



# **Response to the Senate inquiry into grain export networks, including the on- and off-farm storage, transport, handling and export of Australian grain**

**July 2014**

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## Background

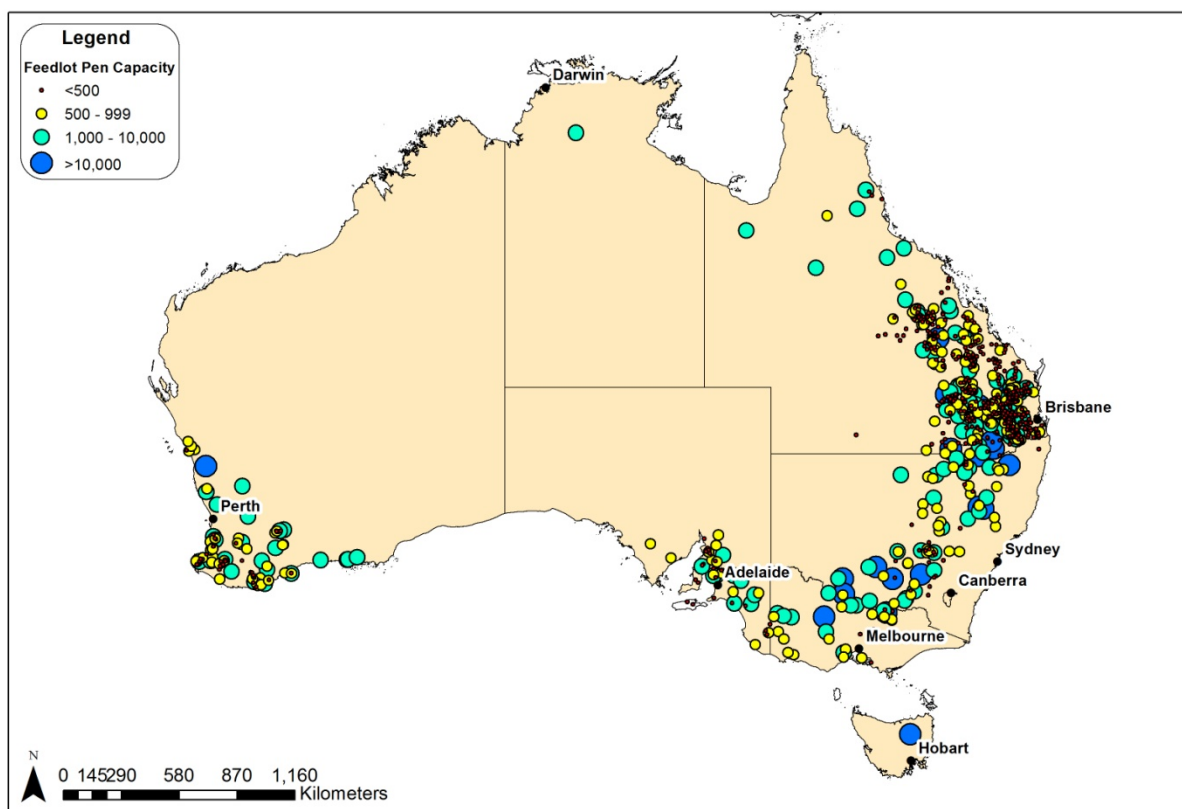
The Australian Lot Feeders' Association (ALFA) appreciates the opportunity to respond to the Senate inquiry into grain export networks, including the on- and off-farm storage, transport, handling and export of Australian grain.

ALFA is the peak representative body for the cattle feedlot industry. The industry has a value of production of approximately \$2.7 billion and employs some 9000 people directly and indirectly. Approximately 25% of Australia's total beef supply, 80% of beef sold in domestic supermarkets and the majority of beef industry growth over the last 15 years has been due to the expanding feedlot sector.

There are approximately 400 accredited feedlots in Australia located in areas that are in close proximity to cattle and grain supplies. Feed grains represent the single biggest cost in a kilo of beef, pork, dairy and chicken.

In a normal season, 80% of Australia's east coast grain production is consumed by these intensive livestock industries with the feedlot sector the largest user with 2.7 million tonnes. During drought periods, this percentage increases greatly as exports diminish. The main grains used by the sector include wheat, barley, sorghum and corn.

### Graph 1. The location, number and size of feedlots throughout Australia



### Response to inquiry matters

On 19 June 2014, the Senate moved that the following matters be referred to the Rural and Regional Affairs and Transport References Committee for inquiry and report by 3 December 2014.

Grain export networks, including the on- and off-farm storage, transport, handling and export of Australian grain, with particular reference to:

- a. the principles and practices underpinning an efficient grain supply chain from farm-gate to port;
- b. grain marketing and export arrangements and their impact on farm-gate returns;
- c. competition constraints on grain transport, storage and handling services;
- d. the extent to which transport, storage and handling arrangements are transparent and accountable;  
and
- e. any other related matter.

ALFA's key concerns with respect to this inquiry particularly relate to domestic grain stock data provision.

There are a number of reasons why the provision of accurate and timely grain stock data is of significant importance to the cattle feedlot sector;

1. The cattle feedlot sector (among other Australian intensive livestock industries) is demanding an increasing proportion of the Australian grain crop over time;
2. The inability to import grain means that an understanding of domestic grain stocks is vital;
3. Our major export beef competitors such as the US have superior grain stock data collation systems and market transparency;

Accordingly, we argue that;

- The market has to date not provided timely, accurate and complete domestic grain stock data with trade instead characterised by incomplete information, a lack of price discovery and information asymmetries (due to commercial vested interest). This outcome has become worse with the removal of ABS collated grain stock data and has perpetuated despite numerous reviews addressing the subject;
- There is a material benefit from the provision of this information to all supply chain participants (not just intensive livestock industries). It is a basic principle of micro economics that markets operate more efficiently and effectively with full information disclosure;
- The existence of a competitive grain market does not mean in itself that there are no information asymmetries or that it cannot be improved by better disclosure. Importantly, it only indicates that buyers and sellers are operating on the best information available;
- The delivery of improved domestic grain stock data transparency may not necessarily lead to better prices, but will lead to more informed decision making with respect to pricing, accumulation, risk management, whilst also helping to address the distorted market signals that currently exist.

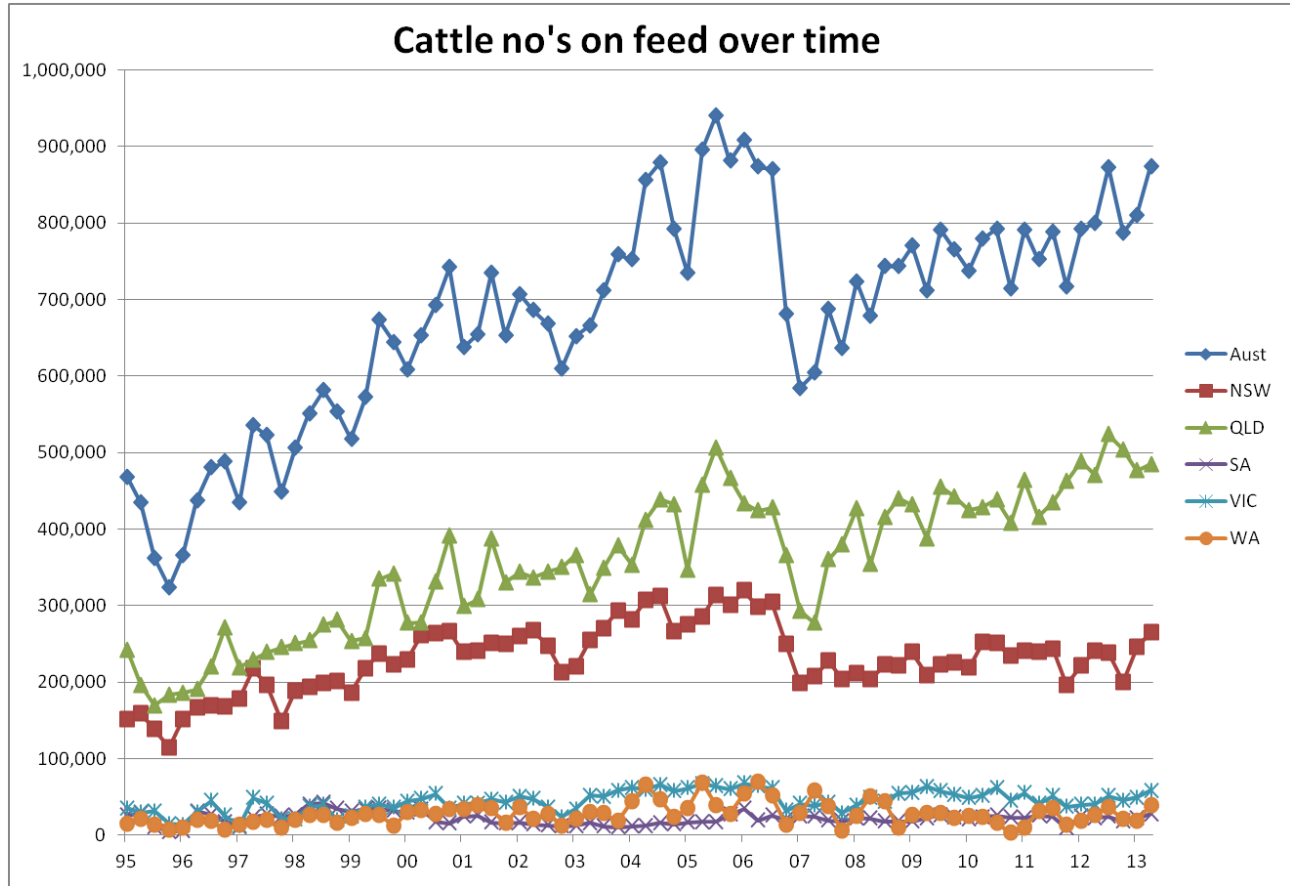
ALFA recommends the following;

- Grain stock data provision should relate to all grains and oilseeds, not just wheat;
- Committed and uncommitted grain stock data should be provided by grain type, port zone (not just state) and certain particulars such as grade for wheat, feed/ malt for barley and GM/ non GM for canola;
- Aggregated data should be collated and reported on a weekly and monthly basis;
- There needs to be communication to all supply chain participants regarding the collective industry good benefits of providing a more transparent market place that would allow for more informed decision making to occur.
- An independent body such as the GRDC (which does not stand to commercially benefit from this information and is funded by industry levies) should collate aggregated data from the supply chain on industry's behalf. A tender process however should determine this provider.
- There should be some level of compulsion imposed on key supply chain participants to disclose grain stock data. The options available are legislation or a code of conduct/ memorandum of understanding signed by the bulk handling companies, storage companies and GRDC. Whilst the latter option would not have legal standing it would invoke a level of collaboration and support that is not currently present.
- A randomized and statistically relevant number of growers should be surveyed each week to establish estimated and aggregated on farm storage tonnages.

**1. The cattle feedlot sector has grown over time**

The following graph demonstrates the trend of rising cattle numbers in Australian feedlots over time with an 89% increase experienced since 1995 (when such data was first collated). This trend exemplifies the increasing demand for grain fed beef in export markets and the inherent advantages provided by the feedlot sector.

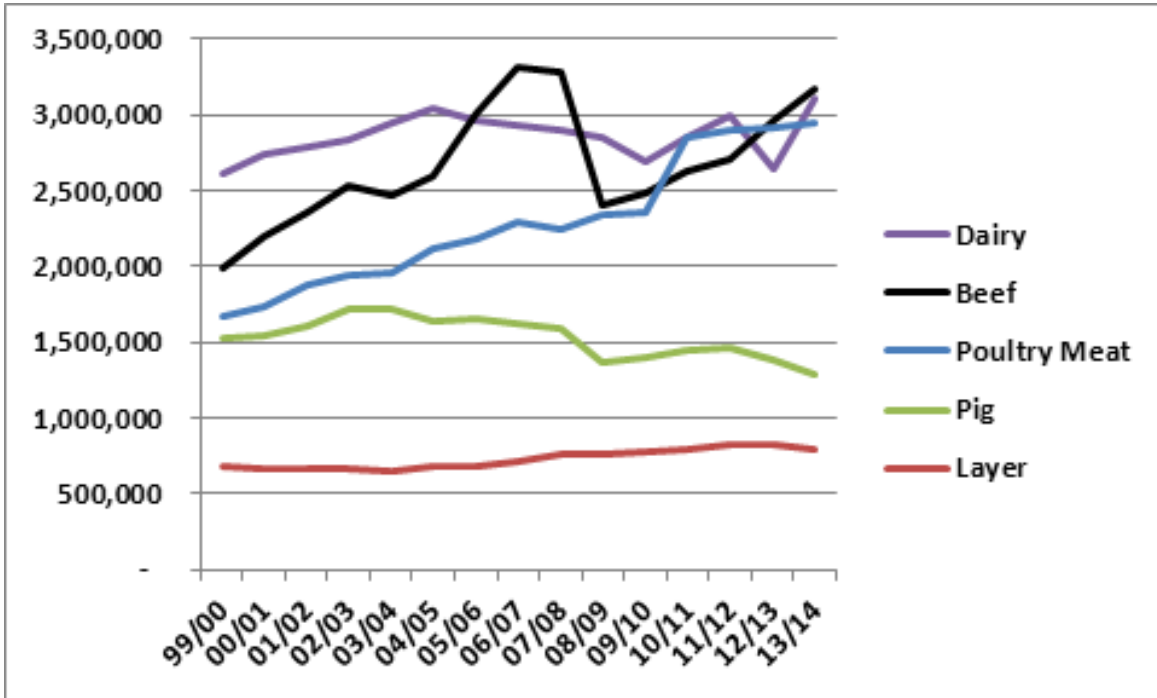
**Graph 2 - Cattle feedlot numbers (1995-2014)<sup>1</sup>**



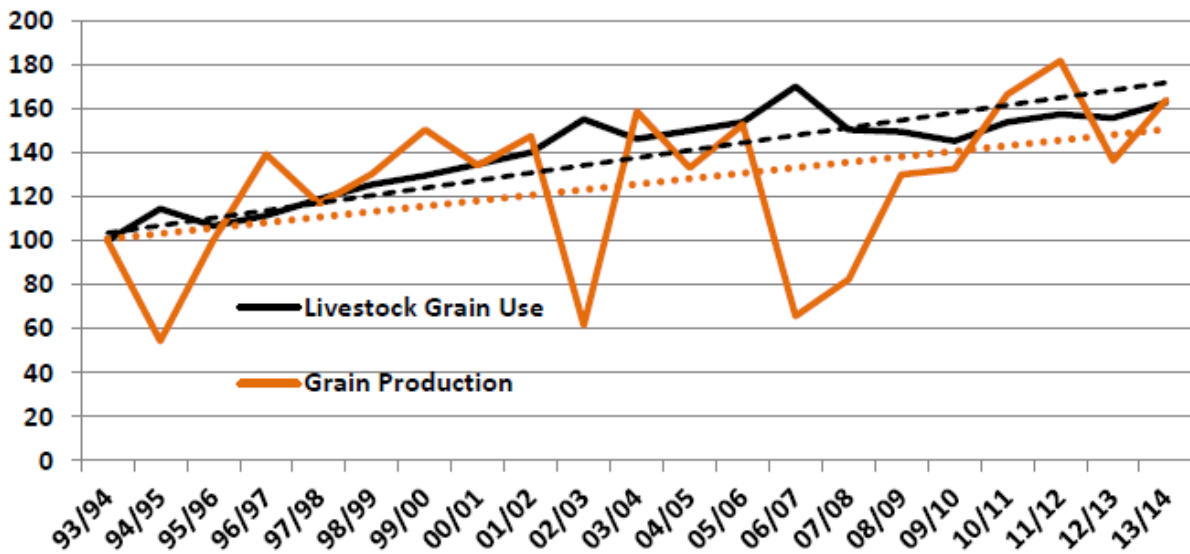
The rising numbers of both feedlot cattle and poultry over time has in turn led to an increasing demand for feed grain as seen in Graph 3,4 and 5.

<sup>1</sup> ALFA/ MLA quarterly survey

**Graph 3 – Intensive livestock industry grain use over time<sup>2</sup>**



**Graph 4 – Intensive livestock industry grain use vs wheat production<sup>3</sup>**

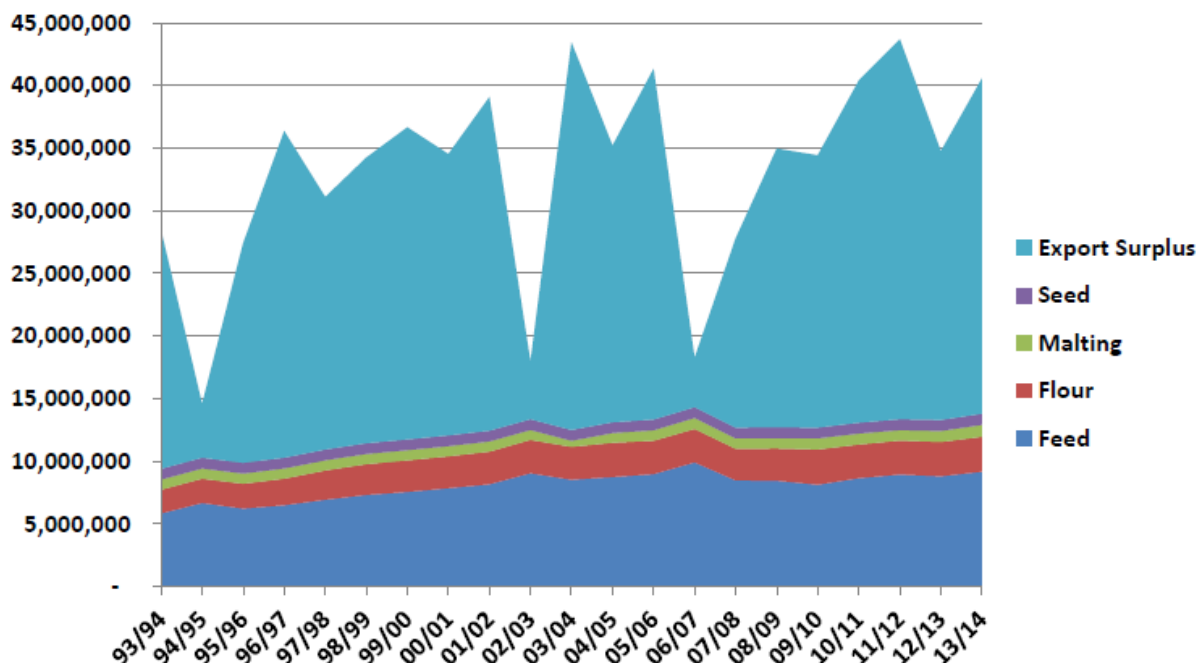


Sources: ABS, Dairy Australia and JCS Solutions estimates

<sup>2</sup> Spragg, J (2014), *Feed grain supply and demand report 2013/14 report*, prepared for the Feed Grain Partnership

<sup>3</sup> Spragg, J (2014), *Feed grain supply and demand report 2013/14 report*, prepared for the Feed Grain Partnership

**Graph 5 – Australian grain use by sector<sup>4</sup>**

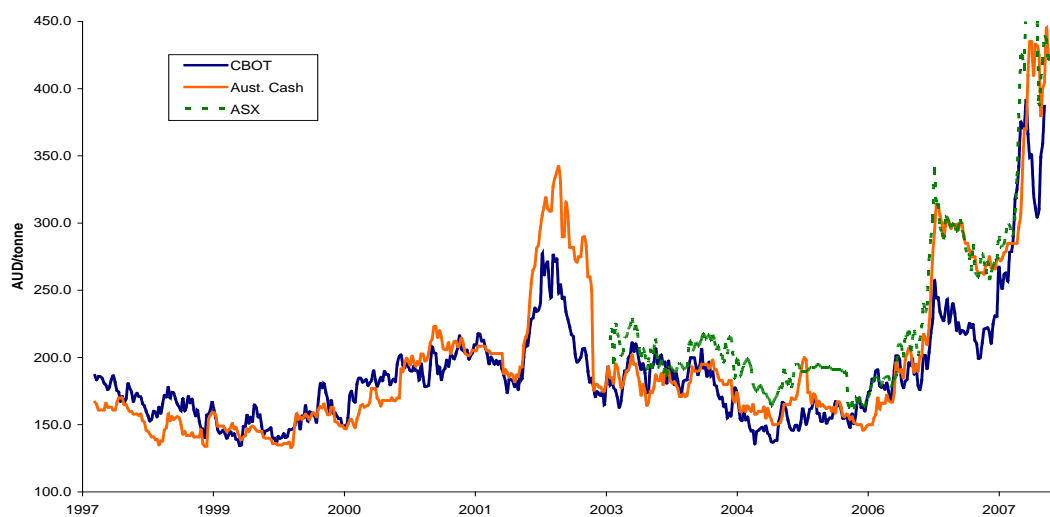


Sources: JCS Solutions derived from published industry data

**2. The inability to import grain means that an understanding of domestic grain stocks is vital**

Australian grain prices are determined by a combination of US futures prices, exchange rates and change in basis. Accordingly, they generally have a high correlation with world prices. However, when droughts occur in Australia, the lack of grain supply can often lead to domestic grain prices increasing by over \$100/ tonne greater than world parity prices (see graph 5 below). Given that grain represents the highest cost of production for intensive livestock industries, this leads to Australia being placed at a significant competitive advantage to our foreign counterparts.

**Graph 6 - Australian versus world grain prices (ASX & Newcastle Wheat Prices, 1997-08)<sup>5</sup>**



<sup>4</sup> Spragg, J (2014), *Feed grain supply and demand report 2013/14 report*, prepared for the Feed Grain Partnership  
<sup>5</sup>Bloomberg, Profarmer, Rabobank Food & Agribusiness Research and Advisory, 2008

As Australia has a conservative approach to quarantine and biosecurity, the restrictions, delays and costs to import grain effectively makes this option unachievable. This is because of the following reasons;

- Import permit restrictions are extensive, complex and resource intensive depending on the nation where grain is sourced.
- All imported grain requires 'devitalisation' (ie hammer milling and steam pelletisation) in dedicated stock feed manufacturing plants in metropolitan areas in order to treat pathogens, pests and weeds. This is not only an additional cost to the importation process but results in a reduction in feed grain quality.
- The requirement that devitalisation occurs in stock feed manufacturing plants in metropolitan areas (given Biosecurity concerns) means that the quantity of available imported grain is restricted by the capacity of such plants. Notably, these plants have limited excess capacity given existing contractual obligations to domestic grain users such as maltsters, flour millers and chicken meat producers. With current plant capacity levels around 1 million tonnes (the feedlot sector alone requires 2.7mill tonnes of grain per year), this is a limiting factor preventing increased grain imports. Problematically, at precisely the same time that intensive livestock industries require capacity to devitalize imported grain, stockfeed manufacturing plants are running at full capacity due to drought feed requirements. The effect of this requirement for metropolitan processing is to allow only some grain users to utilise existing on site processing facilities with both high costs and delays the inevitable result.
- Once devitalisation occurs, there are also additional costs to transport the grain to up country users.

Given the above constraints, it is of no surprise that very little grain has been imported throughout Australia's history despite the numerous droughts that have occurred.

### **3. Our primary export beef competitors such as the US has superior grain stock data provision**

The Australian beef industry competes in an extremely aggressive and competitive world market for access into various countries. Accordingly, the delivery of grain prices which have international parity is vital to maintain our market share. From a beef perspective, our main competitor is the United States. The US has a number of competitive advantage tools at its disposal with the ability to make informed market decisions based on transparent and accurate market data chiefly among these.

Importantly, given the difficulty of sourcing grain at world parity prices during drought periods, Australian grain users are placed at a competitive disadvantage to countries such as the US during such times. The ability to obtain an accurate understanding of Australian grain availability, particularly during drought periods is accordingly of primary importance to the Australian cattle feedlot industry.

### **4. The Australian grain stock situation**

The provision of Australian grain stock data is currently piecemeal, imprecise and untimely. Overall, it is ALFA's view that this has led to market imperfections, information asymmetries and a lack of effective price discovery.

The current situation is the result of the removal of Federal Government funding towards various surveys along with the inadequacy of data provision by bulk handlers, storage companies and growers. From a bulk handling perspective the oligopolistic nature of competition along with related commercial sensitivities around market share has meant that they are reluctant to disclose grain stock information. Growers are similarly reluctant to disclose on farm grain tonnages given that on farm storage has become an increasingly important price risk management tool in recent years. It is estimated for instance that growers on the east coast alone have an average 15 million tonnes of on-farm storage<sup>6</sup>. Whilst a number of private grain trading and consultancy companies have emerged in recent years (particularly since the deregulation of the single desk for

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<sup>6</sup> Reading, Peter (2012), *Information requirements for an effective bulk wheat export market*, sourced from the internet 7/7/14, [http://www.daff.gov.au/\\_data/assets/pdf\\_file/0011/2157770/information-req-for-an-effective-bulk-wheat-export-market.pdf](http://www.daff.gov.au/_data/assets/pdf_file/0011/2157770/information-req-for-an-effective-bulk-wheat-export-market.pdf)

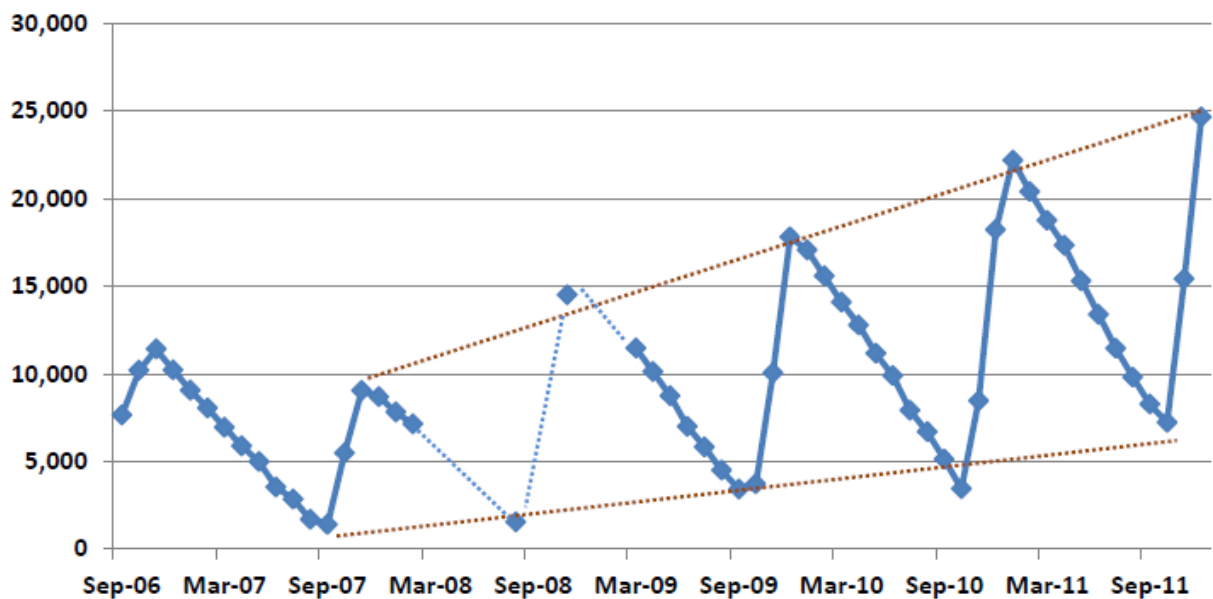
bulk wheat exports) and great increases in buyer competition for grain experienced as a result, the issue of stock data accuracy is still prevalent.

Market failure occurs when economic efficiency is not achieved due to imperfections in the market mechanism<sup>7</sup>. Generally market failure occurs due to market power, incomplete information, externalities and public goods.

Whilst it is arguable that the oligopolistic nature of competition among bulk handlers has created some market power imperfections, the strongest argument that potential market failure exists in the provision of grain stock data relates to incomplete information. Specifically, the lack of accurate and timely grain stock data leads to information asymmetries whereby bulk handlers have superior knowledge and hence commercial advantage over grain growers and users. Ultimately, the lack of robust and timely data held in a central repository leads to distorted market signals, market inefficiency and potential market failure - a substandard outcome particularly when compared to the data and transparency provided in the US grain market for example.

Up until September 2012, the Australian Bureau of Statistics (ABS) compiled monthly data on stocks and commitments of wheat grain in Australia for licensed exporters and bulk grain handlers<sup>8</sup>. These estimates were derived from various monthly surveys conducted by the ABS, including the Grain Handlers Stocks Survey, the Wheat Export Sales Survey, and administrative data relating to wheat grain exports. Whilst this data was useful, it nonetheless did have limitations given the absence of information regarding contractually committed tonnages, the lack of data provision from smaller grain storage operators and tonnages held on-farm; and the time lags involved between data collation and publishing. Moreover, the sporadic collation of the data (as seen in the below table) was also a weakness.

**Graph 7 – Wheat stocks held by bulk handlers and traders<sup>9</sup>**



Source: ABS, missing data points through no ABS collection have been replaced with trendlines.

The key challenge with the private market addressing this issue is the lack of compulsion on bulk handlers, storage companies and growers to provide the data. In fact there is arguably an incentive for these supply

<sup>7</sup> Bannock, G et al (1987), *The Penguin Dictionary of Economics*, Penguin Group, London, England.

<sup>8</sup> ABS website,

<http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/7122.0.55.001Explanatory%20Notes1Sep%202012?OpenDocument>

<sup>9</sup> Spragg, J (2014), *Feed grain supply and demand report 2013/14 report*, prepared for the Feed Grain Partnership



chain participants not to provide such data given the advantages provided by information asymmetries along with disadvantages associated with commercial sensitivity concerns.

Notably, several inquiries into this matter in the past have recommended improved grain stock disclosure including the 2010 Productivity Commission Inquiry Report into Wheat Export Marketing Arrangements, the 2012 Reading report into Information requirements for an effective bulk wheat export market, and the 2013 Wheat Industry Advisory Taskforce. However, such recommendations have not been implemented in practice due in particular to an unwillingness among supply chain participants to look beyond their own commercial interests for the overriding benefits of the broader sector. The voluntary approach therefore represents a clear market failure.

Accordingly, ALFA recommends the following;

- Grain stock data provision should relate to all grains and oilseeds, not just wheat;
- Committed and uncommitted grain stock data should be provided by grain type, port zone (not just state) and certain particulars such as grade for wheat, feed/ malt for barley and GM/ non GM for canola;
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