

Livestock Feed Grain Users Group

23rd February 2006

Committee Secretary
Senate Rural and Regional Affairs and Transport Committee
Parliament House
Canberra ACT 2600
rrat.sen@aph.gov.au

Dear Sir / Madam

Re: Submission to the inquiry into Fuel Issues

Attached find the Livestock Feed Grain Users Group Submission to the above mentioned inquiry.

Yours sincerely



Chair
Livestock Feed Grain Users Group

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Submission



Inquiry into Fuel Issues

by the

**Senate Rural and
Regional Affairs and
Transport Committee**



**Livestock Feed Grain
Users Group (LFGUG)**



22nd February 2006

PURPOSE

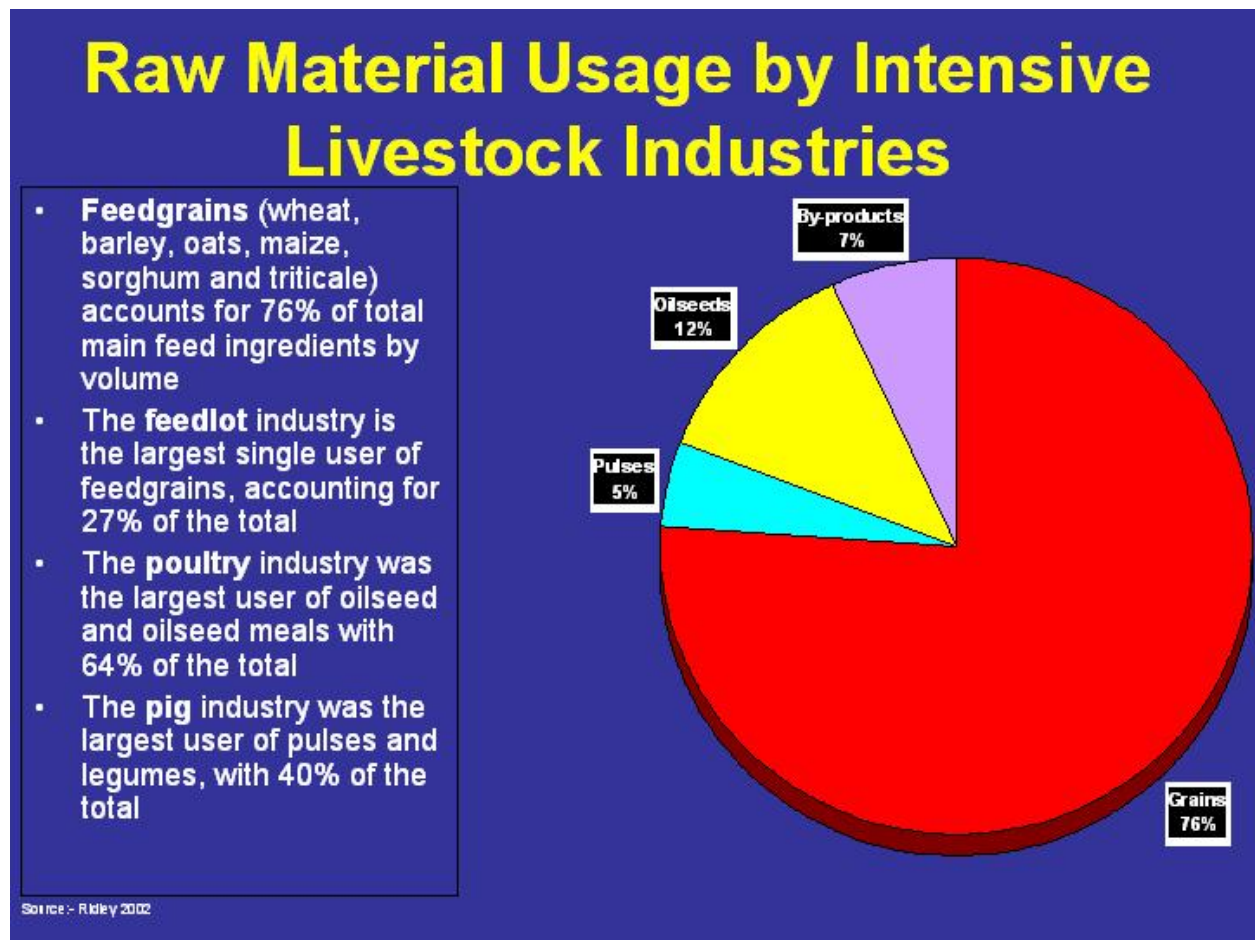
This submission focuses on one of the committee's terms of reference. i.e.: potential of new sources of oil and alternative transport fuels to meet a significant share of Australia's fuel demands, taking into account technological developments and environmental and economic costs.

This submission is specifically concerned with the issue of government support for grain based ethanol manufacture in Australia. Our industries are grain dependent, and have a large stake in this issue.

EXECUTIVE SUMMARY

This submission is prepared by the Livestock Feed Grain Users Group (LFGUG), a group of the major grain dependent intensive livestock industries (pork, cattle feedlots, dairy and poultry products).

The following chart shows the dependency of our industries on grain based feeds



LFGUG has a large stake in the debate on transport fuel policy in Australia, since government subsidies to foster domestic production of grain based ethanol distort the Australian feed grain market to the detriment of our industries. This is a view that is consistent with the findings of three successive reports carried out in 2003, 2004, and 2005 by ABARE, and, most recently, the Biofuels Taskforce (hereafter referred to as the Taskforce) set up by the Prime Minister.

We are not opposed to the production and use of biofuels in Australia. We are opposed to the ongoing subsidisation of grain based ethanol in Australia; this will disadvantage our grain dependent industries, and result in the propping up of an essentially non viable industry at the expense of successful industries.

Transport fuel policy should not be confused with industry assistance. If greater liquid fuel self sufficiency is sought, it should not be at the expense of existing agricultural industries that have proven viability, compete in global markets, and have the capacity to contribute to economic growth. Our industries are major employers, and wealth creators, in regional Australia. Subsidy induced diversion of grain to ethanol manufacture, taken with grain import restrictions and a highly variable climate, jeopardises our access to feed grains across a range of seasons. The Taskforce referred to above concluded "to the extent that this production is stimulated artificially by government assistance, there will be other possibly unforeseen regional impacts. For example, an assisted biofuels industry may increase grain prices at a cost to some domestic livestock industries which are heavily dependent on these feed stocks. This may be especially so around times of shortage due to drought, given the difficulty or cost of importing grain under strict quarantine requirements".

It is unclear whether, under Australian agronomic and transport conditions, cropping for ethanol manufacture is a significant net energy producer. US studies have drawn mixed conclusions on this subject, even though US corn crop yields are consistently much higher than feed grain yields in Australia, and we do not have the benefit of the lower transportation costs prevalent in USA. An independent study of net energy yield, from paddock preparation to final ethanol manufacture, under Australian conditions is planned to be commissioned within LFGUG.

Our submission points out the fundamental differences between the circumstances of the Australian economy, and our rural sector, compared to ethanol producing countries such as Brazil, USA and EU member states. Australia is a net energy exporter, benefiting from higher oil prices. Our grain production base is fragile, and variable. We are a minor grain producer in the global context, and we do not have the huge exportable surpluses of grain that the USA does, or the reserves of arable land that Brazil has utilised for cane based ethanol. The Australian grain belt is a long, but quite narrow, area of land in Eastern Australia, and in Western Australia. It is circumscribed by a rapid fall off in the average volume, and reliability, of rainfall further inland, and by urbanisation, disease and other agronomic factors closer to the seaboard.

The area planted to grain in Australia has plateaued, and Grains Council of Australia forecasts a long term decline. Production increases have relied on higher yields in traditional grain growing regions rather than expanding into less sustainable regions.

The grains industry and LFGUG have agreed to cooperate to develop longer term ways of improving the security of feed grain supplies in Australia. Stimulating the feed grain supply response to growing demand from livestock industry customers to ensure adequate supplies, within sound environmental parameters, will be challenging enough without the distortions attributable to ethanol subsidies.

LFGUG submits that current ethanol subsidies, in particular the ethanol excise concession, should run their course. If the ethanol industry has not responded to this support by 2011, and cannot compete with imported product subsequently, it is not a viable transport fuel option for Australia, at least on a large scale basis.

The option of mandating ethanol content in transport fuel would be, as the former Chairman of the Government's 2002 fuel tax inquiry recently commented, about the worst type of public policy that could be imagined

OUR PROPOSALS

We request that this Committee:

- recognises that Australia has distinct differences to countries such as Brazil, USA and EU member states in the impact of oil prices on our economy, and in our capacity to redirect grain to fuel production.
- affirms its support for the Government policy that the current taxation concessions to ethanol producers phase down within the current timetable.
- opposes the concept of ethanol mandating in Australia.
- supports the conclusions of the 2005 Biofuels Taskforce that there are insufficient grounds to justify further government intervention in the ethanol industry beyond ensuring a "level playing field" (however, see our comments later).
- supports the role of Government in fostering research into new technologies that may offer viable alternatives to fossil oil that do not compromise existing viable industries.

VIABILITY OF ETHANOL IN AUSTRALIA

The concept of using grain based ethanol as a transport fuel in Australia is not new. It has been discussed for several decades, and there is limited ethanol production in Australia. The problem is that ethanol production is not viable on a large scale without ongoing Government support.

The Biofuel Taskforce, chaired by John Keniry, drew on a very large body of expert analysis in preparing its 2005 report to the Prime Minister. This expert advice, the findings of the 2002 fuel tax inquiry, three successive ABARE reports (in concert with other agencies) on biofuel viability in Australia; and an earlier paper on this subject prepared by the Commonwealth Parliamentary Library.

Non government analysis includes a 2005 paper prepared by the respected Centre of International Economics on the potential impacts of ethanol mandating on Australian livestock industries, and a 2003 report prepared by Macarthur Agribusiness on feed grain security in Australia.

The Taskforce concluded that "globally, and in the absence of subsidies, biofuels cost more to produce than petroleum fuels. ABARE analysis suggests that Australian biofuels will generally remain uncompetitive with conventional fuels without continuing assistance in the longer term. Depending on market conditions, exceptions could be biofuels that are produced by existing plants with sunk costs, or biofuels made from wastes".

The Taskforce stated that government assistance to biofuels producers in the form of capital grants and excise concessions involved substantial costs to the economy "because government assistance changes the relativities between the activity that is assisted and other activities that add value to the economy". Each job in the biofuels industry created by government subsidies was estimated by the Taskforce to result in an annual loss of national income of an extraordinary \$111,000.

The Taskforce discussed possible benefits from biofuels that had been put to it, i.e.:

- improved public health
- reduced emissions of greenhouse gases
- import substitution or kick starting a new industry
- improved energy security
- regional development

The Taskforce report contains comprehensive commentary on the above "benefits" and was not persuaded that the above claimed benefits justified further government support for the industry. However, having reviewed all the material in front of it, including many submissions, the Taskforce came to the view that, in effect, committed assistance to ethanol producers was water under the bridge, and that "irrespective of whether the costs of assistance to biofuels exceed the benefits of the programs, it is important to ensure that existing and potential industry participants are given every fair chance of success".

The Prime Minister subsequently announced a range of steps after meetings with oil companies to reduce so called barriers to biofuel uptake.

POST TASKFORCE DEVELOPMENTS

The LFGUG welcomed the Government's decision following the report not to extend further assistance to biofuel producers. We are, nevertheless, concerned that pressure may be applied to oil companies to promote the use, and purchase, of ethanol beyond levels that would make commercial sense.

To elaborate on the above point, the 2011 biofuel usage target of 350 megalitres has now evolved into a formal commitment, and has been the fulcrum to lever oil companies (who as a regulated industry are vulnerable to such pressure) to step up ethanol purchase commitments. In its ACT trial outlets, BP has retail labelling claiming ethanol is good for the environment, and for Australia. Since Senior Ministers were publicly associated with the launch of that trial, we presume that such public claims have official sanction. However, we are not aware of regulatory approval for this retail labelling.

The Prime Minister has committed the Commonwealth car fleet to use ethanol, but no information is available, as far as we are aware, on any contracts that may have been entered into with oil companies for that purpose.

There has also not been any public release of the "action plans" discussed between Government Ministers and oil companies, and which form the basis of the projected increases in oil company purchases of biofuels to 2011 as announced by the Prime Minister on 22 December 2005. Since company purchasing intentions have been linked to the fulfilment of government policy targets, the public has every right to be informed of any government undertakings that may have influenced those plans.

By "government" we include State Governments which, in some cases, have added to the subsidies available to ethanol producers. The Queensland Government has a policy of national mandating of ethanol content, and has made various grants available to ethanol producers and distributors. The NSW Government supports ethanol mandating, and, as with the Queensland Government, requires ethanol to be used in its car fleet.

The net effect of the above is a lack of transparency in the assistance available to ethanol producers, and a fragmented approach to transport fuel policy across governments.

ETHANOL SUBSIDY CLAIMS AND REALITIES IN AUSTRALIA

The proponents of further ethanol subsidies, including mandating, in Australia, typically claim regional development and balance of payments benefits from such policies. These claims are based on misconceptions.

Australia is a net energy exporter. To reduce growth in national income (see earlier) through ethanol subsidies to foster import substitution is bad policy. Moreover, it should be clearly understood that from 2011 imported ethanol, which on current indications will be much cheaper than the Australian product, will have open access to the currently protected Australian market.

The following table shows the scheduled changes to the biofuels taxation regime:

ETHANOL SOURCE	2005-2010	2011	2012	2013	2014	2015
Domestic Producers						
Gross excise paid	38.143 c/l	NA	NA	NA	NA	NA
MINUS PRODUCTION RATE	38.143 c/l	grant will probably cease, being replaced by lower net excise below				
Equals net tax payable	Nil	2.5 c/l	5.0 c/l	7.5 c/l	10.0 c/l	12.5 c/l
Imported Ethanol						
Gross excise paid	38.143 c/l	2.5 c/l	5.0 c/l	7.5 c/l	10.0 c/l	12.5 c/l
COMPETITIVE TAX ADVANTAGE OF DOMESTIC PRODUCERS	38.143 c/l	Nil	Nil	Nil	Nil	Nil

The claims that subsidised ethanol plants will revitalise the grains industry do not stand up to close scrutiny.

There is no ongoing surplus of feed grains in Australia. While production fluctuates with the seasons, the area planted to all grains in Australia has plateaued over the past couple of decades. Increased yields are responsible for the upward trend in wheat production.

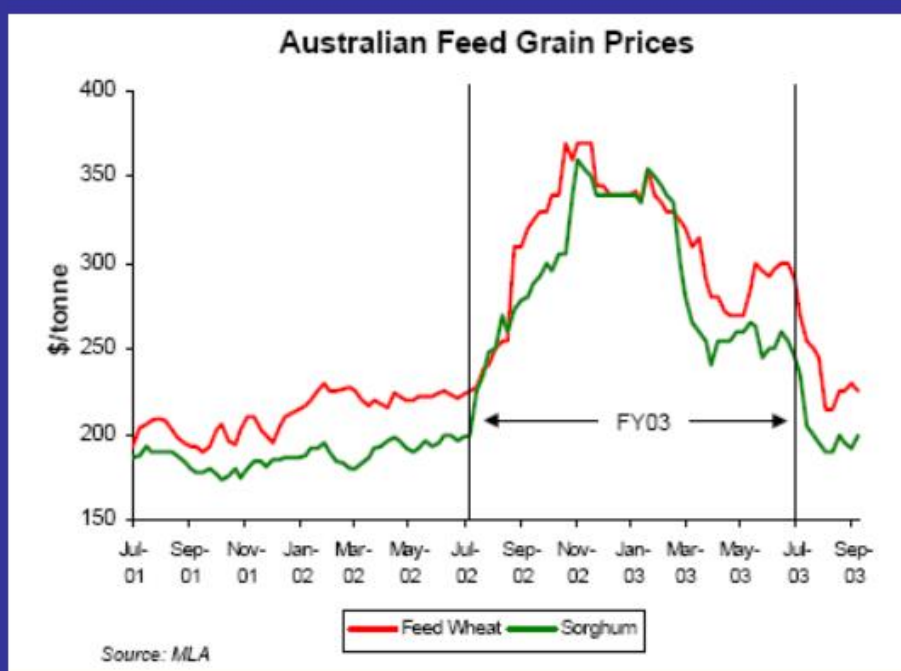
Within the limited area of Australia suitable for crop production, alternative land uses compete for capital, water and land. In the summer rainfall zone, plantings of cotton have increased markedly. Since the mid 1970's cotton plantings have increased from less than 8000 hectares to over 150,000 hectares in Queensland with a similar increase in NSW where cotton plantings are of similar size. Over this period sorghum production has not shown any significant upward trend, and in drought years the margin between domestic demand and supply is worryingly narrow; in 2002/3 Australia exported a miniscule 70,000 tonnes of sorghum. These shifts in

land use have taken place despite a doubling of the nominal price of sorghum over that period, and must reflect the relative profitability of those alternative land uses.

Subsidised ethanol plants may, in the short term create regional grain shortages, and force up local prices as grain has to be freighted in for livestock customers. This instability would be accentuated in drought years, and is at the heart of our opposition to ethanol subsidies. The 2005 CIE report referred above calculated that the co-existence of large scale subsidised ethanol output in Australia and drought, as well as the current grain import restrictions, would result in rapid escalation of feed grain prices in Australia well above import parity for a period until market forces resulted in some downward adjustment.

In fact, this is what happened in the 2002/3 drought, as shown in the following graph.

Drought Increases Feedgrain Prices but Once Import Parity is Reached Imports Cap Future Price Rises. A return to "normal seasons" brings price back to trend



It is illusory to assume that over an extended period feed grain prices in Australia can be forced up to a sustainable level substantially above global levels. This is the rationale for arguing that ethanol subsidies will expand grain output. How could livestock industry customers stay in business against global competitors in such a scenario? Why would customers with access to imported grain, in particular poultry

companies with seaboard processing facilities, purchase Australian grain under such circumstances?

Since domestic feed grain production has not kept pace with the growth in demand from livestock industries a concerted effort is needed to improve the productivity of feed grain farming, and to better prepare for recurrent droughts that may become more frequent and severe as climate change occurs. There is already a grain shortage in eastern Australia every three years on average due to drought.

The LFGUG and the Grains Council of Australia have agreed to work together to improve feed grain security in Australia. We will address issues such as the accelerated development of improved feed grain varieties; more efficient interstate transport, and enhanced drought impact modelling.

DISSIMILARITIES WITH OVERSEAS ETHANOL POLICIES

We acknowledge that ethanol policies of other countries are often seen as useful precedents for Australia. In fact, there are fundamental differences between circumstances in Brazil, USA and EU member states.

Australia is a net energy exporter. Our economy is a net beneficiary of higher oil prices, although not all sectors share those benefits.

Brazil has been able to bring vast new areas of arable land into sugar cane production for ethanol production. We are not similarly placed.

USA has a consistently huge exportable surplus of maize and, while we are not attempting to justify diverting maize into transport fuel, USA has a huge and growing balance of payments deficit due, in sizeable measure, to imported oil.

EU agriculture is widely subsidised, and there is probably a certain logic in diverting those subsidies to the replacement of imported oil.

Even if we wished to do so, we have no practical capacity to produce grain based ethanol to E10 or even E5 levels without serious distortions to the rural economy.

The LFGUG will separately make available to the committee further analysis on these points at a later stage.

CURRENT ETHANOL PURCHASING INTENTIONS BY OIL COMPANIES

In his 22 December 2005 statement on biofuel uptake in Australia, the Prime Minister reported that the oil companies had advised the Government that by 2010 they intended to purchase between 403 and 625 megalitres of all biofuels, including ethanol. These purchasing intentions are qualified, as they are conditional upon competitive pricing, and an increase in consumer confidence.

With those qualifications, domestic sales of biofuels are expected to be between 403 ML and 625 megalitres by 2010. Since the Taskforce reported investment plans to produce around 1,000 megalitres by that date, it is clear that a major part (40%-60%) of planned investment will not take place by 2011.

Our concern is that as the limited level of demand becomes apparent and the era of import protection runs out, political pressure will increase for ethanol mandating, or an extension of the current period of excise rebate. Such pressure should be resisted; if Australian ethanol is not viable after the allocation of start up grants, and further start up assistance through the excise rebate, it would be foolish to extend further support which must be at the expense of our industries.

ETHANOL AS AN ENERGY SOURCE AND STOCK FEED RATION

Various US studies have assessed the net energy yield of ethanol from planting to ethanol manufacture, i.e. how much fossil energy is consumed to produce corn based ethanol.

These studies have resulted in mixed conclusions, ranging from a Cornell University study finding that ethanol is a significant net consumer of energy to USDA studies that, by factoring in the value of ethanol biproducts, conclude it is a net energy producer to the extent of around 40%. It is important to note that these studies are based on benign US growing conditions in the US corn belt, where yields are the beneficiaries of rich soils and reliable rainfall, and where transport costs are lower than in more sparsely populated Australia. No equivalent studies under Australian conditions have yet been carried out. Note that the LFGUG is proposing to carry out such a study within its membership.

US reports indicate that wet distiller's grain, and to a lesser extent dry distiller's grain, as biproducts of ethanol manufacture, are useful components of the cattle feedlot ration. While there is limited experience with these products in Australia, it is self evident that the extraction of energy from grain for fuel results in a loss of residual grain energy. While distillers grain may well be another protein feed option, it is not a substitute for whole grain. Animal growth requires energy, as do transport vehicles.

OTHER ASPECTS OF ETHANOL

We are not qualified to judge the various claims about the environmental qualities of ethanol that could, theoretically, justify government subsidisation.

As mentioned above, the Taskforce examined this issue in great detail and came to the view that such qualities were not sufficient to warrant further government support for ethanol production.