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SUGAR CRISIS

Sugar Coated Sugar Crisis and Cartelization

By Uzma Zia

“See, if you look at the drug war from a purely economic point of view, the role of the government is to protect the drug cartel. That’s literally true.” ~ Milton Friedman

Introduction

In Pakistan, sugarcane is considered as a high value cash crop with value addition in agriculture of almost 2.9 percent. Sugarcane farming offers partial and seasonal employment to about 3.9 million individuals, which is about 12.14% of the total agricultural labor force. Since 2014-15, the production of sugarcane increased and an impressive target was achieved in 2017-18. In 2018-19, sugarcane crop production was observed to be lower by 19.4 percent (to 67.174 million tonnes) compared to 83.333 million tonnes in 2017-18 (Figure 1). The common reason for the decline was thought to be the shrinking of cultivated area (by 17.9 percent from 1,343 thousand last year to 1,102 thousand hectares). Likewise, low economic earnings dispirited the growers to bring more area under the cultivation of sugarcane crop. A surplus crop doesn’t let farmers get a good price, therefore, they usually look at their specific paybacks.

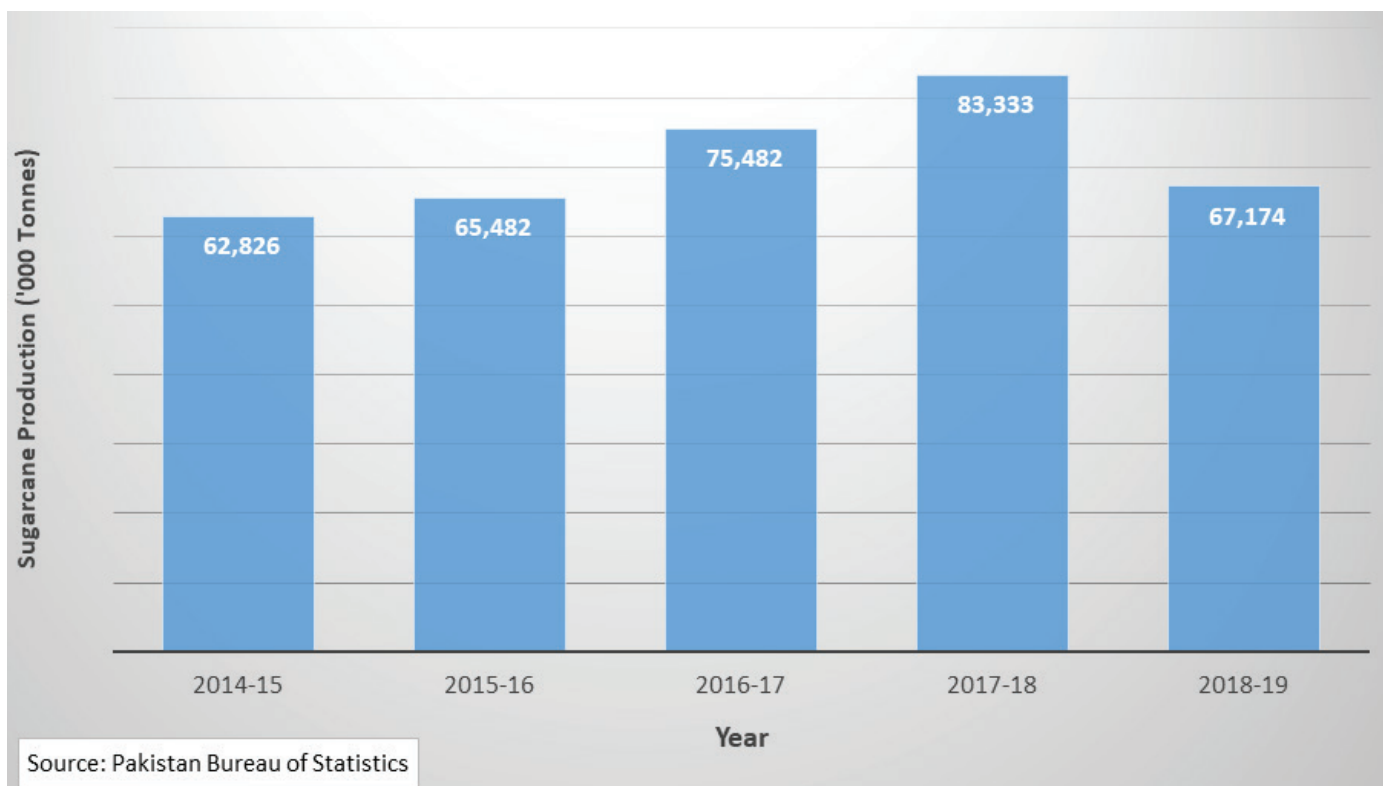


Figure 1: Sugarcane Production in Pakistan



A SNAPSHOT OF THE SUGARCANE INDUSTRY

Sugar is an important byproduct of Sugarcane. Sugarcane is one of the most important cash crops of Pakistan, the main input for sugar production. Sugar industry is an agro-based industry and volatile worldwide. It contributes in the economy by providing employment to the rural population and being a source of foreign earnings. Pakistan is the 6th largest sugarcane producer in the world while ranked number nine in the world for sugar production. It is the 8th largest sugar consuming country in the world. There are over one million hectares of land used for sugarcane cultivation, which produces more than five million tons of refined sugar.

The government monitors the price of sugar and undertakes various measures to keep the prices stable. The retail price of sugar in Pakistan has become equal to the cost of producing sugar. At present, the cost is between 72-83 rupees while the retail price of sugarcane (including tax) makes it Rs 75 with tax. This is currently the highest GST on any item. If the price of sugar equals its cost then there is an unstable system and farmers don't get good price for supplying cane to mills.

SUGAR CRISIS & CARTELIZATION

In the past few years, the production of sugar was historically more than the local requirements (Figure 1). The production of sugar till 2017-18 was enough and it was exported. In the year 2018-19, sugar production decreased, exports continued and the country observed a shortage. The export of sugar was unjustified as producers expected sugarcane production to be low in harvesting season 2018-19 and with the export of sugar in Jan 2019, the price of sugar sharply increased locally. Exports play a major role in the economy but it is important to note that only the Punjab government provided the export subsidy. The financial outlay of subsidy was 3 billion rupees. Has the government prompted the sugar crisis by giving an export subsidy?

Sugar mills obtained an export-related subsidy for the year 2018-19. A few mill owners obtained maximum benefit during the crisis. Having multiple sugar mills, they availed export subsidies during 2015-18. Despite the emerging crisis, the Sugar Advisory Board failed to take a timely decision to ban the export of sugar. Why? This is an unanswered question. Six groups have been observed to have control over more than half (51%) of local sugar production in the country. These groups have developed the capacity to manipulate the market by joining hands in a cartel.

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Out of six, three groups benefited the most as they took advantage of more than half of the total subsidy and sold their product in the local market after prices soared. The exporters gained in two ways - The exporters gained in two ways - they received a subsidy and hoarded sugar to make a killing by increasing sugar prices in the local market (the price increased from PKR 55.00 per kg in December 2018 to PKR 71.44 in June 2019, although GST increased from July 2019). They raised prices at the expense of taxpayers who had to buy sugar at prices over 50% higher than last year's prices. In this sugar cartel, sugar mill owners have colluded to raise prices by controlling supply, and they have benefited due to their political influence. The sugar stock hoarding was found to be completely illegal, as exposed by government reports and media. The overcharged prices of sugar during this period imposed a huge economic cost on consumers. No wonder, consumer-welfare losses were observed in the country.

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Table 1: Timeline of Major Events

Event	Time/cause
1 Increased sugar prices	PKR 55 per kg (Dec 2018) - PKR 71.44 per kg (Jun 2019)
2 Sugar price rise in local market	Sugar export allowed in Jan 2019
3 Major increases in sugar price	Jun 2019
4 GST raised retail prices increased by PKR 16/-	Implemented from Jul 01, 2019
5 Discrepancies in the amount of sugarcane produced and the amount of sugarcane crushed [1]	Tax evasion motive
6 PSMA's claims they paid excessive prices to farmers [2]	Prices 15% higher (due to speculation around low production)
7 Punjab Government provided subsidy [3]	PKR 3.0 billion subsidy provided
8 Mill owners benefitted from exports	Export subsidy led to huge profits
9 Millowners gained from local markets	Earned profits by raising price in local market
10 Sugar Mill owner's reaction	Cartel formed

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Note:

[1] Mills buy, produce and sell sugarcane off the books

[2] Higher than the support price

[3] Punjab government provided subsidy for export of sugar when the price of sugar was increasing in the local market.

(The Express Tribune, May 10, 2020)

CAUSES OF THE SUGAR CRISIS

The causes of the sugar crisis are important to note.

1-POLITICAL INFLUENCE AND LICENSES GIVEN TO SPECIFIC PEOPLE

In 2005-06, the Control of Industry Act in Punjab placed a ban on the establishment of sugar mills. But the sugar industry continued to expand in the last few years. Licences were given to establish sugar mills in Rahim Yar Khan and some key industrialists (mostly politicians) availed this opportunity and started grabbing a big market share. Those industrialists for whom there were no favorable incentives left; they had to shut down their industries. Currently, there are 85 sugar mills mostly licensed to political people. Sugar has become a political commodity. It has been over-regulated and profits have been substantial.

2-ABSENCE OF OPEN MARKET COMPETITION

In the year 2002, the highest capacity of sugarcane crop was witnessed in Faisalabad region. Specific licences were given and there was no open competition. Rather than attempting to compete, other competitors opted to shut down their businesses. By 2018, capacity utilization decreased in Faisalabad region as the government itself supported establishment of mills in Rahim Yar Khan. The problem from competition point of view as indicated by Khan (2020) is that all these mill owners, due to political status, are able to influence the government. They work outside of market forces and unite for their own benefit. The government ends up over-regulating domestic market, by intervening through prices, subsidies, export quotas, and import controls.

3-SUPPORT PRICE MECHANISM

The government of the PPP, the ruling political party in 2008, increased support price of sugarcane again and again. On the other hand, PML-N government increased support price only once, which proved to be a disincentive for farmers and the reason for the shortage of this raw material.

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It is the responsibility of provincial governments to fix the procurement price of sugarcane from farm to mills. The government fixes price above the global market price and below the domestic prices (Khan, 2020). The mechanism didn't work well and farmers' exploitation started here with low and delayed payments. It was planned to be the price at which the mills would buy sugarcane from the farmers, but gradually it turned out to be a floor price. This policy instrument remained ineffectual and became a source of farmer's exploitation (PIDE Webinar, 2020).

4-TRADE CONTROLS AND INEFFICIENT POLICIES

As ruling party, the PML-N did not increase the price of raw material. In 2014-17, the government announced support and quotas only as policy tools. In 2018-19, the current government announced quota and subsidy of Rs 3.0 billion for all sugar mill owners, which was not a suitable policy option. The sugar mill owners availed this export subsidy. Hence it led to hoarding of excess sugar production, export and became a source of high revenues leaving others worse off. Untimely export created a shortage inside the country.

Sugar industry remained over-regulated in the past without any comprehensive policy. This is the time to get rid of inefficient sugar mills and political alliances.

Some more subsidies to sugar industry also exploited the country. Subsidies on canal water use, fertilizer/inputs, electricity and credit also led towards the sugar crisis. In the same way, the government intervenes in the domestic sugar market and sets policy options for import or export decisions. In the wake of inefficient policies and trade controls, nobody bothers about domestic demand of sugar; it was shocking to see government approval for exports.

RECOMMENDATIONS

- 1- Sugar industry is availing multiple subsidies on water pricing, support price payments to farmers, export subsidy etc. In the current scenario, it would be a good option to break cartels formed by sugar mills.
- 2- Moving away from export subsidies in sugar industry is a prerequisite. Removing politics from policy making and implementation process is essential.
- 3- Sugar industry remained over-regulated in the past without any comprehensive policy. This is the time to get rid of inefficient sugar mills and political alliances. Price of sugarcane should be based on its recovery and an environment of open competition should be a priority.
- 4- As sugar export is a good source of foreign earnings, an efficient domestic sugar industry is

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required. Greater investment in R&D will lead to productivity and efficiency enhancements.

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