Article:

Why government's intervention to deal with sugar industry crisis does not solve much on ground

While welcoming the limited relief the package will bring, sugar industry also thinks that it is inadequate for the sector.

The Cabinet Committee on Economic Affairs (CCEA) has approved a Rs 7,000 crore package to deal with the crisis in sugar industry (Rs 8,500 crore if the Rs 1,540 crore announced earlier is included) .

A slump in prices following a glut in production has created around Rs 22,000 crore in pending arrears for sugar cane farmers. Unlike rice and wheat, where the government procures the crop at Minimum Support Prices (MSPs), sugar cane farmers sell their produce to sugar mills at government-notified Fair and Remunerative Prices (FRP).

While welcoming the limited relief the package will bring, sugar industry also thinks that it is inadequate for the sector.

A press release issued by Indian Sugar Mills Association (ISMA) says that for the mills to be able to pay FRPs to sugarcane farmers, ex-mill sugar prices need to be Rs 35 per kg.

The CCEA has fixed sugar prices at Rs 29 per kg at the moment.

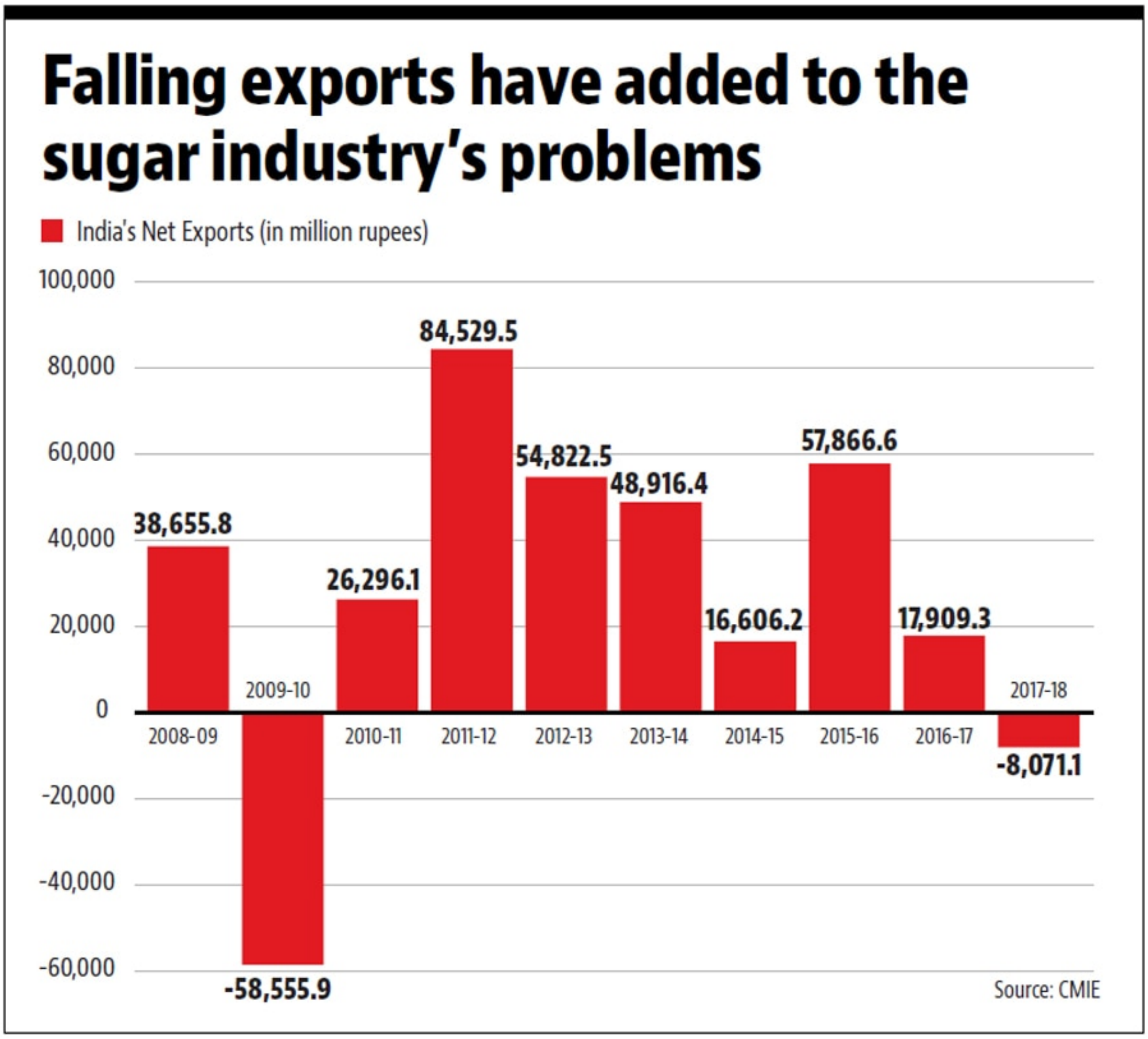
While the FRP for sugar cane increased by 10.8% in the current year, the highest in the last 5 years, sugar prices have fallen by more than 24% since the beginning of this season in October 2017 according to sugar price data by National commodity exchange (NCDEX).

India's sugar production has increased by an average 8-9% in the last eight years.

This has been owing to the usage of a higher-yielding variety of sugar cane Co-0238 by farmers.

While the country's production is increasing, its exports have fallen in the last five years except in 2015-16 owing to a global supply glut and falling global sugar prices.

Global sugar prices have fallen by 45% in the last 18 months from their highs in October 2016 according to data from the International Sugar Organization.



While increasing the minimum selling price to Rs 29 per kg the CCEA release states that the "government will put in place a mechanism to ensure that the retail prices of sugar are kept fully under control. At present, this would be done along with imposition of stock holding limits on sugar mills."

This limit will be set till September 2018. Stock holding helps the government regulate the amount of sugar released in the market. This helps in controlling the sugar prices.

The industry body, in its press note, has disapproved the government's decision of imposing stock holding measures on sugar mills. ISMA's Sanjay Banerjee said such proposals limit the working capacity of mills and their ability to service loans in the long term, as 85% of the sugar produced by the mills is pledged with the banks for their working capital loans.

In May, the government had announced an extension of financial assistance to sugar mills by providing Rs 5.50 per quintal of sugar cane crushed in the 2017-18 sugar season (October-September).

This benefit was announced only for the current year. According to Banerjee this measure does not help the whole industry.

He said" the assistance to sugar mills is based on certain criteria retrospectively and due to this about 40% of sugar-mills are unable to meet them".

The industry in its press note stated that government's creation of buffer stocks of 30 lakh metric tonnes would help reduce surplus sugar only for the current year.

It raised concerns regarding the absence of any ideas on rationalisation of cane pricing policy according to market prices of sugar in the CCEA release.

Banerjee said: "For the long term we are looking for implementation of the C Rangarajan committee suggestion of rationalisation of sugarcane prices with sugar prices."

The committee, in its 2012 report, had suggested making actual payment for cane dues in two steps, where the first would include payment of a floor price (FRP) from mills to farmers and the balance payment would depend on the final sugar price that mills sell at.

This balance payment would be based on sharing of revenues generated in the sugarcane production chain including by-products of sugar between farmers and millers in the ratio of 70:30 thus sharing sugar price risk between both millers and farmers. That though, is a politically sensitive move, and a government burnt by Kairana (where the angst of sugar farmers is expected to have played a part in the defeat of the BJP in the recent Lok Sabha bypoll) is unlikely to press for it.

By Vineet Sachdev

Jun 10, 2018 11:06 IST

Commentary:

The article describes the situation of the three stakeholders: Indian sugar farmers, sugar mills, and the government.

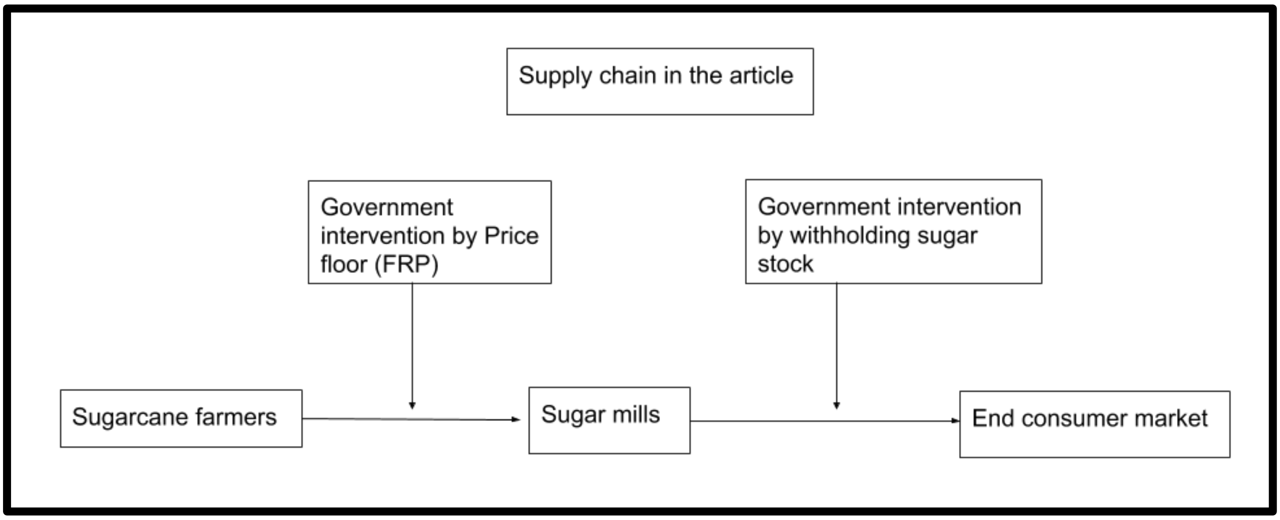


Figure 1: Supply chain in the article

The mills pay government set FRP (Fair and Remunerative Prices: A Price Floor) to the Indian farmers which has been increasing annually, whereas, refined sugar prices, sold by the mill to the consumer market have been declining. Price floor is a price regulation set by the government, in which the price paid by the mills to the farmers is set above the equilibrium price. Moreover, the ever falling global sugar prices, pose a threat to the sugar industry in India. To battle this situation, the government decided to purchase stocks, to generate scarcity in the domestic market, and raise prices.

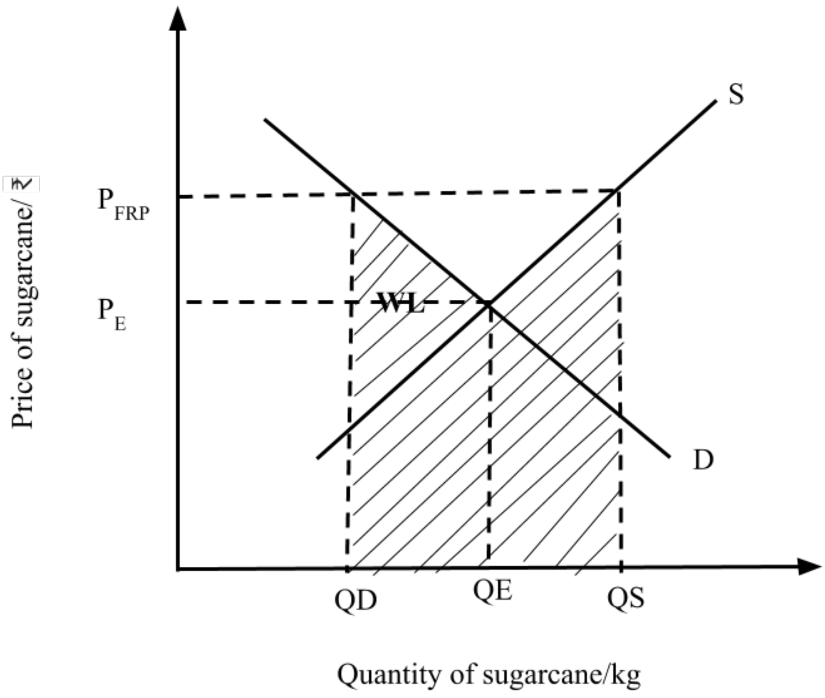


Figure 2: Price floor for sugarcane farmers

As illustrated in *Figure 1*, the implementation of FRP by the government caused an excess supply in the market, shown by the difference between QD and QS. The price, P_{FRP}, is greater than the equilibrium price, P_E, which leads to the formation of welfare loss, shown by the shaded region WL. The welfare loss is created due to lower demand as the mills have to pay higher prices. Hence there is surplus left with the farmers making them worse off. The government may need to intervene to purchase surplus in order to sustain the farmers' income.

Implementation of FRP can lead to producer inefficiency, which can occur due to the over or under usage of “Co-0238”, as the farmers know they are going to get paid a fixed amount regardless of the inputs. Moreover, there could be overallocation of resources: because the farmers receive prices higher than equilibrium for sugarcane, they are incentivized to increase production of sugarcane by investing more fertilizers for higher profits, leading to a high opportunity cost for other crops. The excess sugarcane will require maintenance and additional financial assistance will be expected from the government for disposal.

The impact of this policy on the main consumer, the mills, of this commodity is adverse. The mills refine sugarcane to sugar, which adds value to the raw material, and justifies the higher prices paid by the end consumer market. In this situation, the mills face a diminishing profit margin bracket as the government supports the farmers by raising the prices they receive, whereas, the consumers demand reduction in prices by expressing dissatisfaction. The farmers benefit off this decision as they receive higher prices than equilibrium price. The employment in farms and mills increases as the QS increases. The government benefits from political support from farmers.

The government implements the price floor to enable the supply chain to work efficiently, however, this action leads to a welfare loss as expressed in the article, “limited relief”, and “inadequate for the sector”. The policy benefits one group while making the other group worse off. To support the mills, the government purchases the produce, known as the buffer stock.

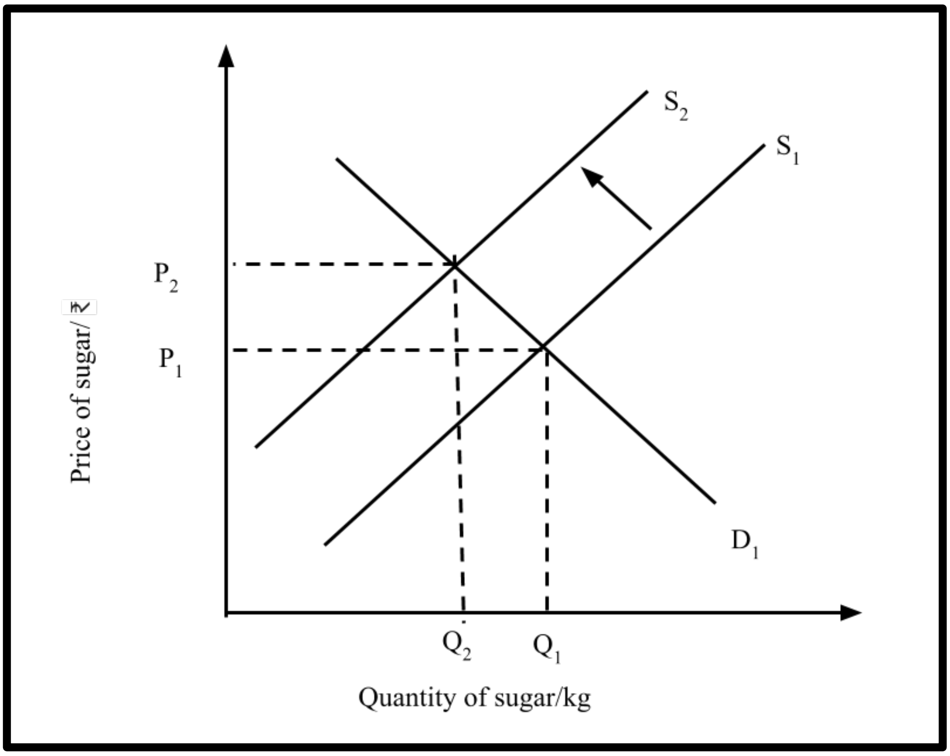


Figure 3: Government holding on sugar supply on global market

In *Figure 2*, the equilibrium price and quantity is at P_1 and Q_1. Due to the action of holding back of stocks, there is a decline in the supply, shown by the shift in the supply curve from S_1

to S_2. This causes a change in equilibrium price and quantity, from Q_1 to Q_2 and P_1 to P_2. Since the equilibrium price has increased, the problem due to the falling prices has been tackled through the creation of scarcity.

The impact of this on sugar mills is that they receive the higher prices and earn a greater profit per unit sold. The buffer stock will also reduce the maintenance costs of the firms as they won't have to pay to keep old stock fresh, whereas, the government will have to incur this cost. However, the policy harms the firms' credit rating, due to pledged stocks to banks, and limits their scope of expansion. The consumers also suffer as they have to pay higher prices for sugar. The mill workers and farmers may be made redundant due to slow down of production, causing increase in unemployment. The mills may become overdependent on government assistance. Moreover, the mills' proposal regarding distributing by-products of production between farmers and mills, could increase the mills' revenue and lead to sustainability.

The government's decision to help both farmers and mills, creates a huge opportunity cost on the taxpayer. The extent to which the assistance provided benefits the society, depends on the efficiency achieved by farmers and mills.

Word Count: 750 words

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