REPORT

CENTRE FOR INTERNATIONAL ECONOMICS

Unshackling Queensland Sugar

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Centre for International Economics
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Glossary

NCP	National Competition Policy
QSL	Queensland Sugar Limited
SIA	*Sugar Industry Act 1999*
STL	Sugar Terminals Limited
TPA	*Trade Practices Act 1974*

Summary

A proposal to free up Queensland sugar marketing is overwhelmingly in the public interest

A Working Group, established by the Queensland sugar industry, has proposed the replacement of the existing marketing arrangements based on compulsory vesting of all bulk raw sugar, with voluntary arrangements involving Queensland Sugar Limited (QSL) becoming a contractually based marketing company.

We have concluded that the goal and the general thrust of this proposal are overwhelmingly in the interest of the industry, its stakeholders and the community generally. Its implementation would help unshackle the industry's development by stimulating a more commercial culture.

Marketing based on compulsory vesting is holding the industry back

Like several other recent reviews, we have concluded that current arrangements are holding the industry back. They:

- shackle the industry from embracing opportunities to manage finances and risks of marketing more effectively;
- mitigate against opportunities for product diversion from bulk raw sugar;
- impede the take up of opportunities to install whole-of-value-chain systems in all operations;
- prevent the industry from developing a range of commercial marketing skills to fully exploit these opportunities and challenges; and
- negate the need to attract and develop the enterprise and management required to run growth oriented commodity marketing organisations.

The marketing of Queensland sugar may well have long been an embryonic commercial opportunity held dormant by regulatory restrictions placed on it.

The industry clearly needs a new marketing system

Queensland's sugar industry needs to attain a structure that will enable it to prosper rather than merely survive, even at the low end of a range of prices considered likely for planning purposes. For this to happen:

- its marketing arrangements must support the behavioural changes that recent statutory amendments to the cane production and bargaining systems now allow;
- it will be necessary to move, as other Australian export oriented agricultural industries have been moving, from production driven marketing to market driven production; and
- dynamic leadership must be embedded in the marketing framework to encourage business management skills, whole-of-value-chains in all operations and product diversification.

This will involve a diversity of marketing avenues that handle more than the sale of Queensland bulk raw sugar and may involve multi-commodity trading and multi-sourcing of differentiated products.

Adopting the Working Group's proposal would go a long way in these regards

The Working Group's proposal would help unshackle the industry's development and promote its prosperity by stimulating the kinds of changes identified above. Its adoption would:

- add significantly to the *efficiency and competitiveness* of the industry by:
  - providing greater incentives for value adding within the production/marketing chain and opportunities for forging strategic alliances with stakeholders in other industries;
  - leading to the development of a wider range of marketing options by QSL that would introduce a degree of dynamism into the ways in which sugar is processed, stored and sold for both domestic and export use; and
  - increasing incentives to match marketing methods and costs to the returns that can be reaped from sales;
- build a *commercial culture* by:
  - providing options to millers and QSL and its customers to do business in diverse ways and with other industry players; and
  - allowing growers, millers and QSL and its customers the freedom to use a wider range of commercial instruments tailored to their individual needs;

- improve the *ability of the industry and its stakeholders to become more commercial* by:
  - allowing entry into the industry of new players with entrepreneurial skills and wider commercial linkages;
  - creating better incentives among overseas traders to develop sales of Queensland sugar and among buyers to develop purchases; and
  - encouraging new uses of cane and greater product differentiation and diversity of value adding;
- encourage better production and marketing ideas by allowing those who develop them the opportunity to reap the benefits of any market premiums obtained; and
- create incentives to develop standards and quality assurance systems in ways that are best managed by those who gain directly from them.

Some transition features of the proposal could defer benefits

The Working Group has not proposed a fully contestable market at this stage, but rather a transition pathway towards it. Several features of the proposal should ensure that dislocation and transition costs in achieving these benefits would be minimal. However, adoption of some of the recommendations would qualify the extent of the gains in the near future. Of greatest concern are proposals to allow QSL to negotiate before 31 December this year (that is, before the market would become contestable) that:

- all initial supplier contracts be for three years; and
- the goal be that contracts cover 100 per cent of each supplier's bulk sugar for export.

If these outcomes were realised, they could defer the benefits of terminating compulsory vesting by restricting the entry of new market players for three years.

Some implementation issues also need to be resolved

Some of the Working Group's recommendations raise a number of implementation matters that involve wider policy issues and procedures. These need to be worked through, though none is insurmountable.

- Any action by QSL (or any other marketer) to negotiate uniform contracts covering two or more suppliers would require authorisation under the *Trade Practices Act 1974*, as might contracts covering 100 per cent of a supplier's product. To be approved it would be necessary to demonstrate that such requirements are in the public interest.

- If compulsory vesting were terminated it would be necessary to ensure third party access to bulk sugar terminal and storage facilities owned by Sugar Terminals Limited (STL). If a voluntary protocol were developed by the current directly interested parties (QSL and STL) it would need to be externally reviewed (possibly by the Australian Competition and Consumer Commission) to ensure competitive neutrality.
- If compulsory vesting were terminated it would appear be necessary for the Commonwealth to devise a new mechanism for allocating Queensland's share of Australia's access to the US quota market. If all sugar continued to be sold under QSL contracts for an interim period, it would be appropriate that all of Queensland's share continue to be allocated to QSL for that interim period.

Removing statutory marketing interventions would impact in various ways

Current statutory marketing interventions empower QSL by:

- vesting sugar in it; and
- allowing it to direct mills about where to store sugar, where to deliver it, and to deliver sugar of certain brands/standards.

Other statutory interventions limit QSL from exploiting these powers by:

- requiring it to define payment schemes;
- requiring it to follow Ministerial directions;
- placing restrictions on Board structure and appointment of auditor; and
- specifying reporting functions.

Removing these interventions is likely to impact favourably on the industry, many of its stakeholders and the community generally for all the reasons summarised above. Impacts on QSL and some if its less commercially oriented suppliers are likely to be more equivocal. To retain longer-term market share, QSL would have to relate far more commercially to its suppliers and possibly establish ownership links and/or forge strategic alliances with them. But if QSL were to become a company limited by shares, it would have the freedom and be better positioned commercially to make the appropriate responses.

One impact for the Government and the community generally would be that some production and marketing information currently in the public domain would become commercial-in-confidence and no longer be freely available.

Adopting the proposed change would open the industry to an exciting future

What the final organisational structure of Queensland sugar marketing would become under the Working Group's proposal is difficult to predict. A few large regionally oriented marketers might emerge, together with several smaller niche operators. Several existing stakeholders could be interested in entering a contestable market. International commodity traders could also become involved.

Despite the uncertainty about which companies will end up marketing Queensland sugar, what is certain is that the Working Group's proposal to make QSL a contractually based marketing company no longer reliant on compulsory vesting will introduce long denied competition. This will create a spur to innovation, growth and cost control. It will provide incentives to explore more broadly the commercial opportunities and challenges represented by marketing about one billion dollars worth of commodity each year. It will create incentives for companies to develop a diverse range of commercial skills to better exploit such opportunities and challenges. This will attract and develop the management needed to run growth oriented commodity marketing organisations which may take a global focus.

This new dynamism potentially will help the industry, the sugar regions and the wider Queensland economy. The skills developed are likely to be transferred to help develop other opportunities both within the sugar industry and beyond as other growth oriented commodity based companies of the world have done.

1 Introduction

A Working Group, established by the Queensland sugar industry, has proposed the replacement of the existing marketing arrangements based on compulsory vesting of all bulk raw sugar, with voluntary arrangements involving Queensland Sugar Limited (QSL) becoming a contractually based marketing company (Working Group 2005).

The task for this review

The Queensland Government has asked the Centre for International Economics (CIE) to evaluate the costs and benefits of this proposal:

- focusing on its likely economic costs and benefits on businesses involved in the Queensland sugar industry and the general community;
- considering its implications for:
  - the efficiency and competitiveness of the industry; and
  - the ability of the industry and industry stakeholders to become more commercial;
- considering the impacts of removing a range of specific legislative marketing interventions.

Background

Notwithstanding a long term downward trend in sugar prices since federation, the Australian (chiefly Queensland) sugar industry developed to become highly export oriented and generally prospered over much of this period. Its prosperity, however, fluctuated more from year to year than most agricultural industries. Over this period sugar production and marketing have also been more heavily regulated than virtually any other Australian agricultural industry. Despite regulation locking in many features of the industry’s production and marketing systems, the industry was a world leader in production technology until quite recently, and it kept ahead of the rest of the world in productivity growth.

However, by the end of the 1990s Australian sugar's productivity gains had stalled, compared with both many other Australian agricultural industries and with sugar industries in competitor countries, principally Brazil. Production and marketing regulation had been abolished or were in advanced stages of being liberalised in virtually all other major Australian agricultural industries, giving them a competitive incentive to lift their productivity growth. Due to deregulation of the Brazilian industry, producers in that country adopted and adapted Australian technology and expanded their production to take advantage of economies of scale. This, together with massive depreciations of the Brazilian currency, left Brazil with a substantial competitive advantage, placing downward pressure on world sugar prices and severely eroding incomes of Australian producers.

Various reports during the 1980s and 1990s concluded that production and market regulations were significantly restricting the exploitation of production opportunities and the development of marketing innovation. Queensland's *Sugar Industry Act 1991* liberalised some of the regulations holding back the industry. This allowed areas of cane, yields of cane and sugar output to expand rapidly, but these gains stalled in the latter half of the 1990s. Further flexibility was introduced through the *Sugar Industry Act 1999* (SIA), but an independent assessment commissioned by the Commonwealth Minister for Agriculture, Fisheries and Forestry in 2002 (Hildebrand 2002) concluded that legislative arrangements generally were hampering the development of the industry's business skills and leadership.

Following Hildebrand's assessment, the Queensland Government asked the CIE to undertake a comprehensive quantitatively based impact analysis of possible changes to the SIA (CIE 2002). This analysis focused on the cane production area and statutory bargaining systems and the compulsory acquisition and marketing arrangements then operating. The CIE assessed the industry's (and its regional components') viability under several scenarios of prices and technology growth. It concluded that if prices were to stay low ($245 per tonne) and productivity were not to improve, the industry could collapse by 2006-07 (the worst case scenario). Assessing this worst case scenario, the only ways in which to restore the industry to its 1996-97 baseline level of prosperity would be for:

- productivity in growing, harvesting, transporting and milling to increase by 37 per cent; or

- the world price (in Australian dollars) to increase by 33 per cent to $326 per tonne.

To increase the world price is largely beyond the control of the industry, but the analysis concluded that the industry could achieve the productivity gains of the order required. Several features of the cane production area and statutory bargaining systems, however, were discouraging individuals and progressive groups from implementing the necessary changes. Legislative changes that could directly encourage the types of productivity gains were identified.

The analysis also examined the implications of compulsory vesting powers and the status of QSL as a sole seller. It did not identify changes that would lead to specific productivity gains in production or marketing. However, it supported Hildebrand's conclusions that the industry's statutory acquisition powers had hindered the development of the industry's commercial culture by:

- dampening opportunities for the development of business management skills in the regions;
- impeding the installation of a whole-of-value chain systems approach in all operations; and
- mitigating against product diversification from raw sugar.

In addition, the analysis concluded that vesting is not required to achieve any economies of size that might exist in selling. Further, the use of vesting to defend price premiums, in the unlikely event that they do exist because of market power, could be both dangerous and misguided. This is because there is a high likelihood that, if things turn out badly rather than well, losses resulting from behaving as a price discriminating monopolist will be greater than the gains.

Following the CIE's report and extensive discussion between the Queensland Government and the sugar industry, the *Sugar Industry Reform Act 2004* completely removed the provisions of the cane production area system that had previously applied. All of the compulsion provisions of the previous statutory bargaining system were also removed, though some do not cease until 31 December 2005. However, the compulsory acquisition of raw sugar has remained, with some minor exemptions for use in alternative products (such as ethanol) and bagged sugar for export.

It is too early yet to observe the full impacts of the important legislative reforms of 2004. However, some significant productivity gains have been arising from structural adjustments taking place as these reforms are being introduced. Some 16 per cent of cane growing businesses exited the industry in Queensland between 2002 and 2005. Average production per farm increased by 14 per cent from 6700 to 7600 tonnes over the same period. Numbers of cane harvesters have declined by 20 per cent over the last five years, leading to an increase in the average throughput per harvester of some 45 per cent. The legislative framework controlling production should allow further changes to be made. The focus of regulatory reform must therefore now shift to marketing and in particular the statutory underpinning of vesting and QSL's effective single desk status.

The Working Group's proposal to replace current marketing arrangements, based on compulsory vesting of all bulk raw sugar, with voluntary arrangements involving QSL becoming a contractually based marketing company, is therefore timely. 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.

The approach we have taken in this review

In evaluating the Working Group's proposal we have been particularly aware of the background issues summarised above. This requires keeping the worst case scenario strictly in mind, that is, the need for the industry to attain a structure that remains viable under a world price at the low end of a range of prices considered likely for planning purposes (suggested by Hildebrand to be $245 to $333 per tonne). Following the CIE's 2002 report the world price did rise to in excess of $330 per tonne, but subsequently it has settled back to slightly over $250. At prices of this order margins will be very fine for many growers and mills even if productivity gains are achieved. Thus marketing arrangements must support the behavioural changes that recent statutory amendments to the cane production area and statutory bargaining systems now allow.

But to encourage an adaptive industry that prospers rather than merely survives, it will be necessary to move, as many other Australian export oriented agricultural industries have been moving, from production driven marketing to market driven production. Thus, as Hildebrand stressed, dynamic leadership must be embedded in the marketing framework to encourage business management skills, whole-of-value chains in all operations and product diversification. This will involve a diversity in marketing avenues that handle more than the sale of Queensland raw sugar and may involve multi-commodity trading and multi-sourcing of differentiated products. In our evaluation of the benefits and costs we have looked at how the proposal might contribute to the industry’s overall commercial culture. In doing so we have drawn on the experiences of some other rural industries undergoing change in their marketing arrangements and of other world commodity traders.

In not being based on compulsory vesting, the Working Group’s proposal can also be interpreted as a positive response by the industry to NCP objectives. It also goes a long way towards reaping a number of net benefits we specified in our report of 2002. In chapter 2 we evaluate the overall thrust of the proposal in terms of the advantages we identified in that report of removing compulsory acquisition.

Nevertheless, it is important to ensure that, even if legislative backing for marketing power is removed, consequences of specific recommendations in the proposal do not restrict competition to the detriment of the community’s wider interest. In chapter 3 we evaluate the benefits and costs of specific recommendations in terms of their impacts on the industry, its stakeholders and the community generally. In particular, we deal with some issues arising during a period of transition. Impacts of removing specific legislative marketing interventions are also discussed.

Chapter 4 raises some wider issues regarding the types of marketing organisations and modes of buying and selling that could arise after deregulation. It also discusses some of the types of responses to emerging market dynamics that could best serve the interests of the industry, its stakeholders and the wider Queensland and Australian communities.

2 General evaluation of the proposal's overall impact

The Working Group's proposal is premised on the SIA being amended to remove compulsory vesting which would permit QSL, operating without any specific statutory backing, to be transformed into a contractually based sugar marketing company. Thus, though QSL might continue as a sole or dominant seller for some time and a number of transitional issues may need to be resolved, it is envisaged that the market will become contestable in the future. That is, all regulatory barriers restricting entry to or exit from Queensland's sugar market will be removed.

The current chapter considers the overall net benefits of such a move. Its point of comparison is the current situation of compulsory vesting of all raw sugar produced in Queensland and the effective statutory status of QSL as single desk seller. It begins with the arguments that traditionally support that situation. It examines those arguments in the light of current market realities. Its intent is to be general without getting bogged down by the details of the proposal. Its conclusion is that the goal of the proposal and the general thrust of its measures are overwhelmingly in the interest of the industry, its stakeholders and the community generally.

Arguments supporting vesting in a single desk seller

A number of arguments have traditionally been put forward in support of single desk selling of agricultural commodities. Because vesting in QSL applies to the output of mills rather than of growers, some of these arguments (such as to countervail the market power of processors) do not directly apply to Queensland sugar, but most still do apply. Arguments supporting the current system fall into four general categories.

- To guarantee that all raw sugar produced in the State will be received for sale and that costs, returns and risks from all sales will be equitably shared between mills.

- To promote the reputation of the industry as a reliable quality provider through mandatory standards, provision of information, development of markets, and defence of market access.
- To maximise sales throughput so that marketing costs can be reduced through economies of size.
- To maximise returns by exercising power in tight export markets to which other suppliers do not have access or have access at higher costs, and to prevent the erosion of those premiums resulting from overseas buyers playing off weaker Australian exporters.

Although proponents of these arrangements have acknowledged that they impose administrative, compliance, enforcement and some efficiency costs, they have argued strongly that their benefits far exceed their costs.

Contrary conclusions about net benefits of single desk selling

Several independent studies have come to other conclusions (Industry Commission 1992, Hildebrand 2002, CIE 2002, Williams 2003). In particular, these studies have drawn attention to how the lack of competition in marketing has retarded the development of a commercial culture in the sugar industry.

The trade in Queensland sugar is a relatively large commercial undertaking and an important one for Queensland. It requires considerable skills to market such volumes of sugar and represents significant commercial opportunities and challenges. However, marketing Queensland sugar through a statutory monopoly single desk seller shackles the industry and the commercial opportunity represented. It prevents the Queensland sugar industry from developing a diverse range of commercial skills to better exploit such opportunities and challenges. It negates the need to attract and develop the management required to run growth oriented commodity marketing organisations. Potentially, this is a loss to producers and the wider Queensland economy. Development of such skills would likely have positive economic spillovers. The skills developed are likely to be transferred to help develop other opportunities both within the sugar industry and beyond as other growth-oriented commodity based companies have done. The marketing of Queensland sugar may well have long been an embryonic commercial opportunity held dormant by regulatory restrictions placed on it.

Exactly where the development of a commercial culture might take the sugar industry and wider Queensland economy is difficult to predict. Fonterra, New Zealand's large dairy co-operative was formed out of two pre-existing co-operatives and the single desk New Zealand Dairy Board in 2001. Though still largely dairy product based, Fonterra has branched out into acquiring interests in the Australian dairy industry, both for the profits to be obtained from Australia's domestic market and also to better position itself in the world dairy product market. It now markets about one fifth of Australia's milk output and Nestlé, another food product marketer that has branched out from its dairy trading base, is its major global customer. Fonterra also has a biotechnology company as well as selling its expertise in branding, packaging and marketing to a range of other processed food product companies. Other commodity trading organisations started somewhere and branched out to become significant global organisations.

Although it is not possible to know where the development of a more commercial culture might eventually lead the sugar industry, specific analysis of existing arrangements does suggest these are holding the industry back. For example, table 2.1, which is adapted from the CIE's 2002 report, summarises its conclusions about some of the benefits and costs of retaining or removing compulsory acquisition of raw sugar for sales on domestic and export markets.

The discussion that follows fleshes out the conclusions drawn in this table in terms of the general thrust of the Working Group's proposal.

Ensuring sales of all supplies and the equitable sharing of returns

Under compulsory vesting, all raw sugar produced is received by QSL and is paid for at price structures defined under QSL's payment schemes. In a contestable market QSL would no longer be a receiver of last resort and pricing structures would be more fluid. Supplies in excess of contractual quantities or from less reliable sources could receive discounted or spot prices compared with proven suppliers and quantities sold forward under normal commercial premiums. However, preventing such differentiation discourages the development of the commercial culture that Hildebrand considered to be so lacking in, yet so necessary for, the sugar industry.

2.1 Benefits and costs of retaining and of removing the vesting of Queensland sugar

	Benefits	*Costs and risks*
Retention	▪ Guarantees that all raw sugar produced in Queensland will be received for sale and that through pooling returns from all sales will be shared among all suppliers. ▪ Guarantees domestic price remains at export parity, keeping prices at a minimum to Australian sugar users. ▪ By mandating standards and grade requirements on mills it defends market reputation and access. ▪ By mandating QSL as a sole seller, needless duplication of market infrastructure is prevented and a degree of size economies of marketing is assured. ▪ Premiums obtained from quality of sales and access to quota restricted markets are assured and spread among all suppliers.	▪ Compulsory pooling leads to inefficient locations and levels of cane growing and sugar milling. ▪ Compulsory pooling is inimical to best use of financial and risk management instruments that match needs of individual growers and millers. ▪ Misses an opportunity to allow more flexible commercial links between millers and refiners that encourage differentiation and innovation and promote commercial thinking in the industry. ▪ Dampens incentives to develop standards suiting new products or current products in markets with different quality requirements. ▪ A high risk of losses resulting from QSL trying to behave as a price discriminating monopolist, because market dynamics usually cause things not to turn out as expected.
Verdict	Retention is a strategy that gives comfort by sharing incentives, risks and market requirements among existing industry stakeholders. However, it imposes some inefficiencies in production and dampens opportunities for commercially oriented stakeholders and potential operators to innovate. There is also a high risk of industry loss if attempts are made to exploit market power that market dynamics undermine.	
Removal	▪ Encourages innovative use of financial and risk management instruments. ▪ Provides incentives to develop standards and quality assurance in ways that are managed best by those who gain from them. ▪ Raw sugar prices may better reflect their value to cane growers, millers and Australian users. ▪ Creates better incentives among overseas traders and buyers to develop sales of Queensland sugar. ▪ Encourages new uses of cane and greater product differentiation and diversity in value adding. Marketing costs are appropriate for the scales of operations best suited to the industry's various buyers and sellers. ▪ Provides scope for sellers to appropriate price premiums because of the quality of services they provide and the value they add. ▪ Creates commercial incentives for new players with entrepreneurial skills to enter the market and drive it forward in as yet unexplored directions.	▪ There may be an increased likelihood of failures to meet specifications, but costs are likely to be born by those who fail to meet them and will not spill over to others. ▪ If a single or dominant state-wide marketer were to arise, or one or more dominant marketers were to emerge at state or regional level, some regulatory oversight with power of intervention could be in the community's interest in order to prevent inefficient and inequitable discrimination against suppliers. ▪ It would be necessary to develop a third party access agreement for physical marketing infrastructure currently owned and/or operated by a monopoly provider and for this to be reviewed by a neutral party. ▪ It would be necessary to develop a mechanism for equitably and efficiently allocating benefits of sales into export markets restricted by quota access.
Verdict	Removal is a low-risk strategy with considerable benefits that arise from incentives to innovate new products and services. It better matches marketing costs, risks and qualities of service with opportunities to innovate and develop new markets and marketing arrangements. It is likely to change modes of operation of existing industry stakeholders and to encourage new entrants. Though there will be many winners, some existing suppliers may find the going harder.	

Source: Adapted from table 6.3 in CIE 2002

Compulsory pooling of returns and some marketing costs can be particularly inimical to the development of a commercial culture. By requiring all suppliers to share their returns, it discourages the more commercially oriented suppliers from pursuing higher valued sales. And it rewards marginal production across the industry at high returns than it is worth in some of the markets in which it must be sold. Thus pooling discourages best production and marketing behaviour. Production and marketing may be encouraged in some inefficient locations, at inefficient levels or at inefficient levels of quality. It also inhibits the use of financial instruments that tailor price risks to the needs of individual growers or millers. Indeed, it prevents the shifting of price risks to merchants who might be prepared to take them on in return for the opportunity to profit from sales.

Some mills and canegrowers might prefer to share risks through pooling, and it might be efficient for them to do that if they prefer. But under the proposal it would become a voluntary response, not one that is imposed. However, if it were voluntary there would be built-in disincentives against participation from suppliers likely to obtain higher or safer returns. Those that can develop better production and marketing ideas to achieve premiums through their own efficiency and innovation would be encouraged to do so. Providers of voluntary pools (were they offered) might also only include supplies up to agreed levels that would not reduce expected pool returns, or they might set up a hierarchy of pools. This too would provide clearer market signals to encourage innovation and efficiency and discourage less efficient practice, since industry players would face incentives to supply to the best pools where possible. This does not mean that supplies excluded from pools would be unable to find a seller or buyer, but rather that the returns obtained would reflect their worth in the market and their costs in bringing them to sale.

Our conclusions

Under the Working Group's proposal no longer would there be one marketing organisation required to accept all raw sugar supplied to it, or that costs, returns and risks from all sales would be shared between mills and through them to growers. Although this would remove the comfort of current marketing arrangements, we consider that benefits would exceed costs on a number of counts.

- Were QSL not locked into paying some mills returns that exceed the worth of their supplies in the market, this would provide benefits that exceed the extra cost of having to deal with such mills on an individual basis.

- Were mills not locked into receiving pooled returns that are lower than the outcomes they could obtain if returns and costs for their sales were accounted separately, and/or if contracting arrangements allowed them to sell part of their output in other ways, their benefits would increase and costs decline.
- Were growers, mills, QSL and other marketers to have the freedom to use a wide range of commercial financing and risk management instruments tailored for their individual needs, risk spreading could be achieved more efficiently.

Promoting the reputation and development of the industry

Product standards and quality assurance are important means of promoting the reputation of an industry and developing its markets. There are examples of sellers of commodities who have not met specified standards damaging the reputation and sales of all producers of those commodities. Such problems might be exacerbated where many sellers are involved, their activities are difficult to monitor, and cost of complying with and enforcing industry standards are large. A statutory single desk seller has often been seen as a least cost way of avoiding such problems. This has been particularly so for industries whose sales from all Australian suppliers into certain export markets can be excluded on grounds of the failure of a few to meet specifications of those markets.

This said, most rural industries have now developed quality assurance protocols that meet standards required by their export customers at costs that are more than covered by the added revenues from being able to guarantee the qualities that various markets require. These do not depend on a statutory sole seller. Rather, they depend on the development and protection of brands and their integrity due to tight accountability and trace-back.

Furthermore, to impose uniform industry standards suiting the needs of one marketer could have lessened incentives to develop the market for new products or for current products into markets with different quality requirements. Indeed, it is the dynamism of many sellers developing products and standards suitable for needs in markets in which they have a commercial interest that the sole seller status of QSL has suppressed. Many other rural industries in Australia are benefiting from such dynamism as they have been deregulating their production and marketing regimes. The absence of competitive sellers might be detracting from the reputation and development of the sugar industry by more than a statutory single desk seller is contributing.

Under the Working Group's proposal the onus for promoting the reputation of the industry would be shared on a wider front between merchants, other types of traders and individual mills doing direct business with end users. This is likely to create a greater differentiation of quality specifications, brand identities and information needs than characterise the current market. This by no means downgrades the need for standards specifications and quality assurance systems, but they would be driven at levels closer to the participants who supply to and buy from the market than at present. Such activities are as likely to contribute to the development of markets and defence of access as is the involvement of a single statutory seller with vested interests with particular customers and in particular modes of selling.

Our conclusions

We consider that benefits of such changes would exceed their costs, arising from:

- incentives to develop standards and quality assurance systems in ways that are managed best by those who gain from them;
- the increased likelihood that costs of failures to meet specifications will be born by those who fail to meet them and will not spill over to others;
- the encouragement of greater product differentiation and diversity in value adding activities; and
- the creation of incentives among overseas traders and buyers to develop sales of Queensland sugar products by being better placed to specify their own requirements and to work with their own governments to defend access by Australian suppliers if it is challenged by domestic producers in their countries.

Ability to minimise marketing costs through economies of size

Selling costs arise from the use of physical infrastructure, expertise required to sell and promote sales, and the management of financial instruments. Economies of size in sugar marketing could arise from each of these sources, and a dominant marketer might be able to offer low cost services to its suppliers and reduce those costs by maximising its market share. The threat of undermining economies of size has been used as an argument for legislation supporting single desk selling.

It is unlikely, however, that all of these sources of size economies operate uniformly over all scales of operation. For example, the use of physical infrastructure, which requires large establishment costs, exhibits average fixed costs that fall rapidly with scale of use but average operating costs are relatively constant. Furthermore, such economies are likely to be based regionally where major infrastructure facilities are located. Thus it is unlikely to require a single state-wide marketer to fully appropriate them (see Industry Commission 1992, p. 74). On the other hand, average costs of other marketing and financial services might decline more uniformly with scale of use. While size economies from these sources might be enhanced by state-wide operations, their significance in minimising overall unit costs might be quite small.

Cost savings resulting from the pressures of competition are highly likely to exceed the size economies imposed through a state-wide statutory monopolist. Also, as a seller's market share increases, reductions in average costs usually become quite small. It is for this reason that in many industries, where size economies exist but there are no restrictions on market entry, it is common for a few large firms to operate, each often with a regional orientation. Alternatively, one dominant provider might emerge with many small marketers who operate profitably because of their economies of smallness, often by adding value in niche markets having limited volumes of sales. Either scenario could develop in a contestable Queensland sugar market.

It is possible that size economies are significant enough that the most efficient solution is where a single provider dominates. Provided the market remains contestable, the single provider will face commercial pressures to be competitive and efficient. Significant size economies do not necessarily impose insurmountable barriers to entry or allay fears of retaliatory commercial actions by other large players or groups of players in the industry, were monopoly power to be exerted. It is not difficult to imagine that if QSL was a natural monopoly and if it were to try to exploit its monopoly position, CSR, Mackay Sugar and Bundaberg Sugar would agitate against QSL. QSL would be more dependent on CSR, Mackay and Bundaberg than any of these companies would be on QSL. The value added by the three large groups far exceeds that of QSL.

Nonetheless, if size economies were so large that a dominant provider is able to exert market power to the detriment of its suppliers, or emerge as a 'natural monopoly', social intervention might be required if the market appears to be uncontestable. Such intervention might be required to ensure that suppliers are not discriminated against, or that competitors are not excluded from essential infrastructure controlled by the dominant provider. This is normally provided for under provisions of the TPA.

Our conclusions

Under the Working Group's proposal, no longer would economies of size in marketing be imposed through a statutory state-wide single seller. We consider, however, that it is unnecessary to impose a monopoly status on a marketer to achieve economies of size. If they are big and exist at a state-wide level (which we consider unlikely) they will be manifested either by QSL retaining its single seller status or a new state wide single seller emerging to replace QSL. If economies of size are significant, however, a more likely outcome is that a few large marketers will emerge, each with a regional orientation. In this scenario, or if a dominant state-wide marketer arises, several smaller marketers are also likely to operate, serving niche markets and adding value in a variety of ways that meet limited market needs.

- Whatever the outcomes, we consider that the benefits of the changes proposed would exceed the costs, arising from costs of infrastructure use, marketing expertise, and financial instruments being appropriate for the scales of operations best suited to the industry's various potential markets.

This said, if as a result of size economies QSL were to remain a single or dominant state-wide marketer, or if one or more dominant marketers were to emerge at state level, some regulatory oversight with power of intervention could be in the community's interest to prevent inefficient and inequitable discrimination against suppliers. Under terms of NCP, it may also be necessary for external review of access by third parties to physical marketing infrastructure that can only be provided by or through a sole or dominant provider. Were some regulatory oversight deemed necessary, it would still be likely to be a more competitive outcome than having a statutory monopoly single desk seller.

Maximising export returns through the use of market power

Proponents of a statutory single desk seller of Queensland sugar have argued strongly that QSL has been able to extract price premiums from certain export markets and that to open exports to other sellers would undermine the industry's ability to maintain those premiums. For example, the Boston Consulting Group (1996) valued, at least in the short term, use of the sugar industry's market power at around $35 million per year, or some $7 per tonne, which would far exceed any regulatory costs. However, these contentions have been just as strongly challenged in other quarters.

Whatever might have been the opportunity to exert market power in the past, today raw cane sugar is part of a global sweetener market in which Queensland provides a largely undifferentiated product. Even for this component it is not a dominant provider. The merchant activities of ED and F Man Sugar, and Czarnikow Sugar handle far more. Furthermore, there is no evidence that QSL holds back supplies from certain markets in order to increase prices it receives in them, which would be the expected behaviour of a price discriminating monopolist.

Even in the unlikely event that market power potentially could be exploited, the frequent shifts in customer wants, the quick reaction times of some other suppliers and the opportunities to use alternative sweeteners impose large information requirements to ensure that gains are reaped (see Williams 2003). In our earlier report (CIE 2002) we demonstrated that losses resulting from behaving as a price discriminating monopolist are more likely to be greater than the gains, because market dynamics usually cause things not to turn out as expected.

This is not to say that premiums cannot be obtained by Queensland exporters from quality assurance, reliability of supply to preferred customers, superior brokerage arrangements and other value adding services. Premiums might also be available through rights to export to countries whose prices are supported by domestic policies of their governments. Quality premiums might not be achieved by a sloppy competitor, and mechanisms might be needed to allocate premiums from quota markets. But price premiums of these types need not be eroded by the transition of QSL from a statutory sole seller to one facing competition, provided quality of service is maintained.

Our conclusions

For Queensland to retain a statutory single desk seller in the hope of obtaining premium returns from attempting to behave as a price discriminating monopolist is a high-risk policy. These high risks are incurred through QSL but are borne collectively by suppliers. If, of course, significant numbers of suppliers considered that QSL does have market power and that the likely gains more than offset the risks, QSL might be able to retain sufficient volumes of supply to test its power in the market. But this would not require legislative support.

This, of course, is not to deny that QSL is not able to obtain premiums from quality assurance, reliability of supply, superior brokerage, value adding services and access to quota restricted export markets. None of these however, depends on single desk selling, and indeed we consider that the changes proposed would promote returns from export markets, not by relying on market power but by:

- providing stronger incentives and scope for sellers to appropriate price premiums through quality of service and value added; and
- better matching of risks of export options with returns sought from them.

General conclusions

There is considerable evidence that a statutory monopoly single desk seller does not face the incentives necessary to fully exploit commercial opportunities available in a large modern industry (see Borrell et al 1991, Productivity Commission 2000 and ACIL Tasman 2004). The opportunities forgone impose a cost on the industry and the wider community. The benefits it is likely to achieve compared with having a normal competitive commercial structures are illusory as most, if not all, are likely to be achieved without monopoly. Our overall conclusions therefore are that the goal of the Working Group's proposal and the general thrust of its measures are overwhelmingly in the interest of the industry, its stakeholders and the community generally. The general implications of the proposal for the efficiency and competitiveness of the industry, and the ability of the industry and its stakeholders to become more competitive, are summarised below.

Efficiency and competitiveness

Moving to a contestable market, with QSL's activities based on contractual arrangements with suppliers should add significantly to the efficiency and competitiveness of the industry. QSL could remain the dominant trader, retaining its advantages of size economies. Although the diversion of some of its sales could marginally reduce its cost advantages, competitive disciplines and not having to meet all the obligations of compulsory vesting (such as being a seller of last resort) could more than compensate for these.

Notwithstanding QSL's current advantages in the market, in the longer term a small number of large traders could emerge, perhaps with regional orientations in their operations, and several smaller marketers servicing niche markets could also operate. The operations of some of these might be more costly, but they will add value and better manage quality differentiation and brand imaging from which additional sales revenue will more than offset additional costs. Opportunities to move away from compulsory pooling will also improve in areas where sugar is grown, milled and sold. This will add to the efficiency of resource use and raise returns by better matching production to prices received in the market.

Ability to become more commercial

Several features of the proposal should encourage the industry to operate in a more commercial way. Because QSL currently is a company limited by guarantee, it is not possible for individuals to trade its shares. If it were to become a company limited by shares, stakeholders would be able to own and trade its shares and transfer the benefits into their own balance sheets. This would give them an incentive to ensure that QSL's Board performs well commercially. An ultimate discipline in this regard would be the threat of takeover that currently does not exist. QSL will face greater opportunities to operate in a variety of contractual or spot purchase modes, and will have greater freedom than at present to enter into value adding activities and to form strategic alliances — all of which are normal commercial options. QSL and its suppliers will have commercial options to better finance their market requirements and to manage their risks. To all these advantages must be added the opportunity for other operators to enter the market by offering similar or differentiated commercial incentives and instruments.

Transitional issues

This said, several specific matters relating to industry organisation and to transitional issues raised by the Working Group's recommendations qualify the extent of these gains and the pathways to them. Of greatest concern in this regard are proposals designed to position QSL in the market during a period of transition. Some of these might lead to the deferment of the benefits of market deregulation for up to three years. These matters are the subject of the following chapter.

3 Specific evaluation of the proposal's recommendations

The Working Group's proposal is premised on the SIA being amended to remove compulsory vesting which would permit QSL, operating without any specific statutory backing, to be transformed into a contractually based sugar marketing company. It is assumed in the proposal that the Board of QSL will cooperate in this transition. The approach taken by the Working Group is to identify minimal structural changes required for QSL to operate on a voluntary basis, and then to identify the level of changes to structure and operations that would be necessary to deliver enhanced outcomes.

In this context the Working Group makes eleven recommendations relating to the structure of the arrangements it proposes. In what follows we have evaluated each of these recommendations under headings used by the Working Group, bearing in mind their effects on the industry, its stakeholders, and the community generally. In regard to the general community, we have used the guiding principle of NCP as our criterion, and we begin with an introduction to it.

After our assessment of each of the recommendations, we assess the overall impact of the proposal on the efficiency and competitiveness of the industry and on the ability of the industry and its stakeholders to become more commercial. As well, the effects of removing specific statutory interventions that currently relate to QSL are assessed.

The Guiding principle of National Competition Policy

As we have demonstrated in the preceding chapter, restricting market entry to or exit from an industry can be costly to the community in terms of gains from innovation and productivity forgone. So too can limitations imposed by natural monopolists on the use by others of essential services they control but which cannot economically be supplied by others. These are two major concerns lying behind NCP.

The current statutory backing for QSL's single desk status is the strongest possible form of restriction on entry to sugar marketing. But contracts enforced by a dominant seller not supported by legislation could also lock out some competitors and/or lock in some suppliers. Also, the ownership of, or contractual relationships with, infrastructure in the form of bulk terminals and storage facilities owned by Sugar Terminals Limited (STL) could be used to deny or increase costs of access to market entrants.

When evaluating these matters, the guiding principle of NCP makes it clear that if a regulatory restriction on competition is to remain it must be demonstrated that its retention is in the community's interest. This said, its removal might involve dislocation and transition costs, and it could be in the community's interest to ensure that these are minimised, provided that longer term benefits are not compromised.

In this context, and following our conclusion in the preceding chapter, we have concluded that retention of restrictions imposed by compulsory vesting of sugar in Queensland have not been demonstrated to be in the community's interest and the Working Group's proposal that they be terminated is sound. This said, we have examined each of the Working Group's recommendations in terms of how well they facilitate or defer the attainment of the net benefits outlined in the preceding chapter, bearing in mind transitional dislocations and costs. In particular we have examined whether each of the recommendations will:

- exclude or otherwise add to costs of new sugar marketers;
- make it unduly costly for mills to shift some or all of their supplies to an alternative marketer;
- ensure access to essential physical marketing infrastructure by all marketers at competitive costs; and
- give comfort to suppliers and customers that marketing arrangements will not be unduly disrupted and that short term dislocation and transition costs will be sufficiently small that they will not offset longer term benefits.

In regard to the impact of NCP on rural and regional Australia generally, there is considerable evidence that its overall benefits have significantly exceeded its overall costs (see Productivity Commission 1999 and 2005).

The recommendations

The marketing vehicle

Recommendation 1 — QSL be the vehicle used as a basis for a contractually based sugar marketing company.

As indicated above, the proposal's approach is to graft onto and modify the marketing structure that already exists rather than to design new institutions *de novo*. In this regard the Working Group considers QSL to have considerable goodwill with suppliers and customers, and very few of its commercial activities actually depend on legislation. Following a change to a contractual base, it also considers that, at least in the first instance, QSL would be the preferred marketer by suppliers of Queensland raw sugar and a supplier of preference for customers. It further considers that a contractual arrangement between bulk raw sugar suppliers and the marketer would:

- ensure certainty of supply and seamless forward contracting with customers for export;
- allow funding of operations and advances to suppliers; and
- allow hedging of product, exchange requirements and margin call financing.

Our evaluation

Subject to qualifications about the nature of contracts that might be offered by a reconstituted QSL (discussed under recommendations 7 and 8) we consider this approach to be in the interest of the industry, its stakeholders and the community generally.

For the industry

- Repealing statutory backing for QSL to operate as a sole seller would reduce the likelihood that losses resulting from it behaving as a price discriminating monopolist will be greater than the gains, because market dynamics usually cause things not to turn out as expected (see chapter 2). Checks from competitive suppliers should mute this possibility. There is, of course, a large likelihood that in a contestable market QSL will be able to reap price premiums from quality assurance, reliability of supply to preferred customers, superior brokerage arrangements and other value adding services.

- Repealing statutory backing for QSL should also, in the longer term, allow for the development of a wide range of marketing options that would introduce a desirable degree of dynamism into the ways in which sugar is processed, stored and sold on both domestic and export markets. Contractual arrangements between mills and QSL would be only part of these, but important parts. They would allow greater scope for negotiating skills to be developed by all parties, even going back to growers if they were able to sell their own sugar milled for them on a toll basis (as analogously occurs in the cotton industry).
- Given QSL's existing marketing base, its established relationships with other stakeholders, and its consequential economies of size of operations, QSL should continue to be a preferred marketer of Queensland sugar for the foreseeable future. Thus there is minimal likelihood of a transitional interruption in marketing services or a breakdown in confidence about the industry as a reliable provider.

For industry stakeholders

- In the longer term, QSL and other potential marketers, as well as other potential stakeholders (including canegrowers themselves), will face incentives to explore marketing options that best suit their individual circumstances and thereby will lower costs and/or create opportunities for product differentiation and diversity in value adding activities.
- Notwithstanding and advantages of size economies that QSL might currently enjoy, these should not unduly disadvantage alternative regionally based market entrants. It is likely that principal activities amenable to size economies are storage, bulk handling, loading and shipping, and these are available at a regional level rather than statewide. Thus, provided there are adequate arrangements for competitively priced access to these facilities (see recommendation 11) there is no reason why a regionally based marketer (say in the Burdekin) could not operate at relatively low cost.
- Regardless of how the final structure of marketing organisations and trading relationships turn out to be in a deregulated market, current suppliers and customers have the comfort of continuity in a time of transition during which they can assess changes and their marketing options. Thus dislocation and transition costs should be minimal without (depending on the nature of the initial contracts) unduly deferring gains.

For the community generally

- Greater diversity of sales options should lead to additional services and businesses supporting the sugar industry, particularly in regional centres. Existing businesses that service the industry and its regional communities would not be placed under significantly greater adjustment pressures than those they have been experiencing in recent years as the industry has been undergoing considerable structural change.

Drivers to responsive marketing within a standard business framework

Recommendation 2 — In order to ensure maximum participation and ensure that transformation takes place in a timely manner, the initial contractual arrangements between the marketer and suppliers include obligations on the marketer to meet defined milestones by due times. A failure to meet a milestone could enable the supplier to opt out of the supply contract.

The Working Group recognises the potential for tensions to arise if suppliers become locked into contracts but QSL fails to make the changes expected of it when the contracts are negotiated. It proposes that milestones for progress and due dates be determined by QSL itself, but in consultation with suppliers, and they be incorporated into the contractual arrangements.

Our evaluation

We consider that, for an interim period during which QSL itself is adapting to a more normal business framework and before other marketing options have had time to develop, this discipline would be in the interest of the industry, its stakeholders and the community generally. It could be used to embody the direction in which change is to take place and to minimise dislocation and transition costs. However, it is important that the milestones be understood as stepping stones to open up the market to choice and to allow contestability in marketing, and not be used to put breaks on it. It is also important that the due dates be specified to ensure that a fully contestable market is in place as soon as feasible.

The timing of legislative changes

Recommendation 3 — Sections of the Sugar Industry Act 1999 covering vesting and marketing of sugar in QSL operate only for the 2005–06 season. To facilitate the introduction of commercial, contractually based marketing arrangements from the 2006–07 season, transitional arrangements would need to be introduced during 2005 to enable QSL to enter into contractual arrangements with suppliers.

This recommendation is made on the basis of a statutory review of vesting arrangements required by s 112 of the SIA before any withdrawal would be made from statutory intervention in marketing. However, if the Working Group's proposal is accepted and implemented by the Queensland Government, the 2006-07 review would not be required, and presumably the review clause in the SIA would be removed as part of a package of legislative amendments to remove the vesting clauses from the Act.

Our evaluation

Without pre-empting the need for a further review of sugar industry legislation in 2006, we consider this recommendation to be in the interest of the industry, its stakeholders and the community generally. It may be necessary to make some legislated transitional changes in order to extricate the Government and QSL from the consequences of vesting and Ministerial direction. But, in view of the longer term gains to be achieved and the minimal shorter term dislocation and transition costs already discussed, a contestable market should be fully implemented as soon as practicable.

Corporate structure of the marketer

Recommendation 4 — The Board of the marketing company take appropriate steps to address the ownership structure of the company once commercial operations have been commenced. Structural change will necessitate referral to and support of current members.

Currently QSL is a company limited by guarantee and because it operates as a cost centre and passes revenue back to suppliers it is exempt from tax. The Working Group notes that marketing bodies in a number of other rural industries following deregulation have been transformed into companies limited by shares. This has given them a greater sense of ownership and a better environment for commercialisation, and a better capital basis for funding growth and participating in value adding activities.

The Working Group indicates that procedures for changing the type of company are relatively simple, and there are several models for determining equitable share allocations between current guarantor members and extending them to new members. QSL's tax status could change if or as it moves from operating solely on a cost recovery basis.

Our evaluation

Without making any judgement about how the ownership of shares ought to be allocated or the rights that should be attached to various classes of shares, we consider it to be in the interest of the industry, its stakeholders and the community generally that QSL be transformed from a company limited by guarantee to a company limited by shares.

For the industry

By transforming QSL from being solely a cost recovery centre to becoming a marketer that can take a position in the products it sells, add value to them and form strategic alliances and possibly trade in a variety of commodities, a long needed dynamic will be added to the industry that will help it to grow. Benefits should flow on a broad front throughout the industry from this dynamism.

For industry stakeholders

QSL itself should benefit from this change by allowing it better to retain profits (albeit taxed but with imputation credits) and be given considerably more commercial flexibility in terms of capital raising. It could also become involved in value adding activities in its own right and with vertically and horizontally integrated activities with others.

It should benefit current guarantor members by allowing them to bring the value of ownership into their own balance sheets, which currently is not possible. They could then increase or cash these assets depending on their individual need. They could use such assets as security and borrow against them. Furthermore, other types of stakeholders might choose to invest in QSL. This added sense of ownership, and the values attached to it, should help to drive QSL more commercially than has the previous structure.

For the community generally

The wider community should gain from QSL being a strictly commercial entity along side others, with no special status and need for government direction. The community could gain comfort that it is being driven by normal commercial incentives, the ultimate discipline being the threat (or opportunity) of takeover by another market operator that could manage QSL's assets and operate its activities more effectively.

An example from another industry of how the transformation of a statutory marketing authority into a company limited by shares is AWB Limited. Although this is still a statutory single desk exporter, since it has been transformed from the preceding Australian Wheat Board it has not only carried on its traditional role of operating a pool for export sales of bulk wheat but has become active in many other facets of grains marketing. It purchases wheat and other grains and trades in them as a principal in its own right. It has entered into a joint venture arrangement with GrainCorp Ltd, the eastern States' grain handling organisation which itself is a grower controlled company, to better integrate grain receival, transport, storage and handling of grains for export in eastern Australia. And it has acquired Landmark, a large supplier of agribusiness goods and services, from Wesfarmers Ltd.

Recommendation 5 — There should be sufficient grower and miller representation on the Board of the marketer to ensure transparency and a number of independent directors to bring a depth of experience and diversity of skills and perspectives. The present composition and skill base would need to be flexible to ensure that the company is able to respond to ensure a more standard business framework.

This recommendation has to be viewed in a transitional context in which the current Board of QSL has eleven members — four elected by growers, four by millers, and three independent members appointed by the other eight. The recommendation allows for a shift in the composition and skills base of the Board to a structure more aligned to QSL operating in a fully commercial environment. But it doesn't specify what that structure should be.

Our evaluation

The composition and skills base of the Board clearly needs to be flexible so that QSL can respond efficiently to a fully commercial environment. Depending on the structure of voting rights, shareholders should be able to vote for those whom they believe will best direct QSL to fulfil its objectives. Like AWB Limited, QSL might be established with only non-listed shares carrying voting rights, with members elected by growers and millers. This said, all Board members should work solely to fulfil QSL's objectives and not consider that they 'represent' various classes of industry stakeholders. To benefit most from becoming fully commercial the relative numbers of independent specialist Board members should be increased and it might prove necessary for all shares ultimately to be listed.

We consider that a move away from a 'representative' board and towards one incorporating more special marketing skills and experiences would be in the interest of the industry and the wider community. It would better focus on the objectives of marketing and be less prone to capture by interests of particular classes of industry stakeholders. Indeed, it could serve industry and wider community interest well by cutting across compromises currently made within classes of growers and millers that are driven by regional interests or types of ownership. For this latter reason it is difficult to conclude that it would be in the interests of all current industry stakeholders, as there would be winners and losers. However, net outcomes for growers and suppliers should be positive.

Recommendation 6 — Subject to taxation and legal advice, the Constitution of QSL should be amended [in a number of ways, including] Clause 6 'Objects' – to be replaced with:*

(a) The principal object of the company is to purchase, sell and participate in any form of trade and commerce about the products of the Queensland sugar industry or a sugar industry, and

(b) In carrying out its object, and without limiting its powers under the law, the company will promote the development of the sugar industry elsewhere.

(*A number of other amendments of a technical nature in reference to the existing Act are also listed.)

Although an objects clause would no longer be strictly necessary in the Constitution of a company limited by shares, the proposal modifies an objects clause in QSL's existing Constitution. It is sufficiently broad to encompass any form of marketing of sugar and of entering into any form of value adding arrangements. It also implies that it might broaden its ambit from Queensland sugar alone (it already sells on behalf of the industry in New South Wales) to promote the development of sugar industries elsewhere.

Our evaluation

The current objects and powers of QSL allow it to purchase, sell and participate in any form of trade and commerce about the products of the Queensland sugar industry or a sugar industry elsewhere. However, the change proposed would sharpen the focus of QSL on marketing and market development and encourage it into a greater variety of selling methods. It also makes it more explicit that QSL's activities, though centred on Queensland sugar, can encompass sugar product sales from whatever source provided they are commercially attractive.

We consider that this simplification and sharpening of focus, yet broadening of scope, of QSL's marketing objects would be in the interest of the industry, its stakeholders and the wider community. However, we envisage that in a truly dynamic commercial setting QSL should not be limited to be a sugar trader solely, but as with many other trading agribusinesses in Australia and elsewhere could consider trading on a wider commodity front. There is no inherent reason why it should not trade also in sugar and other sweeteners or fermentables from non-Australian sources, being able like some of the grains traders to better position themselves in the overall world trade.

As discussed previously, New Zealand's large dairy co-operative, Fonterra, is an example of a transformation in some of these respects. It is branching out into acquiring interests in the Australian dairy industry to better position itself in the world dairy product market. It also has a biotechnology company as well as selling its expertise in branding, packaging and marketing to a range of other processed food product companies.

The relationship between the marketer and suppliers

Recommendation 7 — Rules relating to participation, entry and exit be determined by the Board of the marketer in consultation with suppliers and incorporated into supply contracts. It is recommended that the goal of the marketer is that suppliers should commit to 100 per cent of bulk sugar for export.

Recommendation 8 — The initial contract arrangements be finalised no later than 31 December 2005 and the term of that contract should be three years. Beyond that initial three-year period a rolling two-year period could be appropriate.

Being commercial operations, the terms of contractual arrangements would be determined between suppliers and QSL. This said, the Working Group considers that there would be two basic types of contract:

- a Sale of Goods contract under which ownership of bulk raw sugar would pass to QSL; and
- a Principal / Agent contract where QSL sells bulk raw sugar on behalf of the supplier.

QSL would determine rules relating to participation, entry and exit, its goal being to secure a commitment from each participating supplier to supply 100 per cent of its bulk sugar for export. The Working Group considers that to commit less than all of a supplier's output could reduce QSL to be an export marketer of last resort. No reason is given by the Working Group as to why an initial contract period of three years is proposed, but some of QSL's current forward contracts could extend at least for that period.

Our evaluation

These two recommendations would give power to QSL to negotiate entry to or exit from the export market for three years. This would be so if no alternative marketer was foreshadowed before the end of 2005 and all initial contracts were for three years and covered all bulk raw sugar produced for export without any clauses allowing for withdrawal during this period (apart from the milestones referred to in recommendation 2). Such power, even if not enshrined in legislation, ranks among the strongest of all forms of anti-competitive powers and needs to be assessed in terms of whether in this case its benefits to the community exceeds its costs.

In a fully contestable market, for a marketer to insist on contracts of a minimum duration or to require adequate foreshadowing of withdrawal from contracts that roll over are issues to be settled commercially in light of how suppliers react. So too are requirements that all or a significant percentage of a supplier's output be covered by a contract. But for the initial year or so of the proposed new arrangements, the market is unlikely to be contestable. By limiting entry or exit, the recommendations could effectively defer the implementation of competition for up to three years.

The recommendations are also likely to lock QSL into receiving the entire price premium to be obtained from access to the US quota market for the first three years of the new arrangements. The quota is allocated by the US to Australia, and it is not for QSL or the Queensland Government to determine how it is allocated. Currently the Commonwealth allocates the quota to an industry body in each of the three sugar producing states — to QSL in Queensland — and the industry co-operatives in New South Wales and Western Australia sell their quota to QSL. In a fully deregulated market, the method for allocating Queensland's quota would need to be negotiated by the industry with the Commonwealth Government.

For industry stakeholders

This recommendation would discriminate against an alternative marketer emerging in the near future. It would, of course, benefit QSL by minimising initiatives it would have to take in order to secure supplies to meet any forward sales contracts and as it plans to position itself in the market. It would also help it defend any economies of size it currently enjoys in the market. However, size economies drop away very quickly as a firm gets bigger, and marginal losses of market share generally have little impact on unit costs of sales.

The recommendations might also benefit existing mills that have not developed independent skills in marketing their own products or assessing the marketing options proposed by others, and by taking advantage of the scale economies available through QSL. But they could discriminate against those mills that have these skills. Thus there is no clear picture as to whether industry overall would gain from the recommendations. The existing marketer would gain at a cost to potential market entrants. And between mills there would be winners and losers.

For the industry

Postponing competitive pressure on QSL for up to three years would defer the dynamic gains sought for the industry through deregulation of the market. We consider that the industry would gain from QSL having to offer commercial incentives to suppliers to commit themselves to certain levels of supply and for extended periods into the future, even in the initial period of transition. This is normal commercial practice in the negotiation of contracts in other rural industries. There should certainly be some differentiation in these regards between a Sale of Goods contract (under which marketing risk is born in the first instance by the marketer) and a Principal/Agent contract (under which risk is retained by the supplier). This might occur because different costs are likely to be imposed on QSL under different forms of contract.

For the community generally

While QSL remains effectively a sole seller, we consider that even if its statutory basis is removed the economic costs of the recommendations could exceed their benefits for the community generally. This does not mean that in a fully contestable market QSL should not seek, subject to general competition law, to secure a commitment from each participating supplier to secure all of its bulk raw sugar for export. However, if QSL were permitted to exercise its remaining market power to achieve this during a period of transition from compulsory vesting, innovation from more dynamic suppliers and alternative marketers would be discouraged.

For this reason we consider that it would be in the community's interest that:

- initial contracts be issued for a shorter period than three years and do not require the commitment of all of a supplier's output; and
- commercial incentives be used to encourage contracts for longer periods of supply or for greater proportions of supply outputs.

In these regards we note that if QSL (or any other marketer) wished to negotiate with two or more suppliers to establish industry or region wide contractual agreements, an authorisation under the TPA would be required. This could also be the case if any contract were to require a supplier to sell all of its output to or through the marketer. To be approved it would be necessary to demonstrate that such requirements are in the public interest.

When Fonterra was established in 2001, in part out of the prior New Zealand Dairy Board, the New Zealand Government considered that it was necessary to limit the power over suppliers that the new dominant marketer might have. In passing legislation to facilitate the merger, a number of measures were introduced to ensure the freedom of movement to or from the new marketer, including market share limits placed on Fonterra, the requirement that Fonterra have open entry and exit arrangements for suppliers, the entitlement of suppliers to a one-year supply contract (though longer contracts could be negotiated provided at least a third of all contracts turn over each year) and suppliers must be allowed to supply at least 20 per cent of their milk to other processors without penalty.

Operational structure

Recommendation 9 —The marketer would focus on marketing bulk raw sugar for export under contractual arrangements with suppliers.

Although the proposed objects of QSL in a deregulated marketing environment would permit and even encourage the company to participate in a range of marketing and value adding activities, the Working Group envisages that in an initial phase it would continue to focus on export sales of bulk raw sugar. No reason is given why QSL should continue to focus in this way, though it might be assumed that, since this has been the core activity in which it has expertise, it is from such activity that it would grow its skills in other directions.

Our evaluation

Though this recommendation might appropriately apply during an initial phase of QSL's operations in a deregulated environment, its wording implies that the exporting of bulk raw sugar should be its continuing focus. Given the large proportion of Queensland's sugar production that is exported and the nature of sugar's international trade, it is highly likely that the major marketing activity for Queensland sugar will continue to be the export of bulk raw sugar. This, however, does not mean that the focus of market development activity should relate to such sales.

It is self evident that it is in the interest of the industry, its stakeholders and the community generally that QSL's principal activity continues for the foreseeable future to be to facilitate the export of bulk raw sugar. This said, we consider it to be in the interest of the industry, its stakeholders and the community generally for the focus of QSL's market development activities, even in an initial stage, to be the exploration of how it can best relate to and become involved with sugar as a world traded commodity along side other traded commodities and commodity traders, and how it best adds value along the sugar processing / marketing chain in those contexts.

Recommendation 10 — Initially treasury, risk management and pooling functions would be similar to current arrangements but the marketer is expected to develop in the transition to standard business practice to more innovative arrangements.

The Working Group considers that within the first two years of the new arrangements QSL would develop more innovative treasury, risk management and pooling arrangements. However, under a Sale of Goods contract these functions could initially be the same as under the current compulsory acquisition arrangements where sales returns are pooled and shared risks passed back to suppliers.

The Working Group points out that the treasury, risk management and pooling functions currently carried out by QSL would change under different contractual arrangements. Under a Sale of Goods contract, QSL could also purchase supplies on its own behalf for forward sale, absorbing all the risk and financing costs itself. Under a Principal / Agent contract the treasury and risk management functions could be determined by QSL in consultation with suppliers, or in some cases suppliers might make their own arrangements more directly.

Our evaluation

Suppliers of sugar are likely to vary considerably in their abilities and preferences with respect to financing the sales of their products and the risks they bear in the market. For some, the sharing of financial costs and risks with others may be a preferred option. For others the individual management of market finance and risk, either by QSL on their behalf or by themselves still selling through QSL, may be preferred. The proposed arrangements, as indicated in this recommendation, would allow these outcomes to occur.

We consider that such a range of options would be in the interest of the industry, its stakeholders and the community generally. Pooling arrangements could continue, though participation in them would be voluntary. For those suppliers who chose to sell more directly to QSL without pooling, sales risks and financing obligations would be directly shifted to QSL who would seek to maximise its own revenue and manage its own risks from these sales. For those who used QSL as a sales agent, costs of finance and the management of risk would be tailored on the basis of best meeting individual needs — though perhaps some of those risks would be shared through pooling.

This would add to the overall efficiency of operations within the industry as a whole and lead to a more dynamic commercial orientation. Thereby it would not only be in the overall interest of the industry but would also be in the general community interest. In particular it would develop the market for financial and risk management instruments, possibly feeding back to growers themselves, and in particular the location of such services in regional centres.

Recommendation 11 — Bulk sugar terminals and storage operations would continue to be similar to current arrangements. The marketer, in conjunction with STL, will have to develop a third party access protocol prior to the commencement of the 2006–07 season.

Under a lease agreement, QSL currently manages all aspects of the operations of the bulk sugar terminal and storage facilities owned by STL. These facilities are natural monopolies. That is, it would not pay a potential competitor of QSL, which currently is the sole user of these facilities, to duplicate them in order to compete. Under NCP, essential infrastructure considered to exhibit natural monopoly characteristics must be made available to competitive users, and processes are established for providing access to infrastructure services. For Queensland's bulk raw sugar terminal and storage facilities, under deregulated marketing it would be necessary for a regulatory access regime to be imposed or a voluntary access undertaking be developed by the owner of the facilities.

Our evaluation

The development of a third party access protocol is needed for STL's facilities under NCP requirements. But whereas the wording of the recommendation places the onus for its development on QSL (in consultation with STL as owner of the assets), we consider that the outcome would be more competitively neutral if the onus lay with STL (in conjunction with QSL as manager of the assets). Terms and conditions of the lease arrangement between STL and QSL are presumably confidential, but STL is the owner with the interest in how its assets are managed, and QSL has an interest which should be seen not to compromise the competitive neutrality of the outcome. Also of relevance is the requirement under Part IIIA of the TPA that a voluntary access agreement be approved by the Australian Competition and Consumer Commission. We consider such an external review of any third party access protocol undertaken to ensure competitive neutrality between parties to be in the public interest.

With these caveats, we consider that, in fulfilment of NCP obligations, the recommendation is in the interest of the wider community.

Impacts of removing specific marketing interventions

Current legislated marketing interventions

The SIA empowers QSL to act in a number of ways that deny or restrict competition while at the same time limiting and monitoring what QSL does.

The principal instrument empowering QSL is vesting. All sugar (as defined in the Act) produced in Queensland is vested in QSL upon its manufacture, though 0.25 per cent of each mill's production is divested back to the mill for local use and exemptions have recently been made for sugar used in the domestic manufacture of some products (bioplastics and ethanol) and for bagged sugar for export. To facilitate the marketing of sugar vested in it, QSL may make standards regarding quality and can direct mills to produce a particular brand / quality of sugar. QSL can also direct where mills store vested sugar before delivery and the location(s) to which it must be delivered.

QSL's power is limited and monitored in a number of ways. It is required under the Act to pay for sugar vested in it via payment schemes that reflect the raw sugar equivalent that each mill delivers. However, QSL has considerable discretion regarding the number of payment schemes it establishes and how revenues it receives and costs it incurs are distributed among the schemes. The Minister can also give directions to QSL with which it must comply.

Although QSL is not a statutory body *per se*, the Act places requirements on the composition of its Board and the appointment of its auditor. Its performance is also monitored and audited under the Act through the statutory Sugar Authority, and as well it is subject to Ombudsman and Freedom of Information legislation. QSL's Constitution also makes extensive reference to its functions and obligations under the Act.

Although the SIA grants compulsory acquisition power to QSL, no explicit authorisation is given to vesting in the Act in regard to requirements under general competition legislation that would otherwise prescribe an arrangement that has the purpose and effect of substantially lessening competition. Authorisation for such arrangements is generally required under the Commonwealth's TPA. This said, it is noted that no such authorisation is required for the vesting of ownership of agricultural produce, including produce subjected to a manufacturing process, which is specifically authorised under the TPA.

Impacts of removing interventions that currently empower QSL

Legislated interventions that empower QSL include vesting, making quality standards and directing mills to produce particular brands/ qualities of sugar, and direction of mills regarding where vested sugar is stored and delivered. Removal of the vesting power is the foundation of the whole proposal made by the Working Group. Impacts have been discussed widely throughout this report. In summary they include:

- the necessity for QSL to change its company structure and develop a greater variety of marketing options, including contracts with supplying mills;
- QSL no longer being a receiver of last resort;
- the entry of other marketers and forms of buying and selling sugar, potentially including international commodity traders;
- greater incentives to offer differentiated sugar products and services within marketing, and to add value to sugar before its sale; and

- a wider range of finance and risk bearing instruments and options for canegrowers, sugar marketers and buyers.

Although these are positive for the industry and the community generally, the impacts on QSL are more equivocal. In the first instance QSL will seek to lock in suppliers to minimise any dislocation costs of transition. In part this will be to cover forward contracts previously made on the assumption that total supplies of Queensland sugar will be at its disposal. However, it is understood that such contracts are a small proportion of QSL's overall sales portfolio. Although there could be some inter-seasonal transfers in QSL's portfolio of payment schemes, it is also understood that its current payment obligations would not be significantly compromised by not being assured of all future raw sugar supplies. Nevertheless, QSL may have to negotiate new lines of credit in order to finance contract options it offers to suppliers in a deregulated market environment.

The loss by QSL of powers to direct where sugar is stored and delivered, as well as to direct the delivery of sugar of specified brand/quality characteristics, will pass the direct costs of these functions from supplying mills to QSL itself. Under the current Act, QSL is required to reimburse mills for the costs of such directions, but in a fully commercial environment QSL may have to pay more to mills for such services than simply offsetting the costs of their supply. Also, although QSL undoubtedly benefits from the goodwill attached to the brands and standards of sugar it can direct mills to deliver, no explicit property rights are attached to these standards and brands. In a deregulated market the benefits from them could therefore be transferred from QSL to the supplier mills, which could also affect the manner in which sales revenues are shared between QSL and its supplier mills.

These changes, and any erosion of market share, could impact on QSL's cost structure. The nature of any shifts in having to purchase operating services commercially or of size economies forgone cannot be readily assessed from QSL's published accounts. However, if there are marked economies of throughput through infrastructure use and finance and risk management instruments, QSL should be more readily able to retain its market share by offering low cost services. If, however, its market share were significantly to decline and its unit costs increased, it would be because others were able to offer low cost services in relation to returns from the services they offer.

To retain market share, QSL might also need to establish ownership links with suppliers and/or forge strategic alliances with them. Under its current structure of ownership and operations it at marked disadvantage in these regards compared with many of its potential competitors.

A further impact of the termination of vesting is that QSL would lose its automatic right to receive the benefit of the price premium obtained from Queensland’s allocated share of the US quota market. As explained earlier, the Commonwealth currently allocates this share to QSL as the appropriate industry body in Queensland. But in a contestable market the Commonwealth would need to determine an alternative mechanism for distributing it, which could involve QSL and other marketers competing for its use.

Impacts of removing interventions that currently control QSL

Legislated interventions that limit the power of QSL to exploit its status as a single desk seller include some features of the payment schemes, the power of the Minister to issue directions to QSL, statutory requirements regarding the composition of QSL’s Board and the appointment of its auditor, and general accountability and information requirements.

With the transformation of QSL from a company limited by guarantee to a company limited by shares, each of these interventions would be removed. No longer would it be a requirement that QSL payments to suppliers be based on some specified costs and on the raw sugar content of the product supplied. QSL would be free to negotiate such payment arrangements with suppliers as it chose, subject to general trade practices law. In this latter regard, two potential issues raised in the Working Group’s proposal arise. First, if the marketer wished to negotiate with two or more suppliers to establish industry or region wide contractual agreements, an authorisation under the TPA would be required. This would also be the case if any contract were to require a supplier to sell all of its output to or through the marketer. To be approved it would be necessary to demonstrate that such requirements are in the public interest.

QSL would also be relieved of potential interventions by way of Ministerial directions. Thus far only one such direction has been given, namely that raw sugar for domestic use is to be purchased from QSL according to formulae based on export parity prices. This seeks to ensure that domestic users of raw sugar are not disadvantaged in terms of price by the sole seller status of QSL. Without such a direction, QSL could (as it had prior to the direction) price domestic sugar on the basis of import parity.

In a contestable market, the impact of removing this direction might be minimal, since it could be expected that competition between marketers would drive domestic prices toward export levels. However, as in other industries with multiple domestic and export sellers, the advantages of domestic users having local sources of supply to provide for their specific needs could result in domestic premiums akin to export premiums that can be obtained from a variety of sources that are not dependent on market power.

With the transformation of QSL into a company limited by shares there would be some significant changes in accountability requirements. QSL would no longer be as directly accountable to the Minister as in the past. As proposed by the Working Group, this would lead to the removal from QSL’s Constitution (if it were to retain one) of meeting any requirements of the SIA, and would free QSL to structure its Board and its accounting procedures best serve its own commercial interests, subject to requirements of company law. QSL would presumably become a tax paying entity, offering imputation credits to its shareholders.

This also would mean that considerable information that had previously been in the public domain would now become commercial-in-confidence and no longer freely available to government and the community generally. This raises several issues regarding the value of information, how it should be paid for and how freely it should be available. These issues go well beyond the scope of this assessment. Here it is simply observed that with the transformation of statutory marketing authorities, through corporatisation to privately owned marketing companies there has been a general diminution of production and marketing information that is freely available and an increase in private resources committed to the generation of information servicing market research.

4 Potential developments of marketing organisations and sources of competition for QSL

Proposals made by the Working Group all relate to QSL as 'the marketing company'. However, following deregulation the nature and structure of QSL would change, depending on the number, structure and size of competitors that might enter the market and the nature of economies of scale and scope. Some existing stakeholders in the industry could enter the market, some marketers of sugar or agricultural commodities located elsewhere could commence trading sugar, or businesses eager and able to add value to sugar in food or industrial products might enter into direct relationships with growers or mills to purchase sugar for their needs. Furthermore, the whole dynamics of the market should change, with commercial incentives integrating Queensland sugar into a more complex yet rewarding network of trade and value adding.

This chapter examines some tenable outcomes in these regards and points towards the character of such a dynamic market. In doing so it draws heavily on the overview of potential outcomes of Queensland sugar market deregulation presented in Williams (2003).

Current stakeholders with a potential interest in marketing

Current industry stakeholders with a potential interest in marketing include QSL itself, individual mills or milling groups, individual canegrowers or canegrower organisations, and STL which owns the industry's major physical export marketing infrastructure.

QSL as a contractually based marketing company

The Working Group's proposal envisages QSL being transformed into a contractually based marketing company and many of its recommendations are designed to position QSL in such a way that it can continue as the principal or a major player in the future. Many features of QSL favour this. It starts from a position of total market dominance and presumably the goodwill of many supplying mills and customers who identify its product as having the quality attributes they desire. Many growers and their mills are likely to opt to remain with its financing, risk management and pooling arrangements. It has an established lease with STL and a proven record in managing terminal, storage, handling and shipping arrangements.

This said, QSL does not have any direct ownership links with other elements of the production and value adding chains. It does not own any physical infrastructure or value adding facilities. Nor does it own any mills from which it could assure dedicated supplies. Furthermore, it has not had a company or equity shareholding base that could finance it into a rapid acquisition of such facilities. This does not preclude it from continuing as a viable trader, but initially it will have to be based on its current marketing expertise and any strategic alliances it can quickly form with other non-aligned stakeholders. In this scenario it might find it difficult to maintain a position of market dominance for very long unless it can offer lower costs, better service and innovation that delivers benefits to its stakeholders. This highlights the competitive pressures that will emerge and influence QSL.

Sugar milling companies and the competitive pressures they could apply

Three milling groups, CSR, Mackay Sugar and Bundaberg Sugar, currently control about three quarters of the Queensland industry’s raw sugar output. The remaining quarter is produced by seven independent mills. Each of the big three owns several mills and could enter the market drawing on supplies dedicated from those mills. In addition, Bundaberg Sugar grows considerable quantities of cane in its own right and is linked through ownership into a world marketing network. Each of the three groups is also linked through ownership to refining (as do the NSW Sugar Marketing Co-operative’s mills through the Manildra Group), and all undertake various other value adding activities. As well, Mackay Sugar has a vessel that handles 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. 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 seven independent mills do not have ownership links with domestic refining and probably have less expertise and financial backing to act as competitive merchants in their own right. They could, however, add value for some small but highly profitable niche market situations. Rocky Point (organically grown sugar), Mulgrave (Plantation White sugar) and Maryborough (High Pol brand sugar) already have capacity in these regards. The independents could also mill cane on a toll basis for growers or other interests who would sell into other markets, sell to or through major world commodity traders, or develop long term contractual relationships with QSL or other Australian marketers.

Individual canegrowers or canegrower organisations

As suggested above, it might be feasible for individual canegrowers or grower organisations to grow sugar with identifiable qualities, such as organic purity, that have customer appeal. Individually or as groups they may wish to have their cane milled on a toll basis, or in joint venture with a mill, to sell in their own right. Such ventures might be small, but they might provide an opportunity for the development of entrepreneurial skills.

Sugar Terminals Ltd (STL)

STL owns seven bulk sugar terminals at strategic ports along the Queensland coast. The company is owned by growers and millers. As suggested in earlier chapters, its infrastructure assets are unlikely to be reproduced under competitive marketing arrangements, and would be the subject of third party access protocols to ensure that sugar marketing genuinely remains contestable.

STL itself has not had any direct involvement in sugar marketing, and its assets are currently leased to and managed by QSL. However, users of its assets could reap size economies on a regional basis. It is a tenable scenario that STL itself could take advantage of its infrastructure base to market sugar in its own right, or in joint venture with mills or a milling group in certain regions, or in a joint venture with QSL.

International commodity traders

Although Queensland is a major source of sugar in world trade, most of the trade in fact takes place through large international trading houses, such as Czarnikow Sugar, and ED and F Man Sugar, both of which operate as brokers and merchants. QSL uses the services of Czarnikow, of which CSR owns 25 per cent. Sugar Australia, which owns sugar refineries in

Melbourne and Mackay and a liquid sugar-refining depot at Fremantle, as well as port loading / unloading facilities at several ports, was established in 1998 as a joint venture between CSR, Mackay Sugar, and ED and F Man Sugar. However, in 2004 CSR acquired the interest of ED and F Man. With QSL's single desk status on bulk raw sugar exports, thus far neither Czarnikow nor ED and F Man Sugar has entered the Australian sugar market directly as a merchant.

In the event of the termination of compulsory vesting, QSL or other Australian based merchants would be likely to continue to use these or other commodity traders, either as brokers or as firms to whom they on-sell. It is highly likely, for example, that CSR would use its ownership interest in Czarnikow to sell some of its sugar into the international market. However, it is also likely that both companies, as well as other world agricultural commodity traders such as Cargill or Louis Dreyfus, would create opportunities to trade directly, possibly through alliances with mills to which they would offer marketing expertise and finance.

It must be stressed that the direct presence of international traders would not necessarily be a threat to other marketers in Australia, but rather could an opportunity to open them to and integrate them with the rest of the world trade. The large export sugar industries of Brazil, Thailand and the EU use these traders, that 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.

Businesses adding value to sugar in Australia

Apart from encouraging the entry, in the longer term, of new merchants or other types of export traders, following the termination of compulsory vesting it is likely that deregulation would stimulate the direct transformations of products in process in sugar mills into value added products. Such value might be added either by existing stakeholders in the industry or by other firms wishing to buy inputs directly for these activities or to joint venture for them with existing growers or mills.

The principal value adding activity in Australia currently is the refining of raw sugar by Sugar Australia, Bundaberg Sugar and the Manildra Group. Each of these groups is linked by ownership to milling interests. CSR also has a half interest in a New Zealand refinery that holds an 80 per cent share of that country's refined sugar market. Following deregulation, the sugar refining components of these milling groups are likely to remain buyers for

Australian use of their outputs, plus some niche market export sales, rather than become merchants. However, they and others may become interested in buying product in process from sugar mills for other value-added products.

The Manildra Group, which had its origins in grains based products, already has interests in glucose, fructose, ethanol and alcohol products. Under deregulation, Manildra could become interested in buying sugar mill products as a base for producing value added products for both domestic and export use.

Under the current regulatory framework some producers have already been utilising molasses (which is not vested in QSL) and (since the legislated changes of 2004) sugar exempted from vesting used in the domestic manufacture of some designated products for the production of rum (distilleries at Bundaberg and Beenleigh), anhydrous ethanol (Rocky Point) and ethanol (Sarina). CSR's Sarina power alcohol/ethanol plant is Australia's largest supplier of industrial alcohol. However, following deregulation, with no legislated restriction along a mill's value chain on how products are streamed into raw sugar or other uses, it is likely that there will be much greater incentives to add value in ways other than via the raw sugar route. It should also encourage other businesses to buy mill outputs other than raw sugar to manufacture value added products in their own right or to joint venture with mills to produce them for third parties to sell.

Many of these products could be for the pharmaceutical, cosmetic or other industrial industries or for animal feed use. Many could also be in the human food, confectionary and beverage industries that have special sweetener or fermentable requirements. Value might also be added from highly individualised services provided for particular customers. For example, in a deregulated market existing Australian multiple food product exporters could source their sugar requirements more directly and cheaply. Indeed, some Australian firms which in the past have been restricted in growing on the world scene might become global operators along side the likes of Nestlé or Cadbury Schweppes.

Unshackling marketers to become world players

Exactly which companies end up marketing Queensland sugar is difficult to predict. What is more predictable is that the industry's proposal to make QSL a contractually based marketing company will introduce long denied competition to the marketing of Queensland sugar over the longer term.

The competition will create a spur for innovation, growth and cost control. It will provide incentives to explore more broadly the commercial opportunities and challenges represented by marketing a billion dollars a year's worth of commodity. It will create incentives for companies to develop a diverse range of commercial skills to better exploit such opportunities and challenges. This will attract and develop the management needed to run growth oriented commodity marketing organisations which may take on a global focus. Potentially, this will help the industry, the sugar regions and the wider Queensland economy. The skills developed are likely to be transferred to help develop other opportunities both within the sugar industry and beyond as other growth oriented commodity-based companies of the world have done.

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