

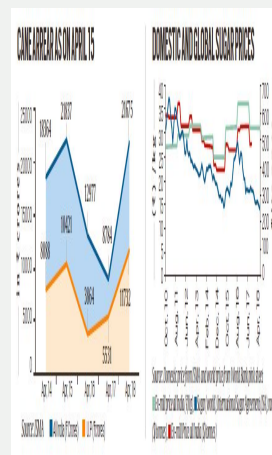
FROM PLATE TO PLOUGH: DROWNING IN SWEETNESS

Relevant for: Indian Economy | Topic: Agriculture Issues and related constraints

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The sugar sector is heading for a major crisis of plenty. India will begin the sugar season (October to September) with a sugar stock of about 10 million metric tonnes (MMT). The industry's production estimate for 2018-19 is 35.5 MMT, up from 32.3 MMT in 2017-18, against an annual consumption of about 26 MMT. Contrast this with the production of just 20.3 MMT in 2016-17, and one can imagine the enormity of over-flowing stocks. But the real problem is of rising arrears to cane farmers, which stood at Rs 21,675 crore on April 15, up from Rs 8,784 crore a year earlier. And it won't be a surprise if these arrears spike further by 50 to 100 per cent by April 2019, if no bold corrective action is taken quickly by the government. More than half of these cane arrears will be in Uttar Pradesh. And this may hit the [Narendra Modi](#) government hard, politically, as it heads for parliamentary elections, presumably in March-April, 2019.

Before we think of possible solutions, we must get the diagnosis right. The root cause of the mounting cane arrears is that in 2016-17, domestic sugar production was as low as 20.3 MMT, necessitating imports, and domestic sugar prices (ex-mill) crossed Rs 36/kg (see graph). Global sugar prices were also high (\$490/tonne in October 2016). This led to an expansion of the area under the crop, and with a good monsoon, improved yield and recovery ratio, lead to dramatic increase in sugar production from 20.3 MMT in 2016-17 to 32.3 MMT in 2017-18, a historic increase of 59 per cent. This production boost substituted imports and replenished stocks, but it became a problem when the world prices of sugar dropped by almost 50 per cent to \$244/tonne by August 2018 (see graph), making Indian sugar non-competitive in global markets.



What are the policy options when the sugar sector is jolted by such volatility? The first option is trade policy. In June 2016, India had imposed an export duty of 20 per cent to discourage exports as domestic production was low and sugar prices high. In 2017-18, when production jumped, export duty was removed, though belatedly, in March 2018, and import duty raised from 50 to 100 per cent in February 2018. Although the import duty of 100 per cent seems very high, yet the direction of trade policy is broadly right.

The second option is exporting 5-7 MMT of sugar. But at prevailing world prices, this is not feasible. Unless the rupee falls further and global prices improve, the export situation may remain grim. Exporting sugar through heavy subsidisation has its limits, as exporting countries

like Brazil, Thailand, and Australia may drag India to the WTO.

The third policy option is to create a larger buffer stock (of say 5 MMT). This may help India stabilise prices in lean years. But it will cost quite a bit and, given the surplus supplies and low domestic prices, the sugar industry cannot bear this burden without the government underwriting a part of the stocking costs.

The fourth option is to divert cane to ethanol. The government has already taken a bold step by allowing ethanol from sugarcane juice or B-molasses and deserves compliments for this decision. It will help the industry diversify and reduce risk. Just to cite an example, in 2017-18, Brazil put almost 60 per cent of its cane to produce ethanol as global sugar prices were depressed. The Government of India (GoI) has also announced soft loans to the sugar industry for capacity expansion to produce ethanol. This is a proven technology and much better than the idea of producing ethanol from agri-waste, an idea that some oil companies are toying with, with capital investments of Rs 8,000-10,000 crore. However, one critical point in ethanol business is its pricing. Since ethanol is a substitute for petrol from imported crude, its pricing should be linked to the import parity price of petrol (IMPP). At a crude price of about \$75-80/barrel, IMPP works to around Rs 47/litre, after accounting for its refining and other costs. But the sugar industry is asking for ethanol price of Rs 52/litre based on its cost of production, where pricing of cane remains a key factor.

That brings us to the core of this problem — the pricing of sugarcane. The GoI announces Fair and Remunerative Price (FRP), but the UP government tops it with the State Advised Price (SAP). In UP, the SAP was about 39 per cent higher than what its adjusted FRP would have been during 2010-11 to 2017-18. No wonder, sugarcane remains one of the most profitable crops.

For the 2018-19 season, while the GoI is trying to ensure 50 per cent margin over cost A2+FL for kharif crops, in case of sugarcane this is already 87 per cent at all India level and 97 per cent in UP. The problem is that the SAP is quite divorced from prevailing sugar prices. Ideally, cane price should be a contract price between cane farmers and sugar mills, with the government acting as a referee. The Rangarajan Committee on the pricing of sugarcane had recommended 75 per cent of the sugar price to be given to farmers as cane price. Karnataka and Maharashtra had agreed to this formula but UP did not. Anything above this 75 per cent threshold speaks of a political component to cane pricing.

If the UP govt wants to give a higher price for sugarcane than 75 per cent of sugar price, the best way would be to give it as bonus directly to farmers, as Chhattisgarh and Madhya Pradesh did for paddy (Rs 300/quintal) and wheat (Rs 265/quintal), respectively this year. A similar principle should apply to sugarcane. Else, if we force the sugar industry to pay irrationally high prices of cane, it will be pushed towards sickness, large NPAs, and an even bigger mess.

Can the Narendra Modi government convert this crisis into an opportunity to reform sugar policies? If it does, it will be good economics and good politics, ensuring sizeable votes from UP in the parliamentary elections.

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