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Australian Sugar Milling Council and CANEGROWERS submission to the Department of Foreign Affairs and Trade

Australia-European Free Trade Agreement

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Executive summary

The Australian Sugar Milling Council (ASMC) is the peak body for the sugar milling sector. We represent six sugar milling companies who collectively produce approximately 95 percent of Australia's raw sugar at their 20 sugar mills in Queensland. Over 85 percent of Australia's raw sugar production is exported.

Representing around 80 per cent of Australia's sugarcane growers, CANEGROWERS is the peak body for Australian sugarcane growers. CANEGROWERS, a federation of local grower companies located in all sugarcane regions, ensure growers' needs are represented at the highest possible levels of industry and government decision-making.

In the protected global sugar market, the Australian sugar industry seeks preferential, duty-free trade deals to broaden its market opportunities and ultimately, to increase the demand for, and value of, Australian high-quality sugar.

The proposed Australia Europe FTA represents an opportunity for Australia to considerably improve our Tariff Rate Quota to this market. The current TRQ of 9,925 tonnes is commercially insignificant. The punitive in-quota CXL duty of €98/tonne means it is uneconomic to fill this quota and the quota is currently unfilled. . The proposal to split this between the EU-27 and UK would further reduce the commercial viability of the quota, making supply to this market unfeasible.

The combination of Australia's freight cost disadvantage and high CXL tariff rates, and the preferential duty treatment now (and potentially) given to competitive suppliers under recently negotiated bi-laterals, means Australia is currently not competitive on a straight best return basis into this market.

There are however a number of trends in the EU sugar market that in conjunction with a meaningful TRQ and Australia's strong supply characteristics (high reliability and consistency and quality of product) would significantly improve Australia's competitiveness and attractiveness to EU sugar refiners.

The EU sugar market is in a state of transition following the 2017 de-regulation reforms. Positively for Australia:

- Reflecting their declining production levels and high cost structures, there is a significant trend away from Least Developed Country• raw sugar suppliers to lower cost suppliers that have preferential, duty free access under FTA's
- The EU cane refining sector is seeking to remove barriers to refiners sourcing competitively price raw cane sugar and to broaden and deepen its access to low cost, duty-free suppliers through an ambitious FTA outcome with Australia (with a strong focus on achieving duty free supply to compete against the beet sector and to improve viability)
- Demand for raw sugar for refining in the EU is falling but is expected to settle at around one million tonnes per year.

The Australian sugar industry seeks to secure unrestricted market access for a commercially meaningful volume of Australian raw sugar, leading to open (duty free, quota free) access. This would include an immediate quota increase and elimination of the €98/t in-quota (CXL) tariff on day one of an EU-Australia FTA entering-into-force with remaining out-quota tariffs eliminated over a phasing period.

1 The Australian Sugar Milling Council and CANEGROWERS

The Australian Sugar Milling Council (ASMC) is the peak body for the sugar milling sector. We represent six sugar milling companies who collectively produce approximately 95 percent of Australia's raw sugar at their 20 sugar mills in Queensland.

Representing around 80 per cent of Australia's sugarcane growers, CANEGROWERS is the peak body for Australian sugarcane growers. CANEGROWERS, a federation of local grower companies located in all sugarcane regions, ensure growers' needs are represented at the highest possible levels of industry and government decision-making.

Achieving improved trade policy and market access is one of ASMC and CANEGROWERS' priorities. We support the development of a comprehensive and ambitious FTA with the EU.

2 The inadequacy of current EU trade settings on sugar

Australia has an annual WTO tariff rate quota (TRQ) access for raw sugar into the EU of 9,925 tonnes. An in-quota CXL duty of €98/tonne is payable on this volume. **Table 1** shows that the quota has been filled four times in the past six years. The TRQ is almost inconsequential from a commercial perspective and would need to be substantially revised to be of any benefit to the Australian sugar industry.

Table 1: Australian uptake of the EU-28 raw sugar TRQ

Tariff code	Description	EU-28 imports from Australia (tonnes)					
		2012	2013	2014	2015	2016	2017
17011410	Sugar for refining	9,918 (delivered to T&L London)	19,859 (9,925 t delivered to T&L London and 9,943 t delivered to Agrana in Hungary)	0	0	9,925 (delivered to T&L London)	0

Source: Eurostat

This small quota is problematic for Australian raw suppliers for a number of reasons:

- 9,925 tonnes is roughly one-quarter the size of a small handy-size vessel of approximately 40,000 dead-weight-tonnes. This means Australian supply needs to be shipped with other ACP/LDC countries with the cargo delivered to the refinery. This involves marketers in Australia having good relationships with refiners in-country.
- Co-shipping with ACP countries substantially increases operational risk against sales made to next best alternative markets and is not preferred.
- Splitting the tariff (50 percent UK and 50 percent EU-27) as currently proposed would make it more difficult to put a cargo together as it would require two cargoes (potentially different qualities – or pols) to be put together and supplied into two different locations.

- Splitting the quota would make it much less commercially feasible, if not unfeasible (theoretically possible but practically uneconomic to execute).

3 The export reliance of Australian raw sugar supply

The Australian sugar industry in 2017 produced 4.3 million tonnes (mt) of raw sugar of which 85 percent was exported to countries in the Asia-Pacific like South Korea (1.6 mt), Japan (0.8 mt) and Indonesia (0.6 mt) where it is refined into white sugar.

With a relatively small domestic market, access to the export market is vital for the Australian sugar industry. Despite annual consumption of around 172 million tonnes of raw sugar globally, only around 66 million tonnes is traded each year to supply refineries with raw sugar manufactured from sugarcane to meet domestic shortfalls[1]. Australia competes for market share in this competitive global market against countries like Brazil, Thailand, Guatemala, India and Mexico.

Total global demand for sugar remains strong and is expected to grow at between 1.8 - 2 percent per annum over the next five years[2]. The countries with the largest net-import requirements are Indonesia (4.6 mt), China (3.2 mt) and the USA (2.7 mt)[3].

Due to the significant size of sugarcane and sugar beet acreages and the number of people employed, sugar is a politically 'sensitive' product in many countries. Governments commonly subsidise cane and sugar production and use import barriers to protect their domestic sugar industries against more competitive imports. Maintaining a level playing field and seeking new supply opportunities and increased demand for Australian raw sugar (and higher price premiums) is a fundamental objective of the Australian sugar industry. Achieving preferential, duty free access in FTAs is critical to securing the opportunity for EU sugar refiners to source raw sugar from Australia going forward.

4 The EU sugar market is transitioning with changing raw sugar requirements

The European sugar market is undergoing a significant transition since EU beet production quotas ended in 2017. The impacts include greater exposure to global prices, higher beet production (in absolute terms) with strengthened competitiveness (relative to EU cane sugar refining), and a return to being a large net exporter. These changes are likely to create a number of risks to the EU's cane sugar refiners but also present opportunities for Australia. That is, whilst there is a risk that demand for raw sugar may decrease in absolute terms there is likely to be a preference away from high cost ACP/LDC supplies to lower cost supplies from Brazil, Australia and Thailand and a continued price premium above global parity.

Potential for price premiums to offset higher freight costs remains

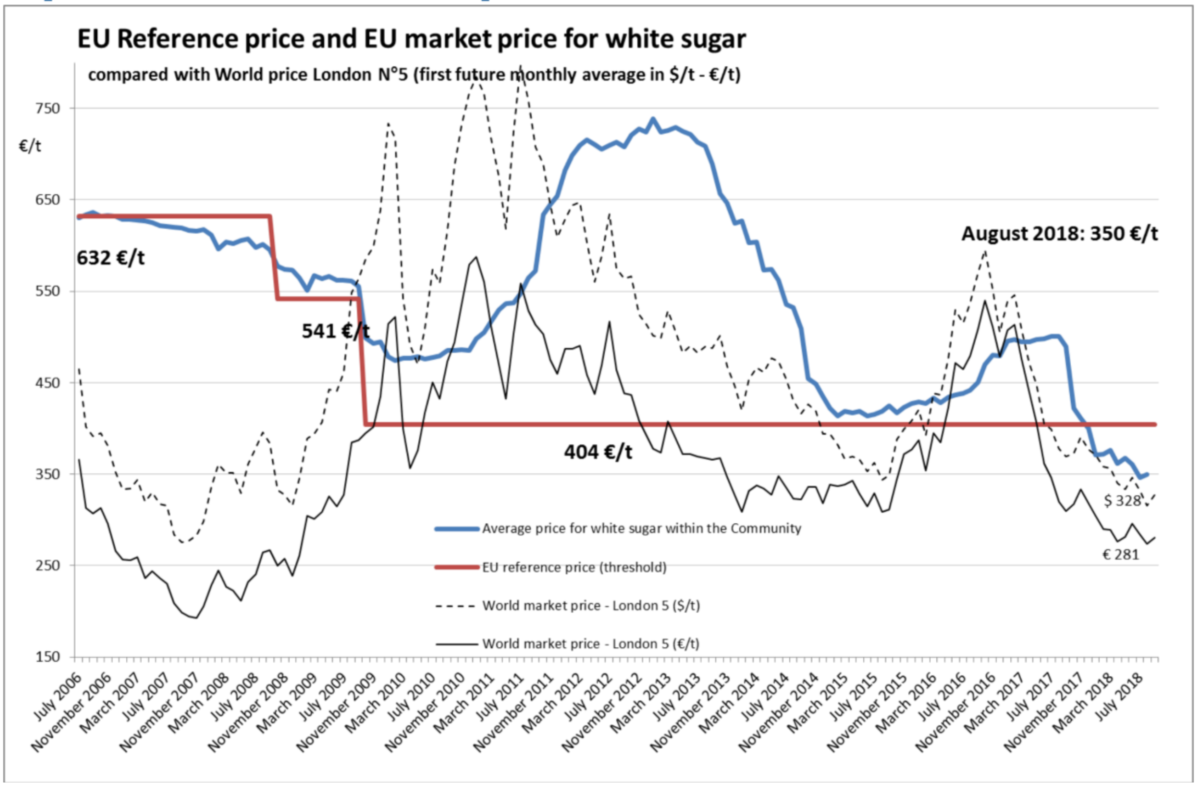
The European Commission forecast[4] that in 2018/19, the EU will produce 19.18 mt of sugar, import around 1.85 mt, consume approximately 17.65 mt, and export around 4.15 mt. The overwhelming majority of this domestic demand will be met by beet sugar supply.

Chart 1 shows that since deregulation in 2017, average prices for white sugar in the EU community have converged with falling global prices but have been above world market prices (note - August

[1] International Sugar Organisation, 2018 Sugar Year Book.
[2] Copersucar analysis: Mr Paulo Roberto de Souza presentation to the Dubai Sugar Conference 2018.
[3] International Sugar Organisation, 2018 Sugar Year Book.
[4] European Commission, DG Agri Dashboard: Sugar, 28 September 2018

prices were 25 percent higher). Whilst falling prices will place cane refiners under competitive threat, the maintenance of a domestic price premium improves the affordability of more expensive Australian raw sugar and may generate returns for Australian exporters on par with 'first-option' Asian markets.

Chart 1: EU reference price and market price for white sugar compared with World price London No. 5



Source: European Commission, Sugar Price Reporting, August 2018

Reduced demand for raw sugar imports but increasing need for duty free and least cost raw supply

The EU-27 cane refineries are located in nine states (Bulgaria, Croatia, Denmark, Finland, France, Italy, Portugal, Romania and Spain) and in 10 when the UK is added EU-28 (UK).

Sugarcane, from which the raw sugar is manufactured to supply these refineries, is not grown in the EU and these refiners rely on EU trade policy which is currently heavily biased towards domestic agriculture and the domestic beet sector specifically.

Consistent with the growing trend away from LDC supply (see **Chart 1**), **Table 2** shows that in 2017 the LDCs supplied 43 percent of the EU-28's raw sugar needs, 5 percent from CXL quota nations and 52 percent under FTA's (and the considerable cost advantage that is accrued to countries that can negotiate duty free access under an FTA). The preference for least cost, duty free supplies reflects the increased competitive threat to the cane sugar refiners from lower prices and lower cost beet supply.

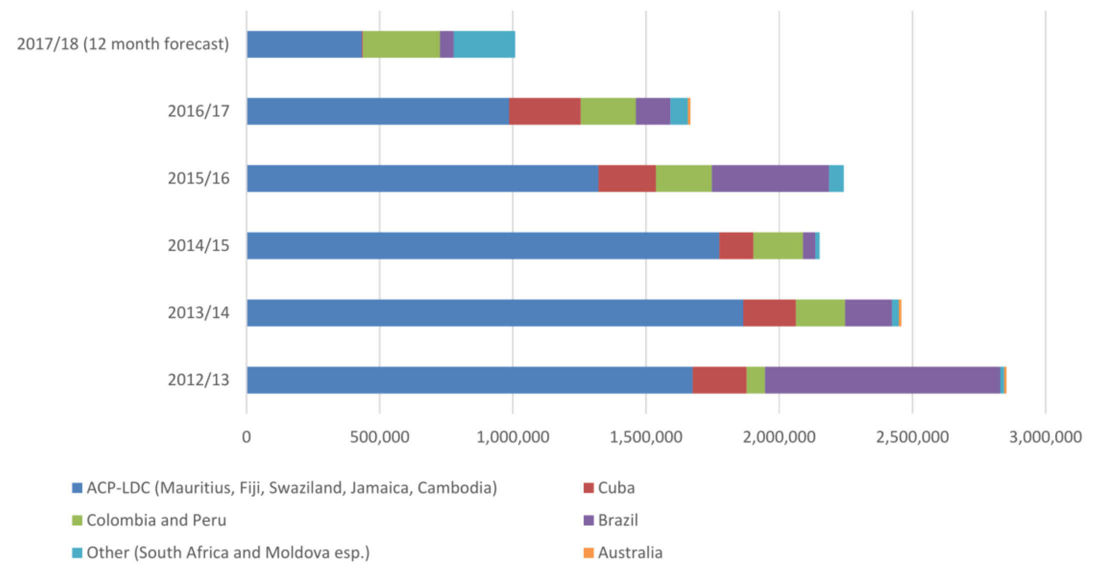
Table 2: 2017 imports into the EU under current trade settings

Type of agreement	Countries in which this applies	Amount of sugar allowed for import	Actual amount imported in 2017/18	Import duties	% of total raw sugar imports
Economic Partnership agreements (EPAs) and Everything but Arms Agreements (EBAs)	Least-developed countries and African, Caribbean and Pacific Group of States (Mauritius, Swaziland, Fiji, Jamaica, Mozambique and Cambodia etc)	Unrestricted	433,148 t	Zero duty	~43%
CXL quota	Brazil	412,054 t	51,431 t	€98/tonne	~ 5%
	Cuba	68,969 t	3,833 t	€98/tonne	
	Australia	9,925 t	0 t	€98/tonne	
	Erga Omnes (mostly Brazil)	289,977 t	0 t	€98/tonne	
Free Trade Agreements (FTAs)	Central America-Colombia and Peru	600,000 t	289,711 t	zero duty	~52%
	South Africa	150,000 t	130,000 t	zero duty	
	Moldova	100,000 t	100,000 t	zero duty	
	Mexico	30,000 t	0 t	€49/tonne	

Source: EuroStat

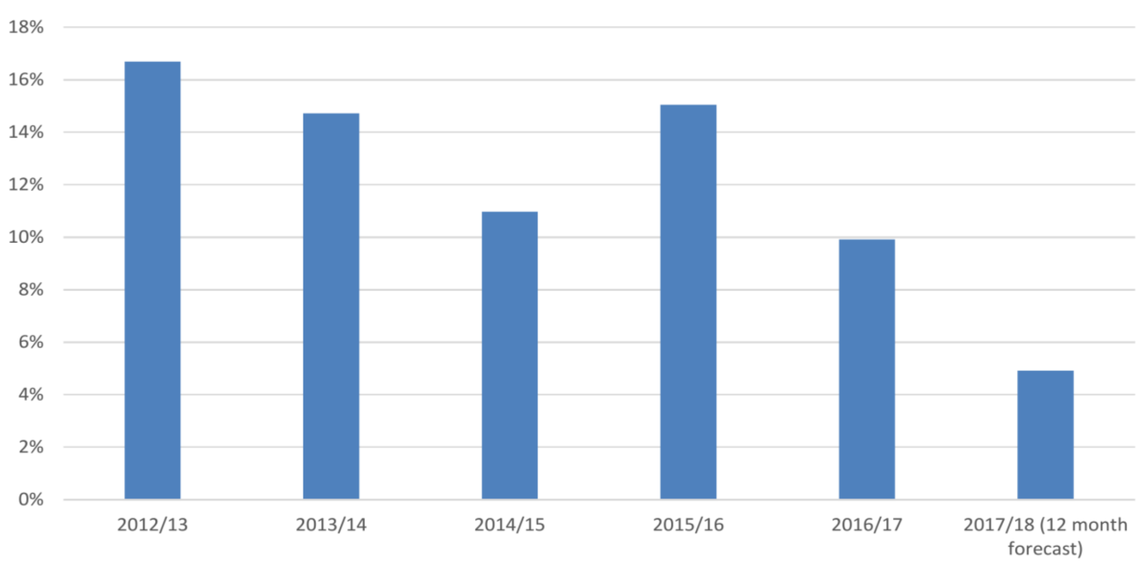
Chart 2 below shows that raw sugar imports between 2012/13 and 2017/18 have fallen 65 percent to an estimated 1 million tonnes (mt) (and an estimated 20 percent of total raw sugar refining capacity). **Chart 3** below shows that raw sugar imports as a percentage of all EU-28 sugar production has fallen from 17 percent to 5 percent between 2012/13 and 2017/18. DEFRA also estimated that the EU from 2018 onwards would import around 1 mt of raw sugar (**Chart 4**).

Chart 2: EU-28 raw sugar imports by country, 2012/13 – 2017/18



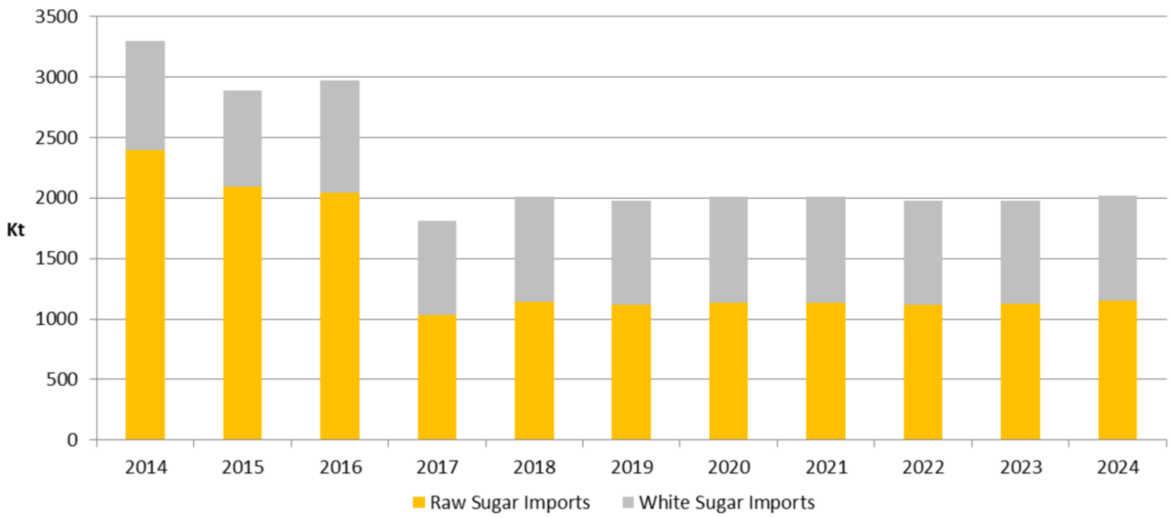
Source: Eurostat - COMEXT, updated 26/7/2018

Chart 3: Raw sugar imports as a percentage of total EU-28 sugar production



Source: Eurostat - COMEXT, updated 26/7/2018

Chart 4: Estimated European Sugar (White and Raw) Imports



Source: DEFRA, 2016, *Modelling the EU cane refining sector after 2017*

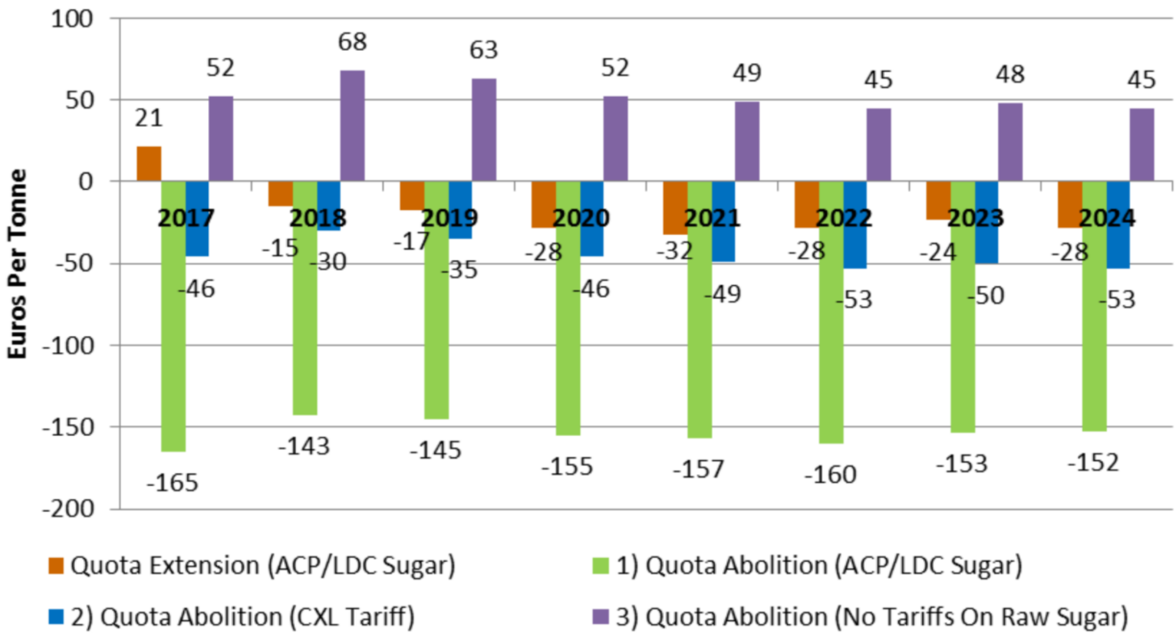
EU raw sugar refiners need duty-free access to be viable

DEFRA also projected the refining margin of EU-28 raw sugar refineries on a single tonne of sugar in four scenarios:

(1) in which quotas are abolished and the raw sugar from ACP/LDC suppliers is imported
(2) in which quotas are abolished and the raw sugar is imported under the CXL tariff
(3) in which quotas are abolished and raw sugar is imported at the world price under a duty free TRQ (i.e no tariffs)
(4) and a counterfactual of an extension of the current policy scenario.

With EU sugar prices closer to world price levels when quotas have been removed, the modelling suggests that EU refining margins (under plausible price scenarios out to 2024), only become positive in a scenario where raw sugar can be sourced at the world price through a duty-free TRQ. This is represented by Scenario (3) in **Chart 5** with EU refining margins between €45 and €70 / tonne.

Chart 5: Change in refiner profitability under different regimes



Source: DEFRA, 2016, *Modelling the EU cane refining sector after 2017*

5 The competitive and comparative advantages of Australian raw sugar supply

The combination of the high CXL tariff rate applied to Australia and the freight cost advantage (to Brazil, Mauritius and South Africa for example) (see **Table 3 below**) and preferential duty treatment to certain suppliers (ACP/LDC's, Central America, Mexico and South Africa for example) (see **Table 2** above) means Australia is currently not competitive on a straight best return basis into this market.

Whilst unlikely the freight cost differentials can be bridged, a preferential TRQ that provides sizeable duty-free access in conjunction with the following supply strengths is likely to provide Australia certain competitive and comparative advantages into this market:

(1) Reliability and consistency of product. With the Australian sugar industry being located across four major growing regions with quite different climatic conditions, production risk is very low with the industry producing between 4.25 and 4.9 million tonnes per annum over the past seven years. With 2.5 million tonnes (mt) of bulk storage spread across six regional ports with world leading handling facilities Australian supply is year-round and efficient. Australia also has a proven track record of consistently meeting its contractual supply obligations meaning near to zero counterparty risk.

(2) Quality. Raw sugar is produced and sold in 'brands' to customers with specified quality standards (sucrose content as measured by polarisation or pol, moisture etc). Australian supply is high quality with the majority produced as Brand 1 (greater than 98 pol).

(3) Low cost supply. Australian millers are one of the lowest cost producers of sugar globally, currently sitting in decile 1 on the global cost curve.

Table 3: EU-28 cane refinery raw sugar requirements, polarity preference and estimated shipping costs

Country	Refineries	Annual raw sugar requirements (tonnes) (avg last 5	Pol preference (Aust equivalent)	Preferred port	Freight rates (US$/t) ex Australia	ex Mauritius	ex South Africa	ex Brazil (North)	ex Brazil (Centre-South)
Bulgaria	Zaharen kombinat Plovdiv AD*	82,500	Aust Brand 1	Constanza	$ 62	$ 52	$ 51	$ 48	$ 55
Spain	Azucarera EBRO, S.L.S.U	175,000	Aust Brand 1	Cadiz					
	Accor - Tereos Olmedo*	150,000	Aust Brand 1	Santander	$ 51	$ 35	$ 35	$ 29	$ 35
Italy	SFIR Raffineria di Brindisi S.P.A*	300,000	Aust Brand 1	Brindizi	$ 48	$ 38	$ 38	$ 33	$ 38
	de Açúcar Reunidas*	240,000	Aust Brand 1	Leixeos					
Portugal	Sidul Açúcares*	264,000	Aust Brand 1	Lisbon	$ 51	$ 35	$ 34	$ 28	$ 34
	Roman	50,000	Aust Brand 1	Constanza/Split					
	S.C. Agrana Bazau	300,000	Aust Brand 1	Constanza/Split					
	S.C. Zahar Corabia		Aust Brand 1	Constanza/Split					
Romania	S.C. Zahar Calarasi		Aust Brand 1	Constanza/Split					
	Ludus	25,000	Aust Brand 1	Constanza/Split	$ 62	$ 52	$ 51	$ 48	$ 55
Finland	Porkkala Refinery	214,500	Aust Brand 1	Kantvik	$ 70	$ 51	$ 50	$ 46	$ 53
UK	T&L Sugars Ltd, Thames Refinery*	1,200,000	Aust Brand 1	London	$ 55	$ 38	$ 38	$ 33	$ 38
Croatia	Kaposvar Refinery	20,000	Aust Brand 1	Ploce/Rijeka	$ 54	$ 43	$ 43	$ 38	$ 44

* full time cane refiner (others do beet and cane with an emphasis on the former)

Source: COFCO International, ASMC, Affinity

6 Recent EU FTA outcomes and the Australian sugar industry's preferred FTA outcome

The EU in the recent South African and Mexican FTA discussions presented first offers that were eventually improved upon during the negotiations (Table 4). In November 2017 the EU offered to Mercosur a 100,000 t TRQ with a €98/tn duty. In subsequent rounds, this was increased to 120,000 t at a yet to be confirmed duty of €49/tn. This would follow the precedent in the deal with Mexico.

Brazil industry officials describe the EU offer as a 'non-offer' because the proposed in-quota duty represents a prohibitive barrier to entry

Table 4: Starting and final positions South Africa and Mexico EU-FTAs

Country	EU first offer	Negotiated outcome
Mexico	30,000 t @ €98 / t duty	30,000 t @ €49 / t duty
South Africa	50,000 t @ €98 / t duty	150,000 t @ zero duty

Source: ESRA

The Australian sugar industry seeks to secure unrestricted market access for a commercially worthwhile volume of Australian raw sugar, leading to open (duty free, quota free) access. This would include an immediate quota increase and elimination of the €98/t in-quota (CXL) tariff on day one of an EU-Australia FTA entering-into-force with remaining out-quota tariffs eliminated over a phasing period.