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Price controls not an instant sweetener for sugar industry

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In another instant move to push down commodity prices, the government has decided to introduce a price ceiling for sugar sold for household consumption, despite the policy potentially hampering the domestic sugar industry in the long run.

On Monday, Trade Minister Enggartiasto Lukita sealed a memorandum of understanding (MoU) with eight sugar refiners and 11 sugar distributors for them to maintain the price of household sugar at Rp 12,500 (93 US cents), lower than current market prices that vary between Rp 12,650 and Rp 17,250 depending on the province.

The ministry confirmed on the same day that it would soon issue import permits for 400,000 tons of raw sugar, which would be refined into household sugar.

Enggartiasto said the government's intervention into sugar prices had undergone lengthy discussions with various stakeholders and received an endorsement from President Joko "Jokowi" Widodo.

"It started with the President showing his concern about several staple food prices. Sugar is one of those [with prices] that keep fluctuating and significantly affect inflation rates," he said.

Indonesia, under the Dutch colonial administration, was the world's second-largest sugar exporter in the 1930s, behind Cuba. Declining sugarcane plantation areas and a failure to revitalize sugar production facilities, however, have made Southeast Asia's largest economy the world's fifthlargest importer of sugar, according to data from the Geneva-based International Trade Center.

National demand for household sugar, meanwhile, stands at between 3.2 million and 3.5 million tons annually, but production dropped to 2.1 million tons last year and is predicted to fall further this year to 1.7 million tons because of a bad harvest during the prolonged wet season in 2016.

Central Statistics Agency (BPS) data, however, shows sugar only contributed 0.06 percent to 2016's inflation and 0.05 percent to 2015's inflation. The rates are considered low by economists.

With such a situation, economist Dwi Andreas of the Bogor Institute of Agriculture said the government should have focused more on increasing local production rather than on setting fixed prices for sugar.

The declining sugar production in the country, Dwi continued, was also partly due to the absence of any obligation for sugar refiners to run their own sugarcane plantations.

"The government should be strict and oblige sugar refiners to open up their own sugarcane plantations here," he said.

Meanwhile, economist Mohammad Faisal from the Center of Reform in Economics (CORE) acknowledged the government move might control inflation as intended, but said a set price lower than the market price could hamper local sugarcane processors and farmers.

Sugar distributor PT Hasil Karya Wijaya director Erwin Haryono admitted profits could decline by up to 30 percent due to the new policy, but said the firm would still support it.

Indonesian Sugarcane Farmers Association (APTRI) chairman Soemitro Samadikun said with the price set at Rp 12,500 per kg, distributors would only buy what they produced for Rp 11,500 per kg or even lower while production costs were Rp 9,500 per kg during normal weather and double during unsupportive weather.

"With the policy, it seems like the government doesn't care about local farmers," he said.

Since taking office in 2014, President Jokowi has repeatedly used interventions as an instant measure to bring down prices of important commodities.

In 2015, at a time when the nation was gripped with soaring beef prices caused largely by mismanagement of imports and distribution, the National Police forced feedlots to immediately sell the cattle that were still below minimum weight for slaughter.

In the same year, Jokowi also forced state cement company PT Semen Indonesia to slash its prices, sending shockwaves through the cement industry.

Last month, Jokowi demanded the application of one price for fuel sold in the remote province of Papua, causing losses of more than Rp 1.5 trillion (US$ 111 million) for state energy company Pertamina.

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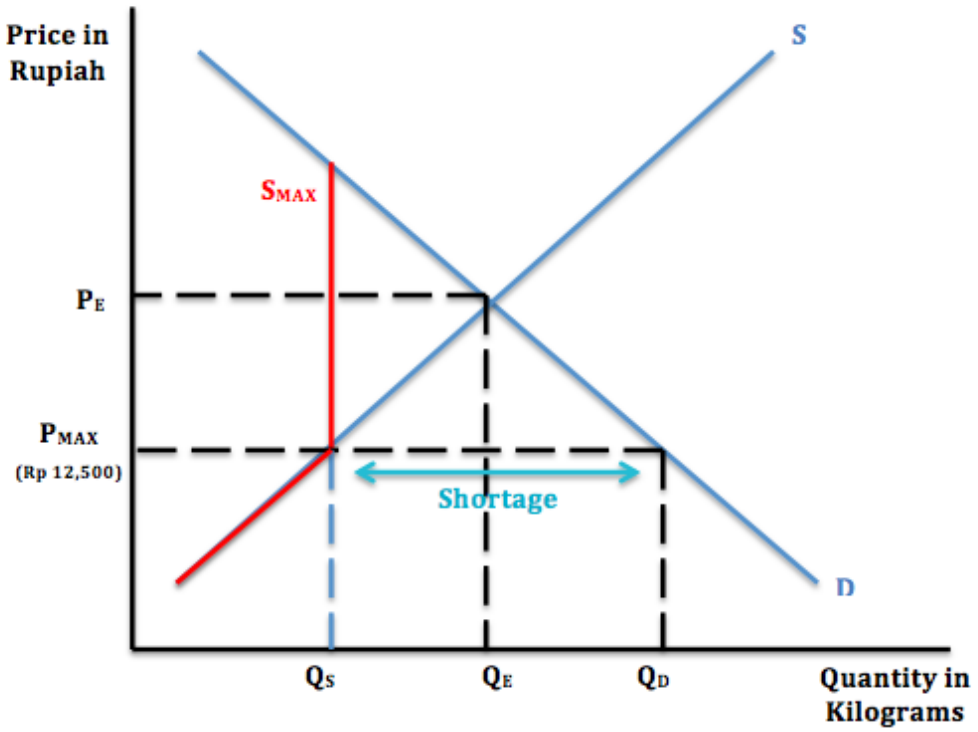
The article concerns the decision of the Indonesian government to impose a price ceiling of 12,500 rupiah on sugar. Implemented as a means of controlling sugar prices, it has caused discontent amongst local producers, and has received mixed responses.

A price ceiling is defined as a maximum legally allowable price for a good, set by the government. As mentioned in the article, the price ceiling was set in order to "push down commodity prices". A supply and demand diagram of the Indonesian sugar market can depict the effects of the price ceiling.

Diagram 1: Indonesian Sugar Market with Price Ceiling



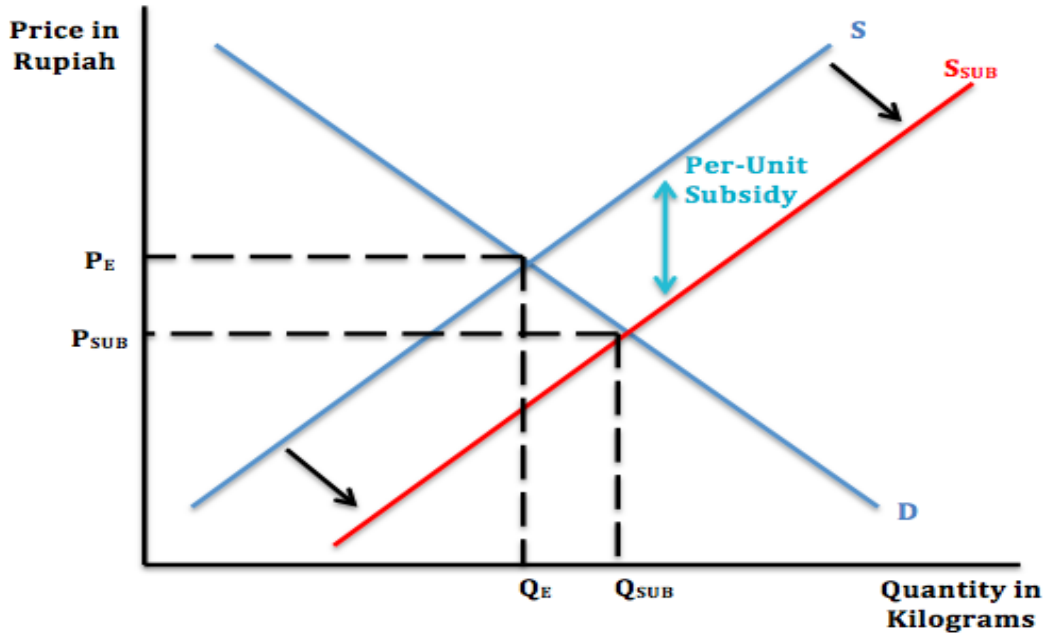
As can be seen in Diagram 1, P_E represents the price at market equilibrium, which is the intersection of supply, the quantity of a good or service that producers are willing and able to offer for sale at various prices, and demand, the quantity of a good or service that consumers are willing and able to purchase at various prices. This indicates the price and quantity that is produced and sold in the market before the price ceiling is imposed. P_{MAX} (Rp 12,500) indicates the price ceiling that will be set by the government, and it is significantly lower. Q_S denotes the quantity supplied at a

lower price, whereas Q_D indicates the quantity demanded at the same price. The distance between the two indicates that there is excess demand for sugar at an artificially low price, otherwise known as a shortage. If the price is kept at P_{MAX}, there will be many left who want the good but will not have access to it.

The introduction of a price ceiling has various advantages and disadvantages. One of the benefits is that it allows the government to protect consumers from increased prices. It also means that the government can lessen the negative impacts on consumers by controlling the accessibility of the sugar. Finally, it also enables the government to control the domestic market in relation to imported goods. On the contrary, however, a price ceiling results in alternative rationing methods, since price will no longer determine who receives the product. Furthermore, it naturally results in a decreased market size, meaning less overall utility to consumers and producers. This results in its harmful effects for domestic producers of sugar. Most importantly, however, informal or black markets can be created. Due to the gap between Q_S and Q_D, many consumers have a strong incentive to pay more on the black market in order to acquire the good. The creation of the black market is shown in Diagram 1 with the red curve entitled S_{MAX}, since it indicates that the informal supply could rise as high as the point on the demand curve.

Since the imposition of a price ceiling has certain negative effects and eliminates allocative efficiency, another potential form of government intervention to lower the price can be a subsidy on sugar as shown in Diagram 2. A subsidy, suggested by economist Dwi Andreas in the article, is a payment from the government to an individual or firm for the purpose of increasing the purchase or supply of a good. The imposition of the subsidy will result in a shift of the supply curve from S to S_{SUB}, according to the amount of the per-unit subsidy marked in the graph. As a result, the price of sugar will decrease from P_E to P_{SUB} and the quantity will increase from Q_E to Q_{SUB}.

Diagram 2: Indonesian Sugar Market with Subsidy



One of the benefits of a subsidy is that it is an expansionary measure, as it increases the equilibrium quantity and does not inhibit the economy in any way. Another advantage of a subsidy is that it does not disadvantage the producers of sugar, which would solve the issue of producer dissatisfaction as mentioned in the article. A subsidy can also improve balance of payments and export revenues by lowering costs enough to make sugar more competitive on the world market. While there are various benefits to introducing a subsidy, this form of intervention also has certain disadvantages. For instance, the cost of the subsidy will be a burden on government spending, as well as consumers through taxation. Even more so, there is a dangerous possibility that subsidies may encourage producers to be inefficient by increasing their reliance on government support. At the same time, the subsidy will equally encourage the over production and consumption of sugar, which is not particularly a healthy commodity. Despite these shortcomings, it seems that a subsidy may have been a better resolution for the Indian sugar market, given its evident economic advantages.