Partial de-control to provide some respite to the sugar industry …

The much awaited decision of the government to decontrol the sugar sector will provide respite to the sugar industry which is currently reeling under problems of high sugarcane cost and declining sugar prices.

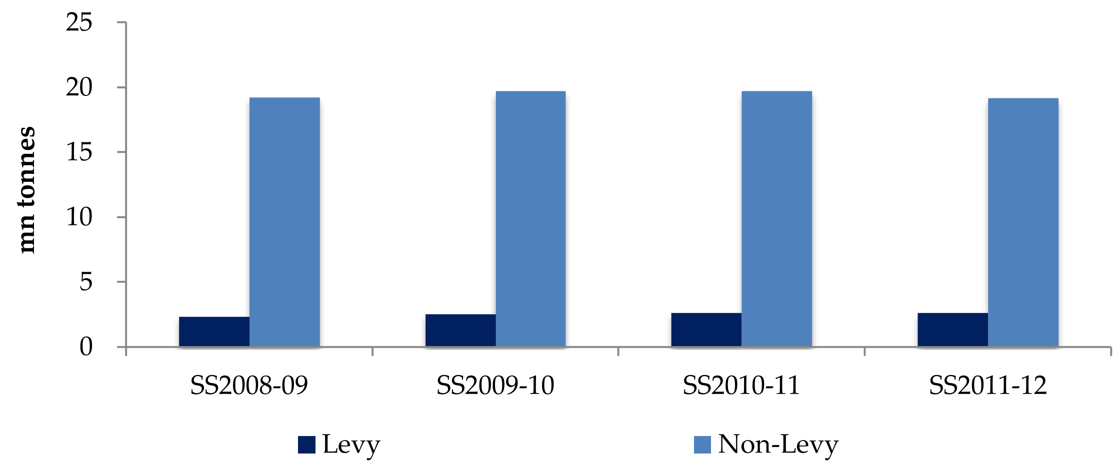
Until now, the Indian sugar industry was the most regulated industry across the globe. The entire value chain of the sugar industry was kept under the tight control by the Central and State governments. The sugar industry in India was regulated right from cane procurement to cane pricing, allocation of cane area to the distribution of sugar in the market. To regulate the price and supply of the essential commodity, the Central government used to fix the quantum of sugar to be sold in the open market through levy and non-levy quota.

Heavy regulations artificially impacted the demand-supply forces resulting in imbalance in the sugar market dynamics. In January 2012, to address the plight of the sugar industry, the government of India had setup a committee under the chairmanship of C. Rangarajan. Some of the key recommendations made by the committee were:

- Removal of the levy obligation which is used for sugar distribution through PDS
- Abolition of the regulation on release mechanism of non-levy sugar
- The sugarcane prices to be determined by linking it to the revenue generated from sugar and saleable primary by-products produced in the process of sugar production
- The reservation of sugarcane area to be phased out and contract between farmers and mills to be allowed freely etc.

Taking a step to de-regularize the sector, the government has now decided to abolish the levy quota mechanism and dismantle release mechanism as well. The removal of levy quota will provide freedom to the sugar mills to sell their entire sugar output in the open market. Under the levy mechanism, the sugar industry was compelled to sell 10% of the total sugar production to the government for distribution through PDS at a subsidised price fixed by the government.

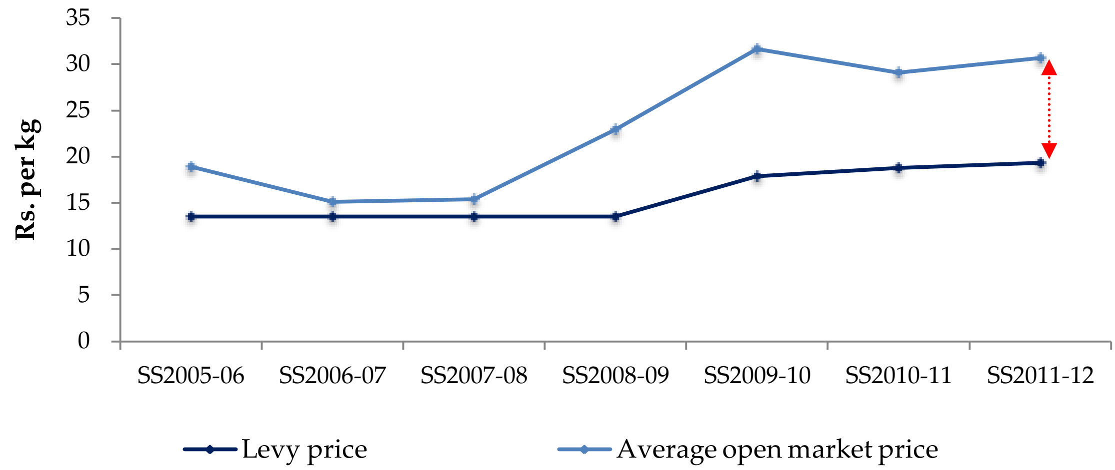
Trend of levy and non levy sugar quota



Source: ISMA and CARE Research

The levy price fixed by the government was well below the market price and the cost of sugar production as well. In SS 2011-12, levy price was about Rs.19 per kg while the average market price was about Rs.31 per kg. Sugar industry had to incur a loss of Rs.6 per kg (below cost of production of about Rs. 25 per kg) on sugar sold through levy quota in the last sugar season.

Trend of levy and non levy sugar prices



Source: ISMA and CARE Research

Realisation of sugar mills will increase by about Re.1 per kg …

Considering a difference of approx Rs. 10 between the average open market price of sugar and the levy price, the sugar mills are expected to gain an additional realisation of Re.1 per kg of sugar sold. However, with the removal of levy quota mechanism, the state government will have to procure sugar from the open market for distribution through the PDS, thus increasing subsidy burden by approx Rs. 2500 to Rs.3000 crores.

Also, the removal of release mechanism will provide freedom to the sugar mills to sell sugar in the open market without any quantitative restriction. At present, the sugar mills are facing a liquidity crisis and have considerable arrears (~Rs.10,000 crores as on Jan 2013 as per ISMA) towards payment for sugarcane to farmers. CARE Research believes that in near term, sugar mills would sell more sugar in the open market in order to reduce these sugarcane arrears. This may exert some downward pressure on sugar prices in the short term.

Eventhough, the government has provided some relief to the sugar industry by the partial de-control, it still needs to address measures to rationalize sugarcane pricing.

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