The CIE

BRIEFING PAPER

Current and future arrangements for the marketing of Australian sugar: Senate Inquiry

Prepared for
Wilmar

October 2014

THE CENTRE FOR INTERNATIONAL ECONOMICS
www.TheCIE.com.au

The Centre for International Economics is a private economic research agency that provides professional, independent and timely analysis of international and domestic events and policies.

The CIE's professional staff arrange, undertake and publish commissioned economic research and analysis for industry, corporations, governments, international agencies and individuals.

CANBERRA

Centre for International Economics
Ground Floor, 11 Lancaster Place
Canberra Airport ACT 2609

GPO Box 2203
Canberra ACT Australia 2601

Telephone +61 2 6245 7800
Facsimile +61 2 6245 7888
Email cie@TheCIE.com.au

Website www.TheCIE.com.au

SYDNEY

Centre for International Economics
Suite 1, Level 16, 1 York Street
Sydney NSW 2000

GPO Box 397
Sydney NSW Australia 2001

Telephone +61 2 9250 0800
Facsimile +61 2 9250 0888
Email ciesyd@TheCIE.com.au

Website www.TheCIE.com.au

Contents

Abbreviations **4**

1 Background and context **5**

Deregulating sugar marketing: needed to address various problems 5

Deregulating promised overwhelming net benefits 7

Supported by Queensland and Commonwealth Governments 7

Deregulation since 2006 spawned some innovation 8

However restrictions still apply leaving scope for innovation 9

Potential for further innovation and improvement 10

Senate Inquiry 11

This brief 11

2 Recent developments **12**

Current changes were anticipated in our 2005 report 12

CIE 2005 conclusions still remain valid 19

3 Implications and conclusions **22**

Growers' economic interest 22

Wilmar's offer to growers meets the test: it unambiguously preserves grower economic interest in sugar 23

Equitable access to essential infrastructure 24

Foreign ownership impacts on the industry 25

Adequacy of formal competition and consumer laws 27

Related matters 30

References **31**

BOXES, CHARTS AND TABLES

2.1 Matters to be considered for determining unconscionable conduct 18

Abbreviations

ACCC	Australian Competition and Consumer Commission
CIE	Centre for International Economics
CCA	Competition and Consumer Act
ISDS	Investor-State Dispute Settlement Provisions
NCP	National Competition Policy
QSL	Queensland Sugar Limited
SIRP	Sugar Industry Reform Program
STL	Sugar Terminals Limited

1 *Background and context*

Over the years, the Centre for International Economics (CIE) has produced many reports on deregulating and reforming the sugar industries of Australia, Brazil, India, Mexico, Argentina, Vietnam, Philippines, Indonesia, the United States, the European Union, Japan and the global market more generally.

In 1991, CIE produced a comprehensive document on the benefits of deregulating the Australian sugar industry, including the benefits from, and the need for, deregulation of marketing. That report was titled *Sugar: winning in a corrupt world market* and it brought together and added to work that commenced in 1982.

Later, the CIE produced two reports for the Queensland Government in support of deregulating the marketing of sugar in Queensland.

- 2002 — *Cleaning up the Act: The Impacts of Changes to the Sugar Industry Act 1999*
- 2005 — *Unshackling Queensland Sugar*.

The 2005 CIE report was an evaluation of the then Queensland Sugar Industry Working Group[1] proposal to replace marketing arrangements based on compulsory vesting of all bulk raw sugar, with voluntary arrangements involving Queensland Sugar Limited (QSL). One of the aims was to make QSL more commercially and competitively oriented and, generally, to make the marketing of Queensland sugar more contestable and therefore open to long-term competitive pressures.

Deregulating sugar marketing: needed to address various problems

The CIE 2005 report concluded that:

- like several other reviews around that time, pre-2006 arrangements were holding the industry back by:
  - preventing it embracing opportunities to manage finances and risks of marketing more effectively
  - mitigating against opportunities for product diversion from bulk raw sugar
  - impeding the take up of opportunities to install whole-of-value-chain systems in all operations

[1] It is of particular relevance that the initiative to establish the Working Group came from the industry itself (CANEGROWERS and the Australian Sugar Milling Council) since it implies that the industry perceives that it will benefit from market deregulation, albeit in the context of wider National Competition Policy (NCP) objectives and disciplines that require a rigorous demonstration of net benefits for the community as a whole if any regulatory intervention that restricts competition is to be retained (CIE, 2005).

  - preventing the industry from developing a range of commercial marketing skills to fully exploit these opportunities and challenges
  - negating the need to attract and develop the enterprise and management required to run growth oriented commodity marketing organisations
  - retaining a production driven marketing focus instead of favouring a market driven production orientation needed in a globalised world
- the traditional arguments put forward supporting pre-2006 arrangements and, in particular, compulsory acquisition, a single desk and the ability to behave as a price discriminating monopolist, had been strongly discredited[2] over the previous decade:
  - the use of vesting to defend price premiums and behave as a price discriminating monopolist is both dangerous and misguided because of:
    - unknowable market demand parameters, the volatile nature of the world sugar price and exchange rates, the frequent shifts in customer wants, the quick reaction times of some other suppliers, the apparently fine margins being targeted, opportunities to use alternative sweeteners, volume discounts, market development strategies and other factors meant it is almost impossible for a price discriminating monopolist to behave as one
    - restricting supplies to a close market and diverting them to more distant markets usually costs as much in extra freight as the price (freight) premium in the close market the price discriminating monopoly is trying to expand, so diversion between markets can create observable (and much proclaimed) price differences, but the net premium may be zero or negative
    - net premiums can only be extracted if the nature of demand response to price (the price elasticity of demand) is sufficiently, and favourably, different between Queensland's export market (the close market needs to be relatively inelastic and the distant market absorptive or elastic) and these demand parameters are known with a high degree of certainty, and are stable, and other demand factors such as freight rates and exchange rates are stable, and no alternative supplier of sugar or alternative sweeteners or alternative supplier of sweetener containing products can increase supplies, and the world price is stable, and, of course all this is entirely unlikely
    - the (mathematically provable) likelihood that, if important parameters are not known with accuracy, the probability of things turning out badly rather than well is high, that is, losses resulting from behaving as a price discriminating monopolist will be greater than the gains[3]
    - restricting supplies to a market to try to price discriminate runs the risk of retarding market development when the usual aim in marketing is to increase demand and sales in the long term
  - vesting is not required to achieve economies of size that might exist in marketing and selling of sugar

---

[2] For mathematical details and proofs, see CIE (2002).

[3] The saga of the Australian Wheat Board Limited trying to act as a price discriminating monopoly in Iraq illustrates another and different problem.

- several other independent studies (Industry Commission 1992, Hildebrand 2002, CIE 2002, Williams 2003) had drawn similar conclusions and, in particular, drew attention to how the lack of competition in marketing retarded the development of a commercial culture in the sugar industry.

Deregulating promised overwhelming net benefits

The CIE 2005 report also concluded that the proposed deregulatory changes of the Queensland Sugar Industry Working Group:

- were overwhelmingly in the interest of the industry, its stakeholders and the community generally and that its implementation would help unshackle the industry's development by stimulating a more commercial culture
- would add to the efficiency and competitiveness of the industry by:
  - providing incentives for the development of a wider range of marketing options and introduce a degree of dynamism into the ways in which sugar is processed, stored and sold for both domestic and export use
  - increasing incentives to match marketing methods and costs to the returns that can be reaped from sales
  - providing options to millers/marketers and customers to do business in diverse ways and with other industry players
  - allowing growers, millers and QSL and its customers the freedom to use a wider range of commercial instruments tailored to their individual needs
  - allowing entry into the industry of new players with entrepreneurial skills and wider commercial linkages
  - encouraging better production and marketing ideas by allowing those who develop them the opportunity to reap the benefits of any market premiums obtained
  - creating incentives to develop standards and quality assurance systems in ways that are best managed by those who gain directly from them
- would change the organisational structure of how and who will market Queensland sugar but in ways that cannot be predicted, however it was anticipated that:
  - a few large regionally oriented marketers might emerge, together with several smaller niche operators
  - international commodity traders could also become involved.

Supported by Queensland and Commonwealth Governments

Marketing deregulation occurred on 1 January 2006. The Federal Government made available to the industry $444 million to assist with transitional arrangements through the Sugar Industry Reform Program 2004 (SIRP). This was supplemented by further funding of $33 million made available by the Queensland Government.

Federal Governments assistance came as part of a reform package that involved a range of industry commitments by agreement with state and federal governments. The

Queensland Government Heads of Agreement signed in early 2004 contained, among other things, the establishment of an industry-working group to develop voluntary marketing arrangements as soon as possible with the objective of having a new system in place for marketing of raw sugar prior to the requirement for National Competition Review (NCP) review in 2006.

The SIRP 2004 was partially funded by a levy on domestic sugar sales, including imported sugar. The levy rate was set at three cents a kilogram of sugar (ABARE, 2010).

Deregulation since 2006 spawned some innovation

With deregulation, a minority of mills (Maryborough Sugar, Mossman and Mulgrave: producing around 10 per cent of export sugar) chose to independently market their own sugar while the majority entered into voluntary agreements with QSL[4] to market their export raw sugar. The New South Wales sugar industry continued to independently market its own sugar as it had done since withdrawing from voluntary pooling arrangements with Queensland in order to market its own sugar after the Commonwealth/Queensland Sugar Agreement lapsed on 1 July 1989.

Through QSL and its more commercially open and competitive orientation, sugar millers and growers were able to influence change and innovation in marketing. Many new pricing and selling options emerged. Millers can now elect to allocate their raw sugar to a variety of QSL-managed pools or can elect to price a proportion (about a third) of their output separately. Each pool represents different pricing and risk management strategies. Millers are also entitled to sell independently a proportion (about a third) of their output to their own customers by agreement whereby QSL sells this sugar on an FOB basis back to millers at an agreed price.

Through cane supply agreements (that millers have with cane growers), growers also have options to choose different pricing and risk exposure/management options including individual grower forward pricing options. [5] These options can be directly linked to the QSL pools. None of these options were previously available with all prices and costs being pooled across all sales.

Before the introduction of grower forward pricing, growers had no means to manage their exposure to sugar price . Growers' cane prices were based on a single net sugar price determined by QSL. Growers now have control and choice about how the price they

---

[4] QSL is a public company limited by guarantee, incorporated under the Corporations Act 2001. It has 30 members representing the Australian sugar industry.

[5] For example, the introduction of forward pricing in 2008 by CSR Sugar, allowed growers to determine independently the $A-equivalent of the ICE#11 sugar futures price. This price constitutes 99 per cent of the net sugar price used to determine a grower's cane price. The balance comprises marketing premiums and selling costs which typically represent eight and seven per cent of the net sugar price respectively. Before forward pricing, millers received a single sugar price determined by QSL. Now both growers and millers can independently manage their sugar price exposure and select from a variety of pricing pools managed by QSL or third parties. In recent years, forward pricing has represented about a third of all grower pricing by volume.

receive for cane is determined and can also price their cane based on forward pricing options for as far out as three years in advance. Effectively, this (largely) separates the pricing of cane from the physical marketing of sugar as growers can manage the ICE #11 sugar futures price, which constitutes virtually all (99 per cent) of the net sugar price used to determine a grower's cane price. The marketing premiums and selling costs, which are associated with the physical sale of sugar, offset each other (they typically represent eight and seven per cent respectively of the net sugar price) and therefore account for only 1per cent of the net sugar price.

However, care is needed to ensure that too much sugar is not over-hedged or physically sold before it is produced. That is, there is always an element of uncertainty about the size of the crop and a margin for error needs to be factored in, so physical delivery of cane can eventually be used to close out forward contracts for sugar.

Sugar futures prices are still pooled within separate QSL pools and marketing premiums, storage, transport, financing and other marketing costs are still pooled across all sales. Blending for quality purpose across all QSL sales also implies some general price and cost pooling.

The outcome has resulted in increased competition in pricing and marketing of a certain proportion of the crop. Objectives of the various pools include:

- distributing the returns for sales made under the US Tariff Rate Quota
- a guaranteed minimum return with the potential for higher returns should the world sugar market rally
- a best return over the season by pricing more actively as short-term market opportunities arise
- a best return over the season by the use of significant discretion on the timing of when to price as market opportunities arise, and with the ability to actively establish, unwind and re-establish hedges according to a market view
- to manage production variations
- a two year pricing profile for best returns for next year's crop
- a three year pricing profile for best return for a crop the year after next.

However restrictions still apply leaving scope for innovation

Although there has been a significant increase in choice, under voluntary agreements millers are entitled to independently market and price only a limited proportion (about a third) of their sugar. To date, under voluntary agreements with QSL, contracted millers have elected to restrict competition in the marketing of their sugar by collectively marketing most of their sugar. This reduces their commercial flexibility and the ability to respond to new opportunities and challenges.

Further, the pooling of marketing premiums, costs and quality holds back various opportunities. Requiring all suppliers to share certain costs and returns:

- discourages the more commercially oriented suppliers from pursuing higher valued sales and developing better production and marketing ideas to achieve premiums through their own efficiency and innovation
  - closely integrating and coordinating production, processing, storage, handling, transport and marketing along the value chain have provided economic gains in many industries
  - integration allows competing organisations within an industry scope to differentiate themselves from one another and to capture the gains from small but cumulative product and marketing differentiation and innovations
  - differences created within an industry through integration help promote a wider variety of experimentation and testing of new ideas, which promotes change and successful ideas tend to be copied by competing organisations
- rewards marginal production across the industry at higher returns than it is worth in some of the markets in which it must be sold
- discourages best production and marketing behaviour by potentially encouraging activity in some inefficient locations, at inefficient levels or at inefficient levels of quality.

Potential for further innovation and improvement

From the end of the 2016 season, three sugar milling companies (Wilmar, MSF Sugar and Tully Sugar) have decided to market all their sugar independently (of QSL) to pursue greater flexibility, innovation and improvement.

Wilmar claims that marketing its own sugar will provide higher returns and profits not only for itself but for its 1 500 cane growers. It argues it can better leverage its global market power and sugar marketing expertise to secure higher sugar prices than QSL can.

- It achieved an average net sugar price on the sugar it marketed in the 2012 and 2013 seasons that was $45 per tonne higher than its growers received under the QSL system.
  - The $45 per tonne included a contribution from higher marketing premiums of $11 per tonne. Wilmar's marketing premiums were 60 per cent higher than those achieved by QSL.
  - If growers had achieved the same sugar price as Wilmar, they would on average have received a cane price which was more than $4 per tonne higher, resulting in an increase of more than 50 per cent in average farm gross margins.
- Wilmar believes that with its global footprint and significant expertise in sugar marketing and price risk management it can provide opportunities for growers to achieve higher sugar prices via:
  - better price risk management (pool management)
  - better marketing premiums
  - more flexible options for grower payments and advances
  - continued innovation and reduced bureaucracy.

The decisions of the millers to independently market their own sugar also follows the $105.5 million loss by QSL in 2010 season (QSL 2010/11 Annual Report). This occurred as a result of early and extensive forward pricing of too much sugar before volumes were well known. This resulted in an unreliable, and what turned out to be an unsustainable and undeliverable, over-commitment of Queensland sugar to the market. The cost of QSL over-hedging and overcommitting of sugar sales was borne by millers and growers, because QSL can make neither profits nor losses. All profits and losses are distributed to millers via the sugar prices they receive from QSL, and in turn, to growers via the cane prices determined under cane supply agreements.

Further, pooling of marketing premiums, costs and quality removes incentives to find optimal solutions for cost and quality problems. Were those growers and millers creating the cost and quality anomalies to directly face the problems they create, incentives would exist to find more economic solutions than exist now.

Senate Inquiry

The decision of millers to independently market their sugar has led to a Senate inquiry into the marketing of sugar. The terms of reference cover the following matters.

Current and future arrangements for the marketing of Australian sugar, including:

- the impact of proposed changes on the local sugar industry, including the effect on grower economic interest sugar
- equitable access to essential infrastructure
- foreign ownership levels in the industry and the potential to impact on the interests of the Australian sugar industry
- whether there is an emerging need for formal powers under Commonwealth competition and consumer laws, in particular, whether there are adequate protections for grower-producers against market imbalances
- any related matters.

This brief

Wilmar has asked CIE to consider each of the matters raised by the senate inquiry in light of its earlier work on deregulating Queensland sugar marketing. Here we address each of these matters by assessing our earlier arguments in light of contemporary factors (changes since 2006).

2 Recent developments

Current changes were anticipated in our 2005 report

The recent decision of three more mills to independently market their own sugar was a scenario strongly anticipated by CIE in its 2005 report. In 2005, CIE assessed that, were this to occur, it would arise due to commercial and competitive responses to pursue economic opportunities in the market previously denied the industry under compulsory acquisition and monopoly marketing.

Pursuit of such opportunities would provide a spur to innovation, growth and cost control that would be in the interests of growers, millers and marketers (the whole industry). It would provide incentives to explore more broadly the commercial opportunities and challenges represented by marketing over a billion dollars' worth of commodity each year. It would create incentives for companies to develop a diverse range of commercial skills to better exploit such opportunities and challenges. And, it would help to attract and develop the management needed to run growth oriented global commodity marketing organisations, including from foreign sources.

The original (2005) CIE scenario

The 2005 CIE scenario indicated that:

- the 2005 Queensland Sugar Industry Working Group's original proposal envisaged QSL being transformed into a contractually based marketing company that could continue as the principal or a major player in the near future because:
  – it would start from a position of total market dominance
  – it would have the goodwill of many supplying mills and customers who identify its product as having the quality attributes they desire
  – most mills would likely opt to remain with its familiar financing, risk management and pooling arrangements in the near term
  – it had an established lease with Sugar Terminals Limited (STL) and a proven record in managing terminal, storage, handling and shipping arrangements
- however, it was also noted that QSL did not have any direct ownership links with other elements of the production and value adding chains, it
  – did not own any physical infrastructure or value adding facilities
  – did not own any mills from which it could assure dedicated supplies
  – had no company or equity shareholding base that could finance it into a rapid acquisition of such facilities

  - might find it difficult to maintain a position of market dominance for very long unless it could offer lower costs, better service and innovation that delivered benefits to its stakeholders
- QSL would face strong competitive pressures to perform and its long-term structure and role could change dramatically through time:
  - the three largest milling groups then controlled about three quarters of Queensland industry's raw sugar output
  - each of the big three owned several mills and could enter the market drawing on supplies dedicated from those mills
  - Bundaberg Sugar grew considerable quantities of cane in its own right and was linked through ownership into a world marketing network
  - each of the three groups was also linked through ownership to refining
  - all undertook various other value adding activities
  - CSR and Mackay Sugar operated a sugar refining joint venture that had a vessel that handled bulk refined sugar for Pacific and Asian markets
  - the three large milling groups could readily enter the market following deregulation were QSL unable to meet their expectations
  - each could enter as buyers of raw sugar for domestic and export manufacture in their own facilities and CSR and Mackay could also operate as merchants of raw sugar for export, while Bundaberg might export its raw sugar through another operation within its international network
  - the independent mills might develop long term contractual relationships with QSL or other Australian marketers
- QSL or other Australian based marketers would be likely to continue to use commodity traders:
  - they might form strategic alliance to obtain marketing expertise and finance and to integrate with them for opportunities in the wider global sugar market
  - Brazil, Thailand and the European Union use traders to provide finance and hedging facilities, access to shipping, storage and unloading facilities in export markets, as well as opportunities to integrate export sales into value adding activities in import markets
- STL's infrastructure assets would be unlikely to be reproduced under competitive marketing arrangements, and would be the subject of third party access protocols to ensure that sugar marketing genuinely remained contestable.

CIE (2005) concluded that if economies of size are significant in marketing (as they seemed to be), a likely outcome is that a few large marketers will emerge, each with a regional orientation. In this scenario, several smaller marketers are also likely to operate, serving niche markets and adding value in a variety of ways that meet limited market needs. It also concluded that whatever the outcomes, the benefits of the changes proposed would exceed the costs because they would occur in a highly competitive environment and represent well thought out commercial responses to new opportunities as they presented themselves. Costs arising from infrastructure use, marketing expertise, and financial instruments would be appropriate for the scales of operations best suited to the industry's various potential markets.

Competition and safeguards

The CIE concluded that, although under the envisaged scenario there would likely be regional concentration in marketing, competitive pressures would be enhanced and adequate safeguards existed under National Competition Policy provisions and the then Trade Practices Act to provide an adequate balance of power between growers, harvesters, millers and marketers. Further, under the then Trade Practices Act, cane growers were granted authority to collectively bargain with mills[6].

Increased competition and natural economic safeguards

By definition, competition would be enhanced with the removal of compulsory acquisition and a single monopoly seller. With increased commercial flexibility and new commercial opportunities it is reasonable to expect that such opportunities would translate into increased demand for cane, sugar and by-products. To realise such opportunities would most likely require achieving increased cane supplies. To induce increases in production, any economic gain from the new opportunities would need to be shared with growers in the form of financial incentives.

Moreover, growing, harvesting, milling and marketing are characterised by large economies of scale. The efficiency of each operation is highly dependent on volume throughput to spread large fixed costs in each operation. For the mill to realise benefits from increased economies of scale, arising from any increased opportunity and demand, requires increased cane throughput. Again, financial benefits need to be shared along the supply chain to ensure opportunities are realised.

As the economies of scale and profitability of mills depends on cane supplies, mills are highly dependent on growers and their continuing profitability. If mills were to reduce payments to growers, growers would reduce their use of inputs (land, fertiliser, fuel, water etc), cane output and mill throughput would decline and unit milling costs would rise lowering mill profitability. This would be self-defeating for a mill. There would be less volume over which to spread fixed costs.

Moreover, were this to occur, growers have some choice to use their land and other resources for alternative uses, but millers have no choice but to use their capital to crush cane. If, on the other hand, growers in a region were to collude against a mill and restrict its profits, ultimately they would receive reduced service and indeed could drive the mill out of business. This is unlikely because both parties know they depend tightly on each other and growers know their profitability links to the ongoing profitability of mills. A

---

6 Several agricultural industries are characterised by many producers supplying a single available processor. For most of these, a mixed system of collective and individual contracting arrangements applies. Previously authorisations under the Commonwealth's Trade Practices Act 1974 were granted for collective agreements in these situations, if the Australian Competition and Consumer Commission was satisfied that any anti-competitive conduct is offset by an accompanying public benefit. Collective bargaining is now authorised under Subdivision B of the Competition and Consumer Act 2010. There are numerous examples of such authorisations, some of them quite recent including dairy, poultry meat, eggs, fruits and vegetables supplied to Golden Circle, and even a collective agreement for cane supply (CIE 2002).

new opportunity that increases the return on capital in milling will give mills incentives to provide a higher level of service and to invest in new and perhaps better capital, and place mills in a position to pass back some of their gain to attract even more throughput to further increase efficiency.

The strong mutual dependence between growers and millers means there is a natural, economically determined, close balance of power between the two parties. Each group must be profitable for the other to prosper. There is no strong argument that either millers or growers have or would misuse, excessive market power. To do so would be to the detriment of both parties.

Marketing costs are also characterised by large economies of size and throughput. The main cost and economies of scale relates to terminal operations and storage. This accounts for around two thirds of costs. Most of the remaining costs relate to financing which in turn relates closely to interest rates. These are favourable as the sugar in storage and the pipeline is used as collateral. All milling groups and QSL are big enough to obtain favourable rates.

Premiums relating to physical Queensland sugar sales, due to location (Far East) and quality premiums earned, generally offset (pay for) all these marketing costs. This has long been the case and is highly transparent to millers and growers.

Institutional and legal safeguards

Apart from the economic forces balancing market power, institutionally, legally and politically there are strong deterrents to the misuse of market power.

Institutional

There are very active cane grower organisations in each region and state-wide. Combined with their Australian Competition and Consumer Commission (ACCC) authorisation to collectively bargain with mills, they have potential to operate as colluding and countervailing forces should mill owners seek to exercise their potential power. ACCC authorisations are given effect under the *Sugar Industry Act 1999 Chapter 6, section 237* that provides practical guidance to forming collective contracts. Further, general contract law provisions and general dispute resolution mechanisms such as those under *Queensland's Commercial Arbitration Act 2013* (previously 1990) underpin contracts.

Six bulk terminals, corresponding to the various sugar regions, are operated by Sugar Terminals Limited (STL) on behalf of growers and millers who own STL through share allocations. These terminals are leased to QSL on a contract that runs to the end of 2018 unless volumes drop below specific thresholds. Some terminals are used exclusively for storing the sugar of a particular milling company while others are shared. This reflects the regional concentrations of sugar produced by particular milling companies. Mills currently marketing their sugar independently of QSL also have access to the terminals and also own shares in STL.

Shareholding is highly dispersed. The largest single shareholder is Wilmar with only 18.6 per cent of shares. Trading of shares is restricted to industry participants and split into

Grower and Miller class shares. With special resolutions requiring a 75 per cent majority of both classes of shares, it makes it highly unlikely for any one group to gain control. Growers and millers alike, as shareholders and as stakeholders in the value chain, have strong incentives to see throughput maintained and for the terminals to be run as efficiently as possible irrespective of who conducts the marketing. There is enough capacity to store 2.5 million tonnes, or about half the size of a large crop. Seasonal shipping patterns are such that storage capacity is sufficient to efficiently handle logistical arrangements and is reasonably cheap. As such, the capacity does not represent a major constraint (or bottleneck) on the performance of the industry.

Legal: competition policy provisions

In addition to authorisation to collectively bargain, there is general competition legislation under the now *Competition and Consumer Act 2010* (previously the *Trade Practices Act 1974*). This prohibits the misuse of market power and precludes unconscionable conduct. It is enforced by the ACCC under the provisions of the *Competition and Consumer Act 2010* (the Act). In enforcing compliance with provisions of the Act, the ACCC's main goals are to:

- maintain and promote competition and remedy market failure
- protect the interests and safety of consumers and support fair trading in markets.

The ACCC gives enforcement priority to matters that demonstrate one or more of the following factors[7]:

- conduct of significant public interest or concern
- conduct resulting in a substantial consumer (including small business) detriment
- unconscionable conduct, particularly involving large national companies or traders which impacts on consumers and small businesses
- conduct demonstrating a blatant disregard for the law
- conduct involving issues of national or international significance
- conduct detrimentally affecting disadvantaged or vulnerable consumer groups
- conduct in concentrated markets which impacts on small business consumers or suppliers
- conduct involving a significant new or emerging market issue
- conduct that is industry-wide or is likely to become widespread if the ACCC does not intervene
- where ACCC action is likely to have a worthwhile educative or deterrent effect, and/or
- where the person, business or industry has a history of previous contraventions of competition, consumer protection or fair trading laws.

7 http://www.accc.gov.au/about-us/australian-competition-consumer-commission/compliance-enforcement-policy

The ACCC has considerable powers to investigate and prosecute offending parties. While aiming to correct failures, the *Act* is designed to provide a powerful deterrent to anticompetitive behaviour.

Specifically, under the provisions of the law (The Australian Consumer Law Schedule 2 of the Competition and Consumer Act 2010) a person must not, in trade or commerce, engage in conduct that is unconscionable. In determining unconscionable conduct, a court may have regard to virtually all of the important economic, legal and compliance aspects of trading and commercial arrangements. These include[8]:

- the relative strengths of the bargaining positions of the acquirer and the supplier
- the amount for which, and the circumstances in which, the supplier could have supplied identical or equivalent goods or services to a person other than the acquirer
- the extent to which the acquirer's conduct towards the supplier was consistent with the acquirer's conduct in similar transactions between the acquirer and other like suppliers
- the requirements of any applicable industry code
- the extent to which the acquirer unreasonably failed to disclose to the supplier:
  - any intended conduct of the acquirer that might affect the interests of the supplier
  - any risks to the supplier arising from the acquirer's intended conduct (being risks that the acquirer should have foreseen would not be apparent to the supplier)
- the extent to which the acquirer and the supplier acted in good faith.

From an economic perspective, these matters provide a court with considerable power to consider the economic aspects of whether there is any misuse of market power by either growers or millers, or indeed other parties such as terminal operators, toward each other. The full list of matters to be considered is set out in Box 2.1. This shows that under the Law, there are also a number of powers to enforce aspects of fair legal contracting and compliance. Under the provision, businesses may take action to seek damages for loss suffered or seek an injunction to prevent an offending party from breaking the law.

Legal safeguards also assure access to infrastructure exhibiting natural monopoly characteristics. Part IIIA of the *Competition and Consumer Act 2010* (CCA) establishes the National Third Party Access Regime for services provided by significant monopoly infrastructure. There are several pathways by which third parties can gain a legally enforceable right to access services provided by publicly and privately owned facilities where access is not contrary to the public interest. Pathways to access are likely to require being provided on a competitively neutral basis, (a 'level playing field') and a right to earn a commercial risk adjusted rate of return on the infrastructure.

The ACCC is responsible for enforcement, which involves:

- assessing and monitoring compliance with access undertakings
- arbitrating notified access disputes.

---

8 http://www.accc.gov.au/business/anti-competitive-behaviour/unconscionable-conduct#penalties-and-remedies

Box 2.1 Matters to be considered for determining unconscionable conduct

Section 22 (2) of the Australian Consumer Law provides the following list of matters to be considered for the purposes of determining unconscionable conduct:

- the relative strengths of the bargaining positions of the acquirer and the supplier
- whether, as a result of conduct engaged in by the acquirer, the supplier was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the acquirer
- whether the supplier was able to understand any documents relating to the acquisition or possible acquisition of the goods or services
- whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the supplier or a person acting on behalf of the supplier by the acquirer or a person acting on behalf of the acquirer in relation to the acquisition or possible acquisition of the goods or services
- the amount for which, and the circumstances in which, the supplier could have supplied identical or equivalent goods or services to a person other than the acquirer
- the extent to which the acquirer's conduct towards the supplier was consistent with the acquirer's conduct in similar transactions between the acquirer and other like suppliers
- the requirements of any applicable industry code
- the extent to which the acquirer unreasonably failed to disclose to the supplier:
  - any intended conduct of the acquirer that might affect the interests of the supplier
  - any risks to the supplier arising from the acquirer's intended conduct (being risks that the acquirer should have foreseen would not be apparent to the supplier)
- if there is a contract between the acquirer and the supplier for the acquisition of the goods or services:
  - the extent to which the acquirer was willing to negotiate the terms and conditions of the contract with the supplier
  - the terms and conditions of the contract
  - the conduct of the acquirer and the supplier in complying with the terms and conditions of the contract
  - any conduct that the acquirer or the supplier engaged in, in connection with their commercial relationship, after they entered into the contract
- whether the acquirer has a contractual right to vary unilaterally a term or condition of a contract between the acquirer and the supplier for the acquisition of the goods or services
- the extent to which the acquirer and the supplier acted in good faith.

http://www.accc.gov.au/business/anti-competitive-behaviour/unconscionable-conduct#penalties-and-remedies

Political

As well as the collective activities of cane grower organisations in each region in forming collective contracts with millers, cane growers have traditionally been well organised to present collective concerns and issues politically at the regional, state-wide and federal level. The general threat of government and political intervention also (potentially) would work as a strong deterrent to anticompetitive behaviour should any market imbalances arise.

CIE 2005 conclusions still remain valid

For the reasons above, in 2005 the CIE concluded that an industry scenario such as is emerging now, would be in the overwhelming interests of all stakeholders in the industry. Clearly, the CIE's conclusion was that such changes in the industry would be in the growers' economic interests.

In the (near) decade since the CIE (2005) conducted its assessment there are no changes to the sugar industry which would invalidate our assessment. The major changes since 2005 are as follows.

- The world sugar price has increased considerably since 2005. World sugar prices have long fluctuated and this was anticipated to continue in the 2005 assessment.
  - The increases in price have no impact on the assessment other than to increase the incentives to pursue new opportunities.
  - Australia and Queensland are such small players in the massive global sweetener market that they cannot influence the world price (ICE#11), and historically they have never been in a position to influence it to their advantage.
- The Asian regional deficit in supply of sugar has made the Far East Price Premium (the premium for physical sugar over and above the relevant underlying ICE#11 futures contract) more secure. This further negates arguments that a single desk (price discriminating monopolist) was needed to fully realise such premiums. All Australian export sugar can be sold within this favourable region. The increased security of the Far East Premium increases incentives to pursue new opportunities.
  - The Far East Premium exists because the cost of supply into the Far East market from the marginal supplier (Brazil) is greater than the cost of supply from regional suppliers. Regional suppliers (Australia and Thailand) have insufficient export volume to satisfy the rapidly growing market and freight is more expensive from distant Brazil (the marginal supplier), creating a freight advantage and locational premium for Australia and Thailand[9].
  - Previously, Australia supplied up to 50 per cent of all imports into the region. Today, it supplies less than 25 per cent and Australia's market share is diminishing steadily as demand continues to grow in the Far East region.

[9] For further information on the Far East regional premium see QSL Raw Sugar Supply Agreements Marketing Guide 2014 Season edition 20: a guide to how QSL manages it marketing, risk management and sugar pricing activities for Queensland growers and suppliers.

  - Suppliers from Brazil and Thailand are increasingly capturing market share and Australia now competes more and more with these suppliers, particularly Brazil.
- The industry (particularly the milling sector) has attracted considerable amounts of foreign capital, with around 75 per cent of milling capacity in Queensland being now foreign owned.
  - The availability of foreign capital reflects optimism in the outlook for the Australian industry, its deregulated structure and the potential for opportunities and synergies with the wider global sweetener market.
    - Wilmar and other milling companies have substantial international global sugar trading operations and expertise and shipping capacity.
    - Through its operations, Wilmar seeks to generate value through superior market intelligence, scale, and global presence brought about from not only being a major trader of raw sugar, but also a sugar miller and refiner in a number of countries. It has leading capability in price risk management and is an experienced global sea freight provider with a fleet of around 120 vessels that it owns or operates.
    - Wilmar already trades five million tonnes of raw sugar globally which is considerably greater than QSL.
  - The increased availability of capital has helped to sustain the industry, helped introduce new ideas and reinforce its future.
  - Foreign owners are subject to the same business and competition policy law as Australian owned companies.
  - Foreign owners are subject to the same commercial, economic and political pressures as Australian companies.
  - The increase in foreign capital and ownership are entirely consistent with what was anticipated by the CIE in 2005 and in no way invalidate the conclusions made. Recapitalisation of the industry and injection of new ideas and opportunities was needed and has been in the industry's interest.
- There have been significant changes in marketing which mean:
  - independent millers, those not in voluntary contracts with QSL, separately market their own sugar
  - contracted millers separately and independently may market up to (about) one third of their sugar
  - there is no longer a single desk or a single desk trying to behave as a price discriminating monopolist, as is now the case with other agricultural industries (for instance compulsory acquisition for wheat and the Australian Wheat Board Limited was abolished)
  - up to 40 per cent of sugar may be marketed and priced independently of QSL
  - millers and growers now have a large variety of different pricing and risk exposure/management options which effectively separate the pricing of cane from the physical marketing of sugar and mean growers and millers can independently lock in prices for a proportion of their nominal sugar exposure well ahead of delivery

  - these changes in marketing are consistent with the CIE 2005 assessment and were anticipated, and are in the interests of all industry stakeholders.

What hasn't changed is the following.

- The regional concentration of the industry has remained intact, although this will be accentuated with the independent marketing by regional based milling companies. However, as discussed, this was fully anticipated[10] and in no way invalidates the conclusions reached.
- The high dependence on economies of scale at all level of the industry, the tight interdependency between growers and millers and the natural economic safeguards against imbalances of power remain as strong as ever, as do institutional, legal and political safeguards.
- The 'cane payment formula' still directly links the cane price to the net sugar price and delivers approximately two third of the net sugar revenue to growers and one third to millers, although more flexibility and choice in locking in the net sugar price is offered, which is in the industry's best interests.
- Location (Far East) and quality premiums are still earned on the sales of Queensland sugar and generally these offset (pay for) all marketing costs[11]. This remains highly transparent to millers and growers.

[10] The Hildebrand Report (2020) also pointed out that the regional nature of the industry must be recognised and restructure to ensure change could happen on a regional basis. The centralised nature of regulation and industry structures were holding back the industry.

[11] There is a net premium, after selling costs, of about 1 per cent of the value of the sugar price.

3 *Implications and conclusions*

Growers' economic interest

Despite deregulation of the sugar industry and other changes, the fact that growers and millers continue to rely on the well-established 'cane payment formula' to determine the price of cane is instructive. The formula has long been in existence. It directly links the cane price to the sugar price minus marketing costs, in a highly predictable and stable manner.

That this has endured in the face of deregulation is strong testimony to the even and stable balance in power between growers and millers and the fact that there is broad support for the linkage of cane price to sugar price, despite the removal of legislative requirement for this linkage by the Sugar Industry Reform Act (2004). Proposed changes from 2017 are unlikely to change this. All natural economic, institutional, legal and political safeguards will remain intact. Moreover, the nature of grower contracts and options being proposed by milling companies confirms that existing or improved terms and conditions will be offered. Legal safeguards available under the *Competition and Consumer Act 2010* will ensure these are locked in, although natural economic pressures make it difficult to contemplate any other outcome.

Moreover, the main component determining growers' cane prices is the highly competitive world raw sugar futures price over which neither QSL nor any Australian milling company has any control.

- The world price is a reflection of all the information on the supply and demand for sugar and other sweeteners everywhere in the world and its relative availability to the market.
- Price is determined through competitive bidding and trading on the Intercontinental Commodity Exchange and is reflected in the ICE# 11 futures contract.
- The sugar futures market is renowned for its liquidity and volatility and ICE#11 contracts are available three years in advance in four contract months per year providing ample opportunity for proactive price risk management activities.
- The total global sweetener market is well over 200 million tonnes in volume per year and Queensland supplies less than 2 per cent of this nowadays.
- A large proportion of world supply and demand is directly traded, about 30 per cent of production, and the remaining 70 per cent can influence it depending on the extent of trade barriers in each country, which have tended to decline in recent decades.
- The large directly (and freely) traded component of the world sweetener market alone makes the market a highly competitive one.

Despite the market's volatility, growers now have choice about how they can price their cane based on forward pricing options for globally traded sugar (via sugar futures contracts). And, they can do this independently from the physical marketing of sugar. This means they too can be (largely) financially independent of who markets their sugar. The current grower forward pricing options embraced by growers and millers, are determined and underpinned by the structure of the cane price formula. And, the ICE# 11 futures contract world price accounts for virtually all (99 per cent) of the net sugar price used to determine cane price in the cane payment formula. The net price is the price after marketing premiums and costs. Because locational and quality premiums for Queensland sugar are assured and they tend to closely match costs, these factors are mostly netted out leaving the ICE# 11 as the driving parameter in both sugar and cane pricing.

- Premiums and costs under QSL's management have respectively been around eight and seven per cent of the ICE# 11 price in recent years.
- Under the cane payment formula and available pricing options, because premiums and costs net off, it is the ICE# 11 price, through the constant cane pricing formula that drives the cane price, not who markets it, QSL or some other marketing company.

Wilmar's offer to growers meets the test: it unambiguously preserves grower economic interest in sugar

The Wilmar proposed marketing model and offer to growers includes the following features. Features that will not change from current arrangements include the following.

- The cane price formula will remain unchanged.
- Growers will still be able to forward price via the company provided website (Grower Web).
- Growers will still have a range of pricing and pooling options via the Grower Web including the Call and Target (forward pricing) methods.
- Growers will still have access to the US Quota[12].
- If growers don't wish to select specific pricing and pooling options, their nominal sugar exposure will still be allocated by default to a pool used to manage production risk (similar to the manner in which QSL's Harvest Pool currently operates).
- Growers will still have the option of selecting cane payment based on the existing advances arrangement.
- Growers will still receive actual marketing premiums achieved on physical sales to end customers.
- The net sugar price will still reflect storage and handling charges, finance charges for grower advances and other selling costs, consistent with existing practices.

[12] To achieve equitable access to the preferential US quota-protected market, the Australian Government allocates a tonnage of raw sugar exports to separate Australian mills through Certificates of Quota Eligibility (CQEs). Currently suppliers to QSL pass their certificates onto QSL and it exports sugar to the US. Under the new arrangements, Wilmar will use its certificates directly to export to the US. Growers will be able to participate in a pricing pool associated with these exports to the US.

Additional features and improvements will include the following.

- Some additional pricing and pooling options will be offered.
- An opportunity to participate in a pool where the sugar pricing is managed with the same strategy that Wilmar uses for its own Australian sugar exposure.
- The option to choose an independent third party pricing manager for a pool administered by Wilmar. This could be QSL or another provider.
- New cane payment options will be available. These may include:
  - pre-harvest payment (in March prior to the commencement of harvesting in June) with the balance paid progressively from July to June during the relevant season
  - cash payment when the cane is delivered (Cash on Delivery with, for example, 90 per cent payment within seven days) with the balance paid in July the following year
  - a deferred advance payment, similar to the existing advance system but with the first payment deferred to 1 July.
- The opportunity to review Wilmar's marketing performance each year — including the right to have an independent audit conducted for growers or grower collectives — so growers will know marketing premiums and costs are transparent.

The Wilmar proposal establishes a company jointly owned by Wilmar and growers to capture and transparently share value with growers in relation to the 1 per cent of net returns generated from the premiums derived from the sale of physical sugar, less the associated costs for storage and handling, marketing, financing and other such expenses.

Continuation of the cane payment formula unambiguously preserves grower economic interest in sugar. Other terms and conditions further lock this in and new options offer scope to improve grower terms and conditions. The offer for grower appointed representatives to oversee marketing of Wilmar's sugar helps provide opportunities for growers to extend their interest and involvement into marketing and it helps guarantee transparency. Legal safeguards available under the *Competition and Consumer Act 2010* would lock in these advantages. Under provisions relating to unconscionable conduct if there is a contract between the acquirer and the supplier for the acquisition of the goods or services then two important factors become determinable matters should any case of unconscionable conduct go to court:

- the conduct of the acquirer and the supplier in complying with the terms and conditions of the contract
- any conduct that the acquirer or the supplier engaged in, in connection with their commercial relationship, after they entered into the contract.

Equitable access to essential infrastructure

Sugar terminals exhibit natural monopoly characteristics and significant economies of size. However, growers and millers jointly own them and no one group has a majority shareholding, nor is likely to obtain one. In addition, the shareholding structure (with two classes of shares, Grower and Miller) and company constitution limit the control of any one shareholder, or class of shareholder. Both growers, and millers, through their company STL, have strong incentives to see these facilities efficiently run and to ensure throughput is maximised to realise economies of size. Capacity is adequate to ensure that these facilities do not constrain the efficient marketing of the industry.

STL currently leases the bulk sugar terminals to QSL who operate them to store, handle and load sugar onto ships as part of their marketing function. The lease expires in 2018 and requires continued QSL minimum throughputs to remain valid. STL with its grower and miller ownership has strong incentives to determine efficient and equitable outcomes should marketing arrangements change. STL could operate the terminals itself, involve an agent or lease individual terminals to regional suppliers.

In the unlikely event of there being problems, efficient and equitable access is also guaranteed under the National Third Party Access Regime in Part IIIA of the CCA. That mills marketing their sugar independently of QSL currently have access and own shares in STL is a strong indicator that current arrangements are flexible enough to efficiently embrace change.

Foreign ownership impacts on the industry

In the past five years, the industry has attracted considerable amounts of foreign capital. Around 75 per cent of milling capacity in Queensland is now owned by foreign parent companies. The industry was financially depressed between 1999 and 2005 due to low world prices, climate, disease and competition for land from forestry managed investment tax schemes. The industry was highly dependent on government assistance during this period and it accepted, in return, that it needed to restructure, deregulate, modernise and become more commercial if it were to survive. To survive through this period the industry delayed needed on-going capital replacement and upgrading. By the end of the period the milling sector, in particular, needed to be recapitalised to recondition and upgrade milling assets and infrastructure.

Deregulation helped attract foreign investment and provided recapitalisation

Progressive deregulation and eventually (almost) full deregulation of the sugar industry in 2006 held the promise of a more commercial orientation and flexibility, reduced bureaucratic and political interference, a stable and predictable regulatory environment, an increased application of modern and global business strategies and skills and an opportunity to integrate with the globalised world sweetener market. This, and a much modernised and globalised Australian economy, helped attract the foreign investment that subsequently flowed in to provide the needed recapitalisation of the industry.

Sugar deregulation followed two decades of commercial and policy reform of the wider Australian economy aimed at modernising the whole economy and making it attractive, predicable and less vulnerable to sovereign risk[13] for investors, including foreign investors. Investors want certainty and fear inconsistent and poor government decision-making (lacking consultation, evidence and forethought). Through the eighties, nineties and early noughties Australia established a good record of stable and generally well-regarded (evidence-based) policy-making, which provided businesses with rising degrees of certainty about their investments. Government, or sovereign, risk was generally regarded as low.

- Australia has been highly dependent on attracting foreign capital for its development since European settlement.
- In a globalised world, it became increasingly obvious that Australia needed a less distorting, even and predictable tax system and a less distorting, more predictable business regulatory environment were it to continue to attract capital and to gain productivity advantages from the uptake of new technologies.
- Australia also became highly active in seeking multilateral, regional, bilateral and unilateral trade and investment agreements to help deregulate and depoliticise the economy and to provide frameworks that facilitated and protected inward and outward foreign investment, as well as freer trade. Some of these agreements have Investor-State Dispute Settlement Provisions (ISDS) designed to protect foreign investors from breaches of commitments, discrimination against foreign investors and expropriation.
- Wilmar purchased Sucrogen from CSR Limited in December 2010 for $1.75 billion. Since then, Wilmar has invested another $530 million in capital expenditure[14], upgrading existing assets and purchasing farm land to support its sugar milling business. Wilmar also acquired the Proserpine Mill, which was in voluntary administration, for a total consideration of $120m in 2011.

Investments assumed low sovereign risk and compliance with business law

Foreign investments were made in the knowledge that foreign companies operating in Australia must comply with the same business and competition policy law as Australian owned companies. Moreover:

---

13 Euromoney measures aspects of sovereign risk in its country risk ratings for instance (see http://www.euromoney.com/poll/10683/PollsAndAwards/Country-Risk.html). These evaluate the investment risk of a country taking into account such factors as political risk, economic performance/projections, structural assessments, debt indicators, credit rating and access to bank finance. Political risks have a quantitative weighting in the overall index of 30 per cent. They also provide assessments of a country's regulatory environment, taking account of labour freedoms, freedom from corruption, property rights, financial freedoms, monetary freedoms, government spending, fiscal freedom, trade freedom and business freedom. In 2011 Australia was ranked 3rd out of 41 countries in the Asia–Pacific region, but its overall score was lower than the global average. http://www.euromoneycountryrisk.com/Wiki/Australia).

14 Including year ending December 2014 budgeted capital expenditure

- the Foreign Investment Review Board approved Wilmar's foreign investment subject to the possibility that should it ever operate a STL sugar terminal, it would provide the same open access arrangements as QSL
- foreign investments were made assuming a deregulated, stable and depoliticised sugar regulatory environment and a wider Australian politico/economic environment equipped with safeguards to avoid sovereign risks that would otherwise discourage needed foreign investment.

Conclusion

Foreign investment in the sugar industry has impacted positively on the industry helping to recapitalise it, sustain it and introduce new ideas/technologies and helping to reinforce its future. In a deregulated environment foreign investment has the opportunity to help integrate the Australian industry with the global market and ensure an on-going flow of capital, best practice ideas and opportunities.

Foreign owners must comply with the same business and competition policy law as Australian owned companies and they are subject to the same commercial, economic and political pressures as Australian companies. It has long been realised that having the ownership of capital contestable through an open stock and wider globalised capital market helps attract operators with a strong comparative advantage in managing particular assets. The change in sugar milling ownership that has occurred in Australia in recent times is consistent with this. It has attracted new capital and freed up existing Australian capital for other endeavours.

The on-going supply of foreign capital will depend on the stability of the regulatory environment and the opportunity to freely pursue commercial ideas and opportunities. Without it, the Australian sugar industry is less likely to successfully integrate with the globalised world sweetener market, to update itself and modernise.

Adequacy of formal competition and consumer laws

Australia has progressive and far-reaching competition and consumer laws. These are designed to operate as much as a deterrent as an avenue for redress. As well as many natural economic forces at work to ensure an efficient workable balance of market powers between growers, harvesters, millers, marketers, terminal operators and shippers, there are many institutional, legal and political safeguards that guarantee the efficient balance of power between parties. These were reviewed earlier.

There is no need for additional competition law

Given the strength, applicability and adequacy of formal competition and consumers laws that already exist, there is no argument for these to be extended, especially given that no economic problem is identified. Should a problem arise, the powers of the ACCC are omnipotent. They should be used to deal with any issue ahead of developing specific regulation which is vulnerable to political capture and manipulation, bringing with it unpredictable and non-commercial solutions.

One of the driving forces behind deregulation of the sugar industry over the two and half decades up to 2006 was to create a more commercial, less bureaucratic and less politically vulnerable industry. In the past regulation has been shown to cost the industry and the Queensland economy dearly[15].

The 2002 Hildebrand report, concluded that:

- the industry must change its culture: the hierarchical, inward-looking culture of the industry stifles change and encourages grower-miller conflict and mistrust
- the industry should make its decisions on a regional and through-value chain basis: too many decisions are made by industry peak bodies in Brisbane, stifling regional initiatives and agreements between growers and millers that take into account local circumstances
- the industry is in urgent need of productivity improvements and cost reductions.

The industry long operated within one of the most regulated industrial structures created for any industry in Australia. These structures greatly reduced the ability of farmers, harvesters, millers, refiners and marketers to make normal commercial choices. They were not free to choose how much they produced, where they produced, who they bought from, whom they sold to, what technologies they used, who could enter the industry, what conditions needed to be met to leave the industry, and how revenues were divvied up. In short, the industry operated in a regulatory straight-jacket that allowed little room for competition for resources or markets and little room to find meaningful negotiated changes.

When diverse commercial and competitive decisions based on personal responsibility, enterprise, risk and price are swapped for a few decisions made centrally by small groups with narrow vested interests, an industry becomes vulnerable to political interference by lobby groups. What may be profitable for a particular lobby group may not be so for the wider industry or community. When political interference occurs, decisions are no longer made on purely competitive and commercial grounds, but other considerations are allowed to intrude. This can drive away the commercially minded. Even the fear of political interference alone, and the unpredictability this creates (sovereign risk[16]), can be enough to block innovation and new investment. It could cause capital flight.

---

[15] In 1991, the Centre for International Economics (CIE) estimated that the industry's regulatory structure appeared to be costing the industry around $500 million a year in lost sales due to forgone production and economies of scale and $200 million a year in income. By 2002, the CIE found that even after some deregulation that had allowed some expansion of the industry, remaining regulation was still imposing costs in terms of forgone income and opportunities of around $0.5 billion a year.

[16] It is possible to insure against sovereign risk, but the premiums impose a cost to doing business. See for instance http://www.sovereignbermuda.com/main.html . Sovereign Risk Insurance (Sovereign) is one of the world's leading underwriters of political risk insurance and reinsurance. Sovereign's clients include many of the world's largest banks, exporters, multinational corporations, export credit agencies and multilateral agencies.

Ad hoc, specific industry regulation is highly vulnerable to political manipulation through time and the direction this can lead an industry is highly unpredictable. Re-regulation of the sugar industry would be a retrograde step and would unravel the gains that have been made toward creating a commercial culture in the industry.

General economy-wide regulation (such as exist through the ACCC) is likely to be more robust and be more broadly assessed and considered (than specific industry regulation) as well as being cognisant of the national community interest. The powers of the ACCC are adequate to deal with any emerging problems, should they emerge, and they should be considered, when and if a problem occurs, through this channel.

Re-regulating compulsory acquisition and single desk: a retrograde step

In 1991, CIE pointed out how most regulation in the industry was ultimately underpinned by the compulsory acquisition and the single desk. Removing this has been a major impetus toward commercialising the industry. Several independent studies (Industry Commission 1992, Hildebrand 2002, CIE 2002, Williams 2003) have drawn attention to how the lack of competition in marketing retarded the development of a commercial culture in the sugar industry.

Moreover, with progressive deregulation the need for compulsory acquisition to underpin other regulations has become unnecessary, making compulsory acquisition redundant. Re-regulating to reestablish compulsory acquisition and a single desk (or by any other means remove or restrict millers existing legal and commercial rights to independently market their total sugar production) would likely be viewed with trepidation by investors in the sugar industry. It would be seen as a major reduction in commercial freedom and flexibility and signal a major constraint to further development and innovation. It would be viewed as a major increase in sovereign risk, not only by investors inside the industry but others in the broader Australian economy who might fear that their industry too may become vulnerable to ad hoc political interference.

Moreover, it would be viewed as a direct affront on 'property rights' established under the deregulated environment. Foreign investors who have bought Australian assets knowing that they owned all the sugar they produced and were entitled to market under a deregulated environment, would have major constraints (a major diminution) placed on those property rights. Expropriation of property rights without full compensation could become a major legal, political (sovereign risk) and international issue (witness the attempted introduction of a large mining tax on existing Australian mining investments[17]). Expropriation of property rights is a major consideration and worry to investors who assess the sovereign risks that various investment destinations might pose (also, see footnote 13).

Further, under ISDS provisions designed to specifically protect foreign investors from expropriation, re-regulating to reestablish compulsory acquisition or loss of sugar ownership or marketing rights could test these provisions under Free Trade Agreements Australia has signed. This could create a liability for the Commonwealth.

Related matters

Ever since 1982 when the high economic costs of sugar regulation were first discussed and quantified, some groups in the sugar industry have resisted deregulation and change. However, with each step toward deregulation and change the industry has innovated and increased its efficiency. In the past two decades it has increased in size,[18] it has achieved significant economies of scale in growing, harvesting, milling and handling and has made big strides in spreading and managing risk. Through much of this the industry has faced a highly challenging external trading environment. Had these changes not happened, it is doubtful the sugar industry would have survived. Quantitative analysis by the CIE in 2002 demonstrated just how perilous the industry's position was.

The industry must continue to become more commercial and attract capital to ensure it survives and prospers.

---

[17] For instance, former Australian Ambassador to China, Geoff Raby, has warned that 'Australia is being seen as a sovereign risk by Chinese business people due to the introduction of the Mineral Resource Rent Tax and the carbon tax…. These have spooked potential investors…. Australia had been seen as a very stable regime and now was not viewed in the same way…. The Chinese will seek to diversify away from Australia for strategic reasons… and Australia has become a more costly and difficult place to operate in.' Business Spectator, 9 August 2012 (http://jamiemcintyre.com/australia-sovereign-risk-exchina-ambassador/)

Also see https://www.businessthink.unsw.edu.au/Pages/Mining-Super-Profits-Tax-and-Sovereign-Risk-The-Weakest-Link.aspx where Peter Swan (2010), professor of Banking and Finance at the Australian School of Business is quoted with the following. 'I think foreign investors were spooked to some extent by the very large arbitrary element to the government's tax grab from the miners. It wasn't justified and it wasn't explained. It was quite different from what it was alleged to be. All of this has created a lot of uncertainty about whether other investors are safe from potential government expropriation.'

[18] From just over 3 million tonnes for Australia in 1983 to over 5 million tonnes between 1995 and 2007, although it has faced production issues since 2007.

References

ABARE (2010), A report on the impacts of the Sugar Industry Reform Program (SIRP): 2004 to 2008, Canberra, November 2010.

Centre for International Economics (CIE) 1991, Borrell B, Quirk D and Vincent D, *Sugar — Winning in a Corrupt World*, Centre for International Economics, Canberra.

Centre for International Economics 2002, *Cleaning up the Act — The Impacts of Changes to the Sugar Industry Act 1999*, Canberra.

Centre for International Economics 2005, Unshackling Queensland Sugar, Canberra.

Hildebrand C. 2002, *Independent Assessment of the Sugar Industry 2002*, Report to the Hon. Warren Truss MP, Minister for Agriculture, Fisheries and Forestry, Canberra.

Industry Commission 1992, *The Australian Sugar Industry,* Report No 19, Canberra.

Productivity Commission 1999, *Impact of Competition Policy Reforms on Rural and Regional Australia*, Inquiry Report No 8, Canberra.

—— 2000, *Single Desk Marketing: Assessing the Economic Arguments*, Staff Research Paper, Canberra.

—— 2005, *Review of National Competition Policy Reforms*, Inquiry Report No 33, Canberra.

Queensland Sugar Limited Annual Report 2010/11, http://www.qsl.com.au/sites/default/files/QSL5255_AnnualReport2011_LR_SP.pdf

Williams J. 2003 *Overview of Australian Sugar Marketing Under Full Deregulation in Queensland*, Agribusiness Financial Management, Melbourne.

Working Group 2005, *Proposal to Introduce a New Marketing System for the Queensland Sugar Industry,* Report of the Industry Working Group, Brisbane

THE CENTRE FOR INTERNATIONAL ECONOMICS
www.TheCIE.com.au