

Report Summary

Report of the Committee on the Regulation of Sugar Sector in India: The Way Forward

The Economic Advisory Council to the Prime Minister (Chairperson: C. Rangarajan) submitted a 'Report on the Regulation of Sugar Sector in India: The Way Forward' on October 5, 2012. The Report examines the issues related to the regulation of the sugar sector, and suggests ways to promote efficiency and investments in the sector.

Current regulations in the sugar sector and recommendations

A major step to liberate the sugar sector from controls was taken in 1998 when the licensing requirement for new sugar mills was abolished. Delicensing caused the installed capacity in the sugar sector to grow at almost 7% annually between 1998-99 to 2011-12 compared to 3.3% annually between 1990-91 to 1997-98. Delicensing also contributed significantly to a structural transformation in the sugar industry. Till 1997-98, sugar cooperatives dominated the sugar industry but by 2011-12 this changed significantly with the private sector contributing the largest share of total installed capacity.

Although delicensing removed some regulations in the sugar sector, other regulations persisted. The drivers for regulations were: (i) the highly perishable nature of sugarcane; (ii) the small land holdings of sugarcane farmers; and (iii) the need to keep the price of sugar at reasonably affordable levels while making it available through the Public Distribution System (PDS). However, the Committee found that existing regulations were stunting the growth of the industry and recommended that the sector be deregulated. Deregulation would enable the industry to leverage the expanding opportunities created by the rising demand of sugar and sugarcane as a source of renewable energy. The principal aspects regulated in the sugar sector, the issues that arise due to such regulations, and the Committee's recommendations, are as follows:

- i. **Cane reservation area and bonding-** Every designated mill is obligated to purchase from cane farmers within the cane reservation area, and conversely, farmers are bound to sell to the mill. This ensures a minimum supply of cane to a mill, while committing the mill to procure at a minimum price.

However, this arrangement reduces the bargaining power of the farmer. He is forced to sell to a mill even if there are cane arrears (occurs when sugar mill owners delay payment to farmers for the sugarcane supplied). Mills, on their part, lose flexibility in augmenting cane supplies, especially when there is a shortfall in sugarcane production in the cane reservation area. Mills are also restricted to the quality of cane that is supplied by farmers in the area.

The Committee recommended that over a period of time, states should encourage development of market-based long-term contractual arrangements, and phase out cane reservation area and bonding. Such individual contracts with farmers would give them the flexibility to decide which mill they want to sell their produce to.

- ii. **Minimum distance criterion-** Under the Sugarcane Control Order, the central government has prescribed a minimum radial distance of 15 km between any two sugar mills. This regulation is expected to ensure a minimum availability of cane for all mills. However, this criterion often causes distortion in the market. The virtual monopoly over a large area can give the mills power over farmers, especially where landholdings are smaller. In addition to restricting competition, the regulation inhibits entry and further investment by entrepreneurs.

In order to increase competition and ensure a better price for farmers, the Committee recommended that the distance norm be reviewed. Removing the regulation will ensure better prices for farmers and force existing mills to pay them the cane price on time.

- iii. **Price of sugarcane-** The central government fixes a minimum price, the Fair and Remunerative Price (FRP) that is paid by mills to farmers. States can also intervene in sugarcane pricing with a State Advised Price (SAP) to strengthen farmer's interests. Typically, SAP is higher than FRP. There have been divergent views on which is a fair price to both farmers and millers.

The Committee recommended that states should not declare an SAP. It suggested determining cane prices according to scientifically sound and economically fair principles. The committee agreed that sharing of the revenues/value created in the sugarcane production chain should be in a ratio of 70:30 between farmers and millers. This ratio should also apply to the revenue generated from sale of primary by-products of sugar. Thus, actual payment for cane dues would happen in two steps. The first would be a payment of a floor price (FRP) from mills to farmers. Balance payment of cane dues will depend on the final sugar price that mills sell at. These dues will be split between farmers and millers on the lines indicated above.

- iv. **Levy sugar obligation-** Every sugar mill mandatorily surrenders 10% of its production to the central government at a price lower than the market price – this is known as levy sugar. This enables the central government to get access to low cost sugar stocks for distribution through PDS. At present prices, the centre saves about Rs 3,000 crore on account of this policy, the burden of which is borne by the sugar sector.

The policy of levy sugar puts the burden of a government social welfare programme (PDS) on the industry. A price lower than the open market price implies lower returns for mills, which eventually impacts cane payments to farmers.

The Committee recommended dispensing with levy sugar and doing away with a centralized arrangement for PDS sugar. States that want to provide sugar under PDS may henceforth procure it directly from the market.

- v. **Regulated release of non-levy sugar-** The central government allows the release of non-levy sugar into the market on a periodic basis. Currently, release orders are on a quarterly basis. Thus, sugar produced over the four-to-six month sugar season is sold throughout the year by distributing the release of stock evenly across the year.

The mechanism of regulated release imposes costs directly on mills (and hence indirectly on farmers). Mills can neither take advantage of high prices to sell the maximum possible stock, nor dispose of their stock to raise cash for meeting various obligations. This adversely impacts the ability of mills to pay sugarcane farmers in time.

The Committee recommended removing the regulations on release of non-levy sugar. Removal of

these controls will improve the financial health of the sugar mills. This, in turn, will lead to timely payments to farmers and a reduction in cane arrears.

- vi. **Trade policy for sugar-** The government has set controls on both exports and imports. These controls are imposed after taking into account the domestic availability, demand and price of sugarcane. A number of cascading import controls and export permits are used to achieve this. As a result, India's trade in the world trade of sugar is small. Even though India contributes 17% to global sugar production (second largest producer in the world), its share in exports is only 4%. This has been at the cost of considerable instability for the sugar cane industry and its production.

All existing quantitative restrictions on trade in sugar should be removed and converted into tariffs. Appropriate tariff in the form of a moderate duty on imports and exports, not exceeding 5-10%, should be applied. Such a trade policy will be neutral to consumers and producers. The tariff can be changed when world prices are very high or low.

- vii. **Regulations relating to by-products-** Certain restrictions have been placed on by-products of sugarcane such as molasses and bagasse. State governments fix quotas for different end uses of molasses and restrict their movement, particularly across state boundaries. Some states have also imposed restrictions on the mills that can sell power generated from bagasse to users other than the local power utility. Mills are also restricted from selling power generated from bagasse to other states. Such restrictions impede the revenue realization from cogeneration and reduce economic efficiency.

The committee recommended that there should be no restrictions on sale of by-products and prices should be market determined. States should also undertake policy reform to allow mills to harness power generated from bagasse.

- viii. **Other issues-** The Jute Packaging Materials (Compulsory use in Packing Commodities) Act, 1987 (JPMA) mandates that sugar be packed only in jute bags. The sugar industry estimates that this leads to an increase in cost by about 40 paise per kg of sugar besides adversely impacting quality. The committee recommended removing the sugar industry from the purview of the JPMA.

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