



A Grains Industry Strategic Initiative for Indonesia: Concept Brief

BACKGROUND

Australian grain is faced with strong competition in our important Asian markets. Failure to retain Australia's market position, as a supplier of high value wheat in this region will result in downward pressure on prices, and indirectly, added pressure on technical elements. Recent market feedback in Malaysia and Indonesia indicates Australia now has only a \$AUS10 - \$15/tonne advantage over Black Sea wheat. Five years ago this price differential was in the order of \$AUS30.

The US and Canada continue to push technical support for sales of their grain in the region. This adds considerable pressure to supply of Australian wheat to high value markets as demonstrated by substitution of Australian Prime Hard with Dark Northern Spring in the Japanese ramen market. The US and Canada spend \$US0.47/tonne of wheat and \$C0.36/tonne of grain exported respectively, on international commodity promotion and market support. This is funded by farmer check-off funds, supply chain contributions and government contributions representing 80% for the US and 40% for Canada of total expenditure.

Coupled with significant levels of production support in the US and Canada (underpinning more competitively priced grain with 7.5% and 11.5% of income derived from government policies) there are signals that the value proposition of Australian wheat, in some of our important markets, is being undermined. In recent periods where shipping rates have been at historically low levels, even the freight advantage component of that value proposition has been put under particular pressure.

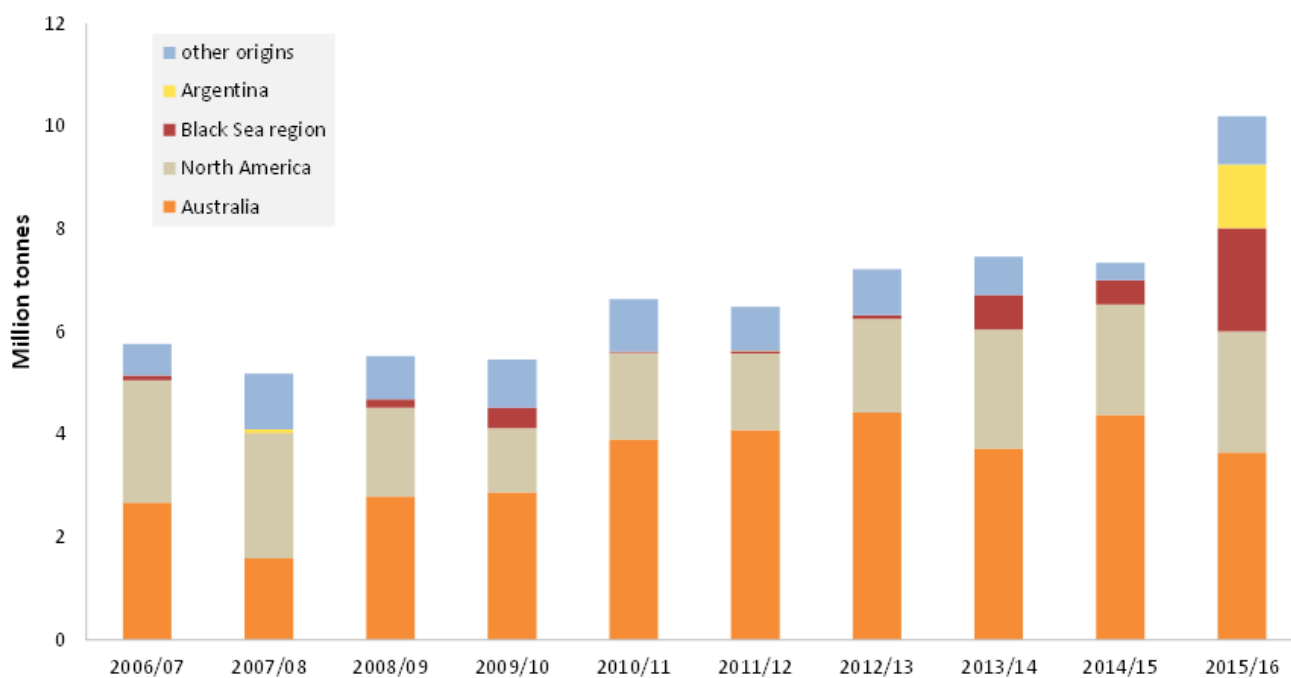
Indonesia is Australia's most important wheat export market. Wheat exports have averaged 3.7 million tonnes over the last 5 years (3.72 million tonnes in 2013-14, down from a record 4.42 million the previous year) representing 20% of Australia's wheat exports. The Indonesian market sits within the ASEAN group of countries which account for 45% of Australia's wheat exports.

Australian wheat exports to Indonesia are not only important to the Australian grains industry, but to the entire economy. Wheat exports to Indonesia are worth an average of \$1.3 billion per annum (5 years to 2015) in export earnings. This is close to 25% of total Australian merchandise exports to Indonesia, over 40% of all agriculture exports and more than twice the value of Australia's next most important agricultural export to Indonesia, live cattle.

Australian wheat exports are a great example of a mutually beneficial trade. Australian wheat does not compete with locally produced wheat, and instead provides the basis for employment and exports via flour milling and consumer product manufacture. The domestic industry is characterised by an increasing number of flour mills and family owned to medium size enterprises account for 66% of the countries wheat flour end-users. Meanwhile Indonesian flour based exports have been growing, with the most recent data showing growth of 27% between 2009 and 2010, and expectations are for solid growth to have continued since that time.

Indonesian demand for wheat has been growing at around 5% per annum, and the country is anticipated to import consistently more than 10 million tonnes by the end of the decade, overtaking Egypt as the world's largest importer of wheat.

FIGURE: Indonesia wheat imports by origin



Data sources: Australian Bureau of Statistics; International Grains Council; GrainGrowers analysis

This growth is based on flour based products increasingly displacing rice as a breakfast option, the currently relatively low level of flour consumption in Indonesia (currently 22kg per annum) compared to other south east Asian nations (Malaysia is 38kg per annum) and the international average of 50kg per annum), as well as growth in Indonesian exports of wheat based processed products.

The Indonesian wheat market:

- is a vital market for the Australian grains industry, so warrants a concerted industry initiative to demonstrate our grain's value and our value for the Indonesian market, and ensure the trade is underpinned by links that are greater than the last consignment;
- the growth in the market presents a valuable opportunity, but capture of that growth is not assured (see growth in other origin wheat supply in figure above); and
- is a logical supply chain partner, with:
 - Australia offering a freight advantage (cost and timing);
 - Indonesia offering efficient transformation options to deliver processed grain products to the wider Asian region;
 - Australia offering high and consistent quality grain which will be increasingly important as Indonesia develops its exports.



A range of trade dynamics that influence the Australian-Indonesian wheat partnership include:

- Higher protein wheats from US & Canada are considered to perform better in sponge and dough baking method. This baking method is promoted by North American technical support. Australian wheat is considered superior for noodle production, and performs well using the Rapid dough bread baking method.
- Cheaper (but lower quality wheat) from 'new' origins – Ukraine, Russia, India – are in cases replacing Australian wheat in baking grist blends.
- Food security discussions at the parliamentary level in Indonesia often favour self-sufficiency rather than trade solutions.
- Commonality of technical understanding is an increasingly valuable feature of trade as technical trade barriers increase.
- The current proximity advantage enjoyed by Australian grain exports is important however cannot be taken for granted as ship capacity and efficiency increases into the future. Recent and continuing low shipping rates internationally have lead to increased contestability in the Indonesian market, illustrating the future challenge of relying on proximity alone.

PROPOSAL CONCEPT

GrainGrowers have identified the opportunity to develop a collaborative industry initiative that focusses on Indonesia, but that also provides the basis on which to consider the wider south east Asian market. The proposal is to open a Centre for Australian grains within an Indonesian University that includes the following operational elements:

- a baking and noodle school, staffed by local bakers and noodle makers who receive training in/by Australians;
- conduct wheat milling courses; and
- delivery of storage and grain testing courses.

In conjunction with this, the Centre would host 4 -5 local or Australian post grad students (PhD /Masters) undertaking strategic projects that are jointly overseen by an Australian University (TBC) and the Indonesian University. The strategic areas would align with the operational elements of the school, the objectives of the Australian Export Grains Innovation Centre and Australian grain exporters. The fundamental aim of the initiative is to maintain and expand demand for Australian grain via research and skill sharing to:

- expand the understanding of the use of Australian wheat in Indonesia;
- provide a non-commercial and independent point of reference for users of Australian grains (with a focus on wheat);
- deepen industry to industry links;
- demonstrate the Australian grains industry value for the Indonesian market;
- explore innovative end-market uses for Australian grains in the Indonesian market;
- provide the basis for increased use of other Australian grains, especially pulses, in Indonesia; and
- enhance Indonesia's capacity to transform grain products for export.



STAKEHOLDERS

This proposal has at its core the following Australian stakeholders:

- Australian grain farmers; and
- Australian grain export marketers.

This proposal is to be:

- supportive of the commercial efforts made by marketers of Australian origin wheat;
- not displace those commercial efforts;
- be undertaken collaboratively with marketers; and
- provide industry wide underpinning that no one commercial marketer controls.

At minimum this project requires support from:

- A minimum of two large marketers into the Indonesian market;
- Australian Export Grains Innovation Centre;
- An Australian university (TBA); and
- DFAT.

In Indonesia, collaboration with the Flour Millers Association, a number of Indonesian importers and an Indonesian University such as Bogor Agricultural University, University of Gadjah Mada, or the University of Indonesia and with large importers such as Bogasari will be vital.

POLICY CONSIDERATIONS

It was a failing of the deregulation process to not establish a post-deregulation industry international marketing/technical support function to replace the underpinning work previously provided by AWB Ltd/AWB. The grain production sector, via the Grains Research & Development Corporation (GRDC), and the Western Australian State Government Department of Agriculture and Food (DAFWA) has established the Australian Grains Export Innovation Centre (AEGIC) to support the trade and use of Australian grains around the world through grain quality and processing technology and market research innovation. However, AEGIC is limited in that:

- a) it cannot engage in promotion (by virtue of the stipulations on the RD&E funds from GRDC that underpin it); and
- b) there is no binding engagement between AEGIC and commercial marketers (either by financial contribution or systems), and increasingly (especially for multinational marketers) not by a common value for the Australian grain proposition).

Having consulted with marketers, GrainGrowers has revealed appreciation for this concept proposal. However, the consistent issue is the lack of coordinating mechanism (ie, regulation and/or funding) for what is an 'industry good', and indeed economy wide good. Marketers must be involved in such an initiative. However, with commercial short-term imperatives, the long term benefits render it a secondary consideration. There is a market failure.



This initiative will increase information flow in the supply chain. It will provide the opportunity for more closely linking market needs with grain supply, including linking needs to the development of new Australian varieties to suit the market. Increased information in the Australia– Indonesia wheat supply chain will:

- allow Indonesian end-users to best capitalise on the functional qualities of Australian wheat, thereby creating efficiencies in their operations by both reducing costs and more reliably meeting the needs of their end users. This will be especially important for the growth of Indonesia's processed wheat products export industry; and
- greater recognition of the intrinsic functional values of Australian grain. This leads to greater opportunity for reflective price signals, which allow Australian grain farmers to respond to market needs and receive corresponding reward for performance.

The Indonesian wheat processing sector is growing. It is characterised by some large players, but a wider array of small to medium sized, mostly family operations. These operations are not in a position to directly invest in technical support, or connect with grain suppliers. This initiative would in particular, assist the Indonesia's small to medium sized enterprise sector to grow. Growth in this sector not only generates employment for Indonesia, but also underpins greater competition – and this competition is positive for the demand profile of Australian grains.

This proposal presents the opportunity for a collaborative Australia-Indonesia initiative to underpin the spirit of the current Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA), as well as the Australia-Indonesia relationship more broadly. As such, this proposal was contributed to the Indonesia-Australia Business Partnership Group and forms a recommendation in the TWO NEIGHBOURS, PARTNERS IN PROSPERITY submission to IA-CEPA.

Contact:

Dr Cheryl Kalisch Gordon | Trade & Economics Manager | Grain Growers Ltd

E c.kalischgordon@graingrowers.com.au

September 2016