Africa Agricultural Markets Program (AAMP)

Getting Fertilizers to Farmers: How to do it? Who should do it? and Why it Should be Done?

KEY POLICY MESSAGES

The COMESA Regional Policy Seminar was held at David Livingstone Hotel on 15 – 16 June, 2009. The seminar was held under the theme "How to deliver fertilizer to smallholder farmers? Who should do it? and why it should be done?"

African farmers pay the highest fertilizer prices in the world. This contributes to the lowest fertilizer application rates and the lowest agricultural productivity in the world. How can COMESA countries reverse this situation and stimulate agricultural productivity gains?

The seminar began by identifying the cause of high fertilizer prices in the region. High fertilizer prices arise, in large part, because of small countries, small individual markets, hence inability to buy and handle fertilizer in bulk. Poor transport and port infrastructure contribute to high procurement, handling and transport costs. Credit constraints limit the number of firms able to participate in fertilizer markets, while high collateral requirements lead to long lead times and force poor farmers to incur price risk that ensues. Unpredictable government policies likewise discourage private competition that would drive down price margins.

A variety of types of fertilizer subsidies have been used to reduce fertilizer prices and increase fertilizer use. The universal subsidies and state-controlled distribution systems of the 1970s and 1980s proved to be fiscally unsustainable and inefficient. After a period of market liberalization, there is a renewed interest in fertilizer subsidies, particularly the use of input vouchers. The experience with input vouchers in various countries shows that properly designed and implemented voucher system can be used to provide purchasing power support (PPS) to resource poor farmers while promoting, rather than displacing, the private-sector distribution network. It is important that private agro-input dealers be allowed and encouraged to participate in these schemes. The appropriate targeting strategy depends on whether the objective is to boost output or to help the poor. One approach to targeting to the poor is to provide input vouchers in exchange for participation in labor-intensive public works or in-kind payment at harvest time. However, there remain questions whether voucher-based subsidy schemes are fiscally sustainable and whether the returns, in terms of additional crop production, exceed the cost of the subsidy. In addition, it is necessary to consider the opportunity cost of subsidy schemes in terms of foregone investments in agricultural research and infrastructure.

An alternative approach to increasing fertilizer use and farm productivity is to take steps to reduce inefficiencies and transaction costs in fertilizer procurement and distribution. This implies providing complementary investments in human capital development, research on fertilizer-responsive varieties, extension services to promote improved agronomic practices, infrastructure, and regulatory institutions. The removal of trade barriers within the region are necessary to enable firms and governments to benefit from the economies of scale in fertilizer procurement and distribution. Investment in improved infrastructure -- notably deep water ports, bulk handling facilities and transport systems from the ports to key interior – will drive down both procurement and distribution costs. Relieving credit constraints will require access to improved financial services. Policy reforms are needed in some countries to improve predictability, reduce market displacement and promote competition and efficiency in fertilizer marketing (marketing implies improvements at all levels- wholesale, retail and stockists).

The participants reviewed a rich set of country experiences from Ethiopia, Kenya, Malawi, Tanzania, Uganda and Zambia. They provided clear contrasts in approach, in the level of private sector involvement and in the level of subsidies provided. Input subsidies have proven politically popular as a means of reducing fertilizer costs to farmers. Yet questions remain about the efficiency and fiscal sustainability of these subsidies. In the future, it will be important to place increasing emphasis on driving down fertilizer costs in a different way, by reducing transaction costs, improving efficiency through scale economies, infrastructure investments, improved credit, transport systems and improved policy consistency and transparency.

The Policy Seminar noted that some of the regional initiatives that COMESA could promote to reduce marketing costs through economies of scale in the fertilizer supply business include establishment of facilities for finance and warehousing; ensuring competitive private sector involvement; and coordinating public and private investments that will lower regional and domestic distribution costs e.g., expanding capacities at ports and transport networks to allow for bulk handling. A constructive role for COMESA would be to provide policy support, to increase the capacities of the regulatory agencies and distribution chains to ensure affordable prices and expanded choices for producers. COMESA can also help in eliminating non-tariff barriers for cross-border movements.

Participants discussed various options for regional procurement. Continent-wide or region-wide large scale fertilizer procurement by a centralized agency was not supported, nor was procurement by national governments or donors endorsed. Rather, establishment of regional holding warehouses for economies of scale in procurement, consolidation of private sector-based orders, and strengthening of business and market linkages among small and large importers through regional procurement platforms should be encouraged. Improving availability of finance and risk-sharing arrangements for imports and marketing should also receive priority in COMESA program.

Views from the public sector

Farmers face different circumstances and participate in markets in varying degrees. For the resource poor farmers who are not in the market, subsidies are needed to assist them learn use of modern technologies and deal with short to medium term food emergencies. Governments will not phase out such purchasing power support. What is of concern to government is how to improve implementation and targeting of support to resource poor group. Private sector involvement in public fertilizer distribution programs is needed to avoid crowding them out and ensure service continues long after the subsidy program ends. Subsidies for the resource poor group need not be for free. An in-kind contribution from beneficiaries e.g., supply of labor in public works activities can assist in self targeting.

The assertion that investments in infrastructure generally have a higher social payoff than fertilizer subsidies need to be supported by empirical evidence. In SSA, there is no empirical work to inform this debate. Analysis on returns to various public investments done outside the region has shown that fertilizer subsidy programs achieve much less in terms of poverty reduction and increasing GDP when compared to investments in roads, education and research and development. However, the issue of returns or sustainability should be addressed broadly. Social rather than financial returns/sustainability should drive policy choice. When governments spend on subsidies, the objective is not just to improve returns to public resources, but to improve food security and avoid social and political instability.

Governments are concerned about the risks that regional food markets pose to political stability. Rather than enjoy the benefits of regional and international trade in food staples, governments have consistently chosen to pursue food self-sufficiency. Subsidies are not only popular with politicians but with benefitting farmers and fertilizer firms. The targeted farmers appreciate the production increment while distributing firms deliver fertilizer at minimum risk. The emphasis in analysis need not be on political benefits alone but should address impacts on reducing poverty levels and boosting private sector capacity even though the latter impacts are for selected beneficiaries.

It is very important to understand that spending on subsidies does not suggest diversion of funds from agricultural research and infrastructure investment. Investment in research and infrastructure remain a priority for government. It is also simplistic to think that cutting subsidies will increase resources to research and infrastructure. Cutting back on subsidies could simply divert resources from agriculture to other economic and social sectors.

Views from the private sector

The regional procurement arrangements for financial support and physical bulking centers will be attractive to the private sector if they can reduce the existing domestic import parity prices. The goal of introducing these institutions is to reduce marketing costs otherwise the private sector will shun them. Investment to upgrade existing ports will definitely make an immediate impact on distribution costs and reduce farm gate prices of fertilizer. While the focus maybe on reducing costs of imports, incentives should be available to enhance economically viable domestic fertilizer production. Domestic production will utilize local resources, add value, create jobs and earn countries much needed foreign exchange.

There have been significant improvements in fertilizer technology. Rather than continuing with existing products, there is need to support adaptive research and development of new fertilizer products. This new fertilizer technology has potential to reduce costs for the farmer and increase crop responsiveness. Such direct impacts could result in increased fertilizer use and output levels. In addition, blending plants are an essential part of the fertilizer supply strategy in future. Blending requires government support in terms of expanding capacity of soil testing laboratories. If soil tests can be conducted conveniently and regularly, it will ensure delivery of high quality blended fertilizer products.

Fertilizer prices in the COMESA region are based on the same FOB price but vary across Member States because of different transport costs. Generally, domestic transport costs add 50% -75% of the FOB price due to the poor state of distribution infrastructure. Our ports are shallow and can only accommodate smaller 10000 ton vessels resulting in high per unit freight cost. The only deep port at Mombasa is congested.

Finance for fertilizer importers and agro-dealers is a major bottleneck. Importers are obliged to extend credit to agro-dealers. Financing agro-dealers is not a business fertilizer importers are good at as it adds costs. Agro-dealers and farmers need the support of equity banks so that business for importers is made easy. The whole fertilizer value chain require financing if fertilizer use is to increase in the future.

Government fertilizer subsidy programs in some member states are negatively affecting fertilizer dealers. At the time of making their orders, dealers do not have information on the extent of government programs. Dealers are forced to sale at a loss when subsidized fertilizer is introduced in the market. If dealers had full information of the impending subsidy program, they would have stopped making their orders and avoided such losses. Fertilizer subsidy programs and other government interventions should be predictable to allow other stakeholders to plan and reduce on avoidable losses. Fertilizer subsidy programs should continue to utilize the private sector to import but should avoid using government agencies or marketing boards in distribution. To build capacity and ensure sustainability, agro-dealers should be the sole distributors instead.

Other views

Over the past few years, the policies in the region have been biased towards subsidies. It is now time to move away from general subsidies and move towards supporting the FIVE pillars of market development, that is, policy, human capital, finance, market information, and regulation (quality assurance) as well as infrastructure improvement. Generally, subsidies tend to harm the market. Farmers who participate in the market can benefit from market development. Those farmers that cannot participate in the market should receive targeted support in the form of public works programs. For the sake of market development, free fertilizer should be avoided.