

FOREWORD

This Review of the Barley Marketing Act 1993 was conducted under the National Competition Policy (NCP), which was agreed to by all Australian Governments in 1995. Under this agreement, Australian governments were to review all legislation that affects competition, and to complete these reviews by the end of 2000.

An earlier review of the complementary barley marketing legislation operating in both Victoria and South Australia was completed in 1997. Both governments subsequently accepted the recommendations contained in the review to remove *domestic* market restrictions and to retain the barley export monopoly ("the single desk") for the shortest possible transition period which was initially determined by both governments to be until 30 June 2001.

However, in September 2000 the South Australian Government announced that it would extend the single desk export monopoly indefinitely, citing as reasons "overwhelming grower support" and the findings of a consultant's report which concluded that the company could extract price premiums, especially in the Japanese barley market, which could be attributed to the legislation.

The South Australian Parliament subsequently passed the Barley Marketing (Miscellaneous) Amendment Act 2000, which removed the sunset date (of 30 June 2001) and amended Section 5 of the Barley Marketing Act to require that the Minister review Part 4 of the Act (which establishes the single-desk export arrangements in favour of ABB Grain Export Ltd), ABB hereafter, at the end of two years of operation of those arrangements (i.e. by November 2002).

On 6 November 2002 the Hon Paul Holloway, Minister for Agriculture, Food and Fisheries announced Cabinet's decision to establish a Review Panel to conduct an "open, independent and robust" review of the Barley Marketing Act.

The independent Review Panel appointed by the Minister comprised Professor David Round, Mr Ian Kowalick and Mr Greg Schulz. Initially the Panel was to provide a report to the Minister by 14 April 2003. However, under an amended timetable the Panel was to deliver its decision to the Minister on 30 May 2003. The final report was to be delivered shortly afterwards.

The Panel consulted with key stakeholder groups throughout the review process. These groups were given the opportunity to provide written submissions and to meet privately with the Panel. The Panel wishes to thank all those who took the time to meet with them and who were involved in drafting submissions.

In addition, a model of the effects of the single export desk on the net public benefit was revisited through funding provided by ABB. However, ABB's involvement in revisiting the model was limited to the provision of spot export

contract data from 1995 to 2002. All of the work done on the model was through the direction of the Panel. An independent review of the model and its associated report was also conducted on behalf of the Panel. As a further check on the modelling and its results a “hot tub” style conference between the modeller, the independent reviewer and the Panel was held in Adelaide.

Given severe constraints on both resources and time, no public discussion paper was released during the review process.

The Panel would like to thank Mr Doug Young for his most professional support as executive officer for the review.

Professor David Round
Chair

Mr Ian Kowalick
Member

Mr Greg Schulz
Member

EXECUTIVE SUMMARY

Introduction

In September 2000 the Government of South Australia announced that it would extend the single desk powers for the export of barley, granted to ABB Grain Export Ltd, indefinitely. However, it agreed under national competition policy requirements to review these single desk marketing arrangements at the end of two years of operation of these arrangements. Pressure has been mounting on the Government by the National Competition Council to remove anti-competitive restrictions in State legislation, under the terms of clause 5 of the National Competition Principles Agreement agreed to between the Commonwealth and all Australian states in 1995. Accordingly the Government established a Review Panel to assess whether the single desk for barley produced a net public benefit that was not achievable through a more competitive set of arrangements, such that the continuation of the single desk could be justified under national competition policy principles.

National Competition Policy requirements

In April 1995 all Australian Federal, State and Territory governments signed three inter-governmental agreements to give effect to the National Competition Policy. The Competition Principles Agreement contained a requirement that all signatories conduct a legislation review of all existing legislation, and also of new legislation, that restricted competition. In September 2000, however, the South Australian Government announced that it would extend the single desk barley export monopoly indefinitely, citing as reasons “overwhelming grower support” and the findings of a consultant’s report which concluded that the company could extract price premiums, especially in the Japanese barley market, which could be attributed to the legislation. The South Australian Parliament subsequently passed the Barley Marketing (Miscellaneous) Amendment Act 2000, which removed the sunset date (of 30 June 2001) and amended section 5 of the Barley Marketing Act to require that the Minister review Part 4 of the Act (which establishes the single-desk export arrangements in favour of ABB Grain Export Ltd), ABB hereafter, at the end of two years of operation of those arrangements (i.e. by November 2002).

Terms of Reference

A Review Panel was established with terms of reference that required it to assess and update the debate between different sets of researchers that had previously provided input into the Government’s decisions on the single desk for barley, and to determine whether any legislative restrictions were “clearly and credibly” in the public interest. The Panel was also asked to consider alternatives to a legislated monopoly, including an examination of the impact of the recent deregulation of the export barley market in Victoria, and to take account of other recent changes in the barley marketing environment.

The Review Panel

The Review was conducted by an independent Review Panel established by the Government, comprising Professor David Round, Chair, Mr Ian Kowalick, and Mr Greg Schulz. Executive support was provided by Mr Doug Young. The Panel met on a large number of occasions from December to early June, both for discussion among Panel members, in consultation with representatives from a number of stakeholder groups and other interested parties, and for a “hot tub” debate between a company retained to model the single desk and an independent assessor of this work.

The Barley Marketing Act 1993

Several sections contained in Part 4 of the Barley Marketing Act 1993, which establishes the single export desk marketing arrangements for barley, impose restrictions on competition in the South Australian export barley market. Sole rights to export South Australian barley are given to ABB Grain Export Ltd, with a few exceptions relating to barley not meeting quality standards; exports in bags or containers holding less than 50 tonnes; and the export of propagating material. The Act also exempts the export of barley by ABB Grain Export, or anything done by this company with respect to the export of barley, from the operation of the Trade Practices Act 1974.

Clause 5 of the Competition Principles Agreement

Clause 5 (1) of the Competition Principles Agreement states:

“The guiding Principle is that legislation . . . should not restrict competition unless it can be demonstrated that:

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

It is in this context that the Panel must review the operation of the single export desk for barley. It is noted that for the clause as a whole to be satisfied, both parts of it must be satisfied.

Stakeholder consultation

Due to the nature of the review the Panel was asked to conduct (it was asked to revisit an earlier decision of the Government), the Panel met only with a limited number of key stakeholder groups. It did not conduct a full National Competition Policy review. No public discussion paper was issued, nor were any public meetings held. The Panel met with the various stakeholder groups early to inform them of its procedures, and to outline to them the broad areas of interest for the Panel. Formal written submissions were received from most of the groups, and in addition submissions were received from a small

number of other interested parties. Subsequently the Panel produced a long list of questions on which it sought further comments, and these were distributed to all stakeholder groups and other submitting bodies. Meetings were arranged for a final and detailed round of consultations with any group that wished to be heard.

Economic modelling

The Panel was asked in its Terms of Reference to “determine the adequacy of the current debate on Single Desk marketing by updating the Centre for International Economics 1997 and Econtech 2000 reports”. Due to severe budgetary restrictions funding for an update on both of these models was unavailable. However an offer was made by ABB to fund the revisitation of the Econtech model, with the Panel alone to be responsible for the instructions to be given to Econtech. The only involvement of ABB was to be through the provision of spot export contract data from 1995 to 2002. All of the work done by Econtech was to be through the direction of the Panel.

The Panel accepted ABB’s offer but was not comfortable with accepting uncritically the Econtech results, whatever they might be, without them being rigorously tested and challenged. It therefore sought assistance from AGEA, the main stakeholder group opposing the single desk, to fund the CIE to revisit its model and update it, such that the Panel could fully test the two sets of results. AGEA declined to fund the CIE model update. The Panel thus sought the assistance of Professor Gordon MacAulay, a distinguished modeller, as an independent assessor of the Econtech model and its results

The Panel made it a condition of accepting the work of both Econtech and Professor MacAulay that they attended a “hot tub” style conference with the Panel, in which each would be asked to outline their findings briefly, and would then be asked to assess each other’s work, both being subject to rigorous questioning by the Panel about their assumptions, methods, findings and conclusions. The Panel was greatly informed by the proceedings.

Assessment of the single desk

The Panel has concluded that the Econtech estimates have a high degree of uncertainty attached to them which cannot be quantified in any normal statistical sense, and that the future net public benefit from the continued operation of the single desk, while not certain, is likely to be relatively small. When this is added to the absence of any comparative cost benchmarking of ABB, and the large number of non-quantifiable benefits and costs associated with the single desk, the Panel believes that the test established by cl 5 of the CPA has not been met in full. While the Panel has doubts about the extent to which the single desk meets the first part of the test, it is prepared to accept that a small amount of net public benefit to the overall Australian community currently exists, but it has not been presented with any positive proof that these benefits could or could not be achieved under some other form of market environment, or that they can be sustained into the future.

Alternatives to the single desk

The Panel considered five main policy options that could be considered by the Minister: retain the single desk in its entirety; retain a single desk for feed barley exports to Japan only; full deregulation; an “opt in opt out” model; and controlled deregulation through a contestability process, of the type recently introduced in Western Australia.

Recommendations

The Panel recommends that the Barley Marketing Act 1993 should be amended with respect to ABB's single desk powers. Of the alternatives to the single desk that it considered, it believes that the only one that is economically feasible and appropriate public policy is the Western Australian model which involves the establishment of an independent licensing authority to consider applications from traders who wish to export bulk barley in competition with the single desk operator. The Panel therefore recommends to the Minister that consideration be given to the early implementation of a similar process, subject to the need to consider carefully a number of contentious issues, especially the composition, independence and operating guidelines of such an authority.

The Panel makes the following recommendations:

Recommendation 1: ABB's single desk for barley exports should be deregulated, so that it is exposed to a greater degree of market forces. This deregulatory reform should proceed by means of a streamlined process in which ABB retains its single desk, but is opened to competitive challenge through a contestability process.

Recommendation 2: That careful consideration be given to the principles of the Western Australian Grain Marketing Act 2002 as a model to form the basis of introducing contestability into the South Australian export barley market.

Recommendation 3: If Recommendation 2 is accepted, ABB should be deemed to hold the principal export licence for barley.

Recommendation 4: If another company other than ABB is granted an export licence, it is essential that growers who sell barley to this company can return to dealing with ABB in subsequent seasons if they so desire.

Recommendation 5: A licensing authority to oversee the process of contestability, and to grant export licences where appropriate, must be established. Its composition will be crucial to its success and the success of deregulation. No more than two of its five members should have any association with the barley or the wider grains industry.

Recommendation 6: The licensing authority should be reviewed within one year of commencing its role and thereafter at least every three years.

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PART 1

INTRODUCTION

1.1 Background

The South Australian Government identified the Barley Marketing Act as an Act that restricted competition in a survey of all the State's legislation in 1996. The survey was conducted to satisfy the requirements in clause 5(3) of the Competition Principles Agreement between the States and the Commonwealth. Clause 5(3) required the States to develop a timetable by June 1996 for the review and, where appropriate, reform of all existing legislation that restricts competition.

The South Australian and Victorian Governments commissioned the Centre for International Economics ("CIE") to conduct an independent review of the Barley Marketing Act. At that time both States had complementary barley marketing legislation. Both governments subsequently accepted the recommendations contained in the CIE Report of November 1997 to remove *domestic* market restrictions and to retain the barley export monopoly ("the single desk") for the shortest possible transition period which was initially determined by both governments to be until 30 June 2001.

However, in September 2000 the South Australian Government announced that it would extend the single desk export monopoly indefinitely, citing as reasons "overwhelming grower support" and the findings of a report prepared for ABB Grain Limited by Econtech Pty Ltd ("Econtech"). The Econtech Report concluded that the company could extract price premiums, especially in the Japanese barley market, which could be attributed to the legislation.

The South Australian Parliament subsequently passed the Barley Marketing (Miscellaneous) Amendment Act 2000, which removed the sunset date (of 30 June 2001) and amended section 5 of the Barley Marketing Act to require that the Minister review Part 4 of the Act (which establishes the single-desk export arrangements in favour of ABB Grain Export Ltd, ABB hereafter), at the end of two years of operation of those arrangements (i.e. by November 2002).

To give effect to that legislative requirement, the Hon Paul Holloway, Minister for Agriculture, Food & Fisheries, in a News Release issued on 6 November 2002 announced Cabinet's decision to establish a review panel to conduct an "open, independent and robust" review of the Barley Marketing Act.

The Review Panel membership is:

- Chairman: Professor David Round, Professor of Economics at the University of South Australia's School of International Business;
- Mr Ian Kowalick, former Chief Executive of the South Australian Department of Premier and Cabinet; and,

- Mr Greg Schulz, Deputy Chairman of the Grains Council of the South Australian Farmers Federation.

The Panel recognises the assistance of Mr Robert Rees, Primary Industries and Resources South Australia in providing barley industry background and Executive Support provided to the Panel by Mr Doug Young, Primary Industries and Resources South Australia.

There have been other significant changes in grain marketing, both nationally for wheat and, in other states, for barley and other grains. Regardless of national competition policy requirements, the efficacy of the South Australian barley marketing legislation needed to be reviewed as a consequence of future developments such as federally legislated changes in wheat marketing arrangements and already legislated changes to future grain marketing arrangements in New South Wales. Having regard for competition policy requirements, Victoria has repealed its single desk legislation for barley, so that exporting from Victoria is now fully deregulated. To meet competition policy requirements Western Australia has also amended its legislation to establish grain export licensing that alters the environment surrounding single desk trading in that state.

This review has been conducted to conform with the requirements of national competition policy. The essential criteria laid down in clause 5 of the Competition Principles Agreement of 1995 for a review are:

1. whether or not the legislation provides a net benefit to the community as a whole, **and**
2. if there are net benefits whether they can be delivered in another way that has a lesser impact upon competition.

1.2 Key sections of the Barley Marketing Act 1993

The following sections of the Barley Marketing Act 1993 create the single desk arrangements that restrict competition:

- s. 33.(1) A person must not sell or deliver barley to a person other than ABB Grain Export Ltd, except for:
- barley retained by the grower for use on the farm where it was grown;
 - barley purchased from ABB Grain Export Ltd;
 - barley sold or delivered for consumption in Australia; and,
 - barley that does not meet the standards specified by ABB Grain Export Ltd.
- s. 33(2) A person must not transport barley that has been sold or delivered in contravention of s. 33(1) or bought in contravention of s. 33(4).

- s.33(4) A person, other than ABB Grain Export Ltd, must not buy barley from another person other than for consumption in Australia.
- s. 34 On delivery of barley to ABB Grain Export Ltd, unless otherwise agreed, or the barley does not meet the standards determined by ABB Grain Export Ltd:
- (a) property in the barley passes immediately to ABB Grain Export Ltd; and
 - (b) the owner of the barley is taken to have sold it to ABB Grain Export Ltd at the price at the time applicable.
- s.35 ABB Grain Export Ltd may, by instrument, appoint a person to be an authorised receiver. A person may deliver barley to an authorised receiver, which will be taken to be delivery to ABB Grain Export Ltd. An authorised receiver holds on behalf of ABB Grain Export Ltd all grain in its possession which is the property of ABB Grain Export Ltd.
- s.41 A person does not have a claim against ABB Grain Export Ltd in respect of any right, title or interest in barley delivered to ABB Grain Export Ltd.

There are however, three exemptions under the Act, that may be termed:

the “niche market export exemption”:

- s.33(5) The single desk export restrictions do not apply to a sale, delivery or purchase of barley for consumption outside Australia if the barley is packed in a bag, or in a container not capable of holding more than 50 tonnes of barley, and the barley:
- (a) meets the prescribed standards (if any); and
 - (b) is packed in accordance with the prescribed requirements (if any)

the “plant breeder’s rights exemption”:

- s.33(5a) The single desk export restrictions do not apply to a sale, delivery or purchase of propagating material of a plant variety covered by a plant breeders right if the sale, delivery or purchase is for use of the propagating material for a purpose involving the production or reproduction of the propagating material.

and “the Trade Practices Act exemption”:

- s. 33A The following conduct is authorised for the purposes of section 51 of the *Trade Practices Act, 1974 (Commonwealth)*, (“**the TP Act**”), and of the Competition Code:

- (a) the export of Barley by ABB Grain Export Ltd; and
- (b) anything else done by ABB Grain Export Ltd in connection with the export of barley.

These legislative restrictions have the potential to cause several anti-competitive outcomes that impinge on growers; grain traders; domestic barley markets; transport and infrastructure providers, including the grain receiving and handling industry; stock feed manufacturers; and lot feeders, by creating entry barriers to the export trade and by raising the domestic and export market power held by ABB.

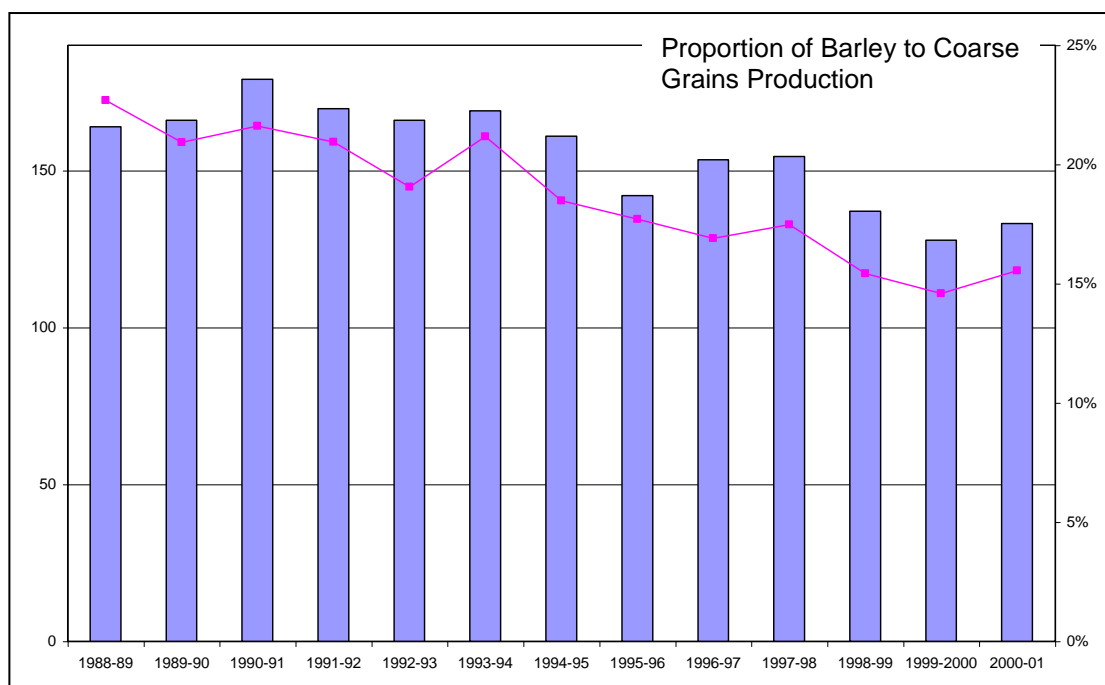
1.3 Description of the barley market

1.3.1 World barley production

The following charts and tables update those that were presented in the 1997 CIE Report. Brief comments are made regarding any significant changes that can be observed.

World barley production has averaged 141 Mt in the six years to 2000-01 (see Chart 1 below). This is a significant drop from the average of 164 Mt reported by CIE in the six years to 1995-96. The proportion of barley in total world coarse grain production has continued to decline to 16 per cent.

Chart 1: World Barley Production

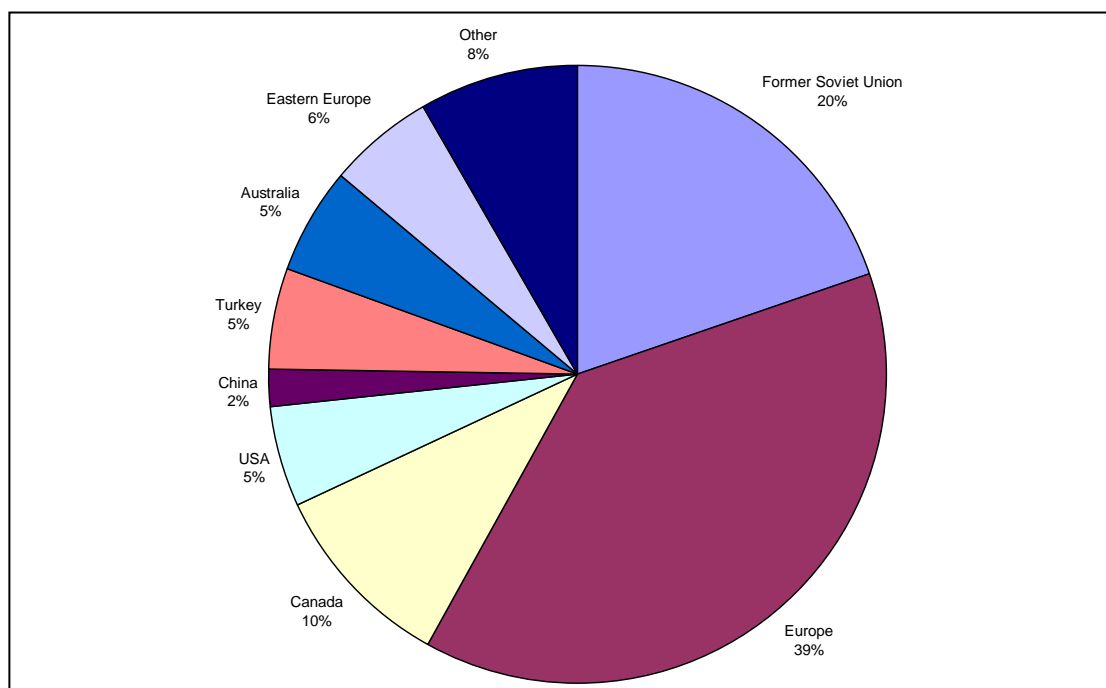


Source: ABARE 2001

The major producers of barley are shown in Chart 2 below, which updates Chart 3.2 presented in the CIE report. The Former Soviet Union economies

and Europe continue to dominate world production. Australia produced 5.3 per cent of world barley in 2000-01, up from 4 per cent in 1996.

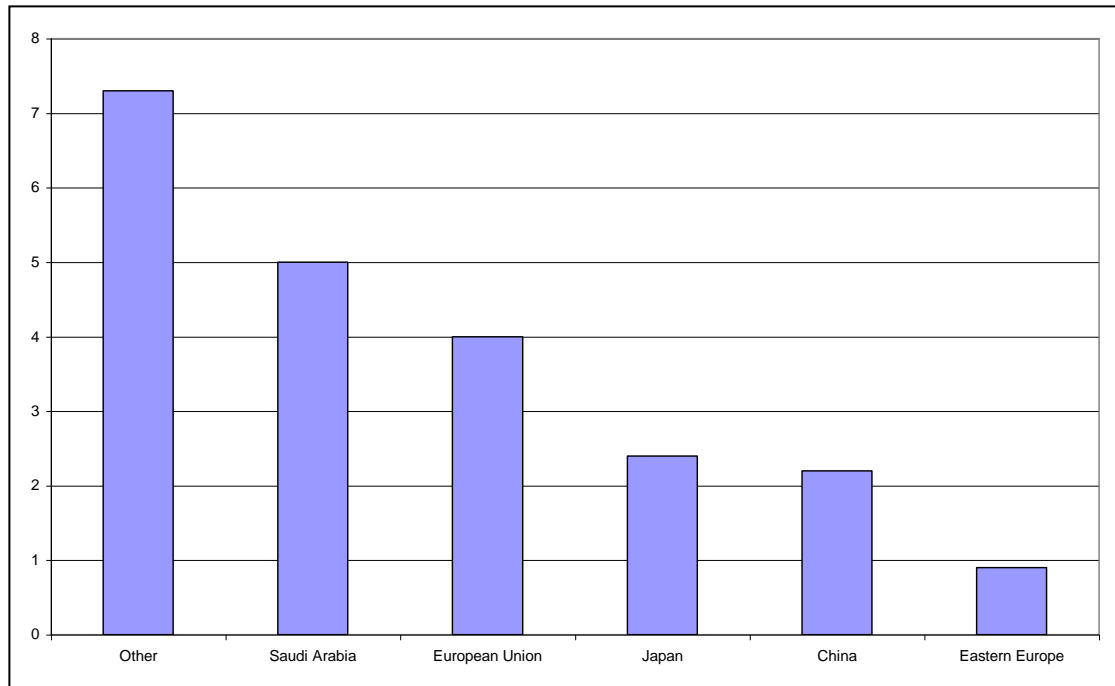
Chart 2: Major Barley Producers 2000-01
World Production = 135 Mt



Source: USDA 2003

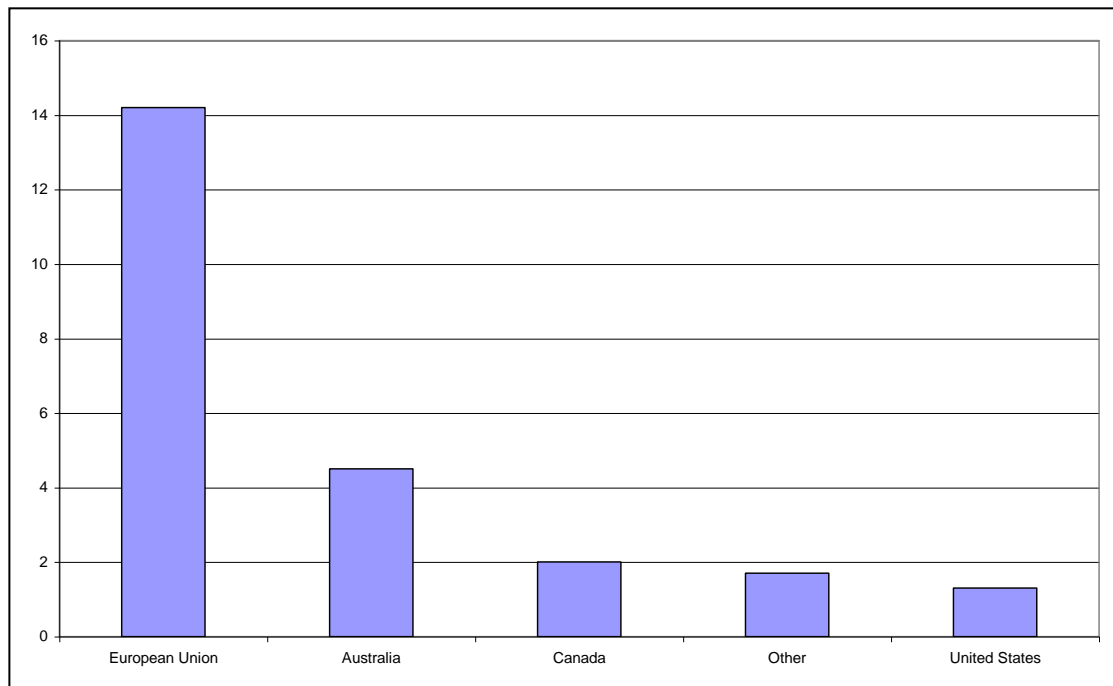
The European Union is still the major exporter of barley, accounting for 60 per cent of the total barley exports (CIE reported 40 per cent in 1996-97, although this may reflect the different data sources as the ABARE data (depicted below) include intra EU trade). Charts 3 and 4 update Chart 3.3 presented in the CIE report.

Chart 3: Major Importers in World Barley Trade 2000-01



Source: ABARE 2001

Chart 4: Major Exporters in World Barley Trade 2000-01



Source: ABARE 2001

1.3.2 ABB sales of barley

Table 1 updates Table 3.2 in the CIE report that details sales of barley by the ABB.

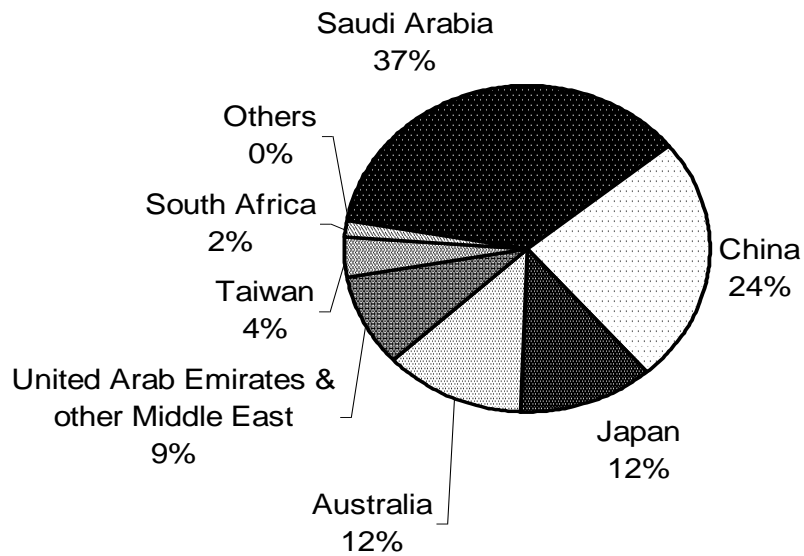
A comparison of the ABB sales data presented in Table 3.2 in the CIE report with that presented in Table 1 and Chart 5 shows that over the last 10 years the percentage of export sales to total sales of barley by ABB has increased. In particular, there have been significant increases in the volumes of barley sold by ABB to China and Saudi Arabia.

Table 1: Sales of barley By ABB

Destination	1996 kt	1997 kt	1998 kt	1999 kt	2000 kt	2001 kt
Malting Barley						
Domestic	259.4	168.3	176.4	193.6	223.7	286.3
Export	906.5	395.5	718.1	491.3	1,259.0	1,201.8
* China	621.5	375.5	644.8	389.8	975.4	966.6
* Japan	128.2	20.0	61.8	45.0	103.0	82.4
* South America	76.2					
* South Africa	25.0		0.5	43.5	111.3	86.8
* Taiwan	31.5			13.0	69.3	66.0
* Korea	16.6		11.0			
* Zimbabwe	7.5					
Total malt barley sales	1,165.9	563.8	894.5	684.9	1,482.7	1,488.1
Feed barley						
Domestic	134.5	114.4	102.1	73.3	106.2	233.1
Export	1,075.0	1,423.6	1,053.2	869.7	1,614.5	1,416.0
* Saudi Arabia	295.0	337.4	237.8	225.8	687.3	911.2
* Japan	388.3	500.0	271.4	358.8	266.3	172.8
* Abu Dhabi	59.0	25.0	67.9	54.8	64.0	41.8
* Dubai	58.0	63.6	76.8	17.9	24.1	39.9
* Ethiopia				5.8		
* Iran		97.0		2.8	160.3	
* Jordan		35.0				
* Kuwait	149.9	111.9	98.5	33.9	136.0	30.6
* New Zealand		15.1	85.6		15.4	27.5
* Oman	39.4	41.6	5.3	26.9	47.5	37.9
* Qatar	30.5	40.4	24.2	29.2	41.2	27.9
* Taiwan	34.4	116.3	107.8	49.9	125.4	67.2
* United Arab Emirates	20.6	40.3	77.9	63.9	47.0	59.2
Total feed barley sales	1,209.5	1,538.0	1,155.3	943.0	1,720.7	1,649.1
Total all sales	2,375.4	2,101.8	2,049.8	1,627.9	3,203.4	3,137.2
Sales of malting barley as a % of total sales	49.1%	26.8%	43.6%	42.1%	46.3%	47.4%
Export sales as % of total sales	83.4%	86.5%	86.4%	83.6%	89.7%	83.4%

(Source: ABB)

Chart 5: Destination of barley from ABB in year ending 30 Sept. 2002
Includes bulk barley exports, containerised shipments and Australian domestic business



Source: ABB

1.3.3 Regional barley production

Barley is a crop not as widely adapted to the South Australian conditions as the major South Australian cereal, wheat.

The dominant barley producing regions in South Australia are Yorke Peninsula and Lower Eyre Peninsula, the milder parts of the Mid North and Northern Agricultural Districts, and parts of the Murray Mallee.

Barley is grown for use as the raw material for the production of malt and beer, and as a feed grain, usually combined with other coarse grains for livestock feeding rations. As shown in table 2 the main varieties of barley grown to produce malt are Schooner, Sloop, Gairdner, Franklin and Chebec. Whilst these varieties are grown to produce malt, the barley must meet specific criteria to be accepted as malting quality. Should the barley not meet these criteria it can be downgraded and used to provide animal feed. The main varieties grown for animal feed are Keel, Barque, Galleon and Skiff. Generally barley graded as malting quality has received a higher price than barley used for animal feed.

Table 2: Barley varieties sown in SA 2001 and 2002 (% of total area sown)

Malting Varieties	2001 (%)	2002 (%)	Feed Varieties	2001 (%)	2002 (%)
Schooner	29.7	26.8	Keel	1.7	5.3
Sloop	28.5	25.4	Barque	15.0	17.0
Gairdner	4.8	6.1	Galleon	6.2	10.0
Franklin	0.4	0.4			
Chebec	9.3	-	Others (includes Skiff)	4.4	9.0

Source Professor Andy Barr, University of Adelaide.

Over the years, the average barley production in South Australia is approximately 65% feed barley and 35% malting barley.

Malting quality barley has traditionally come from Lower Eyre Peninsula and Yorke Peninsula, where the spring climate of cooler conditions and higher frequency of spring rains provide an ideal environment for the crop to finish.

Yorke Peninsula is the major barley producing region in the state. However, the region produces the lowest portion (historically around 25%) of barley meeting malting specifications of any region. A cereal root disease caused by a nematode

(Cereal Cyst Nematode or CCN) influences farmers' decisions on crop variety, favouring feed barley varieties with resistance to the disease over CCN-susceptible malting varieties. By comparison, Lower Eyre Peninsula produces around 75% of barley meeting malting specification.

Table 3 shows the ten-year average (from 1992-93 to 2001-02) of the area planted and the production for each region within the state.

Table 3: Ten Year Average of area planted and production (by SA region) 1992-93 to 2001-02

	ha	tonnes	% Share of Area	% Share of Production
Murray Mallee	215,720	289,791	22%	15%
Central	15,382	27,540	2%	1%
Eyre	248,050	450,030	25%	23%
Northern	234,540	493,085	24%	25%
South East	54,335	129,585	6%	7%
Yorke	206,500	574,550	21%	29%
TOTAL	974,527	1,964,581	100%	100%

Source: ABARE, ABS, PIRSA

While all regions except the South East have been affected by the drought in 2002-2003, the Murray Mallee has been most heavily affected with production forecast to only achieve 22 per cent of the ten year average in 2002-03.

1.3.4 Regional grain transport arrangements in South Australia

In the Eyre Peninsula region major storage sites are located at Tumby Bay, Cummins and Port Lincoln. Transport is primarily by rail which is supplemented by road for some coastal silo delivery points not serviced by rail. Export is from Port Lincoln. Thevenard has port facilities but is not used for barley exports.

All export shipments from the Yorke Peninsula region are made from the port terminals at Port Giles and Wallaroo. Other silos (including Ardrossan which has port loading facilities) only act as delivery points for farmers. Grain is road freighted to Port Giles or Wallaroo for export.

For the Central and Northern Agricultural Districts major storage facilities are located at Port Pirie, Gladstone, Bowmans, Snowtown and Port Adelaide. Grain from these major storages and from smaller silo delivery points is sent to Port Adelaide by either road or rail.

Barley from the Murray Mallee is mainly freighted to Port Adelaide by road.

Barley from the South East is freighted to Port Adelaide for export. However a significant portion is traded domestically direct from storage. There is some

interstate trade, but this varies with year and price differentials between South Australia and Victoria. If trade occurs transport is by road. Should any South Australia barley be sold into the Victorian system it would be exported from Portland.

The following table depicts the destinations of ABB grain deliveries in South Australia.

Table 4: ABB Grain Deliveries

	Malting (all grades)		Feed (all grades)	
	2000/01	2001/02	2000/01	2001/02
Pt Adelaide South	176,000	273,000	158,000	102,000
Pt Adelaide North	122,000	154,000	133,000	210,000
Pt Giles	67,000	85,000	142,000	138,000
Ardrossan	31,000	13,500	132,000	155,000
Wallaroo	97,000	115,000	185,000	226,000
Pt Pirie	185,000	175,000	102,000	185,000
Pt Lincoln	224,000	245,000	239,000	309,000
Thevenard	17,000	18,000	62,000	61,000
Statewide	919,000	1,078,500	1,153,000	1,386,000

Source: ABB

1.3.5 2001 season

Exceptional production years like 2001 can have mixed effects on grain quality. Yields well above expectations resulted in farmers tending to under fertilise malting barley crops resulting in grain with low protein. Grain protein determines the diastase level (measured as DP or diastatic power), an enzyme essential in the malting process. Low protein has been found to reduce DP, reducing malt extract. Recent seasons have seen the introduction of a grain protein minimum into barley quality specifications to reduce the risk of low protein, low DP malting barley. High protein barley also is not required for malting and price penalties have been applied to these deliveries for many years. High protein barley is usually produced in drought seasons or where a dry spring is experienced.

Despite the production of low protein barley in 2001, the malting barley crop production still was believed to exceed the demand from domestic and export malting barley markets. Some excess malting grade barley in these circumstances is often sold into feed barley markets. Currently growers are not rewarded for high protein feed barley.

Grain prices received were not greatly affected by the season – domestic prices probably were driven by export prices available. Prices were above the long term average despite the record grain supply.

1.3.6 2002 season

Drought years where rainfall is deficient throughout the growing season tend to have less impact on grain quality and much more impact on grain yield. The 2002 drought resulted in generally below average to well below average grain yields, and in some districts, total crop failure. In many cases where grain was produced, the percentage of deliveries meeting malting specification was near normal.

Prices for feed grain were strongly influenced by strong domestic demand as a result of the widespread national drought and widespread feed grain shortages. This may have influenced the prices paid for export pools although many of the major international exporting countries were also adversely affected by poor seasons.

1.4 **National Competition Policy reviews**

1.4.1 The National Competition Policy Inter-governmental Agreements

On 11 April 1995 the Commonwealth, State and Territory members of the Council of Australian Governments signed three Inter-governmental Agreements to give effect to the National Competition Policy ("NCP"):

- the Conduct Code Agreement dealt with the extended application of the Trade Practices Act 1974 (Commonwealth), with the legislative assistance of the States, to areas beyond Commonwealth constitutional power;
- the Competition Principles Agreement ("the CPA") dealt with a number of competition policy issues that, when implemented by the relevant governments, would enable the NCP's theme of competition and microeconomic reform to be extended beyond the prohibitions of certain anticompetitive conduct made by the Trade Practices Act. One of the competition policy issues was the requirement that the parties to the CPA review all legislation that restricted competition.
- the National Competition Policy Implementation Agreement also dealt with specific reforms in the areas of electricity, water, gas, road transport and national standards. Importantly, for the States and Territories, the agreement also provides for per capita Competition Payments to be made by the Commonwealth to the States and Territories as their share of the national productivity dividend anticipated to be achieved as a result of implementing all the NCP reforms. The National Competition Council ("NCC") was given the role of assessing the parties' compliance with the NCP agreements. The NCC can recommend to the Commonwealth Treasurer that a State or Territory

have its Competition Payments, or a part of them, withheld if it has assessed that there is insufficient compliance with NCP obligations.

1.4.2 NCP legislation reviews

The legislation review obligation is contained in clause 5 of the CPA, and requires that any restrictions contained in legislation be assessed in accordance with the process described in this clause. The guiding principle in undertaking this assessment is that legislation should not restrict competition unless:

- 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.

Clause 5 (9) of the CPA requires that the Terms of Reference for a Legislation Review must, at least:

- (a) clarify the objectives of the legislation;
- (b) identify the nature of any restriction on competition;
- (c) analyse the likely effect of the restriction on competition and on the economy generally;
- (d) assess and balance the costs and benefits of the restriction; and,
- (e) consider alternative means for achieving the same result including non-legislative approaches.

In addition, clause 1 (3) of the CPA provides that where there is a requirement to balance the benefits of a policy or course of action against its costs, or to assess the most effective means of achieving a policy objective - and both are required by the legislation review process - without limiting other matters, the following matters, shall, where relevant, be taken into account:

- government legislation and policies relating to ecologically sustainable development;
- social welfare and equity considerations, including community service obligations;
- government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
- economic and regional development, including employment and investment growth;
- the interests of consumers generally or a class of consumers;
- the competitiveness of Australian business; and
- the efficient allocation of resources.

1.4.3 Links to the Barley Marketing Act 1993

The NCC commented (at page 4.20 of its 2002 NCP assessment):

"The South Australian Government has provided a written commitment to the Council that the review due by November 2002 will be open, independent and robust and with terms of reference consistent with CPA clause 5.(9). The Council will therefore finalise the assessment of South Australia's compliance in the 2003 NCP assessment. It will closely examine:

- the 2002 review process, analysis, conclusions and recommendations; and
- the Government's subsequent response, and its implementation of appropriate reform.

For the Council to find in 2003 that South Australia has met its CPA clause 5 obligations, the Government will need to have either:

- legislated to remove the export monopoly at the earliest practical date; or
- clearly and credibly demonstrated that its retention is in the public interest".

The Panel notes that the obligation in section 5 of the Barley Marketing Act is not to have completed the Review by November 2002, but for the Minister to have at the end of two years of operation of the single desk export arrangements (thus, by November 2002) commenced the review.

1.4.4 The Review required by section 5 of the Barley Marketing Act, 1993

Section 5 of the Barley Marketing Act provides:

"Review of operation of Part 4

5.(1) The Minister must, at the end of two years from the commencement of this section, review the operation of Part 4.

(2) A report on the review must be prepared and laid before both Houses of Parliament."

There are no special requirements specified in section 5 of the Barley Marketing Act for the tabling in Parliament of the Review, or as to the details of the Review. These matters were determined by Cabinet, and are reflected in the Terms of Reference for the Review (as announced in the News Release of 6 November 2002 by the Minister for Agriculture, Food and Fisheries presented as Attachment A). The Panel is required to provide its Final Report to the Minister. That will enable the Government to table the Report in both Houses of Parliament at a time that it considers appropriate.

The Terms of Reference also indicate that the section 5 Review will be in accordance with the NCP requirements, and reiterate the Government's commitment to the NCC that the Review will be "open, independent and robust".

1.5 Terms of Reference

The Panel was asked to review the single desk established by the Barley Marketing Act 1993 under the following terms of reference:

- To determine the adequacy of the current debate on Single Desk marketing by updating the Centre for International Economics 1997 and Econtech 2000 reports;
- To determine whether any restrictions on competition in place at June 30 2003 are clearly and credibly in the public interest;
- To examine alternatives to the objectives of the legislation other than having a legislative monopoly;
- To determine whether the legislation imposes high costs or high entry barriers to market entry or imposes substantial costs on competition;
- To examine the impact on South Australian growers of two years of deregulation in Victoria and other recent changes in the marketing environment; and
- To provide a final report to the Minister for Agriculture, Food and Fisheries by April 2003.

To this extent, the review is an update rather than a full de novo NCP Review.

1.6 Timetable

Initially the Review Panel was to provide a report to the Minister by 14 April 2003. However, the initial timetable was adjusted to accommodate unforeseen delays in both process and in obtaining substantial submissions and reports from a consultant and key stakeholder groups. Under the amended timetable the Review Panel was to deliver its decision to the Minister on 30 May 2003. The final report was to be delivered shortly afterwards.

1.7 Process

1.7.1 Stakeholder consultation

At the start of the review key stakeholder groups were identified. These groups were contacted and invited to attend a meeting with the Panel. Because of time constraints, no issues paper was produced. Each of these stakeholder groups was sent a letter outlining the review process, the Panel's Terms of Reference and a broad set of issues about which the Panel was seeking extra information. These stakeholder groups were invited to raise any other relevant issues of

concern to them at the meeting with the Panel. A copy of this letter is provided as Attachment B.

The key stakeholder groups contacted at this stage were:

- ABB Grain Ltd
- Advisory Board on Agriculture
- Australian Grain Exporters Association
- AusBulk
- AWB Ltd
- Commonwealth Bank of Australia
- Laucke Mills
- Ridley Agriproducts Pty Ltd
- South Australian Farmers Federation

Meetings with these stakeholder groups were held in February 2003.

In addition, the Panel received written submissions from ABB, SAFF, the Advisory Board on Agriculture, United Grower Holdings Pty Ltd, Australian Lot Feeders Association and the Yorke Peninsula Branch of the South Australian Farmers Federation.

Follow-up meetings with stakeholder groups were held in May 2003. Prior to this second round of meetings each key stakeholder group was sent an extensive set of questions (Attachment C) about which the Panel was seeking extra information. These questions were developed by the Panel from a synthesis of the information provided at the first round of stakeholder meetings and from consideration of the Econtech modelling and report on the benefits of ABB's single export desk. A separate list of questions was asked only of ABB, and these are provided at Attachment D)

Each group was invited to provide responses only to those questions of relevance to them and for which they had substantial evidence to support their position. It was explained to them that the entire set of questions was provided to each party on the grounds of transparency, so that they would all know the entire set of questions that was exercising the Panel's mind. With the exceptions of the Commonwealth Bank and Laucke, all of the above stakeholder groups took the opportunity to meet again with the Panel. In addition, United Grower Holdings Pty Ltd also met with the Panel. Written responses to some of the questions were also provided by several of the stakeholder groups.

1.7.2 Modelling the single export desk

In its Terms of Reference, the Panel was required to "determine the adequacy of the current debate on Single Desk marketing by updating the Centre for International Economics 1997 and Econtech 2000 reports". Between the time

that the terms of reference were devised and the commencement of the inquiry by the Panel, severe budgetary restrictions were imposed upon PIRSA and these meant that funding for an update on both of these models was unavailable, at the consulting rates proposed by the developers of the models. The Panel enquired as to whether it might be feasible to engage another contractor to construct a similar model, but once again sufficient funds and time were not available for such an exercise to be completed.

Having heard of the problem, an offer was made by ABB to fund the revisitation of the Econtech model, with the Panel alone to be responsible for the instructions to be given to Econtech. The only involvement of ABB was to be through the provision of spot export contract data from 1995 to 2002. All of the work done by Econtech was to be through the direction of the Panel.

The Panel acknowledged the generosity of ABB in making this offer, which indicated that it was funding the model in order to try and get some closure to the debate over the single export desk which had now been dragging on for some time. Given the previous comments made by the NCC on the Econtech 2000 model and its estimation, however, the Panel was not comfortable with accepting the Econtech results, whatever they might be, without them being rigorously tested and challenged. It therefore sought assistance from AGEA, the main stakeholder group opposing the single desk, and which had used CIE's services previously, to fund the CIE to revisit its model and update it, such that the Panel could fully test the two sets of results.

While these negotiations were taking place, the Panel was attempting to secure the agreement of ABB to make available to the CIE the same data as had been provided to Econtech, in order to ensure that whatever differences might transpire from the two sets of models, they could at least not be ascribed to the use of different data sets. Ultimately ABB agreed to do this, although not without serious concerns, subject to very strict confidentiality provisions being accepted by CIE.

Unfortunately, AGEA subsequently decided not to fund the CIE to undertake the modelling task, arguing that it was the responsibility of the Government that had commissioned the review to fund the modelling deemed to be necessary. The Panel revisited the question of PIRSA being able to fund the CIE, but to no avail. The Panel was thus left in the position of not being able strictly to satisfy one of its terms of reference. However, it knew that there were available several distinguished modellers who were qualified as independent credible assessors who could assist the Panel in its evaluations of the Econtech model and the way it would be applied to the ABB's updated data set.

After making inquiries as to the acceptability of this option under the NCP review requirements, and as to the likely cost of such a review, and the ability of PIRSA to fund such an evaluation, the Panel asked Professor Gordon MacAulay of the

Department of Agricultural and Resource Economics at the University of Sydney to assess the model, modelling process and conclusions of Econtech. Professor MacAulay revealed that he had previously consulted for ABB, but the Panel determined that this created no conflict of interest that might damage the credibility of his report. ABB agreed to provide Professor MacAulay with the same data provided to Econtech, and Econtech co-operated by providing him with its complete model specifications. Professor MacAulay was asked to prepare a report for the Panel on the Econtech findings, to both review the model and critique its assumptions, to verify the findings of the model if possible, and to suggest, if appropriate, where the model might need further work.

As a further check, the Panel made it a condition of accepting the work of both Econtech and Professor MacAulay that they attend a “hot tub” style conference in Adelaide with the Panel, in which each would be asked to outline their findings briefly, and would then be asked to critique each other’s work, in all cases being subject to rigorous testing by the Panel of their assumptions, methods, findings and conclusions. The conference resulted in vigorous theoretical and empirical debate. The Panel was greatly informed by the proceedings, and was satisfied at the end that all the contentious issues it had identified had been fully explored, such that it felt able to meet the first of its terms of reference, at least with respect to the Econtech model.

1.8 Outline of the report

This report is arranged in the following manner. Part 2 presents the key messages from both the written submissions and discussions with the key stakeholder groups. It also provides a discussion of the methods, assumptions and results of the Econtech modelling and a review of that model provided by Professor MacAulay through both the hot tub process and in his written reports. Another area covered in this part of the report is a discussion of developments in both the domestic and international barley and associated markets which need to be considered in any assessment of the likely future net benefits from maintaining ABB’s single export desk.

Part 3 provides the Panel’s assessment of all the information it has gained through the review process. Part 4 provides the Panel’s recommendations and conclusions.

PART 2

SUBMISSIONS AND MODELLING

2.1 Stakeholder views

The Panel sought information from stakeholders about how the existence of ABB's single export desk contributes to national benefits, whether these benefits are sustainable over the longer term, the nature of any costs that the single export desk might impose, and the potential impacts of either partial or full deregulation. The contributions from the key stakeholder groups have been grouped under the following headings in this section of the report:

- Benefits of the single export desk
- Costs of the single export desk
- Potential impacts of full or partial deregulation

2.1.1 Benefits of the single export desk

The ability of ABB to achieve price premiums in international markets and to return these premiums to growers through higher prices is central to the demonstration that ABB's single export desk provides net benefits to Australia.

ABB has stated that it has been able to gain premiums in several markets for both feed and malting barley. Econtech's price discrimination model indicated that over the period from 1995-2002, ABB achieved an average export price premium of \$7 per tonne. In particular, Econtech's model indicated that price premiums of \$33, \$24 and \$7 per tonne were achieved in the Japanese malt, Japanese feed and United Arab Emirates feed barley markets respectively. According to Econtech, these export price premiums raise annual economic welfare by \$9 million. ABB raised the concern that the modelling approach only considered the ability of ABB to achieve different prices in different export markets, rather than its achievements in the lowest price or volume dominant markets eg Saudi Arabia and China. It argued that:

"The fact is that the competitive price into Saudi Arabia is the EU price, as the largest supplier to the market and with an export subsidy/domestic intervention program that impacts on the prices offered by traders for EU barley. ABB is achieving a premium above this price, however as the lowest price market, it does not appear through the model".

However, ABB recognises that part of this premium is likely to be related to the buyer's preference for the colour of South Australian barley, rather than the existence of the single export desk per se.

The South Australian Farmers Federation's (SAFF's) view is that *"Many of the benefits of the ABB Grain (Export) Limited single export desk for South Australian barley...combine to allow for the company to extract price premiums for South Australian barley in international markets"*. It further stated that such premiums could be achieved because the single desk marketed Australian barley as opposed to a trading situation where the origin of the barley is irrelevant. Significant grower support for the single export desk was also revealed in a SAFF commissioned survey of South Australia grain growers. The report of this survey stated *"over nine in every ten growers believe that ABB Grain gets them a premium price"*. However, the Panel notes that the phrasing of many of the questions in this survey was leading.

In contrast, the Australian Grain Exporters Association (AGEA) stated *"the only credible premiums are from the Japanese market, and these are fast eroding.... Any premiums from this market are because of the particular circumstances of the JFA, which are changing and not because of the ABB single desk"*. This sentiment was supported by AusBulk during the first round of stakeholder meetings. In its submission AGEA notes *"A key point is that the JFA appears to pay above world trade prices to all major suppliers. Australia is not unique in this respect, although it does appear that Australian prices are marginally better than those received by other suppliers. But this could easily be explained in terms of the additional marketing services provided (at a cost) and a preference for Australia's inherent better quality grain"*. Further, it suggests that the price premiums indicated for the UAE *"can be explained by freight and quality characteristics that would be available irrespective of marketing arrangements in South Australia"*.

Whilst expressing confidence in the Econtech model, ABB also considers that the modelled results underestimate the benefits associated with the single export desk because the modelling approach is unable to incorporate several other types of benefits. ABB states that, in particular, the model has not included the following classes of benefits:

- Grain Australia (ie the recent marketing alliance between ABB and Grain Pool Pty Ltd from Western Australia) benefits through not competing for export sales;
- Promotion of Australian barley in the marketplace as opposed to traders supplying barley from all origins;
- Focus on maximising absolute grain price, as opposed to making a trading margin;
- Market development expenditure;
- Harvest surplus management;
- Direction of all market returns to growers, as opposed to diversion to corporate profits;

- Benefits of chartering ships (as opposed to selling fob) are passed back to growers in the pool (not taken as profit). The Econtech model requires all contracts to be converted to an fob basis, so this benefit is missed;
- Rapid payment at harvest to growers; and
- Grain quality management.

ABB presented evidence to the Panel that the coordinated activities of Grain Australia enabled it to receive higher prices in several international markets than would have been possible, had ABB and Grain Pool been acting independently in their own interests. Whilst the Panel has no doubts that Grain Australia was able to achieve these higher prices, it does have some doubts over whether the achievement of these prices was solely dependent on the existence of ABB's single export desk. It is more likely to be the result of greater market power and enhanced ability to control export sales.

Several of the other classes of benefit such as maximising absolute grain price, direction of market returns to growers, harvest surplus management and rapid payment to growers are likely to lead to increased grower incomes. However, this is not the same as providing net benefits to Australia. For example, it is not clear that the nation is better off by higher grower incomes as opposed to higher corporate profits. This could mean simply a redistribution of income from growers to shareholders provided that the total revenue generated from international grain sales remained the same as under the single desk system. If it did not then it is likely that the corporate profit would remain the same and the grower would bear the reduction in returns.

The management of surplus production would not be in the national interest if it resulted in lower prices within some markets or if ABB's efforts resulted in excess production of barley. Such a situation would contribute to an inefficient use of national resources and would impose a net cost on the nation. Some indication that current levels of production exceed a socially optimal level is provided first by comments from both ABB and SAFF that the quantity of barley produced would likely decline under deregulation, and second, the difficulty that ABB has expressed that it occasionally has in disposing of all the barley delivered to it, especially in those years where the level of production is high. On this issue the Review of the *NSW Grain Marketing Act 1991* commented:

"It was a concern to the other members of the Review Group, however, that the presence in the market of a statutory 'buyer of last resort' could be a disincentive to growers to invest in information to enable an objective assessment of the price risk associated with the production of vested crops. To the extent that growers are shielded from endemic market risks and provided with an operating environment which promotes production decisions which do not reflect market conditions, there is the potential for inefficient levels of investment and for appropriate, on-going adjustment to be impeded. However, no evidence was presented to the Review Group that this was actually occurring".

Nevertheless, the panel acknowledges that matching production to demand and endeavouring to be a reliable source of barley when seasonal variations can dictate both quantity and quality, can be difficult. It is unclear if carry over stocks could be managed as effectively in a deregulated market in a manner that could maintain customer confidence, ensure stability for the industry and capture market opportunities as they arose.

ABB has a reputation as a company that pays promptly. A number of purchase and payment options exist. Growers can receive funds as loans, direct cash sales or instalment payments as the pooled grain is sold off. Further, for the standard pool, growers have the option to purchase underwriting as insurance in the event that loan advance payments exceed the final pool payments. Reliability and prompt payment are valued by growers as is the flow-on effect as cash flow is passed to other industry players and the community at large. It is difficult, however, to quantify this in terms of net public benefit.

It could be expected that management of grain quality would be rewarded through both continued access to key markets and the prices received in these markets. As such, it is likely that the benefits of grain quality management are incorporated through the observed prices used in the Econtech model.

In discussions ABB also noted that the single export desk provides a marketing advantage by providing it with an in depth knowledge of both the quality and quantity of production as well as stocks at a regional level over time. In its submission it states *“Full knowledge of the volume and quality profile of the year’s barley harvest ensures that the barley can be placed into the market to best commercial advantage. This is in contrast to the systems applying in most competitor countries where grain floods the market at harvest”*. However, the Panel observes that AusBulk and others may have some of this knowledge but that without knowledge of receivals and committed stocks in the handling system, any competitor to ABB would be at a competitive disadvantage.

SAFF claimed that ABB’s single export desk enabled ABB to secure seasonal funding on very competitive terms and that this flowed through to reduced financing costs for barley growers. This position was supported in discussions with the Commonwealth Bank, which reported that in the absence of the single export desk, it would be likely that the costs of finance to ABB would increase. The Bank also reported that costs of finance to growers could be significantly greater if growers borrowed directly through the bank rather than through ABB. Whilst this aspect of ABB’s single export desk provides benefits to growers, these financial arrangements are based on the supply and demand for funds and associated levels of risk, and given reasonably functioning financial markets it is not clear that they represent a net benefit to the nation. Whilst not a submission to this review, the Panel notes the comments of the Productivity Commission (2000) Report on ‘Single Desk Marketing: Assessing the economic arguments’.

With respect to the issue of grower access to cheaper finance, the Productivity Commission report stated:

“It may be the case that explicit or implicit government guarantees underwrite the debt of statutory authorities, or that the protected monopoly status of the single desk itself, reduce financial risk and lead to lower debt costs which can be passed on to growers. But this raises a question why agricultural producers should receive a form of assistance not available to most other Australian producers. Though financiers might consider a business with a regulated monopoly or government guarantee to be a better risk than a business operating in a competitive environment, it does not necessarily follow that the monopoly or guarantee is in the national interest”.

The Productivity Commission report also noted *“Producers may save on finance costs but are compelled to bear a level of risk which may not reflect their risk preferences”*. Nevertheless, the Panel observes that under a deregulation scenario, more risk management would be the responsibility of growers, and that unless deregulation led to an increase in the provision of risk management tools by the market, growers would lose something of value to them.

Discussions with Ridley Agriproducts Pty Ltd, which mixes grain for livestock industries, indicated that ABB’s accumulation of barley provided a benefit to it by enabling it to access grain later in the season. In a sense this lowered Ridley’s need for extra storage by providing top up storage for it. However, the price at which it was able to access barley from ABB reflected the ABB’s costs of holding and storing that barley.

Discussions with Laucke Mills indicated that it used both forward contracts and storage to ensure that it had sufficient quantities of barley throughout the year. It said that forward contracting required it to have considerable market knowledge. Laucke Mills noted that one of the difficulties associated with profitable forward contracting was that the various components of feed mixes were very substitutable and that overall mixes varied in response to price differentials between the various components. It further noted that these price differentials could change substantially over a short time.

The submission from SAFF paid considerable attention to the contribution of the single export desk to enabling ABB to compete in what SAFF called “distorted international markets” for grain. This point was reinforced in discussions with SAFF where the Panel was told that agricultural production in many other countries was subsidised. It was also pointed out to the Panel that even crop insurance in the United States is substantially subsidised by government contributions. The distorted nature of international markets for agricultural products was supported in discussions with AWB who reported that US wheat growers obtained approximately 40 per cent of their income from government support programs. Whilst the Panel accepts that agricultural production in many

other countries is heavily supported by governments, it is aware that, as part of current World Trade Organisation arrangements, Australia is under increasing pressure to dismantle its statutory marketing authority arrangements supporting its agricultural industries.

The Panel accepts that ABB is able to achieve higher prices in the Japanese feed barley market. Further, the Panel accepts that the single export desk was probably instrumental in the development of the relationships with both the Japanese Food Authority and Mitsui, which have ultimately led to these higher prices. The Panel also notes recent data from the United States Department of Agriculture which show that Japan has recently imported significant quantities of barley from the United States, which does not operate with a single desk, and for which there was little difference in the price paid and the price paid for Australian barley. As such the Panel is not convinced that ABB's single export desk is necessary for the maintenance of this relationship with Japan and the achievement of future premiums.

2.1.2 Costs of the single export desk

Stakeholder submissions and discussions have presented to the Panel a variety of considerations on the various costs of ABB's single export desk monopoly.

The Australian Lot Feeders Association (ALFA) stated that the ABB's single export desk powers have *"had the effect of putting upward pressure on domestic feedgrain prices at the expense of end users"*. In making this point it illustrates how the existence of the single export desk together with several other factors raises the price of barley (a key component of the preferred grain of the lot fed beef ration) to the cattle feedlot industry. To demonstrate this it pointed out that quarantine restrictions prevent the importation of feed grains for inland, unprocessed usage. Further, the high costs of local shipping rates (due to coastal shipping regulations) combined with an effective ban of imports into the eastern states of grain which may contain anthracnose-infected lupins, restricts the movement of grain from Western Australia to the eastern states. In addition, in 2001, ABB aggressively accumulated grain from Victoria to counter the potential of other exporters marketing Schooner malting barley from Victoria into China. ALFA contend that the resultant stockpiling of barley made it difficult for domestic users to acquire grain. However, given the substitutability of grain in feed mixes and the quantity of grain that ABB sent to the eastern states the Panel is not convinced that the single export desk has substantially contributed to higher costs for the feedlot industry.

In its submission, ABB contended that it was unlikely that its operations resulted in higher prices to end users such as piggeries and dairies. It argued that the Australian feed grain industry is highly competitive and that there are many other grains apart from barley that contribute to the domestic feed grain mix. Further, ABB represents just one of a large number of traders in this industry and that as

such it has little influence on setting prices. Recent data indicate that between 1996-97 and 2000-01 ABB sold on average 126,000 tonnes out of a total annual Australian domestic feed barley consumption of about 1.9 million tonnes. This represents about 7 per cent of the national annual total feed grain consumption, and tends to support ABB's assertion of the limited extent to which it can influence domestic feed barley prices.

The results from the Econtech model indicated that the single export desk was responsible for a slight increase in domestic prices of feed barley, resulting in costs to domestic purchasers of feed barley of about \$1 million each year, over the period from 1995-2002.

The United Grower Holdings (UGH) submission contends that the barley cash market on Eyre Peninsula has been stifled because ABB is the only cash buyer in that region of South Australia, with most of the grain being exported through Port Lincoln. Based on a Kronos (2002) report it states *"in recent harvests there have been examples of cash barley achieving a \$15-25 discount at Port Lincoln to cash barley prices at Port Adelaide. ie ABB purchase Eyre Peninsula barley at \$15-\$25 below the price they purchase it in other parts of the state and then sell it into their barley pools. The profit from this transaction can then go directly to ABB. It is acknowledged that ABB distribute a proportion of their profits to shareholders through dividends, but from the point of view of an Eyre Peninsula grower who for whatever reason sold barley for cash, they are being negatively impacted by this activity"*. ABB, however, provided evidence to the Panel that the difference in price received by growers on Eyre Peninsula and in other parts of South Australia was significantly less than this. ABB also provided the Panel with audited evidence that the extent of this practice is limited by principles which define the level of operational transparency between ABB Grain Ltd and ABB Grain Export Ltd.

The UGH submission also raised concerns about the lack of transparency with which ABB conducts its cash purchases. Of particular concern is the estimation of Port Cost Differentials, and it makes the observation that South Australian Port Cost Differentials are amongst the highest in Australia. UGH suggests that these differentials are high compared to other supply chain costs, and impact on current and future infrastructure investment in the barley industry. The Panel accepts that the industry would benefit from a greater level of transparency and accountability, and an understanding of the formula used to calculate these differentials.

In further discussion of this point, UGH indicates that South Australia possesses a number of very good at-port storage facilities, which would enable marketers to ship out most of the grain received at harvest in the first six months of a calendar year. It contends that the higher prices generally associated with this six month period would provide benefits to South Australian pool participants. Further, it suggests that such early movement of grain would result in lower storage and

handling costs for growers. From the Panel's perspective the potential foregone benefits (both higher prices and lower costs) of such early movement need to be compared to any benefits of accumulating more barley such as lower shipping costs from being able to fill appropriately sized ships. It might appear that this is an area where grower choice is limited by the current pooling and single export desk arrangements, but in the absence of detailed information on shipping and demand, it is not possible to come to any firm conclusion.

The AGEA submission stated *“Barley growers in South Australia who deliver to pools are exposed to market risk and are unable to effectively plan their operations to receive the best price for their barley. Growers delivering to the export pools take whatever price eventuates when ABB finally sells the barley, less all marketing, transport and handling costs. Growers also finance the pool, sometimes waiting in excess of 18 months for their final payments with consequent effects on cash flow”*.

Whether growers sell to the pool or sell on to the cash market seems to be dependent on several factors, including, but not limited to, the expected relative difference in price between the pool and the cash price, their financial position (in terms of requirements for cash flow), their location and access to a depth of cash markets, and their attitude to risk as well as other individual preferences. However, ABB's submission revealed that ABB offers growers a variety of packages to suit individual grower circumstances, but were asked by a significant number of growers to provide a more basic option. This resulted in the introduction of the Traditional pool in 2001. As such, these growers preferred ABB to provide the bundling of services inherent in the pooled price that they received for their grain. During discussions ABB made the observation that over the longer term the pool has outperformed cash prices and would have provided higher returns to growers. This may reflect the influence that ABB has on cash prices through setting a conservative Estimated Silo Return (ESR).

Overall, the Panel accepts that without pooling growers would have more choices and that this could result in individual growers having greater control over their exposure to price risk. Also, some growers would obtain higher prices for their barley although the average price of the crop overall might be lower. However, the Panel also accepts that many growers are happy for ABB to make many of these decisions for them. To a degree this confidence was captured in the positive responses to the SAFF survey, although, as stated above, the phrasing of many of the questions in this survey was leading.

AGEA also submitted that the single export desk system has resulted in higher supply chain costs because lack of competition in the supply chain has stifled innovation and led to inefficiencies in grain handling, storage and transport. However, ABB contends that its involvement has reduced supply chain costs. It submitted *“One of the greatest benefits for growers and shareholders of SDS (Single Desk System) is the management by ABB of all components of the*

supply chain. As explained above, maximum value is generated from SDS by participation, management and control of all points along the supply chain from grain receipt through to delivery by ship at an overseas client's discharge point. Any diminution of involvement or control by the SDS holder would ultimately reduce efficiencies and increase costs". The Review Panel also notes the Kronos (2002) report which recommended *"Industry rail and road cooperation along the lines of AWB/ABB/AusBulk arrangements in SA be continued and also encouraged in other states"*.

2.1.3 Potential impacts of full or partial deregulation

ABB submitted that following export deregulation

"overall income returned to SA farmers and ultimately the community would diminish:

- *Pricing would be focussed on the lowest returning markets for malting and feed – China and Saudi Arabia.*
- *Premiums would generally be eroded by competition or taken as trader's profits.*
- *Growers would not establish significant new links with end users, as international traders would become the exporters.*
- *Harvest prices would generally be depressed as the market cannot consume the SA crop during this period and therefore must discount price relative to anticipated future demand.*
- *Pools would be less relevant and not provide a haven of last resort for growers to avoid harvest pricing pressure.*
- *The barley crop would likely get smaller over time related to wheat and oilseeds".*

With respect to the future of ABB, the ABB submission stated *"The inescapable conclusion is that the loss of the single desk would increase the likelihood of ABB being taken over by a larger company, based outside South Australia"*.

By comparison, AGEA's submission stated that allowing multiple companies to export South Australia's barley would provide many benefits to growers. According to its submission benefits would come from:

- Higher cash prices as a result of more competition for growers' grain
- Greater ability to align marketing risk with cropping programs and risk preferences as a result of more risk management options including a variety of forward cash offers.
- Lower supply chain costs as a result of increased competition in the supply chain and other marketing areas.

In contrast to the view presented by AGEA, AWB considered that under a deregulation scenario prices to growers would be unlikely to increase. It

suggested that it was illogical to expect that traders, with a profit maximisation objective, would pay higher prices for their inputs when, as a result of increased competition, they would be getting lower prices for their product.

Whilst Laucke Mills suggested that under a deregulation scenario ABB would be likely to become both more customer oriented and more efficient, it also suggested that in the short term under a deregulation scenario that major changes would be unlikely. One of the reasons for this, it suggested, was that in the short term ABB could use its accumulated funds to stifle competition by making it harder for new entrants to enter the market in South Australia.

The AGEA submission also responded to some concerns about deregulation that had been raised to the panel by the Advisory Board on Agriculture (ABA) and SAFF. ABA and SAFF were concerned that following deregulation there would be a fall in both quality standards and security of payment to growers. The potential for a fall in quality under a deregulation scenario was also presented to the Panel in discussions with AWB. AWB considered that under such a scenario a greater effort would go towards maximisation of yield rather than maintenance or improvement of quality.

With respect to a decline in quality, AGEA argued that standards would not be expected to fall under deregulation because the National Agricultural Commodity Marketing Association has taken a major role in developing standards that are enforced at the point of receipt through AusBulk. AusBulk supported the view that receipt standards would be unlikely to fall under deregulation and made the point that quality standards are ultimately determined by customers. AusBulk also made the point that a single export desk could not guarantee the maintenance of standards. However ABB supplied evidence to the panel that traders had supplied deregulated Victorian barley into the Chinese market where it had been described as malting but that had previously been received as feed. This had impacted on the reputation of Australian barley. ABB indicated that this barley had displaced higher quality malting barley and had been sold up to US\$30 below the malting price. It claimed this impacted negatively on net returns from that market.

The ABA expressed the view that the single export desk provided growers with the security that they would always receive payment for their barley crop. They cited examples of traders suffering business failure and not paying growers. The AGEA submission presented the view that ABB is no longer guaranteed against business failure by government and would be in a similar position to other marketers with respect to failure. However, it suggested that the presence of more exporters would mean that less growers would be at risk if one was to fail. Under the current situation, the failure of ABB would have a significant effect on a large number of growers. In reporting these claims, the Panel by no means implies any suggestion of apparent risk.

During discussions AGEA also stated that following deregulation ABB would maintain a large share of the SA barley market through the relationships that it had developed with both growers and overseas importers of Australian barley. This view was supported in discussions with Ridley who indicated that should deregulation occur, the preference of a large number of growers would be to continue to sell their barley to ABB, even in the cash market.

AGEA presented a range of views on the likely importance of pools following deregulation. In one respect it suggested that the importance of pools would diminish as the variety of other risk management options increased. Another view was that growers attach a high level of importance to pools and that if growers indicated a preference for pools then some pools would be offered. A common view was that following deregulation growers would take on a much larger share of decisions about risk. Whilst some growers would welcome this role, it does require the emergence of a market for risk management products.

Other anticipated direct effects of the loss of the single export desk for barley presented by ABA include:

- Extra workload and higher stress levels on farm business members due to the additional role of marketing barley, often during peak work loads.
- Loss of independently accepted independent grain price forecasts.
- Reduced value of Australian grain branding.
- Loss of a readily available mechanism to manage price risk and to provide price smoothing and flexibility of income streams.
- Increased difficulty for farm businesses to access finance at favourable rates.
- The reduced ability of ABB Grain Ltd to negotiate an efficient pathway to premium barley markets on behalf of producers.
- Loss of an organisation with the duty to accept all barley that meets delivery standards regardless of market conditions.

Overall, the Panel accepts that under a deregulation scenario, growers would be given the opportunity to be more greatly involved in decisions about how best to handle price risk and how best to dispose of their barley. Further, that for some growers this would cause anxiety. This view is supported in the submission by the Yorke Peninsula Branch of SAFF, which stated *“A grower’s core business is to maximise the production of a quality product. The provision of comprehensive risk management for pricing and sale of grain produced is best left to a centralized service provider such as ABB”*. This submission also estimates that the annual costs to individual farm businesses of managing risk would be in excess of \$15,000. However, the Panel also notes that some growers would be keen to take on more of these activities themselves. Similarly, the Panel accepts the loss of forward price estimates that are seen as independent and accepted by financial institutions. It also accepts the increased difficulty in accessing finance at favourable rates but notes from the discussion presented above that this may not represent an overall loss to the nation. The Panel accepts that it

would also result in the loss of a mechanism which would accept all barley which meets delivery standards, but again notes that this may not represent an overall loss to the nation. The Panel notes that ABB cannot assume that, under deregulation, in all cases it would be best placed to capture a particular premium barley market.

2.2 The Modelling Process

2.2.1 The Econtech model and its findings

The effects of ABB's single export desk were modelled using Econtech's Barley Export Model (BEM). In BEM, ABB is modelled as allocating barley exports between different export markets in order to achieve price premiums in less price-responsive markets. So while BEM captures price premiums relative to sales by ABB itself in different markets, it does not capture ABB price premiums relative to other suppliers in the same market. So its estimates of gains from the single desk activities of ABB may be conservative, or may be overstated.

BEM was originally developed in 2000. It is distinguished from earlier models in taking into account that the domestic barley market has been deregulated, so it models deregulation of the export market only. The distinction between deregulation of the domestic and export markets is crucial. Deregulation tends to bring lower prices. Lower prices on the domestic market from domestic deregulation stopped price exploitation of domestic barley buyers and raised national economic welfare. In contrast, if deregulation of the export market proceeds, it may lower export prices, reducing both grower incomes and economic welfare.

The following six important enhancements were made to BEM for this review, compared with Econtech's 2000 estimates:

- more recent barley contract data were included, so that the model contract database now extends from 1995 to 2002, covering over 7,000 contracts;
- a new treatment of the Japanese feed barley export market was introduced as an alternative to the standard treatment, to accommodate a wide range of views about the operation of this market;
- two 'less restrictive' marketing arrangements were introduced into the model, lying between the polar extremes of the single desk and full deregulation;
- the sensitivity of the modelling results to alternative assumptions for price elasticities in the base markets was analysed;
- interest and holding charges were deducted from the export prices received by ABB, reducing the extent of the measured price premium for sales of feed barley to Japan; and

- \$US contract prices were converted to \$AU contract prices using the exchange rate for each year, rather than an average exchange rate.

The key findings from the 2003 Econtech modelling were as follows (The final report is provided at Attachment E):

- Over the period 1995-2002, ABB achieved an average export price premium of \$7 per tonne for feed barley, the margin by which its export pool price exceeded the hypothetical competitive price that would have prevailed in the absence of the single desk.
- This export price premium varies from year-to-year but shows no obvious trend. In 2002 the export price premium was \$6 per tonne.
- If it is assumed that the Japanese market is not special, the estimate of the export price premium drops from \$7 per tonne to \$2 per tonne. However, this ignores the role played by the Japanese Food Agency (JFA) in regulating imports of feed barley.
- The single desk export price premium raises annual grower incomes by \$10 million on average – the benefit of the single desk. This is partly offset by a loss of consumer surplus of \$1 million, because higher export prices spill into higher prices for Australian buyers of barley – the cost of the single desk. So the benefit outweighs the cost, giving an estimated annual net gain in economic welfare of \$9 million.
- These estimated gains are robust to alternative modelling assumptions. Wide variations in assumed values for base price elasticities result in the estimated net gain varying in a range of \$8 million to \$10 million – what Econtech claims to be the confidence interval for the welfare gain. The range is narrow because the estimated gains in net economic welfare from the single export desk depend largely on accurately measured price differentials.
- Of the \$9 million gain, \$8 million is from feed barley and \$1 million from malting barley.
- Of the \$9 million gain, \$8 million is received in South Australia and \$1 million in Victoria. SA is a much larger producer of feed barley, which has bigger export price premiums.
- Reducing the number of export markets covered by the single desk would reduce its scope to obtain price premiums by controlling the allocation of exports between different markets. For example, using special licences to allow open access to certain markets (China for malting barley, and Saudi Arabia and Kuwait for feed barley) would reduce the annual gain from \$9 million to \$6 million.
- Further restricting the single desk so that it only covers Japanese feed barley exports would mean having to devise potentially inequitable restrictions on grower access so that the single desk only accepts from growers the amount

of feed barley that it sells to Japan. The annual gain in economic welfare would fall from \$9 million to \$8 million.

The final Econtech report was delivered to the Panel after the hot tub debate. It was the third version of Econtech's work presented. Attachment F details the final set of modelling questions presented to Econtech by the Panel at its first meeting with this company; and Attachment G was sent to Econtech after the Panel had considered the first draft of its report. Attachment H likewise details the questions put to Econtech by the Panel after it had considered the draft final report.

2.2.2 Evaluation of the Econtech model by Professor MacAulay

Key extracts from 'Econtech's Barley Export Model: A Review' by Professor MacAulay, who was engaged by the Panel to analyse and comment on the Econtech BEM model and report, are presented below. (his first report is at Attachment I and his response to the hot tub and the final Econtech report is at Attachment J). Generally speaking, Professor MacAulay had major reservations as to whether the model was the most appropriate one to estimate the outcomes of the single desk.

Professor MacAulay reported that he was able to verify the Econtech model calculations by reproducing its results for 1995. However, he argued that the BEM can only be considered to provide an approximation to some key aspects of the price discrimination activities of ABB as it does not measure what actually happened, but allows measurement of what would happen if ABB were a perfect price discriminator. He proposed that both the Carter-Knetter model and the BEM be used jointly for the assessment.

The Carter-Knetter model permits calculations to be made of the revenue gains and losses actually made from price discrimination, and permits an evaluation of whether the results in each overseas market are statistically different from each other. Professor MacAulay suggests that this model does not necessarily produce determinative results, but that it could have been used to test the reliability of the estimated net public benefits made by Econtech. Unfortunately, this model was not included in the Panel's Terms of Reference and neither funding nor time were available to commission its application.

Professor MacAulay noted that the BEM model involves a number of assumptions that were not explicitly stated in the Econtech report, but were implied in a number of places. These assumptions are broadly as follows:

- that ABB behaves as a perfect price discriminating monopolist in relation to its exports.
- that should ABB's single export desk be removed, a perfectly competitive environment will ensue in relation to exports of barley from South Australia.

- that a reasonable estimate of what is termed the base elasticity can be obtained and elasticities for all the other export destinations are based on this elasticity, given the observed prices.
- feed barley and malt barley are not considered to be substitutes.
- the Japanese market is assumed to be fully controlled by quota.
- that the price in the domestic market under deregulation will be equivalent to the average export price.
- that no account is taken of the possible responses of other traders supplying ABB's markets.

Professor MacAulay went on to provide a detailed critique of the BEM under six main headings, all of which he considered had not been satisfactorily dealt with by Econtech. His advice to the Panel was as follows:

1. Perfect price discrimination

In the BEM model, it is assumed that ABB is a price discriminating monopolist that has complete control over the destination of its product and wishes to maximise the revenue from the sales of its product. The method of doing this is by selling relatively less into the price inelastic markets and relatively more into the price elastic markets. In this way revenue is increased over what would be obtained if there was no control over the destination and the market prices and quantities were competitively determined. To maximise revenue the 'perfect' price discriminator would equate the marginal revenue across the markets in which it has control. The BEM model also assumes that the markets remain separate in the sense that there is no subsequent trade between the markets in barley.

The results reflect what would happen if ABB were to perfectly price discriminate and obtained the prices actually measured in the contracts. The results are not necessarily a measure of what happened. There is no account taken of the fact that ABB may not have complete control over the quantities sold into a market and may not have perfect power to price discriminate. ABB may not be a perfect price discriminator since it may face competition from other suppliers in the markets it supplies and in the Australian context is not the only supplier of Australian barley to world markets. It is thus much more likely to behave as an oligopolist. Professor MacAulay proposed that the key assumption that ABB is a price discriminating monopolist should be tested through a series of directed questions to ABB (see later).

2. The perfectly competitive base

The derivation of the perfectly competitive price in the BEM model is based on the idea that if the power to price discriminate were removed by some means then perfect competition would prevail and the same price (fob) would be charged for all export destinations. In reality it is unlikely that removal of the

single desk power from a large player in the market will generate a perfectly competitive market outcome, particularly in an industry where there appears to be substantial economies of size, at least in the context of Australia.

Another difficulty with the competitive price derived by Econtech is that by using only the information from ABB to determine the competitive price, a significant amount of information is being ignored in terms of the behaviour of other players in the market, such as exporters from Canada and the United States. It would be appropriate to include more of the world's markets in the calculation of the model's base competitive price.

3. Base elasticities

The choice of base elasticity is problematical. There is a discontinuity in the marginal revenue formulae as the demand function effectively changes from downward sloping to horizontal and then upward sloping. It makes no sense to have a base elasticity which generates positive elasticities anywhere in the set as this implies an upward sloping demand function. Such a situation is unlikely to persist. The approach used in the BEM model of changing a positive elasticity to -50 was not appropriate, and Professor MacAulay recommended that the choice of base elasticities should be reviewed.

4. Feed and malt substitution

Econtech took no account of the possible substitution between feed barley and malting barley. Although both uses tend to require barley with different characteristics, there is a margin within which substitution can take place. This will be particularly the case when there is a quality downgrade for feed or when there is a large crop and what might otherwise be malting barley can be used for animal feed.

5. Japanese quota

The Japanese quota was taken into account in the BEM by setting the elasticity for Japan to zero. The implication is that Japan has a fixed demand equal to the scale parameter in the demand function which also equals the quota. This was acceptable as it allows the quota volume to be valued at the competitive price and at the export price to Japan. However, the larger issue was the extent to which recovering the economic rent from the quota restriction necessarily requires a trader with a single desk power. While the model gives an indication of the rent that can potentially be recovered for Australia given the difference in value using the estimated competitive price from the model and the actual export price, the extent to which this rent is recovered will, however, depend on the power of the trader to extract that rent in the bargains that are struck with the Japanese importers.

6. Domestic deregulation

Within the BEM it is assumed that the domestic price elasticity of demand is -5.0 and that the price in the domestic market will be the same as the pool price. The elasticity of -5.0 seems to have been arbitrarily chosen and no discussion is given of the source or rationale for the choice of elasticity. The assumption that the domestic market price is the same as the pool price is reasonable if the domestic market is dominated by the ABB and the pool is the dominant determinant of domestic prices. It would also be reasonable if there is perfect competition in the domestic market and the 'law of one price' holds. However, with some degree of substitution between malt and feed barley, then the pool price for export barley may not be the only determinant of the domestic price.

Throughout his review Professor MacAulay made several suggestions for improvements to the BEM and Econtech's analysis. He argued strongly that the key issue is that the results are really only indicators of the likely gains from price discrimination *if* the ABB were acting as a perfect discriminating monopolist. One way of determining if the ABB is acting in this manner would be to document its management procedures to ensure that the gains from price discrimination are being accessed. He suggested that the following questions might be asked:

1. Are price differences observed for the same product in markets with different characteristics?
2. Are decision-making procedures in place systematically to sell less into the inelastic markets and relatively more into the elastic markets?
3. Are market information systems in place to gain information on the price sensitivity of the various markets?
4. Are different services offered to different buyers so as to obtain different prices for essentially the same product?
5. Is reselling of grain between countries and buyers observed or not?
6. Is there a demonstrated ability to manage grain flows through time so as to sell less in years of lower volumes and more in years of higher volumes (that is, is it possible to increase or decrease stocks between time periods)?
7. Are marginal revenues equated across markets, after allowing for transfer costs (that is fob marginal revenues) rather than prices?
8. After allowing for storage charges, are different prices (fob) charged at different points in time (during the year or specific pool selling period) for the same grain?

9. Are rules in place to restrict sales to some markets and sell more freely to other markets?
10. Do export decision-makers understand, and can they explain, the factors which affect the elasticity of demand for Australian grain in an importing country?

Unfortunately, due to the tight time frame imposed on the Panel by the late delivery of the Econtech model and some submissions, the Panel was unable to explore these questions in any detail. It did, however, raise them informally in a meeting with ABB.

Other suggestions for improvement made by Professor MacAulay included:

1. It is possible to adjust the BEM to allow for various degrees of market power. It would seem reasonable to assume that the market power of the ABB single desk is less than perfect. However, this adjustment requires an estimate of the level of market power, which in general is unknown and can only be estimated through examination of market shares and other information. One approach could be to examine the results at different levels of market power using sensitivity analysis.
2. Another difficulty with the competitive price estimated by Econtech is that by using only the information provided by ABB to determine the competitive price a significant amount of information is ignored in terms of the behaviour of other players in the market. Although it is difficult to obtain data on an international scale that is separated for feed and malt barley, it would seem possible to do so for some countries and these could then be included in the calculation of the competitive price. A check on the competitive price is to review the level of prices of other major exporters in which a number of traders trade in barley. However there are issues of quality, seasonal variability and the services that are associated with a particular trade including issues of credit to be taken into account in this approach.
3. In the case of the quota, intermediate positions might be calculated rather than the two situations currently modelled (full capture of the quota rent, and using the observed Japanese price and quantity and assuming that trade with Japan was not subject to quota). A simple means of doing so is to take various proportions of the calculated quota rent as the amount gained from the activities of ABB.

While the Panel had neither the funds nor the time to pursue these suggestions, the comments by Professor MacAulay do lead it to treat the findings of the Econtech model with some circumspection.

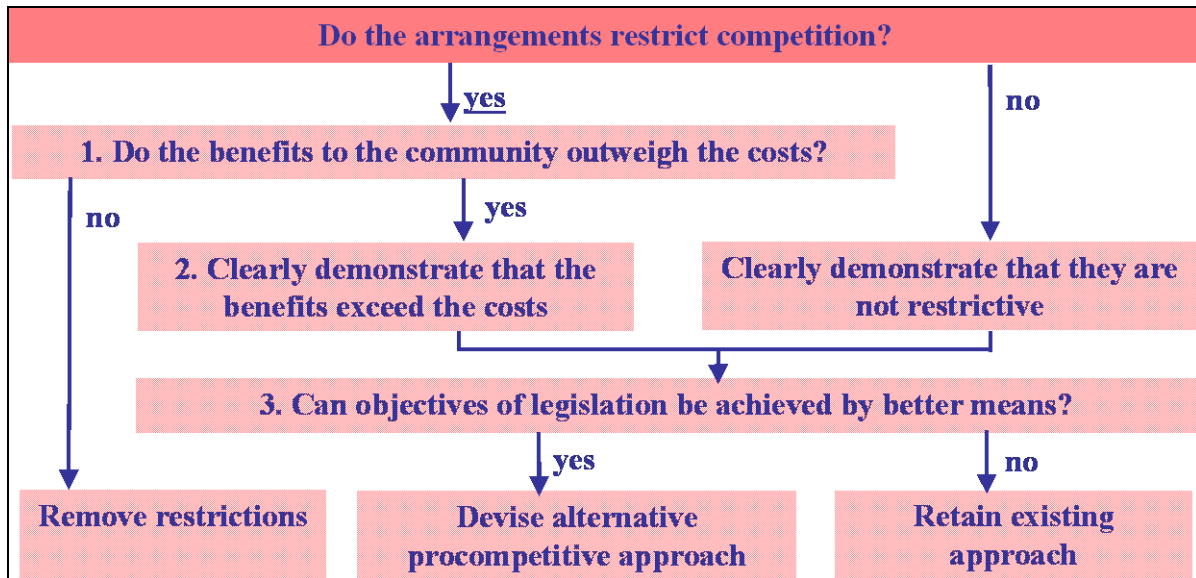
2.2.3 The hot tub

When faced with independent experts with a propensity to have opposing views, it can be difficult for a court or review body to determine which if any of the conflicting arguments might have the greatest force. This is especially the case if the experts' reports are highly technical. A procedure adopted with great success by the Australian Competition Tribunal, and its predecessor, the Trade Practices Tribunal, has become known as the "hot tub". By this process the experts are empanelled together and left to argue with each other their respective cases in front of the Tribunal, which can ask questions inquisitorially at any time.

It was the Panel's intention from the beginning put Econtech and CIE into a hot tub, given their past extensive disagreements. When CIE was no longer in the picture, and the only formal modelling was to be done by Econtech (funded by ABB), followed by a critical review of its work by Professor MacAulay, the Panel determined that a fully inquisitorial hot tub of both parties was even more essential. They were advised of this and they agreed to participate. Econtech provided in strict confidence the specifications of BEM and the data that it had used to Professor MacAulay, with the permission of ABB, and a copy of the Econtech report was made available to Professor MacAulay.

At the hot tub, which lasted a whole afternoon, Econtech made a brief presentation outlining its results and putting them in the context of a NCP review as shown in the following chart:

Diagram 1
Guidelines for NCP Reviews



Professor MacAulay responded with an outline of his critique of the model, and Econtech responded to that. Both parties then engaged in free flowing argument, both between themselves and with the Panel. Professor MacAulay was able to

verify the Econtech model, that is, he confirmed that he was able to replicate its results, but he expressed doubts as to the relevance of some of its assumptions, mainly with respect to elasticities and whether ABB acted in the price discriminatory manner assumed by Econtech. Econtech countered by saying elasticities did not determine the model's results, which rather were driven by relative prices. It justified its use of a price discrimination model by saying that it was of the type that had been previously been approved by the NCC for evaluations of a single desk exporting authority.

Professor MacAulay argued that while the Econtech model may have been of the kind endorsed by the NCC for evaluating the effects of single desks, it did not actually show what ABB is actually achieving. He recommended instead that the Carter-Knetter model be used for this task. Econtech rejected the need to use this model.

The Econtech model had not used any estimate of ruling world competitive prices for barley but had determined a competitive price from within the operation of the model. This adds even greater uncertainty to any interpretation of its estimates. As Professor MacAulay argued in the hot tub, the competitive price in each market is critical in evaluating net public benefits, and they should have been collected. He also pointed out that Econtech could have investigated rival sellers to ABB from other countries, and their prices could have been used as a guide to what ABB would face in a deregulated future for a "future with and without evaluation". The Panel agrees. The most appropriate way in which to assess whether a single desk should be retained is to compare the outcome in the future with it still in operation, compared with the outcome that would be achieved in a more competitive environment.

Econtech argued also that it had not been able to incorporate into its model any of the intangible benefits associated with the single desk such as the insurance premium equivalent of running the export pool, and also the role of ABB as buyer of last resort, leaving the Panel with the impression that the estimated benefits were very much subject to a host of factors that could push the net benefit figure either up or down. The Panel has no way in which it can determine the true net benefit figure, especially when it is considered that one of the main characteristics of a single desk, which is the denial of choice to growers as to whom they can sell their barley, is also not easily modelled.

The Econtech model assumes implicitly that ABB makes full use of its monopoly powers in acting like a price discriminator between markets. Professor MacAulay questioned this assumption and the Panel sought an assurance from Econtech that it had verified with ABB that it in fact acted thus. Econtech replied that it did not believe that such questioning was useful, a response that the Panel did not find helpful. Rather than trying to understand how in practice ABB decides to sell its barley into export markets, Econtech committed to a theoretical model. It argued that it did not need to ask these questions as ABB had as a stated goal

the desire to maximise revenue to growers, and that therefore the price discrimination model was the correct one to use.

The Panel notes, however, that even a single desk monopoly exporter like ABB is exposed to restraints imposed by international supply and demand factors, and that domestic issues also impinge on its export operations. In addition, there exists the possibility that ABB could exhibit some of the traits of the “lazy monopolist” that is not subject to rivalry for its purchases of export barley, such that its costs may not be minimised, or that it may not have extracted the largest possible export premiums, and that it may not seek in practice to equate marginal revenue in each export market, which is a fundamental assumption driving the Econtech model.

Considerable debate took place between Econtech and Professor MacAulay over the most appropriate choice of the model’s base country and base elasticity, as the model is driven in a relative sense from these cornerstones. Depending on this choice, quite different estimates will be obtained. Econtech’s response was that its model was robust regardless of these choices, a conclusion with which Professor MacAulay disagreed, as was the case with the two parties’ argument over the implications of the positive price elasticities that emerge in the Econtech model.

Given evidence that had been presented to the Panel of substitution of feed barley for malting barley in some export contracts by some traders, the Panel had expected the modelling process to take this possibility into account through an assessment of cross-price elasticities, but Econtech argued that this was essentially done in its determination of the competitive price. The Panel did not find this response to be entirely convincing.

Detailed questioning from both the Panel and Professor MacAulay could not shake Econtech from its belief that its model had produced a definitive result. However, economic modelling of this kind is part art, part science, and it is necessarily a simplification of the real world such that there can never be one correct model, and, in the absence of an appropriate counterfactual, the results of the model can at best be taken as offering a possible but necessarily imprecise estimate of what has happened in the past. It offers no basis on which realistic future projections can be made.

The hot tub left the Panel with the impression that the assumptions of the modelling exercise may have caused the model to conceal at least as much as it revealed. Given the construction of the model, there does appear to be some net public benefit from the single desk operation of ABB, but this would appear to come mainly from the sales of feed barley to Japan, and the actual quantum of the monetary benefit coming from the price premium obtained by ABB is quite uncertain, and could in the opinion of the Panel be relatively small in dollar terms. Econtech did admit during the hot tub that most suppliers to Japan through the

JFA received substantial premiums, although it argued that there was a risk that ABB could lose access to this market if it lost its single desk powers. Yet the Panel observes that many if not most of the suppliers to Japan are private traders, and believes that the Japanese preference for dealing with single desks is now largely a matter of history rather than a reflection of current trading realities.

Generally, the result of questions put to it during the hot tub was that Econtech would not amend its theoretical assumptions and embrace any notion of trying to make the estimation process more practical or forward looking, as ideally is needed for a “future with and without” test.

The Econtech model was of some assistance to the Panel, however, in so far as it produced some historical estimates of annual net public benefits from 1995 to 2002 associated with the single desk (but not necessarily causally related to it), benefits which varied widely from year to year, from feed to malting barley, and from geographic market to geographic market. The results showed that by far the greatest proportion of the modelled net public benefits came from feed barley sales to Japan, with some other non-marginal benefits also attributable to feed barley sales to the United Arab Emirates. High measured premiums were also found on malting barley sales to Japan and to a lesser extent Taiwan, but the tonnages in these two markets were relatively small.

The Panel sought evidence of robustness in the Econtech results, and it was claimed that over a range of elasticities the results held up. Yet with no formal statistical error allowance being possible, and with evidence of significant variability in earned premiums (which undoubtedly include payments for higher levels of cost incurred in delivering the export packages) between the years, the Panel came to the view that the results were useful on perhaps an ordinal rather than cardinal basis, at least in identifying the source of most of the estimated net public benefit. In the absence of real counterfactuals, the Panel could not place any great weight on the absolute level of the estimated net public benefits, especially in light of the fact that cl 5 of the CPA requires that the net public benefits attributed to a legislative restriction on competition must be demonstrated, and it must also be shown that they could not be achieved in any other more competitive manner.

In order to try and answer the second part of the cl 5 requirement, the Panel had asked in its brief to Econtech that it investigate the net public benefits emanating from alternative scenarios, including complete deregulation, a single desk covering Japan only, an “opt in opt out” situation, and the Western Australian legislative model, in which ABB would continue to hold the main export licence, with special licences being granted to grain traders for particular markets if they could present suitable evidence to justify this.

In this modelling, Econtech assumed, questionably, that no special licences would be granted to markets in which a high premium had been estimated, and so assumed that markets with lower prices would be the ones most likely to be granted a special licence to export. It assumed such licences would be granted for malting barley sales to China and feed barley sales to Saudi Arabia and Kuwait, thereby lowering prices in these markets instantly to the modelled competitive price. It was estimated that the annual net public benefit from the single desk would fall from \$9 million to \$6 million, but cautioned that these were gross estimates that did not take account of the costs of administering such a scheme. The Panel was not convinced that these would be the only markets in which special licences might be granted, nor that prices would revert instantly to the competitive price in markets where licences are granted. It would have liked to see convincing evidence of the likely time path of adapting to the issue of competitive export licences, but no such estimate was made.

2.2.4 Summary of the MacAulay criticisms

Professor MacAulay, in his original report to the Panel, and in his contribution to the hot tub, made several strong criticisms of the Econtech approach. None of them were accepted by Econtech, largely it appears on the grounds that the comments were not significant. The Panel, however, believes that criticisms are valid and lead to some doubt as to the weight that it can put on the conclusions derived by Econtech from its model.

First, Professor MacAulay argues that the assumption by Econtech that ABB acts like a perfect price discriminator is invalid, and he thus cautions that the results should not be interpreted as the gains ABB has received from the single desk. Instead, he warns that the results can only “reflect the gains the ABB could have received had they behaved as a price discriminating monopolist”. In the absence of perfect knowledge and by not equating marginal revenue across all markets, ABB clearly does not act like a perfect price discriminating monopolist, and so the estimated net public benefit is likely to be overstated.

Second, Professor MacAulay points out that in the event of deregulation, ABB would certainly still retain some market power and so it could continue to practise price discrimination to a degree, thus blunting some of the gains available from deregulation. He notes also that ABB does not determine the competitive world price for barley (its share of world barley sales is quite small compared with those of the US and Canada) and so the Econtech model, which used ABB sales to determine the competitive world price, produces estimates of net public benefits that could overstate or understate the true figure, depending on what real competitive price is.

Third, Professor MacAulay argues that Econtech made an arbitrary choice of the countries whose elasticities of demand were to be used as the bases for determining the competitive feed and malting barley prices, such that the results

may not in fact estimate the true net public benefit. However, it is agreed by Professor MacAulay that the value of elasticities chosen as a base does not significantly affect the results, which are more affected by the choice of the base country, which determines the competitive price to be used in the model.

Apart from these specific criticisms of the Econtech model, Professor MacAulay warned the Panel that it should be aware that there may be natural economies of size in the grain sector in Australia, due to falling transport and communications costs, which lead to an enhanced ability to operate large and complex organizations. He cautioned the Panel to be wary of any deregulation option that left open the possibility that the barley industry could become dominated by “an even more powerful natural monopoly in which the rents go to those who own the market power”. The Panel believes that this is sound advice.

Despite his criticisms of the Econtech model, Professor MacAulay conceded that the modelling does show “a strong likelihood of gains being obtained from price discrimination”. However, he strongly warned that these gains “will generally be small and some of them will be dissipated in additional costs or traded as benefits to enhance market share”.

2.3 Developing market issues

The marketing environment in which ABB operates is one of continued change and any assessment of the single export desk needs to be made against that changing environment, rather than against what has happened historically. In this section some of these changes are briefly discussed.

2.3.1 Japan

Prior to 1999 all purchases of imported barley for both malting and feed purposes were made under annual supply agreements between single export desk entities and the Government of Japan. In 1999 the Simultaneous Buying and Selling (SBS) system was introduced. The SBS system only applies to imports of feed barley. There are now two government controlled purchasing systems in place – the Japanese Food Agency (JFA) system and the SBS system.

Under the JFA system, the JFA conducts regular tenders for both feed and malting barley through registered importers such as Mitsui, Mitsubishi, Marubeni and Itochu. Up until 2002 JFA negotiated annual supply agreements with single desk entities such as ABB, GPWA, Grainco, NSWGB and CWB. Japan decided in 2002 that it would no longer negotiate any barley and wheat agreements.

With the development of the SBS system, the share of Japanese purchases of barley at JFA tenders has declined whilst the approved quotas for SBS have steadily increased from 360,000 tonnes in 1999 to 850,000 tonnes in 2003, to represent approximately 50 per cent of feed barley imports. Whilst the share of

barley imported through the SBS system has increased total barley imports into Japan have remained relatively stable.

In 2002, under the SBS system, barley was purchased from Ukraine, rather than just from the traditional sources of Australia, Canada and the United States of America. It has been estimated that the importation of barley from Ukraine represented nearly 10 per cent of SBS tenders in 2002.

Whilst the Japanese feed barley market remains highly controlled compared to other markets, the changes in this market since 1999 point to a possible reduction in the proportion of barley imports directly controlled by the JFA. As such, there would be increased competition for this market.

2.3.2 World supplies

Connell, Barrett, Berry and Sheales (2003) forecast that world consumption of feed grains is likely to increase by 5 per cent between 2002-03 and 2007-08, with growth mainly occurring in the United States, China, the Russian Federation, eastern Europe and south east Asia. ABARE projects that much of the increase in coarse grain consumption will be the result of increased per capita incomes in the developing countries. Such changes in income are expected to be associated with changes in dietary preferences towards more processed and higher protein based foods such as meat.

Whilst the area under grains has remained virtually unchanged over the last 20 years, grain production has increased as a result of improvements in productivity. In many cases, government policies have contributed to higher output by making payments to growers well above ruling world prices or through trade policies that insulate domestic producers from world prices (Connell, Barrett, Berry and Sheales, 2003).

Gradual consolidation of farms, liberalisation of grain trading and privatisation and modernisation of grain handling infrastructure along with low labour costs and access to cheap energy have contributed to an expansion of grain production in the Russian Federation and Ukraine (Connell, Barrett, Berry and Sheales, 2003).

Both direct payments to compensate growers for the reduction of support prices and a set-aside scheme were introduced in the European Union (EU) under Agenda 2000. More countries are expected to join the EU and grain production from the enlarged EU region is expected to increase as the agricultural industries in these new member countries adapt to the support provisions of the Common Agricultural Policy (CAP).

In the United States the Farm Security and Rural Investment Act of 2002-07 was signed in 2002. Connell, Barrett, Berry and Sheales (2003) expect that this new

bill will encourage US farmers to both plant more of the supported crops and to use more inputs to increase yields.

2.3.3 Alliance with the Grain Pool of WA

In late 2001 ABB formed an international marketing alliance with the Grain Pool of Western Australia (GPWA). This alliance is called Grain Australia and becomes what ABB believes is the world's single largest exporter of barley. According to ABB, this marketing alliance should increase its strength on the international market, with both organisations working together rather than competing with one another. ABB also expects the alliance to result in increased efficiencies with respect to the costs of both international representative offices and shipping with Grain Australia having 14 grain terminals around the coast of Australia.

2.3.4 ABB/Josscos merger

In May 2003 ABB announced its plans to purchase Josscos, a privately owned group of commodity trading companies operating in NSW and Queensland markets, as well as exporting pulses, cottonseed and sorghum.

The acquisition of Josscos will result in ABB gaining new grain acquisition and trading offices in Toowoomba, Moree, Sydney, Auckland and Christchurch. ABB expects that the acquisition will increase both the supply and variation of grains marketed by ABB, as well as increase its grain financing and marketing services to growers in NSW and Queensland.

2.3.5 Victorian deregulation

Barley exports from Victoria were deregulated from 1 July 2001. Whilst two seasons have passed since full deregulation in Victoria, there are insufficient data to draw strong conclusions about either how deregulation in Victoria might affect the South Australian single export desk or about what might happen in South Australia if the ABB single export desk were to be deregulated. One of the reasons for this is that the most recent season has been a drought, with Australian barley prices being driven by domestic demand rather than by export markets. However, since deregulation of the Victorian market traders operating there have accumulated barley for export into China in competition with ABB. ABB has actively sought barley from Victoria and has developed a Victorian No 1 pool so that Victorian growers can still have access to ABB's pools. In addition, there is some indication that both spot and forward prices received by Victorian growers not delivering to ABB are no less than those paid to South Australia growers. The Panel notes here, however, that the Victorian barley market sells a much higher proportion of its crop into domestic markets, in contrast to South Australia where the majority of the crop is exported.

2.3.6 Malt and AusBulk

In December 2002 AusBulk acquired Joe White Maltings (JWM). This followed the acquisition of Adelaide Malting Company (AMC) in April. This extra acquisition has significantly increased the annual malting barley requirements of AusBulk. To ensure that it has the right quality profile for production requirements, and to allow for a significant downgrade of malt barley to feed quality, the accumulation requirements of AusBulk have also substantially increased. The extra accumulation requirements have also raised the issue for Ausbulk of its ability to sell barley surplus to its needs back into ABB's pools. The two malting company acquisitions by AusBulk also demonstrate how its business is rapidly changing as it expands its core business from logistics and storage and the handling of grain into other value added activities, including the marketing of grain.

2.3.7 International trade negotiations and US single desk objections

Many other countries are moving towards more liberalised trade arrangements. Under the 1994 World Trade Organisation (WTO) arrangements, state trading arrangements including statutory marketing authorities (SMAs) with monopoly powers are under review. These developments and Australia's desire to promote further significant deregulation in agricultural trade are placing extra international pressure on the removal of the single desk selling powers of SMAs. In addition, SMAs have been identified as an issue in the potential development of a free trade agreement between the USA and Australia.

PART 3

ASSESSMENT OF THE FINDINGS

3.1 What is a premium?

Before the Panel begins its assessment of the single desk, it is appropriate to clarify what it understands by the word "premium".

The term "premium" is frequently used when describing the prices obtained in export markets by a single desk exporting authority, but its definition is rarely carefully spelled out. The Panel notes that in theory a premium is not, as appears to be commonly used by growers and those associated with the grains industry, a price obtained in one market that is higher than the price obtained by the seller in a different geographic market. Like must be compared with like.

The Panel does not believe that the prices obtained by ABB in markets like Japan can be properly termed "premium". While they may be higher than the competitive world price, they nevertheless are on a par with those obtained by rival sellers from other countries offering a similar product.

In addition, if a higher price is obtained because a product is simply better, then the price reflects that higher quality. Also, if the price obtained is higher simply because the total package of product, quality, service, delivery terms etc is more favourably regarded by the buyer, then part of the so-called premium is simply a recovery of the extra expenses incurred in differentiating the product in this way. It is not a return of something for nothing. However, the Panel agrees that if the pool price covers these costs and if market access is gained by the overall package delivered by the single desk, and if this return can not be achieved in any other way, then a premium has been obtained.

The Panel believes that a premium is more correctly understood as being a higher price which the seller can obtain for the same quality of barley sold under the same terms of service, delivery etc, compared to a rival seller bidding into the same market. In this sense the premium reflects competitive superiority over rivals and is a return to entrepreneurial abilities. It is this sort of return that justifies the creation and retention of a single desk – it is a return that rivals, both domestic and foreign, are unable to achieve when fighting with competitive parity on a level playing field; all participants have an equality of opportunity to win a contract, but one seller for whatever reason brings in a higher price.

Thus, if ABB can negotiate a higher price with Mitsui for its quota under the JFA importing system, by means of long-standing commercial relationships, trust, longevity, and reputation, that no other trader can achieve, i.e. the higher price is

not otherwise achievable, then the difference between this higher price and the next best price obtainable for the same package is the true premium.

The Panel believes that a premium is a reward for competitive excellence above the next best price that a well-credentialed rival could achieve. To measure a premium by the excess of an achieved price over a hypothetical benchmark competitive price will overstate the true return to a single desk.

3.2 The Econtech model and its findings

3.2.1 The relevance of the assumptions

As has been noted previously, the Panel is not convinced that the Econtech model is the most appropriate one to assess the outcomes of the single desk for exporting South Australian barley. The Panel acknowledges that the model developed by Econtech is of the sort commonly used to assess whether price discrimination can be carried out profitably in exports to different markets, and recognizes that the NCC appears to have endorsed the use of such price discriminating models in such situations. However, the Panel believes that in the real world the conditions faced by ABB are quite different to those assumed as key characteristics of the Econtech model.

The Panel believes that ABB does not possess perfect information about demand characteristics in all of the markets into which it sells, nor that it sells identical “total” product into each market (the barley may in many cases be physically identical but the package of services etc clearly differs from market to market), nor that the ABB seeks consciously to equate marginal revenue across all export markets, which is the requirement for the goal of profit maximization that lies at the heart of the Econtech model.

In addition, it appears to the Panel that ABB does not act as the short-run profit-maximizing opportunist that the model depicts. Rather, ABB seems to take a much longer-term view of developing new markets and preserving older ones, in the process carefully judging the best long-term time path of prices, after allowing for seasonal supply influences. It does not appear to be using its significant market power to achieve the best short run result achievable from each individual market.

With the increasingly competitive international market for barley, ABB would appear to have even less opportunity to systematically practise across all markets the sort of price discrimination on which the Econtech model is founded.

The premiums identified by Econtech could be due to one or more of at least four sources – market power, price discrimination, a return for extra costs, or pure price premiums due to marketing superiority. The Econtech model, being one

based on assumptions of price discrimination, has not offered any enlightenment as to the underlying causes or sources of the premiums that it has measured.

The Panel believes that the Econtech model's calculations of the premium probably overstate the real "value added" obtained by ABB from the single desk. This is because the model generates hypothetical competitive prices, which are then compared with the export spot prices, adjusted for insurance, freight and holding costs. The benefit obtained from the single desk is more accurately measured by a comparison of the prices obtained by ABB with those obtained in the same market for comparable grain and associated services by its overseas rivals. Such a comparison was not done, nor indeed could it easily be carried out without access to confidential commercial contract data. Thus the Econtech estimates of the premium should be regarded, the Panel believes, as upper limit estimates.

These factors must be taken into account by the Panel in its assessment of the legislative restriction on export barley competition, as the only valid way of assessing whether the restriction is in the net public interest is in terms of a "future with and without" investigation, in which the future is assessed by reference to a scenario with the restriction still in place, compared with a scenario where more competitive forces are in effect.

The Econtech model was not applied in a "future with and without" context. Its approach was entirely historical, despite the Panel asking it to consider a "future with and without" approach. Its results tell us that some premiums have been found in the past, but they do not prove that the single desk per se is responsible for them – that is, causation is not proved by mere association and description, and the estimates do not provide positive proof that such premiums will continue into the future. Indeed, the only time Econtech assesses the future is to opine that, should ABB lose its single desk powers, the premiums will not dissipate immediately but will disappear over "a process that may take about five years". While it would be unrealistic for the Panel to expect Econtech to have produced detailed projections as to the likely future premiums that ABB could be expected to earn, some tentative future estimates in the light of forecast changes in the international barley market would have been of assistance to the Panel in evaluating the single desk in the proper "future with and without" framework.

In addition, as has been noted elsewhere in this report, there are many aspects of the single desk operation that the Econtech model does not, and cannot in fact, quantify. Thus the Panel believes that the Econtech results should be regarded as informing its evaluation of the single desk, but not being determinative of its conclusions. The model is to a large extent one-dimensional, although the Panel admits that there is unlikely to be one single correct approach to modelling a single desk.

3.2.2 The absence of a counterfactual

Even so, the Panel still has reservations about the conclusions drawn by Econtech, given the absence of a counterfactual with which the single desk premiums can be put to the test. The Victorian deregulation experience is very recent, and has been compounded by one very poor season, while the Western Australian legislation, that offers the potential for competition to the existing single desk operator, has not yet come into operation. However, evidence available to the Panel suggests that while Econtech has found that high premiums are obtained by ABB in Japan, the prices which it has achieved there are not significantly higher, and in some cases are lower, than exporters to Japan from other countries that are not single desk operators have achieved.

The problem with the Econtech model, as the Panel sees it, is that it compares the prices obtained by ABB with hypothetically derived competitive world prices, and not with prices obtained by rival sellers offering the same total package of services and quality of barley. The Panel believes that the Econtech approach in all likelihood overstates the true premium being obtained by ABB, when the premium is defined and measured in the way it thinks is proper.

The premiums estimated by Econtech come from a model that is complex and full of uncertainties and assumptions that are arguable, as was brought to the Panel's attention by Professor MacAulay. The estimated results are necessarily descriptive, in the sense that no error allowance can be made for the estimating process. Rather, the approach was to model a number of different scenarios based on different underlying assumptions, and take the range of outcomes resulting from this process as the likely range over which the "true" picture might lie.

Thus it appears to the Panel that a prudent observer might not accept Econtech's estimate of \$9m as the net benefit of the single desk. Rather, a lower figure might be a safer one on which to base any recommendations. When on top of this all the unmeasurable benefits and costs of the single desk are taken into consideration, the Panel does not feel comfortable in concluding unambiguously that a significant net benefit can be ascribed to the single desk. Price premiums certainly have been found by Econtech in the context of its model, but they might best be treated in some ordinal rather than cardinal fashion, as the estimating process is complex and full of statistically-unmeasurable uncertainties.

3.2.3 Are the premiums causally related to the single desk?

Even if the premiums estimated by Econtech could be accepted as valid, numerous other problems remain in using them to estimate whether the single desk powers held by ABB satisfy the cl 5 test of the CPA.

The Econtech model does not prove that the premiums it has found are ascribable only to the single desk. Some premiums have undeniably been

achieved by ABB, but there is nothing in the modelling or in Econtech's report to suggest that these premiums could not be achieved under any other form of exporting arrangement, or that while premiums might be lower under some alternative selling regime, costs could also be less. The Econtech model has identified correlation, but not causation. To infer the latter requires a leap of faith unsupported by the evidence in front of the Panel.

Several stakeholders told the Panel that the single desk for barley had solved many of the problems faced by growers in the past when barley was sold in an unregulated export market. They believe, and the Panel accepts, that the single desk has made life much easier for them, and has led to premiums being obtained from some markets. That having been said, however, does not prove that the premiums currently being achieved could only be achieved under single desk export powers. Other export regimes may be no less successful, or at least no worse in a benefit-cost sense, in delivering the same returns to those growing barley.

3.2.4 Other factors that could explain the premiums

The Econtech model fails to consider in any detail a number of other factors that could account for the premiums that are ascribed from the model to the single desk operated by ABB. For example, the premiums coming from the Japanese feed barley market, by far constituting the majority of the net public benefit identified by Econtech, may represent ABB being able to derive a share of the importer's rents, given the quota system under which the JFA administers feed barley imports into Japan. Such a bilateral monopoly division of rents may have nothing to do with the existence of single desk export powers, and may still be achieved by ABB if its legislative monopoly were to disappear.

The premiums that ABB has earned are in all probability not pure price premiums, but rather comprise to some extent payment for the extra services provided by ABB that accompany the mere physical transfer of barley as a commodity. These services provided by ABB are not costless, and it is not correct to assert that the price premiums are a net return to the single desk per se. They are a gross return, and the opportunity cost of providing these add-ons must be netted out of the premium in order to determine the true value added by ABB due to its single desk powers.

The Panel believes that while it is undeniable that premiums as measured by Econtech have been achieved in Japan and to a lesser extent elsewhere, no proof has been provided that such premiums could not be achieved in the absence of single desk powers. ABB, the Panel has been told, and accepts, has excellent marketing skills and long-standing relationships with its overseas buyers. It has a reputation for quality, service and delivery that would not desert it if it were to lose its legislative monopoly over barley exports. New entrants into a deregulated market would have to work hard to overcome its pioneering brand

advantage. Overseas buyers would not easily give up the benefits of a long standing and reliable source of supply. ABB would still have considerable market power in the event of deregulation, and any attrition in this market power would likely be slow, as the Panel cannot see why ABB would not fight to keep its market share.

Even disregarding the issue of the appropriateness of the data used by Econtech, the results presented by it do not display evidence of either a high or constant premium or a sustained increasing premium being earned, either in aggregate or in separate geographical markets or in separate feed and barley markets, except perhaps for some instances where volumes sold are relatively small.

Along these lines, the Panel notes the apparent change in Japan with respect to imports of feed barley. The JFA is gradually relaxing its strict quota controls over the import of barley and appears to no longer display a strong preference for dealing with government backed sellers. With the new SBS system, it must be expected that feed prices for export barley to Japan will fall in the light of increasing international competitive action, and a single desk for South Australian barley will not be able to stem the downward effects of these international supply and demand pressures.

Unlike Econtech, the Panel is not convinced that the estimated premiums present compelling and unchallengeable evidence of a net public benefit from the legislative restriction on competition that is not otherwise achievable, and thus it believes that consideration must be given to alternative legislative approaches for the export of South Australian barley.

3.3 Non-quantifiable aspects of the single desk

The Panel has already noted that the Econtech model is unable to take account of numerous factors associated with the single desk that undeniably offer utility to barley growers in a number of ways. Some of these factors may be otherwise available to growers, but in less attractive packages or at a greater cost, or only associated with adjustment costs.

These factors are undeniably an important part of the services associated with the single desk. The Panel cannot quantify them, but acknowledges that they are important to many growers. Among the many variables brought to the Panel's attention are the following:

- ABB would no longer have any obligation to maximise pool returns in the absence of a single desk. This culture would change ABB from being a marketer to "just another trader". The obligations of the ABB board would be to its shareholders. The profit to turnover ratio would likely increase. Revenue would be transferred from growers to shareholders. "A" class shareholders

could eventually disappear. "B" shareholding would increasingly be held by non growers. The constitution of ABB would change to allow for potential take-over.

- ABB's terms of access to finance would change. CBA provides finance for about 70% of the pool value with ABB having a considerable loan facility. ABB obtains that finance at the market rate plus a favourable margin. An individual grower would pay the market rate plus a significantly larger margin. For some growers the effect of this increase in their financing costs would also mean that their total effective available facility would be less. If the single desk for wheat also disappeared, the effect would be significant. The majority of cropping costs are debt funded. There are questions as to where the security would come from in the absence of a single desk.
- Risk management poses a problem. The only avenue available post deregulation, assuming any pool being run would be for the benefit of the trader (not the pool), would be forward pricing by contract, which can lead to expensive mistakes being made by growers. Another problem with barley is that there is no available mechanism to hedge the position taken. Growers and traders would have to 'pick winners'. Many would argue that taking a forward position with no hedging arrangements is the most risky way to market grain.
- In the absence of the single desk there would be no buyer of last resort. No commercial company would take up this responsibility without market influence. This would cause serious problems for growers in the years when over supply, reduced demand or quality problems occur. Added to this would be the compound effect of tonnage being carried forward to be priced against a new crop.
- ABB has told the Panel that the most valuable asset of the single desk pool is the knowledge of stocks and the capability to market a crop over time. To be able to withdraw from the spot market without losing market share is critical. The economic cost of a larger carry over of low quality barley in a weak market that all traders would have knowledge of would be significant.
- The domestic cash market currently takes its lead from ABB's estimated pool returns. The starting point is the pool. There is no doubt that the cash market would become more volatile in the absence of a single desk. Any trader that wanted to run a pool would find it difficult to flag an estimated pool return because as soon as it announced it, the market would be informed and its competitors would have an advantage.
- Growers don't like wide daily fluctuations in price with no hedging mechanism that makes marketing a lottery. No single desk would mean the advantage of stock swapping would reduce or disappear, decreasing competition for barley

not grown close to domestic markets. This could have a major impact on regional communities in terms of private and public infrastructure, population demographics, and social and economic change.

- Growers know that they will receive a substantial part of the final price from ABB soon after delivery, even though at that time the final pool price cannot be known. It was argued to the Panel that there was the risk that a trader might be unable to pay, unlike ABB, which had substantial funding available to it. The Panel agrees that such comfort could be important to growers, but notes that this safety blanket comes at a cost, including lack of choice for the grower, and delayed final payment of an uncertain amount for the grower's crop, rather than the grower receiving a known amount on delivery of barley to the storage facility, and interest costs on the advance from ABB.
- While even ABB cannot control price variability due to seasonal conditions and international supply and demand factors, growers do value lower income variability and several parties submitted to the Panel that the operation of pools acted to give growers this comfort. It was especially pointed out that the buyer of last resort facility meant that in abundant harvest years or when the crop was badly damaged, growers could be certain that their crops would ultimately be disposed of through storage, manipulation of stocks, and blending. It was argued that this service would not be available in the absence of a single desk, yet the Panel was told that traders were known for blending different qualities of grain to match a buyer's overall specification.

The Panel readily admits that the foregoing factors are undeniably characteristics of the operation of the single desk to which most, but possibly not all, growers attach significant value. However, other non-quantifiable factors associated with the single desk exist which have been argued by some parties to be not in the public interest. Among these are the following:

- The single export desk denies growers the choice as to whom to sell their export barley. ABB is the sole buyer. Growers are therefore not allowed to make their own independent commercial decision as to whom, and on what conditions, they will sell. Growers situated close to the Victorian border do have a choice, as they can transport their harvest into the deregulated Victorian market where it can be sold to any trader. Growers on Eyre Peninsula, however, face large transport costs to take advantage of this option, and so are not treated in the same manner as those in the South East of South Australia.

A more efficient market outcome would be achieved if growers had a choice of buyer. Markets work best when there are no artificial barriers to new entry. In this situation buyers and sellers are free to respond to market forces. The operation of the single desk precludes the operation of these forces.

While the Panel accepts that many growers believe that the advantages associated with a single export desk outweigh the loss of choice, this lack of choice might be important for others, especially for those whose crop is of high quality, although currently under the single desk there does exist a sliding scale of payments for barley of different qualities. This is determined by screenings, test weight, weeds and other contaminants in the case of feed barley, and in addition malting barley is classified for protein, trueness to type and harvest damage. Growers of feed barley will be paid directly against broad delivery grades, while growers of malting barley will be paid a base price plus a margin for screening protein advantage, thereby rewarding quality. In a deregulated environment it would be reasonable to expect similar arrangements. Traders who wished to capture a special advantage would need to differentiate grain parcels by other means.

- It was suggested to the Panel that ABB as operator of the single desk might not have been as extensively involved in innovation as might be hoped for. While ABB has certainly been active in developing shochu malting barley for sale to Japan, it has not been otherwise especially prominent. Indeed, it has emphasised as one of its strengths its ability to market older strains of malting barley and get good prices for them in the face of better international varieties being available from Canada (but which are not agronomically suited for growing in Australia).
- It was suggested to the Panel that ABB's strong export focus, except in drought years, had a detrimental impact on the operations of domestic feed grain buyers. However, these buyers buy a mixture of grains for blending to the protein requirements of their customers and in this sense they can readily substitute out of barley into other grains and pulses should it be inappropriately priced or in short supply.
- It proved to be difficult for the Panel to obtain any cost data by which it could benchmark the operation of ABB. As a single desk operator, it might be assumed that ABB can operate more efficiently compared with several traders exporting barley. But in the absence of competitive pressures to minimize costs, this may not happen. In addition, international grain traders are much bigger than ABB, and so could be expected to have lower unit costs due to scale and scope economies. On the data before the Panel, it is not possible to assess the relative cost position of ABB in relation to other grain marketers and traders.

3.4 Evaluation

3.4.1 Alternative options to be considered

The Panel was asked to assess the single desk operations of ABB to determine whether they resulted in a net public benefit that could only be achieved through this legislative restriction on competition. In the terms of reference the Panel also was asked to examine alternatives to the single desk that could be pursued in order to achieve the goals of maximizing net public benefit.

This necessarily required the Panel to consider complete deregulation as well as alternative ways of marketing barley that lie between the extremes of a legislated export monopoly and a free market. Four alternatives were considered: full deregulation; a partial deregulation based on ABB losing single desk powers to all markets but Japan, where the major part of its success appears to lie; an “opt in opt out” model where ABB retains most of its current powers but growers who choose to sell to another buyer are free to do so; and the new Western Australian legislation, in which the single desk remains but is subject to market forces if applicants can prove to a licensing authority that can they operate into a market without harming the premiums obtained in that market by the single desk operator.

3.4.2 The test that must be satisfied

The Panel was told by many stakeholders that ABB had done an excellent job and that it had operated to the benefit of South Australian growers and their communities. But the test of whether legislative restrictions on competition should continue is a wider one than this – it is required to be shown that the restrictions lead to a net public benefit for the Australian community that could not otherwise be achieved in a less anti-competitive way at the same cost. In other words, the impact of the legislation must be considered across all sectors of the economy and across all states, and even if there exists a clear and credible net public benefit, consideration must be given as to whether this benefit could be achieved at the same cost or less by some other administrative arrangement that is less anti-competitive.

In this exercise, the burden of proof lies on those wishing to see the legislative restriction on competition continue to operate. It will not be enough to show simply that benefits exist. The Panel must be convinced that the test of cl 5 of the CPA is met, before it can recommend that the legislation supporting the single export desk should remain in operation.

3.4.3 Factors to be considered if a legislative change is warranted

In the event that the Panel cannot be satisfied that the single desk is justifiable under the cl 5 test of the CPA, there are many factors that need to be taken into account in deciding the extent to which deregulation should occur. The introduction of market forces may have unexpected and unintended repercussions (unfortunately the Victorian experience to date is too recent and borne of unusual seasonal conditions to be of much assistance to the Panel),

such that some degree of light-handed regulatory oversight would be needed to guide the industry through its new environment. Yet another regulatory layer adds costs and uncertainties, and also possibly creates time delays. In addition the composition of such a regulator needs to be given careful thought, it being crucial that no one group constitutes a majority of its members, and the chair must be independent of the barley industry. It is essential to avoid regulatory capture. The regulatory process must be transparent and fully accountable. Political expediency must be avoided.

If deregulation is to occur, it needs to be planned for. It cannot happen overnight without causing large and damaging transition costs, especially given the seasonal nature of barley production. All parties would need time to adjust.

The timing and speed of any process of deregulation must be carefully considered. After the relatively simple world faced by growers under a single desk, the need for careful adjustment and education about the changed environment is critical. While it might cost more in the long run, a staged process of change may make the transition easier for growers, ABB and those in charge of making the more competitive environment work in a socially efficient manner. Once market forces are introduced, it is inevitable that they will ultimately overtake pressures to retain monopoly elements associated with the single desk, and indeed broader market forces might be used to hasten this process, such that regulatory developments in other grains markets (such as the end of the single export desk for wheat) could be used as the basis of sunset clauses signalling the emergence of free export markets for South Australian barley.

3.4.4 Should the single desk be removed?

Submissions to the Panel claimed that the single desk worked well for growers and that there was no point therefore in eliminating it. It was put to the Panel by some stakeholders that the single desk for barley exports in South Australia was “the envy of growers around the world”. That may well be the case, at least in the eyes of some, but the Panel was provided with no real proof of these assertions. If the system is so unfailingly good, it might be asked why other countries have not adopted or retained single desk exporting systems. The Panel believes that single desks are seen internationally as creating serious trade distortions, at a time of moves for less restrictions on trade between countries, and notes that US President Bush has put the Australian Government on notice that any free trade agreement between the US and Australia will depend inter alia on what Australia does with its single desk selling systems for agricultural products.

The Panel notes that barley exports have now been deregulated to a greater or lesser extent in all other Australian states except New South Wales, where deregulation will occur at the end of September 2005. Of the major barley exporting nations, only Canada operates a single desk. Were South Australia not

to deregulate, even if cl 5 of the CPA could be satisfied, it would be in the minority in the world with respect to export barley marketing.

In response to the claims that the single desk has performed well, the Panel makes four observations. First, there has been no proof that the South Australian market is so different from any other barley market so as to justify retention of the single desk, although the Panel does note that the Victorian market, which has been fully deregulated, relies to a much lesser extent on export sales than does South Australia. Second, the other Australian states that have deregulated, or are in the process of doing so, do not appear at this admittedly early stage to have experienced any major problems to the overall detriment of growers. Third, in the face of mounting deregulation elsewhere, it is difficult for the proponents of the single desk to justify its retention, especially given the legislative test that has been set down under the Australia's national competition policy reforms. Fourth, while it was frequently pointed out to the Panel that growers were protected by the requirement that in its operations ABB maximized growers' returns (and paid them directly), growers should at least in theory be indifferent between a dollar of income as a direct return and a dollar received as a dividend, assuming, of course, that the total for distribution would not change (but this is something about which the Panel could not find any solid evidence).

If some form of deregulation is to occur, many things will change, and it was important for the Panel to try and discover answers as to what might transpire in the event of market forces coming into play in the South Australian market for export barley.

Of prime importance, perhaps, is how ABB would change in its approach to buying and selling barley. The Panel sought information in its meetings with ABB and other stakeholders on whether ABB would be likely to change its conduct with respect to export pools; the services, financial and otherwise, that it offers growers and overseas buyers; research and innovation; market development activities; its position as a buyer of last resort; whether it would be able to work as effectively in the absence of complete information about barley production and stock levels; and whether, and how, it would seek to maximize returns to growers or would revert to the usual public company objective of maximizing shareholder returns. The answers to these questions were not as clear cut as the Panel would have hoped for, but it is recognized that the future environment must at this stage be uncertain for ABB. ABB did, however, emphasize to the Panel that in a deregulated market it would be forced to seek to maximize returns to all shareholders, and not just to growers. It was not clear to the Panel whether this would be an orchestrated long run goal, or whether ABB would simply seek to get the most out of each season, regardless of long run implications.

That ABB is preparing for a less regulated market was evident to the Panel. It has been gradually diversifying its activities beyond marketing barley, to include other grains and pulses, and, argued to the Panel that under deregulation it

would have to act like any other trader in the market, to the possible disadvantage of growers. It has recently announced a takeover of the grain trading group Jossco, in which the vendor will receive as part payment an issue of a significant number of ABB shares. This acquisition will expand the reach of ABB into New South Wales and Queensland, and together with its heavy buying in the deregulated Victorian market, suggests that ABB is seeking to establish a significant trading position in the barley market in each state (the Panel notes that ABB does already have a trading arm), and perhaps is also seeking to raise entry barriers to grain traders seeking to establish themselves in these markets.

This development follows the recent marketing alliance by ABB with the current Western Australian single desk operator, the Grain Pool of Western Australia, to form Grain Australia, which has by reducing competition resulted in joint market power on export markets, and has reportedly led to a \$4-5 a tonne increase in achieved prices.

The Panel observes that none of these developments rely on ABB having single desk powers, although their continuing success may be re-inforced by their single desk powers. They demonstrate ABB reacting to market forces and undertaking the strategic behaviour of a participant in a deregulated market. The Panel has no doubts that ABB is preparing itself for deregulation should it occur.

In order to assess the future with and without the single desk, the Panel needs to be able to estimate what ABB might do were it to lose its single desk powers, and to assess whether there are some things which ABB can do that no other trader can do, given the appropriate time and incentive, such that the public would unquestionably be worse off if deregulation were to occur. There will of course inevitably be short run adjustment costs under this scenario, but in the long run the Panel believes that there is little that ABB currently does in any of its activities as the single desk operator that cannot be replicated by other traders, transport operations, finance suppliers or storage operations. They may be offered as different packages, and may not all come from the same source, and may come at a different cost, but the market will adapt to supply growers and buyers the tailored packages that they each want.

At the same time markets, whether regulated or not, do not stand still. They are subject to continual change and evolution. International supply and demand conditions change, as does the level of government intervention in markets in other countries (as recent developments in the apportionment of barley sales into Japan demonstrate). Institutional and commercial market developments within Australia will impinge on the future operation of the South Australian barley market. In particular, the growth by acquisition of AusBulk into an integrated grain market player, and the vertical integration of the Australian Wheat Board into storage and other logistical operations, could each pose major problems for ABB, should either of these two companies decide to confront ABB in the South Australian barley market, with or without its possession of the single desk.

As a listed public company, despite it being largely owned by growers, ABB is not immune to takeover itself, in which case growers would need to develop new relationships with the new buyer and with a possibly quite different set of commercial imperatives to deal with. With grain traders having increasing access to Australian export barley from other states, South Australian growers run the risk of not being able to deal directly with these traders in their early forays into the Australian barley market, possibly leading to growers in other states getting a first mover advantage with the traders. However, the Panel does acknowledge that traders may not seek to develop such relationships, but rather may seek to buy opportunistically from different growers each season.

Concern was expressed to the Panel that following deregulation the quality of barley could fall, leading to damage to the reputation of the South Australian crop. However, if AusBulk, as the operator of storage facilities operates its receivals function based on defined quality standards, the Panel sees no reason why barley quality should fall. After all, barley is sold to a buyer's specifications, and a trader who tries to cheat on these will not likely get much repeat business. The trader will be blamed, as barley is sold to specifications, but in the process there could occur some damaging effect on the reputation of South Australian barley.

It was suggested to the Panel that if ABB were to lose its single desk a consequence could be that some growers might switch out of barley production. The Panel notes that this may reflect a better allocation of farming resources, and queries whether farm gate prices would in fact fall across the board, as is implied, as it is likely that some growers at least will enjoy strong competitive pressures as rival traders seek to purchase their grain. Growers will only cease dealing with ABB if it fails to offer as good a competitive package to growers as do the new entrants. After any deregulation, ABB would retain its reputation with both growers and overseas customers, and indeed in order to make life hard for the newcomers it could be expected to engage in greater levels of service, delivery, quality, research and so on.

The Panel was told frequently that ABB would act like a trader should it lose its single desk licence. That may be so, but the Panel notes that whether anything would be lost except for the way ABB would distribute its earnings – to shareholders rather than to growers – is a matter of some debate. This is an equity issue rather than one relating to efficiency. Besides, all these submissions overlook the point that in the absence of formal benchmarking of ABB, there remains the likelihood that ABB, protected from competition in selling South Australian barley to export markets, and not in any way reviewed in the performance of its single desk activities, could have done better.

3.5 The options for deregulation

With the foregoing points in mind, the five main policy options that could be applied to the export barley market are now discussed.

3.5.1 Retain the single desk

This is obviously the option favoured by ABB, and by most growers and their representative organizations. They believe fervently that the single desk has worked well, and find the prospect of change unsettling. The Econtech model does show that the single desk yields net public benefits, although the Panel has doubts as to the quantum of them, as well as on the relevance of the model. ABB would obviously prefer to retain its single desk, but has shown by its very actions recently that it is preparing for the possibility of some deregulation, and its recent alliance with Grain Pool in Western Australia indicates that it believes that it can enhance its market power by restricting the independent influence of its Western Australian single desk rival.

Even though it holds the single desk licence, ABB is subject to the constraints imposed by the market on a public company, and is also of course constantly monitored by growers. The general impression received by the Panel was that it is very well managed and is seen as having the growers' interests at the forefront of its commercial activities. Yet for a company with so much legislated market power, ABB is subject to no independent regulatory review. The Panel believes that this situation should not continue.

The Panel was provided with considerable evidence on what ABB has done for the barley market in South Australia. In operating export pools and acting as a buyer of last resort it has provided security and a measure of income smoothing for growers, while at the same time offering them a wide range of services, and through the existence of the single desk, growers have access to finance at favourable rates. Some growers might lack choice as to whom they can sell their export barley, and some may be disadvantaged because of their geographic location, but on balance ABB appears to manage the export pool in the interests of its constituent grower stakeholders.

However, by virtue of its power to grant the single desk licence, the Government of South Australia is also a stakeholder in ABB. The Government should be seeking to make sure that any legislative rights that it grants yield large and sustained net public benefits, not only to South Australia, but in the light of the competition policy reforms of 1995, to the broader Australian community. The only hard empirical evidence that the Panel has on these benefits comes from the Econtech model, which in its "most likely" version suggests a net gain to the Australian community on average of \$9 million per annum.

In the absence of any alternative modelling that provides another set of estimates, the Panel must of necessity treat the Econtech findings as at most broadly indicative of the net public gains from the single desk, and of little help in

projecting forward what the future benefits of the single desk might be, unless it can be assumed that the international market environment will continue little changed from that which was present during the years on which the Econtech estimates are based. This obviously is not the case, given the increasingly competitive world market for barley and especially the more contestable market for feed barley that is developing in Japan, the source of the majority of the benefits estimated by Econtech.

In the light of Professor MacAulay's critique of the Econtech modelling, the hot tub debate, and of the Panel's own reservations as to the extent to which it can rely on past estimates as a predictor of future gains to be achieved, it must be concluded that the Econtech estimates have a high degree of uncertainty attached to them which cannot be quantified in any normal statistical sense, and that the future net public benefit from the continued operation of the single desk, while not certain, is likely to be relatively small. When this is added to the absence of any comparative cost benchmarking of ABB, and the large number of non-quantifiable benefits and costs associated with the single desk, the Panel believes that the test established by cl 5 of the CPA has not been met in full – that is, it has not been demonstrated to the Panel's satisfaction in any convincingly rigorous way that the single desk delivers benefits to the Australian community as a whole that outweigh the costs, and that the objectives of the legislation in granting single desk powers to ABB can only be achieved by restricting competition.

That is, the burden of proof lies on ABB or those who wish to see the single desk retained. While the Panel has doubts about the extent to which the single desk meets the first part of the test, it is prepared to accept that a small amount of net public benefit to the overall Australian community exists, but it has been presented with no real proof that these benefits could not currently or in the future be achieved under some other form of market environment.

Accordingly, the Panel recommends that the Barley Marketing Act 1993 should be amended with respect to ABB's single desk powers.

The next step, then, is to investigate what might be a feasible approach to take to deregulation, which retains as many of the benefits of the single desk as possible, but which lowers entry barriers and makes the market for the export of South Australian barley contestable for those potential entrants that can add value to the barley export market for some or all of its stakeholders.

3.5.2 Retain a single desk for Japan only

Despite the Panel's reservations about the quantum of the net public benefit, it is abundantly evident that the greatest proportion of this amount is due to the sale of feed barley to Japan, where import controls, long-standing commercial relationships and the ability to package and deliver barley in a manner

acceptable to the importers have traditionally led to ABB obtaining a much better price in Japan than it could obtain in any other world market.

While some argument was put to the Panel that this favoured relationship was due to the origins of ABB as a statutory authority, it cannot be denied that ABB is now a public company in which the Government has no involvement, other than as the licensor of the single desk. ABB is a public company and the importers are well aware of this. Loss of the single desk, assuming no change in the behaviour of ABB, will not result per se in the loss of sales of feed barley to Japan. ABB will still have its first mover advantage with Mitsui, the importer with which it deals, and if this changes it is likely to be the result of international pressures rather than loss of the single desk.

Nevertheless, the Panel explored whether it might be feasible to retain a single desk for feed barley sales to Japan only. While a high premium was measured by Econtech for malting barley sales to Japan, the volumes are small and the Panel was informed that these sales are for a special type of barley developed especially to the buyer's specifications. None of this premium is likely to be due to the single desk per se, and loss of single desk status will not alter the fact that ABB supplies this desirable type of barley.

The Econtech model shows that over the period 1995-2002, Japanese feed barley sales yielded estimated annual net public benefits of \$8 million, only \$1 million less than the overall estimated annual net public benefits. While, as with the overall estimates the annual values varied considerably and there was no apparent trend, the very large contribution of feed barley sales to Japan suggested to the Panel that it might be worthwhile retaining a single desk for this market only.

Surprisingly, this sentiment was not supported throughout the industry. Both ABB and growers' organizations rejected the idea, largely on the grounds that there would be major equity issues in deciding how to allocate each grower's crop to a Japan-only feed barley export pool, as there would be an oversupply relative to the volumes for which ABB was able to contract. Currently all growers get a proportionate share of the Japanese feed barley premiums through the operation of the single export pool. The Panel observes that such pooling also carries with it some inequities as not all growers deliver the same quality barley, and not all farmers' barley will go to Japan as feed barley, yet they receive the same pool price.

However, most commercial organizations have to deal with problems of scarcity, either in terms of supply or demand. Rules for rationing have to be developed, and are part of commercial life. So long as they are transparent and reviewed regularly, they need not be cause for any concern.

Perhaps of greater concern are the implications of a one-country single desk for efficiency. Currently ABB can spread the costs of its single desk activities across all of its export markets. Some amount of cross-subsidization, either explicit or implicit, may well be involved. This might not be possible in the advent of a single desk for Japan only, and costs of servicing some markets could rise in ways that cannot be predicted. ABB was firm in its expression to the Panel that a single desk for Japan only was unworkable.

A further problem might be that it could be politically difficult to be seen to discriminate only against Japan in terms of barley exports. The Panel notes however that higher prices are already being charged to Japanese importers of feed barley than are charged to customers in some other countries. However, it is clear that part of the reason why prices are higher for feed barley sold to Japan is that more services are provided with the product for this market. The Panel doubts whether a charge of discrimination could be successfully made.

The Panel believes that a review body would be needed to oversee ABB's activities in the operation of such a narrow single desk. The costs of this, plus the extra costs imposed on ABB by having to operate a narrowly focussed single desk, might soon erode the annual net public benefit that has been earned in the past.

The Panel does not wish to recommend an option that is clearly unacceptable to the industry. And it would not be keen to recommend the entrenchment of a single desk for Japan in the hands of ABB forever. No legislative monopoly should stand forever unchallengeable. Regular review, transparency and contestability are all essential. Depending on the extent of the sunk costs involved, a deregulatory option could have been to deregulate all export markets apart from Japan, and to grant ABB a special export licence to Japan for some defined relatively short period, say two to three years.

At the end of this period the licence could be made contestable, by opening it up to some kind of competitive tendering process administered by an independent body, to which any party including ABB could make a bid for the monopoly right to supply barley to Japan for a certain period, say three years in order to provide some certainty of tenure. This would put the onus on the bidding parties to evaluate the true value of selling feed barley to Japan, and they would then have to bid enough to secure these returns. Of course, it could be that no other party believed that it could find the same reliable long term import partner as ABB has, and that no other bid would be made. Equally possible, however, is that the freeing up of the Japanese market could make it appear to traders other than ABB that it is a worthwhile market to bid for.

Under these circumstances the Government would receive revenue; the party that offered the best deal would secure the export licence, and would have to be confident of securing the co-operation of growers in enabling it to meet its

delivery targets. An independent licensing authority would need to be established. Careful planning and execution of this contestability process would be essential, however, and the explicit and implicit costs of implementing it could be high. But it would ensure that the group achieving the best returns should secure the licence – and if this turned out over the years to remain in the possession of the same party, whether ABB or any other trader, comfort could be taken in the fact that this position of market power had been obtained through market forces, rather than through legislative or administrative allocation or award.

However, on balance, given the evidence and the submissions made, the Panel does not recommend that a single desk be retained solely for export sales to Japan.

3.5.3 Full deregulation

Having thus considered and rejected two types of policy option involving a single desk, the Panel next moves to the other end of the spectrum, and assesses whether full deregulation might be a suitable policy option. Other things being equal, more competition is always to be preferred to less. At the polar extreme to a monopoly single desk obtained through legislation is a market where there are no legislated barriers to entry and market positions are won through rivalry in all dimensions of the price-product-service package, a principle that has guided the Australian Competition Tribunal and its predecessor, the Trade Practices Tribunal, for many years now. Given that the Panel has found that the continued operation of the single desk cannot be justified under cl 5 of the CPA, then full deregulation is an option that must be considered.

What is being sought under national competition policy guidelines is flexibility and genuine competition in markets – the use of market forces to achieve socially efficient outcomes. Market forces work through the competitive process of rivalry and independence, with all parties enjoying an equality of opportunity to succeed. Not all will succeed, of course, when exposed to market pressures, but those that survive will have done so through simply being better able to accommodate the wishes of both their suppliers and the buyers in the market. If the market ends up with only one seller, then market forces have produced this result and so long as no anti-competitive tactics were used to achieve this result, then it must be a socially acceptable one.

In this context a careful distinction must be made between competition within the market and competition for the market. The former applies to the interplay between current and potential rivals as they battle for market supremacy. The latter applies to a battle between applicants for the rights to a licence to operate a market for a defined period of time. Both types of competition can produce a similar outcome. In the case of an existing single desk, competition could be introduced through deregulation in one of these two ways.

The market for export barley could be entirely deregulated and in the absence of entry barriers it would be left to market forces alone to determine how many parties entered to challenge ABB, which would no longer hold the statutory right to operate the single desk. Alternatively, the Government could elect to maintain a single desk, but could initially assign the rights to ABB operate it. Subsequently the rights to operate could be put out to tender, the successful tenderer being the one that offered the best apparent return to the Government and the public.

It is the Panel's opinion, however, that full deregulation at this time, in either form, would present significant short run adjustment costs and problems, such that the long run net social return might be low. The previous section discussed the problems that might be encountered in any process of competition for the rights to operate a single desk for Japan, and those problems would be no less, and possibly greater, in any process of tendering for the rights to operate a full single desk across all export markets for barley. This is not a preferred option to achieve deregulation.

To open the market up to unhindered competition overnight would cause perhaps even greater uncertainties. Some traders might seek to take advantage of some growers in less favoured geographic locations or whose barley was of lower quality. Finance problems could emerge overnight, both in amount and in the interest rate paid. ABB might elect to change completely the way it operates. If there were to be full deregulation, it would need to be carefully and slowly phased in. While this would certainly raise the costs of achieving full competition, it would no doubt also retain at least some of any existing single desk benefits that might otherwise be quickly dissipated. There will always be an optimal time path to achieve successful full deregulation, but the Panel did not seek to delineate this.

The Econtech modelling showed, unsurprisingly, that deregulation would immediately reduce the net public benefit from the single desk to zero. This is of course axiomatic in the sense that if the single desk is removed, by definition none of the benefits attributable to it alone will remain. The Panel believes, however, that some of the benefits achieved by ABB are not due to its single desk powers alone, and that these benefits would decline only slowly over time, if at all, holding all other national and international market factors constant. When pressed, Econtech agreed that these benefits would not instantly vanish, but asserted without explanation that the measured annual net public benefits would disappear in "about five years". The Panel was not persuaded either by the assertion that ABB could not retain at least some of its benefits, nor by the untested claim that these benefits would in any case all disappear in five years. If nothing else, this conclusion effectively refused to concede that deregulation would produce even one dollar of sustainable net public benefits, an assertion that the Panel found difficult to accept.

The single desk for barley has now been entrenched for many years in South Australia. The Panel agrees that instant deregulation might cause some massive adjustment problems and costs, especially in some fragile rural communities, much the same as those caused by the across the board tariff cut instituted by the Whitlam Government in 1973. Considerable monitoring would be needed to ensure that the process was moving in the right direction. Resources would be taken away from other productive uses, both within the barley industry and within government. The Panel can find nothing in the evidence to support a recommendation for complete and instant deregulation.

3.5.4 The “opt in opt out” solution

One deregulatory possibility that the Panel was keen to explore in the face of an entrenched but widely, although not unanimously supported, single desk, was the feasibility of an “opt in opt out” model.

There are two scenarios under this model. In the first, the single desk would remain, but those growers who preferred not to sell to ABB because they believed they could do better elsewhere would be free to sell their barley to any other buyer. Of course this means that they would forego any of the benefits of the ABB pool, but it could be expected that they would have taken this into account in coming to their decision to opt out. In the second scenario, the single desk as it currently stands would be abolished, but growers would be free to opt in to an export pool should ABB wish to offer one.

The latter option would appear to be unlikely, in so far as once the single desk is abolished, it would probably be difficult to resurrect it on the same scale. The opt out approach, however, starts with the status quo but permits exports of barley to occur outside the single desk. The concept was new to most of the stakeholders and the idea was not warmly received, as it was perceived to be tantamount to complete deregulation. That this model offered those who wanted to choose the right to do so, on a caveat venditor basis, was understood, but was challenged as being just another way of eliminating the single desk by a long slow process of attrition. It was described as constituting "deregulation by stealth".

The Panel tends to agree with this assessment. An “opt in opt out” model may work well under different market circumstances, when a new regulatory solution is being sought where none previously existed, or where the structure of the market in question has changed significantly, but the situation in the barley market is quite different. The single desk is well entrenched and it is quite possible that few would choose to opt out of it, especially if there were no legislated guarantees that would grant them automatic re-entry to the export pool. The uncertainties prior to each harvest as to who might deliver to the pool and who might not would add to the costs of ABB, and in the medium term if too many people opted out of the pool then ABB might well decide it was

uneconomic to operate it and the market would then move into the complete deregulation scenario.

On balance, the Panel can find nothing to recommend for the “opt in opt out” model for the barley market.

3.5.5 The Western Australian model – controlled deregulation

3.5.5.1 *Background*

Given that the Panel cannot be satisfied that the single desk should continue in its present form, and also that full deregulation would, in its opinion, cause considerable transition costs that may never be recouped, it remains to consider a system that has the potential to preserve the benefits of the single desk, if they can be justified, while at the same time making the market for barley exports fully contestable. The scheme adopted by Western Australia, but not yet operating, offers this potential, although the Panel recognises that it has not been tested and notes that there are some doubts over exactly how the scheme will work in practice.

Under the Grain Marketing Act 2002, the Western Australian Parliament has established the Grain Licensing Authority (GLA). This regulatory body will oversee a contestability process by granting export licences to applicants that can demonstrate that if they are permitted to supply bulk export barley (no licence is necessary for export in bags and containers, a situation that has applied in South Australia for some years now) to a market already served by the current single desk operator, Grain Pool, any price premiums enjoyed by Grain Pool will not be significantly damaged.

Licences may be granted subject to conditions on grain quality, season of production, and how the barley to be exported may be described. Grain Pool, as the holder of the main export licence, is required to buy all the barley that is offered to it, unless it fails to meet certain quality standards or unless it was harvested in a previous season.

If the GLA is satisfied that a premium is being obtained by Grain Pool, it is required by the Act to consult Grain Pool before granting a special export licence (no details are given as to how this should occur), and it is not to grant a licence if to do so would be likely to affect the premium currently being earned in the relevant market to “an extent that the Authority considers to be significant”. In addition, the GLA is to consider the effect that the granting of any new licence might have on either the state’s reputation as a barley exporter or on the barley industry generally.

Applicants must provide the GLA with detailed information on the type and quantity of grain they wish to export, the market that they wish to supply, the

season of production from which they wish to supply (the Panel notes here that whether this permits supply from more than one season is a matter of statutory interpretation and also a determination of the underlying purpose of the Act), and the term for which the licence is sought (the GLA is empowered under s 32 to grant a special licence for at least one year and it has the power to extend the term of the licence, although the conditions that must be met in order to secure such an extension are not spelled out).

The Act establishes the GLA as a five person body and specifies that its membership should comprise two growers or people associated with growing entities, one person from the Department of Agriculture, one from Treasury, and one other person not from these interested parties to act, presumably, as the independent chair of the Authority. It will be supported by an executive officer and other staff drawn from within the Department of Agriculture. Under s 17 of the Act the GLA is subject to receiving written directions from the relevant Minister as to the performance of its functions, either in general or in relation to any particular matter. Section 20 also gives the Minister the entitlement to have access to any information in the possession of the GLA. It is of some concern to the Panel that the independence of the GLA could be threatened under these two sections.

Appeals against the decision of the GLA may be made within 30 days of the decision to the relevant Minister, who may confirm, vary or reverse the GLA's decision and whose determination will be final. The Panel notes here that no detail is given as to the process by which the Minister might come to this decision, but it is essential that it be transparent to all concerned.

The Act provides that the Minister must carry out a review of the "operation and effectiveness" of the Act and of the GLA's activities as soon as practicable after five years of the Act's commencement, or if in the opinion of the Minister there is a material change in the ownership or control of Grain Pool or Co-operative Bulk Handling Limited, whichever occurs first. The Panel believes that this period before the first review is inappropriately long, given developments in both the Australian and international markets for barley.

Finally, the Act contains a sunset clause that causes its expiration as soon as practicable after the 30 April next following the day on which a relevant Commonwealth legislative change with respect to the single export desk for wheat comes into effect. The Panel believes that this is a sensible provision.

3.5.5.2 Application to South Australia

The Panel believes that in principle the Western Australian Act could be used as a model for a process of constrained deregulation of the South Australian barley market. It could be called "deregulation by delay", but it has the advantage of not immediately causing disruption for either growers or ABB, and it gives potential

entrants time properly to plan their applications for special export licences. A special export licence should not be granted during the year following the day on which the Act comes into operation, as is the case in Western Australia. That is, a one season grace period should be allowed to protect the existing single desk operator. This may give it time to improve its marketing position and to create strategic barriers to the entry of new licensees, but some phase-in period is nevertheless desirable, so long as appropriate safeguards are in place to control such strategic behaviour.

The Panel is attracted to this scheme because it introduces contestability and transparency into the operation of the export barley market. It would replace a legislative monopoly with a system in which ABB would be exposed to market forces on the buying side as well as on the selling side into export markets, which would sharpen its competitive edge and which would force it to prove it was doing a better job than any potential entrant. If it could retain its monopoly position through proving it can do better, so be it. There is nothing socially or economically inefficient about a monopoly position that has been exposed to market forces and has prevailed by virtue of technical or commercial excellence in producing the price-product-service packages that appeal to those from whom it buys and those to whom it sells.

Over time, if ABB cannot gain premiums that can be achieved by new entrants, its market power will wane. The single desk will have been eroded by market forces. In the process, all buyers and sellers will have had the opportunity to adjust both to the process and to the new operating environment. The hand of government, other than through supporting legislation and the establishment and funding of the licensing authority, will be largely absent from the process, unless final appeal rights from any decision by the authority are settled by the Minister, a process with which the Panel is not comfortable. The ability to appeal from the licensing authority's decision is essential, but the Panel believes that the decision on review should be independent of the government of the day.

The major social, political and economic advantage that the Panel sees in this approach is that it supports the status quo with ABB as the single desk operator, unless an applicant can demonstrate, in effect, that it can do better, or at least not damage the premiums being earned by ABB. This approach does, however, place a very large responsibility on the shoulders of the licensing authority to get convincing objective and quantitative evidence that proves on the balance of probabilities that the premiums claimed by ABB are correct, and that they are attributable to the exercise by it of its market power arising from the single desk per se, and that they could not be obtained by any other exporter at a similar cost. The Panel has found such evidence to be in short supply in the current Review, and notes that it will be expensive to produce such evidence, both from the point of view of ABB and of any applicant.

The Western Australian process on which the Panel bases its recommendations appears to be one of annual challenges to the principal export licence holder, Grain Pool WA, which currently holds single desk powers and which by default under the legislation remains the sole bulk exporter of barley until an applicant passes the tests set down by the Act. No defined path to full deregulation is apparent in the scheme, however – it will proceed according to market forces each year, but with each new season presenting new challenges. It is possible that the uncertainties of having a licence perhaps for only one season (or a small number of seasons) may deter some potential entrants, if the sunk costs of applying for a licence are too great or if overseas customers would prefer dealing with a supplier who will always be able to deliver. The Panel believes that careful attention should also be paid to behaviour that all participants might engage in that involves "gaming" the market in order to try and achieve a privately optimal result. It will be important for the Government, if it decides to pursue the Western Australian model, to be alert to and be able to control such self-serving strategic behaviour.

The operation of a licensing authority of the type being discussed will not be inexpensive. The method of funding it will need to be considered in great detail. It is important to make sure that the costs of application are not artificially raised to uneconomic levels. If there is no charge to ABB for its principal export licence, any new rival will immediately face a barrier to successful entry by having to incur a cost that ABB does not have to bear.

While applicants should indeed expect to be subject to a user pays charge, that charge should go no further than to cover the attributable costs of the application, plus some allowance towards the fixed costs of the scheme (which the Panel believes ABB should also be required to pay). The application costs will presumably not be refunded and are therefore to be regarded as sunk. If they are too high they will deter applications that might otherwise offer a new competitive option for growers or overseas buyers of barley. There will also no doubt be charged an on-going annual licence fee for the period to which the licence applies. Ideally this should only seek to recover the on-going costs of administering the scheme.

The Panel also believes that the composition and credibility of the licensing authority is of fundamental importance. It needs to contain a careful balance of barley industry representatives and independent members. Given the complexities of evaluating premiums and establishing net public benefits, the Panel believes that the ideal composition might include two grower representatives; an accountant, economist or finance expert; a person familiar with state political processes, but who ideally is not a current public servant; and a fully independent chair with experience in export markets beyond the grains industry.

The authority's investigation and decision-making should be transparent and fully accountable to the Minister, but it should not be subject to political direction except in the most exceptional circumstances. The Panel believes that such an authority will only work well if it is completely politically independent and is seen to be so. Appeals from its decisions should be possible, and preferably to some independent person, group or tribunal other than, or not connected to the Minister.

Nevertheless, the authority and its operations should certainly be subject to audit and review, in the first instance at the end of the first year of its operation and thereafter at least every three years, even if the barley export market is showing strong signs of real competition and consequent improved net public benefits.

3.5.5.3 *Summary*

In summary, the Panel believes that with appropriate safeguards and changes, the Western Australian legislative model offers the most attractive way for South Australia to respond to its obligations under the CPA. This approach will expose ABB to market forces, but not for their own sake. What ABB has achieved will not be lost if it can prove that the entry of rivals will damage these gains, or if the potential entrants cannot provide proof to the licensing authority that they can do a better job than ABB. Traders wishing to secure access to markets hitherto denied to them would now have the opportunity to do so, on proof that they can deliver a socially beneficial result that either surpasses what ABB has achieved or at least does not diminish the net public benefit attributable directly and causatively to ABB's single desk powers. ABB will be subject to regulatory review, something that has not occurred to date. Growers will have choice as to whom to sell for the first time. Deregulation will take place through market forces, not for its own sake, but only upon initial and then continuing proof that more competition will in fact yield a greater net benefit to the Australian community than will retention of the single desk.

PART 4

SUMMARY AND RECOMMENDATIONS

4.1 The benefits and costs of the single desk

There can be no doubt that many of the stakeholders in the South Australian barley industry believe that ABB is doing an excellent job as the holder of the single desk monopoly right to sell South Australian barley into export markets. Growers in particular see it as working in their direct interests through its obligation to maximize pool returns and as providing a “one stop shop” for a complete package of services. Its role as buyer of last resort is greatly valued by growers, as is the risk management services it provides, especially given the absence to date of a hedging market for barley.

The position of ABB as operator of the single desk also means that it can access finance on favourable terms from lending institutions, and that growers have the security of knowing their crops will be sold, albeit at a price that is not known with any certainty, such that they can secure finance at relatively favourable rates to fund, inter alia, cropping costs each year. The ABB also has the great market advantage that it alone currently knows accurately the level of barley stocks at any given time (although its advantage here is probably declining over time).

It is also believed that the export pool results in less volatility in prices to growers than would be the case if a cash market alone existed for barley, but it is undeniable that some growers are being denied choice as to how and to whom to sell their export barley, and at what price, especially if their properties are situated a long way from the Victorian border, beyond which exports have been deregulated and over which growers are free to transport their barley.

While barley growers and others in the main speak highly of ABB and its achievements, there are nevertheless several issues that were raised with the Panel that indicate that the performance of ABB, protected by its legislated monopoly, could be improved in the face of market discipline, especially in terms of research and development, an alleged lack of transparency by which ABB conducts its cash purchases, and willingness to seek out small new markets.

The Panel shares this concern about the need for accountability and transparency between ABB and barley growers (and also notes that as a listed public company ABB has other responsibilities to its shareholders, some of whom are not barley growers), but believes that broader social issues are also involved in any market where licensed single desk monopoly powers are held, such that measures are needed to ensure greater *public* accountability. It believes that the most efficient way to achieve this is through exposing ABB's single desk powers to market forces.

The modelling done by Econtech, the relevance and conclusions of which have caused the Panel some concerns, shows that the single desk is associated with premiums, especially in terms of feed and malting barley sold to Japan. Econtech's modelling purports to show that some \$9 million is associated with the overall operation of the single desk, and that by implication this amount would be lost over time (Econtech asserts that this could take as little as five years) if complete deregulation were to occur. Independent consideration by the Panel of confidential data provided to it by ABB confirms that premiums probably do exist for Japan and for feed and malting barley in a limited number of other small markets by tonnage. However, the Panel is not convinced that the evidence proves that these premiums are unambiguously the result of the single desk monopoly export powers per se. There is a need to distinguish carefully between correlation and causation.

It cannot be denied that the current arrangements provide insurance, finance and risk management benefits to growers in addition to any net premiums that arise from the operation of ABB in the export market. The Panel has to assume that there are no differences in marketing costs under the single export desk and deregulated markets. In that case the Panel accepts that there are likely to be small net public benefits associated with the single export desk.

However, publicly available data demonstrate that the major premium associated with the single desk, for feed barley sold to Japan, is little different to the prices obtained by unregulated traders from other countries that also have supply arrangements with the JFA. While the Panel does not take issue with the widespread claim that the premium is (historically) due to the existence of the single desk, it believes that to the extent that ABB currently achieves a premium over the competitive international benchmark price for barley, this could be due to factors other than its single desk powers per se and that international supply and demand developments mean that any premiums associated with single desk exports of Australian barley in the future are likely to face downward pressures.

The Panel believes that it is possible that the premiums now being achieved by ABB could simply reflect its skills and excellence as a marketer, and these skills would not disappear in the absence of a monopoly licence to operate a single desk for export barley. ABB has a fine reputation for quality, delivery and service in overseas markets. It has long standing contacts with major importers of barley in all of the major importing countries. It is this pioneering brand advantage that will underpin its future, and not the single desk alone, in the light of increased international competition for premium markets. However, in a deregulated market ABB would no longer have an obligation to maximise pool returns.

The Panel is prepared to accept, at least in some ordinal measure, that benefits exist from the single desk. But it is not prepared to accept assertions that these net public benefits could not be achieved in any other way. There is no simple

market counterfactual to rely upon, however, although the Panel does note that in Japan, the market where most of the net public benefit has been identified by Econtech, traders from other countries are getting the same or even higher prices than ABB for feed barley. Accordingly, the Panel believes that neither the modelling nor any of the submissions made to it demonstrate unambiguously and unequivocally that the single desk meets the entire test posed by cl 5 of the CPA, namely that legislation should not restrict competition unless it can be shown that the benefits outweigh the costs to the Australian community and that these net benefits can only be achieved by restricting competition.

4.2 Proposals for change by way of market forces

The Panel recommends that some form of deregulation is needed. There exists a wide spectrum of deregulatory procedures, from complete removal of legislative support for the single desk, with any necessary transitional protection being allowed for, to a staged removal of some or all of ABB's single desk powers through an administrative process. The Panel believes, however, that neither an instant withdrawal of the single desk nor a cumbersome and staged administrative dilution of its powers is either privately or socially efficient.

Recommendation 1: ABB's single desk for barley exports should be deregulated, so that it is exposed to a greater degree of market forces. This deregulatory reform should proceed by means of a streamlined process in which ABB retains its single desk, but is opened to competitive challenge through a contestability process.

Full deregulation, albeit with a staged transition process and with suitable precautions taken to ensure the retention of the advantages of the single desk that have not been modelled but which the Panel acknowledges to be important factors for growers, would be a socially costly and divisive process that would be difficult to sell to growers and their representative organizations.

The Panel believes that reliance on emerging market forces represents a more socially efficient way to proceed, taking a long term perspective into account, and is an approach that should avoid costly administratively-imposed uncertainties. It recommends that any reform to the Barley Marketing Act 1993 should operate to the greatest extent possible through the operation of the competitive process, where through their strategic behaviour all parties, buyers and sellers, are free to seek to create their own competitive advantage, in the process allowing choice, encouraging innovation in both product and market development, and in which all parties are free to make their own independent commercial decisions.

The Panel has sought therefore to produce a recommendation that will cause the least disruption to growers and ABB, and to ensure that what ABB does well will not be damaged, while at the same time exposing ABB to the discipline of the

market, in terms of competition from other organizations that seek to export South Australian barley.

The Panel recommends that a streamlined process be developed in which the single desk be retained, but is opened to competitive challenge. In this way there will be no major erosion of what ABB has done well, if that in fact is the case. However, the Panel concedes that, should ABB not perform well, the progressive loss of its single desk powers could have a compounding deleterious effect on its costs of operating in its remaining protected markets. In addition, if ABB's monopoly positions are challenged on a "hit and run" basis each season, these added uncertainties would undoubtedly raise its costs.

Nevertheless, by making the various markets in which ABB operates contestable, with the onus of proof lying with the potential entrant, which would be required to show that it could secure a better net return for the Australian community, or as a minimum not damage the premium earned by ABB, there would be brought to the South Australian barley market the ability to choose on the part of growers, and would serve as a warning to ABB that it could lose its monopoly export rights to some markets if a new rival could demonstrate that it could do a better job. The Panel believes that the best interests of all participants in the barley market in South Australia would be met by eliminating the current inability of other organizations to compete with ABB, yet at the same time preserving single desk returns where they can be shown to be unobtainable in any other way.

Having concluded that this is the way to proceed, the Panel is faced with three remaining issues: the nature of the exposure to market forces and its timing and the administrative support needed to ensure its effective operation; the costs of its implementation; and the time period after which a review should be conducted of its achievements, and in addition, what market triggers would necessitate a review.

4.3 Potential competitive instruments for change

The Panel considered three main alternatives to complete deregulation: keeping a single desk for Japanese feed barley alone; an "opt in opt out" model whereby growers may elect who they wish to deal with; and a process of a similar kind to the recent approach taken in Western Australia.

4.3.1 A single desk for Japan only

Given that Econtech's findings were that most of the net public benefit that arises from the single desk can be attributed to the export of feed barley to Japan, one option was to recommend that ABB retain single desk powers for this market only. This approach was generally not supported by the industry, as it was asserted that there would be difficult equity problems in operating a pool solely

for export to Japan, in so far as deciding how barley delivered to ABB would be assigned to the high-paying Japanese pool. The Panel believes that such distribution problems are a constant feature of commercial decisions that have to be made in many markets, and that equitable rules for access to the pool could be derived. However, it also believes that the costs to ABB of operating a single desk for one market, while continuing to offer the same level of services and competing in all other feed and malting barley markets, would be high and possibly commercially unrealistic, certainly in the long run. Cross-subsidization might be needed, which would be difficult in open competition with other buyers of grain. The Panel accordingly would not recommend that ABB be permitted to continue operating a single desk for Japan feed barley alone.

There undoubtedly is a high premium attached to the sales of malting barley to Japan, but the quantity sold is not large and these sales are to a niche market for a special type of barley developed to suit the unique tastes of Japanese consumers. The Panel does not believe that single desk powers are necessary for ABB to continue to do well in this market.

4.3.2 The "opt in opt out" model

The "opt in opt out" model was found by many stakeholders to be difficult to understand. But in essence this process allows growers to either stay with the single desk or opt instead to exercise their own commercial choice and deal with whatever buyer offers the best conditions. The Panel concluded that this represented deregulation in disguise, and that if growers were free to opt in and out of the single desk pool at will, the single desk could become unworkable. It was emphasised that the uncertainties of this model for ABB as the pool operator were real, and would likely produce the same result as complete deregulation, but with more costs being incurred over a greater period of uncertainty. The Panel finds nothing to recommend in this approach to deregulation.

4.3.3 Make the market contestable

The Western Australian approach, while as yet untested and possessing, it seems to the Panel, problems of implementation in terms of administration and political intervention, nevertheless offers the opportunity to introduce some real competition or contestability into the *process* of buying grain for sale on export markets, while preserving any demonstrable benefits achieved by ABB as the incumbent single desk operator.

The Panel recommends to the Minister that careful consideration be given to the principles of the Western Australian Grain Marketing Act 2002 as a model to form the basis of introducing contestability into the South Australian export barley market. In making this recommendation, the Panel is of the opinion that in the face of legislation supporting a single desk, unfettered potential competition *for* the market can be as effective as competition *within* the market, and with less

likelihood of lasting damage being done to any net public benefits that may in fact be achievable only through a single desk. It is axiomatic in the Panel's recommendation that ABB should be deemed to hold the principal export licence.

Recommendation 2: That careful consideration be given to the principles of the Western Australian Grain Marketing Act 2002 as a model to form the basis of introducing contestability into the South Australian export barley market.

Recommendation 3: If Recommendation 2 is accepted, ABB should be deemed to hold the principal export licence for barley.

Such a model potentially gives growers the benefits of an "opt out" approach if another market participant can offer them a superior deal, and can convince the administrator of the scheme that it can either secure benefits that ABB was not achieving, or that its trading will not in any case damage the premium that ABB can demonstrate for its operations in the relevant export market. However, the Panel recommends that it would be imperative under this scheme to preserve the rights of these growers to revert back to dealing with ABB in subsequent seasons.

Recommendation 4: If another company other than ABB is granted an export licence, it is essential that growers who sell barley to this company can return to dealing with ABB in subsequent seasons if they so desire.

4.3.4 Getting the process right

The administration of such a contestable system would need to be alert to the potential for opportunistic behaviour by traders to act in their long term self interest to the detriment of the net public benefit.

The mechanics of the scheme would need careful consideration, including inter alia the following issues:

- The appropriate lead time to implement the system (it would need to be at least one season)
- The composition and the operating rules of the licensing authority (it will be imperative to avoid regulatory capture)
- The method of funding the authority
- The burden of proof on the applicants for a licence, and the requirements on ABB to justify why the granting of such a licence might damage any demonstrable premium being obtained
- The nature of licence conditions, including the term and whether re-applications might be necessary for each season in each market (the sunk costs of the licence application process need to be kept low)
- Whether the decision of the authority is final, and if not the terms and conditions of the appeal process

- The nature and duration of any sunset conditions, and what domestic and international factors could trigger their application
- The need to consider the long term impact on the net public benefit of issuing new licences.

The Panel notes that the WA model has been both slow in its development and not without controversy in terms of membership of its Grain Licensing Authority. There will be no opportunity to observe it in action for some time yet. However, crafted carefully and with the creation of sensible operational rules and evidentiary requirements, this approach offers the ultimate market test at acceptable cost levels: applicants will have to prove that on the balance of probabilities they can do as good a job as ABB has done, without significant long term damage to the net benefits ABB has achieved in the relevant market, and ABB will be forced to extract the best premium it can achieve for fear of being supplanted, in whole or in part, in the relevant market.

The approach recommended by the Panel does involve additional costs for all parties, including applicants, the incumbent and the Government for administering the scheme. Careful monitoring will be needed to ensure that these additional costs do not outweigh the incremental social benefits achieved through the operation of the scheme, and the panel recommends that the licensing authority itself will need to be transparent and accountable to a review process, certainly within one year of commencing its role and thereafter at least every three years.

Recommendation 5: A licensing authority to oversee the process of contestability, and to grant export licences where appropriate, must be established. Its composition will be crucial to its success and the success of deregulation. No more than two of its five members should have any association with the barley or the wider grains industry.

Recommendation 6: The licensing authority should be reviewed within one year of commencing its role and thereafter at least every three years.

Notwithstanding the single export desk issue, the Panel believes that the current legislation needs to be amended to allow access to the export pool by non growers such as AusBulk. This will assist in making more fully effective the Panel's recommended changes for barley market reform.

4.3.5 Conclusion

Ultimately, what the Panel has recommended will increasingly expose ABB to market forces. Some will call this "deregulation by delay" while others would argue that it would be more socially efficient to move immediately to deregulate. The Panel disagrees with this, given the enormity of timing problems, market and

financial uncertainties and the likelihood of considerable disruption. The adjustment costs to regional communities could be severe.

However, it is recognised that the viability of ABB remaining as the principal export licence holder will erode over time if additional export licences are issued. That may lead to ABB being unable to fulfil obligations as a buyer of last resort.

On balance, however, the Panel believes that by making the market contestable, albeit via a licensing authority, there will be continual market discipline on ABB to offer real choice to all growers in South Australia, to operate with maximum efficiency, and to be innovative in its product, service offerings and market development.

It is also worth noting in conclusion that independent political and commercial developments in overseas markets will concurrently force ABB to be a progressive and efficient operator, regardless of any changes to its single desk export powers. The impact on ABB of developments within Australia by large grain industry companies such as AusBulk and AWB, the merger of ABB and Jossco, and the recently proposed merger of Graincorp and Grainco Australia also cannot be ignored.

The Australian grains market is in transition, and legislated monopoly powers are in decline while at the same time market concentration is increasing. The South Australian barley market cannot escape these pressures, and will be better equipped to accommodate them if market reform proceeds in the manner of the Panel's recommendation.

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