Sugar Conundrum – Needed a National Policy

OPINION | A VELLAYAN

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An American President was most annoyed by economists who answered questions about economic policies by giving an assessment only to say "on the other hand." The American President remarked that he longed for the day when he could meet a one-handed economist. Over his term, the American President must have realised, the discipline of economics cannot be dealt with "one-hand."

Central to the present crisis of the Sugar industry is the cane pricing policy of both the Union and State Governments. Theoretically after discussions with the farmer bodies, industry associations, consumer forums and State Governments, the Committee on Agricultural Costs and Prices [CACP] submits its recommendations for a fair and remunerative price [FRP] for sugarcane after taking into consideration the cost of production of sugarcane; The return to the grower from alternative crops and the general trend of prices of agricultural commodities; the availability of sugar to the consumer at a fair price; The price at which sugar produced from sugarcane is sold by producers of sugar; The recovery of sugar from sugarcane; The realization made from sale of by-products viz. molasses, press mud and bagasse or their imputed value; and Reasonable margins for the growers of sugarcane on account of risk and profits.

In order to give adequate time to the farmers to plan their sowing, CACP submits its report around August every year for the season commencing from October in the subsequent/next year i.e. almost 14 months prior to the season. This is ostensibly to allow farmers plan better.

From the CACP report, it is seen that the FRP is calculated on the basis of an All India average weighted cost of production of sugarcane, cost of transportation from field to factory gate, insurance premium to the farmers and element of profit and to cover risks of the farmers. The following table provides the basis of calculating FRP for the past six years.

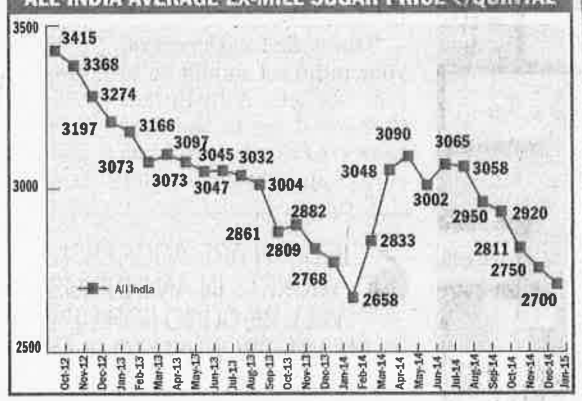
BASIS OF CALCULATION OF FRP (₹/QUINTAL)

S.No	Particulars	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
1	All India Weighted average cost of production of cane	85.66	99.07	129.76	179.15	193.13	203
2	Transportation	13.36	13.36	Not given	15	16.38	21
3	Insurance	1.79	2.86	Not given	3.13	3.13	
	Total (1 to 3)	100.81	115.29	129.76	197.28	212.64	224
4	FRP	139.12	145	170	210	220	230
Therefore Profits (FRP - Total of 1 to 3)		38.31	29.71	40.24	12.72	7.36	6

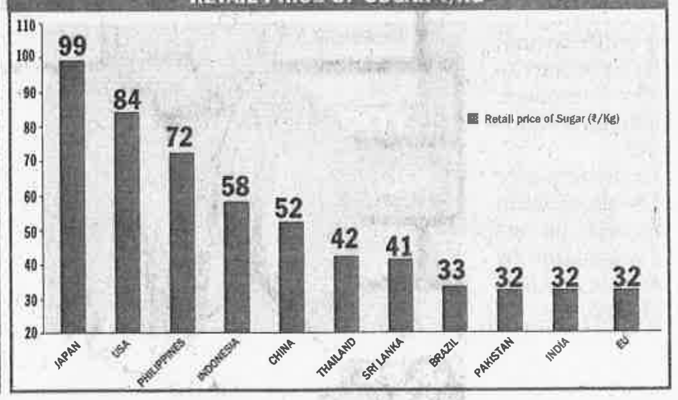
It is pertinent to note that while recommending the FRP, the CACP takes a comprehensive view of the costs and risks involved as explained above. As can be seen over the past six years the CACP has more or less aligned the FRP to the costs incurred by a farmer. However state governments in a competitive race to the bottom have announced ad-hoc bonus over and above the FRP computed by the CACP.

This corrosive policy of pricing cane in turn has completely dynamited the economics of the Sugar industry. On one hand the CACP raises the price of cane on a scientific basis taking into all costs and risks associated with cane production. However, ad-hoc increase in cane prices as mandated by certain state government over and above the FRP price determined by the CACP by certain states like UP and Tamil Nadu has wrecked havoc on the finances of the sugar mills. This in turn has driven the industry in these states to the point of no return.

ALL INDIA AVERAGE EX-MILL SUGAR PRICE ₹/QUINTAL



RETAIL PRICE OF SUGAR ₹/KG



It may not be out of place to mention that the revenue sharing model recommended by Rangarajan Committee, as well as those adopted by Karnataka and Maharashtra Governments, prescribe that 70% of the revenue realized from sugar and primary by-products or 75% of revenue realized from sugar sales alone, will be the cane price. The model also prescribes payment in two instalments to farmers, the first being at the level of FRP determined by the Government and second at the end of the sugar season as per the formula. However, the minimum guaranteed price that the farmers would get would be the FRP.

Further, it may be noted that the central government could tweak the prices of sugar on the basis of the ultimate buyer. For instance, according to a KPMG Report industrial bulk constituted 65% of our domestic consumption, retail 25% and government the balance 10 %. Government can introduce differential pricing for each class of consumers – especially industrial and bulk consumers. This has been effectively tried in countries like Thailand successfully.

Moreover, Government earlier regulated sugar sales under the release mechanism, wherein each mill was prescribed a quota or a quantity that it had to necessarily sell every month (later quarterly), not less not more. In other words, each mill was not only required to achieve the quota sales, but was also assured of a certain share of the total market sales. Therefore, during the regulated release mechanism, there was hardly any option to sell more or the need to plan or strategize sugar sales. Now that there is no quota system or regulated sugar releases in the market, the mills can sell the sugar immediately on production or can hold and sell later as per the commercial considerations and market conditions.

Therefore, there is need for the mills to be better informed of the current and futures prices. For this, there needs to be a proper platform for price discovery. Further, the platform should also provide for genuine contracts in the future which are guaranteed. These are best ensured by the forward market for sugar. Since the global futures market is very well developed, the domestic futures/forward market could align itself to the global market.

The earlier system of buffer stock by the Government, where carrying stock was reimbursed, is no longer feasible because there is no release mechanism under which once the buffer stock is dismantled, the sugar sales could be controlled by the Government. Therefore, all the buffer stock so kept will come into the market at one go. Further, the buffer stock does not give any cash flows to the mills. Also, one will be postponing the problem to a future date because sugar production does not seem to be falling significantly in the next few years.

Instead, the Government can buy 20-30 lac tons of sugar from the sugar mills and create strategic reserve. The Government can still use the godowns of sugar mills till it is removed for either sale by the Government in the domestic or foreign market. The Government can also use the strategic reserve for its PDS requirements. This will give cash flows to the sugar mills and also reduce their burden to carry surplus opening stock every year unnecessarily.

To conclude pricing of cane, a glut in domestic sugar prices and of course excessive regulations has wrecked havoc on the Indian sugar industry. The earlier the government resolves the same it is better for the 40 million cane farmers, millers and of course the consumers. One way out is to have a national Sugar Policy with a mandate that the Union Government alone must be determining the cane prices through FRP. Any state that seeks to pay over and above FRP prescribed by the CACP must pay the same from its exchequer and not burden the sugar industry.