

Food Aid in WTO Agricultural Trade Policy

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1 Introduction

The Principles seek to assure that food and other agricultural commodities which are exported on concessional terms result in additional supplies for the recipient country and do not displace normal commercial imports; and similarly, that domestic production is not discouraged or otherwise adversely affected.

Principles of Surplus Disposal and Consultative Obligations of Member Countries, Food and Agricultural Organization of the UN, Rome 1992

With these opening words the handbook of the soon-to-be 50-year-old FAO Sub-Committee on Surplus Disposal (FAO/CSD) seeks to address the two key potentially adverse affects of food aid – distortion of commercial markets (*market effects*) and depressive effects on local production (*development effects*). Were these principles and their implementation successful in their objectives, food aid might well not be on the agenda of the Committee on Agriculture. Both the non-binding nature of the principles and the 'creativity' shown in circumventing them ensures that food aid continues to be a controversial topic in both development and trade circles.

Table 1 shows the relative amounts of cereal food aid during the period 1995-2000, the last period for which all data is available. Cereals represent the 85-90% of all food aid. While international traded cereals represent between 5-20% of global production levels, food aid volumes in turn represents only 2-4% of traded cereal volumes. In the case of wheat, there have been years when food aid has risen as high as 8% of internationally traded wheat volumes. Food aid is a relatively small factor in overall traded volumes. However, targeted at specific markets, its impact can be significant.

Table 1 Food Aid in Perspective (1995-2000)

Commodity	Global Production ¹ (,000 mt/yr)	Int'l Trade ¹ (,000 mt/yr)	Global Food Aid ² (,000 mt/yr)
Wheat	584,000	120,000	5,200
Maize	582,000	76,000	1,600 ³
Rice	460,000	24,000	1,000

Food aid is provided in three general modalities:

1. **Programme Food Aid** – bilateral resource transfers in the form of food commodities to be used as balance of payments support or to fund government programs through *monetization* (the local sale of these commodities).

1 Source: FAOStat data for 1995-1999

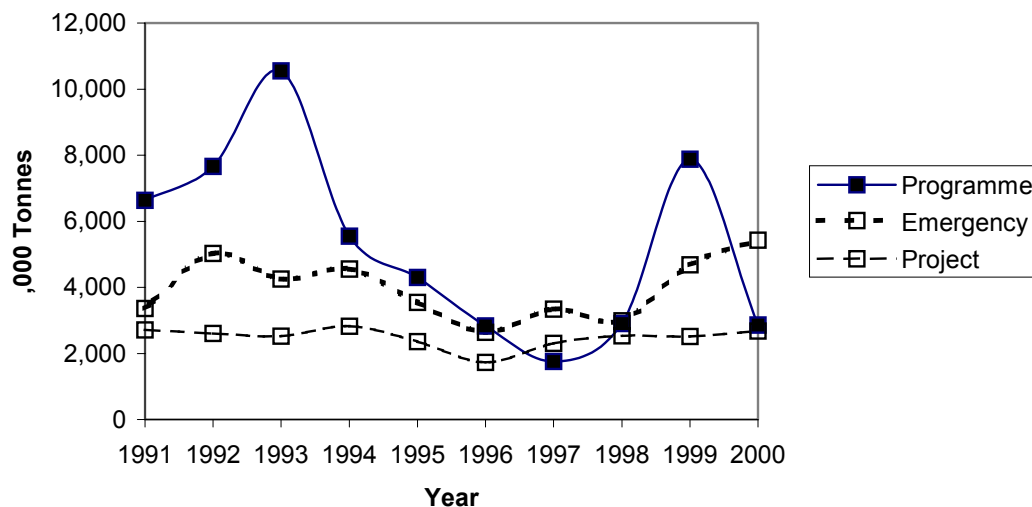
2 Source: "The Food Aid Monitor, Special Issue May 2000", WFP

3 Note that data only available for all coarse grains taken together

2. **Project Food Aid** – multilateral or bilateral transfers of food commodities to be distributed directly to targeted food insecure beneficiaries (including through food-for-work) and/or monetized to fund other development projects.
3. **Emergency Food Aid** – food aid that is supplied for direct distribution in times of acute food stress brought about by manmade or natural disasters.

Of these three modalities, programme food aid is the most volatile and tends to be *supply driven* rather than *demand driven*. It should be noted that 1993 and 1999 correspond to periods of particularly high cereals stocks and low world cereals prices.

Figure 1 **Types of Food Aid – 1991-2000**



Source: WFP, "The Food Aid Monitor – 2000 Food Aid Flows, May 2001

2 Market Effects

From the perspective of the ideal market, food aid, whether given by outright grant or by concessional loan, is a distortion. The concern about market effects is not so much whether or not the market will be affected but by how much. Clearly, where food is provided to those who are so destitute that they are unable to trade in the market, this effect is minimal. However, large shipments of food that are provided as concessional sales or sold on the local market to generate local currency (monetizations) can have a major impacts on markets. The relative market impact depends on the scale, timing, circumstances and the nature of the food aid transaction.

2.1 International Market

From the perspective of the WTO, the impact of food aid on the international market is the key issue. This is largely a controversy among the major food exporters where the US, in particular, is alleged to use large grants of food aid and/or concessional sales, particularly in times of low prices, to improve the access of its commercial companies to certain national markets. Although this is specifically proscribed by Article 10.4 of the Agreement on Agriculture, such allegations are extremely difficult to prove given the proprietary nature of any resulting commercial transactions.

It should be noted that impacts on markets heavily affected by such 'market development' uses of food aid are similar to those caused by high levels of export subsidies by other exporters such as the EU. However, in the case of concessional sales, there is the additional negative effect of increased indebtedness, even if the terms of repayment are over a lengthy period.

2.2 Local Market

Local markets play a critical role in the welfare of those involved in local food production. Sharp reductions in local market prices caused by a large influx of food aid into the market, while possibly yielding some benefit to food purchasers (including some of the poor), can have a devastating effect on rural people whose livelihoods depend on the production and sale of staple crops. When such situations occur, they result in a transfer of wealth from rural areas to urban areas and can accelerate the migration of people into urban slums.

Even the direct distribution of food aid to targeted beneficiaries will usually have some effect on the local market. Frequently only 1-3 commodities are provided as food aid and recipients will sell some of this food on the local market to obtain the other elements of their diets. However, these impacts are usually highly localized for short periods of time and can be largely mitigated by good program design.

2.2.1 Programme Food Aid Monetizations

The danger of widespread market disruptions is particularly acute in the case of monetizing programme food aid. In these situations, large volumes of food aid received by the recipient country are sold on the national market and the proceeds of the sale are then used for a variety of purposes ranging from national budget support to funding development projects. The principal, and often only, benefit to developing countries of such programs is the transfer of resources from the donor to the recipient government. Such programs are particularly common during periods of low global cereals prices, both a reason for their being offered and a factor that magnifies their destructive effects on local farmers.

The effects of all kinds of monetizations are dependent upon the way the monetization is done, particularly the prices at which the food commodities are sold. In well functioning markets, the usual effect of monetizations is to reduce prices. It is not unusual for the price effect (due to this sale and/or other monetization sales at the same time) to be so great that the currency generated by the sale is significantly below the exchange costs of getting the food to the market. In such cases, even the resource transfer is inefficient and the effect on local markets can be very destructive.

There are exceptions where the local markets function poorly, prices are well above world prices and the monetized food provides additional food that would not be there otherwise. In these cases the effects of monetization on food security can be positive. However, these situations are increasingly rare as markets are liberalized.

The *financial efficiency* (ratio of the local funds generated from the sale to the exchange cost of getting the food to the market) is usually a good indicator of whether or not the effect on local food security is positive or negative. Financial efficiencies approaching or exceeding 100% usually indicate that monetizations are adding food to the local market rather than displacing other suppliers.

3 Development Effects

Food aid has been and continues to be a widely debated development topic. Food aid has the potential to do either great good or considerable harm. The negative effects attributed to food aid include:

- Discouraging local economic activity and creating dependency by providing 'free food' beyond the immediate aftermath of an emergency.
- Depression of market prices for locally produced staples thereby acting as a disincentive for local production.
- Changing of local food preferences

There is widespread agreement that in emergency situations appropriate food aid is often essential to prevent the further loss of life and, if provided in a timely fashion, to arrest and even reverse the descent into destitution brought on by such emergencies. Even in such situations, the provision of locally acceptable foods and the cessation of food aid so as not to hamper the restoration of normal economic activities and local agricultural production are important issues.

The use of food aid in non-emergency situations, development food aid usually in the form of project food aid, is more controversial. Like most food aid interventions it will usually have some effect on local markets. In some cases where hoarding has resulted in high food prices outside of harvest seasons, the appearance of food aid commodities on the market can have the effect of beneficially reducing prices for everyone including local producers who may be buying food at that time. In other cases, particularly if food aid arrives during a harvest season, the resulting drop in market prices can have a very detrimental effect on local farmers who are growing and selling food staples. These are largely food aid project design and implementation issues which can be overcome by good planning.

Aside from these market related issues, however, there remain many contentious aspects to the use of development food aid that are outside the interest of this paper.

4 Proposals

Food aid is much more than a market issue. However, it clearly has the potential to have significant market effects in addition to its development effects. The following proposals are intended to be elements that can significantly reduce the negative market impacts of certain types of food aid without taking on the entire food aid debate.

4.1 Elimination of Concessional Sales

Concessional sales are listed as part of the food aid in the Food Aid Convention 1986 as referenced in Article 10 4(b) of the Agreement on Agriculture.

(c) sales on credit, with payment to be made in reasonable annual amounts over periods of 20 years or more and with interest at rates which are below commercial rates prevailing in world markets

As noted earlier, such sales directly distort the international market and can also be highly disruptive to the local market as well. It is therefore proposed that Article 10 4.(c) be amended to read:

(c) That such aid shall be provided in fully grant form.

This would eliminate the identification of concessional sales as food aid.

4.2 Disciplining of Food Aid Monetizations

There are currently no enforced disciplines applied to monetizations. Two alternatives are presented below:

4.2.1 Option 1 – Financial Efficiency of Monetization

Reliable criteria to ensure that food monetizations don't disrupt local markets and the incentives for local producers are difficult to formulate. However, the concept of the financial efficiency of a monetization may be useful in this regard.

$$\text{Financial Efficiency} = \frac{\text{local funds generated by the sale}}{\text{the exchange cost in local currency of getting the food to the point of sale [including any duty even if not applied]}}$$

The disciplining of food aid monetizations could be achieved by establishing

1. A *deminimus tonnage* below which no discipline is required. Scale is an important factor and small monetizations, even if they have low financial efficiencies, often have offsetting benefits related to the use of the funds derived (e.g. NGO operated food security projects, closed monetizations where the sales are made at concessional prices to targeted groups of food insecure purchasers).
2. A *minimum acceptable financial efficiency level* below which food aid monetizations would be prohibited. If this level was set at or above 100%, monetizations would only occur in situations of poorly functioning markets.

4.2.2 Option 2 – Limiting Percentage of Monetization

Alternatively, it may be simpler to monitor a limit on the percentage of a donor country's food aid that can be monetized. This would be a coarser tool that would fail to differentiate between those monetizations that damage markets and producers and those that don't. As noted above however, the number of situations where monetization can be carried out without serious disruption to local markets has been decreasing. The establishment of a low percentage that would decline over time would recognize this trend and could reduce the negative impact of this type of food aid on the local market.

Reference Materials

1. FAO, Principles of Surplus Disposal and Consultative Obligations of Member Nations, Rome 1992
2. WFP, The Food Aid Monitor – 2000 Food Aid Flows, Rome, May 2001
3. International Grains Commission, The Food Aid Convention 1986 (available at <http://www.austlii.edu.au/au/other/dfat/treaties/1988/33.html>)
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5. McCreary, I. 1998. “Report of the Food Aid Monetization Pilot Program”, Canadian Foodgrains Bank 1998