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28 June 1974

MEMORANDUM FOR: Mr. Edward Casey, Jr.
Special Assistant to
Ambassador Martin
Department of State

SUBJECT : Japan: Decline in Fertilizer Exports
Threatens LDC Supplies

In response to conversations with members of the US delegation to the 30th IAO meetings, we are forwarding the attached report on Japanese nitrogen fertilizer exports. Although there will be a decline in Japan's exports in the 1974-75 fertilizer year, the drop will be less than Tokyo has indicated. Nonetheless, countries which rely heavily on Japan for fertilizer, such as the Philippines, Indonesia and India could face serious shortfalls. If there is any further information you may require on this or related matters we will be happy to assist.

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Japan: Decline in Fertilizer Exports Threatens
LDC Supplies

Introduction

1. Shortages and sharply rising prices of fertilizer, especially nitrogen, are causing concern about their impact on world food production. Fertilizer supplies already were tight before the energy crisis because of the rapid growth in demand. Since nitrogen fertilizer production depends on petroleum derivatives, the oil crisis aggravated the supply problem. Natural gas or petroleum products are the primary raw material used in nearly 90% of the world's nitrogen fertilizer production. Developing countries, which rely heavily on imports, are faring worst from the scarcity and high price of fertilizer. Asian LDCs in particular, which consume about one-fifth of the world's nitrogen fertilizer, will be even more hard pressed in the coming year.

2. Japan plays a strategic role in the world fertilizer balance as the leading nitrogen fertilizer exporter (see Table 1).^{1/} In FY 1972, Japan accounted for nearly 20%

^{1/} Japan accounts for only 1 to 2% of world phosphate fertilizer exports and about 4% of world potash fertilizer imports. The bulk of Japan's phosphate fertilizer production is consumed domestically and all of its potash fertilizer is imported.

Table 1
 Leading World Exporters of Nitrogen Fertilizer
 1971/72 ^{1/}

	<u>Metric Tons (N) ^{2/}</u>	<u>% of Total</u>
Total World Exports	6,954,420	100
Japan	1,274,400	18.3
US	935,000	13.4
Netherlands	651,822	9.4
Belgium	482,463	6.9
Italy	442,214	6.4
Canada	437,900	6.3
West Germany	369,693	5.3
Romania	348,800	5.0
Poland	319,931	4.6
Norway	303,100	4.4
All Others	1,389,097	20.0

^{1/} The fertilizer year extending from 1 July 1971 through 30 June 1972, or FY 1972.

^{2/} All tonnage data in this report are given in terms of nitrogen (N) content.

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of world exports and its share probably increased in FY 1973. Urea makes up about 75% of Japanese exports while ammonium sulphate and ammonium chloride account for the remainder. Japan, which exports about two-thirds of its output, is particularly important to the developing countries in Asia. Indonesia and the Philippines rely on Japan for 90% of their imports and 60% of their consumption. Together with India and with China, the largest buyer, they take almost 90% of Japan's nitrogen fertilizer exports.

Export Shortfall

3. Japan's exports of nitrogen fertilizer fell 13%, or 220,000 tons in FY 1974 and a further drop in 1975 is certain (see Table 2). Production is expected to remain stagnant in the upcoming year while domestic demand will continue to increase. Indeed, Tokyo is predicting a 15%-20% decline in exports, and exporters are cutting back new commitments by as much as 25%. We believe Tokyo is overstating the extent of the decline to assure that domestic needs are covered. Nonetheless, a 10%, or 150,000 ton drop in 1974-75 seems probable.

4. Production fell by about 2% in 1973-74 for a number of reasons. A series of explosions at petrochemical plants and accidents at urea factories was one factor. The oil crisis caused some production losses by reducing naphtha

Table 2

Japan: Supply of Nitrogen Fertilizer
(1,000 MT Nitrogen (N))

	<u>Production</u>	<u>Consumption</u>	<u>Exports</u>	<u>Ending Stocks</u>
1969-70	2,131	879	1,236	684
70-71	2,105	866	1,410	513
71-72	2,125	880	1,274	484
72-73	2,454	970	1,680	288
73-74*	2,400	1,020	1,460	208
74-75*	2,400	1,090	1,310	208

* Estimate

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supplies, the largest feedstock in Japanese urea production. Although the fertilizer industry was exempt from Tokyo's energy conservation program, supplies of raw material inputs for fertilizer, especially ammonium sulphate, were reduced because of oil-related production bottlenecks in other industries.

5. The industry is operating near full capacity and production is not expected to increase in the upcoming fertilizer year. Prior to 1973 the industry had substantial over capacity, especially in urea. As a result, investment has dropped off sharply -- at least by 20% in 1974 -- and is going mainly into major repairs and pollution control equipment. Thus, despite strong domestic and foreign demand, no expansion of capacity is underway. In the case of urea, new capacity probably could not be brought on stream for about three years. Increasing ammonium sulphate production will be difficult because of a sharp slowdown in the synthetic fiber industry which provides the caprolactam needed to produce ammonium sulphate.

6. Domestic consumption of nitrogen fertilizer, which changed very little during the late 1960s, began increasing fairly sharply in FY 1973 and is expected to continue

growing at a rapid pace for the next few years. Initially, Tokyo was predicting a 7% increase in consumption in FY 1975, but recently boosted the estimate to 9%. The rapid growth in consumption reflects Tokyo's effort to increase domestic crop yields in order to reduce reliance on imported foodstuffs. Although fertilizer use is not subsidized directly, farmers receive a substantial price support for fertilizer intensive crops such as rice, grain and soybeans. In addition to rising home consumption Tokyo is planning a substantial increase in stocks during the coming year. Industry spokesmen on the other hand, have argued current stocks of about 200,000 tons could be reduced somewhat without jeopardizing market stability at hand. Assuming no change in stocks and a 7% increase in consumption, fertilizer supplies available for 1975 will amount to almost 1.3 million tons, a 10% reduction from current levels.

Export Policy and Practices

7. In Japan, domestic concerns outweigh all others in allocating fertilizer supplies, and the government intervenes in the market to ensure that domestic requirements are met first. Each of the two major interest groups -- farmers and fertilizer manufacturers -- is represented by a government ministry. The Ministry of Agriculture assures that farmers

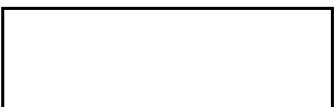


get sufficient supplies at the lowest possible price, and the Ministry of International Trade and Industry (MITI) looks after the interests of the fertilizer manufacturers.

8. When supplies are plentiful, MITI administers production restraints to avoid price cutting competition. In 1971 and 1972, for example, MITI used administrative guidance to limit production of ammonium sulphate to halt the steady decline in prices. When supplies are tight, the Ministry of Agriculture and MITI together determine the amount needed for the domestic market and MITI monitors exports to be sure domestic demand is met. The monitoring effort is relatively easy since the industry is dominated by only about a dozen firms.

9. Currently, in the face of uncertain production and strong foreign demand, MITI is keeping a tight rein on exporters. When nitrogen fertilizer production began to slip late last year because of shortages of oil-based feedstocks, MITI urged exporters to dole out shipments piecemeal until the situation clarified. Although the production slowdown was short-lived, exports have continued to run behind schedule.

10. MITI is urging exporters to be conservative in making contracts for the coming year. As a result, contracts are being negotiated much later and for shorter periods and smaller amounts than usual. Japan normally sells most of



its fertilizer on annual contracts, but in view of the volatility of prices and uncertainty of supply MITI is insisting that exporters make commitments for no more than six months and include a provision for renegotiation of prices. In past years, contract talks began by February and the bulk of exports had been committed by the end of May. This year, talks with major customers began in late May and in many cases are not yet concluded.

11. Japan apparently intends to be as equitable as possible in supplying its traditional customers. China, by far the largest buyer, has been notified of a 15-20% cut in shipments in the coming year. Contracts recently signed with India and Indonesia for 69,000 tons of urea each during the last half of 1974 represent a cut of 25% from the corresponding period a year ago. Some countries which purchase small amounts on a spot basis may be unable to buy any Japanese fertilizer this year, but Tokyo apparently is looking out for the interests of countries such as Sri Lanka and South Vietnam, to which it provides economic aid.

12. On strictly economic grounds, the Japanese would prefer to cut shipments to China by a greater margin than some others. Because they bulk so large as buyers, the

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Chinese have managed to bargain for lower prices than other customers. In 1973, for example, the Chinese paid \$66 per ton of urea compared with a \$80 average for other importers. Last January the Chinese agreed to pay \$130 per ton for urea delivered during Jan-Jun 1974, while other Asian countries agreed to pay \$140. Despite the price differential Tokyo is avoiding disproportionate cuts in shipments to China because it values growing political and economic ties with Peking. Tokyo is especially concerned about jeopardizing seemingly good chances for obtaining greatly increased oil supplies from China by the end of the decade.

13. The Japanese would like to establish uniform export prices in the new fertilizer year, but are not hopeful in view of China's intransigence. The Indians have agreed to pay \$215 a ton for urea (product weight) during July-December 1974. The Chinese, have thus far refused to accept that price and talks have been temporarily suspended. According to Tokyo, \$215 a ton for urea is still about \$35 below the price other large exporters are getting.

Implications

14. Even without a shortfall in Japanese exports, world supplies of nitrogen fertilizer will be tight in 1974/75. A decline in Japan's exports will, of course,

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aggravate the situation and could cause serious problems for certain Asian countries. Those hardest hit probably would be Indonesia and the Philippines (see Table 3). Both countries anticipate a substantial rise in import requirements in FY 1975 and were counting on Japan to cover the bulk of it. Unless other suppliers make up the difference the drop in Japanese exports would result in about a 20% shortfall in planned imports for Indonesia and about 30% for the Philippines.

15. India is much less reliant on imports for its nitrogen fertilizer and Japan provides only about 10% of Indian consumption. The Japanese, however, do account for 30% of India's imports. Since India was apparently counting on Japan for the same share in 1974/75, they would suffer about a 10% shortfall in imports. China probably will be hurt little by a decline in Japanese exports because domestic production is increasing rapidly.

16. The Japanese foresee a surplus in the world nitrogen fertilizer market by the late 1970s. MITI, for example, estimates that China will be self-sufficient by 1978/79. Manufacturers, thus, are not likely to expand production without official guarantees of stable demand. The high degree of pollution caused by the chemical fertilizer industry, the uncertainty of raw material supplies, and other industrial demand for naphtha -- the basic feedstock

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Table 3Japan's Share of Selected Countries'
Imports and Consumption of Nitrogen Fertilizer

	1972-73		Percent		1973-74	
	<u>Imports</u>	<u>Consumption</u>	<u>Imports</u>		<u>Consumption</u>	
China	72	30	64		21	
India	29	11	30		11	
Indonesia	51	42	92		58	
Philippines	NA	75	88		61	



for fertilizer in Japan -- also serve to discourage expansion of nitrogen fertilizer production.

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