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POLICY NOTE

FIXING OF MAXIMUM RETAIL PRICE OF SUGAR BY GOVERNMENT OF PUNJAB

BACKGROUND

1. The Competition Act 2010 entrusts the Competition Commission of Pakistan (the 'Commission') to provide for free competition in all spheres of commercial and economic activity, to enhance economic efficiency. The Punjab Government recently fixed the maximum retail price of sugar at PKR 85 per kilogram[1] following the federal government's calculated ex-mill price of sugar at PKR 80 per kilogram. While this decision was taken in the spirit of ensuring that consumers not pay exorbitant prices, particularly in Ramadan, and protect that segment of the population that cannot meet price increases, the Commission by virtue of its mandate is compelled and deems it necessary to caution and explain the unintended consequences of putting a price ceiling.

UNINTENDED CONSEQUENCES OF PRICE CONTROLS

2. Price controls are meant to prevent prices from exceeding a certain maximum level. They have been a popular measure with governments worldwide including Pakistan. The possibility of political fallout of higher prices makes governments frequently resort to regulating prices, particularly in times of price inflation and shortages. But price

[1] The News, *Punjab fixes sugar retail price at Rs85/kg*, 3 April 2021, HTTPS://WWW.THENEWS.COM.PK/PRINT/814115-PUNJAB-FIXES-SUGAR-RETAIL-PRICE-AT-RS85-KG

controls have ramifications on both the demand (consumer) and supply (farmers and millers) sides.

3. Price controls rarely work and fail to protect those consumers who are the intended beneficiaries. The negative implications, both temporary and long-term, direct and indirect, of instituting price controls far exceed their benefits to consumers. For sugar, as Punjab is the only province to set a price ceiling, one immediate effect could be that sugar moves to other provinces where no price ceiling is in place and it can command a higher market price. Price control could also encourage hoarding by suppliers or impulsive buying by consumers, especially ahead of Ramadan, both of which will likely result in shortage in the market. This shortage could directly affect price with the result that consumers may end up paying even more for sugar than what they would have to pay if price controls were not in place. Although the Punjab Government's decision for promulgating the Sugar Supply-Chain Management Order 2021 is a step in the right direction to prevent hoarding of sugar by the mills as well as any other entity involved in the supply of sugar by requiring them to register their god-owns with the Government and declare their stocks at any given time.

4. In the long term, price controls could result in output cuts. The financial viability of sugar could be compromised by rising minimum support price on the one hand and the price ceiling on the other hand. Since Punjab is the major sugarcane producing area (around 60% of Pakistan's requirement), any measures introduced by the Punjab Government could have a spill-over effect in other provinces.

5. On the production side, mills do not operate at a comparable or equivalent level of efficiency. Factors such as economies of scale, labour, equipment productivity and access to crop vary between different mills, thus giving some undertakings/mills a competitive advantage over others. Thus, it may not be possible for all the mills to produce sugar at the same cost and offer the same rate. Imposing the maximum retail price could mean that some mills, which must purchase sugarcane at the minimum support price as fixed by the Punjab Government, may not be able to break even.

6. The price of sugarcane is the major cost factor in sugar production. Mills may be hesitant to buy sugarcane at the Government's minimum support price (MSP). Support

prices have a tendency to raise domestic cost of production when compared to international prices. If cost of production is more than the fixed retail price, this could lead to a temporary shutdown of operations on their part or, in the worst case scenario, their closure; if such price fixing measures are allowed to continue for a long period.

7. Mills could put pressure on farmers to sell sugarcane below the MSP or they may reduce the quantity they purchase[2]. If farmers continue to face such a situation in medium to long term, they may shift cultivation from sugarcane to other crops, which would set the stage for reduced domestic production and undesirable shortages in the market in future. In this case, the Government may have to import sugar subject to the vagaries of international market prices. The immediate implication of this would be a rising import bill for a commodity for which there is sufficient land and infrastructure available in the country.

8. Price controls could provide relief, though only temporarily, to the poor directly affected by high prices. More crucial is the fact that price of sugar may rise more rapidly once the controls are lifted to recoup the losses incurred during the period of price control, triggering high price inflation. Rapid inflation is always a concern for consumers whom the price controls intend to protect.

9. In doing so, the Punjab Government may remain mindful of the fact that the benefit of price fixing, particularly at the time of Ramadan, is also likely to go to the industrial consumers and perhaps, not to the target poor population because the industrial consumers make up for about 70% consumption. And that it is such consumers who have the ways and means as well as the wherewithal to capture such benefit. That they pass on the benefit to the ultimate individual consumer is also a concern that calls for attention.

10. In addition to the economic costs of price controls, there is also an administrative cost of a price fixing decision. The monitoring of such a decision to ensure that only those who are truly affected by rising prices might well require involvement of the entire

[2] This concern, duly highlighted in the Opinion on the Sugar Sector issued by the Commission in April 2018, has the undesirable outcome of non-payment, delayed payment or, in some cases, a ridiculously low payment to the farmers. Available online at HTTPS://WWW.CC.GOV.PK/IMAGES/DOWNLOADS/POLICY_NOTES/25_APRIL_2018_SUGAR_OPINION.PDF

bureaucracy with no guarantee of the proposed outcome. In the past, Punjab Government's scheme of cheap wheat flour resulted in long queues of consumers wanting to purchase an extra bag of cheap atta. Shortages, albeit temporary, emerged in the normal supply chain and people who did not want to purchase subsidised flour were forced to pay extra amount to get it or go unnecessarily without it for days.

EXPERIENCE WITH PRICE CONTROLS

11. Price controls have a direct distortionary effect on the supply-demand equation. Pakistan's historical experience with price controls provides sufficient evidence about the futility of such a measure, both in sugar and other commodities. In the late 2000s, wheat was transported to Afghanistan when the government tried to keep domestic prices lower than the commodity's global prices. The resulting shortage forced the government to import wheat at a much higher price to cover the shortages despite domestic production that resulted in surplus stocks.

12. In 2009, when superior courts fixed the price of sugar at PKR 40 per kilogram, mills maintained that for them to break even, the minimum price ought to be at least PKR 48 per kilogram. Within months, many mills stopped operations resulting in a severe supply shortage in the market and prices, at times, reached as high as PKR 100 per kilogram. Thus, a measure whose objective was to ensure supply of sugar to ordinary consumers at affordable prices resulted in a vastly different outcome.

13. Pakistan is currently considering to float an international tender for import of 50,000 tonnes of sugar to import the same to maintain domestic prices, ensure steady supply and counter price disparity effectively. Earlier this year, the ECC had approved a proposal to allow import of sugar by millers and the Trading Corporation of Pakistan[3]. However, the tenders were cancelled due to quotation of higher prices[4]. The Government allowed import, however, the fixing of the maximum retail price takes away the incentive from the private sector for such import despite lifting of the import duty.

[3] HTTPS://WWW.THENEWS.COM.PK/PRINT/801225-TCP-FLOATS-TENDER-TO-IMPORT-50-000-TONS-SUGAR
[4] HTTPS://WWW.DAWN.COM/NEWS/1616667

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THE INTERNATIONAL EXPERIENCE

14. Price controls, whether at the farm level or further down the supply chain are common among the major sugar producing countries i.e., Brazil, India, and Thailand. While minimum support price at the farm level is done with the intention of preserving farmers' interest and incentivising crop production, price controls introduced at the ex-factory or retail level are customised to the individual goals of each country.

15. In Brazil, since 1997, the Government of Brazil announced that it would cease to, *inter alia*, set the price of sugarcane, set production quotas and to control exports[5]. As far as its domestic market is concerned, Brazil's emphasis is not to ensure supply of sugar at affordable rates, but rather to promote exports or sale of ethanol (a by-product of sugar production). This is achieved through cross-subsidisation of sugar and ethanol so that any subsidy extended to sugar-producing mills is to incentivise ethanol production. This simultaneous emphasis on sugar and ethanol production helps reduce the overall cost of sugar production and, as a result, the gains made are passed to the farmers. The Brazilian model is, therefore, one of higher domestic prices and a substantial surplus for ethanol production and exports. The sugar and ethanol industries are particularly closely integrated and commercially interdependent. This means that any support offered to one activity can benefit the other. Both products are manufactured from sugar cane, whose lengthy crop production cycle spanning several years limits the sector's ability to respond to market signals to inform growing decisions in terms of production scale. Apart from cross-subsidisation in production, the Brazilian government also extends subsidies geared towards improvement in machinery and agronomy, in addition to assisting those farmers whose crops faced destruction or low production due to unforeseen circumstances. Brazilian cane supply contracts also include revenue sharing conditions in which the price to be paid to farmers is generally derived from the market prices of both sugar and ethanol, hence, protecting the interests of farmers[6].

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[5] "Government Support and the Brazilian Sugar Industry" prepared for the American Sugar Alliance (2013) *HTTPS://SUGARALLIANCE.ORG/WP-CONTENT/UPLOADS/2021/01/GOV-SUPPORT.PDF*

[6] *HTTPS://WWW.ABSUGAR.COM/SUGAR-MARKETS/CASE-STUDIES/BRAZIL*

16. In Thailand, price control mechanisms are in place. Thailand maintains sugarcane price support programme under the Cane and Sugar Act (1984). Thailand's sugar policy has been largely export-centric. In Thailand, sugar production has been historically divided into Quotas. Domestic sugar sales were controlled and limited by a fixed annual quota (Quota A). Any sugar produced more than Quota A could not be sold internally and had to be exported (Quotas B and C). The price paid to the farmers for sugarcane is the average price of the sales of Quota A and B. Furthermore, production revenues are distributed in the 70:30 ratio between the farmers and the millers, respectively. Despite deregulation of the ex-factory wholesale price of sugar, sugar is still listed on the Ministry of Commerce's List of Controlled Goods and Services. As a result, the retail ceiling price for sugar remains unchanged. The retail ceiling exists to protect consumers from upwards price fluctuations[7]. The fact that Thailand's sugar industry is export-centric, they have to remain competitive.

17. In India, the concept of Minimum Selling Price (MSP) of sugar was introduced in 2018 for sale by sugar mills at the factory gate (ex-mill price) for domestic consumption so that the sugar industry could get the minimum cost of production of sugar to enable them to clear the payment to farmers for sugarcane. It is a stated objective and a priority to ensure supply of sugar to consumers at an affordable price. Due to recent surpluses, the Government has dispensed with the requirement of obtaining an export release order and import duties have been set quite high to deter imports of sugar[8].

RECOMMENDATIONS

18. Most of the problems in the sugar sector stem from both over-regulation and lack of competition. If the market is deregulated, with free entry and exit, regulations and repeated interventions would not be needed. In an environment of open market competition, even mandatory crushing laws would not be required. These laws weaken the price signals in the market and have led the farmers in the past to over-invest in sugarcane cultivation and the millers to maintain higher stocks than required. Therefore,

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[7] United States Dept. of Agriculture Thailand Sugar Annual (2020)
Source:
HTTPS://APPS.FAS.USDA.GOV/NEWGAINAPI/API/REPORT/DOWNLOADREPORTBYFILENAME?FILENAME=SUGAR%20ANNUAL_BANGKOK_THAILAND_04-15-2020

[8] HTTPS://DFPD.GOV.IN/GEN_POLICY.HTM

the issue is not whether a government must intervene to set prices for consumers but how distortionary signals can be prevented from being sent to the farmers and the sugar millers. It is, after all, economic regulation for the long term benefit of the public. Short term gains may be structured in such a way that they do not provide foundation of long term or potential economic distress to the consumers as well as the state.

19. The past practice of imposing import tariffs of 40 percent on private sugar importers does not let them respond to the changes in the international markets. This also shields the domestic sugar industry from competition in the international markets. In periods of excess supply, the sugar mill owners get export quotas and subsidies whereas in periods of shortages, they make profits in the domestic market. Pakistan's protection of the domestic sugar industry through tariffs and subsidies has not allowed it to develop the necessary capability to compete in the international market for sugar by-products (like ethanol), for which demand is stronger. A more efficient agriculture policy may be considered, which would take all factors into consideration, including domestic exigencies as well as international reality and direction. This will be in line with the Federal Government's desire to achieve effective deregulation.

20. Better options for Pakistan than setting a price ceiling lie in deregulation, removing subsidies, and ensuring competition in the market. When regulations consistently fail to achieve their desired objectives of fair prices and competition, it is perhaps prudent to reconsider them - even scrap them. Competitive pricing in the sugarcane market would enable the growers to analyse alternate choices. Competitive sugar pricing and removing restrictions on the imports and exports of sugar (without subsidies) would give sugar producers market-based incentives to enhance their productive, technical and allocative efficiencies as well as focus on the necessary research and development to improve the sector.

21. The savings from not giving export subsidies would enable the government to focus on the growers instead of the mill owners. An incentive based system wherein farmers are paid in accordance with the quality may also be introduced and effectively executed. The Punjab Government may consider the viability of non-price interventions at the farm level such as introducing a revenue-sharing policy between the millers and the farmers - for instance, in some countries, there is direct payment to farmers' model.

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22. R&D may well have prevented the sugar industry from realising its potential (both export and local), particularly at the farm-end where there appears to be no efforts to introduce more effective seed varieties and indigenise them to produce superior quality sugarcane (with high sucrose content). Pakistan is ranked 5th globally in terms of production[9], whereas per hectare yields in Pakistan are relatively low[10]. Yield and quality are therefore important areas where the R&D ought to be focused. Similarly, and equally importantly, R&D activities must also be carried out to make technological improvements in the processes at the mills. Such activities should range from making the manufacturing process more efficient and cost productive to making the most efficient use of by-products.

23. Finally, free trade in sugar would make consumers better off by discouraging hoarding and over-pricing in the domestic market. These measures would definitely impact the development of the competitive sugar industry in Pakistan, leading to economic efficiency.

CONCLUSION

24. The Commission's view on the matter of sugar production, distribution and sale have been open to public since long. As early as 2009, this Commission was unambiguous in its recommendations on the price fixing that fixing of prices, output *etc.* are universally recognised as having the most detrimental effects on competition, eradicating or seriously reducing the benefits that competitive markets deliver for consumers. While the Commission has noted reports of alleged attempts to create artificial shortages of sugar, the Commission is of the opinion that this stopgap measure of 'fixing price' can at best provide temporary relief to cap the excessive price increase. However, this measure fails to benefit the sector or the economy at large. The short-term benefit of fixing prices (if any) does not justify the long-term loss caused by such policies.

[9] HTTPS://WWW.ATLASBIG.COM/EN-US/COUNTRIES-SUGARCANE-PRODUCTION

[10] United States Department of Agriculture Pakistan Sugar Annual (2020), Source: HTTPS://APPS.FAS.USDA.GOV/NEWGAINAPI/API/REPORT/DOWNLOADREPORTBYFILENAME?FILENAME=SUGAR%20ANNUAL_ISLAMABAD_PAKISTAN_04-15-2019

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25. In the 2009 One-Man Commission Report appointed by the Court, it recommended to allow full and free interplay of market forces and make provision for institutional intervention to correct any market malfunctioning as well as maintenance of appropriate strategic reserves to draw upon where needed.

26. In 2012, on the bar placed on the establishment, enlargement and expansion of sugar mills in Punjab, the Commission recommended lifting of the bar to let the market forces of demand and supply prevail, which will ensure competition[11].

27. The 2018 Commission Report regarding any artificial shortage of sugar supplies on the retail/wholesale or mills' end, the Commission *inter-alia* expressed the view that the Federal Government, through the Trading Corporation of Pakistan, may maintain certain amount of reserves of sugar as a check/deterrent for any such market manipulation. Ideally market forces must be allowed to operate freely, and so this must be done very sparingly if at all needed, as the scenario thus described is less likely to sustain in current circumstances where owing to excess supplies and lack of export channels, the market is very likely to correct itself within a short period of time. However, any such reserve, apart for being a deterrent may also be considered for export at an opportune time in the event of international prices of sugar rising at any point in time.

28. In conclusion, rather than price ceilings, the deregulation of the sugar market would be a better and sustainable option to promote free trade mechanisms where price signals can be effectively conveyed to all stakeholders to attract investment, increase competitiveness, and reduce distortions in local supply.

ISLAMABAD, 8 APRIL 2021

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[11] HTTP://CC.GOV.PK/IMAGES/DOWNLOADS/POLICY_NOTES/POLICY_NOTE_COMPLETE_BAN_ON_SUGAR_08_06_12.PDF

Note: The Supreme Court of Pakistan endorsed the ban imposed in Punjab in 2016 due to environmental factors as well as maintaining food security and the economy. Source: HTTPS://TRIBUNE.COM.PK/STORY/1149313/APPEAL-REJECTED-SC-ENDORSES-PUNJAB-BAN-NEW-SUGAR-MILLS