

Chapter 2

The Australian sugar industry

Background

2.1 It is estimated that the Australian sugar industry directly employs approximately 16,000 people across the growing, harvesting, milling and transport sectors.¹

2.2 The Australian sugar industry produces both raw and refined sugar from sugarcane. The industry's major product is raw crystal sugar which is sold domestically and exported. The industry is largely concentrated along Australia's eastern coastline – between Mossman in far north Queensland, and Grafton in northern New South Wales. Approximately 95 per cent of the sugar produced in Australia is grown in Queensland with the balance being grown in northern New South Wales.²

2.3 The sugar cane industry is one of Australia's largest and most important rural industries and sugar has been identified as Queensland's most important rural crop. The approximately 35 million tonnes of sugar cane grown annually can produce up to 4.5 million tonnes of raw sugar, one million tonnes of molasses and 10 million tonnes of bagasse.³ Approximately 80 per cent of Australia's sugar production is exported as bulk raw sugar, making Australia the second largest sugar exporter in the world. Over recent years, Asian exports have become a major focus, with markets such as South Korea, Indonesia, Japan and Malaysia becoming some of the most important.⁴

2.4 Around 85 per cent of the raw sugar produced in Queensland is exported and generates up to \$2 billion in export earnings. The majority of Australia's domestic market is supplied by sugar cane grown in New South Wales.⁵

2.5 In Australia, there are an estimated 4,400 cane farming entities growing sugar cane on approximately 380,000 hectares annually. These farms – the majority

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- 1 Australian Sugar Milling Council, <http://asmc.com.au/industry-overview/>, accessed 30 March 2015.
 - 2 Department of Agriculture, <http://www.agriculture.gov.au/ag-farm-food/crops/sugar>, accessed 30 March 2015.
 - 3 Bagasse is the fibrous matter that remains after sugar cane or sorghum stalks are crushed to extract their juice. It is used as a biofuel and in the manufacture of pulp and building materials.
 - 4 Department of Agriculture, <http://www.agriculture.gov.au/ag-farm-food/crops/sugar>, accessed 30 March 2015.
 - 5 Australian Sugar Milling Council, <http://asmc.com.au/industry-overview/>, accessed 30 March 2015.

of which are owned by sole proprietors or family partnerships – supply the 24 mills which are owned by seven separate milling companies. The ownership structures of the mills are a combination of publicly owned entities, privately held companies (limited by guarantee) and co-operatives.

2.6 What follows is a summarised history of the regulation of the Australian sugar industry. Whilst the summary focuses primarily on the situation in Queensland, some of the documented reviews, inquiries and the resulting changes also impacted the New South Wales industry.

1912 – Royal Commission

2.7 The Australian sugar industry was first reviewed in 1912. At that time, the Royal Commission on the Sugar Industry reported that the price of cane sugar was set by mill owners, while the prices of raw and refined sugar were set by sugar refineries. The Commission concluded that market forces alone may not provide an equitable distribution of the profits across the sugar supply chain. The report recommended that the raw sugar price be fixed under a sliding scale developed by a commission, and the price of sugar cane be determined by a board in each mill area.⁶

1915 – Introduction of industry regulation

2.8 In response to the 1912 Royal Commission, the Queensland Government introduced the *Regulation of Sugarcane Prices Act 1915* and the *Sugar Acquisition Act 1915*.

Regulating the sugar cane price

2.9 The 1915 legislation regulated the price of sugar, and introduced a system under which growers and millers shared the proceeds of sugar sales.⁷ The Regulation of Sugarcane Prices Act established the Local Sugar Cane Prices Boards and the overarching Central Sugar Cane Prices Board, which were tasked with providing a fair distribution of raw sugar returns between growers and millers.⁸ It was determined that proceeds were to be shared, with two thirds

6 *Report of the Royal Commission on the Sugar Industry*, 4 December 1912, as reported in *The Australian Cane Farmer*, July 2014, p. 3, http://www.acfa.com.au/wp-content/uploads/2013/05/ACF_July-2014-e-webnew.pdf (accessed 9 April 2015).

7 CANEGROWERS, *Sugar marketing: the State government can and must take action*, http://www.CANEGROWERS.com.au/icms_docs/194489_Sugar_Marketing_choice_rights_and_your_future.pdf (accessed 15 December 2014).

8 Wilmar Sugar Australia, *Submission 10*, Attachment 3, *J.M. Craigie, Regulation and Reform of the Queensland Sugar Industry*, October 2014, p. 6.

provided to the grower and one third to the miller. This tied the price of cane to the price of raw sugar.⁹

2.10 Under this arrangement, growers were considered to have a 'two thirds economic interest' in the raw sugar produced. This approach was reflected in what became a recognised formula for determining the cane price:

Price of cane = Price of sugar x 0.009 x (CCS – 4)/100 + 0.328, where CCS is a measure of the amount of recoverable sugar in the cane, and 0.328 is a constant measure based on industry production values in 1916.¹⁰

2.11 By 1994, the constant measure 0.328 had increased to 0.57.8, that is, 58.7 cents, to adjust the 1916 formula for 1990s industry production values.¹¹

Export restrictions

2.12 The Sugar Acquisition Act authorised the Queensland Government to acquire all raw sugar manufactured in Queensland and to sell it to the Commonwealth Government. In 1923, with the agreement of the Commonwealth, the Sugar Board was established to oversee the export of raw sugar.¹²

1999 – Moves toward deregulation

2.13 In 1995, a review of the sugar industry concluded that, whilst the industry should continue to be regulated, the level of regulation should be reduced.¹³ As a result, the Queensland Government repealed the Regulation of Sugarcane Prices Act, and the Sugar Acquisition Act, and replaced them with a new regulatory framework under the *Sugar Industry Act 1999*.

Regulating the sugar cane price

2.14 Under the new legislation, 'cane production areas', which linked cane growers to local mills, were established.¹⁴ The new legislation also introduced a

9 *Australian Canegrower*, 9 June 2014, p. 7, http://www.CANEGROWERS.com.au/icms_docs/205070_australian_canegrower_2014-06-09.pdf (accessed 17 April 2015).

10 *Australian Canegrower*, 9 June 2014, p. 7, http://www.CANEGROWERS.com.au/icms_docs/205070_australian_canegrower_2014-06-09.pdf (accessed 17 April 2015) and Clive Hildebrand, *Independent Assessment of the Sugar Industry*, 2002, Appendix A.

11 Clive Hildebrand, *Independent Assessment of the Sugar Industry*, 2002, Appendix A.

12 Wilmar Sugar Australia, *Submission 10*, Attachment 3, *J.M. Craigie, Regulation and Reform of the Queensland Sugar Industry*, October 2014, p. 6.

13 Sugar Industry Bill 1999, Explanatory Notes, p. 1.

14 Sugar Industry Reform Bill 2004, Explanatory Notes, p. 4.

requirement that growers and mill owners negotiate income distribution.¹⁵ Whilst the Act allowed for collective and individual negotiations, a grower could not agree to an individual contract if the contract had the potential to adversely affect other cane growers.¹⁶

2.15 *The Sugar Industry Act 1999* also prescribed matters that were to be included in the contracts, including:

- arrangements for harvesting;
- delivery to the mill;
- transport and handling;
- acceptance and crushing by the mill; and
- payment by the mill owner.¹⁷

2.16 The legislation stipulated that the price of cane be linked to the price of raw sugar. However, the contract negotiation team had the discretion to determine a different approach.¹⁸ Dispute resolution mechanisms were also established under the Act.¹⁹

Export restrictions

2.17 The Sugar Industry Act continued the 'single desk policy', under which all raw sugar produced was vested in Queensland Sugar Limited (QSL) (and its predecessors such as the Sugar Board). Only QSL was authorised to market raw sugar milled in Queensland for export, with proceeds pooled and distributed on a pro rata basis.²⁰

The role of Queensland Sugar Limited (QSL)

2.18 Queensland Sugar Limited (QSL) is a not for profit company limited by guarantee which is owned jointly by mill-owner members and grower-members, with voting rights divided evenly between QSL's two classes of members. Under QSL's constitution, the company is required to act in the best interests of the sugar

15 Sugar Industry Bill 1999, Explanatory Notes, p. 2.

16 *Sugar Industry Act 1999*, s.32 –33 and Clive Hildebrand, *Independent Assessment of the Sugar Industry*, 2002, Appendix A.

17 Clive Hildebrand, *Independent Assessment of the Sugar Industry*, 2002, Appendix A.

18 Clive Hildebrand, *Independent Assessment of the Sugar Industry*, 2002, Appendix A.

19 *Sugar Industry Act 1999*, Division 2, Part 2.

20 *The Australian Cane Farmer*, July 2014, p. 3, http://www.acfa.com.au/wp-content/uploads/2013/05/ACF_July-2014-e-webnew.pdf (accessed 9 April 2015).

industry. It is also a tax exempt, not for profit entity and, as such, it is not permitted to distribute profits to its members.²¹

2.19 The primary activities currently undertaken by QSL include:

- acquiring raw sugar intended for bulk export from Queensland mill owners under the Raw Sugar Supply Agreements (RSSA) (These are discussed below);
- selling the raw sugar acquired to international customers;
- chartering shipping for the raw sugar acquired;
- financing and hedging activities related to that raw sugar;
- sub-leasing, operating and providing storage and handling services at the six bulk sugar terminals; and
- conducting other initiatives considered to be in the best interests of the Queensland sugar industry.²²

2.20 When the Queensland sugar industry was deregulated in January 2006 (see below), QSL entered into voluntary agreements with the majority of Queensland mills to market their export raw sugar. The company currently has RSSAs with each of the seven Queensland mill owners under which each of the mill owners supply 100 per cent of their raw sugar production intended for bulk export to QSL. QSL is therefore responsible for more than 90 per cent of all raw sugar exported from Australia. Raw sugar for domestic supply (or exported in bags or containers) is not supplied under the RSSA and marketing can occur independently of QSL.²³

2.21 QSL undertakes export sales direct to raw sugar refiners in a number of countries. Proceeds are pooled for payment purposes and distributed back to mills and growers after being adjusted for marketing costs incurred by QSL. With the pooling of sales proceeds, producers receive an average of prices received from sales during the course of the year.²⁴

2.22 Returns to producers are determined primarily by the world futures price for sugar but are also influenced by the level of the Australian dollar, regional sugar premiums and the costs of marketing and transporting the product.²⁵

21 Queensland Sugar Limited, *Submission 16*, p. 10.

22 Queensland Sugar Limited, *Submission 16*, p. 10.

23 Department of Agriculture, <http://www.agriculture.gov.au/ag-farm-food/crops/sugar>, accessed 30 March 2015.

24 Department of Agriculture, <http://www.agriculture.gov.au/ag-farm-food/crops/sugar>, accessed 30 March 2015.

25 Department of Agriculture, <http://www.agriculture.gov.au/ag-farm-food/crops/sugar>, accessed 30 March 2015.

2002–2005 – industry reviews

2.23 In the early 2000s, successive reviews of the Queensland sugar industry concluded that the regulatory system established under the Sugar Industry Act stifled the industry's productivity. The consistent message coming from the reviews was that the regulatory system 'created a set of formal and informal rules – called the principle of adverse effects – which have the effect of blocking productivity gains'. It was also found that the system created antagonism between growers and mill operators and fostered a resistance to change, which together hindered productivity and diminished innovation.²⁶

2.24 In response to these reviews, a Memorandum of Understanding (MOU) was signed in 2005, between the Queensland sugar industry – represented by the Australian Sugar Milling Council and CANEGROWERS – and the Queensland Government. The MOU noted that all parties recognised that 'the future cannot simply be an extension of the past and that previous assumptions driving production and structural arrangements need to be changed'.²⁷ Industry agreed to move to a commercial, non-legislative marketing structure and the state government agreed to introduce the necessary legislative amendments to support the structural changes.²⁸

2006 – Industry deregulation

2.25 On 1 January 2006, the Sugar Industry Act was amended to deregulate the sugar industry. The new legislation included two significant deregulation measures.

Parties are free to determine contractual terms – including price

2.26 The legislative amendments included changes to the arrangements between growers and mill operators. The amended legislation requires growers and mill operators to enter into contracts for the supply of sugar cane, but does not prescribe matters to be addressed in them.²⁹ In other words, the new legislation created a framework for the sale of sugar cane, but left the parties free to determine contractual terms.

26 Sugar Industry Reform Bill 2004, Explanatory Notes, pp 2–4.

27 Memorandum of Understanding between the Queensland sugar industry and the Queensland government, 13 October 2005, https://www.daf.qld.gov.au/_data/assets/pdf_file/0006/75903/Sugar-Memorandum.pdf (accessed 9 April 2015).

28 Memorandum of Understanding between the Queensland sugar industry and the Queensland government, 13 October 2005, https://www.daf.qld.gov.au/_data/assets/pdf_file/0006/75903/Sugar-Memorandum.pdf (accessed 9 April 2015).

29 *Sugar Industry Act 1999*, s.31 (as amended in 2006).

2.27 In line with the move to a commercial, non-legislative marketing structure, the parties to the contract were left to determine the terms of sale – including the formula for setting the cane price.³⁰ The new legislation also removed the 'cane production area' restrictions, thereby providing cane growers with choice in relation to which mill to supply.³¹ As indicated by a number of stakeholders throughout this inquiry, however, growers are effectively restricted in relation to their choice of mill because cane has a very limited shelf life once harvested.³²

2.28 The 2006 reforms distinguished 'sugar cane' from 'sugar'. The supplier of sugar is taken to be the person who owns the sugar cane at the moment the cane is used to manufacture raw sugar.³³ The Australian Cane Farmers Association (ACFA) has reported that contracts between cane growers and mill operators commonly transfer ownership of the cane from the point of delivery at the mill. In this scenario, it is the mill operators who own the sugar cane at the time it is processed into raw sugar.³⁴

Export restrictions removed

2.29 The 2006 deregulation reforms also removed restrictions on the marketing of raw sugar for export. While QSL would continue to be the industry's preferred bulk raw sugar export marketer, the legislation was amended to no longer prohibit others from marketing raw sugar for export.

2.30 QSL currently operates within a commercial environment under contractual arrangements with suppliers. These contracts are known as raw sugar supply agreements (RSSAs). Under the new legislation, QSL became a public company limited by guarantee – and while it has grower representative members and mill representative members, its contracts for the sale of raw sugar are with Queensland's mills and not with sugar cane growers.³⁵

2.31 QSL operates a pooling system, whereby profits are divided by mill owners on a contribution percentage basis.³⁶ There are a number of pricing pools, each with separate levels of costs and risks. QSL argued that sugar cane supply contracts may

30 CANEGROWERS, *Cane payment information*, http://www.canegrowers.com.au/page/Industry_Centre/grower-centre/Finance_tools/Cane_payment_information (accessed 19 April 2015).

31 Sugar Industry Reform Bill 2004, Explanatory Notes, p. 4.

32 See, for example, MSF Sugar Limited, *Submission 8*, p.1, Queensland Sugar Limited, *Submission 16*, p. 2 and Tully Cane Growers Ltd, *Submission 26*, p. 1.

33 *Sugar Industry Act 1999*, Schedule (as amended in 2006).

34 *The Australian Cane Farmer*, July 2014, p. 3, http://www.acfa.com.au/wp-content/uploads/2013/05/ACF_July-2014-e-webnew.pdf (accessed 9 April 2015).

35 Queensland Sugar Limited, *Submission 16*, p. 1.

36 Queensland Sugar Limited, *QSL value offering*, March 2014, p. 2.

provide cane growers the right to influence price risks by allowing cane growers to select which of its pricing pool (or pools) the mill will access.³⁷

Grower Economic Interest Sugar (GEI) and Supplier Economic Interest Sugar (SEI)

2.32 The committee received conflicting evidence regarding the concepts of GEI³⁸ and SEI, which refer to a residual interest by the grower and the miller, respectively, in the final price achieved for raw sugar. Contradictory evidence, underpinned by different interpretations of the two concepts, as well as their real-world operation in the market, made a consistent, accurate understanding of their relevance and role difficult for the committee to achieve.

2.33 QSL, for example, told the committee that, traditionally, 'mill owners receive one third and growers two thirds of the net returns achieved, through the cane payment formula for deriving the cane price which existed prior to deregulation and continues generally to be used'.³⁹ Further, it was argued that this situation is reflected by the terms 'supplier economic interest sugar' and 'grower economic interest sugar'.⁴⁰

2.34 The committee was told that the relevant proportion of SEI and GEI varies for each mill, and depends on a number of variables, including whether mill owners grow their own cane, and the terms of its CSAs. Generally, however, SEI sugar is anticipated to be between 33 and 50 per cent.⁴¹

2.35 In December 2013, seven mill owners entered into new RSSAs with QSL. Under the new arrangements, mills were provided the right to elect to market the proportion of the raw sugar they supply to QSL. Under these arrangements, the mill retains the pricing exposure under the cane payment formula, in accordance with their respective cane supply agreements (CSAs) with cane growers (that is, each mill's SEI sugar).⁴²

2.36 QSL submitted that during the 2014 season, this option was exercised by Wilmar, MSF Sugar, Mackay Sugar and Tully Sugar. For each of those suppliers, QSL sold back to the supplier (or a related body corporate) a volume of raw sugar

37 Queensland Sugar Limited, *Submission 16*, p. 13.

38 During the inquiry, various terms were used to refer to 'GEI sugar' - including 'a growers' nominal sugar price exposure' or 'cane pay sugar' which essentially refer to how much raw sugar needs to be priced and marketed to determine the price paid for the cane a grower supplies and accordingly refer to the GEI in the final product marketed.

39 Queensland Sugar Limited, *Submission 16*, p. 13.

40 Queensland Sugar Limited, *Submission 16*, p. 13.

41 Queensland Sugar Limited, *Submission 16*, p. 13.

42 Queensland Sugar Limited, *Submission 16*, p. 1.

reflecting its SEI, which the companies could then market themselves or on-sell again to others in the market.⁴³ As a consequence, several entities are marketing raw sugar for export, including QSL, Wilmar, Copersucar, MSF Sugar and China Foods.⁴⁴

2.37 From the perspective of growers, the Australian Canegrower magazine confirmed that the RSSA between Wilmar and QSL describes growers' share of sugar as 'growers economic interest (GEI) sugar'. According to the magazine, under the RSSA, given that RSSAs now allow mills to market their SEI sugar, it has been argued that 'the next logical step is for growers to have the same rights to choose who sells their GEI sugar'.⁴⁵

2.38 The evidence provided by the milling sector offered a different perspective in relation to the concept of GEI sugar. Wilmar, for example, acknowledged that growers 'have an underlying exposure to sugar price' and therefore 'an interest in the price that millers receive for the sale of their sugar production'. It noted, however that the growers' interest in the price that millers achieve does not translate to growers having any title or ownership of the sugar produced by a mill. Wilmar in fact suggested that the term 'GEI sugar' first appeared in 2014, in the RSSA between millers and growers. Wilmar argued that the term was initially defined with the intention of determining the amount of SEI sugar; being that portion of the total sugar a miller supplies to QSL, and which QSL agrees to sell back to that miller (an amount of approximately one third) to enable them to directly manage the physical sales to end customers.⁴⁶

2017 – Anticipated future changes to the marketing structure

2.39 QSL have advised that three mills – Wilmar, MSF Sugar and Tully Sugar – have given notice to terminate their RSSA agreements with QSL in 2017.⁴⁷

2.40 The concepts of SEI and GEI, together with current and anticipated changes to the marketing structure post 2017, which see millers take on an export and marketing role (formerly solely undertaken by QSL), are at the heart of the committee's inquiry. The possible consequences of the changes, and the concerns raised by stakeholders are examined in more detail in Chapter 3.

43 Queensland Sugar Limited, *Submission 16*, p. 13.

44 Queensland Sugar Limited, *Submission 16*, p. 14.

45 *Australian Cane Grower*, 9 June 2014, p. 7, http://www.CANEGROWERS.com.au/icms_docs/205070_australian_canegrower_2014-06-09.pdf (accessed 17 April 2015).

46 Wilmar Sugar Australia Limited, *Submission 10*, p. 18.

47 Queensland Sugar Limited, *Submission 16*, p. 14.

