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“WTO Consistency of Indian Fertilizers policy”

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UNDERTAKING

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Satish Chandra

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“WTO Consistency of Indian Fertilizers policy”

ABSTRACT OF THE THESIS

Indian Fertilizer Industry made spectacular growth during fourth quarter of the last millennium, and contributed substantially to the success of Green Revolution, which helped India to meet food requirement of its ever-increasing population. This growth is highly indebted to Government Subsidy. Now India as a signatory of the World Trade Organisation (WTO) is obliged to bring its policies in conformity with its obligation to the WTO. The Agreement on Subsidies and Countervailing Measures (SCM) requires every Member state to refrain from granting or maintaining subsidy specific to any industry or enterprise and contingent on use of domestic goods over imported one or subsidies which causes or threaten to cause injury to domestic industry or serious prejudices to other Member. The new Indian Fertilizers Policy encourages production and consumption of the domestic fertilizers over the imported one .Thus it is construed that the existing Fertilizer Policy is not consistent with India’s obligation to the Agreement on SCM. Similarly ban on export of Urea is not in tune with the commitment undertaken as per the provisions of the GATT and TRIM agreement. So, an inference is drawn that the New Fertilizer Policy is inconsistent with India’s WTO obligations.



Table of Contents:

ACKNOWLEDGMENT	3
ABSTRACT OF THE THESIS	4
CHAPTER I	7
INTRODUCTION	7
CHAPTER II	11
INDIAN FERTILIZER INDUSTRY	11
Fertilizers productions:.....	14
Capacity Utilisation:.....	14
Strategy for growth:	14
CHAPTER III	15
INDIA'S WTO COMMITMENT (FERTILIZER SECTOR).....	15
1. General Agreement on Tariff and Trade 1994 (GATT 94):.....	16
(i) Most Favored Nation Treatment:.....	16
(ii) National Treatment:	17
(iii) Publication and Administration of Trade Regulations:	17
(iv) General Elimination of Quantitative Restrictions:	17
(v) State Trading Enterprises:.....	18
(vi) Subsidies:.....	18
2. Agreement on Subsidies and Countervailing Measures (SCM):	19
3. Agreement on Agriculture (AA):.....	19
4. Agreement on Trade Related Investment Measures (TRIM):.....	19
PART IV.....	20
GOVERNMENT MEASURES OF SUPPORT- SUBSIDY.....	20
1. Retention Pricing Policy (RPS):	20
2. Concession Scheme for Decontrolled Fertilizers:.....	21



3. Freight Subsidy:	21
4. Fixation of MRP:	22
5. Expenditure on Urea Subsidy:	22
6. Expenditures on subsidisation of Decontrolled Fertilizers:	24
7. Concessions/ Incentive On Import Of Capital Goods For Fertilizers Industry:	25
PART V	26
INDIAN FERTILIZER POLICY	26
1. Controlled Fertilizers (Urea):	26
2. De-Controlled Fertilizers:	29
3. Overseas Joint Ventures:	31
PART VI	32
POLITICAL ECONOMY OF INDIAN FERTILIZER POLICY	32
PART VII	40
WTO CONSISTENCY OF INDIAN FERTILIZER POLICY	40
1. General Agreement on Tariff and Trade 1994 (GATT 94):	40
(i) Most Favored Nation Treatment:	40
(ii) National Treatment:	43
(iii) Publication and Administration of Trade Regulations:	45
(iv) General Elimination of Quantitative Restrictions:	46
(v) State Trading Enterprises:	46
(vi) Subsidies:	48
2. Agreement on Subsidies and Countervailing Measures (SCM):	48
3. Agreement on Agriculture:	56
4. Agreement on Trade Related Investment Measures (TRIM):	58
CHAPTER VIII	60
CONCLUSION	60
BIBLIOGRAPHY	61



CHAPTER I

INTRODUCTION

India is the third largest producer and consumer of chemical fertilizers in the world. The production of nitrogenous (N) and phosphatic (P) chemical fertilizers taken together has increased from a modest volume of 0.03 million tonnes in 1950-51 to 14.4 million tonnes in nutrient terms in 2003-04. And during the same period, the overall consumption of fertilizers in nutrient terms (NPK) frog-leaped from 0.07 million tonnes to about 16.1 million tonnes¹. This success is attributable to Retention Pricing Scheme (RPS)² adopted by the Government of India (GOI) in 1977 to foster investment in fertilizer industry and growth of agriculture production and productivity through increased consumption of chemical fertilizers. The twin objectives of RPS had been to guarantee fixed return (12%) on capital investment by reimbursing each fertilizer manufacturer the differential amount of cost of production and sale prices fixed by the GOI, while ensuring timely availability of fertilizers to farmers at affordable prices. The gap in production and consumption of nitrogenous and phosphoric fertilizers is met through imports, which are subsidised on the basis of differential of landed price and sale prices fixed by the GOI. The potassic requirement is fully met through imports in absence of known commercially viable resources in the country. The increased production and consumption of fertilizers has provided food security to ever increasing population of the country. But this has not been without price. The fertilizers subsidy has been ballooning year after year since introduction of RPS in 1977. Now the rising trajectory of fertilizers subsidy has become

¹ Fertilizers Statistics, 2002-2003, Fertilizer Association of India, 10 Saheedjit Singh Marg, New Delhi.

² Retention Price-cum-Subsidy Scheme, 1977: Gazette Notification (Resolution) No.166 (24)/77-FDA dated 01.11.1977.



an eyesore and subject to adverse criticism at various forums. It is estimated that Indian exchequer may foot the bill of about Rs.170 billions for subsidisation of fertilizer consumption during 2004-05³.

India became signatory of World Trade Organisation (WTO), which came in operation on 1 January 1995 replacing General Agreement on Tariff and Trade 1947 (GATT). It has brought a new global constitutionalism and its Agreements on Subsidies and Countervailing Measures (SCM) read with Agreement on Agriculture (AA) have introduced a new rule-based legal regime of subsidies and countervailing measures⁴. The implementation of various Multilateral Agreements, including the aforesaid, is to be monitored by the WTO, which commands increased power to compel nations to alter their domestic trade laws when they violate the negotiated GATT/WTO Agreements. The key to the execution of this power lies in the system that resolves trade disputes known as the Disputes Settlement Body (DSB)⁵. Unlike other international organizations, such as International Monetary Fund (IMF) or World Bank, the WTO is not controlled by the Board of Directors, but instead is governed by all its members who are obliged to be a party to all the trade agreements and understandings it includes. Member States can neither opt out of any covered agreement nor can make any reservations. The entire package is a single undertaking and has been offered on a take-it-or-leave-it basis. This is indeed unprecedented in the history of international law. The new rule-based regime of subsidies and quasi-judicial dispute settlement procedure⁶ as detailed under WTO, limit policy space for a Member State to deploy instrument of subsidies for their economic development. The WTO Agreement on Subsidies and Countervailing Measures prohibits the subsidies, which are contingent 'upon export performance' as well as contingent upon

³ Budget Estimate 2004-05 Government of India

⁴ Koul A.K.- The Legal Regime of Subsidies and Countervailing Measures in World Trade Organization (WTO)- Delhi Law Review-Volume XXI: 1999

⁵ Bryan Scott Cuppett: Case Study on WTO Dispute Settlement: European Communities-Hormones, Complaint by the United States.

⁶ Palmeter, David and Petros C. Mavroidis, Dispute Settlement in the World Trade Organization – Practice and Procedure. The Hague, London, and Boston: Kluwer Law International, 1999.



the use of domestic over imported goods. While defining the subsidies and categorizing them into prohibited, actionable and non-actionable, it lays down procedures for imposition of countervailing measures. It tries to discipline both the use of subsidies as well as the use of the countervailing measures. Now, like other WTO member countries, India has also lost the freedom of independence in choice of use of subsidies and countervailing measures for their economic development.

The embryonic New Pricing Policy (NPP)⁷ for urea manufacturers, has sprouted from the womb of unit based Retention Pricing Scheme (R.P.S.), which raised country's annual urea consumptions to over 20 million tonnes. The new pricing policy is another death nail in the coffin of pronounced socialistic values permeating throughout politico-economic fabric of post independent India till Manmohanomics heralded dawn of Liberalisation, Privatization and Globalization (L.P.G.) in early nineties, pursuant to which phosphatic and potassic fertilizers were decontrolled and decanalised in August 1992⁸. The pronounced objective of the new policy is to phase out unit based R.P.S. regime which had always been embroiled in bureaucratic secrecy, subjective interpretations and vulnerable to various pressure lobbies. It intends to lay foundation for efficiency parameters of international standards & viable rate of returns through groups based system of concession for urea manufacturer. This will be another milestone, after decontrol of potassic and phosphates fertilizers in 1992, on way to reform Indian fertilizer sector. It will pave the way for unfettered operation of market forces in shaping the health and growth of fertilizer Industry, which is credited, to an extent, to success of green revolution responsible for country's self-sufficiency in food grain production. But how far this policy is on line and logic with the principles and objective of World Trade

⁷ Government of India, Ministry of Chemical & Fertilizers, Department of Fertilizers, letter No.12019/5/98-FPP dated January 30, 2003.

⁸. Gazettes Notification No. S.O.642 (E) dated 25.08.1992 regarding decontrol of potassic and phosphoric fertilizers, issued by the Department of Agriculture & Co-operation, Government of India.



Organisation (W.T.O.) is subject of deliberation. Similarly freeing of fertilizers industry from the clutches of permits and licences is a positive step for liberalising the sector but need of administrative clearance for Urea plant for subsidisation is retrograde to market driven economy. It is also feared that these efforts of liberalisation may short live due to political sensitivity of the subject as was the case with potassic and phosphoric fertilizers which were decontrolled and decanalised in August 92 but subsequently year after they were brought back under Concession Scheme for subsidisation. The subsidisation of fertilizer production seemingly is not in consonance with the non-discrimination principles of GATT94 and subsidy scheme of SCM. So it is a matter of evaluation to assess whether Indian Fertilizer policy is WTO consistent.

This paper examines the WTO consistency of Indian Fertilizer Policy. The brief introduction will be followed by an overview of current status of the Indian Fertilizer Industry. The third chapter will list the WTO commitments of India with regard to Fertilizer Sector and next one will focus on government measures of supports taken by the India to promote its Fertilizer Industry. The fifth chapter will dwell on existing Indian Fertilizers Policy and next one will focus on political economy of Indian Fertilizer Policy. The WTO consistency of Indian Fertilizes policy will be analysed and discussed in chapter seven, which will be followed by the conclusion.

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CHAPTER II

INDIAN FERTILIZER INDUSTRY

Indian Fertilizers Industry made a very humble beginning in 1906, when the first manufacturing plant of Single Super Phosphate (SSP) was set up in Ranipet near Chennai with an annual capacity of 6000 metric tonnes (MT)⁹. Later on in forties and fifties large-sized plants were set up with a view to establishing an industrial base in India to achieve self-sufficiency in food grains. Subsequently, need to increase food grain production led to green revolution in the late sixties. This gave an impetus to growth of fertilizers consumption in India. However, the introduction of the Retention Pricing Scheme (RPS)¹⁰, in 1977 was the real instrument for significant additions to installed capacity of fertilizers production.

There are three main fertilizers nutrients, namely nitrogen (N), phosphate (P), and potash (K) required by the crops. Of these three main nutrients, India is endowed with mainly nitrogen and in case of phosphates; the indigenous rocks supplies meet only 5-10% of the total requirement of P₂O₅¹¹. There is no commercially viable known source of potash in India consequently the entire requirement is met through imports. So the government of India's policy regarding the fertilizers sector has been the achievement of a maximum degree of self- sufficiency in nitrogen production based on utilization of our own feedstock, leaving only marginal quantities to be met through imports¹². The guarantee of 12% return on net worth of the company provided an attractive business opportunity for investment in fertilizers sector, particularly in urea units.

⁹ Annual Report 2003-04, Government of India, Department of Fertilizers, Ministry of Chemicals & Fertilizers.

¹⁰ Sup era note 2

¹¹ Sup era Note 9 and see Fertilizer Statistics 2002-03,FAI, Delhi

¹² Report of the Working Group on Fertilizers for the eight Plan, Department of the Fertilizers,p59, Fertilizer Pricing policy ,Report of the High Powered Review Committee Department of Fertilizers.



Prior to 1980, nitrogenous fertilizers plants were mainly based on naphtha as a feedstock. But during 1978 to 1962 a number of fuel oil/LSHS based ammonia urea plants were set up. India also made some unsuccessful ventures in the field of coal based technology. However the real breakthrough in urea production could be achieved after the availability of natural gas from offshore Bombay High and South Basin, when number of the gas based urea units got established in India since 1985. At present natural gas based plants account for more than 60% of urea capacity, naphtha is used for less than 30% of urea production and the balance capacity is based on fuel oil and LSHS as feedstock¹³.

In view of poor availability of indigenous quality rock phosphate, a policy mixes of three options has been adopted to raise the production of phosphatic fertilizers in India. First, domestic production based on indigenous/ imported rock phosphate and imported sulphur. Second, domestic producer based on imported intermediates, viz ammonia and phosphoric acid; and third import of finished fertilizers. During 2002-03 roughly 91 % of the requirement of phosphatic fertilizers was met through the first two options¹⁴.

The installed capacity of the nitrogen as on 31.03.2004 has reached a level of about 12 million MT of nitrogen and 5.42 million MT phosphate nutrient, making India the third largest fertilizers producer in the world¹⁵. This rapid growth in this sector is attributable to favourable government policies, which encouraged large-scale investments in Public, Private and Co-operative Sectors. Presently there are 57 large sized fertilizers plants in the country manufacturing a wide range of nitrogenous, phosphate and complex fertilizers. Out of these, 29 units produce urea, 20 produces DAP and complex fertilizers, 13 plants manufacture Ammonium Sulphate (AS), Calcium Ammonium Nitrate (CAN) and other low analysis fertilizers. Beside there are about 64 medium and small-scale units

¹³ Sup era Note 9

¹⁴ Ibid

¹⁵ Sup era Note 1.



in operation producing Single Super Phosphate (SSP). Sector wise installed capacity is given in the table 1.

Table1.

Sector-wise, Nutrient –wise Installed Capacity

As On 31.03.2004

S. No.	Sector	Capacity		Percentage Share	
		Million MT		N	P
		N	P		
1	Public Sector	3.5	0.4	2.9	0.8
2	Cooperative Sector	2.8	0.8	3.3	1.2
3	Private Sector	5.7	4.2	4.8	7.7
	Total	12.0	5.4	10.0	10.0

(Source Annual Report 2003-04, Department of Fertilizers, GOI)

It is observed from the aforesaid table that Public and Cooperative Sector share is more than 50% in production of nitrogenous fertilizers, where as it is the Private Sector which plays dominant role in ensuring availability of phosphatic fertilizers to Indian farmers.



Fertilizers productions:

10.63 million tonnes of nitrogenous and 3.63 million tonnes of phosphatic fertilizers was produced in India during 2003-04. The production target for 2004-05 has been fixed at 11.70 million tonnes of nitrogen and 4.88 million tonnes of phosphatic fertilizers, representing a growth rate of 10.04% in nitrogen and 34.4% of phosphate as compared to actual production during 2003-04¹⁶.

Capacity Utilisation:

Indian fertilizers Industry have achieved a level of capacity utilization that is comparable with the world. The capacity utilization during 2002-03 and 2003-04 was 87.2% and 88.8% for nitrogen and 72.8% and 67% for phosphate respectively¹⁷. The capacity utilization of fertilizers is expected to increase through revamping, modernization of the plants and closer of unviable sick units.

Strategy for growth:

The fertilizer industry has adopted the following strategy¹⁸ to increase fertilizers production:

- Expansion/retrofitting of existing plants.
- Setting up of Joint ventures in countries having abundant and cheaper raw materials.
- Working out the possibility of the adopting alternative sources like liquefied natural gas to overcome the constraint in the domestic availability of natural gas.

¹⁶ Sup era Note 9

¹⁷ Supera Note 9

¹⁸ Ibid



CHAPTER III

INDIA'S WTO COMMITMENT (FERTILIZER SECTOR)

Representatives of the 124 countries, including India, affirmed in Markesh Declaration of 15 April 1994 that establishment of the WTO ushered in a new era of global economic cooperation, reflecting the widespread desire to operate in fairer and more open multilateral trading system for the benefit and welfare of their peoples¹⁹. The affirmation was not just a wishful thinking as legally binding nature of the commitment is well informed to the provisions of the Final Act²⁰ and Markesh Agreement Establishing the WTO. The Art.4 of the Final Act says that acceptance of the WTO Agreement shall be open for acceptance as a whole, by signature or otherwise, by all the participants pursuant to Art.XIV thereof. And such acceptance shall be applicable to this Agreement and Multilateral Trade Agreement annexed hereto. The Para 2 of Art:II of Markesh Agreement further reinforces the legally binding nature of the WTO by saying that the agreements and associated legal instruments included in Annexes 1,2 and 3 are integral parts of this agreement, binding on all Members. Further all Members are obliged to ensure the conformity of their laws, regulations and administrative procedures with their obligations as provided in the annexed agreements²¹. This means that a country cannot opt out of one agreement without being obliged to opt out of all. Nor can a country make any reservations to any of these instruments²². The entire package has been offered as single undertaking on a take-it-or-leave-it basis. This is indeed unprecedented in the

¹⁹ Para 2 of Marrakesh Declaration of 15 April, 1994. The legal Texts, The Results of the Uruguay Round Of Multilateral Trade Negotiations

²⁰ Final Act Embodying The Result Of The Uruguay Round Of Multilateral Trade Negotiations, The legal Texts, The Results of the Uruguay Round Of Multilateral Trade Negotiations

²¹ Para 4 of Art.XVI of Markesh Agreement Establishing The World Trade organization. The legal Texts, The Results of the Uruguay Round Of Multilateral Trade Negotiations

²² Para 5 of Art.XVI, Ibid



history of international law. It is a Treaty of Treaties²³. The legal implication of the binding character of the WTO is that if there is an infringement of any obligations assumed under a covered agreement, the action is considered to constitute a *prima facie* case of nullification or impairment. This means that there is a presumption that a breach of the rules has an adverse impact on other Member parties to the covered agreement and in such cases it shall be up to the Member against whom the complaint is brought to refute the charges²⁴. Since India is a signatory of the WTO, it has an obligation to see that its Policies affecting the Trade should be in conformity with its WTO commitments. In this context, *India's WTO* commitments under various covered agreements in respect of Fertilizers Industry are detailed below:

1. General Agreement on Tariff and Trade 1994 (GATT 94):

Most Favoured Nation Treatment (MFN), National Treatment (NT) and Transparency in Governance are the titanic forces of the GATT 94 informing all the covered agreements and crusaders against trade barriers obstructing the smooth conduct of trade-business amongst the WTO members in matters related to agreements and associated instruments included in the Annex of WTO Agreement.

(i) Most Favored Nation Treatment:

The MFN²⁵ obligation ordains that any advantage, favour, privilege or immunity granted by any member to any product originating or destined for any other member shall be accorded immediately and unconditionally to the like product originating or destined for the territories of all other member states subject to some exceptions enshrined in Para 2&3 of Art. I of the GATT 1994.

²³ Dubey Muchkund: "An Unequal Treaty: World Trading Order After GATT" New Age International Limited Publishers, New Delhi.

²⁴ Art.3, Para 8 of Understanding on Rules and Procedures Governing Settlement of Disputes., The legal Texts, The Results of the Uruguay Round Of Multilateral Trade Negotiations.

²⁵ Art. I of General Agreement on Tariff and Trade 1994, The World Trade organization. The legal Texts, The Results of the Uruguay Round Of Multilateral Trade Negotiations



(ii) National Treatment:

The principle of NT²⁶ requires that internal charges, laws and requirement affecting internal sale, purchase or transportation shall not be applied to imported products so as to afford protection to domestic production. The products of the member states imported into the territory of other member state shall not be subjected, directly or indirectly, to internal taxes or internal charges of any kind in excess of those, applied directly or indirectly, to like domestic products. Besides, imported products shall be accorded treatment no less favourable than that accorded to like product of national origin in respect of all law, regulation and requirement affecting their internal sale, offering of sale, purchase, transportation and their use. However this principle is subject to some exceptions as stipulated in the Art.III of the GATT 94.

(iii) Publication and Administration of Trade Regulations:

Each WTO member is obliged to publish²⁷ promptly laws, regulations, ruling and administrative decisions affecting trade and custom valuation in a manner as to enable governments and traders to become acquainted with them. Agreements affecting international trade policy, which are in force between the government and governmental agencies of a member state and the government or a governmental agency of any other member state are also to be published. In addition each member shall administer its laws and regulations in a fair manner and provide recourse to judicial, arbitral or administrative procedure of review.

(iv) General Elimination of Quantitative Restrictions:

Member States are obligated to eliminate all type of quotas, licences or other measures restricting import or export or sale of any product from or to any other member

²⁶ Art.III of General Agreement on Tariff and Trade 1994, The World Trade organization. The legal Texts, The Results of the Uruguay Round Of Multilateral Trade Negotiations

²⁷ Art.X of General Agreement on Tariff and Trade 1994, The World Trade organization. The legal Texts, The Results of the Uruguay Round Of Multilateral Trade Negotiations.



states. They, however, can impose duty, taxes or other charges to regulate their imports and exports²⁸.

(v) State Trading Enterprises:

As per Art XVII of the GATT 94 each member states undertakes that if it establishes any state enterprise with exclusive or special privileges in regard to sale or purchase of goods involving import or export, such enterprises shall act in a manner consistent with the general principle of non-discriminatory treatment for government measures affecting import or export by the private parties. It is also stipulated that such enterprise, having due regard to the other provisions of the GATT94, shall make sale or purchase solely in accordance with commercial considerations including price, quality, availability, marketability and other conditions of purchase or sale and shall afford to enterprises of other member states adequate opportunity, in accordance with the customary business practice, to compete for participation in such purchase or sale.

The aforesaid obligation, however, shall not apply to imports of products for immediate or ultimate consumption in governmental use and not otherwise for resale or use in the production of goods for sale. With respect to such import each member state shall accord to the trade of other member fair and equitable treatment.

(vi) Subsidies:

Member states are under obligation to notify the extent and nature of subsidisation, if they grant or maintain subsidy, including any form of income or price support²⁹, which operates directly or indirectly to increase export of any product from or reduce import of any product in to its territory.

²⁸ Art XI of General Agreement on Tariff and Trade 1994, The World Trade organization. The legal Texts, The Results of the Uruguay Round Of Multilateral Trade Negotiations

²⁹ Art. XVI of General Agreement on Tariff and Trade 1994, The World Trade organization. The legal Texts, The Results of the Uruguay Round Of Multilateral Trade Negotiations



2. Agreement on Subsidies and Countervailing Measures (SCM):

Subsidy has been defined as a benefit conferred through contribution by government or governmental body³⁰ operating in the territory of the subsidy granting Member. Only specific subsidy is prohibited or actionable³¹. Subsidy will be specific in nature if it is limited to certain industry, an entrepreneur or group of industries or group of entrepreneurs³². And WTO members shall not maintain or grant a subsidy, which is contingent on export performance or upon the use of domestic consumption over imported goods³³. A specific subsidy granted or maintained by the member will be actionable if it causes injury to domestic industry or serious prejudices to the interest or impair or nullify the GATT 94 benefits to other member state³⁴.

3. Agreement on Agriculture (AA):

Art.3 of the Agreement on Agriculture³⁵ says that subject to Art.6 of this agreement, a Member shall not provide support in favour of domestic producers in excess of the commitment level specified in section I of Part IV of its schedule.

4. Agreement on Trade Related Investment Measures (TRIM):

No member shall apply any TRIM that is inconsistent with the provision of Art.III or Art.XI of GATT 1994³⁶.

³⁰ Art.1:1 of the Agreement on Subsidies and Countervailing Measures., The legal Texts, The Results of the Uruguay Round Of Multilateral Trade Negotiations

³¹ Art.1:2 of SCM

³² Art.2:1 of SCM

³³ Art.3 of SCM

³⁴ Art.5 of SCM

³⁵ Agreement on Agriculture, World Trade Organisation: The legal Texts, The Results of the Uruguay Round Of Multilateral Trade Negotiations

³⁶ Art2 of Agreement on Trade- Related Measures, World Trade Organisation: The Results of the Uruguay Round Of Multilateral Trade Negotiations



PART IV

GOVERNMENT MEASURES OF SUPPORT- SUBSIDY

1. Retention Pricing Policy (RPS):

To encourage investment in fertilizers sector and ensure timely availability of chemical fertilizers to millions of Indian farmers spread over 600 thousand villages through out the country having a land mass of 327 million hectares of land³⁷, India adopted a two pronged policy of fertilizer-consumption subsidisation. It introduced Retention Pricing Policy (RPS)³⁸ in 1977 for subsidisation of all chemical fertilizers. Under the said scheme, a fair ex-factory price was worked for each unit on the basis of prescribed efficiency norms in regard to capacity utilization and consumption of raw material and utilities capital depreciation norms and normative distribution cost popularly known as Retention Price. It includes 12 per cent post tax return on the net worth of the units (Bhat2003)³⁹. Retention price differed from unit to unit depending upon the technology, feedstock used, the level of capacity utilization, energy consumption and distance from the feedstock/raw material etc. Now only Urea is under price and partial distribution control of government of India and its sale and production is subsidized as per New Pricing Policy, which is to phase out RPS since 1 April 2003⁴⁰, and all Potassic and Phosphatic fertilizers are subsidised under Concession Scheme⁴¹.

³⁷ Inpara 76.

³⁸ Retention Price-cum-Subsidy Scheme, 1977: Gazette Notification (Resolution) No.166 (24)/77-FDA dated 01.11.1977.

³⁹ D.K. Bhatt, Impact of New Policy Regime Especially Movement Decontrol On Fertilizer Marketing, presented in FAI Seminar, 4-6 December, 2003, New Delhi.

⁴⁰ Inpara 57.

⁴¹ The Department of the Fertilizers is administering the concession scheme for extending financial supports to decontrolled fertilizers P&K on sale w.e.f. 1.10.2000. -Annual Report 2003-04, GOI, DOF, Ministry of Chemical and Fertilizers.



2. Concession Scheme for Decontrolled Fertilizers:

The RPS did achieve its objective of investment and increased used of consumption of chemical fertilizers but it had not been free from criticism of fostering inefficiency. Consequently production, import and sale of phosphoric (P) and potassic (K) fertilizers were decontrolled and decanalized since August, 1992, giving market a free hand to fix the prices⁴². But following steep fall in consumption of P and K, ad-hoc Concession Scheme⁴³ was announced to subsidise consumption of these fertilizers leaving only urea under price and distribution control of the government. Under the said Concession Scheme producers and importers of Potassic and phosphatic fertilizers are reimbursed the differential in cost of production/ imports and indicative prices fixed for each type of fertilizers on sale to farmers. The current subsidisation rate of DAP is Rs. 4215/per ton for indigenus and Rs. 3843/per ton for imported DAP. The rates and scope of subsidization is notified periodically⁴⁴. However, production and sale of low analysis nitrogenous fertilizers continued to be dependent on market forces.

3. Freight Subsidy:

The Government of India (GOI) controls the distribution and movement of urea. 50% of the urea production and entire imported urea is moved as per the Movement Order⁴⁵ issued by the Department of Fertilizers, GOI under section 3 of the Essential Commodities Act 1955⁴⁶.GOI is providing subsidy for transportation of the urea from production point/port to retail point under Equated Freight Scheme⁴⁷ and a fixed amount is paid for decontrolled fertilizers as a component of the Concession Scheme. For the

⁴² Gazettes Notification No. S.O.642 (E) dated 25.08.1992 regarding decontrol of potassic and phosphoric fertilizers, issued by the Department of Agriculture & Co-operation, Government of India.

⁴³ Ad-hock Concession Scheme on Sale of Decontrolled Fertilizers, Department of Agriculture, Ministry of Agriculture, GOI, New Delhi.

⁴⁴ S-5/2004-Shiping II dated 30-8-04 issued by the Department of Fertilizers, Ministry of Chemical and Fertilizers.GOI.

⁴⁵ The Fertilizer (Movement control) order, 1973 Gazette Notification No. SRO 249(E) dated 25th April 1973, The Fertilizer Association of India, 10 Saheedjit Singh Marg, New Delhi- Clause 3 of this order, interalia, says "No person shall export or attempt to export, or abet the export of any fertilizer, of which allocation is made by the Government, from any state, except with the authority of Department of Fertilizers"

⁴⁶ Essential commodities Act, 1955, The Fertilizer Association of India, 10, Saheedjit, Singh Marg, New Delhi. 27

⁴⁷ Letter No. 4-20/78-FDO-1 dated 1.1.1979-E.equated Freight, Department Of Agriculture and Cooperation, Government Of India.



There is a special scheme for subsidisation of transportation of fertilizers to North East Provinces and J&K.

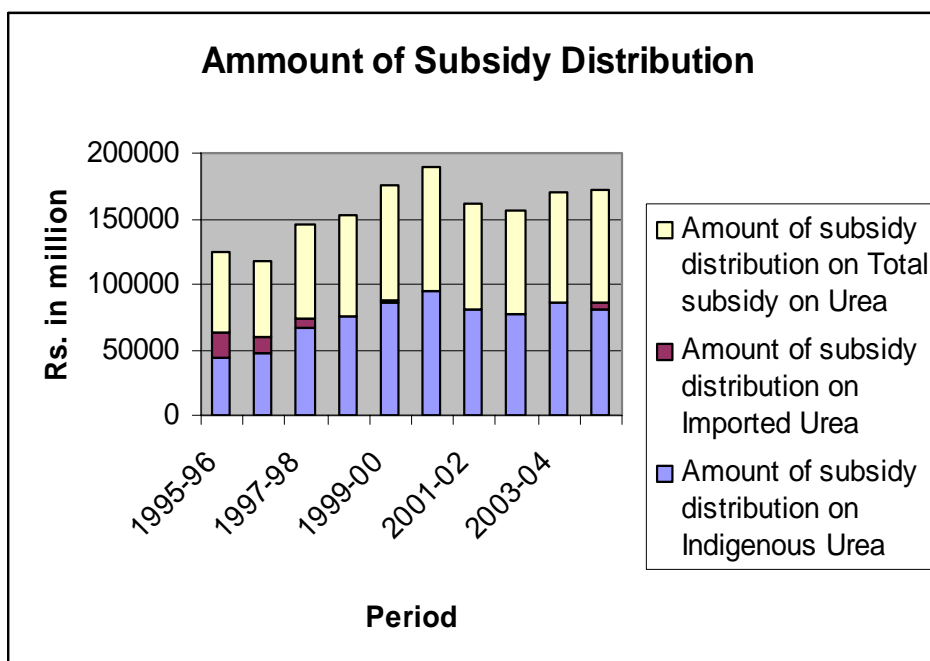
4. Fixation of MRP:

Government of India is fixing Maximum Retail Price (MRP-Rs 4830/per ton) of urea for sale to farmers under Para 3 of Fertilizer (Control) Order 1985⁴⁸ issued under section 3 of the Essential Commodities Act 1955. However in case of decontrolled fertilizers it fixes indicative prices (Rs.9350/per ton) and manufacturers/importers are supposed to sell fertilizers at the indicative prices if they want to get reimbursed under concession scheme⁴⁹.

5. Expenditure on Urea Subsidy:

The financial support to indigenous and imported urea from the year 1995-96 to 2004-05 is shown below:

Figure 1.



⁴⁸ Maximum Retail Price of urea is fixed by the Government of India under clause 3 of Fertilizer (Control) order 1985, Gazette Notification order No. GSR 758 (E) dated 25th September 1985. The Fertilizer Association of India, 10 Saheedjit Singh Marg, New Delhi.

⁴⁹ Sup era 44.



Table 2. (Rs, in millions)

Period	Amount of subsidy distribution on		Total subsidy on Urea
	Indigenous Urea	Imported Urea	
1995-96	43000	19350	62350
1996-97	47430	11630	59060
1997-98	66000	7220	73210
1998-99	74730	1240	75970
1999-00	86700	740	87440
2000-01	94800	10	94800
2001-02	80440	470	80310
2002-03	77900	0	77900
2003-04	85210	0	85210
2004-05(BE)	81430	4730	86160

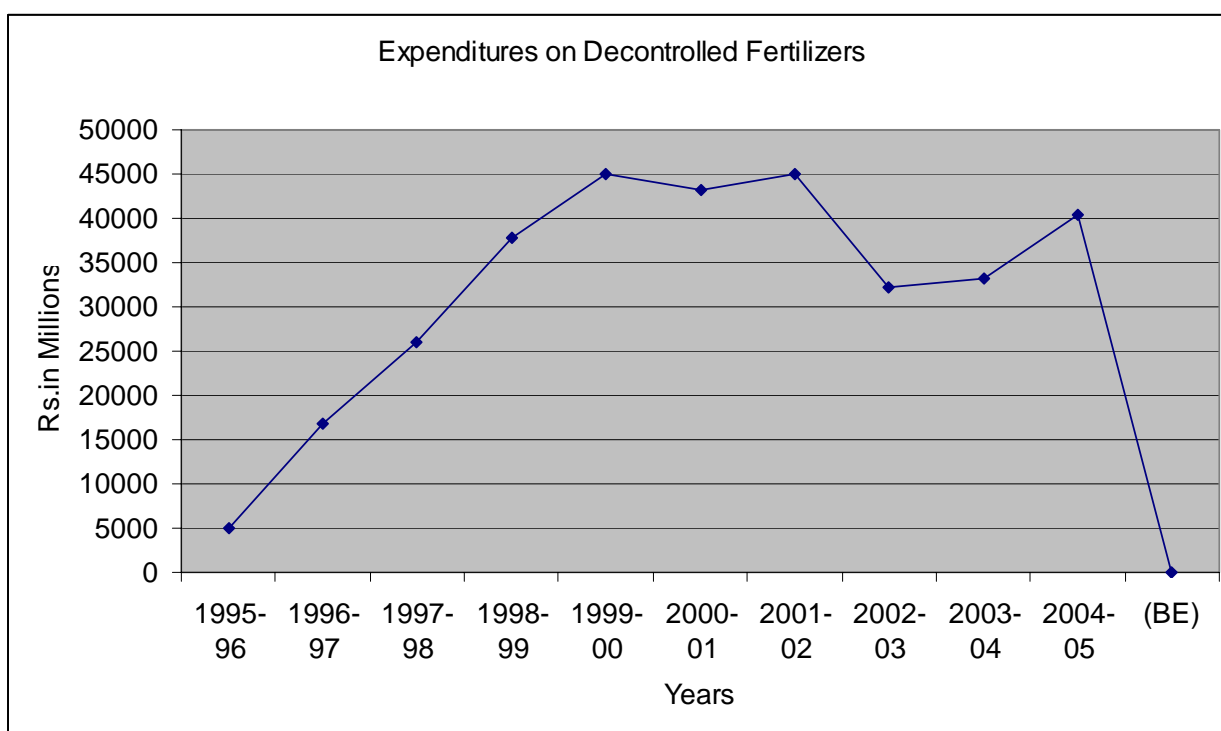
(Source Annual Report 2003-04 Department of Fertilizers, Government of India)

The aforesaid data reveals that Indian fertilizes subsidy bill has been rising unabated except during 2000-02 when rising trend halted for a short while to look up again.

6. Expenditures on subsidisation of Decontrolled Fertilizers:

The actual expenditure on Concession Scheme during 2003-04 was Rs.33260 millions and for 2004-05 it is estimated at Rs, 40460 millions. The amount of concession distributed on sale of decontrolled P&K fertilizers since 1995-95 is shown in figure 2.

Figure 2.



(Source Annual Report 2003-04 Department of Fertilizers, Government of India)

From the above graph, it is observed that rising trajectory of fertilizers subsidy could not be arrested till 2001-02 after its three-fold jump from Rs.5000 million in 1995-96 to Rs.16720 million in 1996-97. It declined slightly in 2000-01, stagnated a while to slump in 2002-03 and to rise again in 2003-04. Now there are strong indicators that it may again behave like an unwieldy horse due to up world fluctuation in fertilizers prices at international market.



7. Concessions/ Incentive On Import Of Capital Goods For Fertilizers

Industry:

To encourage investment in fertilizes industry following incentives are available to the domestic Industry⁵⁰:

- Concessional duty on import of capital goods for setting up of new units/ substantial expansions/renovation/modernization of the existing plants.
- Deemed export benefit to indigenous supplies of capital goods for fertilizers which had been started in 8th & 9th Plan period and spilled over to the 10th Five Year Plan period.

⁵⁰ Sup era Note 9.



PART V

INDIAN FERTILIZER POLICY

India is not having a holistic and integrated Fertilizer policy but a hyphenated one dichotomized into Controlled and De-Controlled Fertilizers. The basic elements of fragmented Indian Fertilizers Policy (ies) are discussed below.

1. **Controlled Fertilizers (Urea):**

Urea is the only fertilizers under distribution/movement and price controls of Government of India, which fixes Maximum Retail Price (MRP)⁵¹, under Fertilizer (Control) Order, 1985 for sale to farmers. The differential between cost of production and MRP is reimbursed to producers under RPS, operative since 1977, which stands modified by New Pricing Policy⁵². Under the said Scheme, Government of India allocates 50% of urea production of each units⁵³ to be sold at pre- fixed- MRP(Rs.4830/ per ton) and moved as per Fertilizers (Movement Control) Order 1973⁵⁴ in their respective Economic Marketing Zone(s)/ State(s) during the season, namely Kharif (April-September) and Rabi (October-March). The transportation cost is born by the government under Equated Freight Scheme (EFS) if fertilizer is moved as per the movement order issued by the department of the fertilizers⁵⁵.

⁵¹ Maximum Retail Price of urea is fixed by the Government of India under clause 3 of Fertilizer (Control) order 1985, Gazette Notification order No. GSR 758 (E) dated 25th September 1985. The Fertilizer Association of India, 10 Saheedjit Singh Marg, New Delhi.

⁵² Sup era 7.

⁵³ Clause 6 of the Fertilizer (Control) order, 1985, issued under section 3 of E.C. Act requires allocation order for sale of urea by Manufacturers and importers

⁵⁴ Sup era Note 45.

⁵⁵ Ministry of Chemical & Fertilizers, Department of Fertilizers letter No.18-1/2000-FM dated 15.03.2000 on violation of Movement order



(i) Production of Urea:

As per the recent Urea Production Policy⁵⁶ notified by the Government of India, investors are free to install urea production units in the country without GOI approval, but if they want to avail government subsidy, they need to obtain government clearance before putting up the plant. Since urea is under price and movement control, investors cannot recover their investment without government support as price and distribution is regulated by the Government. As a result any one interested in investing in urea plant has to take recourse to government subsidisation scheme and so will need approval from the government of India.

(ii) New Pricing Policy:

The new pricing policy will phase out RPS in three stages by grouping urea manufacturing units into six categories based on the feedstock used and plant vintage⁵⁷. The stage –I is to commence from 1st April'2003 for one year, followed by stage-II for two years – ending 31st March'2006. The stage-III is to be spelled out based on review of the implementation of the stage-1 and stage-2. The plants in each group are to be paid a retention price based on the production- weighted average of the retention prices of the entire group. There is also stipulation for adjustment of escalation/de-escalation in variable costs, adjustment in rates of concession on account of reduction in capital related charges, adoption of group energy norms as per recommendation of Gokak committee (Bhatt 99)⁵⁸. The new policy, while encouraging efficiency parameter of international standards based on the usages of the most efficient feedstock, state of art technology, intends to ensure viable rate of return to the units, as well as freeing urea sales &

⁵⁶ Notification No. 12019/11/2003-FPP-dated 29-1-04 issued by the Department of Fertilizers, Ministry of Chemical and Fertilizers, GOI.

⁵⁷ Government of India, Ministry of Chemical & Fertilizers, Department of Fertilizers, letter No.12019/5/98-FPP dated January 30, 2003.

⁵⁸ Sup era Note 39.



marketing from the clutches of Essential Commodity Act after having evaluated the stage-1 during which allocation of Urea under the Essential Commodities Act, 1955(ECA) has been restricted to 50% installed capacity (as assessed) of each units⁵⁹. But Urea, whether allocated under ECA or not is to be sold to farmers as per Maximum Retail Price (MRP) fixed by the government⁶⁰.

(iii) Feedstock Policy:

The pricing of feedstock is an important factor in the production of the urea as cost of feed stock accounts for about 60% to 75% of the total cost of production of the urea. In case of gas-based units, cost of feedstock accounts for 60% of cost of production, whereas for naphtha based and FO/LSHS based units, it accounts for about 75% of the cost of production. So to improve the cost competitiveness of the domestic urea producers, Government has announced a policy for treatment for conversion of the non-gas based units in to NG/LNG. As per the said policy benefits arising from the conversion will not be mopped up by the government for the maximum period of 5 years in case of naphtha-based units and for 10 years in respect of the FO/LSHS based plants from the date of conversion of the unit⁶¹. However the investment will not be recognised by the government for subsidy.

(iv) Freight:

Government will bear transportation cost in the form of equated freight to be worked out on the basis of average normative lead and railroad mix of each unit for the last three years i.e. 2000-01, 2001-02 and 2002-03. For the quantity outside the ECA allocation, a reduction of Rs, 100 PMT is to be made from equated freight. The existing scheme for special freight subsidy continues as such for supplies to the North Eastern and Jammu &

⁵⁹ Supera note 57.

⁶⁰ Sup era note 51.

⁶¹ Sup era note 57.



Kashmir. The government retains the right to issue special movement for difficult and remote areas⁶².

(v) Imports/Exports:

Imports of Urea in India is to be made by the three nominated State Trading Agencies⁶³ (STAs) namely-M/S Indian Potash Limited (IPL), M/S State Trading Corporation (STC) and M/S Mineral and Material Trading Corporation (MMTC) on commercial considerations⁶⁴. But these agencies are authorized to move urea in a particular state as per Movement Orders and to sell it to farmers at pre fixed MRP as per ECA allocation issued by the Department of Fertilizer, Government of India. Other than the STAs no individual or company can import urea without obtaining permission from the government of India⁶⁵.

Manufacturers are permitted to sell urea to complex fertilizers manufacturing Units on the principle of import parity price or to export with the conditions that no subsidy/ concession is payable on that quantity and it is to be computed towards the quantity permitted for decontrolled sale⁶⁶. They cant not export the quantity government intend to allocate for domestic sales, so they have to take clearance from the government if it intend to buy the amount it did not cover under allocation for domestic sales to farmers⁶⁷.

2. De-Controlled Fertilizers:

As per the Industrial Licensing Policy of July 1991, license for setting up a chemical fertilizer unit is no more needed.

⁶² Sup era Note Ibid.

⁶³ Public Notice No.2 (RE-2003) 2002-03 dated 31st March'03 we've. 1st April'03, Ministry of Commerce & Industry, Government of India.

⁶⁴ Notification No.2 (RE-2001) 1997-2002 dated 31st March 2001, Serial No.166 Exim Circular No. 310-210-PO, Subject to Para 4.8 of Exim Policy, Ministry of Commerce & Industry, Government of India.

⁶⁵ Ibid

⁶⁶ Supera Note 57.

⁶⁷ Ibid



(i) Concession Scheme:

As per the current Concession Scheme⁶⁸, Producers and Importers are reimbursed at pre-fixed rate, subject to periodical updation, on sale of per tone potassic/phosphatic fertilizers at indicative MRP issued by the Department of Fertilizers, Government of India. The rate of concession to Producers is worked out on the basis of obtaining input cost and per tone MRP. But in case of Importers of DAP/MOP, it moves along the line of landed cost depending on ruling prices at international market, which are updated every quarter. So indigenous Producers and DAP Importers are subsidized at differential rates⁶⁹. Similarly Complex fertilizers are subsidised as per their nutrient contents of NPK. Since the entire consumption requirement of MOP (K) is met through imports, the rate of subsidisation is dependent on prevalent international prices and MRP fixed by the Government.

(ii) Freight:

The Government takes care of distribution margin and transportation cost of decontrolled fertilizers on normative basis under Concession Scheme operated by the Department of the Fertilizers.

(iii) Imports/Exports:

The import of DAP and MOP is free and any individual or company can import and sell these products in any part of the country. The export of decontrolled fertilizers has also been permitted recently, under conditions to be observed by the exporters, without prior approval of the government⁷⁰.

⁶⁸ Sup era note 44.

⁶⁹ The domestic cost of production is higher than landed cost of imported DAP consequently consumption of the indigenous DAP is subsidised at higher rate than Imported one.

⁷⁰ Notification No. 30 (RE-2003)/2002-2007, dated 28th January,2004, Department of Fertilizers, Ministry of Chemical and Fertilizers, GOI.



3. Overseas Joint Ventures:

The restricted availability of feedstock/intermediates has forced Indian producers to go for joint –ventures abroad. Most of the joint ventures are having provision of buy back. In case of phosphatic fertilizers, Indian companies are buying phosphoric acid and in respect to nitrogenous fertilizers urea is to be imported at prefixed price⁷¹.

The government of India (GOI), Indian Farmers Fertilizers Cooperative (IFFCO) and Southern Petrochemical Industries Corporation Ltd. (SPIC) are equity partner in a joint venture set up in Senegal. The company produces phosphoric acid and finished phosphatic fertilizers in the plant. The phosphoric acid produced in the plant is used under buy back system to produce phosphatic fertilizers in India. SPIC, Jordan Phosphates Mines Company Ltd. (JPMC) and Arab Investment Company (AIC) have set up a joint venture to produce phosphoric acid under buy back arrangements. Similarly a joint venture (Indo Morocco Phosphore SA) between OCP Morocco and Chambal Fertilizers & chemical Ltd (CFCL) has been set up to produce phosphoric acid under buy back system⁷².

Oman India Fertilizer Company (OMIFCO) is another joint venture between IFFCO & KRIBHCO along with Oman Oil Company set up in Oman to produce urea and ammonia. The OMIFCO will sell urea produce to Government of India at fixed long term prices (LTPs) for a period of 15 years and ammonia to IFFCO for 10 years at fixed price. The implementation of the project has commenced on 15.8.2002 and is expected to be completed in 35 months i.e. by 15.7.2005⁷³.

⁷¹ Sup era Not 57.

⁷² Ibid

⁷³ Ibid.



PART VI

POLITICAL ECONOMY OF INDIAN FERTILIZER POLICY

In India, subsidies have been a potent instrument of effectively addressing the problems of large-scale poverty and unemployment. Subsidies play a vital role in facilitating development of indigenous production capabilities and in turn ensuring the low cost supplies on sustained basis⁷⁴. This is of particular relevance in the context of food and fertilizers wherein, given the inevitable linkage with the overriding objective of maintaining food security, a country of India's size and population simply cannot afford to depend heavily on imports. Fertilizer and food subsidies have played a vital role in promoting agricultural growth in post-independent India⁷⁵. Indian Agriculture contributes 23% of Indian GDP in 2002-03 and support, directly or indirectly, 72% rural population⁷⁶. Consequently increasing agriculture production and productivity became one of the top priorities of India for ensuring sustainable economic development and poverty eradication. It adopted a policy of subsidisation of farm inputs and out put support prices to encourage investment and adoption of new farm technology to increase agriculture productivity (Sharma Vijay Paul 99)⁷⁷. In the process of farmer's empowerment, Fertilizer Industry became a conduit for subsidization of fertilizer consumption due to administrative problem of disbursement of subsidy to over 110 million cultivators inhabiting more than 6 million villages spread over length & breadth of country having mass of 327 million hectares⁷⁸. The vestige of the present system of

⁷⁴ Dr. Gupta Uttam: "Fertilizer Subsidy: The Inevitable Monster: Concept Agrotech Consultants Limited, New Delhi publication.

⁷⁵ Ibid

⁷⁶ Agriculture Statistics at a Glance, 2002-03: Directorate of Economics & Statistics, Ministry of Agriculture, Government Of India.

⁷⁷ Vijay Paul Sharma, Domestic Support commitments Under WTO and their Implications for Indian Agriculture, Paper Presented in FAI seminar December 4-6 1999, New Delhi.

⁷⁸ Sup era Note 76.



defraying fertilizer subsidy to Indian farmer through Industry is traced to RPS, which became operative in 1977 pursuant to Marathe Committee set up in 1976⁷⁹. Under the said Scheme, Government of India started fixing MRP⁸⁰ for sale of fertilizers to keep them within affordable limit of the farmers and reimburse differential amount of production-cost of each unit (not favoured by the Marathe Committee) and MRP to Producers for ensuring economic viability of the sector. As per the demand –supply management, gap between the domestic production and demand is bridged through imports of Urea, Di-ammonium Phosphate (DAP) and requirement of Murate of Potash (MOP) is fully met by imports in absence of commercially known exploitable resources in the country. The consumption of the imported fertilizers is also subsidised on the basis of differential in MRP and landed cost of imported fertilizers. In addition manufacturers and importers are also reimbursed the cost of transpiration of the fertilizers.

The RPS achieved the twin objective of making fertilizers available to farmers at affordable prices, while offering 12% post tax return on net worth of the production unit to encourage investment in this sector so as to make India self reliant in production of food-grain and fertilizers (Prof. Hanumans Rao 98)⁸¹. Nevertheless it suffered the deficiency anticipated by the Marathe Committee that a system of unit- wise retention price would tend to create a vested interest in proving cost rather than in reducing them; in claiming escalation rather than finding ways and means of containing cost⁸². Though RPS was not the first best policy for effecting equitable income distribution or efficiency in resource allocation, it helped the government in abating erosion of farmer's income resulting from market failure due to subsistence farming and lack of rural marketing infrastructure. So, perhaps, India was left with limited choice for RPS in prevailing socio-

⁷⁹ Report of the Fertilizers Prices Committee (Marathe Committee) (Part I & II) (1978); Ministry of Petroleum, Chemical and Fertilizers, Government of India.

⁸⁰ Supera Note 51.

⁸¹ Infra Note 93.

⁸² Sup era Note 79.



economic conditions which obliged it to balance competing interest of farmers, interested in low sale price, and Industry always looking for increase in MRP. But this had a price. Fertilizers subsidy became the function of MRP fixed by the Government of India and Retention Price time quantum of production. So it kept on rising due to government's inability to raise the MRP in consonance with the rise in input costs of feedstock or intermediates and growth in fertilizers consumption in India. The subsidy jumped from Rs. 3.81 billion in 1981-82 to about Rs.51.85 billion in 1991-92⁸³. The ever-increasing food and fertilizers subsidy became an eyesore and subjected to adverse criticism at various forums.

However, in 1990-91, the country witnessed a historical shift from command economy to 'market economy' when Narasimha Rao Congress government launched the policy of economic liberalisation and reforms under the leadership of Dr. Man Mohan Singh⁸⁴. The new policy of economic liberalisation was presented as an only way to help out India from unprecedented economic crisis. Everyone saw large-scale debt formation and the difficulties of balance of payment system as a legitimate reason for a free market economy. Soon a belief system gained currency according to which economic growth and social equity was possible if foreign capital and technologies and rich industrial classes could collaborate for the globalization of India. The government quickly dismantled the regime of discretionary control over private investment in industries and trade⁸⁵. The requirement of licensing for investment was eliminated. As per the Industrial Licensing Policy of July, 1991, no more licenses were required for setting up a chemical fertilizer unit⁸⁶. And finally constrained by the mounting fiscal deficit and foreign exchange crisis in 1991, the government announced an increase of 40% in the fertilizers prices in July

⁸³ Sup era Note 77.

⁸⁴ Singh Parmanand, State, Market and Economic Reforms, Delhi Law Review, Volume XVII, 1996.

⁸⁵ Ibid

⁸⁶ Gazette Notification No. S.O. 477 (E), Ministry of Industry, Deptt. of Industrial Development dated 24th July, 1991



1991. However, the prices of the Urea were rolled back by 10% almost immediately⁸⁷. Low analysis fertilizers were decontrolled in the same month. In December 1991 a Joint Parliamentary Committee (JPC)⁸⁸ was set up to revive the existing system of the computation of the unit prices and suggest the ways to reduce the fertilizers prices. The committee submitted its report in August 1992 and, inter alia others, concluded that rise in subsidy had been mainly due to rise in prices of inputs, which were not reflected in farm gate prices and increase in the cost of imported fertilizers. The committee recommended decontrol of imported fertilisers and accordingly Phosphatic and Potassic fertilizers were decontrolled with effect from 25.8.1992⁸⁹. The imports of Potassic and Phosphatic fertilizers were decanalised by placing them on Open General Licence (OGL). However this step depressed the domestic production as imports were cheaper but surge in domestic prices of these fertilizers forced the government to introduce scheme of ad-hoc-concession of Rs.1000/ per tonne on sale of both domestic and imported DAP and MOP⁹⁰. But soon concession on imported DAP was withdrawn in 1994 to foster protection to domestic Industry. But this did not help congress government to improve its image of anti farmer and consequently was voted out of power. So the new coalition government, taking a lesson, increased concession to Rs.3750 per tone on domestic DAP and Rs.2250 on imported one in April 1997⁹¹, ostensibly for improving skewed NPK consumption resulting from negligible increase in urea prices. This decision of the government led the subsidy amount to frog-leap from Rs.51.85 billions in 1991 to Rs.113.88 billions in 1998-92 comprising Rs.73.60 billions on indigenous urea, Rs. 2.38

⁸⁷ Infra Note 93.

⁸⁸ Report of the Joint Committee on Pricing, Tenth Lok Sabha (1992): Government of India.

⁸⁹ Gazettes Notification No. S.O.642 (E) dated 25.08.1992 regarding decontrol of potassic and phosphoric fertilizers, issued by the Department of Agriculture & Co-operation, Government of India.

⁹⁰ Infra Note 93.

⁹¹ Ibid



billion on imported urea and Rs.37.90 billions on the sale of decontrolled fertilizers (Government of India 1999)⁹².

In view of the rising subsidy and criticism of RPS, Government appointed a High Powered Committee under the chairmanship of noted economist Sri, C.H.Hanumantha Rao in January 1997, to review the existing system of subsidization of the Urea and correct the shortcomings of the RPS⁹³. The said committee submitted its report in April 1998 and recommended Long Run Marginal Cost (LRMC) for working out Normative Referral Price (NRP), subject to periodical revision, to adopt Group based pricing system for urea in place of Unit based one. The Committee favoured fixation of sale prices by the producers while putting ceiling on MRP to ensure subsidy benefits are passed to farmers⁹⁴. However government did not accept the recommendation of the committee and appointed Economic Reforms Committee (ERC)⁹⁵, which also suggested Group Pricing to phase out RPS and decontrol of the Urea. The Committee held the view that RPS served the purpose of attracting the investment and encouraging the use of chemical fertilizers and so government support should be gradually withdrawn by periodical increase in urea price. The ERC's view that green revolution technology is now widely accepted and the need to subsidized fertilizers to induce farmers to increase their usages has gone down⁹⁶, was a paradigm shift in nucleus of forces fixing the contours of public policies, but did not detour from the beaten path of improving the fiscal deficit. Unfortunately subsidies are not viewed as a part of public finance framework and principles but in a narrow perspective of reducing fiscal deficit⁹⁷.

⁹² Sup era Note 77.

⁹³ C.H.Hanumantha Rao, Fertilizer Pricing Policy, Report of the High Powered Review Committee, Department Of Fertilizers, GOI,

⁹⁴ Ibid

⁹⁵ Report of Economic Reform commission on Rationalising Fertilizer Subsidies, September 2000.

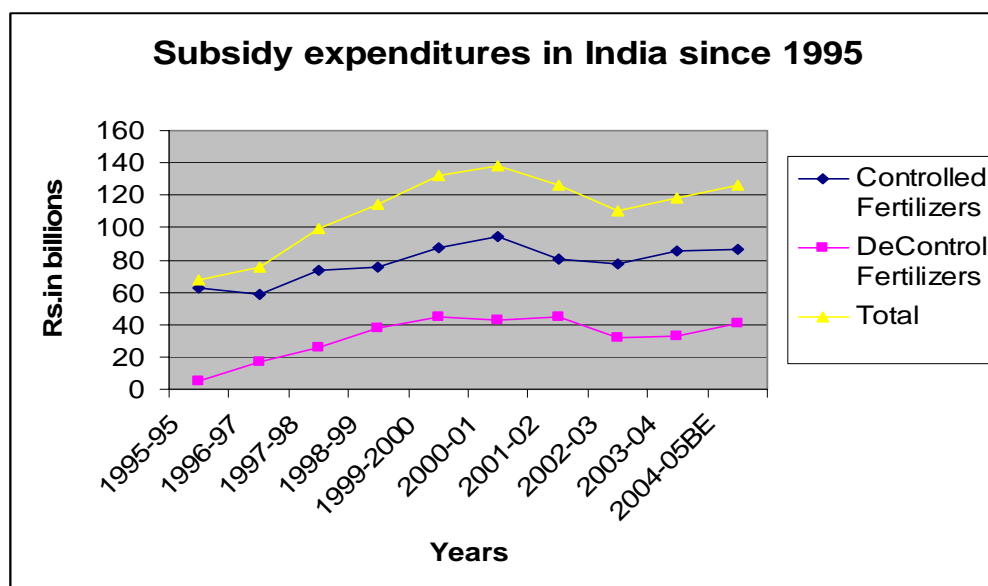
⁹⁶ Ibid

⁹⁷ Bhupati H. Desai; Theoretical And Policy Making Contributions of Research on Agricultural Economics: A Success or Fertilizer or Neither? Indian Economy in the New Millennium, Himalayan Publishing House, Mumbai



However, in pursuance of ERC recommendation, GOI adopted New Fertilizers Pricing Policy⁹⁸ to phase out RPS by Group Concession Scheme and all naphtha and Fuel/ LSHS based plant to switch over to Gas based technology.^{31st March, 2006.} Nevertheless government could not increase urea prices by 7% annually as suggested by the ERC. It buckled down under the pressure of farm lobby and consequently twice rolled back fertilizers price increase⁹⁹. Rs 250/-per tone increase in urea prices w.e.f. 28.2.2003 was later withdrawn w.e.f. 12.3.2003¹⁰⁰. However the damage control measures could not help the then NDA government led by Sri, Atal Bihari Vajpayee. It was also perceived as anti-farmers to be voted out of power in the recently conducted general election March-April 2004. Now the present Congress led UPA government of Dr. Man Mohan Singh is hesitant to increase fertilizers prices engendering increase in fertilizers subsidy bill, expected to touch Rs.170 billions in 2004-5 and may rise unabated in future. The following graph shows the fertilizers subsidy trend since 1995, the year of the commencement of the WTO and signing of SCM.

Figure 2.



(Source Annual Report 2003-04 Department of Fertilizers, Government of India).

⁹⁸ Sup era Note 57.

⁹⁹ Role-back of urea price increase-GOI-Budget proposal 2003-2004.

¹⁰⁰ Sup era Note 57.



From the aforesaid figure of rising bill of subsidy it is inferred that both Industry and Farmers want protection against crusading market forces¹⁰¹. Industry want level-playing field with urea exporting countries, on account of low-priced gas feedstock offered to them by their respective government to enable exporters to manoeuvre prices at international market in consonance with demand-supply fluctuation. Indian urea producers have to buy gas at market prices¹⁰² and thus are incapable to compete with foreign supplier at equal footing. So they need some protection. Similarly, Indian farmers need protection as developed countries keep on restricting import of agro-products from developing countries, while providing high domestic support to agriculture and heavily subsidising their export to depress agro-prices at international market¹⁰³ and there by dissuading the farmers of developing countries to grow more. Besides, increased production at diminishing rate¹⁰⁴ and inefficient post harvesting treatment increase the cost of production and erode their purchasing power and competitiveness. So farmers want some protection against market forces. In this perspective, any move to reduce governmental assistance in terms of subsidized inputs will not be a welcome proposition.

Both RPS and Group Concession Scheme (NPP) are alive to the concern of Industry & farmers. However, both envisage Industry as a conduit for fertilizer subsidisation and wish to continue the present system of reimbursing Industry the amount equivalent to differential in cost of production and M.R.P. fixed by the government in view of affordability of farmers. But this approach has never been free from blemish of unwarranted favour to a class of farmers and inefficient unit of production. Since fertilizers usage is much dependent on availability of water/irrigation, the fertilizers

¹⁰¹ U.S.Awasthi: Impact Of The Policy On The Health Of Urea Industry, 'Fertilisers And Agriculture' F.A.I.Seminar December 2002, New Delhi.

¹⁰² Fertiliser Situation In India-Policy Changes In The Hydrocarbon Sector, Fertiliser News December 2001, F.A.I., New Delhi.

¹⁰³ Sup era Note 77.

¹⁰⁴ Super Note 97.



subsidisation has benefited greatly to paddy and wheat growers in irrigated areas which comprises only 40% of the gross cultivated area of 189.74 million hectare of the land¹⁰⁵. So N.P.P. like RPS will remain in vortex of criticism for helping big farmers particularly wheat & rice growers at the cost of others¹⁰⁶. And it may not be possible for the government to withdraw fertilizers subsidy altogether in view of strong farm lobby and their dominant role in Indian polity. Similarly Naphtha and Fuel Oil/ LSHS based urea producers, with high production cost, will continue to lobby for continuation of the existing system of subsidisation to protect them from exogenous competitions. So it may be a matter of research to devise ways for using subsidy as an instrument of public finance to help farm community without violating the WTO commitment.

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¹⁰⁵Fertilizer Statistics, 2002-2003, The Fertilizer Association of India, New Delhi.

¹⁰⁶ Prem S.Vashishtha: Prospect Of Fertiliser Sector In The Next Decade, Fertiliser & Agriculture Future Direction, December 2001,New Delhi.FAI



PART VII

WTO CONSISTENCY OF INDIAN FERTILIZER POLICY

A new global constitutionalism has been brought in mainly through WTO and its multilateral agreements. Agreement on Subsidies and Countervailing Measures (SCM) read with Agreement on Agriculture (AA) has introduced a new rule-based legal regime of subsidies and countervailing measures (Koul 99)¹⁰⁷. How far Indian Fertilizers Policy is consistent with its WTO obligation is examined under relevant provisions of the following Agreements.

1. General Agreement on Tariff and Trade 1994 (GATT 94):

(i) Most Favored Nation Treatment:

The embryonic New Pricing Policy (NPP)¹⁰⁸ for urea manufacturers, has sprouted from the womb of unit based Retention Pricing Scheme (R.P.S.)¹⁰⁹, which raised country's annual urea consumptions to over 20 million tonnes¹¹⁰. The NPP like its predecessors intends to subsidise urea consumption through Fertilizers Industry and bridge demand –supply gap through imports without discriminating or favouring any particular source of fertilizers. The producers and importers have to sell urea at MRP (Rs.4830/per ton) fixed by the government. The differential of groups' *production cost, which ranges from Rs.5159 of gas based plant (KRIBHCO) to Rs.14686-naptha based plant (MFL-Madras), and MRP (Rs.4830/ per ton) is reimbursed to them*¹¹¹. *In case of imported urea the difference of landed price, which is currently around Rs. 13000/pe ton and MRP of Rs. 4830/per ton is reimbursed. All most the same principle is adopted for subsidisation of decontrolled fertilizers, but rate of subsidisation*

¹⁰⁷ Koul A.K.- The Legal Regime of Subsidies and Countervailing Measures in World Trade Organization (WTO)- Delhi Law Review-Volume XXI: 1999.

¹⁰⁸ Sup era Note 57.

¹⁰⁹ Sup era Note 38.

¹¹⁰ FAI statistics Book 2003-04. Fertilizer Association of India, 10 Saheedjit Singh Marg, New Delhi.

¹¹¹ FICC/CE/72-2003/164 dated 28-5-2003. Notification issued by the FICC, Department of Fertilizers,GOI.



is periodically updated in consonance with price fluctuation at international market. The current MRP of DAP is Rs.9350/per ton and the subsidisation rate is Rs. 4215/per ton of indigenous DAP and Rs. 3843/per ton of imported DAP¹¹². There is no restriction on sourcing of the imports. But does it passes the litmus test of non-discrimination, as stipulated under the principle of MFN enshrined in Art. I of the GATT 94 is subject of evaluation. The MFN obligation requires Member States to treat all the goods coming from other WTO Members on equal terms and accord immediately and unconditionally the privilege, favour or advantage granted to the product of one country to the products of other Member states¹¹³. So absence of any embargo on import of decontrolled fertilizers (DAP/MOP) on private trade account or controlled fertilizer (urea) by the nominated State Trading Agencies and equal subsidisation are in conformity with the MFN obligation. However, import of urea from M/S Oman India Fertilizer Company (OMIFCO) by M/S IFFCO and KRIBHCO on pre-fixed rate, as guaranteed by the government of the India, may not be so. India is importing Urea through nominated State Trading Agencies, who are to operate on commercial considerations. These State Trading Agencies buy urea through open tenders on lowest quotation basis. They move it as per the movement orders issued by the government and sell it at notified MRP¹¹⁴. The differential in landed cost of urea and MRP is reimbursed to them. So if these Agencies are forced to import urea from M/S OMIFCO at prefixed rate, *if the same being higher than the then prevailing prices at international market, they may run the risk of violating the principle of commercial considerations.* This may amount a favour to the product (urea) coming from Oman and thus constitute infringement of MFN obligation, only if it is purchased at higher price as compared to prevalent prices at international prices. And even if IFFCO & KRIBHCO are notified as State Trading Agencies to bring Urea from M/S OMIFCO to India, such imports

¹¹² S-5/2004-Shiping issued by the Department of Fertilizers, Ministry of Chemical of Fertilizers, GOI.

¹¹³ Art.I:1 of GATT 94.

¹¹⁴ Sup era Note 45 and 48.



will contravene the pronounced scheme of Urea import¹¹⁵ being denial of equal opportunity to other Urea Producers. Besides, in such a situation, government may be forced to subsidise urea import from Oman India at higher rate compared to import from other sources of Middle East Asian Countries. This is MFN violation as imported urea from Oman India and from other countries being 'like product' will not be treated alike¹¹⁶. The underline principle of non-discrimination was explained by the Appellate Body in *Canada – Autos* "Th[e] object and purpose [of Article I] is to prohibit discrimination among like products originating in or destined for different countries. The prohibition of discrimination in Article I: 1 also serves as an incentive for concessions, negotiated reciprocally, to be extended to all other Members on an MFN basis."¹¹⁷ In this case the Appellate Body found the prohibition of discrimination under Article I: 1 includes both de- jure and de facto discrimination. This view was also taken in *EC-Banana III case*. The AB also held that the Canadian import duty exemptions granted to motor vehicles originating in certain countries were inconsistent with Article I: 1. This approach was accepted by the Panel in *Indonesia – Autos* when it held that the exemption of import duties and sales taxes to those automobiles which met certain origin-neutral requirements was inconsistent with Article I:1¹¹⁸. On this analogy import from Oman India at price higher than prevailing at international market may entail de-facto favor on account of higher subsidization compare to imported urea from other sources. This will be violation of the MFN as the measure may not accord the same treatment immediately and unconditionally to like urea import from all other Members, as required under Article I: 1 of the GATT 1994. So India will be failing in fulfilling its obligation under Art.1:1 of GATT94, which says '...any advantage, favour, privilege or immunity granted by any member to any product originating or destined for any other member shall be accorded immediately and

¹¹⁵ Sup era Note 64.

¹¹⁶ Japan Alcoholic beverage case, and also see EU-Asbestos case

¹¹⁷ WTO ANALYTICAL INDEX: GATT1994, General Agreement on Tariffs and Trade 1994.accessed on 28.8.2004, www.wto.org.

¹¹⁸ Ibid.



unconditionally to the like product originating or destined for the territories of all other member states'. However, some may say that most of the urea exporters are adopting dual feed stock pricing policy to supply cheaper gas to their domestic urea producers and are not the members of the WTO, so no breach of any privilege flowing to Members under the GATT94. But this argument is not tenable as Saudi Arabia will soon be joining the WTO. Russia as well other erstwhile member countries may also accede to the WTO. Besides, Members are obliged to discharge their obligation by virtue of their own WTO membership and not because of others. Nevertheless, India can negotiate the issue of dual gas pricing with these countries at the time of negotiating their accession to the WTO to safeguard the interest of its domestic urea producers.

One vantage point may be that urea import from Oman India is government procurement. Article I: 1 of Agreement on Government Procurement (AGP)¹¹⁹ provides that this Agreement applies to any law, regulation, procedure or practice regarding any procurement by entities covered by this Agreement, as specified in Appendix I. Since India is not the signatory of the Agreement on Government Procurement (AGP), it is not constrained to follow MFN obligation in government procurement. But protagonist of this theory forgets that *MFN obligation as stipulated under Art. I of GATT 94 do not have any such exception.*

(ii) National Treatment:

The principle of national treatment, Article III of GATT94, is of fundamental importance in succession of MFN to ensure non-discriminatory treatment to imported products after their entry in the importing country. The MFN treatment puts the products of all trading partners on equal terms with one another, whereas the principle of National Treatment equates those products with the 'like products' of the importing country itself. It says that once imports have passed the national frontier (and in so doing have paid whatever import duty is imposed) they must be accorded treatment 'no less favourable than like products of national origin in

¹¹⁹Agreement on Government Procurement, World Trade Organisation: The legal Texts, The Results of the Uruguay Round of Multilateral Trade Negotiations. See also Panel Report on *Korea - Measures Affecting Government Procurement* (WT/DS163/R) WorldTradeLaw.net Dispute Settlement Commentary (DSC), © 2001 WorldTradeLaw.net LLC



respect of all laws, regulations and requirement affecting their sale or offering of sales, transportation, distribution, purchase or use'¹²⁰. However, *the NPP will favour domestic urea over imported urea, as latter will be marketed under ECA allocation¹²¹, whereas part of indigenous urea will be sold in free market¹²². Thus it will deny national treatment to urea importers*, despite being like domestic urea, in managing their distribution and development of stable market net-work. In addition NPP and Concession Scheme will continue to discriminate consumption of imported Urea and DAP over like domestic product by way of differential subsidies¹²³. This will be violation of the national treatment as like products are to be treated alike held in *Japan Alcoholic Beverage case¹²⁴*. The subsidisation of domestic production at differential rate, ensuring reasonable returns, gives added advantage to domestic producers who can afford to discount MRP in depressed market condition to maintain their share or liquidate their production. On account of discounts, as per a rough estimate, Indian Fertilizers Industry had lost, on an average, Rs.6-.7 billions per year during last few years. But Urea/DAP importers cannot indulge in price war in absence of assured returns as import subsidisation is function of the landed cost and MRP. The landed cost need not to ensure reasonable returns. Thus differential subsidy hurt importer in depressed market and pre-fixed MRP does not allow them to get compensated in buoyant market. Thus New Pricing Policy is not consistent with India's commitment to Paras 4 and 9 of Art.III of the GATT Nevertheless in the light of the Para 8(a) of Art.III of GATT 94, it may be argued that Urea imports being government purchase are out of the purview of national treatment of Art.III of GATT 94. But the government of India is not the end users of these purchases and the same are traded in the open market. So it may not satisfy the conditionality of the government procurement as stipulated in Para 8(a) of Art.III of the GATT 94. Similarly National Treatment exception of Para 8(b) of Art.III of GATT 94 will not be

¹²⁰ Art.III of the GATT 94.

¹²¹ Sup era Note 46 and 57.

¹²² Sup era Note 57.

¹²³ Subsidy on domestic production is higher than subsidy on imported urea due to low prices at international market. Subsidy on imported fertilizer is equal to amount of differential of landed cost of imported urea and M.R.P. fixed by the government. On domestic product it is equal to differential of groups average cost of production and M.R.P. fixed by the government.

¹²⁴ Sup era 116.



applicable on account of subsidy being extended to both domestic and imported fertilizers; whereas this clause protect exclusive subsidisation of domestic industry.. Besides, this exception protects against the violation of the national treatment and not from the other provisions of the General Agreement or the Agreement on SCM.

One may also argue that as per the Art.XVIII:3 of the GATT 94, Developing Countries are permitted to deviate temporarily from the provisions of the General Agreement to grant the government assistance required to promote the establishment of a particular industry with a view of raising general standard of living of its people. But Para 4(a) of the Art.XVIII of the GATT 94 limits this right by qualifying that a Member, the economy of which can only support low standards of living and is in early stage of development, shall be free to deviate temporarily from the other Articles of this Agreement. And for that a Member who falls in the category of 4(a) has to take recourse provided in Para 13 by notifying requirement as per Para 14 which meets the objectives of Para 13 of Atr.XVIII of the GATT 94. Since Indian economy does not satisfy this conditionality, it may not be entitled to claim exemption from the MFN and National Treatment obligation.

(iii) Publication and Administration of Trade Regulations:

W.T.O. aims at achieving transparency in International trade relations by obligating members to notify changes in their trade regulations affecting sales, distribution, and transportation etc.¹²⁵ with the objective of enabling governments and trade to become acquainted with them. New pricing policy demonstrates government's intent to bring transparency in fertilizer sector by removing bureaucratic clutches and cobwebs clouding R.P.S. The group based concession is certainly an improvement over unit based R.P.S. which has always been criticised for being cost plus¹²⁶ and favouring inefficiency¹²⁷. New policy will give weight age to energy consumption norms, but it will still have some frills of RPS due to subjective interpretation in

¹²⁵ Art.X of the GATT 94.

¹²⁶ Sup era Note 93.

¹²⁷ Sup era Note 95.



fixing energy norms, calibrating escalation/de-escalation in variable costs and modulation of groups in stage –II on account of reduction in capital related charges. The policy is short of detailing complete road map for reforming fertilizer subsidy. It intends to review the experience of stage I&II to spell out future course. So transitory nature of the new policy may keep the industry in lurking doubts and fail to induce fresh investment in the fertilizer sector. Besides, new policy may be criticised for exhibiting derisory lack-lustre approach in tackling the subsidy issue as per WTO commitment, while leaving scope for desirable steps to instil much needed confidence and certainty in fertilizer sector¹²⁸.

(iv) General Elimination of Quantitative Restrictions:

Member states are obliged to refrain from imposing quotas, licences or other measures, except duties or taxes, restricting import or export or sale of any product from or to any other member states¹²⁹. Since New Pricing Policy does not accord indigenous urea producers a right to export freely, it is contrary to the obligations of Art.XI of the GATT. However the Producers of the decontrolled fertilizers are now free to export their product, on observance of some conditions, without prior approval of the government of India. Thus Indian Fertilizers Policy for controlled fertilizers is inconsistent with the provision of Art.XI of the GATT 94.

(v) State Trading Enterprises:

Exim policy (1st April, 1997-31st March, 2002)¹³⁰ was in discharge of India's obligation to W.T.O. principle of free trade and removal of trade barriers¹³¹. Consequently India removed Quantitative Restriction (QR) on imports of urea on government account but restricted urea import through nominated State Trading Agencies¹³² to protect domestic industry. These agencies are to make purchases or sales, involving imports or exports, solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation

¹²⁸ U.S. Jha, Future Outlook Of Fertilisers Marketing In India, Fertilisers & Agriculture Future Direction, December 2001, New Delhi, FAI.

¹²⁹ Art.XI of the GATT 94.

¹³⁰ Sup era Note 63.

¹³¹ Art.XI of the GATT 94.

¹³² Sup era Note 63.



and other condition of purchase or sales. These enterprises shall act in a non-discriminatory manner and shall afford the enterprises of other countries adequate opportunity, in accordance with customary business practice, to compete for participation in such purchase or sale¹³³. In this context, New Pricing Policy (N.P.P.) may draw flak. First, it has not agonized about whether imported urea will be marketed freely on commercial consideration as proclaimed in Exim. Policy or continue to slog under E.C.A allocation system in violation of Article III of GATT94, requiring member countries to give national treatment to imports. Secondly, urea importing State Enterprises will remain dependent on government assessment about the need of import rather than banking on commercial considerations, which are deeply entwined with the rate of concession and marketing area, assigned to state enterprises through allocations and movement orders¹³⁴ under EC Act. Thirdly, the import of urea from M/S Oman India Fertilizers Company at pre determined rate may be a violation of the provision of Art.XVII of the GATT 94 with regard to State Trading Agency, which are to operate on commercial considerations. If arrival of Oman India product is to be treated as import, it has to be routed through State Enterprises bound to operate on commercial consideration. In that case, how will imported urea from Oman India, if the then obtaining prices at international market are lower than long term buy back prices, as agreed under Oman India agreement, be purchased by State Enterprises supposed to operate on Commercial considerations. Similarly, the view that government imports are in accord with GATT 94 obligations and India is not a signatory of Agreement on Government procurements is also a moot point. But propagators of this view tend to overlook the facts that the end users of urea are Indian farmers and not the government of India per-se, which acts only as facilitator for imports. So, in the light of Art.31 of VCLT, a harmonious interpretation may not tend to treat urea imports as a commodity for government consumption within the stipulation of government procurements under Article III: 8 (a) of GATT 1994 and keep them away from the sweep of

¹³³ Sup era 63 & 64.

¹³⁴ Urea importing State Trading Agency are authorised to move and sell urea in a particular state during specific time period through movement orders & allocations issued by the Department of Fertilizer, Government of India,



national treatment. Besides, some may say that Middle East and erstwhile Russian Block Countries are not the member of the W.T.O., so import from Oman India will not be violative of provisions of State Trading Agency as enshrined in Art.XVII of GATT 94. Champion of this view should not negate the fact that all these countries are be-lining to become member¹³⁵ of the WTO; it is only a matter of time. But why do we forget that members are obliged to ensure conformity of their laws, regulations and administrative procedure by virtue of Para 4 of the Art.XVI of the WTO Agreement and not on the basis of the WTO membership of any country.

(vi) Subsidies:

GATT 94, Art. XVI neither defines nor prohibits subsidy as such. It only says that if any member grants or maintains subsidy to promote exports or reduce imports, it has to notify the effect of such subsidy. And if it causes or threatened to cause serious prejudices to the interest of any other Member, it will consult, on request, with the other Members the possibility of limiting such subsidisations. Since a separate Multilateral Agreement of Subsidy (SCM) has been concluded and in case of any conflict with general agreement covered agreement will prevail¹³⁶, the subsidy aspect will be examined under SCM.

2. Agreement on Subsidies and Countervailing Measures (SCM):

The Agreement on Subsidies and Countervailing Measures (SCM) is intended to build on the Agreement on Interpretation and Application of Articles VI, XVI and XXIII which was negotiated in the Tokyo Round¹³⁷. For the first time, ‘Subsidy’ was defined as *benefit conferred by the financial contribution by the government or governmental body operating within the territory of the Member State conferring the benefits*¹³⁸. This was confirmed by the Appellate Body in US-FSC case, when it said that “Article 1.1 sets forth the general definition of the term ‘subsidy’ which applies ‘for the purpose of this Agreement’”. It also introduces the

¹³⁵ ArunGoyal, Noor Mohd.-WTO in the new Millennium, 5th Edition: September, 2001, Academy of Business Studies, 24/866Sheeltara House, Ansari Road, New Delhi. Saudi Arabia one of the major Urea exporter may become member of the WTO by the end of the 2004.

¹³⁶ Annex 1A, WTO Agreement.

¹³⁷ WTO analytical index: SUBSIDIES & COUNTERVAILING MEASURES, Agreement on Subsidies and Countervailing Measures, accessed on 28.8.2004, www.wto.org accessed on 24.8.04.

¹³⁸ Art.1 of the Agreement on SCM.



concept of a "specific" subsidy - for the most part, a subsidy available only to an enterprise or industry or group of enterprises or industries within the jurisdiction of the authority granting the subsidy¹³⁹. Only specific subsidies would be subject to the disciplines set out in the agreement and will be prohibited if 'contingent on export performance' or 'contingent upon the use of domestic over imported goods'¹⁴⁰. All other specific subsidy may be actionable under Art.5 of SCM if it causes adverse effects to the interests of other signatories, i.e. injury to domestic industry of another signatory, nullification or impairment of benefits accruing directly or indirectly to other signatories under the General Agreement and serious prejudice to the interests of another member. "Serious prejudice" shall be presumed to exist for certain subsidies as per Art.6 of the SCM. In such a situation, the burden of proof is on the subsidizing member to show that the subsidies in question do not cause serious prejudice to the complaining member. The agreement also recognizes that subsidies may play an important role in economic development programmes of developing countries, and in the transformation of centrally-planned economies to market economies. Least-developed countries and developing countries that have less than \$1,000 per capita GNP are thus exempted from disciplines on prohibited export subsidies¹⁴¹.

Do the New Pricing Scheme for urea and Concession Scheme for decontrolled fertilizers confirm 'benefit' on Indian Fertilizers Industry to constitute subsidy as per the provisions of the SCM? To analyse and comprehend it better, it will be germane to revisit the concept of fertilizers demand supply mechanism in India. Indian Fertilizers policy intends to ensure reasonable returns to encourage investment in fertilizers sector to increase fertilisation by offering it to Indian farmers at affordable prices. So its anatomy comprises (a) reasonable return (12% on net worth), (b) affordable price (MRP), and transportation and distribution cost¹⁴². To achieve the purpose, differential in MRP fixed by the government and cost of production,

¹³⁹ Art 1:2and Art 2 of the Agreement on SCM, and also see sup era 137.

¹⁴⁰ Art.3:1 of the Agreement on SCM.

¹⁴¹ *ibid*, see also Art 27 of SCM Agreement

¹⁴² Sup era Note 57.



including reasonable return, is paid by the fertilizers Coordination Committee (FICC), Department of the Fertilizers, Government of India, to industry along with normative transportation and distribution cost¹⁴³ which always lag behind the actual expenditures incurred by the industry. Before examining which of the component amounts to financial contribution by the government of India conferring benefit on recipient, it will be relevant to have a look what WTO jurisprudence says about subsidy as defined in SCM.

The Panel in *Canadian Aircraft case* noted that SCM Agreement Article 1 provides that a "subsidy" exists when there is a "financial contribution" by a "government or any public body within the territory of a Member" that confers a "benefit." (Para.9.96)¹⁴⁴. Examining the ordinary meaning of the term "benefit," the Panel stated that "benefit" refers to an "advantage" to a recipient and not to the net cost to the grantor. This advantage, the Panel said, is made in comparison to the position the recipient would have been in absent the financial contribution. Accordingly, a financial contribution confers a "benefit" *if it is provided on terms that are more advantageous than those that would have been available to the recipient on the "market."* The Panel further observed that the context provided by SCM Agreement Article 14, which sets out guidelines for calculating "the benefit to the recipient conferred pursuant to paragraph 1 of Article 1," supports this interpretation, as these guidelines rely on a commercial benchmark that examines whether the terms are more advantageous than those available on the commercial market. (Paras 9.111-113) On appeal, the Appellate Body upheld the Panel's finding¹⁴⁵.

If in the light of WTO jurisprudence we analyze the aforesaid components of the Indian Fertilizers Policy, it is understood that payment of differential amount of MRP(Rs.4830) and Cost of production (ranging from Rs.5159 to Rs.14686) in case of urea or higher rate of concession to domestic DAP manufacturers(Rs.4215 compared to Rs3842 for imported DAP) is a financial contribution conferring benefit to industry, as it ensures a reasonable return to

¹⁴³ Ibid

¹⁴⁴ Panel Report of Canada - Measures Affecting the Export of Civilian Aircraft (WT/DS70/R), WorldTradeLaw.net Dispute Settlement Commentary (DSC) © 2001 WorldTradeLaw.net LLC, accessed on 24.8.04.

¹⁴⁵ Ibid



industry which otherwise may not necessarily accrue in market driven economy. The fertilizers importers are subsidized on the basis of landed imported cost, which vacillate with the price fluctuation depending on international demand-supply scenario, minus MRP. So they may not get reasonable return on their net worth as is the case with Indian fertilizers producers. Since comparative advantage is the essence of 'benefit', the differential rate of subsidization amounts 'benefit' and provide Indian Fertilizers Industry a comparative advantage. This view is also supported by the Panel on *US – Lead and Bismuth II* when it said “[T]he existence or non-existence of ‘benefit’ rests on whether the potential recipient or beneficiary, which ‘logically’ must be a legal or natural person, or group of persons, has received a ‘financial contribution’ on terms more favourable than those available to the potential recipient or beneficiary in the market...”¹⁴⁶. Do Indian producers have more favourable terms? At current ruling prices of urea at international prices, the landed cost of urea is coming around Rs.13000/per ton, which is greater than domestic cost of all gas based plants(ranging from Rs.5159- 6573) as well most of naphtha based plants(Rs.12554). So they can very well argue that their return will be far better if allowed to sell in the open market and thus no benefit is conferred on them. In that case government assistance may not amount 'benefit' to those units which are having lower cost of production compared to delivered cost of imported urea, but it will certainly be a 'benefit' to those who can not survive but for the government contribution. *Such government contribution will amount advantage and be treated as subsidy under Art.1 of the SCM.*

Some may argue that urea procurement is basically government purchase for ensuring timely availability to farmers at affordable price through Industry, due to administrative convenience and exigencies, and no 'benefit' is conferred on Indian Fertilizers Industry. But even if it is considered as government purchase, for the sake of discussion, it may amount financial contribution as held by the Appellate Body in *US lumber Case*, while examining Article 1.1(a)(1)(iii), that there is a financial contribution where "a government provides goods or

¹⁴⁶ WTO analytical index: SUBSIDIES & COUNTERVAILING MEASURES, Agreement on Subsidies and Countervailing Measures.



services other than general infrastructure, or purchases goods." (Paras. 50-53)¹⁴⁷. The benefit to recipient differs from the cost to government as was the view of the Panel in *Canadian Aircraft case* "The structure of Article 1.1 as a whole confirms our view that Article 1.1(b) is concerned with the 'benefit' to the recipient and not with the 'cost to government'..."¹⁴⁸ For the existence of the subsidy actual transfer of the fund from the government is not necessary in the view of the Panel on *Brazil – Aircraft case* when it held "[A]ccording to Article 1:1 (a)(i) a subsidy exists if a government practice involves a direct transfer of funds or a potential direct transfer of funds and not only when a government actually effectuates such a transfer or potential transfer..."¹⁴⁹ Since both NPP and Concession Scheme do involve direct transfer of the fund from the government to Fertilizers Industry, it constitute subsidy within the definition of the Art.1:1 of the SCM. But the fixation of the MRP cannot be termed as financial contribution and consequently does not confer any benefit amounting to subsidy. Similarly, reimbursement of the transportation cost on normative basis, despite being a financial contribution, may not be construed as 'advantage' to the recipient because these *terms are not more advantageous than those that would have been available to the recipient on the "market"*¹⁵⁰ so no benefit within stipulation of the Art.1:1 of the SCM.

The implication of the subsidy is explained in Art.1:2 SCM, which says that a subsidy as defined in paragraph 1:1 shall be subject to the provisions of Part II (prohibited) or Part III/IV (actionable/non-actionable) if it is specific in accordance with the Art.2 of the SCM.

Now let us examine whether it is specific in nature as required by the Art.1:2 of the SCM. Art 2:1 of the SCM explains that in order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries within the jurisdiction of the granting authority, following principles, shall apply¹⁵¹:

¹⁴⁷ Appellate Body Report, *United States - Final Countervailing Duty Determination With Respect To Certain Softwood Lumber From Canada*, (WT/DS257/AB/R) WorldTradeLaw.net Dispute Settlement Commentary (DSC) © 2004 WorldTradeLaw.net LLC

¹⁴⁸ Sup era 144.

¹⁴⁹ Sup era Note 146.

¹⁵⁰ Sup era 144.

¹⁵¹ Sup era Note 146.



(a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.

(b) Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions **(2)** governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.

(footnote original) **2** Objective criteria or conditions, as used herein, mean criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise.

(c) If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.**(3)** In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation.

(footnote original) **3** In this regard, in particular, information on the frequency with which applications for a subsidy are refused or approved and the reasons for such decisions shall be considered¹⁵².

¹⁵² Ibid



A perusal of the above mentioned Article 2:1 of the SCM Agreement reveals that Paras a-c use the phrase ‘subsidy to certain enterprises’ rather the phrase ‘subsidy specific to an enterprise or industry or group of enterprises or industries’ as deployed in its chapeau of the said Article. This does not mean that the principles, as laid down in Paras a-c of Art.2:1 of the SCM, are not applicable to ‘industry’. But in the light of Art.31 of the VCLT¹⁵³, a harmonious contextual meaning of the word ‘enterprise’ should also encompass the phrase ‘industry’. So, taking the broader meaning of ‘enterprise’ used in Para (a) of Art.2:1, it is inferred that financial assistance of the government of India under NPP for urea and Concession Scheme for potassic and phosphoric fertilizers is specific to fertilizers industry within the meaning of Art.2:1 of the SCM Agreement, as the same is not available to other industries.

Now it is clear that Indian Fertilizers Policy does have component of specific subsidy .Is subsidy specific to Fertilizers Industry a prohibited or actionable?Art.2:3 of the SCM Agreement explains that any subsidy falling under the provisions of Article 3 shall be deemed to be specific. The Art.3:1 of the SCM says that except as provided in the Agreement on Agriculture, the subsidies, within the meaning of Art.1, shall be prohibited (a) if it is contingent, in law or in fact, whether solely or as one of several other, upon export- performance, or (b) upon use of domestic over imported goods. Such subsidy shall neither be granted nor maintained by a Member as per the provision of the Art.3:2 of the SCM Agreement. So the ***determinant factor for prohibited is the contingency of the subsidy either on export performance or use of domestic goods over imported one.***

The ordinary connotation of ‘contingent’ is ‘conditional’ or ‘dependent for its existence on something else’. Regarding the interpretation of the term “contingent ... in fact”, the Panel in *Australia – Automotive Leather II* established a standard of “close connection” between the grant or maintenance of a subsidy and export performance¹⁵⁴. The ‘contingency’ in Art.3:1(b) is not only confined to de-jure (law) as was the view of the Panel in *Canada – Autos*

¹⁵³ The Vienna Convention on Law of Treaties.

¹⁵⁴ Sup era Note 146.



but also *extend to de-facto* situation as was finally held by the appellate Body¹⁵⁵. On application of this meaning of ‘contingent’ it is found that reimbursement of concession amount to domestic producers of phosphoric fertilizers under Concession Scheme and payment of differential cost of production and MRP to urea manufacturers under NPP is contingent upon sale of fertilizers to domestic farmers. The sale of fertilizers to domestic farmers is the eligibility conditions for payment of subsidy. Thus payment of subsidy has ‘close connection’ with the sale of fertilizers to domestic users and so contingent on use of domestic goods over imported. However it can be argued that the phrase ‘domestic use over imported goods’ in Art.3:1 (b) of the SCM mean subsidy is contingent on use of domestic input for the production of the goods. So to fall within the purview of prohibited subsidy, as being contingent on use of domestic goods over imported one, it has to be administered on input basis and not out basis. Since Indian Fertilizers Subsidy is an output based subsidy and not input based as stipulated within the meaning of Art.3:1 (b) of the SCM, it cannot be categorised as prohibited subsidy. But this will be a narrow view of ‘contingent on use of domestic over imported one’. The essence of the subsidy is to confer advantage to domestic industry to protect it from outside competition and this causes market distortion by limiting market access to competitive like products. And in this sense it covers the output subsidy also if it is contingent upon domestic use. In this context it would be essential to refer the Panel, in *Indonesia – Autos case*, which was called upon to decide whether the Indonesian subsidies contingent upon the use of domestic over imported goods were specific: It observed “As with any analysis under the SCM Agreement, the first issue to be resolved is whether the measures in question are subsidies within the meaning of Article 1 that are specific to an enterprise or industry or group of enterprises or industries within the meaning of Article 2”¹⁵⁶. We have seen that subsidy is available only to fertilizers producers and so it is specific within the meaning of Art.2 of the SCM. However, India says that fertilizer subsidy is to the farmers and not to the industry and being (input-subsidy) a *non-product support* within the *de*

¹⁵⁵ Sup era Note 144.

¹⁵⁶ Sup era Note 146.



minimis of 10% of Agriculture value in case of developing country is permitted within Art.6.4 (b) of the Agreement on Agriculture. But as discussed somewhere else, domestic producers, assured of reasonable return, are better placed as compared to importers to discount the MRP, which induces Indian farmers to have preference for the domestically produced fertilizers over the imported fertilizers. Thus *de-facto* implication of the present subsidy regime is to encourage consumption of the domestically produced fertilizers over imported one. Since Art.3.1 (b) of the SCM Agreement cover both de-jure and de-facto situations, as held in *Canada Auto case*, Indian Fertilizers Subsidy falls within the category of prohibited one and so it should not be maintained as per Art.3:2 of the SCM. The argument of *de minimis* will be discussed in a moment.

Nevertheless, still it can be argued that as per the Art.27:3 of the SCM, developing country are entitled to Special and Differential (S&D) treatment and prohibition of Article 3 does not apply to them within certain time-periods from the date of entry into force of the *WTO Agreement*¹⁵⁷. As a consequence, subsidies contingent upon export performance and upon the use of domestic over imported goods are, when granted by qualifying developing country Members, merely be actionable rather than prohibited subsidies. As a result, these subsidies will be inconsistent with the *SCM Agreement* only if, interalia others, they are specific within the meaning of Article 2. Since India is a developing country and fall in the category of qualifying list of countries, it can legitimately grant subsidy till it is proved that it is prejudicial to the interest of other Members as it impede their exports to India. But advocates of this view will recall that the aforesaid exception was meant for a limited period of five years and that period has already expired. So this argument may not hold good.

3. Agreement on Agriculture:

Another defence may be that fertilizers subsidy is basically agro-input subsidy, which is administered through Industry. Art.3 of the Agreement on SCM is subject to

¹⁵⁷ For a period of five years prohibition of Art.3.1 (b) shall not apply to Developing Country Members.



Agreement on Agriculture(AA)¹⁵⁸, which permits conditional export subsidy and domestic supports to the extends of 10% of agriculture value in case of developing country like India. So fertiliser subsidy, being input support, cannot be termed as prohibited one. Since export subsidy is not our immediate concern, the discussion will be confined to domestic support only. Reference to relevant provisions of the Agreement on Agriculture will be of immense help in comprehending the issue of domestic support as enshrined in AA. Art.3 of the Agreement on Agriculture says that subject to Art.6 of this agreement, a Member shall not provide support in favour of domestic producers in excess of the commitment level specified in section I of Part IV of its schedule. Art.6:2 of the AA permits, inter alia, input subsidy to low-income and resource-poor farmers. Art.6:4 (b) limits the Aggregate Measure of Supports (AMS) to 10% of annual agriculture value in case of developing country. But perusal of Art.13 and 13(b) (i) of the AA reveals that during the implementation period, notwithstanding the provisions of the GATT 94 and the SCM Agreement, domestic support measures that fully conform to the provisions of Art 6 of this agreement shall be exempt from the countervailing action under Art.VI of the GATT 1994 and part V of the SCM Agreement. As per the Art.1 (f) of the AA, implementation period in the context of Art.13 means 9 years commencing in 1995, which expired on 1st January 2004. It means that all subsidies are now subject to the SCM Agreement, which after the laps of Art.8¹⁵⁹, categorises subsidies either prohibited or actionable. So the defence that fertilizers subsidy being agro-input and within permissible limits of 10% of agriculture value may not be available. Similarly even if it is treated as actionable under Art.5 of SCM, being specific in nature, the exemption from action permitted under Para(c) of Art.5 to subsidies related to agriculture products falling under Art.13 of the AA will not be available due to expiry of the so called peace clause or 'due restraint' as mentioned above. Now fertilizers subsidy will be an actionable under Article 5

¹⁵⁸ Sup era Note 35.

¹⁵⁹ As per Art.31 of SCM Agreement says that provision of paragraph 1 of Art.6 and the provision of art.8 & 9 shall apply for the period of five years, beginning with the date of entry of WTO Agreement i.e. 1 January 1995.



read with Article 6.3(a) of SCM for having effect of impeding the imports of a like product. However, criticism has to be evaluated in perspective of determination of urea prices by the forces of demand- supply operating at International Market, which remains vulnerable to manoeuvrings of low-cost gas-based plants due to differential feed stock-pricing policy of these countries.

4. Agreement on Trade Related Investment Measures (TRIM):

This agreement is basically a clarification of applicability of the principle of National Treatment & Quantitative Restrictions, enumerated in Art.III & XI of the GATT 94, to trade aspect of the investment in goods production. The agreement recognizes that certain investment measures restrict and distort trade. It provides that no contracting party shall apply any TRIM¹⁶⁰ inconsistent with Articles III (national treatment) and XI (prohibition of quantitative restrictions) of the GATT 94. For the purpose a list of such trade distorting measures, inconsistent with TRIMs, has been appended to the said Agreement. The agreement requires mandatory notification of all non-conforming TRIMs and their elimination within two years for developed countries, within five years for developing countries and within seven years for least-developed countries¹⁶¹. To examine the consistency of the Indian Fertilizers Policy with TRIM, it would be appropriate to reproduce the relevant rule of the TRIM. The Para 2.and sub-para (c) of the Annex (Illustrative List) of the TRIM says that trade related investment measures shall be inconsistent with Art.XI of GATT 94, if they are mandatory or enforceable and which restrict the exportation or sale for export by an enterprise of products either in terms of value or volume. The NPP does not permit free exportation of the urea from India and so inconsistent with the TRIM obligations. The New Production Policy for the urea requires government clearance for installation of the plant if manufacturer wants to avail the benefit of the subsidy offered by the government. Since no urea producer can survive without government support it has to take clearance from the

¹⁶⁰ Art.2:1 of the TRIM

¹⁶¹ Art.5:2 of the TRIM.



government and as such cannot have the freedom of free import and export. This is not TRIM consistent.

In the background of aforesaid discussion, it is concluded that Indian Fertilizers Policy is not WTO consistent

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CHAPTER VIII

CONCLUSION

In India, like any other developing countries, subsidies are potent instrument of economic development for addressing effectively the problems of large-scale poverty and unemployment. Subsidies play a vital role in facilitating development of indigenous production capabilities and in turn ensuring the low cost supplies on sustained basis. This is of particular relevance in the context of food and fertilizers wherein, given the inevitable linkage with the overriding objective of maintaining food security, a country of India's size and population simply cannot afford to depend heavily on imports. Fertilizer and food subsidies have played a vital role in promoting agricultural growth in post-independent India. It is estimated that exchequer is going to foot the bill of about Rs.170 billions for fertilizer subsidy during the year 2004-05.

However, a new global constitutionalism has been brought in mainly through WTO. Agreement on Subsidies and Countervailing Measures (SCM) read with the Agreement on Agriculture (AA) has introduced a new rule-based legal regime of subsidies and countervailing measures. Now the Members are required to ensure the conformity of their laws, regulation and procedures with their WTO obligations. Consequently the member countries have lost the freedom of independence in choice of use of subsidies and countervailing measures for their economic development. Since Indian is signatory of the WTO and its Fertilizers Policy is not in conformity with its WTO obligations, it should take measure to make it consistent with its obligations under GATT 94, Agreement on SCM and TRIM.



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