SUBMISSION

RURAL & REGIONAL AFFAIRS & TRANSPORT REFERENCES COMMITTEE

GRAIN EXPORT NETWORKS, INCLUDING THE ON- AND OFF-FARM STORAGE, TRANSPORT, HANDLING AND EXPORT OF AUSTRALIAN GRAIN

GrainCorp

GrainCorp Operations Limited
Level 28 175 Liverpool Street,
Sydney NSW 2000
ABN 52 003 875 401

T: 02 9325 9100
F: 02 9325 9180

graincorp.com.au

EXECUTIVE SUMMARY

GrainCorp notes that the Australian grain industry has been the subject of numerous parliamentary and regulatory inquiries over recent years. We believe there is an opportunity for this inquiry to make a difference and to deliver real value to growers and the broader industry, by focussing on the most significant challenge to Australian grain industry competitiveness: **the high cost and poor performance of rail transport**.

As part of the Committee's inquiry into the grain export network, GrainCorp also recommends an evidence-based analysis of the level of competition operating in the eastern Australian market, both in terms of up-country storage and port access.

To support this objective, this submission provides detailed facts and constructive suggestions to improve the grain industry. The submission is structured in two parts:

1. Focus should be on fixing rail transport

The major issue facing the Australian grain industry and growth of grain exports is the poor performance of rail transport, which constrains grower returns and limits export capacity.

- Rail transport cost in eastern Australia is estimated to be $10 per tonne above best practice, due to lack of investment in rail loading and track infrastructure.
- The portion of export grain moved by rail has declined from 90% to around 50% - with 2 million additional tonnes of export grain moving by road.

There is an opportunity for the Committee to urge the Federal Government to take a leading role, working with industry players such as GrainCorp, to improve rail efficiency for export grain in eastern Australian for a relatively modest investment.

Government co-investment in rail in eastern Australia will deliver substantial economic and public benefits:

⇒ A $10/tonne forecast improvement in prices bid at grain silos translates into a **$180 million** annual injection into communities in regional eastern Australia.

⇒ Increasing the portion of bulk grain moved to ports from 50% to 70% would reduce road movements by **1 million tonnes** – 25,000 less truck movements a year.

⇒ Australia's balance of trade could be improved by **$500 million** per annum in 10 years, based on grain production increasing by 2 million tonnes, in line with historic yield trends.

2. Strong competition in eastern Australia

Contrary to the unfounded view that GrainCorp has a 'monopoly' or 'near monopoly', the grain supply chain in eastern Australia is very competitive and competition is driving efficiency.

- Growers have access to a large range of marketing options. The export of bulk grain only represents a minor share (30%) of grain production.
- Growers are serviced by a large number of country and port grain handlers. GrainCorp's share of country and port elevation has halved in the past 15 years.

There is substantial excess grain handling capacity in eastern Australia, where non-GrainCorp facilities have the capacity to handle both the country and export grain tasks.

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1. FOCUS SHOULD BE ON FIXING RAIL

Australian grain growers are 'price takers' in the international market, which means the delivered country silo price must absorb the fixed cost of the grain supply chain from farm to customer, regardless of the market price of grain.

In 2011 the Australian Farm Institute (*Transport Costs for Australian Agriculture*, 2011) examined the total grain supply chain cost for grain consigned from North West NSW (Burren Junction) to Japan. The total grain supply chain cost was estimated to be $111 per tonne. Transport made up 71% of this grain supply chain cost - **and the largest component was rail transport from the country silo to the port terminal.**

To improve grain competitiveness - the most important goal of the grain industry and the Australian Government should be improving rail efficiency. This was reinforced in the Farm Institute's report:

> *The price a producer receives for exported product will reflect the global market price less the costs of transport and logistics to land product in that country. Movements in transport costs, delays and inefficiencies in handling product…will ultimately be transmitted through price signals back into the price received by the producer. Conversely, reductions in transport costs and improvements in efficiency will lead directly to improvement in producer returns.*

Inefficient rail transport endangers the ability of eastern Australia to participate fully in the global food growth opportunity:

1. **High rail cost**: Australian growers will not be prepared to risk producing more grain if rail inefficiency continues to limit the grain price and their ability to generate an adequate return.
2. **Limited rail capacity**: International customers will question Australia's ability to meet growing demand if the limited capacity and reliability of our rail network persists.

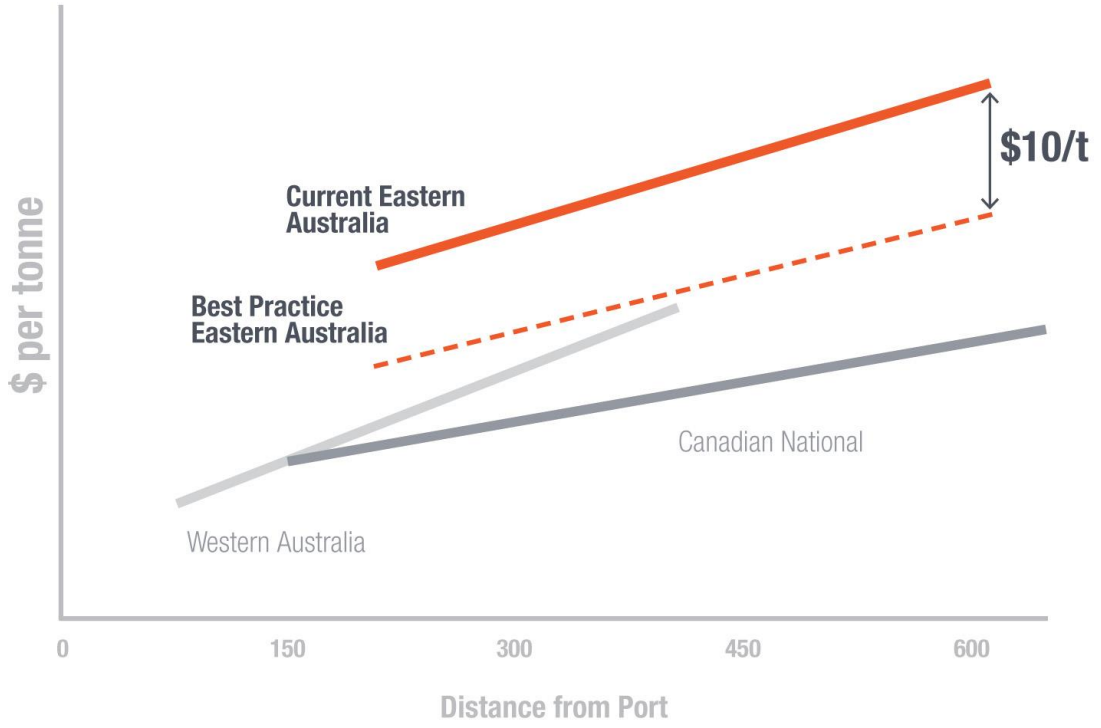
1.1 High rail cost

Rail rates in eastern Australia are estimated to be $10 per tonne above 'best practice' and can cost, for similar distances, $20/tonne more than in Canada and $10/tonne more than in Western Australia (see Figure 1).

Poor performance of rail in eastern Australia is attributable to:

- **Slow loading speeds and cycle times**: Loading infrastructure at most country silos is dated, with "unit trains" (40 wagons) taking over 12 hours to be loaded.
- **Short sidings**: Most country silo rail sidings, (which are government-owned), are unable to accommodate a full unit train. This requires trains to be shunted at a site or broken between two or more country silos.
- **Weight restrictions on branch lines**: Most of the regional rail network has suffered from persistent underinvestment, as governments have prioritised road infrastructure. Consequently a substantial portion of the rail network has payload restrictions, requiring trains to be at least 20% under-loaded.

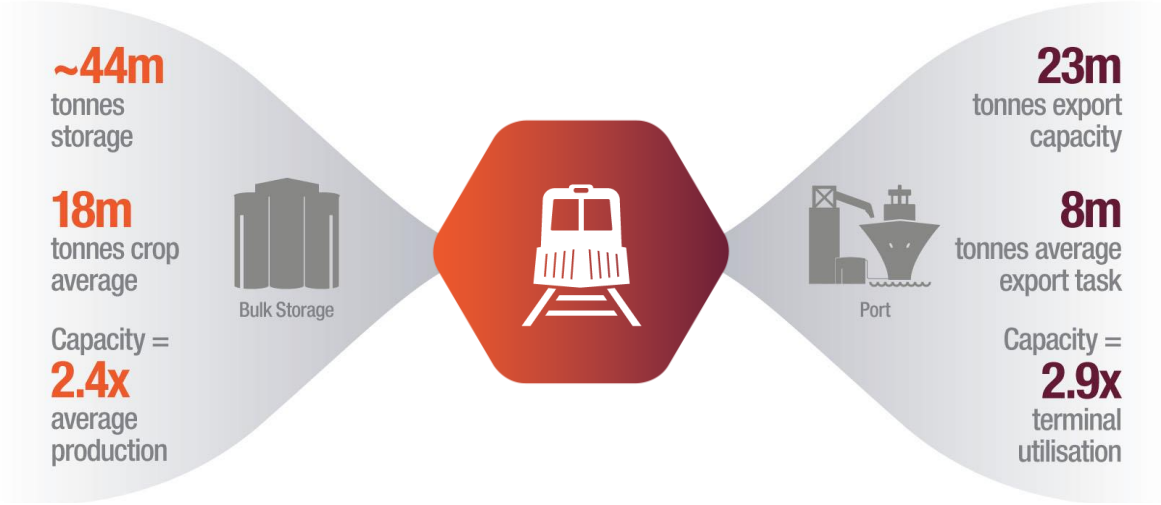
Figure 1: Rail cost curves



1.2 Limited rail capacity

As indicated in Figure 2, the grain supply chain in eastern Australia has significant excess capacity at the country receival and export shipping end; but suffers from a significant rail bottleneck in the middle.

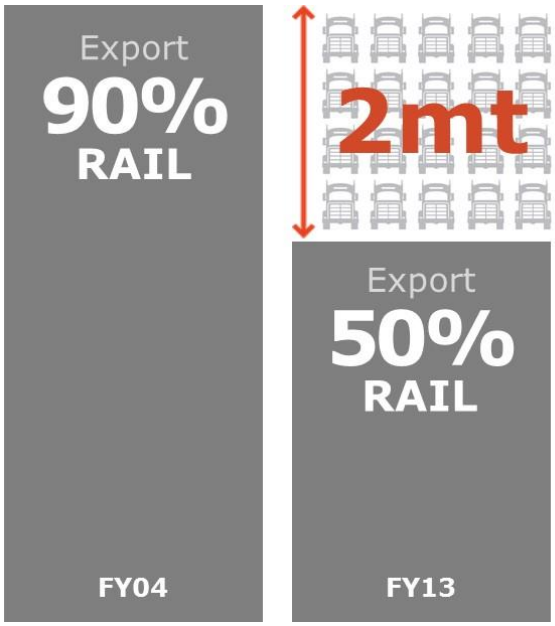
Figure 2: Rail = the bottleneck



The capacity of rail to transport export grain has been declining over many years, due to high cost and limited capacity. This has resulted in modal shift from rail to road transport.

Rail's declining competitiveness is illustrated in Figure 3, which shows rail now only handles 50% of bulk export grain into GrainCorp's ports, compared to 90% 10 years ago. This is the equivalent to up to 2 million tonnes of export grain per annum in an average year that would arrive at GrainCorp's ports by train, now being transported on a truck.

Figure 3 Share of rail for bulk export grain



1.3 Improving rail will benefit the entire grain industry

There are substantial grower and public benefits that can be realised from a co-ordinated approach to improve rail efficiency, given:

- Agriculture's position as one of the five pillars of the national economy;
- The opportunity presented by growing demand for grain in the developing world; and
- The substantial economic benefit to growers and the economy.

The increasing cost of transporting export grain leads to lower country prices for export grain. Furthermore, lower prices for export grain translate to lower prices for all grain, including domestic bound grain, as the export grain surplus sets the floor price for all grain.

Any reduction in rail transport cost and resultant increase in export grain prices will have a **multiplier 'public benefit'** for all grain. That is, moving eastern Australian rail transport costs to 'best practice' (a $10 per tonne saving) would generate a $180 million per annum benefit for all growers, based on average grain production of 18 million tonnes.

1.4 Government and industry investment is required

There is an opportunity for the grain industry in eastern Australia to access improved rail transport cost for a relatively modest investment in a short period, by leveraging and upgrading existing elevation and track infrastructure.

GrainCorp acknowledges that funding responsibility for rail is split across Federal and State jurisdictions. However GrainCorp believes that the Federal Government has a critical role to play in co-ordinating the response from all levels of government to this investment challenge.

1.4.1 Project Regeneration: GrainCorp investment in rail loading capability

In June this year, GrainCorp announced a major $200 million program of investment in its country network, known as Project Regeneration. This initiative:

- Invests in a core network of 68 high capacity sites (Primary sites) across eastern Australia, focussed on export grain. These sites, with a storage capacity of 10 million tonnes, could handle most of the bulk export rail task.
- Establishes a new rail operating model based on fast cycling 'point to point' 40 to 48 wagon unit-trains between the Primary sites and port terminals. These trains would achieve superior and reliable turnaround time to significantly improve productivity.

Project Regeneration involves investment in new rail loading capability at the Primary sites:

- New or upgraded rail bins, with fumigation and blending capability, to pre-position the grain for loading;
- New or upgraded high speed elevators, tripling the current average load speed a reducing it to less than 5 hours; and
- Single rail load points with over-rail garner bins, longitudinal spouts and weight optimisation. This will enable the accurate loading of a train in motion.

GrainCorp estimates that this investment, if supported by government investment in the government-owned rail sidings at Primary sites, will:

- Increase train productivity by around 25%. GrainCorp is targeting a reduction in all rail transport costs of around $5 per tonne. This lower rail transport cost will be passed back to growers in the form of higher bids at silos.
- Support increased movement of grain by rail. GrainCorp is targeting an increase in the portion of rail into its port terminals from 50% to 70%. This would shift 1 million tonnes of grain from road to rail.

1.4.2 Government short term investment in sidings

Supporting government investment will be required to extend government-owned rail sidings at many of the Primary sites. This would enable the sites to handle unit-trains, by reducing the need to break and shunt trains, unlocking the train productivity benefits outlined above.

As an indicative figure, GrainCorp believes that required investment from government in sidings would be around **$50 million**.

GrainCorp is engaging the five separate track owners, seeking support for this investment. However, this engagement would be more likely to be successful if there were:

- Direct support from the Commonwealth owned ARTC track owner, where 16 of the 68 Primary sites are located; and
- Commonwealth support of the State-owned track owners.

1.4.3 Government long term investment in track

Over the longer term, further investment from Commonwealth and State governments is required to increase track weight load limits and standardise gauges.

A. **Reinstate missing rail links**: Grain volumes on rail can be improved by reinstating a number of existing closed lines at relatively low cost, namely:

- Victoria: The short Dookie line to reinstate the Dookie silo to Geelong.
- Queensland: The short line to Moura to reinstate the Moura silo to Gladstone.
- Queensland: The short line at Capella to provide a direct route to reinstate direct access to the closer Mackay port.

B. **Increase payload weights**: Around 60% of grain is moved on track that is limited to 76 tonne (gross) or less per wagon. Best practice is 82-92 tonnes per wagon. A program to increase track weight limits, which involves upgrading bridges, would:

- Enable train providers to invest in new low tare and high payload wagons.
- Deliver in excess of 20% improvement in payload productivity.

C. **Inland rail route to Brisbane**: Export grain into Brisbane by rail is constrained by track capacity over the Toowoomba range. The proposed new inland standard gauge railway from Moree to Brisbane via Goondiwindi (with the connecting Thallon line standardised) would:

- Increase rail capacity into Brisbane.
- Provide growers in Northern NSW an alternative supply chain for their grain.

D. **Victorian track gauge standardisation**: Victoria is serviced by two different rail gauges. Ongoing standardisation of the track in Victoria would provide an integrated rail network in NSW and Victoria and:

- Reduce rail costs through greater integration.
- Increase rail capacity by enabling trains to be moved between NSW and Victoria.

2. STRONG COMPETITION IN EASTERN AUSTRALIA

There is a view held by some growers and other stakeholders that there is limited competition in grain handling and exports in eastern Australia. Furthermore some stakeholders have publicly stated that GrainCorp has a 'monopoly' position.

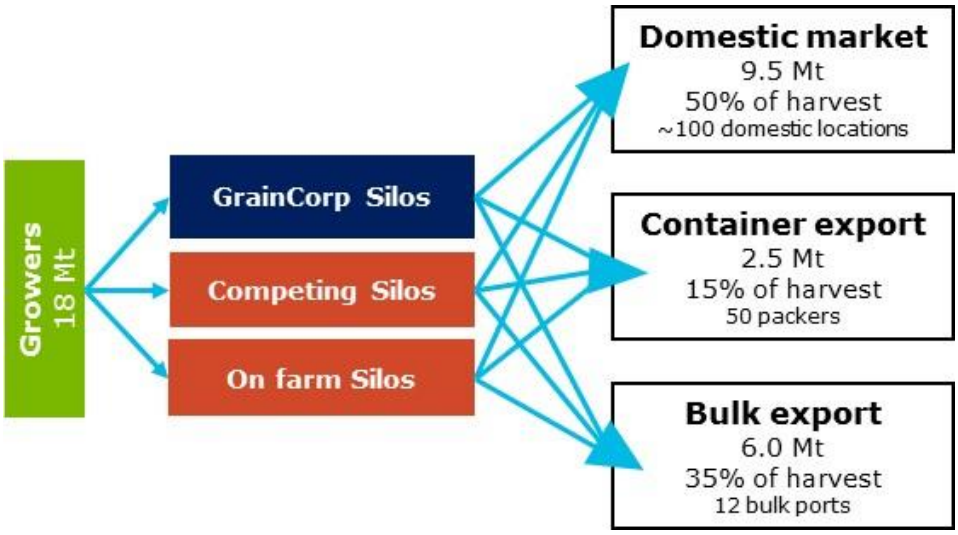
GrainCorp strongly refutes any argument that it holds a 'monopoly' or 'near monopoly' position in grain handling. The eastern Australian grain market is characterised by strong and increasing competition at all levels:

1. Growers have access to a **wide range of marketing options**, and bulk exports account for only a minor share (30%) of grain production.
2. There is increasing participation and **investment by large international companies**, many times the size of GrainCorp, with:
    - Rapidly increasing **export elevation competition** and surplus capacity;
    - Strong **up-country storage and handling competition** and surplus capacity.
3. Consequently, independent regulatory bodies have repeatedly confirmed that the grain supply chain in eastern Australia is competitive and that GrainCorp does not have substantial market power.

2.1 Numerous market options

Growers in eastern Australia produce an average 18 million tonnes of grain per annum. Unlike growers in South and Western Australia, eastern Australian growers have access to large number of alternative markets for their grain as shown in Figure 4.

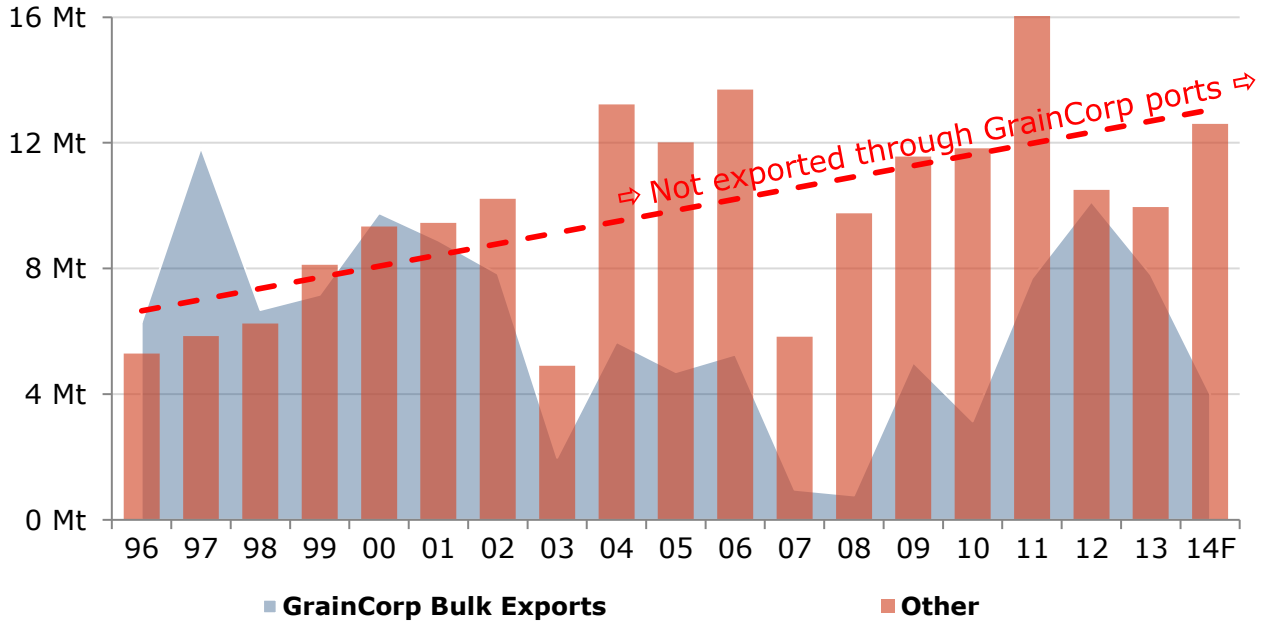
Figure 4: Eastern Australian grain marketing options



As a result, the export of grain in bulk and GrainCorp's operation of bulk export elevation only has limited influence on grower's marketing choices.

Figure 5 below shows the volume of eastern Australian grain production that does **not** pass through GrainCorp's bulk port elevators has doubled in the past 15 years from 6 to 12 million tonnes. GrainCorp's bulk grain exports now only represent around 30% of total grain production – and less in years impacted by poor seasonal conditions.

Figure 5: Declining influence of GrainCorp bulk ports



2.2 Growing export competition

GrainCorp faces significant competition at its seven port terminals from five (existing and new) competing bulk port elevators and around 50 competing container packers.

GrainCorp's share of export (elevated) grain has declined from 90% to around 60% in the face of this increasing competition from:

- **Existing bulk competition**: GrainCorp faces competition from four bulk terminal elevators with substantial elevation capacity:
  - MPT in Melbourne: serviced by 45,000 tonne bins with rail access.
  - NAT in Newcastle: serviced by 60,000 tonne bins and balloon loop rail access.
  - QBT in Brisbane: serviced by an 80,000 tonne shed.
  - LDC in Newcastle: serviced by a 25,000 tonnes shed with rail access.
- **Export containers**: Over 50 container packers have increased container exports by 400% to 2.5 million tonnes over the past decade. This growth has been supported by competitive transport rates into Asia from shipping lines seeking to backload product for their empty containers.

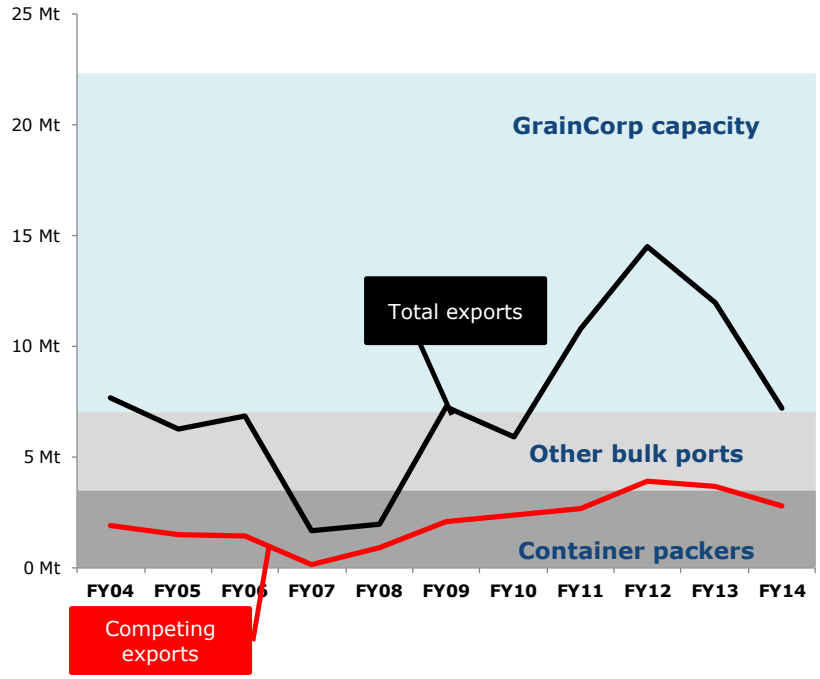
GrainCorp's share of export (elevated) grain will be further contested by new competitors:

- **Confirmed new bulk competition**: GrainCorp will face competition from the recently announced Quattro terminal in Port Kembla. This terminal is serviced by 100,000 tonne bins with rail access, and it is planned to be operational by 2016.
- **Planned new bulk competition**: There is industry speculation that international exporters are in advanced stages of planning for new port elevators at Portland and Geelong.

The substantial excess port capacity in eastern Australia acts as a significant constraint on GrainCorp.

Figure 6 shows that competing bulk export facilities have capacity to handle 100% of an average export task. GrainCorp's elevation capacity is 15 million tonnes, while competing facilities have 8 million tonnes (the average export task is 8 million tonnes). As a result, the average capacity utilisation rate at eastern Australian ports is 32%.

Figure 6: Excess export handling capacity



Export Handler	Capacity
GrainCorp	15,346,637
Est Other BHCs	2,000,000
New Other BHCs	2,500,000
Est Containers	3,500,000
Export Capacity	**23,346,637**

Export Scenario	Tonnes
Max exports	14,511,591
Low exports	1,673,784
Average exports	**7,458,609**

Export Scenario	Utilisation
Max exports	62%
Low exports	7%
Average exports	**32%**

2.3 Strong competition up-country

GrainCorp faces significant competition at its 180 country silos from 125 independent silos and substantial on-farm storage. Accordingly, while GrainCorp operates an extensive network of country silos, it does not have the ability to use its port terminals to foreclose access to its facilities.

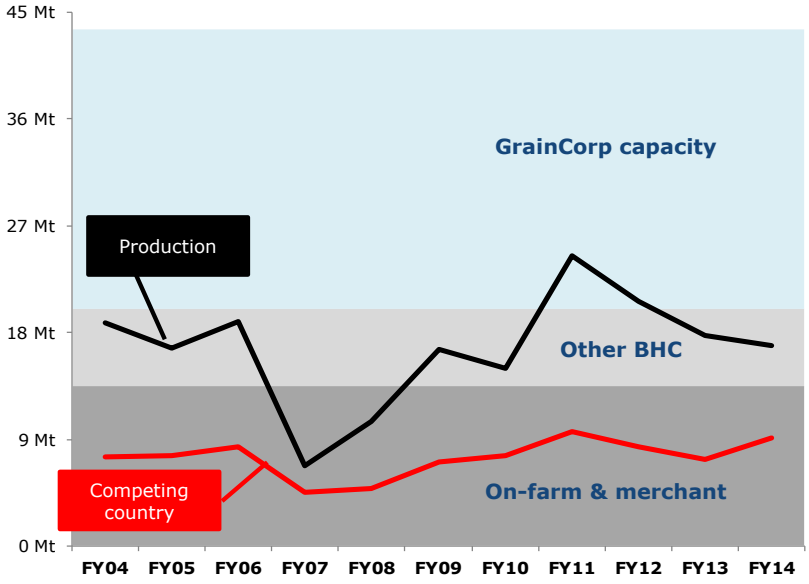
GrainCorp's share of country grain has declined from 80% to less than 50% in certain recent seasons, in the face of this increasing competition from:

- **Exporter owned country silos**: Competing exporters own around 50 country silos, most of which have access to rail and are supported by take-or-pay trains.
- **Merchant country silos**: Merchants and grower cooperatives, who service domestic customers and / or are aligned with international exporters, own around 75 country silos.
- **On farm storage**: Most growers have access to on farm storage that can access the domestic grain, container packers and direct to port terminals. ABS estimates there is 12 million tonnes of storage capacity on-farm. This estimate is conservative, as it excludes storage bags and bunker storage.

The substantial excess country storage capacity in eastern Australia also acts as a significant constraint on GrainCorp.

Figure 7 shows the excessive surplus country storage capacity in eastern Australia. This capacity services an average 18 million tonne crop and competing facilities have capacity to handle 100% of average production. As a result, the average capacity utilisation rate at eastern Australian country silos is 41%.

Figure 7: Excess country handling capacity



Country Handler	Capacity
GrainCorp	23,574,760
Other BHCs	6,195,000
Merchant	2,956,600
On-farm	11,242,497
Country Storage	**43,968,857**

Production Scenario	Tonnes
Max production	24,524,000
Low production	6,786,000
Avg production	**18,000,000**

Production Scenario	Utilisation
Max production	56%
Low production	15%
Avg production	**41%**

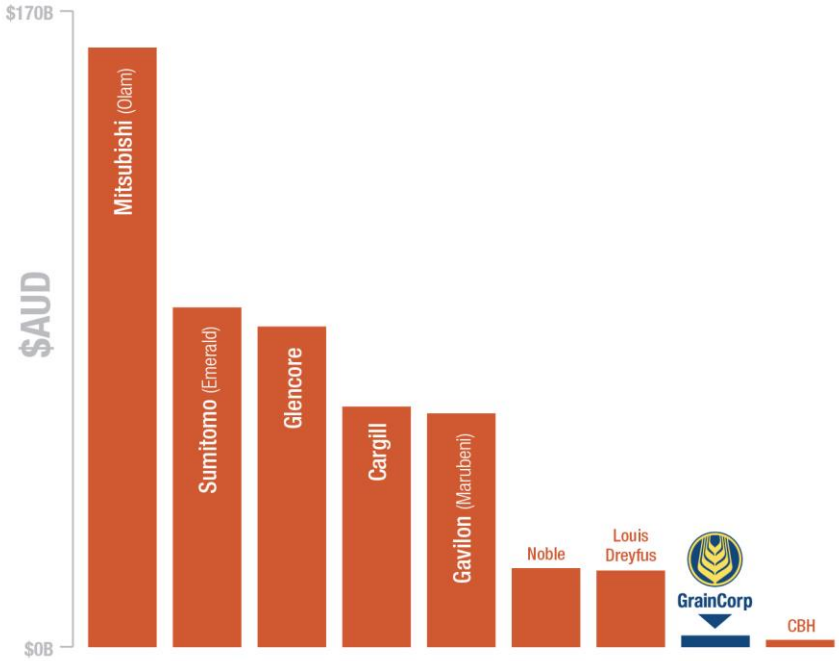
2.4 Investment by large, multinational grain exporters

Since export wheat deregulation in 2008, many international grain exporters have entered into the market and provide new marketing options to growers. These exporters have also used their marketing volume to also reshape handling infrastructure in eastern Australia.

International grain exporters have significant scale (see Figure 8 below) and in the past four years have invested in five new bulk export facilities plus country silos and rail transport.

These international grain exporters have significant advantages in terms of access to capital, (with total assets up to 30 times the size of GrainCorp), access to grain infrastructure overseas and market reach.

Figure 8: Scale of competing grain exporters



Exporter	Export	Country	Rail
Gavilon (Marabeni)	QBT		
Louis Dreyfus	LDC	Yes	Yes
Glencore	NAT	Yes	
Olam (Mitsubishi)	NAT	Yes	
CBH	NAT	Planned	Planned
Noble	Quattro		Yes
Cargill	Quattro	Yes	Yes
Emerald (Sumitomo)	Quattro	Yes	Yes
Emerald (Sumitomo)	MPT	Yes	Yes

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2.5 Independent confirmation of competitive grain handling

The grain industry (and GrainCorp) has been subject to a large number of Federal and State regulatory reviews to assess industry competition and market power. These fact-based inquiries have delivered consistent messages.

In particular, the Productivity Commission and ACCC have confirmed that GrainCorp operates in a competitive market and does not have significant market power.

The Productivity Commission's *Wheat Export Marketing Arrangements (2010)* inquiry found that the grain supply chain was competitive and that this competition was driving an increase in the service offering to customers and increased efficiency.

> *Following deregulation, growers are now seeing prices that more accurately reflect the quality of the wheat they grow and the costs of transport, storage and handling to export wheat. There are also pressures for efficiency improvements in the rail and road components of the transport system stemming from reform to the road and rail sectors.*
>
> *Clearer price signals and reforms in the transport sector are creating pressure for structural change in the bulk transport, storage and handling of wheat and other grains. The trends include:*
>
> - *greater use of on-farm storage by growers – giving rise to trials of on-farm grading and blending and development of quality assurance systems to facilitate delivery of stored grain to bulk receival sites or direct to port – giving growers greater flexibility about where and when to deliver wheat,*
> - *greater use of large trucks to deliver grain from farms to receival sites or to ports. The lower marginal cost of using larger trucks means growers have more choices about where to deliver grain,*
> - *consolidation and rationalisation of receival sites and the development of super-receival sites close to main rail lines,*
> - *consolidation and rationalisation of branch lines, particularly low volume lines linking small remote receival sites,*
> - *bulk handling receival sites being developed by rivals to the three incumbent bulk handling companies offering port terminal facilities,*
> - *rationalisation of the use of rail rolling stock (grain wagons) and greater use of trucks by bulk handlers to move grain from bulk receival sites to ports – this is particularly efficient for handling the peak load associated with larger harvests in good seasons, or to temporarily increase peak load capacity to assemble large shipments of grain*
> - *an increase in the export of premium quality wheat (and other grains) in containers.*
>
> *In light of the emerging competition between rail and road and the pressures for change in the transport, storage and handling of grain, the Commission has concluded that there is no case for regulated access of the bulk handlers' logistics chains.*

The competitive environment in eastern Australia was acknowledged by the ACCC in its approval of GrainCorp's ports Access Undertaking. For example, the ACCC's final determination on this Undertaking states:

> *The ACCC notes in particular that port terminal capacity is relatively unconstrained on the east coast and that the export of bulk wheat through GrainCorp's port terminals are subject to a number of competitive pressures, including from domestic users, up-country supply chains, from other ports and the threat of customers by-passing*

GrainCorp facilities.... further, the incentive for self-preferential treatment is moderated by countervailing competitive pressures in the case of GrainCorp.

It should also be recognised that regulatory agencies have approved lighter regulatory regimes for GrainCorp in Victoria and Northern NSW, given their acknowledgement of the competitive environment.

Given similar levels of competition in Southern NSW and Southern QLD, it is likely that GrainCorp could also obtain a lighter regulation in these areas.

a) The Essential Services Commission of Victoria recommended the removal of gain handling regulation in Victoria, which was subsequently adopted by the Victorian Government. Their report found:

The conclusions in this Review … do not present a strong case that access to prescribed services at a particular terminal would be 'essential' for market participants given the degree of substitutability between alternative options:

- *the [Melbourne Port Terminal] has established itself as a major participant in the industry, enabling at least the larger marketers (but perhaps not smaller marketers to the same extent) to substitute between terminals, i.e. access to a particular terminal may not be essential,*
- *although the increased degree of integration of the grain supply chain has assumed increased importance, and is coupled with wheat market deregulation which lessens the countervailing power of grain marketers, this has blurred the degree to which the grain terminals themselves are to be considered bottleneck facilities, and to what extent integrated supply chains form the relevant bottlenecks,*
- *other supply chain options such as containerisation, appear to provide viable alternative options for marketers of some minor grains.*

Given this degree of substitutability between terminal services or supply chains, in the Commission's preliminary assessment….These conclusions tend to indicate that the Victorian export grain terminals are no longer "significant infrastructure facilities"…

b) In June this year the ACCC approved the effective removal of port regulation at Newcastle, and also acknowledged there is significant competition in Northern NSW. Their decision found:

The significant degree of competition within the Newcastle Port Zone for bulk wheat means that port competition is not the only limit on GrainCorp's market power at Carrington. The ACCC concludes that the bulk terminals' influence on upstream markets is generally offset by the domestic market, competing storage and the container trade. The presence of a number of grain traders at both port and up-country suggests it will be less likely that any one grain trader or port operator will dictate trade along the supply chain.