Australian Senate
Rural Affairs and Transport Reference Committee

Inquiry into Operational Issues in Export Grain Networks

Public Hearing

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Witness

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I am the Senior Commodity Analyst with NZX Ltd (operators of the New Zealand Stock Exchange and owners of Profarmer, Australian Crop Forecasters and Clear Grain Exchange in Australia), and editor of Profarmer Grain, Australia's leading grain market information service. I am formerly from South Australia and continue to hold grain growing assets in South Australia.

I appear as an employee of NZX Ltd, but my views are not necessarily those of NZX Ltd. Rather I seek to express views that are representative of what is in the best interests of the grower clients of Profarmer Grain.

Preface

The industry needs to accept that with natural geographical barriers, there may need to be some rules and regulations in logistics and grain handling to make a deregulated grain market work.

1. **Accept that there are geographical monopolies and do not do things to foster competition that can never occur.** For example, there is no point in encouraging CBH in WA and Viterra in SA to have different systems for allocating shipping slots in the name of competition, because a grower in South Australia (and vice versa) cannot exercise any choice between CBH or Viterra as a supplier of bulk grain export services. Growers cannot choose a provider of export services, they can only choose a buyer of their grain. Likewise, any system that restricts a buyer from operating freely will have a negative impact on growers.

2. **Accept that a monopoly system of shifting grain to port might be most efficient and do not assume that a system that forces competition and destroys economies of scale and removes logistical efficiencies is better** For example, forcing CBH to dismantle its monopoly system of grain transport from country to port may not help growers. Growers cannot choose a service provider for freight, they can only choose a grain buyer. Having multiple providers of transport services in eastern Australia has confused the market at the grower level, with buyers competing not on their skill in marketing grain to export markets, or requirements for grain, but on whether they have a better freight deal than another buyer at a particular site, or are prepared to subsidise freight at one site at the expense of another.

    a. Why at some sites does it cost one trader $5/t more to shift grain to port than another, but at a site up the road both buyers have the same freight rates?
    b. If a site has poor logistics and is a high cost site to freight from, should that not be the case for all buyers?
    c. In a competitive market operating properly there should be little difference in execution costs between one buyer and another at the same site. A buyer accumulating across a port zone for bulk export who has the best price at one site should have the best price across the whole zone, except at sites where a domestic or container buyer may also be trying to buy that same grain.

3. **Accept that growers might prefer to pay a little more for services to reduce complexity, and that this might reduce total industry costs.** Maximising competition might reduce costs, but it may make the process overly complex (eg trying to track movements in the grain market in eastern Australia where there are large differences in freight rates being used by buyers). Maximising competition may reduce the costs that a Bulk Handling Company (BHC) has to charge growers, giving the appearance of reducing costs to the industry, but it may simply be shifting costs back to the farm

business level. Paying more for grain storage, receivals and logistics beyond the farm gate, may allow farm costs to be lower, and reduce total industry supply chain costs from the paddock to the boat. eg closing receival points and moving receivals to large strategic sites might decrease Viterra's costs but increase costs at the farm business level where more trucks, employees and on farm stage are now needed. Another example might be reducing operating hours for receivals to cut back on staff overtime costs, with Viterra knowing that in the end they will receive all the grain (because there is no choice for bulk exports), while growers have to invest in on farm storage to keep their harvest going.

I wish to cover 5 main points in this submission

1. Receival classifications and segregations
2. Receival and outturn standards
3. Allocation of shipping slots
4. Grain stock information
5. The role for a statutory body (eg WEA)

1 Receival Classification and Segregations

Accept that most growers will only have one practical choice for delivering grain into the bulk export supply chain (ie a monopoly). Even where there are several BHC companies within a region, most growers will find that one is really only available from a freight cost point of view, unless two BHC's operate alongside each other with the same level of service and same access to traders buying from their systems.

Make sure that the monopolist that growers have to deal with does not exploit their market power by forcing growers to accept less than best practice service levels. Eg the decision by Viterra not to use Falling Number machines was forcing a less than best practice level of service on growers, that could only be avoided by incurring significant additional costs to go to an alternative receival point (eg growers at Cowell on Eyre Peninsula bypassing the local Viterra silo and travelling 292 km to go the AWB Grainflow site at Crystal Brook to get access to a falling number machine to prevent wheat being downgraded to feed grade).

There were three issues here.

1. Viterrra decided on behalf of growers that the costs (dollars and time delays) of using falling number machines would be too high.
    a. Growers should have been able to make that choice themselves, not Viterra.
    b. Growers were subject to inconsistent visual assessments of sprouting, and the benchmark moved over time as Viterra adjusted their tolerances.
    c. Smart growers chose one queue over another at the same site to get a more lenient assessor (ie join the long queue - word travels fast!)
    d. The costs of getting it wrong were extreme. On January 5th for example, APW was valued at \$312/t Pt Adelaide, against Feed Grade at \$210/t. A \$100/t plus penalty for misclassification was common during and after harvest.
2. Industry protocols published by Grain Trade Australia indicate that if 1% visual sprouting is detected, the grower can ask for a falling number test. The result of that test will be binding on both parties. (Pages 6 and 84 GTA Wheat Standards 2010/11). These protocols are not enforceable on the BHC's and Viterra chose to not allow growers that choice.
3. Confidence in the integrity of segregations for outturn. With so much grain classified visually, and so many instances where misclassification was being detected by growers getting their own tests done, one has to assume that the segregations in South Australia cannot be guaranteed to be of the milling quality normally expected.

Stop the practice of the BHC's setting up segregations that only their marketing arm are buying (eg various Industrial malt segregations), where those segregations are commingled with higher grades, effectively rendering the whole bin unattractive to other buyers and leaving the BHC as the only buyer of all the segregations in that one bin.

It is a particular issue wth malting barley, and occurs both in South Australia with Viterra and in NSW/Vic with GrainCorp, where coincidently Viterra and GrainCorp are not only the BHC's and major traders, but also the dominant processors of malting barley into malt for domestic and export markets.

The problem has arisen where growers with Malt 1 in a bin also containing Industrial Malt, cannot find a buyer other than Viterra for their Malt 1 because of the downgrading of the whole bin. The grower with Malt 1 can still sell their grain as Malt 1, but only to Viterra, rather than against a contract they may already have in place with another buyer, or to a buyer with a higher price than Viterra. At the time of delivery the growers are not warned that lower grades are being comingled.

BHC's need to be forced to follow an industry agreed set of protocols for the receival and classification of grain.

2 Receival/Outturn Standards

There is a perception that the minimum receival standard set for growers is now becoming the guaranteed outturn specification by the BHC's. This makes no sense. If there is a minimum specification, then a lot of grain will be delivered above that minimum, meaning that the stack average, or the outturn average, will be higher than the minimum, particularly if stocks are managed and blended to achieve optimal outturn specifications.

Under the single desk AWB were able to regularly outturn parcels of wheat at above the minimum grower receival standard, to the benefit of growers, without compromising the quality delivered to overseas customers.

It seems now that the BHC's are only guaranteeing the minimum grower delivery specification as their outturn standard. If the buyer requirement is above that standard, exporters cannot guarantee being able to meet those standards. In response there is a move to increase the delivery standard imposed on growers.

Test weight is the first example, where the industry has agreed to lift the farmer delivery standard from 74 kg/hl to 76 kg/hl. The justification seems to be that many importers require a higher standard than 74 kg/hl, and that our competitor exporters are able to outturn wheat at higher test weight levels as well. I suspect that this is no different to the requirements before removal of the single desk.

It did not seem to be a problem when AWB were able to control blending and outturn standards. It is now a problem because no-one can enforce an outturn standard on the BHC's which is higher than the base grower delivery standard.

There are several implications.

1. There will be an increase in the percentage of the crop that now drops down to lower grades, at the expense of growers.
2. The BHC's are the only ones who currently hold the stocks information as to where the lower test weight stocks are, and where the higher weight stocks are. Their marketing arms can buy enough high grade stock to blend with lower priced low grade stock, to meet the required export standards. Other exporters have to buy the higher priced stock

to meet the same benchmark. There is a flow of income from growers to the BHC's, that used to be captured by growers in the single desk system.

3. There is now an incentive for growers to blend on farm and deliver as close to the minimum specification as possible. This in turn reduces the whole Australian crop down to a lowest common denominator and limits the opportunities for high quality segregations of high value to be available for export from Australia.
4. A lot of modern high yielding varieties are pushing the lower limits on test weight because the proposed higher test weight standard was not required in the breeding programs. A lot of very useful, higher yielding, disease resistant, profitable varieties for growers, will not be able to be grown, at a cost to Australian wheatgrowers.

The BHC's should be forced to match historical outturn standards, and be forced to have outturn standards that are higher than the minimum standards for grower deliveries, rather than being able to use their monopoly positions to be able to extract super normal profits from the industry by blending lower grades with higher grades.

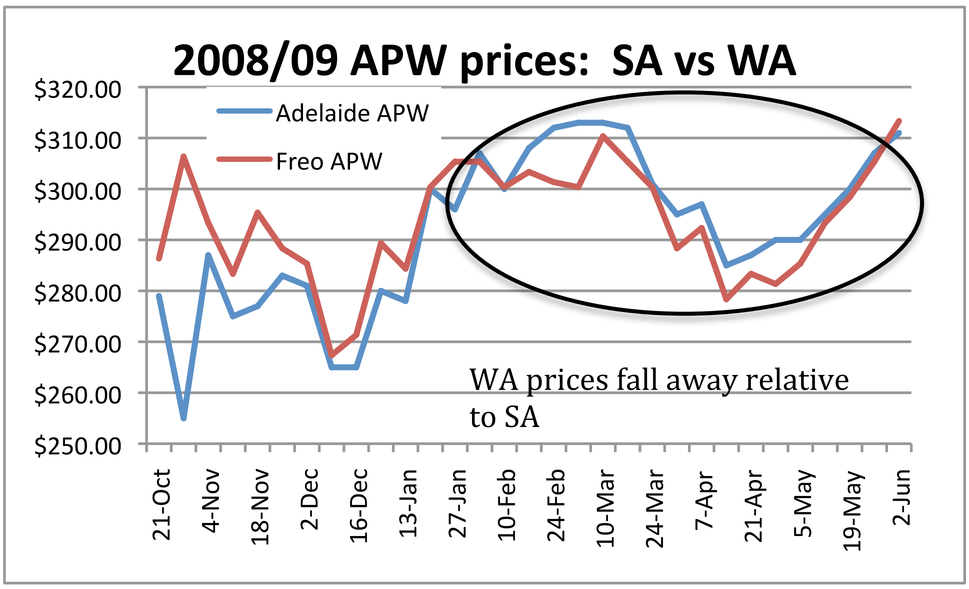
3 Shipping Stems

The first three years of deregulated bulk wheat exports have shown that Australia needs to have one national system, across all BHC's with export terminals, for allocating the shipping slots to the shipping stem.

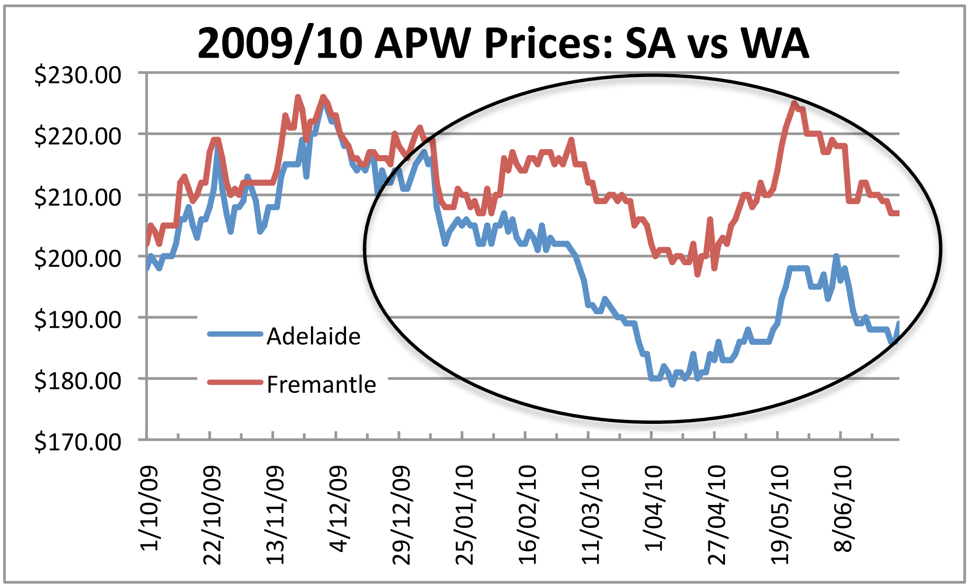
There is no point in allowing Viterra to have one system, and CBH to have another, to give lip service to the concept of competition in storage and handling and export logistics, when a grower, the core customer, in South Australia cannot choose to use the CBH system for their bulk exports. Growers cannot access any competitive gains that might be on offer from differing export allocation systems.

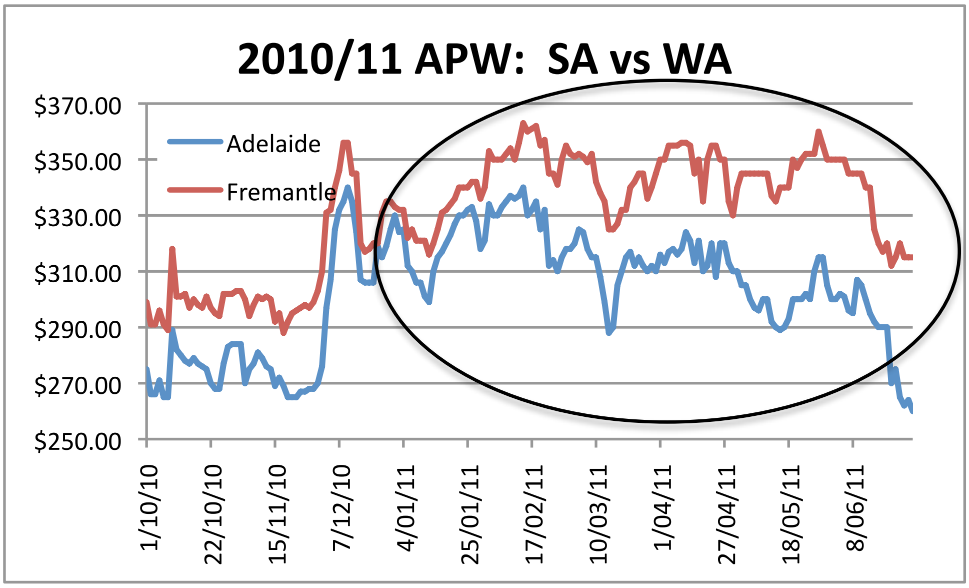
In each of the three years of deregulation to date, differences in shipping allocation systems between South Australia and Western Australia have produced market failure, to the cost of the industry, and to the cost of growers in one region and to the benefit of growers in another.

Year 1 (2008/09) CBH over allocated shipping in WA, and could not get the grain delivered to the point of export at a rate fast enough to match the booked shipping. Exporters left WA and shifted ships to SA and further east where possible. Wheat prices in WA fell away relative to prices in South Australia. The benefit to South Australian growers was limited because Viterra had allocated a lot of the prime slots to themselves.



Years 2 and 3 (2009/10 and 2010/11) WA implemented an auction system for allocating shipping slots, while South Australia continued with a First in First Served System, with a strong allocation to themselves again. With Viterra taking a lot of capacity, other traders naturally participated in the WA auction and got slots there. The penalty for default in South Australia was minimal (eg $5/t), while in WA the system imposed significant penalties ($20 - $30/t in some cases) for defaulting on a shipping slot. When Viterra could not use all its own slots and opened the stem up to others, no-one wanted them because they were locked into WA. In some cases other traders cancelled SA slots to concentrate on buying grain in WA because that was the least cost pathway for them. With no ability to get out of WA slots, traders have been prepared to pay extreme prices for the last grain required to fill a ship, rather than cancelling the ship.





The current system generates market failure, where competition and prices have been reduced in South Australia, and competition and prices have been increased in WA. Effectively, there has been an income transfer from SA growers to WA growers, with the price differential between WA and SA growers now being many, many more times that prevailing under the single desk. It is difficult to justify the price differentials of the last two seasons in favour of WA.

Recommendations

1. We need the same auction system operating at in all states for all ports.
2. It needs to be administered by an independent organisation, rather than by the BHC's themselves, to ensure that the BHC's do not get an opportunity to allocate prime shipping slots to themselves.
3. All players must have the same, real cost of defaulting, and not just pay a penalty from one division to another within the same organisation.
4. There needs to be a secondary market where shipping slots can be traded after the initial allocation

4 Grain Stocks Information

The Australian grain industry needs a robust system of reporting on grain stocks and grain disappearances for the benefit of the bulk export market and the domestic market. Currently ABS collect and disseminate this information for wheat only. The funding and arrangements are about to expire with no replacement system or funding yet agreed to.

The risk of not having complete information available to the industry is catastrophic market failure when we have our next serious drought, with disruption to the operations of the export grain network, simply because no-one will know for sure what stocks are being held where. The BHC's will have more information than others and be able to use that to manipulate the grain markets and export networks to their own advantage.

Under the single desk system we have a similar lack of information during droughts, but at least AWB knew the full picture and were able to use that information for the benefit of growers, and prevent third parties from benefiting. However, we still had market failure in that

- End users with limited information panicked and bought more grain than they should have at higher prices than they should have, in their quest to secure supplies that they thought were tighter than they really were.
- Growers who had forward sold and were looking to washout contracts got caught up in the overinflated market as well (eg 2007).
- Other growers were convinced that the higher prices indicated real shortages, and hoarded grain.
- In some instances grain is imported because of the perception that stocks are too tight

There is a cost to

1. Domestic users who end up paying more than they should for grain.
2. Growers who hold grain only to see prices collapse as grain imported or as the market realises that stocks were never as tight as feared.
3. Bio-security as grain is imported.

Information on stocks of wheat, barley and sorghum (at the very least) should be freely available to all industry participants. No organisation or group should be able to get a competitive advantage from having information. Any competitive advantage should simply come from the skill with which freely available information is analysed and used, not from one party having the information and another not.

Recommendation

1. That ABS continue to collect all the data and release it publicly at predetermined times. Collection must be independent, and enforceable.
2. Timeliness needs to be improved. At the moment monthly data is released up to 6 weeks after the end of the accounting period. BHC stocks and shipping data should be available within a week of the end of the month.
3. It is not the government's role to pay for the collection of this information.
    a. Growers have the most interest in domestic stocks, on farm stocks and disappearance. They could cover this cost for ABS operations from their GRDC levies.
    b. Exporters and traders have the most interest in BHC stocks export commitments and shipments. Accredited exporters could pay for this part of the service via their accreditation fees based on the number of tonnes they are accredited to export.

5 An Industry Body

The grain industries in Australia need a legislatively backed organisation to enforce rules and regulations that are sensible for a deregulated export and trading environment, but where natural geographical monopoles have to be accepted.

The Wheat Export Authority is the current form of such a body and the recommendations to disband it are likely to be retrograde if adopted.

There are three things at least for such a body to do

1. Accredit exporters in a similar way to the current system, and to collect fees from those exporters to cover costs like the ABS stocks and use data collection and dissemination.
2. Oversee the running of the auction system for shipping allocations (either run it directly or oversee another entity with expertise in running auction systems, online for example).
3. Industry Good Functions They could be charged with enforcing receival and outturn standards, based on industry agreed standards.
    a. Enforcing BHC receival protocols and systems
    b. Promoting Australian grain in overseas markets and overseeing the provision of customer services for importers of our grain.

While such an organisation should sit under the umbrella of federal legislation as a statutory authority, it should be funded by the industry by way of fees charged to exporters on the basis of tonnes accredited, with an expectation that the costs would pass back to growers via the prices paid for their grain.