

Growers Must Own Sugar Mills, in Part

That is the long-term solution to the sugar mess

The Supreme Court's recent order, saying that sugarcane farmers, and not the banks that have lent working capital to sugar mills, are to be the first recipients of payments, violates the fundamentals of finance. Under limited liability, a provision that evolved from monastic orders and guilds in 15th-century England and was finally made into law for all companies in 1811 in the US, the first claim on default is by the lender, in this case, banks to sugar mills. For the sugar industry of Uttar Pradesh, our largest producer, the court's ruling means that banks with a heavy exposure to the sector, like SBI, HDFC, Axis Bank and so on, will have to wipe out their debts — and, consequently, stop lending to — this vital sector. This is just not unacceptable.

It is true that the sugar industry in Uttar Pradesh owes about ₹3,000 crore to cane farmers, estimated at current cane prices. But it is also true that the Uttar Pradesh government sets cane prices in whimsical ways, usually before elections, to try and win cane farming votes. The current price of ₹280 per quintal was set



just before the last assembly polls and is considered too high by millers, who now say that they will not crush any cane this season, which begins this month. So, what are we to do now?

State-advised prices must go. The Rangarajan committee's recommendation that mills should share 70% of revenue from sugar and associated products with farmers is sound. But this is difficult to implement as an administrative measure. But what could really make a difference would be an equity-sharing agreement between mills and cane farmers that would enable each to manage short-term monetary gains with medium-term capital gains in stock price. The ideal solution is for complete vertical integration, with farmers forming producer companies that own and operate sugar mills. Given the degree of mutual dependence between farmers and mills, integration into a single firm is superior, by far, to contractual arrangements. It is easier for farmers to form companies than for companies to own and cultivate crops, given the huge resistance to corporate farming.

The Economic Times

25/10/14

✓✍