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BRIEF TO THE MINISTER FOR TRADE AND INDUSTRY ON THE REFORM AND ADJUSTMENT OF THE SUGAR INDUSTRY TO TRADE POLICY REFORM

PART A:

1. INTRODUCTION

Papua New Guinea (PNG) has initiated a policy of gradual trade liberalization as part of the structural adjustment reforms and at the institutional level, the policy is reflected in PNG’s full membership of the World Trade Organization (WTO) and the Asia Pacific Economic Cooperation (APEC).

Apart from those two (2) international trade organizations, PNG is also a member of numerous other trade agreements and arrangements, one notably is the Africa Caribbean and Pacific (ACP)/ European Union (EU) arrangement facilitated under the Cotonou Agreement.

This is a reflection of PNG’s attempt to integrate into the global economy.

PNG’s trade policy therefore is changing and pursuing a degree of market openness to international trade. This is being supported by the current Government’s national development strategy based on three pillars: (i) good governance; (ii) export driven economic recovery and growth strategy (EDERGS); and (iii) rural development, poverty reduction and empowerment through human resource development.

Similarly, the tariff reform program endorsed by the National Executive Council (NEC) or the Cabinet in November 1995 is pursued as per its implementation schedule. This program, which is a component of this change in policy, intends to encourage the development of an efficient and productive private sector more exposed to competition while reducing the price level in the economy. A strengthening of the duty drawback system to encourage more outward oriented economic activities should support the rationalization and lowering of tariff rates.

Thus, leads to the industry discussed here; the ‘Sugar Industry of Papua New Guinea’. The Brief will only cover part of the issues relating to the opening up of the industry and improving its efficiency and competitiveness and will not include other impediments like the high cost of doing business in PNG.

Part A also has some background information on the industry and the changes that it is going through.

Part B, the Brief will discuss the adjustment process, the concerns of the interest groups, the linkages to all government departments and agencies, the analysis on the reform and the adjustments and finally a list of recommendations. It is anticipated that an NEC policy submission with the recommendations mentioned here is submitted to the Cabinet for their noting and approval of the continuation of the trade policy reform and the industry adjustments.
2. **BACKGROUND**

The government decided in 1979, following the completion of a feasibility study, to establish a sugar industry to meet PNG’s sugar needs with the objectives of:

- Saving foreign exchange and achieving food self-sufficiency through import replacement;
- Generating employment, providing infrastructure and services and generally bringing development to an undeveloped and under-populated area;
- Creating a focus for participative, entrepreneurial agriculture-based business activity;
- Training Papua New Guineans in skills highly relevant to nation-building; and
- Generating tax revenue for government and a source of income for other businesses upstream and downstream.

Sugar operations started in 1982 with the production of 10,000 tonnes. With the policy of import replacement or substitution, the Government banned the importation of sugar. Sugar was no longer imported particularly from Australia and the consumers did not have much choice but to consume Ramu sugar, which at that time was not of high quality. As an infant industry and a pioneer in that sector, the Government was also provided the company Ramu Sugar Limited (RSL) tax holiday.

Output increased rapidly until 1986 when sugar cane was ravaged by a disease hitherto unknown to science, which became known as “Ramu Stunt”. This nearly put the company out of business but through loan rescheduling and hard work on the ground, it recovered.

The ban and the tax holiday remained for more than 10 years and the company never grew out of it. In mid 90’s policies started to change as PNG was preparing for its accession to the WTO. The Bretton Woods Institutions also imposed their program and one of which was the review of the tariff. While that was going on the private sector particularly the manufacturing industries that rely on sugar as an input to their industries pressured the Government to have the policy reviewed.

Responding to the above, the Government directed a major overhaul of the tariff structure in November 1995 and came up with an eight-year tariff reform program from 1999-2006. This resulted in removal of the ban in 1996 and replaced with a protective rate of 82% and that lasted till 1999. The rate continued to reduce and the current rate is 70% and by the end of the reform program in 2006, the tariff on sugar will be at 40% and as anticipated in the current discussion between the industry and the Government, it will be further reduced to 5% in 2010.

**PART B**

3. **PNG IS COMMITTED TO TRADE LIBERALIZATION**

Being a member of the WTO and APEC PNG is fully committed to the ultimate aim of opening its market and upholding its commitments and meeting its obligations under these Agreements.
As a small country with limited capacity, an inter-agencies committee is formed to assess the impact of the tariff reform program on all industries including sugar. The committee consists of line departments, research institutions, and interested parties including Manufacturers Council and RSL.

Through the activities of the Committee, it is assessed that by adhering to the tariff reduction and subsequently allowing liked products to enter the market competing with PNG made sugar, the sugar industry:

- has to change its production and marketing strategies to meet the competition;
- improve efficiency in its production and processing stages through enhanced mechanization resulting in quality and competitive products for use by other domestic industries and local consumption;
- through its new marketing strategies target the niche markets in the region once dominated by Fiji sugar and continue to pursue the traditional export markets such as United States; and
- move into diversification of products and invest in niche competitive by-products of sugar such as molasses and ethanol.

4. ADJUSTMENTS BY THE INDUSTRY

Since the tariff reform program was announced some six years back and the reduction program was gradual together with previous years of assistance from the Government, the company adjusted quiet smoothly. The company invested in the following:

- developed a fine agronomic research capability led and staffed by PNG scientists (now highly regarded in the world). Thus, the Industry has urged the government not to turn its back on large-scale agricultural development, particularly those that develop both farming and industrial skills;
- as an integrated agric-industrial project that apart from producing sugar, the company diversified into producing molasses, potable export grade alcohol and ethanol, beef cattle operations, an abattoir, and is involved in meat boning and packaging and manufacture of blood and bone meal, which is used as a feed supplement in the pig industry; and
- new machinery and conversion of cane into sugar is done in a largely environmentally friendly process.

Apart from these investments, RSL was also investigating the possibility of venturing into oil palm, involving local out-grower as well as estate production.

Whilst improving its operation as a response to the tariff reduction program and opening of the sugar industry, RSL announced that it was likely to make a profit of K14.7 (US$ 4.5) million in its 25th year (2004) of operation.

5. EFFECTS OF ADJUSTMENT & SAFETY NET PROGRAM

With the list of areas that the company has invested in and other areas that it is proposing to invest in, in order to sustain its products amidst the tariff reduction reflected that effects of adjustments might not be too drastic.
However, since RSL is a monopoly in that industry and is a major source of income for the local economy, with permanent employees numbering 700 and temporary/seasonal workers reaching 1000 at times of the year. Payments to direct employees, out-growers and subcontractors amounts to K18 (US$0.6) million annually.

Some 150 independent cane farmers or out-growers supply Ramu with about 120,000 tonnes of cane, around 25 per cent of the total. These farmers receive over K1 (US$0.3) million net each year.

Considering the reduction in the protective rate of sugar and opening up of the market for imports of other countries, RSL will off course face competition and the value of return of sugar sold domestically will surely drop.

Moreover, with the revenue raised from the domestic sales that has been used to cover the cost of the exports, this might not be possible if the domestic sales dropped.

As a consequence, RSL would start to put off the employees and some of them are the 700 highly skilled workers. Similarly, the 1000 seasonal workers will no longer needed.

The Government will not provide and financial assistance to those who are laid off. Nevertheless, it is anticipated that with the current economic environment and the growth in the resources sector those highly skilled workers will be able to find a suitable employment after being laid off. The seasonal workers on the other hand will not be unemployed since it is only during certain period of the year that they provide their service to the company and thus will be able to go back and toil their land.

6. **GOVERNMENT SUPPORT**

In pursuing the initiative of EDERGS and open market policy, the Government will provide research and development (R&D) assistance through its National Agriculture and Research Institute (NARI) to do research on how to improve the performance of the industry through product development.

The research will focus on:
- new type of high yielding crop;
- improved methods of cultivation;
- type and the proper use of fertilizers and pesticides and proper; and
- pest resistance crop.

As it is an industry in least development area of the country where it is making reality a Government’s policy of rural development and creating employment for those in that region of the country, the Government will allocate necessary funds to NARI to carry out the R&D activities.

7. **RECOMMENDATION**

It is therefore recommended that you:
- note the policy direction of gradual trade liberalisation being supported by the Government’s initiative of EDERGS;
- note the tariff reduction program and subsequently for the sugar industry to adhere to the implementation schedule of the tariff reduction on sugar, i.e. down to 40% in 2006 and 5% in 2010 as being discussed (Government & Company – RSL);
- endorse that this program be pursued as planned;
- endorse the findings of the Inter-Agencies Committee for the company to improve its performance and operation including going into product diversification;
- note the company’s preparation for the eventual lowering of the protective rate and the investment that it has already made;
- be informed on the possible negative effect such as unemployment when tariff is lowered and RSL products become uncompetitive; and
- endorse that Government provides adequate funds to NARI through budgetary process to carry out R&D activities on improvement on methods and product development.

Finally, as mentioned in the introduction of the Brief, should you agree with the content, it will be converted to a Cabinet policy submission for the Cabinet’s noting and approval.

Department of Trade and Industry, Waigani. 18th November 2004