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PAKISTAN: PRIVATIZATION OF FERTILIZER MARKETING
A DISCUSSION PAPER

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A. CURRENT SITUATION

Presently, the Federal Directorate of Fertilizer Imports (FDFI) is responsible for arranging imports of all fertilizers in the country. As an operating arm of the Ministry of Food and Agriculture, FDFI is involved from the planning stage to actual implementation. All funds required for the imports of fertilizers under bilateral aid loans and grants, supplier credits, barter and the country's own cash resources are made available by the Ministry of Finance to FDFI to arrange imports. FDFI floats international tenders and places orders directly with the suppliers. At the port when the products are received, FDFI is responsible for all physical handling and costs, and allocates products to the four Provinces and Fauji Fertilizer Company Limited (FFC) in a predetermined ratio. FDFI also arranges transportation and absorbs the costs for this transportation to the first destination within the country as given in the despatch plans of the Provinces and FFC. FDFI then bills the Provinces and FFC for product cost on the basis of the Government controlled internal fertilizer prices less the "incicentals' that are allowed.

There is usually a wide variation in the total costs incurred by FDFI (C&F prices of the product plus the local handling/transportation costs), and what they receive from the Provinces and FFC on the basis of the internal prices of these products, which are fixed by the Government. This element of subsidy, which is substantial, is assumed by the Government of Pakistan as FDFI is a Federal Government agency. Neither the Provinces nor FFC are in any way involved in the subsidy. They only have to table their needs and have the advantage of one agency fulfilling their requirements and undertaking all of the above activities.

Currently, the distribution system at the Provincial level is a financial drain on the national economy. We thoroughly agree with the premise that the private sector can distribute fertilizer much more cheaply and efficiently. This report does not focus on the details of these financial issues, however, but only on the ways and means of the gradual achievement of the goal of maximizing private sector distribution. Additionally, we are not making any recommendations as to how 'incidentals' should be treated or how government subsidies should be reduced.

Currently, 22.5 percent of imported fertilizers go to Sind, 67 percent to Punjab, 9 percent to the North West Frontier Province and 1.5 percent to Baluchistan. While the Agriculture Development Authority (ADA) and the Agriculture Department are the sole recipients of imported fertilizer from FDFI in NWFP and Baluchistan, respectively, Fauji Fertilizer Company (FFC) shares the imported supply with both the Sind Agricultural Supplies Organization (SASO) in Sind, and Punjab Agricultural Development Supplies Corporation (PADSC) in Punjab. Fauji receives directly from FDFI 30 percent of the Punjab allocation and 25 percent of the Sind allocation. Effectively, Fauji receives 26.5 percent of total imports. The Provincial organizations may make available some portion of their imports upon request of the marketing arms of Urea producers. This system tends to result in Exxon, Dawood Hercules, and National Fertilizer Corporation never being certain of having sufficient supplies of phosphatics, and of the provincial agencies being uncertain as to having sufficient Urea.

At present no Urea is being imported. Nitrophos (NP) can only be imported on a grant or barter basis. Other phosphatics can still be imported under all forms of financing. Currently DAP is the major phosphatic fertilizer imported, but FDFI is considering importing TSP and MAP in the future. Undoubtedly, prices will be a major determinant in the selection. Various NPK compounds may also be imported.

B. RECOMMENDATIONS

The purpose of this study was to research possibilities of maximizing distribution of fertilizers to the farmers of Pakistan, while at the same time making it possible to improve efficiency of the distribution network through greater involvement of the private sector. Two of the four manufacturers of nitrogeneous fertilizer in Pakistan are government controlled organizations. However, their marketing organizations operate along private sector lines. For the purpose of this discussion, the distributors of these entities will be considered private sector. Through discussions with officials of the fertilizer trade at both the public and private sector levels, this team has formulated the following recommendations:

1. If the Government of Pakistan agrees to any changes in fertilizer import procedures, they should be applicable for all fertilizer imports, and not just for those financed by A.I.D.

Discussion

Fertilizer imports to Pakistan are financed by (a) bilateral loans and grants; (b) supplier credit; (c) barter arrangements and (d) foreign exchange supplied by the Government of Pakistan. These imports, consisting primarily of phosphatic fertilizers and to a lesser extent potash, are distributed to the farmer largely by public sector whereas Urea, the main nitrogeneous fertilizer, is currently only produced and marketed locally by the private sector. Thus the farmer may have to procure his requirement for nitrogen from one place and his phosphatic needs from yet another. The maximum incentive for both private and public distributors to promote and sell fertilizer is derived when they have direct access to either the manufacturer or to the importer. This leads to a situation where the distributor of a Urea manufacturer will not have a full range of fertilizers available to him when the manufacturers depend on getting the phosphatics from a provincial public sector company. Conversely, the distributor of the provincial public sector company will have less incentive to promote and sell Urea when it comes from a source other than the imported material. Additionally, nitrogen producers are reluctant to make their product (mainly Urea) available to the provincial organizations, and since there is not official manadate to do so, they are only doing it on an ad hoc basis. Again, conversely, when provincial organizations can sell the imported phosphatics easily themselves, they are reluctant to make them available to manufacturers of nitrogen. Thus, neither the public nor the private distributor can ever be certain of having sufficient material on hand.

Since A.I.D.-financed imports constitute only a portion of total phosphatic imports, the benefit to the farmer would not justify a change in procedure solely for the A.I.D. share. Thus, the main reason for recommending changes in import procedures is to make it possible for the farmer to purchase a balanced ratio between nitrogeneous and phosphatic fertilizers from a single source.

2. FDFI operations should remain as they exist today.

Discussion

There must exist an agency such as FDFI that can equalize pricing of imports and coordinate allocations of fertilizer. The landed costs of individual deliveries, even under large scale procurements, are not equal becuase of varying factors such as FOB costs and freight rates, even if demurrage and despatch are not taken into account. Some organizations therefore must equalize prices for each imported fertilizer product.

The infrastructure currently exists for the procurement and onward movement from the port, and while there is room for improvement, it is probably better than what the private sector could accomplish at this time.

Additionally, FDFI owns the existing bagging facilities at the port. If every importer would want to do his own bagging the additional investment, or the cost of renting the equipment would not be justified. While the private sector assured us that they would be able to make all necessary arrangements with the port authorities and the National Logistics Cell (NLC), which transports all imported fertilizer from the port, we are of the opinion that government-to-government agency arrangements would be hard to duplicate.

Through the use of the FDFI for the importation of fertilizers, the Government of Pakistan is achieving economies of scale through tenders for large quantities of product and economies of existing infrastructure usage. Currently, there is a lack of enthusiasm by the private sector to make accommodations for orchestrating fertilizer imports for the whole country rather than for themselves only.

3. Allocations of fertilizer to the provincial government agencies should be reduced to below 40 percent of the total and be progressively phased out completely.

Discussion

Today provincial government distribution agencies are no longer able to offer the farmer the complete range of fertilizer products as they did in the past. Since Pakistan has reached self-sufficiency in Urea production, Urea is no longer imported and therefore not distributed via the provincial agency distribution channels. The time will come when lesser demanded fertilizers will be imported and when a variety of NPKs and DAP will be produced in Pakistan.

Under present conditions the allocation of imported fertilizers to the provincial governments is already restricted because the two major Provinces, Sind with 22.5 percent and Punjab with 67 percent already are required to make 25 percent and 30 percent, respectively, of their allocation available to FFC, which as mentioned above, is considered a private sector distributor for the purpose of this study.

It appears to us that the major function of the provincial distributors at this time is to assure that security stocks remain on hand. The more fertilizers to be produced locally the less will be the importance of this function. Equally, the more fertilizer is made available to the private sector, the more the function of keeping fertilizer stocks will be shifted to it.

We are unable to recommend a time table of further reductions of the 40 percent because timing and magnitude depend on unpredictable events within Pakistan, such as further reduction of the fertilizer subsidy, additional production, etc.

Our reason for suggesting an immediate goal of 40 percent allocation to the provincial agencies was derived from the expressed desire of the private sector to have an immediate allocation of at least 50 percent to be meaningful. This also would prevent a too rapid disruption of the function of regional organizations.

4. Distribution subsidiaries of fertilizer manufacturers should be able to apply for direct allocations of fertilizer imports for a minimum of 50 percent of the total, to be progressively increased as provincial allocations are reduced. No more than 10 percent of total imports should be set aside for general private sector importers. If no applications for imports by the private sector are received, then their share should be added to the allocations of the fertilizer manufacturers.

Discussion

With the exception of the National Fertilizer Corporation, which has limited production of phosphatic fertilizers (NP and SSP), none of the other local producers have any direct access to phosphatic fertilizers for their distributors. They too are dependent upon extra imported phosphatics in order to provide their distributors' access to the nitrogen-phosphate ratio necessary for a product balance.

While, theoretically, producers of Urea should make their product available to the provincial organizations in return for imported phosphatic fertilizers, they are only providing it at the time when their stocks are in excess of the needs of their own distributors. At such a time they prefer the provincial agencies to bear the cost of storage. Conversely, they only ask the provincial agency to make phosphatic fertilizers available to them at the time when they can sell immediately through their distribution network.

In a nutshell, the provincial agencies are always left with the cost of storage, since the Federal Government does not require the producers to make nitrogeneous fertilizer available to the provincial agencies, nor require that they make phosphatic fertilizers available to the producers.

Private sector importers have been clamoring for participating in the importation and distribution of fertilizers. Therefore, we believe that an opportunity should be afforded to them to participate. However, it is our feeling that these general importers would be interested in importing only when international market prices are attractive and excess demand for fertilizer exists within Pakistan. An exception may be importers of pesticides who might want to complement their current distribution of ag-chemicals. Even though these general importers might wish to augment their current distribution of pesticides, it is unlikely that they would want to expand their distribution network based solely on new imports of fertilizers. It is also unlikely that the private commercial sector would be very much interested in making commitments before they know what prices they would have to pay.

We are therefore proposing that only 10 percent of all fertilizer imports be made available to them on the basis that they make advance commitments to accept a share of all imports throughout the year. If no such commitments are forthcoming, or if they do not reach a level of 10 percent, the resulting shortfall should be added to the amounts being made available to the distribution organizations of the manufacturers.

Furthermore, it may not be fair to expect these private sector importers to expand their distribution systems, since their participation in imports will undoubtedly decrease when more of the currently imported fertilizers are produced locally.

Another constraint for the participation of general importers in an across-the-board share of imported fertilizers is the fact that Urea is no longer imported. In order for them to have what we consider to be a desirable distribution network, which provides all nutrients necessary to the farmer, they will have to have access to locally produced nitrogeneous fertilizers. If this cannot be arranged on a permanent basis it might be desirable to restrict their direct access to imports of NPK and NP.

5. At the beginning of the fertilizer year, both manufacturers and commercial importers will have to make known to the Government their annual requirements of each type of fertilizer, and be subsequently committed to accept the percentage of their overall commitment whenever fertilizer arrives. Allocations set aside for the private sector will be divided in proportion to the requests received by the various organizations.

Discussion

As mentioned above, all private sector distributors are trying to minimize their expenses by only accepting imported fertilizers at times when they are easily saleable. In order to make a transition to the private sector for the importation of fertilizer, it is therefore essential that they be committed to accept allocated quantities of fertilizer whenever they become available at the port. By the same token, it will enable the private sector to more easily forecast their market requirements when they know what portion of imports will be allocated directly to them.

Some of the private sector importers may want to have the bags of imported fertilizer identified with their logo or name, and others will not. When it is known in advance what proportion of any awarded tonnage will be allocated to a given firm, it will be easy to have the awardee mark the bags correctly.

6. Until such time as the controlled price of fertilizer to the farmer is eliminated, the spread between the landed cost at the port of imported material and the fixed sales price should be the same within sales territories to everyone getting allocations.

Discussion

The current system of varying incidentals provided to companies may be valid for the manufactured products. It should not be extended to the imported products, since this would give manufacturers such as Fauji a tremendous advantage over its competitors. It is relatively simple to start out from the fixed price to the consumer and arrive at an adequate margin between that price and the landed cost of the imported fertilizer. Additional transportation charges for sales in remote outlying areas could then be compensated for cost of transportation in areas close to the point of first delivery. A detailed analysis of differentials leading to a uniform spread between import costs and sales go beyond the scope of this report.

7. Procurement procedures currently followed by A.I.D. should remain the same and A.I.D.-financed tenders should continue to be held in Washington, D.C.

Discussion

The procurement of DAP with fiscal year 1982 funds worked very smoothly. The FDFI used standard A.I.D. terms and conditions for the tender document. The tender was properly advertised according to A.I.D. regulations and potential suppliers were asked to present their sealed bids as well as their bid bonds to the Pakistan Embassy in Washington. At the time prescribed in the announcement, all bids were opened publicly in the presence of A.I.D. and GOP officials. Simultaneously, bids were received for both U.S. and foreign flag freight for the delivery schedule specified in the IFB. Shortly thereafter, proposed awards for fertilizer were matched with offers for freight, and A.I.D. concurred with all decisions of the Pakistani Embassy.

It has been alleged by commercial importers, who act as agents for foreign suppliers, that prices tendered against an IFB issued in Pakistan would lead to lower prices. We dispute this contention and are of the opinion that the Government of Pakistan was able to finalize this procurement at the best prices possible at the time.

One reason cited for the desire to have tenders opened in Pakistan was that suppliers' agents would be able to get commissions from successful bidders, and that they would receive no commission if bids were opened in Washington. We again dispute this contention because, in our experience, U.S. suppliers who have a valid contractual agreement with a foreign agent will pay the agent a commission, though possibly reduced, if the bid is being held in Washington, D.C. The agent provides the suppliers services more than being present at a bid opening. They help in getting bid and performance bonds released promptly and, in general, they guard the interests of the supplier, especially if disputes of one sort or another arise.

One great advantage of holding a tender in Washington is that a situation as occurred with the recent IBRD tender for DAP will not be duplicated. The IBRD tender was opened in Pakistan and the two lowest bidders were traders who did not have products pledged to them. As a result, a court case in New York is still pending. It has been our experience that A.I.D.-financed tenders opened in Washington only attract bona fide suppliers. Also, an early award assures that speculators cannot participate because they do not have the time to locate sources. Any disputes revolving around the responsiveness or non-responsiveness of offers can also be rapidly adjudicated to the satisfaction of all parties.

We therefore see every reason to recommend continuing the procurement procedures that proved successful in the last tender.

8. Private sector fertilizer distributors should have an active voice in the type of fertilizer to be imported.

Discussion

Private sector distributors have the most direct contact with the farmers in their areas, and therefore the best knowledge of acceptance of different types of fertilizer for their crops. While government agronomists may recommend fertilizer application, it is the farmer who makes the ultimate decision as to what he believes will give him the best potential harvest. We therefore believe that organizations with the most intensive methods of distribution and the closest relation with the farm community should be part of the decision-making process as to what type of fertilizers are to be procured.

We have been informed that FDFI will be asked to import some fertilizers such as TSP and MAP on an experimental basis. We belive this to be a good idea, but would like to see the fertilizer distributors concur in such a decision since they will be the ones who must sell that fertilizer. Phosphatic fertilizers readily procured from the U.S. include DAP and TSP and to a lesser degree MAP and SSP.

In an effort to provide the farmer with a complete fertilizer in a single bag, there has been some consideration given to bulk blending. However, there has been resistance at the farm level to accept a physically mixed product. We believe, however, that as the private sector gains a larger share of the distribution, they will be able to expand their efforts to blended NPKs. Also, plants to produce chemically mixed products are under consideration, although they are considerably more expensive than blending facilities. If mixing plants should ever become a reality, the private sector voice in the selection of fertilizer imports will become more pronounced.

C. CONCLUSION

These recommendations are interim measures to be taken until such time as local production expands to direct application products other than Urea, and the import needs change to raw materials.

We do not believe it feasible to eliminate all subsidies without at the same time eliminating the fixed price to the farmer. As this is done, the more aggressive marketing techniques associated with the private sector become ever more critical. At the same time, the private sector distributors will have to assume stocking of fertilizers as well as other services now available to the farmer by the provincial organizations, such as the supply of seeds and farm implements.

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ANNEX I

LIST OF INTERVIEWEES

1. National Fertilizer Development Center, Islamabad

   Mr. R. M. U. Suleman
   Project Director

2. USAID Liaison Officer, Peshawar

   Mr. Tariq Durrani

3. National Fertilizer Corporation, Peshawar

   Mr. Asif Nazir Ali
   Deputy Regional Manager

4. Agricultural Development Authority, Peshawar

   Mr. Bangash
   Managing Director

5. Jaffer Brothers Limited

   Mr. Nasser N. S. Jaffer, Islamabad
   Director

   Mr. Wasi Ahmed, Islamabad
   General Manager

   and

   Mr. S. A. Rehman, Karachi
   Divisional Manager

6. Sind Agriculture Supplies Organization, Karachi

   Mr. Gulsher Khan
   Director (Operations)

7. Exxon Chemicals Pakistan Limited, Karachi

Mr. D. S. Lall
Sales Manager

and

Syed Anwar Husain
Regional Sales Manager

8. Federal Directorate of Fertilizer Import

Ch. Anwar-ul-Haq, Lahore
General Manager (Acting)

and

Mr. Mir Asadullah, Karachi
Director

9. Karachi Port visit aboard vessel "Star of Texas"

Mr. C. T. Shaw
Chief Officer

and

Mr. Harris Tucker
Captain

10. Shahnawaz Limited, Karachi

Mr. Mohammad Naeem
Chief Executive

11. National Fertilizer Marketing Limited, Lahore

Mr. Ahmed M. Shah
Managing Director

12. Fauji Fertilizer Company Limited, Lahore

Mr. Feisal Beg
Manager Marketing

13. Dawood Hercules Company

Mr. Khawaja Amanullah
Director

14. Punjab Agricultural Development & Supplies Corporation, Lahore

Dr. Ghulam Rasool Chaudhry
Managing Director

15. Department of Planning and Development, Lahore

Dr. Bashir Ahmad
Joint Chief Economist

16. Ministry of Food & Agriculture, Islamabad

Mian Manzur Ahmed
Additional Secretary

17. World Bank, Islamabad

Mr. Wolfgang Siebeck
Resident Representative

ANNEX II

GLOSSARY

ADA	- Agricultural Development Authority
Bulk Blending	- Creation of a specific NPK fertilizer grade through the physical blending of products such as Urea, DAP, Sulfate of Potash, etc.
C&F	- Cost and freight. Cost of commodity plus freight charges.
Chemical Mixing	- Creation of a specific NPK fertilizer grade by chemically reacting raw materials such as Ammonia, Phosphoric Acid, Potassium Sulfate, etc.
DAP	- Diammonium Phosphate (18-46-0)
FDFI	- Federal Directorate of Fertilizer Imports
FFC	- Fauji Fertilizer Company Limited
FOB	- Free on Board. Cost of Commodity loaded on board ship at port of shipment.
GOP	- Government of Pakistan
IBRD	- International Bank for Reconstruction Development. World Bank.
IFB	- Invitation for bids
Landed Cost	- Cost of product delivered to port of discharge.
MAP	- Mono-ammonium Phosphate (typically 11-52-0)
NFC	- National Fertilizer Corporation
NLC	- National Logistics Cell
NP	- Nitrophos (23-23-0)

NPK	- Fertilizer product containing all three nutrients--Nitrogen (N), Phosphorous (P), and Potassium (K). For example, 14-14-22.
PADSC	- Punjab Agricultural Development Supplies Corporation
Private Sector	- Marketing arms of National Fertilizer Corporation, Fauji Fertilizer Company, Exxon, Dawood-Hercules, and also general commercial importers.
Public Sector	- Governmental organizations (federal and provincial) involved in importation and distribution of fertilizer.
SSP	- Single Super Phosphate
SASO	- Sind Agricultural Supplies Organization
TSP	- Triple Super Phosphate (0-46-0)