THE E.E.C. AND AUSTRALIAN SUGAR

By E.R. Behne

(Mr. E.R. Behne, Managing Director of Pioneer Sugar Mills Limited, delivered this address to a luncheon meeting of the New South Wales Branch of the Society in Sydney on 1 December 1971.)

In the Brisbane "Sunday Mail" of 21st November 1971, John Bragg, writing from London introduced an article on the E.E.C. in the following way:-

> "You can feel optimistic or depressed about the effect on Australia of Britain's forthcoming entry into the European Economic Community depending on the last argument you heard.
>
> The plain truth is that nobody knows for sure what it will be."

This is only too true. Accordingly, the best I can do is to try to place before you some relevant facts and leave you to decide whether you are optimistic or depressed.

Personally I am optimistic.

In this brief talk there is no time to describe even briefly what the E.E.C. is, how it came about and how it has developed. So I shall plunge straight into the subject - "The E.E.C. and Australian Sugar".

Sugar is an international commodity and is subject to controls and agreements on a national and an international basis. The two pertinent agreements in the present context are:-

- The British Commonwealth Sugar Agreement, (B.C.S.A.)
- The International Sugar Agreement, (I.S.A.)

The British Commonwealth Sugar Agreement commenced in 1951 and the expressed objectives were:-

- The supplying of the U.K. with sugar.
- The development of sugar in the Commonwealth countries.
- The orderly marketing of that sugar.

The "Text of 1968" is the original agreement modified by the various amendments made in the intervening period. This "Text" is now under review and no doubt a "Text of 1971" will emerge to cover the three years ending December 1974.

An important provision in the current agreement is that three years' notice of change must be given, with the important exception that six year's notice is required to affect changes in the quotas of the less developed countries.

Australia is of course a developed country and the three years' notice applies. Thus this year the U.K. can give notice that Australia's quota will cease on 31st December, 1974.

All the other exporting countries with quotas under the agreement are less developed countries and the six year notice period applies, but again with a big proviso, viz. that in the event of U.K. successfully completing negotiations for accession to the E.E.C., the U.K. cannot be committed to continuing the contractural obligations under the agreement after 31st December, 1974. If at that date the U.K. decided not to extend beyond 1974, it however undertook to consult with the other party seeking some alternative.

Thus whilst it recognises some obligations to the less developed countries extending beyond December 1974, it has none in the case of Australia.

The main obligation is of course for the U.K. to accept annually from each exporting member a tonnage quota at a price fixed every three years. The price is known as the negotiated price, (N.P.), and the quota the negotiated price quota, (N.P.Q.).

The (N.P.) agreed upon in 1968 was £43.10.0. (Stg. per ton of sugar f.o.b.). It is to be renegotiated this year for the three years 1972, 1973 and 1974.

The quotas are:- (long tons, tel quel)

	Tons
Australia	335,000
West Indies and Guiana	725,000
Mauritius	380,000
Fiji	140,000
East Africa	7,000
British Honduras	20,500
India	25,000
Southern Rhodesia (suspended)	25,000
Swaziland	85,000
Total:	1,742,500

The value to Australia of the N.P. sugar is some $A30M. per year, (after devaluation of sterling).

The B.C.S.A. also provides for the payment of British preference on "free" sugar sold in the preferential markets of the U.K. and Canada up to certain limiting tonnages. Thus each exporting country has an Overall Agreement Quota, (O.A.Q.), which includes the N.P.Q.

Australia's O.A.Q. is 662,000 tons. Deducting the N.P.Q. of 335,000 the tonnage attracting preference in these two markets is 327,000 tons, (subject to adjustment for shortfalls in the "frees"). The U.K. preference is £3.15.0 Stg.

Since the N.P. and U.K. preference is fixed in terms of sterling the devaluation of sterling in November 1967 reduced the value of exports to the U.K. by about $A5.4M. The Commonwealth Government has compensated the sugar industry for this loss up to this year. It will cease thereafter.

Exports from Australia to the U.K. and Canada in recent years were:-

	1968	1969	1970	
United Kingdom	532,866	362,118	433,877	tons. (metric r.v.)
Canada	152,225	230,376	283,554	" " "
Total	685,091	592,494	717,431	" " "

Now let us look briefly at the International Sugar Agreement.

Of the total production of the world, 70M. tons, the disposal is roughly as follows:-

	Million Tons	Per Cent
Total production	70.0	100.0
Consumed internally	50.0	71.4
Net Exports	20.0	28.6
Special Arrangements	11.0	15.7
World Market	9.0	12.9

The world market is thus a residual market.

With sugar being produced all over the globe, total production will fluctuate as the result of climatic, political and other factors. Whilst this fluctuation as a percentage of total production may not be great it is unfortunately all concentrated in the residual 9 million tons on the world market where it is of significant weight and with consequent large effects on the World Market Price.

It was to control these fluctuations and to stabilise the world price that the International Sugar Agreement, (I.S.A.), was negotiated in 1968. It commenced on 1st January, 1969. It uses a quota-price mechanism.

In this it has been successful.

The I.S.A. recognises sugar sales made under "special arrangements" and the Basic Export Tonnages, (B.E.T.), of the agreement, i.e. the basic equities of the exporting members, have been established on the assumption of continuity and stability of these bilateral arrangements.

It also provides for the increase, (or reduction), of a member's B.E.T. by the full extent of any reduction, (or increase), in his annual export entitlement under a special arrangement. Where however the compensating adjustment would involve a major change in the sugar market, the Council of the I.S.O. would seek to amend the "agreement" by special vote or by the re-negotiation of the B.E.T.'s.

Exports to the U.K. under the British Commonwealth Sugar Agreement up to the amount of the Negotiated Price Quotas are recognised as such "special arrangements". These total about 1.74M. tons.

For dealing with its agricultural products the E.E.C. has established the Common Agricultural Policy.

The C.A.P. comprises three main elements:-

(i) The common organisation of markets for particular commodities.
(ii) Common price aims through the community for particular commodities.
(iii) Arrangements for financing the policy.

The regulations are in general based on a system of prices only, without production control, (with the notable exception of sugar). Usually a "target" price is fixed, which the community farmers should be able to obtain. Protection from imports takes the form of variable levies to raise the price of imports to at least the "target" price. In some cases this protection is supplemented by a system of support buying at intervention prices somewhat below the "target" price and by the subsidisation of community exports to other countries.

For financing the C.A.P. the Community has created an Agricultural Guidance and Guarantee Fund. The Guidance Section is to finance assistance for improving the structure of agriculture in member countries. The Guarantee Section - much the greater part of the Fund - is to finance intervention and support buying where markets are depressed, and the subsidisation of exports.

Originally it was intended that the Fund would ultimately draw its resources mainly from levy proceeds on imports from third countries. It soon became obvious however that this would be inadequate so the revenue from import levies had to be supplemented by direct levies from the members.

For the year 1968-69 the budgetted make-up of the fund was:-

	U.A. Millions
Import levies	893
Direct levies on members	1,387
Total:	2,280

(N.B. The term 'UA'. In the Community agricultural prices etc. are expressed in Units of Account which at that time were equivalent to $US.)

The Guidance Section required 286 million U.A. so the bulk 1,994 million U.A. was for the Guarantee Section.

The Community is concerned at the high and increasing cost of its C.A.P. and has examined a number of proposals, (e.g. the Mansholt Plan), but it is understood that so far no firm decisions for limiting the fund have been made.

The E.E.C. Sugar Regulations

Sugar is unique in that it is the only commodity to which the Community has applied a quota system. However the sugar regulations are regarded as "transitional" largely because the sugar quotas are an exception to the E.E.C.'s normal C.A.P. arrangements. The Community is opposed to policies involving any suggestion of quantitative control over production. The relevant article states that the quotas will cease to have effect from 1st July, 1975.

There is no indication of what will happen after 1st July, 1975.

The current arrangements therefore combine a quota system with a system of target, threshold and intervention prices.

The basic quotas in terms of white sugar, and which are expected to equal 105 per cent of the Community's consumption, are:-

	Metric Tons
West Germany	1,750,000
France (inc.o/s.Depts.)	2,400,000
Italy	1,230,000
Netherlands	550,000
Belgium - Luxembourg	550,000
Total:	6,480,000

Incidentally these quotas, if realised, would make the E.E.C. the second largest sugar producer in the world, (after U.S.S.R.) In 1969 the E.E.C. produced over 8M.tons.

These quotas are not limiting, they are primarily reference points in a price system involving incentives and disincentives. Also "white" sugar is not refined sugar. It is raw sugar that has been subjected to more intensive clarification during processing.

For the 1970-71 sugar year the price arrangements were:-

(i) A Target price of 22.35 U.A. per 100 kg. of white sugar, (over $A200 per long ton), is paid to the factory producing the sugar.

(ii) An Intervention price of 21.23 U.A. per 100 kg., (about $A190), (95 per cent of the target price), is also set. This provides a floor to Community sugar prices since the government will purchase the sugar at this price.

(iii) A Minimum beet price for beet within the base quota, of 17 U.A. per metric ton, ($A15.3 per long ton), for beets containing 16 per cent sucrose is set. For beets within a supplementary quota the price is 10 U.A. per metric ton. ($A9 per long ton).

(iv) A Threshold price equal to the target price in Northern France plus freight costs to Palermo in southern Italy - 24.94 U.A. per 100 kg. (about $A218 per long ton). The north of France is the area of the greatest surplus of sugar.
The levy to protect the Community market from low priced imports is the difference between the threshold price and the lowest price at which imports are offered.

(v) If production exceeds the basic quota a production charge or levy of not greater than the 8.97 U.A. per 100 kg. of white sugar, (about $A80 per long ton), is made to recover the cost to the Community of disposing of this excess sugar, provided the quantity does not exceed the ceiling tonnage. This is a maximum tonnage for each factory set at 135 per cent of the basic quota. Sugar in excess of the ceiling tonnage is sold on the world market without subsidy.

Thus a grower will get not less than the minimum price for beet he can sell within the basic quota: a lower price for additional beet if the Community is producing more than the basic quota, i.e. 105 per cent of its requirements; and an even lower price related to the price at which sugar can be sold on the world market if his beet is sold to produce sugar above the ceiling quota.

The French O/S. Department of Guadaloupe, Martinique and Reunion receive the raw sugar equivalent of the white intervention price 18.66 U.A. per 100 kg., ($A168 per long ton). The sterling equivalent of this is £ stg. 79. For comparison the N.P. in 1970 for the underdeveloped countries was £ stg.47.10.0 - £ stg.31.10.0 lower.

(N.B.) The raw sugar equivalent on this figure is 87.5% of the white sugar value).

The U.K. and the E.E.C.

In 1970 when it became apparent that the present U.K. Government was determined to seek entry into the E.E.C. there was great speculation as to the future of the sugar industries of the members of the British Commonwealth Sugar Agreement, particularly those which depended largely on their sugar exports to the U.K. for their livelihood.

Eventually, in May 1971, representatives of the U.K. Government met representatives of the governments of all the developing countries of the British Commonwealth Sugar Agreement and discussed with them the sugar proposals that had been reached between the U.K. and the E.E.C.

A statement made in the House of Commons indicated that a result satisfactory to the developing countries had been arrived at. At the time about the only things that were clear to us in Australia were that Australian sugar was to be phased out at the end of December 1974 and that the arrangements for the other members of the B.C.S.A. were accepted by them as satisfactory.

The excuse for phasing out Australia, (and again, the "phasing out" is not defined), is that the sugar exports from Australia to the U.K. represent only 0.7 per cent of Australia's total exports, and that consequently they are not significant.

Statistics can of course be used to produce almost any desired result. From Australia's point of view its sugar exports to the U.K. represent about 20 per cent of its total sugar exports and about 12 per cent of its total sugar production. Also the U.K.'s imports of sugar from Australia represent about 17 per cent of her total net sugar imports. These are quite significant figures.

Whatever the statistics, the fact remains that Australia is to be phased out in December 1974.

This was the situation when the House of Commons debated the question of the U.K. entry to the E.E.C. in October. As is now known, the subsequent vote on 28th October was in favour of the principle to take up full membership with the Community.

At the same time three other nations will join. These are Ireland, Denmark and Norway.

So far of course only the principle to join is approved and years of adjustment and legislation must follow before complete assimilation is possible. To illustrate this - whilst the U.K. will adopt the price structure of the C.A.P. in the first year of membership it will take five years before the threshold and intervention prices can be brought to the full community levels - it will take till mid 1977 before the move to the common export tariff, (C.E.T.) is achieved - and so on.

Now let us look at the possible sugar position in the E.E.C. when it becomes the "ten", and the B.C.S.A. ceases.

This of course cannot happen until after December 1974, so that a lot of conjecture must come into any attempt to project so far ahead. However, as an exercise let us look at the position in the light of the latest statistics available - those for 1970 - i.e., let us assume then that the changes were made and were operative in 1970. These would result in:-

<u>Importers</u>	
United Kingdom	1,977,000 tons (metric)
Ireland	11,000 " "
Norway	175,000 " "
<u>Total Imports</u>:	2,163,000 tons
<u>Exporters</u>	
E.E.C. (the Six)	806,000 tons "
B.C.S.A. Developing Countries (within N.P.Q.)	1,371,000 " "
Denmark	40,000 " "
<u>Total Exports</u>:	2,217,000 tons "
<u>Net Exports</u>:	54,000 tons "

Thus had the change been made for 1970 self sufficiency in sugar could have been achieved. At the same time the exporting countries concerned were able to meet their quotas in effect under the I.S.A. and the U.S. Sugar Act, (where they had quotas).

However it would have taken virtually the entire production of the "ten" plus the N.P.Qs. of the developing nations of the B.C.S.A. to achieve this, and so, there would have been an increase in the world market of about 800,000 tons, viz. the E.E.C.'s net exports.

Put another way it would have meant that had the E.E.C. wished to maintain its level of exports it would have had a deficit of some 800,000 tons on the domestic front, and so could not be said to have been self sufficient.

As already seen self sufficiency under the C.A.P. consists of a target of 105 per cent of home consumption with price support to achieve it and subsidised exports to the open market if it exceeds it. This is an ideal formula for over-production!

The E.E.C. has already expressed its intention to expand and representatives of the U.K. who have visited Australia this year have made it clear that the U.K. beet industry would also expand.

In these circumstances it can be concluded with reasonable certainty that Australia's 335,000 tons market to the U.K. will disappear when it is "phased out" in 1974.

Obviously, Australia must seek some compensation for this loss. Much can happen in the next three years.

- World consumption is rising at about 2,000,000 tons per year.
- The United States has just renewed Australia's import quota for a further three years. An improvement quota in 1975 is always a possibility.
- Japan, the largest importing member in the I.S.A. is increasing its consumption at 100,000 tons per year and this is expected to go on for the next two decades. It also has given the I.S.A. a special undertaking "that it will aim to import each year not less than 1.5 million tons, and in addition, a quantity of sugar equivalent to 35 per cent of the future growth in its domestic consumption over and above 2.1 million tons".
- The emergence of Mainland China is one of the greatest events, but what is going to be the result is anybody's guess. The population of China is about 770 million and their sugar consumption is at the extraordinary low level of about 9.2 lbs. per head - a total consumption of 3,150,000 tons. It produces about 2,900,000 tons and has net imports of 450,000 tons. World average consumption per head is about 50 lb., whilst that of the developed countries, e.g. U.K., U.S.A., Australia, is in excess of 100 lbs.

  The potential here is tremendous, and the emergence of China greatly enhances the prospects of the potential being converted into reality. Whether this will take the form of expansion in its own industry or of increased imports, (or both), only time will tell. Up to the present its imports come almost entirely from Cuba.
- It is hardly likely that the E.E.C. would deliberately wreck the I.S.A. This thought is strengthened by the claim of the U.K. representatives that as a member of the enlarged Community the U.K. would be in a stronger position to prevent this. In some quarters the hope is expressed that the U.K. might even prevail on the E.E.C. to take up its membership with the I.S.A. It was allotted a B.E.T. of 300,000 tons when the I.S.A. was negotiated and Denmark has a B.E.T. of 41,000 tons.

In all, whilst Australia stands to lose a good market of 335,000 tons at the end of 1974, there are avenues for compensation, and there can be no doubt that Australia will explore these to the maximum.

<u>Pioneer Sugar Mills Limited</u>

One of the most remarkable features of the world sugar industry is that through the various agreements it is possible with almost mathematical precision to determine the equity in the world's production of a single miller or even a single canegrower in Australia.

For example in the case of Australia, its production in a given season is limited to the aggregate of:

. Australia's domestic consumption
. The I.S.A. quota in effect
. The N.P.Q.
. The quota under the U.S. Sugar Act adjusted for shortfalls
. Provision of end-of-season storage requirements.

The Queensland Government controls production by means of "The Regulation of Sugar Cane Prices Acts, 1962 to 1966" and "The Sugar Acquisition Act of 1915".

Under the former each sugar mill is allotted a tonnage of raw sugar known as its "mill peak". The "Sugar Board" constituted under the Sugar Acquisition Act each season determines the percentage of the peak beyond which it will not accept sugar for marketing. This is referred to as "The Acquisition". For example if the acquisition is fixed at 110 per cent of its peak or 10 per cent in excess of peak, then a mill producing beyond 110 per cent, (with a margin of 0.5 per cent to cover inadvertent overshooting), will receive virtually nothing for the extra amount. This control is almost clinical in its effectiveness.

The growers supplying cane to a mill are "assigned" to that mill under the Cane Prices Act. This means that they can supply their cane to that mill only and the mill must take it - provided that no cane may be accepted after the mill has produced the tonnage corresponding to its acquisition. It also provides for a "farm" peak for each grower and even the actual acreage and its description in relation to the parish maps, of the lands from which the grower may harvest his cane for the mill. Cane from outside these defined boundaries is "unassigned". It is an offence under the Acts for a grower to harvest unassigned cane for crushing and for the miller to receive it for crushing.

Thus in general the farm peak defines a grower's equity in the mill's production which in turn is defined in terms of the acquisition which the Sugar Board has set in order to meet its domestic and export commitments under the various agreements.

The word "acquisition" also has its literal meaning in that the Sugar Board on behalf of the State Government acquires the sugar and through its agents, the C.S.R. Co., markets it. The net returns from the sales are pooled and a mill's equity in the pool is basically its peak. (In practice the price structure is a little more complicated than this but the above description does illustrate the point).

Under the Cane Prices Acts the miller pays the grower for his cane an amount related to the Sugar Price. This results in the grower receiving about 70 per cent of the sugar moneys and the miller about 30 per cent.

Because of these step-wise relationships and the pooling of the sugar receipts it is possible to establish with reasonable accuracy a Queensland mill's equity in a change at the international level.

Pioneer Sugar Mills Limited has two mills - Pioneer and Inkerman - whose combined peaks total 186,000 tons. The aggregate of all mills in Queensland is 2.1669 M. tons, but because shortfalls, i.e. failure of some mills to reach their peaks, occur each year, and because Pioneer and Inkerman always supply up to the acquisition, (which incidentally also provides for the shortfalls), the company's two mills generally produce about 10 per cent of Australia's production. So roughly speaking Pioneer Sugar Mill's equity in the Australian Sugar Industry is about 10 per cent.

Hence the specific loss of about $A30M, if Australia's N.P.Q. disappears, means a loss in revenue to the company of the order of $A3M. The growers have of course to stand 70 per cent of this leaving a direct gross loss to the Company of $A0.9M. Production would be reduced by some 33,000 tons, (one-tenth of the N.P.Q.). After allowing for the reduction in production costs and taxation the net profit would be reduced by about $A330,000. At current sugar prices this would leave an annual profit after tax of about $A1M. This is provided there were no compensations whatever. There will of course be some compensation along the avenues mentioned earlier and the extent to which this compensation materialises will determine the degree by which the profit would exceed $A1M. It is impossible to quantify these expectations but you will remember that at the start I said I am optimistic.

Diversification

So far only the Company's activities in sugar have been dealt with. This of course is because sugar is the company's main product and this commodity is the one likely to be most affected by Britain's entry to the E.E.C.

It is of course axiomatic that, in the interests of the shareholders, if the company suffers damage in the sugar area then in addition to seeking compensation in the same field it should also extend its search into other fields.

In any case intelligent diversification is desirable to avoid having all the eggs in the one basket.

Since the company went public in 1960 it has followed a policy of diversification by acquisition of an industrial chemical company; Pioneer Chemicals Pty. Ltd. whose main activities lie in the field of protective coatings notably with Killrust and Fishoilene; and several cattle properties grouped under Pioneer Stations Pty. Ltd. These stations comprise a total area of 707 square miles and carry 27,000 head of cattle. A droughtmaster stud is also operated adjacent to Pioneer Mill.

Other avenues for diversification have been examined, but so far there has been nothing that the directors could accept.

Though a departure from normal practice, rather than a true diversification, the matter of the exploitation of one of the industry's main by-products - bagasse - has received the attention of large U.S. chemical companies in the last year or so.

Bagasse is not a waste product as it is used as the fuel to run the entire factory. Consequently the direction of this material into other avenues involves its replacement with oil or coal and the costly conversion of the existing steam generating plants.

So far the developments in this direction have not passed the initial feasibility stage.

AUSTRALIAN MANAGEMENT INVESTMENT COMPANIES - IS MODESTY A VIRTUE?

By A.J. MacQuillan (Sydney)

This article is concerned with the history and problems of investment policy for managers, in Australia, of management investment companies and attempts to explore the theme 'that within the limitations of local equity markets modesty may very well be a virtue'.

BACKGROUND

The investment company concept in Australia like that of many other institutions was imported from overseas where it dates from the early nineteenth century. Some authorities give the Societė General de Belgique, founded in Brussels in 1822, credit for being the first investment company, but the Massachusetts Hospital Life Insurance Company, formed in 1818, according to the U.S. Investment Company Institute, gave "beneficiaries a share in total fund income for 'annuities in trust' and 'endowments in trust' issued in a manner similar to the method used by investment companies today."

Apparently the concept did not thrive in Belgium or elsewhere on the continent. In Scotland, England and the United States, on the other hand, it became steadily popular despite a number of spectacular British failures between 1890 and 1895.

Undoubtedly the popularity of investment companies in the United States had much to do with the attainment by the U.S. of creditor nation status and the coincidental growth in the number of investors from an estimated 500,000 prior to World War I to between fifteen and twenty million by 1927.