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Government of India Raises Procurement Price of Fuel Ethanol

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Report Highlights:

The Government of India (GOI) announced a price fixing scheme for fuel ethanol procurement for parastatal oil marketing companies (OMCs). The program fixes landed-ethanol prices at OMC depots from INR 48.50 to INR 49.50 per liter, a three to five percent increase over the previous price. This will likely accelerate India's ethanol blending program (EBP), infuse cash into the local sugar industry, help millers pay down debts, and curtail (by some estimates) upwards of $750 million in crude oil imports.

General Information:

On December 24, 2009, the GOI approved its National Policy on Biofuels, which encourages the use of renewable energy resources as fuel for motor vehicles. On December 10, 2014, the GOI announced a fuel-grade ethanol price fixing mechanism for state-owned OMCs to procure for government's EBP. Ethanol procured under this program will be blended with gasoline, and based on a 'benchmark price' established by the OMCs. EBP ethanol prices may be updated each marketing year (MY) (October-September). In previous years, Post has observed that India has the capacity to fulfill its ethanol blending mandate, provided there are equal incentives for both the producers (sugar millers) and blenders (parastatal petroleum companies).

The Ministry of Consumer Affairs, Food, and Public Distribution has stated that the current ex-sugar mill price for ethanol is around INR 42.02 per liter. Ethanol suppliers incur additional costs of around six to eight rupees per liter, depending on the applicable state (value added tax) VAT, distance of sugar mill/distillery from OMCs' depot and the Excise duty. Thus, for ethanol suppliers, the landed cost of ethanol at OMC depots would be upwards of INR 48 per liter. With the procurement price of ethanol now raised, the new program not only fixes ethanol procurement prices, but also introduces 'supply or pay' agreements, which obliges the OMCs to buy ethanol from sugar mills (which in turn are obligated to sell ethanol to the OMCs). If the mills cannot provide ethanol, they are required to compensate the OMCs.

According to a recent PIB press release, the Cabinet Committee on Economic Affairs (CCEA), which is chaired by Prime Minister Modi, approved the implementation of the EBP. Under this program, the delivered price of ethanol may be fixed in the range of INR 48.50 per liter to INR 49.50 per liter, depending upon the distance of sugar mill from the depot/installation of the OMCs as per the table below. The delivered prices are estimated to be three to five percent higher than previous quotes.

Distance in Kilometers	**Price in INR per liter**
a) 0-100	48.50
b) 101-300	49.00
c) above 300	49.50

- Proposed rates for landed prices at depot locations include all central and state taxes, transportation costs, and other associated expenses. These costs will be borne by the ethanol suppliers.
- The OMCs will incorporate "supply or pay" clauses in their supply agreements with ethanol suppliers, which will be backed by bank guarantees.
- OMCs will sign MOUs with state governments for uninterrupted inter-depot transfer of ethanol within respective states. This may include annual excise permits to OMCs for movement of ethanol and other relevant measures.

Scope and Limitations of EBP:

Scope:

- Incentivize the sugar industry and benefit sugarcane growers.
- EBP has higher octane than petroleum, which results in reduced emissions of pollutants.
- It is a renewable fuel.
- At a five-percent blending level, OMCs will have surplus petrol production of 1.1 billion liters which (by some estimates) will save Indian foreign exchange upwards of $745 million annually.
- Ethanol supplies could increase, provided B-heavy molasses and cane juice can be diverted toward ethanol production. According to the Indian Sugar Mill Association, diverting 1.0 million metric tons (MMT) of sugar into ethanol would yield 600 million liters of ethanol.

Limitations:

- The OMCs are expected to procure only about 41 percent of their total ethanol requirement in calendar year (CY) 2014, which is about 1.3 billion liters (for more information please refer our GAIN report IN4055).
- Transportation of ethanol from sugar mills to OMC depot and its inter-depot transfer is regulated by the state excise agencies. The procedure adopted by states (particularly for inter-state supplies) in issuance of licenses and import/ export NOCs is complicated, time consuming and acts as an impediment.
- OMCs purchase ethanol at a benchmark price, which is based on the average refinery transfer price (RTP) of gasoline from the previous financial year. The EBP price could become less viable during periods of low petroleum prices. Prices quoted by sugar mills could also be at higher than benchmark price levels, resulting in actual procurement being less than the offered quantity. This scenario would likely create market uncertainty.

Provided the crude oil market remains bearish throughout MY 2014/15, and with ethanol selling cheaper than gasoline (INR 42 versus INR 61.3 per liter or $0.97 per liter), the OMCs should be able to procure enough ethanol for the EBP. The Indian crude oil basket averaged $105.62 a barrel and slid to $77.8 a barrel in November (*Source: Business Line*). However, if crude oil prices increase, OMCs will likely start to blend more ethanol with gasoline, assuming that that domestic sugar prices remain stable (e.g. low). Conversely, if local sugar prices happen to rise in tandem with crude oil prices, the pricing mechanism for ethanol and its flexibility in accommodating the change will be reevaluated.

An important point from the perspective of an exporter or foreign supplier is that the imported fuel is not allowed for blending with gasoline unless government owned petroleum companies float an EOI/global tender and ethanol exporter bids are competitive. In March 2013, the GOI tried to tender for ethanol from the international market for the first time in a decade. However, the tender rates received were 68 percent to 108 percent above the domestic prices (INR 44 or $0.7 per liter). The blending program mandates that ethanol procured should be indigenous.

Market penetration for fuel ethanol in CY 2013 was limited and the blending rate amounted to less than one percent of the fuel consumed in India. In CY 2014, 13 states will establish blending rates of 2.1 percent and may increase to 2.5 percent by end of CY 2015. At a national level, the current installed capacity and market penetration for gasoline, a target of 7.5 percent blend is theoretically feasible. If the GOI decides to mandate E-10 levels, the industry's installed capacity would need to be raised by another 2.5 percent. This may present an opportunity to temporarily fill the gap through imports, although that remains an unlikely prospect at this time.

Currently, a main objective of the GOI is to assist sugar millers in clearing debts to farmers and to accelerate sugarcane crushing operations which, were delayed, particularly in north India. However, per the latest update from the Indian Sugar Mills Association, sugar production during the first 2.5 months of MY 2014/15 was 4.23 MMT, an increase of 1.35 MMT over the same period in the last marketing year. Some 442 sugar mills have begun crushing operations this season compared with 426 mills last year. Additionally, sales of molasses, ethanol and bagasse are providing mills with some liquidity in an otherwise surplus sugar season when sugar mills are finding difficult to break even.

A five-percent increase in the ethanol blending rate would, by some estimates, help India save foreign exchange by upwards of $750 million per year. CCEA had on November 22, 2012, recommended five-percent mandate. The GOI is working to contain India's current account deficit (target for Indian fiscal year 2014/15 (April-March) is at or below four percent) and reduce India's substantial dependence on imported crude oil. Historically, the GOI's current ethanol blending target of five percent has been partially successful in years of surplus sugar production and unfilled when sugar production declines.

According to media reports, the GOI has reviewed the sugar supply and production situation for MY 2014/15 and is likely to decide soon as to whether or not it will extend its raw sugar export subsidy. Although domestic sugar prices are constantly under pressure from rising supplies, they are still above world price, industry sources think that government may announce a subsidy in excess of INR 3300 per metric ton to compete at world market, infuse cash flows and ease off excess inventory. However, it is yet to be seen whether falling crude oil prices will in fact encourage mills to produce more sugar or ethanol.