Sugar Industry Reform: Some WTO Compliant Policy Options

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The main objectives for sugar industry policy are very simple and straightforward.

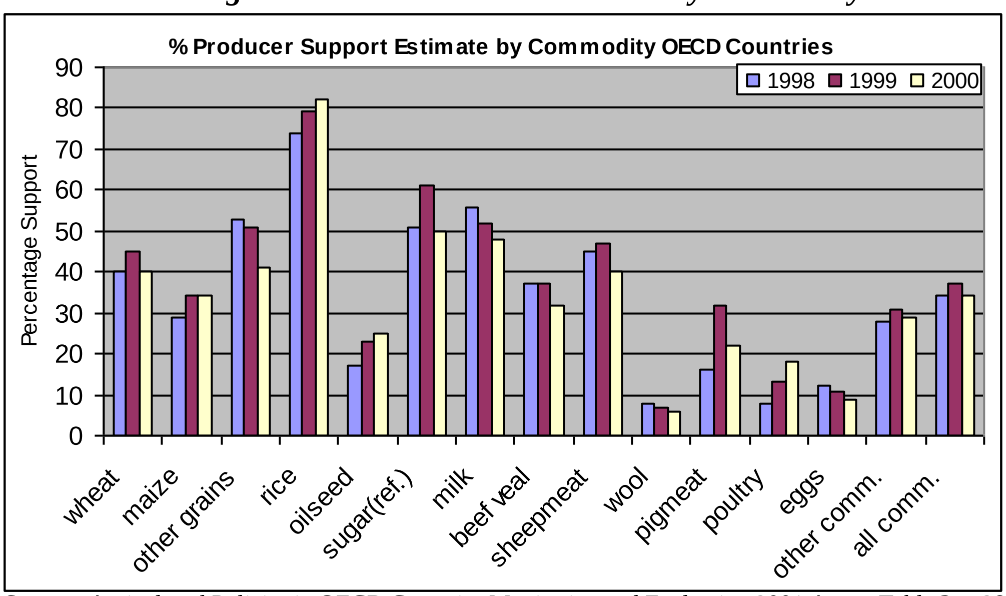
- Faced with international market failure, the short term urgently needs to focus upon stabilizing industry income and hence the socio-economic wellbeing not only of the farm sector but also of support communities.
- Over the longer term, the industry must look to reduce its dependence upon corrupt international markets. [1]

Some of the available WTO compliant options are put forward in this brief for consideration and discussion. Comments and suggestions are invited and welcome.

Level of Support Intervention OECD

Internationally, sugar is the second most highly protected commodity across OECD countries. Faced with this demand side reality, Australian domestic supply side reform cannot solve the industry's malaise because it does not address demand side real world phenomena.

Figure 1: % PSE OECD Countries by Commodity

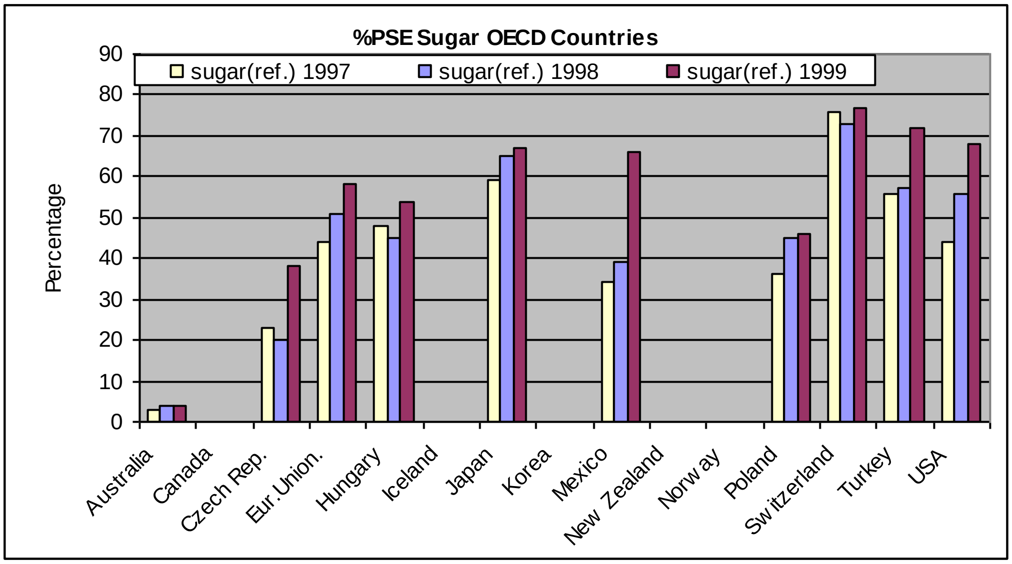


Source: Agricultural Policies in OECD Countries Monitoring and Evaluation 2001 Annex Table 3, p.28

[1] The importance of this strategy is highlighted, for example, by the claim in an ASA web site Sugar Policy abstract " 'World Sugar Price' Myth Exposed: Foreign Subsidies Distort Global Markets". The authors claim that about 75% of world sugar production is either consumed domestically or traded profitably in captive markets. The remaining 25% is dumped below cost of production in the "world sugar market". Australia would be selling into the 25% bracket.

Relative to other OECD countries, Australia provides minimal support to the sugar industry. Figure 2 demonstrates the reality of Australian producer support (as measured by %PSE) relative to other OECD countries.

Figure 2: OECD Country Producer Support for Sugar (refined)



Source: Agricultural Policies in OECD Countries Monitoring and Evaluation Tables III.22-III.64 pp.195-251

Supply side reform for the Australian sugar industry without regard to the high level of public sector intervention by international producer nations cannot be justified except on ideological grounds.

Common sense must tell even the most hardened free market advocate that removal or reduction of Australia's minimal supply side %PSE will not influence established levels of international support creating imperfect international markets or demand side market structures. The end result of supply side reform in isolation by Australia would mean decimation of an established and valued industry in rural Australia.

Short Term Industry Stabilization

The preferred option would be a WTO Agreement on Agriculture (or AoA) exempt, decoupled income support program. The most suitable option lending itself to early introduction would be a deficiency payment system designed to support the difference between the actual market price and a predetermined "target price". The difference would be calculated on a per tonne farm cane price sufficient to stabilize industry profitability and survival.

Decoupled income support programs must be publicly funded either as a direct payment or tax concession. Consumer transfers are prohibited and the program must not have the effect of supporting prices and consequent market distortion.

Eligibility for a decoupled income support program has to meet clearly defined criteria based upon: income; producer or landowner status; factor use or production level in a defined fixed base period. Another important feature is that payments can be made for nil production. Implementation of supply constraint through set aside programs is allowed.

A suitable eligible base production area for the sugar industry could be the existing CPA's. Historical CPA data could be used to calculate base hectares and yield over a selected time frame. To meet the requirement of decoupling from current production, the historical base hectares times yield is discounted. The US applies an 85% factor to the historical base period selected.

The eligible payment would then be calculated by the following formula:

$$DP = (TP - AP)\ [\ (BH \times Y)\ 85\%\ ]$$

where

DP = deficiency payment
TP = Target Price
BH = Base hectares
Y = Average Tonne per Farm Hectare
AP = Final market Price

When DP = 0 or is a negative value, no deficiency payment would be necessary. Intervention is required for positive values of DP. Administration could be at either mill area level or by CPA Boards, whichever the industry prefers.

The eligible payment could be broken into more than one payment. For example, the difference between the Target price and ABARE's annual price projections could provide the basis for projecting the level of expected deficiency payment. Half of this amount could be paid early in the season to assist farm liquidity and management. A final payment based upon actual market price received would be paid at season closure.

Over time, the deficiency payment would vary depending upon the actual price determined by the international price of sugar and the pre-determined target price. When international sugar price converts into high farm sugar cane price, the target price could be lower than the market price. Consequently, government input would not be required. Conversely, when farm cane price fell below target price, payments would become necessary.

The essence of a deficiency payments system is that a stabilized farm income allows production to flow freely through the market in times of low commodity price or market failure. Farm viability is maintained and flow-on effects underwrite viable rural support communities.

Given program goals, it will be necessary to place a cap or maximum payment for any one producer. This needs to be thought through carefully. Countering "imaginative" entity structures or accounting systems, addressing the reasonable income support needs of even larger producers and other issues require appropriate balances and levels to be set.

Because of the implications for AMS obligations to impact upon the power of the Commonwealth to pay bounties under Section 51(iii) of the Constitution, the deficiency payments system might need to be implemented under the power of Section 91 but funded under Section 96.

Long Term & Structural Adjustment

Australia cannot continue to increase rural output and accept lower and lower real prices on international markets. For sugar the consequences of this policy direction is now very evident in a debilitated industry.

Long term policy can address the industry's plight through structural adjustment. WTO Agreement on Agriculture rules provides for this contingency within the system of exempt direct payments directed towards farmer and resource retirement programs, investment assistance, environmental and regional assistance.

Retirement of farmers from marketable agricultural production or movement to non-agricultural production can be facilitated. Eligibility for payments is conditional on permanent retirement from marketable agriculture.

Resource retirement programs provide the opportunity to incorporate conservation and environmental policy objectives into rural policy. Entitlement is determined and conditional upon defined policy objectives that require removal of land or livestock from marketable production. Retirement of the resource must be for a minimum of three years, or in the case of livestock for slaughter or permanent disposal. Other remaining farm resources are not affected in any way. In the US, Conservation Retirement programs have proven popular with two main groups: older farmers approaching retirement and existing farms with high debt imposts.

Investment aid can be built into rural restructure programs. Clearly defined government programs can be funded by using financial assistance to assist the physical or financial restructure of a farm enterprise. Payments cease once the agreed time frame is met. Assistance shall not direct the direction or composition of production except to prohibit production of a certain product. Payments shall be based upon the actual structural disadvantage.

Regional assistance is another area that can benefit from exempt direct payments. Producers in disadvantaged clearly defined regions given a defined administrative and economic identity can benefit from direct payments. Assistance is limited to the extra costs or loss of income experienced in agricultural production in the defined region.

Supply Management through Environmental and Conservation Policy

Particular government environmental objectives can be funded under the exempt direct payments system. Specified conditions must be met and can include input and production method requirements. Payment is limited to additional costs or income loss experienced under the program. In other words, compensation is paid for the decline in farm efficiency and productivity.

An overseas example of environmental application to structural adjustment is the use of environmental easements for conservation or environmentally sensitive areas. The concept of an easement is that the landowner leases the use of his land for a fixed term to a third party to pursue environmental objectives. The landowner retains access and limited use of the resource whilst the third party carries on their environmental program. Lease payment is calculated using foregone production income less income generated from restricted use production.

This concept, amongst others, is one that could be applied to environmental problems associated with land clearing or input run off. Environmentalists would lease the area and compensate the landowner for lost production. It would internalise or structure a market mechanism to solve the current policy stalemate between landowners and environmentalists.

Conclusions

Under WTO AoA there are available a range of policy options for stabilizing the sugar industry. The main short-term instrument is the deficiency payment system of direct payments to support farm income whilst oversupplied international markets clear. Over the long term there are viable direct payment options that can be used to restructure the sugar industry and reduce its reliance upon corrupt international markets. A properly constructed direct payments system could be used to effectively influence supply, particularly in times of market failure.

Current proposed restructure programs based upon supply side analysis and subsequent supply side reform contain inherent dangers not only for the sugar industry and support communities but also for the long term credibility of government. The major weakness in the supply side direction is that it has to assume away the reality of demand side market imperfections. Restricted assumptions might be fine for some analysis but, when assumptions do not reflect reality, they imply grave danger for any policy so-based and for governments that would follow such limited thinking.