

**IMPACT OF COMPETITION
POLICY REFORMS ON
RURAL AND REGIONAL AUSTRALIA**

Submission to the
PRODUCTIVITY COMMISSION

Prepared by:
Grains Council of Australia
PO Box E10
KINGSTON ACT 2604
Ph: (02) 6273 3000 Fax: (02) 6273 3756

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Grains Council of Australia

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Competition Policy Reforms on Rural and Regional Australia

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APPENDIX A - (SUPPLIED ON A STRICTLY COMMERCIAL -IN-CONFIDENCE BASIS)

Issues Paper 14: Structure of the AWB, Paper Prepared by BT Corporate Finance Limited
for the GCA/AWB/DPIE Working Group on the Restructure of the Australian Wheat Board.

SUMMARY OF RECOMMENDATIONS

THE FUNDAMENTAL OBJECTIVE OF COMPETITION POLICY

- Federal and State Governments ensure that National Competition Policy is not implemented without reference to its core objective of enhancing community welfare by way of a positive impact on economic efficiency and other social goals.
- In undertaking a review of an anti-competitive arrangement, the purpose for which this arrangement was designed is taken into consideration and, further, that any subsequent reviews are not undertaken according to an arbitrary timetable but are undertaken when the situation to which the anti-competitive arrangement is directed has materially altered.

THE INTERNATIONAL COMPETITIVENESS OF AUSTRALIAN INDUSTRY

- A distinction is made between arrangements which restrict competition and operate in an international context, and arrangements which restrict competition and operate predominantly in a domestic context.
- It is recognised that, in certain circumstances, international competition can be an effective substitute for domestic competition.

THE IMPACT OF COMPETITION POLICY ON RURAL AND REGIONAL AUSTRALIA

- Anti-competitive arrangements established to assist agricultural producers designed to address international market failures should not be dismantled without due consideration of the effects of such an action on Australia's rural and regional communities.
- For those communities bearing the costs of any change, an assessment is made of their ability to adjust, the alternative opportunities available to them and the necessity for relevant governments to provide appropriate adjustment assistance.

CLARIFICATION OF PUBLIC INTEREST AND ITS ROLE IN THE NATIONAL COMPETITION POLICY PROCESS

- Any analysis of an anti-competitive arrangement takes full account of the complexities of the relationship between supplier and consumer.
- Comparisons should take into account not only price but also other, often less quantifiable benefits, such as service and quality.

1. INTRODUCTION

1.1 THE GRAINS COUNCIL OF AUSTRALIA

The Grains Council of Australia is the peak policy body of the Australian grains industry, representing some 60,000 grain growers. The Council is a non-government, grower funded federation of farmer organisations from Australia's five main grain growing states. The Council's member and associate member bodies are:

- Western Australian Farmers' Federation
- South Australian Farmers' Federation
- Victorian Farmers' Federation
- New South Wales Farmers' Association
- Queensland Graingrowers' Association
- Tasmanian Farmers' and Graziers' Association (Associate Member)

The Council is also a major commodity member of the National Farmers' Federation which represents over 120,000 Australian farmers.

The Council's fundamental objective is to maximise the economic and social welfare of Australian grain growers by seeking to initiate and influence policies and interact with government on issues which affect their profitability and international competitiveness.

The Council's policy interests extend from macro and micro-economic reform of Australia's economy including the cost-effectiveness of land and sea transport, farm inputs and grain export inspection, to research, development and extension policy, grain marketing and handling arrangements and trade strategies, international trade reform and strategic planning for the industry's future.

The Council has a keen interest in National Competition Policy (NCP) because of the benefits that the grains industry and the wider community can achieve from a more efficient Australian economy. However, we are concerned that the fundamental objective of NCP - that is, that competition can enhance community welfare because of its positive impact on economic efficiency and other social goals - may be overlooked in the implementation process. The Council welcomes this opportunity to place our views on NCP before the Productivity Commission.

1.2 THIS SUBMISSION

This submission argues that a key determinant of the impact of National Competition Policy (NCP) on rural and regional Australia is the effect of NCP policy measures on the international competitiveness of Australian industry. While the timely and effective implementation of NCP is essential for developing an efficient Australian economy and enhancing our international competitiveness, it should not be assumed that increasing competition will, under all circumstances, be of benefit to the Australian community.

In the first instance, NCP reviews of anti-competitive arrangements must take account of the fact that the benefits of competition can be derived either from international or domestic competition. Secondly, it must be recognised that the focus of NCP reviews is on arrangements which affect competition in the domestic market and, further, that such arrangements need to be distinguished from arrangements designed to maximise returns from the international market. Accordingly, providing they operate transparently and efficiently and confer a net public benefit to the Australian community, anti-competitive structures that have been established to assist industries to compete in the international market should not be discontinued as a result of the NCP review process.

In the case of the grains industry, we are the largest of Australia's primary production industries. Grain production accounts for around one quarter of Australia's total farm gross value of production and around one quarter of the value of total Australian farm exports. For the year 1996-97, the Australian Bureau of Agriculture and Resource Economics (ABARE) estimates that the total gross value of production for the Australian grains industry was over \$7.5 billion, of which around \$6 billion was earned from exports. In 1996-97, Australia exported nearly 80% of the total value of Australia's grain crop. In the case of wheat, in 1996-97, 90% of the total \$4.7 billion earned by wheat growers was earned from exports.

These statistics indicate that, if NCP initiatives do not take account of the international competitiveness of Australian industry, these initiatives would have an adverse impact on those employed in these industries. In the case of the grains industry, this would not only include those directly employed in grain production, but also those involved in other aspects of the grains industry, including, for example, inputs into grain production, such as chemicals and machinery, research and development, bulk handling, storage and transport, grain marketing, and financial services.

Increases in unemployment also increase dependency on social welfare and add to social dislocation. In the case of increased unemployment in primary industries, these effects would impact disproportionately on rural and regional Australians due to their higher dependence on income derived from primary production, including grain production. Consequently, when an assessment is made during NCP reviews of the net aggregate community welfare accruing from increased competition, NCP reviews should also take into account the geographical distribution of the benefits and costs. For those communities bearing the costs of any change, an assessment also needs to be made of their ability to adjust, the alternative opportunities available to them and the necessity for relevant governments to provide appropriate adjustment assistance.

2. THE FUNDAMENTAL OBJECTIVE OF COMPETITION POLICY

The Independent Committee of Inquiry into National Competition Policy undertook an extensive study of the role and objectives of competition policy in its August 1993 report¹. This report, commonly known as the 'Hilmer Report', recommended that Australia implement a national competition policy (NCP). The report's central argument was that competition can enhance community welfare because of its positive impact on economic efficiency and other social goals. While it should be axiomatic that competition policy should not be implemented without reference to the fundamental objective of enhancing community welfare, this is not always the case. Sometimes competition is viewed as the solution for problems for which it is ill-suited to cure and which, under certain circumstances, it may in fact worsen. As the Chairman of the Australian Competition and Consumer Commission (ACCC), Professor Allan Fels, has stated, "*In most countries unrestricted competition is not an end itself.*"² Instead, the aim of competition policy should be to achieve greater economic efficiency in the context of public benefit. This was the position of the Hilmer Committee, which stated in its report that:

*Competition policy is not about the pursuit of competition for its own sake. Rather, it seeks to facilitate effective competition in the interests of economic efficiency while accommodating situations where competition does not achieve economic efficiency or conflicts with other social objectives. These accommodations are reflected in the content and breadth of application of pro-competitive policies, as well as the sanctioning of anti-competitive arrangements on public benefit grounds.*³

The Hilmer Report further argues that there are some situations "*where unfettered competition is not consistent with economic efficiency*". These situations include examples of 'market failure', such as situations where participants in the market have imperfect information about products, producers or suppliers, and 'natural monopolies' where a single firm can supply an entire market more efficiently than two or more firms.⁴

However, an anti-competitive arrangement needs to be justified on the grounds of public benefit. In relation to authorisations for anti-competitive conduct under the *Trade Practices Act*, public benefit has been found to include many different things, such as, for example: promotion of equitable dealings in the market; growth in export markets; development of import replacements; promotion of industry cost savings; and expansion of employment.⁵ That there may be situations in which anti-competitive conduct is of public benefit was recognised by the current Government in its 1996 election policy document, *Meeting the Challenge*. In this document, the Government stated that:

*A Federal Coalition government will maintain the Australian Competition and Consumer Commission which will be adequately resourced to guard against anti-competitive conduct. Authorisation of conduct, on the grounds of public interest, shall continue where the public benefit warrants it. The Federal Coalition is of the view that the authorised newsagency system and the single desk for the export of wheat are in the public interest and will be preserved.*⁶

In relation to the development of a *national* competition policy, the Council of Australian Governments (COAG) has agreed that competition laws and policies should be consistent throughout Australia and across all businesses regardless of ownership. In order to put the COAG agreement

¹ Hilmer F., M Rayner, G. Taperell. 1993. *National Competition Policy*. Report by the Independent Committee of Inquiry, August 1993. Canberra: AGPS.

² Fels, Allan. *National Competition Policy and the Trade Practices Act: Implications for the Rural Sector*. Address to Grains Week '98, Adelaide, 31 March 1998.

³ Hilmer. op. cit. p. 6.

⁴ *ibid.* p. 5.

⁵ Fels. op.cit.

⁶ Liberal and National Parties of Australia, *Meeting The Challenge*, 1996. p. 148.

into effect, among other things each Government must review systematically every ten years all legislation which restricts competition. In June 1996, the Commonwealth Government issued its Legislation Review Schedule. In his Foreword to the Review Schedule, the Treasurer made the following statement:

*The review processes will provide an opportunity to establish the case for retaining, modifying or reforming current regulatory arrangements. The guiding principle is that legislation should not restrict competition unless it can be demonstrated that the benefits of the restriction to the community as a whole outweigh the costs and the objectives of the legislation can only be achieved by restricting competition.*⁷

In this statement, the Treasurer makes two points of note. In the first instance, review processes are designed to examine the case for retaining, modifying or reforming current regulatory arrangements. Secondly, the main focus of the review process is to test whether or not an anti-competitive arrangement is detrimental to the welfare of the wider community. In other words, the reviews are to test the *general theory* that anti-competitive arrangements are detrimental to the welfare of the wider community in the context of a *specific arrangement*. This is particularly necessary because reviews are being undertaken in relation to a timetable that has been agreed to by COAG and not in relation to the specific purpose of a specific anti-competitive arrangement. As anti-competitive arrangements have been put in place to deal with a specific situation, the logical time to review such arrangements is when the nature of that situation has substantially altered.

For example, the statutory single desk export power for wheat is in place in order to assist growers in dealing with the corrupt nature of the international grain market. Thus, the logical time to review the single desk export powers is when there is tangible evidence of substantial reform to the international grain market. Full implementation of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) will not occur until 2001, and even then it is expected that the international grain market will still be profoundly corrupted. Furthermore, World Trade Organisation (WTO) negotiations on agriculture are scheduled to commence in 1999, with these negotiations aimed at further freeing up world trade in agriculture. However, the review of the *Wheat Marketing Act 1989* is scheduled to be undertaken in 1999-2000, *before* the effects of the GATT can be accurately assessed and before the outcome of the 1999 WTO negotiations can be known. While the Council understands the necessity for governments to undertake their reviews according to a set schedule, we believe that it is necessary to guard against the assumption that the situation which a specific anti-competitive arrangement has been designed to combat will be neatly resolved according to the timetable established by COAG.

In summary, while the Council believes that effectively implementing NCP is essential for developing an efficient Australian economy, we are deeply concerned that the fundamental objective of NCP of enhancing community welfare may be forgotten in its implementation. The Council believes that, in most cases, anti-competitive arrangements are detrimental to the wider community. However, we wish to emphasise that this is a *theory* to be applied and tested and not a given fact. We further believe that the benefits of the NCP review process will only be derived when the basis of this theory is made clear and it is matched against the reality of a specific anti-competitive arrangement, thus making the review process both rigorous and transparent.

2.1 RECOMMENDATIONS

It is recommended that:

- **Federal and State Governments ensure that National Competition Policy is not implemented without reference to its core objective of enhancing community welfare by way of a positive impact on economic efficiency and other social goals; and**

⁷ Costello, P. *Commonwealth Legislation Review Schedule*, June 1996.

- **in undertaking a review of an anti-competitive arrangement, the purpose for which this arrangement was designed is taken into consideration and, further, that any subsequent reviews are not undertaken according to an arbitrary timetable but are undertaken when the situation to which the anti-competitive arrangement is directed has materially altered.**

3. THE INTERNATIONAL COMPETITIVENESS OF AUSTRALIAN INDUSTRY

The Council notes, and concurs with, the following statement by the Hilmer Report:

If Australia is to prosper as a nation, and maintain and improve living standards and opportunities for its people, it has no choice but to improve the productivity and international competitiveness of its firms and institutions. Australian organisations, irrespective of their size, location or ownership, must become more efficient, more innovative and more flexible. Over the last decade or so, there has been a growing recognition, not only in Australia but around the world, of the role that competition plays in meeting these challenges.⁸

Underlying this statement is one of the central arguments in favour of implementing NCP: that it will enhance Australia's international competitiveness. However, this statement also demonstrates one of the central dilemmas of NCP: that the globalisation of the Australian economy means that Australia's *national* competition policy must operate in an *international* environment.

There are two ways in which globalisation affects the competitiveness of the Australian economy. In the first instance, many of the growth opportunities for Australian industry are only to be found in the international market place. This necessitates Australian industry operating according to the conditions found in that international market place and NCP usually can be expected to increase the international competitiveness of Australian firms by making them more efficient, particularly where reforms are directed toward services that are inputs into exports, for example public utilities and transport services.

However, implementing NCP without due consideration of the realities of international trade can undermine the competitiveness of Australian industry if domestic *national* competition policy reforms inhibit the ability of Australian industry to cope with *international* market failure. A distinction must therefore be drawn between an arrangement which restricts competition and operates in an international context, and an arrangement which restricts competition and operates predominantly in a domestic context. In the case of arrangements operating predominantly in an international context, NCP requirements should be that these arrangements operate transparently and efficiently and confer a net public benefit on the Australian community. ***The Council is pleased to provide, in confidence, a copy of a paper prepared by Bankers Trust which discusses this issue in the context of the restructure of the Australian Wheat Board and the NCP requirements for the single export desk for wheat.***

A second effect of globalisation is that Australian firms must compete with foreign firms, either in the domestic or international market. The Hilmer Report defined competition as the "*striving or potential striving of two or more persons or organisations against one another for the same or related objects*"⁹. In this definition of competition, as well as in terms of the benefits to be derived from competition, the Hilmer Report makes no distinction between domestic and international competition. This is because the economic efficiencies to be gained from competition can be derived either from international or domestic competition. The greater the exposure of an industry to international competition, the greater the likelihood that competitive pressure is being applied through international competition. Thus, while an organisation may benefit from a specific arrangement which is *prima facie* anti-competitive in a domestic context, this organisation may still be subject to substantial competitive pressures due to its exposure to international competition.

It is the Council's firm view that it is essential that the nature of the international market in which a firm has to compete, and the openness of the domestic Australian economy, is taken into account when determining the public benefit of an arrangement which restricts competition. Australia cannot hope to have a dynamic, export-oriented economy operating at the level of best practice if Australian

⁸ Hilmer, op. cit. p. 1.

⁹ *ibid.* p. 2.

companies are not allowed to develop a strong domestic base. Without such a base, Australian companies will not have the critical mass necessary to launch themselves into the world market, or the strength to compete effectively against international competitors operating within Australia. Those who argue against the proposition that anti-competitive arrangements be allowed for reasons of international competitiveness are ignoring the realities of a modern globalised economy.

3.1 RECOMMENDATIONS

It is recommended that:

- **a distinction is made between arrangements which restrict competition and operate in an international context, and arrangements which restrict competition and operate predominantly in a domestic context; and**
- **it is recognised that, in certain circumstances, international competition can be an effective substitute for domestic competition.**

4. THE IMPACT OF NATIONAL COMPETITION POLICY ON RURAL AND REGIONAL COMMUNITIES

Fundamentally, if NCP initiatives do not take account of the international competitiveness of Australian industry, they would have an adverse impact on those employed in these industries. In the case of the grains industry, this would not only include those directly employed in grain production, but also those involved in other aspects of the grains industry, including, for example, inputs into grain production, such as chemicals and machinery, research and development, bulk handling, storage and transport, grain marketing, and financial services. Increases in unemployment also increase dependency on social welfare and add to social dislocation. In the case of primary industries, these effects would impact disproportionately on rural and regional Australians due to their higher dependence on income derived from primary production, including grain production.

Not only are the livelihoods of most regional communities dependent on the income they derive from agricultural production, they are particularly dependent on export income. While the Uruguay Round Agreement on Agriculture was an important step toward trade reform, its greatest practical effect was to put in place international trade rules applicable to agriculture rather than liberalise agriculture *per se*. As such, despite recent reforms international agricultural markets, and in particular the world grain market, are some of the most corrupted in the world. As Australia is a significant exporter of agricultural produce the incomes of rural communities can be considerably depressed because of these international market distortions.

Relative to other primary industries, the grains industry is the largest of Australia's primary producers. It accounts for around one quarter of Australia's total farm gross value of production and around one quarter of the value of total Australian farm exports. For the year 1996-97, the Australian Bureau of Agriculture and Resource Economics (ABARE) estimates that the total gross value of production for the Australian grains industry was over \$7.5 billion, of which around \$6 billion was earned from exports. The five year average for the percentage of the total value of the grain crop exported is 68%. In 1996-97, Australia exported nearly 80% of the total value of Australia's grain crop. In the case of wheat, in 1996-97, 90% of the total \$4.7 billion earned by wheat growers was earned from exports.

Australia's share of the total international grain trade is around 10-15% and we are the world's fourth largest grain exporter. However, the Australian grains industry produces only around 2% of the world's total grain production. As a small producer but a large exporter of grain, the underlying price levels for the Australian grains industry are set by world supply and demand. Consequently, the trade distorting policies of other governments have adversely affected, and continue to adversely affect, the prices received by growers for their grain. The recent barley subsidy activity of the European Union (EU), which is currently having a severe, adverse impact on barley returns for Australian growers, is an archetypal example of the effect that the corrupting practices of other countries in the world grain market can have on the incomes of Australian growers. These effects include:

- ***A serious deterioration in the price of feed barley:*** On 12 March 1998, restitutions were granted for 17,000 tonnes of barley at 31.75 Ecus (A\$49) per tonne, while bids were rejected for 392,000 tonnes at 50 Ecus per tonne. However, on 18 March 1998 the EU offered a subsidy of 47 Ecus per tonne for that day for unlimited quantities of barley. A total of 1,059,000 tonnes of barley was booked by traders, resulting in a fall in the price of feed barley to US\$82-85 per tonne FOB (A\$120-125 per tonne).

These prices are in stark contrast to the international prices for feed barley during the initial stage of the Australian 1997-98 barley marketing campaign. At this stage, when EU subsidies were at around 10-15 Ecus (A\$15-23) per tonne, international prices were around US\$130-135 (A\$180-190) per tonne.

As a result of the EU's actions, Australian growers will not only have to bear the cost of this collapse in the price of feed barley but also the real possibility that some buyers could renege on their existing, higher priced, contracts. In some instances, legal remedies may not be

available to enforce contracts due to reasons of culture or country of origin. Furthermore, even where remedies are available, legal action will be both lengthy and expensive.

- **Downward pressure on the price of malt barley:** Prior to the subsidies, malt barley prices were around US\$165-170 per tonne. However, with the sharp increase in subsidies, traders covered their short positions and then offered an estimated 100-200,000 tonnes of malt barley to China at prices of around US\$130-135. This activity has disrupted market signals and confused Chinese buyers to the extent that they have withdrawn from the market until the price situation is clear. As a result of these events, the Australian Barley Board has withdrawn from the market in the belief that, once the European barley has been absorbed, prices will firm.
- **Downward pressure on the price premium usually earned for high quality Australian malt barley:** Generally, malt barley trades at a premium to feed barley, with this premium determined by world supply and demand for malt barley. However, with the recent subsidies, the price differential between malt and feed barley has widened to the extent that some buyers will seek to buy lower quality malt barley at a lower price, thus placing significant downward pressure on the price of higher quality malt barley.

As Australia produces some of the highest quality barley in the world, this will have an adverse impact on malt barley returns. This situation is even more disappointing as, given evenly balanced world supply and demand for malt barley, Australian growers would have had a reasonable expectation of being able to sell most of their malt barley into the Chinese and other premium markets at higher price levels than is now the case.

Another example of the effect of these distortions on Australian industry is the effect of EU subsidies on flour. For many years, the very high flour subsidies offered by the EU and the United States prevented Australian millers from expanding their flour exports. Suspension of these subsidies from mid-1995 led to an improvement in the international competitiveness of Australian flour millers and an increase in exports. However, in September 1997, the EU reintroduced their restitutions. While initially restitutions were at low levels, they were progressively increased throughout 1998 to a significantly high level of around 23-26 Ecus per tonne. In late July 1998, these subsidies jumped from 23 Ecus per tonne (A\$43) to 38 Ecus per tonne (A\$70). This sudden escalation in subsidies is of major concern to the Flour Millers' Council of Australia, as it is likely to affect their members' exports to Asian markets, in particular Vietnam, which is a major market that has opened up to Australian millers in the last eighteen months.

The statistics clearly show that grain growers rely heavily on exports for the majority of their income. In order to combat distortions in the international grain market, Australian governments assist industry to compete internationally by maintaining mechanisms designed to support growers in coping with these market distortions, without actually shielding growers from the competitive pressures of the international market. Such mechanisms include, for example, the national single desk export powers for wheat, and the state-based single desk powers for other grains, in particular barley.

The Council believes that the effect of dismantling structures such as the single desk for wheat would have a variable impact across the Australian community and that this needs to be taken into consideration when these structures are reviewed under NCP. Even if at some future time trade agreements reform much of the current distorting actions and impacts and, further, that a positive net community benefit is demonstrated from removing single desk, the adverse effects of such an action would fall disproportionately on rural communities in comparison with any benefits which could accrue to largely metropolitan areas.

The Council therefore believes that any changes to anti-competitive arrangements that are in place which assist agricultural producers, and hence regional communities, to deal with the corrupt state of the international agricultural market should not be dismantled without due consideration to the effect that such a policy would have on Australia's regional communities. Thus, when an assessment is made during NCP reviews of the net aggregate community benefit accruing from increased competition, NCP reviews should also take into account the geographical distribution of the benefits and costs. For those communities bearing the costs of any change, an assessment needs to be

made of their ability to adjust, the alternative opportunities available to them and the necessity for relevant governments to provide appropriate adjustment assistance.

4.1 RECOMMENDATIONS

It is recommended that:

- **anti-competitive arrangements established to assist agricultural producers designed to address international market failures should not be dismantled without due consideration of the effects of such an action on Australia's rural and regional communities; and**
- **for those communities bearing the costs of any change, an assessment is made of their ability to adjust, the alternative opportunities available to them and the necessity for relevant governments to provide appropriate adjustment assistance.**

5. CLARIFICATION OF PUBLIC INTEREST AND ITS ROLE IN THE NATIONAL COMPETITION POLICY PROCESS

When a judgment is made as to the benefits conferred on the Australian community of an arrangement which restricts competition, in general a comparison is made between the price that a good or service is sold at under the anti-competitive arrangement, and an estimated price that the good or service would be sold at if the anti-competitive arrangement was to be removed. If this analysis demonstrates that under the anti-competitive arrangement the price is higher than what it would otherwise be without the anti-competitive arrangement, then it is usually considered that the anti-competitive arrangement is detrimental to public welfare. An anti-competitive arrangement is considered to be particularly detrimental to public welfare if another industry uses that good or service as an input into the production of its own goods or services.

The Council would like to point out that making such price comparisons may be too simplistic. A price comparison alone will not take account of a myriad of other, often non-quantifiable, factors which may be as important as price considerations. For example, it is often said that without the single export desk for wheat, Australian flour millers may be able to purchase wheat domestically at a lower price. This may or may not be true. However, to be comprehensive, such an assessment would need to take into consideration many other factors besides price, such as the benefits that the flour millers gain from the single export desk. In many instances, these benefits will not be immediately obvious and include, for example:

- security of supply;
- storage facilities for their grain which they might otherwise have to provide themselves;
- enhanced customer focus whereby AWB Limited can always provide individual flour millers with wheat that exactly meets the specifications that the millers require; and
- very favourable credit terms - flour millers have a guaranteed supply of a certain amount of grain for the year, but they only have to pay for the grain as they use it.

In this way, the single desk acts to enhance the competitiveness of flour millers, rather than detract from it.

5.1 RECOMMENDATIONS

It is recommended that:

- **any analysis of an anti-competitive arrangement takes full account of the complexities of the relationship between supplier and consumer; and**
- **comparisons should take into account not only price but also other, often less quantifiable benefits, such as service and quality.**

APPENDIX A