

## **AUSTRALIAN GRAIN EXPORTERS ASSOCIATION**

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04/04/08

Ms. Jeanette Radcliffe  
Committee Secretary  
Senate Rural and Regional Affairs and Transport Committee  
Department of the Senate  
P O Box 6100  
Parliament House  
Canberra A C T 2600

Dear Ms. Radcliffe

**AGEA Submission to Senate Rural and Regional Affairs and Transport Committee Inquiry into the Wheat Export Marketing Bill 2008**

Please find attached the A G E A Submission to the proposed legislation for wheat marketing.

Yours truly



Robert L. Green  
President

## AUSTRALIAN GRAIN EXPORTERS ASSOCIATION

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### Submission to the Senate Rural and Regional Affairs and Transport Committee Inquiry into the Wheat Export Marketing Bill 2008

The Wheat Marketing Bill 2008 proposes to deliver much needed competition to the Australian bulk export wheat market. The Bill promises to allow a range of new entrants to participate in the market which will result in higher net prices for Australian producers, and the introduction of a range of new products, services and investment.

The Australian Grain Exporters Association (AGEA) has long advocated:

- No restrictions on competition amongst buyers
- There is maximum choice for growers in purchasing, transporting, storing and marketing Australian wheat
- A clear separation of the commercial, market development, trade access policy, monitoring, and oversight activities of the wheat industry
- Industry self-regulation and industry responsibility for stewardship functions to eventually replace government intervention as is the situation in almost all other commodity markets<sup>1</sup>.

The benefits to growers of this policy are numerous and well documented where state grain markets have been deregulated in Australia. The benefits of a contestable wheat market can be summarized as:

- the activities of a number of export buyers competing to purchase growers' wheat will drive up prices paid to growers and result in a range of new selling options
- improving growers cash flow by having a liquid cash market
- net returns will also be increased from reduced costs as accredited export wheat buyers compete to find more efficient ways to store, transport and finance their grain to its end use;
- new pricing options and more accurate price signals provide timely market information to all players along the marketing chain and will lead to more market responsive production decisions and create incentives to improve efficiency;
- the industry will expand from increased demand for Australian wheat as new buyers and more profitable markets are developed as a result of strong competition between accredited exporters
- a contestable market with many accredited exporters will reduce the risk of losses to growers, that did occur when the single desk marketer's activities resulted in a damaged reputation and forgone sales, as was the case with AWB in Iraq and its subsequent ramifications in other markets

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<sup>1</sup> ACIL Tasman, 2007, *Marketing Australian Wheat; Competition and choice in the Australian export wheat market – increasing growers' net returns*. Prepared for the AGEA

The direct costs of the single desk have been well documented, but the real costs have been the exclusion of new entrants to the market that bring with them capital, alternative selling and financing options and a range of new services for grain buyers and sellers. New entrants will also introduce new buyers for Australian grain, and develop new grain products.

The rationale for Government involvement in the Australian export wheat market has been to protect the interests of Australian wheat growers. The main objective when protecting growers' interests is to maximise net returns at the lowest possible risk. It is the AGEA belief that previous Government intervention in the wheat market, through the establishment of the export wheat monopoly, has manifestly failed to act in the interest of growers.

Why will competition protect the interests of growers? The simple answer is that growers will be able to make an assessment of the quality of the product and the business and choose the one that best satisfies their individual business needs. Each wheat grower will be able to choose the accredited exporter with whom they deal and the sort of information they will need to make the choice. Accredited exporters will compete to build the confidence of growers, to ensure an ongoing business relationship.

Competition will be optimised by:

- removing constraints on the development of new products and services which will provide a choice of marketing options to best meet individual circumstances, including the provision of risk management and financing options
- reducing the barriers to entry (license requirements) to optimise the number of accredited exporters active in the export market
- ensuring that prompt and accurate price signals are provided to all players along the marketing chain, allowing growers and others to respond to market trends and improve efficiency
- allowing growers to make informed decisions on whom they deal with when selling grain, and utilising risk management services
- removing the constraints on the development of highly liquid secondary markets that provide efficient prices discovery and risk management options
- ensuring there is transparency of supply chain costs, operations and services.

In the AGEA's view, this legislation delivers much need competitive reform to the Australian wheat market. However, to maximize the benefits of these reforms, the AGEA submits to the inquiry, the following recommendations.

### ***General comments on the Bill***

Alan Greenspan, in his book 'The Age of Turbulence'<sup>2</sup> attributes part of the strength of the US financial system to its self-regulation through what is known as counterparty surveillance. In other words,

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<sup>2</sup> Greenspan, Alan, 2007: The Age of Turbulence: Adventures in a New World, Artisans Books.

constraints are imposed on lenders — in this case grain marketers — by their investors and the banks and other institutions that lend them money. The current liquidity crisis is in part due to extreme sensitivity to credit risk in financial markets.

Alan goes on to observe, based on his experience, how much better situated and staffed banks and investors were to understand what lenders were doing as compared to ‘by-the-book’ regulation done by government financial regulatory agencies.

Alan Greenspan put forward three rules of thumb for effective financial market regulation:

- Regulation approved in a crisis should be refined once the situation stabilizes
- Several regulators working together are better than one. Solitary regulators become risk adverse as he or she guard against all imaginable negative outcomes, creating a crushing compliance burden. Several regulators acting together maintain checks and balances
- Regulation outlives its usefulness and should be renewed periodically.

While the current Wheat Marketing Bill does not appear to be being drafted in a state of crisis, the grains industry is undergoing a period of transition in response to the findings of the Oil for Food Inquiry and in response to National Competition Policy. During this transition, some have sort to paint a bleak picture of an unregulated wheat export market, which is not at all supported by the experience of other grain markets, after deregulation. The bill once passed will be operating in concert with several other regulations such as the *Trade Practices Act 1979* and parts of the *Financial Services Reform Act 2001*. The regulatory oversight of the agencies formed under these statues appears to overlap with that proposed by the Wheat Export Marketing Bill 2008. This overlap may cause unnecessary compliance costs on licensees, unless there is recognition of the role of these Acts in the proposed legislation or the licensing scheme.

### ***Objectives of the Bill***

Cl 7(1) of the exposure draft of the Wheat Export Marketing Bill 2008 provides that Wheat Exports Australia (WEA) ‘may, by legislative instrument, formulate a scheme (to be known as the ***wheat export accreditation scheme***)...’ The wheat export accreditation scheme is required to have certain accreditation provisions, financial and business eligibility tests, certain conditions as to accreditation and certain provisions as to cancellation and surrender of accreditation—cls 8-18.

The legislation would appear to reflect the simplicity and pragmatism of the recently adopted ESCOSA model for the deregulation of the South Australian Barley Market. The AGEA would encourage the WEA to study this model closely when it considers what criteria to use in developing a licensing scheme.

However, the scheme is neither established by the Bill, nor is there an express or complete list of matters with which the scheme has to deal. WEA is not obliged, by the Bill, to actually make a scheme or keep one in a particular form.

There is also a limited role of the Minister in the current draft Bill. Many of the functions of the Minister in relation to the WEA are similar to his functions in relation to the present Export Wheat Commission (EWC), such as appointments to the WEA board and the approval of operating plans. However, the minister has no role in the accreditation process and no power to direct that there be an accreditation scheme or the

criteria upon which a scheme should be based. The AGEA is not advocating a greater role for the Minister but cites this as an example of wide discretion conferred on the proposed WEA by the draft Bill.

Thus the AGEA believes that the Bill, in its present form, provides the WEA with considerable discretionary powers in relation to the establishment and administration of the licensing scheme. The AGEA recognizes the need for the WEA and the scheme to be responsive to changing needs of growers and the broader industry, particularly during the period of transition from a regulated to a contestable market. However, the AGEA believes that the WEA, growers and the wheat industry would be better served if the Bill contained clear directions to the WEA in relation to the aims of the scheme and what it has been established to achieve.

Clearly stated objectives and periodic formal reviews of the WEA's performance against those objectives would be a substantial improvement of the governance arrangements of this Bill, and provide far greater transparency to the activities of the regulator.

Two important economic Acts provide precedents for the inclusion of objectives into legislation, one general and the other more detailed.

- S 2 of the *Trade Practices Act of 1974* states that:

The object of the Act is to enhance the welfare of Australian's through the promotion of competition and fair trading and provision for consumer protection

- S 3 of the *Workplace relations Act 1996*, prior to recent amendments provided:

The principle object of this Act is to provide a framework for co-operative workplace relations which promotes the economic prosperity and welfare of the people of Australia by...

*(the Act then goes onto list 11 specific objectives and actions to guide the work place regulator)*

The AGEA recognizes that if no objectives were inserted in the Bill and objectives were required to interpret the Bill they could be taken from other sources including under s15AB(2)(f) of the *Acts Interpretation Act 1901*, from the ministers second reading speech on the Bill.

The AGEA believes that express objectives may be easier to find and apply than objectives to be extracted from a speech, the contents of which are at present unknown.

The AGEA recommends that the following objectives be considered for inclusion in the Bill:

- When establishing the licensing scheme the WEA observe the following objectives:
  - The licensing scheme enhances competition, security and transparency in the Australian export wheat market
  - The licensing scheme not be unduly discretionary
  - The licensing scheme be transparent and predictable.

In addition to the inclusion of objectives in the Bill, the Bill could include some of the elements of the accreditation scheme in the Bill itself. At present the Bill neither contains an accreditation scheme nor requires one to be made. It is thus possible—although unlikely—that no scheme be would be made, or that the scheme could be terminated. It is also possible, and not quite as likely, that a scheme could contain restrictive provisions, because of the WEA's free hand in making a scheme.

It would be possible to avoid these problems by including in the Bill an accreditation scheme that could contain some but not all of the assessment criteria. This would ensure that at least some of the criteria would be subject to parliamentary scrutiny if they were to be changed, and still allow some flexibility for the WEA to respond to grower demands.

There are many precedents for this type of legislation. An example of a registration scheme governed both by an Act and rules under the Act, is in the provisions for registration of private health insurer bodies under Part 4-3 of the *Private Health Insurance Act 2007*. This part includes provisions for the content of applications by companies seeking such registration (s 126-10) and the matters the Private Health Insurance Administration Council is to consider in deciding applications (s 126-20). Rules may be made both requiring matters to be considered and prohibiting matters from being considered (s 126-20(3)) and (4)).

**Recommendation: that the Act include a clear set of objectives based on enhancing competition, transparency and security. The objectives should also direct the WEA to establish a transparent and predictable scheme that is not unduly discretionary. Consideration should also be given to including some of the accreditation criteria in the Act itself.**

#### ***Formal review of the legislation***

Perhaps the most relevant of Alan Greenspan's rules of thumb for this proposed Bill is the third where regulation needs to be reviewed periodically. At this stage there is no formal review obligation in the Act, which is a significant omission. In an industry as dynamic as the Australian grains industry, and where there is such clear evidence that growers adjust and prosper in deregulated markets, it is essential that this legislation be subject to periodic review against the objectives of the Act.

In addition to an assessment against the objectives of the Act, the legislation and the WEA should also be assessed against their contribution toward:

- Build the capacity of wheat growers to assess for themselves whether a company is fit and proper to trade with (manage their own commercial risk) in the domestic and export market for grain.
- Encouraging the Australian grain industry to assume a greater level of self-regulation.

**Recommendation: that a clause stipulating a formal review of the legislation against its objective be conducted in 2011 and every five years thereafter.**

#### ***Section 11***

Section 11 of the draft Bill provides the WEA with some guidance as to what criteria should be included in the licensing scheme. Of particular interest to the AGEA are subsections c(i to iii). The sections state that the WEA is satisfied that the company is a fit and proper company, having regard to the following:

- (i). The financial resources available to the company
- (ii). The company's risk management arrangements
- (iii). The company's business record

All parties actively trading in the grain supply chain constantly scrutinize those with whom they are dealing. Counterparty risk assessment relies on knowledge of both the size and nature of each transaction and knowledge of the counter party's security as it relates to each transaction. For the vast majority of transactions, counterparty risk assessment is based on the performance of both parties in previous transactions. Hence, within the market, a marketer establishes a commercial history.

Thus counter party risk is assessed on the trading history of the company and the size and terms of each transaction. For example cash sales of small parcels of grain with short terms of trade (i.e. cash on delivery, cash 7 days after delivery etc) require a buyer to demonstrate different capital adequacy to the large transactions with extended payment terms, such as those for substantial quantities of pooled grain.

Assessing the financial resources of the company will require some assessment of the:

- volumes the marketer will be trading
- types of products the trader will be offering; and
- counter party risks the trader will be exposed to themselves.

It would be difficult to assess the financial resources of an export wheat license applicant without knowledge of these factors for the life of the license. A license issued to a marketer who demonstrated sufficient financial resources based on the criteria as they stand in the draft Bill, implies that the trader will be constrained to trading the volumes, products and with the counterparties specified in the license application.

Similarly, issuing a license to an exporter that satisfies the regulator's risk management arrangement criteria implies that the licensee will continue to operate as per the license application.

If too much prominence is placed on these criteria, the effect will be a reduction in the innovation in the products and services offered and therefore ultimately the price buyers will be able to pay, for wheat from growers.

It should also be noted that all of the members of the AGEA are members of the National Agricultural Commodity Marketers Association (NACMA), as virtually every other grains industry participants in Australian. Membership of NACMA requires each member to comply with the organization's code of conduct. The NACMA code of conduct stipulates that members will:

- comply with the laws and regulations relating to the merchandising, inspection, grading, weighing, storing, and handling and shipment of grain and other commodities.
- maintain and promote the highest ethical standards and honest procedures in the transaction of business with other members of NACMA and the public.
- serve the public and employees, fairly and honestly, and continually strive to gain and maintain respect for the NACMA and the industry locally, nationally and internationally.
- engage in sales and purchasing methods, promotional practices and other transactions, giving consideration to the best interests of the agricultural industry as well as the public<sup>3</sup>.

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<sup>3</sup> Taken from the NACMA website on the 03/04/2008 [http://www.nacma.com.au/about\\_nacma/code\\_of\\_conduct](http://www.nacma.com.au/about_nacma/code_of_conduct)

Failure to comply with the code of conduct results in NACMA membership being cancelled which would have serious ramifications for the company involved, as other marketers would reconsider trading with the company. The AGEA believes that maintenance of NACMA membership by a license applicant be considered as an important assessment criteria under S 11(iii) of the proposed Bill.

High barriers to entry for new entrants may reduce the number of exporters active in the market making the clearing of large wheat export surplus difficult in some years. Having a large number of active exporters will also mean constant attention to the demand for grain, at all times. At present growers are forced to price their grain between sowing and harvest as there are few active traders at other times of the year.

A far more effective test to determine if a company is fit and proper would be the company's business record. That is the company has traded within prudent limits, and has risk management arrangements appropriate to the products and services it is offering.

Where a new company, without a trading history, is applying for an export license, the regulator should include in its assessment, the counterparty risk assessment undertaken by the financiers of the new company. This would reduce the application costs of a new company and reduce barriers to entry into the wheat market.

The AGEA believes that there is considerable regulatory overlap with the compliance requirements of the *Trade Practices Act 1974*, and sections of corporate law as administered by the Australian Investment and Securities Commission.

In particular the *Financial Services Reform Act 2001* requires grain marketing companies selling derivative based products (futures and options) to maintain a Financial Services License. Companies offering pooled grain products must also seek Managed Investment Scheme exemptions from the Australian Companies and Securities Investment Commission (ASIC).

The AGEA strongly urges the WEA to recognize the security offered by these and other regulations, and to work closely with other regulators, to ensure that the compliance burden of the draft Bill be reduced as far as is practicable.

The AGEA supports the inclusion of subsections (iv) to (xvi).

The inclusion of section (xvii) such *other matters (if any) as WEA considers relevant...* is another example of the discretionary powers given to the WEA by the draft Bill that will be given direction by the inclusion of a set of objectives.

**Recommendation: that the WEA assess whether a company is a fit and proper company to market export wheat on its trading history. In the event of a new firm applying for a license, the WEA take into account the counter party risk assessment undertaken by the financiers of the company and/or any guarantees provided by them.**

## **Section 20**

The AGEA is supportive of the inclusion of the access provisions of the draft bill. An efficient and transparent storage handling and port terminal services market will be critical to encouraging new entrants to the Australian wheat export market.



The AGEA is concerned that the access provision does not cover domestic storage and handling infrastructure pre-port terminal. There is considerable concentration of ownership of storage and handling infrastructure between the farm gate and the port terminal, which could present a significant barrier to entry into the export grain market.

The AGEA believes that section 47(1), the third line forcing provision of the *Trade Practices Act 1974*, may prevent storage and handling infrastructure operators from barring others direct access to port terminals and in effect forcing them to use pre-terminal bulk handling facilities. However, actions under the *Trade Practice Act 1974* can be prohibitively expensive.

The Access test does appear adequate to meet the concerns of the AGEA, but reducing the barriers to entry, of which access to infrastructure is an important part, will require a much broader policy response than just the Access Test proposed in the draft Bill.

In particular, the AGEA encourages a broad policy approach to reducing barriers to entry to the Australian export grain market. This would include the WEA working closely with other agencies such as DAFF, the ACCC, and the Department of Infrastructure and Planning etc.

Additional policies that would reduce the barriers to entry of new entrants include the collection and publication of key industry information and statistics such as:

- Accurate timely crop forecasting at a regional level
- Stocks held by bulk handling companies, farmers, domestic users and stocks in transit
- Export sales and shipments
- Market intelligence from export and domestic markets.

Not only is the collation and dissemination of this information likely to increase transparency, it will assist regulators responsible for competition regulation to be able to ensure firms are compliant with competition laws.

At present, the collection of information in the draft Bill under S 13(1)(c) would be of little use with the collection of a much larger suit of grain industry statistics.

**Recommendation: that the WEA ensure that pre-terminal storage and handling infrastructure and transport access is assured either as part of the access regime (being the subject of the same statements in S 20(1) and (2) ) or under third line forcing provisions of section 47(1) or other relevant sections of the TPA. That the Access Test in S 20 of the draft Bill be part of a wider policy to reduce barriers to entry to the export wheat market.**

### ***Section 27***

The AGEA would like to raise several questions relating the provisions of this section. The first question is who should pay for an external audit if requested by the WEA?

The AGEA would also like some clarification as to whether an audit, conducted as part of the routine operation of a company when complying with general company laws, would be adequate to satisfy a request by the WEA under S 20? If not what additional information would be required by the WEA.

**Recommendation: that any audit requests under S 27 of the draft Bill that are in addition to routine company auditing undertaken by companies as part of the general company regulation obligations, be paid for by the WEA.**

### ***Conclusion***

The AGEA supports the introduction of competition reform in the Australian wheat export market as present in this draft Bill. The introduction of competition will improve growers' net returns, as well as delivering a range of new and innovative products and services.

However, to optimize the benefits of the competition introduced in the draft Bill, the AGEA make the following recommendations:

- That the Act includes a clear set of objectives based on enhancing competition, transparency and security. The objectives should also direct the WEA to establish a transparent and predictable scheme that is not unduly discretionary. Consideration should also be given to including some of the accreditation criteria in the Act itself.
- That a clause stipulating a formal review of the legislation against its objective be conducted in 2011 and every five years thereafter.
- That the WEA assess whether a company is a fit and proper company to market export wheat on its trading history. In the event of a new firm applying for a license, the WEA take into account the counter party risk assessment undertaken by the financiers of the company and/or any guarantees provided by them.
- That the WEA ensure that pre-terminal storage and handling infrastructure and transport access is assured either as part of the access regime (being the subject of the same statements in S 20(1) and (2)) or under third line forcing provisions of section 47(1) or other relevant sections of the TPA. That the Access Test in S 20 of the draft Bill be part of a wider Government policy to reduce barriers to entry to the export wheat market.
- That any audit requests under S 27 of the draft Bill that are in addition to otherwise routine auditing undertaken by companies, as part of the general company regulation obligations, be paid for by the WEA.