

Banks or farmers?

Worrying implications of a judgment on sugar

The Supreme Court has upheld the directive of the Allahabad High Court to sugar mills in Uttar Pradesh that they should sell the sugar stocks hypothecated to the banks in order to clear the arrears of the sugarcane farmers. The banks had filed a petition challenging the directive in the Supreme Court, which has been struck down. According to news reports, the banks have an exposure of ₹3,000 crore to the mills, and they fear these loans might now turn into non-performing assets, because they will fall short on collateral. The banks have argued that they will be left with no option but to proceed against the mills under the coercive Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, or Sarfaesi Act. The mills say they will run short of working capital in the future, and, in the short run, the price of sugar could tumble when the stocks pledged to the banks are liquidated. The mills are mired in losses, and a sharp fall in prices will only make matters worse.

Apart from raising these questions, the decision highlights once more how politics has wreaked havoc on the industry. Mills get working capital from banks by offering sugar stocks as security. A sizable part – 85 per cent – of this money is used to pay the sugarcane farmers. Clearly, bank credit has not been enough for the mills to clear the sugarcane arrears. At last count, the arrears stood at ₹2,800 crore. This is because the high price at which the Uttar Pradesh government requires mills to buy sugarcane. At last year's sugarcane price – ₹28 a kg – the mills say their production cost comes to ₹36 a kg, while the current price of sugar (ex mill) is ₹28.50. Since working capital is provided by banks on prevailing market prices, this money has proved inadequate to clear the dues of the farmers.

For political reasons, successive governments in Uttar Pradesh have chosen to keep the sugarcane price high. A solution suggested by the committee headed by C Rangarajan, the chairman of the economic advisory council to former prime minister Manmohan Singh, was to link sugarcane prices to sugar prices. So if the price of sugar moves up, farmers will get a higher price for sugarcane, and *vice versa*. But the formula has not found favour with the Samajwadi Party government of Uttar Pradesh that wants to give the farmers a say in sugarcane prices. It is now working on its own formula with which it hopes to keep everybody happy. Meanwhile, the other two large sugar-producing states of Maharashtra and Karnataka have initiated moves to switch to the formula suggested by Dr Rangarajan.

The Supreme Court's endorsement of the Allahabad High Court's decision poses a broader question: will the interests of the banks – even if holders of senior claims on assets – now be required to be subservient to the public good? This might prove tricky, particularly in sectors such as jute and tobacco that deal with farmers. This has serious implications for the banking sector.

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