

A new single desk for Western Australia?

Submission to the ACCC interested party
consultation in relation to Cooperative Bulk
Handling Limited (CBH) exclusive dealing
Notification N93439

Alan Moran
Louise Staley

Institute of Public Affairs
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1.	Background to this submission.....	3
2.	The current structure of the WA grains industry	3
2.1	Wheat is a major export earner	3
2.2	Global demand is changing	4
2.3	Grain growing is increasingly specialised and concentrated	4
2.4	WA grain market characterised by a monopoly infrastructure provider and a monopoly export buyer4	
2.5	Grain Logistics moving away from rail	5
3.	Impact of the Commonwealth Wheat Export Marketing Act 2008.....	5
3.1	New entrants to the export market	6
3.2	An end to the national pool	6
3.3	Creation of a Secondary Market in WA	6
3.4	CBH required to make access undertakings to the ACCC	7
4.	Issues concerning the structure of industries.....	7
4.1	The theory of the firm	7
4.2	Monopoly and its Economic Disadvantages	9
4.3	Natural Monopoly.....	12
5.	The Proposal in the context of Australia’s competition policy.....	13
5.1	Authorisation	14
5.2	Full Line Forcing and the CBH Application for Authorisation	15
5.3	Ring Fencing.....	15
6.	The proposal in the context of grain logistics in other Australian markets	16
6.1	Pre-harvest information collection.....	16
6.2	Deliveries to CBH at harvest.....	17
6.3	Grains ain’t grains.....	17
6.4	Supply Chain Costs Transparency	18
7.	Impacts of the Proposal	19
7.1	Grain growers subsidize the rail network	19
7.2	Cross subsidisation of wheat growers by other growers	19
7.3	Disguises poor investment decision by CBH in container shipping	20
7.4	Limits development of a secondary grain trading market	20
8.	Conclusion.....	21
	Bibliography	22
	Appendix 1	24

About the authors:

Ms Staley is Director, Food and Environment Unit at the Institute of Public Affairs. She was previously an equities portfolio manager with a major investment manager where she specialised in telecommunications and food stocks. Recent publications include a submission to the Senate Enquiry on the Wheat Export Marketing Bill 2008 and a briefing paper for Federal MPs on the Australian wheat industry. Ms Staley is also a wheat grower in Victoria.

Dr Moran is Director, Deregulation at the Institute of Public Affairs. He has previously been a senior official in the Productivity Commission and the Deputy Secretary (Energy) in the Victorian Government. He has written widely on competition policy, including publishing a book , “Regulation of Infrastructure”, co-authored with Warren Pengilley.

1. Background to this submission

The Institute of Public Affairs is pleased to have the opportunity to make a submission to the Australian Competition and Consumer Commission's interested party consultation in relation to the lodgement of Cooperative Bulk Handling Limited (CBH) of an exclusive dealing notification, N93439, hereafter referred to as "Grain Express".

The IPA is supportive of the removal of barriers to competition in the Australian economy and has taken a particular interest in deregulation of wheat export marketing. The IPA has been an active participant in infrastructure pricing and access debates for some years, and has consistently argued for the regulatory authorities to disengage from fixing price and access conditions except where unchallengeable natural monopoly conditions are evident. Such an approach is necessary in order to allow the development of the most efficient outcomes.

The proposal by CBH to force wheat growers and grain buyers to use its infrastructure and be subject to its freight pricing regime is contrary to the national interest, will result in poorer returns to grain growers and other market participants, including consumers, and should therefore be rejected.

2. The current structure of the WA grains industry

Wheat is the most important crop produced by WA grain growers. ABARE forecasts WA will produce 8.3m tonnes of wheat in the coming harvest from 5.2 m hectares planted. Total acreages for all other broadacre crops are forecast to be 2.1 m hectares planted.¹ Other grains falling within the proposal include barley, canola and lupins.

2.1 Wheat is a major export earner

Australia is the world's second largest wheat exporter. Major markets include China, Iraq, Indonesia, Japan, Korea and Egypt. In the last non-drought year, Australian wheat exports earned \$3.591 billion.

While drought seriously affected the two most recent seasons, the future for Australian wheat is very attractive with global prices higher than they have been for many years and planned plantings well up on recent years. If the drought has indeed broken, returns from cropping can be expected to reach record levels over the next few years.

Western Australia is the largest wheat producing state despite having only 18 percent of wheat growers. The Pastoralists and Graziers Association of WA estimates WA produces "up to 8 to 10 percent of the world's internationally traded wheat."² The WA industry has undergone the largest degree of specialisation and concentration in recent years so that the average wheat-growing farm in WA is now 1½ times larger than in NSW and 2½ times larger than in Victoria.

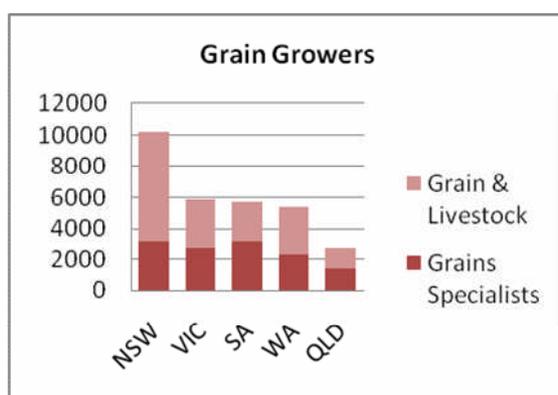


Figure 1, Source: ABS 7121.0

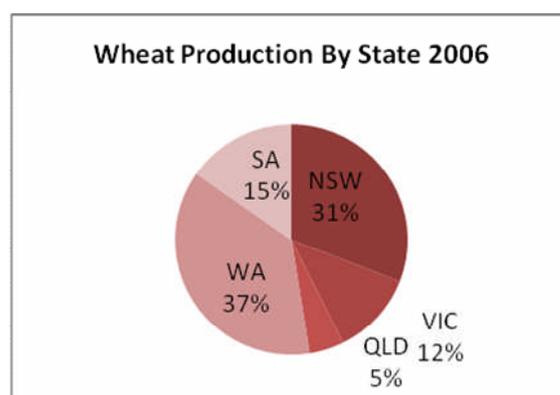


Figure 2, Source: ABARE³

¹ ABARE, *Australian Crop Report* (Canberra, 2008), no. , 146.

² Pastoralists and Graziers Association, *Statutory Review of the Grain Marketing Act 2002* (Perth, 2008), page 7, Submission to the Economic Regulation Authority.

³ ABARE, "Australian Commodity Statistics 2007," ed. wheat.xls (2008).

Access Economics estimates 90 – 95 percent of the Western Australian wheat crop is exported each year compared to a much higher domestic consumption of eastern seaboard wheat. Because of the lack of domestic demand in WA, at harvest growers there have to date been captive to the single desk price unlike eastern states wheat growers who can choose to sell to the national pool or to a wide variety of domestic buyers.

2.2 Global demand is changing

The Grains Research and Development Corporation (GRDC) has repeatedly drawn attention to increasing specialisation in international wheat markets and the need for Australian farmers to move away from producing traditional commodity varieties. Market research has also highlighted the strengthening North American competition in varieties traditionally dominated by Australia such as Udon noodle wheat.

Increasing competition and changes in demand suggest Australian wheat growers will be best served by increased specialisation and the development of new varieties for niche markets.

2.3 Grain growing is increasingly specialised and concentrated

Over 80 percent of the national wheat crop is produced by the top 25 percent of wheat growers and the proportion grown by the biggest farmers is continuing to increase as Figure 1 shows. The Productivity Commission estimated only “ten percent of Australian farm businesses now produce over 50 percent of output”.

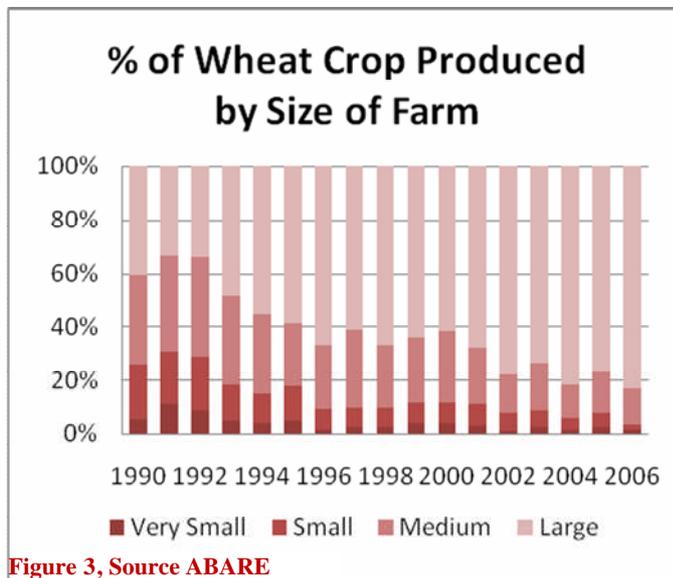


Figure 3, Source ABARE

Larger growers can see the benefits from being able to enter into highly vertically integrated contracts with overseas buyers for specialist varieties and from trading their own grain.

Similarly, these growers are already experienced users of financial hedging instruments such as futures, options and swaps. The opening of the export grain market will reduce the risk of these instruments because Australian prices will trade more transparently in line with global prices allowing Australian growers to minimise basis⁴ risk.

2.4 WA grain market characterised by a monopoly infrastructure provider and a monopoly export buyer

Unlike the Eastern Seaboard, there is a very limited domestic market for Western Australian wheat. Until recently, the combination of an export monopoly in the form of the single desk and a legislated monopoly for grain receivals meant almost the entire WA wheat crop was handled by CBH and AWB.

For grains other than wheat, the dominance of CBH is even more marked. The WA Grain Marketing Act 2002, and subsequent guidelines issued by the WA Government to the Grain Licensing Authority (GLA), effectively perpetuates an export marketing monopoly for barley, canola and lupins in WA⁵. CBH, through its subsidiary Grain Pool Pty Ltd is the monopoly licence holder for these commodities. The

⁴ Basis is the difference between wheat prices in Australia and the global price with both prices expressed in the same currency. Basis exists due to supply and demand changes between domestic and international demand.

⁵ Grain Licensing Authority, <http://www.gla.wa.gov.au/index.htm> (accessed 9 July 2008).

removal of the Commonwealth wheat single desk triggers a review of the WA legislation and it is likely these markets will be deregulated for the 2010 season.⁶

2.5 Grain Logistics moving away from rail

A recent study of WA grain infrastructure noted receivals volume growth in recent years has been away from rail sites to road serviced sites and the ports.⁷ As Table 1 shows, of the 545,600 tonne increase in grain freight tonnages over the past decade only 130,300 has travelled by rail. The same study shows significant differences in the proportion of grain moved by rail: Albany 53% rail, Geraldton 46% rail, Kwinana 91% rail, Esperance 13% rail, for a total of 64% by rail. “Most road sites are in the coastal and wetter zones. Consequently production is more reliable at these sites. Rail served sites are, on average, more distant than road sites and therefore suffer less reliable conditions.”⁸

Table 1 Change in receival site types 95-99 to 00-04⁹

Site type	Tonnes 95-99	Tonnes 00-04	% change
Road	1,523,252	1,740,909	14.3%
Port	1,650,860	1,848,469	12.0%
Rail	6,203,473	6,333,787	2.1%
Totals	9,377,585	9,923,165	5.8%

Various factors are driving the move away from rail. Road freight is now price competitive with rail from many locations and growers have been choosing to increase deliveries straight to port and bypass the CBH delivery system entirely. These trends are likely to continue.

3. Impact of the Commonwealth Wheat Export Marketing Act 2008

The Grain Express proposal is predicated on an effective continuation of the former wheat export marketing arrangements and an incorrect characterisation of the new arrangements that began operation on 1 July 2008.

In their application Grain Express states:

6.14 The key difference between the current and proposed wheat export arrangements is the requirement under the Proposed Act that a company must be accredited by WEA (as the regulator) in order to export bulk wheat. Accreditation is not required under the current scheme – the consent of the EWC is all that is necessary at present to export bulk wheat.¹⁰

The implication is that the new arrangements will be more restrictive than the previous law but not a major change in approach. However, the above characterisation fails to accurately describe the current export arrangements which have been changed from a veto provision held by AWB to an approval vested with the Minister for Agriculture. The Wheat Export Marketing Act 2008 achieves a further significant deregulation of wheat export arrangements.

In moving the second reading of the bill, the minister for Agriculture, the Hon. Tony Burke, drew the House’s attention to the historic nature of the changes:

⁶ Corrs Chambers Westgarth and CBH, *Grain Express Cbh Grain Supply Chain Solution: Notification under Trade Practices Act 1974 (Cth) Section 93* (2008).

⁷ Sd+D, *Wa Strategic Grain Infrastructure Study* (2005), Final Report for the Department for Planning and Infrastructure, WA Australian Railroad Group, AWB Limited, CBH Limited.

⁸ Ibid.

⁹ Ibid., page 29.

¹⁰ Corrs Chambers Westgarth and CBH, page 68, par. 6.14.

Under these changes, for the first time in more than 60 years, Australian wheat growers will be able to choose whom they sell their grain to based on the very best deal they can get.

Today's farmers continue to benefit from the abolition of trade tariffs and the trade liberalisation reforms introduced by the Hawke-Keating Labor governments.

Today's wheat growers also enjoy the benefits offered by the deregulation of the domestic wheat market in 1989.

Tomorrow's farmers stand to benefit from the reforms introduced to the parliament today.¹¹

Similarly, the Opposition drew attention to the importance and impact of the bills

Under a deregulated system, new opportunities will be available from the innovation and diversification that will arise. We believe the time has come to introduce competition and choice into the wheat export market.¹²

3.1 New entrants to the export market

The Commonwealth Wheat Export Marketing Act 2008 came into operation on 1 July 2008. The Act lifts the previous AWB¹³ export monopoly over bulk export of wheat. The Commonwealth has instituted a licensing regime under which potential exporters need to demonstrate they are a company under Australian law and that they meet various tests of probity and financial capacity. The result of these changes will be an immediate reduction in the market share of AWB in Australian export wheat and the entry of an expected forty or more licensed exporters, including a number of international grain traders already active in the Australian domestic grain market. CBH itself announced on 4 July 2008 that it has applied to Wheat Exports Australia (WEA) for accreditation to export bulk wheat for the coming harvest. The press release notes CBH "has been positioning itself for a reformed wheat marketing environment for many years now and has customers around the world who are ready to buy wheat this year."¹⁴

3.2 An end to the national pool

Another consequence of the deregulation of export wheat marketing is the dismantling of the national wheat pool. AWB has confirmed there cannot be a national pool without guaranteed volume therefore without the certainty of the export wheat it will not be operating a national pool. AWB and other market participants have indicated they will offer limited regional pools in certain commodities.¹⁵ The end of the national pool has by far the largest impact for growers (and bulk storage handlers) in WA. In the past, a far larger percentage of the crop has been delivered to the pool in WA than in the Eastern States. Many growers near Melbourne or Sydney's large domestic flour mills may have never delivered to the national pool whereas it would only be very specialised WA growers servicing the domestic or container export markets that has not used the national pool.

While some grain marketers will operate regional or specialised pools, the closure of the national pool will, necessarily, lead to a greater proportion of grain being traded via a greater variety of contractual mechanisms. These include cash contracts at harvest, forward contracts, and contracts based on traded financial instruments such as the ASX futures markets.

3.3 Creation of a Secondary Market in WA

Since 90 – 95 percent of WA grain is exported, to date overwhelmingly in bulk by AWB, there have been very limited opportunities to develop secondary grain markets in WA as AWB was effectively the only final buyer. With the deregulation of bulk export new market opportunities will arise for grain traders to transact amongst themselves. The Grain Express proposal appears not to account for this possibility.

¹¹ Tony Burke, *Wheat Export Marketing Act* (House of Representatives, 2008), 2nd Reading Speech.

¹² Brendan Nelson, *Wheat Export Marketing Act* (2008), 2nd Reading Speech.

¹³ Since 1997, exporters other than AWB have been able to apply for very limited licences to export. These licences amount to less than 2% of the national wheat crop.

¹⁴ CBH, "Grain Pool Applies for Wea Accreditation," 4 July 2008.

¹⁵ AWB has announced an east coast pool and a WA pool will operate for the coming harvest.

The benefits of the development of such a market include greater depth of individual varietal markets and lower transaction costs, as buyers will specialise at up country receivals sites and then trade in the secondary market to fulfil their export books. In addition, the creation of a deep secondary market in Australia's largest wheat producing state is likely to have important positive implications for the liquidity of wheat based financial products such as the ASX wheat futures contracts.

3.4 CBH required to make access undertakings to the ACCC

The dismantling of the single desk provides the grain port infrastructure providers (CBH, Graincorp and ABB) with an opportunity to export wheat on their own account. As noted above, CBH has already moved to take advantage of the new accreditation procedures.

The Commonwealth Government has recognised these infrastructure owners will have the potential to exert market power as a result of the monopoly ownership of port facilities. As a result, the Wheat Export Marketing Act 2008¹⁶ requires these organisations to enter into access undertakings under Division 6 of Part IIIA of the Trade Practices Act 1974 or to obtain a decision under Division 2A of Part IIIA of the Trade Practices Act that a State based access regime is acceptable.

During the review process for the Wheat Export Marketing Act 2008 many submission expressed considerable unease that the intent of the Act, to open up export wheat markets, would be stymied by the infrastructure owners prioritising their own shipments or by setting discriminatory access charges.

Aside from consideration about whether growers and Australia generally is best served by establishing a new grain monopoly in WA, CBH is acting precipitously by seeking to establish the Grain Express model, which entrenches a supply chain monopoly, before dealing with the port access issues as required by the Act.

4. Issues concerning the structure of industries

4.1 The theory of the firm

It is now universally agreed that the best outcomes emerge from freely contested markets, where there are many suppliers and many customers and the suppliers are profit maximising firms not subject to political direction. ACCC Chairman Graham Samuel put this case when he argued,

“Competitive markets usually deliver good outcomes because they act to align the interests of consumers and suppliers. In seeking to maximise profits, suppliers have strong financial incentives to produce at the lowest cost, to provide the mix and quality of goods and services required by consumers and to innovate in order to achieve a competitive edge. Provided that certain threshold conditions, such as secure and enforceable property rights exist, competitive markets work by themselves.”¹⁷

Within the context of competitive markets, there are powerful incentives for internalising activities within the firm. Integration in this way creates a monopoly whereby the firm's component parts act in unison vis-à-vis customers and suppliers. Barnard¹⁸ stressed the importance of a coordinated administration with deep knowledge in a “conscious, deliberate and purposeful” way. This allows adaptation without lengthy negotiation.

Coase in the *Theory of the Firm*¹⁹ saw transaction costs as the key to why most integration takes place. Unlike with bilateral binding contracts, the firm becomes its own court – it contracts within itself allocating overheads and determining accounting practices and changing conditions without recourse to a

¹⁶ Commonwealth of Australia, *Wheat Export Marketing Bill*, 2008. pt. C2008B00160, Division 8, Section 24.

¹⁷ Graeme Samuel, "Australian Infrastructure Reform: Where to from Here?," in *South Australian Centre for Economics corporate lunch* (Adelaide: 2006).

¹⁸ Chester Barnard, *The Functions of the Executive* (Cambridge: Cambridge University Press, 1938).

¹⁹ Ronald Coase, *The Firm, the Market, and the Law* (Chicago, IL: University of Chicago Press, 1988).

third party. Vertical integration becomes a way of relieving bargaining where there is a bilateral monopoly – in that case the division of profits is indeterminate²⁰.

As Coase identified, bargaining is not costless but vertical integration can lead to inflexibilities in capital and labour usage and may sacrifice the individual's entrepreneurial motivations. Where tasks are known with considerable certainty and contracts are therefore easily transmitted and recorded, vertically integrated firms are not usually the best vehicle for production. Where contracts are easily monitored, as in the house building industry, having independent contractors ensures a very high degree of motivation. Repeat contracts and the need to ensure a good name are important adjuncts to the efficiency of such arrangements.

The issue of vertical integration is a long-standing one of management decisions about "make or buy". In a great many industries, vast factories once maintained an in-house production system to allowed good coordination of quality and stocks. This factory system was at the heart of the industrial revolution but, over time, production systems have been radically transformed and factories now concentrate on final assembly of parts and components that are sourced from a considerable number of sub-contractors, many of which are competing with each other and some also source supplies to rival concerns of the main contractor. Sub-contacting in this way is the successor to the previously vertically integrated businesses in manufacturing of cars, clothing, whitegoods and other products and has led to the just-in-time models developed by US businesses and further perfected as *kanban* in Japan. However, subcontracting requires far greater coordination.

Models based on voluntary sub-contracting are also the essence of the business success of supermarket chains with Wal-Mart leading the way. The models depend on firms freely contracting with each other and developing mutual trust. Innovation and cost saving is created by the lack of constraint on how the supplier and purchaser mutually arrange the transport and delivery.

Other types of production, especially where a process is concerned, leave too many risks in having people independently contracting rather than under a management system. In some industry structures, such advantages were seen to be crucial by the Infrastructure Task Force, which noted²¹,

“The difficulties associated with physical coordination of complementary investments are, however, greatly complicated by disputes over the division of the gains from those investments. Historically, vertical integration between infrastructure providers and the activities that most rely on their services has been a way of avoiding these complications. In some cases, this has taken the form of direct ownership of infrastructure assets by their sole or major user; in others, ownership has been through what amounts to buyers’ joint ventures. But where vertical integration is impossible, or for wider policy reasons judged undesirable, coordination issues — be it for complementary or for substitutive investments — are likely to arise. Difficulties in organising all the parties required for complementary investments to occur, and in securing agreement as to the sharing of the costs of needed capacity expansion, can paralyse the capacity expansion process — perpetuating bottlenecks that all parties would be better off resolving.”

As the above passage makes clear, vertical integration is often a more efficient means of arranging production and the major iron ore producers clearly are of that view as regards their operations in the Pilbara. In such industries, the integration develops spontaneously and without compulsion. It resembles the pattern which occurs in an assembly plant with its interlinked series of operations often, conducted on a moving conveyor belt. Indeed, with regard to the Pilbara iron ore operations, in Robe River (1998) Kenny J., of the Federal Court, determined that access sought by North's to a rail line owned by Rio was not justified because the rail facility was akin to an integrated manufacturing facility which is specifically excluded from coverage of Part IIIA of the Trade Practices Act. This ruling remains pertinent although in BHP Billiton Iron Ore v NCC (2006) Middleton J considered this to be incorrect and ruled that access to

²⁰ Fritz Machlup and Martha Taber, "Bilateral Monopoly, Successive Monopoly and Vertical Integration," *Economica* 27, no. 106 (1960).

²¹Exports and Infrastructure Taskforce, *Australia's Export Infrastructure* (Canberra, 2005), page 18, Report to the Prime Minister.

the railway is not “use of a production process” but it is a transport or conveyance service and cannot fall within the production process exception.

This Middleton interpretation best describes the typical situation where the transport function is divorced from other elements of production because the skills and risks involved are not those of the upstream and downstream businesses. This can be observed with electricity supply – although the vertically integrated state businesses were disaggregated by government decision, most privatised Australian electricity businesses have voluntarily further disaggregated their distribution businesses in recognition of this. Most other businesses contract with specialised transport firms rather than provide the services in-house.

At issue in this regard is the question whether the grains industry most closely resembles a manufacturing process, as Kenny J ruled was the case with the Pilbara iron ore mining and transport; or whether it is a more common situation whereby producers are best making their own transport arrangements or arranging for their buyer to do so with the transport system adapting to undertake the task efficiently. In the former case an issue to be considered is why the various parties were not driven by the pursuit of better profits to set up in an integrated way without the intercession of government agencies to require this.



4.2 Monopoly and its Economic Disadvantages

4.2.1 Market Dynamics

Networks within which grain growing and marketing functions are integrated under tight co-ownership arrangements have not evolved. Where forms of such arrangements are in place, as with primary industry producer boards, this is because of government requirements or at least because of government support. Government compulsion of producers to use a common marketing arm has now been removed in Australia. This recognises that forcing independent businesses to use a monopoly supply system is no more cost minimising in agricultural industries than it is with other industries.

Transport and inventory management is often the key element in a firm’s success. In the *World is Flat*²², Thomas Friedman describes how the world’s most successful retailer, Wal-Mart, has reached its current position by developing a distribution network that ensures timely delivery of goods from all over the world to all of its thousands of stores at the best prices. The kernel of its success is the management of its distribution chain. Similarly, the world’s major grain marketers have achieved their success by concentrating on:

- seeking out customer needs in terms of different quality facets and their price/availability trade-offs;
- assembling the appropriate supply packages from growers;
- arranging transport storage and final delivery to meet the needs of the customer.

Wheat, like other grains is not and cannot be a homogenous product which a single firm might be able to supply the market more profitably than competing firms. A single monopoly integrated supplier would be most unlikely to be able to obtain and process all the changing information that comprises the market and its supply. Evidence in support of not forcing the creation of a monopoly on efficiency enhancing grounds is that such a business does not appear to have evolved (without government compulsion) anywhere in the world.

Forcing the supply through a single entity would deny the market the alternative providers and the specialised knowledge they can obtain. It would leave growers who consider their product would be better marketed in ways that would improve their profitability no means of testing this. It would, in leaving no independent scope for suppliers and marketers to experiment with new product categories, reduce the scope for innovation in better meeting market needs and thereby, over time, reduce the industry’s productivity.

²² Thomas Friedman, *The World Is Flat* (New York: Farrar, Strauss and Giroux, 2005).

Markets are in a continual process of development and change and the creation of barriers to that change causing considerable harm in preventing adjustment and innovation. Schumpeter famously referred to the “gales of creative destruction” which he considered to be of such great importance to economic growth and well-being as to dwarf the worth of the incremental gains in productivity seen in stable business situations.

For these reasons, the notion that national benefits can be gained by constraining the number of suppliers in a particular industry is not one that finds favour with any branch of economics.

Although there are often considerable economies of scale the importance of these is often overstated. It might for example be claimed that transport, stocking, and managerial economies would accrue if only one supermarket chain were to be permitted. The vast array of goods, perhaps 30,000, on the supermarket shelves, their infinite variety of sources, availabilities and sizes present a tempting offer for mandating a single supplier. Yet it is the competitive jockeying (an activity that the ACCC has suggested may be deficient in Australia) that has created the cost savings and customer orientation that mark out privately owned and rivalrous supermarkets as delivering the products consumers want; and where such outcomes are less than optimal, it is largely because government regulatory bodies limit access of new providers into the market.

Rather than constraining possible new suppliers to ensure a monopoly is created or preserved, competition authorities have been focused on the gains from competition and the dangers of a dominant firm exercising market power. Rightly or wrongly, competition authorities across the world have been anxious to ensure that dominant firms do not use the market power they are said to enjoy to exclude new competitive offerings. Microsoft and possibly Google and at one time IBM are firms that have achieved market dominance because of their skills in meeting market needs. Competition authorities have often sought to restrain what they see as abuse of market power being exercised by those firms.

In Australia and elsewhere, competition, its promotion and removal of barriers to it is now enthroned as the key industry policy to the promotion of efficient outcomes. Though always a dominant feature of the Trade Practices Act, this was invigorated as a policy approach by the competition reforms of the 1990s. The touchstone for these was Hilmer Report.²³

The Hilmer Report and its subsequent acceptance by Australian Governments represented a decisive shift in policy perspectives. Prior to its recommendations being adopted, often a claim was made that legislated monopoly was necessary to avoid ‘destructive’ or ‘wasteful’ competition. There have been suggestions, in this respect, that with the lifting of some regulatory controls a subsequent parallel roll-out of Optus and Telstra cable was an instance of such wasteful competition. This is unlikely in a competitive market characterized by profit-maximising behaviour where firms will cooperate with competitors to share facilities of component production when these require economies of scale that the firms cannot individually reach. Examples of this cooperation are to be found in petrol retailing where the majors share storage facilities and in component manufacturing in the motor industry where assemblers sometimes source from rivals.

In any event the adoption of competition policy principles was an acceptance that if private sector businesses did not always undertake investments and policy choices that were, especially in hindsight, sub-optimal, government and government supported monopolies tended to be far worse. Though not necessarily promoting privatisation, the principles adopted then, which remain in place today, were that far from protecting monopoly practices governments committed themselves to dismantling them whenever possible.

Such a position prevailed even in areas where “natural monopoly” appeared inevitable – thus, the electricity transmission system is deemed to be contestable (and two incursions into the monopoly have been made though they failed to prosper). Natural monopoly is discussed in Section 5.3.

There have been examples in the past where products were required to use a particular mode in their transport. This was the case with coal briquettes in Victoria, which prior to the early 1990s reforms were obliged to use rail transport which was inefficient and in many cases inappropriate. The requirement was in place to support the business of the Victorian railway system – as with the CBH proposal under the

²³ Fred Hilmer, Mark Rayner, and Geoffrey Taperell, *National Competition Policy Review* (Canberra: AGPS, 1993).

supposition that forcing firms to use rail would assist that mode in maintaining economies of scale and scope thereby bringing wider benefits

Such protection of rail from road competition has been a frequent occurrence. Indeed in 1988, Trebeck reported, “road transport is restricted by legislation granting rights to rail within a State or region; by practices, such as in South Australia, where additional charges can be levied on road transport of grain; by road receivals facilities at some port terminals being non-existent”²⁴. Other measures favouring rail were removed as a result of a dual assault by an unlikely alliance of the High Court and a blockade of the Hume Highway in the 1970s led by a truckie who went by the colourful name of “Greendog” Stevens.

The widespread use of a facility brings benefits that augment those accruing to early users. A telephone network, for example, is more useful the wider the number of connections. Recognition of this led network businesses to seek (and in the main gain) exclusivity and protection from rivals. It was thought that a rival network would lead to duplication of facilities and erode the economies of scale and scope that were present with a single network. However, there is no example anywhere in the world where access economies have been retained by forbidding competition. Barriers to entry in the provision of goods and services epitomise high cost and reduced competitiveness



4.2.2 Static Production Considerations

Monopoly is considered to bring about higher costs to consumers for other reasons. Conventionally, monopoly is opposed because it enables the monopolist to constrain supply below costs so as to take advantage of a downward sloping demand curve that is generally evident in major product classes. This brings a social loss as illustrated by the following standard depiction of a monopoly.

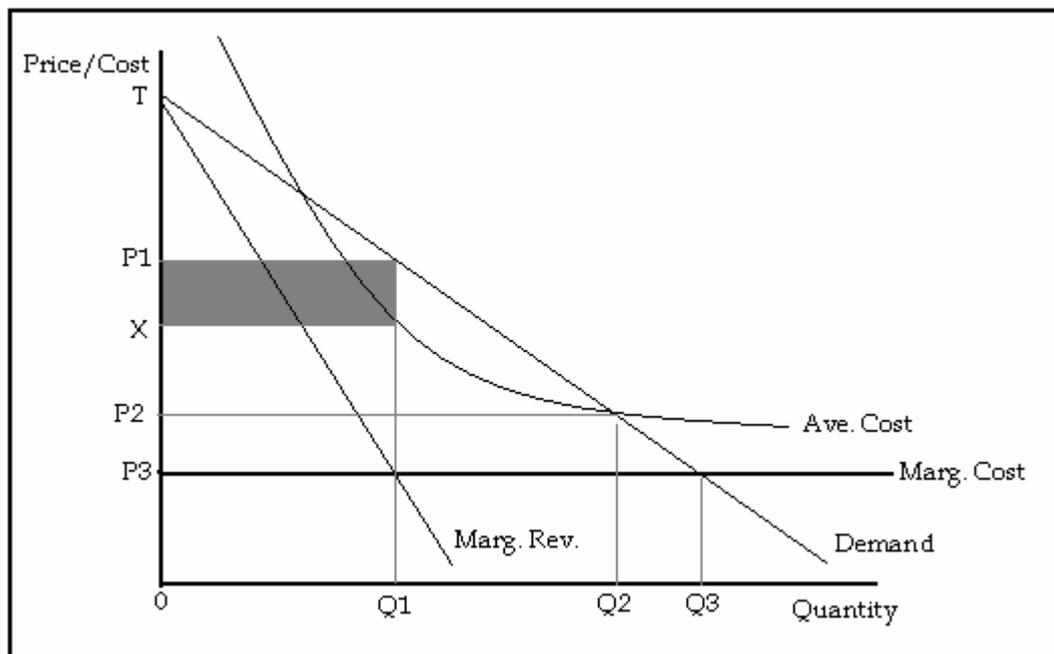


Figure 4

Price in a stylised competitive market as depicted in **Figure 4** would be at P3 and quantity at Q3 which is where marginal revenue intersects marginal cost. Such a market would be unstable as suppliers would be unable to cover their fixed costs and longer-term price and quantity are likely to move to P2 and Q2 where average costs and demand intersect. But in a monopoly situation the firm is able to constrain production and raise price without rivals being attracted to the consequent profitable opportunity and would do so to the point where marginal revenue and marginal cost intersect which gives a price of P1 and a quantity of Q1.

In the diagram, the firm earns a ‘super’ or ‘rental’ profit as shown by the shaded area. There is a welfare loss which would be the triangle bounded by

- the horizontal line from P2 to the average cost curve;
- the vertical line from Q1 to the demand curve; and
- the demand curve.

4.3 Natural Monopoly

4.3.1 The Notion of Natural Monopoly

Natural monopoly is one area where in principle government agencies can legitimately intervene to bring about a more efficient outcome than that which would prevail in Figure 4. Natural monopoly is where only one provider is ever likely to be viable. Viscusi, Vernon and Harrington describe natural monopoly as existing “if the production cost of a particular firm minimizes cost.”²⁵ Often this is associated with economies of scale.

Natural monopolies are often considered to be public goods that are made available to all at a fixed price or freely. But there is no immutability about a particular good or service being regarded as a natural monopoly. In the first Australian edition of Samuelson’s *Economics* in 1970,²⁶ examples of public goods (which he termed “social goods”) involving a natural monopoly supplier to a city were cited as being, “water mains, gas pipes, electricity wires, telephone cables, train tracks and postal services”. It is notable that not all of these – certainly not all aspects of them – would now be considered natural monopolies and be subject to regulation.

This and similar experiences overseas has led many to argue that natural monopoly is only possible with government protection. Indeed, in the pre-Hilmer days in Australia the only such businesses were either protected by government from competitors (e.g. AGL’s gas monopoly in NSW) or were in fact government institutions with no provision to permit competing providers.

4.3.2 Addressing the Adverse Effects of Natural Monopoly

The CBH proposal appears to be intent on creating or maintaining a simulated natural monopoly. Its proposal distinguishes itself from other situations where a genuine natural monopoly is considered to be an unfortunate occurrence requiring a government agency to intercede to ensure it does not exploit its market power.

Aside from galvanising informed opinion about the merits of competition, Hilmer was fundamentally about removing the previous, largely government owned, monopoly positions that other businesses were forbidden to contest. The government businesses controlling the bottlenecks were encouraged to favour their up-stream and down-stream affiliates (sometimes all parts of the supply system were reserved for the monopolist). Following the Hilmer report, Australian Governments accepted their policy of creating monopolies, especially government owned monopolies, had led to poor productivity levels. The solution was to smash these long-standing monopolies and allow organic change in the structure of their service delivery, possibly leading to re-integration should that be the most efficient outcome. The Productivity Commission has documented the effects of the “competition reforms” of which such measures formed a part and estimated them to have been crucial to the development of the economic gains Australia has experienced over the past two decades (the PC’s report, *Microeconomic Reforms and Australian Productivity: Exploring the Links* is discussed later).

Where facilities or businesses grew to be regarded as having some monopoly features because they crowded out rivals, this was sometimes because the owners spotted an opportunity and became a successful “first mover”; sometimes it was through forms of innovation management. In the main, whether or not they were “first movers” the facilities achieved their essential nature by virtue of their owners providing a service that proved more attractive than alternatives. In the past twenty years, we

²⁵ W. Kip Viscusi, John Vernon, and Joseph Harrington, *Economics of Regulation and Antitrust* (Cambridge, Mass: MIT Press, 1995), 351.

²⁶ Paul Samuelson, *Economics: An Introductory Analysis*, Australian edition adapted by Keith Hancock, Robert Wallace. ed. (Sydney: McGraw-Hill, 1970). As well as authoring a standard economics textbook, Samuelson is generally credited with originating the theory of public goods in a 1954 paper.

have seen Microsoft and eBay do this but though they may seem impregnable to competition, they can retain their dominance only by constant innovation and cost-cutting.

The classic cases of dominance due to government licensing and exclusion of competition occurred with the mail system (though its monopoly is now trivial since it would have less than a one per cent share of the market for messages). Electricity lines too were generally vested as monopolies and even now where those rights have formally been abolished (as in Australia) the incumbent facilities' strengths and the difficulties rival facilities have in funding an investment means sustained breaches of the monopoly have not been made.

At a time in Australia when monopolies had legal protection from competition, price gouging (usually in the form of operational inefficiency) by the monopolist was likely, indeed was pervasive. Because rival facilities are no longer forbidden, non-regulatory price disciplines on existing facilities are in place. In fact, with access now mandatory and its terms subject to regulatory rulings, the price set by the regulator is often claimed to be too low.

This potentiality is among the reasons why even regulatory agencies say they are most reluctant to embark upon the detailed analysis (with its uncertain success) necessary to replicate the market disciplines that are present with genuine competition. Disadvantages of regulation designed to offset the economic harm that can occur with a monopoly are fivefold:

- First, the regulated firm is not incentivised to innovate. Indeed, unless given a guaranteed return, out of fear of regulatory expropriation the firm will avoid all but defensive capital investment.
- Secondly, the low price will leave access seekers with no incentive to build new facilities for themselves. Competition, except in the form of re-sale of the regulated facility, will thereby be constrained.
- Thirdly, the availability of a recourse to government to fortify one side's commercial negotiations leads to strategic business approaches which deflect firms from a customer focus.
- Related to this, the regulatory procedure for fixing prices is necessarily highly procedural and time consuming and can paralyse commercial decision making; while this can sometimes be to the advantage of the applicant which can thereby delay decision taking by a rival, it is to the disadvantage of the economy as a whole.
- Finally, the procedural nature of the regulation involves government and private legal and administrative resources that represent serious costs.

Regulatory control is a necessary corollary of natural monopoly but can lead to decision paralysis. The issue before us is the wish to create a contrived natural monopoly by forcing all the suppliers to use a common transport and storage system. To accommodate this, the checks that competition brings to prevent abuse have to be synthesised by the regulator – a process that no regulator considers to be as effective as the real disciplines on exploitation and inefficiency that is provided by genuine alternative market providers.

5. The Proposal in the context of Australia's competition policy

The CBH proposal breaks new ground in terms of the policy requirements in two directions. First, it proposes that suppliers should only use the services of CBH in the supply chain and secondly that they only use the transport services nominated by CBH.

There have been several competition policy matters that have been addressed by the NCC and the ACCC covering issues related to those in the CBH application. Mostly, these competition authorities and the Productivity Commission are rightly highly sceptical of claims that constraining competition will bring about "access economies". We have certainly seen seemingly impregnable monopolies like General Motors and IBM replaced as a result of competition even though their market positions gave great advantages against usurpers.

In the case of rail facilities, this demand constriction and super profit level of earnings would come about by a diminished service level (less frequent trains, closing some lines and facilities and so on). A

regulatory agency would need to ensure that the monopolist performed in a manner that is consistent with what would be expected in a rivalrous supply situation.

This is a task of considerable difficulty. As the Productivity Commission noted in *Microeconomic Reforms and Australian Productivity: Exploring the Links*²⁷ the monopoly rail service in NSW was highly inefficient as a result of the monopoly powers it had been granted. The PC noted that the increase in the economy's productivity observable from the late 1980s had been due to factors that included "reforms (to) remove those regulatory barriers that unnecessarily prevent firms from making productivity-enhancing adjustments to products and production processes". In singling out the NSW rail industry the PC stressed the importance of competition in forcing productivity gains.

In its review of national competition policy the PC said "NCP is based on an explicit recognition that competitive markets will generally serve the interests of consumers and the wider community, by providing strong incentives for suppliers to operate efficiently and be price competitive and innovative"²⁸. It reduces the onus of proof recognising that open access is likely to offer cost savings and other efficiencies by subjecting incumbents to the continual test of alternative suppliers. As the PC put it "in the case of NCP, governments endorsed the approach proposed by Hilmer (1993, p. 190) and reversed the onus of proof on the grounds that theory and evidence strongly suggest that removing restrictions on competition will typically be in the public interest."²⁹

Indeed, the PC in seeking further reform of rail freight did not even contemplate this encompassing restraint of competition for the mode. Instead, the PC argued,

"Taking account of reforms to date by the Australian Transport Council and individual jurisdictions, this review should map out what is required to:

- achieve competitive neutrality across all transport modes;***
- address barriers to competition and efficiency in individual modes; and***
- enhance interfaces between modes.***

There is a widely accepted view that monopolies can only exist - or persist for any length of time – if they have government support restraining rivals. This view, often attributed to Demsetz,³⁰ but actually goes back to Adam Smith. The proposal by CBH seeks government barriers against competitors on the basis that this will allow economies of scale, and scope that will offer benefits to the community in general. Such claims about the merits of exclusive rights were the basis for the granting of all monopolies – and Adam Smith was an early agitator against them.³¹

5.1 Authorisation

These matters were addressed in the Review of the Trade Practices Act Chaired by Sir Daryl Dawson and published in 2003.³² The report noted that some collective agreements have been dismantled in response to the National Competition Policy. It examined the *per se* provisions (s 47(6, 7) that prohibit exclusive dealing and third line forcing. It argued that there should be some relaxation of the *per se* provisions governing third line forcing. It accepted that third line forcing could be beneficial to the consumer where it allows two or more products to be sold in combination because it allows cost sharing.

However the Review made it clear that, "Third line forcing is anti-competitive where corporations are able to exploit their market power ... perhaps facilitating anti-competitive price discrimination or

²⁷ Productivity Commission, *Microeconomic Reforms and Australian Productivity: Exploring the Links* (Canberra, 1999), p.117, Commission Research Paper.

²⁸ Productivity Commission, *Review of National Competition Policy Reforms* (Canberra, 2005), page XIV, Inquiry Report, 33.

²⁹ *Ibid.*, page 135.

³⁰ Harold Demsetz, "Two Systems of Belief About Monopoly," in *The Organization of Economic Activity* (Oxford: B. Blackwell, 1988).

³¹ Smith opposed local monopolies of tradesmen and he sought the abolition of the East India Company's monopoly of the Indian trade and British shipping monopolies to North America that were a cause of the War of Independence

³² Daryl Dawson, Jillian Segal, and Curt Rendall, *Review of the Competition Provisions of the Trade Practices Act* (Canberra: DOCITA, 2003).

barriers to entry”. Noteworthy is the fact that this Review (like the PC analysis) did not even contemplate the possibility that there would ever be a claim for the “full line forcing” like that being sought.

This is hardly surprising, since as already discussed, the nexus of the Competition Reform program embarked upon by governments from the early 1990s was competitive neutrality. Importantly this involved preventing areas of business being reserved for particular suppliers and where monopoly was natural, ensuring that the provision of the services was on cost reflective and efficient terms. Reserving an area of business for a particular firm or preventing rivals from challenging for specific parts of a business is inimical to competition policy as it is stated and largely practiced throughout Australia and the rest of the world. Indeed, the activities of competition policy agencies like the ACCC are geared towards preventing such activities and trade monopolies from arising or, if they arise, examining ways that they can be freed up.

5.2 Full Line Forcing and the CBH Application for Authorisation

CBH seeks to characterise its application as one of “full line forcing”. This is different from third line forcing, where the Dawson report called for relaxations of the *per se* provisions.

Full line forcing is a voluntary agreement between firms at different stages of the production cycle. It is at the heart of franchising operations and of “voluntary chains”, like the Independent Grocers of Australia where tight and binding commitments are made in a common interest. Importantly, these agreements are entered into voluntarily. In the examples of this that are present in the economy none entail the coalition of firms or the central agency recruiting the power of the state to create a compulsory arrangement. A business is never obliged to commit to using the bundled product by dint of the government forbidding others from offering an alternative.

Arguably, such an approach is being contemplated by the ACCC for the broadband network by the Optus led G9 group of businesses which is seeking approval to build a new network on condition that no rival may overbuild it. The ACCC has not agreed to the proposal. Even if it did, the Special Access Undertaking that it would entail is different from that being promoted by CBH since it would be offered as part of a package which entails considerable investment in a facility that, the G9 argues, would not be undertaken to the extent proposed without such support.

CBH claims that the network benefits it provides are considerable and that these would be undermined if competition were to be permitted. It argues that suppliers would cherry pick or perhaps choose an alternative transportation that they mistakenly believe to be superior to the incumbent system.

Such claims must be tested. It seems remarkable that wheat in Western Australia has production and marketing characteristics that make it different from every other commodity that is produced and traded. CBH:

- points to volatility
 - but this is common in agricultural products;
- argues that it is uniquely placed to ensure appropriate product varieties emerge
 - but the varieties in “homogeneous” products like wheat are often considerable and these standard variety categories emerge from the demands of the consumer interplaying with those of producers and transport systems;
- suggests that it must be the central point to minimise shipping costs,
 - yet in no other industry is that required, still less permitted;
- argues that the logistics of opening storages and applying fumigants make it necessary to have a monopoly operating system,
 - a public schedule of openings would achieve this;
- repeats the discredited case for reserving business for rail that dogged the Australian transport network until the 1970s and in some cases up to the 1990s, namely that economies of scale require road to be banned and traffic to be funnelled onto rail.

5.3 Ring Fencing

There are frequently legitimate concerns about affiliated companies being ring fenced to ensure some parts of them so not divulge commercial-in-confidence material to other parts that might obtain benefit from such knowledge.

With profit maximising firms operating in competitive markets, such concerns have proven to be groundless. In the motor vehicle industry, for example, many subsidiaries of major vehicle assemblers also produce parts which are sold to both their parent companies and to competitors. The market itself provides disciplines to prevent information leaking across the ring fence since a component producer allowing this to happen would be adversely affected in terms of reputation. Unaffiliated firms would stop doing business with the subsidiary.

These same conditions have been observed in the electricity industry. At the time of corporatisation and privatisation, the electricity retailers were considered to have little value since they had few assets. They were amalgamated with ring fences with the host distributor in the area where their customers lay. Firms recognised that retailing and distribution were entirely different businesses and the retailers were split for the most part into different corporate entities. Retailers and generators have tended to form closer alliances with cross investments. This represents a need to develop a profile for risk reduction. The retail entities with generation affiliates are operated in a strict ring fenced manner from their affiliated generators because of the need for the retail arm (and the generation arm) to ensure it is able to deal with all potential customers without the customers being wary of compromising confidential information.

These developments have occurred because of the rivalrous nature of the businesses. Were one firm to have a monopoly of one stage in the production chain, there would be fewer automatic business disciplines to ensure that the ring fence was complete.

6. The proposal in the context of grain logistics in other Australian markets

Although all of Australia has, until now, been constrained by the single desk monopoly in wheat marketing, the greater depth of domestic markets for wheat and other grains in Eastern seaboard states has resulted in them already experiencing the multiple buyers and sellers of grain that WA is now open to. In NSW and Victoria the interaction of millers, feed lot operators, extractors as well as domestic and export traders results in thousands of participants in the overall grain supply exercise. The level of complexity faced by the NSW and Victorian industries is very unlikely to be reached in WA because in WA most grain will end up at port, whereas on the eastern seaboard a significant proportion is intra and inter-state freight.

Other States have developed operational procedures to account for the complexity claimed in the CBH proposal and provide some indication of the sorts of solutions to logistical complexity claimed by CBH. In no case has the lack of the sort of restrictive practices sought by CBH been necessary to run the Eastern States grain logistics operations.

In the submission by CBH, including the report by Synergies Economics, a number of specific claims are made in support of their claim for approval of Grain Express. Many of these claims arise purely from the historical choices CBH has made as a monopolist or from the unique position of AWB as the buyer of over 90 percent of the historical crop and are of an administrative or procedural nature. In addition, there are current procedures undertaken by CBH not in accordance with their State based legislation which CBH are now seeking to rely on in their application.

6.1 Pre-harvest information collection

The Bulk Handling Act Regulations 1967, Section 11.(1) requires growers to inform CBH of crop estimate data before being permitted to deliver any grain. CBH claims “important information exchanges occur at the production stage, which influence the rest of the grain supply chain”.³³ However, growers contacted by the IPA assert this information is rarely collected before harvest so has limited planning utility, and even at harvest there is substantial local discretion as to when these forms are lodged with a substantial minority lodged at the end of deliveries. The value of any pre-harvest data must therefore be regarded as questionable³⁴.

³³ Corrs Chambers Westgarth and CBH, page 17, par. 2.25.

³⁴ Ibid. See page 5, par 1.7 for confirmation that grain tonnages are only known at harvest.

6.2 Deliveries to CBH at harvest

For all grain growing, the harvest period is intensive and concentrated, with virtually all grain harvested in a ten week period. In many respects this is the most difficult and complex part of the grain logistics exercise because there is an external constraint (the weather) on its achievement. There will be no change to this task under Grain Express. Approximately 5,300 individual growers will still strip their crops according to their preferred harvesting schedule, carters (either the growers themselves or their agents) will truck the grain to the storage facility where the trucks will line up, sometimes for hours, to be weighed, the grain tested, the individual load tests printed out on a receipt and then emptied onto a bunker based on its grade.

There is no suggestion within the Grain Express model that growers will be required to adhere to a harvest and delivery schedule or only hire specified carters. Yet it is at this point of the whole logistics operation where there is the greatest number of participants: 5,300 growers,³⁵ in the order of 4,000 truck drivers, 193 individual storage sites,³⁶ and a growing number of buyers. It is incongruous that CBH appears confident of operating this part of the logistics task in the most efficient manner but requires ACCC protection once the grain is in the storages and has the entire year to be moved, to perhaps 50 buyers.

CBH has identified a current bottleneck in the site receivals process, namely the current operational requirement for the truck driver to nominate the buyer of the grain on a Carter's Delivery Form (CDF) upon delivery to the storage facility. CBH claims 30% of all loads delivered to storage facilities had errors on the CDF. CBH plans to fix this problem by allowing growers 21 days grace before they have to either nominate a buyer or start paying warehousing charges and to make the nomination electronically. CBH claims the current arrangements are required under Section 37 (1) of the Bulk Handling Act 1976 which requires CBH to issue a warrant to the buyer in respect of all grain received. However, the Act does not specify a period for this to occur instead saying "as soon as practicable after being so required by the grower."³⁷ Furthermore, the Grain Express proposal notes some 50 percent of all deliveries are not covered by a CDF but does not explain why this is the case if there is a legislative requirement for nomination on receivals.

The ACCC should be aware that the requirement to nominate a buyer on delivery is unique to WA. Furthermore, the proposed "fix" is below standard practice on the east coast. For example growers delivering to Graincorp's Victorian storages have 31 days past the end of the week of delivery to nominate a buyer before warehousing charges are payable. Similarly, all nominations are processed electronically through Graincorp's "Grain Transact"³⁸ site at no cost to the grower.

6.3 Grains ain't grains

In its application CBH notes it currently segregates wheat into a number of grades, e.g. ASW or AH, at individual storage sites.³⁹ Current practice is to co-mingle all grains of the same specification within each location's storage facilities. This means that a buyer of, say, 300 tonnes of noodle wheat from a Katanning grower will get noodle wheat from Katanning but that 300 tones could come from many Katanning growers' farms rather than the specific farm of the seller on the contract.

The Bulk Handling Act and Bulk Handling Act Regulations specify that buyers be only entitled to receive grain at least equal to the grade specified on the warrant of sale. Growers, CBH and buyers have to date interpreted those provisions as requiring CBH to deliver wheat from the same storage or silo the grower entering into the contract delivered.⁴⁰

Under Grain Express, buyers will no longer be able to receive wheat from a specific location. While the buyer will still be entitled to grain that meets the specifications in the standard, the grain could come from

³⁵ ABS 7121.0

³⁶ Corrs Chambers Westgarth and CBH, page 21, par. 2.43.

³⁷ WA Bulk Handling Act 1967, Section 37(1).

³⁸ Graincorp, "Grain Transact" <http://apps.graincorp.com.au/graincorp/> (accessed 5 July 2008).

³⁹ Corrs Chambers Westgarth and CBH, page 22, par. 2.47.

⁴⁰ Ibid. See page 28, par. 2.83 for confirmation that grain is geographically sourced at present

anywhere in WA. CBH claims a major part of any efficiency gains of Grain Express will come from its ability to aggregate grain of the same specification into larger parcels for transport and storage at port.

However, while standard grain specifications measure some attributes (e.g. moisture, protein and screenings) they do not capture all the differences between loads of wheat. For example, two parcels of wheat may both test as meeting ASW standards yet will exhibit different “bakeability” characteristics. These characteristics are often geographically based and come from the specific growing conditions experienced by the wheat that season. It is common on the East Coast, where more wheat sells to the domestic market, for individual growers to mail samples of wheat to prospective buyers to be test baked before being offered a price. The premium above the standard grade price will depend on the ability of the grower (or grain trader) to identify a buyer wanting those particular characteristics, a highly information dependent process. With the opening of the WA market to export competition, the opportunity now arises for grain growers and buyers to seek out valuable regional differences in grains that are not captured by the specifications. Grain Express will make such a development impossible.

The Grain Express proposal notes the existence of different characteristics within grades but takes a peculiarly anti-competitive stance in accusing marketers of seeking “to “mine” co-mingled stacks in order to obtain a greater share of high quality grain than the Marketer has paid for.”⁴¹ This is indicative of a major deficiency of the proposal. Arrangements do develop that provide adequate assurances to all parties about quality characteristics of produce that allow contracts on the basis of standardised goods that may be sourced through swap systems from suppliers other than those making the original contract. However, the standard thus arrived at are developed by the mutual interaction of buyers and sellers. The appropriate standards are unlikely to be static and can only be developed through the freedom of growers and marketers to contract one with the other without the standards being dictated by another party. Indeed, the superfluous costs and inefficiencies created by parties trying to “mine” co-mingled stacks emanate from the arbitrary establishment of standards not fully reflective of market needs.

6.4 Supply Chain Costs Transparency

The Grain Express proposal claims:

2.95 Transparency of Supply Chain costs is a real issue in the Western Australian Supply Chain because, in the case of AWBS, service fees (including transport) are deducted in an aggregated fashion and the fees for particular movements are not distinctly disclosed.

And

3.18 Under current arrangements, Marketers quote prices on a port basis, and therefore generally deduct freight charges from Growers’ payments. The actual cost under marketing options of carrying a Grower’s grain to port is not transparently disclosed.

These statements are redundant for the upcoming harvest and all subsequent harvests as they are premised on the conduct of AWBS under the former single desk arrangements. In a regulated market, the point of export is up country receivals storages whereas in the newly instituted deregulated market, the point of export is often the port.

Because such a large percentage of the WA crop is exported and has therefore been delivered to AWB pools there was real transparency issues for growers, particularly in relation to transport charges and internal management fees. Post the passing of the Wheat Export Marketing Act 2008, AWB no longer holds the single desk. Competitive pressures will therefore force AWB to move to a port price as every other grain buyer offers now. Attachment 1 is an actual payment advice issued by Graincorp for wheat delivered in the last season for delivery from Willaura to Portland (port). The freight to port is clearly identified as such in the 15th column of the table. This is standard practice for east coast wheat payments. Just because AWB was not transparent in the past because it offered a pool price is not the relevant benchmark for the future. In an environment where pools will decline and entities such as Graincorp will enter the WA market to export on their own account, the experience in the Eastern States informs with

⁴¹ Ibid., page 49, par. 3.29.

some certainty that the WA grain market would anyway move to transparent pricing without the heavy hand of Grain Express.

7. Impacts of the Proposal

7.1 Grain growers subsidize the rail network

In its proposal CBH asserts that the consequences of inaction will be serious and immediate. The only actual consequence claimed by CBH of failing to have the Grain Express proposal authorised is further leakage from rail to road freight (see par. 1.13). As has been identified above, grain freight has been progressively moving away from rail although rail maintains the largest market share of grain freight in WA. A recent study of WA grain infrastructure found that for an average grain harvest size, the rail network as currently configured generates a loss of \$5.7m p.a. Furthermore, of the four rail networks, two, “Albany and Geraldton do not return positive results under any practical rationalisation scenario, primarily due to low grain volume density and competitive road networks.”⁴² The Kwinana zone is found to be negative on its current configuration however a program of line rationalisation could reverse this.

Failing other policy changes it is likely therefore that grain freight will continue to exit rail for reasons unrelated to the deregulation of the wheat market.

The choice of transport mode should be based on the costs to the user. Both road and rail have distortions in the charges that are levied as a result of political overrides of cost based charging which has brought subsidies and averaging of costs. Overall freight road users’ tax payments far exceed the expenditures on roads, including appropriately allocated externalities.⁴³ Rail delivers a very low return on the investment incurred in its development and upkeep and is inherently unsuited to the increased segmentation of grades and varieties in the Australian grain industry.

What the Grain Express proposal seeks to do is force grain to stay on rail despite its lack of price competitiveness and the unprofitability of the rail system. The result of this is growers, who pay the freight charges from silo to port, are required to prop-up a rail system in need of significant investment and which is uncompetitive with road without subsidy.

The WA Strategic Grain Infrastructure Study contended “the grain rail network is of strategic and economic value to the local, state and national communities. State government is the most direct beneficiary of the rail system and is best placed to develop funding support mechanisms to ensure its sustainability, including a track CSO arrangement.”⁴⁴ And,

“Having sold Westrail and legislated for an access regime and a regulator, the state government has not taken any substantial role in planning for the grains logistics industry. The Government has a stated objective of supporting rail and transferring freight from road, but there are few direct signs of this support.”⁴⁵

If, as appears likely, the WA Government supports the Grain Express proposal, a key motivation for doing so may be that Grain Express is a mechanism to reduce the level of any CSO arrangement necessary to support its policy objective of supporting the rail industry.

In any case, it is not the role of the ACCC to intervene in policy questions outside its competition remit.

7.2 Cross subsidisation of wheat growers by other growers

Grain Express proposes to mandate a single receipts and handling fee for all up-country storage sites. However, as the Synergies report makes clear, these facilities vary considerably in “size, geographic

⁴² Sd+D, page 8.

⁴³ Productivity Commission, *Road Freight and Infrastructure Pricing* (Canberra, 2006), Inquiry Report, 41.

⁴⁴ Sd+D, page 9.

⁴⁵ *Ibid.*, page 14.

location and mobilisation cost.”⁴⁶ Similar to the well-positioned growers subsidizing rail costs of outlying growers above, Grain Express will force growers located near to efficient, low-cost receivals sites to cross subsidize those growers less well located. The creation or maintenance of hidden cross subsidies in this manner is akin to the creation or maintenance of a community service obligation (CSO) which is contrary to national competition policies and more properly explicitly funded by government policy outlays than by other growers.⁴⁷

A consequence of flat receivals pricing will be the continuation of smaller, otherwise uneconomic sites thereby placing an additional cost burden on the entire system. Additionally, while the very small or outmoded receivals sites continue via cross subsidies, this hinders the possibility of either rationalisation by CBH, or the entry of new storage and receivals operators. A fact the Grain Express proposal notes.⁴⁸

CBH claims that because it is a cooperative, owned by growers, its interests are aligned to growers.⁴⁹ However, growers are not an homogenous body, instead they exhibit significant differences in scale, profitability, access to transport and port. In an environment where there is the entry of additional grain buyers from the deregulation of export marketing, the divergence of growers’ interests is likely to accelerate. Just as in other markets opened to competition there will be winners and losers from this process. However, successive competition authorities and policy makers have recognised the overall economic benefit from additional competition and have acted to remove, or at least make transparent, hidden cross subsidies rather than embed them.

7.3 Disguises poor investment decision by CBH in container shipping

CBH has invested in considerable container loading and handling facilities known as the Metro Grain Centre (MGC) at Forrestfield. The Grain Express proposal states this facility can now handle approximately 1,000,000 tonnes of grain per annum.⁵⁰ In 2007 CBH commenced construction of a container park at the MGC as a noted component of its reported \$16 million of capital works.⁵¹ The 2007 annual report from CBH notes the rapid increase in containerised exports as the basis for this investment decision. In 2007, the export of wheat in containers was deregulated and prior to the limited issue of export licences, this was the only mechanism to circumvent the single desk monopoly.

Despite reductions in containerised shipping rates in the past few years, it is still more expensive to load and ship via container than in bulk. With the recent lifting of restrictions on bulk export wheat, it is unlikely containerised wheat will comprise anything but very limited niche opportunities. In this environment, CBH’s recent capital expenditures are unlikely to make returns above the cost of capital if handling charges for containers are priced transparently.

However, the creation of Grain Express provides CBH with the opportunity to subsidise container loading at the expense of bulk loading and thereby recoup their investment. The access provisions in the Wheat Export Marketing Act 2008 do not stop CBH from cross-subsidising container loading as long as all customers have access to the same pricing.

7.4 Limits development of a secondary grain trading market

The creation of Grain Express will stymie the creation of such a secondary physical market. This will occur in a number of ways. Firstly, as Grain Express makes clear, it will be the only possessor of whole of system stocks information. Competitive markets are by definition predicated on efficient flows of information and the Grain Express proposal makes clear CBH has no intention of sharing this information. The creation of Grain Express will remove the otherwise natural incentives for grain traders at least to share stocks information as a mechanism to aid the development of a secondary market.

The Grain Express proposal does not explain how costs will be charged for intra-system trades between buyers. It is not explained whether grain buyers will be forced to pay to physically move the grain to an

⁴⁶ Synergies Economic Consulting, *Benefits of Grain Express* (Brisbane, 2008), page 15, Report for Corrs Chambers Westgarth.

⁴⁷ Hilmer, Rayner, and Taperell.

⁴⁸ Corrs Chambers Westgarth and CBH, page 71, par. 6.32(i).

⁴⁹ *Ibid.*, page 9, par. 1.26.

⁵⁰ *Ibid.*

⁵¹ CBH, *Annual Report* (Perth, 2007).

outturn site, aggregate it there, before transporting it again to the new buyer or whether stocks trades will be permitted in system and if so how these will be charged. For example if buyer A held an entitlement to Geraldton port zone wheat that he or she sold to buyer B in Esperance zone, under Grain Express CBH could deliver wheat to buyer B from stocks held in Esperance, yet what freight and other charges will be levied? The potential exists for CBH to charge as if the wheat had physically moved from Geraldton to Esperance.

8. Conclusion

The premise of the Grain Express proposal is that the increasing complexity caused by deregulation of the Australian wheat export market will cause costly inefficiencies in the supply chain. The solution proposed by CBH is to corral all grain logistics movements within the CBH system.

This submission argues that CBH's solution to increasing supply chain complexity is anti-competitive and likely to result in sub-optimal development of the grain industry in WA. Logistics costs are not the only, or even the major, mechanism for increasing total returns to grain industry participants. In any case, the restriction of grain logistics to higher cost transport modes is not consistent with the development of an efficient supply chain that can adapt to changing needs and costs.

The development of specialist varieties and grades, with associated price premia is an important driver of value within the industry. The operation of the Grain Express proposal explicitly seeks to limit grain buyers from seeking out markets that will pay premia for such specialist grades and subsequently promoting more profitable growing practices. This would leave the Australian industry at sub-optimal levels of output.

Furthermore, a key basis for the CBH proposal is that by virtue of its monopoly position in grain receivals and port facilities, CBH is the only entity with all the information to move grain across the WA network in the most efficient manner. Other industries such as power generation have demonstrated the economic benefits to all industry participants from the sharing of information and it is to be expected that in the absence of the Grain Express proposal secondary information markets in grain stocks would develop.

Overall, CBH through Grain Express proposes a significant barrier to the development of the WA grains market in a manner inconsistent with competition policies. The application by CBH should be rejected.



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Appendix 1

RESTRICTION OF PUBLICATION PART CLAIMED