The 1ST National Sugarcane Growers Conference

Keynote Address

Improving the Economics of Sugar Sector

by

Dr. C. Rangarajan

Chairman

Economic Advisory Council to the Prime Minister

May 24, 2013

Consortium of Indian Farmers Associations

Bengaluru

Improving the Economics of Sugar Sector

by

Dr. C. Rangarajan

Chairman

Economic Advisory Council to the Prime Minister

The importance of agriculture in the Indian context cannot be overstated. Over half the workforce is still employed in the farm sector, and even a small shortfall in food production causes serious difficulties for the economy. It continues to constitute the single largest expenditure category in the household budget. World Development Report 2008 brings out clearly that agricultural growth is at least twice as effective as non-agricultural growth in reducing poverty.

Certain developments in the evolution of India's agriculture sector in recent decades need to be taken note of in arriving at the contours of an agenda for its further

development. I would like to mention five such developments, each of which has a bearing on the need for liberalisation in Indian agriculture.

The first is that the pattern of investment in agriculture has shifted decidedly towards private investment, with the share of private investment rising from about half in the early 1990s to about 80% now. This is salutary since the private sector responds better and faster to incentive structures. However, public investment plays a key role in major and medium irrigation and research. Private investment may often follow public investment.

A second notable development has been diversification. The share of horticulture and livestock has overtaken cereals in the overall agricultural output over the last two decades. While the area under food grain crops has remained the same over this period, there have been

significant increases in the area under other major crops like oilseeds, sugarcane and cotton. The rate of growth in the production of oilseeds, sugarcane and cotton over the last decade has been significantly more than of food grain crops. There has thus been a marked movement towards high-value agriculture, driven by a change in demand patterns. This development offers an opportunity since there has been a slowing down of the rate of growth in agricultural yields in traditional crops. Recent price increases clearly show that food inflation can be triggered by both increases in the prices of foodgrains and other food articles. In the case of other food articles such as vegetables and fruits, while output has shown significant increases, they have fallen short of demand.

A third notable development has been the increasing opening up to global agriculture, with the ratio of agricultural exports and imports as a percentage of agricultural GDP increasing from 4.9% in 1990-91 to 12.7%

in 2010-11. Nevertheless, the share of agricultural exports in India's overall exports has declined from 18.5% to 10.5% over the same period. Given the relatively low share of exports in our agricultural GDP, there is clearly scope to step up exports. However, exports and imports are two sides of the same coin and we need to make our agriculture more competitive if we are to sustainably access global markets on a more ambitious scale.

A fourth development is the progressive diminishing of the size of operational landholdings, from 1.55 hectare in 1991-92 to 1.23 hectares in 2005-06. With small operational holdings, most farmers are unable to earn a reasonable income and are also at greater risk of impoverishment on account of cyclicality in the agricultural produce market. This is all the more so in respect of commercial crops, for which the competitive pressures from market forces are greater. To address the challenge, farmers could be encouraged to form formal or

informal groups, explore contract farming, and legally enabled to undertake land lease formally with due safeguards.

A fifth development is the continued growth of food processing industry at a rate much faster than the rate of growth of agriculture. To the extent producers are able to integrate up the value chain, they will have the opportunity to realise a higher share of the value-added consumer demand and thus increase their incomes.

These five developments constitute a compelling case for liberalising the agriculture sector in order to get the incentives right for investment, high-value agriculture, exports, scale and value-addition. The thrust of such liberalisation should be to secure India's comparative advantage, create more efficient markets at home and trade competitiveness, while ensuring environmental sustainability.This will lead to better terms of trade for the

farmers, on the back of competitiveness and sustainability, and thus achieve a balanced and integrated price structure, with due regard to the interests of both the producer and the consumer.

Sugar sectors displays all the five features mentioned – preponderance of private investment, high-value of agricultural produce, large export potential and increasing value addition through processing into primary products and by-products. As such, this is one sector that is ideally positioned to benefit and grow from greater liberalisation. The experience of delicensing in 1998 bears this out. The average annual growth rate of sugar industry, in terms of installed capacity, increased from 3.3% over the period from 1990-91 to 1997-98 to 6.9% over the period from 1998-99 to 2011-12. Further, with liberalisation, investment flowed in, enabling increase in installed capacities and the scale of operations, making Indian sugar industry more

competitive. As a result, India has emerged exporter of sugar over the last decade.

Government's commitment to take the next steps in liberalising the sugar sector was evident in the setting up of the committee to look into issues of deregulation of the sugar sector. Some of the key recommendations of this committee, which I chaired, have recently been implemented. The dismantling of the levy obligation and the regulated sugar release mechanism will bring in a more competitive, efficient and profitable sugar sector, thereby benefiting all stakeholders – the growers, the millers and the consumers.

The system of cane area reservation and maintaining a minimum distance between mills has been shielding mills from competition and has created perpetual monopolies. The farmer has no freedom to choose the buyer and is more likely to get delayed payments and

unfair price for the cane than in a competitive set-up. These policies have enabled inefficient sugar mills to survive. Markets are a superior option to state allocation of both raw material and manufacturing capacity. Further, the distance norm comes in the way of entrepreneurial initiative and entrepreneurs certainly factor in raw material availability while making investment and location decisions. Therefore, our committee recommended that over a period of time, states should encourage the development of long-term contractual arrangements, and phase out cane reservation area and bonding, although the current system may continue in the interim.

Reforms in sugarcane pricing, trade policy and regulation of by-products are also needed to unlock the full value of the raw material. Since states too have been playing a role in cane pricing, it may be necessary to have a broad consensus on reform of cane pricing. Nevertheless, it is clear that as in respect of any other

produce, the revenues realised from the sale of all the products and by-products should be equitably shared among producing stakeholders, and consumers too should get a competitive price. Based on this premise, our committee had estimated the relative share of costs incurred by farmers and millers and recommended sharing of 70% of the revenue from sale of sugar, molasses, bagasse and press-mud to rationalise prices, making them fair and predictable across years. This worked out to about 75% of the *ex*-mill value of sugar alone andcould ensurethe absence of cyclicality which has plagued the Indian sugar industry and has led to the accumulation of cane arrears from time to time. Even during the current season, the level of cane arrears has reached very high levels, crossing 23.7% of cane dues as on 31st March 2013. It must be understood that under the revenue sharing formula sugarcane growers will, in the first place, be paid the Fair and Remunerative price as fixed by CACP. This will happen in all cases. The balance will be paid at a later

stage as per the procedure indicated in the Report. The need to effect rationalisation of cane pricing remains, and government – both at the Centre and in states – needs to work towards this. India is perhaps the only major sugar-producing country that still follows a fixed price formula for cane-pricing while all others follow a revenue-sharing model.

Instead of *ad hoc* decisions on exports and imports, we need a predictable trade policy with moderate tariff levels and no quantitative restrictions. This would enable long-term investment aimed at realising our export potential and also achieving greater economic efficiency.

Sale of molasses is an important revenue stream for sugar mills. Emergence of a competitive nationwide market for molasses, without quantitative or inter-state movement restrictions, would result in realisation of better prices for this key by-product. As molasses come within the purview

of states, they need to enable this reform. Ethanol too has emerged as a major sugarcane-based product, with large potential demand from both the chemical industry and the possibility of blending with petrol. However, the growth of a market for this is adversely impacted by end-use restrictions on the raw material and such restrictions need to be dispensed with. State governments and state electricity regulatory commissions also need to enable assured open access for sale of electricity produced from cogeneration.

However, liberalisation from regulations is only one dimension for growth of the sugar sector. Equally important is ensuring the productivity and long-term sustainability of sugarcane cultivation. It is a matter of concern that the yield of sugarcane over the past decade has stagnated, with the annual growth being only 0.3% over the period from 2000-01 to 2010-11. The recent drought in Maharashtra has focussed attention on the

need to undertake water-use efficient cultivation practices and cropping decisions. Fortunately, initiatives like the Sustainable Sugar Initiative of ICRISAT and WWF hold out the hope that stepping up productivity and ensuring economy in use of water as well as other resources may be reconciled to a considerable extent. Evaluation trials conducted on the principal components of the Sustainable Sugar Initiative resulted in about 20% higher yields, even while effecting large savings in the use of water and other resources. We need to evaluate this experience, as well as experiences from other countries that have sustainably achieved high productivity, to achieve this goal through adoption of proven best practices in cultivation. In evaluating such experiences, we need to be conscious that while production per unit area is at present taken into consideration in comparing productivity of sugarcane across states, it would be more appropriate to also look at other relevant dimensions of productivity. In particular,productivity comparisons should adjust for the

duration of the crop, its water intake, and the conversion/recovery rates for any value-added produce. This assumes importance as land and water are increasingly becoming scarce, and value-addition is increasingly accounting for an ever larger share in consumer spending. Such evaluation would be of value both at the level of individual farmers and agro-based industry, as well as policy-makers, and would assist both in making the right cropping decisions. From a long-term perspective, wisdom lies in aligning cropping patterns with India's natural comparative advantage.Only competitive production and pricing would enable sustained growth and investment in the sector, and secure livelihoods.

I am sure the National Sugarcane Growers Conference will deliberate on all these aspects and help in the evolving a shared understanding among all stakeholders of the opportunities that lie before us and how best these may be realised. A vibrant and thriving sugar sector will catalyse

change in rural India, bringing in prosperity, contributing to higher incomes for farmers and also energy security.