



CANEGROWERS ISIS

48 Churchill Street Childers 4660
PO Box 95 Childers 4660
Phone (07) 4126 1444 Fax (07) 4126 1902
iss@canegrowers.com.au

18th August 2016

Australian Productivity Commission

Regulation of Australian Agriculture Public Enquiry

Locked Bag 2, Collins Street

MELBOURNE VIC 8003

By email: agriculture@pc.gov.au

Dear Commissioner,

**Re: Regulation of Australian Agriculture Public Enquiry
Draft report on the "Regulation of Agriculture"**

Thank you for the opportunity to provide our submission in relation to the Australian Productivity Commissions' Draft report 'Regulation of Agriculture'.

Canegrowers Isis have reviewed the Draft report and whilst we remain neutral across a range of the commission's recommendations, we provide this submission to express our serious concerns for a number of the assumptions and ultimately conclusions in relation to Competition Regulation (Chapter 11). Of particular concern is the regulation of sugar marketing in Queensland, from our review it appears that the commission may have incorrectly assumed or been ill advised on a number of factors relating to:

1. Statutory marketing;
2. Protecting Competition;
3. Collective bargaining;
4. Economic Interest in sugar;
5. Premiums; and,
6. Economies of scale.

To address our primary concerns and ensure the commission are aware of the mitigating facts to facilitate fair consideration in determination of viable outcomes for sugar marketing we have outlined the relevant arguments over.

CANEGROWERS Isis Limited implores and strongly recommends the Productivity Commission remove draft recommendation 11.2 'The Queensland Government should repeal the amendments made by the Sugar Industry (Real Choice in Marketing) Amendment Act 2015' of the Draft report on the Regulation of Agriculture be removed from the report.

Should you wish to further discuss CANEGROWERS Isis' stance on removal of draft recommendation 11.2 we warmly welcome your direct contact.

Sincerely,

Donna P Sheehy
Manager
CANEGROWERS Isis

1. Statutory Marketing

Actual or potential introduction of new statutory marketing arrangements in Queensland's sugar industry and re-regulation of international marketing of Australian sugar are not provided by 'The Real Choice in Marketing' amendments as suggested in the Commissions draft report.

The Act does not compel sugar mills or supplying cane growers to any course of action, the Act merely describes a minimum default position, "unless the grower and mill owner otherwise agree"¹. This default ensures that there are appropriate protections for growers against the potential abuse of market power by mills. As such, the Act, in its current form facilitates negotiations and encourages growers and mills to reach agreement. Repealing the Act would not enable consolidation and productivity gains, nor would it enhance the international competitiveness of the sugar industry. In turn, competition for the provision of raw sugar marketing services will provide the discipline on all raw sugar marketers to continually strive to improve their performance both domestically and internationally whilst lifting productivity and lowering costs.

Growers are free to nominate the mill they supply and unless they specifically choose otherwise any other provider of marketing services. This freedom of choice enables and protects competition in the provision of marketing services. This is very different to previous arrangements that provided a package of inter-related regulations including the compulsory acquisition of raw sugar on its production and the requirement that the acquired sugar be sold through a single marketing company to the exclusion of all others.

2. Protecting Competition

The net market value of GEI sugar flows 100% to the growers through their payment for cane. Mills receive no share of this value. Correspondingly, the value of mill economic interest (MEI) sugar flows 100% to the mills. Growers receive no share of this value.

The Act establishes the vital framework that protects growers' and millers' rights to deal with their respective economic interest sugar and provides each party individual choice for the marketing services that best suits their needs. This framework ultimately encourages competition in the provision of those marketing services. In the same respect, should the growers choose to do so they retain the choice of selecting the mill they supply to provide marketing services, this is a choice provided by the Act and as such the Act does not compel choice and the mill marketing services are provided as the default.

The Act is not designed to and does not protect any corporation. It protects competition by enabling choice and the right to choice. Choice is an essential and critical requirement for competitive markets to evolve. Competition in turn drives innovation and provides incentives for service providers to target the needs of their clients more closely than would otherwise be the case.

By providing protection against abuses of market power, the Act's framework will support growers' confidence to invest in the sugarcane industry, will boost the industry's long-term economic sustainability and promote growth.

Competition can be seen to drive innovation and productivity, conversely uncontrolled competition can strangle innovation and devalue productivity. Left unbridled competition can drive environmental degradation, monopoly development and ultimately industry disarray.

¹ *Sugar Industry (Real Choice in Marketing) Amendment Act 2015 (Qld)*, Section 33B.

3. Collective Bargaining

Mills and growers do not meet at negotiation on equal footing. Although the Act makes provision for the use of collective bargaining in the negotiation of cane supply agreements, it is not sufficient alone to offset the imbalance in marketing power between millers and growers.

Many mills are large corporates with deep pockets that can sustain long negotiations whilst the majority of sugarcane farms are small family held operations. Sugar cane being a low value, high volume perishable product that must be processed within twelve hours of harvest leaves cane growers vulnerable to industrial actions and delays. Given the significant investment by growers in specialised on-farm equipment and farm layout, suited only to sugarcane production, most growers have no viable alternative outlet for their cane and economic capacity to change land use practice, as such the grower remains captive to the mill they supply.

The relationship between grower and mill is not symbiotic, rather it verges on being parasitic toward the grower. With businesses to operate, families to sustain and fewer financial resources at their disposal, cane growers have a low appetite for and limited ability to engage in collective boycotts withholding supply from the mills. This reality limits the effectiveness of collective bargaining as an offset to mill market power, leaving the risk for market failure unchecked.

Although the performance of different marketers can change from one season to another, it is important that growers and mills can choose the marketing option that matches their circumstances and risk profile.

4. Economic Interest in Sugar

Unlike many other agricultural producer's sugarcane growers retain a long line economic interest in the price of the cane they grow. This economic interest is retained well beyond title change of the cane at the mill. The interest is retained through milling and onto bulk sugar storage by the designated raw sugar marketers for final sale.

As change of title does not extinguish the economic interest that either growers or mills have in the sale of the raw sugar the growers price of sugarcane is directly linked to the market price of raw sugar. The flow of title merely permits the sale and associated price risk management activities to proceed with raw sugar used as the basis of futures market transactions and as collateral for financing marketing, advance payment and related activities.

With growers retaining a clear and direct interest in the net proceeds derived from the sale of raw sugar, longstanding arrangements for cane payment were devised to allocate net proceeds from sugar sales between millers and growers. This system ensured fairness by apportioning relevant risk and profit on roughly the ratio of the assets and costs of production for both grower and miller. The current two-thirds attributed to growers and one-third attributed to the miller assumes base levels of industry efficiency. In its design, the payment system also provides economic incentives to both growers and mills with the grower's incentive to maximise the amount of commercially recoverable sugar in each tonne of cane and Mills incentive to maximise the recovery of sugar from the cane.

There is no contention or dispute in the industry about the calculations or incentives contained in the cane payment arrangements.

To manage the futures component of their own raw sugar price exposure, pricing structures evolved in the early 2000's and arrangements were introduced to enable individual growers and millers to manage the futures component. To accommodate this innovation, the cane payment formula is used to calculate the amount of sugar mills have an economic interest in and the right to price and the amount of sugar growers have an economic interest in and right to price. With this change, the intent

of the original sharing has been largely preserved with approximately two-thirds of the sugar produced from a grower's cane apportioned to the grower for pricing and one-third apportioned to the mill.

In 2006, recognising the market price of sugar was determined by more than the hedged futures price, arrangements were further altered to enable mills to manage the marketing of all the sugar in which they held an economic interest. This change was partial deregulation because it did not provide growers with the same freedom to manage the marketing of the sugar in which they held an economic interest. By formally recognising grower economic interest sugar and providing growers with the ability to choose how that sugar is taken to market, the Act completes the deregulation process by protecting competition in the provision of marketing services.

5. Premiums

Choice in marketing has significant impact on the protection of some \$250M in premiums for quality supply of sugar. For example, at present the marketer has to be diligent at securing the 'Far East Premium' which accommodates the difference in freight charges for Australia Vs Brazil. It is unlikely that the foreign owners of QLD mills will pass this premium on when dealing with associated entities.

At present the Act provides incentive for industry owned Corporations, such as QSL, to match the premiums for growers and millers, as such the Far East Premium is passed onto growers as a gross payment without marketing costs removed. Foreign owned millers have no incentive to pass on the gross premiums and have potential to remove marketing costs and in effect remove the far east premium in it's entirety from the grower in the guise of stating a 'net premium.

The concept of a net premium is farcical and simply a manner of misleading growers with the impression that marketing costs should be deducted from a premium not related to costing.

The only manner in which premiums for quality Australian product can be realised is through giving growers their choice of marketer.

CANEGROWERS Isis disputes entirely the premise that grower choice could reduce returns to the industry by adding extra costs. We reiterate that the benefits of competition from two or more marketers will always outweigh the costs of capturing the freight differentials and other physical and quality premiums not identified under the millers proposal.

6. Economies of Scale

The Commission reports that the size of sugarcane farms in Australia is smaller than sugarcane farms in the United States. A comprehensive comparison of the sugar policies in the two countries was undertaken by LMC International² in 2015. LMC found, that in the first six months of 2015, the world raw sugar price averaged US 13.3 cents/lb (basis ICE No.11 nearby futures contract) while US raw sugar prices (behind the tariff wall) averaged US 24.6 cents/lb during the same the time (basis ICE No.16 nearby futures contract).

The significant premium in the US domestic sugar price over the world sugar price based on US tariff and import quota policies continues.

LMC observed, "With no import tariffs or quota restrictions, the Australian sugar industry is open to world market sugar imports and current sugar-specific support is limited to financial assistance to SRA. Beyond the assistance to SRA, the Australian industry receives no support in its domestic market and no support for its exports.

² LMC International (2015), A Comparison of the Sugar Policies in Australia and the United States, Report for: Australian Sugar Industry Alliance

In contrast, the US sugar market is governed by a complex supply management system. In normal circumstances, the US sugar supply management system supports US prices above the world price.

The cost of producing sugar is on average lower in Australia than in the US.

At the field level, LMC estimates costs per tonne of cane in Australia to average US\$36 (and range from US\$31-39 between the main cane-growing regions). The equivalent figures for the US cane and beet sectors are US\$41 (US\$35-45) and US\$57 (US\$53-59)^{3,4}

At the factory level, cane is milled first to produce raw sugar; it is then refined to produce white refined sugar. Beet sugar is produced only in white form.

Once milling costs are added, we estimate the following ex-factory costs per tonne of raw sugar in Australia and the US cane sectors: US\$350 (US\$330-400) and US\$430 (US\$350-500), respectively.

LMC estimate costs per tonne of white refined sugar to be: Australia – US\$440 (US\$410-490); US cane – US\$530 (US\$450-610); US beet – US\$460 (US\$430-560)⁵.”

CANEGROWERS Isis suggests that the difference in sugarcane farm size between Australia and the United States can be explained in large part by the differences in support structures received by the two industries.

An effect of the Act is to ensure growers are able to choose between marketing systems and select the system that offers an outcome that meets their needs and matches their risk profile. This will provide growers with a range of risk management tools and options that underpin their long term investment decisions. Whilst the Act may not guarantee new investment in the cane farm sector, its repeal would be certain to deter new investment.

Conclusion

CANEGROWERS Isis implores the commissioner to implement our recommendation that the Productivity Commission remove draft recommendation 11.2 *‘The Queensland Government should repeal the amendments made by the Sugar Industry (Real Choice in Marketing) Amendment Act 2015’* of the Draft report on the Regulation of Agriculture be removed from the report. By removing the Act the Australian Productivity Commission ultimately risks making the sugar cane growing sector and their assets unviable by leaving them vulnerable to the monopoly power of mills.

Freedom of choice is a key enabler of competition and innovation. The Sugar Industry (Real Choice in Marketing) Amendment Act 2015 (Qld) recognises the economic interest that both growers and millers have in the final sale price of sugar. It protects competition in the provision of marketing services by enabling both millers and growers to choose how their respective economic interest sugar is taken to market.

The Act facilitates negotiations and encourages growers and mills to reach agreement whilst providing for a minimum default position in the event that agreement cannot be reached. In this way the Act ensures that there are appropriate protections for growers against the potential abuse of market power by mills. The Act does not compel millers or growers to any course of action.

³ LMC’s cost estimates include cash operating costs plus an allowance for depreciation costs based on the full replacement cost of capital. We have not included any allowances for return on capital employed. Revenues from the sale of by-products are netted out of processing costs. Costs are presented for the latest completed crop year: 2014/15.

⁴ These costs include allowances for the cost of haulage to the processing factory.

⁵ Refining costs are based on the cost of refining at the cane mill. In Australia and the US, raw sugar is also refined at refineries located in consumption centres.