Crushed!

There will be hardly any respite for sugar mills from the production subsidy. Even the Rangarajan's revenue share pricing formula does not offer a solution

RAJALAKSHMI NIRMAL

Sugar stocks have been in focus recently — first plummeting on concerns of a supply glut and crash in sugar prices, then rallying smartly on the Cabinet's decision to provide a production subsidy to reduce the burden on mills. The Cabinet decided to dole out ₹5.5 per quintal as production subsidy for cane. Will this ease the pain for sugar mills, saddled as they are with sugarcane payment arrears of a whopping ₹20,000 crore for the current season (2017-18)?

Sadly, no.

First, subsidy or no, the problem of plenty in sugar is here to stay. At 31 million tonnes, the output for 2017-18 is 50 per cent more than last year's. This has triggered a sharp correction in domestic sugar prices to ₹26-27/kg. This, in turn, has resulted in huge losses for sugar mills, which are forced to pay farmers the assured support price for cane, that is way above the market prices. With a yearly sugar consumption of 24-25 million tonnes, the excess supply in the market cannot be wished away.

Two, the production subsidy will reduce mills' dues by only about ₹1,600 crore. The sugarcane payment arrears would still be a burdensome ₹18,400 crore.

Lastly, the revenue-share formula recommended by the Rangarajan Committee is yet to offer a sweet deal to mills, as they are forced to cough up fair and remunerative price (FRP) in a bad year, when sugar prices are in a free fall. Hence, while the formula assures higher profits to farmers in a good year, it offers little respite to mills in a bad year. Even in Maharashtra and Karnataka where cane price is fixed as per the revenue-share formula, mills are in a state of despair.

BusinessLine digs deeper to understand why the sugar story is turning bitter.

Demystifying the Rangarajan formula

Cane was priced as per the provisions of the Sugarcane (Control) Order until 2009, wherein a statutory minimum price (SMP) was set every year. This was replaced by the fair and remunerative pricing (FRP).

Under both the regimes, however, the support price offered to cane farmers only moved up.

While in the late 1990s, the yearly increase under the SMP was ₹3-4/quintal, it became ₹5-8/quintal in 2000s. Since 2009-10, the increase under FRP has been ₹10-25/quintal.

In UP, which fixes its own price (SAP or state advised price) for cane, farmers are paid substantially higher — ₹50-100/quintal.

In a bid to address the challenges in the support price system, a panel chaired by C Rangarajan, suggested a revenue-share formula.

In this, farmers and mills share the revenue made from sugar in the ratio of 70:30 or 75:25 (if the value of sugar alone, without by-products, is considered). The proposed formula is based on a working that suggests that farmers incur 69 per cent of the total production cost. A farmer will be paid either 70 per cent of the revenue generated from sugar and its by-products, namely, molasses, bagasse and press mud or, simply, 75 per cent of the revenue from sugar.

While the revenue-share appears to address the problem to some extent, the stipulation that the minimum price a farmer will receive at any point will be the FRP, has put sugar mills in a sticky situation. The Rangarajan Committee holds that 'farmers will, under all circumstances, be paid FRP as the minimum'.

So, in years of low sugar prices such as now, when the price remuneration to farmers as per the revenue-share formula works out lower than the FRP, mills still have to pay FRP.

Mills are thus making a loss of ₹8/kg on sugar in the current season with cost of production at about ₹34/kg.

Hence, the adhoc fixing of FRP without considering the market price of sugar, continues to hurt mill owners.

The FRP on cane is ₹255/quintal at the basic recovery rate of 9.5 per cent. This means, if a mill crushes one tonne of cane and recovers 95 kg of sugar, it will pay its farmer ₹255/quintal for the cane. With every increase in recovery by 0.1 percentage point, the FRP will increase by ₹2.68/quintal.

Not much respite

Given the anomalies in the revenue-share formula, the burden of sugar mills is unlikely to ease, even if all States move to this model.

> **Arrears will remain**
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> Maharashtra and Karnataka have switched to Rangarajan formula. Still FRP is the minimum price to be paid to the farmer
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> In the current season, had all the States switched to this formula, mills would still have had cane arrears amounting to ₹18,900 crore

Let us assume that the average recovery rate is 10.8 per cent in the current season. This means from every tonne of cane crushed, 108 kg of sugar is recovered. The FRP payable then works out to ₹290/quintal.

If we take the average selling rate as ₹28/kg for mills, the revenue mills would make from a tonne of cane will be ₹3,024 (108 kg of sugar multiplied by ₹28/kg).

Now, as per the Rangarajan formula, mills will have to pay 75 per cent of ₹3,024 to the farmer, which is ₹2,268 per tonne of cane or ₹226.8/quintal. Now, given the FRP of ₹290/kg, the loss per quintal of cane for the mills is ₹63. If the industry crushes about 3,000 lakh tonnes of cane, the loss the industry will make is ₹18,900 crore.

This is not markedly different from the current season's arrears of ₹20,000 crore, with most States out of the ambit of the revenue-share formula.

Had the minimum FRP requirement not been there in the Rangarajan formula or the Centre had pitched in to make good the difference between the revenue share price and FRP, the industry would have been in a better situation.

The Cabinet's decision of providing ₹5.5/quintal as subsidy for every tonne of cane, does not make the deal any sweeter. The loss in the above scenario would go down to ₹56 per quintal of cane for the mills.

The overall cane arrears will move down to ₹17,000 crore — still a worrisome figure for the industry.

Insufficient balance in SDF

To help mills cope with times when they have had to pay FRP to farmers despite lower market prices for sugar, the Commission for Agricultural Costs and Prices (CACP) has been suggesting a sugar price stabilisation fund (SPSF) under the sugar development fund (SDF).

The SDF gets its money from the cess levied on sugar. The Sugar Cess Act, 1982 enabled the Centre to collect cess for the purposes of the Sugar Development Fund.

In 2016, the ceiling on the amount of cess was increased from ₹25 to ₹200 per quintal to help the Government meet expenses on interest subvention-based soft loans, export incentives, production assistance and liquidation of arrears of cane dues. But as GST kicked in (July 1, 2017), sugar cess, which was ₹1.25/kg, was scrapped.

However, whatever cess that was collected earlier through the excise route is in the 'Consolidated Fund of India' (which is exclusively earmarked for SDF).

As of July last year, the amount in this fund was ₹3,000 crore.

In 2018-19, the Budget announced a transfer of about ₹500 crore from the Consolidated Fund of India to SDF.

Thus, ₹500 crore in SDF and ₹2,500 crore in the Consolidated Fund of India is what is currently available to support any intervention by the Government.

It is nowhere close to the requirement to meet the cane arrears.