Submission on Queensland biofuel mandate

CommAg welcomes the Queensland Government's strong support for the development of a sustainable, internationally competitive, biofuels industry.

Benefits of a developing a bio-energy industry

CommAg hopes to see the development of a strong bio-energy production industry in North Queensland, in the expectation that this will:

1. Provide during construction a stimulus that will help lift Townsville and North Queensland out of the current economic stagnation and generate consumer and business confidence;

2. Help develop another key high value sustainable industry for the region that will attract further add-on industries and a highly skilled workforce that will enrich the technological, educational and economic capacity of the region; and

3. Do that through the deployment of capital raised from a broad based local and Australian investment house equity, to retain local control of the industry and return profits to our region.

We need to reverse the hollowing out of regional economies

This will help reverse the hollowing out of our region's economy that has occurred in the past 30 years. Consumer income rapidly leaves our region, to create wealth in the hands of corporate managers and administration, shareholders and consultants based in the major population centres of Southern Australia. For example for consumer spend in:

- shopping centres – most of retailers' income is paid in rent paid to centre owners with management in Sydney and Melbourne;
- Woolworths, Coles and Bunnings with corporate bases in Sydney and Melbourne;
- Superannuation savings – fund managers are most located in Sydney and Melbourne;
- Franchised businesses – franchisor management in Sydney and Melbourne;
- National retail chains - corporate bases in Sydney and Melbourne; and
- Event catering – Spotless at the V8's & Cowboys.

Rural incomes being squeezed and not available to spend in the region:

- Grazing – between JWS and Wellards there is an effective buyer duopoly;
- Sugar – there is in the Townsville hinterland a Wilmar monopoly;
- Small crops – between Coles and Woolies substantially a buyer duopoly; and
- Dairy – Kirin monopoly compounded by Coles and Woolies duopoly at retail end.

Local manufacturing and value added industries being squeezed out:

- Internet & China – someone can always do it cheaper (if not better);
- Corporate and Government headline cost cutting – instead of whole of life value;
- Specialty foods squeezed out from supermarket shelves by own brand generics;
- Local specialty distributors driven out of market by big box discounters; and
- Discounters sell high turnover items – destroy specialist's bread & butter market.

There is a repeating phenomenon in North Queensland and other regional economies, where one national player identifies the narrowest point of competition in the value chain, drives out the competition with aggressive pricing and then rent seeks to the disadvantage of others in the supply chain and the economy of the region.

As a result, Townsville's economy declines year on year whilst Sydney has a housing bubble!

Why an ethanol mandate makes a difference

By providing certainty that there will be a local ethanol market, early stage high risk investors will have greater confidence in the bio-energy production business model. Once a critical level of early stage investment is committed, ample investment from superannuation funds, other fund managers and overseas investors is available.

A very good example of how government market intervention can make a difference, was the decision by the Western Australian Government to commit to purchase gas produced from the North West Shelf gas reserves as a foundation customer. This gave parties prepared to commit early stage capital top prove up the business model, sufficient certainty to do so. This was the trigger that made $50 billion plus industry possible.

Bio-energy projects can be delivered at a scale that is achievable for a start up enterprise, with local early stage foundation investors providing the initial high risk pre-approval capital. When the project is de-risked, capita from the capital markets is readily available. This type of project is achievable for grower based collectives, which helps broaden the economic base of the region and provide a wider market for existing and greenfield crops such as sugar cane. This can facilitate development of capital market funded grower owned processing in North Queensland. CommAg suggests that the future prosperity of our region will be secured by fostering the development of further grower controlled processing and marketing capacity. Examples of such successful organisations are Mackay Sugar, Sunrice and Fontera in New Zealand.

The North Queensland economy desperately needs the lift provided by this regional investment and long term jobs. A strong and certain ethanol mandate will provide the trigger for the development of this industry.

The key design features of an ethanol mandate that will give investor certainty

Potential investors will not invest in bio-energy projects unless they know there will be a market for the fuels produced. Incumbent fuel distributors have a vested interest in NOT selling ethanol blended fuel. They derive greater profit by keeping control of a greater share of the supply value chain. The oil companies that operate retail fuel outlets, are in the business of selling petroleum based products. They will only sell ethanol if there is a mandate requiring them to do so.

To provide the required certainty, investors and financiers need to know with certainty what the mandated ethanol content levels will be when their facilities come on line. This requires a clear mandate to be set for each subsequent year.

Concerns of fuel distributors about supply risk, can be simply dealt with by providing an exemption, to the extent that they cannot obtain supply at a reasonable price. This pricing assessment should take in to account significant fluctuations in retail margins, not just be referable to Singapore crude based petroleum pricing parity. For example, certainty around ethanol pricing could be delivered by identifying a maximum monthly price point based on a 2 year moving average. The capacity of large fuel distributors to pass on any temporary additional ethanol cost due to shortage of supply, is obvious. If only one or two of the bio-energy projects in the current development pipeline proceed as a result of the mandate, there will be far more ethanol available for supply and market forces will prevent price gouging by producers due to any disparity between the maximum monthly price point and the market petroleum price.

Market forces will only intervene where there is a price benefit to buying a bio-fuel blend. At the moment, much of the price advantage that should be available from ethanol excite rebates, is not being fully passed on to the consumer. If the benefit of the ethanol excise rebate was fully passed on for E10 fuel, it should be 3.8c/litre cheaper. CommAg understands that fuel wholesalers pay a market price for ethanol that is at parity with available petrol supplies, reduced by the whole fuel excise rebate. Further, a discount is demanded for the lower energy content of ethanol. It should be a simple matter for Government to determine wholesale ethanol prices being paid in the market at the moment, to verify this. Assuming fuel wholesalers pass on the full rebate and energy coefficient discount they achieve, market forces will drive the wide scale adoption of ethanol blended fuel.

Accordingly, CommAg submits that the key features required for an ethanol mandate to provide the required certainty to investors and financiers to "kick-start" a bio-fuel industry are:

1. A binding mandate with specified annual increments. CommAg considers that the mandate should start at 3% and then rise 2% per annum until it reaches 10%.

2. Provide an exemption for fuel distributors if they cannot source Queensland produced bio-fuels at a reasonable price;

3. Set a formula to determine a reasonable ethanol price cap, that provides a reasonable margin referable to a 2 year moving average of a basket of State-wide retail prices; and

4. Fuel distributors must be able to demonstrate that on average in any one year, they pass-on in full to the consumer any price advantage obtained from buying bio-fuel supplies at a discount to the prevailing price of petroleum based products.

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Responses to specific discussion points

1. **Will the changes to excise arrangements proposed by the Federal Government have an effect on the use of biofuels by consumers?**

   These will have limited impact in the first 3 to 4 years of the mandate.

2. **What measures can be taken to offset any possible negative impacts by the proposed changes to excise arrangements by the Federal Government?**

   Require fuel distributors to pass-on in full to the consumer any price advantage obtained from buying bio-fuel supplies at a discount to the prevailing price of petroleum based products

3. **Is a two per cent ethanol mandate appropriate?**

   Existing supply and supply that is readily come on line will satisfy a 4% mandate introduced in 2016. To provide some margin, 3% would be appropriate. 2% is insufficient to make any difference to projects that could come on line in 2016, as supply is currently at 1.6% and 2 % can be readily delivered from current supply

4. **Should the percentage increase, and if so, over what time period should any increases occur?**

   Yes, at 2% per annum until it reaches 10% pa.

7. **When do you think that a mandate will no longer be necessary?**

   When oil companies no longer have a vested interest in selling their own petroleum products in place of bio-fuel products, ie once new players enter the retail market focused on selling bio-fuel products

18. **Should Queensland have an expert panel or implementation board? If so, which sectors should be represented?**

    If there is to be such a panel or board, it should have equal representation from fuel distributors and the bio-fuel industry.

24. **What are the issues that need to be addressed if consumer choice is maintained?**

    Fuel retailers should be required provide equal access for E10 as compared to regular unleaded. In other words, where practicable E10 should be a choice on each pump stand, or at least as many stands as provide diesel.

25. **Will choice of fuel increase costs to retailers or consumers?**

    Any additional cost would have no significance compared to typical short run volatility of retail fuel prices.

26. **Would a targeted education campaign on the actual benefits and disadvantages of biofuels/E10 contribute to informed consumer choice?**

Yes. This would help dispel myths purposely perpetuated by opponents of an ethanol mandate.

28. **What options could we employ to protect consumers?**

With appropriate policy settings, there is very little likelihood that consumer protection will be an issue when it comes to bio-fuel pricing. Consumers in regional areas already currently suffer from price gouging and the introduction of fuel source competition will only serve to lessen that problem.

29. **How can we ensure that fuel companies pass the benefits of ethanol through to consumers?**

Fuel distributors must be able to demonstrate that on average in any one year, they pass in full to the consumer any price advantage obtained from buying bio-fuel supplies at a discount to the prevailing price of petroleum based products.

This must be part of the mandate legislation.

30. **What is an appropriate method for estimating a 'reasonable' ethanol price?**

Set a formula to determine a reasonable ethanol price cap, that provides a reasonable margin referable to a 2 year moving average of a basket of State-wide retail prices.

31. **What is an appropriate balance between costs to consumers and the creation of regional jobs?**

Refer to answers to 25 and 28.

32. **Will an effective 'floor' in grain prices, as a result of a mandate, signal to grain growers an opportunity to increase production and investment on-farm**?

This will not be an issue as soon as the first second generation bio-fuel production facility comes on-line. Grain based ethanol will simply not be able to compete on cost.

33. **What mechanisms, if any, should be put in place to avoid distorting the drought feeding market next time drought conditions persist in Queensland?**

Refer to 32.

34. **What is the role of the Government in attracting a new bio-manufacturing industry in Queensland? Are there specific policy mechanisms or actions that will attract investment and development?**

Refer to commentary above.

35. **What additional actions can the Queensland Government take to increase the likelihood of project opportunities becoming operational projects?**

Refer to commentary above

36. Development of the biofuel industry, specifically ethanol, has struggled from a lack of long-term certainty and a problematic history. How do stakeholders including the Government provide the long-term certainty necessary for the development of, and investment in bio-manufacturing?

Refer to commentary above

37. What regional centres could become hubs for bio-refinery investment/development in Queensland?

Townsville is the natural location for a biofuels and downstream manufacturing hub. It has the required skilled population, infrastructure and educational facilities already in place. It is centrally located in the North Queensland sugar growing regions and is the major service centre for a catchment that includes very substantial access to water resources and arable land suitable for greenfield sugar and biomass production.