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A Case for Statutory Marketing Arrangements

by

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Statutory marketing arrangements are said to stifle innovation and reduce marketing opportunities. This proposition is examined in this paper with reference to the marketing arrangements in place for the Queensland sugar industry. It is concluded that there is no fundamental reason why statutory marketing arrangements must provide for a less efficient outcome than private marketing arrangements. The way they are managed is the most important determinant of whether the arrangements are efficient. Moreover, when examining the appropriateness of various marketing arrangements, it is important to pay regard to the nature of the market within which the industry operates.

Introduction

Statutory marketing arrangements have been subject to a multitude of government inquiries in recent years. These have included the Davis (1990) inquiry and the recent Industry Commission (IC 1991) review which examined statutory marketing arrangements for a wide range of primary products. The Industry Commission has also reviewed several industries in separate inquiries.

The sugar industry appears to be a favourite industry for review. The Industries Assistance Commission reported on the industry in 1978 and 1983 (IAC 1979; 1983). The Industry Commission is finalising the report on its current review of the sugar industry. Furthermore, in Queensland, there have been reviews by two sugar industry working parties (Savage, Fitzpatrick, Stevens, Robinson, Bradley, Desmarchelier and Ferguson 1985; Fitzpatrick, Watson and Soper 1990) plus a Committee of Inquiry into pooling arrangements (Matthews, Andrews and Watson 1989). Forthcoming reviews include the division of sugar monies and another review of pooling arrangements. With these reviews and a number of other inquiries in train, perhaps the much publicised housing led recovery in the Australian economy will be an inquiry led recovery. This should continue to present a number of employment opportunities for economists.

Clearly, with the number of reviews being undertaken there are a number of perceived problems in the operation of statutory marketing arrangements. The focus in this paper is on one criticism of statutory marketing arrangements :- that they are based on compulsion, at least to some degree. Compulsion is said to stifle innovation and reduce marketing opportunities, and thereby reduce long term returns to the industry.

The first statutory marketing arrangement

The Queensland sugar industry has the distinction of being the first primary industry in Australia on which the Commonwealth government conferred statutory marketing arrangements. Originally, statutory marketing arrangements were established so that the Queensland sugar industry would employ European labour rather than lowly paid Melanesian labour. One of the conditions on which the Queensland government entered federation was that the Commonwealth government would compensate Queensland sugar producers for the cost disadvantage of having to employ more expensive European labour.

In 1902, the Commonwealth imposed an excise on manufactured sugar both imported and domestically produced. The revenue from the excise was used to subsidise the sugar grown and harvested by European labour. Other regulations which governed the relationship between cane growers and mill owners were introduced in 1915. A key reason for their introduction was the perceived imbalance in market power between different segments of the industry at that time (Fisher and Ryan 1915). Later, in 1923, when Australia became an exporter of raw sugar the Commonwealth and Queensland governments entered into an arrangement which banned the importation of sugar and maintained an agreed price on the Australian market. These price levels were generally higher than export prices. The arrangements remained remarkably unchanged, until the Queensland government introduced the *Sugar Industry Act* in July 1991. This has allowed for a remarkable freeing up of the sugar industry.

Marketing environment

The world sugar market is around 110 million tonnes and growing by about 2 per cent per year (figure 1). Less than one-third of sugar produced is traded. Of this about a third is sold under special arrangements which are insulated from world market prices. Therefore only 13 per cent or about 15 million tonnes is 'freely' traded at world market prices.

INSERT FIGURE 1 ABOUT HERE

Even this 'freely' traded sugar is subject to the influence of government policies in both producing and consuming countries. Australia is the only sugar exporting country in the world in which the price for all of its production is based on world sugar market prices (figure 2). Of the other exporting countries, only in Thailand is the world price used to determine the commercial value of more than 28 per cent of its production. Even Thailand has a large and growing domestic market. The 30 per cent of Thai sugar sold into this market receives an attractive return, US 22c/lb, three times the world price.

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Generating a competitive advantage

The Queensland Sugar Corporation is the single seller of all raw sugar produced in Queensland. It markets all the raw sugar produced in Australia for export. The world sugar market is dominated by a few large and powerful trade houses. Moreover, the domestic market for raw sugar is heavily concentrated on the buying side - almost 90 per cent of the Corporation's domestic sales are to one buyer, CSR Limited. The statutory marketing arrangement enables the Queensland Sugar Corporation to counter the market power of traders and other large buyers that are the customers for Queensland raw sugar. This is in contrast to marketing practices in Thailand where the bulk of the sugar is sold to traders who either on-sell to other traders or place the sugar with refiners. Thai producers have no control over the final destination of their product.

The central strategy in the Corporation's marketing package is to develop a high degree of product differentiation. This product differentiation enables the Queensland Sugar Corporation to earn premium returns in the world market despite the interventionist policies of its major competitors.

The main elements of the Queensland Sugar Corporation's marketing services package include the management and control of the bulk sugar terminals and of raw sugar quality. Other elements include the ability to engage in long term sales contracts, often with government supported central buying agencies and the achievement of economies of size.

The clear benefits to the industry which arise from the integrated management and control of bulk sugar terminals include the low cost of storage and handling, the ability of the industry to sell on either a C & F or CIF basis thereby controlling the destination of the final product, the ability to ensure that particular cargoes of raw sugar have the quality attributes which meet customers specific requirements, lower shipping costs derived from shorter more predictable loading times and enhanced standing with customers as a reliable supplier of high quality raw sugar. Of this range of benefits only the first two could be maintained on a regional basis if the terminals were established as separate trading companies. The integrated management of the bulk sugar terminals is central to the Queensland Sugar Corporation's ability to differentiate Queensland raw sugar from raw sugar available from other origins in the world market. Having developed such significant benefits by taking a co-ordinated approach in the marketing of raw sugar, or for any other product, they should not be dismissed lightly.

The management and control of raw sugar quality enables the Corporation to sell raw sugar based on its quality attributes rather than price alone. Long term relationships with customers have been established because purchasers know that the product they are receiving will be delivered in a timely fashion and will be of good and consistent quality. As a result, Queensland is the preferred supplier of raw sugar in all its markets.

At ABARE's Outlook 92 Conference, there was much discussion about the benefits of value-adding and how such activity is essential for the future development of the Australian economy. Statutory marketing arrangements are one method by which the value of primary commodities can be enhanced at low cost to the economy. The important point is that adding value to a product does not necessarily mean obtaining a higher price for it or further processing. More importantly, it means earning a higher return for domestic producers.

It is true that Australia is a small player in the world sugar market and therefore has limited influence over world prices. However, the marketing package offered by the Queensland Sugar Corporation enhances the value of Queensland raw sugar and generates a competitive advantage for the industry by consistently meeting or exceeding the buyers expectations in a way which is unmatched by its competitors.

There is no fundamental reason why statutory marketing arrangements must provide for a less efficient outcome than private marketing arrangements. The way they are managed is the most important determinant of whether the arrangements are efficient.

The rewards for entrepreneurship and innovation in marketing activities are not the sole preserve of the private sector of the economy. The transport, storage and handling facilities developed by the Queensland Sugar Corporation are widely accepted as the most efficient in the world. The Queensland Sugar Industry was amongst the first in the world to develop bulk sugar terminal facilities and to integrate their management structures. This integration assisted the development of the most efficient waterfront system of any Australian export industry - a factor often overlooked in reviews of the industry's operations and analysis of the marketing arrangements currently in place. As a result of the efficiency achievements, the cost of loading raw sugar in Queensland is significantly lower than in Thailand, Queensland's major competitor. This helps the industry to overcome the additional freight costs caused by the extra distance from the market of the Queensland sugar industry.

A key issue to be considered when evaluating the benefits of statutory marketing arrangements is whether the Queensland Sugar Corporation can through its marketing services package attract premium returns for Queensland raw sugar which more than offset the cost of gaining those returns. The sugar industry's ability to generate premium returns, that is to add value to its product, hinges on the Queensland Sugar Corporation's ability to distinguish its product from that of other sugar producers. The task is not simply to minimise the handling costs of raw sugar, rather it is the dual task of maximising the returns available from the sales of Queensland sugar at least cost to the industry, that is, to enhance the value of Queensland raw sugar. This does not mean necessarily to receive a higher price but a combination of a higher price, although that is important, and lower cost of servicing the market.

When examining statutory marketing arrangements, it is important to pay regard to the nature of the market within which the industry operates, for example there are high degrees of market concentration which characterise the sugar industry particularly in the domestic milling and refining sectors as well as the export markets. Under these circumstances, the paradigms of competition and choice cannot be applied without full acknowledgment of the impact of industry concentration and market power (Lipsey and Lancaster 1956). Great reliance is often placed on the ability of trade practices legislation to deal with these issues (see, for example, IC 1991). However, such reliance simply replaces one regulatory regime with another. For example, there is not evidence to suggest that the trade practices legislation will provide a more efficient outcome for the sugar industry than the legislation currently in place. The *Sugar Industry Act 1991* is directed to overcoming particular problems in the sugar industry and provides a framework in which the industry can establish a competitive advantage in the world sugar market.

Summary

The Queensland raw sugar industry has developed a reputation in its international markets as a supplier of a high quality product which meets buyer's specifications and is free from contamination. The high production standards achieved by the industry and as a consequence the competitiveness of Queensland raw sugar on the international market is closely linked to the efficiency of the Queensland Sugar Corporation's marketing activities. In the face of widely fluctuating world prices, rising market competition and highly protected markets in many of the major sugar consuming countries the Queensland Sugar Corporation has successfully maintained existing markets and developed new markets. In developing these markets the Queensland Sugar Corporation has acted to ensure that market signals are efficiently and effectively passed between consumers and producer. More importantly, the existence of compulsory acquisition and statutory arrangements have ensured that the returns to the Queensland industry are consistently higher than those to other sugar industries around the world where returns are enhanced by government support.

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Figure 1: The world sugar market

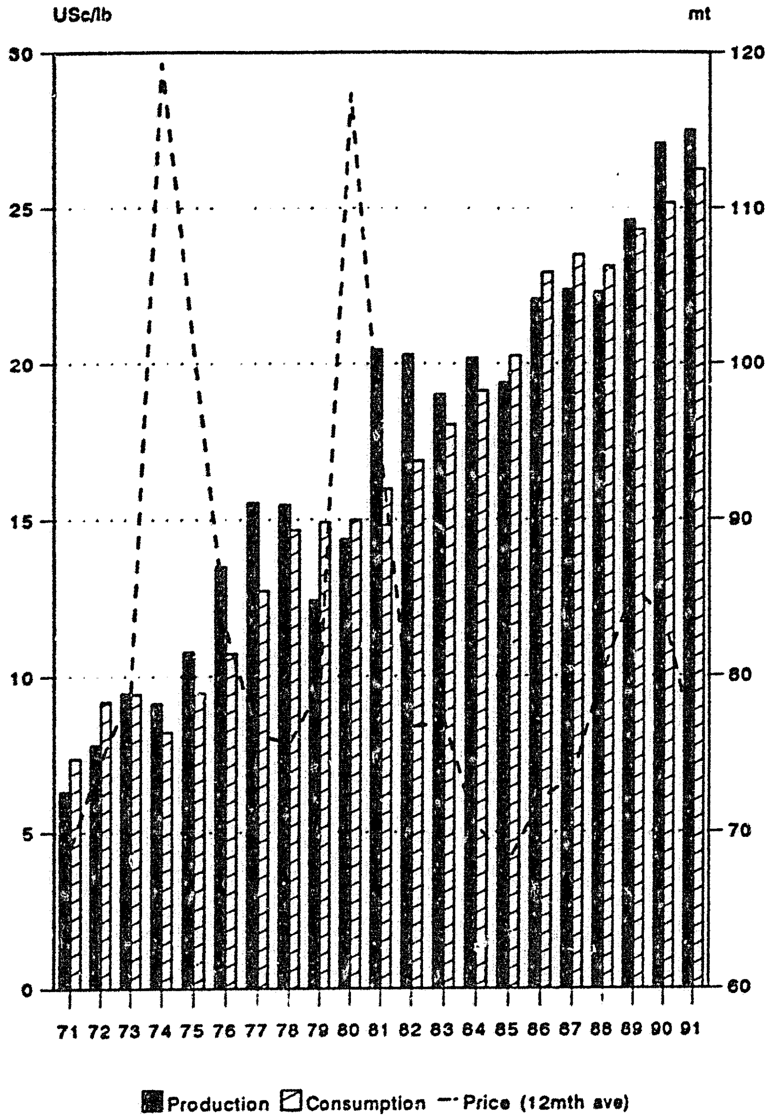

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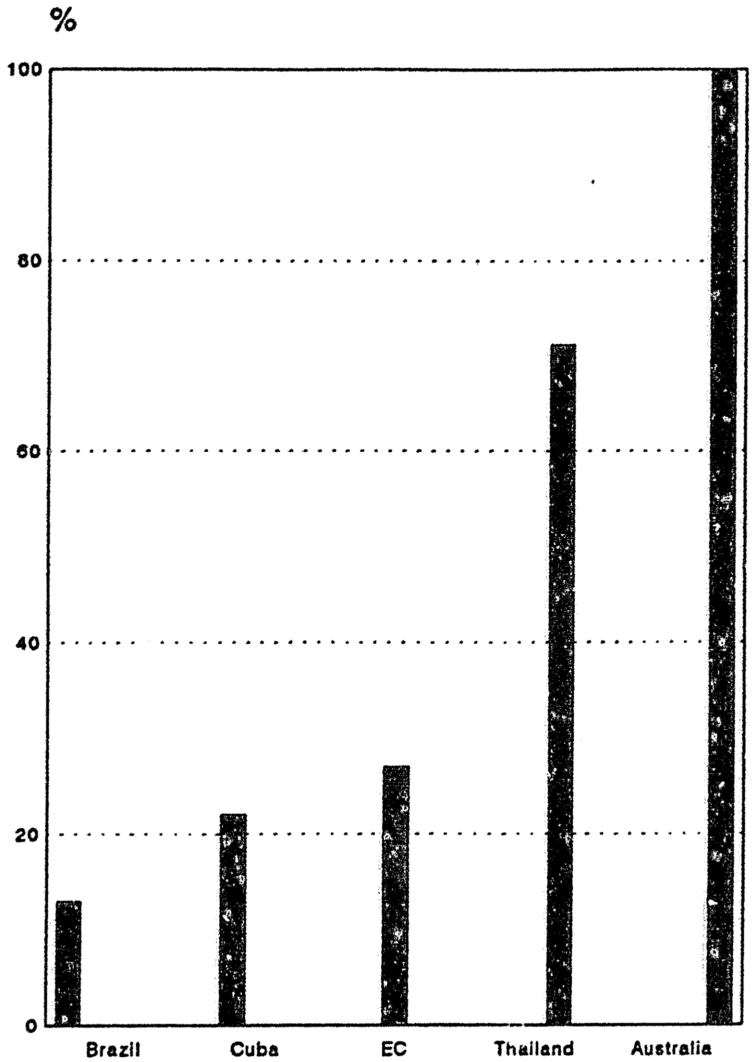
Figure 2: Proportion of sales made at world market prices



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