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# Government Policy Success: A Tale of Sugar - a Comment on Edwards

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There have been significant changes to the sugar industry's regulatory regime over the past five years. New investment is flowing into all sectors of the industry. Consumers have benefited by rationalisation of the white sugar industry. The raw sugar industry is undergoing a period of sustained expansion. There is a resurgence of confidence in the industry and surrounding rural communities. The industry is making an important contribution to export earnings and the national economy. In short, the sugar industry is a tale of government policy success.

## 1. Introduction

Readers of the August 1993 *Review* were presented with an overview of recent policy developments in both the sugar and wool industries (Edwards 1993). It is unfortunate that Edwards has chosen to link the two industries for policy analysis in the way that he has. The economic performance of the wool and sugar industries is quite different, as are their regulatory regimes and the consequences of the regulations affecting the two industries.

The wool industry has recently been in decline. It has been characterised by falling production, negative farm incomes and profits, falling investment and the rundown of existing capital stocks. The price support arrangements (the minimum reserve price scheme) have clearly failed. The legacy of government policy failure has been an enormous cost to the industry, the surrounding rural communities and the Australian economy at large. The wool industry is expected to reach its nadir in 1993-94 (Oliver, Clark and Gleeson 1994). The outlook for the industry is brighter thereafter.

By contrast, the sugar industry is a vibrant, expanding industry. It is characterised by rising production, positive incomes and profits, new investment flowing into all sectors of the industry and the build up of existing capital stocks despite being subject to a declining terms of trade (more than 3 per cent per annum on average). The consequence is a

resurgence of confidence in the industry, an economic boost to surrounding rural communities and an important contribution to export earnings and the national economy.

Against this background and despite the significant changes which have occurred in the sugar industry's regulatory structure over the past five years, Edward's (1993) review of sugar policy concludes:

'the tale of sugar industry policy in 1992 and 1993 is one of a strong economic case for sweeping deregulation being made and rejected.'

The Queensland and Commonwealth governments' rejection of the so called 'strong economic' case for deregulation made by ABARE (1991), Borrell, Quirke and Vincent (1991) and the Industry Commission (IC 1992a) appears to be portrayed as evidence that sugar policy should be counted as a government policy failure. Given the above characterisation of the industry and the nature and extent of changes which have been made to the industry's regulations by both state and federal governments, this portrayal warrants closer examination.

## 2. Sugar Industry Regulation

Sugar cane is not a tradeable commodity. Apart from sugar milling there is not an alternative fresh cane market. The concentrated nature of the milling industry in Queensland means that even where cane growers can supply more than one mill — those mills usually have the same ownership struc-

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ture. Balancing the relative market power of the different players in the industry was a central reason for introducing industry regulations in 1915.

The Royal Commission which reviewed the industry in 1912 considered that the distribution of proceeds among segments of the industry could be considered to be fair where there is strong competition, where there is potential for competition, or from collective bargaining (Brown, Hinchcliffe, Anderson and Shannon 1912). The Royal Commission observed that it would be futile to contend that competitive forces are reasonably effective as a means of securing an equitable distribution of profits in the sugar industry.

The reasons for introducing industry regulations in the first instance, that there was a lack of competitive forces operating in the fresh cane market, still pervade the sugar industry in the 1990s. Nevertheless, both the Queensland and Commonwealth governments have made some significant changes to the industry's regulations in the last five years. Outside of the sugar industry little appears to be understood of the industry's structure, of the different effects of the previous state regulations and the Commonwealth-Queensland sugar agreement on different parts of the industry and how these influence consumer benefits. This is evidenced by the writings of Borrell *et al* (1991), IC (1992a) and Edwards (1993).

### 3. White Sugar

When considering the effects of various government policies on consumers it is important to realise that consumers generally purchase white sugar not raw sugar. White sugar can be produced from both sugar beet and raw sugar, whereas raw sugar is produced from sugar cane. The world price for white sugar reflects fluctuations in the supply of both beet and cane. It does not equal the world price of raw sugar plus a fixed refining margin.

In Australia, the price consumers pay for refined sugar reflects the world price for white sugar. This price has as its upper bound import parity and as its lower bound export parity. The precise level at which white sugar prices are struck and the extent

to which the value of the tariff on sugar imports is reflected in these prices depends in large part on competition amongst refiners for domestic market share.

The Australian white sugar industry is not covered by current regulations governing the raw sugar industry in Queensland. Nevertheless, the development of the white sugar industry was retarded by the Commonwealth-Queensland sugar agreement which existed until 1989. Under this agreement there was an embargo on sugar imports and domestic white sugar production was a cost plus activity with the product sold at administered prices. The lack of competition resulted in a high cost inward looking white sugar industry. The removal of the Commonwealth-Queensland sugar agreement heralded a period of dramatic change in the white sugar industry. This has been marked by a high level of new investment flowing into the industry.

Two refineries have ceased operations, a new refinery has been commissioned in northern New South Wales, a second is under construction in Mackay and the Bundaberg refinery has been substantially upgraded. In the latest development the Bundaberg Sugar Company announced, in a press release dated 18 October 1993, plans for an additional investment to boost the capacity of its refinery by another 50 per cent.

The rationalisation and developments which have occurred in the Australian white sugar industry have already given rise to increased competition among refiners for domestic market share. The Trade Practices Commission (TPC) expects this competition to intensify following its disallowance of the proposed joint venture between CSR Limited and the principals of Mackay Refined Sugars.

From a policy analysis perspective, the rationalisation and new investment in the Australian white sugar industry and the associated lower white sugar prices to consumers have occurred in response to changes in regulations affecting the Australian white sugar industry. They have not been restricted by regulations governing the raw sugar industry in Queensland nor by raw sugar marketing arrangements. Despite the recent TPC decision the prospects of Australia developing an economically

viable white sugar export capability have been enhanced as a result of developments which have occurred in white sugar shipping technology. These issues and the effects of the *Trade Practices Act 1974* appear to have been overlooked by Edwards (1993).

## 4. Raw Sugar

The raw sugar industry in Queensland has not been isolated from changes in regulations. The *Sugar Industry Act 1991* introduced a series of changes and structural innovations in regulations affecting the raw sugar industry. Although these changes were introduced during the course of the IC inquiry their recommendations failed to recognise the steps taken to free up the industry in the 1991 legislation (Wayne Goss, the Premier of Queensland, *The Australian* 1 May 1992).

There is little doubt that the previous regulatory regime was a constraint on industry production. It was largely due to the restrictive regulatory structure that no new land was assigned to sugar cane production in the six years from 1983 to 1989. The present regulatory structure enables production decisions to be made by cane growers in each local region in consultation with the mill owner they supply. This ensures that cane production is matched with mill crushing capacity.

The area of land assigned to sugar cane production has increased by 33.4 per cent since 1989. In 1993, a 5.5 per cent increase in land assignments was made available. Not all of which was taken up by cane growers when offered. A second public offer was required before the total expansion for the season was allocated. Before the 1994 expansion was determined industry requirements for expansion were canvassed at a local level. A similar process is expected to be implemented in future seasons. This process of matching industry requirements with increases in land assignment is evidence that the previous constraints on industry production have been lifted.

## 5. Single Desk Marketing

The other significant element of the Queensland sugar industry's regulatory structure is the retention of single desk marketing arrangements supported by compulsory acquisition. Single desk marketing enables coordinated management of raw sugar quality, service and supply standards. This differentiates Queensland raw sugar from that which is available from other origins. The reliable supply of a consistent high quality product and attention to individual customer requirements has resulted in Queensland being the preferred supplier in its markets and generated premium returns for the Queensland raw sugar industry.

Lack of competition in the marketing of raw sugar is seen by Borrell *et al* 1991, the Industry Commission (1992) and Edwards (1993) as evidence that single desk marketing arrangements are inherently inefficient. They discount the benefits received by the industry from taking a coordinated approach to export marketing and in the purchase of marketing services. For example, the Queensland sugar industry charters around 200 ships per year. This places the industry as one of the largest charterers of ships in Australia and provides the industry with the ability to negotiate more favourable shipping conditions (generate cost savings and thus receive higher FOB returns) than would otherwise be available to it. The integrated management of the industry's bulk storage facilities means that ships can be directed to any port in Queensland without incurring additional freight or demurrage costs.

The Industry Commission (1992a) and Edwards (1993) assert that because the marketing functions undertaken by the Queensland Sugar Corporation have statutory backing and are not subject to competition, the costs of providing these services will be inflated and the industry returns lower than they otherwise would have been. No empirical evidence is provided to support the broad generalisations made. There is no fundamental reason why single desk marketing arrangements must provide a less efficient outcome than private marketing. The appropriateness of the marketing arrangements and the way they are managed are the most

important determinants of whether the arrangements minimise costs.

The marketing, management and investment activities undertaken by the Queensland Sugar Corporation are structured in a way which emphasises cane growers' and mill owners' joint interests in minimising system costs. To this end, most of the services — including shipping and brokerage (the major marketing expenses) — provided by the Queensland Sugar Corporation are purchased on a commercially competitive basis. Quiggin, Fisher and Peterson (forthcoming) note in common property systems, if costs are pooled through a uniform pricing rule, then the investment decisions of such authorities will be technically efficient, since there will be unanimous agreement to adopt cost-minimising techniques.

The other arguments espoused against single desk marketing of raw sugar relate essentially to pricing arrangements. Edwards (1993) claims that the present raw sugar pricing policy of the Queensland Sugar Corporation to domestic refiners reduces the likelihood of Australia exporting refined sugar, and is a disincentive to value adding activities for raw sugar. A point not reflected on by Edwards but one which has been considered by the Industry Commission is the fact that the tariff is rebated on all raw sugar sold to the domestic market which is destined for export either as refined sugar or in a sugar containing product.

The price charged by the Queensland Sugar Corporation for raw sugar is determined in the world market. Following its study of the Corporation's pricing policy the Industry Commission (1992b) concluded that the relatively small loss of potential output associated with import parity pricing, coupled with the availability of export rebates, suggests that the domestic pricing policy of raw sugar producers is not causing a significant distortion to efficient resource use.

## 6. Conclusion

The regulations governing the sugar industry have been significantly changed in the past five years.

Australian consumers have benefited from the rationalisation and increased competition in the white sugar industry. Production controls in the raw sugar industry, no longer a constraint on production, are managed at a local level to ensure cane production is matched by milling capacity. The single desk marketing arrangements are managed in a manner which does not impose a significant economic cost to the economy. They do provide, however, a mechanism by which the industry can minimise its marketing costs and through which the relative market power of different players in the industry can be balanced. There is ample evidence to suggest that the sugar industry is a tale of government policy success not, as some would suggest, of policy failure.

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