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FOOD AID AS SURPLUS DISPOSAL? THE WTO, EXPORT COMPETITION DISCIPLINES AND THE DISPOSITION OF FOOD AID

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1.0 BACKGROUND

Agricultural exporters have long been dissatisfied with international efforts to curtail the use of food aid as a tool of surplus disposal. The Doha Development Agenda (DDA) round of WTO negotiations includes discussions on food aid in an attempt to bring binding rules on aid deliveries under the umbrella of the WTO's dispute settlement mechanism. This, combined with the renegotiation of the Food Aid Convention (FAC), has generated momentum towards new international disciplines and guidelines for food aid shipments.

On one level, there is an inherent conflict between guidelines that ensure the viability of food aid and trade rules that discipline shipments. Development advocates seek guidelines that ensure the delivery of adequate aid volumes, while policy makers from competing exporting countries seek to discipline the use of food aid as means of circumventing export competition disciplines.

Food aid disciplines that emerge from a trade agreement may not tell the whole story of how food aid shipments may be affected, however. Rules that govern export subsidies and credits may play important roles in the size and disposition of food aid shipments. Export subsidy and credit arrangements have been the primary outlets for agricultural surpluses for some time, and WTO members are poised to tighten export competition disciplines in the DDA. This could apply increased pressure on food aid as a means of surplus disposal.

2.0 US DISPOSAL OF AGRICULTURAL SURPLUSES

The Commodity Credit Corporation (CCC) administers the USDA's loans and purchase programmes. The primary avenue through which the CCC has traditionally acquired commodity stocks is nonrecourse support loans to primary producers. In cases where a commodity's market price is below the current US loan rate, producers forfeit the collateral, thus adding to the CCC's stocks.[1] Once the CCC has acquired stocks, it is faced with either storing or disposing of its surplus. The disposal takes two primary forms, export programmes and food aid.[2]

The CCC's export programmes are comprised of export credits and export subsidies. Export credit programmes include Export Credit Guarantees (GSM 102 and 103[3]), the Supplier Credit Guarantee Program and the Facility Guarantee Program. Export subsidy programmes include the Export Enhancement Program[4] (EEP) and the Dairy Export Incentive Program (DEIP) which pay cash bonuses directly to exporters.

US food aid policy is driven largely by domestic policy motivations. US aid shipments have been shown to be *positively* related to grain production in the recipient country,

[1] The USDA's loan deficiency payment programme has tempered the CCC's acquisition of stocks.
[2] The CCC also operates domestic assistance programmes that provide commodities to the Bureau of Indian Affairs, the armed forces, correctional facilities and a range of charities.
[3] GSM 103 is to be discontinued as a result of the Brazilian cotton case.
[4] The EEP, though still on the books, has not been used for more than ten years.

and are closely related to US domestic stocks (figure 1). There is ample anecdotal evidence that the US uses food aid as a tool of surplus disposal.

3.0 INTERNATIONAL GOVERNANCE OF FOOD AID

Disquiet over the use of food aid as a tool of surplus disposal predates its formal inclusion in trade negotiations. The Food and Agricultural Organisation's (FAO) Consultative Subcommittee on Surplus Disposal (CSSD) is charged with monitoring member countries' food aid practices. Two key principles govern the CSSD; Usual Marketing Requirements (an attempt to ensure that food aid does not displace commercial imports) and notification of food aid shipments. The second principle has gone largely unfulfilled. Two important points are worth making about the CSSD. First, the CSSD does not have a development agenda; it serves as an oversight body for the disposition of commodity surpluses as food aid. Second, its principles are not binding and are unenforceable.

The Kennedy Round of trade negotiations in 1967 included the International Wheat Agreement, and generated the FAC. The FAC was a non-enforceable agreement between signatory countries for minimum annual food aid donations, and has been renewed several times over the past 40 years. The current convention has been extended to July 2007 in the hope that the DDA negotiations will be completed before a new convention has to be convened.

The Uruguay Round Agreement on Agriculture (URAA) contains food aid guidelines in an effort to prevent the circumvention of export subsidy commitments. The first of these guidelines calls for food aid to be untied; that is, aid should not be dependent on procurement from a specific country (usually the donor) or group of countries. This guideline has been widely flouted by donor countries. The second guideline defers to the FAO's "Principles of Surplus Disposal and Consultative Obligations" as outlined by the CSSD. The third guideline calls for food aid to be provided in grant form - most donors comply with this guideline, with the notable exception of the US which provides up to 20 percent of its food aid as concessional sales (Young).

The URAA also contains disciplines on export subsidies. Member countries agreed to bound levels of export subsidies and instituted schedules of reduction over a six-year implementation period. The URAA does not contain disciplines on export credits. As such, there still exists limited use of export subsidies, and relatively undisciplined use of export credits, food aid and storage as tools of surplus disposal under the current agreement.

DDA draft modalities[5] and chair's reference papers[6] contain provisions that outline the direction that food aid disciplines are likely to take. The most persistent proposal is the creation of a "safe box" for emergency food aid. Safe box aid would not be subject to WTO disciplines, akin to a "green box" for domestic support programmes. The stumbling block for this proposal is determining under what circumstances food aid

[5] WTO. 2006. *Draft Possible Modalities on Agriculture*. TN/AG/W/3. 22 July.
[6] WTO. 2007. *Communication from the Chairman of the Committee on Agriculture.* 30 April.

would qualify for the safe box. It appears as though an appeal from either a United Nations agency or the International Committee of the Red Cross would be the "bedrock standards" for conformity with the safe box.

The draft modalities also contain reference to non-emergency (programme and project) food aid. Proposals include: allowing programme food aid only when based on an assessment of need by a third-party, improved targeting of recipients, and phasing out programme aid by 2013.

Despite the growing emphasis on food aid in trade negotiations, WTO rules on export competition might have the most significant effects on food aid shipments. Stricter trade rules that reduce allowable levels of export credits and eliminate export subsidies might increase the pressure for disposal of domestic surpluses through other channels.

The most recent DDA draft modalities indicate that export subsidies are likely to be eliminated. Export credits are also likely to be disciplined in an effort to bring their use more in line with commercial transactions. The availability of export subsidies and credits as outlets for domestic commodity surpluses will decrease with a new WTO agreement and pressure may mount on alternative outlets (i.e. food aid). However, the DDA is likely to include constraints on the domestic support programmes that create surpluses from which a large share of food aid is drawn. Whether these cuts will be large enough to reduce domestic surpluses by an amount commensurate with required reductions in export competition remains to be seen.

4.0 THE RELATIONSHIP BETWEEN FOOD AID AND EXPORT COMPETITION

Our Commissioned Paper develops a conceptual and empirical model that estimates how changes in one outlet for surplus wheat (export subsidies and credits) have affected changes in other outlets (food aid or carry-over stocks) in the US.[7] The model's results provide insight into how a trade agreement that affects export subsidies and credit guarantees could impact food aid shipments.

Historical time-series data for US food aid shipments, commodities shipped under subsidy or credit guarantees and carry-over stocks are assembled as an endogenous group of surplus outlets, and the relationship between them is examined using time-series econometrics. The model is then shocked in the form of a decrease in the volume of commodities shipped under export subsidies and credit arrangements, and the time paths for the other endogenous variables are traced out. Figure 2 illustrates the model's results.

A one-time decrease in the volume of commodities shipped under export subsidies and credit arrangements creates a contemporaneous increase in both food aid shipments and carry-over stocks. As one vent for surplus disposal contracts, a larger share of that surplus is pushed through alternative outlets. The effect is persistent; the response of food aid shipments to the decrease in subsidy and credit sales lasts several periods

[7] The empirical analysis focuses on the US. The US is the largest donor of food aid and has been accused of being the worst offender of using food aid as a tool of surplus disposal.

before decaying towards zero. The economic significance of the estimated responses is ambiguous. A decrease in subsidy and credit shipments of approximately 2 million tonnes generates a small immediate jump in food aid shipments and carry-over stocks (figure 2). The effect on food aid shipments peaks at approximately 400,000 tonnes after four years, and decays thereafter. The small immediate increase likely reflects institutional barriers to quickly arranging aid shipments, and is certain to have a negligible effect on world prices. There is the possibility for such an increase to be important beyond its effect on world prices, however. A large aid shipment arriving in a single location could be enough to trigger local production disincentive effects. Such a shipment could also displace commercial imports and trigger a trade grievance from a competing exporter.

It is important to note that the empirical results from this study are not forecasts of the effects of a trade agreement on food aid shipments. The econometric relationships that are estimated in this study are based on a sample period during which there were no binding limits on any of the outlets for surplus. A trade agreement that introduced binding caps on export subsidies and credit arrangements would likely generate larger responses in the endogenous variables. The empirical model does demonstrate that food aid, export subsidies/credits and carry-over stocks have been used as alternative outlets for surplus disposal in the US, and that a new trade agreement could increase pressure on food aid as a means of skirting disciplines on export competition.

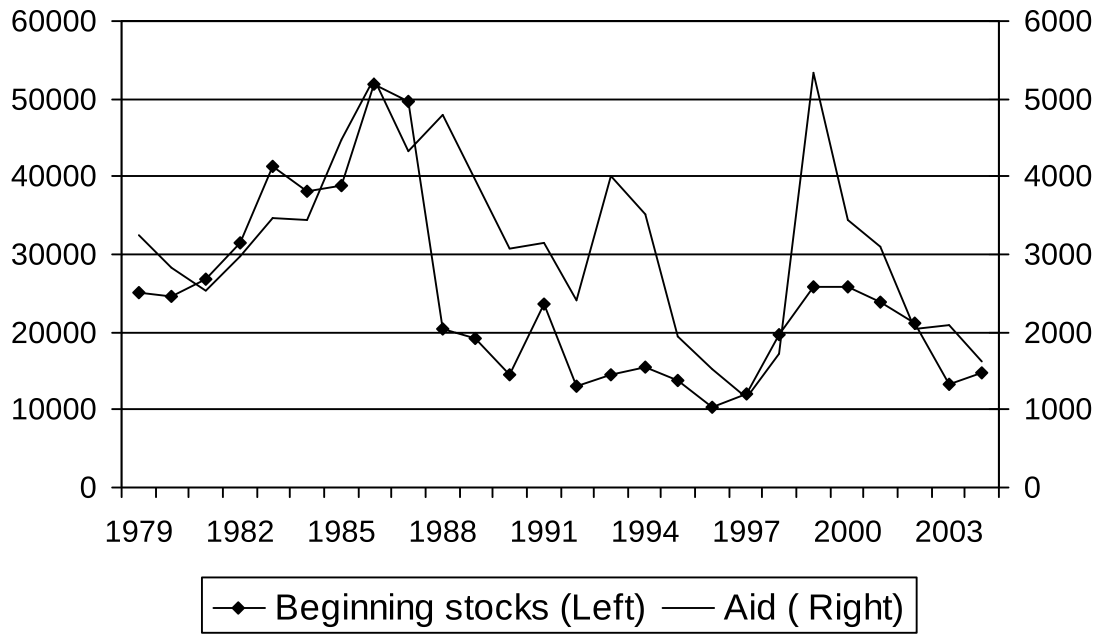
6.0 CONCLUSION

The implementation period for URAA disciplines on export subsidies is past and there will be no new constraints imposed on their use without a DDA agreement. Donor countries retain export subsidies (subject to URAA limits), export credits and food aid as outlets for surplus disposal.

The status of the DDA is murky, at best. If a breakthrough occurs and new deal is done, then an agreement that resembles recent draft modalities and ministerial declarations could have two effects on food aid shipments. First, a DDA agreement would restrict the use of export subsidies and export credits. This is likely to increase pressure on food aid as an outlet for disposing of surplus commodities. Second, an agreement could limit the circumstances under which food aid shipments are allowed. Though such rules could theoretically reduce food aid volumes, their actual effects on donations are uncertain. It is unclear how eager a WTO member country will be to pursue a case against a competing exporter over the delivery of food aid.

There may be room for another multilateral organisation to put forward new rules on food aid if the DDA collapses. The current FAC expires in July of 2007 and is currently being renegotiated. However the effectiveness of the FAC is constrained by its nature as a voluntary non-binding agreement. Non-binding agreements on food aid have a chequered past; one of the primary motivations for bringing rules on food aid into the WTO was to coerce member nations into changing their behaviour by making their actions subject to the WTO dispute settlement mechanism. Another important factor is that nations may be less willing to make concessions on their food aid positions outside of the reciprocal deal-making environment of the WTO.

Figure 1. Aid and Stocks, Wheat



Source: USDA

Figure 2. One Standard Deviation Shock to Subsidy/Credit Sales ('000 tonnes)