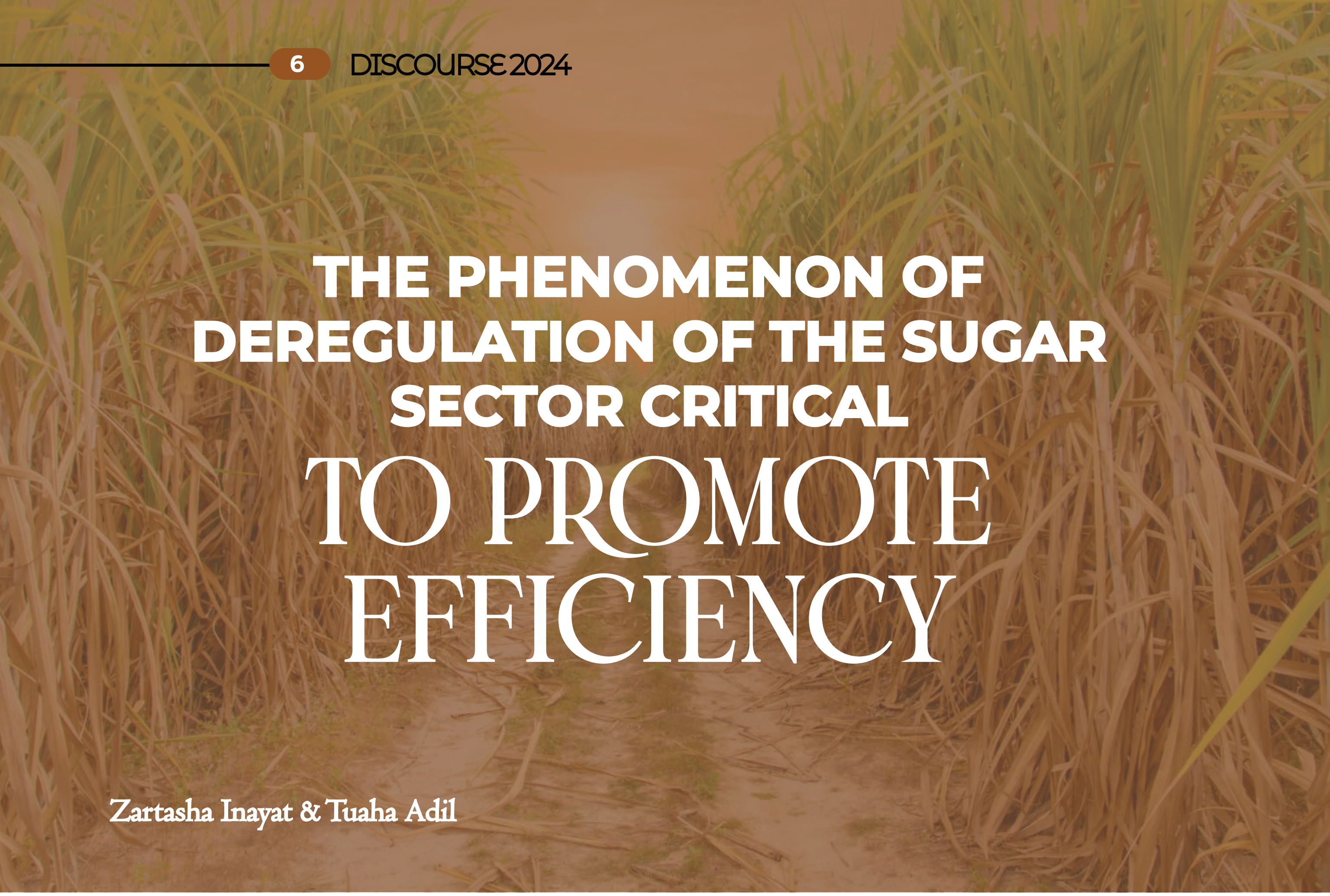


THE PHENOMENON OF DEREGULATION OF THE SUGAR SECTOR CRITICAL TO PROMOTE EFFICIENCY

Zartasha Inayat & Tuaha Adil

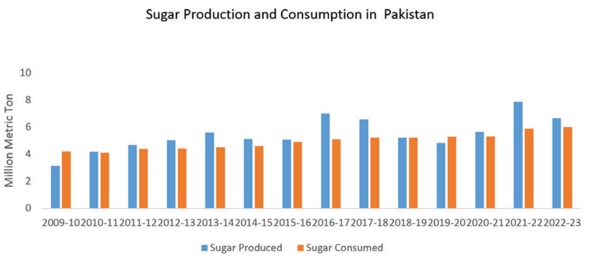
The sugar sector has been susceptible to trade restrictions and domestic regulations by the government of Pakistan. These regulatory measures create distortions in the sugar industry, thus disrupting the whole supply chain. Placing the sector under Schedule I of the Export Policy Order, 2020, the government restricts the private sector from exporting sugar to meet the domestic demand for sugar. In cases when there is excess sugar supply, quotas are assigned to the private sector by the federal government to export the determined amount of sugar. Recently, the Economic Coordination Committee (ECC) allowed the producers to export 0.10 million tons (MT) of sugar, following 0.15 MT of exports in June 2024. The restrictions exist on the import side of the trade as well, where the import of sugar by the government has been restricted or hampered through high tariffs and embargoes. Given the shortage of sugar in the market, import is allowed under the special regulatory order (SRO), to avert any market failure. However, the import ban is only lifted once the shortage of sugar has been realized, creating chaos in the market.

The sugar sector is highly regulated with a significant government footprint, where approval from relevant government officials is required at every step of the supply chain. The sugar industry faces price controls by the federal government of Pakistan under the act under Article 6-I of the Sugar and Sugar Products Control Order, 1948. Due to these price controls, the artificial shortage of sugar in the market is created, causing a rise in high prices, as per the law of demand.

Policy Research Institute of Market Economy (PRIME) evaluated the policies and regulations governing the entire supply chain of the sugar sector in Pakistan. The report also presented an analysis of the stock position of sugar and domestic requirements and recommended the opening up of exports. The government allowed the exports resulting in $270 million foreign exchange earnings in 2023.

The sugar industry is one of the important industries in Pakistan, contributing substantially to agricultural output and providing employment to many in Pakistan. Ranking among the top ten producers globally, most of the sugar is produced in Punjab and Sindh. The importance of sugar industry could be derived from the fact that it is providing direct employment to around 1.5 million people in Pakistan[20]. Furthermore, contributing 20.5% to important crops of the country and 0.8% to the country's GDP during the fiscal year 2022, Pakistan's production of sugar stood at 7.9 MT[21].

However, the production of sugar declined by 1.25% in FY23, where it reached a total of 6.65MT, as shown in the graph below.



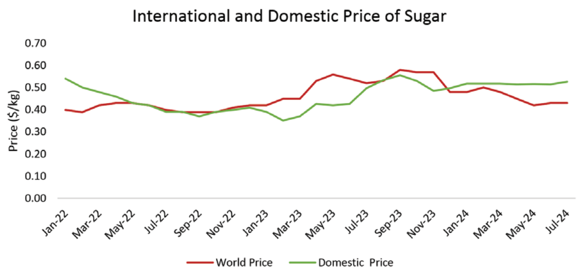
Data Source: Pakistan Sugar Mills Association (PSMA)

The country's sugar policy to date revolves around four objectives: ensuring self-sufficiency, affordability of sugar for consumers, protection of farmers, and profits for mills. To achieve self-sufficiency, the government has maintained support prices of sugarcane and protected the native sugar industry by imposing restrictions and tariffs. Moreover, the government has administered the marketing of white sugar including its rationing at fixed prices to maintain its prices low for consumers. The consequences of current policies are the volatile domestic price of sugar compared to the international price, the burden on the government in the form of export subsidies, seasonal shortages at home, price hikes, exploitation of farmers, and abnormal profits for sugar manufacturers.

A policy is only effective if it encompasses local dynamics and is implemented to the fullest; however, the existential sugar policy has failed to reap its objectives because of the government's inability to bring efficiency into the sector. Paradoxically, a highly regulated market has given rise to market failures that are beyond the government's control. To begin with, the benefits of the support price on sugarcane are not passed on to the farmers who are exploited by sugar factories to sell sugarcane at a price below the determined by the government.

In addition, the government controls licenses for the establishment of factories to provide protection to existing mills, ensure a significant supply of sugarcane to the mills, and meet self-sufficiency of sugar. Moreover, when the government determines the price of sugar not keeping in view the actual cost of production then it encourages sugar manufacturers to adopt other avenues for profit maximization like exploiting farmers, maneuvering accounts, artificially raising costs, and creating shortages, which raises the retail price of sugar.

The review of the domestic and international prices of sugar indicates that the domestic price has remained below the international price from July 2022 to December 2023. The government allowed the export of sugar in 2023 and the country earned more than $270 million. It is pertinent to highlight that the domestic price of sugar increased from January 2024 as compared to the international price. This increase can be attributed to lower productivity and higher cost of production. Furthermore, the sugar smuggling across the Afghanistan borders in 2024 led to a shortage of sugar in the market, thus causing a hike in sugar prices. The surge in sugar prices can also be attributed to an increased price cap by the government to stabilize the prices and limit the prices to increase post-ex-mill prices, thus preventing them from exceeding a certain point. Moreover, the increase in domestic price also results from the management of the exchange rate as the government-initiated crackdown in the foreign exchange market in September 2023 and the currency has remained stable since then. However, there are several markets like the USA where the price of sugar is significantly higher and Pakistan has the potential to export surplus sugar and earn foreign exchange.



Data Source: World Bank and Pakistan Bureau of Statistics

[20]Sugar Sector Report September 2023
[21]Sugar Sector Study by The Pakistan Credit Rating Agency Limited August 2023

CURRENT CHALLENGES FACED BY THE SUGAR INDUSTRY IN PAKISTAN

Despite the availability of sugar and surplus stocks for local consumption, the government remains reluctant to allow the export of sugar. The rationale behind restricting the trade of sugar is to ensure the sugar availability for domestic consumers. However, imposing trade restrictions often leads to disincentivizing producers, leading to the stagnancy of the sector. Similarly, the embargoes and high tariffs on the import of sugar can also hurt the sugar market, where if the domestic supply of sugar is not sufficient, it can lead to higher sugar prices for consumers.

In addition to the trade restrictions, the government also controls prices of the sugar to prevent them from exceeding a certain limit. However, these price controls often lead to volatile domestic prices of sugar, due to disruption in the supply chain of the sugar. The domestic prices can be higher than the international prices, making the sugar industry inefficient and unproductive. Similarly, the existing policies of price control create a burden on the government in the form of export subsidies, seasonal shortages of sugar domestically, and exploitation of farmers.

Sugarcane is known for its extreme water requirement, where it needs around 1500-to-2500-millimeter water over the growing period, depending on the climate situation. Pakistan being a water-scarce country, directs a significant portion of water towards the sugarcane crop, which has lower economic gains because of a nonexistent pricing mechanism, which makes the sugar more expensive than the sugar we can import.

In the context of crop productivity, farmers lack access to formal capital and have to resort to informal sources of capital that make it impossible for farmers to adopt modern farming techniques and use better quality seeds.

RECOMMENDATIONS

To address the challenges in the sugar industry and improve the productivity of the sector, the following recommendations are in order:

1. There should be no trade restrictions and the export of sugar should be allowed at all times to incentivize the producers due to high international demand. Furthermore, lifting trade restrictions can prevent price fluctuations and loss of $1 billion of foreign exchange annually.
2. The government should refrain from regulating the prices of sugar through price controls and let the forces of supply and demand determine the prices.
3. The government may not restrict the free movement of sugar across the provinces, thereby creating price differences across the provinces.
4. The impact of support price should be assessed as it removes incentives for farmers to improve crop yield because of guaranteed returns, increases the input cost of mills, and encourages farmers to cultivate sugarcane, which is a water-intensive crop with low economic returns and substitutes cultivation of crops with better returns.
5. Pakistan is a water-scarce country and there is no mechanism to ensure conservation and efficient utilization. As a result, water is being used to cultivate crops with low economic returns. An efficient water pricing mechanism should be devised and implemented in the country.

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