

The **Allen Consulting** Group

## **Industry Good Services - Wheat**

Rationale and future options

**March 2008**

Report to AWB Limited

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## Executive summary

### **Background**

Industry good functions comprise a number of services that to date have been provided by AWB (and previously the former Australian Wheat Board) on the grounds that they provide benefits to growers and the grains industry in general.

These services were part and parcel of the monopoly export marketing arrangements known as the ‘single desk’, whereby AWB and its predecessor had responsibility for overall market coordination and all associated functions. They were funded, in effect, by industry: primarily as expenses associated with annual wheat pools out of the pool returns, or in some cases as functions undertaken by AWB (Limited) along with other functions. The exact attribution of costs is difficult given the effect was marginal (on average their cost amounted to less than 0.3% of the value of Australian wheat exports in any one year) and because the industry good functions were inextricably associated with overall AWB responsibilities under the export marketing arrangements.

While AWB maintained a monopoly on bulk exports of wheat from Australia, the problem of ‘free riders’ on industry good services was to some extent avoided. Although there were minor exceptions to the export monopoly, most export wheat growers indirectly both funded and benefited from industry goods. However, some industry good services (e.g. wheat classification, research and development and the Australian Crop Report) benefited domestic as well as export interests: meaning that in effect following domestic deregulation in 1989 exporters began subsidising domestic growers. This was not a major concern in the industry given the overall scale of export wheat and the historically pivotal role of AWB and the Australian Wheat Board in the industry.

That situation has now changed.

With the foreshadowed move to an accreditation model for wheat exports, in which AWB if accredited will potentially be only one (and not necessarily the dominant one) of a number of firms marketing Australian wheat, there is no economic justification for AWB Ltd. to continue to fund the industry good services. For it to do so would put it at a disadvantage compared with other firms in the market.

The question for this project then is what options exist for the future of the industry good services that AWB has provided to date.

This report examines the economic justification in principle for provision of such services, and then for each industry good in turn considers:

- whether or not the service is a result of an apparent market failure; if not, the services might either be provided by firms competing for business in the wheat market, or discontinued with no adverse effects.
- parallels with international practice and any comparable domestic industries (noting that this is not necessarily a good guide as to whether the service is economically justified).

- where a case can be made for continuation of the industry good service, potential mechanisms for ongoing delivery of the service, including who should deliver it and how it should be funded.

### **Conclusions and recommendations**

The report suggests that the economic rationale for many of the previously provided industry good services is questionable, particularly in light of proposed new export wheat marketing arrangements. Some of the services, such as wheat classification and research and development, do have public good characteristics that suggest they may not be provided in the more competitive market envisaged; but many others will continue to be provided through normal price and competition incentives that will apply.

There has been some contention around whether industry good services should be transferred as a whole to a new body, or rest with a number of bodies – the conclusion from the analysis suggests that the services would be best delivered if they became the responsibilities of bodies with the skills and background to deliver them in conjunction with other activities.

## Chapter 1

# Introduction

### 1.1 Industry good services

AWB Limited ('AWB') has historically held the monopoly right to export wheat in bulk from Australia – first, as its predecessor the Australian Wheat Board (a statutory authority of the Federal Government from 1939) and, more recently post-privatisation in 1999, through its subsidiary AWB (International). As part of this 'single desk' arrangement, AWB performed a market coordinator role. This role meant AWB also assumed the responsibility for the provision (and funding) of a number of *industry good services* (IGSs).

It is important to note that this report will not examine functions associated with the single desk (such as buyer of last resort, pool management, setting of floor and ceiling prices) or the single desk arrangement itself. While there are a number of such activities that were put in place at various stages on the grounds that they provided benefit to the Australian grains industry, they are ultimately part of grain marketing arrangements and thus not relevant to the current discussion. The debate over the future of the single desk, and whether or not there is a market failure argument for it to continue, has been canvassed exhaustively and resolved elsewhere. This report focuses on the specifically identified industry good services detailed below.

According to AWB (2007: 1), IGSs are those of its business activities that meet one or more of the following criteria:

- 'clear benefits flow through to other industry participants apart from AWB and its direct customers – for example, to the domestic grains industry;
- the activity represents an industry self-regulatory framework and a large part of the industry agrees to operate within it; and
- examples of similar functions are funded and/or performed overseas by government agencies or industry associations.'

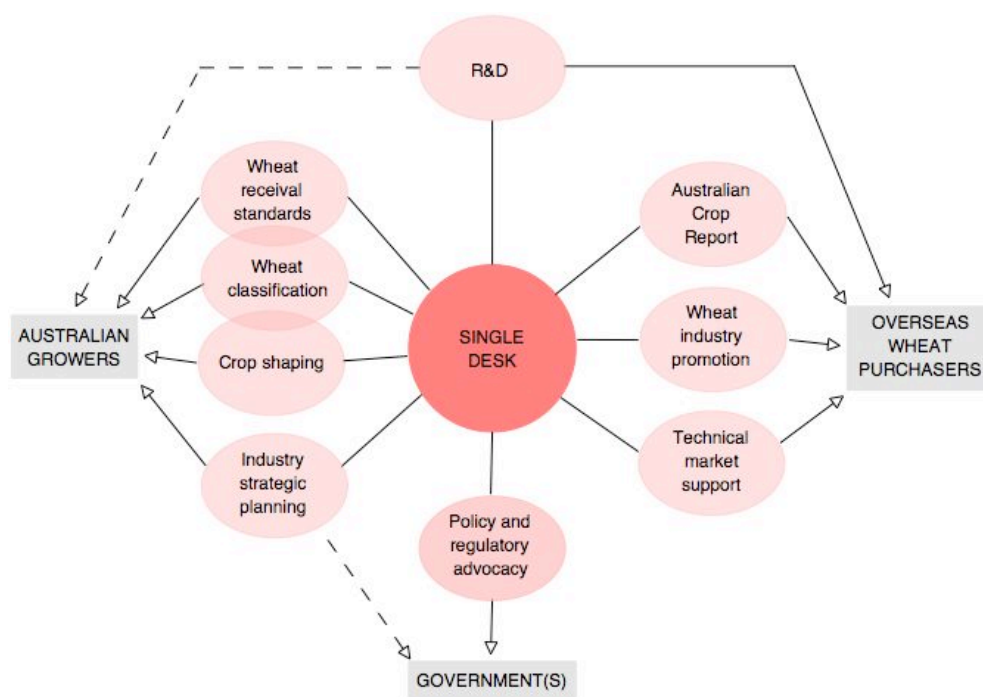
On the basis of these criteria, AWB identifies the following nine activities as IGSs:

- **'Industry strategic planning and execution:** development of strategic plans for the wheat export industry;
- **Wheat receival standards:** quality assurance (QA) function and regulatory compliance;
- **Wheat classification panel:** framework providing market signals to new varietal development;
- **Crop shaping activities:** grade systems and incentives for matching production volumes to market and customer demands;
- **Australia wheat crop report:** collation of data across Australian wheat grades to inform the international and domestic markets of wheat crop quality;

- **Technical market support:** direct technical training to customers to assist their understanding of the quality of Australian wheat from year to year and how best to assess and use it;
- **Promotion of Australian wheat industry:** generic promotion of the key points of differentiation and customer value propositions of Australian wheat derived from production, logistics and quality systems;
- **Policy and regulatory advocacy:** input into development of national and international policy and regulatory issues to remove impediments to profitability of the industry and to ensure Australian wheat is not disadvantaged in international trade; and
- **Research and development:** to improve understanding and management of wheat quality across the industry.’

Figure 1.1

**INDUSTRY GOOD SERVICES**



It is important to note that, while this report will analyse AWB’s IGSs separately, many of them overlap and are inter-related. For instance, an element of crop shaping is appropriately managing the wheat classification system, while varietal classification helps define wheat receival standards. Likewise, the Australian Crop Report is an important marketing tool, and thus is linked with wheat industry promotion.

For the three years to 2005/06, AWB spent an average of \$10.5 million per year on the provision of IGSs (see Table 1.1).

Table 1.1

**AWB EXPENDITURE, INDUSTRY GOOD SERVICES, 2003/04 – 2005/06**

Industry good service	Average annual expenditure
Industry strategic planning and execution	\$2 925 478
Wheat receival standards	\$47 000
Wheat classification panel	\$452 290
Crop shaping	\$30 504
Australian wheat crop report	\$1 493 000
Technical market support	\$1 677 760
Promotion of Australian wheat industry	\$730 040
Policy and regulatory advocacy	\$730 040
Research and development	\$3 162 523
<b>Total</b>	<b>\$10 488 090</b>

Source: AWB

**1.2 Current debate**

Over the past twenty-four months, a number of factors have fundamentally transformed the policy environment surrounding the future of wheat export marketing in Australia. Key amongst these are:

- The 2005 *Inquiry into Certain Australian Companies in Relation to the UN Oil-for-Food Programme*, the report of which (published in November 2006) raised questions about the appropriateness of AWB's wheat export monopoly.
- The *Wheat Marketing Amendment Bill 2006*. Passed by the Federal Parliament in December 2006, this bill amended the *Wheat Marketing Act* to transfer the right to veto certain export applications from AWB (International) to the Minister for Agriculture, Fisheries and Forestry until 30 July 2007. The Minister, Peter McGauran, subsequently granted rights to Wheat Australia (a joint venture between CBH, ABB, and GrainCorp) to export 300 000 tonnes of wheat to Iraq, and CBH to export 500 000 tonnes of wheat to Indonesia.
- The Howard Government's appointment of the Wheat Export Marketing Consultation Committee (WEMCC) in January 2007, which sought to ascertain the 'wheat export marketing needs' of the Australian grains industry. Amongst the issues on which it sought growers' views was the future of industry good services. The WEMCC's report was presented to the Government on 30 March 2007.
- The Howard Government's announcement in May 2007 that:
  - the single desk would be retained;
  - AWB would keep control over the single desk for 2007/08; and
  - after this period, control over the single desk would be transferred to an unspecified, grower-owned entity.

- The *Wheat Marketing Amendment Bill 2007*. Introduced in June 2007, this bill amended the *Wheat Marketing Act* to:
  - replace the Wheat Export Authority with the Export Wheat Commission (EWC), and grant the new body with greater information gathering powers;
  - empower the Minister for Agriculture, Fisheries and Forestry to direct the EWC to undertake certain investigations;
  - extend the transfer of veto power from AWB (International) to the Minister until 30 June 2008;
  - empower the Minister to designate a company other than AWB (International) as the holder of the single desk privilege; and
  - deregulate the export of wheat in bags and containers.
- The release by the Labor Opposition in October 2007 of its policy regarding Australian wheat export marketing. The key plank of this policy was that there would be ‘a single desk with multiple accredited exporters’, ensuring that ‘export marketing services are contestable’ (ALP 2007: 1). Labor’s policy appears to be based on the South Australian Government’s deregulation of the State’s barley marketing arrangements and associated introduction of an accreditation system for barley exporters. Labor, under Kevin Rudd, was subsequently elected in November 2007.

The new Minister for Agriculture, Tony Burke, has subsequently reaffirmed Labor’s commitment regarding the single desk; and promised to introduce legislation by 1 July 2008. Consequently, it is highly likely that Australia’s wheat marketing arrangements will shift from heavy regulation of exports and control of markets to a light touch regulation of suitability to export along with prudential standards to protect growers and provide stability in the transition from a single to multiple exporters. More specifically,

- AWB will not retain exclusive control over the single desk after June 2008; and
- for the 2008 harvest and subsequently there will be a number of accredited wheat exporters operating in a competitive market environment.

Given the likelihood of such a scenario, AWB (2008: 11) has concluded that:

- by 1 July 2008, it will no longer formally represent the industry as it once did as single desk manager;
- ‘[i]t will not be commercially feasible for [the company] to continue to provide industry good services in an environment where the ability to export and market Australian wheat internationally is held by a number of different organisations’; and
- it is thus ‘committed to a smooth transition of industry good services provided by AWB on behalf of National Pool participants to appropriate industry groups and statutory agencies.’

## Box 1.1

**'INDUSTRY SERVICES' AND THE DEREGULATION OF SOUTH AUSTRALIA'S BARLEY EXPORT MARKETING ARRANGEMENTS**

In 1993, the South Australian Government, through the *Barley Marketing Act (SA)*, gave ABB Grain exclusive rights to export barley in bulk from South Australia. However, after a review of the Act in 2003, the State Government sought to deregulate its barley export marketing regime. This was achieved in 2007, with the enactment of the *Barley Exporting Bill*.

In the lead up to the introduction of this bill, there was some concern about what would happen to a range of 'industry services' provided by the single desk manager. These services included:

- continued investment in research and development;
- identification and development of new markets;
- availability of finance options, particularly the continuation of pools;
- information on varieties and their suitability to the marketplace;
- classification of varieties;
- risk management services;
- supply chain management for least cost pathways to market; and
- factual and timely market information.

In 2006, the South Australian Minister for Agriculture, Food and Fisheries established a joint working group to explore and make recommendations about issues relating to the deregulation of the barley single desk. With reference to the 'industry services' outlined above, the joint working group:

- 'suggested in relation to a number of grower services that there should be an increasingly important role that Barley Australia should perform on behalf of the industry' – particularly regarding 'the co-ordination of research priorities for barley marketing', generic promotion and varietal classification; and
- recommended '[t]hat the government develop an MOU with the SA Farmers Federation Grains Council ... to facilitate the provision of a range of grower services in line with the needs of a deregulated market.' This MOU would:
  - require the South Australian Government and SAFF to push for a national model to ensure the free, detailed and transparent provision of market intelligence relating to barley and other important grains; and
  - discuss the provision of ABB's 'industry services', noting that '[i]t is highly likely that these services are not necessarily going to be delivered by a single government agency or industry organisation. There are potentially already a range of service providers who could perform these roles.'

Since the publication of the working group's report, the State Government and SAFF do not yet appear to have reached an MOU about ABB's industry services. However, Barley Australia has assumed responsibility for national varietal classification, and barley-related R&D continues through GRDC and the South Australian Grains Industry Trust Fund (SAGIT).

Source: SABMWG (2006)

The question of what should happen to AWB's IGSs has become a topic of hot debate within the Australian wheat industry. On the one hand, there are those who argue that:

- 'most' of the functions identified by AWB as IGSs are 'commercial activities that should be the responsibility of exporters' (Morris 208: 6); and

- ‘the only two [IGSs] that are not commercial activities – wheat classification and receival standard setting – could be covered by existing industry processes’ (Morris 2008: 6). Specifically, the current wheat classification panel ‘can be reorganised to involve new bulk wheat exporters once they are accredited and commence trading’, while the National Agricultural Commodities Marketing Association (NACMA), which already sets commodity standards for the domestic wheat market, could assume control over receival standards (Grains Policy Institute 2008: 4-5).

As the Grains Policy Institute (2008: 1) states, the basic premise of this line of reasoning is ‘that there is no generic “industry good” role in the Australian wheat industry that warrants the establishment of an industry development organization.’

Others have taken various contrasting positions to this argument. For example:

- The Grains Council of Australia (GCA 2007a: 2) passed a motion in March 2007 stating that ‘regardless of the outcome of the Governments deliberations on wheat export marketing, that the agreed industry good functions should be assumed by a grower owned and controlled entity and that a timetable for this should be considered’; and
- ITS Global (200a: 3) contends that AWB’s marketing and promotion services should be transferred to a new statutory corporation, whose projected budget of \$15 million could be drawn from both industry and government sources.

Underlying the above arguments is a structural debate. Specifically, whether the IGSs should be transferred to a single body or a range of bodies. The GCA appears to endorse the former of these options, as does the New South Wales Farmers Association, which stated in February 2007 that ‘industry good functions may need to be moved to another independent body such as the Wheat Export Authority (WEA)’ (GCA 2007b). Likewise, AgForce (2007: 8) contends that ‘[i]ndustry good functions for wheat marketing need to be retained and returned to an independent group not related to any commercial company.’

Conversely, the Grains Policy Institute in its arguments above seems to endorse the opposite viewpoint. AgFarm Marketing Commodities (2007: 9) expresses a similar perspective: ‘There are a number of bodies that currently exist that could share some of the ... Industry good functions. A review of the current infrastructure could lead to the merger or closer cooperation of some of these bodies to deliver Industry good outcomes.’

The Federal Government has sought clarity about this debate, with the Agricultural Minister, Tony Burke, establishing a Wheat Industry Export Group ‘to advise him by late April on how wheat industry development functions should be managed after AWB loses its single-desk status’ (Burke, 2008).

### **1.3 This report**

This report seeks to inform the debate by through a fundamental, first principles examination of the nature and rationale of the IGSs provided by AWB.

It considers each of the nine IGSs highlighted above in turn, ascertaining whether there is market failure, providing options for addressing, and offering conclusions. But first, this report will briefly outline its underlying rationale – specifically, the concept of ‘market failure’.

### *Market failure*

‘Market failure’ is the inability of an unregulated market to achieve, in all circumstances, allocative efficiency’ (McTaggart, *et al.* 1992: 462). Market failure may arise under a number of conditions including:

- *public goods* — these goods will tend to be under-produced because they are non-excludable (i.e. people who have purchased the good cannot stop others using it) and non-rivalrous (i.e. the good is not used up with use). Common examples include aspects of the natural environment and national defence. A problem associated with public goods is free riding. A ‘free rider’ is a third party who benefits from a transaction without contributing to its cost. If free riding is too prevalent regarding a particular good or service, then the provision of the good or service may be threatened, no matter its intrinsic value;
- *natural monopolies* — where the costs of establishment, resources or infrastructure mean that setting up competition is not viable (for example, where economies of scale in a large network like a fixed wire telephone system create impossible barriers to entry, an incumbent will potentially gain large monopoly rents). In these situations governments may decide to regulate in the public interest;
- *externalities* (i.e. spillovers) — positive or negative impacts of market transactions which affect third parties and are not reflected in prices. Pollution is commonly referred to as a negative externality; and
- *severe information asymmetries* — where information is not evenly distributed throughout the community. The uneven distribution of information may mean that production and consumption decisions do not maximise community welfare.

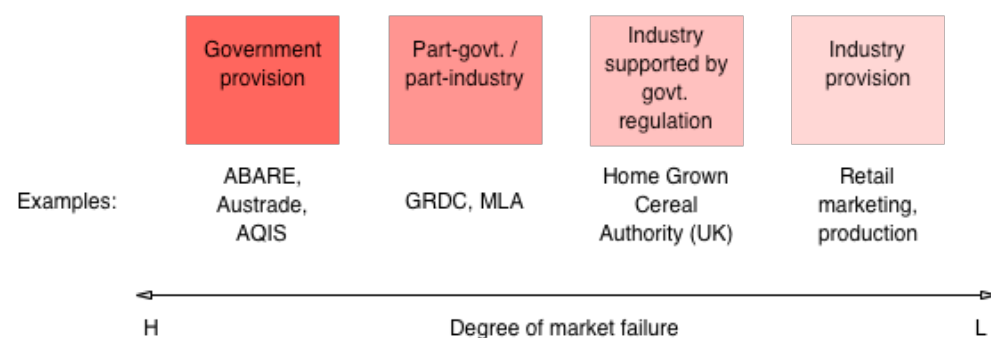
Options for dealing with market failure include:

- *government provision through spending or regulation* – in this situation, a government (or governments) assume responsibility for the allocation of the good or service that the market is unable to distribute efficiently. Examples relevant to agricultural production include: the collation and distribution of statistics by the Australian Bureau of Agricultural and Resource Economics (ABARE) and the Australian Bureau of Statistics (ABS); the market facilitation services offered by the Australian Trade Commission (Austrade); food safety standards; labelling laws; and the various services provided by the Australian Quarantine and Inspection Service (AQIS). (Note: in some of these examples, government provision is partly funded through user charges; in others, costs are borne by taxpayers generally).

- *joint government/industry provision* – an example of such an arrangement is rural research and development, which for most large rural industries in Australia is funded equally through compulsory grower levies and government contributions. Grains Research and Development Corporation (GRDC) research is one such example, jointly funded by a grower levy and the Federal Government. Joint provision can take a variety of forms: for example, Meat and Livestock Australia (MLA) performs not only research and development but also a number of other promotional and food safety services for the red meat industry, which are also collectively funded by producers, the Federal Government and processors/wholesalers.
- *industry provision supported by government regulation* – for example, the single desk arrangement (leaving aside heated debates over whether or not a market failure was involved);
- *industry provision* – e.g. retail marketing, production.
- *no action* – not all instances of market failure justify intervention. The costs of intervening to correct market failure may outweigh the benefits.

The extent to which governments have been inclined to intervene in a mixed market economy such as Australia’s has (in general terms) depended on the extent to which it perceives a market failure exists, as shown in Figure 1.2.

Figure 1.2



This traditional view of the role of government has been challenged by more recent economic literature that identifies government failure as being as much of a problem as market failure. It is useful to be reminded when considering industry good services that:

- not all cases of market failure justify government spending or regulation;
- government intervention is not always the best solution;
- that there are a range of options for moving forward (including government, industry, and a mix of government/industry actions); and
- the costs of intervention should also be considered carefully.

## Chapter 2

# The nature and rationale of industry good services

### 2.1 Industry strategic planning and execution

#### *Background*

According to AWB (2007: 1), it has ‘responsibility for the overall strategic business plan for the wheat export industry.’ AWB launched its most recent industry strategic plan, *Shaping the Future*, in 2004. The five key planks of this strategy were:

- ‘enhancing international sales and marketing;
- improving research and development and crop shaping;
- optimising supply chain operations;
- strengthening trade advocacy; and
- improving grower communications’ (AWB 2007: 1).

For the three years to 2005/06, AWB spent a total of \$8.8 million on industry strategic planning and execution – an annual average of \$2.9 million.

#### *Extent of market failure*

The starting point for consideration of each IGS in this report is whether it has any public good character at all (which would mean it may need to be transferred to another entity or entities) – or whether it could simply be discontinued.

Answering this question in the context of the provision of industry strategic planning is difficult. On the one hand, there is a growing body of literature that outlines the benefits which industry strategic planning can bring to agricultural industries (Hall and Lyford 2001; Lyford *et. al.* 2002). These benefits include:

- improved vertical coordination of supply chains;
- greater transmission of customer quality demand;
- easier development of critical masses of new products; and
- greater focus of industry communication and action.

A number of agricultural industries in Australia, as well as the Canadian wheat export industry have sought to capture benefits like these through devising and implementing their own industry strategic plans (see Box 2.1 for more detail). Industry strategic planning has also at various stages been popular in a range of non-agricultural industries, such as the Victorian automotive manufacturing and the Australian textile, clothing, and footwear industries.

Box 2.1

**INDUSTRY STRATEGIC PLANS, INTERNATIONAL AND OTHER INDUSTRY COMPAIRSONS**

Apple and Pear Australia Ltd. (APAL) is the peak industry body representing the interests of commercial apple and pear growers in Australia. In 2005, it released *Apple and Pear Industry Strategic Plan 2005-2010*. The key elements of this document are: a Strengths, Weaknesses, Opportunities and Threats (SWOT) analysis; 14 'priority strategic initiatives'; and an action plan for achieving these initiatives. APAL is primarily funded through a grower levy, though it does receive administrative support from Horticulture Australia, which is jointly funded by government and industry. APAL's operating expenditure for 2007 was \$2.9 million.

In 2005, the Rural Industries Research and Development Corporation (RIRDC) commissioned Lenah Consultancy to develop an industry strategic plan for the Kangaroo industry. This strategy is based on a SWOT analysis and focuses on such key issues as: industry image; industry management; product marketing and quality; industry practices; resource sustainability; and industry viability. The RIRDC is funded through 'Commonwealth appropriations, voluntary industry contributions, industry levies and Commonwealth dollar for dollar matching.'

In 2003, the Canadian Wheat Board (CWB) released its *Long Term Plan 2003-2008*. This document outlined a vision ('To create value for Prairie farmers by being an innovative world leader in marketing grain'), four goals (relating to Western Canadian farmers, CWB's customers (including storage and handling companies), CWB's mandate, and corporate responsibilities), and a range of strategies to achieve these goals. CWB reported administrative expenses in 2006 of CA\$69 million.

In 2001, the Victorian Government's Office of Manufacturing (OOM), in conjunction with an Industry Working Group, developed an industry strategic plan for Victoria's automotive manufacturing industry. Titled *Victorian Automotive Manufacturing Industry 2001 to 2011 Strategic Plan*, this plan outlines a vision and a series of strategic priorities and objectives relating to people, products, processes, policy, positioning and promotion.

In 2002, the textile, clothing, footwear and leather (TCFL) forum, a body of industry leaders, released an industry strategic plan for the TCFL industry. This document set out five objectives and a number of strategies to achieve these objectives. The overall goal of the TCFL industry strategic plan is that, '[b]y 2012, the Australian TCFL industry will be market led and globally focused, with innovation expertise and world leading lifestyle niche brands driving a doubling of exports, thereby growing annual production to over \$14 billion and enhancing profitability.' Funding for the TCFL Forum and its activities was drawn from the Australian Department of Industry, Tourism and Resources.

Source: APAL (2007); APAL (2005); CWB (2006); CWB (2003); Lenah Consultancy (2005); OOM (2001); RIRDC (2007); and TCFL Forum (2002)

In the context of the Australian wheat export industry, this report contends that there is only a need for industry strategic planning at some levels (specifically, wheat receival standards and varietal classification), but not all. Two observations form the basis of this judgement. First, it is unlikely that a well-managed corporation would neglect to have a strategy in the absence of centralised funding or regulation. In other words, were this particular industry good service no longer provided by AWB or some alternative body, competitive pressures in the Australian wheat market would still drive accredited wheat exporters to think strategically.

Second, the benefits from strategic planning are likely to vary across the different business areas of the wheat export industry. On the one hand, an industry strategic plan is unlikely to improve vertical coordination of supply chains since supply chains in the wheat export industry are not fragmentary. Rather, they are largely state-based and dominated by specific bulk-handling companies (BHCs) and above-rail providers (GrainCorp and QR in Queensland; GrainCorp and PN in New South Wales and Victoria; ABB and Genesee & Wyoming in South Australia; and CBH and QR in Western Australia).

Likewise, the likely exporters of Australian wheat under the new marketing arrangements (such as CBH, ABB and GrainCorp) are well-resourced and highly competitive organisations. They thus do not have the same need or incentives to participate in communal market research activities under an industry strategic plan.

Conversely, industry strategic planning would appear to benefit the development of wheat receival standards and varietal classification. To be effective, both these activities need to be forward-looking. That is, they need to be able to anticipate shifts in quality demand (from both customers and regulatory bodies) and institute changes amongst breeders, growers, BHCs and transport companies. Individual corporations could undertake such strategic planning. However, given that accredited exporters under the new marketing arrangements are likely to share aspects of the supply chain, there would appear to be greater advantages for the industry to strategically plan the development of wheat receival standards and varietal classification.

Consequently, this report concludes that industry strategic planning should only be transferred to another entity in the context of receival standards and varietal classification. The entity (or entities) that will eventually be in charge of these activities (see Sections 2.2 and 2.3) would be best placed to assume responsibility for their strategic planning.

## **2.2 Wheat receival standards**

### *Background*

This IGS involves the development and publication of minimum standards for the inclusion of wheat in an export Pool. According to AWB (2007: 2), the purpose of receival standards is to:

- ‘establish base-line technical specifications for each of the wheat pay grade and binning grades used by AWB to pay growers and to create differentiated wheat products in the market place;
- ensure wheat in the National Pool meets national and international regulatory requirements addressing phytosanitary and food safety issues. Australia’s *Export Control Orders* (enforced by the Australian Quarantine and Inspection Service) regulate wheat as a prescribed good for export. Importing countries have different regulatory requirements for the importation of wheat;
- prevent loss of quality of wheat parcels through the introduction of mixing of wheat parcels of lower quality into the bulk storage system;
- protect the condition of the wheat during prolonged storage through limiting moisture and contaminating biological agents; and

- contribute to the assurance systems underpinning AWB's promotion and supply of wheat of required quality, consistently to markets around the world.'

The AWB's receival standards cover the following quality and safety criteria:

1. 'wheat variety restrictions – on pay grades and binning lines;
2. basic quality parameters – moisture, protein, screenings, etc.;
3. defective grains – sprouted grains, strained grains, heat damaged etc.; and
4. contaminants – unapproved chemical residues, foreign seeds, insects, moulds.'

AWB reviews its receival standards on an annual basis. This process involves consultation with internal and external stakeholders, such as BHCs, industry representatives, milling companies and government representatives.

For the three years to 2005/06, AWB spent a total of \$141 000 on wheat receival standards – an annual average of \$47 000.

#### *Extent of market failure*

The use of receival standards is prominent in other grains industries nationally and wheat export industries internationally (see Box 2.2 and Table 2.1 for more detail).

#### Box 2.2

#### RECEIVAL STANDARDS, INTERNATIONAL AND OTHER INDUSTRY COMPARISONS

In Australia, the National Agricultural Commodities Marketing Association (NACMA) develops and publishes receival standards for coarse grains (e.g. barley, sorghum and oats). NACMA is Australia's grains industry body. It is a not-for-profit organisation and 'derives all of its income from either membership fees or the provision of commercial services/products.' As of 2007, NACMA had 178 full members and 68 associate members, encompassing traders, storage and handling companies, grower associations and major financial institutions. Its core activities centre on grain standards, contracts, trade rules and dispute resolution services. For the 2006/07 financial year, NACMA reported revenues of \$503 143 and expenses of \$503 004.

In Canada, the *Canada Grain Act* grants authority 'for maintaining Canada's wheat classification system' to the Canadian Grain Commission (CGC). Section 16 of this Act states:

*The Commission may, by regulation, establish grades and grade names for any kind of western grain and east grain and establish the specifications for those grades and set out a method or methods, visual or otherwise, for determining the characteristics of the grain for the purposes of meeting the quality requirements of purchasers of grain.*

The CGC is a Federal agency that reports to the Minister of Agriculture. It is funded by a combination of service fees and parliamentary appropriations. In 2007, the CGC reported total revenue of CA\$78.4 million and total expenses of CA\$67.2 million.

In the United States, the Federal Grain Inspection Service (FGIS), which falls under the US Grain Inspection, Packers and Stockyards Administration, which in turn is part of the United States Department of Agriculture, sets wheat grade standards. Two underlying pieces of legislation support this quality assurance system: the *US Grain Standards Act* and the *Agricultural Marketing Act*. As Rosenberg *et. al.* note, 'FGIS inspects all grain that is exported from the US, although it does delegate part of this function to other agencies. Domestic movement of grain is officially inspected by designated agencies.'

Source: CGC (2007); Department of Justice (2007); NACMA (2007a; 2007b); Rosenberg *et. al.* (2005)

Table 2.1

**WHEAT GRADING SYSTEMS, INTERNATIONAL COMPARISON**

Attribute	Australia	Canada	United States	Argentina	France	United Kingdom	Ukraine
Protein (min or max)	Y	Y	N	N	Y	N	Y
Falling number	Y	N	N	N	Y	N	Y
Moisture	Y	Y	N	Y	N	N	Y
Test weight	Y	Y	Y	Y	N	N	Y
Foreign material (criteria)	31	9	8	N/A	N/A	N/A	10
Irregular kernels (criteria)	13	17	3	6	N/A	N/A	5
Wheat from other classes (criteria)	N/A	2	2	1	N/A	N/A	1

Source: Rosenberg *et. al.* (2005: 10)

Notwithstanding their widespread usage, wheat receival standards represent only a mild-to-moderate case of market failure. As they are currently designed, they have a strong public good character: it is questionable, given their generic nature, whether a company could enforce property rights over them. Consequently, other exporters and domestic traders can potentially ‘free ride’ by using the wheat receival standards developed by one exporter or domestic trader as the basis (wholly or in part) of their own. However, in a more competitive market, there may be competitors who seek to enforce tighter standards for specifically branded shipments of wheat, and protect those standards through trade marks or some other form of intellectual property right.

The non-excludability of wheat receival standards is also balanced by:

- commercial imperatives: customer demands for quality assurance; the need to meet regulatory requirements in destination markets in order to achieve sales; and the need for traders to apply standards in order to maintain the quality of wheat during transport, storage and handling (that is, they will have a commercial incentive to minimise losses due to poor standards); and
- the relatively low costs associated with developing and maintaining wheat receival standards.

The international comparisons in Table 2.1 are potentially misleading: it is not possible to determine for countries with a monopoly exporter whether the standards adopted by the monopoly exporters are designed to meet an identified need based on market failure, or the standards it would in any case have had to adopt in order to meet normal commercial objectives.

On the basis of the above analysis, this report identifies three possible options regarding the transition of wheat receival standards from AWB. The first of these is for wheat exporters and domestic traders to assume individual responsibility for developing their own wheat receival standards. The primary advantage of this option is that it would give exporters and domestic traders greater flexibility to adjust their standards and thus differentiate themselves from international and domestic competitors. For instance, an exporter could develop more stringent receival standards in order to command a premium on the international market.

The disadvantages of the ‘company responsibility’ option are:

- it does not address possible ‘free rider’ problems associated with wheat receival standards;
- it will likely cost exporters and domestic traders more than if they cooperated and pooled their resources; and
- if one exporter lessens its receival standards, there is a risk that the reputation of Australian wheat as a whole could be affected, reducing the marketing power of all exporters. (Though, it is important to note that governments can regulate in order to protect the reputation of Australian commodities. For instance, in Western Australia, licences for exporting grain are dependent on the licensee maintaining Australia’s trade position. It would be possible to introduce, as a condition of accreditation, a requirement that a company seeking accreditation demonstrate it had processes and systems in place designed to safeguard against problems arising from lax receival standards).

The second option is for NACMA, or another body, to assume responsibility for developing wheat receival standards for both the domestic and export industries. The advantages of this option are:

- it would likely be a cheaper means for exporters and domestic traders to maintain wheat receival standards than if this responsibility was left to individual companies;
- given its role in maintaining receival standards for coarse grains, NACMA has the capability (in terms of expertise, experience and industry contacts) to manage wheat receival standards;
- given its current capability, transferring the maintenance of wheat receival standards to NACMA would likely be cheaper, in the near-term, than transferring the maintenance to another organisation with little or no commodity standards experience;
- NACMA would likely be able to assume responsibility for wheat receival standards immediately, without the need for a transition arrangement; and
- NACMA has broad representation amongst the wheat industry, including BHCs, grower associations and traders.

The disadvantages of the option are that:

- it would require a modest increase in NACMA's operating budget, which would need to be met by members;
- further discussion and negotiation would be needed with NACMA management and stakeholders.

The third operation is for Standards Australia to assume responsibility for developing wheat receival standards for both the domestic and export industries. The advantages of this option are:

- it is not a grains-specific option – that is, it puts wheat on the same footing as other Australian products and services which seek to maintain standards
- it would likely be a cheaper means for exporters and domestic traders to maintain wheat receival standards than if this responsibility was left to individual companies;
- it would be a simple, commercial transfer of responsibilities that would not require additional regulation;
- as the peak non-governments standards development body in Australia, Standards Australia has considerable expertise in developing and maintaining standards; and
- Standards Australia has an excellent domestic and international reputation
- The arrangement could be funded according to the well-established commercial model whereby Standards Australia charges users for access to standards manuals and certification.

The disadvantages of the 'Standards Australia' option are:

- Standards Australia has little experience or expertise regarding commodity standards – though the organisation would not be required to 'reinvent the wheel' and could rely heavily on the existing standards already developed; and
- it is likely that a transition arrangement would be necessary before Standards Australia could assume responsibility for wheat receival standards.

### **2.3 Wheat classification panel**

#### *Background*

This IGS involves the rigorous classification of new wheat varieties. Currently, before new varieties are released to growers, they are assessed through the AWB's Wheat Classification System. 'The assessment, which comprises a range of a standardised grain, wheat flour and end product tests, identifies the dominant valued quality traits of the wheat and assigns the variety to an AWB Wheat Grade. As wheat quality is a function of genotype and growing conditions that varieties may have different classifications in different geographical zones identified by the Classification System' (AWB 2007: 5).

According to the AWB (2007: 5), its classification system ‘leads to a large number of varieties contributing to each wheat grade. This provides a robust means of supplying wheat blends (i.e. grades) of desired quality each year to the international market. The wheat grades subsequently form the basis of AWB’s marketing and promotion of AWB wheat internationally. The grades also provide a useful wheat quality framework for the domestic market.’

At present, AWB’s wheat classification system is conducted by the Wheat Classification Panel – consisting of seven experts (four from AWB, one from the Flour Millers Council of Australia, and two independents). AWB provides oversight, management and support of the operations of the panel by:

- ‘determining the overall Wheat Classification System and publicising it in the Wheat Classification Guidelines;
- accrediting particular laboratories to perform the quality tests required by the Wheat Classification Process;
- acting as Secretariat to the Wheat Classification Panel; and
- providing direct financial support for the process including providing testing services free of charge and funding the operational expenses (including sitting fees) of the Panel’ (AWB 2007: 5).

For the three years to 2005/06, AWB spent a total of \$1.4 million on the Wheat Classification Panel – an annual average of \$452 290.

#### *Extent of market failure*

The accepted position on wheat classification is summed up in Rosenberg *et. al.* (2005: 2):

... wheat is not a homogenous product. Two samples of wheat may vary by colour, growing season, hardness, baking characteristics, amount of contaminants, soundness, end-use, or many other properties. In the absence of a **mechanism** to assess and classify these features, the lack of necessary information available to buyers would make the wheat market inefficient, unorganized and inoperative [original emphasis].

It is also important to note that all of Australia’s major wheat export competitors have some form of wheat classification system (AWB 2007: 10), as does the barley industry in Australia – the country’s second most valuable grain export industry (see Box 2.3 for more detail).

Box 2.3

**VARIETAL CLASSIFICATION, INTERNATIONAL AND OTHER INDUSTRY COMPARISONS**

Barley Australia is responsible for the varietal classification of malting barley. It is a non-profit industry body that is wholly funded by its seven foundation members – ABB, GrainCorp, CBH, Barrett Burston, ADM, Kirin and Joe White Maltings. At the centre of Barley Australia's accreditation process is the Malting and Brewing Industry Barley Technical Committee. This is 'comprised of a panel of malting and brewing experts who assess each variety to establish it will meet international and/or domestic market performance requirements.'

In Canada, a federal agency, the CGC, is responsible for maintaining the country's wheat classification system. This system is unique amongst the major wheat exporting countries. As Rosenberg *et. al.* state:

*Under the system, a benchmark variety exists against which all other potential varieties are measured. If a proposed wheat variety does not meet or exceed the characteristics of the benchmark in terms of agronomic, quality, and disease-resistant traits, it may not be placed into any of the classes. Instead, it is designated as feed wheat.*

Source: AUS-MEAT (2006a; 2006b); Barely Australia (2008); MLA (2008); Rosenberg *et. al.* (2005)

The evidence that wheat classification is required to address market failure is compelling. It is hard to prevent free rider or spillover effects from wheat classification: if one exporter were to fund and manage a wheat classification system, other exporters, domestic traders, and the domestic breeding community would benefit from the information produced from it.

International comparisons are also revealing. In Canada, the United States, the United Kingdom, Argentina, France and the Ukraine – Australia's major export competitors – wheat classification is provided by bodies that are funded (either wholly or in part) by their respective national governments (AWB 2007: 10).

**Options**

On the basis of the above analysis, this report identifies two possible options regarding the transition of AWB's wheat classification system. The first of these is for a body funded by both government and industry to assume responsibility for managing the secretariat and membership of the wheat classification panel and the varietal testing process. This body could be either an existing agency, such as the Grains Research and Development Corporation (GRDC), or a new agency. GRDC would appear to be a suitable candidate, given:

- its reputation in the wheat industry;
- its technical and scientific expertise, especially with regard to the development of new grain varieties and interaction with breeders;
- that the task of varietal classification would likely fit into the GRDC's existing portfolio, thus requiring minimal changes to the agency's statutory arrangements; and
- that the GRDC's budget of roughly \$120 million would appear sufficient to cover the expenditure related to varietal classification.

The second option is for an industry-funded body to assume responsibility for wheat classification. Again, this body could be either an existing entity, such as NACMA, or a completely new entity. NACMA would appear to be a suitable candidate, given its:

- wide industry representation; and
- general expertise in dealing with grains and grains standards issues.

However, to be able to manage the wheat classification panel and associated duties, NACMA would require:

- a sufficient expansion of its budget (the roughly \$450 000 that AWB spends per year on wheat classification represents 90 per cent of NACMA's current budget); and
- a significant expansion of its personnel.

Furthermore, due to reasons of commercial secrecy, traders may be unwilling to provide NACMA (as a wheat classifier) with complete information about grades and related topics, given that NACMA would be accountable to its entire membership (including other traders).

In either of the above options, the success and long term future of a wheat classification system would require its designated body to have both industry support and sustainable, guaranteed funding.

## **2.4 Crop shaping activities**

### *Background*

'Crop shaping' is the attempt 'to influence grower production volumes of particular varieties in particular locations to provide an annual crop which matches as closely as possible customer demand for volumes of wheat of particular quality characteristics at different times in different markets' (AWB 2007: 6).

AWB's primary crop shaping activities include such industry coordination functions as:

- managing the Wheat Classification System, to ensure 'varieties with appropriate quality characteristics are available for production';
- providing market signals to the breeding industry (through publications, scientific meetings and direct communication);

and such commercial functions as:

- providing growers with payment incentives 'to grow premium varieties with higher protein levels through its Premium Choice Varieties and Golden Rewards programs'; and
- segregation, binning and blending strategies – 'through understanding the quality characteristics of each variety and how they interact on blending AWB is able to "customise" wheat shipments meeting the particular requirements of markets and customers' (AWB 2007: 6).

For the three years to 2005/06, AWB spent a total of \$91 511 on crop shaping activities – an annual average of \$30 504.

### *Extent of market failure*

This report will determine the extent to which crop shaping represents a case of market failure by focusing on particular crop shaping activities.

‘Managing the Wheat Classification System’ and ‘providing market signals’ are arguably public goods, in that the benefits of both are non-rivalrous and non-excludable. See Section 2.3 for more information about market failure and varietal classification.

‘Segregation, binning and blending strategies’ are essentially private goods, in that the benefits from customising wheat shipments primarily lie with the exporters who undertake the customisation.

‘Payment incentives’, meanwhile, display characteristics of both a private and public good. On the one hand, payment incentives are an important commercial function for exporters. They are a mechanism by which exporters seek to maximise their marketing power (and hence returns) by ensuring that the wheat they buy from growers best matches the quality and performance characteristics of their customers.

On the other hand, payment incentives are non-rivalrous (e.g. one grower’s use of AWB’s Golden Rewards Program does not prevent its use by others) and do suffer from a degree of non-excludability. As AWB (2007: 6) states, its crop shaping activities:

provide incentives for the planting of particular varieties which then offsets end point royalty payments for the newer higher quality varieties under the Plant Breeder’s Rights legislation. This directly benefits the plant pre-breeding and breeding community as it makes their varieties more affordable providing greater, or more rapid, market uptake. This in turn provides better return on capital allowing further investment in varieties for the future.

Nevertheless, this report deems that payment incentives do not represent a serious case of market failure because:

- their associated benefits primarily lie with the exporters that utilise them; and
- given this, the ‘new’ exporters are likely to institute payment incentives regardless of government regulation or industry self-regulation.

### *Options*

This report will not discuss options for the transfer of ‘managing the Wheat Classification System’, since it has already made such recommendations in Section 2.3.

‘Providing market signals’ should be transferred to the entity that will eventually be responsible for varietal classification (see Section 2.3). However, a formal transfer is not likely to be necessary, since the new classification body will likely provide market signals as part of its normal classification duties.

‘Segregation, binning and blending strategies’, given their private good nature, are best left to the accredited exporters that will form the basis of the new export marketing regime.

This report concludes that the ‘new’ exporters should assume responsibility, either individually or cooperatively, for the provision of ‘payment services’; unless grain growers themselves decide to establish a new industry body to undertake this function.

## **2.5 Australian Crop Report**

The Australian Crop Report is an information gathering and dissemination service about wheat quality in Australia. It involves:

- the collection of weighted average composite samples of the wheat segregations at each of Australia’s more than 800 receival sites and 17 port zones;
- the testing of these samples, the results of which provide ‘an assessment of the crop’s quality by wheat grade and port zone from the basic quality parameters of the wheat, through to flour quality (e.g. dough strength) and end product quality’ (AWB 2007: 7); and
- the collation and publication of this data ‘in the form of an annual AWB Crop Report to international markets and customers’ (AWB 2007: 7). This document ‘provides not only the quality data of the year crop but comments also on the suitability of each grade for particular end products (breads, noodles, etc.).’

According to AWB, ‘whilst not widely available, the AWB Crop Report is effectively in the public domain as AWB has historically not sought to limit its circulation’ (AWB 2007: 7).

For the two years to 2005/06, AWB spent a total of close to \$3 million on the Australian Crop Report.

### *Extent of market failure*

The Australian Crop Report is, in essence, a marketing tool. As AWB (2007: 7) states, the ‘Crop Report allows AWB’s customers and potential customers to assess the quality of wheat from Australia in any particular year and compare it to wheat available from other sources’. The Australian Crop Report is thus an important service (especially given that similar documents are produced in other major exporting countries; see Box 2.4 for more detail), though arguably not a necessary one.

## Box 2.4

**WHEAT CROP REPORTING, INTERNATIONAL AND NATIONAL COMPARISONS**

In Canada, the CGC publishes a series of annual reports on its website about the quality of Western Canadian wheat, Western Canadian wheat exports, and Ontario wheat. Likewise, in the United States, USWA publishes an annual report on its website about the quality of American wheat. The information contained in these reports is similar to that published in the Australian Crop Report.

In Australia, the Australian Bureau of Agricultural and Resource Statistics (ABARE) collects and publishes a range of commodity statistics. In relation to wheat, these statistics include: estimated and actual production (globally, nationally and at the State-level); total area under harvest (Australia/States); domestic, export, feed and seed volumes; price per tonne; and expected and actual rainfall (Australia/States). The Australian Government directly funds the majority of ABARE's activities; though ABARE does perform some fully cost-recovered work for industry.

Furthermore, a number of State Governments, through their respective primary industry departments, also collect and publish data relating to wheat quality. For instance, the Western Australian Department of Agriculture and Food publishes *Wheat Variety Guide*, which summarises 'performance characteristics of commercially available wheats and some pre-commercial lines... This information includes variety summaries, agronomic disease and herbicide tolerance characteristics, recommended planting times and medium- to long-term yield performance by wheat grade and Agzone.' Likewise, the Department of Primary Industries of New South Wales regularly publishes the *NSW Grains Report*, which documents seasonal conditions and production information (e.g. area under harvest and volume of production) for major grains in the State.

Source: ABARE (2007); CGC (2008); NSW DPI (2008); USWA (2007); and WADAF (2007)

Nonetheless, the Australian Crop Report does display some characteristics of a public good; it has spillover benefits for grain growers, in that it can contribute to their information on likely prices and volumes, and thus to commercial decisions made on-farm. More importantly, an equivalent product in future could potentially be exploited by firms seeking a free ride on the information. For example, it would be conceivable in a competitive market for one firm to prepare information for an overseas buyer about that year's Australian wheat crop characteristics, only to find another Australian trader entering that market without having made the same investment in information provision.

**Options**

This report identifies two possible options regarding the transition of AWB's Australian Crop Report. The first of these is for the accredited exporters that will form the basis of the new export arrangements to assume responsibility for the Australian Crop Report at their own discretion. Underlying this option is the observation that, as outlined above, the Australian Crop Report is, in essence, a marketing tool; the benefits of which primarily reside with exporters. Thus, the 'new' exporters should determine, on the basis of their commercial judgment, whether there is any benefit in producing an Australian Crop Report and, if so, whether they should do so individually or cooperatively.

Because of the free rider problem, it is possible that no equivalent product would emerge from a market approach: that is, no one trader would have an incentive to invest in a crop report because of the likelihood that other suppliers would target the buyer to whom the information had been provided.

The second option is for a third party (funded by either industry, government, or both) to assume responsibility for the Australian Crop Report. Possible third parties that could assume responsibility for the Australian Crop Report include ABARE, NACMA, GRDC or whatever body (if none of the above) assumes responsibility for AWB's wheat classification system (see Section 2.3).

Underlying this option is the contention that the benefits of the Australian Crop Report to the domestic wheat industry are sufficient enough to justify a broader intervention, regardless of the commercial judgments of the 'new' exporters. Though the wheat industry as a whole will have to determine the accuracy of this contention, a survey of relevant internet sources suggests that ABARE's crop reporting has greater significance to the broader wheat industry than the Australian Crop Report.

It is also important to note that if the wheat industry were to establish and a promotions arm in the future, it would likely have a crop report as part of its promotional campaign. For instance, the generic promotion provided by the Wine and Brandy industry will frequently include commentary about the state of the vintage year in question (although not in the same format as the Crop Report, this sort of commentary provides similar guidance to the export market).

On balance, the case for continuation of the Australian Crop Report under a new body is at best marginal; it would be preferable for a body such as ABARE to take decisions on what if any further information was required in its regular crop reporting in light of industry feedback. It may be that, instead of seeking to mimic the Australian Crop Report, ABARE (or some other third party) may simply seek to aggregate and publish information contained in ABARE's own Crop Report, along with relevant wheat publications released by the State Governments (such as outlined in Box 2.4).

## **2.6 Technical market support**

This IGS is a customer support service. As AWB (2007: 7) states, given that '[w]heat flour quality and processing is integral to final product quality', AWB provides technical training to customers to ensure they understand:

- 'how to assess the quality of different wheat grades and flours;
- the different Australian wheat grades, their suitability for particular end products and advantages compared to wheats of other origins; and
- how to process Australian wheat to meet their own particular down stream product requirements.'

AWB provides its technical training 'in a number of formats ranging from one-on-one and small groups with individual customers to larger groups from a number of customers ... There is also a range of training provided from instructional seminars through to workshops and hands-on milling and end-product processing courses' (AWB 2007: 8).

AWB was not available to provide a specific figure for its expenditure on technical market support.

### *Extent of market failure*

As a form of customer management, technical market support is an important service (especially given that similar services are offered by international competitors; see Box 2.5 for more detail), but not one that growers as a whole or taxpayers need necessarily support.

Box 2.5

#### **TECHNICAL MARKET SUPPORT, INTERNATIONAL COMPARISON**

In Canada, the Canadian International Grain Institute (CIGI) ‘promotes Canada’s field crops and their products through educational programming and technical activities.’ Such market support involves:

- ‘programs that focus on grain marketing and commercial applications for grain, oilseeds, pulses and special crops’; and
- CIGI technology staff travelling ‘to importing countries to provide technical information to customers as well as to gather information that will help future exports.’

In the United States, USWA offers: ‘technical courses at U.S. institutions’; ‘USW[A] consulting services onsite’; ‘establishment of training facilities in wheat importing countries’; ‘collaborative research on new and improved uses of wheat in foods’.

Source: CIGI (2007: 4); USWA (2008).

Technical market support is best conceived as a private good and thus does not represent a case of market failure. It is, fundamentally, a means for exporters and domestic traders to:

- build and sustain their customer relationships; and
- reconcile the needs of their customers with the quality and performance characteristics of the wheat they are selling.

The benefits of technical market support thus primarily reside with the exporters and domestic traders that provide it.

### *Options*

On the basis of the above analysis, it is likely that exporters will continue to provide technical market support in the absence of government regulation or industry self-regulation.

Consequently, there is no reason to expect that a more competitive market will abandon the provision of technical market support. Companies are free to use their own commercial judgment to determine the extent to which they should seek to manage their customer relationships and enhance their marketing power.

## **2.7 Promotion of the Australian wheat industry**

As AWB (2007: 1) states, this IGS entails the ‘generic promotion of the key points of differentiation and customer value propositions of Australian wheat derived from production, logistics and quality systems’.

AWB primarily promotes the Australian wheat industry by hosting ‘Grain Industry Orientation tours by overseas customers, industry groups and government officials. The tours vary in their range and duration but they may include visits to:

- up-country growers, receival sites and storage facilities to demonstrate the range of conditions under which Australian wheats are grown and harvested. There are also practical demonstrations of quality assurance systems, including the application of Receival Standards at receival sites;
- port terminals to high complete demonstration of the logistics supply chain to port... ;
- previously, the AWB laboratories (Agrifood Technology) responsible for assessing wheat quality including the testing of shipping samples which are taken for each shipment of wheat. AWB recently sold Agrifood Technology as it prepares for the new wheat export marketing regime (which in itself support the analysis that follows that suggests under new arrangement this sort of promotion would become an individual company responsibility); and
- the offices of AWB, and BHCs to receive briefings from the industry, updates on the current and projected wheat supplies ... and possible changes to the Australian grain industry in the future' (AWB 2007: 8).

For the three years to 2005/06, AWB spent a total of \$5 million on the promotion of the Australian wheat industry – an annual average of \$1.7 million.

#### *Extent of market failure*

When discussing the promotion of Australian wheat, it is important to differentiate between three different types of promotion: 'customer promotion', 'end-user promotion' and 'brand promotion'.

*Customer promotion* is targeted primarily at the direct buyers and potential buyers of Australian wheat – specifically, millers and like wheat processing companies. Because they are heavily involved in the wheat production process, the audience of customer promotion is informed – that is, knowledgeable about different wheat grades and the broader wheat market. Accordingly, it is reasonable to assume that the decision-making process of 'customers' is largely based on tangible factors – such as when and how much wheat is available, the quality and performance characteristics of a particular variety, and cost per tonne. However, non-tangible factors (such as perceptions of quality and reliability and personal relationships) also play an important role. Customer promotion activities are primarily aimed at addressing these non-tangible factors.

Examples of consumer promotion include:

- The AWB activities listed above.
- The technical market support services provided by CIGI and USWA (see Box 2.5).

*End-user promotion* is targeted at the general population (both in Australia and globally) who consume and can potentially consume wheat-based products. Examples of end-user promotion include;

- USWA conducts 'consumer promotion' campaigns in markets 'where per capita wheat consumption is low'. Promotion activities include: surveys to determine levels of consumer 'awareness and interest in wheat based foods'; media promotions; and cooking and baking contests (USWA 2008).

Comparable examples of end user promotion in other industries include:

- MLA runs a number of programs (e.g. ‘Red meat – we were meant to eat it’ and ‘We love our lamb’) that ‘aim to increase demand for red meat by reducing barriers to consumption and promoting the popularity, enjoyment and convenience of red meat’ (AWB 2008).
- The Australian Wine and Brandy Corporation promotes sales of Australian products, especially in US, Canada, Europe and Japan.
- Tourism Australia promotion of Australia as a holiday destination (noting that the efficacy of such promotions has been hotly questioned).

*Brand promotion* is targeted to both customers and end-users, and involves branding wheat, in terms of perceptions of quality and desirability. Examples of brand promotion include:

- USWA has developed an ‘American Quality Wheat’ logo to differentiate American wheat in the international marketplace. This logo forms a significant part of USWA’s consumer promotion campaigns.
- In 2007, CWB launched a co-branding initiative with Robin Hood flour. This involves the placement of a CWB label and wheat quality message on Robin Hood flour bags, and the wider dissemination of a document outlining the ‘goodness of Western Canadian wheat’ (CWB 2007).
- Australian Wool Innovation Limited (AWI) is responsible for the ‘Woolmark’ logo, which differentiates Australian wool in the international marketplace. AWI has also undertaken a number of marketing campaigns to raise the profile of Australian wool.

Aside from the agricultural sector, (with some exceptions such as tourism, mentioned above) few Australian industries undertake generic overseas promotion. Major non-agricultural commodity exports such as coal, iron ore and other minerals are generally not the subject of international promotion activity (with some exceptions: for example, Argyle Diamonds, where promotion is based on the individual corporate brand rather than generic). The areas of largest export growth in services (financial services and education) do depend heavily on the reputation of Australian accreditation and regulatory standards, but are not promoted generically. However, major financial services providers and educational institutions do invest heavily in specific promotion of their own products and brand.

Wheat can be distinguished from exports of manufactured goods or services, and even from a number of other agricultural exports, in that the final consumer is not the target: rather, intermediates in the supply chain (whether individual mills or national wheat purchasing organizations) are the purchasers who need to be targeted. In this sense, the closest analogy to wheat is wool promotion – although the key difference is that Australian export wheat on average represents only some 15% of international trade, whereas Australia is the world’s largest wool exporter. Wool promotion, like tourism, has also been subject to some criticism, and there is little hard data on the effectiveness of generic promotion in either industry.

There is little doubt that in a competitive wheat market individual companies would continue to market to their customers. The more problematic issue is whether there is a case for generic promotion. Given the bulk commodity nature of wheat exports, and that Australian wheat is a known ‘quantity’ in the international marketplace, there seems at best only a marginal case for such promotion.

### *Options*

The preferred option arising from this analysis would be to leave responsibility for promotion to accredited exporters under the new wheat marketing arrangements.

## **2.8 Policy and regulatory advocacy**

This IGS involves the active participation in national and international policy and regulatory discussions ‘which relate to international trade in wheat and other commodities’ (AWB 2007: 8). Examples of AWB’s policy and regulatory advocacy include:

- its ‘participation in the Australian Quarantine Inspection Services Grain Industry Consultative Council providing specialist technical skills on the phytosanitary condition of Australian wheat’;
- AWB’s participation ‘as a member of the DFAT Technical Working Group on multilateral trade reform, focusing on issues such as WTO, Free Trade Agreements and US Farm Bill reform’; and
- AWB’s ongoing provision of ‘submissions to the Australian government on international trade policy issues, including the opportunities for the expansion of trade in the north Africa region’ (AWB 2007: 8-9).

For the three years to 2005/06, AWB spent a total of \$2.2 million on policy and regulatory advocacy – an annual average of \$730 000.

### *Extent of market failure*

Policy and regulatory advocacy to date has been invested primarily in defending and upholding the ‘single desk’ arrangements. In light of the proposed new marketing legislation, at the very least the nature of policy advocacy will need to change. More broadly, there is no reason to suppose that individual accredited companies competing in the Australian wheat market will forego policy work: it is an important function in any large corporation.

Box 2.6

**POLICY AND REGULATORY ADVOCACY, INTERNATIONAL AND OTHER INDUSTRY COMPARISONS**

In the United States, USWA engages in policy advocacy, seeking to create a trade environment that provides for 'open and fair competition'. In Canada, CWB similarly engages in such activities, seeking to establish a favourable trade environment for Western Canadian grain. Part of CWB's advocacy involves 'providing direction and support to Canada's negotiating team at the WTO'.

In Australia, Cotton Australia engages in policy advocacy, seeking 'to reduce (and eventually eliminate) the negative impact of the financial viability of the Australian cotton industry of trade distorting subsidies implemented by some countries', and an 'Australian cotton industry that is an active player in the world market supported by up to date an efficient transport and trade infrastructure.' AWI also engages in policy advocacy, recently highlighting the potential benefits from a China-Australia free-trade agreement.

Source: Cotton Australia (2006); CWB (2008); and USWA (2008)

It is also important to note that the Federal Government, through the Department of Foreign Affairs and Trade, already provides generic advocacy services on behalf of Australian industry, and has extensive consultation with industry. Likewise, a number of agricultural industry bodies also perform policy and regulatory advocacy on behalf of their membership, such as the National Farmers Federation (which is heavily invested in international trade issues), the Grains Council of Australia (which represents Australia's grains growers), and various State lobby groups, such as Queensland's AgForce.

**Options**

There appears to be no case for transfer of this industry good service to any other body, or for it to be preserved in some alternative form. In the competitive market, competitors will be free to determine, on the basis of their own commercial judgment, the extent to which they should seek to influence relevant discussions and by which means (i.e. individually or cooperatively).

**2.9 Research and development**

This IGS involves the provision of research and development (R&D) relating to the Australian wheat industry. AWB (2007: 9) states that it 'has conducted a large number of [R&D] projects. In many cases the projects have been in the form of collaborations with other industry members and have resulted in widespread dissemination of the results, to benefit of many industry players.'

For the three years to 2005/06, AWB has spent a total of \$9.5 million on R&D – an annual average of \$3.2 million.

*Extent of market failure*

The importance of R&D to the agricultural sector, especially in the Australian context, has long been recognised. For instance, Alston (2002: 317) notes that the ‘lion share’ of ‘growth in agricultural production (and productivity) experienced globally since 1960 can best ‘be attributed to changes in technology coming from investments in agricultural R&D and investments’ (rather than such other factors as economies of scale and infrastructure investments). Likewise, Mullen (2002: 15) maintains that, in regard to the Australian agricultural sector,

[a] reasonable scenario may be that a third of productivity gains can be attributed to better infrastructure, higher quality inputs, resource depletion and economies of scale, one third comes from imported technologies and one third comes from local public and private research activities.

The observation that wheat-related R&D is prevalent amongst Australia’s major wheat export competitors also heightens its importance (see Box 2.7 for more detail).

## Box 2.7

**GRAIN-RELATED R&D, INTERNATIONAL AND NATIONAL INDUSTRY COMPARISON**

In Canada, grain-related research is undertaken by two organisations. The first of these is CGC, which operates the Grain Research Laboratory (GRL). Programs at the GRL include; applied barley research, Asian products and wheat enzymes, durum wheat research and milling research. For the year ending 31 March 2007, CGC spent \$9.6 million on grain research. The second organisation is the Canadian International Grain Institute (CIGI). Research activities at CIGI focus primarily on ‘the evaluation of the end-use suitability and performance of Canadian grains, oilseeds, pulses and special crops, and on the feed value of Canadian feed ingredients.’ CIGI’s total expenses in 2006/07 were \$7.2 million.

In the United States, two organisations perform grain-related research. The first of these is the Wheat Marketing Center (WMC). A non-profit corporation funded by both government and industry sources, it conducts research projects and provides technical market assistance. The second organisation is USWA., which undertakes some ‘collaborative research on new and improved uses of wheat in foods’.

In the United Kingdom, the Home Grown Cereal Authority (HGCA) ‘funds and manages research on sustainable, competitive and profitable production for UK cereals and oilseeds’. Recent wheat-related research programs include: *Maximising the yield of high value components from wheat by fractionation*; and *Adapting wheat to global warming*. In 2006/07, HGCA spent £3.8 million on R&D.

In Australia, there are 15 rural R&D corporations. These cover the following industries: rural industries (geneal), egg, pork, wool, cotton, dairy, fisheries, forest and wood, grains, grape and wine, horticulture, land and water, live export, meat and livestock, and sugar. These R&D corporations are funded under a joint industry-government model.

Source: CGC (2007: 4); CIGI (2007: 4, 29); HGCA (2007: 38); HGCA (2008); Rural R&D Corporations (2008); USWA (2008)

There is a wealth of literature on rural R&D that establishes the degree and extent of market failure involved and the means of overcoming such failure (Mullen *et. al.* 2000; Norton 2004; and Picciotto 2002)

Technological and regulatory change (for example, plant variety rights and gene typing) may at some stage weaken the case that agricultural research can be classified as a public good: to the extent that access to research results can be controlled and the results patented and protected, the research has more of the character of a private good. However, the type of wheat R&D supported by AWB to date has been oriented more broadly, and has not lent itself to this sort of protection.

On the other hand, it is important to note that, in the Australian context, AWB is not the only provider of wheat-related R&D. The Grains Research and Development Corporation (GRDC), established in 1990 by the Primary Industries and Energy Research and Development Act, has an annual budget of approximately \$120 million and is the country's major supplier of wheat- and grain-related R&D. Its activities include: pre-breeding research, biosecurity, crop protection and agronomy. The GRDC is funded by a grower levy, matched by the Federal Government.

AWB industry good spending on R&D is minuscule compared with GRDC expenditure (equivalent to only some 3% on average).

#### *Options*

It is reasonable to assume that significant wheat-related R&D activities will continue in Australia in the absence of AWB's R&D program.

## Chapter 3

# Findings and recommendations

The goal of this report has been to inform the debate surrounding the future of AWB's industry good services. It has sought to achieve this by:

- scrutinising the nine IGSs identify by AWB;
- determining the extent to which they suffer from market failure; and
- suggesting whether they should be transferred to another entity and, if so, how.

Table 3.1 below provides a summary of the findings and recommendations detailed in the previous chapter.

Table 3.1

### INDUSTRY GOOD SERVICES – SUMMARY OF CONCLUSIONS

Industry strategic planning	<ul style="list-style-type: none"> <li>• benefits limited to receival standards and varietal classification</li> <li>• entities responsible for these activities should assume responsibility for their strategic planning</li> </ul>
Wheat receival standards	<ul style="list-style-type: none"> <li>• a mild-to-moderate case of market failure</li> <li>• three transition options: leave to the discretion of the 'new' exporters; transfer to NACMA (or a similar wheat industry body); or transfer to Standards Australia</li> </ul>
Wheat classification panel	<ul style="list-style-type: none"> <li>• compelling case of market failure</li> <li>• two transition options: transfer to a joint government-industry funded body (e.g. GRDC); or transfer to industry funded body (e.g. NACMA).</li> </ul>
Crop shaping activities	<ul style="list-style-type: none"> <li>• mixture of public and private goods</li> </ul>
Australian Crop Report	<ul style="list-style-type: none"> <li>• primarily a marketing tool, though some public good characteristics</li> <li>• two transition options: leave to the discretion of the 'new' exporters; transfer to a new body, funded either by government, industry, or both.</li> </ul>
Technical market support	<ul style="list-style-type: none"> <li>• private good</li> <li>• 'new' exporters are likely to continue to provide</li> </ul>
Promotion of Australian wheat industry	<ul style="list-style-type: none"> <li>• leave to 'new' exporters</li> </ul>
Trade advocacy	<ul style="list-style-type: none"> <li>• no case for transfer to another body</li> <li>• 'new' exporters free to engage in at their own discretion</li> </ul>
Research and development	<ul style="list-style-type: none"> <li>• wheat-related R&amp;D likely to continue in absence of AWB's R&amp;D program</li> </ul>

It is clear from this Table that:

- Some IGSs (such as policy and regulatory advocacy, and technical market support) are primarily commercial activities, and thus their provision is best left to either:
  - the discretion of the traders/exporters; or
  - if the industry decides that the respective services are necessary and they are willing to act cooperatively, an industry representative body (or bodies).
- Some IGSs (such as the promotion of the Australian wheat industry and R&D) do display some public good characteristics. However, because they:
  - are already sufficiently provided by other agencies (e.g. GRDC and wheat-related R&D);
  - provide significant commercial value to those that undertake them; and/or
  - may not be suitable, given the nature of the industry and its product (for instance, is there value in generically promoting wheat?),their provision is thus best left to either:
  - the discretion of the traders/exporters; or
  - if the industry decides that the respective services are necessary and they are willing to act cooperatively, an industry representative body (or bodies).
- Some IGSs (such as wheat receival standards and varietal classification) do represent cases of market failure and thus should be transferred to another entity (or entities); funded either by industry or jointly by government and industry.

Three of the IGSs do not fall into any of the above categories. The first (industry strategic planning) is of value only in respect to receival standards and varietal classification. Thus, it should only be transferred to another entity in a limited sense. The second (the Australian Crop Report) is a more complicated case, since its public versus private good characteristics are blurred. The seemingly best option would be for the ‘new’ exporters to offer (if they choose) their own version of the Australian Crop Report, and for ABARE to review its Crop Report and determine if there is any scope for the collation and provision of extra data. The third (crop shaping) is a mixture of public and private goods. Thus, some crop shaping activities (such as managing the wheat classification system and providing market signals) should be transferred to another entity, while the remainder (i.e. payment incentives and segregation, binning and blending strategies) should be left to the discretion of the ‘new’ exporters.

It is important to note that this report has only examined the nine IGSs identified by AWB. It is possible that, under the new legislative arrangements, other cases of market failure may arise relating to different services. In these cases, greater government intervention and/or industry cooperation may be required.

### 3.1 Structural arrangements for IGS

There has been some contention around whether industry good services should be transferred as a whole to a new body, or rest with a number of bodies. The arguments in favour and against both these options are outlined below:

Table 3.2

#### STRUCTURAL ARRANGEMENTS FOR THE PROVISION OF INDUSTRY GOOD SERVICES

	For	Against
Single body	<ul style="list-style-type: none"> <li>• simple solution</li> <li>• ensures continuity</li> <li>• efficiency of coordination</li> <li>• welcome by some grower organisations</li> </ul>	<ul style="list-style-type: none"> <li>• risks perpetuating services that are no longer required</li> <li>• would require the establishment of a new entity and the sourcing of new funding</li> <li>• the rationale for central coordination of IGSs is less powerful, given the changes to the single desk arrangement</li> </ul>
Multiple bodies	<ul style="list-style-type: none"> <li>• allows for greater specialisation and a better matching of skills (e.g. a standards body assuming responsibility for standards)</li> <li>• would encourage a rationalisation of IGSs</li> </ul>	<ul style="list-style-type: none"> <li>• might meet some grower resistance</li> <li>• might generate instability</li> </ul>

This report concludes that the ‘multiple body’ approach is the most appropriate. Underlying this conclusion are the findings that:

- some IGSs (industry strategic planning, in particular) should not be transferred to another entity;
- the future of a number of IGSs (e.g. policy and regulatory advocacy, promotion of the Australian wheat industry, crop shaping, technical market support and R&D) is best left to a reconciliation between the commercial judgments of the traders/exporters and the broader desires of the industry as a whole. Transferring these IGSs to a new entity simply for the sake of it would hamper this process; and
- the seemingly smoothest and easiest transition option would be to transfer IGSs to those bodies which already have the skills and background to deliver them in conjunction with their other activities. For example, NACMA or Standards Australia assuming responsibility for the delivery of wheat receival standards.

## Appendix A

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