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Food Aid as a Development Tool: Colombia, 1950-80

S. Elaine Grigsby and James R. Simpson¹

Abstract: The US commodity export programme (CEP) provides subsidized credit to the importer (rather than subsidized commodity prices) to alleviate foreign exchange and income problems on the part of the importer. In the case of Colombia, credit subsidies were such that the total cost of financed imports approximated the cash price. The impact of CEP subsidies on wheat import demand in Colombia was estimated. CEP credit increased demand for CEP and commercial imports. The cost of CEP financing behaved as a price variable. CEP aid included providing credit subsidies and making available the revenues from the resale of commodities in the domestic market (net of loan repayment) that could then be used for economic development or other purposes.

Introduction

Will the world be able to feed itself over the next few decades? Burdensome commodity surpluses on the one hand and the spectre of famine on the other provides a turbulent world setting in which a need exists to investigate the pros and cons of food aid programmes.

The US "Food for Peace" programme, begun in 1954 to consolidate post-war food programmes, is a policy instrument that has been used to alleviate both overproduction and malnutrition. One part of the Food for Peace programme is the commodity export programme (CEP), one of several concessionally-financed US export programmes. CEP trade agreements initially provided for commodity sales for payment in nonconvertible local currencies. Nonconvertible local currency sales were phased out in 1972. Dollar credit sales were added in 1962 when there was concern for the US balance of payments and the lack of dollars being returned to the USA.

CEP is often characterized as an aid programme (Maxwell and Singer, 1978) or commodity subsidy programme (Hall, 1980) that provides cheap exports. In contrast, the hypothesis of this study is that CEP is a market export programme that provides external purchasing power (Rodriguez and Carter, 1979) to the importer that can expand market demand (Grigsby, 1982). The CEP also provides finance subsidies that decrease the cost of market finance but may still increase the cost of importing. Financial assistance to the importer from credit and reduced repayment costs can be used for economic development.

Based on our conceptualization, CEP commodities would be expected to have the same effect as commercial trade in the importing country market; e.g., gains from trade that include a domestic price decrease, an income effect, and changes in domestic resource allocation. In addition, foreign exchange from local currency payments and dollar credits is expected to shift import demand. Finance subsidies or costs are expected to behave as a price variable and influence the quantity demanded of CEP wheat. Our view has implications for the kind of aid CEP provides for development and for the effect of CEP imports on the importing economy.

The US Commodity Export Programme

CEP trade agreements provide financial assistance rather than commodity aid. Finance subsidies are available through loan repayment terms, but loan repayment still incurs additional costs. In addition to the credit and finance subsidies, funds are available for development. The trade agreements provide export credit and foreign exchange in addition to the commodity exports that are sold at market prices. Two kinds of agreements were in effect during the period of this study (1950-80): nonconvertible local currency agreements (1954-72) and US dollar credit agreements (1962-80).

The nonconvertible local currency agreements provided foreign exchange by selling US commodities for local currency, payable in cash on delivery. The nonconvertible local currency agreements also provided credit for domestic expenditures. The local currency was deposited in US owned accounts in the importing country. A percentage of the US-owned local currencies were loaned to the importing country for medium-term investment projects. Finally, a foreign exchange subsidy or tax resulted if exchange rates changed against the US dollar. The loans reported in US dollars were made at market repayment terms; the exchange rate used to establish the US dollar equivalence for local currency repayment was fixed at the time of the loan agreement. If the local currency depreciated, the borrower gained; if the currency appreciated, the lender gained.

The US dollar credit agreements provided foreign exchange by extending trade credit. The repayment terms were specified in the agreements and varied by country. Repayment terms generally included a long-term repayment period with interest rates that were below market rates, a small down payment, and a grace period. Under those terms, financed imports cost less than they would have at commercial credit terms, but they cost more than cash imports. Loan repayment costs changed if the price of foreign exchange changed. A depreciating local currency increased costs to the importer/borrower, in which case more local currency was required to purchase a US dollar. Finally, the long-term repayment period meant that revenues from the resale of commodities in the domestic market could be used for domestic expenditures until loan repayment was due. Revenues net of credit repayment were available if the domestic resale price were greater than the import price. Changes in the price of the loan from fluctuating interest rates also resulted in market costs or gains to the lender. However, those lender costs or gains had no impact on the analysis unless the loans were resold in a secondary market, which has not been the case with CEP trade credit.

Colombia: A Case Study

CEP wheat agreements were examined to obtain import and finance data and to determine the extent to which CEP commodities were subsidized. CEP wheat was exported to Colombia during 1955-73 under six nonconvertible local currency agreements (during 1955-66) with a market value and foreign exchange saving of \$28 million and six US dollar credit agreements (during 1963-73) with a market value and foreign exchange earned of \$37 million. Loans extended by the USA from US owned nonconvertible local currency accounts include 5 loans to the Colombian Government and 25 loans to the private sector in Colombia during the 11-year period. The market value of the loans at the time of issue was \$18 million. The domestic market value of CEP wheat imports from the six US dollar credit loans (net of repayment of CEP obligations from previous years) was the equivalent of \$54 million. Those revenues resulted from the domestic support price for wheat being greater than the import price.

The agreements did not provide evidence of a commodity ("in kind") subsidy. No explicit price subsidy existed, either; in Colombia, CEP export prices approximated commercial prices and were even higher at times. No fixed quantity subsidy existed either; even though the quantity of CEP imports was negotiated through agreements, the agreements were amended to allow for changes in the quantity imported of the agreement commodity or even for changes across commodities. Actual imports could then be adjusted based on demand and supply. Since no evidence existed of fixed or variable quantity subsidies or price subsidies that would distort the market (Browning and Browning, 1979; and Grigsby, 1982), we initially assumed that import demand was based on consumer preferences.

The agreements did include other types of assistance or subsidies that were financial in nature. They also included provisions that increased importer costs. CEP costs included the cost of borrowing and the cost of foreign exchange for credit repayment. In Colombia, the costs and subsidies cancelled each other out so that financed imports were purchased for the approximate price of cash imports. The discounted value of the cost of borrowing was positive, constituting a subsidy based on repayment terms that are "softer" than commercial terms. The subsidized cost was used since the actual subsidy could not be calculated because no commercial trade loans occurred with the same repayment structure with which to compare the interest rate (Horne, 1978). The agreements in Colombia included a foreign exchange subsidy from the use of a fixed exchange rate to determine the US dollar value equivalent for local currency loan repayment. The cost of foreign exchange for US dollar credit repayment was positive.

The discounted cost of local currency loans was \$1 million and Col.\$9 million, equivalent to an annual average of \$0.25 and Col.\$2.23 per ton. The discounted cost of US dollar credit was \$0.9 million and Col.\$16.7 million, equivalent to an annual average of \$0.18 and Col.\$3.23 per ton. Nominal interest costs for US dollar credit repayment were \$11 million and Col.\$202 million.

The foreign exchange subsidy for repayment of US owned local currency was \$14.2 million and Col.\$336 million, equivalent to \$3.51 and Col.\$83 per ton per year. Foreign exchange costs for US dollar credit repayment were \$11.4 million and Col.\$410 million, equivalent to \$2.20 and Col.\$79 per year.

CEP purchasing power and the price of CEP finance were included in a market model for wheat in order to analyze the impact of CEP credit and finance costs of Colombian import demand.

Previous studies have included CEP imports as an argument in a single import demand equation (Abbott, 1979; and Hall, 1980). However, in order to obtain more information on the relationship between imports, credit, and finance costs, a CEP import demand equation was specified. Commercial import demand, CEP import demand, domestic demand, and domestic supply for wheat were estimated simultaneously. For a discussion of the specification of the model, see Grigsby (1982).

In the model, trade purchasing power, the value of foreign exchange saved from local currency payments, and foreign exchange earned from US dollar credit trade agreements were used to measure the extent of the demand shift from CEP. Purchasing power available for domestic expenditure from local currency loans and revenues from the domestic resale of the commodities could be an incentive to import more than would be imported based on market import demand criteria; i.e., relative prices and income. That incentive for "over-importing" compared to the market norm could result in a substitution of CEP for commercial imports that would not otherwise have occurred without CEP assistance. The over-importing incentive could also result in a domestic price decrease greater than that which would have resulted from market imports and a price disincentive effect on domestic production. Loan costs and foreign exchange costs for loan repayment in commodity units were included as the price of CEP finance.

Results

Based on the reduced-form coefficients and the cumulative multipliers, foreign exchange for trade and non-trade credit expanded CEP and commercial import demand in Colombia. Purchasing power also increased domestic demand and decreased domestic supply. Results from previous studies that the decrease in supply is less than the increase in demand (Hall, 1980; and Mann, 1967) are also confirmed. Wheat consumption increased. The increase in imports from trade purchasing power is interpreted as the increase in market demand from CEP. The increase in imports from domestic purchasing power could be interpreted as an increase in non-market imports. However, caution must be used in interpreting that variable since some of those revenue gains are also available from commercial imports. The domestic purchasing power variable is more a reflection of government price policy than it is of effects peculiar to CEP in that the domestic purchasing power variable represents the value of revenue gains from domestic and import price differentials derived from domestic price supports. The decrease in supply from the domestic purchasing power variable supports the results of Dudley and Sandilands (1975). The estimation results also supported our hypothesis that CEP finance costs per ton of CEP wheat behave as a price variable.

Policy Implications

CEP provides trade purchasing power and financial aid. Export credit and repayment terms are an important factor in expanding market export demand. Market risk from changes in the exchange rate is a factor to consider in calculating repayment costs over time. Change in the effective cash price from CEP financing was relatively small. The CEP, in effect, made trade possible without the high finance costs that normally include a return to risk taking. Domestic price policy was a factor in the import decision in Colombia since there were considerable revenue gains from the domestic resale of both CEP and commercial imports.

CEP can provide financial assistance that can be used for economic development. In order to assess how useful CEP is as a development tool, the first task is to determine the type and value of aid. The success of economic development efforts depends on how the assistance is used in the importing country and whether returns from the use of assistance exceed the cost. Otherwise, borrowing is a drain on the economy in the long run.

CEP aid includes: providing credit for commodity imports to create effective demand at times when long-term import credit has not been readily available from finance markets, providing finance subsidies so that the importer can purchase financed imports for the approximate cost of cash trade, and making available revenues from the resale of commodities in the domestic market net of credit repayment that can be used for economic development or for fiscal or commodity policies. The final effect of CEP on development depends on how the resources are used.

Use of the assistance is affected by importing country's domestic policies. Government pricing and distribution policies influence the effect of CEP commodities. If the government sells the

commodities at lower prices to subsidize consumers, the government pays the difference between the import price and the subsidized resale price. If the government sells the commodities at prices higher than the import price, revenues are available to defray credit costs or to use for other domestic expenditures. Often, the revenues are used to support the price of other commodities. A third alternative is to distribute the commodities in differentiated markets with controlled access to lower price shops. However, if the government subsidizes the commodity price in the domestic market, it pays the difference from the domestic budget. The only CEP assistance is from the opportunity cost of credit.

One task of this study was to analyze the type and amount of aid provided through CEP. In order to say anything further about its effects on development, one would have to examine returns from investment projects or commodity programmes that were funded with CEP funds. CEP is not a panacea for helping countries help themselves, but, then, no such panaceas have yet been forthcoming to solve the food problems of the developing world.

Note

¹Economic Research Service, USDA, and University of Florida, respectively.

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