Grants a monopoly to the NSW Grains Board over domestic and export marketing of	Review was completed in July 1999. It recommended: • removing restrictions on domestic sales by no later than 31 August 2001 for malting barley and by no later than 31 August 2000 for all other grains;	In October 2000, the Government announced that it would retain restrictions until	Does not meet CPA obligations (June 2002)

		all barley, sorghum, oats, canola, safflower, sunflower, linseed and soybeans grown in the State.	• retaining restrictions on export sales of feed and malting barley for only overseas markets where market power or access premiums can be demonstrated, subject to a further review by 31 August 2004; and • removing restrictions on export sales of all other grains by 31 August 2001 for canola and by 31 August 2000 for sorghum, oats, safflowers, linseed and soybeans.	2005 on: • domestic sales of malting barley; • all export sales of feed and malting barley; and • all export sales of sorghum and canola. There will be no further review and Graincorp now acts as an agent to the insolvent Grains Board.	
Victoria	Barley Marketing Act 1993	Granted a monopoly to the Australian Barley Board over domestic and export marketing of all barley grown in the State.	Review of this Act and the South Australian Act was completed in 1998, it recommending that Victoria: • remove the domestic barley marketing monopoly; • retain the export barley marketing monopoly for only the 'shortest possible transition period'; and • restructure the Australian Barley Board as a private grower-owned company.	The Act was amended in 1999 to remove the monopoly on: • domestic barley from 1 July 1999; and • export barley from 1 July 2001. The board was transferred to grower ownership on 1 July 1999. It has no regulatory powers.	Meets CPA obligations (June 2001)
Queensland	Grain Industry (Restructuring) Act 1993	Granted a monopoly to Grainco Australia Limited over domestic and export marketing of all barley grown in the State	Review was completed in 1997, recommending that Queensland: • remove the domestic monopoly; and • extend the export monopoly until at least mid-2002.	The Government accepted the recommendations and amended the legislation accordingly, including sun-setting the export monopoly on 30 June 2002.	Meets CPA obligations (June 2002)
Western Australia	Grain Marketing Act 1975	Grants a monopoly to the Grain Pool of Western Australia over export marketing of all barley, lupins and canola grown in the State	Departmental review was completed in 2002, recommending that the Government: • establish a licensing authority to issue permits for bulk grain exports by parties other than the Grain Pool; and • allow free export of grain in bags and containers.	The Grain Marketing Act 2002 establishes a bulk grain export licensing scheme and repeals the former Act. It will expire following the removal of the Commonwealth's wheat export restrictions. Ministerial guidelines for the Grain Licensing Authority are still	Review and reform incomplete

				to be completed.	
South Australia	Barley Marketing Act 1993	Grants a monopoly to Australian Barley Board over domestic and export marketing of all barley and oats grown in the State	Review of this Act and the Victorian Act completed in 1998 (see above). Following the removal of the June 2001 sunset, a further review was completed in June 2003, recommending 'controlled deregulation' via a licensing authority similar to that being established in Western Australia.	Domestic market for feed and malting barley deregulated in 1999	Review and reform incomplete
Northern Territory	Grain Marketing Act 1983	Granted a monopoly to the Grain Marketing Board over domestic and export marketing of all barley and coarse grains grown in the Territory	Review was completed in 1997, recommending repeal of the Act.	Act was repealed in 1997.	Meets CPA obligations (June 2001)

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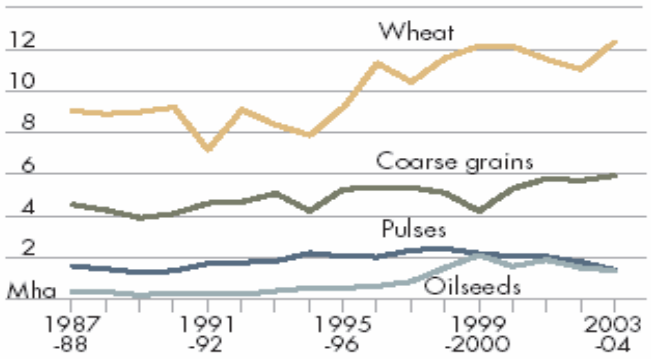
4.2 Australian grain industry overview and regulation

Wheat dominates crop production in Australia. Coarse grains, the majority of which is barley, used for feed and malting, is the next most significant crop type grown but is overshadowed by wheat by a large margin (Chart 1). Wheat remains regulated at a national level by the Wheat Marketing Act 1989 and the export market is regulated by the Wheat Export Authority (WEA).

Chart 1 **Area sown of main crop types**



ABARE 2004

Many of the minor crops such as oats, lupins and sorghum have been regulated along with barley and canola. Of these grains only oats and sorghum are exported regularly but in relatively minor quantities (oats 130,000 tonnes and sorghum is 450,000 exported annually). Regulation of coarse grains other than barley in the domestic and export markets has generally not been enforced

with many regulators issuing licenses at little or no cost or oversight to those wishing to export these grains. An example of legislation in place but not applied was in NSW where licenses were issued for most minor grains. The trade of minor grains in NSW is summarised below.

- Oats – no exports
- Grain sorghum – insignificant exports
- Linseed-no exports
- Safflower- no exports
- Sunflower-no exports
- Soybeans-no exports

Restriction on competition in grains markets is generally applied when:

- there is a belief that compulsory collective marketing may produce some market power in international markets;
- producers feel they faced unfair competition from subsidized producers or are operating in corrupt international markets; or
- markets are dominated by a small number of substantial buyers that may have strong buying positions as a result.

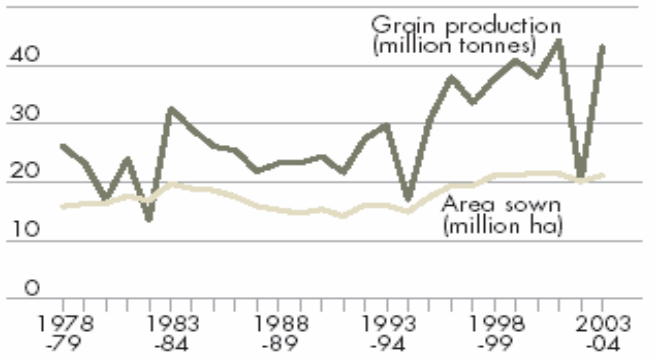
The focus of this report is where regulation has been applied most consistently which are malting and feed barley and canola markets, and where the effects of deregulation are likely to be observable.

5 Australian grain industry trends

The major trends in Australian grain production over the last ten years have been:

- between 1993-94 and 2003-04 the area sown to crops has increased by 32% while production has increased 45% (ABARE 2004);
- Australian farms are increasing the proportion of the farm used to grow crops and grain dominant farms have been acquiring more land;
- domestic feed grain production has risen substantially over the last 20 years and is projected to increase another 14% by 2007 (Yates and Coombs 2003); and
- there has been substantial consolidation of the marketers and bulk handling companies in Australia since 1995.

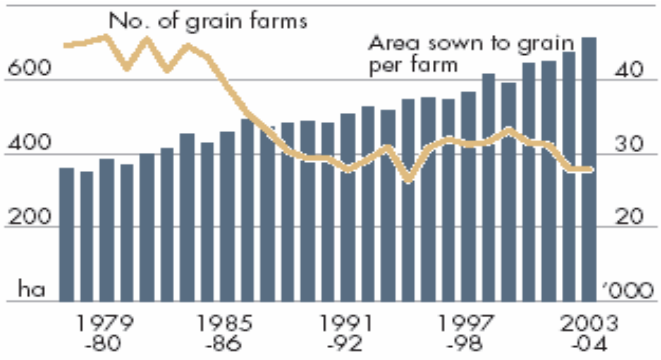
Chart 2 **Australian grain production and area sown**



ABARE 2004

Chart 2 illustrates the rising trend in both area sown and yield of crops grown in Australia since the late 1970s. The major drivers of this expansion in production have been the higher productivity improvements of cropping compared to other broad acre industries, and historically low prices for wool and beef over this period.

Chart 3 **Number of grain farms and area sown to grain per farm**



ABARE 2004

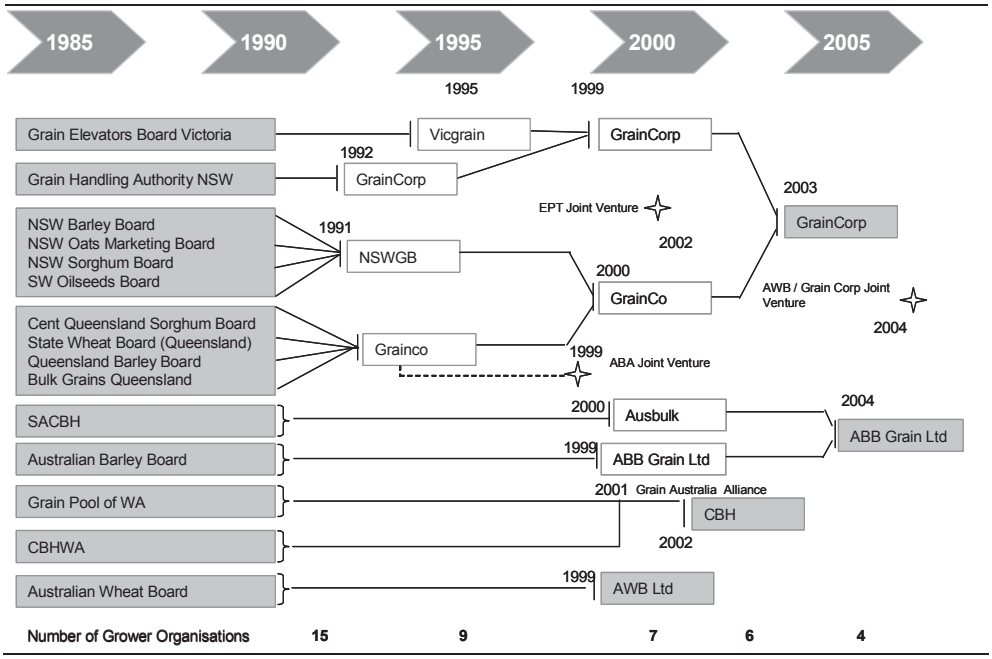
A great deal of the expansion of the crop area has come from an increasing proportion of farms dedicated to grain production, and the expansion of grain dominant farms by acquisition or leasing; ABARE reported in 2003 that 42% of grain farms in 2001-02 had acquired more land.

Consolidation has been a major theme at all levels in the grains industry in Australia since the late 1980s. Most of the consolidation in storage, handling and marketing of grains has occurred from 1995 to 2002 which coincides with the introduction of NCP. This consolidation has been in part due to deregulation as traders see opportunities to invest in new enterprises and in part to realise economies of scale.

Another motivation of the consolidation of grain traders in Australia has been a need to raise more capital for trading activities. In a deregulated market traders have to compete to accumulate grain from producers. To compete,

traders need to offer a range of cash and pool products. To be able to offer cash based products traders need sufficient capitalization to raise funds, hold grain and take positions in the cash market where they hold all of the price risk. Statutory marketing authorities do not have sufficient capitalization to trade products other than pools. These organizations have had to privatize, merge and form alliances with other traders to increase their capitalization.

Figure 1 **Australian grain industry consolidation**



Data source: Adapted from Kronos 2002

It was mentioned on several occasions to the consultants by internationally based traders, as an observation not a criticism, that most Australian traders are domestically focused and need to understand better how international markets operate. (It is worth noting that all of the international traders consulted were either not of Australian origin, or had spent a lot of time trading in international markets away from Australia).

Another significant trend in the Australian grain industry has been the rise in domestic consumption of feed grains. The major feed grain users in Australia are poultry, dairy, pig meat and beef producers all of which are expected to expand production over the next 10 years. Total feed grain demand is predicted to rise by 14% by 2007 (Yates and Coombs 2003).

6 The international barley market

The effect of deregulation needs to be distinguished from international and domestic market trends.

A summary of the international barley market appears below.

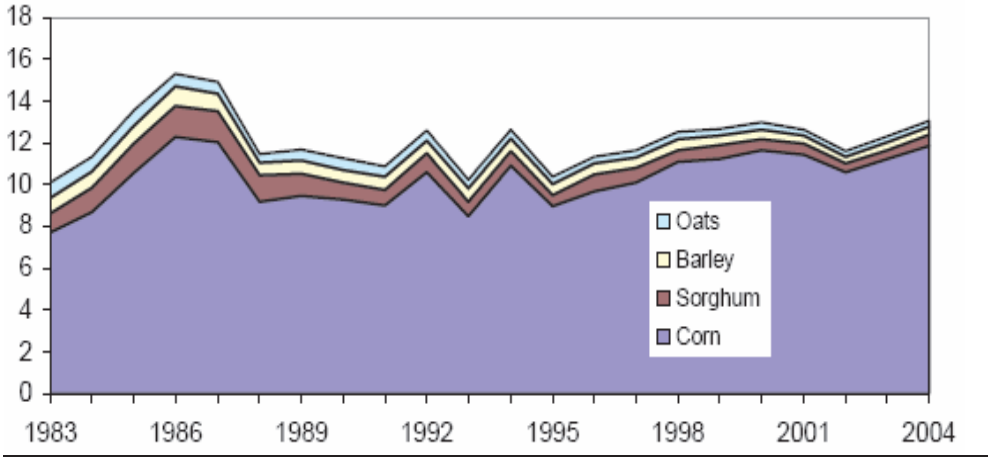
- Total international barley trade has averaged 14.6 Mt over the last 5 years (Sparks 2004) which is approximately 10 – 12% of total barley production.
- Australian total barley production has averaged 6.069 Mt from 1998 to 2003, ranging from 3.3 Mt in 2002-03 to 8.3 Mt in 2001-02 (ABARE 2004).
- Total Australian exports of barley have averaged 3.988 Mt (ABARE 2004) which is 66% of total Australian production and 27% of total world trade.
- Australian feed barley exports have averaged 2.64 Mt which is 66% of total Australian exports and 20% of total world feed barley trade. Australian feed barley exports are 2.6% of total world coarse grain trade.
- Australian malting barley exports have averaged 1.35 Mt which is 33% of Australian exports and 32% of world trade. Almost all of Australia malting barley exports are bought by China which imports close to 50% of its total malting barley requirements from Australia.

6.1 General context

There are a number of significant issues for barley trading in Australia that need to be understood to understand the effects of deregulation of the Australian barley market.

Coarse grains include oats, sorghum, barley and corn and are mainly used for animal feeds. International production and trade in coarse grains is dominated by corn (see Chart 4); barley is a small proportion of global coarse grain production and trade.

Chart 4 **World coarse grain production (million tonnes)**



USDA 2004

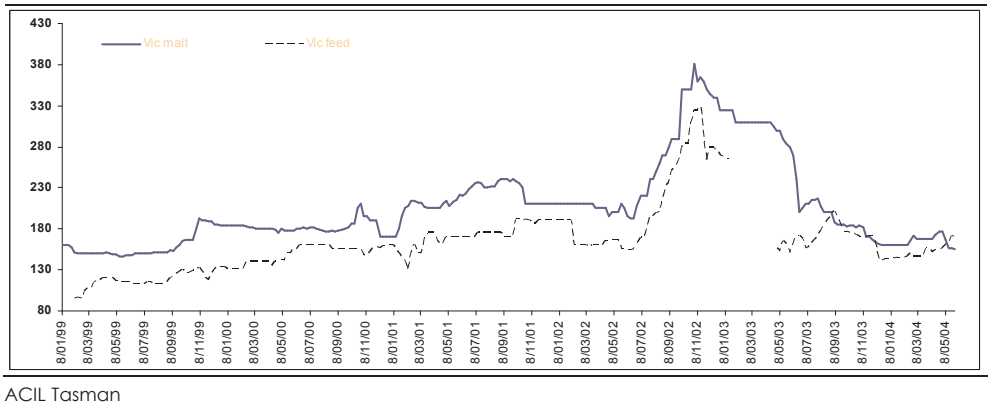
Unlike wheat, corn, canola and soybeans there is no high volume futures market that provides effective price risk management for either feed or malt barley.

Some grains, particularly feed quality grains, have a high level of substitutability which, from a demand perspective, should create reasonably predictable relative prices, which allows some hedging across crop types. For example, the Chicago Board of Trade (CBOT) corn contracts are sometimes used to hedge lower quality wheat and CBOT soybean contracts can be used to hedge canola. While corn and feed barley prices do have some relationship there are several factors that influence the spread between them which reduces the ability to use corn futures to hedge feed barley prices.

One of these factors is the low elasticity of demand in both the Saudi Arabian and Japanese markets. Both these markets use large quantities of feed barley, and have a preference for Australian grain. Until recently the Saudi market has been heavily subsidized by the Saudi government which fixed the domestic price and paid the importer the value of the variation between domestic and international prices. Prior to 2002 Japanese grain buying was regulated, with all purchases arranged by the Japanese Food Agency (JFA). Japanese prices were designed to ensure security of supply usually from two of three major suppliers. Both these markets have reduced the level of government intervention (see below) which may make feed barley prices track substitute prices more closely in future.

The second major influence on the relative prices between barley and other feed grains is the price spread between malt and feed barley. Virtually all barley can be used to produce malt, but certain varieties are preferred over others to produce better quality malt and increase malting efficiencies. The malt spread in Victoria is shown is shown in Chart 5. Victorian based maltsters consume the majority the malt barley available to the domestic market.

Chart 5 **Victoria malt and feed barley cash prices (AUD tonne)**



ACIL Tasman
Data source: ProFarmer

The malt spread is determined by the supply and demand of malt and feed barley and the relative malting efficiencies between various barley varieties.

The way the international barley market is arranged has implications for the way barley is traded in Australia. The most important influences are:

- benchmarking grain traders' prices and longer term performance is almost impossible without knowing other traders' prices, which are closely guarded secrets;
- the resources and networks a company needs to be able to trade barley internationally are much larger than for wheat;
- small domestic barley traders have to rely on physical contracts to manage risk whereas wheat trading deals mainly with basis risk (cash price – less futures prices);
- the range of risk management products that are offered to growers will be low as traders do not have the ability to offer risk management products over the counter (OTC) based on exchange traded contracts; and
- pooling for traders becomes a much more attractive option as price risk is transferred to the grower.

Box 1 Price discovery and risk management in wheat

Wheat prices in Australia are based on the prevailing world price with adjustments for local supply and demand factors and quality differences. The most important market for the discovery of international prices for wheat is the Chicago Board of Trade (CBOT) where, on any given day, the amount of grain being traded in open future contracts is approximately 23 – 25 million tonnes of wheat, 70 million tonnes of corn and 36 million tonnes soy beans (as well as several other types of crops).

The AWB price risk management strategies are heavily reliant on the CBOT which, given the AWB's influence on the domestic grain market through its pooling activities, pass the influence of the CBOT wheat, corn and soy bean prices onto Australian markets. In the AWB's own words: "The Chicago Board of Trade soft red winter wheat futures contract is the most actively traded and publicly visible wheat futures contract in the world. The contract is widely accepted as the pre-eminent indicator of world wheat price movements." (Pyle 1992)

Box 2 Grain trading resources and deregulation

Report of discussions with several major international trading houses.

- Resources are invested in trading in proportion to the volume and the flexibility of the tradable grain.
- Optional destination is an important aspect of the contract for barley traders. Restrictions on barley destinations are often made by ABB, GPPL. This attracts a $US3-$US5.00 discount on the shipment.
- The GLA has proven to have a significant amount of uncertainty as to the decisions it makes which is causing most potential traders in Western Australia to take a cautious approach to investing trading resources.

- The current level of unregulated barley trading in Australia is not sufficient to attract investments in storage, handling and market infrastructure from major international grain traders.
- Wheat is the main game in Australia—deregulation of all the other grains may not attract large investment until wheat is deregulated.
- International traders require large volumes to manage risk.
- Australia has a reputation as slow to change. We seem to need to analyse the need to invest where as many unregulated countries leave commercial risk to the private sector.
- Australian traders are good but domestically focused.

6.2 Feed barley market

The international feed barley trade averages 13.3 Mt per year and is approximately 12% of total annual consumption. Feed barley accounts for 75% of the international trade in barley, which has fallen from 85% about a decade ago due to the increase in malting barley trade, mainly to China (Sparks 2004). While the EU and Australia have dominated international trade in feed barley, Russia the Ukraine and Eastern Europe have increased production and now produce large exportable surpluses that are shipped from Black Sea Ports. Black Sea barley has become a major competitor in Australia's Middle East and North African Markets (Liefert, et al, 2004). Traders estimate that the Ukraine will export 5.5 Mt this year.

Major importers of feed barley are the Middle East and North Africa. The single biggest importers of feed barley in the world are Saudi Arabia which has averaged 4.2 Mt over the last five years and Japan which takes 1.3 Mt (Sparks 2004).

Saudi Arabia

The Saudi market has been a major influence on the world barley market due to the quantity it imports each year and its subsidization of imports.

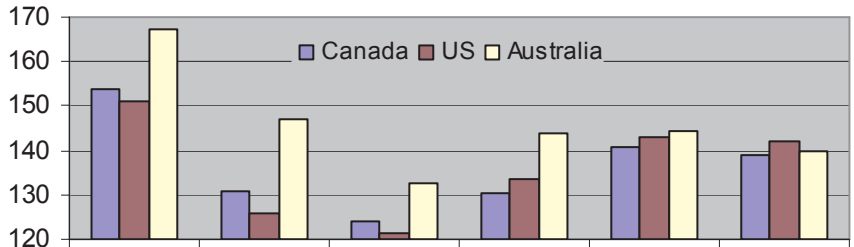
Until recently the Saudi government capped the domestic price at $US106.67/tonne for barley and $US96.00/tonne at importers bagging facilities (Hussein 2004) . The government paid the difference between the domestic price and the international price.

The Saudi government has now fixed the subsidy in the range of $US40 - $US50 per tonne (Hussein 2004). The changes to the subsidies mean that Saudi barley users will be exposed to international prices less $US40-$US50 tonne. The effects of this are largely uncertain at this stage but are likely to be an increased sensitivity to prices by domestic consumers. This may reduce total

demand for barley; increase substitution with lower cost feed sources, and may lead to a reduction in quality spreads between Australian barley and other sources. Australia though, is a large holder of feed barley during harvest when feed supplies from the northern hemisphere are low.

Japan

Chart 6 **Japanese feed barley market (USD tonne)**



	1997	1998	1999	2000	2001	2002
Canada	154	131	124	130.4	140.5	139.1
US	151.2	125.8	121.2	133.6	142.9	142.1
Australia	167.2	147	132.7	143.8	144.2	139.9

Sparks 2004
Data source: Japanese Ministry of Finance

Australia has dominated the Japanese feed barley market where the quality of Australian barley is considered superior to other sources. Until recently the Japanese feed barley market was highly regulated through the use of tariff-rate quotas (TRQs). By setting non-quota grain tariffs at substantially higher rates to quota imports, the Japanese government effectively fixed the tonnage of a commodity that could be imported. The quotas were managed by several Japanese government agencies that decided how much to import, when to import and at what price to resell the imports into the Japanese markets. The agency managed the program not only to protect Japanese farmers but to secure supplies of commodities. It has been suggested that the Japanese agencies preferred to deal with other government agencies such as the ABB and CWB, but they consistently dealt with private trading companies supplying US grain.

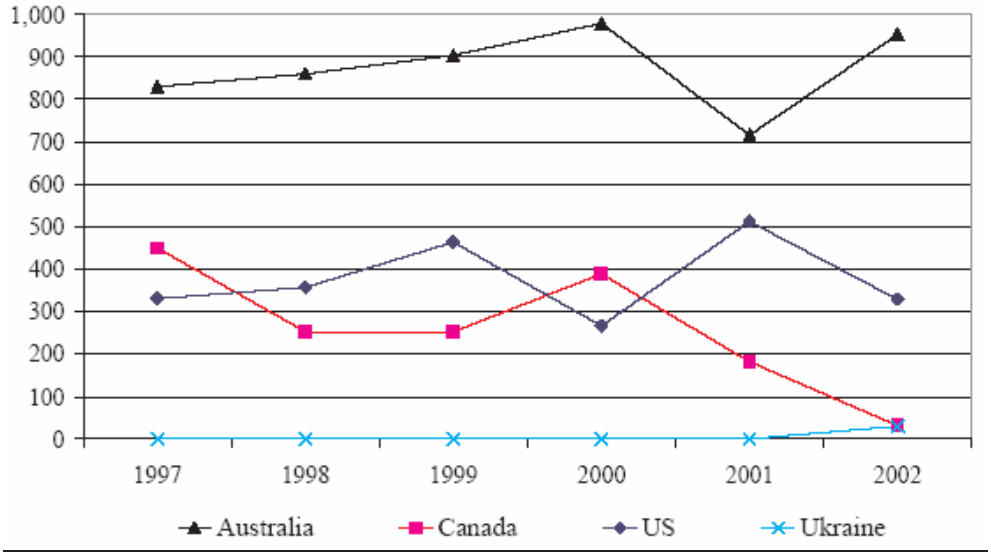
In 2002 the regulation of the Japanese market was reduced with the introduction of the simultaneous-buy-sell program (SBS). Under the new program companies wishing to import and companies wishing to export to the Japanese market jointly make a bid to import a specified quantity of grain. The joint bid proposes a purchase price (from the exporter) and sale price (to the Japanese markets). The administering trading agency in Japan chooses the bids

that have the biggest difference between them. The state trading enterprises retain the difference between the purchase and sale prices.

The new system allows closer communication between sellers and buyers which was not possible under the old system. One of the results of this has been the entry of several new traders into Japan from Australia, and in 2002 the first sales of Ukrainian barley was made to Japan.

Australian barley has enjoyed a premium in the Japanese market, due to its bright colour and consistency (see Chart 6). This premium is referred to by the Japanese as the 'Australian premium'. As can be seen in Chart 6 the 'Australian premium' declined between 1997 and 1999. This decline occurred before any of Australia's export markets were deregulated.

Chart 7 **Japanese imports by country of origin ('000 tonnes)**



Sparks Companies Inc 2004

Chart 7 shows the relative market shares of various countries. It shows that Australia has clearly dominated the Japanese market and continues to do so. There is no evidence of any loss of market share in Japan or any deviation of the prices trends established prior to deregulation of the Victorian market in 2001.

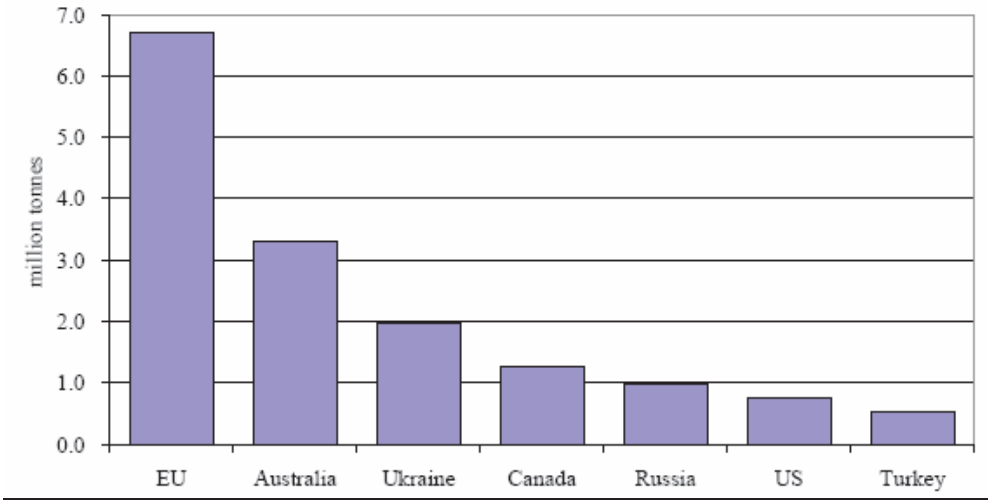
The combined effect of the changes in Saudi Arabia and Japan may increase the elasticity of demand for barley in general in the international barley market. This may lead to a greater correlation of feed barley and corn prices which will allow traders to use the CBOT corn futures market as a risk management tool. It may also lead to greater use of the Australian Stock Exchanges (ASX) feed barley futures contracts (see Box 9).

6.2.2 Malting barley market

While total feed barley trade is predicted to remain static, as it has for the last 20 years, world trade in malt and malting barley is predicted to rise substantially over the next 5 years. The International Grains Council (IGC) estimated that total malt trade increased by 37% from 1995-2003. Most of the increase has been due to increased beer consumption in Russia and China.

Malting barley trade is catching up to feed. The IGC estimates that the combined trade of malting barley and malt exceeded feed barley in 2003-04. It predicts that trade in malt will stagnate as traditional importers will begin to process more barley themselves.

Chart 8 **Major barley exporters (5 year average 1998-99 to 2002/03)**



Sparks 2004

Total world malting barley trade has averaged 4.2 Mt for the last 5 years, but has steadily risen from 3.2 Mt in 1994-95 to 4.6 in 2001 (Sparks 2004).

Table 2 **Malting barley exports (historical and projected) by country**

	1997-2001	2006	2011
Australia	1,350	1,875	2,100
Canada	1,144	1,700	2,025
EU	1,081	1,400	1,500
US	186	175	190
Others	274	425	560
World Total	4,035	5,575	6,375

a Sparks 2004

The main markets for malting barley are China and the US which combined account for 60% of all malting barley imports. China alone accounts for 50% of world barley imports and consumption is expected to rise in line with expected further increases in beer consumption.

Malting barley is increasingly becoming a specialty grain as maltsters demand higher levels of performance. Maltsters are increasingly dealing direct with producers and specialty traders to achieve improved malting efficiencies and quality. This is causing higher levels of differentiation in the market as direct supply chains to maltsters are being formed by specialist malting barley traders.

A major issue for the malting barley trading is substitution of feed grades for malt quality barley. A constant claim made by single desk sellers is that they withhold Australian feed grain supplies from China to inflate the malt-feed barley quality spread. They claim that in deregulated markets the temptation of private traders to sell feed quality into China will be too strong and malt premiums will fall (in 1998 prior to any barley market being deregulated in Australia 300,000 tonnes of Australian feed grade barley was sold to China according to Chen Min of Top Glory – a subsidiary of COFCO, China's state trading agency).

China

Chinese imports 50% of its malting barley requirements from Australia. While this may be due to quality differences, Australian barley tends to be available as northern hemisphere stocks are beginning to run out. As malting barley is a perishable commodity, Chinese buyers have few options other than to purchase from Australia at certain times of the year. This can be two edged sword as Australian traders holding barley from the market to push prices up for too long can be left with malt barley that is only worth feed grain prices as quality has diminished.

In a recent study of the Canadian barley industry Sparks Inc described the Chinese barley market as highly competitive and low returning. This is due to the fierce competition by Australia, the EU and Canada. China often substitutes higher priced malting barley from Australia and Canada quality with average quality barley from the EU.

Buying of barley and a range of commodities in China was regulated and all purchases were organized by the Chinese trading organisation COFCO. This regulation has been relaxed and there are now a number of private barley buyers in China.

Box 3 **Sparks Inc Review of the Chinese malt barley market**

Sparks Inc review of the Chinese barley market:

'China is known to exploit its position as a major malt barley importer, leveraging the considerable competition between Australia and the EU and Canada. [Malting barley is perishable loosing germination over time which reduces quality. Exporters need to ship in time to avoid a drop in quality]. For this reason it is considered to be amongst the most competitive and, therefore, lowest returning destinations in the world. In times of surpluses among the major exporters, competition becomes fierce into China with Chinese buyers responding well to price, a scenario that tends to depress values into China relative to other destinations.

Chinese buyers are very sensitive to price and so do not refuse competitive price offerings from any of the major suppliers. With a proportionately smaller growing region, Australian quality and yield variability are proportionately higher in a given year than Canada. However, Australian exports in the range of 90% of its production, which makes it a very aggressive seller into China.

China is also well known for importing good quality cheap EU feed barley (graded as 'Fair Average Quality') for use as malt. This is fully dependent on price but underscores China's sensitivity to price over quality.'

The Australian traders interviewed for this report indicated that they manage the Chinese market to prevent substitution of malting barley with feed grades by refusing to trade feed grains with China, as a result very little feed barley is shipped to China. (A couple of shipments over the last 2 years were mentioned to us where Australian traders had sold feed barley to China but there was little more specific information than this).

Barley market summary

- The international barley market is changing. Elasticity of demand in the Saudi and Japanese market may be increasing which may reduce any capacity that there may have been to price discriminate.
- With a reduction in the influence of the Saudi subsidies and changes to Japanese buying, an international barley futures market may emerge.
- China may become a more important market for Australian malting barley, but it is a highly competitive market, demonstrating a willingness to regularly substitute Australian malting barley with cheaper, fair average quality barley from the EU.
- The way barley is traded is different from wheat. Barley traders do not have a dominant international barley futures market, to benchmark price and provide price discovery. To be a successful barley trader it is necessary to understand the supply and demand situation of a number of key exporting and importing countries.

- Barley is traded more on the views of traders which can and do vary from one another from time to time but generally the market appears to be reasonably transparent.
- It would be reasonable to draw the conclusion that barley trading is riskier than wheat or canola and usually requires more resources; as a result traders prefer to accumulate barley through pools than cash or spot trading.

7 The international canola market

Canola is usually traded as a complex between the oil and meal, and both are readily substituted with a range of vegetable oils and protein meals. Almost all canola meal produced in Australia is consumed domestically.

As Canada is the single largest canola exporting country, accounting for over 40% of global trade, Winnipeg canola futures contracts are the main world canola price indicators. Australian canola is generally priced on an export parity basis against Canadian canola. However, in smaller production years, such as in 2002/03, this relationship may weaken as Australian domestic demand factors become more important.

Canada's large share of global canola markets has occurred despite a temporary loss of access to Europe as a result of the cessation on the granting of regulatory approvals for new GM varieties in 1998, and reduced production due to poor seasonal conditions in 2001-02 and 2002-03. The European Union GM regulatory approval process recommenced in 2004, and Canadian production in 2003-04 was close to normal volumes allowing it to recover export market share.

The emergence of China as a major canola importer, as well as increased exports into Japan and Mexico, has accounted for Canada's increased canola exports. China is now the largest market for Canadian exports of canola.

Table 3 **Canadian canola exports by destination ('000 tonnes)**

	Europe	Japan	China	Mexico	USA.	Others	TOTAL
1992/93	272	1,485		104	14		1,876
1993/94	868	1,662		434	371	14	3,347
1994/95	1,139	1,655	252	495	288	83	3,912
1995/96	322	1,679		531	272	1	2,804
1996/97	163	1,734		356	265	2	2,519
1997/98	11	1,829	110	593	391	29	2,964
1999/00	1	1,815	1,269	529	278	9	3,900

2000/01	1	1,801	1,211	570	280	22	3,885
2001/02		1,874	1,890	846	249		4,859

Source: Statistics Canada 2002

Being a major exporter of canola onto the international market, Australian canola prices fluctuate with changes in the world supply and demand dynamics for canola and the broader oilseed complex. Normal factors that influence canola values include:

- supply and usage forecasts for canola;
- world vegetable oil prices;
- world protein meal prices; and
- canola prices from competing origins including Canada and Europe.

Table 4 **World canola seed production ('000 tonnes)**

	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
Australia	860	1,760	2,460	1,780	1,750	790
Canada	6,390	7,640	8,800	7,210	5,150	3,950
US	350	710	620	920	910	710
EU	8,730	9,500	11,420	8,950	8,870	9,340
India	4,650	5,000	4,900	3,750	4,850	3,700
China	9,580	8,300	10,000	11,380	11,320	10,530
Other	5,770	5,320	7,360	3,540	3,810	3,510
Total	36,330	38,230	45,560	37,530	36,660	32,530

Data source: Oil World Annual 2003

The main markets for Australian canola are Japan and China which between them account for 60 – 70 per cent of total Australian exports. In both these markets Canada has steadily grown market share over the last five years. Australia has begun to export larger quantities to Pakistan and Bangladesh. Both these markets are highly price sensitive.

Europe is a residual market for Australian canola, where traders will look to place exports when other markets are full. The expansion of the EU includes central European countries who are large rapeseed producers. Intra European trade is over 20 Mt per annum on average.

Table 5 **Australian canola exports by destination ('000 tonnes)**

	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03
Bangladesh	94.6	126.4	99.4	148.2	151.8	70.1
Bel/Luxembg	17.6	33.1	-	107.8	0.7	
China	132.7	393.8	1212.0	294.8	335.8	50.08
Germany	69.3	160.5	-	253.9	-	
Japan	230.3	293.2	370.0	375.9	395.4	444.4
Mexico	21.0	123.9	97.2	-	-	
Netherlands	3.2	92.8	-	-	-	
Pakistan	20.9	42.8	56.2	224.3	306.7	38.5
U.K	-	28.5	-	-	62.1	
Other	0.5	24.8	57.8	74.0	25.7	9.2
Total	590.1	1319.8	1892.6	1478.9	1278.2	612.3

Source ABARE 2003

8 Expectations of effects of reform

During our consultations with industry and a review of the rural media, there were four main areas where deregulation was postulated to have its greatest impacts. These were:

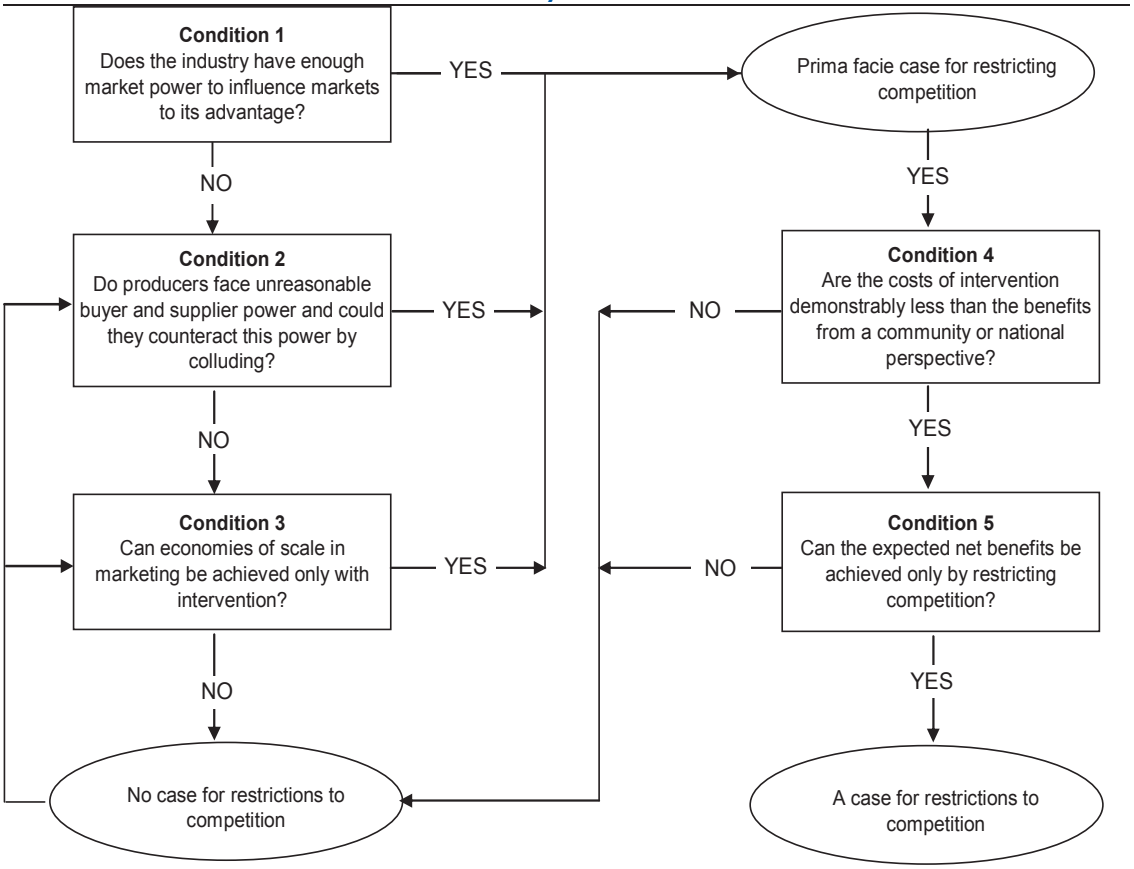
1. the erosion of market power held by statutory marketing bodies;
2. the rise of unreasonable buyer and supplier power that is counteracted by single desk marketing;
3. a loss of scale economies in marketing that can only be achieved by regulation; and
4. the removal of the single desk would cause a reduction in industry support, through lower investments in research and development.

The first three issues listed above are consistent with the criteria used by the Victorian Government to assess the effect of deregulation in the Victorian and South Australian Barley Marketing Act 1993 Review in 1999 shown in Chart 9.

Further criteria that were mentioned to the consultants by a number of industry participants — mostly by those who expressed concern about deregulation—were the social and environmental effects. These concerns were not very well articulated and were difficult to document. They appear to stem from a perception that prices would fall after deregulation (some extreme views even felt that barley production would almost completely disappear in

Western Australia) which would lead to substantial contaction in rural communities. There was also a belief that price falls would also lead to changes to farming practices that would be environmentally unsustainable. No evidence was put forward to support these views by those who expressed them.

Chart 9 **Conditions under which regulation may create a net benefit to the community**



Centre for International Economics 1997:

The majority of the debate, and most of the reviews that have been conducted to date, have focused on establishing if market power is held by the single desk marketing organisations, and if deregulation removes this power. Those opposed to deregulation have consistently argued that Australian barley producers would compete with each other in international markets and receive a lower price for their grain if markets are deregulated. Claims as high as $A30.00 per tonne have been suggested as the amount that rival traders have competed away in some key markets.

Fear of buyer dominance of grain markets, particularly large multinational corporations, has been a constant issue raised during the NCP process since it began. This was raised again by several participants consulted during this study. Although no evidence was provided, multinational grain trading companies

were accused of extracting large margins from Australian producers and adding another layer of costs to Australian grain sales. This concern was based on the belief that Australian producers would become weak sellers in a deregulated market and large organized multinational traders would exploit this weakness.

A view was also expressed that multinational trading companies have no incentive to promote Australian grain as they trade mostly on multi-origin contracts which allow them to source grain from anywhere in the world.

The major effects of deregulation from those who held a positive view of market reforms are summarised as:

- gross prices achieved by traders in deregulated markets rise;
- prices received by growers rise not only from higher gross prices but also from competition reducing marketing costs and margins;
- a range of selling options have become available for growers to market their grain;
- deregulation promotes transparency of prices; and
- there is more likely to be greater investment in infrastructure in deregulated markets.

The NCP process has generated a considerable amount of debate in the grains industry over the last 10 years.

Box 4 **Media activity before and after export deregulation in Victoria**

Letters to the editor The Weekly Times May 30th 2001

'Send message over barley plan'

I urge all barley growers to vote for the retention of the single desk in the forthcoming vote…Over 90 per cent of delegates at the VFF grains conference, representing a similar percentage of all barley producers, voted for the single desk. Deregulated grain has traditionally been transported by road. Has the Bracks government factored in the escalation in road expenditure after deregulation?

'Take action now'

In a bombardment of politicians by whatever means of communication chosen, there are many points that can be made. Some of these are:

- that national competition policy had been proven to not work in the best interests of primary producers;
- the Australian Barley Board's ability to deliver guaranteed quality attracts premiums in corrupt overseas markets; and
- that most private traders have multi-national companies backing them, and their first obligation is to shareholders.

Article in the Stock and Land 15th May 2002

Going by the busy shipping schedule that major barley exporter ABB Grain Ltd has been keeping since harvest, it appears deregulation has had little effect. The opening

of the market to new buyers with the opportunity to export was tipped by ABB to cause uncertainty and volatility in the Victorian barley market. To date, there are no signs this has happened.

The only blip on the radar was allegations made by ABB that feed barley was being sold to China as malting barley at lower prices than that for malting barley, causing two effects.

One was damage to Australia's reputation and the other was a reduction of malting barley prices.

ABB Victorian state manager Michael Wood said the heavy shipping —nearly 500,000 tonnes had been shipped since January—reflected servicing of existing contracts and also new customers secured. "Our people at ABB's international offices, like the one in Beijing, are going out and being proactive to get new markets around the world' he said…."They [Chinese maltsters] are now looking at Australian barley as a viable alternative to other malting barley" he said.

Deregulation also seems not to have shifted growers' loyalty or faith in the ABB, with the company selling 70-80% of the Victorian crop, Mr Wood said.

The current reviews in South Australia and the introduction of the Grains Licensing Authority (GLA) in Western Australia are no exception. Observations of the media activity during periods of competition review shows that almost all of the activity precedes deregulation. This has been the case in Victoria where there have been very few reports that relate to deregulation after the domestic and export barley markets were deregulated.

Box 5 **Press releases from the ABB**

Press release issued on the 2nd of October 2004 by the Australian Barley Board

'Cutting the cake doesn't make it bigger'

As might be expected, the GLA opened and immediately there were trading companies applying for permits. Permits that would destroy WA's single desk marketing system…Doesn't it mean new ideas? No, it means a retrograde step to having more exporters offering the same barley to the same few customers and competing prices down. Growers can only receive what the market pays, so more exporters is just like cutting up the cake and ending up with less—it's growers who lose.

Press release issued on the 3rd October 2004 by the Australian Barley Board

'ABB Victorian No 1 Pool closes soon'

The Victorian No 1 Pool was designed to give growers the opportunity to achieve a premium price for their grain by committing it to the ABB before the harvest period. Mr McNair said, 'this gives us an indication of the amount of grain that will be available for both domestic use and for export over the coming year. With some markets

needing commitment prior to harvest, ABB can then secure the company's place in these markets and achieve the best possible price for the grain in the No 1 Pool.

One of the most interesting observations made by the consultants during consultations with industry has been the small quantity of empirical evidence provided to support claims made by those opposed and those who support deregulation. Despite recent media activity and claims of a complete collapse of the Western Australian barley market the Western Australian Farmers' Federation told the consultants that they have no evidence to support these claims.

Box 6 Western Australian Farmers Federation (WAFF)

WAFF believes that total deregulation of the barley market in Western Australia will force at least 50% of barley producers out of business in 4-5 years. This assertion is based on a belief that deregulation will make pooling completely unviable. WAFF believes that without the Grain Pool of Western Australia, producers will have no option but to sell for cash. They believe that at harvest the cash market will not be able to absorb all of the grain and growers will have to store grain. The resultant volatility of prices and enormous surplus in the domestic market at harvest will force barley producers to stop growing barley and plant other crops, most likely wheat.

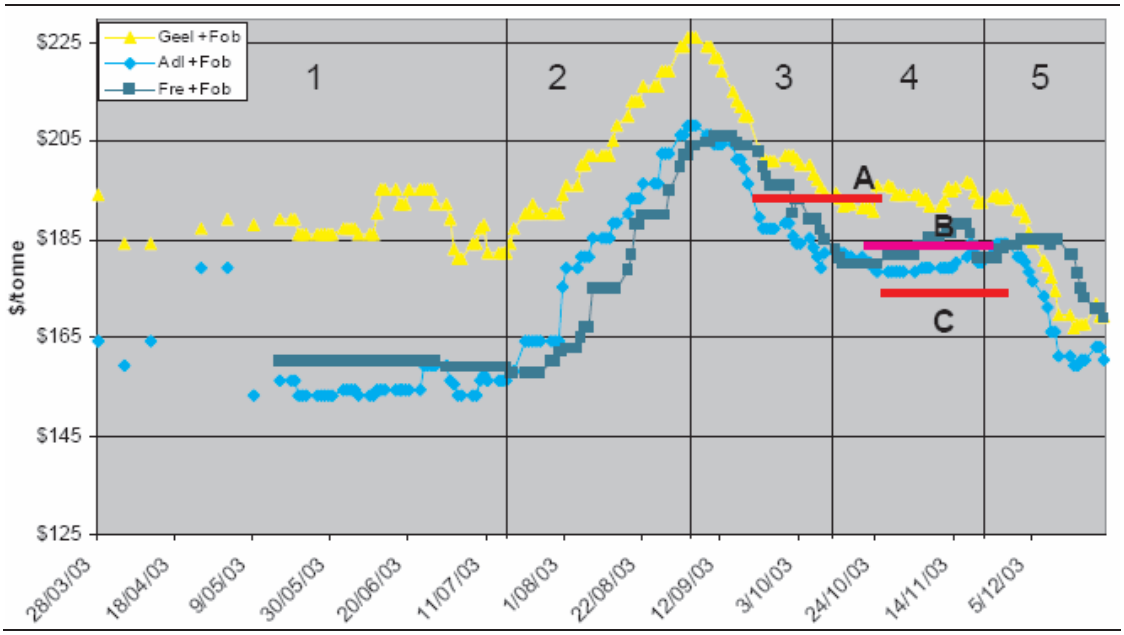
The major reason for the collapse of the pool put forward by WAFF is that commercial traders have no incentive to participate long term in the Western Australian barley market. Only domestic users will remain as buyers after deregulation.

According to WAFF the removal of barley from cropping rotations will cause significant environmental problems and create social upheavals in rural communities. WAFF believes that regional impact of NCP at the social and environment level are being ignored.

WAFF representatives said that they have no data or analysis or anecdotal evidence to support these claims.

Those that support deregulation provided an analysis of feed barley prices in Western Australia in 2002 conducted by Farm Horizons for the Australian Grain Exporters Association (AGEA). The key finding of this report was that at the time of licenses being issued in Western Australia, prices for feed barley in Western Australia rose above South Australian and tracked Victorian prices, a situation that does not normally occur.

Chart 10 **2003 barley prices for Victoria, South Australia and Western Australia**



Farm Horizons 2003

While Chart 10 does show a change in relative prices between the states coinciding with the issuing of licenses in Western Australia, to draw a conclusion that the price increase resulted from partial deregulation is misleading. A review of price relativities of Victoria, South Australia and Western Australia is shown in Charts 10 to 14 of this report. They clearly show that delivered port cash prices change relative positions regularly. For example, in 1999-00 it appears Western Australian feed barley bids were higher through most of 1999 and 2000. In 2002-03, prior to the drought induced price rises, the Western Australian cash market traded higher for several months and Victoria appeared to trade at a discount to both the other states. From late 2003 to the end of June 2004 cash bids in Western Australian traded at a premium to Victoria and South Australia.

9 Overview of grain pooling

Inherent in many of the concerns about the loss of market power and the effects of deregulation is the effects on, and possible loss of, pooling of grain, which has been the primary method of acquisition in Australian grain markets for many years.

Pooling grain averages all of the returns and costs across each tonne of grain delivered and therefore each grower has an equal stake in the outcome per tonne of grain.

The main features of pooling in Australia in regulated markets are:

- regulated pools are always 'long' grain, that is they receive all of the grain at harvest, the majority of which is usually not sold prior to harvest—international markets usually know the approximate size of the crop and regular pool sale commitments;
- pooled grain is sold over an extended period, sometimes up to 18 months;
- pools are required to be a receiver of last resort—although this is heavily qualified by the ability to set standards. In deregulated markets there are not large quantities of grain unsold, all grains have generally got a market at a price;
- pool managers claim they are a marketer not a trader which is correct. Pools market grain on growers' behalf receiving a fee to do so. Changes in the value of the grain are passed onto growers; and
- currency and freight is partially managed by pool managers prior to harvest.

Pool managers in Australia decided to trade direct to users in the early to mid 1990s rather than sell a proportion of the crop to the international trade. This is primarily done to reduce costs. Industry sources have indicated that the cost per tonne of dealing through international traders is typically $US9.00-$US10.00 per tonne depending on the market. This amount was mostly charged by the trader to offset risk of default of the customer. For trades in secure markets this was expensive, but for risky countries and contracts with a number of small customers the cost may have been better value.

Another reason dealing direct with market was introduced by Australian pool managers were the discounts private traders placed on 'restricted destination' contracts. A trader buying grain in Australia often negotiated the price with the pool manager and was then presented a list of destinations the barley was not allowed to be sold too. This restricts a trader's ability to manage risk. Therefore the traders had to build in a risk premium into the deal. Grain trades with restrictions on origin and destination attract discounts of up to $US5.00 per tonne (from discussions with a range of international barley traders).

One of the consequences of dealing direct with customers has been a reduction of liquidity in international barley markets.

9.1.1 Market power

Market power is difficult to define precisely and is harder to prove where it has been used. While market power may or may not be a feature of single desk marketing, NCP requires that it needs to be established whether this power stems from compulsory marketing legislation or is a result of other factors that can operate after deregulation.

Market power is defined in the Victorian Government Review of the Victorian and South Australian Barley Market Act 1993 (1997) as the ability to:

- identify buyers with different elasticity of demand;
- increase the price of the low demand elasticity market by withholding grain; and
- sell the surplus grain to the high elasticity markets which will purchase more at the same price to that paid at lower quantities.

The increased revenue comes from the volume of grain sold at the higher price which, provided the remainder of the grain is not sold at a lower price, increases the total average price.

To be able to obtain market power a trader needs to:

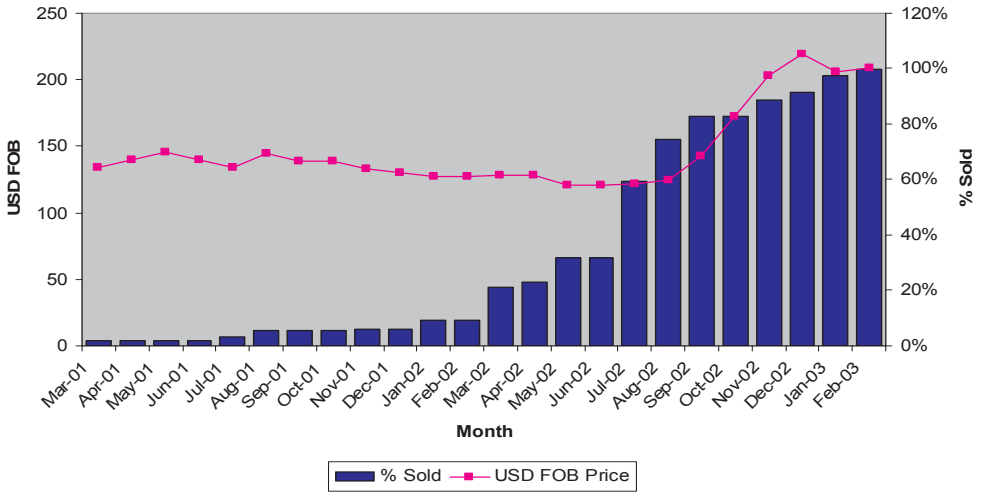
- have a detailed and highly accurate understanding of the elasticity of demand for a range of buyers all of the time;
- have a comprehensive knowledge of all of the relevant supply and demand for the grain being traded;
- acquire sufficient quantities of the grain to be able to restrict supply to target markets;
- have a full knowledge of rival suppliers' behavior; and
- be able to exercise the power at a lower cost than the additional revenues generated.

If the trader does not meet all of these criteria then the strategy can produce a return no different from general market returns but additional cost will have been incurred in storage and financing, or worse the total value of the grain could diminish.

Market power is only of benefit when the total average net returns from all grain sales are higher. Often scenarios are advanced where market power is thought to have been exercised when the withholding of grain coincides with a rise in prices, but there is little consideration given to the disposal of surplus grain withheld from the higher priced market, and the costs of storage and finance are not included in the calculation.

The following chart was provided by the Grain Pool Pty Ltd (GPPL) as an example of the market power that it believes it had been able to exert as a result of the regulation of the barley market in Western Australia prior to 2003. The GPPL believes that the chart illustrates how Grain Australia, an alliance between the GPPL of WA and the ABB, withheld malting barley from sale to the Chinese market with the result that the price was forced up in late 2002 through to early 2003.

Chart 11 **Malting barley sales to China made by Grain Australia from the 2001-02 crop**



GPPL 2004

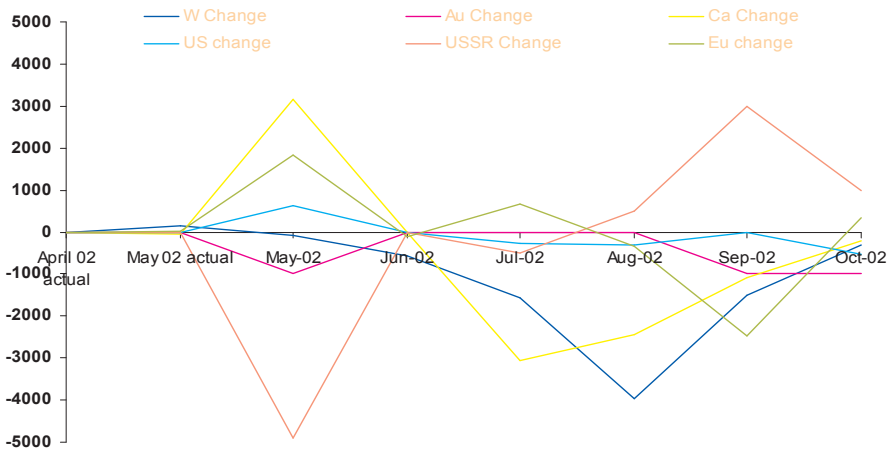
Note: Provided to consultants by the GPPL

GPPL representatives explained that, grain that would normally be offered for sale from the 2001-2002 barley pool early in 2002, was purposefully held back until July 2002. This created a situation where Grain Australia held the only significant quantity of malting barley in the world from July 2002 to February 2003, making it a strong seller. The Chinese, unable to buy from another source, were forced to pay prices set by Grain Australia. GPPL describe this as a clear demonstration of their market power that stems from the single desk. The GPPL claimed that this market power will diminish if multiple sellers of Western Australian malting barley are allowed to compete with the GPPL in certain markets.

While market power may have been held by Grain Australia at this time it is difficult, if not impossible, to prove based solely on the information presented in the chart. There were a number of factors impacting on the barley market at this time that could provide alternative explanations of the outcome.

In June and July 2002 dry conditions were affecting cereal and oilseed crops in both North America and Australia. Chart 12 shows the revisions the USDA was making to international barley crop forecasts each month during 2002. In July the USDA estimated that Canadian barley production was likely to be 3.0-4.0 million tonnes less than expected. By August 2002 the USDA estimated total world barley production would be well over 4.0 Mt lower then initially forecast. In a world trade situation of 15 Mt this represented a decline of 20-30% per cent. With demand estimated to remain stable, the projected reduction could only mean that prices would rise, especially when production declines in other grains were predicted.

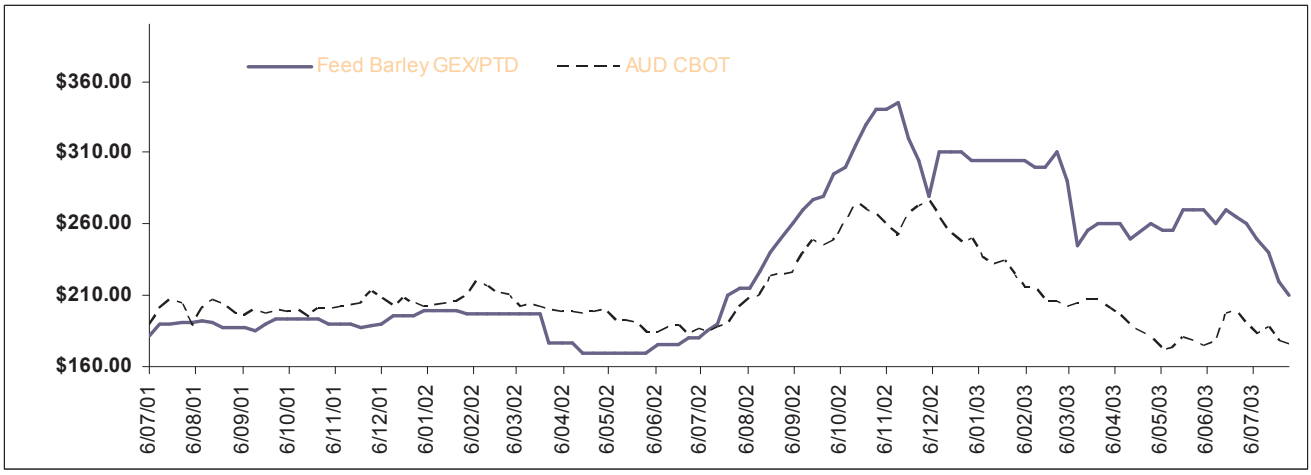
Chart 12 **USDA world barley production forecasts changes ('000 tonnes)**



ACIL Tasman 2004
Data source: USDA

By September 2002 dry conditions had intensified further and prices for wheat, corn and soybeans were rapidly appreciating around the world. International prices of wheat as reflected in the CBOT contract price rose substantially between August 2002 and December 2002. Moreover, Australian prices (feed barley) rose by even more reflecting drought induced demand. In Australia, cash prices for feed barley delivered port compared to CBOT corn prices are shown in Chart 13

Chart 13 **Victorian feed barley and CBOT wheat prices AUD tonne**



ACIL Tasman 2004
Data source: Graincorp

In summary, international (and local prices) were rising during the latter half of 2002 reflecting underlying supply and demand factors — not the carryover of 2001 stocks by GPPL.

Another problem of the chart provided by GPPL is the origin of the price being quoted. The USD price per tonne illustrated in the chart is the price received by Grain Australia for the sales it contracted which may not be the prevailing world price. A comparison with Victorian malting barley prices during this period shows a close correlation between Grain Australia prices but at times Victorian domestic malting barley prices exceeded those obtained by Grain Australia in China. Again this reinforces the point that the underlying demand and supply factors were determining price movements.

Another factor that needs to be taken into consideration is the costs of the strategy to withhold grain from the market in order to push prices up (or take advantage of what turned out to be higher prices). The cost of storage and finance per tonne would have been substantial and reduced the net return of the strategy. Costs associated with holding grain over this period would have at least $A2.00 per tonne per month.

There are also significant risks associated with holding the grain off the market to either effect prices rises or to capitalise on expected price rises. To be successful in this strategy a trader needs to be certain that substitution is not likely and the demand of the target buyer is sufficiently inelastic. It appears that a strategy of this kind would be more attractive to a pool manager where the price risk and all of the costs of carry are born by the grower. The major issue with exporter analysis such as this is that one can never be quite sure whether the outcome reflects market intelligence, market power or just good luck.

If there were market power held by Grain Australia at this time was it dependant on the single desk and what have been the effects of the introduction of the GLA on the exercise of the power if it existed?

Any market power held by Grain Australia was a result of it holding a large quantity of grain at this time which any trader has the capacity to do. A private trader that does not hold a single desk license could accumulate grain and not sell. Multiple sellers may dilute the capacity to exercise market power if they have a similar strategy and held grain. But this was not the case in Victoria over this period. In July and August 2002 prices rose dramatically as the dry conditions extended across most of the grain belt. As prices began to rise many feed grain traders were not selling large quantities as their analysis of the supply and demand situation indicated that prices may increase further. All traders acted in a similar fashion with the grain stocks they held. Those that waited until late in the year and into early 2003 obtained much higher prices than those in September and October 2002.

To the extent that the GPPL has market power it will be able to demonstrate that to the GLA who will restrict access to these markets accordingly.

Deregulation in WA has not lessened the GLA's capacity to use market power where it can demonstrate that it has it.

10 Observations of the effects of grain market deregulation

10.1 Pools and cash markets

The most significant change to a grain market when either fully or partially deregulated, that we have observed is the development of a 'deeper' or higher volume cash market for grain. Cash or spot markets involve the exchange of grain at a fixed price, within a defined specification range and a fixed delivery point and date. Cash markets can either be for immediate or future delivery. A cash trade transfers the grain title from the seller to the buyer with no further involvement of the seller.

When producers sell for cash they are committed to selling the grain to the buyer. While the producer no longer faces a possibility of price variation they are now committed to delivering a certain quantity of grain. If farmers cannot deliver their own grain they need to purchase grain of similar quality and organize delivery or pay the grain trader the difference between the price agreed and the market price at the agreed delivery time. The farmer is exchanging price for production risk.

There are several levels of cash traders in deregulated barley markets differentiated on the method and size of trades. Local traders based in regional centres trade truck loads of grain, usually storing it and selling to local users who have limited storage facilities. These traders will often move in and out of the market quickly and often trade the spreads between various types of grain. For example if feed barley looks cheap to a local trader compared to wheat, he will buy barley and sell wheat.

Pooling is possible in a deregulated market. In every state in Australia that has undergone full or partial deregulation the traditional pools have endured the transition to deregulation. These pools have undergone some changes but the central elements of pooling remains.

The entry of new participants in most NCP deregulated markets has been limited. This is due partly to the fragmented nature of regulation across states and partly due to the lack of access to the export wheat market which would provide significantly more volume to trade. The Australian grains industry remains dominated by a handful of domestic traders that are largely owned by growers as a result of statutory marketing boards being privatised.

It was pointed out to the consultants that huge infrastructure investments are being made by multinational grain trading companies in the Black Sea region, Brazil and Argentina. Investments in these regions by private traders are in storage, handling, port facilities and rail network and total billions of dollars. In these countries and in North America, services provided in the supply chain are seen as profit centres where additional value can be added. In Australia the supply chain is seen as a cost centre which provides no incentives to invest.

The traditional pools run by the state trading organisations not only have had to compete with the development of cash selling options, but often new pools developed by new entrants as well. After deregulation the majority of new products are based on cash or spot sales, but in several cases new pools have been established by new entrants to the market.

If pooling were not possible to operate after deregulation it may be argued that grower choice has not expanded as cash markets simply take the place of pools. Observations of all of the grain markets in Australia suggest that the pools that were run prior to deregulation continue to accumulate a significant amount of grain. It is estimated that on average the ABB pools in Victoria acquire up to 80% of exportable barley produced in that state depending on market conditions.

Table 6 **Average proportion of barley pooled (trade estimates)**

State	Total barley production average 1996/97 – 2002/03 ('000 tonnes)	Barley pooled in an average production year
WA (2003)	1150	83%
Vic	1134	80%
NSW	1154	
SA (pooling varies depending on proximity to Victorian ports)	1951	80%
Qld	226	

ACIL Tasman 2004

Note based on industry estimates from a variety of sources as statistics are not available

In deregulated markets the traditional pools have to acquire and sell grain. Prior to deregulation pool managers only had to sell grain as accumulation was assured. As domestic markets were deregulated pool managers did not have to compete strongly if the crop was of sufficient size to satisfy domestic demand and produce an exportable surplus large enough to meet sales made and long standing customer needs.

Direct comparisons between pool and cash prices are not valid. Pool returns quoted during the season are estimates of what a pool will realize when all the grain is sold and paid for. When finalized the pool price is the average price received per tonne of grain after all of the marketing and other transaction costs have been subtracted. The pool return paid to growers has further deductions based on freight and storage and handling costs incurred between the export terminal and the silo into which the grain was originally delivered.

Pool returns may also reflect the payment and finance options a grower chooses. As a pool is realized over an extended period, with irregular cash flows, the only effective way to compared pools to alternative selling methods is to calculate the present value of the pool return. A present value calculation is dependant on the discount rate used to determine the present value of future cash flows. Each farm business will have a different discount rate which will be based on the opportunity cost of the funds in the pool and the farm business operator's attitude to risk.

The effect of the opportunity cost of the funds on the final calculation of the pool return is irrelevant in a regulated market as there are no alternatives. In a deregulated market funds tied up in pools do have an opportunity cost and this will vary from producer to producer.

As the opportunity costs associated with delivering to a pool are highly dependant on the individual farming enterprise, maximizing the gain from grain marketing is best done by producers. A major effect of the combination of deregulation of the grain and financial markets is the payment and risk management choices now available to producers.

Support of alternative selling options for grain by producers is clearly demonstrated by the partial deregulation in Western Australia in 2003. The licensed exporters, offering cash contracts, acquired approximately 12% of the total exported barley crop that year.

It is clear that price received is only one component, albeit a major one, of the decision to sell a tonne of grain. An analysis of the effects of deregulation therefore needs to focus on the emergence of a spot or cash market for grains and the effects this has on:

- variation in prices received by growers between pools and cash options;
- the development of grain selling products and services and the changes to pools; and
- the impact of deregulation on risk management.

Box 7 **Overview of industry consultations**

There was not a great deal of enthusiasm for the project from most of those contacted to contribute. For some the lack of enthusiasm appeared to stem from the attitude that the effects were somewhat obvious and to get on with the job. As one private trader indicated, traders operate and adjust to the parameters they have to operate in, international traders can work in Australia if possible but it is only a relatively small market and if they don't have access they will source from other origins and support them. For those from this section of the market the need to do a study such as this is academic, they just want to get on with trading and doing business in what ever market they can.

Some of the incumbent traders, while not quite openly hostile to the project, could not see the need for it as they 'are not going to get the single desk back' (where it has been lost). They also felt that their views had been ignored in the past by the regulation review process so why would they contribute time and resources this time with so little gain in it for them? The ABB provided no data to this study to support some of their views of the effects of deregulation.

The views conveyed to the consultants on the effects of deregulation by the incumbent traders were;

- there has been a significant reduction in market power for Australian grain as competitors undercut each other in international markets;
- they are reconsidering their investments in Australian grain research and development and in infrastructure;
- the higher prices reported to the GLA by license holders were not realised by growers (no evidence of this was provided or any clear explanation of how it was calculated);
- growers are trading what appears to be short term gains in cash markets for longer term market development and prices;
- the ability of pool managers to manage risk is severely weakened as there is no idea of how much grain or of what quality will be received;
- the cash market is taking the cream from the market; and
- licensed traders are operating at the margin and making large profits as they are not investing in infrastructure in the state.

10.2 Gross price effects

The prices that have been used in the following charts are based on the delivered port price for feed barley, malting barley and canola in Australian dollars per tonne. They are based on the best cash bid each week for a crop of a particular year. Cash markets have a very close relationship with pools in both barley and wheat markets in Australia as pools dominate trade in both grains in regulated and deregulated markets.

In markets that have little or no domestic consumption of a particular grain the relationship between the cash market and the pool is even closer.

When comparing cash prices across various states several factors need to be taken into account:

- Western Australia and South Australia have similar levels of domestic demand and large exportable surplus;
- in Victoria domestic consumption dominates trade but an exportable surplus of both malting and feed barley is produced most years;
- there are quality differences between the states, Victoria and South Australia produce a bright colored feed barley while Western Australian feed barley is slightly darker but is still considered bright by world standards; and
- while the export market in South Australia remains regulated the domestic market is open which sees a large amount of cross boarder trade between Victoria and South Australia.

Table 7 **2003 State barley production and demand estimates ('000 tonnes)**

	NSW	Vic	Qld	WA	SA	Total
Production	1,140	1,650	213	2,950	2,550	8,503
Domestic (estimated)	775	1,263	465	301	294	3,099
- feed demand	650	850	400	100	100	2100
- malting demand	100	382	60	150	150	842
- seed usage	25	31	5	51	44	157
Surplus	365	387	-252	2,649	2,256	5,404

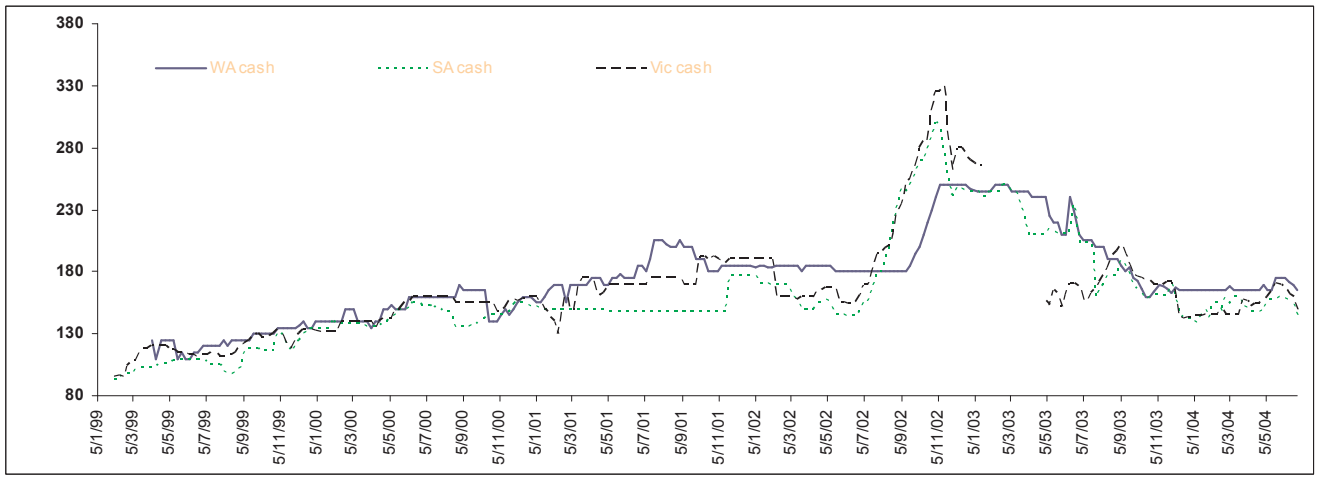
Data source: Farm Horizons 2003

Table 7 shows the production and consumptions patterns for each state based on the 2003 year. In 2003 production for most states was well above average but consumption is relatively stable compared to previous years.

Cash markets are a useful way to compare prices across state based markets in Australia as they reflect the day to day price which the domestic consumers have to bid to attract grain away from the export markets (pools). They will therefore reflect current and future views on domestic and international supply and demand and expectations of price trends.

10.2.1 Feed barley

Chart 14 **South Australian, Victorian and Western Australian feed barley cash prices 1999-2004 (AUD tonne)**

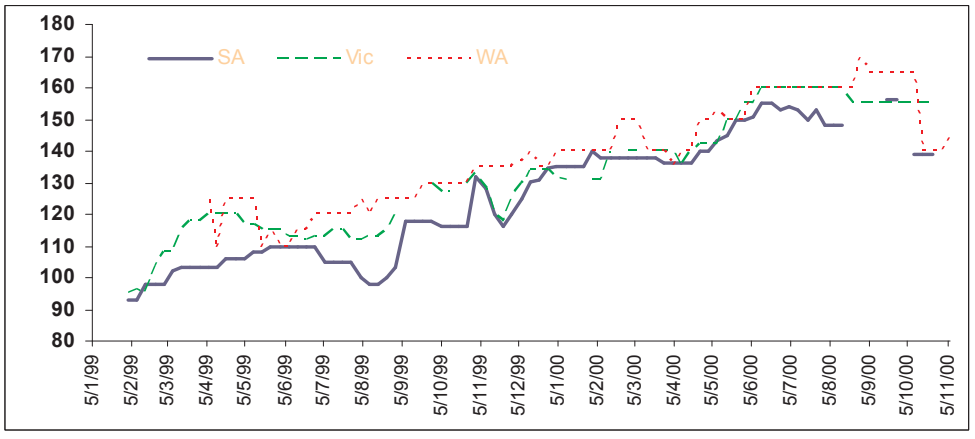


ACIL Tasman
Data source: ProFarmer and USDA

Chart 4 shows the cash prices for feed barley quoted in Australian dollars a tonne from 1999 to 2004. While chart is coarse and cannot be used for detailed price comparisons it does show how relative prices in Australia change with no 'state' price showing any sustained premium or discount to the others.

Charts 14 to 20 show the relative prices of feed barley each year for Victoria, South Australia and Western Australia. They show in more detail the high level of correlation between the states and the movement in relative prices between them. If there were any sustained or periodic effects of the different degrees of regulation in each of the states it would be expected to be seen in these charts.

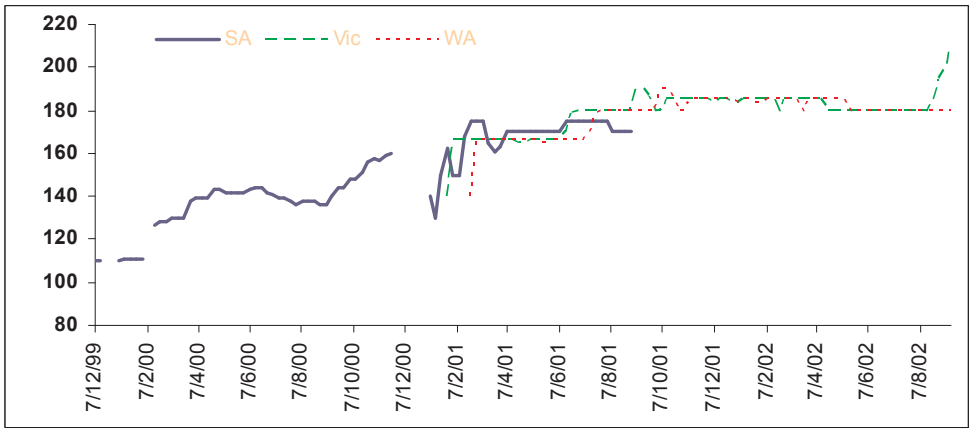
Chart 15 **1999-00 feed barley cash prices delivered port (AUD tonne)**



ACIL Tasman
Note: Best cash price delivered port bid per week
Data source: ProFarmer

Victoria and South Australia deregulated the domestic markets for malting and feed grain on the 1st of July 1999. There is no clear change in relative prices apparent in Chart 15 that could be attributed to the change in regulation.

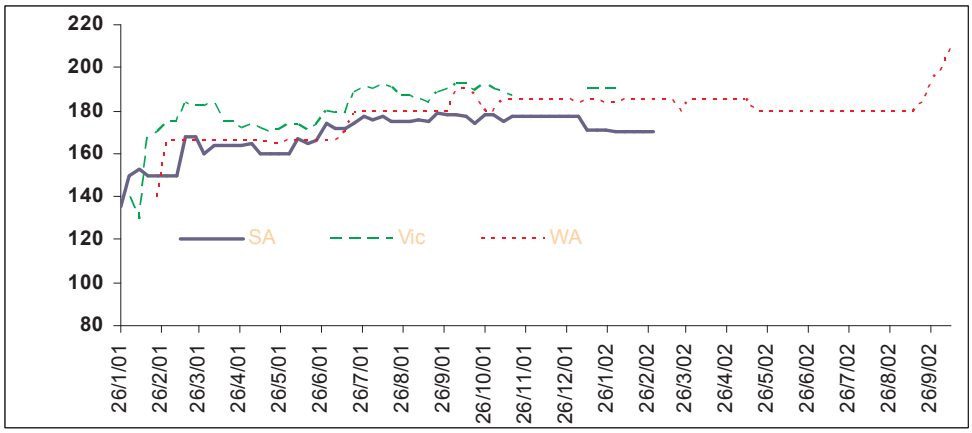
Chart 16 **2000-01 feed barley cash prices delivered port (AUD tonne)**



ACIL Tasman
Note: Best cash price delivered port bid per week
Data source: ProFarmer

On the 1st of July 2001 Victoria deregulated the export market for both malting and feed barley (with the change applying to grain harvested after that time). As with Chart 15 there is no apparent change in the Victorian price compared to the South Australian and Western Australian prices.

Chart 17 **2001-02 feed barley cash prices delivered port (AUD tonne)**



ACIL Tasman
Note: Best cash price delivered port bid per week
Data source: ProFarmer

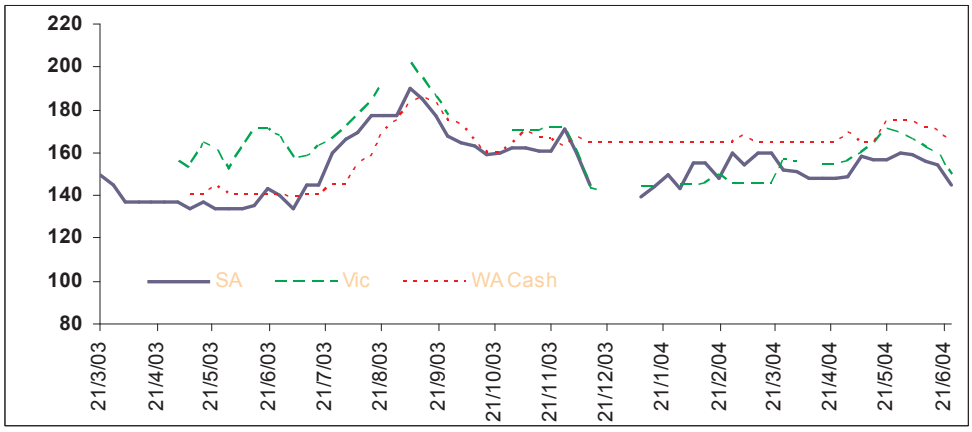
Chart 17 shows Victoria trading at a premium to South Australia and Western Australia from the beginning of 2001. After harvest in December 2001 and January 2002 the Western Australian and Victorian cash prices appear to converge but the data is coarse.

Chart 18 **2002-03 feed barley cash price delivered port (AUD tonne)**

ACIL Tasman
Note: Best cash price delivered port bid per week
Data source: ProFarmer

Drought across Australia created a situation where most of the eastern states became net importers of feed and malt barley in late 2002. This meant that in Victoria the price switched from export to potentially as high as import parity. South Australia and Western Australia sold grain into the Victorian market. Prices paid in exporting states at this time were east coast prices less freight.

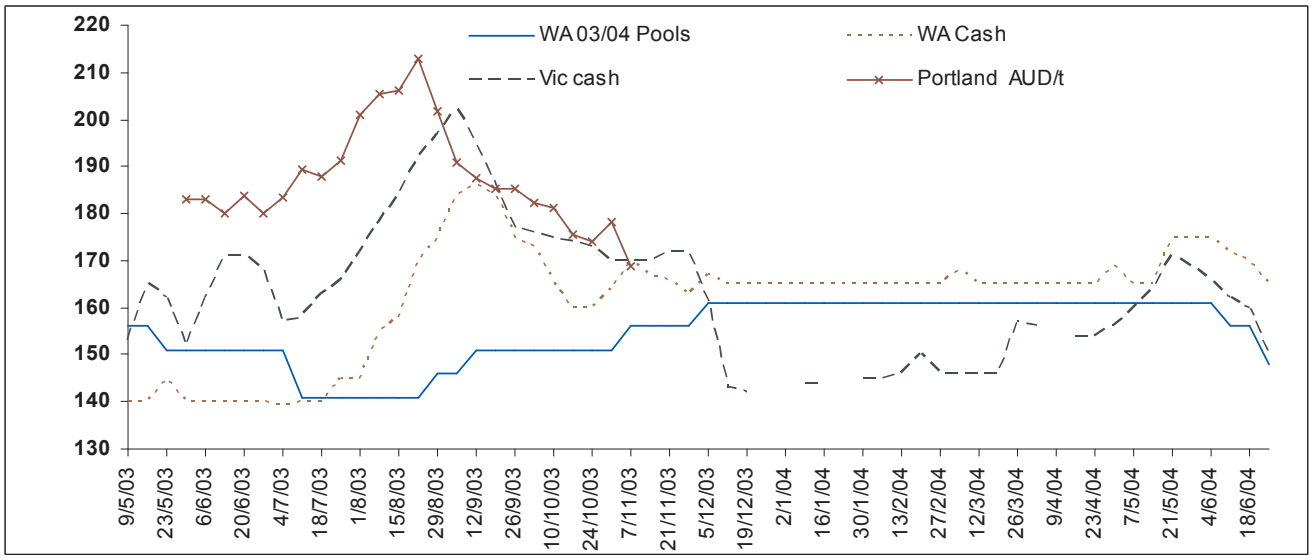
Chart 19 **2003-04 feed barley cash price delivered port (AUD tonne)**



ACIL Tasman
Note: Best cash price delivered port bid per week
Data source: ProFarmer

In August 2003 the first licenses were issued for export of feed barley from Western Australia. These were prices for new crop so any effect would be observed for the 2003-04 harvested grain. Chart 20 is an expansion of the relative prices over this period.

Chart 20 **Victoria, South Australian, Portland US and Western Australian feed barley cash and pool prices 2003-04 delivered port (AUD tonne)**



ACIL Tasman

Data source: Profarmer and Agriculture and Agri-food Canada

The inclusion of the Portland, Oregon, feed barley price in this chart serves to illustrate that international prices for barley were appreciating strongly in July and August 2003. This was due to drought concerns surrounding the northern hemisphere cereal and oilseed crops, mostly in the EU, Eastern Europe and Canada (Roberts 2003). It is typical for the market to watch closely northern crop progress and be driven by weather at this time of the year.

Victorian prices followed the apparent international trend, rising during July and August and peaking in early September. The cash price in Western Australian began to rise in July and continued in a similar fashion to Victoria and Portland. In September the price began to fall and stabilized in December 2003 at around $A165 per tonne just above the GPPL pool estimates of $A161.00. Licenses for over 430,000 tonnes of export feed barley were issued at this time, combined with a typical domestic market consumption of 150,000 tonnes of feed barley this created a cash market for over 580,000 tonnes. This level of cash market liquidity had not been experienced by Western Australian growers before. Neither had Western Australian growers had cash bids actively marketed to them.

The 2003-04 pool did not change its estimates at this time as the pool cannot make large cash sales before receiving the grain. The pool manager though, was selling remaining stocks from the 2002-03 harvest into this market which increased the estimated returns for this pool.

The increase in prices for Western Australian grain cannot be explained by the issuing of licenses. Chart 20 shows that the cash market in Western Australia was beginning to moving up as international prices increased. Observations of previous year's shows that the cash market in Western Australia would have appreciated as world prices increased. The big difference between 2003 and other years is that large tonnages were being offered at this time which allowed more growers to participate than otherwise would have been the case. Our conclusion is that cash prices would not have stayed as high as long if licenses had not been issued.

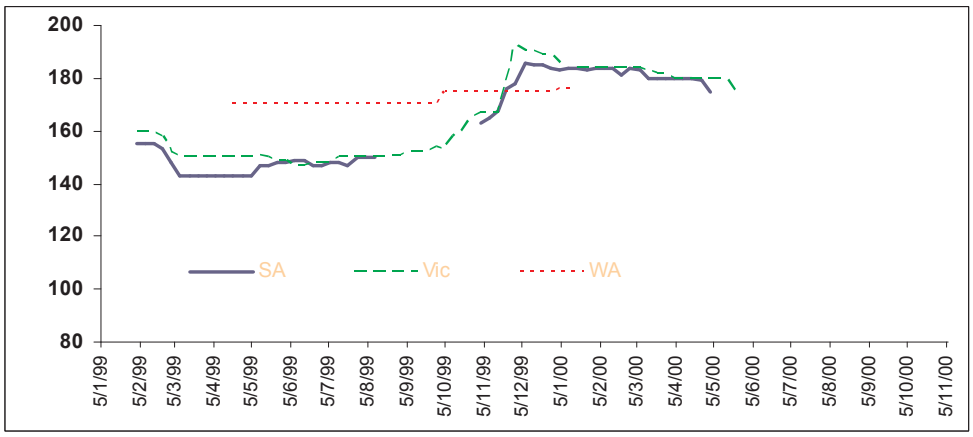
The introduction of the licenses allowed more Western Australian grain to be sold for a higher price than otherwise would have been the case. 2002-03 pool sales were made into this market but the amount of grain available for the pool manager to sell was limited at this time of the year. The issuing of licenses meant that a larger portion of the expected 2003-04 feed barley market was sold at these prices. This would not have been the case if licences had not been issued as the pool does not trade any significant quantities of grain until it is received.

Not all of the license quantity was shipped and not all of the grain shipped was purchased directly from growers. Only 339,000 tonnes of feed barley was eventually shipped some of which was purchased by the licensees from the pool to fill orders. This provided a bonus for the pool manager where some market opportunity was exercised as traders were committed to shipping and were forced to buy from the pool.

10.2.2 Malt barley

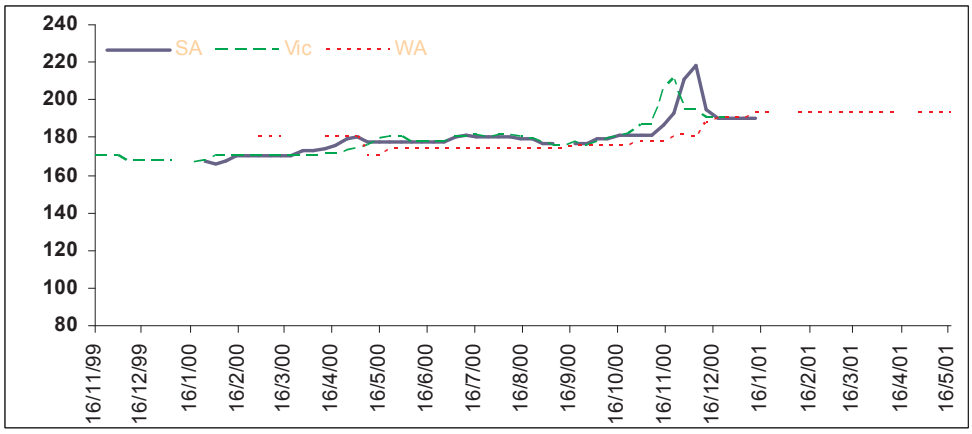
The malting barley prices shown in charts 21 to 25 show a similar pattern to the feed barley prices in the preceding section. Again there is no clear evidence of any sustained or periodic price premium or discount for any state. Prices regularly interchange relative positions and in 2003 the effect of the drought can be clearly seen.

Chart 21 **Victorian, South Australian and Western Australian malt barley cash price delivered port 1999-00 (AUD tonne)**



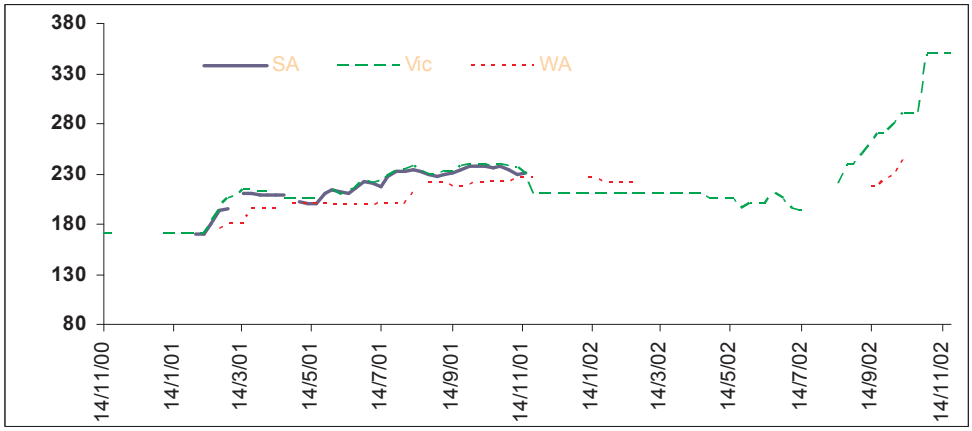
ACIL Tasman
Data source: Profarmer

Chart 22 **Victorian, South Australian and Western Australian malt barley cash price delivered port 2000-01 (AUD tonne)**



ACIL Tasman
Data source: Profarmer

Chart 23 **Victorian, South Australian and Western Australian malt barley cash price delivered port 2001-02 (AUD tonne)**

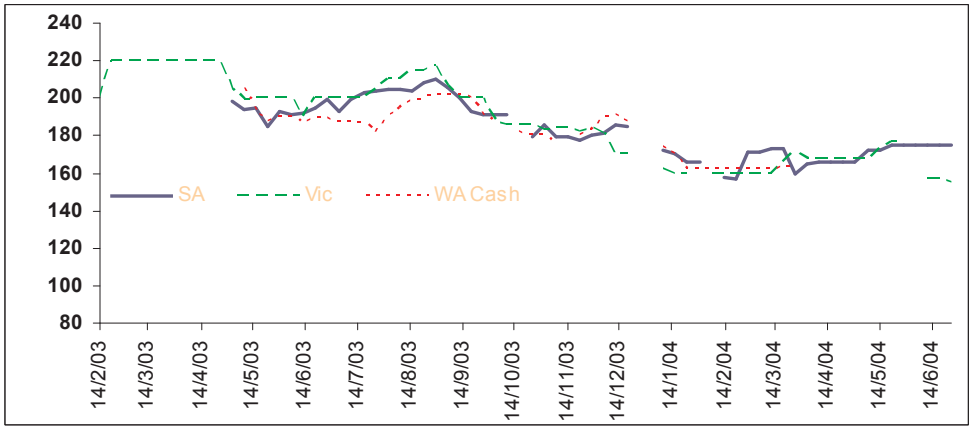


ACIL Tasman
Data source: Profarmer

Chart 24 **Victorian, South Australian and Western Australian malt barley cash price delivered port 2002-03 (AUD tonne)**

ACIL Tasman
Data source: Profarmer

Chart 25 **Victorian, South Australian and Western Australian malt barley cash price delivered port 2003-04 (AUD tonne)**



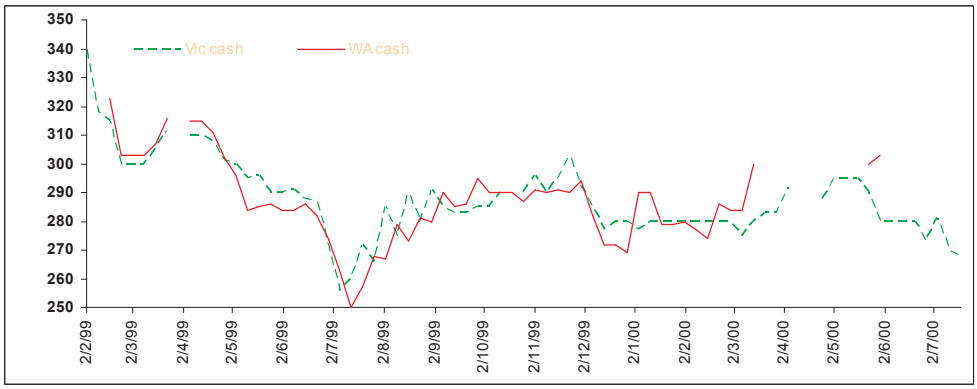
ACIL Tasman
Data source: Profarmer

10.2.3 Canola

The only states to have regulated canola have been NSW and Western Australia. Victoria has not regulated canola trading so it is useful to use to compare the prices of regulated states. Most of the domestic canola processing capacity is in Victoria. Western Australia is the only state that has run a large scale canola pool. Pools have been available in NSW and to a lesser extent in Victoria, but the volumes sold through them have been small.

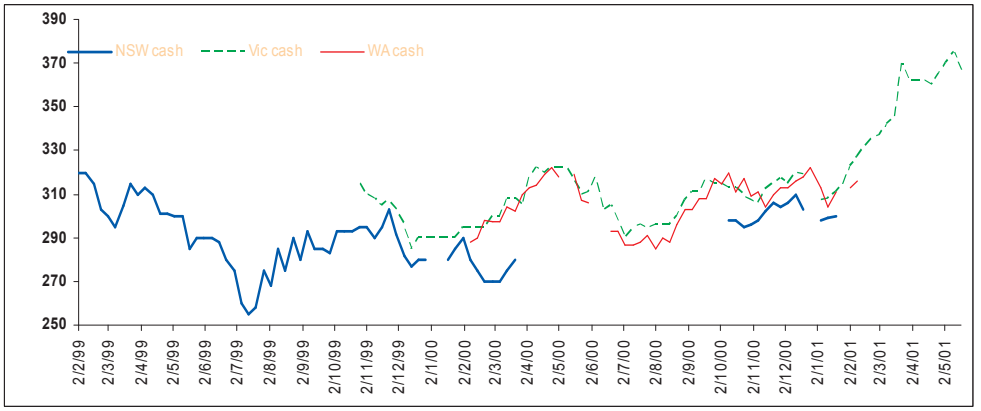
Charts 26 to 29 show a similar situation to malting and feed barley although Western Australia does appear to frequently trade at lower prices to the other states. There were no shipments of canola from Western Australia by GLA license holders, although a license was granted for the export of 48,000 tonnes into the Indian subcontinent.

Chart 26 **Western Australia and Victorian canola cash prices delivered port 1999-00 (AUD tonne)**



ACIL Tasman
Data source: Profarmer

Chart 27 **NSW, Western Australia and Victorian canola cash prices delivered port 2000-01 (AUD tonne)**



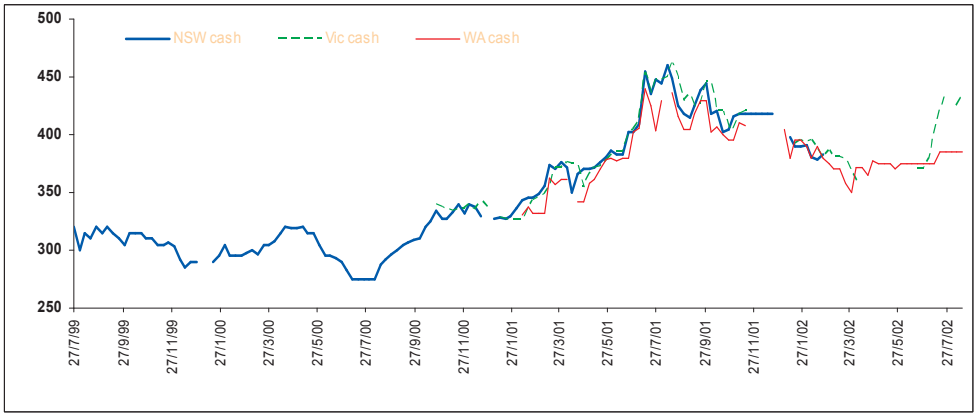
ACIL Tasman
Data source: Profarmer

In 2000 the NSW Grains Board experienced financial difficulty and was eventually placed into receivership. This may explain the significant and persistent variance between NSW and Victorian canola prices during this year. This difference in relative prices is not repeated in any of the subsequent years.

In 2000-01 Western Australian prices tracked Victorian values closely. This pattern is repeated in 2001-02, 2003-04 where Australia as a whole produced a large exportable surplus of canola seed. In these years Europe became a residual market for Australian canola seed. Pakistan and Bangladesh were also increasing their imports of Australian canola. Pakistan has increased it imports from 20,000 tonnes in 1999-00 to over 300,000 tonnes in 2001-02.

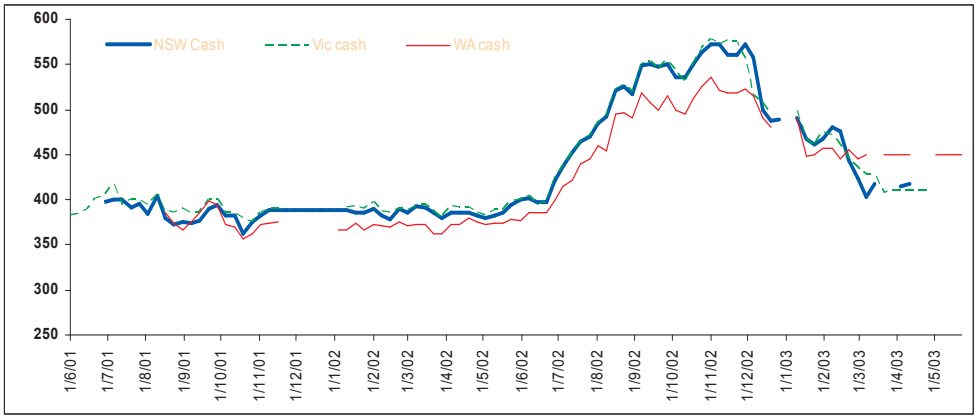
As freight rates from Western Australia to Europe and the subcontinent are lower than the eastern states, when a large portion of Western Australian canola is sold to these destinations Western Australian canola will trade at prices closer to the eastern states.

Chart 28 **NSW, Western Australia and Victorian canola cash prices delivered port 2001-02 (AUD tonne)**



ACIL Tasman
Data source: Profarmer

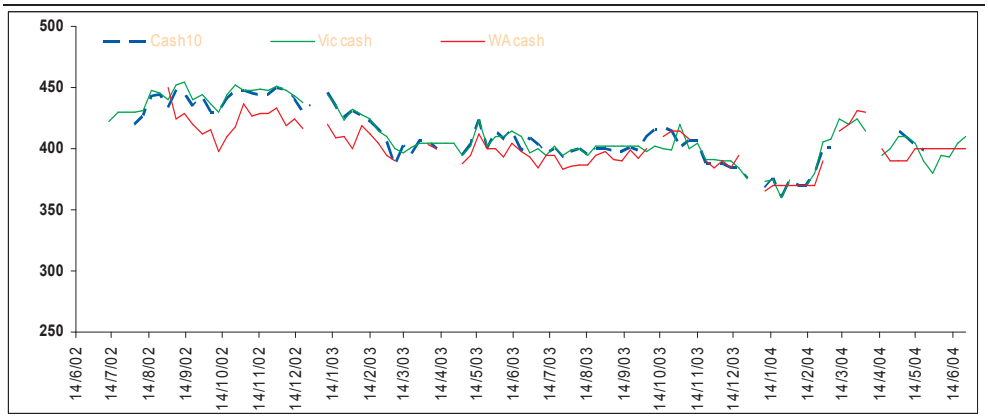
Chart 29 **NSW and Victorian canola cash prices delivered port 2002-03 (AUD tonne)**



ACIL Tasman
Data source: Profarmer

In 2002-03 the effect on prices of the Australian drought is clearly evident. Western Australian canola production was approximately 790,000 tonnes. Domestic demand is approximately 300,000 to 400,000 tonnes per annum with most of the processing capacity in Victoria and New South Wales. In 2002-03 sufficient canola was produced it eastern states and South Australia to meet domestic demand with no significant exportable surplus. Western Australia produced 330,000 tonnes the majority of which appears to have been exported possibly to Japan with only small quantities exported to other markets. In this year Western Australian canola was priced on a delivered east coast of Australia basis.

Chart 30 **NSW and Victorian canola cash prices delivered port 2003-04 (AUD tonne)**



ACIL Tasman
Data source: Profarmer

The charts above indicate that canola prices in regulated and deregulated markets appear to follow international prices. Differences in prices can be attributed to freight rates to various markets advantaging Western Australia over eastern states in years of large exportable surpluses. The relative prices do not show Western Australia realising the freight advantages it does have into the subcontinent and Europe as strongly as might be expected. (The freight advantage of Western Australia over the Eastern States quoted by traders to the consultants is between $US3.00 - $US5.00 per tonne.). However, due to the low level of regulation of canola and the lack of significant trade of canola in Western Australia when licenses were issued no conclusions can be drawn at this stage. There does appear to be a case for more work to be done on the differences between east and west coast canola prices, particularly if a significant volume of canola is exported under GLA licenses.

Given the high substitutability of canola oil with other vegetable oils and the small role Australia plays in international vegetable oil markets, and the lack of any significant quantities of meal being exported it is unlikely that any regulated trader would have market power in canola. This means that any deregulation of the canola market will have little if any observable effect on prices at port.

10.2.4 Gross price conclusions

While this is not an econometric review of prices, and there are complexities associated with comparing prices due to volumes traded and quality differences, the charts do not even indicate where an econometric analysis may be required.

There are three major observations of the feed and malt barley and canola prices since 1999:

1. the first is that there is considerable and random overlap and changes in relativity across all of the market and commodities;
2. the second observation is that all of the prices show a strong correlation to each other over the entire period. While there is no international benchmark for barley prices to be compared to, the Pacific North West prices show correlations almost as strong as between domestic market prices. (It has been reported to the consultants that research conducted by traders shows feed barley has 70% correlation with CBOT corn and wheat contracts); and
3. the third observation is that any differences between domestic prices appears to be swamped by general variations in prices.

The combination of all three of these observations leads us to conclude that there does not appear to be any substantial or sustained effects of deregulation on the port prices in the various states. Further to this, any market power claimed by the holders of single desks attributed to regulation in barley and canola markets do not appear to be substantiated in the prices we have analysed.

This does not mean that what were statutory marketing organisations do not have market power, rather the market power they may or may not have does not appear to have been effected by deregulation in those markets where it has occurred.

10.3 Net prices

While a great deal of the debate about the effects of deregulation focus on the gross price effect it is of limited farm gate relevance to farm business operators. Farm profitability relies on net prices received by the farmer and payment options that will allow capital to be managed to optimize returns.

Price received by farmers is the other side of the coin usually overlooked in most discussions about the effects of deregulation. In a deregulated market, traders not only compete to sell the grain they also have to compete to accumulate it from growers. Deregulation of a grain market introduces competition to accumulate which, for single desk holders, is an entirely new area of activity. Even in deregulated domestic markets, where exports are regulated, the production of exportable surpluses limits competition to the grain used for domestic consumption.

Competition to accumulate grain is based on the range of factors, the most important of which is price. Each trader must be able to offer a competitive price to grain producers to accumulate grain. Traders who buy cash have all of the price risk and are less likely to participate in weak selling situations. If a trader becomes a weak seller in an export market he will either reduce the

margin he makes on the trade, or make himself less competitive in buying the grain if it is not held.

As we have discussed in the preceding section, barley and canola (and most other grains) are traded based on a world price and there is no evidence of any sustained market power for either private or statutory traders. Combined with highly transparent and uniform storage and handling costs (a result of highly concentrated storage and handling system in Australia) competition to accumulate grain will almost always be based on the terms of the trade and the margin the trader makes.

The effects of deregulation on traders' margins and costs are almost impossible to document other than to record anecdotal evidence. On several occasions comparisons were made to the consultants, by farmer representative organisations and the state based traders themselves, on the way in which the statutory marketers have had to 'pick up their game' and 'tighten up their trading activities'.

The pressure to reduce costs and deregulation of storage and handling access are significant factors impacting on the grains industry in Australia. The effect of regulation on the way the grains industry has developed is evident in the way the supply chain has been developed. Kronos Corporate, in a report to the Regulator General in Victoria, compared the storage and handling in Australia and overseas and made the following observation:

"there is a major difference between the Australian central handling system and the system of other major exports in that the Australian system has been built as a storage system, in overseas countries the grain systems have been built for fast and efficient throughput of grain (Kronos Corporate 2001)."

Cost savings made are passed on to growers as higher prices for grain purchased in deregulated markets through competition to accumulate grain.

10.4 Pricing efficiency and price signals

Deregulation of the grains industry and the introduction of cash prices provides significantly more transparency in prices and costs at each stage in the supply chain. When grain is pooled a range of services and other activities are bundled into the price of grain. This bundling not only has the potential to distort price signals of the underlying value of the grain which impacts on the production decisions made by growers, it also reduces the contestability of the range of services provided.

The range of services provided to the grower which are bundled into the price of grain are many and have been raised in other sections of this report, the major ones being risk management, freight, storage and handling, and finance.

Bundling of these services in the grain supply chain restricts competition to provide them as buyers of these services cannot differentiate between separate services and suppliers and there is often substantial cross subsidisation.

Freight and storage and handling have been analysed in some detail in the Kronos Corporate Report, A Review of Structural Issues in the Australian Grain Market (2002). The major recommendation of this report was to make the national wheat pool begin at FOB, thus rolling back the bundling of pool services from the domestic supply chain. The Kronos report concluded that contestability of these services could reduce costs by as much as $A9.33 per tonne.

The other area of major impact that is not covered by the Kronos report and is within the scope of this study is the effect of pooling and deregulation on the financing the grains industry. The inventory of a grains industry dominated by pools is financed entirely by capital raised by the pool manager. In this situation all of the inventory finance costs are passed directly to the grower. As has been explained to us by several private grain traders who have considerable US experience, a result of the low level of competition has been the extended 'terms of trade' offered by Australian suppliers, which are much longer than those in most other countries. In Australia a payment is often made 30 days from the end of the week of delivery. In the US payment is often made on delivery or loading.

A consequence of the extended terms of trade is that there is an increased risk of default in Australia which is translated into high margins required by traders. Another consequence of this is generally high inventory finance costs as the cash cycle in Australia is longer.

In a cash market each stage of the supply chain where the grain changes hands provides the opportunity for a range of financiers to compete to provide services. At each point finance can be provided to suit the needs of the grain holder. Also as traders are the holders of grain, payment terms appear to be shortening.

In 2003 in Western Australia payment terms offered by traders to growers were 14 days after delivery and many growers were paid within 10 days. Anecdotes provided to the consultants suggested that spending on crop inputs rose substantially after cash contracts were paid after harvest.

10.5 The development of products and services and changes to pools

A grower's choice of buyer is based on a number of factors not just price: terms of payment, risk of non-payment, brand image of the buyer and delivery

options all influence the decision. Deregulation has created a range of new products and services and an incentive to invest in brand and brand profiles. A major asset held by the GPPL and the ABB is their brands.

10.5.1 Changes to the way pools are run

One of the most significant effects of the deregulation of a grain market is on the ways pooling and pools are run. In a regulated market the only way orderly marketing can be achieved is through the pooling of growers production. Several different methods of doing this have been used in Australia from vesting the grain (effectively taking ownership of the crop once sown), to preventing exports, thus forcing growers to deliver to the statutory marketing authority. Either way growers are forced to pool their grain and participate in its returns less costs (equally shared) per tonne delivered.

This places a number of important constraints on the way the grain is marketed. All growers need to be able to deliver grain to the pool irrespective of the time of harvest. This can spread out selling schedules and requires that pools remain open irrespective of price movements and changes in supply and demand. A great deal of concern has been expressed over the years by pool managers about the need to balance growers' interests who have delivered to the pool and those that have not finished harvesting their grain.

The different way pools are managed in a regulated and deregulated market has given rise to the term 'commercial pool' by some pool managers. A 'commercial pool' refers to a pool run on strictly commercial grounds competing to accumulate grain from alternative selling options growers have in a deregulated market.

- Pools in a deregulated market are opened and closed more regularly to protect prices, for example the Victorian No 1 Barley Pool.
- Pools for different grades are also becoming more common.

The development of these pools appears to differ from the historical view that a pool intended to ensure that all growers received the same average price.

Box 8 **Discussions with the ABB on how pools have accommodated change**

There is still demand for pools from growers due to several factors apart from price which includes:

- loyalty to the organisation running it and the principles of collective marketing;
- growers view the organisation as having a high credit worthiness and offering high security of payment; and
- a preference for the risk management function of the pools.

In discussions with the ABB, while not providing any substantive evidence, they assert that there has been a return by growers to the pools this year.

They also point out that if a GLA type system is introduced into the SA pool they will no longer be able to run the pool as they currently do. They believe that they will have to break the pool up into a series of smaller pools to secure returns at different levels. This has been their experience in Victoria where a number of pools have been developed for various grades and for various marketing opportunities.

An example of this is the Victorian Number 1 feed barley pool in 2003. The ABB indicated that they opened this pool as a direct result of the deregulation of Victorian barley exports. The Victorian No 1 pool was opens during the growing season and closes before harvest. This type of pool management gets growers to commit to pools during the season rather than wait until harvest.

10.6 Risk management

The effects of deregulation are greatest on the way grain price risk is managed. The development of cash (spot and forward) markets after deregulation has provided barley growers with a fundamentally different way to manage price risk. A cash market allows a grower to lock in a price at any time during the year for all or a portion of expected production. A grower who sells for cash has a guaranteed price for grain as the price risk has been transferred to the buyer. The grower though does then have the risk of not being able to produce the grain at the agreed time and specifications if seasonal conditions deteriorate.

This transfer of price risk has produced a whole range of associated risk management tools and services for grain producers, traders and consumers. The development of advisory services to growers to manage price risk has grown from 3 or 4 businesses offering these services 10 years ago to over 30-40 that operate today.

The return growers receive for their grain is influenced by a range of factors the most important of which are the underlying price of the commodity, changes to currency and, storage, handling and freight charges. All of these elements are affected by deregulation in some way.

10.6.1 Price risk management

Pooling grain, particularly barley, does not offer participants a high level of price risk management prior to harvest, as generally only a very small percentage of the grain is sold forward by the pool manager. The low level of forward sales by pools is a result of several factors the most dominant of which are:

- the low levels of capitalization of statutory pool managers who cannot finance adverse cash price movements;
- a lack of willingness of buyers to commit to prices more that 2-3 months before expected delivery; and
- a lack of a liquid futures market where price risk can be managed.

In a deregulated market where there is a reasonable volume of cash trading, grain buyers and sellers have the flexibility of locking in as much or as little of the grain as necessary for their business needs.

Pooling does offer a grower the opportunity to participate in a longer series of price fluctuations but this comes at the opportunity cost of holding the grain and financing the inventory. In a year when barley prices are low during the growing season, growers will be reluctant sellers and may choose to wait for prices to recover. This is the case this year as supplies around the world are high, and prices are depressed, so cash trading prior to harvest by growers will be minimal. Many growers will harvest the grain and deliver to pools in the hope of participating in an increase in prices after harvest and into the next year.

All of the markets that have been deregulated in Australia still have a pool as an option to deliver to.

10.6.2 Currency

Currency exposure can add significantly to price changes of grain. Pool managers have expressed the view that in deregulated markets currency risk management is more difficult as there is greater uncertainty as to the amount of grain that will be accumulated. Thus currency risk management is likely to be more expensive and less manageable. This appears to be a function not of the uncertainty of the pool size in a deregulated market but the type of currency hedging strategy employed by the pool manager and the transaction costs of the strategy and products used.

Traditional currency management strategies have relied on calculating the likely amount of grain that will be delivered to the pool using production forecasts less domestic consumption. The total currency exposure is the current market price of the grain multiplied by the number of tonnes likely to be received by the pool. A pool manager will then seek to progressively manage the currency through the growing season using a range of tools dominated by options until harvest. Using options allows the pool manager to limit adverse currency movements while participating in the falls in the AUD. The effect is to smooth out the impacts of large currency movements.

Option strategies are often set up to manage currency movements outside a certain range. Often called collars, these option strategies only provide cover

above and below currency values to reduce premium costs. These strategies are used until grain is received at harvest and forward sales are made where currency risk is managed in a similar fashion to other traders.

Currency trading strategies are commercially sensitive and therefore closely guarded by pool managers. Indications are that most of the statutory pool managers continue to use similar currency strategies pre-harvest when markets are deregulated.

Currency is only partially managed by the pools prior to harvest due to the collar strategies used and the way exposures are calculated which is the expected crop size multiplied by the expected price. In deregulated markets growers can participate in currency movements directly through the cash market.

In deregulated markets currency changes are reflected in the AUD cash price offered by traders depending on the traders' currency hedging strategies. Most cash trades will be based on the export price offered by the trader converted into AUD. For the seller, once the grain is contracted there is no more currency risk as payment is in AUDs. For the trader, once the export contract is negotiated the currency conversion rate is fixed in the money market. Currency movements add to price volatility in the cash market.

In deregulated markets pool managers have had to assess the likely competitiveness of the pool estimates, traditional pool accumulation and likely grade spreads and use this information to hedge currency. Experience in Victoria suggests that pool managers in deregulated markets have adopted currency hedging strategies and remained competitive.

Box 9 The Australian Stock Exchange feed barley contract

In June 2003 the Australian Stock Exchange (ASX) released a range of agricultural commodity futures contracts including milling wheat, feed wheat and feed barley. The contracts can be delivered against and are based on the 'track' market which is the most common form of pricing used by Australian traders. Track prices are based on a common delivery point usually a port zone, less up country delivery point differentials. The contracts are proving to be popular and volumes traded are climbing steadily (see Chart 31). Currently there are 6418 January 2005 open feed barley contracts which is 128,000 tonnes of grain or 6.1% of domestic consumption and 1.3% of internationally traded feed barley.

Feed barley is the most traded contract on the exchange and is providing a useful risk management tool for traders and producers. As Australia is a significant trader of feed barley, the ASX feed barley contract could become a major international barley price discovery and risk management tool such as the CBOT, Kanasas and Winnepeg markets have become for other grains. For volumes to grow the contract needs a large number of industry participants with a range of risk profiles. Diverse trading activity in the underlying commodity creates a demand for secondary market

contracts which can be used to manage price risk.

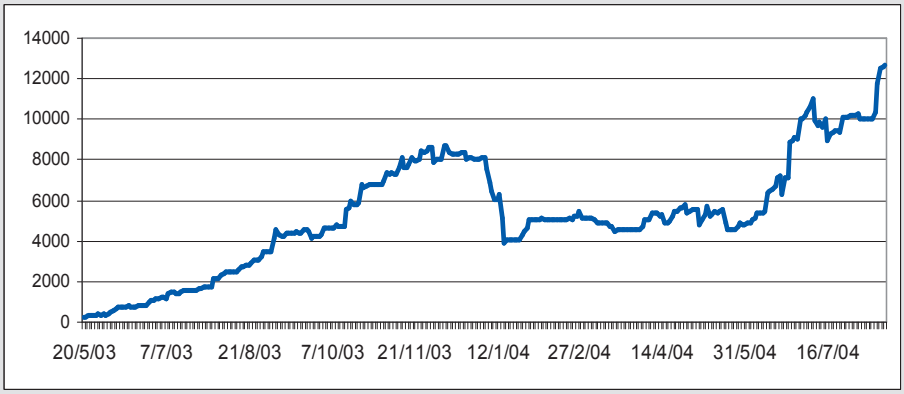
'The more market participants in any market, and the more diverse their risk profile, economic theory would suggest the greater the potential for increased market activity and the better the possibility of improved liquidity… Increasing the number of participants alone is not, in itself, a solution to improving liquidity. The makeup of the market must also have a spread of participants with differing risk profiles, viewpoints, strategies and ambitions. If a market has a large number of participants but they all want to trade the market from the same side then liquidity cannot be improved.
(ASX 2004)

It is the view of the consultants that deregulation of the feed barley market that has occurred to date appears to have contributed to the growth of the ASX contract. Further deregulation in Australia and changes to the subsidies in Saudi Arabia and buying arrangements in Japan may create the conditions for the contract to grow further.

Most of the traders consulted during this study expressed the view that a high volume feed barley contract would be a highly useful risk management tool and provide for a degree of price transparency not currently available in feed barley marketing.

If the ASX feed barley futures contract did grow to a sufficient scale, pool managers for the first time could use the contracts to manage some price risk prior to harvest.

Chart 31 **ASX grain futures contract volumes (no of contracts traded)**



Australian Stock Exchange 2004

10.7 Industry investment

A topic that has been raised during debates that have preceded deregulation, and which has been raised during consultations for this study, is the industry development impacts of deregulation. This is not a topic that has been very well articulated but the main issues appear to be associated with a reduction of investment in agronomic research and development in deregulated markets and changes to farming practices that are not environmentally sustainable.

On several occasions ex-statutory marketers have indicated that they will not be able invest as much in the grains industry as they had when markets were regulated. A drive through country Victoria and a visit to the Birchip Cropping Group clearly shows that commercial trading companies do have an interest in industry development. The ABB and AWB are major sponsors of the group. In southern Victoria the Southern Farming Systems group is funded by a range of sponsors including private grain traders and the ABB.

Discussions with the GPWA indicated that over $A900,000 is spent each year on industry development and agronomy extension and research. This investment has not fallen and indications were given that while it is a possibility, support of the GPPL brand is important to secure grower loyalty.

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A World barley trade statistics

Table 8 **Global Barley Trade Matrix**

	Australia					Canada					EU-15					Others					Total			
	99/00	00/01	01/02	02/03	03/04	99/00	00/01	01/02	02/03	03/04	99/00	00/01	01/02	02/03	03/04	99/00	00/01	01/02	02/03	03/04	99/00	00/01	01/02	02/03
EU-15	---	---	---	---	---	---	0.00	0.01	---	---	N/A	N/A	N/A	N/A	N/A	0.04	0.04	0.65	**0.54**	**0.34**	0.04	0.04	0.66	**0.54**
Cyprus	---	---	---	---	---	---	---	---	---	---	0.17	0.03	0.00	---	**0.00**	0.05	0.06	0.25	**0.30**	**0.16**	0.22	0.08	0.25	**0.30**
Other	---	---	---	---	---	---	---	---	---	---	0.12	0.06	0.04	**0.05**	**0.05**	---	0.01	0.03	**0.07**	**0.05**	0.12	0.07	0.07	**0.12**
Poland	---	---	---	---	---	---	---	---	---	---	0.13	0.25	0.12	**0.08**	**0.05**	0.00	---	---	---	---	0.13	0.25	0.12	**0.08**
Romania	---	---	---	---	---	---	---	---	---	---	0.02	0.06	0.00	**0.03**	**0.00**	---	---	---	**0.02**	**0.01**	0.02	0.06	0.00	**0.05**
Other East Europe	---	---	---	---	---	---	---	---	---	---	0.10	0.31	0.02	**0.02**	**0.00**	---	---	---	**0.01**	**0.01**	0.10	0.31	0.02	**0.02**
FSU-15	---	---	---	---	---	0.00	---	---	---	---	0.28	0.23	0.22	**0.15**	**0.23**	0.01	0.22	0.15	**0.18**	**0.18**	0.29	0.45	0.37	**0.33**
Saudi Arabia	0.54	**0.70**	**0.81**	**0.39**	**0.60**	0.16	0.30	---	---	**0.40**	4.63	3.09	1.73	**2.20**	**1.65**	0.05	0.56	0.99	**1.39**	**0.82**	5.38	4.65	3.53	**3.98**
Japan	0.93	0.81	0.93	**0.40**	**0.60**	0.36	0.30	0.05	0.04	**0.25**	0.01	0.00	0.00	---	---	0.35	0.45	0.41	**0.38**	**0.40**	1.65	1.56	1.40	**0.85**
China	1.04	1.27	1.34	**0.80**	**0.98**	0.49	0.50	0.42	0.08	**0.40**	0.68	0.18	0.35	**0.80**	0.30	---	0.06	---	---	**0.05**	2.20	2.01	2.11	**1.68**
Israel	---	---	---	---	---	---	---	---	---	---	0.13	0.06	0.03	---	---	0.05	0.15	0.16	**0.17**	**0.15**	0.19	0.20	0.19	**0.17**
Taiwan	0.18	**0.13**	**0.15**	**0.10**	**0.05**	---	---	---	---	---	0.00	---	---	**0.00**	---	0.00	0.06	---	**0.00**	**0.00**	0.18	0.19	0.15	**0.10**
Jordan	---	---	---	---	---	---	---	---	---	---	0.60	0.45	---	---	---	0.05	0.05	---	**0.10**	**0.01**	0.65	0.50	---	**0.10**
Iran	---	---	**0.05**	---	---	---	0.11	---	---	---	0.64	0.74	0.12	---	---	0.00	0.15	0.30	**0.10**	**0.10**	0.64	1.00	0.48	**0.10**
Other Asia	0.31	**0.30**	**0.35**	**0.15**	**0.27**	0.06	0.01	0.01	0.01	**0.01**	0.70	0.54	0.06	**0.10**	**0.10**	0.09	0.16	0.10	**0.19**	**0.05**	1.16	1.01	0.52	**0.45**
Algeria	---	---	---	---	---	---	---	---	---	---	0.63	0.24	0.09	**0.01**	**0.05**	---	0.03	0.05	**0.15**	**0.05**	0.63	0.27	0.15	**0.16**
Libya	---	---	---	---	---	---	---	---	---	---	0.06	0.10	0.04	**0.01**	**0.05**	---	---	0.05	**0.15**	**0.05**	0.06	0.10	0.09	**0.16**
Tunisia	---	---	---	---	---	---	0.01	0.02	---	**0.01**	0.18	0.50	0.12	**0.10**	**0.10**	0.02	0.02	0.11	**0.25**	**0.14**	0.20	0.53	0.25	**0.35**
Morocco	---	---	---	---	---	---	0.02	---	---	**0.01**	0.64	0.42	0.29	**0.10**	**0.10**	0.02	0.10	0.10	**0.17**	**0.07**	0.65	0.53	0.39	**0.27**
Other	---	---	---	---	---	---	0.03	0.05	0.09	**0.12**	0.09	0.09	0.05	**0.10**	**0.05**	---	0.03	---	---	---	0.09	0.15	0.10	**0.19**
United	---	---	---	---	---	0.60	0.62	0.48	0.23	**0.25**	0.00	0.01	0.00	**0.10**	**0.00**	---	---	---	---	---	0.60	0.62	0.48	**0.33**
Mexico	---	---	---	---	---	0.10	0.03	0.01	0.00	**0.05**	0.01	---	---	---	---	0.10	0.11	0.07	**0.07**	**1.00**	0.22	0.14	0.08	**0.07**
Brazil	---	---	---	---	---	---	---	---	---	---	0.06	---	0.05	**0.04**	**0.05**	---	---	---	---	---	0.06	---	0.05	**0.04**
Other West Hemis.	0.11	**0.15**	**0.15**	**0.10**	**0.15**	---	0.01	0.06	0.00	**0.05**	0.22	0.20	0.33	**0.35**	**0.35**	0.03	0.03	0.09	**0.10**	**0.12**	0.35	0.39	0.63	**0.55**
Total	3.10	**3.36**	**3.78**	**1.94**	**2.65**	1.77	1.94	1.10	0.44	**1.55**	10.10	7.57	3.65	**4.24**	**3.13**	0.87	2.26	3.53	**4.34**	**2.76**	15.83	15.14	12.07	**10.96**
	Nov/Oct					Aug/Jul					Jun/May													
Carryin	0.47	0.39	0.98	**1.91**	**0.27**	2.74	2.84	2.52	1.90	**1.20**	13.73	10.47	8.22	9.41	**10.00**	1.41	1.67	3.49	6.29	**6.38**	18.35	15.37	15.20	**19.50**
Production	5.03	6.74	8.42	**3.27**	**6.70**	13.20	13.17	10.85	7.28	**12.03**	48.93	51.57	48.36	48.34	**46.70**	19.45	23.18	28.60	28.30	**24.30**	86.61	94.66	96.23	**87.19**
Imports (Crop Year)	0.02	0.00	**0.00**	**0.00**	**0.02**	0.03	0.04	0.10	**0.25**	**0.08**	0.04	0.04	0.66	**0.54**	**0.34**	0.90	0.48	0.26	**0.20**	**0.25**	0.99	0.55	1.02	**0.99**
Total Supply	5.51	7.13	**9.41**	**5.17**	**6.99**	15.97	16.05	13.46	**9.43**	**13.30**	62.70	62.09	57.24	**58.28**	**57.04**	21.76	25.32	32.35	**34.79**	**30.93**	105.94	110.58	112.45	**107.68**
Domestic Use	2.45	2.55	**3.61**	**3.90**	**3.32**	11.37	11.59	10.44	**7.83**	**10.39**	42.13	46.29	44.17	**44.05**	**46.91**	18.79	20.37	23.60	**24.60**	**24.13**	74.74	80.80	81.83	**80.37**
Exports (Crop Year)	2.68	3.60	**3.89**	**1.00**	**3.20**	1.76	1.94	1.12	**0.40**	**1.61**	10.10	7.57	3.65	**4.24**	**3.13**	1.30	1.46	2.45	**3.81**	**2.10**	15.83	14.57	11.12	**9.45**
Total Use	5.13	6.15	**7.50**	**4.90**	**6.52**	13.13	13.53	11.57	**8.23**	**12.00**	52.23	53.86	47.83	**48.28**	**50.04**	20.09	21.84	26.06	**28.41**	**26.23**	90.57	95.38	92.95	**89.82**
Carryout	0.39	0.98	**1.91**	**0.27**	**0.47**	2.84	2.52	1.90	**1.20**	**1.30**	10.47	8.22	9.41	**10.00**	**7.00**	1.67	3.49	6.29	**6.38**	**4.70**	15.37	15.20	19.50	**17.96**

Note: Bold numbers are Sparks Projections.

Data source: The Canadian Barley Industry in Transition: A Study for Alberta Agriculture, Food & Rural Development, 1November 2003, Table A1.2, p.83.

B Western Australia and partial deregulation

Western Australian is the largest producer of cereals in Australia. Average production of wheat is 7.0 million tonnes, barley 1.6 million tonnes and canola 0.440 million tonnes. Domestic consumption of grain is small accounting for less than 10% of the total production for most grains. The lack of domestic consumption and Western Australian distance from eastern states buyers means that the state is highly dependant on export markets for all of the grain it produces.

The dominance of export markets and the degree of regulation has meant that Western Australian growers have had the least access to any form of unregulated grain marketing compared to other states. In 2003 a partial deregulation model was introduced through a licensing system administered by the Grain Licensing Authority.

B.1 One year after the introduction of the GLA

Quantifying the effects of deregulation on the WA barley, canola and lupin markets after only one year of partial deregulation is difficult. While there is some price information it is not sufficient to draw conclusions on, but there are some observations that can be made.

Our initial investigations lead us to conclude that how the GLA applies the legislation will provide the most substantive information. In particular there are indications that the intent of the legislation is prone to interpretation by vested interest groups who spend considerable resources trying to influence the GLA and public opinion.

The legislation enacting the GLA states that the GLA will continue to operate while a national single desk for wheat remains. This part of the act appears to address a concern of the vulnerability of CBH to a take over by the AWB Ltd, or other large trader if the single desk for barley is abolished before the wheat single desk. The reasoning behind this appears to be the low capitalization of the CBH compared to the AWB and the inability of CBH to move into alternative grain markets due to the dominance of export wheat in WA. If CBH loses market share in barley canola and lupin trading it has few alternative markets in which to expand. Unlike the eastern states where there is a large, unregulated domestic market for a range of grains, WA grain markets are dominated by the export of wheat, the monopoly to which is held by the AWB.

Box 10 **Grain Pool competing in new markets**

Professional Choice Managed Wheat Pool

This managed pool was established in April 2004 to provide growers a transparent and cost-effective wheat marketing alternative. It is a joint initiative between AgraCorp (Grain Pool) and commodity management company, Plum Grove Pty Ltd.

Plum Grove manages the pool in terms of locking in foreign exchange, futures, basis and other elements of wheat pricing on behalf of participants. Grower returns are benchmarked against AWB National Pool values, with any premiums gained, less an administration fee, returned to participating growers. The pool will be managed by Plum Grove over its 18 month life span to take advantage of further marketing opportunities.

The pool was closed in May 2004 as the 100,000 tonne target set for the pool was reached. The decision to close the Professional Pool was made to protect existing gains made on behalf of growers from any dilution effect.

The current price indicator for the Professional Pool is $A231 per tonne (25/07/04) for APW grade compared to AWB's price indicator of $A220 per tonne for the same grade.

As a result of the success of the Pool, a second professionally managed wheat Pool – has been introduced - The Seeding Pool – which opened mid June.

There are opportunities for introducing additional options for growers including selling by land area rather than tonnage.

http://www.gpwa.com.au/AgPriceIndex.html

B.2 Grains Licensing Authority

The Grain Licensing Authority was created by the Grain Marketing Act 2002 to administer the grain licensing scheme which allows the issuing of *bulk* export licences for prescribed grain exports from Western Australia. Licences are not required for prescribed grains exported in bags and containers nor for the bulk export of certain *value added* grains.

There are five members of the Authority who are appointed by the Minister for Agriculture for a period no longer than three years but can be eligible for reappointment.

The Authority is required to report to the Minister annually, and whenever directed by the Minister to do so, on the operation and effectiveness of the licensing scheme and on any other matters relating to the operation of the Act.

The role of the Authority is to:

- Administer the licensing scheme which includes ability to issue special export licenses and the main export licence. (Part 3)
- Report annually to the Minister on the operations of the licensing scheme. (Section 20)
- Power of entry for ascertaining whether there has been a contravention of the Act. (Section 22).
- Power to cancel a licence. (Section 37)
- Power to grant a special export licence that, while the licence has effect authorises its holder -
  - To buy any prescribed grain specified in the licence for the purpose of its export in bulk and in accordance with the Act; and
  - To export in bulk any prescribed grain specified in the licence to any market specified in the licence. (section 29)
  - Power to place conditions on the licence that the Authority thinks are appropriate.(Section 33)
  - Power to seek additional information on licence applications necessary for proper consideration of the licence. (Section 35(2))

B.2.1 Licenses

In 2003, the Authority granted twelve licenses to export 536,000 tonnes of feed barley, canola, lupins and malting barley overseas (see Table 9). Of this amount only 339,791 tonnes of feed barley was shipped in 2003-04. To date in 2004, 180,000 tonnes of feed barley licenses have been issued.

An additional three licenses were declined as illustrated in Table 10.

Table 9 **Approved - July 2003 to date - 12 Licences Issued**

Grain	Export market	Tonnage	Shipped to date
Feed Barley	Middle East	433,000	339,791
Canola	Subcontinent	48,000	Nil
Lupins	East Asia	20,000	Nil
Malting Barley	Asia	35,000	Nil

Source: Grains Licensing Authority (www.gla.wa,gov.au)

Table 10 **Declined - July 2003 to date**

Grain	Export market	Tonnage	Status
Canola	Asia	40,000	Unsuccessful Appeal
Canola	Subcontinent	45,000	
Feed Barley	Middle East	318,000	

Source: Grains Licensing Authority (www.gla.wa,gov.au)

Box 11 **Greater choice**

The introduction of the Grains Licensing Authority allows Western Australian growers another choice of method for selling their grains. Growers now have the option to sell their grain:

- To the Grain Pool
- In bulk to the export market through a licensed exporter who holds a GLA license
- To the domestic market
- In bags or containers to the export market
- In value added form to the domestic or export market

In addition to these options are a range of new Pools that are being offered by the Grain Pool (see Box 10).

B.2.2 Decision making process

The key tasks of the GLA are to determine the existence of a "premium", and to assess the effect the issue of a special export licence may have.

Premium is defined as the market advantage that can be leveraged by the existence of a main export licence. In deciding whether a premium exists the Authority should take into account:

- the market structure and trade policies for the relevant prescribed grain in a particular market;
- prices and price trends in the market for the supply of the relevant prescribed grain;
- the quality and quantity of grain being exported to a particular market; and
- the effect on the State's reputation as a grain exporter and on the State's grain industry generally.

If the GLA determines there is a premium in a market for which a special export licence is sought the GLA must consult the main export licence holder and must determine if the granting of the special export licence would effect that premium to the extent it will damage current or future market access or the ability of the main export licence holder to maintain the premium it currently receives.

The Act does not require the Authority to determine that the premium will be significantly effected, only that this is considered likely.

B.2.3 Value added grains

The definition of value added grains under the GLA regulations are as follows:

Barley

h) heated so that its starch is fully gelatinised
i) de-hulled so that it is at least 95% kernel by weight
j) milled into flour, at least 98% of which passes through a sieve none of the meshes of which exceed 3mm in any dimension
k) soaked in water then germinated then dried in a kiln so that it is malted
l) steamed or flaked; or
m) treated, processed or otherwise dealt with so that its chemical nature or feed value have been substantially altered

Lupin

a) milled into flour, at least 98% of which passes through a sieve none of the meshes of which exceed 3mm in any dimension
b) subjected to a process of de-hulling and separation into components each of which contains-
   - i) at least 95% kernel by weight; or
   - ii) at least 80% hull by weight
c) steamed or flaked
d) treated, processed or otherwise dealt with so that its chemical nature or feed value have been substantially altered

Canola

e) converted into meal and contains less than 10% canola oil; or
f) treated, processed or otherwise dealt with so that its chemical nature or feed value have been substantially altered

Seed

Seed is not excluded from the definition of grain in the Act only because -

g) its moisture content has been manipulated; or
h) vitamins, minerals, enzyme preparations, amino acids, fats or similar materials have been added to it.

Box 12 Value adding

The Grains Marketing Act allows for the trade of certain bulk grains without a licence if the grain is value added. The Regulations under the Act provide a detailed description of what is considered value added for barley, lupins, canola and seed.

Anecdotal evidence suggests that industry is gearing itself to take advantage of this opportunity. The Grain Pool is planning the construction of a lupin dehulling plant this year with production expected in early 2005.

The general industry view suggests that there could be a number of growers who will establish small value adding operations in an attempt to receive a premium for their grains in a competitive market.

B.2.4 Relationship with CBH/Grain Pool

The legislated objective of the GLA is to maximise the benefit of competition in the market place whilst maintaining the protection of the single desk. CBH/Grain Pool is the main license holder. In issuing licenses to private traders, the GLA must ensure that it does not harm any identified premium arising from the exercise of market power advantages that are available to the main export licence holder. The onus of proof of market power falls in the GPPL under the GLA system.

Box 13 A new risk management tool for growers

In the first year of operation the GLA issued 12 licenses for some 536,000 tonnes of grain. The Pastoralists and Graziers Association report this grain was sourced from around 700 growers across Western Australia. In addition, 403,000 tonnes of grain were rejected for licenses.

This interest indicates that growers are using the GLA as a risk management tool by selling some of their crop in the cash market as well as the Pool.

C Coarse grain production and disposal in Australia

Table 11 **Australian coarse grain production and consumption ('000 tonnes)**

	Area'000 ha	Production tonnes	Exports kt	Domestic consumption kt	Seed kt
Barley					
1997-98	3521	6482	3463	1948	143
1998-99	3167	5987	4765	2041	117
1999-00	2596	5032	3325	1854	157
2000-01	3454	6743	4567	2158	168
2001-02	3707	8280	5274	2361	138
2002-03	3062	3268	2534	1965	164
Oats					
1997-98	937	1634	154	1437	44
1998-99	909	1798	248	1522	28
1999-00	584	1118	135	951	31
2000-01	650	1050	86	927	37
2001-02	784	1434	190	1210	34
2002-03	718	725	133	546	40
Sorghum					
1997-98	507	1081	184	894	3
1998-99	587	1891	493	1396	3
1999-00	622	2116	665	1448	4
2000-01	758	1935	501	1429	4
2001-02	823	2021	375	1644	3
2002-03	503	1065	71	986	4
Maize					
1997-98	57	271	19	251	1
1998-99	66	338	36	300	1

1999-00	82	406	53	352	1
2000-01	74	345	45	299	1
2001-02	83	457	61	395	1
2002-03	60	316	43	272	1
Triticale					
1997-98	366	633	2	614	19
1998-99	386	708	0	690	18
1999-00	361	764	0	744	14
2000-01	389	841	0	826	14
2001-02	409	860	0	847	13
2002-03	264	269	0	252	17
Total					
1997-98	5	10101	3822	5143	209
1998-99	5	10722	5542	5949	167
1999-00	4	9436	4177	5350	207
2000-01	5	10914	5199	5639	224
2001-02	5	13052	5900	6456	189
2002-03	4	5643	2785	4021	227

a ACIL Tasman 2004
Data source: ABARE 2004

D Saudi Arabian barley statistics

Table 12 **Calender year 2003 Saudi Arabian barley imports listed by supplying countries**

Month	Ukraine	Germany	France	Russia	Holland	Turkey	Australia	Canada	Other	Total
January	219883	0	0	54565	56800	0	0	0	0	331248
February	274899	137484	51239	104442	26939	0	0	0	0	595003
March	326352	219768	169583	118674	164350	106685	0	0	0	1105412
April	194568	156707	62302	50000	223152	80737	0	0	4500	771966
May	143129	169840	60474	84333	10035	36534	0	0	30874	535219
June	99704	85530	221159	54418	60927	54700	0	0	0	576438
July	57806	82033	124404	37106	0	0	0	0	119019	420368
August	0	549668	54771	54704	109515	36608	0	0	87849	893115
September	243386	277271	13066	50248	98964	0	55593	0	50000	788528
October	276626	38630	130854	63818	0	0	35519	0	57000	602447
November	595013	49502	0	98600	0	0	60168	20147	60684	884114
December	140762	54084	0	85970	0	0	76107	95113	0	452036
Total	2,572,128	1,820,517	887,852	856,878	750,682	315,264	227,387	115,260	409,926	7,955,894

a Gain Report USDA 2003

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