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Regulation of Australian Agriculture
Productivity Commission
Locked Bag 2, Collins Street
MELBOURNE VIC 8003

By email: agriculture@pc.gov.au

Dear Commissioner

Re: Response to the Commission draft recommendations on the regulation of agriculture

CANEGROWERS welcomes the opportunity to respond to the Productivity Commission's draft report "Regulation of Agriculture" and look forward to participating in the Commission's public hearing scheduled to be held in Brisbane on Wednesday, 24 August. Equally many of our regional representatives will be taking the opportunity to provide submissions and make representations to you at your hearing in Townsville.

CANEGROWERS has considered the draft report and supports many of the recommendations made. CANEGROWERS has made specific comments on selected recommendations and is neutral on the others. These are outlined below.
CANEGROWERS also supports the National Farmers Federation (NFF) and Queensland Farmers Federation (QFF) submission comments and recommendations.
In doing so we encourage your commission to consult further with the NFF in developing your final report.

We take the opportunity in this submission to point out that our industry has serious and grave concerns about the conclusions drawn in your draft report with respect to regulation of sugar marketing in Queensland. It appears that the Commission has not taken full account of the effect and likely impact of the *Sugar Industry (Real Choice in Marketing) Amendment Act 2015 (Qld)* (the "Act").

CANEGROWERS absolutely rejects Draft Recommendation 11.2 and the recommendation should be removed from the report.

CANEGROWERS is available to expand on any of the issues raised in this submission and is particularly keen to discuss draft recommendation 11.2.

If you have any further questions, please don't hesitate to contact our organisation.

Yours faithfully

Dan Galligan
CHIEF EXECUTIVE OFFICER

CANEGROWERS response to the Productivity Commission on the draft recommendations on the regulation of agriculture.

Competition regulation - *CANEGROWERS rejects Draft Recommendation 11.2 and the recommendation should be removed from the report.*

Statutory Marketing

The *Sugar Industry (Real Choice in Marketing) Amendment Act 2015* does not provide for either the actual or potential introduction of new statutory marketing arrangements in Australia's sugar industry in Queensland as suggested in the Commission's draft report nor do they re-regulate the international marketing of Australian sugar.

Based on the premise that growers and mills are partners in the Queensland raw sugar industry, sharing risks and rewards from the sale of raw sugar, the Act facilitates negotiations and encourages growers and mills to reach agreement. Not compelling sugar mills or their 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.

The Act does not mention QSL nor does it require growers to nominate QSL or any other marketer for the sale of Grower Economic Interest (GEI) sugar. Growers are free to nominate the mill they supply or any other provider of marketing services. It enables and protects competition in the provision of marketing services.

Competition in the provision of raw sugar marketing services will provide the discipline on all raw sugar marketers to continually strive to improve their performance, lift productivity and lower costs.

Mills have every opportunity to provide a competitive offer for growers to choose. However, without the Act they would be the only marketer available with no incentive to offer growers any benefit from innovative marketing.

This is very different to previous arrangements that provided a package of inter-related regulations including the compulsory acquisition of raw sugar which was sold through a single marketing company to the exclusion of all others.

Economic Interest in Sugar

Sugarcane growers produce sugar cane, harvest it and transport it to the mill delivery point. The miller then processes it and delivers the resultant raw sugar to the nearby bulk sugar storage facility before final sale. Title to the cane changes hands at the mill delivery point and, under previous and current structures, title of raw sugar is handed to the designated marketer at the bulk sugar storage facility.

This change of title does not extinguish the economic interest that either growers or mills have in the sale of the raw sugar. The flow of title merely enables 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.

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

With the price of sugarcane directly linked to the market price of raw sugar, growers have a clear and direct interest in the net proceeds derived from the sale of raw sugar.

The longstanding arrangements for cane payment were devised to allocate net proceeds from sugar sales between millers and growers so that profits were shared on roughly the ratio of their assets and costs of production, two-thirds to growers and one-third to the miller at base levels of industry efficiency. In its design, the payment system provides economic incentives to both growers and mills

- growers are given a clear incentive to maximise the amount of commercially recoverable sugar in each tonne of cane
- Mills are given a clear incentive to maximise the recovery of that sugar from the cane.

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

In the early 2000s, pricing structures evolved and arrangements introduced to enable individual growers and millers to manage the futures component of their own raw sugar price exposure. 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 statutory marketing structures were removed. In recognition that the market price of sugar is 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[2].

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 GEI 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.

Protects Competition

One hundred percent of the net market value of GEI sugar flows to growers through their payment for cane. Mills receive no share of this value. Similarly, one hundred per cent of the value of mill economic interest (MEI) sugar flow to the mills. Growers receive no share of this value.

The Act establishes a macroeconomic framework that protects growers' and millers' rights to deal with their respective economic interest sugar, enabling them to independently choose who provides the marketing services that best suits their needs. In doing so it provides for competition in the provision of those marketing services.

[2] The quantity of mill economic interest sugar is calculated as the total amount of all sugar produced *less* the amount of grower economic interest sugar.

Under the Act, growers are free to choose the marketing services of the mill they supply, should they wish to do so. The Act does not compel choice and the mill marketing services are the default.

The Act is not designed to and does not protect any corporation. It protects competition by enabling choice. The right to choose who provides marketing services. 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.

Collective Bargaining

Although the Act makes provision for the use of collective bargaining in the negotiation of cane supply agreements, this is not sufficient to offset the imbalance in marketing power between millers and growers.

As large corporates mills are able to sustain long negotiations. In contrast the majority of sugarcane farms are small family held operations. Sugar cane is a low value, high volume perishable product that must be processed within twelve hours of harvest. Growers have a significant investment in farm layout and highly specialised machinery suited only to sugarcane production. With no viable in-season alternative outlet for their cane and few economically viable alternative land uses, growers are captive to the mill they supply.

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 market failure unchecked.

It's interesting to note that in the 2015 season, the Wilmar sugar pool result was AUD35/t IPS lower than the result achieved by QSL in its equivalent pool. For the 2016 season, the 28 July progressive pool result reported by Wilmar is AUD72/t IPS lower than the equivalent QSL pool result.

Although the performance of different marketers can change from one season to another, this example demonstrates that growers can benefit from choice. The Act provides for this.

Structural Adjustment

The draft report suggests there is some evidence that the 2006 agreement between the industry and the Queensland government constrained structural adjustment and productivity growth in the sugar industry compared with the dairy industry, comparing growth in dairy milk yields with sugar yields.

In the period since 2006, there has been significant structural adjustment in the sugar industry. Several new mill owners entered the industry – in 2010 Wilmar purchased the sugar assets of CSR Limited and invested significant capital in restoring mill capacity and operational reliability; in 2011 the Foreign Investment Review Board approved the CoFCO acquisition of Tully Sugar; and, in 2012, Mitr Phol purchased MSF Sugar and followed this purchase with a substantial restructuring program. This included the closure of the Babinda mill, the associated optimisation of cane supply to the Mulgrave and South Johnstone mills and a significant capacity upgrade at the Tableland mill.

Industry marketing structures which existed at that time, were clearly not a deterrent to either the acquisitions or the subsequent investments in milling capacity, which were welcomed by cane growers across the state.

The sugar cane yield plateau has been a major concern for the industry since the mid-1970s[3]. There has been substantial research into yield decline since the mid-1970's and a farming system incorporating break crop (mostly legumes), reduced-tillage and controlled traffic has emerged this added to wide adoption of green-cane harvesting and trash retention is expected to provide a long term solution.

Added to this improving sugarcane yields through plant breeding and farm system development programs continues to a be a key focus of Sugar Research Australia's annual R&D budget of $33 million.

Structural change is not a prerequisite for the successful adoption of these initiatives.

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 International[4] 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.

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.

[3] AL Garside and MJ Bell (2006), Final Report - SRDC Project YDV002 Sugar Yield Decline Joint Venture Phase 2 (July 1999 – June 2006)

[4] LMC Internationa (2015), A Comparison of the Sugar Policies in Australia and the United States, Report for: Australian Sugar Industry Alliance

- 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)[5],[6]
- 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)[7]."

CANEGROWERS 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

The *Sugar Industry (Real Choice in Marketing) Amendment Act 2015 (Qld)* recognises the economic interest 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 freedom to choose is a key enabler of competition and innovation.

The Act does not compel millers or growers to any course of action. It facilitates negotiations and encourages growers and mills to reach agreement and merely provides 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.

Competition in the provision of marketing services that the *Sugar Industry (Real Choice in Marketing) Amendment Act 2015 (Qld)* is a new development. It will take time to fully test the mill assertions that they can generate higher premiums from the sale of sugar than other marketers. The evidence from the results seen to date does not support these assertions.

[5] 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.
[6] These costs include allowances for the cost of haulage to the processing factory.
[7] 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.

Other Draft recommendations

CANEGROWERS make the following specific comments on selected recommendations and is neutral on the others.

Land use regulation - Support draft information request 2.1

Environmental regulation - Support draft recommendations 3.1, 3.2 and 3.3

There is no specific mention of Reef regulations in the draft report however the Reef regulations under the Queensland Government's *Great Barrier Reef Protection Amendment Act 2009* must harmonise with other environmental regulations relating to the use of chemicals and nitrogen in Queensland.

On farm regulation of water – support draft finding 4.1

Access to technologies and agricultural and veterinary chemicals - support draft finding 6.1 and draft recommendations 6.1, 6.2 and 6.3

Biosecurity – support information request 7.1

Transport – support draft findings 8.1, 8.2 and 8.3 and draft recommendations 8.1, 8.2, 8.3, 8.4 and 8.5

CANEGROWERS **do not** support the Commissions draft recommendation 8.6. CANEGROWERS believe that the overall long term benefits of a biofuels industry will outweigh the possible increased cost due to increased demand for feedstock and concur with the NFF comments and recommendations.

Electricity – The Productivity Commission doesn't discuss electricity pricing.

CANEGROWERS notes that electricity prices in Australia are higher than overseas jurisdictions[8], disadvantaging our commodity exports on the global market. The Productivity Commissions Draft Report into the Regulation of Agriculture has not addressed energy regulation. 'Table 1 – Regulation across the agricultural supply chain' omits energy regulation despite significant regulatory impediments to Queensland's agricultural sector.

CANEGROWERS strongly recommend that this critical issue should addressed.

[8] CME. (2012). Electricity Prices in Australia: An International Comparison. A Report to the Energy Users Association of Australia.